



ACG[®] New York

2018 PE in Review

Data provided by

 PitchBook



Welcome Letter: Navigating an aggressive M&A environment	3
Deals	4
Exits	5
Fundraising	6
Growth Economy	7-8
SEC continues to scrutinize “accelerated” monitoring fees	9
Global M&A activity soars in 1H 2018	10
Supply chain as a growth lever	11
Five M&A trends in 2018 and beyond	12

Credits & Contact

PitchBook Data, Inc.

JOHN GABBERT Founder, CEO
ADLEY BOWDEN Vice President,
 Market Development & Analysis

Content

GARRETT JAMES BLACK Senior Analyst
JORDAN BECK Data Analyst
CAROLINE SUTTIE Production Assistant

Contact PitchBook

RESEARCH

reports@pitchbook.com

EDITORIAL

editorial@pitchbook.com

SALES

sales@pitchbook.com

ACG New York

Bobby Blumenfeld, Executive Director
 bobby@acgnyc.org
 www.acgnyc.org



COPYRIGHT © 2018 by PitchBook Data, Inc. All rights reserved. No part of this publication may be reproduced in any form or by any means—graphic, electronic, or mechanical, including photocopying, recording, taping, and information storage and retrieval systems—without the express written permission of PitchBook Data, Inc. Contents are based on information from sources believed to be reliable, but accuracy and completeness cannot be guaranteed. Nothing herein should be construed as any past, current or future recommendation to buy or sell any security or an offer to sell, or a solicitation of an offer to buy any security. This material does not purport to contain all of the information that a prospective investor may wish to consider and is not to be relied upon as such or used in substitution for the exercise of independent judgment.

Navigating an aggressive M&A environment

Recently, I was a panelist for an event focused on trends in middle-market private equity. As our moderator was reviewing potential questions, I knew the standard “What broad themes are you seeing in middle market PE?” would be asked of me. I quickly jotted down the following: unused allocated capital toward PE, competition for deals, access to cheap debt capital, etc. I stopped, reviewed my answer and quickly asked myself, “Is this 2018? 2017? 2016? 2015?, etc.”

What to do in this environment if you are a PE firm (or family office, independent sponsor or strategic)? As the lower-to-middle M&A market has become more transactionally efficient—information flow is very strong—the flow of capital to PE firms from LPs has increased dramatically due to PE’s attractiveness as an asset class. Leverage is easy to access and remains relatively cheap, and valuations have increased. Pitchbook and other information data services regularly address this trend in their reports—the consensus seems to be that acquisition multiples have increased roughly 2x in the past five years.

The days of financial engineering are long gone. The opportunities for strategically sourcing undervalued, proprietary deals are scarcer as time passes. And upward pricing pressure on operationally complex (read: hairier) deals has increased. A banker friend of mine, whose firm specializes in marketing storied (again, hairier) situations, tells me that the multiples have grown and tangentially thinks the delta between storied and well-performing companies is not as wide as one would think! Same characteristics, higher price. Even larger PE funds that developed sophisticated direct sourcing efforts have changed their focus. As an ACG New York Board member, it surprises me that they are aggressive in their direct outreach to their smaller PE brethren in order to understand their portfolios and develop strategies to get ahead of the inevitable auction processes, as evidenced by the successful PE to PE Deal Source Event held in May 2018. As a result, many larger PE funds now go so far as to maintain full-blown “shadow portfolios” of companies they like, drawing up detailed business plans long before they ever come up for sale so that they are ready to pounce.

Here are the three major areas in which a PE firm can be competitive:

Value creation counters high entry multiples and drives returns. There is a shift among PE firms to focus not on cost cutting but instead on tangible value creation activities that are growth-oriented. Operating partners, supply chain consultants, talent management strategists and IT professionals are all examples of value creation providers who are seeing significant growth in their practices with PE portfolio companies. Growing top-line revenue, combined with prudent cost-containment management and an effective add-on acquisition program, is an effective investing strategy to counter higher entry multiples and drive returns.

Industry specialization expands rapidly. Many generalist firms in the lower-to-middle market have recognized the need to focus their sourcing and investing activities on a small, select group of industries. By refining their industry knowledge, they can source better deals, become more attractive buyers, close deals in shorter time frames, and build stronger, more relevant businesses. Sellers and management teams do not care if you know and invest in many industries—they only care that you know their industry well. As one GP of a multi-billion-dollar fund told me, they can compete with speed due to industry specialization.

“Buy, build and enhance” is the way to go. A focus on just financial engineering does not work anymore. Leveraging up and paying down debt by cost cutting alone will not deliver the returns that LPs expect, especially when considering a 10x deal is standard in today’s market. A true “buy, build and enhance” investing approach, in which there is meaningful industry consolidation and also the ability to focus on value creation and leverage synergies, continues to be an effective strategy.

At ACG New York, we are committed to helping our members grow their businesses and remain relevant in a fast-changing M&A world through quality networking and value-added content. Our network of dealmakers, transaction advisory firms and value creation providers forms an ecosystem where everyone builds off one another. While it is true that our ecosystem starts and ends with dealmaking, the other components of the ecosystem are critical contributors to the success of any investment. And the ACG New York network is an efficient, productive and fun way to build and grow relationships that are relevant to your business or firm’s success.

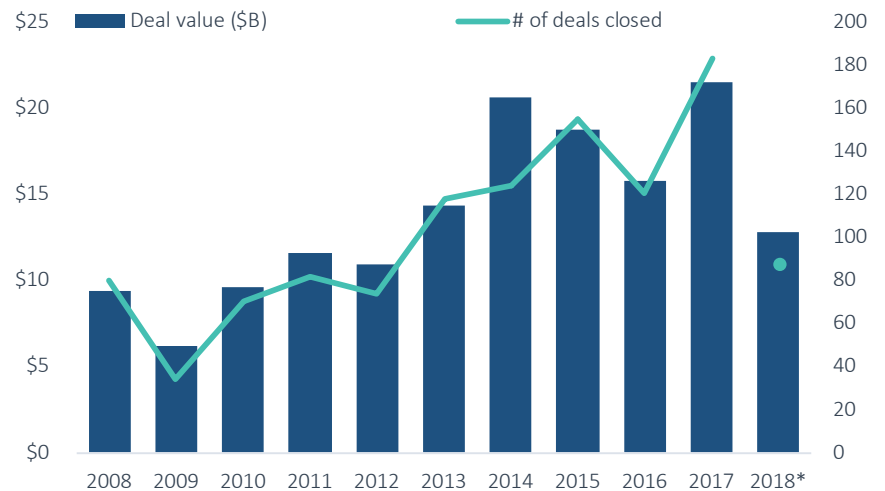
David Acharya is President of ACG New York and a Partner at AGI Partners LLC (www.agi-llc.com), a PE firm based in New York City.

Reverting to the mean

New York middle-market PE deals

Since the depths of the financial crisis in 2009, PE activity in the middle market has steadily climbed upward, culminating in a remarkably high tally of 183 transactions in 2017, for a record in deal value as well. New York has seen a slowdown since, however, if only in volume, as quarterly deal flow reveals below. The hefty tally of three straight quarters, in addition, to the recent downturn in volume, does suggest that cyclical effects are beginning to take hold. It is no secret the environment is quite high-priced currently, with many opining that transaction multiples are currently threatening PE funds from reaching their historical outperformance. That said, within the middle market there are still opportunities according to dealmakers, who continue to close at a historically robust rate.

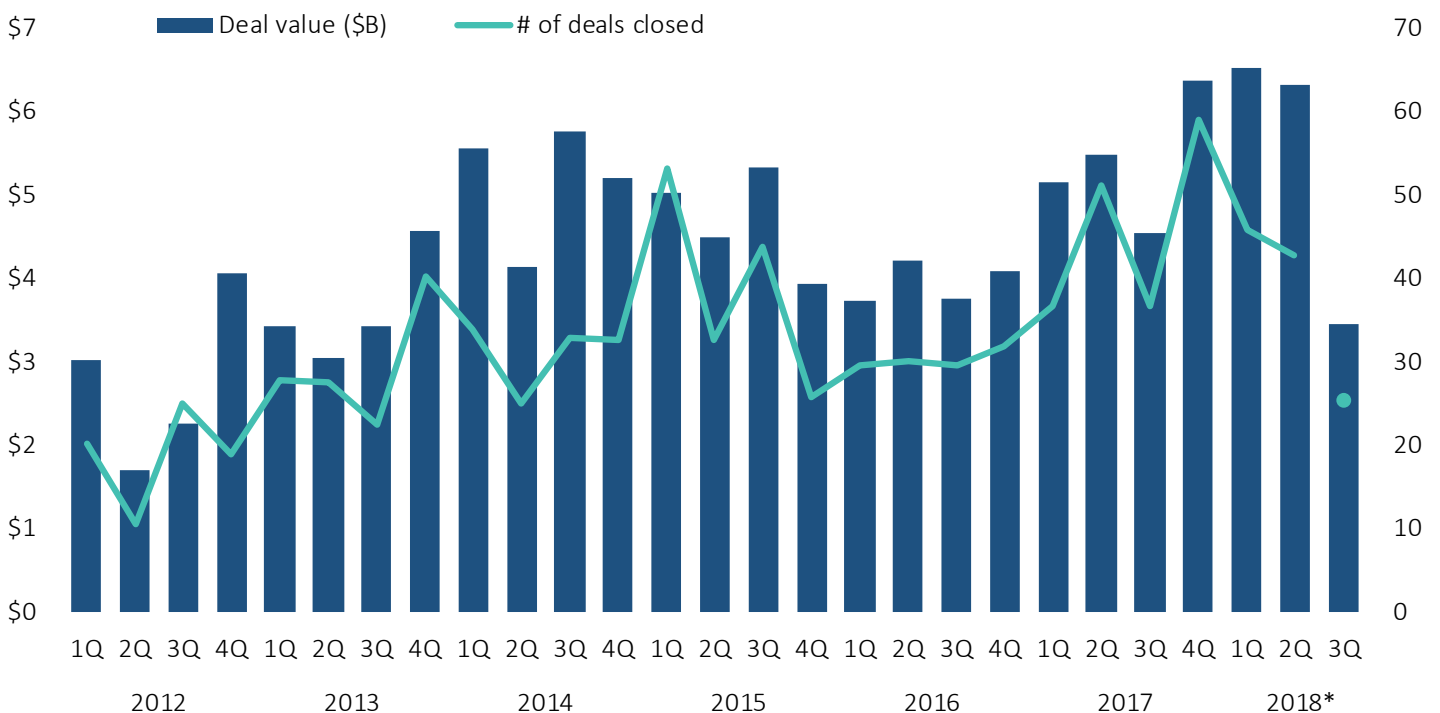
A slowdown after a record 2017
New York middle-market PE deals



Source: PitchBook. *As of September 17, 2018. Note: As the PitchBook database is updated continuously, there can be minute shifts in data totals in between time periods, hence estimated figures take such a historical change into account.

Quarterly volume momentum diminishes, while deal values stay very high

New York middle-market PE deals



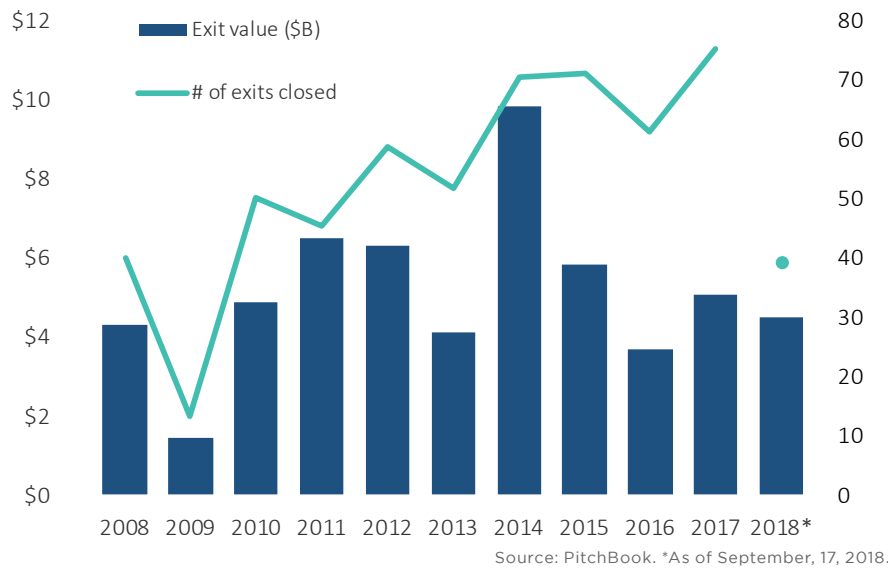
Source: PitchBook. *As of September, 17, 2018.

Exit value stays robust

New York middle-market PE-backed exits

Sellers take a breather

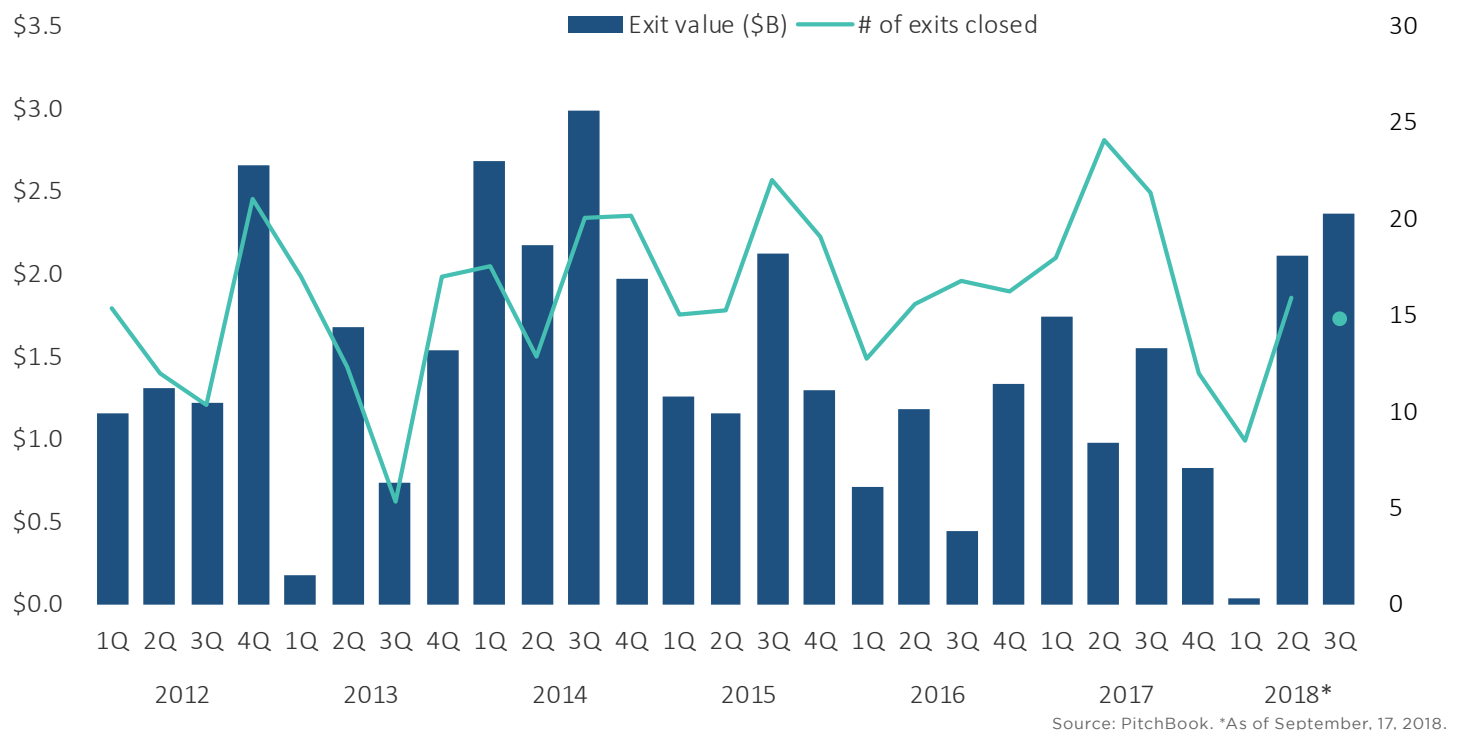
New York middle-market PE exits



The lifeblood of financial markets, liquidity has been quite steady for PE backers over the past four years, with an increasing proportion of secondary buyouts boosting overall volume on top of M&A and IPOs. 2018 saw an atypically slow quarter to start, but since has rebounded in terms of exit values to align with historical medians. What this cycle indicates is that there is currently no slump in appetite for overall PE portfolio assets, but rather a bit of a reversion in the cycle, likely again due to how pricey the environment is. Especially for fellow PE funds scrutinizing mature portfolio companies, forecasting future growth potential may be contributing to a slowing incidence of those SBOs mentioned above, although not unduly so as of yet.

A low 1Q drags down yearly tallies

New York middle-market PE exits



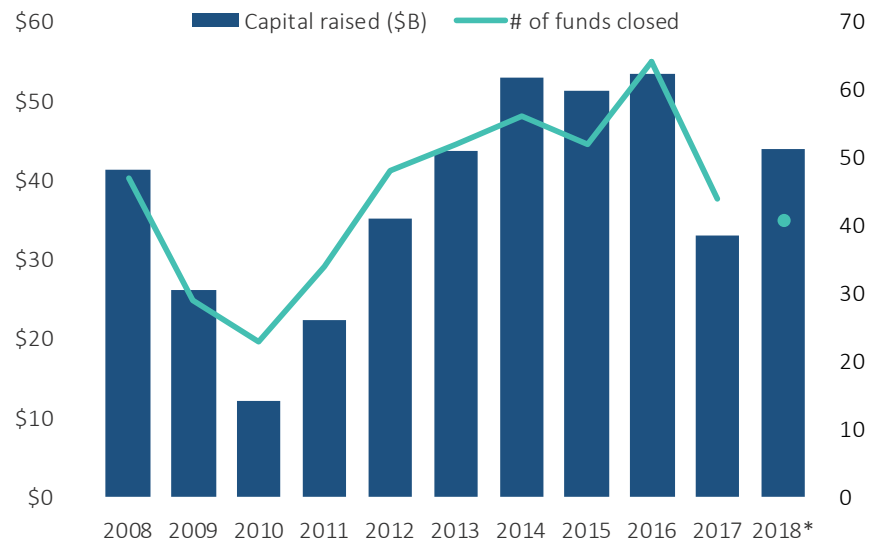
Fundraising resurges

New York middle-market PE fundraising

The appetite of limited partners for exposure to the PE asset class could appear to remain undiminished, when looking at aggregate funds raised in 2018 to date. For New York in particular, it should be noted that as it hosts many flagship buyout firms, its numbers will necessarily be skewed and speak more to the health of the US PE fundraising cycle on the whole. Accordingly, PE fundraising numbers for the US do seem currently healthy, although the cycle's timescale is necessarily long, so the ramifications of the current high-priced environment have not yet resulted in returns that may shift the cycle up or down. That said, it isn't unreasonable to presume a lowered volume going forward, at least relative to the highs of 2014-2016, due to LPs waiting to see eventual results.

2018 bounces back

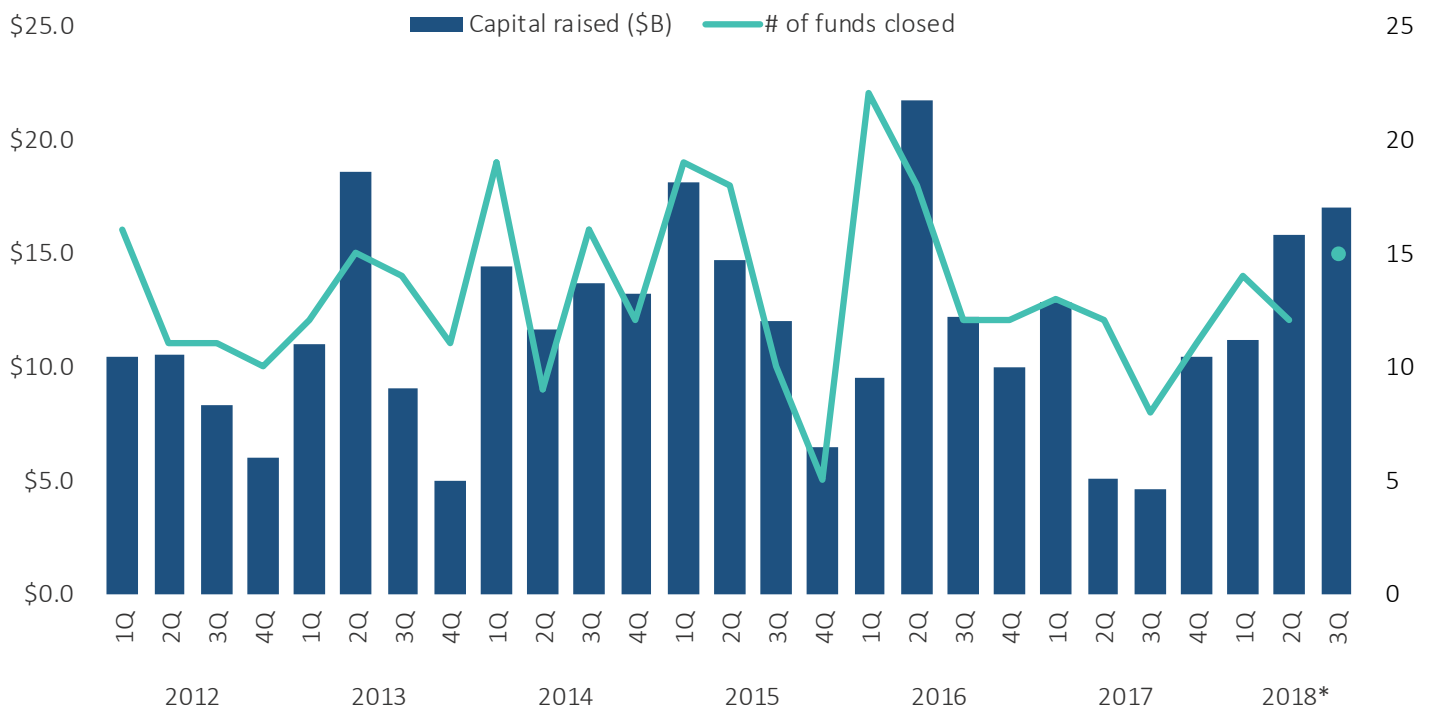
New York middle-market PE fundraising



Source: PitchBook. *As of September, 17, 2018.

Consecutive quarters of recent growth

New York middle-market PE fundraising



Source: PitchBook. *As of September, 17, 2018.

Growth Economy



NEW YORK-NEWARK-JERSEY CITY, NY-NJ-PA MSA 2010-2017

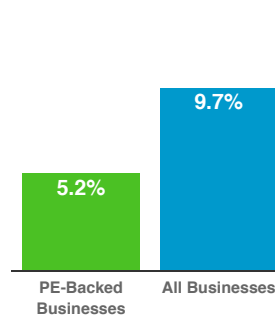


Summary

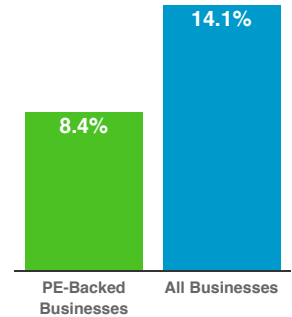
Jobs grew 5.2%
Private equity-backed companies in **middle market segment 3** with sales between \$100 million and \$1 billion led the way with 68% of job growth.

Sales grew 8.4%
Private equity-backed companies in **middle market segment 1** with sales between \$10 million and \$50 million led the way with 82% of sales growth.

Comparative Jobs Data



Comparative Sales Data



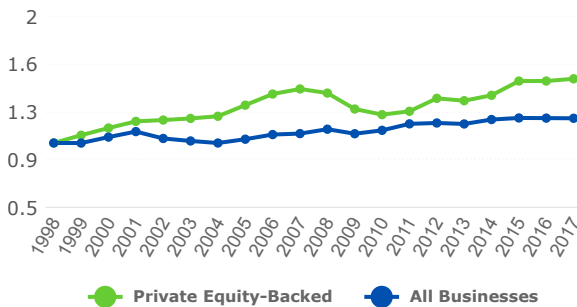
ESTABLISHMENTS	2010	2017	Change	%
Private Equity Totals	1,267	1,328	60	4.8%
All Company Totals	963,848	1,055,901	92,113	9.5%

JOB	2010	2017	Change	%
Private Equity Totals	109,114	114,799	5,685	5.2%
All Company Totals	9,514,284	10,443,449	934,850	9.7%

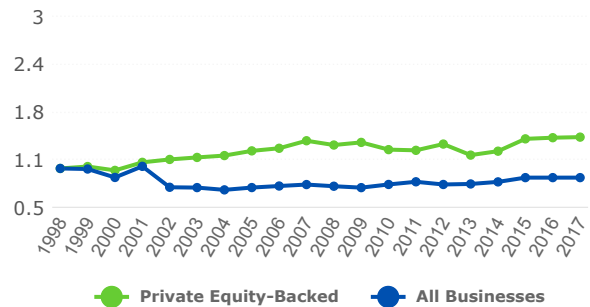
SALES	2010	2017	Change	%
Private Equity Totals	158,107,591,980	171,458,599,800	13,351,007,820	8.4%
All Company Totals	1,322,613,735,490	1,517,474,100,300	208,211,372,630	14.1%

Private Equity-Backed Index 1998-2017: New York-Newark-Jersey City, NY-NJ-PA MSA

Jobs



Sales



Growth Economy

NEW YORK
1998-2015



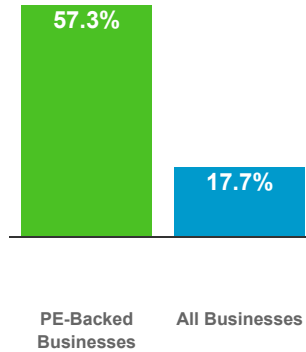
Summary

Jobs grew 57.3%
Large private equity-backed companies with sales more than \$1 billion led the way with 43% of job growth.

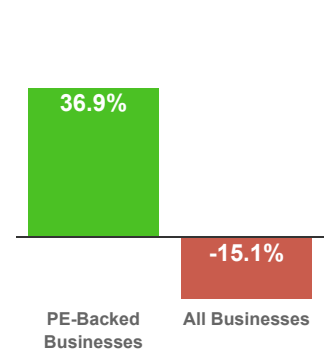
Sales grew 36.9%
Private equity-backed companies in **middle market segment 3** with sales between \$100 million and \$1 billion led the way with 69% of sales growth.

2015 Total Capital Invested New York: \$51,616,210,000

Comparative Jobs Data



Comparative Sales Data



PE MARKET SEGMENTS
Middle Market Results
2010-2017

- Small** Less than 10M in Sales
- Middle Market 1** 10-50M in Sales
- Middle Market 2** 50-100M in Sales
- Middle Market 3** 100M-1B in Sales
- Large** More than 1B in Sales

PE GROWTH NUMBERS breakdown of sales, establishments, and jobs

SALES NUMBERS
by Segment

sales 2d chart

ESTABLISHMENTS NUMBERS
by Segment

estab 2d chart

JOBS NUMBERS
by Segment

jobs 2d chart

PE GROWTH PERCENTAGE (%) breakdown of sales, establishments, and jobs

SALES %
by Segment

sales chart

ESTABLISHMENTS %
by Segment

estab chart

JOBS %
by Segment

jobs chart

For more information, visit www.growtheconomy.org
Questions? contact ACG at policy@acg.org
© 2018 Association for Corporate Growth. All Rights Reserved.

SEC continues to scrutinize “accelerated” monitoring fees

The SEC recently settled its latest enforcement action around the practice of PE fund managers receiving so-called “accelerated” monitoring fees from portfolio companies without adequate disclosure to their funds’ LP.

The attention on this issue has been part of the SEC’s overall focus on PE fund managers’ disclosure practices. The actual practice of earning accelerated monitoring fees—that is, charging portfolio companies fees for performing consulting, advisory, or similar services, and then upon “early” exit (i.e. before the end of the term of the management agreement), earning a lump sum of all the fees the fund manager would have received if the companies had not been exited early—has not been the focus of enforcement by itself. Rather, the SEC has brought actions where this practice was not adequately disclosed to a fund’s LPs in its offering materials. As management services agreements often have long terms, an accelerated fee provision can result in a significant payment to the fund manager that the SEC has indicated requires adequate disclosure pre-commitment.

There are some nuances on this issue around whether the fund in question has a management fee “offset” provision. The practice of charging accelerated fees clearly reduces the value of the applicable portfolio company upon exit. However, many PE funds provide for a management fee offset, where the fund-level management fee is reduced by any portfolio company fees earned by the fund manager and its partners and employees. To the extent that accelerated monitoring fees are fully offset against fund-level management fees, LP investment returns would not be affected. However, while there has been a trend in the industry recently to move toward more 100% offset provisions, many PE funds still have management fee offsets of 75%-80% (or lower in a few cases). Furthermore, even funds with a 100% offset provision do not necessarily insulate themselves from scrutiny if there are excess fees retained by the fund manager where no further fee offset can be applied upon fund liquidation.

The regulatory focus on accelerated management fees has also put more emphasis on the issue from a commercial perspective, and a number of firms are no longer charging these fees in order to avoid being perceived in the marketplace as earning fees for services they did not ultimately provide. However, there can be circumstances where the facts and circumstances around charging an accelerated monitoring fee can be justified. A portfolio company going up for sale earlier than originally anticipated could require the fund manager to spend more time advising management through a sale process earlier than originally planned, for example.

With regulators zeroing in on this issue, transparency with investors will continue to be key. Prior to entering into a management service or similar agreement that will include a provision for accelerated monitoring fees, it is best practice to consider whether the possibility of a fund manager earning accelerated fees was adequately disclosed in the fund’s private placement memorandum and other offering documents.

Brad Mandel is a partner at Winston & Strawn, LLP, focusing on PE and other US and non-US alternative investment fund sponsors and managers in fund formation, maintenance, and regulatory matters. Brad can be contacted at Bmandel@winston.com or 312-558-7218.

Global M&A activity soars in 1H 2018

In the first six months of 2018, worldwide M&A volume shot up by 60% compared to the first half of 2017, reaching \$2.5 trillion, said Jeremy Swan, managing principal, financial sponsors industry for CohnReznick. In the midst of a strong and highly liquid market in both equity and debt, the total for 2018 could reach \$5 trillion. And that's despite uncertainties over trade, tariffs, and interest rates, Swan said.

COHN **REZNICK**

Much of the growth came from mega deals, which hit levels not seen since 2007, Swan said. Some 38% of global M&A deals were of \$10 billion or more, and almost 50% were deals of \$5 billion or greater. The first half also saw intense activity between countries, as cross-border deals made up 40% of total volume, despite a large drop in Chinese purchases of US assets, he noted. Much of the activity has been driven by strategic buyers who often can outbid PE buyers. "That said, we have seen a steady increase in the percent of deals closed by financial sponsors globally," Swan said. "That's a trend we expect to continue, because we have close to \$1 trillion available globally that financial sponsors need to put to work."

A squeeze of the middle market

Notably, while mega-deals dominated, another 40% of volume was driven by deals of \$25 million or less. "This leaves a very small component in the middle market," Swan said, "where we haven't seen a lot of activity." That's a big change from the past several years which featured a high level of middle-market action.

The greatest M&A activity occurred in three industries: media/entertainment, health care and telecom. In these markets, "large companies are seeking to acquire more growth, more vertical integration, and more technology," Swan said. "They are expanding into new industries and new geographies."

Companies are also acquiring smaller companies to add technical or executive talent, said Elizabeth Sanders, chief counsel, transactions/M&A at Panasonic.

Tax reform juices M&A

The passage last year of the US Tax Cuts and Jobs Act, which lowered the corporate tax rate to 21% from 35%, among other changes, has helped the M&A market, said Jeff Marks, managing director, corporate finance advisory at JP Morgan. "It feels like the US is much more competitive on a global basis in terms of tax policy, with the caveat that there are wild cards that may not be tax-related," Marks said.

The most notable wild cards are tariffs and trade wars that are ratcheting upward. "It's harder and harder to do strategic transactions in a global market where supply chains are as integrated as they are," he said, "and you can't figure out what you're going to pay within your own company for business services."

The US tax law changes also influence how to structure deals, Sanders said. Consider whether it makes more sense to create a c-corporation or a pass-through, for example. Other changes include how to value intangible assets and the allowable uses of net operating losses.

Jeremy Swan, is the managing principal of CohnReznick's Financial Sponsors and Financial Services practice. In addition to managing a multi-disciplinary team of professionals across various service lines, he advises financial sponsors and their portfolio companies in mergers & acquisitions, IPO readiness, financing transactions, post-acquisition integration, and operational and financial due diligence. He can be contacted at jeremy.swan@cohnreznick.com, or 646-625-5716.

Supply chain as a growth lever

Supply chain performance is inextricably linked to the success of a PE value thesis today. The direct-to-consumer demand increase is traversing all industries. As a 3x-5x growth lever with positive margin gains of 8%-10%, diligence to supply chain design and operations is quickly becoming one of the most important disciplines to evaluate and master throughout the deal cycle.

Despite supply chain costs typically being the second largest expense in organizations today, it is most commonly undiagnosed as a key success lever to scalable, profitable business. It's practices, or lack thereof, are typically deeply rooted. Because it has tentacles in nearly every operative function within a company, it frequently lacks a single owner with centralized controls and visibility. With no one line item on a financial statement identifying it, the supply chain's quantifiable benefit is often buried in the details.

A supply chain that adds value and profits

Here are three pointers to ensure your supply chain gains the proper relevance in your investment strategy.

1. Supply chain evaluation as a growth lever: When supply chain performance is influenced by multiple functions in an organization, it can be difficult to attribute its true cumulative bottom-line impact. Understanding supply chain operational health and wealth early in the deal cycle, cultivating its ability to scale and deliver to new markets quickly at a competitive price point and raising the capital required to do so are paramount to timeliness and success of acquisition integration.

2. Supply chain as a value-creation priority: The incessant tug of war between price, velocity and quality creates tension around investment priorities. The legacy adage that you can achieve only two of the three at any one time is no longer adequate. By valuing supply chain as a priority lever early in the acquisition cycle and funding supply chain transformation to align with investment growth strategy, you can proactively transform its capabilities to deliver with speed, agility and profitability.

3. Digital supply chains are resilient and agile: Beyond acquisition integration, supply chain designs and performance should scale with growth while sustaining, and further improving, captured margin gains achieved during its acquisition transformation. The need for mobility and visibility continues to rise, generating momentum around digital transformation. Digitizing the supply chain enables continual alignment of supply chain design as organizations mature and grow while automating the mechanics of supply chain disciplines. Collaboration and transparency between the many moving functions within a supply chain is a necessity to delivering to today's consumers with a high rate of satisfaction at a competitive, profitable price.

Complex supply chains require a deep competency around the practical application of best practices versus shallow competency around many things. This requires an organization to look at many facets, including distribution network re-design, purchasing policies, inventory optimization, operational efficiencies and logistics strategies. Supply chain performance is quickly becoming one of the top three to five growth levers of PE investment thesis.

Wendy Buxton is the President of LynnCo Supply Chain Solutions. She can be reached at wendy.buxton@lynnco-scs.com.

Five M&A trends in 2018 and beyond

As the seasons change, so does the investment and political environment that the M&A markets face for the remainder of 2018 and well into and beyond 2019. Whether you brand these trends as threats, opportunities or otherwise, each of the issues below will impact the M&A world:

- 1. Politics and tariffs:** Politics (either way the pendulum swings) and national and global volatility or stability will affect every decision. As the tariff implementations ratchet upward, willingly or not, the impact on all markets will be evident, effectively stalling discussions and action in the M&A markets. Those willing to act may create true added value. This applies in all directions of cross-border deals and investments.
- 2. Regulations and policies:** The current trend is to ease regulations. The SEC is seeking to reduce the burden of compliance and reporting while expanding opportunities for more private investment opportunities. The trends and changes will affect many sectors.
- 3. Interest rates:** As the Federal Reserve Board seeks to disassemble the bond-buying programs under QE II and other programs, all market participants will be casting a wary eye on the impact of interest rate changes as the strategy unwinds and its impact on capital market liquidity unfolds.
- 4. TCJA:** While growth after the tax legislation has been robust this year, will the impact of limits on the deductibility of interest lead to a slowdown and a search for more expensive capital? As Aswath Damodaran states, “No matter what you think about the tax reform package, there is the one thing that is not debatable: it will impact equity value [not EBITDA] and affect corporate behavior in the coming year.”
- 5. Technology:** Whether it is blockchain, AI, cybersecurity or IoT, technology continues to impact strategic decision making. While some technologies may not result in creative disruption, they will create change across traditional industries and how M&A is strategized, structured and executed.

While these issues are not all inclusive, nor are they independent from each other, they represent several of the risk considerations for the M&A landscape.

Predictions for 2018 and beyond

Mega-mergers will lessen for two reasons. Cost/expense cutting is arguably short-term in nature and not necessarily a value add over the long term, and the culture thing—the ability to assimilate, integrate and grow—is critical to the overall success of these efforts. The jury is still out on this for many companies. Industry consolidations are beginning to narrow, and governments are focused on fair trade.

We will see more platform acquisitions. This will include not just initial acquisitions seen in the PE world but those by larger companies seeking new business models. Consider Aeon’s acquisition of Boxed. Add-ons currently dominate M&A activity. More opportunities will arise for platforms with the next downturn.

We will see reverse platform acquisitions. These are acquisitions in which the incumbent is not only seeking a platform/product but is using its platform to extract more value. Consider Amazon’s robust logistics and data capabilities married to the Whole Foods platform and the resultant value add.

These are interesting times, during which the ability to adopt, translate and integrate technological advances will drive action in the M&A market. Additionally, the need to understand organizational culture and recognize its impact on integration will continue to play its ever-present role in successful M&A activity. Finally, the ability to withstand and overcome external environmental and political forces will play an ever-important role in 2019.

Edward Pratesi (epratesi@uhy-us.com) and Corey Massella (cmassella@uhy-us.com) are Partners at UHY LLP. Copyright © 2018 UHY LLP. All rights reserved.

Platinum Sponsors



Platinum Sponsor - Research & Analytics Outsourcing



Platinum Emeritus



Gold Sponsor



Partners



