THE WALL STREET JOURNAL

M&A Bankers Saying No to More Junk

Banks retreat from the lucrative but risky business of backing debt-heavy buyouts

By **MATT WIRZ**, **LIZ HOFFMAN** and **EMILY GLAZER** Updated March 21, 2016 6:30 a.m. ET

Banks are increasingly turning down companies seeking financing to pay for debt-laden takeovers after the recent market rout left them saddled with debt from earlier deals.

Credit Suisse Group AG, Jefferies Group LLC and Wells Fargo & Co. are among the firms turning down new requests for financing—typically from low-rated companies—as they retreat from the lucrative but risky business of backing debt-heavy buyouts, people familiar with the matter say.

Banks guarantee the funding in these deals, hoping to then offload all or most of it to bond and loan investors. They promise to provide the money themselves if they can't find others to buy the debt. But as markets swooned in the months since the summer, investors have lost their appetite for the riskiest securities, making them harder to sell.

Some banks have unloaded the debt at discount prices, taking losses, while others are holding the loans in hopes of getting better prices later, which ties up bank capital and can hurt profitability. Banks were left with at least $1 billion in debt on their books over the past 12 months, according to banks and analysis by The Wall Street Journal.

With banks less willing to underwrite the most leveraged loans, the flow of new takeovers has slowed. U.S. mergers and acquisitions announced this year have fallen 21% from a year earlier to $229 billion, according to data from Dealogic. The pullback has made it hard for private-equity firms, which use a lot of debt in their takeovers, to get deals done. Those that are getting done, many are built to minimize junk debt, or debt rated below investment grade.New junk-bond sales are down 70% this year.

Banks including Wells Fargo and Jefferies have also started cutting the number of finance bankers in response.

"Some banks that have exposure from deals last year are being quite careful," said Byung Choi, co-head of the finance group at law firm Ropes & Gray LLP.

The trend is favoring corporate buyers with lots of cash on hand. On Sunday, Sherwin-Williams Co. and Valspar Corp. announced a $9.3 billion all-cash merger.

While junk bond prices have rebounded in a broad market rally, debt-financed M&A and new sales of high-yield debt have yet to pick up. Banks still remain cautious about making new loans and are passing on big deals that would burden companies with debt far in excess of earnings.

Still, Wall Street could recover its lending appetite if the rebound in junk debt markets that began in late February continues, making new buyout loans easier to sell. And the hiccups are mainly in the market for junk-rated deals.

Demand remains strong for debt backing blue-chip deals, such as the [$46 billion of investment-grade bonds sold] in January backing Anheuser-Busch InBev NV's pending purchase of rival brewer SABMiller.

In February, Credit Suisse passed up the opportunity to arrange almost $5 billion of loans for [Apollo Global Management LLC's purchase of security-alarm company ADT Corp.], which is expected to close in June, people familiar with the matter said.

The decision drew attention on Wall Street, because the Swiss bank has typically been active in leveraged finance. Other banks stepped in to provide the financing.

Credit Suisse feared that the deal could fall apart if ADT's credit rating were downgraded in the months before the acquisition was completed, a person familiar with the matter said, triggering the need for even more debt financing. While a downgrade is unlikely, Credit Suisse decided the risk of losses from selling so much debt under current market conditions was too high, the person said.

It isn't just Credit Suisse. Banks across Wall Street are becoming less willing to finance riskier takeovers. It is a turnaround from the past few years where record junk bond sales and soaring stock prices helped drive a mergers boom.

Regulators are playing a role, too. Federal bank regulators in general have cracked down on loans that would saddle companies with debt that exceeds six times their annual earnings.

The retreat is notable, because with trading businesses under pressure from crisis-era laws, advising on and financing acquisitions is one of the most profitable areas left to investment banks.

Banks collected a record $5.4 billion in fees from buyout loans in 2015, according to consultancy Freeman & Co.

Banks still have tens of billions of dollars of debt to sell for announced takeovers, such as Western Digital Corp.'s $19 billion purchase of SanDisk Corp. and Dell Inc.'s $67 billion buyout of EMC Corp.

In November, a group including Bank of America Corp., Morgan Stanley, UBS Group AG and Jefferies struggled to sell about $5 billion of loans and bonds they had guaranteed for Carlyle Group LP's $8 billion buyout of Symantec Corp.'s Veritas data-storage unit, according to people familiar with the matter. Investors balked at buying the debt after Veritas reported a sharp decline in quarterly earnings, the people said.

Carlyle ultimately renegotiated the deal in January at a price about $1 billion lower. Even so, the banks have yet to sell the loans and would face a loss of at least $250 million if they tried to unload the debt in current market conditions, bankers say.

A syndicate of banks led by Credit Suisse and Deutsche Bank AG has sold debt backing the purchase of Kraton Polymers at a loss of about $90 million over the past six weeks, the banks say. Discounted sales of loans for the buyout of department-store chain Belk Inc. have cost firms including Morgan Stanley, Bank of America, Credit Suisse and Jefferies about $100 million, they say.

Wells Fargo, the third-biggest provider of so-called leveraged loans, has sidestepped most troubled buyouts, but the bank has still scaled down underwriting of debt-heavy takeovers and has fired more than a dozen leveraged-loan bankers over the past six months, according to people familiar with the matter.

The move follows pressure from regulators and losses on loans it made to energy companies now in distress, the people said.

Late last year, Wells Fargo decided not to lead the financing for Nexstar Broadcasting Group Inc.'s $2.1 billion pending takeover of Media General Inc., people familiar with the matter said. It later came back to the table, taking a much smaller piece around 10%, these people said.

Broker-dealer Jefferies' buyout lending business has grown quickly over the past few years. Now that expansion is backfiring following turmoil in the junk-bond market that has forced Jefferies to sell buyout loans it made at large losses.

In February the firm fired two of its senior investment bankers responsible for buyout lending and has been laying off more-junior employees, according to people familiar with the matter.

The personnel changes "were implemented to better serve clients and enhance Jefferies' business with a view to the recovering market," a Jefferies spokesman said via email.

Corrections & Amplifications

Byung Choi is co-head of the finance group at law firm Ropes & Gray LLP. An earlier version of this article misspelled his name.

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