SouthernSun
ASSET MANAGEMENT

6000 Poplar Avenue, Suite 220, Memphis, TN 38119
Telephone: 901.333.6980 Fax: 901.333.6981

SouthernSun 4Q09 and 2009 Year End Commentary January 27, 2010

Beginning in late 2008 and into 2009, you may recall that we regularly espoused that the marketplace generally suggested a view that most assets were virtually worthless. You may even recall our interim commentary back in March of '09, an illustration we used to help communicate that notion. In conjunction with that illustration, we suggested that we would begin to have a greater confidence in valuations when businesses, certainly our portfolio businesses, but also companies at large, began to make regular strategic, predominantly bolt-on, acquisitions. Based on the activity we have seen in the past several months, it appears we may be in the early stages of such a shift towards fundamental valuation.

Prior to October of 2008, the merger and acquisition market was generally fluid, albeit over levered, with multiple buyers and sellers in the marketplace. After October 2008, we believe management teams rushed to manage their businesses for cash, thus increasing the accumulation of cash for healthy and unhealthy businesses alike; this ultimately resulted in marketplace bids for virtually all assets drying up as global systemic deleveraging took place.

As this scene unfolded, we closely monitored our portfolio companies. What we observed was that, in most of our companies, expense cuts, restructuring and implementation of new technological innovations represented the key initiatives over the course of the following nine months. Thus, as we entered the last quarter of 2009, the emerging environment was, in reality, very close to what we had expected and articulated in late 2008. That is, with the cash gains that had been made over the course of the year and the deleveraging and/or restructuring of debt that took place, coupled with a new sense of fundamentally substantiated valuation confidence, we began to see merger and acquisition activity pick up. I think it's interesting to note, although there have been several large scale acquisitions which have captured most headlines, the reality is quite simply that much of the current acquisition activity began with the small and the mid-sized businesses.

To summarize, I think there are at least three reasons we believe merger and acquisition activity has picked-up, particularly in the last quarter of 2009. First, there was a higher degree of confidence in the financials that businesses were evaluating as they went out and looked at potential acquisitions. Second, our businesses established more clarity regarding their own business models. I think that it took at least nine months, if not longer, for most businesses in general to understand their own position as a result of the downturn, and then begin to make plans for the future. And third, and probably as important as any, opportunities are still out there in the marketplace to leverage the skills and the capabilities of our businesses without adding debt. Nine of our portfolio companies made acquisitions over the last several months - many of which were product oriented or distribution oriented, and we all believe are very nice additions in the long run.

Over the last two decades, one of our tenancies has been to buy management teams that know how to buy businesses, and we believe that this, in turn, enables us to keep your portfolio concentrated while allowing the businesses within that portfolio to leverage our capacity and positively influence returns on invested capital via accretive acquisitions.

For 2010, we propose the following syllogism. Point one: we see increased regulation taking center stage in the areas of finance, energy, healthcare and labor. Point two: governments are not blind to corporate return to profitability and they will wish to garner their share via tactical taxation. Thus, we believe this may lead to a tug of war of sorts, which may, in the interim, make for a very, very uneven year from a performance standpoint – remember, policy risk and volatility are classmates. This notion, when coupled with our view of increasing merger and acquisition activity, may only exacerbate this unevenness.

One possible corporate response to this might be that regulation could push more business out of the United States, and even out of the EU, to head towards developing markets. This, we believe, would favor those companies with current capacity in alternative locations with a history of local experience.

We further believe that the energy discussion will take on meaningful shifts. We do not believe that the discussion of alternatives, as we've seen it over the past two or three years, will continue on the same course, rather there will be some significant shifts particularly as data is scrutinized, technologies advance, and interpretation of imbalances and costs are revisited.

Finally, based on our aforementioned views, we will not be at all surprised to see a substantial number of public and private business failures in 2010. We can even imagine the number being larger than in 2009. New appraisals on farm land and commercial real estate, along with additional bank failures, may set the scene for some very interesting opportunities over the course of the year. (Note: between October 1, 2000 and December 31, 2008 there were about 53 bank failures in the U.S. – by contrast, in 2009 alone, the US saw about 140 failures and we have already seen about 9 in the first month of 2010.)

Finally we, as always, appreciate your confidence in our firm as we continue to do our very best to perform at an exceptional level.

Michael W. Cook
CEO/Chief Investment Officer