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THE MINTZ **2021**

MID-YEAR, MID-MARKET PRIVATE EQUITY REPORT

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INTRODUCTION

Welcome to the first edition of Mintz's Mid-Year, Mid-Market Private Equity Report, comprising a series of reports detailing our private equity team's observations of emerging trends and opportunities in the private equity middle market. In this introductory volume, we present our outlook for the remainder of 2021 and beyond.

On the following pages, you'll find insight on the tragic COVID-19 pandemic and the potential for economic recovery, an update on deal trends, a table highlighting today's hot sectors, and an analysis of the state of debt markets.

If you have any questions, please reach out to an attorney in our Private Equity practice group.

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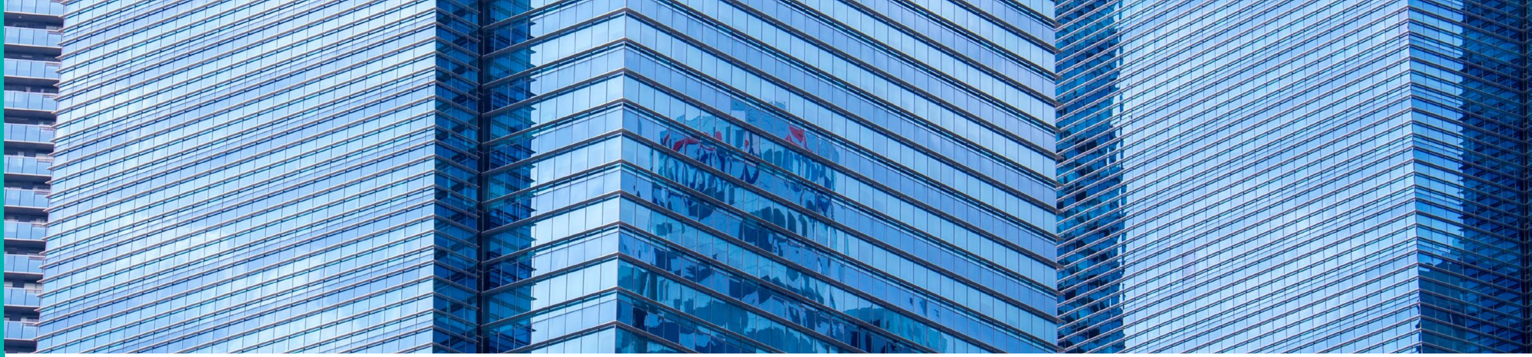

2021 REFLECTIONS & TRENDS IN MIDDLE-MARKET PRIVATE EQUITY

A Year of Uncertainty, but Optimism Ahead

The COVID-19 pandemic and civil unrest, among other things, resulted in a tumultuous 2020 and early 2021. In particular, COVID-19 and government issued stay-at-home orders disoriented the global economy and presented a major threat to business health. Private equity deal activity in the middle market all but ceased in March through May 2020, but the promise of election clarity and vaccines coupled with fears of capital gains tax hikes spurred unparalleled deal activity in the second half of 2020 and first half of 2021. Pent-up demand, deal backlog, favorable credit conditions, and optimistic sellers are all likely to see this momentum carried through the remainder of 2021 in increasingly competitive processes.

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Portfolio Company Triage

In the immediate aftermath of the onset of the COVID-19 pandemic, private equity funds shifted their focus from making deals to portfolio company triage. The type of triage mostly depended on the industry and local factors such as location and the duration of government imposed lockdowns. A reevaluation of portfolio companies saw private equity funds take a range of approaches during this time, including pivoting for future growth, digitization, cost-cutting, securing financing and/or hibernating the particular asset with sufficient reserves, or preparing for a sale process. Additionally, this turbulent period highlighted that private equity funds in the middle-market offer portfolio companies more than just capital. They offer management input and support coupled with deep industry knowledge and connections. These helped steady the ship in 2020 and the first half of 2021. We anticipate that private equity funds with deep sector expertise will be best positioned to navigate changing times and to take advantage of it.

Dry Powder and "Buy and Build" Plays

Capital overhang (or "dry powder"), which represents the amount of committed but unallocated capital raised by a private equity fund, remains at record levels. Private equity funds are ready and willing to deploy capital for quality assets that align with their core value propositions. We anticipate that private equity funds will increasingly look for "buy and build" opportunities. This means acquiring businesses below their ideal "equity" check. These plays are likely to be driven by utilizing increasingly sophisticated technologies to accelerate due diligence and recognize market trends and acquiring businesses with complementary capabilities and/or the potential for operational transformation across a platform. Add-on acquisitions are expected to take center stage as less-risky alternatives to deploying capital on more sophisticated platform deals, and they will continue to present an attractive way for funds to grow their portfolios, even in the face of COVID-19-related effects.

Behavioral Changes and Creative Deal Strategies / Structuring

The COVID-19 pandemic accelerated behavioral changes for both consumers and businesses, in particular the use of technology, data driven analytics, and working remotely. Many of these behavioral changes are likely to continue in some form after the conclusion of the crisis. In the deal context, private equity funds have utilized virtual due diligence and deal closings, which have brought efficiencies to the transaction but also challenges — in particular, in meeting and vetting potential management teams. In an increasingly competitive market for quality assets, we've also observed, among other approaches, private equity funds with significant dry powder over-equitizing initial consideration with an expectation of refinancing at a later date, and utilizing a seller note and co-investment opportunities to mitigate risk.

Potential for Distressed Deals

Government stimulus packages buoyed the economy and inspired confidence that any recession would be temporary. But even after the health crisis has arguably receded, the great challenge for the economy is how it will manage once it is no longer protected by fiscal and monetary policy. Depletion of stimulus funds may expose sectors that have relied on it (e.g., restaurant, hospitality, leisure, media, and entertainment), and this may be exacerbated by capital constraints placed upon the banking sector. However, this may be good news for both businesses operating in such sectors and private equity funds. Private equity funds may ultimately deploy excess dry powder on distressed and other opportunistic businesses in these sectors. Such acquisitions/investments may help grow market share for existing portfolio companies by broadening geographies or generating new revenue streams, and provide an alternative other than bankruptcy for owners of distressed businesses.

The SPAC Phenomenon

Special purpose acquisition companies (SPACs) continue to dominate headlines in the financial press. SPACs — also known as "blank check companies" — are companies with no commercial operations that are formed strictly to raise capital through an initial public offering (IPO) for the purpose of acquiring an existing operating company. SPACs are attractive to some larger private equity funds because they offer an alternative to LP fundraising and a wider base of investors (i.e., public capital markets), and the potential for liquid returns on a relatively short timeline. In the private equity middle market, the surge in SPACs may drive overall valuations higher (due to most SPACs having a predetermined time to find a target, often a maximum of two years) and present an attractive option for private equity funds seeking to exit existing investments. For more information on SPACs, our in-depth review of key trends and issues defining the SPAC phenomenon can be found here. Other exits using the public markets may be available also.

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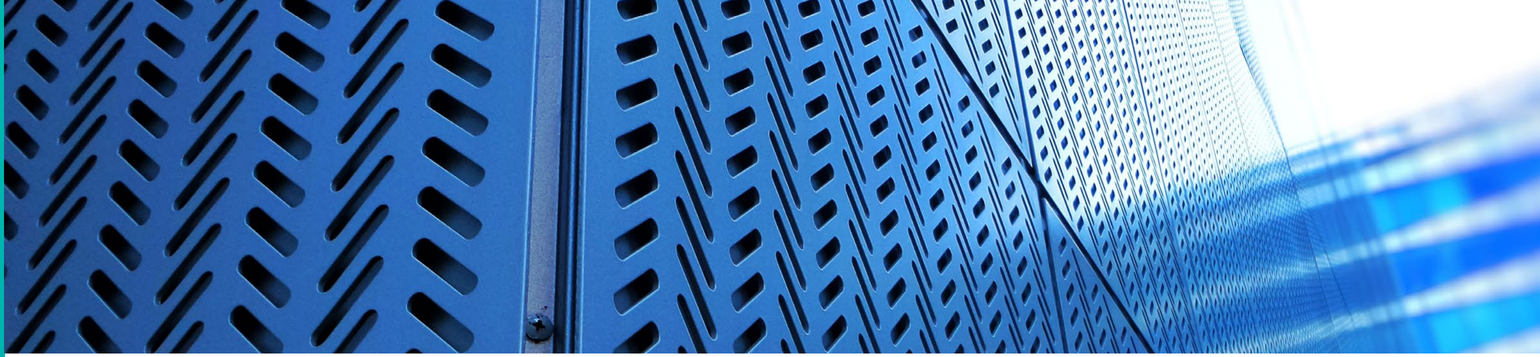
HOT SECTORS FOR PRIVATE EQUITY

HOT SECTORS	
Technology	Enterprise software, data, cyber defense related, and other technology-enabled businesses present increasingly attractive assets for private equity funds as they often can sustain growth through the current – and any future – regional or global disruption. Software-as-a-Service and IT managed services companies are particularly attractive for "buy and build" plays as these are regarded as being scalable with recurring revenue models. Other technology-enabled businesses in cloud-hosted solutions, online training and education, digital health (which includes remote patient monitoring, traditional telemedicine, combinations of software platforms and medical services), e-commerce, food-tech, and distribution and delivery are thriving, and with private equity funds behind them, are looking for debt-financing opportunities to leverage low-interest rates.
Industrial	The industrial sector is ripe for technology innovation and has mostly proven resilient to the COVID-19 pandemic. Manufacturers of industrial goods, including building products, supplies, and packaging, present private equity funds with growth capital opportunities and the potential to partner with business owners that have the ability to take advantage of the current economic environment in a sector positioned for growth as the economy recovers.
Health Care, Generally	While private equity interest in health care initially dipped as a result of the COVID-19 pandemic due in large part to plummeting revenues of traditional health care providers, general uncertainty, and lack of access to capital, the sector quickly recovered in the second half of 2020 for a variety of reasons. Interest in and valuations of certain types of health care companies are now soaring. Provider revenues ultimately rebounded, and we expect to see consolidation of hospitals, physician groups, and other provider types continue in 2021. *contd.*

Health Care, Generally, *contd.*	As discussed in greater detail below, the COVID-19 pandemic resulted in exponential growth in telehealth, home care, and health IT solutions needed to facilitate remote patient care, and we expect this trend to continue. The COVID-19 pandemic accelerated interest in outpatient mental health providers in particular, given the high demand for such care during the COVID-19 pandemic and the ability of such providers to quickly pivot to service delivery through telehealth. As the global community recovers from the COVID-19 pandemic, we anticipate that this heightened level of activity will continue.
Health Care, Telehealth 	The COVID-19 pandemic and government issued stay-at-home orders changed the traditional approach to the delivery of health care. Following the federal and state public health emergency orders, regulatory restrictions were loosened and government and commercial payor reimbursement increased. As a result, the digital transformation of this sector has been accelerated. Telehealth in all its forms was adopted rapidly by patients, payors, and providers. Continued digital development, innovation, and transformation require capital and as competition in this sector escalates, private equity funds will be well-positioned to consolidate growing businesses.
Pet Industry, Veterinary Medicine 	The US pet industry is ripe for investment and digitization and has proven recession-resistant. Isolation and working from home resulted in "Pandemic Pets" becoming a social trend in 2020. The adoption of a pet is a long-term commitment for an owner, making owners a dependable and repeatable source of revenue for businesses in the industry. With many pet retail stores closed or being inaccessible as a result of the COVID-19 pandemic, the necessity for e-commerce solutions in the pet industry accelerated. We anticipate that direct-to-consumer pet care and food products with subscription solutions, premium pet food retailers and wholesale businesses, and veterinary clinics with strong digital platforms and/or telehealth solutions will present an attractive asset for private equity funds. Consolidation of assets in and across these segments is likely as the pet industry's adoption of e-commerce and digitization continues.



PRIVATE EQUITY DEBT FINANCING

2020 Reflections

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> Pricing, leverage multiples, and deal terms have since returned to their pre-pandemic levels and are arguably even more sponsor-friendly now for the right credits.

As it was for the rest of the world, 2020 turned out to be an erratic and unpredictable year for debt financing transactions and the debt markets in general. While new deals screeched to a halt in March 2020 and sponsors generally considered themselves fortunate to have completed transactions earlier in the first quarter, covenant resets, amendments, waivers and forbearance arrangements in connection with existing credits rapidly accelerated during the second quarter. Previously healthy portfolio companies suddenly found themselves with sharp declines in EBITDA and almost universally opted to draw down on available revolving credit facilities in order to preserve precious liquidity. Middle-market lenders, both traditional banks and alternative debt providers, had no choice but to honor draw-down requests and work with their sponsor customers' existing portfolio companies on temporary waivers to, or amendments of, leverage and fixed charge coverage ratios (often with minimal fees or impact to overall pricing). For the most part, a spirit of partnership among lenders and sponsors prevailed. Adjustments to EBITDA definitions to account for one-time COVID-19 related shutdowns, costs, and expenses were common. Smaller private equity sponsors found themselves working closely with their outside lawyers and accountants to determine if their portfolio companies qualified for PPP loans and quickly discovered that they were facing a constantly changing landscape of rules and interpretations. Given the affiliation rules regarding aggregation of employees, however, portfolio companies of seasoned middle-market private equity funds generally found themselves unable to incur PPP loans. Larger government sponsored financing options were made available under the since expired Main Street lending program, but ultimately were not widely utilized by private equity backed companies, in part due to tight restrictions on dividends, distributions, and executive compensation concerns.

Other than for opportunistic distressed investments, debt funds were generally sidelined for the first half of 2020 in terms of new issuances and refinancings. As fear of a prolonged recession subsided and with COVID-19 vaccines on the horizon, however, private equity sponsors were again ready to complete new transactions in the second half of 2020 and their debt financing counterparts were ready as well. Platform and add-on acquisition activity constituted the bulk of these transactions. Leverage levels were slightly tighter and pricing slightly higher for credits, but that did not stop the flood of middle-market acquisitions during the second half of 2020.

> In addition to typical deal activity, given the impending demise of LIBOR, borrowers and lenders will spend considerable time in 2021 determining the new reference rates for loans.

Debt Markets Positioned to Fuel New Deal Activity

Given the recent historic buildup of dry powder by alternative lenders, BDCs, and CLOs, the debt markets are well positioned to continue to fuel new deal activity in 2021 and beyond. More traditional middle-market banks have also become competitive in sponsor finance and have worked hard to advertise their attractive rates, although leverage multiples are typically tighter than they are for deals with alternative lenders. Pricing, leverage multiples, and deal terms have since returned to their pre-pandemic levels and are arguably even more sponsor-friendly now for the right credits. Traditional large market terms, EBITDA addbacks, limited financial covenants, and other covenant lite structures continue to permeate middle-market sponsor finance, driven in large part by sponsor precedent and documentation principles included in commitment papers.

Reference Rates

In addition to typical deal activity, given the impending demise of LIBOR, borrowers and lenders will spend considerable time in 2021 determining the new reference rates for loans. This is a major transition for the debt markets as LIBOR is of course the reference rate for trillions of dollars of loans. Although there is not yet a settled market convention, a rate based on SOFR (the “Secured Overnight Financing Rate”) will likely be the winner. “Term SOFR (forward looking)” appears to be the logical choice to replace LIBOR as its underlying features are the most similar. The good news is that a large number of middle market credit agreements have general replacement rate provisions built in already (automatically in connection with new documentation, and via recent amendments to existing documentation), which should reduce the need for significant amendments to existing credit agreements. US dollar LIBOR-based rates will continue to be calculated through June 30, 2023 for existing credits, although the date for cessation of new issuances with a LIBOR-based reference rate is December 31, 2021. The transition by major banks and financial institutions to a replacement rate for existing syndicated credit facilities that they agent will in large part determine whether or not we will be living in a multi-rate environment beyond the end of the year. We have recently seen at least one main line US bank require the replacement of LIBOR with SOFR (with further transition to Term SOFR when available) effective immediately in connection with a significant amendment of its credit facilities with a company.

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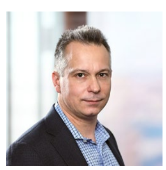

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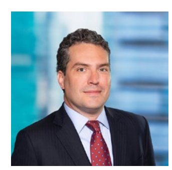

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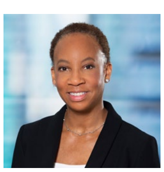

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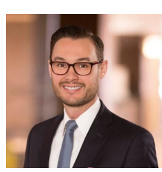

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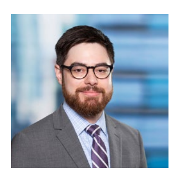

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