INVESTMENT BANKING

JULY, 2023

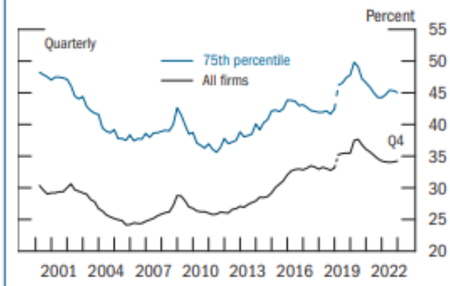
HIRING PROJECTIONS
Q3 & Q4

JACKSON | LUCAS

Mergers & Acquisitions Market

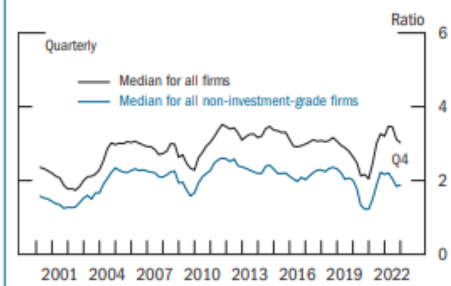
The first half of 2023 experienced a slowdown in M&A activity and a decrease in 50% of deals made as a result of changes in monetary policy. It is projected that mega deals are unlikely to happen in the second half of this year, but there has been interest expressed across various industries. Lower, as well as middle market deals are likely to occur due to monetary constraints and predatory mergers from larger firms, resulting in increased traffic on the smaller side. Tighter credit limitations will likely lead to businesses borrowing less debt, resulting in banks feeling increased pressure from the loss of revenue. With the elevated cost of capital, some smaller firms will be forced to merge. For those small firms using regional banks, uncertainty continues to loom from concerns regarding the latest bank collapses.

Figure 2.5. Gross leverage of large businesses remained at high levels



Source: Federal Reserve Board staff calculations based on S&P Global, Compustat.

Figure 2.6. Firms' ability to service their debt, as measured by the interest coverage ratio, was strong



Source: Federal Reserve Board staff calculations based on S&P Global, Compustat.

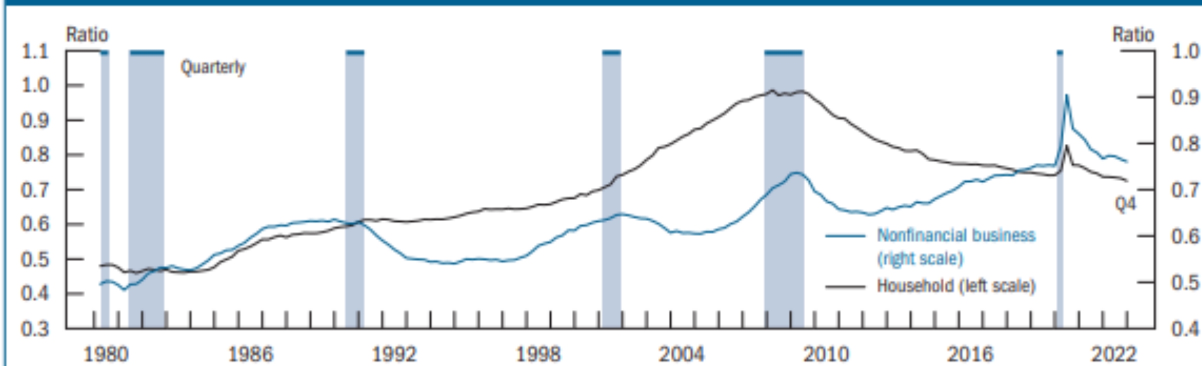
Further, lower valuations resulting from an increase in COGS and reduced profit margins could lead to businesses selling at steep discounts. It is projected that private equity shortfalls may also contribute to the slowdown in the M&A market, due to "cash-out" obligations.

Human Capital

A decrease in deal flow has resulted in a "rolling reduction in force" in the labor markets. These continual, selective cuts are creating a culture of anxiety amongst the Director and Junior MD-level employees. With these issues arising, we are seeing an emphasis on the protection of junior execution resources at the expense of junior origination professionals (e.g., Senior Directors and Junior MD's). This comes as a result of banks anticipating an uptick in deal execution in the second half of 2023. While larger investment banks continue to reduce headcount, we will continue to see selective hiring practices in other areas. Given the disruption of acquisitions at larger banking platforms, we will likely also see opportunistic hiring at the senior level. At the lower and middle market levels, however, an increase in hiring is projected for two reasons:

1. deal activity has not been as adversely affected as the larger and mega capitalized deals;
2. the disruption at the larger platforms enables smaller platforms to attract and hire senior talent out of the bulge bracket and elite boutique banks.

Figure 2.2. Both business and household debt-to-GDP ratios edged down



Source: Federal Reserve Board staff calculations based on Bureau of Economic Analysis, national income and product accounts, and Federal Reserve Board, Statistical Release Z.1, "Financial Accounts of the United States."

Risk, Sustainability, and Recession

Levels of geopolitical risks have decreased over the last six months, alleviating stress on the American consumer. At the moment, the economy is running on the cornerstone of American consumerism since the highest ever nominal increase in wages. We have had two consecutive quarters where GDP decreased, and the FED has forecasted one percent GDP growth in the near future, thus creating tension between American consumerism and the FED's quantitative tightening policy. Recent surveys show that although wage increases have not kept up with inflation, these increases have been beneficial in softening its impact. In the pre-pandemic era, 75% of households earning more than $100k had been putting aside cash for investments or contributing to their 401k plans; however, this number has since decreased. In addition, many households earning between $45K to $99K hold investments that have lost value by up to 40%.

It is important to note that although the labor market remains strong and some companies are showing a slight increase in profits, the cost of goods and other labor services are also still continuing to rise, offsetting those profit gains. Seventy-nine percent of companies have shown this trend during earnings season. The credit crunch is also likely to continue into late 2023 since Business Income-to-Debt GDP has slowed down. Businesses are decreasing their borrowing practices in reaction to increased interest rates, as corporate bond premiums continue to soar. According to the latest FED Sustainability Report, Real Estate valuations remain very high, thus creating stress among

Figure 2.3. Business debt adjusted for inflation declined modestly

Source: Federal Reserve Board, Statistical Release Z.1, "Financial Accounts of the United States."

the rental income and homeowner's markets. Given the strong labor market coupled with a slowing economy, we are seeing a middle ground territory that leaves the potential for a recession in limbo.

Resulting Projections

To conclude, despite the lingering uncertainty evidence suggests we are slowly shifting back to normalcy in the market. Historically, and as we have already begun to witness, middle and lower middle market M&A hiring will be the first to recover. Hiring has increased at the lower middle market level across multiple sectors and is starting to pick up at the mid-to-upper middle market levels as well. Most hiring increases in the area of market capitalization are taking place at the advisory, non-balance sheet platforms. For the most part, this is because they do not possess a lending apparatus and usually run leaner in headcount and bureaucracy.