M&A and Market Update

June 2017

GLEASON
ADVISORS

Gleason Advisors Service Offering

Gleason Advisors provides strategic & financial advisory services to middle market companies through the following offerings

Investment Banking*

Sell-Side

- Run the marketing process for the sale of a business
- Approximate financial criteria
  - Revenue: $5 - $150 million
  - EBITDA: $2 – $10 million
- Industry Agnostic

Buy-Side

- Investment thesis origination
- Prospective target outreach
- Arrange acquisition financing
- No size criteria for target

Capital Raise

- Growth Equity
- Venture Capital
- Business plan development

Strategic Consulting

Business Valuation

- Auction value expectations, along with accredited (ABV / CPA) valuations (income, asset, market approaches)
- Intellectual Property valuations
- 409A Valuations
- Estate and Gift Valuations

Strategic Financial Advisory

- Detailed financial modeling
- Unit level product economics and detailed customer analysis
- Debt capacity and lending covenant analysis
- Exit planning strategy and timeline
- Profit improvement strategy
- Cap table management

Restructuring

Out-of-Court Services

- Operational assessments
- Refinancings, asset sales, capital infusions
- Liquidity management
- Valuation (liquidation, asset sale, auction)
- Litigation support and expert testimony

Bankruptcy

- Run §363 sales
- Court appointed trustee / receiver
- Prepackaged Chapter 11 plans
- Arrange DIP financing

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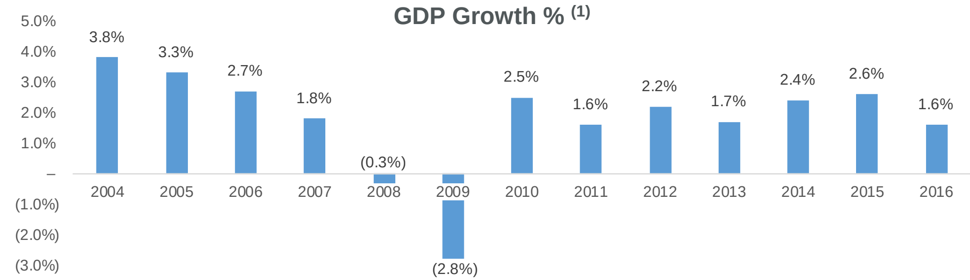
Key Economic Indicators

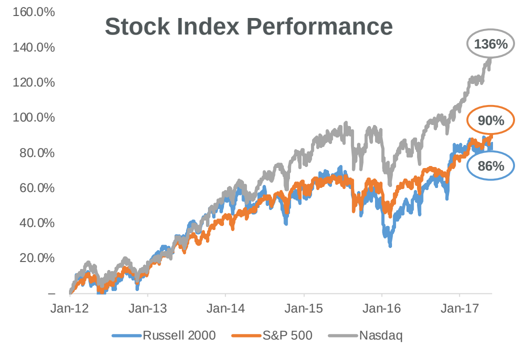
Macro US Performance

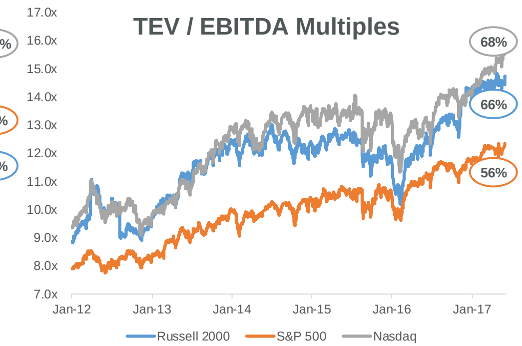
– Wall Street continues to look for a post-recession GDP growth above 3.0%, which has yet to happen
– Economist, consumers and investors are optimistic about economic prospects of the Trump presidency as stocks and consumer sentiment are at all time highs
– Despite strong expectations, first quarter GDP grew at 0.7%, the weakest quarterly report in three years



Stock Market (2)

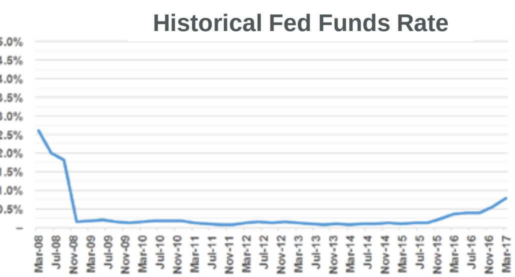
– The Nasdaq has been the best performer of the major stock indices, increasing 136% since January 2012 (vs 90% and 86% for the S&P and Russell 2000, respectively)
– EBITDA Multiple increases from January 2012 to the present have accounted for 50%, 62%, and 78% of the gain in stock price for the Nasdaq, S&P 500, and Russell 2000 indices, respectively
– Investors may be pricing in increased corporate earnings potential for 2017, the S&P 500 earnings were up 14.0% in Q1 2017

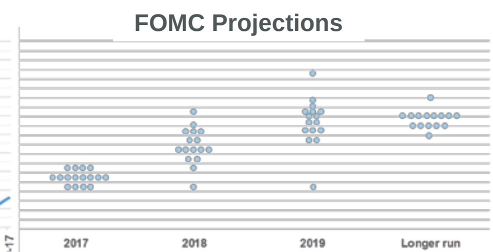




Interest Rates / Federal Reserve (3)

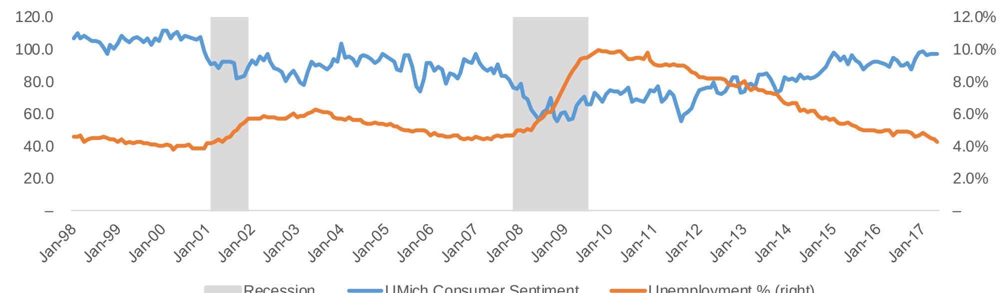
– The Federal Reserve raised the Fed Funds Rate in December '16 and March & June 2017 (current target range of 1.0% to 1.25%)
– The Fed is meeting 4 more times in 2017, with market participants expecting one to two more rate hikes (longer term FOMC projections in the chart on the right)
– 10-yr Treasury yields have softened (2.13% at 6/14) since the start of the new year in the face of the Fed's continued rate hikes





US Consumer (4)

– The University of Michigan Consumer sentiment is at a 16 year high as of the May reading
– Unemployment dropped to 4.3%, the lowest figure since March '01
– Wage growth has ticked up from below 2% during the recovery to 2.5% in the most recent report in May



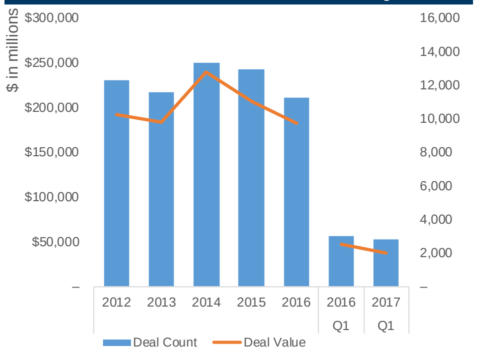
Sources:
1. Nominal GDP – Bureau of Economic Analysis
2. S&P Capital IQ
3. FederalReserve.gov
4. University of Michigan / Bureau of Labor Statistics

Middle Market M&A Environment

While M&A has softened of late, conditions remain ideal for sellers as financial and strategic purchasers are awash with cash

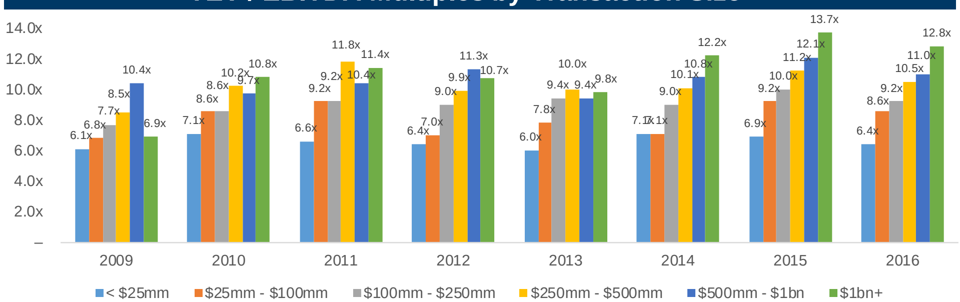
Since the Great Recession, US Middle Market M&A has remained incredibly active relative to historical levels. However, the market has recently softened over the last two years, with the total number of transactions decreasing 3.1% and 12.8% in ’15 & ’16, respectively. The 1st quarter 2017 was down 8.2% relative to the prior year quarter as well. That said, many expect the M&A activity to continue its relative strength due to the ideal market conditions.

Middle Market M&A Activity [1]



The ideal M&A market conditions are a result of increasing corporate profits, historically low interest rates, and healthy lending markets, among other factors. This environment has not only led to increased activity, but also increasing valuations across transactions of all sizes.

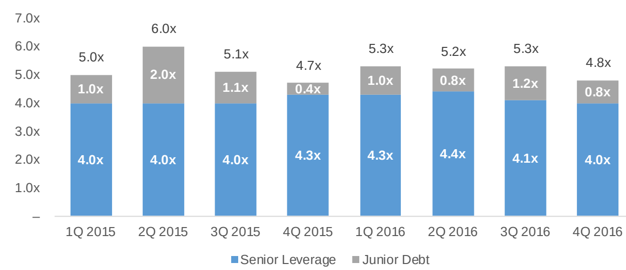
TEV / EBITDA Multiples by Transaction Size [2]



It is clear from the exhibit above that acquirers are placing a premium on the size of the target. One of the main drivers of the robust M&A markets, is transactions have been significantly easier to finance than in years past due to strong momentum from capital providers across the entire capital structure.

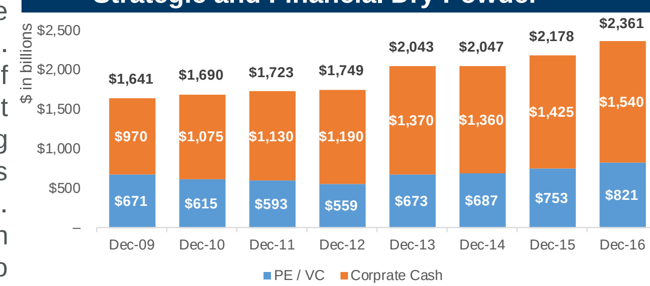
Banks, mezz lenders, and other alternative debt providers have been aggressive in deploying capital since the downturn. As you will note in the exhibit to the right, the leveraged loan market is willing to finance M&A transaction in the 5.0x range. Many of these capital providers are not typical lenders that are governed by regulators like commercial banks. This affords the alternative lenders the flexibility in terms of covenants (covenant lite deals have increased to 73% of institutional deals in 2016) [6] and deal structures (equity capital required in an LBO has decreased to below 45% in 2016) [7]. These market forces increase the returns to an acquirer which is one of the reasons for increased valuations in both the public markets and private market M&A.

Middle Market LBO Leverage Multiples [3]



That gets to the last part of the capital structure which is the equity acquirers. There has never been more cash available on corporate America’s balance sheets and private equity group coffers. As a result, one of the biggest challenges facing the industry is deploying capital. There is too much money chasing too few companies, so buying companies at reasonable prices is difficult. However, these groups are in the business of deploying capital and the ones that don’t invest will be left behind, which should mean strong M&A markets for the foreseeable future.

Strategic and Financial Dry Powder [4],[5]



Sources:

1. *S&P Capital IQ – Middle Market defined as TEV greater than $1mm and less than $500mm (# of transactions includes empty values)*
2. *S&P Capital IQ*
3. *William Blair & Company*
4. *FactSet*
5. *Preqin*
6. *Standard & Poor’s*
7. *Pitchbook*

Tax Reform: The Trillion Dollar Question

Long overdue reform to the corporate tax code looks set for debate in 2H 2017

Background and Policy Proposals

Since the election, tax reform legislation has been a hot topic and highly anticipated by the business community. While many stakeholders have voiced opinions on tax policy, the Trump Administration and Congress will ultimately determine the reforms. At a high level, tax reform will involve cutting corporate tax rates, while eliminating certain deductions and loopholes to subsidize these rate cuts.

The GOP's stance has been laid in the House Ways & Means Committee's report "A Better Way – Our Vision for a Confident America," published last June. The GOP shares the same basic desire to reform the tax code and cut rates. However, the party's proposal to date is more focused on revenue neutral reform. It plans to pay for cuts by introducing new and controversial revenue streams like the Border Adjusted Taxes, and altering allowable deductions to incentivize companies to increase expenditures to drive economic growth.

	TRUMP[1]	GOP[1]
Corporates Tax Rate	15% Eliminate AMT	20% Eliminate AMT
Pass-through Entities	TBD; possibly 15% entity level tax	25% on distributions to members
One-Time Tax	10.0% (foreign-held cash) 4.00% (other earnings) Payable over 10 years	8.75% (foreign-held cash) 3.50% (other earnings) Payable over 8 years
Deductions	Favors keeping interest deductions on debt	Eliminating interest deductions, for expensing capital investments
Territorial System	"Level the playing field for American Companies"	Foreign earnings exempt
Border Adjustment	None	Favors Destination-Based Cash Flow Tax

From the White House, the Trump Administration has been less detailed on tax reform, issuing "2017 Tax Reform for Economic Growth and American Jobs," a one-page proposal, containing just 4 bullets on Business Reform. While the proposal was brief, the Trump Administration has made it clear that lowering corporate tax rates is at the center of its tax reform plan. How the Administrations plans to pay for these cuts is less clear, and is not directly addressed in its release. The President has indicated, however, that revenue neutrality is not essential to his policy, and has indicated a willingness to increase the deficit in order to "prime the pump" for economic growth. If the Trump plan is not revenue neutral, reform would be only temporary, ending within a 10-year budget window for it to pass in Congress. [3]

Sources:

1. *Nicholas DeNovio, "U.S. Tax Reform: Strategies for Executing Transactions in the Face of Uncertainty." March 12, 2017.*
2. *Lynnley Browning, "Trump 'Preference' for Interest Deduction May Snarl GOP Tax Plan," Bloomberg.com. May 12. 2017.*
3. *Paul Bonner, "Trumps tax reform priorities unveiled," Journalofaccountancy.com. April 26, 2017.*

Tax Reform: The Trillion Dollar Question

Debate will revolve around a few policy ideas with significant economic consequences

Tax Reform…Still Not a Gimme

A Republican Congress and White House create an opportunity to accomplish long overdue tax reform. However, policy change won't come uncontested. The two proposals advanced to date have differing views on several policy issues, which will likely be debated over the remainder of the year, both in congress and in the media. The hot topics and buzzwords to be debated are likely to include interest rate deductibility and border adjustment taxes (BAT).

Deductibility of Interest

The Trump administration favors keeping the deductibility of interest payments. On the other hand, GOP leaders favor removing this deduction, which is estimated to generate tax revenue of approximately $1 trillion over a decade. In its place, the GOP would like to allow companies to immediately expense capital spending, a move viewed by its proponents to spur corporate investment. A third alternative, which Trump has indicated support for in the past, would be to allow companies to choose between deducting either interest expense, or capital spending.

Border Adjusted Tax (BAT)

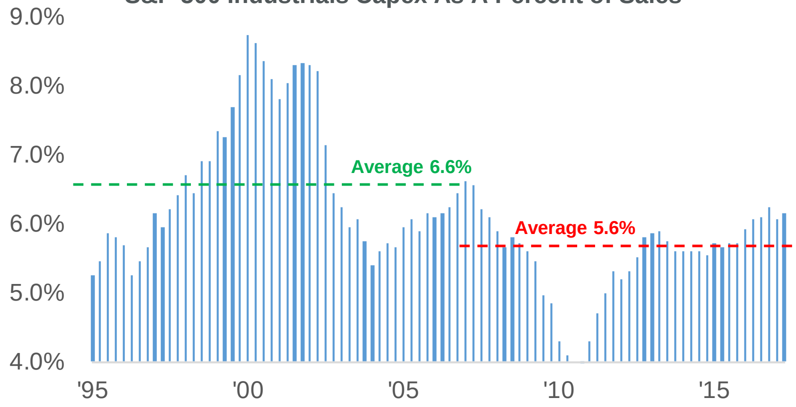
The concept behind a BAT is to tax based on where a product is consumed, not based on based on the location of a company's headquarters. Under the GOP plan, imported goods used in production can no longer be deducted by companies, thus increasing their tax burden. This tax is intended to raise tax revenue, off-setting cuts to the corporate tax rate, and reduce the trade deficit by incentivizing domestic consumption. The Trump administration opposes BAT, on the grounds that it has the potential to raise prices for consumers.

A major goal of these new policies is to generate new revenue streams to compensate for the proposed tax cuts. The revenue streams from immediate expensing of capital spending and BAT attempt to generate the lost revenue, while simultaneously incentivizing increased corporate spending and consumption, which are still below historic averages. Proponents of these policies argue that such structures will boost production and economic growth more effectively than incentivizing the use of debt through the deductibility of interest.

However, opponents have voiced concerns that these policies will have unintended consequences. Many argue that the proposed BAT will ultimately hurt consumers, as companies attempt to pass through cost increases. While eliminating the deductibility of interest may have significantly negative impact on the financial services industry and the private equity market.

It is the trade off between these positive and negative impacts that are expected to be intensely debated later this year.

S&P 500 Industrials Capex As A Percent of Sales [2]



The GOP's plan aims to increase corporate spending, in order to stimulate growth

Sources:

1. *Lynnley Browning, "Trump 'Preference' for Interest Deduction May Snarl GOP Tax Plan," Bloomberg.com. May 12. 2017.*
2. *Joe Ciolli, "Corporate America investing in itself is going to be what powers stocks higher," BusinessInsider.com. May 25, 20 17.*

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Tax Reform: Boom or Bust for M&A?

While the results of policy change is uncertain, tax reform WILL have an impact on M&A

Potential Impacts on M&A Transactions

The goals of both the Trump and GOP tax reform proposals is to spur economic growth. However each takes a different approach to accomplish those goals. Mergers and acquisitions will see varied impacts, depending on which policies are eventually implemented. The following offers a summary of some of the potential impacts from tax reform.

Capital Markets and Financing

The proposals advanced have the potential to significantly impact capital structuring decisions and the way deals are financed, and ultimately the capital markets. Specifically the deductibility of interest expense will affect the demand for debt financing. If the GOP plan is accepted and the interest deduction is eliminated, the loss of the tax shield may dampen demand for debt financing. This impact may be offset by the desire to finance increased capital expenditures, incentivized by such a plan.

Deal Structures

If the immediate deduction of capital spending is included in reform, asset deals will become more attractive to buyers and likely more common. While this structure is more beneficial to buyers, the tax impact to sellers is less certain and will depend on the magnitude of cuts to the corporate tax rates.

Deal Appetite and Valuation

A reduction in the corporate tax rate will lead to increased availability of capital and could have a positive impact for mergers and acquisitions, especially in the middle market. While there are many unknowns that will impact deal flow, there are several proposed policies that could impact M&A activity.

– A more near-term factor will be the one-time tax on foreign-held capital will result in the repatriation of significant cash. As companies look to put that cash to work, one area likely to benefit is M&A. Industries with large multinationals are most likely to see this increased activity in the near term.
– One highly politicized issue in recent elections cycles has been the tax treatment of carried interest. Historically treated as capital gains to general partners of private equity firms. Neither the Trump or GOP plan have taken a position on this issue, but any change in policy could have significant ramifications on the economics of this industry, and therefore impact private equity's demand for deals.
– The immediate deduction of capital spending may incentivize companies to increase their CapEx and organic growth, instead of pursing acquisitions. However, as discussed above, the immediate expensing applies to assets deals and therefore may also serve to bolster M&A as a way to cut tax bills.

Sources:
1. *Nicholas DeNovio, "U.S. Tax Reform: Strategies for Executing Transactions in the Face of Uncertainty." March 12, 2017.*
2. *Lynnley Browning, "Trump 'Preference' for Interest Deduction May Snarl GOP Tax Plan," Bloomberg.com. May 12. 2017.*

GLEASON

One Gateway Center, Suite 525
420 Fort Duquesne Boulevard
Pittsburgh, PA 15222

(412) 391 -9010
www.gleasonexperts.com