PACENOTE CAPITAL

Year in Review
- 2024 -

Contents

A Letter to our Friends

Partners, family, mentors, peers and friends – we hope you all were able to unplug and recharge over the holidays with your loved ones and your 2025 is off to a great start.

2024 was a milestone year for Pacenote as we celebrated our five-year anniversary. It was the busiest we've had, but we were able to take some time in the spring to reflect on the journey to date, and most importantly, consider all the people who have supported us in building Pacenote to where it is today. We are grateful to our partners, collaborators and friends who have been unwavering in their conviction, trust, and guidance.

Since we launched in '19, we have **raised ~$2bn in capital commitments on behalf of 11 funds for eight GPs** (eight Fund Is, and three GPs for whom we subsequently raised Fund II). These commitments have come from **64 distinct LPs**, ~one-third of which have invested with multiple Pacenote partners. Our average fundraise timeline (not including the Fund IIs) is **sub-four months from first LP meeting to final close**, and our team has **personally invested more than $8mm across our partners to-date (exclusive of our Pacenote Equity GP Commitment)**. In 2024 we also closed **Pacenote Equity I, our ~$90mm fund to invest with independent sponsors**. Lastly (and most importantly), when Pacenote launched in '19, Casey, Matt and Sam collectively had three kids. Today that number is 10 (soon to be 11 with Sam and Chelsea expecting their fourth over the next few weeks). To say it's been a busy five years would certainly be an understatement.

We entered 2024 coming off stagnating private equity deal activity, a decline in exits, and a trough in what was already a meaningfully slow prior few years for fundraising. We wrote about the haves and have-nots in our '23 Year in Review, with our anticipated theme for 2024 of **divergence**. That said, as the Fed held interest rates steady through September and cut by 100 basis points over the four months since, deal volume noticeably accelerated (despite continued geopolitical conflicts and tension), up 12% from '23 per Pitchbook. Worth noting, however, that despite the uptick in dealmaking, fundraising figures in '24 were roughly equivalent (or potentially below as final tallies come in) to the '20 COVID lows both by fund count and volume of capital raised, with the average fundraise timeline hitting 19 months per Buyouts.

That said, if the first few weeks of '25 are any indication, our sense is that, barring escalation of geopolitical volatility, market participants will remain eager to return to their 'animal spirits.' The operative word, at least in our opinion, is *eager*, and, at the risk of being too foreboding, our stance is more of **preparedness** for the year ahead rather than outright excitement. With the return of President Trump and his new administration, we'd expect '25 to be anything but predictably status quo. Furthermore, while increasing utilization of creative liquidity solutions such as continuation vehicles and GP-led secondaries could signal to the market a return to equilibrium for available LP capital, we are **steadfast that fundraising will remain extremely difficult, with only the highest quality opportunities garnering investor support**.

Much like the year prior, we entered '24 without being 'in market' with any partners. After an extensive industrials landscape, we launched with **StoneTree Investment Partners'** Fund I in May and closed at their $155mm hard cap in July. There were a handful of other industrials specialists with whom we spent meaningful time and thought highly of, but ultimately Joel Stanwood's and Chris Dupré's operational and transactional experience, as well as their commitment to building a lasting firm predicated on exceptional returns, made our decision easy. We're excited to see what the StoneTree team accomplishes in the years to come.

Cuadrilla Capital closed Fund II in Q3 at their hard cap. Cuadrilla was our third partner to date for whom we raised Fund I and subsequently raised Fund II (**Rallyday Partners** and **Care Equity** the others). This process was another case study for us in strong existing LP support + adding a select group of new partners in a limited fundraise. Cuadrilla now has over $500mm in assets under management and has done an excellent job with what many new firms struggle doing – building a cohesive team (12 team members today) and relentlessly sticking to their strategy. Cuadrilla has made five platform and four add-on investments to date and we're proud to have been their partner from day one.

We'll be discussing European opportunities in more detail below, but after much discussion and numerous trips over the course of '23 and '24, we made the intentional decision to devote meaningful resources to European opportunities. We've partnered with our first non-U.S. GP, and are extremely excited about the opportunity set we believe exists both for independent sponsor investments as well as specialist LMM Fund Is.

2024 also marked the formal close of **Pacenote Equity I ("PNE I")**. We're extremely proud of our investors who have entrusted us with their capital, and are excited to prove them right in partnering with us. We'll discuss more in the independent sponsor section of Observations and Trends, but suffice it to say, we continue to see a massive opportunity for outperformance in this market. But, as we've stressed to the dozens of LPs who have reached out to us over the course of the year to pick our brain on the space, it's imperative to have a disciplined and consistent approach to investing with independent sponsors, as the spectrum of quality is vast, and given that most of these companies are in the lower middle market, entry valuations can be intoxicating at first blush. We've made two investments from PNE I to date, and our next two partners are spinouts from blue chip GPs, one industrials-focused and one growth equity in bootstrapped, vertically focused software. We expect our next investment to be with the industrial group in Q1, with an investment alongside the software group likely to follow in H1 2025.

We also hosted our inaugural **Pacenote Summit** in March at the Soho House Austin (working session picture below). We had 35 guests attend, strictly limited to LPs (predominantly CIOs and/or Heads of PE), and structured the time around a series of topics such as *"What are the 3-5 leading indicators of future returns for an emerging buyout manager?"* and *"What are 2-3 beliefs you held about investing 5-10 years ago that you no longer hold or that have evolved?"* We're excited for our '25 Summit in a few weeks, with 70 confirmed attendees representing 56 distinct LPs, as well as a session with two to three GPs (who have yet to raise their Fund Is) providing an overview and Q&A on their respective sectors.

We'd be remiss if we didn't highlight that Casey was nominated and selected to [Chief Investment Officer's 2024 list of Knowledge Brokers](), their *"12th list of the world's most influential investment consultants and advisers, individuals whom CIOs and other asset allocators would recommend to their peers."* As Casey described in his interview, ***"we love investing with new specialist sponsors who have honed their skillsets through exceptional training at their prior shops and recently spun out to form their own firms. While underwriting new firms can be***

difficult (particularly if an individual or team does not have attribution for their prior investments), we're adamant believers in the alignment that exists for a new firm in 'having to get it right' with their first few investments under their own flag. We particularly find opportunities in the lower middle market where exceptional investors cultivate proprietary relationships directly with founders and management teams to be compelling." We appreciate the LPs who nominated him and are extremely proud of the niche we've built in the market.

Wishing you all a peaceful, healthy, safe and prosperous 2025. We are grateful for your support.

- Team Pacenote

Matt Evans

Observations and Trends

As we mentioned above, while headlines from the new administration could certainly justify excitement for U.S. private markets going forward – executive pressure to reduce interest rates and encourage spending, emphasis on deregulation and 'open' markets, alternative investment managers at the helm of the Treasury Department – **our outlook for 2025 is more of a prepared, athletic stance than outright full body dive-in**. Public markets ripped the day after Trump's election win, and while we continue to hear of the aforementioned 'return to animal spirits,' **we believe the years to come will ultimately be remembered by a wider divergence between top performers and their laggards, rather than markets buoyed by a broad rising tide**. As we often tell our partners, details matter, and even the most seemingly minute factors can make a huge difference on ultimate outcomes when markets are as volatile as we expect them to be.

We wrote about this anticipated theme of divergence in our prior Year in Review and expect this trend will continue in '25. While deal volume experienced a noticeable uptick in '24, final fundraising tallies suggest that new LP commitments may not keep up with GP deal activity in the year to come, but rather, as the large sums of dry powder from years prior are invested, **institutional investors will continue to be more measured in selecting new partners**. The beauty is that it's in times of market uncertainty when real alpha can be generated. Let's explore.

Performance Disparity = Fundraising Haves and Have-nots

We've written about the ongoing **consolidation of private equity firms and expect this trend to continue.** A surplus of middle market and large-cap GPs generating lackluster returns (and the realization among LPs that overdiversifying at this end of the market is unnecessary) have led to a **growing list of established sponsors whom we expect to fail to meet fundraising targets for their upcoming vintage**. With fewer management fees to go around, and slow exit activity leading to muted carry pools, top talent will continue to seek opportunities elsewhere. Whether moving to a competitor with a strong market position, or forming a new firm, we expect more senior-level departures in the coming years. As investment professionals leave for larger, more secure platforms (or launch out on their own), **what happens to these legacy funds?** We predicted last year that many of these firms will fade away, and continue to expect a growing number of GPs to acquire other firms outright in '25. What's more exciting (at least for us), is a **continued proliferation of high-quality investors setting out on their own**.

"When will Private Equity Get Out of its Fundraising Rut?," "Private Equity Fundraising Slogs Through First Half as Assets Remain Frozen," "Private Equity's Fundraising Skid Continues" – these were some of the headlines throughout the year. Yet 2024 also marked New Mountain

(~$15.5bn), Vista ($20bn) and Silver Lake ($20.5bn), all raising their largest flagship funds to-date. CD&R ($26bn), Hellman & Friedman ($22.5bn), Apollo ($20bn) and CVC (€26bn) all raised new records for their buyout strategies in '23, and KKR set out to raise ~$20bn for their flagship fund in Q4, a feat we expect will likely be closed in H1 '25. So, one might ask, how can such stark opposites both be realities?

As we've written, nascent industries are often fragmented, but as they mature and become more efficient, most follow a predictable amalgamation lifecycle. While Private Equity has been doing just this across sectors for decades, we have begun to see the early innings of consolidation of the actual "players" (i.e., the GPs). While we don't think the trend will get to quite the extreme that some such as Partners Group's CEO David Layton do – *"We could see the current 11,000 or so industry participants shrink to as few as 100 next-generation platforms that matter over the next decade"* – we continue to **believe there will be a consolidation of GPs, particularly in the mid- and large-cap markets (as defined by funds greater than ~$1bn).** Editor's Note: while we don't purport to be clairvoyant, we have been quite early in this observation, a benefit of receiving the unabashed feedback from individuals 'on the inside' at middle and upper market firms regarding the day-to-day realities, regardless of what facade may be polished for public consumption.

As returns generated by middle market and large-cap GPs continue to asymptote to the mean, decisionmakers at many LPs have begun to recognize that they do not need to overdiversify their exposure of underlying companies, call it greater than ~$50mm of EBITDA. Instead, as performance across their managers has largely tracked in unison (and in some instances, lagged broader public market indices), the question is, *"why are we paying these sponsors 2 and 20?"* Particularly when assets of this size are typically traded through highly efficient, intermediated processes, with the ability to source 'proprietarily' virtually nonexistent, many LPs have recognized that **sufficient middle and upper market private exposure can be accomplished with a roster of only a handful of GPs**, rather than the double-digit list of partners that historically was typical at most LPs. Said differently, while large/mega cap managers may not be able to generate 2.5x+ net MOIC fund-level outcomes given sheer fund size constraints, the best of the best (TA Associates, CD&R, H&F, etc.) have continued to demonstrate their value by generating consistent, attractive risk-adjusted returns. As they continue to scale (and attract more and more talented resources), and the majority of MMBO firms fail to deliver performance that even matches returns of the aforementioned heavyweights, why wouldn't LPs sleep better at night consolidating their commitments from a dozen middle and upper market managers to a handful? **Where/when PE returns start feeling more commensurate with public market equity beta, we expect LPs to continue concentrating their mid- and large-cap private equity exposure with fewer, larger managers, while focusing their higher alpha-seeking efforts down-market with specialist LMM groups.**

One soundbite from a highly regarded and sought after GP who's become a friend of ours about his personal investments (away from his meaningful GP Commitment across his firm/multiple funds), ***"If I had to do it all over knowing what I know now, I think I would essentially only invest in Fund I's."*** Interesting perspective from an investor who has lived fund size growth and, transitively, why the highest octane returns typically live in the earlier, most aligned, vintages with smaller fund sizes.

As these self-fulfilling trends continue, what will happen to the previously well-established GPs who have sputtered in market for re-up capital, not just shuttering their ancillary strategies, but in some instances failing to reach a critical mass of fresh capital raised to maintain team members? The most talented individuals will either join the likes of the clearcut market leaders where they will be adequately compensated for their talents, or for the smaller universe of highly ambitious entrepreneurs, they'll spin out and attempt to build their own firm. These stories will largely unfold quietly, as the key people at the top maintain a tail of economics, and a transition from funded sponsor to family office and/or deal-by-deal investor is more likely than an outright retirement of GP namesake.

While we expect to see continued consolidation among mid-sized and large firms, we conversely expect to see an increased number of new firms investing in the lower middle market. To be clear, by no means are we implying that fundraising at this end of the market is easier. Quite the contrary, actually. **That said, as we've told many of you over the past few years, there is no barrier to entry in *becoming* an independent sponsor (i.e., anyone can hang their own shingle). While we expect the number of LMM firms who successfully raise a first, and subsequent, fund(s) to be finite, we continue to observe a dramatic proliferation of new, deal-by-deal investors: the universe now ubiquitously known as Independent Sponsors.**

Independent Sponsor Investing

In our '21 Year in Review we titled a section, **"Independent Sponsors as an Asset Class."** The following year, **"Independent Sponsors as a Growing Asset Class."** In our '23 Review we introduced **Pacenote Equity**, our strategy exclusively focused on investing with independent sponsors. Suffice it to say, **investing with sponsors on a deal-by-deal basis is no longer a cottage approach, but rather a wholly separate and distinct asset class that has fully arrived**.

During our ~830 LP catch-up conversations in 2024, nearly half inquired about the independent sponsor space. In our '21 Review we used a soundbite from our friends at McGuireWoods as a proxy to summarize the growth in independent sponsor interest, *"our first independent sponsor conference years ago was eight local groups. One of the sponsors brought their dog with them. Fast* *forward to 2021 and we have almost 900 attendees set to attend the conference."* That figure was ~1,600 for MW's '24 Independent Sponsor Conference (and ~1,000 for their Emerging Manager Conference). What's more interesting in our opinion is that **the number of university endowment LPs and middle market GPs attending have each grown ~200% YoY since the '23 conference**. It's clear to us that 1) a growing number of thought-leading LPs who historically only considered direct deal efforts via existing GP co-investments are contemplating what investing with independent sponsors would look like in their portfolio, and 2) established GPs with comingled funds are actively sourcing new opportunities 'down market' via partnering with independent sponsors (and willing to pay full freight economics to do so).

As we tell prospective new sponsors, a commingled fund is not always the answer…at least not now…Raising capital for a first-time fund is time consuming, and there is opportunity cost in not executing investments or focusing on the existing portfolio. The flipside is that it's extremely difficult to simultaneously juggle finalizing deal diligence, structuring term sheets with lenders, raising equity capital and negotiating terms with said equity providers. The universe of capital partners for independent sponsors continues to grow, though. We know several independent sponsors who have cultivated a reliable stable of capital partners who will speak for the required equity on go-forward deals, a potentially elegant solution for new investment managers.

For LPs, there are certainly a few benefits to investing with independent sponsors on a single deal, namely no fees on unfunded commitments and no blind pool risk with full visibility into the underlying asset(s). Conversely, underwriting an independent sponsor and their current deal opportunity in parallel, often on a meaningfully condensed timeline, is not for the faint of heart. The confluence of these factors has led to what we've observed this year in an **intense demand from LPs for specialist independent sponsor investors (e.g., funds of underlying IS opportunities).** Ocean Avenue deserves a ton of credit as the first mover in this strategy raising their first fund over a decade ago (closing their Fund V in '24 and now in market raising their Fund VI), and with the growth in demand, there have also been newly formed funds such as Align Capital's Collaborate Fund, among others.

We continue to believe there is an extraordinary opportunity to generate consistent, risk-adjusted 'net-MOIC outperformance' by investing with talented independent sponsors. We also feel strongly that investing in the space is not for tourists. Investing with a mediocre independent sponsor is much riskier than investing with a mediocre commingled fund manager, and without a hyper-focused approach + keen sense of pattern recognition, compelling entry valuations (on what are typically smaller companies) can mask other issues. Furthermore, given the wide dispersion of independent sponsor quality (see the aforementioned zero barrier to entry), we **adamantly believe that the strategy needs to be executed out of an appropriately**

sized fund, without overly diversifying the number of underlying investments, in order to maximize the chance of capturing alpha.

Opportunity Abroad

As the winding road through the English countryside on this year's cover signifies, we spent meaningful time in Europe in '24 and intentionally will be doing so in the years to come.
Given we won't work with multiple sponsors whose strategies directly compete (a novel concept!), there is a natural limit to the number of partners with whom we can engage. Furthermore, as we remain adamant believers of staying strictly focused on opportunities in the lower middle market given the relative inefficiencies and potential for high octane returns, our universe of potential partners will remain finite. That's a good thing, in our opinion, as we strive to remain disciplined in keeping our bar exceedingly high and only working with our absolute 'best ideas.' As a result, when we're frequently asked *"how do you think about how Pacenote scales?"* we find ourselves responding that *scale* is not our modus operandi.

Over the past few years we've continued to hear about an increasing number of high-quality European individuals/teams leaving their respective prior shops to fly their own flag. Investing in Europe is not new to us, as our team has extensive experience backing European managers, rather we have been cautious about the timing of broadening our advisory business beyond the U.S. Interestingly, we've observed a disproportionate number of these new groups ceding a GP stake in exchange for investable and/or working capital to execute on their strategy and firm buildout. As we've described in prior years' letters, **we feel strongly that the best investors in the world should not need to give up management company or carry economics, and rather, are best positioned for long-term success with a diversified roster of LPs who are all appropriately aligned and engaged as 'true partners' adding strategic value where possible (more below).**

Additionally, as we continued exploring the opportunity set, it became clear to us that while there are certainly active institutional investors in Europe, the landscape of 'go-to' capital partners for independent sponsor investments is far less established than in the U.S. This did not come as a surprise to us, as we generally have found that trends in European private markets historically have lagged relative to the U.S. We also continue to receive feedback from LPs *"feeling light"* in Europe, with the focus during and immediately-post the pandemic on emphasizing domestic opportunities slowly giving way to an increasing number of trips to Europe. Like many of our LP relationships, though, the Pacenote 'bar' in Europe is higher. Risk-adjusted potential returns must be commensurate for the 'across the pond' risk relative to what continues to be, in our opinion, a healthy opportunity set here in the States.

While our decision to dedicate resources to hunting in Europe is intentional, we'll also be mindful that by no means do we *need* to work with European partners (and our core focus will continue to be with sponsors in the U.S.). Shifting governmental dissatisfaction and subsequent volatility has not been exclusive to the U.S., with (now former) French Prime Minister Barnier and German Chancellor Scholz both facing votes of no-confidence and leaving their respective countries at the bequest of rapidly changing power shifts, and transitively, a reshuffling of various economic priorities has begun to transpire. We are in no rush to jump into a new partnership while macroeconomic footing is so capricious, but as we did over the course of '24, plan to be in Europe frequently in '25, and continue to see an increasing number of opportunities at the top of our pipeline as we intentionally ramp our sourcing efforts.

Some of our past observations persisted throughout '24, and we continue to monitor these trends and believe them to be meaningful dynamics in our ecosystem.

Continuation Vehicles

In our '23 Review we titled a section **What's an Exit?**, describing the persistence in continuation vehicles and other secondary strategies (and how certain LPs were approaching the phenomenon vis a vis conversations with their existings GPs). As the exit environment remained relatively muted in '24, we continue to see a proliferation in these types of liquidity solutions, predominantly of the GP-led variety. While CVs historically had a somewhat negative connotation as the last resort exit option, over the past few years, GPs have made the case that they'd love to hold their top assets for even longer. The crux of the issue of course comes down to valuation, and potential conflict of a GP's fiduciary responsibility to its existing LPs (who own the asset(s) currently), and LPs in the new CV, who are perhaps not the same investors.

For the avoidance of doubt, we are massive proponents of long-term compounding and understand the power of long duration asset ownership. We've spent time with a handful of sponsors over the past few years we think highly of who are executing their strategy via a long-dated or evergreen vehicle. But, through the lens of the 'typical' LP/GP relationship (and the 'self-funding' cycles even the most long-dated LPs have built their pacing models on), **we expect to see a heightened level of scrutiny, pre-commitment, from LPs to better understand how each sponsor thinks about hold period**. We've synthesized these dynamics and distilled them into one question that's now at the top of our diligence list: ***"what are you doing at your companies that is so unique that a future owner 'has to have it'? Regardless of whether they need to pay a premium multiple to acquire it from you."***

Rise of Private Wealth Channels and 'PE Democratization'

As fundraising continues to prove more difficult, the burgeoning RIA landscape and corresponding interest from GPs to tap into these channels will persist. To us, the movement makes sense, particularly as the feat of attracting investments from institutional investors becomes increasingly difficult. We quoted a Bain analysis last year that spoke to the fact that while individual investors hold roughly 50% of the estimated $275 to $295 trillion of global AUM, those same investors represent only 16% of AUM held by alternative investment funds. Given this data, it makes sense to us that while institutional capital in alternative investments is projected to grow 8% per annum over the next decade, investments from wealthy individuals are expected to grow closer to ~12% annually.

Issues such as complicated reporting, eligibility and filing requirements (as well as sheer access) historically had been impediments to retail investment in alternatives, but the industry arms race to solve these issues and capitalize on new sources of AUM is already meaningfully underway. Digital platforms designed to reduce friction for individual investors have become essential for large asset managers. Qualified individuals now have easy access to portals where they can explore investment strategies from leading firms. On the sponsor side, GPs' hunger for growth has often surpassed the supply of capital from traditional institutional LPs, prompting firms to target RIAs and wealth management platforms to fill the gap. Whether through strategic RIA partnerships, specialized IR professionals, or aggregator platforms like iCapital or CAIS, GPs are leveraging every avenue to access these funds.

While we believe the trend of high-net-worth individuals seeking alternative exposure and asset managers looking for fee-paying clients will persist, we feel our niche is insulated (and have no intention of addressing retail investor interest, either for our GPs' funds or our own in Pacenote Equity). We're frequently asked *"whether tech-enabled platforms will disintermediate the placement industry?"* Our answer: it depends on what you're placing.

While the retail landscape is still largely untapped (and supply of fresh capital for GPs relatively uncapped), it's hard to envision what an AUM ceiling could look like for some of the largest PE firms in the world. That said, **in our opinion the highest-return potential opportunities are capacity-constrained, and thoughtful LPs are focused on judicious fund sizes as such, creating intense competition for access to top-tier GPs**. Furthermore, while many GPs prioritize scaling AUM, those focused on defining their legacy by returns are often the same groups who value LPs who bring more than just capital to the table. In sum, we don't foresee a scenario where blue-chip LPs are competing with retail investors in oversubscribed fundraises.

‘Strategically Valuable’ Capital

Based on how difficult fundraising has been over the past few years for the broader market (and will likely continue to be for the foreseeable future), one would be fair to deduce that most GPs will “take any capital they can get.” **Despite these fundraising conditions, however, each year there continue to be a handful of GPs who command wildly oversubscribed funds. Interestingly, most of these ‘food fights’ are in Fund Is or appropriately sized Fund IIs.** During these processes, LPs will utilize a variety of techniques to convey to the GPs why their capital should be prioritized (read: not pared back versus their peers). Speaking to the causes exceptional returns enable, as well as examples of how they’ve *“been able to add value for their GPs beyond just their capital,”* are two of the most common examples we see. As an aside, a trick of the trade we use when underwriting potential GPs is asking about what their ‘dream LP roster’ would look like. Answers such as *“we don’t care, just want to hit our hard cap as quickly as possible”* is a red flag for us, signaling a myopic short termism symptomatic of bigger issues.

Similarly, as GPs are competing for highly sought after assets, they must demonstrate why their post-close value is superior relative to another sponsor (unless their value add is always paying the top price, but that’s a topic for separate discussion). In the current environment with far fewer transactions consummated, and sponsors still reticent to pay top price, the ability to demonstrate (and effectively communicate) how you’ll drive value uplift is paramount. The result is **“A Glut of Proprietary Sourcing & Post-Close Playbooks”** as we wrote about in our ’21 Year in Review. The private equity landscape has never been more competitive than it is today. Finding value, demonstrating value, creating value and, ultimately, generating value for investors (read: outsized returns) is exceptionally difficult.

“Fund 0.5”

Perhaps our theme most frequently discussed is the concept of “Fund 0.5.” Many LPs have existing portfolios that are ’overdiversified,’ and while we frequently hear groups speaking to their goal of concentrating the roster of managers, this culling occurs primarily in their mid- and large-cap portfolio. Contrarily, within their LMM allocation, LPs are hunting for new relationships to augment the rest of their roster. Furthermore, as ‘blind pool risk’ is a top consideration for LPs, the prospect of committing to a portfolio that’s three-four companies (vs. ~eight), invested over two-three years (vs. ~five), feels far less daunting when considering a new manager relationship, a point we believe is particularly salient given the current distribution challenge. The confluence of these factors has led to our theory that in short order, **the nomenclature ‘Fund 0.5’ will no longer have a negative connotation suggesting that a sponsor couldn’t raise a full-sized fund. Rather, Fund 0.5’s will be a staple in top institutional LPs’**

private equity portfolios as a means to increase their allocations to smaller companies via a greater number of diversified LMM partners (while simultaneously reducing the number of mid- and large-cap GPs in their portfolio).

We continue to be surprised by the number of sponsors we speak with who have the same misconceptions about 'what LPs want.' This is somewhat a function of the fact that the individuals/teams we partner with rarely have been LP-facing in their prior roles (typically one level removed from the most senior brass at the organization). *"LPs need a diversified portfolio of 8-10 companies, right? And I need to build a big enough team before I can raise a fund, right? I heard I need a great office."* A question we've found ourselves asking sponsors, ***"if you were to raise roughly half of the hard cap figure you're currently thinking, and invest in half the number of companies over a shorter investment period, would you lose any crucial hires? Would it impair your strategy in any way?"*** After some quick mental math on half the management fee income (a forcing function we find quite helpful in identifying the 'truly crucial' hires for each GP), the answer has almost always been a resounding no.

Themes of Interest

We're constantly on the hunt for exceptionally motivated teams with differentiated strategies and/or approaches. The following are themes we've identified as areas with sustainable market tailwinds and attractive white space for new entrants, particularly in the lower middle market. While we have other areas we are exploring as potential theses, we are most bullish on the below. As a refresh, we're exclusively focused on 1) equity-oriented strategies, 2) in the lower middle market, 3) with sector and/or strategy experts focused on a clearly defined, repeatable competitive moat, and 4) aspirations to build world class firms predicated on sustained outperformance. Said differently, we want partners who want their firms to ultimately be defined by exceptional returns (*'making their money in the carry'* rather than via scaling AUM).

We're typically connecting with potential partners well in advance of their new firm being widely known about (or even existing), so if you have any friends who are exceptionally motivated with a differentiated strategy in any of these themes, we'd love to meet them, and no introduction is 'too early.'

Transportation, Logistics, Supply Chain and Route-based Businesses

While the culture of instant gratification and next day delivery did not commence with COVID, the pandemic further intensified this trend while also shining a light on global supply chain pressures. As consumer 'at-home' delivery activity surged during the pandemic, new carrier entrants looking to capitalize on demand flooded the space. But, as COVID lockdown subsided and consumer activity restored to pre-2020, an oversupply of carriers drove a substantial "freight recession" that began in '22 and persisted through much of '24. That said, general sentiment from specialist sponsors, bankers and other industry participants with whom we met in '24 is that we're approaching market equilibrium again, with valuations and deal activity in the space anticipated to rebound. **Worth noting, however, that with looming retaliatory tariff measures and uncertainty around the flow of global supply chains, our bar for a partner in the space (with experience to navigate these types of volatility) has continued to rise.**

Standards for continued efficiency and logistical perfection are constantly increasing, and, importantly, underpin successful execution in almost every industry. The global supply chain is the backbone (or even circulatory system) of all commerce. While the opportunity for technological innovation, consolidation and collaboration is apparent, we also like the fact that the industry (at least in comparison to others like healthcare, software, consumer, etc.) is relatively nascent when it comes to number of sector-specialist private investors. **We feel strongly that this is a specialty that needs to be executed by industry experts who understand**

the complexities of all market participants and have the experience – and expert networks – to look around corners (not dissimilar to our thoughts regarding why, given the technology obsolescence risk, cybersecurity is too specialized to live as part of a broader software investment mandate).

As globalization and an ever-connected world persist, ongoing geopolitical trade tensions make the expectation that everything should be readily accessible increasingly more difficult to deliver on. The answer for one industry or specialty can be wholly distinct from the key considerations of another (e.g., the movement of specialty chemicals through the global supply chain necessitate specialization that can't simply be duplicated for infrastructure building materials). **To this end, tailored distribution and specialty freight solutions continue to pique our interest, as does less than truckload shipping, last-mile delivery, cold chain logistics, predictive supply chain technology and e-commerce fulfillment.**

Aerospace and Defense

A&D remains a top theme of interest for Pacenote amidst economic uncertainty, growing geopolitical tensions, and despite broader budget threats domestically. Consumers continue to prioritize air travel within their wallet share, with total global air passenger volume up 10% year-over-year and 4% ahead of pre-COVID levels. Aircraft demand and production appears poised to follow a similar trend, with Fitch forecasting deliveries of passenger aircraft to increase 30% in 2025, following resolution of operational and supply chain challenges, especially within Boeing. **Commercial aero aftermarket surged in 2024 amidst these challenges and will likely continue to thrive even with pull-through from the OEs, but another rocky year for deliveries would further burgeon demand amongst subsegments such as maintenance, repair, and overhaul (MRO) and replacement part production and distribution.**

Beyond traditional aircraft, space continues to grow in relevance, shifting from a niche segment to a widespread enabler of innovation across industries. Per a McKinsey report, the space economy is forecast to reach $1.8 trillion by 2035, up from $630 billion in 2023 and growing at an average of 9% per annum. As the mix shifts from primarily government outlay to increasing private sector spend, private equity will increasingly play a role in the nascent sector. Brand name investors such as Veritas, AE Industrial and Advent have all made major platform investments in space, and we anticipate growing interest in the industry as commercial applications broaden.

Growth in military conflict globally coinciding with budget uncertainty and trade conflict in the U.S. creates a mixed outlook for government services and defense companies. While defense spending is vital to maintaining national security, the growing national debt poses a significant risk to economic strength and international influence. Striking a balance between addressing defense priorities and ensuring long-term fiscal sustainability will be a priority of the Trump Administration. While Republican administrations are typically associated with an increase in defense spending, increases and decreases have historically been split amongst parties, and the recent addition of the Department of Governmental Efficiency heightens the probability that growth in the world's largest defense budget is curtailed. If this administration does temper spending, subsegments like defense tech focused on streamlining processes could experience growth, while traditional contractors (particularly smaller scale) may be challenged. Nonetheless, global conflict will continue to be an organic growth tailwind for U.S. government services and defense businesses: foreign military sales grew 45% in 2024 to $118 billion and commercial direct sales to foreign parties grew ~30% to over $200 billion.

As for deal volume, it remains to be seen whether there will be a rebound in activity in 2025 after a muted '23 and '24. One note of interest, across the sector broadly, mid-tier strategics have had declining roles, but financial sponsors have filled the gap in the middle market where deals continue to remain competitive. PE now comprises 59% of M&A activity relative to 27% in 2009-2012. Perhaps more importantly than any other sector, Pacenote believes it takes a specialist to navigate the confluence of variables at play in A&D (macro conditions, contract complexities, clearances, etc.) while building platforms attractive to middle market sponsors with sizeable war chests.

European Market Specialists

We believe traditional European middle market private equity is every bit as competitive as North American PE. There are, however, compelling opportunities in the European lower middle market. Within specific geographies and/or sub-sectors, we see significant opportunity to access founder & family-owned businesses at relatively attractive entry valuations. It's a broad overgeneralization, but as mentioned in our Opportunity Abroad section, compared to the U.S., the private equity landscape in Europe remains marginally less competitive, with 1) fewer private equity sponsors hunting for opportunities, and 2) SMEs, as defined by less than 250 employees, making up ~99% of EU businesses. To us, the fragmentation down-market makes the opportunity set ripe for expert investors.

While we are certainly openminded to specific geographical experts, our current priority is with sponsors who are not beholden to one country or region, but rather **sector and/or strategy specialists who, while understanding the importance of local jurisdictional tendencies and culture, can execute across borders.** Two examples of such experts are highly technical healthcare investors who understand that the success of certain scientific moats is ultimately graded on international adoption such as life sciences, or experienced deep-value turnaround experts with a track record of navigating various types of restructuring across jurisdictions, similar to what our partners at **Saothair Capital** are building here in North America.

Infrastructure and "Electrification" Services

We've written about this theme in our prior three Year in Reviews, and we continue to adamantly believe that strengthening critical infrastructure and addressing energy needs will be prevailing megatrends in the decade to come. Despite any administrative preferences for types of alternative energy sources, it's clear that as the world is getting more 'electrified,' the growing need to power and service these energy sources will continue.

Digital infrastructure is a theme we've discussed with many LPs over the course of '24, and one we are believers in going forward. Much as we've discussed owning 'picks and shovels' businesses servicing into energy megatrends, rather than owning data centers, cell towers or power generation assets outright, opportunities to invest in derivative business models that are still exposed to this overarching digitalization pique our interest. Companies maintain fiber optic wiring, testing and maintenance businesses ensure safety at high-voltage electrical plants, specialty engineering and design firms assist in the construction of utility-scale energy projects, and manufacturers of specialty distribution transformers remain largely insulated from energy supply/demand price fluctuations, buoyed by the insatiable need to provide more power to the digital era (J.P. Morgan expects global data traffic to grow 25% p.a. by 2030).

While over the past few years we hadn't spent much time thinking about traditional oil and gas markets, it seems likely that the new administration will look to accelerate production of 'traditional' energy sources such as natural gas in the spirit of "Unleashing American Energy." What's interesting to us is that much of the infrastructure used to harness, transport and even convert to electricity, has grown old. We've seen opportunities to invest in companies specializing in cleaning and inspecting existing steel pipework (or replacing internal casings that line these pipes) used to run downhole into an oil and gas well.

In addition to energy-related infrastructure services, we continue to be bullish on other services opportunities such as construction, engineering, building/facility maintenance, environmental, waste and water. The essential nature and mission-criticality of these services provide a stable revenue underpinning, and regardless of what happens over the coming months/years with respect to international tariff trade impacts, we feel confident that specialists in these spaces will endure domestically.

Essential Services

Perhaps the most publicly discussed sector within private equity is home services. A WSJ article, "America's New Millionaire Class: Plumbers and HVAC Entrepreneurs" described the phenomenon that most of us who spend our day-to-day in PE have seen proliferate over the past decade. **In addition to its high degree of fragmentation, the essential "blue collar skilled trades" services market is unique in that homeowners can't afford to defer these projects (leaking roofs, basement flooding, foundation repair, etc. are all mission critical), much like the essential nature of the infrastructure services described in the section above**. We've also seen interesting data from sponsors regarding the sheer number of existing homes with roofs and/or foundations reaching 'end of life' (against tightening lending criteria, often requiring these remedied prior to mortgage approval).

While our bar for acquisitive roll-up strategies has gotten meaningfully higher both with more players in the space and rising interest rates, we continue to believe there is significant white space for numerous scaled platforms to succeed (and for the most sophisticated operators/investors to outperform the sector's growth). We've seen numerous consolidation opportunities over the past eighteen months across non-deferrable specialties such as roof, gutter and garage door repair, as well as landscaping, paving, pest control, foundation repair and flood/mold remediation. **We also have ramped our sourcing efforts around our interest in 'essential white collar' professional services such as accounting, insurance and audit.**

As always (in our opinion), the strategy is best executed at the micro-cap level where sponsors can sell to sponsors upmarket who can't afford to spend time on small initial equity investments but are willing to pay premium valuations for a larger, more mature enterprise.

Tech Services and Digital Transformation

Within the global tech sector's boom of the past decade, software and the SaaS subsector have been the unanimous belle of the ball. The allure of recurring revenue models and unequivocal reality of software eating the world have made investing in the space highly attractive. That said, **IT services, digital transformation & data harnessing consultancies and other 'derivative' business models servicing into technology companies have become an area of focus for us**.

Similar to the transportation & logistics space, there are far fewer sponsors who exclusively focus on tech services investing, a dynamic we like. Furthermore, while not all companies in the space are purely recurring revenue business models (some more re-occurring), many target companies are highly advanced technologically, and some have built defensible moats with 'software-like' switching costs/underlying customers who view their service(s) as truly essential.

As a Bain report on PE tech trends described, given the continued heightened interest rate environment (and more selective dealmaking conditions), *"the importance of healthy growth isn't going away, but assets that exhibit strong growth prospects and robust cash flow are the ones rewarded with premium valuations in today's market."* **One element of the opportunity set in tech services we find compelling is the opportunity to meaningfully flip a company's revenue makeup from largely project based to truly recurring in nature**. That said, while the prospect of *"buying off an EBITDA multiple and selling for a revenue multiple"* sounds amazing, given the pace at which technological innovation renders entire legacy approaches/businesses obsolete, we feel strongly that the tech services sector must be addressed by true industry specialists with expert-level technical understanding of underlying business models + customer landscape and their hyperspecific needs (and what unique characteristics will separate the winners in any subspecialty). Particularly given the 'early spend' we've found to be typical during a hold period in the space, we believe it is paramount for a GP to be unbelievably confident in their strategic plan going into an investment (which product line(s) need to be prioritized for future investment vs. cut, how should sales and marketing resources be delineated, which customers should be prioritized, how can AI be harnessed, what are potential tech obsolescence risks, etc.).

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