Deal Market Perspective

2nd Quarter 2022

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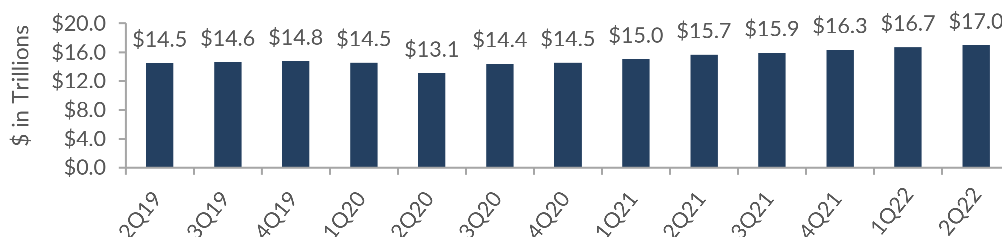
Economic Overview

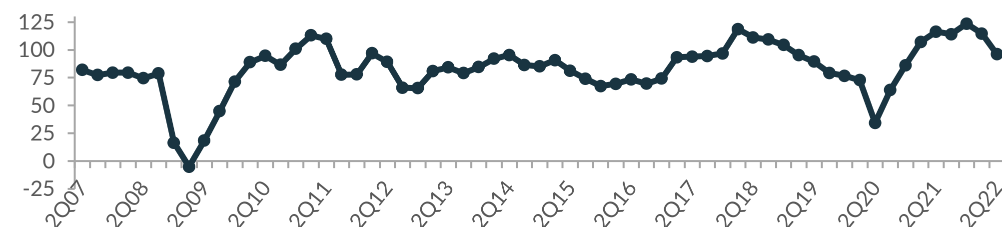
The economic environment in the U.S. certainly is not dull. We may – or may not be – in a recession. Prices are soaring, interest rates are rising, and supply-chain issues persist, albeit less extensively. But employment remains strong and consumers keep spending, more so these days on services than goods. Hopefully, Jerome Powell and his crew can deliver us the soft landing that they and we all seek.

- U.S. GDP decreased at a 0.9% seasonally-adjusted annual rate in Q2 2022, a deceleration from the 1.6% decrease seen in Q1, driven by a decline in private sector inventory investment, residential fixed investment, and government spending, partly offset by increases in exports and personal consumption expenditures[1]
- At the end of Q2 2022, the U.S. unemployment rate remained at a post-pandemic low of 3.6%, where it has sat for four months in a row[2]
  - Total nonfarm payroll employment rose by 372,000 in June, with notable gains in leisure/hospitality, professional/business services, and healthcare
- The International Monetary Fund lowered its outlook for global economic growth again for 2022 and 2023 to 3.2% and 2.9%, respectively, far below the 6.1% expansion that occurred in 2021[3]
- In July, the U.S. Treasury yield curve inverted, as the gap between the ten-year and two-year yields turned negative[4]
  - Yield curve inversion is Wall Street's most talked about recession indicator
- According to a recent survey of economic forecasters, 44% believe there will be a recession in the near term; historically, when economic forecasters have said the odds of a near-term recession are at least 30%, it means that a recession is actually more likely than not[3,4]
- The World Container Index (WCI), which tracks container freight rates, is down 27% since the beginning of the year, and as of the end of July, had decreased for 21 consecutive weeks (for more container volume and rate trends, see the guest article by FreightWaves starting on page six)[5]
  - High-priced freight contracts that were written when carrier capacity was tight and there was a rush to restock inventories are losing their shine as slowing demand and a wavering U.S. economy send shipping rates sliding[3]
- Trucking spot rates fell 22% during the first six months of this year, dipping below the contract rate in May for the first time in two years[6]
- Sales of new homes are falling and the number of homes that have been completed but not yet sold hit a 15-month high in May[6]
  - Buyers are trying to back out of sales agreements at the fastest pace since the early weeks of the pandemic[7]
- The U.S. consumer confidence index decreased in Q2, finishing the quarter at 98.4, down from 107.2 at the end of Q1 2022, but still well above the 15-year average[8]
  - Consumer appraisal of current business conditions continues to decline, with just 17% of consumers saying business conditions were "good" in July
- Over 80% of American consumers plan to cut back spending by buying cheaper or fewer products, according to a May survey[9]
- Business Roundtable's CEO Economic Outlook Survey, a composite index of CEO expectations for capital spending, hiring, and sales over the next six months, fell to 96.0 in Q2 2022, down from 115.0 in Q1, but still above its 19-year historical average of 81.5[10]

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



Business Roundtable's CEO Economic Outlook Index[10]



1. *Bureau of Economic Analysis*
2. *Bureau of Labor Statistics*
3. *The Wall Street Journal*
4. *The New York Times*
5. *Drewry Shipping Consultants*
6. *DAT Solutions, LLC*
7. *Redfin*
8. *The Conference Board*
9. *The NPD Group*
10. *Business Roundtable*

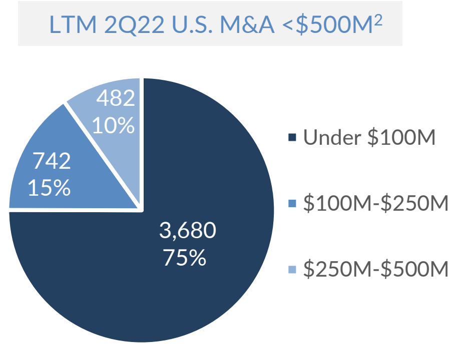
Mergers and Acquisitions

Unsurprisingly given the economic climate, M&A volume has dropped off significantly. Acquirers are exhibiting caution and also addressing their own issues before taking on the pursuit and integration of target companies. But strategic acquisitions are a way to increase profits in a soft economy and corporations have built up quite a lot of cash, so M&A activity will remain busy, just not as busy.

- North American (N.A.) M&A value was $547.7B and volume was 4,571 in Q2 2022, representing an 18% decrease in value and a 20% decrease in transaction count as compared with Q2 2021; however, dealmakers are still acting on opportunities despite the volatility and valuation adjustments[1]
  - Geopolitical tension, inflation, interest rate increases, and pandemic-related supply-chain issues were the leading drivers of dampened M&A activity
  - With governments prioritizing price stability, significant interest rate hikes could push the market into a mild recession and further stifle M&A activity going forward, as well as reduce company valuations
- Strategic buyers and private equity firms sought to take advantage of volatility to find attractive growth prospects in companies that are cyclically, but not secularly, under pressure[1]
  - Going into the second half of the year, the number of large strategic acquisitions is likely to fall as company boards prepare for a possible recession and strengthen their balance sheets

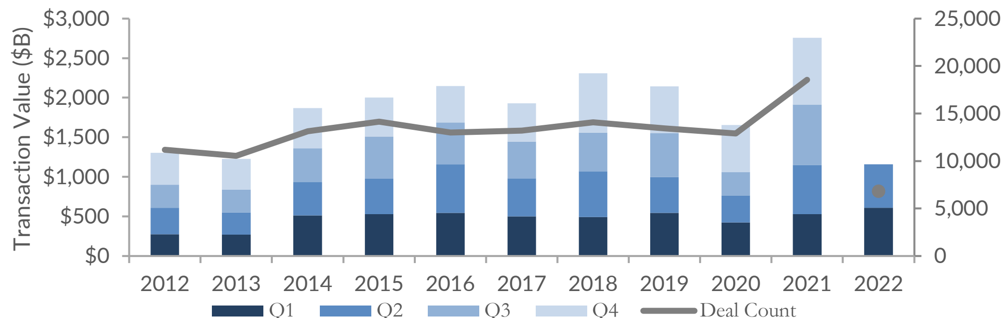
- M&A-related leveraged loan issuance decreased to $55.1B in Q2 2022, the lowest it has been in five quarters[2]
- S&P 500 company cash holdings, excluding financial institutions and utilities, decreased to $1.5T in Q2 2022 from $1.6T in Q1 2022, but still providing strategic acquirers with ample capital to put to work[2]

LTM 2Q22 U.S. M&A <$500M[2]

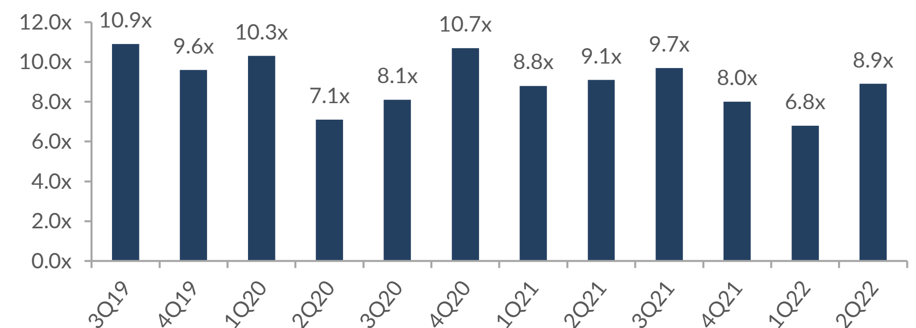


- Dealmaking in Q2 2022 was dominated by smaller transactions, as 75% of the sub-$500 million U.S. M&A market was accounted for by transactions under $100 million[3]
- Cross-border M&A deal value in N.A. in Q2 2022 (N.A. M&A transactions with non-N.A. acquirers) fell 22.3% from Q2 2021 to $53.5B[1]
- The median U.S. middle-market M&A EV/EBITDA multiple in Q2 2022 for deals between $1M and $500M was 8.9x, a sizeable increase from the 6.8x multiple in Q1 2022, mainly attributable to a decrease in LTM earnings juicing the overall multiple[3,4]
- 16 mega-deals closed in Q2, with $207.3 billion of aggregate deal value, making up 37.8% of the total M&A value, the lion's share of which was accounted for by technology companies[1]

North America M&A Activity [1]



U.S. Middle-Market Median EV/EBITDA M&A Multiple[3,4]



1. *PitchBook*
2. *S&P Capital IQ*
3. *FactSet*
4. *These multiples reflect prices paid for mainly companies at the upper end of the valuation range and do not account for smaller company transactions that tend to change hands at much lower multiples*

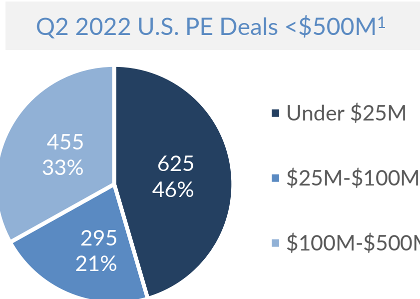
Private Equity

Private equity (PE) fundraising has been extremely strong in recent years and remains active even now. PE firms raise those funds with the intent to and promise of investing them. So, while economic uncertainty and rising interest rates will dampen aggression, deals will be made to deploy the huge amount of dry powder. As a way to mitigate higher interest rates and greater business risk while, at the same time, not being uncompetitive on valuations, PE acquirers are seeking to incorporate equity rollovers, seller notes, and earnouts to a greater degree.

- U.S. PE investment activity slowed in the second quarter of 2022, with 1,425 closed deals worth a combined $234.1B, representing a 20% decrease in volume and a 13% decrease in value as compared to Q2 2021[1]
  - Rising interest rates and falling public market indices are having a direct impact on the pricing environment; multiples are coming down and, until a more stable environment is established, deal activity likely will remain tepid
- Financial sponsors are likely to witness less competition from strategic buyers, with corporations less bullish on the future, but could see more competition from other financial buyers with so many firms actively raising capital[1]
- Take-privates are one area of opportunity, as public market valuations have fallen much more quickly than those in private markets; many public companies are off 50% or more from their 52-week highs[1]

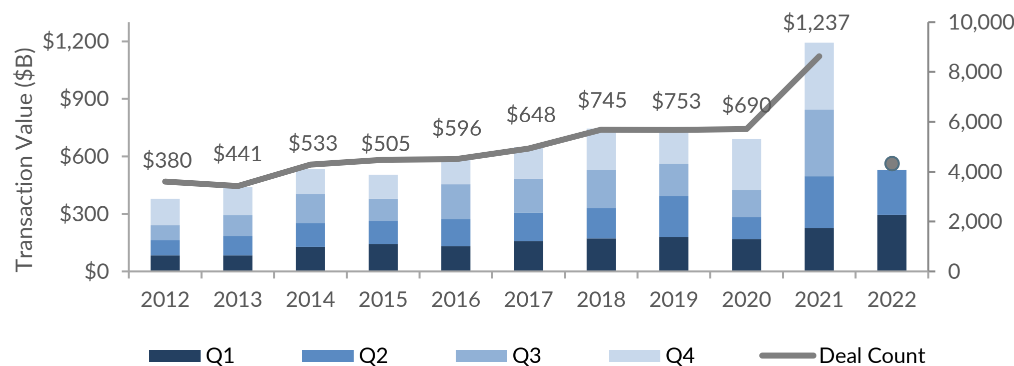
- For PE-led transactions between $10M and $250M, the average EV/EBITDA multiple was 7.3x, according to the most recently available quarterly data[2]
- Add-on investments continue to drive the overall U.S. PE market, accounting for 63.6% of all deals in Q2 2022[1]

Q2 2022 U.S. PE Deals <$500M[1]

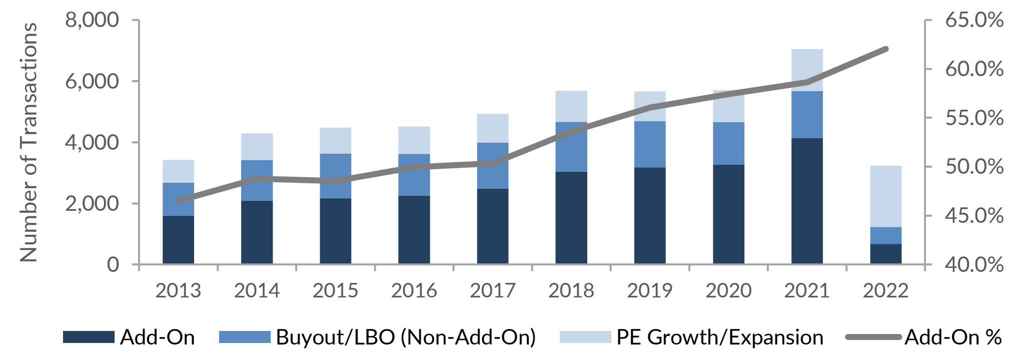


- Global PE dry powder has remained near all-time highs at $1.86T, meaning that acquirers will continue to seek opportunities to deploy their ample capital[3]
- Exit activity by deal enterprise value is down 51% year-over-year; falling valuations in public and private markets have influenced financial sponsors to choose to hold their portfolio companies rather than sell them for less favorable prices[1]
- U.S. PE fundraising increased in the second quarter of 2022 with a combined $111.2B raised across 93 funds, a 22% increase in capital raised and a 15% decrease in the number of funds compared to Q2 2021[1]
  - After a record-shattering deployment year in 2021, many managers now are back fundraising, are preparing to fundraise, or have just finished fundraising
  - There are 2,845 funds in the market, collectively seeking over $1T in capital, an increase of more than 60% compared to the beginning of 2021[3]

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

Aramar Capital Group, LLC

Needless to say, public securities markets have been weak thus far this year. That has helped suppress IPO and SPAC activity, which has cut off avenues for many PE and venture capital (VC) firms seeking an exit vehicle for their investments and endangered many startups without adequate cash flow or available funds. Banks and credit markets have tightened but are still supplying capital, VC funds have raised substantial amounts of money, and alternative lending sources have proliferated, so quality companies and deals will still find capital.

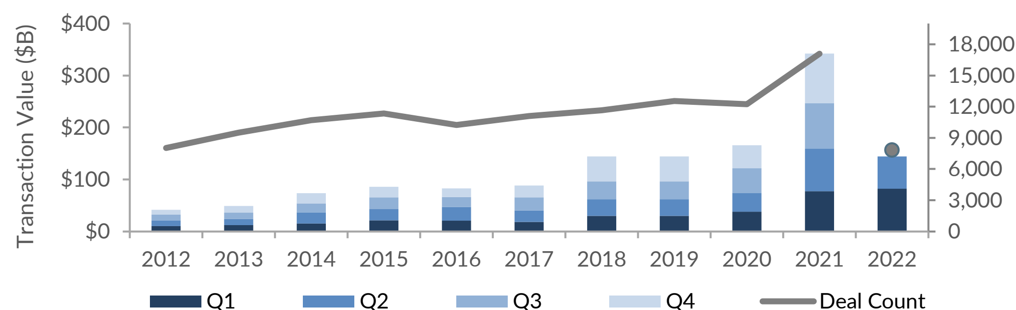
Equity Markets

- IPO momentum continued to slow from Q1 into Q2, resulting in a considerable decline in both deal numbers and proceeds[1]
  - In aggregate, Q2 2022 saw 305 global IPOs raising $40.6B, decreases of 54% and 65%, respectively, on a year-over-year basis[1]
  - Heightened volatility caused by geopolitical tensions and macroeconomic factors, declining valuations, and poor post-IPO share price performance led to the postponement of many IPOs this past quarter[1]
  - Despite the weak IPO volume, private equity markets continue to be active; as of the end of the second quarter, there were 1,173 private companies valued at more than $1B, up from 1,074 in Q1[2]
- After closing out 2021 within 1.0% of its all-time high, the S&P 500 experienced a serious decline in Q2 2022, dropping into bear market territory as it hit a low of 23.7% below its year-end value (and then recovering somewhat so far in Q3)[3]
  - Investors' reaction to the war in Ukraine, high inflation, supply-chain shortages, and Fed tightening have driven the volatility and weakness
- Earnings for S&P 500 companies in Q2 slowed, with a blended growth rate of 4.8%, down from 7.1% in Q1 2022[4]
- The share prices of companies that listed publicly in Q2—IPOs, direct listings, and SPAC listings—were up an average of 6.3% since their listings through August 4th, a strong rebound from Q1 which saw a 5.5% decrease[5]
- U.S. VC deal value fell 23.3% to $62.3B in Q2 2022 and deal count decreased 20.1% to 3,374 deals, relative to Q2 2021[6]
  - The second quarter brought an expected continuation of tightening in some parts of the U.S. VC ecosystem; however, startups in their early stages have been somewhat insulated from corrections
- The value of startup exits—a sale or public offering—plummeted to $13.1B in Q2 2022, a 95% decrease on a year-over-year basis[6]
- Investors allocated $19.9B to seed- and early-stage startups in Q2 2022, a 20.0% decrease from Q2 2021[6]
  - Deal value dropped well below the quarterly highs set in 2021, but it is still ahead of pre-pandemic levels, suggesting the exponential growth seen in 2021 is subsiding and returning to a more modest annual trend
- Corporate VC investment has remained relatively strong in 2022, but participation from nontraditional and crossover investors showed a prominent pullback in the second quarter[6]
- VC fundraising in H1 2022 reached 87% of 2021's full-year total, driven by $1B+ funds, which accounted for almost two-thirds of the capital raised[6]
- Approximately 70% of startups fail[7]
- PitchBook's deSPAC Index, which tracks the performance of SPAC mergers post-IPO, had dropped 52% at quarter-end since the beginning of 2022[6]

Debt Markets

- The 10-year yields at quarter-end on U.S. investment-grade and high-yield bond indices have risen dramatically with the tightening of monetary policy, earning investors 2.97% and 8.63%, respectively[3]
- For PE-led transactions between $10M and $250M, the average total debt/EBITDA multiple was 3.9x, according to the most recently available data, at the lower end of the 3.9x to 4.1x range that existed pre-pandemic[8]
- U.S. CLO issuances for 2022 are projected to reach $130B, a 30% pull-back following the unprecedented $187B in new issuances for 2021[3]

U.S. Venture Capital Deal Flow[6]



1. *Ernst & Young*
2. *CB Insights*
3. *S&P Capital IQ*
4. *FactSet*
5. *IPO Scoop*
6. *PitchBook*
7. *CB Insights*
8. *GF Data*

Inbound Container Volumes to the U.S. are Reverting to Pre-pandemic Levels, Providing Welcome Relief to Importers

The latest ocean container bookings data reveal that despite the strong levels of inbound cargo during the first half of 2022, import demand is not just softening — it's dropping off a cliff. Because capacity on the trans-Pacific has remained relatively stable, Freightos's container spot rates from China to the West Coast have plunged 60% over the past three months to $6,519 per container.

Freight forwarders will enjoy expanding margins on ocean freight, while U.S. trucking carriers and intermodal volume providers may start to see volume risks. Importantly, importers of consumer, industrial, and other products manufactured overseas will benefit from lower costs to help offset rising costs elsewhere and slackening demand, as buying patterns are rapidly normalizing to pre-COVID levels and U.S. retailers are stuck with excess inventory.

Container imports bound for the U.S. have dropped 37% since May 25th. (This index measures departing container volumes at the port of origin.) This is a troubling sign for domestic U.S. freight markets that have been benefiting from an unprecedented surge of containerized import volumes over the past 18 months.

This softening puts U.S. containerized imports from all countries of origin down 42% year-over-year, which is a reversion back to the volume levels of the summer of 2020. What is the cause of the sudden drop in containerized import volumes?

The inventory glut

At the forefront is the buildup of inventory in the U.S. resulting from companies attempting to both replenish inventories that were largely depleted in 2021 and keep enough inventory on hand in case of any further disruptions that may occur. Consecutive rounds of COVID lockdowns in China only exacerbated those fears, but after the war between Russia and Ukraine broke out more than 160 days ago, the geopolitical risks seem to only be escalating, and companies decided that they would rather have the inventory safely in the U.S. than risk having it abroad should there be a sudden surge in consumer demand.

So, if consumers are now shifting buying trends from goods to services, those goods-producing companies may get stuck with too much inventory or the wrong inventory in order to try to capture sales. This buildup of inventory is slowing down new import orders abroad and thus adding to the demand destruction we are seeing for containerized imports into the U.S.

Retailers' rising inventories and falling imports reveal that retailers are upside down after the last surge of freight to hit U.S. shores and are throttling down freight velocity in their networks.

The consumer is getting crushed

Conditions for the consumer seem to be getting worse and worse as inflation takes hold and prices get more and more expensive. AAA reports that gasoline prices are $4.16 per gallon on average nationally, up from $3.18 a year ago.

Some economists speculate that with the Fed in the midst of raising interest rates and drawing down its balance sheet, we may be experiencing "peak inflation." However, even if inflationary pressures begin to ease, consumers may still be overexposed to rising interest rates through the use of credit in a way that could further deteriorate demand and discretionary spending.

Credit card spending has been accelerating at a time when personal savings rates have continued to decrease and move toward some of their lowest rates (last reading 5.1) since the Great Financial Crisis (4.5 in August 2009). There are two ways to read very low savings rates: either consumers are exceptionally confident and exuberantly spending their money or they are spending in an attempt to keep their heads above water in a high-inflation environment. Either way, there isn't much slack left in consumer wallets — it's hard to imagine consumer spending growing from here in the near term.

Unfortunately, inflationary pressures in energy and food don't know or care that American consumers are running out of money — inflation in those sectors was caused by supply shocks, not artificially stimulated demand. It is also important to keep in mind that the rate of growth for the Producer Price Index has been outpacing the Consumer Price Index, so some producers may still be taking some hits from rising costs that have not yet been passed on to the consumer.

So even though total revolving credit outstanding is at pre-pandemic levels, it is nonetheless accelerating. If prices continue to rise, it is reasonable to expect that revolving credit outstanding will rise as well.

At first glance, one may look at retail sales and conclude that they are growing, but keep in mind that sales are measured in nominal dollars unadjusted for inflation and represent increases in the prices of goods being sold — not so

much the strength or resilience of consumers. Goods-producing companies will not be alone. Services and tech companies also will be under pressure in the coming months and sell-offs could lead to layoffs.

China factory and port shutdowns

When looking at aggregated container volumes from China to all U.S. ports, we see that volumes have been declining from the "peak-of-peak season" in September 2021 through August 1, 2022 (currently down 54% from that peak). While late March through the beginning of May is historically (pre-trade war/pre-pandemic) a softer period for volumes on this trade lane, it is important to realize that this decline in volumes also has been amplified by the COVID restrictions and lockdowns implemented by the Chinese government in Shanghai as well as other important manufacturing regions in China (most notably around Beijing and its major nearby port of Tianjin).

Despite the lockdowns, a decline in volumes on this major trade lane was seemingly inevitable in 2022, as the massive volumes that moved between these two countries in 2021 were at unprecedented and unsustainable levels. Now some industry observers are calling for a "container surge" as China reopens, but it seems that the demand destruction has already spilled over into this trade lane in a big way.

The "container surge" that never was

The "container surge" that many have been expecting from Shanghai (thought to be building during the lockdowns) appears to have mostly already been rerouted through the Port of Ningbo. With access to the Port of Shanghai being largely blocked due to landside restrictions (*i.e.*, road closures), shippers were quick to reroute volumes through the closest alternate major port to the Port of Shanghai.

Since the lockdowns began in Shanghai in late March, the decline in Shanghai new bookings (and thus load volumes) has been more than offset by a surge of volumes through Ningbo from rerouted containers. This led to booking lead times hitting their lowest levels on record as shippers scrambled to get their volumes moving.

Despite the reopening of Shanghai, total container volumes from China to the U.S. have continued their downward trajectory. That trend is not likely to be reversed by an easing of COVID restrictions alone.

This steady decline in volumes from China to the U.S. has also put significant downward pressure on spot rates from the demand side. As capacity remained relatively consistent in the first few weeks post-lockdown (March 28 onward), the drop in volumes caused a decline in the Freightos Baltic Daily Index spot rates from China/East Asia to the U.S. West Coast (down 60% per FEU over the past three months to $6,519 per container), as well as from China/East Asia to the U.S. East Coast (down 48% per FEU month-over-month to $9,639 per container).

If bookings continue to soften through September 2022, we expect to see spot rates on this trade lane decline further, but ocean carriers may go to greater lengths than ever before to try to protect their record-setting earnings. Carriers already have been cutting capacity on major trade routes through measures such as blank sailings and reassigning vessels to other services, but if the decline in volumes accelerates in the weeks ahead, we may see the alliances test their strength and discipline like never before.

If freight rates start dropping quickly, it is reasonable to suspect that the ocean carriers that have not locked in a majority of their allocations in longer-term contracts may begin aggressively undercutting one another as they compete in the spot market. That would provide further welcome relief to U.S. importers.

By Henry Byers, FreightWaves

About the Author:

Henry Byers is the head of ocean intelligence at FreightWaves, with a focus on international freight forwarding and on data utilized by shippers, carriers, and 3PLs to help navigate the complexities of global and domestic supply chains. The company is the world's leading supply chain intelligence platform. More than one million professionals and 500+ global enterprises use FreightWaves intelligence to make decisions about their current and future supply-chain operations.

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