February 2025

the ASCEND REPORT

The fourth annual in-depth look at the lower middle market

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the 2024 ASCEND REPORT:
Executive Summary

A rapid rise in interest rates coupled with economic uncertainty stalled dealmaking in 2023 and 2024, but with rate cut guidance and a stable economy, sponsors expect an active M&A market in 2025.

Tree Line is pleased to present the fourth annual *Ascend Report*, which provides insight into the state of the lower middle market ("LMM"). We begin by providing a refreshed introduction to the LMM, including market sizing statistics, recent private equity deployment, fundraising metrics and key market trends that have impacted deal flow in 2024. Similar to prior versions of the Ascend Report, we analyze troubled industries through Tree Line's "Bad Deal Database", which leverages data of ~5,000 borrowers per quarter through public reports issued by business development companies ("BDCs") to highlight sectors which carry the highest percentage of investment mark downs.

Next, we highlight the findings from our annual *Ascend Survey* of over 90 LMM private equity managers recently conducted by the Tree Line team. 2024 has delivered unique challenges via inflation, rising interest rates and broader economic uncertainty. The findings from our Sponsor partners regarding 2024 deal flow as well as outlook for 2025 is incredibly insightful. As always, we are grateful for the participation and support of all participants as the feedback is extremely valuable to take a pulse on the state of play in the LMM.

The 2024 *Ascend Report* concludes with Tree Line's market insights. Tree Line recently celebrated its ten-year anniversary and our entire platform is dedicated to the LMM. We have issued nearly $6B in commitments across over 400 transactions and have used our experience and market intelligence to monitor and analyze critical LMM trends. Tree Line's findings suggest that following a slow M&A environment throughout 2024, 2025 is expected to be active based on significant private equity dry powder and expected rate cuts.

Opinions expressed in this Ascend Report are those of Tree Line Capital Partners, LLC as of February 2025 and are subject to change. Furthermore, the data contained herein is for informational and discussion purposes only and is neither an offer to sell nor a solicitation of any offer to buy any securities, investment product, or investment advisory services.

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Market Overview

Lower Middle Market & Middle Market Definition & Sizing

Deal Activity Update

Pitfalls and “Bad Deals”

Lower Middle Market & Middle Market Overview

Market Definitions and Statistics.

A growing sector.

MIDDLE & LOWER MIDDLE MARKET STATISTICS

$312B **Capital Raised For LMM Funds (< $500M) Since 2019[1]**	**181,386** **Companies with between $10 - $100M in Revenue[2]**
$500B+ **North American Middle Market PE Dry Powder[3]**	**40%** **Of PE Deals Completed in 2024 Between $25 - $100M in Size[4]**

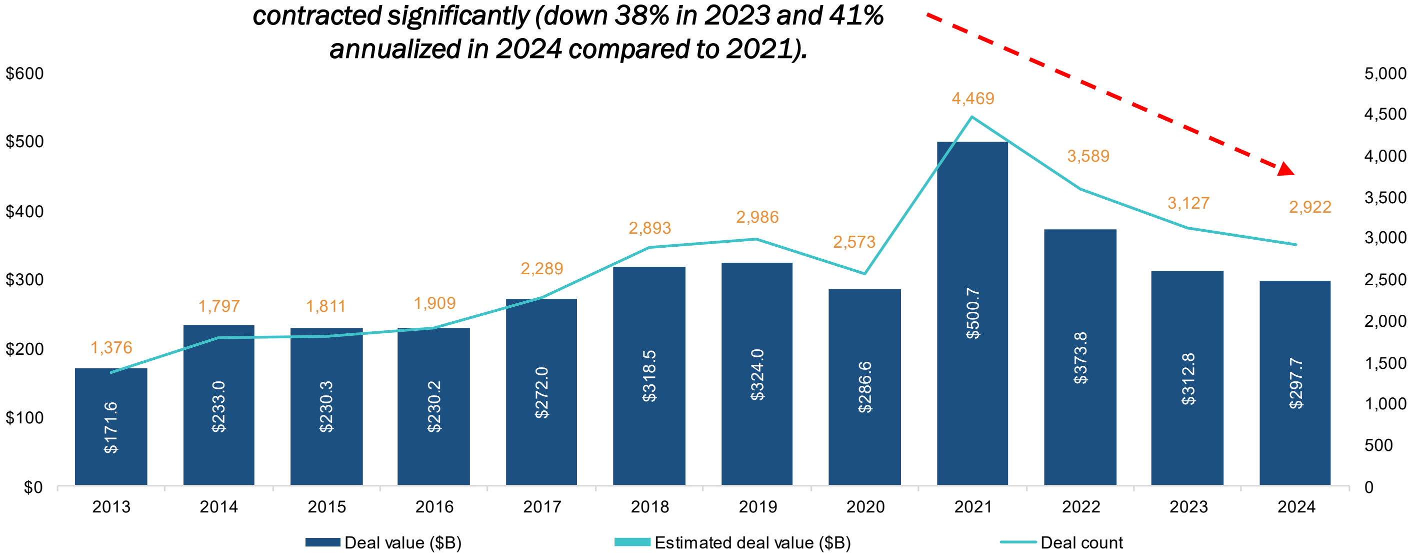
- *The Ascend Report is focused on the LMM and the data throughout is geared towards LMM trends. However, in certain situations and particularly throughout the market overview, data is only available for the Middle Market and noted as "MM" data. The MM remains a strong proxy for the LMM in terms of fundraising and deal activity trends.*
- Tree Line defines the LMM as being comprised of companies with between $5M - $30M of EBITDA, which translates to revenues of ~$25M - $150M. MM data throughout the report relates to deal activity, which is defined as enterprise values between $25M to $1B.
- There is a vast and expanding opportunity set of deals driven through a network of direct relationships with private equity sponsors. The number of new MM private equity platform acquisitions increased 62% from 2014 to 2024.[5]
- Private equity firms targeting LMM companies typically raise funds up to $500M with more established firms raising up to $1B whereas MM private equity firms target funds up to $5B.
- The MM has experienced rapid growth as there is a significant addressable set of acquisition targets and opportunities for sponsors to drive value through attractive valuations and buy-and-build strategies. From 2014 to 2024, the number of MM add-ons increased rom 994 in 2014 to 1,988 in 2024 (100% growth).[5]

2024 Deal Flow Activity

Macro Activity Slowed Deal Flow in 2024.

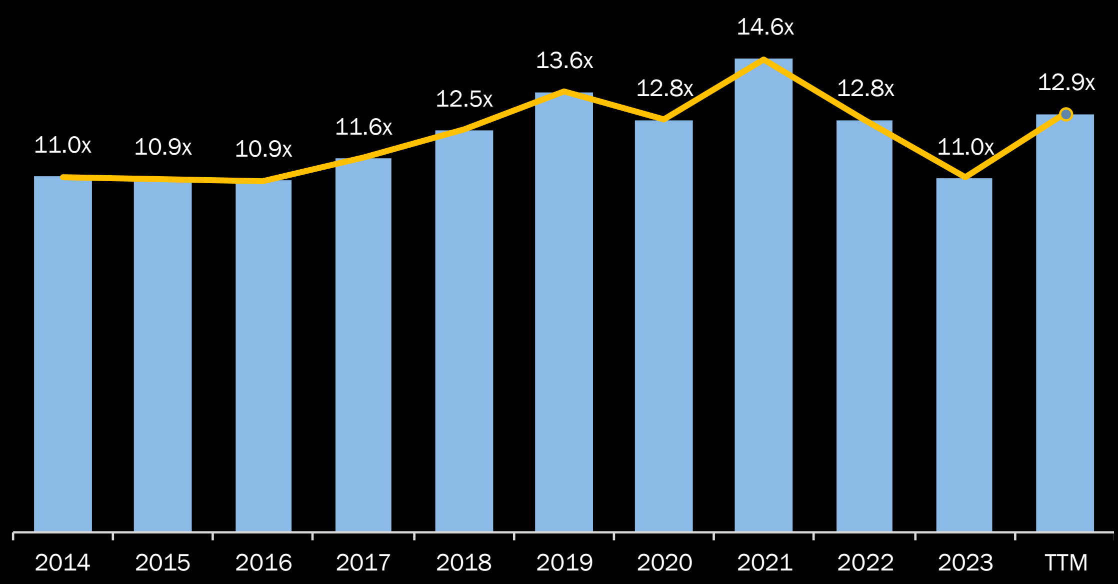
PE Middle Market Deal Volume and Activity[5]

Following the economic downturn in 2022, deal volume contracted significantly (down 38% in 2023 and 41% annualized in 2024 compared to 2021).



As deal volume contracted, there has been a noted "flight to quality" as LMM and MM sponsors have targeted higher quality platform acquisitions albeit at higher valuations as noted below:

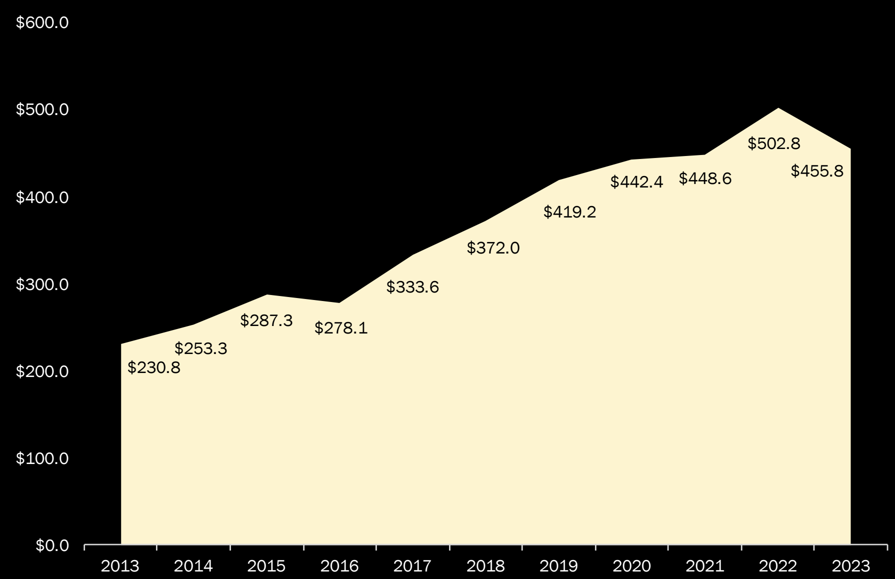
PE Middle Market Deal Volume and Activity[6]



Purchase multiples increased from 11.0x to 12.9x due to sponsors pursuing higher quality deals and competitive sell-side auctions as a limited set of premium assets came to market in 2024.

LMM & MM Private Equity Growth

Private Equity MM Dry Powder ($ millions)[7]



MM Private Equity AUM Growth[8]

While mega-funds dominate the headlines, the LMM and MM growth is delivering a large and fragmented market for both private equity and private credit managers.

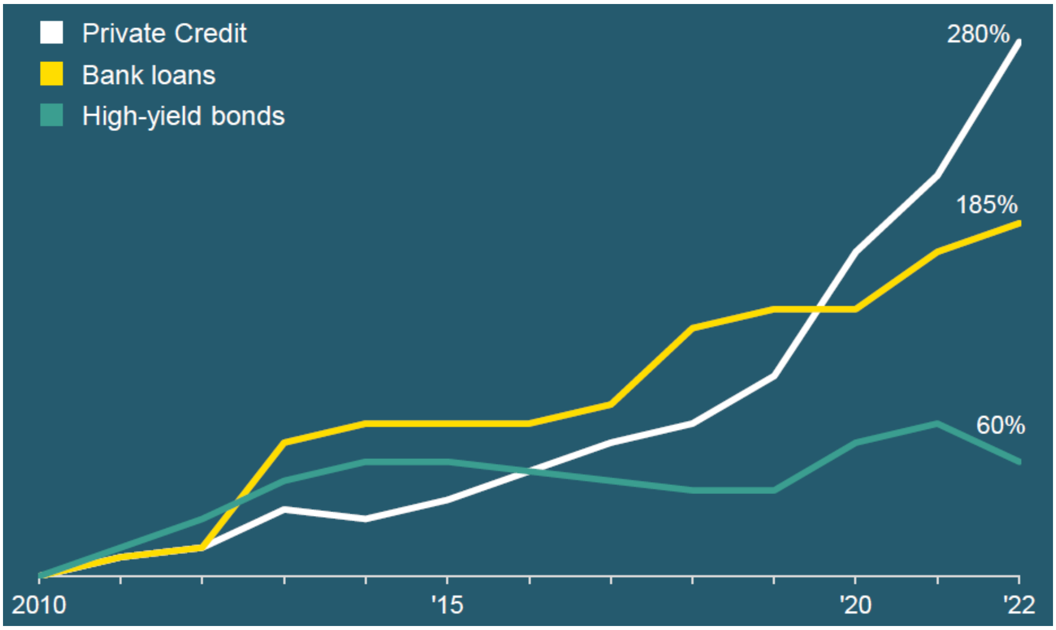
LMM sponsors are attracted to the sub-$100M revenue opportunity set which enables directly sourced deal flow outside of the traditional auction led origination channel that dominates the upper market. There are over 181,000[2] companies within the US with revenue between $10-100M, creating a massive market opportunity.

Although deal flow was muted in 2024 (as seen on the previous page), MM private equity funds are sitting on near-record levels of dry powder ($456B as of FYE 2023). As a result, Tree Line remains confident regarding the long-term prospects of the LMM sponsor acquisition market, regardless of short-term fluctuations.

Lastly, the middle market private equity asset class continues its strong growth and interest from LPs, increasing AUM to peak levels of $1.3T.

Private Credit's Market Share Expansion

Surging Demand for Private Credit[9]

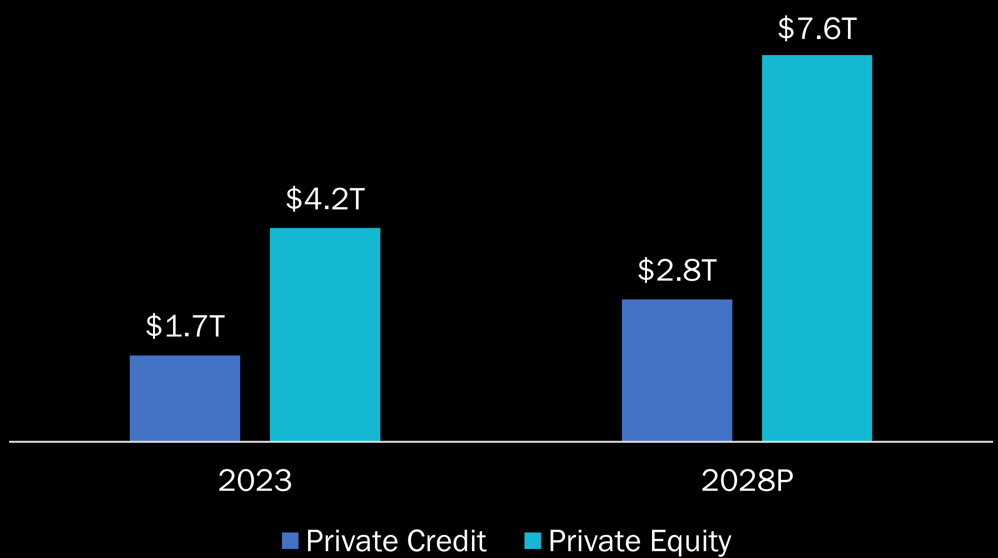


Private credit offers numerous advantages to alternative debt capital solutions, including efficient closing processes, tailored capital structures and flexibility.

As a result, private credit outstanding capital rose 280% from 2022 vs 2010, which represents a 51% increase vs. bank loans and a 367% increase vs. high-yield bonds.

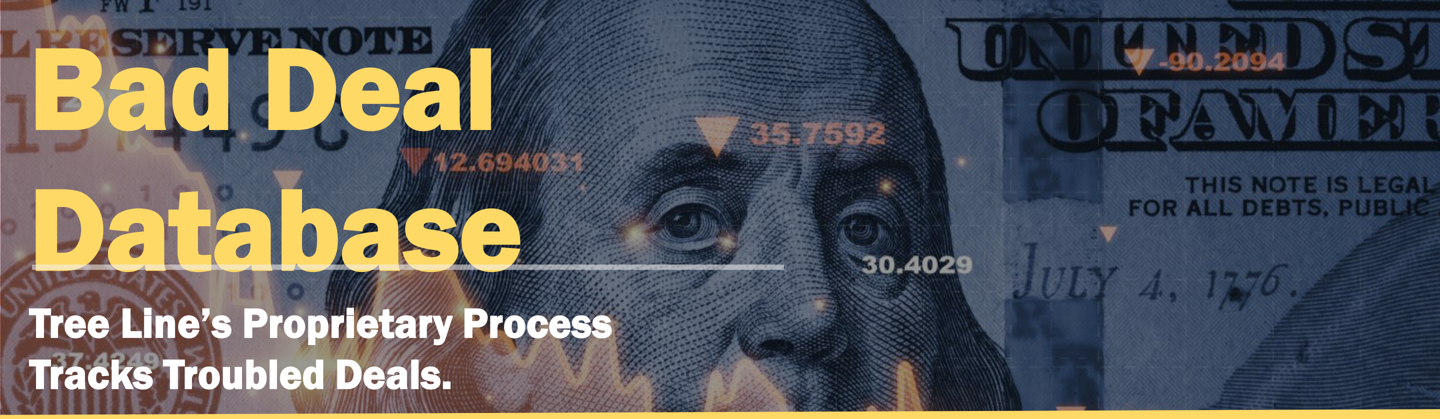
"Private credit shot ahead in the pandemic when crisis-struck banks froze up, stoking worries of mass defaults." –Wall Street Journal.

Private Equity & Private Credit Forecasted Growth[10]



According to Prequin, middle market private equity AUM is forecasted to increase from $4.2T in 2023 to $7.6T in 2027, respectively.

Over the same period, private credit AUM is forecasted to grow from $1.7T to $2.8T.



Bad Deal Database

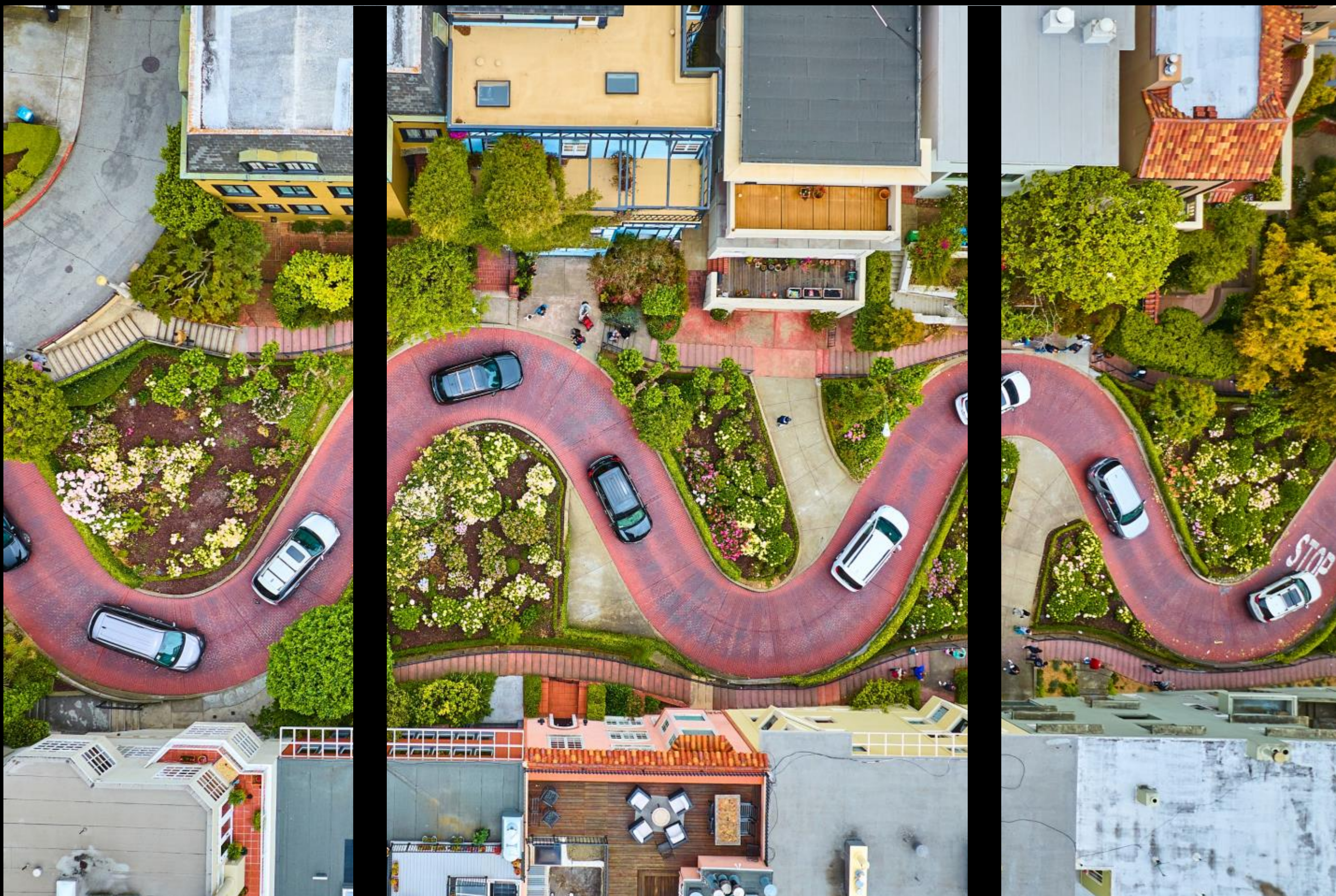
Tree Line's Proprietary Process Tracks Troubled Deals.

Tree Line tracks data comprising ~5,000 borrowers per quarter from public BDC filings dating back to 2019 to monitor the prevalence of underperformance by sector. A "bad deal" is defined as a deal marked at less than 80% of amortized cost. Tree Line has aggregated a database of 1,724 "bad deals" since Q4 2022 that have been marked below 80% of cost.

Tree Line uses the database to identify trends in industries and sub-industries to help inform investing decisions.

Bad Deal Database	Q2'24			Q1'24			Q4'23		
Sector	Total Deals	Q2 Bad Deals	% Total	Total Deals	Q1 Bad Deals	% Total	Total Deals	Q4 Bad Deals	% Total
Educational Services	18	3	16.7%	34	2	5.9%	39	2	5.1%
Metals & Mining	22	3	13.6%	22	1	4.5%	22	3	13.6%
Printing & Publishing	40	5	12.5%	23	4	17.4%	23	3	13.0%
Manufacturing	96	10	10.4%	110	5	4.5%	112	3	2.7%
Telecommunications	87	9	10.3%	85	6	7.1%	76	7	9.2%
Home Furnishings	49	5	10.2%	35	1	2.9%	34	4	11.8%
Gaming And Hotels	33	3	9.1%	30	3	10.0%	23	3	13.0%
Consumer Nondurables	24	2	8.3%	78	2	2.6%	79	6	7.6%
Retailing	282	22	7.8%	148	16	10.8%	152	17	11.2%
Media	164	12	7.3%	106	9	8.5%	107	7	6.5%
Environmental Services	42	3	7.1%	36	3	8.3%	39	2	5.1%
Building Materials	43	3	7.0%	51	6	11.8%	59	6	10.2%
Computers & Electronics	1,061	74	7.0%	735	45	6.1%	815	55	6.7%
Real Estate	50	3	6.0%	40	3	7.5%	44	4	9.1%
Entertainment And Leisure	122	7	5.7%	76	2	2.6%	90	2	2.2%
Top 15 Sectors	2,133	164	7.7%	1,609	108	6.7%	1,714	124	7.2%
Other	3,218	137	4.3%	3,094	126	4.1%	3,231	150	4.6%
Total	5,351	301	5.6%	4,703	234	5.0%	4,945	274	5.5%

- **Education Services:**
  - Education services have faced challenges due to de novo build-out strategies that failed to reach expected enrollment and rising teacher wages, which outpaced tuition growth.
- **Manufacturing:**
  - The number of bad deals in the manufacturing sector doubled in Q2'24. Tree Line expects the softness in the manufacturing segment relates to complex supply chains, inflation on input costs and rising labor expense.
- **Home Furnishings:**
  - The number of bad deals in the home furnishing sector climbed in Q2'24, increasing from one in the previous quarter to five. Businesses within the consumer goods segment face pressure during challenging economic environments as the purchases are discretionary. Likely due to recent inflation pressures, Tree Line assumes 2024 discretionary home furnishing purchases experienced a pullback due to reduced discretionary spend.



2024 Ascend Survey

Feedback from Over 90 Private Equity Sponsors

Assessment of 2024 Activity and Outlook for 2025

Growing Trend of Buy-and-Build Strategies

2024 Recap & 2025 Expectations

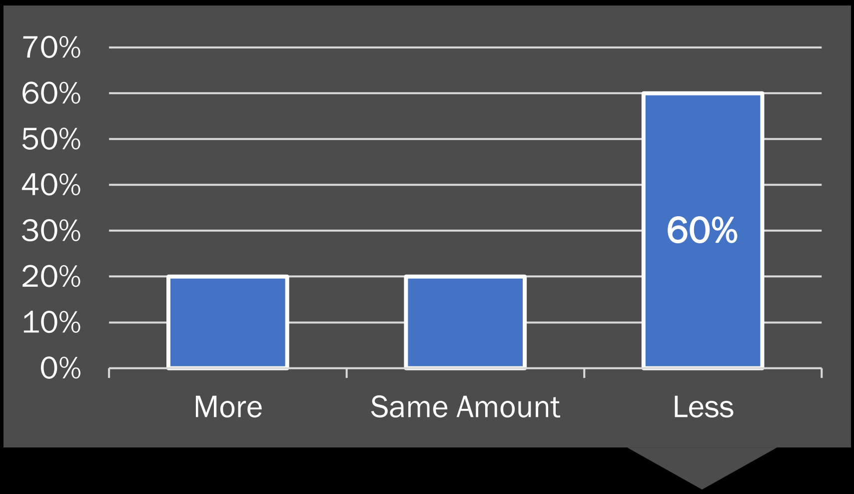
The past two years have presented unique challenges for deal volume in the lower middle market. According to PitchBook data, deal volume declined 41% in 2024 vs. 2021 and the number of private equity exits fell by 55% over the same period.

Contributing to the decline in lower middle market deal activity was the unexpected pace and sheer magnitude of rate increases, with 3M Term SOFR peaking at 5.5%.

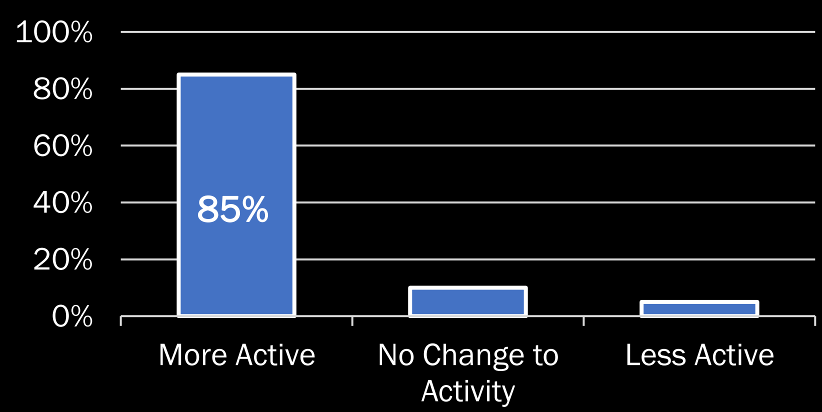
Despite the slow pace of deal activity over the past two years, there is optimism across the lower middle market private equity community that deal volume will significantly improve. Interest rates have started to retreat (3M SOFR has declined from 5.5% late-2022/early-2023 to 4.3% as of February 2025) and private equity firms are sitting on $456M of dry powder.

The responses to our annual Ascend Report corroborate much of the market sentiment. As seen to the right, 60% of sponsors noted that their firms have deployed less capital in 2024 than expected, but through projected rate cuts and an improving economic environment, 85% of sponsors expect deal flow activity will accelerate in 2025.

How much capital have you deployed in 2024 compared to your expectations at the beginning of the year?

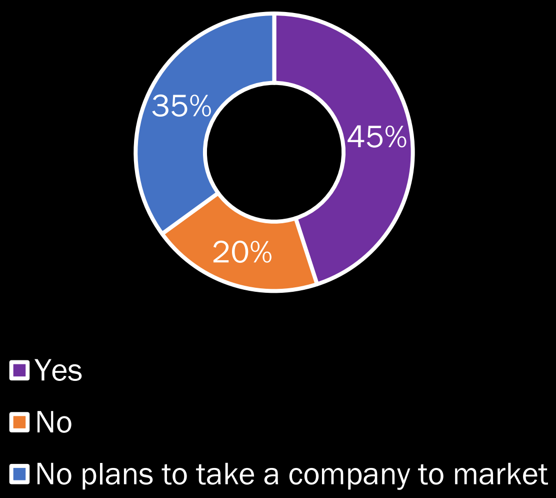


Do you expect deal activity to change as interest rates are forecasted to decline moving forward?

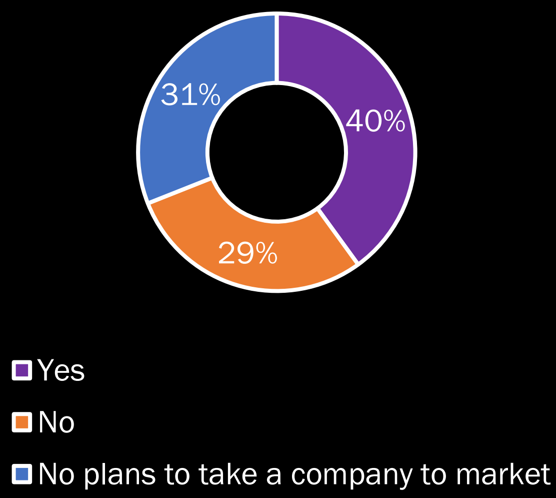


2024 Recap

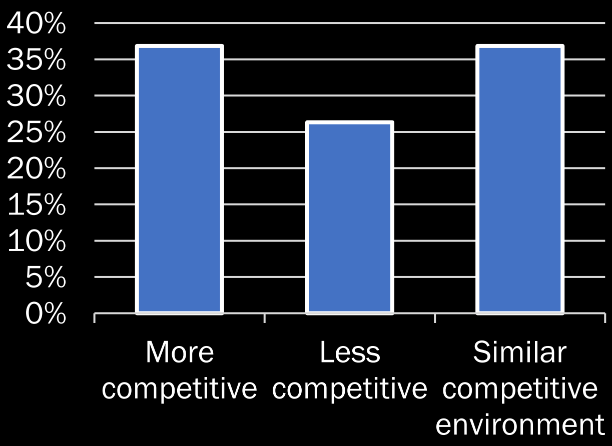
Due to market conditions in 2024, have you delayed taking portfolio companies to market?



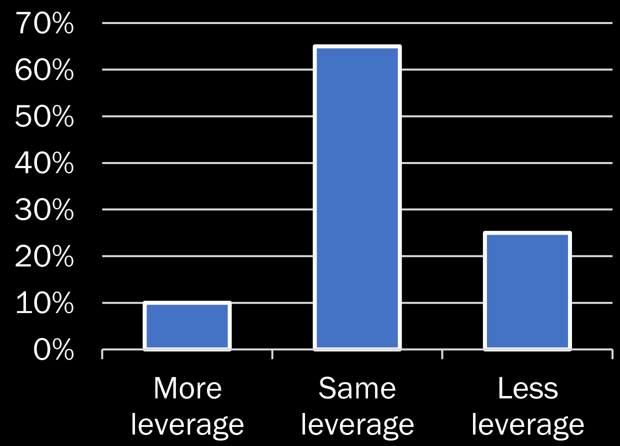
Due to market conditions in 2023 and 2024, have you pulled a sell side deal from market?



Have sell side processes been more, less or comparably competitive in 2024 vs. 2023?

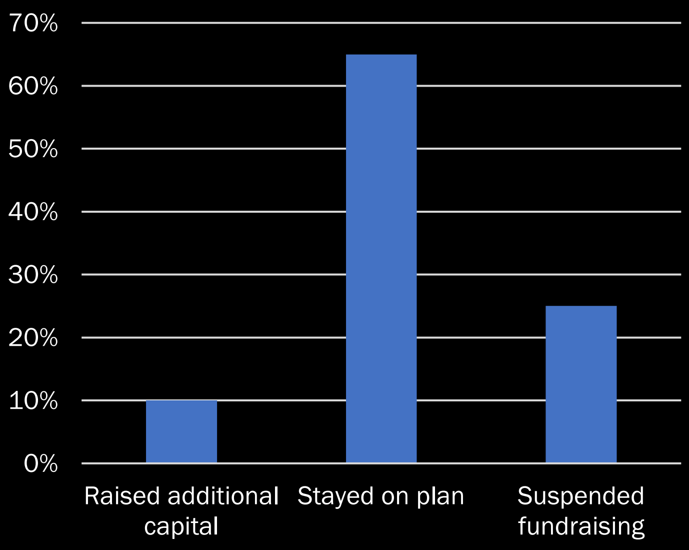


On average, how much leverage have you utilized in 2024 compared to 2023?



Fundraising

Did your fundraising plans change as a result of the economic slowdown over the past 12 months?

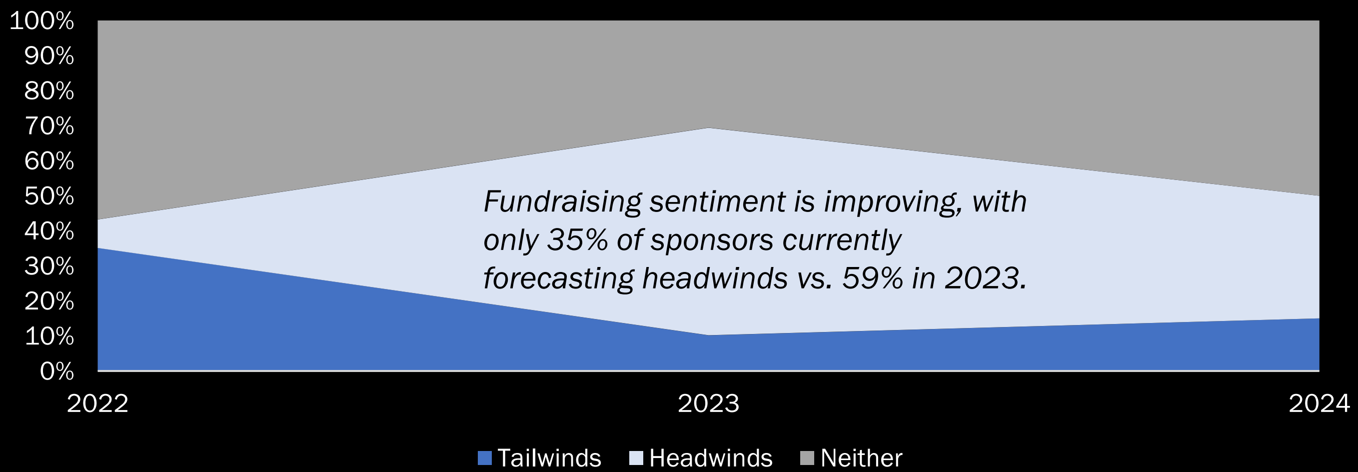


Lower middle market private equity dry powder declined from $503M in 2022 to $456M in 2023 as a result of a more challenging fundraising environment against the backdrop of recession fears.

According to PitchBook, the attraction of lower and middle-market funds faded somewhat. Expectations for lower interest rates in the back half of 2024 have done more to stir interest in mega-funds because of the extra constraint that higher rates had imposed on megadeals.

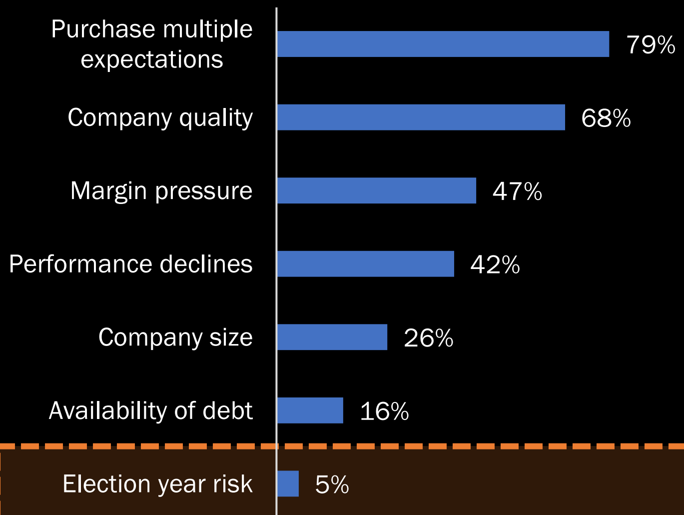
After six consecutive quarters of PE lower and middle-market funds outperforming mega-funds on a one-year horizon basis, that trend reversed in the final quarter of 2023. Historically, these changes in leadership between mega and middle-market funds tend to last between one and three years, and experts would not be surprised if a reversal to momentum in the lower middle market is on the horizon.

As a lower middle market or middle market sponsor, do you feel tailwinds or headwinds in your fundraising?



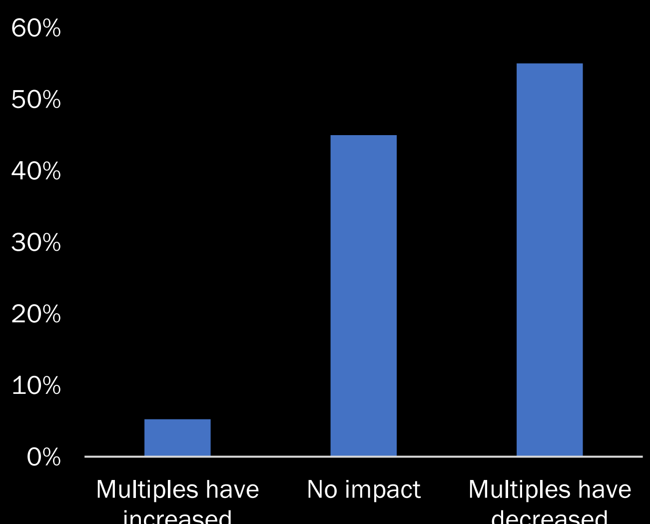
Current Environment

What are the most common reasons for electing to pass on a new platform acquisition in this environment?



Rank the top concerns in the current environment when evaluating a new platform?

Have rising interest rates/cost of debt impacted purchase multiples?



Despite the uncertainty leading up to the recent US Presidential election, sponsors noted election year risk didn't pose a significant risk to their deal evaluation.

Inflated purchase multiples, long-term recession concerns, company quality and availability of debt generated the highest level of concern.

NTM Expectations

65%

of Sponsors expect to deploy more capital in 2025 compared to 2024.

Prior Ascend Report noted sponsors expected to deploy 62% less capital in 2024 vs. 2023.

65%

of Sponsors expect purchase multiples to stay the same in 2025 compared to 2024.

Prior Ascend Report noted 64% of sponsors expected purchase multiples to decrease in 2024 vs. 2023.

2025 Outlook

The 2024 Ascend Report highlights significant optimism for 2025 compared to 2024. Sponsors expect to deploy more capital, expect the M&A market to be more active and expect purchase multiples to remain comparable to 2024 levels.

90%

of Sponsors expect LMM M&A activity to be more active in 2025 vs. 2024.

Prior Ascend Report noted 57% of sponsors expected 2024 to be less active than 2023.

63%

of Sponsors expect utilize the same amount of leverage in 2025 compared to 2024.

Prior Ascend Report noted 45% of sponsors expected to use less leverage in 2024 compared to 2023.

Buy-and-Builds

Tighter forecasted spreads and reductions in interest rates are expected to drive continued growth in buy-and-build strategies.

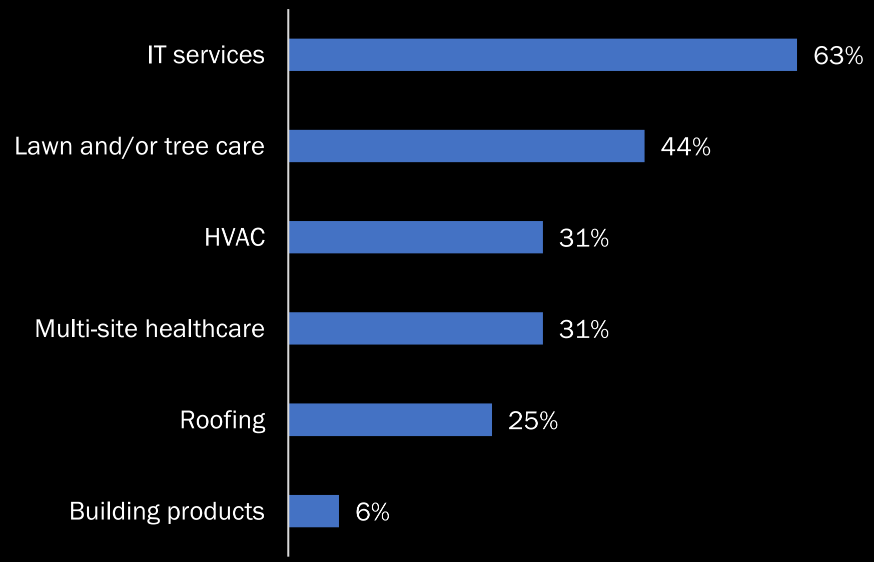
Given the scarcity of high-quality platform companies coming to market over the last two years, purchase multiples have increased for new LMM buyouts from 11.0x in 2023 to 12.9x as of June 2024.

LMM sponsors have turned their attention towards accretive add-on acquisitions, which are often sourced on a proprietary basis and can be acquired for substantial discounts to high-quality, new platforms.

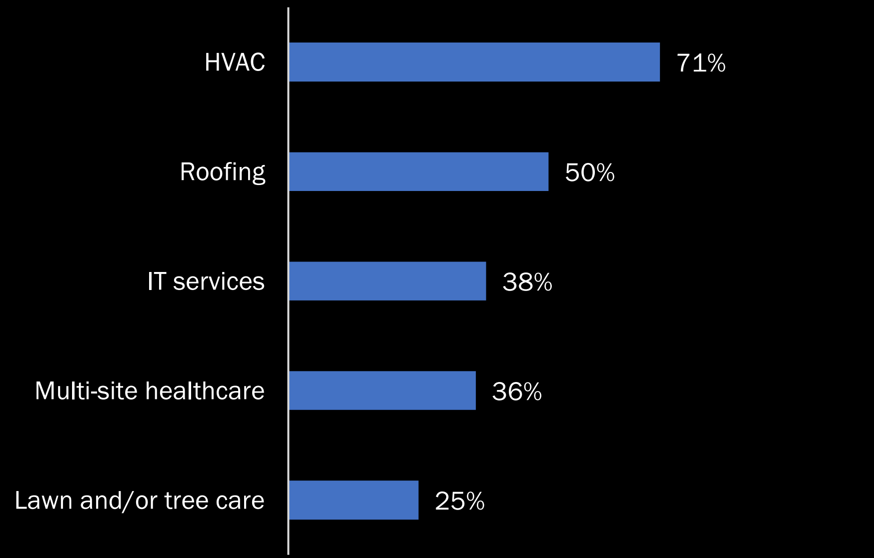
The share of overall deal volume ($ basis) attributed to add-on acquisitions has increased from 29% in 2007 to 55% in 2024.

In terms of sector focus, Tree Line has observed a significant amount of attention directed at HVAC, roofing and multi-site healthcare strategies over the past few years. As these markets have become saturated with many private equity-backed platforms, sponsors noted in the Ascend Survey that they have begun focusing on new roll up strategies in the IT services and lawn/tree care sectors.

What industries do you view as attractive to pursue a buy-and-build strategy? *Multiple industries may be selected.*

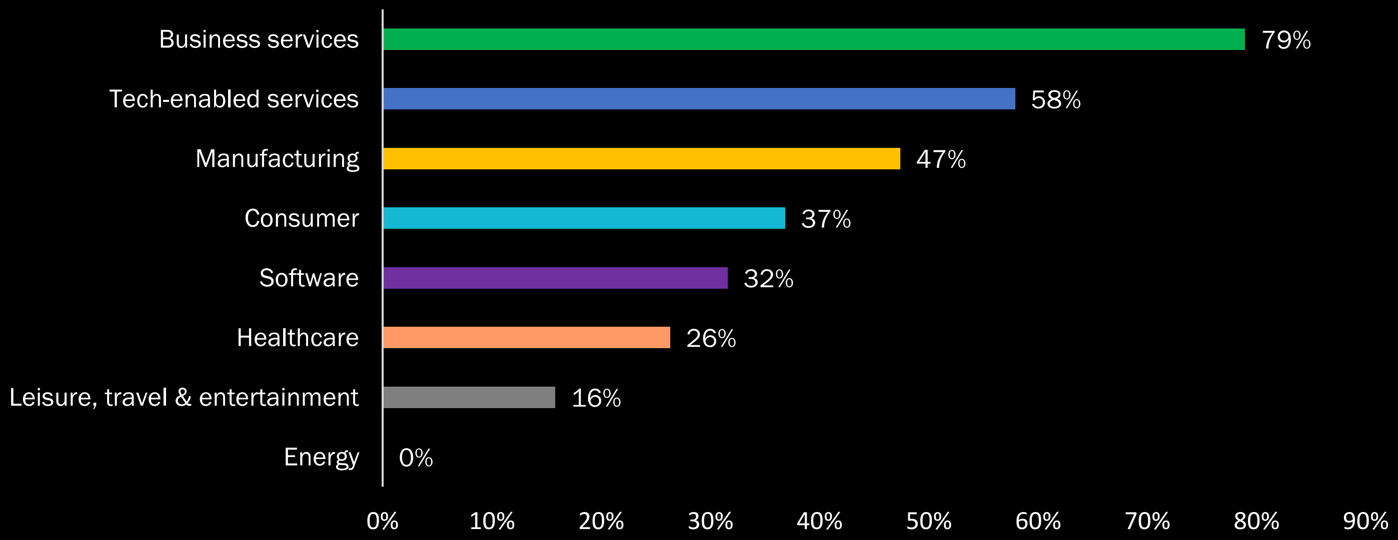


What industries do you view as unattractive to pursue a buy-and-build strategy?

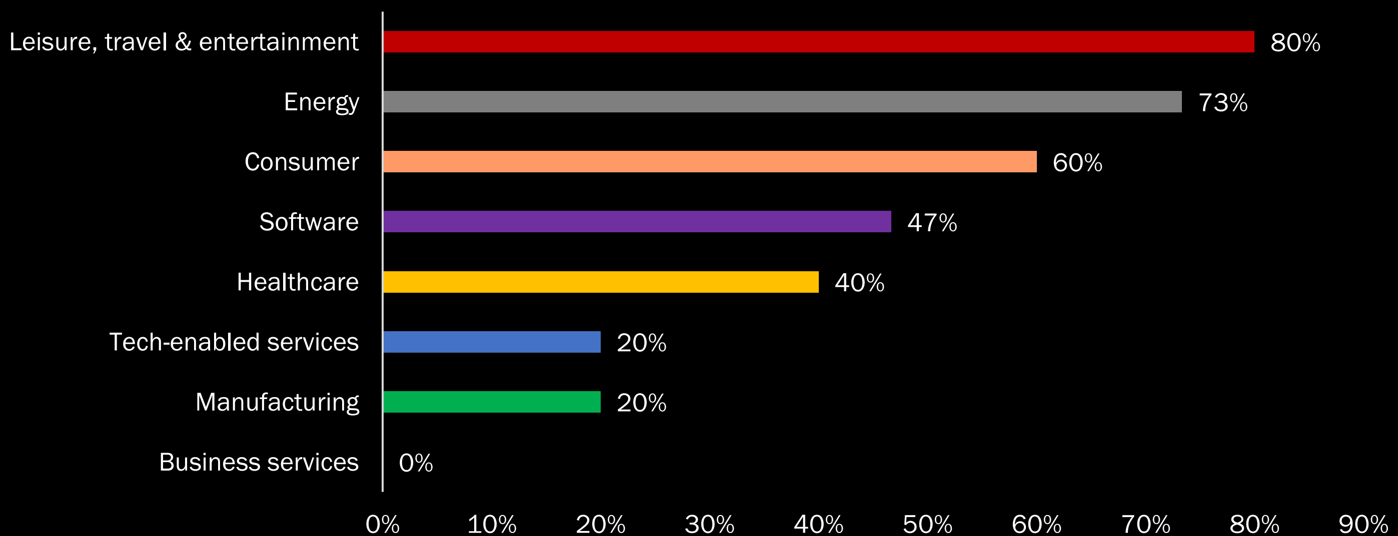


Sector Preferences

What sectors do you plan to target in the current environment?



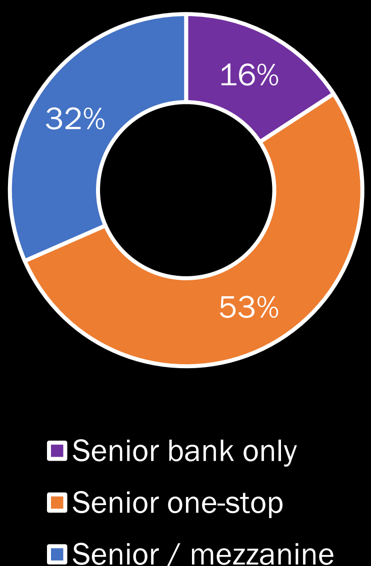
What sectors do you plan to avoid in the current environment?



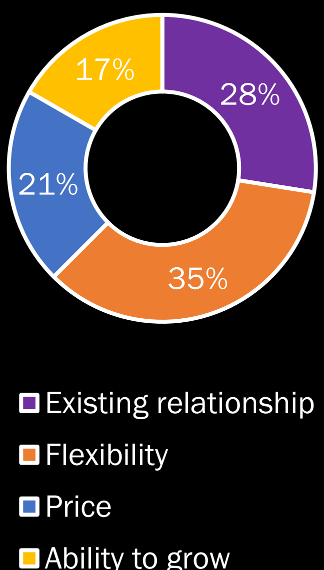
Lender Preferences

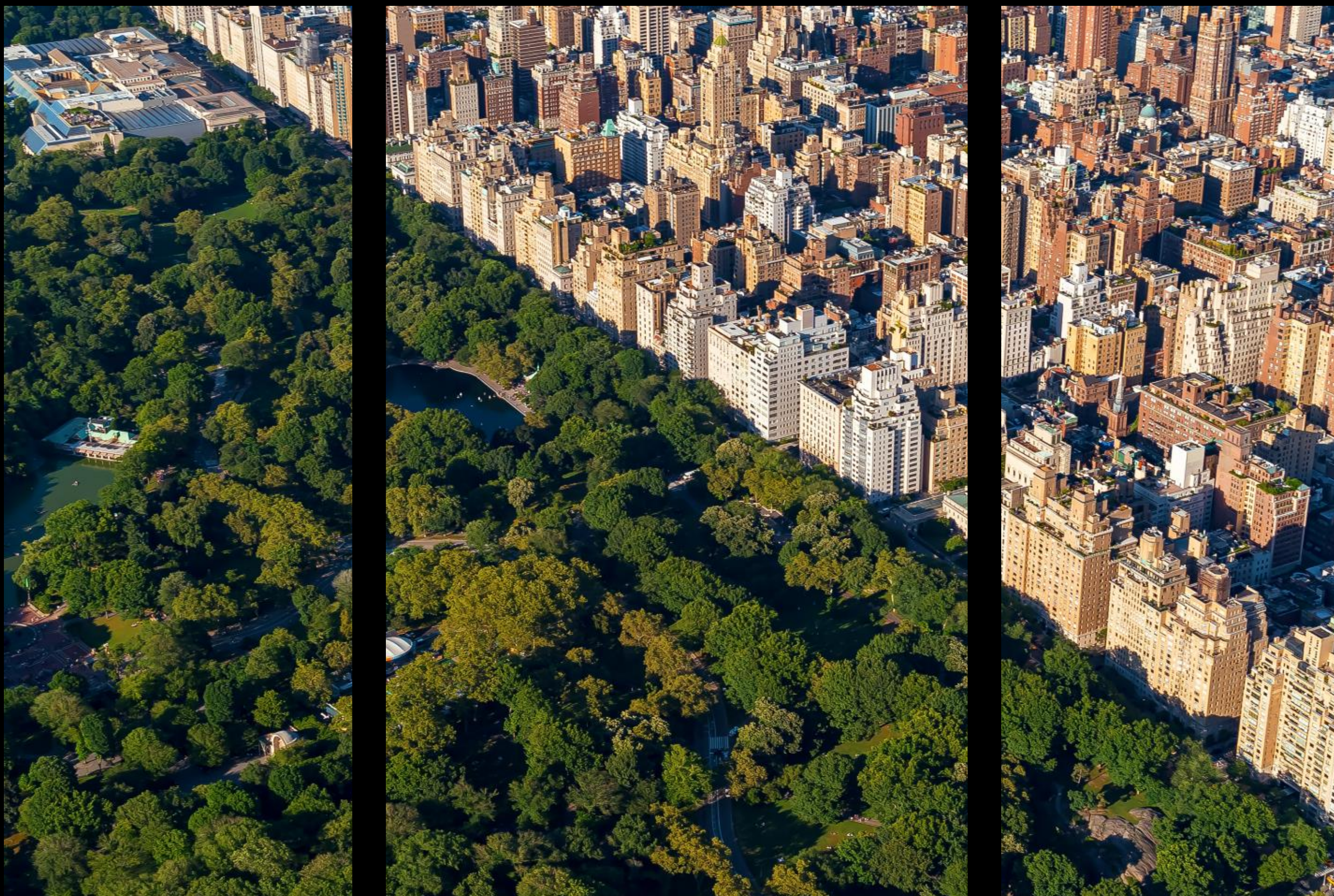
LMM sponsors indicated that relationship and flexibility remain the top two considerations when selecting a lender to partner with on a new platform acquisition. This dynamic translates to 53% of sponsors preferring a private credit firm as a key player in the capital structure.

What is your preferred debt structure?



Rank the most important factor when selecting a lender:





Tree Line’s Market Insights

Tree Line’s History and Growth

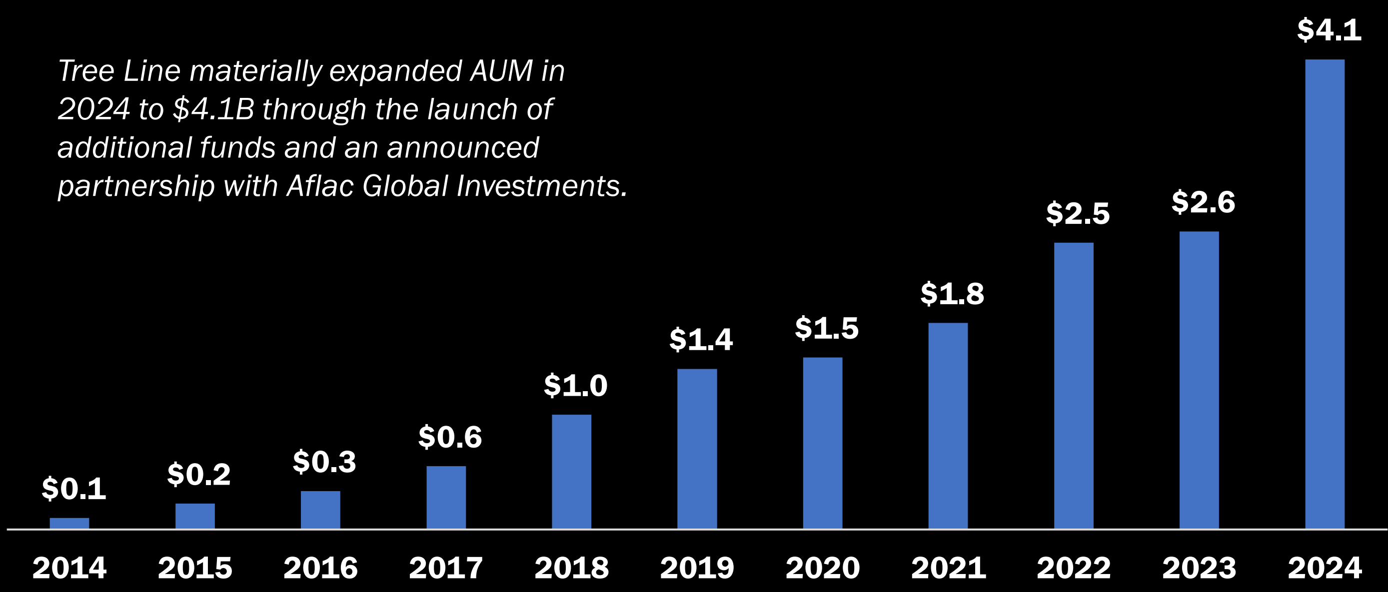
Visibility Towards Improving Debt Service Costs

Value Creation through Add-On Acquisitions

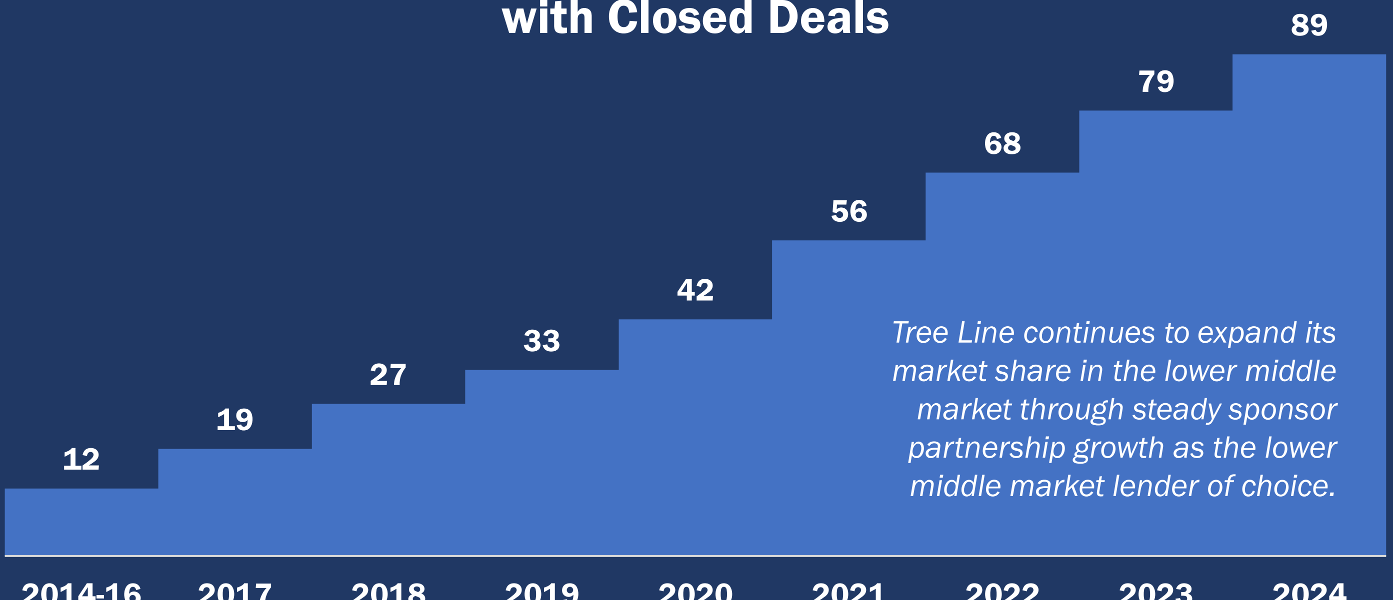
Tree Line's History & Insight into the LMM

Over the past ten years, Tree Line has made significant investments in its platform, systems and team. The data-focused approach provides Tree Line with a unique ability to analyze trends in the lower middle market

Significant Recent AUM Growth ($ billions)



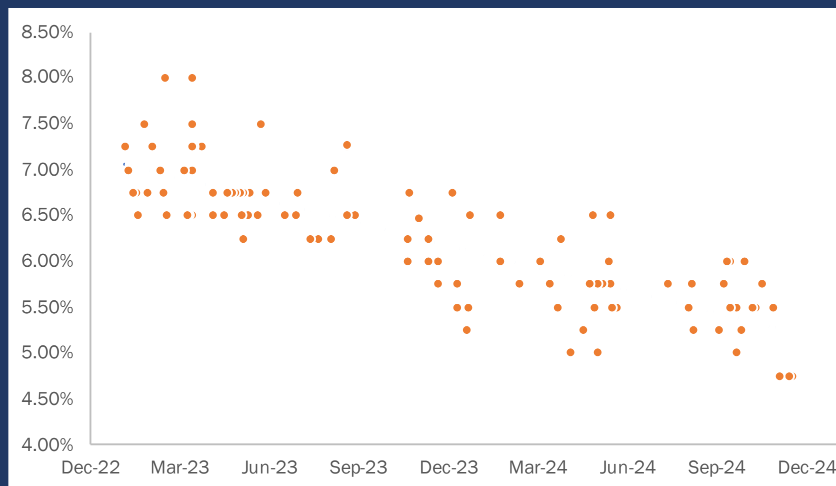
Cumulative Sponsor Relationships with Closed Deals



Tightening Spreads and Rate Cuts Driving Lower Cost of Debt to Borrowers

Cash Spread Trends (Deals Reviewed by Tree Line)

Through a competitive M&A environment, Tree Line has seen continued tightening of cash spreads through an increased number of private credit firms bidding on the same opportunity. In response to market conditions, average cash spreads on reviewed new platform acquisitions decreased 1.0% from 2023 to 2024.



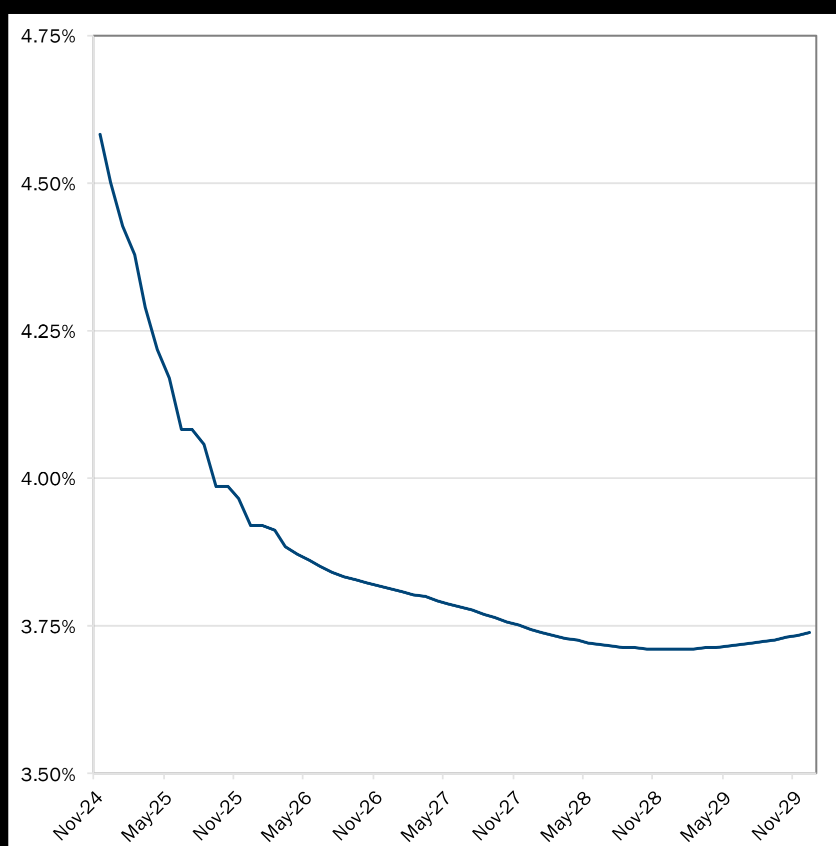
Forward SOFR Curve[11]

The Fed began cutting rates in 2024 and has provided guidance towards future rate cuts, which is reflected in the forward 3M Term SOFR curve.

3M Term SOFR peaked at 5.5% in late-2023, early 2024 and have declined to 4.3% as of February 2025.

3M Term SOFR compression, coupled with ~1.0% cash spread tightening, has led to ~2.0% lower borrowing costs to lower middle market borrower.

Additionally, by analyzing the forward 3M Term SOFR curve, borrowers are expected to see further rate compression, leading to 3.0%+ expected debt service cost reductions in 2025.



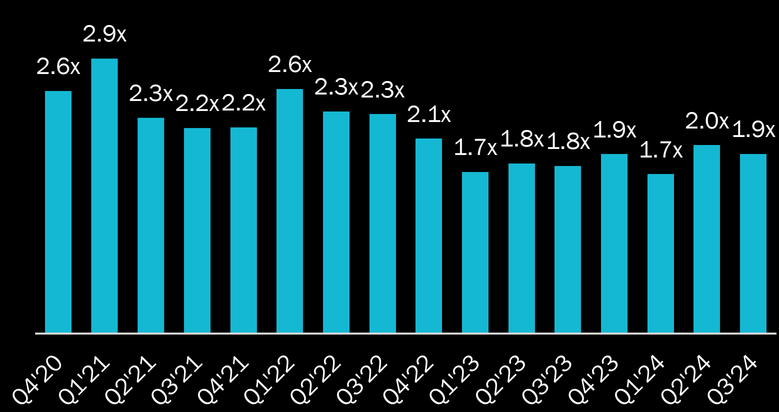
Conservative Credit Structures & Shift to Add-on Acquisitions

Disciplined Transaction Structures

Tree Line aims to construct reasonable capital structures and target non-cyclical, asset light businesses that provide meaningful downside protection, which has been particularly valuable in a rising interest rate environment.

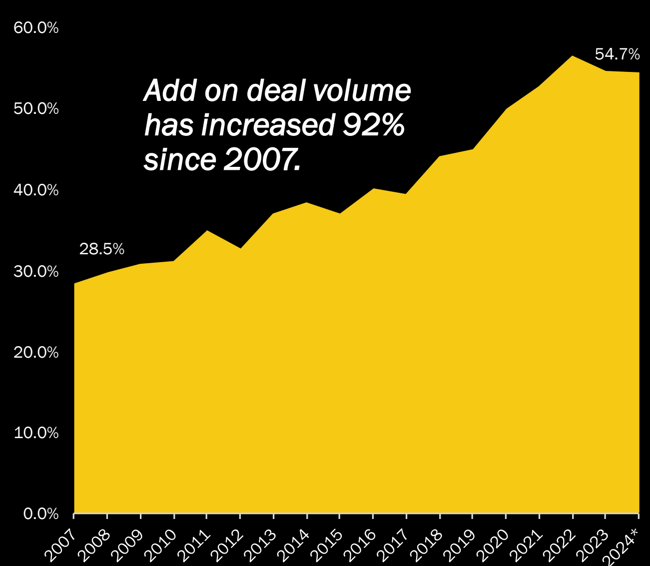
Despite 3M Term SOFR increasing to 5.5% Tree Line's portfolio maintained an average fixed charge coverage ratio of 1.7x over the past four years.

Tree Line's FCCR Trends

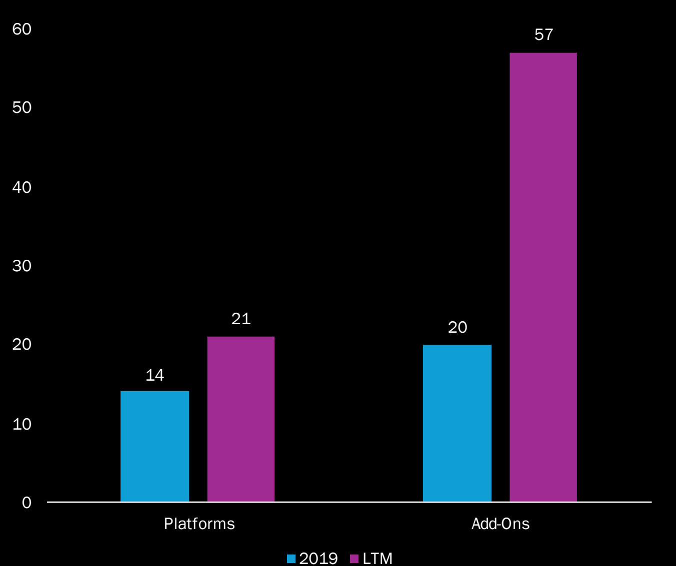


Through recent economic uncertainty and volatility, deal flow volumes declined, but add-on acquisition opportunities remained robust as LMM sponsors focused on growth of existing portfolio companies and add-on targets were available at attractive valuations.

PE MM Add-Ons as % of Deal Volume[12]



Tree Line Deal Count Mix (Platforms vs. Add-Ons)



Commitment to ESG

Tree Line has made significant enhancements to our ESG approach in 2024, further institutionalizing our ESG approach, team and policy. We spent months studying the role ESG plays in private markets looking at a large sample of ESG policies across the market and best practices from some of our largest stakeholders and investors.

Corporate responsibility and ESG aren't just boxes we check; they are fully embedded into our investment processes and at the heart of our business. We believe that by being good partners to our investors, and by being good members in our local communities, we can create lasting value for everyone involved.

Our Impact *by the Numbers*

7

Vetted Non-Profit Partners

~$650K

Direct Charitable Contributions to Non-Profit Organizations

PRI Principles for Responsible Investment

Signatory since October 2020

Vetted Non-Profit Partners:

1% FOR THE PLANET – MEMBER –

COMPASS FAMILY SERVICES Housing. Support. Hope.

LOS PADRES FORESTWATCH

ADVENTURE SCIENTISTS EXPLORE. COLLECT. PROTECT.

PROTECT OUR WINTERS POW

WILDCOAST COSTASALVAJE

Conclusions

To the readers:

In 2024, Tree Line celebrated its ten-year anniversary and announced several key milestones, including a strategic partnership with Aflac Global Investments, bringing total investible capital to $4.1B. Since our founding, Tree Line has been singularly focused on financing and supporting the growth of businesses within the lower middle market. As we embark on the next ten years of Tree Line, we are excited to remain committed to the lower middle market, a growing and critically important segment of the economy. Despite a challenged economy over the past two years, LMM tailwinds remain strong with over $456B of LMM private equity dry powder on the sidelines. Private credit continues to be the financing option of choice for private-equity backed acquisitions, increasing capital deployed by 280% since 2010 and significantly outpacing expansion by commercial banks and the high-yield bond market.

At Tree Line, our objective is to use our unique access to data within the growing lower middle market segment to share our insights with investors and sponsor partners. Our portfolio today sits at $2.6B across 71 portfolio companies and we are Agent or Lead Lender on 88% of the portfolio. We have expanded our team to 36 investment and operations professionals and a national footprint with offices in San Francisco, New York City, Austin and Los Angeles.

As our platform has grown, we have analyzed our own deal data, implemented a data-driven approach and endeavored to eliminate any areas that that would introduce a higher likelihood of default or loss. In particular, we utilize the “bad deal data base” (outlined on page 9), which studies every loan in the BDC market valued less than 80% of cost which provides critically important information across thousands of deals to help identify business models with the highest probability of loss.

At Tree Line, our investment strategy focuses on first lien structures, modest leverage, and business models with high free cash flow and strong sponsor support. We are thrilled to continue to expand our relationships across the LMM private equity community, which currently includes partnerships with 89 private equity firms over the past ten years.

Thank you again to our sponsor partners that provided valuable insight through responses to the Ascend Survey. We look forward to an expected busy 2025.

Best Regards,

The Tree Line Team

Disclaimer & Footnotes

Disclaimer

Opinions expressed in this *Ascend Report* are those of Tree Line Capital Partners, LLC as of February 2025 and are subject to change. Furthermore, the data contained herein is for informational and discussion purposes only and is neither an offer to sell nor a solicitation of any offer to buy any securities, investment product, or investment advisory services.

Footnotes & Sources

1. *PitchBook (data as of May 1, 2023)*
2. *https://www.naics.com/business-lists/counts-by-company-size/*
3. *PitchBook's 2023 Annual US PE Middle Market Report*
4. *PitchBook (data as of October 31, 2024)*
5. *PitchBook Q2 2024 US PE Middle Market Report – 2024 represents Q2'24 annualized*
6. *PitchBook Q2 2024 US PE Middle Market Report*
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8. *PitchBook Q2 2024 US PE Middle Market Report*
9. *WSJ, "The New Kings of Wall Street Aren't Banks. Private Finds Fuel America."*
10. *(i) Private Credit: https://flow.db.com/trust-and-agency-services/private-credit-a-rising-asset-class-explained#:~:text=By%20the%20end%20of%202023,were%20in%20search%20of%20yield and (ii) Private Equity: Preqin; Future of Private Credit & Private Equity Report (2023)*
11. *Chatham Direct*
12. *PitchBook Q2 2024 US PE Middle Market Report*