

M&A

The Entrepreneurial Pre-Exit: How Everybody Wins. Twice.

By Luc Keltjens

With a lot of ‘dry powder’ available by private equity firms, a relatively new type of M&A transaction is gaining popularity in the Netherlands and Europe’s midmarket: the entrepreneurial pre-exit. This type of transaction provides serious business opportunities for financial and legal advisors to benefit from long-term relationships with clients and create recurring business for several years.

During a pre-exit transaction, the sale of a company is completed in two separate stages over a time horizon of typically five to seven years. During the first stage, all shares of the target company are sold to a newly founded holding entity (hereafter: ‘Newco’). About half of the transaction value is funded by both the investor and the seller, often the founder(s) of the company, as the seller is required to co-invest in Newco and stays committed to the business for a pre-agreed period of time. The remainder of the transaction value is funded through external financing (bank). Typically, this stage of the transaction is structured in such a way that either the investor or the seller has a

substantial minority or a slight majority ownership stake in Newco, hence, in the initial target company.

After several years of collaborative efforts by the new investor and the seller to accelerate growth through value enhancing initiatives, the second stage will take place. During this stage, 100% of shares in Newco are sold to a third party, either another financial investor or a strategic buyer. In other terms, a full exit will take place. The process of a pre-exit is illustrated below.

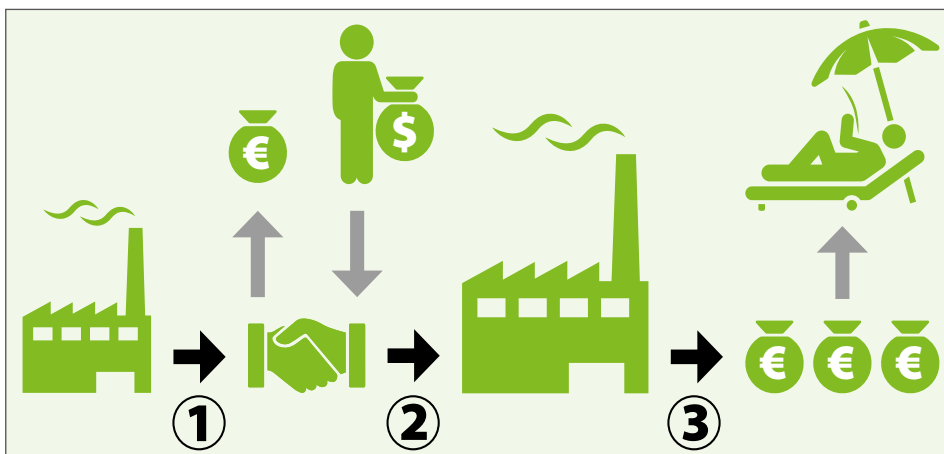
The pre-exit offers an interesting alternative for entrepreneurs who wish to monetise part of their company value today, yet still want to be involved in the business in a more strategic and/or advisory role. Investors welcome the pre-exit not only because they are able to benefit from the combined expertise of buyer and seller, but more importantly, it limits risks and allows for the mutual alignment of interests of all shareholders when taking the business to the next phase of sustainable growth. A win-win.

But what about the accountants, lawyers, consultants, tax and all other specialists who have been the trusted



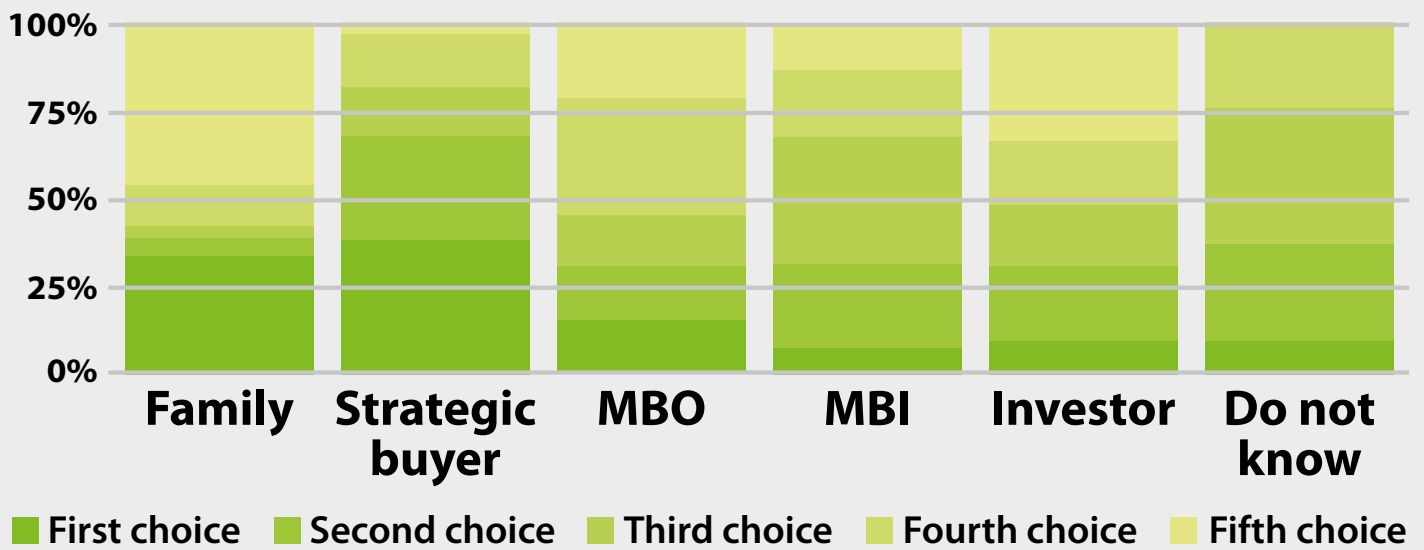
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advisor to their client for years? During a full exit, most advisors usually see their clients leave as advisory costs are cut due to synergy advantages between buyer and seller. However, during a pre-exit transaction, instead of seeing their client walk out the door, most advisors stay onboard for a prolonged period of time. Not only will they benefit from the obvious doubling of the workload when their services are required for a second time during the full exit process, but even more interestingly, by maintaining their position as trusted advisor, they will also benefit from the additional business generated by the new growth initiatives. As a result, advisory fees that otherwise would have been foregone after a traditional full exit not only remain, but tend to increase substantially depending on the growth strategy. In some cases, for example during a buy-and-build strategy, some advisors see their revenues triple or even quadruple from clients who are engaged in a pre-exit transaction. An aggressive growth strategy or



1 Pre-exit transaction – 2 Value enhancement initiatives – 3 Full exit

Suppose you would sell your business today, who would be the most probable buyer?



value enhancement proposition leads to an incremental need of expertise, which results in a window of opportunities for external advisors to enter the picture. Another clear win.

The rationale for a pre-exit transaction might seem obvious from a financial perspective. Yet recent research conducted by SAMR in collaboration with Marktlink Mergers and Acquisitions has shown that the level of trust and motives between financial investors and entrepreneurs are far from aligned. Questioning over 200 Dutch midmarket executives, 73% still believe that the main goal of participation of a financial investor is not aligned and is not in the best interest of the company they invest in. Furthermore, 61% of the participants believe that financial investors have to deal with a bad image and only 19% of the midmarket executives would consider selling their company to a financial investor as a first or second choice. The diagram below demonstrates the preferred sale partner of the midmarket participants.

Besides the revenue perspective and financial opportunities that a pre-exit transaction withholds for financial and legal advisors, there is still a lot of work that can be done to close the gap between midmarket executives and financial investors. Independent advisors who can collaborate with both financial investors and midmarket executives should elaborate on the benefits of such a transaction for both entrepreneurs and investors and are advised to use their position during a transaction process in order to bring the two parties together. When successfully doing so, advisors will gain the trust of both parties and can start to build long term relationships with their clientele which will ultimately result in an incremental flow of revenues over a longer period of time. Hence, the pre-exit transaction is a perfect way to open the mind of current or new clients about an alternative option to establish future and sustainable growth.

Marktlink Mergers and Acquisitions has been the sell-side advisor in more

than 30 pre-exit transactions in the last 12 months.

Authors Luc Keltjens and Maikel Bárcena, respectively Manager and Consultant at Marktlink Mergers and Acquisitions in Amsterdam, have accompanied several shareholders of mid-market companies in a pre-exit transaction in the last 12 months. For more information about these type of transactions or background stories, please contact Marktlink Mergers and Acquisitions or send a direct message to the author, Luc Keltjens.

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