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Supply Chain Blues (Third of a Series)

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Before Covid the persistent view on private credit was too much capital was chasing too few deals. Transaction inflation caused compressed spreads, higher leverage and weakened terms.

When Covid hit this balance shifted dramatically in favor of the investor. Deal supply dried up, lenders retreated, and terms strengthened. But within weeks central bank liquidity ended that run.

Today the private credit pipeline is at record levels, fueled by near-zero risk free rates, low relative value for riskier assets, and volatility of liquid strategies such as public equities.

There’s also a strong tailwind in earnings growth from companies benefiting from the pandemic. Owners are eager to sell and sponsors are eager to buy. As Delta infections rise, though, bottlenecks could inhibit deal-making.

Private equity sponsors describe their due diligence teams being “flat out.” And that was in the middle of August! By all accounts the rest of the year will see even higher levels of deal activity.

Supply chain problems are spilling into support areas as well. Law firms, industry consultants, and valuation experts report record flow with delivery times pushed out and managing new business a challenge.

Private capital providers are feeling the same pinch. By one measure – the number of NDAs being signed – deal flow has never been higher.

Others bemoan the lack of young associates. “Second-tier shops are struggling to attract talent, so they’re waving around big offers,” one friend told us. “If you’re inexperienced and working from home, it’s hard to distinguish the good platforms from the rest.”

Sponsors are divided between those struggling to find value in auctions and those voting with LP dollars. For the latter, logistic hurdles remain. As one investment banker reported: “The constraint right now is not that there’s not enough deals or capital; it’s the bandwidth of the private equity firms.”

Next week we look at supply chain challenges for PE portfolio companies.