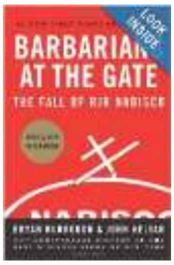

Book Summary: Barbarians at the Gate: The Fall of RJR Nabisco (HarperBusiness) by Bryan Burrough & John Helyar

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Note: This is a very concise paraphrased summary. Please support the author and buy the book.

- RJR Nabisco was wildly undervalued.
  - **Tried to recognize values through a leveraged buyout.**
- Delaware is where RJR Nabisco and so many public corporations were chartered.
- Ross Johnson had a personal philosophy called **"shit stirring": a love for constant restructuring and reorganization.**
- The theory behind the merger between Reynolds and Nabisco was that by combining Reynolds's huge line of products with Nabisco's, the new company would command greater sway with buyers, demanding more and better shelf space in supermarkets and deeper discounts from wholesalers.
- **Johnson used investment bankers as free advice with the constant flow of ideas** – he formed an "idea of the week" club.
  - "Why have a dog and bark yourself?" Johnson would ask.
- Preceding all of this, **Henry Kravis set up a dinner with Ross Johnson at his Park Avenue apartment.** At dinner Henry Kravis talked about:
  - How pouring on debt made a company tighten its operations.
  - Hoe executives can reap millions from little extra effort.
  - "If you're interested, maybe we could get together," Kravis said. **"If you'd like, we could send out people to look at your numbers."**
- **Post LBO companies are run in a notoriously Spartan manner to conserve cash.**
- Golden parachutes are often considered part of antitakeover contingencies.
- **MBO Process**
  - After management proposed a buyout, a special committee of board members is formed to consider it.
  - At some point, the offer has to be made public.
  - And when made public, other companies even Wall Street raiders are free to top it.
  - **Kravis doesn't like giving management control of the board.**
- KKR: Kravis Kohlberg & Roberts.
  - Jerome Kohlberg, Kravis's long-time mentor was shunted.
  - Kravis grew up rich in postwar Tulsa.
  - Ray Kravis began a second career as a **petroleum engineer** after the war, **estimating oil reserves** for Wall Street firms such as Goldman Sachs.
  - Just a year older, George Roberts grew up in Houston.
  - Kravis enrolled at Columbia business school and completed his 2 years there with Bs and Cs.
  - He went to work for Madison as a **corporate finder.**
    - He spent a year travelling the backroads of Louisiana **buying mom-and-pop companies.**
  - George Roberts and Henry Kravis went to work for Bear Sterns under Jerome Kohlberg, which was the head of the corporate finance division.
  - Kohlberg's LBO strategy:
    - **He bought cast-off divisions.**
    - He **liked basic industry**, companies that made things like bricks and wires and valves, whose management, products, and earnings were solid and reliable
    - Because he borrowed heavily to buy companies, **getting a fix on future earnings and cash flows was crucial** if Kohlberg was to avoid having his loans called.
    - **Balance sheets were his tarot cards, cash flow projections his crystal ball.**
    - Once Kohlberg got his hands on a company, he ruthlessly cut costs and sold unwanted businesses, **freeing up every extra dollar to pay debts**.

        - In most cases **he gave management stock incentives,** which he found did wonders for their ability to run the business more efficiently.
    - The three left Bearn Sterns. Kravis was a partner and the three had their own money invested in the portfolio companies.
    - 1976: They set up shop in the Old Mutual of New York building on Fifth Avenue.
        - Kohlberg preferred a low profile, so for years there was no name on the door.
        - For overhead they raised $50,000 (R12m inflation adjusted) from each of eight investors
    - 1978: First fund raised $30m ($105m inflation adjusted).
    - 1983: Fourth fund. Reached $1 billion.
        - By 1983 Kohlberg Kravis claimed an average annual return of 62.7% to their investors.
    - 1984: Completed the first $1 billion LBO.
- **Money raised from an LBO breakdown:**
    - 60%: Secured debt comes in the form of loans from commercial banks.
    - 10%: From the buyer itself.
    - Remaining 30%: **The meat in the sandwich**
        - Came from a handful of major insurance companies.
        - Whose commitments took sometimes months to obtain.
        - Then in the mid-eighties, Drexel Burnham began using **high-risk "junk" bonds to replace the insurance company funds.**
    - In most large takeovers, loans are parcelled out, or syndicated, to banks, around the globe.
- **Raising a fund**
    - Use publicity of previous deals.
    - Waive the management fee.
    - Pension funds are the major source of KKRs money.
- **Henry Kravis and George Roberts New Strategy**
    - Kravis and Roberts started to **secretly accumulate stock in their targets.**
    - These **toehold investments** would give Kravis **negotiating advantage with chief executives** **(bargaining leverage),** and
    - Allow the firm to **profit from the inevitable run-up in the target company's stock.**
    - Toe-hold with an eye toward launching an **unsoliticed takeover bid.**
- Stock market crash in October of 1987.
- **Investment Banks make a tremendous amount of money in upfront fees alone** – for **advising and money lending** & and a **"success fee",** maybe $200 million in all for the RJR Nabisco deal. Later, there is **fees for refinancing, fees for advice**, and **fees for simply minding the shop.** Also **fees from divestures.**
- "Gun-to-the-head" strategy
    - Corporate executives secretly work with a Wall Street firm to assemble financing.
    - Once the financing is lined up and an offering price is agreed on, the chief executive presents the bid as a **take-it-or-leave-it proposition** to his board.
- **10-week schedule for management in approaching its own buyout**

WEEKS ONE THROUGH THREE: Preliminary work on values and price discussions.
WEEK FOUR: Meet with banks to discuss loans.

WEEK FIVE: Banks work to refine a loan structure.
WEEK SIX: Management decides whether to pursue LBO.
WEEK SEVEN: Directors are quietly informed and asked to secretly form an "independent" committee to analyze any LBO proposal.
WEEK EIGHT: Management prepares a merger agreement.
WEEK NINE: Management makes an initial proposal to the board. Negotiations begin with the independent committee. A press release is issued stating the board is "considering a buyout proposal."
WEEK TEN: An acquisition agreement is executed and announced publicly.

- **It is crucial in MBOs for management to sneak up on the board with a fully financed offer ready to be launched.**
- **MBO Bidding Process**
  - **The management group bids low on purpose** knowing the board would want to coax a few dollars more.
  - The ruse allowed directors to claim they had pushed for the best price.
  - Used as a defence against the inevitable shareholder lawsuit.
  - Peter Akins had constructed a set of **formal bidding guidelines.**
    - **They key is the deadline.**
  - It in the board's best interest to draw the contest out.
- **LBOs are not democracies**: each executive in a PE-owned company answers to the PE firm.
  - To Shearson's amazement, Ross Johnson had demanded control of the board and a veto over major strategic decisions both during and after the deal.
- Johnson's executives would **put up no money for their stake in the business**; **Shearson would loan them the funds to buy their stock**, which could be **repaid through the use of incentive bonuses.**
- Kravis **hired an additional investment bank purely as a defensive move.**
  - Better to hire the roly-poly deal maker and lock him in a closet than allow him to run loose and perhaps assemble a competing bidding group.
  - Also, **hire an investment bank on an exclusive basis.**
- **If worried that the management group will steal the deal in some darkened room, make an immediate tender offer.**
- The RJR Nabisco deal was the first time KKR had launched a bid without the aid of a friendly management team.
- Teddy Forstmann:
  - Was 35 years old and with no money.
  - One thing that Teddy had was a seat on a board of directors of a company he helped take public whilst at his Wall Street job.
  - He **convinced the company's president not only to sell his firm**, but to let Forstmann **handle the action.**
  - Conned his brother's secretary into taking his phone calls. Secretary would tell callers he was in a meeting and quickly messages to his apartment.
  - 1978: Forstmann Little & Co opened it doors: two salaries – Ted didn't take one for years – and a secretary.
- Ronald Perelman
  - Revlon was the first hostile takeover of a major public company by a junk-bond-backed buyer.
  - Because the use of junk bonds allowed corporate raiders to raise money cheaply and easily, it tended to drive up the prices of takeover targets.
- Bid: **Cash and "Paper"/Securities**
- PIK Stock is convertible into junk bonds.
- By the end of the 1980s**, each entrant into a takeover fight routinely hired a p.r. firm** to work alongside its investment banker and attorneys.
  - P.R. firm appoints a chief spokesperson.
- **In one way, an LBO is a lot like buying a used car.**
  - A target company's annual report and public filings can be compared to a classified ad.
  - Like an advertisement, they contain useful information, although a savvy buyer knows the numbers can convey anything a clever accountant needs them to.
  - The car buyer wants to know more than just what's in the ad. He wants to talk to the owner, check under the hood, go for a ride around the block. For LBO buyers, a thorough inspection is equally crucial.
  - **More so than any takeover artist, the LBO buyer must know his prey. His success depends on determining exactly how much debt the target company can take on, and figuring precisely what budgets can be cut and what businesses sold to pay down that debt quickly.**
  - To take the used car analogy a step further, the LBO buyer must estimate, in precise detail, how many miles the car has left, how many spare parts he will need, and how much maintenance will be required. His margin of error is so thin that a worn crank shaft or a blown gasket could prompt the bank to call his loan.'
- **Information is the key to success.**

- **Thorough due diligence requires management buy-in.**
- **Preemptive bid:** a high bid that is intended to prevent the opposing players from bidding.
- SOB = Suggested Opening Bid
- **Preselling assets**: Agreeing to sell businesses/assets to outsiders before the bidding is over.
- **For CEOs: The way to build significant wealth is through equity ownership, not salary and bonuses.**
- KKR won the bidding process.