Burger King deal not done yet

by Josh Kosman and Kelly Holman Posted 05:52 EST, 8, Oct 2002

A **Texas Pacific Group**-led consortium of private equity firms is struggling to close its $2.26 billion leveraged buyout of Burger King, the world's second-largest hamburger chain, several sources said.

Backed by the lenders **J.P. Morgan Chase & Co.** and **Citigroup Inc.**'s Salomon Smith Barney Inc., a TPG-led consortium agreed July 25 to buy **Diageo plc**'s Burger King Corp. on the contingency of securing the LBO's financing. But since then, the lenders have postponed two bank meetings, including one scheduled for last week, to sell their debt package, because of market conditions, sources said.

Making matters worse, Burger King's profits have softened in the months following the July buyout agreement. While the chain's sales increased earlier this year, they flattened or decreased in August and September, said Robert Hill, a principal at Rosemont, Ill.-based investment boutique **J.H. Chapman Group llc**, who is also the former head of M&A at Burger King.

These two factors are combining to give TPG and its private equity partners — **Bain Capital Inc**. and **Goldman Sachs Capital Partners** — indigestion as they try to close the Burger King deal in the fourth quarter, as planned. Some sources said the TPG-led group may even seek to renegotiate the purchase price, citing a material adverse change clause in its buyout agreement.

Press officers for TPG, Bain Capital, Salomon and Goldman declined to comment. A press officer at J.P. Morgan did not return calls.

A Diageo spokesman, Ian Wright, said, "Diageo remains confident in the agreement with the buyers and remains constructively engaged."

TPG and its partners won Burger King in a drawn-out, closely watched auction. The British conglomerate Diageo said it would use sale proceeds to reinvest in its world-leading premium drinks business.

The buyers agreed to pay Diageo a 7.29 times Ebitda multiple by raising 4.7 times Burger King's $310 million of projected 2002 Ebitda in the debt markets. That now looks like a tall order. According to **Portfolio Management Data**, the average total debt to Ebitda level raised for an LBO this year, through Oct. 5, is 3.6 times — more than 20% lower than this deal.

The TPG-led group plans to raise $500 million of its $1.66 billion debt package in the high-yield bond market, which is struggling. For 13 of the past 17 weeks, there has been a net outflow of money from the high-yield market, according to **AMG Data Services**.

That has taken its toll on financial buyers. Last week, for instance, **Clayton, Dubilier & Rice Inc.** pulled the £175 million ($274 million) European junk bond offering supporting its $967 million LBO of the British food company **Brake Bros. plc**

Burger King could also expect a difficult time. Margaret Patel, portfolio manager of Boston-based **Pioneer High Yield Fund**, said restaurant-related high yield deals have historically had a "poor performance record." AmeriServe Food Distribution Inc., for instance, a Dallas food distributor that served Burger King among other fast-food restaurants, issued $200 million in a Donaldson, Lufkin & Jenrette-led underwritten high yield syndication in 1999 — only to file for bankruptcy in January 2000.

J.P. Morgan and Salomon are expected to reschedule the Burger King bank meeting for the week of October 21, a source said. But Burger King's performance erosion might prove TPG's bigger pickle.

Burger King planned to boost revenue this year by selling new products and reinvesting in its franchisees. So far, the results have been underwhelming. Hill said the attitude of the franchisees has changed since the time the TPG group was conducting due diligence.

"The state of affairs seemed to change around mid-summer," he said, adding that many franchisees did not like Burger King's recent decision to offer a 99-cent "value menu" in response to a similar promotion from industry leader **McDonald's Corp.** Hill said many of the franchisees believe Burger King has lost focus — a potential problem since most of Burger King's revenue is generated by royalty fees paid by the franchisees, which own about 90% of Burger King's 11,435 restaurants.

"I think the franchisee sentiment should be very important to the buyers," Hill said.

But several sources believe Diageo and the Texas Pacific Group will still complete the deal.

Jay Jordan, whose **Jordan Co.** owns AmeriKing Inc., the largest Burger King franchisee, said he expects a positive outcome.

"Diageo is committed to sell, and this is the best buyer available. And I think if it's a different deal, it's a different deal, but this will get sold."