



***Leveraged Recapitalization
and Exchange Offers***

Prof. Ian Giddy
New York University

Leveraged Recapitalization

- Strategy where a company takes on significant additional debt with the purpose of paying a large dividend (or repurchasing shares)
- Result is a far more leveraged company -- usually in excess of the "optimal" debt capacity
- After the large dividend has been paid, the market value of the shares will drop.

Leveraged Recapitalizations

- Motivations:
 - ◆ Defensive
 - ◆ Proactive
 - ◆ Ownership transition/liquidity
- Which produces what value?

Sealed Air

1. Why did Sealed Air undertake a leverage recapitalization? Do you think that it was a good idea? For whom?
2. Dunphy was an MBA (HBS class of '56), shouldn't any self-respecting MBA be able to find a way to spend several hundred million dollars?
3. How much value was created? Where did it come from?

Exchange Offers

- Give one or more classes of claimholders the option to trade their holdings for a different class of securities of the firm.
- Typical examples are allowing common shareholders to exchange their shares for bonds or preferred stock,
- Or vice-versa
- Motivations?

Exchange Offers-- Effect Depends On:

- Leverage increasing or decreasing
- Implied increases or decreases in future operating cash flows
- Implied undervaluation or overvaluation of common stock
- Increase or decrease in management share ownership
- Increase or decrease in management control over cash usage
- Positive or negative signalling effects.

Exchange Offers

Right to exchange from:	to:	Net return
Common stock	Debt	
Common stock	Preferred stock	
Preferred stock	Debt	
Preferred stock	Income bonds	
Debt	Private equity	
Debt	Common stock (forced)	
Preferred stock	Common stock	
Debt	Preferred stock	
Debt	Common stock	

Exchange Offers

Right to exchange from:	to:	Net return
Common stock	Debt	+14%
Common stock	Preferred stock	+8.2%
Preferred stock	Debt	+2.2%
Preferred stock	Income bonds	+2.2%
Debt	Private equity	-0.9%
Debt	Common stock (forced)	-2.1%
Preferred stock	Common stock	-2.6%
Debt	Preferred stock	-7.7%
Debt	Common stock	-9.9%

Dual-Class Recapitalizations

- The creation of two classes of common stock, one of which has limited voting rights but typically a preferential claim on the company's cash flows
- Must be approved by shareholders
- May create entrenched management

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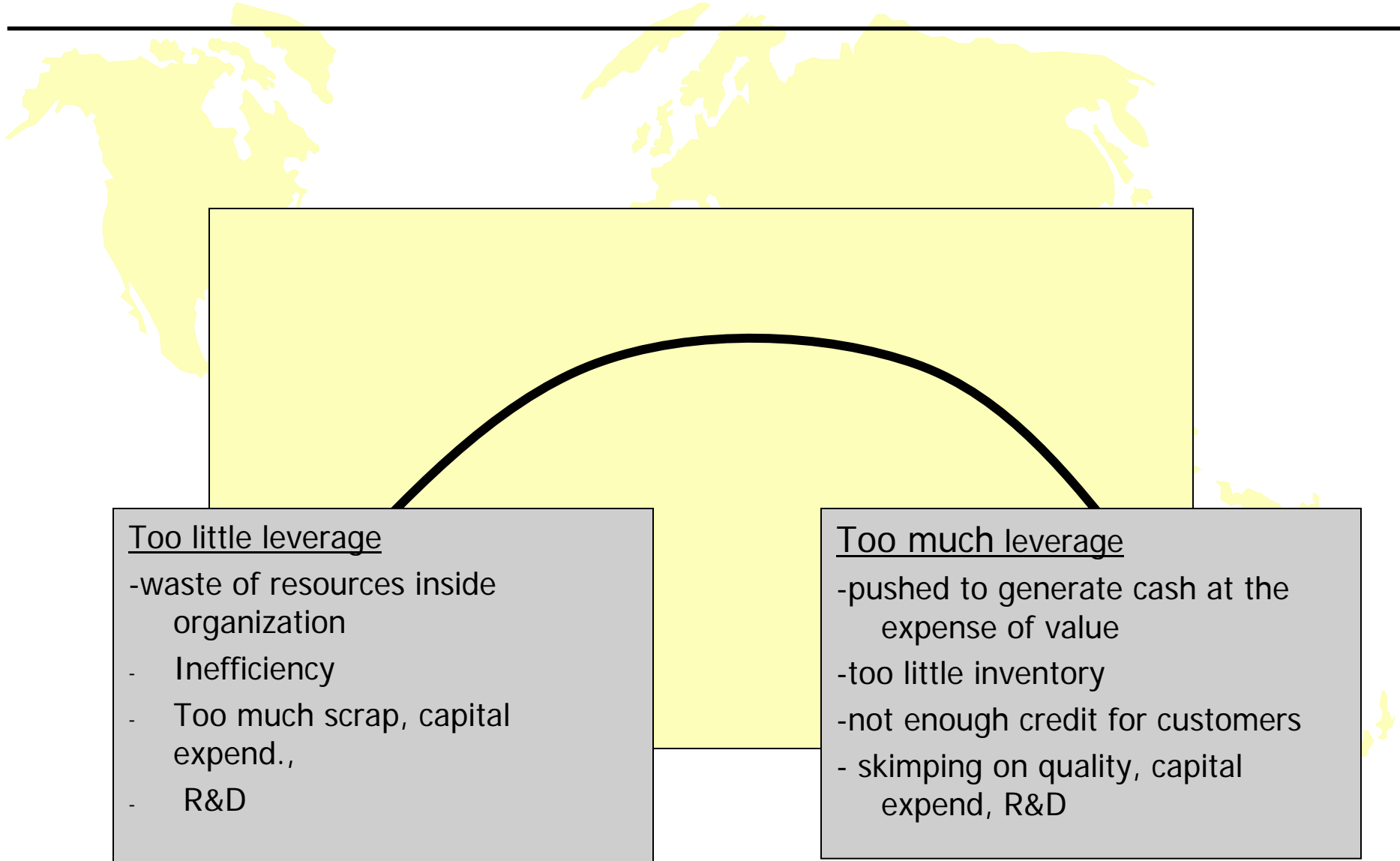
Restructuring Truck Toys

- Evaluate the leveraged recap:
 1. What would be the value of what outside investors received? Of what management received?
 2. What would be the percentage of ownership held by management after the recapitalization?
 3. How receptive do you think senior and subordinated investors would be to this? Develop a pro-forma balance sheet and interest coverage analysis, after the recap, assuming senior debt pays 12% and subordinated debt pays 15%.
 4. Would the company be able to pay down its subordinated debt? How?
- Which of the three alternatives might make sense? How would they work?

Sealed Air

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Organizational Effects of Leverage



Sealed Air's Changing Competitive Environment

- They had traditionally neglected manufacturing in favor of marketing. - able to do this because of a lack of competition
- About a year before the recap, they launched a program of manufacturing excellence.
- When this worked, SA had cash and debt capacity

Sealed Air: Before and After

Shareholder Value Before and After the Announcement of the Leveraged Recapitalization

Date	Closing Stock Price	Market Value of Common Stock (Millions)	Special Dividend at \$40 per share (Millions)	Total Value (Millions)	Change in Value from Day before Announcement of Recap (Millions)
Day Before Announcement of Recap	\$45.875	\$378.2	—	\$378.2	—
One Day After Announcement of Recap	50.500	416.4	—	416.4	\$38.2
One Day Prior to Ex-Dividend Date	50.750	418.4	—	418.4	40.2
Ex-Dividend Date	12.500	103.1	\$329.8	432.9	54.7
Closing Price for 1989 (12/31/89)	20.375	168.0	329.8	497.8	119.6
Maximum Price in 1989	23.000	189.6	329.8	519.4	141.2

April 1989

December 1989

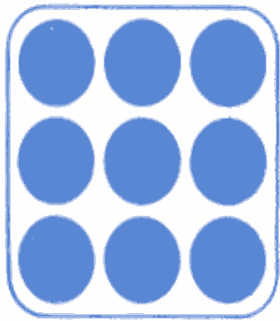
Post-Recap Balance Sheet

(dollars in millions)

	1989	2002 (1)
Operating Data:		
Net Sales	385	3,204
Gross Profit	135	1,058
Gross Profit Margin	34.9%	33.0%
EBITDA	70	689
EBITDA Margin	18.2%	21.5%
Interest Expense	32	65
Preferred Dividends	0	54
Capital Expenditures	14	92
Balance Sheet Data:		
Cash / Short-term Inve	24	127
Total Assets	229	4,261
Total Debt	311	923
Preferred Stock	0	1,327
Stockholders' Equity	(161)	810
Total Capitalization	151	3,060

The Financial Restructuring?

- What about the negative net worth?
- How did the the Special Dividend work?
- Effect of the recap on firm value and performance?
- Change in shareholder value over the years following the recap?



Sealed Air Corporation

Company Overview

- ◆ **The world leader in food, protective and specialty packaging materials and systems including:**
 - ◆ **Cryovac[®] brand of food and specialty packaging products**
 - **Instapak[®], Bubble Wrap[®] and Jiffy[™] brands of protective packaging and other products**
- ◆ **Plants - over 105 manufacturing facilities and operations in 48 countries**
- ◆ **2002 sales - \$3.2 billion**
- ◆ **2002 EBITDA - \$689 million (excludes asbestos settlement charges)**
- ◆ **Approximately 18,000 employees**



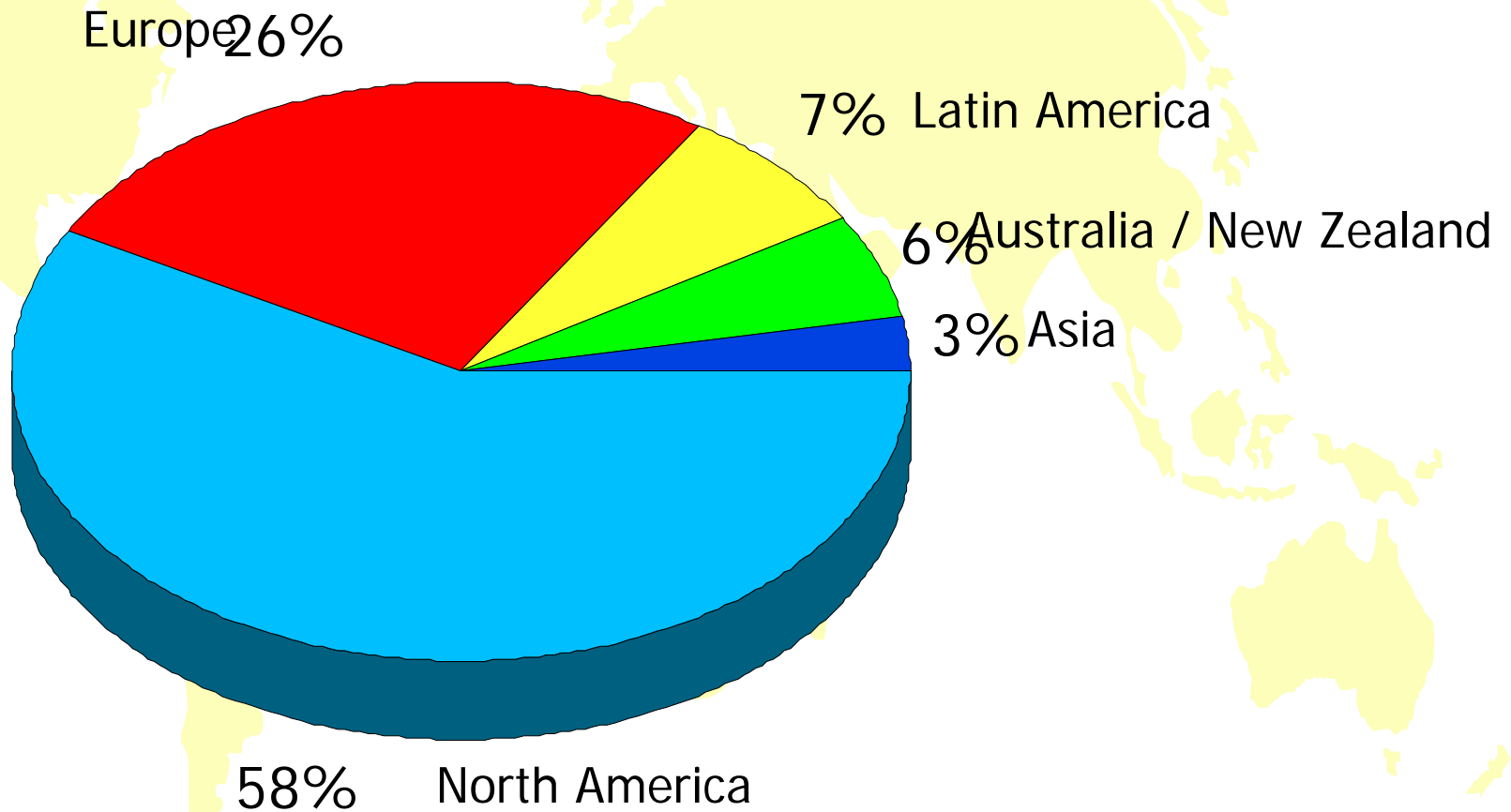
Company Overview

	Food Packaging	Protective Packaging
2002 Sales (\$mm)	\$1,958 (61%)	\$1,246 (39%)
Packaging Applications	Fresh meat, smoked and processed meat, poultry, cheese, fish, produce, bread, fluid food	Cushioning, blocking, bracing, surface protection, presentation
Major Products	Shrink bags, shrink films, non-shrink films, absorbent pads, rigid containers, packaging systems	Air cellular cushioning, polyurethane foam, shrink and non-shrink films, protective and durable mailers, suspension and retention packaging, polyolefin foams, packaging systems
Product Benefits	Superior package integrity Extended product shelf life Superior shrink, clarity and gloss	Superior protection from shock, vibration, and abrasion Superior shrink, clarity and gloss
Competitors (US/EU)	Pechiney, Bemis, Other product alternatives	Bemis, Pactiv, Other product alternatives



Company Overview

Geographic Sales Breakdown



Note: Results for the twelve months ending December 31, 2002



Company Overview

Powerful Brands

- ◆ **Bubble Wrap[®]**
- ◆ **Cryovac[®]**
- ◆ **Instapak[®]**
- ◆ **Jiffy[®]**

Cushioned
& Durable
Mailers



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Cushioning

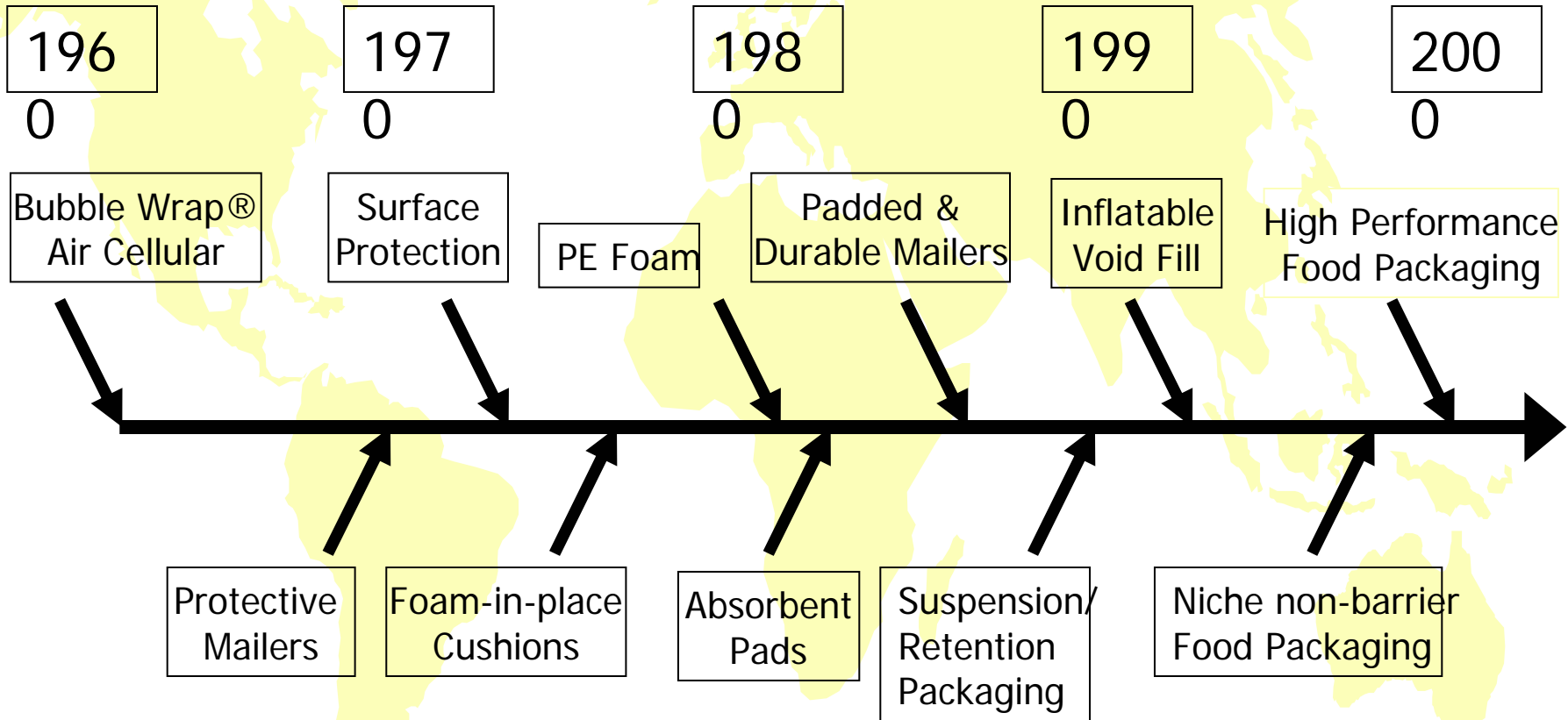
Vacuum
Shrink
Packaging



Foam
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place

Company Overview

Proven Record of Business Development



Financial Overview

Highlights: 1998 through 2002

- ◆ **Net sales have grown at a 3.4% CAGR since 1998**
- ◆ **Gross margins of 32% - 35%**
- ◆ **EBITDA margins**
 - ⤵ EBITDA margins of 20% - 23% (5-10% higher than average packaging company)
- ◆ **Five year average FCF of \$251 million per year**
 - ⤵ 2002 free cash flow of \$220 million - \$250 million
- ◆ **Net reduction of debt and preferred stock, net of cash, of \$945 million from March 31, 1998 through December 31, 2002**



Financial Overview

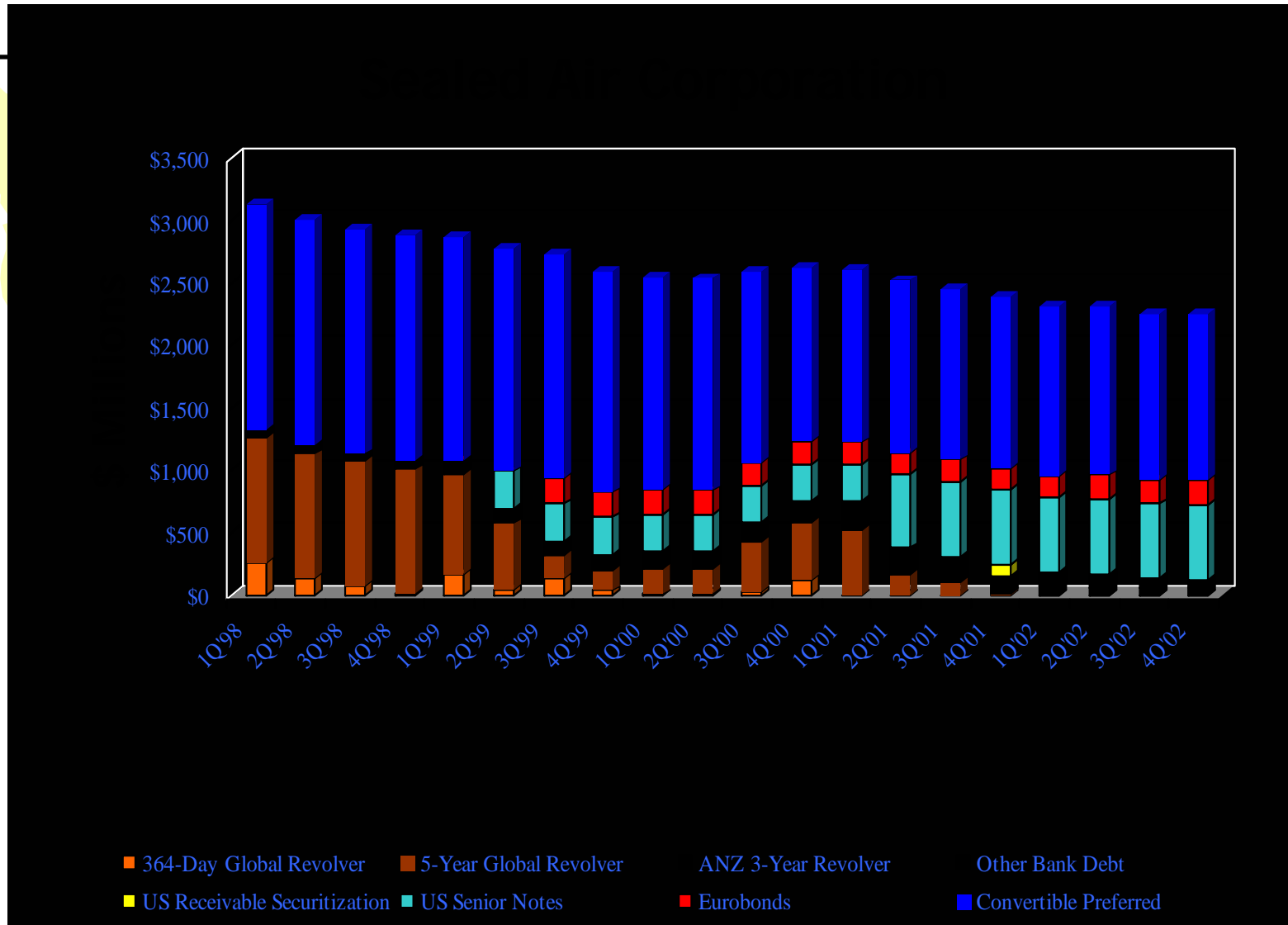
Historical Financials - Then and Now

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Liquidity: Debt Distribution





Sealed Air Corporation



Contact Info

Ian H. Giddy

NYU Stern School of Business

Tel 212-998-0426; Fax 212-995-4233

ian.giddy@nyu.edu

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The logo for Giddy.org, featuring the text "Giddy.org" in white on a dark blue rectangular background. A red arc is positioned above the "y" in "Giddy".