

Middle Market Update

Q2 2018



**BRYANT PARK
CAPITAL**

www.bryantparkcapital.com

NEW YORK
489 Fifth Avenue
16th Floor
New York, NY 10017
212-798-8200

PHILADELPHIA
161 Washington Street
Suite 310
Conshohocken, PA 19428
484-586-8200



Gross Domestic Product

- The real U.S. GDP increased by an annualized rate of 4.1% in Q2 2018, up from the 2.2% rate in Q1 2018, primarily due to¹:
 - Positive contributions from non-residential fixed investment, personal consumption expenditures, exports, and federal, state, and local spending, partly offset by
 - Negative contributions from private inventory investment, residential fixed income, and increases in imports

Consumer Income and Savings

- Real disposable personal income grew by 2.6% in Q2 2018, a decline from the 4.4% growth in Q1 2018¹
 - Compensation, government social benefits, and personal interest income decelerated in Q2 2018, which were somewhat offset by accelerations in personal dividend income and an upturn in farm proprietors' income
- The personal savings rate, expressed as a percentage of disposable income, was 6.8% in Q2 2018, down from 7.2% in Q1 2018¹

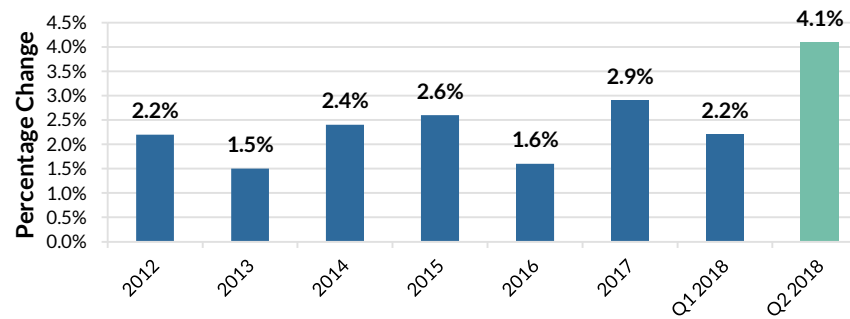
Federal Reserve

- The Federal Open Market Committee (FOMC) views recent economic activity as positive, as evidenced by the continued strengthening of the labor market and rising economic activity, including gains in household spending and business fixed investment
 - During its August 2018 meeting, the FOMC decided to maintain the target range for the federal funds rate between 1.75% and 2.00%
- The committee expects that the near-term economic outlook will remain favorable, fueled by sustained expansion of economic activity, stable inflation, and strong labor markets²

Employment

- The U.S. unemployment rate remained at 4.0% at the end of Q2 2018, leaving the total number of unemployed unchanged at 6.6 million³
- Average U.S. employee hourly wages rose by 0.5% from Q1 2018 to Q2 2018³
 - As the gap between the number of available jobs and unemployed persons continues to narrow, upward pressure on wages is rising
 - This pressure has been partially mitigated by the decline of unions, decrease in productivity growth, and improvements in technology and automation

Real GDP Growth Since 2012 (annualized)



Source: U.S. Bureau of Economic Analysis

U.S. Treasury Securities

- The 10-year U.S. Treasury Note yield increased from 2.74% at the end of Q1 2018 to 2.95% at the end of Q2 2018⁴

	Q3 2017	Q4 2017	Q1 2018	Q2 2018 ⁵
5-year Treasury Note	1.85%	2.10%	2.56%	2.79%
10-year Treasury Note	2.29%	2.40%	2.74%	2.95%
30-year Treasury Note	3.00%	2.97%	2.97%	3.16%
10-year Treasury (Inflation Protected)	0.45%	0.50%	0.69%	0.79%

Outlook for 2018

- Leading CEOs surveyed by Business Roundtable projected that the U.S. GDP will grow by 2.7% in 2018, a slight decrease of 0.1% from the previous quarter's forecast⁶
 - Due to increasing concerns regarding the Trump Administration's approach to trade, business leaders have exhibited less confidence, as plans for hiring and capital investment have dropped slightly
- The U.S. Office of Management and Budget revised its budget deficit forecast from earlier in the year to reflect nearly \$1 trillion of additional debt over the next decade; corporate tax payments fell in H1 2018 by a third from the same period last year to a 75-year low as a share of the economy⁷
- The International Monetary Fund predicts that the global economy will increase by 3.1% in 2018 and then expand gradually over the next two years, as accelerated economy growth decelerates and the recovery in developing and emerging economies levels off⁸

1. U.S. Bureau of Economic Analysis

4. Baird

7. U.S. Office of Management and Budget and U.S. Treasury Department

2. U.S. Federal Reserve

5. U.S. Department of Treasury

8. The World Bank

3. Bureau of Labor Statistics

6. Business Roundtable

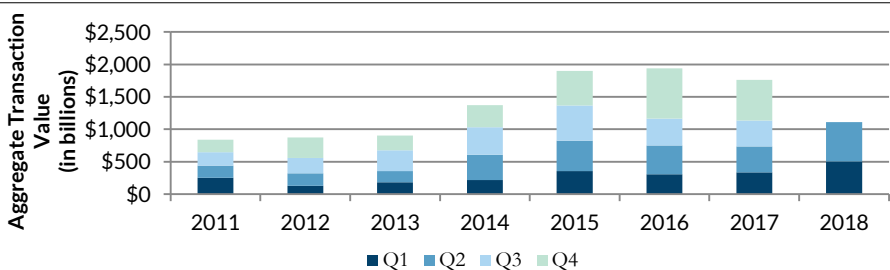
Bryant Park Capital

Mergers and Acquisitions and Private Equity



- Global mergers and acquisitions (M&A) activity reached \$1.94T across 8,560 transactions in the first half (H1) of 2018; Q2 deal value alone reached \$1.01T¹
 - Q1 2018's momentum carried over, pushing global M&A in H1 2018 to an H1 post-economic-crisis record, with Q2 2018 becoming just the fourth quarter to reach the \$1.0T mark since the 2007-08 crisis
 - The robust activity can be attributed to abundant cash and relatively inexpensive debt financing, as well as pressure on traditional companies to execute more spin-offs, divestitures, and transformational acquisitions to compete with newer, more innovative firms
- U.S. M&A value reached \$807.9B in H1 2018, an increase of 15.9% from \$697.1B in H2 2017 and 31.1% from \$616.3B in H1 2017; however, the total deal count decreased by 8.7% from H2 2017 and by 10.2% from H1 2017 to a 2,593 total in H1 2018¹
 - Various established industry giants, forced to innovate by newer disrupters, continue to pay high prices for the most valuable acquisition targets; as a result, the average value for disclosed deals in H1 2018 jumped 51.4% to \$736.7M from H1 2017
 - Deals with exceptionally high values are likely to persist in the coming quarters with a number of large transactions already announced, including the \$67B acquisition of Express Scripts by Cigna
 - Indicators that can impact access to financing, such as business sentiment, corporate fundamentals, and macroeconomic forces, continue to trend upward, pointing toward the global M&A boom persisting
- Cross-border M&A activity grew by 11.6% in H1 2018 to \$740.3B, as compared to \$663.4B in H1 2017¹
 - Despite the growth in cross-border M&A, the transaction value of M&A with China plunged by 94.3% from a high in 2016 due to increased trade tensions and government scrutiny

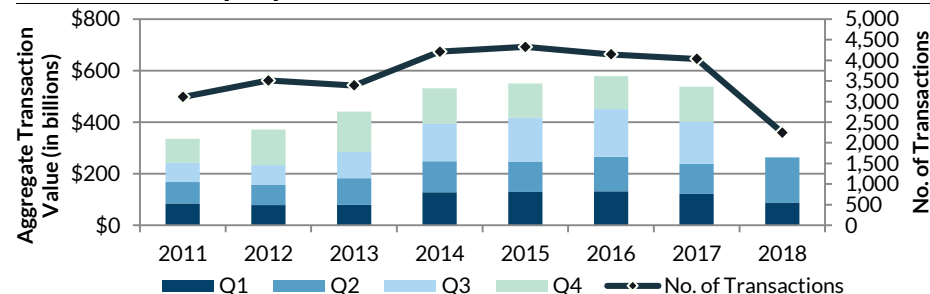
U.S. M&A Activity



Source: FactSet

1. Mergermarket
2. PitchBook
3. Preqin
4. FactSet
5. These multiples reflect prices paid for mainly public companies and do not account for smaller private company transactions that tend to change hands at much lower multiples
6. GF Data

U.S. Private Equity Deal Flow



Source: PitchBook

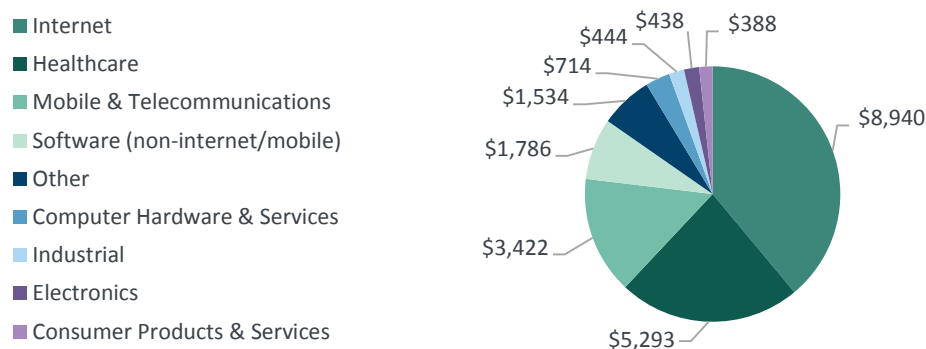
- U.S. private equity (PE) deal value was \$263.9B across 2,247 deals in H1 2018, representing a 2.0% increase in volume and a 5.6% decrease in value compared to H1 2017²
 - Activity continues to be driven by easy access to credit and sustained strength in fundraising that have resulted in a buildup of dry powder (\$1.1T globally)³
- U.S. middle-market PE firms completed 1,358 deals worth \$178.5B in H1 2018, an increase of 16.5% and 4.8%, respectively, as compared to H1 2017²
 - The number of PE-backed middle-market companies has continued to swell; the expansion of the industry can also be seen by the increase of total fund capital, which has eclipsed \$300B in the U.S. during three out of the past four years and is on pace to do so again in 2018
 - Funds, deals, and exits all are increasing in size, while purchase-price multiples remain elevated
- Middle-market PE firms raised \$61.4B across 73 funds in H1 2018, representative of the strong PE fundraising environment²
 - Fundraising figures are expected to remain solid through year-end, with 38 buyout funds currently seeking at least \$1 billion
 - The average middle-market fund size was \$841 million in H1, a 25.7% increase over the \$669 million average in full-year 2017 and exceeding the high-water mark of \$786 million set in 2009
- Median EV/EBITDA multiples reached 9.3x in Q2 2018^{4,5}
 - For PE-led transactions between \$10 million and \$250 million, the median EV/EBITDA multiple was 7.4x in Q1, up from 6.9x in Q1; the size premium for larger versus smaller deals in this range hit a record high 3.4x⁶
- After exits got off to a slow first quarter in 2018, activity picked up in Q2 with 183 exits worth \$14.8 billion, bringing the H1 total to 393 exits worth \$29.2 billion, compared with 476 totaling \$43.7 billion in H1 2017²
 - Secondary buyouts and corporate acquisitions have accounted for 51% and 47%, respectively, of middle-market exit volume to date



Venture Capital Investing

- In Q2 2018, transactions for U.S. venture capital (VC)-backed companies totaled 1,416 valued at \$23.0B, an increase in volume of 9.2% and in value of 2.7% compared with Q1 2018¹
 - The rise in volume can be partially attributed to the increase in funding from nontraditional investors, such as private equity and family offices, which are investing in sophisticated early-stage investments that have reported revenues and scalable business models²
 - VC-backed companies have satisfied their capital needs in the private markets rather than raising public funds, thereby increasing the value of VC transactions as these companies continue to grow²
 - Mega-round investment (capital raise rounds of \$100M or more) activity for U.S.-based companies saw a record quarter with 45 deals, a 28.6% increase compared with Q1 2018¹
- Corporate VC participation has continued at a brisk pace, with \$13.5B invested over 403 deals in Q2 2018, a year-over-year increase in value of 104%²
 - Due to increasing competition from agile startups as well as tailwinds from the recent tax reform legislation, corporations have become more willing to engage with startups directly, whether through partnerships, acquisitions, or corporate VC investments
- In response to tighter national security reviews, trade tensions, and a continued thirst for new technologies, China is shifting its U.S. deal focus to VC investing, which totaled \$2.4B through May 2018, already reaching the previous full-year record³

U.S. VC Deal Value per Industry (in millions) – Q2 2018



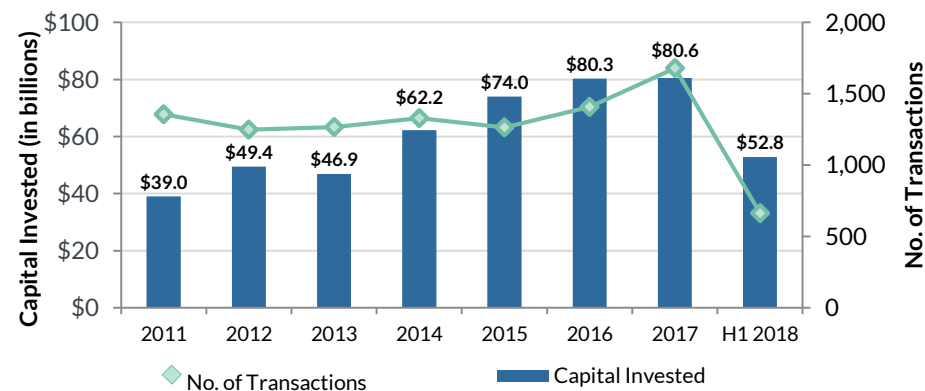
Source: MoneyTree Report

1. PricewaterhouseCoopers
 2. PitchBook
 3. Rhodium Group
 4. The Deal
 5. FactSet

PIPE Investing

- There were 312 private-investment-in-public-equity (PIPE) deals that closed in Q2 2018, almost a 40% year-over-year increase in total capital raised⁴
 - With the rising interest rate environment, real estate investors, particularly REITs, are lining up capital ahead of their needs, which has largely contributed to the significant capital raised
- The real estate sector generated the most amount of capital raised at almost \$6.5B in Q2 2018, followed by the industrial sector at nearly \$6.2B and the technology sector at almost \$2.2B⁴

U.S. PIPE Activity



Source: DealFlow Report

Corporate Earnings

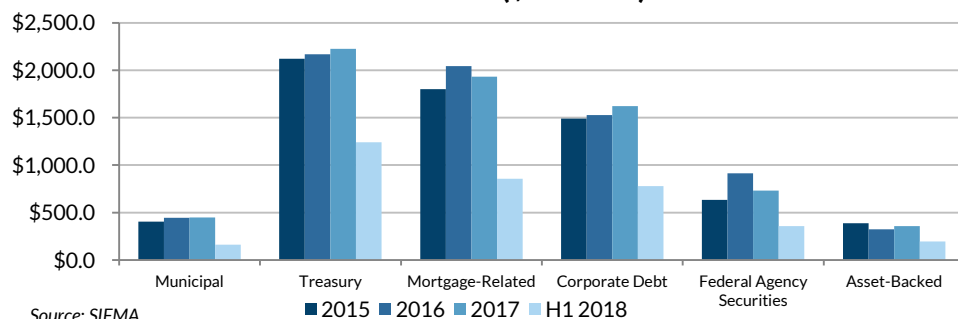
- S&P 500 company earnings for Q2 2018 are on pace to jump 21.3% year-over-year, which would mark the second highest increase since Q3 2010⁵
 - The energy sector is reporting the highest earnings growth of all followed sectors at 124.3%, due to a combination of rising oil prices and a comparison to unusually low earnings in Q2 2017
 - Amazon in the consumer discretionary sector was the largest contributor to the increase in the overall earnings growth rate, followed by Gilead Sciences, Bristol-Myers Squibb, and Eli Lilly in the healthcare sector



Debt Capital

- The Barclays U.S. Aggregate Bond Index recorded a 0.16% loss during Q2 2018, an increase from the 1.46% loss in Q1 2018¹
 - Investors are becoming increasingly wary as the fears on the trade and political fronts were realized in Q2 2018, draining liquidity from the market and ultimately leading to increased volatility; however, this pressure has been partially mitigated by a stronger dollar and expansive second quarter economic growth in the U.S.
- The Barclays Investment Grade U.S. Corporate Bond Index generated a loss of 0.98% in Q2 2018, above the 2.23% loss in Q1 2018¹
 - As in Q1, sentiment in the investment-grade corporate bond market remained mixed with strong fundamentals and generally healthy technicals, overshadowed by fears of a tighter Fed policy, trade wars, and political unrest
 - In the new issue market, activity picked up during the quarter with an increase in long-term maturities amid a flatter yield curve; investor demand also remained healthy with most new issues oversubscribed
- Total U.S. bond issuances reached \$1,838B in Q2 2018, a 4.9% increase from the Q1 2018 level of \$1,752.0B and a 1.7% decrease year-over-year from the Q2 2017 level of \$1,869.4B²
 - U.S. corporate debt issuances were down 14% this year through April 2018, while equity underwriting was up 3.2%, in part due to the effect of interest deduction caps in the new tax bill^{2,3}
 - The largest contributing factor to this increase was the expansion in municipal and U.S. Treasury bond issuances, which rose 49.6% and 14.2%, respectively, to a total of \$97.1B and \$662.5B, respectively
 - U.S. corporate bond issuances in Q2 2018 edged up slightly relative to Q1 2018, driven by an increase in investment-grade debt, which has accounted for 69% of issuances this year; high-yield debt added \$15B in Q2, but is down 28% year-over-year

Issuances in the U.S. Bond Market (\$ billions)



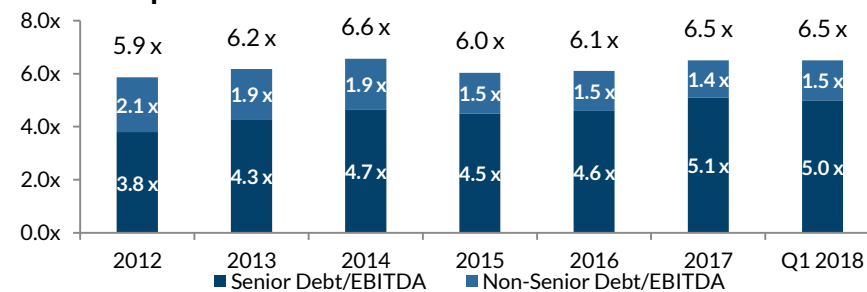
Middle-Market Lending

- Total U.S. middle-market lending in Q2 2018 was \$48B, a 14.3% increase from the prior quarter's issuance level of \$42B³
 - The new issuances were most pronounced in the larger segment of the middle market (\$100M to \$500M), accounting for 86% of Q2 2018 volume
 - The average new-issue yield for Q2 2018 was 7.50%, which is 90bps higher than it was in Q1 2018 and 100 bps higher than it was in Q2 2017
 - There has been \$16.65B of institutional loan default debt for the year to date, as compared to \$15.21B in 2017 over the same period
 - The trailing 12-month default rate was 2.3%, an uptick from the 1.9% in 2017 during the same period
- Lending activity remained high, with U.S. leveraged loan year-to-date volume at \$811B, as compared to last year's year-to-date record issuance of \$835B over the same period³
 - The technology sector continued to lead the way for new issuance volume, comprising \$110B or 13.6% of the total

IPO Market

- The first half of 2018 saw the highest level of proceeds for the first half of a year since H1 2015, with \$94.3B in proceeds; H1 2018 experienced a 5% increase from the prior year, while the first half's 660 IPOs marked a 21% decrease from the activity in H1 2017⁴
 - Risks and uncertainties returned to the IPO market in Q2 2018, as geopolitical frictions and shifting trade policies softened IPO confidence in many parts of the world

Debt Multiples of Middle-Market LBO Loans



1. Prudential
2. SIFMA
3. Thomson Reuters LPC

4. Ernst & Young



The Tax Cuts and Jobs Act (TCJA) made widespread changes to the U.S. Tax Code. Many of those changes will reduce tax liabilities, such as lowered tax rates and enhanced business deductions. Other deductions, such as business interest expense, will now be subject to new limitations. These changes also affect many aspects of M&A transactions, including business entity selection, financing considerations, and purchase price allocation considerations.

Entity choice considerations

Historically, pass-through business entities were often preferred for M&A transactions since they only resulted in the imposition of a single level of taxation to the owners and more easily provided for increases to the tax basis of assets inside target companies. In certain circumstances, C corporations were beneficial and corporations were also utilized further up the chain of ownership as blocker entities.

The TCJA has altered the entity choice analysis due to several key changes:

- The corporate tax rate has been reduced from a maximum of 35 percent to a flat 21 percent.
- A new 20 percent deduction has been created for individuals and trusts with respect to qualified business income, which is generally ordinary income from trade or business activity effectively connected with the United States.
- The tax brackets for individuals have been widened and the top incremental rate lowered to 37 percent.
- State and local taxes, including allocations from pass-through entities, are subject to limitations at the individual and trust level, but such taxes continue to be fully deductible by C corporations.
- Many changes were made to the U.S. treatment of foreign activities.

In light of these changes, parties on both the buy and sell sides of a transaction will need to consider whether a C corporation or a pass-through entity structure is best suited to satisfying their objectives. Making a proper determination of the ideal entity structure requires a holistic view – not only an analysis of the tax burdens on operating income, distributions, and exit transactions, but also an analysis of legal and practical business considerations, which may not have changed.

In general, if the business will distribute significant amounts of earnings in the near future, a pass-through entity structure will likely be more beneficial. That analysis is further enhanced if the business activity is eligible for the 20 percent qualified business income deduction. Conversely, if the business intends to retain significant earnings to fund growth, then the lowered corporate rate will provide meaningful benefits. Additionally, the impact of changes to the treatment of foreign business activity and state and local tax deductions can swing the analysis in a meaningful way.

As a practical matter, it's relatively simple to transform pass-through entities into C corporations, but it is much more difficult to transfer assets and built-in gains out of a C corporation.

Buyer/seller considerations

When approaching M&A transactions the buyer and seller typically have divergent interests. The seller generally would prefer to sell corporate stock or to maximize purchase price allocations to properties generating long-term capital gains. Conversely, the buyer normally would prefer to purchase the underlying assets of the business (either directly or through a deemed asset transaction) and to maximize allocations to assets that offer the shortest path to cost recovery.

The TCJA has altered the positions of buyers and sellers in the following ways:

- The effective tax rates on operating business income have been reduced, but tax rates applicable to dividends and long-term capital gains remain unchanged.
- Bonus depreciation was increased to 100 percent for new and used assets until 2022.
- Business interest expense deductions are subject to new limitations, including a cap equal to 30 percent of tax basis Earnings Before Interest Depreciation and Amortization through 2021 and 30 percent of tax basis Earnings Before Interest thereafter.

The TCJA didn't alter the general preferences of the parties in a transaction, but it did adjust their modeling. In particular, the potential availability of 100 percent bonus depreciation on used equipment significantly increases the preference of a buyer for an asset acquisition with large allocations of purchase price to fixed assets.

The reduction in effective tax rates on business income impacts both the buyer and seller. From the seller's perspective, the reduced tax costs on an asset type



of transaction may result in lower demands for a tax gross-up payment. On the other hand, the lower tax rates on operating income reduce the cash value of tax attributes, including amortization deductions that are acquired in an asset acquisition.

The new limitations on business interest expense deductions may also impact the cost of debt-financed acquisitions, resulting in the suspension of tax deductions until the business creates excess income or until the business is sold. In some cases, the interest might not even be deductible at all to the company but rather carry forward to buyers after an exit transaction. As a result, these limitations may increase the after-tax cost of significantly leveraged M&A transactions.

Buy-side tax due diligence

Changes made by the TCJA can also impact a buyer's approach to conducting tax due diligence on target companies. The following items should be considered:

- There is a one-time tax on the deemed repatriation of foreign earnings, for which an election can be made to pay the tax in eight installments.
- Net operating losses (NOLs) are subject to new limitations, with the elimination of NOL carrybacks, removal of the expiration date for carryforwards, and new limitation for the use of NOL carryforwards equal to 80 percent of taxable income in any year.
- The enhanced bonus depreciation requires additional analysis related to fixed assets.
- States may modify their laws to compensate for federal changes.

It will be important for buyers to understand how these items impact the amount of tax payments due currently or in the future. Has the target accounted for those changes in the information disclosed? Are there any concerns about improper tax positions or reporting on recently filed tax returns?

Most states that have a corporate income tax start their calculation with federal taxable income. Many states among that group have already started efforts to modify their laws to make sure that not all of the federal changes will reduce state taxable income. Tax due diligence needs to account for the potential effect of changes in every state where the target is required to file an income tax return.

With any change in tax law, the early days after enactment tend to be filled with more questions than answers. We've provided a very high-level look at how some of the provisions of the new law may affect the deal space, but there's still considerable detail to be filled in by IRS guidance.

About the author

Plante Moran is among the nation's largest certified public accounting and business advisory firms. It provides clients with audit; tax; risk management; financial, technology, and business consulting; and wealth management services. Whether a client has a single, specific need or requires comprehensive services on a worldwide scale, Plante Moran has the knowledge, experience, and resources to meet the client's goals.



EXECUTIVES & PRINCIPALS

Joel Magerman
Managing Partner

Raymond Kane
Managing Director

Matt Pennino
Managing Director

Dan Avnir
Managing Director

LOCATIONS

NEW YORK CITY
489 Fifth Avenue
16th Floor
New York, NY 10017
212-798-8200

PHILADELPHIA
Eight Tower Bridge
161 Washington Street
Suite 310
Conshohocken, PA 19428
484-586-8200

PLEASE VISIT

www.bryantparkcapital.com

Member [FINRA](#) / [SIPC](#)

Selected Transactions

<p>\$250,000,000</p> <p>DIVIDENDSOLAR has merged with Figtree FINANCING</p> <p>and secured equity and debt financing affiliates of LL Funds, LLC</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$150,000,000</p> <p>MoneyLion</p> <p>Senior Secured Credit Facility</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$31,000,000</p> <p>ReMeD has been acquired by US Community Behavioral a portfolio company of BregalPartners</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$95,600,000</p> <p>US HOME SYSTEMS (NASDAQ:USHS) has been acquired by TRUE HOME MORTGAGE (NYSE:HD)</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$240,000,000</p> <p>J.G. WENTWORTH has sold a majority stake in the company through a leveraged buyout transaction to JLL Partners</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>
<p>\$50,000,000</p> <p>PAWNEE LEASING CORPORATION a Chatham Group Limited company</p> <p>Term-Out Facility</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>Up to \$50,000,000</p> <p>THRIVEST™</p> <p>Senior Credit Facility</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$20,000,000</p> <p>ADF APPLIED DATA FINANCE</p> <p>Mezzanine Debt</p> <p>CO-ADVISER</p>	<p>Amount Not Disclosed</p> <p>MDAligne has merged with Angelrush VENTURES to form HealthRight</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$30,000,000</p> <p>FOX POINT TRUCKS</p> <p>Credit Facility</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>
<p>\$60,000,000</p> <p>Northern Leasing Systems, LLC Excelling at service. Exceeding expectations.</p> <p>Senior Secured Credit Facility</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>Amount Not Disclosed</p> <p>123 LUMP SUM</p> <p>Private Placement of Preferred Stock with GCP Capital Partners</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>Amount Not Disclosed</p> <p>Frankford FRANKFORD CANDY & CHOCOLATE CO., INC. has sold its business operations and real estate to Frankford. FRANKFORD CANDY LLC a company formed by Management and a Strategic Partner</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>Amount Not Disclosed</p> <p>QUANTUM CLEAN has acquired the assets of Chamber Performance Services a division of APPLIED MATERIALS. (NASDAQ:AMAT)</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$150,000,000</p> <p>GOLDEN PEAR FUNDING</p> <p>\$100,000,000 Senior Secured Credit Facility \$50,000,000 Additional Commitment</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>
<p>\$200,000,000</p> <p>ENTERRA ENERGY TRUST Oil & Gas Income Trust (NYSE:ENT and TSX:ENTUN)</p> <p>Senior and Junior Secured Credit Facilities</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$185,000,000</p> <p>glori ENERGY has merged with INFINITY CROSS BORDER ACQUISITION CO. (NASDAQ: INXBU)</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$20,000,000</p> <p>ADF APPLIED DATA FINANCE</p> <p>Mezzanine Debt</p> <p>CO-ADVISER</p>	<p>\$140,000,000</p> <p>EnergySouth (NASDAQ NMS: ENS) & FORTRESS have acquired MISSISSIPPI HUB LLC</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$278,000,000</p> <p>i-trax NASDAQ NMS: ITRX AMEX: DMX has been acquired by Walgreens</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>

The information in this newsletter is believed by Bryant Park Capital to be accurate and current and comes from reliable sources. However, unintentional errors may occur. With this being said, the information is "as is" and without any representation or warranty of any kind, implied or expressed. Reproduction, retransmission, republication, or use of any of this document is prohibited.