

## Are leveraged buyouts on the rise?

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Nirma probably won't be the last LBO. Photo: Ramesh Pathania/Mint

Are leveraged buyouts on the rise? The short answer is yes.

More than eight out of every 10 leveraged buyouts (LBO) that happened in post-liberalization India took place after 2007, shows an analysis of Thomson Reuters data. Of the 83 such completed deals since 1991, 68 have happened after 2007.

The latest of these was when washing powder maker Nirma Ltd announced its purchase of Lafarge India Pvt. Ltd's cement assets earlier in the week. Nirma will raise around ₹4,000 crore in debt for its purchase through a bond issuance which will be financed by Lafarge's cash flows.

An LBO is a deal which is mostly financed by debt. The acquiring company finances the debt by using the target company's assets or cash flows.

Thomson Reuters defines an LBO as one where an investor or firm offers to acquire a company, taking on an extraordinary amount of

debt, with plans to repay it with funds generated from the company or with revenue earned by selling off the newly acquired company's assets. Only completed deals were considered for the analysis. The data does not split between domestically-funded LBOs and dollar-funded LBOs.

Interestingly, the trend of more LBOs in the post-2007 phase is not restricted to India. A similar trend is seen across other emerging markets as well. Major emerging markets like Brazil, Russia and China all saw a significant chunk of their LBOs happen in 2007 or later. The figures are 83% for Brazil, 81% for Russia and 75% for China; compared to 82% for India. Although deal values are not always made public perhaps because many are led by private equity investors whose obligations to make disclosures are limited, an examination of trends in disclosed deal values also show an upward spike in this period.

This is even as global LBO volume has been on the decline. The rolling three-year average annual deal value for global LBOs was \$152.87 billion in 2006, according to *Bloomberg* data. This is down to \$81.86 billion in 2015. The rolling average number of deals also fell from 100 to 59 in the same period.

What explains all this? The US economy entered a recession in 2007, with global volatility peaking in 2008 and 2009. Lower interest rates and easy liquidity conditions became the norm afterwards. The low-interest-rates regime established itself even as emerging economies began to do relatively better than advanced ones.

The International Monetary Fund (IMF) noted in its January 2016 World Economic Outlook that emerging markets and developing economies accounted for 70% of global growth. A possible reason for increase in emerging market LBOs could be cheap money chasing economies which were doing relatively well.

To be sure, not all emerging economies are performing well now. While commodity exporters like Brazil and Russia are facing a slowdown, India has maintained its high-growth trajectory, something which was also noted by the IMF report.

There is reason to believe that unless economic recovery takes off in advanced economies, the spurt in LBOs in emerging markets will continue.

Financial (rather than strategic) investors are likely to help. Mehul Savla, partner at RippleWave Equity, said that the rise in LBOs is largely driven by private equity or buyout funds. Such funds often look to buy a majority stake in entire companies when they are seen to be trading below their intrinsic value. Then they may monetize some of the assets for a profit. An opportunity is now seen for any fund which wants to buy into the emerging market story.

"There is a lot of liquidity, and they would want to lock into great financing terms with interest rates low or negative in many developed nations," he said.

The World Bank's June 2016 Global Economic Prospects Report noted that interest rate regimes are not tightening just yet.

"With increasing downside risks to growth, and inflation persistently below target, the European Central Bank (ECB) and Bank of Japan are pursuing further policy accommodation, while the US Federal Reserve will normalize policy interest rates more slowly than expected in January," it said.

Lower interest rates make it easier to fund such transactions.

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