

**Role Play**

**Licht aus (Lights out):**

Role of Preiss

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This role play was written by Eva Shen, John Rizzetto, Jusuf Merukh, and Tobias Funke, INSEAD MBA Alumni, under the supervision of Martin Schweinsberg, Associate Professor of Organisational Behaviour at ESMT Berlin, Horacio Falcão, Professor of Management Practice of Decision Sciences at INSEAD, and Eric Uhlmann, Professor of Organisational Behaviour at INSEAD. It is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

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General Information (For All Parties)

Intelligente Beleuchtungssysteme (IBS) is a fast-growing German manufacturer of home automation products. IBS’s products are sold via electronic wholesalers who sell to electricians. Electricians sell and install the product both in new build residential as well as new build commercial buildings. The European electric wholesale market is dominated by a few large traditional (mainly brick and mortar) players with a high market share and strong customer loyalty. Recently, new pure-play online wholesalers have emerged and are growing rapidly. Due to their low-cost structure, they can be competitive on price, despite selling less volume than the large players. Any savings from cheaper procurement will not be passed through to the ultimate customer but will stay with the electrician, and in most cases the end-costumer will not know the brand of product installed in her/his home.

IBS competes with large, diversified electronics and industrial companies. The competition is mainly servicing the market via the top 2 traditional wholesalers, while IBS found its niche in online wholesalers as well as in smaller local wholesalers.

The underlying market for home automation products is growing above 10%. The main drivers for market growth are increased penetration of home automation solutions in new built residential buildings, driven by consumer preferences (increased connectivity) as well as increased regulation for energy efficiency.

Over the past years, IBS has significantly outgrown the market with annual revenue growth of 20-35%. IBS’ successful strategy centers around self-developed innovative products at a significantly lower price point than competing products, which makes them highly popular among electricians. IBS has further focused on a particular technological niche in the home automation space, targeting the high-end segment. Despite the significant scale and resource disadvantages vs. its competitors, IBS managed to gain substantial market share. Given the very lean and focused product portfolio, the company operates at a very high level of efficiency resulting in EBITDA margins of more than 50%, which is unheard-of in this industry.

Ms. Fischer has founded IBS about 20 years ago and has led the company ever since. While refurbishing her home, she increasingly became frustrated with the high market prices of home automation products and the lack of desired features. Being an electrical engineer by training and convinced that she could develop better products at a lower price point herself, she launched IBS. Since then, Ms. Fischer has run the company as CEO and has developed some of the most innovative products in the current portfolio.

As Ms. Fischer is approaching her 55th birthday, she is considering selling the company. She does not have any children who could take over the firm. She has hired the investment bank GT Corporate Finance to advise her on the potential sale of the business. Erika Haldermann, who is leading the sales process, has been working in the industry for many years and has focused on the construction segment in the past. As customary in this industry, the investment bank will be paid a certain percentage of the transaction value upon the successful sale of the company.

Over the past weeks, Ms. Fischer had several discussions with leading private equity firms in Europe that would be interested in acquiring IBS. After initial rounds with a broader group of potential acquirers, the field has been narrowed down to few potential parties. Also, competitors of IBS would be highly interested in acquiring the company.

Today Ms. Fischer and Ms. Haldermann are meeting with Ms. Preiss and Mr. Trachtner, both Partners at TCP Capital Partners, to negotiate acquisition terms. The parties have met during the due diligence on IBS, where Ms. Fischer has presented TCP Capital Partners with her business plan for IBS. However, they have not yet discussed the concrete terms of the potential deal. TCP Capital Partners is a leading European private equity firm with several offices around Europe. They have been interested in acquiring IBS for a long time and have signaled strong interest to Ms. Fischer and Ms. Haldermann over the previous weeks while conducting due diligence. Given their strong footprint and experience in this sector, they seem like a good partner to accelerate growth for IBS and expand its operations into new geographies.

On their way to this important meeting, both parties are discussing their strategy for the upcoming negotiation, hoping to be able to sign this deal ahead of the approaching Christmas break.

Role of Ms. Claudia Preiss – TCP Capital Partners, Lead Partner for this Deal

You, Claudia Preiss, have been a Partner with TCP Capital Partners for two years. You joined the firm together with Mr. Trachtner, an experienced private equity professional who has worked many years in this industry, to expand TCP Capital Partners’ operations into Germany. In total, you have more than 15 years of private equity experience and have successfully negotiated several deals during your career at your previous employer. Unlike Mr. Trachtner, you have not yet closed a successful deal at TCP Capital Partners, which bothers you and you believe it to be a scar on your otherwise excellent track record.

You are very excited about the opportunity to acquire IBS. You and your team have been working intensively over the last weeks to analyze the company in the due diligence phase and to present the investment to the internal investment committee of TCP Capital Partners. The investment committee is a panel of senior partners within TCP Capital Partners, that needs to authorize any new acquisition. An approval by the investment committee authorizes you to negotiate a transaction within a certain price range. In addition, the investment committee may provide further recommendations on the deal structure, which you can choose to ignore, but only if well justified.

Your colleague, Mr. Trachtner is acting as a 2nd pair of eyes for this transaction. TCP Capital Partners has established this role as a counterweight for the partner leading the deal. He has been discussing the deal closely with you and your team. In addition, he has attended all important due diligence meetings and has attended most meetings with Ms. Fischer.

While the due diligence, in general, came out without any negative findings, the investment committee is concerned about the dependency of the firm’s success on its founder/CEO Ms. Fischer. The investment committee has thus asked you to assure that Ms. Fischer will stay with the company as part of the deal. While their clear preference is to keep her as full-time employee for the first 2-3 years, the minimum requirement would be a commitment for at least 1 day of work per week, where she is ideally leading IBS’ product development.

The investment committee also hopes to reach an agreement in which Ms. Fischer will maintain a 10% to 30% stake in the company, as a confirmation that she has conviction in her presented business plan, as customary in private equity transactions.

Despite the strong performance of the company, TCP Capital Partners is also experiencing difficulties raising external financing for this acquisition. In the eyes of the lenders, the asset “looks too good to be true” (high margins, high growth). The lenders are especially concerned with the large blue-chip competitors, who they perceive to have strong market power, and consequently, see a risk that they will push IBS out of the market. As a result, you have not yet managed to secure the required financing to sign a deal. This leaves you with two options:

Option A: Negotiate and sign the deal now with a full guarantee by TCP Capital Partners to pay the purchase price. A private-equity firm normally pays the purchase price with a mix of equity (money from their fund) and debt (money lent from a bank). The use of debt to pay parts of the purchase price is customary and is often referred to as using leverage (this is why private equity transactions are often called leveraged buyouts). While the leverage increases the return for the private equity fund, the seller should be indifferent about this issue as long as she/he will receive the full agreed price. Consequently, the buyer takes the risk for being able to find a bank to lend money for the transaction. Failing to do so will decrease the private equity fund’s returns.

Option B: Negotiate and sign the deal now but make its execution contingent on TCP Capital Partners’ ability to find a bank to finance the deal within the next weeks. In this case, the seller carries the risk. If TCP Capital Partners is not able to find a suitable bank to finance the transaction, they have the option to withdraw from the signed deal. Consequently, there is execution risk born by Ms. Fischer.

Given the Christmas holidays are approaching, you are confident that you could raise the required financing by mid-January. The final, anonymous vote of the investment committee was 5 to 1 approving the transaction. You have received the mandate to go for either of the two options, but are worried about the risk profile of Option A. In the end, then final bid will be at your discretion within the investment committee mandate. Mr. Trachtner cannot veto your decision.

Competitive Environment and Position

You truly believe than you and TCP Capital Partners are well positioned to acquire IBS. Not only could you provide a great structure to further develop IBS and expand its operations into new geographies, but TCP Capital Partners and your team have also particularly strong experience in acquiring companies directly from founders and managing the transition to an external management team. You are further excited about the opportunity to use IBS as a platform to acquire additional, smaller players in this industry— a strategy called “buy and build”, with which you and TCP Capital Partners have been very successful in the past.

There are various rumors in the market about potential competing private equity firms, looking at IBS. However, you assume they have similar issues in raising external financing. TCP Capital Partners is also aware that IBS would be very attractive to competitors and that they would be able to pay a high price for IBS.

Valuation

Based on the team’s analysis as well as precedent transactions in this sector, you have received a mandate from the investment committee to offer a price of 300 to 365m EUR for IBS. To reduce the risk of the deal, you want 5%-15% of the valuation to be contingent on achieving the business plan for the next year.

To be clear, you should aim to agree on an **equity valuation** of the firm, in other words its total financial value [of all shares] in the company, as well as what percentage of the company the seller will retain (if any). The payment from the buyer to the seller will be less than the equity valuation, if the seller retains some percentage equity.