COMMENTARY

November 30, 2012

Dear clients and colleagues,

Mergers and acquisitions (M&A) activity around the globe had a rough spot in the third quarter, with deal volumes falling to lowest level since 2005. Deal activities are down 8% from the previous quarter. According to Thomson Reuters, worldwide M&A activity is down 16%, to $1.7 trillion as compared to last year.

Companies prefer certainty before making major investment decisions. Deal making is usually driven by the economy and the financial markets. The European debt crisis, slowing emerging economies and a mild recovery in the US do not help the case. We think M&A activity will pick up in the months ahead.

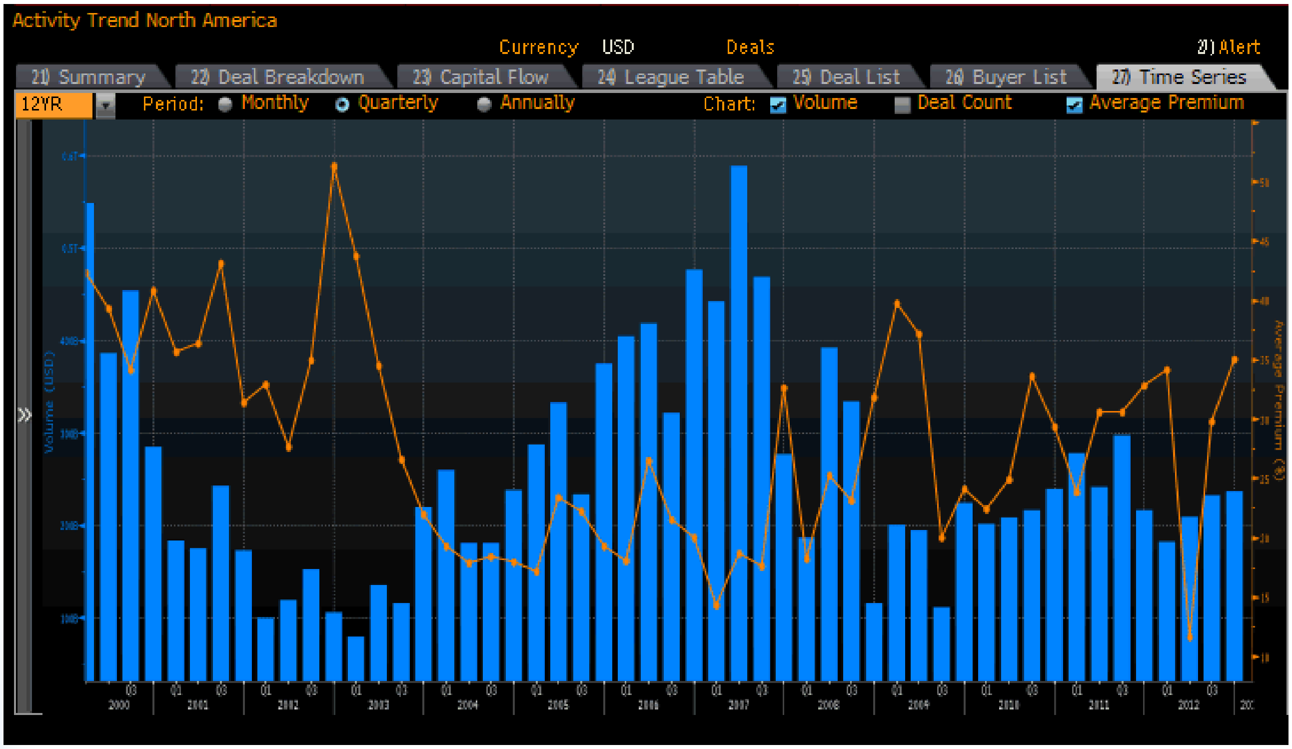
The US presidential election is behind us. The fiscal cliff is the next biggest uncertainty facing the economy. This is not a thriving environment for deal flow. Tax increases in January 2013 are making many companies re-evaluate their businesses. Baby boomers who wanted to retire had to delay their plans as valuations for their businesses were low during the recession. Managements of various companies we meet have highlighted an increase in late stage conversation for finalizing M&A deals. Many small mom and pop business want to sell their businesses and close the deals before year end. This will help them avoid paying higher capital gains if they were to sell next year.

A massive pile of cash is sitting on large companies' balance sheets. According to the Federal Reserve, as of June 2012 corporations had piled up $2.2T on hand, up from $1.5T at the end of 2007, sufficient to bail out a few European countries. M&A activities in some sectors are showing signs of picking up.

The Energy sector, for example, has had M&A deals valued at $297B to date, which is 9% above last year according to Dealogic. The number of deals has fallen from 1,956 to 1,493 indicating buyers are paying a higher valuation. The average premium is up in all sectors, and certainly above the 2007 level and closer to levels seen in early 2000 as shown in the chart on the next page which covers activity trends in North America.

This situation is positive for smaller companies, as it appears their mega counterparts are willing to pay extra to be first to acquire small and innovative companies that can provide positive long-term growth perspectives. What's more, big companies seem to be diversifying the types of acquisitions they make. Larger, maturing companies do not have the same ability as small companies to innovate. Small companies have the capacity to adjust, create and develop faster due to their nimble structure.

This is the first time in a decade that we have seen only one acquisition in our portfolio year to date. However we see many companies in our portfolio as potential targets. Rumors surrounding a few of our companies suggest that large corporations are ready to deploy capital once more clarity on the economy and the fiscal cliff is attained.



Source: Bloomberg

Have a good weekend.

The Global Alpha Team