Equity Firms Cheer Return of 'Staple'; Critics Don't

The Wall Street Journal
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March 5, 2010

It is the surest sign yet that corporate credit markets are roaring anew: The "staple" is back.

During the private-equity frenzy of the past decade, investment bankers worked both sides of deals, advising sellers while offering financing to prospective buyers. That practice, known as staple financing because lending terms were stapled to a deal's term sheet, helped fuel the largest buyout boom in history.

While these financing packages are still a far cry from those arranged for the megadeals of yore, the staple is quietly showing up in a number of new transactions.

That is welcome news for private-equity firms, which aren't only looking to sell portfolio companies, but also are keen to acquire businesses with their billions of dollars in unused capital.

The staple is now a factor in the $3 billion auction for financial data provider Interactive Data Corp. Goldman Sachs Group Inc. is offering a staple of five times the company's earnings before interest, taxes, depreciation and amortization, or Ebitda, according to people familiar with the deal.

That in turn has prompted Bank of America Merrill Lynch to offer 5.5 times Ebitda to buyers, a group that includes McGraw Hill Cos.; Apax Partners; Kohlberg Kravis Roberts & Co.; and Bain Capital LLC and Advent International Corp., these people said.

An IDC spokesman declined to comment.

Staple financing came under legal criticism during the buyout boom for causing a number of conflicts of interests among banks. But no one in the market seems overly concerned about that today, as they are happy to have more capital available after the historic credit crunch of 2008 and 2009.

"It is suddenly the new reality for these deals. You have to do it," said one banker advising on a staple-financed deal. "It is on smaller deals than the last time, so a little more responsible. Still, we never learn."

The staple is now playing a role in a slew of previously unreported auctions. Michael Foods, a Minnetonka, Minn.-based food processor and distributor owned by private-equity firm Thomas H. Lee Partners, is on the block, according to people familiar with the deal.

Bank of America is handling the sale and offering financing of six times Ebitda on the deal, which could command a price of more than $1.5 billion. A spokeswoman for THL declined to comment.

Another auction underway is for the Hillman Group, a Cincinnati, Ohio-based manufacturer of nuts, bolts and other fasteners sold to Home Depot, Lowe's and other home-improvement stores, according to people familiar with the deal.
Barclays PLC is handling the auction and has indicated to potential buyers it would offer financing at about five times the company's Ebitda.

Hillman, which has more than 1,700 employees and is controlled by Chicago private-equity firm Code Hennessy & Simmons LLC, is expected to fetch more than $800 million.

Another deal being considered with staple financing is Bresnan Communications, a Purchase, N.Y.-based cable and telecommunications provider controlled by Providence Equity Partners, Quadrangle Group and Comcast Corp. The three firms have owned Bresnan for eight years, and hope to fetch at least $1 billion for the company.

Bresnan is talking with UBS about an auction to shop the company around, said people familiar with the matter. That process has not started yet, but could soon, said these people.

Another bank, Credit Suisse AG, is talking with Bresnan about offering staple financing to potential buyers at about six times the company's Ebitda, according to these people. That agreement has yet to be inked but could soon, they added.

Bresnan spokesman Shawn Beqaj said "it is natural that our partners take an opportunity in year eight of the private-equity cycle to determine their valuation and explore options."

But staple financing has its risks: Namely, potential for conflicts of interest, as investment banks advising a seller may have incentive to favor a buyer who takes advantage of the bank's offered financing.

Influential Delaware Court of Chancery Judge Leo Strine wrote, in a 2005 ruling related to the sale of Toys "R" Us Inc., that using Credit Suisse as advisor and lender on the deal created an "appearance of impropriety."

The practice of staple financing played "into already heightened suspicions about the ethics of investment banking firms," Mr. Strine wrote.

Mr. Strine noted that there were situations when staple financing can be beneficial to a company. When an adviser commits to provide financing to any bidder, for instance, it can induce more bidders to participate in the auction, a scenario "wholly consistent with the best interests" of the company, he wrote.

In an article published last year in the Delaware Journal of Corporate Law, Christopher Foulds, now a lawyer at Skadden, Arps, Slate, Meagher & Flom in Wilmington, Del., argued that staple financing is advantageous to corporate sellers in weak credit markets because it is more likely that a staple-financed deal will close. Also, with the lending terms set by the selling bank, staple financing can set a floor on the company's value.

"While there's a clear conflict of interest," said Guhan Subramanian, a professor of law and business at Harvard University who studies corporate acquisitions, "that conflict has to be weighed against the benefits of creating a more robust auction."