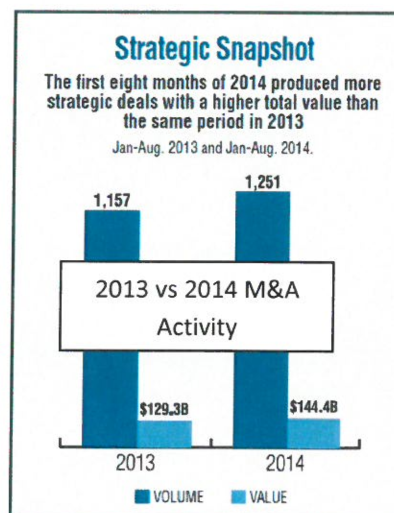
Are You a Scaredy Cat CEO?

What's Driving Growth in M&A Deal Financing in 2014?

By Rick Andrade Oct 2014

For some it's a new day, for others the smell of fear lingers on more than 7 years past the Great Recession when life changed in America. Back then the pace of global M&A was approaching $4 Trillion, today it's half that. But like all cycles long or short things come back around and when they do, it's no time to hide behind a pumpkin in the dark.

According to Mergers & Acquisitions News, many fearless middle market CEOs in the U.S. are indeed pulling the trigger on new M&A deals in 2014, and they have the numbers to prove it. More than 1,250 new deals thru August topped last year's 1,157 by 8%. And the total value of these deals exceeded 2013 figures by 12% topping $144Bil so far this year. But it should be better. So what's behind why so many CEOs are still afraid of the dark?



In 1923 University of Oxford Professor of Psychology George William Humphrey noticed a pattern interrupter in the way humans think and coined it "Humphrey's Law." The Law is simple, it states "...that consciously thinking about one's performance of a task that involves automatic processing impairs one's performance of it." The typical application is in understanding athletic performance, but elsewhere like in many U.S. Boardrooms it's called "analysis paralysis." And despite evidence of an improving US economy, an improving labor market, the wealth effect from lower oil & gas prices headed into the 2014 shopping season, and a dozen other positive economic reports this past year, there still lingers far too many Scaredy Cat CEOs lurking in the shadows that should know better.

Private Equity deals turning up the heat

One reason for the hold-back used to be getting the financing to close a deal. That's changed. Lending restrictions have loosened significantly in the past year and for many CEOs who see the opportunities ahead there's no better time to make a deal. Leading the pack is Private Equity owned companies who recognize the low interest

Total Debt/EBITDA (TTM Adjusted)

Debt Structure	2013	2014 1H
Uni-tranche	3.3x	4.8x
Senior Debt Only	2.9x	3.2x
Senior & Subordinated Debt	3.7x	3.8x
All deals	**3.4x**	**3.8x**
N =	123	62

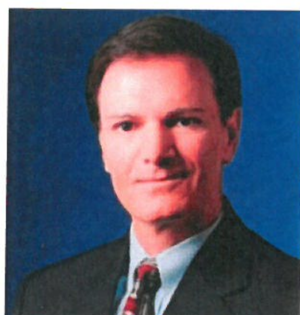
Source: GF Data

rate lending environment is just what the doctor ordered, an ability to fund a new deal at a low enough cost of capital to heat things up (See my recent CEO Magazine article: *The M&A Market Is Heating Up. Is the Time Right to Make a Move?* And not since 2007 has the cost of capital available for M&A deals been as affordable. The support comes from GF Data, who tracked middle market M&A activity in 2014 which shows a jump in demand for hybrid debt financings for Private Equity M&A transactions including "deals with uni-tranche financing." So why is that important?

Uni-tranche financing investment vehicles combine both senior and junior lending rates into a single debt product. These hybrid loans are considered riskier because they include a split between lower-rate secured (senior) and higher-rate unsecured (junior) debt instruments typically issued separately. Given more demand from deal makers, more banks are stepping up with more flexible loan products like uni-tranche loans to fill the gap in new deal financings. The result in effect helps to increase M&A activity, as noted, and quicken the pace of M&A deal flow across the board.

The real trick is to recognize that there's nothing to fear from the current M&A environment. Scaredy Cat CEOs can't hide in the dark analyzing risk and market-trend data endlessly, whilst their intrepid competitors pull ahead in the months to come. Unlike S&P 500 companies with cash hordes still in excess of $1 Trillion, middle market companies don't have the luxury of indecision any more, and must be more aggressive in the hunt for growth in this market.

If Private Equity groups can continue to find ways to close more M&A deals, so too must CEOs of middle market companies step up and take a second look at the growing availability of deal financing options in an improving economic backdrop. At the very least consider if the damaging consequences and the paralyzing implications of Humphrey's Law are working against you and/or the best interests of your shareholders. Have an objective discussion with your investment banker before year end. His job is to help you focus, take your foot off the brake and execute a real M&A strategy. Absent a plan of action Scaredy Cat CEOs who stay afraid of the dark this year might find themselves spooked out of a good M&A deal.



About the author: Rick Andrade is an investment banker at Janas Associates in Pasadena, Ca and finance writer in Los Angeles helping CEOs buy, sell and finance middle market companies. Rick has earned his BA and MBA from UCLA along with his Series 7, 63 & 79 FINRA securities licenses. He is also a Real Estate Broker, a volunteer SBA/SCORE instructor, and blogs at www.RickAndrade.com on issues important to middle market business owners. He can be reached at RJA@JanasCorp.com. *This article is for informational purposes only and should not be considered in any way an offer to buy or sell a security. Securities are offered through JCC Advisors,* Member FINRA/SIPC.