

# *Middle Market Update*

Q1 2019



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### Federal Reserve Perspective and Inflation

- The Federal Open Market Committee (FOMC) views recent economic activity as positive, as evidenced by the continued strengthening of the labor market and robust economic activity, along with the low unemployment rate<sup>1</sup>
  - During its March 2019 meeting, the FOMC decided to maintain its target range for the federal funds rate at 2.25% to 2.50%
- The committee expects that the near-term economic outlook will remain favorable, fueled by a sustained expansion of economic activity, stable inflation, and strong labor markets<sup>1</sup>
- The U.S. Consumer Price Index (CPI) rose by 0.2% in February and 0.4% in March after remaining unchanged during the previous three months; there was a 1.9% increase for the 12-month period that ended in March<sup>2</sup>

### Employment

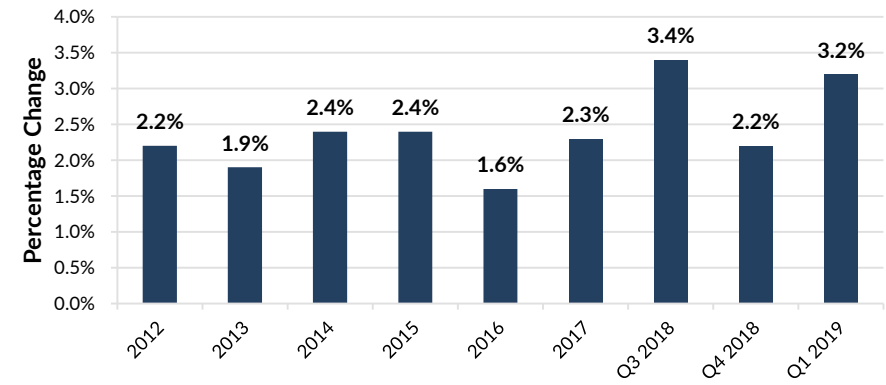
- The U.S. unemployment rate decreased slightly to 3.8% at the end of Q1 2019, as compared to 3.9% at the end of Q4 2018, with the number of unemployed persons at 6.2M<sup>2</sup>
- U.S. employers added 196,000 jobs to their payrolls in March, an impressive jump from the 33,000 jobs added in February<sup>3</sup>
  - The most notable job gains occurred in health care and in professional and technical services<sup>2</sup>
- The average U.S. employee hourly earnings rose by 29 cents or 1.1% in Q1 2019 to \$27.77<sup>2</sup>
- In recent months, over 70% of people securing jobs had not been counted as unemployed the previous month, which is well above historical levels and indicates the strong labor market is attracting people off of the sidelines<sup>4</sup>

### U.S. Treasury Securities

- The 10-year U.S. Treasury Note yield decreased from an average of 3.04% in Q4 2018 to an average of 2.65% in Q1 2019<sup>5</sup>

	Q2 2018	Q3 2018	Q4 2018	Q1 2019 <sup>5,6</sup>
5-year Treasury Note	2.79%	2.81%	2.88%	2.46%
10-year Treasury Note	2.95%	2.92%	3.04%	2.65%
30-year Treasury Note	3.16%	3.06%	3.27%	3.01%
10-year Treasury (Inflation Protected)	0.79%	0.81%	1.06%	0.79%

### Real Gross Domestic Product (GDP) Growth Since 2012



Source: U.S. Bureau of Economic Analysis

### Outlook for 2019

- Leading CEOs surveyed by Business Roundtable project that the U.S. GDP will grow by 2.5% in full-year 2019, which is lower than the previous quarter's forecast of 2.7%<sup>7</sup>
  - Q1 2019 marks the fourth consecutive quarter in which CEOs' expectations for GDP growth fell, which is primarily due to concerns over trade disputes, trade barriers, and increasing labor costs
- The Congressional Budget Office forecasts a budget deficit of \$896B for fiscal year 2019, up sharply from the \$779.0B deficit incurred in fiscal year 2018<sup>8</sup>
  - The budget deficit is expected to exceed \$1.0T each year beginning in 2022 and average 4.3% of GDP
  - While revenues and outlays both are projected to increase, the enduring gap between them would expectedly drive up budget deficits and debt
- The U.S. consumer confidence index declined to 124.2 in March, down from 131.4 in February, but above the low level of 121.7 in January<sup>9</sup>
- Global economic growth projections were downwardly revised from 3.0% in 2018 to 2.9% in 2019<sup>10</sup>
  - The easing global growth forecast is due to a decrease in demand for exports, tightening global financing conditions, and elevating trade tensions

1. U.S. Federal Reserve

2. Bureau of Labor Statistics

3. The Wall Street Journal

4. The New York Times

5. U.S. Department of Treasury

6. Federal Reserve Economic Data

7. Business Roundtable

8. Congressional Budget Office

9. The Conference Board

10. World Bank Group

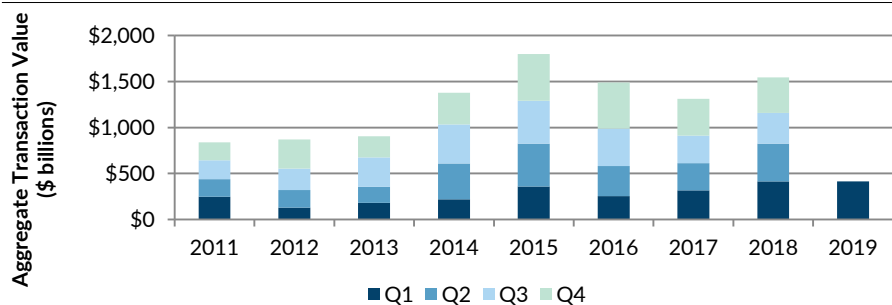
# Bryant Park Capital

## Mergers and Acquisitions and Private Equity



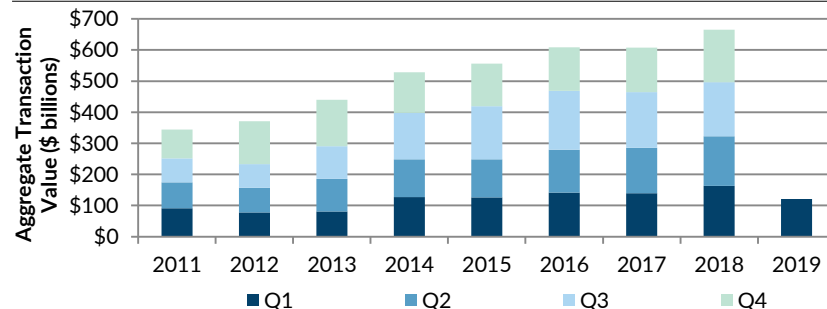
- Global mergers and acquisitions (M&A) activity totaled \$801.5B during Q1 2019, a 15.1% decrease in deal value compared to Q1 2018; over the same period, the deal count dropped 30.0% to 3,558<sup>1</sup>
  - Q1 2019 experienced a decline in M&A value and volume as strategic acquirers cautiously navigated market volatility, geographical tensions between the U.S. and China continued, Brexit concerns persisted in Europe, and economic headwinds rose
  - Growing cash reserves, technology disruption, and slowed growth in emerging markets will continue to lead companies to pursue M&A strategies
  - However, the market stress from last year remains, and acquisition targets today generally are more expensive than they were during previous M&A peaks, making it more challenging to identify and close on attractive deals<sup>2</sup>
- U.S. M&A value logged in at \$414.2B in Q1 2019, a decrease of 0.3% as compared to Q1 2018; 1,081 transactions were posted in Q1 2019, the lowest for one quarter in half a decade<sup>1</sup>
  - Despite the drop in deal count in Q1 2019, U.S. M&A activity was buffeted by numerous, multi-billion, empire-building mergers, such as Bristol-Myers Squibb's \$89.0B acquisition of Celgene – the largest biopharmaceutical transaction ever recorded in the U.S.
  - The BMS / Celgene deal illustrates a continued sense of optimism toward M&A as a viable growth strategy<sup>3</sup>
  - Healthy domestic M&A trends are evidenced by the fact that 76% of M&A executives at U.S.-headquartered companies anticipate their organizations will close more transactions in 2019 than in previous years<sup>3</sup>
- Cross-border M&A accounted for only 30.8% of global M&A in Q1 2019 (\$246.9B), as compared to the average of 39.0% between 2015 and 2018, further illustrating regulatory obstacles<sup>1</sup>
  - Large cross-border M&A deals that propelled activity in previous years have drastically shrunk during the past year, with only nine mega-deals closing in Q1 2019, as compared to 14 mega-deals having closed in Q1 2018

### U.S. M&A Activity



Source: Mergermarket and FactSet

### U.S. Private Equity Deal Flow



Source: PitchBook

- After four consecutive years of growth in global buyout activity, private equity (PE)-led transactions saw a decline in deal value and volume in Q1 2019; PE firms closed 993 deals worth \$121.4B, representing year-over-year declines of 27.9% and 26.7%, respectively<sup>3</sup>
  - Competition from strategic acquirers, relatively lofty valuations, market volatility, and potential trade wars all contributed to the softer market
  - Ample cash (dry powder), relatively low interest rates and high debt availability, and aggressive add-on acquisition strategies portend a rebound during the rest of the year in sectors not heavily impacted by tariffs
- U.S. middle-market PE deal activity also experienced a sluggish start to the new year, as PE firms closed 649 deals totaling \$75.1B in Q1 2019, representing year-over-year declines of 17.9% and 32.6%, respectively<sup>3</sup>
  - The median deal size for Q1 2019 was \$155.0M, 19.3% below that of full-year 2018
- U.S. middle-market PE firms raised \$25.7B in Q1 2019, comprising 56.6% of U.S. PE fundraising capital, down from 62.6% in 2018<sup>3</sup>
- During Q1 2019, buyout funds remained the most sought-after strategy among PE investors, with 69% expecting to commit to these funds in the year ahead over other fund types, such as venture capital, growth, turnaround, and secondary funds<sup>4</sup>
- Dry powder has reached a new record of \$1.3T, as the growing number of strategic buyers and relatively high valuations have made it more challenging for U.S. PE firms to compete and deploy funds
- There are currently 7,800 PE-owned companies in the U.S., up 65% since 2010<sup>5</sup>
  - As PE firms become an even larger player in the U.S. economy, they will become even more competitive with strategic buyers for add-on acquisitions
- For PE-led transactions between \$10.0M and \$250.0M, total enterprise value multiples ranged between 3.0x to 15.0x trailing 12-month adjusted EBITDA and averaged 7.2x, essentially in line with 7.3x in the prior year<sup>6</sup>

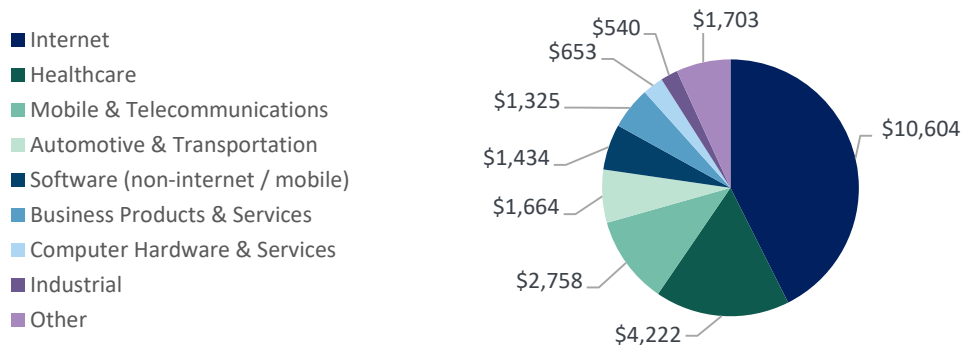
1. Mergermarket  
 2. Willis Towers Watson  
 3. Pitchbook  
 4. Preqin  
 5. Milken Institute  
 6. GF Data



### Venture Capital Investing

- In Q1 2019, transactions for U.S. venture capital (VC)-backed companies totaled 1,279 valued at \$24.6B, a decrease in volume of 16.1% but an increase in value of 7.9%, as compared with Q1 2018<sup>1</sup>
  - The venture capital markets saw a sharp decrease in seed-stage deal share from 30% to 24% year-over-year, while the later-stage median deal size increased for the second consecutive quarter in Q1 2019, reaching \$40.0M
  - Although the \$9.6B in raised capital during Q1 2019 did not match the record-breaking quarterly fundraising activity in 2018, capital raising for VC is expected to remain robust in 2019 as more prominent firms – including Khosla Ventures, Andreessen Horowitz, New Enterprise Associates, and Vivo Capital – launch fund raises with ambitious targets throughout the year<sup>2</sup>
  - The highest growth by amount of funds raised in Q1 2019 came from funds between \$250M and \$500M; funds of this size represented 21.6% of total fundraising during in Q1 2019, up significantly from 13.7% in 2018<sup>2</sup>
- U.S. corporate VC participation continued its upward trend that started in 2018, totaling \$19.4B across 316 deals in Q1 2019<sup>2</sup>
  - Corporate VC activity, as a share of overall VC activity, has reached a new high, increasing from 52.7% of deal value in full-year 2018 to 59.6% in Q1 2019
  - The rapidly growing figure can be attributed, in part, to corporate investors becoming increasingly invested in large rounds at later stages, driving the trend of VC-backed companies staying private for longer than they have historically
- Global VC deal volume declined for the fourth consecutive quarter with only 2,657 deals – the lowest number in 31 quarters<sup>3</sup>
- Global VC investment also has fallen from record heights of \$71.0B in Q4 2018 to \$53.0B in Q1 2019 largely due to a decline in Chinese investment<sup>3</sup>

### U.S. VC Deal Value per Industry (\$ millions): Q1 2019



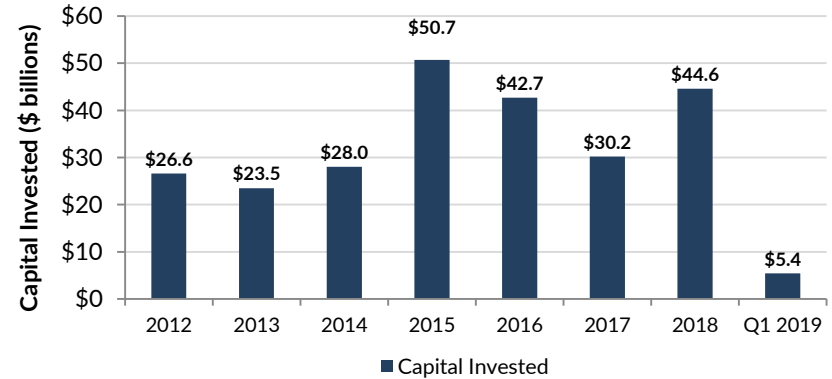
Source: MoneyTree Report

- |                           |                      |
|---------------------------|----------------------|
| 1. PricewaterhouseCoopers | 4. Placement Tracker |
| 2. PitchBook              | 5. CNBC              |
| 3. KPMG                   | 6. FactSet           |

### PIPE Investing

- There were 235 U.S. private-investment-in-public-equity (PIPE) transactions valued at \$5.4B that closed in Q1 2019, a 5% increase in deal volume, but a 30% decline in total capital raised compared with the same period in 2018<sup>4</sup>
  - Biotech and cannabis companies are expected to drive the 2019 PIPE market

### U.S. PIPE Activity



Source: Placement Tracker

### Corporate Earnings

- The S&P 500 registered its best quarterly start to a year since 1998, surging 13.1% in Q1 2019<sup>5</sup>
  - The outperformance came as a result of the Federal Reserve's softening of its interest rate policy stance and increasing optimism about the trade negotiations between the U.S. and China
- S&P 500 company earnings for Q1 2019 are expected to fall by 0.5%, which would mark the first year-over-year decline in earnings for the index since Q2 2016<sup>6</sup>
  - More than 90% of companies have reported earnings during Q1 2019 thus far, with 76% having had a positive EPS surprise and 59% having had a positive revenue surprise
  - According to Q2 2019 earnings predictions, 65 S&P 500 corporations have issued negative EPS guidance and 17 S&P 500 companies have issued positive EPS guidance



### Debt Capital

- The Barclays U.S. Aggregate Bond Index recorded a 2.94% gain during Q1 2019, an increase from the 1.64% gain in Q4 2018<sup>1</sup>
  - Concerns about the impact of tightening economic conditions on corporate earnings growth and equity performance have continued, but with risk assets significantly improving from a poor performance in Q4 2018, investors are looking to slightly rebalance their portfolios into riskier fixed-income markets
- The Barclays Investment Grade U.S. Corporate Bond Index gained 5.14% in Q1 2019, following a 0.18% loss in Q4 2018<sup>1</sup>
  - In the first quarter of the year, U.S. corporate bonds delivered 273 bps in excess return as compared to similar-maturity U.S. Treasuries
    - Long-term BBB corporates posted the strongest returns
  - New corporate debt issuances increased in Q1 2019 due, in part, to continued demand from companies looking to fund M&A deals and share buy-backs as well as new demand from non-U.S. buyers looking for low-cost currency hedge strategies
  - Despite the expectations for continued economic growth and tailwinds from corporate tax reform, corporate bond issuance for the remainder of 2019 is expected to fall due to new tax rules that incentivize companies to hold less debt
- Total U.S. bond issuances for Q1 2019 were \$1,617.3B, a 5.7% decrease from the Q4 2018 level of \$1,715.1B, and a 9.7% year-over-year decrease from the Q1 2018 level of \$1,790.2B<sup>2</sup>
  - U.S. bond issuances across mortgage-related and asset-backed debt securities drove the decline from Q4 2018 to Q1 2019
    - Municipal, treasury, and mortgage-related securities volumes dropped by 11.6%, 26.3%, and 20.3%, respectively
  - This falloff was partially offset by a significant gain in corporate debt issuances of 80.2% from Q4 2018 to Q1 2019

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



Source: SIFMA

■ 2016 ■ 2017 ■ 2018 ■ Q1 2019

1. Prudential
2. SIFMA
3. Refinitiv LPC
4. William Blair
5. Ernst & Young
6. Goldman Sachs

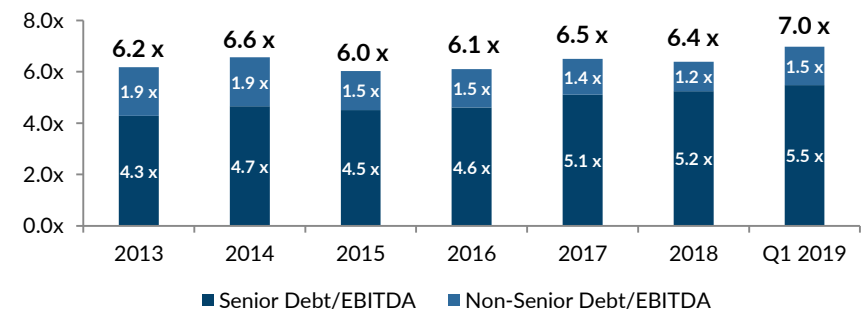
### Middle-Market Lending

- Total U.S. middle-market lending in year Q1 2019 decreased 46.3% to \$23.0B, down from \$42.8B in Q4 2018 and 48.1% from \$44.3B in Q1 2018<sup>3</sup>
  - New money issuance and opportunistic deals were off in the first quarter of 2019, as the middle market remains slow to rebound from 2018 year-end volatility
  - High-yield lending enjoyed its strongest first quarter since 2003 with a return of 7.3%, which was attributable to low issuance levels, revised Federal Reserve expectations, and the largest retail fund inflow since 2012<sup>4</sup>
  - The average issuance yield increased to 7.45% for large corporate loans and 8.14% for middle-market loans in Q1 2019; yields for large corporate loans and middle-market loans rose 2.52% and 1.86% from Q1 2018, respectively<sup>3</sup>
  - There have been a total of \$4.8B in institutional loan defaults in Q1 2019, as compared to \$11.9B in Q1 2018<sup>3</sup>
    - The trailing 12-month default rate dropped to a multi-year low of 1.20% from 2.70% a year ago
- The total leveraged finance volume for the first quarter of 2019 was \$191.0B, a 41% increase from Q4 2018, but a decrease of nearly 20% from Q1 2018<sup>4</sup>
- Secured bond issuance accounted for approximately 15% of total Q1 2019 middle-market volume, up from 4% at year-end 2018<sup>4</sup>

### IPO Market

- The U.S. IPO market saw 20 IPOs raising a total of \$3.0B in Q1 2019, a 57% drop in deal volume from the same period during the previous year, caused by a smaller backlog resulting from geopolitical uncertainty and foreign trade disputes<sup>5</sup>
  - The downward trend has reversed in Q2 with the IPOs of several prominent unicorns, including Beyond Meat, Luckin Coffee, Lyft, Pinterest, and Uber
  - The value of companies that have completed IPOs during the past two years has fallen by an average of 8%, as compared to an increase in the S&P 500 stock index of 12% during the same period<sup>6</sup>

### Debt Multiples of Middle-Market LBO Loans



Source: Thomson Reuters LPC

■ Senior Debt/EBITDA ■ Non-Senior Debt/EBITDA





*By Kay Cruse, Vice President at Strategex, Inc.*

Secondary buyouts (SBOs) have been on the rise over the past two decades, and even more so during the last two years. SBOs now account for nearly one-third of all M&A deals and, more often than not, these deals come with a premium attached to the purchase price. According to Pitchbook, this premium now averages nearly 14%, as compared to private equity (PE) acquisitions that are not SBOs. Pitchbook hypothesizes that these premiums are attributed to the shifting profile of firms seeking SBOs: larger PE firms with more dry powder, increasing pressure from limited partners to deploy capital, and favorable macroeconomic conditions.

In most instances, sponsor-backed companies are put up for sale because the current owners believe that operational improvements have been realized and that a sufficient return has been (or will be) generated through the sale. The question for subsequent sponsors, then, is how to ensure there is enough runway for continued growth that will translate to returns which justify the cost of the SBO.

Determining untapped market needs and identifying white space into which the company can expand (either on its own or by being bolted on to an existing platform) is a good place to start. Conducting customer due diligence, either pre- or immediately post-close, is key to the success of this approach. Customer due diligence is highly effective at validating which innovation and new product development initiatives have the most in-market potential.

**When evaluating an SBO, consider the following best practices:**

**DO:** Stress test new product or service concepts in the real world, with real customers

**DON'T:** Take the seller's word that the new product or service is what customers want, unless there has been third-party validation of the concept

**DO:** Quantify the size of the opportunity based on customers' willingness to buy, the timeline for a potential purchase, and whether there are in-sourced or competitive substitutes

**DON'T:** Rely on revenue projections attributed to a new product or service concept until the in-market impact has been independently validated

**DO:** Assess the company's ability to bring new products and services to market based on the success of their past launches

**DON'T:** Use company-generated scorecards to measure success; many times, they are adjusted to reflect a more optimistic outcome than financial results or customer feedback would suggest

**DO:** Determine if there are other market trends or disruptors that customers believe are on the horizon which can translate to longer-term innovation opportunities

**DON'T:** Act on broad commercial due diligence or market research alone; results and insights from these sources are based on secondary research, not direct feedback from the target's most critical and highest value customers

Customer due diligence can help define and optimize the customer experience but, perhaps more importantly, it can be highly insightful and influential in defining what the next ownership team must accomplish to grow the business. If, in fact, there is little room to create value through operational improvements, then there would be no place to turn to for organic growth except to capture greater wallet share and acquire new customers. For that, there are no better people to ask than the customers themselves.

**About the Author and Strategex, Inc.:**

Kay Cruse is a veteran of customer research, strategic planning, and brand development. With over 25 years of experience, Kay serves as Vice President of Voice of the Customer (VOC) Strategic Practice at Strategex, Inc. She champions clients' success by focusing on business strategy and maximizing their ROI.

Strategex is a research and consulting firm based in Chicago, Illinois that is dedicated to providing direction and support for sustainable, profitable, and aggressive growth. Strategex's Customer Due Diligence practice area helps firms mitigate risk and accelerate value creation.



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## Selected Transactions

<p>\$250,000,000</p>  <p>has merged with</p>  <p>and secured equity and debt financing affiliates of <b>LL Funds, LLC</b></p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$150,000,000</p>  <p><b>Senior Secured Credit Facility</b></p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$76,000,000</p>  <p><b>Senior Credit Facility Convertible Notes</b></p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$95,600,000</p>  <p>has been acquired by</p>  <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$240,000,000</p>  <p>has sold a majority stake in the company through a leveraged buyout transaction to</p>  <p>EXCLUSIVE FINANCIAL ADVISER</p>
<p>\$75,000,000</p>  <p><b>Term-Out Facility</b></p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>Up to \$50,000,000</p>  <p><b>Senior Credit Facility</b></p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>Amount Not Disclosed</p>  <p>has been acquired by</p>  <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$31,000,000</p>  <p>has been acquired by</p>  <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$30,000,000</p>  <p><b>Credit Facility</b></p> <p>EXCLUSIVE FINANCIAL ADVISER</p>
<p>\$60,000,000</p>  <p><b>Senior Secured Credit Facility</b></p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$40,000,000</p>  <p><b>Private Placement of Preferred Equity</b></p> <p>FINDER</p>	<p>Amount Not Disclosed</p>  <p>FRANKFORD CANDY &amp; CHOCOLATE CO., INC. has sold its business operations and real estate to</p>  <p>FRANKFORD CANDY LLC a company formed by Management and a Strategic Partner</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>Amount Not Disclosed</p>  <p>Private Placement of Preferred Stock with</p> <p><b>GCP Capital Partners</b></p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$150,000,000</p>  <p><b>\$100,000,000 Senior Secured Credit Facility \$50,000,000 Additional Commitment</b></p> <p>EXCLUSIVE FINANCIAL ADVISER</p>
<p>\$200,000,000</p>  <p>(NYSE: ENT and TSX: ENTUN)</p> <p><b>Senior and Junior Secured Credit Facilities</b></p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$185,000,000</p>  <p>has merged with</p> <p><b>INFINITY CROSS BORDER ACQUISITION CO.</b> (NASDAQ: INXBUI)</p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$20,000,000</p>  <p><b>Mezzanine Debt</b></p> <p>CO-ADVISER</p>	<p>\$140,000,000</p>  <p>(NASDAQ NMS: ENS) &amp;</p>  <p>have acquired</p> <p><b>MISSISSIPPI HUB LLC</b></p> <p>EXCLUSIVE FINANCIAL ADVISER</p>	<p>\$278,000,000</p>  <p>has been acquired by</p>  <p>EXCLUSIVE FINANCIAL ADVISER</p>

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