The Factors of Success and Failure of LBOs-Case of Morocco

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Abstract: ***Appeared in Morocco in the 2000s, this technique has become over time a profession in its own right, which allows a growing number of companies to solve their transmission problems, and many managers employees to become entrepreneurs. But the reality is that very few companies are likely to be the object of an LBO given the criteria of the target to be respected and that it is a business that remains extremely risky where reversals of situation can be very fast and very important losses. The specificity of the Moroccan capitalism represents a favorable environment for the development of the private equity business and more precisely that of the LBO. During the elaboration of this paper, we tried to analyze the factors of success and failure of the LBO operation. In spite of the scarcity of information concerning this type of operation in Morocco.***

Keyword: Leverage Buy Out, LBO, Finance, Private Equity, Value

1. Introduction

The Private Equity business consists of taking majority or minority stakes in the capital of small and medium-sized companies (SMEs), generally unlisted. This equity investment to finance their start-up, growth, transfer, and sometimes their recovery and survival. Private equity is an essential financial and economic resource for companies, alongside bank loans or private financing. Private Equity supports companies in various areas:

It provides the financing and capital necessary for its development,
- It supports management in strategic decisions,
- It enables it to improve its value creation potential for the benefit of its customers, shareholders and all its employees, managers and staff.

To carry out the financing and management of the companies accompanied in the medium and long term in the different phases of their life cycle, private equity is structured around four business lines: Venture Capital, Expansion Capital, Buyout Capital and (LBO) and Turnaround Capital.

Investment funds are increasingly present in the market for acquisition market and in the national economy. The majority of companies concerned by acquisitions, especially leveraged buyouts (LBOs), are more and more (LBOs), are performing significantly better than the national sector averages.

More than a financial issue, the transfer of companies is a social issue. Sometimes criticized, the LBO (Leveraged Buy Out) is nevertheless a classic financial technique combining capital and debt in the context of the transfer of a company, whether this operation is carried out with or without professional financial investors.

The acquisition debt put in place is not there to hamper the company's capacity for growth capacity of the company. The interests of the investor and the company are totally aligned, and it is the growth of the company's results that will constitute the essential added value for the investor: it is thus by the growth of the results of the company that will build its financial performance.

Remember that the success of the LBO depends on the profitability of the funds invested by the in the operation. However, the profitability of the investments made weakens when the companies are kept in the portfolio for too long because if the IRR1 depends on the capital gains realized at the sale, it also depends on the length of time the invested funds are tied up.

Exit strategies are crucial for investors since the resale of investments will determine part of the return on this investment. The strategies depend on a large number of aspects ranging from the specific characteristics of the target company to external factors such as market conditions or the macroeconomic environment.

Frequently, a transaction fails on an exit issue and investors abandon the acquisition of a target only because they are not sure that they will be able to resell their stake in within a reasonable period of time. It should be noted that exits from LBOs are becoming increasingly rapid, so in general LBO investors generally keep their assets between 3 and 5 years. A distinction must be made in what follows between the case of success and failure of the operation. This article aims to analyze the different factors of success and failure of LBOs.

2. The Exit from the LBO arrangement

The exit determines the success of the LBO, it must be considered from the beginning of the arrangement

If successful, after a few years during which the target's performance has been satisfactory and have allowed for regular repayment of the senior debt and in case of failure, when the company's performance does not live up to the initial expectations.

1) In case of success

The problem of the exit of the investors is an essential data of the operations of LBO since they must be able to concretize their capital gains by transferring the shares of the target company. Several exits are available.

The IPO2

The initial public offering of a company acquired through leveraged financing is a measure of success of the LBO in so far as it ensures the sustainability of the company, which will thus be able to resort

1 Internal Rate of Return 2 Initial Public Offering to public savings to finance its growth with the positive effects of the brand image and credibility that the IPO brings, while image and credibility that the IPO brings, while allowing the investor to realize the return of all or part of the funds invested.

However, this outcome is only possible if the stock market conditions are favorable and the company to be valued at an attractive price.

However, it comes up against, on the one hand, the technical difficulty of the conditions for the introduction of the company on the stock market (minimum size, history of growth and profitability, the rule of two years of activity and two balance sheets approved before the introduction on the Second Marché, etc.) and, on the other hand, the economic and economic stumbling block given the chronic morosity of the stock market.

The IPO consists in selling securities, shares or bonds, for which information is limited before the launch of an operation to a large number of different investors (institutions, individuals and employees). This operation takes place in different stages and in a first phase there are studies which are carried out by the banks to know the choice of the place for example, which do the due diligence. We then move on to a phase of publishing the analysis notes and a marketing campaign during which the offer is launched.

Vernimmen also points out that since the IPO can only be carried out in stages, it does not allow investors to demand a control premium potential buyer to increase their capital gain. Indeed, all minority and majority shareholders will receive the same premium when transferring control of a listed company. Indeed, this premium will only be determined according to the strategic value of the company, which will not be the same for all potential buyers.

In the case of an IPO, investors will be subject to an IPO discount, which is explained by the asymmetry of information between the seller and the investors. But such a transaction is not easy to set up and not all companies are able to meet the requirements for access. Several criteria must be taken into consideration:

- Have a minimum size
- Have a history of growth trends
- Evolution of profitability
- Presentation of certified accounts.

However, going public remains random and rare, not impossible.

Sale to an industrialist

One of the outcomes of an LBO is the resale of the acquired company to a competitor or in search of vertical or horizontal integration. It is in this configuration that 100% of the capital can be mobilized, while the valorization of the synergies of rapprochement makes it possible to maximize the selling price. This is a profitable solution for the financial investor in so far as the competing industrialist is inclined to offer a good buyout price in order to achieve its growth policy, and is sustainable for the company, however, it often comes up against the hostility of the management team which is deprived, at best of freedom of action, and at worst, of activity, in so far as the team in place is often replaced in the long term by the team of the new industrial purchaser. Despite all the inherent qualities of a company that has been the subject of an LBO: profitability and visibility, niche position in a buoyant market, not all of them find industrialists interested in a buyout. They then have to find new partners either in a classic development capital context (without debt, or by debt), or by resorting to a new LBO arrangement that we call secondary LBO.

Secondary LBOs

These secondary LBOs, often referred to as secondary buyouts, which are not their explanation in stock market exits and difficult industrial disposals.

The phenomenon is more complex and broader. It is linked to a fundamental trend in the organization of this market: the increase in the number of funds active in leveraged deals, as well as it is linked to a fundamental trend in the organization of this market: the increase in the number of funds active in leveraged transactions, as well as the increase in available funds. The institutional investors are allocating more and more assets to private equity.

By definition, secondary LBOs take place on companies that have already been through an LBO. Therefore, equity and debt are less subject to risk. The company and the management team have already proven themselves during the primary LBO.

The company has demonstrated its ability to repay the acquisition debt on proven cash flows and has put in place a management control and monitoring system adapted to the requirements of shareholders and bankers. Finally, the management knows how to manage the partnership with the financiers.

In short, the disposal process is better prepared, more structured and better documented. For these same reasons, the risk profile is also more favorable in a secondary LBO than in a primary LBO for the lending banks, which banks, which can favor a higher financial leverage.

Secondary LBOs are based on a different project than primary LBOs because a secondary LBO only makes sense if it is based on a new "founding project" based on a growth strategy. In this case, the secondary LBO has the same value creation potential as a primary LBO. The company must be able either to create value again or to continue the value creation process initiated in the primary LBO. This enrichment is not easy to generate because during the first LBO the target company has already management difficulties have been eliminated.

It is therefore understandable that before considering a secondary LBO, one must ensure that the target respects a few essential qualitative criteria:

- The primary LBO must have been a great success
- The company must be in a positive dynamic
- It must have development projects that allow it to constitute a strategic line that creates value
- The company's position in its segment must provide it with an indispensable sustainable value.

As we have just indicated, the candidate company for a second LBO, and its management, have demonstrated their ability to operate independently and generate sufficient cash flow to sufficient cash flow to repay the debt of the first transaction.

The "classic" risks associated with the first LBO are therefore very much reduced. On the other hand, if the fear of debt repayment has virtually disappeared, an AFIC report insists on the difficulty of reaching a high IRR level.

Leverage recap

Faced with the scarcity of industrial buyers, the hazards and risks of going public, and the price of certain LBO funds, recapitalization, or leverage recap, is an exit alternative to consider.

A recapitalization is an operation in which a company that had taken on a lot of debt some time ago, for example in the context of an LBO, and which was able to repay a large part of its debt thanks to the amount of cash flow generated, decides to surrender.

But this technique cannot, obviously, be used by all investment funds: the investment funds: setting up this type of financing to repay the equity invested in the company the equity originally invested in order to maintain a constant leverage effect, must be accompanied by active management of the target's cash flow to guarantee the cash flows. This technique is therefore reserved for high-performing investments.

This operation does not really represent an exit, as the fund remains the shareholder of the company, but it does allow for a of the company, but it does allow for a partial exit of the equity capital initially invested. The recapitalization technique requires several factors to be taken into, because the risks associated with any LBO are reinforced here.

2) In case of failure

Since LBOs are by nature risky transactions, failure is part of the business. However, LBOs are probably one of the least risky private equity activities. Indeed, the deals are based on very profitable target companies with a strong market position, it is therefore rare, even if it happens, to see a target file for bankruptcy a few months after the takeover. On the other hand, it is more often the case that the company's performance, while remaining positive, does not live up to initial expectations and that the operation requires restructuring. In any event, it is estimated that the most critical period of an LBO is during the first three years following the takeover.

When the difficulties encountered do not lead to an irremediably compromised situation, the shareholders and the bankers must discuss the solutions to be implemented to ensure the sustainability of the operation. Most of the time, the solution involves an exchange of time for money: the bank agrees to extend the life of its loan (and thus increase its risk), or even to give up part of its claim, if the investors inject equity into the business, and thus demonstrate that they believe in the viability of the operation and the turnaround plan.

If the shareholders and the bankers cannot agree on a restructuring plan, or if the situation is restructuring plan, or if the situation is seriously compromised, the commercial court must pronounce a judicial reorganization. We then return to a classic procedure where the court is seized and orders, generally at the end of an observation period, the continuation of the company, the transfer of the company or the judicial liquidation.

Thus, the exit from the arrangement will be all the easier if the investors have the investors will have been able to improve the profitability and/or to grow the company. This may take the form of a successful restructuring or cost reduction plan or a series of acquisitions of smaller companies in a sector.

In case of insufficient results of the target company, which would jeopardize the payment of dividends to the holding company and therefore the payment of financial fees to the banks, several the restructuring of the LBO, the loss of control and finally the filing for bankruptcy.

Restructuring of an LBO

The restructuring of the LBO does not necessarily lead to the exit of the main shareholder; it is linked to the reorganization of the debt such as rescheduling, deferred repayment, new debt, consolidation of short-term debt etc. And sometimes it results either in the exit or consolidation of certain minority shareholders.

The loss of control

The loss of control may be linked to the first case and involves either the entry of a new investor or the sale of the shareholder's shares, or the transfer of the shares of the main shareholder to another shareholder already in place who will also subscribe to an increase capital. This consolidation of equity capital will also allow for a possible.

The bankruptcy filing
Filing for bankruptcy is the most radical solution. It is the result of the non-viability of the set-up, generally linked to major problems in the target company.

Indeed, a dysfunction due only to the holding company would see the first two solutions being preferred.

It can be seen that the unwinding of the LBO is not achieved through a single operation. In the same way, the exit from the arrangement is not always obvious.

Depending on the results of the initial LBO, different options can be considered industrial sale, exit on the stock market, sale to the management or even new operations such as secondary LBOs or recapitalization. On this point, the question that arises is: What are the factors that led to the difficulty of the operation?

Financial difficulties
The financial difficulties concern the holding company of the takeover, whose financial structure may not be suitable. The weight of the debt may be too high and take up too much cash from the target company, which can no longer finance its investments or the growth of its or the growth of its working capital. Conversely, if the holding company does not generate enough free cash flow, the debt service will not be flows, the debt service cannot be ensured.

The financiers may have been too greedy and eager to benefit from an excessive leverage effect. Faulty asset/liability management means that the financial EBITDA is much too high compared to economic EBITDA. This management error can be due to poorly performed audits, a poor understanding of the target market, a sudden this management error may be due to poorly performed audits, a poor understanding of the target market, a sudden turnaround in the economy, or to ineffective social leverage.

The managerial difficulties
As we have pointed out, LBOs are based on extensive audits. The target and its sector of activity are rarely badly identified. The management problems are rather linked to human difficulties.

The case of LBOs is certainly more revealing. Thus, at the time of the set-up, the management team can be "parachuted" into the target without a complete mastery of the sector. LMBIs are riskier than LBOs.

The importance of social leverage is clear. It is absolutely necessary that the management invests equity in the holding company and feels truly involved in the operation. The lure of profit must therefore be a real driver for good management.

It is true that failures of LBO operations are rare, as the IRR they generate prove it, but they would like to analyze the value creation generated by buyout operations.

The Ex-Post impact of the LBO

Do LBOs create value?

1) **Value creation according to the classical financial theory**

The LBO model uses a very high level of debt to finance its assets and debt is at the top of the list. In 1986, Jensen analyzed the impact of very high debt in order to understand the impact on the different stakeholders of LBOs. He formulated his famous free cash flow theory, which will shed light on our discussion as it shows the solutions that debt can offer to agency conflicts, as well as Modigliani Miller's contribution to this approach.

LBOs and the resolution of agency problems
The agency theory is based on the principle that each individual act in such a way as to maximize his or her self-interest. In so far as the managers are not shareholders, each party seeks to maximize its personal objectives. The managers seek to maximize their compensation and job security, while shareholders seek to maximize the return on their investment given the risk involved.

Managers prefer to finance the growth of the company they lead by a massive recourse to self-financing, because this resource is very simple to find. But it is much more complicated for managers to call upon shareholders to finance an asset, it would be necessary to set up a capital increase difficult and time-consuming to carry out.

The point of view of the shareholders is totally different; they consider that sound management would consist in distributing the management would consist of distributing all potential dividends after each year-end and then and then to proceed with very targeted capital increases, intended to finance a particular project, the risk of which to finance a particular project whose risk and profitability expectations can be correctly identified. These differences of opinion can lead to real tensions between management and shareholders. They have a cost.

They can be quantified according to size of the company, as they are materialized by financial audits requested by managers, for example. These conflicts have another cost that is much more difficult to define but very real: the loss of efficiency or loss of opportunities that the company suffers as long until these conflicts are resolved. Thus, highly leveraged structures such as buy out structures can mitigate agency costs in companies that generate significant free cash flow.

For a company to manage its flows effectively and maximize its value, free cash flow should be distributed to shareholders rather than retained within the company and used to the company's self-financing capacity. We know that shareholders prefer that the result be totally distributed and that the managers proceed to very targeted and identified capital increases, intended to finance very specific projects for which the IRRs are identified.

The retention of this cash gives managers certain autonomy with respect to the financial markets and shareholders. They do not have to raise capital, they prefer excess cash, and a strong autonomy towards shareholders and the markets.

Conversely, if managers were to distribute their excess cash to shareholders, who are fond of dividends, they would have to finance themselves on the markets in order to be entrusted with the funds needed to finance clearly defined opportunities.

When all the potential dividends are distributed, the shareholders have a real means of control over the managers. In short, they are subject to the control of the markets.

This battle for free cash flow highlights the fundamental role of debt in an LBO structure. It effectively guarantees the managers' commitment to distribute a significant proportion of future cash flows so that the holding company can ensure the repayment and interest payment of its debts. Debt appears to be a real substitute for dividends, it simply reduces the agency conflict by reducing the cash flow available at management's discretion. In an LBO operation where debt represents up to 75% of the assets, financial management must be very tight, and it is this tightness that creates wealth because it forces the managers to be particularly efficient.

The Modigliani-Miller approach

Lower agency costs, coupled with debt, should encourage shareholders to take on more debt. We have seen that debt can reduce agency conflicts and generate agency conflicts and generate significant tax savings, yet this analysis is not free of flaws and even goes against the classical financial theory formulated by Modigliani and theory, who show that a simple financial decision does not create wealth. But what do these two analysts contribute to the understanding of buy-out operations?

Modigliani and Miller proved that in the absence of tax distortions, there is no optimal financial structure. In short, the value of the economic asset is independent of its independent of the way it is financed. The increase in the debt level of the takeover holding company increases the shareholder's risk and therefore the profitability required by the shareholder. Debt increases the risk of the company's non-liquidity, so it is normal that the required remuneration is higher. Adapted to the LBO, this analysis would stipulate that the high returns demanded by the shareholders of the takeover holding company would only be a fair compensation for the enormous financial risks they incur.

With a corporate tax, the value of an indebted company is equal to the value of the economic assets of a non-indebted company plus the present value of the tax savings tax savings generated by the financial costs, discounted at the cost of equity. We find ourselves here in the context of LBOs and tax consolidation, where the financial costs are deductible from the tax base, debt should therefore be preferred. Its tax treatment would increase the value of the economic asset.

From this point of view, the cost of bankruptcy should not be neglected in the evolution of the holding because the higher the leverage, the higher the probability of bankruptcy.

The statistical analysis of too much leverage shows that the present value of the related bankruptcy costs bankruptcy costs cancel out the goodwill or the goodwill related to the tax savings generated by the debt. If debt increases the wealth created by financing a larger asset, it increases assets, it also increases the probability of default and therefore there would be no consequently, there would not be an optimal structure, which would have no impact on value creation.

2) Factors of value creation

In this section we will try to analyze whether LBOs really create value or if their financial structure generates too much risk for the target and the holding company.

We will distinguish two levels of analysis, the first of which concerns the way in which shareholders, managers and customers of the targets have perceived this operation, and then the one the one devoted to the analysis of the rates of return generated by these operations.

Qualitative factor

Managers of companies involved in LBOs claim that these operations allow their companies to grow more, avoid bankruptcy or even avoid being absorbed. In this type of operation, the operating cycle is analyzed and all expenses are carefully examined in order to avoid carefully of the financial situation which can even lead to the failure of the set-up.

According to the AFIC, the acceleration of the growth of the companies is explained by the action’s strategies set up following the LBO such as the conquest of new markets, the assertion of the external growth or the widening of the product range. This model of LBO pushes managers to be aggressive on the commercial level and this willingly launches in a secondary LBO.

It should be added that a majority of managers and financiers would not make substantial changes to the legal and fiscal conditions for setting up LBOs, even if certain limits were clearly identified, such as tax incentives for investors, lowering the threshold for tax consolidation, etc. And this is how a majority of managers consider the LBO favorable.

Financial factor

LBOs must generate a substantial IRR, which is essential for the investment fund to be able to remunerate its own capital providers. The IRRs generated by private equity and its LBO branch are very high and push the other types of investments that can be envisaged by financial backers far behind the results obtained by private equity.

The analysis of the financial aspect reveals two main points:

The dispersion of IRRs around the average is significant

An analysis by the AFIC of the IRR generated by LBOs reveals a strong dispersion of results, with 37% of the dispersion of results, since 37% of LBOs have a rate of return between 0% and 10%. This result, according to AFIC, includes two very different types of LBOs:

- Those that have failed
- Those that have just been created and have not yet

generated a return.

The valuation of the holding's equity is almost equal to the investment price, and the debt of the holding company is only slightly amortized.

These operations truly create value and are able to meet the requirements of funds and institutional investors who pay on this return. An analysis by sector reveals other revealing disparities.

IRRs vary greatly depending on the sector of activity
The service sector has the lion's share of the market, with the highest IRRs in the service sector. Financial services and information technology and telecom activities, and the lowest in the more traditional sectors, such as sectors, such as distribution or media and communication.

The sectors of activity that have been subject to provisions confirm these trends; the return is well correlate well with the risks taken. These provisions represent, on average between 15% and 20% of the sums injected. These amounts are still very significant and show that private equity is indeed a very risky business, that losses can be very heavy and affect future results.
This is why we can say that LBOs are one of the least risky activities in private equity investment.

III. Buy out operations in Morocco

Unlike in Europe and the United States, LBOs in Morocco has not yet reached the market phase.

The financing of the transmission and development of Moroccan companies
The foundations of a Moroccan LBO market exist and indicate a promising future for this type of operation. The necessary conditions for the development of an LBO market are present:

- An increase in the demand for equity capital, not only to face the problem of transmission but also to accompany the development of the companies of recovery,
- A supply of capital which is being structured around investment funds interested in the potential of Moroccan companies.
- A business context encouraging the use of leverage.

The problem of transmission

In Morocco, the need for equity capital has been clearly identified in order to face the same transmission problem that has been identified in Europe. Indeed, 98% of the Moroccan economic fabric is made up of SMEs, almost half of which have a family shareholding structure. Faced with this reality, several companies belonging to this category are experiencing a transmission problem.

Arriving at retirement age, a majority shareholder in a family SME who cannot find a successor in his descendants, will find in the LBO the best alternative to transfer in due form to a direct competitor. Of course, in an economy strongly made up of SMEs, they often tend to group together in unions by sector where the direct competitors of this sector meet. As a result, the shareholder-manager of an SME only sees the sale of his company through their competitors or other colleagues that they work within the trade unions of their sector.

Aware of the opportunity presented by the issue of transmission in Morocco, the managers of private equity funds in Morocco, seriously engage in strategic monitoring in several sectors with a growth potential, in order to detect the possibilities of recovering the business of a majority shareholder wishing to withdraw.

LBO and the development of Moroccan companies
It is difficult to understand that an acquisition operation with purely financial motivations is in fact a real growth vector for the takeover holding company on several levels, namely the commercial, social and technical levels.

The distribution of the debt has allowed the companies under LBO not to burden their capacity to invest, but also in many cases, has given them back the means financial means and a freedom of action that did not exist under the previous ownership. The companies undergoing an LBO are strong job creators, since the number of employees in the sample has increased much more rapidly than in other companies.

The Moroccan economy is an economy in the development phase of its life cycle. The governmental effort to support this development is not sufficient, since the kingdom relies on the private sector with all its capital and professional potential to pull growth upwards and to be able to compete with more developed economies, a challenge of the opening of the borders in which Morocco is registered.

Private equity has also been part of this challenge, whether through venture capital, development capital or capital-transmission which is only the LBO. Private equity investors in Morocco are unanimous in their support for this cause and affirm that they are in favor of this approach in order to accompany the economic and social development of Moroccan companies.

The development of LBOs in Morocco should therefore consider the specificities of this country. Most economic sectors are in a development phase need development and need investments to stimulate upgrading, technology transfer, business transfer of technology, business prospecting and the social adhesion of employees to the logic of competition.

Opportunities and ways to optimize LBO arrangements
The specificities of Moroccan capitalism (SMEs, family-owned companies etc.) represent a favorable environment for the growth and development of private equity in general, and LBO in particular.

Opportunities: An encouraging business environment
The Moroccan business environment is very favorable and encourages companies to adapt the leveraged finance model, and this according to several components:

The banking sector is being restructured
The awareness of Moroccan banks to the interest of LBOs constitutes a real development vector for this type of

operation. Thus, the development of structured finance marks the evolution of the Moroccan banking sector towards a culture of project financing, since some banks, notably BMCE Bank and BMCI, have integrated into their structured finance offer a specialized variant for the financing of acquisitions through leverage. Moreover, the setting up of a Mezzanine fund that can complement the senior debt is a factor that will stimulate the multiplication of LBOs in Morocco. In addition, interest rates have never been so low in Morocco, reinforcing the financial opportunity of a buy-out for investors.

A Favorable human capital

The existence of managers to support leveraged buyouts is becoming a reality. Indeed, a new generation of non-family entrepreneurs are now seeking to become independent and are ready to take the risk of becoming shareholders in the companies they manage accompanied by active financial investors able to design offensive development strategies with them.

Support for business acquisition operations

Morocco's legal arsenal is satisfactory in several respects. In acquisition and transfer of businesses, the legal rules necessary for the protection of the parties to its operations and third parties, in the same way that the legal tools for these operations are provided by the legislation. Thus, certain values to protect the future purchaser, they constitute instruments that allow the control of the capital. From here, they generate a legal and financial leverage.

Ways to optimize

In order to optimize the realization of the LBO operation and to make the arrangement more favorable to the purchaser, several possibilities are offered on the legal, fiscal and financial levels, which are the tools of financial engineering. However, there are various limits to the optimization of the arrangements, whether the constraints are imposed by the seller or linked to the absence of financial transparency.

Choice of the legal form of the holding company

In the event of a capital increase, the controlling holding company is in principle a joint stock company. Thus, the holding company can take the form of a public limited company, a private limited company or even a simplified public limited company (if the shareholders have legal personality).

These forms of companies have the advantage of allowing,

- The limitation of the responsibility of the external investors and the free transferability of their social rights
- The payment of limited registration fees in case of resale of the shares,
- The possibility of issuing investment certificates.

Alternatives to the tax consolidation regime

The legal and financial leverage created by an LBO arrangement can only be optimized for tax purposes to the extent that the borrowing interests borne by the can be deducted from the company's pre-tax earnings, which are used to finance the financing. This is not the case when the holding company ensures the repayment of the debt through dividends which, by definition, have been subject to corporate income tax at the level of the distributing company.

Financial consequences of not charging loan interest

Dividends distributed by the target company to the holding company for servicing the loan debt are not subject to corporate income tax. In fact, they benefit from a deduction of 100%.

As the holding company does not, by hypothesis, have any other income than the dividends received in exemption from corporate income tax, the loan interest expense will consequently generate tax deficits that the holding company risks losing at the end of the four-year period (deficits linked to the operation).

This consequence can be partially limited by generating taxable results through the development of a management activity. If one ignores this last solution, which is limited in scope, it should be noted that the holding company is unable to set off the loan interest expense against the income used to finance it, in this case, if it finances the loan expense with the dividends from the target company. The real cost of debt is therefore not reduced. The ability to repay the debt is consequently reduced.

Tax optimization techniques

The effective deduction of interest on loans is made possible by the use of certain legal and tax techniques that allow for a consolidation of the results of the holding company and the target company. Indeed, this is possible by proceeding to the merger of the holding company and the target company.

The merger of the holding company and the target company is the normal outcome of an operation when all the loans have been repaid by the holding company, the merger of the latter with of the holding company with the target company during the course of the transaction, or even within a very short period of time after the legal and financial closing of the advantages.

The merger of the holding company and the target company allows:

- The direct charging of the interests due by the holding company because of the loan
- The direct deduction of the interest due by the holding company on the loan it has taken out to finance the takeover from the taxable profit of the target company: the acquisition is thus directly financed by the corresponding tax savings.
- The immediate appropriation of the target company's cash flow avoids the constraint of the cash flow gap resulting from the distribution of dividends,
- The constitution of loan guarantees on the target's assets.

It follows from the above that the merger between the holding company and the target company is an efficient solution to optimize financially the takeover of the company within the framework of an LBO arrangement. However, the merger operation is confronted with certain financial and legal limits. However, this merger is not without its legal and financial disadvantages:

1) Legal limits:

The merger between the holding company and the controlled company is only possible if it only if it is not likely to result in a change in control of the merged company to the resulting from the merger to the benefit of the minority shareholders of the acquired company, if any from a legal point of view, the merger involves two major risks, namely:

- The constitution of an abuse of majority. Indeed, the minority shareholders can claim that the interest of the target has been harmed by the merger,
- The constitution of an abuse of power, in the case where it is claimed that the directors acted in a way that they knew was contrary to the interests of the corporation, serving their personal ends or favoring another company in which they were directly or indirectly interested.

2) Financial limits

From a financial point of view, the merger is not without disadvantages because it can weaken the financial structure of the merged company by encumbering the liabilities of the balance sheet. The financial structure of the company resulting from the merger by encumbering the liabilities of the balance sheet of this company by the loan debt contracted by the holding company. This aggravation of the liability structure of the liabilities results in a deterioration of the ratio (debt/equity), which may lead to a likely to lead to a loss of financial credibility of the company vis-à-vis its external partners (suppliers, banks, etc.).

3. Conclusion

Leveraged transactions involve a combination of four main levers. The mechanisms for each of these are relatively simple. The complexity of this type of operation is nevertheless generated by the multiplicity of the various levels of possible combinations. The main leverage effects are financial, fiscal financial leverage, fiscal leverage, legal leverage and social and managerial leverage.

Leveraged operations require the intervention of many actors whose objectives may be perceived as different, even if the interests of all converge in the success of the operation, their level of exposure to risk and therefore their behavior are behaviors are different. This is why these operations are often experienced as real "culture chambers of agency conflicts”.

In the context of LBOs, where the debt reaches its maximum level and the risk of bankruptcy weighs extremely heavily on the viability of the company, the reconciliation of interests makes sense.

On the one hand, we know that the debt "disciplines" the managers because it reduces the cash-flow available to the managers, which makes it possible to reduce useless expenses, and then, there is the obligation to repay the debt on time and even the threat of bankruptcy discipline of managers, who will fear for their jobs and careers.

On the other hand, in order to increase the commitment of managers to the performance of the company, a whole system of profit-sharing is put in place, where the managers are asked to put all their savings into a stake in the company’s capital, stock options of the company, stock-options, or percentage on the capital gain at the exit of the deal.

All these incentives will make the managers provide efforts and performances superior to their normal, since their fate would be linked to that of the company they manage.

Investors naturally seek to make a return on their investment in an LBO via a high IRR. Fund profitability generally follows stock market cycles: the higher profitability of funds compared to stock market indices is largely explained by the higher risk. Note that the performance of large funds is higher than that of smaller funds; this is justified in particular by their ability to diversify their investments to a greater extent, which allows them to reduce their risk.

From a theoretical point of view, the IRR is "the particular discount rate that allows equality between the present value of the sums received in the context of the investment and the present value of the sums paid to make it". The average level sought for an IRR varies according to the monetary rates on the market.

The LBO thus has an impact on the performance of the target and therefore on its value, but the impact of the LBO on the value of the target but that the impact of the LBO on the valuation methods is much murkier as it is based more on a "valuation because it is based more on a "detour" of the techniques aimed at making the valuation is not a stage in the negotiation process but a negotiation in its own right. This underlines the need for regulation of the valuation profession.

Leveraged buyouts (LBOs) have experienced a remarkable boom worldwide. They represent the most widely used technique in the transfer of companies. Indeed, the buyer, often lacking resources, finds in it a good technique to finance the acquisition and make the invested capital as profitable as possible.

In the current state, the majority of the Moroccan company managers ignore the existence of the product or at least of the legal-financial function called LBO. It is necessarily one of the reasons of the absence of this type of operation, with strong added value, in our country. This factor combined with the reluctance of investment funds, risk-averse banks risk-averse banks and the absence of legislative measures facilitating the transfer of companies. . . still leaves the LBO on the sidelines.

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