Aramar
Capital Group, LLC

Deal Market Perspective

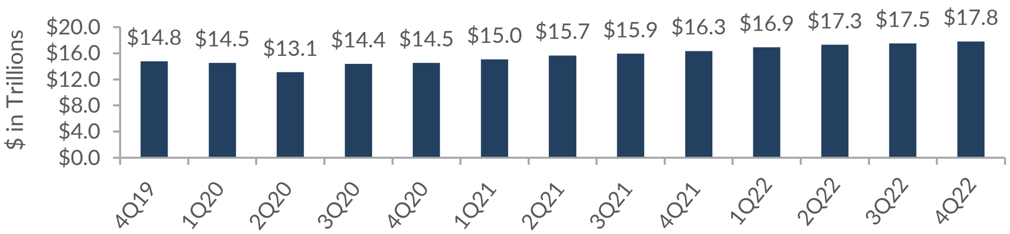
4th Quarter 2022

Economic Overview

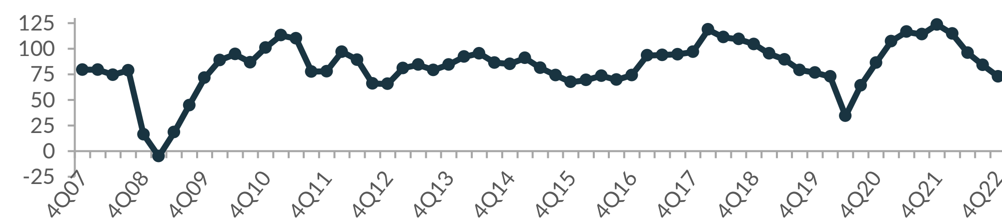
The economy and job growth have been resilient, leading to optimism about a so-called soft landing. Still, the Fed is walking a tightrope. On the one hand, it no doubt is heartened by signs that inflation is abating. On the other hand, any hint that interest rate hikes will be curtailed lifts securities markets and the broader economic outlook, potentially leading to spending that will boost inflation and derail the Fed's efforts. Most of our clients have been experiencing soft results for months, as their customers reduce purchases and/or inventory. But the spigots seem to be opening and freight and certain other costs (but not labor) have been declining, so the hope is that 2023 will strengthen as the year progresses. (Let's hope there is an end to the war in Ukraine soon … and no more spy balloons penetrate our continent!) To be safe, our guest article (on page six) this quarter provides tips to small businesses on how to operate during a recession.

- The U.S. GDP increased at a 2.9% seasonally-adjusted annual rate in Q4 2022, a deceleration from the 3.2% increase seen in Q3, driven by upticks in inventory investment and consumer spending that were partly offset by a decrease in housing investment[1]
- The International Monetary Fund slightly raised its outlook for global economic growth to 2.7% for 2023, still well below the 6.1% and 3.2% that occurred in 2021 and 2022, respectively[2]
- The Federal Reserve has instituted eight interest rate hikes since March 2022, taking its target range to its highest level since October 2007[3]
- U.S. households turned cautious at the end of 2022, cutting spending during the holiday shopping season and increasing savings, adding to signs of an economic slowdown[3]
  - Consumer spending fell a seasonally adjusted 0.2% in December from the prior month[4]
- A surge in hiring by American small businesses complicates the Federal Reserve's effort to cool inflation[4]
  - Small companies have been responsible for nearly all of the net job growth in the U.S. since the onset of the pandemic and currently account for almost four out of five available job openings[5]
- At the end of Q4 2022, the U.S. unemployment rate decreased again to 3.5%, its lowest level since May 1969 (until the 3.4% January 2023 rate), as compared to 3.9% at the end of Q4 2021[6]
  - The average workweek rose in January 2023 to its highest level since March 2022, reversing declines in the fourth quarter
  - Employers had 11 million job openings at the end of December, nearly double the number of unemployed people looking for work that month
- The new year brought more bleeding in Silicon Valley; Google, Facebook, Microsoft, and Salesforce each announced plans to reduce headcount by 8,000 to 12,000 workers[7]
- In 2019, around 5% of fully-paid working days in the U.S. were completed remotely; that proportion jumped to more than 60% in May 2020, and for the past year the percentage has been hovering around 30%[6]
  - Job seekers on average said they would take a 14% pay cut in order to work remotely[8]
- The U.S. consumer confidence index increased in December following back-to-back monthly declines; the index now stands at 108.3, up sharply from 101.4 in November and still well above its 15-year average[9]
- Business Roundtable's CEO Economic Outlook Survey, a composite index of CEO expectations for capital spending, hiring, and sales over the next six months, declined 11 points from last quarter to 73, which is the first time it has dipped below its long-run average of 84 since Q3 2020[10]

U.S. Consumer Spending (Annualized)[1]



Business Roundtable's CEO Economic Outlook Index[9]



1. *Bureau of Economic Analysis*
2. *International Monetary Fund*
3. *The Wall Street Journal*
4. *U.S. Department of Commerce*
5. *Jefferies Group*
6. *Bureau of Labor Statistics*
7. *U.S. Survey of Working Arrangements and Attitudes*
8. *ZipRecruiter*
9. *The Conference Board*
10. *Business Roundtable*

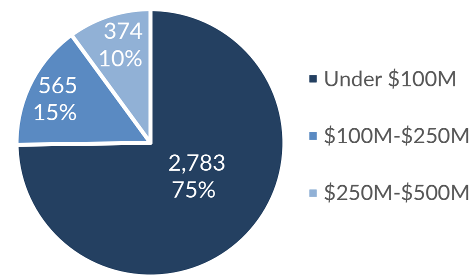
Mergers and Acquisitions

The M&A market fell off during the back half of 2022 following a robust post-Covid period. Declining securities markets, rising interest rates, and a softening economy led acquirers to address their existing operations and act more conservatively rather than spend money on deals and invest time on due diligence and then the integration of acquired entities. But cash remains plentiful, and acquisitions are a good way to increase revenues during an otherwise soft period, so deal activity should pick up as 2023 advances.

- North American (N.A.) M&A value was $498.1B and volume was 4,703 in Q4 2022, representing a 38% decrease in value and a 17% slide in transaction count as compared with Q4 2021[1]
  - Staggering inflation figures across global markets, driven by rising demand, supply chain issues, and labor shortages led central banks to aggressively raise interest rates in 2022, depressing deal activity
  - Economic and geopolitical uncertainty also weighed on dealmakers and led to heightened caution in Q4
  - Private equity firms struggled against increased borrowing costs for potential deals, and the leveraged loan market came to a virtual standstill in the second half of the year, further complicating dealmaking
- The second half of 2022 saw the largest percentage drop in M&A volume since recordkeeping began in 1980[2]
- According to a recent survey, 72% of tech CEO respondents plan to pursue M&A in the next 12 months and 59% of CEO respondents across all other industries are looking at M&A[3]

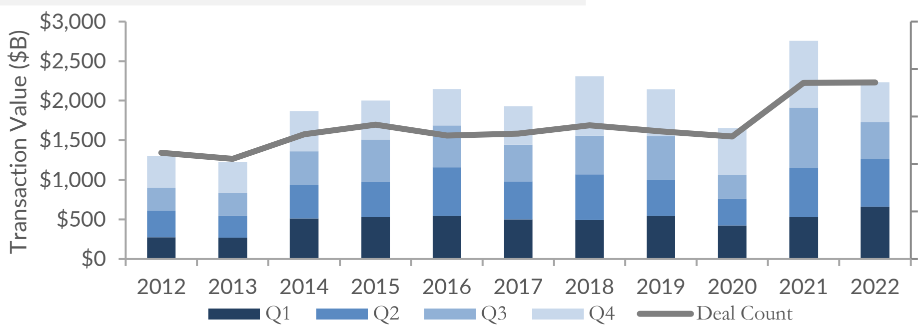
- M&A-related leveraged loan issuance increased to $35.2B in Q4 2022, up from $22.9B in Q3 2022, as the market shows signs of stabilizing after four straight quarterly declines[1]
- S&P 500 company cash holdings, excluding financial institutions and utilities, remain elevated at just under $2.0T, below the all-time high reached in 2020, but providing acquirers with ample capital[4]

2022 U.S. M&A <$500M[5]

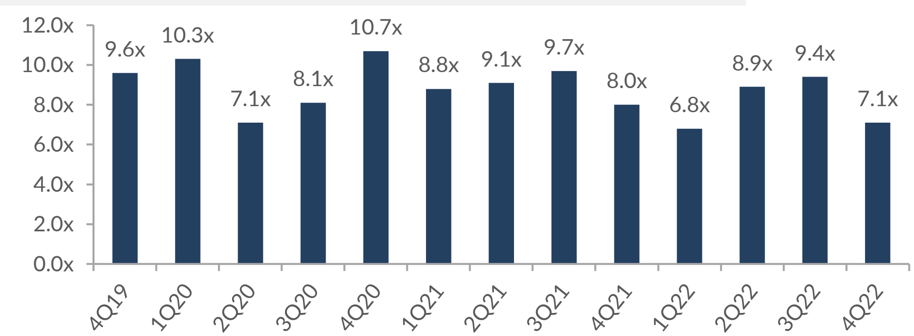


- Dealmaking in Q4 2022 was again dominated by smaller transactions, as 79% of the sub-$500M U.S. M&A market was accounted for by transactions under $100M[1]
- Cross-border M&A deal value in N.A. in Q4 2022 (N.A. M&A transactions with non-N.A. acquirers) increased 14.1% from Q4 2021 to $78.8B after falling the past four quarters[1]
- More companies are going private; among the top 20 deals in Q4 2022, eight involved a public company that either was taken private in its entirety or sold a piece of itself to a PE buyer[1]
- The median U.S. middle-market M&A EV/EBITDA multiple in Q4 2022 for deals between $1M and $500M was 7.1x, a sizeable drop from the 9.4x multiple in Q3 2022[5,6]

North America M&A Activity [1]



U.S. Middle-Market Median EV/EBITDA M&A Multiple[5,6]



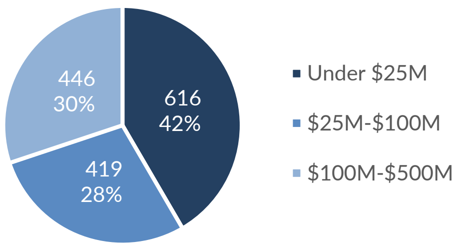
1. *PitchBook*
2. *Refinitiv*
3. *Ernst and Young*
4. *S&P Capital IQ*
5. *FactSet*
6. *These multiples reflect prices paid for mainly large public companies and do not account for smaller private company transactions that tend to change hands at much lower multiples*

Private equity (PE) and other investment firms curtailed their activity in the latter part of 2022. The reluctance of sellers to scale back their purchase price expectations despite generally soft financial results and a weaker deal market, combined with the effect of higher interest rates and the bad optics to LPs of aggressively closing deals while the media trumpets the onset of Armageddon, certainly impacted investment fund and family office managers. But they are paid to find deals, and good companies and the dry powder to buy them are out there, so activity should rebound in 2023, especially in the lower and middle markets, which are far less sensitive to interest rates because of lower leverage.

- U.S. PE investment activity slowed in Q4 2022, with 2,377 closed deals worth a combined $234.1B, representing a 16% decline in volume and a 36% decrease in value as compared to Q4 2021[1]
  - In Q4 2022, deal activity succumbed to recession talk, higher interest rates, and lower multiples
- From its 2021 highs, U.S. annual PE deal value fell 20% and fundraising fell 17% in 2022[1,2]
- A notable portion of the limited PE investment activity was by mega-funds attempting to take advantage of sliding multiples to deploy capital[1]
  - At its October lows, the 24.9% YTD drop in the S&P 500 allowed PE firms to buy up public companies at discounts to their recent high-water marks
- More acquirers turned to short-term loans known as 364-day facilities to finance acquisitions in Q4; demand for such facilities in the U.S. jumped 17% to $317.3B in 2022 compared with 2021[3]

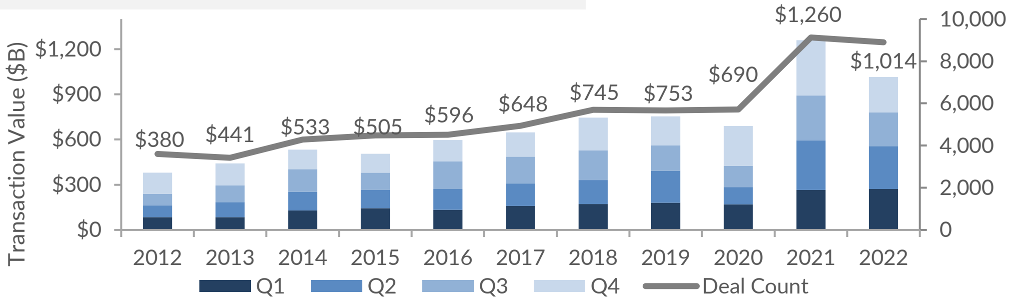
- For PE-led transactions between $10M and $250M, the average EV/EBITDA multiple was 8.1x, according to the most recently available quarterly data[4]
  - This multiple was up from 7.4x the prior quarter, likely because many small businesses experienced weaker performance in the back half of 2022, leading to depressed unadjusted EBITDAs

Q4 2022 U.S. PE Deals <$500M[1]

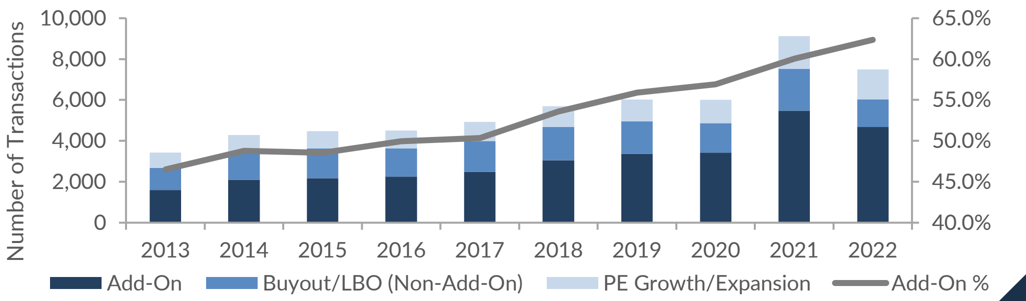


- Global PE dry powder rocketed to a new all-time high of $1.96T in 2022, a 21% year-over year increase from 2021[5]
- PE firms struggled to raise capital as an economic slowdown and rising interest rates have prompted many investors to re-evaluate their commitment plans[6]
  - As equity markets fell, pension funds found themselves over-allocated to private vehicles – a phenomenon called the denominator effect – and were forced to cut back[6]
  - U.S. PE fundraising dropped in Q4 2022, with a combined $84.3B raised across 109 funds, a 34% decrease in capital raised and a 73% reduction in the number of new funds compared to Q4 2021[1]
- U.S. PE exit activity in Q4 2022 by deal enterprise value and exit count was down 72% and 44%, respectively, compared with the record-breaking number of exits seen in Q4 2021[1]
  - Exits slowed as potential sellers chose to hold portfolio companies amid headwinds and the exit-to-investment ratio decreased to 0.39x, the lowest figure seen since the Global Financial Crisis

U.S. Private Equity Deal Flow[1]



U.S. Private Equity Deal Activity by Type[1]



1. *PitchBook*
2. *Ernst & Young*
3. *Dealogic*
4. *GF Data*
5. *S&P Capital IQ*
6. *The Wall Street Journal*

Equity and Debt Capital Markets

Venture capital (VC) investing and fundraising took big hits in the last two quarters of 2022, as deal euphoria faded and the opportunities for exits via IPOs, SPAC mergers, and sales were limited. Portfolio companies had to slash costs and conserve cash in order to survive. Ironically, while many investors lay low in soft markets, these are the times that attractive prospects and valuations can be found. Exit markets ultimately will reopen, particularly once the Fed eases its tightening and securities markets respond favorably. Debt markets too have been tight, especially the leveraged loan market, but the increasing importance of alternative debt sources does provide support.

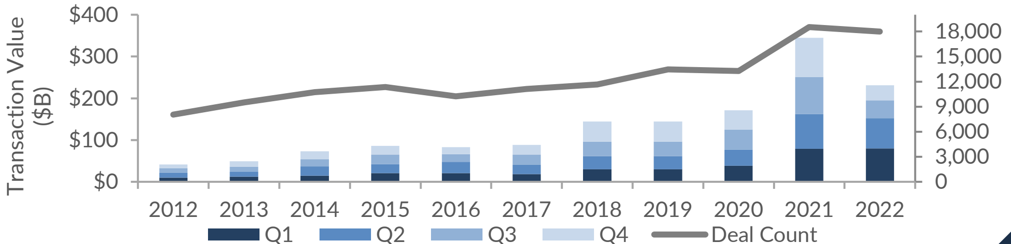
Equity Markets

- After a record-breaking 2021, the global IPO market took a sharp turn in the opposite direction in 2022; Q4 2022 IPO activity dipped 55% and 73% by number of deals and proceeds, respectively, over Q4 2021, with only 341 IPOs raising $33.5B[1]
  - Financial-sponsored IPO activity took a steep fall in 2022, with the number of deals and proceeds down 77% and 93%, respectively
  - While current activity represents a stark decline from 2020 and 2021, the global IPO market in 2022 still registered a 16% increase in the number of deals when compared to pre-pandemic 2019
- U.S. equities ended Q4 2022 mostly higher; the S&P 500 increased 7.6%, breaking three consecutive quarters of losses[2]
- In Q4 2022, analysts cut their full-year 2023 earnings-per-share forecasts by 4.4% to $230.51B, representing the biggest downgrade since 2014[3]
- In 2021, American investors put more money into Mexico – buying companies and financing projects – than into China, representative of a shift toward more regional manufacturing networks[4]
- Startup company valuations were down 43% on average in Q4 2022 from a year ago, but generally remain higher than their public tech-stock peers[2]
  - High valuations have endured in part because of insider rounds, when startups raise money from existing investors with minimal valuation dings
  - Venture capitalists say they have seen a surge in insider rounds; some estimate 10 times the number from prior years, helping keep startups afloat
- Q4 2022 VC exit activity fell to $5.2B, the lowest quarterly total in over a decade, capping off a staggering 90.5% decline in annual exit value[5]
- Startups currently demand more than twice as much capital as VC firms supply; unfilled demand by U.S. startups reached $42.8B in Q4 2022[5]
  - Bid-ask imbalances have been an issue across all venture stages, but nowhere is it more overextended than at the later stage, with capital demand outpacing supply by 148.5%, as compared to 50.5% and 67.1% for the early and venture growth stages, respectively
- Despite potential inflated valuations, the VC market in 2022 looked much less menacing than the narrative suggests; venture investors deployed $238.3B and VC funds raised a record $162.6B[5]
  - Even as deal value declined each quarter, with the Q4 2022 figure falling back to pre-pandemic levels, the estimated Q4 2022 deal count was just under 4,000, which is the most active quarter outside of the past two years

Debt Markets

- For PE-led transactions between $10M and $250M, the average total debt/EBITDA multiple was 3.6x according to the most recently available data, below the 3.9x to 4.1x range that existed pre-pandemic[6]
- Total new-issue volume in the broadly syndicated loan market tumbled 63% to a 12-year low of $225B in 2022, as deal flow dried up on all fronts amid market volatility; private credit increasingly stepped in during the market disruption to support large LBO deals[5]
- Institutional leveraged loans due to mature in 2023 are minimal at around $10B, but within three years that amount will balloon to $298B; analysts agree that may translate into higher refinancing volume in 2023 as issuers address looming maturities[5]
- The 10-year yields at quarter-end on U.S. investment-grade and high-yield bonds remained high due to the continued tightening of monetary policy, earning investors 3.88% and 9.22%, respectively[7]

U.S. Venture Capital Deal Flow[5]



1. *Ernst & Young*
2. *The Wall Street Journal*
3. *FactSet*
4. *McKinsey Global Institute*
5. *PitchBook*
6. *GF Data*
7. *Bloomberg*

Ten Ways Small Businesses Can Prepare for a Recession

Aramar Capital Group, LLC

Small business owners face a variety of challenges, and one of the biggest is how to prepare for a recession. A recession can have a devastating impact on a small business, leading to reduced revenue and even bankruptcy. However, with the right planning and preparation, small business owners can weather the storm and come out stronger on the other side. In this article, we discuss ten ways small business owners can prepare for a recession.

1. *Build an emergency fund*: One of the most important things a small business owner can do to prepare for a recession is to build an emergency fund. This fund should have enough money to cover three to six months of expenses, including rent, salaries, and other bills. This will ensure that the business can continue to operate even if revenue drops significantly.

2. *Reduce expenses*: Another important step in preparing for a recession is to reduce expenses. Small business owners should look for ways to cut costs, such as negotiating better deals with suppliers, reducing energy consumption, and finding more cost-effective marketing strategies.

3. *Diversify your customer base*: Diversifying your customer base can help protect a small business from the impact of a recession. By having a diverse group of customers, a small business can reduce its reliance on any one group and be less affected if one group's spending decreases during an economic downturn.

4. *Increase your online presence*: During a recession, consumers are more likely to shop online. Therefore, small business owners should focus on increasing their online presence. This can include building a website, creating social media accounts, and investing in online advertising.

5. *Network*: Networking is a great way to build relationships with other business owners and learn about new opportunities. During a recession, networking can also help small business owners find new customers and partners.

6. *Focus on quality and value*: During a recession, consumers are more likely to be price-sensitive. Small business owners should focus on providing quality products and services at a fair price. By offering value, small business owners can attract and retain customers even during tough economic times.

7. *Be flexible*: Small business owners should be flexible and willing to adapt to changing conditions. This could mean offering new products or services, adjusting prices, or changing the way they do business.

8. *Seek professional advice*: Small business owners should seek professional advice from accountants, lawyers, and other experts. They can help small business owners navigate the challenges of a recession and develop a plan to weather the storm.

9. *Keep an eye on the economy*: Small business owners should keep an eye on the economy and be aware of any signs of a recession. This could include a rise in unemployment, a decrease in consumer spending, or a drop in stock prices.

10. *Stay positive*: Finally, small business owners should stay positive and maintain a strong sense of optimism. While a recession can be difficult, it is important to remember that it is not the end of the world. With the right mindset and preparation, small business owners can survive and even thrive during a recession.

In conclusion, a recession can be a difficult time for small business owners. However, with the right preparation and planning, small business owners can minimize the impact of a recession and come out stronger on the other side. By building an emergency fund, reducing expenses, diversifying the customer base, increasing online presence, networking, focusing on quality and value, being flexible, seeking professional advice, keeping an eye on the economy, and staying positive, small business owners can weather the storm and come out on top.

About the Author:

ChatGPT is a chatbot released in November 2022 by OpenAI. Previously, the bot had no work experience and earned no educational degrees.

Differentiation

Aramar is a boutique investment bank focused on providing merger, acquisition, and strategic private placement services; we are unique among our investment banking peers in that we:

- Focus on middle-market transactions; these transactions are a priority, not a default for when larger deals are dormant
- Have significant transactional expertise
- Provide senior-level attention
- Have a proprietary marketing process that follows a comprehensive approach tailored to each buyer or investor candidate, rather than a typical generic approach utilizing blast teaser e-mails and other automated contacts

Services

Aramar offers a highly focused set of corporate finance services to assist our clients in conceiving, defining, executing, and optimizing their objectives:

- Mergers and acquisitions
  - Negotiated sales of closely-held companies
  - Corporate and private equity firm divestitures
  - Leveraged and managed buyouts
  - Buy-side advisory
- Private placements and recapitalizations
- Fairness opinions, valuations, and financial advisory

Clientele

Aramar focuses on providing high-quality, high-touch services to middle-market clients

- Our M&A transactions range in size from approximately $10 million to $250 million and strategic private placements range in size from approximately $10 million to $100 million
- We provide the high quality of service and substantial transactional experience offered by a major national investment bank, but to a clientele that either is too small for, or cannot receive, the proper level of attention from a larger investment bank, or would receive lesser services and capabilities from a business broker, consultant, or smaller investment bank

Team

Aramar has assembled a unique team of professionals with a comprehensive and attractive mix of skills and backgrounds

- Significant investment banking experience, including stints at many other prominent financial services firms
- Entrepreneurial, managerial, and ownership experience that sets apart Aramar's "principal" perspective from that of most investment banks; our team members have founded, sold, and merged our own companies; acquired businesses; and acted as officers and directors of both public and private enterprises
  - As such, we can relate more closely to our clients and better advise them, at the same time as ensuring senior-level investment banking attention