

US Private Equity
Mid-Market Monitor:
Q2 2023 & Outlook

‘Understanding new dynamics’

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Introduction

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We expect 2024 to bring new activity to the US market as private equity firms deploy capital in innovative ways for both buyers and sellers. However, it will take time for transactions to come to fruition.

The past few years have been tumultuous in terms of private equity dynamics and Q2 2023 continued to be a slow and challenging fundraising environment, leading to an overall decrease in M&A deals in the market.

The build-up of anticipated activity over the next six months is on track as the market stabilizes. We already foresee new opportunities being presented from companies that have been waiting out the storm

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Sponsor Coverage

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As we complete 2023 and begin 2024, there are strong indications of increased momentum in the marketplace. Private equity investors are ready. While 2023 has been a 'down' year, it has been one of deal preparation and analysis to gain an understanding of the dynamics within the macroeconomic and geopolitical environment in order to establish a 'new normal' for transactions and terms going forward

”



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What you need to know

- H1 2023 deal count was down considerably from the more robust levels of the previous few years
- More recently, due to supply and demand imbalances across multiple industries, Q2 2023 continued this significant decline in deal count from 2022
- Investor apprehension and the persistent denominator effect may cause this decline to carry through H1 2024
- As we begin Q4 2023, an abundance of dry powder remains available to private equity firms, providing a solid foundation for potentially increasing the number of sponsor-to-sponsor exits expected throughout the rest of this year and into H1 2024

How the market feels today

- For now, we expect the following trends to continue until the M&A market fully stabilizes:
 - Pre-emptive transactions between sponsors
 - Continued aggressive activity from strategics limiting sponsor participation in sell-side processes
 - For those 'broader' processes, a limited number of private equity fund buyers are being included in buyer lists for transactions

Q4 and beyond

- The market will stabilize, and a new valuation reality established
- Continued strength and accelerated volume, particularly in the sectors of Infrastructure, Defense, Education, Healthcare, Technology and ESG-related industries
- Investors and lenders will begin to transact on the significant backlog of saleable businesses for completion in Q4 and H1 2024
- As a result, private equity will increase divestiture/investment activity in this 'new normal' to prime the pump for 2024/2025 new fund raises

Read on for our in-depth sector commentary >

Aerospace, Defense & Government Services

“ Aerospace, Defense & Government Services M&A volumes are expected to remain strong – fueled by multiple sector tailwinds, including robust budgets and strong buyer interest. 2023 deal volumes in the defense and government sub-sectors are on track to meet or surpass 2022 levels, which already exceeded 2019 levels by 13%¹ ”



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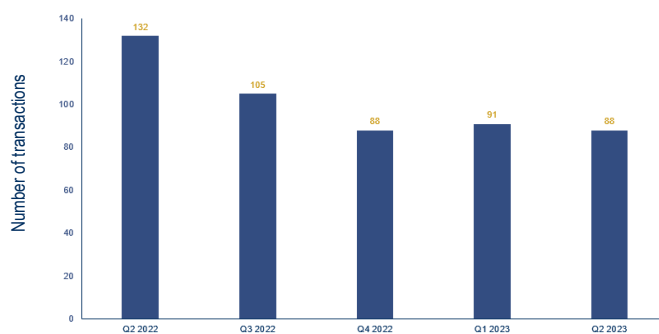


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What you need to know

- Despite temporary Q2 instability surrounding the US government debt limit negotiations, interest and deal activity in the defense and government market remain strong due to continued sector growth
- Defense and government services buyers remain acquisitive with high levels of interest from private equity as strategic buyers remain disciplined in their pursuits
- While Q1 and Q2 2023 ADG deal counts are down relative to 2022, momentum continues to build with increased volumes expected in late 2023 and early 2024

Fig. 1: Aerospace, Defense & Government Services transactions by quarter



Source: Mergermarket
For search criteria, see Appendix

Outlook

- While passage of the bipartisan debt limit ceiling extension in June 2023² largely resolved the most meaningful near-term risk factors facing the defense and government sub-sector, there remains a level of risk for a government shutdown this fall. Congress must pass appropriation legislation by October 1 to avoid this
- Long-term, ever-growing debt levels remain headwinds for the Department of Defense and other public sector budgets. Mandatory expenditures, including interest expense and social security, are increasingly crowding out other budget priorities with only 27% of the US federal government's projected 2023 spend allocated to discretionary line items³
- An aggressive regulatory and antitrust environment, including heightened antitrust activity from the current administration (including the failed attempt to stop Booz Allen Hamilton's acquisition of EverWatch Corporation), could dampen deal activity⁴
- Public valuations remain robust with the government services index increasing 7% in Q2 2023⁵

Key trends to watch

- Defense and government contractors may benefit from sector tailwinds including robust US Department of Defense budgets and a recently agreed upon two-year spending deal for the US federal government
- The US is in the early stages of a new defense build cycle that supersedes politics and budget headwinds
- We anticipate increasing competition with China and Russia that will fuel investment in next generation technologies
- Due to the urgent need to modernize the US federal government's antiquated and unsecured IT infrastructure we expect a significant and growing \$115 BN federal IT market⁶

Business & Tech-Enabled Services

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Several notable private equity to private equity minority stake sales have taken place in the Business & Tech-Enabled Services sector providing an opportunity for sellers to raise capital relatively quickly and quietly and provide a ‘mark to market’ on portfolio assets while retaining control

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What you need to know

- There is a meaningful gap between buyer and seller value expectations
- We expect to see uncertainties around capital availability and costs

Outlook

- Long-term robust secular outsourcing growth drivers will likely continue to positively affect the overall Business & Tech-Enabled Services M&A market
- Deal activity will likely resume in earnest once the “new normal” of borrowing costs are accepted and a new valuation reality is established
- Dry powder at both strategics and private equity remains near all-time highs providing a solid footing to a potential recovery in M&A
- Private sources of credit have provided a very meaningful source of capital to private equity funds and are expected to continue to grow as the market recovers

Key trends to watch



Acquirors continue to express strong interest in high-quality assets that provide a critical service with demand supported by long-term industry tailwinds

For existing assets or portfolio companies, acquirors are also interested in assets that expand product offerings or increase geographic footprint and global reach



In this slower M&A environment, private equity firms have shifted their focus toward portfolio reviews, identifying and executing bolt-on size acquisitions and investing in digital capabilities

Consumer, Leisure & Retail

“ The near-term outlook for deal activity remains uncertain due to doubts regarding the outlook for the US economy. As we continue the path towards the ‘new normal,’ buyers and sellers will become increasingly confident in the condition of the US economy, and we expect to see activity pick up in the next six to twelve months ”



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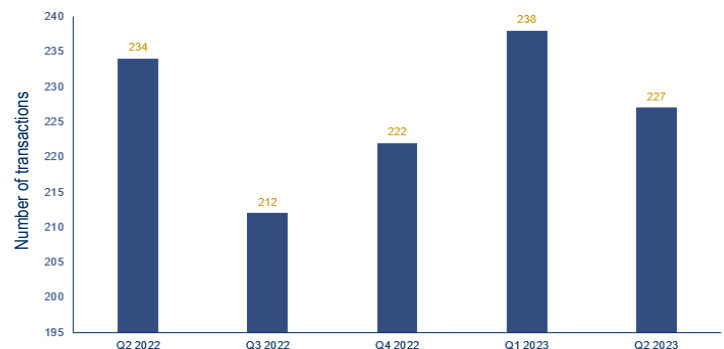
What you need to know

- In Q2 2023, deal activity was constrained in the Consumer sector because of lingering effects of the pandemic and cost inflation
- Companies in the following sectors are finding it challenging to achieve growth in sales and profitability, therefore not currently going to market;
 - Outdoor and recreational products are experiencing lackluster demand trends
 - Soft consumer spending trends in home furnishings have led to a decrease in demand for 2023, in comparison to the height of the pandemic
 - Apparel has been impacted by cost inflation and the disruption of supply chains around the world
- Significant shifts in consumer spending patterns from goods to services have created uncertainty and led to a cautious approach among potential buyers and sellers
- Private equity firms should carefully consider which of their consumer companies are best positioned for a sale when the market environment becomes more favorable

Outlook

- The uneven and slow growth of the US economy over the past year may lead to challenges in the next six months for operators in the consumer sector⁷
- Companies are having difficulty projecting demand and cost trends

Fig.2: Consumer, Leisure & Retail transactions by quarter



Source: Mergermarket
For search criteria, see Appendix

Key trends to watch

- Secular long-term demand within beauty and personal care products
- Residential and home services such as house cleaning, landscaping, plumbing, and HVAC are trending as Americans continue to work from home and are reluctant to move as high interest rates drive down activity in the housing market
- Pockets of robust deal activity within the health and wellness services, specifically the medical spa sector, as consumers increasingly seek services that will improve their appearance and offset the effects of aging
- We expect the food and beverage sector to have significant activity as strategic buyers purchase young and growing brands

Education & EdTech

“ Sellers are increasingly willing to enter the market in late 2023. Those who have prioritized preparation will be on track to transact as more favorable conditions arise ”



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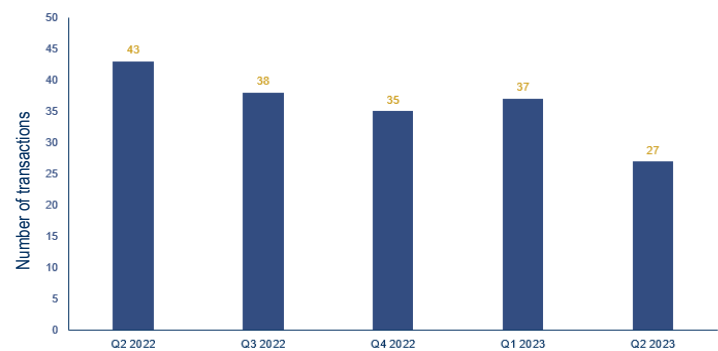
What you need to know

- Potential buyers continue to express interest in acquiring Education and EdTech assets
- Sellers have been exercising a level of caution due to valuation concerns, and are prioritizing targeted negotiations with potential buyers

Outlook

- During the first half of the year, many processes have been in preparation mode or a holding pattern, with the intention of launching after Labor Day
- After exercising levels of caution earlier this year, sellers may start to revisit going to market as conditions improve

Fig.3: Education & EdTech transactions by quarter



Source: Mergermarket
For search criteria, see Appendix

Fiscal quarter

Key trends to watch



The Education sector is more resilient to macroeconomic conditions as it is a powerful lever for social mobility and opportunity

The level of activity is likely to return to more normalized levels of deal flow in 2024



Healthcare training and test preparation, special education and behavioral health remain significant areas of focus for investors

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Companies that are the best candidates for capital raise and M&A have sustainable revenue growth, are profitable and encompass a business model with low Capex and operating leverage

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What you need to know

- M&A activity has declined significantly because of lower valuations in public and private sectors, in addition to increased borrowing costs
- Companies that are profitable and have sustainable revenue growth will be the top contenders for M&A activity

Outlook

- Segments of the FinTech sector have continued to attract investor interest in the growing and less mature parts of the market such as B2B payment software and digital banking software
- Financial sponsors are focused on finding opportunities to invest given the significant amount of capital they have raised in the last few years. Key areas include:
 - Platform opportunities, companies that grow and scale through follow-on acquisitions
 - Portfolio companies' acquisition of competitors or companies with meaningful synergies
 - Later stage investing into sponsor portfolio companies, especially through an acquisition with synergistic opportunities

Key trends to watch



Corporates are less focused on growth through acquisitions given the challenging financial environment and instead are pursuing divestitures of non-strategic assets to streamline profile of the company and focus on core business

Strategic and tactical acquisitions to fill the technology gap and replace old solutions



Healthcare

“ We expect to see an increase in M&A activity in the next year due to the large shadow pipeline of assets and available capital on the sidelines waiting to be deployed. The outlook is strong as well-capitalized companies continue to focus on long-term growth and margin enhancing initiatives as they wait for M&A market conditions to improve ”



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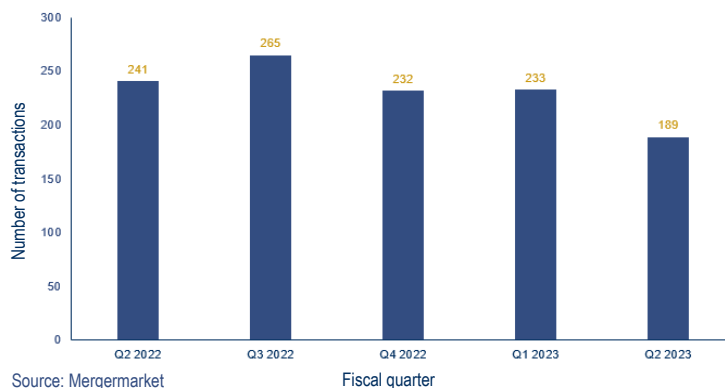
What you need to know

- Healthcare deal activity has decreased significantly on a year-over-year basis driven by the uncertain macro-economic environment and high cost of capital creating a gap in the bid-ask spread and impacting the ability for buyers to “stretch” on valuations
- Within the broader Healthcare sector, medtech companies are performing well as COVID related backlog is still clearing up, driving up demand for medical products and opening opportunities for deal activity
- While valuation remains strong for exceptional assets, there is a shortage of availability of such assets in the market resulting from reluctant financial sponsors and founders to monetize premium assets in a challenging deal and financing environment

Outlook

- We expect a more normalized economic environment in the next year will lead to an increase in deal volume
- We also expect that the quality of companies coming to market will be high as exit timing for premium assets are being pushed back by their owners due to current M&A and credit market environment

Fig. 4: Healthcare transactions by quarter



Source: Mergermarket
For search criteria, see Appendix

Key trends to watch

- Continued consolidation in medtech driven by strategics and private equity backed strategics
- Potential for strategic M&A in the healthcare provider space due to balance sheet distress despite stable operating profiles
- Renewed level of interest in sub-sectors with long track records of strong performance of returns, such as dental services and vision services
- Increased levels of investment activity in the medical spa sector as the industry has delivered stable performance across multiple recessionary environments and continues to grow.
- Within medtech, sectors such as contract development and manufacturing, and consumable medical products will garner strong buyer and investor interest

Industrials

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We will likely see a pickup and increase in deal activity within the Industrials sector in the second half of 2023, especially for high-quality companies that are viewed as leading performers in their categories

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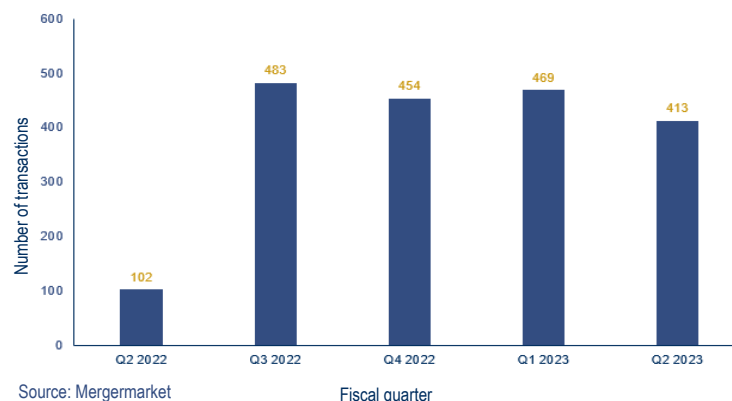
What you need to know

- Industrials companies are taking their time to move forward on activity, as economic conditions solidify in the space
- Pent-up activity levels are likely to drive increasing volume of transaction announcements

Outlook

- Spending and performance have been resilient year-to-date amid a general environment of 'belt-tightening' with large industrial corporates continuing restraint on spending as activity levels continue to be strong and resilient
- Private equity firms remain well positioned with a surplus of dry powder available for investment

Fig. 5: Industrials transactions by quarter



Source: Mergermarket
For search criteria, see Appendix

Key trends to watch



Continued increased interest in the energy transition for companies that are serving electrical grid or alternative sources of power driven by many industrial companies

Driven by long-term goals of reaching carbon neutrality, buyers are seeking out companies that enable carbon neutrality



Continued investment in broader infrastructure trends, such as highways, transportation, and water infrastructure in connection with the Inflation Reduction Act and spending programs by the US federal government

Information Services

“ While there will continue to be a flurry of scaled assets coming to market, deal activity will likely remain relatively muted as buyers and sellers adapt to evolving valuation expectations ”



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What you need to know

- The bid-ask spread between buyers and sellers continues to have an impact on deal activity in the space
- Strategics that have compiled significant cash balances are selectively engaging in auction processes, however, there remains a reluctance to overpay for assets
- Private equity dry powder is near an all-time high.⁸ In many processes private equity firms can, and have been, outperforming strategics from a valuation perspective
- We expect deal activity to remain low relative to 2021, as assets currently on the market are few and far between. “A” class assets (companies with strong recurring revenues, operating margins and growth prospects), remain the focus for investors. Scarcity value, in conjunction with strong operating metrics, is resulting in uncharacteristically fast processes for these assets at above-market multiples.

Outlook

- Industry consolidation is likely to cause smaller participants to re-evaluate strategic plans, often serving as a catalyst to transact
- Strategics and private equity-backed platforms that continue to grow via inorganic activity are creating challenging competitive dynamics for emerging, founder-owned participants
- Pricing pressure will continue to persist as customers review data spend in an evolving and challenging economic environment. Growth via price increases is no longer a given. In many cases, market operators are holding prices steady, or even decreasing prices to hold on to customers
- Companies continue to focus on profitability given the increase in cost of capital, which has negatively impacted growth for those that are under-capitalized

Key trends to watch



Convergence of data and software due to investor demand in greater insights into their portfolios and investments (both current and future), and turning to robust analytics and reporting platforms to drive decision making

The emergence of Artificial Intelligence (AI) and Machine Learning (ML) remains at the forefront of strategic imperatives. Technology such as AI and ML that streamline workflows to generate data and analytics are critical to gain an edge



Bolt-on acquisitions for platforms that are additive to existing data sets can provide gateways to new geographies and customer bases, or present additional functionality that remain attractive at the right price

GP Strategic Advisory

“ Knowledge is power. It is important to be knowledgeable about this market and the various ‘tools in the toolkit’ at your disposal, even if a transaction of this nature does not make sense today. This market is very dynamic and constantly evolving so it is important to be current on the latest trends, market participants, and structures ”



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DC Discusses:



Q&A: The revolution at hand in the alternative asset management industry

Our GP Strategic Advisory group discusses the spectrum of strategic opportunities available to alternative asset managers and how this market is being accessed by many GPs to achieve a wide variety of objectives. While the following focuses on transactions at the management company / GP-level, there is a rapidly growing market for alternatives at the fund-level that are particularly relevant in the current market environment.

[Read here >](#)



Q&A: The use of fund-level financing solutions to help GPs navigate a challenging market environment

Our US GP Strategic Advisory co-leads discuss the macro headwinds impacting the alternative asset management industry, and how fund-level financing solutions can be used to help alleviate many of these pressures.

[Read here >](#)

Technology & Software

“ We expect the remainder of the year to show improved M&A activity as sponsors are focused on building their portfolio companies through acquisitions, and strategics are interested in companies that can fold well into their core business. However, we doubt volumes will reach previous levels due to the US financial environment and fundraising challenges ”



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What you need to know

- The mid-cap software M&A market continued to be active this quarter, with the number of disclosed transactions increasing by 11%⁹ in the first and second quarters, despite the US Federal Reserve’s continued effort to bring inflation under control and market volatility
- Software companies outperformed the overall market through the second quarter showing a positive outlook for the industry. The S&P 400 Software Index was up 25% compared to the S&P 500 which recorded an increase of 15% through June 30¹⁰
- Arm has completed a very successful IPO¹¹ which should open the market, we expect deal activity to increase given companies that have announced their intention to go public by the end of the year

Outlook

- Even with the current macroeconomic uncertainty, sponsors continue to complete transactions and deploy capital. Less common transaction types, such as ‘bolt-ons,’ can increase a portfolio company’s value in lieu of organic growth in this economic environment
- Strategic acquirers have a more cautious approach and continue to look at businesses that can provide long-term value to core assets
- We expect the remainder of the year to show improved M&A activity as sponsors are focused on building their portfolio companies through acquisitions, and strategics are interested in companies that can fold well into their core business

Key trends to watch

- A focus on profitability and operating KPIs. There is a renewed focus on profits, efficiency and customer retention, over revenue growth. Software-as-a-Service (SaaS) companies will likely continue to reduce costs, increase automation and be more disciplined in pricing their services
- We expect that choosing vendors that are aligned with sustainability objectives will become integral to the selection criteria of the customer
- In our view, we are likely to see rapid growth in the expansion of AI throughout the software industry. We expect that this will result in more M&A activity and investment from industry participants and more regulation as the industry matures
- Sponsors will likely be focused on bolt-on acquisitions for their portfolio companies over platform investments. Bolt-on acquisitions have allowed sponsors to deploy capital and reduce deal sizes until lending markets can support larger platform buyouts

Telecom & Digital Infrastructure Services

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M&A activity has slowed in 2023 for Telecom & Digital Infrastructure assets due to the uncertain macro-economic environment and a heavy investment cycle in most digital infrastructure sectors. As the need for capital continues, business plans mature, and the macro environment improves, we expect an increase in deal activity in 2024 and beyond

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What you need to know

- The demand for constant connection, coupled with sophisticated, network intensive applications (streaming, cloud, AI), will lead to continued growth in the Telecom & Digital Infrastructure sectors
- Telecom networks, data centers, and more recently, consumer broadband are now widely considered critical infrastructure assets. Over the last few years, there has been a proliferation of new company formations and business plans funded by private equity
- Broadband and wireless companies continue to invest and raise capital to build out or upgrade to higher speed fiber and wireless 5G networks
- Data center businesses are investing in new buildouts as they approach full capacity with significant incremental demand coming from the digital migration to the cloud and early demand of computer-intensive AI

Outlook

- Demand outlook is strong for Telecom & Digital Infrastructure sectors:
 - The US remains behind most developed nations for high-speed data availability, presenting a large opportunity for fiber builders
 - US wireless industry capital expenditure is up 30%¹² to build 5G and increase densification (including indoors), benefiting the wireless tower sector
 - Data center demand is at a record high¹³ from migration to the cloud and AI, leading to pricing power for DC developers
- However, increasing costs for equipment, labor, and capital, will result in incremental capital needs for companies in build-out mode
- As the need for capital continues, business plans mature, and the macro environment improves, we expect an uptick in deal activity in 2024 and beyond

Key trends to watch

- Existing broadband platforms will likely position and compete for the release of government subsidies allocated to reduce the “digital divide” in more rural areas
- Competition will likely intensify as incumbent broadband providers (cable and telcos) will seek to protect their customer base from new entrants through pricing, bundling of wireless, and upgrading networks
- Given the expected future demand for data centers, finding optimal power locations/sources will become increasingly important
- Cloud communications companies must continue to focus on profitability vs. “growth at all costs” to achieve a premium valuation
- Ultimately, sector consolidation can lead to scale and breadth of services advantages, which is critical to industry leadership and long-term profitability

Our full team

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Appendix

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Mergermarket search criteria for figures 1, 2, 3, 4, 5, reference 1 & 5

Sector	Search criteria
Aerospace, Defense & Government Services	Target or Buyer or Seller sector is Aerospace or Government or Government or Armoured vehicles, etc or Defence or Missiles and missile guidance systems or Other ordnance or Small arms manufacturing or Defence, transactions located in USA, value is between USD (m) 75 and 500 (undisclosed value deals are included) and transaction completed between 01/01/2022 - 31/06/2023
Consumer, Leisure & Retail	Target or Buyer or Seller sector is Agri processing/ cereals or Baby food or Baked goods or Dairy products or Fish/ meat/ poultry or Food ingredients or Food-others or Fresh produce or Frozen and chilled foods or Sugar and confectionery or Consumer: Foods or Beer or Bottling/ canning or Clothes or Household electrical appliances or Household products or Luxury goods or Manufacture and supply of other consumer products or Personal care or Soft beverages or Tobacco or Toys or Wine/spirits or Consumer: Other or Apparel or Building materials/DIY/Garden or Chemists/health or Department stores or Electrical appliances or Furniture or Lifestyle including sports/music/ books etc or Other retailing of consumer products and services or Supermarkets (food chains) or Vehicles or Consumer: Retail or Accommodation or Other entertainment or Restaurants/Pubs or Travel/ holidays/tour operators or Leisure, transactions located in USA, value is between USD (m) 75 and 500 (undisclosed value deals are included) and transaction completed between 01/01/2022 - 31/06/2023
Education	Target Sector is Educational & Training Services, transactions located in USA, value is between USD (m) 75 and 500 (undisclosed value deals are included) and transaction completed between 01/01/2022 - 31/06/2023
Healthcare	Target or Buyer or Seller sector is Handicap aids and basic healthcare supplies or Health institutions or Hospital management or Medical equipment & services, transactions located in USA, value is between USD (m) 75 and 500 (undisclosed value deals are included) and transaction completed between 01/01/2022 - 31/06/2023
Industrials	Target or Buyer or Seller sector is Automotive components or Vehicle manufacturing or Automotive or Agrochemicals or Commodity chemicals (non-petrochemical) or Construction chemicals or Cosmetic/care chemicals or Fine chemicals- other or Fine chemicals- pharmaceuticals or Flavours and fragrances or Food additives/ ingredients or Industrial gases or Inorganic chemicals or Paints and chemicals or Petrochemicals- base or Petrochemicals- derivatives or Specialities - intermediates or Speciality-other or Chemicals and materials or Electronic components or Semiconductor fabrication equipment or Semiconductors or Computer: Semiconductors or Aggregates or Building suppliers (trade) or Cement or Concrete or Construction services or Glass or Heavy construction or Manufacture of pre-fabricated buildings and system or Other heavyside materials or Other lightside materials or Plastics or PVC Windows or Residential builders or Construction or Industrial measurement and sensing equipment or Machine vision systems or Numeric and computerised control of machine tools or Process control equipment or Robotics or Industrial automation or Aluminium raw material production or Industrial equipment and machinery or Industrial Services or Iron and steel production or Other metal products or Pollution and recycling related or Pumps and compressors or Rail stock and parts or Refrigeration equipment or Security & safety systems or Ship Building and parts or Ventilation/heating/air conditioning or Analytical and scientific instrumentation or Batteries and Power supplies or Electrical components or Fibre optics and electric cabling or Industrial: Electronics or Business products or Hardware and plumbing supplies or Office and household furniture or Packaging products and systems or Printing and binding or Pulp and paper or Textiles or Manufacturing (other), transactions located in USA, value is between USD (m) 75 and 500 (undisclosed value deals are included) and transaction completed between 01/01/2022 - 31/06/2023

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[For data sourcing included in this publication, please see Appendix >](#)

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