Middle Market Update

Q3 2022

BRYANT PARK
CAPITAL

PHILADELPHIA, PA
484-586-8200

NEW YORK, NY
212-798-8200

www.bryantparkcapital.com

Federal Reserve Perspective

- U.S. real gross domestic product ("GDP") increased by 2.6% in Q3 2022, compared to a 0.6% decrease in Q2 2022. This marks the first quarterly increase in GDP in 2022; nonetheless, the Federal Reserve (the "Fed" or "FOMC") continued to decrease its cumulative GDP forecasts for full year 2022 and 2023[1,5]
- Steady job gains throughout Q3 2022 have led to modest growth in spending and production. Inflation in the U.S. and globally remains elevated due to continued supply and demand imbalances related to the ongoing war in Ukraine, higher food and energy prices, and broader price pressures[1]
  - The Fed continued to raise the Federal Funds Rate throughout Q3 2022, expanding its target rate to 3.00% - 3.25% in September after a series of rate hikes totaling 275 bps, while expressing the likelihood of further rate hikes in Q4 2022 and early 2023
  - Additionally, the FOMC continued its balance sheet runoffs, doubling its redemption caps on Treasury securities and agency mortgage-backed securities to $60 billion and $35 billion, respectively
    - Current staff projections remain consistent, with the portfolio anticipated to decline by roughly $400 billion by the end of 2022
- The Consumer Price Index ("CPI") measures the change in prices paid by consumers for goods and services. The CPI data released in September is reflective of decelerating costs in energy commodities throughout Q3 2022; however, multiple components of the index continued to accelerate[2]
  - The CPI increased 0.4% in September on a seasonally adjusted basis, compared to a 1.3% increase in June; the index has risen 8.2% over the last 12 months
  - Energy commodities and energy services remain the largest increases in the index over the last 12 months, both rising 19.8%

Employment

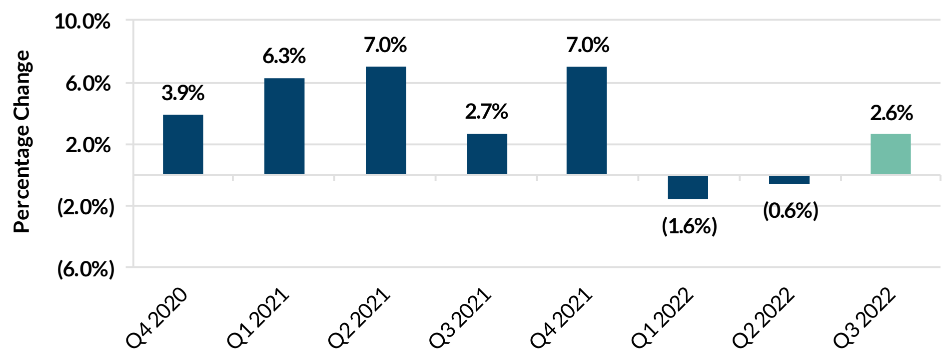
- At the end of September 2022, the U.S. unemployment rate fell to 3.5% from 3.6% in June 2022[2]
  - The participation rate increased slightly in Q3 2022, from 62.2% in June to 62.3% in September

U.S. Treasury Securities

- Treasury yields continued to rise in Q3 2022 with the average one–year and five-year yield increasing by 125 bps and 28 bps, respectively, from Q2 2022[3]

	Q4 2021	Q1 2021	Q2 2022	Q3 2022
1-Year Treasury Bill	0.18%	0.92%	2.13%	3.38%
5-Year Treasury Note	1.18%	1.83%	2.95%	3.23%
10-Year Treasury Note	1.53%	1.95%	2.94%	3.10%
30-Year Treasury Bond	1.95%	2.26%	3.04%	3.26%

Real GDP Annualized Growth[5]



Outlook for 2022

- The Federal Reserve projects U.S. real GDP expansion of 0.2% in 2022 and 1.2% in 2023 as of September 2022. The projection for 2022 and 2023 decreased by 1.5% and 0.5%, respectively, from the projections released in June 2022[1]
  - The Fed's projection for inflation in personal consumption expenditures in 2022 increased to 5.4%, 0.2% higher than its June projection. It projects inflation will decline to 2.8% in 2023 and remain near 2.0% in the long-run
  - Additionally, the Fed's projections for unemployment also rose, reaching 3.8% and 4.4% for 2022 and 2023, respectively, representing a 0.1% and 0.5% increase from its June projections
- Business Roundtable's CEO Economic Outlook Survey, a composite index of CEOs' plans for capital spending, hiring, and expectations for sales over the next six months, had an index reading of 84 in Q3 2022, a decrease of 12 points from Q2 2022[4]
  - The index has steadily decreased from the record high Q4 2021 score of 124 due to decelerating sales growth and heightened global economic concerns
  - When asked about expectations for sales growth in the coming six months, 16% of respondents said they expected decreases, up from 11% in Q2 2022
  - When asked about expectations for employment growth in the coming six months, 19% said they expected decreases, also up from 11% in Q2 2022
- Consumer confidence increased for two consecutive months in Q3 2022 largely due to increasing wages and decreasing gas prices[6]
  - The Consumer Confidence Index ("CCI"), a survey which measures how optimistic or pessimistic consumers are regarding their expected financial situation, increased to 108.0 in September from 103.6 in August, now standing 9.3 points higher than June 2022

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

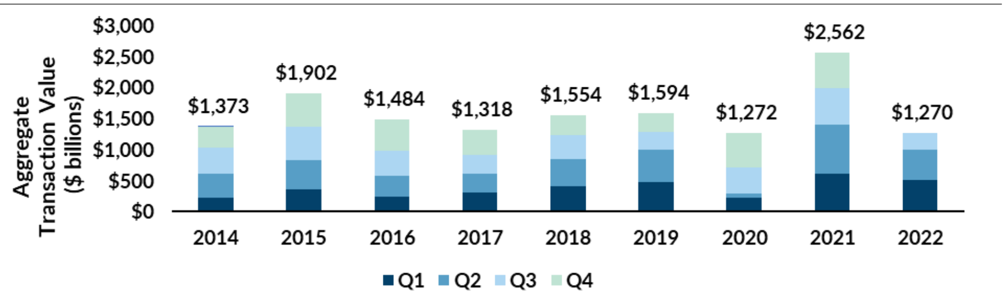
Bryant Park Capital

Mergers & Acquisitions and Private Equity

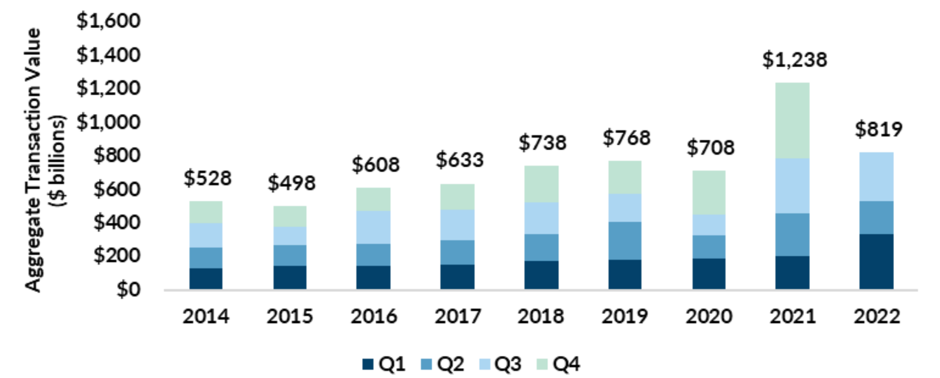
Mergers & Acquisitions

- Global merger and acquisition ("M&A") values decreased in Q3 2022 to $1.0T in deal value, down from $1.2T in Q2 2022. Global M&A volumes remained near their previous levels, with 10,118 deals in Q3 2022 compared to 10,037 deals in Q2 2022[1]
  - The current decrease in deal value can be viewed as a correction from last year's post-pandemic deal momentum which peaked in Q4 2021 with $1.4T in aggregate deal value
  - The number of M&A deals remained above the quarterly pre-pandemic average between 2010 and 2020 of 6,819
  - The consumer products and services sector saw the largest decrease in M&A value, from $205.1B in Q2 2022 to $104.3B in Q3 2022
  - Materials and resources was the only sector that saw growth in deal value, from $30.7B in Q2 2022 to $32.8B in Q3 2022
- U.S. M&A deal value totaled $274.3B in Q3 2022, representing a 43.9% decline from the Q2 2022 value of $489.1B. U.S. M&A volume decreased by 483 transactions in Q3 2022 to 1,496 from 1,979 in Q2 2022[2]
  - The slump in U.S. M&A activity was attributed to rising interest rates, public stock market decline, and the ongoing war in Ukraine[1]
    - Due to persistent inflation, the Fed has raised interest rates five times throughout 2022. This has led to expectations of slower economic growth due to company earnings being discounted at higher rates
    - The ongoing war in Ukraine continued to disrupted energy supply lines and deteriorate the economic outlook in Europe, in turn, weakening the euro. A weaker euro may begin attracting U.S. investors with greater purchasing power to opportunities abroad
    - Tech remains a leading sector for sizeable deals with the largest acquisition being Adobe's $20.0B purchase of Figma
- The U.S. middle market median Enterprise Value / EBITDA multiple increased from 7.4x in Q2 2022 to 9.8x in Q3 2022[3,4]

U.S. M&A Activity[1]



U.S. Private Equity Deal Flow[1]



Private Equity

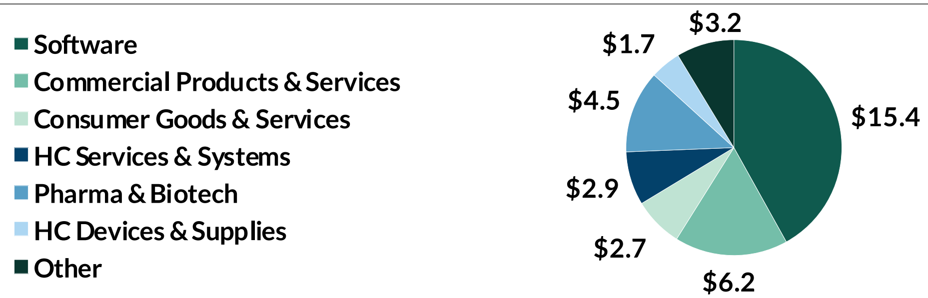
- U.S. private equity ("PE") fundraising slowed in Q3 2022 with $82.8B raised, a decrease of 25.5% compared to the Q2 2022 value of $111.2B[1]
  - Q4 2022 is expected to produce further declines in fundraising and the consensus view among analysts is the majority of funds will need to postpone their closings to 2023
  - Nonetheless, fundraising activity remains on par with 2021 which was a record year for PE fundraising at $366.1B
- U.S. PE deal value increased by 46.2% from $198.4B in Q2 2022 to $290.0B in Q3 2022. Despite a hostile market environment, the industry remained resilient and continued to deploy its reserves of dry powder[1]
  - 2,530 deals were completed in Q3 2022, as compared to 2,296 in Q3 2021, representing a 10.2% increase year-over-year
  - Take-privates are on track for a second year of $100B or more in aggregate deal value, a first for the industry in more than a decade
    - The notable take-privates featured several software-as-a-service companies, including Avalara, Zandesk, and ChannelAdvisor which presented steep discounts in valuation as compared to the prior year
    - The trend with take-privates mirrors fundraising, where fewer funds with larger transaction sizes are leading the market
- U.S. PE exits reached a cumulative value of $89.0B in Q3 2022, a slight decrease from $94.5B in Q2 2022[1]
  - Although PE exits are decreasing as compared to previous quarters and the record levels of 2021, they are still on pace to meet the $400B annual average of pre-pandemic years
  - The slow down is expected to continue due to a resistance among sponsors to accept lower valuations caused by higher interest rates

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. *GF Data*

Venture Capital Investing

- Globally, venture capital ("VC") investments dropped in value and count from $120.2B across 8,420 transactions in Q2 2022 to $87.0B across 7,817 transactions in Q3 2022[1]
  - Slowdowns are expected to continue in Q4 2022 as VC investors remain very conservative with their investments, focusing primarily on proven companies with resilient business models and profitability
  - While startups with profitable business models are likely to continue to raise traditional VC funding rounds, others are showing increasing interest in alternative financing solutions, such as debt financing, to avoid delay in their next funding round
  - These alternative solutions can be more expensive, creating a challenge for startups with little to no hard assets available for collateral
- U.S. Q3 2022 YTD VC fundraising value reached $150.9B across 593 funds, surpassing the $96.0B raised across 526 funds throughout Q3 2021 YTD[2]
- Deal value in the U.S. fell 31.0% from $62.3B in Q2 2022 to $43.0B in Q3 2022[2]
  - Despite the challenges permeating the U.S. market, several companies raised large funding rounds during the quarter, including space exploration company SpaceX at $1.9B, electric vehicle infrastructure company TerraWatt Infrastructure at $1.0B, and nuclear innovation company TerraPower at $750M[1]
  - U.S. VC mega-deals, deals valued at $100M or more, decreased in aggregate value by 40.2% from $32.1B in Q2 2022 to $19.2B in Q3 2022
- VC exit value increased slightly from $13.1B in Q2 2022 to $14.0B in Q3 2022[2]
  - Acquisitions accounted for the largest exit strategy by value, making up 72.9% of the total exit value across 151 deals in Q3 2022
  - Five companies exited via traditional Initial Public Offerings ("IPO") in Q3 2022 compared to eight traditional IPO exits in Q2 2022
- Non-traditional investors in VC, such as corporations, limited partnerships, and PE firms, deployed $30.2B in Q3 2022, a 30.7% decrease from $43.6B in Q2 2022[2]
  - The slowdown in non-traditional investors is expected as they tend to participate heavily in mega-deals, which decreased in volume by 34.5% this quarter
  - Deal count participation has declined for all non-traditional investor types except for corporate investors, which were involved in more than a quarter of all completed deals in 2022

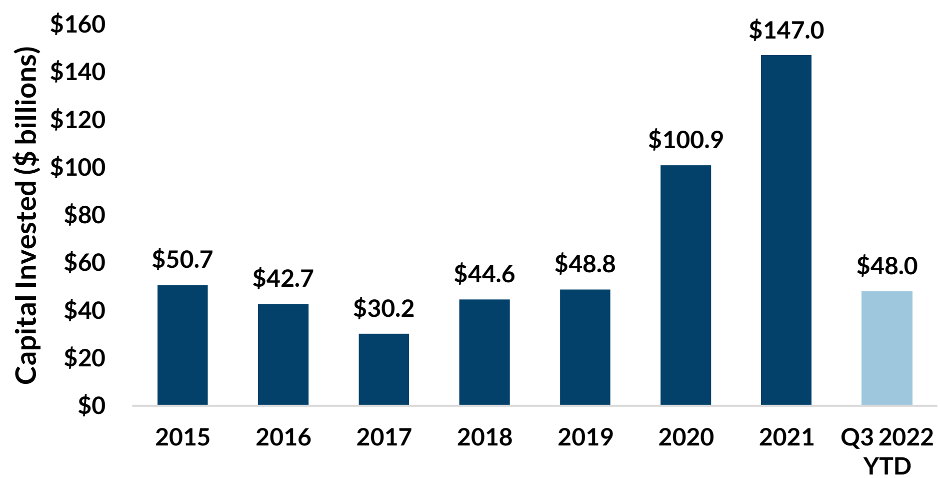
U.S. VC Deal Value per Industry ($ billions): Q3 2022[2]



PIPE Investing

- Through the first three quarters of 2022, there have been 950 U.S. Private Investment in Public Equity ("PIPE") deals valued at $48.0B compared to 1,502 deals valued at $125.0B through Q3 2021
  - This represents a year-over-year decrease of 36.8% and 61.6% in deal volume and value, respectively

U.S. PIPE Activity[3]



Equity Markets and Corporate Earnings

- U.S. equities continued to see price depreciation throughout Q3 2022, with the S&P 500 Index, Nasdaq Composite, and Dow Jones Industrial Average falling 6.3%, 7.6%, and 5.0%, respectively[4]
  - The primary factors driving market volatility include inflation, Fed quantitative tightening, and the surfacing energy crisis in Europe[6]
  - High-growth technology stocks, such as Google and Meta, have been especially sensitive to rising interest rates, which increases discount rates, resulting in lower company valuations[5]
- 71.0% of S&P 500 company earnings reported a positive EPS surprise and 68.0% reported a positive revenue surprise in Q3 2022[7]
  - The forward 12-month Price to Earnings ("P/E") ratio for the S&P 500 is 16.3x as of Q3 2022, below its 5-year and 10-year averages of 18.5x and 17.1x, respectively. This demonstrates the broad market decreases in stock valuations compared to company profits
  - The Energy sector was the largest contributor to earnings growth for the S&P 500 in Q3 2022. The sector reported an aggregate year-over-year increase in earnings of $33.0B, while the S&P 500 overall reported $10.1B

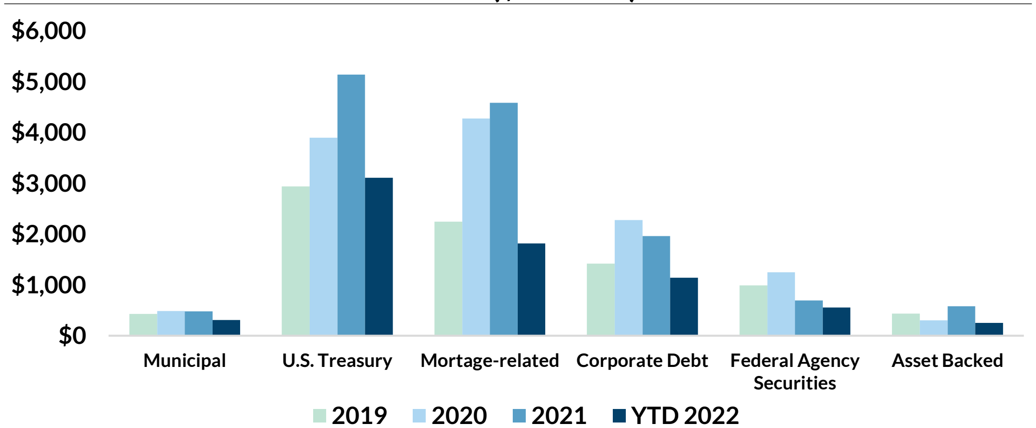
1. *KPMG*
2. *PitchBook*
3. *PlacementTracker*
4. *CapIQ*
5. *Morningstar*
6. *Winthrop Wealth*
7. *Factset*

Bryant Park Capital
Debt Capital, IPO Market, and Middle-Market Lending

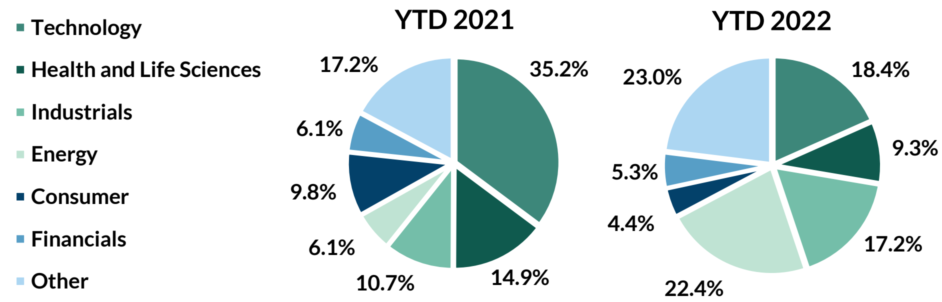
Debt Capital

- The return on the Barclays U.S. Aggregate Bond Index declined 4.8% in Q3 2022, compared to a loss of 4.7% in Q2 2022[1]
- Persistent inflation and strong job growth will keep the Fed aggressively raising rates to reduce demand, which ultimately drives hard landing fears. Spreads and yields on government bonds have continued to rise. This is unlike previous cycles where widened spreads and economic slowdowns led to lower government bond yields, and presents a rare circumstance of both peaking yields and spreads[1]
- In Q3 2022, corporate bond issuances totaled $298.0B, representing a decrease of 3.4% from Q2 2022 and a decrease of 32.5% from the same period last year[2]
  - Investment-grade corporate bond issuances totaled $274.3B in Q3 2022, a decrease of 2.7% from $281.8B in Q2 2022
  - The Barclays Investment Grade U.S. Corporate Bond Index declined by 5.1% in Q3 2022, after posting a loss of 7.3% in Q2 2022[1]
- Total U.S. bond issuances for Q3 2022 were roughly $2.1T, a 9.1% decrease from Q2 2022 and a 34.8% decrease from $3.2T in Q3 2021[2]
  - U.S. Treasuries, mortgage-backed, municipal, and asset-backed issuances were down 11.8%, 19.4%, 16.1%, and 39.0%, respectively; meanwhile, federal agency security issuances increased 72.5% compared to Q2 2022
  - Both the returns for U.S. Treasuries and mortgage-backed securities declined 4.4% and 5.4%, respectively, while the return for municipal bonds was slightly higher with a loss of 3.5% at the end of Q3 2022[1]
- Global sustainable-bond issuances, which include green, social, and sustainability-linked bonds, totaled $169.0B in Q3 2022, down 8.6% from Q2 2022[2]
  - Green Bonds, bond instruments whose proceeds are dedicated to Green Projects, remained near a two-year low for issuances at $106.0B, a decrease of 14.5% from $124.0B in Q2 2022

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



Global IPO Proceeds by Sector[3]



IPO Market

- Globally, Q3 2022 saw 366 IPOs, representing a 20.0% increase in volume from Q2 2022[3]
  - IPO deal proceeds reached $51.0B in Q3 2022, a 25.6% increase from Q2 2022 and a 55.9% decrease from Q3 2021
  - The sectors with the most IPO volume were technology, consumer, and industrials, with 98, 55, and 49 deals, respectively, in Q3 2022
- Q3 2022 continued the dry spell for U.S. IPOs with only five traditional IPOs during the quarter[4]
  - There were a total of 6 SPAC IPOs in the U.S. during Q3 2022, down 57.1% from 14 SPAC IPOs in Q2 2022
- Globally, there were 48 SPAC mergers announced in Q3 2022. Out of 140 pending SPAC deals, 18 deals were cancelled, representing a 63.6% increase from Q2 2022. Nonetheless, extensive liquidity has kept market participants optimistic of new opportunities, leading to investors shifting their focus to more mature businesses with consistent cash flow; this also addresses the high redemption environment[5]

Lending Market

- Issuances for institutional leveraged loans totaled $21.4B in Q3 2022, the lowest output since 2009, decreasing 61.2% from Q2 2022 and 86.0% from Q3 2021[6]
  - Leveraged buyout ("LBO") loan issuances fell to $10.6B in Q3 2022, down 44.7% from $19.1B in the previous quarter
  - M&A (non-LBO) loan issuances totaled $5.7B in Q3 2022, decreasing 67.5% from $17.5B in Q2 2022
  - In addition, refinancing and dividend recapitalization loan issuances fell by 80.7%, and 92.8%, respectively, from Q2 2022
- As investors become more risk-averse, lower-rated borrowers become less attractive. There were no issuances of bonds rated CCC or lower in Q3 2022, marking the first quarter with no CCC prints since Q1 2009[6]

1. *Prudential*
2. *SIFMA*
3. *E&Y*
4. *PwC*
5. *ICR*
6. *PitchBook*

By Dr. Joe Brusuelas, RSM US LLP Chief Economist, and Dr. Tuan Nguyen, RSM US LLP U.S. Economist

Restoring price stability is now the paramount policy goal at the Federal Reserve. That objective will shape economic conditions over the next few years in a manner that will most likely result in slower growth and higher unemployment. But how high must unemployment rise to push inflation back toward the Fed's 2% target?

For an answer, we revisit the Phillips curve—which shows the relationship between inflation and the unemployment rate—to estimate the job losses that would be required to meet such a difficult goal. We then introduce a new variable—the RSM US Supply Chain Index—that accounts for the supply chain distortions during the pandemic and improves the performance of the Phillips curve model.

To reduce inflation to acceptable levels—using the personal consumption expenditures price index as our preferred metric—it will be necessary to sacrifice between 1.7 million and 6 million jobs, in our estimation. That decline would translate to an unemployment rate that rises to a minimum of 4.6%, or possibly as high as 7.2%.

The policy implications are stark.

First, it will be difficult to get back to a 2% inflation target in the near term without triggering a recession that results in somewhere between 5 million and 6 million job losses. Second, the Fed could engage in "opportunistic reflation" and lift its inflation target to 3%, which would require an increase in unemployment to 4.6% and result in a loss of roughly 1.7 million jobs. That is as close as we may get to a soft landing.

While that outcome would be optimal, resetting the inflation target from the flexible target of 2% announced two years ago would hurt the Fed's credibility. But the Fed may have little choice. Given the size of the policy challenge, the economy's move from insufficient aggregate demand to insufficient aggregate supply, and the proliferation of risks to the economy, we would not be surprised if the Fed pushed inflation back down to 3% and then revised its target rate to match.

The Phillips curve trade-off

Named after the economist A.W. Phillips, the Phillips curve has become a cornerstone of modern macroeconomics. In his seminal paper published in 1958, Phillips pointed out the inverse relationship between unemployment and wage growth. Since then, the curve has been extended and augmented to show the short-term relationship between unemployment and inflation, with major contributions from two Nobel laureates in economics, Edmund Phelps and Milton Friedman, in the 1960s. The theory behind the trade-off between unemployment and inflation is that when unemployment is low, wage income is higher, which fuels more spending demand in the short run. Given the stickiness of supply in the short run, an increase in demand will push prices higher, causing inflation to rise.

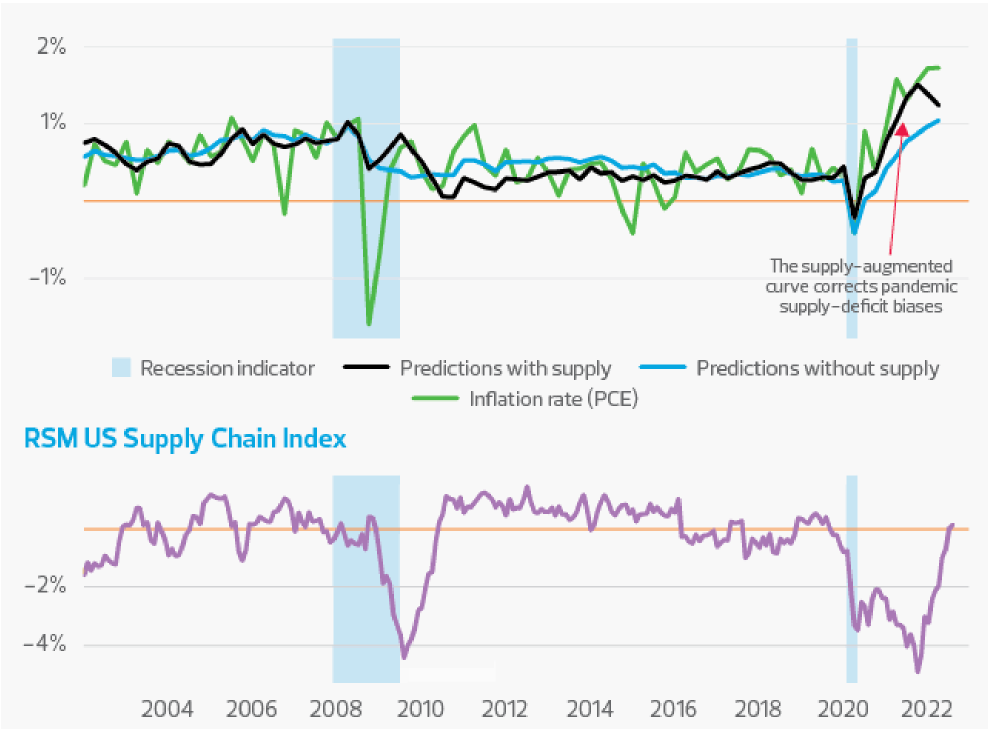
The opposite is also true: High unemployment leads to lower inflation. But in recent years, and especially during the pandemic, the Phillips curve relationship has become less clear, adding to the reasons why both market participants and the Fed's inflation forecasts were so wrong. In hindsight, the primary explanation for the Fed's failure to stay in front of the curve regarding inflation is the unique pandemic-related supply chain disruptions, which have been anything but transitory.

Given that explanation, we revisit the Phillips curve to identify the level of unemployment that would be needed to bring inflation back down to the long-term target, but with an important twist: adding a proxy variable for supply chain deficiencies using data from our proprietary RSM US Supply Chain Index.

Our supply-augmented Phillips curve includes five variables:

- Inflation expectations measured by the Fed's index of common inflation expectations
- The unemployment rate
- The Congressional Budget Office's natural rate of unemployment estimates
- The RSM US Supply Chain Index
- The inflation rate based on the personal consumption expenditures price index

Phillips curve inflation predictions vs. actual inflation*



Source: Various government and private organizations; Bloomberg; RSM US LLP *Quarter-over-quarter % growth*
Note: An index value of zero is defined as a normal level of supply chain efficiency. Positive values of the index suggest adequate levels; negative levels suggest deficiencies.

The inflation prediction results from both Phillips curve versions—those with and without the supply chain index—are shown in the graph above. Without controlling for supply chain deficits during the pandemic, the Phillips curve shows significant downside biases, failing to predict how elevated inflation would be. In contrast, by including a proxy for the supply chain, the Phillips curve predictions track actual inflation levels significantly better.

Similarly, from 2012 to 2016, when there was a supply surplus, the supply-augmented Phillips curve shows a much better fit to the actual data, correcting the upside biases. With the supply chain index added, the predicting performance of the Phillips curve in the studied period improves by 73% in terms of mean-squared error benchmarks.

The takeaway

Despite the economic pain that will be required to restore price stability, it is ultimately in the interest of the real economy that it be done and done quickly. In 1980 and 1981, Fed Chairman Paul Volcker arguably did the right thing by hiking the overnight rate to 18% to 20% to create the conditions to restore price stability over the long term. While the current bout of inflation in the United States will not require that type of root-canal economics, it will be necessary over the coming year or two to drive the unemployment rate higher.

Click here to access the full article on RSM's website.

About the Authors

Dr. Joe Brusuelas is principal and chief economist for RSM US LLP, serving as a leading voice of the middle market and the U.S. economy. He has more than 20 years of experience as an economist specializing in the accounting industry. Joe is committed to identifying conditions and trends in the U.S. and global economy to help RSM's clients prosper in an age of rapid transformation.

Dr. Tuan Nguyen is an economist at RSM US LLP who analyzes high-frequency economic data within the United States and global economies to better understand its impact on the American middle market. Based in the firm's New York City office, Tuan's data-driven economic analysis and insights enhance the ability of middle market companies to thrive in an increasingly competitive and global economy.

Executives & Principals

Joel Magerman
Managing Partner
jmagerman@bryantparkcapital.com

Matt Pennino
Managing Director
mpennino@bryantparkcapital.com

Raymond Kane
Managing Director
rkane@bryantparkcapital.com

Bill Miner
Principal
bminer@bryantparkcapital.com

Receive our *Middle Market Update* straight to your inbox

Sign Me Up

CELEBRATING 30 YEARS
30 YEARS
M&A - Capital Raising - Advisory

Please Visit

www.bryantparkcapital.com

Member FINRA / SIPC

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	$40,000,000 RapidFunds Senior Secured Term Loan EXCLUSIVE FINANCIAL ADVISOR	$50,000,000 HIGH RISE FINANCIAL Senior Secured Debt Facility EXCLUSIVE FINANCIAL ADVISOR	$250,000,000 DIVIDENDSOLAR has merged with Figtree FINANCING and secured equity and debt financing affiliates of LL Funds, LLC EXCLUSIVE FINANCIAL ADVISOR
$75,000,000 PAWNEE LEASING CORPORATION Term-Out Facility EXCLUSIVE FINANCIAL ADVISOR	$104,500,000 lēgis Capital Raise EXCLUSIVE FINANCIAL ADVISOR	Amount Not Disclosed NORTH MILL EQUIPMENT FINANCE LLC has been acquired by WAFRA CAPITAL PARTNERS EXCLUSIVE FINANCIAL ADVISOR	$31,000,000 ReMeD has been acquired by US Community Behavioral a portfolio company of BregalPartners EXCLUSIVE FINANCIAL ADVISOR	$35,000,000 HEALTHCARE FUNDING + PARTNERS Senior Secured Debt Facility EXCLUSIVE FINANCIAL ADVISOR
$150,000,000 MoneyLion Senior Secured Credit Facility EXCLUSIVE FINANCIAL ADVISOR	Amount Not Disclosed Lighthouse Life Growth Capital Investment EXCLUSIVE FINANCIAL ADVISOR	Amount Not Disclosed nuehealth Senior Credit Facility ARES EXCLUSIVE FINANCIAL ADVISOR	$150,000,000 GOLDEN PEAR FUNDING $100,000,000 Senior Secured Credit Facility $50,000,000 Additional Commitment EXCLUSIVE FINANCIAL ADVISOR	$95,600,000 US HOME SYSTEMS (NASDAQ:USHS) has been acquired by THE HOME DEPOT (NYSE: HD) EXCLUSIVE FINANCIAL ADVISOR
$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	Amount Not Disclosed USCLAIMS LITIGATION FUNDING | Est. 1996 Senior Secured Debt Facility EXCLUSIVE FINANCIAL ADVISOR	Amount Not Disclosed AEQUUM has received an equity investment EXCLUSIVE FINANCIAL ADVISOR	$140,000,000 EnergySouth MIDSTREAM (NASDAQ NMS: ENS) & FORTRESS have acquired MISSISSIPPI HUB LLC EXCLUSIVE FINANCIAL ADVISOR	Up to $120,000,000 GOLDEN PEAR FUNDING Structured Portfolio Sale & Forward Flow Agreement EXCLUSIVE FINANCIAL ADVISOR