Aramar

Capital Group, LLC

Middle Market Update

3rd Quarter 2017

Third Quarter Economic Performance and Future Outlook

Gross Domestic Product

- The real U.S. GDP increased at an annualized rate of 3.0% in Q3 2017, down slightly from the 3.1% annualized growth rate in Q2 2017, primarily due to[1]:
  - Negative contributions from residential fixed investment and state and local government spending, which were partially offset by:
  - Positive contributions from personal consumption expenditures, private inventory investment, nonresidential fixed investment, exports, and federal government spending

Consumer Income and Savings

- Real disposable personal income grew by 0.6% in Q3 2017, as compared with the 3.3% growth witnessed in Q2 2017[1]
- The personal savings rate, expressed as a percentage of disposable personal income, was 3.4% in Q3 2017, down from 3.8% in Q2 2017[1]

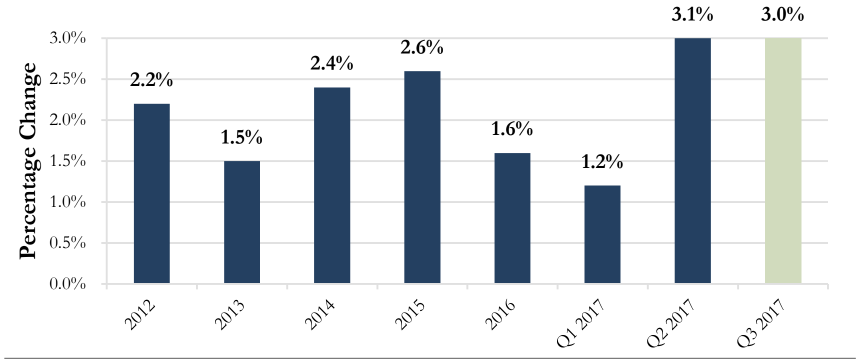
Federal Reserve

- The Federal Open Market Committee (FOMC) views recent economic activity as positive, despite hurricane-related disruptions, evidenced by moderate increases in household spending and growth in business fixed investment[2]
  - During its September meeting, the FOMC decided to maintain the target range for the federal funds rate between 1.00% and 1.25%
- The committee expects that in the near term economic activity will expand at a moderate pace and labor markets will continue to strengthen[2]

Employment

- The U.S. unemployment rate declined slightly to 4.2% at the end of Q3 2017, with the total number of unemployed persons at 6.8 million[3]
- Average U.S. employee hourly wages have increased by 2.9% from Q3 2016 to Q3 2017, the highest yearly increase in more than eight years[4]
  - Key indicators of wage growth could be attributed not only to increases in construction employment after Hurricanes Harvey and Irma, but also to job losses in the low-wage food services sector

Real GDP Growth Since 2011 (annualized) [1]



U.S. Treasury Securities

- The 10-year U.S. Treasury Note yield increased slightly from 2.31% at the end of Q2 2017 to 2.33% at the end of Q3 2017[5]
  - The yield curve flattened, with only an 86-basis-point spread between the 2- and 10-year securities

	Q4 2016	Q1 2016	Q2 2017	Q3 2017[6]
5-year Treasury Note	**1.69%**	**2.01%**	**1.86%**	**1.85%**
10-year Treasury Note	**2.21%**	**2.52%**	**2.32%**	**2.29%**
30-year Treasury Note	**3.05%**	**3.27%**	**3.12%**	**3.00%**
10-year Treasury Inflation Protected Security	**0.33%**	**0.44%**	**0.44%**	**0.45%**

Source: U.S. Department of Treasury

Outlook for 2017

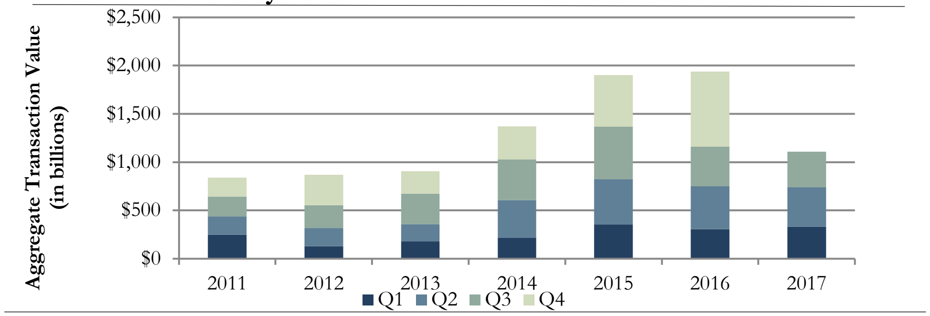
- Leading CEOs surveyed by Business Roundtable projected that the GDP will grow by 2.1% in 2017, an increase of approximately 0.1% from the previous quarter's forecast[7]
  - A more favorable regulatory environment, increased hiring, and expectations that tax reform is on its way could lead to continued economic growth
- The National Federation of Small Businesses (NFSB) survey found that sourcing qualified labor is the single most important problem facing small businesses in the U.S.[7]

1. *U.S. Bureau of Economic Analysis*
2. *U.S. Federal Reserve*
3. *Bureau of Labor Statistics*
4. *CNN Money*
5. *U.S. Department of Treasury*
6. *Quarterly yields are three-month averages*
7. *Business Roundtable*

Mergers and Acquisitions and Private Equity

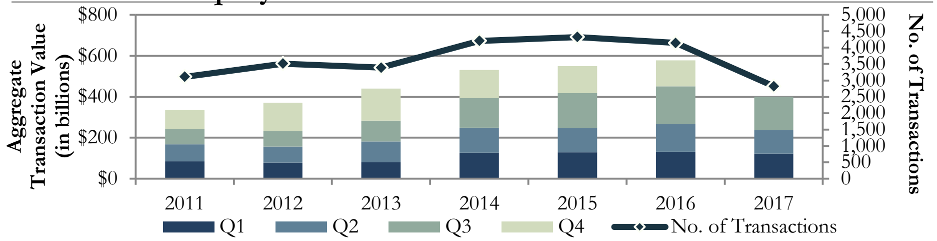
- Global mergers and acquisitions (M&A) activity reached $2,200.9B for the year-to-date (YTD) period ended Q3 2017, a decrease of 2.0% from $2,246.6B for YTD Q3 2016[1]
  - – Some dealmakers continue to sit on the sidelines amid ongoing political uncertainty, relatively low economic growth, and an uncertain economic outlook in many regions, as only one of the top five sectors for transactions in the quarter – business services – saw an increase in total value
- M&A activity in North America decreased during the quarter, reaching $971.5B for the YTD period ended Q3 2017, a 7.4% decrease from $1,049.2B for YTD Q3 2016[1]
  - – A series of damaging hurricanes and Congress's gridlock regarding major tax and healthcare reforms have made U.S. investors wary, with many dealmakers taking a wait-and-see approach[1,2]
  - – Despite the slowdown in M&A activity in North America, prices continued to rise, with the median EV/EBITDA multiple reaching 10.6x[2,3]
  - – The average deal size increased due to rising valuations, platform roll-ups, and large cash reserves on corporate balance sheets[2]
- Cross-border activity fell precipitously in Q3 2017, as only $276.7B in transactions involved companies from separate countries, representing a 29.8% year-over-year decrease[1]
  - – Chinese investments into Europe and the U.S. decreased 61.9% to $45.7B for YTD Q3 2017, down from $119.9B for YTD Q3 2016, as increased regulation in China, Europe, and the U.S. has left sellers wary of pursuing Chinese bidders due to concerns over whether deals will be able to close

U.S. M&A Activity



Source: FactSet

U.S. Private Equity Deal Flow



Source: PitchBook

- U.S. private equity (PE) investments recorded 2,820 completed deals worth $401.7B for the YTD period ended Q3 2017, an 11.0% decrease from $451.3B in YTD Q3 2016[2]
  - – Despite the strong year of fundraising and PE firms sitting on $555.6B of dry powder, higher multiples, competition from strategic buyers, and the dearth of quality targets are fueling the pullback in PE deal making
  - – Add-on acquisitions continue to be a key strategy in this high-priced environment, representing 64.2% of buyout activity, as PE firms are holding portfolio companies longer and utilizing add-ons to grow platform companies and enhance operations
  - – The EBITDA multiple for add-on acquisitions globally is 8.4x since 2006, as compared to 9.0x for platform buyouts[3]
  - – Driven by the increasing appeal of software-as-a-service (SaaS) business model and acquisitions by non-tech strategic investors, the IT sector accounted for nearly a fifth of the deal flow for YTD Q3 2017, with 505 completed deals worth $71.4B
- Middle-market PE firms invested $233.0B over 1,662 deals for YTD Q3 2017, a year-over-year increase of 13.0% and decrease of 0.9%, respectively[2]
  - – Middle-market PE firms consummated larger deals on average, as successful managers have been able to raise larger pools of capital given the recent wave of heightened LP interest in the PE-asset class
- The latest available data for PE-sponsored transactions between $10.0M and $250.0M showed an average EV/EBITDA multiple of 7.4x, the highest quarterly mark in the past 15 years[4]
- U.S. PE exits continued the downward trend that began in 2015, with $40.8B in exit value over 224 deals in Q3 2017, a 20.1% decrease from $51.1B in Q2 2017 and a 26.1% decrease year-over-year[2]
  - – 37.7% of U.S. PE-backed companies have been held for more than five years, the highest level in past ten years

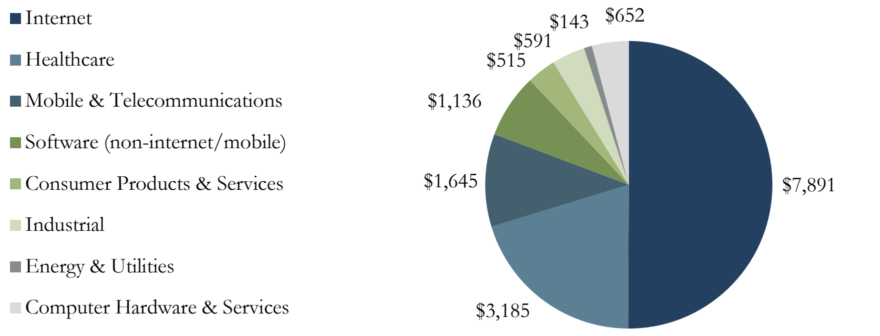
1. Mergermarket
2. PitchBook
3. These multiples reflect prices paid for mainly public companies and do not account for smaller private company transactions (for which there typically are no publicly available data) that tend to change hands at much lower multiples
4. GF Data

Venture Capital, PIPEs, and Corporate Earnings

Venture Capital Investing

- In Q3 2017, transactions for venture capital (VC)-backed companies in the U.S. totaled 1,207 deals valued at $19.0B, a year-over-year increase in value of 32.0% and decrease in volume of 6.1%[1]
  - The industry continues its transition of deploying more capital to fewer deals, as private companies valued at $1.0B or more commanded approximately 22% of the aggregate deal value for YTD Q3 2017, despite representing less than 1% of the total deal count[2]
  - Strong VC funding activity continued to be driven by capital raise rounds of $100M or more (mega-round investments), as 40% of total VC dollars raised in Q3 2017 came from 26 mega-round investments[1]
  - Strategic companies' participation in VC deals declined by 2%, but remained active, as folding in startups is an important source of growth for corporations and a way to avoid competing with potentially disruptive companies[1,2]
- With $7.9B invested over 574 deals in Q3 2017, the internet sector received the largest amount of funding for the 32nd consecutive quarter [1]
  - Investors continued to exhibit strong interest in U.S. artificial intelligence, as funding for this sector exceeded $1.0B for the third straight quarter in Q3 2017
- The VC exit environment for YTD Q3 2017 was relatively sluggish, as just 530 exits were completed, the lowest quarterly total since 2009[2]
  - Record levels of dry powder available have enabled companies to raise additional capital later in their lifecycle, thereby prolonging the exit timeline for many businesses

U.S. VC Deal Value Per Industry (in millions) – Q3 2017



Source: MoneyTree Report

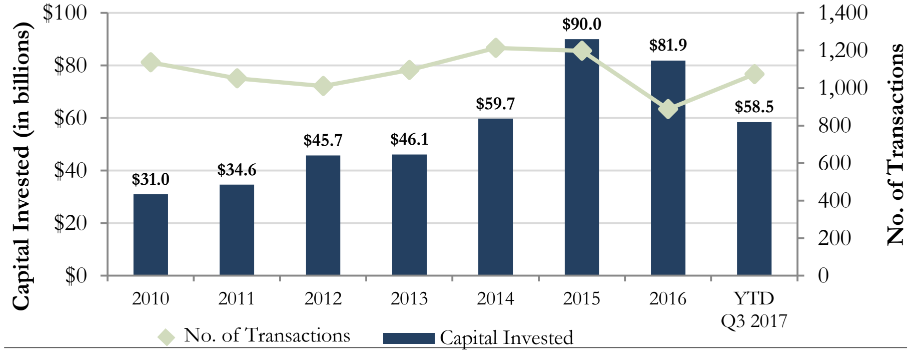
PIPE Investing

- Approximately $20B in private-investment-in-public-equity (PIPE) deals closed in Q3 2017 in the U.S., representing a 14.5% increase from Q2 2017 and 4.8% decrease year-over-year[3]
  - While volatility remained low, uncertainty regarding the current state of political affairs restrained the PIPE market somewhat
- Energy investments in the PIPE market are projected to pick up in Q4 2017, as oil and gas companies start replacing infrastructure damaged by the recent hurricanes[3]

Corporate Earnings

- U.S. corporate earnings for Q3 2017 are on pace to increase 4.7% from the same period last year, marking the lowest earnings growth rate for the index since Q3 2016[4]
  - Of the 55% of S&P 500 companies that have reported earnings thus far, 76% of them have beaten their EPS estimates
  - Losses experienced by insurance companies due to the recent spate of natural disasters was the major contributor to the slowdown of corporate earnings growth in Q3 2017
- The markup of prices over variable costs ranged from 16% to 32% until 1982 and has since risen to 67%, evidencing the effect of reduced competition due to industry consolidation, the globalization of the economy, and the weakening of trade unions[5,6]

U.S. PIPE Activity



Source: DealFlow Report

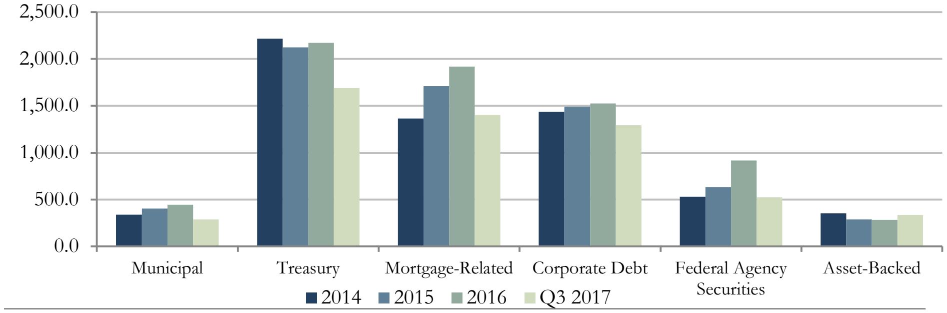
1. *PricewaterhouseCoopers*
2. *PitchBook*
3. *The Deal*
4. *FactSet*
5. *De Loecker / Eeckhout Study*
6. *National Bureau of Economic Research*

Debt Capital and IPO Markets

Debt Capital

- The Barclays U.S. Aggregate Bond Index recorded a 0.9% positive return during Q3 2017, a decrease from the 1.5% return in Q2 2017[1]
  - U.S. corporate bonds posted another positive return in Q3 2017, spurred by the Federal Reserve's desire to normalize interest rates and the encouraging signs of global economic growth, strong earnings, and increased investor demand
- The Barclays Investment Grade U.S. Corporate Bond Index generated a positive return of 1.3% in Q3 2017, below the return of 2.5% experienced in Q2 2017, but above the 1.2% experienced in Q1 2017[1]
  - Demand for U.S. corporate bonds strengthened, as investors continued to search for higher-yielding investments compared with lower-yielding alternatives that are affected by near-zero rates in developed countries
  - In light of impending tax reform, the supply of corporate bonds has increased, as companies try to capitalize on current relatively high tax rates for deduction purposes
- Total U.S. bond issuances reached $1,705.4B in Q3 2017, a 8.2% decrease from the Q2 2017 level of $1,857.4B and a 15.4% drop from the Q3 2016 level of $2,015.4B[2]
  - The largest contributing factor to the decline in U.S. bond issuances in Q3 2017 was the decrease in U.S. Treasury and asset-backed issuances, which totaled $463.9B and $57.5B and declined 18.7% and 64.5%, respectively, from Q2 2017
  - There was a surge in U.S. corporate bond issuances, which was driven by an increase in investment grade debt and a decrease in high-yield debt issuances, which hit $354.9B and $61.0B, respectively, in Q3 2017, representing an increase of 6.7% and a decrease of 4.9% from the Q2 2017 volume, respectively

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



Source: SIFMA

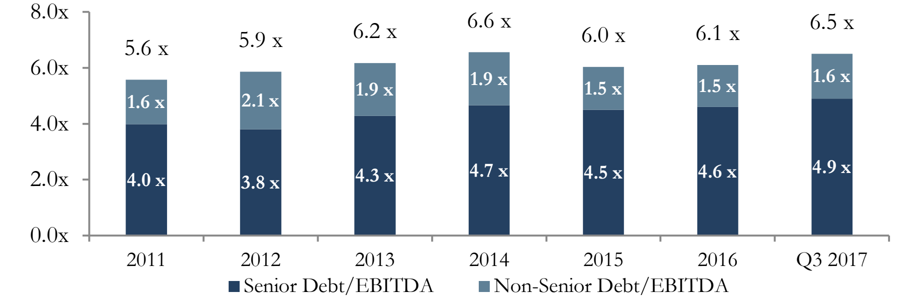
Middle-Market Lending

- Total U.S. middle-market lending added $31B in Q3 2017, taking the YTD total past $114B, 14.0% above the YTD Q3 2016 issuance level[3]
  - This increase was most pronounced in the larger segment of the middle market ($100.0M to $500.0M), which accounted for 81.0% of total volume in Q3 2017 at $25.0B
  - Yields on newly issued loans moved upward, with the large corporate credit yield increasing to 5.0%, while the middle-market yield tightened to 5.9%
- The average debt-to-EBITDA level for broadly syndicated LBO transactions increased to 6.5x in Q3 2017, up from 6.4x in Q2 2017[3]
  - The debt-to-EBITDA ratio for institutional middle-market LBOs remained at 6.2x in Q3 2017
- The U.S. leveraged loan volume is up 53% year-over-year and is on track to beat the $534.0B record achieved in 2007, while U.S. loans issued to fund LBOs have reached $88.5B, a year-over-year increase of 74%[4]

IPO Market

- Globally, more than 1,450 companies have gone public thus far in 2017, raising over $170.0B, putting the year on pace to hit the highest IPO count since 2007, though still well below the pre-financial crisis years[5]
  - Approximately two-thirds of the IPOs have been in the Asia-Pacific region[5]
  - IPO activity has been curtailed by the ample availability of private capital; 170 companies globally are valued at $1.0B or higher, up from roughly 75 three years ago[6]

Debt Multiples of Middle-Market LBO Loans



Source: Thomson Reuters LPC

1. *Prudential*
2. *SIFMA*
3. *Thomson Reuters LPC*
4. *S&P Global Market Intelligence*
5. *Dealogic*
6. *Dow Jones VentureSource*

The Advent of Family (Investment) Offices

By Jeremy Swan, Managing Principal, CohnReznick LLP

Family offices are private wealth management advisory firms that serve ultra-high-net-worth investors, often consisting of a single or extended family. These investors are searching for higher returns in today's low-interest-rate environment, and an increasing number are finding them by investing directly in private companies.

Wealthy families that once stood on the sideline and let asset managers handle their investments are now acting more like private equity (PE) firms themselves. They're investing directly, or co-investing, in deals rather than investing in PE firms as limited partners.

There are several reasons for this. The primary reason is that family offices are increasingly looking for ways to avoid the fees associated with private fund managers, such as the 2 percent management fee and the 20 percent carried interest, where the managers take a full fifth of the profit from investment.

Another reason is transparency. Families are getting away from black-box investing, where they give their money to an investment management company as a traditional limited partner and let the firm conduct all deal-making activity. After the Great Recession of 2008, family offices started paying close attention to what's going on inside that black box. They don't want to cross their fingers and hope that the investment firm makes the right moves. They want a larger say in decisions.

A third motivation is a general misalignment with the objectives of the traditional investment management firm. This misalignment can occur in different places. One is in the investment timeframe. PE and venture capital firms, for example, typically prefer a shorter timeframe from sourcing a deal to execution to exit, and this schedule often is not aligned with the longer-term wealth-building objective of family offices, which tend to see investments as a way to build wealth over the years via a dividend or income strategy.

For all these reasons, more family offices are now going their own way. Last year, the Family Office Exchange surveyed 80 family offices and found that 70 percent were engaged in direct investing. Interestingly, they reported that their direct deals returned an average of 15 percent in 2015, more than double the returns of PE firms that year.

So, should every family office climb into the driver's seat and start investing directly? Not without some serious preparation.

Before they do their first direct deal, family offices need to build a structure that supports direct investment activities. It is important to develop an investment model or policy statement that among other things identifies the types and sizes of investments to be considered.

Designing an effective direct investment program needs to be job one for a family office. One of the first steps should be to implement a policy statement that's agreed upon by all family participants and that specifically states what the family wants to achieve from its new program, such as increasing its wealth for the next generation or diversifying into new lines of businesses.

Once the policy statement has been designed, the planning process can begin in earnest. This next phase includes determining the types of investments the family office wants to pursue, the size of those deals, the industries the family wants to operate in, and the desired holding period.

For instance, the family might decide it wants to support only socially responsible companies or invest in a specific industry in which it has unique expertise and insight—typically the industry in which the family amassed its wealth in the first place.

Another critical element in a successful direct investment program is the internal staffing that the family office must put in place to execute on its deals. Many family offices are not sufficiently well-equipped to do direct investments and they underestimate the work that a PE manager must do to create value. They don't appreciate all that's involved in monitoring an investment and significantly improving a company.

Success in the field of family office direct investment requires more than a policy statement. It also requires trusted advisers who can help execute on the program, support transactions, mitigate risk, and build ongoing value through the direct investment process.

Family offices would be best advised to hire one or more PE professionals who understand and have experience with the deal acquisition, negotiation, integration, and operational oversight post-close. The M&A market is ultra-competitive and the due diligence process has become exceedingly complex. Investing in additional resources in advance of initiating direct investment activities will enhance the likelihood of hitting growth targets and creating value.

This is why family offices are increasingly joining together and doing “club deals.” A club deal provides access to an investment through a lead family office that may in fact look like, and market itself like, a traditional PE fund. The lead family office shares investment opportunities with a small number of other families to raise the capital needed for the investment. This also provides a test for family offices, a time during which they can decide if it’s feasible for them to work with other co-investors and perhaps even to gain some experience sitting on a board post-close.

Family offices are an increasingly important source of capital for private companies in the market for investment. From a seller’s perspective, family offices represent an avenue they may not have thought of before. For some businesses, there are real advantages to working with a family office compared to a traditional PE firm. These advantages may include a longer investment holding period, lower investment return requirements, and a more common family-oriented management philosophy.

But as more family offices take on the challenges and responsibilities that they once entrusted to PE firms, they need to adopt many of the strategies embraced by PE firms. Family offices need to conduct the proper due diligence, strive for operational efficiencies, and better manage risk.

That is why they also need trusted advisors who can help them execute on their strategy, support transactions, and build ongoing value through the direct investment process. That is how they can ensure success and maximize the value of their investments.

About the Authors

Jeremy Swan is the managing principal of CohnReznick’s Financial Sponsors & Financial Services Industry Practice. With more than 20 years of experience working with financial sponsors as both an investment banker and a consultant, Jeremy has expertise in mergers and acquisitions, IPO readiness, financing transactions, post-acquisition integration, and operational and financial due diligence. Jeremy can be reached at (646) 625-5716 or jeremy.swan@cohnreznick.com.

CohnReznick LLP is one of the top accounting, tax, and advisory firms in the United States, combining the deep resources of a national firm with the hands-on, agile approach that today's dynamic business environment demands. With diverse industry expertise, the firm provides companies with the insight and experience to help them break through and seize growth opportunities. CohnReznick, with origins dating back to 1919, is headquartered in New York, NY with 2,700 employees in offices nationwide. It is a member of Nexia International, a global network of independent accountancy, tax, and business advisors. For more information, visit www.cohnreznick.com.

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.

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.

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

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.