Leveraged Buyouts: The Debt / Equity Ratio

- This is a **re-do** of last week’s video…
- **PROBLEM:** We attempted to explain why PE firms prefer to acquire companies with low debt balances
- This topic does not lend itself to an Excel-based explanation, and ours didn’t highlight the actual reasons well enough
- **Here:** Covering a more useful / explainable topic

Leveraged Buyouts: The Debt / Equity Ratio

- “Help! I just got a **case study** from a private equity firm I’m interviewing with.”

- “I have to pick a **consumer/retail company**, download its filings, complete a **leveraged buyout model** for the company, and recommend for or against the deal.”

- “How can I determine <u>how much debt</u> to use in the deal? They didn’t give me any instructions!”

Leveraged Buyouts: The Debt / Equity Ratio

- **Step 1:** Estimate the purchase price and Debt / EBITDA by looking at comparable buyout deals (**NOT** publicly traded companies)

- **Step 2:** Test your assumptions in Excel and see if the company can manage that much debt

- **Step 3:** Go back and tweak your assumptions as necessary

Step 1: Purchase Price and Debt / EBITDA

- **Why?** Also need to know the price for an LBO case…
- **Why?** 6x Debt / EBITDA makes no sense if you're paying 5x EV / EBITDA for the entire company…
- **Public Company:** In *most* cases, must assume at least a 20-30% premium to the company's share price
- **And:** Make sure the implied EBITDA multiple is in-line with those for recent deals in the sector

Step 1: Purchase Price and Debt / EBITDA

- **Example:** Let's say you pick **Bed, Bath & Beyond** for your LBO candidate

- **Google Search For:** "consumer retail" "leveraged buyouts" [This Year or Last Year]

- **Goal:** Find 2-3 recent deals in the sector with the purchase EV / EBITDA multiple, offer premium, and Debt / EBITDA

Step 1: Purchase Price and Debt / EBITDA

"consumer retail" leveraged buyouts" 2015

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About 16,900 results (0.70 seconds)

Investment Bankers' Revenue Spikes From Consumer ... - U.S.
blogs.wsj.com/privateequity/2015/.../investment-ba... The Wall Street Journal
5:36 pm ET Oct 2, 2015. Deals. Investment Bankers' Revenue Spikes From **Consumer, Retail** Deals ... "For the lower middle market, you're likely to see **private equity** continue to be pretty active," said Mr. Cohen. "But as you move up the scale, ...

PE Activity Slows Among Consumer, Retail Deals in Third ...
pevc.dowjones.com/article?...DJFLBO0120151... Dow Jones & Company
PE Activity Slows Among **Consumer, Retail** Deals in Third Quarter. **LBO** Wire ,. Lillian Rizzo,. November 02, **2015**,. (c) **2015** Dow Jones & Company, Inc. ... as evidenced by the increase in deal value size--**private equity** firms increasingly are ...

Consumer Retail Investment Banking - Mergers & Inquisitions
www.mergersandinquisitions.com/consumer-retail-investment-banking/
Consumer Retail Investment Banking: What You Do, Deals, Key Metrics, ... As with any **leveraged buyout**, you want stable cash flows, tangible assets, and, ...

[PDF] BGL Consumer Retail Insider Spotlight On Facilities ...
www.smsassist.com/wp-content/uploads/2015/05/Featured-Story-5.pdf
2009 2010 2011 2012P 2013P 2014P **2015P** 2016P 2017P. RoW. LATAM. MEA ..... **Private equity** capital is flowing to the FM industry, with growth equity and ...

Operational Private Equity: Consumer, Retail, Marketing and ...
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Castanea Partners is a leading **private equity** firm focused on middle-market ... NOV **2015** - Castanea Partners announced today that Jill Beraud has joined ...

TPG Capital and Leonard Green Partners Agree to Acquire ...
hf.com/tpg-capital-and-leonard-green-partners-agre... Hellman & Friedman
August 14th, **2015** ... Leonard Green is one of the nation's preeminent **private equity** firms with over $15 billion of **private equity** capital raised since inception.

Sycamore Partners ' pending $2.7 billion acquisition of Belk Inc . was the largest sponsor-backed deal announced during the quarter, according to PwC. In total, there were six sponsor-backed deals announced valued more than $50 million in the third quarter, and excluding the Belk deal, private equity-backed deals made up about 5% of the total deal value in the third quarter, PwC reported.

The investment firms Leonard Green & Partners and TPG Capital agreed on Monday to buy Life Time Fitness, a gym operator, for about $4 billion, including the assumption of debt.

Under the terms of the deal, the private equity firms will pay $72.10 a share in cash, a 7.3 percent premium to Life Time Fitness's closing price on Friday. The offer is also a 73 percent premium to the company's closing price on Aug. 22, the day before Life Time Fitness said it had begun exploring corporate financing options.

Life Time Fitness on deck for Monday with $1.1B TLB backing LBO

A Deutsche Bank-led arranger group has scheduled a bank meeting for noon EDT on Monday, May 18 to launch a $1.1 billion, seven-year covenant-lite B term loan to help finance the take-private LBO of **Life Time Fitness** by Leonard Green & Partners and TPG, according to sources.

Deutsche Bank, Goldman Sachs, Jefferies, BMO Capital Markets, RBC Capital Markets, Macquarie, Nomura, and Mizuho are arranging the transaction, which marks the fitness club operator's debut in the institutional loan market.

The senior secured financing also includes a $250 million revolver, while the company also plans to tap the high-yield market for $600 million of unsecured notes.

November 23, 2015 at 4:03pm

Petco nets financing commitments for $4.6B leveraged buyout

Petco Animal Supplies will be acquired by CVC Capital Partners and Canada Pension Plan Investment Board via a $4.6 billion agreement reached today with an owner group led by TPG and Leonard Green & Partners.

Debt financing for the transaction has been committed by Barclays, Citigroup, Royal Bank of Canada, Credit Suisse, Nomura and Macquarie, sources said. Financing specifics haven't emerged yet.

The acquisition is expected to close in early 2016.

Step 1: Purchase Price and Debt / EBITDA

- **Comps:** CVC Partners / Petco, Leonard Green and TPG / Life Time Fitness, and Sycamore / Belk
- **Petco:** 10x EV / EBITDA, 6x Debt / EBITDA
- **Life Time Fitness:** 11x EV / EBITDA, 5.5x Debt / EBITDA
- **Belk:** 7x EV / EBITDA, 5-6x Debt / EBITDA

What If You Really Can’t Find Info?

- **Easy:** Find the filings for the deal (edgar.sec.gov for U.S. companies) and search for “debt financing” or “commitment letter”:

Parent estimates that the total amount of funds required to complete the merger and related transactions, including to pay fees and expenses in connection with the merger, is approximately $3.1 billion. Parent expects to fund this amount through a combination of:

- cash equity contributions from affiliates of Sycamore Partners of up to $658.8 million, which is described below under “—*Financing of the Merger—Equity Financing*,”
- the contribution to Parent of shares of our common stock (an aggregate of 385,295 shares, the equivalent of an approximately $26.2 million investment based upon the merger consideration of $68.00 per share), which is described below under “—*Financing of the Merger —Rollover Financing*,” and
- debt financing consisting of commitments for (i) a senior secured first lien term loan facility in an aggregate principal amount of up to $1.775.0 billion, (ii) a senior secured second lien term loan facility in an aggregate principal amount of up to $600.0 million, and (iii) an asset based revolving credit facility in an aggregate principal amount of $800.0 million. Parent has received firm commitments from certain financial institutions to provide the debt financing, which is described below under “—*Financing of the Merger —Debt Financing*.”

The consummation of the merger is not subject to a financing condition (although the funding of the debt, rollover and equity financing is subject to the satisfaction of the conditions set forth in the commitment letters under which the financing will be provided).

Step 1: Purchase Price and Debt / EBITDA

- **Likely Ranges:** 8-10x EV / EBITDA purchase multiple and 5-6x Debt / EBITDA

- **BBBY:** Market cap of $7.15 billion, cash of $566 million, and debt of $1.5 billion; EBITDA of $1.8 billion

Bed Bath & Beyond Inc. (NASDAQ:BBBY)

42.94 +0.75 (1.78%)
Feb 12 - Close
NASDAQ real-time data - Disclaimer
Currency in USD

Range	41.43 - 43.12	Div/yield	-
52 week	41.26 - 78.50	EPS	5.03
Open	42.01	Shares	163.59M
Vol / Avg.	0.00/2.78M	Beta	0.71
Mkt cap	7.15B	Inst. own	102%
P/E	8.54		

In Millions of USD (except for per share items)	As of 2015-11-28
Cash & Equivalents	490.74
Short Term Investments	0.00
Cash and Short Term Investments	490.74
Accounts Receivable - Trade, Net	-
Receivables - Other	-
Total Receivables, Net	-
Total Inventory	3,219.67
Prepaid Expenses	-
Other Current Assets, Total	480.13
Total Current Assets	4,190.54
Property/Plant/Equipment, Total - Gross	4,186.63
Accumulated Depreciation, Total	-2,500.00
Goodwill, Net	487.17
Intangibles, Net	-
Long Term Investments	74.67
Other Long Term Assets, Total	404.99
Total Assets	6,843.99
Accounts Payable	1,402.97
Accrued Expenses	467.65
Notes Payable/Short Term Debt	0.00
Current Port. of LT Debt/Capital Leases	-
Other Current liabilities, Total	321.76
Total Current Liabilities	2,192.38
Long Term Debt	1,500.00
Capital Lease Obligations	-
Total Long Term Debt	1,500.00
Total Debt	1,500.00

Step 1: Purchase Price and Debt / EBITDA

- **BBBY Current EV / EBITDA:** 4.5x
- **20-30% Premium:** 5.3x – 5.7x EV / EBITDA
- That seems reasonable, right?
- **NO!** Not so fast!

Step 1: Purchase Price and Debt / EBITDA

- **This seems reasonable…** BUT:

- **Shareholders:** Will likely want a much higher premium!

Step 1: Purchase Price and Debt / EBITDA

- **50% Premium ($64 / share):** 6.5x EV / EBITDA

- **75% Premium ($75 / share):** 7.5x EV / EBITDA

- **QUESTION:** These higher premiums seem to imply more reasonable deal multiples, but does the math still work?

- **Can** the company support this much debt?

Step 2: Test Your Assumptions in Excel

- **Keep It SIMPLE** At First:

Bed Bath & Beyond Inc. (NASDAQ:BBBY)

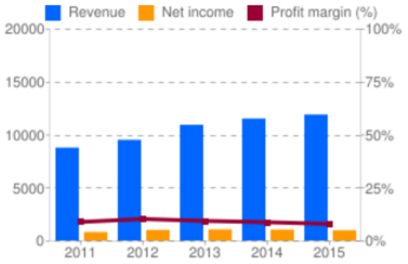
Add to portfolio

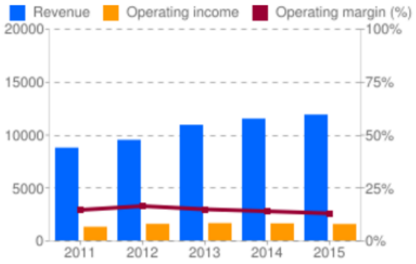
More results

Income Statement | Balance Sheet | Cash Flow

View: Quarterly Data | **Annual Data**

Hide charts





In Millions of USD (except for per share items)	52 weeks ending 2015-02-28	52 weeks ending 2014-03-01	53 weeks ending 2013-03-02	52 weeks ending 2012-02-25
Revenue	11,881.18	11,503.96	10,914.58	9,499.89
Other Revenue, Total	-	-	-	-
Total Revenue	11,881.18	11,503.96	10,914.58	9,499.89
Cost of Revenue, Total	7,261.40	6,938.38	6,525.83	5,568.96
Gross Profit	4,619.78	4,565.58	4,388.76	3,930.93
Selling/General/Admin. Expenses, Total	3,065.49	2,950.99	2,750.54	2,362.56
Research & Development	-	-	-	-
Depreciation/Amortization	-	-	-	-
Interest Expense(Income) - Net Operating	-	-	-	-
Unusual Expense (Income)	-	-	-	-
Other Operating Expenses, Total	-	-	-	-
Total Operating Expense	10,326.88	9,889.38	9,276.37	7,931.52
Operating Income	1,554.29	1,614.59	1,638.22	1,568.37

In Millions of USD (except for per share items)	52 weeks ending 2015-02-28	52 weeks ending 2014-03-01	53 weeks ending 2013-03-02	52 weeks ending 2012-02-25
Net Income/Starting Line	957.47	1,022.29	1,037.79	989.54
Depreciation/Depletion	239.19	220.12	194.73	183.87
Amortization	-	-	-	-
Deferred Taxes	-22.30	11.73	17.60	30.24
Non-Cash Items	70.98	67.31	61.08	43.66
Changes in Working Capital	-59.51	72.12	-118.21	-22.03
Cash from Operating Activities	1,185.85	1,393.56	1,192.99	1,225.28
Capital Expenditures	-330.64	-320.81	-354.68	-243.37

Step 2: Test Your Assumptions in Excel

- What *really* matters for debt support in an LBO?

- Revenue and Revenue Growth

- Margins and EBITDA → Cash Flow Conversion

- CapEx and Interest Expense

- Debt Repayment, Debt / EBITDA, and EBITDA / Interest

Step 2: Test Your Assumptions in Excel

- What about **interest**?

- Given the rates on other deals, a simple **5%** works here:

Nov 18 Fashion department store operator Belk Inc widened the discount to 89 from a range of 98-98.5 on the proposed US$1.5bn first-lien term loan backing its approximately US$3bn buyout by private equity firm Sycamore Partners, sources told Thomson Reuters LPC.

The revised guidance comes the day after data storage provider Veritas pulled a US$4.8bn debt package backing its buyout by the Carlyle Group. The financing had already been reduced from US$5.5bn, citing market conditions.

In addition to widening the discount, Belk set the spread on the wide end of the original 450-475bp range over Libor. The floor remains at 1%.

Underwriting banks were also helped by the trading profile of a comparable deal for PetSmart Inc, which syndicated a US$4.3bn term loan backing its buyout by BC Partners in February. That loan was priced at 400bp over Libor with a 1% floor before being repriced at 325bp over Libor in May.

Although precise details of Petco's debt financing have yet to be released, the financing is expected to mirror PetSmart's recent deal, with a similar loan and bond structure and leverage in the same range of around 4.0-4.5 times senior debt and 6.0-6.5 times total debt side, banking sources said.

Standard & Poor's put Petco on negative ratings watch after the announcement. The company is currently rated B, but S&P noted the deal will increase leverage to "well above" the current level of 5.0 times and that higher interest could keep the company from reinvesting in improving the customer experience.

Petco repriced its US$1.2bn loan at 300bp over Libor with a 1% floor in February 2013.

Step 2: Test Your Assumptions in Excel

- Set up a **simple model** that lets you tweak these figures and see how the company does with varied debt levels

- **Focus on the downside cases** – What happens if revenue, EBITDA, cash flow, etc. decline? Margins and growth HAVE declined historically for BBBY!

- **Ideal:** Debt / EBITDA should **decline** over time and EBITDA / Interest should **rise** as the company repays debt

Step 2: Test Your Assumptions in Excel

- **So:** If Debt / EBITDA *rises* instead, or EBITDA / Interest falls, you'll have to assume a lower debt level

- **Conclusions:** Metrics seem reasonable at a 75% premium (7.5x EV / EBITDA) with low revenue growth and declining margins….

- **But:** If revenue **declines** or we pay closer to a **100% premium**, it's not so positive (~7x Debt / EBITDA in some cases then)

Step 3: Tweak Your Assumptions

- **Here:** We'd say the 5-6x Debt / EBITDA level is a stretch for this company, given recent financial performance
- **More Realistic:** 4-5x Debt / EBITDA, or around 60% Debt at a 75% – 100% purchase premium
- **Credit Stats:** Improve even with low growth, and don't get *too much worse* if revenue declines; maybe reduce the deal to 50% debt (~4.2x Debt / EBITDA) with a 100% premium

The Debt / Equity Ratio in LBOs

- **Step 1:** Estimate the purchase price and Debt / EBITDA by looking at comparable buyout deals (**NOT** publicly traded companies)

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