

## insights

TYPES NOT MAPPED YET June 21, 2023 | TTR not mapped yet | Nathan O. Viehl

# The New Sell-Side Playbook: Going on Offense

With interest rates no longer at historic lows, private equity firms are finding it difficult to cheaply leverage their investments, causing valuations to fall. This has left profitable, healthy businesses that would ordinarily be obvious private equity targets in a “wait and see” position as they pause for a rebound in valuations.

For many of these potential targets, that means it's time to shift their focus and consider acquiring other businesses in their industry, which in turn can be had at lower valuations because of the aforementioned softening private equity market. Described below are some suggestions on how to structure those acquisitions to maximize attractiveness to private equity buyers in the future.

### Structuring Acquisitions to Maximize Attractiveness to Private Equity

While the current market may be favorable for strategic players to make acquisitions, it is critical to structure these “add-on” transactions with the following PE best practices that will drive their ultimate value:

#### 1. Use a Multiple to Determine Purchase Price

When making an acquisition, base your valuation on a multiple of EBITDA or other financial metric. Private equity will always base their valuations on some kind of financial metric, and basing the purchase price on the prevalent metric in your industry will make your company more attractive to potential private equity buyers. Furthermore, as your business grows, it will merit a higher multiple. So, by simply acquiring a smaller company at a multiple lower than your exit multiple, you can easily realize additional value for your business.

#### 2. Rely on Earnouts to Validate Financial Assumptions and Help Finance the Transaction

Earnouts are a common tool used to help validate financial assumptions and help finance the transaction. By structuring the acquisition with an earnout, this will keep you disciplined and provide validation that the stream of revenue you are purchasing is repeatable and will be valued appropriately upon exit. Furthermore, this can ease one of the most significant pressures strategic buyers face - financing. As a business without access to the capital from a private equity fund, earnouts help defer purchase price over time so you can complete a transaction with minimal third-party financing.

#### 3. Use Best Legal and Financial Due Diligence Practices to Prevent Surprises Upon Exit

Finally, it is imperative to use industry-standard due diligence practices when making an acquisition. This will make your business appear more professional and help to prevent any surprises upon exit and make your company more attractive to potential private equity buyers in the future. A thorough legal due diligence process will help to identify any potential issues that may arise upon exit and allow you to address those issues proactively. Private equity firms will typically do a full quality of earnings accounting analysis and legal due diligence review of their targets, among other things. You should approach your targets with the same level of scrutiny. Even if you are comfortable with more risk, your target will become part of your business and undergo that scrutiny in due time if you plan to exit in the near future.

### Conclusion

If you are a company that was considering selling in the coming years, now may be the perfect time to shift your focus and consider acquiring smaller companies instead. The slow-down in private equity has created a market where strategic players can make acquisitions at more attractive valuations and build their businesses through a combination of organic growth and acquisitions. By following these suggestions on how to structure those acquisitions to maximize attractiveness to private equity in the future, you can build your business with an eye towards a potential exit to private equity down the road.



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