



Private Capital: Impact on 2025 M&A Activity

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From the second half of 2020 through most of 2022, M&A activity was very robust as capital was cheap and readily available, allowing many companies to deploy that capital and take more risks to consummate acquisitions. But as the Federal Reserve increased its target interest rate in 2022 and 2023, buyers and their capital providers became more sensitive to the expense of financing these acquisitions, increased their due diligence (financially, legally and culturally), and became generally more selective of their acquisition targets, leading to a slowdown in M&A deals in 2023. While 2024 M&A activity saw a slight uptick from 2023 – in both deal value and the number of deals – 2024 still lagged behind the robust activity seen in 2021 and 2022.

At its September 2024 meeting, the Federal Reserve decreased its target interest rate by 50 basis points, thereby lowering the target rate to below 5.00% for the first time since March 2023. The Fed subsequently implemented two 25 basis points cuts before the end of 2024, but the Fed also signaled it was likely to cut rates only twice during 2025.

While the 2024 rate cuts brought much needed relief and an economic boost to many companies, there remains some uncertainty for middle market M&A as we begin 2025, which uncertainty may not stabilize until the Fed further cuts interest rates and the impact of President Trump's economic and regulatory policies are fully implemented.

Although some economic uncertainty remains, with the 2024 Presidential election over and a more favorable regulatory environment expected, many market conditions are, or are anticipated to become, more primed to boost middle market M&A into 2025. This article explores how private capital – in the form of private equity, private credit and family offices – will navigate improving market conditions to deploy capital to boost 2025 middle market M&A activity.

Private Equity Push

Private equity (PE) was a key driver of M&A activity in 2021 and 2022, as PE firms directed their platform companies to engage in aggressive acquisition strategies (sometimes referred to as “buy and build”, “roll up” or “add-on” acquisitions) by rolling up smaller companies to create accretive value in their industries and/or expand their geographic presence.

However, faced with a more challenging and expensive debt market as described below, many private equity firms pulled back and reserved their capital in 2023 and 2024, not only with respect to new investments in target companies but also on their buy-and-build strategies for their existing platform companies. This pause and pullback resulted in significant “dry powder” (or uncommitted capital) held by private equity firms, which in 2025 are now looking to reignite their acquisitive growth strategies by deploying this dry powder in a more friendly credit environment.

Further, many investors (typically limited partners) in PE funds are applying pressure on PE sponsors to provide returns on the investments made by those investors a few years ago. PE firms generally plan for an exit or maturity event around five years after an investment in a platform company, so as PE funds raised significant private capital back in 2019 through 2021, those fund sponsors are now on the clock to return the investment to their investors and to justify the fees charged by the funds. As a result, many PE sponsored companies are becoming sellers in the acquisition market, as their sponsors are looking to exit the investment and realize a return to their investors.

However, prior to launching their exit strategies, PE sponsors are aiming to ensure that they do not exit their investment at a lower-than-expected value. In an effort to boost their prospects of a successful exit, PE sponsors are reemphasizing their buy-and-build acquisition strategies that had stalled over the last couple of years. Additionally, with general economic conditions improving heading into 2025, many PE firms are more confident in target valuations improving. As the valuations between potential buyers and sellers become more aligned, PE firms are increasingly ready to move

forward with growing their portfolios through accretive acquisitions.

Private Credit Impact

As the Fed steadily increased interest rates, the relatively cheap debt capital that PE firms put on their platform companies to fund aggressive acquisition strategies became not only more expensive, but more difficult for their platform companies to obtain – causing many buyers to pause or terminate prospective acquisitions. In addition to more expensive capital, borrower-buyers began facing more extensive diligence, more detailed reporting requirements and more restrictive covenants in their bank credit documents. On the lending side, economic uncertainty, coupled with regulatory scrutiny stemming from bank failures in 2023, caused traditional bank lenders to become more cautious in making loans, particularly with respect to acquisition financing facilities.

As a result, private equity firms leveraged their relationships with private credit funds to obtain more flexible and more borrower-friendly credit facilities than would otherwise be available for traditional bank lenders. Private credit providers could also consummate these loans more efficiently and expeditiously than traditionally regulated banks, helping to put in place the capital necessary to allow their borrowers to fund proposed acquisitions when called upon. The familiarity between private equity funds and private credit funds also allowed for more adaptive and customized credit terms and documents.

In particular, private credit providers were more willing to work with private equity sponsors on two key, and heavily negotiated, terms of their acquisition credit facilities: (i) the amount of the maximum commitment allocated to the facility in the form of a delayed draw term loan (DDTL), and (ii) the “Permitted Acquisition” definition and covenant, which provides a clear roadmap for both parties to fund a draw on the DDTL to fund. The DDTL terms of these credit facilities are crucial to funding acquisitions, and private credit funds’ willingness to partner and work with PE sponsors has created an increased preference to access private capital rather than traditional bank lending.

Now, with interest rates having declined in the second half of 2024 and with more anticipated in 2025, private credit is expected to again help fuel an increase in M&A deal volume. Recently, *The Wall Street Journal* noted that “Many on Wall Street anticipate a dealmaking rebound, bringing with it a rush of private-equity activity,”^[1] and that the growing impact of private credit in the market is causing many large Wall Street banking institutions to analyze their place in the credit market. Notably, the *Journal* reported that many at Goldman Sachs believe “a handful of private-credit firms and similar institutions will soon dominate the debt landscape.”^[2] Accordingly, the combination of private equity and private credit with aligned investment strategies should spur more private capital into the M&A market.

Family Offices – More Direct Investments

Family offices – private firms that manage ultra-high net worth families and individuals’ assets – have long been investors in private credit and private equity funds. However, as these offices develop and become more robust and sophisticated, the managers of these offices are aiming to make more direct investments. These direct investments are taking the form of both equity in private companies as well as providing debt capital with above-market interest rates to companies. In effect, these more developed family offices are becoming their own private equity and private credit firms, but direct investing allows the family office to reduce or eliminate the carried interest and management fees typically paid to private equity management companies. Direct investing also allows family offices to take a more active role in managing and controlling their investments, versus being a passive investor subject to another private fund’s management.

Despite these advantages, many family offices lack the operational, administrative and structural support necessary to fund their own direct investments and then to maintain and operate those investments going forward. However, in an effort to confront these challenges, many family offices are becoming more capable by expanding their internal teams and effectively utilizing external resources. The result is that family offices are becoming more

sophisticated and self-sustaining, allowing them to focus more on direct investing and management. As family offices aim to expand and develop their direct investment, even more private capital is expected to enter the M&A market in 2025.

Conclusion

Although the 2024 middle-market did not rebound like many anticipated, the capital that was raised or preserved during 2024 seems more likely to be deployed in 2025 by private equity and credit firms, as well as family offices increasingly making direct investments. This anticipated private capital deployment could be bolstered by further interest rate cuts by the Fed, as well as a more favorable economic and regulatory market. Although it remains early in 2025, the available dry powder coupled with improving market conditions suggests that 2025 M&A activity will be very robust in the middle-market.

[1] AnnaMaria Andriotis, *Goldman Sees Financing as the Future. It Is Rearranging Itself to Reflect That*. The Wall Street Journal, January 13, 2025, available at: www.wsj.com/finance/banking/goldman-sees-financing-as-the-future-it-is-rearranging-itself-to-reflect-that-72a22cd7

[2] *Id.*

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