



LBO Best Practices

I'm going to break this out into two sections: timed template and timed blank sheet assessments. The very bottom will include detail about the nuances of take-home vs. timed assessments.

I am also going to walk through 4 broad categories:

1. Where to start and how to digest the information provided
2. Model set up
3. Sense-checking
4. Formatting

-Template-

Where to Start:

Open the prompt / CIM and immediately begin pulling assumptions into the model. You're looking for sources and uses of a purchase (top of the CIM), income statement drivers (often towards the bottom of the CIM), balance sheet drivers (also towards the bottom), and exit assumptions (typically around the risks and mitigants section or near the purchase sources and uses).

When working off of a template, it is easy to stay organized and lay out your assumptions quickly. However, still take your time setting up assumptions and double checking the inputs. Screwing up this section will ruin the output of your model and cause unnecessary headache tracing back the steps of where you went wrong.

Model Set Up:

This should be provided in the template. Try to stick closely to their sections and avoid adding too many unnecessary rows.

Sense-Checking:

- Most LBOs are built to achieve a 20-30% equity IRR. Anything outside of that range should signal a check of key drivers: entry + exit multiples, revenue growth rates, and EBITDA margins
- Your sources and uses should always be equal. No exceptions
 - Double check the prompt / CIM to ensure you have every relevant purchase consideration reflected



- Your balance sheet should always balance. No exceptions
 - Double check that line items such as cash, goodwill, and equity are being pulled in correctly
- FCF should rarely be negative. If you are showing draws on your revolver, there is usually something wrong with the set up of your model. Remember to add back amortization

Formatting:

- Not much to think about here, just stick with the formatting provided in the template. Try not to butcher things too badly
- Have some reservations about adding new line items unless it is absolutely necessary. Many of these models are just checked to see that the outputs on certain lines are within a ballpark range of their answer keys. Adding new lines can make it challenging for interviewers to find the right outputs

-From Scratch-

Where to Start:

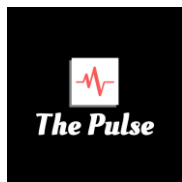
Open the prompt / CIM and immediately begin pulling assumptions into the model. You're looking for sources and uses of a purchase (top of the CIM), income statement drivers (often towards the bottom of the CIM), balance sheet drivers (also towards the bottom), and exit assumptions (typically around the risks and mitigants section or near the purchase sources and uses).

When working off of a blank sheet, I recommend you dump all purchase, income statement, balance sheet, and exit assumptions into one tab and construct your model off of another tab. This way you can silo data aggregation from model construction.

Model Set Up:

Generally follow the layout presented in our models. Below is a 10-step breakdown you should commit to muscle memory

1. Start with a purchase assumptions section laying out the acquisition
2. Move to the sources and uses section to show how the purchase will be allocated and the securities used for the purchase
3. Build out a section to account for any kind of write-ups or write-downs associated with the acquisition (do not fill this in yet)



4. Build the income statement by connecting provided LTM figures to relevant growth rates / margins. Remember to leave the interest expense line item as blank for now
5. Construct your FCF build pulling relevant line items from the income statement. Remember to check your boxes here to include any DTL Roll offs, amortization of issuance fees, amortization of write-ups, etc. Many of these items will be left blank for now because the 'Acquisition Premium' section has not been filled out yet. Regardless, you'll have the meat and bones of FCF composition, which is good enough to run with
6. Build a debt schedule. Carefully lay out each debt instrument associated with the purchase and connect debt assumptions to key line items (interest rate, borrowing / repayment, etc). Carefully lay out the priority of the cash waterfall as it flows through the repayment of the various debt securities. Build a switch at the top of the sheet to connect total interest expense back to the income statement
7. Build a balance sheet reconciliation section. This will make it very easy to assess a pre-close vs. a closing balance sheet. Now, you can go back up to the 'Acquisition Premium' section and begin filling in relevant line items such as Goodwill, DTLs, and total equity. It is key to remember that every component of the sources & uses + the 'Acquisition Premium' sections must be reflected here to get your closing balance sheet to balance
8. Construct your forecasted balance sheet using your post-close BS as the starting point. Connect relevant line items to the associated balance sheet assumptions. Remember small line items such as Capitalized Debt issuance fees!
9. Construct your returns section. Be considerate of who you're building returns for:
 - a. Equityholders: equity purchase of the business, residual equity from the sale of the business, intermittent cash flow generated by the business, and any associated management fees
 - b. Lenders: initial principal lent, principal paid, cash interest received, and any underwriting fees / yield step-ups (OID)
10. Construct a sensitivity analysis. Always anchor to IRR and MOIC unless instructed otherwise. Setting up data tables can be finnick. You need 6 columns and 6 rows. The top left cell should be connected to the desired output (IRR or MOIC). The assumed entry and exit multiples should be HARDCODED. The whole table will break if these are not hardcoded. Once set up, highlight the entire table and select Alt + A + W + T to run the table. Bang F9 a few times to make it calculate correctly



Some key formulas / parameters to establish:

1. Acquisition Premium Adjustment: $\text{Purchase Value of Equity} - \text{Book Equity} + \text{Current Goodwill} = \text{Revalued Equity}$. $\text{Revalued Equity} - \text{write-up of assets} + \text{DTL created} = \text{Revalued Goodwill}$
2. Revolver Borrowing / Repayment Formula: $\text{Minimum of (Remaining Draw Available, - MIN (Beginning Balance, Cash Available for Repayment))}$
3. Interest Expense per Debt Instrument: $\text{Average of (Beginning Balance, Ending Balance)}$. Interest is constantly compounding, never just calculated based off of a point in time
4. Balance Sheet:
 - a. $\text{Cash} = \text{minimum cash} + \text{cash available after all debt payments}$
 - b. Current Assets and Liabilities are typically calculated based on their cash conversion cycles, not just as a blanket % of revenue
 - c. $\text{PP\&E} = \text{Beginning balance} + \text{capex} - \text{D\&A}$
 - d. Goodwill & Intangibles: Add write-ups and write-up amortizations
 - e. Include capitalized debt issuance fees
 - f. Add a DTL line and include the DTL amortization
 - g. $\text{Total Equity} = \text{Beginning equity} + \text{net income} - \text{dividends}$
5. Learn the if statements needed to calculate returns. Remember to include recognition for intermittent cash flows

Sense-Checking:

- Same as above

Formatting:

- During a timed assessment, formatting does not need to be perfect. No need to convert everything to currency or stress about color-coding. However, the model cannot look like shit. It needs to be easy to follow with important line items clearly distinguished
- If it's a take-home, then it should be pretty

-Timed vs. Take-Home-

For take-home assessments, your model should be incredibly detailed. Every line and consideration should be laid out perfectly with 0 errors allowed. Formatting should also be perfect. Really think carefully about assumptions because the debrief is going to test you further on the quality of the investment vs. just checking boxes to see if you built the model correctly.



For timed assessments, your model needs to be detailed, but the focus should be on analyzing the core components correctly (entry price, growth, free cash flow, leverage, and the exit). Formatting just needs to be readable, no fancy numerical denominations or color-coding required. The interviewer is primarily going to test you based on how complete and correct the model is vs. incredibly detailed questions regarding the quality of the investment. However, you must still hold a view about whether it is a good or bad investment.