

## Inside this Issue

Welcome to the November 2013 issue of the Private Company Group DealReader, a newsletter focused on merger-and-acquisition trends, transactions and events of interest to owners of private companies and their advisors.

In this issue, we pose five questions to Nicholas Altieri, Paul Stam and Nikita Ramchandani of the Wealth Strategies Group in Morgan Stanley's Private Wealth Management Division. The team discusses commonly encountered tax, trust and estate planning issues. In addition, the

interview provides a short look at some of the recent changes due to the American Taxpayer Relief Act of 2012 and its effect on strategies used by taxpayers.

Other topics covered in this issue include:

- The Lincoln 500 Index and a discussion of our unique perspective on the middle market
- Key M&A market and purchase agreement statistics

- Profiles of recent Lincoln International transactions, including the sale of General Donlee to Triumph Group and the capital raise for Clarion Capital Partners' acquisition of Cross Accessory Division.

We hope you find this newsletter a useful tool and we welcome your comments or questions.

Lincoln International

## Five Questions For: Morgan Stanley Wealth Strategies - Tax, Trust and Estate Planning

*Morgan Stanley Wealth Strategies Group seeks to increase its clients' awareness of tax planning opportunities as it relates to their investments. They work with the clients' Private Wealth Advisor as well as legal and tax advisors to construct investment portfolios that incorporate all elements of a client's balance sheet.*

*Nicholas Altieri is a Managing Director who joined Morgan Stanley in 2004, Paul Stam is an Executive Director who joined in 2005 and Nikita Ramchandani is an Associate who joined in 2011.*

*We asked the Morgan Stanley team five questions regarding certain tax, trust and estate planning issues which are commonly encountered by private company owners.*

**Q: Estate Planning Transfers attracted a great deal of attention last year. What prompted that activity? How does the estate planning landscape look in 2013?**

A: For estate planners, 2011 and 2012 presented what appeared to be a significant albeit short-lived opportunity for wealth transfer. This was due to the fact that the amount one could transfer free of estate and gift taxes was temporarily set at \$5 million for 2011 and \$5.12 million for 2012. The excitement last year was caused by the impending reduction in the amount of that credit from \$5.12 million to \$1 million for 2013, resulting in a flood of gifts from clients to trusts for children, grandchildren and even the donor's spouse. This appeared to

lock in a \$10.24 million credit per couple, in comparison to the \$2 million credit slated in 2013.

However, in somewhat anti-climactic fashion, the 2013 fiscal cliff tax laws maintained the \$5 million transfer tax credit – and, in fact, increased the amount due to an inflation adjustment to \$5.25 million. As such, the gift trusts that were enormously popular in 2012 have slowed significantly. While from a tax perspective it is still beneficial to remove assets – in particular, the future growth and income on such assets – from one's estate, with the \$5.25 million credit now "permanently" in place, many clients are reluctant to part with a \$5 million or \$10 million gift.

**Q: If they're not gifting, what types of estate planning are clients engaging in?**

A: Many clients are now returning to a category of planning strategies known as "leveraged gifting". In short, a leveraged gift (which in fact, does not utilize any third party leverage as the name seems to imply) typically involves a loan of assets from donor to a trust for family beneficiaries (typically, children and grandchildren). The loan mechanism varies but it generally freezes the value of the loaned asset in the donors' estate and transfers future asset appreciation out of the estate free of estate

### Morgan Stanley

and gift taxes. It also avoids consuming one's gift tax credit or paying any gift tax. More importantly, since leveraged gifting only removes assets from the donor's estate if there is appreciation in the future, it provides an inherent hedge against over-gifting where the gifted asset has a speculative future value, as in the typical pre-liquidity client.

*"In somewhat anti-climactic fashion, the 2013 fiscal cliff tax laws continued the \$5 million transfer tax credit... As such, the gift trusts that were enormously popular in 2012 have slowed significantly."*

Leveraged gifting can seem to be "too good to be true" since the strategies can (if successful) move significant amounts of wealth transfer tax-free and often with little to no tax downside if not successful.

Nevertheless, these strategies are often very conservative and conform to the provisions contained in the Internal Revenue Code. That said, even a very conservative leveraged gifting strategy can be made more aggressive if the assets used in the strategy are heavily discounted.

**Q: What other themes are you seeing this year?**

*(Continued on page 2)*

(Morgan Stanley, continued from page 1)

A: Aside from a reversion back to “traditional” estate planning (as opposed to substantial lifetime gifts), we are also seeing heightened interest in income tax efficiency and planning, given the steep increase in the income tax burden on wealthy individuals. To this end, even the new tax laws were somewhat uncharacteristically cooperative.

For example, the new laws extend the favorable tax treatment given to “qualified small business stock” (“QSBS”). To quickly explain, a QSBS permits the exclusion of some or all of the gain on the sale of the stock. Although QSBS had gone dormant for some time since the exclusion’s value was limited, the new tax laws allow a greater exclusion percentage, which, combined with higher long term capital gains rates and the 3.8% tax on investment income, makes the exclusion more valuable on the federal level. Additionally, the QSBS might also result in state income tax savings separate from the federal benefits.

Indeed, state income tax planning is another area of growing focus. For clients looking to move to sunnier and more tax-friendly locales, Puerto Rico recently joined the list of income tax jurisdictions that are attractive for its residents. The Commonwealth recently enacted legislation that exempts from local tax dividends and interest from US companies and exempts from all tax capital gains on appreciation that occurred after a taxpayer moves to Puerto Rico.

Taxpayers for whom moving to an income and estate tax-free area is not a viable option might consider specially designed trusts in jurisdictions that do not impose their own income tax on trust income or out-of-state beneficiaries. One such trust known as a Delaware Incomplete Gift Non-Grantor trust (“DING trust”) is not designed to transfer assets out of one’s estate. Instead, it is aimed at setting assets aside in a trust that can benefit the grantor but also not pass back state income tax liability on trust assets to the grantor.

Tax deferral is also a valuable component of the planning process these days. In addition to traditional retirement account structures and investments through insurance policies, a charitable remainder trusts (“CRT”) can offer tax deferral options as well. Investments in CRTs can provide valuable tax deferral as a result of “borrowing” the tax-exempt status of a charitable beneficiary that is named as the beneficiary of at least 10% of the trust. However, it is important to note that they are best suited for clients for whom philanthropy is an important objective as there can be a meaningful set-aside for

charity through a CRT. Other tax deferral strategies that will likely regain popularity are sales to employee stock ownership plans, like-kind exchanges and exchange funds for select public securities.

**Q: Timing – when should an individual approaching a liquidity event consider some of the strategies you’ve discussed?**

A: When it comes to laying out the blueprint, the sooner the better. However, that might not necessarily be the case for execution. In the case of wealth transfer techniques (e.g. gifts to individuals and/or leveraged gifting), acting early is generally advantageous as values tend to be lower than they will be at the point of some future liquidity event, presumably. The greater the appreciation, the more effectively a wealth transfer vehicle can remove assets from the donor’s taxable estate. Charitable giving, on the other hand, tends to be more attractive later in the sale timeline, but not too close to the ultimate deal. The risk of getting too close to

*“When it comes to laying out the blueprint, the sooner the better. However, that might not necessarily be the case for execution.”*

the consummation of the deal is that the IRS will raise the “assignment of income” doctrine which argues that if the deal is beyond the point of no return, then the taxpayer may no longer assign the income/gain in the asset to another party.

**Q: Are there any other tax law changes that you anticipate your clients might be facing in the near term?**

A: Clients could see another round of tax discussions that could impact discounts, grantor trusts, estate tax and municipal bond interest. Grantor trusts (i.e., trusts that are income taxable back to the grantor) could be the subject of estate tax inclusion, which would be a significant change to current law and one that would eliminate a very popular tool in the estate planner’s toolbox. The estate tax, which appears to be at levels Congress is comfortable with, could change in either direction – reverting to lower credits and higher rates as has been the historical norm or, on the other extreme, being repealed altogether. Finally, there is some speculation that the federal tax exemption for municipal bonds could be capped at being exempt only up to a certain rate. We have not seen any significant advancement of any of these in recent

### About Morgan Stanley Wealth Strategies

Morgan Stanley Wealth Strategies has a full team of professionals with expertise in tax, trust and estate planning, asset allocation and quantitative analysis as well as due diligence and manager selection. Morgan Stanley Wealth Strategies offers those capabilities as part of the suite of services its Private Wealth Management Division offers to its ultra high net worth clients.

months, but they are items that we are keeping an eye on. ■

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# The Lincoln 500 Database — Lincoln's Perspectives on the Middle Market

**About The Lincoln 500 Database:** Lincoln maintains an extensive proprietary database in connection with its quarterly portfolio valuation activities containing valuation and financial data for a diverse group of companies across ten primary industry segments. The database offers a glimpse into the middle market where reliable data is otherwise limited. Valuation metrics reflect observed transaction multiples. Financial results reflect information available at the end of each calendar quarter (typically, financial statements for one or two months preceding the end of the period). The database contains nearly 500 companies.

As in the earlier part of 2013, lending conditions in the financial markets remain robust. Equity markets performance remains strong, with the S&P 500 reaching an all-time high. While LBO activity remains slower than expected, pricing is still attractive. In fact, loan terms continue to drive refinancing activity across industries.

Based on the data collected by Lincoln, middle market company performance has improved since Q1 2013, albeit at a barely noticeable rate. Despite continued improve-

ment in many macro-economic indicators, the majority of middle market companies find that they are faced with revenue declines and margin compression. For the second time since we began tracking this data in Q1 2011, the number of companies in our data set showing quarterly year-over-year revenue and EBITDA declines exceeded 50%. In fact, 57% of companies evidenced a decline in EBITDA, a slight decrease over the prior quarter.

Declining performance continues to be broad-based, impacting all size strata and most industry segments. While more companies show declines than increases this quarter, the declines did not accelerate as we had feared might happen. This represents a continuation of a trend which we first observed in Q3 2012. Flat to declining top line revenue on lower-than-expected demand and margin compression from higher input costs and various industry headwinds.

Presented below are selected data from our Q2 valuation activities as captured by our proprietary database.

## M&A Transactions

	Q3 '11	Q4 '11	Q1 '12	Q2 '12	Q3 '12	Q4 '12	Q1 '13	Q2 '13
TEV / EBITDA	6.0x	7.1x	7.2x	6.6x	8.1x	7.5x	7.7x	7.2x
Total Debt / EBITDA	3.4x	3.7x	3.9x	3.9x	4.5x	4.1x	4.3x	4.3x
Senior Debt / EBITDA	2.7x	3.0x	2.9x	3.2x	3.4x	3.3x	3.3x	3.3x
Equity % of Total Cap	41%	45%	43%	39%	44%	43%	46%	38%
LTM EBITDA (Average)	\$21	\$19	\$30	\$32	\$35	\$30	\$29	\$19
Count	19	7	11	13	22	28	8	8

### Commentary:

- Average equity cushions observed in Q2 2013 decreased to 38%, the lowest level observed since the beginning of 2011 and a significant decrease from 46% last quarter.
- Average total enterprise value (TEV) to LTM EBITDA multiple implied by closed M&A transactions in Q2 2013 declined to 7.2x.
- Total leverage (4.3x) and senior leverage (3.3x) remained flat in Q2 2013 relative to the prior quarter.

## % Financial Growth Rates (Mean)

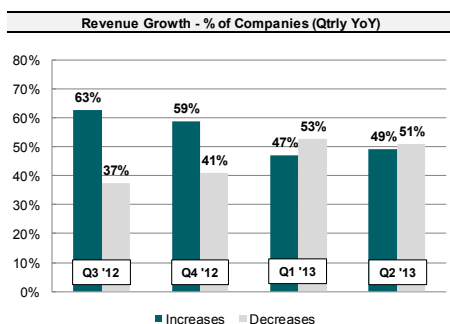
### By Size:

EBITDA	Q2 '13 LTM EBITDA Margin	Q1 '13 vs. Q1 '12 Revenue	Q1 '13 vs. Q1 '12 EBITDA	Q2 '13 vs. Q2 '12 Revenue	Q2 '13 vs. Q2 '12 EBITDA
\$0 - \$10	16.7%	-3.7%	-4.7%	-1.7%	-6.0%
\$10 - \$50	19.8%	3.4%	-4.5%	0.8%	0.5%
> \$50	23.7%	-2.3%	-8.1%	-1.9%	-0.8%
<b>Total</b>	<b>20.0%</b>	<b>0.6%</b>	<b>-5.2%</b>	<b>-0.5%</b>	<b>-1.2%</b>

### By Industry:

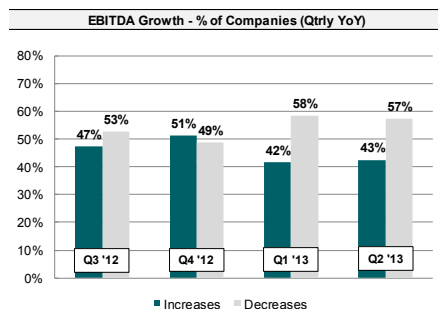
Industry Sector	Q2 '13 LTM EBITDA Margin	Q1 '13 vs. Q1 '12 Revenue	Q1 '13 vs. Q1 '12 EBITDA	Q2 '13 vs. Q2 '12 Revenue	Q2 '13 vs. Q2 '12 EBITDA
Business Services	21.2%	3.5%	2.9%	-0.2%	-0.1%
Consumer	16.6%	0.4%	-2.9%	2.2%	-2.1%
Healthcare	22.8%	3.1%	-14.4%	4.9%	-0.4%
Industrials	16.1%	-3.5%	-7.4%	-6.9%	-2.0%
Technology	23.2%	-7.9%	-10.0%	-7.3%	1.3%
<b>Total</b>	<b>20.0%</b>	<b>0.6%</b>	<b>-5.2%</b>	<b>-0.4%</b>	<b>-1.2%</b>

## Revenue & EBITDA Trends



### Commentary:

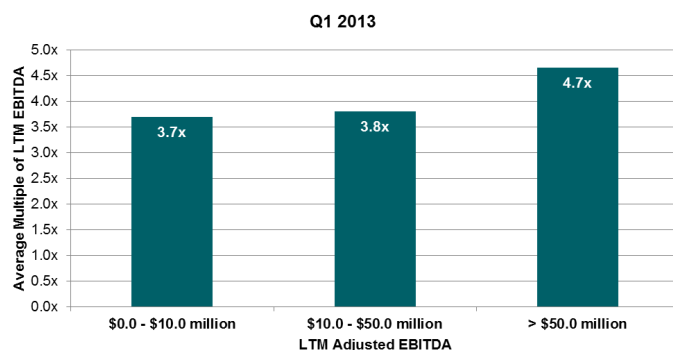
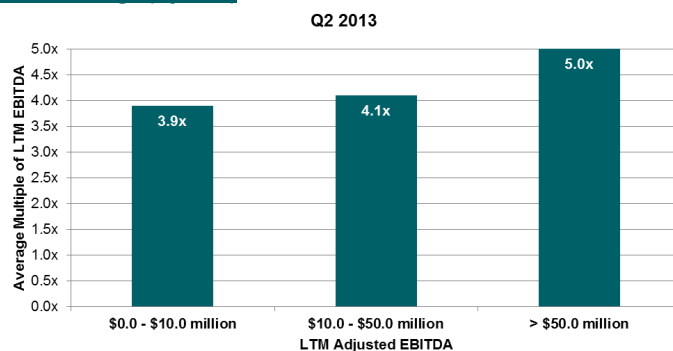
- Since Q3 2012 financial performance has trended downward as evidenced by the percentage of companies reporting revenue and EBITDA growth.



- Approximately 49% of the companies observed reported revenue growth in Q2 2013 vs. Q2 2012. This was an increase from 47% in the prior quarter. Similarly, the proportion of EBITDA gains increased from 42% in Q1 2013 to 43% in Q2 2013.

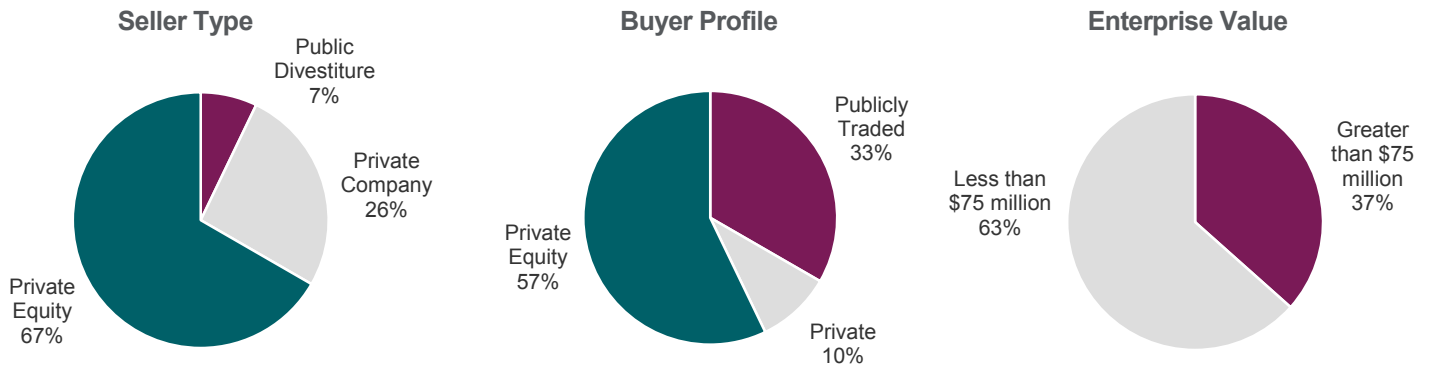
Note: Aerospace & Defense, Automotive & Truck, Chemicals, Energy, and Financial Services excluded due to limited historical data

## Total Leverage (By Size)



# The Market Pulse: DATA THAT AFFECTS THE MID-MARKET M&A LANDSCAPE

## Lincoln Completed Transaction Data (N. America) — Last 12 Months Ended July 31, 2013



### Valuation Statistics: Average Enterprise Value Multiples Last 12 Months Ended July 31, 2013

	EV / LTM EBITDA		EV / LTM Revenue	
	Adj. Mean	Median	Adj. Mean	Median
Less than \$75 million	6.78x ▲	7.04x ▲	1.09x ▲	0.85x ▲
Greater than \$75 million	7.12x ▲	7.78x ▲	1.03x ▼	0.93x ▼

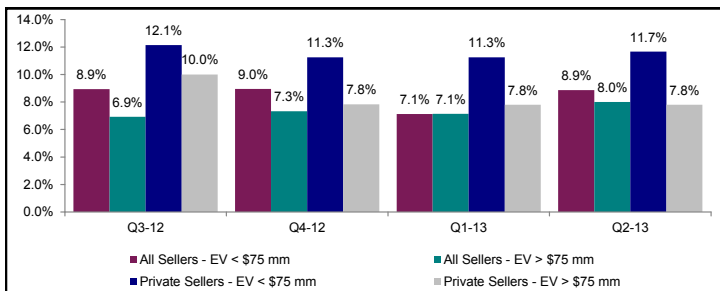
Note: Arrows denote comparison with M&A transactions completed during the 12 months ended March 31, 2013; adjusted mean excludes high and low values prior to mean average calculation

### Observations

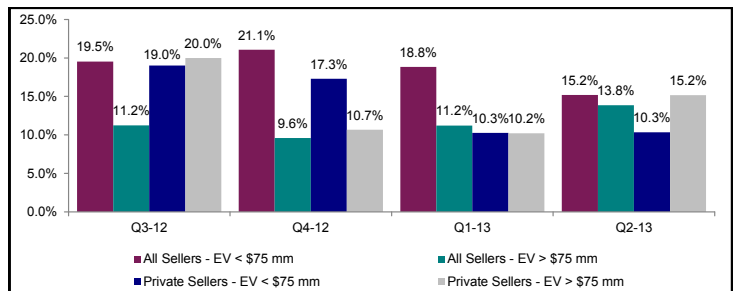
- Valuation multiples have increased
- Larger companies' premiums over smaller businesses, as measured by EBITDA and Revenue multiples, have remained relatively stable or declined slightly

## Key Purchase Agreement Terms — Lincoln's North American transactions

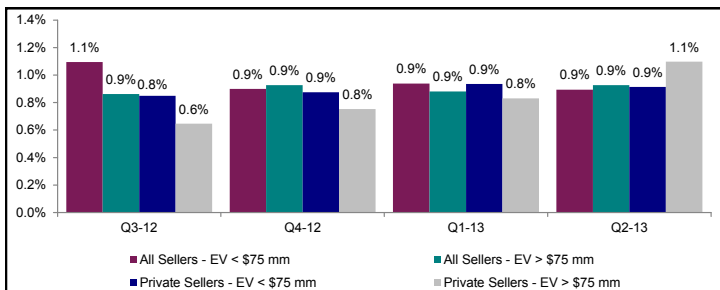
### Escrow as a Percentage of Purchase Price



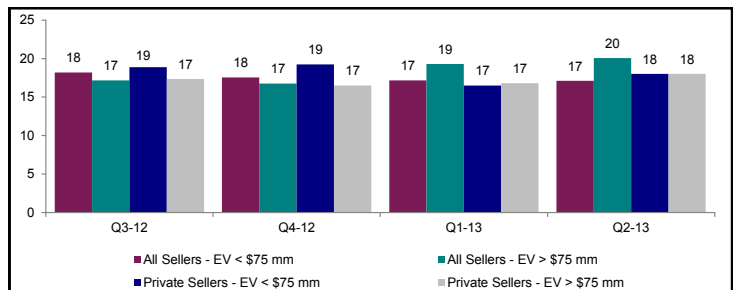
### Indemnity Cap as a Percentage of Purchase Price



### Basket as a Percentage of Purchase Price



### General Indemnity Term (in months)

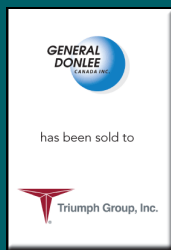


### Observations

- In general, terms for smaller companies have improved relative to larger companies, as increased activity in the lower middle market has driven competition in purchase agreement terms for smaller companies
- Public strategic acquirers remain active
- Lenders remain active, driving private equity groups to be more flexible on terms

Note: Agreement terms on last twelve month basis ended in noted quarter  
Source: Lincoln International

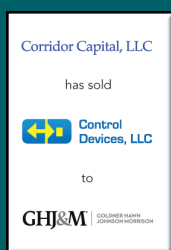
## Selected Recent Lincoln International Transactions



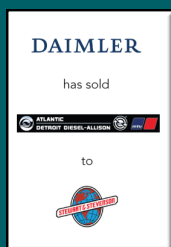
- Sell-side transaction (October 2013)
- General Donlee Canada Inc. is a leading provider of close-tolerance precision machined components for the aerospace, nuclear and oil and gas industries. The company is headquartered in Toronto, Canada.
- Acquired by Triumph Group, Inc., a leading manufacturer of aero structures, aircraft components, subassemblies and systems worldwide. The company is headquartered in Berwyn, Pennsylvania.



- Capital raise transaction (September 2013)
- Cross Accessory Division is a leading designer and marketer of branded personal and business accessories, marketed under the iconic Cross brand name. The company is headquartered in Lincoln, Rhode Island.
- The debt financing consisted of a senior asset based revolving credit facility provided by HSBC Bank and a unitranche term loan provided by GSO Capital Partners.



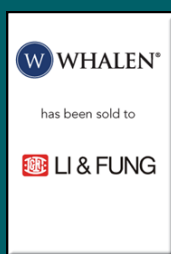
- Sell-side transaction (August 2013)
- Control Devices is a leading designer and manufacturer of highly engineered flow control solutions. The company is headquartered in Fenton, Missouri.
- Acquired by Goldner Hawn Johnson & Morrison Inc., a leading private equity group which has invested over \$600 million in 33 platform companies. The company is headquartered in Minneapolis, Minnesota.



- Sell-side transaction (August 2013)
- Atlantic Detroit Diesel-Allison, LLC distributes and services diesel and alternative fuel engines, transmissions, power generation systems and a wide range of related products, components, parts and accessories. The company is headquartered in Lodi, New Jersey.
- Acquired by Stewart & Stevenson LLC, a leading designer, manufacturer and provider of specialized equipment and aftermarket parts and service for the oil and gas and other industries. The company is headquartered in Houston, Texas.



- Sell-side transaction (July 2013)
- Exacq Technologies, Inc. is a leading developer of open architecture video management systems ("VMS") for surveillance and security applications. The company is headquartered in Fishers, Indiana.
- Acquired by Tyco International Ltd., a market leader in the \$100 billion global fire protection and security solutions industries. The company is headquartered in Schaffhausen, Switzerland.



- Sell-side transaction (July 2013)
- Whalen is the leading platform providing branded consumer durables and services in North America, offering a diverse mix of products that include home and garage storage systems, closet storage systems and dining and juvenile furnishings. The company is headquartered in San Diego, California.
- Acquired by Li & Fung Limited, a holding company engaging in the design, development, sourcing and distribution of consumer goods worldwide. The company is headquartered in Kowloon, China.

## Lincoln International's Global Footprint



150+ professionals throughout the United States

100+ professionals plus a 24-person advisory board in Europe

Offices throughout the “BRIC” economies of Brazil, Russia India and China

★ Indicates Lincoln International office

### About Lincoln International

Lincoln International specializes in merger and acquisition advisory services, debt advisory services, private capital raising and restructuring advice on mid-market transactions. Lincoln International also provides fairness opinions, valuations and pension advisory services on a wide range of transaction sizes. With fifteen offices in the Americas, Asia and Europe, Lincoln International has strong local knowledge and contacts in key global economies. The firm provides clients with senior-level attention, in-depth industry expertise and integrated resources. By being focused and independent, Lincoln International serves its clients without conflicts of interest. More information about Lincoln International can be obtained at [www.lincolninternational.com](http://www.lincolninternational.com).

### Industry Groups

Lincoln International's dedicated industry verticals are organized on a global basis and led by senior professionals with significant advisory and sector expertise:

- Aerospace and Defense
- Automotive and Truck
- Building and Infrastructure
- Business Services
- Chemicals
- Consumer
- Electronics
- Healthcare
- Industrials
- Packaging
- Renewable Energy
- Technology
- Transportation and Logistics

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