THE LEAD
https://theleadpc.com/deal-no-deal-first-of-a-series/

Deal, No Deal (First of a Series)

THE LEAD | October 16, 2019

"I left it right on the piano bench. Now I can't find it!" Our daughter's flute instruction book had somehow vanished or walked off on its own. Her father is notified of this catastrophe three minutes before she is to be dropped off for her 7:30 a.m. lesson.

Well, when was the last time you saw it? we demanded, dashing around madly, opening every conceivable drawer and closet in the house. "July," she answered.

Alas, time stands still for no lost thing, woodwind or otherwise. Take loan syndications deal flow. According to Refinitiv, both large cap and middle market volume was off, 28% and 14%, respectively, for the quarter just ended.

Similarly, 3Q midcap LBO activity slumped. Refinitiv's numbers show buyout volume declined 13% over 2Q, with the actual number of deals falling to 83 from 104.

Digging into the numbers, it appears that total sponsored loan volume, including refis and dividends, was relatively flat at $35 billion. Of that total, the direct lending share represented $21 billion, and syndicated loans, $14 billion.

What's behind this listless performance? Over the next few weeks, we'll try to answer that question. But first let's see if we can get behind some of the deal flow drivers.

No question there's been a staggering amount of private equity dry powder raised – well north of $500 billion. But middle market PE fundraising softened in the second quarter, per PitchBook. They report $41 billion raised for 1H 2019, compared to $97 billion for all of last year. And the fund count was only 39 vs. 111 for full year 2018.

PitchBook also reports fund size is growing while the middle market as a percent of the overall is shrinking. Less than a quarter of all funds are sized less than $1 billion. Nevertheless, it appears big PE is increasingly deploying dollars downmarket.

A recent FT article highlights this trend. While large deals like EQT's buyout of Nestle's skin health unit make headlines, other transactions have fallen apart. Examples cited include Apollo's $15 billion bid for Arconic. Blame it on continued uncertainties in the economy and a cloudy global trade outlook.

Yet the problem remains for sponsors: how to grow companies when the background radiation of GDP is registering at only 1-2%? Add to that the fact that good companies, even barely good companies, are commanding sky-high purchase price multiples.

This challenge is compounded by a reluctance of founding owners to sell their businesses in the midst of confusing cross-currents, particularly those with overseas trading exposures. And going public is not a great option at the moment, as recent high-profile IPO flops have demonstrated.

In this environment, smaller deals are easier to get done. As one analyst put, they come with “less risk to capital.”