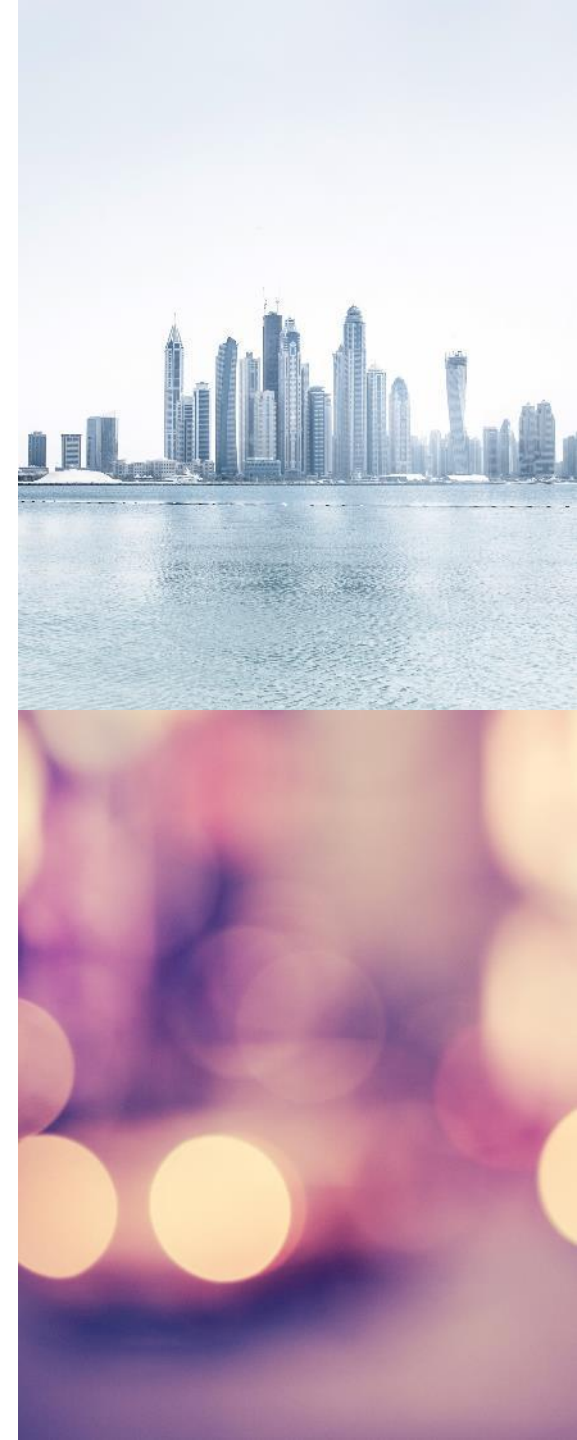




Introduction to Leveraged Buyouts and Key Features

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1. Introduction to Leveraged Buyouts and Key Features

Definition and Basic Concept

- An LBO is an acquisition funded largely with borrowed money.
- The debt is usually secured by the target's and the acquirer's assets.
- The target's income, usually EBITDA, is the primary source of debt repayment.
- The acquirer makes large purchases without committing much of its own capital.

Purpose and Benefits

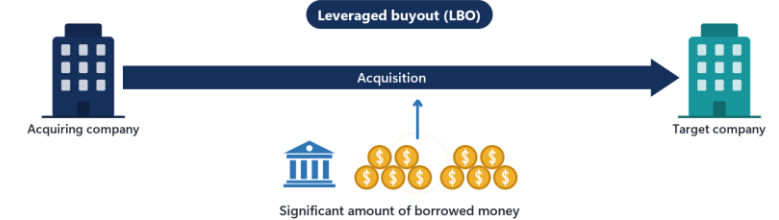
- Primary objective: enhance the return on equity (ROE) through leverage.
- Levers: operational improvements, strategic repositioning, financial restructuring.
- Large acquisitions become possible with relatively small equity investments.
- Interest on LBO debt is tax-deductible, giving the acquirer a tax advantage.

Historical Context and Evolution

- LBOs gained popularity in the 1980s; KKR's RJR Nabisco deal is a famous example.
- The 2008 financial crisis and tighter credit markets reduced LBO activity.
- LBOs have resurged with better economic conditions and easier access to credit.
- Blackstone's 2021 Medline acquisition: \$34 billion, one of the largest recent LBOs.
- Medline's future cash flows are expected to service the substantial buyout debt.

What is an LBO?

Definition and basic concept

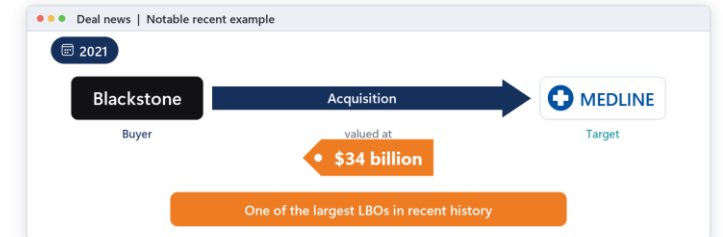


What is an LBO?

Historical context and evolution



What is an LBO?



1. Introduction to Leveraged Buyouts and Key Features (Part 2)

Structure of LBO Financing

- LBO financing combines debt and equity.
- Debt often makes up 70-80% of the purchase price.
- Financing is layered, prioritising debt types to balance risk and return.
- Investors leverage their equity investment, potentially achieving higher returns.

Senior Debt

- Secured by the company's assets, with the highest priority in liquidation.
- Lowest interest rates, thanks to its secured nature and priority in claims.
- Maturity typically ranges from 5 to 8 years.
- Provided by banks or institutional investors; a primary funding source in LBOs.

Subordinated Debt

- Also known as junior debt; ranks below senior debt in repayment.
- Its lower priority brings higher interest rates.
- Maturity typically ranges from 7 to 10 years.
- Fills the gap between senior debt and equity, accepting higher risk.

Mezzanine Financing

- A hybrid of debt and equity, often convertible into equity later.
- Higher interest rates reflect the added risk and flexibility.
- Maturity typically 5 to 8 years, with potential conversion to equity.
- Suits companies that have maximised senior and subordinated debt capacity.

High-Yield Bonds

- Also known as junk bonds: unsecured, with higher risk.
- The highest interest rates among LBO debt instruments.
- Maturity typically ranges from 7 to 10 years.
- Issued in capital markets to raise large amounts of unsecured debt.

Mechanics of LBOs (Part 1)

Structure of LBO financing



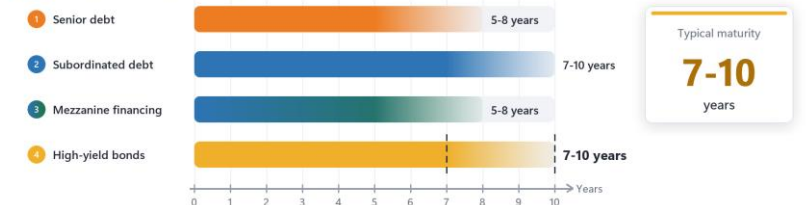
Mechanics of LBOs (Part 1)

1 Senior debt Usage



Mechanics of LBOs (Part 1)

4 High-yield bonds Maturity



1. Introduction to Leveraged Buyouts and Key Features (Part 3)

💰 Sources of Equity Financing

- Equity typically covers 20% to 30% of the purchase price.
- The equity share can vary with the deal's specifics.
- Equity financing comes from various sources, described below.

👛 Private Equity Firms

- Provide a significant portion of the equity required.
- Often the primary initiators of LBO transactions.
- Use their expertise to improve the target company's value.
- Aim to generate high returns on their investment.

🏢 Strategic Investors (Corporations)

- Large corporations join LBOs that fit their strategic goals.
- They leverage financial strength and industry expertise.
- Aim: competitive advantage and synergies with existing businesses.

🔄 Management Rollovers

- Current management rolls existing equity into the new capital structure.
- Aligns management's interests with the new owners.
- Shows confidence in the company's future prospects.
- Incentivises management to improve performance.

🏛️ Institutional Investors

- Pension funds and insurers co-invest alongside private equity firms.
- Seek higher returns than traditional investments.
- Diversify their portfolios and leverage private equity expertise.

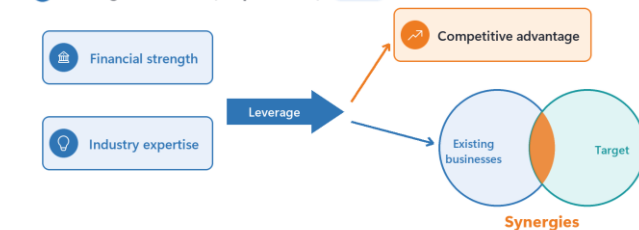
Mechanics of LBOs (Part 2)

Sources of equity financing



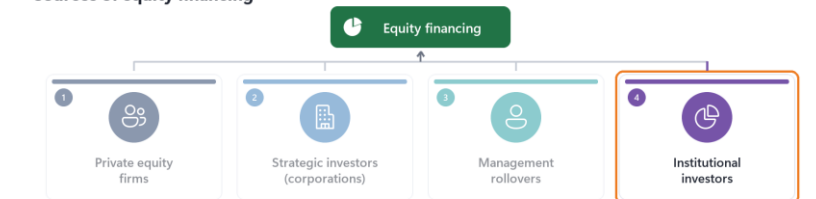
Mechanics of LBOs (Part 2)

2 Strategic investors (corporations)



Mechanics of LBOs (Part 2)

Sources of equity financing



1. Introduction to Leveraged Buyouts and Key Features (Part 4)

👛 Investors Leading LBOs

- Private equity firms lead about 80% to 90% of all LBO deals.
- They use strategic and operational expertise to enhance target value.
- Strategic investors and special situation funds make up the remaining 10-20%.
- Corporations seek strategic acquisitions; funds seek distressed or unique opportunities.

🎯 Typical LBO Targets

- LBOs target specific types of companies with attractive opportunities.
- Recent preference: healthcare, technology and consumer goods, yet targets span sectors.
- Key: strong fundamentals, growth potential and value creation opportunities.

🏢 Private Companies

- A prime target: greater control and flexibility than publicly traded companies.
- Untapped growth and improvement potential unlocked through private ownership.

🏠 Family-Owned Businesses

- Often targeted when seeking succession planning or liquidity.
- Established brands, loyal customers and strong market positions attract investors.

✂️ Divestitures or Carve-Outs

- Large corporations divest non-core units or subsidiaries through LBOs.
- Underperforming or non-aligned units can be acquired and revitalised.

🔧 Companies with Mismanagement Issues

- Temporary difficulties from mismanagement or inefficiencies can make attractive targets.
- PE expertise can turn them around and unlock their full potential.

🔄 Cyclical Industries

- Manufacturing or energy companies may face distress during downturns.
- Investors acquire undervalued assets and benefit from the eventual recovery.

Characteristics of LBOs (Part 1)

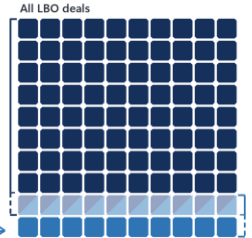
Investors leading LBOs

Private equity (PE) firms
80-90%
of all LBO deals

Other investors
10-20%
of LBO participants

Strategic investors

Special situation funds



Characteristics of LBOs (Part 1)

3 Divestitures or carve-outs

Non-core unit

↓ Underperforming

Not fully aligned with the parent's strategic focus



Characteristics of LBOs (Part 1)

Typical LBO targets



The key

Identify companies with

✓ Strong fundamentals

✓ Growth potential

✓ Opportunities for value creation

through

📈 Operational improvements

🎯 Strategic initiatives

1. Introduction to Leveraged Buyouts and Key Features (Part 5)

Differences from Public Equity Investments

- Leverage: LBOs rely heavily on debt to finance the acquisition.
- Public equity investments do not involve such high levels of leverage.
- Control: PE firms gain significant control to implement strategic and operational changes.
- Public equity investors usually have less influence over management decisions.
- Active management: LBO investors manage and restructure the company to enhance its value.

LBOs' Active Due Diligence

- Goes beyond financial and legal checks to seek value-creation opportunities.
- Examines the target's operations, financials and market position in depth.
- Identifies cost-saving measures, synergies and growth opportunities to maximise value.
- Unlike venture capital, prioritises tangible value enhancement over future potential.
- Assesses the management team's capabilities and ability to execute post-acquisition strategies.

LBOs' Benefits

- Value creation: efficiencies, cost reductions and repositioning increase the company's value.
- Tax advantages: tax-deductible interest reduces the tax burden and enhances returns.
- Increased control: investors drive improvements and strategic changes effectively.
- Diversification: acquiring companies in different industries spreads risk across sectors.

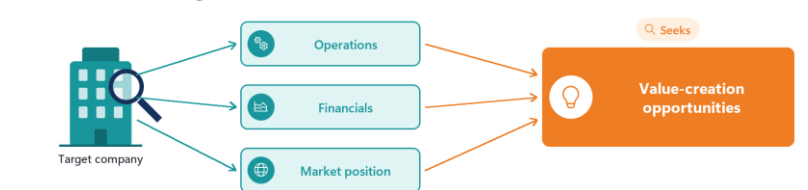
Characteristics of LBOs (Part 2)

2 Control and influence LBO vs public equity



Characteristics of LBOs (Part 2)

LBOs' active due diligence



Characteristics of LBOs (Part 2)

4 Diversification Benefit



1. Introduction to Leveraged Buyouts and Key Features (Part 6)



Financial Risks

- LBOs offer attractive potential returns but carry significant risks.
- High leverage: substantial debt magnifies both gains and losses.
- Underperformance can make the debt burden unsustainable, leading to distress or bankruptcy.
- Interest rate risk: rising rates increase debt-servicing costs, squeezing cash flow and profitability.
- Refinancing risk: if market conditions change, refinancing may become difficult or expensive.



Operational Risks

- Integration challenges: integrating the acquired company can be complex and disruptive.
- Cultural clashes, operational conflicts and management turnover can impede value creation.
- Over-optimistic projections are often used to justify the high leverage.
- Unrealistic projections can leave the company struggling to meet debt obligations.
- Management misalignment: the PE firm and management may conflict over direction, decisions and goals.

Risks and Mitigations of LBOs (Part 1)

1 High leverage Financial risk



Risks and Mitigations of LBOs (Part 1)

3 Refinancing risk Financial risk



Risks and Mitigations of LBOs (Part 1)

2 Over-optimistic projections Operational risk



1. Introduction to Leveraged Buyouts and Key Features (Part 7)

Market and Economic Risks

- Economic downturns: recessions can severely impact revenue and profitability.
- Downturns make it difficult to service debt and meet financial obligations.
- Competitive pressure: competition erodes market share and profitability.
- This puts additional strain on the company's financial performance.
- Regulatory changes can affect operations, cost structure and cash flow generation.

Mitigating LBO Risks

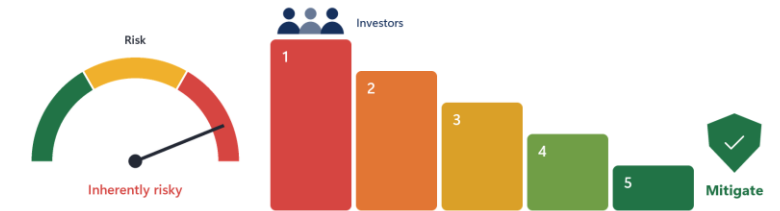
- Thorough due diligence: assess financial health, operational efficiency and growth potential.
- Conservative projections: avoid over-optimism and stress-test models under various scenarios.
- Strong management team: capable, experienced and aligned with the investor's goals.
- Flexible financing: covenants that provide flexibility in challenging economic conditions.
- Diversification: spread investments across industries and geographies to reduce exposure.

Increasing the Likelihood of Success

- LBOs are inherently risky, but investors can take steps to mitigate the risks.
- Carefully evaluate risks and implement appropriate mitigation strategies.
- This increases the likelihood of successful LBO outcomes.

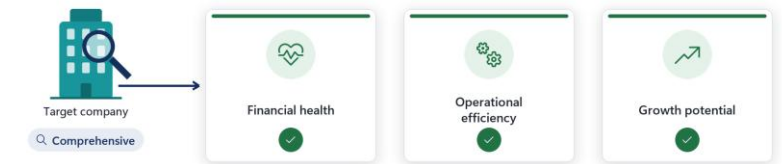
Risks and Mitigations of LBOs (Part 2)

Mitigating LBO risks



Risks and Mitigations of LBOs (Part 2)

1 Thorough due diligence Mitigation



Risks and Mitigations of LBOs (Part 2)

5 Diversification Mitigation

