CENTERBRIDGE / GREAT WOLF RESORTS CASE ANSWERS

MASTERCLASS FUSIES & OVERNAMES, DR M NAWAS, 29 June 2021

CENTERBRIDGE CASE QUESTIONS (NL)

1. Welke verdienmogelijkheden zag Apollo in 2012 bij de acquisitie van Great Wolf Resorts?
2. Waarom zou Apollo in 2015 Great Wolf aan Centerbridge verkopen, in plaats van er nog iets langer aan vast te houden?
3. Wat zijn de voors en tegens van Secondary Buy Outs (SBO’s)?
4. Welke verdienmogelijkheden zag Centerbridge in 2015 bij haar acquisitie van Great Wolf Resorts?
5. Welk financieringspakket zou Centerbridge moeten kiezen en waarom?
6. Hebben de overnames door Apollo en vervolgens door Centerbridge op de lange termijn waarde gecreëerd voor de business van Great Wolf Resorts?

CENTERBRIDGE CASE QUESTIONS (ENG)

1. In 2012, what opportunities did Apollo identify for the business?

2. Why would Apollo sell rather than continue to hold Great Wolf in 2015?

3. What are the pros and cons of SBOs?

4. What did Centerbridge see in 2015?

5. Which of the two financing packages should Centerbridge choose?

6. From a long-term perspective, where the buyouts buy Apollo and Centerbridge valuable for Great Wolf?

Q1: IN 2012, WHAT OPPORTUNITIES DID APOLLO IDENTIFY FOR THE BUSINESS?

- Public investors likely more worried than Apollo with the debt burden of Great Wolf, as they have less influence on the firm to protect their interests.

- Apollo likely valued Great Wolf's EBITDA and EBITDA-margin growth more than public shareholders.

- Apollo may have been counting on its ability to de-lever and seek more favourable debt terms. Note though that Apollo had to take on the existing, onerous debt, rather than repay it upon acquisition, as would be normally the case.

- Apollo saw opportunity to cut costs. In a highly levered business, a 10% cut in costs has an amplified effect on profit.

Q2: WHY WOULD APOLLO SELL RATHER THAN CONTINUE TO HOLD GREAT WOLF IN 2015?

- To avoid long horizon investments in new properties and operational improvements.
- Quickly realise a gain, as it was nearing the end of the investment period of its fund.
- The most impactful cost reductions had already been made, future improvements will be harder, and so there will be a trade off between further improvements versus a longer investment period.
- Perhaps Apollo could use the proceeds to invest in another firm out of the same fund (although usually this is subject to approval by investors)
- Apollo may be concerned that their key portfolio manager for Great Wolf, Scott Ross, had resigned and quality of oversight may suffer.

Q3: WHAT ARE THE PROS AND CONS OF SBOS?

– Typically buy out firms have similar strategies. If so, it may be unlikely that a secondary buyer will add more value than the first buyer.

– Investors often invest in many funds, so may end up investing again in Great Wolf via an SBO, having lost the transaction costs of the SBO for no good reason.

– SBO buyers may have a wrong incentive: buy quickly before their investment period lapses

\+ SBO buyer may have a different time horizon, investment thesis or skill set

\+ SBO buyers may be able to merge/cooperate Great Wolf with another portfolio company

Q4: WHAT DID CENTERBRIDGE SEE IN 2015?

- “Bigger is better” to stay competitive, and Great Wolf may be well-positioned given its high NPS and 15% market share, provided it would be allowed to grow

- Non-business travel spending was rising, and domestic (road) travel is more resilient through the economic cycle. Also indoor water parks are less weather dependent

- Ability to execute operational improvements that Apollo did not undertake (See the 6 levers of Murray Hennessy, p.9-10), including development of new revenue streams (smarter pricing, onsite attractions, partnerships and licensing)

- Insert new capital for expanding across US and internationally

- New management that supported the longer term growth that Centerbridge envisaged

Q5: WHICH OF THE TWO FINANCING PACKAGES SHOULD CENTERBRIDGE CHOOSE? (1 OF 3)

Traditional LBO

- Carried the risk of the banks “flexing” the price in bad market conditions. Therefore Centerbridge had to make assumptions. They assumed a blended cost of debt of 7.25% on bank debt and bonds.

- Banks were offering $575M in bank debt and suggested arranging $250M in bonds, in total $825M of funding. If Centerbridge offered Apollo $1.35B, the resulting equity investment would be $585M.

- Dividend restriction covenant

- Covenants on performance, probably financial debt ratios, set as Events of Default

Q5: WHICH OF THE TWO FINANCING PACKAGES SHOULD CENTERBRIDGE CHOOSE? (2 OF 3)

CMBS – ALL IN ALL FAR SUPERIOR

- The cost of CMBS debt was ($500M x 5% + $370M x 9%) = 6.7%
- The CMBS structure allowed Great Wolf to retain the existing TRUPS. Together the blended rate of non-equity was circa 6.5%
- On a purchase price of $1.35B, the resulting equity investment would be $459M
- CMBS structure was for a 7 year fixed term
- No covenant restrictions; investors were apparently convinced by the ICR even in the downside case (Exhibit 13a)

Q5: WHICH OF THE TWO FINANCING PACKAGES SHOULD CENTERBRIDGE CHOOSE? (3 OF 3)

Comparison LBO package with CMBS package

- No Cost of Equity has been given. Let us assume 12%.
- Total uses of funds is $1410M (see Exhibit 14).
- The WACC for the LBO package is ($585M x 12% + $825M x 7.25%) / $1410M = ($70.2M + $59.8M) / $1410M = 9.2%.
- The WACC for the CMBS package is ($459M x 12% + [$870M + $52M + $29M] x 6.5%) / $1410M = ($55M + $61.8M) / $1410M = 8.3%.

CMBS is far better: the WACC is lower, as are the restrictions and risks.

Q6: WHERE THE BUYOUTS BUY APOLLO AND CENTERBRIDGE VALUABLE FOR GREAT WOLF?

It appears so, indeed:

- Centerbridge valued Great Wolf’s TEV at $1.35B. With Q1 2015 LTM EBITDA of $128.6M (Exhibit 11), that is a multiple of 10.5x, only slightly higher than the 9.9x paid by Apollo (Exhibit 12). This multiple compares favourably to industry average of 14x and M&A average of 11.3x.

- The starting Debt-to-TEV was not higher, from ($800M–$262)/$800 = 68% in 2012 (p.3-4) to ($1.35B–$459M)/$1.35B = 66% in 2015.

- So the buy-outs did not put the company under undue financial stress.

- Apollo had successfully cut operational costs. Centerbridge allowed Great Wolf to evolve its strategy by enabling CAPEX and bringing in new management.

WHAT HAPPENED?

- Centerbridge indeed bought Great Wolf in May 2015 for **$1.35B**.
- They raised the CMBS from $870M to $1.075B and at the same time reduced the blended cost of non-equity from 6.5% to **5.24%**.
- As a result, equity was much lower, $294M in stead of $459M (the uses increased from $1410M to $1450M due to unforeseen transaction costs). And WACC became much lower: ($294M x 12% + [$1075M + $52M + $29M] x 5.24%) / $1450M = ($35.3M + $60.6M) / $1450M = **6.6%**.
- New management, dedicated to (a) real estate and (b) digital media, the latter allowing development of new branded revenue streams outside park income.
- CAPEX grew aggressively: 2015-2019 new sites spread regionally across the US. New site in Canada since 2020. More to follow, internationally too.
- In 2019, Blackstone Real Estate acquires 65% of Great Wolf from Centerbridge, who now form a joint venture.