CHAPTER 6

LEVERAGED BUY OUT

INTRODUCTION

A leveraged buyout (or LBO, or highly-leveraged transaction (HLT), or "bootstrap" transaction) occurs, when a financial sponsor acquires a controlling interest in a company's equity and where a significant percentage of the purchase price is financed through leverage (borrowed money).

It is a strategy involving the acquisition of another company using a significant amount of borrowed money (bonds or loans) to meet the cost of acquisition. It is nothing but takeover of a company using the acquired firm's assets and cash flow to obtain financing. In LBO, the assets of the company being acquired are used as collateral for the loans in addition to the assets of the acquired company. A LBO occurs when a financial sponsor gains control of a majority of a target company's equity through the use of borrowed money or debt. The purpose of leveraged buyouts is to allow companies to make large acquisitions without having to commit a lot of capital.

Leveraged buyouts are risky for the buyers if the purchase is highly leveraged. An LBO can be protected from volatile interest rates by an Interest Rate Swap, locking in a fixed interest rate, or an interest rate cap which prevents borrowing cost from rising above a certain level. LBOs also have been financed with high-yield debt or Junk Bonds and have also been done with the interest rate capped at a fixed level and interest costs above the cap added to the principal. For commercial banks, LBOs are attractive because these financings have large up-front fees. They also fill the gap in corporate lending created, when large corporations begin using commercial paper and corporate bonds in place of banks loans.

In an LBO, there is usually a ratio of 90% debt to 10% equity. Because of this high debt-equity ratio, the bonds usually are not investment grade

and are referred to as junk bonds. In 1980, several prominent buyouts led to the eventual bankruptcy of the acquired companies. This was mainly due to the fact that the leverage ratio was nearly 100% and the interest payments were so large that the company's operating cash flows were unable to meet the obligation. In the US, specialised LBO firms provide finance for acquisition against target company's assets or cash flows.

Stages of LBO operation:

The following are the procedure involved in LBO operations:

- Arrangement of Finance
- Taking Private – The organising sponsor buys all the outstanding shares of the company and takes it private or purchases all assets of the company.

Firms of all sizes and industries may be the targets of a leveraged buyout, but because of the importance of debt and the ability of the acquired firm to make regular loan payments after the completion of a leveraged buyout, some features of potential target firms make for more attractive leverage buyout candidates, including:

- Low existing debt loads
- A multi-year history of consistent and reliable cash flows
- Hard assets (property, equipment, real-estate, inventory) that may be used as collateral for new debt
- The potential for new management to make operational or other improvements to the firm to boost cash flows
- Temporary market conditions that are depressing current valuation or stock price

As a percentage of the purchase price for a leverage buyout target, the amount of debt used to finance a transaction varies according to interest rates, the financial condition and history of the acquisition target, market conditions and the willingness of lenders to extend credit to the LBO's financial sponsors and the company to be acquired. Typically, the debt portion of a LBO ranges from 50%-85% of the purchase price, but in some very rare cases debt may represent up to 95% of the purchase price. Between 2000-2005, debt averaged between 59.4% and 67.9% of the total purchase price for LBOs in the United States.

Leveraged buyouts allow financial sponsors to make large acquisitions without committing all the capital required for the acquisition. The use of debt also significantly increases the returns to a LBO's financial sponsor, as cash flows from the target company, rather than the financial sponsors, are used to pay down the debt used to purchase the company. This, in combination with the fact that financial sponsors pay only a portion of the original purchase price, means that a later sale of the company produces significant returns for the financial sponsor.

As transaction sizes grow, the equity component of the purchase price can be provided by multiple financial sponsors "co-investing" to come up with the needed equity for a purchase. Likewise, multiple lenders may band together in a "syndicate" to jointly provide the debt required to fund the transaction. Today, larger transactions are dominated by dedicated private equity firms and a limited number of large banks with "financial sponsors" groups.

In the recent years, the business and legal climates have changed dramatically. Public companies as a whole recorded a loss in their market capitalisation. The collapse in the market valuations has affected the finances of being public. In particular, while a public company should still generally be able to raise capital more easily than a private company, the advantage is diminished if the company cannot easily tap the capital markets at an acceptable price.

The recent developments have affected the costs and risks of staying public. The increased costs and risks include the following:

Cost of Reporting: A publicly-owned company must file quarterly reports with the SEC and/or various State officials. These reports can be costly, especially for small firms.

Disclosure: Management may not like the idea of reporting operating data, because such data will then be available to competitors.

Self-dealings: The owners/managers of closely-held companies have many opportunities for self-transactions, which they may not want to disclose to the public, although legal.

Inactive market, low price: If a firm is small, and its shares are not traded frequently, then its stock will not really be liquid and the market price may not be truly representative of the stock's true value.

Control: Owning less than 50 per cent of the control could lead to a loss of control for the owners/management. Against this background, two financial developments have led to the increase in the number of going-private transactions. First, large pools of capital are currently available for going private transactions. Second, relatively low interest rates may permit privatisations to be financed on attractive terms with borrowed funds.

This has led to increasing number of companies' going private' in recent times.

'Going-Private' Transactions

The transformation of a public company into a privately held firm is called a going-private transaction. In other words, it can be termed as the repurchasing of some or all of a company's outstanding stock by a private investor or sometimes by the employees. Over the past few years, transactions involving public companies turning private have grown dramatically world over. One of the significant elements in a going-private transaction is justice to minority or outside shareholders thus, avoiding allegations of

security fraud against the controlling shareholders. But the most important aspect of going-private is from where the money would come from.

Going-private requires a great deal of more financial planning than going public. Most going-private deals are structured as Leveraged Buyouts (LBOs) involving a company's management, an equity player and a lender. Let us look at leveraged buyout transactions in more detail.

Methods of Going-Private

A company can go private in a variety of ways, including a merger, a tender offer and a reverse stock split. A privatisation typically commences when a prospective buyer approaches a public company, which may form a special committee to consider the proposal. The special committee retains legal and financial advisors and negotiates with the prospective acquirer.

(1) In a going-private merger, the parties execute a merger agreement, and the company sends its stockholders a proxy statement soliciting votes on the merger. If all conditions to the merger are satisfied, the parties file certificates of merger with the relevant states and the public company merges with an entity formed by the buyer. As a result of the merger and by operation of law, the shares of the public company's stock (other than shares owned by the buyer) are converted into the right to assert appraisal rights or receive the merger consideration. The merger consideration is the cash or stock paid, to the stockholders. A merger typically leaves the surviving corporation with one stockholder, a subsidiary of the buyer.

(2) In a tender offer, the acquirer purchases shares directly from the public company's stockholders. The acquirer sends the stockholders a written offering document, the "offer to purchase," and a letter of transmittal, which stockholders use to tender shares. Tender offers are commonly conditioned on the buyer's holding at least 90 per cent of each class of the company's stock following the offer. Ownership of at least 90 per cent of the stock permits the buyer to complete a short-form merger, without a vote of stockholders or soliciting proxies. In the short-form merger, the shares that were not tendered are typically converted into the right to assert appraisal rights or receive the same consideration that was paid to the tendering stockholders. At the conclusion of the short-form merger, the company typically has one stockholder, a subsidiary of the buyer.

(3) Companies can, but rarely 'go-private' through a reverse stock split. In a reverse stock split, each outstanding share is converted into a fraction of a new share, and stockholders receive certificates representing whole shares and cash in lieu of fractional shares. For example, in a 1-for-10,000 split, each stockholder who owned less than 10,000 shares would receive cash only, each stockholder who owned 10,000 shares would receive 1 new share, and each stockholder who owned more than 10,000 shares would receive 1 new share for each 10,000 shares owned and cash for the remainder

of his shares. A reverse stock split is generally affected by amending the company's certificate of incorporation; this requires the company to distribute a proxy statement and permit stockholders to vote on the amendment. A 1-for-10,000 split effectively cashes out holders of less than 10,000 shares and reduces the number of stockholders.

Leveraged Buyout

The ideal mechanism to finance an acquisition or a going-private transaction might be to use the cash held by the target in excess of normal working capital requirements. However, having such huge amount of liquid cash is difficult. Use of stock may be an appropriate way to minimise the initial cash outlay, but such an option is hardly ever available in a buyout by privately held firms. Venture capital funding may become an expensive form of financing, since the firm might have to give up as much as 70 per cent of the ownership in the acquired firm. The use of a public issue of long-term debt to finance the transaction may minimise the initial cash outlay, but it is subject to restrictions placed on how the business may be operated by the' investors buying the issue. For such reasons, asset-based financing or a leveraged buyout has emerged as an attractive alternative to the use of cash, stock, or public debt issues, if the target had sufficient tangible assets to serve as security.

A leveraged buyout is a financing technique where debt is used to purchase the stock of a corporation and it frequently involves taking a public company private. It is used by a variety of entities, including the management of a corporation, or outside groups, such as other corporations, partnerships, individuals or investment groups. The leveraged buyouts are usually cash transactions in which the cash is borrowed by the acquiring firm. The target company's assets are often used as security for the loans acquired to finance the purchase. This type of lending is often called the asset-based lending. Thus, capital-intensive firms with asset having high collateral value can easily obtain such loans. Non-capital intensive firms (like the service industries) having high enough cash flows to service the interest payments on the debt can also obtain such loans.

History of LBOS

LBO transactions started when entrepreneurs in the 1950s and 1960s, who were considering retirement, were often willing to sell their businesses at or below the book value to the younger individuals who were willing to expand the entrepreneur's business. Such buyers only provided equity amounting to 20-25 per cent of the purchase price and borrowed the remainder from the commercial finance companies using the assets of the target firm as a security to the borrowing. Most of these leveraged transactions were of privately held, small to medium-sized businesses.

Later, in the 1960s, a bull market encouraged many businesses to go public rather than to get involved in highly leveraged transactions. Hence, LBO activity fell during the late 1960s. But, in the 1970s in the wake of

rising bankruptcies and high P/E ratios, the public excitement for new equity shares had subsided. New interest in LBOs emerged by the late 1980s. Conglomerates that were formed during the 1960s and early 1970s began to divest many of their holdings which ranged in annual sales from $5 million to more than $250 million. LBOs were commonly used to finance these transactions.

The value and the number of LBOs increased significantly starting in the early 1980s and peaking by the end of the decade. Larger companies started to become the target of LBOs in mid-1980s. By 1980s LBOs attracted much attention but were small compared to the mergers in terms of number and volume.

Origins of the Leveraged Buyouts

The first leveraged buyout may have been the purchase by McLean Industries, Inc. of Pan-Atlantic Steamship Company in January 1955 and Waterman Steamship Corporation in May 1955. Under the terms of that transaction, McLean borrowed $42 million and raised an additional $7 million through an issue of preferred stock. When the deal closed, $20 million of Waterman cash and assets were used to retire $20 million of the loan debt. Similar to the approach employed in the McLean transaction, the use of publicly traded holding companies as investment vehicles to acquire portfolios of investments in corporate assets was a relatively new trend in the 1960s popularised by the likes of Warren Buffett (Berkshire Hathaway) and Victor Posner (DWG Corporation) and later adopted by Nelson Peltz (Triarc), Saul Steinberg (Reliance Insurance) and Gerry Schwartz (Onex Corporation). These investment vehicles would utilise a number of the same tactics and target the same type of companies as more traditional leveraged buyouts and in many ways could be considered a forerunner of the later private equity firms. In fact it is Posner who is often credited with coining the term "leveraged buyout" or "LBO"

The leveraged buyout boom of the 1980s was conceived by a number of corporate financiers, most notably Jerome Kohlberg, Jr. and later his protégé, Henry Kravis. Working for Bear Stearns at the time, Kohlberg and Kravis along with Kravis' cousin, George Roberts began a series of what they described as "bootstrap" investments. Many of these companies lacked a viable or attractive exit for their founders as they were too small to be taken public and the founders were reluctant to sell out to competitors and so a sale to a financial buyer could prove attractive. Their acquisition of Orkin Exterminating Company in 1964 is among the first significant leveraged buyout transactions. In the following years, the three Bear Stearns bankers would complete a series of buyouts including Stern Metals (1965), Incom (a division of Rockwood International, 1971), Cobblers Industries (1971), and Boren Clay (1973) as well as Thompson Wire, Eagle Motors and Barrows through their investment in Stern Metals. By 1976, tensions had built up between Bear Stearns and Kohlberg, Kravis and Roberts leading to their departure and the formation of Kohlberg Kravis Roberts in that year.

Leveraged Buyouts in the 1980s

In January 1982, former US Secretary of the Treasury, William Simon and a group of investors acquired Gibson Greetings, a producer of greeting cards, for $80 million, of which only $1 million was rumoured to have been contributed by the investors. By mid-1983, just sixteen months after the original deal, Gibson completed a $290 million IPO and Simon made approximately $66 million. The success of the Gibson Greetings investment attracted the attention of the wider media to the nascent boom in leveraged buyouts. Between 1979 and 1989, it was estimated that there were over 2,000 leveraged buyouts valued in excess of $250 million

During the 1980s, constituencies within acquired companies and the media ascribed the "corporate raid" label to many private equity investments, particularly those that featured a hostile takeover of the company, perceived asset stripping, major layoffs or other significant corporate restructuring activities. Among the most notable investors to be labelled corporate raiders in the 1980s included Carl Icahn, Victor Posner, Nelson Peltz, Robert M. Bass, T. Boone Pickens, Harold Clark Simmons, Kirk Kerkorian, Sir James Goldsmith, Saul Steinberg and Asher Edelman. Carl Icahn developed a reputation as a ruthless corporate raider after his hostile takeover of TWA in 1985. Many of the corporate raiders were one-time clients of Michael Milken, whose investment banking firm, Drexel Burnham Lambert helped raise blind pools of capital with which corporate raiders could make a legitimate attempt to takeover a company and provided high-yield debt financing of the buyouts.

One of the final major buyouts of the 1980s proved to be its most ambitious and marked both a high water mark and a sign of the beginning of the end of the boom that had begun nearly a decade earlier. In 1989, KKR closed in on a $31.1 billion dollar takeover of RJR Nabisco. It was, at that time and for over 17 years, the largest leverage buyout in history. The event was chronicled in the book (and later the movie), Barbarians at the Gate: The Fall of RJR Nabisco. KKR would eventually prevail in acquiring RJR Nabisco at $109 per share, marking a dramatic increase from the original announcement that Shearson Lehman Hutton would take RJR Nabisco private at $75 per share. A fierce series of negotiations and horse-trading ensued, which pitted KKR against Shearson Lehman Hutton and later Forstmann Little and Co. Many of the major banking players of the day, including Morgan Stanley, Goldman Sachs, Salomon Brothers, and Merrill Lynch were actively involved in advising and financing the parties. After Shearson Lehman's original bid, KKR quickly introduced a tender offer to obtain RJR Nabisco for $90 per share—a price that enabled it to proceed without the approval of RJR Nabisco's management. RJR's management team, working with Shearson Lehman and Salomon Brothers, submitted a bid of $112, a figure they felt certain would enable them to outflank any response by Kravis's team. KKR's final bid of $109, while a lower dollar figure, was ultimately accepted by the board of directors of RJR Nabisco. At $31.1 billion of transaction value, RJR Nabisco was by far the largest leveraged buyouts in history. In 2006 and 2007, a number of leveraged

buyout transactions were completed that for the first time surpassed the RJR Nabisco leveraged buyout in terms of nominal purchase price. However, adjusted for inflation, none of the leveraged buyouts of the 2006 – 2007 period would surpass RJR Nabisco.

By the end of the 1980s, the excesses of the buyout market were beginning to show, with the bankruptcy of several large buyouts including Robert Campeau's 1988 buyout of Federated Department Stores, the 1986 buyout of the Revco drug stores, Walter Industries, FEB Trucking and Eaton Leonard. Additionally, the RJR Nabisco deal was showing signs of strain, leading to a recapitalisation in 1990, that involved the contribution of $1.7 billion of new equity from KKR.

Drexel Burnham Lambert was the investment bank most responsible for the boom in private equity during the 1980s due to its leadership in the issuance of high-yield debt.

Drexel reached an agreement with the government in which it pleaded nolo contendere (no contest) to six felonies – three counts of stock parking and three counts of stock manipulation. It also agreed to pay a fine of $650 million – at the time, the largest fine ever levied under securities laws. Milken left the firm after his own indictment in March 1989. On February 13, 1990 after being advised by Secretary of the Treasury Nicholas F. Brady, the SEC, the NYSE and the Federal Reserve, Drexel Burnham Lambert officially filed for Chapter 11 bankruptcy protection.

Age of the Mega-buyout 2005-2007

The combination of decreasing interest rates, loosening lending standards and regulatory changes for publicly traded companies (specifically the Sarbanes-Oxley Act) would set the stage for the largest boom private equity had seen. Marked by the buyout of Dex Media in 2002, large multi-billion dollar U.S. buyouts could once again obtain significant high yield debt financing and larger transactions could be completed. By 2004 and 2005, major buyouts were once again becoming common, including the acquisitions of Toys "R" Us, The Hertz Corporation, Metro-Goldwyn-Mayer and SunGard in 2005.

As 2005 ended and 2006 began, new "largest buyout" records were set and surpassed several times with nine of the top ten buyouts at the end of 2007 having been announced in an 18-month window from the beginning of 2006 through the middle of 2007. In 2006, private equity firms bought 654 U.S. companies for $375 billion, representing 18 times the level of transactions closed in 2003. Additionally, U.S.-based private equity firms raised $215.4 billion in investor commitments to 322 funds, surpassing the previous record set in 2000 by 22% and 33% higher than the 2005 fund raising total The following year, despite the onset of turmoil in the credit markets in the summer, saw yet another record year of fund raising with $302 billion of investor commitments to 415 funds. Among the mega-buyouts completed during the 2006 to 2007 boom were: Equity Office Properties, HCA, Alliance Boots and TXU.

In July 2007, turmoil that had been affecting the mortgage markets, spilled over into the leveraged finance and high-yield debt markets. The markets had been highly robust during the first six months of 2007, with highly issuer friendly developments including PIK and PIK Toggle (interest is "Payable In Kind"), and covenant light debt widely available to finance large leveraged buyouts. July and August saw a notable slowdown in issuance levels in the high yield and leveraged loan markets with only few issuers accessing the market. Uncertain market conditions led to a significant widening of yield spreads, which coupled with the typical summer slowdown led to many companies and investment banks to put their plans to issue debt on hold until the autumn. However, the expected rebound in the market after Labor Day 2007, did not materialise and the lack of market confidence prevented deals from pricing. By the end of September, the full extent of the credit situation became obvious as major lenders including Citigroup and UBS AG announced major writedowns due to credit losses. The leveraged finance markets came to a near standstill. As 2007 ended and 2008 began, it was clear that lending standards had tightened and the era of "mega-buyouts" had come to an end. Nevertheless, private equity continues to be a large and active asset class and the private equity firms, with hundreds of billions of dollars of committed capital from investors are looking to deploy capital in new and different transactions.

Rationale

The purposes of debt financing for leveraged buyouts are two-fold:

(1) The use of debt increases (leverages) the financial return to the private equity sponsor. Under the Modigliani-Miller theorem, the total return of an asset to its owners, all else being equal and within strict restrictive assumptions, is unaffected by the structure of its financing. As the debt in an LBO has a relatively fixed, albeit high, cost of capital, any returns in excess of this cost of capital flow through to the equity.

(2) The tax shield of the acquisition debt, according to the Modigliani-Miller theorem with taxes, increases the value of the firm. This enables the private equity sponsor to pay a higher price than would otherwise be possible. Because income flowing through to equity is taxed, while interest payments to debt are not, the capitalised value of cash flowing to debt is greater than the same cash stream flowing to equity.

Germany currently introduces new tax laws, taxing parts of the cash flow before debt interest deduction. The motivation for the change is to discourage leveraged buyouts by reducing the tax shield effectiveness.

Historically, many LBOs in the 1980s and 1990s focused on reducing wasteful expenditures by corporate managers whose interests were not aligned with shareholders. After a major corporate restructuring, which may involve selling off portions of the company and severe staff reductions, the entity would likely be producing a higher income stream. Because this

type of management arbitrage and easy restructuring has largely been accomplished, LBOs today focus more on growth and complicated financial engineering to achieve their returns. Most leveraged buyout firms look to achieve an internal rate of return in excess of 20%.

Management Buyouts

A special case of such acquisition is a management buyout (MBO), which occurs when a company's managers buy or acquire a large part of the company. The goal of an MBO may be to strengthen the managers' interest in the success of the company. In most cases, the management will then make the company private. MBOs have assumed an important role in corporate restructurings, beside mergers and acquisitions. Key considerations in an MBO are fairness to shareholders, price, the future business plan, and legal and tax issues. One recent criticism of MBOs is that they create a conflict of interest—an incentive is created for managers to mismanage (or not manage as efficiently) a company, thereby depressing its stock price, and profiting handsomely by implementing effective management after the successful MBO.

- Current price of the target company understate the original value of the firm so some values are created by taking the firm private
- The values so created is transferred to the shareholders and buyout groups from parties involved in such an operation
- Consumer non-durable goods and manufacture sector

MBO is the form of corporate divestment by way of 'going-private' through management's purchase of all outstanding shares. It is a special case of acquisition which occurs when the managers of a company buy or acquire a large part of the company. In this form of acquisition, company's existing managers acquire a large part of all of the company. It occurs when the manager's executives of a company purchase controlling interest in a company from the existing shareholders. In many cases, the company will already be a private company, but if it is public then the management will take it private.

In most cases, the management will buyout all the outstanding shareholders and then take the company private because it feels it has the expertise to grow the business better if it controls the ownership. Quite often, management will team up with a venture capitalist to acquire the business because it is a complicated process that requires significant capital.

Criticisms

The LBO form of restructuring is criticised under the following ground:

- Heavy Deployment of Debt
- Employees of Target company are threatened of loosing their jobs

- Long-term growth of restructured firm is disrupted due to new management
- Degree of bankruptcy is more

Purpose of MBO

What drives managers to become owners of the business they have run under the direction and control of a parent? A survery of MBO managers by " WRIGHT et.al." (1991), revealed a number of reasons of which the most important was the desire to run one's own business. In order of importance managerial motivation in MBOS is as follows:

- Opportunity to control lown business
- Long-term faith in company
- Better financial rewards
- Opportunity to develop own talents
- Absence of head office constraints
- To save their jobs, either if the business has been scheduled for closure or if an outside purchaser would bring in its own management team
- Feat of redunancy
- To maximise the financial benefits they receive from the success they bring to the company by taking the profits for themselves
- To ward-off aggressive buyers
- Fear of new owner ofter anticibated acquisition

The goal of an MBO may be to strengthen the manager's interest in the success of the company. In most cases, the management will then take the company private. MBOs have assumed an important role in corporate restructurings besides mergers and acquisitions. Key considerations in an MBO are fairness to shareholders, price, the future business plan, and legal and tax issues.

Benefits

MBO generate value to a corporate under the following way:

- It provides an excellent opportunity for management of undervalued companies to realise the intrinsic value of the company.
- Lower Agency Cost: Cost associated with conflict of interest between owner and managers
- Source of tax savings: Since interest payments are tax deducible, pushing up gearing rations to fund a management buyout can provide large tax covers

Ideal MBO Candidates

The companies having the following situation are the ideal candidates for MBO:

- Stable predicable earnings
- Undervalued by market
- Minimal sales fluctuations

Structure of an MBO:

Since managers do not have the financial resources to buyout their companies on their own, the financial structure of an MBO depends on the capital supplied by specialist capital providers and banks. Management provides a small part of the equity. Institutions which specialise in MBO financing, such as venture capital firms, provide additional equity. Further funding is provided by debt, which falls into two types: senior "debt" and "mezzanine debt".

In some MBOs, equity has also been raised from the employees by the formation of an employee share ownership plan, (ESOP). Contribution from the company towards the purchase of its shares by an ESOP is corporation tax free. Moreover, the plan can borrow money to buy shares, and the contribution from the company can then be used to pay interest and repay the borrowing. Thus, an ESOP is a tax-efficient method of raising funds to finance equity.

Senior debt has priority in payment of interest and repayment of principal. It is a secure debt and if it is a term loan, has a pre-arranged repayment schedule. The interest rate is normally a floating rate at a margin of 2-3 per cent over LIBOR (London Inter-Bank Offer Rate). Some part of the Senior debt may be short-term. Mezzanine debt, as the name suggests, is junior or subordinated to senior debt in terms of interest payment and capital repayment. It is not secured and is, therefore, more risky. Both debt components rank above equity.

The mezzanine layer is often in the form of preference shares or convertible loan stock or convertible preference shares. In the United Kingdom, some firms specialise in providing mezzanine or intermediate finance. The interest rate is generally 4-5 percent above LIBOR. Interest rate margins for both senior and mezzanine debt depend on the general level of interest rates, the demand for debt and the competition among banks.

Institutional equity providers earn their reward from the return realised at the time of exiting the MBO. Exit is the process of realisation of the investment made in an MBO. Equity investors may expect an internal rate of return (IRR) of 25-30%. Once again this return depends on the riskiness of the MBO, demand for funds and competition among institutional equity providers, and the lead time to exit. The following case provides an example of such a structure:

Financing the DRG Litho Supplies MBO, 1991

DRG Litho Supplies Ltd. was bought out by the management team from DRG Plc after it was taken over in a contested bid by Pembridge Investments in 1989. The total financing needed was:

Price payable to vendor	£20.70m
Working capital	1.65m
Fees	1.00m
	23.35m
This was provided by:	
Management equity	£0.50m
Institutions: share capital	7.35
Mezzanine:	4.00
Senior debt: Term loan	7.00
Overdraft and short term	4.50
	23.35m

SOURCE: Ernst and Young 1991 MBO guide

In larger deals, the number of institutional equity and debt providers increases substantially as a mechanism for spreading risk. To the senior lenders, the mezzanine and equity provide a cushion. In the above case, senior debt of £11.5 million is backed by £11.85 million of equity and mezzanine. However, the larger the mezzanine, greater the cash outflow, the smaller will be the retained earnings owing to interest payment and the smaller the resulting net worth. Senior lenders are therefore wary of too much mezzanine, although it ranks behind the Senior debt.

Mezzanine lenders often demand an 'equity kicker' or 'sweetener' to compensate them for the high risk they run. An equity kicker is an equity warrant, and it enables the mezzanine holder to partake of the upside potential of an MBO by exercising the warrants, and to receive shares in the company. When there is a financing gap after tapping all the above sources, sometime vendor the farm of inseured loan notes or preference shares or convertibles. Vendar financing also demonstrates goodwill towards the management. When the MBO maintains some trading links with the erstwhile parent such as a supplier vendor financing smoothens such links.

Failures

Some LBOs in the 1980s and 1990s resulted in corporate bankruptcy, such as Robert Campeau's 1988 buyout of Federated Department Stores and the 1986 buyout of the Revco drug stores. The failure of the Federated buyout was a result of excessive debt financing, comprising about 97% of the total consideration, which led to large interest payments that exceeded the company's operating cash flow. In response to the threat of LBOs,

certain companies adopted a number of techniques, such as the poison pill, to protect them against hostile takeovers by effectively self-destructing the company if it were to be taken over.

The inability to repay debt in an LBO can be caused by initial overpricing of the target firm and/or its assets. Because LBO funds often add value through the resale of assets or selling off business units, any initial overpricing may directly result in insolvency as the expected cash flow is not obtained to sufficiently repay the debt. Another reason is over optimistic forecasts of the operating cash flows (or revenues) of the target company. Capital structure in an LBO are often based on fairly tight margins, so that any deviations from expected cash flows may result in financial distress, costs and risky situations.

Elements of a Typical LBO Operation

A leveraged buyout transaction takes place as follows:

(1) The first stage in an LBO operation consists of raising the cash required for the buyout and devising the management incentive system. Usually around 10 per cent of the cash is put up by the firm's top managers and/or the buyout specialists. Managers also receive incentive compensation in the form of stock option or warrants. Hence, the percentage of equity share on the management will be around 30 per cent. Other outside investors provide the remaining equity.

Approximately 50 to 60 per cent of the required cash is raised by borrowing against the company's assets through secured bank loans. The bank loan usually is taken from different commercial banks. This portion of the debt is sometimes also taken from insurance companies, pension funds or from limited partnerships specialising in venture capital investments and leveraged buyouts. The remainder of the cash is obtained by issuing senior and junior subordinated debt in a private placement or in a public offering as high-yield notes or bonds like the junk bonds.

(2) The second stage of the transaction involves making the firm private. The company can be made private, either in a stock purchase format where all the shares of the company are bought or in an asset purchase format where all the assets of the company are purchased. In an asset purchase format, the buying group forms a new privately held corporation. Some of the parts of the business are sold-off by the new management to reduce the debt.

(3) In the third stage, the management tries to increase the profits and cash flows by cutting operating costs and changing marketing strategies. It may strengthen and restructure the production facilities, change product quality, product mix, customer service, pricing, improve inventory control and accounts receivable management. It may even lay-off employees and reduce the expenditure on research and development as long as these are necessary to meet the payment on the huge borrowings.

(4) In the fourth stage, the investor group may again take the company public if it has become stronger and the goals of the group are achieved. This process is called a reverse LBO and is achieved through a public equity offering which is referred to as a Secondary Initial Public Offering (SIPO). The purpose is to provide liquidity to the existing shareholders.

The Candidates for implementation of LBO strategy are the possible target firms threatened by takeover proposals from outside. The typical targets include any of the following:

- If the company does not have shareholding more than 51%
- If the company is over leveraging with the debt components nearing to Maturity
- If the company has diversified into unrelated areas and thus, facing problems
- If the company is earning low operating profits due to poor management and there is a possible of turnarounds.
- If the company is having an assest structure which is grossly under utilised
- If the company's present management is facing managerial incompetence.

Aspects of LBO Financing

The RBI has to come out with guidelines for financing LBOS. Financing Indian M&As needs a new orientation. It is high the Regulator realises that absence of bank lending for corporate takover is serioulsy hampering the growth of Indian M&A activity. The numerous financing cost raits that continue should become a matter of great concear for contral balance. The basic issue is that RBI continues to have archaic rules which do not allow banks to finance corporate acquisitions. The work rational behind these rules: Banks should stay away form financing speculative activities. "But M&As are not speculative acfivities" accepted by many Banks and Managers. They said "Acquisition of a starategic controlling stake in a company's an economies activity. It works creates value. That is why acquisition needs to be financed like any stere economic activity. What is needed now is a plan of action to enable public sector banks finance carporate acquisitions, since these banks are guided by RBI's lending norms, it is essential that the central banks takes the initiative and frames clear and focussed guidelines for M&A financing by bank's. There are RBI guidelines setting out sectoral funding linit to protect a banks portfolio Similar guidelines should make takeover funding easier and transparent. As of now RBI is expected to tell the banks to put in place transpoart leverged buyout rules approved by their boards.

Two general categories of debt are used in LBOs-secured and unsecured debt and they are often used together.

Secured LBO Financing or Asset-based Lending

Under the asset-based lending, the borrower pledges certain assets as collateral. Asset-based lenders look at the borrower's assets as their primary protection against the borrower's failure to repay. Such loans are often short–term, i.e., around 1-5 years in maturity and secured by assets that can be easily liquidated such as accounts receivable and inventory. Secured debt also called the asset-based lending contains two sub-categories: senior debt and intermediate-term debt. In some small buyouts these two categories are considered as one. In bigger deals there may be several layers of secured debt, which vary according to the term of the debt and the types of assets proposed as security.

Senior Debt

Senior debt consists of loans secured by liens on particular assets of the company. The collateral which provides the risk protection required by lenders includes such physical assets as land, plant and equipment, accounts receivable and inventories. The level of the accounts receivable that the firm averages during the period of the loan is assessed, based on which the amount of loan to be lent is determined. Lenders usually will give 85 per cent of the value of the accounts receivable and 50 per cent of the value of the target inventories (excluding the work--in-progress).

The process of determining the collateral value of the LBO candidate's assets is sometimes called qualifying the assets. Assets that do not have collateral value such as accounts receivable that are unlikely to be collected are called the unqualified assets.

Intermediate-term Debt

The intermediate-term debt is usually subordinate to senior debt. The loan is often backed by the fixed assets; such as land, plant and equipment. The collateral value of these assets is usually based on their liquidation value. A debt backed-up by equipment usually has a term of six months to one year and a debt backed by real estate will have a one- to two-year term. Usually, the loan amount will be equal to 80 per cent of the appraised value of equipment and 50 per cent of the value of real estate. However, these percentages may vary depending on the area of the country and conditions of the market. The collateral value depends not on the book-value of the asset but on its auction value. If the auction value i.e., the liquidation value is greater than the book value of assets, the firm's borrowing capacity is greater than what is reflected in the balance sheet.

Costs of Secured Debt

The costs of secured debt vary depending on the market conditions. Secured debt rates are often quoted in relation to other interest rates such as the prime lending rate. The prime rate is the rate which the bank charges for their best customers. It often ranges between two and five points higher than the prime rate for a quality borrower with quality assets.

Unsecured LBO Financing

Leveraged buyouts are typically financed by a combination of secured and unsecured debt. The unsecured debt also referred to as subordinated and junior subordinated debt has a secondary claim on the assets of the LBO target. Unsecured financing often consists of several layers of debt each secondary (subordinate) in liquidation to the next most senior issue. Those with the lowest level of security normally get the highest yields to compensate for their higher level of risk.

It is also often called mezzanine financing, because it has both equity and debt characteristics. It has more characteristics of a debt but it is also like equity because lenders receive warrants that may be converted into equity in the target. The warrant allows the holder to buy stock in the firm at a pre-determined price within the defined time-period. When the warrant is exercised the share of ownership of the previous equity holders is diluted. Hence, this form of LBO financing is often used when there is no collateral. The main advantage of the mezzanine layer financing is the profit potential that is provided by either the direct equity interest or warrants or warrants convertible into equity. The added return potential offsets the lack of security that the secured debt has.

Unsecured LBOs are sometimes called cash flow LBOs because stable cash flows can also act as an important source of protection. The more regular the cash flows, the more assurance the lender has that the loan payments will be made. These deals have a more long-term focus with a maturity of around 10-15 years. On the contrary, secured LBOs might have a financing maturity of only around 1-5 years. The cash flow LBOs allows firms that are not in capital-intensive industries like the service industries to be LBO candidates. Usually, lenders of an unsecured financing require a higher interest rate as well as an equity interest. The equity interest may be as low as 10 per cent or as high as 80 per cent of the company's shares. If the risk is higher this percentage will be even more.

Unsecured lenders are entitled to receive the proceeds of the sale of the secured assets after the full payment has been made to the secured lenders.

In India in the absence of norms governing M&A financing, banks have gone for asset financing. For example, Deutsche Bank partly financed the acquisition of 25 per cent government holding in Videsh Sanchar Nigam Ltd., (VSNL) by the Tatas. The foreign bank undertook the buyout deal by placing debt instruments with mutual funds and FIIs. The Tatas raised the required funds by leveraging their own balance sheet.

Structuring Leveraged Buyouts

The structure of the leveraged buyout is aimed at optimising the relationship between a company's capital structure and the equity values realisable by both its current shareholders and prospective future shareholders. The current shareholders receive an acquisition value that

reflects the financial capabilities of the company and its ability to assume a significant debt burden. New investors bear the risk of the ownership of the leveraged company with the expectation of receiving an outstanding return on their investment as compensation for the financial risk being assumed.

Leveraged buyouts can be divided into three categories depending on the probable mechanism for debt repayment and the realisation of value to equity. They are:

(i) Bust-up LBOs

(ii) Cash Flow LBOs

(iii) Selective Bust-up/Cash Flow LBOs (Hybrid).

Bust-up LBOs

LBOs of this kind depend on the sale of assets of the acquired company to generate returns for the equity investors. This type of LBO is usually seen in acquisitions of diversified public companies where the equity markets may not fully value the various sub-entities of the company. In such cases the acquirer seeks a relatively short-term return based upon a rapid sale of the individual parts of the firm to exploit the markets' failure to recognise the full value of a diversified business.

The finances of the bust-up transaction depend upon the value of the assets of the various individual units. The greater the value of these assets, the less equity is required to accomplish the transaction as the acquirer can subsequently sell-off the various sub-entities to generate cash required to retire the debt. These forms of leveraged buyout transaction are very rare.

Cash Flow LBOs

Cash Flow LBOs is a second category of leveraged buyout which is the most common in managementled transactions that requires repayment of acquisition financing through the operating cash flows. Equity investors receive the returns through the replacement of debt capital with equity and also through any increase in the total market value of the company. This type of LBO is similar to the purchase of a real estate property with mortgage financing and equity. Returns are obtained when the value of the property increases with an increase in rent (operating income) and when the debt is replaced by equity as debt is retired from the income from property.

Selective Bust-up/Cash Flow LBOs (Hybrid)

The third type of leveraged transaction is a hybrid of a bust-up and cash flow techniques. It involves the purchase of a fairly diversified company and the subsequent divestiture of selected units to retire a portion of the acquisition debt. The acquirer gets the control of a smaller group of assets

which are best suited for longer term leverage and have captured a premium on the assets which have been sold.

Sources of LBO Financing

The primary sources of LBO financing are the different categories of institutional investors such as life insurance companies, pension funds, etc. Institutional investors either fund LBOs by direct investment or fund LBOs indirectly through an LBO fund. Pools of funds are created by contributions made by various institutional investors, to invest in various LBOs. By investing in LBOs, institutional investors anticipate realisation of higher returns than those available from other sources or forms of lending. Also, by pooling the funds, they could achieve broader diversification and hence, can reduce the risk. Diversification is designed to limit the exposure of default to any one borrower.

Tata Tea - Tetley Deal - Not Everyone's Cup of Tea

After a pitched battle against the MNCs in the domestic arena, not many Indian companies would have thought of going global. Devour competitor and destroy competition - the mantra that the global conglomerates had been chanting so far, had not gone down well with their Indian counterparts. But fortunately, that does not remain their (MNCs) prerogative anymore. The war averse domestic companies are now fast shedding their inhibitions. The roles, no doubt, have changed. And, after fighting it out successfully in global commodities arena, it is time now for the global teacup.

Taking the plunge in this global tea war now is India's corporate giant Tata Tea. Though it was not an easy decision to make, that too when the competitor was of no less than a stature of Unilever, a global food and beverage behemoth, but then Tata Tea had little choice - shape up or be swamped. It chose the former. And, what else could have been a better vehicle than Tetley for Tata Tea to piggy back on to take on the might of global tea giants like Lever and Hillsdown. But that has not come to it easily. After a long-drawn out battle first with Schroder Ventures, followed by a bitter retreat in 1995, and then with Sara Lee, Tata Tea finally tasted victory on March 10, 2000 when it finally bought out Tetley for a staggering Rs. 2,135 crore (305 million pounds sterling). Such a deal has never been heard or seen before in the Indian corporate world. What makes the deal so special is the fact that it is the first-ever LBO (Leveraged Buyout) by any Indian company. In fact, this also happens to be the largest-ever cross-border acquisition by any Indian company.

Leverage Buyout Structure

With a reserve of just around Rs. 400 crore in its kitty, it could not have been possible for Tata Tea to go for such a gigantic acquisition on its own. Or, even bringing such a colossal debt upon its own books could have meant putting enormous pressure on the bottom-line. So, it went for Leveraged Buyout or LBO (see box on LBO).

The deal had been structured in such a way that although Tata Tea retained full control over the venture, the debt portion of the did not affect its balance sheet. The deal had been tied up through a leveraged buyout based on Tetley's assets so that Tata Tea's gearing was not impaired as a result of it.

Tata Tea had created a Special Purpose Vehicle (SPV) - christened as Tata Tea (Great Britain) -to acquire all the properties of Tetley. The idea of the (SPV, essentially, wasto ensure that Tata Tea's balance sheet did not suffer additional funding costs, while at the same time, allowing it to benefit from the acquisition of the international brand. The SPV hadbeen capitalised at 70 million pounds out of which Tata Tea had contributed 60 million pounds; that include 45 million pounds raised recently through its GDR issue. The US subsidiary of the company, Tata Tea Inc., has contributed the balance 10 million pounds. The SPV had leveraged the 70 million pounds equity 3.36 times to raise a debt of 235 million pounds to finance the deal.

The entire debt amount of 235 million pounds comprised 4 tranches whose tenor varied from 7 to 9.5 years, with a coupon of around 11 per cent, 424 basis points over the LIBOR. Of this, the Netherlands-based Rabobank had provided 215 million pounds while venture capital funds Mezzanine and Schroders each had contributed 10 million pounds.

The debt had been divided into four tranched, namely A, B, C and D. While A, B and C are senior term loans, tranche D is a revolving loan that had taken the form of recurring advances and letters of credit. Of the four tranches, money from tranches A and B is meant for funding the acquisition, while tranches C and D were meant for capital expenditure and working capital requirements, respectively.

While tranche A was a 110 million pounds loan scheduled to be retired in 2007 through semi-annual installments, tranche B was a 25 million pounds loan which matured in 2007 and will be paid back in two equal installments at the end of 7.5 years and 8 years respectively. Tranche C was a 10 million pounds loan, to be that matured in 2008, and was repaid in two equal installments at the end of 7.5 years and 8 years respectively. Tranche D was a 20 million pounds loan which, had been made available through 'advances, letters of credit, overdrafts and had retired in 2007.

The debt had been raised against Tetley's brands and physical assets. The valuation of the deal had been done on the basis of future cash flows

that the brand was expected to generate in the foreign market as well as the synergy and benefits that Tata Tea received.

Though the actual cost of the Tetley takeover came to 271 million pounds, Tata Tea had spent 9 million pounds on legal, banking and advisory services and another 25 million pounds for Tetley's working capital requirements and additional funding plans; thereby swelling the total acquisition cost to 305 million pounds. Since entire securitisation was based on Tetley's operations, Tata Tea's exposure was limited to the equity component only i.e., 70 million pounds.

Characteristics of an Ideal Leveraged Buy-out Candidate

Lenders often look for certain features in a business to identify whether the business makes a good leveraged buyout candidate. Not all of the following characteristics are necessary for the completion of a leveraged buyout. However, the greater the number of these characteristics in a target company and the stronger any individual characteristic is, the more likely it is for the LBO to be successful.

Experienced Management Team

A strong management team consisting of a highly qualified chief executive officer and chief financial officer are key components to an LBO. In a leveraged situation, the company has little room for trial and error. Because of this, lenders and investors will insist on having a management team that has a long track record in the industry and knows how to meet projections with few surprises. Lenders also like to see a management team that has either been in a leveraged situation or who has had to meet projections on a consistent basis.

Strong and Secure Cash Flow

Cash flow must be sufficient enough to fund both the company's ongoing operations and to service the debt. Future cash flows based on strong and stable historical performance are most saleable to lenders. Projections that need little explanation and that replicate past performance can withstand the greatest scrutiny and will therefore produce the highest borrowing capacity. To the extent these projections are based on changes in the business, detailed assumptions with specific explanations should accompany the first set of numbers presented to lenders. Prior explanation allows the lender to follow the flow from start to finish with little guess work. This type of presentation maximises the lender's belief that the cash flows are strong and secure and leaves a strong first impression. In addition to supportable cash flow, cash flow with a significant depreciation component is also desirable, because it can be used to pay down acquisition debt and not to pay taxes.

Strong Asset Base

Because assets are used as collateral for financing, assets should have significant value relative to the purchase price of the company. Machinery

and equipment that have multiple uses or that can be easily converted for alternative uses will derive a higher borrowing percentage than equipment that is highly customised. Customised equipment is difficult to sell in a downside situation and therefore, has a lower borrowing value. In addition, accounts receivable and inventory that can be collected quickly or has a high liquidation value are attractive to lenders. Finished inventory and raw materials generally have higher advance rates than work-in-progress. Generally, the more commodity-like the asset is, the higher the advance rates will be.

Low Operating Risk

Because the financial risk of the business is high under an LBO, the business cannot afford to have a bad year. Therefore, those companies that have less operating risks are better LBO candidates. Companies with strong market positions can usually weather downturns in the economy and thus, have less operating risk. Companies with a diversified product, customer base, or geographic market have less operating risk because the company's cash flow is less dependent on any single source of revenue. These companies are better able to withstand the obsolescence of a product, loss of a customer, or change in a region's economy. Companies that have long-term contracts with their customers or who have customers that would incur high changeover costs if they switched suppliers also have less operating risk.

Limited Debt on the Firm's Balance Sheet

The lower the amount of debt on the firm's balance sheet relative to the collateral value of the firm's assets, the greater the borrowing capacity of the firm. If the firm's balance sheet is already burdened by significant financial leverage, it may be more difficult to finance the LBO. The already existent debt limits the borrowing capacity of the company.

Equity Interests of Owners

The equity investment of managers or outside parties who are buying the company acts as a cushion to protect lenders. The greater the cushion, the more likely it is that secured lenders will not have to liquidate their assets since the management would try its best to save the company in tough times due to their equity investment.

Separable, Non-core Businesses

If the LBO candidate owns non-core businesses that can be sold-off quickly to pay back a significant portion of the firm's post-LBO debt, the deal may be easier to finance. Deals that are dependent on the sale of most of the businesses of the firm are referred to as breakup LBOs.

Other Factors

Lenders look for many other factors depending on the business of the LBO candidate. The existence of unique or intangible factors may provide

the impetus for a lender to provide financing when the lenders are indecisive of the performance of the LBO candidate. A dynamic, growing and innovative firm may provide lenders with sufficient incentives to ignore some shortcomings.

Timing

Timing is often the most important element to take advantage of an LBO opportunity. Below are some examples of situations where timing makes a business a good buyout candidate.

Companies that Lack Strategic Fit with Parent

Often larger corporations that have multiple subsidiaries have businesses that no longer fit with their strategic objectives. A common example is when a company decides to focus on the marketing end of a business and decides not to manufacture a product but rather to outsource it. This is a great opportunity for an LBO, because the buyer can usually negotiate a long-term supply agreement with the seller. This allows the buyer to purchase the business based only on the cash flows from the supply agreement, thus minimising the purchase price. In addition, it creates the base of business necessary for the new company to grow and be competitive in the marketplace.

There are many more reasons a parent corporation might decide to exit a business, all of which might be valid for that owner. However, just because the owner wants to exit the business based on its standards, it does not mean it is a bad business to be in. Instead, it means that there may be an excellent opportunity for someone to attempt a leveraged buyout.

Retiring Owner Situations

One of the most common reasons for the sale of a business is that the owner wants to retire and there are no family members who want to take over the business. Confronted with the decision to sell to a competitor, the owner often turns to the management team to see if they have an interest in purchasing the business. Selling to the management team can provide a smooth transition for the owner and minimise the interruptions to the business.

Companies that must be Sold because of Regulators

With the continued consolidation going on in many industries, the Trade Commission is faced with the task of maintaining a competitive environment for the consumers. In many cases, the trade commission may order companies to divest assets in particular markets where the divesting company has too much market share. Generally, the trade commission will require the sale to be made to a qualified buyer who will continue to run a competitive business and therefore promote competition in the market place. This is a right kind of situation to attempt an LBO, because there is a seller who must sell the business and who also wants to sell to the least competitive buyer as possible. Selling to another big player in the industry is usually not the seller's first choice.

Subsidiaries that Lack the Attention of the Parent Company

Often smaller divisions or units of larger corporations lack the attention necessary to maximise their potential. Therefore, these divisions or units appear to be much less valuable than they really are. This is an ideal time for an LBO to be structured. With parent company management at headquarters believing that they are selling a business with little potential, the buyer can negotiate a bargain purchase, raise the necessary capital to move the business in the right direction and generate the cash flows necessary to pay off the transaction debt. Although the parent company is usually the initiator of the transaction, management should not hesitate to ask the parent company if it is willing to sell. Management teams are the natural buyers in these situations and can usually find an equity sponsor to back their ideas.

Good LBO candidates have experienced management teams, strong and secure cash flows, a healthy asset base and low operating risk. In addition, a business is a good LBO candidate when the owner believes it no longer fits its strategic objectives; when the owner is considering retiring or estate planning; when regulators are requiring the sale of the business; or when the business lacks the attention of its parent. Combining the characteristics of a good buyout candidate with proper timing will maximise the probability of a successful transaction.

Sources of Gains in LBOs

The gains associated with a leveraged buyout transaction are mainly:

(i) Taxes;

(ii) Management incentives;

(iii) Wealth transfer effects;

(iv) Asymmetric information and under-pricing; and

(v) Efficiency considerations.

Taxes

The new company formed can operate without payment of any tax for as long as five to six years. The high amount of leverage provides the benefits of interest savings. Moreover, the asset set ups can provide higher asset values for depreciation expenses.

Management Incentives and Agency Cost Effects

Management ownership is enhanced by the leveraged buyout or the management buyout. Hence, there are more and stronger incentives for an improved performance. Some investment proposals may require disproportionate effort of managers. In such cases, the managers are given disproportionate share of the proposal's income. The going private buy-outs facilitate compensation arrangements that induce managers to undertake these proposals.

A going-private transaction may eliminate certain costs incurred by managers to defend their position to potential proxy contestants and to the outside shareholders. In many buyouts the promoters retain a large stake and their desire to protect their reputation as efficient promoters give them the incentive to closely monitor post-buyout management. This will decrease the information asymmetry between the managers and the shareholders. The ownership resulting from the LBO represents reunification of ownership and control, which reduces agency costs.

Finally, presence of internal cash accruals will encourage managers to use more of these cash flows for self-expenditure rather than pay them to the shareholders as dividends. However, an increase in debt through a leveraged buyout commits the cash flows to debt payments. Hence, the agency costs of the free cash flows will be decreased in the leveraged buy-outs. In case of risk, averse managers increased debt will put pressure on managers and gives them an incentive to perform to prevent bankruptcy, since bankruptcy will cause a decline in their compensation and value of human capital. Hence, an LBO is a debt bonding activity which bonds the managers to meet newly set targets.

Wealth Transfer Effects

Payment of premium in the leveraged buyout transactions represent wealth transfers to shareholders from other stakeholders like the bondholders, preferred stockholders, employees and the government. Hence, there is an increase in the value of the equity. The existing bondholders are protected by the covenants in the event of change in control, new debt issues, etc., to some extent but not completely. The new debt issue might not be subordinated to the outstanding debt and the maturity of these debts may be of shorter duration. Hence, there might not be an absolute security for the outstanding debt.

Asymmetric Information and Under Pricing

Large premium paid in the LBO transactions indicate that the buyers or the managers have more information on the value of the firm than the public shareholders. The buyout proposal signals to the market that the future operating income will be greater than what was expected and the firm is less risky than what was perceived by the public.

Efficiency Considerations

Under a private ownership the decision process is more efficient. Actions can be taken more promptly. Getting a new investment programme started is critical for the success of a firm and it is easily achievable under a private ownership. A public firm has to disclose information that is vital and competitively sensitive to rival firms which a private firm need not.

Types of LBO risk

The risk of a leveraged buyout transaction may be a business risk and/ or an interest rate risk.

Business Risk

It refers to the risk that the firm going-private will not generate sufficient earnings to meet the interest payments and other current obligations of the firm. Cyclical downturn in the economy and competitive factors within the same industry such as greater price and non-price competition are some of the factors which affect the risk of the firm. Firms that have cyclical sales or firms that are in very competitive industries are not considered as good LBO candidates.

Interest Rate Risk

Risk that the interest rates will rise; increasing the firm's current obligations of interest payments is the interest rate risk. This is more important for firms that has more variable rate debt. Increase in interest rate could force a firm into bankruptcy even when it experiences greater than anticipated demand and holds non-financial costs within reasonable limits. The level of interest rates at the time of the LBO may be a guide to the probability that rates will rise in the future.

Reverse LBO

A reverse LBO occurs when a company goes private in an LBO only to be taken public again at a later date. This may be done if the buyers who take the company believe that it is undervalued, perhaps because of poor management. They may buy the firm and introduce various changes, such as replacing senior management and other forms of restructuring. If the new management converts the company into a more profitable private enterprise, it may be able to go through the initial public process again.

Leveraged Buyouts as White Knights

Managers in target firms have used LBOs as part of an anti-takeover strategy, providing stockholders an offer that they may accept instead of the hostile bid. This phenomenon became very common in the fourth merger wave and declined with the overall slowdown in the LBO activity in the 1990s.

Management Buyouts and Management [MBOs and MIBs]

In a MBO, the parent seles a division or subsidiary to the incumbent management or a private company is bought by incumbent management. In MBI, a new management team replaces the incumbent management. Where a public listed company is bought by its management, it is pertinent to note that MBOs, MBIs have been significant in UK acquisitions in last few years accounting for about 11% of the acquisitions.

MBIs arise from a number of different sources. The vast majority of them are disinvestments by UK and foreign parents of subsidiaries. Private family owned companies are also often sold to managers. Companies in receivership, or parts of those companies, are also brought by managers as MBOs Receivership as a source of MBOs is obviously related to the state of the economy and become more prominent is recession. Disinvestment in recession tend to be detensive and drive by rationalisation and cost cutting, where in boom time they are triggered more by strategic restrecturing.

A management buyout is a special type of a leveraged buyout where the management decides that it wants to take its publicly traded company or a division of the company, private. Since large sums are necessary for such transactions, the management has to usually rely on borrowing to accomplish such objectives. There should be a premium to be given above the current market price to convince the shareholders to sell their shares.

Management buyouts have been an important aspect of a business. However, the following points should be considered by managers before going ahead with the management buyout.

- Management buyouts are risky and can result in the managers losing their personal wealth as well as their jobs.
- When the new company becomes independent there are possibilities of problems being encountered. For example, there are chances of losing the customers if they consider the existing firm to be too risky.

A management buyout can also be advantageous as follows:

- Though the risks are high the potential rewards are also high. The returns to the shareholders can be high once the loans have been repaid.
- Management buyouts are less risky than starting a new firm altogether.
- Firms that have been subject to management buyouts tend to operate at a higher level of efficiency. The separation of ownership and control is effectively ended and managers and the shareholding employees have greater incentive to improve the efficiency of the firm.

A management buy-in occurs when a group of outside managers buys a controlling stake in a business. Management buy-in is particularly effective when the existing management is weak and need to be replaced and when more efficient managers are able to quickly gain new responsibilities. However, employee resistance can be experienced when the new management tries to impose new ways of running the business. Another disadvantage is that the new management might concentrate on the short-term profitability at the expense of securing the company's long-term prosperity.

Leveraged Cash Outs

It is also known as leveraged recapitalisation. It is a defensive reorganisation of the capital structure in which the outside shareholders receive a large one-time cash dividend and inside shareholders i.e., the management receives new shares of stock instead. The cash dividend is largely financed with newly borrowed funds, leaving the firm highly leveraged and with greater proportional ownership share in the hands of management

Illustration

Godrej Ltd. is a successful publicly - traded manufacturer of consumer durables. It acquired a smaller company BPL Ltd. manufacturing glassware. However, BPL did not fit into its mould and suffered for a number of years. In the year 2010, a small group of disappointed executives of BPL began to consider a leveraged buyout. Godrej was ready to consider the divestiture as it was never comfortable with BPL product line. BPL has always had stable production costs and good contribution margins which consistently resulted in a strong and steady cash flow. Though the production equipment was old it was in a good condition and its replacement cost exceeded its book value. Till the acquisition by Godrej, BPL was always managed well and had little debt.

The following financial information for 2009 is available for BPL:

Revenues	Rs. 80 lakh
EBIT	Rs. 12 lakh
Net Income	Rs. 7.2 lakh

After negotiations the purchase price was settled for Rs. *30* lakh. Because of the high replacement cost of its assets, its strong cash flow, and its relatively unencumbered balance sheet, BPL was able to take on large amount of debt. Banks supplied nearly Rs. 20 lakh of the senior debt at an interest rate of 13 per cent. This was secured by finished goods inventory, plant and equipment and was amortised over a five-year period. An insurance company also provided a loan of Rs. 6 lakh in the form of subordinated debt. Finally, the management of the company took an equity position of Rs. 4 lakh.

Estimate the value of the firm after the Leveraged buyout.

Solution

Amortisation Table of Bank Loan

Year	Interest	Principal	Balance
1	2,60,000	3,08,666	16,91,334
2	2,19,873	3,48,793	13.42,541
3	1,74,530	3,94,136	9,48,405
4	1,23,293	4,45,373	5,03,032
5	65,394	5,03,032	-------

* Rs. 20 lakh at 13%, annual payment X

20,00,000 = X $PVIF_{\Delta}$ (13%, 5 yrs)

X = 20,00,000/3.517 = Rs. 5,68,666

Amortisation Table of Insurance Company Loan

Year	Interest	Principal	Balance
1	78,000	92,600	5,07,400
2	65,962	1,04,638	4,02,762
3	52,359	1,18,241	2,84,521
4	36,988	1,33,613	1,50,908
5	19,618	1,50,908	-----

* Rs. 6 lakh at 13%, annual payment X

6,00,000 = X $PVIF_{\Delta}$ (13%,5 yrs)

X = 6,00,000/3.517 = Rs. 1,70,600

The following proforma cash flow calculations are made on the basis of a number of conservative assumptions. It is assumed that there is no growth. The tax rate is assumed to be 36 per cent. Depreciation is calculated on a straight-line basis over a period of 15 years.

Cash Flows Statement

Particulars	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
EBIT	12,00,000	12,00,000	12,00,000	12,00,000	12,00,000	12,00,000
- Interest		3,38,000	2,85,835	2,26,889	1,60,280	85,012
EBT		8,62,000	9,14,165	9,73,111	10,39,720	11,14,988
- Taxes @ 36%		3,10,320	3,29,100	3,50,320	3,74,300	4,01,396
NI		5,51,680	5,85,065	6,22,791	6,65,420	7,13,592
+ Dep		2,00,000	2,00,000	2,00,000	2,00,000	2,00,000
CFBDR		7,51,680	7,85,065	8,22,791	8,65,420	9,13,592
-Principal Repaid		4,01,266	4,53,431	5,12,377	5,78,986	6,53,940
Cash Flow Cushion		3,50,414	3,31,634	3,10,414	2,86,434	2,59,652
Equity	4,00,000	9,51,680	15,36,745	21,59,536	28,24,956	35,38,548
Debt	26,00,000	21,98,734	17,45,303	12,32,926	6,53,940	-----
Total Assets	30,00,000	31,50,414	32,82,048	33,92,462	34,78,896	35,38,548
% Debt	87%	70%	53%	36%	19%	0%

(CFBDR) - Cash flow before debt repayment.

Leveraged Joint-venture

We have learnt that the leveraged buyouts have become increasingly popular forms of acquisitions for management groups who intended to buy private companies, divisions of public companies, or public companies in going-private transactions. It is hardly ever used as an M&A device by the publicly-held corporation. However, in situations where there are volatile market conditions or where the transaction size is so huge that the acquisition is apparently expensive and unaffordable, the LBO technique can be used by public companies to make acquisitions that are otherwise not possible. The use of leveraged joint venture as an M&A technique makes this possible.

A leveraged joint-venture LBO attempts to overcome a major disadvantage of a public company using an LBO to acquire a target company. The public company, along with a passive financial partner can acquire the target business through an LBO but does not have to show the related debt on its balance sheet. It is still free to operate in the business, turn it around and ultimately purchase and consolidate the entire operation when the debt declines to a manageable level. A typical joint- venture LBO is where one partner is a publicly-owned corporation owning up to 50 per cent of the acquired company's voting stock and sometimes owns a large block of preferred stock as well. The other passive partner is a leverage financing buyout firm, or a investment bank, owning to the remainder *of* voting stock. Sometimes the management of the acquired firm may also own some of the common stock.

The acquired firm is usually managed and operated by the corporate partner. A fee for the management services is paid to the corporate partner.

Leveraged Sell-out

A leveraged sell-out is a transaction which enables a company to raise cash from the sale of one of its business units. The main difference between the leveraged sell-out and a leveraged buyout transactions is that the former transaction enables the seller to retain an interest in the equity of the divested business.

When a company intends to sell 50 per cent or more of its holding in its subsidiary, it can enter into an agreement with a financial partner (an LBO fund or an investment bank) to restructure the subsidiary and obtain the necessary buy-out financing. After the sale, both the corporate and the financial partners own 50 per cent interest in the entity.

Divestment of Public Sector Enterprises - Indian Scenario

India's public enterprises account for approximately 15 per cent of the Gross Domestic Product (GDP) and 30 per cent of investment. The performance of central public enterprises has been poor over the years and they place a heavy burden on the Indian economy. Approximately 40 per cent of the central public enterprises are constant loss-makers. The public enterprise

sector requires a budget support of 0.5 per cent of the GDP. The present rate of return on investment from the public enterprises is much lower than that of private firms. Investments in the loss-making PSUs divert resources from growth-enhancing public spending. The poor qualities of products and the high cost of inputs, produced by public enterprises, is affecting India's industrial competitiveness. Their inefficiency is hampering growth, and indirectly hindering the national effort to reduce poverty.

Meanwhile, over the period of time, the private sector companies did well and performed better than firms in the public sector. The PSUs, suffered losses due to various factors like inefficient management, inability to adapt to the changing economic and market scenario and excessive Government interference which prompted the Government to seriously consider disposing them to the private players. These PSUs were constantly incurring huge losses that necessitated the Government to step in time and again with generous grants of funds from the Budget. The idea of seriously disinvesting these PSUs cropped up around the late 1990s when, in the midst of a severe economic crisis, the Government finally decided that it was no longer feasible to continue providing ~ life-support systems to them.

As on March 2001, the total Government investments in about 240 PSUs aggregated more than Rs. 1,10,000 crore. Of these, the profit-making companies were around 120-130 in number while the others were all loss-making, with the disease being acutely chronic and incurable in most cases. This gave successive Finance Ministers a new topic to add to in their annual Budget speeches - "Disinvestment of PSUs". The main benefit from disinvestment is that apart from unlocking investments in non-productive assets, this amount can be productively utilised for investing in infrastructure projects so that they lead to a higher growth in the economy. While the idea raised a lot of hopes about the Government's intention to exit from these enterprises, hardly anything was done in this regard till the year 2000. The progress of disinvestment in India has been a bit too slow considering the giant strides that other developing countries made by transferring productive assets to private investors, especially in infrastructure (power, telecommunications and oil).

Current Status

A separate Disinvestment Commission was set up in 1996, by the then Finance Minister, P Chidambaram and the same had been converted into a full-fledged ministry with Arun Shourie as the then Divestment Minister, to specifically identify the units for disinvestment in the public sector and propose ways and means to sell them, either in part or in full to the private players.

The Government finally made some concrete progress in the fiscal 2001-2002 by selling 51 per cent stake sale in Bharat Aluminum Company (BALCO) to Sterlite Industries, despite strong opposition from the Chattisgarh Government, 51 per cent stake in CMC to TCS, 74 per cent stake in Hindustan Teleprinters to HFCL, 74 per cent stake in Paradeep Phosphates

to Zuari Maroc Phosphates and a 25 per cent stake in Videsh Sanchar Nigam Ltd. (VSNL) and around 34 percent stake in IBP to the Tata Group and Indian Oil Corporation (IOCL) respectively. It also managed to dispose some of the hotel properties which were previously under the control of Hotels Corporation of India (HCI). For the year 1999-2000 the Government was able to sell only Modern Foods to Hindustan Lever Ltd., which netted around Rs. 105 crore as against announcing its decision to garner Rs. 10,000 crore.

Some of the other PSUs lined up for disinvestment before in the fiscal year 2002-2003 were Hindustan Zinc Ltd., IPCL, HPCL, some hotels of ITDc, Mamti Udyog Ltd., JESSOPS and Hindustan Newsprint. Going by the flurry of recent activities, the Government seems to be going in the right direction while we can only hope that a good financial gain for these are not sacrificed at the altar of serious political compulsions.

LBO and Corporate Governance

LBOs offer a useful format for effective governance of corporations. They are not merely deals but represent an alternative model for corporate ownership and control just as public ownership, venture capital ownership and franchise arrangements. Temporary ownership by LBO firm can provide an important bridge to better long term management and performance. LBO model of ownership is quite adaptable to a wide business enterprise. The unique aspect of LBO approach to ownership and governance is exemplified by direct lines of communication between owners and top management, managerial automony and willingness by owners to step in and direct operations to solve chronic problems. Trust is built overtime in a variety of ways including the alignment of intered through equity ownership and incentive compensation.

In India, while attempting to put forward principles of best practice in British Corporate Governance, the Cadbury Committee studied LBOs, venture capital firms and relational investing (Warren Buffet) as different possible models for best practices. Since LBOs are mainly seen as mere financial transactions, their effect on governance is often ignored. But the fact is finance and governance are closely related. Equity (corporate governance) is a matter of constant negotiation. Debt and equity are not only two different types of financial claims but represent alternative approaches to check corporate performance and direct management governance. Equity and debt are opposite ends of a range of potential governance management. Debt is inflexible but leads to a simple and low cost administration while equity is flexible and adoptive but complex and costly. The ideal form of governance depends on the nature of the assets to be managed, the transaction stream which these assets support and the growth opportunities. A leveraged buyout (LBO) is one form of governance that is suitable for a wide cross-section of business. It represents a young and still growing organisational form in a market- determined economy.

Leveraged Buyouts in India

LBO financing is liked to emergy in India against the backdrop of the Government. disinestment programme. The RBI neither prohibits nor endorses M&A financing. Banks have lent money to some corporate which have picked up public sector undertakings through dismiuestment route. But this is more in nature of balance sheet financing, not leveraged buyout financing. Indian banks have traditionally been doing either balance sheet financing or assets based financing. Loan decisions are mainly taken on the basis of the cash flow. In a leveraged buyout, a significant amount of funding of the takeover of the controling interest in a company comes from barrowed funds usually to 70% or more of the total purchase prise. As per international buyout practies a torget company's assets serve as aecurity for the loans taken by the acquiring firm.The latter repays the loans out of the cash flow of the acquired company through its profits or by selling its assets. Globally many LBO have been financied through junk bonds, This is not practics in India yet.

In the absence of clear rules governing M&A financing banks have gone for assets financing. Deutsche Bank for instance part financed the Tata's acquisction of a 25% Government. holding in VSNL. The foueigh bank undertook the buyout deal by placing debt instrument with mutual funds and foreign institutional inves tors. The Tatas raised the required funds by leveraging their own balance sheet. Generally, 3 fucture are considered for LBO:

- As acquiring company must have the ability to borrow significant sums againt its assets
- It should also be able to retain or attract a strong management team and enhance value of each investment
- The ability of a company to support a LBO depends on whether it can service the principal and intrest paymat obligations.

Traditionally, public sector banks have stayed away from M&A financing because there are no clear guidelines for this. However, leveraged buyout financing is likely to emerge in India against the backdrop of the government's divestment programme. Till a couple of years ago, banks were reluctant to sponsor any Leveraged Buyout (LBO). But, as the divestments accelerated, most banks have come forward to fund the acquisitions. Now banks have realised that funding an acquisition of a running company is safer than funding a new company. Unlike the foreign practice of funding based on the acquiree balance sheet, in India, banks fund acquisitions relying on the acquirer's balance sheet and the cash flows that the company can receive after the acquisition. The recent exemptions on the utilisation of the foreign reserves raised in the form of External Commercial Borrowings (ECBs), American Depository Receipts (ADRs) and Global Depository Receipts (GDRs), have created a new channel of funds for the companies going for acquisition. One instance of a leveraged buyout by an Indian company with international funds is Tata Tea's £271 million acquisition of Tetley.

Due to the determined drive to big-ticket divestments from Arun Shourie, most banks were open to the funding acquisitions, at least funding for the PSUs being disinvested. Although so far the interest is only in PSU disinvestment bankers say that the experience gained here could pave the way for creating a formal system of financing takeovers even in the private sector. The move by the RBI that loans for acquisitions of divested PSUs will not come under the 5 per cent cap on exposure to loans against shares has encouraged banks to provide loans for acquisitions. Among the domestic players, ICICI has been the first to do such deals and has funded Sterlite and Piramal in their acquisitions.

Warburg, Newbridge bid for Punjab Tractors

Public sector banks which have avoide this kind of financing with a few experence. On the ofter hand foreign banks, which have the expertise and experence, have taken the lead infinancing LBO. The Govt. has ruled that MNCs will have to bring funds from abroad rather than raise money from local banks for acquisitions.

With financial investors like Warburg Pincus and Newbridge Capital joining the race for the Punjab Tractors (PTL) stake, the deal could well be the first leveraged buy-out (LBO) corporate India has ever seen.

The Punjab Government plans to sell 23.5 percent stake held by the Punjab State Industrial Development Corporation in PTL.

So far, corporates in India have raised funds for buyouts by leveraging their own balance sheets. The acquisition of a strategic stake in PTL, which would give the successful bidder management control of the company, is expected to cost upward of Rs. 650 crore, an amount most bidders would find hard to raise on the strength of their own balance sheets.

The companies that have put in bids for PTL include Mahindra and Mahindra, Eicher, Escorts, the Eicher Group, John Deere, TAFE, SAME Tractors and Ford New Holland. Though Warburg Pincus and Newbridge are putting in independent bids, it is understood that they may partner with successful bidders as financial investors in the event of their own bids not being accepted.

The successful bidder for PTL will have to come out with open offers for two of PTL's associate companies as well- Swaraj Mazda and Swaraj Engines. PTL holds 34 per cent in Swaraj Engines and 29 per cent in Swaraj Mazda. Under the SEBI's takeover code, the change in promoters in PTL will trigger off the open offer clause for the two PTL associate companies. The successful bidder will also have to make an open offer for a further 20 per cent in PTL, taking its stake to 43.5 per cent.

Investment bankers say Shipping Corporation of India (SCI) and Nalco are also strong candidates for an LBO, given the cost of acquisition involved. While a strategic investor in SCI would have to pay upwards of Rs. 1,000 crore, in the case of Nalco it would be about Rs. 3,000 crore.

Source: www.ecollomictimes, December 7, 2002.

Lenders have to evaluate whether the cash flows that accrue to the acquirer after the purchases are enough to repay the debt raised for the takeover. The cash flows could arise out of forward integration of the acquired company or by way of dividend. All this requires heavy financial structuring. For this reason, the target company's cash flows, debt profile, shareholding pattern, etc., are to be understood properly. Hence, LBOs can be selectively used in PSUs, which have low leverages in their capital structure. Bank of Dnerica financed Guyarat Dombuya for acquiring DLF cement and also funded rfrasim for acquiring the brand of costs viyela. But such M&A financing deals are few. The only financial institution taking some interstist in funancing M&A deals is ICICI. The French cement major, laforge peutly fincnced its takeover of TISCOS cement dicision through loans from DCICI and HDFC. Meanwhile laforge is planning to part finance its acquistion of Raymond's cement division through domestic loans. After all money is fungible. So, Banks and FIs should provide financial assistance to campories for various purposes and LBO is vertainly one economic purpose which needs funding.

Multiple Choice Questions

(1) Which of the following terms is given to an acquisition of all the stock or assets of a previously public company by a small group of investors financed largely by borrowing?

(a Going Private.

(b) Management Buy-out.

(c) Management Buy-in.

(d) Leveraged Recapitalisation.

(e) Leveraged Buyout.

(2) A division or subsidiary of a public corporation acquired from the parent company by a purchasing group led by an executive of the parent company or members of the unit's management is called the:

(a) Leveraged Buyout.

(b) Going Private.

(c) Management Buyout.

(d) Management Buy-in.

(e) None of the above.

(3) In which of the following types of LBO transactions do target shareholders simply sell their stock and all interests in the target corporation to the buying group?

(a) Asset Purchase Format.

(b) Stock Purchase Format.

(c) Cash Purchase Format.

(d) Both (a) and (c) above.

(e) All of the above.

(4) LBO is a purchase aprinate company with

(a) Borrowed fund (b) capital funds

(c) Own funds (d) all of above

(e) None of above

(5) When company managers acquire a large part of the company it is called

(a) MBI (b) MBO

(c) LBO (d) all of above

(e) None of above

(6) Leveraged Buyout is Undertaken by

(a) Stock purchase format (b) Assets purchase format

(c) Both (i) and (ii) above (d) Either (i) or (ii) above

(e) None of above

(7) Investor in LBOs are referred to as financial buyers who hold their investment for

(a) 3 to5 years (b) 5 to7 years

(c) 7 to 9 years (d) 9 to11 years

(e) 11 to 13 years

(8) Temporary ownership by an LBO firm can provide an important bridge to better long term:

(a) Management (b) Performance

(c) Both (i) and (ii) (d) Either(i) or (ii)

(e) None of above

(9) LBO represents bonding activity of

(a) Debt (b) Equity

(c) Debt and Equity (d) Debt or Equity

(e) None of above

10 The Purchase Price in LBOs should be slightly above than

(a) Debt (b) Equity

(c) Book (d) Preferance

(e) Debenture

(11) In a LBO, a significant amount of the takeover of the controlling interest comes from

(a) Own found (b) Mutal fund

(c) Capital fund (d) Borrowed fund

(e) All of above

(12) LBO financing is likely to emerge in India against the backdrop of the Goverments

(a) Investment Programme (b) Disinvestment Programme

(c) Economic Program (d) All of above

(e) None of above

(13) In a Management Buy In; a new management team replaces the

(a) Incumbent Management (b) Indumbent Mmanagement

(c) Inccummbent Management (d) Incumbbent Management

(e) Incumbennt Management

(14) Disinvestment in a recession tends to be dedensive and driven by rationalisation and cost cutting whereas in boomtime they are triggrred by strategic

(a) Replacement (b) Replanning

(c) Restructuring (d) All of above

(e) None of above

(15) Senior debt has priority in payment of

(a) Interest (b) Principal

(c) Interest and Principal (d) Intrest or Principal

(e) None of above

(Answer1) e; 2) c; 3) b; 4) a, 5) b; 6) d;
7) b; 8) c; 9) a, 10) c; 11) d; 12) b,
13) a; 14) c; 15) c.)

Theory Questions:

(1) Explain the concept of LBO and state how it is undertaken

(2) How is LBO an alternative model for Corporate Governance?

(3) Explain different stages of LBO operation

(4) Discuss the methodlogy of financing LBOs and with partucular reference to India

(5) Explain the managerial motinations of an MBOs

(6) Explain the development stages of LBOs since 1950 with examples

(7) What do you mean by MBO?; Explain its benefit

(8) Discuss the structure of an MBO in details

(9) Describe different elements of a LBO operation

(10) Explain Financing aspect of LBO indetail

(11) Write different characteristics of an Ideal LBO candidates

(12) Discuss different sources of gains in LBOs

(13) Distinguish between MBOs and MBIs

(14) Explain different types of LBO risk and its failure

(15) Explain leveraged cashouts with suitable Illustration