

In simple terms, how do they work?

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Video source from the blue economy - www.theblueeconomy.org

The Evolution of LBOs
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What is an LBO?
The term leveraged buyout refers to the acquisition of a company or divested segment of a company funded predominantly with debt (Macabactus, 2012)

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Who is normally involved?
Private Equity (PE) and Venture Capital firms, Management Buyout Teams and of course Entrepreneurs!

Entrepreneurs and LBOs
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The Value and the emergence of Private Equity
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Current LBO Market Landscape
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Funding Sources

- 1 Institutional Asset Managers
- 2 Hedge Funds
- 3 Private Equity

Growth in LBO size

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Current Market Dynamics

Softbank's New Strategy

Current LBO Market Landscape

Managing Investment Risk

Key Considerations for Investors

Current LBO Market Landscape

Why Investors Like MBOs

Entrepreneurs and LBOs

LBO Popularity Post GFC

Advantages and Potential for Returns

Investor Logic

References

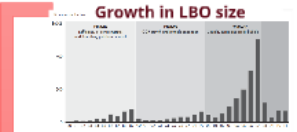
Softbank's New Strategy: The Largest LBO in Japan

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The Popularity of LBOs

The evolution of Leveraged Buyouts and their role in a post-GFC global economy

3 Often require additional incentive or "equity kicker" - options/warrants
 Large corporates can often prefer to vendor finance part of a deal in order to see it off their books



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 *Private equity (LBO) investment is highly sensitive to macroeconomic availability of credit (Kaplan, Greenberg & Neivaach, 2008).
 Examples of this sensitivity can have been seen resulting from:
 - The junk bond crisis of the late '80s
 - Savings and loans crisis of the early '90s
 - Dot.com era bust and September 11 terrorist attacks
 - Global financial crisis

The 1980's and the emergence of "Private Equity"
Thecasesolutions.com
 Cheap credit and rapid growth
 Size and number of LBO deals increase over 100 fold from 1980-1989
 Market topped with RJR Nabisco LBO in 1989
 Even when leverage dropped from 1989-2000 LBO firms AUM grew over 300%
 Leverage during the same period went from an average equity contribution +10% in 1988 to +40% by 2001.
 Strong public aversion to LBO firms saw re-branding of industry as Private Equity

The Evolution Of LBOs
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 Originally associated with bootstrap financing activities used by entrepreneurs (Miller, 1978).
 Conglomerate buying of the 1960s
 "Big executives" announced themselves chairman and placed their subordinates and family "outsiders" on their board of Directors (Walker and Smith, 1998).
 Modern leveraged buyout market was born of the:
 • Inefficiency
 • Excess capital
 • Culture of middle management bias

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...for Investors
 • Opportunity for managers to gain equity in company
 • Privacy since no longer publicly listed or within corporate from which it is to be divested
 • Tax advantages due to tax deductibility of debt interest payments vs dividend payments
 • Corporate LBO target businesses have strong historical cash flow and can undergo various improvements
 • Opportunity to unlock value via operational changes, cost cutting and/or look at acquisition (creating synergies)
 Perhaps most importantly, LBOs allow (in management) to capitalize on an oft needed major coding ownership or influence

Common LBO Structures
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 Standard LBO - Private Equity/VC
 MBO - Management Buyout where firm management bid for control of firm with partner financiers typically PE
 MBI - Management Buy-in where outside management team backed by PE ousts existing management to take control
 IBO - Institutional Buy-in typically where institutional investor acquires a company and rewards existing management with equity
 BIMBO - Buy-in Management Buyout where a combination of existing and external managers work alongside PE

Why Vendors Like MBO
 Potential investors understand the company and potential
 No need to risk confidential and proprietary information to competitors and trade buyers
 If MBO team walks, a trade sale can still take place even but is unlikely to the other way around

Entrepreneurs and LBOs
 Most commonly MBO/MBI or BIMBO structure and reasons for an LBO usually include:
 • Divestment
 • Succession/Retirement
 • ACCC/Competition Issues
 • Insolvency
 • Divergent Interests
 • Surplus acquisition
 • Take co. private for comp adv
 • Secondary MBO where original investors seek to realize gains

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Originally associated with bootstrap financing activities used by entrepreneurs (Miller, 1978).

Conglomerate building of the 1960s

'[top executives] anointed themselves chairmen and placed their subordinates and friendly "outsiders" on their Board of Directors' (Baker and Smith, 1998).

Modern leveraged buyout market was born of the:

- Inefficiency
- Crony capitalism
- Culture of middle management bloat



The 1980's and the emergence of "Private Equity"

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Cheap credit and rapid growth

Size and number of LBO deals increase over 100 fold from 1980-1989

Market topped with RJR Nabisco LBO in 1989

Even when leverage dropped from 1989-2000 LBO firm AuM grew over 800%

Leverage during the same period went from an average equity contribution <10% in 1988 to >40% by 2001.

Strong public aversion to LBO firms saw re-branding of industry as Private Equity



Current LBO Market Landscape

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Entrepreneurs still use LBOs

Dominated by colossal PE firms such as US-based Blackstone Group and Kohlberg Kravis Roberts (KKR)

The days of extremely high leverage (>90%) are very much in the rear view mirror.

PE firms are now focusing on adding value to firms

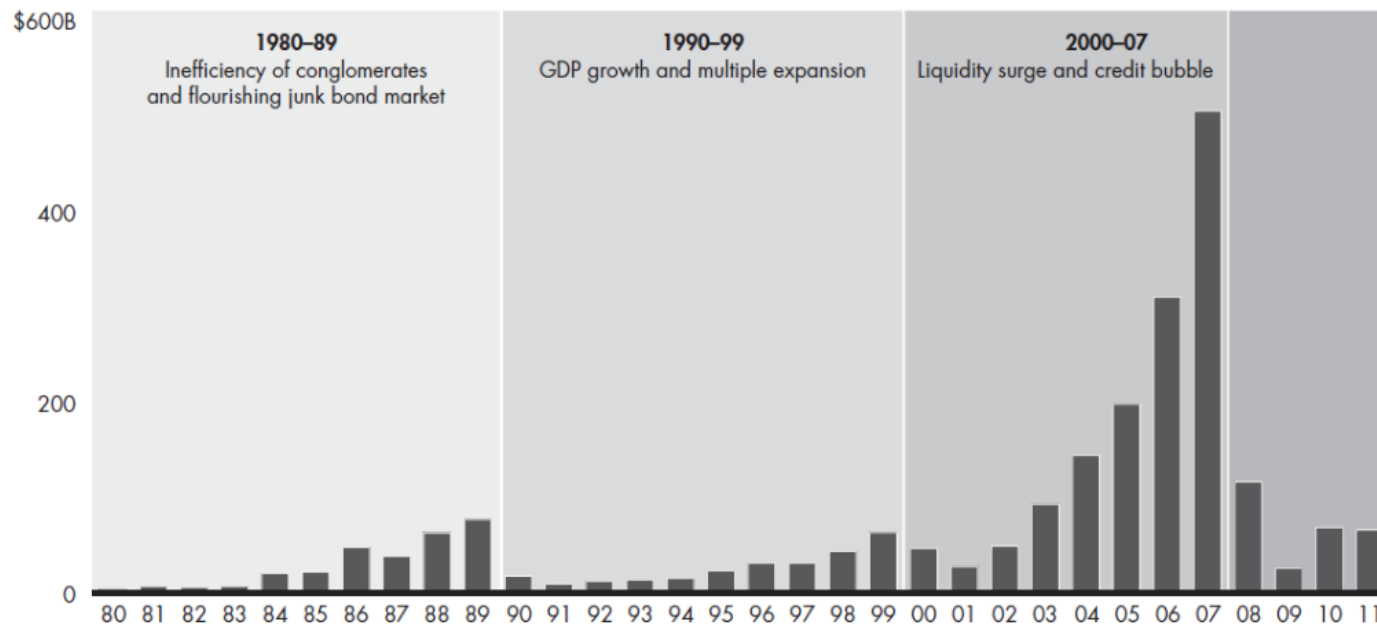
- Searching for synergies between acquisition targets they can “bolt-on”
- Produces size and scale to achieve desired returns

According to Bain and Company (2012 p. 27),

“...over the past three years, nearly 45% of all buyouts have been additions to existing portfolio companies”

Growth in LBO size

US buyout deal value



Notes: Represents control buyout transactions by US-based firms; includes closed deals only; represents year deals were closed
Source: Bain US LBO deal database

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"Private equity [LBO] investment [is] highly sensitive to economy-wide availability of credit" (Axelson, Stromberg, & Weisbach, 2008).

Examples of this sensitivity can have been seen resulting from:

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