VALUATION REPORT

March 11, 2016

ALLEGIANCY, INC.

(OTC QX: ALGC)

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MANAGEMENT
Stevens Sadler, Chairman & CEO
Christopher Sadler, President & CFO

SECTOR: Financial Services
SUB INDUSTRY: Real Estate Services
SHARES OFFERED: 2,150,000

PROJECTED IPO PRICE RANGE: $13-$15
PROJECTED IPO DATE: Within 60 days of March 14
UNDERWRITERS: W.R. Hambrecht + Co., LLC

OVERVIEW

- Allegiancy, Inc. provides strategic, active asset and property management services related to commercial real estate, focusing on suburban office properties in secondary and smaller markets. Revenues are derived from asset management fees, leasing fees, construction fees, financing fees and advisory services.
- As of the offering, the company's aggregate managed portfolio consists of 61 buildings, managed under 28 separate contracts. In fiscal year 2015 (June), revenues totaled $3.34 million, while incurring a net loss of $302,204 ($0.14 per share). As of March 1, 2016, the company's real property portfolio was valued at $790 million, with about $380 million of AUM managed directly by Allegiancy (or its wholly-owned subsidiary) and $406 million of AUM managed by Allegiancy Houston, in which the company owns a 70% economic interest and 40% voting interest following a mid-2015 acquisition.
- As we detail in this report, our analysis indicates long-term upside potential for earnings, a fair value on the shares above the expected offering price, and an investment case that offers exposure to the commercial real estate services industry as well as current income.

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SHARE OFFERING

Allegiancy has authorized capital stock consisting of 2,000,000 shares of preferred stock (par value $0.01 per share) and 40,000,000 shares of common stock (par value $0.01). As of the offering, it will have 999,994 shares of Series A Preferred Stock and 2,757,400 shares of Common Stock issued and outstanding. An additional 46,000 shares of Series A Preferred Stock are subject to issuance under warrants issued to Moloney Securities Co. in a prior Regulation A offering.

OPERATING MODEL

In providing asset and property management services to the commercial real estate industry, the company's goal is to increase the profitability of its client's real estate assets by making investments in personnel, technology, research and systems that will result in improved operating results for its properties under management.

Through its "Aggressively Proactive" approach, Allegiancy focuses on:

- Aggressive marketing and effective management in an effort to increase tenant occupancy at its managed properties and increase tenant retention.
- Use of technology and data-driven decision-making in an effort to reduce property operating costs (thus providing improved financial performance of properties) and provide better service to the tenant base of managed properties.
- Improve communication with key tenants, investors and vendors to provide quality customer service, all in an effort to help with tenant retention.
- Proactive and effective management of capital investment at each property with a goal to maximize rental income, tenant retention and long-term value of managed assets.

Some 50% to 60% of the company's revenues are derived from asset management fees that are based on the gross property revenue, with fees ranging from 1.15% to 6% of property revenues depending on the type of property and tenants, and the geographic market. The company tends to earn higher fees for full-service buildings with multiple tenants. Its weighted-average management fee per property is currently 5.0% of property revenue.

A second component of Allegiancy's revenues comes from asset administration fees, which account for 40% to 50% of revenues. These fees are event-driven such as from construction projects, new and renewal leases and when properties are sold. Allegiancy expects to earn between 75-100 basis points (0.75% - 1.0%) on AUM, of $7,500 to $10,000 in revenues for each $1 million in asset value.

Directly, or through a wholly-owned subsidiary, Allegiancy manages properties in Pennsylvania, Virginia, North Carolina, South Carolina, Georgia, Florida and Texas consisting primarily of 40 office properties governed by 14 contracts. Square footage of the properties ranges from 10,784 sq. ft. to 299,186 sq. ft. with an aggregate 2,681,924 sq. ft. under management.

Allegiancy Houston manages properties in North Carolina, Georgia, Tennessee, Oklahoma, Texas, Utah, and California consisting of 21 office properties governed by 14 contracts, with square footage of ranging from 53,500 sq. ft. to 550,980 sq. ft. with an aggregate 2,511,478 sq. ft. under management.

GROWTH STRATEGY

The company's growth strategy is not changing as a result of the offering but will rather be enhanced by the use of offering proceeds. Allegiancy seeks to expand properties under management by:

- Marketing directly to property owners.
- Acquiring the operations of other asset managers whose assets under management fit its targeted portfolio.
- Strategic alliances with private equity real estate funds to provide outsourced services
- Developing its property and asset management platform through capital expenditure on software development and other technology.

In marketing to property owners, Allegiancy targets asset management opportunities where it sees significant potential to improve cash flow and asset value, while creating higher gross revenue on which to earn fee income.

For acquisitions, Allegiancy intends to target asset managers with oversight of commercial real estate property, with a focus on commercial office space, located in the lower 48 states, particularly in the southeastern region where most of its operations are already focused.

The company intends to use 87% of the net proceeds from the public offering (or $26.1 million) for acquisitions, with the balance for capital expenditures and working capital. We believe acquisitions will be of a scale that will not place undue pressure on current company resources. We believe the company is well placed to offer an attractive sale opportunity to portfolio managers seeking to exit the asset management business. Some of these managers had business models were based largely on transaction revenues, which may no longer be sustainable in the current environment.

The company closed its first acquisition in June 2015, using an affiliate structure, adding $406 million in assets under management by forming the Allegiancy Houston joint venture to acquire assets of TriStone Realty Management. The acquisition is expected to increase revenues by $2.0 million to $2.5 million and net income by $900,000. In 2016 the company's goal is to achieve one additional large-scale acquisition, which it defines as generating at least $300 million of additional assets under management and $1.5 million in revenue.

As of March 2016, the company was in negotiations for two acquisitions; one for management contracts on properties that would add about $250 million in AUM, $1 million in revenue and $650,000 in EBITDA; and a second that would add about $1 billion in AUM.

OPPORTUNITY

The property and asset management industry has a few large players, including national asset managers CBRE and Jones Lane LaSalle, but remains extremely fragmented, providing considerable opportunity for consolidation. This should be especially true among small- and mid-sized properties that lack the ability to make large investments in systems and technology that can provide notable improvement in efficiencies and financial returns. The larger firms also tend to focus on tactical management rather than strategic, active management. By offering a complete outsourced asset management solution and becoming a strategic partner with owners, we believe Allegiancy is well positioned as an attractive provider.

According to census data, there are more than 85,000 service providers in the U.S., offering considerable chance to differentiate its own offerings and achieve greater efficiencies than can be deployed by smaller operators. In addition, smaller players such as Allegiancy compete on both price and service,

For acquisitions, we believe Allegiancy will generally be competing for smaller- to mid-sized asset managers that are likely to not be on the radar of national players. This should provide a considerable number of target opportunities.

Allegiancy brings several advantages to property owners in an industry that has generally not used scale and technology to its benefit, often due to implementation costs being sizeable for owners with single properties or a few number of properties. In addition to bringing administrative expertise, project management experience and a cost-control mindset that can have an immediate favorable impact on general efficiency, Allegiancy goes a step further by using technology platforms that improve overall visibility of asset administration and provide timely monitoring/reporting on all facets of property operations. Technology benefits include close monitoring of equipment and using predictive analysis to identify maintenance issues before they become more serious and costly to address, which helps to keep capital expenditures to a minimum.

In addition, by improving communication with tenants and closely watching local trends, the company has also been able to improve the tenant retention ratio for its serviced properties to above 85%. Less turnover among tenants means higher overall rents on which Allegiancy earns fees. The company is generally able to improve returns for property owners by 200-250 basis points.

Services include basic active management such as budget preparation, rent collections, landscaping, vendor management, tax and insurance payments, property inspections and tenant communications, but also strategic management services such as re-development planning, tenant mix strategy, competitive analysis, lease roll-over management and refinancing. Many of these services are far beyond the core expertise of property owners.

INDUSTRY PROFILE

The commercial real estate industry is valued at some $15 trillion. In the aftermath of the 2008/09 financial crisis, the industry went through a period of underperformance, hurt by high debt levels and reduced tenant occupancy that lingered and prevented a strong initial rebound. More recently, however, fundamentals for the industry have been improving, particularly as measured by rent rates and vacancies, while steadier financials and low interest rates have enabled better financing options with lower interest costs. Helping to raise rents has been relatively muted development activity for new properties. This has led to improved capital inflow, as well as increases in the number of transactions and pricing.

According to Prequin, which provides data and intelligence on alternative asset classes, the institutional appetite for real estate remained strong in 2015, with $96 billion raised by real estate funds, above the $85 billion pace of the prior year. About 67% of funds raised in 2015 targeted North America. Meanwhile, private equity real estate funds have $221 billion of dry powder, with $167 billion earmarked for North America.

As the macroeconomic environment continues to slowly improve, we would expect many of these same trends to continue. The economy is doing well enough that modest rent increases can continue, but not too robust that would attract additional development, increase available square footage and potentially put pressure on rents. Meanwhile, banks remain on firmer footing, with regulatory mishaps from the financial crisis largely resolved, credit quality continuing to improve from a better job environment, and capital available to worthy borrowers. All of this bodes well for further increases in real estate asset values.

With the value of commercial real estate highly dependent on the cash-flow return of the underlying properties, improving those returns through services such as Allegiancy's should make sense as owners look to increase property value. By improving returns by 200-250 basis points without upfront capital commitments, the company provides a compelling value proposition to property owners.

FINANCIAL ASSUMPTIONS

Revenues grew rapidly in calendar 2015 to $2.9 million from $1.1 million the prior year, as a result of the Allegiancy Houston transaction that acquired assets of TriStone Realty. The acquisition increased assets under management to $770 million from $400 million. The company operated at a net loss, however, of $302,214, due to a rapid expansion of staff to accommodate its acquisition growth strategy, and higher software development costs. With this higher cost base now factored in, a substantially higher proportion of revenues will translate to operating earnings going forward.

On a pro-forma basis including the TriStone Realty Management acquisition, revenues in fiscal 2015 came to $5.7 million, with 53% from management fees, 29% from leasing commissions, and the balance mostly to sales commissions and administrative fees.

Looking to 2016, the company is in negotiations for two acquisitions; one for management contracts on properties that would add about $250 million in AUM, $1 million in revenue and $650,000 in EBITDA; and a second that would add about $800 million in AUM. Assuming these acquisitions close by June 2016 per management's expectation, Allegiancy's revenues would increase to $11.4 million and EBITDA would rise to $4.2 million, for an EBITDA margin of 37%. For 2017, our assumptions include an additional $2 billion of AUM, revenues of $28.5 million, and EBITDA of $13.1 million, for a margin of 46%. We expect the EBITDA margin to then improve gradually from the mid-40s to the high-40s by 2020.

VALUATION

Our approach to valuing Allegiancy uses traditional EBITDA and dividend discount valuation methods.

EBITDA multiples for commercial real estate servicing companies range from the high single-digits to the mid-teens, depending we believe on growth expectations and risk characteristics, with a mean multiple about 12. Given Allegiancy's expected above average growth rates due to its concentration on a faster growing regional geographic footprint, focus on consolidation and cost savings for property owners, and strong operating margins, but with a bit higher average risk profile due to its more limited operating history, our base case applies a 13 EBITDA multiple, slightly above the mean. However, we assume a range of 12 to 14 is possible.

Assuming an average EBITDA of $8.6 million over the next two calendar fiscal years, which implies offering proceeds being used to expand the current portfolio, we obtain a value for the firm of $112.2 million. A share count of 5,899,970 expected after the offering results in a value of $19.01 per share. Using our low and high EBITDA multiple range of 12 and 14, we note a valuation of $17.55 to $20.47, with the lower multiple valuation still well ahead of the expected offering price.

Our dividend discount model (DDM) assumes an initial $0.90 per share dividend (6% of the $15.00 offering price), a 12% cost of capital and 7% rate of growth, which results in a valuation of $18.

Blending our base case EBITDA multiple and DDM models, we obtain an $18.51 value, or 23% above the expected offering price. This is well ahead of our expectations for the broader market and, considering risk/reward, we find the shares attractively valued at the offering price and up to $17.50.

INVESTMENT CASE

We believe Allegiancy offers a unique approach within the highly fragmented real estate services industry. An investment in the company will enable shareholders to participate in trends that we believe are sustainable for many years, including consolidation and the use of scale and technology for property owners to realize significant cost savings. While Real Estate Investment Trusts as investment vehicles are plentiful and provide investment exposure to owned commercial real estate, there are far fewer publicly-traded companies that provide exposure to the commercial real estate services industry. Allegiancy allows exposure not only to general growth in commercial real estate rents, but also a trend of consolidation in the real estate services industry through technology and scale.

We note that property management, while not recession-proof, is a bit countercyclical and takes place regardless of economic conditions. In fact, property owners will seek the company’s services even more during difficult times to try to improve profitability of owned properties. The real estate services industry is generally characterized by recurring revenue streams, and in the company’s case from a well diversified customer base in terms of both geography and retail type.

An expected dividend of 5%-6% adds an above average yield to the investment case.

MANAGEMENT OWNERSHIP AND ALIGNMENT

Current executives Stevens Sadler and Christopher Sadler, through their control of Continuum Capital, LLC and Chesapeake Realty Advisors, LLC, will collectively control the voting of 2,500,200 of the company’s common shares, representing 42% of the outstanding shares at the maximum offering amount.

These shareholders are not selling any shares in the Reg A offering and thus in our view their interests are completely aligned with new shareholders.

REGULATION A+

The SEC has adopted final rules to facilitate smaller companies’ access to capital. Regulation A had been the existing exemption from SEC registration for small companies seeking to go public. In March 2015, the SEC updated and expanded Regulation A with establishment of the Regulation A+ guidelines. The Reg A+ guidelines became effective on 6/19/15.

The new guidelines create two tiers of securities offerings. Tier 1 consists of public offerings up to $20 million within a 12-month period, with not more than $6 million in offers by selling shareholders affiliated with the issuer. Tier II consists of public offerings up to $50 million within a 12-month period, with not more than $15 million in offers by selling shareholders affiliated with the issuer. For both tiers, Regulation A+ securities purchased by non-affiliates are free-trading (no lock-up period) from the initiation of trading.

For tier II offerings, the new rules preempt Blue Sky laws at the individual state level. These companies can take advantage of a coordinated review program developed by NASAA, which should help reduce cost and facilitate faster time to market.

Both tiers are subject to basic requirements including issuer eligibility and disclosure. Tier II companies have a more rigorous set of requirements, including an obligation to file audited financial statements in the offering document. Tier II companies are responsible for filing audited annual financial statements, but are not subject to the quarterly filings required for larger companies. Tier II Reg A+ companies must file an annual report on Form 1-K; a semi-annual report on Form 1-SA; and current reports (event-driven) on Form 1-U.

REGULATION A+ IPO OF ALLEGIANCY

Allegiancy has filed under Regulation A+ as a tier II company. The company is offering 2,150,000 shares of its common stock at an offering price range of $13 to $15 per share, or $30.1 million at the mid-range price. The minimum purchase requirement is 500 shares ($7,500, based on an offering price at the upper end of the price range), although this can be waived at the company's discretion. The underwriter for this offering is W.R. Hambrecht + Co., LLC.

The company intends to list its common stock on the OTC QX. Following the IPO, there will be approximately 5,899,970 diluted shares outstanding.

RISK FACTORS

Allegiancy's risk factors include exposure to U.S. and regional economic down cycles and general cyclicality in the commercial real estate sector that could result in higher tenant vacancies, downward pressure on rental rates, or other inability to execute its business strategy. With acquisition of other asset management firms a part of its strategy, the company may not be able to enter into transactions on terms it finds favorable.

About 44% of revenues are derived from asset management contracts with tenant-in-common owners, which must be renewed by each tenant annually. Allegiancy also competes with regional and national real estate service firms, some of which have greater financial resources than the company.

We also note the limited operating history of the company, and the potential for volatility of its earnings stream as it rapidly expands its managed portfolio of properties. (Stephen Biggar)

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