

# Debt Market Update

## Q2 2023

U.S. institutional leveraged lending issuances exhibited a slight decrease from \$52B in Q1 to \$48B in Q2.<sup>1</sup> Lenders have signaled continued conservatism, driven by preexisting fears around federal fund rates policy, recession rumors, as well as lingering concerns regarding bank failure and the potential for a deposit run. The decline in lending activity has been accompanied by a reduction in U.S. M&A announced transactions deal value, down 44% in Q1 2023 year-over-year.<sup>2</sup> Private equity backed deals disproportionately drove declines in deal volume as a tighter lending environment created barriers to LBO financings and made it difficult for financial sponsors to meet their preferred hurdle rates.

Alongside the decreasing number of new loans, June saw a continued rise in leveraged loan default rates. Default rates for the LSTA U.S. Leveraged Loan Index reached a rolling 12-month rate of 1.86%, above the 10-year average default rate of 1.6% but below the 25-year average default rate of 2.7%.<sup>3</sup> The share of LSTA loans with a B-minus rating or lower reached a record high of 36% in June as downgrades outnumbered upgrades for the 13th consecutive month.<sup>1</sup>

Against this backdrop of sustained tight credit conditions, companies are staring down approaching maturity dates of leveraged loans. Recent refinancing activity has helped extend maturity timelines and has given companies more breathing room than Q1. However, the 2-year and 3-year amounts coming due were higher at the end of Q2 2023 than after the second quarter for any of the past five years, with half of the 2-year maturities rated B-minus or lower.

1. PitchBook  
2. Refinitiv  
3. Yahoo Finance



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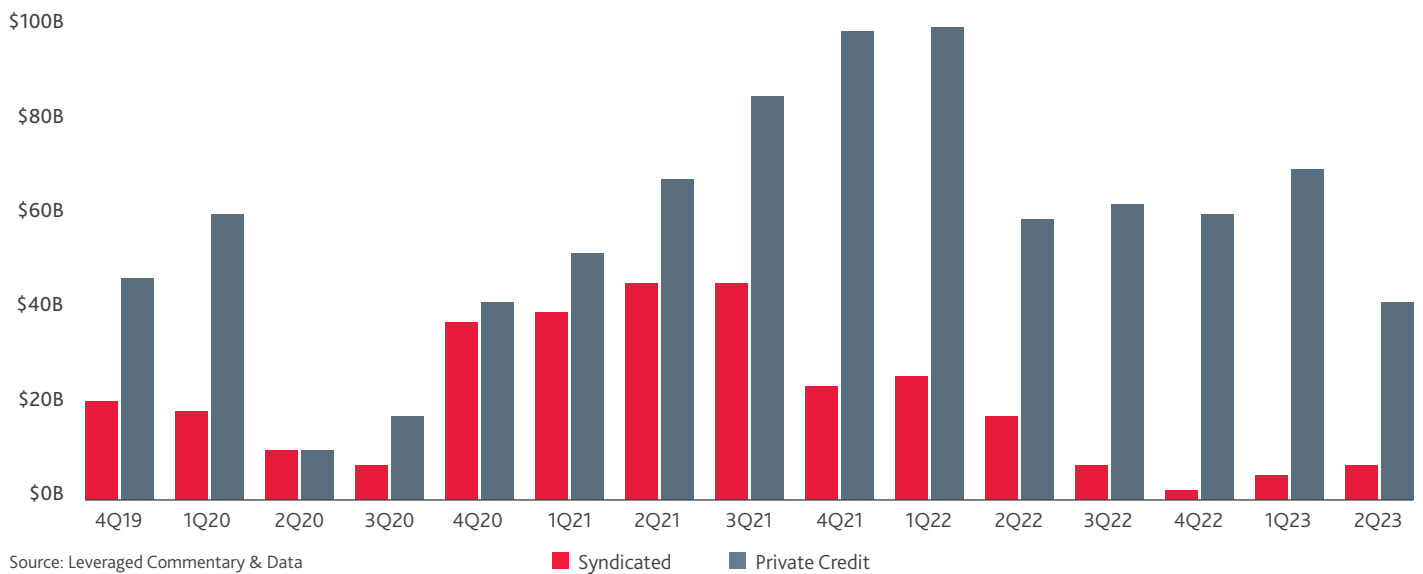
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## U.S. LBO FINANCINGS COUNT SYNDICATED VS. PRIVATE CREDIT



	Senior Debt/EBITDA	
	< \$5M	> \$10M
Jul 2023	1.50x – 2.00x	2.00x – 3.00x
Jul 2022	1.50x – 2.50x	2.75x – 3.25x

Source: BDO Capital estimates

A decrease in M&A activity and cautious investor sentiments have contributed to reductions in the leveraged loan space over the past 12-18 months. This has been felt most heavily in the syndicated loan space, which has declined precipitously as the vehicle of choice for funding LBO transactions. In its place, private credit funds have predominated as debt fund structures look to deploy significant amounts of capital raised during the pandemic – a time when monetary stimulus and low interest rates drove LPs toward higher return credit asset classes.

Base rate SOFR stood at 5.3% as of August 15<sup>th</sup>. Debt pricing trended upward from January through April before steadying for the remainder of the second quarter.

	Senior Debt Pricing	
	Bank	< \$10.0M*
Jul 2023	S+3.75% – 5.00%	S+6.50% – 8.50%
Jul 2022	S+3.00% – 4.50%	S+6.50% – 8.50%

\*Non-bank lenders / Source: BDO Capital estimates

	Total Debt/EBITDA	
	< \$5M	> \$10M
Jul 2023	2.50x – 3.50x	3.50x – 4.50x
Jul 2022	3.75x – 4.25x	4.00x – 5.00x

Source: BDO Capital estimates

As lenders come to terms with the world in the wake of the U.S.'s second-largest bank failure, a more conservative approach pervades. While debt pricing increases seem to have hit a ceiling, lenders are focusing more on uses of proceeds and on capital structure, putting downward pressure on leverage levels. Persistent tight credit conditions have been felt most poignantly in the lower middle market. These companies, which typically cannot access large institutional capital pools, instead expect to receive debt financing from local and regional banks – entities which face restrictions as depositors become increasingly jittery and regulators more stringent.

	Subordinated Debt Pricing (Total Coupon)	
	< \$5M	> \$10M
Jul 2023	13.00% – 16.00%	12.50% – 14.00%
Jul 2022	12.00% – 14.00%	11.00% – 13.00%

Source: BDO Capital estimates

## SELECT TRANSACTIONS



**U.S. Auto Sales**  
**\$60,000,000**  
 Revolving Credit Facility



**WT Hardwood Groups**  
**\$60,000,000**  
 Senior Credit Facility & Junior Capital



**Jindal Films**  
**\$50,000,000**  
 Senior Credit Facility



**TruFoodMfg**  
**\$36,000,000**  
 Senior Credit Facility



**MOGAS Industres, Inc.**  
**\$50,000,000**  
 Senior Credit Facility



**Leader Distribution Systems, Inc.**  
**\$9,000,000**  
 Senior and Subordinated Notes

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