Advisory Series Webinar

Growth, Legacy and Transition

Tuesday, May 17, 2022 | 2:00–3:00 p.m. ET

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Growth, Legacy and Transition

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Capital Markets Experiencing Rising Volatility, M&A Remains Resilient

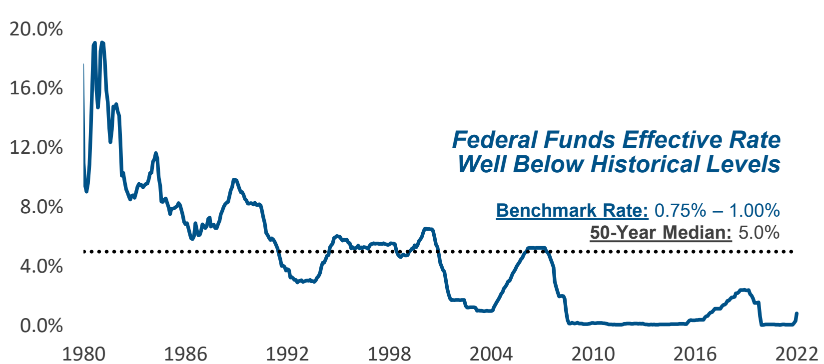
While the public markets have experienced significant volatility in the first few months of 2022, M&A and private market investments remain less affected.

Macro Backdrop

- Lingering effects of COVID-19 shutdowns, supply chain issues, and effects of unprecedented monetary inflation
- Bifurcation between the "haves" and "have-nots" of businesses able to perform and generate results in this unique environment
- Ukraine / Russia conflict taking center stage in 2022 and creating heightened geopolitical risk

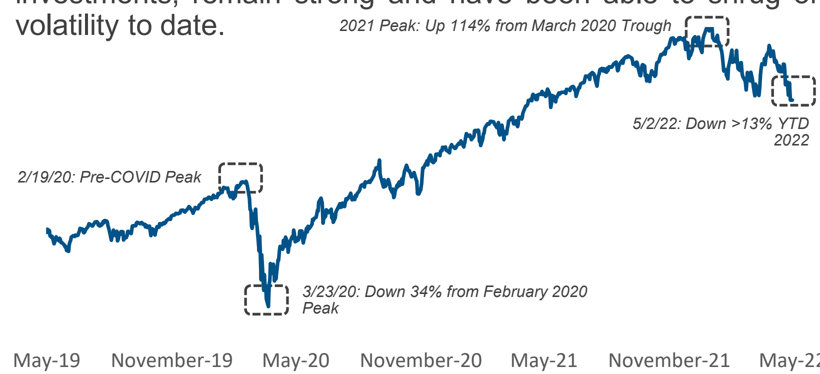
Rates and Responses

- The Fed raised rates by half a percentage point in May – the biggest hike in two decades – to help counter negative real yields and persistent inflation.
- Although the Fed has raised rates three times already in 2022, rates remain well below historical averages.
- With increasing volatility surrounding the Ukraine / Russia conflict, the Fed and other global central banks risk hiking rates and cutting QE into a softening backdrop.



Public Market Volatility

- The S&P 500 rose almost 27% in 2021, marking the benchmark's third straight positive year.
- The index is down over 13% thus far in 2022, with day-to-day gyrations following market headlines, as investors remain cautious given increasing geopolitical risk.
- High-yield bond markets, which follow equity trends, remain choppy in early 2022.
- Private markets, led by private equity and private debt investments, remain strong and have been able to shrug off volatility to date.



Sources: National Bureau of Economic Research, Bureau of Economic Analysis, The Organization for Economic Cooperation, and Standard and Poor's.

M&A Market Continues to be Competitive

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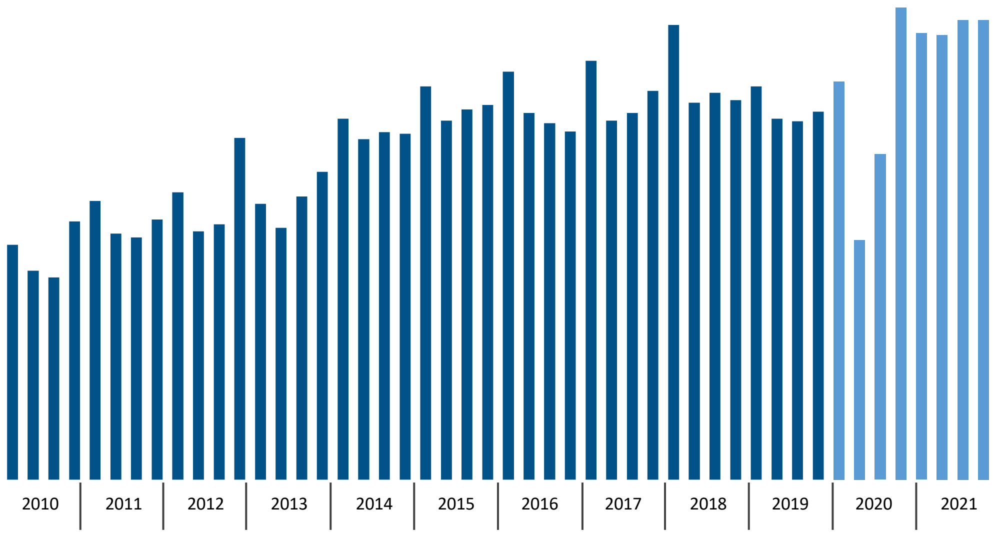
The U.S. Market is Gaining Momentum Despite Recent Volatility…

of North American M&A Closed Transactions



…However, Buyers Are Shifting Their Mindset

2021	2022
COVID normalization	Highly volatile public market
+	+
SPAC / IPO craze	Greater focus on the highest quality platforms
+	+
Record M&A volume and valuation levels	Valuations expected to hold for best-in-class assets
+	+
Risk-on, growth mindset	Risk-off, profitability proven mindset
Record level of capital deployed with a focus on high-quality, platform investments	***Heightened focus on quality with the expectation to aggressively pursue shorter list of platform opportunities***

Current Market Dynamics

Rising Interest Rate Environment

Clear expectation for rate increase(s) in 2022 with inflation on the rise; debt markets remain **supportive of high-quality businesses**

Private Equity

Record levels of Private Equity capital still to be deployed standing at **$1.5 trillion**; fundraising environment continues to **remain strong in 2022**

Strategic Buyer Funding

Soaring levels of cash, with the S&P 500 constituents holding **$2.1 trillion of cash** in aggregate on their balance sheets

Russian / Ukrainian War

Immediate-term impact is greatest on businesses with **personnel / customer exposure to Ukraine / Russia** and / or linked to the **energy sector**

Sources: National Bureau of Economic Research, Bureau of Economic Analysis, The Organization for Economic Cooperation, and Standard and Poor's.

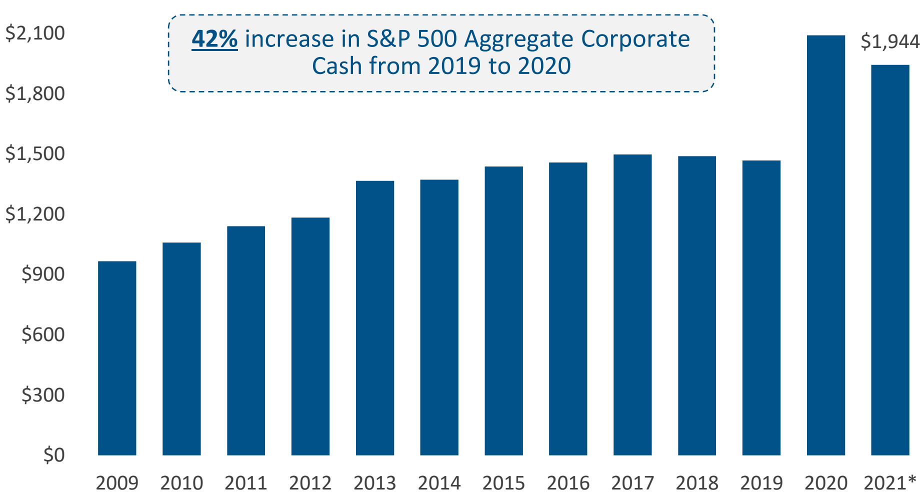
Excess Capital Driving Both Volume and Valuations

Unprecedented low rates and quantitative easing have exacerbated the capital overhang – strategic buyers, financial sponsors and leveraged lenders are under constant pressure to invest in growing businesses.

- The abundance of capital continues to shape the M&A landscape in 2022.
- In a world of heightened monetary inflation, financial investors and corporations are all looking for accelerated growth, and acquisitions are a proven way to scale efficiently and strategically.
- Capital overhang remains near all-time high levels, with more than $1 trillion of private equity dry powder and nearly $2 trillion in S&P 500 cash balances searching for returns in this low-yielding environment.
- Increased competition for deals has made its way into the lower middle market; roll-ups strategies have elevated valuations in consolidating sectors.

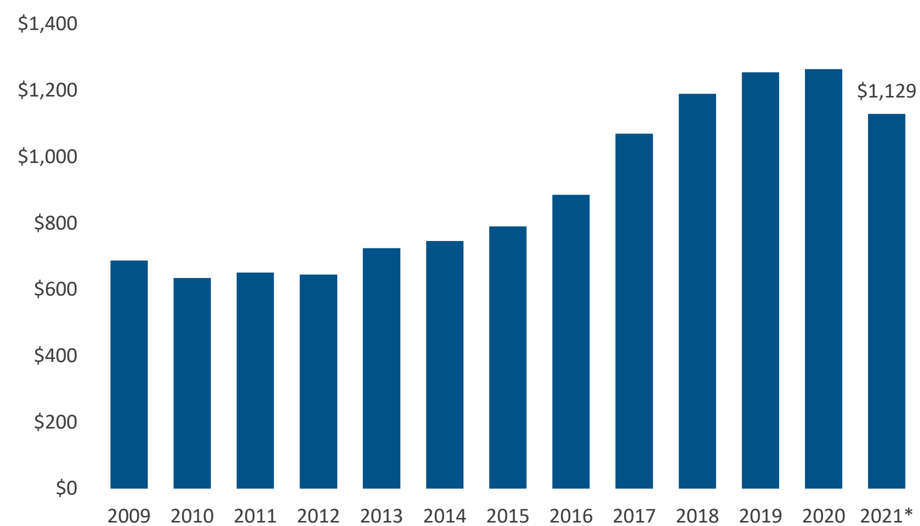
S&P 500 – Aggregate Corporate Cash Balances

($ in billions)



Record Levels of Private Equity Dry Powder Remain

($ in billions)



*Sources: CapitalIQ, Pitchbook. *Cash Balances as of Jun-21 and Dry Powder as of Sep-21.*

Private Markets – Growing and Return Generating

Private equity and private debt remain dominant forces in M&A, and the asset classes continue to grow at accelerating paces.

- As the private markets continue to evolve and generate outsized return/yield, coupled with less day-to-day volatility, investors have continued to increase allocations to private market investments.
- While the M&A market cycles alongside the economy, this secular trend has supported shallower troughs and quicker snapbacks over the past decade.
- Fundraising had another banner year in 2021, as investors looked to boost their private market exposure on expectations that most of the capital received from deal exits will be recycled into new equity and debt funds and investments.
- Lofty valuation multiples, increased competition for quality assets, and a constant search for growth have led to a disproportionate number of buy-and-build strategies in recent years.

Record Statistics in 2021

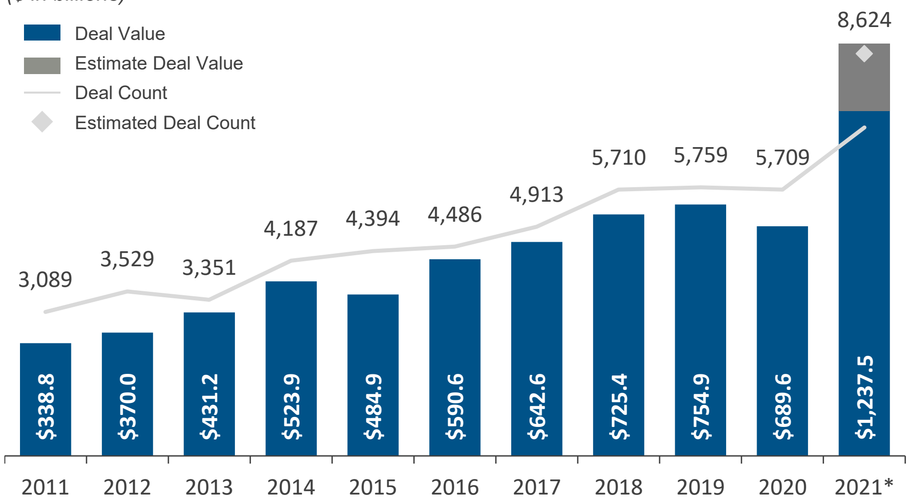
8,600+
Private Equity Transactions

~$1.2 Trillion
Combined Deal Value

>50%
Above the Previous Annual Record for Deal Value

U.S. PE Deal Activity

2011 – 2021, by Year
($ in billions)



U.S. PE Fundraising

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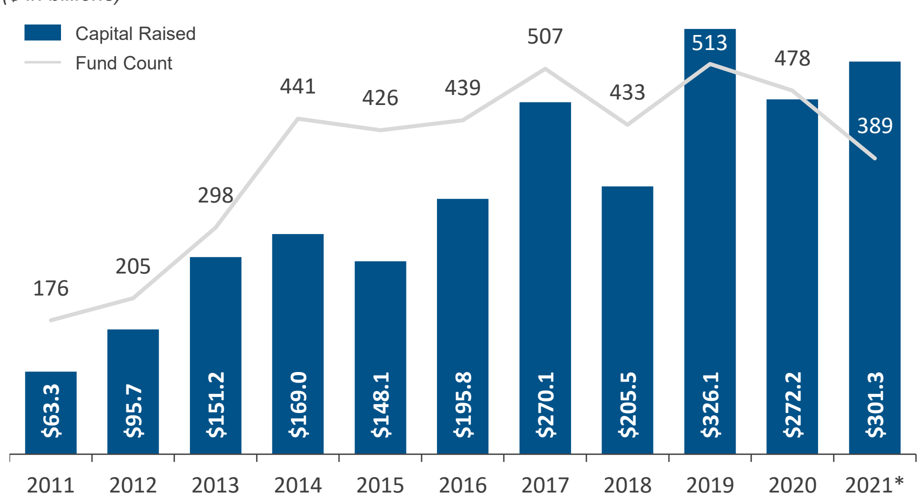
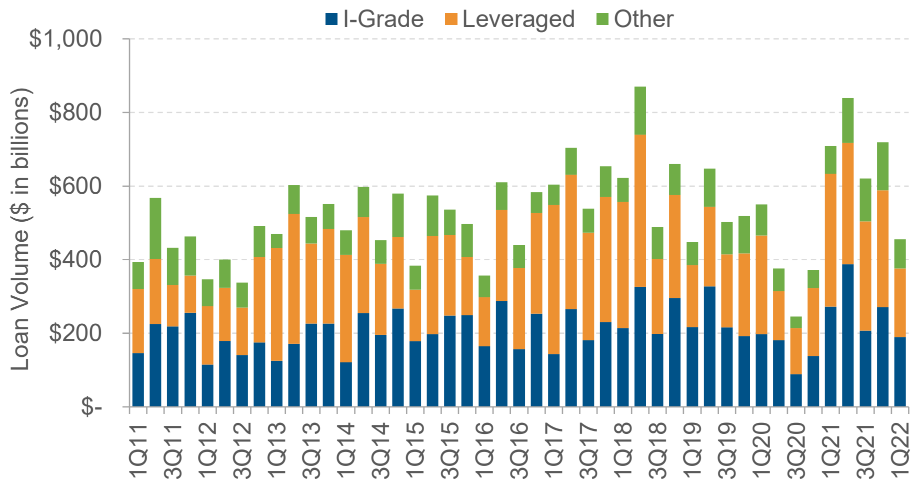


*Source: Pitchbook. *Preliminary numbers as of December 31st, 2021.*

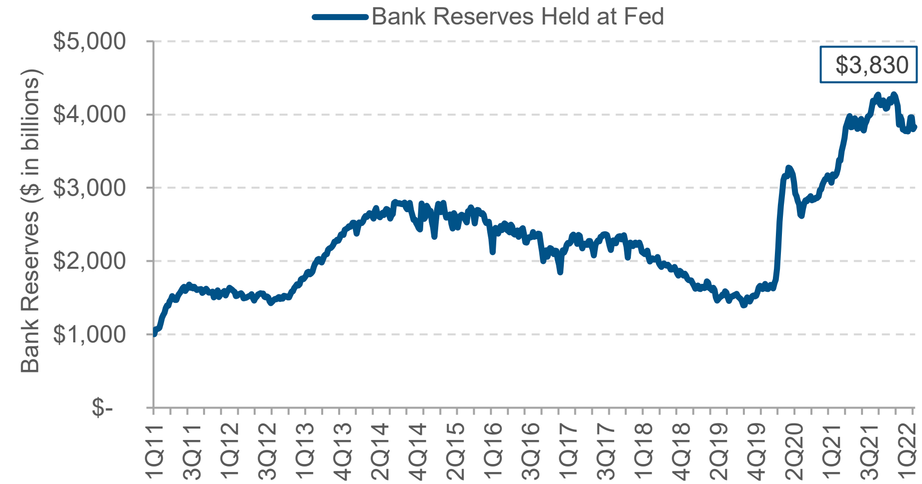
U.S. Syndicated Lending Slows in 1Q22

International Instability, Volatility, & Economic Headwinds Challenge the Market

Syndicated Lending Down 36% Q/Q as Companies Navigate Supply Chain Disruptions, a Challenging Labor Market and Rising Inflation

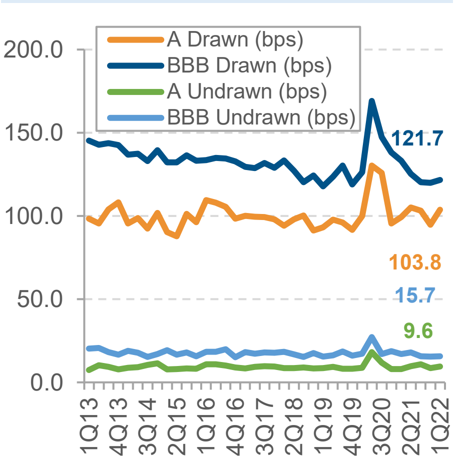


Lender Appetite for Loans Remains Strong as Bank Liquidity Continues to be Near All-Time Highs

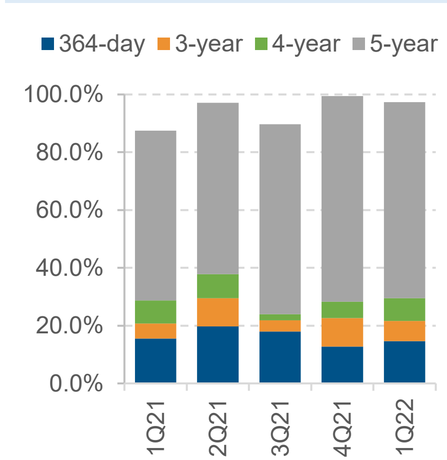


Drawn Margins Slightly Increase in 1Q22, Share of 5-Year Revolvers Steady at Pre-COVID Levels

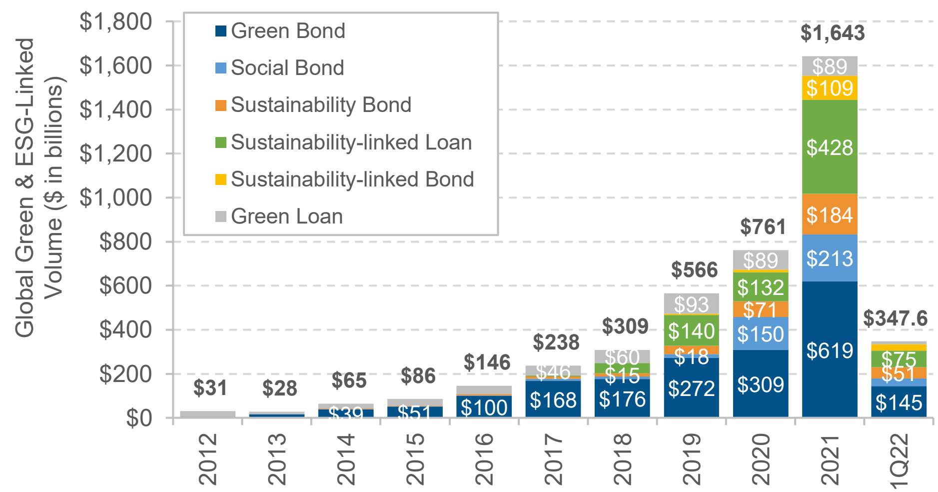
Revolver Pricing



Revolver Tenors[1]



ESG Issuance Off to a Slower Start YTD after a Record Year of Issuance in 2021



Sources: Refinitiv LPC, Federal Reserve Bank of St. Louis

[1]Outstanding share comprises tenors not represented in the chart

Economic Growth Concerns Result in Market Unease

Corporate Fundamentals Remain Healthy but Uncertainty Abounds

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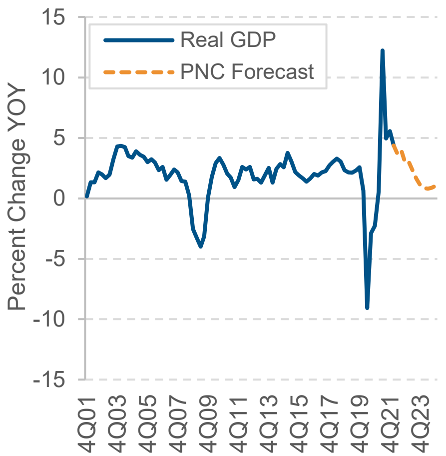
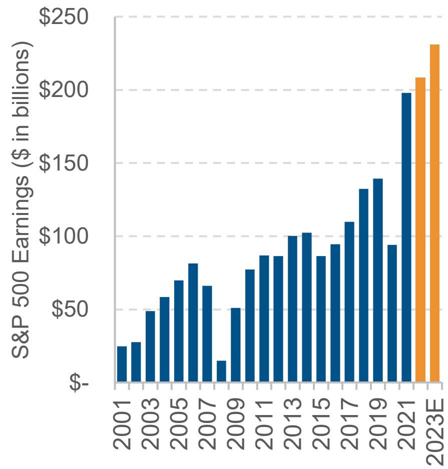
Economic Growth Slowed by Inflation, Rising Interest Rates, and Ukraine / Russia Conflict

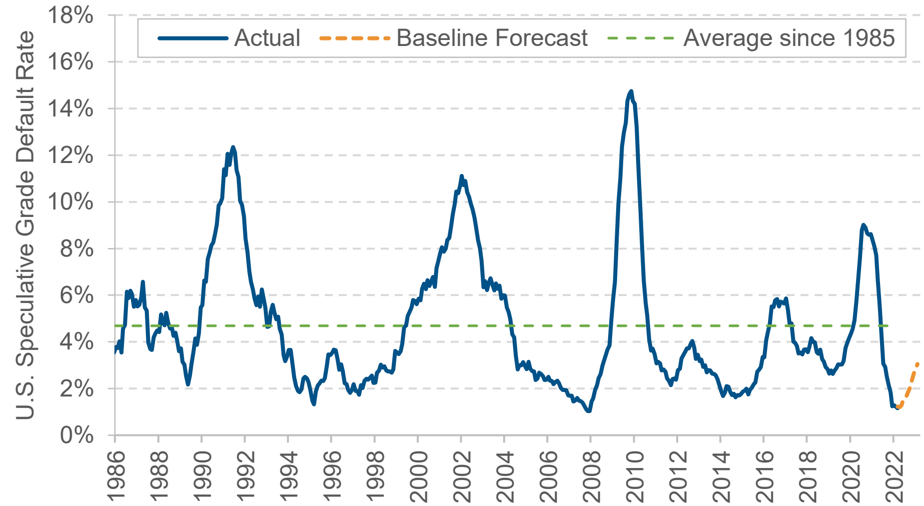
GDP Growth Slows



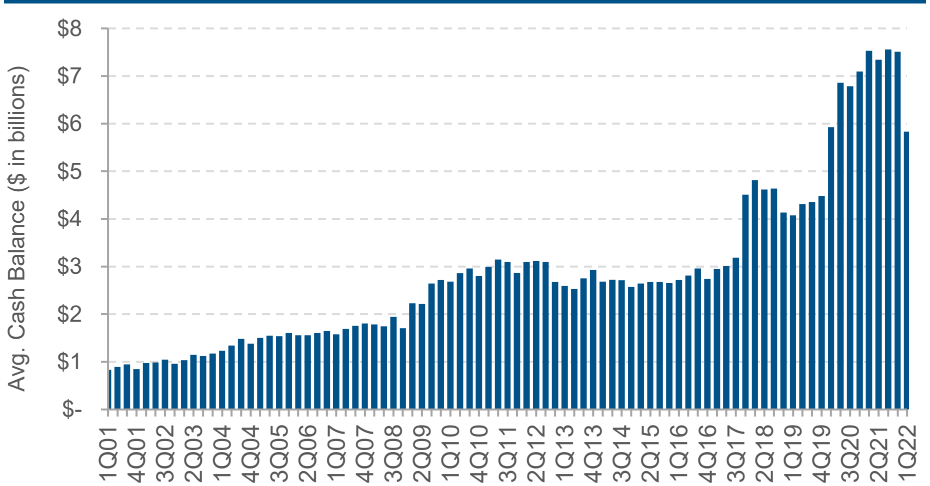
Positive Earnings Growth



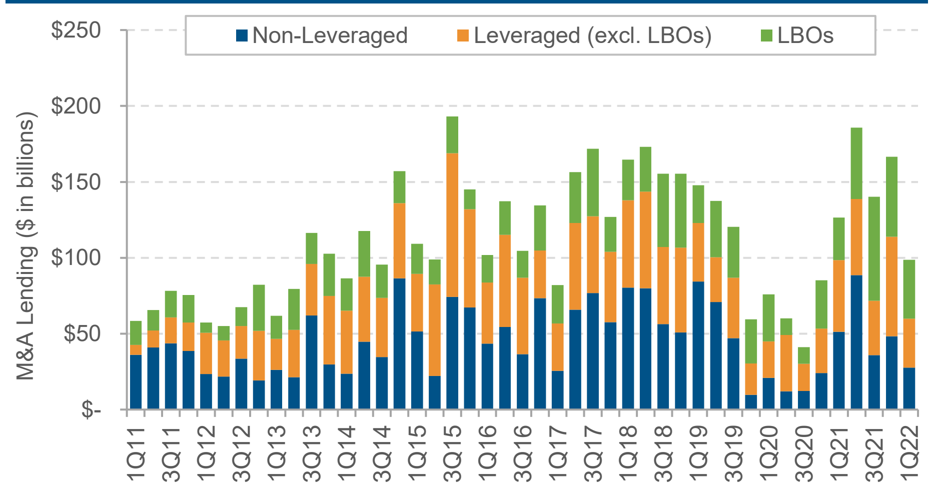
Near-Term Default Rates Expected to Remain Below Average Due to Lowered Refinancing Risk



Cash Balances Decline as Corporates Put Cash to Work



1Q22 M&A Loan Volume Totals Less Than $100B, Down 23% Y/Y, as IG Lenders Faced a Thinning Pipeline of M&A Deals



Sources: S&P Dow Jones, Bloomberg, S&P Capital IQ, US Bureau of Economic Analysis, S&P Earnings Estimates Report

Key Trends for Privately Held Businesses

How PNC Can Help You Meet Your Corporate & Shareholder Goals

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Key Trends for Privately Held Businesses

- Analyzing opportunities to invest in business & ***drive shareholder value***
  - Focus on growth (organic and potential acquisitions)
  - Opportunities to drive operating efficiencies
  - Working capital efficiencies
- Focus on finding ways to ***attract & retain key talent*** that is critical to business
- Exploring strategic alternatives and longer term planning
  - Assess shareholder goals
  - Understand art of the possible on potential paths at corporate level
  - Impact to other key stakeholders
  - Determine impact of market conditions and tax landscape to various strategies

How Corporate Advisory Can Help

As you develop a strategic plan designed around your corporate and shareholder goals, we can help you in analyzing and integrating the following key items:

- Help your management team, board and shareholders assess:
  - Transition and succession planning
  - Assess the ***optimal capital structure*** and mechanics of execution that can provide appropriate liquidity, align with risk tolerance and fund corporate and shareholder goals
  - Integrate strategies around estate, tax, personal and family planning
  - Identify opportunities to enhance ***executive compensation and benefits*** and align with value creation they are driving
  - Corporate governance, including dividend policy framework
- Identify additional opportunities to ***drive shareholder return*** – growth, margins, working capital, capex efficiencies, etc.
  - Provide ***peer benchmarks***
  - Provide financial analytics to show directional impact to enterprise value, cash unlocked and ROIC
  - Guidance around acquisition strategy and process including debt capacity and insights on M&A landscape
- Provide update and make recommendations based on
  - Macro economic environment
  - Capital and M&A markets
  - ***Key trends*** across the broader portfolio

Buy-Side Transaction Process

Overview and Timeline

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Key Drivers

It is a Numbers Game

The more targets the better

Value of Proprietary Deal Flow

There is *significant* value buying a company not in market

Be Decisive

Have a process and continue to progress to a LOI

Strategic > Financial

Explain family values and long-term vision for combined companies

Use M&A Professionals

Leverage M&A professionals for legal, accounting, diligence, etc.

Multiple Arbitrage

There is immediate value creation from an acquisition

1 Strategy Formation

Formulate clear and thoughtful plan, determine goals, build internal team and have a programmatic approach with consistent follow up.

2 Marketing Materials Creation

Develop materials that will be presented to targets to illustrate objectives, provide a Who, What and Why. Include one-page teaser and letter introducing your company and the opportunity.

3 Identify Targets

Build an extensive list of companies that fit your search criteria and leverage all networks and resources. It's a numbers game.

4 Build the Pipeline

Begin target outreach, response rates are driven upwards by rigorous follow-up. Be creative and grab the attention of the owner and/or CEO.

5 Maintain the Pipeline

Organization is paramount. Utilize an internal or 3rd party software to keep track of outreach and next steps. Deals do NOT age like wine, momentum is crucial.

6 Discussions with Targets

Be acquisitive and have questions prepared. Have genuine curiosity in their business. If interested in pursuing further, provide a NDA and initial diligence request list.

7 Offer Preparation

Indication of Interest (IOI) is provided, includes valuation range. After positive reception of the IOI, 2 to 4 weeks is spent finalizing a Letter of Intent (LOI), typically includes site visit and more due diligence.

8 Due Diligence and Closing

Expect last minute negotiations as it's an emotional decision for the seller. Once LOI is signed, work with legal and accounting to move towards an efficient closing.

Key Considerations for Integration

Integration management in the first 100 days following an acquisition often defines the success of the combined entity. It is important to establish ***analytical drivers***, co-write a ***value creation plan*** and assess and confirm your ***leadership team*** early on.

Key Considerations for Acquisitions

Key Areas of Focus for Acquirors

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It is a Numbers Game

- Do not put all your eggs in one basket. There are a lot of factors that need to align to make an acquisition happen. Your starting list should have 25+ companies and ideally more than 50, if you are in a fragmented industry.
- ***Keep an open mind***. You will be surprised what you learn on intro calls and who you ultimately acquire.

M&A Professionals

- Once you are in the acquire phase, your legal counsel will be the most important asset to closing a deal. As such, make sure you are working with an ***experienced M&A attorney***.
- There are investment banks that will run the entire buy-side process for you.

Be Decisive and Move Fast

- Have a well thought out plan and execute it on a timeline. From start to finish an ***acquisition should occur in 6 to 9 months***.
- Understand you will not be able to learn every detail of the company you are acquiring. Therefore, prioritize what you ***need to know*** and make sure you have that information prior to an LOI.

Value of Proprietary Deal Flow

- Waiting for sell-side advisor to show you deals is not a viable growth strategy. ***You need to be proactive*** and in market contacting companies to successfully acquire.
- Additionally, there is ***significant value in buying companies not in market*** or going through a competitive process.

Strategic > Financial

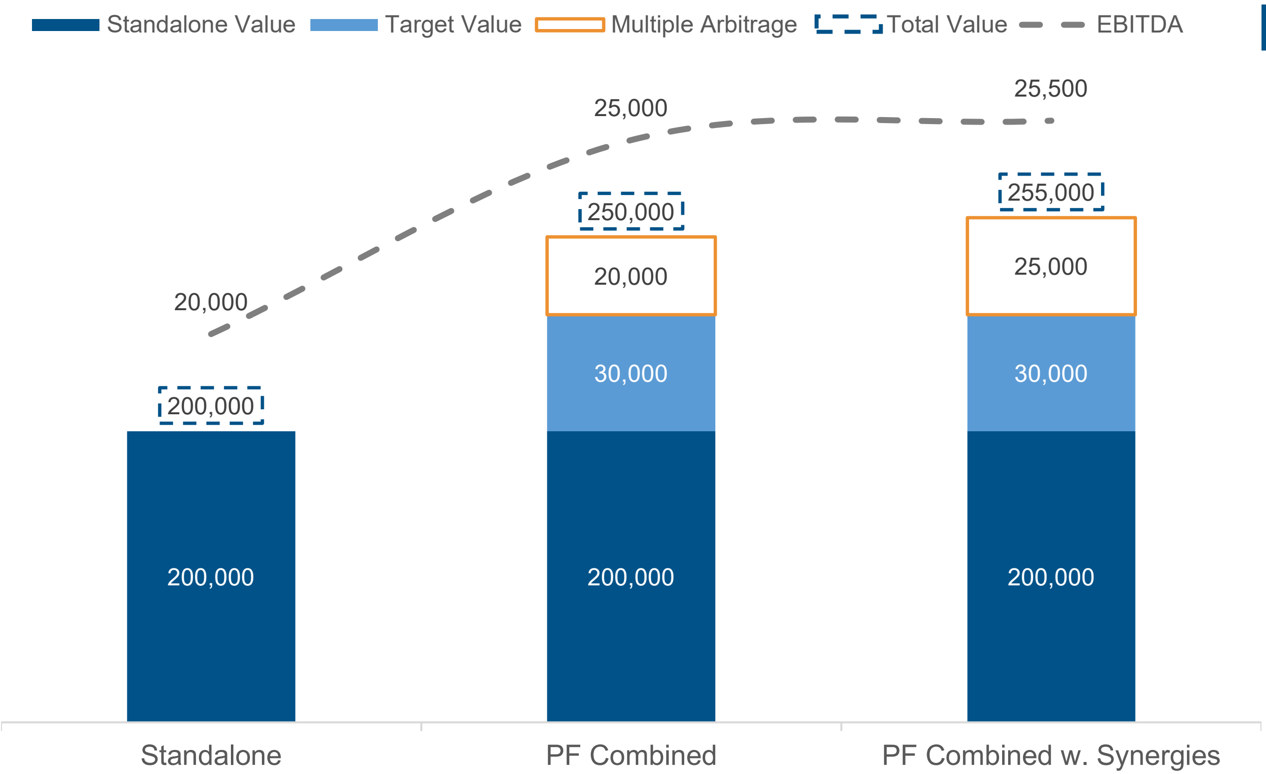
- Sometimes companies prefer selling to a strategic as opposed to a financial buyer. ***Explain the family values your company instills and long-term plans of the business.***
- One of the top concerns for sellers is their employees. Be prepared to discuss their role in the combined companies early on in the process.

Multiple Arbitrage

- As companies grow so do their multiples. Therefore, buyers pick up ***immediate value when making an acquisition*** – prior to any operational efficiencies realized.
- This practice is often used by private equity firms to enhance returns.

Capitalizing on Multiple Arbitrage

Value Creation Through Bolt-on Acquisitions



	Standalone Acquirer	+	Acquisition Target	=	Pro-forma Combined	Pro-forma w. Synergies
Revenue	$100,000		$30,000		$130,000	$130,000
Synergies						500
EBITDA	20,000		5,000		25,000	25,500
Multiple	10.0x		6.0x		10.0x	10.0x
Valuation	200,000		30,000		250,000	255,000
Multiple Arbitrage	-		-		**20,000**	**25,000**

Key Takeaways

- Multiple arbitrage is the practice of increasing the value of a company before having made any operational improvements to it. ***Essentially, you are arbitraging the multiple at which the company is bought and sold.***
- Some strategic buyers and private equity portfolio companies build strategies around rolling up industries solely for the purpose of achieving multiple arbitrage.
  - That is, ***increasing aggregate EBITDA and then selling the whole company for a greater value than the sum of its parts.***
- This practice has become more common as competition has driven larger firms to look for smaller add-ons to accelerate growth in their existing business.
- Multiple arbitrage hinges on the fact that asset valuations vary widely for different types of buyers, allowing there to be a buy-sell spread for savvy acquirers.

Note: For illustrative purposes

Analyzing Options for Deploying Capital

Investing in the Business vs. Returning Cash to Shareholders

Your strategic goals for the business, as well as individual shareholder and family goals, will drive your decision around near and long term plans for how capital will be deployed.

Invest in the Business

- Fund growth opportunities (M&A or organic growth) and support associated working capital impacts
- Invest in technology to drive operating efficiencies
- Reward key management/employees
- Paydown debt and/or repurchase shares
- Build liquidity reserves to provide flexibility or navigate challenging economic times
- Fund working capital needs
  - Expedited AP to take advantage of discounts
  - Delays in AR collection
  - Unique inventory build needs

Return Cash to Shareholder

- Fund shareholder's personal goals
- Provide opportunity for portfolio diversification
- Offer liquidity to facilitate a sale or transfer across family members
  - This can be executed under numerous structures depending on desired mix of gift vs. sale
- After a generational transfer has occurred a dividend from the business can be executed to create liquidity for the new shareholders to cover any estate tax obligations
- Create liquidity across the shareholders with proceeds from distributions so individual shareholders can use their pro rata share to buy one another out

Executing a Leveraged Recap

Estate Planning Benefits to Consider

Key Drivers

A leveraged recap is a tool that has been used by business owners for years as a way to generate liquidity and execute planning. They are gaining particular popularity because of the following key drivers:

- Current favorable interest rate environment
- Recent economic uncertainty – many business owners looking to diversify investment portfolio
- Concerns over changes in federal income tax, capital gains taxes, estate and gift exemptions, and tax rates

Estate Planning Benefits

1 Diversify Portfolio

Generates liquidity for broad shareholder group that can be used to drive portfolio diversification or execute buy-outs amongst shareholder group

2 Reduce Future Capital Gains Tax Obligations

Additional debt from recap reduces the value of the equity. Depending on timing of when shares are sold, the amount of gain and the income tax paid on such gain could be lower.

3 Receive Tax Deduction on Interest Payments

For businesses taxed under subchapter C of the Internal Revenue Code, interest related to the new debt may be tax deductible.

4 Lock in Current Tax Rate on Qualified Dividends

Paying a dividend now may take advantage of lower tax rates if the tax rate on qualified dividends increases in the future.

5 Transfer Shares Post-Transaction at Lower Value

Additional debt from recap reduces the value of the equity. Consider making gifts outright to, or in trust for, family members, or using a freezing technique, such as a GRAT, while value is depressed.

Key Considerations for the Business

Understand impact to leverage and credit profile

Ensure sufficient remaining capital to support corporate goals

Employee Ownership

Attracting and Retaining Talent

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1

More Competitive

S-Corp ESOPs generated approximately 12.1% compound annual returns from 2002 – 2019, outpacing the S&P 500 Total Return Index by ~33% over this period[1]

Employee Owned S-Corp distributions totaled more than $8.7bn in 2019[2]

2

More Stable and Resilient

Default rate on bank loans to ESOP companies from 2009–2013 was 0.2% annually, 10 times lower than mid-sized U.S. companies[3]

Employment in S ESOPs increased 37% since 2002, exceeding private sector[4]

3

Great Place to Work

48% of *Fortune* 2019's 100 best companies to work for have broad-based ownership plans

Median job tenure is 5.1 years – 46% greater than non-ESOP companies[5]

Millennial employees at ESOP companies, by a factor of 46% to 15% of their counterparts, have a current net worth of $50,000 or more[6]

4

Create Value for Workers and Economy

Median household wealth for employee owners aged 35 in 2017: $44 million vs. $30 million for non-employee owners (49% greater)[3]

More financially secure and less worried about economic positions to withstand major financial obligations[6]

5

Superior Retirement Benefit

ESOP retirees feel 3 times more secure about retirement savings than non-ESOP retirees, and 91% of ESOP workers feel confident about retirement versus only 49% non-ESOP[7]

S-Corp employee owners had 2 times higher ESOP balances, on average, than traditional 401(k)s[8]

[1] *Ernst & Young's ESCA S-Corp ESOP Analysis 04/2022*
[2] *Ernst & Young's ESCA S-Corp ESOP Analysis 04/2022*
[3] *NCEO Study. Jun 2014.*
[4] *ESOPs as an Exit Plan for Private Business Owners. May` 2017.*
[5] *NCEO. Employee Ownership Report. Nov/Dec 2018.*
[6] *John Zogby Strategies Study commissioned by ESCA. 2017.*
[7] *John Zogby Strategies Study. 2019.*
[8] *NCEO Study. 2019.*

Executing a Shareholder Buy-Out

Strategies and Structuring Considerations

Execution Strategies

Distribution Strategy (Recap)

Company uses excess cash or borrows to make a distribution to shareholders. Purchasing shareholders use proceeds to purchase shares from selling shareholders.

Shareholder Loan

Company uses cash or borrows to provide loan(s) to purchasing shareholder(s). Purchasing shareholder(s) use loan proceeds to purchase shares from selling shareholders.

Share Repurchase

Company uses cash or borrows to purchase shares from selling shareholders. With fewer outstanding shares, all remaining shareholders increase % of ownership pro rata.

Seller Note

Selling shareholders take back a note for some or all of the purchase price of the shares being sold. Interest, term and amortization can vary (as seller and buyer agree).

Executive Compensation

If intent is to reward key executives, shares or options might be part of compensation over time. Also, cash bonuses can help fund share purchases.

Voting / Non-Voting Shares

Shareholders establish voting and non-voting shares. Equity can be transferred while current owners retain control. Control changes by the transfer of voting shares.

Key Structuring Considerations

- Understand impact to ***corporate / personal liquidity, leverage and cash flows***
  - Ensure structure provides sufficient capital to fund corporate goals if they are of higher or aligned priority
  - Using a seller note will delay seller's receipt of cash
  - Shareholder loan and seller note tenor, amort., interest, etc. should be structured to work with corporate / personal goals
- Integrate time frame under which shares would be purchased and at what value (all at once or staged)
- Shareholder loans must be ***bona fide*** – loans must have an end date and be commercially reasonable
- Share repurchase strategy only works if the intent is for all ***existing shareholders to increase % of ownership on a pro rata basis***
- Consider ***tax implications*** (capital gains vs. ordinary income)
  - Critical to understand tax results
  - Distributions can trigger capital gains or dividend income. Understand the different tax implications
  - Shareholder loans and seller notes can delay payment which can also defer gain recognition and capital gains tax
  - A share repurchase can offer a way to defer a capital gain
- Techniques can be combined to produce the desired result

__Comment:__ PNC does not provide tax or legal advice. To ensure you fully understand and integrate the impact from a corporate and individual shareholder perspective it is critical you work closely with your tax and legal advisors to determine the optimal structure. These insights are being provided to offer high level directional education.

Attracting and Retaining Key Employees

A Strategic Approach

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How you structure your compensation program can greatly affect the likelihood that you can attract and retain the key employees who are vital to your success.

Define Your Goals

Before committing financial resources, it is crucially important to determine exactly what your goals are.

Align Comp with Desired Results

Timing flexibility and using different compensation arrangements may be designed to accomplish your specific business goals.

Tailor to Individual Employee

If the plan does not motivate or incentivize a particular employee or group, you risk wasting financial resources.

Decide Who is "Key"

Compensation level does not always mean "key" and there are ways to reward other employees beyond compensation.

Review and Modify

Major events may warrant reconsideration of compensation arrangements and incentives offered to key employees.

Communicate

To maximize return on investment, it is important that your key employees fully understand additional compensation plans.

Non-Compete Agreements

A well-designed non-compete agreement may be useful, but also limited if your primary goals are employee retention and focus on growth – offer a carrot to go with the stick.

Equity Compensation Plans

Compensation through ownership may be the most direct way to align compensation and business success, but it is critical to understand all implications of ownership.

Synthetic Equity Plans

Synthetic equity plans attempt to mirror the financial rewards of direct ownership without providing the employee with all the legal rights of ownership.

Key Compensation Strategies

- ***Cash Bonus***
- ***Restricted Bonus***
- ***Restricted Stock***
- ***SERP***
- ***Grants of Stock***
- ***Nonqualified Deferred Compensation***
- ***Stock Options***
- ***Phantom Stock***
- ***Stay Bonus***
- ***Stock Appreciation Rights***

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  - Using a seller note will delay seller's receipt of cash
  - Shareholder loan and seller note tenor, amort., interest, etc. should be structured to work with corporate / personal goals
- Integrate time frame under which shares would be purchased and at what value (all at once or staged)
- Shareholder loans must be ***bona fide*** – loans must have an end date and be commercially reasonable
- Share repurchase strategy only works if the intent is for all ***existing shareholders to increase % of ownership on a pro rata basis***
- Consider ***tax implications*** (capital gains vs. ordinary income)
  - Critical to understand tax results
  - Distributions can trigger capital gains or dividend income. Understand the different tax implications
  - Shareholder loans and seller notes can delay payment which can also defer gain recognition and capital gains tax
  - A share repurchase can offer a way to defer a capital gain
- Techniques can be combined to produce the desired result

__Comment:__ PNC does not provide tax or legal advice. To ensure you fully understand and integrate the impact from a corporate and individual shareholder perspective it is critical you work closely with your tax and legal advisors to determine the optimal structure. These insights are being provided to offer high level directional education.

Dividends to Shareholders

Helping Shareholders Accomplish Personal and Family Goals

Absent opportunities to use cash to invest in growing or improving the business, taking cash out of the business can help accomplish personal and family goals.

Potential Uses for Cash Proceeds

1 Portfolio Diversification

- Owners can "take some chips off the table" using the cash to fund personal goals.
- Owners can diversify away from a heavy portfolio concentration in the business asset.

2 Family Sales / Transfers

- The liquidity generated can be used to facilitate a transfer or sale of the business to family members.
- Intrafamily transfers of the business can be accomplished through various structures, including sales and gifts or a combination thereof.

3 Tax Liability

- After a transfer, a cash distribution from the business can create liquidity for the new shareholders.
- Following an owner's death, cash distributed can be lent to a deceased owner's estate to help pay estate tax.

4 Owner Buyout

- A cash distribution can provide liquidity to all owners so that certain owners can purchase other owners' interests in the business.

Advisory Series Webinar

Growth, Legacy and Transition

Thank you for attending.

PNC BANK