Leveraged Buyout as a financing form of M&A

M & A market is functioning at a high level in Ukraine. In the last year there has been an increase in amount of 20 %, till EUR605,3 millions. Actually, we should mention, that it is still growing market now and in that case, acquiring capital and the optimal financing terms for M&A transactions is surely a tricky task for Ukrainian companies. The challenge is to secure the right financing mix with the least cost of capital. The sub-prime lending crisis in the past and prolonged sluggishness in the global economy in the past couple of years has led to significant alterations in our financial system and the way people perceive risk. Thus, one of the most popular forms of M&A is Leveraged Buyout. Technically defined, LBO is a purchase of a public/ private company or the assets of a company which is financed by a mix of debt and equity.

Leveraged buyouts originally began back in the 1970’s. They increased in frequency throughout the 1980’s as a result of the advent of the junk bond market. One of the most popular examples of a leveraged buyout in the current news media is the case of Dell’s takeover by private equity.
The deal is worth about $60 billion with two-third of it financed by debt. Large-scale LBOs have generally been less common within M&A, but due to the debt market’s availability in recent years, this deal has proven that LBOs are becoming a savvy move for businesses of all sizes. This deal with Dell has illustrated how advantageous it could be for other large companies to break into the M&A market, with the debt market wide open and the overhang of capital currently held by private equity groups working to their advantage.

The core idea behind LBOs is to compel organizations to produce a steady stream of free cash flows to finance the debt taken for their acquisition. This is mainly to prevent the siphoning off of the cash flows to other unprofitable ventures.

So, leveraged buyout we can suggest as a healthy way to create value for the company. It can be proposed as a means of improving operating performance by restoring strong, constructive relationships among owners, managers, and other corporate stakeholder. Moreover, sometimes it can be as a useful format for effective governance of corporations. And of course, under the right conditions, LBOs are not merely deals. They represent an alternative model of corporate ownership and control just as public ownership, venture capital ownership, and franchise arrangements do.LBO is adaptable to a much wider universe of businesses than commonly assumed—including not only the underperforming low-tech companies that have

fig.1 "Scheme of the M&A transaction"
long been associated with LBOs but also neglected divisions and other pieces of corporations with potential for growth and an appetite for investment.

All LBO acquisitions are made with the goal in mind of improving the company, paying down debt, and selling the company for a handsome profit. There are three typical exit strategies for a private equity LBO transaction:

- **Sale:** Can sell company to another financial sponsor or a strategic buyer;
- **IPO:** This is usually not a full sale of the company, however it offers an opportunity to realize a significant return on investment;
- **Recapitalization:** The equity holders may recapitalize by borrowing new funds to re-leverage the company and take cash out of the company to realize part of their investment.

Don’t forget about some shade sides of LBOs, however, let’s consider also some potential disadvantages. If the company's cash flow and the sale of assets are insufficient to meet the interest payments arising from its high levels of debt, the LBO is likely to fail and the company may go bankrupt. Another disadvantage is that paying high interest rates on LBO debt can damage a company's credit rating. Finally, it is possible that management may propose an LBO only for short-term personal profit.

**References:**