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an employee owned company

Prairie Middle Market Perspective

M&A and Capital Markets Outlook — Winter 2017

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Transaction Highlight
- Prairie acts as exclusive financial advisor to Harlow-HRK Sales & Marketing, Inc.

Overall M&A Market Commentary

Market psychology has a tremendous impact on the business environment. The U.S. has endured seven years of a slow, tepid recovery that has struggled to produce sustained economic growth above 2%. Continuing this trend, many economists expect 2016 GDP growth to be between 1.8 to 1.9%. This eight year period of slow economic growth has diluted the markets' "animal spirts" and sapped the optimism of business owners. While business sentiment began to show improvement in 2016, few in the business community were optimistic for the future. As a result, business investment in capital assets and new employees has been muted over the last eight years. The business community became accustomed to the low growth, "new normal."

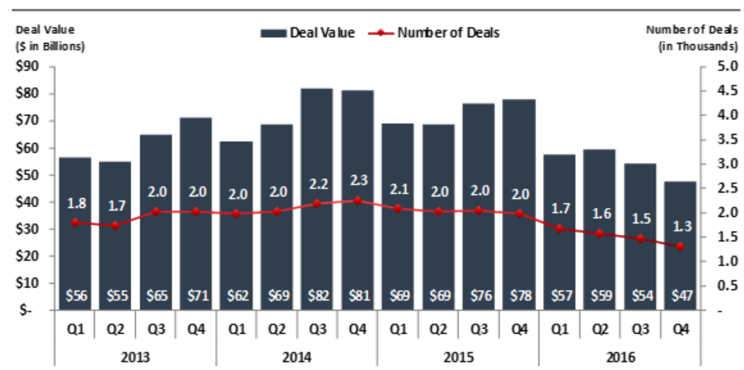
But then in 4Q16 it happened. The ***surprising election*** of Donald Trump as the 45th President of the United States has led to a significant stock market rally and a dramatic improvement in business and consumer psychology. The Dow and NASDAQ are up 8.5% and 7.3% respectively during the two months since the election even though the new President has not yet taken his position. A more business friendly President and Cabinet Secretaries with substantial business experience represents a significant change from past Presidential administrations. Business owner expectations are very high and the stock market rally reflects this new optimism.

The National Federation of Independent Business ("NFIB") December Small Business Optimism Index spiked to its highest level since 2004, with a 38 point jump in the number of business owners who expect better business conditions ahead. "This is the second consecutive month in which small business owners reported a much brighter outlook for the economy and higher expectations for their businesses," said William Dunkelberg, the NFIB Chief Economist. "In this month's report, we are also finding evidence that higher optimism is leading to increased business activity, such as capital investment." NFIB President and CEO Juanita Duggan added, "Business owners are feeling better about taking risks and making investments. Small business is ready for a breakout and that can only mean very good things for the U.S. economy." Clearly there is a return of the animal spirits in the middle market business community.

Deal volume in the M&A market remained soft through the end of 2016. However, improved market psychology and better economic conditions are expected to lead to increased deal activity in 2017 and 2018. Expectations for corporate, individual and capital gains taxes cuts coupled with reduced regulations under the more business friendly Trump Administration are all expected to heighten interest in M&A activities. The entry of more sellers in the M&A market will likely lead to more competition for buyer attention and will likely limit business valuation increases. In addition, increased expected inflationary pressures induced by greater economic activity will result in a return to a more normal interest rate environment. This will further serve to limit the upward move of business valuations. We believe that middle market company valuations are at a market peak, with growing risk that valuations will trend slightly lower over the next two years.

Strategic and financial buyers have plenty of "dry powder" and remain anxious to make acquisitions. While interest rates are rising, rates are still relatively low at this point in the business cycle. The demand for good quality acquisition targets remains largely unsatisfied. The current M&A market still favors sellers, but that can change quickly. We encourage business owners to look at their transition goals and objectives and determine whether a company sale makes sense for their circumstances.

Total U.S. M&A Deal Volume and Value <$300M Transaction Value
Q1-2013 to Q4-2016



Source: Capital IQ

M&A Market Activity

Middle market deal activity continued its negative trend through 4Q16 producing numbers of deals and dollar volume totals that only slightly exceed the post-recession quarterly low points. PE exit activity through 4Q16 continued its slow pace as well, although this activity was not as soft as the activity in the overall market. While a continuation of these negative activity trends is disappointing, we see reason for significant market optimism in the near future. The surprising outcome of the U.S. Presidential election and the resulting "Trump Rally" has resulted in the return of "animal spirits" and a more positive feeling across the business community. Improved small business optimism and a feeling that Company valuations are likely at peak levels has increased business owner interest in considering their strategic alternatives including a company sale. We believe this strong level of interest in exploring strategic alternatives may be a leading indicator for significant growth in middle market M&A activity during 2017.

- The $47 billion of middle market deals recorded in 4Q16 reflects a 12% reduction in dollar value from 3Q16. Furthermore, the 4Q16 dollar value of deals was down 39% compared to levels experienced in 4Q15. Similarly, full year 2016 activity showed weakness as well with $217 billion of deals, down 25% from the $292 billion recorded in 2015.

- The number of middle market deals recorded in 4Q16 declined 34% from the number of deals in 4Q15 and the number of deals closed during 2016 as 26% lower than the number of deals closed in 2015.

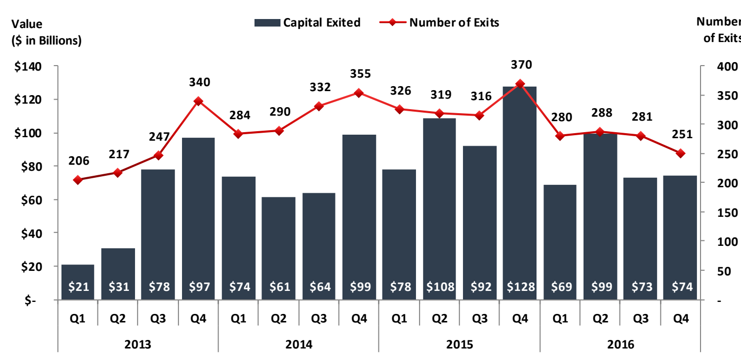
- The average middle market deal size of $36.3 million in 2016 was up slightly from the average $35.9 million deal size closed in 2015.

PE exit activity showed a slightly different trend in 4Q16, with the number of exits decreasing about 11% from the 3Q16 exits and the capital exited increasing about 2% from 3Q16. During 2016, the number of PE exits fell 17% from the number of 2015 exits. Like the trends in the overall M&A market, this decline in exit activity is somewhat disconcerting but will likely change in 2017.

Middle Market Deal Valuations

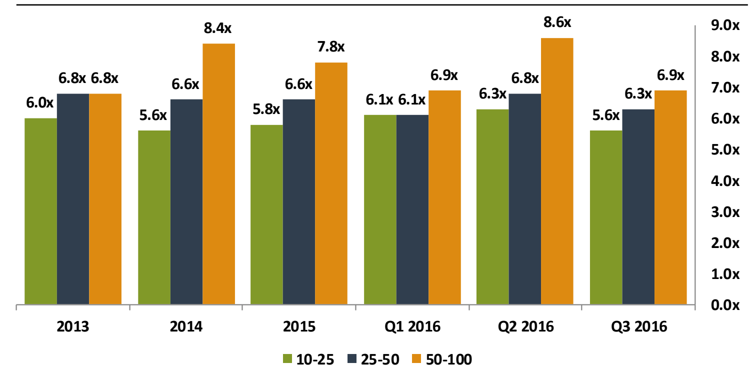
As noted in previous quarters, the deal size valuation data is particularly volatile at the current low level of market activity. With the low levels of deal volume, the quarterly data comparisons can move significantly from quarter to quarter. In our opinion, the 2016 quarterly data displayed does not portray accurate trend data for overall 2016 while the annual data for 2013 through 2015 is more accurate. PEs have more than $500 billion in unused investable capital and strategic buyers have more than $1.5 trillion in balance sheet cash balances. All of these resources are chasing the low volume of quality acquisition targets. We believe that a lack of supply of new middle market deals has helped sustain higher valuation levels in the current M&A market. This abundant capital and an unsatisfied demand for acquisitions has continued

Private Equity Exits
Q1-2013 to Q4-2016



Source: Pitchbook

TEV*/EBITDA by Deal Size ($ Millions)
2013 to Q3-2016



Source: GF Data
**TEV = Total Enterprise Value*

the post-recession sellers' market. With major changes in business regulation, taxation and general business sentiment, a more business friendly environment may be at hand. This new deal environment coupled with higher interest rates and greater inflation could constrain further improvements in company valuations. We believe middle market company values are likely at or near a market peak.

- Sub-$25 million deal valuation multiples moved a little lower in late 2016 averaging a 5.6x multiple in 3Q16 reflecting a return to the long run average. Buyers continue to aggressively pursue deals across the middle market size spectrum.

- Similarly, valuations on the large end of the middle market ($50 to $100 million segment) moved lower in 2016 likely due to sampling error induced by the small number of recorded deals during the quarter.

- Valuations in the $25 to $50 million segment trended a little lower in the first half of 2016, but because of the volatility of the quarterly statistics, will likely be higher by the end of the year.

- As we have suggested in our previous reports, properly prepared, solid performing companies are always welcome in the M&A market and will continue to receive strong buyer interest and premium valuations.

Private Equity versus Strategic Valuations

In the low growth economy, strategic buyers have limited organic growth opportunities and use acquisitions to increase revenues and meet earnings growth objectives. The market data and our recent deal experience suggests that strategic buyers continue to be aggressive and active M&A market participants. Strategic buyer acquisition synergies and more aggressive pursuit of acquisition targets has resulted in a trend of strategic buyers paying about 0.5x to 1.0x of EBITDA more than the PEs. While PE funds remain motivated to put capital to work, PEs are far more cautious at these higher valuation levels and more conservative in their acquisition offers. As a result, successful sellers in the M&A market are shifting from PEs toward strategic buyers.

- During 2016, strategic buyers continued to bid on middle market acquisitions and appear to pay a 0.5x to 1.0x premium over the PEs.

- PE acquisition multiples have remained in a stable range in the high 6.0x EBITDA valuation level over the last few years. The last two quarters show a slight tick upward to 7.0x EBITDA perhaps reflecting the dearth of quality acquisitions.

- The supply demand imbalance continues in the middle market, although the quality of the average companies coming to market has declined somewhat. Well-prepared, attractive sellers can still take advantage of interest in M&A deals by both strategic buyers and PE funds and achieve reasonably high valuations.

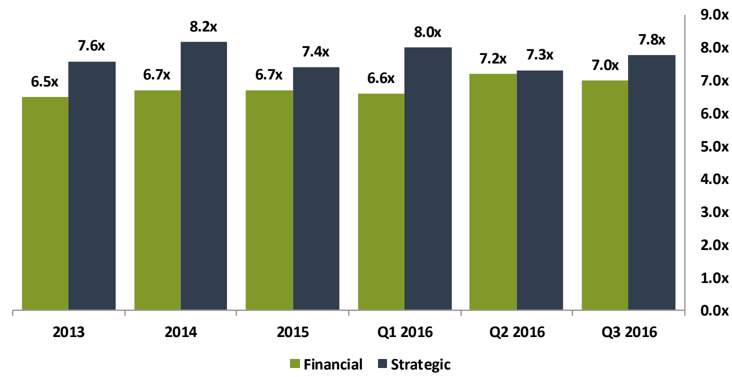
- The data reflects valuation multiples for all size deals. Prairie Capital Advisors estimates that for middle market deals below $50 million, valuations are generally 1.0x to 2.0x multiples of EBITDA lower than the levels reflected in the table.

Middle Market Leveraged Buy Out Capitalizations

The amount of senior debt leverage employed during 3Q16 in the Leveraged Buyout ("LBO") market increased slightly from earlier periods. Although mezzanine capital is an important part of the capital structure, during the third quarter the use of mezzanine declined to about 7% of a typical LBO capitalization. While senior debt increased to 48.4% of total capitalization during 3Q16, the amount of equity used in LBOs has decreased to about 45% of the total capitalization. Debt availability has not been a limiting factor for deal activity in the current market.

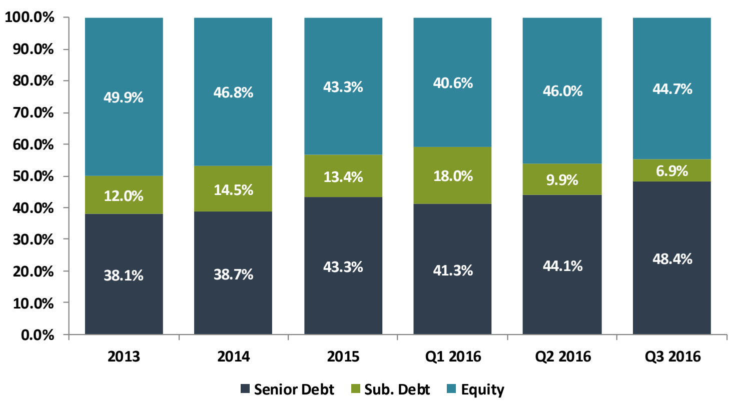
- Growth in the number of lending sources coupled with the greater sophistication of borrowers has made the use of and amount of debt capital employed an important decision in the acquisition process. PEs, for example, use debt leverage to offset the effects that high valuations have on their expected investment returns.

TEV/EBITDA Multiple by Buyer Type ($10-250M of TEV)
2013 to Q3-2016



Source 1: Financial Buyers: GF Data ($10-250M TEV)
Source 2: Strategic Buyers: Capital IQ ($10-250M TEV; Excluding outliers defined as transactions with TEV/EBITDA of less than 3.0x and more than 14.0x)

Equity and Debt Capitalization
2013 to Q3-2016



Source: GF Data

- Banks and other debt sources are all competing aggressively for new opportunities leading to continued low capital costs. Deal structure and terms on the other hand are starting to tighten reflecting a more discerning lending community.

- The mezzanine funds continue to aggressively pursue deal opportunities but in 3Q16 the use of this type of funding continued to decline. While interest only and payment in kind structures still dominate the markets, warrants have started to return to the mezzanine return structure, particularly in smaller or more leveraged deal structures. Mezzanine funds continue to pursue equity co-investment opportunities to improve their returns and increase their investment amount in deals.

Overall Comment on the Financing Markets

Lending community loan growth continued to be weak through late 2016. Middle market loans booked in 2016 were about $1 billion short of the aggregate loans made in 2015. With an economy growing at less than 2% annually, it has become increasingly difficult for businesses to find good projects like plant expansion or plant improvements with strong enough returns to make borrowing necessary. Lackluster middle market M&A activity has further reduced the demand for bank lending. More intense bank regulation, particularly on the smaller, more middle market oriented banks, is leading to higher regulatory compliance costs and more conservative lending terms for middle market credits. Even with these impediments, credit worthy companies with a need for long term debt capital are always well received in the lending market.

The election of Donald Trump is expected to positively effect the bank credit markets as well. Improved business owner sentiment, stronger economic growth and the prospect of a roll back of regulations all could lead to more demand for loans. The bank sector itself also saw a substantial “Trump rally.” The Dow Jones U.S. Financials Index is up almost 12% since the election reflecting investor’s belief in the better future for this sector. Improved market sentiment in the ranks of bank CEOs was evident in early January 2017 investor earnings announcement calls. “We are very optimistic about the future, optimistic about new policies which could spur growth” said Bank of America CEO, Brian Moynihan. “The economy is getting a little better, interest rates help and looking forward, you probably have a better political, legal and regulatory environment” stated Jamie Dimon the JPMorgan CEO. Across the lending market there is optimism for greater future lending and financing activity.

Total U.S. Middle Market Loan Issuance

- Loan issuance showed softness in 2016 continuing a trend that started several years ago. As pointed out in previous quarters, muted acquisition activity coupled with lower capital spending and slow economic growth all have reduced the need for additional borrowing.

- A 25 basis point Fed interest rate increase in December 2016 with expectations for additional rate increases in 2017 and beyond seems to point to a more “normal” yield curve where lenders can earn a reasonable spread on their loans. More profitable lending operations and an improving economy could lead to more lending activity.

- Bank lenders continue to focus on relationship banking, corporate borrowers’ lines of credit and areas where they have a competitive advantage like operating business needs including payroll and checking accounts. Due to regulatory scrutiny, banks continue to be selective in making new loans and are very selective in new leveraged transactions.

Loan Issuance for the Middle Market <$100M
2008 to 2016

Source: Thomson Reuters

- The non-bank BDC lenders, due to their problems in attracting new funding, have reduced their participation in the leveraged loan market and have become more conservative in their lending practices.

Interest Rate Environment

- At the end of 2016, one month and three month LIBOR were up 34 and 39 basis points over the rates at the end of 2015. These increases reflect the 25 basis point Fed rate increase and the market expectation that there will be more rate increases in 2017.

- The year-end 2016 yields of the five and ten year U.S. Treasuries, the long end of the yield curve, are up 17 and 18 basis points respectively from the end 2015, reflecting emerging inflation concerns and the increased certainty of additional Fed rate increases.

- The unemployment rate is still slightly below 5%, but monthly new job numbers, while adding new jobs are still not portraying a more robust economy. President elect Trump’s focus on increasing U.S. jobs and more positive market psychology may lead to more robust job growth in 2017.

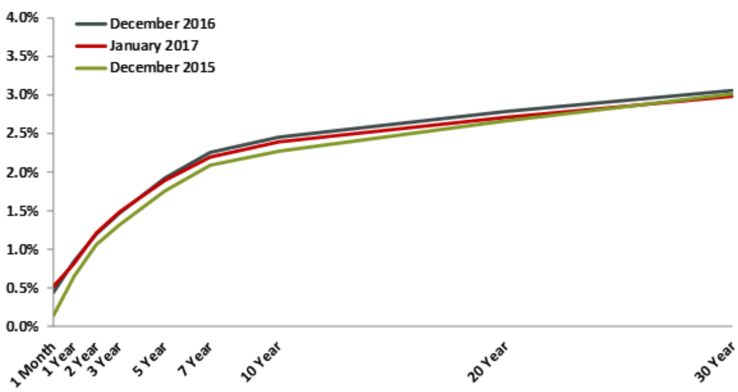
- Low LIBOR base rates coupled with stable lending spreads make this an attractive market for borrowers.

KEY INTEREST RATES

	12/31/2015	12/30/2016	1/13/2017
Prime Rate	3.50%	3.75%	3.75%
Libor - 1 Month	0.43%	0.77%	0.77%
Libor - 3 Month	0.61%	1.00%	1.02%
U.S. Treasury - 2 Year	1.06%	1.20%	1.21%
U.S. Treasury - 5 Year	1.76%	1.93%	1.90%
U.S. Treasury - 10 Year	2.27%	2.45%	2.40%

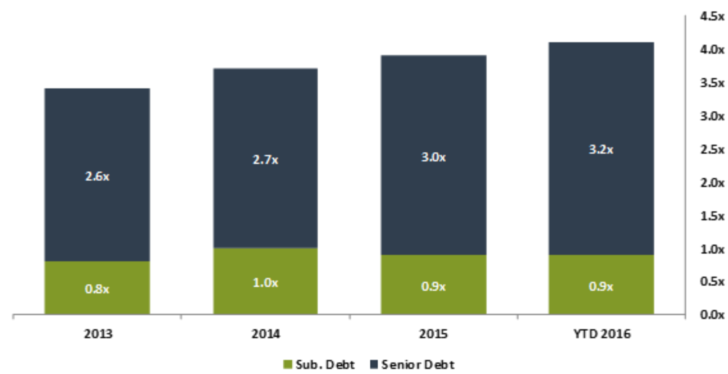
Source: Capital IQ

Yield Curves – U.S. Treasuries



Source: Capital IQ

Senior Debt and Sub. Debt/EBITDA – TEV of $10-250 Million
2013 to YTD 2016



Source: GF Data

Middle Market Debt Multiples

- Total acquisition debt leverage levels have increased slightly in 2016 crossing the 4.0x level to 4.1x total leverage. While market tolerance for higher leverage in the middle market has remained muted since the recession, there appears to be the emergence of more aggressive lender behavior, particularly on the larger transactions.
- Mezzanine capital remains an important part of a buyout capital structure. Over the last few years mezzanine debt has represented about 1.0x cash flow and 2016 was consistent with that level of mezzanine capital usage. Any increases in total leverage have been due to more aggressive senior lender behavior.
- The use of debt leverage helps sustain high middle market M&A valuations. If interest rates rise significantly, the use of senior debt may decline somewhat putting downward pressure on M&A valuations.
- Bank lenders continue to maintain credit discipline largely to satisfy their regulators. The regulators limit the amount of HLT ("Highly Leveraged Transactions") exposure that a bank can hold. Bank provided senior credit facilities remain at the relatively conservative 3.0x EBITDA senior debt ratio, so the slight increase in the use of senior debt is likely due to more aggressive BDC lenders.

FINANCING PRICING

Bank Financing	Upfront Fees	LIBOR Spread
Asset Based Loans	25-50 bps	150-200 bps
Cash Flow Loans		
EBITDA less than $10M:		
Unleveraged Loans	0-50 bps	150-250 bps
Leveraged Loans	75-150 bps	300-425 bps
Cash Flow Loans		
EBITDA more than $10M:		
Unleveraged Loans	0-50 bps	150-250 bps
Leveraged Loans	100-150 bps	350-475 bps

Mezzanine Debt	<$10M EBITDA	> $10M EBITDA
Upfront Fees	2.00%	2.00%
Current Pay Coupon	11.00%-13.00%	10.00%-12.00%
Payment-in-Kind (PIK) Interest	0.00%-3.00%	0.00%-2.00%
All in IRRs	14.00%-17.00%	10.00%-13.00%

Source: Pricing is based on guidance provided by a number of commercial and mezzanine lenders

Note: Warrants and other yield enhancements comprise the incremental return required to meet the all-in internal rate of return ("IRR").

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About Harlow-HRK Sales and Marketing, Inc.

For over 35 years, Harlow-HRK Sales & Marketing, Inc. and Affiliates has been a leader in providing sales, marketing, analytical, and retail support to manufacturers of grocery, natural, multicultural, and drug & general merchandise items. Harlow provides services to approximately 385 manufacturers representing nearly 875 brands within the grocery, natural, multicultural, and drug & general merchandise market segments.

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