M&A ALERTS™

The Must Read For the Middle-Market Finance Professional

February 11, 2011

CELEBRATING 10 YEARS

The M&A Advisor was founded in 1998 to offer insight and intelligence on middle-market activities. In 2002, the first M&A Advisor Awards were presented to the year's top professionals in M&A, financing and turnarounds.

Since that time, The M&A Advisor Awards have become synonymous with excellence in dealmaking. Each year we recognize the leading transactions by innovative firms and individuals whose acumen is exemplary.

In 2011, we will celebrate the 10th anniversary of The M&A Advisor Awards. With the following five awards programs, we continue the tradition of honoring the accomplishments and the contributions of the industry's leading firms and professionals:

M&A Distressed Turnaround Awards Gala
Awards Gala: March 7, 2011 Palm Beach, FL

M&A Advisor Financing Awards
Awards Gala: May 4, 2011 Chicago, IL

M&A Advisor 40 Under 40 Awards
Awards Gala: July 25, 2011 Los Angeles, CA

M&A Advisor International M&A Awards
M&M&Awards Gala: September 26, 2011 New York, NY

M&A Advisor Awards
Awards Gala: December 13, 2011 New York, NY

M&A Advisor Sweet Spot™

· Join us for our 2011 Distressed Investing Summit and Turnaround Awards in Palm Beach, FL (March 6th & 7th)!

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Top Stories

Deal For Headlines: AOL Buys Huffington Post

The week started off with AOL's purchase of Huffington Post for $315M. The $315M all-cash deal is expected to close in the first half of 2011. Huffington Post is a privately held company owned by its co-founders, Ms. Huffington, Chairman Kenneth Lerer and a group of investors. The purchase was made to bolster AOL's current attempt to transition from its subscription-based service to an Internet portal and ad-supported digital media company. In Q4 of 2010, AOL's ad revenue, the focus of the company's turnaround strategy, dropped 29%. The Huffington Post acquisition marks the largest deal for AOL since Tim Armstrong started as chief executive in April 2009. AOL went on a shopping spree in September of 2010, buying TechCrunch blog, 5min Media and Thing Labs Inc. Comparatively, the previous three deals were

much smaller acquisitions.

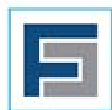
When in Need Deal: Kindred and RehabCare Merge

Kindred Healthcare Inc. agreed earlier in the week to acquire RehabCare Group Inc. for approximately $900M in the latest industry merger. The deal is said to be driven by cost cutting by both government and private health insurers. Under the terms of the deal, RehabCare stockholders will receive $26 in cash and 0.471 Kindred shares for each share currently held. Kindred is expected to issue approximately 12M shares in connection with the transaction. The deal also includes the assumption of $400M in debt. Kindred is backed by financing from J.P. Morgan Chase, Morgan Stanley and Citigroup Inc. The merger creates the largest "post-acute" health-care company in the country, with more than $6B in revenue and operations in 46 states. Morgan Stanley and Cleary Gottlieb Steen & Hamilton advised Kindred. Citigroup and attorneys at Armstrong Teasdale and Bryan Cave advised RehabCare.

Sowing the Seeds of a Deal: Uralkali and Silvinit Merge

Shareholders of both Russian fertilizer producers OAO Uralkali and Silvinit have approved a $1.4B merger, creating the world's second largest potash producer, announced Uralkali on Monday. The deal comes after Canada's government blocked BHP Billiton's $39B bid for Potash Corp. in November of 2010. Profits of fertilizer producers have been rising steadily as wheat, corn and soybeans prices increase. Uralkali will purchase approximately 20% in Silvinit for $1.4B under the terms of the deal. Uralkali and will purchase the remaining 80% of Silvinit's assets through an issuance of new shares. The companies' management teams expect to achieve synergies of $100M a year from the merger by 2013. The merger is expected be completed in May 2011, subject to regulatory approvals.

Equity for Deals: Fifth Street Raises $145.5M



Fifth Street Finance Corporation announced that it has closed its public offering of 11,500,000 shares of common stock at a price of $12.65 per share, raising approximately $145.5M in gross proceeds. The 11,500,000 shares of common stock include the over-allotment option granted to the underwriters, which was exercised in full. All shares were offered by Fifth Street. Wells Fargo Securities, Morgan Stanley, UBS Investment Bank, Deutsche Bank Securities and RBC Capital Markets served as joint book-running managers for the offering. Stifel Nicolaus Weisel acted as lead manager and Gilford Securities Incorporated, FBR Capital Markets and ING acted as co-managers for the offering. Fifth Street intends to use

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the net proceeds from this offering to make investments in small and mid-sized companies in accordance with its investment objective and strategies described in the prospectus supplement and accompanying prospectus and for general corporate purposes.

Pipeline Professional

Working to turn around a telecommunications, media and technology company in the lower middle-market? Try reaching out to Frank Graziano, Managing Director at Core Capital Group. Graziano's background is in structured finance and derivatives, merchant banking focused on turnarounds and workouts and corporate development in the Internet, new media and technology industries. You can find him here on our M&A Advisor network.

Metrics Meter

So Far, So Good
According to Grant Thornton's deal tracker, $2.5B in US M&A and PE deals were struck in January 2011. Meanwhile, Thomson Reuters says this year, global M&A activity is at its highest since 2000. The total value of all global M&A activity thus far in 2011 is $309.6B, up 61% over last year and the highest since companies brought in $554.2B in 2000.

Funding Distressed Deals

Roger's Corner
by Roger Aguinaldo

I want to invite everyone to our 2011 Annual Distressed Investing Summit and Turnaround Awards. If you haven't taken a look at it yet, look at it now. With all the snow and frigid temperatures lately, Palm Beach, Florida is not a bad place to be. Now in its 5th year The 2011 Turnaround Awards and Distressed Investing Summit in Palm Beach, Florida, on March 6 and 7, will honor the accomplishments of the top distressed investing, restructuring and turnaround M&A professionals and firms, bringing together top dealmakers for an exclusive symposium featuring industry leaders in roundtable forums.

On that note, some new distress debt numbers are in. Starting off the year this January, as compared to December of 2010, the number of Chapter 11 filings nationwide edged forward 5%, according to bankruptcy research firm Epiq Systems.

2011 M&A ADVISOR FINANCING AWARDS

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- Sector Deal of the Year
- Firm of the Year
- Deal-maker of the Year
- Product/Service of the Year

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Q&A

Distressed Investing: What PE Needs to Know

Thomas D. Hays, III

This week we had the pleasure of interviewing Tom Hayes, Founding Principal of NHB Advisors. NHB is one of the most experienced, if not the longest standing, advisory firms in the middle market.

Along with the firm's advisory services, the company has formed affiliate NHB Capital Partners, LP, sourcing investment capital to be deployed in challenging situations throughout North America's middle market. NHBCP's institutional limited partners target investments between $10M and $30M with an average holding period of 3-5 years.

During his tenure at NHB, Hayes has

All tallied, 1,048 businesses filed Chapter 11 in January 2011 compared to 997 in December 2010. Yet the number of filings last month was 20% lower than the previous year when 1,320 businesses filed Chapter 11 in January 2010.

All commercial bankruptcies, meanwhile, which account for Chapter 11, Chapter 7 and some types of Chapter 13 filings, decreased by 12% in January 2011, as 5,639 businesses filed compared to 6,426 in December 2010. Overall, the aggregate number of commercial bankruptcies fell last month by 14% compared to January 2010 when 6,611 businesses filed in bankruptcy court.

What does this signal? A couple of things. First, the drop in filings means that distressed deals are waning. (But that does not mean there is no opportunity out there.) It also means that our colleagues are doing their work by providing different forums for companies to work out their challenges or insolvency in other ways.

For more encouragement, there are new funds and capital sources being raised. On the PE side, fund-raising was down overall last year, so dealmakers smartly shifted their focus to mezzanine debt. Dow Jones LP Source reported that such funds collected $6.2B for 27 funds last year, up from $3.4B for 20 funds in 2009.

Making big headline news not long ago, of course, was Morgan Stanley Investment Management's announcement that their team raised $956M for a brand new fund that also invests in corporate mezzanine debt, which is--for alternative investment vehicles--a good thing.

On the hedge fund side, Morgan Stanley Credit Partners, which buys credit sold by midsize companies to finance buyouts, refinance existing debt and pay for acquisitions, has hauled in $160M into five companies thus far this year.

And competition in the distress real estate market is heating up. For example, Hilco Real Estate has created a new division to handle distressed assets. Hilco Real Estate Managed Asset Resolutions is jockeying to work with lenders, servicers and real estate investors to work out or dispose of distressed loans and REO assets. The company is aiming to manage undeveloped land assets along with commercial and residential projects. Hilco said it plans to use all resolution alternatives including brokerage, auction, foreclosure, receivership and bankruptcy. Although real estate values are still in flux, access to available debt through the CMBS market has improved. The firm "believes that distressed loans will continue to trouble lenders as poor vintage loans mature."

Meanwhile, Manulife Financial, owner of John Hancock, has also rolled out a new investment fund targeted at distressed commercial real estate assets. The firm's new Declaration Management & Research division will manage the commercial real estate fund. "The new fund, DMR CRE Debt Fund 1, will focus on special situation recapitalizations in all property sectors. The fund, which is looking for an all-in yield in the low to mid teens, will pursue investments in opportunistic distressed debt acquisition; discounted pay-offs and will originate new debt at both the senior mortgage and mezzanine levels." Manulife and John Hancock will both provide co-investment capital to the new fund.

Castle Creek also announced this week that it closed its fourth fund, Castle Creek Capital Partners IV, L.P. ("Fund IV"), raising $331M. Fund

served as CEO and Chairman or Advisor to the Board to both private and public companies. Hays began his career in 1969 as a CPA with Arthur Andersen and advanced to 3M and Conrail. He has also served as Chairman of the Turnaround Management Association. In addition, Hayes has been Chairman of the Association of Certified Turnaround Professionals and served on its Standards Committee for several years. He was an early supporter of professionalism for turnaround managers and holds the distinction of becoming one of the first Certified Turnaround Professionals (CTP) in the country.

M.A.: What should PE firms consider to best manage their remaining capital before their commitment periods expire in order to diversify their holdings of distressed investments?

T.H.: It mostly depends on the remaining capital, timing and degree of distress. Generally, an assessment of turnaround opportunities of distressed investments should be made to determine a course of action--that is, whether sell to immediately, liquidate to eliminate risks, hold on and hope for better conditions or actively engage in a turnaround that will either make the investment more attractive for a near-term sale or actually turn it around. Keep some "powder dry." I have seen a couple of situations where a fund was literally tapped out, and it would have only taken a few hundred thousand dollars to have saved an investment.

M.A.: You have warned of a looming capital crunch, especially for marginal or underperforming portfolio companies. What should PE firms do if their portfolio companies are caught in the crunch?

T.H.: PE firms need to understand the needs of their individual portfolio companies and address those needs through refinancing, sale or operational improvement, and by extending maturities wherever possible.

M.A.: What are some steps PE firms can take to manage distressed investments that are not generating value?

T.H.: If there is time, assess whether the business can and should be fixed. If it can be fixed, at what cost? Analyze the probability of a successful outcome and

IV will be deployed for recapitalization, growth equity and buyout investments in US-based community banks. The firm raised the capital from institutional investors, including public and private pension funds, prominent fund of funds and financial institutions. Thomas Capital Group is serving as placement agent. To date, Fund IV has closed transactions on seven bank investments across six major US metropolitan markets.

And our colleagues at Golub Capital have introduced a new line of business that will invest in long/short credit opportunities. Their new focus is directed at opportunistic and distressed credit assets with emphasis on event-driven investment opportunities in the US and Europe.

In the meantime, I hope to see you all in Palm Springs.

expected valuation.

M.A.: What should PE firms with distressed investments be looking for in terms of capital sources?

T.H.: Funds looking at distressed investing should probably not be looking for longer term financing other than on the investment company level. Value creation in distressed investing comes from moving an investment from liquidation value to discounted cash flow. That can be done in a relatively short time. There are substantial risks in attempting to move a distressed purchase all the way to a strategic valuation. The mind-set and company culture must shift dramatically, and at least in my experience, that has been difficult to do.

M.A.: Do you think LPs will have to pare down the number of PE sponsor relationships they have going forward? How will this impact distressed investments?

T.H.: I think LPs will look carefully at the next fund series put out by a PE group. Distressed investing is tough business. Those that did well in their existing fund will be oversubscribed for their follow- up fund. There will be many PE groups that will not be able to generate the interest for follow-up on funds due to their performance.

M.A.: In 2011, do you think debt markets will remain strong through traditional bank and high-yield refinancing as well as amend-and-extends and exchange offers?

T.H.: Things should remain strong for a while. Down the road, I see a credit crunch caused by ongoing trade and government deficits exacerbated by the huge number of refinancings coming up in the next few years. The tight credit markets will force interest rates dramatically higher and cause huge problems for the currently large number of "walking wounded." Thus, I would act aggressively to refinance long term or sell portfolio companies now while there is opportunity.

M.A.: Will we continue to see a climb in the issuance of high-yield bonds for refinancing? Should these be considered junk bonds?

T.H.: Probably for the near term as investors wish to gain current yield, but not for the long term with the anticipated credit crunch, where safety will be an issue.

M.A.: You point out that successful funds are increasingly concentrated in larger and larger pools of capital, with a shrinking pool of smaller funds in the middle market. What can middle market PE firms do to ensure they make it to fund II or III?

T.H.: Produce good returns for your LPs and treat them like future customers because they are.

M.A.: Thanks, Tom!

The M&A *Alerts* is published bi-monthly by The M&A Advisor
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