Aramar Capital Group, LLC

Deal Market Perspective

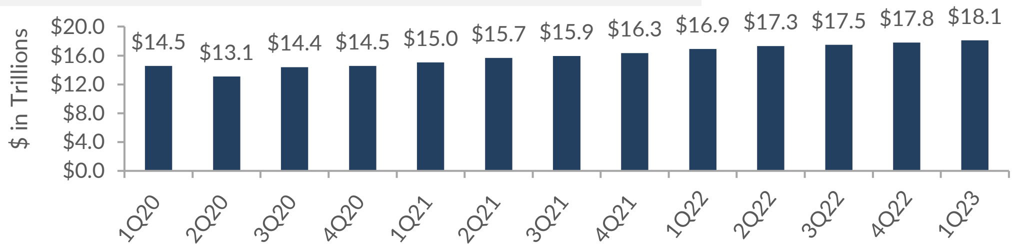
1st Quarter 2023

Economic Overview

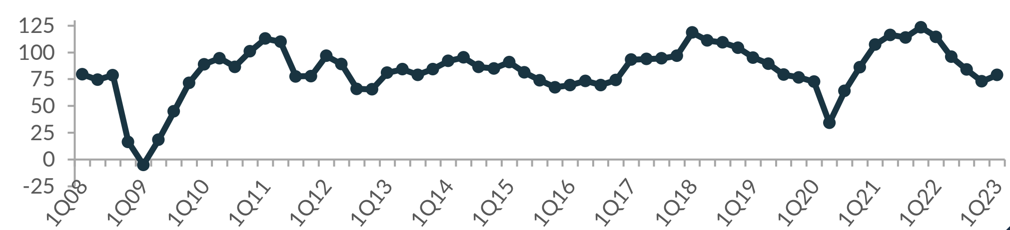
As if the global economy hasn't had enough so-called black swans to overcome, we now have yet one more … a banking crisis (which is the subject of this report's guest article by Kroll on page six). The collapse of Silicon Valley Bank (SVB), Signature Bank, Credit Suisse, and First Republic Bank has raised fears about the health of other financial institutions, the commercial and real estate lending market, and accordingly the overall economy. The Fed seems to have paused or even ended its rate hikes (after its most recent one on May 3rd) in order to walk the tightrope between allowing inflation to remain high and acting as a catalyst for a recession. Hopefully, wages and economic activity can keep increasing while inflation recedes. And we can avoid further surprises, except perhaps for an NBA championship for the Knicks!

- U.S. GDP increased at a 1.1% seasonally-adjusted annual rate in Q1 2023, a deceleration from the 2.9% rise seen in Q4 2022[1]
- At the end of Q1 2023, the U.S. unemployment rate held steady at 3.5% for the second quarter in a row (and dropped to 3.4% at the end of April)[2]
  - Despite declines in manufacturing and job openings, the U.S. economy in general and the labor market in particular remain solid
- The International Monetary Fund lowered its outlook for global economic growth again for 2023 and 2024 to 2.8% and 3.0%, respectively, amid looming fears of a potential upcoming recession[3]
- Core CPI — which excludes food and energy — rose a seasonally adjusted 5.6% over the past 12 months, a decrease from the 6.5% seen at this same time last year, as the Fed continues to combat inflation[4]
  - Consumer spending rose a seasonally adjusted 0.2% in March from the prior month[5]
- Global shipping companies are wrestling with plunging exports, falling freight rates, and a potential price war in a reversal of the soaring demand the industry experienced during the pandemic[6]
  - The cost of sending a 40-foot container from China to Los Angeles dropped to $1,238 by mid-April, down from $15,600 at the same time last year, before jumping over 30% to $1,659 by month's end[7,8]
- Lenders with less than $250B in assets (such as SVB) play an outsized role in the economy, accounting for 80% of commercial real estate lending and 45% of consumer lending[9]
  - Small and midsized banks are expected to slow lending drastically in an effort to strengthen their balance sheets after the crisis; the pullback is likely to result in a 0.25% to 0.50% drag on GDP[10]
  - Community and regional banks make 60% of all small-business loans and more than 80% of farm loans, meaning any lending squeeze likely would disproportionately affect small companies and those outside large cities[10]
- Higher funding costs for banks will reduce both profits and lending activity; every 10% decline in bank profitability lowers lending by 2%[9]
- If the share of Fed interest rate changes that are passed on to bank deposit rates, sometimes called "deposit betas," reach levels seen in 2007 — which was the last time the Fed raised rates close to current levels — it could lead to a 3% to 6% decline in lending in the U.S.[9]
- The U.S. consumer confidence index decreased in Q1 2023, finishing the quarter at 104.0, down from 108.3 at the end of Q4 2022[11]
- Business Roundtable's CEO Economic Outlook Survey, a composite index of CEO expectations for capital spending, hiring, and sales over the next six months, increased six points from last quarter to 79, making it the third consecutive quarter at or below the long-run average of 84[12]

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



Business Roundtable's CEO Economic Outlook Index[11]



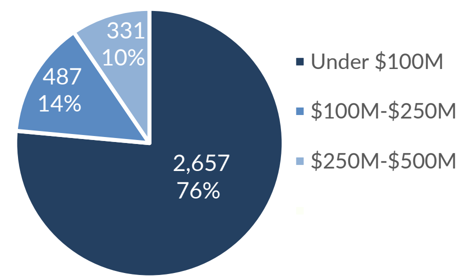
1. *Bureau of Economic Analysis*
2. *Bureau of Labor Statistics*
3. *International Monetary Fund*
4. *U.S. Department of Labor*
5. *U.S. Department of Commerce*
6. *The Wall Street Journal*
7. *Freightos Data*
8. *Xeneta*
9. *Goldman Sachs*
10. *Independent Community Bankers of America*
11. *The Conference Board*
12. *Business Roundtable*

Mergers and Acquisitions

Global M&A activity remains depressed as compared to recent levels because of economic and geopolitical concerns and, increasingly, credit market constraints. Still, many strategic and financial acquirers are sitting on a lot of cash generated or raised during the pandemic and are seeking ways to kickstart earnings through synergies typically realized with purchased companies and subsequent add-on acquisitions. The impact of the so-called Covid bump, freight rate jumps, and other supply-chain issues are falling out of last-twelve-month (LTM) financial results and making company profits more reliable to use as a base for valuation purposes. Given the abundance of capital and stabilizing normalized profits, we look for M&A volume to pick up as the year progresses.

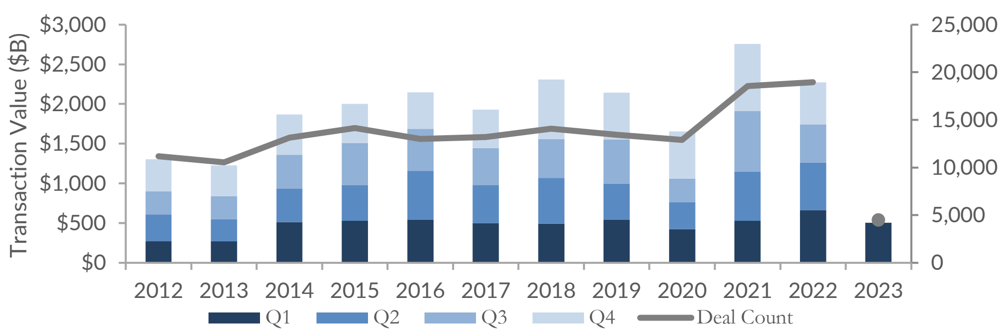
- North America (N.A.) M&A deal value was $503.2B and volume was 4,492 in Q1 2023, representing a 16.0% decrease in value and a 5.1% slide in transaction count as compared with Q1 2022[1]
  - M&A faltered in Q1, with deal value retracing Q4 2022's modest gains; it now sits 32.2% below the peak hit in Q4 2021[1]
  - The volume of transactions fell to its lowest level in a decade, reflecting economic uncertainty, higher interest rates, and geopolitical issues[2]
- Business founders, who tend to reflect personal and not just market factors in their decisions as to when to sell, stepped in and filled part of the void left by investment firms awaiting a firmer M&A market[1]
  - Private owners have always been the largest block of sellers in the U.S. M&A market; in 2023, their share increased to 85.3%, an all-time high

Q1 2023 U.S. M&A <$500M[4]

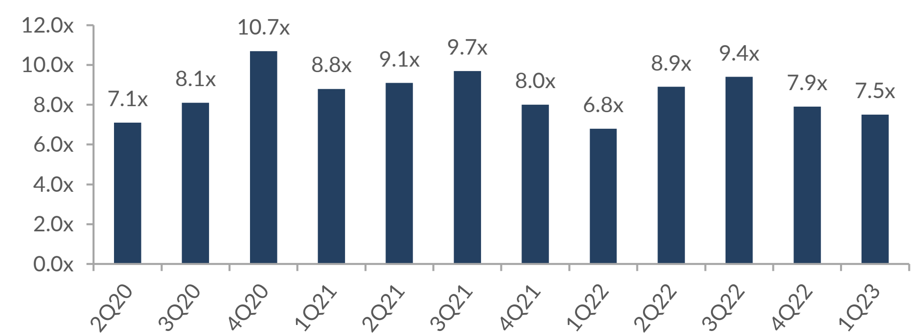


- M&A-related leveraged loan issuance decreased to $18.2B in Q1 2023, the lowest it has been in seven quarters[1]
- U.S. companies are sitting on over $2.0T of cash, with a quarter of it concentrated in a few top technology companies[3]
  - Other big holders of cash are carmakers and healthcare companies
- Dealmaking in Q1 2023 was again dominated by smaller transactions, as 76% of the sub-$500M U.S. M&A market was accounted for by transactions under $100M[4]
- Cross-border M&A deal value in N.A. in Q1 2023 (N.A. M&A transactions with non-N.A. acquirers) fell 60.3% from Q1 2022 to $47.4B[1]
- Last year, 21% of private M&A transactions in the U.S. contained earnout provisions, up from 17% in 2021; 23% of these deals incorporated an earnout measured on an EBITDA target — a performance metric more favored by buyers than revenue — an increase from 16% recorded the prior year[5]
- The median U.S. middle-market M&A EV/EBITDA multiple in Q1 2023 for deals between $1M and $500M was 7.5x, down from 7.9x in Q4 2022[4,6]

North America M&A Activity [1]



U.S. Middle-Market Median EV/EBITDA M&A Multiple[4,6]

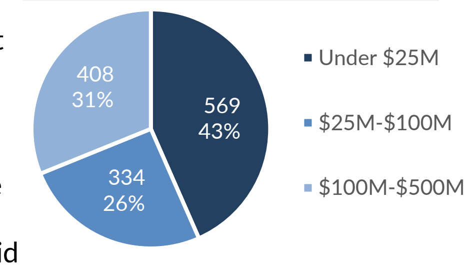


1. *PitchBook*
2. *Refinitiv*
3. *Moody's Investors Service*
4. *FactSet*
5. *SRS Acquiom*
6. *These multiples reflect prices paid for mainly large public companies and do not account for smaller private company transactions that tend to change hands at much lower multiples*

Private equity (PE) deal flow has remained relatively quiet, as PE firms and other financial buyers focus on their existing portfolio companies in the current challenging environment and exercise caution in making new acquisitions given the uncertainty in the economy. The increase in interest rates and decrease in bank credit availability have added to the reasons for vigilant decision making. But PE firms are paid to make deals and the amount of dry powder is substantial (though lower), so they are motivated to seek acquisition targets, albeit more so now with transaction structures that have a higher sharing of risk and reward (*i.e.*, contingent payments) than has been the norm, as noted on the prior page.

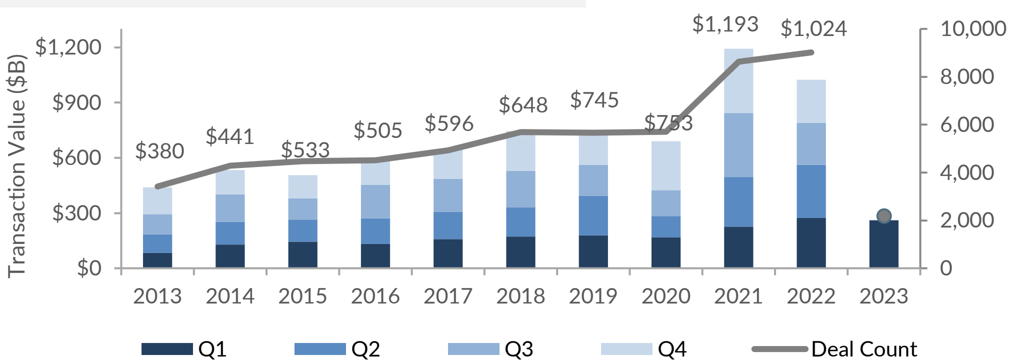
- U.S. PE investment activity slowed in Q1 2023, with 1,399 closed deals worth a combined $175.4B, representing a 39% decline in volume and a 36% decrease in value as compared to Q1 2022; deal activity felt the pressure of stress in the banking system and higher interest rates[1]
  - Q1 activity is still flat to slightly up when compared with the "old" normal of 2017 to 2019, which at the time was considered a breakneck pace for U.S. PE dealmaking
- U.S. PE firms inked more than 2,000 deals with a combined potential value of $261B in Q1 2023 (some have yet to close), pointing toward a potential healthy pace of dealmaking later in 2023 even as investors grapple with numerous headwinds[1]
- For PE-led transactions between $10M and $250M, the average EV/EBITDA multiple was 6.8x, according to the most recently available quarterly data, down from 7.7x over the preceding three quarters[2]
- After holding firm at 2.4x to 2.5x for the past two years, the median total-enterprise-value-to-revenue multiple paid by PE buyers has fallen to 1.7x on buyouts this year and 1.1x for companies worth under $100M[1]

Q1 2023 U.S. PE Deals <$500M[1]

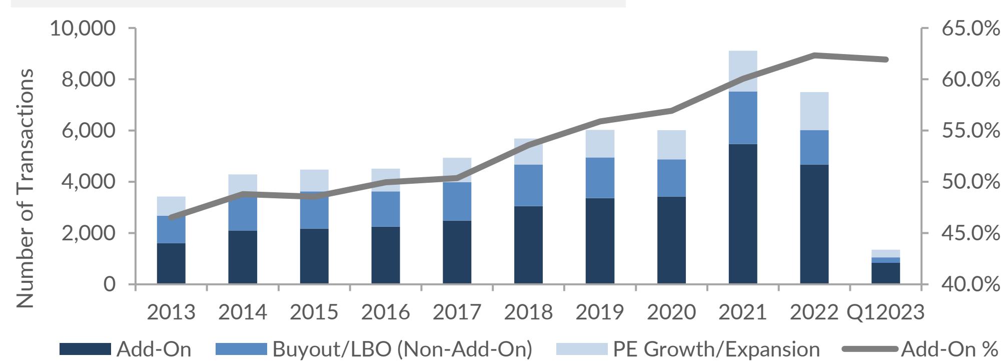


- Add-on investments continue to drive the U.S. PE market, accounting for 62% of all deals in Q1 2023[1]
- Global PE dry powder has declined to $1.3T, down from its previous record of $1.9T at the beginning of 2022[3]
- U.S. PE fundraising was mixed in the first quarter of 2023, with $66.8B raised across 73 funds, a 3% increase in capital raised but a 26% reduction in the number of new funds raised as compared to Q1 2022[1]
- US PE exit activity by deal enterprise value is down 38% and exit activity by volume is up 1% in Q1 2023 relative to Q1 2022, with 279 exits worth a combined $55.8B[1]
  - GPs continue to hold on to their portfolio companies instead of exiting them at lower valuations than desired

U.S. Private Equity Deal Flow[1]



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



1. *PitchBook*
2. *GF Data*
3. *Preqin*

Equity and Debt Capital Markets

The venture capital (VC) market continues to be in a tight spot. With the IPO market virtually closed and other exit activity very low, VC investors have been focused on select opportunities and on keeping existing portfolio companies afloat given the overall market's limited investments in later-stage companies and the maladies of SVB and certain other lenders that have been serving the startup community. The debt market as a whole has tightened, though alternative credit providers have filled part of the gap.

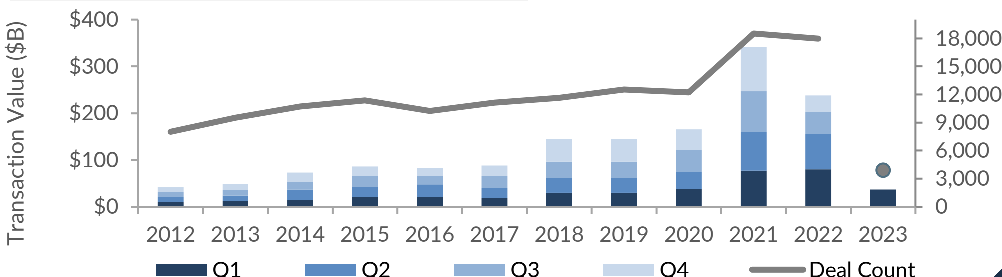
Equity Markets

- IPO momentum continued to struggle in Q1, resulting in a considerable decline in both deal numbers and proceeds; in aggregate, Q1 2023 saw 299 global IPOs raising $21.5B, decreases of 8% and 61%, respectively, on a year-over-year basis[1]
  - The tepid IPO market is due to rises in interest rates, a lukewarm stock market, inflation concerns, and global banking industry turmoil
  - Despite ongoing uncertainty around the economic and geopolitical environment, the IPO pipeline continues to build up and hope remains for a turnaround later this year
- After dropping precipitously to close out 2022, the S&P 500 rose in Q1 2023, ending 7.5% above its year-end level[2]
- Earnings growth for S&P 500 companies in Q1 2023 dropped significantly, with a blended growth rate of -6.2%, marking the largest earnings decline reported by the index since Q2 2020[3]
- The share prices of companies that listed publicly in Q1 2023 — IPOs, direct listings, and SPAC listings — were up an average of 8.6% since their listings through May 1, 2023, which was in line with the S&P 500 return of 8.6% for the year-to-date period through May 1, 2023[4]
- U.S. VC deal value fell 55.1% to $37.0B in Q1 2023, while deal count dropped 45.5% to 2,856 transactions, relative to Q1 2022[5]
  - VC activity dropped in all stages and sectors in the first quarter of 2023; high-profile bank failures, instability abroad, and stubborn inflation rates outweighed positive economic indicators
  - Investors allocated $12.9B to seed- and early-stage startups in Q1 2023, a 58.2% decrease from Q1 2022; late-stage startups are now seeking 3.13x more capital than is being supplied, which is a new record
- The value of startup exits — a sale or public offering — plummeted to $5.8B in Q1 2023, an 81.9% drop on a year-over-year basis[5]
  - Patent-seeking startups exit via the public markets 23.2% of the time, in stark contrast to 4.0% for companies that have not sought patents
- Capital has become increasingly concentrated within the New York City and Bay Area markets, where VC funds have raised $330.8B since 2019, while other regions' funds couldn't secure even half that amount[5]
- Roughly half of VC-backed companies are on pace to run out of cash in the second half of 2023[6]
- SPAC IPO activity plunged in Q1 2023, with 78 IPOs worth a combined $14.7B, representing a 75% decrease in volume and an 86% decline in value as compared to Q1 2022[5]

Debt Markets

- The 10-year yields at quarter-end on U.S. investment-grade and high-yield bond indices rose dramatically with the tightening of monetary policy, earning investors 3.49% and 8.70%, respectively[2]
- For PE-led transactions between $10M and $250M, the average total debt/EBITDA multiple was 4.0x, according to the most recently available data, in line the 3.9x to 4.1x range that existed pre-pandemic[7]
- Debt maturing this year for the 75 non-financial firms in the S&P 500 that have filed annual reports since this past fall amounts to $73.6B with a weighted average interest rate of 2.65%, a much lower rate than companies can secure today, portending far higher debt servicing costs[8]
- Loan volume from pension funds, money market funds, asset managers, and other private credit providers has risen sixfold since 2013 to $850B and will help fill part of the gap as commercial bank credit tightens[9]

U.S. Venture Capital Deal Flow[5]



1. Ernst & Young
2. S&P Capital IQ
3. FactSet
4. IPO Scoop
5. PitchBook
6. Morgan Stanley
7. GF Data
8. Calcbench
9. Preqin

Still Not a Banking Crisis

We are not in a banking crisis. Many developments over the past few months have set off the Spidey senses of those who followed developments in 2008. But the financial instability we have witnessed in the U.S. and Europe has so far been limited to idiosyncratic cases. We face a problem of liquidity (whether banks have the cash to meet demands from customers and counterparties) rather than solvency (when the value of the loans on bank balance sheets is called into question). There is a playbook for successfully tackling a liquidity crisis: the central bank steps in as a lender of last resort, as the Fed and the Swiss National Bank (SNB) have done. While we are not in a banking crisis now, markets could make one happen. The financial instability we have seen so far will weigh on economic growth, which will hopefully help lean against inflation.

I was reminded recently by a note put out by JPMorgan that we have a saying in economics: “Whenever the Fed hits the brakes, someone goes through the windshield.” It’s possible that Silvergate, Silicon Valley Bank (SVB), Signature Bank, First Republic, and Credit Suisse (CS) have all been sitting in the passenger seat. We buy this argument for the small U.S. lenders, which were unusually exposed to interest rate risk and in SVB’s case didn’t bother to hedge for it. But just as the small regional U.S. lenders were idiosyncratic, so is CS.

While the failed U.S. lenders and CS are idiosyncratic, the overreaction of markets to developments feels very reminiscent of 2008 (to be clear, a lot is completely different from 2008). Bank runs are a question of psychology and, at times over the past two months, Global Wall Street hasn’t always seemed to be in the mood to discern between idiosyncratic cases or between liquidity versus solvency problems. Just because we are not in a banking crisis does not mean we can’t land there in the end. Markets have a way of generating self-fulfilling prophecies. The liquidity operations that the Fed and SNB launched should be enough to stem the immediate panic, and yet the sale of First Republic since these operations were established suggests there are likely to be additional casualties in the banking sector and possibly in shadow banking.

What does all of this mean for the economy and central banks? Financial instability will feed through into the real economy through two channels. One channel is confidence, which is very difficult to measure, let alone predict. If everyone worries about a financial crisis and economic downturn, they will spend and invest less, the labor market will deteriorate, and we could land in recession. So far, this has not materialized in the U.S. or the eurozone, with consumer confidence remaining robust in March and April. The second channel is bank lending. If banks see deposits flee, their overall balance sheets will shrink, and they may extend fewer loans. Small- and medium-sized banks in the U.S. will almost certainly face more regulation going forward and they may begin complying with anticipated regulatory changes immediately, reducing their profits and constraining their lending. Banks may also pull back on loans as they anticipate financial instability will be a drag on growth. Loan demand in both the U.S. and the eurozone has fallen significantly in the first quarter of this year (though it has risen again in April in the U.S.). But according to the Senior Loan Officer Opinion Survey (SLOOS) on bank lending, U.S. lending standards have been tightening significantly since last year but did not do so more aggressively since March. According to Bank Lending Survey in the eurozone, the vast majority of banks (73%) reported that lending to businesses remained basically unchanged in March, while none reported it had tightened significantly.

On the margins, lending should slow this year and this is likely to contribute to the downturn we expect in the U.S. economy. But this isn’t necessarily a bad thing. Lower growth should take some heat off inflation. With inflation remaining sticky, more demand destruction may be necessary if the Fed is going to get inflation down to its 2% target.

Central banks have distinct tools for financial stability issues (supervision and lender of last resort capabilities) and macroeconomic stability (rate moves and the balance sheet). Given growth is holding up better than expected in the developed world and inflation remains stubbornly high, more rate hikes might be necessary to lean against inflation while financial stability tools are used to address wobbles in the banking sector. But financial stability impacts macrostability at a certain point, so the tools aren’t always as distinct in practice as they are in theory.

The failed U.S. regional lenders and CS are idiosyncratic cases, and there is no reason to expect they necessarily represent system-wide risk. So far, we are still dealing with a liquidity crisis and there are tools that can be (and have been) deployed for liquidity squeezes. Moves in U.S. Treasury yields have at times been dramatic, but this is not 2008 all over again. In 2008, banks were under-regulated and undercapitalized. Their asset quality was in question, generating a solvency crisis. That said, the market overreactions we have seen in recent weeks raise the risk that investors will generate a full-blown banking crisis as a self-fulfilling prophecy. The recent instability will drag on loan growth and therefore economic growth. But with inflation stubbornly high in the U.S. and Europe and assuming a banking crisis does not materialize, this could be a feature and not a bug.

By Megan Greene, Kroll, LLC

About the Author:

Megan Greene is Global Chief Economist for the Kroll Institute. With a global focus drawn from a career split between the UK and U.S., Megan examines the intersection of macroeconomics, financial markets, and politics. She has a breadth of experience working in financial services, academia, and policy and tailors her insights and forecasts specifically for her audiences.

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

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