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Back to School Issue

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With the unofficial end of summer almost upon us, we thought it would be appropriate to take a look at what's in store for the loan markets in September.

First, let's examine total deal volume. Thomson Reuters LPC reports that year-to-date middle market LBO activity is on track relative to last year: $10.7 billion vs. $13.4 billion for the full three quarters in 2014. Large cap volume is lagging last year more significantly ($35 billion so far vs. $60 billion through 3Q 2014), thanks to a busy 2Q that skewed last year's numbers.

The total pipeline of institutional loans on the docket for both middle market and broadly syndicated loans is on par with last year's pre-Labor Day metrics, at $50 billion. That number was down, though, from a multi-year high of over $80 billion in the pipe earlier this summer.

Now let's turn our attention to pricing. At the latest measure, LPC shows middle market all-in yields up slightly so far for 3Q at just under 6.25%, from around 6% the quarter prior. This has been consistent, give or take, with reported yields over the past three years.

Steady as well has been the middle market premium – the additional yield mid caps enjoy over large cap issues – which today stands at 112 bps. This number has been as low as just under 70 bps a year ago, and over 200 bps back in 1Q 2012.

As we've discussed in other columns, pricing for smaller deals, unlike their broadly syndicated counterparts, tends to be driven less by technical concerns such as retail fund flows, and more by the competitive dynamics among middle market arrangers. Nevertheless, both markets will see a positive impact to yields if deal volume comes out strong in September.

On the leverage front, after two quarters that demonstrated close adherence to the Fed's Leveraged Lending Guidance, middle market arrangers have come out with LBOs that averaged close to 6.5x total debt/cash flow. The good news for lenders is that private equity sponsors are also contributing high levels of cash equity. LPC indicates almost 55% of the capital structure for buyouts so far this quarter was comprised of GP equity. That's up smartly from just over 40% only nine months ago.

Interestingly, purchase price multiples for middle market buyouts (10.46x) exceeded those of their more liquid cousins (10.16x) for the first time in over a decade, demonstrating the keen competition for good mid cap companies. LPC highlights a small data set that seems to be driving these stats, including two outliers that weighed in with over 15x multiples.

Finally, middle market investment banks report a frothy period of deal bidding this summer, which could lead to a healthy flow of new loan activity through the end of 3Q and beyond. Certainly strategic corporates flush with cash have been active buyers of properties at auction, but anecdotal evidence suggests that at least 50% of total deal activity has been sponsor driven. If true, that's certain to keep middle market investors busy as they return from the summer break.

From the Editor: The Lead Left will be on its annual August break and will return the week of September 7.