Leveraged Buyout Case Study: Silver Lake's $24 Billion Leveraged Buyout of Dell

In this case study, you'll analyze Silver Lake Partners' $24 billion leveraged buyout of Dell, the single largest LBO since 2007, and also one of the top 15 biggest LBOs on record.

Announced on February 5, 2013, the deal represented an aggressive bet on Dell's ability to turn itself around and move away from its declining desktop PC and notebook businesses and re-orient itself toward software, services, and possibly tablets.

In addition to the challenges of turning around a $50+ billion revenue company like this, the deal also stood out for the following reasons:

- A key strategic partner of Dell, Microsoft, also participated in the deal via a **$2 billion subordinated loan** – it is highly unusual for strategic partners to invest in the capital structure of partner companies that are being taken private.
- Michael Dell, the Founder, already owned 15% of the company and planned to retain his stake – so this was a leveraged buyout for **85%** of the company rather than 100% of it.
- The deal immediately sparked **controversy**, with a letter from Southeastern Asset Management, one of the company's largest shareholders, arriving several days afterward and announcing the firm's intent to vote *against* the deal because they believed that Dell was worth at least $24.00 per share rather than the $13.65 per share that Silver Lake offered.
- The company has many different **business lines**, some of which are declining (desktops and notebooks), and others that are growing quickly (servers and networking); as such, you'll need to consider different revenue and expense scenarios on a segment-by-segment basis.
- Finally, the company is unlikely to turn itself around strictly from organic growth, so **acquisitions** must factor into this deal. You'll need to analyze potential post-buyout acquisitions and determine what margin and growth profiles would be required for Silver Lake to realize an acceptable IRR.

Part 1: Gathering Data, Capital Structure & Model Setup

In this part of the case study, you'll fill out the "Transaction Assumptions," "Debt Assumptions," "Sources & Uses," "Ownership Percentages," and "Goodwill Creation & Purchase Price Allocation" sections of the model, as well as all the historical financial statements and trend analysis using the provided template.

You should also fill out as much of the "Segment-Details" tab as you can at this stage.

To do this, you'll have to comb through a variety of sources:

- Company filings.
- Investor presentations.

- Earnings call transcripts.
- Industry reports and data from sources such as IDC.
- The proxy statement, merger agreement, 8-K filings, and filings from other parties involved.
- Annual (10-K) and quarterly (10-Q) filings.
- Call key customers, suppliers, partners, and any industry experts that you can get ahold of – be creative, and do not hesitate to reach out, because this is how you come up with ideas that no one else is thinking of.

Fill in all the required information in the schedules using the methods outlined above.

NOTE: Since the deal is not yet finalized, you'll have to do some guesswork on the capital structure and the interest rates and principal repayment terms. Base these on the terms of the company's existing debt, modifying them as appropriate for the company's lower credit rating after the deal announcement.

Part 2: Creating Revenue & Expense Scenarios

Since a wide variety of outcomes are possible with Dell – the company is in the midst of a major product shift – you need to create and analyze multiple scenarios.

It's up to you to decide exactly how to set up these scenarios. *At the minimum*, your model should include the following:

- At least **3 scenarios** for revenue – upside, base, and downside cases.
- Revenue should be projected on a **segment-by-segment basis** and should *not* just be a simple percentage growth rate. Tie it to underlying data such as market share or units sold. It is up to you how to divide the company's revenue into segments.
- You do **not** need granular assumptions for expenses, but you should still consider how different revenue scenarios might also impact expenses.
- At least *one* of your scenarios should approximate Wall Street consensus thinking. We encourage you to disagree with the consensus and present your own view, as it is always critical to do that as an investor, but you should also reflect these consensus numbers in one of your cases for comparative purposes.

Aside from the points above, the only requirements are that 1) You must be able to **back up your numbers with data** and 2) The numbers must **flow through** your model correctly.

Once you've completed these scenarios, you can build and link the projected financial statements.

Part 3: Building In Support for Post-LBO Add-On Acquisitions

Since Dell is unlikely to grow revenue significantly on its own, most likely it will need to acquire other companies, in-line with its strategy over the past few years.

Please follow these instructions to build in support for post-LBO acquisitions:

- Your model should include support for **2 acquisitions**, one in Year 2 and one in Year 4.
- You do **NOT** need to create full purchase price allocation, sources & uses, and other schedules for these. However, you *should* build in the following options:
  - You should be able to adjust the **purchase price** and the **form of payment** (additional investor equity from Silver Lake vs. debt) for both deals. Make simple assumptions for the debt that are in-line with those used in the LBO's initial capital structure.
  - You should be able to adjust at least the **revenue** and **expenses** for each acquisition; for simplicity, you can assume that these stay constant or increase at a constant percentage each year.
  - Make **simple assumptions** for the Balance Sheet and Cash Flow Statement combinations. Do not get hung up on creating full statements for the acquired companies – keep it very, very simple because revenue and expenses should drive everything here.
  - You should tie each acquired company's Operating Income (EBIT) to its purchase price and assume an "effective yield." Also assume a margin and link the revenue contribution to the Operating Income and this margin.

How big should these companies be? What should their revenue growth and margins look like? How much debt and equity can Dell really use to acquire companies?

All of that is up to you. For inspiration, look to some of Dell's recent acquisitions and take into account the additional debt repayment and interest expense from the LBO, as well as changes in other major cash outflows such as CapEx, dividends, and share repurchases.

The only requirement is that your assumptions should be in-line with the company's previous acquisitions and with its financial capacity post-buyout.

Part 4: Completing the Debt Schedules and LBO Analysis

This part is similar to what you do in any leveraged buyout model, but here's the summary:

- Make sure that you link the **mandatory repayments** to the assumptions you set up in the beginning and the company's available cash flow each year.
- **Optional repayments** should be made in order of loan seniority in the capital structure and you should handle all cases in your formulas, including those where revolver borrowing is required, those where no revolver borrowing is required, and those where an entire debt balance is paid off early.

- The **interest expense** should be based on your assumptions in the beginning and should flow directly into the Income Statement, creating a circular reference.

Calculating the 5-year IRR at the end is also straightforward. Please remember to:

- Factor in **all** equity invested by Silver Lake, as well as any additional equity invested over the years, e.g. capital used for acquisitions.
- Create sensitivity tables based on your different scenarios, the post-buyout acquisitions, and more standard metrics such as purchase price, exit multiple, and % debt.

Part 5: Answering the Case Study Questions and Presenting Your Findings

Once you've completed all the work above, please answer the following case study questions in your presentation to our firm:

1. If you were Silver Lake, would you do this deal? **You must give a definitive "Yes" or "No" answer**.
2. **Support your answer** with the results of your analysis, your insights into the market, and other quantitative and qualitative factors. If you're recommending *against* investment, explain what conditions, if any, would cause you to change your mind. If you're *recommending* investment, make sure you address the potential risks and how to mitigate them.
3. Several days after the deal was announced, Southeastern Asset Management sent a letter to Dell's Board of Directors announcing their intention to vote against the deal and stating that Dell was worth **$24.00 per share**, rather than the $13.65 per share purchase price, based on a Sum-of-the-Parts analysis. Is their argument convincing? Do you believe the purchase price should have been higher? Or is $13.65 acceptable given the stock's performance in the year prior to acquisition?
4. What are the advantages and disadvantages of **going private**? Do you think the strategy makes sense for Dell? In other words, are the added interest expense, debt burden, and other constraints worth the benefits that Dell would gain in the process?
5. Which of the **scenarios** you modeled is most likely to transpire? How can you use these scenarios to determine whether or not the deal is a good investment, and to limit your downside risk?
6. In light of Dell's previous acquisitions, such as Quest Software for $2.4 billion and Perot Systems for $3.9 billion, how important are post-LBO acquisitions in this deal? What's the **relationship** between the acquisitions, the growth rates and margins of those companies, and the overall IRR to Silver Lake?
7. Are there any other factors that you *haven't* considered in this case study that might impact the deal, the potential returns, and the risk factors? If so, what are they, and what additional research would you need to do on them?

You have 5 days to complete the LBO model and your presentation and 1 hour to present your findings to the committee and answer questions on your investment thesis, analysis, and conclusions.