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PitchBook

2019 in Review
and Observations
for 2020

PErspectives
on U.S. Middle Market Private Equity

Volume III Edition I

Contents

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PErspectives Editors/Producers: Carl Roston and Palash Pandya.

2019 in Review and Observations for 2020

As private markets are highly correlated with macroeconomic conditions, it is a safe bet that the buyout market will ebb and flow with the economy. And since our piece in late 2018, we have become circumspect about how long a record economic expansion in the U.S. can last. The durability of this aging and historically-long economic expansion, a potential reversion to the mean of interest rates, uncertainty in Washington as to trade, economic and tax policy in advance of the 2020 elections, increasing sovereign debt, geopolitical tensions and the inevitable angst that expansions often reverse due to unforseen events will all continue to weigh on the U.S. buyout middle market. The impact of these factors largely will be determinative of whether the slowdown in transaction activity for U.S. sub-$1B buyout funds, and in exit activity throughout the U.S. buyout middle market, during the fourth quarter of 2019 are indicators of things to come or anomalies. Political rapprochement, business-friendly public policy, good fortune with respect to geopolitical events, and a deft touch by the Federal Reserve, can only improve the buyout landscape and assuage the recently expressed macroeconomic and market concerns of respected market pundits.

Despite a slowdown in fundraising during 2019, the number of fund offerings remains healthy.

As the industry continues to mature, it is logical to continue to see a broader array of choices (e.g., by industry, stage, size, and geography) to attract LPs to this illiquid asset class.

Increased sophistication of GPs and developing relationships with management teams well in advance of a potential liquidity event will also be a differentiator in returns.

Rapid industry consolidations, buy-and-build, and add-on strategies are expected to support U.S. buyout middle market activity during 2020. And as the amount of dry powder raised by larger funds remains at record levels, secondary buyouts are expected to significantly bolster middle market buyout activity in 2020.

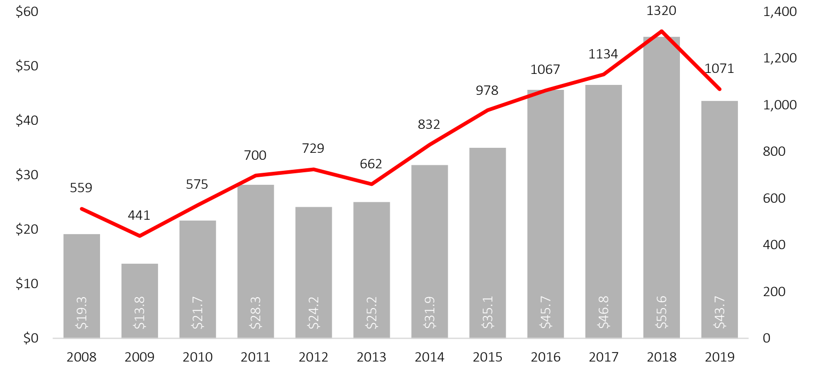
Deal Activity

Strengthened by record dry powder, accommodative credit markets, and a historically long period of uninterrupted economic growth, and consistent with overall U.S. and global M&A transaction activity, the U.S. buyout middle market and the sub-$1B subsector remained strong (albeit at a weakening pace) in 2019 following a record setting 2018 for annual deal value and count. While deal activity for the overall U.S. buyout middle market was stronger in each quarter during 2019 compared to the prior year, deal activity for the sub-$1B subsector declined during the second half of 2019 compared to the prior year.

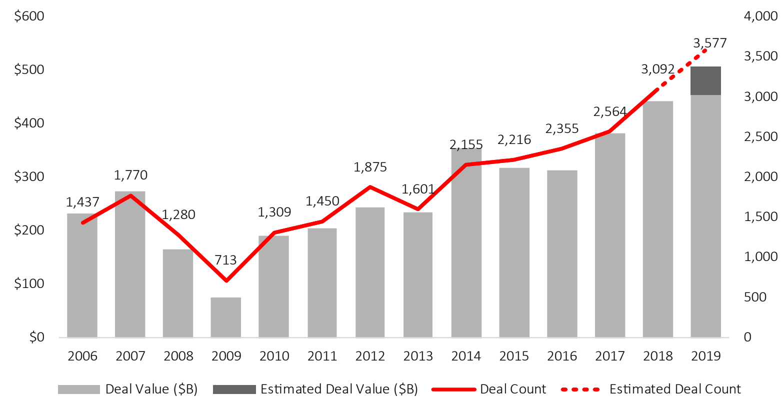
Acquisition activity in the sub-$1B subsector as a percentage of the U.S. buyout middle market continued its slight decline for the fourth year.

Deal activity during 2020 likely will continue to be highly correlated with the continuation of the factors that led to a decrease in deal activity in the sub-$1B subsector: weakening the U.S. economy, tightening credit markets, increasing market volatility, and increasing political uncertainty and geopolitical tension.

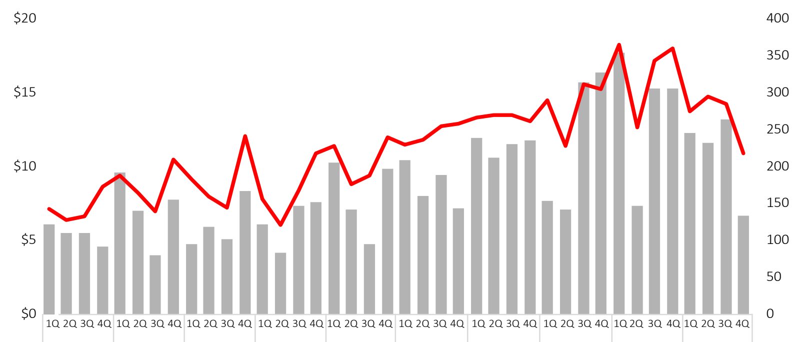
US PE activity by year (Akerman methodology)



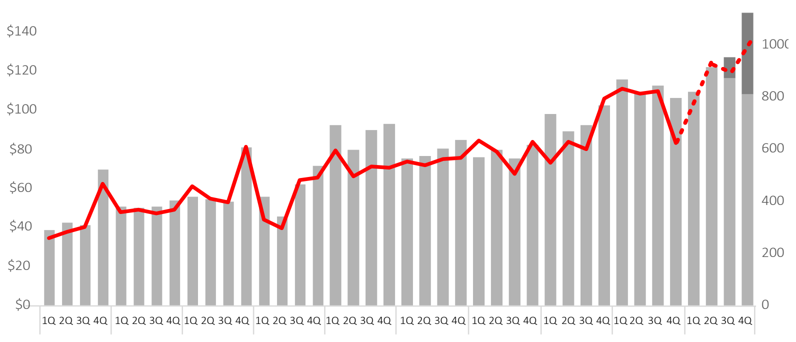
US PE MM deal activity by year (PitchBook methodology)



US PE activity by quarter (Akerman methodology)



US PE MM deal activity by quarter (PitchBook methodology)

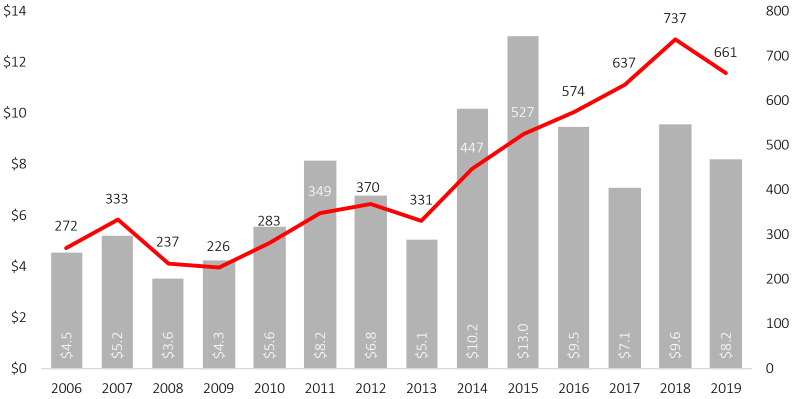


Source: Pitchbook

Add-Ons

The number of add-ons during 2019 in the sub-$1B subsector declined compared to a record setting 2018, while the aggregate value of add-ons declined slightly from 2018.

US PE add-on deals (Akerman methodology)

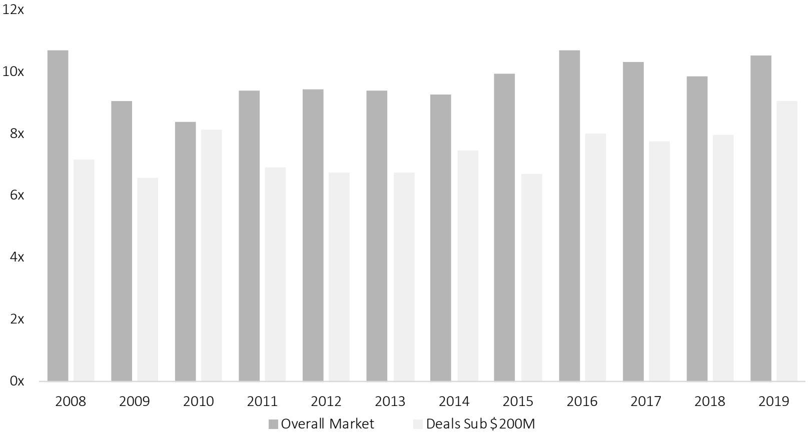


Source: Pitchbook

Valuation Multiples

Valuation/EBITDA multiples in the U.S. buyout middle market remain at historically rich levels, in large part due to the factors that drove record deal activity. Valuation/EBITDA multiples for the sub-$1B subsector increased during 2019 to eclipse the record highs of 2016, while these valuation multiples for the overall U.S. buyout middle market experienced an increase following two consecutive years of declines. While the valuation multiples for these asset classes has narrowed, there remains room for multiple expansion as multiples for the broader U.S. buyout middle market remained almost one and one-half turns higher on average than for the sub-$1B subsector.

US PE valuation/EBITDA multiples (Akerman methodology)



Source: Pitchbook

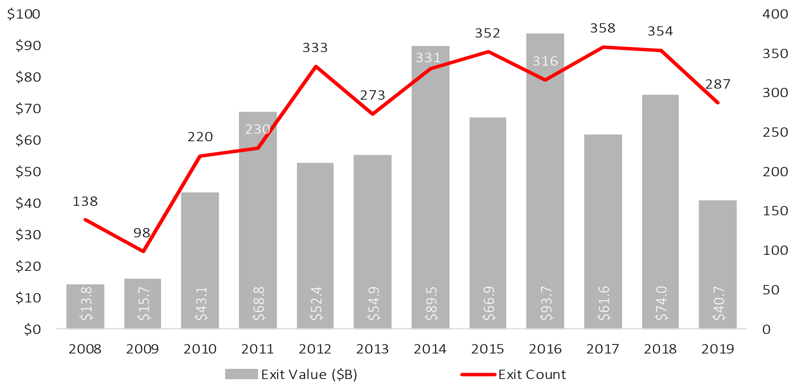
Exits

While exit activity has experienced tailwinds from heightened acquisition activity since the Great Recession, longer hold periods and the factors noted above that adversely impacted acquisition activity during 2019 are creating headwinds. Exit activity in terms of the number of exits and exit value for U.S. sub-$1B buyout middle market declined sharply during 2019 compared to the prior year.

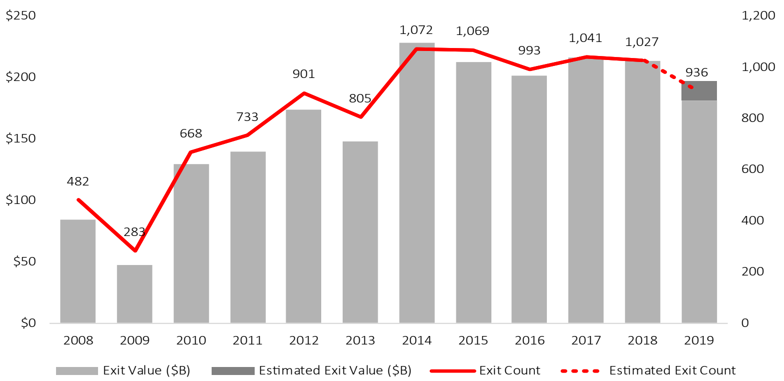
Fund-raising

During 2019, for the U.S. buyout middle market, the number of funds and aggregate dollars raised by those funds increased from the prior year. While for the sub-$1B subsector, the aggregate dollars raised by these funds remained steady from the prior years, even through the, the number of funds declined from the prior year. The decline in the aggregate dollars for sub-$250M funds was more pronounced during 2019 than was the case for larger U.S. middle market buyout funds.

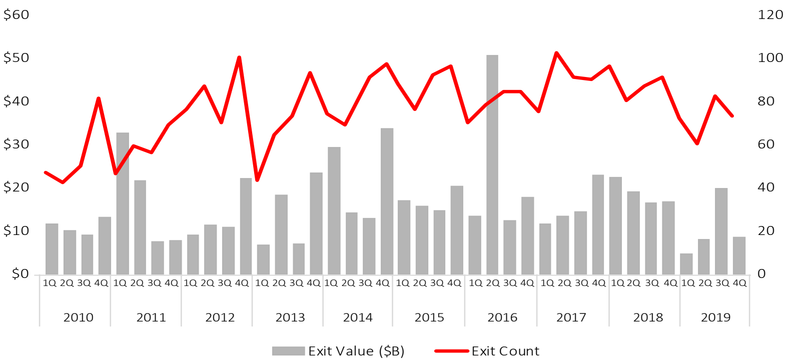
US PE exit activity by year (Akerman methodology)



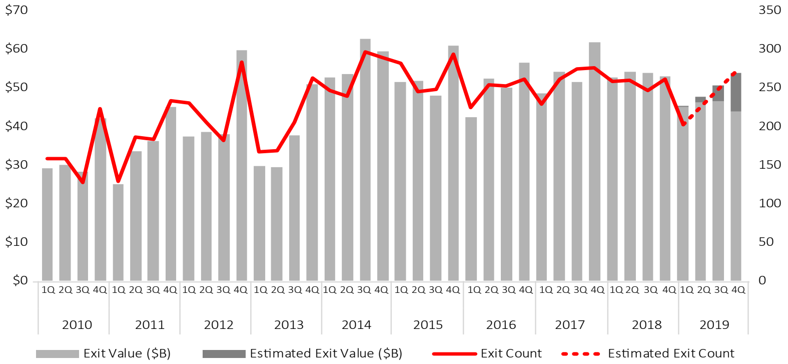
US PE-backed MM exits (PitchBook methodology)



US PE exit activity by quarter (Akerman methodology)



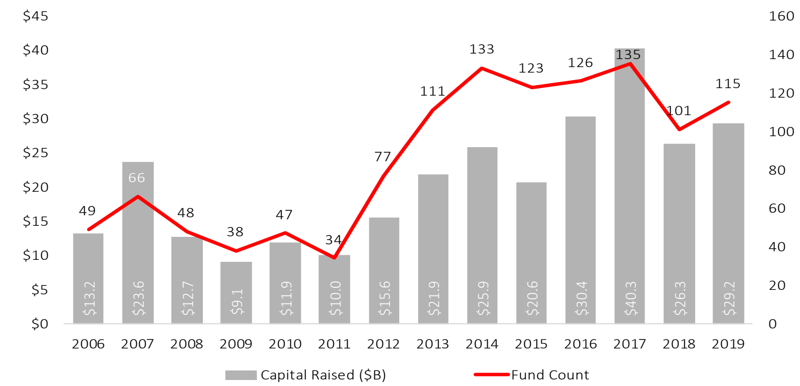
US PE-backed MM exits (PitchBook methodology)



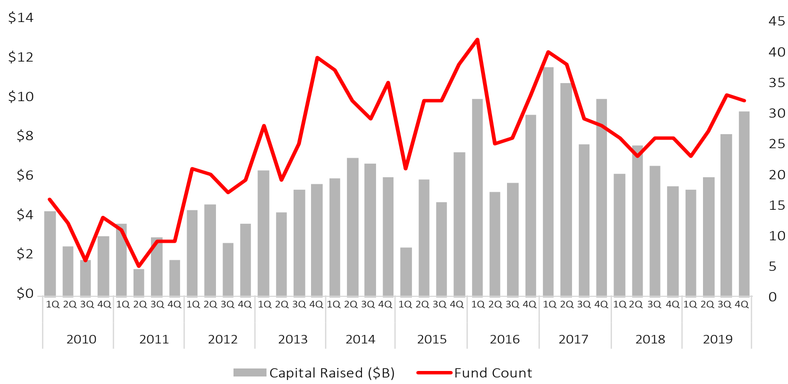
Source: Pitchbook

Where both funds between $250M-$500M and $1B-$5B saw a substantial increase, they also decreased significantly in terms of value raised and number of funds to levels fund in 2013. This decline was in large part due to the record levels of dry powder, concerns about the age of the economic cycle, a narrowing of the out-performance of the asset class compared to public markets, and unease with GP economics. What the statistics do not reflect is the strategy shift among some LPs to invest in more sectors or geography-specific funds, and smaller, niche strategies that are large enough for an expansive set of targets but nimble enough to invest effectively. Nonetheless, the demand from other LPs to put increasingly larger amounts of capital to work efficiently, creates relative headwinds in fundraising for smaller funds. Looking forward, the tug-of-war will continue between concerns of investors about high valuations, economic cyclicality, and a reversion to the mean for interest rates and the historical risk-adjusted out-performance of this asset class.

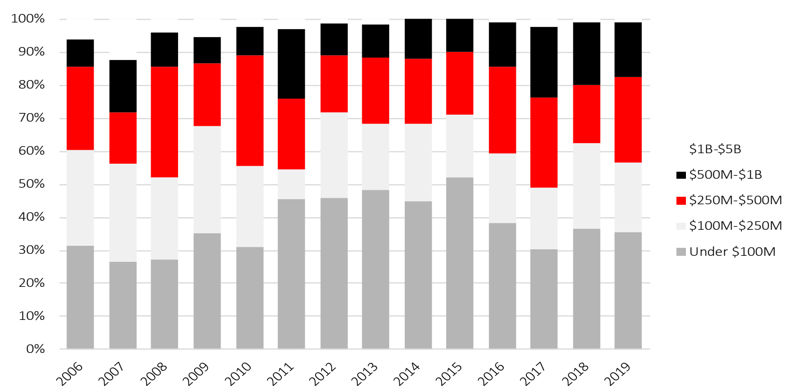
US PE Buyout fundraising by year (Akerman methodology)



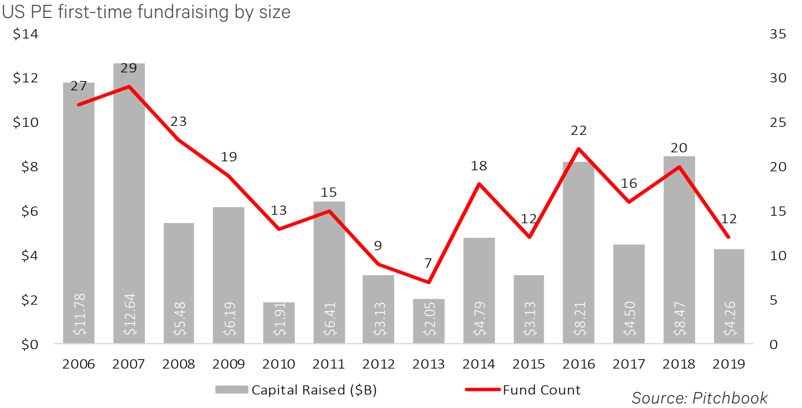
US PE Buyout fundraising by quarter (Akerman methodology)



US PE MM fundraising by size ($B)



US PE first-time fundraising by size



Source: Pitchbook