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LBO & Sale-Leaseback Analysis

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This is a fictional case study provided by Houlihan Lokey for the ACG Cup Competition.

To: Internal Investment Team

From: Highroad Equity Investment Committee

Subject: Project Fastlane

Dear Investment Team:

We want to welcome all of you to Highroad Equity ("Highroad"). We are excited to bolster our investment team with the talent and experience that you bring to our family office. Our primary objective is to provide our private capital base with the highest possible risk-adjusted returns through our business of investing and operating middle market businesses around the globe. We believe that the skills from your investment banking background will translate well in our principal investing environment, and we look forward to your future recommendations and leadership.

We understand that at your previous firm, MBA Investment Bankers, LLC, you met with the board of Fastlane (the "Company"), an international automotive retail group with operations in both the United States and Europe to present your thoughts on valuation and potential strategic alternatives. As you are no longer subject to the terms of the confidentiality agreement you signed with Fastlane while at your previous employer, the Investment Committee (the "Committee") would like your team to prepare an investment analysis to discuss the merits of Highroad pursuing the acquisition of Fastlane.

As you may already know, Fastlane decided to reject Autobahn's $160 million offer and has engaged another investment bank to run a sale process for the Company. Further, we have signed a confidentiality agreement with Fastlane and are interested in investing in the Company. Using all information that was provided during your previous analysis of strategic alternatives for Fastlane, we would like you to present an analysis on the following scenarios to the Committee:

- Acquisition of the entire operations of Fastlane, inclusive of the Company owned real estate.
- Acquisition of the entire operations of Fastlane, including a sale-leaseback where the Company owned real estate would be purchased by a real estate investor from Highroad on the transaction date, in which our newly acquired entity would lease the buildings back from the real estate investor. The Company owned real estate has recently been appraised at $80 million.

In presenting these alternatives to the Committee, please address the following investment considerations:

- What are the sources and uses as it relates to both scenarios?
- What are the expected returns to Highroad assuming both a five-year and ten-year hold period in terms of Internal Rate of Return (IRR) and as a multiple of invested capital?
- Under both a five-year and ten-year hold period, which transaction presents the most attractive return to Highroad?
- Other merits to own or not own the real estate (outside of strictly projected investment returns)
- Recommendation to Highroad's investment committee, including discussion of the risk-adjusted returns relative to the size of the investments.

Highroad Equity Background Information

Highroad Equity is the private investment arm of Smith Investors Inc., a family office that manages over $5 billion of family assets for the Harry L. Smith family. In order to achieve proper diversification of the family assets, Smith Investors Inc. operates in four distinct divisions, including Smith Micro-Cap Investments (which invests in publicly traded stocks), Smith Real Estate Partners (which is an investor in commercial real estate), HLS Fixed Income Investments (which purchases bonds and other long-term fixed income instruments) and Highroad Equity, a principal investment firm that invests in middle market businesses.

Highroad has been allocated $1.5 billion from Smith Investors Inc., and seeks to invest between $50 million to $150 million of equity in each of their portfolio companies. Highroad is a control investor, and due to its private capital base, the firm does not have a defined investment time horizon, such as more traditional private equity firms whose capital comes from institutional investors. This provides Highroad more flexibility to consider a wide range of businesses for acquisition. The firm is based in Los Angeles, California.

Other Factors to Consider

- Highroad seeks to achieve at least a 22.5% IRR on investment opportunities with a five-year hold period, and an IRR of at least 13.5% on investment opportunities with a ten-year hold period.
- Senior debt is available for companies similar to Fastlane's size and risk profile at up to 3x adjusted EBITDA.
- Total debt is available for companies similar to Fastlane's size and risk profile at up to 4.5x adjusted EBITDA.
- Senior lenders are quoting LIBOR + 400 basis points with a LIBOR floor of 1.5% for a seven-year term loan with an amortization schedule as follows:

Year 1	**Years 2-5**	**Years 6-7**
0.0%	15.0%	20.0%

- The mezzanine market is seeing increased competition for business with pricing for better credits of 12% cash interest and 2% PIK interest.
- Lenders will require Fastlane's fixed charge coverage ratio to be above 1.25 throughout the projection period.
- Highroad would expect to pay transaction expenses of 1.0% for the amount of senior debt utilized, 1.5% for mezzanine debt utilized and $2.0 million for all other diligence and deal expenses to acquire the business.
- Highroad would expect to pay transaction expenses of $2.0 million upon the sale of the real estate to a real estate investor.
- Cap rates for automotive dealership properties should be assumed to be approximately 9%.
- In the sale-leaseback scenario, assume both capital expenditures and depreciation and amortization expenses each represent approximately 0.2% of sales.
- Assume consistent growth rates and margins for the second five-year projection period as what was presented in the first five-year projections previously provided.

Information Provided

- Please utilize the financial data that was provided in Round 1 of the case competition (all information presented in the "Other Factors to Consider in a Potential Transaction" section of the Round 1 case materials should be considered to be relevant).
- In addition, we would advise participants to utilize analyses that were completed during Round 1 to assist in determining acquisition and exit multiples.
- Capitalization rate ("cap rate") definition: the cap rate is a ratio used to estimate the value of income producing properties. For the purpose of this analysis, it is defined as the annualized rent divided by the purchase price for the property.

ACG CUP - COMPETITION RULES

Time

You will be given 20 minutes to present your recommendations to the judges. There will not be a separate time allotted for questions and answers – Q&A will take place during your presentation.

Judges

The judges are ACG members who are local industry professionals in areas such as investment banking, valuation, private equity, junior capital providers, etc. The judges will represent the Board of Directors for purposes of your presentation, and should be addressed as such.

Presentation Format

You should prepare a PowerPoint presentation (or equivalent) for the judges. The format of the 20 minutes is to give this presentation on the screen in front of the judges and answer any questions that they raise.

Please bring 10 hard copies of this same presentation in order for the judges to follow along and refer to this while you are speaking.

It is expected that everyone in your group will participate in a meaningful way. While it is not required that everyone in the group has a primary speaking role, if you choose to lead most of the discussion with one or two of your best speakers you should make it clear that everyone contributed in a significant manner.

Anything beyond this presentation is completely up to your discretion – it should be whatever you believe is best to communicate the findings, recommendations, and analysis of your team.

Judging Criteria

Your presentation and analysis will be judged based on both your content as well as your presentation itself. While there is no "right" answer, the judges will be looking for you to have a well thought-out analysis that is effectively presented and well defended when questioned. You should treat the judges as members of the investment committee and answer their questions in a non-defensive manner. In addition, this is designed to be a "real-world" experience, and judges may interrupt with questions, just as an investment committee would, so be ready!

Below are listed some of the judging criteria:

ANALYSIS

- Investment analysis of Fastlane
    - Ability to discuss and defend key investment considerations, such as:
        1. What scenario presents the most attractive return profile to Highroad?
        2. Capital structure selected and reasons for selection
        3. Impact of sale-leaseback transaction on the financial results of the Company
        4. Use of proceeds of a potential sale-leaseback transaction

PRESENTATION

- Provide a clear outline of the situation and the factors the Committee needs to both understand and consider
- Present a clear analysis and recommendations
- Answer the judges' questions effectively in an "advisory," not defensive manner

Honor Code

By participating, you agree to be bound by the honor code of your school, the rules contained herein and the rules that are provided prior to entering the data room. In particular, please note that NO outside help is allowed once you have received the case. Specifically, this includes help from anyone at your school, including faculty and other students.

Furthermore, no outside research is needed in addition to the facts in the case and ACG will not answer questions regarding the case itself. If you feel that there is missing information or something is unclear, simply make an assumption and be prepared to explain that assumption (do not say "the case did not say", remember that the judges are acting in the role of investment committee members and should be addressed as such).

Investment banking services provided by HL Capital, Inc.; investment advisory services provided by HL Financial Advisors, Inc. In the European Economic Area and Hong Kong services provided by HL (Europe) Limited and HL (China) Limited, respectively.

About Houlihan Lokey

Houlihan Lokey is an international investment bank with expertise in mergers and acquisitions, capital markets, financial restructuring, and valuation. The firm serves corporations, institutions, and governments worldwide with offices in the United States, Europe, and Asia. Independent advice and intellectual rigor are hallmarks of our commitment to client success across our advisory services. Houlihan Lokey is ranked globally as the No. 1 restructuring advisor, the No. 1 M&A fairness opinion advisor over the past 10 years, and the No. 1 M&A advisor for U.S. transactions under $1 billion, according to Thomson Reuters. For more information, please visit www.HL.com.

Fastlane Historical and Projected Financial Statements

A. Consolidated Income Statement

($ in thousands, December fiscal year)	2010	2011	2012	2013	2014	2015	2016	2017
	Actual	*Actual*	*Estimated*	*Projected*	*Projected*	*Projected*	*Projected*	*Projected*
Sales	$ 535,358	$ 564,930	$ 610,585	$ 647,131	$ 673,989	$ 697,567	$ 724,315	$ 752,091
% change	*NA*	*5.5%*	*8.1%*	*6.0%*	*4.2%*	*3.5%*	*3.8%*	*3.8%*
Cost of sales	446,798	471,289	508,998	539,009	561,201	580,855	603,375	626,521
Gross profit	**$ 88,559**	**$ 93,641**	**$ 101,586**	**$ 108,122**	**$ 112,789**	**$ 116,712**	**$ 120,940**	**$ 125,571**
% of sales	*16.5%*	*16.6%*	*16.6%*	*16.7%*	*16.7%*	*16.7%*	*16.7%*	*16.7%*
Personnel expenses	$ 50,542	$ 52,001	$ 56,770	$ 59,582	$ 60,434	$ 61,095	$ 61,545	$ 62,196
Depreciation and amortization	5,127	5,207	4,994	4,946	4,989	5,052	5,055	5,062
Other operating expenses	27,560	28,619	29,218	29,098	29,347	29,418	30,446	31,648
Total operating expenses	**$ 83,229**	**$ 85,827**	**$ 90,982**	**$ 93,627**	**$ 94,771**	**$ 95,565**	**$ 97,047**	**$ 98,906**
% of sales	*15.5%*	*15.2%*	*14.9%*	*14.5%*	*14.1%*	*13.7%*	*13.4%*	*13.2%*
Operating income	**$ 5,331**	**$ 7,814**	**$ 10,605**	**$ 14,495**	**$ 18,018**	**$ 21,147**	**$ 23,893**	**$ 26,665**
% of sales	*1.0%*	*1.4%*	*1.7%*	*2.2%*	*2.7%*	*3.0%*	*3.3%*	*3.5%*
Interest expenses (income)	$ 4,863	$ 4,687	$ 4,348	$ 4,071	$ 3,544	$ 3,191	$ 2,995	$ 2,719
Income before tax	**$ 468**	**$ 3,127**	**$ 6,257**	**$ 10,424**	**$ 14,474**	**$ 17,956**	**$ 20,898**	**$ 23,946**
% of sales	*0.1%*	*0.6%*	*1.0%*	*1.6%*	*2.1%*	*2.6%*	*2.9%*	*3.2%*
Income tax expense	164	1,095	2,190	3,648	5,066	6,285	7,314	8,381
Net income	**$ 304**	**$ 2,033**	**$ 4,067**	**$ 6,776**	**$ 9,408**	**$ 11,671**	**$ 13,584**	**$ 15,565**
% of sales	*0.1%*	*0.4%*	*0.7%*	*1.0%*	*1.4%*	*1.7%*	*1.9%*	*2.1%*
Capital expenditures	$ 4,212	$ 4,390	$ 4,664	$ 4,883	$ 5,044	$ 5,185	$ 5,346	$ 5,513

B. Consolidated Balance Sheet

($ in thousands, December fiscal year)	2010	2011	2012
	Actual	*Actual*	*Estimated*
Assets			
Cash and cash equivalents	$ 16,600	$ 5,424	$ 7,562
Accounts receivables	22,225	25,934	28,269
Inventories	80,953	85,312	83,485
Other current assets	12,384	14,758	10,981
Total current assets	**132,163**	**131,429**	**130,297**
PP&E, net	74,230	83,994	81,360
Goodwill	-	11,934	11,934
Other assets	4,011	4,038	6,124
Total long-term assets	**78,241**	**99,966**	**99,419**
Total assets	**$ 210,403**	**$ 231,394**	**$ 229,716**
Liabilities and stockholders' equity			
Notes payable (1)	$ 28,445	$ 36,378	$ 42,622
Accounts payable and accrued expenses	44,295	43,602	38,240
Other current liabilities	12,581	13,099	12,520
Total current liabilities	**85,321**	**93,079**	**93,382**
Long-term debt	50,471	65,099	60,264
Other long-term liabilities	23,132	21,156	22,399
Total long-term liabilities	**73,603**	**86,255**	**82,663**
Stockholders' equity	**51,479**	**52,060**	**53,671**
Total liabilities and stockholders' equity	**$ 210,403**	**$ 231,394**	**$ 229,716**

(1) Consists of "floor plan financing", a credit line used to finance inventory