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US PE Middle Market Report

1Q 2019

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Introduction

1Q 2019 middle-market (MM) dealmaking activity slowed compared to 2018's record pace, and cumulative value declined as PE firms closed on smaller deals. Financing costs were prohibitive due to distress in the high-yield and leveraged loan markets during 4Q 2018, prompting numerous GPs to push back deals. Despite the lower deal value, multiples remained elevated as competition continues to be fierce and technology—which typically trades at higher multiples—accounts for a swelling portion of deal flow. GPs, though, are combating these pressures by utilizing dividend recapitalizations (recaps) and sale-leasebacks, among other strategies, to boost returns.

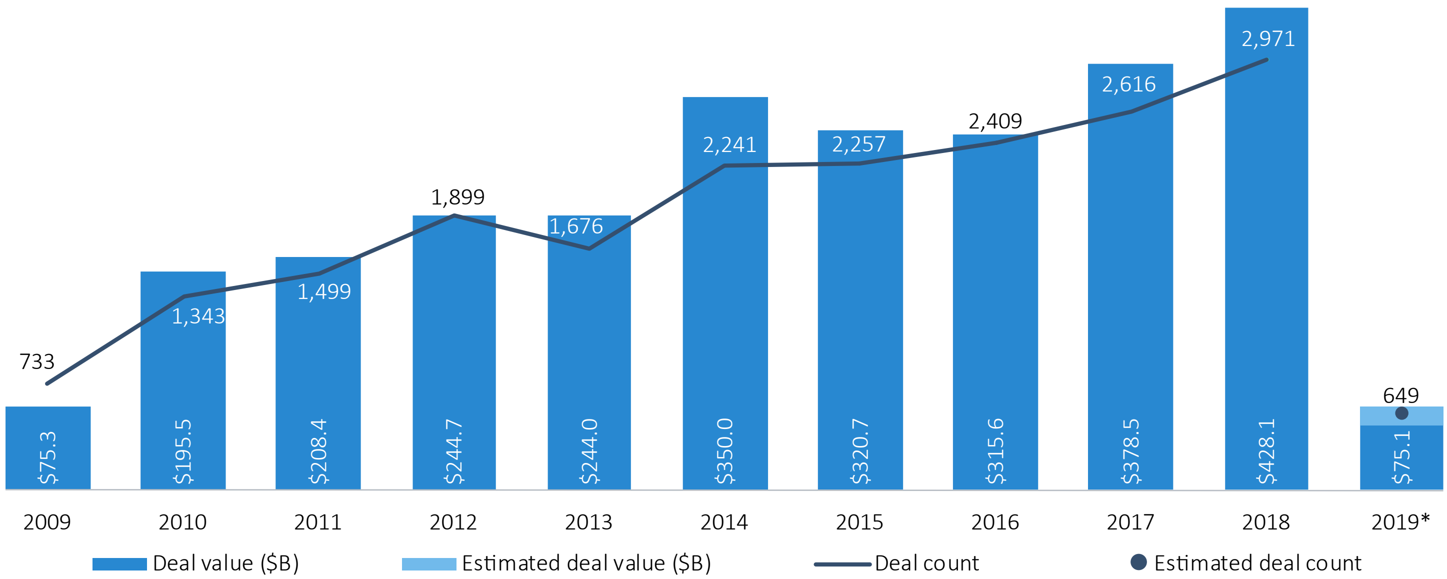
Exits, on the other hand, saw declines in count and value as GPs were reluctant to sell in an adverse pricing environment. Public markets in the US declined meaningfully in the quarter, causing mark-to-market losses that many GPs would loathe to realize. The decline in markets, coupled with the longest government shutdown in history, meant 1Q was devoid of MM PE-backed IPOs for the first quarter since the global financial crisis (GFC). An unremitting market recovery in fixed-income and public equity markets during the first quarter leads us to believe exit activity will pick up throughout the year.

Despite declines in deal and exit value, fundraising figures remained steady in the quarter. LPs continue to allocate to PE at a record clip, boosting MM fundraising. Funds—within and above the MM—continue growing in scale, with vehicles between $1 billion and $5 billion accounting for over three-quarters of capital raised in the MM. This proliferation of massive funds will have downstream effects, likely leading to larger deal and exit sizes. As fund sizes grow persistently, GPs with a history of raising mega-funds ($5 billion+) continue to return to the MM with smaller, more-focused funds.

Wylie Fernyhough
Analyst, PE

Overview

US MM PE deal activity



Source: PitchBook
*As of March 31, 2019

US PE MM deal activity remained fervent in the new year, though GPs were closing on smaller deals as the industry saw a noticeable decline in the most sizable transactions. In 1Q 2019, GPs closed on 649 deals totaling $75.1 billion—YoY declines of 17.9% and 32.6%, respectively. The slowdown witnessed in the broader PE market was not fully reflected in the MM as GPs continued to rapidly ink deals despite downward pricing movements in leveraged loan and high-yield markets during the fourth quarter of 2018 (likely when the deals that closed in 1Q were negotiated).

Median deal size ticked lower in the quarter, dropping from 2018's full-year figure of $192.0 million to $155.0 million. However, it should be noted that with three additional quarters of data, these figures may move meaningfully by year end. A batch of massive restaurant deals closed—including a couple of household names. As discussed in the spotlight for our 2018 Annual PE Middle Market Report, restaurant buyouts have occurred frequently in recent years—a trend which seems to be continuing. The largest restaurant buyout in the quarter was a $740.0 million take-private of Bojangles—a fast-food company operating in the Southeast—by Durational Capital Management and The Jordan Company. The Jordan Company has made food services investments in recent years, but Bojangles represents its first foray into restaurants. Its portfolio of investments seems to offer areas for collaboration, including Carlisle FoodService Products and Mallet, a producer of food-grade oils. Another notable restaurant buyout to close—due to the deal size and brand-name recognition—was P.F. Chang's China Bistro, which TriArtisan Capital Advisors and Paulson & Co. bought for $700.0 million from Centerbridge Partners and Quilvest Private Equity.

The MM has seen its proportion of overall PE activity steadily ascend since 2009. Much of this advance can be attributed to myriad add-ons GPs have completed in recent years. Additionally, GPs are targeting a lower proportion of deals under $25 million (our lower bound for the MM) as investment sizes for platforms and add-ons balloon. On the other hand, the declining median deal size meant the MM did not substantially grow its share of overall US PE deal value. Indeed, longer term, the MM has accounted for approximately the same proportion of deal value for a decade, falling between 55% and 65% in seven out of the last 10 years.

Investment in the technology sector has been a driving force for MM growth in recent years. The sector accounted for 27.1% of cumulative deal value in 1Q 2019, lagging only B2C. During the quarter, the technology sector saw the largest MM deal, Thoma Bravo's $950.0 million LBO of cybersecurity firm Veracode. The company was carved out of CA Technologies as it was being purchased by Broadcom.

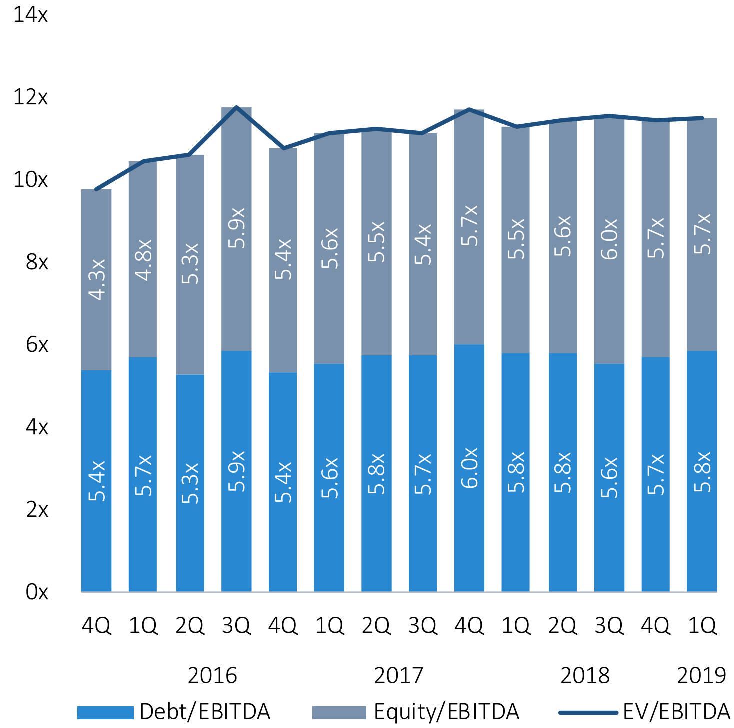
Overview

Thoma Bravo has been an aggressive acquirer in recent years, and Veracode is yet another company to add to their current arsenal of cybersecurity firms. This transaction speaks to another trend that will likely provide an increased number of deal sourcing opportunities to GPs: corporate carveouts. Corporate CEOs are reviewing their portfolios of companies more frequently and increasingly taking action to streamline business focus and divest noncore businesses following years of aggressive consolidation.[1]

Turning back to B2C, retail showed up meaningfully in the deal flow this quarter. The most notable deal in the sector was the $487.2 million take-private add-on of Essendant—a wholesale distributor of workplace items beyond office supplies—by Staples, backed by Essling Capital, HarbourVest Partners and Sycamore Partners Management. The combination shows how add-ons—often cited in reference to the roll-up strategy—can be used for “scope” rather than “scale” acquisitions. The timing comes just months before Staples began preparing for a $1 billion dividend recap, seeking to return the bulk of the original invested equity.

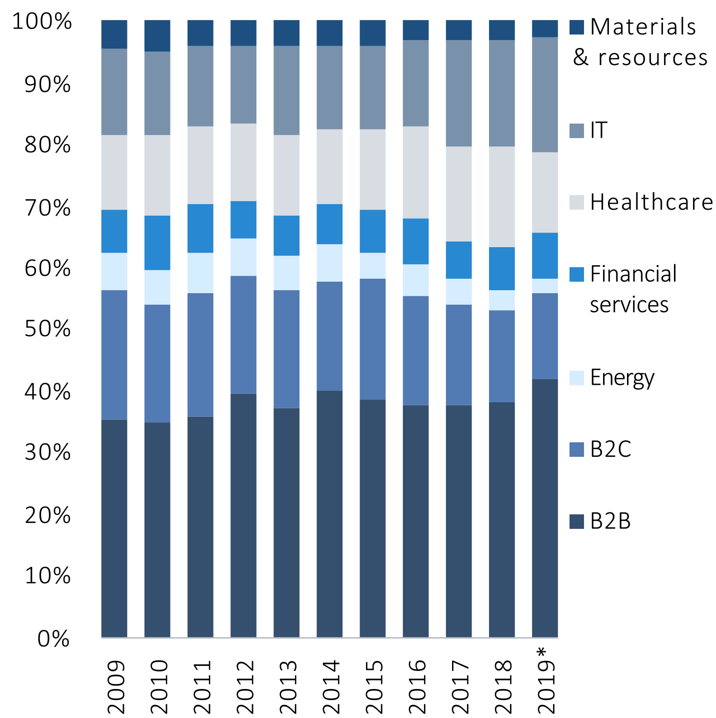
Dividend recaps and add-ons have become ordinary methods by which GPs endeavor to boost returns in today’s elevated pricing environment. Remarkably, multiples have remained quite steady, albeit elevated, over the past couple of years, possibly showing pricing discipline amid a swelling dry powder base. To mitigate the risk that comes with high prices, many GPs are focusing on downside protection and intensifying the due diligence process. One method by which some PE firms have been combating elevated multiples has been the sale-leaseback. The thesis is that land and buildings tend to sell at a higher valuation than the company itself, allowing PE firms to sell an asset and lease it back, capturing a sort of multiple arbitrage and blending down the purchase price multiple. The sale-leaseback is also a way to create liquidity and return cash to LPs early on in a holding period, subsequently boosting IRRs. The strategy tends to be popular with industrial companies because they tend to own the land on which they operate and the arbitrage between real estate value and the company is often greater as they often sell at lower valuations. While changes to accounting standards mean these arrangements will no longer be treated as off-balance-sheet financings, which, in turn, made debt-to-equity ratios and return on assets look more favorable, many GPs continue to utilize the strategy.[2] We expect GPs to discover and undertake creative methods to combat the performance pressure induced by elevated multiples.

US PE buyout EV/EBITDA multiples (four-quarter rolling median)



Source: PitchBook
*As of March 31, 2019

US MM PE deals (#) by sector



Source: PitchBook
*As of March 31, 2019

1: “In an Age of M&A Complexity, Do You Pause or Proceed?,” Global Capital Confidence Barometer, Ernst & Young, October 2018

2: According to the new Financial Accounting Standards Board (FASB) accounting standard (ASU 2016-02), companies must recognize operating lease assets and liabilities on their balance sheets. Previously, only capital (finance) leases showed up on balance sheets.

Antares Capital outlook

2019 off to a slow start

US-sponsored, middle-loan volume of just $28 billion started 1Q 2019 down 37% YoY and 39% QoQ, according to Refinitiv LPC. The broad-based drop occurred across channels (syndicated and direct lending) and purposes (M&A, refinancing/repricing and dividend recaps) and appears to have reflected the lingering fallout of 4Q 2018's stock market correction and volatility spike. On the deal supply side, PitchBook's data appears to confirm the slump in 1Q 2019 US MM PE deal activity. On the loan demand side, loan mutual funds and ETFs have continued to see net outflows for 20 weeks in a row for a cumulative withdrawal of $24 billion through to the end of 1Q 2019, according to Capital IQ LCD/Lipper. Likewise, CLO issuance of $29.2 billion in 1Q 2019 was down 9% YoY. On the positive side, loan markets appear to be healing, with Antares' pipeline up YoY heading into 2Q 2019.

Resilient if less-robust confidence in US economy; outlook abroad less rosy

Despite the rocky end for markets in 2018, confidence among US MM participants appears to have held up relatively well heading into 2019. Our 3rd Annual Compass survey of PE sponsors, borrowers and investors completed in January suggests optimism over prospects for the US economy remained resilient heading into 2019. Confidence in the US economy was down a bit from the remarkably high levels seen in early 2018 but remained strong across PE firms, loan investors and borrowers. Furthermore, a recession in 2019 was generally viewed as "unlikely."

In contrast to the US, optimism regarding economies abroad has fallen sharply with a modest majority of sponsors and investors now uncertain or pessimistic about the outlook for the global economy versus the strong confidence seen a year ago.

Deal activity expected to taper

On the deal front, a small majority of survey respondents expect M&A activity to be relatively flat in 2019, but of the balance, about twice as many expect a decline as expect an increase, suggesting a tilt toward the downside. Most of the polled loan investors expect leveraged loan volume to decline modestly in 2019 in contrast to a flattish forecast view held in early 2018.

Selectivity and credit discipline remain critical

While the pivot by the Fed to a more dovish stance appears to have helped uphold optimism heading into 2019, as late 2018 activity demonstrated, market trauma can flare quickly. As a lender, it remains as critical as ever to be selective and maintain credit discipline.

Q&A: David Brackett

David Brackett

Managing Partner & CEO
Antares Capital

Dave is a member of Antares' Investment Committee as well as Antares' Board of Directors. Previously, Dave served as president and CEO for GE Antares. He was a founding partner when Antares was formed in 1996. Prior to starting Antares, Dave was a senior executive with Heller Financial.

A recent inversion of the yield curve and other signals have some worried that the end of the cycle is near. What does your recent Compass survey suggest about the outlook?

We sent out our 3rd annual survey in mid-January after the Fed pivoted to a more dovish stance; the results generally suggest resilient optimism in the US economy. Confidence was down a bit from the remarkably high levels seen in early 2018 but remained relatively strong with 75% of sponsors, 81% of investors and 72% of borrowers "confident" in the 2019 US economic outlook. Likewise, almost 90% of sponsors and investors indicated that they see the odds of a US recession in 2019 as "unlikely" or "very unlikely." Borrowers were somewhat more apprehensive with a lesser 60%, saying a recession in 2019 is "unlikely" or "very unlikely." Nevertheless, nearly 75% of borrowers expect moderate to strong revenue and EBITDA growth in 2019.

What are you currently seeing and expecting going forward for MM M&A and related PE loan activity in 2019?

So far in 1Q 2019, MM M&A deal activity has been sluggish. We see this in PitchBook's data (showing total deal count and value down 18% and 33% YoY, respectively) as well as our own M&A "deals-seen" activity index which is down about 7% YoY in 1Q 2019. Looking forward, based on our

Compass survey, most sponsors (69%) and investors (57%) expect M&A activity to be about flat in 2019, but of the balance, about twice as many expect a decline as those that expect an increase, suggesting a tilt toward the downside. Within the mix of M&A, responses on LBO activity tilt toward "less active" while add-on activity is expected to be flat to "more active." Some of this, in turn, no doubt reflects headwinds of higher purchase price multiples, late-cycle worries and rising financing costs. The median purchase price multiple was up to 11.1x in 1Q 2019 versus 10.5 in 2018, 10.1x in 2017 and 9.8x in 2016 including private/club deals, according to LCP. On a positive note, Antares' latest weekly pipeline stats have seen a pickup so far in April, so 2Q 2019 appears to be off to a decent start.

On the leveraged loan volume front, most (62%) loan investors polled expect volume to decline by 3%-10% in 2019 in contrast to the flattish forecast view held in early 2018. In addition to potentially more tepid M&A activity, some of the expected slowdown may reflect expectations of lower refinancing/repricing activity versus robust activity a year ago due to rising yields as all components (LIBOR, spread and OID) have widened over the last six quarters for first-lien institutional primary term loans (source: LPC). Looking forward, polled investors expect yields to generally be flat to up in 2019 versus 2018. In the broadly syndicated market, 52% expect flat at 33%, a rise of 50-100 bps. In the MM, 43% expect flat, 38% see a rise of 50-100 bps and 10% see a rise of more than 100 bps. The broadly syndicated market also saw a large jump in the percentage of investors expecting loan document terms to tighten (52%) instead of loosen further (only 5%) which was a big swing from last year's findings.

What trends are you seeing in your portfolio of PE-backed borrowers? Any signs of an impact from trade disputes?

Generally speaking, Antares' portfolio is performing very well with favorable loss, default and non-earnings trends. Likewise, LTM revenue and EBITDA growth trends continue to look healthy. While we have seen a slight uptick in our watchlist count, this typically reflects idiosyncratic, borrower-specific reasons related to missing EBITDA "add-back" benefits (e.g. anticipated acquisition synergies and other such adjustments) that were anticipated. We are not seeing much in the way of general macroeconomic-related issues. Likewise, trade tariffs/tensions do not appear to be having much direct impact on our borrowers.

Looking forward, as per our Compass survey findings, the vast bulk of our borrower respondents expect moderate (3%-5%) to strong (5%+) revenue and EBITDA growth in 2019. Relatedly, the outlook for their hiring looks strong, with 58% planning to grow their workforce by more than 3% in 2019. According to sponsors, the top-five industries expected to experience the most growth in 2019 include business services, technology, software & communications, healthcare, food & beverage and packaging—all somewhat more recession-resistant areas.

A near majority of surveyed investors (48%) expect the borrower default rate to remain low at about 2% in 2019, with most of the balance (43%) expecting defaults to tick up into the 2%-3% range. Interestingly, the trailing 12 month default rate for leveraged loans, as reported by S&P LCD, has actually fallen to 0.93% as of March 2019 compared to 1.6% at year-end 2018 and a recent high of 2.4% in March 2018; this runs counter to our survey expectations. The increased prevalence of cov-lite loans may suppress defaults and make default rate trends more of a lagging indicator of borrower stress in the future. However, other more market-based "distressed" ratios (e.g. % of loans priced below 80 bps or first-lien loans with a secondary spread of >L+1000) also continue to remain relatively benign as of late.

While portfolio vital signs thus remain healthy, higher leverage, EBITDA add-backs and generally looser terms in today's environment suggest less room for error should some geopolitical or economic event precipitate a downturn. As such, selectivity and credit discipline remain evermore critical.

Antares Capital

Antares is a private debt credit manager and leading provider of financing solutions for middle-market private equity-backed transactions. In 2018, Antares issued more than $24 billion in financing commitments to borrowers through its robust suite of products including first lien revolvers, term loans and delayed draw term loans, 2nd lien term loans, unitranche facilities and equity investments. Antares' world-class capital markets experts hold relationships with over 400 banks and institutional investors allowing the firm to structure, distribute and trade syndicated loans on behalf of its customers. Since its founding in 1996, Antares has been recognized by industry organizations as a leading provider of middle-market private debt, most recently being named the 2018 Lender of the Year by ACG New York. The company maintains offices in Atlanta, Chicago, Los Angeles, New York and Toronto. Visit Antares at www.antares.com or follow the company on Twitter at www.twitter.com/antarescapital. Antares Capital is a subsidiary of Antares Holdings LP., collectively ("Antares").

Spotlight: Chinese PE

This section appeared first in Private Equity in China, written by Lead PE Analyst, Dylan Cox.

The global economy is becoming increasingly interconnected and investors' portfolios are gradually becoming more global. While US investors have long invested in Europe, Asia—and in particular China—has been underrepresented in portfolios. This is beginning to change as China pivots to primarily operating as a service (as opposed to a manufacturing) economy and opens itself to outside investment into public and private markets. Meanwhile, GPs recognize China and other developing economies as fruitful opportunities to launch new strategies and grow AUM. In terms of capital commitments, PE fundraising for China-focused funds more than doubled from 2017 to 2018. Many US investors may not allocate to Chinese private markets today, but the country is playing a more prominent role in the PE industry.

Contrary to the perception that Chinese PE is dominated by well-established firms from the US and Europe, domestic funds (i.e. by firms headquartered in Greater China) have been one of the key drivers of growth over the last decade. Domestic funds generally account for more than two-thirds of new offerings in the region, though there are more recent reports that domestic funds have been shutting down at a rapid pace due in part to the recent deleveraging campaign and crackdown on shadow banking.[3] In any case, foreign (mostly US-headquartered) investors still account for an outsized proportion of capital raised. The Carlyle Group, KKR and TPG have each raised more than $15 billion in Asia-focused (and China-headquartered) funds since 2000, and together non-Chinese firms accounted for more than half of capital raised in 2018.

A change in the mix of foreign versus domestic PE funds, and therefore how many vehicles are denominated in RMB versus foreign currencies, could have major implications for how these funds can invest in the region. Just 7% of funds were denominated in RMB in 2018, among the lowest levels in the last decade. Much of this decrease has come from the unwinding of domestic PE firms (which tend to raise funds denominated in RMB) following the aforementioned deleveraging campaign. Going forward, however, we expect non-Chinese firms to pursue a similar mix of RMB versus USD (or other) denominated funds given that many of the benefits to raising a fund in RMB remain intact.

Top investors* by capital raised for China-focused funds

Investor name	Capital raised ($B)
The Carlyle Group	$21.2
Kohlberg Kravis Roberts	$19.8
TPG Capital	$16.5
Bain Capital	$11.1
CVC Capital Partners	$10.3
The Blackstone Group	$2.9
Goldman Sachs Merchant Banking Division	$2.5
Warburg Pincus	$2.0
EQT	$1.7
Intermediate Capital Group	$1.4

Source: PitchBook
*Headquarted in North America & Europe
**As of March 31, 2019

A few of these benefits—which are mostly related to having access to domestic stock exchanges—are outlined below:

- RMB funds benefit from less regulatory oversight, greater exit options, and fewer restrictions on sectors in which they can invest.
- Two stock exchanges were launched in the last decade (ChiNext in 2009 and the National Equities Exchange and Quotations exchange in 2012) that expand exit opportunities for RMB funds.
- Currently the government does not allow firms with foreign backing (i.e. non-RMB funds) to exit via IPO on domestic exchanges.

A quick glance of open and upcoming funds in the region reveals investors—both domestic and foreign—are continuing to target larger sums. CVC, a British firm with its headquarters in Luxembourg, is targeting $4 billion for its fifth Asia-focused fund, above the 3.5 billion it raised for the same strategy in 2014 (though still below the $4.1 billion it raised just prior to the financial crisis). On the domestic side, Centurium Capital, based in China and led by former Warburg Pincus China head David Li, is targeting $1.9 billion for its debut fund, focusing on consumer and healthcare investments in China.

3: "China Private Equity Funds Suffer Wave of Closures," Financial Times, Gabriel Wildau & Yizhen Jia, August 5, 2018

ACG: Q&A

The National Center for the MM found that the fastest-growing MM retailers are thriving thanks to a willingness to invest in digital technologies to boost efficiencies, increase sales and enhance the customer experience, both online and in-person.[4] The research counters the widely cited notion that retail is dead and addressed MM companies' "digital strategy." As president and COO of dpHUE, can you describe what digital means for your company?

Digital is a tool to achieve your vision, and digital technologies can fundamentally alter the way goods and services are obtained. They can be applied throughout the product life cycle, from the beginning of the value chain, to working with suppliers and managing operations, including warehousing and distribution. They also have an impact on the consumer-facing side, where technologies are leveraged to enhance or improve consumer engagement of the brand right through the path to purchase.

Do you agree that above-average performance for MM retailers is linked to the sophistication of their digital strategy?

It depends on how they use digital. The companies that can link success and profitability to their digital strategy are very clear about what they want to accomplish with digital. In retail or any consumer brand, every channel matters. A critical element of a successful digital strategy is being able to track three key consumer behaviors: engagement, purchase and consumption. Retailers need to build strategies to improve the customer journey and be working to build and execute plans to better achieve those objectives.

What distinguishes companies that build and execute well?

Those companies are likely taking the time to look internally at operations and externally at brand experience. They use a SWOT analysis to develop digital strategies that fill gaps in the supply chain and remove other impediments in the customer journey.

How much of your time as president and COO is dedicated to dpHUE's digital strategies?

Digital has always been at the core of our business. About 60% of my time is dedicated to supporting the organization and operations around our digital strategy. We operate in B2C and B2B channels. Our B2C website dpHUE.com is direct-to-consumer. Our B2B channels include the wholesale side of our business, which includes distribution through retailers such as Sephora and ULTA. The second part of B2B involves our licensed stylists and salons that purchase and then resell our products or that order them directly on behalf of their customers via a specialized app.

Marty Okner

President
dpHUE

Before his tenure at dpHUE, Marty co-founded and served as Managing Director of SHM Corporate Navigators, a strategic advisory firm to MM companies. Okner serves as vice chairman of the board for ACG Global, is the former chairman of the ACG New York chapter and has been an active member ACG since 2009.

Regarding our own SWOT of dpHUE's operations, we looked at how we brought product to consumers via the salon professional. We found that for many salons operating as small businesses, holding inventory requires cash and a person to order, maintain and manage it. We explored how we could remove cash and labor obligations. We recently rolled out the salon pro app. Our salon pros recommend our product to their client, show them the product on the app and create the point of purchase for their client. We fulfill the order, and the salon pro receives a generous commission without inventory and cash commitment.

Do digital technologies level the playing field for MM companies?

I think it does, in part because the digital transformation has happened in concert with a generational transformation. Many millennials and members of Generation Z only know how to interact with brands via a digital channel. This consumer demographic does not want to be a brand loyalist to legacy companies or to work for them. MM retailers are nimble and innovative. They can manage for the long term, which makes them attractive to a digital-savvy and technologically versed workforce.

How have the talent needs of MM retailers changed?

Talent is key in any business. In retail, the customer is still the focus. There are probably more people committed to the steps in between the point of brand awareness and the

4: "Middle Market Retail: How Digital Transformation Is Fueling Growth," National Center for the Middle Market, December 5, 2018 product sale than what was once primarily a consumer-facing interaction. What has dramatically changed for retail is the time needed for gathering information to inform, develop and market a product. On the content-creation side, you might develop content that would last six months. At dpHUE, we create content weekly for organic use via social channels. That content is also used by our influencers and then amplified by their followers. Finally, it's the foundation for paid social media channel campaigns grounded in brand awareness and customer engagement.

The major difference between today and 20 years ago is consumption, and with it the availability of data around and about purchases. Consumers expect more. Fortunately, it's less costly and nearly instantaneous to acquire information about consumer behavior. This shift in consumption has created a reallocation of retail's workforce. We need people to track the customer journey, create the content to engage them and extrapolate the data to inform our sales strategies and operations.

How does a MM company's investment and success with its digital strategy play into its valuation?

Digital strategies play into a company's valuation through metrics. Questions in which investors would be interested include: How does the company use technology to lower customer-acquisition costs? How does it leverage data to increase the frequency of a purchase? How is it using data to increase average transaction value? The answers come through in the metrics. Combined with a healthy gross margin and a manageable selling, general and administrative expense (SG&A), you have now created a good recipe for growth and valuation. The business fundamentals still make a difference, but digital becomes the overlay on how to improve the performance of those business metrics.

What characteristics should investors look for in MM retail companies?

I think it comes down to four factors. First, the strength of the brand. Today, it's less about the product than the brand. Second, the strength of the consumer relationship, which translates into the cost to acquire and maintain, the service model involved and how that compares to competitors. Third, it's the people of the organization, if the culture is wired to innovate, and if the organization is committed to its customers. If the people are strong, chances are the strength of the brand and its relationship with its customers will be as well. Last, it's the financial fundamentals, from the potential for sales growth to their promotional spend, and how that is reflected in the quality of earnings. Combined, those four factors will help investors determine if the company is poised for growth.

Has the Amazon effect helped or hurt retail?

Amazon's velocity has changed customer expectations and experience. The company proficiently decreases time between need-identification and need-fulfillment, which is a very functional benefit.

There is always fear that the behemoth will take out the competition, but I do think Amazon has helped a lot of retailers. Its web services division has done a lot for retailers large and small. It has lowered their cost structure by giving them access to technology that allows them to compete on and off the Amazon platform. Retailers in the attitudinal and lifestyle categories operate where it's hard for Amazon to compete. They use editorial content to influence those decisions because consumers make those purchase decisions very differently.

20 years ago, Walmart was the behemoth we thought would wipe out all of retail. That's not to say it can't happen, but it's safe to say you can't assume one channel will dominate all categories for all people. It's unrealistic. At dpHUE, Sephora and ULTA are great retailers that offer a great value proposition to their customers in their store. Our customers who visit our site get a positive experience through that channel, as do the customers who we now serve through the salon pro app. There are plenty of pockets where retailers can compete with Amazon because not all customers are alike.

ACG® Association for Corporate Growth

About the Association for Corporate Growth

Founded in 1954, ACG has 59 chapters across the globe. ACG's worldwide network comprises 90,000 professionals within the middle market, including 14,500 members who serve as the investors, lenders, owners, executives and advisers to growing middle-market companies. ACG's mission is to drive middle-market growth. ACG's InterGrowth has been the nexus of the middle-market dealmaking community for more than half a century. Pitchbook estimates that 2018 InterGrowth attendees were involved in more than one-third of US private equity deals and sat on more than $189 billion in dry powder. InterGrowth will be held May 6-8, 2019, at the Waldorf Astoria Orlando. For more information, please visit www.acg.org.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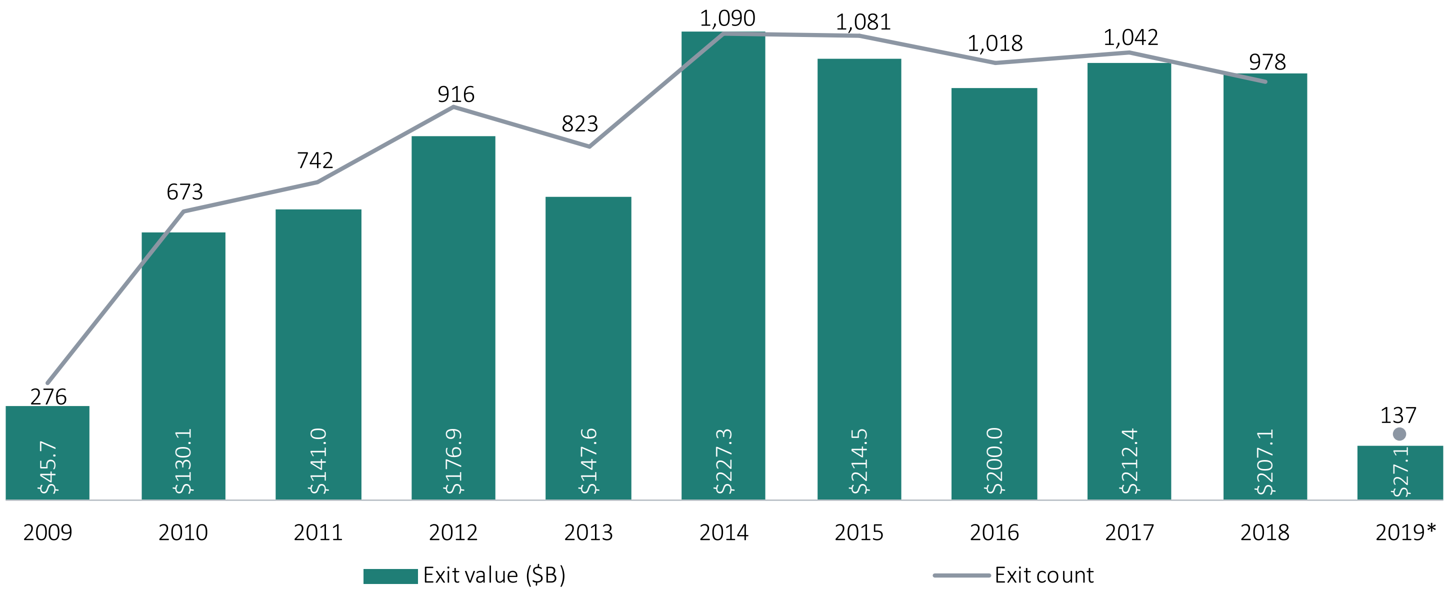
Exits

US PE MM exit activity



Source: PitchBook
*As of March 31, 2019

Exit activity was tepid in the first quarter of 2019, with GPs exiting 137 companies totaling $27.1 billion—YoY declines of 41.8% and 46.3%, respectively. Sharp moves downward for US public equity markets in 4Q 2018 pressured mark-to-mark valuations of PE-backed companies, making GPs less likely to finalize an exit in that environment and more likely to wait for price improvements. At one point in 4Q 2018, the Russell 2000 had fallen over 20%.[5] Through the first quarter of 2019, fortunes reversed, with the index gaining more than 15%. This period of price recovery likely caused many GPs to begin the sale process for companies they intended to sell but held through the volatile 4Q 2018. We expect exits to pick up throughout the year so long as it remains a seller's market. To that end, many GPs have been growing anxious about a looming economic downturn, hoping to sell portfolio companies before liquidity dries up and multiples decline. This worry is further fueled by the recent inversion on several spots of the US Treasury yield curve. Additionally, the GFC remains fresh in investors' minds. All of this is to say we expect healthy exit activity in the coming years as GPs take advantage of the same high prices they so detest on the deal side.

Notably absent in the quarter was IPO activity. Just one PE-backed company in the US exited via IPO in 1Q 2019, though it was above the MM threshold. While the portion of MM companies to exit via IPO has been diminishing for a decade, there hasn't been a quarter without an MM IPO since 1Q 2009, following the worst period for public equities in decades. While much of the decline in this quarter may be attributable to the government shutdown, we expect IPOs to account for a lower portion of MM exits as secondary buyouts (SBOs) and corporate acquisitions offer competitive pricing while providing full liquidity sooner.

Although exit count was down on the quarter, three-quarters of US MM exits were sized $100 million or higher. Technology represented an outsized portion of overall exit value—similar to the deal side—nearly accounting for one-third (32.1%) of the total. The largest technology exit, which was also the largest exit of any sector, was the $750.0 million sale of LGS Innovations (backed by CoVant Management and Madison Dearborn Partners) to CACI. LGS grew rapidly under PE ownership, growing its EV nearly 4x in five years after it was originally bought out for $200.0 million in 2014. These types of robust returns in technology—spanning the MM and above—ought to keep driving investment, and subsequent exits, in the sector.

The second-most-active sector for exits was B2C, accounting for 18.7% of exit value. B2C has consistently accounted for a higher portion of US MM exits than US PE exits overall. This may be due to the scalability issues for many consumer-facing businesses that limit potential

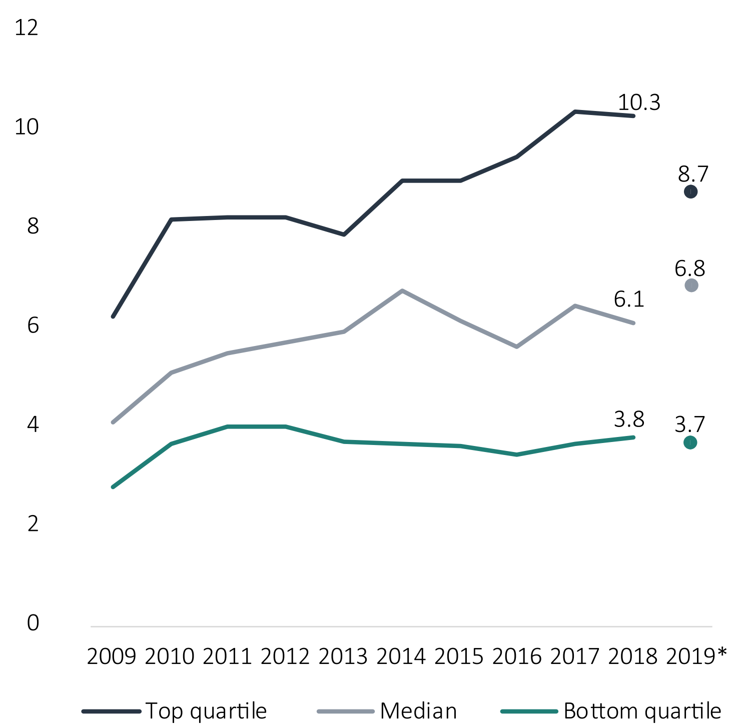
5: Morningstar data

growth and exit size compared to software firms, for example. One of the larger exits for the sector in 1Q was Clairvest Group's $407.0 million sale of Midwest Gaming Holdings to Churchill Downs. This deal expands Churchill Downs' footprint but also has a technology component due to Midwest's online-gaming operation and sports-betting business. It appears that deals across all sectors will increasingly contain a technology component.

The growing complexity of companies and buyouts, coupled with 2018's changes to corporate tax law, is having knock-on effects for GPs. One of those effects is longer holding times. The rule of thumb in PE investing is that portfolio companies are held for three to five years before being exited. While this may have held true in the golden age of PE leading up to the GFC, it is simply no longer the case; GPs are holding portfolio companies longer than ever. In fact, fewer than 50% of MM exits occur in under five years, as shown by the median holding time of 6.8 years. Interestingly, the top quartile for holding times (meaning 25% of exits occurred after longer holding times) has hovered around a decade in recent years. This is one reason we have seen LPs' and GPs' attitudes shift regarding holding times, which in turn has driven an uptick in long-dated funds with investment periods stretching out to 15 years or more. These funds are being pursued by newcomers and established GPs alike, seeking to offer differentiated risk/return profiles beyond the vanilla buyout fund. BlackRock is seeking to raise a $10 billion-$12 billion permanent capital vehicle that is being positioned as an offering that sits between publicly traded equities and the vanilla LBO fund.[6]

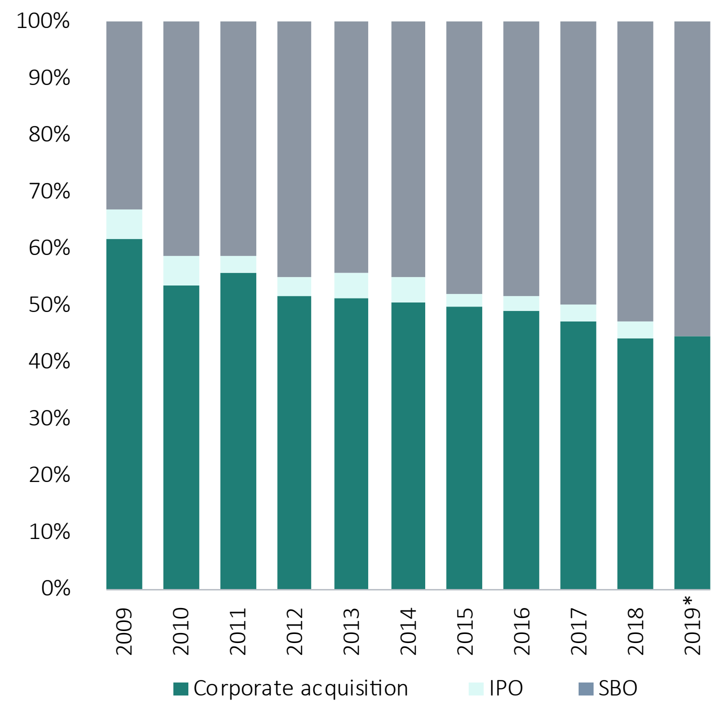
In 1Q, we saw a prominent example of longer holding times, with Summit Partners and KRG Capital Partners selling Aurora Diagnostics for $540.0 million to Sonic Healthcare after establishing Aurora back in 2006.[7] Along the way, Aurora underwent multiple rounds of debt refinancing, a canceled IPO in 2010 and a canceled acquisition in 2016. The precrisis acquisition timeframe could also help explain the longer holding time of this company and numerous others. Buyouts before the great recession may have taken a substantial financial hit, causing a steep decline in value. GPs would either have to sell at a loss after three-to-five years or try to ride out the business cycle and wait for a non-negative return. As more of these precrisis investments are liquidated, we will have to see whether the longer holding times reflect a paradigm shift in buyout investing or are a result of the GFC.

US PE MM holding time quartiles



Source: PitchBook
*As of March 31, 2019

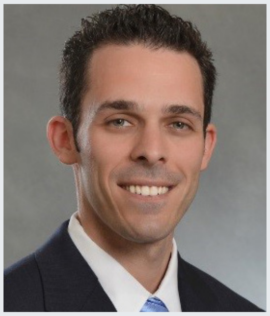
US PE MM exits (#) by type



Source: PitchBook
*As of March 31, 2019

6: "BlackRock Shakes Up the Private Equity Industry," Institutional Investor, Christine Idzelis, April 1, 2019
7: Aurora Diagnostics was originally backed by GSO Capital Partners and Summit Partners, but GSO sold its stake to KRG Capital Partners in June 2009.

Chubb: Q&A



Scott Williams

Senior Vice President
North America Financial Lines

Scott leads Chubb's Private Equity Industry Practice for Financial Lines in addition to overseeing all underwriting and products for Chubb's Private/Not-For-Profit Management Liability group. Since joining Chubb in 2009, he has held a variety of legal and underwriting leadership positions throughout North America. Scott received his J.D. from New York Law School and his Bachelor of Arts degree in Economics from the University of Delaware.

Ryan France

Senior Vice President
Private Equity Industry Practice Leader
North America Commercial Insurance

Ryan leads a team of underwriters and practice leaders throughout North America. He has held a number of leadership positions throughout North America. Ryan received his Bachelor of Arts degree from Chapman University in Orange, California.

What are some key trends to watch?

Scott Williams: We saw an increase in global M&A activity in 2018 with attractive financing offers for organizations while interest rates in North America started to slowly rise.

PE has a growing influence in M&A markets, and the number of PE-backed companies in the US is increasing rapidly. This may be a result of a surge in private lending funds and increases in leveraged loan issuance. Investors are capitalizing on the opportunity to partner with PE firms who have been outperforming public markets.

Based on our regional footprint and broker network, we expect to see more deals occur in the financial services, telecommunications, energy, resources and media & technology sectors in 2019.

Ryan France: Top strategic drivers for acquisition have been technology and manufacturing companies or assets. Tech's popularity has underscored a long-term shift for PE firms which often focused on underperforming companies they could improve and sell. Many PE firms have raised large funds solely focused on technology and manufacturing.

Manufacturing comprises nearly 12% of our GDP with contributions of approximately $2.1 trillion to the economy.[8] US manufacturing is the ninth largest economy in the world and a major source of R&D. The movement we see with physical manufacturers using technology to enhance their process and create innovative products and services aligns well with Chubb's broad product offerings. This allows us to create an integrated insurance solution for the ever-changing needs of our core middle-market clients.

With so much focus on IT, data, automation, and digital capabilities many companies of all sizes across all sectors from retail to finance are looking to adapt technology into their business model.

8: "US Manufacturing Soars as Economy Fuels Growth," Floor Covering Weekly, Sharyn Bernard, August 6, 2018

What is the breakdown of the current Chubb portfolio by sector, broadly speaking, for PE? What do you think has driven that composition?

SW: Our target industries include:

- Technology
- Advanced manufacturing
- Life sciences
- Energy & clean Technology
- Financial institutions
- Real estate & hospitality
- Healthcare
- Professional services
- Retail
- Food
- Transportation (risk management accounts)

This industry appetite is backed by our approach to address risk across the breadth of the product lines we offer, which includes transactional risk, multinational property and casualty, primary casualty, excess casualty, property, general liability, commercial package, errors & omissions/professional liability, cyber, management liability, environmental, surety, product recall, and more.

RF: In addition to our comprehensive industry-specific insurance solutions, we also have the expertise to service customers in the large account, middle market, and small business sectors. Our strategy is to craft and deliver tailored insurance solutions to PE firms and their portfolio companies through our dedicated PE underwriting team. This allows us to take a holistic approach to both line of business and account underwriting for the vast array of PE firm and individual portfolio company needs.

How does Chubb's types of services within its portfolio differ by sector? Given the current economic climate, do we see transactional risk insurance usage soar across the board?

SW: It's important to note that PE touches every sector within Chubb's portfolio and our industry practice is aligned to both support and react to the various nuances of the PE industry.

Our suite of transactional risk products facilitates M&A and other transactions by protecting deal participants from risks that arise in connection with the underlying deal. This is available to both buyers and sellers.

RF: Chubb's insurance solutions are designed to help address the potential effects of both pre- and post-close risks for PE firms and the companies in which they invest. The industry of the customer or portfolio company and their individual needs determine how we craft our coverage and service offering.

A hypothetical example is as follows: If we were to insure a mid-size, PE-backed industrial manufacturer in the US, we may respond with a commercial package addressing their property and general liability exposures, auto, worker's compensation, umbrella, cyber, E&O, product recall, discontinued products, pollution, medical or aviation products solution, all with the ability to tailor a global response as needed.

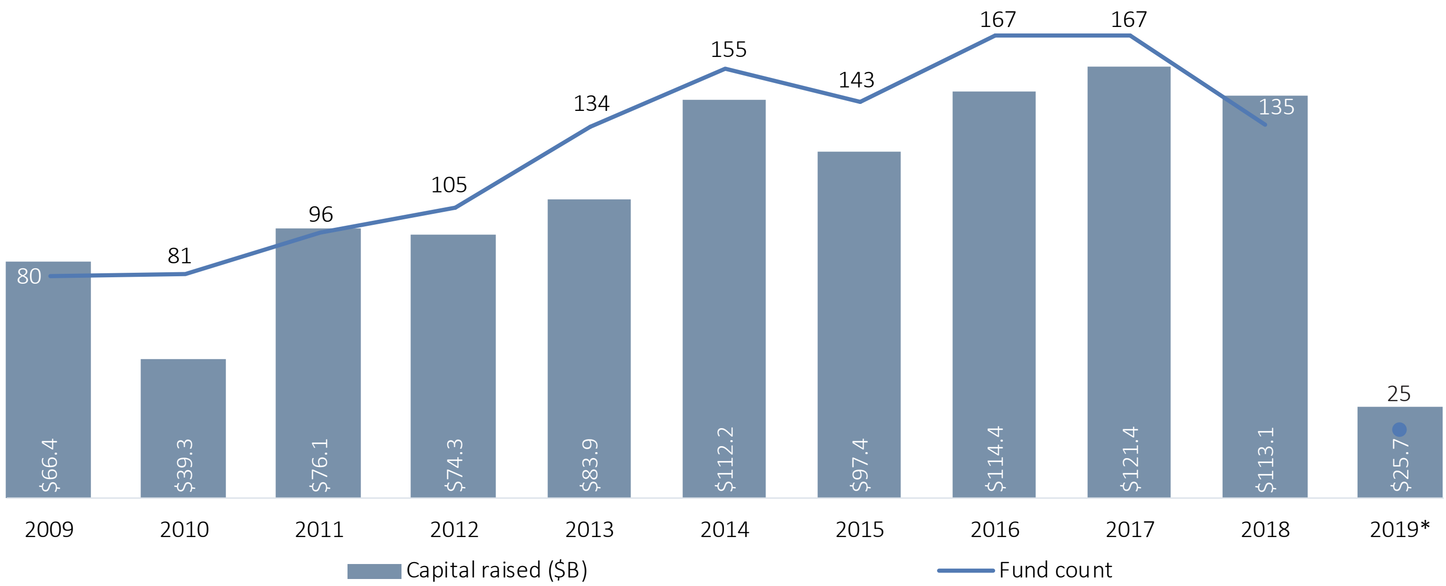
What significant factors currently in play in the US economy does Chubb forecast affecting some of its relevant industries?

SW: Despite rising interest rates, many are forecasting that 2019 will remain an active year for M&A activity. They expect growth to remain stable, and it's possible we'll continue to see an upward trend in the number of mega-deals.

Lead sponsor Antares Capital | In partnership with ACG Association for Corporate Growth | Co-sponsored by VRC | Co-sponsored by CHUBB

Fundraising

US PE MM fundraising activity



Source: PitchBook
*As of March 31, 2019

Fundraising activity sustained elevated levels in 1Q, driven by several large growth equity fund closings. Overall, US PE MM funds raised $25.7 billion spanning 25 funds. Poor performance in public markets and a subsequent potential denominator effect could be a hindrance for fundraising through the remainder of the year; however, the longer-term trend of increasing private market allocations is still intact. MM funds are playing less of an important role within the larger PE market, comprising only 56.6% of US PE fundraising capital, down from 62.6% in 2018. We expect this trend to continue with multiple mega-funds from GPs such as Vista Equity Partners, Blackstone and TPG expected to close in the coming quarters. Furthermore, according to our 2018 Annual Institutional Investor Survey, institutional investors are planning on allocating larger amounts of capital toward private market investing strategies in terms of their short-term portfolio rebalancing. The survey showed LP portfolio allocation toward the private market expected to grow from 30.9% to 32.5%.

Along with mega-funds, growth equity funds are becoming more prevalent as well. In 1Q 2019, PE growth funds accounted for 24.0% of the PE funds to close, the highest figure on record; growth funds have been steadily rising as a percentage of all PE funds since 2016.

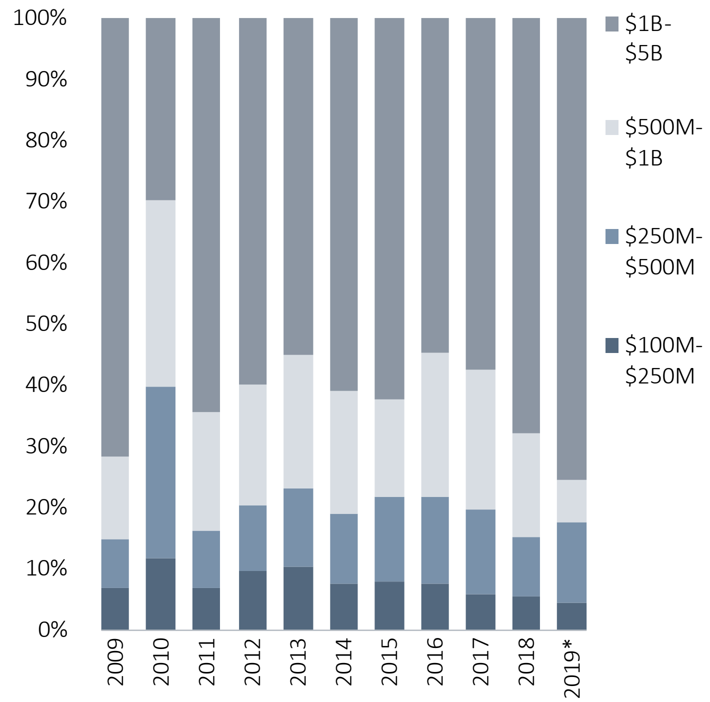
One point of interest is that the largest MM fund to close in 1Q is a growth equity fund. Summit Partners closed its $4.9 billion growth vehicle in the first quarter, continuing the trend of PE firms raising larger non-buyout funds. In another example, Insight Venture Partners X raised a $6.3 billion growth fund which closed in July of 2018. This is the largest PE growth fund to date (excluding Dyal's $7 billion GP stakes fund, Dyal Capital Partners IV, which is a growth equity fund exclusively for alternative asset managers).

Although funds are increasing in size across the board, many GPs raising mega-funds are also raising smaller, MM-focused vehicles to satiate LPs' appetite for MM return profiles with the largest GPs. Vista Equity Partners closed on a $5.8 billion buyout fund in 2014, but it consistently fundraises for MM buyout funds as well. In 2017, Vista closed on its $500 million Endeavor fund, which invests in smaller MM buyouts of companies whose enterprise value may be too small for its larger flagship fund.

The largest funds ($1 billion-$5 billion) comprised 75.3% of all MM capital raised in 1Q 2019, showing a clear trend toward LPs needing to make larger commitments to meet growing allocations. This, in turn, necessitates larger vehicles, but may also manifest in the form of pushing some vehicles above the MM cusp (meaning they would not be included in these datasets). As fund sizes grow, managers may have trouble finding ways to efficiently deploy capital. Along these lines, we have observed lower relative performance for mega-funds when compared with smaller funds over shorter- and longer-term horizons. During this time frame, only funds under $250 million underperformed mega-funds. Average fund sizes also continue to rise, with the average MM PE fund size topping $1 billion for the first time on record. Although this figure may fluctuate in coming quarters, we expect the evident trend of increased average fund sizes to continue.

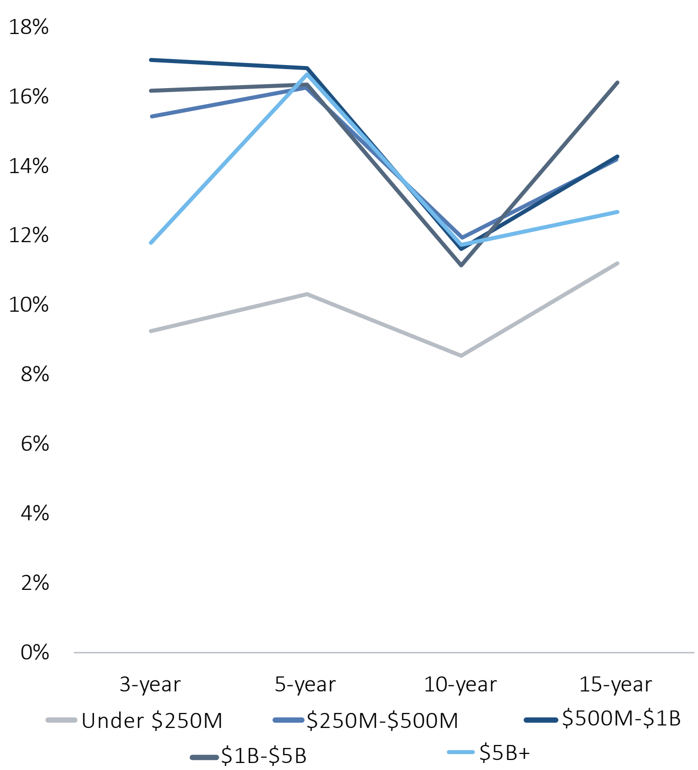
First-time funds are no exception to the trend of larger capital raises. As an example, Alex Navab (formerly of KKR), is targeting $4 billion for his debut fund for which he has a strategic partnership with the Petershill division of Goldman Sachs. In 1Q 2019, the number of first-time funds comprised 20.0% of MM PE funds, up from 12.6% last year and 9.6% above the five-year average. Notably, 60% (3 out of 5) of first-time vehicles that closed this quarter are growth funds, and the remaining pair are buyout funds, reflecting the drift toward growth that we see across all PE vehicles.

US MM PE fundraising ($) by size



Source: PitchBook
*As of March 31, 2019

US PE fund horizon IRRs by size



Source: PitchBook
*As of March 31, 2019

First-time funds (#) as proportion of all US PE MM funds

Source: PitchBook
*As of March 31, 2019

1Q 2019 US PE MM lending league tables

Overall

1	Antares Capital	35
2	Barings	25
3	MidCap Financial	18
4	Twin Brook Capital Partners	16
5	Churchill Asset Management	14
5	BMO Financial Group	14
5	NXT Capital	14
8	Crescent Direct Lending	13
9	Citizens Bank	12
9	Bank of Ireland	12
11	Madison Capital Funding	11
11	PNC	11
13	SunTrust Banks	10
14	Genworth Financial	9
15	Ares	8
15	Monroe Capital	8
17	Orca Capital Securities	7
17	Golub Capital	7
17	Varagon Capital Partners	7
20	BBVA Bank	6
20	The Goldman Sachs Group	6
20	Bank of America	6
20	Capital One	6

Source: PitchBook

Select roles*

1	Antares Capital	31
2	Twin Brook Capital Partners	15
3	Barings	12
3	MidCap Financial	12
5	Madison Capital Funding	10
6	PNC	9
6	NXT Capital	9
6	Citizens Bank	9
9	BMO Financial Group	7
9	Crescent Direct Lending	7
9	Bank of Ireland	7
12	Monroe Capital	6
12	Bank of America	6
12	Golub Capital	6
15	Ares	5
15	SunTrust Banks	5
17	Jefferies Group	4
17	Churchill Asset Management	4
17	Fifth Third Bank	4
17	Varagon Capital Partners	4
21	Credit Suisse	3
21	White Oak Healthcare Finance	3
21	Capital One	3

Source: PitchBook . *Select roles are comprised of bookrunners, lead arrangers, mandated lead arrangers and administrative agents only.