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M&A Outlook for 2023 (Last of a Series)

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After a deep-dive into the various elements of the M&A market last year, our panel of five top bankers told 650 registrants of our exclusive Lead Left Presents webinar that conditions for 2023 are beginning with "wait and see."

"We're having daily conversations with clients about how long to wait," one reported. "What won't change is rates. Indicators that may change will come from the economic picture." For example, what is the likelihood of a recession. And if it happens, how long will it be, and how deep? The latest GDP numbers for 4Q came in at 2.9%, modestly off from 3Q's 3.2%.

Higher for longer rates and any kind of slowdown could kick middle market loan default rates up to 3-5%, a meaningful lift compared to the past near-zero decade. "If defaults come back down that could energize lenders, if not they could back off."

How will market conditions affect private equity fundraising? Right now there's a "logjam"; only the best of the best get through. LPs are overextended with the denominator effect, public market valuations are coming down, and selling (and therefore) distributions are declining.

"If you don't know how a company will perform or where rates are going, you don't know how much it's worth. But if there's a snap-back, it'll be busier than ever, like the second half of 2020." Lower tier PE firms are challenged by lack of capital. "Name brand sponsors found they didn't have the money to close the deal. The waters are still very choppy out there."

Another banker offered: "Case-by-case there are issues, but there's not a shortage of PE capital overall. The long-term fundraising trend line will look consistent. Those funds that missed targets stayed open for longer. LPs can afford to be pickier. And GP's will adjust. For example, $1.5 billion vs $2 billion raise makes a real difference."

The panel identified creative structures as a necessity now. "We need to be scrappy this year." Family-owned businesses are more open to minority owners than institutional owned sellers. Sellers are motivated by Covid factors, a sense of mortality, and life-style moves. There will be a rush to the market if rates ease, buyers will still focus on quality.

Lots of headwinds impacted deal making since 2020 – Covid, supply chains, reverse Covid expansion, and rates. But not sluggish earnings. Will that change? Companies could lose momentum if a recession results from the Fed's medicine. Some analysts say 2023 and 2024 earnings estimates are too high.

In the long run, corporate earnings will be bolstered by "restoring the US industrial base and untangling supply chains." And why has tech not produced more productivity gains?

Finally, there's a backlog of sellers hiring advisers then waiting. "You need to prep your firm to go to market," one banker concluded. "When the time comes there will be a rush to the door."