DEBT MARKET UPDATE
Q2 2022 – NORTH AMERICA

Featuring BDO Capital Advisors and BDO Canada

United States

After setting new records in 2021, U.S. leveraged lending in 2022 has not been able to keep pace with last year given global economic uncertainty, continued inflationary pressures and Russia's invasion of Ukraine. According to Debtwire, total leveraged loan volume declined 40 percent compared to the prior year to approximately $168 billion and institutional leveraged loan volume declined 54 percent compared to the prior year period to approximately $103 billion. New money issuance was a bright spot as total leveraged and institutional loan volume increased 12 percent and 17 percent, respectively, compared to the prior year period to approximately $94 billion and $67 billion, respectively. However, this could not offset the decline in refinancing and repricing volume of 62 percent. M&A related volume, including LBO activity, remained active and helped to drive the increase in new money institutional volume which accounted for over 55 percent of the volume.

Many predicted 2022 would be another active year, and M&A volume continued to be strong according to PitchBook at approximately $496 billion through March 2022, a six percent decrease compared to the prior year period. While previously announced deals closed on time, dealmaking slowed or was on pause for several weeks during the first quarter due to geopolitical conflict uncertainties. The M&A outlook for the second half of 2022 and 2023 is uncertain given forward economic fundamentals.

As we try to look beyond the COVID-19 pandemic, consumer spending faces uncertainties as the U.S. Consumer Price Index hit 8.5 percent in March 2022, and the price of nearly everything appears to be rising. Consumer spending will be critical to keep the economy moving forward. If these underlying inflationary pressures continue and the Federal Reserve's interest rate hikes potentially result in a recession in the U.S., debt markets could quickly return to conditions seen during the initial stages of the pandemic.

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PLEASE DIRECT INQUIRIES TO:

WILLIAM R. SHIRY, JR.
Managing
Director, Chicago
312-233-1856 (Direct)
216-272-3129 (Mobile)
wshiry@bdocap.com

JOHN Y. KIM
Director, Houston
713-548-0964 (Direct)
832-416-0248 (Mobile)
jkim1@bdocap.com

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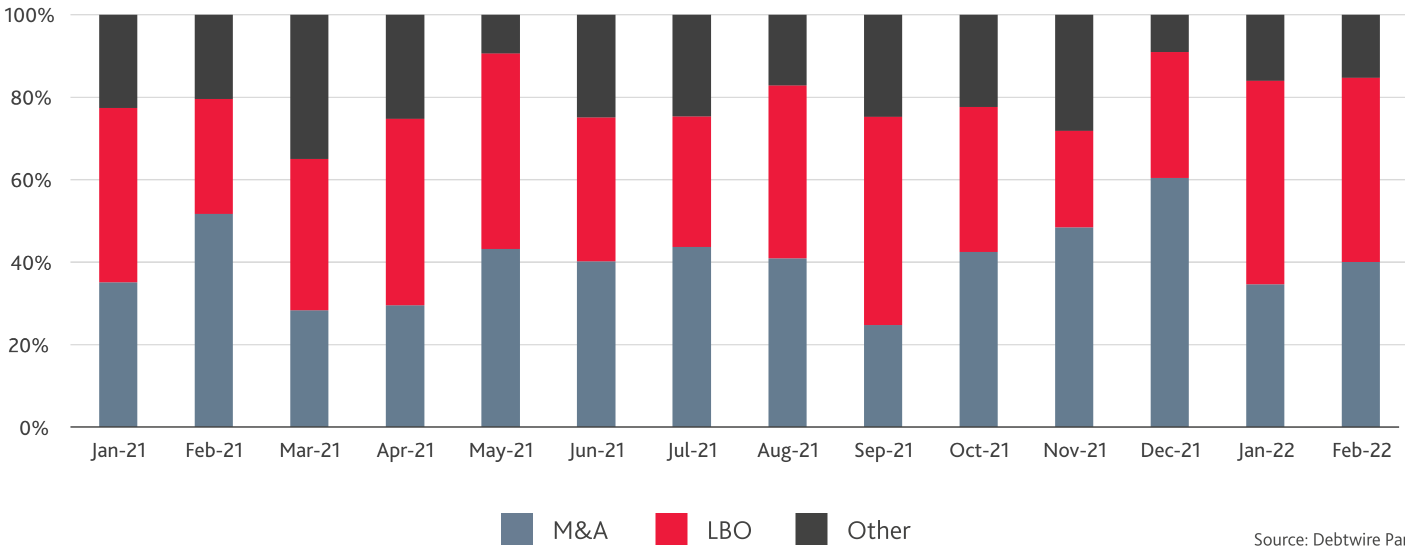
U.S. LEVERAGED INSTITUTIONAL LOAN NEW MONEY ISSUANCE



Source: Debtwire Par

Total Debt/EBITDA			
	< $5M	> $10M	> $20M
Mar 2022	3.00x – 4.00x	4.50x – 5.50x	5.50X – 6.50x
Dec 2021	3.00x – 4.00x	4.50x – 5.50x	5.50X – 6.50x
Mar 2021	2.75x – 3.75x	4.00x – 5.50X	4.50x – 5.75x

Source: BDO Capital estimates

Sub. Debt Pricing (Total Coupon)			
	< $5M	> $10M	> $20M
Mar 2022	12% – 15%	10% – 13%	8% – 11%
Dec 2021	12% – 15%	10% – 13%	8% – 11%
Mar 2021	12% – 15%	10% – 13%	9% – 11%

Source: BDO Capital estimates

In the private debt market, approximately $30 billion of loans were issued for middle market borrowers during Q1 2022, up slightly over the prior year period. New money transactions accounted for approximately 61 percent of the quarterly volumes, with the remaining for refinancing as borrowers continued to refinance existing debt and extend maturities ahead of the upcoming interest rate hikes. Sponsor-backed financings accounted for approximately $8 billion of volume in Q1 2022 which represented a 36 percent decline compared to the prior year period.

While the broader debt markets cooled off in the quarter, private lenders maintained their risk appetite. The Federal Reserve followed through on its more hawkish views by raising the benchmark rate by 25 basis points to a range of 0.25 percent to 0.50 percent during Q1 2022, the first interest rate hike since 2018. The Federal Reserve signaled more aggressive moves may be in store noting that one or more half-point increases could be appropriate in future meetings which has increased benchmark rates. Non-bank direct lenders still mandate interest rate floors ranging from 50 basis points to 100 basis points which have somewhat insulated them during this period of historically low rates; however, this may become moot as interest rates increase.

Senior Debt/EBITDA			
	< $5M	> $10M	> $20M
Mar 2022	1.75x – 2.75x	2.75x – 3.50x	3.50x – 5.50x
Dec 2021	1.50x – 2.75x	2.75x – 3.50x	3.50x – 5.00x
Mar 2021	1.50x – 2.75x	2.75x – 3.00x	3.25x – 4.50x

Source: BDO Capital estimates

Senior Debt Pricing			
	Bank	< $10M*	> $15M*
Mar 2022	S+2.0% – 4.5%	S+5.8% – 8.3%	S+4.5% – 7.0%
Dec 2021	L+2.0% – 4.5%	L+5.5% – 8.0%	L+4.0% – 6.5%
Mar 2021	L+3.5% – 4.5%	L+6.0% – 8.0%	L+5.5% – 7.0%

*Non-bank lenders / Source: BDO Capital estimates

SELECT TRANSACTIONS

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

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

TruFoodMfg
$36,000,000
Senior Credit Facility

Jindal Films
$50,000,000
Senior Credit Facility

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

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

Canada

March 2022 year-to-date loan issuance in Canada was $1.14 trillion, a four percent increase over the previous quarter. Although the Bank of Canada increased their overnight rate by 25 basis points in Q1 2022, interest rates were still near all time lows and lenders continued to provide new money to the market. Growth capital, acquisition financing and working capital loans accounted for 85 percent of the new lending.

Similar to Q4 2021, domestic banks remained the largest business credit provider. Given the excess liquidity and low cost of capital, banks continued to compete on rates, structure and terms. In addition, the Canadian banks were active in deals traditionally reserved for alternative lenders. However, alternative lending continued to be a key source of capital for mid-market businesses. U.S. alternative debt providers continued to grow market share in Canada.

In Q1 2022, of the $1.14 loaned, 60 percent ($0.69 trillion) was from domestic banks and 40 percent ($0.45 trillion) was from alternative lenders. Quarter-over-quarter growth for domestic banks and alternative lenders was three percent and five percent respectively.

Real estate (25 percent), and financial services (16 percent) continued to make up the bulk of lending in Canada. Services (10 percent), and agriculture (5 percent) followed. Services consists of education, healthcare, business services, and social services. These four areas made up 56 percent of total business lending in Canada.

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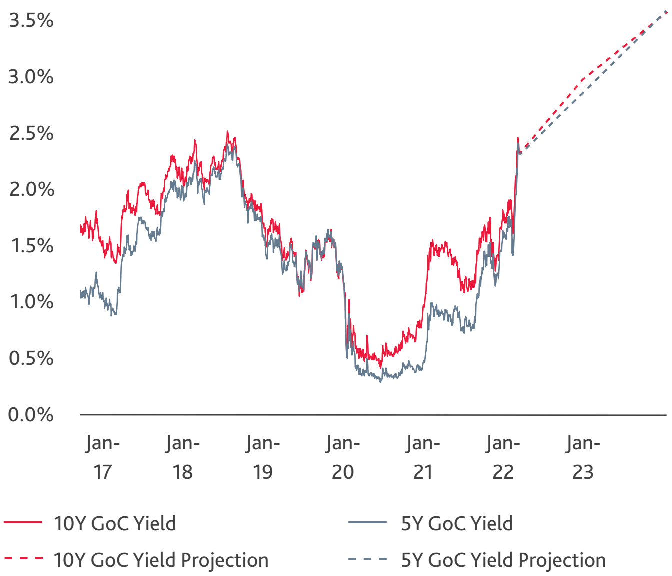
PLEASE DIRECT INQUIRIES TO:

MICHAEL MORROW
Managing Director,
Toronto
416-865-0200 (Office)
416-890-6185 (Mobile)
mmorrow@bdo.ca

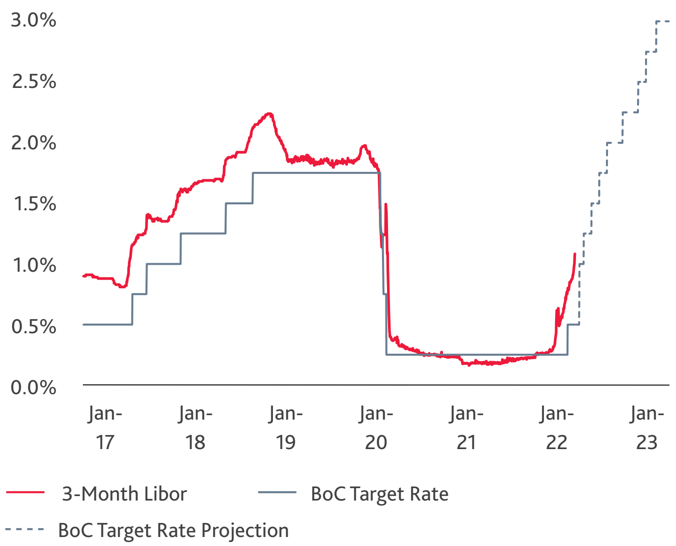
SHILPA MISHRA
Managing Director,
Toronto
416-865-0200 (Office)
smishra@bdo.ca

10Y GOC YIELD VS 5Y GOC YIELD (2017-2024)



Data Source: https://www.bankofcanada.ca/rates/interest-rates; forecasted data was made at the discretion of BDO, M&A and Capital Markets estimates after talking with Canadian banks

3-MONTH CDOR VS BANK OF CANADA TARGET RATE (2017 - 2024)



Data Sources: https://www.bankofcanada.ca/rates/interest-rates and https://www.iiroc.ca/markets/canadian-bankers-acceptance-rates; forecasted data was made at the discretion of BDO, M&A and Capital Markets estimates after talking with Canadian banks

Alternative Lenders - Total Debt/EBITDA

	< $5M	> $10M	> $20M
Jan 2022	3.00x – 4.00x	4.00x – 4.75x	4.25x – 5.00x
Feb 2022	3.00x – 4.00x	4.00x – 4.75x	4.25x – 5.00x
Mar 2022	3.00x – 4.00x	4.00x – 4.75x	4.25x – 5.00x

Source: BDO, M&A and Capital Market estimates

Alternative Lenders - Pricing (Coupon)

	< $5M	> $10M	> $20M
Dec 2021	10% – 15%	8% – 12%	8% – 12%
Dec 2020	10% – 14%	8% – 12%	8% – 12%
Dec 2019	13% – 15%	11% – 13%	10% – 12%

Source: BDO, M&A and Capital Market estimates

M&A activity declined 50 percent in Q1 2022, compared to Q1 2021. Several factors contributed to this, including concerns regarding interest rate hikes, inflation, and geopolitical instability surrounding Russia-Ukraine. M&A deal value in Q1 2022 was $131 billion, an 18 percent decline compared to the prior quarter. Every sector saw a decline in M&A activity except consumer staples which increased 17 percent. Although economic fundamentals remain strong and excess liquidity continues to persist in the market, rising interest rates and geopolitical factors could add stress to the Canadian M&A markets in 2022.

With the continued reopening in Canada, the Canadian economy remained strong with a 3.5 percent annualized GDP increase in Q1 2022. The Canadian GDP is now at pre-pandemic levels and is expected to remain robust. GDP is forecasted to grow 4.2 percent by the end of 2022 and three percent in 2023.

Russia's invasion of Ukraine in Q1 2022 caused increased volatility in financial markets. Rising commodity prices continued to disrupt supply chains and create bottlenecks. Globally, food and energy prices soared as oil prices increased and agricultural production was met with limitations. Canada's inflation topped 6.7 percent in March 2022 representing a new high. On March 2, the Bank of Canada increased the overnight rate by 25 basis points and then another 50 basis points on April 13, 2022.

The Bank of Canada is expected to implement another 50 basis point hike followed by five 25 basis point increases in the overnight rate by the end of 2022, bringing the overnight rate to 2.75 percent. In early 2023, another two 25 basis point rate hikes leading to a 3.25 percent overnight rate are expected. Rising rates will ultimately result in an increased cost of borrowing, leading to more disciplined underwriting and credit structuring by lenders. Overall, the Canadian economy is expected to withstand pressure created by rate hikes.

Canadian Banks – Senior Debt/EBITDA			
	< $5M	> $10M	> $20M
Jan 2022	1.75x – 2.75x	3.00x – 4.00x	3.50x – 4.00x
Feb 2022	1.75x – 2.75x	3.00x – 4.00x	3.50x – 4.00x
Mar 2022	1.75x – 2.75x	3.00x – 4.00x	3.50x – 4.00x

Canadian Banks – Senior Debt Pricing			
	< $5M	> $10M	> $15M
Jan 2022	C+3.0% – 5.5%	C+3.0% – 5.0%	C+2.5% – 3.5%
Feb 2022	C+3.0% – 5.0%	C+3.0% – 5.0%	C+2.5% – 3.5%
Mar 2022	C+3.5% – 5.5%	C+3.5% – 5.5%	C+2.5% – 3.5%

Sources: BDO, M&A and Capital Market estimates; Bank of Canada; StatsCanada; Canadian Bankers Association; Reuters

SELECT TRANSACTIONS

Winch Group
$10,500,000
Capital Advisory

Rodan Energy Solutions
$25,000,000
Capital Advisory

Insig/TIA Health
$6,000,000
Capital Advisory

Large HVAC Company
$48,000,000
Capital Advisory

Large Chemical Dist.
$6,500,000
Capital Advisory

ADDITIONAL BDO CAPITAL ADVISORS CONTACTS

ROBERT SNAPE
President
617-239-4177 (Direct) / 339-236-1050 (Mobile)
bsnape@bdocap.com

VALENTINA MIDURA
Senior Managing Director
617-422-7593 (Direct) / 978-873-1314 (Mobile)
vmidura@bdocap.com

PATRICK BISCEGLIA
Managing Director
804-401-4311 (Direct) / 804-513-9724 (Mobile)
pbisceglia@bdocap.com

ERIC HIGGINS
Director
617-422-0904 (Direct) / 978-761-8111 (Mobile)
ehiggins@bdocap.com

ADDITIONAL BDO CANADA M&A AND CAPITAL MARKETS CONTACTS

ADAM MALLON
Managing Director
780-643-6192 (Direct)
amallon@bdo.ca

RYAN FARKAS
Managing Director
416-775-7804 (Mobile)
rfarkas@bdo.ca

JAMIE WINDLE
Managing Director
416-865-0200 (Office)
jwindle@bdo.ca

DEREK VAN DER PLAAT
Managing Director
416-865-0200 (Office)
dvanderplaat@bdo.ca

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