THE LEAD
https://theleadleft.com/the-alternative-pipeline/

The Alternative Pipeline

THE LEAD | December 20, 2022

We noted last week the state of play with the Fed's battle to slay the inflation dragon without also cratering the entire village. The prospect of increasing spreads on top of a five percent-plus benchmark rate has dampened enthusiasm for M&A and financings.

Nevertheless we find private equity sponsors in the traditional middle market space remaining constructive around opportunities heading into next year.

Experienced buyers have long-established strategies buying and building businesses with high growth potential. They are guided by senior operating executives who layer add-on companies onto platforms at lower purchase price multiples, bringing down the effective overall entry cost.

These companies tend to be in less-cyclical B2B arenas such as healthcare, business services, technology, software, logistics, and distribution. Here prospects for revenue and cash flow growth remain healthy with valuations still at the level where sellers have not despaired of achieving their asking price.

Indeed, as we will hear next month from top M&A professionals on our exclusive *Lead Left Presents* webinar, certain higher growth businesses are commanding record multiples regardless of the expectations for a 2023 slowdown.

But financing is another matter.

Despite the encouraging news on inflation last week, the Fed's hawkish higher-for-longer voiceover has embedded recession risk more firmly in investors' minds. Lenders are more risk-off with lower-for-longer leverage on LBO financings. For some more cyclical plays, any leverage may be a challenge.

This assumes the Fed doesn't hike rates much beyond today's expected terminal rate, an outcome that could shut down a broader range of deals. Regardless, private credit, with its long-term buy-and-hold lenders, is better positioned to take advantage of continued disruption in the BSL market.

As our *Chart of the Week* highlights, for the last several years direct lenders have taken share from syndicated loans. For the current quarter the latter barely registered as clearing prices became all but impossible to determine.

Our own pipeline of financings lined up for early first quarter is relatively healthy; some spilling over from December, others represent sponsors' continuing search for value in areas of expertise. If the economy stabilizes later in the year, and rates moderate, that trend could accelerate.

? From the Editor: The Lead Left will be on its Christmas break and will return the week of January 9, 2022.