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2020: A Year of Surprises (Last of a Series)

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We conclude our special series, “Five Biggest Private Capital Surprises of 2020,” with:

Surprise #5: The M&A Big Bang

Last July we published a white paper (see “COVID-19 and M&A Activity”) showcasing conversations with leading middle market investment bankers. They reported distinctions between businesses hit by the pandemic and those depending less on the consumer showing up in person.

The “haves,” they told us, could be sold at Ebitda multiples exceeding pre-virus levels. The “have-nots” would be challenged to transact at any price.

Besides logistical challenges (“Few sponsors will invest in any new platforms without personally meeting management”), there were worries about second and third infection waves. “We’re expecting a light second half,” one banker told us. Others thought tax concerns would drive selling decisions, with accumulated sponsor dry powder providing the engine.

The latter proved correct. Overall US M&A activity (per White and Case) rose to almost $400 billion in 3Q, from less than $300 billion the previous quarter. It ended 4Q at around $475 billion, a bit higher than 4Q 2019.

In early August private credit managers began to see a swift rebound in healthcare, technology, and business services. Private equity sponsors had plenty of cash, and after five quiet months didn’t want to show LPs a goose egg year.

As monthly performance for the haves improved, the deal surge accelerated. Private credit arrangers with deep pockets and relationships found familiarity breeds repeat business. “You’re comfortable with our docs,” one sponsor told us. “It’s makes doing the next deal a lot easier.”

It’s true some cyclicals like energy and financials showed impressive value restoration from the second quarter to year-end. But investors in those sectors had a roller-coaster ride. More stable were healthcare and technology. By Ebitda growth, those sectors (as components of Lincoln’s portfolio) were up 4.8% and 3.5%, respectively, for 2021 vs. 2020.

With 2020 hindsight private market participants saw how unprecedented and pervasive the pandemic turned out to be. And how disconnected infections became from the overall markets.

But private capital investors discovered how a year that looked like it would be a total wipe-out, ended up being very constructive indeed.