

NASHVILLE NOTES

## Musk Can Look to Blackstone's Playbook on Hilton

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Love him or loathe him, I think Elon Musk is one of the most interesting and consequential persons of this century. As an investor and inventor, his involvement in [Tesla Inc.](#), [Boring Co. LLC](#), [Space Exploration Technologies Corp.](#), [Neuralink Corp.](#), [PayPal Holdings Inc.](#), [SolarCity Corp.](#) and other companies is amazing and, in my opinion, unrivaled by anyone since at least the mid-20th century.

He does run roughshod over the rules at times. When he offered to take Tesla private for \$420 per share in August 2018 (about \$25 per share adjusted for stock splits), I never had heard of the connection between 420 and marijuana; however, when a once-coffee shop behind my office put on its signage that it is "420 somewhere" I got it. The SEC did not see humor in the episode and forced Musk to step down as Chairman of Tesla, and fined him and the company \$40 million.

In April 2022, the Delaware Court of Chancery ruled in favor of Musk and Tesla that the 2016 acquisition of SolarCity, in which Musk was also a major shareholder, was "entirely fair," after plaintiffs (certain Tesla shareholders) alleged that the acquisition was orchestrated to bail-out an insolvent SolarCity. I was a bit surprised by the ruling because SolarCity appeared to be a debt-laden cash incinerator, but the court considered the procedures followed by the Tesla board, in addition to pricing, in handing an unequivocal victory to Musk.

Musk's latest controversy seems to involve everything about his recent acquisition of [Twitter Inc.](#), which even he came to regret given his efforts to void the agreement prior to closing. Most investors, including I, think Musk would agree that the \$44 billion cash purchase was excessive. The \$46 billion enterprise value equated to roughly 56x the recurring EBITDA of \$818 million in 2021 and roughly 32x the consensus EBITDA for the next 12 months when the deal was announced.

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The \$13 billion of acquisition debt load was over-the-top, too. It represented roughly 15x the EBITDA in 2021, or more than double the 6x threshold that loans are subjected to as part of the 2013 update to leverage lending guidelines.

The debt financing includes \$6.5 billion of leverage loans, which presumably entail little amortization and a floating rate that has been swapped fixed for at least a couple of years, \$3 billion of secured bonds and \$3 billion of unsecured bonds. Annual interest expense could be around \$1 billion, assuming an 8% all-in rate (my guess), or roughly equal to EBITDA.

Leverage presumably will increase if media reports are correct that some advertisers have fled Twitter, though Musk has fired a boatload of staff; so, perhaps it is a wash. [Morgan Stanley](#), [Bank of America Corp.](#), [Barclays PLC](#) and other lenders know what the leverage is, but S&P and Moody's withdrew their ratings in early December due to a lack of information from the company, and there are no investors because the banks were unwilling to sell the debt to investors at what would be very low market clearing prices.

So, has Musk finally bitten off more than he can chew?

Twitter's financials prior to going private do not indicate the company could service this level of debt unless the bulk of financing entailed some form of zero coupon or payment-in-kind structure that delays when interest is paid. Absent a viable plan to boost profitability, it appears Twitter eventually will need more equity, or its debt will have to be restructured.

Maybe Musk is preparing to inject capital, though he also may be hit with a margin call given the 69% reduction in Tesla's shares year-to-date through Dec. 27. In mid-December, Musk disclosed he sold an additional 22 million Tesla shares that raised about \$3.6 billion. It is not ironic that Musk recently warned investors not to margin in a falling market. Likewise, he has complained about how much the Federal Reserve has raised rates after everyone got used to zero rates.

That said, I would not bet against Musk. He is a master of pulling rabbits out of hats. Perhaps [Blackstone Inc.](#) has the playbook from the last financial crisis. Blackstone took Hilton Hotels private in 2007 in a \$26 billion deal that was mostly funded with debt. Hilton cratered in the ensuing recession, and its lenders were stranded like Twitter's, with the buyout debt having been unable to sell to CLO and other investors before liquidity evaporated.

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Blackstone was able to negotiate a restructuring with its lenders in 2010 that reduced Hilton's debt by about \$4 billion. The move rescued the investment and set the stage for one of the most successful private equity real estate transactions ever. Blackstone completely exited the investment in 2018.

Maybe Musk can engineer a similar transaction if Twitter's finances worsen in the recession that he has been forecasting. His lenders will be making an installment on any restructuring by writing down their debt this quarter.

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