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US PE Middle Market Report

3Q 2019

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Introduction

Dealmaking in the MM continues to flourish. GPs have taken particular interest in tech investments due to the sector's high level of growth, which is outpacing the broader market. Take-privates and divestitures were also a major focus in the quarter as PE firms have taken advantage of companies that performed poorly in the public markets or needed to sell off non-core assets. These sizable transactions helped bolster the median deal size, which sits at an all-time high YTD.

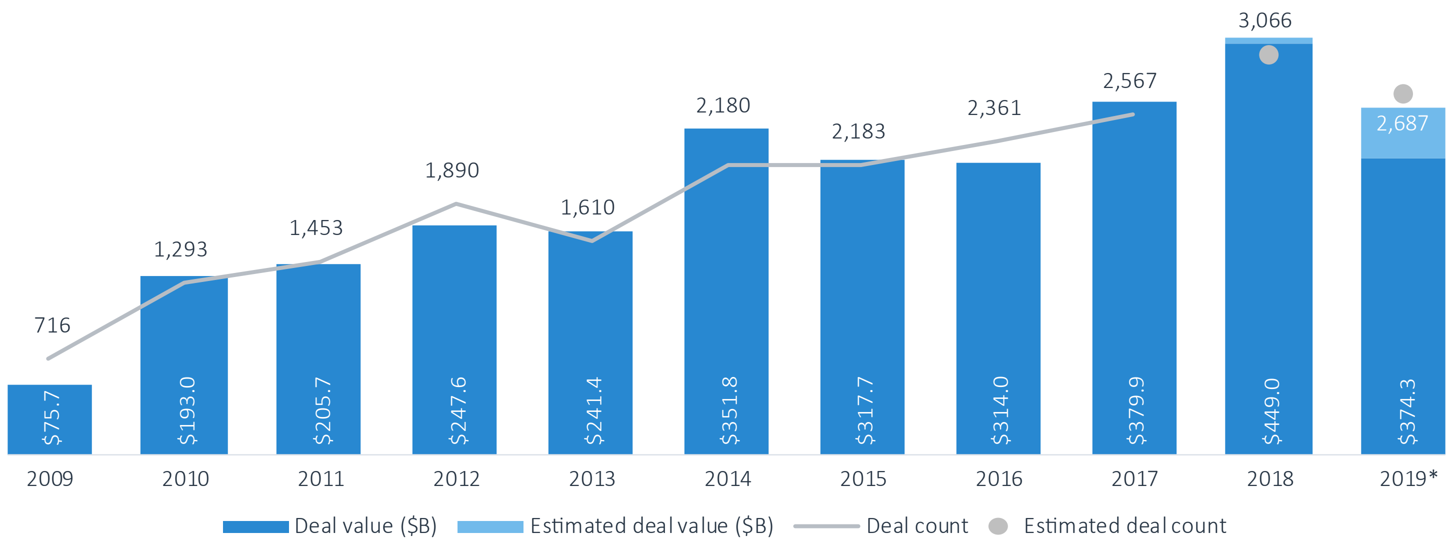
MM exits saw a downturn due to a pullback in corporate acquisitions. Due in part to many deals outgrowing the MM threshold through organic means and add-ons, MM exit count and value are on pace for their lowest annual results in years. SBOs in the quarter helped pick up some of the slack from the decline in corporate acquisitions. Similarly, a few IPOs on the larger end of the MM spectrum have buoyed results.

MM fundraising is on pace to set annual records. Perennial MM shops continue to propel fundraising, sticking to their skillset in the interest of consistent returns, but some larger GPs boasting several strategies have also been raising MM funds as LPs seek to diversify their allocations.

Stephen-George Davis
Analyst, PE

Overview

PE MM deal activity

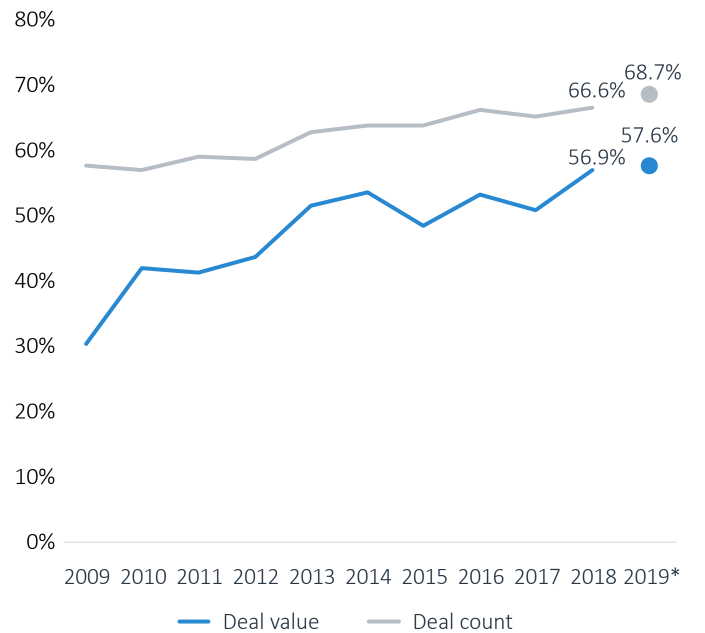


Source: PitchBook | **Geography:** US
*As of September 30, 2019

The third quarter saw PE MM deal activity further proliferate, with $374.3 billion closed over 2,687 deals in 2019 thus far. This puts 2019 on track to overtake 2018's highs. One sign of elevated dealmaking activity is the increasing median MM deal size—which has risen to $205.0 million through 3Q 2019—despite add-ons, which tend to be smaller than non-add-ons, having grown further as a proportion of all deal flow. A major driver of deal value in 3Q involved GPs sourcing deals from public markets, either through take-privates or large-scale divestitures. Many PE firms successfully targeted companies that performed poorly in the public markets, some of which put themselves up for sale. A continued push for underperforming companies to refocus on core offerings and pay down debt also drove divestiture activity.

GPs continue to use add-ons to target lower-multiple acquisitions in the current high-price environment. Although median EV/EBITDA multiples have come down slightly in the most recent quarters, pricing remains aloft. However, continued MM revenue and earnings growth should partially allay investor worries about headline prices. Companies within the MM experienced YoY earnings growth of 13.2% and revenue growth of 9.6% in 3Q.[1] These gains are even more pronounced in the tech sector, which saw earnings growth of 20.1% and revenue growth of 11.9%. This profound growth has attracted GPs to the sector, which has comprised 21.1% of MM deal value through 3Q 2019, up from 16.4% in 2018.

Add-ons as proportion of overall PE MM deal activity



Source: PitchBook | **Geography:** US
*As of September 30, 2019

1. This is according to the Golub Capital Altman Index (GCAI), which is an index based on revenue and earnings for MM companies. The index measures median revenue and earnings growth for more than 150 private US companies in the loan portfolio of Golub Capital.

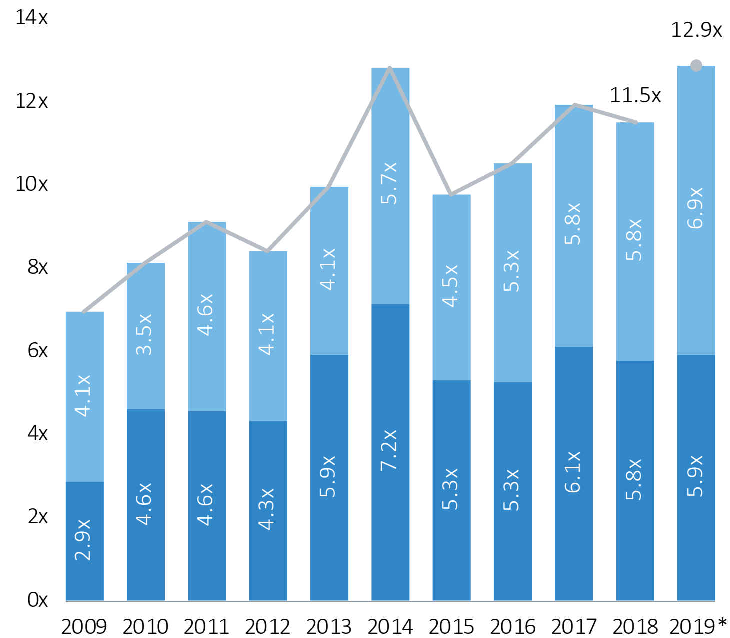
Overview

Along with tech, massive deals in the energy sector have helped buoy deal value as PE firms take advantage of relatively lower prices for oil & gas stocks. As of December 3, 2019, the energy sector has lagged all others on the S&P 500 (+12.8%) YoY at -11.3%. PE firms are drawn to the space because of the lucrative opportunities for M&A and divestitures that resulted from the current downturn in oil & gas stocks, which began in 2014 and saw further price declines at the end of last year. The largest MM deal of the quarter was the $925.0 million buyout of a portion of Concho Resources' (NYSE: CXO) New Mexico assets by KKR-backed Spur Energy Partners. In this carveout, KKR was able to capitalize on the trend of oil & gas companies divesting non-core assets and paying down debt as the industry combats near-term oversupply and as investors lose patience with companies that have produced negative cash flows for years. Another notable deal in the energy sector was the take-private of Third Coast Midstream by ArcLight Capital Partners, the firm that already had a controlling interest in the entity before the acquisition. ArcLight purchased the remaining stake with favorable terms given Third Coast Midstream's rapid stock price drop in 2018 due to changes the company made to its scrip dividend.[2] The final buyout offer from ArcLight, which was finalized in March, was less than the offer the company had previously received from ArcLight in September 2018. This deal highlights one way in which GPs may be able to acquire publicly traded assets at more favorable prices following temporary sell-offs.

Significant take-private deals also occurred outside the energy sector and played a prominent role in the quarter, comprising 2.7% of MM deal value, up from 0.6% in 2Q 2019. A notable take-private in the B2C sector saw Waterstones, a portfolio company of Elliott Advisors' UK division, purchase Barnes & Noble for $683.0 million. Elliot Advisors is the UK subsidiary of Elliott Management, the famed activist hedge fund. In the last few years, Elliott has diversified beyond simply buying stakes in companies and agitating for change to buying them outright. This is a trend we are seeing more frequently at a time when hedge funds are under pressure due to prolonged underperformance and many are looking to adjust their playbooks. While hedge funds have struggled to outperform passive benchmarks, buyout funds still put up comfortable gains over the S&P 500. The strategy behind Elliott's acquisition of Barnes & Noble seems to double down on the concept of brick & mortar locations and diverge from the general shift to ecommerce. Going forward, we expect GPs to continue coming up with atypical methods to procure value from their portfolio companies.

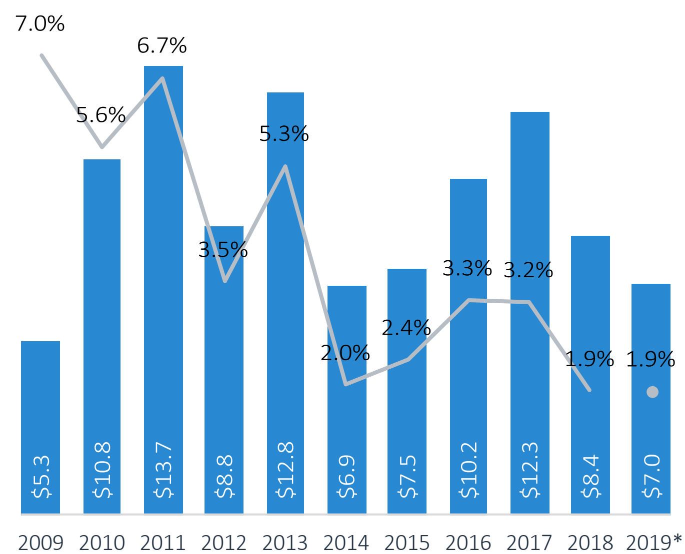
2. A stock dividend as an alternative to a cash dividend.

Median PE EV/EBITDA buyout multiples



Source: PitchBook | **Geography:** US
*As of September 30, 2019
Note: Totals may not reflect debt and equity figures due to rounding. To clarify, this represents all US PE and not only the MM.

Take-privates as proportion of overall PE MM deals



Source: PitchBook | **Geography:** US
*As of September 30, 2019

Antares: Private debt—Top five things to watch in 2020

But first, a few tidbits from 2019...

Equity markets cheer Fed "put"

The Federal Reserve Bank has signaled recently that it may pause its adjustments following three Fed Fund rate cuts since July, hopeful that it has completed a mid-cycle adjustment that will support a continued mature economic expansion. Yield curves are no longer inverted and public equity markets have cheered the Fed "put" with the S&P 500 up a stellar 23% as of November 11, 2019 (albeit up only 4% since the first Fed cut at the end of July). PE return data tends to lag, but the listed S&P Listed Private Equity Index up is 33% as of November 11, 2019. Meanwhile, PE buyout fundraising has been on a tear, hitting a post-credit crisis high of $219.4 billion as of November 25, 2019 according to PitchBook.

Credit markets appear more circumspect

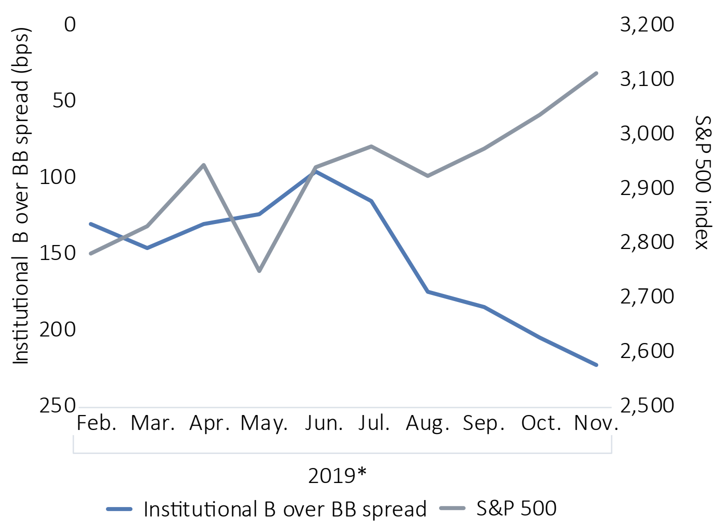
In contrast to equity markets, credit markets have appeared to be more apprehensive about looking over the valley of the current "earnings recession" to brighter pastures ahead. Loan mutual funds and exchange-traded funds (ETFs) have continued to see net outflows ($7 billion in 3Q 2019 and $27 billion as of November 11, 2019) and collateralized loan obligation new issuance is down 9% through October 2019. Most recently, syndicated loan markets have witnessed a "risk off" flight to quality with B-rated new issuer spreads widening dramatically over BB-rated spreads in October and November. Wary loan investors also have been increasingly pushing back on "storied" credits, with some issues price flexing wide of the mark or even getting hung in the market. As a result, PE sponsors have been increasingly turning to private club or unitranche loans looking to put dry powder to work. According to Refinitiv LPC data, sponsored unitranche loan volume has surged to $28 billion through 3Q 2019, up 44% YoY compared to sponsored middle-market syndicated loan value of $43 billion over the same time period, down 33% YoY.

David Brackett

Chief Executive Officer
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.

Mixed signals: S&P 500 index vs. B over BB spread (inverted left scale)



Source: S&P LCD LoanStats | **Geography:** US
*As of November 7, 2019

Top five things to watch in 2020

1) Trade tariff negotiations. US-China trade talks continue to roil markets with some recent reports pointing to a possible phase-one agreement and related tariff relief. The US-China trade war has no doubt been a drag on global growth and hit the manufacturing markets, as evidenced by weak purchasing manager's index (PMI) activity (with US ISM PMI readings in contraction territory below the 50 mark since August 2019). Some speculate potential for trade resolution is effectively a presidential "put" option should the stock market face pressure ahead of the 2020 presidential election. However, in the meantime, economic damage could be taking deeper root as uncertainty lingers.

2) Consumer confidence. The US consumer has been an enduring source of strength for the US economy, with consumer spending driving about 70% of GDP. Low unemployment, rising wages and easy credit have helped boost consumers' willingness and ability to spend. Confidence remains generally high but has slipped some in recent months and could be vulnerable should employment trends become less favorable (e.g. following tepid business investment and earnings growth pressures). Trade developments (good or bad) also are top of mind for consumers. On the positive side, lower interest rates should help consumers with big-ticket item affordability—for example, homes and automobiles.

3) Credit pressures. Although default rates remain quite low, there are some early warning signs that stress may be building. As mentioned previously, the spread between new-issue B and BB spreads has been widening. In the secondary loan market, the average bid on the S&P/LSTA leveraged loan index has been drifting lower from its recent peak of 97.5 in May 2019 to 95.4 as of November 11, 2019, with the distressed ratio (i.e. percentage of loans priced below 80) rising to more than 5% in October 2019 versus 1%-3% from January 2018 through July 2019. While the recent earnings recession has been mostly confined to vulnerability in the energy and materials sectors and/or companies with exposure to global weakness and trade-related issues, there have been signs of decelerating growth more broadly, too. For example, the National Center for the Middle Market reported that its surveyed middle-market company revenue growth forecasts for the next 12 months dropped sharply in 3Q 2019, with employment growth predicted to decelerate (albeit remain positive) across all major industry segments. Lenders are beginning to see some of this stress in their portfolios. In Refinitiv LPC's 4Q 2019 lender survey, participants were asked: "How are you feeling about portfolio performance?" 26% responded that "issuers [are] starting to show softness, tracking below plan," which is up from 20% in 2Q 2019 and only 7% in 4Q 2018. It will be interesting to see how new direct lenders with large loan holds respond if and when defaults and losses mount. Of course, if earnings growth reaccelerates as average S&P 500 earnings forecasts seem to suggest, then signs of credit stress will likely subside.

4) M&A activity. 2019 started off weak, but Antares' "seen deal" M&A index has since recovered significantly to relatively robust levels over the summer months and into the fall and winter. In fact, US-sponsored middle-market LBOs and add-ons have been the main driver of US-sponsored middle-market loan volume at 67% of total volume through 3Q 2019 versus 57% in 2018, according to Refinitiv LPC.[3] M&A activity has remained relatively strong despite sponsored middle-market LBO purchase price multiples (PPMs) rising to record levels of 11.5x in 3Q 2019 versus 10.7x in 3Q 2018, as add-on activity has increased. Looking forward to 2020, LBO activity could face increasing headwinds unless PPMs fall or growth reaccelerates.

5) The US presidential election. The implications for PE and debt markets are potentially quite significant. For example, in July, Elizabeth Warren (D-MA), along with other 2020 presidential candidate hopefuls and Democrats in both chambers, introduced the "Stop Wall Street Looting Act of 2019." The bill is a cornerstone of Senator Warren's "economic patriotism" agenda and seeks to overhaul the PE industry by instituting a comprehensive set of changes that would fundamentally alter the PE business model. There are also less direct but nonetheless important areas in PE and debt that could be affected by potentially significant regulatory and policy changes in various industry segments, such as healthcare, with material investment implications.

Although the odds of a recession in the near term may have declined of late, smooth sailing in 2020 looks far from assured. As a lender, credit underwriting rigor and selectivity are as critical as ever.

3. M&A volume is down only 8% through 3Q 2019, versus a 26% drop for total volume, also according to Refinitiv LPC.

Spotlight: Taking stock of private market returns

*This section appeared originally in **PitchBook Benchmarks**, written by Senior Strategist and VC Lead Analyst James Gelfer and published December 13, 2018.*

Overview

One of the benefits of private market strategies is that they insulate investors from the volatility of public markets. Some argue that this is naïve, and that the perceived lower volatility is really just illiquidity. But even if that is the case, the fact remains that the closed-end fund structure largely restricts investors (i.e. LPs) from panic selling during a downturn. "I think a lot of people go into [private equity] with very open eyes, knowing the inability to mark to market allows them to be better investors," said Cliff Asness, founder of quantitative investment firm AQR Capital Management, during a recent interview.[4]

$$\text{Quarterly percentage change} = \left[\frac{\text{(NAV at end of quarter + distributions during the quarter - contributions during the quarter)}}{\text{NAV at the beginning of the quarter}}\right] - 1$$

But while the long-term perspective of private market funds is one of their purported benefits, investors nonetheless have a desire to evaluate fund performance on a regular basis. This is a difficult undertaking in private markets, however, with quarterly intervals being the shortest feasible timeframe to measure aggregate performance. To assess quarterly performance, we calculate the aggregate percentage change in aggregate NAV for each group of funds in a sample, considering contributions and distributions during the quarter.

This calculation employs the same pooling methodology used for other aggregated metrics in PitchBook Benchmarks. Our default is to use capital-weighted calculations, but equal-weighted versions are also available. When public indices are shown, the quarterly change is based on the average value of the index during the period.

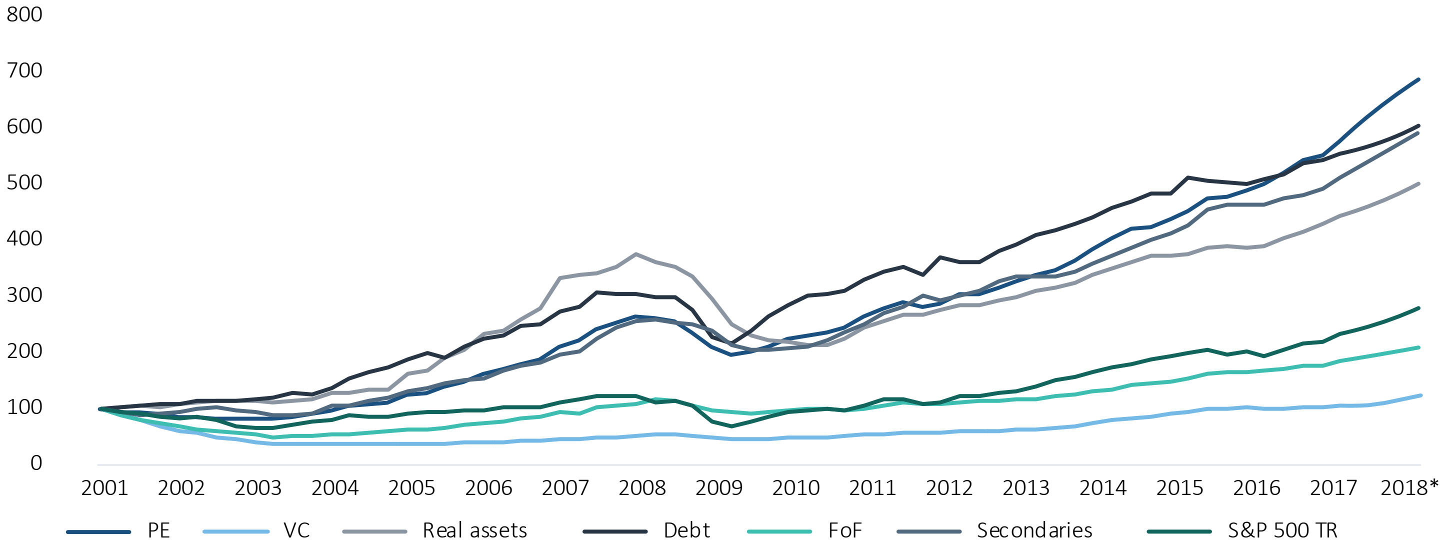
To help visualize this data, we utilize an indexing methodology starting at a base of 100, then apply the quarterly return on a rolling basis to create a "NAV index." Performance across different periods of the market cycle can be made by rebasing the calculation at a different start point. The NAV index can also be tailored to specific fund sizes or geographies, and multiple strategies can be combined to more accurately reflect specific portfolio exposure.

Another benefit of this methodology is that it provides an output with which investors are familiar and that can be easily juxtaposed against public market indices. While there are shortcomings to these comparisons—and we still recommend PME calculations for benchmarking against public market indices—the NAV index view can be instructive when assessing broad market trends.

4: "Cliff Asness - The Past, The Present & Future of Quant," Invest Like the Best, Patrick O'Shaughnessy

PE outperforms over the long term

NAV index rebased to 100 in January 2001



Source: PitchBook | **Geography:** Global
*As of March 31, 2018

PE comes out on top

For this spotlight, we rebased our calculation to three different years to assess how performance has evolved over different periods. In terms of aggregate value accretion, PE finishes at the top of the pack among private market strategies across all three timeframes, with some of the most significant outperformance occurring over the last three years. When starting the calculation in 2001, private debt funds had outperformed through 2015, largely due to superior relative performance through the GFC, before ceding the top position to PE in the recent rally.

Over the longest horizon, VC funds have significantly underperformed due to the damage of the dot-com bubble. It took nearly 15 years for VC funds to fully recover, only managing to consistently crest the breakeven point since mid-2016. But the lasting effects of the dot-com bubble perhaps become most evident when rebasing VC returns to more recent periods. When observing performance from either 2008 or 2013, for example, VC funds have posted strong returns on both an absolute and relative basis, outperforming every private market strategy besides PE.

The performance picture looks relatively consistent across the two longest timeframes in our spotlight, but it changes drastically in the most recent period (i.e. when rebasing to 2013). Private debt funds—one of the best-performing strategies over the longest horizon—trail all other strategies in the most recent period. FoFs significantly underperform over the longest horizon, but performance more recently has been better than most private market strategies. One major factor that appears to be contributing to these changes is the powerful performance of equity markets, with the S&P 500 TR beating all private market strategies by a healthy margin since 2013, which has provided a strong rationale for equity-oriented private market strategies to raise their portfolio valuations.

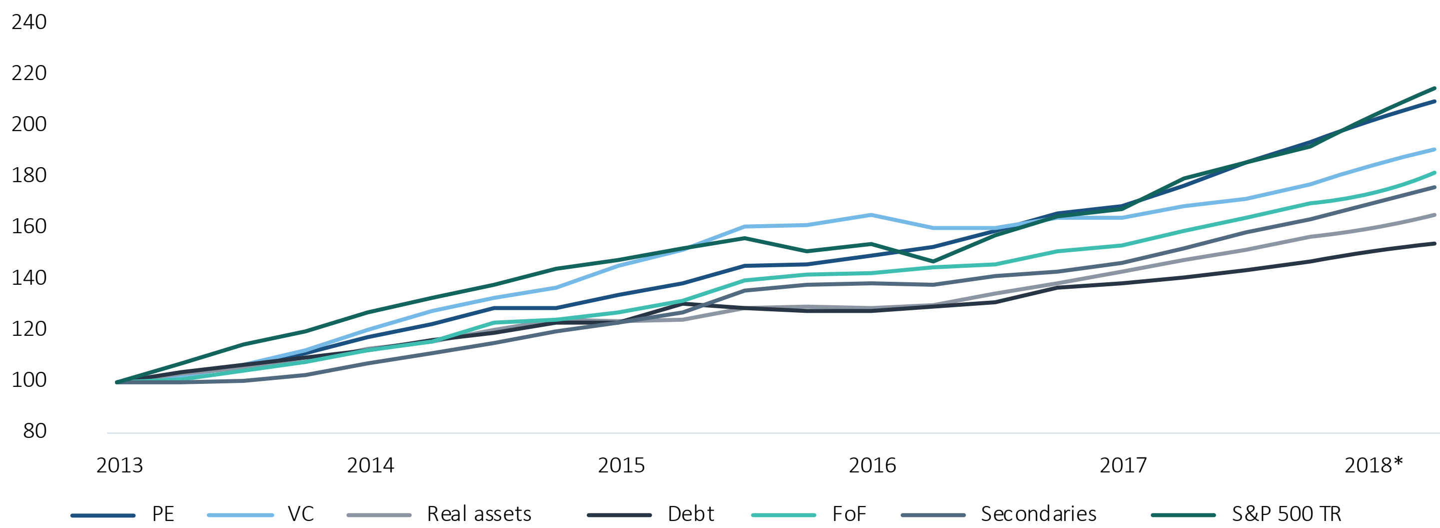
We're not so different after all

In addition to assessing performance, quarterly returns data is useful in determining the correlation between different strategies. Diversification is often touted as a primary benefit of private market strategies, but many detractors have called that into question. PE, for instance, is often accused of being a high-priced strategy that can be replicated in public markets by adding leverage and screening for factors such as size and indebtedness. Indeed, numerous academic studies have found correlations between public equity and PE markets.[5]

5: "Private Equity's Diversification Illusion: Economic Comovement and Fair Value Reporting," Kyle Welch, January 14, 2014

Private market strategies recently failed to keep up with public equities

NAV index rebased to 100 in January 2013



Source: PitchBook | **Geography:** Global
*As of March 31, 2018

While our quarterly PE NAV index is not investable, it does corroborate these findings; the correlation between PE NAV index and the S&P 500 TR has been 0.75 since 2001. It is even higher when rebased to 2008 (0.84), but we have seen the correlation fall to 0.51 since 2013. We attribute this to the sizable quarterly moves in the public equities in the last five years, with correlations tending to be lowest in periods of high volatility and dramatic market movements, as well as the significantly fewer number of reporting periods that results in a relatively small sample size. Correlations may be high, and this methodology does not account for differences in variables such as leverage and illiquidity, but the PE NAV index has outperformed the S&P 500 TR by a wide margin across long time horizons.

Between private market strategies, the highest correlations occur between PE and FoFs, which is intuitive given that FoFs are highly allocated to PE funds. Correlations are also high between PE and VC funds, which may be surprising given the documented differences in their risk/return profiles; however, both strategies involve equity investments and, therefore, employ mark-to-market practices that often mirror public equity returns. Many other private market strategies also have higher correlations than may be expected, but the best diversifiers are real asset and secondaries funds.

PE and public equities tend to be highly correlated

Correlation of quarterly returns

Since 2001

	PE	VC	Real assets	Debt	FoF	Secondaries	S&P 500 TR
PE	1						
VC	0.68	1					
Real assets	0.71	0.33	1				
Debt	0.62	0.26	0.38	1			
FoF	0.77	0.82	0.45	0.37	1		
Secondaries	0.57	0.48	0.60	0.29	0.58	1	
S&P 500 TR	0.75	0.58	0.41	0.67	0.57	0.40	1

Since 2008

	PE	VC	Real assets	Debt	FoF	Secondaries	S&P 500 TR
PE	1						
VC	0.77	1					
Real assets	0.76	0.68	1				
Debt	0.74	0.50	0.43	1			
FoF	0.70	0.71	0.55	0.56	1		
Secondaries	0.61	0.60	0.80	0.21	0.52	1	
S&P 500 TR	0.85	0.65	0.59	0.76	0.46	0.08	1

Source: PitchBook | **Geography:** Global
*As of March 31, 2018

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ACG Q&A: Canadian PE veterans look to the future

A record number of US dealmakers attended October's annual ACG Capital Connection conference hosted by ACG Toronto, reflecting American investors' growing interest in Canadian opportunities. Following a panel discussion at the conference featuring five leaders from Canada's PE industry, panelists Brent Belzberg, founder and senior managing partner of TorQuest Partners, and Pascal Tremblay, president and CEO of Novacap, spoke with ACG's Middle Market Growth magazine. Interviewed by MMG Editor-in-Chief Kathryn Mulligan, the two PE leaders discussed investing across borders and how they're drawing on their experience in previous recessions to prepare for a future slowdown.

Brent Belzberg

Founder and senior managing partner of TorQuest Partners

Brent formed TorQuest in 2002 following the 2001 sale of Harrowston, Inc., a publicly traded investment fund he founded to invest in and build businesses in 1992. Torquest invests in middle-market companies and currently has more than C$2 billion of equity capital under management.

Pascal Tremblay

President and CEO of Novacap

Novacap is a Canadian buyout and growth equity firm with over C$3.6 billion of AUM. Prior to joining Novacap, Tremblay was a partner at Argo Global Capital, a VC firm. He previously worked in the PE division at CDP Capital, one of Canada's largest fund managers and PE investors, and served as founder and CEO of Laserpro, a manufacturing and distribution company.

Kathryn Mulligan: As PE investors who have weathered past recessions, how are you preparing for the eventual end of the current economic cycle? Has your strategy evolved since the last downturn?

Brent Belzberg: It's always hindsight. We spend a lot of time ensuring that our balance sheets can last through tough times. We model recession cases in everything we do. We're focused way more on free cash flow than we are on EBITDA. These days, it makes a big difference to what we buy and what we don't buy. We look at creating value and debt repayment in addition to bringing value to grow.

We're doing all those things you do when you're a little bit more worried about the next five years than you were initially. In 2009, when we came out of the recession, it was easy to do things that didn't have lot of free cash flow because you were going to ride the movement in the economy.

We're also modeling reduction in multiples in things we're doing: We buy them at 7x and we sell them at 6x. We buy them at 9x and we sell them at 7x. We're all changing our views on things. We pass on a lot more transactions than we have historically for that reason. In every deal, we focus on risk in the first three to four pages of a memo; the opportunities page follows that.

Pascal Tremblay: I have a plaque in front of my desk that I've had for about two years now. it says: "recession-resistant revenues." All the companies we're investing in now must have a large component—not all—of recession-resistant revenue. Moderate leverage is very important for us because in a recession, we don't know how long it's going to last. If you're overextended, you never know the real impact on cash flow in those businesses. When you're in the lower middle market like we are—we do $1 billion dollar-or-less transactions—you have to have flexibility on the cash flow side. That's what we're trying to get, as much as we can, while fostering growth, but flexibility on cash flow is very important. We know the current cycle is going to end, we just don't know when—we know it's not going to be another 10 years, for sure. It's not going to be another three years, either. But I fully agree with the economists who say that it will not be as deep of a recession as what we had in 2008-2009.

Mulligan: As you look at younger funds that were founded in the last decade and haven't yet gone through a recession, are there things they're doing that could hurt them in a downturn?

Tremblay: I would say investing in uncharted territory is risky. We don't know how those markets will react in a downturn. The most prevalent trend today is that valuations are extremely high. People are talking about 15x or 20x EBITDA. That's the norm now. In 2010, the norm was 6x-8x. If you underwrite based on multiple expansion or on getting out at the same multiple that you're coming in for those deals, it's a mistake.

At Novacap, we now underwrite at a lower multiple. We do this not only with the incoming multiple, but with exit multiples, as well. It used to be that everybody was underwriting at 25% IRR, then that went down to 20%. Now I hear people underwrite at 15%-18%. With the high valuations, about 40% of all sales processes for businesses in North America right now are not closing because expectations are so high. Sellers have such a high price in their mind, so they can't sell. Expectations are way too high from the sellers' perspective.

Belzberg: There are a lot of startup, young funds. There was an article published this week about funds that will back people doing search funds, people leaving institutions and coming out to create new funds and people creating seven different industry funds. They're taking advantage of the fact that there's a lot of capital out there at this time. It's a good thing for lot of funds, but expertise matters a lot.

Mulligan: Are you seeing institutional investors become more selective about which funds they invest with, or consolidating their investments into fewer funds?

Belzberg: Yes, but having said that, you see lots of new funds coming up and getting capital to do what they do. Somebody splits off from one firm and raises millions of dollars. There's capital available, but at the same time, there's a focus on performance and track record. Institutions are trying to concentrate on that, but lots of new groups are coming in and raising new money as well.

Mulligan: To what extent have you seen the time to close shrink?

Tremblay: We used to have 90 days, then 60 days, then 45 days, then 30 days. We underwrote two deals this week: one was 15 days exclusivity and the other one was 23 days exclusivity. The fastest I've seen was four days exclusivity. And now in larger transactions, there is no exclusivity whatsoever. I've seen a process in which we were selling a company where we had four buyers spending between $4 million and $8 million in due diligence without knowing if they could get the deal. And that's not unusual.

Mulligan: As more US-based PE funds look to Canada for opportunities, is it difficult for them to compete against Canadian funds for deals?

Belzberg: I think it's hard for them to be the first institutional capital. It's not hard for US funds to do transactions that are fully auctioned in Canada. Our legal systems are the same, our languages are the same, our financing tools are the same. US funds can easily participate in auctions. What they have a harder time doing is finding a deal that has never had an institutional capital partner before.

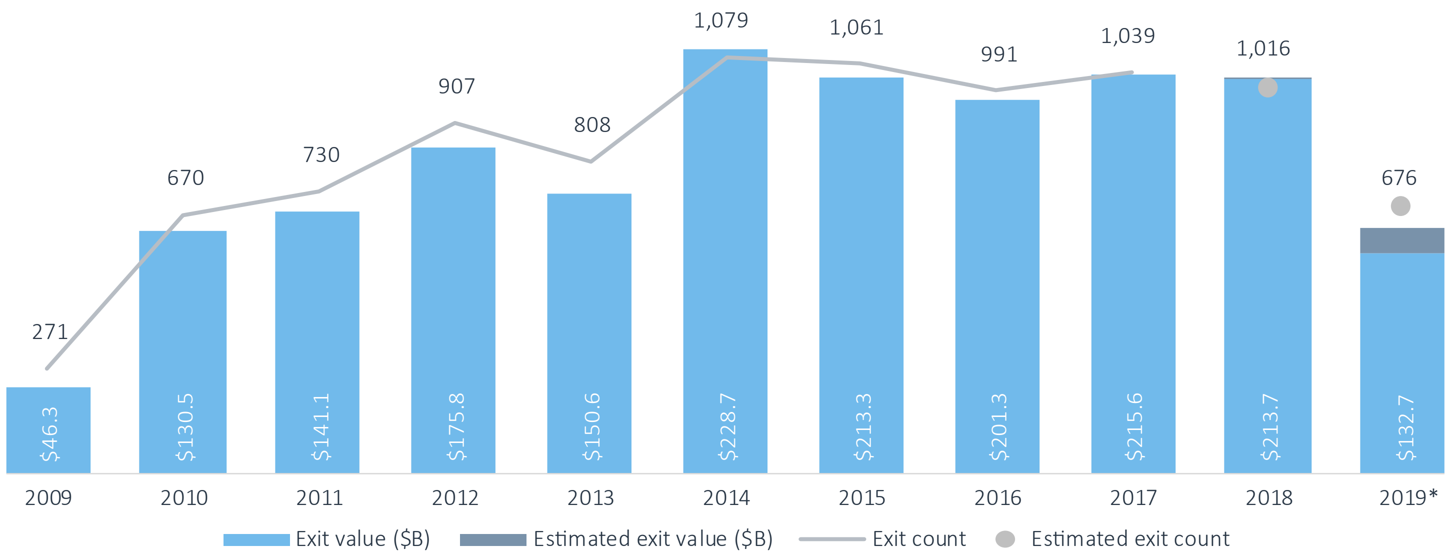
Mulligan: What impact is regulation having on Canadian PE funds' ability to be competitive in cross-border transactions?

Tremblay: As a foreign investor in the United States and in Europe, regulation puts us at a disadvantage. When we close a deal, even when there's certainty of closing, there's a time lapse. Going through review by CFIUS—the Committee on Foreign Investment in the United States—can take three or four months. If the seller has the choice of closing tomorrow with a domestic buyer, or signing and closing in four months with us, this is a key disadvantage. You have to show the value for that, for sure.

I think regulation is here to stay, and it's going to increase. We're lucky in Canada: We haven't had a lot of regulation yet, but it's increasing in Europe, the US and all over the world. PE has such a dominant place now in the equity space (versus public markets that are highly regulated), so we need to adjust.

Exits

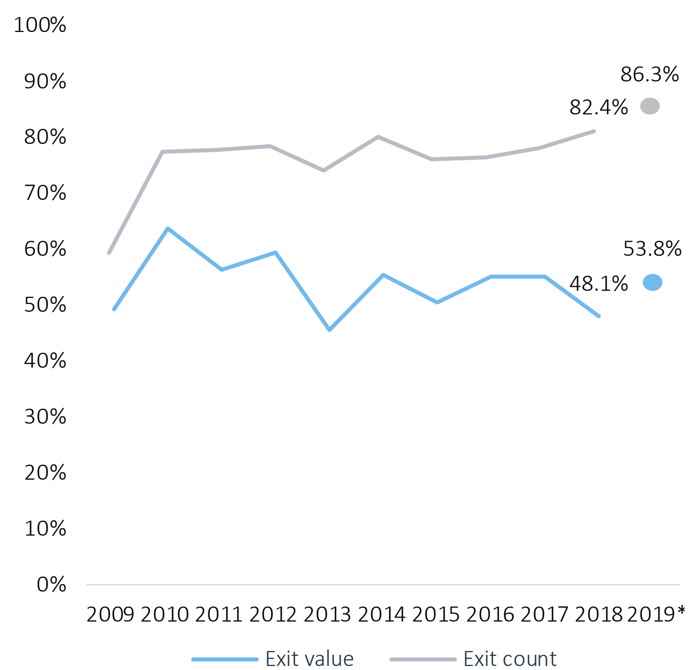
PE MM exit activity



Source: PitchBook | **Geography:** US
*As of September 30, 2019

While PE MM deals in the US are set to reach new highs, annual exit value is on pace to fall short of $200 billion for the first time since 2013. Through the first three quarters of 2019, GPs have completed 676 exits totaling $132.7 billion, YoY declines of 9.5% and 17.7%, respectively. MM exits often lag MM deals because a good portion of MM deals go on to exit in above the $1 billion threshold, often through a combination of organic growth and add-ons. Overall, MM exit value has declined largely due to fewer exits between $500 million and $1 billion closing YTD.

MM exit activity as proportion of overall PE exit activity



Source: PitchBook | **Geography:** US
*As of September 30, 2019

Notable IPOs took place at the top end of the MM in the quarter. We expected this rebound in IPO activity after the government shutdown stalled the market toward the end of 2018 and beginning of 2019. The largest exit of the quarter was the public debut of security software company Ping Identity by Vista Equity Partners, which marks the high-profile GP's first exit of a portfolio company via an IPO. The exit saw Ping raise $187.5 million, valuing the company at $1.2 billion,[6] a sizable gain given that Vista bought Ping for $600.0 million in 2016. However, Vista reportedly had even loftier ambitions and had anticipated a price tag of over $2 billion for Ping. The GP decided to stand by its initial valuation ambitions and publicly list the company while retaining a majority share. A move like this allows GPs that feel they are not receiving satisfactory bids for portfolio companies to make bets on future public market valuations. In these scenarios, GPs are increasingly

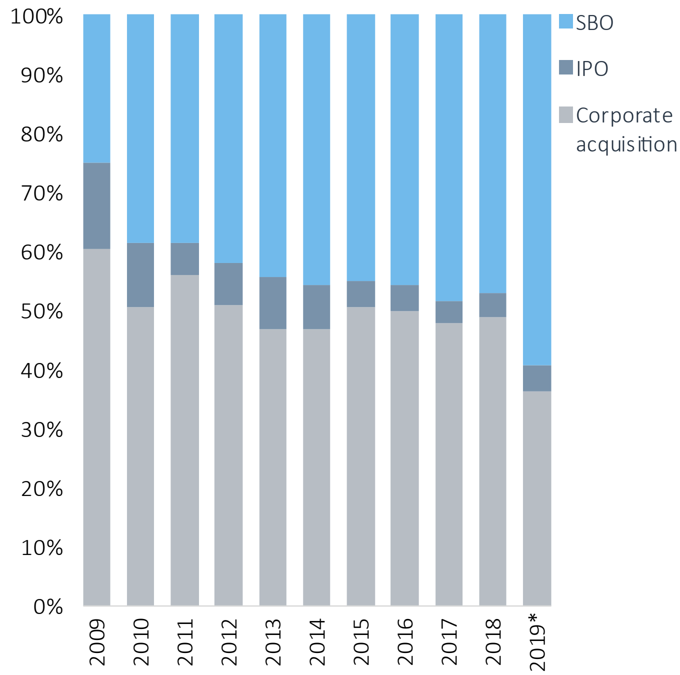
6. The valuation before raising additional capital was $977.1 million, making it an MM exit.

choosing to hold on to certain portfolio companies past typical lockup periods.

SBOs also played an important role in terms of both number and value of exits in the quarter, which picked up some slack from the reduction in corporate acquisitions. The uptick in SBOs continues a longer running trend within PE. Thus far in 2019, SBOs have comprised about 60% of MM exit value, which will be a new annual record if the fourth quarter continues this streak. One of the larger SBOs in the quarter was Onex's sale of Jack's Family Restaurants to AEA Investors for $730.0 million, more than triple the $234.0 million Onex paid for the restaurant chain in 2015. Onex reportedly procured dividend distributions from the chain for $106.0 million,[7] illuminating liquidity options prior to a full exit. Another notable SBO occurred when TPG Growth and Instawares Holding sold Hot Schedules, an Austin-based employee-scheduling application company, for $300.0 million after buying the company in 2013 when it was VC-backed. VC-to-PE buyouts have been growing in frequency over the last few years, and we expect them to account for a higher proportion of exits as assets change hands between PE firms.

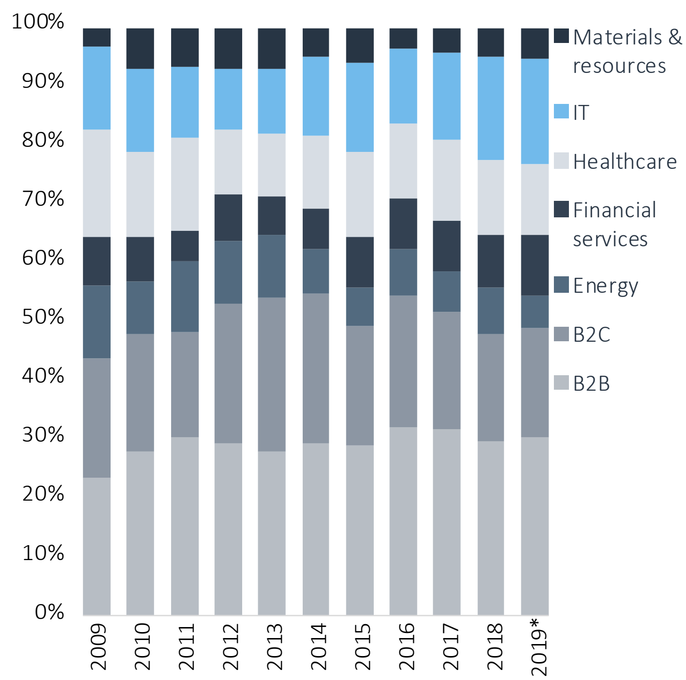
As software continues to "eat the world," as Marc Andreessen put it, technology and further digitization have had an impact on MM exit activity. Through 3Q 2019, IT has continued to grow as a proportion of both exit count and value. If this trend holds, IT may comprise around 18% of full-year MM exit value, which would mark a new record for the sector. This is not surprising as software offers a space where GPs can find the highest levels of organic growth in recent times. Additionally, SaaS companies with recurring revenues can be compelling opportunities for corporates, secondary financial sponsors and the public markets alike. Given that tech investing continues to become more frequent, we expect the sector to continue gaining share of exit count and value as well.

PE MM exits ($) by type



Source: PitchBook | **Geography:** US
*As of September 30, 2019

PE MM exits ($) by sector

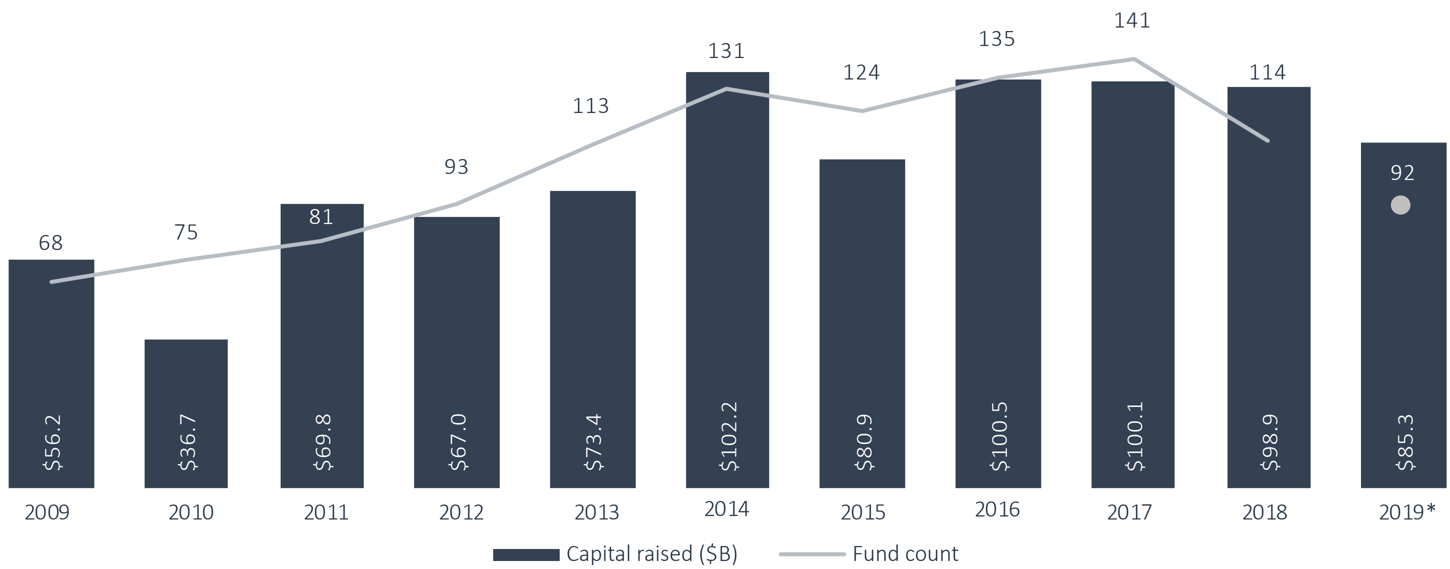


Source: PitchBook | **Geography:** US
*As of September 30, 2019

7. "Private Equiy Firm to Sell Jack's Family Restaurants," Restaurant Business Online, Jonathan Maze, July 19, 2019

Fundraising

PE MM fundraising activity

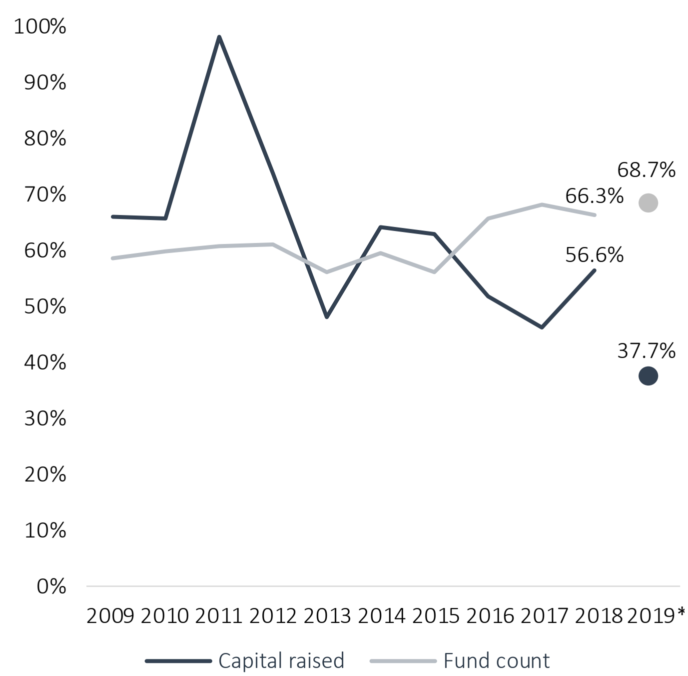


Source: PitchBook | **Geography:** US
*As of September 30, 2019

2019 appears poised to reach a new high for PE MM fundraising in the US, with $85.3 billion raised over 92 vehicles through 3Q. We need to see only $17 billion more raised in 4Q to reach a new peak; with a $3.1 billion MM fund from H.I.G. Capital and funds in the $2 billion range from shops such as Elliot Management and TSSP Capital Solutions already closing in 4Q, this outcome seems likely. The robust fundraising market has even led some industry participants to speculate that we may be at the top of the market for fundraising activity,[7] though this would not be the first time this cycle that pundits have called for a top.

Many of the larger MM funds closed in 3Q were raised by prominent GPs with buyout strategies spanning several size targets. These GPs are raising smaller funds in order to entice LPs looking for diversified return profiles beyond mega-funds. Many of these LPs also want fewer relationships with GPs. One notable example of these smaller offerings is KKR's Global Impact Fund, which closed at $1.0 billion, a far cry from the size of its more well-known $10.0 billion+ flagship buyout funds. The fund seeks to capitalize on the inclination of LPs and institutional investors looking for returns that also yield a net positive on a social and environmental level and align with the UN's Sustainable Development Goals (SDG). Swiss Bank UBS raised $225.0 million from its private wealth management clients for KKR's fund, showcasing that demand for impact investment-related products is driven by individuals as well

MM fundraising activity as proportion of PE fundraising activity



Source: PitchBook | **Geography:** US
*As of September 30, 2019

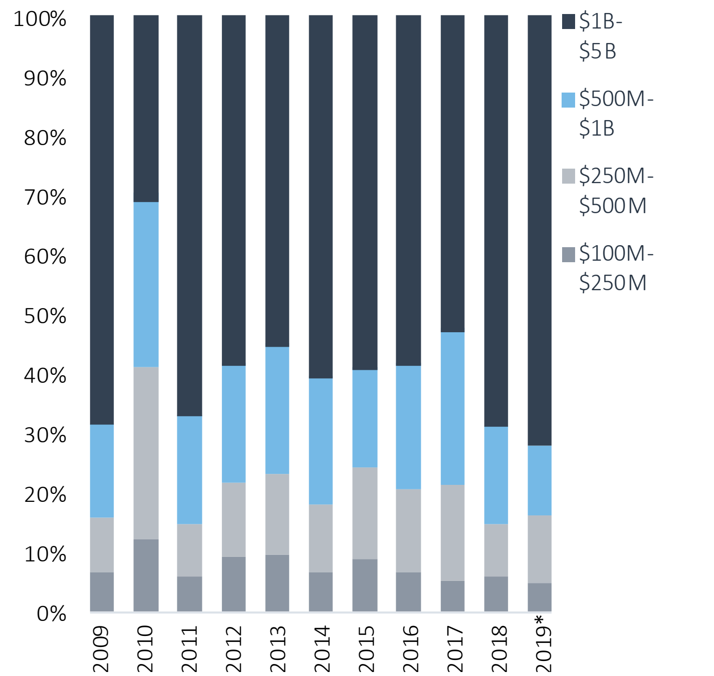
7. "Hamilton Lane Flashes Warning on Buyout Funds," Institutional Investor, Julie Segal, November 14, 2019

as institutional investors. KKR is the latest large buyout shop to take advantage of the shift toward responsible and sustainable investment in order to appeal to its LP base, following competitors such as Bain and TPG, which have similar offerings.

Another example of a GP with mega-fund credentials opting to raise smaller funds is Vista Equity Partners, which closed its Endeavor Fund II. Vista, a tech-focused shop, recently raised the largest tech buyout fund ever at $16.0 billion (Vista Equity Partners VII). This fund, however, raised just $850.0 million and was heavily oversubscribed. The Endeavor Fund distinguishes itself from Vista's flagship by its smaller size and its mandate to target tech companies with $10 million-$30 million in annual recurring revenue. Companies within this range, especially at the lower end, are too small to move the needle in larger flagship funds. The firm also has another buyout strategy that sits between the Endeavor Fund and the flagship fund. The Foundation Fund, as it is known, is currently fundraising and reportedly expected to raise at least $4.0 billion. Vista is part of a cadre of buyout shops that outgrew the MM but are opening secondary or tertiary funds with the same strategy to capitalize on a segment of the market that used to be its bread and butter.

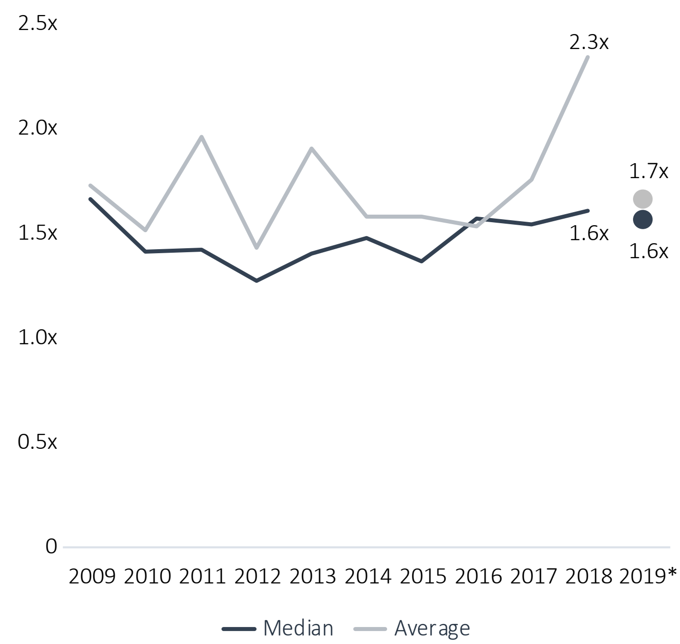
While some GPs outgrow the MM and return later, many raise funds only in the MM, content to stick with their niche. Through 3Q 2019, the median MM fund size step-up sits at 1.6x, indicating a healthy fundraising environment for smaller firms. One shop that remains a specialist in the MM is Trilantic Capital Partners, which raised the second-largest MM fund of the quarter, a $2.8 billion buyout vehicle. Trilantic, which was spun out of Lehman Brothers, is a perennial player in the MM, with most of its eight other funds raising between $1 billion and $2 billion. This is the firm's largest fund to date, with a step-up of 1.3x from its last fund in the family, Trilantic Capital Partners V in 2013. The vehicle was oversubscribed and surpassed the initial target of $2.25 billion. The firm's steady dedication to the MM and restraint in raising capital may be partly why LPs were keen to allocate to the fund. As LPs seek the best possible returns given their resource limitations, many understand that one large, diversified GP cannot be a panacea, and they still need some exposure to other GPs of varying sizes to better diversify their private market allocations.

PE MM funds ($) by size



Source: PitchBook | Geography: US
*As of September 30, 2019

Median and average PE MM fund size step-ups



Source: PitchBook | Geography: US
*As of September 30, 2019

PitchBook

3Q 2019 US PE MM lending league tables

Overall

1	Antares Capital	42
2	Ares	25
3	Churchill Asset Management	20
4	Barings	19
5	Crescent Capital Group	15
5	Golub Capital	15
7	Monroe Capital	13
7	BMO Financial Group	13
7	Twin Brook Capital Partners	13
10	Varagon Capital Partners	12
11	NXT Capital	11
11	The Carlyle Group	11
11	Audax Group	11
11	MidCap Financial	11
15	Kayne Anderson Capital Advisors	8
16	Bain Capital	7
16	Madison Capital Funding	7
16	Credit Suisse	7
19	Citizens Bank	6
19	SunTrust Banks	6
19	Bank of Ireland	6
19	Capital One	6
19	Owl Rock Capital Corporation	6

Source: PitchBook

Select roles*

1	Antares Capital	35
2	Ares	17
3	Twin Brook Capital Partners	13
4	Churchill Asset Management	11
5	MidCap Financial	9
5	Varagon Capital Partners	9
7	BMO Financial Group	7
7	Golub Capital	7
9	Barings	6
9	Citizens Bank	6
11	Madison Capital Funding	5
11	The Carlyle Group	5
11	Owl Rock Capital Corporation	5
11	NXT Capital	5
15	Capital One	4
15	Monroe Capital	4
15	Jefferies Group	4
15	SunTrust Banks	4
15	Credit Suisse	4
15	Crescent Capital Group	4
21	Bain Capital	3

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