HEC PARIS

swatch

Structuring of a LBO

Olivier Levyne
2019
Mobile: 33 7 83 35 67 65
Mail: Levyne@hec.fr

1. Business plan of Swatch

1.1. Income statement

Target's P&L		Consensus of Brokers			Soft landing				
December	2018	2019	2020	2021	2022	2023	2024	2025	2026
Sales	8 475	8 483	8 796	9 166	9 474	9 714	9 877	9 960	9 960
Growth rate		0,1%	3,7%	4,2%	3,4%	2,5%	1,7%	0,8%	0,0%
EBITDA	1 648	1 635	1 754	1 891	1 955	2 004	2 038	2 055	2 055
EBITDA margin	19,4%	19,3%	19,9%	20,6%	20,6%	20,6%	20,6%	20,6%	20,6%
(D&A)	-494	-484	-503	-515	-532	-546	-555	-560	-560
In % of sales	-5,8%	-5,7%	-5,7%	-5,6%	-5,6%	-5,6%	-5,6%	-5,6%	-5,6%
EBIT	1 154	1 151	1 251	1 376	1 422	1 458	1 483	1 495	1 495
(Net interests)	-21	14	11	6	2	-2	-5	-7	-8
Cost of net debt		2,0%	2,0%	2,0%	2,0%	2,0%	2,0%	2,0%	2,0%
Profit Before Tax	1 133	1 165	1 262	1 382	1 424	1 456	1 477	1 488	1 488
(Corporate tax)	**-288**	**-306**	**-345**	**-351**	**-362**	**-370**	**-376**	**-378**	**-378**
Net income	**866**	**845**	**906**	**1 025**	**1 060**	**1 088**	**1 107**	**1 117**	**1 117**

- For the 2019-2021 period: forecasts based on a consensus of brokers
- 5 additional years (2002-2026) for the sake of consistency with the maturity of acquisition debt (7 years) to be raised on December 31th, 2019
- Soft landing on the 2022-2026 period
  - Linear phasing of the sales' growth rate from 4.2% in 2021 to 0.0% in 2025 (conservative approach)
  - Sustainability of some 2021 expected ratios
    - EBITDA margin: 20.6%
    - D&A/Sales: 5.6%
    - Corporate tax rate; 25%
- Recalculation of interests
  - Pre-tax cost of net debt: 2.0%
  - Net debt in line with the financing of dividends based on a 100% pay out rate

1. Business plan of Swatch

1.2. Cash flow

Target's CF=Δnet debt		Consensus of Brokers			Soft landing				
December	2018	2019	2020	2021	2022	2023	2024	2025	2026
Net income	866	845	906	1 025	1 060	1 088	1 107	1 117	1 117
(Dividends paid to H)		-866	-845	-906	-1 025	-1 060	-1 088	-1 107	-1 117
+D&A	494	484	503	515	532	546	555	560	560
(Net CAPEX)	-481	-514	-551	-572	-570	-567	-565	-562	-560
(ΔWCR)		-6	-242	-286	-238	-185	-126	-64	0
CF = Δ net debt		-57	-228	-224	-240	-178	-117	-57	0
Pay out rate		100%	100%	100%	100%	100%	100%	100%	100%

- Cash flow to be looked upon as a change in net debt
  - Dividends to be taken into account, (whereas they are excluded from the FCF calculation which must not depend on the firm's pay out policy)
  - Exclusion of the debt redemption as this has no impact on net debt
  - Cash flow based on net income, in order to include all the P&L's aggregates including interests (whereas interests are excluded from the FCF calculation as the FCF are bound to be discounted thanks to the wacc which already includes the cost of debt)
- Linear phasing of the CAPEX from 572 M CHF in 2021 to the expected D&A in 2025 ie 560 M CHF
- Change in WCR based on an assumed stability of the 77% 2018 WCR / Sales (cf.: next slide)

1. Business plan of Swatch

1.3. Balance sheet

Target's balance sheet		Consensus of Brokers			Soft landing				
December	2018	2019	2020	2021	2022	2023	2024	2025	2026
Fixed assets	4 203	4 233	4 281	4 338	4 375	4 396	4 406	4 409	4 409
WCR	6 542	6 548	6 790	7 075	7 313	7 498	7 624	7 688	7 688
Total	10 745	10 781	11 071	11 413	11 689	11 895	12 030	12 097	12 097
Equity	11 274	11 253	11 314	11 433	11 468	11 496	11 515	11 525	11 525
Provisions	190	190	190	190	190	190	190	190	190
Net debt	-719	-662	-433	-209	30	208	325	382	382
Total	10 745	10 781	11 071	11 413	11 689	11 895	12 030	12 097	12 097
WCR	6 542	6 548	6 790	7 075	7 313	7 498	7 624	7 688	7 688
In % Sales	77,2%	77,2%	77,2%	77,2%	77,2%	77,2%	77,2%	77,2%	77,2%

2. Business plan of the holding

2.1. Income statement

H's P&L		Consensus of Brokers			Soft landing				
December	2018	2019	2020	2021	2022	2023	2024	2025	2026
Dividends received from target			845	906	1 025	1 060	1 088	1 107	1 117
(Interests on acquisition debt)			-171	-145	-119	-92	-66	-40	-13
Tax received from the target			345	351	362	370	376	378	378
(Tax paid to the Tax Authority)			-298	-315	-332	-347	-359	-368	-375
Net income			**720**	**798**	**936**	**991**	**1 039**	**1 078**	**1 107**

H's tax		Consensus of Brokers			Soft landing				
December	2018	2019	2020	2021	2022	2023	2024	2025	2026
Target's PBT		1 165	1 262	1 382	1 424	1 456	1 477	1 488	1 488
(Interests on acquisition debt)		0	-171	-145	-119	-92	-66	-40	-13
Taxable income for the tax group		1 165	1 090	1 237	1 305	1 363	1 411	1 449	1 474
Corporate tax rate		26%	27%	25%	25%	25%	25%	25%	25%
Tax to be paid to the Tax Authority		**306**	**298**	**315**	**332**	**347**	**359**	**368**	**375**

H's acquisition debt		Consensus of Brokers			Soft landing				
December	2018	2019	2020	2021	2022	2023	2024	2025	2026
Outstanding debt		5 040	4 320	3 600	2 880	2 160	1 440	720	0
(Installments)			-720	-720	-720	-720	-720	-720	-720
6M Euribor		-0,336%							
Spread		3,000%							
Cost of swap		1,000%							
All in cost of debt		3,664%	3,664%	3,664%	3,664%	3,664%	3,664%	3,664%	3,664%

- Set up of a tax group between H and the target
  - Payment by H to the target of the corporate tax, the latter would have paid to the Tax Authority if there had been no tax group
  - Calculation of a taxable income for the whole group based on the target's Profit Before Tax and the holding's interests on acquisition debt
  - Payment of the corporate tax by H for the whole group
  - Tax saving, corresponding to the tax deductibility of interests, that can be used to optimize the acquisition debt repayment
- Features of the acquisition debt
  - Maturity (reminder): 7 years
  - Linear installments
  - All in cost: 3.7% including a 1.0% cost of swap that enables to turn the floating rate (based on 6M Euribor) into a fixed rate

2. Business plan of the holding

2.2. Cash flow and balance sheet

H's CF		Consensus of Brokers			Soft landing				
December	2018	2019	2020	2021	2022	2023	2024	2025	2026
Net income			720	798	936	991	1 039	1 078	1 107
(Installments)			-720	-720	-720	-720	-720	-720	-720
CF			**0**	**78**	**216**	**271**	**319**	**358**	**387**

H's balance sheet		Consensus of Brokers			Soft landing				
December	2018	2019	2020	2021	2022	2023	2024	2025	2026
Target's shares		11 977	11 977	11 977	11 977	11 977	11 977	11 977	11 977
Cash balance		**0**	**0**	**78**	**294**	**566**	**884**	**1 242**	**1 629**
Total		11 977	11 977	12 055	12 271	12 543	12 861	13 219	13 606
Equity		6 937	7 657	8 455	9 391	10 383	11 421	12 499	13 606
Acquisition debt		5 040	4 320	3 600	2 880	2 160	1 440	720	0
Total		11 977	11 977	12 055	12 271	12 543	12 861	13 219	13 606

- Cash flow calculation
  - No dividend to be paid by the holding to the PE fund in order to optimize the repayment of the acquisition debt
  - No CAPEX at holding's level as it requires no intangible and tangible assets: its purpose is limited to the holding of the target's shares
  - No D&A at holding's level as it has no intangible and tangible assets to be amortized or depreciated
  - No change in WCR at holding's level as it has no current assets and no current liabilities
  - As a consequence: cash flow, to be looked upon as the change in cash balance, equal to the net income reduced by the installments of the acquisition debt
- Balance sheet
  - Fine-tuning of the acquisition debt so that the cash balance is always positive: 5.04 bn CHF
    - Impossibility to run again into debt once the LBO is set up
    - Overdraft, which is a financial debt, in the case of a negative cash balance
  - Equity in line with a 20% IRR for the PE fund
  - Price of the target in the background of the LBO equal to the total amount of funds raised by the holding: 12 bn CHF

2. Business plan of the holding

2.3. Capital

H's capital		Consensus of Brokers			Soft landing				
December	2018	2019	2020	2021	2022	2023	2024	2025	2026
Target's market cap		12 877							
Target's net debt		-662							
Target's EV		12 215							
EBITDA		1 635							
EV/EBITDA		7,5			7,5				
EBITDA					1 955				
EV					**14 603**				
Target's net debt					30				
H's acquisition debt					2 880				
(H's cash balance)					-294				
Consolidated net debt					**2 616**				
Equity value = EV - Consolidated net debt					**11 987**				
Required IRR		20%							
PE fund's investment		**6 937**							

- Assumed exit of the PE fund at the end the 3rd year ie 2022
- Possible exit modalities: IPO, sale to a strategic player or to another PE fund
- Exit price based on an EV/EBITDA of the current year, assuming an unchanged market status of the target ie an unchanged EV/EBITDA over time
- Consolidated net debt, to be deducted from the EV, based on target's the net debt, H's acquisition debt and H's cash balance
- Investment to be looked upon as the present value of the exit value, assuming a 20% discount rate (corresponding to the required IRR)