ABSTRACT

This chapter reports on the post-offering performance of 114 US firms that went public between 2000 and 2008 following leverage buyouts. The objective of this paper is to examine accounting performance of following reverse leverage buyouts compared to the industry competitors before, at the time of, and the following four years after initial public offering. In addition to accounting performance measures, capital expenditures, working capital and employment levels are also compared to rival firms. The evidence indicates that the RLBO corporations have superior accounting performances compared to their industries exact year of IPO and following years after public offering. Also, the RLBO corporations have less operating income compared to the reverse leverage buyout firms in previous studies, but have more operating income and operating cash flows than their industry counterparts. The RLBO firms typically make less capital expenditure except the IPO year and four years after the initial public offering.

1. INTRODUCTION

In last two decades, intense public examinations have surrounded around the reverse leverage buyout phenomenon that had been previously bought out by another corporation or special private equity entrepreneurs and investors. The goal of reverse leverage process differs from one company to another, while it is also related to firms’ sizes. The initial purpose of Leverage Buyout process is to reduce inefficiencies and to improve performance.

Happern, Kieschnick & Rotenberg (1999) find that the leverage buyout companies have better growth prospects and lower Tobin q values than the rest of the publicly traded firms in associated industries. Similarly, Jensen (1989) documents leverage buyout companies have less motivation problems especially in the sectors with less growth opportunities. Moreover, Degeorge & Zeckhauser (1993) cite that the accounting performances of
reverse leverage buyout corporations exceed their counterparts in the year before and at the time of the initial public offering, but deteriorate thereafter.

Kaplan (1997), in explaining the trends in 1980s, gives important clues about the RLBOs behavior in general:

*In the first half of the 1980s, the LBO insights led to great success. Buyout companies experienced improved operating profits and few defaults. Adjusting for the overall stock market or industry these early buyouts generated abnormally positive returns. Because the overall stock market increased over this period, buy out sponsors earned substantial nominal returns.*

In this paper, 144 reverse leverage buyout corporations that returned to initial public trading between 2000 and 2008 are examined. We examine the performance of these reverse LBOs as well as the changes in their organizational structures (in terms of leverage and employment level). In addition to the expenditure decisions of the reverse leverage buyout firms, the working capital management is also investigated in order to have a better understanding on the position of the reverse leverage buyout companies compared to their industry counterparts. We also analyze the degree of changes in performance and change in the working capital management associated to the changes in organizational structure. To perceive the relationships between change in performance and change in debt, capital expenditures, working capital and employment management, sectional and cross-sectional analysis are conducted.

The results show a decrease in the mean leverage ratio, although the leverage level of reverse LBO firms remains high compared to their industry peers. However, the reverse LBO sample used in this paper has lower debt level compared to the ones in the past studies. The change in debt/capital of post-IPO period was found as -23% by Holthausen & Larcker (1996), but we find -35% or -36.45% for/with the firms (including those have zero debt mentioned in their 10-Ks) which can be seen from the Table 2 Panel A. Moreover, the accounting performance of reverse leverage buyout firms has better position than the industry counterparts (the evidences suggest a weakness in performance in the second year) and continue to outperform throughout the years. Also, the evidence shows that the reverse leverage buyout corporations spent less on capital expenditures than their peers in associated industries, except the year of the public offering and four years after the initial public offering differently than Holthausen & Larcker (1996) as mentioned earlier. With respect to working capital management, the evidence suggests that reverse leverage buyout companies carry less working capital than their industry equivalents. It needs to be mentioned that although the RLBO corporations increase their working capital, the working capital remains at a lower level than peer firms. In terms of employment intensity, there is not much difference found between reverse LBO firms’ staffing level and their associated industries. Yet, the evidence refers a continuous increase in employment level starting from the two years after initial public offering and shows continuity to four years after the offering.

The plan of this paper is as follows: the next section covers conceptual issues and the literature review. The third section discusses the role of the leverage level in reverse leverage buyout firms. Section three states the formal hypotheses. Section four discusses data and methodologies which are used in this study. The results are given in section five, with subsections discussing accounting performance, median levels of working capital, capital expenditures and employment level are analyzed. Section six concludes the paper.
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