The Value Props

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We typically dedicate the new year's first issue to reviewing the year gone by. Unfortunately when we emerged from the holidays, 2020 seemed lost in a fog of masks, sanitizers, and Netflix bingeing.

Two items in December did manage to penetrate our consciousness. First was an opinion piece from our content partner, Creditflux. Fellow columnist and top credit manager, Tom Majewski, wrote: "[2020] will represent the Credit Suisse loan index's 27th year of positive total returns in its 29 years of publication."

An impressive statistic, we thought. Hard to imagine any asset class matching that consistent performance over time, particularly through a pandemic year.

The other item was a superb credit webinar, courtesy Lincoln International's Valuations and Opinion Group. Topics included COVID's impact on terms, structures, and valuations. Their data, gleaned from over 1600 portfolio companies spread among over 100 investment fund clients, are a strong proxy for private credit behavior:

Public markets: The major indices rebounded smartly from 1Q 2020 lows, supported by early and strong Fed liquidity, then good news on COVID vaccines. Despite worries at the onset of the crisis, 76% of the S&P 500 met or beat Q3 guidance.

Sector performance: Various performance data underlined as-expected valuation advantages for less COVID-impacted industries such as tech, healthcare, and business services. The losers remain energy, consumer discretionary, and real estate.

Enterprise values: The "better" companies are pushing multiples above the previous high watermark at Q4 2019 of 9.8x ebitda to 10.4x at Q3 2020. That includes a total debt multiple of 5.2x.

Amendments: During Q2 and Q3 Lincoln observed 325 credit agreement amendments among its portfolio companies. Top three most popular changes affected covenant thresholds, holidays, and pricing. Roughly 15% of companies busted at least one covenant during the period.

Market indicators: Loan spreads and secondary bids are approaching pre-COVID levels. Also mounting a come-back are hold levels, cut in half in the midst of the crisis last summer. Similarly, revolver draws continue to witness repayments.

Leverage and pricing: Using unitranche financings as a example, Lincoln estimates leverage crept back to 5.5x ebitda, compared to 6.0x in 1Q 2020. Unitranche pricing has also contracted about 100 bps to L+550-700 bps from its mid-year highs.

Volatility: Finally, as our *Chart of the Week* reprises, values in Lincoln's proprietary database showed significantly less volatility than the LPC 100 broadly syndicated loan index. The lower correlation of private credit is even more pronounced if you consider the intra-quarter BSL low on March 23 of 77.9%. Hard to find a better test of asset stability.