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Sent: Friday, April 24, 2015 4:46 PM
To: David Bonrouhi
Subject: CalCap Viewpoint: Why PE-Backed Strategics Make Great Buyers

CALABASAS CAPITAL

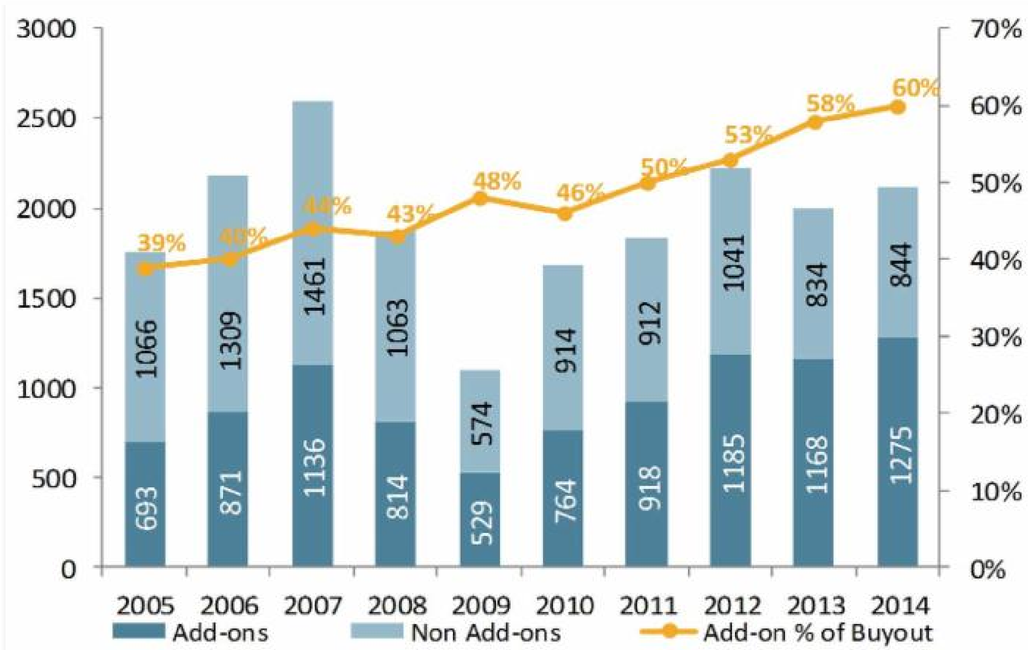
CalCap Viewpoint & Event Invite

April 2015

Dear David,

According to PitchBook, private equity investment in Q1 2015 was down 26% from Q4 2014. However, while private equity firms struggle to find new platform investments in an increasingly competitive investment landscape, add-on investment activity has continued unabated. According to PitchBook, add-ons comprised 60% of all private equity buyouts in 2014, up from 40% in 2006. Increased add-on activity is also a function of the trend toward more industry specialization in the PE community which allows them to better understand the markets involved and play a more meaningful role in adding value to their investments.

Middle Market Private Equity Buyouts: Add-Ons vs. Non-Add-Ons*



- As an investment banking firm focused on the lower end of the lower middle market, we and our clients have benefited from the trend of increased add-on acquisition activity tremendously. While many of our clients are not large enough to be considered for a platform investment because their EBITDA is less than $10 million or often even less than $5 million, they are typically very attractive candidates as an add-on investment to an existing private equity portfolio company.

*Source: PitchBook.

We routinely advise our clients to prioritize private equity-owned companies as potential suitors for the following reasons:

- **Maximizing Value**: Strategic buyers in general can of course pay more for a business in their industry than a pure financial buyer can because of potential synergies. This is not news. However, private equity firms routinely average down the purchase price of their investments by acquiring add-ons at lower EBITDA multiples than what they pay for the original platform. This gives PE-backed strategics even more incentive to aggressively pursue add-on acquisitions which are typically quite a bit smaller than the original platform company.
    - To illustrate, in a recent sell-side transaction, we represented a growing tech-enabled business services company with approximately $2.5MM in EBITDA which was acquired by a much larger PE-backed strategic for 7x. The PE firm had acquired the platform originally for 9x and over the course of five years acquired a number of smaller players for 5 - 8x effectively averaging down its

aggregate purchase price multiple. Once synergies are implemented this average cost goes down even further.

- **Certainty of Closure**: One of roles as advisers is to qualify buyers and help our clients do due diligence on the buyers while they are doing due diligence on our sellers. The strongest endorsement as to the financial strength of a potential buyer is the existence of a private equity sponsor already backing the buyer. In addition to this readily available equity, availability of debt capital also becomes less of a concern since banks typically love to lend to PE firms. Knowing the buyer really has the money goes a long way in maximizing the probability of actually getting the deal closed.

- **Timing**: Most companies that are acquired by lower middle market private equity firms do not have in-house corporate development teams. This function becomes one of the roles of the PE investor. While many strategic buyers without PE are also interested in acquisitions, evaluating deals is one of 20 things on the priority list of management and it often does not crack the top 10. Therefore, when they do look at deals, it is a slow process which can be very frustrating for sellers. PE-backed strategics however do have an outsourced corporate development team whose full-time job in many cases is to source and evaluate acquisitions. As a result they can move much faster during a deal process.

- **Retirement:** Some owners prefer to stay on board and are comfortable with the concept of rolling over a significant minority share in a change of control recap with a PE firm making a platform investment. These owners are excited about the potential to accelerate growth with an experienced deep pocketed financial partner and ultimately striving for that elusive 'second bite of the apple.' However, many owners in the lower middle market are looking to sell because they want to retire in the near term so to them the prospect of a recap involving a rollover is not really appealing. When a business is sold as an add-on, the seller most often has the flexibility of retiring very soon after closing since the platform company already has experienced and capable management in place.

- **Industry Familiarity**: Over the years we have found that most of our clients strongly prefer to deal with a buyer either from their industry directly or from an adjacent industry. Entrepreneurs seeking a liquidity event prefer to deal with a buyer that understands their business and speaks the same language.

- **Need to Put Capital to Work**: The need by PE firms to deploy their committed capital in an environment where completing large platform investments is getting extremely competitive makes add-on investments a very high priority for these firms. Growth via acquisition also expedites the timeframe to an ultimate exit for a PE portfolio company. Sellers can exploit this dynamic by being positioned as an attractive add-on investment to an existing portfolio company.

ACG 101 Event on Aerospace, Defense & Private Aviation
Wednesday, May 6, 2015
Clay Lacy Aviation (Van Nuys Airport)

Join us for a panel discussion from the perspective of business owners and executives, including:

- Brad "Brick" Conners, CEO, Vaughn Management & Services

- Brian Kirkdoffer, CEO, Clay Lacy Aviation
- David Schmidt, President, Hartzell Aerospace

Our moderator will Greg Range, Managing Director with Stout Risius Ross

To register please click here (a private tour is also being offered)

Calabasas Capital is an Annual Sponsor of ACG 101 (the 101 Corridor Chapter of the Association for Corporate Growth).

About Calabasas Capital

Calabasas Capital is a boutique investment banking firm that provides the following financial advisory services primarily to lower-middle-market privately-held companies, business owners and entrepreneurs:

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

Our principals have significant investment banking and private equity experience working with companies in a broad range of manufacturing and services industries with particular expertise in:

- Consumer products and services (i.e., food, apparel, footwear, electronics, household goods)
- Retail (including restaurant chains)
- Business Services (online and offline, including but not limited to financial, marketing, printing, equipment rental, information technology, and facilities maintenance);
- Technology (i.e., eCommerce, software, IT services, digital media, hospitality)
- Healthcare Services
- Entertainment
- Industrial Manufacturing

Thank you for continuing to keep us in mind for opportunities.

Regards,

David Bonrouhi   Brandt Blanken   Leslie Lum

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