Middle Market M&A and Capital Markets Update

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I. Middle Market M&A and Capital Markets Update

Introduction

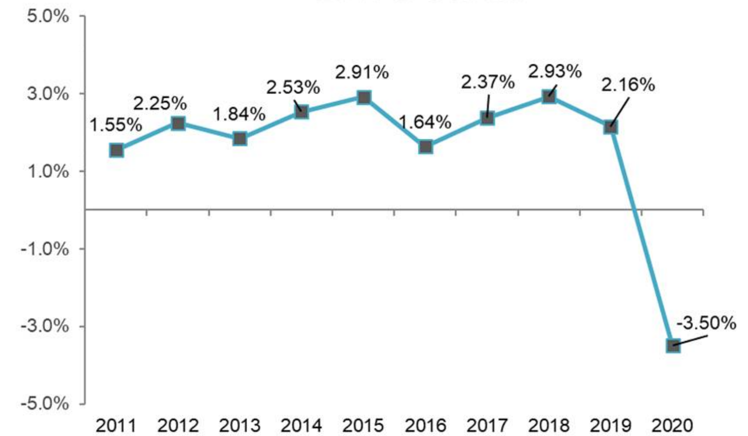
- Griffin's Middle Market M&A and Capital Markets Update has 3 primary objectives:
    1) Broadly summarize the current state of the U.S. economy, including Federal Government economic policy
    2) Describe the effect of this economic and political backdrop on the Middle Market deal and capital environment
    3) Offer some guidance on expectations going forward

Macroeconomic Overview

Gross Domestic Product ("GDP") Breaks Historic Growth Trend due to Coronavirus Impact

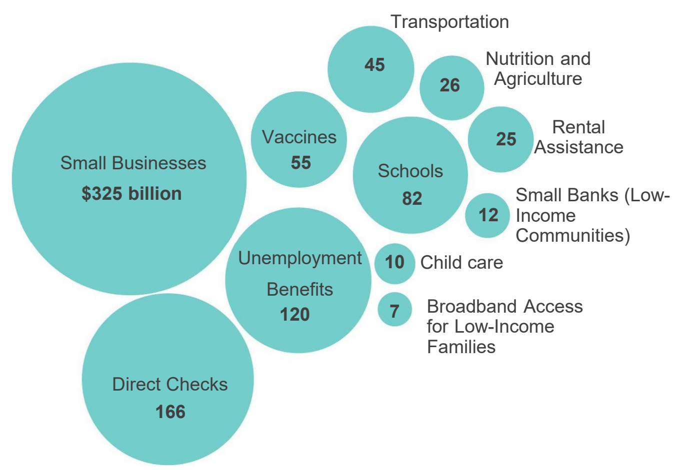
- The U.S. economy contracted 3.5% in 2020, despite a strong rebound experienced in the second half of the year
  - Marked the end of the longest U.S. economic expansion, which began in June of 2009 and lasted for 128 consecutive months until February of 2020
  - Real GDP increased 33.4% in Q3 2020 after falling 31.4% in Q4 2020
  - The BEA's initial Q4 2020 GDP estimate reflects a 4.0% annual rate increase
- The government stimulus response in April was swift, substantial, and impactful:
  - Congress passed the CARES Act, a $2.0 trillion economic relief package designed to offset the negative effects of government shutdown policies
  - The $659 billion Paycheck Protection Program ("PPP"), implemented by the SBA, provided small businesses with funds to maintain payroll
  - Main Street Lending Program, a $600 billion lending program run by the Federal Reserve System to support small and medium-sized businesses and non-profit employers impacted by the pandemic
  - The Federal Reserve took forceful, proactive, and aggressive measures that far surpassed the playbook from the Great Recession
- In December, Congress passed a second Covid-19 Relief Bill, which amounted to $900 billion
  - Revives the PPP and direct payments to U.S. households
  - Investors expect that the additional spending will help cushion the economy amid restrictions put in place by states and local authorities to manage Covid-19's spread in the winter
- The Biden administration has proposed a third $1.9 trillion Covid-19 Relief Bill

Annual GDP Growth (%)
2011 to Current



Source: Bureau of Economic Analysis, January 2021

$900 Billion Covid-19 Relief Bill
Selected relief categories, in billions

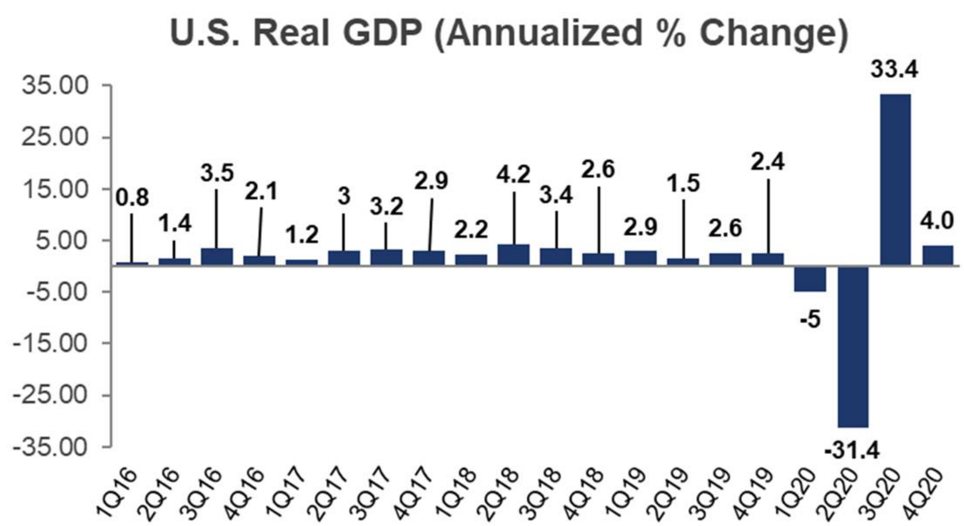


Source: Legislative text and congressional summaries; WSJ

Macroeconomic Overview

Gross Domestic Product (“GDP”) Breaks Historic Growth Trend due to Coronavirus Impact

- The IMF expects the U.S. economy to grow 5.1% in 2021 (1)
    - The forecast increased 2 percentage points relative to its October 2020 WEO projection, citing a carryover from the strong momentum in the second half of 2020 and additional support from the December 2020 fiscal package
    - Continued vaccine distribution and less restrictive state and local government economic shutdowns are expected to greatly boost the economy



Source: Bureau of Economic Analysis, January 2021

(1) International Monetary Fund (IMF) World Economic Outlook Update, January 2021

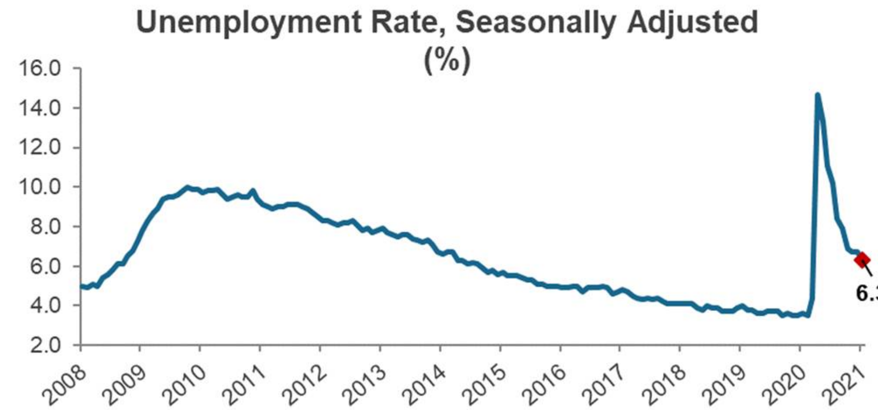
Macroeconomic Overview

Despite Strong Improvement, the Unemployment Rate is Still at an Elevated Level

- The national unemployment rate increased from a generational low of 3.5% in February of 2020 to 14.7% in April 2020, and has since decreased to 6.3% in January 2021

- In addition, the more comprehensive U6 unemployment rate (which includes those who are underemployed or who have given up on job searches) reached 22.8% in April 2020 and decreased to 11.1% in January 2021 (February 2020 = 7.0%)

- The labor market recovery shows signs of resilience as indicators suggests that the recovery is continuing amid the numerous headwinds (1)
  - The number of job openings fell in half over a two-year period due to the Great Recession, but the decline has been much smaller and shorter-lived in the Covid crisis
  - Job openings fell almost 29% between February and April, but they rapidly recovered and are only down 5.0% as of December 2020



Source: Bureau of Labor Statistics (BLS), February 2021

Source: BLS, Job Openings and Labor Survey (JOLTS), December, 2020

(1) Coronavirus Recovery Tracker – December 2020, ZipRecruiter

Macroeconomic Overview

The Bifurcated Industry Impact of the Pandemic [1]

- By unraveling the effects relating to the financial and economic turmoil created by the pandemic, it is evident that the outcome is industry-specific, and for the most part binary

The Winners		The Losers
Remote Working Tools and Software With businesses struggling to find ways to maintain adequate levels of productivity, many are turning to remote working apps and software	***E-Commerce*** A greater proportion of consumers shifted to online shopping for essential products, such as food and beverages, cosmetics, and medicines	***Transportation and Travel-Related*** Examples: Airlines, Charter Flights, Limousine Services, Cruise Lines, Hotels and Motels, Ride-hailing
Healthcare, Pharma and Medical Devices The COVID-19 outbreak has reaffirmed the need for investment in both healthcare and safety equipment (e.g. PPE) as well as pharmaceuticals	***Big Box Retail*** Shoppers prefer bulk-buying and one-stop shopping, thereby limiting their physical shopping exposure	***Entertainment and Recreation*** Examples: Movie Theaters, Amusement Parks, Casinos, Hotels, Event Promotion
Logistics Supply chains that support food deliveries and online shopping experienced a boost due to the increased demand	***Food/Grocery Stores*** "Mission-driven" shoppers increased food retail spending, as they eat more at home and forgo eating at restaurants	***Brick-and-Mortar Retail*** Examples: Chain Restaurants, Department Stores, Bars and Nightclubs, Florists
Commercial Cleaning and Disinfecting COVID-19 has resulted in an increased demand for specialized cleaning and disinfecting services from a variety of industries	***Building Products/Home Improvement*** According to a Consumer Specialists' survey, 57% of homeowners put an emphasis on home improvement during the first three months of COVID-19	***Other Industries*** Examples: Hair and Nail Salons, Tanning Salons, Religious Organizations, Colleges and Universities, Trade and Technical Schools

(1) IBISWorld, Pandemic Economics: What Bankers Need to Do to Beat COVID-19's Shock and Awe Attack, June 2020

Question for the Audience (1)

- How has COVID-19 impacted your company's revenues?

  a. Increased revenues greater than 20%
  b. Increased revenues 0-20%
  c. Flat or N/A
  d. Decreased revenues 0-20%
  e. Decreased revenues greater than 20%

The Pandemic Effect on Middle Market M&A/Capital Markets

Middle Market M&A Deal Activity Surged after Initial Fall

- In a tale of two cities, "above average" financial performers with recession-resistant business models are highly sought after, and therefore demand a quality premium, while the plethora of distressed companies that were victimized by pandemic woes are deeply discounted
- M&A activity in Q4 surged 8.0% over 2019 levels, recovering from the Q2 freefall in deal activity (1)
  - Annual M&A activity in 2020 was still the lowest since 2009
  - Acquirers are pursuing defensive M&A in effort to survive, or offensive M&A to capitalize on distressed situations
  - Uncertainty surrounding the tax implications of a change in U.S. political landscape lingers
- Intralinks Deal Flow Predictor forecasts North American M&A announcements to increase 5% year over year in H1 2021, but notes that a resurgence of Covid-19 cases, and the third COVID-19 wave fosters uncertainty. As such, there is a sizable difference in the forecast parameters, as the expected range spans from -4% and +16%, respectively (2)
  - While expectations are volatile, the current crisis is not characterized by the deal flow stagnation experienced in late 2008/2009
  - During an unquestionably volatile year, global M&A activity is showing continued signs of confidence and recovery
- RSM's US Middle Market Business Index (MMBI) composite score saw a modest decrease from 123.0 in November to 121.2 in December, as 39% of respondents stated the economy improved in December, and 59% expect continued growth over the next six months (3)
  - Leading indicator showcasing that not only has the middle market regained its strength following the reopening of the economy, but also that once a COVID-19 vaccine is widely distributed, the economy will boom and grow
- According to PwC, pricing deals may be more complex today than before COVID-19
  - Traditionally global shocks to the economy have led to lower valuations, instead, post-pandemic valuations are soaring, as there is a large number of investors competing for deals along with an abundance of available capital and bullish global stock markets (4)

(1) 2020 Annual North American M&A Report; 2020 Annual US PE Breakdown, PitchBook, January 2021
(2) Q1 2021 Deal Flow Predictor, Intralinks Deal Flow Predictor, December 2020
(3) RSM US Middle Market Business Index, December 2020
(4) PwC, "Fierce competition ahead for dealmakers shaping the post-pandemic economy", January 2021

The Pandemic Effect on Middle Market M&A/Capital Markets

The Lending Environment for Middle Market Companies Retrenched, with Lower Risk Appetite as Volume Nonetheless Inches Toward Pre-Covid Levels [1,2,3]

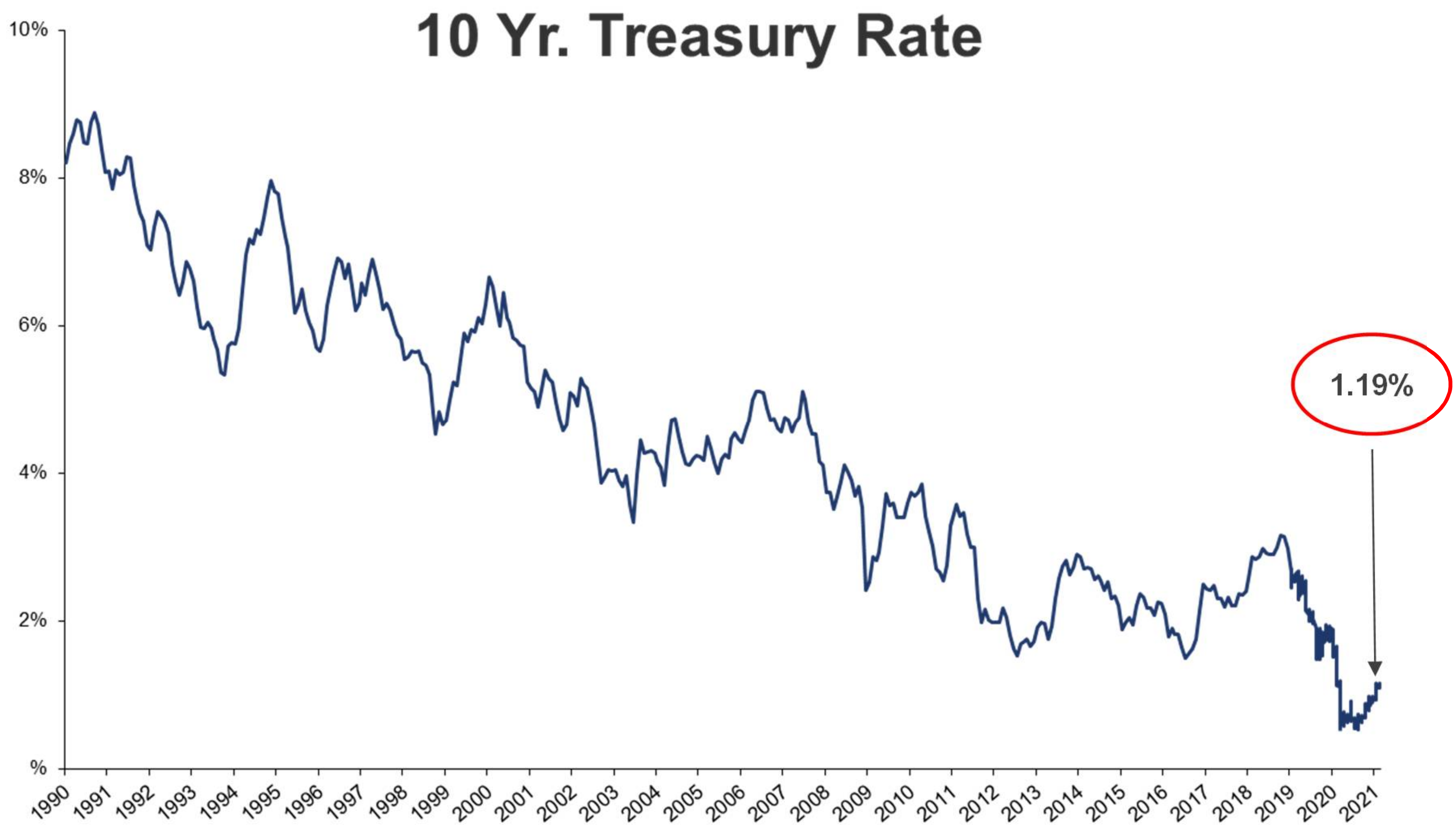
- Senior lenders continue to focus on the liquidity of existing borrowers, and are cautious to underwrite new deals
  - Conservative leverage levels and more restrictive covenants limit exposure
  - Increase in frequency of financial reporting requirements
  - Decrease in the unfunded portion of revolving credit facilities
  - Commercial Banks and Non-Bank lenders exhibit preference for deals that are highly equitized, and led either by a reputable sponsor, or a large and well-capitalized strategic company

- Opportunistic Mezzanine/Junior capital providers experienced increased activity as they bridged the gap created by by the more cautious senior lenders

(1) GF Data Leverage Report, GF Data®, November 2020
(2) S&P Global Market Intelligence , Busy Q4 in middle market lending adds to optimism for 2021, December 2020
(3) S&P Global Market Intelligence, Leveraged Commentary and Data, November 2020

Interest Rates are at Historic Lows

Unprecedented Monetary Stimulus = Historically Low Interest Rates



Source: U.S. Treasury, February 8th, 2021

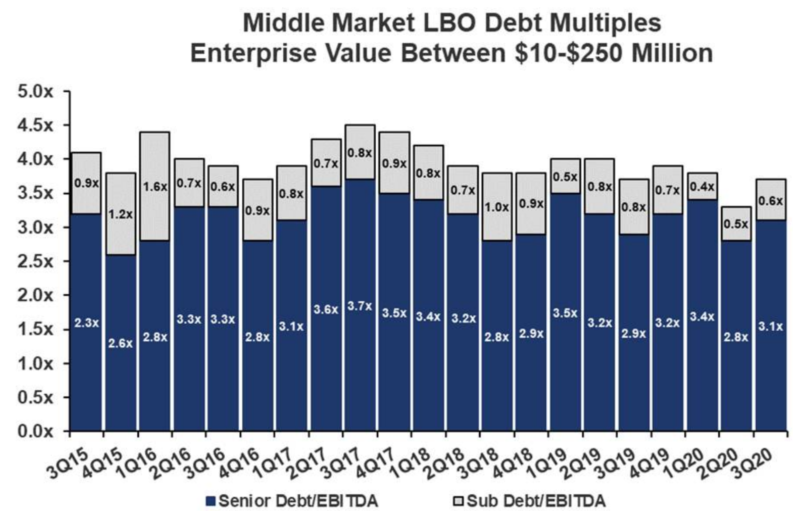
Debt for Acquisitions is Restricted Due To Lack of Earnings Visibility

Institutional Credit Markets Remain Active, yet Prudent as Volatility Lingers

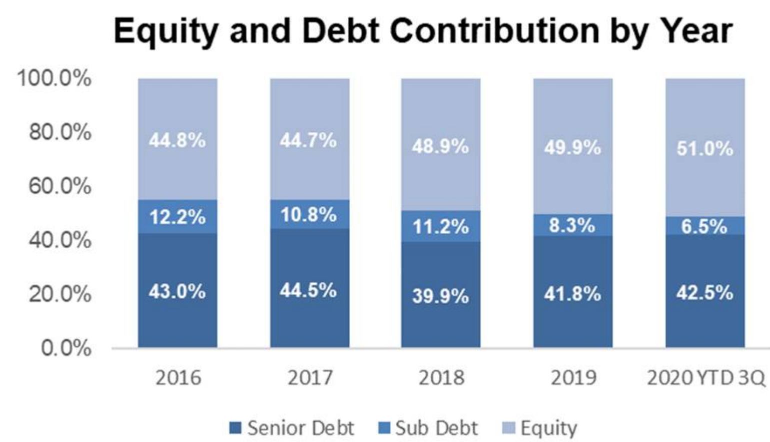
- Leverage multiples have declined in 2020 roughly 0.5x EBITDA
  - Lenders concerned about lack of earnings visibility
  - Senior debt multiples around 2.5x-3.0x versus 3.0x-3.5x in prior years
  - In order to be aggressive, Buyers “over-equitize” in effort to bridge the leverage price gap

- 100-200 basis points increase has emerged along with elevated LIBOR floors, yet still very attractive terms and pricing for “A” or “B” companies (e.g. LIBOR + 200-400bps from banks)
  - Non-bank lenders at LIBOR + 650-850bps
  - LIBOR only at roughly 0.2-0.25%

- Subordinated debt can add another 0.5-1.0x EBITDA to bank debt with pricing between 10%-12%, paid-in-kind (PIK) rates ranging between 1%-3%



Source: GF Data Leverage Report, GF Data®, November 2020



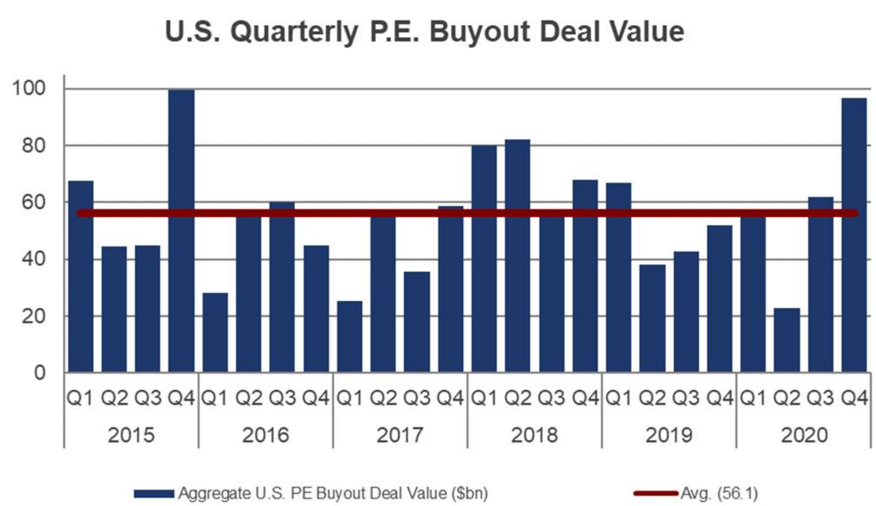
Source: GF Data Leverage Report, GF Data®, November 2020

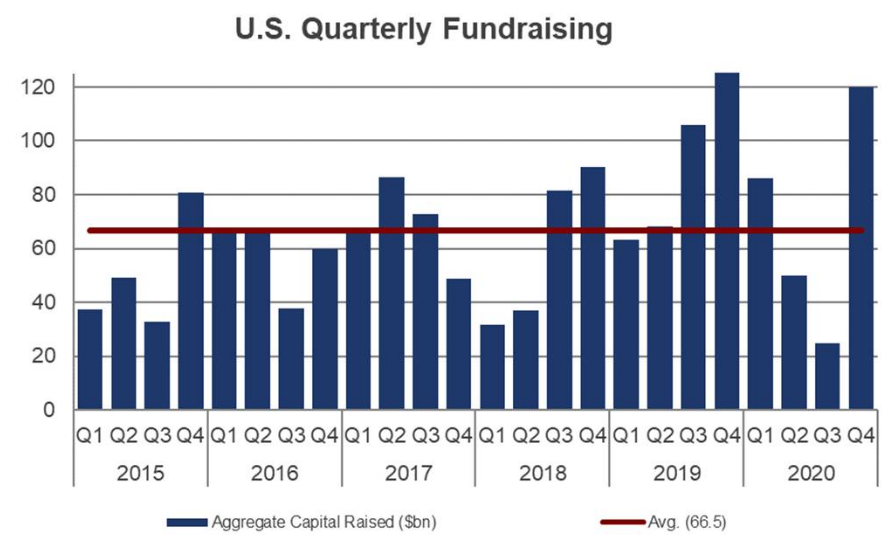
N.B. GF Data®, annual reports are released at the end of February

Private Equity Funds – Investment vs. Fundraising during the Pandemic

$96.6 bn Aggregate U.S. Private Equity Investment Value in Q4 2020

$119.9 bn U.S. Private Equity Funds Raised in Q4 2020



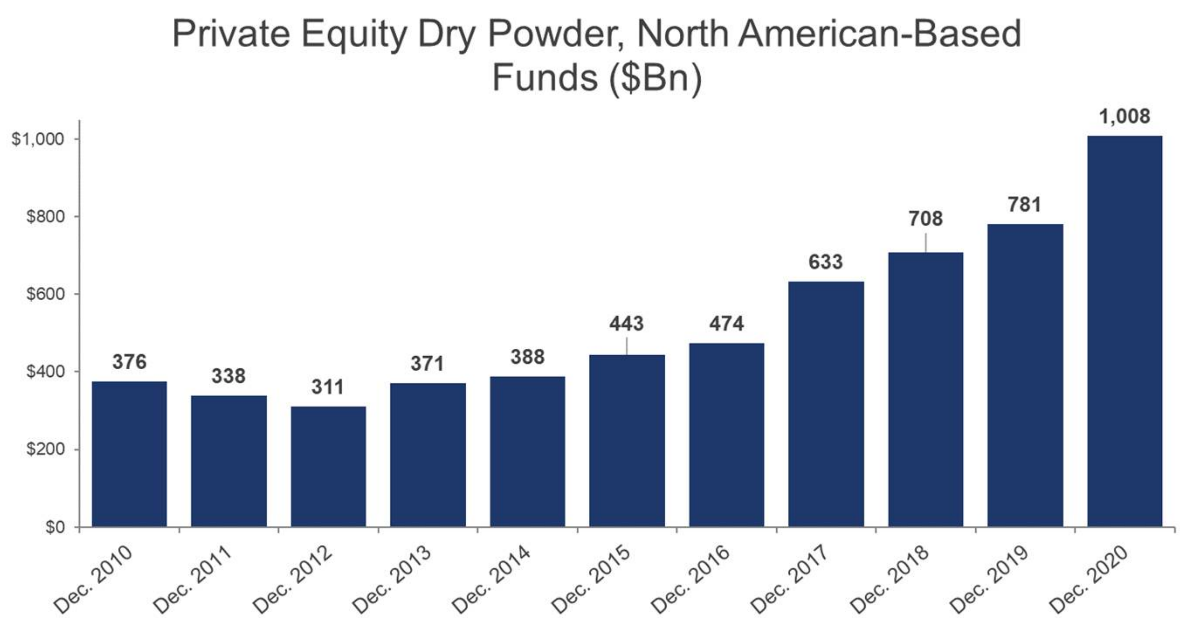


- While PE investments declined dramatically in Q2 2020, they soared in Q4
  - Likewise, PE fundraising struggled in Q2-Q3, but exploded to near record levels in Q4 2020

Source: Preqin data retrieve, January 2021

Record Private Equity Dry Powder Remains Intact

- Despite the pandemic, Private Equity markets remain flush with cash looking for a home
  - Private equity funds did not lose their capital as a result of the pandemic
  - Total dry powder for U.S. private equity firms continued to climb in 2020, rising dramatically from $474 billion at the end of 2016 to reach a record exceeding ***$1 Trillion***
  - The decline in M&A activity during the pandemic, and the corresponding drop in PE investment, has only served to increase the PE dry powder

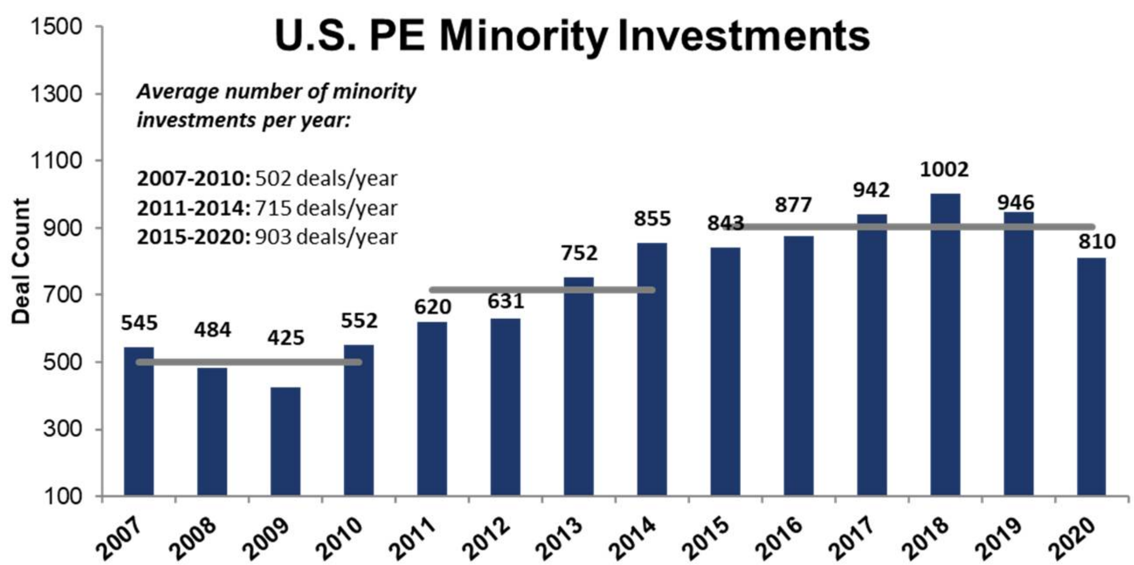


Source: Preqin, January 2021

Private Equity Alternatives

Minority (i.e. Non-Control) Equity Overview

- Griffin has seen an increase in PE minority equity products during the pandemic
  - Provides a solution for companies that need liquidity, but do not want to sell a control stake at lower valuations
- Minority investments, which have been a common feature among smaller growth-equity deals, have become increasingly prevalent in larger PE transactions, despite a decrease in 2019 and 2020
  - Buyout funds are holding record levels of dry powder, driving them toward minority transactions in order to deploy capital
- Based on recent research by Boston Consulting Group, motivations for over 90% of minority transactions included access to capital either for growth or restructuring
  - Research also suggests that companies may opt for minority equity as an alternative to a buyout to avoid adverse publicity and customer fallout



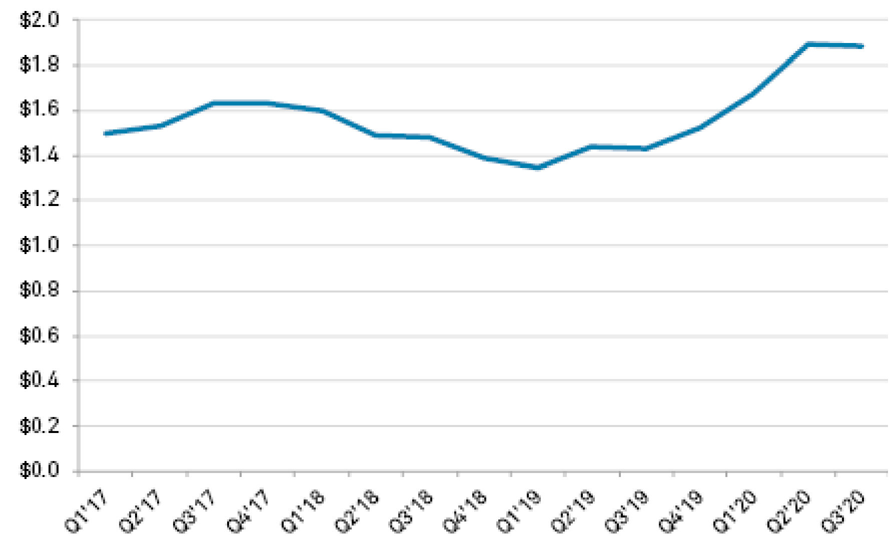
Source: PitchBook Annual U.S. Private Equity Breakdown, January 2021

S&P 500 Companies Amassed Record Amount of Cash

Corporate America, Overall, Is On Solid Footing

- U.S. companies issued record-breaking amounts of debt to bolster their balance sheets in response to the uncertainty arising from the Covid-19 pandemic's disruptions (1)
- In Q3 2020, S&P 500 Industrials cash and equivalents stood at a near-record high of $1.88 trillion (2)
- Investors anticipate that companies will explore alternative uses of capital, such as making Acquisitions, and take advantage of the current favorable interest rate climate by forgoing debt repayments

Cash holding among S&P 500 Industrials near record high ($ trillion)



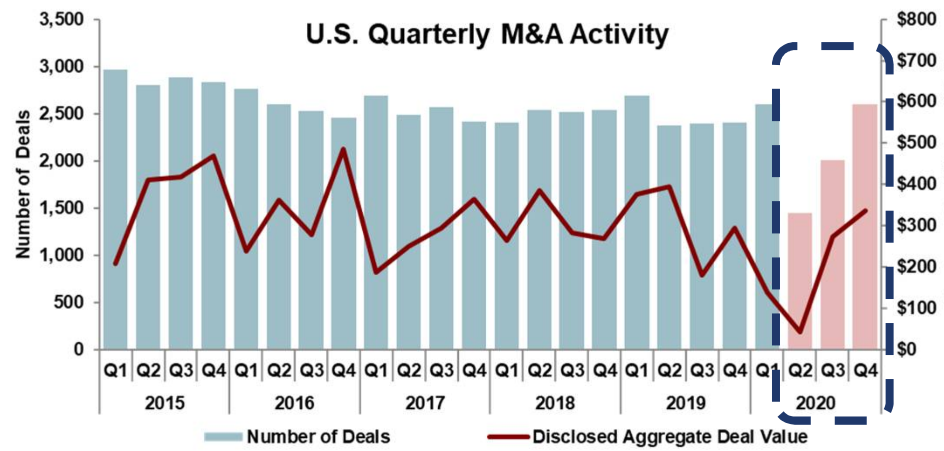
Source: S&P Dow Jones Indices; Data as of Jan. 19, 2021

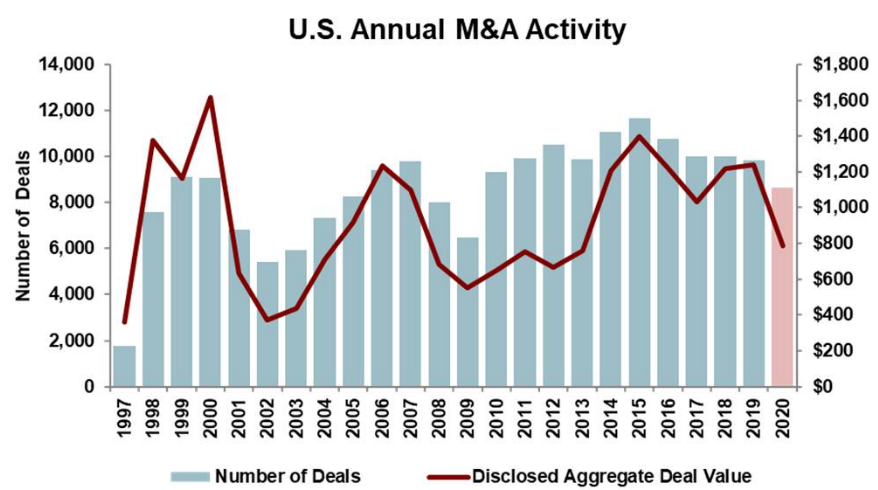
(1) Investors Circle Largest Corporate Cash Hoard Ever, The Wall Street Journal, December 2020
(2) S&P Dow Jones Indices; Sectors excluded: Financial, transportation, and utility

The Lockdown of the US Economy led to a Big Fall in M&A Activity, Followed by a Strong Rebound

Deal Making Increased in the Fourth Quarter of 2020, Closely Tracking Q1 2020 Levels

- Deal activity dropped 44% in Q2 vs. Q1 2020, but Q3 2020 showcased a return to M&A activity, up 39% versus Q2
- The momentum carried over into Q4 2020 with a 30% increase over Q3, and a slightly higher performance relative to Q4 2019
- Furthermore, the conclusion of the U.S Presidential Election served as a catalyst for PE firms and corporates to close transactions in 2020 before the shift in political, fiscal, and tax landscape
- 2015 was a record year for M&A, both in terms of number of deals and deal value, and 2016 – 2019 saw only small decreases in deal activity
    - While 2020 saw the lowest deal activity since 2009, momentum from a strong Q4 is expected to continue in 2021



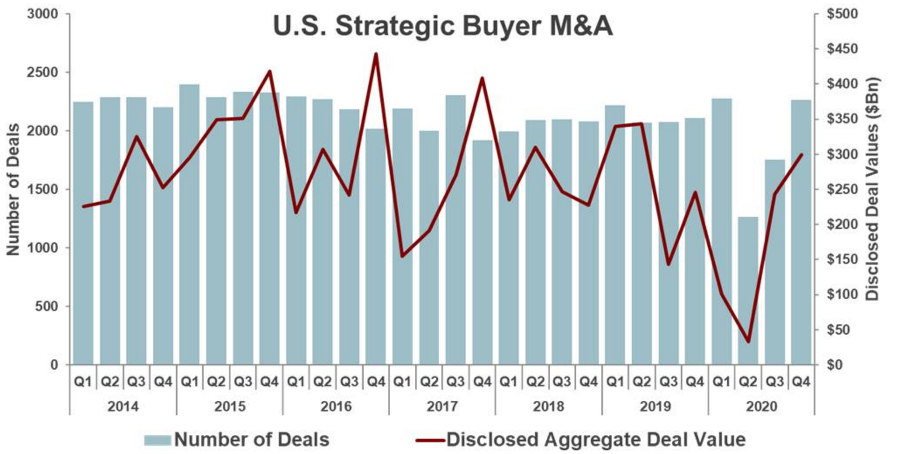


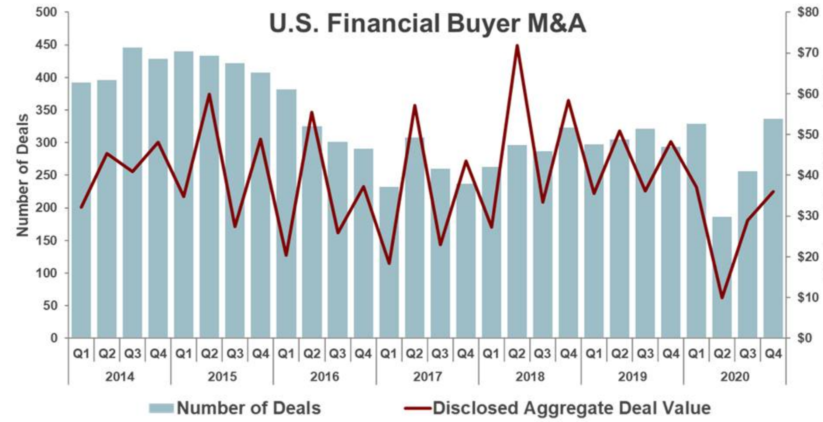
Sources: S&P Capital IQ, January 2021

Includes: Announced and Closed transactions in the U.S. (excluding asset/product purchases, government organizations, and charitable organizations and foundations)

M&A Activity – Strategic vs. Financial Buyers

Strategic Buyers Continue to Remain More Active Than Financial Buyers During the Pandemic





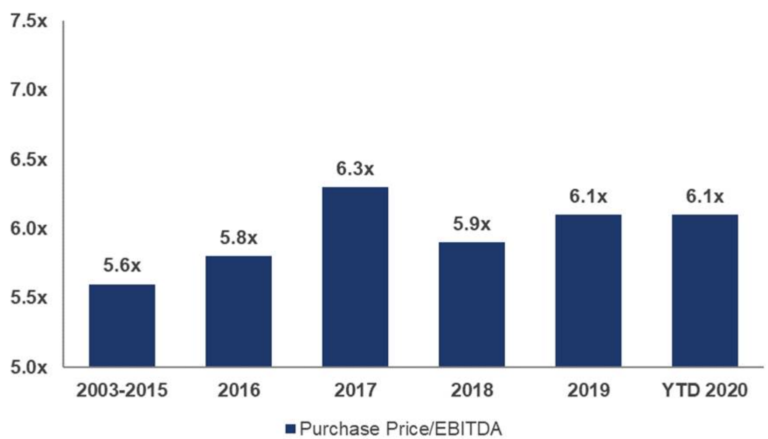
- Even during the pandemic, Strategic buyers continue to be very active in pursuing M&A targets; buyers find value in growth and expense synergies, deploying cash on the balance sheet, and leveraging debt over combined companies
  - Attractive valuation opportunities with distressed deals
  - Strategic partnerships to bolster operational and supply chain resilience
  - Portfolio optimization, divestments, and new business models
- Financial buyer transactions have slowed since the 2015 peak due to higher-than-expected valuations, a lack of worthwhile targets, and overheated competition
- According to PitchBook, deal seekers are focusing on a new class of undervalued-yet-attractive assets from struggling companies in the Russell 2000
  - These targets are the result of the divergence in performance between the S&P 500, which was up 9.1% in Q4, and the lagging Russell 2000

Source: S&P Capital IQ, January 2021; PitchBook 2020 Annual North America M&A Report. January 2021
Includes: Announced and Closed transactions in the U.S. (excluding asset/product purchases, government organizations, and charitable organizations and foundations)
Excludes: transactions with unknown buyer type

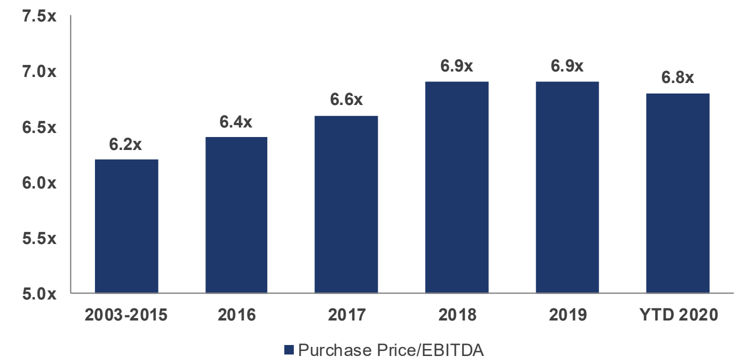
Private Equity M&A Activity – Historical Valuations

- Valuation multiples are heavily influenced by the size of a transaction, the industry, and the revenue model
- **Valuations in most sectors of the middle market are at or near multi-year highs, virtually unchanged from 2019, and even slightly higher for deals in the $50mm - $100mm purchase price range**

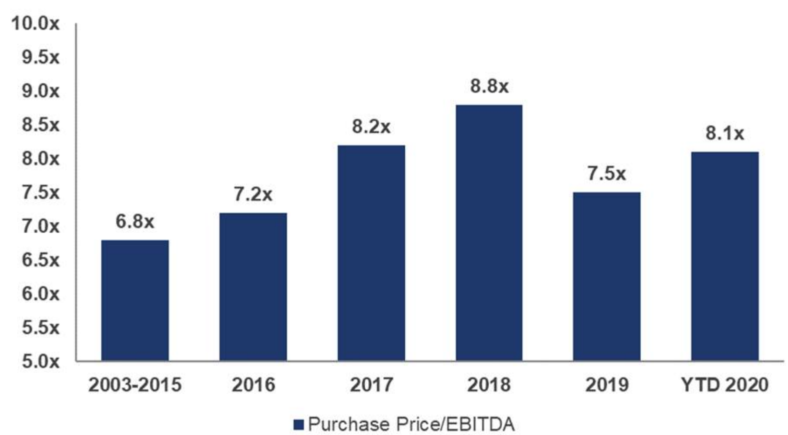
Purchase Price $10mm - $25mm



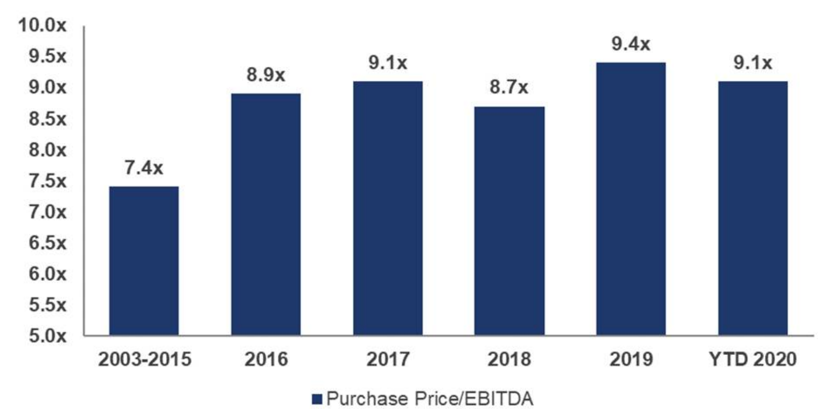
Purchase Price $25mm - $50mm



Purchase Price $50mm - $100mm



Purchase Price $100mm - $250mm



Source: GF Data M&A Report, GF Data®, November 2020

N.B. GF Data®, *annual reports are typically released at the end of February*

Political Landscape Overview – The Biden Administration

- Increases the corporate income tax rate from 21% **to** **<u>28%</u>**
- Taxes long-term capital gains and qualified dividends at the ordinary income tax rate of **<u>39.6%</u>** on income above $1 million and eliminates step-up in basis for capital gains taxation
- Reverts the top individual income tax rate for taxable incomes above $400,000 from 37% under current law to the pre-Tax Cuts and Jobs Act level of **<u>39.6%</u>**

Partial Reversal of Trump's 2018 TCJA (1)

Democratic

President

Joe Biden

Extensive Fiscal Spending

Additional Proposed Changes to the IRC

- Imposes a 12.4% Social Security payroll tax on income earned above $400,000, evenly split between employers and employees
- Phases out the qualified business income deduction (Section 199A) for filers with taxable income above $400,000

- Extensive deficit-funded fiscal package (COVID-related and other) will drive US interest rates higher
- Prior to taking office, Biden announced a two-step $1.9 trillion stimulus package titled "American Rescue Plan"
- A group of 10 Republican senators offered a $618 billion, but Biden panned it as insufficient, though private talks with the Republicans continue

De-escalation of Trade Tensions

- Biden's plan to reconcile relations with China could bolster economy activity
- Uncertainty regarding tariffs and "trade wars" is expected to be mitigated in 2021

- **The proposed increase in the capital gains rate to nearly 40% would have a chilling effect on middle market M&A activity**
  - Fiscal policy experts expect tax changes to come in 2022 rather than 2021, as the Democrats focus on fiscal stimulus first and tax increases second (2)

(1) The Tax Foundation, January 2021
(2) CNBC, "How concerned investors should be about Biden's tax proposals", January 2021

Question for the Audience (2)

- How much do you expect Biden Administration policies will impact your company's revenues?

  a. Increase revenues greater than 20%
  b. Increase revenues 0-20%
  c. Flat or N/A
  d. Decrease revenues 0-20%
  e. Decrease revenues greater than 20%

Takeaways

Within the current M&A landscape, there is broad optimism within a bifurcated market:

- The recently-passed $900 billion Covid-19 Relief Bill and FDA-approved vaccines are expected to further catalyze economic gains
  - A third Covid-19 Relief Bill is expected to further support economic growth
- Following the slowdown caused by the pandemic outbreak, deal making increased rapidly in the second half of 2020
  - Deal activity slowed dramatically in April and May, but started to grow during the first half of summer and progressed impressively through the end of 2020
  - 2020 marks the second straight year of decline in deal count activity, albeit from record levels
- Total dry powder held by PE groups is still at record levels, and well-capitalized strategic acquirers in "pandemic winner" industries are eager to deploy record levels of capital
- Pandemic Bifurcated Market: Investors pay a quality premium for "above average" financial performers, while deeply discounting struggling companies
- Senior debt leverage more conservative
- Mezzanine/Junior capital is abundant, and in some cases, without warrants or other 'equity kickers'
- Some private-equity-backed deals are being completed with lower levels of debt and more equity during COVID, and in many cases, with rolled equity contributions from sellers for a "second bite of the apple"
- Strategic buyers are doing better vs. PEGs in competitive processes

But…

Takeaways

…the current M&A and Capital Raising environment faces continued uncertainty:

- Further economic gains are expected to come at a slower pace than in the latter half of 2020
  - It could take until the fall for the majority of the US population to be vaccinated
- Multiple new and potentially more infectious variants[1] of the novel coronavirus could further exacerbate the economic recovery
- Since the Republicans lost two January Senate runoffs in Georgia, Mr. Biden's tax increases are expected to be enacted
  - Consensus among fiscal policy experts indicates that the Biden administration's tax plan will come at a later date, and most likely take effect in 2022
  - Razor-thin Democrat margins in the House and Senate, plus strong Small Business lobby opposition to 40% capital gains tax provides hope it won't apply to middle-market M&A, nonetheless, the threat of 40% should spur deal activity this year

(1) New, more highly contagious Covid-19 variants from the United Kingdom, South Africa, and Brazil are in the U.S.

Question for the Audience (3)

- How do you feel COVID-19 and the Biden Administration will impact M&A and Capital Raising in 2021?

  a. Significantly Increasing the number of transactions
  b. Slight Increasing the number of transactions
  c. Flat
  d. Slightly Decreasing the number of transactions
  e. Significantly Lower the number of transactions

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II. Case Studies

Case Study – Current Transaction

2021 In Process Transaction

Supplier of Construction Materials and Services

Supplier of Construction Materials and Services

Transaction Type: M&A – Sell-Side Advisory
Industry: Construction Materials & Services

Key Transaction Points

- The Company is a supplier of construction materials and services with $60 million of revenue
- Sale process launched in February 2020, and led to multiple strategic buyer offers and management meetings in March
- The pandemic and state economic shutdowns put the process on hold in April
    - Multiple buyers indicated their Boards/Management shut down acquisition activities to preserve capital
- By mid-summer, many of these buyers indicated they were back in the acquisition game
    - Griffin solicited revised offers
- In September, the Company received multiple offers, but at a 17% lower valuation on average
- The Company elected to not accept the lower valuation offers
- In December, more buyers indicated they would increase their valuations to pre-pandemic levels
- The Company has narrowed the sale process to two finalists

TESCO

Transaction Type: Capital Raise
Industry: Electric Meter Testing Equipment Mfg.

Key Transaction Points

- TESCO (the "Company") is a leading manufacturer of electric meter testing equipment and related products and services which are sold to electric utilities throughout the U.S. and internationally
- TESCO's electric metering business had outgrown its original line of business which provides unrelated engineering services to third-party manufacturers. In order to simultaneously accomplish the strategic and personal goals of the Company's two equal owners, the Company elected to purchase one owner's equity in TESCO and to spin out the legacy business unit to this departing shareholder
- In addition, the Company had negotiated and entered into a Letter of Intent to make a strategic acquisition and sought to inject additional growth and working capital into the remaining business and refinance its existing credit facilities
- Griffin was engaged by TESCO to (i) design a leveraged recapitalization plan that achieved all of these goals, and (ii) raise the institutional capital required to finance the recapitalization
- Griffin managed a competitive capital raise process, which ultimately resulted in new debt facilities being provided by the Philadelphia office of TriState Capital Bank ("TriState") and Energy Impact Partners ("EIP") in a transaction that closed in May 2020

Question for the Audience (4)

- How likely are you to enter into an M&A or Capital Raising transaction in 2021?

    a. Absolutely
    b. Likely
    c. Not Likely
    d. No Way
    e. N/A