Navigating Debt Financing in an Acquisition

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Today’s Presenters

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Overview

• **Part I: Acquisition Financing - the Basics**
  - What is “Acquisition Financing”?
  - What are “Commitment Papers”?
  - What is “Conditionality”?
  - What is an “Auction Process”?
  - What are “Debt Financing Provisions”?

• **Part II: A Deeper Dive**
  - Structuring
  - Bridge to Bond & Securities Demand
  - Credit Support
Part I: Acquisition Financing – the Basics
What is “Acquisition Financing”? 
Typical Stages of an Acquisition Financing

**Financing Process Commences**
- **Bid Date**
  - e.g., 3 weeks
- **Signing Date**
  - e.g., 1 week
  - 1-6 months, longer in limited circumstances
- **Closing**

**Single-headed commitment letters signed by banks and submitted along with a bid draft / comments on acquisition agreement:**
- SunGard conditionally, no “diligence out”
- Agreed financing structure and amounts
- Sign-off on bid version of the acquisition agreement
- Expiration date matching acquisition agreement outside date (in some cases, plus a cushion)
- May be more than one bid date

**Multiheaded commitment letters signed by banks and sponsor, acquisition agreement executed:**
- Bank commitments allocated
- Bank economics allocated
- All open points resolved
- Sign-off on final acquisition agreement

**Credit agreement, bond indenture and related documents signed, funds advanced and acquisition consummated**

Note: Graphic adapted from Leveraged Financing 2019: Financing an Acquisition – Current Trends presented on Practical Law Institute
What are “Commitment Papers”? 
Commitment Papers

Bank Deal

- Commitment Letter:
  - Letter
  - Transaction Description
  - Term Sheet
  - Funding Conditions

- Fee Letter:
  - Fees
  - “Market Flex”

Bridge to Bond

- Commitment Letter:
  - Bridge Term Sheet
- Fee Letter:
  - Securities Demand
- Engagement Letter
- Fee Credit Letter

Other “Letters” & Agreements

- Highly Confident Letter
- Interim Facilities Agreement
- Syndications Strategies Letter
What is “Conditionality”?
Conditionality

- Consummation of Acquisition
- Minimum Equity Contribution
- No “Material Adverse Effect”
- Financial Statements
- Offering Memorandum
- Marketing Period / Inside Date
- Limited “Sungard” Conditionality
- Solvency
What is an “Auction Process”?
… and what are “trees”? 
Auctions and Trees

- **Seller(s)** – selling shareholders
- **Target** – company up for sale

- **Bidders** – potential buyers (could be ‘strategics’/‘trade’ (aka corporates) or private equity bidders)
- **Banks** – prospective finance providers to the bidders

- The **“Sell Side”** team generally includes
  - the seller(s)
  - the target
  - one or more banks acting as M&A advisors to the sellers (note these banks often are some of the same banks competing to provide financing to the bidders)
  - often a financial advisor (e.g. Rothschild)
- Often the banks acting as M&A advisors will offer a ‘staple’ financing
  - terms are sent out with M&A process materials
  - guide valuation and provide confidence that leverage is available
- Here, Bank A is a potential financing source for all bidders – they are providing/offering the ‘staple’ financing
- Banks B and D are working with multiple bidders (Bank B with bidders 1 and 3; Bank D with bidders 1 and 2)
  - Different individuals within the bank would be working for different bidders, similar to the way law firms tree themselves up
- Each of banks C, E, F and G are exclusive to their bidder
  - may be required by the bidder for confidentiality reasons
What are “Debt Financing Provisions”? 
Debt Financing Provisions

- In a leveraged buy-out or a transaction without a funding condition, the debt financing provisions serve to allocate risk of a financing failure as between Buyer and Seller.

- “Xerox provisions” emerged in the wake of the 2008 financial crisis and serve to limit liability of the debt financing parties *vis-à-vis* Seller/Target.
Part II: A Deeper Dive
Structuring
Choosing the Right Debt Solutions

Capital Provider

- Commercial banks
- Funds and other Institutional Investors (e.g., CLOs)
- Direct Lenders

Acquisition Consideration

- Term Loan A
- Term Loan B
- Bilateral Loan
- Direct Loan
- Bridge Loan
- Bond Issuance
- Mezzanine Debt
- Seller Financing

Working Capital Solutions

- Cash Flow Revolving Credit Facility
- Asset-Based Revolving Credit Facility
- Reserve-Based Revolving Credit Facility
- Recurring Revenue Revolving Credit Facility
- Factoring Arrangement
- Securitization
Assumed or Acquired Debt

• In certain circumstances, it may be preferable to leave a target’s debt outstanding upon closing rather than paying it off or refinancing it.

• Feasibility Considerations:
  • Call protection
  • Pricing
  • Covenant package
  • Guarantee and collateral requirements
  • Existing debt of Acquiror

• Portability provisions mitigate the need for change of control consents from debt holders.

Portability conditions vary transaction to transaction, but may include one or more of the following:

- Leverage Ratio
- Ratings
- Minimum Equity Contribution
- Minimum AUM
- KYC
- Timing
Bridge to Bond & Securities Demand
The Route to Permanent Financing

THE GOAL

SPA Signing Date

Notes issued into Escrow

THE BACKUP

Loan Signing Date

Draft/Negotiate Bridge Loan

Conversion Date

THE STICK

Acquisition Completion Date

Best Efforts High Yield Bond

Demand Securities

Conversion Date

Extended Term Loan

Holiday

Potential to call Securities Demand

Maturity of Permanent Debt

7 Years

Potential happens anywhere in this time range
Understanding The Take-out Fee
Credit Support
U.S. v. UK/European Differences

• Guarantees
  • All domestic subsidiaries, subject to customary limited exceptions
  • Foreign subsidiary guarantees typically excluded

• Collateral
  • Substantially all assets
  • All jurisdictions, subject to exceptions
  • Equity pledge of borrower and subsidiaries, subject to exceptions

• Guarantees
  • Guarantor coverage test is typical (e.g. 80% of Group EBITDA)
  • Further limited to agreed jurisdictions and subject to further limitations

• Collateral
  • Material assets
  • Specified Jurisdictions
  • Equity pledge may be limited to specified material subsidiaries
THANK YOU

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