

**Do Management Buyouts of US Companies Demand Higher Premiums
than UK Companies? Why?**

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I. INTRODUCTION

“Control Premiums” and “Synergies” help justify most discrepancies between the market price of an asset and the price a buyer actually pays to acquire the asset.

That is not necessarily the case in Leveraged Buyouts (LBOs) and more specifically Management Buyouts (MBOs). For the purpose of this research we define MBOs as transactions where a public company goes private and the management of the company is part of the buying consortium.

MBOs do not have synergies in most cases. Unlike an acquisition, the company continues to run as it was doing before going private. No two assets are being put together to generate synergies. Control premium theory also does not provide enough justification for the ~35% premium on average (over all MBO transactions since 1st Jan 2000) that MBOs require. In most MBOs the management’s share in the company does not change significantly before and after the transaction. The control does change hands, from shareholders to the new equity holders (PE players etc.) but that does not explain why management would be willing to pay a premium.

MBOs and LBOs share a common characteristic, benefit from leverage, that partially drives their premiums. In this paper we have attempted to develop a better understanding of the drivers of MBO premiums through a specific observation: significant difference in premiums paid in US MBOs and UK MBOs when no such difference exists between US and UK for LBOs and for general acquisitions.

In Section II of the paper we talk about the minimal previous research that has been done in this area, Section III outlines the data source and attributes that we have used in our research. In Section IV we establish the existence of a statistically significant difference between MBO premiums in US and UK and that no such difference exists for LBOs and general acquisitions. In Section V we analyze the transactions with respect to the various hypothesis that could potentially support our observations and demonstrate why none of them seem to be valid and finally in Section VI we provide our conclusion and some suggestions for future research.

II. PREVIOUS WORK

Not much systematic research has been done on the drivers of MBO premiums or on identifying or understanding differences in MBO premiums in different parts of the world. Renneboog, Simons and Wright[2] have done some research on the sources of shareholder wealth gains of UK going-private transactions, but nothing specific to MBOs and nothing to differentiate MBOs from LBOs.

III. DATA

i. Data Description

We are analyzing Premiums paid in Management Buyouts. We define Management Buyouts as Leverage Buyouts where Management was part of one of the bidder groups who eventually won the transaction. Specifically, we are looking at transactions from Jan-2000 to Oct-2006 with Transaction Size > \$50 million. We have 47 MBO transactions with UK targets and 52 MBO transactions with US targets that meet the above criteria.

The key quantitative aspects of the transactions which we collected and have used in our analysis are:

- Target nation. Target industry
- Final premiums, 1-day, 1-week and 4-weeks prior to the announcement date
- Initial premiums, 1-day, 1-week and 4-weeks prior to the announcement date
- Increase in premium between initial and final offer
- % ownership of the acquirer (management team in case of an MBO) prior to the transaction
- Number of bidders

ii. Data Source

We are using SDC to get data described above. SDC has flags that allows the user to choose: 1) Date range of transaction, 2) Leveraged Buyouts, 3) Management Involvement, 4) Transaction value range, hence allowing us to get exactly the data that we require. We further used Factiva to do a detailed analysis of a small subset of the transactions by going through relevant news articles around the dates of the transaction. This analysis helped us understand in further detail the nuances of the transactions and verify some of the data we obtained through SDC database.

IV. PREMIUM ANALYSIS

A detailed analysis was performed on the premiums paid during transactions involving US and UK targets that were announced between 1st January, 2000 and 31st October, 2006. The summary of the same is given below:

Table 1: Summary of Average Premiums Paid for US and UK targets during various transactions

	# of Transactions	1-Day	1-Week	4-Weeks
LBO-US	168	28.25%	31.25%	34.21%
LBO-UK	86	26.38%	31.19%	31.29%
Difference		1.87%	0.06%	2.92%
MBO-US	52	36.27%	42.08%	44.69%
MBO-UK	47	26.39%	31.19%	32.48%
Difference		9.88%	10.89%	12.20%
All-US	2250	28.40%	32.25%	36.77%
All-UK	491	27.21%	31.24%	32.86%
Difference		1.19%	1.01%	3.92%

As can be seen above, Premiums paid for US targets are significantly higher than the premiums paid for UK-targets for Management Buyouts, while the difference is negligible for LBOs (a super set¹ of MBOs) and All-transactions (a super set of LBOs). Further, the difference – 9.88% for 1-Day prior to announcement premium, 10.89% for 1-Week prior to announcement premium and 12.20% for 4-Weeks prior to announcement premium is statistically significant as demonstrated by the t-value tests. t Statistic for the 1-Day prior premium is 1.85, for the 1-Week prior premium is 1.89 and the 4-Weeks prior premium is 2.34.

Further detail of the distribution of the premiums paid during Management Buyouts of US and UK targets (histograms) are provided in Exhibits 1, 2 & 3. The histogram for US MBO transactions are skewed right. To verify that it was not just a few blockbuster deals in US that was causing the right skew and our

¹ Set A is a super set of set of set B if all transactions in set B are also in set A. By definition given in Section III, LBO transactions is a super set of MBO transactions and All-Transactions is a super set of LBO transactions.

higher mean premium, we analyzed the distribution more carefully. We looked at the medians, 75th percentile and 90th percentile premium values for US and UK.

The data demonstrates that even the median premium value for the 4-Weeks prior premium between US and UK MBOs differs by around 10.5%. Further the difference increases as we go to higher percentiles (19.7% for 75th Percentile and 17.56% for 90th Percentile). To verify that the difference in the means of the two distributions is statistically significant, we performed the Wilcoxon Rank-Sum test. The Wilcoxon Rank-Sum test confirms that the US MBO 4-weeks prior premiums are greater than the UK MBO 4-weeks prior premium with alpha = 0.05 and US MBO 1-Week prior premiums are higher than the corresponding UK premiums for alpha = 0.1.

We believe that the 4-Week prior premium is the most reliable metric strongly confirming our hypothesis that US MBO premiums are significantly higher than UK MBO premiums.

V. TRANSACTION ANALYSIS

Having established the significance of the difference in premiums paid in MBOs of US targets vs. UK targets, we looked at the various transactions in further detail in order to find possible reason for the difference.

Number of Transactions: The number of MBO transactions is US and UK is very similar – 52 vs. 47, hence this probably does not help in explaining the discrepancy.

Size of Transactions: UK Transactions in general are of a smaller size than US transactions (almost 1/3rd on average). It is not clear intuitively whether smaller transactions should get a higher premium than larger transactions or lower.

Correlation between Enterprise Value of the deals and premium compared to 4-Weeks prior is -0.26 for UK MBO transactions and -0.17 for US MBO transactions. Both the values are small and negative probably implying that smaller deals get higher premiums which runs counter to what we observe between US and UK where UK has smaller deals but have lower premiums.

Competition: MBO transactions in US seem to be more competitive than UK MBO transactions. Couple of data points that help understand this further are given below:

1. Almost all UK MBO transactions had a single bidder. Only 1 transaction had 2 bidders leading to an average of 1.02 bidders per transaction. On the other hand, for US MBO transactions the equivalent number is 1.1. 5 out of 52 transactions had more than 1 bidder.
2. An interesting (though unexpected) related observation is that the final premiums paid for transactions with more than 1 bidders are *not* significantly different (one would expect them to be higher) than the overall average. For example, the average premium paid for the 5 US MBOs which had more than 1 bidder is 38.72%, 44.81% and 41.14% for 1-Day prior, 1 Week prior and 4 Weeks prior to announcement respectively. This is very similar to the average

- premiums paid for all US MBOs – 36.27%, 42.08% and 44.69% for 1-Day prior, 1 Week prior and 4 Weeks prior to announcement respectively.
3. On the other hand, quite contrary to our expectations, the initial premium offered for transactions with more than 1 bidder is 18.61%, 23.92% and 22.37% for 1-Day prior, 1 Week prior and 4 Weeks prior to announcement respectively which is around 10% lower than the average initial premium paid for all US MBOs.
 4. A more drastic data point is the % change in Final Price offered as compared to the Initial Price offered. For UK MBOs this number is only 0.68% implying that for most deals, the initial offer is accepted as-is, or that the negotiations result in very little change from the initial offer. On the other hand for US MBO transactions, the equivalent number is 7.70%! This implies that the final offer for the MBO transactions on an average is 7.70% higher than the initial offer indicating that the bidding and negotiation process was intense and quite competitive.

Table 2: Comparison of Initial & Final Premiums Paid for US and UK targets during MBOs

	1-Day	1-Week	4-Weeks
MBO-US-Final	36.27%	42.08%	44.69%
MBO-UK-Final	26.39%	31.19%	32.48%
Difference	9.88%	10.89%	12.20%
MBO-US-Initial	27.76%	32.43%	35.50%
MBO-UK-Initial	24.40%	28.98%	30.19%
Difference	3.36%	3.45%	5.31%

5. Finally, a very interesting observation is that the difference in the initial premium (i.e. premiums calculated based on the initial offer) between US MBOs and UK MBOs is significantly smaller than the difference in the final premiums (Table 2).

Based on 1, 2 & 3 above, we can conclude that although there is a slight difference between the number of bidders in US MBOs and UK MBOs (US MBOs having slightly higher number of bidders on average), that does not by itself explain the higher final premium paid in US MBOs. In fact, we observe that transactions which have multiple bidders have lower initial offer premiums probably implying that low initial offer premiums attract other bidders driving the bids up to a high final premiums. This points towards a more competitive bidding environment in US and highlights one probable reason why even transactions with single bidders have final premiums close to the final premiums of transactions with multiple bidders; the fear of multiple bidders.

4 & 5 above clearly demonstrate that although the US environment requires a higher premium upfront as part of the initial offer, a key difference arises between the announcement date and the completion date, probably due to the way the process is conducted even when there is a single bidder.

Ownership Structure: Another possible hypothesis was the difference in ownership structure causing the difference in premiums i.e. higher % ownership of acquirer in UK prior to the transaction causing a reduced competition and lower premiums paid. Interestingly the average % of company owned by the

management led team prior to the transaction in UK is around 9% and is lower than % held prior to transaction in US which is around 18.5%. Hence this does not support the hypothesis that larger pre-transaction ownerships in UK leads to lower premiums. Even for the cases where pre-transaction ownership by MBO team is non-zero, ownership in UK (38%) is lower than ownership in US (42.5%). Further, the correlation between % ownership prior to transaction and premium 4 weeks prior for UK is 0.067, hence almost no correlation. For US the equivalent number is 0.10324. Hence the correlation is extremely low and probably not significant enough for us to make any conclusion about the relation between pre-transaction ownership structure and premiums paid.

Detailed UK Transaction Analysis: To further understand the UK transactions, we randomly sampled 7 UK deals and followed the transactions through various Factiva articles. Our key observations are:

1. In all the cases the deal was not awarded directly to the management led team. In all cases the independent board rejected the original offer (in some form or shape) and opened it up for competitive bidding.
2. In spite of the existence of competitors in some cases who kept increasing their stake in the company, in no case did that translate into a counter offer. Hence, in all the cases management led team was the only party to officially make an offer to the board. This could have been because of other factors such as “the need of approval from RBS” to make a bid for Macdonald hotels when RBS was supporting the management led team.

Hence, although procedurally boards in UK do open up the process for competitive bidding, there are probably other not so obvious factors that keep the process from being truly competitive.

VI. CONCLUSION

In this article we started with a discussion about the factors that drive Management Buyouts and how that is significantly more complicated than explaining premiums of general acquisitions. We further focused on the differences on premiums paid in Management Buyouts in UK and US, first demonstrating that the difference is statistically significant and then exploring the various obvious hypothesis of why the differences could exist. In our research we have demonstrated that none of the most obvious hypothesis e.g. higher number of transactions in US, higher management ownership in UK, difference in transaction size in US and UK, seem to be consistent with our observations of the premiums in US and UK MBOs.

We did find indications of US MBO environment being more competitive than in the UK with noticeable differences in premiums arising between the first offer and the final offer. This is probably due to way MBOs are conducted in US vs. UK but our research is inconclusive about what exactly in the US process leads to higher premiums or what in the UK process keeps the premiums low on a general basis.

As part of our research we have identified two key areas which warrant further investigation and might bring us closer to understanding the driving factors of the premium differences between US and UK MBOs.

First is the difference in leverage ratios in US and UK. US transactions seem to be much more levered as compared to the UK transactions[2]. If UK markets in general allow lower leverage this might help explain why acquirers might be able to extract a lesser value with a LBO type structure in UK as compared to US which might translate into lower premiums paid in UK LBO and MBO transactions. It is still not clear if this will help explain why the difference exists between US and UK only for MBOs and not for LBOs.

Another issue worth further exploration is the issue of “irrevocable commitments” in UK transactions[1]. In general, a bidder in US can withdraw his bid at any time, at least prior to the execution of the merger agreement. If the bids in the UK cannot be withdrawn as easily, it would not be surprising for managers to bid lower price, since their risk in the deal is not diversified across many deals. Further research into the structure of “irrevocable commitments” in UK might help clarify the impact of those on the premiums paid. Again it needs to be seen why the impact is seen primarily for MBOs and not for LBOs in the two countries.

EXHIBITS

Exhibit 1: 1-Day Prior Premium Histogram comparison of MBOs of US and UK targets

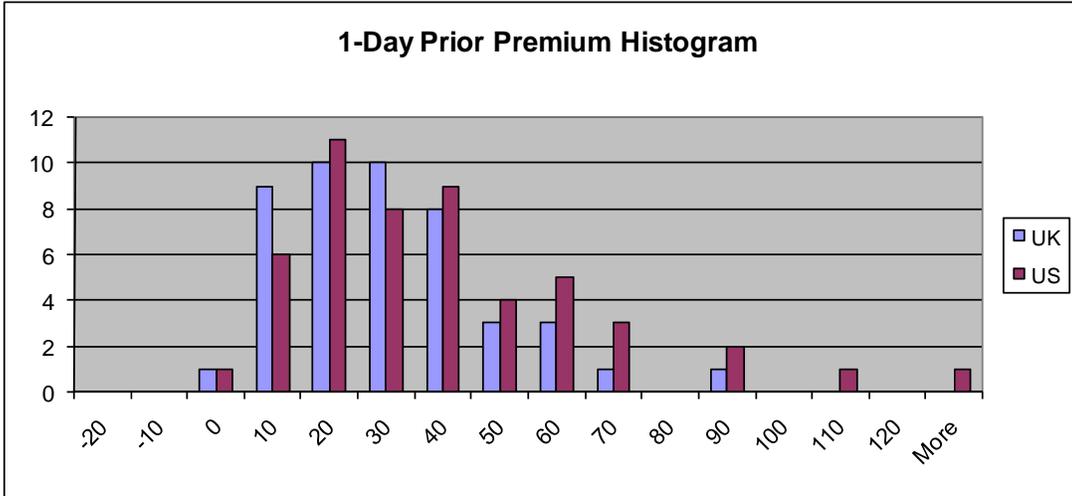


Exhibit 2: 1-Week Prior Premium Histogram comparison of MBOs of US and UK targets

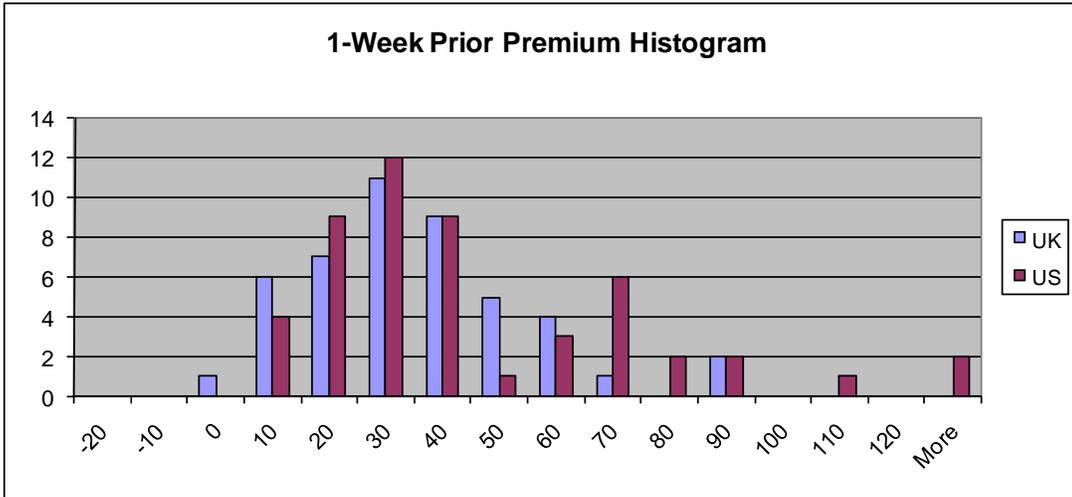
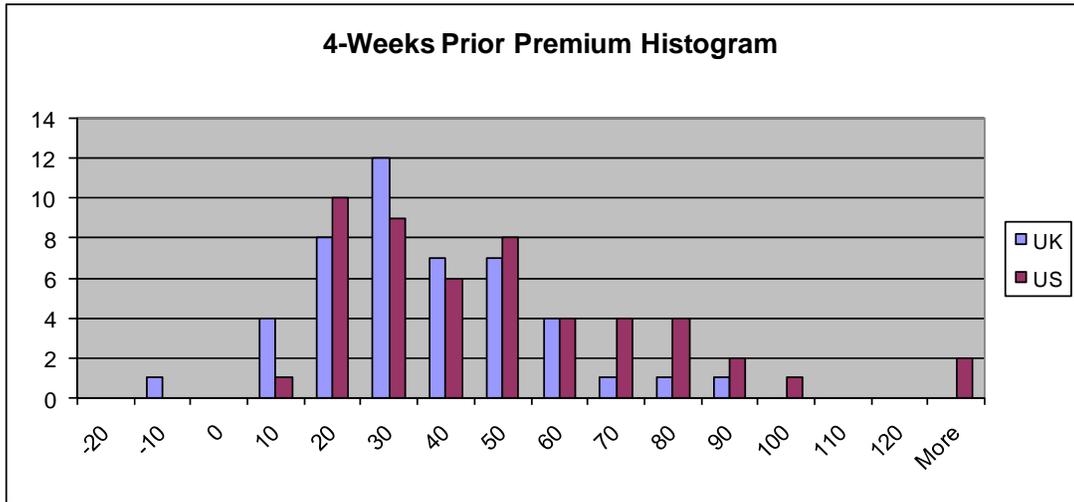


Exhibit 3: 4-Weeks Prior Premium Histogram comparison of MBOs of US and UK targets



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1. Wright, M., Weir, C.M. and Burrows, A. 2007. "Irrevocable commitments and going private", *European Financial Management*, (in press)
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