Middle Market Update

Q4 2021

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Fourth Quarter Economic Performance and Future Outlook

Federal Reserve Perspective

- Economic and employment indicators have further improved following the increased vaccination rate. The Federal Reserve ("The Fed") continues to closely follow the progress of the pandemic as risks of new variants remain. Easing of supply constraints are expected to promote economic growth and curb inflation. The Fed also stated balance sheet reduction will likely be appropriate following the first increase in the fed funds rate. Less accommodative financial conditions are approaching with rate hikes of up to three quarter-percentage points in 2022[1]
  - The Consumer Price Index increased 0.5% in December on a seasonally adjusted basis, compared to a 0.4% increase in September; the Index has risen 7.0% over the last 12 months[2]
  - Some of the largest increases include the indices for energy commodities and used cars, which rose 48.9% and 37.3%, respectively, over the last 12 months
- The Fed indicated they will reduce asset purchasing by $20B Treasury securities and $10B mortgage-backed securities[1]
  - This decision was made in response to developments in inflation and a strengthening labor market
  - Starting in January, the Fed will purchase no less than $40B in Treasury securities and $20B in mortgage-backed securities per month
  - Expectations from the Fed are that a similar reduction in asset buying will be continued monthly unless the economic outlook warrants adjustments

Employment

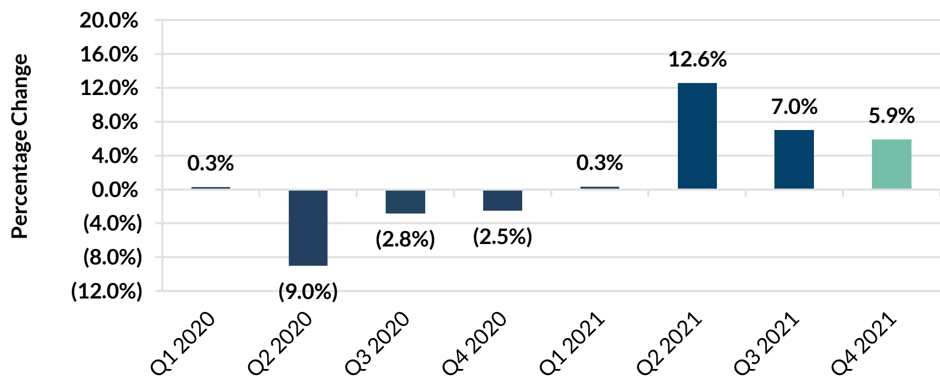
- The U.S. unemployment rate decreased to 3.9% in December 2021 from 4.8% in September 2021[2]
  - 6.3M people were unemployed in December 2021, a decline of 4.5M people over the course of 2021
- The number of unemployed people on temporary layoff decreased to 812,000 in December 2021 from 1.1M in September 2021[2]
- In December 2021, 11.1% of employed people worked from home due to the pandemic, a decrease from 13.2% in September 2021[2]

U.S. Treasury Securities

- Long-term Treasury yields rose slightly in Q4 2021; the average 10–Year and 30-Year yield increased by 21bp and 2bp, respectfully, from Q3 2021[3]

	Q1 2021	Q2 2021	Q3 2021	Q4 2021
1-Year Treasury Bill	0.08%	0.06%	0.07%	0.18%
5-Year Treasury Note	0.61%	0.83%	0.80%	1.18%
10-Year Treasury Note	1.32%	1.58%	1.32%	1.53%
30-Year Treasury Bond	2.08%	2.26%	1.93%	1.95%

Real Gross Domestic Product ("GDP") Year-Over-Year Growth[4]



Outlook for 2022

- Business Roundtable's CEO Economic Outlook Survey, a composite index of CEO plans for capital spending, hiring, and expectations for sales over the next six months, had an index reading of 124 in Q4 2021, an increase by 10 points from Q3 2021[5]
  - The 20-year-old index is currently at its highest value ever
  - The CEOs cited labor shortages as well as supply chain complications when asked about cost pressures facing their business
- The Federal Reserve projects U.S. real GDP expansion of 5.5% and 4.0% for 2021 and 2022, respectively[1]
  - Although the projection for 2021 decreased from 5.9% in September, the 2022 projection increased, demonstrating the Federal Reserve maintains confidence the U.S. will have strong growth in 2022
  - The U.S. economy in Q4 still felt the aftermath of the pandemic, Covid-19 restrictions remained while government relief programs across the board decreased or expired, ending the capital injection to U.S. families and businesses[4]
- As of December 2021, members of the Federal Reserve Board projected 5.3% inflation in personal consumption expenditures in 2021, up 2.1% from the June 2021 expectation[1]
  - Inflation is expected to decline to 2.6% in 2022 and remain near 2.0% over the long run
- Consumer confidence improved for the last three months of 2021, indicating positive sentiment toward 2022[6]
  - The Expectations Index, which is based on consumers' short-term outlook for income, business, and labor market conditions, rose to 115.2 in December from 87.7 in September 2021

1. *U.S. Federal Reserve*
2. *Bureau of Labor Statistics*
3. *The Wall Street Journal*
4. *U.S. Bureau of Economic Analysis*
5. *Business Roundtable*
6. *The Conference Board*

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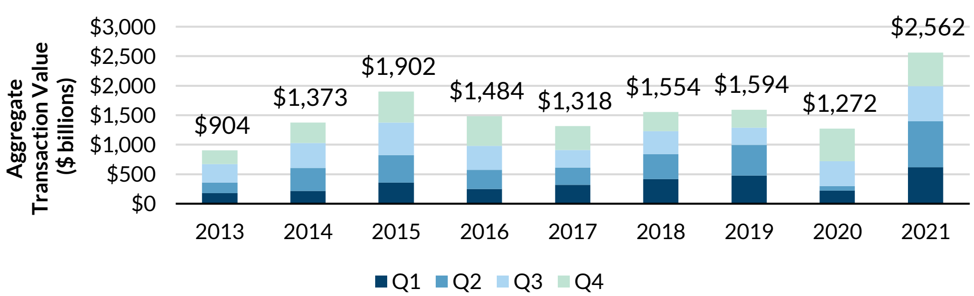
Mergers & Acquisitions and Private Equity

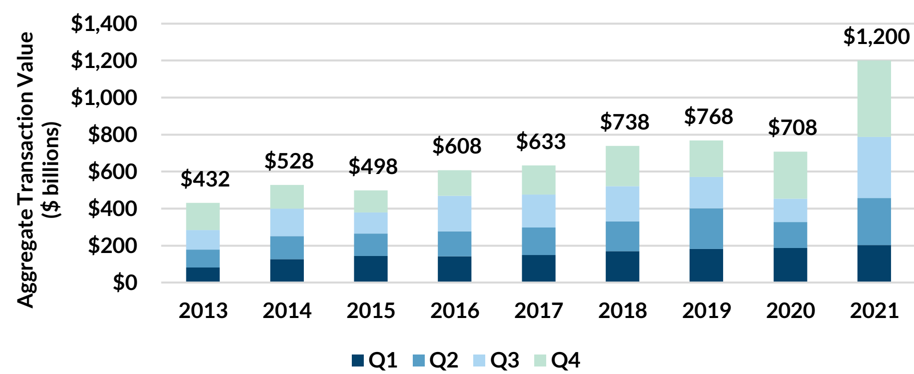
Mergers & Acquisitions

- Global merger and acquisition ("M&A") activity finished out the year with $5.0T worth of deal value. This record high 2021 year represents a 54.8% increase compared to 2020[1]
  - 11,178 deals were completed in Q4 2021, a 20.9% increase from Q3 2021
    - Significant headwinds face M&A activity heading into 2022 including dealmakers concern that authorities will pursue aggressive tax auditing practices in order to recoup some fiscal spending from the pandemic
  - The share of sponsor backed M&A activity continues to rise with 2021 having a record high of 37.8% of deals characterized as sponsor-backed
  - Environmental, Social, and Governance ("ESG") related acquisitions more than doubled in 2021 and, heading into 2022, ESG will be a key area of focus when sourcing and delicensing potential deals
    - In the financial services sector, net-zero emissions targets have been set and committed to by insurers, banks, and asset managers to be achieved by 2050
- U.S. M&A deal value totaled $568.7B in Q4 2021, representing a 4.4% decline from Q3 2021; U.S. M&A volume also dropped to 1,447 transactions during the same period[2]
  - The new leadership at the Federal Trade Commission ("FTC") announced that they will extend their scope on antitrust enforcement beyond market concentration effects[1]
    - Despite the widened scope, the largest impact remains on major technology firms; Amazon, Apple, Meta, and Google are all currently facing active or anticipated antitrust litigation
    - Transaction lawyers in the middle market say the public FTC commentary on greater antitrust enforcement currently lacks enforceability and likely will not have a significant impact on M&A activity[3]
- The U.S. middle market median Enterprise Value / EBITDA multiple decreased 25.2% in the last year from 10.7x in Q4 2020 to 8.0x in Q4 2021[3,4]

U.S. M&A Activity



U.S. Private Equity Deal Flow[6]



Private Equity

- U.S. private equity ("PE") fundraising continued its ascent in Q4 2021 with $63.6B raised across 94 funds, a 9.5% increase in fundraising from Q3 2021[1]
  - PE funds are being raised in less than 18 months driven by LPs looking to increase their private equity exposure to capitalize on PE's recent stellar performance
  - The top U.S. PE funds have amplified funding efforts overseas, with Asia particularly being targeted for newly launched funds
- U.S. PE deal value in 2021 set a record of $1.2T across 8,624 deals; the previous record stood at $754.9B in value in 2019[1]
  - 2021 saw the most add-on deals at 72.8% of total US buyouts; PE firms felt the market climate was best for utilizing a buy-and-build strategy
  - Businesses with track records of employee retention or increasing productivity with technology are currently attracting premiums in the marketplace
  - The rising multiples in the market have led to PE firms realizing their desired valuations faster; the average investment cycle is closer to two-to-three years versus the average five years
- Q4 2021 saw U.S. PE exit value of $216.0B, completing the 2021 year with an exit value of $854.3B; this year more than doubled the full-year record of $413.2B set in 2018[1]
  - 1,731 companies were sold by PE firms in 2021, taking advantage of the significant exit multiples available in the market
  - Private companies acted on favorable marketplace conditions by listing their companies publicly; 134 companies representing $241.4B in value were listed by sponsors in 2021

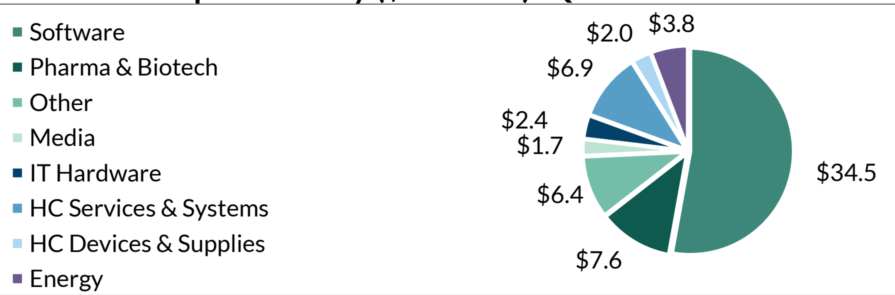
1. *Pitchbook*
2. *White & Case using Mergermarket data*
3. *"Middle market" is defined as deals valued between $1 million and $500 million, plus undisclosed deals*
4. *FactSet*

Venture Capital, PIPEs, Equity Markets, and Corporate Earnings

Venture Capital Investing

- Global venture capital ("VC") investments remained strong, with $171.4B invested across 8,710 transactions in Q4, a slight reduction from $171.7B across 8,682 transactions in Q3 2021[1]
  - Unicorns continue to be a driving force in VC investment across global markets, with several striking large fundraising deals in Q4: J&T Express ($2.5B), Lacework ($1.3B), and Thrasio ($1B)
  - As economies begin to emerge from the pandemic era, investors are focusing on efficient and effective HR solutions, with payroll and compliance platform Deel raising $425M and background check automation firm Chekr raising $250M in Q4
- In Q4 2021, companies backed by U.S. VCs raised $102.8B, representing a 24.2% surge from the $82.8B raised in Q3 2021[2]
  - In Q4, a record high of $27.3B was invested in early-stage VC deals, doubling from the amount invested in Q4 2020
  - Mega-deals (those with a valuation of $5B or more) led the market in 2021 with $190.6B raised across 819 deals, a 149.2% increase from the $76.5B raised in 2020
  - In 2021, U.S. VC fundraising surpassed $100B for the first time in history, setting a record of $128.3B across 730 funds, $42.5B more than 2020's total of $85.8B
- Annual exit value created by U.S. VC-backed companies reached $774.1B, a 167.9% increase from 2020's record high of $289.0B[2]
  - Public listings remained the most popular exit strategy, accounting for 88% of the total value of VC exits during 2021
  - SPAC IPOs finished 2021 strong with a total of 556 deals completed, a 141.7% increase from the 230 deals completed in 2020
  - Electric car maker Rivian was the largest IPO in 2021, raising a total of $66.5B via the listing
- Nontraditional investors (such as corporations, LPs, PE firms, etc.) invested $253.5B in 2021, nearly doubling 2020's figure of $126.3B[2]
  - An estimated 6,483 deals received investment from a nontraditional investor in 2021, compared to an estimated 3,982 deals in 2020
  - In 2021, 42.1% of the total VC investments were made in deals with at least one nontraditional investor participant

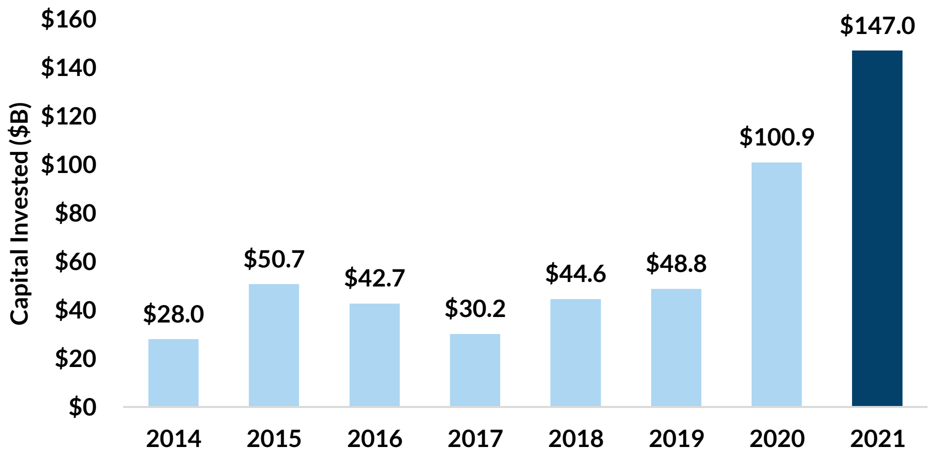
U.S. VC Deal Value per Industry ($ millions): Q4 2021[2]



PIPE Investing

- Throughout 2021, there were 1,839 U.S. Private Investment in Public Equity ("PIPE") transactions with a total value of $147.0B, an increase in volume and value of 28.6% and 45.7%, respectively, compared to 2020[3]
  - Although deal volume decreased by 2.9% from Q3, PE investments climbed 22.4% in value as investors concentrated their capital on larger deals[4]
  - PIPE transactions represented 54% of global private equity deals completed in Q4 2021, up from 50% in Q4 2020[4]

U.S. PIPE Activity[3]



Equity Markets and Corporate Earnings

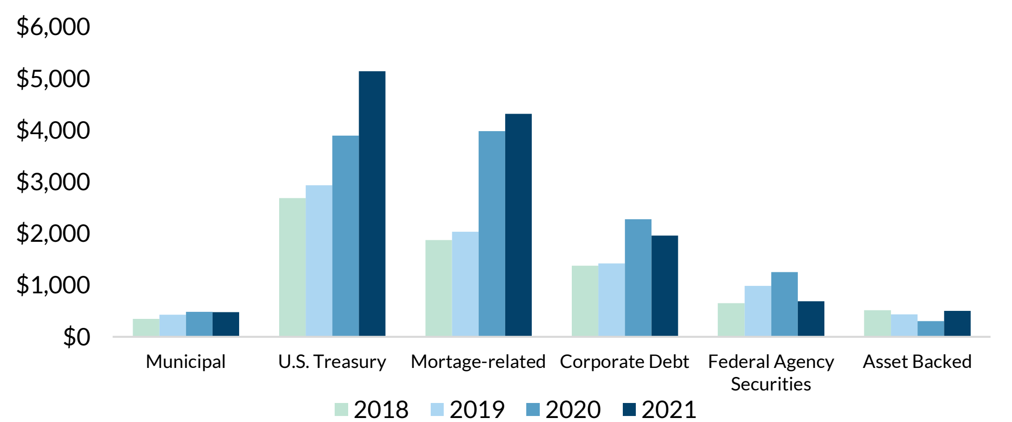
- U.S. equities closed out 2021 near record highs, generating a 9.4% return through Q4 and a 25.8% gain for the year[5]
  - With broad economic recovery across market sectors, equities continued their year-long rise in Q4 despite short-lived turbulence caused by the highly contagious Omicron variant
  - The S&P 500 Index increased 9.5% through Q4 2021, while the Dow Jones Industrial Average and the Nasdaq Composite gained 8.5% and 7.9%, respectively
- Of the 56% of companies in the S&P 500 that reported Q4 2021 earnings, 76% reported positive EPS and revenue surprises[6]
  - Earnings growth over Q4 2020 exceeded 25%, resulting in a 45% increase for 2021 as a whole when compared to 2020
  - While consumer discretionary, tech, and financials led earnings growth in Q4 2021, the energy and healthcare sectors were the major contributors to the rise in total revenues

1. *KPMG*
2. *PitchBook*
3. *PlacementTracker*
4. *Aranca*
5. *Morningstar*
6. *FactSet (as of February 4th, 2022)*

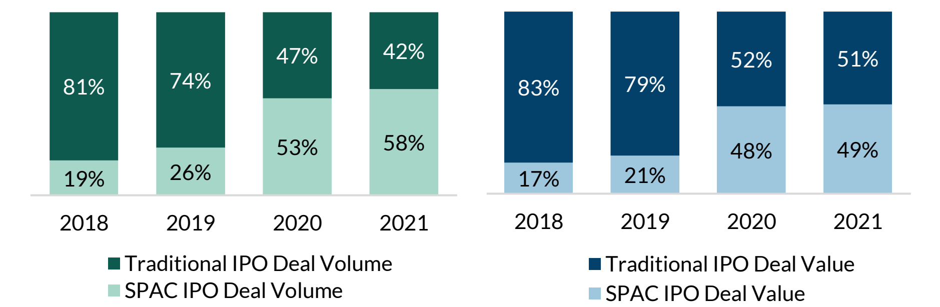
Debt Capital

- The yield on the Barclays U.S. Aggregate Bond Index was -1.4% at the end of 2021, down from its yield of 7.5% at the end of 2020, with little change in quarterly yield from 0.05% in Q3 2021 to 0.04% in Q4 2021[1]
- Persistent inflation, anticipation of Federal Reserve rate hikes, and uncertainty surrounding the pandemic may continue to cause volatility in the fixed income market[1]
- The Barclays Investment Grade U.S. Corporate Bond Index increased 0.2% in Q4 2021, after remaining flat in Q3 2021[1]
  - In Q4 2021, corporate bond issuance totaled $379.4B, a decrease of 13.7% from Q3 2021 due to uncertainty surrounding new Coronavirus variants as well as persistent inflation
  - Investment-grade corporate bond issuance decreased by 7.4% compared to Q3 2021, with total issuance of $304.7B in Q4 2021
  - Mortgage-backed securities performed the worst, with a -0.4% return in Q4 2021
  - Municipal bonds had the highest total yield over 2021 at 1.5%, while U.S. Treasury bonds had the lowest total return of -2.3%
- Total U.S. Bond issuances for Q4 2021 were roughly $2.9T, a 9.6% decrease from Q3 2021 and a 12.5% decrease year-over-year from $3.3T in Q4 2020[2]
  - Nonetheless, total bond issuances in 2021 were $12.9T, up 5.5% from 2020, in part driven by $5.1T in U.S. Treasury bond issuances, up 31.9% from 2020
- Global sustainable-bond issuances, which include green, social, sustainability, and sustainability-linked bonds, totaled $992T in 2021, more than doubling 2020 issuances[3]
  - Sustainable bonds are forecasted to reach nearly $1.4T of issuances in 2022

Issuances in the U.S. Bond Market ($ billions)[2]



SPAC IPOs by % of all U.S. IPO Activity[4]



IPO Market

- Globally, Q4 2021 saw 621 IPOs worth $112.2B, representing a 16.1% increase in volume and a 9.0% increase in value compared to Q4 2020[4]
  - 2021 saw a total of 2,388 deals raise $453.3B, making it the most active year for IPOs in the past 20 years
  - Technology and health care IPOs were most dominant in 2021, accounting for 26% and 16% of global total IPO volume, respectively
  - A total of 646 SPACs globally raised $161.1B in 2021, an 136% increase in volume and a 97% increase in proceeds from 2020
- The U.S. saw 951 IPOs raise $282B in 2021, the largest all-time in both volume and proceeds[5]
  - SPACs drove U.S. IPO activity, with a total of 613 SPAC IPOs raising $145B in 2021
- A total of 274 SPAC merger announcements were made in 2021, with the majority coming from the tech sector[5]
  - 2021, set the record for completed SPAC acquisitions with roughly 160 completed transactions totaling $450B in acquisition value
  - As of December 2021, almost 570 SPACs are in search of acquisition targets, with an estimated $134B in total equity

Lending Market

- Issuances for institutional leveraged loans totaled $615.2B in 2021, marking an 113% increase from 2020 levels as borrowers looked to take advantage of low interest rates and a booming M&A market[6]
  - Loan issuances in Q4 2021 fell to $126.8B, a 19% decrease from Q3 2021
  - LBO issuance continued to slow in Q4 2021, decreasing 56.4% to $20.4B from $46.8B in the previous quarter, but still finishing the year with the second-highest volume on record
  - Total non-LBO M&A ($184.5B) and dividend recapitalization ($82.2B) loans reached record highs in 2021

1. *Prudential*
2. *SIFMA*
3. *Moody's*
4. *E&Y*
5. *PwC*
6. *S&P Global Intelligence*

Finalizing Forgiveness: Fighting SBA Decisions and Pursuing Borrower Claims

By Amy L. Arndt and Terence M. Grugan, Partners, Ballard Spahr

Recent increases in Paycheck Protection Program (PPP) loan forgiveness denials by the Small Business Administration (SBA) are causing anxiety across the market for both borrowers and lenders. Grounds for adverse decisions have included disputable application of agency rules, administrative challenges to loan calculations, or even retroactive challenges to loan eligibility. Not only have these decisions created financial uncertainty for denied applicants now facing the prospect of repaying loans they expected forgiven, they raise the specter of further scrutiny through SBA audits or potential referrals for enforcement proceedings.

The SBA Interim Final Rule (IFR) lays out procedures for appealing adverse PPP forgiveness decisions.

While borrowers and lenders expected forgiveness to mark the conclusion of the PPP process, adverse decisions by SBA are triggering potentially lengthy processes through which borrowers defend their claims. These processes include pursuing appeals through administrative proceedings and, later, the court system or even affirmatively challenging SBA rules through court actions. Where SBA has referred claims for audit or enforcement proceedings, borrowers find themselves forced to defend their eligibility for their loans and the legitimacy of their claims. Additionally, lenders are facing increased scrutiny and must ensure that their loan programs are fully compliant in order to defend challenges to both PPP lending and forgiveness decisions.

Among the thorny situations borrowers and lenders face:

•The evolving nature of SBA rulemaking through the PPP process has resulted in uneven and inconsistent application of program rules to forgiveness decisions. For instance, changing eligibility criteria has meant some borrowers who were eligible for their loans are now being determined ineligible for forgiveness.

•There is uncertainty around qualification of private equity portfolio companies for initial funding. The rules evolved, as did the issuance of subsequent FAQ's and the interpretation of the "credit elsewhere test" of the 7(a) loan requirement. Scores of companies with private equity ownership are now being challenged.

•SBA is scrutinizing borrower affiliations and rejecting forgiveness applications where it considers loans proceeds improperly applied to an affiliate's covered expenses.

•SBA disputing loan eligibility or forgiveness amounts may give rise to claims of applicant fraud, which, in turn, may create additional civil or even criminal exposure for denied applicants.

•Borrowers should take care to protect privileged or proprietary information. Facts required during the appeals process might include trade secrets or financial information a company wouldn't want a competitor to see.

•The number of employees at a company may have fluctuated during the term of the PPP loan, affecting eligibility and leaving business owners confused about how to move forward with a forgiveness appeal.

•Time is of the essence. Appeals must be filed to the Office of Administrative Hearing within 30 calendar days after receipt of the SBA decision, and they must be filed using the online portal.

•Any argument made in an appeal must be well-conceived and complete. In addition to including a copy of the SBA decision, appeals must contain a "full and specific" statement as to why the SBA decision is in error, as well as all supporting information. Exhibits and attachments must be clearly labeled. Incomplete petitions may be dismissed, and borrowers may not be able to refile.

We have been on top of the administration of the PPP since its inception, helping clients—ranging from small and mid-sized business owners to stakeholders—navigate the lending process. *(cont'd on next page)*

As issues with the loan forgiveness process began to emerge, our transactional lawyers and litigators have worked together to provide support to clients pursuing challenges to SBA forgiveness decisions and defending against enforcement actions.

We also help lenders ensure their loan programs are compliant with all applicable laws and regulations, assists in responding to government inquiries, and defends challenges to PPP lending and forgiveness decisions. For more information, click here or reach out to one of the authors of this alert.

About the Authors

Amy Arndt is the Managing Partner of Ballard Spahr's Sioux Falls office, a member of the firm's Elected Board, and is the Practice Leader of the firm's Owner-Managed and Closely Held Businesses Group. Known for her strategic and client service-oriented approach, Amy assists business owners with operational issues, management succession, financing options for growth, and restructuring. Her practice emphasizes securities and corporate finance and she represents clients in various industries such as agri-business, real estate, hospitality, consumer products, manufacturing, and renewable energy.

Amy has significant experience advising privately held companies on private offerings/placements and finance, corporate governance, disclosure matters, mergers and acquisition transactions, and asset acquisitions and divestitures. She acts as outside general counsel to clients advising on various matters including formation, shareholder agreements, and internal corporate structuring.

Terence M. Grugan is an experienced civil litigator, investigator and trial attorney. His practice consists of representing clients in investigations and litigation implicating compliance with and enforcement of government regulations, principally the Bank Secrecy Act (BSA) and related regulations and securities laws. In addition, he regularly represents clients in corporate governance and shareholder disputes. He is a frequent writer and speaker on issues of compliance and enforcement.

Terence is co-leader of the Firm's Anti-Money Laundering (AML) practice team. In his AML practice, Terence represents financial institutions in matters implicating their practice under the BSA and related AML laws, including compliance program advice, internal investigations, regulatory examinations, and related civil litigation. Terence has represented national banks in civil litigation relating to account holders engaged in Ponzi, securities fraud and consumer fraud schemes. He has also conducted due diligence on entities' compliance with applicable BSA and AML laws. In addition, Terence has represented lenders in ensuring compliance with the Small Business Administrations' PPP loan program and borrowers appealing Small Business Administration denials of PPP loan forgiveness applications.

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Selected Transactions

$300,000,000 HONOR CAPITAL has raised debt and equity growth capital, and recapitalized its balance sheet EXCLUSIVE FINANCIAL ADVISOR	Amount Not Disclosed ACUMEN has been acquired FINANCIAL ADVISOR	Amount Not Disclosed REVENUE GUARD has been acquired by CORONIS EXCLUSIVE FINANCIAL ADVISOR	$50,000,000 HIGH RISE FINANCIAL Senior Secured Debt Facility EXCLUSIVE FINANCIAL ADVISOR	$250,000,000 DIVIDENDSOLAR has merged with Figtree and secured equity and debt financing affiliates of LL Funds, LLC EXCLUSIVE FINANCIAL ADVISOR
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$200,000,000 ENTERRA ENERGY TRUST Oil & Gas Income Trust (NYSE: ENT and TSX: ENT.UN) Senior and Junior Secured Credit Facilities EXCLUSIVE FINANCIAL ADVISOR	$185,000,000 glori ENERGY has merged with INFINITY CROSS BORDER ACQUISITION CO. (NASDAQ: INXBU) EXCLUSIVE FINANCIAL ADVISOR	$20,000,000 ADF APPLIED DATA FINANCE Mezzanine Debt CO-ADVISOR	$140,000,000 EnergySouth MIDSTREAM (NASDAQ NMS: ENS) & FORTRESS have acquired MISSISSIPPI HUB LLC EXCLUSIVE FINANCIAL ADVISOR	$278,000,000 i-trax (AMEX: DMX) has been acquired by Walgreens EXCLUSIVE FINANCIAL ADVISOR

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