Aramar
Capital Group, LLC

Deal Market Perspective

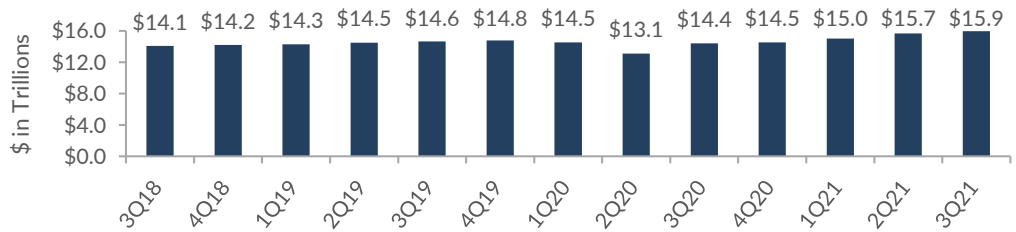
3rd Quarter 2021

Economic Overview

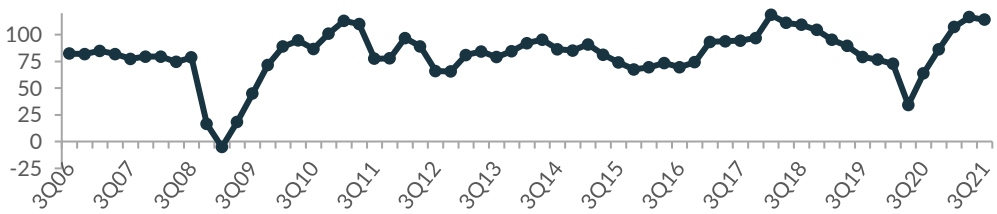
The U.S. economy has continued its recovery from the period of initial shock from the pandemic, as consumer demand has remained strong and the money unleashed by robust government stimulus programs continues to juice the economy. However, supply-chain issues, rising inflation, and tight labor markets threaten to curtail the growth rate.

- U.S. GDP grew at a 2.0% seasonally-adjusted annual rate in Q3 2021, a meaningful deceleration from the 6.7% rate seen in Q2, driven by a slowdown in consumer spending and a resurgence of Covid-19[1]
- Fed officials are closely watching many inflation measures to gauge whether the recent jump in prices will prove transitory[2]
  - One such factor is consumer expectations of future inflation, which can prove self-fulfilling as households are more likely to demand higher wages and accept higher prices when they anticipate higher future price growth[2]
  - Many companies already are planning to pass on increased labor and materials costs to consumers; in September, 46% of small businesses said they planned to raise prices in the next three months, the most since monthly recordkeeping began in 1986[3]
  - The annual inflation rate surged to 6.2% in October, the highest since November 1990 and above average forecasts of 5.8%[4]
- Cumulatively, Americans are sitting on piles of cash; they have $2.3 trillion more in savings in the last 19 months than would have been expected in the pre-pandemic path[5]
  - The median household's checking account balance was 50% higher in July of this year than in 2019
- The U.S. unemployment rate declined to a post-pandemic low of 4.8% at the end of Q3 2021, as compared to 5.9% at the end of Q2 2021[1]
  - The U.S. has experienced record quitting, as the number of available job openings dwarfs the number of unemployed workers; as of November 5th, there were 11.2MM job openings and only 7.4MM unemployed workers[6]
  - The so-called quits rate — a measurement of workers leaving jobs as a share of overall employment — was 3% in September, a record high[1]
- The cost and time to transport products from overseas continue to create supply-chain issues
  - The trucking industry is some 80,000 drivers short of the workers needed to keep goods moving freely this year, up from an estimated shortage of 61,500 drivers before the pandemic[7]
  - In September, the average cost to hire a big rig on the spot market was up 14% over the same month in 2020, hitting the highest monthly average since data tracking began in 2010[8]
  - The average price for the long-term contract rates that shippers negotiate with trucking companies jumped 23%, to $2.49 per mile, also a new high[8]
  - According to retail and shipping executives, it's taking roughly 80 days to transport goods across the Pacific, or twice as long as it did pre-pandemic[9]
  - On the positive side, the cost to move a container from China to the U.S. West Coast fell 26% last week compared with the week before to $13,295, though that is still more than three times as high since the year's start[10]
- The U.S. consumer confidence index declined each month in Q3, falling from 127.3 at the end of June to 109.8 in September, as concerns about the Delta variant, inflation, and supply-chain issues rattled consumers[11]
- Business Roundtable's CEO Economic Outlook Survey, a composite index of CEO expectations for capital spending, hiring, and sales over the next six months, was 114.0 in Q3 2021, down slightly from 116.4 in Q2 2021

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



Business Roundtable's CEO Economic Outlook Index



1. *Federal Reserve Bank of St. Louis*
2. *Federal Reserve Bank of New York*
3. *The National Federation of Independent Business*
4. *Bureau of Labor Statistics*
5. *JP Morgan Chase Institute*
6. *Indeed*
7. *The American Trucking Association*
8. *DAT Solutions LLC*
9. *The Wall Street Journal*
10. *Freightos Baltic*
11. *The Conference Board*

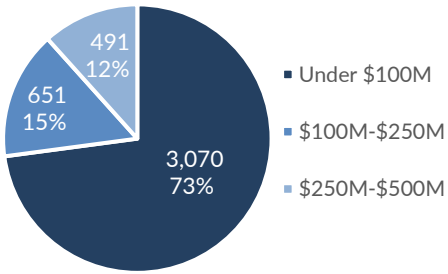
Mergers and Acquisitions

The global M&A market remains extremely active, as acquirers seek to deploy their large cash balances, capitalize on relatively low interest rates, and benefit from revenue and cost synergies. Valuations have followed suit. In particular, the continued shift of transactional business from traditional retailer, distributor, and dealer channels to e-commerce has placed a premium on firms with the capability to benefit from this transition.

- M&A activity in North America continued its bull run in Q3, with 4,609 deals closed for a combined $708.3B, putting both deal count and deal value on pace to easily exceed the previous annual record[1]
  - The continued economic recovery, strong stock prices, ample cash on corporate balance sheets, and cheap financing gave dealmakers the confidence to forge ahead despite escalating labor shortages, supply-chain disruptions, and other inflationary pressures
  - A wave of IPOs is creating more potential acquirers with buying power, and record levels of private equity (PE) dry powder will provide a floor under M&A activity as firms look to deploy cash quickly
  - A survey of C-suite executives and M&A professionals found that 86% of respondents expect deal valuations to stay steady or increase during the next six months[2]

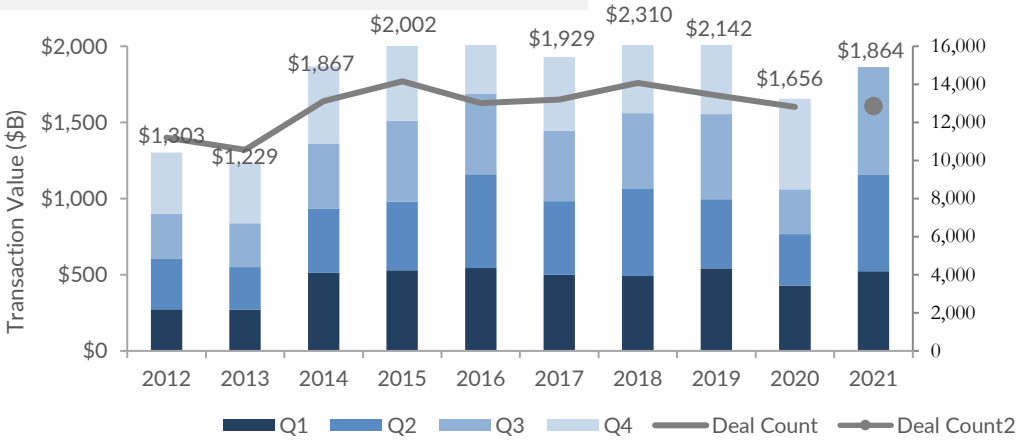
- M&A-related leveraged loan issuance is on a record pace in 2021, reaching $250B through Q3, above the all-time high of $226B during the same period in 2018[3]
- S&P 500 company cash holdings, excluding financial institutions and utilities, reached an all-time high of over $2.0T, providing strategic acquirers with ample capital to put to work to drive growth[3]

LTM 3Q21 U.S. M&A <$500M[1]

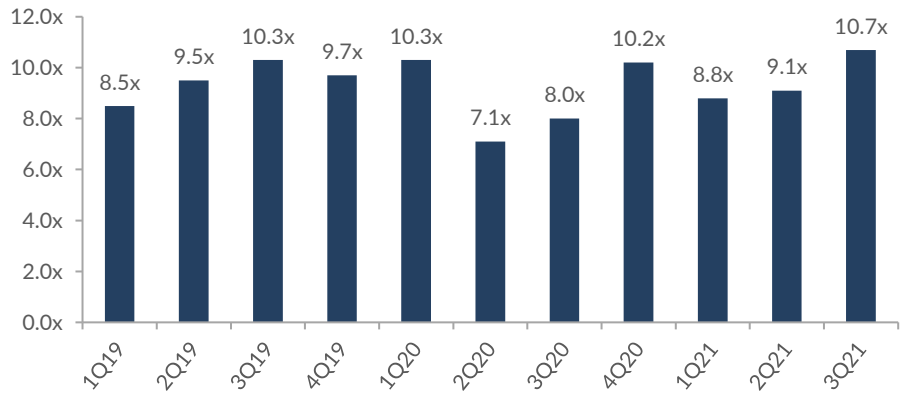


- Global M&A activity continued on its record-setting pace in Q3, with just over 27,000 deals for a combined $3.4T completed through the first three quarters of 2021[1]
  - High stock prices are giving acquirers additional financing firepower to complete deals, as the consideration in nearly half of all completed deals consisted of or included stock
- The median U.S. middle-market M&A EV/EBITDA multiple in Q3 2021 for deals between $1MM and $500MM was 10.7x, a sizeable increase over Q2 2021[4,5]

North America M&A Activity [1]



U.S. Middle-Market Median EV/EBITDA M&A Multiple[4,5]



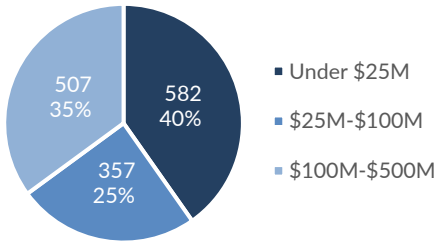
1. *Pitchbook*
2. *Grant Thornton*
3. *S&P Capital IQ*
4. *FactSet*
5. *These multiples reflect prices paid for mainly large public companies and do not account for smaller private company transactions that tend to change hands at much lower multiples*

Private Equity

PE deal activity continues to hum along, so much so that many firms have been encountering bandwidth issues. The rush by many sellers to head off expected tax law changes created a bit of a logjam among buyers and their lenders, legal and financial advisors, QofE providers, and other third-party professionals. Much of the backlog should clear by year end, at which time the prevailing low interest rates and significant PE dry powder should sustain the strong deal environment.

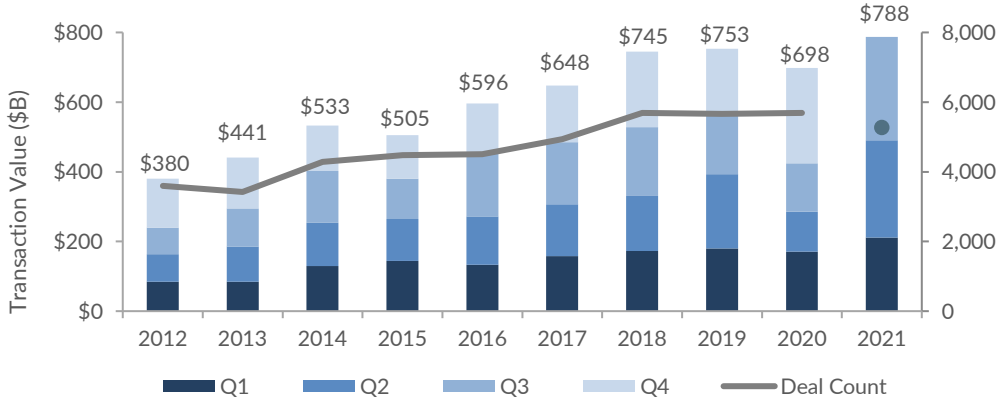
- U.S. PE investment activity already notched an annual record though Q3 2021, with 5,273 closed deals worth a combined $787.6B[1]
  - Deal pipelines are full through the end of end of 2021, as PE funds deploy capital faster and sellers who began processes to try to front run a potential capital gains tax increase seek to close their deals before year end
  - Although some headwinds are on the horizon — including inflation and the possibility of interest rate hikes — dealmakers are, so far, undeterred
- Environmental, social, and governance (ESG)-related deal flow has received increased attention as GPs look to capitalize on shifts in consumer sentiment, regulation, and government infrastructure spending[1]
  - 57.1% of PE firms report evaluating ESG risk factor during due diligence
  - A study found that 51% of students would accept a lower salary to work for an environmentally responsible company[2]
- For PE-led transactions between $10.0MM and $250.0MM, the average EV/EBITDA multiple was 7.2x, according to the most recently available quarterly data[3]
- Add-on investments continue to drive the overall U.S. PE market, accounting for a record 74.7% of all deals in Q3[1]

Q3 2021 U.S. PE Deals <$500M[1]

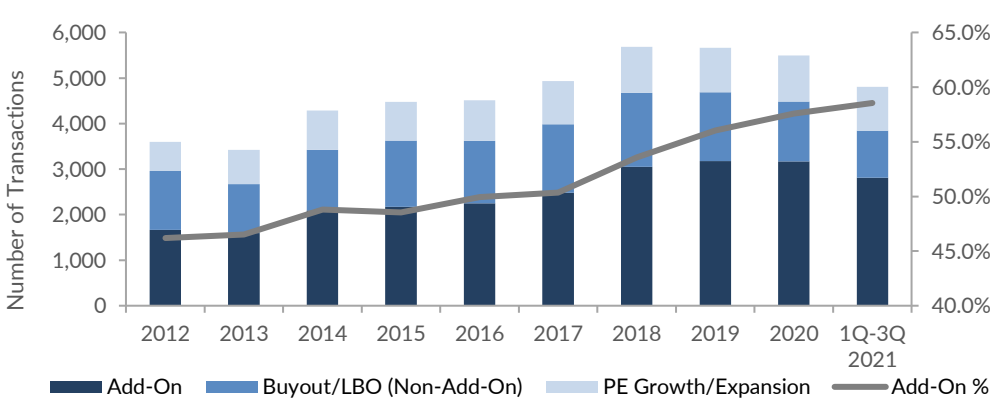


- Global PE dry powder has remained elevated around $1.5T, meaning that acquirers will continue to aggressively seek opportunities to deploy their ample capital[1]
  - While large strategic buyers still account for the bulk of M&A activity, PE firms have continued to make inroads; financial sponsors now account for nearly 40% of all M&A on both a count and value basis
- PE exits are on an astounding run, with year-to-date exit value more than 50% higher than the next-highest annual figure[1]
  - In response to soaring valuations, GPs are truncating exit timelines; 69.1% of year-to-date exits occurred within five years
- U.S. PE fundraising continued at a rapid pace; through the first three quarters of 2021, PE firms raised a combined $237.7B across 295 funds[1]
  - The average number of years between funds now stands at 2.8 years, a precipitous drop from the low of 3.5 years in 2020

U.S. Private Equity Deal Flow[1]



U.S. PE Deal Activity by Type[1]



1. *PitchBook*
2. *Yale School of Management*
3. *GF Data*

Debt and Equity Capital Markets

The SPAC craze has subsided to a large degree, but the IPO market remains quite active. The public exit opportunities, robust private markets, and low-interest-rate environment have propelled venture capital investments to new heights. One particular sector that has seen substantial investor interest has been the ESG area, which is discussed in further detail in the guest EisnerAmper article on the ensuing pages.

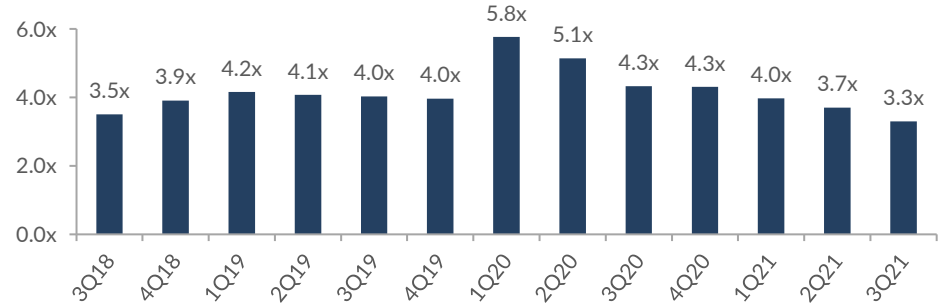
Equity Markets

- Global IPO volumes rose 87% and proceeds rose 99% in Q3 2021 over the same period a year earlier[1]
  - During the first three quarters of 2021, 1,635 companies went public raising $330.7B, both record-setting paces that portend a strong IPO market in the coming quarters
- The S&P 500 has continued its surge upward, rising over 9.0% from the end of Q2 2021 through the middle of November
  - The overall rise occurred despite a 4.8% drop during the month of September, as investors worried about high inflation, slowing growth, and supply-chain logjams
  - The S&P 500 P/E ratio now sits above 29.0x, well above the 21.9x average P/E multiple seen from 1981 to 2020
- SPAC IPOs raised $11.5B in Q3 2021, up 41.9% over Q2 2021, but down 73.3% from the $42.9B raised in Q3 2020[2]
- Investors, starved for yield, pushed capital into riskier plays, pouring $2.7B into angel commitments this year through September; if sustained in Q4, this pace would produce a 2021 total of $3.6B, up from $2.5B in 2020 and $2.7B in 2019[3]
- The global venture capital (VC) funding pace continued its record clip in the third quarter, with $160B invested, up 78% year-over-year[4]
  - Prior to 2021, global VC funding had not reached over $100B in a single quarter[4]
  - While late-stage valuations declined slightly quarter-over-quarter, half of all late-stage rounds in the last four quarters raised new capital at more than double their previous valuations[3]
  - Exit demand likely reinforced VC valuation growth; public listing step-ups rose by 1.8x, while the median valuation step-up for acquisitions swelled to 2.8x, the highest increase on record[3]
- It is estimated that existing technologies can reduce up to 65% of emissions needed to reach net zero by 2050; for the remaining 35%, the climate tech industry is counting on breakthroughs in large funded by venture capital[3]
  - Private capital could provide 70% of the $32T in investment needed by 2030 to be on track for a net zero economy by 2050[5]

Debt Markets

- For PE-led transactions between $10MM and $250MM, the average total debt/EBITDA multiple was 3.9x according to the most recent available data, in line with the 3.9x to 4.1x range that existed prior to the pandemic[6]
- The $3T market for low-rated companies' debt is having its best year ever, powered by a rebounding, stimulus-fueled economy and investors' demand for extra yield in the current low interest-rate environment[7]
- Collateralized loan obligation (CLO) issuance for 2021 remains on track to easily set an annual record — surpassing the $503B issued in 2017 — as investors devour these floating-rate instruments and leveraged loan defaults are at a nine-year low[3]
- Looking forward, headwinds for global bond issuance in 2022 include inflation concerns, prospects for rising interest rates, still-high cash balances, and possible tax reform[7]
- The average 10-year yields on U.S. investment-grade and high-yield debt remain near all-time lows, earning investors 2.7% and 5.6%, respectively[7]

S&P 500 Total Debt/EBITDA[7]



1. *Ernst & Young*
2. *Factset*
3. *Pitchbook*
4. *Crunchbase*
5. *Glasgow Financial Alliance for Net Zero*
6. *GF Data*
7. *S&P Capital IQ*

The Drivers and Challenges of ESG for Acquirers

Environmental, social, and governance (ESG) impact investing and socially responsible investing (SRI) continue to be hot topics for private equity firms and other acquirers, and the trends appear here to stay. However, while these initiatives are at the forefront of the industry, there are challenges to successfully planning, implementing, and measuring the impact of ESG-related strategies.

Foundations of the Movement

ESG concepts are not new. The foundation for the movement has been an element of worldwide initiatives for years. Beginning as early as 2000, the Global Reporting Initiative (GRI), an international association focused on helping organizations understand and report on their impact, developed and expanded on a sustainability reporting framework, and most recently introduced the GRI Standards in 2016.

The United Nations Principles for Responsible Investment (UNPRI) listed below were developed by an international group of the world's largest institutional investors in 2005. They include:

1. Incorporating ESG issues into investment analyses and decision-making processes;
2. Being active owners and incorporating ESG issues into their own ownership policies and practices;
3. Seeking appropriate disclosures on ESG issues by the entities in which they invest;
4. Promoting acceptance and implementation of the Principles within the investment industry;
5. Working together to enhance their effectiveness in implementing the Principles; and
6. Reporting on their activities and progress toward implementing the Principles.

In addition, the UN General Assembly set up the 17 sustainable development goals (SDGs) in 2015, which include (as written): (1) No Poverty, (2) Zero Hunger, (3) Good Health and Well-Being, (4) Quality Education, (5) Gender Equality, (6) Clean Water and Sanitation, (7) Affordable and Clean Energy, (8) Decent Work and Economic Growth, (9) Industry, Innovation, and Infrastructure, (10) Reducing Inequality, (11) Sustainable Cities and Communities, (12) Responsible Consumption and Production, (13) Climate Action, (14) Life Below Water, (15) Life On Land, (16) Peace, Justice, and Strong Institutions, and (17) Partnerships for the Goals. Realizing the breadth of these goals, the UN adopted a resolution two years later in 2017 to provide targets and indicators for each of the 17 goals.

These goals and principles, along with many others worldwide, are being referenced by private equity and corporate development managers working to implement ESG strategies into their business and investment policies. Similarly, ESG and impact investing funds are not new strategies.

Challenges in ESG Adoption and Implementation

Until recently, even with a history of ESG-related initiatives, investment managers and other acquirers have faced challenges that have delayed the buy-in to ESG investing and implementation:

1. The misperception that focusing on these initiatives is at odds with investment or corporate managers' fiduciary duty to their investors and shareholders.
2. The lack of a clear definition on what qualifies as an ESG strategy, what makes something sustainable, and the differences in which ESG initiatives are considered material. Will a fund or other acquirer prioritize socially responsible investing, diversity, equity and inclusion, governance issues, or environmental issues?
3. Varying approaches to ESG incorporation due to a lack of guidance. There remain inconsistencies in how ESG is used in investment decision-making and due diligence, which creates difficulty when evaluating impact.
4. The risk that ESG measures taken by funds, companies, and their portfolio holdings will be seen as superficial, in which case they risk "greenwashing," or giving a false impression of the sustainability of investments within a portfolio. In more extreme cases, this could also result in non-compliance.

Key Drivers

While many of these challenges remain, there are drivers pushing and supporting more change in the perception of ESG and impact investing.

The Pandemic Has Led to Increased Momentum

Environmental issues have always been a main ESG focus, but the Covid-19 pandemic helped bring social considerations into the limelight as well. The pandemic disproportionately impacted poorer populations and minorities, further highlighting inequality. While many that remained employed were forced into a long-term work-from-home (WFH) situation, decreased morale and depression were on the rise. The lack of in-person schooling and child care created both learning challenges and balance struggles in the home. In the age of social media, company and fund responses to these issues were also on full display. As social pressure has increased, so have expectations.

ESG is a Focus for Stakeholders

Limited partner behavior has been a key force driving ESG in private equity, as many investors have begun to include ESG considerations in their allocation decisions. Data have suggested that ESG funds have been outperforming, and the perception of ESG has shifted from "the right thing to do" to an opportunity for value creation. This is changing the landscape of investors that are allocating to ESG.

Due diligence and expectations from limited partners have also changed. Investors are not only prioritizing how a private equity group or business may be implementing ESG, they are also looking to allocate to minority- or women-owned funds and businesses. ESG is also becoming an increasingly important factor in attracting and retaining talent. There are now reputational risks as well as fundraising challenges facing managers that fail to include ESG in their business and investment decisions.

Regulations are Forthcoming

Domestically, President Biden has made it clear that ESG is a priority for his agenda, which is expected to translate into increased regulation. The SEC is focused on ESG disclosures, further fueled by the European Union's Sustainable Finance Disclosure Regulation (SFDR), which went into effect in March 2021. The SFDR imposes stricter rules and requirements on financial market participants, such as investment firms, with regards to their sustainability practices and disclosures. Even if not impacted by the SFDR directly, private equity firms will need to begin to think about how these regulations could be adapted to them in the future.

Data and Technology Are Creating Opportunities for ESG

Tools have been surfacing to monitor ESG performance, such as Preqin ESG Indicators providing ESG scoring for a portfolio and the Global Impact Investing Network's (GIIN) IRIS+ system for measuring, managing, and optimizing impact. In 2020, Apex Group launched an ESG ratings and advisory platform specifically for private markets. Further, companies are offering ESG materiality assessments for private equity. As technology advances, so will the availability of data and statistics to measure impact, breaking down some of the challenges to successful implementation and creating better transparency for investors.

The Evolution of Accepted Metrics and Guidelines Can Lead to Greater Consistency

There has been an increased push to provide the market with guidelines and metrics related to ESG. In mid-2019, the Institutional Limited Partners' Association (ILPA), a global community of private equity investors, released its ILPA Principles 3.0, which included a section dedicated to ESG policies and reporting. The group also developed an ESG Roadmap for its members to guide them in best practices for implementing an ESG strategy. In 2020, the World Economic Forum introduced the "Stakeholder Capitalism Metrics" to guide companies in how to align reporting with ESG indicators. In 2021, the Value Reporting Foundation was formed through the merger of the Sustainability Accounting Standards Board and the International Integrated Reporting Council, with the goal of unifying to provide integrated reporting frameworks and standards. Most recently, the SEC's Asset Management Advisory Committee discussed forming a subcommittee for recommendations on ESG-related disclosure. As frameworks and standards become more widely accepted, they will provide clarity when defining and disclosing an ESG strategy.

Conclusion

The bottom line is that many of the difficulties in ESG adoption and implementation are currently being addressed, and with this comes both risk and opportunity for the private markets. Private equity funds and corporate acquirers should expect to receive increased questions during due diligence from their limited partners and other stakeholders on how they think about ESG in both their organization and their portfolio companies, as well as more questions from their own staff on how ESG is viewed and practiced at the fund. Funds and companies that have already employed a thoughtful strategy with assistance from stakeholders and consultants may have a competitive advantage. With private equity and corporate stakeholders and regulators making this a priority, funds and other acquirers should take a proactive approach to evaluating and implementing ESG initiatives to minimize the risk of inaction.

By Jennifer Cuello, EisnerAmper

About the Author:

Jennifer Cuello is an Audit Senior Manager in the Financial Services Group of EisnerAmper with nearly ten years of experience serving clients in the insurance, private equity, and venture capital industries. She is responsible for all phases of the audit, including planning, organization, supervision, and review.

EisnerAmper is a leading accounting, tax, and business advisory firm with over 2,000 employees. The firm works with a diverse client base, including sophisticated financial institutions and start-ups, global public firms and middle-market companies, high-net-worth individuals, family offices, not-for-profit organizations, and entrepreneurial ventures across a variety of industries.

To learn more about EisnerAmper, please visit www.eisneramper.com.

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 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