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Canards in the Coal Mine

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According to the National Retail Federation some 150 million US adults will "participate in Halloween-related activities." Digging deeper into the data, 53% will decorate their homes, 46% have pumpkin-carving plans, and 18% will "dress up their pet."

Recognizing some animals are more receptive to costuming than others, having one in five Americans squeezing Fidos into pumpkin outfits seems more trick than treat. Nevertheless we are encouraged that families are leaning into the second-costliest holiday in terms of dollars spent.

Putting cash to work is also much on the minds of private credit and private equity investors. With 60 shopping days until year end, the appetite for yield remains keen.

This leads some observers to fret about market conditions getting frothy again. "Aren't you worried lenders will get too aggressive" one journalist inquired this week. "Or that too much capital is being raised again for private credit?"

Let's look at some stats. Refinitiv LPC published their 3Q 2020 Middle Market Sponsored Private Deal Analysis last week. Their data showed sponsor volume of $18.3 billion, returning from the dismal second quarter levels of $10 billion. But that pales in comparison to the $36 billion reached in 3Q 2019.

Even more anemic was midcap buyouts. Only $3.3 billion of LBO activity was recorded last quarter, the same as 2Q. Add-on acquisitions, unsurprisingly given the environment, outnumbered buyouts two-to-one; again, well below pre-COVID.

Similarly there's little froth evident in valuations. As our *Chart of the Week* shows purchase price multiples are down across the middle market in the crisis. For the first time since 2017 issuers with ebitda below $20 million fell below the 10x ebitda mark.

But even these metrics are misleading. As averages, valuations represent a blend between the "haves" – COVID-friendly businesses going for higher multiples – and the "have-nots" – whose prices have been flattened this year.

With middle market financing activity down, don't these supply/demand dynamics favor issuers? Not all lenders can be aggressive, given the underperformance of some portfolios. Also, the persistence of virus risk has induced arrangers to lower holds to half of January's levels. That drains liquidity from the direct lending ecosystem.

Finally, with M&A processes demanding faster executions, sponsors are tightening their circle of trusted lenders. So rather than a more crowded space, traditional senior middle market sponsored transactions are involving fewer, more capable relationship providers.

We'll see how the rest of the year plays out, but it's bound to be a bumpy ride. One homeowner spoke for many with a big **"2020"** on his front lawn, next to a sign that read: **"It was the scariest thing I could think of."**