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The potential impact of the Twitter LBO on Twitter´s future performance

Private Equity Team – December 2022

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Introduction

In this report, Twitter's leveraged buyout is investigated, and detailed circumstances are outlined. Firstly, the deal is analysed in its entirety. Its rationale is described by analysing the economic, Private Equity Industry, and Media & Communications Industry climates, Twitter's Financial position before the deal was announced, and the public statements made by Elon Musk/Twitter representatives. Its timeline is described with the dates on which notable events regarding the buyout took place, and the financing responsibilities of both creditors and debtors are outlined with the amount of debt and equity provided and by whom. The report then proceeds to analyse the problems Elon Musk has been having with the SEC, the financing and regulatory risks incurred by Musk, the company's share price fluctuations since April 20202, and the current economic and Private Equity Industry climates to understand how they pose risks to the company's future performance. Thus, it also analyses the potential effects the LBO will have on different stakeholders such as creditors, shareholders, employees, and the most important customers (the advertising agencies).

The Deal

This section analyses the deal based on three distinct aspects. First, the rationale behind the deal is studied by describing the economic, Private Equity Industry, and Media/Communications Industry climates before the deal was announced. Correspondingly, Twitter's Financial position over the past few years and Elon Musk's/Twitter representatives' publicly shared opinions on the topic are outlined. Moreover, the timeline of the deal is displayed, by signalling the dates of notable events regarding the buyout. Lastly, the financing responsibilities of both shareholders and creditors are mentioned, by outlining the amount of debt and equity provided by each respective stakeholder.

The rationale of the deal

The rationale of the deal based on the economic and the Private Equity Industry climates before the announcement of the deal

The following paragraphs depict the rationale of the deal based on the economic and Private Equity Industry climates before the announcement of the deal, to evaluate if they contributed to the LBO's attractiveness at the time.

As a response to the Covid-19 pandemic, in the U.S., The Federal Reserve had cut interest rates from 1.5%-1.75% to almost 0% by March 2020. To further support the economy, they also introduced various measures, such as buying debt from the government, corporations, and other securities. The global economy suffered a major hit in 2020 due to the coronavirus pandemic, which resulted in a spike in the unemployment rate, after which, to avoid a recession, the Federal Reserve produced stimulus checks to increase the purchasing power of households. This created excess money in the hands of the public, which resulted in the surge of the stock market, with major indexes rapidly recovering from the covid crash. Although the amount of circulating dollars was higher than ever, interest rates have remained as low as 0%, which was the result of the cuts in March 2020, up until the first quarter of 2022. In an economic climate like this, excess household savings surged, since borrowing money was cheap.

As a result of the Federal Reserve's measures, the Private Equity market was favoured because of an abundant supply of capital, low interest rates, and favourable terms, causing cheap borrowing costs combined with the deployment of vast amounts of cash. The historically low interest rates, which were between 0.5% and 0.75% at the time the deal was first announced in early 2022, meant that the banks were keen on lending money to investors, resulting in the private equity boom. The trillions of dollars in stimulus checks provided by the federal reserve to combat the negative effect of the Covid-19 pandemic also played a huge role in the unforeseen spike of dealmaking and exits. Since liquidity has surged, the debt that is required to fund these leveraged buyouts has remained incredibly cheap, resulting in a record-breaking $1.1 trillion of buyouts happening in 2021. Compared to the previous year's $577 billion, it has almost doubled, beating the historical record of 2006, when the amount was $806 billion. The industry has also set a new record for the average deal size, which was over $1 billion for the first time in history, in the year 2021.

Thus, due to the enormous amount of capital available, the Private Equity Industry was at its peak. By the time Elon Musk announced his intentions to acquire Twitter, it seemed like a reasonable course of action, which perfectly fit the industry trend in that period. Nonetheless, borrowers such as Musk had to be cautious, as the economic climate indicated it was only a question of time before the Federal Reserve started hiking interest rates, and inflation was imminent.

The rationale of the deal based on the Media and Communications Industry climate before the announcement of the deal

The following paragraphs evaluate the Media and Communications Industry climate and analyse whether it added to the LBO's attractiveness at the time of the deal's announcement.

The Media and Communications sector has historically been an industry fueled by growth and innovation, not least due to increasing global trends in the last decades, such as social media, online purchasing, movie or music streaming and digital workspaces. The climate of the media and communications industry in 2020-2021 overall was healthy. After the global outbreak of Covid-19, the ensuing market crashes and supply chain shortages, the media industry, unlike most other sectors in the economy, remained largely impervious to the following economic recession. Most digital media and communication companies even benefitted from the subsequent social restrictions, lockdowns and remote work mandates imposed by governments and companies. This also led to increases in related digital markets; US e-commerce sales, for instance, skyrocketed by 44% during 2020, consequently also affecting social media advertising revenues. Overall, the social media industry remained attractive for shareholders and potential investors as the global social media market grew at a compound annual growth rate (CAGR) of 38.6%, that is from $159.68 billion in 2021 to $229.29 billion in 2022. Furthermore, industry outlooks projected a market increase to $777.64 billion by 2026.

However, this general rise of attractiveness for the digital and communications industry was not representative of Twitter before the deal's announcement. Although the stock price of Twitter was in relatively decent shape despite its moderately high volatility, the company itself had been incurring net losses in its operation for eight out of ten of the previous years. These operating losses were fueled by its weak revenue model, which centred heavily around ads, the increasing operating costs for the creation, and the expansion of new data centres (Momin, 2021). This has put Twitter at a competitive disadvantage compared to other digital media and communication companies such as TikTok, Snapchat and the technology conglomerates Meta and Alphabet.

Hence, a sale could have been attractive for Twitter, as a way to rescue its operating losses. Nonetheless, unless Elon Musk believed he could turn things around and start growing the platform by changing the operations along with the Media & Communications Industry as a whole, such operating losses made it unattractive for a buyout, as the company was not profitable and, thus, did not promise a return on investment (ROI).

The rationale of the deal based on Twitter’s Financial Context *(Q2 2022- before acquisition)*

The following paragraphs outline Twitter’s financial conditions before the acquisition took place, analysing how attractive the firm was for a potential buyout at the time and how it was performing.

The final update on the financial position of Twitter was released on the 22nd of July in the form of a Q2 earnings release. After this point, the Elon Musk buyout deal was finalised, and the company was taken private. Thus, it no longer has any obligations to share detailed financial information with the public.

This latest filing has shown that the average monetizable daily active usage (mDAU) was 237.8 million, representing a 16.6% annual growth. The increase was driven by ongoing product improvements and global conversation around current events. The revenue generated through the monetisation of this user base totalled $1.18 billion, which represents a decrease of 1% year-over-year. These results reflect the advertising industry headwinds associated with the macro environment and the uncertainty related to the pending acquisition of Twitter by an affiliate of Elon Musk. Moreover, the costs and expenses have increased by 31% year-over-year, totalling $1.52 billion. All these factors contributed to a net loss of $270 million, representing a net margin of -23% and diluted EPS of -$0.35. This compares to a net income of $66 million, a net margin of 6% and diluted EPS of $0.08 in the same period last year. Lastly, due to the pending acquisition of Twitter by an affiliate of Elon Musk, Twitter has not hosted an earnings conference call, issued a shareholder letter, or provided financial guidance in conjunction with its second-quarter 2022 earnings release.

The analysis of financial statements shows slight annual growth in the company; however, a significantly worsening financial position with decreasing assets (-3.42% YOY), increasing liabilities (13.25% YOY) and decreasing total stockholders’ equity (-3.42% YOY). Moreover, according to this latest financial statement from Twitter, just $101 million (-27% YOY) in revenue originated from “Subscription and other revenue”, whilst the rest came from advertising.

Figure 1 below shows Twitter´s last presented Balance Sheet.

TWITTER, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)
(Unaudited)

	June 30, 2022		December 31, 2021	
Assets				
Current assets:				
Cash and cash equivalents	$	2,680,596	$	2,186,549
Short-term investments		3,440,147		4,207,133
Accounts receivable, net		972,591		1,217,404
Prepaid expenses and other current assets		180,247		266,484
Assets held for sale		—		40,800
Total current assets		7,273,581		7,918,370
Property and equipment, net		2,175,290		2,082,160
Operating lease right-of-use assets		1,372,465		1,195,124
Intangible assets, net		52,643		69,324
Goodwill		1,303,438		1,301,520
Deferred tax assets, net		997,900		1,148,573
Other assets		403,970		344,445
Total assets	$	13,579,287	$	14,059,516
Liabilities and stockholders' equity				
Current liabilities:				
Accounts payable	$	153,092	$	203,171
Accrued and other current liabilities		676,189		918,350
Operating lease liabilities, short-term		187,982		222,346
Total current liabilities		1,017,263		1,343,867
Convertible notes, long-term		3,563,136		3,559,023
Senior notes, long-term		1,683,713		693,996
Operating lease liabilities, long-term		1,282,393		1,071,209
Deferred and other long-term tax liabilities, net		41,190		40,691
Other long-term liabilities		59,111		43,531
Total liabilities		7,646,806		6,752,317
Stockholders' equity:				
Common stock		4		4
Additional paid-in capital		7,019,800		8,432,112
Treasury stock		—		(5,295)
Accumulated other comprehensive loss		(200,456)		(117,320)
Accumulated deficit		(886,867)		(1,002,302)
Total stockholders' equity		5,932,481		7,307,199
Total liabilities and stockholders' equity	$	13,579,287	$	14,059,516

Figure 1, Twitter´s balance sheet as of June 30th, 2022 (*Twitter, Inc. - Financial Information - Quarterly Results*, n.d.)

Adding up to this poor financial performance in the past year, are the prior years' financial statements of the company. Twitter has only been profitable for two years since its inception in 2010 (in 2018 and 2019, making $1.21 and $1.47 million in net profits respectively), and has incurred losses of $1.4 and $0.22 million in 2020 and 2021 respectively (Karaian, 2022). Hence, a company acquired at a valuation of $44 billion, could barely make a million dollars in profits.

All things considered, the financial context of the company over the past year and even years before that has not been great. This suggests that the company was not attractive for a buyout at the time of the announcement of the deal to the eyes of an investor, looking only at the financial context. Thus, Musk's decision was undoubtedly driven largely by other qualitative factors.

The rationale of the deal based on Elon Musk's and Twitter's public announcements

The following paragraphs depict the rationale of the deal based on the public statements made by Elon Musk and Twitter's representatives concerning it.

Regarding the rationale of the deal from Elon Musk's perspective, it is argued that he acquired Twitter to develop the social media app into a place where people can discuss a wide range of topics in a healthy manner (The Washington Post, 2022). Hence, his main publicized reason is to *"help humanity"*, by making the app "warm and welcoming for all" (Clayton, 2022). Nonetheless, although less showcased, he has shown an interest in the company to start generating profits, as it has been in a deficit for a long time (Saul, 2022), and had a negative free cash flow of US$ 124 (The Guardian 2022).

From the side of Twitter, it has been said that the past CEO, Jack Dorsey, believed in Musk's goal of transforming the company for the *"greater good"*, and endorsed the sale publicly (Reilly, 2022). Another reason is that after the latter's exit from the company, Twitter's stock price fell significantly and did not seem to be recovering, as investors were hesitant to trust the new CEO, Parag Agrawal, and the performance of the company's operations (Hegde, 2022). Hence, it seems that Elon's offer of $44 billion could not have been refused, as it was a larger sum than Twitter's market cap of $39 billion at the time of the offer (Hegde, 2022).

Hence, as indicated by the public opinions of both Twitter's representatives and Elon Musk, it seemed that the buyout was attractive for both parties at the time of the announcement. Nonetheless, other statements have been made that suggested Elon Musk felt obligated to complete the deal, as he tried to back out of it and supposedly only completed it to avoid being sued by Twitter (Milmo, 2022).

The timeline of the deal

As rumours of the potential acquisition began circulating in early spring 2022, and the tumultuous negotiations lasted all throughout the year until the end of October when the deal was finalized, this section outlines the timeline of the deal with the use of Figures 2-4.

Figure 2 depicts the first timeline, which begins on March 26th, 2022, and ends on May 14th, 2022.

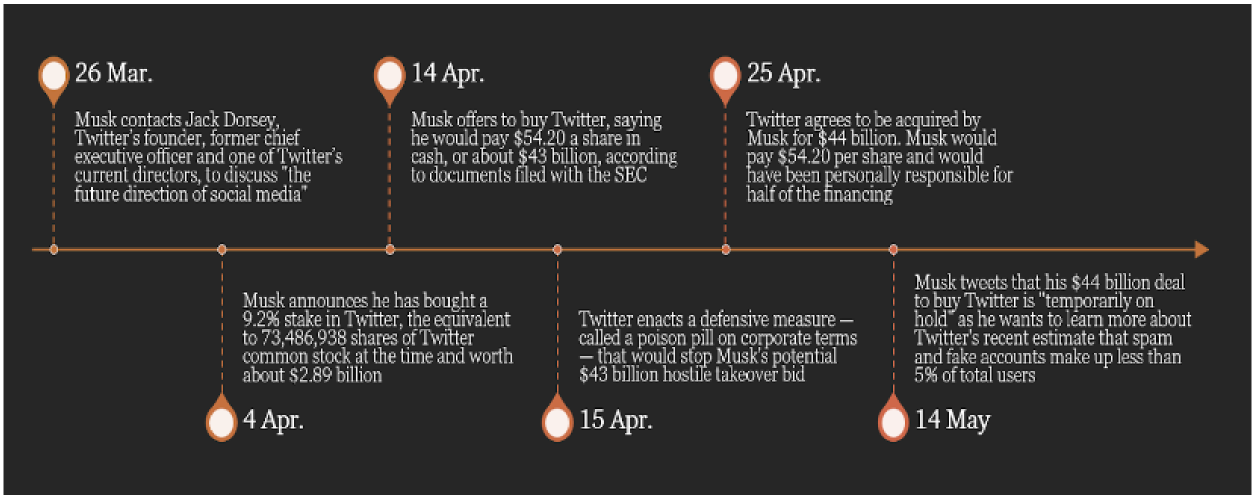


Figure 2, Timeline 1 of the deal

Figure 3 depicts the second timeline, which begins on June 6th, 2022, and ends on October 26th, 2022.

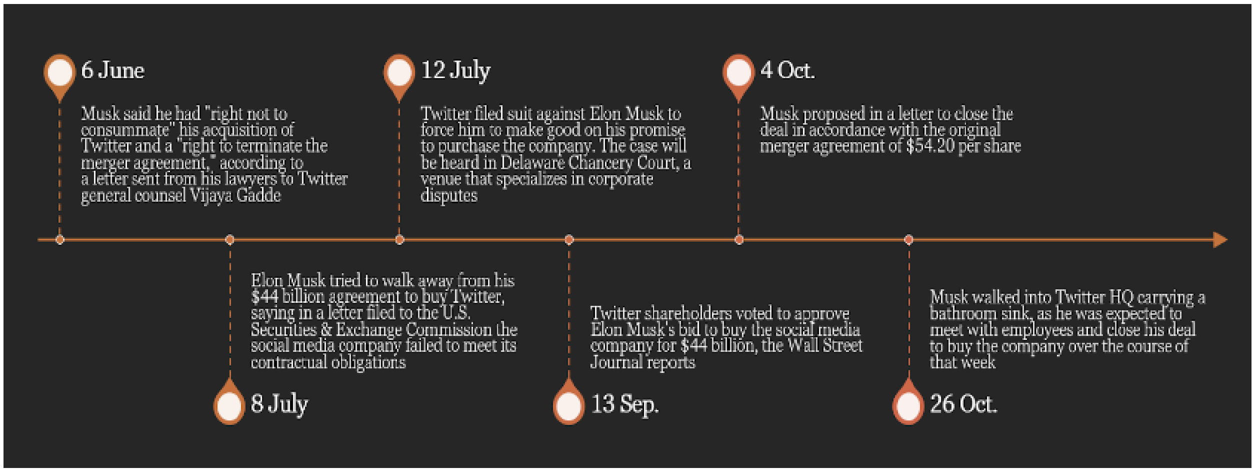
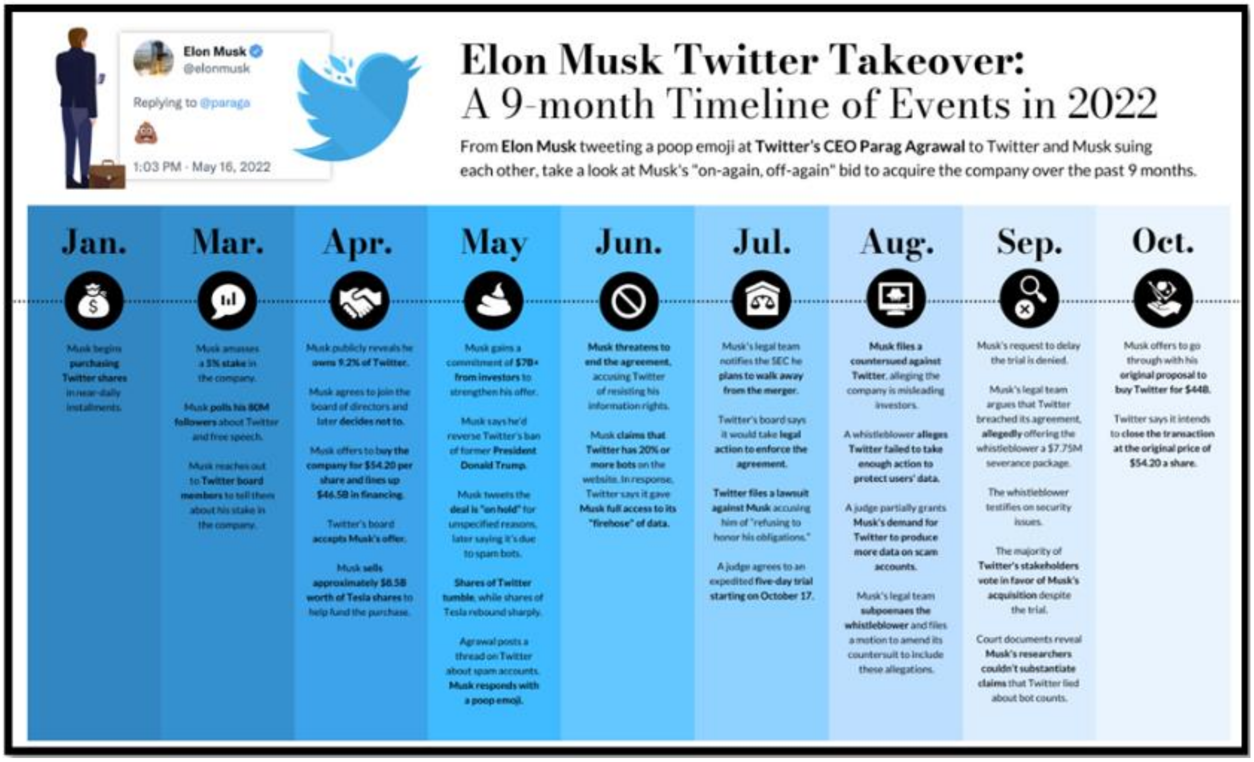


Figure 3, Timeline 2 of the deal

Figure 4 details the entire timeline, including events that took place from January 2022 to October 2022.



Figures 4, Timeline Detailed (Wile, 2022)

Owing to these Figures, one concludes that the deal took 9 months to be finalized and that difficult negotiations were required before it could happen.

The Equity and Debt Financing of the deal

This section depicts the financing responsibilities of both creditors and debtors that participated in the deal.

As for the debt financing behind the buyout, the banks leading the deal were Morgan Stanley, Bank of America, and Barclays. Nonetheless, Mizuho Financial Group, Societe Generale, Mitsubishi UFJ Financial Group, and BNP Paribas were also part of it. Together, they provided $12.5 billion in a debt package comprised of $6.5 billion in leveraged loans, $3 billion in secured loans, and $3 billion in unsecured loans (Reuters, 2022). The package is shown in Figure 5 below, provided by Reuters.

Joint loan arrangers	$13 billion debt financing package
Bank of America Barclays BNP Paribas Mizuho Morgan Stanley MUFG Societe Generale	$6.5 billion term loan facility $500 million revolving loan facility $3 billion secured bridge loans $3 billion unsecured bridge loans

Figure 5, Financing Commitments of Creditors (Jin et al., 2022)

Concerning the equity financing of the deal, $31.5 billion were provided. Reuters has provided the following cyphers (Figure 6), signalling the financing commitments of the shareholders:

Equity Investor	Description	Equity Commitment
A.M. Management & Consulting	-	$25 million
AH Capital Management	VC firm founded by Marc Andreessen and Ben Horowitz	$400 million
Aliya Capital Partners	SpaceX investor	$360 million
BAMCO	Investment adviser	$100 million
Binance	Cryptocurrency firm	$500 million
Brookfield	Canadian investment firm with over $690 billion assets under management	$250 million
DFJ Growth IV Partners	Tesla, SolarCity, SpaceX and The Boring Company investor	$100 million
Fidelity Management & Research Company	Acts as the investment advisor to Fidelity's family of mutual funds	$316 million
Honeycomb Asset Management	Private investment firm led by Chief Investment Officer David Fiszel	$5 million

Key Wealth Advisors		$30 million
Lawrence J. Ellison Revocable Trust	Oracle co-founder Larry Ellison's trust	$1 billion
Litani Ventures	Chicago-based VC firm	$25 million
Qatar Holding	Investment house founded by Qatar Investment Authority	$375 million
Sequoia Capital Fund	Invested in The Boring Company	$800 million
Strauss Capital LLC	-	$150 million
Tresser Blvd 402 LLC (Cartenna)	-	$8.5 million
VyCapital	Invested in The Boring Company	$700 million
Witkoff Capital	New York-based real estate tycoon Steven Witkoff's firm	$100 million
Saudi Arabian investor Prince Alwaleed bin Talal	Twitter investor	$1.89 billion (34,948,975 shares)

Figure 6, Financing Commitments of Shareholders (Jin et al., 2022)

From Figure 7, the largest equity investor helping Musk with the financing was Prince Alwaleed bin Talal from Saudi Arabia, followed by Lawrence Ellison and the venture capital firm Sequoia Capital.

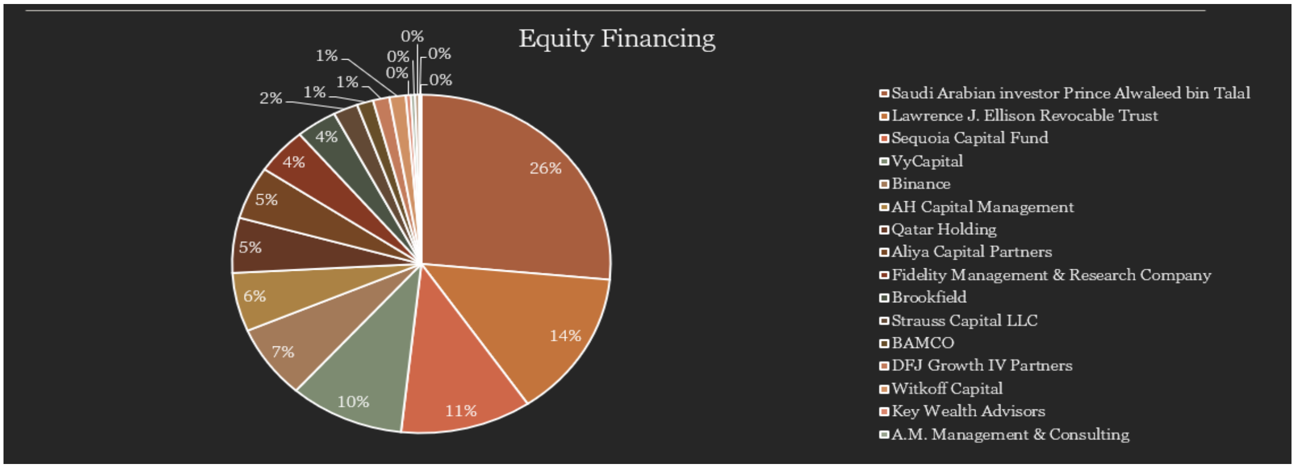


Figure 7, Pie chart of the Financing Commitments of Shareholders

From this section, it is concluded that 70.8% of the financing behind the deal came from equity, and the other 29.2% came from debt.

The five factors currently putting the company's future performance at risk

This section analyses the current factors putting Twitter's future performance at risk. It does so by analysing the problems Elon Musk has been having with the SEC, the share price fluctuations since the announcement of the deal, the financing and regulatory risks incurred by Musk, and the current economic, and Private Equity Industry climates.

Elon Musk's problems with the SEC

The following paragraphs depict the problems Elon Musk has been having with the Securities and Exchange Commission (SEC) since before the deal's announcement.

Elon Musk has had many issues with the SEC in the past, concerning various tweets, jokingly suggesting that he plans on privatizing Tesla (TSLA) at $420 per share. The SEC investigated this under the pretext of market manipulation since the stock price was affected by the tweets. Consequently, in the end, Musk, and Tesla each agreed to pay $20 million in civil fines over Musk's tweets about having the "funding secured".

In the first half of 2022, the SEC got another reason to come after Elon Musk. Musk announced that he's acquired a 9.2% stake in Twitter, increasing the social media company's share price by more than 28% in afternoon trading. The filing marked Musk's accumulation of common shares to March 14, and according to the financial disclosure, the stake was passive. However, the SEC dictates that anyone who acquires more than 5% of a company's common shares must disclose their holdings within ten calendar days, and Musk submitted his filing 21 days after March 14. Exceeding the limits by 2 weeks allowed him to accumulate a greater stake in the company at a substantially lower cost. This type of behaviour and disclosure violation would warrant an SEC investigation and punishment. The SEC´s disclosure punishments are historically modest, fluctuating around $100,000. Nevertheless, since Musk's net worth, according to Forbes, is about $300 billion, a $100,000 fine amounts to a mere 0.00003% of his wealth. An equivalent fine to a median American household would be about 3 cents.

At the time of writing this report, there is no definite information regarding disclosure fines for Musk. Even though this lack of disclosure may have potentially posed major hurdles for the deal, other factors were more significant, and Musk has already "successfully" completed his acquisition of Twitter. (Elon Musk Thumbs His Nose at the SEC Again With Twitter Stake, 2022) (Vittorio, 2022). Thus, it is difficult to measure how much these problems with the SEC will affect Twitter´s future performance.

The financing and regulatory risks incurred by Elon Musk & Twitter

The following paragraphs study the financing and regulatory risks associated with the deal being incurred by Elon Musk.

The risks of this deal for Musk were plentiful, even disregarding the obvious financial gamble of taking over a company that has struggled with profitability. Over the past decade, Twitter has earned a small profit in just 2 out of the 10 years. To finance his Twitter acquisition, Musk has sold $15.3 billion of his Tesla shares. $8.4 billion worth of shares were sold in April, and an additional $6.9 billion in August. Thus, the acquisition has had a significant impact on Musk's financials. Making the issue worse is the fact that the company was acquired at a $44 billion valuation, which is seen as excessive by most.

Additionally, Twitter's surge in executive turnover risks bringing a fine for the company and personal liability for Musk over potential data privacy and security lapses. The social platform is subject to ongoing scrutiny from the Federal Trade Commission (FTC) as part of an earlier enforcement deal reached over previous issues with user data protection. If Twitter is found to breach the deal, the FTC could seek substantial financial penalties and impose compliance restrictions on Musk himself, according to former regulators. The commission is allegedly tracking recent developments at Twitter with “deep concern,” after the company’s chief information security officer, chief privacy officer, and chief compliance officer all resigned. Twitter must designate an executive responsible for decisions related to users’ personal information or risk being in breach of the FTC deal. Musk announced extensive firings at the company immediately after he took over. Consequently, the sharply scaled-down staff may struggle to deal with security threats.

Further regulatory risks include fines that need to be paid to the FTC. Twitter agreed in May to pay $150 million to settle additional recent FTC allegations that phone numbers collected for security purposes were used for advertising, violating a previous regulatory order. The commission could seek to name Musk in a potential enforcement action, putting him on the hook to ensure compliance or pay penalties for noncompliance. These compliance measures could apply personally to the chief executive officer and follow the CEO even if he leaves the company.

Thus, the deal appears to carry with it an outsized risk for Musk in both the financial and regulatory sense. However, that seems to be the price he is willing to pay to be a free speech absolutist (Vittorio, 2022) (Elon Musk Thumbs His Nose at the SEC Again With Twitter Stake, 2022).

Share price fluctuations from the deal’s announcement to closure

The following paragraphs depict Twitter’s share price fluctuations from the deal's announcement until its finalization.

The Twitter stock price has fluctuated significantly since the company became public in 2013 (Figure 9). However, the past year has certainly been the most tumultuous (Figure 8), with the price moving between $30 and $55. The stock price increased significantly after Musk announced his intention to acquire the company for $54.20 per share. Nevertheless, after he repeatedly showed intentions to back out of the deal after Twitter implemented “poisoned pill” defences, the share price dropped as low as $32.50 in mid-July of 2022. The company later sued Musk, trying to force him to close the deal at the agreed-upon price. Consequently, at the end of October, Musk decided to proceed with the original deal, to mitigate the lawsuit, and the price spiked back up to the acquisition price (Bove, 2022).

Figure 8 shows the company's share price fluctuations from April to July 2022.

Figure 8, Stock Price Timeline (Bove, 2022)

Figure 9 depicts Twitter's share price history, from November 2013 to October 2022.

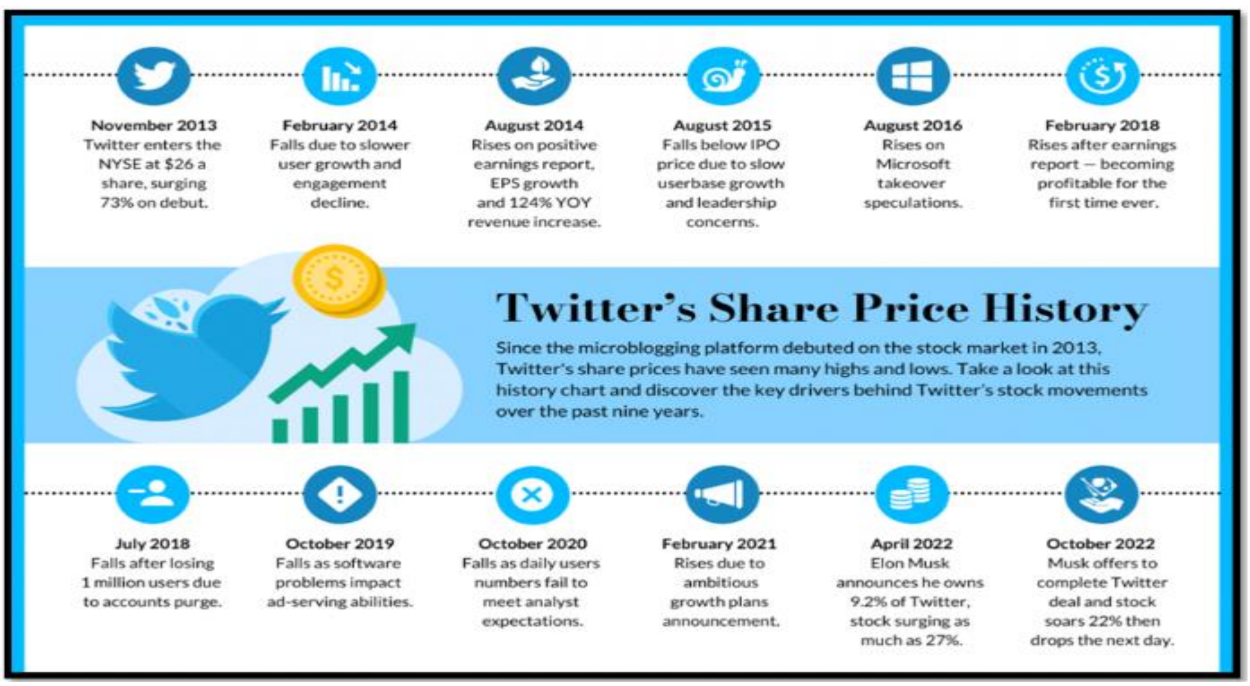


Figure 9, Twitter Share Price History (*Elon Musk Twitter Timeline*, n.d.)

From this section, it is concluded that Twitter's shares have had high volatility in the past year. If this continues in the future, Twitter´s market capitalization will continue to be affected.

The current global economic climate and its impact on the PE industry

The following paragraphs outline the current global economic climate based on two relevant forces, described by the International Monetary Fund, affecting it. They will then analyse its impact on current and future LBOs, such as the Twitter acquisition.

The first force is the war between Russia and Ukraine and the sanctions imposed on Russia by the E.U. and the U.S., which have significantly decreased Russia's supply of gas, food, and raw materials to Europe. Gas prices have quadrupled in Europe since 2021, as Russia decreased its gas supply by approximately 20% (International Monetary Fund, 2022, xiii). As a result, E.U. countries decided to ration their gas use, causing the British thermal units' benchmark price to top $9 million in the U.S. in July, twice as much as in the same period in 2021 (Lee & Anchondo, 2022). To strengthen alliances with the E.U., the U.S. increased its liquid natural gas exports and decreased its supply for its own country (Lee & Anchondo, 2022). This affected the U.S. energy sector the most due to gas being the principal source of electricity fuel; hence, utility bills have spiked (Lee & Anchondo, 2022). It also affected many manufacturing companies whose plants run on gas. Some of the latter have had to shut down part of their operations and are hesitant to invest in new projects or hire more workers as gas prices are unstable (Lee & Anchondo, 2022). Moreover, the increasing food prices, accounting for Russia's lower supply of staple foods, such as vegetable oils (of which Russia is the largest exporter globally) and wheat, have caused households to allocate a more significant part of their income towards food provision, thus increasing the cost of living (Emediegwu, 2022). Lastly, the price of raw materials is rising as well, as both Russia and Ukraine, which have dominant positions in the global market, decreased their exports. The costs of Crude Oil, Nickel, and Aluminium are the highest they have been in the past 10 years (Silicon Expert, 2022), which drives the cost of production and prices further up (Lavsi, 2022).

The second force is represented by the pandemic supply-side disruptions, especially in China. China, the leading global manufacturer with 28.7% of all manufacturing output, underwent a zero-Covid policy with harsh lockdowns that cut production in several factories and affected more than 288 million workers by preventing them from attending their jobs after the Chinese New Year (Kuttner, 2022). The country has yet to recover, as, from April to June 2022, it was not utilizing over 24% of its manufacturing capacity (the lowest utilization in five years, not including the lockdown period). Hence, its exports to other countries have significantly decreased, and inflation has been empowered (International Monetary Fund, 2022, 7-8). This could be disastrous, as countries such as the U.S. are heavily dependent on China's massive manufacturing capacities for the supply of all kinds of goods (Farrer, 2022). Similarly, as the first force, the lower supply applies price pressures and leads to an increased cost of living (International Monetary Fund, 2022, xvi).

As a result of these two forces, global inflation has worsened. The Global Food Price Index is at its highest level since 1990, averaging 159.3 points since March 2022 (12.6% higher than the month before) (Emediegwu, 2022), and Global Growth is expected to slow to 3.2% this year, the weakest growth in 21 years (International Monetary Fund, 2022, xvi). Inflation is expected to peak this year, reaching 8.8%, and to remain elevated for longer than expected until 2024, when it is expected to decrease to 4.1% (International Monetary Fund, 2022, xvi). The dollar cost increased against other currencies, which further increases the cost of living and leads to domestic price pressures (International Monetary Fund, 2022, xiii). This, in turn, could worsen the debt distress being borne by many countries (International Monetary Fund, 2022, xvi). Moreover, inflation brings the risks of both over-tightening and under-tightening monetary conditions to stabilize it. If central banks over-tighten them, countries risk entering a recession (International Monetary Fund, 2022, xiii), which would cause unemployment rates to rise, investment portfolios to suffer increased volatility, banks to hesitate to loan money, and stock prices to dip (Q.ai - Powering a Personal Wealth Movement, 2022). If central banks under-tighten them, the expected inflation could be de-anchored, prices would continue to increase, and central banks could lose credibility (International Monetary Fund, 2022, xiii).

The conditions outlined above regarding the current economic climate negatively affect the Private Equity Industry. Due to the rising interest rates, the discount factor is increasing (ICAEW, 2022), reaching 4.00% in the US on November 28th, 2022 (YCharts, 2022). Thus, the cost of lending has risen, and banks are reluctant to lend due to the risk of not being paid back in case of their debtor's poor performance (Raimonde, Gurumurthy & Amodeo, 2022). Moreover, this is lowering company valuations and causing investors to opt for lower-risk investments. Leveraged buyouts have three ways of generating returns (rising valuations, high leverage or improving operational performance) (The Economist, 2022), and the chance of increasing valuations or obtaining high leverage on their investments is currently exceptionally low (ICAEW, 2022).

Hence, deals done at an extremely high valuation, such as the Twitter deal, are endangered. Twitter is now at risk, as the higher costs and the slowing economic growth negatively impact company profits, lower the share price, and make it difficult to sell companies at an attractive price (The Economist, 2022). Thus, it is forced to improve its operational performance fast.

Potential implications of Twitter going private

This section analyses the potential effects the LBO will have on different stakeholders such as creditors, shareholders, employees, and the most important customers (the advertising agencies).

Cutting the workforce

This section studies the possible effects that cutting the workforce might have on the company and the employees, as Elon Musk has already begun laying off the latter based on the company´s poor operational performance and the need to cut costs (The Washington Post, 2022).

It is known that the CEO Parag Agrawal, CFO Ned Segal, and head of legal policy Vijaya Gadde have already been laid off (The Washington Post, 2022). Moreover, Elon Musk made far-reaching decisions effectively firing almost 50% of Twitter's workers across all divisions only days after taking over, as he states that, by working at a global company, employing thousands of people, individual contributions often become less scrutinized, work accountability decreases and productivity sinks (URBAIN, 2022). Thus, Musk has pledged to instate a demanding and 'hardcore' work mentality, and informed employees to prepare for long hours and intense work, addressing the problem of a lack of control over staff many other multinational tech companies are experiencing as well. This has caused former employees to discuss the potential risk of a culture of fear and scapegoating at Twitter. Moreover, in an attempt to further reduce costs, Musk has instructed staff to review and scrutinize all outstanding bills, even not paying external vendors at all. (Ewing, 2022).

However, critics say that while his tactics of wiping out staff, establishing a hardcore 24/7 culture and talking bankruptcy may have worked for smaller, rapidly growing companies and start-ups, they are not appropriate for a mature multi-national like Twitter.

The effect on banks

The following paragraphs describe the effect this deal might have on the banks that provided the debt package.

Due to the current economic climate, the banks have stated that they plan on keeping the $13 million debt for the time being, as a loss of $500 million is very probable on any sale value (Saul, 2022). The economic climate creates uncertainty around the company's future (Sen & Ramakrishnan, 2022); thus, selling the debt to investors is not an option, as Twitter's debt package deal is a very risky loan due to the amount of debt that the company is taking on. Rising interest rates have pushed investors away from junk-related debts as the possibility of banks defaulting is surging in these scenarios. For that reason, the banks have decided to keep the debt in their balance sheets and see if Twitter can turn things around from their current situation, so that they can syndicate their debt to investors.

Nonetheless, Elon Musk has come out to declare the possibility of bankruptcy if Twitter's situation does not improve (Gittins, 2022). Since Twitter earned a profit only in 2 of the past 10 years, a bankruptcy scenario with the current debt is very plausible unless the company starts generating returns by improving its operations. The loans provided by banks such as Barclays, Bank of America and Morgan Stanley are thought to be accumulating around $1 billion in interest per year. Hence, a bankruptcy possibility would cause substantial losses for the banks. Thankfully, when discussing the LBO, the banks ensured their loan by backing approximately $10 billion through specific assets so that they would receive something back instead of a complete loss (Klein, 2022). This allows them to have a safety net in case of possible bankruptcy.

Impact on Twitter's most important clients: the advertising agencies, and, in turn, Twitter

The following paragraphs describe the effect this deal is already having on the advertising agencies and how this might impact the company´s performance.

It is known that advertising agencies' contributions to Twitter made-up 90% of the platform's revenues up until the acquisition (Kern, 2022). However, the acquisition has acted as a driver for an increase in hate speech and misinformation on the platform (it has been reported that there has been a 500% increase in racial slurs), and Musk's tweets have also raised concerns (Kern, 2022). As a result, 50 out of its top 100 advertising agencies, which have spent almost $2 billion on Twitter ads since 2020, have decided to leave the platform due to brand safety, community standards, and controversy concerns (Hubbard, 2022). A notable advertising agency is Mediabrands, which, on November 7th, 2022, instructed its clients to stop advertising on the platform. Said company represents clients such as Coca-Cola, Levi Strauss & Co, and American Express, and oversees over $40 million in advertising spend globally (Kern, 2022). Moreover, seven other agencies, which contributed more than $255 million to Twitter since 2020, have also significantly decreased their advertising (Hubbard, 2022). This poses a significant risk for the company, as, if it loses 90% of its revenue, it will greatly expose itself to bankruptcy.

From this section, it is concluded that Twitter must act fast to fix this issue, reassuring advertising agencies of their brand safety and community standards policies to recover and maintain them.

Advantages and disadvantages of turning private

The shareholders of Twitter accepted Elon Musk's offer of acquiring Twitter for $44 billion, consequently meaning that the company is going private. The greatest advantage of private companies is that they are not required to provide a quarterly report on the company's financials, therefore avoiding publicity. Subsequently, these companies are subject to fewer legal obligations, which gives Musk, and the new leadership of Twitter more flexibility to reform the platform according to the billionaire's vision, as the control over the company will be more centralised in the hands of the owner. Meanwhile, major decisions regarding the future of the company will not have to be approved by the shareholders (The New York Times, 2022).

However, going private and avoiding publicity can increase internal pressure, since Musk did not single-handedly provide the financials for acquiring Twitter, but was helped by numerous aforementioned entities. These investors are likely to put private pressure on the owner, to meet the loan payments on capital that has been provided by them for the acquisition. Thus, turning into a private company will not only internalise the decision-making but the financials of the firm as well.

Conclusion

This report investigated Twitter's leveraged buyout by analysing the deal, the potential risks for the company's future performance, and the potential effects that the LBO might have on the different stakeholders.

Regarding the rationale of the deal, it is concluded that such an LBO was attractive for Elon Musk, due to the opportunities that the economy, the Private Equity Industry, and the Media & Communications Industry presented at the time, and due to his own interest in free speech and in driving the company's operational improvements. Moreover, it was also attractive for Twitter, as its unprofitability over the past years made the offer presented by Musk irrefutable. Nonetheless, this LBO would not have been attractive for investors only looking at the financial context of the company over the past years, and who did not have the willingness to work on the improvement of the company's operations.

Regarding the factors putting the company's future performance at risk, it is concluded that both Elon Musk and Twitter must focus on relaxing Musk's issues with the SEC, generating returns fast, and fixing regulatory concerns.

Lastly, regarding the potential effects of this LBO on the different stakeholders, it is concluded that the most affected ones will be the employees, the banks, and the company.

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