Aramar
Capital Group, LLC

# Middle Market Update

## 3rd Quarter 2015

# Third Quarter Economic Performance and Future Outlook

### Gross Domestic Product

- Real GDP grew at an annualized rate of 1.5% in Q3 2015, down from the 3.9% increase in Q2 2015 and short of the consensus estimate of 2.6%[1]
  - The moderate uptick in GDP reflected positive contributions from personal consumption expenditures, state and local government spending, and residential fixed investment[1]
  - One cause of the deceleration was that real exports of goods and services expanded by only 0.7% in Q3, mainly due to weaker global demand[2]
  - Imports, which are a subtraction in the calculation of GDP, rose 1.7%, up from the 0.5% increase in Q2[2]

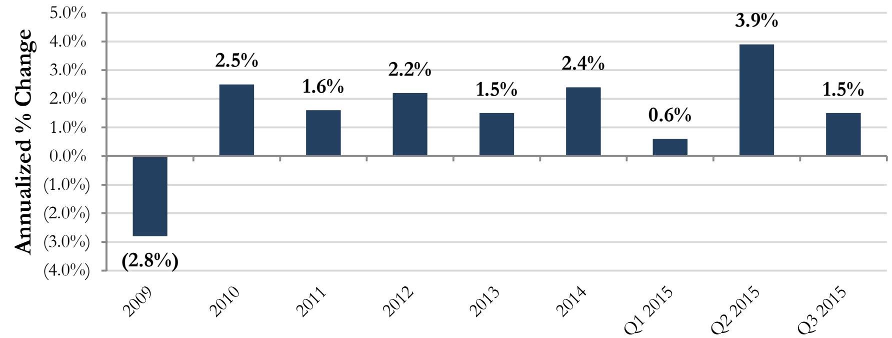
### Consumer Spending

- Consumers were net savers, as real disposable personal income grew 3.5% in Q3, as compared with an increase of 1.2% in Q2, while the personal savings rate edged up from 4.7% to 4.8% in Q3[1]
  - Real personal consumption expenditures rose slightly by 0.2% in Q3, down from the 0.4% increase in Q2
- Private consumption increased 3.2% in Q3, as compared with 3.6% during the prior quarter, supported by low energy prices and labor market gains[1]

### Outlook for Late 2015

- Despite the projected consensus 2.6% GDP growth in 2015[1], U.S. CEOs remain cautious about projected sales, so will be paring capital investments and hiring over the next six months[3]
- The Business Roundtable CEO Economic Outlook Survey shows that U.S. CEOs expect GDP growth of 2.4% in 2015, a 0.1% decline from their prediction as of Q2 2015[4]

**Annualized Real GDP Growth Since 2009**




*Source: Bureau of Economic Analysis.*

### Employment

- In Q3, the unemployment rate was essentially unchanged at 5.0% from Q2, but down 0.7% from the same quarter last year[5]
- Employment rose by 1.1 million people, mainly in the professional and business services, healthcare, retail trade, food services, and construction sectors[5]

### U.S. Treasury Securities

- The U.S. Treasury yield curve experienced significant flattening during Q3, as short-term rates were up marginally and long duration notes dropped in excess of 40 bps[6]

| | Q4 2014 | Q1 2015 | Q2 2015 | Q3 2015 |
|---|---|---|---|---|
| 5-year Treasury Note | 1.7% | 1.5% | 1.6% | 1.6% |
| 10-year Treasury Note | 2.4% | 2.1% | 2.3% | 2.3% |
| 30-year Treasury Note | 3.2% | 2.7% | 3.1% | 3.2% |
| 10-year Treasury Inflation Protected Security (TIPS) | 0.5% | 0.6% | 0.5% | 0.6% |

### Federal Reserve

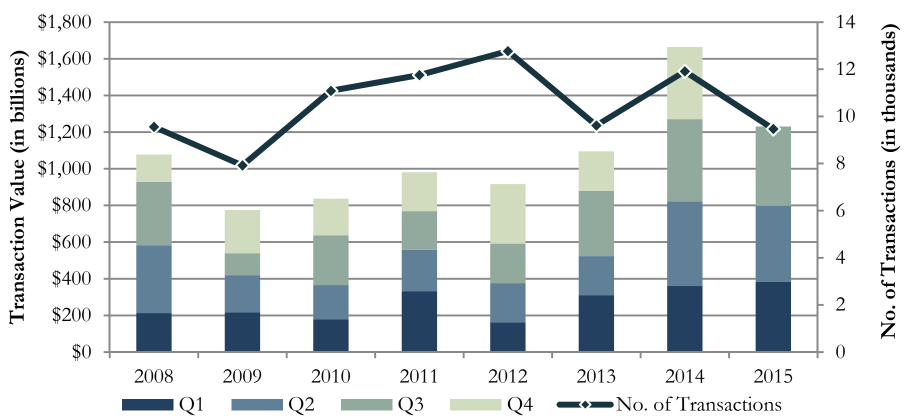
- Markets anticipate that the FOMC will increase the federal funds rate at the December meeting, with the final decision depending on the prevailing unemployment rate, inflation rate, and other economic factors[7]

1. *U.S. Bureau of Economic Analysis*
2. *National Institute of Statistics and Economic Studies*
3. *Regions Financial Corporation*
4. *CEO Economic Outlook Survey published by Business Roundtable*
5. *Bureau of Labor Statistics*
6. *U.S. Department of the Treasury*
7. *U.S. Federal Reserve*

## Mergers and Acquisitions and Private Equity

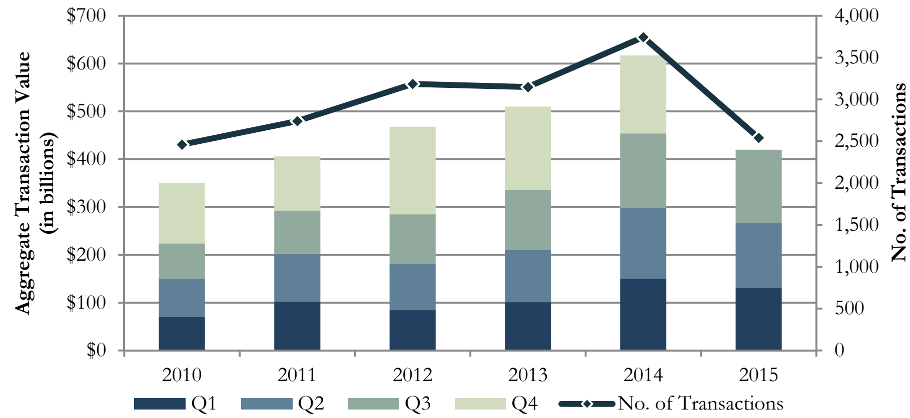
- The aggregate global mergers and acquisitions (M&A) transaction value rose 21.1% to $2.9T over 11,754 deals year-to-date (YTD) Q3, as compared with $2.4T during the same period in 2014[1]
- M&A activity is projected to reach an all-time high by year end, as companies take advantage of low-cost financing in advance of an anticipated increase in U.S. interest rates, and pursue acquisitions to compensate for slowing organic revenue and profit growth[1,2]
- North America accounted for 52% of the global deal value, representing $1.4T through 3,773 transactions YTD Q3 2015[1]
  - Transactions not including a foreign entity accounted for 70.7% of the total North American M&A transactions in Q3
  - Charter Communications' $77.8B acquisition of Time Warner Cable and Avago Technologies' $33.7B purchase of Broadcom Corporation led to the technology, media, and telecommunications (TMT) sector comprising a fifth of all M&A activity in Q3
- The global private equity (PE) market has completed 1,722 buyouts worth $276.6B YTD Q3, decreases of 13.8% and 2.8%, respectively, from the same period in 2014[1]

### U.S. M&A Activity




*Source: FactSet U.S. Flashwire September Report.*

### U.S. Private Equity Deal Flow




*Source: PitchBook.*

- U.S. PE total invested capital finished Q3 with $153.7B across 778 deals, including the $45B merger of Heinz and Kraft Foods Group[3]
- So far this year, 47% of PE deals have been valued at under $25M and 21% have ranged between $25M and $100M[3]
  - Add-on acquisitions accounted for 47% of all consummated U.S. deals thus far this year and for a record 62% of all buyouts
- Overall valuations of PE-acquired companies continue to decrease from 2014, with median EBITDA multiples for buyouts falling to 8.3x in Q3 2015, down from 10.7x in 2014[3,4]
- However, PE multiples for middle-market deals ($10MM to $250MM) improved to an average of 7.1x EBITDA, the highest quarterly mark in at least the past 13 years[5]
- Debt-to-EBITDA multiples are at 5.0x, down from 6.6x and 6.7x in 2013 and 2014, respectively[3]
- PE activity, valuations, and leverage all have declined, as fund managers reel back in the face of aggressive strategic buyers and geopolitical disruptions, preferring to focus on add-ons and smaller transactions

1. *Mergermarket*
2. *The Wall Street Journal*
3. *PitchBook*
4. *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*
5. *GF Data*

# Venture Capital and PIPEs

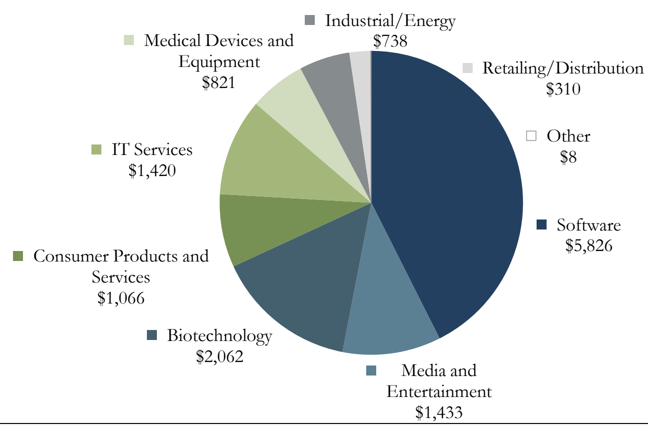
## Venture Capital Investing

- In Q3 2015, the venture capital (VC) industry invested $16.3B across 1,070 deals, a decrease of 5.0% in value and 11.0% in number, as compared with $17.3B across 1,189 transactions in Q2 2015[1]
  - This downturn is attributable to concerns over lofty valuations and reduced exit opportunities
- First-time financings increased 7.0% from Q2 to $2.5B in Q3, while the number of deals declined 3.0% from the prior quarter[1]
- There were a total of 13 VC-backed IPOs in Q3 worth $1.7B, a drop of more than 50% from Q2's 29 deals that generated $3.8B[2]
- VC-backed M&A deals rose 21.6% to 90 transactions in Q3 from 74 in Q2[2]
  - The total value for the 20 deals whose data were disclosed was $5.1B, which was up 39.5% from the disclosed value of $3.7B in Q2 and down 40.8% from the $8.6B in Q3 2014
  - Although VC-backed M&A activity is down from this time last year, it still is seeing more life than IPO volume, which has suffered from fewer billion dollar "unicorn" exits

## PIPE Investing

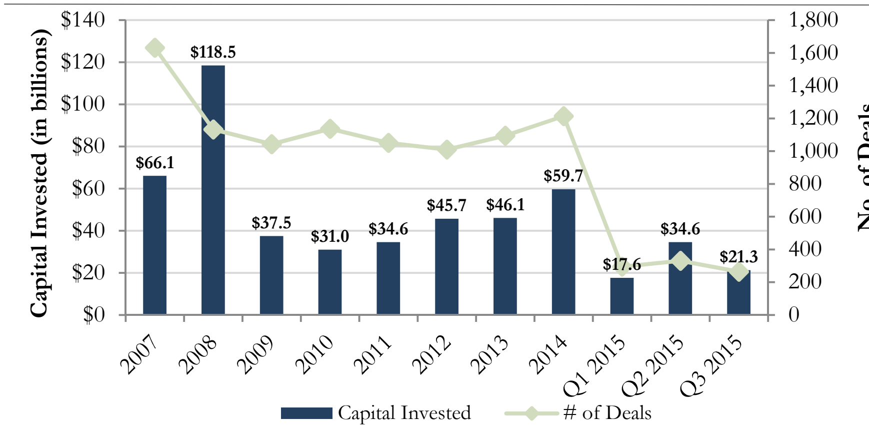
- $21.3B was raised across 264 PIPE transactions that were announced or completed in Q3 2015[3], more than doubling in value from the $9.0B raised across 256 transactions in Q3 2014[4]
  - PIPEs investors believe that the market will have a strong finish in Q4 2015, as the volatility that affected the market in August subsides
  - While Q3's volume was still far lower than the $34.6B invested in Q2, there have been only a few quarters since 2008 in which PIPEs have raised more than $20B
- The most popular deal structure was a common stock offering, which accounted for about 50% of the total, while ATMs were the second most popular, comprising another 18%[4]
- Energy PIPEs stood out in the quarter with 20 deals that derived over $7B, accounting for 34% of the capital raised[4]
  - Energy companies shored up their bottom lines, which were crushed by falling prices and decreased revenues, and set up ATMs for easier access to future capital[5]

### VC Deals Per Industry – Q3 2015 (in millions)




*Source: MoneyTree Report.*

### U.S. PIPE Activity




*Source: PrivateRaise/DealFlow.*

1. *MoneyTree Report by PricewaterhouseCoopers LLC and the NVCA*
2. *Exitround*
3. *PrivateRaise; excludes PIPEs that raise less than $1mm and includes ATM offering facilities for Q3*
4. *PrivateRaise/Dealflow*
5. *ATMs are at-the-market offering facilities, which may not raise capital initially – or ever*

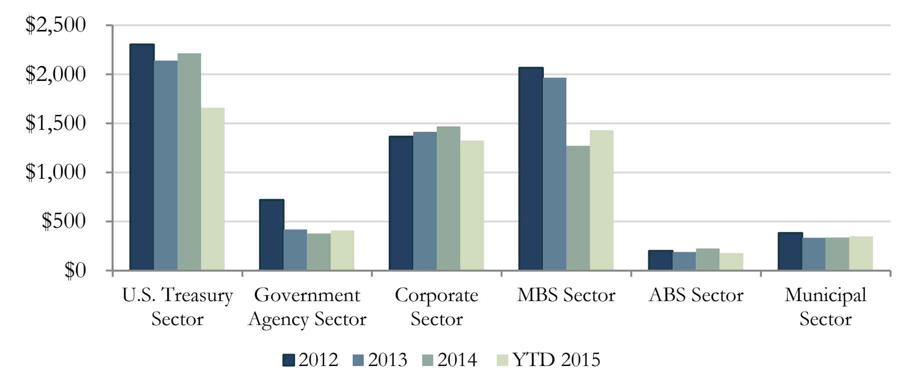
# Debt Capital

- The Barclays U.S. Aggregate Bond Index posted a 1.2% return in Q3 2015, up sharply from a negative return of 1.7% in Q2 2015[1]
  - Market conditions were often challenging, as investors tried to adjust to the effects of slowing global growth, lower commodity prices, uncertainty over the Fed's interest rate stance, and increasing leverage from debt-financed acquisitions, dividend payments, and share buybacks
- The Barclays U.S. Corporate Bond Index posted a positive 0.8% return in Q3 2015, driven by a flight by investors to higher quality fixed income securities and many consumer-related sectors benefitting from a pick-up in U.S. economic growth this year[1]
  - U.S. corporate spreads over similar maturity Treasuries rose 24 bps from 145 bps in Q2 to 169 bps in Q3
- Total debt issuances decreased 11.2% from $1,736.0B in Q2 to $1,541.9B in Q3[2]
  - The overall decline was driven by a 35.9% drop in asset-backed bond issuances, down markedly to $38.6B from $60.1B in Q2
  - Corporate debt securities issuances decreased 27.9% from $450.1B in Q2 to $324.5B in Q3
- By delaying the rate hike, the U.S. Federal Reserve exacerbated investors' fears that global turmoil stemming from the unresolved troubles in Greece, Syria, and China could have real adverse consequences for the U.S. financial markets[3]
- The Credit Suisse High-Yield Bond Index posted a loss of 5.2%, which is the worst performing quarter since Q4 2008[3]
- The Barclays U.S. Corporate High Yield Index spiked 78 bps and ended the month above 8.0% for the first time since 2012[4]
- Approximately 16.0% of all U.S. bonds rated below investment grade traded at distressed levels, the biggest share since 2011[6]

**Middle-Market Loan Issuances**

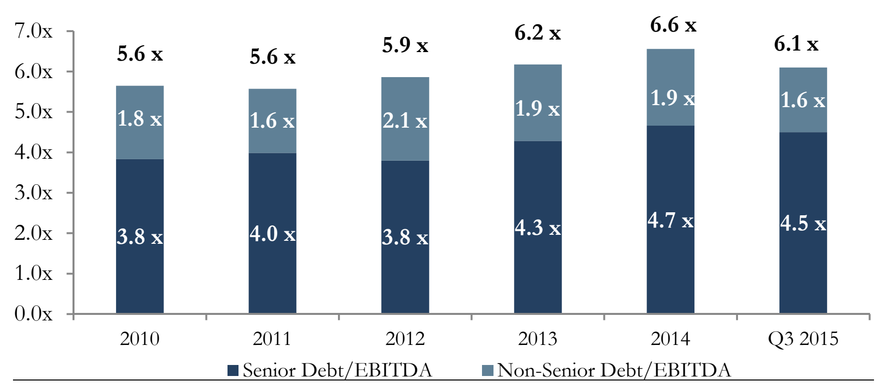
- Middle-market yields increased to 6.3% in Q3, up from 6.0% in Q2[4]
- Leverage multiples for broadly syndicated LBO transactions have decreased in 2015, following four years of consecutive growth[4,5]
  - The average debt-to-EBITDA multiple has declined to 6.1x for broadly syndicated LBOs, but increased to 5.5x for institutional middle-market LBOs
- Middle-market lending stands at $102B YTD, with 24.5% for transactions under $100M and 75.5% in the $100MM to $500M range[4]

**Issuance 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. *Standard & Poor's*

**By Peter M. Miller, Esq., Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.**

Business owners face difficult choices as they decide on a succession plan for their business or, alternatively, on a strategy for selling their business. Often, there are hard choices to be made that involve a tension between an emotional desire to pass the business to family members or key managers versus the harsh realities associated with succession planning that often leads to a decision to sell, not to mention the desire to achieve the maximum financial reward (valuation) for a lifetime of hard work.

Sometimes a situation is straightforward. For example, for a business owner with no heirs involved in the business and a desire to retire and enjoy life, selling is an obvious solution. Here, there are still planning considerations to get right. For instance, will a buyer want the seller to continue to work after a sale to ensure a smooth transition to the new ownership? Are there corporate structure, tax, financial auditing, or other matters that need to be addressed to "groom" the business to maximize the eventual net purchase price proceeds? Often, the presence of a seller's market will drive the timing of a transaction to a greater degree than the optimum sale date envisioned by the owner.

Other situations are far from straightforward. Nonetheless, selling the business sooner rather than later may be the preferred alternative. Consider, for example, a business owner whose company constitutes the majority of his/her net worth; one child works as a senior executive in the business, but other children are not involved. All of the children are from the owner's prior marriage, and the owner wants to treat them equally and provide for his/her current spouse. This is not an uncommon situation, and it raises difficult issues that need to be worked out to make a plan succeed, including:

- <u>*Planning for estate taxes*</u>: Once an estate exceeds the threshold for the federal estate tax, the tax is imposed on the portion of the estate in excess of the threshold at a 40 percent rate. In states that still impose a state-level estate tax, the top combined federal and state estate tax rate is almost 50 percent. (While the estate tax generally can be deferred until the death of the surviving spouse using marital deduction planning, this isn't available for single business owners, and marital deduction planning frequently is not appropriate in second marriages.) There are special estate tax rules that provide for a deferred payment of the portion of estate taxes attributable to closely-held business for up to 15 years, but these rules are complicated and are not a panacea. Careful planning for the estate tax often is needed to address estate tax liquidity needs, including life insurance planning to provide cash for taxes and lifetime gift planning to minimize overall transfer (estate and gift) taxes. If the estate tax is paid using other estate assets, the family's wealth will be even more concentrated in the business, and if it is financed (through bank borrowing, or by the IRS if the estate is eligible for estate tax deferral), the family's debt burden and risk profile will increase, especially if the taxes will have to be paid over time using future profits of the business.

- <u>*Capabilities of successor management*</u>: Objectively assessing the strengths and weaknesses of one's offspring or trained successors naturally can be a challenge. Even if successor management is capable at the time, they may not be able to navigate the business as it evolves through a changing environment. An owner needs to preserve the wealth he/she has built for the benefit of his/her entire family (and the company itself) and try not to let biases cloud his/her decision

- *Equal treatment of children*: In the above example where the business is the majority of the owner's net worth, there is no possibility that, even before consideration of estate taxes, the business can be given to the child who works in the business and other assets of equivalent value given to the owner's other children while simultaneously providing for the owner's surviving spouse. Something has to give, and there are a number of possibilities.

  - *Selling the business to the participating child*: Under this strategy, through a prearranged buy-sell agreement, the participating child will purchase the business from the owner at the owner's death for an installment note. Thus, the participating child gets the business, and the owner's widow and other family members get the participating child's promissory notes. Assuming fair pricing of the business, economic equality among the beneficiaries nominally is preserved. But the potential intra-familial pitfalls associated with creating a debtor-creditor relationship between the participating child and the other family members are apparent. In addition, the non-participating family members effectively bear equity downside risks (if the business fails, they don't get paid), but typically receive below-market interest on their promissory notes that does not compensate them for the risk. Often, those members realize that they would have been better off had the business been sold.

  - *Distributing business interests among participating and non-participating family members:* This strategy allows for equal treatment among children – but now the participating and non-participating family members are business partners, which can be problematic, particularly if there is not a concerted effort to educate family members on their roles and responsibilities as business co-owners or if the participating member begrudges his/her relatives for profiting off of his/her labor.

  - *Distributing business interests among participating and non-participating family members (continued):* Often, arrangements are made by the owner to give voting interests in the business to the participating child and non-voting interests to non-participating family members. That strategy can make sense, but it also creates the possibility of running or retaining the business based on the decisions of the minority owner notwithstanding the wishes of the majority.

  - *Disproportionate distribution to participating child*: Under this strategy, an owner decides to give the business to the participating child and lesser amounts to other children. This unequal result can sometimes be justified on fairness grounds – for example, an owner could conclude that the participating child "earned" the ownership based on the child's prior contributions to the success of the business. Of course, other family members may not see it that way, and family discord – a result most owners desperately want to avoid – can result in the absence of planning and clear communication.

As suggested above, a business owner wanting to keep a business in the family – but also wanting to make the right decision that furthers the family's overall best interests – will, after proceeding through a comprehensive business succession planning process, realize that his/her initial decision to retain the business did not factor in considerations that suggest that selling the business may be a far better alternative for the sake of the family. Moreover, the value of the business very well may be maximized by selling it rather than holding it, with diversification of financial risk for the family a critical consideration. The next generation may be better off applying their respective shares of the proceeds to investments and new business ventures. For these reasons, the selling alternative should be revisited periodically in light of changed circumstances and the owner's developing understanding of business succession challenges.

**About Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.**

*Mintz, Levin, Cohen, Ferris, Glovsky and Popeo is a leading national law firm with 500 attorneys located throughout the United States. It has deep experience in working with entrepreneurs throughout the full cycle of a business; from creation to successful exit. Mintz Levin is known for its responsiveness and aggressive problem solving, providing clear answers and sound solutions. Peter Miller is the Chair of the firm's Private Client Practice. He represents individuals, businesses, and charitable organizations in a broad spectrum of matters involving estate planning and administration, business income taxation, general business planning, and the creation and administration of private foundations and public charities.*

# 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.

**489 Fifth Avenue, 16th Floor • New York, NY 10017 • 212-708-0700**