January 31, 2014

Acquisition Financing: the Year Behind and the Year Ahead

Following a robust 2012, the financing markets in 2013 continued their hot streak. Syndicated loan issuances topped $2.1 trillion, a new record in the United States. However, as in 2012, financing transactions in the early part of 2013 were devoted mostly to refinancings and debt maturity extensions rather than acquisitions. In fact, new money debt issuances were at record lows during the first half of 2013. The second half of 2013, though, saw an increase in M&A activity generally, and acquisition financing in the fourth quarter and early 2014 increased as a result.

Investment Grade Acquirors

Debt markets have been friendly to investment grade issuers, with strong demand allowing companies to optimize their capital structures, reduce their financing costs, and do deals – investment grade mergers and acquisitions lending was up 68 percent in 2013 to a record $133 billion. Critical to the confidence of even the highest-grade issuers in entering into large transactions has been the ongoing ability to obtain committed bridge financing in record-breaking amounts. Most notably, Verizon entered into a $61 billion bridge facility with JPMorgan, Morgan Stanley, Bank of America and Barclays in connection with its acquisition of Vodafone's interest in Verizon's wireless business. Other recent examples include the $12.5 billion bridge facility from J.P. Morgan and Barclays to backstop ThermoFisher Scientific's acquisition of Life Technologies, the $4.75 billion bridge loan commitment from Goldman Sachs to Sysco to help Sysco fund its acquisition of U.S. Foods and the $1.3 billion bridge loan commitment from Bank of America to Cardinal Health to finance its acquisition of Assuramed.

Spurred in part by the prospect of rising rates, investment-grade firms sought to, and were able to, complete very large bond offerings and permanently finance strategic transactions at historically low yields. In April, Apple issued $17 billion in bonds, setting the record for the biggest ever investment-grade corporate bond deal in the U.S., which record had previously been set by AbbVie, a spinoff of Abbott Laboratories, just the year before. Then, in September, Verizon raised the bar again by completing a $49 billion bond offering to finance the Vodafone transaction.

Leveraged Acquirors

2013 also saw sustained strength in the non-investment grade financing markets: Leveraged debt issuance (including both bonds and bank debt) was almost $1.5 trillion (as compared to 2012's then-record $991 billion), and issuers had great success, in particular, in refinancing existing debt and financing dividends. Private equity sponsors obtained $530 billion of leveraged loans in the U.S. alone (another record), yet only 17 percent of that amount supported buyout activity. Nonetheless, in a few cases, sponsors sought and obtained very large acquisition financing commitments. In February, Michael Dell and SilverLake combined to obtain a $13.8 billion financing commitment to fund their buyout of Dell Inc., and J.P. Morgan and Wells Fargo committed to provide $14.1 billion of new debt financing for Berkshire Hathaway's and 3G Capital's acquisition of H. J. Heinz Company; in May, affiliates of Bain, Golden Gate and other private equity sponsors obtained a $6.2 billion commitment to fund their acquisition of BMC Software; and in December, MacAndrews & Forbes-backed Harland Clarke obtained a $1.4 billion commitment to back its acquisition of Valassis Communications. Outside of private equity, in July, Activision obtained $4.75 billion in commitments to fund its repurchase of stock from Vivendi and CBS just this week consummated $2 billion in high yield financing for its to-be-separated outdoor business segment.

Strong demand for yield among debt investors has continued to afford issuers considerable bargaining power when structuring and pricing new debt issuances, especially relative to floating rate loans, prized as a hedge against rising rates as the Fed begins this month to pull back on its own bond-buying program. Covenant-lite leveraged loans—term loans and revolvers with limited or no financial maintenance covenants—as a percentage of total institutional loan volume continued to rise in 2013, surpassing 2007 levels. In the absence of financial maintenance covenants, borrowers did not hesitate to push for high senior leverage levels, and the market obliged: 2013's senior leverage of 4.7 times surpassed 2007's 4.4 times. Moreover, PIK toggle note issuance reached $10 billion, the highest since 2008, including the first PIK toggle issuance by a company other than a passive holding company since the financial crisis.

Even so, banks also generally remain mindful of the market volatility of recent years. As a result, obtaining long duration commitments (more than six months) and stretching into higher leverage levels to finance acquisitions often came at the expense of ticking fees and some key "flex" terms—that is, the ability to change specified terms of the financing in order to achieve a successful syndication. Further, the joint guidance of the Fed, Treasury Department and FDIC on leveraged lending (which flags 6x total leverage as "rais[ing] concerns"), combined with concerns about capital requirements (already making themselves felt in the revolving loan market), is casting a shadow on the new year. Nevertheless, the acquisition financing market seemed to strengthen across all ratings classes as 2013 came to a close, with no signs of abating in the opening weeks of 2014. Continuing core demand for yield and floating-rate paper should provide fuel for an active year in deal-making.

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