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Where’s the Deal Flow? (Second of a Series)

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Last week we discussed the views of various private equity sponsors regarding the question of why the pipeline of middle market leveraged loans seems soft. Over the past several weeks, we’ve also had conversations with a number of key middle market debt arrangers and lenders. Their consensus mirrors that of the PE firms – deal activity reflects the kind of origination platform each player possesses.

For the top tier arrangers, deal flow seems to be down due to intense completion among these providers to underwrite lead transactions. With a paucity of new LBO activity in the first quarter, in order to lead a refinancing or recap a competitor has to take the deal away from the original lead arranger – a difficult proposition.

For middle market loan buyers relying on deal flow from the syndicated loan market, the environment is challenging. At the lower end of the broadly syndicated market (issuers with Ebitda around $100 million) and at the upper end of the syndicated middle market ($50-100 million Ebitda), these firms compete with CLOs, retail loan funds, high yield funds and other institutional investors who are hungry for paper.

The typical outcome today, particularly with the more sought-after credits (what else should you invest in?), is that most investors will receive a very small allocation for their commitment. In many cases, this means significantly less than $10 million. It’s hard to build a decent book of loans, one lender told us, on “one-sies” and “two-sies.”

On the other hand, players in middle market club deals are having better success in seeing decent loan volume. This is especially true for those firms with strong private equity relationships and the ability to hold larger tickets. Sponsors are increasingly foregoing loan syndications to club up deals amongst their trusted debt providers.

The CEO of a leading middle market finance company told us recently that deal volume was certainly off market-wide in the first quarter, but that the smaller end of the middle market continued to show strength. “We are seeing good flow from our key sponsor relationships for issuers below $20 million in Ebitda,” he reported.

Another senior middle market manager told us to dig deeper into the loan market statistics. “Some of the data out there is misleading,” he said. “If you normalize activity by stripping out re-financings and recaps, and just focus on new LBOs, it’s probably not as bad as it looks.”

With that in mind, take a look at our *Chart of the Week*. Yes, new mid cap LBO volume held its own for most of 2015, but buyout loans did take a real hit in the first quarter.

Interestingly, add-ons represented a greater share of M&A related loans (41%) than for any quarter since 3Q 2013. Expect a future column to cover this trend.

Next week we conclude our series by examining PE multiples and exits, and whether they will contribute to improving middle market loan volume.