Aramar
Capital Group, LLC

Deal Market Perspective

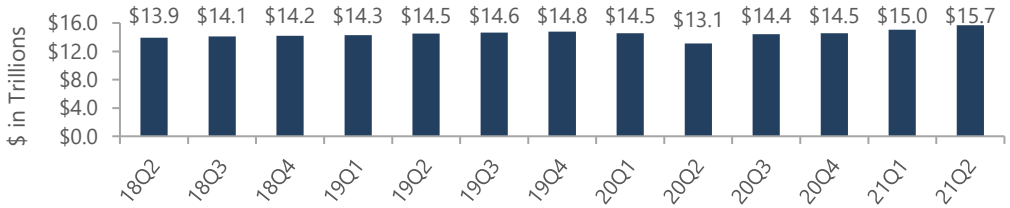
2nd Quarter 2021

Economic Overview

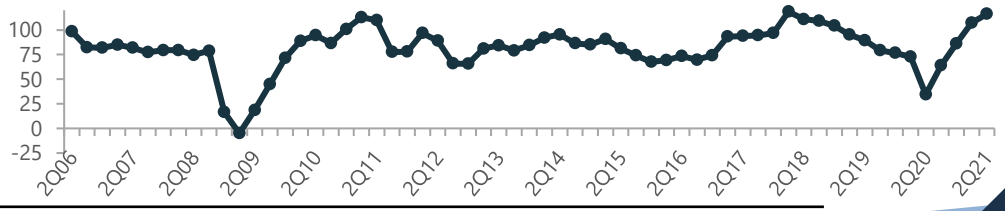
The U.S. and global economies have continued to rebound from last year's Covid-induced woes, fueled in large part by pent-up demand, low interest rates, and prolific government spending. The potential adverse impact of the Delta variant, accelerating inflation, and the continued supply-chain crisis (see the USC Consulting Group guest article starting on page six) pose hurdles, but the economy seems fairly resilient and its outlook remains bright. While the world's large nations are making great progress on taxation, global trade friction still looms as an issue.

- U.S. GDP grew at a 6.5% seasonally-adjusted annual rate in Q2 2021, driving it above the pre-pandemic peak reached in late 2019[1]
- The U.S. unemployment rate declined to a post-pandemic low of 5.9% at the end of Q2 2021, as compared to 6.0% at the end of Q1 2021[1]
  - The share of job postings that say "no experience necessary" is up two-thirds over 2019 levels[2]
- The OECD raised its forecast for global economic growth in 2021 to 5.8%, which would be the fastest since 1973[3]
  - The most recent U.S. government spending program alone is expected to lift output over the next 12 months by up to 0.5% in Japan, China, and the Eurozone and 1.0% in Canada and Mexico
- Fed officials are set to accelerate deliberations over how to scale back easy-money policies amid a stronger than anticipated economic recovery[1]
  - The discussions will focus on two important questions: when to start paring monthly purchases of $80B in Treasury securities and $40B in mortgage securities, and how quickly to taper them
- Americans' incomes have kept rising through the pandemic; U.S. households built up $2.6 trillion in "excess savings" and they are spending heavily on foreign-made goods[4]
- Inflation risk is rising; the share of small business owners raising their firms' average selling prices rose seven points to 47%, the highest reading since January 1981[5]
  - However, advanced economies are much less vulnerable to oil price increases than decades ago because services, which consume less oil than heavy industry, account for a bigger share of output; in the U.S., it now takes about half as much oil to produce a dollar of GDP as it did 35 years ago, adjusted for inflation[6]
- The global shipping issues remain a primary source of distress for companies all around the world, driven by surging global demand, port closures, container shortages, and a mismatch in port productivity[7]
  - In Asia, ships and terminal gates both operate 24/7, compared with 16 and 12 hours a day, respectively, at Long Beach, CA; in China ports, larger ships take 24 seconds to move a container versus 48 seconds in CA, leaving the port system chronically vulnerable to unanticipated volume surges
  - 42% of all containers arriving in the U.S. come from China
  - Smaller importers are finding it particularly difficult to secure containers, and container spot rates have surpassed $20,000 in some cases[8]
- Through the first five months of 2021, more than 400 ships on the trans-Pacific trade lanes and 140 from Asia to Europe were late by more than two weeks, compared with 388 and 69 ships on the same routes, respectively, for all of 2012 to 2020 combined[9]
- The U.S. consumer confidence index continued to rise through Q2, reaching 127.3 at the end of June, marking the fifth straight month of gains as more vaccinations and stimulus payments were rolled out[10]
- 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 116.4 in Q2 2021, up 9.2 points from Q1 2021 and only 2.2 points behind the all-time record set in Q1 2018

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



Business Roundtable's CEO Economic Outlook Index



1. *Federal Reserve Bank of St. Louis*
2. *Burning Glass Technologies*
3. *Organization for Economic Cooperation and Development*
4. *Moody's Investor Service*
5. *National Federation of Independent Business*
6. *Energy Information Administration*
7. *IHS Markit*
8. *The Wall Street Journal*
9. *Sea-Intelligence ApS*
10. *The Conference Board*

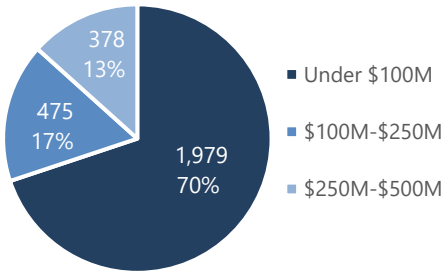
Mergers and Acquisitions

M&A deal volume has continued to be robust and is showing few signs of abating. Ample corporate cash and private equity (PE) dry powder, low interest rates, target-chasing SPACs, and the rush to sell before possible tax rate increases are propelling activity and valuations. The difficulty in determining a recurring base for financial performance due to noise from the pandemic and supply-chain crisis remains vexing and has upped the proportion of contingent-based transaction consideration. Increased antitrust scrutiny may slow large corporate business combinations.

- U.S. M&A activity sustained its remarkable pace in Q2 2021, with 4,369 deals worth $826.9B; this represents the third consecutive quarter that M&A activity by value has reached an all-time record[1]
- Globally, acquisition-hungry buyers have announced $2.5T of deals so far in 2021, an unprecedented number that puts this year on track to be the most active ever[2]
- Fully 65% of surveyed dealmakers say environmental, social, and governance (ESG) impact is important when considering a transaction and 51% say ESG factors have a positive impact on the value of the target[3]

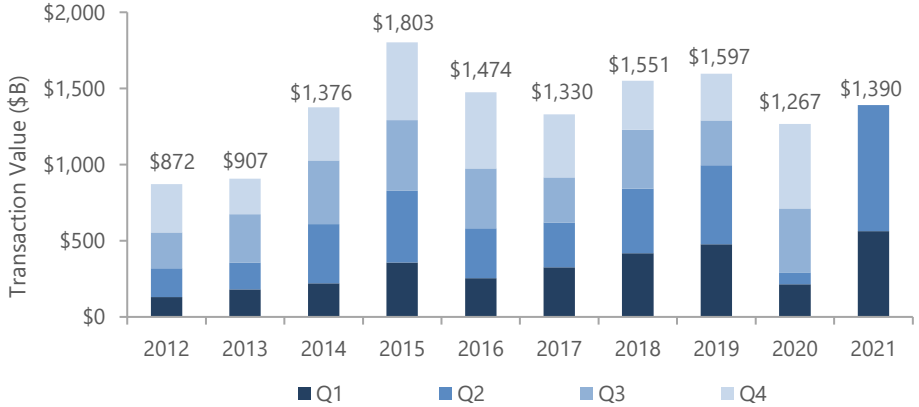
- M&A-related leveraged loan issuance stood at a record $159B in H1 2021, greater than the total issuance in all of 2020 and nearly equal to the total in 2019[4]
- S&P 500 company cash holdings, excluding financial institutions and utilities, remained elevated at $2.0B, giving strategic acquirers ample capital to put to work to drive growth[4]

LTM 2Q21 U.S. M&A <$500M[3]

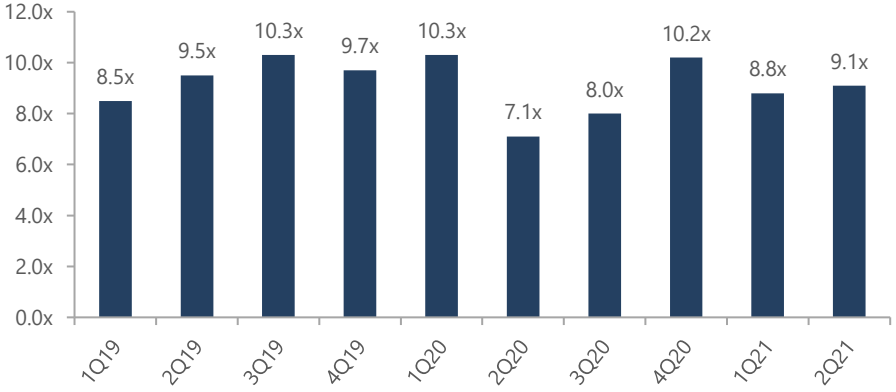


- Due to the heighted risk and awareness of economic disruption, the use of representations and warranties (R&W) insurance is going mainstream; a survey of senior deal-making executives showed that 88% expect their use of R&W insurance to increase over the next 12 months[5]
- In Q2 2021, public companies completed 917 deals worth $324.6B and 23 public companies were taken private in deals worth $70.9B[1]
- During the first half of 2021, SPACs announced 201 business combinations totaling $387.4B[6]
- The median U.S. middle-market M&A EV/EBITDA multiple in Q2 2021 for deals between $1M and $500M was 9.1x, up slightly over Q1 2021[1,7]

U.S. M&A Activity[1,5]



U.S. Middle Market Median EV/EBITDA M&A Multiple[1]



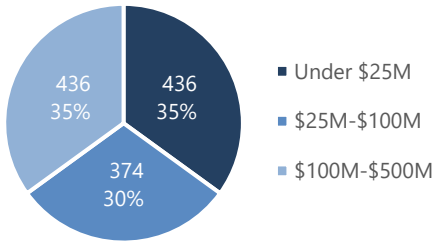
1. *FactSet*
2. *Bloomberg*
3. *Baker Tilly*
4. *S&P Capital IQ*
5. *Mergermarket*
6. *Refinitiv*
7. *These multiples reflect prices paid for mainly large public companies and do not account for smaller private company transactions that tend to change hands at much lower multiples*

Private Equity

Private equity (PE) activity remains strong due largely to substantial dry powder, mega-deals, ample availability of relatively attractive senior and mezzanine credit, and a focus on add-on acquisitions. Exit volume also has been lofty, owing in part to vibrant SPAC and IPO markets and deal thirst by large companies. One side effect of the strong purchase and exit activity among PE firms as well as the influx of sellers ahead of potential tax hikes has been bandwidth constraints that have limited PE firms from considering deals that otherwise would be in these entities' wheelhouses.

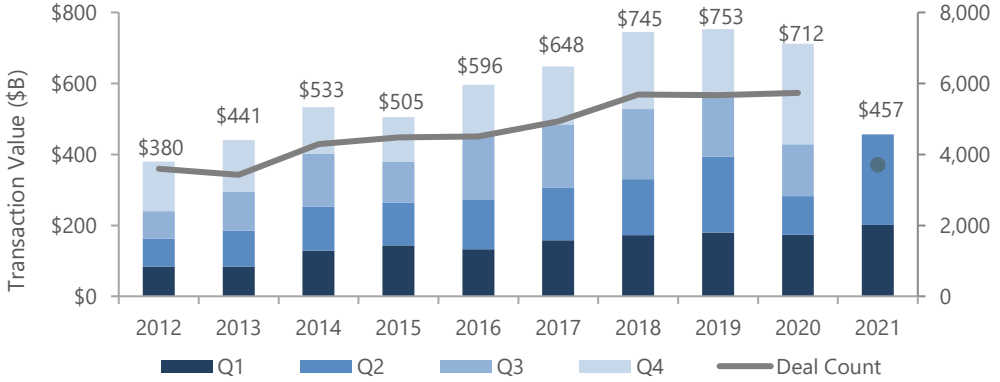
- U.S. PE investment activity notched a record-setting pace through the first half of 2021, with 3,708 closed deals worth a combined $456.6B – nearly two-thirds of the deal value seen in all of 2020[1]
  - This marked the second-highest deal activity in a decade
- Feverish PE activity is being driven by the continued economic recovery, cheap debt, and ample dry powder on the buy side, and by the imminent possibility of a capital gains tax hike and elevated pricing on the sell side[1]
- The total capital investment into U.S. startups jumped from $31.8B in 2010 to $166.0 billion in 2020, representing an expansion of over 5x[1]
  - Non-traditional investors – mutual funds, hedge funds, sovereign wealth funds, pension funds, and corporations – have become a critical piece of the overall market, accounting for 42% of startup financing deals in Q2
- For PE-led transactions between $10.0M and $250.0M, the average EV/EBITDA multiple was 6.8x, according to the most recently available quarterly data[2]
- Add-on investments continue to drive the overall U.S. PE market, accounting for a record 75.7% of all deals in Q2[1]
  - The information technology sector made up the largest share of dollars spent on add-ons at 30.1%

Q2 2021 U.S. PE Deals <$500M[1]

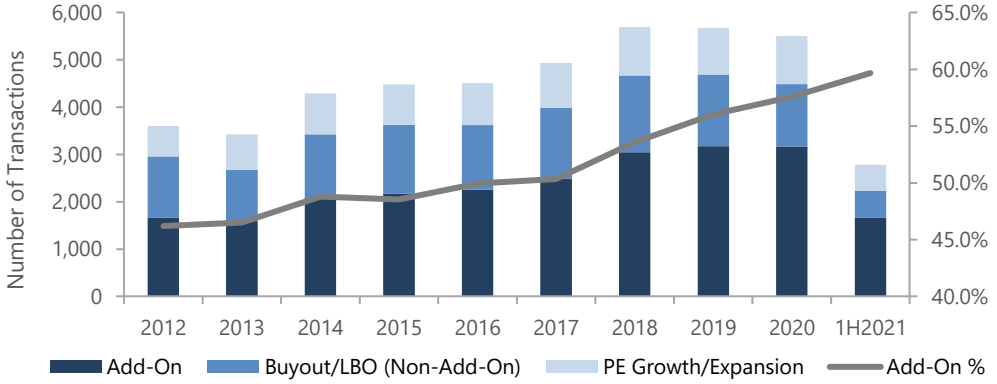


- There was $1.5T in PE dry powder globally at the end of Q2 2021, meaning that acquirers will continue to aggressively seek opportunities to deploy their ample capital[3]
- The public market equivalent (PME) reveals that the ratio of aggregate PE returns to public markets ranged between 1.3x to 1.6x two decades ago; this multiple has slipped to between 0.9x and 1.1x in recent years[1]
- U.S. PE fundraising continued its recovery in Q2, reaching $179.6B in H1 2021, as institutional investors moved away from the conservative decision making they adopted in 2020 and increased their allocation to alternative investments[1]
  - Mega-funds ($5B+) continued to account for the bulk of capital raised, but both middle-market managers and first-time funds also are finding success

U.S. Private Equity Deal Flow[1]



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



1. *PitchBook*
2. *GF Data*
3. *Preqin*

Debt and Equity Capital Markets

Capital markets continue to be inviting on both the debt and equity sides. An easy monetary policy, a strong economy, and robust government spending have kept credit flowing and interest rates low. The search for greater returns has spurred equity markets. The SPAC and IPO markets remain active, though the prospect of increased regulation and Chinese government restrictions are presenting roadblocks. And venture capital fundraising and investing keep on humming given the hype around many unicorns and the expansion of the investor base.

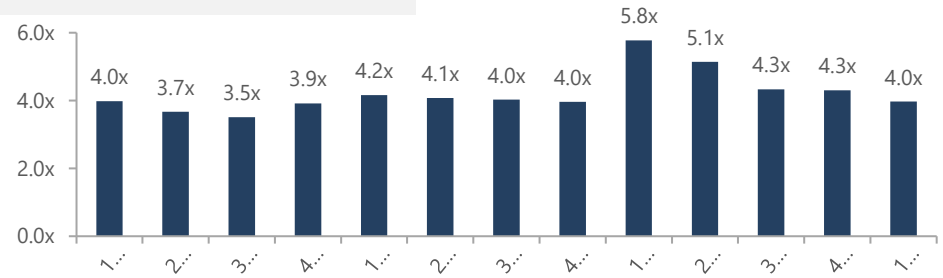
Equity Markets

- After a busy start to 2021, IPO activity in April and May slowed, partly due to the timing of blackout periods and general market volatility; deal activity surged in June, as 57 IPOs were completed – in aggregate, the U.S. IPO market reached record-breaking levels in H1 2021[1]
- SPAC formation slowed during Q2 2021, partly due to the SEC's guidance for all SPACs regarding the accounting and reporting for their warrants[1]
  - The guidance indicated that, in some cases, SPACs should account for the warrants as liabilities rather than as equity, which forced many SPACs to restate their financial statements
- The pressure to execute deals could get more intense in the months ahead due to the nearly 260 SPACs with about $87B on hand that face merger deadlines in the first quarter of 2023[2]
- PE firms are taking portfolio companies public at record levels capitalizing on a highflying market as the strong economic recovery continues[3]
  - In H1 2021, 105 PE-backed companies priced IPOs in the U.S., surpassing the 89 IPOs by sponsor-backed companies in all of last year and more than triple the number of such exits in 2019
- Individual investors have grown in number – more than 10M new brokerage accounts are estimated to have been opened in the first half of 2021, equal to the total for all of 2020[4]
  - Nearly 70% of retailer traders are confident that U.S. stocks will keep rising over the next three months; meanwhile, professional traders are only about 44% confident that the stock rally will continue during that period[5]
  - In each of the four quarters since the pandemic started, companies sold more than $300B of stock – a level not seen since the end of the financial crisis – for a total of $1.3T[6]
- Global venture capital (VC) funding shattered records in H1 2021, reaching $288B, which is 61% ahead of the prior peak and 95% above H1 2020[7]
  - North American VC has outpaced every competing asset class in three-year IRR performance at 18.5%[6]
  - $30.0B has been pumped into e-commerce deals in H1 2021, putting the VC market on track to exceed its $56.1B annual record; e-commerce holding companies like Thrasio and Acquco are gobbling up scores of Amazon third-party brands[8]

Debt Markets

- For PE-led transactions between $10M and $250M, the average total debt/EBITDA multiple was 4.0x according to the most recent available data, reaching the 3.9x to 4.1x range that existed prior to the pandemic for the first time since its onset[9]
- Margin debt across all customer accounts in FINRA-registered institutions hit an all-time high at the end of June, clocking in at $882M[10]
  - Margin debt has been climbing steadily each month since March 2020
- The average 10-year yields on U.S. investment-grade and high-yield debt remain near all-time lows, earning investors 3.0% and 6.3%, respectively[11]
  - The average spread between U.S. investment-grade and U.S. high-yield debt tightened 80 basis points over the Q1 2021 average, as investors chase higher-yielding instruments and accept the risks associated with lower-quality bonds
- The number of private debt funds now sits at 651, more than double the 303 funds in January 2017; these private debt funds have $364B of dry powder[12]

S&P 500 Total Debt/EBITDA[9]



1. Ernst & Young
2. Methuselah Advisors
3. Dealogic
4. JMP Securities
5. Sundial Capital Research
6. PitchBook
7. Crunchbase
8. Refinitiv
9. GF Data
10. FINRA
11. S&P Capital IQ
12. Preqin

Six Steps to Overcoming Supply Chain Challenges in 2021 and Beyond

Most of the challenges supply chain players face in today's market are related to the pandemic and economic shutdowns. Even so, they're no different than what companies have dealt with in the past or what will come after.

Understanding what those challenges mean for the greater market calls for a brief look at current events and existing obstacles.

1. Improving Resilience

The only thing constant in the market and supply chain operations is, interestingly enough, a wave of change. Whether it involves the shifting demands of consumers, raw material and supply shortages, or a global pandemic, something is always changing or evolving.

Despite this, many trends have skewed towards lean processes and a boost in agility. The problem is that in eliminating excess, many of the redundancies that would boost resilience have become less of a focus.

Until now, the tradeoff has been lucrative. By cutting many of those redundancies, operators have been able to conserve funds, reduce operating costs, and speed up mission-critical processes. If there's less inventory on hand, there are fewer goods to sort, worry about, or waste. Unfortunately, the pandemic stomped hard on the entire economy, and not having those extra resources compounded all of the other problems.

The entire supply chain has learned an invaluable lesson about proper balancing, as opposed to leaning heavily on a single paradigm or strategy. Going forward, everyone will be focused on building strong supplier relationships, with multiple access points and opportunities. The goal is to bring some of those redundancies back, without destroying agile processes.

2. Building Out Flexibility

To keep up with market changes, supply chain operations need to be flexible. They need strong alternatives, with clear processes and sourcing adaptations.

How does this differ from resilience? Resilience involves creating a more secure operation, while flexibility is about developing alternatives and fostering relationships to support them.

If one supplier is experiencing delays, then an immediate shift to another, with a reliable supply, may be necessary. Taking that a step further, if that shortage is impacting an entire lineup of suppliers, then it's time to find alternative resources — like a comparable raw material. A move like that cannot always happen quickly or in-the-moment.

Having those avenues in place before an event is the proper solution. The same could be done with regular operations, like a spike in product demands.

3. Unprecedented Visibility

Long before Covid-19, consumers were growing more aware of the environmental impact of their actions and of the companies they're doing business with. This has led to many operators moving not just to more sustainable practices, but also making more transparent moves in the market and sharing them. The pandemic has certainly amplified that need, to ensure safe and healthy practices.

But end-to-end supply chain visibility is challenging, to say the least. That's where modern technologies come into play. Industry 4.0. IIoT (industrial internet of things) devices, supply-related blockchain applications, machine learning, and big data all have a role to play, and they're already being used in the industry to great effect. These technologies also provide a host of benefits, which affect some of the other challenges, like resiliency, flexibility, and security.

More visible practices will become commonplace as supply chain operators work together to create a sustainable, open, and secure network.

4. Data-Driven Operations

The supply chain has always been powered by data, but digitization takes it to a whole new level. Successful management improves planning in operations, materials sourcing, production, and distribution.

Machine learning and advanced analytics will highlight new trends, opportunities, and decisions directly related to the market. A predictive model might help account for a demand shift or shortages before signs of change rear their head. Similar data might empower leaner processes that don't sacrifice mission-critical redundancies.

That's what Industry 4.0 IIoT is all about: smarter and contextually driven processes that utilize real-time market details to bob and weave with incredibly precise actions. It's safe to say that no industry has ever seen anything like this before, which is why these technologies have taken root so deeply and rapidly in the modern world.

Many operators have already adopted and deployed data-driven practices in regular operations, so it's more about discovering new ways to leverage the related solutions. Digital twins have become almost pervasive in the industry, but with the help of artificial intelligence, they can become so much more valuable.

5. International Relations and Trade Agreements

Without touching upon specific events, political or otherwise, the past few years of tumultuous global relations and trade agreements have posed some unique challenges.

In November 2020, 15 countries came together to ratify one of the largest free trade agreements in history — the Regional Comprehensive Economic Partnership (RCEP). While the United States and India withdrew, the agreement still has a significant impact on foreign trade and the supply chain. It should help strengthen the economies in North and Southeast Asia.

Supply chain operators must remain mindful of changes in global interactions and trade agreements, along with any on the horizon, and how they might impact the market, relations, and partnerships. Parsing some of these events is a challenge by itself. There is no straightforward answer, unfortunately, but it does highlight the need to maintain a team of experts for understanding and dealing with them.

6. Trade Disruptions

Despite being a mission-critical component of the modern supply chain, the trans-Pacific trade lane has been disrupted in various ways. From ocean shipping rate spikes due to container shortages, port closures and backlogs, trade tariffs, and physical disruptions like the Suez Canal mishap, there's an ever-growing need to plan for disruptive events and rebound quickly when they do happen.

It's impossible to predict most of these events, which is why resilience and flexibility are so important. Supply chain operators will need to form strong partnerships with all stakeholders across the supply chain to resolve issues quickly and create new opportunities.

Looking to the Future

The entire supply chain faces formidable challenges, and there are no guaranteed solutions. But that doesn't mean there's no way forward. Modern technologies like IIoT and advanced analytics, alongside data-driven operations, can certainly alleviate some of the growing pressure. So can the improved resilience and flexibility of all parties.

Preparing for the future will keep everyone on their toes. But the good news is that there is a light at the end of the tunnel. As the pandemic hopefully winds down, many challenges will become more manageable, as well.

By Devin Partida and USC Consulting Group, LP

About the Author:

USC Consulting Group, LP (USCCG) is an operations management consulting firm that helps client to identify and eliminate wasteful practices and non-value-added processes across the entire supply chain and thereby improve financial performance. Devin Partida is a tech writer at USCCG with an interest in the IIoT and manufacturing. She is also the Editor-in-Chief of ReHack.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