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Slower deal activity set to sap bond sales

M&A deal volumes have fallen by more than a fifth so far this year compared with 2015

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A slide in takeover activity looms over corporate bond markets after a brisk start to the year, posing a challenge for portfolio managers who have been buoyed by a flood of fresh capital as foreign investors search out higher yielding securities.

While those flows have sharply lowered the cost for companies to issue new debt, portfolio managers are braced for a decline in bond supply as merger and acquisition activity has cooled.

M&A deal volumes have fallen by more than a fifth so far this year compared with the same period in 2015, as political uncertainty in the US and UK as well as market volatility has hit executives' confidence to strike new deals.

Blockbuster $10bn plus debt offerings from Anheuser Busch, Dell and Aetna — to finance takeovers announced last year — have buoyed issuance in the US investment grade corporate bond market, which is running just below its record 2015 pace.

However the backlog of transactions that must still be completed has slimmed. Bond sales often lag a merger announcement by at least six months, suggesting a drop in activity later this year. Sales of high yield bonds, which have bounced back after a lull in January and February, are on pace for the slowest first half since 2010, according to Dealogic.

"There isn't a whole lot on the forward calendar, at least in high yield" said Darren Hughes, co-head of high yield at investment manager Invesco. "There are a handful of billion dollar deals, a handful of M&A, but the big complicated deals are done."

The downdraft has been magnified by the rise in importance of acquisition-related financing to underwriters. Twenty-two per cent of corporate bond sales in 2015 and 2016 were earmarked for takeovers, up from less than 12 per cent in 2014.

One of the few marquee deals investors are already eyeing is a bond sale to fundMicrosoft's $26bn purchase of LinkedIn.

"Mega deals tend to come to the capital markets while the smaller bolt-ons are sometimes funded by cash," said Jennifer Powers, co-head of investment grade debt capital markets at Mizuho. "Some of that drop off would have never made it to our market."

Debt sales have also slowed in the lead-up to the UK referendum on EU membership, a trend that Ms Powers added could reverse if companies pull-forward financing needs ahead of the US election in November.

"We are looking at the run-up to the election as being a 'let's take our chips off the table and get our financing needs done before the election'," she said. "I have had three calls with CFOs this week talking about how they need to get the remainder of their financing done ahead of the election."

Dealmakers are split on whether M&A activity can be reversed in the second half of the year. Barely any bankers expect overall deal volumes to top 2015's all-time record with $5tr worth of transactions.

"There has been a meaningful pick up in M&A dialogue after a slow start to the year," said Anu Aiyengar, JPMorgan's head of M&A in North America. "Confidence is much stronger since mid-April as executives believe the debt and equity markets are stronger and Chinese buyers continue to eye opportunities in the US market."