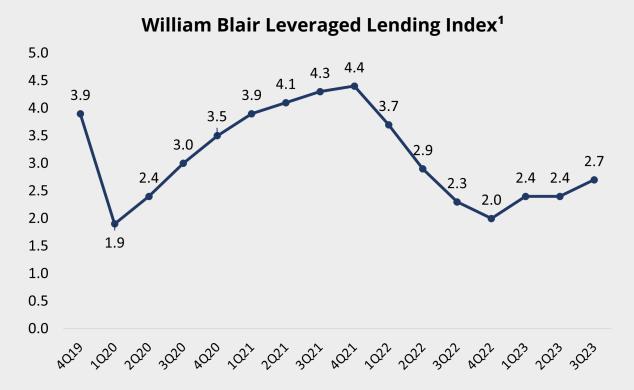


AGGRESSIVE LENDING TO CONCESSIONS

Less than stellar leveraged loan activity rebounded in 3Q 2023 amidst a narrowly avoided government shutdown and ongoing labor strikes. Despite these economic disruptions, the US leveraged loan market closed its strongest quarter in the last 18 months. On a scale of 1 to 5, middle market lenders are asked to rate overall market conditions with 1 being the least borrower-friendly and 5 being the most borrower-friendly. Lender sentiment dipped to pandemic levels in 4Q 2022 at 2.0 index points but has steadily increased to match an economic rebound similar to that of the post-pandemic resurgence at 2.7 index points¹.

Although the index is well below its high of 4.4 index points in 4Q 2021, lenders have indicated an increased willingness to make borrower-friendly concessions to win new deals as indicated loan volume nearly doubled quarter-over-quarter since 3Q 2022 to \$27.8 billion¹. Though this volume level is high relative to the recent past, it remains meaningfully below historical levels.



PRIVATE CREDIT STILL FAVORED

Private credit continues to dominate headlines. According to PitchBook's Leverage Commentary & Data, the number of non-LBO transactions in the U.S. that were financed by private credit exceeded the number of those transactions financed in the broadly syndicated loan market for each of the last five quarters through June 20, 2023².

Private credit providers have broadened their nets to other asset classes, including investment grade lending, asset-based lending, and preferred equity investments. Most notably, market leader, Bain Capital, recently announced its new asset-based lending service in May 2023, and Blackstone reorganized its asset-based finance department in September 2023 before announcing that private credit would be vying for asset-based debt².



SYNDICATED LOAN ACTIVITY

Syndicated loans remained relatively few and far between as private credit dominated LBO financing. Though a market slowdown was expected following Labor Day, many investors are seeking to ramp up activity for a strong beginning to 1Q 2024¹.

Investor confidence in the syndicated loan market was bolstered by a select few LBOs in 3Q 2023 equaling just under \$12 billion. Though market volatility is to remain an ongoing threat, investment arrangers have reported spending more time pre-determining market forecasts and hitting the market quickly to offload risk. Lenders expect the continued elevation of interest rates, inflation, limited deal opportunities, and lender aggressiveness. As a result, lenders continue to expect default rate levels to continue an upward trajectory as portfolio companies struggle with free cash flow and softer than expected performance.

GOVERNMENT IMPACT EXPECTATIONS

Regulatory approval timelines have lengthened significantly with stricter enforcement by the FTC and DOJ as contributing factors to the somewhat lackluster loan market YTD. In addition to creating deal uncertainty, these heightened regulatory schemes can also have economic implications for underwritten debt financings with long commitment periods including ticking fees, duration-based pricing, fee step-ups or price flex rights².

According to PitchBook's Leverage Commentary & Data, 3Q Lending Survey, 55% of respondents believe the worst of market volatility is yet to come and an additional 45% believe the Fed won't look to begin cutting rates until after 3Q 2024³.

Investors should keep the regulatory backdrop top of mind on transactions as they may need to adjust investment plans to account for this continually evolving threat.

A GOVERNMENT SHUTDOWN AND RECESSION IMMINENT?

Although recessionary fears remain, 77% of respondents to Refinitiv's 3Q 2023 survey reported their belief in a shallow recession compared to historical predictions, while 61.5% of respondents believe there will be no recession at all. However, continued inflation, high interest rates, political discord and geopolitical tensions could tilt the scale toward a recession at any time².

A government shutdown could have implications for M&A deals in the market as the FTC would likely only have enough funding to get through a few weeks before it is limited to operating with just "essential" staff – resulting in further delays for deals seeking approvals¹. Similarly, the impact of conflict in the Middle East could affect the loan market, should it spread beyond Gaza and Israel.

MARKET OUTLOOK

The loan market's softening between September and October 2023 continues to demonstrate fragility of the overall loan market. However, with macroeconomic conditions slightly improving over time, in tandem with more positive consumer and investor sentiment, there is reason to be optimistic for deal and lending activity to increase into 1Q 2024.

END NOTES

- 1. https://www.williamblair.com/Insights/Leveraged-Finance-Loan-Market-Gained-Momentum-in-Q3
- 2. https://www.weil.com/-/media/mailings/2023/q3/leveraged-finance-market-update-october-2023.pdf
- ${\it 3. https://pitchbook.com/news/articles/q3-2023-us-leveraged-finance-survey-funds-continue-to-favor-private-credit for the properties of the properties$



MARKET SURVEY

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FIRM OVERVIEW:

Carleton McKenna & Co is an independent investment banking firm providing M&A and Capital Raising advisory services. We work with middle-market closely-held family businesses, multi-generational family businesses, portfolio companies of financial sponsor firms and divisions or subsidiaries of public companies focusing in Specialty Manufacturing & Chemicals, Consumer Products, Food & Beverage and B2B Services.

Our Team is made up of finance and accounting experts, entrepreneurs and operators, C-Suite and Board professionals, lawyers, consultants and marketing professionals. These diverse experiences and skills drive extraordinary results for our clients.

We believe businesses are the economic engine of our society, and that business owners deserve and require a proactive advocate to maximize life changing transactions.

Interested in Learning More About CM&Co?

Contact Emily to learn more about Carleton McKenna's services.



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