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Costly Turn in Debt Financing

By VICKI M. YOUNG

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NEW YORK — The leveraged buyout market may be losing steam.

Previously announced LBOs that are finalizing debt financing are finding out that it will cost more to get the deals done. For example, Alliance Boots, the U.K. health and beauty retailer, is seeing pricing terms change on bank debt in connection with Kohlberg Kravis & Roberts' \$15 billion LBO for the retailer.

William Susman, president of investment bank Financo Inc., said, "Supply and demand always swing in a pendulum. Previously, there was substantial demand [of debt for LBOs] and reasonable supply. Today, the pendulum has swung to where there is now a greater demand than supply. The market is forcing a rebalancing to find an equilibrium level to allow transactions to occur."

Steven Sheldon, founder of SMS Capital Management LLC in Houston, said, "With Blackstone Group down [near or below] its initial public offering price, the market might be saying at this point that we are nearing the end of the liquidity cycle. Companies such as Blackstone going public typically signify the top of the equity market. The smart money is always at the top of the cycle."

According to Sheldon, it "usually starts on the consumer side, but does it evolve to the commercial side with the banks and their loan books? I think that's happening even though there's still lending going on."

Credit analysts said in the coming weeks and months, Cerberus Capital Management might have trouble lining up the \$20 billion in debt to buy Chrysler Automotive, while KKR might have difficulties in getting the \$24 billion of debt for its buyout of First Data.

The pullback in the financing market began in early July.

But just over the past week there has been cause for concern that a "negative tone" in the market might continue in a way to impact the \$200 billion-plus of LBO deals on the table. Should the situation grow worse, buyout activity could stall as banks pull back on commitments to fund deals.

One investment banker explained that the bigger-size deals are underwritten by investment banks that commit capital, but it's done with the intent that the debt would be sold to investors to cover the bridge loans.

A "push back" in the debt market occurs when the debt financing can't be easily raised, and the banks must then make good on the commitments they made. This freezes future buyout activity since the financial institutions wind up with too much risk on their books, and are hesitant to take on more.

So which transactions get done?

Finish Line Inc.'s \$1.5 billion deal for Genesco Inc., for example, is expected to go through because the company already received commitments from banks.

Another deal that may get financing is an LBO run at Foot Locker Inc. by KKR. Last year Foot Locker almost was sold to KKR, but the reported \$28 a share offer was deemed too low, as the company wanted at least \$30, said private equity sources at the time. Now buyout watchers are speculating that KKR and Apollo Management are likely suitors again for Foot Locker, and unconfirmed reports from across the pond say Michael Ashley of Sports Direct International plc, a U.K. company he took public in March, might jump in with a \$29 a share bid due to Ashley's interest in Foot Locker's European division. A buyout of Foot Locker, if it happens at \$4.5 billion, or \$29 a share, might get the green light since it would be a large transaction, but not a "megadeal," sources said.

However, KKR's interest in Macy's might be a deal that is hitting some snags because of its size, which is said to be at least \$24 billion.

Despite the potential slowdown in LBOs, at least one banker sees continuing strength in the M&A market. "We're not seeing a slowdown in acquisitions at all. In terms of people jumping into the market, we see an increase, and the number willing to look at deals, in that respect, getting frenzied," said Richard Kestenbaum, partner at investment banking firm Triangle Capital LLC.

He said people are always rushing to get deals done because parties don't want to wait in case something comes up that impacts completion of the transactions. As for the changing tides, the banker said one often doesn't realize it is happening until after it has occurred.

"Once the party ends, it happens very suddenly and you can't always tell while you're in the middle of a transaction until some short period afterward. It may be that a deal you're working on can't get done and then you find out that other deals are not getting done either, but for reasons that appear specific to those transactions," Kestenbaum said.



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