Vintage Private Equity Deals: Merlin Entertainment – Learnings from one of Blackstone's Most Successful Investments

Introduction

In 2005, Blackstone's [NYSE: BX] private equity fund made a, for its size, relatively modest investment of £102m to acquire Merlin Entertainment, a theme parks company, from the private equity fund Hermes Equity Partners. This was the first step in its strategy of rolling up the attractions and theme parks business in Europe, which it would do through later acquisitions of companies including Legoland and the operator of Madame Tussauds. Following the eventual IPO of the company in 2013, Blackstone sold its equity for £1.1bn, making a tenfold return on its initial investment. In this article, we will analyze this incredibly successful deal, in order to find learnings that can be applied to future investments.

Background

Merlin Entertainment's origins can be traced back to an eventful history that involved several Private Equity investors in its first decade of existence. In 1992, the formation of Vardon Attractions, backed financially by the Foreign & Colonial Enterprise Trust (now known as Graphite Capital), marked the coming together of two leisure franchises. One of the franchises was The London Dungeon, established in 1974 as an educational and entertaining attraction for families, that, at the time, was only present in London and York. The other franchise was Sea Life, an aquarium franchise founded in 1979, which had already managed to grow to nine different locations. With their experienced management team, the merged company aimed to acquire additional leisure assets and grow aggressively.

In 1998 the senior management team of Vardon Attractions, a division of Vardon plc comprising, at that moment, 23 Sea Life centers and the York and London Dungeons, executed a management buyout in a transaction valued at £47m, backed by the private equity firm Apax Partners, to form Merlin Entertainment. Their strategy was based on two pillars: expand the Sea Life and Dungeons franchises across the United Kingdom and Europe, while simultaneously downsizing some of the older, less profitable sites in declining seaside resort locations. The deal generated a 2.4x return on Foreign & Colonial's original investment, but – unfortunately for Apax Partners – it would not prove to be an equally profitable endeavor for its buyers. In fact, despite having managed to create an attractive business on the verge of becoming significantly cash generative, when in 2004 it was sold to Hermes Private Equity for £72m, Apax only obtained £55m for its portion of equity and registered a modest return. However, for its new owners, the investment was once again very attractive. In the 15 months of ownership by HPE, Merlin registered its most successful year to date: a growing number of visitors meant that revenues were up 26% to £44.9m, whilst EBITDA registered a 37% increase to £14.5m. Having affirmed itself as one of Europe's fastest growing operators of branded attractions, with a portfolio that included 28 locations under the brands of Sea Life, Dungeons, Seal Sanctuary, and Earth Explorer, Merlin was acquired in 2005 by Blackstone for £102.5m through its Capital Partners IV PE fund – marking a significant return for Hermes, which was reported to have doubled its original cash investment.

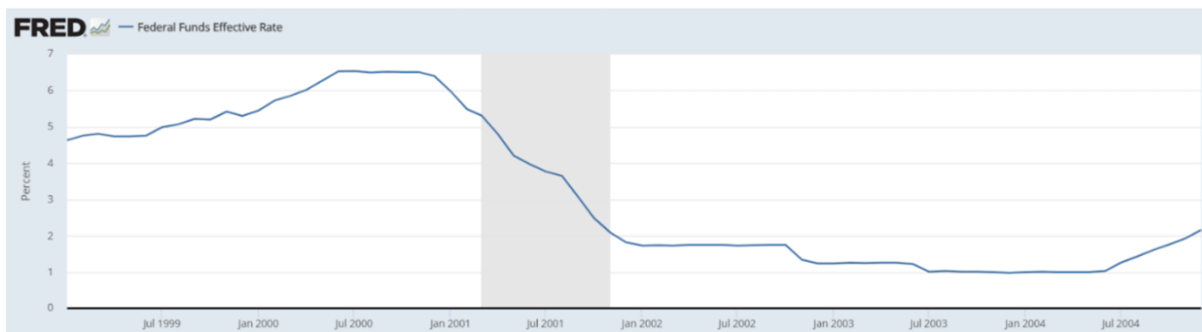
At that time, Blackstone was already one of the world's largest and most respected private equity firms, having around $51bn in assets under management and more than $1.5bn of annual revenues. Since its inception in 1987, Blackstone had raised approximately $32bn for alternative asset investments, with more than $14bn dedicated to

All the views expressed are opinions of Bocconi Students Investment Club members and can in no way be associated with Bocconi University. All the financial recommendations offered are for educational purposes only. Bocconi Students Investment Club declines any responsibility for eventual losses you may incur implementing all or part of the ideas contained in this website. The Bocconi Students Investment Club is not authorised to give investment advice. Information, opinions, and estimates contained in this report reflect a judgment at its original date of publication by Bocconi Students Investment Club and are subject to change without notice. The price, value of and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. Bocconi Students Investment Club does not receive compensation and has no business relationship with any mentioned company.

Copyright © Oct-23 BSIC | Bocconi Students Investment Club

private equity. According to the documents of its 2007 IPO, Blackstone's PE funds had an average annual return of 30.8%. Their Capital Partners IV fund, which acquired Merlin Entertainment, completed its $6.45bn fundraising in 2002 and became, at the time, the largest private equity fund; given its strong reputation, it is hardly suprising that Blackstone's funds were among the few managing to complete large transactions even during the early 2000s recession.

The 2000s, in fact, marked a significant period of growth and turmoil in the private equity and venture capital landscape. As the new century began, the burst of the dot-com bubble and the subsequent Nasdaq crash had a profound impact on the venture capital industry, causing widespread write-offs and a substantial reduction in the industry's size by 2003. Simultaneously, leveraged buyout activity also declined, partly due to the telecommunications sector's sudden downturn. Deals during this time were smaller and relied less on high-yield debt, with private equity firms resorting to bank loans and mezzanine debt instead. The market then started recovering starting in 2003, with private equity experiencing a five-year boom, driven by decreasing interest rates, relaxed lending standards, and regulatory changes like the Sarbanes-Oxley Act, which made private equity ownership more attractive to large corporations.



Lower interest rates also facilitated financing for buyouts and, in fact, the period leading up to the financial crisis was characterized by highly leveraged buyouts realized by PE firms. However, this momentum was abruptly interrupted by the Great Financial Crisis that began in 2007, affecting the leveraged finance and high-yield debt markets. Credit losses led to a standstill in the leveraged finance markets, resulting in the withdrawal and renegotiation of deals that had been completed at the market's peak. As a consequence, lending standards tightened, marking the end of the era of "mega-buyouts." Additionally, the Eurocrisis – with several eurozone member states unable to repay and refinance their sovereign debt – further destabilized the dealmaking landscape in the early 2010s, making large buyouts and investments harder to finance.

Investment Rationale

With the announcement of the deal in 2005, Blackstone's Joseph Baratta – currently the Global Head of Private Equity at the firm –indicated that Blackstone would support Merlin's further roll-out of its brands across Europe. Blackstone believed that Merlin had a clear growth strategy, and identified the company as an excellent platform for future acquisitions that could position it as a leading player in the European attractions and theme park sector. A roll-up is quite a common strategy for PE funds, that consists in acquiring smaller companies within a fragmented industry and combining them under a single parent company. The objectives may vary, but generally the goal is achieving economies of scale, expanding market reach, increasing revenues, improving brand recognition, and accessing new markets. Despite their obvious strategic benefits, it's important to note that

All the views expressed are opinions of Bocconi Students Investment Club members and can in no way be associated with Bocconi University. All the financial recommendations offered are for educational purposes only. Bocconi Students Investment Club declines any responsibility for eventual losses you may incur implementing all or part of the ideas contained in this website. The Bocconi Students Investment Club is not authorised to give investment advice. Information, opinions, and estimates contained in this report reflect a judgment at its original date of publication by Bocconi Students Investment Club and are subject to change without notice. The price, value of and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. Bocconi Students Investment Club does not receive compensation and has no business relationship with any mentioned company.

Copyright © Oct-23 BSIC | Bocconi Students Investment Club

executing roll-up mergers entails a high degree of complexity, due to the necessity to integrate different corporate cultures, infrastructures, and customer bases.

In the case of Merlin, the roll-up of theme parks materialized with the acquisition of Legoland and Gardaland, in 2005 and 2006 respectively. In particular, Gardaland's deal announcement provides valuable insights into the rationale behind Blackstone's roll-up strategy with Merlin Entertainments. Firstly, it offered geographic diversification, balancing Merlin's predominantly northern European portfolio with a substantial presence in southern Europe. Secondly, the Park offered significant areas that could be used to introduce Merlin's other brands – Sea Life and Legoland – within the complex, thus allowing for cross-selling and joint promotion opportunities. Lastly, Gardaland's popular brand in Italy fitted the strategy of focusing on a high-quality offer, with Blackstone initially even envisioning the possibility of expanding the Italian brand to other locations.

An additional perspective that emerges from an analysis of the investment rationale behind the Merlin deal is Blackstone's thematic approach to investments, as articulated by Joseph Baratta in his first comment: "We also believe that the European attractions and theme-park sector will enter into a period of consolidation in the medium term […]". The approach consists in focusing on high-conviction themes within the faster-growing segments of the economy that show strong underlying positive trends. First big-picture convictions are identified, such as the anticipated consolidation in the attractions and theme-park sector in this case, and then funds are strategically invested in companies or assets that would benefit from these trends. According to John Gray – currently Blackstone's president – this method proved successful even in the recent market turmoil of 2022, driven by rising interest rates and inflation. More precisely, Blackstone managed to deliver positive results for investors by focusing on those sectors of the economy where they expected growth to be greater than inflation.

A Timeline of the Deal

On the 23rd of May 2005, The Blackstone Group announced the acquisition of Merlin Entertainments & Management from Hermes Private Equity for £102.5m. This followed one of Merlin's most successful years as a brand from a financial point of view. Visitor numbers had increased by over a million compared to 2003 reaching 6.3 million. The company's revenue figures had increased 26% to £44.9m and EBITDA had gone up to £14.5m - a 37% increase on 2003 (£10.6m).

Following their acquisition of Merlin, Blackstone sought to expand its portfolio by acquiring Legoland which included the Billund resort in Denmark, the California resort in the United States and a German park. This acquisition was originated by Nick Varney (CEO at the time) who wanted to purchase the theme park but Hermes Private Equity was not willing to put more capital into its investment. After Blackstone's acquisition in 2005, Legoland was bought for £250m pounds, with the investment arm of Lego's owners (KIRKBI) receiving a share in Merlin Entertainments. Another accompanying business that the firm acquired was the Gardaland theme park in Northern Italy. At the time Gardaland was home to circa 3 million yearly visitors and, thanks to the combination of the theme park and the 247-room resort hotel, Merlin Entertainments owned several of the top performing brands in the sector, including the likes of Sea Life and Legoland. Several strategic factors drove the acquisition including geographic diversification into Southern Europe and Italy and potential synergies between the other portfolio companies thanks to the large amount of land zoned for leisure development and the 32 million estimated tourists that were within a two hour radius of the park. Growing the Merlin Entertainments brand was one of Blackstone's top priorities at the time, and Gardaland marked one of its marquee transactions that successfully

All the views expressed are opinions of Bocconi Students Investment Club members and can in no way be associated with Bocconi University. All the financial recommendations offered are for educational purposes only. Bocconi Students Investment Club declines any responsibility for eventual losses you may incur implementing all or part of the ideas contained in this website. The Bocconi Students Investment Club is not authorised to give investment advice. Information, opinions, and estimates contained in this report reflect a judgment at its original date of publication by Bocconi Students Investment Club and are subject to change without notice. The price, value of and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. Bocconi Students Investment Club does not receive compensation and has no business relationship with any mentioned company.

Copyright © Oct-23 BSIC | Bocconi Students Investment Club

positioned the British company to continue building distinctive visitor attractions. Although the sum was never disclosed following the November 2006 transaction, Merlin Entertainments owns the park to this day.

Following the transaction in late 2006, Blackstone's was looking for ways to generate liquidity for its investors. The options were to conduct a dividend recapitalization of Merlin Entertainment or to acquire The Tussauds Group. Blackstone's was hoping to make a minimum of 3x on its initial Merlin investment through the dividend recapitalization and at least 5x through the Tussauds acquisition.

Continuing their quest to expand the company, Blackstone acquired The Tussauds Group for $1.9bn in May 2007. Thanks to their holding of the Madame Tussauds Wax Museums, the combination of Merlin's assets with Tussaud's led to the second biggest theme park empire in the world, trailing only Disney. The owners of The Tussauds Group (Dubai International Capital (DIC)) received £1.03bn in cash and retained a 20% stake in the combined company. Through this acquisition, Nick Varney was in control of a varied portfolio of visitor attraction brands which ranged from theme parks to wax museums and even the London Eye.

In July of 2007, Merlin Entertainments and Prestbury (a property investment vehicle) announced that they entered into a sale and leaseback agreement in relation to certain assets owned by Merlin including Madame Tussaud London, Thorpe Park, Alton Towers and Warwick Castle, for £622m.

The properties sold to Prestbury were to be leased back to Merlin on 35-year renewable leases and Merlin was to continue operating and investing in these businesses. Merlin's rationale was to use the proceeds from this transaction to fund it 3-year development programme which had a €400m budget. Additionally, part of the proceeds went to repay the debt incurred to fund the purchase of The Tussauds Group.

Following several action-packed years after the Merlin acquisition, Blackstone set its sights across the pond with an international expansion in Florida by acquiring a rundown theme park called Cypress Gardens for an undisclosed sum in January of 2010. Aiming to expand in the United States, Merlin turned this defunct park into the Legoland Florida Resort. In Australia and New Zealand, Merlin sought to expand their presence through several strategic acquisitions valued at A$116m. Several bolt ons from the transaction included the Village Roadshow Theme Parks & Attractions and the Sydney aquarium. Lastly, Blackstone continued its eastern acquisition spree with a $140m acquisition of Living and Leisure Australia which had several attractions in the APAC region in their portfolio.

Around that time, Merlin Entertainments was looking to go public, however, the process was never completed. Part of the reason why could be attributed to the financial crisis. Therefore, in order to generate some liquidity for investors, in June of 2010, CVC Capital Partners acquired a 20% stake in Merlin from Blackstone at a £2.25bn valuation and bought out the DIC's remaining shares to acquire an extra 8%. At the time, the company had 3 main shareholders: KIRKBI – 36%, Blackstone – 34% and CVC – 28%. This marked an important step for Blackstone as their initial investment more than tripled as Merlin and Legoland were valued 6x higher than when they were originally bought.

Eventually, the time came for Merlin to list its shares through an IPO. On the 8th of November 2013, Blackstone floated 30% of the company on the London Stock Exchange at a valuation of £3.4bn (or $5.6bn). At the time, Blackstone's equity stake was worth more than $1bn. The years following the IPO saw great success, as the stock rose more than 50% to a peak in 2017, after which, due to several factors including a rollercoaster accident at Alton Towers and the London terror attacks, the stock fell below its IPO price. However, Blackstone most likely sold their shares in the post-IPO years, as Merlin rode to its highest valuation.

All the views expressed are opinions of Bocconi Students Investment Club members and can in no way be associated with Bocconi University. All the financial recommendations offered are for educational purposes only. Bocconi Students Investment Club declines any responsibility for eventual losses you may incur implementing all or part of the ideas contained in this website. The Bocconi Students Investment Club is not authorised to give investment advice. Information, opinions, and estimates contained in this report reflect a judgment at its original date of publication by Bocconi Students Investment Club and are subject to change without notice. The price, value of and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. Bocconi Students Investment Club does not receive compensation and has no business relationship with any mentioned company.

Copyright © Oct-23 BSIC | Bocconi Students Investment Club

Learnings from the Deal

As mentioned above, before Blackstone's acquisition of Merlin, the company had already been the subject of private equity ownership: following the Apax-backed management buyout, and then following the acquisition by Hermes. In private equity circles, it is quite common to believe that when a company has been owned by private equity before, it will be harder to make the required 20%+ IRR, as the so-called 'low-hanging fruits' in value creation have already been picked. Blackstone's original Merlin investment, however, qualifies this argument: even though Blackstone bought a business that had already been the subject of private equity ownership, it managed to make the Merlin deal work spectacularily well through rolling up the sector Merlin was operating in. Hence, the first learning is that companies can, in certain cases, turn out to be great deals for financial sponsors, even if they have already been owned by private equity for a long time.

The next learning from the deal pertains to the sale-leaseback of assets, in particular real estate, being an incredibly attractive way of making returns in an investment. As mentioned above, Blackstone sold £622m pounds worth of real estate, which included property assets such as Madame Tussauds London and Thorpe Park, to Nick Leslau's real estate investment vehicle Prestbury 1 in 2007. Doing this is very attractive for the financial sponsor, as markets are frequently not efficient when it comes to businesses owning their real estate. In general, investors value companies on an EBIT or EBITDA multiple basis. Therefore, the two drivers of a company's value are their earnings and then the multiple that investors apply to these earnings. Frequently, the underlying real estate holdings do not, provided the copmany's core business is not real estate, have a lot of emphasis attached to them by investors. Mechanically, when a company sells its real estate, it receives an upfront proceed from the sale, but sees its recurring cash flows decline, as it now has to pay a lease on the property it previously owned. As the earnings decline, the overall valuation of the business falls, as the multiple is applied to lower earnings. Often, this decline in valuation is smaller than the proceeds of the real estate sale, making this transasction incredibly attractive. Further, private equity investors measure their performance based on IRR, meaning that a sale-leaseback is attractive in addition to just increasing the return multiple, as it cristallizes returns at an earlier stage.

On the topic of increasing the IRR of an investment through taking out money from the business prior to selling it entirely, Blackstone attempted to do a dividend recapitalization of Merlin on the eve of the financial crisis. However, given that investment banks were battling to not go bankrupt, Blackstone was not able to get this deal done. Eager to nonetheless realize some of its return, Blackstone looked for other options, eventually selling a stake to the rival fund CVC. From this, we can learn that it is important to stay creative when doing deals. Even though the 'conventional' way of repatriating some of its equity failed, Blackstone came up with the idea of selling a stake to CVC, improving the IRR of its deal. One thing to note, however, is that it is important to only get investors onboard that align with the original investor's goals of running the business, as a battle over the direction of the business is a sure way to ruin an investment.

Conclusion

Blackstone's original acquisition of Merlin and the following roll-up of the European attractions and theme parks business proved incredibly successful for Blackstone, which, according to some sources, netted over £1bn of profits on its investment. This investment also provided a large boost to Joseph Baratta's career, who led the deal and is now Blackstone's Global Head of Private Equity. As students of finance, we can learn many things from this deal, including the fact that just because a company was previously owned by private equity, it doesn't mean that there are no more attractive returns to be made. Therefore, it is only fitting that Blackstone, having sold out of its investment in Merlin following the company's IPO in 2013, took Merlin private once more in 2019.

All the views expressed are opinions of Bocconi Students Investment Club members and can in no way be associated with Bocconi University. All the financial recommendations offered are for educational purposes only. Bocconi Students Investment Club declines any responsibility for eventual losses you may incur implementing all or part of the ideas contained in this website. The Bocconi Students Investment Club is not authorised to give investment advice. Information, opinions, and estimates contained in this report reflect a judgment at its original date of publication by Bocconi Students Investment Club and are subject to change without notice. The price, value of and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. Bocconi Students Investment Club does not receive compensation and has no business relationship with any mentioned company.

Copyright © Oct-23 BSIC | Bocconi Students Investment Club

TAGS: Private Equity, Blackstone, Merlin Entertainment, Financial Crisis

All the views expressed are opinions of Bocconi Students Investment Club members and can in no way be associated with Bocconi University. All the financial recommendations offered are for educational purposes only. Bocconi Students Investment Club declines any responsibility for eventual losses you may incur implementing all or part of the ideas contained in this website. The Bocconi Students Investment Club is not authorised to give investment advice. Information, opinions, and estimates contained in this report reflect a judgment at its original date of publication by Bocconi Students Investment Club and are subject to change without notice. The price, value of and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. Bocconi Students Investment Club does not receive compensation and has no business relationship with any mentioned company.

Copyright © Oct-23 BSIC | Bocconi Students Investment Club