

**Role Play**

**Licht aus (Lights out):**

Role of Trachtner

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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 Mr. Peter Trachtner – TCP Capital Partners, 2nd Pair of Eyes For this Deal

You, Peter Trachtner, joined TCP Capital Partners at the same time as Ms. Preiss, your fellow Partner at the firm. Together you have been leading TCP Capital Partner’s efforts to expand into Germany. Unlike Ms. Preiss, who has yet to close a major deal, you successfully closed a major transaction at the end of last year, which you are very proud of as it was the first transaction for TCP Capital Partners in the region. You have been working in private equity for more than ten years, both in Europe as well as in the United States. Before joining the industry, you were working for a global investment bank based in New York. Back then, your main responsibilities were transactions in the building technology space.

In this transaction, you are acting as 2nd pair of eyes. TCP Capital Partners has established this role as a counterweight for the partner leading the deal. In that function, you have been discussing the deal closely with Ms. Preiss and her team. You have further attended all important due diligence meetings and have attended most meetings with Ms. Fischer.

You have further been part of TCP Capital Partner’s investment committee meeting, a panel of senior partners within TCP Capital Partners, that needs to authorize any new acquisition. An approval by the investment committee authorizes the lead partner to negotiate a transaction within a certain price range. In addition, the investment committee may provide further recommendations on the deal structure. Not following those recommendations needs to be well justified by the lead partner.

From your time in the investment bank, you recall that the large industrial players in this industry tend to be very aggressive in either buying smaller, innovative firms or pushing them out of the market if they refuse to sell. In the meetings with Ms. Fischer, you found her to be very naïve and arrogant about the superiority of her products and the threat from those multi-billion-dollar competitors. If TCP Capital Partners ends up acquiring IBS, you would prefer to remove Ms. Fischer from the company as soon as possible.

For this and other reasons, you have very mixed feelings about this deal. You are worried that Ms. Preiss and her team are too optimistic about this case and will stretch the investment committee mandate to the highest price to secure this deal. You believe that if this transaction turns out to be a wrong decision, it will have significant negative consequences not only for Ms. Preiss, but also for your own career and that it could even lead to the closure of the TCP Capital Partners’ German office. You have been approaching (without the knowledge of Ms. Preiss) her team on several occasions, trying to identify flaws in their work and threatening them with the severe consequences if this transaction goes wrong.

In addition to your doubts, TCP Capital Partners has also been experiencing difficulties raising external financing for this acquisition. In the eyes of most potential lenders, the asset “looks too good to be true” (high margins, high growth) and they have similar concerns as you with regards to competitive threats.

By the time the transaction was discussed in the investment committee, Ms. Preiss had not yet managed to secure the required financing to sign a deal. This left the firm 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.

The investment committee has further asked Ms. Preiss to retain Ms. Fischer at IBS and that she stays invested in the company.

Despite this, and despite all your doubts which you communicated to the investment committee the final vote for this transaction was 5-1 – only you anonymously voted against the deal. Ms. Preiss received the mandate to go for either Option A or Option B with a price of 300m to 365m EUR. She has the authority to take the ultimate decision over the offer made for IBS.

Valuation

You are convinced that the valuation range is way too high, and the firm is worth 290m EUR at most. While you realize that it is too late to persuade Ms. Preiss to drop the deal, you hope to convince her to reduce the valuation significantly. In addition, you would like to see a significant portion (10-25%) of the valuation to be contingent on achieving the business plan for next year to reduce the risk to TCP. As you would prefer Ms. Fischer to leave the company, you intend to persuade her to reduce her shares in the company to a minimum (ideally 0%).

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.

Selling to a Competitor

Another alternative that is on your mind is that TCP Capital Partners could buy the company from Ms. Fischer and immediately sell it to the highest bidding competitor. You want to keep this opportunity open and avoid making a firm commitment not to sell to a competing firm.

New Financing Opportunity

You have reached out to your network and have less than an hour ago identified a bank that is keen on financing the transaction. Given the work the bank has already done together with the other private equity fund, they are willing to commit to a financing this deal within just a few days. With this brand-new information, Option A is no longer riskier than Option B, and you and Ms. Preiss would be indifferent between Option A and B. However, given your strong skepticism regarding the deal, you have not yet told Ms. Preiss about this information.