

KKR acquires RJR Nabisco

Team Singapore
PE&VC Club



Deal Overview

KKR

(GENERAL PARTNER)

Founded in 1976
Winner of the bid war with
the strategy of hiring all
possible advisors.

\$32.6B

1988



RJR Nabisco

(PORTFOLIO COMPANY)

- Conglomerate of Tobacco & Food brands
- Resulted from the merger: RJR + Nabisco
- Today, part of Mondēlez

One of the
greatest
LBOs in
history

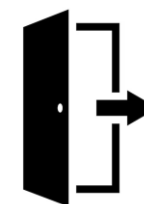


KKR
FIRST BOSTON

BID WAR



HIGHLY LEVERAGED
BUYOUT



IPO IN
1995

KKR vowed to
never put so
much in one
investment

Economic Outlook

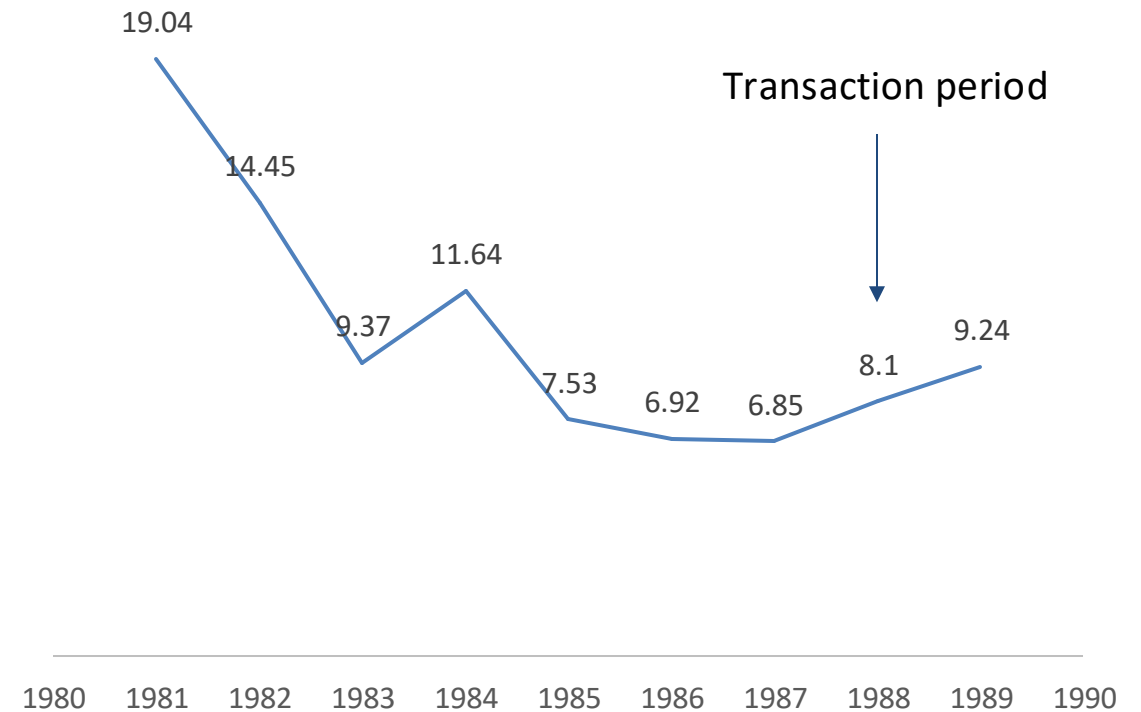
US Economy	High economic growth	Continuous growth for most of the 1980's	Coming from 1970's stagflation	3,5% average growth
	Reaganomics	Low social spending, high defense expenses, low taxes	Heavy emphasis on economic growth	Worries fuelled by growing debt and trading deficit
Financial trends	Deregulation	Most areas used to be heavily regulated	Massive legal reforms as part of reaganomics.	Appearance of junk bonds.
	LBO	Proliferated thanks to deregulation.	Frequent M&A thanks to changes in antitrust and financial regulations.	Ended up causing the junk bonds crisis
Interest rates and the Feds	Interest rates	Rose on early 1980's to combat inflation	The lowered, kept low (for 20 th century standards)	1980-84 – 10-19% 1984-88 – 6-10% 1988 – 8,1%
	1987 Black Monday	\$1.71 trillion market correction. DJIA falls by 22,6%	Worldwide effect, probably caused by uncertainty about trade and fiscal deficit.	Federal Reserve served as lender of last resort, NYSE introduced trading curbs. No long lasting effects.

Economic Outlook – Interest Rates

KKR assumed debt for financing the LBO following the interest rates of the FED:

Short Term Debt	11.3%
Revolving credit	10.8%
Bridge financing	17.3%
Subordinated debt	13.0%
Mezzanine debt	14.0%
Senior debt	14.5%
Bonds	11.2%

Interest rates in the 1980's Credit market context



Market Research – Late 1980's (I)



TOBACCO INDUSTRY

Industry Trends

- Market Consolidation
- Smoking Decline
- Regulatory Pressure
- Pricing Power

Competitive Landscape

- Market Share
- Product Diversification

International Expansion

- Global Growth
- Europe and Asia

Key Risks & Opportunities

- Opportunities
- Risks: increasing regulation and decline in the U.S. smoking population + public health concerns = more aggressive anti-tobacco campaigns.

FOOD INDUSTRY



- Consolidation and Competition
- Health and Nutrition Concerns
- Shift Toward Convenience Foods
- Nabisco's Brand Portfolio
- Product Diversification and Innovation
- Market Position
- Global Markets
- Challenges in International Markets
- Opportunities: increasing population in EMEA & Latin America, offered significant growth potential for its products.
- Risks

PLAYERS – RJR NABISCO

- Key products



Globally recognized cigarette brands such as **Winston, Camel, and Salem**

Cash Flow Stability: generated reliable and substantial cash flows

Challenges: the industry faced increasing regulatory pressures, litigation risks, and negative public sentiment, which raised concerns about the long-term viability of this revenue stream.



Nabisco's iconic consumer brands, including **Oreos, Ritz crackers, Chips Ahoy!, Fig Newtons, and Nilla wafer**

Growth Potential: The food division provided an opportunity for growth in less controversial markets compared to tobacco.

- Financial position

Revenue: The company generated **\$17.8 billion in revenue in 1987**, indicating its significant market reach and operational scale.

Net Income: RJR Nabisco reported **\$1.2 billion in net income**, reflecting profitability, though the margin (approximately 6.7%) was relatively low for a conglomerate of its size.

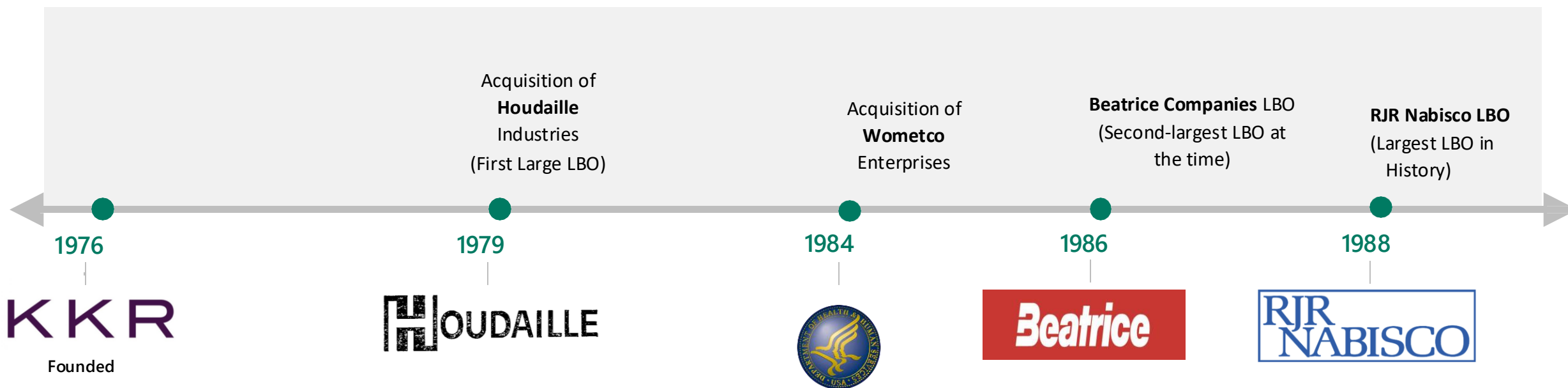
Debt: The company carried **\$4.7 billion in pre-buyout debt**, which, while not unusual for a corporation of its size, limited its financial flexibility.

Stock Price: It was trading at **\$56 per share** before the buyout process. However, the final price of **\$109 per share** represented a 94.65% premium, highlighting the potential for operational improvements.

- Challenges

- The merger created integration difficulties, as the food and tobacco divisions operated under different business models and margins.
- Inefficiencies and lack of strategic focus left the company ripe for an LBO, which could unlock shareholder value through restructuring.

TIMELINE OF KKR'S NOTABLE DEALS



KKR: Background and Expertise



Track Record

- Established reputation with high-profile buyouts.
- Strengthened credibility in executing complex, large-scale acquisitions.



Focus Areas

- Specialized in undervalued companies with stable cash flows.
- Focused on industries with predictable revenue streams.



Pioneering LBOs

- Revolutionized the leveraged buyout (LBO) model.
- Relied heavily on borrowed funds and innovative financing.

Motivations for Acquiring RJR Nabisco

Cash Flow Stability

The tobacco division provided predictable and substantial cash flows. This stability was crucial for servicing the significant debt incurred in the buyout.

Servicing Massive Debt

Operational Improvements

- KKR identified inefficiencies, particularly in the food division.
- Planned actions: Streamline operations, Divest non-core assets and enhance profitability through cost-cutting.

Enhanced Profitability

Prestige

- Largest LBO in history at the time.
- Opportunity to showcase KKR's dominance and ability to execute complex deals.

Elevated Reputation

Other Bidders and Competitive Dynamics

A. Ross Johnson and the Management Group:

- **Bid:** Initiated the process with a \$75-per-share management buyout (MBO), supported by Shearson Lehman Hutton and Merrill Lynch.
- **Motivation:** Johnson sought to privatize the company to escape shareholder pressures and focus on the food division. However, concerns arose over conflicts of interest and Johnson's personal gain, particularly his golden parachute.

B. Forstmann Little & Co.:

Played a critical role in financing competing bids, offering expertise in structuring leveraged buyouts for rival suitors.

C. First Boston:

- **Strategy:** Backed by Morgan Stanley, Forstmann proposed a conservative financing approach, emphasizing limited debt exposure.
- **Outcome:** Forstmann withdrew after realizing they couldn't match KKR's aggressive leverage and premium.

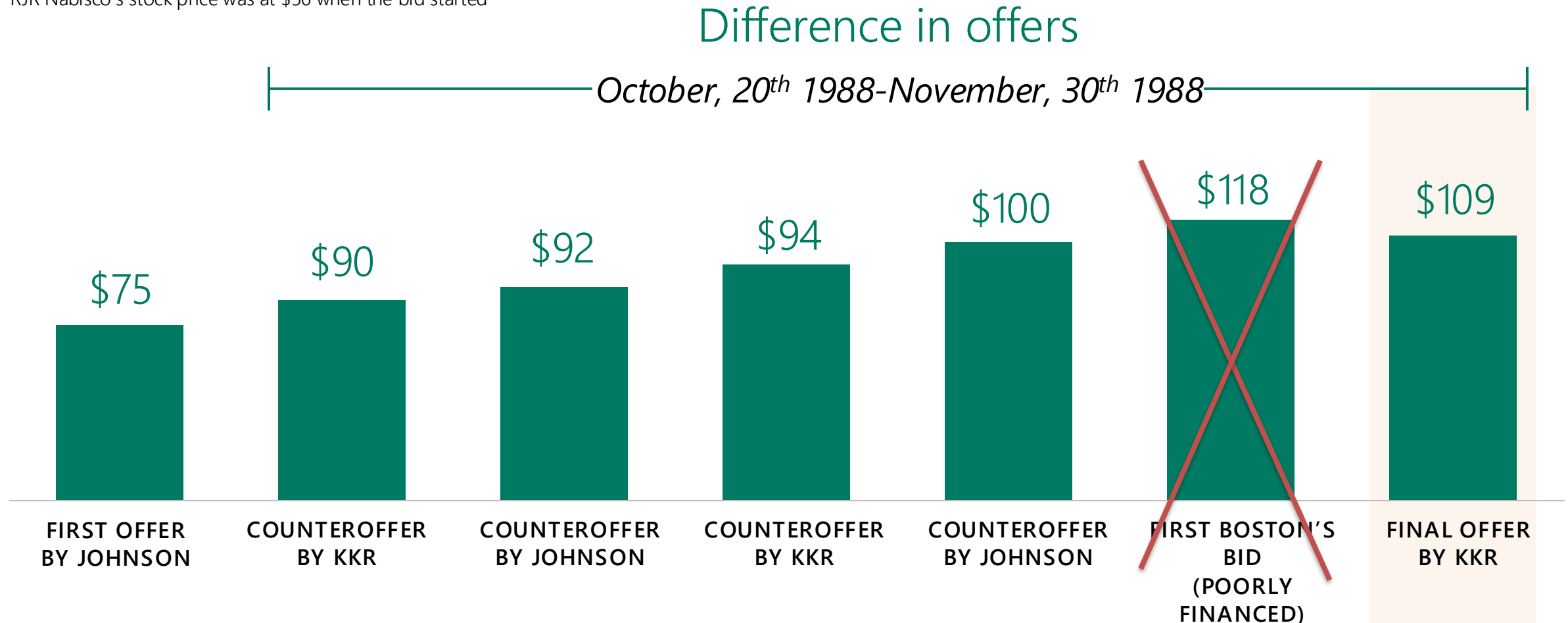
D. Other Financial Players:

- **Goldman Sachs:** Represented shareholders, evaluating and advising on the bids.
- **Drexel Burnham Lambert:** Supported the junk bond market that underpinned KKR's financing.
- **Lazard Frères:** Advised the special committee of RJR Nabisco's board, which ultimately chose KKR's offer.

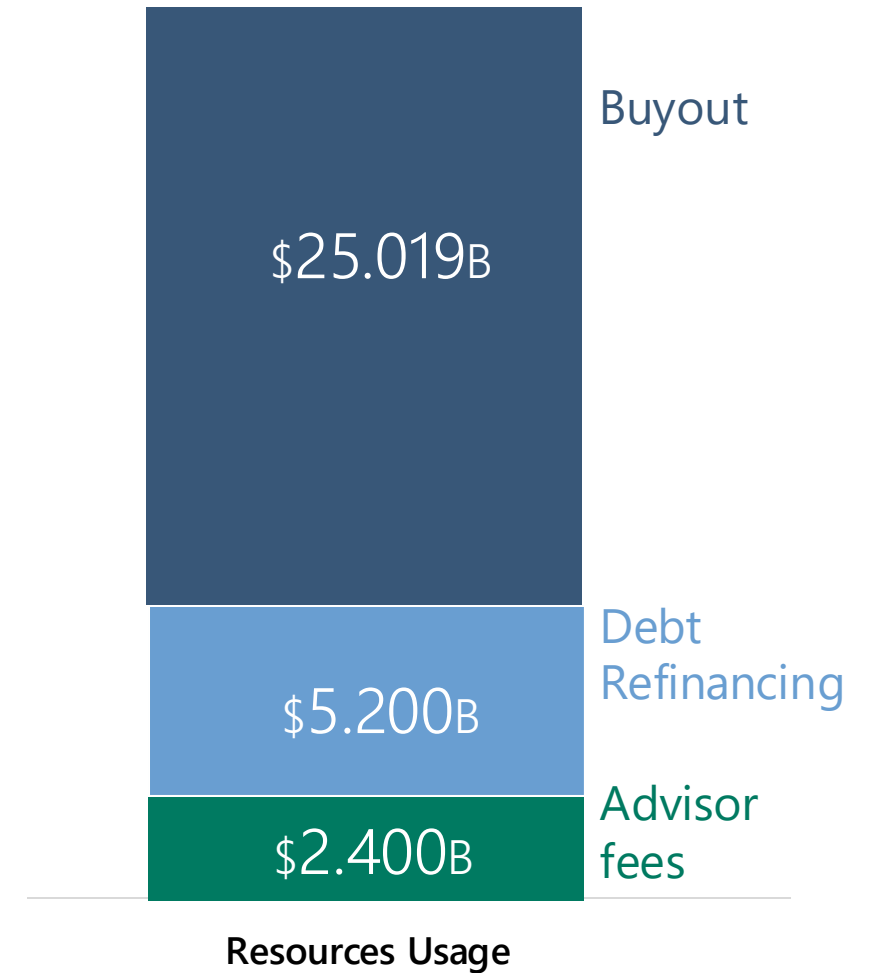
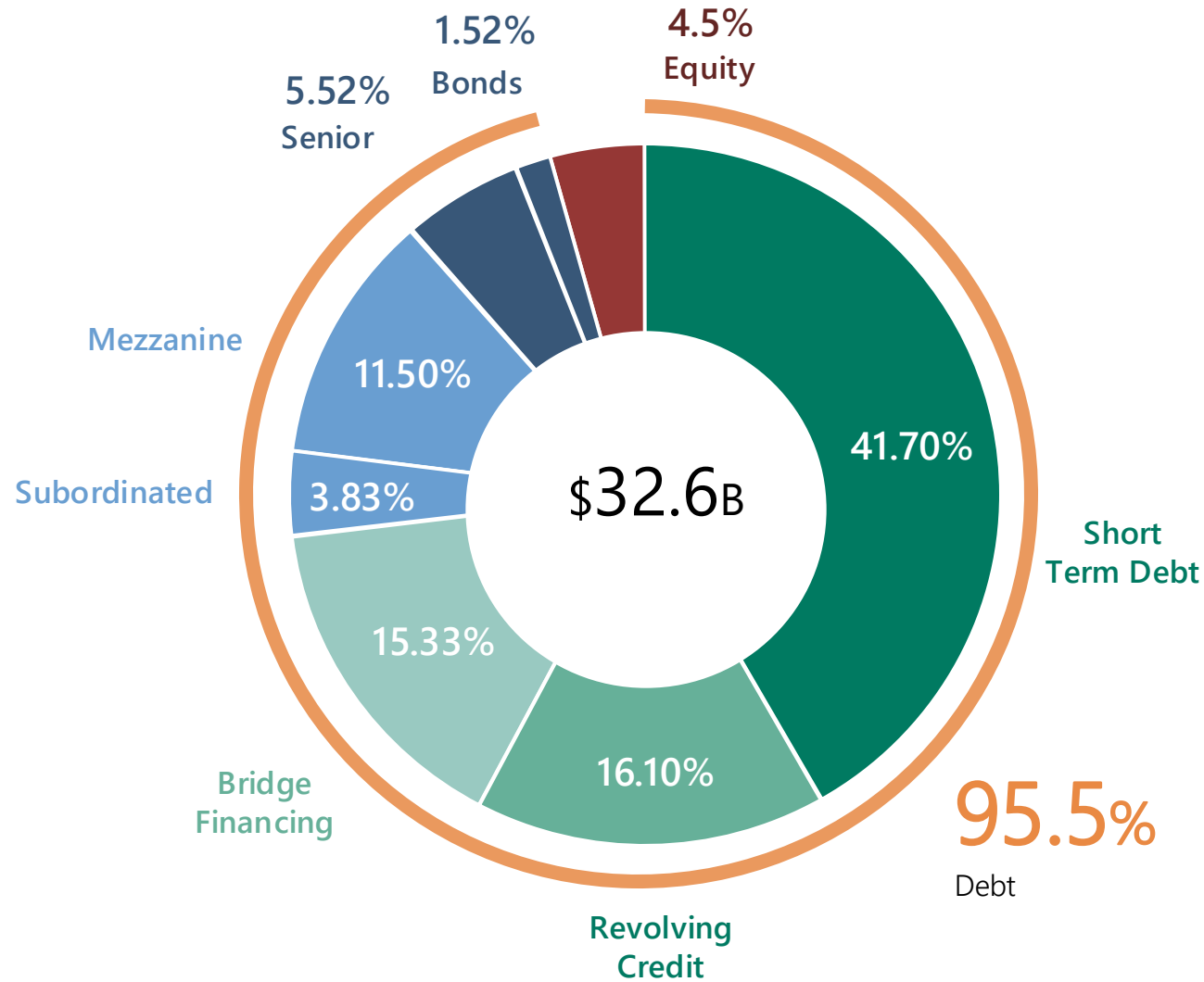
Key Transaction Details — Bid War

Price per share offers

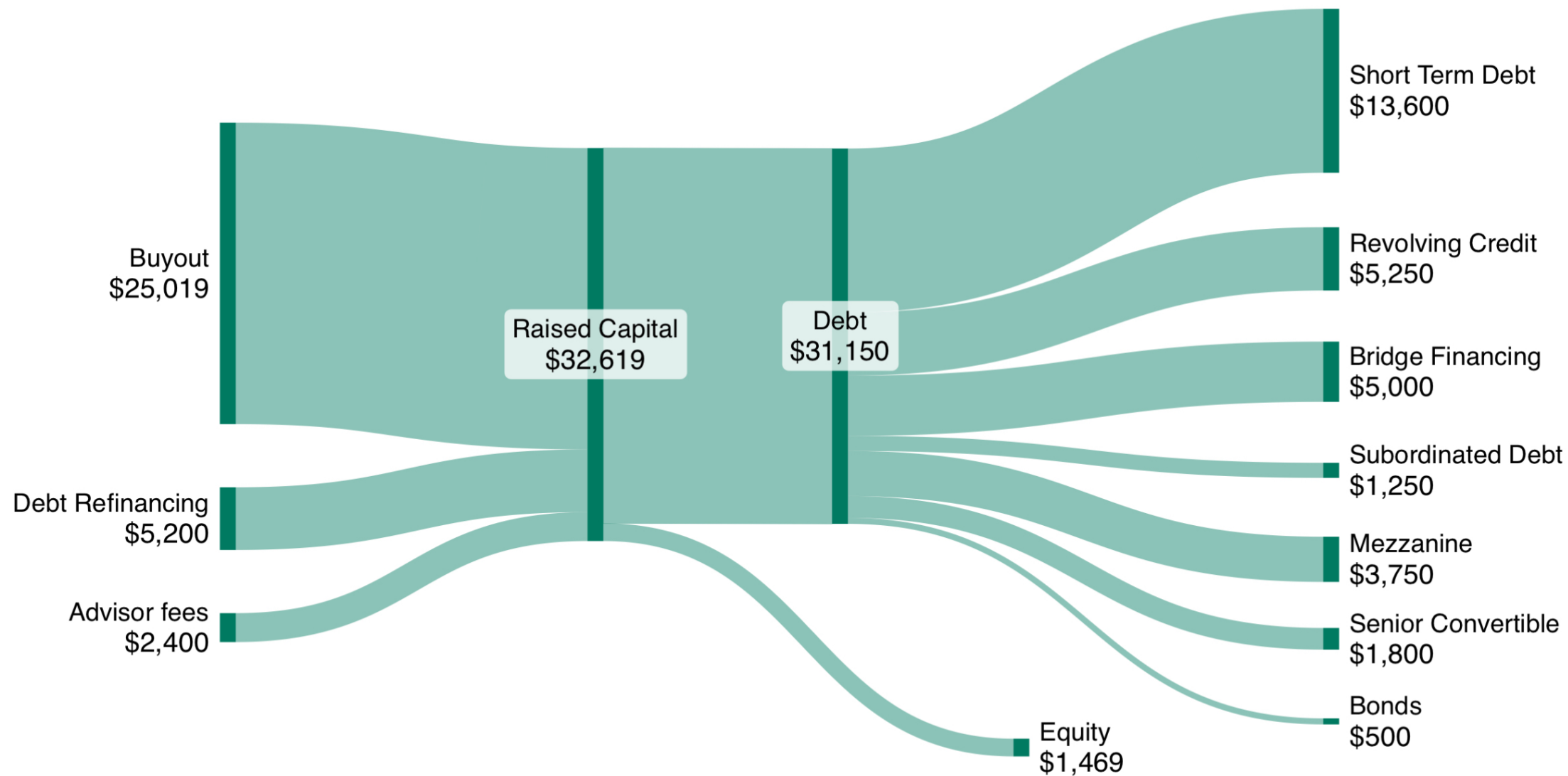
RJR Nabisco's stock price was at \$56 when the bid started



Key Transaction Details — Financing Structure (in %)



Key Transaction Details — Financing Structure (in millions of USD)



Assumptions

Base period: 1988

Required
IRR

25%

Average value

Internal Rate of Return –
annualized return on investments

Equity
at exit

95%

5% for directives as
incentive

Exit
multiple

9.13_x

EV/EBITDA

Since Inception (2022)

Rectified exit
multiple

8.3_x

EV/EBITDA

Advisor fees deducted from
acquisition price



