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US PE Middle Market Report

Q1 2021

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Click here for PitchBook's report methodologies.

Note: Beginning this quarter, we've refined the scope of our middle-market data to improve consistency across deals, exits, and fundraising. Previously, deals included US buyouts and add-ons with EV of $25 million to $1 billion. Beginning this quarter, we only include add-on acquisitions by buyout-backed companies (that is, we exclude add-ons by growth-backed companies). Exits were previously all PE-backed companies with EV of $25 million to $1 billion, but we now only include exits where the entrance type was a buyout. Fundraising remains scoped to buyout funds from $100 million to $5 billion in size.

Introduction

The US PE middle-market saw robust dealmaking activity in Q1 2021, notching the second highest quarterly deal value figure on record after Q4 2020. This sustained vigor is being driven by increased vaccination rates in the US, the Federal Reserve's continued accommodating monetary policies, and an ample supply of cheap debt. Frenzied dealmaking will likely continue throughout 2021. The proposed capital gains tax hike is undoubtedly spurring many business owners to begin sales processes in hopes of finalizing before the end of the year, though it remains to be seen whether the new rate will be applied retroactively.

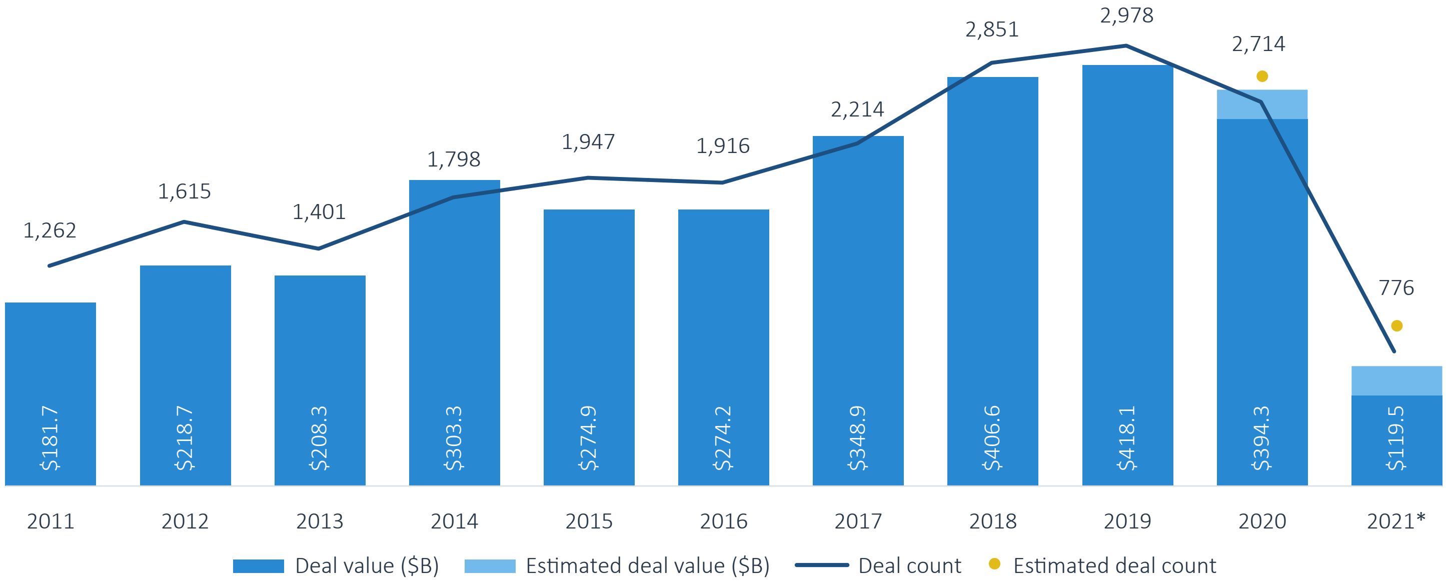
US middle-market PE firms registered healthy exit numbers as the sponsor-to-sponsor and strategic acquisition environments began to normalize in Q1. Firms exited 190 portfolio companies for a combined $37.8 billion in the quarter. Even following the rush of exits in Q4 2020, some of this activity still represents spillover from 2020's slowdown. Middle-market GPs benefited from a range of favorable exit opportunities in Q1, from sponsor-to-sponsor deals to sales to strategic buyers to public listings, including via SPACs.

Middle-market US PE firms had an active Q1 for fundraising. With the disruption of COVID-19 in the rear-view mirror, the fundraising landscape is adjusting to the new normal: 40 funds closed for a combined $37.0 billion in the quarter. After facing a difficult 2020, many emerging managers closed funds in Q1. In a growing trend, large firms are raising continuation funds to support GP-led secondary transactions. Turning to performance, preliminary fund returns data for Q4 2020 shows that middle-market funds, with the notable exception of middle-market funds managed by large GPs, have lagged $5 billion+ funds in recovering from the pandemic downturn.

Rebecca Springer, Ph.D.
PE Analyst

Overview

PE middle-market deal activity



Source: PitchBook | **Geography**: US
*As of March 31, 2021

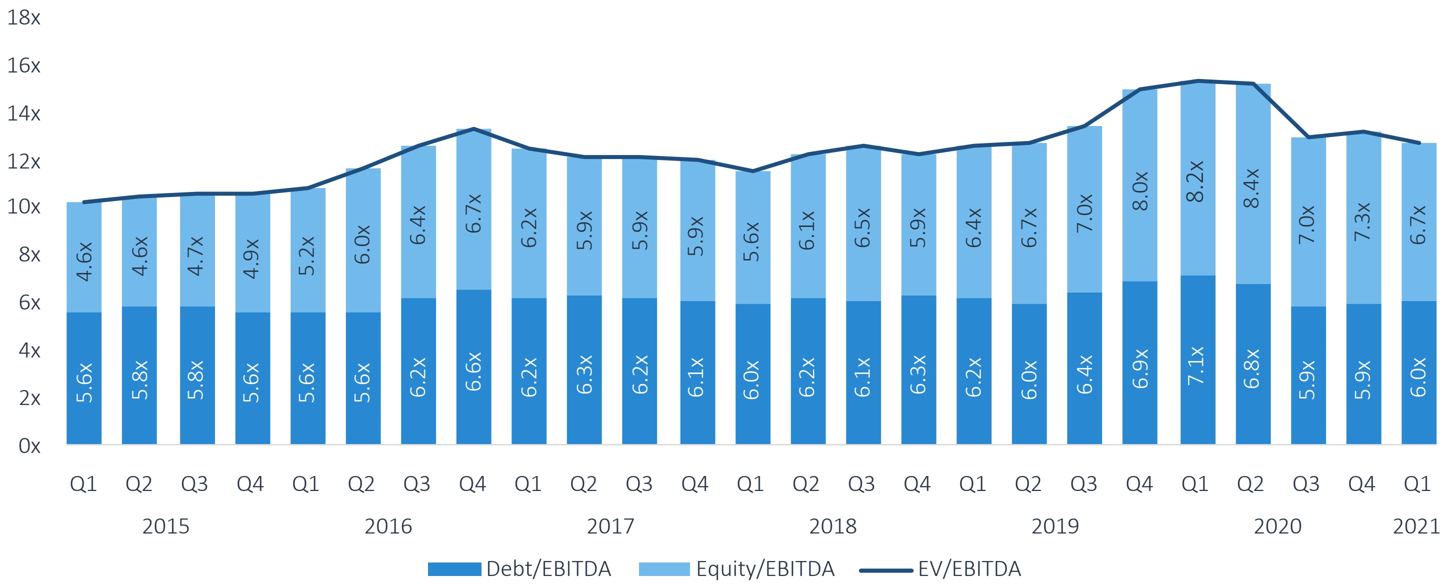
Q1 2021 saw robust middle-market dealmaking activity, with deal count and value easily exceeding pre-pandemic Q1 2020 levels. US PE firms closed 776 deals in the quarter for a combined $119.5 billion, notching the second highest quarterly deal value figure on record after Q4 2020. This sustained vigor is being driven by increased COVID-19 vaccinations in the US, the Federal Reserve's continued accommodating monetary policies, and an ample supply of cheap debt. Leveraged finance markets are currently highly supportive of dealmaking at elevated multiples, with buyouts frequently levered to 7x EBITDA or more. Hunger for yield and inflationary hedging have driven strong demand for collateralized loan obligations (CLOs), which tend to be floating rate instruments. CLOs have grown to account for more than half of the leveraged loan market as LBO financing has tilted toward loans and away from bonds over the past 15 years or so.

Numerous signs point to frenzied dealmaking activity continuing throughout the rest of 2021. The $1.9 trillion American Rescue Plan, signed into law in March, boosted an already vigorous recovery, with consumer and business spending expected to grow as the stimulus works its way through the economy. Two additional federal policy proposal areas are set to further shape dealmaking this year: a significant infrastructure spending bill and capital gains tax hikes meant to help pay for that spending.

Bipartisan negotiations on the infrastructure and tax bills have stalled, and even passing a bill through budget reconciliation on a party-line vote will require President Biden to moderate his ambitions to secure centrist Democratic support. However, even a pared-down tax bill could prompt a feverish second half of the year. Specifically, the proposed 39.6% capital gains tax on investment income over $1 million is undoubtedly spurring many business owners to begin sales processes in the hopes of finalizing before January 1, 2022. Anecdotally, investment banks are staffing up in anticipation of an end-of-year push. Middle-market PE firms will take advantage of a strong supply of motivated sellers to deploy capital efficiently. Importantly, this incentive will be removed if the capital gains hike is implemented retroactively; the Wall Street Journal reports this is a real possibility.[1] In that scenario, the second half of 2021 could still see a bump in deal activity depending on the timing of the announcement, since sale processes will need to be initiated well in advance of year end.

1: "Biden Budget Said to Assume Capital-Gains Tax Rate Increase Started in Late April," The Wall Street Journal, Richard Rubin, May 27, 2021.

Median PE buyout multiples by rolling four quarters

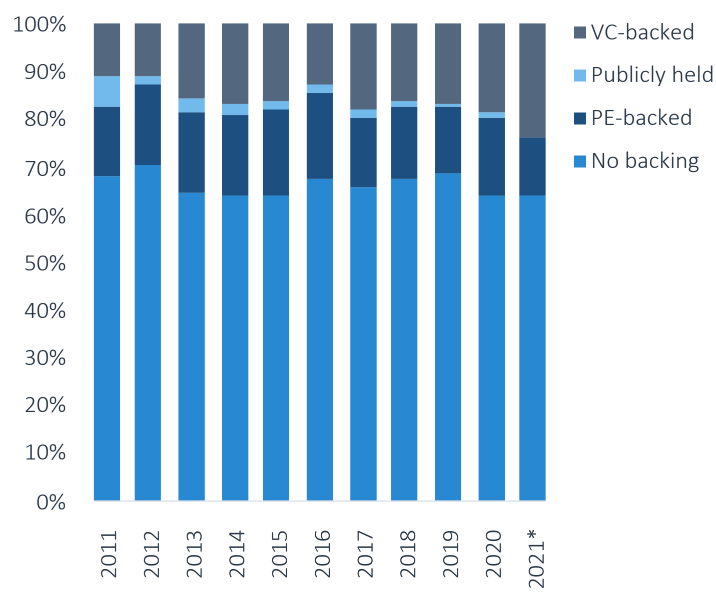


Source: PitchBook | **Geography**: US
*As of March 31, 2021
Note: *Due to low data counts for the middle market, this chart incorporates buyout multiples for all deal sizes (not just the middle market).*

In the IT sector, the largest tech-focused PE firms are driving software deal activity after raising sizable middle-market funds alongside massive flagship vehicles. PE firms have built increasingly sophisticated software playbooks over the past half decade, rapidly developing multi-product platforms through inorganic growth. Alongside strategics, middle-market PE funds have emerged as important buyers of venture-backed and bootstrapped software companies. Venture-backed companies accounted for over 20% of middle-market tech deals in Q1 2021. Clearlake Capital Group and Motive Partners' buyout of InvestCloud, a modular wealth management software platform, exemplifies this trend. InvestCloud is simultaneously merging with two Motive Partners portfolio companies, Finantix and Tegra118.

Another firm pursuing middle-market software buy-and-builds is Vista Equity Partners, which has been growing several education technology platforms in recent months. Although digital learning grabbed headlines in 2020, secondary and postsecondary educational institutions have also been under pressure to improve student outcome metrics. As a result, they are investing in tools that facilitate coordination and data-driven decision making. Education is a prime example of the greenfield opportunity PE firms see in a number of verticals to consolidate smaller software companies—streamlining sales processes, connecting information silos, and boosting customer retention as a result.

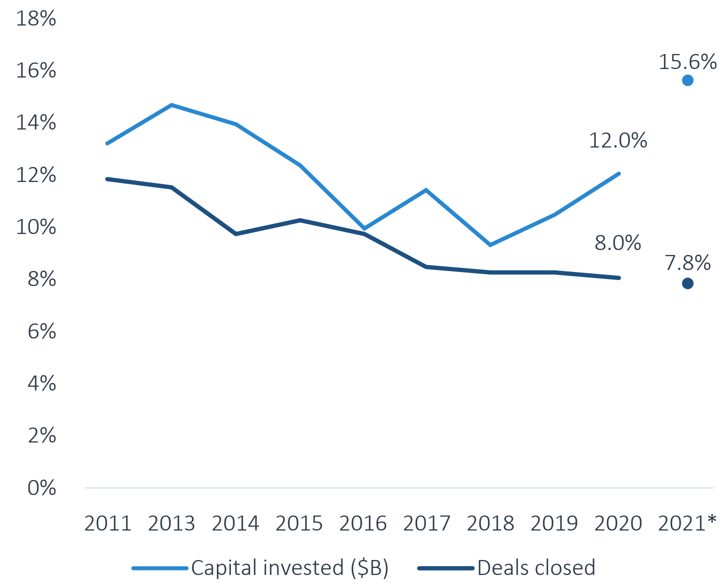
PE middle-market IT deals (#) by backing status



Source: PitchBook | **Geography**: US
*As of March 31, 2021

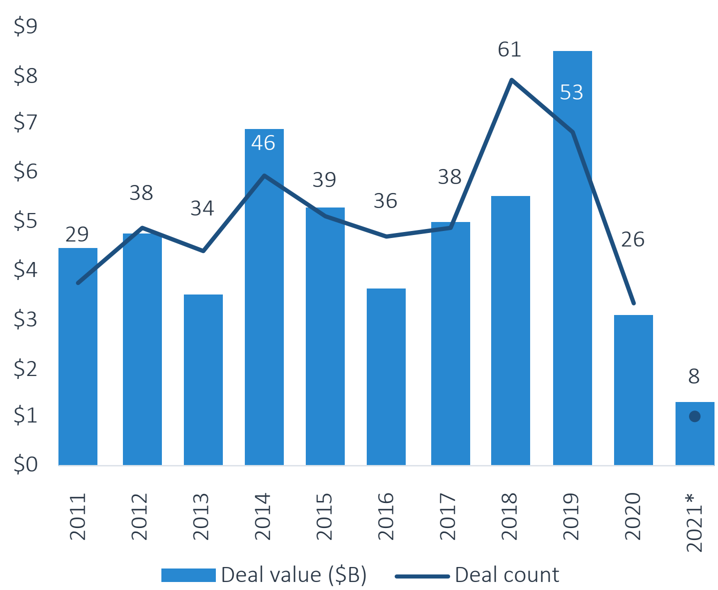
Although we have not seen the wave of distressed deals and "COVID discounts" that seemed inevitable when the pandemic hit, the tapering of direct fiscal stimulus policies may open windows of opportunity for PE firms looking to ride the recovery trajectory of hard-hit industries. The second round of PPP loans, which provided an additional lifeline to smaller businesses in Q1, has now wound down. Some companies that limped through the pandemic exhausted their liquidity options before demand fully recovered—particularly those that were already debt-laden or unable to keep pace as technological trends accelerated. At the same time, some PE firms are buying opportunistically in anticipation of a surge in pent-up demand for travel and other leisure activities, which now seems imminent. Crestview Partners' Hornblower Cruises & Events, now under the name City Experiences, has acquired three port excursion providers so far in 2021, including shuttered ShoreTrips at the meager price of $1.8 million. Sycamore Partners Management, a firm which has historically invested in consumer retail brands such as Nine West, bought the Azamara cruise line from Royal Caribbean Group for $201.0 million in cash, providing liquidity for Royal Caribbean to invest in fleet expansion for its other three brands.[2] As this deal illustrates, large companies in pandemic-affected industries will continue to use carveouts to reposition themselves to compete post-pandemic, and PE firms are likely beneficiaries. Industrial manufacturing and energy companies were also active in spinning off non-core business lines to PE buyers in Q1.

Carveouts as a proportion of middle-market PE deals



Source: PitchBook | **Geography**: US
*As of March 31, 2021

Restaurant, hotel, and leisure PE middle-market deal activity



Source: PitchBook | **Geography**: US
*As of March 31, 2021

2: "What Advisors Need to Know About Azamara's Move to Sycamore Partners," Travelmarket Report, Daniel McCarthy, February 3, 2021.

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Recovery gathers pace, but risks still loom

Antares Capital Keynote

US recovery gathers pace, driving deal activity up and default rates and spreads down

After a brief respite following a year-end 2020 deal activity boom, our open pipeline of PE deal flow has picked up steadily through Q1 2021 and well into Q2. Activity has been buoyed of late by a confluence of factors including 1) a recovering economy, with rising consensus 2021 US GDP growth expectations currently at a robust 6%+ as vaccine distribution proceeds and restrictions are eased; 2) continued significant fiscal and monetary stimulus; 3) related rising revenue and EBITDA growth prospects across most sectors, with Q1 2021 results beating expectations at a high rate; 4) very favorable capital market and private debt financing conditions; 5) potential for a rise in capital gains tax rates; and 6) high levels of PE dry powder. The recovery has also been broadening across industries, with even some of the spaces most severely affected by COVID-19—such as aerospace, travel & hospitality, and fitness—starting to see some signs of improvement.

As a result of these favorable trends, default rates have continued to plummet, with the S&P LSTA Leveraged Loan Index LTM default rate by amount down to as low as 1.73% as of May—well below the 2.9% long-term historical average (since 1999). Looking forward, as per S&P LCD: "without a fresh wave of bankruptcies and payment misses, the loan default rate could fall to less than 1% by the end of July." Declining default rates have also been evident in direct lending markets, as reported by Proskauer, and in the continued fall in average reported business development companies' (BDC) non-accrual rates in Q1.

Lower default rates have in turn led to a narrowing of "all in" spreads back to lows not seen since H2 2017. Based on data in Refinitiv's LPC Middle Market Weekly from May 14, syndicated middle-market 1st Lien term loan yields have narrowed from an average of 6.6% in Q4 2020 to 6.0% so far in May 2021 (albeit up from 5.7% Q1 2021 level). In comparison, syndicated Large Corporate 1st Lien term loan yields have narrowed from an average of about 5.3% in Q4 2020 to about 4.7% so far in May 2021

Dave 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.

(also up slightly from Q1 2021). On balance though, the institutional middle-market yield premium of 1.3% (as of mid-May) remains attractive.

Keep your eyes on the road

Although the markets broadly appear to have adopted a "risk-on" posture, risks of inflation, malware/cyber breaches, geopolitical strife and lagging emerging market vaccination/variant risks continue to loom. While the COVID-19 pandemic recedes in the rear-view mirror (at least in the US), lenders would be well-advised to remain vigilant in looking for potholes in the road ahead.

Q&A with Dave Brackett

With spreads falling, are loan markets still attractive?

In a word, yes. We are still seeing attractive opportunities to put money to work, though being selective and credit-disciplined across the broadest set of opportunities available in the market is ever more critical.

Capital has been attracted to loan markets, reflecting a continued hunger for yield, falling default rates, and rising concerns over inflation and a potential related rise in interest rates (with loans offering a natural hedge against inflation via floating rate terms). The asset class's appeal has also benefited from solid performance through the COVID-19 crisis and continues to appear attractive on a risk-adjusted basis relative to many other asset classes. As a result, money is flowing in. Collateralized loan obligation

(CLO) issuance has surged to over $59 billion as of May 20th, according to S&P LCD—the highest level seen for this period since 2005. Meanwhile, retail loan mutual fund and ETFs have seen net inflows of about $16.3 billion through late May versus approximately $19 billion of outflows during all of 2020. Such inflows have put pressure on spreads, though some spread contraction is justified by falling default rates, and institutional and direct lending middle-market yield premiums remain attractive.

What are the implications of still-rising LBO purchase price multiples?

Middle-market purchase price multiples (PPMs) remained high in Q1 2021 at a little over 12x EBITDA across deals financed in both syndicated and direct markets, according to Refinitv LPC data. This figure was up from 11.8x in Q4 2020 and closer to 11x for all of 2020, but it remains below over 13.5x for the large corporate market. This reflects multiple expansion more broadly across markets (for example, the S&P 500 total enterprise value to EBITDA in Q1 averaged 17.6x versus 14.5x on average for all of 2020, according to Capital IQ) as well as a higher share of high-multiple tech deals in the mix of LBOs. From a lender point of view, rising enterprise valuations aren't a bad thing from a loan-to-value perspective, and although leverage has risen along with PPMs, middle-market equity contributions remain high at 57% in Q1.

With that said, competition among acquirers remains fierce, and PE buyers must find new ways to create value to maintain their returns. This is driving increased investment holding periods and add-on activity to build on existing platforms and create value. This trend should continue to favor incumbent lenders with large portfolios.

Are you worried about inflation? What is Antares doing to protect itself?

Clearly this is a hot topic of debate. From a macro perspective, some transitory inflation and a steepening yield curve is a welcome sign of an entrenching recovery. The US 10-year bond yield has come off its March high of nearly 1.8% and is now back down to 1.6% as of late-May, which suggests the bond market isn't too concerned about inflation—at least not yet. However, recent incoming inflation data, including a 4.2% headline rise in the consumer price index (CPI) in April, has continued to surprise significantly on the upside, giving fuel to those arguing that fiscal and central bank stimulus is excessive.

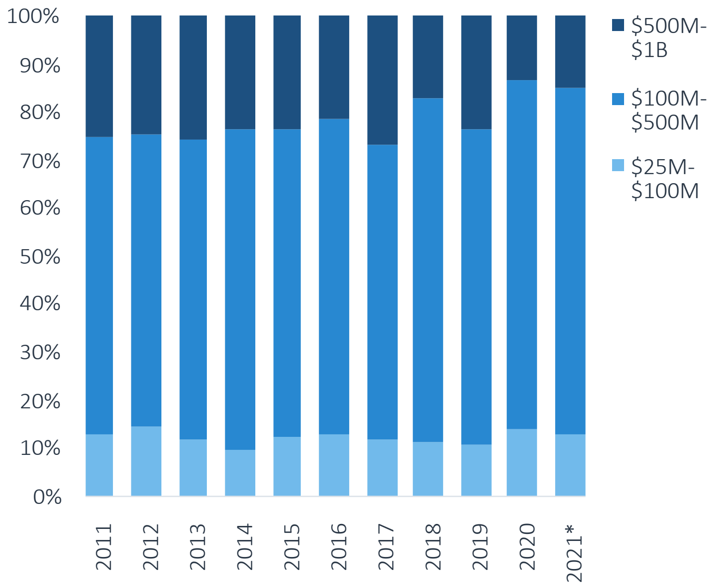
We know that "price allocates resource," so the real debate is how high the price (inflation intensity) and for how long (inflation duration). An analysis of all the moving parts is complex, and we are in somewhat unchartered waters. Labor market tightness has surprised some, and asset inflation may yet make its way into CPI. For example, significant inflation in housing prices (median single-family home prices were up 20% YoY in April) doesn't show in CPI. Meanwhile, rent inflation, which makes up about a quarter of CPI, has dropped sharply over the past year to only 1.8%. Could increasingly unaffordable homes drive up rental costs? How much impact might there be from commercial real estate converting to residential as post-pandemic work-from-home trends settle in? Will productivity gains offset inflationary pressures?

For our part, we believe shortages tend to be "short ages," and that inflation will prove to be transitory; however, that doesn't mean we should dismiss the potential risks/consequences (for example, talk of tapering could drive market volatility, and so on). Inflation intensity won't be uniform across inputs, and could be painful to some. Of course, from a company perspective, inflation pain for some (such as raw material and labor costs) may actually be pleasure for others (revenue/margin gains). While we view a long-lasting, pernicious upward wage/price spiral as unlikely, as a lender, you have to be prepared for unwanted scenarios.

As far as protecting our portfolio from inflation, this mostly revolves around underwriting borrowers with 1) leading positions and pricing power, 2) supply chain diversity to avoid bottlenecks and promote competition, and 3) favorable labor force dynamics (such as the ability to hire from a diverse set of prospects and improve productivity). We also have a dedicated portfolio management team that monitors developments closely.

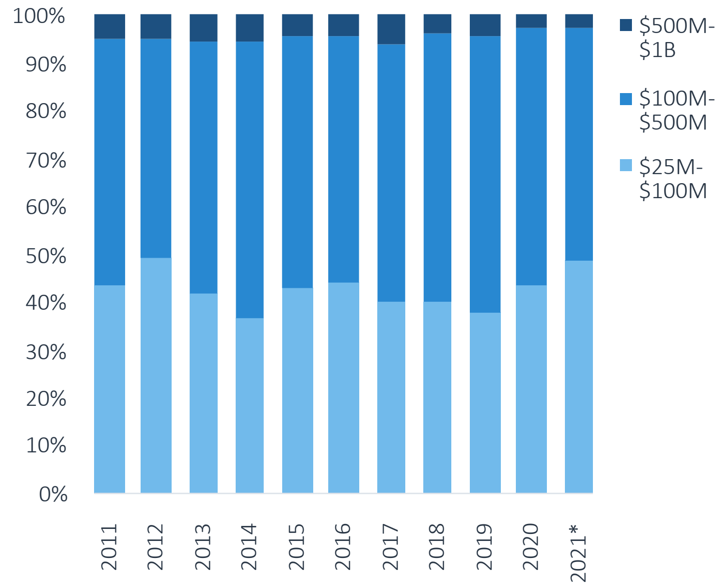
Deals by size and sector

PE middle-market deals ($) by size



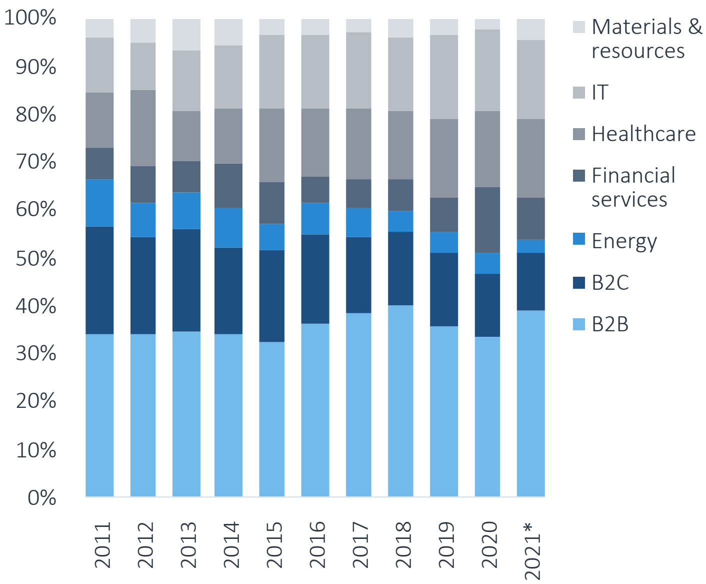
Source: PitchBook | **Geography**: US
*As of March 31, 2021

PE middle-market deals (#) by size



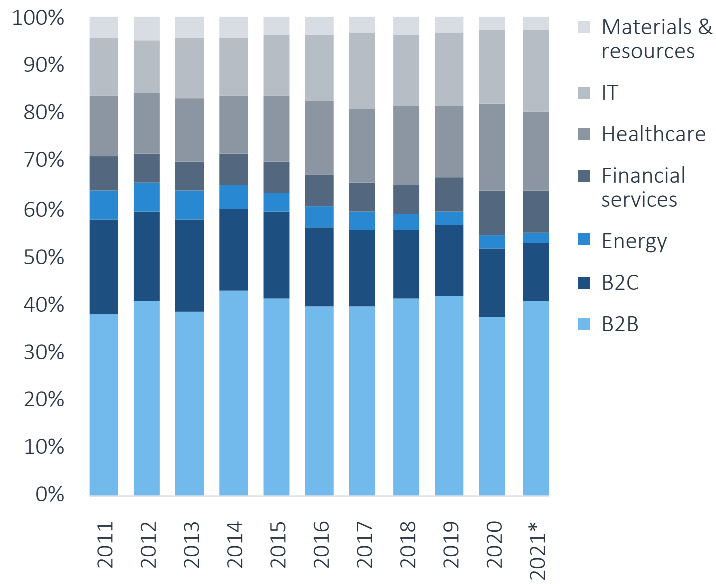
Source: PitchBook | **Geography**: US
*As of March 31, 2021

PE middle-market deals ($) by sector



Source: PitchBook | **Geography**: US
*As of March 31, 2021

PE middle-market deals (#) by sector



Source: PitchBook | **Geography**: US
*As of March 31, 2021

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Q&A: Withum

Tom Angell

Financial Services Group practice leader
Withum

Tom Angell serves a diverse client base of credit funds, hedge funds, funds of funds, investment advisors, and regulated funds. He also provides fund-structure and management-company guidance and assistance to emerging managers and well-established funds. A widely respected financial-services industry thought leader, Tom also is a sought-after speaker, author, and media resource.

After a year like none other, PE dealmaking seems set to be as resilient as ever. However, given the upward pressure on valuations due to factors such as record dry powder, fund managers still seem to face a challenging market environment. How are they adapting?

Despite COVID-19 prompting a swift shutdown last spring—and the dealmaking dip that extended well into Q2—valuations reached their highest levels since 2007 by the end of 2020. While PE initially focused on settling in-progress deals in the shutdown aftermath, the promise of vaccines, election clarity, and government stimulus packages ended the watchful waiting period. As a result, PE has recalibrated, and companies are regaining their footing in the wake of unprecedented pandemic-related disruptions.

While a high-valuation environment is always a good sign, such conditions only bode well for owned entities—not buying entities. High valuations make the decision to sell much easier than the decision to buy. Of course, buying requires deployment of dry powder.

Interestingly, PE may emerge as a primary capital source in the post-COVID-19 recession-recovery period. In fact, some funds are contemplating and acting upon this strategic adaptation. Uniquely positioned to facilitate a reboot among investment companies, PE has the capability to put dry powder to work—especially for high-valuation businesses that have come out the other side.

PE has also adapted in the relationship building and technology areas. Employing agility in terms of both has facilitated a healthy rebound, particularly among established firms where LPs collaborated with established managers. While several newer funds and SPACs entered the market in the pandemic economy, a number cite the lack of strong relationships as one of the biggest challenges during this time.

Specifically regarding the US middle market, smaller companies often faced more pressures due to the pandemic than others. To what degree do you see PE taking advantage of such stresses going forward, and for how long do you anticipate that to encourage rollups in key sectors?

The middle-market space has always had a certain degree of capital-fueled growth exposure. As a result, it remains a PE sweet spot. While these companies are only a small percentage of all businesses nationwide, they account for about one-third of the GDP—which is what makes them so attractive. The middle market also has proven its resiliency.

As with all things related to COVID-19, some industries rallied in the new normal while others were crippled by societal, economic, and health shifts. Although restaurants, hotels, travel, leisure, and entertainment took a big hit, especially in major metro areas, sectors such as direct-to-consumer products, manufacturing, construction, and appliances flourished.

While the former had their valuations plummet, the latter had them skyrocket. Regardless of the valuation needle's direction, this period is too skewed to take under advisement for investment purposes. While the weakest will eventually need to sell or become part of an add-on rollup strategy, PE overall has demonstrated its patience. Although the 28 rollups in Q1 2021 primarily involved highly impacted companies in some of the worst-hit geographies, PE is waiting for greater clarity in a "normal," more stabilized economic environment in 2021 or 2022.

What are the biggest concerns regarding financial reporting that PE fund managers should be wary of? What are the least known, in your opinion?

In PE, the greatest reporting concerns are always related to valuations. With regulatory burdens gradually tightening over the years, the SEC is not the only one watching.

Current and prospective investors are now demanding information and transparency regarding a fund's valuation policies and procedures. This is because it has been so easy to amplify valuations in the past. PE's expansion and free-flowing capital have been catalysts for elevated valuations, actual and otherwise.

Theories abound regarding this surge and motivation. They include proposing exaggerated, self-reported valuation estimates to make fund investments more attractive to investors and paving the way for enhanced LP interest in next-stage funds. Regardless, demand for transparency and consistency are here to stay.

As a result, the American Institute of Certified Public Accountants' valuation guidance is the only valuation best-practices option. Not only does it mitigate risk, it also avoids an unwelcome SEC examination and loss of trust among investors.

With regard to recent PE-associated deals that Withum teams have worked on, what are some of the more novel findings or occurrences that stood out to you?

Speaking in general terms, we are seeing an influx of price increases among Withum's PE clients. While this is not necessarily novel, it is an enduring trend that is becoming entrenched.

With a focus on COVID-19-related volatility and a dislocation in markets, PE has been emboldened. This has been fed by government stimulus packages and implementation of banking-crisis measures. While these lifelines ensured PE's health and wellbeing, they also created a pipeline of cheap debt for new deals. For the foreseeable future, discounted debt will breed a price climb, and those businesses that survived beyond the height of COVID-19—namely IT and healthcare—will continue to command the highest dollars.

Another fund-side trend is greater operating efficiencies, especially in technology. With competition fierce, sophisticated funds are subscribing to a data-driven mantra to enhance value creation.

Given their scale, middle-market businesses sometimes are not yet fully digitized or utilizing the best-in-class technology. Where do you see such businesses needing to invest first, and how does that vary across some of the major sectors that Withum covers?

During the COVID-19 era, agility became the business survival standard. Could a company pivot from one business strategy to another? Was it capable of responding to a telecommuting/e-learning/sheltering-in-place society? Could it keep its own employees and their families safe? By varying degrees, the solution to each of these questions was technology.

In general, businesses that had invested in modern and back-office technologies were better prepared for the quickly changing COVID-19 environment. Interestingly, those companies that had invested in technology also were more likely to have a succession plan. The end game influenced the level of business/tech investment, not the likelihood of a natural disaster or health crisis.

Succession planning asks: Will the business shutter in five to 10 years? Will it be passed on/sold to a relative? Will it be marketed for sale? Pre-pandemic, these decisions were influenced by day-to-day operational philosophies. Could the company get by or is it worth reinvestment? Those that had reinvested were in a better position when a two-week, stay-at-home mandate evolved into a 14-month lifestyle standard. Even now, a majority of middle-market business leaders cite IT infrastructure and communications as improvement areas.

What are your thoughts on the potential for some upper-middle-market PE portfolio companies to be targeted by SPACs, or is that unlikely in your view?

Initially this does not seem to be the case. Most of the deals are much larger thanks to not only SPAC money, but PIPE money as well. There also have been some rollups of multiple same-industry company acquisitions into one entity. Such a scenario depends on the size of the SPAC itself. In the current era, these special-purpose companies are more likely to spend raised funds on acquiring one specific company rather than multiple deals at once. SPAC-favored industries include e-vehicle and green-space companies such as electric cars and solar power.

Please feel free to expand on any of the topics discussed above or broach those that have not yet been addressed.

The year 2021 in PE may be the year of the mass exodus. Several factors point to this possibility. These include exit extensions undertaken in 2020 in the wake of COVID-19, upward-trending valuations, the cheap-debt environment, and an investor desire to monetize. Time will tell on this front.

Spotlight: Exploring trends in add-on acquisitions

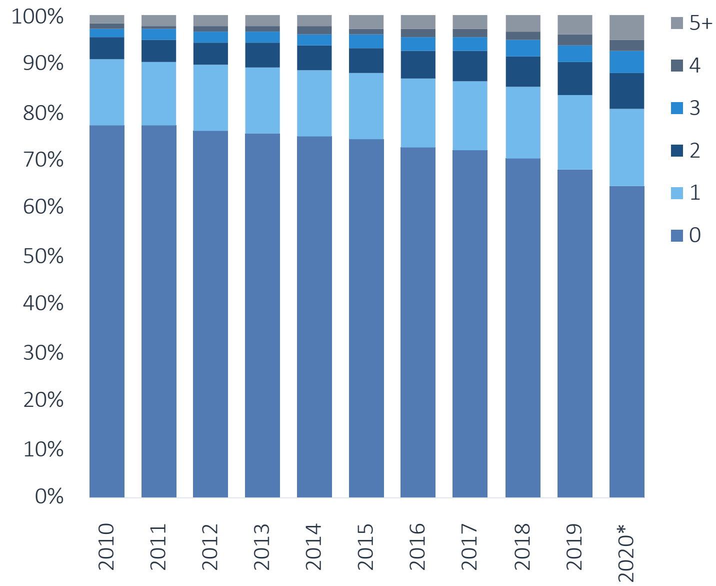
Note: This spotlight was abridged from an analyst note on US PE add-on acquisitions. Please see this note for further analysis.

Add-on acquisitions have been increasing in popularity since the early 2000s. 71.7% of US PE deals in 2020 were add-ons, compared with 43.2% in 2002. Historically, GPs have held platforms that complete add-ons longer than other portfolio companies, with greater numbers of add-ons correlated with longer holding times. The reasons for this are intuitive: Deal sourcing and execution, operational integrations, and the realization of synergistic advantages all take time. However, in the past several years, median exit times for portfolio companies with and without add-ons have converged at approximately five years.

There are several reasons for this convergence. First, both GPs and the management teams of platform companies have become more adept at executing buy-and-build strategies over time. As GPs double down on specific industries conducive to roll-ups, they can move quickly with familiar playbooks. Platform selection also plays an important role. GPs look for platform companies with sufficiently "professionalized" management teams and back-office operations to successfully execute add-ons, though they often bring in additional talent, such as a head of M&A, themselves.

In fact, companies that have grown through additive dealmaking are more likely to be sold in sponsor-to-sponsor transactions than companies that have not; more add-ons correlates with a higher likelihood of a sponsor acquisition. A company's track record of completing acquisitions under the first sponsor represents an attractive selling point for the second sponsor. Moreover, PE buyers tend to be more lenient than strategics when it comes to operational integration of add-ons, making them more likely to purchase platforms that have made many acquisitions. This is because they have the expertise to move integration forward and are likely intending to pursue further inorganic growth anyway. Platforms may be passed between GPs focused on

Share of portfolio company count by number of add-on acquisitions



Source: PitchBook | **Geography**: US
*As of December 31, 2020
Note: *Number of add-ons via the current sponsor at time t.*

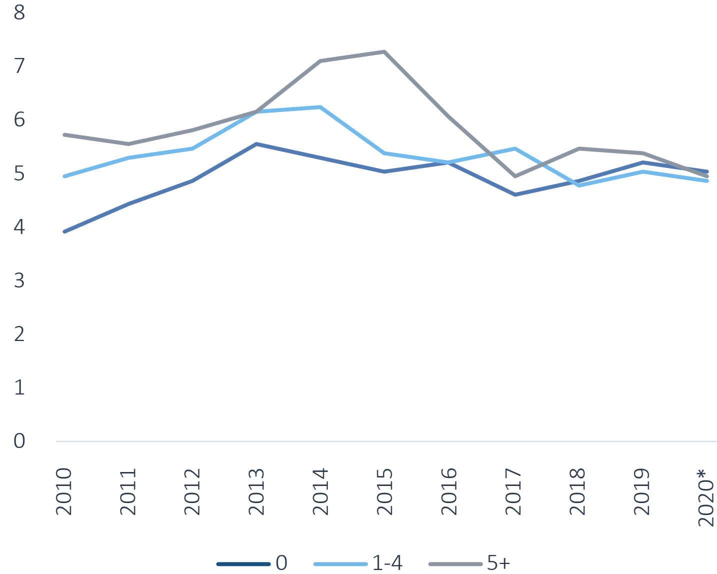
successively larger deal sizes, acquiring add-ons as they go.

However, allowing sufficient time for operational integration within a fund lifecycle remains important for GPs operating in fundamental value industries, especially when targeting strategic buyers. John Stewart, founding partner at MiddleGround Capital, a firm that specializes in the lower-middle-market B2B industrials and specialty distribution, notes the risks of making add-on acquisitions late in a holding period: M&A diverts management team attention from the performance of the core business. Moreover, strategic buyers prefer to buy platforms that have standardized systems across bolted-on components because they will need to integrate the acquisition before realizing synergistic gains.1 For these reasons, some GPs strive to complete add-on acquisitions at least 12 months before their desired exit date.

The logic around holding times is different for upper-middle-market companies in growth-oriented sectors, an area where PE is increasingly active. The current climate of excess dry powder, high valuations, and risk-on investor behavior means that GPs building this type of company may be less concerned about fully integrating add-on acquisitions before bringing a platform to market. According to John Mathis, partner at Harbor View Advisors, buyers of software and other technology-related companies are accustomed to paying premiums for yet-unrealized growth potential and may be content to value a recent add-on acquisition accordingly. The glut of SPACs currently seeking reverse merger targets has created an additional exit route. Again, this has contributed to the convergence in holding times between companies with and without add-ons.

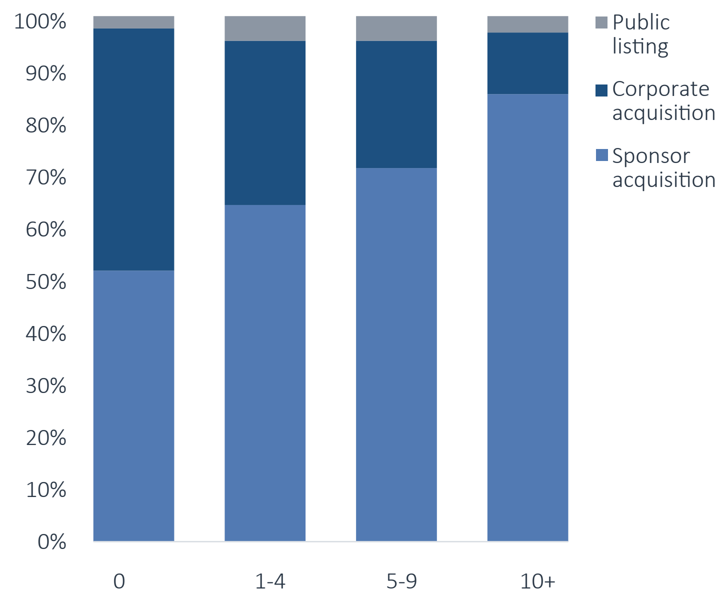
Going forward, the growing popularity of GP-led secondary transactions and long-dated funds will provide new options for GPs seeking to grow successful platforms beyond the traditional fund lifespan. We are already seeing examples of this. Bay Grove Capital, a firm committed to building on one platform company at a time over long time horizons, has completed 31 add-ons with Lineage Logistics Holdings since 2012. In 2019, Blackstone completed a single-asset restructuring of its 2012-vintage Tactical Opportunities Fund to move Phoenix Tower International, a wireless infrastructure operator, into a continuation vehicle. Phoenix Tower International has already acquired several additional add-ons since the fund restructuring. Finally, two insurance distribution platforms recently established by an Oak Hill Capital and Carlyle Group joint venture and Bain Credit, respectively, represent ways that firms are creating bespoke vehicles to facilitate large-scale roll-ups outside the traditional fund structure.

Median time for PE-backed companies to exit (years) by exit year and number of add-on acquisitions



Source: PitchBook | **Geography**: US
*As of December 31, 2020

Share of PE-backed company exits by number of add-on acquisitions and exit type, 2018-2020* aggregated



Source: PitchBook | **Geography**: US
*As of December 31, 2020

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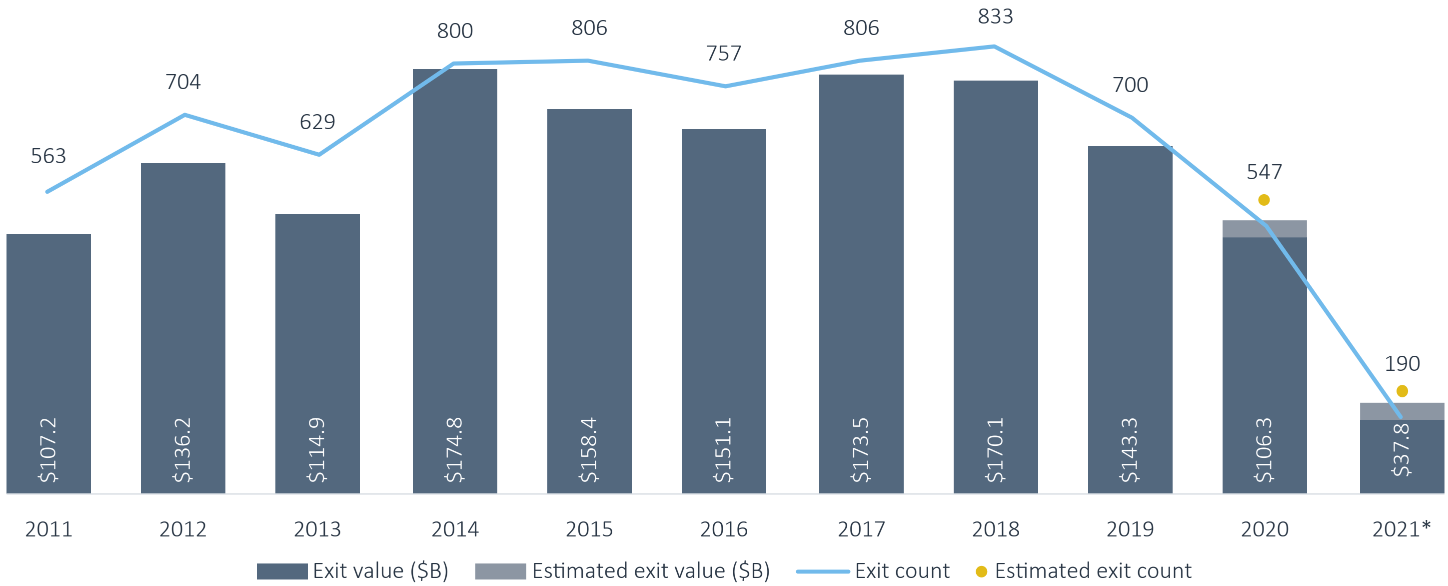
Exits

PE middle-market exit activity

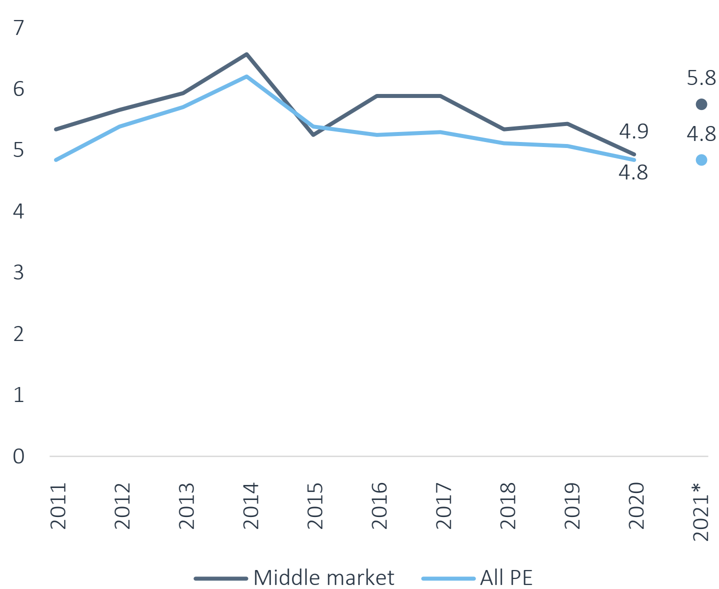


Source: PitchBook | **Geography**: US
*As of March 31, 2021

US middle-market PE firms registered healthy exit numbers as the sponsor-to-sponsor and strategic acquisition environments began to normalize in Q1. Firms exited 190 portfolio companies for a combined $37.8 billion in the quarter. Even following the rush of exits in Q4 2020, some of this activity still represents spillover from 2020's slowdown. Holding times ticked up by approximately three quarters, meaning that many companies sold in 2021 were likely slated to be monetized in 2020 before the pandemic hit.

Middle-market GPs benefited from a range of favorable exit opportunities in Q1. Sponsor-to-sponsor exits, which dropped off in 2020 due to pricing mismatches between sellers and buyers seeking "COVID discounts," appear to be once again growing as a proportion of middle-market PE exits. Additionally, strategic buyers have ramped up M&A as economic confidence returns and equity markets soar. In the financial services sector, where the majority of middle-market PE exits over the last 12 months have been to strategics, technological disruption has spurred M&A activity. Some financial services incumbents are pursuing additive growth strategies to build out multi-functional software platforms for both retail and enterprise clients, while others are consolidating to gain market share amid downward margin pressure.

Median PE holding period (years) for middle-market companies



Source: PitchBook | **Geography**: US
*As of March 31, 2021

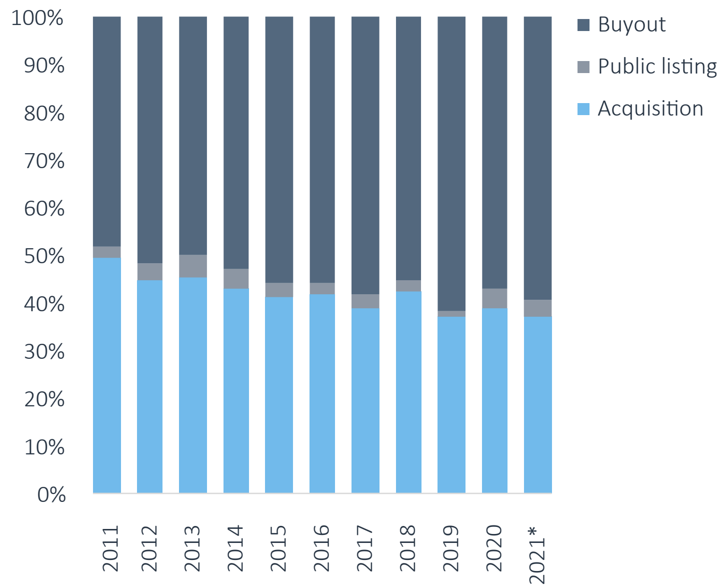
Likewise, consumer companies are using M&A to position themselves in the post-pandemic world. For instance, in the red-hot home and garden vertical, Ares Capital (NYSE: ARES) and Freeman Spogli sold Green Garden Products to Central Garden and Pet (NASDAQ: CENT) for $532.0 million. GPs may be particularly motivated to exit companies that saw revenue spike due to potentially transitory pandemic trends. Meanwhile, strategics in these industries are motivated to take advantage of their high stock prices—and concomitant purchasing power—to grow market share and expand into new product lines.

As in Q4 of 2020, public markets continued to present a viable realization option for some upper-middle-market PE portfolio companies in Q1. This quarter saw one buyout-backed, middle-market company merge with a SPAC. PLBY Group, which was owned by the family office Rivzi Traverse, returned to the public markets at a $381.0 million pre-money valuation including assumed debt. However, around half a dozen additional middle-market SPAC reverse mergers have been announced, ranging from Madison Dearborn Partners and The Tornante Company's The Topps Company, which sells sports collectibles, to ABRY Partners' KORE Wireless Group, an IoT service provider. To be sure, some (not necessarily PE-backed) companies that merged with SPACs in 2020 now present a cautionary tale as they struggle to adapt to the scrutiny of public markets. However, middle-market PE firms will likely continue tapping into the abundant supply of uncommitted blank-check companies in the coming quarters.

The energy sector represents one space that is experiencing a significant trend reversal. Since 2015, depressed oil prices have had a dampening effect on PE activity in the sector, but the modest rally of WTI crude oil futures above $60 per barrel and an explosion of interest in the sustainable energy sector may be changing that. Although exits of energy companies were modest in Q1, there are signs of increased activity ahead. In a splashy deal announced in April, Archaea energy, a venture-backed company that produces renewable energy using landfill gas, will simultaneously acquire Ares-backed Aria Energy for $680.0 million and merge with a SPAC.

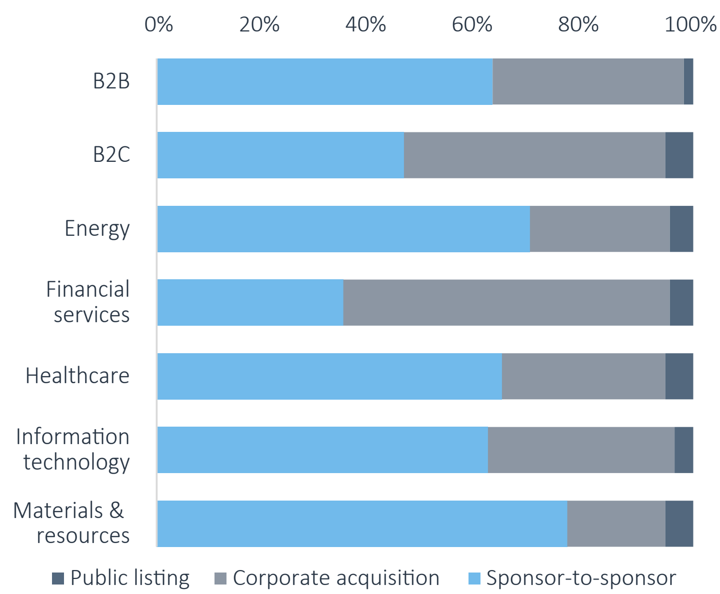
PE firms are not only buying and selling green energy companies, but actively managing the pivot to greater efficiency and reduced carbon emissions for traditional providers. For instance, Stonepeak Infrastructure Partners and Ironclad Energy Partners announced

PE middle-market exits (#) by type



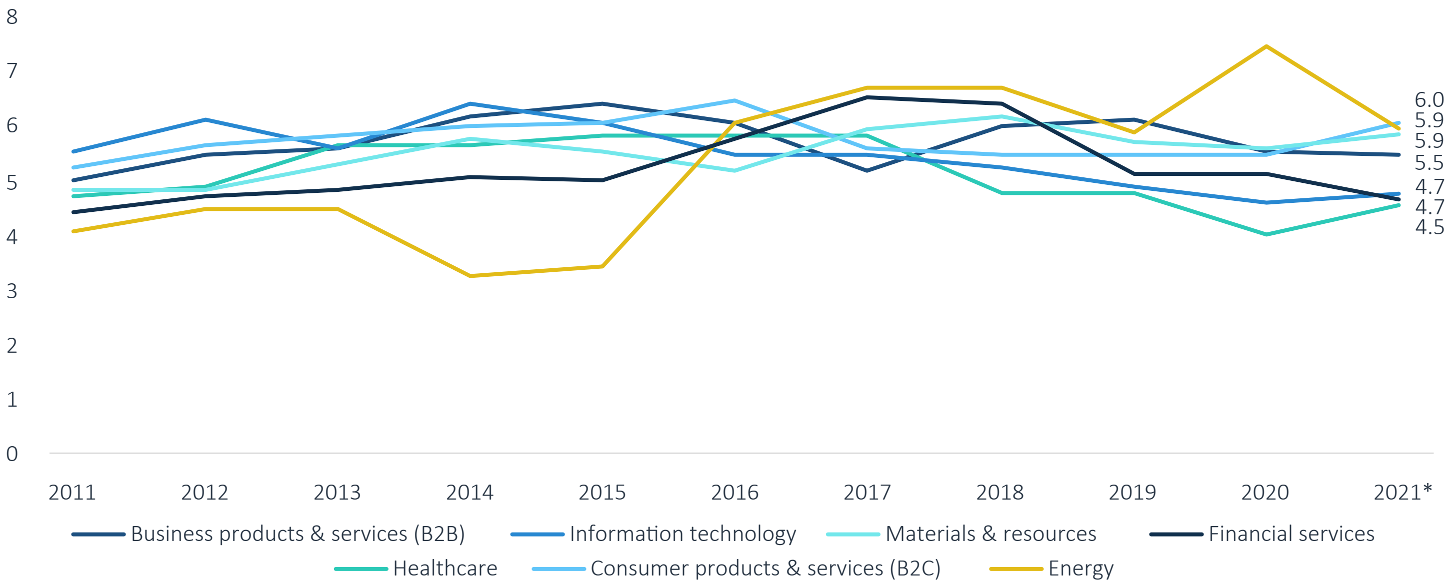
Source: PitchBook | **Geography**: US
*As of March 31, 2021

PE middle-market exits (#) by type and sector, trailing four-quarter



Source: PitchBook | **Geography**: US
*As of March 31, 2021

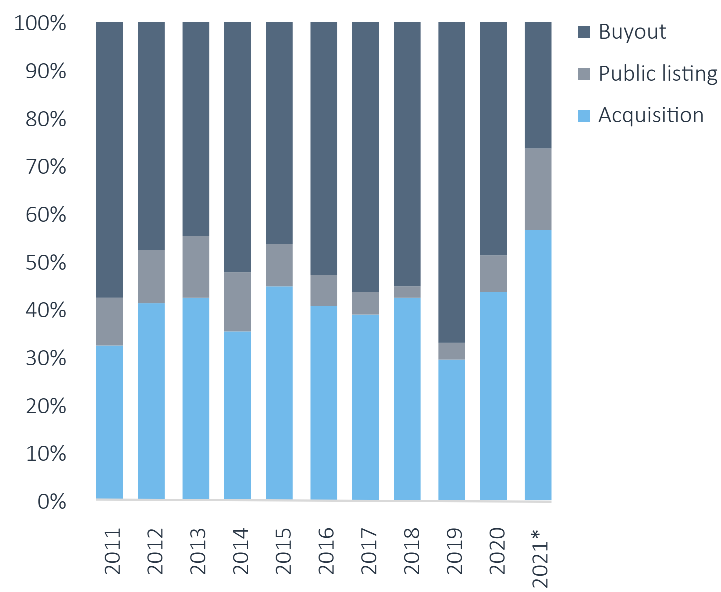
Median three-year rolling holding period (years) by sector for middle-market companies



Source: PitchBook | **Geography**: US
*As of March 31, 2021

the sale of RED-Rochester, an energy provider for the Rochester, NY area, at an EV of $260.0 million after converting the utility's coal-fired power plant to natural gas and laying the groundwork for additional efficiency projects. With the regulatory temperature rising—a Dutch court recently became the first to order an oil major to slash its carbon emissions[3]—the cost of capital for energy assets may rise over time, making it more difficult for PE firms to reach their return objectives in this space. As a result, middle-market firms may begin to exit energy assets more quickly. GPs that can market their portfolio companies under an environmental, social, and governance (ESG) banner will find benign exit conditions, while those still holding carbon-heavy assets may feel pressure to sell before valuations erode.

PE middle-market B2C exits ($) by type



Source: PitchBook | **Geography**: US
*As of March 31, 2021

3: "Shell Ordered by Dutch Court to Cut Carbon Emissions," The Wall Street Journal, Sarah McFarlane, May 26, 2021.

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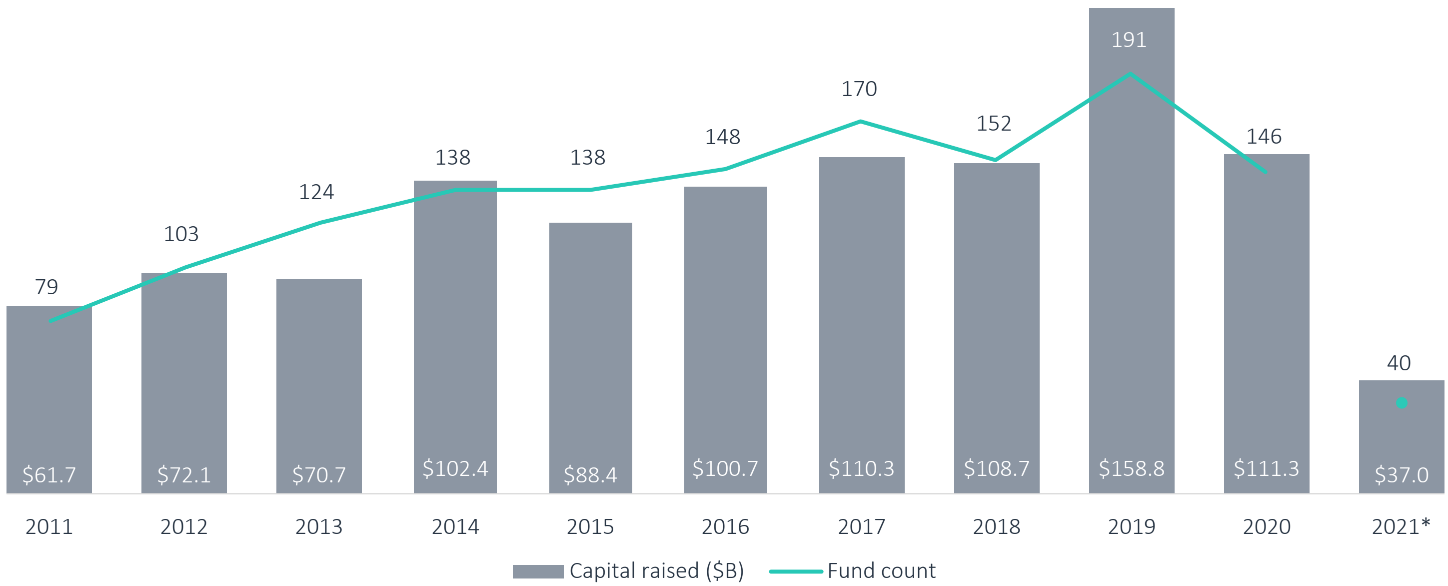
Fundraising

PE middle-market fundraising activity



Source: PitchBook | **Geography**: US
*As of March 31, 2021

Middle-market PE firms had an active Q1 for fundraising, closing 40 funds for a combined $37.0 billion. The effects of the COVID-19 pandemic on fundraising timelines, both in terms of the logistics of due diligence and LPs retreating to established manager relationships, are now beginning to show in the data, with median time to close ticking upward substantially. However, there is broad consensus among industry players that the fundraising landscape is adjusting to the new normal, with fundraising processes once again proceeding quickly for many managers. Anecdotally, we have heard some recent fundraising processes have been conducted fully virtually within quick timeframes, while many managers have also resumed face-to-face due diligence meetings.

Funds raised by emerging managers, defined as the first three funds in a fund family, accounted for over 70% of middle-market fund closes by count, the highest proportion since 2013. While some of these closes no doubt represent a backlog of fundraising processes that stalled due to the pandemic, 2021 will likely see a growing opportunity for first-time and emerging GPs. Strong historical performance of emerging managers, the potential for discounts or revenue sharing in exchange for seed or anchor commitments, and mounting pressure to put money behind diverse managers will all play in new GPs' favor throughout the rest of 2021.

The prevalence of emerging managers closing funds in Q1 coincided with a strong fundraising quarter for sector specialists. Having a sector specialization, specific operational transformation angle, or other calling-card investment style has reportedly become almost a prerequisite for fundraising by emerging managers. Our data backs this up, revealing that new GPs are significantly more specialized than established ones. Examples of specialist emerging manager firms that closed funds in Q1 include Banneker Partners, which raised its first fund focused on lower-middle-market enterprise SaaS companies; CORE Industrial Partners, which invests in manufacturing companies and raised a $465.0 million Fund II; and Accelmed partners, which raised $400.0 million for its second fund to invest in healthcare technology companies. All three fundraises met or exceeded their hard caps.

The quarter also saw noteworthy fundraises from established specialists such as Greenbriar Equity Group, which closed its oversubscribed, manufacturing-focused Fund V at $1.7 billion in less than four months. Looking ahead, several specialist firms are currently in the market. Another manufacturing investor, Sky Island Capital, is seeking $250.0 million for its first fund; Leeds Equity Partners, which invests in education and information companies, is raising a seventh fund; and Amulet Capital

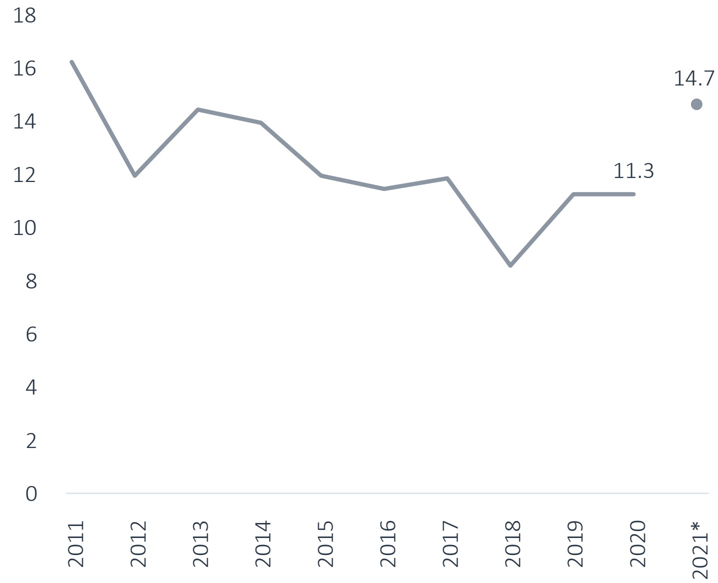
Partners and Altaris Capital Partners, both healthcare-focused firms, are in the market with their second and fifth funds, respectively.

Perhaps the most-discussed fundraising trend of the quarter involves large firms raising continuation funds to support GP-led secondary transactions. For example, in March, Riverside Partners closed a $532.0 million continuation fund for seven companies in its 2012-vintage flagship. These funds are typically three to seven years in length and can purchase anywhere from a single asset to an entire portfolio of companies from an existing fund, usually near the end of the fund life. This gives GPs more time to grow portfolio companies while crystallizing carry and providing a liquidity option for LPs. As mentioned in the spotlight, portfolio companies undergoing buy-and-build strategies are frequent candidates for sale to a continuation fund because of the potential for sustained growth through incremental add-on acquisitions. The continuation fundraise also provides an opportunity to make additional equity investments. Fundraising for these vehicles by middle-market GPs will likely increase in the coming quarters. For instance, BlackRock and the New Mexico Educational Retirement Board are reportedly co-leading a $700 million continuation of at least two assets from AE Industrial Partners' $680.0 million 2015-vintage debut fund.[4]

Preliminary fund returns data for Q4 2020—the latest quarter for which data is available—shows that middle-market funds have lagged $5 billion+ funds in recovering from the pandemic downturn. Assets in middle-market funds are less likely than large companies to be marked to market with public companies, and may have been harder hit by the pandemic, with fewer cost levers to pull and somewhat less access to capital. Elongated holding times may also be weighing on middle-market IRRs. However, middle-market funds will likely see returns continue to tick upward as asset valuations in harder-hit industries recover and exits materialize. The Lincoln Middle Market Index registered a 7.3% increase in portfolio company valuations from Q4 2020 to Q1 2021.

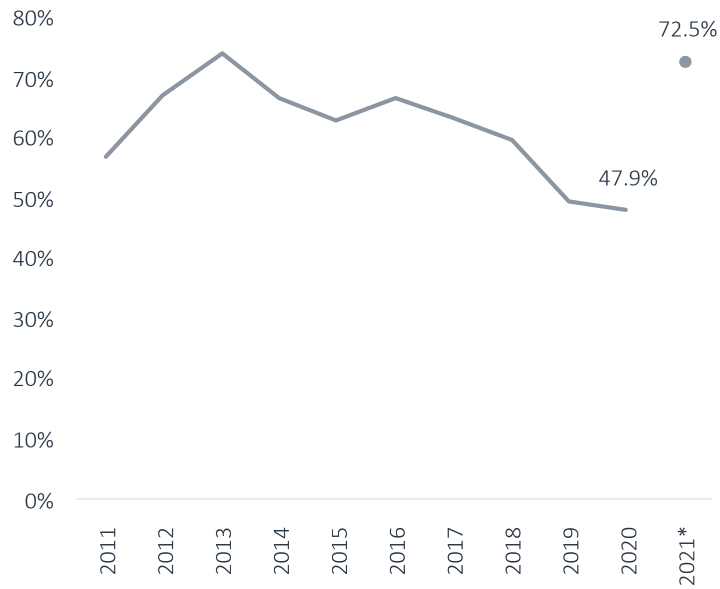
Middle-market funds managed by large GPs represent a notable exception to this trend. These funds, which include a number of sector-focused funds raised by some of the largest PE firms, have shown significant

Median time to close (months) for middle-market PE funds



Source: PitchBook | **Geography**: US
*As of March 31, 2021

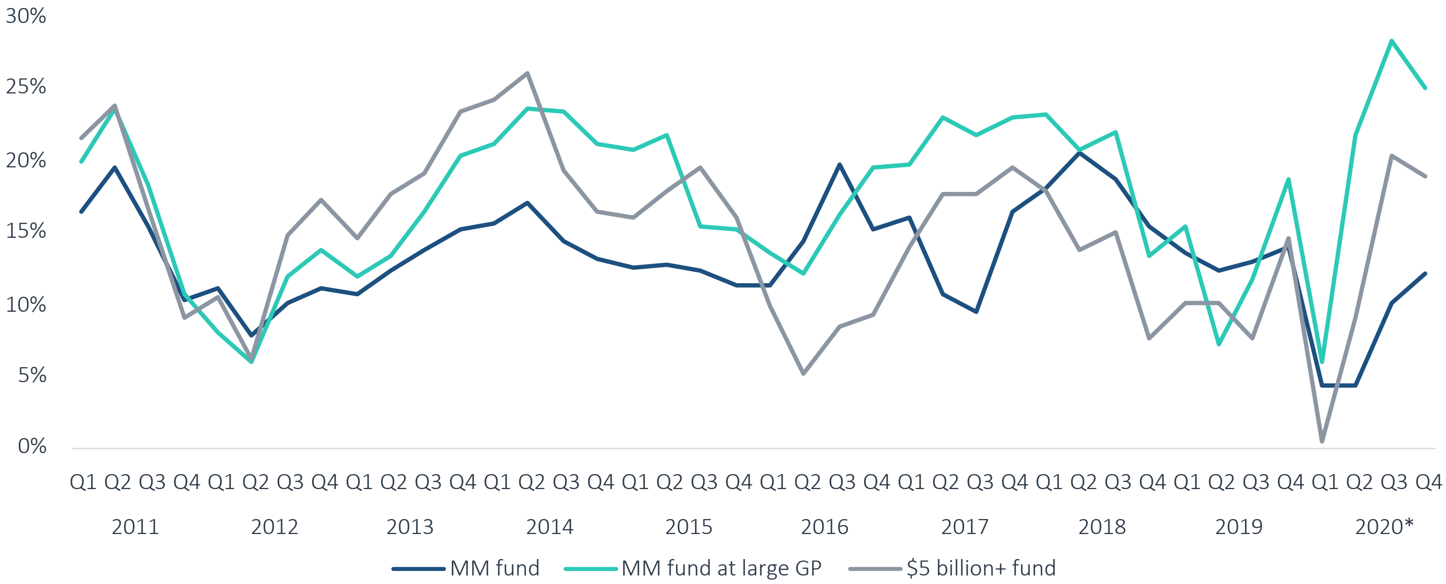
Funds I-III as a proportion of all middle-market PE funds (#)



Source: PitchBook | **Geography**: US
*As of March 31, 2021

4: "BlackRock, New Mexico Pension to Back $700 Million Secondary Deal," The Wall Street Journal, Preeti Singh, May 25, 2021.

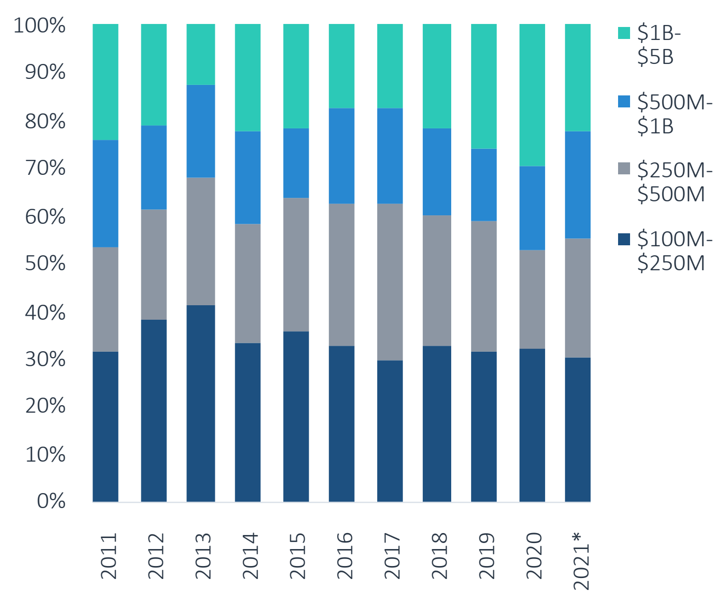
PE middle-market fund rolling one-year horizon IRRs



Source: PitchBook | **Geography**: US
*As of December 31, 2020
Note: For the purposes of this chart, we define "large GP" as a GP that has raised at least one $5 billion+ fund.

outperformance when compared with both large funds and other middle-market funds. The combination of specialized focus with the deal sourcing, operational, and financing resources of a large firm may be contributing factors. Selection bias also affects the data, since only the most successful middle-market managers graduate into this category. Nevertheless, the likely attraction of these funds for LPs, which often prefer investing within existing GP relationships, is obvious. For this reason, we have often seen GPs such as Leonard Green & Partners, Platinum Equity, and Veritas Capital diversify their offerings with middle-market strategies once their flagship funds reach around $5 billion to $10 billion. One fund of this type currently in the market is Carlyle Global Financial Services Partners II, targeting $1.5 billion.

PE middle-market funds (#) by size



Source: PitchBook | **Geography**: US
*As of March 31, 2021

Q1 2021 US PE MM lending league tables

Overall

1	Antares Capital	45
2	Barings	34
2	Churchill	34
4	BMO Financial Group	33
5	Morgan Stanley	28
6	Ares	26
7	Madison Capital Funding	25
8	Bank of America	24
8	Capital One	24
10	Audax Private Debt	23
11	MidCap Financial	21
12	Twin Brook Capital Partners	20
13	Monroe Capital	19
13	Crédit Suisse	19
15	Jefferies Group	18
15	Golub Capital	18
15	Citizens Bank	18
15	Crescent Capital	18
19	NXT Capital	17
19	Truist	17
21	The Goldman Sachs Group	15
22	PNC	14
23	Varagon Capital Partners	13
24	Barclays	12
24	The Carlyle Group	12

Source: PitchBook

Select roles*

1	Antares Capital	42
2	BMO Financial Group	27
3	Madison Capital Funding	25
4	Capital One	21
5	Twin Brook Capital Partners	19
5	Churchill	19
7	Barings	15
7	Bank of America	15
7	Citizens Bank	15
10	Crédit Suisse	14
10	Ares	14
10	MidCap Financial	14
13	Varagon Capital Partners	12
13	PNC	12
15	NXT Capital	11
15	Golub Capital	11
15	Jefferies Group	11
18	Morgan Stanley	10
18	Crescent Capital	10
18	Audax Private Debt	10
21	Monroe Capital	9
21	Truist	9
21	UBS Group	9
24	Barclays	8
24	Fifth Third Bank	8

Source: PitchBook. *Select roles comprise only bookrunners, lead arrangers, mandated lead arrangers, and all types of agents that are specifically listed within PitchBook.

Updated on July 26, 2021. The original data pull did not include Agent tags on select roles properly, thereby underreporting certain submitters. The new data pull changes rankings including the number one most active firm. The updated report takes into account reliable new information that was submitted since the table published, but took place in the time frame indicated.