CALABASAS CAPITAL

Winter 2016 Mid-Market M&A Update & Sector Outlook

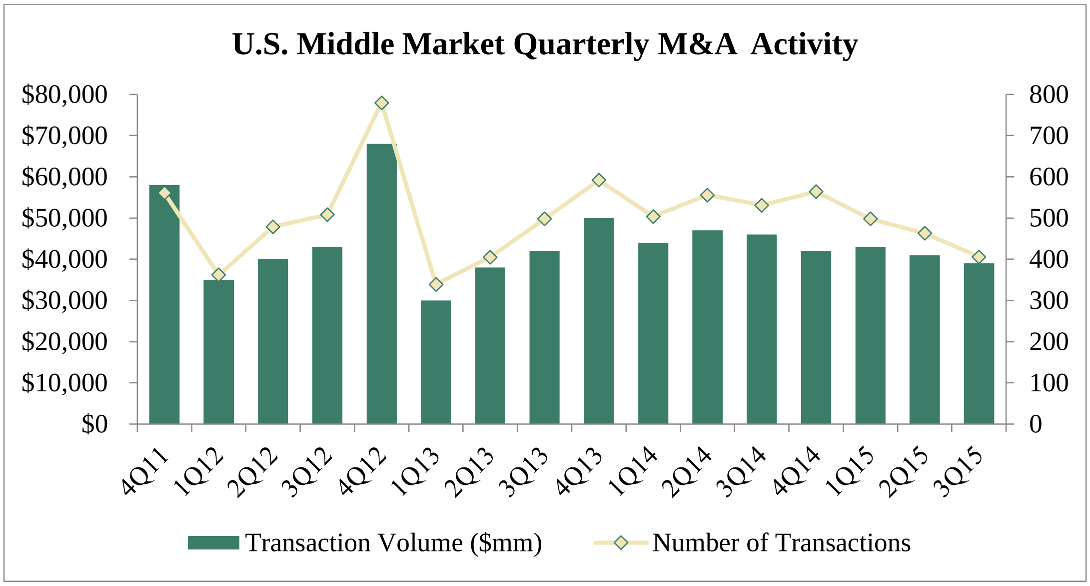
About Us

Calabasas Capital is a boutique investment banking firm focused on serving lower middle-market privately-held companies. We specialize in representing and advising businesses on sell-side and buy-side mergers and acquisitions and we raise private equity and debt capital.

Steady Decline In Activity Persists

Middle market M&A activity continued its steady decline in both deal volume and value in the 3rd quarter of 2015.

- Value and volume of deal flow in 3Q2105 was the third lowest quarterly activity in the past 12 quarters
- One reason could be that the private equity universe already sold its best companies during 2014 and early 2015



Source: Capital IQ.

The Lower End of the Market Expected to Stay Hot

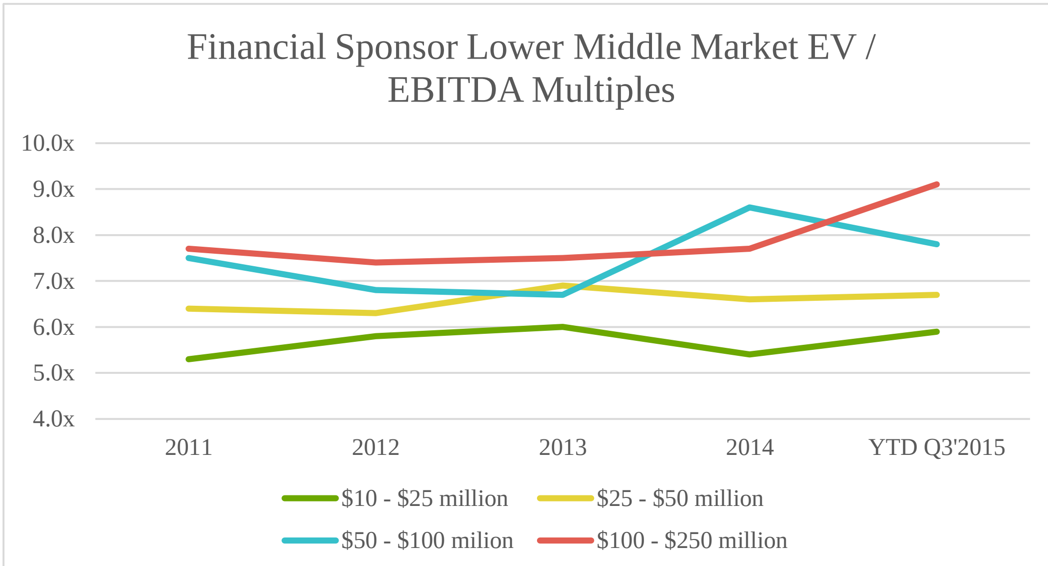
According to Mergers & Acquisitions, while the upper end of the middle market has appeared to peak, the lower middle market ($10 million to $250 million) is expected to remain very active.

- Many of the companies that make up the lower middle market are family-owned, and family-owned businesses tend to bide their time, waiting until all the stars are aligned to ensure they get the most out of the one sale they'll make in their lives.

- Family-owned businesses sense we may be coming to the end of the current economic cycle, and many will be ready to sell in the closing months of 2015 and early months of 2016.

Valuation Multiples Remain Strong

Lower middle market M&A multiples paid by private equity firms have remained strong especially at the higher end.



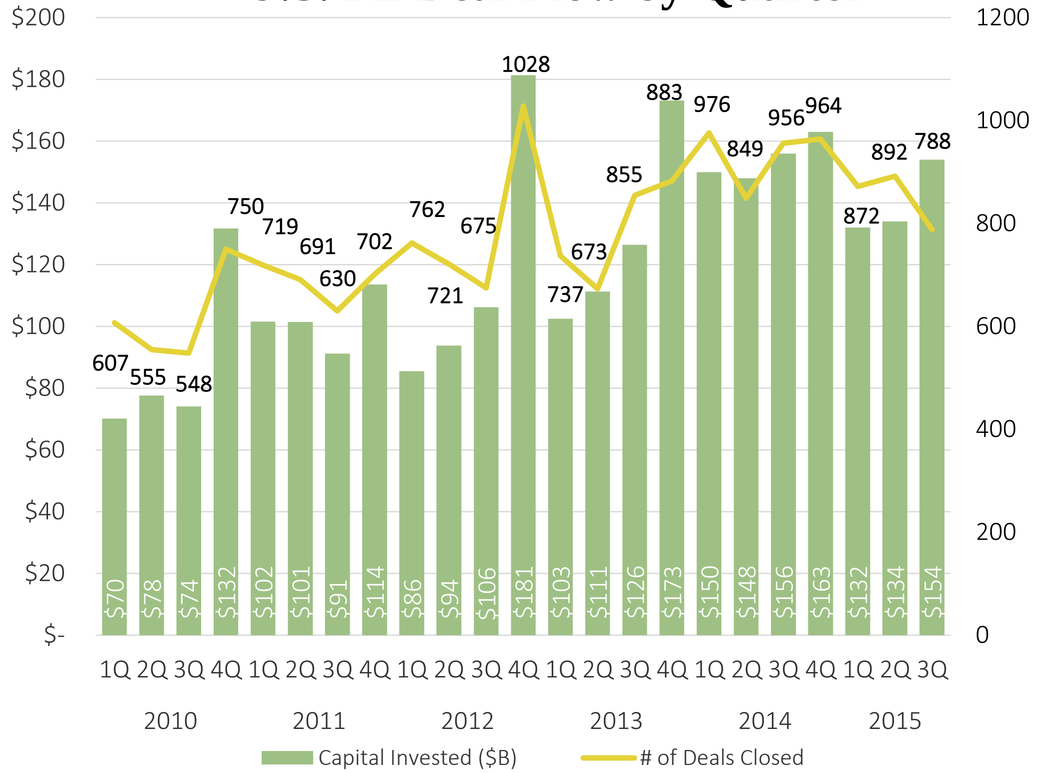
Source: Standard & Poors. Deal sizes of $10 million to $250 million.

- Valuations of deals greater than $50 million remain in the 8 – 9x range while those sub-$50 million continue to garner 6 – 7x on average.

U.S. Private Equity Market

- According to PitchBook, private equity deal activity in terms of number of deals slowed slightly once again in 3Q 2015.
  - ➢ The recovery in deal value however indicates an uptick in average deal size (i.e., valuation multiples remaining strong).

U.S. PE Deal Flow by Quarter



2016 Outlook

- The M&A market appears to be entering 2016 in a bit of transition. While the upper end of the middle market has begun to slow down a little bit, the lower end remains strong and is expected to remain strong for some time.
- Capital remains plentiful and cheap in terms of both debt and equity and in the public and private capital markets.
- If interest rates rise quickly and rise significantly M&A activity will be at risk. As of now, the Fed has indicated a path of gradual increases however. Therefore, the market for at least the first half of 2016 should present a favorable environment for buyers and sellers alike.
- Any potential rapid rise in rates will bring valuations down somewhat quickly and create at least a temporary pause in activity as sellers get used to normalized multiples.

Sector Outlook: Building Products & Materials

- Home sales are on the rise, which is building up demand for building product and material suppliers. According to the Department of Commerce, new U.S. home sales climbed to 495,000 units in October 2015 from 447,000 in September. Both strategic buyers and private equity firms have been active in this sector.

- According to Harris Williams & Co. managing director Michael Hogan, "the housing market has been recovering for four-plus years. While that sounds like a long time, we are still 30% to 40% below average. There is still some way to recover and there is a very strong recovery on the way. Bankruptcies are also near record lows which is a positive."

Sector Outlook: Food & Beverage

- In a slow growth environment for the economy overall, buyer interest in food and beverage companies is expected to stay strong.
- Large global food companies continue to restructure their product lines, selling off orphan brands and aggressively acquiring emerging healthy food and beverage brands. The public market valuations of these large strategics remain near all-time highs providing strong ammunition for acquisitions.
  - According to Glen Clarke, managing director at KeyBanc Capital Markets, “There are still 150 to 200 food companies owned by the private equity community, and as we know, those companies are always for sale. We’re going to continue to see those companies feeding into the M&A market, driving the continued M&A activity.”
- Categories of particular interest of late have been yogurt, protein and pressed juices.

Sector Outlook: Restaurants

- Despite the volatility seen in the valuations of large publicly traded restaurants, emerging restaurant chains, including most notably fast casual chains and bar-centric casual chains, with strong regional presence and the potential for national rollout continue to garner strong interest from both strategic and financial buyers.
- Financial buyers, including private equity firms and family offices, have continued to pour money into the restaurant space with both control buyout and minority investments. While the double-digit valuations (in terms of EBITDA multiples) of PE investments in chains with 10 or fewer stores could be a thing of the past, plenty of capital at attractive terms remains in search of highly differentiated concepts with significant growth potential.
- We also expect to see a continued convergence of grocery, food service and e-commerce. The demands of the millennial customer are compelling companies to expand their offerings and provide more convenient (i.e., on-demand) delivery solutions.

Sector Outlook: Commercial & Industrial Services

- Commercial and industrials services sectors ranging from facilities and equipment maintenance to marketing, technology, outsourced payroll/HR, transportation/logistics, telecom, test and measurement, safety, environmental, engineering, and government services, have been one of the strongest areas of middle market M&A.
- While lower gas prices help the bottom line of some services businesses, almost all have been experiencing rising labor and healthcare costs which have offset any energy cost savings. Assuming energy prices stabilize, if not increase at least to some extent from current levels, company profitability could be challenged especially considering continued slow top-line growth.
- Services companies with recurring revenue supported by long-term contracts have enjoyed very high multiples in the M&A market over the past two years. This has kept the volume of deal flow down as many buyers are unwilling to pay up. In that sense, M&A activity should improve at least in terms of volume if valuations come back down to earth.
- Industrial services businesses in the energy sector have been struggling as their clients have scaled back with low energy prices. Many of these energy-industry services businesses have high recurring capital commitments and significant debt. This turmoil has just begun to present consolidation opportunities but this should accelerate in 2016.

Sector Outlook: E-Commerce & Software

- According to Mergers & Acquisitions, the significant increase in Private Equity investment in the technology industry in 2015 is expected to continue in 2016.
  - "PE investors like tech targets because of their ability to produce returns, their recession-resistant nature and the fact that a slew of tech companies are finally mature enough for private equity investment, including most notably cloud computing and software."
- Software companies have high operating leverage so layering on acquisitions can be quite effective as a profitable growth strategy. Niche software providers which lack scale and growth opportunities but which are very profitable continue to present compelling acquisition targets for larger players.
- According to WWD, "Driven by a need to create a retail environment where online and in-store shopping are a seamless experience for consumers, retailers are expected to continue to make "bolt-on" acquisitions of vendors and e-commerce providers in 2016."
  - Large retailers experiencing modest same store sales have and will likely continue to make acquisitions to satisfy consumers' rapidly changing preferences, including acquisitions of vendors who can help accelerate the omni-channel approach.
- E-commerce is not exclusive to consumer products, however. Many consumer services and business services companies have attracted significant outside investment and been involved in M&A transactions, as they have continued to disrupt traditional business models.

Calabasas Capital

Our comprehensive services include:

- Sell-Side and Buy-Side Mergers & Acquisitions Advisory
- Private Equity & Debt Capital Raising
- Acquisition Financing
- Financial Restructuring
- Sales of non-core assets/divisions of larger public and private companies

Our industries of expertise include:

- Consumer Products & Services
- Commercial & Industrial Services
- Building Products & Materials
- eCommerce & Software
- Industrial Products
- Healthcare

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