Lincoln INTERNATIONAL

DEALREADER | Private Company Group

**The merger-and-acquisition newsletter for owners of private companies and their advisors**

Fall 2014

# Inside this Issue

Welcome to the Fall 2014 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, Greg Davies discusses the effect of individuals' emotions in their investing patterns, and how behavioral finance can help them achieve their long-term goals.

Other topics covered in this issue include:

- The Lincoln 500 Index and a discussion of our unique perspective on the middle market
- Profiles of recent Lincoln International transactions, including the sales of EPM Global Services to STACI Corporation, Dura-Line Holdings to Mexichem and Brook Furniture Rental to Agman Partners.

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

Lincoln International

## Behavioral Finance: In Pursuit of Anxiety-Adjusted Returns — Greg B. Davies

*Greg B. Davies, Head of Barclays' Behavioral / Quantitative Finance Group, provides his views on how emotions can affect individuals' investing patterns, and how behavioral financial can help investors achieve their long-term financial goals.*

The investment management industry remained, for many years, so punch-drunk on classical finance theory that its myopic focus on returns proved to be to the detriment of returns. Behavioral finance has since begun to teach investors that by focusing on something other than long-run financial efficiency, we can actually get closer to it.

The answer to this seeming paradox lies in the fact that, without looking after our short-term need for emotional comfort, we may find it very difficult to enact and stick with the 'right' solution. In short, investors who aim for perfection tend to fail (and fail expensively).

Our innate need for emotional comfort is estimated to cost the average investor around 2–3% per year in foregone returns. For many, the figure is much higher. This shortfall – referred to as the *behavior gap* – stems from the fact that financial decisions that are optimal for the long term are often very uncomfortable to live with in the short term. The classical principles of good investing are based on the assumption that we are all perfectly calm, unemotional beings, concerned only with long-term financial objectives and will, therefore, stick staunchly to the classical rules of good investing.

Although there is much that is right about traditional financial models, they are ultimately designed for an ideal, hyper-rational investor that simply doesn't exist. They assume that once an individual has agreed an optimum investment solution, they can not only implement it, but persevere with it over long periods, regardless of what they have to endure along the way.

***"What investors really want are the best returns they can achieve for the level of stress they are willing to experience along the way."***

Such models also assume that investors care only about risk-adjusted returns. They don't. What investors really want are the best returns they can achieve for the level of stress they are willing to experience along the way. In short, they want maximum *anxiety-adjusted returns*: the best possible returns, relative to the anxiety, discomfort and stress they're going to have to endure over the volatile investment journey.

To illustrate our emotional responses to the short-term environment, we have adapted a much-used diagram to map out the investor's probable response to the rise and fall of their investments. The version below is the result of more than half a decade of studying investor responses to extreme market conditions. At each point

*(Continued on page 2)*

**Cycle of Emotions**


*Source: Barclays*

(Continued from page 1)

along the cycle, investors make specific trade-offs between emotional comfort and long-term returns, all of which have connections to both our Financial Personality Assessment™ and the specific actions we use to tailor portfolios to each investor's personality.

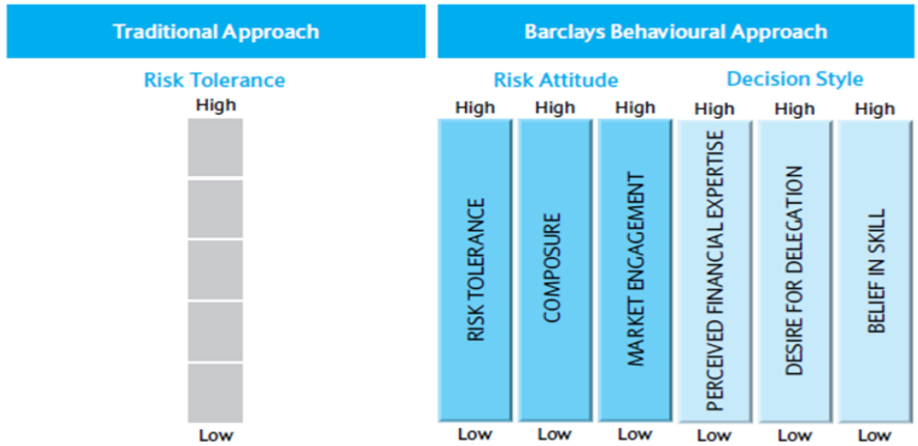
Some of the adaptations we may choose to implement to address the cycle of emotions are at odds with traditional investment theory – however, to discard decades of research on the grounds that the models invoke some simplifying assumptions is to throw the baby out with the bath water. We believe the conflict between behavioral and classical finance is misplaced. Instead, at Barclays, we have taken the best of classical finance and sought to *behavioralize* it.

In our view, a deviation from classical investment techniques is not 'wrong' if it helps investors to overcome greater costs elsewhere by reducing anxiety and curbing expensive knee-jerk responses to short-term moves in the market. The main categories of intervention we employ include education (ensuring the client is fully informed and more confident about the investment tools available to them), constraints (implementing some restrictions can help to minimize the impact of short-term emotional responses), risk targeting (to ensure the level of risk in a portfolio is an appropriate balance between the client's financial and emotional needs), and involvement (can the investor benefit from using the expertise of others to improve their investment outcomes?).

Changing investors' behavior for the better requires practical actions that have tangible results. This requires understanding our emotional needs, and our behavioral proclivities. Only when we have an objective understanding of what makes one investor respond differently over a market cycle from another, and how their needs for short-term comfort differ, are we in a position to make bespoke changes to their portfolio solutions that provide the necessary short-term comfort directly and efficiently.

However, to do this, we need an accurate means of identifying the ways in which each investor is likely to reduce their own returns in the quest for short-term comfort – and we use our proprietary Financial Personality Assessment™ to help with this. This marks a substantial shift away from the traditional approach to investment portfolio design, which focuses almost entirely on the investor's tolerance for risk and ignores other, equally important, factors that were difficult to assess.

## Financial Profiling Approaches




*Source: Barclays*

***"Changing investors' behavior for the better… requires understanding our emotional needs, and our behavioral proclivities."***

The Financial Personality Assessment™ (FPA) is a proprietary tool that measures six different aspects of an individual's personality, each of which relates to their financial behavior and decision-making. It was developed to paint a more complete portrait of each investor's inherent responses to financial decision making, which in turn enables us to develop more effective individual investment solutions. These solutions are deeply tailored, and take into account the vagaries of the investment journey, thus could potentially offer better return. In essence, the FPA helps us to determine which emotional needs are most important to each client, and to identify which costs they are most in danger of incurring. We can only help investors get closer to their long-term financial objectives if we understand these factors at the beginning of the investment process, before they enter the market.

The chart above illustrates the difference between the profiling approach of traditional finance, and our Financial Personality Assessment™. The traditional industry approach measures only the investor's long-term financial willingness to trade off risk and return, and largely proceeds on the basis that this is the only valid objective for an investor to have. Our approach still has risk tolerance at its heart – after all, long-term financial performance is what investing is essentially about – but we also measure five other aspects of financial personality that enable us to help an investor get as close to the long-term optimum as possible.

Since launching our Financial Personality Assessment™ in 2007, we have deployed it around the globe and it is key to how we advise high net-worth individuals, families and institutions. This period has been one of the most turbulent in living memory for investors, and has provided an extreme testing ground for observing investor behavior and, crucially, for stress testing our tools and framework. Though we have made tweaks to the questionnaire as a result of our continued testing, analysis, and experience, the dimensions have proved to do what they were designed to do: provide stable and objective assessments of financial personality traits, even in extreme environments. ■

*To find out more about how Barclays designs investment portfolios around each client's financial personality, visit Barclays dedicated Financial Personality Assessment website: investmentphilosophy.com.*

*Barclays does not guarantee favorable investment outcomes. Nor does it provide any guarantee against investment losses. Barclays offers wealth management products and services to its clients through Barclays Bank PLC ("BBPLC") and functions in the United States through Barclays Capital Inc. ("BCI"), an affiliate of BBPLC. BCI is a registered broker dealer and investment adviser, regulated by the U.S. Securities and Exchange Commission, with offices at 200 Park Avenue, New York, New York 10166. Member FINRA and SIPC.*

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

***About Lincoln's Valuation 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 each calendar quarter) and are presented on a one quarter lag.*

We saw mixed signals in Q2 '14 with divergent top line and bottom line trends, impacted in part by severe weather conditions experienced throughout the United States in Q1 and early Q2 '14.

Year over year financial performance remained mixed. Of approximately 530 companies tracked, 56% grew revenue and 48% grew EBITDA, as compared to 52% and 48%, respectively, in Q1 '14. Higher revenue growth rates were seen across all industries with the exception of industrials. Companies with over $50 million in EBITDA showed the best top line and EBITDA growth while those under $10 million EBITDA companies fared the worst. EBITDA growth was flat, on average, and varied by industry, but generally improved quarter-over-quarter.

Middle market sponsored M&A volume was stable quarter over quarter but enterprise value multiples fell and were lower than average since Q1 2011. We believe this may be an anomaly as M&A valuations continue to be high in general. Leverage ratios in LBOs slightly decreased to 4.3x on average, with equity cushions in the low 30s. Loan pricing for all financings (including refinancings and dividend recapitalizations) increased slightly, but was generally stable. Leverage levels and equity cushions fell quarter over quarter from 4.6x and 40% to 4.3x and 33%, respectively.

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

## M&A Transactions

| | Q1 '12 | Q2 '12 | Q3 '12 | Q4 '12 | Q1 '13 | Q2 '13 | Q3 '13 | Q4'13 | Q1'14 | Q2'14 |
|---|---|---|---|---|---|---|---|---|---|---|
| TEV / EBITDA | 7.2x | 6.6x | 8.1x | 7.5x | 7.3x | 7.4x | 7.5x | 8.2x | 8.2x | 6.8x |
| Total Debt / EBITDA | 3.9x | 3.9x | 4.5x | 4.1x | 4.2x | 4.4x | 4.7x | 4.6x | 4.5x | 4.3x |
| Senior Debt / EBITDA | 2.9x | 3.2x | 3.4x | 3.2x | 3.0x | 3.5x | 3.5x | 3.4x | 3.4x | 3.2x |
| Equity % of Total Cap | 43% | 39% | 44% | 43% | 43% | 38% | 37% | 44% | 44% | 31% |
| LTM EBITDA (Average) | $30 | $32 | $35 | $31 | $24 | $21 | $47 | $30 | $38 | $36 |
| Count | 11 | 13 | 22 | 31 | 10 | 12 | 22 | 15 | 22 | 18 |

***Commentary:***

- Average equity cushions observed in Q2 2014 fell to the lowest level observed in the past nine quarters.
- The average total enterprise value (TEV) / LTM EBITDA multiple implied by closed M&A transactions in Q2 2014 decreased to 6.8x and is below the highpoint multiple of 8.2x observed in Q4 2013 and Q1 2014. Total leverage and senior leverage fell to 4.3x and 3.2x, respectively. The decline in EV multiple and leverage is not reflective of the public markets and is likely due to a limited sample size.

## % Financial Growth Rates (Mean)

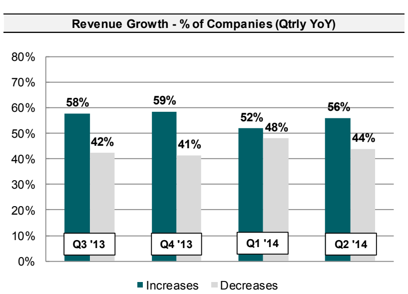
***By Size:***

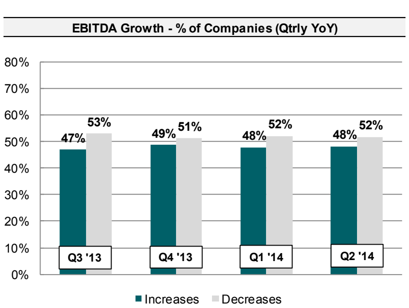
| EBITDA | Q2 '14 LTM EBITDA Margin | Q2 '14 vs. Q2 '13 Revenue | Q2 '14 vs. Q2 '13 EBITDA | Q1 '14 vs. Q1 '13 Revenue | Q1 '14 vs. Q1 '13 EBITDA |
|---|---|---|---|---|---|
| $0 - $10 | 15.7% | -0.4% | -7.6% | 1.7% | -9.9% |
| $10 - $50 | 19.1% | 3.0% | -1.6% | 1.2% | -0.6% |
| > $50 | 24.7% | 4.3% | 3.8% | 3.2% | 5.2% |
| **Total** | **20.0%** | **2.7%** | **-0.8%** | **1.8%** | **-0.4%** |

***By Industry:***

| Industry Sector | Q2 '14 LTM EBITDA Margin | Q2 '14 vs. Q2 '13 Revenue | Q2 '14 vs. Q2 '13 EBITDA | Q1 '14 vs. Q1 '13 Revenue | Q1 '14 vs. Q1 '13 EBITDA |
|---|---|---|---|---|---|
| Business Services | 18.7% | -0.1% | 1.8% | -1.3% | -2.9% |
| Consumer | 14.5% | 4.4% | -1.5% | 3.2% | -1.1% |
| Healthcare | 21.9% | 3.5% | -0.3% | 6.6% | -4.8% |
| Industrials | 17.7% | 1.6% | -10.1% | -4.9% | 0.7% |
| Technology | 23.0% | 3.8% | 1.4% | 0.4% | -0.3% |
| **Total** | **20.0%** | **2.9%** | **-0.8%** | **2.0%** | **-0.4%** |

## Revenue & EBITDA Trends



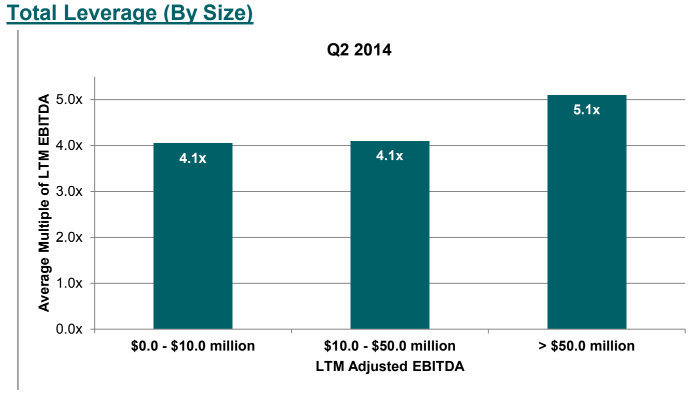



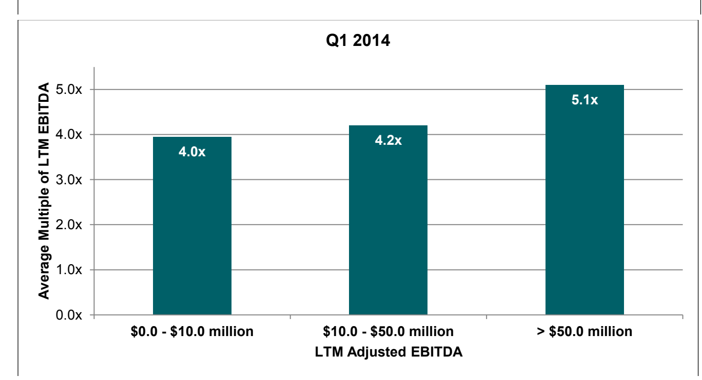

***Commentary:***

- Approximately 56% of the companies observed reported revenue growth in Q2 2014 vs. Q2 2013. This represents a return to growth after a decline in Q1 2014, which came on the heels of three consecutive quarters in which an increasing number of companies reported revenue gains.
- The percentage of companies reporting EBITDA gains remained flat quarter over quarter.
- Since Q3 2013, financial performance has been mixed, as evidenced by the similar percentages of companies reporting revenue and EBITDA growth.
- Severe weather conditions impacted financial performance in the first and early second quarters of 2014.

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

## Total Leverage (By Size)



## Selected Recent Lincoln International Transactions

Graham Partners
has sold
NDS
to
Norma Group

- Sell-side transaction (October 2014)
- NDS is a leading supplier of water management solutions, including products for storm water management, efficient landscape irrigation and flow management. The company is headquartered in Woodland Hills, California.
- Acquired by Norma Group, a global market and technology leader in engineered joining technology solutions. The company is headquartered in Maintal, Germany.

CareerArcGroup
has sold
internships.com
to
Chegg

- Sell-side transaction (October 2014)
- Internships.com is the world's largest internship marketplace bringing students, employers and higher education institutions together in one centralized location to more effectively compete in the war for talent. The company is headquartered in Burbank, California.
- Acquired by Chegg, Inc., a student-first connected learning platform that empowers students to take control of their education to save time, save money, and get smarter. The company is headquartered in Santa Clara, California.

LAI International
a portfolio company of
RLJ Equity Partners
has acquired
Zak Incorporated

- Capital raise (October 2014)
- LAI International, Inc. manufactures precision-engineered finished parts, components, and subassemblies for aerospace, power generation, defense, medical, electronics, and other advanced technology industries. The company is headquartered in Scottsdale, Arizona.
- LAI International raised capital for the acquisition of Zak, Inc., a full service manufacturer of precision-machined and custom-fabricated components. The company is headquartered in Green Island, New York.

EPM Global Services
has been sold to
STACI
a portfolio company of
Centre Lane Partners

- Sell-side transaction (October 2014)
- EPM is a complete supply chain partner for OEMs providing higher level electronic manufacturing services ("EMS") for complex products. The company is headquartered in Markham, Canada.
- Acquired by STACI Corporation, a portfolio company of Centre Lane Partners. The company is headquartered in Gurnee, Illinois.

Stone Arch Capital
has sold
Natural Resource Group
to
ERM

- Sell-side transaction (October 2014)
- Natural Resources Group is a full-service provider of environmental consulting services focused exclusively on the North American energy markets. The company is headquartered in Minneapolis, Minnesota.
- Acquired by Environmental Resources Management, a provider of environmental consulting services. The company is headquartered in London, England.

chs capital
has sold
dura-line
to
Mexichem

- Sell-side transaction (September 2014)
- Dura-Line Holdings is a Knoxville-based manufacturer of high-density polyethylene conduit, duct and pressure-pipe solutions for the telecommunications, energy and infrastructure markets. The company is headquartered in Knoxville, Tennessee.
- Acquired by Mexichem, a global leader in the chemical and petrochemical industry. The company is headquartered in Tlalnepantla, Mexico.

# Selected Recent Lincoln International Transactions (continued)

Palladium Equity Partners has sold Sahale Snacks to Smucker's

- Sell-side transaction (September 2014)
- Sahale Snacks is a high growth, branded snack food business, which offers several lines of premium nut-based trail mixes. The company is headquartered in Seattle, Washington.
- Acquired by The J.M. Smucker Company, a manufacturer of brand food products worldwide. The company is headquartered in Orrville, Ohio.

Brook Furniture Rental has been sold to Agman Partners

- Sell-side transaction (August 2014)
- Brook Furniture Rental is a high-end furniture rental company that serves both the corporate and residential markets across the United States. The company is headquartered in Lake Forest, Illinois.
- Acquired by Agman Partners, a multi-strategy investment fund. The company is headquartered in Chicago, Illinois.

SentrySafe has been sold to Fortune Brands

- Sell-side transaction (July 2014)
- SentrySafe is the leading North American brand of fire-, water- and theft-resistant security safes, files, chests and other protective containers for residential and light commercial markets. The company is headquartered in Rochester, New York.
- Acquired by The Master Lock Company, a subsidiary of Fortune Brands, a leading consumer brands company. The company is headquartered in Deerfield, Illinois.

Weston Presidio has sold evenflo to gb

- Sell-side transaction (July 2014)
- Evenflo manufactures infant and juvenile, on-the-go, playtime and travel products. The company is headquartered in Vandalia, Ohio.
- Acquired by Goodbaby International Holdings, an investment holding company that is engaged in the design, manufacture and sale of durable juvenile products. The company is headquartered in Kunshan, China.

Sun Capital Partners, Inc. has sold Manoir Aerospace to lisi Aerospace

- Sell-side transaction (June 2014)
- Manoir Aerospace is an industry-leading global supplier of highly complex, flight critical forged and precision machined aerostructure and aeroengine components for the aerospace sector. The company is headquartered in Paris, France.
- Acquired by LISI Group, worldwide leaders in screwed and clipped fasteners and mechanical safety components for the aerospace, automotive and medical sectors. The company is headquartered in Belfort, France.

Fulham & Co. has sold Joyce to Graham Holdings

- Sell-side transaction (May 2014)
- Joyce/Dayton Corporation is a leading designer and manufacturer of highly engineered, customized screw jacks and related lifting and positioning products for the solar, metals and metalworking, oil and gas, satellite, and diversified industrial sectors. The company is headquartered in Dayton, Ohio.
- Acquired by Graham Holdings, an investment company whose holdings include educational services, television broadcasting, cable systems, and online, print and local TV news. The company is headquartered in Washington, DC.

## Lincoln International's Global Footprint


**170+ professionals throughout the Americas**

**110+ 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 sixteen 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.**

## 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

## Lincoln International Contacts


Patrick Goy
Managing Director
pgoy@lincolninternational.com
+1-312-580-8320

Scott Hebbeler
Director
shebbeler@lincolninternational.com
+1-312-580-8336

Colin Keeler
Analyst
ckeeler@lincolninternational.com
+1-312-506-2774


Lincoln INTERNATIONAL

AMSTERDAM | BEIJING | CHICAGO | FRANKFURT | LONDON
LOS ANGELES | MADRID | MILAN | MOSCOW | MUMBAI
NEW YORK | PARIS | SAÕ PAULO | TOKYO | VIENNA | ZURICH