

Seagate Technology Buyout

Suggested Assignment Questions

1. Why is Seagate undertaking these transactions (the buyout and the stock swap with Veritas)? Who are the winners and losers resulting from these transactions (e.g., Seagate shareholders, Seagate management, Veritas shareholders, Silver Lake Partners)?
2. Who benefits from generic leveraged buyouts? Who loses? Is the rigid disk drive industry conducive to a leveraged buyout?

NOTE: For the purposes of questions 3 through 5, assume that after the buyout, Seagate will incur NO AMORTIZATION EXPENSE. Therefore EBITA and EBIT will be identical.

3. Luczo and the buyout team plan to finance their acquisition of Seagate's operating assets using a combination of debt and equity. How much debt would you recommend that they use? Why? (Hint: use the projections in Exhibit 8 and the information in Exhibit 11, together with your personal judgement based on the text of the case, to estimate a reasonable annual amount of debt the company should carry)
4. Based on the scenarios presented in Exhibit 8, and on your assessment of the optimal amount of debt to be used in Seagate's capital structure, estimate the value of Seagate's operating assets, assuming the following:
 - As of June 30, 1999, Seagate had \$1.623 billion of cash on its balance sheet. As part of the transaction, \$704 million will be used to payoff existing debt and \$765 million will be transferred to the buyout team. Of the \$765 million, \$500 million is required for net working capital (and will grow as a % of sales) and excess cash is \$265 million. Any cash remaining at the time the transaction is consummated will be distributed to Seagate shareholders.
 - The buyout team will initially borrow \$1.2 billion to finance the deal, and will pay down debt as cash flows permit until the optimal debt level is achieved. For this question, assume that the long-run target level of debt is \$750 million. If cash flow is negative in a given year, assume the firm issues additional debt to make up any shortfall (i.e. the \$265 million of excess cash is maintained as a cushion.)

- What rating is the debt likely to get when the deal closes? What interest rate is the company likely to pay? How will these change over time as the business grows and the debt gets repaid?
 - Cornell and Green (1991, *Journal of Finance*, vol. 46), estimated that bonds with high credit ratings have average betas of 0.25, while bonds with below investment-grade ratings (i.e., junk or high-yield bonds) have average betas of 0.5. How would you incorporate this into your analysis and valuation?
5. Exhibit 10 shows that Morgan Stanley estimated Seagate's terminal value using a multiple of EBITA. How does their procedure compare to the one you used in question 4? What growth rate assumption does Morgan Stanley's calculation implicitly make?
 6. Suppose that, as an investor prior to the announcement of the Silver Lake transaction, you want exposure to Seagate's disk drive assets but not their Veritas stake. What trade/s could you undertake to gain this exposure? How much cash would be required for your recommended trade?