



Elon Musk's Twitter Deal: Valuation and Financing of the Leveraged Buyout

AD 714 Mergers and Acquisitions

Meruyert Balgabek

October 29, 2024

Metropolitan College Boston University

Background

In April 2022, Elon Musk made an offer to acquire Twitter for \$54.20 per share, valuing the company at \$44 billion. Musk aimed to unlock Twitter's potential as a free speech platform. However, the company faced operational challenges, including inefficient monetization, inconsistent cash flows, and a significant issue with fake accounts. While Musk attempted to back out of the deal due to concerns about fake accounts, Twitter's board filed a lawsuit to force completion of the acquisition. This case evaluates Twitter's financial strategy, Musk's funding plan, and the financial justification of the acquisition price.

Twitter's Current and Prospective Business

Twitter had both strengths and weaknesses in 2022. It generated \$5.08 billion in revenue but struggled with operational inefficiencies, declining margins, and an inability to fully monetize its user base. Fake accounts further threatened its credibility and advertising revenue. While there were growth opportunities, such as exploring subscriptions, shifting away from ad reliance posed risks. Addressing fake accounts was critical for credibility and user engagement.

Musk's Interest and Funding Plan

Musk saw Twitter as a vital platform for free speech and believed he could unlock its potential through better management. He planned to fund the acquisition with \$25 billion in debt, including a risky margin loan backed by Tesla shares, and \$21 billion in equity. Key risks included potential margin calls if Tesla's stock declined, high interest payments on the debt, and securing committed equity financing.

Twitter's Valuation at the Time of Acquisition

Using comparable companies (Meta, Pinterest, Snap, Weibo, Match Group, Bumble), I estimated Twitter's implied share price at \$95.78 in the base scenario. Adjusting for 5% and 20% fake accounts, the implied share prices dropped to \$90.73 and \$75.56, respectively. Recognizing that Match Group and Bumble operate in different industries with distinct user engagement and monetization strategies, I excluded these companies from the comparable analysis. This led to a more relevant range of \$37.02 under the base scenario, \$34.90 with 5% fake accounts, and \$28.55 with 20% fake accounts. This illustrates how fake accounts significantly affect Twitter's valuation.

Musk's Claim on Fake Accounts

Musk's concerns regarding fake accounts are justified. The presence of fake accounts significantly reduces Twitter's value, as seen in the drop to \$28.55 per share when 20% fake accounts are considered. This suggests that the fake accounts issue is material and could warrant a renegotiation of the offer price. Musk's concerns about the platform's user quality are valid, and the issue should be addressed before proceeding with the acquisition.

Standalone vs. Transaction Scenario Share Price

In the standalone valuation, the implied share price ranged between \$28.55-37.02 (excluding Match and Bumble from comparables), which is lower than Musk's offer of \$54.20 per share, indicating that Twitter was likely overvalued at the time of the offer. In the transaction scenario, the best-case DCF valuation, which assumed a leveraged buyout structure, resulted in an implied share price of \$24.94. Both scenarios suggest that Twitter's intrinsic value is well below the offer price, raising concerns about the financial viability of the acquisition.

The transaction scenario also highlights the increased financial risk due to the high level of debt involved in the LBO.

Transaction Recommendation

Based on the valuation analysis, I would not recommend this transaction at the offered price of \$54.20 per share. The analysis indicates that Twitter is overvalued, and the acquisition would not meet the required return for equity holders (25%) based on the projected cash flows. Additionally, the high level of debt associated with the leveraged buyout introduces significant financial risk, and the uncertainty surrounding the fake accounts issue further complicates the deal.

A more prudent approach would be for Musk to renegotiate the offer price to better reflect Twitter's intrinsic value, which, based on the analysis, is closer to \$25-\$37 per share.

Alternatively, Musk should consider walking away from the acquisition to avoid overpaying for a platform with substantial operational challenges and financial risks.

Conclusion

Elon Musk's proposed acquisition of Twitter presents significant financial and operational risks. While Musk sees potential in the platform, the current offer price of \$54.20 per share is well above the implied value based on both comparable company analysis and a leveraged buyout model. The presence of fake accounts further reduces Twitter's value, justifying Musk's concerns and possibly warranting a renegotiation of the deal. Given the high level of debt, inconsistent cash flows, and valuation uncertainty, this transaction poses substantial risks, and Musk should either renegotiate or walk away from the deal.