

# Q2 2010: Middle Market Quarterly

265 Franklin Street | Boston, MA | (617) 314-3950 | info@covllc.com

## Second Quarter Highlights

- Middle market M&A deal volume increased by 30% in Q2 2010 on a year-over-year basis. Aggregate deal value rose by 51% during the same period.
- The national unemployment rate fell to 9.5% in Q2 2010.
- Nonfarm employment added 621,000 jobs in the second quarter of 2010.
- GDP continues to grow through the first quarter of 2010, according to the Bureau of Economic Analysis.

## Middle Market Healthcare Steadfast

Second quarter activity in the Healthcare space has, for the most part, continued to trend toward strategic acquirers exercising strong balance sheets to make key product and platform acquisitions and larger deals that open up new markets. Middle market Healthcare M&A activity will continue to improve for those companies that can address the key concerns of the post-ObamaCare market: efficacy and cost. Renewed interest from the private equity community, driven by improvement in the general credit markets, could lead to a period of increased M&A activity, as well as growth in deal valuations. Already on the horizon for the beginning of Q3, the M&A rumor mill is churning about news that Sanofi-Aventis is on the prowl for a \$20 billion acquisition.

## Spending Again

As a result of conservative spending and productivity optimization throughout 2009 and early 2010, cash reserves are at the highest percentage since the 1960's, reaching upward of \$1.84 trillion, according to data from the Federal Reserve.

Q2 2010 has shown an increased appetite among buyers as the debt market improves and competition grows. Private equity firms are playing a bigger role in the marketplace as funds become more readily available. Companies are reaching their optimal productivity level with current internal resources and looking outward to continue growth.

## Vertical Growth

Companies are feeling the pressure to stay ahead of the competition. In order for companies to continue

## Overall Middle Market M&A Activity



Sources: Capital IQ and 451 Group  
 Note: Statistics include announced mergers and acquisitions with disclosed value of less than \$1 billion

to drive productivity and growth they will need to acquire into strong vertical markets or gather new technology. The acquisitions will likely be focused toward the small to mid-sized public and private firms, or to divisions of larger companies. According to a report by Ernst & Young, buyers are paying more for small, innovative companies in high-growth areas with long-term potential.

An example of vertical market expansion seen in Q2 2010 was the acquisition of Phase Forward by Oracle. Oracle, a leader in ERP, has previously made strides to expanding into new markets. This purchase of Phase Forward, a leading clinical research services firm, cemented their commitment to vertical expansion into the healthcare arena.

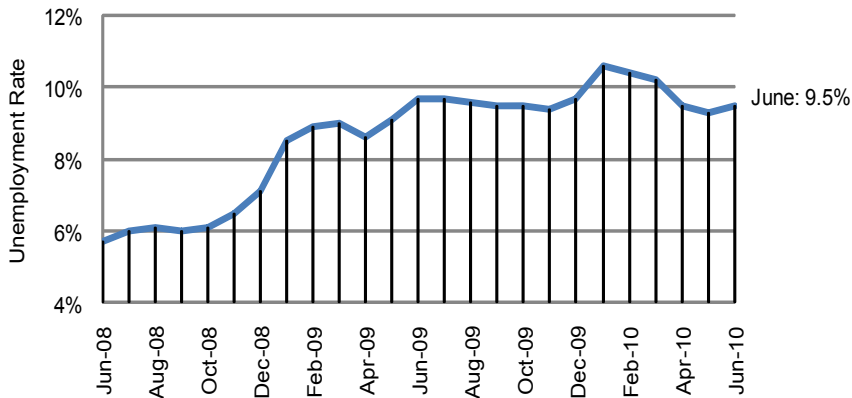
## Capital Equipment Bouncing Back

Capital equipment and technology spending is recovering more quickly than expected. Companies are reaching maximum productivity with current resources and looking elsewhere to continue to improve and expand. This trend is expected to continue into the second half of 2010, as more firms make capital investments and acquisitions to increase revenues and productivity. According to Gartner, Inc semiconductor spending in 2010 is expected to reach \$35 billion, a 113% increase over spending in 2009. We anticipate the semiconductor and networking sectors to benefit greatly as competition for new technology heats up.

## Getting Back to Work

The focus on productivity seen in Q1 2010 is ending as firms are reaching high levels of productivity with their current available resources. Nonfarm employment added 621,000 jobs in the second quarter of 2010 indicating stabilization in productivity levels.

## US Unemployment



The national unemployment rate edged down to 9.5% in June 2010, from 9.9% in April 2010. Employment rose 596,000 throughout the second quarter. Hiring of temporary workers for the Census 2010 strongly influenced the Q2 2010 employment numbers. The Census Bureau added 410,000 jobs in May and concluded 225,000 of those temporary positions in June, thus ending June 2010 with a decline of employment by 125,000 overall. Private-sector employment increased 357,000 this quarter, according to the Bureau of Labor Statistics. Over the past 12 months, the Healthcare sector gained 217,000 jobs. The professional and business services employment rose by 18,000 positions in June and added 379,000 temporary jobs over the past 9 months.

## Business Services M&A Activity

	Deal Volume	Transaction Value (\$mm)	Median EV / Revenue	Median EV / EBITDA
BPO	12	\$2,276	0.8x	10.0x
IT Services - Corporate	2	138	1.8	-
IT Services - Government	1	28	1.8	-
IT Services - General	19	1,110	0.6	7.3
Management Consulting	5	1,198	1.4	8.2
Semiconductor	1	34	-	-
Technical Software	1	138	1.6	18.6
<b>Total</b>	<b>41</b>	<b>\$4,923</b>	<b>1.3x</b>	<b>11.0x</b>

In Q2 2010, IT Services led in deal volume with 22 deals combined across general, corporate, and government divisions. Business Process Outsourcing continued the trend from the first quarter leading in deal value.

Sources: Capital IQ and 451 Group

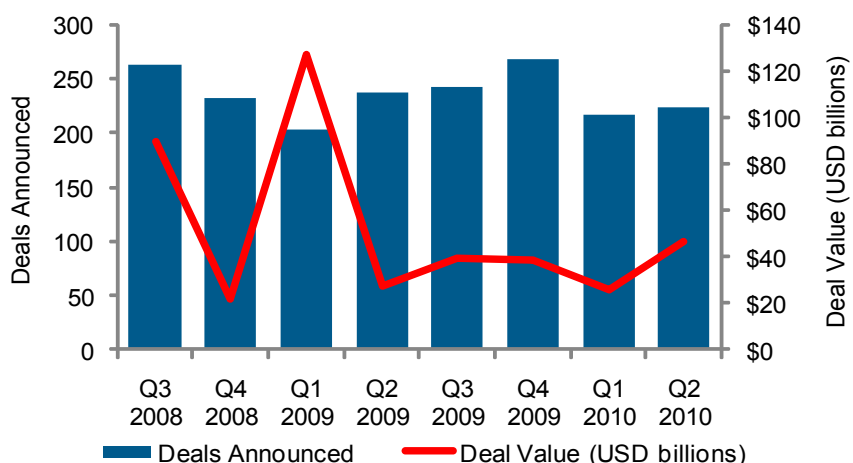
## Selected Business Services Transactions

Category	Announcement Date	Target	Acquirer	Enterprise Value (\$mm)	Enterprise Value to LTM Revenue	Enterprise Value to LTM EBITDA
BPO	May-10	TIVIT Tercerização de Tecnologia e Serviços <i>Telecommunications IT services</i>	Apax Partners <i>Private Equity</i>	\$907	1.8x	9.3x
BPO	Jun-10	iCrossing <i>Digital marketing</i>	Hearst Corporation <i>Media company</i>	425	4.3	NA
BPO	Jun-10	Intelligence <i>Human Resources Services</i>	Kohlberg Kravis Roberts & Co. <i>Private Equity</i>	358.1	0.5	NA
BPO	Jun-10	Alloy <i>Targeted media and marketing services</i>	Natixis, Hamilton Lane Advisors, GenSpring, ZelnickMedia, Rosemont Solebury <i>Private Equity</i>	139	0.5	10.6
Consulting	Jun-10	Scott Wilson Group <i>Property and transportation consulting</i>	URS Corporation <i>Technical consulting</i>	319	0.7	7.6
Consulting	Jun-10	Trafficmaster <i>Intelligent vehicle services</i>	Vector UK <i>Private Equity</i>	121	1.4	8.7
IT Services - Corporate	Apr-10	Reaktor <i>System development and consulting</i>	Know IT <i>IT consulting</i>	16	0.9	4.2
IT Services - Corporate	May-10	Fusepoint Managed Services <i>Managed IT and infrastructure services</i>	SAVVIS <i>IT services</i>	125	3.0	NA
IT Services - Government	Apr-10	Seismic <i>Cybersecurity and IT management</i>	Applied Signal Technology <i>Gov. defences intelligence products and services</i>	28	1.8	NA
IT Software	May-10	Matrikon <i>Industrial efficiency IT software</i>	Honeywell International <i>Diverse technology and manufacturing</i>	129	1.6	18.6
IT Services - Corporate	Jun-10	Portrait Software <i>Customer interaction solutions</i>	Pitney Bowes <i>Mail processing products and services</i>	63	2.7	23.1

Sources: Capital IQ and 451 Group

Healthcare M&A continued to increase through the second quarter of 2010. A total of 223 deals were announced worth \$46.2 billion. This is a 77% increase in deal value over Q1 2010 and a 62% increase over the year-ago quarter. A broadening of the market is indicated by the upswing of healthcare services deals in Q2. Services deals account for 47% of the total deals in the second quarter compared to 40% in Q1 2010 and 37% in Q2 2009. The first half of 2010 produced 440 M&A deals in healthcare at a value of \$72 billion and the second half of the year is expected to continue the upward trend.

## Healthcare M&A Activity



The second quarter of 2010 has been dominated by three main sectors: medical devices with 42 deals, pharmaceuticals with 41 deals,

and biotechnology with 25 deals. These account for 53% of the total Q2 healthcare M&A volume. Sanofi-Aventis expanded its reach into the vascular pharmaceutical arena in June with the acquisition of TargeGen. Cardinal Health is reinforcing the market expansion into services by acquiring Health Solutions Holding.

## Selected Middle Market Healthcare Transactions

Category	Announced Date	Target	Acquirer	Enterprise Value (\$USDmm)	EV to LTM Rev	EV to LTM EBITDA
BioPharma	Jun-10	TargeGen <i>Vascular biopharmaceutical</i>	Sanofi-Aventis <i>General pharmaceutical products</i>	\$560	NA	NA
BioPharma	May-10	FuturaGene <i>Agricultural bio-technology</i>	Suzano Papel e Celulose <i>Forestry-based company</i>	70	264.1x	NA
BioPharma	Apr-10	Javelin Pharmaceuticals <i>Pain management products</i>	Hospira <i>Pharmaceuticals and medication delivery systems</i>	147	72.2x	NA
BioPharma	May-10	Sigma Pharmaceuticals <i>Generic pharmaceutical products</i>	Aspen Pharmacare Holdings <i>Global pharmaceutical products</i>	800	0.3x	5.5x
Diagnostics	Apr-10	RedPath Integrated Pathology <i>Oncology laboratory services</i>	ExonHit Therapeutics <i>Molecular diagnostic tests and therapeutics</i>	32	5.9x	NA
Healthcare IT	Apr-10	Phase Forward <i>Clinical trial and drug safety monitoring</i>	Oracle <i>Enterprise software</i>	591	2.7x	20.0x
Medical Devices	Apr-10	ATS Medical <i>Structural heart disease products</i>	Medtronic <i>Medical device manufacturer</i>	349	4.6x	NA
Medical Devices	May-10	BioSphere Medical <i>Embolotherapy products</i>	Merit Medical Systems <i>Interventional and diagnostic products</i>	66	2.1x	NA
Medical Devices	Apr-10	Medingo <i>Diabetes treatment products</i>	F. Hoffmann-La Roche <i>Diagnostics and pharmaceuticals products</i>	200	NA	NA
Medical Devices	May-10	SenoRx <i>Breast cancer diagnosis and treatment products</i>	CR Bard <i>Medical and diagnostic equipment</i>	193	3.4x	46.3x
Medical Devices	Jun-10	Somanetics <i>Real-time blood oxygen monitoring systems</i>	United States Surgical <i>Medical devices and equipment</i>	291	5.4x	25.4x
Services	Apr-10	American Homepatient <i>Home healthcare services, equipment, and supplies</i>	Highland Capital Management <i>Investment management firm</i>	226	1.0x	21.3x
Services	Apr-10	Dialysis Corp. of America <i>Outpatient kidney dialysis centers</i>	U.S. Renal Care <i>Outpatient kidney treatment centers</i>	119	1.2x	12.4x
Services	Apr-10	Signature Genomic Laboratories <i>Diagnostic cytogenetic services</i>	PerkinElmer <i>Healthcare research and development</i>	90	NA	NA
Tools and Equipment	Apr-10	GENEART <i>DNA engineering and processing</i>	Applied Biosystems Deutschland <i>Global biotechnology tools</i>	61	2.6x	27.8x

Sources: Capital IQ and 451 Group

## Technology M&A Activity

	Deal Volume	Transaction Value (\$mm)	Median EV / Revenue	Median EV / EBITDA
Application Software	31	\$3,679	1.8x	7.4x
BPO	3	961	9.1	-
Consulting	6	132	0.6	11.5
Infrastructure Software	9	1,703	2.4	12.9
Internet & Digital Media	12	886	2.3	4.5
IT Services	18	1,171	0.6	9.4
IT Services - Government	2	87	1.8	-
Network Communications	16	1,860	1.1	7.0
SaaS	9	977	2.7	18.0
Semiconductor	8	1,366	9.2	-
Transaction Processing	3	411	-	-
<b>Total</b>	<b>117</b>	<b>\$13,233</b>	<b>3.2x</b>	<b>10.1x</b>

Sources: Capital IQ and 451 Group

Software continues to be the focus of Technology M&A activity in the second quarter of 2010, as Application Software leads in terms of deal volume. The Infrastructure Software sector posted average deal value of \$189 million, with a median EBITDA multiple of 12.9x.

## Selected Technology Transactions

Category	Announcement		Acquirer	Enterprise Value (\$mm)	Enterprise Value to LTM	
	Date	Target			Revenue	EBITDA
Application Software	Apr-10	Phase Forward <i>Clinical research software</i>	Oracle <i>Enterprise software solutions</i>	\$591	2.7x	20.0x
Application Software	Apr-10	Symyx Technologies <i>Research data management software</i>	Accelrys <i>Software solutions for scientific development</i>	101	0.7	6.4
Application Software	Jun-10	TTI Team Telecom International <i>Operations support systems</i>	TEOCO <i>Network cost optimization solutions</i>	32	0.8	7.4
Infrastructure Software	May-10	Double-Take Software <i>Virtual infrastructure software</i>	Vision Solutions <i>Data management and recovery solutions</i>	154	1.8	11.1
IT Services	Jun-10	Intelligroup <i>Software applications, tools, and services</i>	NTT Data International <i>Research and facility management services</i>	174	1.4	10.7
IT Services	Apr-10	Morse <i>Application and infrastructure services</i>	2e2 Group <i>IT managed services and solutions</i>	81	0.2	3.1
Network Communications	May-10	Teleset Networks <i>Telecommunication services</i>	Volgatecom <i>Telecommunication services</i>	137	4.4	7.5
Network Communications	May-10	AGC Networks <i>Business communication systems</i>	Essar Capital Finance <i>Industrial diverse investment firm</i>	75	0.6	6.4
SaaS	Jun-10	DivX <i>Media enhancement</i>	Sonic Solutions <i>Digital media management</i>	193	2.6	-
SaaS	May-10	Dynamic Change <i>Online governance software</i>	Allocate Software <i>Workforce management solutions</i>	13	2.8	18.0

Sources: Capital IQ and 451 Group
















## Optimistic Outlook

The second half of 2009 and first half of 2010 have given us reason to believe that the recovery of the M&A market is underway. While certain industries, such as Pharmaceuticals and Technology, have weathered the storm relatively well due to their strong balance sheets, other sectors are starting to show an increasing appetite for acquisition. The global recession had shifted the focus of companies from unbridled expansion to the maximization of cost efficiencies, but now in Q2 of 2010 we see a new trend as productivity is reaching maximum capacity with internal resources, firms are looking outward for growth opportunities. Companies are at their highest cash reserves since the 1960's. This cash position in combination with the greater availability of debt is expected to spur the competitive momentum of acquisitions for small and mid-sized companies. The continuous improvement in the debt market and more accessibility to debt is resulting in the emergence of private equity players in the marketplace, as well. M&A activity has picked up over the past 6 months and we expect the transaction activity to continue to grow.

Overall, the M&A market has made great strides toward recovery, especially compared to the marketplace one year ago. This past quarter has seen an uptick in deal volume and the return of the private equity investor to the broad marketplace. And while some sectors will recover more quickly than others, we believe overall M&A activity will continue to improve. We also anticipate that with a steady volume of M&A activity, valuations will begin to increase in the second half of 2010.

# Covington Associates

## Recent Transactions

 <p>acquired by</p> <p>NEW ENGLAND CAPITAL AND CLARKSTON MERCHANT PARTNERS</p>	 <p>has acquired</p> 	 <p>acquired by</p> 	 <p>entered into a development partnership with</p> 
 <p>acquired by</p>  <p>\$133,000,000</p>	 <p>acquired by</p> 	 <p>HEMODIALYSIS CATHETER BUSINESS</p> <p>acquired by</p>  <p>\$12,500,000</p>	 <p>acquired by</p>  <p>\$6,500,000</p>

## Industry Expertise

### Business Services

- Consulting
- Government
- Payment & Transaction Processing
- Real Estate Services
- Research

### Healthcare

- Clinical Trial Services
- Diagnostics
- Disease Management
- Healthcare Information Technology
- Medical Product Outsourcing
- Medical Devices
- Tools and Reagents
- Therapeutics

### Consumer and Industrial

- Analytical Instrumentation
- Consumer Products
- Energy
- Manufacturing & Distribution
- Transportation & Logistics

### Technology

- Communications
- Digital Media Technologies
- Enterprise Software
- Hardware
- IT Services
- Reseller/Distribution

## About Covington

Covington Associates is a specialty investment banking firm founded in 1991 serving business services, consumer & industrial, healthcare, and technology companies throughout the country.

Focused on mergers and acquisitions, debt and equity capital raising, debt and equity restructuring, and strategic advisory assignments for middle market companies, Covington Associates has completed transactions ranging in value from \$10 million to close to \$2 billion for both private and publicly traded companies.

265 Franklin Street  
Boston, MA 02110  
(617) 314-3950  
info@covllc.com

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