Case Study:

Green Landscape Inc., Inc. Leveraged Buyout (LBO)

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OVERVIEW:

You are an officer at Heinz Ward & Co (HW), a private equity firm. HW is looking to purchase the privately own company Green Landscape Inc (GLI), a leading provider of landscape maintenance and snow removal services in the U.S. The asking price is $400 million including the refinancing all the existing debt ($100 million on 20x0). You were asked to evaluate the opportunity and report back if the asking price justifies HW's 25% equity return targets assuming that the transaction will be done in the LBO market (using leverage to enhance the equity returns). You were also asked to see if HW can afford to pay 20% higher than asking price just in case the transaction ends up into an aggressive auction process.

To answer these questions, you need to prepare the following documents:

1. *Prepare the Transaction Sources & Uses*
2. *Prepare a full financial model based on the assumptions provided including the debt service.*
3. *Prepare the proforma balance sheet laying in the new capital (new debt and equity)*
4. *Prepare the Debt Schedules based on the approved terms.*
5. *Prepare an Equity IRR and NPV analysis to determine if the HW can meets its targeted return of 25%*
6. *Run a scenario in which HW to pays 20% premium over the asking price and see if it meets the target.*

TRANSACTION OVERVIEW (LBO)

HW is in the process of raising the necessary funds to cover the purchase price of the equity, refinance GLS's existing debt and pay $20 million in transaction fees. The proposed structure is as follows:

Debt Financing:

After further credit review of the business plan, the maximum leverage that underwriters are willing to underwrite, based on debt capacity analysis, for both the bank loans and senior unsecured notes are maximum 3-4x bank debt / EBITDA and 5-6x total debt/EBITDA, respectively. These debt capacity multiples are what is recommended to be the advisable leverage, along with what the co-underwriters are comfortable underwriting given that GLI's business in seasonal.

Bank Debt: Spring Bank approved a loan based on the Company's last year's EBITDA. Spring Bank proposed three different floating rate tranches so it will be in position to syndicate these tranches to potential loan buyers include other banks and Collateralized Loan Obligation (CLO) funds that prefer longer maturity tranches. The terms of the loan by tranches were as follows (money terms):

7-year Revolving Credit Facility: $100 Million at LIBOR + 3.5% on the funded portion and 0.50% on the unfunded portion. The revolver facility will be used for working capital purposes and not anticipated to be used to fund the acquisition on day one (*Use $0 to fund the acquisition*)

Term Loan A Facility *(this will be syndicated to traditional banks)*

Amount:	1.5x 20x0 EBITDA (approval based on Debt Capacity)
Interest:	LIBOR + 3.5%
Term:	7 years
Scheduled Payment	Year 20x1: 5%, Year 20x2: 5%, Year 20x3: 8%, Year 20x4: 10%, Year 20x5: 12%, Year 20x6:15%, 20x7:45%

Term Loan B Facility (*this will be syndicated to CLO and private credit funds*)

Amount:	2.0x 20x0 EBITDA*(approval based on Debt Capacity)
Interest:	LIBOR + 4.0%
Term:	7 years
Scheduled Payment	Year 20x1: 1%, Year 20x2: 1%, Year 20x3: 1%, Year 20x4: 1%, 20x5: 1%, Year 20x6: 1%, Year 20x7: 94%

LIBOR assumptions: Starting LIBOR at 0.60% and increase 0.5% in 20x1, increase 0.5% in 20x2, and increase 1.0% in 20x3.

Senior Unsecured Notes: Morgan Stanley, an investment bank, managed to raise the Senior Unsecured Notes from various private bond investors. The terms of these notes (money terms) were as follows:

Amount:	$100 million
Interest:	7.5%
Term:	8 years
Scheduled Payment	20x1 – 20x10: 0%, 20x11: 100% (bullet payment)

Equity: The equity will be provided by the private equity firm HW. The equity amount will be the balance of the financing after the debt is calculated.

COMPANY BACKGROUND

Green Landscape Inc. (GLI) is a leading provider of landscape maintenance and snow removal services in the U.S. The company provides these recurring services to a diversified base of over 15,000 enterprise clients including fortune 500 companies.

GLI's landscape services represents approximately 82% of its revenue for the 12-month period ended 20x0. These services primarily include lawn care, flower planting and care, and tree and shrub pruning. These services are through annual maintenance contracts. In addition to the maintenance contracts, GLI provide additional non-contractual supplemental enhancements (*not included in the projections*).

GLI's snow removal services represent approximately 18% of its revenue for the 12-month period ended 20x0. The snow removal services to the same clients provide a counter-seasonal revenue stream for GLI in key seasonal markets.

The 5-year historical Income Statements and last year's Balance Sheets were as follows:

INCOME STATEMENT					
($ 000's)	HISTORICAL				
	-20x4	-20x3	-20x2	-20x1	20x0
Landscape Business	93,935	103,226	109,814	118,080	123,000
Snow Removal Business	19,327	21,474	23,342	25,650	27,000
REVENUE	113,262	124,700	133,156	143,730	150,000
Sales Growth		10.1%	6.8%	7.9%	4.4%
COST OF SALES (excl. Deprec.)	58,896	62,350	67,910	70,428	75,000
Gross Profit	54,366	62,350	65,246	73,302	75,000
Gross Margin	48.0%	50.0%	49.0%	51.0%	50.0%
Selling, General & Administrative Expenses	17,669	19,079	19,574	22,146	22,500
EBITDA	**36,697**	**43,271**	**45,672**	**51,156**	**52,500**
% Sales	32.4%	34.7%	34.3%	35.6%	35.0%

BALANCE SHEET	20x0		20x0
Current Assets		**Current Liabilities**	
Cash	10,000	Accounts Payable	6,000
Accounts Receivable	15,000	Other Current Liabilities	7,000
Inventory	-	**Total Current Liabilities**	13,000
Other Current Assets	5,000		
Total Current Assets	30,000	Total Long Term Debt	100,000
Goodwill		Deferred Taxes	1,000
Capitalized Fees		**Total Liabilities**	114,000
Net PP&E	240,000		
Invesment in JV	30,000	**Shareholder's Equity**	
		Common Stock	135,000
		Retained Earnings	51,000
		Total Shareholder's Equity	186,000
Total Assets	**300,000**	**Total Liabilities & Equity**	**300,000**

<u>Last Year's Operation Assumptions (20x0):</u>

- Average Revenue per Landscape Service (ARPS) per month: $820
- Average number of Landscape services per customer per year: 10 months
- Average Revenue per Snow removal Service: $600 per month per customer
- Average number of Snow removal services: 3 months
- Number of total customers 20x0 for both service: 15,000 corporate clients
- Cost of Revenue as 50% of Revenue
- Operating Expenses as 15% of Revenue

<u>Projections' Assumptions (Years 20x1-20x10):</u>

- Average Revenue per Landscape Service per month Increase: 6.0%
- Average Revenue per Snow removal Service per month 6.0%
- Total Customer annual growth rate increase: 2%
- Cost of Revenue: 50% of Revenues

- Operating expense: 15% of Revenues
- Depreciation: 5% of Revenues
- Tax Rate at 34%
- Deferred Taxes as % of Tax expense 5%
- Capex: 7% of Revenues per year.
- Accounts Receivable Days: 30
- No Inventory (service business)
- Other Current Assets as % of Revenues 1.0%
- Accounts Payable Days: 20
- Other Current Liabilities as % of Revenue 1.5%
- No new Investments during the projected period

LBO ANALYSIS STEPS

To determine if the cash flows meet HW's equity return target, the analyst needs to complete the following steps:

Step 1: Build Pre-LBO Model

1.1. Build the Assumptions page that will drive the income, cash, and balance sheet statements.
1.2. Build Projected Income Statement through EBITA (Earnings before Interest, Taxes and Amortization).

Step 2: Input Transaction Structure

2-1. Enter Financing Structure (debt and equity) into the Transaction Sources & Uses
2-2. Link the Transaction Sources & Uses to the opening Balance Sheet (Post-Transaction Balance Sheet)

Step 3: Complete LBO Model by including the new debt and equity structure.

3-1. Build the Deb Schedule including amount outstanding, interest expense and principal payment.
3-2. Complete Income Statement (*down to Net Income*)
3-3. Complete Cash Flow Statement (*from Net Income to Free Cash Flow)*
3-4. Complete Balance Sheet Statement (*ties to the Cash flow and Income statements*)

Step 4: LBO Valuation and Equity Return Analysis

4-1. Perform equity return analysis (IRR) and determine the valuation (NPV) based on HW's targeted return.
4-2. Run various scenarios (discount-to-the-asking-price scenario if the return is not met and a premium-to-asking-price scenario if the targeted return exceeded - in case there is an auction bidding process.