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The Buyout of ProSiebenSat.1 by KKR and Permira – Blockbuster or Box Office Bomb?

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ABSTRACT

Title: The Buyout of ProSiebenSat.1 by KKR and Permira – Blockbuster or Box Office Bomb?

This case study describes the buyout of ProSiebenSat.1 during the peak of the buyout boom in 2007. Against the backdrop of the global financial crisis, it illustrates how the financial sponsors pursued an internationalization strategy by combining ProSiebenSat.1 with another portfolio company which eventually led to the financial distress of ProSiebenSat.1. The case study addresses the unique features of the investment thesis, namely the target characteristics as well as transaction structure and how the investors adjusted their initial investment thesis to encounter the issues faced. The deal is an example of many unsuccessful buyouts which happened during the financial crisis.

Keywords: Private Equity, Financial Crisis, Distressed, ProSiebenSat.1

INTRODUCTION

When Thomas Krenz heard the news he was electrified. The Managing Partner at Permira, the UK based private equity firm, had just learned that Axel Springer's takeover bid for ProSiebenSat.1 (P7S1), the German TV broadcasting and media company, had been vetoed by the German antitrust commission. After a series of broken deals – Permira recently lost the bidding processes for the Linde forklift truck business as well as for building supply business Max Bahr – he was under pressure to close a deal. As if that was not enough, the investment in telecommunication provider Debitel performed poorly and Permira had just lost its share in automotive supplier Kiekert to creditors due to financial leverage issues. P7S1 was the opportunity Krenz needed right now.

THE BUYOUT BOOM

The private equity industry was booming in 2006.[1] Large government surpluses and pension wealth increased capital allocations to alternative asset classes such as private equity and the new syndicated bank debt model ("originate-and-sell") improved liquidity in debt markets.[2] Higher liquidity and low interest rates in return led to lower credit spreads which contributed to high leverage ratios and often light covenants in leveraged buyouts (LBOs). Financial sponsors increasingly turned their attention towards Europe where the total buyout value had increased more than five times to more than €124bn since 1996. Although the UK still represented the largest European buyout market, other countries such as France, Germany or the Netherlands had become major targets. With record funds being raised – Permira closed its oversubscribed fourth fund at €11bn in July 2006, which was the largest fund ever raised by a European sponsor and the fourth-largest worldwide –

1 See **Exhibit 1** for an overview of the global private equity deal volume and European LBO statistics over time.

2 Syndicated bank debt is originated by one or several banks and placed with a group of investors. It can be in the form of structured products such as collateralized loan obligations (CLOs) where several loans are pooled and sold to investors in different tranches, depending on their risk appetite. Syndicated bank debt can also be traded in the secondary market, thus increasing liquidity even further.

European private equity firms pushed into spheres historically occupied by US "mega funds". Backed by huge amounts of "dry powder", private equity investors were under pressure to deliver returns and the competition for assets was fierce.

THE EUROPEAN TV & ENTERTAINMENT LANDSCAPE

The big picture

In European countries, public TV broadcasters usually coexist with commercial TV broadcasters. Public TV broadcasters perform a public service, usually avoiding advertising, sponsored by the government or through license fees of households. Commercial TV broadcasters on the other hand may be free-to-air TV broadcasters, who finance through advertising sales, or Pay-TV providers, who charge the consumer for their services. As free-to-air broadcasters profit from advertising sales, they indirectly depend on a variety of factors, such as GDP growth and cyclicality, demographics and the buying power of households. Generally, the European media and TV broadcasting industry is characterized by high market concentration. While Western European countries still grew moderately, economic growth in Central and Eastern European countries fueled media and entertainment spending and was expected to continue over the following years.[3]

In 2006, the media industry was on the verge of significant changes. Rising high-speed broadband and wireless internet penetration rates changed media consumption behavior and shifted content distribution to digital and mobile platforms. As a consequence, Internet Protocol TV (IPTV) was becoming increasingly popular and TV subscription growth had constantly surpassed traditional TV advertising over the last years.[4] IPTV enabled to offer streaming-based services, such as live and time-shifted TV as well as video-on-demand. The market entrance of telecommunication com-

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[3] See **Exhibit 2** for an overview of market growth and market size in Europe.

[4] TV subscriptions and license fees describe revenues generated from Pay-TV services and fees paid to public broadcasters. TV advertising describes revenues generated from advertising sales on free-to-air channels.

panies further intensified competition from the subscription TV segment. Thus, traditional TV broadcasters faced an uncertain future. Although it was expected that new analog channels, high definition TV (HDTV) and digital broadcasting would attract advertisers to free-to-air channels in the near future, multichannel advertising through digital platforms and mobile devices was expected to become a major advertising growth driver.

The TV industry in Germany

Since the German TV market was de-nationalized in 1981, Germany has become one of the largest media and TV markets in Europe with one clear distinction: Germany has the largest Free-TV offering in Europe while Pay-TV is a lot more popular in other major markets, such as the UK. The German TV market is highly concentrated as public broadcasters ARD and ZDF and private broadcasters RTL and P7S1 are the only channels with nationwide reach.[5] Although US companies, such as Time Warner (n-tv, CNN Germany) or Viacom (MTV Germany), have made efforts to grab market shares, their viewers' ratings and advertising shares are negligible. Alike the TV industry, the German advertising industry is dominated by a small number of big players. TV broadcasters source advertising deals from advertising agencies, which bundle marketing content and place it on behalf of their contract partners. A major influence on the negotiation position is therefore the "cost per mille", which describes the cost per thousand impressions within a target group. The dual broadcasting system leads to adverse competition policies: Whereas public broadcasters' main mission is to provide information safeguarded by the government, private broadcasters compete in the market to maximize profits. However, competition is limited by federal institutions (Federal State Media Authorities, KEK, KDLM), which propose regulations to control informational content and diversity and limit media concentration and advertising time.

[5] See **Exhibits 3** and **4** for a more detailed overview of the German media and TV industry.

PROSIEBENSAT.1 AND HAIM SABAN (2003-2006)

Business overview

Based in Munich, the ProSiebenSat.1 Group (P7S1) is a leading commercial TV broadcaster and media company in the German-speaking region. While advertising-financed Free TV still represented the group's core business in 2006, P7S1 had recently started diversifying its revenue streams into new areas.[6] These included quiz channel 9Live, which generated revenues from telephone calls, video-on-demand offerings through Germany's leading platform Maxdome, different Pay-TV channels and internet platforms, such as social network lokalisten.de or video platform MyVideo. Furthermore, P7S1 operated its own production and distribution division.

Insolvency of Kirch Media Group and Haim Saban era

P7S1 was part of Kirch Group, one of the largest German media groups, belonging to Leo Kirch, a German media entrepreneur. Kirch's media empire not only consisted of P7S1 but also included Pay-TV channel Premiere as well as media production, distribution and licensing businesses among other assets. Suffering from a heavy debt burden, Deutsche Bank manager Rolf-Ernst Breuer ultimately triggered the insolvency process of Kirch Group in 2002 by publicly questioning the creditworthiness of the group. What followed was a lengthy negotiation process about the breakdown of the group's assets. Although P7S1 attracted many international investors (e.g. French broadcaster TF1 and US film studio Columbia) as well as old shareholders of Kirch Media Group (e.g. Silvio Berlusconi's Italian media firm Mediaset and Rupert Murdoch's News Corp.), it was the Hamburg based publishing firm Bauer, who first negotiated a contract in December. It was however never signed because Haim Saban submitted a higher offer in the very last minute.

[6] See **Exhibit 5** for a segment overview of P7S1.

The Israeli and American media entrepreneur, who made a fortune with the production of Power Rangers, is one of the most renowned media investors in the world. Together with other financial sponsors, Saban acquired 72% of P7S1 voting common shares for €525m, corresponding to €7.50 per share, through their investment vehicle German Media Partners in a club deal in August 2003.[7] In the meantime, Permira acquired a majority stake in Premiere from Kirch Group's creditors.

Saban faced a great challenge. Suffering from a weak economy, the German TV advertising market had shrunk for the third year in a row. Saban based his strategy on cost optimization, strengthening of the core business and expansion into new non-advertising revenue streams. He followed his strategy and results should show quickly. At the end of 2003, P7S1 had more than tripled its earnings. In early 2004, the group started a refinancing process to reduce the group's debt level and improve ratings. As part of the insolvency plan, Kirch Media sold its remaining 15% stake to German Media Partners and Axel Springer in September, leaving Saban with 88% of common and 13% of preferred stock. At the end of 2004, all four Free-TV channels were profitable again. In 2005, P7S1 partnered with major telecommunication firms, such as Vodafone and Telekom, to offer selected channels on mobile phones and computers. Furthermore, the group acquired full ownership in quiz channel 9Live and travel sales channel sonnenklar TV. After another period of record audience shares and strong financial performance, Axel Springer offered to acquire all shares from German Media Partners in August 2005, thus ringing in the end of the Saban era. In September, Axel Springer submitted a public tender offer for the remaining preferred shares. Since then, the deal was subject to approval by antitrust and media regulators.

[7] The consortium consisted of Saban's investment firm Saban Capital Group, Thomas H. Lee Partners, Bain Capital, Hellman & Friedman, Providence Equity Partners, Quadrangle Capital Partners, Putnam Investments and AEP Capital. Axel Springer, a major German media and publishing company, has been a shareholder at P7S1 before. For further information on P7S1's shareholder structure, see **Exhibit 6**.

The buyout by KKR and Permira (2007-2014)

Winning the deal

After it became clear that a takeover by Axel Springer will not be approved by authorities, Saban had engaged investment banks J.P. Morgan and Morgan Stanley to run an auction process for his stake with first round offers due in November 2006. Permira Managing Partner Thomas Krenz knew he had to be quick this time. P7S1 had already attracted interest from major private equity firms, such as Apax Partners, Texas Pacific Group and CVC Capital Partners, as well as from Italian Mediaset and other strategic investors. Despite the failed takeover, Axel Springer also did not admit defeat and acquired a 25% stake in Turkish Doğan Media Group, who participated in the auction. Although Krenz had a track record in the German TV industry since the successful IPO of Premiere in 2005, he knew winning the deal would not be easy. In the final bidding round in December, it was him against a consortium bid of Apax Partners and Goldman Sachs Capital Partners as well as Doğan Media Group and all had one thing in common: they already owned TV assets.[8]

Together with KKR, Permira had acquired a majority stake in Scandinavian Broadcasting Systems (SBS), a leading European commercial TV and radio broadcasting firm with operations in Central and Western Europe, in October 2005 in a transaction valuing SBS at €2.1bn. With this ace up his sleeve, Krenz had again teamed up with KKR and was confident that they could convince P7S1's management. The idea was simple yet promising: Combine SBS and P7S1 to create a new Pan-European broadcaster that is able to compete with RTL.

On December 14th, KKR and Permira signed a share purchase agreement (SPA) to buy the 51% stake of German Media Partners for €28.71 per common share and €22.40 per preferred share, with

[8] Apax Partners acquired a stake in Central European Media Enterprises (CME), an Eastern European free-to-air broadcaster in August 2006. Doğan Media Group operates TV channels in Turkey.

closing date in March 2007. In April 2007, their investment vehicle Lavena Holding 4 acquired additional 0.3% of preferred shares for €22.45 through a public tender offer.[9] Krenz's run of bad luck had finally ended.

SBS Broadcasting and ProSiebenSat.1 – the perfect wedding?

A merger with SBS would immediately transform P7S1 into the second-largest TV broadcaster in Europe, with 26 Free-TV stations, 24 Pay-TV channels and 22 radio networks in 13 countries in Scandinavia, the Benelux countries, German-speaking countries and Eastern Europe, reaching more than 78m households.[10] Further, it was estimated that through joint content rights acquisition and format sharing, the group could realize significant synergies of up to €90m annually, thereof €30m in additional revenues and €60m in cost reductions, by 2010. Together, P7S1 and SBS could drive industry consolidation in Europe, share resources to strengthen their core businesses and expand into new media segments. The two groups were considered to be "a perfect fit".

In June, P7S1 acquired 100% of SBS in a transaction valuing the firm at €3.3bn.[11] The deal was entirely financed by new loans syndicated by a group of banks, led by Bank of America, Credit Suisse, J.P. Morgan, Morgan Stanley and Lehman Brothers among others. Dutch Telegraaf Media Group (TMG), who held 20% in SBS before, received a call option to acquire 12% of P7S1 common shares from Lavena Holdings, exercisable in June 2008. If TMG would not exercise, KKR and Permira had a put option on TMG maturing in August 2008. As part of the acquisition, P7S1 bought back a €150m bond issue prematurely and replaced existing financial liabilities through the new syndicated loans.

9 See **Exhibit 6** for information about the shareholder structure, **Exhibit 7** for a sources and uses table and **Exhibit 8** for further information on the holding structure.

10 See **Exhibit 9** for geographic reach.

11 See **Exhibits 10** for a sources and uses table and **Exhibit 11** for key financials of SBS.

ProSiebenSat.1 – a new era

CEO Guillaume de Posch had just seen P7S1 turning from being part of an insolvency process into a major European player. However, after the biggest acquisition in company history, he knew P7S1 would not be able to make any major acquisition that required new capital in the near future. His job now was to focus on integrating SBS and realizing promised synergies. On top of that, P7S1 had been found guilty for so-called "share deals" earlier this year and would have to pay a €120m fine in 2008, imposed by the German Federal Cartel Office.[12] After assessing all formats on profitability and reach, P7S1 announced the termination of Sat.1 News and dismissal of 180 employees at the Berlin and Munich offices as well as the closing of the SBS Amsterdam office, which would cut another 20 jobs. Nevertheless, the group completed a few minor acquisitions in 2007, one of them being the acquisition of Austrian Free TV station PULS TV.[13]

In January 2008, Axel Springer sold its full stake, 12% of common and 12% of preference shares, to Lavena Holdings for €509m. According to Axel Springer the stake had become a pure financial investment and advertising market prospects did not look promising.

ProSiebenSat.1 and the financial crisis

For the institutional investors and hedge funds who had invested in the leveraged loans of P7S1, the news of Lehman Brothers' insolvency in September 2008 was just another piece in a series of bad events. Had they known that the value of the securities would drop by 27% - as they did in February 2008 - they would not have invested in these collateralized loan obligations. However, first signs that investors panicked and liquidity started drying up already showed in 2007. Shortly

[12] In share deals, TV broadcasters give discounts to advertising agencies for giving them more advertising time.
[13] Other transactions in 2007 included the acquisition of a majority stakes in German online price comparison portal billiger.de and German online advice platform wer-weiss-was.de as well as the purchase of the remaining shares in German video platform MyVideo.

before the SBS takeover, the average price on loans in the US secondary market dropped below par value and European markets were heading the same way. Although the P7S1 loan had been oversubscribed and its margin been cut during the marketing phase, the value had dropped once it was released onto the market.

The year 2008 had not been easy for P7S1. The new advertising time sales model for the German market, which had been developed after the legal issues in 2007, had not paid off and impacted first-quarter results heavily. The effect was amplified when the financial crisis spread to the real economy, leading to a slowdown in advertising spending. As a reaction, P7S1 introduced significant changes within the management team. In January, the Supervisory Board came to an agreement with Lothar Lanz (CFO for 11 years) to leave P7S1 in June. Due to weak advertising sales, Peter Christmann (Executive Board Member for Sales and Marketing) also resigned in June. Ultimately, Guillame de Posch (CEO) left the group in the end of 2008 “to seek new challenges”. With investors panicking, financial markets reacted accordingly. After P7S1 announced two profit warnings within one year, the stock hit an all-time low of €1.26 in December.[14]

For Permira, the year had been equally difficult. Despite various attempts to improve cost structures at P7S1, earnings were negative and the capital structure was trembling. P7S1 decided to relocate Sat.1 from Berlin to Munich, centralize all administrative functions and merge SevenOne Media and SevenOne Interactive. Further, the management planned to cut 225 jobs across the German divisions. In addition, P7S1 signed an outsourcing agreement, transferring all IT assets from the group’s technology service provider ProSiebenSat.1 Produktion to IBM. The group also sold Pay-TV channel C More for €303m, which it had acquired as part of SBS’ Scandinavian assets only a

[14] See **Exhibit 12** for P7S1 stock price information.

year before. Yet, Permira had a hard time explaining to their limited partners (LPs) why the investment was currently valued at about 20% of the initial investment. At least the exercise of the put option against TMG had returned €28.71 per share. On top of that, they had received a lot of media attention – something private equity investors traditionally avoided – for the decision to distribute a dividend of €270m.

When the new CEO Thomas Ebeling began his job in March 2009, P7S1 had become a penny stock. Competition in domestic markets was fierce as advertising-financed broadcasters suffered from the financial crisis while public broadcasters targeted their audience shares. Ebeling's first measures aimed to cut costs, reduce debt and stabilize the stock price. P7S1 sold online platform billiger.de as well as production unit ProSiebenSat.1 Berlin Produktion and began exploring strategic options for N24. In addition to 1.1m preference shares which P7S1 had bought back in 2008, the group repurchased another 4.9m preference shares from April to June. Furthermore, common shareholders forwent any dividends while preferred shareholders received a minimum dividend of €0.02 per share. The strategic shakeup also claimed further personnel victims: Patrick Tillieux (COO) left P7S1 in June, Klaus Peter Schulz (Executive board member Sales and Marketing) left P7S1 after only ten months in July and Marcus Englert (Executive board member New Media) left the group in November although his contract ran until 2010.

In the meantime, KKR and Permira hired investment bank Houlihan Lokey to restructure the debt in their joint holding company after they had to pay interest from equity.[15] Pressure came also from hedge funds who had acquired debt instruments of Lavena at a discount earlier. Since the securities temporarily traded at 20% of face value, they enjoyed wide support from other creditors.

[15] See **Exhibit 13** for balance sheet information of Lavena 1 S.à.r.l..

Both, Ebeling and his majority shareholders, were therefore happy when P7S1 ultimately reported a consolidated net income of €145m for 2009. After efficient cost reductions and a successful last quarter, the group had regained market share and ended the year with a stock price of €5.50.

Like a phoenix from the ashes?

In 2010, the advertising market started to recover and TV broadcasters reported strong sales again. Simultaneously, J.P. Morgan had been engaged to explore strategic options for the divisions in Scandinavia and the Benelux countries. Having reviewed different options for the unprofitable news segment, P7S1 agreed on a management buyout of N24 and its production unit in June. Despite the favorable development in 2010, P7S1 kept exploring further ways to improve the capital structure as liabilities of more than €3.5bn still put weight on the balance sheet.

In January 2011, KKR and Permira used the stock momentum to sell 8m of their preference shares for €24.20 in order to reduce debt and improve liquidity on the Lavena Holding level while J.P. Morgan held first discussions about the disposal of the Scandinavian and Benelux business units with potential buyers. In April, P7S1 sold the TV and print operations in the Netherlands and the TV operations in Belgium to a group of media companies in a transaction valued at €1.2bn.

P7S1 used the sale to repay €1.2bn of the existing term loans and renegotiate maturities for the remaining loans. In addition, the group repurchased another 2.5m preference shares from August to September and expanded its online gaming business as well as global sales and content production business through further acquisitions. Furthermore, P7S1 signed long-term contracts with all major cable network operators in Germany to transmit Free-TV, Pay-TV, HD and video–on–demand content and receive a share in the access fees charged by cable providers. Finally, P7S1 launched new Free-TV channels in Norway and Hungary and shut down operations at quiz channel 9Live after an ongoing decline in revenues.

Fueled by another record-year, P7S1 landed a coup in January 2012, when it outbid RTL in a bidding process for an output deal with Warner Bros. Studios (Harry Potter, The Lord of the Rings, The Dark Knight etc.). The group now had contracts with most major Hollywood production firms, such as 20th Century Fox, Disney and Paramount Pictures.

In October 2012, P7S1 was ultimately approaching the sale of its TV and radio broadcasting assets in Sweden, Norway, Finland and Denmark after reducing the number of potential buyers to a shortlist, consisting of Discovery Communications, Providence Equity Partners and Nordic Capital with binding offers due in December. Although Discovery Communications and Modern Times Group had already been interested in the Scandinavian broadcasting units back in April 2011, P7S1 had decided against a disposal when it sold the Belgium and Dutch assets. According to Ebeling, the assets then belonged to the core business. It was Discovery Communications, who emerged as the winner from the bidding process, agreeing on an enterprise value of €1.3bn.

The deal finally sealed Ebeling's strategic shakeup to refocus on German TV Broadcasting, content production and global distribution and expansion into digital media. The spread of HDTV-compatible TVs created new growth potential in the German Free-TV business. At the same time, the group was experiencing double-digit growth in digital segments, for example in online games and video-on-demand offerings, such as Maxdome and MyVideo, which had been developed into an online TV station. To further elaborate on these achievements, P7S1 had started a venture business which invested in start-ups in selected areas (travel, sports, beauty, health, fashion, home & living and market places) in "media-for-equity deals".[16] At the end of 2012, P7S1 sold the TV and radio broadcasting operations in Central and Eastern Europe.

[16] P7S1 gives advertising time in return for a share of revenues or equity.

P7S1 intended to use €500m of the proceeds from the Scandinavian asset disposal for partial re-payment of term debt and reinvest the remaining amount in operations. Further, P7S1 would pay a special dividend of €1.2bn.

The exit of KKR and Permira

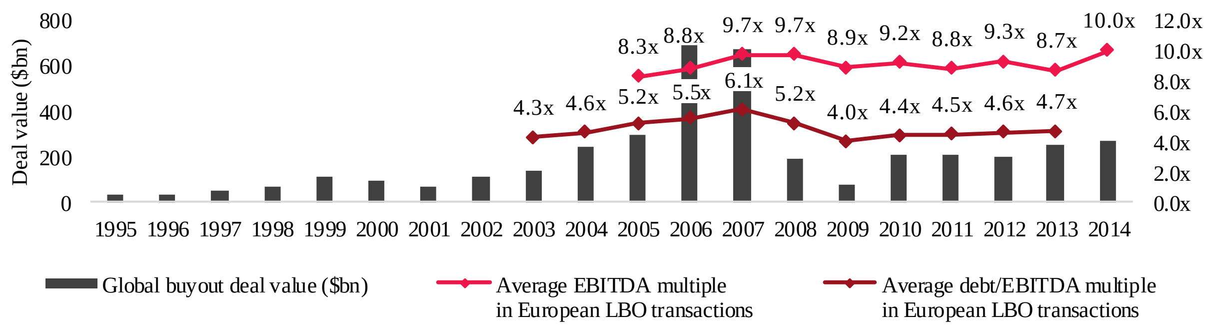
In the beginning of 2013, KKR and Permira engaged J.P. Morgan to explore exit options for their controlling stake. Although strategic buyers, such as Time Warner Inc., Comcast or News Corp., were reported to show interest, KKR and Permira decided on a block trade in February, in which they placed their entire 18% preference shares for €24.60 per share. Together with the 2012 dividend, they intended to use the proceeds to pay down debt in Lavena Holdings. Until 2013, Permira had not distributed any cash from dividends or share disposals to their LPs but used all proceeds to pay debt and interest in the Lavena Holdings. In July 2013, the general meeting decided to convert all publicly listed preference shares into voting common shares, reducing the stake of KKR and Permira from 88% to 44%. In September, KKR and Permira sold another 11% (after conversion) in an accelerated book building process for €30.67 per share. In November, the financial sponsors placed another 16% (35m shares) on the market at an average price of €31.82. After the P7S1 stock price had doubled in 2013, KKR and Permira finally sold their last 17% stake (36m shares) for €34.75 per share in an accelerated book building process in January 2014.

REVIEWING THE DEAL

Permira had just sold its last stake in P7S1 and Thomas Krenz was lost in thoughts. Certainly the investment had not left out anything: a heavy cartel fine at the beginning, the financial crisis and a global recession, changes in top-level management, a full-blown strategic repositioning and a lot of negative publicity. Somehow it all worked out in the end but he could not stop wondering: Should he have made different decisions at some point?

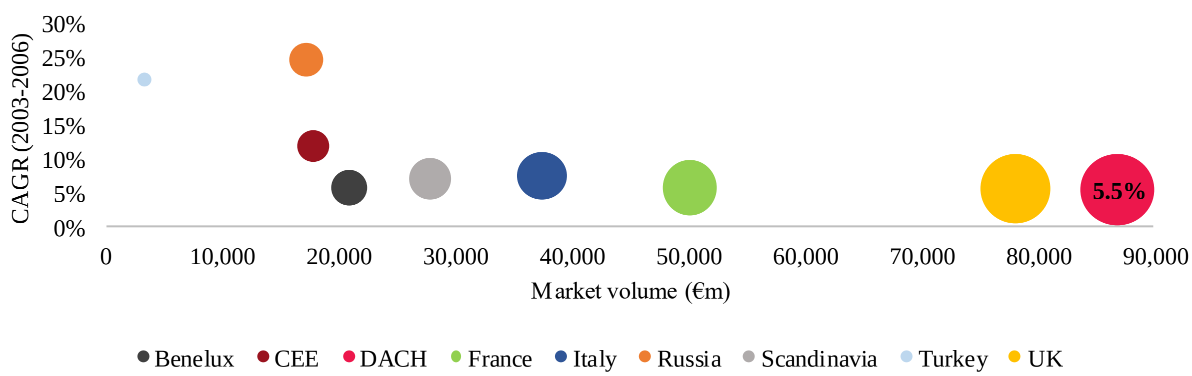
APPENDIX

Exhibit 1: Global Private Equity Deal Volume and European deal statistics (1995 – 2014)



Source: Bain & Company Global Private Equity Reports 2014, 2016

Exhibit 2: Selected European media and entertainment markets (2006)

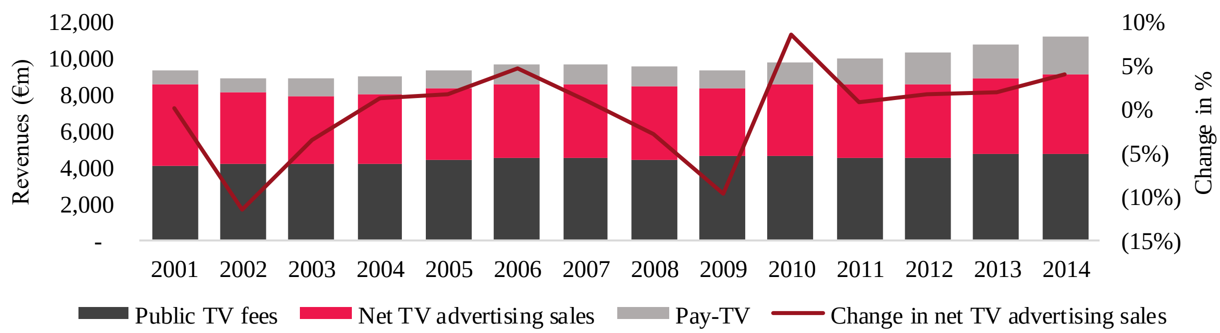


Benelux = Belgium, the Netherlands; CEE = The Czech Republic, Greece, Hungary, Poland, Romania; DACH = Austria, Germany, Switzerland; Scandinavia = Denmark, Finland, Sweden, Norway
FX rate ($ to €) = 0.73082
Source: PwC Global Media and Entertainment Outlook 2008 - 2012

Exhibit 3: Market shares in Germany (2006)

Viewers older than three years, Monday to Sunday, 3:00 to 3:00, representing 34.99 million households or 73.42 million people in Germany.
Source: KEK, AGF/GfK Fernsehforschung

Exhibit 4: German TV broadcasting industry revenues (2001 – 2014)



Source: State Media Authorities in the Federal Republic of Germany, National Reports Germany 2006 - 2014

Exhibit 5: P7S1 segment overview (2007)

ProSiebenSat.1 Media AG

Free TV

German-speaking Free TV
- Sat.1 (Broad audience)*
- ProSieben (Young entertainment)*
- kabel eins (Movie classics)*
- N24 (News and information)
- PULS TV
- SevenOne Media (TV Advertising sales)

* P7S1 operates different versions of the channels, e.g. ProSieben Austria in Austria or ProSieben Schweiz in Switzerland, with different advertising and individual news.

International Free TV
- SBS 6
- Net 5
- Veronica
- Kanal 5 (DK)
- Kanal 5 (SWE)
- Kanal 4
- The Voice TV
- SBS NET
- TVNORGE
- FEM
- Kanal 9
- VT 4
- VIJFtv
- TV2
- Prima TV
- Kiss TV

Diversification

Pay TV
- Cmore/Canal+
- SevenSenses
- kabel eins classics
- Sat.1 Comedy

Transaction TV
- 9Live

Online
- Maxdome
- MyVideo

Online advertising sales
- SevenOne Interactive

Programming sales
- SevenOne International

Music
- Starwatch Entertainment (Music label, live entertainment, artist management, ticketing)

Multimedia

Radio

Print

Merchandising/Licensing

Source: P7S1 Annual Report 2007

Exhibit 6: P7S1 shareholder structure development (2003 – 2014)

Shareholder structure	Unit	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Kirch Media Group	[%]	17%											
German Media Partners	[%]	0%	13%	13%	13%								
Axel Springer	[%]	11%	12%	12%	12%	12%							
Lavena Holdings	[%]					13%	25%	25%	25%	18%	18%	0%	0%
Telegraaf Media Groep	[%]						0%	0%	0%	0%	0%	0%	0%
Free float	[%]	72%	75%	75%	75%	75%	74%	69%	70%	75%	76%	0%	0%
P7S1 treasury shares (1)	[%]	0%	0%	0%	0%	0%	1%	6%	5%	7%	6%	0%	0%
# of preferred shares	**[m units]**	**97.2**	**109.4**	**109.4**	**109.4**	**109.4**	**109.4**	**109.4**	**109.4**	**109.4**	**109.4**	**-**	**-**
Kirch Media Group	[%]	17%											
German Media Partners	[%]	72%	88%	88%	88%								
Axel Springer	[%]	12%	12%	12%	12%	12%							
Lavena Holdings	[%]					88%	88%	88%	88%	88%	88%	17%	0%
Telegraaf Media Groep	[%]						12%	12%	12%	12%	12%	0%	0%
Free float	[%]	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	81%	98%
P7S1 treasury shares (1)	[%]	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	3%	2%
# of common shares	**[m units]**	**97.2**	**109.4**	**109.4**	**109.4**	**109.4**	**109.4**	**109.4**	**109.4**	**109.4**	**109.4**	**218.8**	**218.8**
Kirch Media Group	[%]	17%											
German Media Partners	[%]	36%	51%	51%	51%								
Axel Springer	[%]	11%	12%	12%	12%	12%	0%	0%	0%	0%	0%	0%	0%
Lavena Holdings	[%]					51%	57%	57%	57%	53%	53%	17%	0%
Telegraaf Media Groep	[%]						6%	6%	6%	6%	6%	0%	0%
Free float	[%]	36%	38%	38%	38%	37%	37%	35%	35%	38%	38%	81%	98%
P7S1 treasury shares (1)	[%]	0%	0%	0%	0%	0%	1%	3%	3%	4%	3%	3%	2%
Total share capital (2)	**[€m]**	**194.5**	**218.8**	**218.8**	**218.8**	**218.8**	**218.8**	**218.8**	**218.8**	**218.8**	**218.8**	**218.8**	**218.8**
Market cap at end of year	**[€m]**	**2,499**	**2,954**	**3,577**	**5,437**	**3,586**	**525**	**1,764**	**4,923**	**3,089**	**4,660**	**6,024**	**7,271**
Close	[€]	12.85	13.50	16.35	24.85	16.39	2.40	8.06	22.50	14.12	21.30	36.00	34.83
High	[€]	14.30	17.10	16.35	24.85	30.10	16.62	8.98	23.88	24.80	23.83	36.00	35.55
Low	[€]	4.03	12.19	12.80	16.02	16.00	1.26	0.90	8.13	11.49	14.19	21.85	28.35
Dividend per share of preferred stock (3)	[€]	0.02	0.30	0.84	0.89	1.25	0.02	0.02	1.14	1.17	5.65	n/a	n/a
Dividend per share of common stock	[€]	0.00	0.28	0.82	0.87	1.23	0.00	0.00	1.12	1.15	5.63	1.47	1.60
Total dividend for the year	[€m]	2	63	182	193	270	2	2	241	246	1201	313	342

(1) P7S1 treasury shares originate from share buybacks and serve a long-term incentive stock compensation plan.

(2) The share capital of ProSiebenSat.1 Media AG was initially distributed equally between no-par registered voting common shares and no-par publicly listed non-voting preferred shares.

(3) Preferred shares are given preferential treatment in profit distribution, receiving a priority payment of €0.02 per share more from the annual distributable net profit than common shares, and no less than €0.02 per share in any case.

Source: P7S1 Annual Reports 2003 - 2014

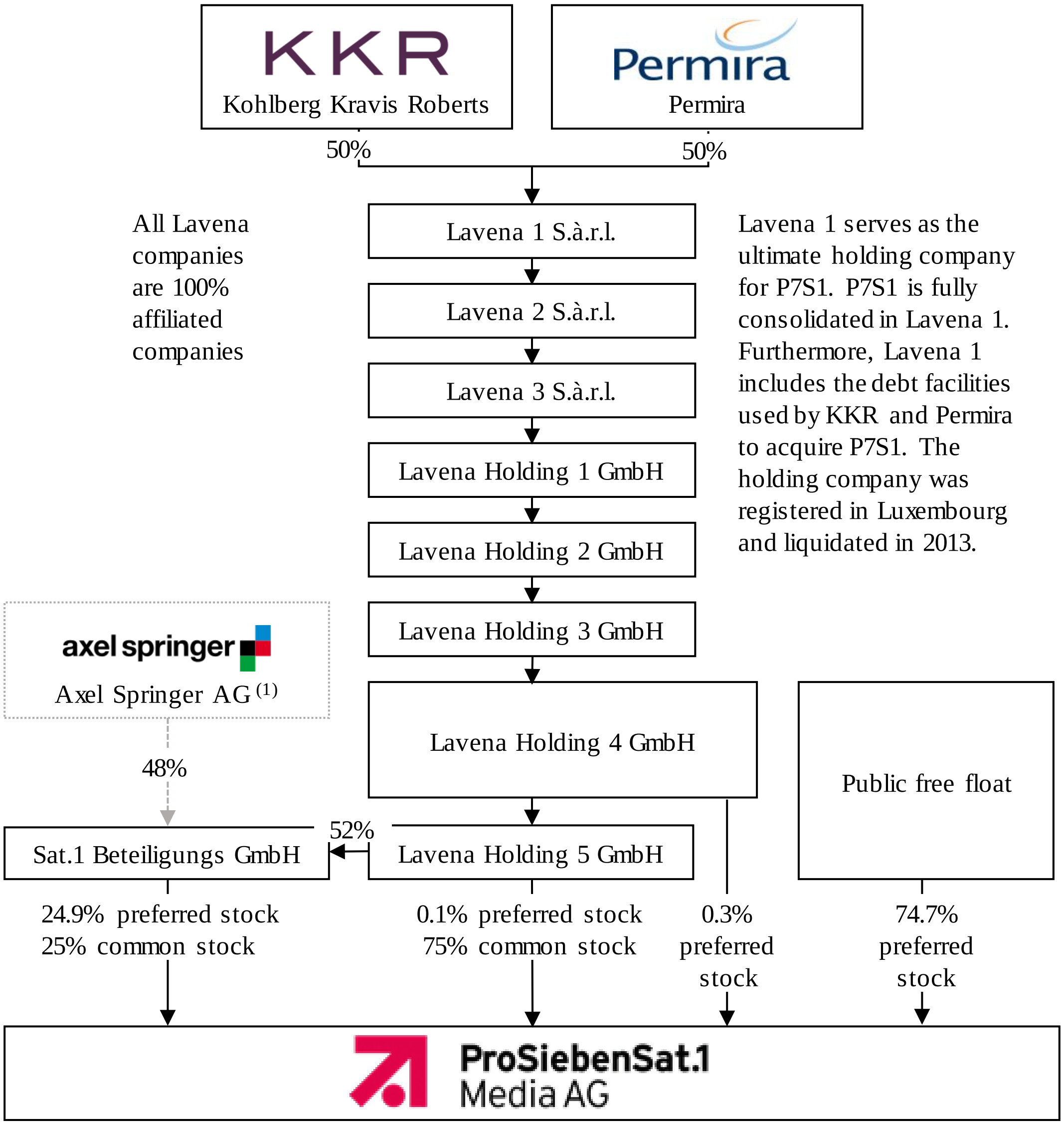
Exhibit 7: P7S1 sources & uses table (2007)

Sources of funds	€m	%	Uses of funds	€m
Senior debt (1)			**Shares**	
Term loan B (Bullet)	686	21%	Common shares German Media Partners	2,764
Term loan C (Bullet)	686	21%	Preferred shares German Media Partners	319
Term loan D (Amortizing)	423	13%	Public tender offer	7
Junior debt (1)				
Subordinated loan (PIK)	501	15%	Assumed transaction costs (7%)	194
Total debt	**2,296**	**70%**		
Equity	987	30%		
Total sources	**3,284**	**100%**	**Total uses**	**3,284**

(1) Senior and junior debt facilities are taken on by Lavena Holding 4 and fully consolidated in Lavena 1 S.à.r.l..

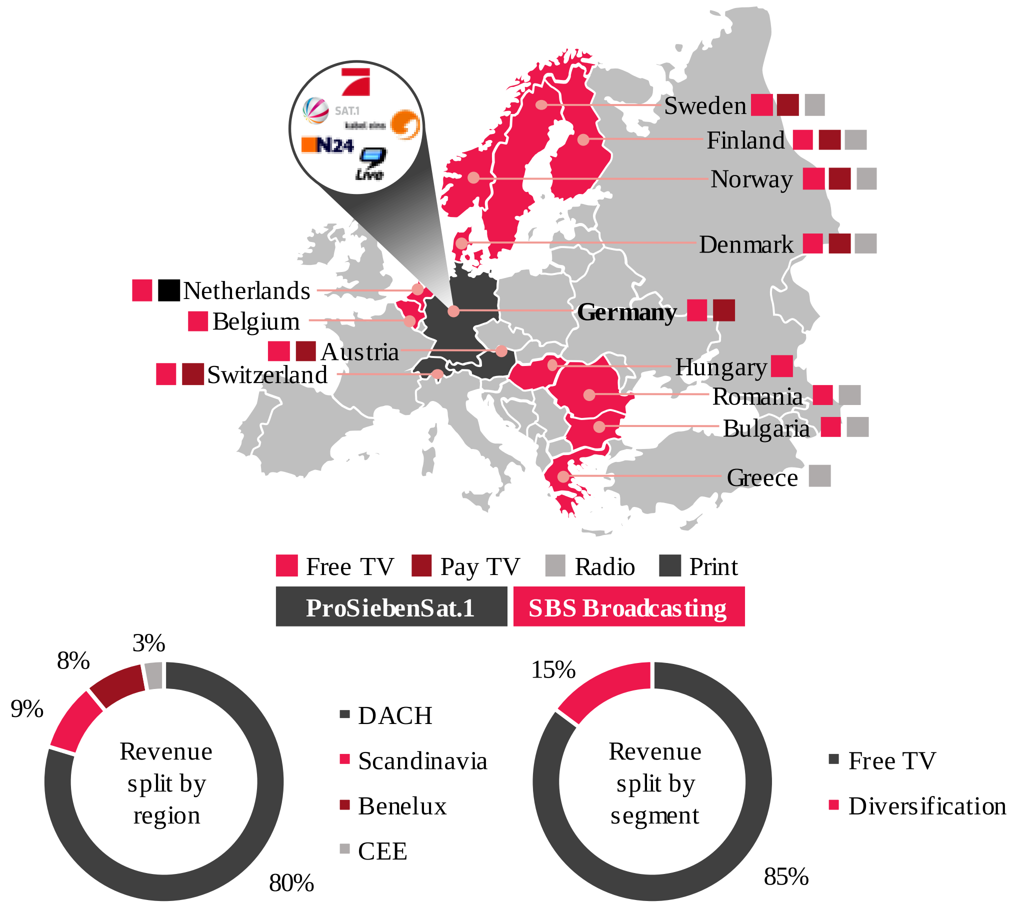
Source: Lavena 1 S.à.r.l. Annual Report 2007

Exhibit 8: KKR and Permira holding structure (2007)



(1) In December 2007, Axel Springer AG announced to sell its stake of 12% common stock and 12% preferred stock in ProSiebenSat.1 Media AG, which it indirectly held through Sat.1 Beteiligungs GmbH, to Lavena Holding 5 GmbH. Axel Springer AG further sold 48% of the share capital of Sat.1 Beteiligungs GmbH to Lavena Holding 5 GmbH.
Source: P7S1 Annual Report 2007

Exhibit 9: P7S1 and SBS geographic footprint (2007)



Source: P7S1 Annual Report 2007

Exhibit 10: SBS sources & uses table (2007)

Sources of funds	Interest	Maturity	€m	EBITDA (1)	%	Uses of funds	€m
Senior secured term loan B	Euribor + 1.75% (2)	Jul-14	1,800	2.6x	43%	**SBS enterprise value**	**3,300**
Senior secured term loan C	Euribor + 1.875% (2)	Jul-15	1,800	2.6x	43%	P7S1 net debt to be refinanced	122
						Other expenses and remaining funds	178
Total acquisition loan agreement			**3,600**	**5.2x**	**86%**	**Total acquisition loan agreement**	**3,600**
Revolving credit facility (RCF)	(Euribor + var. margin)		600	0.9x	14%	Replacement of old P7S1 RCF	500
						Additional new RCF capacity	100
Total loan agreement			**4,200**	**6.1x**	**100%**	**Total loan agreement**	**4,200**

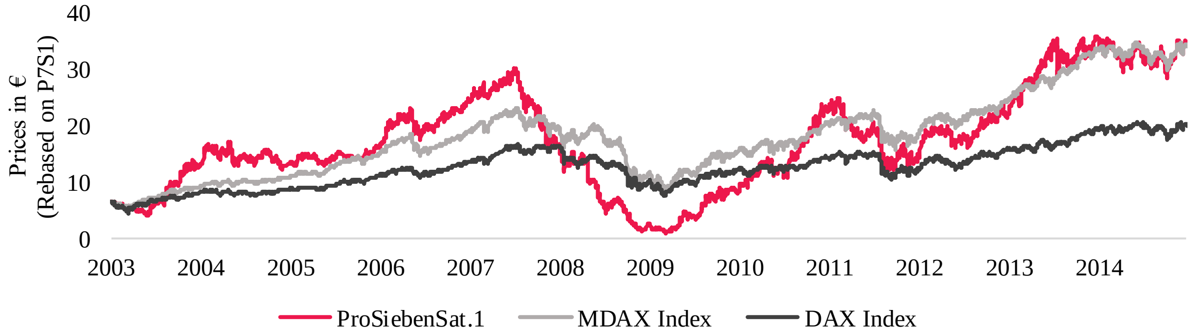
(1) Pro Forma EBITDA of P7S1 and SBS for 2006 = €484m (P7S1) + €207m (SBS) = €691m.
(2) The 12-month average Euribor rate in 2006 was 2.80%.
Source: P7S1 Annual Report 2007, Lavena 1 S.à.r.l. Annual Report 2007

Exhibit 11: SBS key financials (2003 – 2006)

SBS income statement	2003	2004	2005	2006	CAGR	Average
Revenues	**582**	**678**	**880**	**1,003**		
Growth in %		*17%*	*30%*	*14%*	*20%*	*20%*
EBITDA	**73**	**104**	**145**	**207**		
in % of revenues	*13%*	*15%*	*16%*	*21%*	*42%*	*16%*

Source: SBS Company Information, Press

Exhibit 12: P7S1 stock price development (2003 – 2014)



Source: Bloomberg

Exhibit 13: Lavena 1 S.à.r.l. key financials (2007 – 2012)

Lavena 1 S.à.r.l. (€m) (1)	2007	2008	2009	2010	2011	2012
Total equity	**1,849**	**203**	**84**	**381**	**887**	**1,011**
Long-term loans and borrowings	6,080	5,550	5,671	5,697	4,371	4,430
Total non-current liabilities	**6,939**	**6,540**	**6,742**	**6,664**	**5,260**	**5,233**
Short-term loans and borrowings	62	713	730	544	278	473
Total current liabilities	**1,004**	**1,577**	**1,641**	**1,493**	**1,184**	**1,442**
Net financial debt	**5,353**	**5,536**	**5,583**	**5,473**	**4,016**	**4,109**

(1) Lavena 1 serves as the ultimate holding company for P7S1. P7S1 is fully consolidated in Lavena 1. Lavena 1 also includes the debt facilities used to acquire P7S1. The holding was registered in Luxembourg and liquidated in 2013.
Source: Lavena 1 S.à.r.l. Annual Reports 2007 - 2012

Exhibit 14: ProSiebenSat.1 group key financials (2003 – 2014)

Balance sheet (€m)	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Cash & cash equivalents	62	295	158	64	251	633	737	741	518	702	396	471
Programming assets	1,148	1,110	1,058	1,056	1,318	1,380	1,527	1,655	1,531	1,277	1,202	1,212
Total assets	1,898	2,059	2,017	1,932	5,999	5,930	6,175	6,316	5,034	5,413	3,556	3,901
Shareholder equity	602	1,004	1,188	1,241	1,062	479	581	1,026	1,441	1,501	584	754
Non-controlling interests	*1*	*1*	*(2)*	*1*	*10*	*19*	*8*	*9*	*10*	*5*	*10*	*16*
Non-current loans and borrowings	n/a	n/a	n/a	n/a	3,577	3,523	3,535	3,531	2,336	2,342	1,842	1,973
Current loans and borrowings	n/a	n/a	n/a	n/a	2	517	497	231	0	231	-	-
Net financial debt	665	279	227	122	3,328	3,407	3,295	3,021	1,818	1,871	1,446	1,503
Total liabilities	1,296	1,055	829	692	4,937	5,451	5,594	5,290	3,592	3,912	2,972	3,147
Income statement (€m)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Revenues	1,807	1,835	1,990	2,105	2,703	3,054	2,761	3,000	2,756	2,356	2,605	2,876
Gross profit	443	569	714	804	1,084	1,187	1,156	1,392	1,255	1,090	1,174	1,315
Operating profit	131	286	384	444	384	267	476	670	607	601	669	695
Financial income/loss	(70)	(69)	(33)	(58)	(136)	(335)	(245)	(241)	(240)	(144)	(142)	(134)
Pre-tax profit	61	218	351	387	249	(68)	231	429	367	457	527	560
Consolidated profit for the year	39	134	221	244	96	(125)	150	318	644	299	317	354
Profit from discontinued operations	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*375*	*(30)*	*(48)*	*(27)*
Results of continuing operations (€m)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Recurring EBITDA	n/a	n/a	n/a	n/a	662	675	697	906	792	745	790	847
EBITDA	189	321	419	484	521	618	623	808	694	680	758	818
EBIT	129	285	383	444	384	264	475	670	567	601	669	695

Cash flow statement (€m)	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Cash flow from operating activities	**1,184**	**1,056**	**1,166**	**1,272**	**1,594**	**1,352**	**1,478**	**1,607**	**1,357**	**1,565**	**1,407**	**1,444**
Depreciation and amortization	58	35	35	40	137	355	148	138	146	80	89	124
Consumption of programming assets	983	950	937	938	1,127	1,224	1,038	1,063	1,063	836	847	863
Change in working capital	69	(58)	(44)	(1)	190	(79)	93	43	(13)	(33)	(15)	(12)
Cash flow from investing activities	**(1,100)**	**(934)**	**(1,096)**	**(980)**	**(3,269)**	**(1,150)**	**(1,320)**	**(1,325)**	**149**	**(1,264)**	**164**	**(1,174)**
Net investments in intangible assets and PPE	*(6)*	*(15)*	*(24)*	*(25)*	*(37)*	*(82)*	*(77)*	*(73)*	*(87)*	*(88)*	*(90)*	*(91)*
Net investments in programming assets	*(1,091)*	*(919)*	*(897)*	*(946)*	*(1,168)*	*(1,352)*	*(1,214)*	*(1,199)*	*(1,124)*	*(823)*	*(848)*	*(882)*
Net operating CAPEX	(1,097)	(934)	(921)	(970)	(1,205)	(1,435)	(1,291)	(1,271)	(1,211)	(912)	(938)	(974)
Cash flow from financing activities	**(90)**	**110**	**(253)**	**(386)**	**1,863**	**179**	**(56)**	**(290)**	**(1,725)**	**(32)**	**(1,956)**	**(208)**
Change of interest-bearing liabilities	(88)	(168)	(189)	(205)	2,055	464	(31)	(278)	(1,431)	230	(732)	140
Dividends paid	(2)	(2)	(63)	(182)	(193)	(270)	(2)	(2)	(241)	(246)	(1,201)	(313)
Share repurchases	-	-	-	-	-	(15)	(15)	-	(33)	-	-	-
Key performance indicators	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Sales growth in %	n/a	2%	8%	6%	28%	13%	(10%)	9%	(8%)	(15%)	11%	10%
Operating profit margin in %	7%	16%	19%	21%	14%	9%	17%	22%	22%	26%	26%	24%
Profit margin in %	2%	7%	11%	12%	4%	(4%)	5%	11%	23%	13%	12%	12%
Recurring EBITDA margin in %	n/a	n/a	n/a	n/a	24%	22%	25%	30%	29%	32%	30%	29%
EBITDA margin in %	10%	18%	21%	23%	19%	20%	23%	27%	25%	29%	29%	28%
EBIT margin in %	7%	16%	19%	21%	14%	9%	17%	22%	21%	26%	26%	24%
Debt to equity (book value)	2.2x	1.1x	0.7x	0.6x	4.6x	11.4x	9.6x	5.2x	2.5x	2.6x	5.1x	4.2x
Net financial debt to EBITDA	3.5x	0.9x	0.5x	0.3x	6.4x	5.5x	5.3x	3.7x	2.6x	2.7x	1.9x	1.8x
Net financial debt to recurring EBITDA	n/a	n/a	n/a	n/a	5.0x	5.1x	4.7x	3.3x	2.3x	2.5x	1.8x	1.8x
Depreciation and amortization in % of revenues	3%	2%	2%	2%	5%	12%	5%	5%	5%	3%	3%	4%
Consumption of programming assets in % of revenues	54%	52%	47%	45%	42%	40%	38%	35%	39%	35%	33%	30%
Change in working capital in % of revenues	4%	(3%)	(2%)	(0%)	7%	(3%)	3%	1%	(0%)	(1%)	(1%)	(0%)
Net operating CAPEX in % of revenues	(61%)	(51%)	(46%)	(46%)	(45%)	(47%)	(47%)	(42%)	(44%)	(39%)	(36%)	(34%)

Source: P7S1 Annual Reports 2003 - 2014

Exhibit 15: Trading multiples

Trading comparables																	
			Financials in m							Trading multiples					Profitability		
FY2006	**Country**	**Currency**	**Revenues**	**EBITDA**	**EBIT**	**Net income**	**Market cap**	**Net debt**	**EV**	**EV/ Sales**	**EV/ EBITDA**	**EV/ EBIT**	**P/E**	**Net debt/ EBITDA**	**EBITDA margin**	**EBIT margin**	**Profit margin**
British Sky Broadcasting	UK	GBP	4,148	1,017	877	551	9,171	2,836	12,007	2.9x	11.8x	13.7x	16.6x	2.8x	25%	21%	13%
ITV	UK	GBP	2,181	372	264	222	4,142	1,983	6,132	2.8x	16.5x	23.2x	18.7x	5.3x	17%	12%	10%
M6	FRA	EUR	1,283	298	220	152	3,569	554	4,124	3.2x	13.9x	18.8x	23.4x	1.9x	23%	17%	12%
Mediaset	ITA	EUR	3,748	1,922	1,037	506	10,619	2,948	13,568	3.6x	7.1x	13.1x	21.0x	1.5x	51%	28%	13%
Modern Times Group	SWE	SEK	10,137	1,959	1,778	1,499	29,525	3,454	33,100	3.3x	16.9x	18.6x	19.7x	1.8x	19%	18%	15%
RTL Group	LUX/DEU	EUR	5,640	1,220	1,042	1,111	13,111	2,515	16,149	2.9x	13.2x	15.5x	11.8x	2.1x	22%	18%	20%
TF1	FRA	EUR	2,654	403	301	199	6,017	2,065	8,082	3.0x	20.1x	26.9x	30.3x	5.1x	15%	11%	7%
Vivendi	FRA	EUR	20,044	5,738	4,147	5,193	34,198	18,784	54,934	2.7x	9.6x	13.2x	6.6x	3.3x	29%	21%	26%
									Min	**2.7x**	**7.1x**	**13.1x**	**6.6x**	**1.5x**	**15%**	**11%**	**7%**
									Mean	**3.1x**	**13.6x**	**17.9x**	**18.5x**	**3.0x**	**25%**	**18%**	**15%**
									Median	**3.0x**	**13.5x**	**17.1x**	**19.2x**	**2.4x**	**22%**	**18%**	**13%**
									Max	**3.6x**	**20.1x**	**26.9x**	**30.3x**	**5.3x**	**51%**	**28%**	**26%**

Source: Bloomberg, Company Information, Press

Exhibit 16: Precedent transactions

Selected precedent transactions (Figures in m)										
Date	**Bidder**	**Seller**	**Target**	**Country**	**Currency**	**Deal value**	**Equity value**	**EV**	**EBITDA LTM**	**EV / EBITDA**
Nov-06	British Sky Broadcasting	Public tender offer	ITV (18% stake)	UK	GBP	940	5,249	4,559	498	9.2x
Nov-06	Nordic Broadcasting Oy	Schibsted ASA	TV4 (27% stake)	SWE	SEK	1,455	5,409	5,200	445	11.7x
Aug-05	Permira, KKR	TVSL SA	SBS Broadcasting (80% stake) (1)	LUX/NOR	EUR	1,864	n/a	2,094	122	17.2x
May-05	Bertelsmann	Westdeutsche Allgemeine Zeitung	RTL Group (8% stake)	LUX/DEU	EUR	550	7,432	7,542	886	8.5x

(1) KKR and Permira paid €1.691bn to acquire all SBS assets and assumed all its liabilities, resulting in a transaction value of €1.864bn. The deal was based on an enterprise value of €2.091bn. Afterwards they held 80%.

Source: Bloomberg, Company Information, Press

Teaching Notes

The case is sought to be interpreted as an example of many unsuccessful LBOs which happened during the peak of the buyout boom in the early 2000's as a consequence of both, excessive financial leverage and unfavorable economic conditions. The discussion of the case should cover the typical characteristics of a private equity investment and highlight the unique aspects of the P7S1 investment, namely the characteristics of the target and transaction structure in the context of intense competition around M&A transactions and the financial crisis. Finally, students should judge whether the investment was good or bad, based on financial analysis and strategic thoughts. This case can be used in Corporate Finance, Private Equity and other M&A related courses.

1. Which characteristics should a company have to create value in a LBO?

One can distinguish four main value creation levers in LBO transactions (Revenue growth, increase in profitability, deleveraging or cash generation and multiple arbitrage) which determine the key characteristics of a suitable target. As a consequence, financial sponsors ideally invest in companies with a strong and defendable position in a market with significant growth potential and/or a consolidation opportunity. From a financing point of view, the target must generate strong and stable cash flows while having low capital expenditure needs and non-specific quality assets to be used as collateral in order to maximize leverage. From a strategic point of view, the company should have potential for expansion and operational improvements supported by a competent and motivated management team. Finally, there must be a considerable number of potential buyers in order to design a realistic exit scenario. The investment thesis can stress different traits, depending on the target.

2. Put yourself in the position of Permira. Would you invest in P7S1 on a stand-alone basis?

P7S1 features several traits which make the company an attractive LBO target. The group operates in Europe's largest market which grew by a CAGR of 5.5% from 2003 until 2006 (**Exhibit 2**). P7S1 is in a strong competitive position when negotiating with advertising agencies due to its high market share and low cost-per-mille, thus creating significant entry barriers for potential competitors (**Exhibit 3**). Furthermore, the high level of vertical integration allows the group to decrease programming costs and benefit from additional revenue streams. In addition, the group has shown strong financial performance since the investment of Haim Saban: the stock price almost quadrupled, revenue growth exceeded growth of advertising sales in Germany every year and operating profit margin tripled from 7% to 21% (**Exhibits 4, 6, 14**). Finally, P7S1 has driven diversification into new digital segments (e.g. Maxdome) and is therefore well positioned for future growth (**Exhibit 5**). Using this momentum, P7S1 could provide value creation potential.

Some factors may limit the value creation potential of P7S1. First, organic growth in the core business is limited, given the high level of market concentration and regulation in Germany combined with growth rates that represent a rather saturated market (**Exhibits 2, 3, 4**). Also the market concentration in Europe does not easily allow for internationalization. Furthermore, Saban has streamlined the group's operations which reduces sources for further cost reductions and margin improvements (**Exhibit 6**). In addition, the cyclical nature of the advertising business leads to fluctuations in cash flows which represent a financing risk. Furthermore, the shift of advertising from traditional TV to digital media creates competition from new market entrants with considerable financial resources (e.g. telecommunication providers). Since there is only one direct competitor to P7S1 and publishing company Axel Springer has also been prevented from acquiring the group, it is plausible to assume that there is no potential domestic strategic buyer. The size of P7S1 further limits the number of exit candidates. Thus, there exists an exit risk for the investors. While the fact that P7S1 is publicly listed therefore provides a convenient exit route (if P7S1 is not taken private), it also creates reputational risks. Private equity investors are usually not used to deal with public attention and negative publicity may affect their reputation and future fundraising ability.

3. How does the ownership of SBS influence your investment decision?

The fact that KKR and Permira own SBS, changes the investment thesis as it allows to benefit in two ways. First, a sale to P7S1 provides a way to make a quick return on SBS.[17] Second, SBS offers additional value levers for a P7S1 buyout and mitigates some of the issues mentioned before, namely limited growth potential due to saturated domestic markets, limited opportunities for internationalization and cyclicality. The integration of SBS increases the size of P7S1 immediately and develops it into a major European player with exposure to high-growth regions. Furthermore, geographic and product diversification lowers revenue volatility which in return lowers the operational risk. In addition, the group benefits from annual synergies of €90m. As explained in question 1, growth and profitability directly translate into LBO value creation.

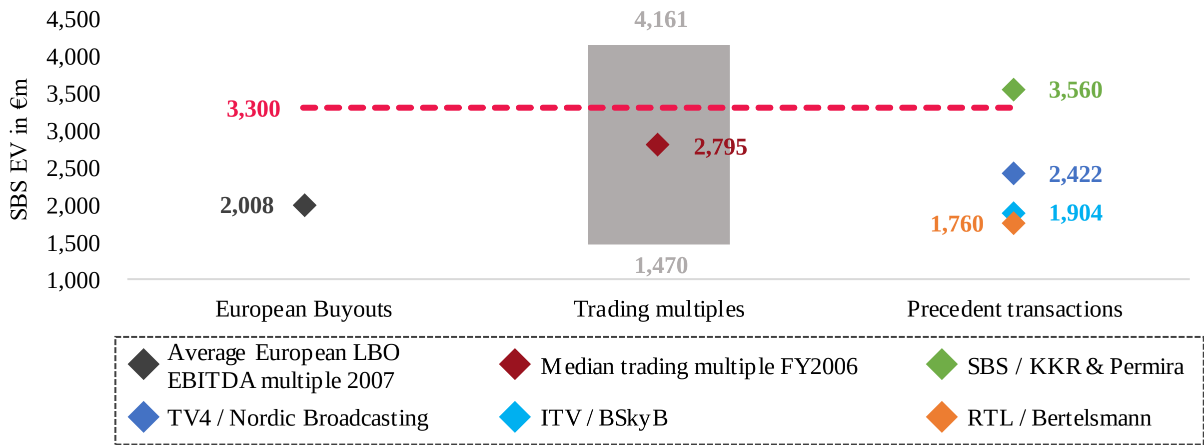
4. What other factors may have played a role for Thomas Krenz and Permira?

Private equity firms were under pressure to make deals and deliver returns despite high valuations. The latter was especially true for Permira and Thomas Krenz, who had recently struggled to make successful deals whilst having a new fund in his back. As a Managing Partner, Krenz thus had not only a professional but also a personal interest to acquire P7S1.

[17] The gross IRR is $(\frac{€3.3bn}{€2.1bn})^{\frac{1}{2}} - 1 = 25\%$. The money multiple for KKR was 2.2x on an equity investment of €351m.

5. Was the SBS deal overpriced from the perspective of P7S1?

In fact, KKR and Permira were heavily criticized by the media when they sold SBS at a price of €3.3bn to P7S1. Taking into account the 2006 EBITDA of €207m (**Exhibit 11**), students can calculate a valuation range for SBS (based on **Exhibits 1, 15 and 16**).



While the overall average multiple paid in European LBOs is not representative for the European media industry, trading multiples give a better impression. Considering a 20-30% control premium on the median EBITDA multiple of 13.5x, the EV range for SBS is €3.4-3.6bn. Precedent transactions indicate a lower EV range. Although the transactions serve as good benchmarks in terms of size, operations and geography, they are not meaningful for the valuation of SBS, as they include minority deals. Only the majority takeover of SBS in 2005 points to a similar valuation.

In conclusion, the SBS valuation of €3.3bn cannot be considered overpriced, especially when considering the strategic value of SBS for P7S1. Nevertheless, one should consider that KKR and Permira acquired SBS only 21 months before at a valuation of €2.1bn. Although this raises questions, we do not have further information to verify whether the EV is appropriate.

6. Had P7S1 been overleveraged?

To discuss this question, students can develop a model to forecast how P7S1 could have developed without the financial crisis, especially with regards to its financial position and credit statistics, as illustrated on the next page. Taking a conservative standpoint (as preferred by banks), future revenue growth is assumed to be 6%, which is in line with P7S1's and significantly lower than SBS's historical performance (**Exhibits 11** and **14**). Growth is expected to come from exposure to growth regions, digital broadcasting and HDTV. The EBITDA margin is assumed to be 18% in line with the four-year average of P7S1. As stated on page 9, synergies will be fully realized in 2010 and are assumed to build gradually until then. The tax rate is based on the statutory tax rate in Germany in 2006. Other assumptions are made in line with P7S1's past financial performance (**Exhibit 14**). The debt schedule assumes that term loan B is fully repaid in July 2014 and interest is paid for the first six months of 2014 (**Exhibit 10**). No RCF drawdown has been taken into account. The income statement uses the combined 2006 results of P7S1 and SBS (**Exhibits 11** and **14**) as starting point. To support the bank case, no dividends for common shareholders were assumed. Although this is a simplified model used for academic purposes, it shows that P7S1 might have digested the deal even under conservative assumptions. While the net debt to EBITDA ratio is very high in the beginning, the cash cover and interest cover indicate that P7S1 has headroom left. Only the repayment of term loan B in July 2014 would require a refinancing. Profitability and free cash flow is positive in every year except for 2014, when P7S1 would have to do a refinancing. Nevertheless, the model builds on the assumption of constant growth. Although the combination of SBS and P7S1 lowers revenue volatility, a cross-border recession such as the financial crisis could cause serious issues. While we do not know the debt covenants, it is plausible to assume that a recession may breach at least one covenant (most likely the maximum net debt to EBITDA ratio). In conclusion, one can argue that although the financing is risky P7S1 does not appear to be overleveraged.

Assumptions	2006a	2007f	2008f	2009f	2010f	2011f	2012f	2013f	2014f
Revenue growth		6%	6%	6%	6%	6%	6%	6%	6%
EBITDA margin		18%	18%	18%	18%	18%	18%	18%	18%
Revenue synergies (€m)		0	10	20	30	30	30	30	30
Cost synergies (€m)		0	20	40	60	60	60	60	60
Consumption of programming assets in % of revenues		45%	45%	45%	45%	45%	45%	45%	45%
∆ Working capital in % of revenues		2%	2%	2%	2%	2%	2%	2%	2%
CAPEX in % of revenues		(46%)	(46%)	(46%)	(46%)	(46%)	(46%)	(46%)	(46%)
D&A in % of revenues		2%	2%	2%	2%	2%	2%	2%	2%
Euribor rate		2.80%	2.80%	2.80%	2.80%	2.80%	2.80%	2.80%	2.80%
Tax rate		38%	38%	38%	38%	38%	38%	38%	38%
Debt Repayment Schedule (€m)		**2007f**	**2008f**	**2009f**	**2010f**	**2011f**	**2012f**	**2013f**	**2014f**
Senior secured term loan B (Euribor + 1.75%)									
Opening book value		1,800	1,800	1,800	1,800	1,800	1,800	1,800	1,800
Repayments		-	-	-	-	-	-	-	(1,800)
Closing book value		1,800	1,800	1,800	1,800	1,800	1,800	1,800	-
Interest payments		(82)	(82)	(82)	(82)	(82)	(82)	(82)	(41)
Senior secured term loan C (Euribor + 1.875%)									
Opening book value		1,800	1,800	1,800	1,800	1,800	1,800	1,800	1,800
Repayments		-	-	-	-	-	-	-	-
Closing book value		1,800	1,800	1,800	1,800	1,800	1,800	1,800	1,800
Interest payments		(84)	(84)	(84)	(84)	(84)	(84)	(84)	(84)
Pro Forma Income Statement (€m)	**2006a**	**2007f**	**2008f**	**2009f**	**2010f**	**2011f**	**2012f**	**2013f**	**2014f**
Revenues (6% growth + synergies)	3,108	3,294	3,502	3,732	3,986	4,255	4,540	4,843	5,163
EBITDA (18% margin + synergies)	**691**	**593**	**650**	**712**	**777**	**826**	**877**	**932**	**989**
(-) D&A		(66)	(70)	(75)	(80)	(85)	(91)	(97)	(103)
(-) Interest payments		(166)	(166)	(166)	(166)	(166)	(166)	(125)	-
EBT		**361**	**414**	**471**	**532**	**575**	**620**	**710**	**886**
Tax Rate		38%	38%	38%	38%	38%	38%	38%	38%
Taxes paid		**(137)**	**(157)**	**(179)**	**(202)**	**(218)**	**(236)**	**(270)**	**(337)**
Pro Forma Cash Flow Statement (€m)		**2007f**	**2008f**	**2009f**	**2010f**	**2011f**	**2012f**	**2013f**	**2014f**
EBITDA		593	650	712	777	826	877	932	989
(+) Consumption of programming assets		1,482	1,576	1,679	1,794	1,915	2,043	2,179	2,323
(-) ∆ Working capital		(66)	(70)	(75)	(80)	(85)	(91)	(97)	(103)
(-) CAPEX		(1,515)	(1,611)	(1,717)	(1,833)	(1,957)	(2,088)	(2,228)	(2,375)
(-) Taxes paid		(137)	(157)	(179)	(202)	(218)	(236)	(270)	(337)
Operating free cash flow		**357**	**388**	**421**	**456**	**480**	**505**	**517**	**498**
Interest payments		(166)	(166)	(166)	(166)	(166)	(166)	(166)	(125)
Debt repayment		-	-	-	-	-	-	-	(1,800)
Minimum dividend to preferred shareholders		(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Free cash flow		**189**	**220**	**253**	**288**	**312**	**337**	**348**	**(1,430)**
Pro Forma Balance Sheet (€m)		**2007f**	**2008f**	**2009f**	**2010f**	**2011f**	**2012f**	**2013f**	**2014f**
Cash		189	220	253	288	312	337	348	(1,430)
Financial debt		3,600	3,600	3,600	3,600	3,600	3,600	3,600	1,800
Net financial debt		**3,411**	**3,380**	**3,347**	**3,312**	**3,288**	**3,263**	**3,252**	**3,230**
Leverage Statistics		**2007f**	**2008f**	**2009f**	**2010f**	**2011f**	**2012f**	**2013f**	**2014f**
Net financial debt to EBITDA		5.8x	5.2x	4.7x	4.3x	4.0x	3.7x	3.5x	3.3x
Cash cover (Operating cash flow to debt service)		2.1x	2.3x	2.5x	2.7x	2.9x	3.0x	3.1x	0.3x
Interest cover (EBITDA to interest payments)		3.6x	3.9x	4.3x	4.7x	5.0x	5.3x	5.6x	7.9x

7. Was it bad luck or bad management what caused trouble for the investment?

While some financial decisions, such as the choice of the level of leverage or the €270m dividend in 2008 can be questioned, other factors outside the sponsor's sphere of responsibility have contributed to the distress of P7S1. The major factor was the credit crunch which did not allow any new financing decisions (e.g. capital increase, refinancing). In addition, the financial crisis hit the real economy to an extent which could not be foreseen. This led to a situation where P7S1 had to meet its debt service commitments despite lower profitability while a €270m dividend and a €120m cartel fine represented additional major cash outflows. Hedge funds creating additional pressure was another logical consequence of this situation. The disposal of all SBS assets can therefore not be seen as a strategic failure of the initial investment thesis but the need to restructure the company and reduce debt. The failure of the new advertising sales model and replacement of the entire management team however indicate some bad strategic decisions. As a result, although the sponsors pursued an aggressive financing strategy, there is no clear indication that their investment thesis would have also failed if the financial crisis had not happened.

8. What was the approximate return for KKR and Permira? Make assumptions, if needed.

The case gives all information needed to calculate the proceeds from share disposals (**Pages 12, 13, 15**). All dividends can be calculated from **Exhibit 6.** The initial equity investment of €987m can be taken from **Exhibit 7**. As no information is available on the financing of €509m for the acquisition of Axel Springer's 12% stake, students can assume it was financed through equity (**Page 10**). Until 2013, Permira had used all proceeds from dividends and share disposals for debt service and restructuring (**Page 15**). Therefore, only 2012 and 2013 dividends can be returned to investors. In the same manner, only 2013 and 2014 share disposals are considered. From the gross proceeds the net financial debt of Lavena 1 is subtracted as it has to be fully repaid before cash can be returned to LPs. Since Lavena 1 was liquidated in 2013, net financial debt is assumed to be the same as in 2012 (**Exhibit 13**). Since P7S1 is fully consolidated in Lavena 1 but the debt of P7S1 is not refinanced at exit, the net financial debt of Lavena 1 is considered net of P7S1 net financial debt. Based on these assumptions the exit waterfall can be calculated. For a simple IRR calculation, all equity proceeds are assumed to happen in 2013.

Share transactions	**Acquisitions**			**Disposals**					
Date	**Mar-07**	**Apr-07**	**Jan-08**	**Aug-08**	**Jan-11**	**Feb-13**	**Sep-13**	**Nov-13**	**Jan-14**
Seller / Acquirer	**German Media Partners**	**Public tender offer**	**Axel Springer**	**TMG**	**Public placement**	**Block trade**	**Block trade**	**Block trade**	**Block trade**
Preference shares									
% acquired / sold	13%	0.3%	12%		7.3%	18%			
# of shares (m)	14.2	0.3	13.1		8.0	19.7			
Price per share (€)	22.40	22.45	19.40		24.20	24.60			
Value (€m)	319	7	255		194	485			
Common shares									
% acquired / sold	88%		12%	12%			11%	16%	17%
# of shares (m)	96.3		13.1	13.1			24.1	35.0	37.2
Price per share (€)	28.71		19.40	28.71			30.67	31.82	34.75
Value (€m)	2,764		255	377			738	1,114	1,293
Total value (€m)	**3,083**	**7**	**509**	**377**	**194**	**485**	**738**	**1,114**	**1,293**

Shares	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
# of preferred shares (m)	109.4	109.4	109.4	109.4	109.4	109.4	-	-
# of common shares (m)	109.4	109.4	109.4	109.4	109.4	109.4	218.8	218.8

Dividends	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Ex-dividend date	Jun-08	Jun-09	Jun-10	Jul-11	May-12	Jul-13	Jun-14	May-15
% preferred shares at end of the year	13%	25%	25%	25%	18%	18%	0%	0%
% common shares at end of the year	88%	88%	88%	88%	88%	88%	17%	0%
Dividend per share of preferred stock (€)	1.25	0.02	0.02	1.14	1.17	5.65	n/a	n/a
Dividend per share of common stock (€)	1.23	0.00	0.00	1.12	1.15	5.63	1.47	1.60
Total dividends received (€m)	**137**	**1**	**1**	**139**	**134**	**653**	**53**	**-**

LBO return calculation	
Exit waterfall	**(€m)**
(+) Total dividends received	1,117
(-) Dividends used for debt service	(411)
(+) Total proceeds from share disposal	4,200
(-) Proceeds from share disposal used for debt service	(571)
Total proceeds	**4,336**
(-) Lavena net financial debt 2012	(4,109)
(+) P7S1 net financial debt 2012	1,871
Total equity proceeds	**2,098**
Money multiple	
Initial investment (2007)	987
Second investment (2008)	509
Total equity investment	**1,497**
Total equity proceeds	2,098
Total cash on cash (Money multiple)	**1.4x**

IRR	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
6.1%	(987)	(509)	0	0	0	0	2,098	0

9. Was it a good investment from a financial point of view? What other factors have to be taken into account when evaluating the investment from a financial sponsor's point of view?

Financial sponsors traditionally aim to generate an IRR of 20-25% and a money multiple of 2.0-2.5x. From a sole returns perspective, the investment can therefore not be considered successful. While LPs expect high returns on their investment, reputation is even more important for a financial sponsor in the long-term as it impacts both, the ability to raise future funds from investors and to gain ownership over companies. In the case of P7S1, Permira and KKR were not able to realize their initial investment thesis. Furthermore, they used too much leverage, had to sell substantial parts of the business, replaced the entire management team and laid off more than 400 employees. In addition, the sponsor's actions received great public attention since P7S1 remained publicly listed. These events may have built a reputation which causes reservation from many company owners and management teams to sell their company. As a conclusion, the investment cannot be considered a good investment, neither from a financial nor from a strategic perspective. In fact, Permira struggled to raise a new fund after the financial crisis.