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 (Macabacus, 2012)

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Who is normally involved?

Private Equity (PE) and Venture Capital firms, Management Buyout Teams and of course Entrepreneurs!

In simple terms, how do they work?

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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

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The Evolution Of LBOs

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"

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

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.

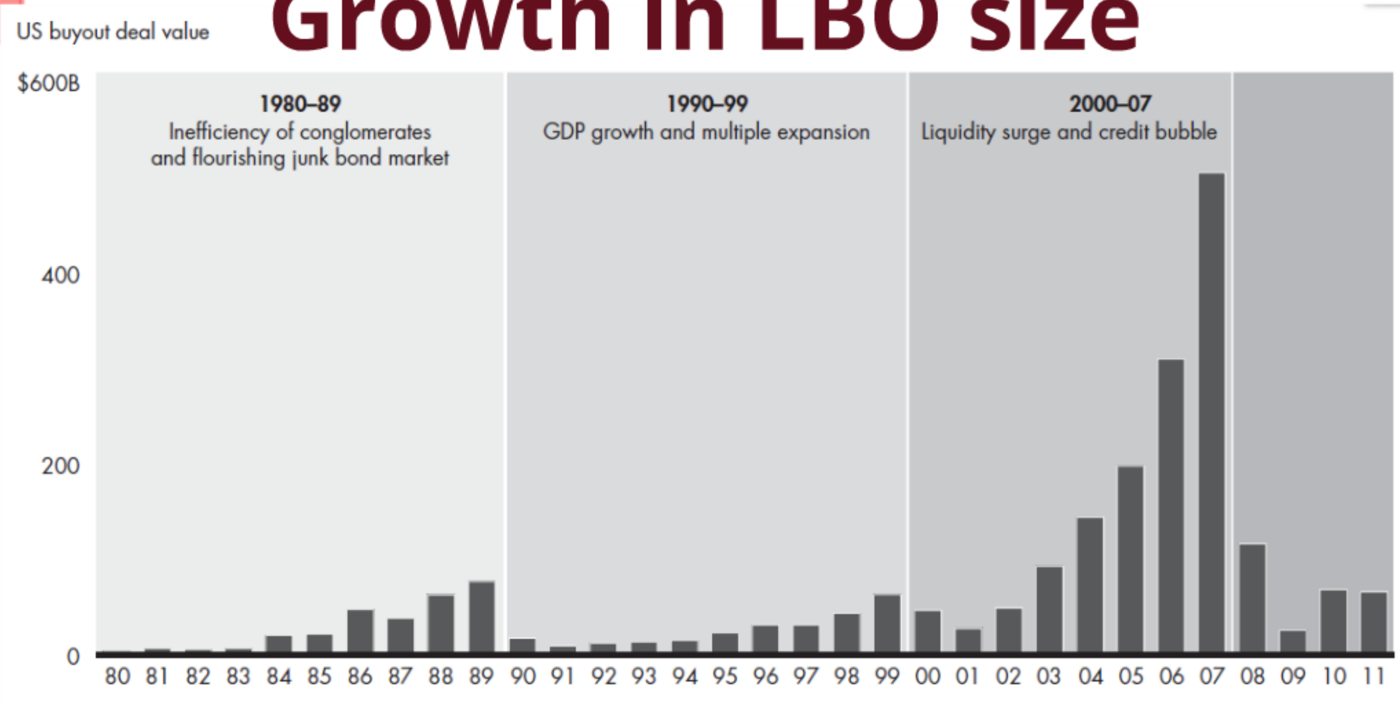
PE firms are now focusing on adding value to firms

- 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 add-ons to existing portfolio companies”

Growth in LBO size



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

"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:

- **The junk bond crisis of the late '80s**
- **Savings and loans crisis or the early '90s**
- **Dot com era bust and September 11 terrorist attacks**
- **Global financial crisis**

In simple terms, how do they work?

Common LBO Structures

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