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# Private Equity and the Privatization of Public Companies - A Case Study

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## PREFACE

The authors would like to grasp the opportunity to express their appreciation to the persons that supported the making of this thesis. First of all, we would like to thank our tutor, Ted Lindblom, for providing us with relevant insights, points of views and criticism and Stefan Sjögren who gave us advice on interesting thesis approaches. Furthermore, we would like to express gratitude to lecturer Taylan Mavruk of the Industrial and Financial Institution at Gothenburg School of Business, Economics and Law for giving us advice and helping us during the teambuilding activities in Istanbul, Turkey.

Last, but far from least, we would like to thank Cem, for always cheering us up and leading the way.

The process of this research has been very interesting and has provided us with insight to a topic of high contemporary interest. We hope that the thesis will make the reader curious and eager to further indulge in the subject.

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## **ABSTRACT**

### Private Equity and Privatization of Public Companies – A Case Study

Due to an increased search for profitable investments in a less volatile world, firms specialized in acquiring companies quoted on a stock exchange have been granted more and more attention by media. These firms, called private equity firms, seek potential target companies where rationalization and efficiency improvements can be achieved by going private. Private equity firms use large amounts of debt when acquiring these companies which is why these transactions are called leveraged buyouts (LBO). The purpose of this study is to highlight the different incentives, financial as well as non-financial, triggering buyout activities by private equity firms. These kinds of studies can be found in the US and the UK but no similar study has been conducted on the Swedish stock exchange which is why this thesis is a case study on the Swedish market. The selected sample has been determined to Capio AB, Gambro AB, and NEA, all involved in LBOs during 2006.

By using a deep qualitative research approach combined with statistical data, common factors for buyout activity have been identified. Factors as hidden values, capital structure, strategy and efficiency improvements, and more focus on long-term performance by replacing the management and board, seemed to be important when selecting buyout targets. The findings on this sample demonstrated that there were many implied reasons for a private equity firm to conduct a buyout. The characteristics found for the case companies could be related to financial theory. A peer group of companies from relevant industries was used to see if the case companies displayed unique buyout characteristics. This peer group confirmed that some certain characteristics of the case companies stood out when compared. However, a larger sample of firms should probably display more significant characteristics and make this kind of study more valid.

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**Key words:** Private Equity, LBO, Buyouts, Swedish Stock Exchange, Value Creation, Agency Costs, Capio AB, Gambro AB, NEA

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# 1. INTRODUCTION

## 1.1 Background

*“The last share of a publicly traded common stock owned by individuals will be sold in the year 2003, if current trend persists.”*

Jensen (1991) wrote this in an article referring to the privatization trends on the American stock market. At the time, the American stock market had seen large restructurings derived from private equity companies buying out firms from individual stockholders. The trend was evolving into individuals investing money in mutual funds rather than directly on the stock market which transferred power to the capital markets. As a consequence, in the United States during the 1980s, leveraged buyouts (LBO), manager buyouts (MBO), share repurchases, leveraged mergers & acquisitions, and takeovers boomed (Jensen, 1991). Between 1979 and 1989, over 2000 LBOs took place in the American corporate sector and the climax were reached in 1989 when Kohlberg, Kravis and Roberts (KKR) acquired RJR-Nabisco for \$25 billion in an LBO takeover (Opler and Titman, 1993). Corporate leverage increased heavily and many firms that were not taken over, quickly restructured their corporate structure in response to the mere threat of takeovers (Holmström and Kaplan, 2001). The reasons triggering this buyout activity were first and foremost the potential for improved corporate governance together with increasingly powerful investors seeking profitable investments. Nevertheless, turbulence on the US capital market following the “Black Monday” 1987 led to a sharp decline in LBO activity in the late 1980s (Allen, 1996).

In Europe, the private equity industry have seen substantial growth more recently, where the UK have faced a similar development during the 1990s as the American market in the 1980s, with some 37 public to private transactions from 1990-1997. This buyout spree escalated in 1998-2000, when a total of 116 public firms were removed from the stock market in leveraged transactions (Weir, Laing, and Wright, 2005). Most notably is the growth in Germany, which has become number one in buyout activities in Europe (Bance, 2002).

In Sweden, the private equity business of buyouts from the stock market has seen a more modest development. In recent years, several companies have been bought out from the Swedish stock market ([www.omx.com](http://www.omx.com)). Moreover, Sweden has had the worlds highest growth rate of private equity investments with an annual average of 188 percent from 1995-2000 (Arundale, 2001).

The common view of private equity firms have changed significantly over time. In the 1980s, the rise of the LBO activity led to a controversial public discussion where private equity firms were pictured as corporate raiders or vultures feasting on companies facing difficulties out of pure greed. That view has changed and today the common belief is that private equity companies actually are able to create value and help poorly managed firms. Especially the unravelling of corporate scandals (Enron, Worldcom, Skandia) shed light on the flaws of corporate governance systems. Thus, LBOs have introduced a novel mechanism for acquiring listed firms with agency problems and organizational slack with the aim of creating a more efficient governance structure (Weir et al., 2005). LBOs thereby replace the public monitoring of the firm with a private monitoring based on leverage, strong ownership and active investors. This is to prevent poor managerial accountability and substantial deviations from shareholder wealth maximization (Thompson and Wright, 1995). Evidently, Jensen's "predictions" from 1991 were not completely correct and that is due to continuous initial public offers of new firms on the stock market. However, many firms have been taken private and the interesting thing is to see what common characteristics can be found for these.

## ***1.2 Problem Discussion***

Private equity and LBOs have evidently been a topic of argument in recent years. This controversy can perhaps be related to the facts that LBOs make some people very wealthy while other are left worse off (Opler and Titman, 1993). The development of the private equity investments has seen a significant increase in Sweden the last decade. In magazines and newspapers, a debate has arisen whether LBOs create wealth or just merely redistributes it, and also how the firms respond to the high leverage in times of economic downturn. For example, the credit rating agency Standard and Poor's claims that Swedish private equity firms increase the leverage to a point that results in financially unstable LBO companies ([www.e24.se](http://www.e24.se), 2006-11-03). Further, they believe that these activities might be justified during a boom economy, but will probably result in many defaults during slowdowns. As described in the background, the long history of private equity investments in the US and UK have resulted in numerous studies on the topic. However, since this is a quite recent phenomenon in Sweden no major studies have been conducted. Therefore, we have chosen to carry out a study on Swedish LBOs, as we believe that the issues discussed in the studies of other countries might be applied on the Swedish market as well.

### **1.2.1 Private Equity and Buyout Activity**

A dramatic increase in LBOs has take place over the last 30 years. The term buyout is usually used for companies that are "taken private", i.e. the company's equity is purchased and removed from publicly traded securities markets (Bruton, Keels, and Scifres, 2002; Fox and Marcus, 1992). The trend started in the US and was a consequence of the inefficiency in

corporate control on the public market. Further, in the 1990s European investors started to catch on to this trend, e.g. Weir et al. (2005) concluded that the UK experienced a significant increase in LBOs during the late 1990s, and Sweden was not an exception.

Numerous scholars have tried to explain this phenomenon and development, and a lot of questions and problems surrounding LBOs have been subject for debate. The underlying issue that is widely discussed is whether or not a company benefits from going private. Jensen (1991) tries to explain the trend of increased LBOs and the transition from publicly held companies to privately-owned companies. Opler and Titman (1993) looks deeper into the causes of going private in their study where they shed light on the various problems with this phenomenon. Furthermore, Fox and Marcus (1992) try to raise questions about why LBOs occur and what their consequences will be. Moreover, Bruton et al. (2000) investigated companies' performance after a leveraged buyout and found evidence of increased performance during the period the companies was privately held.

Many studies have tried to explain the reasons for companies going private, among them Kaplan (1989), who pinpoints tax advantages as one of the main reasons, and Halpern, Kieschnick and Rotenberg (1999), who looks deeper into board shareholdings and incentive effects. Another study, by Loos (2005), examines the sources of value creation; although, approaching the problem from a private equity perspective. His research model includes studies of several buyout transactions in both Europe and the US. In the UK, Weir et al. (2005) tried to conduct a similar investigation and to find the characteristics of all LBOs on the UK stock market during the period of 1998-2000. Evidently, there are different views of what characterizes a company being bought out from the stock market. No similar studies have been conducted on the Swedish stock market which is why this should be interesting to investigate. Thus the question is whether the characteristics found in other countries are similar to those on the Swedish stock market?

The fact that many companies are undertaking buyout actions consequently creates another question of who is doing these buyouts. Jensen (1991) claims that certain companies, through LBOs, MBOs, share repurchases, leveraged mergers and acquisitions, and takeovers, are diminishing the supply of publicly held equity. Henry R. Kravis, founding partner of private equity pioneer KKR and Co, states that the buyout business began as an offshoot to venture capital. At first individual investors were taking part in the deals, however, they later were replaced by banks, insurance companies, and non-financial institutions, such as pension funds. Later, in the early 1980s, some state pension funds became the major suppliers of capital to the buyout industry as they launched their own private equity programs (Kravis, 2005).



Along with venture capital, LBOs are part of the private equity investment asset class. Bance (2002) describes and classifies the private equity, together with hedge funds and real estate as alternative investments. He states that the majorities of private equity investments are in unlisted companies and requires an active investment strategy. Evidently, many investments are done in listed companies as well. What is it that drives these private equity companies to undertake LBOs? Since there is scarce research regarding Swedish private equity investments, it becomes interesting to see what reasons for buyouts Swedish companies are characterized by.

Many different views and reasons for taking a company private have been presented above. Studies have tried to identify and summarize the problems and characteristics related to public firms, and hence their journey to become privately owned. According to many scholars, agency theory seems to have key role in explaining the LBO trend.

Weir et al. (2005) argues that one of the reasons for the LBO trend can be related to inefficiency in public companies, mainly due to poor governance structures resulting in high agency costs for the firms. The new firm structure introduced by LBOs enables firms to cut agency costs when switching from public ownership into privately owned companies with a more effective corporate governance structure. Studies have shown that performance and efficiency in buyout firms have improved significantly (Bruton et al., 2000). The authors further assert that one of the main reasons for the improved performance is that the privatization of companies results in increased managerial ownership, thus the owners' and managers' objectives will correspond more thoroughly; that is, maximizing shareholders' wealth.

### **1.2.2 Active Investors**

Jensen (1991) argues that the principal-agent problem is mitigated when a company is owned by so-called "active investors". According to Jensen, active investors would be more involved in monitoring and controlling the management, deciding the long-term strategic direction, and sometimes manage the companies themselves. He further argues that these firms are creating a new model of general management that would be based on a highly leveraged financial structure, pay-for-performance compensation systems, as well as substantial equity ownership by management and board of directors. Bruton et al. (2000) define the agency theory as a separation of ownership and control in the company. This implies that the owner bears the risk, whereas the managers direct the daily operations of the firm. Fama and Jensen (1983) further expound this theory as conflicts of interests that can

jeopardize a company's performance. Does agency theory have such a significant negative effect on public companies that it becomes disadvantageous to remain public?

This view of management, with increased focus on free cash flows and the maximization of shareholders' wealth, conforms well to modern financial theories stated by researchers (Copeland, Weston, and Shastri, 2001). That is, the firm's aim is to maximize shareholders' wealth, not earnings per shares. The problem is that firms are focused on short-term performance and not the long-term maximization of the company value. Furthermore, Jensen and Meckling (1976) explain the improved efficiency performance following a buyout through the agency theory and point out that the increase in management's ownership stake in the firm has a direct link to performance improvements. Increased managerial ownership makes the interest of the owner and the manager more likely to correspond. The firm then has a greater chance to experience harmonizing goals and interests which leads to better long-term control of the firm (Jensen, 1986). The more concurrent interests of owners and management will lead to more efficiency for the firm. Thus, the firm will experience greater control which leads to the implementation of restructuring activities and in the end this will bring improved benefits to the firm. Jensen argues that the result of a new firm structure formed by an LBO creates incentives for managers to increase shareholders' wealth:

*"More than any factor, these organizations' resolution of the owner-manager conflict explains how they can motivate the same people, managing the same resources, to perform so much more effectively under private ownership than in the publicly held corporate form."*

However, Bruton et al. (2000) also pinpoint possible disadvantages with the LBO trend. They claim that a LBO company does not have enough flexibility to be successful in the long run because of the demands held by third-party sponsors and the constraining presence of a high leverage. How will a high leverage affect the cost of capital for LBOs when facing a slowdown in the overall economy? Additionally, the general opinion proclaimed by media that private equity firms are corporate raiders who strips the LBO targets of its assets is still present. Accordingly, there is a discussion whether the advantages of the performance improvements of a LBO exceeds the above stated disadvantages.

Knowing that buyouts has increased in the world, as well as on the Swedish stock markets during the recent years, we find it interesting to investigate what variables have been the most significant in the decision-making of whether or not a company is target for a LBO. Also, the recent highlights in papers, magazines etc. regarding the activities of private equity companies makes it interesting to conduct our research from a private equity perspective. The theoretical framework that we have constructed shall act as a base for the research. As

seen above, there are many opinions of the consequences regarding LBOs. The private equity and buyout activity evolved from the US and further into Europe. Most studies display the evolution in either the US or the UK, but as far as we know, a major study of the Swedish private equity and LBO market is yet to be conducted. As most scholars argue, there must be certain factors that private equity companies look for when deciding to buy out a company from the stock market and we wish to highlight these in the following section.

The vast research that has been conducted during the last thirty years forms a profound basis for this chosen study. Some issues have been found from the discussion held above, and they are presented below.

### *1.3 Research Questions*

In order to get a closer understanding regarding which firms are objects for LBOs, we have decided to formulate some research questions that we have found interesting:

- In which way are the characteristics of bought out companies "similar" with the company characteristics explained in the theory?
- What are the reasons and incentives for three Swedish companies to go private?
- To what extent do these companies stand out when compared to the firms within the peer group?

### *1.4 Purpose*

The purpose of this study is to provide insight in buyouts from the Swedish stock market by conducting a study of LBOs during 2006. We want to investigate the various financial and non-financial parameters that make these public firms attractive for buyouts by private equity firms and see if these parameters comply with financial theories. Moreover, we want to see if these parameters are common for the firms investigated in this study. Hopefully, the study will intrigue the readers and serve as a foundation for future more elaborate studies.

## 2 METHODOLOGY

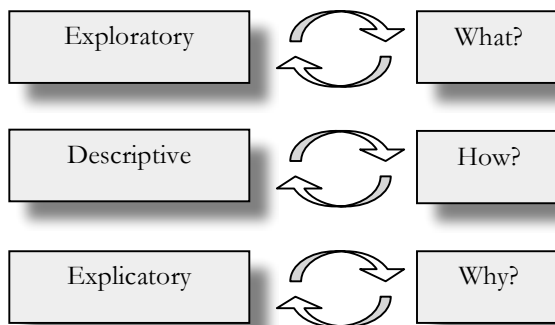
### 2.1 Research Approach

*“The outcome of research will never be better than the original choice of research approach.”*

The above statement by Kinnear and Taylor (1996, p. 155) pinpoints the importance of having a relevant methodology when conducting a research. From the literature review and articles, a methodological approach to solve the identified research issues has been selected. It becomes essential to use an approach that maps out the direction for the data gathering and the following analysis in order to obtain data relevant for the purpose of the study. Consequently, it should result in a reliable and valid analysis from which we can draw adequate conclusions.

A research approach and its purpose can be divided into three parts; exploratory, descriptive, and explicatory depending on what question they answer (Christensen, Andersson, Carlsson, and Haglund, 1998, p.34).

**Figure 2:1 Research Approach**



Source: Christensen et al., 1997, p. 35

The three parts are to a large extent integrated with each other (Figure 2:1). A research usually begins with an exploratory approach in order to acquire general knowledge of the investigated subject. We started our research by conducting a thorough literature review with the aim to get an overview of the private equity business and LBOs. As a result, we could see possible areas where further research could give academia more insight to the subject. The exploratory approach often serves as a pre-study where the researcher identifies questions that can be investigated deeper and more thoroughly (Christensen et al., 1997, p. 36). We did find some questions connected to the Swedish stock market that we believed needed more attention. We could not find a similar study, which seems natural since the buyout by private equity firms in Sweden is a quite recent phenomenon. After the exploratory research one can

face the problem with a more descriptive approach, where the researcher tries to explain a phenomenon by describing it, or state a hypothetical guess. When the researcher is well familiar with the problem and has a good description of it, he may want to examine why the phenomenon occurs. Exploratory and descriptive studies are often the basis for an explicatory research as it tries to identify the reason for the problem or the investigated subject (Christensen et al., 1998, pp. 34-39). Our study is more related to exploration due to our defined purpose and research questions.

We have chosen to conduct a case study on the sample of companies that we have identified as being acquired from the Swedish stock market by private equity firms during 2006. The most prominent reasons behind carrying out case studies are the favorable use of historical data as well as the ability to visualize complex issues and research through real examples (Eriksson and Wiedersheim-Paul, 2001, pp. 102-107). The choice of this kind of research approach derives from the characteristics of our case companies. We have many independent financial and non-financial parameters to examine and only a limited sample of firms for our time frame; moreover, we use large amounts of historical data.

A common view when conducting research is that there is a choice between a quantitative and qualitative method that must be related to research issues and objectives (Hughes and Månsson, 1988, p. 11). Nevertheless, sometimes a combination of the two methods is preferable or even essential (Alvesson and Sköldbberg, 1994, p. 10). Even when conducting a mainly qualitative research, some simple quantification might be sensible for the validity of the results. We are conducting a qualitative research and the main reason for us carrying out this kind of approach is the hardship to find companies that have been involved in buyouts on the Stockholm stock exchange. Thus, we have the opportunity to do an in-depth qualitative study of these few companies to find certain characteristics and to reach an understanding of the underlying patterns. The important thing though, about qualitative empirical research, is to have a certain skepticism against results which at first sight seems to be an unproblematic reflections of reality (Alvesson and Sköldbberg, 1994, pp. 11-12). Generalizations of qualitative case studies are often questioned, which is a weakness with qualitative research. If observable similarities are the only ones considered, there is no guarantee for a pattern to be valid in future studies. Only a statistically significant study, that appoints probabilities for the observed correlations, can make generalized statements (Chisnall, 1997, pp. 373-375). However, it is vital to realize that the “reflection of reality” in fact can contribute to a wider understanding of underlying patterns and that it opens up possibilities rather than sets certain truths. So if the researcher can avoid generalizing and not consider quantitative results as definite reflections of the reality of the underlying patterns, there is no reason in not using a quantitative method as a compliment to the

qualitative empirical findings. Therefore, we have chosen to use quantitative empirical findings as a complement to make this thesis more valid and to support our empirical findings.

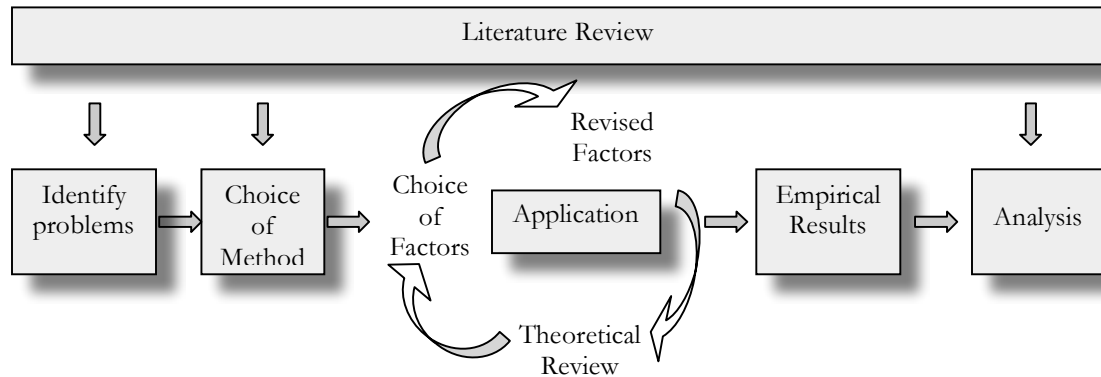
## *2.2 Analysis Process*

When conducting this kind of empirical research, one can choose between three types of helpful approaches when drawing conclusions; inductive, deductive or abductive (Alvesson and Sköldbberg, 1994, p. 41-43). The abductive approach, which we believe is the one most applicable for this thesis, is the preferred approach in most of today's case study research. This is actually a combination of the inductive and deductive approaches and gives the researcher the freedom to develop the empirical content and adjust the theoretical framework as the research process goes on. By allowing this, it is often recognized that the research would be likely to generate a deeper understanding to the field of interest (Alvesson, and Sköldbberg, 1994, p. 42). In order to carry out our study we started by looking into the theory and previous empirical research in articles and papers. After the collection of empirical data, we conducted an evaluation which was related to relevant financial theory. Thereby, we created a framework for our study which resulted in a methodological analysis. This analysis had its base in the empirical findings from the prospects and various articles. But also, empirical findings was measured and explained by the theoretical framework to any possible extent. Furthermore, our aim was to investigate and evaluate the empirical findings, both qualitative and quantitative, and weigh the two parts against each other. Therefore, the analysis was divided in a qualitative and quantitative part. This was conducted in order to find related characteristics, validity and discrepancies within the sample.

## *2.3 Research Process*

A thorough literature review was essential due to the characteristics of this study. That is, for obtaining all relevant parameters as well as for the interpretation of the results, a review of adequate literature was conducted throughout the whole length of this thesis. The research process in Figure 2:2 has been used in this study as it enabled us, through the literature review, to identify the problem and formulate a purpose with the chosen subject. From the identified problem statement and extensive analysis of existing research a method could be chosen to solve the stated research questions. This method was further used to revise the financial and non-financial parameters to obtain an optimal structure resulting in reliable findings. This is shown by the rotating arrows in the figure below. The results were then interpreted and analyzed by comparing them with relevant literature.

Figure 2:2 The Research Process



The primary approach to this thesis was to conduct a quantitative research, i.e. explaining the reasons for LBOs by analyzing relevant key factors for the concerned companies, in relation to a peer group of companies within the same business branch. However, during the research process it was revealed that even a full and total investigation and research would be too insignificant to draw any general conclusions. Thus, we found it more interesting to switch to a qualitative research model and use the quantitative statistics to verify our results.

#### *2.4 Sample Selection*

Tyler and Kinnear (1994) mentions the non-probability and probability processes as two common types of sampling procedures. The probability procedure states that every individual in the population has equal chance to be selected. However, due to the fact that we have chosen to investigate and compare certain companies that have been bought out from the stock markets with similar public companies in the same industry, we have found it more suitable for our purpose to conduct a non-probability sampling procedure. Thus, we have been able to select companies that we believe are relevant for this study.

Our case companies, Gambro and Capió in the healthcare business, and NEA in the industrial business, were selected by doing vast research in the yearly statistics reports from 2000 to 2006 provided by the owner of the Swedish stock market, the OMX Group. This was done in order to see which companies had been acquired from the stock exchange by private equity companies. The case companies we chose were all buyouts from the year 2006. The reason for this was that there have only been five buyouts conducted by private equity firms since the year 2000, and three of those took place during 2006. We believed that the results would be more significant due to the fact that the buyout transactions were all conducted during the same business cycle. For example, it would have been difficult to

compare our case companies with companies that were acquired during the IT-boom in 2000-2001.

When processing and analyzing our case companies we compared the obtained data with data from companies in a chosen peer group. We chose the peer companies on basis of facts provided by Börsguiden (2002-2006). These companies were selected on the basis of having similar market value and turnover as well as being in the same or similar branch as the case companies. We added some of the major companies in order to see if the characteristics apply to large and matured companies as well. After our evaluation of possible peer candidates we found that there were only 7 proper representatives within the healthcare sector, available on the stock market. Within the industrial sector we did not encounter these types of problems because the amount of companies was larger. The selected companies are shown in Figure 2:3 below.

**Figure 2:3 The Sample**

<b>Healthcare</b>	<b>Industrial</b>
Capio Gambro	NEA
Astra Elekta Getinge Nobel Biocare Q-Med	Autoliv Cardo Fagerhult Haldex Nibe Scania Volvo

The input of figures was mainly obtained from annual reports, although some key figures required data from the OMX Group. Furthermore, some key figures from international companies were presented in other currencies than SEK and consequently needed to be recalculated by a relevant exchange rate.

## ***2.5 Data Gathering***

The gathering and processing of information is essential for an academic research. When collecting data one distinguishes between primary and secondary data, depending on when and how the information was extracted. Primary data is information that is gathered for the first time, i.e. no prior studies had generated data useful for the intended study, and is typically collected by methods such as; observations, questionnaires, interviews and experimentation. This way of collecting information is often expensive and time consuming (Chisnall, 1997, pp. 39, 44-53). However, in this study we have mainly used secondary data as our primary source of information. Secondary data is defined as data already gathered for previous studies and other research. Although the collecting of secondary data is



considerable cheaper and less time consuming than obtaining primary data it may lack relevant and up-to-date information suitable for the study (Chisnall, 1997, pp. 39, 53). We started out with collecting secondary information, such as articles, journals, literature etc. in order to obtain a broad understanding for the chosen subject. This gathering of information was conducted by using certain keywords and scanning databases such as JSTOR, Blackwell Synergy, and Business Source Premier. These keywords can be found in the abstract of this thesis. The financial theories used are found both in the literature review and in the literature from previous courses taken by us. Further, numerical data was extracted from the selected companies' yearly reports, OMX, and Börsguiden. The data regarding exchange rates were collected from the Swedish central bank's homepage.

As stated earlier, we have chosen to use a qualitative approach complemented with quantitative data. The quantitative data is gathered with the theoretical background in mind. First, we processed relevant key factors that were derived from specific researchers and their previous theses (e.g. Weir et al., 2005), commonly accepted, or processed by us with its base in the theoretical framework. We divided them in three groups depending on their characteristics. These groups were Growth, Valuation, and Capital Structure. Especially the book by Johansson (2005), which measures the inefficiency in companies by looking at certain key ratios, has been a source of our chosen key ratios. These were further modified by us, with the theoretical framework as a base, to fulfill our analysis. The used timeframe for the quantitative data ranges from 2002 to 2006. As mentioned, this is due to the economic recession in the beginning of this century, peaking in 2001 which might have resulted in irrelevant and misleading figures when looking at trends over time.

## ***2.6 Interview Method***

Additionally, the secondary data has been complemented by interviews with experts on various positions within the area. This was only conducted in order to verify the empirical findings in articles and key ratios. After two phone calls to the respondents, we understood that a formal interview would be impossible to perform. Due to time constraints, the analysts were keener on answering a simple questionnaire. We created a questionnaire (Appendix 2) which has been sent out by e-mail to private equity companies and analysts. This questionnaire was structured after thorough analysis of the prospects from the private equity firms and earlier empirical findings. Moreover, from the theoretical framework some questions regarding certain key factors were formulated.

We selected six respondents that we believed had expertise and experience of the subject. From this sample, four respondents replied. The respondents were very restrictive in their answer which is why the results from these interviews might be questioned. So the

discussion is limited regarding the aim of the questions. On request from, and due to the opaque organizational structure of private equity firms, all our interviewees are anonymously presented in this thesis. The persons we have interviewed mainly referred to losses of competitive advantages if openly presented.

## ***2.7 Quality of Research***

During the course of a research process, many types of errors occur which are more or less predictable. Some of these are removable but not all of them. We will discuss these in more depth in this chapter and also their possible consequences for our thesis.

### **2.7.1 Sources of Error**

While conducting this thesis we have done our best to limit the sources of errors. Nevertheless, one should not neglect the possibility of errors when processing data. Since this study is partly made of quantitative data, partly stemming from qualitative data there are possibilities of potential shortcomings in the data gathering. As for the quantitative part, we have used official figures and numbers and tried, to any possible extent, to adjust or correct these in order for them to be comparable among the peer companies. We have no control over mistakes or corrections made during the original processes of these official figures. During the gathering of the qualitative data we have used mainly articles and interviews as information sources. Both the articles and interviews are many times biased and show only one point of view. However, our intentions with this thesis have always been to neutralize bias and present proper facts. Nevertheless, it is not impossible that some biased data might have escaped our revision.

### **2.7.2 Reliability**

An important issue to consider is how reliable the techniques and the research method for the collection of data are. A high reliability thus means that the study will have a quite consistent result even if it is conducted over and over again. Hence, a high reliability is required to increase acceptance of this kind of study (Yin, 1994, pp. 30-32).

Private equity companies are very opaque which is why we rely heavily on secondary data. Therefore, the main issue has been to find relevant information from reliable sources with research methods that corresponded to our study. This was especially emphasized when we constructed the peer group. Discussions were held within the group, how to create a valid peer group with relevant and reliable sources of information and companies. The structure and number of companies included in this peer group is a result of what we believe was an adequate group, also with respect to time limits and work load. Nevertheless, if we would have included more companies, it might have been possible to increase the reliability in the results. The negative aspects with our interview method are the inflexible structure. This

means that the respondents are able to interpret the questions on their own. This creates the question about the reliability of the results from the interviews. The aim of the interviews was only to verify our empirical findings; therefore, with the time frame in mind, the interviews can be motivated.

### **2.7.3 Validity**

Yin (1994, p. 33) describes the validity as to what extent the research examines what it claims to examine. A research might have high reliability, such as it will show the same result if conducted over and over again, but if it suffers from low validity, i.e. it does not measure what was intended, the quality of the research is still to be questioned.

We have tried to increase the validity of our study through thorough discussions and evaluations of different research approaches and analysis models. Yin (1994, p. 33) also states that there are many dimensions of validity. One dimension shows how well the result of the research correlates with reality. Other dimensions discuss to what extent the outcome might be applicable on other areas than the one conducted in the research. By using, what we believe are, relevant data we have done our best to increase the validity of our study. However, since this thesis is a case study it is not certain that the specific reasons for the buyouts of our case companies are totally applicable on future buyouts. For our intended study the use of solely secondary data appeared to be inappropriate as it is difficult to formulate general conclusion with such a small sample of companies.

### 3. THEORETICAL FRAMEWORK

#### 3.1 *Private Equity*

*“There is obviously a difference between ownership and control, and there is no reason to believe that the manager, who serves as an agent for the owners, will always act in the best interest of the shareholders.”*

*(Copeland, Weston, and Sbastrri, 2005, p. 19)*

Private equity has become a major component in the financial world during the last decade and is now a generally accepted asset class within many institutions’ portfolios. The definition of private equity investment is *“investment in securities through a negotiated process”* and it is typically a transformational, value-added, active investment strategy that mainly takes place in unquoted companies. According to the European Private Equity and Venture Capital Association (EVCA), private equity is sorted as an alternative investment class together with hedge funds, real estate, physical commodities, currencies etc. It consists of investment techniques, strategies and asset classes that differ from the regular stock and bond portfolios used by investors (Bance, 2002). The concept includes mainly venture capital and leveraged buyouts. Bance separates venture capital, as the *“business of building businesses”*, from buyout funds which typically focus on mature companies where they often change management in order to turn the business around.

#### 3.2 *Leveraged Buyouts*

Jensen (1991) describes the action of a buyout and argues that a typical buyout is conducted by a so-called LBO association. It would consist of three main constituencies:

- An LBO partnership, such as a private equity company, that pays for the buyout and advises and monitors management in a cooperative relationship.
- Company managers who hold substantial equity stakes in the company.
- Institutional investors, such as pension funds, insurance companies, money management companies etc., who funds the limited partnerships that purchase equity and lend money to finance the transactions.

Loos (2005) describes that when an investor is undertaking a buyout, his investment style can hold a variety of different strategies, including growth, value, early and late stage strategies. An acquisition is another type of strategy that focuses on *“buy and build”* strategy. Hence, a buyout investor can either take a passive or active role in controlling and monitoring a company. Loos concludes that most firms that have experienced a buyout from a private equity firm hold similar characteristics. The private equity firms tend to focus their investments on mature firms with established business plans to finance expansions,

consolidations, turnarounds and sales, or spin-offs of divisions and subsidiaries (Opler and Titman, 1993). The authors conclude that there are similar characteristics for buyout firms. Loos (2005) defines that a perfect LBO candidate holds the following features; strong, non-cyclical, and stable cash flow with non-optimally used borrowing capacity. Opler and Titman (1993) argue that there is a correlation in the characteristics of LBOs as they can be said to have relatively high cash flows and unfavorable investment opportunities.

Another characteristic is that the firm and its products and services should be well known to the market. Hence, the necessity for improved R&D and marketing is small, resulting in minimal requirements of capital expenditures. On the contrary, firms experiencing high growth and rapid technology improvement are not attractive candidates for a LBO, because these firms will require large amount of capital expenditures and holds great uncertain revenues (Loos, 2005). This is confirmed by Jensen (1991) and the free cash flow theory which can explain why firms become attractive restructuring targets. A firm, whose cash flows exceed its investment opportunities are subject to managerial discretion, hence managers should, instead of spending money on inefficient investments, pay dividends to the stockholders. This can be described as an imbalance in corporate control. Opler and Titman (1993) also conforms to these theories as they state that excess of free cash flow and potential financial distress costs are main reasons for companies to undergo buyouts. They further argue that, in line with the theories of Loos (2005), characteristics of companies undergoing LBOs include relatively low R&D expenditures, more than average diversification, and are more unlikely to be manufacturers of machinery and equipment.

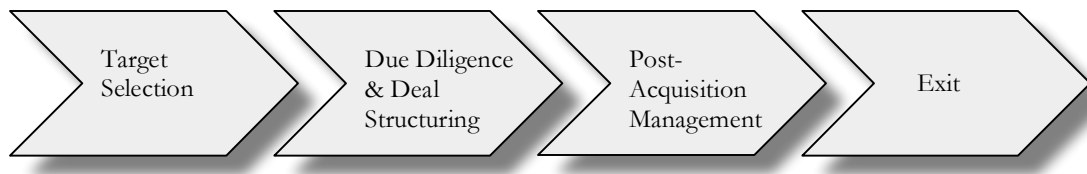
Weir et al. (2005) discuss another characteristic of LBOs, namely the tax advantage generated by leverage. The authors state that LBOs create tax benefits due to their increased leverage. Kaplan's (1989) study confirms this statement as he mentions the increase of debt used to partly finance the buyout as a potential source of tax savings. Furthermore, Weir et al. also focus their study on firm undervaluation as a reason for going private. With support from previous studies they came up with the idea that one major determinant was a perception that the market undervalued the company in terms of their share price, measured by the price to earnings ratio. Many smaller firms that go public often suffer from hardships to issue equity, illiquidity in their stock, and lack of buyers leading to difficulties to fund expansion. Thus, the market value of the company will most likely not correspond with the managers' perception of the company value and consequently, the need for smaller companies to be publicly owned can be discussed. A bid announcement has been shown to increase the share price of the target company as significant premiums are reported to be paid to shareholders. Weir et al. therefore states that firms with higher board and external shareholdings are more likely to go private. Further, the authors claim that agency costs are

of significant matter since LBOs were likely to suffer from high agency costs before their buyout.

### 3.2.1 Definition of the Buyout Process

A leverage buyout can be described as a transaction in which a group of private investors, typically including management, acquire a company quoted on an exchange by taking on large debts with the target firm's assets and/or cash flow as security (Jensen, 1989). This process can be transformational, value-added, or active-investment strategic and it calls for highly special skills by the investment managers. The investment cycle can be categorized into five different stages and each stage requires different skills as they focus on different stages of the company life cycle (Bance, 2002).

**Figure 3:1 The Buyout Process**



Source: Loos, 2005

As illustrated above, the process starts with a target selection phase, where potential candidates are selected based on rigid criteria for successful LBO development. There is a significant difference between strategic acquisitions and typical LBO firms. The latter does not consider aspects like resources relatedness or strategic fit between existing portfolio companies and possible takeover candidates' importance (Loos, 2005).

After the selection of a target company, the next step in the phase is due diligence and deal structuring. During this phase a detailed business plan for the proposed investment is developed. A business plan is always conducted and analyzed cautiously prior to any investment. This is one major area where private equity firms can add value (Bance, 2002). The financial details of the offer are further to be negotiated with the current owners to reach an agreement.

Based on the analyses and information in this step, the private equity firm will come up with a bid. The bid will hold a detailed financial package including not only the acquisition price but also the level and conditions of debt financing (Bance, 2002). Furthermore, the package will contain information regarding management co-ownership and incentive plans as well as details about debt service requirements and financial agreement. The potential value creation in a LBO firm after a buyout has a strong correlation with the package and agreed financial structure of the deal (Baker and Montgomery, 1994).

The new target company will be included in the private equity firm's portfolio with a new ownership structure and agenda. This phase is called the "post-acquisition management phase". During this stage, management will launch their new agendas and starting to transform the target company. Thus, this phase correspond to the key focus of the proposed dissertation as most of the value creation is expected to be realized during this phase (Loos, 2005).

The exit phase is the last phase of the buyout cycle. A typical LBO investment is held for a time horizon of three to five years. A study made by Butler (2001) consisting of 200 public to private chemical companies, indicated that the average exit time to be 4.4 years. An exit can be executed in several ways, a company can undertake an initial public offering (IPO), a re-leverage or a secondary buyout by another firm. Finally, a strategic buyer can buy the complete portfolio.

### **3.2.2 Value creation**

The definition of firm value is the expected cash flows from both assets in place and future growth, discounted at the opportunity cost of capital (Damodaran, 2001). Damodaran further argues that a company needs to perform certain actions in order to create value. These actions are to increase cash flows generated by existing investments, increase the expected growth rate in earnings, increase the length of the high growth period, and reduce the cost of capital.

Damodaran (2001) concludes that other actions made by the firm, which do not affect any of the above, cannot affect company value. Furthermore, it has been shown that it is not unproblematic for a firm to carry out a strategy that puts emphasis on these actions. In reality a large number of value-neutral actions are taken place inside a firm, and these actions are often given too much attention from both managers and analysts. Hence, Damodaran (2001) maps out ways for firms to improve these actions on a variety of fronts – marketing, strategic, and financial. By cutting costs and improve the efficiency of the firm's operations, cash flows from assets can be increased. Furthermore, reduced taxes paid on income and investments will enhance the cash flows, i.e. capital maintenance and non-cash working capital investments. Also, companies can increase their expected growth by increasing the reinvestment rate or the return on capital, but increases in the reinvestment rate will generate value only if the return on capital exceeds the cost of capital. Further, Damodaran (2001) argues that high growth in a firm can be created and administrated by generating new competitive advantages or augmenting existing ones. Finally, by changing the capital structure towards an optimal ratio the firm will experience lower cost of capital, that is, by

using debt more suited for the asset being financed by reduced market risk (Copeland, Weston, and Shastri, 2005).

### **3.2.3 LBOs and Value Creation**

In order to explain the value enhancement created by a LBO, one must look at a number of sources. Loos (2005) points out several drivers that have a direct correlation with the increased value of the firm. These can be drivers that have an effect on the operating efficiency or that are related to the optimal utilization of assets of the company. Loos refers to these drivers as direct intrinsic, operational or “value-creational” drivers and they all improve the free cash flow of the firm. Furthermore, there are a number of drivers which are non-operational in nature, and these also contribute with value during the acquisition and realization phase. These drivers, referred to as indirect, extrinsic, non-operational or “value capturing drivers”, are generally not straightforwardly quantifiable, but do play an important role in the overall value creation process and may be interdependent with the direct value drivers.

Jensen (1989) points out that a weakness and source of waste in public corporations is the conflict over the amount that needs to be divided out to the shareholders. In order to maximize value and operate efficiently, a company must distribute its free cash flow rather than retain it. This argument is built upon the assumptions that investors can use these dividends to invest more profitable than the company providing the dividends, thus increase value (Bance, 2002). Further, active owners contribute to the value enhancement of the company. For example, institutional investors tend to delegate the monitoring job to an agent, whereas the LBO partnership provides the firm with the skills, reputation, and resources of the private equity firm. Consequently, private equity firms require compensation in the form of the target company’s increased value (Jensen, 1989).

In another study by Jensen (1991), it is identified that the performance record for LBO firm is remarkable, and the increased value of the firms seems to appear from real increased productivity. A study made by Kaplan (1989), identified that firms going public again after a buyout had an average increase in shareholder value of 235 percent. Moreover, the operating earnings increased with 42 percent from the year prior to the third year after the buyout, and cash flow increased with 96 percent. This has also been confirmed in prior research, where sales and profit has increased in the private-buyout period, and the results had a direct correlation to lower agency cost and increased management ownership stake among these firms (Bruton et al, 2002). The authors found evidence that buyout firms’ profit margin grew significantly during the period in private ownership, ranging from an average of 10 percent to 13 percent. The sales for these companies also increased in value and the average sales



growth experienced in the sample was 66 percent compared to a 37 percent increase in public firms in the same industry. However, studies have shown that approximately only between 30-40 percent of the LBO targets are introduced on the stock market at a later stage after the LBO (Jensen, 1989; Degeorge and Zeckhauser, 1993; Pagano, Panetta, and Zingales, 1998).

Additionally, Bruton et al. (2002) conclude that following a buyout, the firm experience a dramatic change of concern for efficiency, and a development for changing the firm into being more efficient take place rather quickly. A reason for this is that managers, who also are owners of the firm, “recognize that inefficiency has a direct negative effect on their own personal wealth, so cost cutting becomes a priority.”

### **3.2.4 Stock Efficiency and Company Value**

By entering the stock market, companies are able to raise capital and increase company image. However, studies have shown that a lot of companies actually do not experience all the benefits that come from being public (Weir et al., 2005). Weir et al. (2005) found that 97 percent of the companies that went private had a market capitalization of less than £ 300 million. Compared to the all share index in the UK, the companies that went private displayed lower value than the average small firm. Hence, it seems to be harder for smaller firms to raise capital on the stock market and consequently their cost of capital will increase. Smaller companies are also likely to be undervalued, which can be explained by low attraction from large investors (Kang and Sørensen, 1999). Furthermore, the lack of interest in the share leads to low trading volumes which results in illiquidity in the stock. Institutional investors have a tendency to buy and sell large blocks of stocks and the inefficiency and low trading of the smaller firms then becomes unattractive for investors, since it will be hard to sell the stock without affecting the share price (Bruton et al., 2002).

The problems for small companies presented above have made scholars question whether or not it is beneficial to be public, when it is so hard to raise new capital in this forum. Given that there are significant costs connected with being quoted, for example additional accounting, audit expenditure, and listing costs, going private appears to be an attractive proposition (Weir et al., 2005). Consequently, the market value of the firm will not reflect the true value, and the firm will always be undervalued. Management needs to analyze the pros and cons with being public and decide whether the value of the firm can be increased by going private. A study performed by Maupin (1987), which analyzed factors and characteristics for US firms that went from being public to private, concluded that one of the strongest incentives for going private was the market value of the company. The

assumption was that the market value of the firm did not reflect the management's perception of its true value.

### ***3.3 Corporate Governance***

Scholars argue that one of the most prominent reasons for companies to go private is the benefits implied by the change in the governance structures. Unlike corporate governance structures of public companies, the private equity managers often have a degree of control or influence, permitting strategic and even operational intervention when necessary (Jensen, 1991).

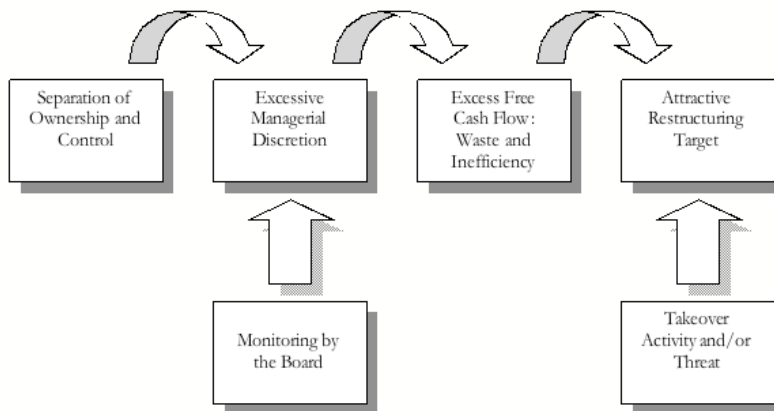
#### **3.3.1 Agency Theory**

Many scholars, among them Jensen (1986), state that corporate managers are involved in an agent-principal relationship with the shareholders which generates conflicting interests. An agency relationship is defined as a contract under which one or more principals (shareholders) give authority to agents (top managers) to make decisions that are supposed to benefit the principals (Jensen and Meckling, 1976). A firm's growth increases the resources under management's control and consequently management's power. Often, management's compensation creates incentives for them to expand and let the firm grow beyond its optimal size. Further, managers may also have incentives to refrain from paying dividends and rather retain cash within the company as it increases their independence towards the capital market. This behavior can many times be positive from a competitive point of view. However, it is not unusual that it leads to waste and organizational inefficiency instead (Jensen, 1991). Consequently, the shareholders might incur significant costs when attempting to mitigate this behavior by monitoring the managers. Thus, there is a trade-off between monitoring costs and the forms of compensation needed to make the managers always act in the shareholders' interest (Copeland, Weston, and Shastri, 2005, p.19-20). As for LBOs, Jensen (1991) argues that they are more decentralized than publicly held conglomerates and that they instead of conducting direct monitoring by the upper management rely on stock ownership, incentive pay that rewards cash flow and other compensation techniques. This is conducted in order to make managers act in the owners' interest when facing agency problems.

Jensen (1989) describes the public company as a social invention, which gives investors the possibility to customize their own risk by diversifying and creating a portfolio consistent of different companies and risk. However, tradable ownership creates incentives for conflicts of interest between those who bear the risk (the shareholders) and those who manage the risk (executives). The private equity firm has a great ability to eliminate these conflicts of interest, without eliminating the critical functions of risk diversification and liquidity once carried out exclusively by the public firm (Kaplan, 1989). According to Jensen (1989) the improved

efficiency in LBO targets is related to the new organization, where conflicts of interests have been eliminated. Furthermore, this organization can better manage to motivate people and allocate the same resources, to perform much more effectively under private ownership than in the publicly held corporate form. Bruton et al. (2002) explains the improved efficiency with a “new strategic focus”, he argues that when a firm begins restructuring activities, the company will often change its strategic focus, now focusing on the core competencies in the firm.

**Figure 3:2 Agency Theory View**



Source: Fox and Marcus, 1992

Jensen (1991) argues that the LBO organizations’ resolution of the principal-agent problem is the most significant factor that explains why those firms could perform better than before the buyout, although managing the same people and the same resources. Fox and Marcus (1992) claim that managers in a public firm might waste more resources than managers in a firm that has gone private, due to the weak monitoring created by dispersed ownership (Figure 3:2). This weak monitoring is not only costly, but it may also reduce the flexibility needed to deal with uncertainty. This, in turn, may give a strong incentive for managers to focus on short-term goals and performance. On the other hand, the authors explain that in the case of buyouts where managers come to own a substantial part of the firm, the separation between ownership and control has been reduced, i.e. the principal-agent problem has eased. The managers, who are now the owners, will operate the firm much more efficiently since the ownership comes with added personal risk and potential reward (Fox and Marcus, 1992). Private equity firms thus monitor the company and identify profitable opportunities in the governance structure of the target firm (Haan and Riyanto, 2006).

### **3.3.2 Ownership Structure**

The type and degree of fragmentation of firm ownership is important to recognize when analyzing the consequences of ownership organization for firm performance (Kang and Sørensen, 1999). Agency theorists generally assume that shareholders influence on firm performance is directly proportional to the percentage of equity they hold. Gillan and Starks (2003) wrote a research regarding corporate governance and the relationship to ownership structure, aiming towards institutional investors. They state that the conflicts between owners and management could be divided into two sets, namely differences in goals and preferences, and the aspect of asymmetric information. Another description is that the owners use their formal authority, social influence, and expertise to strongly influence firm performance. In many firms, there are many independent shareholders owning small stakes of the firm. This dispersed ownership might result in weak monitoring by shareholders and more of the power distributed to management. A central dilemma, according to Berle and Means (1932), is if managers are able to act in the best interest of the owners or if they try to increase their own wealth. In that case, the imbalance in power will effectively lead to a separation between ownership and control in firms.

As mentioned, an issue that is often discussed in corporate governance is the distribution of power between managers and owners. Private equity firms that acquire public companies and take them private, remove this separation with a strong ownership (Damodaran, 2006). Hence, the separation between owners and managers can be corrected and managers' goals can be aligned with the owners'. In addition, the private equity managers become directly involved in the strategic direction of the firm.

### **3.3.3 Organizational Slack**

Firms are sometimes operating in uncertain and highly volatile environments and most often managers of these firms become highly focused on the pure survival of the firm. This means that assets are used in such a way that there is a buffer for the company to perform poorly and still avoid bankruptcy (Shah and Thakor, 1988). Of course management should do everything to prevent the firm from facing financial distress; however, sometimes this risk aversion becomes greatly exaggerated. Instead of preventing a decline in shareholders wealth, this inefficient use of the firm's assets actually creates a slack in the firm's resources which could have been invested in profitable projects or as dividends to the shareholders (Davis and Stout, 1992).

Hence, what is good for the organization is not always good for the owners and therefore shareholder wealth maximization is not pursued. This phenomenon of adapting to dramatic shifts in the environment is called an organizational- or financial slack depending on what

assets, human or financial, are giving rise to the inefficiencies (Bourgeois, 1982). Private equity firms use this slack as an argument for buyouts and the aim is to create value by using these assets better elsewhere (Jensen, 1991). For example, large cash-holdings can be used as dividends or used in acquisitions; thus, when taken private, the company's new owners are able to use these assets or pressure management to use them more optimal (La Porta, Lopez-de-Silanes, Schleifer, and Vishny, 2000).

### **3.3.4 Board of Directors**

The board of directors has an important role to play in the performance of the firm. They have the right to hire, fire, and compensate managers (Gillan and Starks, 2003) Many complex issues confront boards, especially in times of financial distress. It is important to recognize that the performance of the firm can often be improved by making changes in the board structure and organization (Wolfe, 2006). In some companies where the board has become too dependent, underperformance can be related to underperforming board directors. In these kind of boards, restructuring can act as a starting point of increasing shareholder value (Bance, 2002). The problem is often that the board fails to hold the CEO accountable or that the board focuses the strategy on management-level issues instead of the long-term profitability of the firm. The first step in the process of improving an underperforming company at the board level is the appointment of a new non-executive chairman. This is a critical task because a newly elected chairman in an underperforming situation must be as resolute with regard to accountability, performance, and shareholder value as a raider or activist. These factors of improvement are the reasons why private equity firms are often eager to turn companies around (Wolfe, 2006).

In summary, what is needed is a group of clever, hard working, objective individuals who have the abilities and skills to increase value, with a sense of necessity, to the board in an underperforming situation (Wolfe, 2006). By taking a company private, private equity firms are able to replace the existing board with their own experienced and hard working candidates (Bance, 2002). They have the incentives and experience to increase company value so that the firm can be sold at a later stage with a profit.

### ***3.4 Capital Structure***

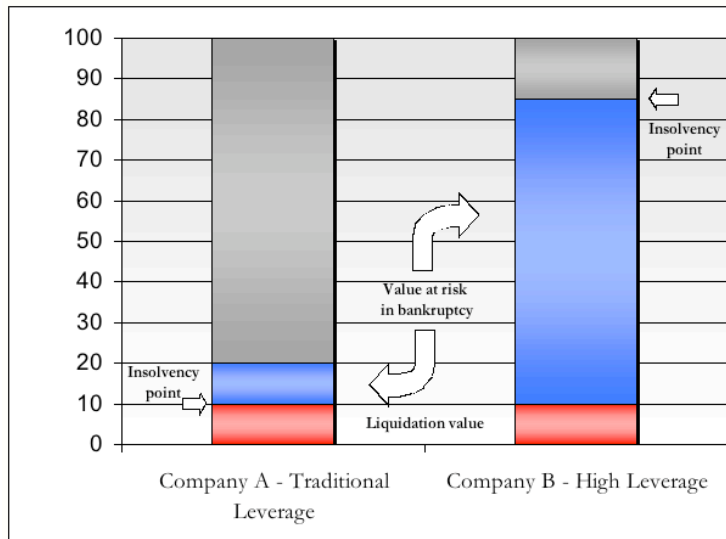
The capital structure of a firm is important to take into account when investigating private equity firms' decisions to take a company private. An acquirer can benefit not only from production efficiencies but also on benefits occurring from the financing of the buyout (Grammatikos, Makhija, and Thompson, 1988). The acquirer is able to use cash, loans secured by the assets of the acquired firm, and issued equity. At a more general view, a firm can have a mix of debt, some hybrid security and equity which is used to finance the firm's operations and they have different affection on the performance of the firm (Damodaran,

2002, pp. 832-859). Debt claim gives the proprietor a right to a contractual set of cash flows, while equity claim entitles the proprietor any residual cash flows after all other claims have been met. Thus, equity has the lowest priority in case it should face financial distress. On the other hand, equity investors, by the nature of their claim on the residual cash flows of the firm, are usually given most of or all the control over the management of the firm (Damodaran, 2006, p. 276). Debt investors have limited and often a passive role in the management of the firm.

Debt provides two major benefits over equity. First and foremost is the tax benefit, where interest payments on debt are tax-deductible. This creates a tax-shield for the firm (Brealey, Myers, and Marcus, 2003). The borrowing may lower the cost of capital which affects the value of the firm. However, there are costs related to increased debt that limits the use of debt. The risk of bankruptcy increases with increased leverage which might show negative effects for the firm's credit rating and thus increase the cost of capital. The financing mix of a firm affects shareholder value; therefore there might be an optimal capital structure to strive for (Damodaran, 2006). The second major benefit is the argument that debt creates incentives for managers to be efficient in the choice of which projects to invest in and the project management.

According to Jensen (1989), managers in firms that have substantial amounts of free cash flows, e.g. cash-holdings, and with no or low debt they carry such a large pillow against mistakes that there are no incentives to be more efficient. Hence, the firm's assets are not fully utilized and the maximization of shareholders wealth is not pursued (Copeland et al., 2005). Jensen (1991) further states that, although admitting that LBOs experience financial difficulties more frequently than public companies, companies with high leverage rarely face bankruptcy. Observing Figure 3:3 one can see that the reason for this is that since there is still a great deal of value when reaching the insolvency point, the creditors have strong incentives to preserve the remaining value by avoiding bankruptcy and instead reorganize the company and turn the business around.

Figure 3:3 Optimal Capital Structure



Source: Jensen, 1991

Private equity firms can use large amounts of debt, with the target firm's assets as security, when they buy companies from the stock market and are able to use this increased leverage to impose pressure on management (Jensen, 1989). As mentioned, leverage creates an incentive for the management to choose good projects and manage the firm in the right direction. Managers must be more careful because the threat of bankruptcy increases by the higher financial risk. By this, private equity firms try to increase the value by forcing managers to utilize the firm's assets more efficiently.

### 3.5 Utilization of Theory

The theoretical framework presented above has been used to give the authors a better understanding of the chosen field and also to support the empirical findings in next chapter. It has been obvious that many different financial theories are applicable when investigating private equity and LBOs. The most significant and relevant factors related to LBOs are, according to theories:

- Strategic values
- Usage of non-optimal capital structures
- Agency problems

These theories will be further analyzed together with the empirical data in order to find correlations and discrepancies between the both. Using our research questions as guidelines we believe that this chapter will provide a thorough foundation for the gathering of empirical data and the analysis process in the following chapters.

## 4. EMPIRICAL FINDINGS

During 2006, three companies have been acquired from the Swedish stock market by private equity firms. These companies are Capio AB and Gambro AB from the healthcare industry and NEA AB from the electric appliances sector. In this section these firms are presented.

### 4.1 *Capio AB*

Capio owns and operates private healthcare clinics in Sweden and throughout Europe. The firm is a leading healthcare provider supplying services within several medical fields. Capio's customer base includes county councils, municipalities, businesses, and insurance companies that buy healthcare services. The Capio group's 100 units are currently operating in the Nordic countries as well as in France, the UK, Germany, Spain, and Portugal with approximately 15 000 people employed (www.capio.com, 2007-05-14).

In 2006, Capio was acquired from the Stockholm stock exchange by Nordic Capital, a Swedish private equity firm, and Apax Partners, a global private equity group. Nordic Capital and Apax Partners created the firm Opica AB and it was supposed to act as parent company for Capio AB. The total value of the deal amounted 16 993 million SEK which corresponded to a premium of approximately 25-36 percent compared to the quoted price some months before the public offer (www.di.se, 2006-10-05, Linda Öhrn). As a result of the fact that private equity companies are able to borrow at a lower cost than many other investors, the deal was financed with a mix of high leverage and equity (www.nordiccapital.se, 2006-12-07, press release).

The background to the deal was argued to be the two private equity firm's long and thorough experience within the healthcare industry. Both Nordic Capital and Apax Partners have had much experience in buying healthcare companies. The private equity firms were impressed by Capio's development and growth for the years after the initial public offer as well as the high potential and hidden values that Capio possessed (www.nordiccapital.se, 2007-05-22, prospect). Besides, the management believed that Capio could benefit from not being publicly traded due to easier and faster financing and less bureaucracy. Moreover, Capio could be described as an ownerless company due to its dispersed ownership. Thereby, Nordic Capital's CEO Robert Andreen argued that Capio should benefit from having fewer and stronger owners who could be more efficient and set clearer targets (www.sr.se, 2006-09-01, Tommy Fredriksson). Another issue to consider is the already high leverage which is a result of Capio owning much of its own property. This property could, according to several independent analysts, be sold to release hidden values from more efficient utilization of assets. This ownership of property is assumed tying up assets and limiting capital from growing (www.di.se, 2006-09-01, Direkt).



The weeks before the publishing of the offer, Capio's share displayed a heavy increase in trading. This raised concern about an information leakage. There have also been some accusations of insider information regarding the Capio deal at management level. The CEO of the private equity firm Bure, Roger Holtback, was the driving force behind the initial public offer of Capio, at the time owned by Bure AB. Roger Holtback, chairman of Capio's board, had close connections to Nordic Capital where he was chairman of the advising committee. Therefore, he publicly relinquished to take part in the negotiations on either side. However, according to media, Roger Holtback was many times more loyal to Nordic Capital than towards Capio's shareholders. Moreover, questions arose when Apax Partners and Nordic Capital asserted that they had all relevant information to go through with the buyout without conducting due diligence ([www.afv.se](http://www.afv.se), 2006-09-01). After the deal, the board of directors was replaced by representatives from both Apax and Nordic Capital. A new CEO was also appointed ([www.privataaffarer.se](http://www.privataaffarer.se), 2006-11-26, press release).

The ownership of Capio before the buyout was widely dispersed. The fifteenth largest owners accounted for 37 percent of the voting majority in the company. Among the 15 largest owners 14 were institutions and the largest owner Orkla ASA held voting rights for 5.1 percent and the second largest, Andra AP-fonden, had 5 percent ([www.capio.se](http://www.capio.se), 2007-04-21, annual report).

**Table 4.1 Ownership Structure, Capio**

<b>Capio</b>	<b>Voting rights %</b>
Orkla ASA	5,1
Andra AP-fonden	5
Fjärde AP-fonden	4,6
Robur fonder	4,5
AFA Försäkring	3,3
<b>Others</b>	<b>77,5</b>
<b>Sum</b>	<b>100</b>

Source: Nordic Capital, prospect

## *4.2 Gambro AB*

Gambro is a medical company that serves the global healthcare market. The main area of business is to develop, manufacture, market, and provide various products and services within the area of dialysis, intensive care, blood bank technology, and therapeutics. Gambro is divided in three business areas: Gambro Renal Products, Gambro Healthcare, and Gambro Blood Components. The company has more than 11 000 employees and operates in over 40 countries ([www.gambro.se](http://www.gambro.se)).

Gambro was bought out from the Stockholm stock exchange during 2006 by the private equity firm EQT and Investor, members of the Wallenberg sphere. The deal amounted 38 257 million SEK ([www.eqt.se](http://www.eqt.se), 2006-04-06). The premium for the offer was set to be 30 percent, compared to the average stock price for the last three months. Analysts have argued that the stock was underperforming due to a non-optimal capital structure ([www.afv.se](http://www.afv.se), 2006-08-29, Birgitta Forsberg). Furthermore, the board of director was criticized for their restrictive dividends payout; analyst had expected a higher payout along with an extra dividend.

The background for taking Gambro private was the belief that it would develop better as a private company rather than a public one. EQT and Investor based their judgment on thorough observation and analysis of the company. If going private, Gambro was thought to have better potential to focus on developing the core business without the restriction and bureaucracy that publicly owned companies encounter. Further, the company had developed worse than the healthcare sector's average performance, and if going through with the deal Gambro was believed to have a better opportunity to perform growth oriented and value adding plans ([www.di.se](http://www.di.se), 2006-04-12). Also, EQT and Investor had come to the conclusion that by linking their expertise, competence and experience, this would serve as a catalyst in the development of Gambro's business operations and in the end create value. Representatives from the firms stated that Investor's long ownership of Gambro and history of building successful global companies, combined with EQT's role as active owners would prove and serve as a base for a successful implementation of a value added growth strategy in Gambro ([www.eqt.se](http://www.eqt.se), 2006-04-06).

The aftermath of the deal showed that a major change occurred in the structure of the board of directors. All of the former board members were fired including the CEO and vice CEO. Journalist and investors have been critical against the deal; the former board of direction was shed light upon when they were questioned to be challengeable during the execution of the

deal (www.va.se, 2006-05-08, Pontus Herin). A new board and CEO, with strong links to EQT and Investor, were appointed (www.afv.se, 2006-08-29).

Gambro had a solvency of 62 percent, which is high compared to the average business companies. Also, the divesting of a business area in the year 2005 had increased the cash holding to 6.4 billion SEK. Gambro had a payout capacity to redistribute 15 billion SEK before the optimal goal set by the board was met. Thus, analysts had pointed out Gambro as being a perfect candidate; with high potential to implement cost efficiency strategies (www.di.se, 2006-04-07, Tomas Linnala). The deal was also a consequence of an increasing interest from actors on the market. Representatives from Investor and EQT was aware of that if they did not act quickly, there was a possibility that others would. Furthermore, in 2007 Gambro Healthcare was divested with it's over 150 healthcare clinics and in addition two other business areas are being investigated for future divesture. (www.di.se, 2007-05-07, Joakim Adler)

The ownership structure of Gambro is received from the annual report of 2005. The majority of the owners were institutions with the exception of the largest owner, Investor who held a majority of 26.3 percent. Among the institutional owners, J P Morgan Chase Bank held a share of 7.3 percent, State Street Bank and Trust Co 5.8, Robur Fonder 5.7 percent, and AMF Pension 2.8 percent. The 10 largest owners presented below, accounts for 57 percent of the voting majority and among these the institutional owners account for 30.7 percent.

Table 4.2 Ownership Structure, Gambro

<b>Gambro</b>	<b>Voting rights %</b>
Investor AB	26,3
JP Morgan Chase Bank	7,3
Robur Fonder	5,7
State Street Bank and Trust Co.	5,8
AMF Pensionsförsäkrings AB	2,8
Others	52,1
Sum	100

Source: EQT, prospect

### *4.3 Närke's Elektriska AB (NEA)*

The NEA group operates a combined electrical contracting and wholesale business. Connected to the group is several service centres providing service for heavy industry customers. The core business of NEA is the electrical contracting which accounts for 76 percent of the total turnover and employs approximately 83 percent of the total of 1 500 employees within the NEA group ([www.nea.se](http://www.nea.se), 2007-05-21).

On September 11, 2005, the private equity company Segulah Alpha AB announced their prospect to acquire all outstanding shares of NEA, noted on the Stockholm stock exchange. The premium, calculated from the trading day prior to the offer, was to be 11 percent. Thus, the offer amounted a total of 1 339 million SEK. The major shareholders of NEA, the families of Broberg and Reveman as well as the investment company AB Latour, who together controlled some 73.2 percent of the voting rights, offered Segulah an irrevocable option of acquiring their shares ([www.nea.se](http://www.nea.se)).

The argument for the buyout was that Segulah had knowledge, experience and capital enough to develop NEA in a proper way. The board's belief and impression was that Segulah intended to run NEA as an independent business unit with unchanged business concept and focus. Segulah asserted that their main objective was to accelerate the development process in all NEA's business areas. Further, the business where NEA operates was characterized by increasing consolidation and Segulah declared that they already had identified future consolidation prospects that would be essential in order to strengthen their position on the market. Segulah further claimed that the development of NEA would call for actions that might have lowered the short-term profitability. However, Segulah's acquisition would, due to further focus on growth strategy, increase the long-term performance of NEA ([www.ngnews.se](http://www.ngnews.se), 2006-09-11, press release).

The members of the board of NEA argued that a withdrawal from the stock exchange would benefit the company since the stock suffered from low turnover and illiquidity. “– Actually, the NEA stock does not really fit on the stock market because of the low amount of trades with the stocks. We believe that the company will do just as good after going private”, says Johan Broberg, chairman of the board of NEA ([www.privataaffarer.se](http://www.privataaffarer.se), 2007-05-10, TT). According to Gustaf Douglas, chairman of AB Latour, one of the major reasons for the deal was the lack of a successor in the Broberg family. Latour AB were not interested in acquiring NEA since that may have lead to conflict of interest with customers and other companies with similar businesses as NEA within the Latour group ([www.di.se](http://www.di.se), 2007-05-10, Mikael Gianuzzi). Gabriel Urwitz, chairman of Segulah, stated, –“Our reasons for

purchasing NEA are that it is a prominent company with a leading market position, there are growth possibilities and the current owners are willing to sell". Segulah had previous experience of the business and Gabriel Urwitz asserted that Segulah already knew the business and also pinpointed that NEA had good potential to grow, both organically and through acquisitions of smaller competitors (www.di.se, 2007-05-10, Mikael Gianuzzi). Furthermore, after the deal a new CEO and board of directors were appointed (www.nea.se, 2007-04-27, press release).

In March 2007, NEA stated that they were about to divest all their real estates to the real estate company AB Sagax. The deal would set free 348 million SEK for NEA and the board argued that these resources would benefit the development of NEA's business areas, as owning real estate properties are not strategically favorable. Instead of owning their own business premises, NEA has reached an agreement to rent the premises for 15 years (www.ngnews.se, 2007-05-10, press release).

According to the buyout prospect, NEA was owned to 58.8 percent by the Broberg and Reveman families and the investment company AB Latour owned 13.6 percent. Thereby, these three owners held the majority of the company's shares with some 72.4 percent of the voting rights. Thus, the company was to be considered more or less a family company. The two major owners offered Segulah, as mentioned above, an irrevocable option to buy all their shares.

**Table 4.3 Ownership Structure, NEA**

<b>NEA</b>	<b>Voting rights %</b>
Broberg / Reveman families	58,8
Investment AB Latour	13,6
SEB fonder	5,5
Skandia Liv	1,2
Helin, Carl Olof	0,9
<b>Others</b>	<b>20</b>
<b>Sum</b>	<b>100</b>

Source: Segulah prospect

#### *4.4 Analysts' Opinions*

The following empirical data consists of summarised interviews from investors and analysts. The interviewees have given their views and analyses regarding different topics and issued concerning LBOs. Due to the limited answers given by the respondents, these results will only be used as a further topic of discussion.

The respondents pointed out that questions regarding management were of great importance when considering undertaking a LBO. Management must be able to carry out new strategies clearly, and at the same time impose a stronger operational focus. Furthermore, they asserted that investors in LBOs often have strong connections and relationships with the managers.

Further, LBO candidates had to have reached a certain level of maturity, since the company must be able to carry the increased cost of leverage. Also, it is important to find the optimal capital structure, which provides a balance between equity and debt. According to the analysts, a criterion for a LBO candidate must be the capability of improving growth, both in terms of organic growth and acquisitions. In the perspective of value creation, a LBO candidate must have hidden values, but the question remains of how to reveal them.

A main reason for companies going private is the benefit of increased flexibility to set long term goals and strategies. A company has to be a stable candidate, with a strong market position and an interesting business plans, as well as show good potential for increased growth and further development of existing business areas.

#### *4.5 Key Ratios*

This section is the quantitative part of the empirical findings. Here, the different key ratios are presented and have been used to serve as a compliment to the qualitative findings. As described in the method, the key ratios have three different groups – Growth, Valuation, and Capital Structure. However, one must consider that these groups have a strong correlation so no single figure can explain the whole picture.

##### **4.5.1 Growth**

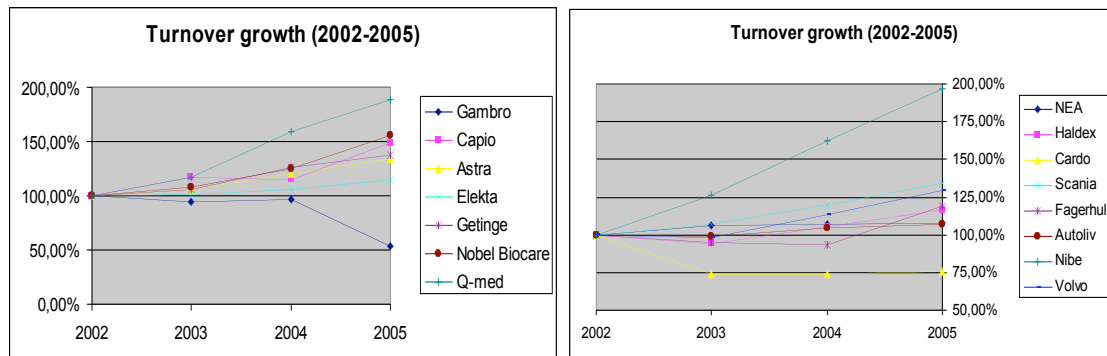
###### **Turnover growth**

The key factors regarding growth were calculated by using an index with 2002 as a base. For Gambro, the turnover was nearly halved due to the divesting of a business area during 2004. Thus, this ratio would not have displayed a fair value. As for Capio, turnover growth showed an increase during these three years of 49 percent. In comparison with the other companies in the peer group, AstraZeneca (34 percent), Getinge (38), Nobel Biocare (56), and Q-Med (88), Capio could be found in the middle layer. Over time, the overall turnover growth

followed the same pattern as most of the other peer companies, namely; a steady growth with a little peak for the last year (Figure 4:1).

When looking at the financial conditions of NEA one can try to find specific reasons for the LBO. The company has had a very low, although positive, growth of 8 percent during the investigated three year period. The peer group was ranging from -25 to 96 percent which compared to other firms in the same industry; NEA has had a significantly lower turnover growth (Figure 4:1).

**Figure 4:1 Turnover Growth**

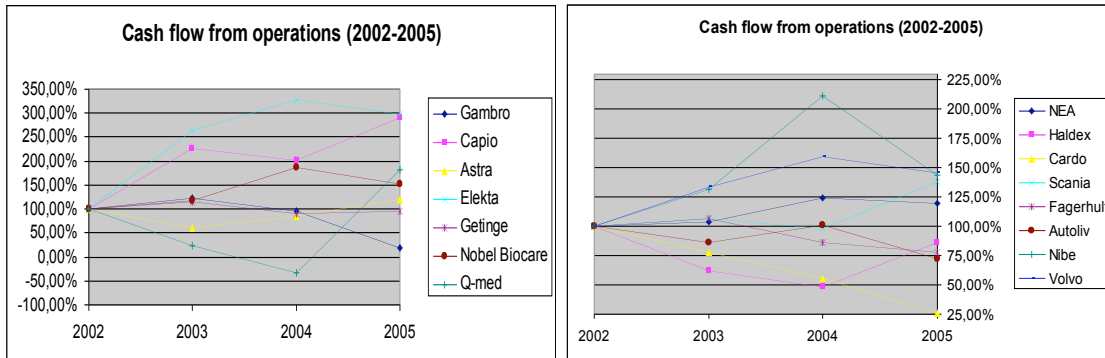


### Cash Flow from Operations

Capio showed a substantial growth increase during 2003 of 127 percent, and the three year increase in 2005 was 189 percent. Furthermore, the peer company AstraZeneca started with a decrease of 40 percent in 2003 and ended up with a 21 percent increase in 2005. Elekta had an increase of 164 percent in 2003 and the three year growth was 198 percent. Getinge displayed a decrease with 3 percent. Further, Nobel Biocare was up 19 percent the first year and ended at 53 percent the last year, while Q-Med showed a decrease of 76 percent in 2003, although ending up in 2005 with 82 percent above index (Figure 4:2).

Looking at cash flows from operations NEA shows an increase with some 20 percent for the three years. Some peer companies showed slightly weaker figures. Cardo's cash flows were down 75 percent for the three years. Autoliv, Fagerhult, and Haldex displayed decreases of 28, 22 and 14 percent respectively. Volvo had an increase with 33 percent in 2003 and a total increase of 45 percent for the three years, which was similar to Nibe who ended up with a 43 percent increase for the three years (Figure 4:2).

Figure 4:2 Cash Flow from Operations

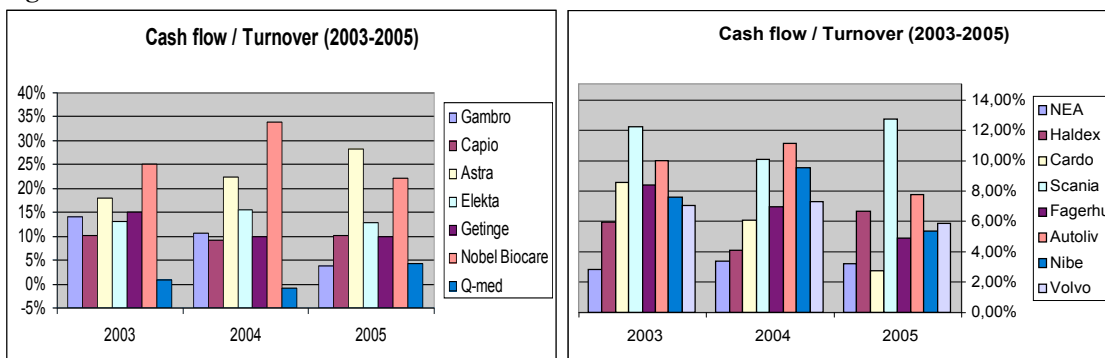


### Cash Flow/Turnover

The key ratio cash flow/turnover is a measure of marginal profit. It is calculated by free cash flow, and is explained as an efficiency ratio. Gambro displayed a decreasing trend with 14 percent 2003, and ending with 10 points down for 2005. In contrast, Capiro displayed value around 10 percentage points over the three years. Furthermore, within the peer group, AstraZeneca increased its ratio from 18 percent 2003 to 28 percent 2005, Elekta's ratio was positioned around 15 percent, Getinge's ratio decreased from 15 to 10 percent. Among the final two, Nobel Biocare's ratio started at 25 percent and ended up at 22 percent for 2005, whereas Q-Med's ratio increased from 1 to 4 percent (Figure 4:3).

Compared to the companies in the peer group, NEA is positioned in the lower layer with a cash flow to turnover ratio of 3 percent in 2005, up from 2 percent in 2003. Most companies in the peer group ranged between 5 to 10 percent, with Scania peaking at 13 percent in 2005 (Figure 4:3).

Figure 4:3 Cash Flow/Turnover



### Cash Flow/Market Value

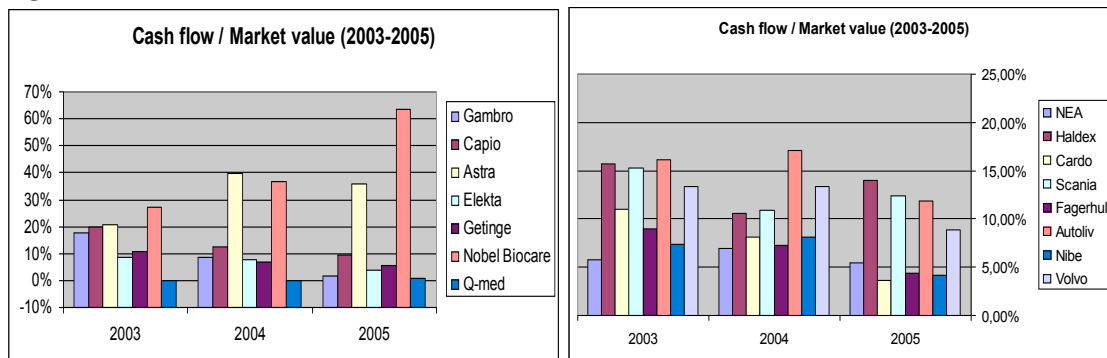
This key factor is a ratio that measures the cash flow divided by the market value. Compared to the peer group for the last year, Gambro showed a lower ratio of 2 percent. Capiro held a ratio of 10 within the peer group, Nobel Biocare had the highest ratio of 63 percent for 2005



and the development for this company has evolved from 27 percent in 2003. However, it must be said that Nobel Biocare's market value was cut in half during 2004. AstraZenecas ratio has gone from 21 to 36 percent. Further, Elekta ended at a ratio of 4 percent while Getinge had a negative trend from 11 to 6 percent. Q-Med had a ratio of around 0 (Figure 4:4).

NEA also, displayed a lower ratio compared to the peer group. The company had a ratio of 5 percent in 2005, down from 6 percent in 2003. Autoliv was substantially higher than the other companies ranging from 31 percent in 2003 to 61 percent in 2005. Most companies ranged from 5 to 15 percent. However, it is notable that all companies, except Autoliv, showed a decrease when comparing the figures of 2003 and 2005 (Figure 4:4).

**Figure 4:4 Cash Flow/Market Value**

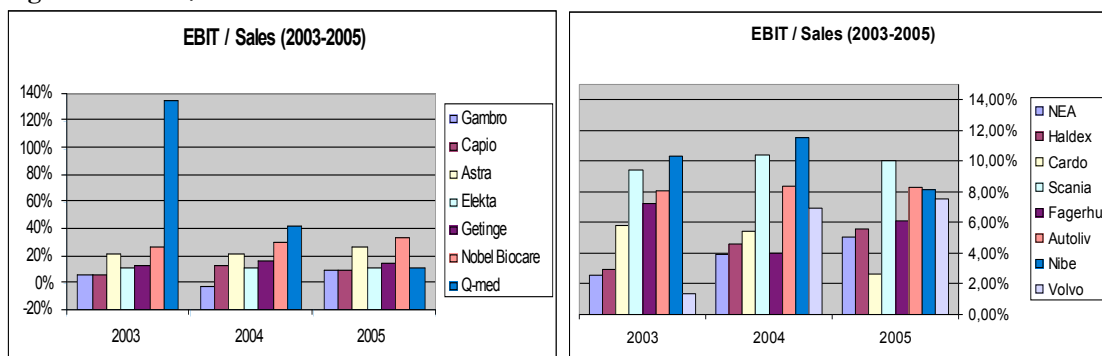


### EBIT/Sales

This ratio shows the marginal profit for sales. All of the companies, with the exception of Q-Med displayed a positive trend for this ratio. In 2005, both Gambro and Capio had a ratio of 9 percent, and the peer group ranged from 1 to 33 percent. Nobel Biocare had the highest ratio of 33 percent and Q-Med the lowest with 1 percent (Figure 4:5).

NEA had an increasing trend, from 2 percent in 2003 to 5 percent in 2005. Just like Capio and Gambro, this positions the company in the middle layer. Regarding this key factor there are not so much fluctuations because most companies range between 3 to 10 percent. Scania had ratio of 10 percent in 2005 and Cardo had the lowest ratio of 3 percent (Figure 4:5).

Figure 4:5 EBIT/Sales

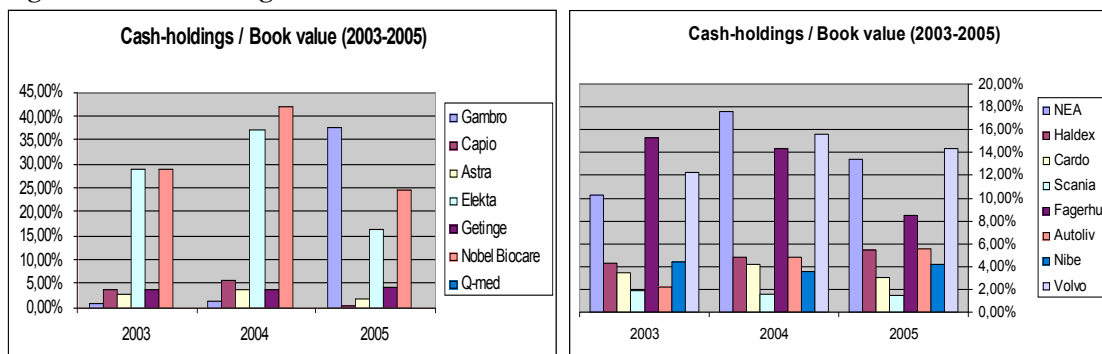


### Cash-holdings/Book Value

The cash-holdings in relation to the book value is the amount of the book value that is derived from the cash-holdings. Gambro's ratio has increased from 1 percent in 2004 to 38 percent in 2005 which is mainly due to the divestiture of a business area. Capio's ratio was 1 percent in 2005, AstraZeneca 2, Elekta 17, Nobel Biocare 25, and finally Getinge and Q-Med had a ratio of 0.01 (Figure 4:7).

NEA's ratio is considerably higher than most of its competitors. The cash-holdings represented 13 percent of the book value during 2005, decreasing from 18 percent the previous year. Most of the other companies in our peer group displayed a significantly lower ratio, mostly ranging between 2 to 5 percent. The exceptions are Volvo, increased from 12 percent in 2003 to 14 percent in 2005, and Fagerhult, decreasing from 15 percent in 2003 to 8 percent in 2005 (Figure 4:7).

Figure 4:7 Cash holdings/Book Value



## 4.5.2 Valuation

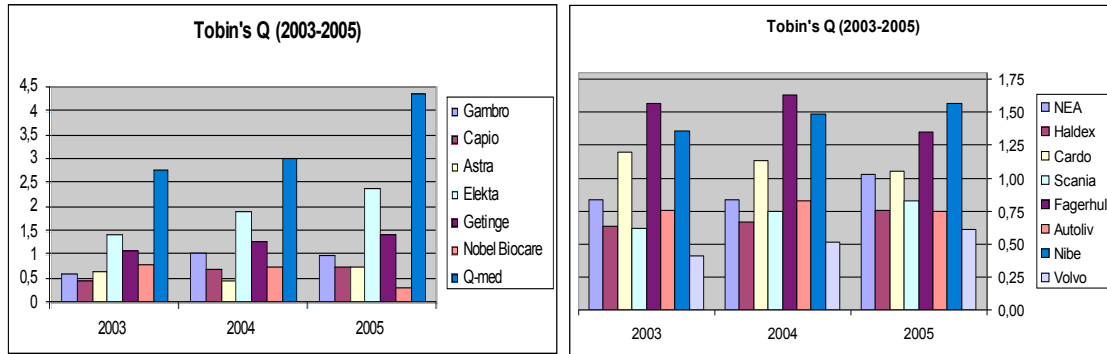
### Tobin's Q

Tobin's Q measures the market value of the company divided by the book value and is explained as a valuation ratio. The Tobin's Q ratio for Gambro's in 2005 was 1.00, Capio 0.75, and Astra had a ratio of 0.76. Elekta's ratio increased from 1.45 for the first year to 2.4 the last year. Getinge had a ratio of 1.4 for 2005, Nobel Biocare of 0.33 which was a negative

trend from 0.8 the first year. The last company in the peer group Q-Med had a Tobin's Q of 4.35 which is very high (Figure 4:6).

Looking at the valuation measurement Tobin's Q, NEA complies with the average value of being around 1.0 (although increasing from 0.83 the previous years). As in the healthcare industry, the companies in the peer group vary greatly from 0.15 to 1.6 (Figure 4:6).

Figure 4:6 Tobin's Q

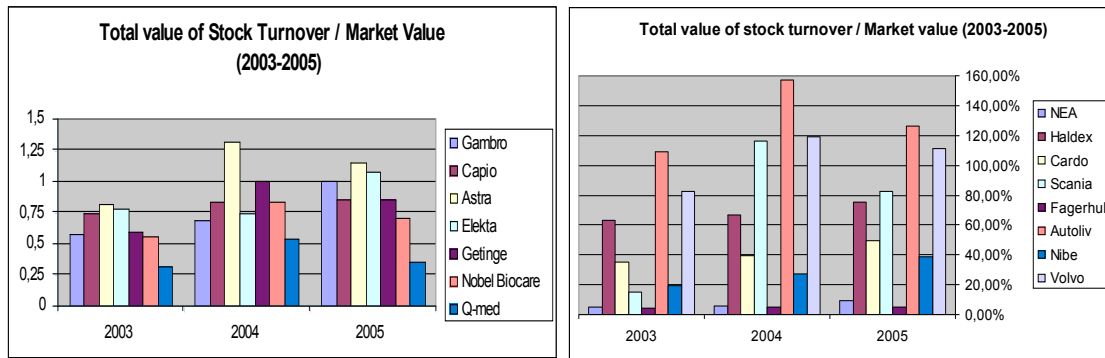


### Total Value of Stock Turnover/Market Value

The total value of stock turnover divided by the market value is a ratio that indicates the value and liquidity of the stock. The average ratio for Stockholm stock exchange was 1.07. Gambro's trend for this ratio has been increasing from 0.57 in 2003 to 1.01 in 2005. This trend can also be seen for the other companies. Capiro increased from 0.75 in 2003 to 0.85 in 2005. For the companies in the peer group, the ratio for 2005 ranged from 0.35 to 1.16 (Figure 4:8).

NEA had a remarkably lower ratio than the other companies in the peer group, only matched by Fagerhult. The figures show NEA's ratio as 0.09 in 2005, an increase from 0.05 in 2003. Fagerhult had an even lower ratio of 0.05 in 2005. Most companies in the peer group ranged from 0.3 to 1.0. The exception in the upper layer is Autoliv, increasing from 2.13 in 2003 to 6.42 in 2005 (Figure 4:8).

Figure 4:8 Total Value of Stock Turnover/Market Value

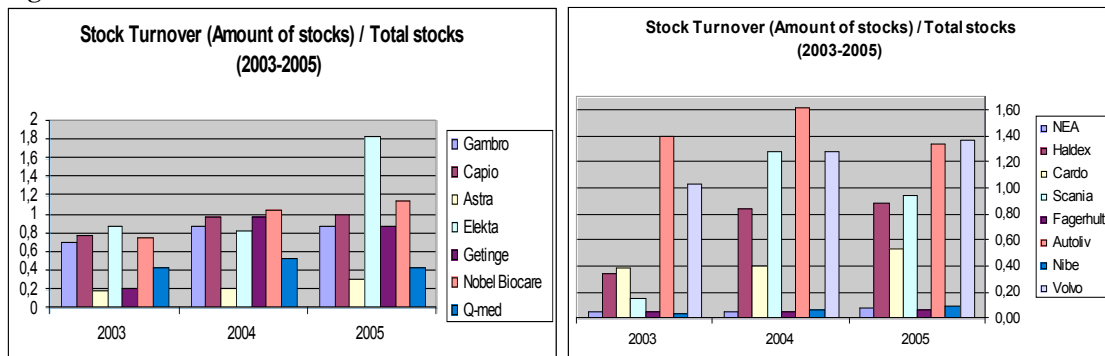


### Stock Turnover/Total Stocks

This key factor also displays the liquidity of the stock. Gambro had a ratio of 0.87 for the last year 2005, Capio 1.01, Astra 0.32, Elekta 1.83, Getinge 0.87, Nobel Biocare 1.14, and Q-Med 0.44 (Figure 4:9).

Compared to the other firms, NEA had a significantly low ratio of 0.09 in 2005. In the lower layer we also find Fagerhult with a ratio of 0.07 in 2005 and Nibe with 0.1. At the other end we find Volvo with a ratio of 1.38 for the last year, an increase from 1.04 in 2003, and Autoliv with a ratio of 1.35 in 2005. Most of the companies have ratios between 0.5 and 1.4 (Figure 4:9).

Figure 4:9 Stock Turnover/Total Stocks



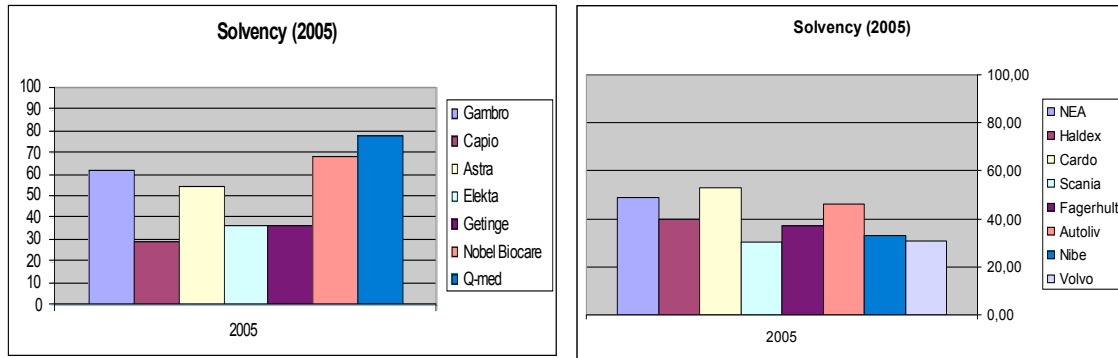
### 4.5.3 Capital Structure

#### Solvency

The Solvency ratio describes the capital structure of the company i.e. what proportions of debt and equity that is being used to finance the company. Gambro's solvency ratio is high (62) compared to the peer group, whereas Capio carries the lowest solvency value among the peer group (29). Furthermore, Elekta and Getinge have the same solvency ratio of 37, AstraZeneca 55.1, Nobel Biocare 69, while Q-med has the highest ratio of 77.8 (Figure 4:10).

The last annual report before the LBO stated that NEA had a solvency of 48.7 percent. This number has been quite steady during the last three years, ranging within less than two percentage points. This is to be compared with the other companies within the business where the majority of the firms had a solvency ranging around 30-40 percent (Figure 4:10).

**Figure 4:10 Solvency**



## 5. ANALYSIS

This section analyzes the relationships between the empirical findings in the previous chapter and the theoretical framework in chapter 3. Furthermore, the analysis intends to prove and highlight links and arguments specifically related to the case companies. By conducting a thorough discussion we hope to find evidence supporting our theses and evolve into a valid and well-founded conclusion.

Most literature discussing LBOs and private equity firms draw the conclusion that buyout candidates always contain underlying hidden values. These hidden values can be in many forms. From the empirical findings drawn from articles, prospects and interviews as well as the processed statistics we can discern these underlying factors. However, one has to ask if these hidden values really are the prime drivers for a buyout?

### *5.1 Qualitative Analysis*

#### **5.1.1 Hidden Values and Value Drivers**

The results obtained from related articles and buyout prospects asserted that, for example, Gambro had a strategic advantage of going private as well as a high rationalization potential. Furthermore, NEA's stocks were illiquid, and Capiro suffered from strategic difficulties due to dispersed ownership. Thus, our findings indicate that certain underlying, hidden values and certain key drivers were to be found among all the case companies.

The theories regarding value drivers are further expressed by Loos (2002) who states that they affect the value of the company and are to be referred to as direct intrinsic, operational and value-creational. Both Loos and Damodaran (2001) assert that these factors must increase the cash flow in order to increase the value of the firm. The empirical data processing and analysis stem from the theories stated by the above scholars. Damodaran states that the actions to increase cash flows, and thereby the value of the company, are to increase the cash flows generated by existing investments, increase the expected growth rate in earnings, increase the length of the high growth period, and reduce the cost of capital.

One of the most prominent stated reasons for a buyout is the strategic flexibility that is involved when the management is tighter bound to the owners. This could be seen in our case companies. Segulah claimed there was a great deal of efficiency improvement to be gained and also a strategic benefit of keeping NEA off the public market. With more focus on the strategic benefits, Segulah means to implement expansion and growth strategies. Since Segulah believes that a revision of the current strategy may result in lay-offs in the short-term perspective it will be of great advantage to be privately owned and thus, be

unaffected of a possible market reaction. Furthermore, Segulah had prior experience of the industry and stated that its ambitions were to enhance and accelerate the growth in all of the three business areas of NEA, both organically and through acquisitions. These statements can be compared to the theories conducted by Bruton et al. (2002) who argue that the improved efficiency is directly connected to a new strategic target, often more focusing on the company's core competencies. Another approach is further developed by Jensen as he puts emphasis on the new strategic target and changes in organizational structures that promote a behavior that often results in higher and more efficient performance under private ownership, albeit allocating the same resources as before.

Similar tendencies can also be identified in Capió as the CEO of Nordic Capital argued that Capió would benefit strongly from having fewer and stronger owners since they could set clearer targets and thus increase the efficiency. In addition, Capió displayed a substantial history of growth but was now considered an ownerless company due to the great dispersion of owners. The aim of Nordic Capital was to change the bureaucracy and state a clear strategy in order to uncover hidden values. Kaplan (1989) supports these actions in his study, which proves the efficiency increase in operating earnings and growth in acquired companies. Further, this behavior is in line with the general perceptions and understanding that owners gain the most from focusing on increasing cash flow as a value driver.

The strategy issue has also been an important aspect of the buyout of Gambro as EQT stated their belief that the company would function and develop better as a private company without the restriction and bureaucracy imposed upon public companies. EQT also emphasized the need for an increased focus on the core business and asserted that the expertise of the purchasing companies would facilitate the implementation of a proper growth strategy. Independent actors, e.g. analysts and other stakeholders, confirms this picture of Gambro being a company with hidden values in the forms of high rationality potential and the possibility to undertake cost reduction strategies.

The great focus on strategy by the private equity firms complies with Damodaran's (2001) theories stating that value-creation can be derived from marketing, strategic, and financial actions. However, he also argues that a large number of value-neutral actions, often given too much attention from both managers and external analysts, take place within a firm. Therefore, one has to be critical when analyzing the statements made by the private equity firms prior to the buyouts. This means to critically question and thoroughly examine the real content of a strategy since strategy sweet talk does not necessarily lead to value-creation. Thus, the question one has to ask is, does a certain action really increase the value of the firm or is it mere value-neutral?

This leads us to the next question. The empirical data showed that all of the private equity companies concerned in this study highlighted, almost solely, the strategic importance of revealing hidden values. One may question this easy way of explaining the buyout reasons and actions. Are there not any other significant and deeper factors involved?

### **5.1.2 Capital Structure**

Although the strategic factors gained the most attention prior the buyouts, there were also other issues in need of consideration. Jensen argues that the capital structure is of substantial importance when selecting and choosing buyout candidates. This factor is not very pinpointed in the prospects given to the shareholders. However, the empirical findings showed that it is a factor of major importance. Grammatikos et al. (1988) call attention to the fact that an acquirer benefits not only from production efficiency strategies, but a substantial benefit also derives from the financing of the buyout. In the case of Gambro, the company had a solvency considerable higher than the other companies in the industry. This was tightly connected to the great increase of cash holdings the year prior to the buyout. The company had cash holdings of 6.4 billion SEK and a capacity to redistribute 15 billion SEK before the optimal capital structure, set by the board, was exceeded. This organizational or financial slack should be observed and criticized since it might be a barrier for change, as it allows the company to perform poorly without intervention. However, private equity firms see this financial slack as a possibility for change and a higher leverage, which generates greater incentives and forces management to perform better due to increased bankruptcy risk.

In the buyout prospect of NEA, the solvency issue was barely mentioned. Nevertheless, NEA had, similar to Gambro, a high solvency ratio compared to the industry. The empirical findings also revealed that during the time subsequent to the buyout NEA sold all their premises at a profit of 348 million SEK, resulting in a lower cost of capital and a higher solvency ratio. According to the management, owning real estate properties was not strategically favorable. The analysis that can be drawn from this action shows that the private equity firms lowered the cost of capital, thus enhanced the value of the company. This complies with the theories of Damodaran (2006), who describes reduced cost of capital as a fundamental value driver.

Capio had, in contrary to Gambro and NEA, a considerably lower solvency compared to the industry average. This contradiction to the above mentioned characteristics should indicate that Capio's lack of this value driver would make the company lesser interesting as a buyout candidate. However, according to analysts and investors some of the hidden values of Capio,



similar to NEA, lies within the ownership of their own properties. By selling this, the company could set free a great deal of value and at the same time lower their debt and increase the solvency.

Furthermore, the analysis that can be made by this information indicates that the solvency is closely connected to the cost of capital and that it plays a major role in the buyout of the case companies. Additionally, analysts and investors seem to consider other factors affecting the solvency ratio and eventually increase value-creation. Thus, the solvency ratio and its affecting parameters are of great importance, albeit not discussed in any deeper sense in any of the case companies' buyout prospects. A topic of discussion when analyzing the occurrence of solvency is that a high solvency itself is not value-creative, but rather increases the cost of capital. However, it enables the company to take on more debt and thereby lower the cost of capital that leads to increased firm value, which benefits the shareholders. This is further supported by Damodaran (2006), who states that the benefit for the shareholders derives from a lower cost of capital resulting from this transaction.

As stated above, a change in the strategy for the acquired company seems to be an important factor in order to create value. In our discussion regarding the strategic values, questions about the given explanations and reasons made by the private equity companies were raised. Theory often explains the benefits gained from LBOs to be a reduction of the agency costs. Can this also be applied to our case companies?

### **5.1.3 Agency Costs**

To exemplify this, the study made by Bruton et al. (2002) sheds light on the fact that after a buyout the firms rather quickly experience a dramatic change of concern for efficiency. The explanation for this is said to be that the managers, who now have significant stakes in the company, start to prioritize efficiency improvements since inefficiency has a direct negative effect on their personal wealth. This is in line with theories regarding agency costs. Looking at the empirical data, there has been a great amount of switches in the management and board structures in our case companies which is further supported by this theory. The theories stated by scholars regarding agency conflicts, bounded rationality, and monitoring costs could for example be applied to Gambro as they fired all of the board directors, including the CEO and vice CEO. Furthermore, the new assigned board members and managers had strong links to the owners, EQT and Investor. In the case of Capio, media expressed critics and accused the chairman of the board, who had close connections to Nordic Capital, of neglecting the needs of the shareholders and instead being a puppet of Nordic Capital. NEA did also change the board members as well as the CEO. These

structural changes can, as stated above, be related and explained in the context of agency costs.

First of all, Jensen (1991) argues that corporate managers and board directors are involved in an agent-principal relationship with the shareholders, which generates conflicting interests. This can be clearly seen in the arguments and actions regarding the case companies. In order to improve the discussion and explanation of the above one can look at Fox and Marcus (1992) and their explanation of the agency relationship. The authors claim that managers in public firms might waste more resources than managers in private firms due to weak monitoring created by a dispersed ownership. Our companies has gone from public companies to private, thus the ownership structure has gone from being dispersed to one strong owner. The theory explains that by doing so, the agency conflict will be eased due to better monitoring, efficiency focus, and control. The new management will have stronger ties to the owner and thus, will have greater incentives to improve company value. This might be an explanation to why our case companies seemed to be so eager to change the upper level management. Further, Wolfe (2006) argues that the performance of the firm often can be improved by making changes in the board structure and organization. In the case of Gambro, the new board consisted of members with close connections to the top management of EQT and Investor. A reason to this is explained by Bance (2002), who argues that underperformance of firms can be related to underperforming board directors who cannot control and hold the CEO accountable. By appointing a board with strong ties to both owners and the CEO these problems can be mitigated. This reasoning is further supported by analysts and interviewees.

#### *5.4 Quantitative Analysis*

As described in the methodology chapter we conducted a statistical research and analysis in order to verify and gain a deeper understanding of the underlying reasons for the buyouts of the case companies. This research was based on findings and theories made by scholars. The general characteristics for a buyout company are; a matured company with stable free cash flow, low growth, non-optimal solvency, rationalization opportunities and illiquid stocks. The following analysis is aimed to map out any relations between the empirical data of the buyout prospects and articles, as well as the statistical data processed by us. The analysis on previous pages shows that most of the characteristics (mature company, stable free cash flow etc.) of a buyout are to be found in our case companies. Also, the analysis indicates that seldom are all different aspects of the actions and consequences of the case buyouts discussed or even conveyed to the former shareholders. The following pages mean to discuss and reveal more information. By doing so, the analysis above will be compared and measured with the statistical analysis. Does it comply with the theoretical framework?

### 5.4.1 Growth

The previous discussion regarding strategy and efficiency improvements and rationality possibilities emphasized that all of the case companies considered these aspects. Also, scholars argue that all these features mentioned above are common for companies undergoing a buyout. This study found results that supported these characteristic features. In the case of Capiro and Gambro the marginal profits for sales were low compared to the peer group. This low value indicates that Gambro and Capiro were having high costs within the company, resulting in lower profit. Also NEA had the lowest ratio within its peer group. These arguments further support the possibilities of cost reductions and rationality improvements within these companies. This raises the question of where this cost inefficiency stem from.

According to some scholars a misdirected or unfocused strategy will likely lead to competitive disadvantages in forms of higher cost and diminishing margins. On the other hand, Jensen (1986) discusses the importance of reducing agency costs, i.e. he states that the company suffers from a non-optimal organizational structure which he claims is affected by conflicting interests between the principle and agent. The question becomes even more significant when one compares the above stated ratio with similar profit margin ratios. In the statistical findings, both NEA and Capiro showed a considerable growth regarding cash flows; albeit still suffered from low profit margin, which also can be seen in the cash flow to turnover ratio. This is also the case of Gambro, although only looking at cash flow in this case will provide a misleading picture due to the divesting of a business area.

The theory states that buyout candidates are stable matured companies, which do not experience high growth and rapid technology improvements. Regarding the turnover growth, the empirical findings did comply with the theoretical framework for two of the case companies, NEA and Gambro. However, Capiro did not display any significant correlation with the statements in the theory. Thus, is this case company not matured and consequently contradicts with theory?

In order to grasp the full picture regarding company maturity, it is essential to look at other key factors. When comparing Capiro with its peer group, it holds more similarities to Elekta and Q-Med, two growth companies, than to matured companies. However, these two peer companies have even higher indications of being in a state of high growth. The difference is that Capiro in contrast to Q-Med indicates having more stable key ratios concerning cash flow to turnover, EBIT to sale etc. Furthermore, the argument of Capiro being more of a growth company is further strengthened by the fact that the company has shown a substantial increase of market value from the year 2002-2005. However, when looking at

Tobin's Q, Capiro's ratio is among the lowest within the peer group, whereas Q-Med and Elekta show distinct growth characteristics as their market value is substantially higher than their book value. Nevertheless, Capiro is neither a high growth nor a mature company.

#### **5.4.2 Valuation**

The market value of the firm is an indication of how investors look at a firm's possibilities, strategies, and values. Several scholars have argued that undervaluation is a reason for taking a company private. For example, Weir et al. (2005) conclude that the undervaluation is reflected in the price of the stock and the stock liquidity, i.e. the amount of stocks traded. As described above, representatives of NEA claimed that the company would benefit from going private, due to the fact that the stock suffered from low trading, thus it is not able to raise considerable funds from the stock market. This can also be seen in our statistical findings which show a significant lower value both in terms of stock turnover and the total amount of stock turnover to market value compared with the peer group. It can be questioned if the stock was underperforming, and in that case, how much? To be able to answer this question one also has to consider the Tobin's Q. In NEA's case it does not display any significant divergence to the rest of the group, as the company lies in the middle layer. Thus, the stock might not be undervalued. But since it suffers from illiquidity, the question remains whether or not it is favorable to be publicly quoted. In addition, Capiro and Gambro are positioned close to the stock market average of total amount stock turnover divided by the market value. Therefore, one can argue that these companies do not suffer from illiquidity within its stock.

#### **5.4.3 Capital Structure**

Earlier in the analysis, a discussion regarding the importance of focusing on the capital structure within the case companies was shed light upon. The discussion showed that this factor was more important than was revealed in the prospects. In the case of Gambro, the company had a solvency in 2005 of 62 percent, which was considerable high compared to the peer companies. Furthermore, the divesture of a business area increased the cash holdings to book ratio vastly. Jensen (1991) states that a company with cash flows that exceeds its investments opportunities, and are not paying dividends, are subject for managerial discretion; hence will most likely suffer from agency cost and therefore might become a target for a LBO. NEA shows similar characteristics because its cash holdings to book value were substantially above the peer group median. Furthermore, NEA's solvency ratio was in the higher layer, which displays a possibility to make rational capital structure changes.

According to theory, the possibility to change the capital structure is of great importance for a LBO target. In the case of Capiro, one cannot see any obvious possibility to radically

change the capital structure, due to already low solvency. However, as the earlier discussion mentioned there were other ways of changing the capital structure, i.e. Capio had hidden values in the forms of their business premises.

The theory explains that a company with weak ownership structure has a greater risk to experience a takeover. This is due to several factors. First of all, the agency costs in these companies are often higher because of the dispersed ownership structure resulting in a strategic indecisiveness; secondly these companies are more likely to be acquired. In the case of NEA, who had one strong owner (Reveman and Broberg families), a takeover would be harder to accomplish. However, in this case the current owner was willing to sell the company, facilitating the whole buyout procedure. Furthermore, the empirical findings presents Capio as an ownerless company, with disperse ownership resulting in high agency costs. This view was supported by our findings, where Capio stood out compared to the peer group regarding ownership structure. However, in the case of Gambro, Investor who already had a majority stake was involved in the buyout together with EQT. This buyout was explained in terms of high agency costs just like the Capio deal.

As presented above, the two empirical materials display unanimous arguments in some of the aspects and reasons for the buyouts. However, there have also been some different opinions regarding some actions. Our intentions have been to clarify and shed light on both the correlations and discrepancy between theory and practice. The differences in opinions make it, in some cases, hard to draw any general conclusions. However, we believe that through the analysis we have discovered certain patterns and behaviors for the case companies; albeit we will not draw any general conclusions for the entire LBO business. This discussion and analysis is meant to serve as a base and foundation for the conclusions that will be presented in the next chapter.

## 6. CONCLUSION

### *6.1 Conclusions From This Study*

Our findings from this study can be regarded as hypotheses due to their specific characteristics. The thesis has shown that hidden values are of significant importance among the case companies and they are the prime drive factors for our case companies. The analysis displays that among the case companies, it was hard to identify and observe the hidden values of importance by just reading the buyout prospects and articles. For example, as discussed in the analysis, the strategy was highlighted by all of the private equity firms. However, we question the simplicity of only focusing on and conveying strategy improvements as the main reason for a buyout. This was also shown when conducting interviews with private equity firm representatives as they were very reluctant of providing a broader analysis. We conclude that by pinpointing focus on strategy as the main buyout reason, the private equity firms avoid to reveal all the hidden values. Hence, the shareholders will not be provided the full picture of the buyout reasons. By conducting two separate empirical studies and compare them with the theoretical framework, we could see evidence that the arguments stated in the prospects and articles were not always the most prominent reasons for the buyouts. Since strategy covers many factors and has a quite diffuse meaning, it is of importance to break it down in order to uncover its components. The private equity firms often stated strategy and efficiency improvements as the main reasons for buyouts. However, the findings demonstrated that this many times implied business divesture, selling parts of the assets, and the change of capital structure. These actions were not proposed in the prospects and articles. We conclude that for the companies in this study two of the main incentives for being a LBO target were the opportunities to divest its business and undertake organizational changes.

Moreover, a conclusion can be drawn that the capital structure seems to be one of the most significant factors regarding value-creation. The high potential of changing this factor was another main reason why our companies were acquired. As we could see in the case of Capio, the solvency ratio alone was not enough to evaluate the capital restructuring potential. By scrutinizing the company figures we found factors that had indirect effect on the solvency. As the analysis points out, both Capio and NEA had possibilities to both lower the cost of capital and set free liquid assets by selling their business premises. This proves that one can not only look at the solvency ratio, but also have to look at affecting factors. The most explicit case company regarding this factor was Gambro, who substantially exceeded their solvency target, in addition to have retained large cash-holdings. We can conclude that this theoretical factor had great correlation and significance with the case companies in this study.

From the analysis, it was hard to draw any conclusions about undervaluation of the stock since there was no correlation to theory among the case companies in the study. Thus, we could not verify that stock undervaluation is a reason for taking a company private. However, in the case of NEA the stock faced illiquidity making it hard to raise funds. Thus, one can argue about the meaning of being a public company. Hence, that would be a strong reason for the company to go private.

We further verified and concluded that, in compliance with the agency theory, all of the case companies replaced their board members and CEOs in order to improve efficiency and flexibility. This is due to the need of minimizing agency costs and the belief that a unanimous management will put increased focus on long-term performance of the firm and the maximization of shareholder wealth. Moreover, companies will reduce their administrative and bureaucracy costs stemming from being a public company, which also was an important reason for going private according to the private equity firms.

As we can see in the analysis and the empirical data, many of the buyout characteristics explained in the theoretical framework can be applied to the case companies. Thereby, we can conclude that our findings can be explained with the dimensions that the agency theory embraces. Furthermore, many of the characteristic factors stated by other theories and scholars can be applied and related to the case companies, e.g. value-drivers, capital structure changes etc.

Regarding the case companies we can conclude that they do not fulfill all the characteristics of the theories, but rather a few of them. As discussed above, we can also see that some characteristics are of more significance than other for a LBO target. One of the characteristics we found not complying with the theoretical framework and also differed between the case companies was the factor of maturity. However, Capio, who displayed considerable higher growth than NEA and Gambro, was indicating a high but quite stable growth, which we conclude being a sign of going towards a more mature state. Through interviews and theory we understood that LBO targets need to have reached a certain level of maturity, i.e. they need to have stable cash flows in order to be able to carry the cost of the increased leverage. We can conclude that although Capio may not yet be what is considered a matured company, they do have high and increasing cash flows, which might be an explanation for the targeting.

Furthermore, we can conclude that one has to look further and beyond the buyout characteristics drawn from the theories. For example, we understood that the agency theory holds a great deal of dimensions and factors. Therefore, one has to scrutinize the softer

targets discussed in the agency theory since it is essential to consider both statistics and soft data and the relationships between them. As we saw in our findings, the underlying factors for the buyouts could not only be explained by numbers and figures, but rather softer factors like business structure, strategies, rationalization potential etc. We can conclude that the case companies many times stood out and complied with the characteristics stated in the theories in comparison to their peer groups. However, regarding some factors, the case companies showed less correlation with the theoretical framework and did not stand out from the rest of the peer group companies. We believe that one reason for this might be related to our peer group sample. Consequently, we have formulated some hypotheses below that could be interesting for future researchers within this area.

### *6.2 Suggestions for Further Research*

During the research process of this study we have encountered various crossroads. We believe it might be of interest to further investigate some of those trails more closely. It is possible that a comparison with a larger peer group might have resulted in more significance regarding these factors. Another reason might be that the selected case companies are too few or that they have non-optimal characteristics. It might be that a company does not necessarily have to, or cannot, fulfill all the characteristics. In order to grasp this picture and conclude this kind of arguments one must have larger samples of case companies and peer groups. However, we can conclude that by looking into statistical data one can find hints of possible LBO candidates and maybe exclude some targets, but as stated above, it is essential to grasp and understand the whole picture. For example, we consider the following proposals to be of certain interest:

- To conduct a study with a higher selection of sample companies, e.g. LBOs in several countries.
- To make a plain statistical survey in order to find significance over a greater sample.
- To observe how the LBOs perform outside the stock market, and how they react to a future reversed LBO.

These kinds of studies should provide a better base for drawing reliable conclusions in this area. Nevertheless, very few companies have actually been bought out from the Swedish stock market by private equity firms. But the trend is definitely increasing towards more and bigger deals which in the future will give researchers a better base for this kind of study.



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## APPENDIX 1 Facts and Figures

### Heavy Industry

		Turnover Index	CF Index	CF/TO	CF/MV	EBIT/Sales	Tobin's Q	STO/MV	TOV	Solvency	Cash/BV
<b>NEA</b>	2005	107,97%	119,83%	3,16%	5,40%	0,05	1,03	0,09	0,09	49	13,40%
	2004	107,25%	124,66%	3,31%	6,92%	0,04	0,83	0,05	0,06	50	17,56%
	2003	106,31%	103,79%	2,78%	5,82%	0,03	0,83	0,05	0,05	49	10,27%
<b>Haldex</b>	2005	116,71%	86,19%	6,59%	13,99%	0,06	0,76	0,80	0,89	40	5,45%
	2004	105,38%	48,25%	4,08%	10,63%	0,05	0,67	0,31	0,85	36	4,81%
	2003	94,11%	62,24%	5,90%	15,65%	0,03	0,63	0,68	0,34	39	4,31%
<b>Cardo</b>	2005	75,94%	25,51%	2,72%	3,67%	0,03	1,05	0,49	0,53	53	3,03%
	2004	74,07%	55,66%	6,08%	8,17%	0,05	1,14	0,39	0,40	56	4,23%
	2003	74,08%	78,19%	8,53%	10,96%	0,06	1,20	0,35	0,40	58	3,43%
<b>Scania</b>	2005	133,93%	138,19%	12,68%	12,39%	0,10	0,83	0,82	0,95	30	1,41%
	2004	120,10%	98,52%	10,08%	10,88%	0,10	0,75	1,17	1,29	30	1,59%
	2003	106,97%	106,23%	12,20%	15,24%	0,09	0,62	0,15	0,16	28	1,84%
<b>Fagerhult</b>	2005	119,25%	77,51%	4,88%	4,34%	0,06	1,35	0,05	0,07	37	8,50%
	2004	93,69%	86,54%	6,93%	7,31%	0,04	1,63	0,05	0,05	59	14,40%
	2003	95,12%	106,59%	8,41%	8,96%	0,07	1,57	0,04	0,05	65	15,30%
<b>Autoliv</b>	2005	107,11%	72,17%	7,72%	11,91%	0,08	0,75	1,26	1,34	46	5,51%
	2004	104,49%	100,95%	11,07%	17,11%	0,08	0,83	1,57	1,62	49	4,78%
	2003	99,22%	86,43%	9,98%	16,13%	0,08	0,76	1,09	1,40	49	2,17%
<b>Nibe</b>	2005	196,44%	143,60%	5,32%	4,14%	0,08	1,57	0,39	0,10	33	4,23%
	2004	162,59%	211,87%	9,48%	8,15%	0,12	1,49	0,27	0,08	36	3,58%
	2003	126,07%	131,45%	7,59%	7,33%	0,10	1,36	0,20	0,05	35	4,36%
<b>Volvo</b>	2005	129,20%	145,83%	5,82%	8,86%	0,08	0,61	1,11	1,38	31	14,37%
	2004	113,36%	159,38%	7,25%	13,31%	0,07	0,52	1,19	1,29	31	15,59%
	2003	98,44%	133,33%	6,98%	13,35%	0,01	0,41	0,82	1,04	31	12,21%

CF / TO = Cash flow / Turnover

CF / MV = Cash flow / Market value

Tobin's Q = Market value / Book value

STO / MV = Stock turnover / Market value

TOV (Turnover velocity) = Turnover amount of stocks / Total amount of stocks

Cash / BV = Cash holdings / Book value

### Healthcare Industry

		Turnover Index	CF Index	CF/TO	CF/MV	EBIT/Sales	Tobin's Q	STO/MV	TOV	Solvency	Cash/BV
<b>Gambro</b>	2005	53,26%	18,92%	3,84%	1,89%	0,09	1,00	1,01	0,87	62	37,90%
	2004	96,53%	95,97%	10,75%	8,80%	-0,02	1,03	0,69	0,87	57	1,38%
	2003	94,77%	122,51%	13,97%	17,81%	0,06	0,60	0,57	0,69	58	1,03%
<b>Capio</b>	2005	148,62%	289,43%	10,09%	9,60%	0,09	0,75	0,85	1,01	29	0,73%
	2004	115,02%	201,61%	9,08%	12,69%	0,13	0,71	0,84	0,97	38	6,15%
	2003	116,68%	227,33%	10,09%	20,00%	0,06	0,49	0,75	0,77	28	3,94%
<b>Astra</b>	2005	134,24%	120,56%	28,15%	35,81%	0,27	0,76	1,16	0,32	55	2,19%
	2004	120,09%	86,13%	22,48%	39,70%	0,21	0,47	1,33	0,23	57	4,11%
	2003	105,65%	60,22%	17,87%	20,87%	0,22	0,68	0,83	0,20	56	3,11%
<b>Elektro</b>	2005	115,12%	297,81%	12,94%	3,79%	0,12	2,41	1,07	1,83	37	16,61%
	2004	105,92%	327,01%	15,45%	7,70%	0,11	1,89	0,75	0,83	46	37,42%
	2003	101,57%	263,50%	12,98%	8,42%	0,12	1,45	0,79	0,88	49	29,14%
<b>Getinge</b>	2005	137,50%	96,52%	9,84%	5,67%	0,15	1,42	0,86	0,87	37	4,71%
	2004	126,03%	90,16%	10,03%	7,01%	0,16	1,28	1,01	0,96	34	3,97%
	2003	106,02%	114,42%	15,13%	10,66%	0,14	1,08	0,60	0,22	29	4,20%
<b>Nobel Biocare</b>	2005	155,95%	153,34%	22,23%	63,41%	0,33	0,33	0,71	1,14	69	24,67%
	2004	124,76%	186,77%	33,84%	36,57%	0,30	0,77	0,84	1,05	79	42,00%
	2003	107,40%	118,63%	24,97%	27,25%	0,26	0,81	0,57	0,75	75	29,12%
<b>Q-med</b>	2005	188,49%	182,49%	4,41%	0,69%	0,11	4,35	0,35	0,44	78	0,01%
	2004	158,98%	-33,36%	-0,96%	-0,17%	0,42	3,01	0,54	0,53	81	0,01%
	2003	117,30%	24,24%	0,94%	0,14%	1,35	2,80	0,32	0,43	86	0,01%

## APPENDIX 2 Questionnaire

- What specific characteristics are interesting when analyzing potential buyout targets?  
With emphasis on:
  - Management
  - Maturity
  - Growth
  - Capital Structure
  - Underperformance
  - Industry
  
- What financial key ratios are of special importance?
  
- Are there any general characteristics that is applicable for all companies or is it dependent on the specific company's situation?
  
- Are there any benefits related to being privately owned compared to being public?
  
- What characteristics were the most prominent in the specific deals of Capiro, Gambro, and NEA?