MERCER CAPITAL

BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

Portfolio Valuation

Private Equity and Credit

Second Quarter 2020

In This Issue

Market Tenor

The market provided maneuvering room for private equity and credit funds during the second quarter as it relates to quarter-end marks. Following a dramatic four week sell-off that occurred during the last week of February through March 23, both equity and credit markets staged strong rebounds during the second quarter as liquidity returned to markets.

Sponsors probably breathed a sigh of relief that second quarter mark downs were not as severe as feared at the end of March when funds and their advisors were still assessing what was transpiring.

Arguably, the elephant in the room is the Federal Reserve, which launched a series of asset purchases on its own (U.S. Treasuries and Agency MBS) and in conjunction with the U.S. Treasury via special purpose vehicles. Although limited, Fed purchases included investment grade credits purchased in the primary and secondary markets and, more controversially, recent fallen Angel junk bonds that were investment grade rated as of March 22 (e.g., Ford Motor Company) and high yield ETFs. The Fed also launched direct lending programs.

The Fed's actions raise an important question: Is the rebound in risk assets a function of an improved outlook for the economy and company fundamentals; or, is it a function of a liquidity deluge?

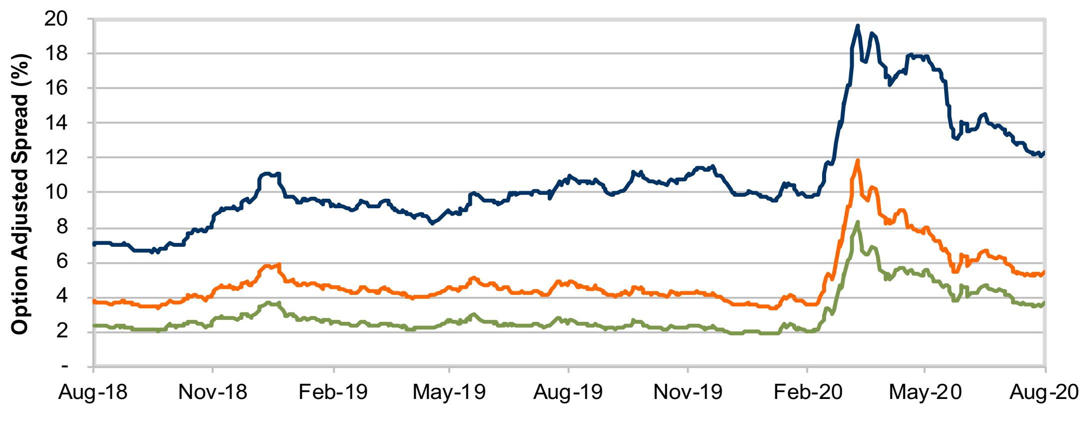
As it relates to marking private equity and credit positions, we at Mercer Capital monitor market data; however, we are keenly focused on company and industry fundamentals as the long-term driver of investment returns. We acknowledge the challenge of establishing fair value marks when it is unclear if earning power should be based upon pre-COVID and/or post-COVID earnings.

If your fund or management firm need assistance in assessing fundamentals and market data to establish markets or obtain a second opinion, please call. We have nearly four decades of experience analyzing both.

Private Credit and Equity

After widening dramatically during late February and March, credit spreads have been grinding tighter as liquidity has returned to the market with Fed intervention. As of 6/30 BB OAS narrowed to 469bps from 641bps at March 31 after having gapped from ~200bps at year-end. The 10- and 25-year average OAS both approximate 325bps. At the other end of the high yield spectrum, CCC (i.e. "triple hook") OAS was 1420bps compared to 1794bps at 3/31, 1008bps at year-end and the 25-year average of 930bps.

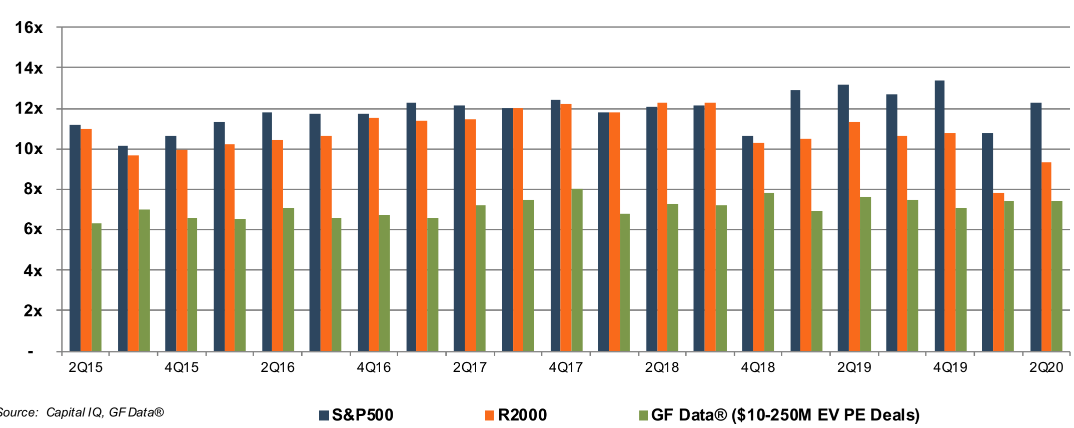
Debt Investments: High Yield Spreads by Credit Rating



Source: BofA Securities via FRED

The EBITDA valuation gap between non-financial small cap and large cap stocks was unchanged from 3/31 at 3.0x at 6/30. When the gap narrows to ~0x the Russell 2000 tends to materially underperform the S&P 500. The gap in favor of the S&P 500 as of 6/30 is high relative to history, indicating small cap stocks could outperform large cap stocks if history is a guide. As for PE-backed lower- and middle-market transactions, GF Data® for 2Q20 exhibited little change with a median EBITDA multiple of ~7x because deals that closed during 2Q20 mostly were negotiated pre-COVID. Data for 2H20 will be more telling in terms of the number of transactions, multiples paid and the amount of financing employed.

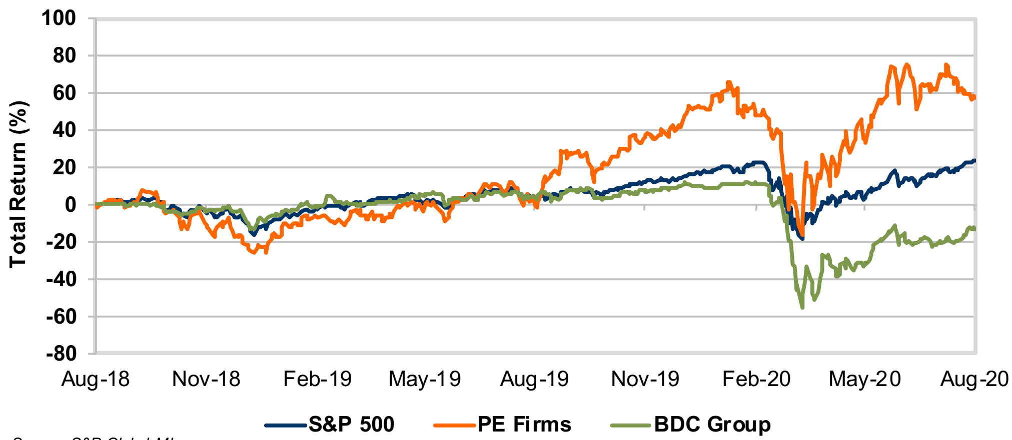
Equity Valuation: EBITDA Multiples Over Time



Source: Capital IQ, GF Data®

The graph illustrates the Wall Street saying that bull markets take the escalator up and the freight elevator down. Depending upon the time span for measurement, a small group of large cap tech stocks (e.g., FANG, Microsoft, etc.) account for about one-third of the market gains for the S&P 500. As such the comparison of the S&P 500 with publicly traded PE funds and credit-focused BDCs may be somewhat unfair.

Stock Performance for Publicly Traded PE Sponsors: Total Returns (Trailing Twelve Months)

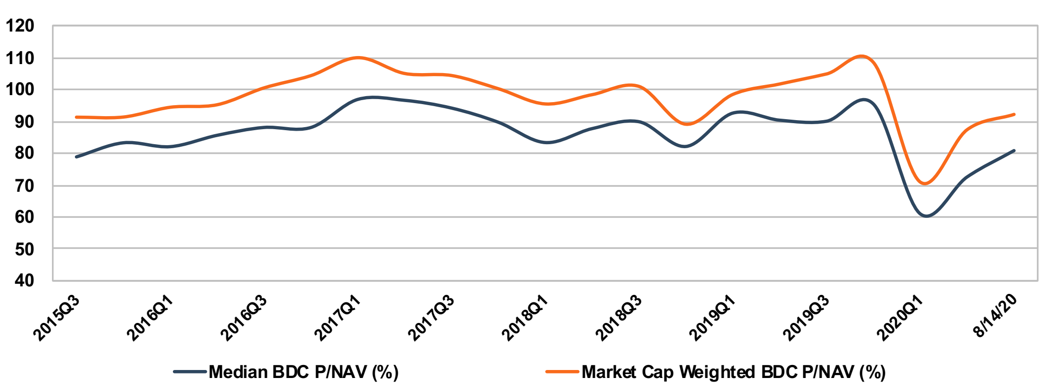


Source: S&P Global MI

Publicly Traded Private Credit

2Q20 was little changed from 1Q20, which was surprising given the havoc COVID-19 had on markets, transactions and public market equity capital raising during the first half of 2Q20. As it relates to 2Q20 activity, fundings were flattish at $34.3 billion while the number of deals closed decreased for the fifth consecutive quarter. The average funding per transaction increased to $15.6 million in 2Q20 from $14.9 million in 1Q20 and $11-12 million in each of the four quarters for 2019.

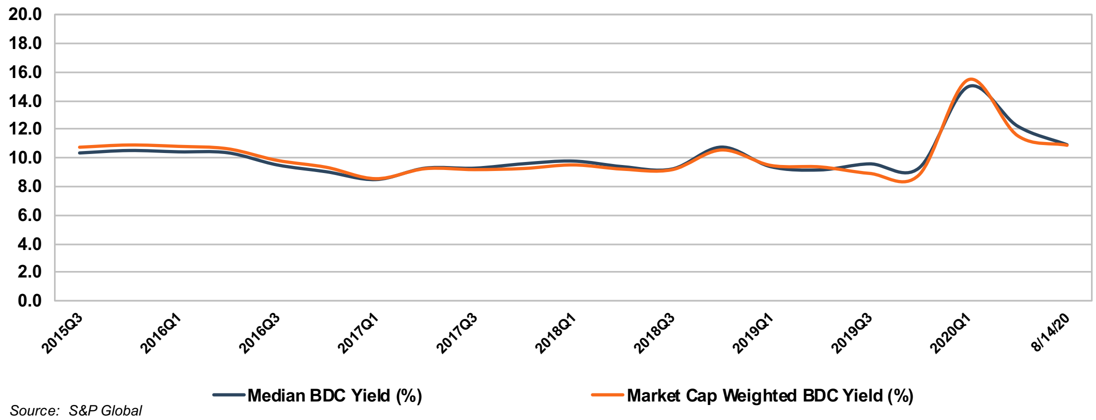
Price / NAV for Publicly Traded Business Development Companies



Source: S&P Global

BDC yields remain elevated around 12% compared to 15% at March 31 and ~9% for each quarter-end in 2019. Realized and projected dividend cuts in addition to the reliability of NAV estimates are an ongoing 2020 theme for BDC investors.

Long-Term Dividend Yield Trend

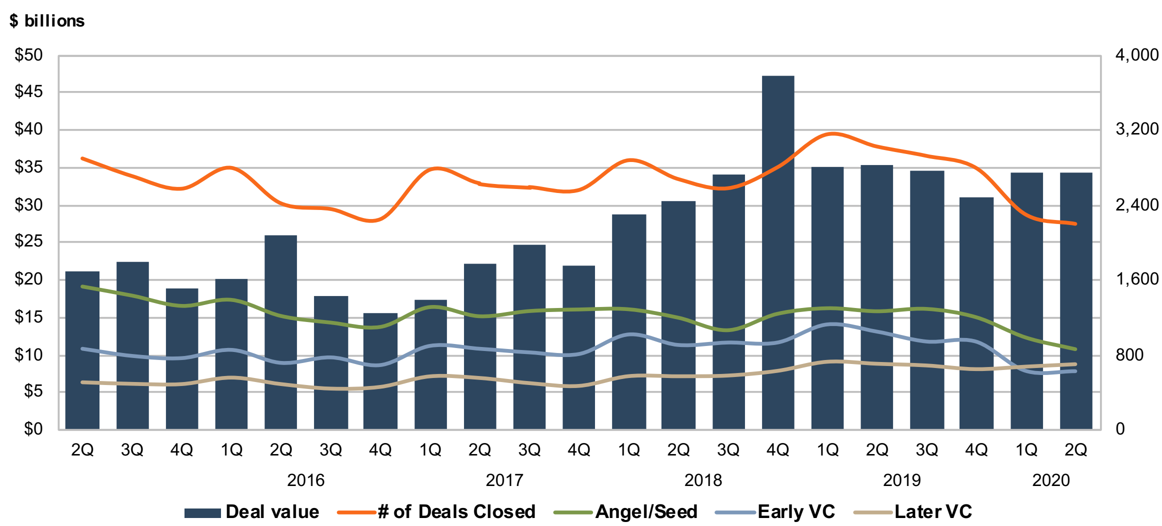


Source: S&P Global

Venture Capital

2Q20 funding detail will not be available for a month or so, but will show lower funding than 1Q20 given the impact COVID-19 had on markets, transactions and capital raising during the first half of 2Q20. As it relates to 1Q20 activity, fundings increased 10% to $34.3 billion while the number of deals closed decreased for the fourth consecutive quarter. The average funding per transaction increased to $14.9 million in 1Q20 from $11-12 million in each of the prior four quarters.

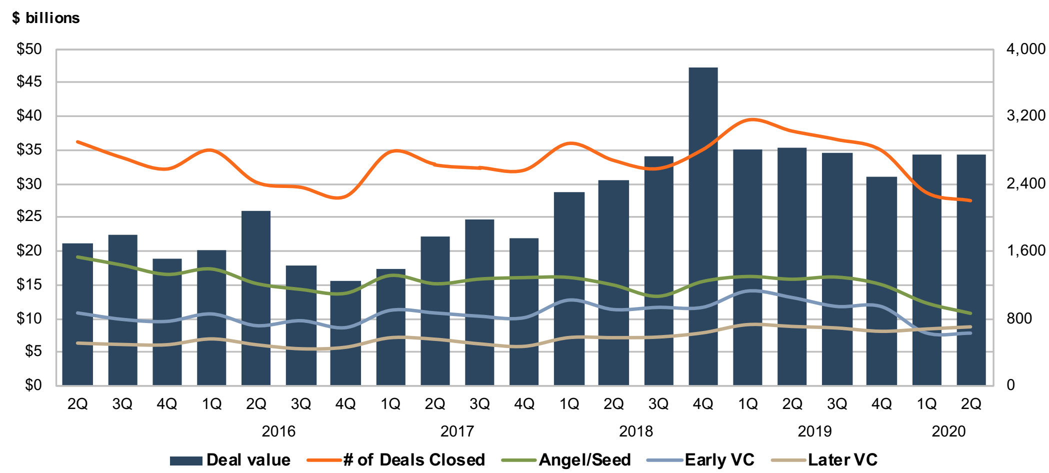
U.S. VC-Backed Funding Activity



Source: Pitchbook/NVCA Venture Monitor

2Q20 exit activity once available will show a reduction from recent quarters given frozen capital markets that existed during part of the quarter; however, the strong performance of the NASDAQ in June and July point to potentially sizable activity in 2H20. Exits for 1Q20 totaled $19.3 billion, the lowest quarterly amount since 3Q17.

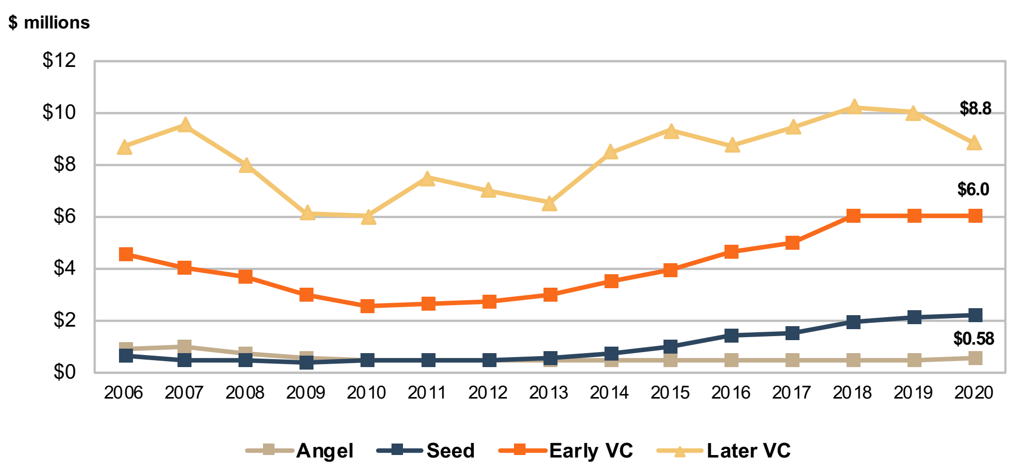
U.S. VC-Backed Exit Activity



Source: Pitchbook/NVCA Venture Monitor

Median deal size showed mixed results for 2Q20. Later VC deals decreased for the second consecutive quarter to $8.5 million while both Angel/Seed and Early VC deals continue to trend higher.

Median Funding by VC Stage ($ millions)



Source: Pitchbook/NVCA Venture Monitor

On the Call

BDC reporting season provided a real-time management view of the potential impact of COVID-19 on publicly traded PE firms because the BDCs generally report results later in the quarter. Below are a few excerpts we found to be interesting.

As it relates to the discrete pipeline, our private equity pipeline is picking up. And even though the markets look to be priced at a premium, when you bifurcate the markets, the bottom 25% of the S&P trades at 10 PE, the top 25% trades above 30. So, there are value-oriented opportunities in Apollo's sweet spot and for the first time (in a while) we are looking at areas other than Tech Data.

On the credit side, we're seeing a very robust flow of opportunities in terms of both bespoke capital solutions that you mentioned, where companies are uniquely impacted by COVID and need capital either to overcome leverage issues or to grow. And so we see our pipeline across everything really being very robust. **–Joshua Harris, Apollo (APO) Co-Founder**

We continue to believe that tradable market technicals are disconnected from economic fundamentals, and we're planning for a slow and uneven recovery over the next few years. Nonetheless, we believe investment opportunities with out-sized returns will be available to those of us with patience, capital and differentiated capabilities. **–Michael Arougheti, Ares Management Corp (ARES) Co-Founder/CEO**

We are speaking to you from our New York City offices as BlackRock employees begin their return to the office in split operations on Monday. I remain cautiously optimistic about our path to recovery, and I'm heartened as we begin to return to somewhat normalcy. There will be positive societal changes from this pandemic despite the uncertainty and the suffering it is causing today. More companies will adopt a more permanent remote work coming out of this crisis, which will have a positive environmental impact as congestion eases in cities and, hopefully, improve quality of life for more people. **–Laurence Fink, Blackrock, Inc. (BLK) Chairman & CEO**

The second quarter saw an extremely strong rebound in virtually every liquid asset class from their March lows, as governments around the world implemented unprecedented fiscal and monetary stimulus to counter the economic impact of the COVID-19 pandemic.

The global economy has started to reopen, but as we discussed previously, the road to recovery will be uneven, with divergent trends across regions and sectors. Asia is clearly further along as is Europe, both of which were impacted by COVID-19 first. While no one knows the exact course of the U.S. economy, it is likely to be slower than anticipated over the next several months as a result. However, once infection levels subside, a stronger economic recovery should occur. **–Stephen Schwarzman, Blackstone (BX) Chairman/ CEO & Co-Founder**

But please do not conflate our tonality and caution on the real economy with our ability to remain active to drive performance in the investment world. It is certainly possible to have a cautious and prudent outlook, while remaining active and successful in our core business, as demonstrated by our second quarter results. The very uneven nature of the recovery is what provides us the opportunity to be selectively aggressive and appropriately circumspect, depending on region, asset class and industry sector.open-end investment vehicles are forced to sell assets due to net capital outflows, the long duration of permanent capital vehicles such as GSBD make them well positioned to withstand market volatility. **–Kewsong Lee, Carlyle (CG) Co-CEO**

On the Call (cont.)

We have outlined three themes beyond good underwriting that we believe drove GBDC's strong fiscal third quarter. First, the U.S. economy began reopening sooner than expected; second, GBDC's portfolio companies generally performed better than expected, especially the ones in COVID-impacted subsectors. And third, our private equity sponsors have generally stepped up to support their portfolio companies. **–David Golub, Golub Capital BDC (GBDC) CEO**

Overall, we did not see a material change in our internal credit ratings metrics this quarter. The percentage of our portfolio, which is a 3 or 4 on our internal rating system, is 13% for the second quarter, up only slightly from 12% in the first quarter. 9% of the portfolio is now rated as a 1 versus 7% in the first quarter. Names in our 2-rated category, names which are performing in line with our expectations, continue to account for over 75% of the portfolio. Further, we continue to have no names in the lowest-rated five category, and we continue to have no loss of original principal on any investment since inception. Less than $950 million or 10% of the portfolio is marked below $0.90 on the dollar today. Further, only one debt investment is marked below $80 million.. **–Craig Parker, Owl Rock Capital Corp (ORCC) President/CEO**

Also, because the fair value of our portfolio increasing from 93.5% to 95.1%, we had $175 million of net unrealized gains during the second quarter. But our yield has decreased from 8.4% at March 31 to 7.9% at June 30. This is driven by the continued decline in LIBOR. The weighted average LIBOR floor on our investment portfolio is 85 basis points. We saw floors generally kick in towards the end of the second quarter. Our cost of debt declined from 4.2% at March 31 to 3.6% at June 30. **–Alan Kirshenbaum, Owl Rock Capital Corp (ORCC) CFO**

As of June 30 average debt EBITDA on the portfolio was 4.6 times and the average interest coverage ratio with the amount by which cash income exceeds cash interest expense was 2.9 times. We had only one non-accrual on our book among 86 different names which represents only 2% of the portfolio at cost. Since its inception PNNT has invested $5.9 billion at an average yield of 12%. This compares to an annualized realized loss ratio of about 24 basis points annually **–Art Penn, PennantPark Investment Corp (PNNT) Chairman/CEO**

Over the course of Q2, LTD first-lien and second-lien spreads, we traced 60% and 71% of the respective Q1 spread widening. Consistent with the broadly syndicated market, the impact of this on valuation of our portfolio this quarter resulted in a reversal of approximately 60% of our Q1 spread-related unrealized losses, which was reflected as an unrealized gain for Q2. We would expect to resume declaring supplemental dividends on over earnings in Q3, provided that our reported net asset value per share at September 30 is greater of $14.92. **–John Easterly, Six Street Specialty Lending (TSLX) Chairman/CEO**

The slight increase in this quarter's non accruals from approximately 0.1% to 0.4% of the portfolio by fair value at quarter end was driven by our Neiman markets first-lien term loan, not our ABL FILO term loan. Our largest retail ABL exposure is our FILO term loan in Neiman Marcus, which was 3.6% of our portfolio at fair value. Our current expectation based on the company's plan of reorganization is that we will be refinanced upon Neiman Marcus exit from bankruptcy. With Sixth Street as lenders of size in each of Neiman and JCPenney's prepositioned capital structure, we were able to have meaningful roles in driving the DIP financing process and terms. . **–Robert Stanley, Six Street Specialty Lending (TSLX) – President**

Mercer Capital

Private Equity Firms & Other Financial Sponsors

Mercer Capital provides business valuation and financial advisory services to private equity firms and other financial sponsors.

Mercer Capital is a valuation and transaction advisory firm. Over four decades we have valued tens of thousands of equity and credit investments in virtually every industry and sub-industry grouping that exist in a variety of markets. We also have significant M&A experience. Please call if we can assist in the valuation of your portfolio companies

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- Fairness Opinions
- Purchase Price Allocations
- Goodwill Impairment
- Equity Compensation / 409(A)
- Buy-Sell Agreement Valuations

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