Aramar
Capital Group, LLC

Deal Market Perspective

4th Quarter 2020

Economic Overview

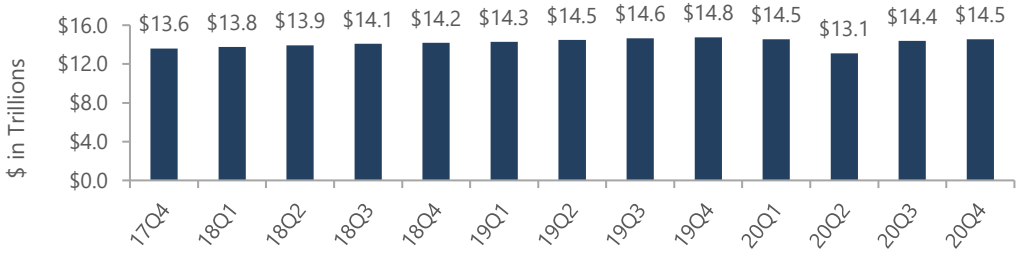
Aramar Capital Group, LLC

It certainly was a wild ride in 2020! Closing out a challenging and unprecedented year, the U.S. economy continued to rebound during Q4 2020, albeit at a slower pace, driven in large part by growth in certain in-favor industries, solid consumer spending aided by access to increased savings, and low interest rates. But unemployment remains high, especially in restaurant, entertainment, travel, and other industries experiencing turbulence due to the ongoing Covid-19 pandemic.

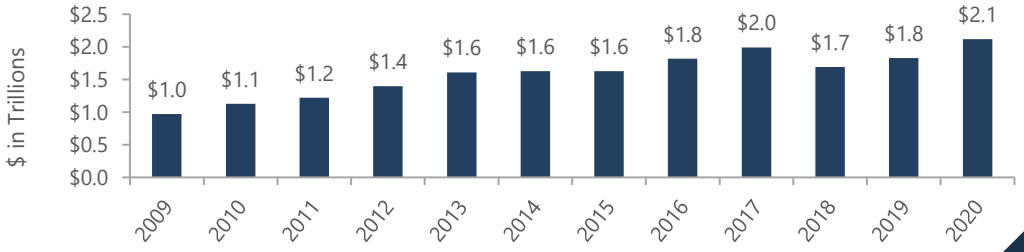
Optimism abounds in 2021. Vaccines are being administered, a new administration with its party (barely) controlling Congress is proposing sweeping stimulus measures (enhanced unemployment benefits, small-business loans, and direct payments to households), the Fed is maintaining a loose monetary policy, and both household and corporate cash levels are lofty. Still, the virus and its variants rage, day-to-day life and business activities are crimped, and individuals and companies in disrupted industries are struggling.

- The U.S. unemployment rate declined to 6.7% at the end of Q4 2020, as compared to 7.9% at the end of Q3 2020
- Americans' income from unemployment insurance benefits was 25 times higher from March through November 2020 than the year-earlier period
  - In total, unemployment insurance programs pumped $499 billion more into Americans' pockets from March to November 2020 than during the previous year; $365B of it was a result of the expansion of the CARES Act
- The Paycheck Protection Program (PPP) prevented a collapse in "proprietor's income;" this income rose by $29B, but would have fallen by $143B if not for the PPP and a food assistance program
- Americans' cumulative after-tax personal income was over $1.0T higher (>8%) from March to November of 2020 than in the year-earlier period
  - At the same time, spending dropped, primarily as a result of expenditures on services falling by $575B
- The combination of soaring personal income and falling spending pushed Americans' savings rate through the roof; from March through November, personal savings was $1.56T higher than in 2019, a rise of 173%
  - The U.S. personal saving rate was 13.7% in December, down from 33.7% in April but still well above the pre-pandemic level of around 8.0%
  - Historically high savings and further stimulus payments could enable Americans to boost spending later this year, fueling the economic recovery
- The Federal Reserve expects to hold short-term rates near zero for at least three more years
- The Congressional Budget Office anticipates that the U.S. economy will return to its pre-pandemic size by the middle of 2021, even if Congress does not approve any more federal money to aid the recovery
- 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 86.2 in Q4 2020, up 22.2 points from Q3 2020 and 49.9 points over Q2 2020; it is now above its 18-year historical average of 81.5
- Goldman Sachs expects U.S. GDP to grow 6.4% in 2021, after contracting 3.5% in 2020
- U.S companies are sitting on the largest pile of cash ever, with cash holdings at non-financial companies reaching a record $2.1T
- According to Digital Commerce 360, U.S. online spending increased by 44.0% in 2020; e-commerce now accounts for 21.3% of total retail sales

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



U.S. Non-Financial Corporate Cash[2]



1. *Federal Reserve Bank of St. Louis*
2. *Moody's Investors Service*

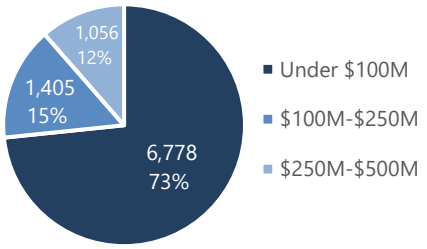
Mergers and Acquisitions

In March and April of 2020, a projection that the M&A market would be robust later in the year would have seemed foolhardy to say the least. But low interest rates, high corporate and private equity (PE) cash levels, and the consolidation of certain industries paved the way toward strong activity and valuations, as did a push to complete transactions by year end to beat potential tax increases for business owners, investors, and PE partners. It certainly was a case of the haves and have-nots, as troubled industries experienced high transaction volume out of necessity and industries that benefited from the pandemic (e-commerce, household and outdoor consumer goods, technology, telehealth, etc.) saw deal activity mushroom.

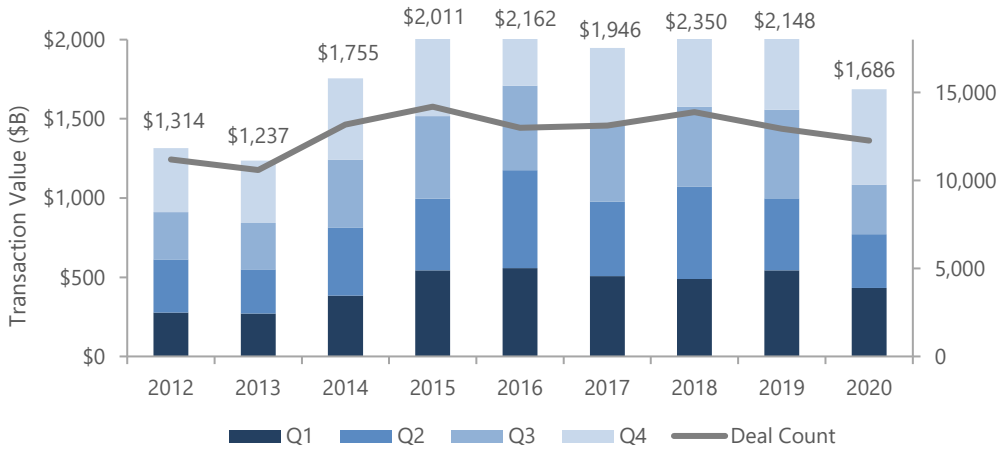
These trends (other than tax-related ones) should continue into 2021, especially with the influx of cash-rich special purpose acquisition companies (SPACs) needing to employ their capital and with acquirers adjusting to the new norms of virtual due diligence (see the guest article by EY later in this report for more on this topic).

- While 2020 deal value and deal count in North America (N.A.) dropped to the lowest levels seen since 2013, Q4 2020 experienced a strong surge, as buyers and sellers raced to close deals by year end
- The $602.8B of deal value in Q4 2020 was the highest seen in a single quarter in two years and the 3,745 deals that closed were the most in nearly three years[1]
- In the final two weeks of 2020, 2,496 M&A transactions were announced globally, an all-time record that was driven partly by the desire of U.S. sellers to complete deals prior to a Democratic administration that could raise taxes[2]
- Dealmaking in 2020 was dominated by smaller transactions, as 73.4% of the sub-$500 million N.A. M&A market was accounted for by transactions under $100 million[1]
- In 2020, the median N.A. M&A EV/EBITDA multiple reached the highest it has been in over a decade at 10.3x, as compared to 9.9x in 2019[1,3]
- Not surprisingly, the $186.5B of cross-border M&A deal value in N.A. in 2020 (N.A. M&A transactions with non-N.A. acquirers) fell to the lowest level seen since 2013[1]

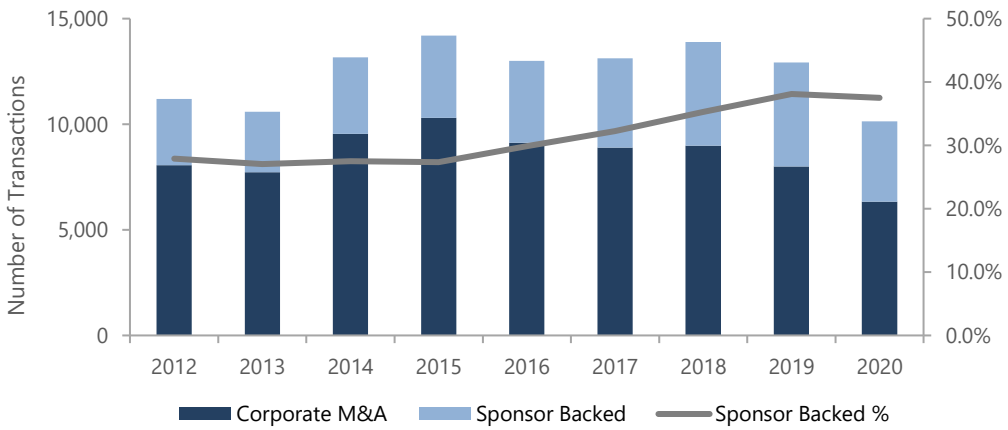
2020 N.A. M&A >$500M[1]



North American M&A Activity[1]



North American PE vs. Corporate M&A Breakdown[1]



1. *PitchBook*
2. *Bloomberg*
3. *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*

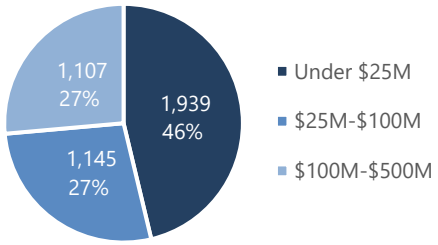
Private Equity

Although PE transaction volume was down for the year, PE firms began and finished the year sitting on mounds of dry powder, which continues to spur deal activity, as that cash must be deployed. PE professionals increasingly sought to take advantage of existing platform investments and expand their focus on add-on acquisitions, thereby becoming more akin to strategic buyers. This helped keep purchase price multiples at relatively lofty levels, albeit with a greater share of transaction consideration being in the form of contingent payments. PE fundraising was slow as the pandemic unfolded, as would be expected, but rebounded as the year progressed as institutional investors chased high returns, mostly by putting capital into funds with established track records.

- There was $2.5T in PE dry powder globally at the end of 2020, meaning that acquirers will continue to aggressively seek opportunities to deploy their ample capital[1]
- U.S. PE investment activity in 2020 totaled $708.4B across 5,309 deals, representing year-over-year dips of 7.3% and 3.4%, respectively[2]

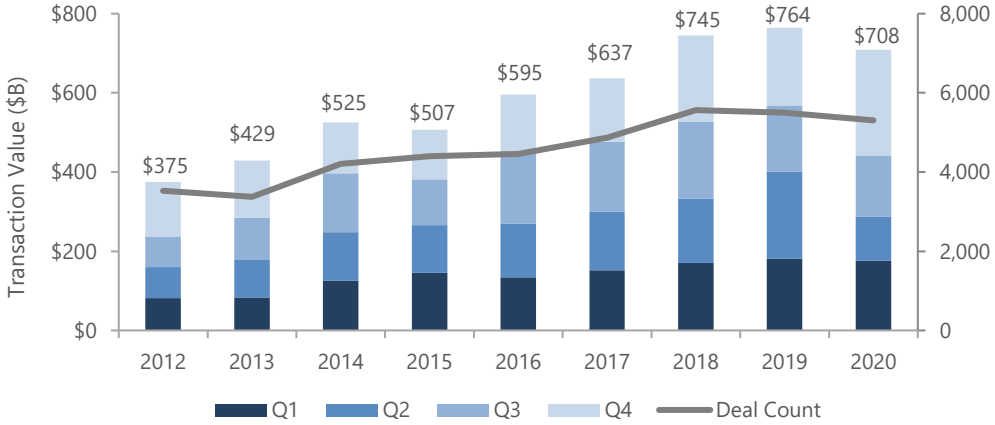
- Following market headwinds that slowed U.S. PE deal flow through the first three quarters of 2020, Q4 was the single most active quarter in over a decade, with 268 transactions worth a total of $267.8B[2]
- Add-on investments continue to drive the overall N.A. PE market, accounting for 72.5% of all deals in 2020, the largest percentage ever[2]

2020 U.S. PE Deals >$500M[1]

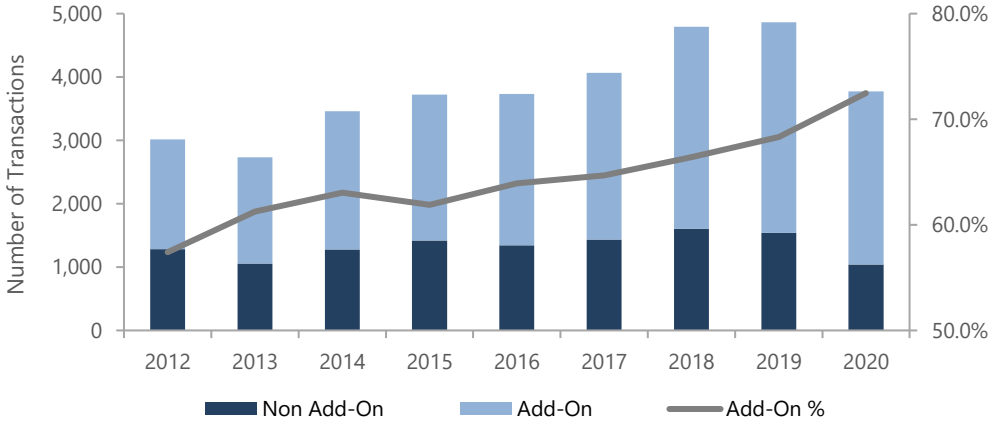


- For PE-led transactions between $10.0M and $250.0M, the average EV/EBITDA multiple was 6.7x, according to the most recent available data, below the 7.3x average during the previous trailing 12-month period[3]
- The portion of transaction consideration represented by forms other than cash (earnouts, seller paper, rolled-over equity, etc.) has risen, as PE buyers seek to share the risk that financial results have been skewed upward or downward by the impact of the pandemic
- U.S. PE fundraising in 2020 fell to $203.2B, its lowest volume since 2016, while the total count of new funds fell to 231, the lowest level since 2012[2]
  - $5.7B of capital was raised across 25 first-time funds in 2020, the lowest number since 2013

U.S. Private Equity Deal Flow[2]



North American PE Deal Activity by Type[2]



1. *Bain & Co.*
2. *PitchBook*
3. *GF Data*

Debt and Equity Capital Markets

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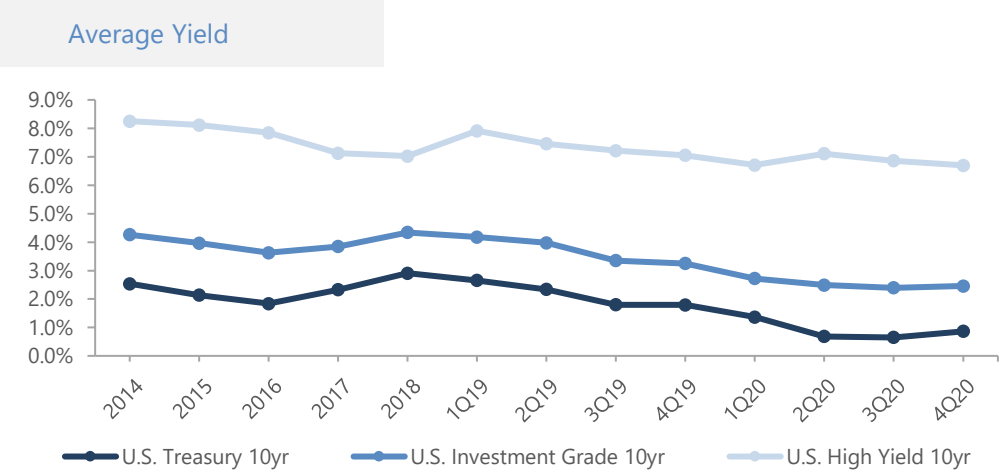
After equity and debt markets initially sank as the pandemic spread, investors took a longer-term view of valuation metrics and capitalized on relatively cheap securities. Low inflation and easy money kept interest rates low, boosting the attractiveness of stocks. Businesses positively impacted by the stay-at-home environment exploded and saw their valuations and access to capital follow suit. In particular, the IPO market surged with big-name disruptive companies and SPACs leading the way. All of these factors led to a relatively strong Q4 in 2020.

Equity Markets

- The S&P 500 trades at 22 times analysts' expected earnings over the next 12 months, its most expensive level since the dot-com bubble[1]
  - The total value of stocks as a percentage of the economy, which Warren Buffett called "the best single measure of where valuations stand at any given moment," is now higher than at any point during the dot-com years
  - AirBnB was the 19th company in 2020 to double in its first day of trading, the most since the early 2000's
- Excluding SPACs, companies issued $342B of stock in 2020, 76% more than in 2019; IPOs accounted for $85.3B of that total, spread across 247 deals, an increase of 32% over the 187 non-SPAC IPOs seen in 2019[1,2]
- SPACs raised $82.1 billion in 2020, more than six times the amount raised in 2019 and a figure greater than all previous SPAC proceeds combined[2]
  - In 2020, 247 SPACs went public, accounting for 49.2% of all IPO proceeds[1,2]
- On average, SPACs that completed mergers between January 2019 and June 2020 lost 12% of their value within six months following the merger, while the Nasdaq rose roughly 30%[3]
  - SPAC sponsors, which typically retain a 20% equity stake, realized a return on investment of over 500% as of the end of 2020
- U.S. venture capital-backed companies raised $130B in 2020, a 14% increase over 2019[4]
  - There are a record 225 unicorns in the U.S. (private companies with valuations over $1B), 28 of which reached this milestone in Q4 2020
- After spending much of the last 12 months fluctuating around $10,000, Bitcoin began surging in Q4 2020, breaking $40,000 in January
  - Much of this rally is attributable to institutional buying, including a $100M purchase by MassMutual, indicating that Bitcoin is gaining mainstream acceptance
- Certain publicly-traded equities with high levels of short interest have been subject to extreme volatility, including GameStop, AMC, Nokia, American Airlines, and Blackberry, as retail investors have utilized the online forum Reddit to organize a powerful short squeeze
  - While the price movement is largely detached from fundamentals, certain of these companies are taking advantage of the opportunity by selling additional stock to shore up their balance sheets; AMC raised over $300M and American Airlines plans to raise as much as $1.1B in at-the-market stock offerings

Debt Markets

- For PE-led transactions between $10.0M and $250.0M, the average total debt/EBITDA multiple was 3.7x according to the most recent available data, an increase over the 3.3x seen during the onset of the pandemic[5]
- Q4 2020 middle-market LBO leverage multiples were 5.5x for senior leverage and 6.2x overall, increases from the 5.1x and 5.4x multiples, respectively, seen in Q4 2019[6]
- Bond issuance soared to a record $2.3T in 2020, 60% higher than the total seen in 2019, as companies took advantage of low interest rates, and those hit hard by the pandemic raised much needed cash[7]
- The average 10-year yield on U.S. investment grade and high-yield debt are near all-time lows, earning investors 2.5% and 6.7%, respectively



1. *FactSet*
2. *Dealogic*
3. *The Wall Street Journal*
4. *PwC*
5. *GF Data*
6. *William Blair*
7. *Securities Industry and Financial Markets Association*

How the COVID-19 Pandemic Affects M&A Transaction Execution

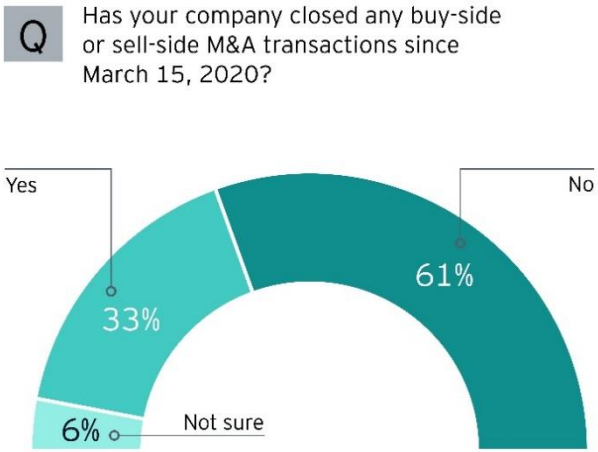
The COVID-19 pandemic may have impacted M&A activity, but there are ways to make transactions work, even in a remote environment.

In brief

- Deals are closing but with more flexible deal structures and virtual post-merger integration.
- Creative solutions should be embraced to establish and maintain relationships with buyers and sellers.
- Valuations have largely come down as a result of the pandemic, but closing mechanisms can help bridge value gaps.

In a recent EY webcast, 33% of the participants said their companies had closed an acquisition or divestiture since March 15, 2020, when the COVID-19 pandemic began to have a significant impact on U.S. businesses. But there are ways to conduct negotiations, perform due diligence, and carry out other work needed to close a transaction, including post-merger integration, in a remote work environment.

"We're all learning that there's a lot more that we can do virtually than we ever appreciated," Chris Rose, Senior VP, Global Business Development, Procter & Gamble Co., said. P&G has closed some transactions during the pandemic, including a divestiture, a small acquisition and some refinancings, he said.



Building relationships virtually

Rose and three others who spoke about closing transactions and integrating companies during the pandemic said that some of the personal interactions that often make deals happen were at risk of being lost in the virtual environment.

"The loss of that personal connection, sitting in a room with the other side when there is a hard discussion — that we haven't figured out how to make up for," Rose said.

Having long-term relationships with the other side can pay off. Sharon Van Zeeland, Director, Corporate Development Operations, Rockwell Automation, noted that Rockwell builds relationships with potential acquisition targets over time. That long-term approach paid off when the company closed two significant transactions during the pandemic.

Rockwell had already signed the purchase agreements before the pandemic hit but found that there were hurdles in executing the deals during the lockdown. One acquisition was in Italy, which is a very face-to-face culture. In both cases, Rockwell found individuals in the target's country to put on-site during the sign-to-close period to help manage the relationships, while also continuing virtual discussions with management.

In fact, maintaining the personal touch in a remote environment can take a great deal of creativity. EY recently helped facilitate a fully remote transaction close and integration. According to Elizabeth Kaske, Principal, Strategy and Transactions, Ernst & Young LLP, the approach incorporated extensive use of video calls and encouraging one-on-one discussions to build relationships.

There was even more than typical engagement and accountability from C-suite management in the integration, as managers had fewer distractions than would normally be the case. Several Day 1 must-have items were accelerated due to concerns about pandemic-related volatility in the industry.

While the pandemic is making it harder to meet with executives in person, Bradley Brown, Director, Private Equity, KKR, said that he is instead having more introductory calls with CEOs and CFOs, since he is not spending time on an airplane. "It's a good time to build relationships that will pay off down the road."

Remote due diligence

Much of the due diligence in an acquisition is already being done virtually, which can help with a remote closing and integration. In the integration that Kaske led, due diligence had been completed and much of the data was already set up in such a way that it could be leveraged into a virtual clean room.

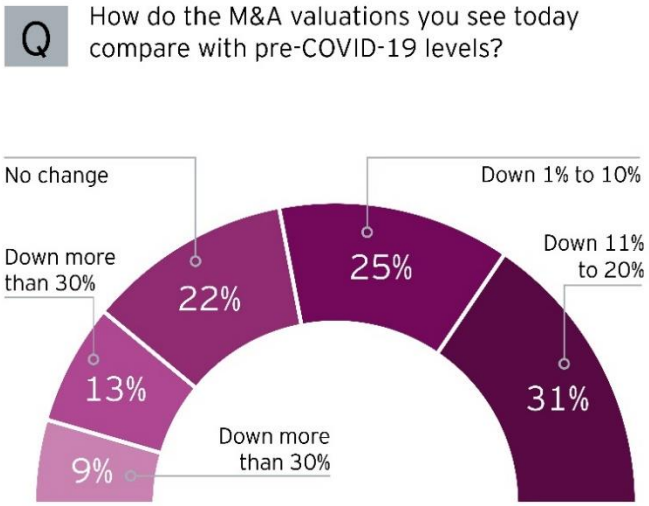
Brown noted that private equity investors are increasingly moving to more data-intensive due diligence, leveraging advanced analytics to assess large amounts of data, often in areas that were previously out of scope for traditional due diligence. This includes analysis of computer code and historical transaction-level data, which can all be performed in a remote environment.

Companies have also been creative in managing site visits during due diligence. In some cases, P&G has been able to conduct virtual plant tours of businesses it was divesting, with the buyers being able to ask questions of those conducting the tour. In cases where a physical tour is necessary, P&G has considered a "double signing" period, which would allow it to notify employees of the sale in the timely manner required by labor law, but still giving the buyer a chance to come to the facility and engage with employees later, when appropriate, before the deal closed. The challenge is to "engage with employees at the right time in a respectful manner," Rose said.

The well-being of employees is at the forefront of dealmakers' minds. In Rockwell's case, the company paused its two deal processes when the pandemic hit to make sure that people at the companies they were acquiring were healthy and safe and to collaboratively figure out the next best steps, Van Zeeland said.

Board meetings have also become remote during the pandemic, Brown said, noting that he expects that some board meetings will remain remote even after the pandemic.

Uncertainty puts pressure on valuations



The pandemic has had an impact on valuations, most webcast attendees agreed, though the level of impact varied and 22% said there was no change to valuations from pre-pandemic levels.

For Rockwell, the two transactions it completed in recent months filled a strategic gap, Van Zeeland said. Once the pandemic hit, the company reviewed the deals and decided the upside remained, so the valuations did not change significantly.

P&G's Rose said that uncertainty was putting pressure on valuations, though smaller companies were being hit more as retailers carry fewer SKUs and consumers focus on well-known brands.

In terms of private equity deals, for the best assets, the price remains the same as it was pre-pandemic, Brown said. Public equity and debt markets have held up, which has taken away some opportunities to acquire assets at a lower valuation. If the buyer is not willing to meet the asking price, the seller will wait. There will be some consolidation in industries, with more successful companies acquiring technologies or products to fill in their portfolios.

Bridging the valuation gap

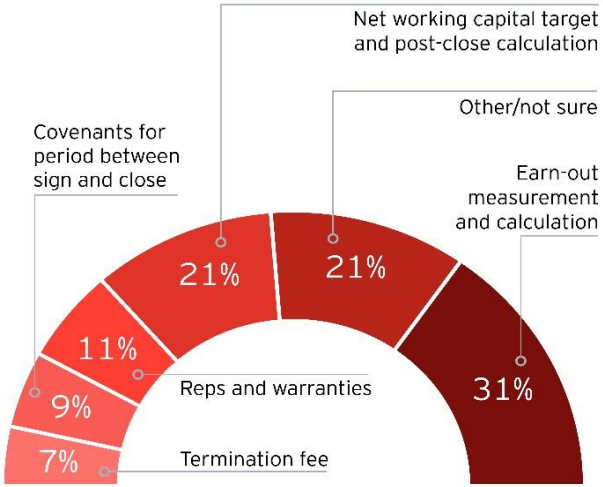
It is essential to properly negotiate deal terms, such as earn-outs and net working capital. In our webcast poll, these were also the two levers most often named as representing the greatest business risk if not negotiated properly.

Some companies are using these mechanisms more frequently now to bridge the valuation gap, and EY has also seen both an increase in the volume of accounting-related arbitrations for transaction disputes and a decrease in the dollar threshold for these disputes.

Van Zeeland said that mechanisms for a combined sharing of future success, including the use of earn-outs and retention agreements, are being employed more heavily during this time.

There is also more pressure testing on synergy assumptions and more direct conversations about issues than in the past, Kaske said. "It was really important to not brush anything under the rug because you never knew when the rug was going to be pulled out relative to the market."

Q In the current environment, which of the following deal terms represents the greatest business risk if not negotiated properly (excluding purchase price)?



Brown noted that he has seen a rise in structured transactions for pandemic protection, with sellers often asking to roll over a higher share of the deal consideration in equity. "Trust is important in this market. We've been getting deals done because people can trust that we are going to show up."

Conclusion

The pandemic has caused a great deal of uncertainty in the deal market, especially as government lockdowns and company health and safety policies require teams from both sides to work remotely. Despite these challenges, there are ways to complete deals. Acting with integrity will set deal executives up for success longer term.

"How people behave during this crisis will impact their brand after the crisis," Brown said.

Authors:

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Elizabeth Kaske, Principal, Strategy and Transactions, Ernst & Young LLP

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