

Fitch Rates Avago's IDR 'BB+' Senior Secured Debt Issuance at 'BBB-'; Outlook Stable

Written by Australian Business

CHICAGO--([BUSINESS WIRE](#))--Fitch Ratings assigns a 'BB+' rating to Avago Technologies Ltd.'s new wholly-owned indirect Cayman Island-based subsidiary, Avago Technologies Finance Pte. Ltd.'s (Avago), and a 'BBB-' rating to Avago's Senior Secured Credit Facilities. The Rating Outlook is Stable. Fitch's actions affect \$6.1 billion of debt issuance, including the undrawn Revolving Credit Facility (RCF).

The ratings and Outlook reflect Fitch's expectations for strengthening credit protection measures from meaningful voluntary debt reduction and profitability growth through the intermediate-term. Pro forma for the debt issuance and acquisition of LSI Corp. (LSI), Fitch estimates total leverage (total debt to operating EBITDA) will exceed 4(x) but decline to below 3.5x in 2015. Longer-term, Fitch anticipates total leverage below 3x.

RATINGS DRIVERS

Avago will use net proceeds from the debt issuance, along with cash balances, to fund the \$6.6 billion cash acquisition of LSI that is expected to close in the first half of 2014. The acquisition doubles Avago's size; makes it a leader in storage end markets; leverages both companies' application specific integrated circuits (ASIC) capabilities in wired infrastructure, and improves substantial customer and end market concentration.

The ratings are supported by Avago's : i) leadership positions in secular growth markets, ii) strong profitability with expectations for profit margin expansion from cost synergies, and iii) consistent and solid annual mid-cycle FCF, providing ample financial flexibility for debt reduction. Rating concerns center on: i) Avago's initially weak credit protection measures at the acquisition's close, ii) improved but still substantial customer and end market concentration, particularly wireless infrastructure and storage markets and iii) potential integration challenges, mitigated by limited product overlap.

Pro forma for Avago's acquisition of LSI, the ratings and Outlook reflect Fitch's expectations for solid operating performance, driven by secular end market growth, improving profitability with a credible operating margin expansion roadmap, and strengthening annual free cash flow (FCF). Fitch expects mid- to high-single digit organic revenue growth in fiscal 2014, driven by solid demand across end markets.

Despite expectations for continued cyclical, accelerating LTE adoption should drive secular demand, including higher smartphone shipments, increasing complexity, growing internet bandwidth demands and greater storage requirements. Customer and end market concentration is reduced but remains meaningful. Wireless communications and wired infrastructure will represent roughly half of revenues, with storage constituting a little over a third. Avago's top three customers will represent 26% of revenues.

Operating profit margin initially will erode, pro forma for the acquisition. Fitch estimates operating profit margin will decline to the mid-20s from roughly 30% for the latest 12 months (LTM) ended Feb. 2, 2014, due to LSI's higher operating expense structure. Nonetheless, Fitch expects \$217 million of cost synergies, which should begin contributing meaningfully to margin expansion in fiscal 2015. As a result, Fitch anticipates operating EBITDA margins returning to 30% in the intermediate-term.

Fitch expects mid-cycle annual FCF will average more than \$500 million beyond the near-term but will be modest in fiscal 2014 due to the impact of cash restructuring. Capital spending should return to normalized levels of \$250 million or below, upon completion of Avago's multi-year capacity expansion for the manufacture of FBAR products. Cash contributions related to LSI's \$335 million underfunded pension obligations should decline from \$75 million in 2014.

RATINGS SENSITIVITIES

Avago's use of FCF for voluntary debt reduction or higher profitability from the achievement of cost synergies resulting in total leverage approaching 2.5x could result in positive rating actions, as Fitch believes the company will have the FCF capacity for debt reduction. Negative rating actions could result from: i) market share erosion at a leading customer or in aggregate, indicating an loss of technological advantage or ii) the degradation of profitability and FCF, limiting voluntary debt reduction and the company's ability to drive total leverage below 4x in the near-term.

Pro forma for the transaction, Fitch believes liquidity is solid and consists of: i) \$750 million of cash and cash equivalents and ii) a \$500 million undrawn senior secured RCF expiring 2019. Consistent annual FCF also supports liquidity. Cash location is not a

concern for Avago, given the company's incorporation in Singapore.

Pro forma for the acquisition, total debt is \$5.6 billion and consists of: i) \$4.6 billion senior secured term loan B maturing in 2019 and ii) \$1 billion of privately placed convertible notes due 2020. The term loan B amortizes at \$46 million (1%) annually until the bullet maturity in 2019.

Fitch rates Avago as follows:

--IDR 'BB+';

--\$4.6 billion Senior Secured Term Loan B 'BBB-'; and

--\$500 million Senior Secured Revolving Credit Facility (RCF) 'BBB-'.

Additional information is available at 'www.fitchratings.com'

Applicable Criteria and Related Research:

--'Corporate Rating Methodology' (Aug. 5, 2013).

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Corporate Rating Methodology — Effective 12 August 2011 to 8 August 2012

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=647229

Additional Disclosure

Solicitation Status

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