Aramar Capital Group, LLC

Middle Market Update

3rd Quarter 2016

Third Quarter Economic Performance and Future Outlook

Aramar Capital Group, LLC

Gross Domestic Product

- The real U.S. GDP increased at an annualized rate of 2.9% in Q3 2016, up from the 1.4% rise in Q2 2016[1], due to:
  - Positive contributions from personal consumption expenditures, exports, private inventory investment, federal government spending, and nonresidential fixed investment, which were partially offset by negative contributions in residential fixed investment, and state/local government spending

Consumer Income and Spending

- Real disposable personal income grew 2.2% in Q3 2016, a slight increase compared with the 2.1% growth in Q2 2016[1]
- The personal savings rate, as a percentage of disposable personal income, was 5.7% in Q3 2016, unchanged from Q2 2016[1]

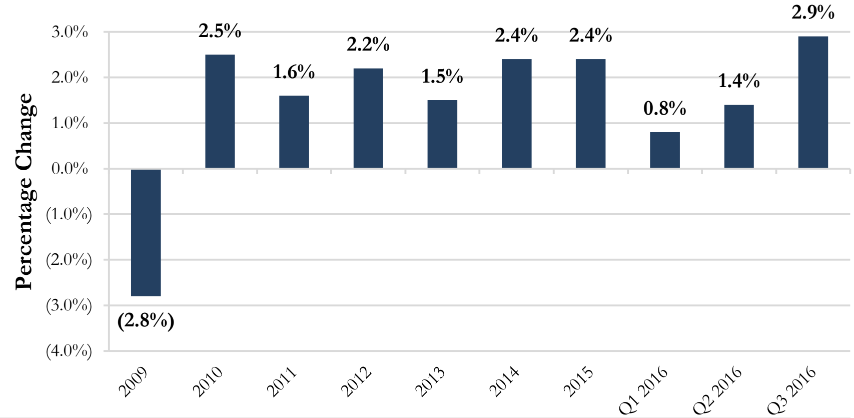
Federal Reserve

- During the most recent Federal Open Market Committee (FOMC) meeting held in September 2016, the committee stated that economic activity picked up from the first half's modest pace[2]
- The committee expects inflation to return to 2% in the medium term, as the transitory effects of low energy and import prices return to normal levels, while the labor market strengthens further[2]
- The FOMC decided to maintain the target range for the Federal Funds Rate at 0.25% to 0.50%, as the committee needs further evidence of continued progress toward its objectives before enacting a rate increase[2]
  - With the election completed, the committee will no longer be constrained by political factors, though uncertainty about the impact of President-elect Trump's promised tax cuts and spending boosts will weigh in on decision-making

Employment

- The unemployment rate and the number of unemployed persons remained little changed in Q3 2016, ending the quarter at 5.0% and 7.9 million respectively[3]
  - Employment continued to increase in the health care, professional and business services, and financial sectors

Real GDP Growth Since 2009



Source: U.S. Bureau of Economic Analysis

U.S. Treasury Securities

- High-yield and investment-grade corporate bonds were among the strongest areas in the fixed income market, while U.S. Treasuries and government-related securities lagged primarily due to a preference for higher income[4]

	Q4 2015[5]	Q1 2016[5]	Q2 2016[5]	Q3 2016[5]
5-year Treasury Note	**1.66%**	**1.44%**	**1.29%**	**1.18%**
10-year Treasury Note	**2.29%**	**2.01%**	**1.82%**	**1.61%**
30-year Treasury Note	**3.21%**	**2.96%**	**2.81%**	**2.49%**
10-year Treasury Inflation Protected Security (TIPS)	**0.66%**	**0.48%**	**0.19%**	**0.08%**

Outlook for 2016

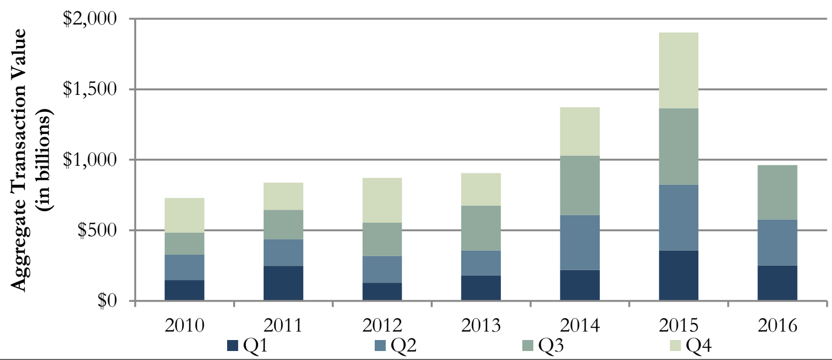
- PwC notes that the percentage growth of real household spending has not kept pace with GDP growth, which poses a challenge moving forward for businesses focused on consumer goods and services[6]
- The Business Roundtable CEO Economic Outlook Survey results indicate that U.S. CEOs believe that the U.S. economy will continue its lackluster growth, with the real GDP expected to grow by 2.2% in 2016, an increase from their Q2 2016 estimate of 2.1%[7]

1. *U.S. Bureau of Economic Analysis*
2. *U.S. Federal Reserve*
3. *Bureau of Labor Statistics*
4. *Baird*
5. *U.S. Department of the Treasury*
6. *PricewaterhouseCoopers*
7. *Business Roundtable*

Mergers and Acquisitions and Private Equity

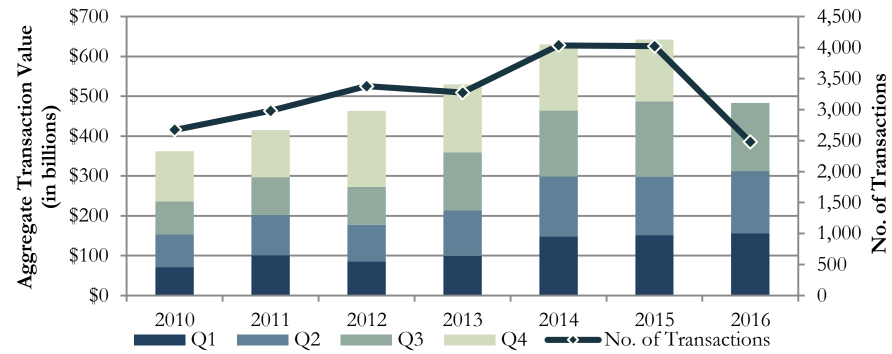
- Global mergers and acquisitions (M&A) activity reached $2.2T across 12,283 deals for the year-to-date (YTD) period ended Q3 2016, a decrease of 20.2% and 7.4%, respectively, from $2.8T across 13,263 deals for YTD Q3 2015[1]
  - The M&A market has not been able to keep pace with the record-breaking 2015, in large part due to political uncertainty, increased regulation, low deal supply, and reduced general confidence in the economy partially attributable to uncertainty over the election
  - U.K. inbound M&A activity increased 283.0% in deal value in Q3 2016 from Q2 2016, as foreign dealmakers purchased U.K. assets in bulk following the significant drop in the sterling's value subsequent to Brexit
- M&A activity in the U.S. remained somewhat resilient during the quarter amidst market uncertainties, but decreased overall during the year with $962.4B worth of deals for YTD Q3 2016, down 29.6% compared with the record-breaking value of $1.4T for YTD Q3 2015[1]
  - With transactions worth $190.6B for YTD Q3 2016, energy, mining, and utilities replaced pharmaceuticals, medical, and biotechnology as the most prolific sector in the U.S.
- Global megadeals (over $10B in value) decreased sharply during YTD Q3 2016, with only 27 of such transactions announced, collectively valued at $553.4B, down 30.7% and 42.9%, respectively, as compared with 39 megadeals valued at $969.2B for YTD Q3 2015[1]

U.S. M&A Activity



Source: Mergermarket

U.S. Private Equity Deal Flow



Source: PitchBook

- U.S. private equity (PE) investments totaled $171.2B in Q3 2016 across 662 transactions, up 9.8% in value but down 26.4% in count relative to the $156.0B over 899 deals that closed in Q2 2016[2]
- U.S. add-on acquisitions as a proportion of deal activity has experienced continued growth since 2006, representing 63.9% of all buyouts for YTD Q3 2016, the highest such percentage during the past decade[2]
  - In response to historically-high valuation multiples and deal competition from strategic acquirers, PE firms continue to utilize buy-and-build strategies for which premium prices can be supported by operating synergies and ultimate multiple arbitrage
- The number of U.S. PE deals below $100M reached 1,750, accounting for 70.6% of all activity for YTD Q3 2016, the largest proportion since 2009, as dealmakers continue to look lower down the value and multiple spectrum in search of better relative value[2]
- Based on the latest available data, PE firms have paid an average of 6.8x EBITDA for transactions between $10 million and $250 million[3] and 6.1x EBITDA for deals under $25 million[2]
- PE dry powder continues its upward trend to a record $839B in Q3 2016, up from the $818B in Q2 2016[4]

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

Venture Capital and PIPEs

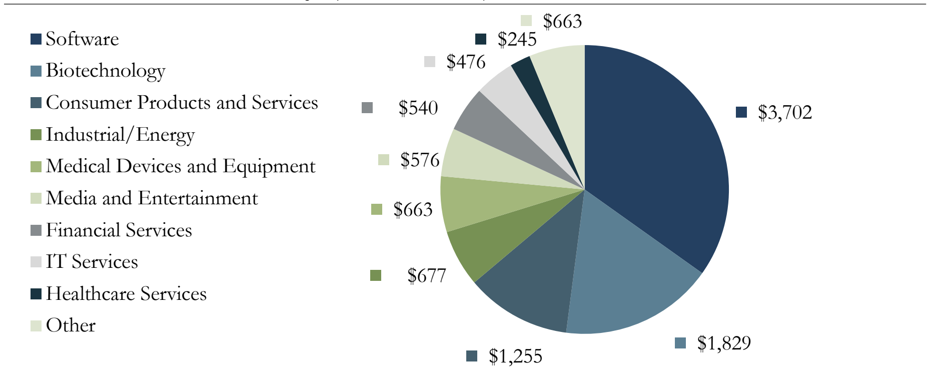
Venture Capital Investing

- In Q3 2016, the venture capital (VC) industry invested $10.6B in 891 deals, a decrease of 31.7% in value and 10.8% in transactions, as compared with $15.6B across 999 deals in Q2 2016[1]
  - Q3 2016 marked the 11th consecutive quarter with $10B or more invested in VC transactions, but was the weakest quarter since Q3 2014 in terms of volume and one of only two quarters with a deal count below 1,000 since Q1 2013
  - The value of follow-on investments decreased by 34.5% to $9.1B, while first-time investments decreased by 9.3% to $1.5B
  - The lowest amount of capital raised via IPOs by VC-backed companies since 2009 is a likely contributor to the decrease in available funds for new deals
- With $3.7B invested over 372 deals in Q3 2016, the software industry received the largest amount of funding for the 28th straight quarter, despite a 58.1% decline in deal value from Q2 2016[1]
- Seed-stage companies experienced a 23% decrease in VC dollars invested during Q3 2016, totaling $388 million in 37 deals and representing just 4% of all venture investment dollars and deals for the quarter[1]
- 68 companies have gone public on U.S. exchanges for YTD Q3 2016, as compared with the 138 companies listed during the same period in 2015[2]
  - The primary reason has been access to cheap capital; with historically low interest rates, companies have had an abundance of low-cost funding options

PIPE Investing

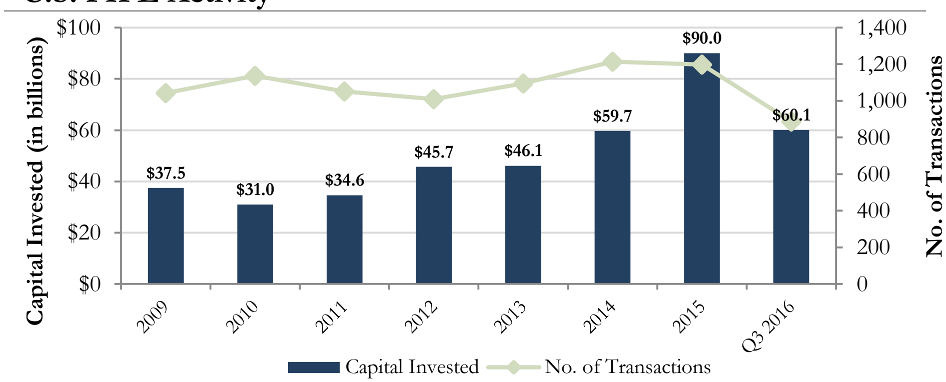
- $23.2B was raised across 325 private-investment-in-public-equity (PIPE) transactions in Q3 2016, a 38.0% increase in value from Q3 2015, but a 4.4% decrease from Q2 2016[3]
  - Despite the decrease from the previous quarter, Q3 2016 marked one of only four quarters since 2008 to exceed $20 billion in value
  - Market volatility remained low and prices were relatively easy to negotiate during the quarter, but analysts are worried about issues that could increase volatility in the upcoming months, such as concerns over interest rate hikes, further complications from Brexit, as well as political changes affecting economies in the U.S., Italy, and Japan
- Healthcare accounted for the highest volume of transactional activity in Q3 2016, with over 130 deals, representing 41% of all PIPEs[3]
- After media PIPEs unexpectedly experienced the most dollar activity in Q2 2016, the energy sector was back on top, raising $8.1B, or 34.9% of the total value in Q3 2016[3]
  - According to energy analysts, recent investment trends in the sector have been geared towards the Permian Basin, as it appears to be a safe investment yielding predictable returns at current prices

VC Deals Per Industry (in millions) – Q3 2016



Source: PricewaterhouseCoopers

U.S. PIPE Activity



Source: PrivateRaise/DealFlow/The Deal

1. *PricewaterhouseCoopers*
2. *The Wall Street Journal*
3. *The Deal*

Debt Capital

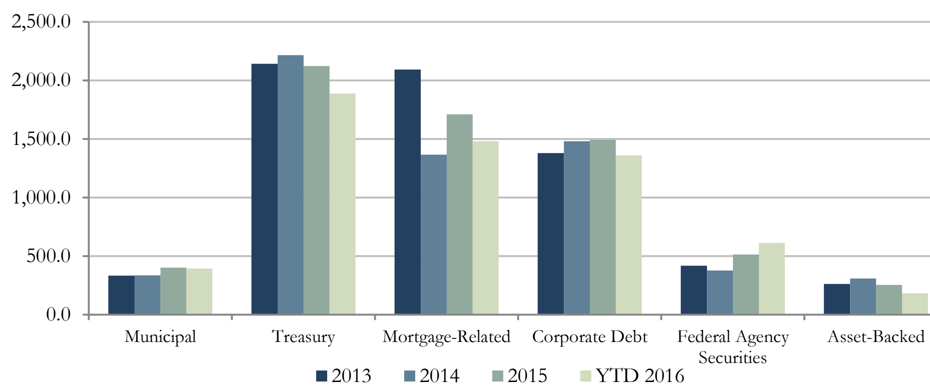
Debt Capital

- The Barclays U.S. Aggregate Bond index recorded a 0.5% return during Q3 2016, a decrease from the 2.2% return in Q2 2016[1]
  - The index posted a 5.8% return for YTD Q3 2016 (largely due to strong returns in Q1 and Q2 2016), as compared with a 0.6% return for 2015
  - The overall market is experiencing relatively sluggish growth, which is projected to continue for the remainder of the year given concerns about the limitations of further monetary stimuli and the falling productivity evidenced by rising unit labor costs[1]
- The Barclays Investment Grade U.S. Corporate Bond index generated a positive return of 1.4% in Q3 2016, below the 3.6% return in Q2 2016, but favorably compared with the negative 0.7% return experienced for 2015[1]
  - A combination of modest, positive economic momentum and negative interest rates in Europe and Japan has attracted investors to the higher yields of the U.S. corporate market
- Total debt issuances increased 3.1% to $1.89T in Q3 2016, up from $1.84T during Q2 2016[2]
  - The overall increase was driven in part by a 21.9% rise in mortgage-related debt issuances, up for the second consecutive quarter, reaching $524.0B in Q3 2016 from $429.8B during the previous quarter
- U.S. investment-grade corporate bond issuances increased by 0.6% to $354.7B in Q3 2016, up from $352.5B in Q2 2016[2]
- The Credit Suisse High-Yield Bond and Leveraged Loan indices posted gains of 5.7% and 3.0%, respectively, in Q3 2016[3]

Middle-Market Loan Issuances

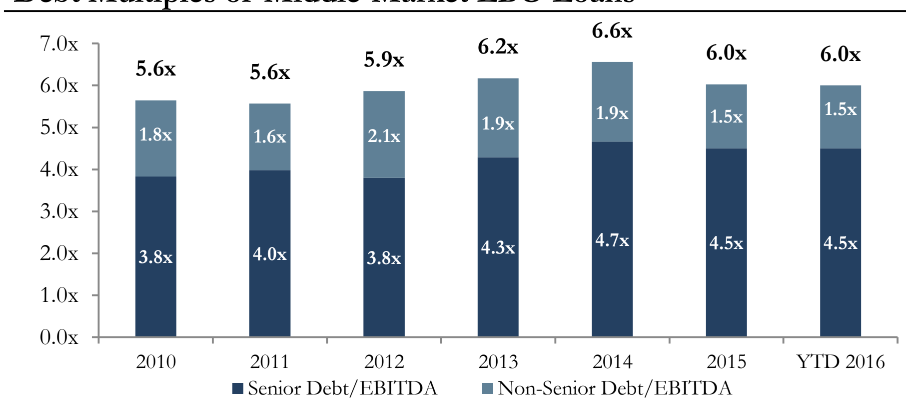
- Total middle-market lending was $97B for YTD Q3 2016, a decrease from $102B during the same YTD period in 2015[4]
  - The volume is comprised of $74B in large middle-market loan issuances (classified as $100M to $500M in deal size) and $23B in traditional middle-market loan volume (deals less than $100M)
- Yields on new middle-market loan issuances increased to 6.6% in Q3 2016 from 6.3% in Q2 2016[4]
- YTD leverage multiples on EBITDA for broadly syndicated LBO transactions are in line with 2015 levels, with 30% of the LBO transactions levered less than five times and 26% levered greater than seven times[4,5]
  - The industry with the most leveraged loan issuances during Q3 2016 was technology (20.7% of quarterly total), followed by retail (7.4%) and healthcare (7.2%)

Issuances in the U.S. Bond Market (in billions)



Source: SIFMA

Debt Multiples of Middle-Market LBO Loans



Source: Thomson Reuters LPC

1. *Prudential Financial*
2. *SIFMA*
3. *Guggenheim Partners*
4. *Thomson Reuters LPC*
5. *These multiples mostly reflect prices paid for larger private companies and generally do not account for smaller private company transactions that tend to change hands at much lower multiples and with lower debt ratios*

By Stradley Ronon Stevens & Young, LLP

On August 2, 2016, the Internal Revenue Service released proposed regulations to Internal Revenue Code Section 2704 which seek to restrict or eliminate certain valuation discounts applied to family-controlled corporations, partnerships, limited partnerships, and limited liability companies in intra-family transfers. For many years, families who owned controlling interests in such entities have used valuation discounts (such as discounts for lack of control or lack of marketability) to reduce the value of an interest transferred during one's lifetime or at death, and thereby reduce accordingly the federal gift tax, estate tax, and generation-skipping transfer tax implications of such transfers. The proposed regulations, in many cases, will prohibit the use of certain discounts, which will result in an increase in gift, estate, and generation-skipping transfer taxes for certain intra-family transfers.

Timing

The proposed regulations are not scheduled to become law until the end of the year, at the earliest. The IRS has requested comments on the proposed regulations, which are due by November 2nd. Following this 90-day comment period, there will be a hearing on December 1st. Families who own controlling interests in corporations, partnerships, limited partnerships, and limited liability companies should review their planning with their advisers and determine whether transferring any part of their affected business interests before year-end would be prudent to reduce or eliminate federal gift, estate, and generation-skipping transfer taxes.

The Proposed Regulations

As indicated above, if enacted into law, the proposed regulations will have significant ramifications with respect to the valuation of, and therefore the taxation of, family-controlled entities upon the transfer of interests therein. Specifically, the proposed regulations seek to accomplish, *inter alia*, the following:

- The proposed regulations provide a broad definition of entities covered by the regulations, which include corporations, partnerships, limited partnerships, limited liability companies, and other entities and arrangements that are business entities.
- An entity must be family-controlled in order for the proposed regulations to apply. The proposed regulations define "control" for limited liability companies (or other entities that are not corporations, partnerships, or limited partnerships) to mean 50 percent of either the capital or profits interest, or owning equity with the power to cause a liquidation. Current regulations define "control" for corporations to mean at least 50 percent of the total voting power or total fair market value of the equity interests in the corporation and for partnerships to mean at least 50 percent of either the capital interest or the profits interest in the partnership, or the holding of any equity interest as a general partner in a limited partnership.
- Upon the transfer of an interest in a family-controlled entity made within three years of the transferor's death, the proposed regulations treat the transferor's lapse, if any, of rights to liquidate the entity as an additional transfer at death, thereby increasing the value of the transferor's gross estate for federal estate and generation-skipping transfer tax purposes by an amount equal to the loss of such rights.

  The proposed regulations provide the following example. An individual owns 84 percent of the stock in a corporation. The bylaws of the corporation require at least a 70 percent vote to approve liquidation. The individual gives one-half of his stock in equal shares to his three children (14 percent interest to each). By making such transfers, the individual relinquishes his right to liquidate or control the corporation. The example suggests that if these transfers occurred within three years of the individual's death, the value of the forfeited liquidation right would be included in the individual's estate.

  The result of such tax inclusion is the creation of a phantom asset in the estate of the transferor, meaning the asset is included in the estate for tax purposes, but of course the asset offers no means for cash payment of the tax attributable to it. Thus, the estate must use other assets to pay the tax on the phantom asset.

- The "applicable restrictions" are on the ability to liquidate the entity that lapsed or that can be removed by the transferor or the transferor's family after the transfer. The proposed regulations seek to include in this definition any applicable restrictions imposed by state law. If enacted, this would mean that restrictions on liquidation imposed by state law would be disregarded for valuation purposes, unless the state law provides that the restrictions cannot be modified.
- The proposed regulations create a new class of "disregarded restrictions," which are restrictions on the ability to liquidate one's particular interest in an entity that lapsed or that can be removed by the transferor or the transferor's family after the transfer. Such "disregarded restrictions" are ignored for valuation purposes and, under the proposed regulations, would include restrictions that:
    1. Limit the ability of the holder of the interest to liquidate the interest
    2. Limit the liquidation proceeds to an amount that is less than a "minimum value" defined by the proposed regulations
    3. Defer the payment of the liquidating proceeds for a period of more than six months
    4. Permit the payment of the liquidation proceeds in any manner other than in cash or other property
- In determining whether a restriction can be removed by the transferor or the transferor's family, the proposed regulations disregard the interests of non-family member owners, unless those non-family members meet certain strict requirements with respect to their interests in the entity.
- The proposed regulations may disregard any discount taken upon an assignment of an interest in a family-controlled entity to an assignee (*i.e.*, one who is not an owner of the business and has no control over the business interest through voting rights or otherwise).

Summary

The proposed regulations raise many questions with respect to their application (specifically the extent to which the proposed regulations affect lack-of-control discounts and, perhaps even more uncertain, the extent to which they affect lack-of-marketability discounts). Nevertheless, it is reasonable to assume that, if enacted into law as is, the proposed regulations would have a significant impact on transferring interests in family-controlled entities to future generations or other family members. Therefore, if you have an interest in a family-controlled entity, it is imperative that you review your planning with your advisors as soon as possible and, if appropriate and desirable, take the steps necessary to transfer the affected business interests, or part thereof, at a discounted value before the door closes on this planning opportunity.

About the Authors

Stradley Ronon Stevens & Young, LLP is a national law firm with more than 200 attorneys practicing across eight offices. Counseling clients since 1926, its attorneys have helped publicly- and privately-held corporations, health care and non-profit organizations, small businesses, entrepreneurs, and individuals achieve their business objectives.

The author, Tara M. Walsh, Esq., concentrates her practice in the areas of estate, tax and business planning, and estate and trust administration.

Aramar Capital Group, LLC

Differentiation

- Aramar Capital Group, LLC 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;
  - We have significant transactional expertise;
  - We offer senior level attention; and
  - We 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" e-mails, letters, and other 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 Buyouts
    - Managed Buyouts
    - Buy-side Advisory
  - Private Equity Placements
  - Private Debt Placements
  - Recapitalizations
  - Fairness Opinions
  - Valuations
  - Financial Advisory

Clientele

- Aramar focuses on providing a superior level of service to "middle-market" clients. Our M&A transactions range in size from approximately $10 million to $200 million. Our 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. This encompasses access to Aramar's senior professionals and proprietary marketing process.

Team

- Aramar has assembled a unique team of professionals with a comprehensive and attractive mix of skills and experience. This team has significant investment banking experience, including stints at many other prominent financial services firms.
- Equally important, however, our team has entrepreneurial, managerial, and ownership experience that sets apart Aramar's "principal" perspective from that of most investment banks, where professionals tend to act simply as "agents." As principals, our team members have founded firms, acquired other companies, sold and merged our own companies, 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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