



# Digi International LBO

Elkington



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# Thesis

6/3/16

Recommendation: Buy

Current Price: \$11.3

Buyout Price: \$15.00

- Digi International is a Machine-to-Machine (M2M) and Internet of Things (IoT) company without debt and a positive growth outlook.
- The company has had stable earnings over the last five years and have enough product power to maintain earnings in the future



# Company research

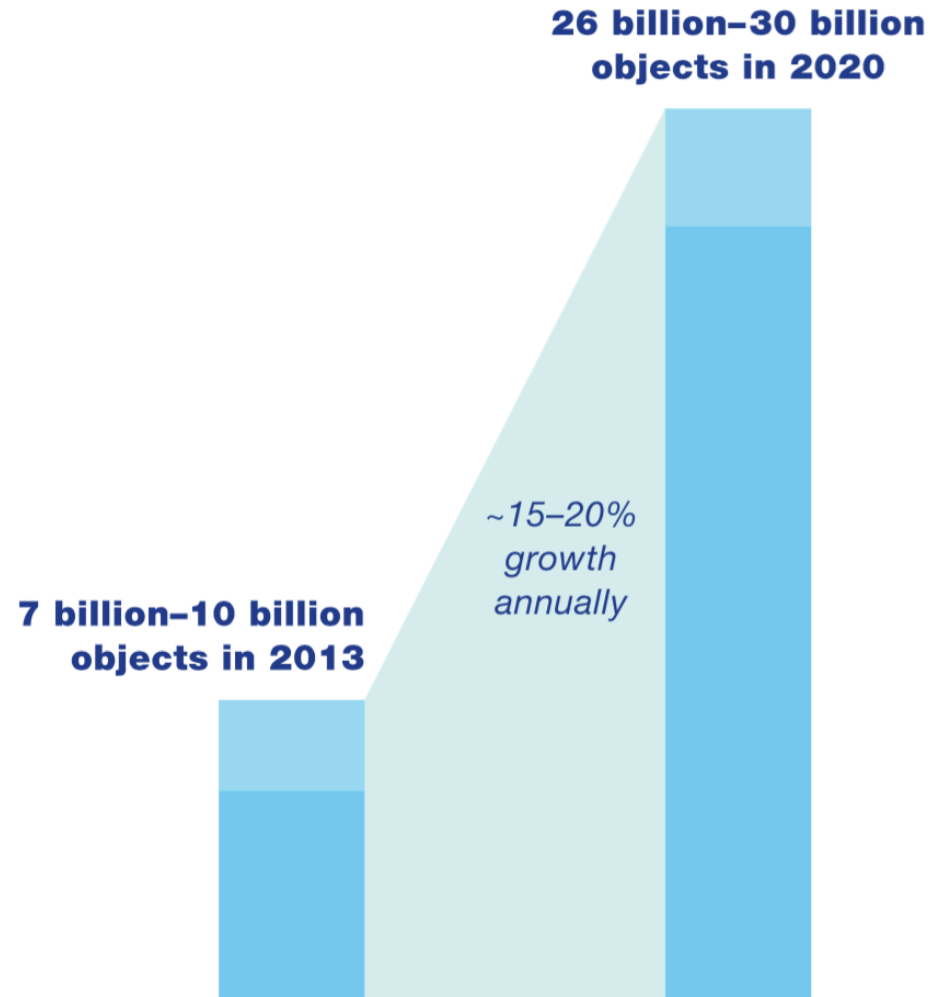
- Digi provides Internet of Things (IoT) networking hardware products and software.
- The company's portfolio includes:
  - Wireless and wired hardware products
  - Services and solutions to support hardware
  - Digi Cold Chain Solutions is a wireless end-to-end solution that utilizes sensors, gateways and an easy-to-use software application that enables companies to monitor the temperature of perishable goods effectively and economically (acquired from Bluenica Corporation)

# Company research

Stock price has been flat over the last five years



# IoT market will see significant growth



# Top Holders

Breakdown	
% of Shares Held by All Insider and 5% Owners:	2%
% of Shares Held by Institutional & Mutual Fund Owners:	84%
% of Float Held by Institutional & Mutual Fund Owners:	85%
Number of Institutions Holding Shares:	122

Major Direct Holders (Forms 3 & 4)		
Holder	Shares	Reported
KONEZNY RONALD	204,310	17-Dec-2015
NAWAZ AHMED	130,957	01-Feb-2016
GOERGEN MICHAEL C.	59,897	19-Nov-2015
RILEY KEVIN C.	55,441	20-Jan-2016
JACKSON GUY C.	44,707	24-Nov-2015

# Top Holders cont.

Top Mutual Fund Holders				
Holder	Shares	% Out	Value*	Reported
DFA U.S. Small Cap Value Series	751,544	2.90	6,854,081	31-Jan-2016
iShares Core S&P Smallcap ETF	724,115	2.80	6,828,404	31-Mar-2016
Vanguard Total Stock Market Index Fund	399,200	1.54	4,542,896	31-Dec-2015
iShares Russell 2000 ETF	385,414	1.49	3,634,454	31-Mar-2016
Pennsylvania Mutual Fund Inc	354,544	1.37	3,343,349	31-Mar-2016
Legg Mason Clearbridge Small Cap Value Fd	309,970	1.20	2,923,017	31-Mar-2016
Loomis Sayles Small Cap Value Fund	310,315	1.20	3,531,384	31-Dec-2015
Vanguard Extended Market Index Fund	276,836	1.07	3,150,393	31-Dec-2015
DFA U.S. Micro Cap Series	234,268	0.91	2,136,524	31-Jan-2016
Pace Select Advisors Tr-Pace Small/Medium Co Growth Equity I	198,002	0.77	1,805,778	31-Jan-2016



# Top Holders cont.

Top Institutional Holders				
Holder	Shares	% Out	Value*	Reported
Edgepoint Investment Group Inc.	2,229,812	8.62	21,027,127	31-Mar-2016
Dimensional Fund Advisors LP	2,176,668	8.41	20,525,979	31-Mar-2016
Riverbridge Partners LLC	1,960,534	7.58	18,487,835	31-Mar-2016
BlackRock Fund Advisors	1,627,829	6.29	15,350,427	31-Mar-2016
Vanguard Group, Inc. (The)	1,056,787	4.08	9,965,501	31-Mar-2016
Punch & Associates Investment Management, Inc.	1,051,072	4.06	9,911,608	31-Mar-2016
Boston Partners	775,660	3.00	7,314,473	31-Mar-2016
BlackRock Institutional Trust Company, N.A.	749,315	2.90	7,066,040	31-Mar-2016
Royce & Associates LP	671,811	2.60	6,335,177	31-Mar-2016
Loomis Sayles & Company, LP	648,580	2.51	6,116,109	31-Mar-2016

# LBO Valuation

Digi International LBO

Dashboard

In millions \$ except per share

Summary Sources & Uses of Funds

	Balance	% of Total	Mult. of LTM EBITDA
Excess cash	\$52.3	13.0%	3.59x
Liquidation of options	–	–	–
Revolver	–	–	–
Term loan - A	50.0	12.5%	3.44x
Term loan - B	–	–	–
Senior note	100.0	24.9%	6.87x
Subordinated note	50.0	12.5%	3.44x
Mezzanine	–	–	–
Seller note	–	–	–
Convertible bond	–	–	–
[Debt 8]	–	–	–
Preferred stock - A	10.0	2.5%	0.69x
Preferred stock - B	–	–	–
Spons or equity	119.9	29.9%	8.24x
Management equity	10.0	2.5%	0.69x
Tax refund	8.7	2.2%	0.60x
Total sources	\$400.9	100.0%	27.55x
Equity purchase price	\$368.0	91.8%	25.29x
Refinance debt	–	–	–
Fund cash balance	–	–	–
OID	8.0	2.0%	0.55x
Prepayment penalties	–	–	–
Financing fees	10.3	2.6%	0.71x
Transaction costs	14.6	3.6%	1.00x
Total uses	\$400.9	100.0%	27.55x

Fair Value Adjustments

Excess purch. price allocated to identifiable intangibles (%)	25.0%
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Asset / Liability

Asset?	Book Value at Close	Fair Value at Close	Fair Value Mark	DTA Created	DTL Created	Depr. / Amrt. Period (yrs)	
PP&E	Yes	\$15.6	\$30.6	\$15.0	–	\$5.3	7.0
Identifiable intangibles	Yes	–	24.0	24.0	–	8.4	5.0
[Asset 3]	Yes	–	–	–	–	–	–
[Liability 1]	No	–	–	–	–	–	–
[Liability 2]	No	–	–	–	–	–	–
[Liability 3]	No	–	–	–	–	–	–
Total				–	\$13.7		

Scenarios

Financing case – LBO C	6
Operating case – Analyst Case	3

Cost Savings

Annual run-rate COGS savings	\$10.0
Annual run-rate SG&A savings	20.0
Total annual run-rate cost savings	\$30.0

Other Switches / Assumptions

Minimum cash balance	\$50.0
Annual spons or management fee	–
Average interest?	No

Calendarization / Timing

Last FYE	12/31/15
MRQ date	3/31/16
Market date	6/3/16
Close date	12/31/16
Calendar quarter in which fiscal year ends	4
Calendar quarter of transaction close	4
Calendar year of transaction close	2016
Next FYE after transaction close	12/31/17
Quarters between close and next FYE	4

Valuation

Current stock price	\$11.30
Offer premium to market	30.0%
Offer price per share	\$14.69
Basic shares outstanding (BSO)	25.050
(+) In-the-money options liquidated	–
(+) In-the-money convertible shares	–
Fully diluted shares outstanding (FDSO)	25.050
(x) Offer price per share	\$14.69
Equity purchase price	\$368.0
(–) Proceeds from liquidation of options	–
Purchase price	368.0
Non-convertible debt	–
Convertible debt	–
Minority interest	–
Total debt and minority interest	–
(–) Cash & cash equivalents	(102.3)
(+) Net debt	(102.3)
Pro forma enterprise value	\$265.7

Multiples

	Metric	Multiple
LTM Sales	\$206.8	1.29x
FY16 PF sales	229.3	1.16x
FY17 PF sales	236.2	1.13x
LTM EBITDA	14.6	18.26x
FY16 PF EBITDA	48.8	5.45x
FY17 PF EBITDA	82.0	3.24x

Exit Assumptions

Valuation method (1=L EBITDA, 2=GAAP P/E, 3=Cash P/E)	1
Exit year	5
Exit EBITDA multiple	5.0x
Exit P/E multiple	18.0x

WACC Assumptions

Pre-transaction levered beta	1.20
Market risk premium	4.00%
Manual WACC	12.00%
WACC selector (1=manual, 2=computed)	2

Model Checks

Sources and uses balance	TRUE
Balance sheet balances	TRUE
Revolver limit observed	TRUE
Error message	

Tax Assumptions

Tax rate	35.0%
AMT tax credit carryforward	–

Section 382 Limitation

Existing NOL	–
Purchase price	\$368.0
(x) IRS long-term tax-exempt rate	2.83%
Annual NOL deduction limit under Section 382	\$10.4
(x) Tax rate	35.0%
Annual allowed tax benefit under Section 382	\$3.6
(x) Remaining NOL life (yrs)	15.00
Realizable tax benefit under Section 382	\$24.7
Existing DTA attributable to NOL	–
Total DTA subject to Section 382	–

Transaction DTA / DTL

DTA from write-down/up of assets/liabilities	–
Write down DTA attributable to NOL (Section 382)	–
Transaction DTA	–
DTL from write-up/down of assets/liabilities	\$13.7
Write off DTL related to purch. acmnt. intangibles	–
Transaction DTL	\$13.7

Purchase Price Allocation

Existing intangibles related to purch. accounting (%)	–
Purchase price	\$368.0
(+) FV of noncontrolling interests	–
(–) Book value	(271.8)
Excess purchase price to allocate	\$6.1
Write off existing goodwill	(110.7)
Write off purchase accounting-related intangibles	39.0
Fair value adjustments	(13.7)
Transaction DTA	–
(–) Book value adjustments	(85.3)
Excess purchase price after allocation	181.5
(+) Bargain purchase gain	–
Goodwill created	\$181.5

# Returns Analysis

## ***Sponsor equity***

Initial investment		(\$1,851.7)
Equity participation at exit		
Total cash flows		(\$1,851.7)
IRR	28.8%	
Cash-on-cash	3.55x	

## ***Management equity***

Initial investment		(\$10.0)
Equity participation at exit		
Total cash flows		(\$10.0)
IRR	30.5%	
Cash-on-cash	3.79x	



# Conclusion

1. Digi International is a company with high growth potential
2. Digi is a debt free enterprise
3. Company is mostly held by institutions, which may make stock amenable to an LBO
4. With growth assumptions, an LBO should yield an attractive return