Aramar Capital Group, LLC

Middle Market Update

4th Quarter 2016

Fourth Quarter Economic Performance and Future Outlook

Gross Domestic Product

- The real U.S. GDP increased at an annualized rate of 1.9% in Q4 2016, down from the 3.5% rise in Q3 2016[1], due to:
  - Negative contributions from decreases in net exports, personal consumption expenditures, and federal government expenditures, which were partially offset by increases in residential fixed investment, private inventory investment, state and local government expenditures, and nonresidential fixed investment

Consumer Income and Spending

- Real disposable personal income grew by 1.5% in Q4 2016, a decrease compared with the 2.6% growth in Q3 2016[1]
- The personal savings rate, as a percentage of disposable personal income, was 5.6% in Q4 2016, down from 5.8% in Q3 2016[1]

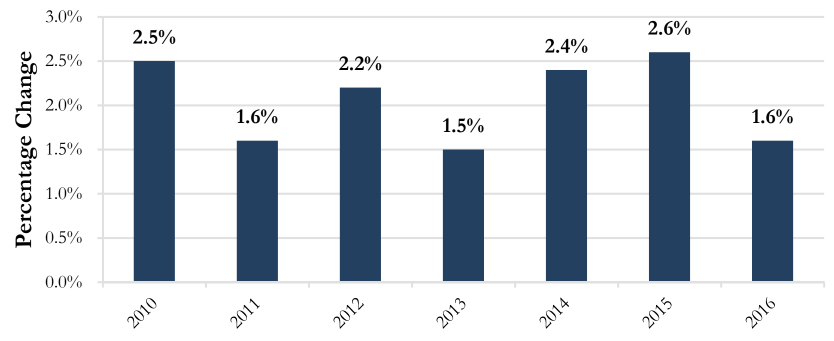
Federal Reserve

- The labor market continued to strengthen, while economic activity expanded at a moderate pace, as job gains remained solid and household spending continued to rise moderately[2]
- The Federal Open Market Committee (FOMC) decided to maintain the target range for the Federal Funds Rate at 0.50% to 0.75%, in a continued effort to further boost the labor markets and return inflation to a 2.0% level[2]
- The committee expects inflation to return to 2.0% in the medium term, as economic activity expands at a moderate pace and labor market conditions continue to strengthen[2]

Employment

- The unemployment rate and the number of unemployed persons both decreased during Q4 2016, ending the year at 4.7% and 7.5 million, respectively[3]
  - Nonfarm payroll employment continued to expand, rising by 156,000 in December 2016

Real GDP Growth Since 2010



Source: Bureau of Economic Analysis

U.S. Treasury Securities

- The 10-year Treasury yield increased from 1.63% to 2.45% during Q4 2016[4]
  - The Fed's decision to raise rates, pro-growth sentiment, and increased investments into equities have contributed to the rapid rise in rates

	Q1 2016	Q2 2016	Q3 2016	Q4 2016
5-year Treasury Note	**1.44%**	**1.29%**	**1.18%**	**1.69%**
10-year Treasury Note	**2.01%**	**1.82%**	**1.61%**	**2.21%**
30-year Treasury Note	**2.96%**	**2.81%**	**2.49%**	**3.05%**
10-year Treasury Inflation Protected Security	**0.48%**	**0.19%**	**0.08%**	**0.33%**

Source: U.S. Department of Treasury

Outlook for 2017

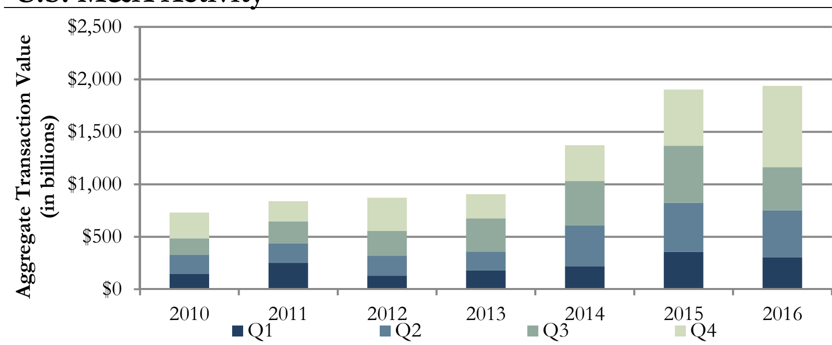
- PwC expects the U.S. real GDP to grow by approximately 2.0% in 2017 on the back of strong job creation and household consumption[5]
- The Business Roundtable CEO Economic Outlook Survey results indicate that CEOs project a 2.0% expansion in GDP with a positive outlook for hiring in 2017[6]

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

Mergers and Acquisitions and Private Equity

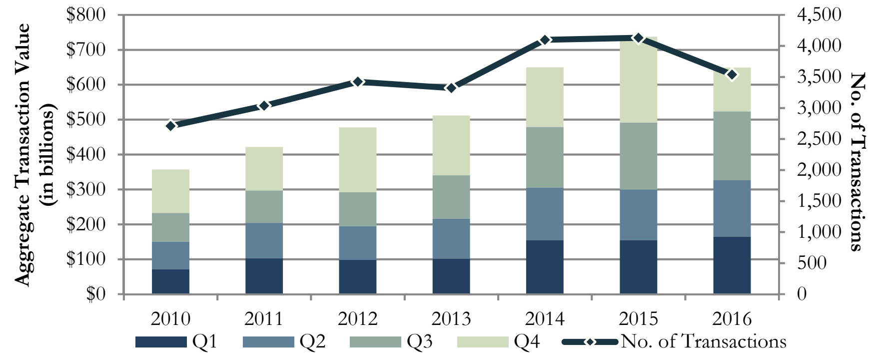
- Global mergers and acquisitions (M&A) activity reached $3.2T across 17,369 deals in 2016, a decrease of 18.1% and 3.2%, respectively, as compared with $4.0T across 18,039 deals in 2015[1]
  - The U.S. contributed the highest number and value of M&A deals in 2016, with 4,951 transactions totaling $1.5T in value
  - Energy, mining, and utilities was the top sector with 1,453 deals worth $608.5B
- The U.S. Q4 2016 M&A deal value was $478.7B, up 15.9% compared with Q3 2016[1]
- The U.S. M&A market in 2016 was the second most active since 2001, despite new regulations from the Obama Administration in the first half and uncertainties surrounding the U.S. elections during the second half[1]
  - The U.S. M&A deal value totaled $1.5T in 2016, second only to a post-2001 high of $1.9T in 2015
  - Soaring inbound activity was a key factor, as U.S. company sales to foreign entities hit a record $450.5B, including $63.3B in Chinese acquisitions of U.S. companies
  - Strong M&A activity in 2016 also was spurred by the large amount of cash held by private equity funds and on corporate balance sheets, historically low interest rates, and strategic acquirers needing non-organic avenues for growth
- M&A activity for 2017 is uncertain because of President Trump's interest in protectionism and revised trade agreements, countered by new disruptive technologies that may cause firms in certain industries to consolidate[1]

U.S. M&A Activity



Source: FactSet

U.S. Private Equity Deal Flow



Source: PitchBook

- U.S. private equity (PE) investments totaled $649.0B in 2016 across 3,538 transactions, down 12.0% and 14.0% year-over-year, respectively[2]
  - The use of equity to finance deals is on the rise, with median equity/EBITDA multiples for M&A transactions in the U.S., including buyouts, increasing to 5.4x in 2016 from 4.3x in 2015[2,3]
  - The use of debt in PE buyouts and M&A fell to 50.5% of enterprise value in 2016, down from 56.8% in 2015[2]
- U.S. add-on acquisitions accounted for 64.0% of buyout activity in 2016, up from 61.0% in 2015, the highest ever recorded[2]
  - The healthcare industry witnessed increased consolidation, in large part due to expected changes to the Affordable Care Act, resulting in 283 add-on acquisitions in that sector
- The median EV/EBITDA multiples for U.S. M&A transactions increased to 10.9x in 2016 from 10.0x in 2015[2,3]
  - The higher multiples were due, in part, to increased competition from strategic acquirers seeking new growth vehicles and synergy profits
- The EV/EBITDA multiples paid for middle-market sellers also remain lofty, with the latest data showing an average of 6.1x for $10M to $50M deals and 8.5x for $50M to $250M deals[4]
- Globally, PE funds ended 2016 with $820B in dry powder, up from $755B at the end of 2015[5]

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*
5. *Preqin*

Venture Capital and PIPEs

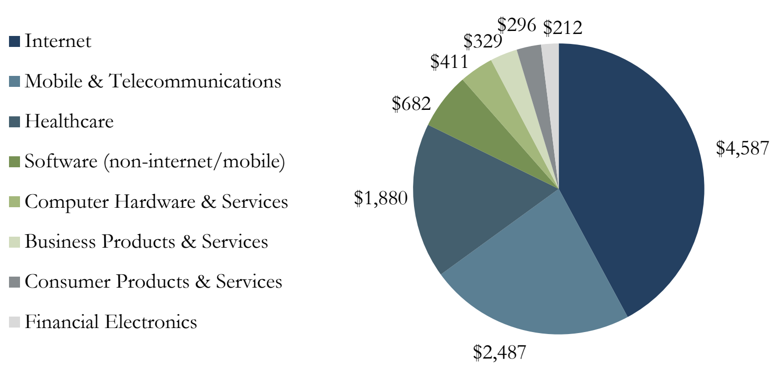
Venture Capital Investing

- Investor caution prevailed, as Q4 2016 saw a 14.0% slowdown in venture capital (VC) deals and 17.0% decrease in total VC funding from Q3 2016[1]
- A total of $69.1B was invested into the venture ecosystem in 2016, representing the second highest annual total in the past 11 years, following the $79.3B invested in 2015[1]
  - Financing to U.S. VC-backed companies totaled $58.6B across 4,520 deals in 2016, down 20.0% and 16.0%, respectively, from 2015
- High prices led to fewer first-time financings during 2016, causing a decrease from 3,333 closed first-time financings in 2015 to 2,340 in 2016[1]
- In Q4 2016, seven venture-backed companies went public, bringing the total for the year to 39, half the number in 2015 and the lowest since 2009[1]
- The largest U.S. VC fund that closed in Q4 2016 was California-based Greylock XIV with capital of $1.1B, followed by Sofinnova Venture Partners X with a fund size of $650.0M[2]

PIPE Investing

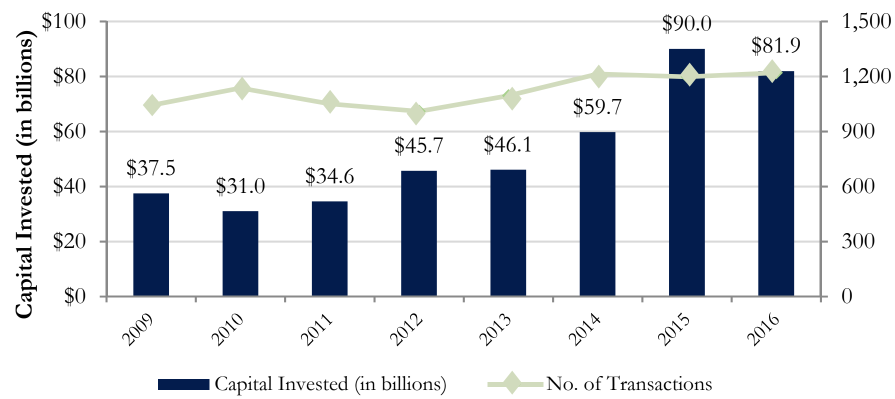
- 333 private-investment-in-public-equity (PIPE) deals totaling $20.4B closed in Q4 2016, representing a 13.7% increase in deal flow and a 50.6% increase in capital compared with Q4 2015[3]
  - As usual, energy PIPEs accounted for much of the investment in the space, with $7.5B invested during Q4 2016
  - Healthcare PIPEs continued to lead the way in terms of deal flow, accounting for over 35% of transactions in Q4 2016
- 2016 was the second biggest year for PIPEs and generated more capital than during any year other than the $100.0B in 2008[3]
  - The 2016 PIPE market recovered from a rocky first quarter, when volatility was high and equity markets were soft
- Some market players believe that the incoming administration and its nominee to head the SEC portend favorable conditions for 2017, especially for younger companies[3]
  - "If Trump's SEC nominee is confirmed, it would be 'like a gigantic gift' with a Trump bow on it," said Patriarch Equity CEO Eric Schiffer. "The appointment will remove the shackles on funding for small businesses."

VC Deals Per Industry (in millions) – Q4 2016



Source: MoneyTree Report

U.S. PIPE Activity



Source: PrivateRaise

1. *PricewaterhouseCoopers LLC and the NVCA*
2. *NVCA*
3. *The Deal*

Debt Capital and IPO Market

Debt Capital

- The Barclays U.S. Aggregate Bond index recorded a 3.0% loss during Q4 2016, a significant decrease from the 0.5% return in Q3 2016[1]
  - The 3.0% total return for 2016 was in large part due to strong returns in Q1 and Q2 2016 and significantly higher than the 0.6% return for 2015
- The Barclays Investment Grade U.S. Corporate Bond index generated a negative return of 2.8% in Q4 2016, below the 1.4% return in Q3 2016[1]
  - However, the total return for 2016 was 6.1% as a result of solid returns during the first half of the year – significantly greater than the 2015 return of -0.7%
- Total debt issuances decreased 21.7% to $1.5T in Q4 2016, down from $1.9T during Q3 2016[2]
  - The total decrease was a result of fewer issuances in all bond classes except for mortgage-related debt issuances, which were up for the third consecutive quarter
- U.S. investment-grade corporate bond issuances decreased by 42.2% to $205.1B in Q4 2016, a drop from $354.7B in Q3 2016[2]

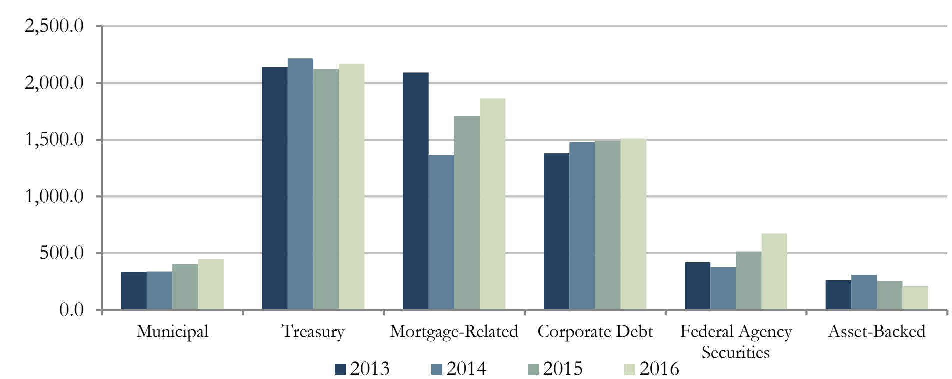
Middle-Market Loan Issuances

- Middle-market lending totaled $139B for 2016, a 2.0% decrease from $142B in 2015[4]
  - The volume is comprised of $105B in large middle-market loan issuances (deal size from $100M to $500M) and $34B in traditional middle-market loan volume (deal size less than $100.0M)
- Yields on new middle-market loan issuances decreased to 6.4% in Q4 2016 from 6.6% in Q3 2016[4]
- Average debt-to-EBITDA multiples increased to 6.1x for broadly syndicated LBO transactions in 2016 and declined to 5.3x for institutional middle market LBOs[4,5]
  - The technology industry had the most leveraged loan issuances during Q4 2016

IPO Market

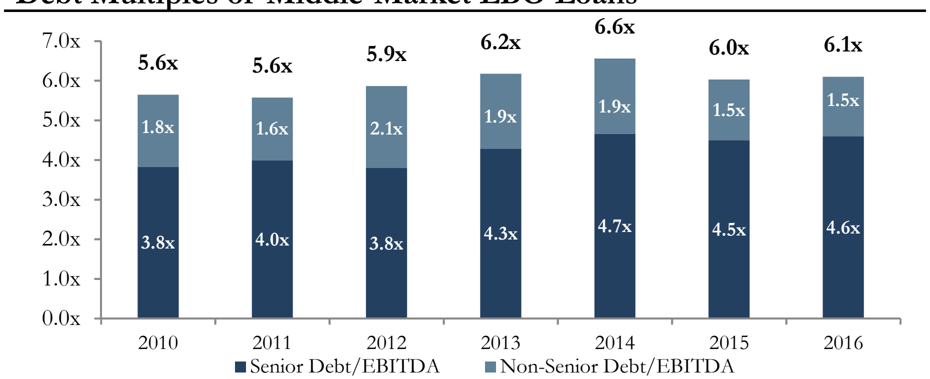
- In 2016, 111 companies went public on U.S. exchanges, raising $24.2B, 33% less than in 2015 and the lowest volume since 2003[6]
- The number of U.S.-listed companies has declined from its 9,113 peak in 1997 to 5,734 in 2016, swelling the average public company size to more than three times its inflation-adjusted 1997 count[7]
- This de-equitization has been a result of the reduced attraction of being public (high costs, reduced long-term focus, and public information disclosure) and the plethora of alternative capital sources
  - M&A activity is far higher today; PE capital is $1.4T, nearly four times its 2000 level; and sovereign-wealth funds have $7.4T of capital, more than double their 2007 level[8]

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



Source: SIFMA

Debt Multiples of Middle-Market LBO Loans



Source: Thomson Reuters LPC

1. *Prudential Financial*
2. *SIFMA*
3. *Guggenheim Partners*
4. *Thomson Reuters LPC*
5. *These multiples mostly reflect prices paid for larger private companies and generally do not account for smaller private company transactions that tend to change hands at much lower multiples and with lower debt ratios*
6. *Dealogic*
7. *University of Chicago's Center for Research in Security Prices*
8. *PitchBook and Sovereign Wealth Fund Institute*

Fraud Detection – Why, How, and When

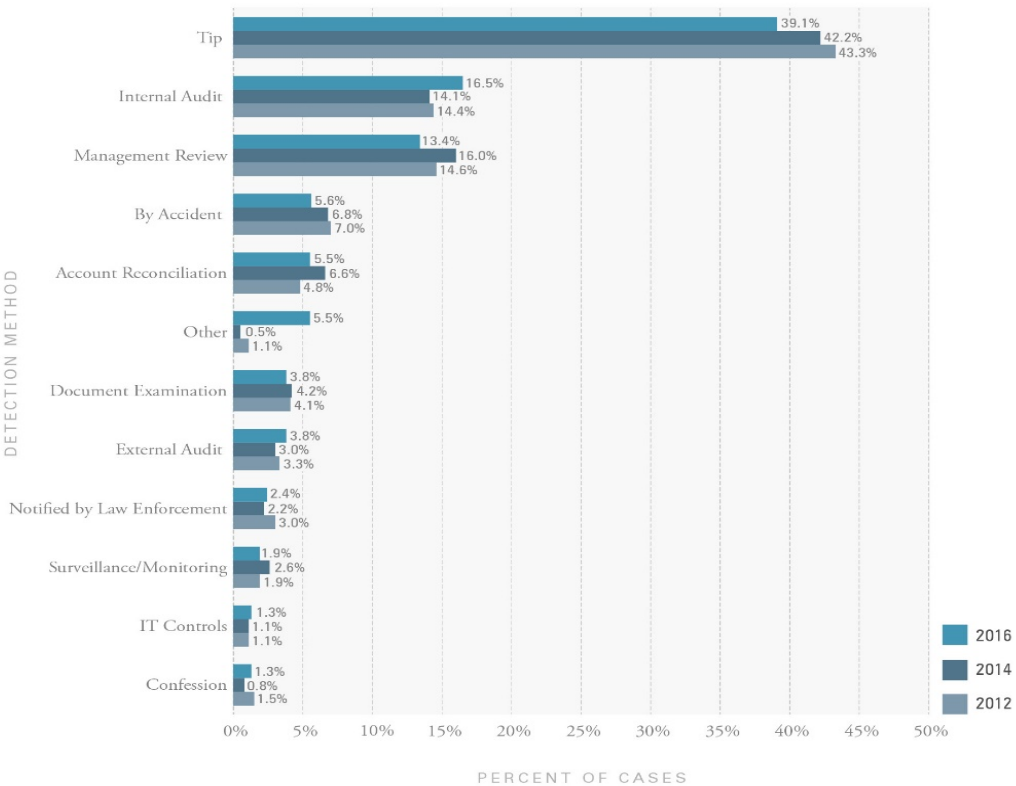
By EisnerAmper, LLP

The Association of Certified Fraud Examiners (ACFE) has released the results of its biannual Occupational Fraud Survey. Occupational fraud continues to plague businesses both domestically and internationally. In our review of the recent survey, we've found that different fraud schemes can have a significant impact on a business's financial operation, cash flow, and public reputation.

- Most fraudsters don't begin their illegal undertakings with the intent of ever getting caught. Generally, they are fully aware of the consequences of their actions and the risks they are putting on their careers, reputations, and in some instances their freedom. Nonetheless, given their circumstances, the perceived rewards of financial gain and status outweigh the risks of getting caught.
- Studies show that there is a paradigm known as the fraud triangle. The paradigm consists of three key elements that generally are present for a fraudster to commit a wrongful act – opportunity, pressure, and rationalization. The perpetrator has the pressure and opportunity to commit the fraud and simply awaits a motive to trigger the act. Motives can be based on many factors – a need for additional income, a financial hardship, self-ego looking for status, an addiction (drugs or gambling), rightful revenge, or some other form of rationalization and validation that he or she is doing the wrong thing for the right reasons.
- From a detection standpoint, the Why and When are generally less important than the How. Uncovering fraud can be a very difficult process given the fact that, initially, it is known only to the perpetrator. While organizations can be vigilant in trying to prevent or detect fraud at its earlier stages, perpetrators usually are aggressively manipulating information and using various techniques to cover their trail.
- Contrary to what most people might think, the majority of occupational fraud schemes are not detected as a result of the work performed by an internal or external auditor. Instead, they usually are uncovered through tips. Most often, these tips come from other employees within the organization, but it is not uncommon for customers, vendors, shareholders, and even competitors to leave a helpful tip.
- For example, the management of a relatively large organization received a tip from an employee about some questionable activity at an affiliate and asked its controller to investigate. His report determined the allegations were unfounded, based in part on employee interviews and consistently clean annual audit opinions. As a result of the increasing attention paid to whistleblower claims in the media, the parent company decided to engage the forensic services team of a recognized accounting firm to further investigate. The affiliate's controller was told that the parent was changing its auditor and that the work being done was for the new audit firm "to get up to speed for year end." After two days of reviewing books and records, the forensic team informed management there was evidence supporting the whistleblower's claims. It was retained to conduct a full-scale forensic investigation and uncovered several fraud schemes that involved multiple individuals and amounted to over $4 million being embezzled, resulting in the prosecution of the controller and termination of several other employees.

- The graph below displays the most frequent ways that occupational fraud is initially detected within an organization.

Figure 21: Initial Detection of Occupational Frauds

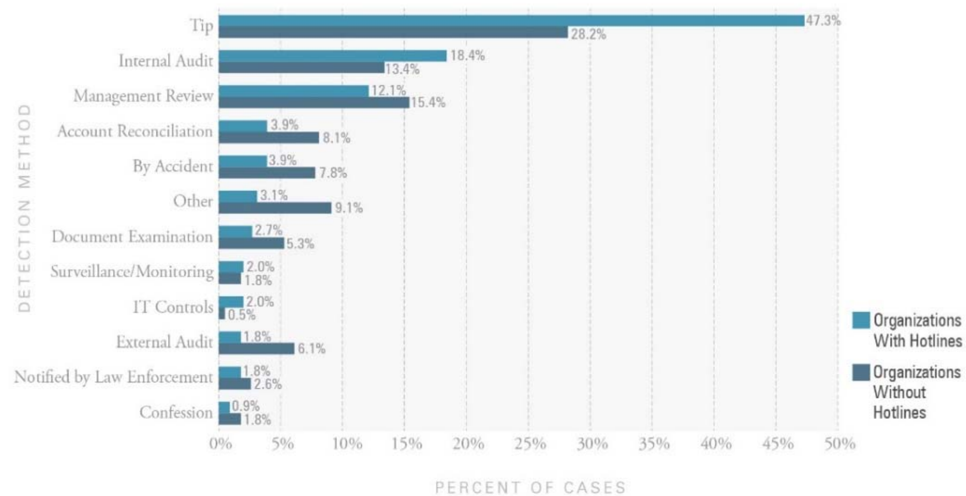


- According to the ACFE study, the majority of whistleblowers (58%) elect to use internet-based reporting, such as emails or web-based/online forms, while the remaining reports come from the submission of physical forms or reports to a direct supervisor. However, there are people who would rather perform their good deeds behind the scenes and remain unidentified. Sometimes it's because their tips may involve a direct superior or another person who may have the ability to negatively impact them or their careers, so they fear retaliation.

- As a result, companies have implemented procedures for those individuals who would like to report suspected instances of occupational fraud through tip hotlines. These hotlines can be either internal (within the organization) or external (a private company or fraud-fighting organization). The ACFE study indicates that 14% of total reporting tips come from anonymous sources through such hotlines.

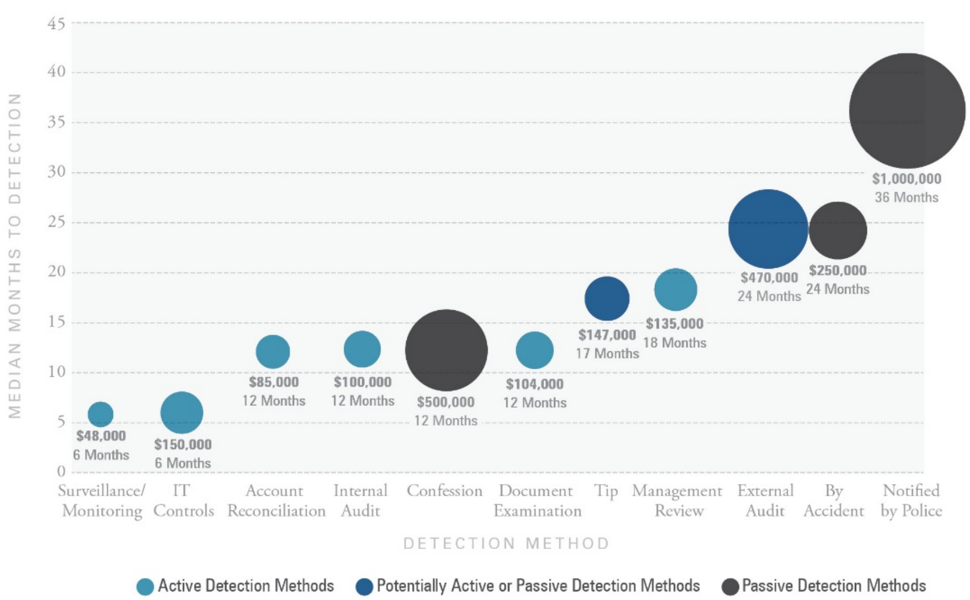
- The graph below depicts the effectiveness of anonymous hotlines and how they can alleviate the pressures and money spent on uncovering occupational fraud through other methods.

Figure 34: Impact of Hotlines



uncovered can vastly impact the effect the fraud has on a company. For instance, if a surveillance camera were to catch an employee stealing from a register, the issue would be resolved fairly quickly, with substantial evidence of wrongdoing and minimal losses to the company. However, if the situation were to go undetected for over a year and outside services such as external auditors, law enforcement, tips, or sheer luck were engaged to detect the ongoing fraud, losses could reach detrimental heights.

Figure 32: Median Loss and Median Duration by Detection Method



Key Takeaway

The longer an occupational fraud continues without being uncovered the greater the risk and size of a financial loss. Knowing how occupational frauds are detected and reported is important, as it helps when designing and strengthening an organization's fraud-fighting controls. Organizations that are proactive can reduce their risk of occupational fraud and resulting financial loss.

About the Authors

EisnerAmper LLP is one of the largest accounting firms in the U.S., with nearly 1,300 employees and 180 partners across the country. Its clients are enterprises as diverse as sophisticated financial institutions and start-ups; global public firms and middle-market companies; as well as high-net-worth individuals, family offices, not-for-profit organizations, and entrepreneurial ventures across a variety of industries.

Hubert Klein is a Partner in the firm's Forensic, Litigation, and Valuation Services Group. He has consulted and provided services in matters including complex damages, business valuations, and fraud and forensic investigations.

Michael DaCosta is a Staff Analyst in the Forensic, Litigation, and Valuation Services Group at EisnerAmper LLP. He provides services in matters pertaining to business valuation, matrimonial disputes, and fraud and forensic investigations.

Aramar Capital Group, LLC

Differentiation

- Aramar Capital Group, LLC is a boutique investment bank focused on providing merger, acquisition, and strategic private placement services. We are unique among our investment banking peers in that:
  - We focus on middle-market transactions; these transactions are a priority, not a default for when larger deals are dormant;
  - We have significant transactional expertise;
  - We offer senior level attention; and
  - We have a proprietary marketing process that follows a comprehensive approach tailored to each buyer or investor candidate, rather than a typical generic approach utilizing "blast" e-mails, letters, and other contacts.

Services

- Aramar offers a highly focused set of corporate finance services to assist our clients in conceiving, defining, executing, and optimizing their objectives:
  - Mergers and Acquisitions
    - Negotiated Sales of Closely-held Companies
    - Corporate and Private Equity Firm Divestitures
    - Leveraged Buyouts
    - Managed Buyouts
    - Buy-side Advisory
  - Private Equity Placements
  - Private Debt Placements
  - Recapitalizations
  - Fairness Opinions
  - Valuations
  - Financial Advisory

Clientele

- Aramar focuses on providing a superior level of service to "middle-market" clients. Our M&A transactions range in size from approximately \$10 million to \$200 million. Our strategic private placements range in size from approximately \$10 million to \$100 million.
- We provide the high quality of service and substantial transactional experience offered by a major national investment bank, but to a clientele that either is too small for, or cannot receive, the proper level of attention from a larger investment bank, or would receive lesser services and capabilities from a business broker, consultant, or smaller investment bank. This encompasses access to Aramar's senior professionals and proprietary marketing process.

Team

- Aramar has assembled a unique team of professionals with a comprehensive and attractive mix of skills and experience. This team has significant investment banking experience, including stints at many other prominent financial services firms.
- Equally important, however, our team has entrepreneurial, managerial, and ownership experience that sets apart Aramar's "principal" perspective from that of most investment banks, where professionals tend to act simply as "agents." As principals, our team members have founded firms, acquired other companies, sold and merged our own companies, and acted as officers and directors of both public and private enterprises. As such, we can relate more closely to our clients and better advise them, at the same time as ensuring senior level investment banking attention.