Aramar
Capital Group, LLC

Deal Market Perspective

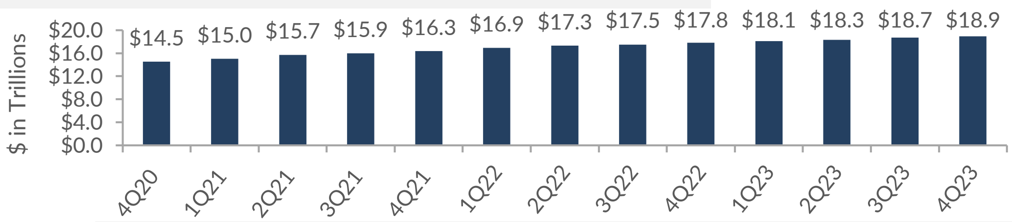
4th Quarter 2023

Economic Overview

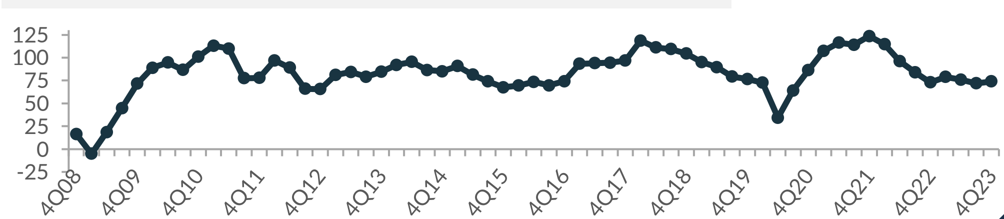
The economy and job growth continue to hum along nicely, and inflation has been abating. Yet the Fed hasn't committed to when it will start bringing down rates, as it walks a tightrope of avoiding supercharging the economy and overly affecting the November elections. Macro issues still hover, including wars, another potential regional bank crisis (spurred by commercial real estate loan issues), U.S. congressional paralysis, new supply-chain challenges, etc. Hopefully, we have sidestepped a recession and achieved the holy grail of a so-called soft landing. And we can continue to obsess about Taylor and Travis!

- The U.S. GDP increased at a 3.3% seasonally-adjusted annual rate in Q4 2023, a deceleration from the 4.9% increase seen in Q3 2023[1]
- The U.S. unemployment rate was 3.7% in both December and January, down from 3.8% in November[2]
  - Employment continued to trend up in government, health care, social assistance, and construction, while transportation and warehousing lost jobs
- The International Monetary Fund increased its outlook for global economic growth to 3.1% for 2024, up from its 3.0% projection last quarter; global growth is expected to rise to 3.2% in 2025[3]
- The annualized core CPI — which excludes food and energy — was 3.9% in both December and January, down from 4.1% at the end of Q3[4]
  - Higher costs for items such as shelter, motor vehicle insurance, and medical care are drivers for core CPI, which remains above the Fed's 2.0% target
- A global wave of national elections in 2024, which will occur in countries that account for 60% of the world's economic output, could incite further volatility in the economic and political landscape[5]
- Covid slashed consumer choices and shook up inventory levels; many choices aren't coming back, but inventory levels are finally adjusting
  - Retailers and suppliers across industries — from groceries to health, beauty, and furniture — have said that it didn't pay to offer products for everyone, and consumers didn't care that much when they limited product offerings[6]
  - New items made up about 2% of products in stores in 2023 across categories such as beauty, footwear, and toys, down from 5% in 2019[6]
  - The ratio of inventories to sales at general-merchandise retailers, which tracks how much companies have in stock compared with what they sell, fell to 1.36 in November, down from a pandemic-era peak of 1.50 in August 2022, but similar to the 1.33 seen in November 2019[7]
- Office and retail spaces still struggle to gain traction in the post-Covid era, but shopping centers are making a comeback
  - A staggering 19.6% of office space in major U.S. cities wasn't leased as of Q4, up from 18.8% a year prior and above the previous records of 19.3%[8]
  - Retailers signed leases averaging 3,200 square feet during the first three quarters of 2023, the smallest size since tracking began in 2006[9]
  - Vacancies at U.S. shopping centers fell to 5.3% in Q4, the lowest level on record[10]
- Banks hold about \$1.4T of the \$2.6T in commercial real estate loans set to mature over the next five years; delinquencies could nearly double from their current rate to between 10% and 12% by year end[11]
  - 14% of commercial and 44% of office real estate loans are under water[12]
- The U.S. consumer confidence index rose in Q4 2023, finishing the quarter at 110.7; up from 103.0 in Q3 2023[13]
- 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 2 points from last quarter to 74[14]

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



Business Roundtable's CEO Economic Outlook Index[14]



1. *Bureau of Economic Analysis*
2. *Bureau of Labor Statistics*
3. *International Monetary Fund*
4. *U.S. Department of Labor*
5. *The New York Times*
6. *Circana*
7. *U.S. Census Bureau*
8. *Moody's Analytics*
9. *CoStar Group*
10. *Cushman & Wakefield*
11. *Trepp*
12. *National Bureau of Economic Research*
13. *The Conference Board*
14. *Business Roundtable*

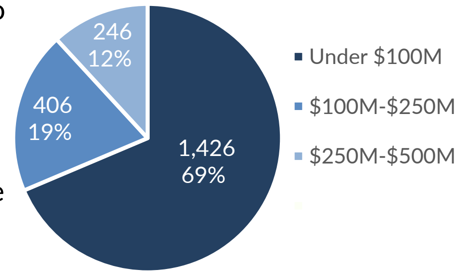
Mergers and Acquisitions

M&A activity remains soft due largely to elevated interest rates, economic and geopolitical uncertainty, and a continuing though narrowing gap between seller and buyer valuations. But pent-up demand, optimistic equity markets, and ample cash portend heightened deal volume to come. Nervousness about credit availability, consumer and business spending, and the upcoming elections are nudging many on-the-fence sellers to take the leap.

- North America (N.A.) M&A deal value was $497.1B and volume was 4,043 in Q4 2023, representing a 17.8% increase in value and a 6.6% slide in transaction count as compared with Q4 2022[1]
  - Q4 appears to be the most recent sign that the deal market is slowly on the mend; another milestone coming up will reinforce the recovery — that being the two-year anniversary of the Fed's historic rate hike cycle
  - If all goes as expected, 2024 will mark the beginning of a new cycle of Fed easing; this would bring welcome relief to the scores of financial acquirers straining under the yoke of 12% or higher borrowing costs, and it will hopefully spur the investment of PE dry powder
- Global M&A value rose by 6.5% in Q4 2023; the total value of deals closed or announced in 2023 came in right at the $3.0T mark, a 15.8% decrease from 2022[1]
  - The good news is that the rate of decline seems to be slowing; last year's decline was much steeper, down 23.4%
  - The most recent quarter sported the best volume since Q2 2022 — approximately 6.5% above Q3 2023 — suggesting that the worst may be behind us

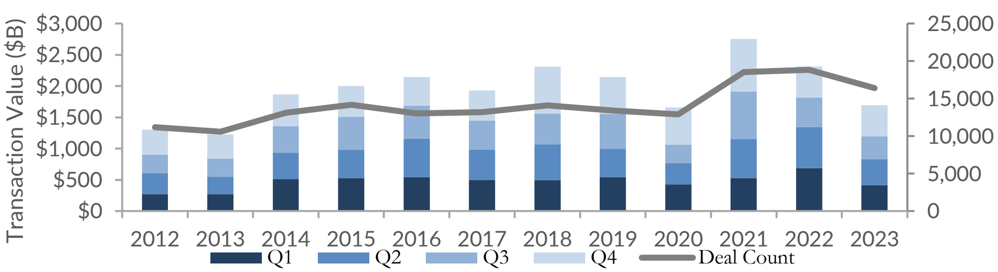
- Dealmaking in Q4 2023 continued to consist primarily of smaller transactions, though the balance shifted somewhat to larger ones, as 69% of the sub-$500M U.S. M&A market was accounted for by transactions under $100M, down from the 76% in Q4 2022[2]

Q4 2023 U.S. M&A <$500M[2]

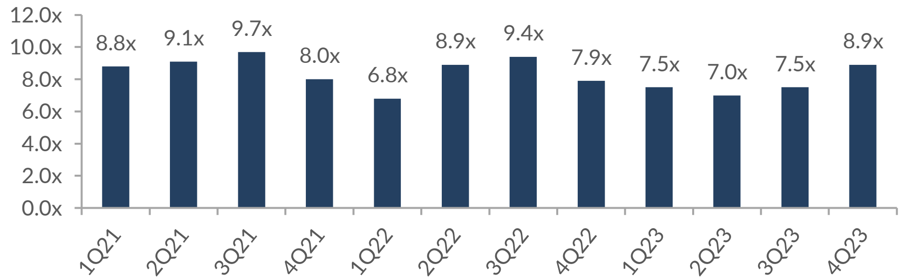


- According to the most recently available data, nearly one-third of private deals included an earnout in 2023, up from 21% during the same period in 2022[3]
  - Earnouts are typically equal to about a third of the amount that buyers pay at a transaction's closing
- U.S. non-financial companies are still sitting on over $2.0T in cash, similar to the levels seen at the end of Q3 2023[4]
- U.S. M&A-related leveraged loan issuance fell to $72.0B in 2023, down from $147.1B in 2022[1]
  - Investment firms were forced to kick in record amounts of cash in 2023 to complete buyout financing; as the yields on leveraged buyout deals hit record highs, leverage levels plunged to 13-year lows[5]
- There was a record $176B of amend-and-extend M&A-related debt activity last year, as indebted borrowers kept a careful eye on upcoming maturities, trouncing the previous record of $110B set in 2021[1]
- The median U.S. middle-market M&A EV/EBITDA multiple in Q4 2023 for deals between $1M and $500M was 8.9x, up from 7.9x in Q4 2022[2,6]

N.A. M&A Activity [1]



U.S. Middle-Market Median EV/EBITDA M&A Multiple[2,6]



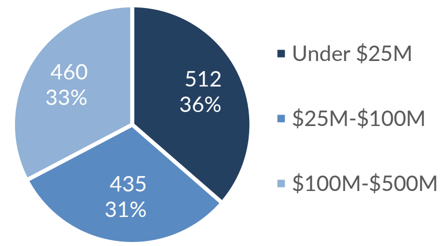
1. *PitchBook*
2. *FactSet*
3. *SRS Acquiom*
4. *S&P Capital IQ*
5. *The Wall Street Journal*
6. *These multiples reflect prices paid for mainly large public companies and do not account for smaller private company transactions that tend to change hands at much lower multiples*

Private Equity

Private equity (PE) firms are sitting on piles of dry powder and anxious to make investments. Dealmaking has continued to be slow, however, because of relatively high interest rates and a lack of sellers. Pursuing add-on acquisitions for existing portfolio companies and bridging valuation gaps with the use of earnouts (*i.e.*, payments contingent on performance) have helped keep deal volume at reasonable levels.

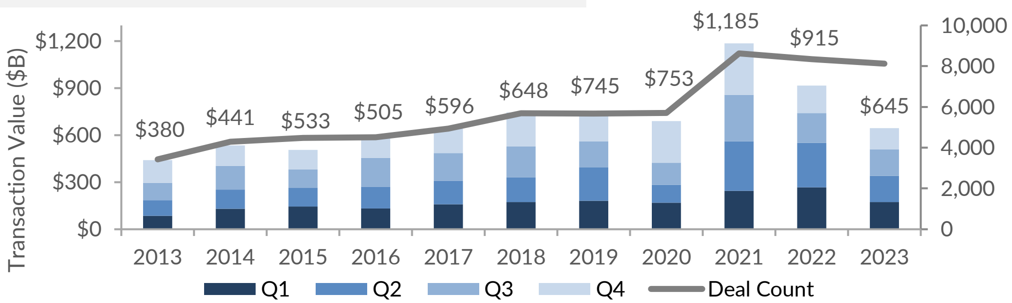
- U.S. PE investment activity slowed in Q4 2023, with 1,444 closed deals worth a combined $135.5B, representing a 30.3% decline in volume and a 22.6% decrease in value as compared to Q4 2022[1]
- U.S. PE just completed its worst year since 2016 in combined deal activity; while PE buying managed to surpass the truncated volumes of 2020's pandemic-induced lockdown, selling activity fell to its lowest point in over a decade[1]
  - PE's end game at present is to grow portfolio companies back into the values of old[1]
  - A PE firm that was borrowing money at a cost of 6% in 2021 could be paying as much as 9% now, disincentivizing new investments[2]
- With interest rates higher for longer, PE firms are holding portfolio companies for extended durations; across the 11,059 U.S. companies currently held by PE owners, the median hold period has stretched to 4.2 years and those that exited were held for 6.4 years, a new all-time high[1]
- Global PE did not fare better; deal activity dropped roughly 40% to $846B in 2023 from $1.44T in 2022, which was already significantly down from the prior year[3]

Q4 2023 U.S. PE Deals <$500M[1]

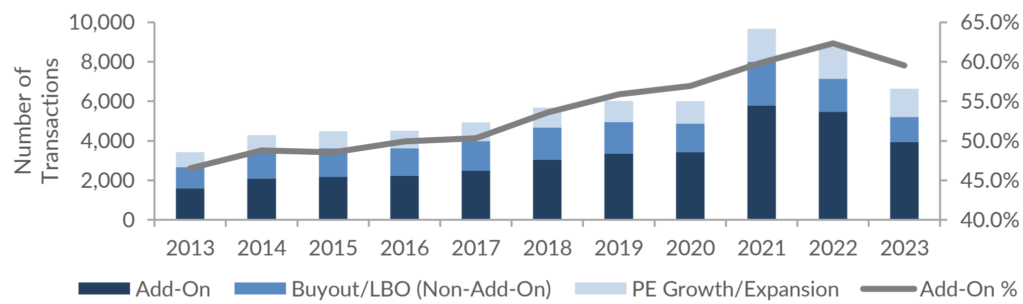


- Add-on investments continue to drive the U.S. PE market, accounting for 56.6% of all deals in Q4 2023[1]
- For U.S. PE-led transactions between $10M and $250M, the average EV/EBITDA multiple was 8.2x, according to the most recently available quarterly data, up from 7.5x recorded in the previous quarter[4]
- Global PE dry powder remained elevated at $2.49T at the end of Q4 2023, in line with the third quarter, as high borrowing costs continued to hamper the desire to deploy capital[5]
- U.S. PE fundraising increased in Q4 2023, with $132.8B raised across 123 funds, a 57.5% rise in capital raised and a 12.8% increase in the number of new funds raised as compared to Q4 2022[1]
- U.S. PE exit activity was down 30.7% by deal enterprise value and 17.8% by volume in Q4 2023 relative to Q4 2022, with 256 exits worth a combined $44.7B[1]
  - Exit activity is down 73% peak-to-trough; a snapback in exit activity is needed to spark a broad-based recovery in PE dealmaking, which is now entering its third year of decline
- PE firms took just 14 businesses public in the U.S. in 2023, one more than in 2022, but a tenth of the 140 in 2021, when the IPO market boomed[1]
  - New listings by PE-backed companies in 2023 fell 74% below their annual average from 2011 through 2020

U.S. Private Equity Deal Flow[1]



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



1. *PitchBook*
2. *Hamilton Lane*
3. *Dealogic*
4. *GF Data*
5. *S&P Capital IQ*

Equity and Debt Capital Markets

Most global equity markets continue to be strong, reflecting optimism despite relatively lofty interest rates, a slowing Chinese economy, and manifold geopolitical conflicts and other issues. But the IPO market has remained tight, which limits exits by PE and venture capital (VC) firms and has exacerbated VC investment performance. Debt markets continue to be boosted by growing private credit as an alternative financing option.

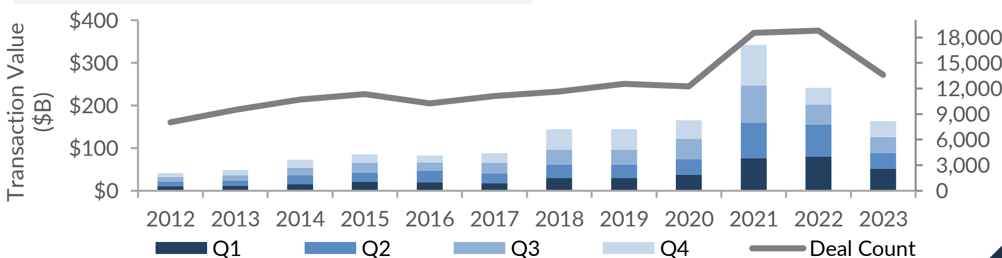
Equity Markets

- Q4 2023 saw 323 global IPOs raising $22.2B, decreases of 19% and 39%, respectively, on a year-over-year basis[1]
  - Improved Western market sentiment was counterbalanced by China's cooldown and a rise in developing market small-cap deals, contrasted with lackluster performance of large offerings in developed nations
- 54 U.S. companies went public last year, compared with 38 in 2022, marking the two slowest years for IPOs since 2008, when the financial crisis brought the market to a standstill[2]
- The S&P 500 was up 11.2% in Q4 2023; the Q1 2024 quarter-to-date gain as of February 13th was 3.8%[3]
  - Strong earnings and a robust January employment report boosted confidence in the economy, while lowering the likelihood that the Fed will cut interest rates any time soon, especially after the January inflation report
- Earnings growth for S&P 500 companies in Q4 2023 rose, with a blended growth rate of 1.6%, down from 3.7% in Q3 2023[4]
  - In Q4 2023, 72% of S&P 500 companies reported a positive EPS surprise and 65% reported a positive revenue surprise
- U.S. VC deal value fell 5.9% to $37.5B in Q4 2023 while deal count dropped 22.5% to 2,879 transactions, relative to Q4 2022, the seventh straight quarter that investing has dropped[5]
  - U.S. investors allocated just $11.4B to seed- and early-stage startups in Q4 2023, a 26.7% decrease from Q4 2022
  - U.S. VC firms have deployed just half of the $435B they raised during the pandemic-era boom between 2020 and 2022
- The value of startup exits — a sale or public offering — plummeted to $6.75B in Q4 2023, a 30.0% drop on a year-over-year basis[1]
- Global VC investments declined 42% to $248.4B in 2023, the lowest level since 2017; quarterly funding fell 24% to $51.0B and the number of deals tumbled by 30% to 29,303 in Q4, despite a strong deal environment for generative AI and sustainable tech startups[6]
  - Rate hikes, general economic uncertainty, and tight exit markets have sharply curtailed investors' appetite for startup investments; in 2023, the industry produced 71 startups with valuations of $1B or more, 73% fewer than the 263 companies to reach unicorn status in 2022[6]
  - 3,200 startups and over $27B in VC funding turned to dust in 2023[1]
- The significant economic benefits that can result from ownership of Qualified Small Business Stock (QSBS) could help spur new company formations; *see Marcum's guest article on the next page for more details*
- As much as half of U.S. VC firms have former operators at their helm, as compared with around 8% of Europe's VC firms[5]

Debt Markets

- The 10-year yields at quarter-end on U.S. investment-grade and high-yield bond indices fell with future expectations of looser monetary policy, earning investors 3.87% and 7.88%, respectively[3]
- For PE-led transactions between $10M and $250M, the average total debt/EBITDA multiple was 3.5x, according to the most recently available data, well below the 3.9x to 4.1x range that existed pre-pandemic[7]
- Repricings of U.S. leveraged loans, which picked up speed late in 2023, have exploded in 2024 with speculative-grade debt issuers rushing to take advantage of declining credit spreads and renewed investor appetite[5]
- Private credit has increasingly stepped into lending voids left by risk-averse banks; the global private credit market size for Q4 2023 was approximately $1.6T and is estimated to grow to $2.3T by 2027[8]

U.S. Venture Capital Deal Flow[5]



1. *Ernst & Young*
2. *University of Florida*
3. *S&P Capital IQ*
4. *FactSet*
5. *PitchBook*
6. *CB Insights*
7. *GF Data*
8. *Preqin*

The C-Corporation Advantage: Qualified Small Business Stock (QSBS) Gain Exclusion

The Qualified Small Business Stock (QSBS) Gain Exclusion – Overview and Benefits

The IRS provides a substantial exclusion from tax on the gain from the sale of C-corporation stock if certain requirements have been met. The exclusion was enacted into law in 1993 but has become more attractive in recent years due to changes to tax law.

When the Qualified Small Business Stock (QSBS) gain exclusion was first allowed, C-corporations were subject to federal tax rates of up to 35% as well as double taxation (on both corporate income when earned and on dividends when the profits were distributed to the shareholders). Although gains could potentially be excluded upon the sale of the stock, many taxpayers found structuring a business as a pass-through entity (such as an LLC or an S-corporation) as the preferred form of doing business because the total tax paid on the profits of the company was usually significantly less than that of a C-corporation.

Although C-corporations are still subject to double tax, the maximum rate on C-corporation earnings has been reduced to 21%. In addition, the maximum QSBS gain exclusion has increased from 50% to 100% of the gain over the years.

This article summarizes the amount of the potential gain exclusion along with some key requirements to qualify for this gain exclusion.

QSBS GAIN EXCLUSION

Since first enacted, the maximum gain exclusion under Section 1202 has increased from 50% to 100% on sales of QSBS. Compounding the attractiveness of the increased QSBS gain exclusion is the reduced corporate tax rate, which is now a flat 21% under the Tax Cuts and Jobs Act. A C-corporation will be taxed on profits and the gain from the sale of the assets if a sale transaction does not qualify for the Section 1202 gain exclusion.

Depending on when the QSBS was acquired, Section 1202 allows noncorporate taxpayers to exclude from gross income 50%, 75%, or 100% of the gain from the sale or exchange of QSBS that is held for more than five years. For QSBS held more than five years, the amount of gain eligible for exclusion is determined based on the following acquisition dates:

QSBS Acquisition Date	Gain Exclusion
Before February 18, 2009	50%
Before September 28, 2010, and after February 17, 2009	75%
After September 27, 2010	100%

The maximum gain exclusion applies to each eligible shareholder. Both the shareholder and the corporation must meet specific requirements to qualify.

SHAREHOLDER LEVEL REQUIREMENTS

1. The shareholder cannot be a corporation; an individual must own the stock directly or indirectly via an interest in a pass-through entity.
2. The shareholder must hold QSBS for more than five years before it is disposed.
3. The shareholder must have acquired the stock when it was originally issued on or after August 10, 1993.

Eligibility requirements will be met if the stock was acquired in exchange for money or other property but not if it was acquired by exchanging stock of another corporation. The requirements can also be met if the stock was issued to the original shareholder as compensation for services provided to the issuing corporation, such as by exercising stock options.

CORPORATION LEVEL REQUIREMENTS

For stock to qualify for Section 1202 favorable treatment, it must have been issued by an eligible corporation. Eligible corporations are any domestic C-corporations that are qualified small business corporations when the stock was issued and during most of the period the stock was held. Additionally, the corporation must satisfy the active business requirement during substantially all of the taxpayer's stock-holding period. It is important to note that the C-corporation requirement means any stock issued by an S-corporation will not qualify as QSBS. However, if an LLC or an S-corporation converts to a C-corporation and subsequently issues stock, and all other QSBS requirements are satisfied, issued stock may qualify as QSBS.

The C-corporation must also be a qualified small business. An eligible corporation is a qualified small business if its aggregate gross assets do not exceed $50 million (based generally on the cost basis) from August 10, 1993, to immediately after the issuance of the stock.

Additionally, there is an active business requirement. A corporation is deemed to have an active business (for purposes of meeting the QSBS test) if at least 80% of the corporation's assets (based on value) are used in the active conduct of one or more qualified trades or businesses. A qualified trade or business means any trade or business other than a business involving services performed in health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services. A business whose principal asset is the reputation or skill of one or more employees will not meet the qualified trade or business test.

The assets that qualify for the 80% of assets test include intangible assets, assets used for research and development, and, in some situations, working capital and investment assets that are temporarily held to be used in the business.

KEY TAKEAWAYS

A business entity and its owners should consider whether they will or can potentially qualify for the QSBS exclusion at the following times:

- Upon the formation of the company
- When considering whether they are operating in the most tax-efficient structure
- Prior to raising new capital or issuing new C-corporation stock
- Prior to selling a business
- After the sale of a business

The QSBS Gain Exclusion is a tax benefit that allows for a significant exclusion from tax on the gain from the sale of C-corporation stock. Recent changes in tax law, including a reduction in the maximum tax rate for C-corporations and an increase in the maximum QSBS gain exclusion, have made being a C-corporation more advantageous.

By: Katy Daiell and Cassie Carangelo, Marcum LLP

About the Authors:

Marcum LLP is a national accounting and advisory services firm dedicated to helping entrepreneurial, middle-market companies and high-net-worth individuals achieve their goals. Headquartered in New York City, Marcum has offices in major business markets across the U.S. and select international locations.

Katy Daiell is the partner in charge of tax and business services for Providence, Rhode Island, a member of the Marcum's Corporate Tax Services group, the leader of the Corporate Tax Advisory Group, and the co-leader of New England's Life Science/Technology Industry Group. Cassie Carangelo is a manager in Marcum's tax and business services group in New Haven, Connecticut.

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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