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Smooth Sailing

THE LEAD | July 30, 2019

"How do you come up with all the ideas for your columns?" That's a question we frequently hear from readers. Our answer is that we don't have to come up with them. They present themselves all week, every week. We just watch and listen.

Take this week. End of July often involves water-related activities. For us it was a cruise with a friend around Greenwich Harbor in his Grady-White Freedom 275.

Seeing docked super yachts, we wondered: *Which hedge fund chief owns that one?* Scanning names as we chugged by – *Utopia*, *America II* – one caught our eye. We did a double-take. But there she was – all 22 unadjusted meters of her – the name proudly emblazoned on the port side: "*EBITDA*."

Of all the waterfront locales in the U.S., Greenwich probably has more boaters who could appreciate the irony of that moniker.

Which got us to thinking about where we are one-third of the way through the third quarter. As expected the Fed eased rates yesterday by 25 bps, the first such move in over a decade. To spark an economy that has boosted the US stock market to all-time highs, set GDP at a steady, if unspectacular, 2.1%, and pushed the GDP price index to 2.4%.

Managers of private credit and private equity meanwhile have grown accustomed to this seemingly endless issuer-friendly market. Lower rates may push off the prospects of an imminent recession. That's overall good for credit, but can be a challenge for equity.

"It's been a tough year," said the partner at a West coast sponsor. Meaning the climate of sky-high valuations. Tough if you're trying to put money sensibly to work. But if you're a seller, it's a tough year to beat.

That froth is being leveraged by bankers in ways that are sometimes counterproductive, according to sources. "You're hurting the process if you set purchase price expectations off Year Four *pro forma* ebitda," said one buyer. "Lenders get spooked because they'll be laughed out of credit committee."

At a recent roundtable, direct lenders offered up various themes on today's market. Headline spreads for middle market deals have stayed range-bound this year. First-lien term debt for a good issuer remains L+450-475 bps, with unitranche roughly 100 bps north of that.

Senior leverage, while very much deal dependent, has been in the 4.0-4.5x arena; total leverage is 5.0-6.0x, and 6.0x and higher for the larger middle market. Unitranche leverage has been tracking the same metric as total leverage for those same issuers.

Where lenders have become increasingly focused and concerned is weak structures. As we highlighted in our special series on "covenantive easing," with stretchier baskets and looser ebitda definitions, you may end up with a very different risk than you thought.

Yet for the moment, the amount of dry private capital powder continues to buoy direct lending. So with few exogenous bubbles identified, expect financing conditions for the rest of the year to be constructive.