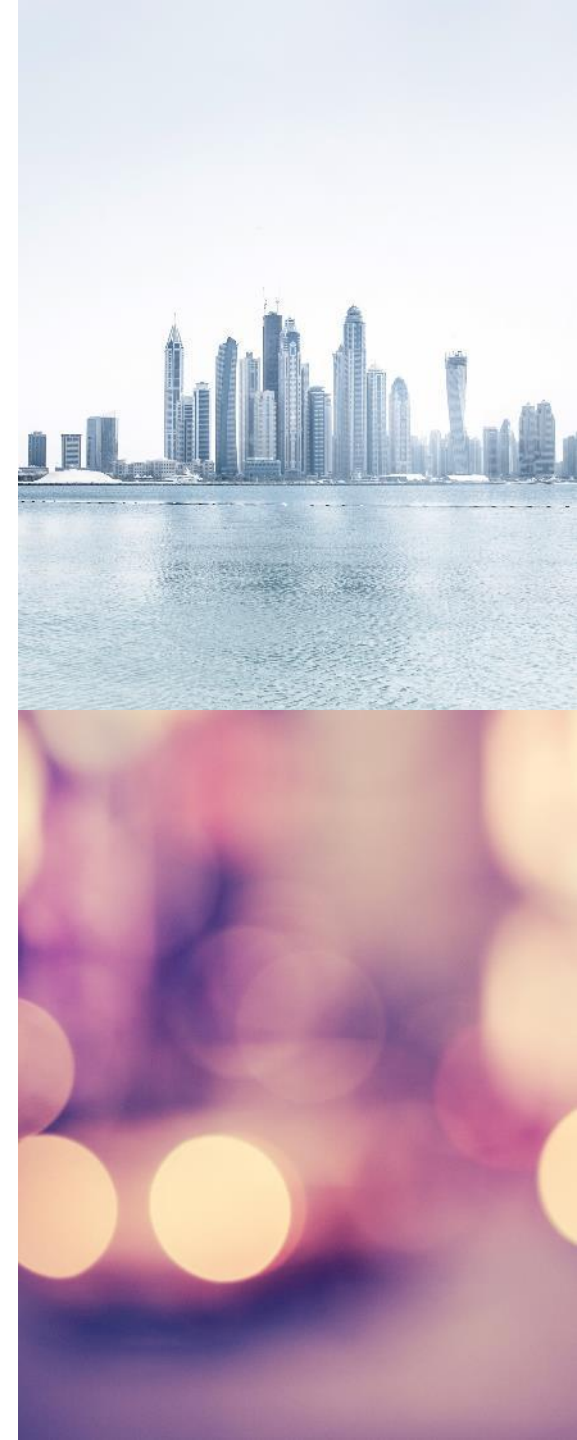




Debt Financing Foundations

Contents

1. Introduction to Debt Financing
2. Senior Loans: The Foundation of Acquisition Debt
3. Subordinated/Junior Loans
4. Bridge Loans
5. Case Study: Broadcom's Acquisition of VMware



3. Debt Financing Foundations

💡 What Is Debt Financing?

- Companies raise acquisition funds by borrowing from lenders.
- Borrowers repay the principal plus interest over time.
- Unlike equity, debt preserves the buyer's ownership control.

📊 Debt's Role in M&A

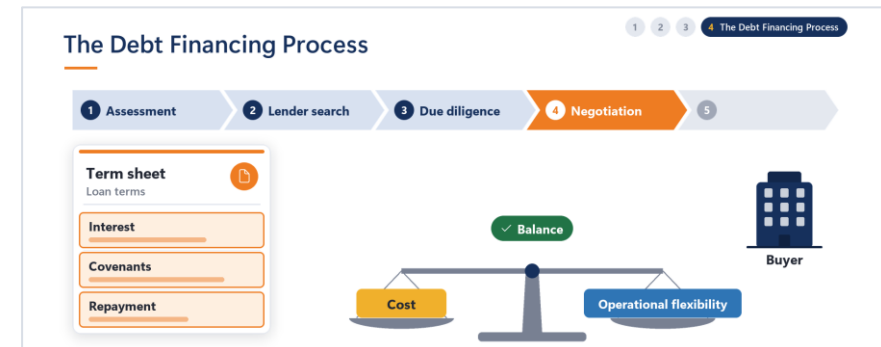
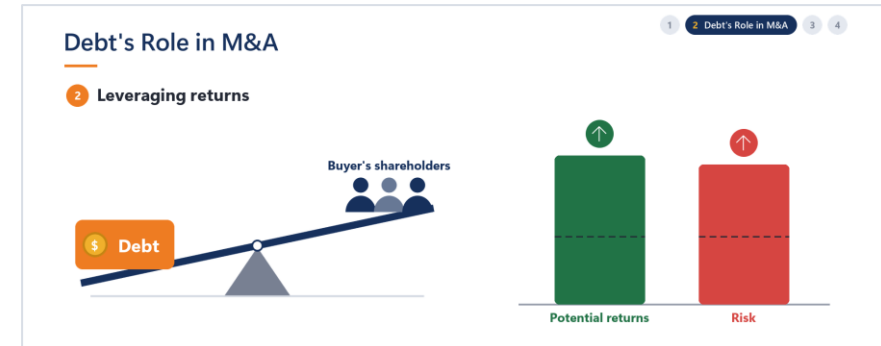
- Leverage lets deal sizes exceed the buyer's own funds.
- Core funding: debt covers a portion of the purchase price.
- Leveraging returns: higher potential returns, but higher risk.
- Tax benefit: interest payments are tax-deductible.

🧱 Types of Debt

- Senior debt: collateral-backed, repaid first, 3–5 year maturities.
- Subordinated debt: higher risk and rates, 7–10 year maturities.
- Bridge loans: short-term gap funding, usually under a year.

🔄 The Debt Financing Process

- Assessment: evaluate debt capacity and financial impact.
- Lender search: compare terms, rates and lender preferences.
- Due diligence: lenders analyse the target and buyer's plans.
- Negotiation: balance cost against operational flexibility.
- Disbursement: the loan is funded at closing.



3. Debt Financing Foundations (Part 2)



Senior Loans: The Foundation of Acquisition Debt

- Secured nature protects lenders and lowers borrowers' cost.
- Senior loans are repaid first in a default.



Key Characteristics

- Priority: top of the capital structure, least risky for lenders.
- Security: backed by the target's assets as collateral.
- In LBOs, equity or future earnings may also count.
- Interest rates: lower than unsecured financing.



Sources of Senior Loans

- Commercial banks: traditional, relationship-driven lenders.
- Direct lending funds: more flexible, often more costly.
- Syndicated loans: banks share risk on sizeable deals.



The Importance of Collateral

- Collateral lowers risk, improving rates and loan size.
- Lenders scrutinise financials, assets and industry outlook.
- Common forms: real estate, equipment, inventory, receivables, IP.
- Valuation uses DCF or comparable sales, adjusted for forced sale.

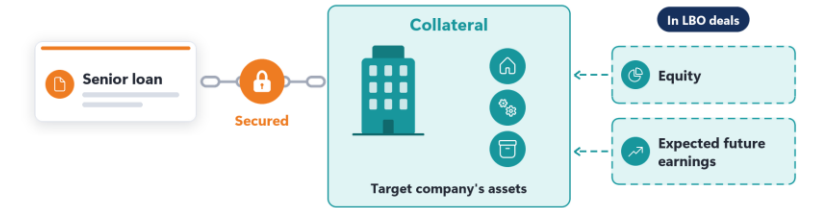


Pricing, Structuring and Strategy

- Floating rate: benchmark plus a risk-based margin.
- Bullet loans keep flexibility; amortising loans reduce principal.
- Covenants such as debt-to-EBITDA protect the lender.
- Prepayment penalties compensate for lost interest.
- Tranches, maturity and cash flow impact must fit the deal.

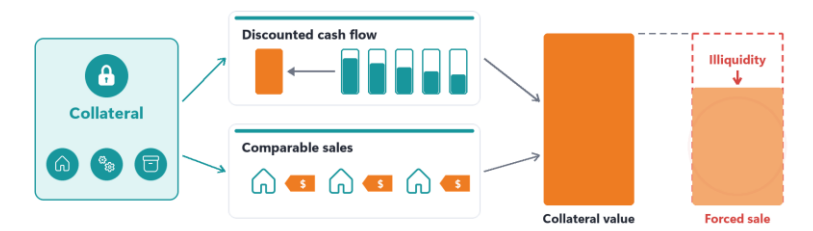
Key Characteristics

2 Security



The Importance of Collateral

4 Valuation



Strategic Considerations in M&A



3. Debt Financing Foundations (Part 3)

Subordinated / Junior Loans

- Rank below senior debt and above equity in repayment.
- More risk for the lender than senior loans.

Why Use Subordinated Debt?

- Borrowers raise capital beyond senior debt without dilution.
- Adds leverage in LBOs or when senior capacity is limited.
- Longer maturities and fewer restrictions than senior loans.
- Lenders earn higher interest for the higher risk.

Characteristics and Advantages

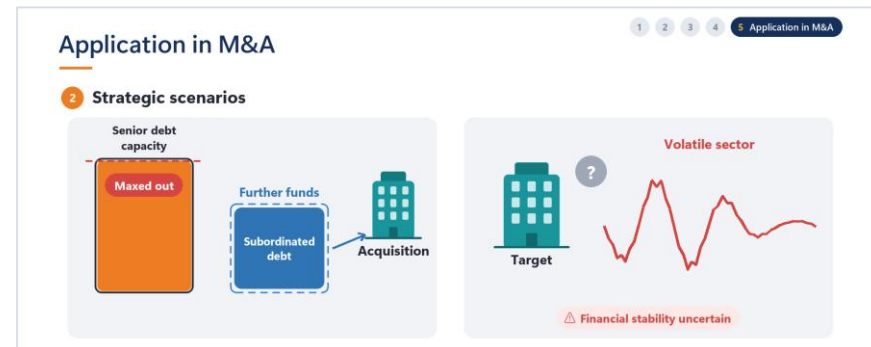
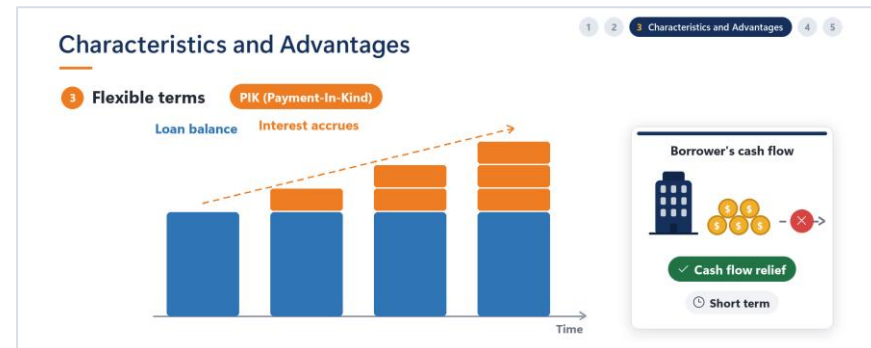
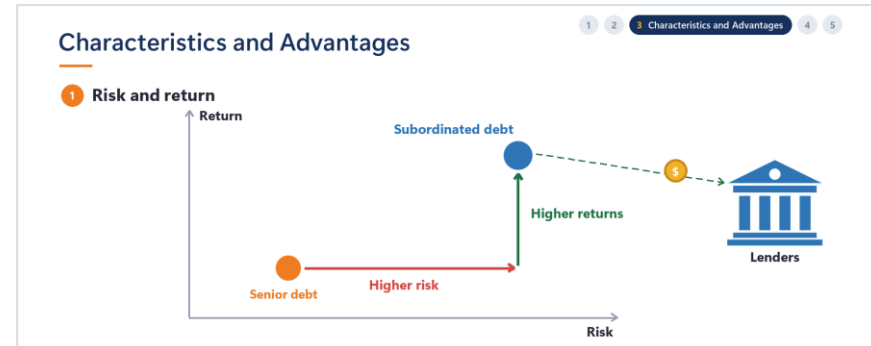
- Higher risk, higher return due to subordinated status.
- Often unsecured, so interest rates are higher.
- PIK features let interest accrue for cash flow relief.
- Equity kickers such as warrants add lender upside.

Sources and Structuring

- Offered by banks, mezzanine funds and private equity firms.
- Rates significantly above senior debt; often bullet repayment.
- Covenants less restrictive, but financial metrics still apply.
- Maturities typically 7–10 years, sometimes longer.

Application in M&A

- Common in LBOs to maximise equity returns.
- Used when senior debt capacity is maxed out.
- Flexible but costly: lenders must assess deal potential.



3. Debt Financing Foundations (Part 4)



Bridge Loans

- Swift funding until long-term financing is secured.
- Enable quick acquisitions and time-sensitive needs.



When Are Bridge Loans Used?

- M&A: close quickly before permanent financing is ready.
- Timing mismatch: cover the gap to longer-term debt or equity.
- Working capital: temporary liquidity in disruptions or seasonality.



Sources

- Investment banks, specialised bridge lenders and private equity firms.



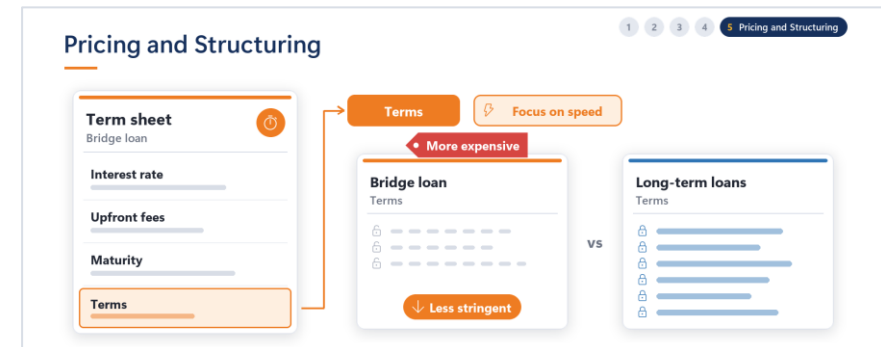
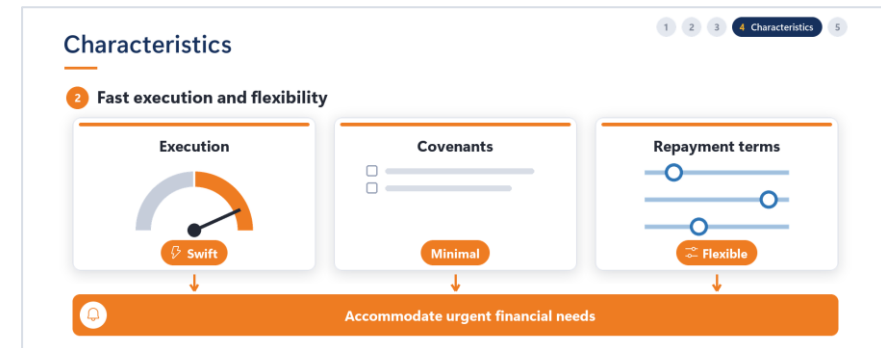
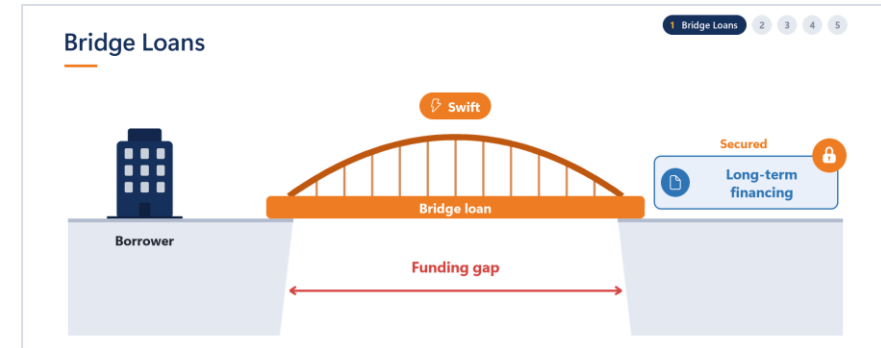
Characteristics

- Higher interest rates for short-term, higher-risk lending.
- Fast execution with minimal covenants and flexible repayment.
- Rollover: replaced by a cheaper permanent facility.



Pricing and Structuring

- Upfront fees on top of high interest rates.
- Maturity typically under a year, sometimes a few months.
- Specialised tools, not substitutes for long-term planning.



3. Debt Financing Foundations (Part 5)



Case Study: Broadcom's Acquisition of VMware

- Announced in May 2022; closed in January 2023.
- \$61 billion cash-and-stock deal.
- Moved Broadcom from semiconductors into enterprise software.



M&A Financing Overview

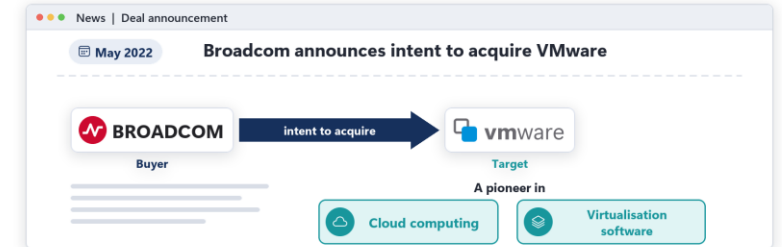
- Initial: \$32 billion bridge loan from a 13-bank syndicate.
- Led by Bank of America, Barclays and Wells Fargo.
- Revised: \$28.4 billion of new term loan commitments.
- Two \$10.7 billion term loans and one \$7 billion term loan.
- Term loans replaced the bridge and bought time for bonds.



Pricing and Terms

- Variable rate based on SOFR plus a margin.
- Staggered maturities of two, three and five years.
- Bridge-to-term transition supported growth and integration.

Deal Synopsis



M&A Financing Overview

2 Revised structure



Pricing and Terms

