

Daniel Pindur

Value Creation in Successful LBOs

With a foreword by Prof. Dr. Frank Richter

Deutscher Universitäts-Verlag

Detailed Contents

I. Introduction	1
A. On the Status of Research on Value Creation in LBOs	3
1. Theoretical Approaches to Analyzing Value Creation in LBOs	3
1.1 Neoclassic Financial Theory	4
1.2 Institution Economics	6
2. Empirical Work to Assess Value Creation in LBOs	10
2.1 Premia-Paid Analysis in Public-to-Private Transactions	11
2.2 Operational Performance Studies	14
2.3 Private Equity Performance Studies	17
B. Shortcomings and Research Gap	21
1. With Respect to the Research Object	21
2. With Respect to the Perspective of the Analysis	23
3. With Respect to the Notation of Value Creation	25
C. Research Design to Assess Value Creation in LBOs	26
II. Preparatory Considerations for Value Creation Analysis in LBOs on Investment Level	31
A. Research Object: Realized LBO Investments	31
1. Defining Leveraged Buyouts	31
2. The LBO Investment Process	33
3. Modes of Entry for LBO Investments	35
3.1 Public-to-Private Entry (Going Private)	36
3.2 Private-to-Private Entry	37
4. Modes of Exit for LBO Investments	39
4.1 Private-to-Public Exit (Going Public)	40
4.2 Private-to-Private Exit	42
B. Perspective: Equity Investors in LBOs	44
1. The Concept of Sources and Uses in LBOs	44

2. Equity Financing Instruments	47
2.1 Common Stock	47
2.2 Quasi-Equity Financing Instruments	48
3. Debt Financing Instruments	50
3.1 Senior Debt	50
3.2 Subordinated Debt	50
C. Objective Function: Value Creation in LBOs	52
1. Total Proceeds to Equityholders in LBOs	53
2. Accounting for the Uncertainty of Total Proceeds or What's the Right Discount Rate	54
3. Value Creation Performance Measures	59
3.1 The Concept of Times Money	60
3.2 IRR as Timing-Adjusted Performance Measure	61
3.3 Alternative Performance Measures	64
III. Value Creation Analysis in the Context of the LBO Transaction Model	67
A. The LBO Transaction Model	67
1. Financial Leverage and the Variation in the Entity and Equity Market Value	67
2. Components of Total Proceeds to Equity Investors	69
3. Perspectives of Value Creation in LBOs	71
B. Internal Perspective: FCF Effects	74
1. Principal-Agent Theoretical Considerations	74
1.1 A Clarification of Agency Costs	75
1.2 Reducing Agency Costs in a LBO Governance Structure	82
2. Management Support	90
2.1 The Impact of the PE Fund and the LBO Organizational Form	90
2.2 Means of Equity Investor's Operational and Strategic Involvement	92
3. Wealth Transfer Hypotheses	95
3.1 Wealth Transfer from Bondholders	95
3.2 Wealth Transfer from Employees	97

3.3 Wealth Transfer from the Government	98
C. External Perspective: Variation in the Transaction Multiple	100
1. Conceptual Valuation Framework	101
1.1 The Risk-Neutral Valuation Theorem	102
1.2 The Binomial Cash Flow Model	102
1.3 Valuation with Multiples	105
2. From the Valuation to the Transaction Multiple	108
2.1 Market Timing, Supply and Demand and the Impact of the Capital Market Environment	109
2.2 Information Asymmetries and Competition in the Divestment Process	116
IV. Research Model, Derivation of Hypotheses and Operationalization of Variables	125
A. Research Model	125
B. Derivation of Hypotheses and Operationalization of Independent Variables	126
1. Internal Perspective: FCF Effects	127
1.1 Agency Cost Reduction Related	127
1.2 Management Support Related	132
2. External Perspective: Variation in the Transaction Multiple	137
2.1 Conceptual Valuation Framework Related	137
2.2 Capital Market Environment Related	140
2.3 Information Asymmetries Related	143
3. Control Variables	146
C. Operationalization of Dependent Variables	153
1. Internal Perspective: FCF Effects	153
1.1 Operating Cash Flow	154
1.2 Net Investing Cash Flow	158
2. External Perspective: Variation in the Transaction Multiple	158
3. LBO Performance Measures	159
V. Empirical Analysis	161
A. Data Sample	161

1. Investment Selection Criteria	162
2. Potential Sample Bias	166
3. Tests for Representativeness	168
B. Methodology	171
1. Financial Data	171
2. Statistical methods	174
C. Independent Variables Descriptive Statistics	176
1. Control Variables	176
2. Purely Internal Perspective Related	178
2.1 Agency Cost Reduction Related Aspects	178
2.2 Management Support Related	182
3. Purely External Perspective Related	183
3.1 Conceptual Valuation Framework Related Aspects	183
3.2 Capital Market Environment Related Aspects	185
3.3 Information Asymmetries Related Aspects	187
D. Total Proceeds to Equity Investors	189
1. The LBO Transaction Model	189
1.1 Financial Leverage and (he Variation in the Entity and Equity Value	189
1.2 Components of Total Proceeds to Equity Investors	195
2. Internal Perspective: FCF Effects	200
2.1 Operating Cash Flow	200
2.2 Net Investing Cash Flow	213
2.3 Cumulated FCF Generation	214
2.4 Internal Perspective Intermediary Results	220
3. External Perspective: Variation in the Transaction Multiple	224
3.1 Descriptive Differences by Exit Mode	226
3.2 Variation in the Transaction Multiple of IPO Exited LBOs	227
3.3 Vanation in the Transaction Multiple of Secondary Buyout Exited LBOs	231
3.4 External Perspective Intermediary Results	234

E. Relative LBO Performance Measures	235
1. Times Money Analysis	236
LI Times Money Descriptive Statistics and Decomposition	236
1.2 Separating Steady vs. Improved Operational Performance	239
1.3 Times Money and the Length of (he Investment	240
2. Investment IRR Analysis	241
2.1 Investment IRR Descriptive Statistics	241
2.2 Investment IRR Sensitivity Analyses	246
2.3 Investment IRR Inferring Statistics	250
3. Alternative Performance Measures	252
3.1 Excess Investment JRRs	253
3.2 Standardized NPVs	253
3.3 LBO Performance Measure Correlation Analysis	256
VI. Conclusion	259
A. Components of/and their Relative Cottribution to Value Creation Measures	259
B. Determinants of Value Creation in LBO Investments	263
C. Discussion and Outlook	267
Appendix	271
Bibliography	287