HILTON hotels LBO, the Most Profitable Private Equity Deal Ever

When Conrad Hilton bought The Mobley hotel in Cisco, Texas, in 1919 for $40,000, he had no idea that this small venture will grow into one of the biggest hotel chains in the world. More than a successful hotel brand, Hilton hotels is an iconic private equity deal. The first IPO took place in 1970, then there was takeover by Blackstone in 2007 and six years later it was the most profitable LBO in history.

Hilton Hotels

Hilton hotels was established in 1948, uniting in one legal entity all the various hotels bought by Conrad Hilton since acquisition of the Mobley hotel. After 16 years of remarkable growth in US, the Hilton international business became a spin off in 1964 and the focus was made on the US market. In 1971, Hilton hotels bought International Leisure Company with its main assets in Las Vegas, Flamingo and the International casinos, financing the transaction in 1970 via IPO.

Although a first casino operator listed on NYSE, Hilton hotels was run conservatively, with its Conrad Hilton and his son Bannon shying away from debt and financial audacity.

In 1996 Bannon Hilton was replaced by Stephen Bollenbach formerly of The Walt Disney Company, who made a series of large acquisitions. Low interest rates and friendly financing conditions of the lates nineties helped the group to acquire brands like Embassy Suites, Doubletree, Hampton Inn, Homewood Suites, Bally's and Caesars. In 2005 Hilton Hotels bought back its own international business for $5.7 billion and sold its casinos.

Helton outgrew its competitors between 1996 and 2007 with its portfolio including more than 350,000 rooms. It went from seventh to the fourth largest hotel group in a world by room numbers. EBITDA also grew. Hilton outperformed all competitors, its revenue growth combined with increasing profitability. However, this growth was financed by debt and in December 2005, and after acquiring its international business, Hilton's rating was cut by Moody's from Baa3to Ba2.

LBO Frenzy

The market crash of 2000 prompted the Federal Reserve to cut interest rates and keep them low for a long time, which led to a stretch of a cheap money, and businesses relying on leverage benefited from this new monetary policy. Private equity firms started looking at targets that were once out of reach. In 2006, KKR, Bain and Merrill Lynch took over Hospital Corporation of America for $32.7 billion, and in just one year this record was eclipsed twice, by Blackstone's buyout of EOP for $38.9 billion and then by KKR-led buyout of Energy Future Holdings for $44.4 billion. The acquisition of Hilton Hotels by Blackstone was the very last jumbo deal of this period.

Blackstone

Blackstone was founded in 1985 by two ex-Lehman Brothers bankers, Peter Peterson and Stephen Schwarzman. Originally an advisory boutique, Blackstone emerged by 2007 as the largest private equity firm in the world, with a total of $79 billion under its management at one time. Active in many segments of private equity, the firm has developed an expertise in real estate sector through investments in amusement parks, hospitality companies and Real Estate Investment Trusts.

In 2007 Blackstone closed the largest LBO in history, acquiring EOP, rental building management company for about $39 billion. Shortly, the Blackstone launched its own IPO, a first among private equities. The firm listed a 12.3% stake that valued Blackstone at $39 billion, and tow founding partners, were instantly ranked among the richest people in the United States.

Blackstone and its interest in Hilton

In the meantime, Blackstone, with its reputation for applying operational charges and investing capital to turn around underperforming hospitality businesses, was plotting to take over the Hilton Hotels and add them to the existing hotel portfolio made up of Extended Stay America, Boca Resorts, Prime Hospitality, Wyndham Hotels and Resorts, La Quinta Inns and Suites, to become the largest hotel operator in the world.

A top player in the real estate sector, Blackstone launched eight funds focused on real estate since 1994, two of them dedicated to international operations. During 2006 and 2007 Blackstone took advantage of the low interest rates to raise three new major real estate funds, one for Europe and two for US: Blackstone Real Estate Partners V ($10.9 billion) and Blackstone Real Estate Partners VI ($5.25 billion).

It took Blackstone a year to strike a deal with the Hilton Hotels, eventually offering a 40% premium at $46.50 per share, compared with the market value of $33. Despite Hilton healthy recent performance, shareholders knew it could not continue growing at the same pace without cash infusion, which was exactly what Blackstone offered.

An Aggressive Capital Structure

Blackstone ended up paying $26.5 billion for the company. It was a large, though not an outrageous deal. Hilton’s EBITDA amounted to $1.68 billion at the time of acquisition. With a total debt of $20.4 billion, the deal’s leverage represented a multiple of more than 12 times EBITDA.

Equity for the deal came from Blackstone recent US funds, the debt was raised from various banks, hedge funds, and real estate debt investors. At 12.4 times EBITDA, the debt level was particularly high, though several recent deals had also closed with double-digit net debt-to-EBITDA ratios. The debt was split in two tranches (i) a senior loan of $14 billion at a margin of 2.75%, and (ii) senior unsecured notes for $6.8 billion at a margin of 4.91%. The whole debt package was secured at cov-lite, a typical feature of LBOs during this period.

	Amount	**Percentage**	**EBITDA Multiple**
Equity	$ 5.7	21.5 %	-
Term Loan B	$ 14	53 %	-
Senior Unsecured Notes	$ 6.8	25.5 %	-
Total Debt	$ 20.8	78.5 %	12.4
Total sources of funds	**$ 26.5**	**100 %**	**15.8**

Source: adapted from Dawoon Chung and Ludovic Phalippou

The Financial Crisis

The 2008 financial crisis was harsh on hospitality industry. The world cut on his travel budget and the hotel revenues dried up globally. Hilton, which was extremely leveraged, was particularly hit. The earnings dropped sharply, but due to cov-lite structure, the lenders were not able to call their debt or take control of the company. Thus, Hilton continued pushing forward in its expansion strategy.

In 2009, Blackstone wrote down the value of its equity in the business by 70%. Next year the lenders restructured their debt and took loss in order to ease pressure on Hilton. The total debt wass reduced from $20 billion to $16 billion. Blackstone bought back $1.8 billion of junior debt at a 54% discount for $819 million.

Blackstone's decision to reinvest in the business was driven by the need to restructure the company's debt and allow some lenders to exit a transaction.

Hilton's Strategy under Blackstone

Hilton had grown a lot since Stephen Bollenbach took over in 1996, but Blackstone thought it still looked more like a holding company with a collection of disparate assets than a true integrated global business, it was too fragmented and lacked a hard-driving organization.

Blackstone replaced Bollenbach with Christopher Nassetta, formerly of Host Hotels and Resorts, a company which had shown impressive growth under his management. Nasetta transformed Hilton. He reset the company culture and changed the headquarters, making it easier and cheaper to operate.

Nasetta's strategy rested on four pillars:

1. A capital light model: pull back on debt fueled acquisitions, without stopping to grow. Now 99% of the growth in hotel rooms came via franchising and the group expanded into emerging markets without a major capital injection.
2. Internationalization: the company continued to invest massively outside of US.
3. Branding: Nasetta revamped Hilton's iconic brands and focused on its two luxury brands, Conrad and Waldorf Astoria.
4. Technology: By 2013 customers could check into hotels using phones, tablets, or computers, and Hilton implemented an extensive loyalty program.

Within a few years Hilton became a leaner company with stronger brands and a larger non-US client base.

Exit Strategies

By 2013 the financial markets recovered from the 2008 crisis. It was a right time for Blackstone to monetize its investment. The firm considered three strategies for exit: (i) a trade sale to a competitor, (ii) putting Hilton up for a secondary buyout, or (iii) going for an IPO.

First two solutions were disregarded. With markets in better shape, Nasetta still believed that a strategic buyer would not pay enough of a premium for synergies. And Hilton's large debt made it unattractive for a secondary buyout.

All things considered, IPO looked like a right thing to do. The S&P 500 was back at its October 2007 levels and there had been substantial IPO activity, with 122 new listings in the first three quarters of 2013. Twenty-two of those IPOs were companies operating in the real estate sector. Blackstone itself had raised $565 million through an IPO of Extended Stay America. The market was bullish again and the private equity had confidence in Hilton.

Hilton went public again in December of 2013. The company raised $2.34 billion for 11.8% of its capital, giving Hilton Hotels an equity valuation of $19.7 billion. Considering the debt of $14 billion Hilton had at that time, tis value was of $33.7 billion (in 2006 it was $26 billion). Blackstone invested $5.6 billion of equity in buying Hilton out, making it the most profitable LBO in history.

Blackstone continuously sold shares through 2014 and cut its stake to less than 50% in 2015. In 2016 25% of Hilton was sold to Chinese HNA group for $6.5 billion, implying an equity value of $26 billion (4.6 times Blackstone initial investment) and leaving HNA as Hilton's largest shareholder. Blackstone sold its final stake in Hilton in 2018, ending an 11-year investment.

Epilogue

Hilton's success in fighting back from the lows of the global financial crisis into a booming, profitable world leader is a dream scenario for private equity specialists. The firm could not have achieved such impressive returns without making ample use of cov-lite leverage terms and the opportunistic buying back of its debt. Hilton is an impressive investment story. It is safe to say that the deal has catapulted Jonathan Gray and Christopher Nassetta into LBO legends.