Blackstone acquires Hilton Hotels

DEAL ANALYST REPORT

Deal overview

Hilton Hotels

- Luxury hotels market
- Public before the deal
- Low free cash flow, high level of debt
- Attractive candidate

July 2007

- Shortly before the real estate bubble
- Peak of the LBO boom period

Most profitable LBO ever

- Blackstone's profits: $8.7bn

$26.2b

Blackstone

- Leading private equity firm
- $44.5bn AUM at the time
- +$1tn AUM today

Leveraged Buyout

- Debt package of $20.08bn
- 78% leverage
- Remaining capital invested by Blackstone itself.

Exit

- December 2013, through an IPO

Economic Outlook & Market Research

Macro Conditions

Global Economic Growth	▪ Global GDP was growing at 5.2% in 2007, caused by the growth of emerging economies such as China and India.
Slowing economic growth in the U.S.	▪ In 2007 the US GDP grew 2.0%, which was slowing down compared to the 2.9% growth in 2006. ▪ The burst of the housing bubble reduced residential investment ▪ As credit conditions tightened, consumer spending started to fall ▪ Business investment started showing signs of slowing
Capital Markets and Liquidity	▪ Financial markets had high liquidity, making credit accessible for large transactions. However, mid-2007 the financial crisis hit due to the subprime mortgage crisis, which led to an increase in risk in the financial market. ▪ Blackstone was left with a high leveraged Hilton with no access to credit and in a slowed down business.
Interest Rates	▪ The interest rates remained low in the US at 5.25%, which made it cheaper for Blackstone to secure debt financing for acquisitions.

Macro Conditions

Opportunities

- The economic growth in emerging markets opens opportunities for expansion, investment, and portfolio diversification and to increase Hilton's profitability.
- Low interest rates reduce the cost of capital, enabling growth-focused borrowing.
- Access to liquid financial markets can make large-scale transactions and support acquisitions or expansions more favorable.
- Favorable financing conditions allowed Blackstone to structure the acquisition with high leverage, aiming to maximize return on investment.
- An increase in disposable income leads to an increase in demand and higher business investments opens opportunities for partnerships, acquisitions, and technology innovation.

Risks

- Financial crises or instability can limit liquidity, tighten credit conditions, and make financing unpredictable.
- Having too much leverage and over-relying on debt magnifies risks when market conditions deteriorate.

Overview hospitality and hotel industry

Key demand drivers

- Key demand drivers:
  - Business travel increased as multinational companies increasing their travel budgets..
  - Rising disposable incomes and increased access to international travel fueled growth in leisure tourism.

Hospitality Market

- The global hospitality industry was growing steadily. Reasons:
  - Rise in disposable income in emerging markets
  - Demand for business and leisure travel was rising, driven by globalization.

Global Ocupancy Rates

- Global occupancy rates were around **60-65%** in 2007, with higher rates in luxury and business travel markets.

RevPAR

- Revenue Per Available Room was growing across most regions

Risk of US recession

- The hospitality industry´s economic sensitivity showed significant risks as the US economy showed signs of a recession.

Overview hospitality and hotel industry

Opportunities

- The steady growth of the global hospitality industry, driven by increasing travel demand and rising disposable incomes, aligned with Hilton's global brand and upscale portfolio.
- As Hilton lagged competitors in its international footprint, emerging markets such as Asia-Pacific or Middle East offered significant room for expansion.
- Higher occupancy rates and demand for premium services in luxury and business segments offer opportunities for premium pricing and value-added services.

Risks

- The hospitality industry's strong dependence on economic conditions posed a significant risk as the U.S. economy showed signs of recession in 2007.

Key trends in travel, tourism and luxury hotel industry

Easier acces to travel	▪ Rise of low-cost Airlines: travelling is more affordable ▪ Onlline travel booking: platforms to compare prices and moblie bookin
Luxury travel	▪ High-net-worth individuals looking for more exclusive experiences ▪ Growth of luxury eco-resorts ▪ Adventure and experience-based travel: growth of adventure tourism and persoanlized services ▪ Luxury hotel chains expanding their portfolios
Emerging destiantions	▪ Rise of emerging markets such as: Asia, India, the Middle East and Easter Europe ▪ Growing demand for luxury hotels and destination hotels, hence the luxury hotel chains' expansion
Innovation and technology	▪ New high-tech amenities to make the stay more personalized ▪ Focus on sustainability and green luxury: eco-luxury experiences available to the public

LBO – BOOM ERA

Leveraged Buyout (LBO): financial transaction in which a company is acquired using a combination of equity capital (their own funds or investors' funds) and a substantial amount of debt to fund the acquisition of a company. They wer extremely popular in 2007, some reasons for this were:

Favorable credit market conditions

Availability of cheap credit

financial institutions willing to lend money

Low interest rates

Easy for private quity firms to raaise capital

Institutional investors

Pensión funds, hedge fundas and insurance companies willing to invest

Private Equity firms' growth

Rapid growth

Both in size and number

Competition among firms

Competition pushed up the prices of the companies being acquired

Demand for larger deals

Operational improvement and cost cutting

Debt burden forced target company to generate strong cashflows

More disciplined managing and restructuring efforts

Increase in profitability

Main competitors

Luxury hotel industry: very competitive back in 2007: the biggest hotel chains were expanding their portfolio into emerging markets, solidifying their positions as cindustry leaders

HILTON HOTELS

Company being acquired: by 2007, Hilton had established itself as a global leader in the hotel industry, with 3,000+ hotels across more than 70 countries. The company was rapidly growing, both in terms of global reach and brand portfolio; focusing on expanding its luxury and mid-range hotel brands

MARRIOT INTERNATIONAL

One of the largest and most prominent competitors to Hilton in 2007, it's portfolio included high-end brands such as Ritz-Carlton (which was acquired in 1998) and the JW Marriott brand, which directly competed with Hilton's Conrad and Waldorf Astoria hotels.

STARWOOD HOTELS & RESORTS

One of the leading global players in the hospitality industry, known for its diverse brand portfolio, strong market presence, and a reputation for luxury, business, and premium leisure travel. Wide range of brands such as St. Regis or W Hotels.

USD (millones)	1999	2000	2001	2002	2003	2004	2005	2006	CAGR
Ingresos									
Hilton	3,555	4,345	3,952	3,816	3,819	4,146	4,437	8,126	7.8%
Marriot	6,255	7,911	7,768	8,222	8,712	9,778	11,129	11,995	6.1%
Starwood	5,396	4,945	4,633	4,588	4,630	5,368	5,977	5,979	0.9%
EBIT									
Hilton	497	1,235	1,023	951	849	988	1,104	1,715	11.9%
Marriot	398	957	642	642	641	741	883	1,275	11.2%
Starwood	674	1,449	1,094	1,039	856	1,084	1,229	1,145	4.9%

Main Players

Hilton Hotels: Buyer Profile

Position Before the LBO:

- **Founded:** 1919 by Conrad Hilton.
- **Scale (2007):** Over 2,900 properties globally.
- **Brands:** Hilton, DoubleTree, Embassy Suites, Hampton Inn, among others.

Growth Strategy:

- Aggressive expansion through acquisitions (e.g., Promus Hotels).
- Debt-financed growth leading to Moody's downgrade to Ba2 (junk status).

Competitive Challenges:

- Reliance on owned/leased properties (vs. franchise/management model).
- Positioned weaker compared to Marriott and Starwood.

Competitive Advantage:

- Strong global brand recognition.
- Extensive franchised and managed hotel network.

Aspect	Hilton Hotels Corporation	Marriot International	Starwood Hotels & Resorts
Founded	1919	1927	1980
Properties (2007)	Over 2,900	Over 3000	Over 850
Operating models	Owned and leased properties	Primarily franchises and managment	Primarily franchises and managment
Credit Rating	Ba2 (non-investmente)	Investment grade	Investment grade
Growth Strategy	Agressive expansion through debt-financed adquisitions	Organic growth and selective adquisitions	Organic growth and selective adquisitions
Brand Recognition	Strong	Strong	Strong

Hilton's debt-financed growth and reliance on owned properties weakened its financial position, but its strong global brand and expansive network made it an attractive acquisition target for Blackstone.

Blackstone: Buyer Profile

Blackstone Group, one of the world's *leading private equity funds*, had a distinguished track record in real estate and hospitality-related acquisitions.

Prior to the Hilton acquisition, Blackstone had made multiple strategic investments in the hospitality industry, including **Extended Stay America**, **Wyndham** and **La Quinta**. These transactions totaled more than **$13 billion** in sector-related investments, cementing its expertise and positioning as a specialty buyer.

Blackstone's *strategy* for Hilton was to maximize profitability through its operational expertise in real estate asset management and to leverage expansion and cost optimization opportunities. To finance the acquisition, it used a typical highly leveraged **LBO** (Leveraged Buyout) structure: **$6 billion** in equity and **$20 billion** in debt.

Advisors involved

Goldman Sachs and Merrill Lynch

Acted as lead financial advisors to Hilton, helping to evaluate Blackstone's offer and ensuring that the transaction maximized shareholder value.

Blackstone's Advisors

Blackstone worked with several financial institutions to structure and underwrite the debt package that financed the transaction, including leading banks such as Deutsche Bank and Bear Stearns.

Law Firms

Both Hilton and Blackstone were represented by law firms specializing in M&A. Skadden, Arps, Slate, Meagher & Flom LLP worked closely with Blackstone to ensure a smooth transition.

Key Transaction Details

Core Transaction Insights: Blackstone's Hilton Hotels LBO

Enterprise Value: $26.2 billion

Equity Value: $6 billion (21,5%)

Debt Value: $20.2 billion (78,5%)

KEY DETAILS

- **Debt/EBITDA multiple:** 12.4x
- Payment of a **premium** of more than **40%** over the company's share price

INVESTMENT THESIS

- **Stable and growing cash flows** that allowed for significant levels of leverage (Hilton recorded annualized EBITDA growth of 11.9%)
- Mature company and industry
- **Feasible divestiture** through sale to other funds or **IPO**
- **Low EV/EBITDA** multiple relative to listed comparables, likely due to the relatively high proportion of owned and leased business segments in Hilton's earnings. owned and leased business segments in Hilton's earnings.

USD (millions except share price)	Share price	Market Cap	Total Debt	EV	LTM EBITDA	EV/EBITDA
Marriott	42.77	16,706	2,284	19,000	1,379	13.8x
Starwood	67.07	14,427	2,606	16,874	1,180	14.3x
Wyndham	36.26	6,610	3,132	9,568	837	11.4x
ChoCe	39.52	2,613	184	2,762	177	15.6x
Harrah's Entertanrnent	66.43	12,383	10,838	22,64	2,342	9.7x
Hilton	33.47	13,045	7,471	20,479	1,680	12.2x

Debt Structure of Blackstone's LBO of Hilton: Key Components

Hilton LBO Estimated Capital Structure.

$, million	Principal	Term	Spread over 5.07% LIBOR
Enterprise value	26,500		
Equity	5700		
Senior Mortgage Notes - Tranche A	3600	6 years	0.80%
Senior Mortgage Notes - Tranche B	2000	6 years	1.20%
Senior Mortgage Notes - Tranche C	2000	6 years	1.60%
Mortgage notes / second lien	1000	6 years	2.40%
Secured mezzanine loans 1	8300	7 years	3.14%
Secured mezzanine loans II	1800	8 years	4.25%
Secured mezzanine loans 111	2100	9 years	5.25%
Total Acquisition Debt	20,800		2.71%

KEY DETAILS

- Interest expense projections are based on a constant **LIBOR** set to the rate as of June 2007 **(5.07%)**
- The debt contracted for this operation is **cov-lite in nature**, i.e., it had no covenants imposed by the banks.
- The 80% **debt quota** was furnished by a **syndication** of seven high reputable financial institution **(Bear Stearns)**: Bank of America, Deutsche Bank, Goldman Sachs, Lehman Brothers, Merrill Lynch and Morgan Stanley.

STRUCTURE THESIS

•**Diversified Debt** :
•Tranches:Senior: $7.6B at low spreads, 6 years
•Second Lien: $1B, medium spread
•Mezzanine: $13.2B, long-term flexibility

Post-LBO & Exit

Value Creation Plan

DEBT RESTRUCTURING	•In 2010, Hilton repurchased $1.8 billion in debt for $819 million. •Lenders agreed to convert $2.1 billion of debt into mezzanine equity. •The repurchase was funded by $819 million in new equity investment from Blackstone. •Between 2010 and 2012, Hilton repaid an additional $1.7 billion in debt.
REAL ESTATE ASSET MANAGEMENT	• Monetize strategic real estate assets through sale and leaseback agreements, freeing up capital for investment in other growth áreas • Invest in high-impact renovations to improve the competitiveness and value of hotels in key markets.
IMPROVED CUSTOMER EXPERIENCE	• Expansion of loyalty programs such as Hilton Honors to increase customer retention and generate recurring revenue. • Training and improvements in service standards to raise customer satisfaction and loyalty.
IPO PREPARATION	• On December 12, 2013, Hilton debuts on the stock market for the second time at a price of $20 per share. • Of the total offering of $2,352.8 million, $1,200 million will be used to repay debt.

Debt Restructuring

Debt restructuring
Hilton's debt was heavily reduced and terms renegotiated

Restructuring agreement
Lenders and institutions receiving ¢35 on the dollar

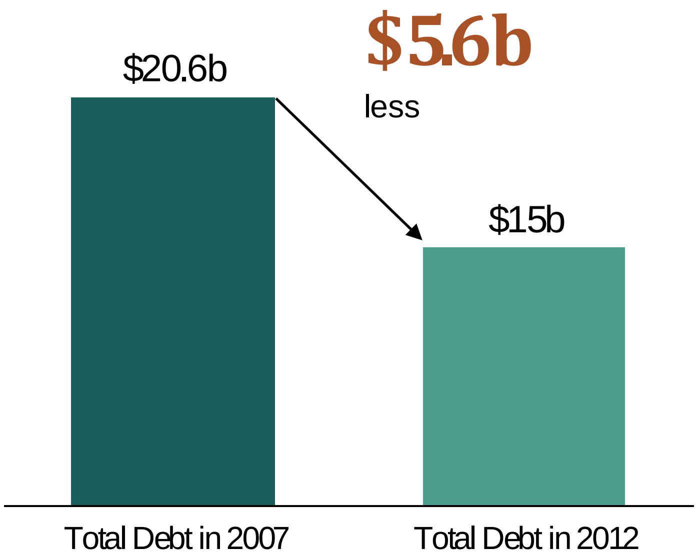
Debt payments
Through Blackstone's investments

Cheap debt
$1.8b of debt acquired

Debt conversion
$2.1b of debt converted into mezzanine

Blacsktone increased its capital contribution from $5.7b to $6.5b in order to make this restructuring possible

Debt reduction



IPO

$20 per share

984.6M

Offered shares, of which **750.6M** were Blackstone's

$8.5b

Blackstone's profit

New valuation

The IPO resulted in a new valuation of **$19.7b**

Blackstone's profit

Blackstone's shares had a total value of $15b, resulting in a $8.5b profit

Where opportunity and good management meet

The Hilton Hotel's LBO resulted in one of the most profitable LBOs of history, thanks to a good management and a great opportunity.