Business services: reliability amid volatility

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'Safe and steady' is a tag that might be readily applied to the sector, and that's just fine as far as investors are concerned.

Alongside technology and healthcare, business services has emerged as a go-to sector for credit funders attracted by its reliable cashflows and sticky customer relationships. But unlike tech and healthcare, which have been characterised by sky-high valuations as sponsors bet on underlying macro growth trends, lending to B2B service providers is less about high growth and more about steady predictability.

While growth might not come from big-picture demographic changes as in healthcare, or fundamental shifts in the way we live our lives, as in tech, there are still plenty of opportunities in a market that essentially covers everything that is not retail or manufacturing.

Unlike more hyped sectors, business services has not seen such aggressive competition for deals among sponsors in recent years, so multiples have not soared in the same way that they have elsewhere, though they have stayed high. In part that is because the space does not attract niche, sector-focused funds in the same way that tech and healthcare do, but remains a part of the market favoured by generalists.

Within services, digitisation and automation has become a prominent investment theme and sub-sectors like financial and cyber risk management, insurance, essential equipment hire, certification and compliance remain attractive, with LPs keen on the sector.

“The sponsors investing in these assets have been paying big multiples, so our loan-to-value is typically below 50 per cent, giving us an equity cushion of 50 to 60 per cent. That gives us a bit of comfort as the debt provider that we are covered if things start to shift,” one market source told us.

No sector is immune from the current challenges around supply chains, inflation and rising interest rates, but business services look well-positioned. “The focus is really on where the business sits in the value chain and who has the pricing power within that. Everyone is increasing prices right now, so you need to know that a company can pass on inflationary cost pressures,” adds the source.

(Past performance is no guarantee of future results.)