

# *Middle Market Update*

**Q3 2019**



**BRYANT PARK  
CAPITAL**

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### Federal Reserve Perspective and Inflation

- The Federal Open Market Committee (FOMC) views recent economic activity as generally positive, as evidenced by the continued strengthening of the labor market, sustained expansion of economic activity, stable inflation, and low unemployment rate, while global trade and other uncertainties remain<sup>1</sup>
  - During its October 2019 meeting, the FOMC lowered its target range for the federal funds rate to 1.50% to 1.75%
- In determining the timing and size of future adjustments to the target range for the federal funds rate, the committee will assess realized and expected economic conditions relative to its maximum employment objective and its 2% inflation objective<sup>1</sup>
  - This assessment will take into account the measures of labor market conditions, inflation pressure indicators, and inflation expectations
- The U.S. Consumer Price Index (CPI) rose by 0.3% in July and 0.1% in August; there was a 1.7% increase for the 12-month period that ended in September<sup>2</sup>

### Employment

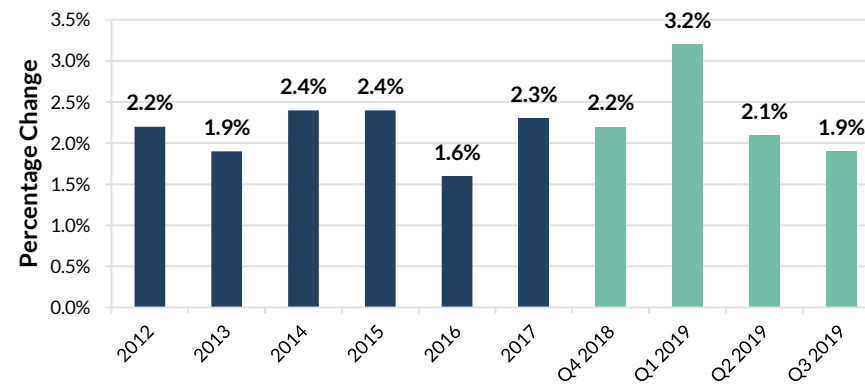
- The U.S. unemployment rate decreased slightly to 3.6% at the end of Q3 2019, as compared with 3.7% at the end of Q2 2019, with the number of unemployed persons at 5.9M<sup>2</sup>
- U.S. employers added 128,000 jobs to their payrolls in October, a slight decrease from the 135,000 jobs added in September<sup>2</sup>
  - The most notable job gains occurred in food services and drinking places, social assistance, and financial activities
- Job growth has averaged 167,000 per month thus far in 2019, as compared with an average monthly gain of 223,000 in 2018<sup>2</sup>
  - The slowing of job growth can be largely attributed to a decline in motor vehicles and parts manufacturing jobs due to strike activity

### U.S. Treasury Securities

- The 10-year U.S. Treasury Note yield decreased from an average of 2.34% in Q2 2019 to an average of 1.80% in Q3 2019<sup>3,4</sup>

	Q4 2018	Q1 2019	Q2 2019	Q3 2019
5-year Treasury Note	2.88%	2.46%	2.12%	1.63%
10-year Treasury Note	3.04%	2.65%	2.34%	1.80%
30-year Treasury Note	3.27%	3.01%	2.78%	2.29%
10-year Treasury (Inflation Protected)	1.06%	0.79%	0.52%	0.15%

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



Source: U.S. Bureau of Economic Analysis

### Outlook for 2019

- Leading CEOs surveyed by the Business Roundtable project that the U.S. GDP will grow by 2.3% during full-year 2019, which is a 0.3% reduction when compared with Q2 2019's estimate of 2.6%<sup>5</sup>
  - CEOs' expectations for annual GDP growth dropped in Q3 2019, which may be indicative of economic uncertainty amid growing trade concerns
- The Congressional Budget Office forecasts a budget deficit of \$960B for fiscal-year 2019, up sharply from the \$779B deficit incurred in fiscal-year 2018<sup>6</sup>
  - The budget deficit is expected to average \$1.2T each year between 2020 and 2029, fluctuating between 4.4% and 4.8% of GDP
  - While both revenues and outlays are projected to increase, the enduring gap between them would expectedly drive up budget deficits and debt
- The U.S. Consumer Confidence Index decreased to 125.9 in October, down from 126.3 in September and up from the year's low level of 121.7 in January<sup>7</sup>
- In October 2019, World Bank Group revised its global economic growth projections downward from 3.0% in 2018 to 2.4% in 2019<sup>8</sup>
  - The easing global growth forecast is due largely to the continued decrease in industrial production and global goods trade growth

1. U.S. Federal Reserve  
 2. Bureau of Labor Statistics  
 3. U.S. Department of Treasury  
 4. Federal Reserve Economic Data  
 5. Business Roundtable  
 6. Congressional Budget Office  
 7. The Conference Board  
 8. World Bank Group

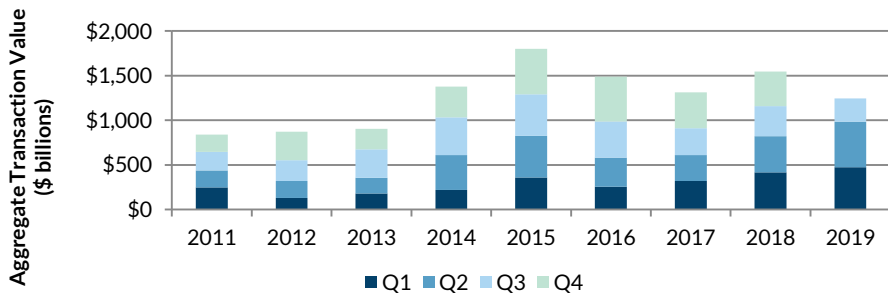
# Bryant Park Capital

## Mergers and Acquisitions and Private Equity



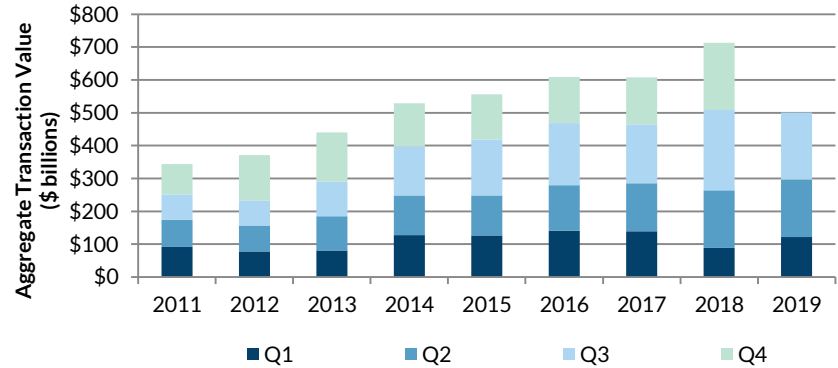
- Global mergers and acquisitions (M&A) activity reached \$2.4T across 13,304 transactions during the initial three quarters of 2019, an 11.4% year-over-year decrease in transaction value<sup>1</sup>
  - Q3 2019 had the lowest quarterly M&A volume since 2016 due to growing global economic uncertainty curbing the risk appetite of companies considering deals
  - Strategic acquirers cautiously navigated market volatility as trade disputes between the U.S. and China continued
- U.S. M&A value reached \$1.25T during the first three quarters of 2019, a 1.6% increase from \$1.23T over the same period in 2018<sup>1</sup>
  - While an increase in valuation multiples led to higher headline prices for acquisitions, relatively low financing rates allowed expensive deals to transact at reasonable costs<sup>2</sup>
- The U.S. M&A deal count totaled 1,206 transactions in Q3 2019, as compared with 1,565 transactions in Q3 2018<sup>2</sup>
  - A mismatch between buyer and seller valuation expectations often proved hard to bridge, resulting in many deals failing to reach the finish line<sup>3</sup>
  - U.S. M&A activity continues to be driven by mega-deals such as Bristol-Myers Squibb's \$74.0B acquisition of Celgene and BB&T's \$66.0B acquisition of SunTrust Bank<sup>4</sup>
  - 2019 is likely to end on a high note, marking the sixth consecutive year in which U.S. M&A deal value surpasses \$1.0T, primarily due to several recently announced large transactions expected to close in Q4 2019<sup>4</sup>
- Cross-border M&A volume was at \$911.4B, accounting for only 36.6% of global M&A in YTD Q3 2019, a 14.6% decrease compared with the same period in 2018<sup>2</sup>
  - During Q3 2019, two large cross-border take-private deals occurred, with BC Partners' acquisition of a 51% stake in Garda World Security and Permira's take-private of Cambrex

### U.S. M&A Activity



Source: Mergermarket, Refinitiv, FactSet

### U.S. Private Equity Deal Flow



Source: PitchBook

- Demand for global private equity remained strong in Q3 2019 despite escalating U.S.-China trade tensions and an impending Brexit; PE funds secured \$163B in aggregate capital, surpassing the \$138B raised in Q2 2019<sup>5</sup>
  - The concentration of capital among a small number of large funds continues to dominate, as the number of funds closed declined significantly to 260 funds in Q3 2019, as compared to 319 in Q2 2019
- U.S. private equity deal value was \$501.2B across 3,883 deals during the initial three quarters of 2019, representing a 1.5% decrease in value and 10.9% increase in volume compared with the same period in 2018<sup>2</sup>
  - Large amounts of dry powder, relatively low interest rates, and motivated investors offset the impact of economic and political uncertainty and tariffs to result in an increase in deal volume in Q3 2019, while fears related to a potential recession and trade wars resulted in the contraction of overall PE-deal valuation multiples<sup>6</sup>
  - B2B and technology remain as key drivers of U.S. private equity transaction activity, as they accounted for 38% and 19%, respectively, of total deal volume in Q3 2019<sup>5</sup>
  - Sovereign wealth funds and other institutional investors are expanding their participation by co-investing as well as directly sourcing deals, which will continue to drive deal volume and value<sup>2</sup>
- Buyout funds remain the most commonly targeted strategy among private equity investors with 60% of investors planning to target the strategy in the next 12 months<sup>5</sup>
- For private-equity-led transactions between \$10.0M and \$250.0M, total enterprise value multiples averaged 7.6x trailing 12-month adjusted EBITDA, up from a 7.3x average during the prior year<sup>7</sup>

1. MergerMarket  
2. PitchBook  
3. Reuters

4. Preqin  
5. PricewaterhouseCoopers  
6. BCG

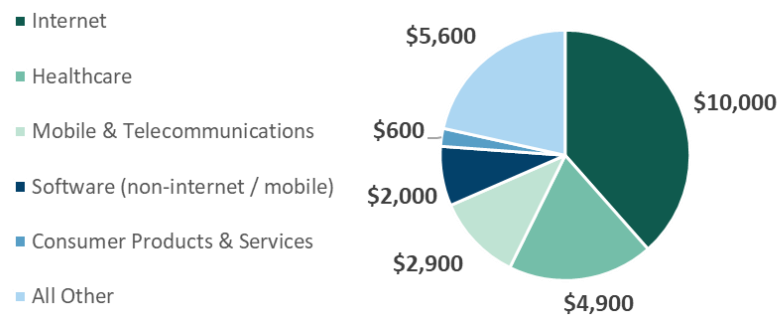
7. GF Data



### Venture Capital Investing

- In Q3 2019, transactions for U.S. venture capital (VC)-backed companies totaled \$26B in value across 1,304 transactions, a decrease in volume and value of 16% and 15%, respectively, as compared with Q2 2019<sup>1</sup>
  - There were 55 VC deals that raised \$100M or more in Q3 2019, down from the record high of 67 deals in Q2 2019
    - \$100M+ deals fell from record levels due to the reduced backlog resulting from previously completed IPOs and sales of prominent unicorns
  - U.S. technology companies continue to lead the IPO surge, with 22 U.S. VC-backed technology companies exiting in IPOs in Q3 2019, following a surge of 33 such IPOs in Q2 2019
  - There are a record-high 180 private VC-backed U.S. companies valued at \$1B+, portending a continued stream of high-profile IPOs and sales
- As corporations assess their exposure to a potential economic downturn, the number of completed VC deals with corporate participation has started to abate over the past couple of quarters<sup>2</sup>
- Global VC investment rose from \$52.7B in Q2 2019 across 3,855 transactions to \$55.7B in Q3 2019 across 4,154 deals<sup>3</sup>
  - The rise in deal volume was largely driven by an increase in seed-stage deals, as well as the ongoing development and maturation of international startup markets<sup>4</sup>
- Late-stage VC continued to prosper in Q3 2019, as companies continued to stay private longer in order to achieve more scale, drawing increased interest from non-traditional investors looking to capitalize on the growth these companies would otherwise have financed via the public markets<sup>2</sup>

### U.S. VC Deal Value per Industry (\$ millions): Q3 2019

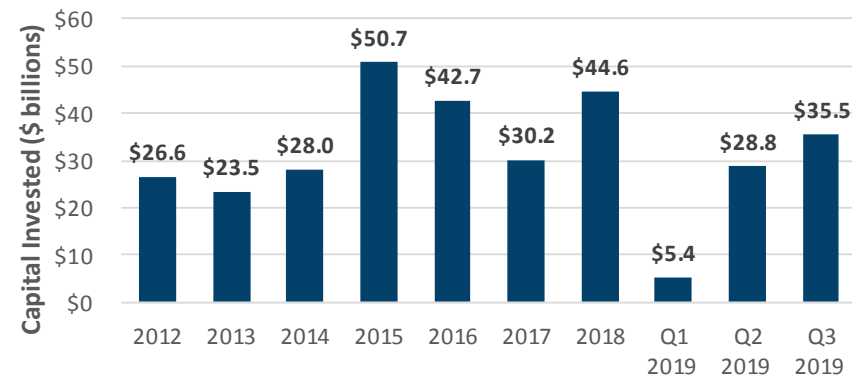


Source: MoneyTree Report

### PIPE Investing

- There were 745 U.S. private-investment-in-public-equity (PIPE) transactions valued at \$35.5B in Q3 2019, a 13% increase in deal volume and 2% decrease in dollar volume compared with the same period in 2018<sup>5</sup>

### U.S. PIPE Activity



Source: Placement Tracker

### Equity Markets and Corporate Earnings

- Equity markets ended Q3 2019 in mostly positive territory despite ongoing trade tensions between the U.S. and China<sup>6</sup>
  - The S&P 500 returned 1.7% during Q3 2019 for a year-to-date total return of 20.6%
  - The U.S. outperformed international equities as the USD strengthened
  - The Fed showed its commitment to addressing a possible economic slowdown by cutting rates twice during the quarter
- The reporting of non-GAAP numbers by public companies has ballooned, as about 97% of filers use non-GAAP figures, up markedly from 59% in 1996<sup>7</sup>
- S&P 500 company earnings for Q3 2019 are expected to have fallen by 4.1%<sup>8</sup>
  - Approximately 71% of companies have reported earnings during Q3 2019 thus far, with 76% having had a positive EPS surprise and 61% having had a positive revenue surprise
  - According to Q4 2019 earnings predictions, 45 S&P 500 corporations have issued negative EPS guidance and 19 S&P 500 companies have issued positive EPS guidance

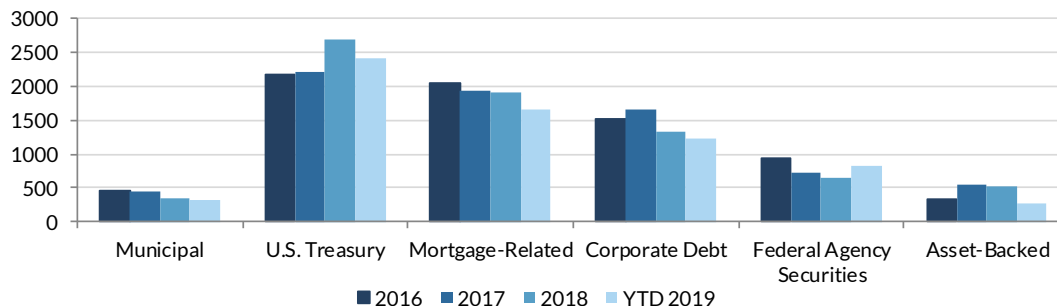
1. PricewaterhouseCoopers	4. Crunchbase	7. Audit Analytics
2. PitchBook	5. Placement Tracker	8. FactSet
3. KPMG	6. Baird	



### Debt Capital

- The Barclays U.S. Aggregate Bond Index recorded a 2.27% gain during Q3 2019, a decrease from the 3.08% gain in Q2 2019<sup>1</sup>
  - With yields at historically low levels, below-average credit spreads on non-government products, and an elongated business cycle, the outlook for bond market returns continues to fade
- The Barclays Investment Grade U.S. Corporate Bond Index recorded a return of 3.05% in Q3 2019, a decline from the 4.48% gain in Q2 2019<sup>1</sup>
  - In the third quarter of the year, U.S. corporate profit margins and free cash flow remained strong, and overall credit metrics remained stable
  - Given the amount of negative yielding global debt, and the higher absolute level of U.S. yields, the “reach for yield” is expected to continue for some time
  - As new issuances continued to steer the market in Q3 2019, proceeds were used to pay off or refinance debt at lower rates and/or extended maturities, leading gross and net supply projections to drop 5% and 23%, respectively, in 2019
- Total U.S. bond issuances for Q3 2019 were \$2,355.6B, a 20.0% increase from the Q2 2019 level of \$1,963.4B, and a 26.9% year-over-year jump from the Q3 2018 level of \$1,855.9B<sup>2</sup>
  - Municipal, U.S. Treasury, mortgage-related, federal agency, and corporate debt drove the increase from Q2 2019 to Q3 2019
    - The only credit instrument to experience declining issuance from Q2 2019 was asset-backed securities, which fell by 23.5%
    - Mortgage-related credit experienced the greatest surge in issuance of 36.1% from Q2 2019 to Q3 2019 as a result of investors seeking less risky assets amid global political and economic uncertainty
- The outstanding debt of domestic non-financial companies is 47% of the U.S. gross domestic product, which is a record percentage share<sup>3</sup>

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



Source: SIFMA

1. Prudential
2. SIFMA
3. U.S. Federal Reserve
4. Ernst & Young
5. VentureSource
6. S&P Global Market Intelligence

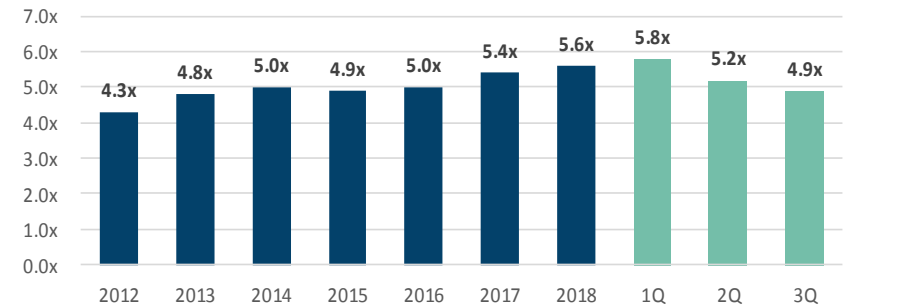
### IPO Market

- Q3 2019 saw 256 IPOs globally, with proceeds of \$40.2B, a decrease of 16% by deal numbers and 32% by proceeds compared with Q2 2019<sup>4</sup>
  - U.S.-China-EU trade tensions, concerns about economic growth, Brexit, social unrest in Hong Kong, and issues related to previous high-profile IPO issuers and candidates (e.g., Uber and WeWork) exacerbated a quiet quarter for IPO activity in many markets
  - The longer-than-expected low interest rate environment may create tailwinds that help to propel IPO activity upward in Q4 2019 and into 2020
- The U.S. IPO market saw 39 IPOs raising a total of \$11.9B, a 6% decrease in deal proceeds from the same period in 2018<sup>4</sup>
  - Market indices were near (and subsequently reached) all-time highs after the volatility experienced midway through Q3 2019 receded, forming a strong fundamental backdrop for issuances
  - Due to an uncertain geopolitical environment and the potential for bouts of volatility, many issuers are preparing to go public in the first half of 2020, ahead of the U.S. elections in early November
- VC-backed companies raised \$23.3B in the U.S. during the first three quarters of 2019, more than any full year on record, including during the dot-com boom<sup>5</sup>
  - Such companies are, on average, over six years old, as compared to just three years old during the previous record year 2000

### Middle-Market Lending

- U.S. middle-market loan volume continued its slowed pace, with Q3 2019 having been down over 25% compared to Q3 2018<sup>6</sup>
  - This drop in loan volume can be largely attributed to a dip in M&A transactions
- Leverage multiples continued to decline throughout the year to 4.9x in Q3 2019, as lenders lean towards more conservative underwriting policies<sup>6</sup>

### Middle-Market Leverage Multiples



Source: Capstone Headwaters





*By Anthony Bahr, Vice President at Strategex, Inc.*

### **Five Ways Tariffs Are Impacting M&A Deals**

Based on thousands of in-depth interviews with B2B decision makers, we have observed five ways that tariffs are impacting M&A deals and portfolio management strategies.

#### **Tariffs can be more disruptive for a company than category-level market research might suggest**

When asked whether they think category-wide demand for a product will increase or decrease, customers tend to be quite bullish and virtually always suggest increased short-term demand. However, when customers are asked if spend for the same product with a specific target company will increase or decrease, they are often more bearish. While tariffs do not (yet) appear to be a drag on macro demand, they clearly have the potential to heavily influence share of wallet allocation. If customers are paying more for a product as the result of tariffs, they are likely to be more discerning about the suppliers from which they source and will favor those with a stronger value proposition.

#### **Willingness of customers to absorb tariffs is highly dependent on the strength of the relationship**

Companies with an above-average Net Promoter Score® – a metric which quantifies customer loyalty – are better positioned to pass on the cost of tariffs to customers. This is because “Promoters” (those which are loyal to a company) are often able to justify a price increase given the incremental value they realize beyond the product itself. Conversely, “Detractors” (those which are not loyal to a company) tend to be far less likely to absorb the cost of tariffs and, if prices are increased, are at a heightened risk of shifting wallet share to a lower-priced competitor.

#### **Tariffs are leading some companies to compete on customer experience rather than on price**

Companies which have been historically differentiated by price are quickly realizing that they need to reposition and establish new competitive advantages. One highly effective approach has been to focus on the customer experience. Companies which have mapped the pre- and post-sale customer journey – and have developed strategies to “surprise and delight” customers at each of the major touchpoints along the journey – are successfully protecting themselves from the impact of tariffs. They are also experiencing a substantial return on their

investment by sustaining premium prices, capturing a greater share of wallet, and acquiring new customers.

#### **Companies which only grant tariff-related concessions to the “critical few” are more profitable**

Companies are being pressed like never before for lower prices and more favorable terms. Management teams tend to be quick to grant concessions out of concern for retaining a revenue base. However, when concessions are made for all customers, even relatively small customers, revenue retention almost always results in a drag on EBITDA. Segmenting customers based on the 80/20 rule, and only granting concessions to the 20% of customers (the “critical few”) which generate 80% of revenue, is a more fair and sustainable methodology for making these decisions. Offering concessions to the 80% of customers (the “insignificant many”) that drive 20% of revenue opens the door to a downward spiral of financial losses.

#### **Tariffs have accelerated Manufacturing 4.0 implementation**

In the manufacturing space, tariffs have led many companies to accelerate the exploration or implementation of Manufacturing 4.0 initiatives. Specifically, these companies are looking to increase their reliance on automation as a way to not only deliver faster, but also to offset price increases through less of a reliance on human capital. For growth equity investors, companies seeking to implement Manufacturing 4.0 are becoming highly sought after given the significant capital expense to implement on a meaningful scale.

#### **About the author and Strategex, Inc.**

Anthony Bahr is a Vice President in Strategex’s VOC Strategic Practice, where he leads research-based consulting engagements. He devotes much of his time to expanding the firm’s Quality of Customers® (QofC®) offering – a proprietary process that incorporates voice-of-the-customer research into customer due diligence on behalf of private equity and strategic acquirer clients.

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



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### PLEASE VISIT

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### Selected Transactions

<p>\$104,500,000</p>  <p><b>lēgis</b></p> <p>Capital Raise EXCLUSIVE FINANCIAL ADVISOR</p>	<p>\$150,000,000</p>  <p><b>MoneyLion</b></p> <p>Senior Secured Credit Facility EXCLUSIVE FINANCIAL ADVISOR</p>	<p>\$76,000,000</p>  <p><b>nuehealth</b></p> <p>Senior Credit Facility Convertible Notes EXCLUSIVE FINANCIAL ADVISOR</p>	<p>\$95,600,000</p>  <p>US HOME SYSTEMS (NASDAQ:USHS) has been acquired by</p>  <p>THE HOME DEPOT (NYSE:HD) EXCLUSIVE FINANCIAL ADVISOR</p>	<p>\$250,000,000</p>  <p>DIVIDEND SOLAR has merged with</p>  <p><b>Figtree</b> FINANCING and secured equity and debt financing affiliates of LL Funds, LLC EXCLUSIVE FINANCIAL ADVISOR</p>
<p>\$75,000,000</p>  <p><b>PAWNEE</b> LEASING CORPORATION <small>a Cleco Group Limited company</small></p> <p>Term-Out Facility EXCLUSIVE FINANCIAL ADVISOR</p>	<p>Up to \$50,000,000</p>  <p><b>THRIVEST™</b></p> <p>Senior Credit Facility EXCLUSIVE FINANCIAL ADVISOR</p>	<p>Amount Not Disclosed</p>  <p><b>NORTH MILL</b> EQUIPMENT FINANCE LLC has been acquired by</p>  <p><b>WAFRA</b> CAPITAL PARTNERS EXCLUSIVE FINANCIAL ADVISOR</p>	<p>\$31,000,000</p>  <p>ReMed has been acquired by</p>  <p>US Community Behavioral a portfolio company of <b>BregalPartners</b> EXCLUSIVE FINANCIAL ADVISOR</p>	<p>\$30,000,000</p>  <p><b>FOX POINT</b> TRUCKS</p> <p>Credit Facility EXCLUSIVE FINANCIAL ADVISOR</p>
<p>\$60,000,000</p>  <p><b>Northern Leasing Systems LLC</b> <small>Exceeding at service. Exceeding expectations.</small></p> <p>Senior Secured Credit Facility EXCLUSIVE FINANCIAL ADVISOR</p>	<p>\$40,000,000</p>  <p><b>peachtree</b> SETTLEMENT FUNDING</p> <p>Private Placement of Preferred Equity FINDER</p>	<p>\$240,000,000</p>  <p>J.G. WENTWORTH has sold a majority stake in the company through a leveraged buyout transaction to</p>  <p><b>JLL</b> Partners EXCLUSIVE FINANCIAL ADVISOR</p>	<p>\$40,000,000</p>  <p><b>RapidFunds</b></p> <p>Senior Secured Term Loan EXCLUSIVE FINANCIAL ADVISOR</p>	<p>\$150,000,000</p>  <p><b>GOLDEN PEAR</b> FUNDING</p> <p>\$100,000,000 Senior Secured Credit Facility \$50,000,000 Additional Commitment EXCLUSIVE FINANCIAL ADVISOR</p>
<p>\$200,000,000</p>  <p><b>ENTERRA ENERGY TRUST</b> <small>Oil &amp; Gas Income Trust</small> (NYSE:ENT and TSX:ENTUN)</p> <p>Senior and Junior Secured Credit Facilities EXCLUSIVE FINANCIAL ADVISOR</p>	<p>\$185,000,000</p>  <p><b>glori</b> ENERGY has merged with</p> <p>INFINITY CROSS BORDER ACQUISITION CO. (NASDAQ: INXBU) EXCLUSIVE FINANCIAL ADVISOR</p>	<p>\$20,000,000</p>  <p><b>ADF</b>   APPLIED DATA FINANCE</p> <p>Mezzanine Debt CO-ADVISOR</p>	<p>\$140,000,000</p>  <p><b>EnergySouth</b> (NASDAQ NMS:ENS) &amp;</p>  <p><b>FORTRESS</b> have acquired</p> <p>MISSISSIPPI HUB LLC EXCLUSIVE FINANCIAL ADVISOR</p>	<p>\$278,000,000</p>  <p><b>i-trax</b> <small>MARKETING TECHNOLOGIES</small> (AMEX:DMX) has been acquired by</p>  <p><b>Walgreens</b> EXCLUSIVE FINANCIAL ADVISOR</p>

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