Private Equity International
PE firms curb use of leverage in 2015 – study
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"The amount of debt PE firms borrowed in 2015 in the US fell by nearly 29%, while debt ratios for Q4 dropped to their lowest level since 2011.

The amount of leveraged loans private equity sponsors borrowed in the US in 2015 fell by 28.7 percent to $284.8 billion from $399.4 billion in the previous year, according to Thomson Reuters' US lending report.

Of the total amount they borrowed in 2015, only $73.37 billion was used to fund new buyouts. The remainder financed other activities such as loan refinancing and dividend recapitalisations.

For the fourth quarter of 2015, private equity investors borrowed $13 billion to fund buyouts, down from $21 billion for the same period a year ago. In the fourth quarter of 2015, they also borrowed $29 billion to finance other activities, according to Thomson Reuters data.

Buyout-related leveraged loan issuance peaked at $210 billion in 2007, while borrowing for other activities peaked at $439.7 billion in 2013, according to Thomson Reuters data.

Debt ratios also fell last year. In the fourth quarter of 2015, the average debt ratio in buyouts was about 5.6x debt to earnings before interest, taxes, depreciation and amortisation (EBITDA), the lowest since the fourth quarter of 2011. The average ratio in the third quarter was 6.2x debt to EBITDA while in the fourth quarter of 2014 it was 6.5x, the report said.

"LBO leverage levels have fallen below 2006 and 2007 peak levels, but still remain high historically," Ioana Barza, director of analysis at Thomson Reuters Capital Markets Insight, who authored the report, told Private Equity International

Investor selectivity and a volatile market backdrop coupled with banks adhering to Leveraged Lending Guidance resulted in leverage levels on large buyouts tightening in the fourth quarter.

"There is tightening with Leveraged Lending Guidance where they [bankers] have to adhere to 6x total debt to EBITDA level," Barza said. "But regulators are looking at amortisation and ability to repay your debt; they are looking at metrics other than just 6x. All these factors have an impact in general on leverage tightening."

The report found that the share of large buyouts levered 7 times EBITDA or more fell to 13 percent in 2015, down from 26 percent in 2014 and 39 percent in 2007. The share of deals levered 6 times or greater ended the year at 57 percent, down from 60 percent in 2014.

Z Capital president and chief executive Jim Zenni agrees that debt ratios remain high considering the softening in the debt markets that took place in late 2015.

“With the credit market shifting in the fourth quarter, the landscape changed dramatically,” he told PEI. “Our assumptions on financing a deal four months ago were different than they are today.”

That being said, “there is a lot of capital chasing deals and there’s a bit of disconnect between the multiples and where the debt markets are,” he added, citing the mid- to low-90s in average leveraged loan pricing today that was over par six months ago. “The silver lining, if there is one, is that there’s a ton of money on the side.”

Zenni said that acquisition multiples in the buyout market are still 9x, 10x or 11x EBITDA, thanks to some $1.3 trillion in dry powder and strong realisations in investments, which fund advisory Palico found resulted in $392 billion of distributions to LPs in the third quarter of 2015.

But it doesn’t mean investors can breathe a sigh of relief, he said, citing the oil price slump that could result in significant asset write-downs and ripple effects of such a downfall: funds owning investments from previous years in these credits will have to deal with major losses and defaults, he said.

Overall, US syndicated lending fell 6 percent in 2015 to $2 trillion, driven by a drop in leveraged loan issuance that fell 17 percent to $783 billion in 2015, the second consecutive year of a downward trend since the $1.13 trillion record in 2013, according to Thomson Reuters report.