Are We Back to 2007? (Third of a series)

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“What’s the definition of an overheated market? One loan and two lenders.”

That’s the supply/demand conundrum in the leveraged loan market today. While institutional and retail cash have certainly re-entered the asset class with vigor since the credit crisis, overall levels are not more than those enjoyed during 2007. Indeed, the short-term outlook might see less capacity than those heady days, not more.

The problem, as one market veteran told us, is not too much cash. It’s too few deals.

The source of muted LBO volume is an enduring mystery. Is it wariness of private equity sponsors to pay up for properties in the face of continued tepid economic growth? Is there more GP focus on add-ons and platform formation? Or are cash-rich strategics simply outbidding sponsors?

A casual glance at the data shows several contrasting trends. New LBO activity since the credit crisis (see our *Chart of the Week*) is certainly modest relative to the soaring volumes immediately before the crisis.

Indeed, for the four years leading up to, and including, 2007, volume totaled $891 billion (courtesy S&P/LCD). For the four years up until 2014, that number was only $453 billion.

The story on overall new-issue leveraged lending, however, is more robust. If you include add-ons, dividends, and new money amendments, the corresponding pre-crisis activity was $1.55 trillion versus $1.67 trillion from 2010-13.

But in terms of “fresh meat” for hungry funds, non-LBO deals tend to favor existing lenders who can easily increase their exposures with significantly less underwriting work.

What really drives demand is a supply of new buyouts, which only comes from sponsors deploying committed capital. That deployment has come slowly relative to GP fundraising from LPs since 2006. The difference between committed and invested capital – the so-called ‘PE overhang’ – stands at $486 billion, according to PitchBook.

That’s a lot of dry powder sitting on the sidelines.

We’ll examine that overhang more closely in future columns. What’s significant is comparing $486 billion with the cumulative deployment of sponsor equity for LBOs since 2000. Per our *Chart*, that number is $539 billion, or roughly $37 billion annually.

At that rate it would take *thirteen years* to use up all the dry powder held by sponsors. Of course, that capital will also go to add-ons, platform creations, and pure growth investments. But those provide fewer opportunities for new lenders than new buyouts.

Still, exits from the industry’s high-water mark of LBOs in 2007 should buoy activity in the form of sponsor-to-sponsor buyouts. That can’t help boosting lenders’ deal pipelines.

Next week, we wrap up our series by comparing deal structures – then and now.