

COMMENT

Increase your exit multiple by getting the expansion strategy right

Armstrong's Mike Callow and Simon Hemsley explain why increasing multiples and more competitive processes mean that it is now even more important for PE funds to get the right expansion strategy for their investments.

It has been a very busy year for mid-market PE investors. DC Advisory's latest *European Private Equity Mid-Market Monitor*, estimates mid-market PE deal volume in H1 2021 up 79 per cent vs. H1 2020. Pricing is high across the board, and scaling new heights in hot sectors. It is even more important that investors have conviction that business plans are achievable, that they can accelerate growth or improve multiples during the hold period, and that they understand the potential buyer universe at exit.

As processes are so competitive, funds must carefully choose the deals to hunt. Understanding value levers and how they are aligned with an investor's track record and house style helps triage deals and focus time on the most promising opportunities.

Mike Callow

Building on DD insight

Good commercial due diligence not only tells investors and management teams what the business is now. Far more important is understanding what it could be in the future, and how it can get there. It gives investors the confidence to make the right decisions, starting with whether to go ahead with a deal on the agreed terms. It provides clear, strategic and practical operational recommendations; what needs to be fixed and how, and which commercial opportunities should be prioritised.

As multiples increase, Armstrong is being asked to use the depth of our expertise to help investors and management teams develop expansion strategies by building on our due diligence fieldwork. Basically, what are the value creation levers, what order should they be pulled, what extra support is required, and when is the right time to exit?

Developing a robust expansion strategy

An expansion strategy builds on the commercial due diligence work by giving investors evidence-based confidence that the business does justify its valuation. It tells them:

- The business is offering the right products and services to the right customers in the right markets;
- The management team have properly understood their business' differentiators, and know how to reinforce them;
- The business plan has fully assessed the commercial implications of new products & services, new customer target segments, and new markets;

- That the business is able to deliver them with the resources it has (or can, buy/build); and
- That working together the investor and the management team will be able to deliver the strategy.

In practice, an expansion strategy validates the business plan and provides granular, actionable and coherent recommendations to achieve the strategy.

What to expect from an expansion strategy

An expansion strategy will provide a thorough evaluation of expansion routes (by vertical, by customer segment, by product/service line, and by geography), strategic and operational recommendations for organic growth, and the opportunity for accelerating this expansion through M&A including:

- Scale of opportunity, competitive intensity, ease of entry (organic vs. M&A) for identified target regions and verticals;
- Potential additional service lines - revenue opportunity, cross-sell potential, underlying technology focus;
- Availability of bolt-on acquisition targets, acquisition strategy and focus areas (e.g. geographical expansion, new capability/service lines);
- Profile of 'ideal' acquisitions, identification of suitable targets, and review of strategic value and achievability; and
- Target 'end state' to maximise equity value for likely exit routes.

Successful exit planning

When formulating strategy, it

is helpful to begin at the end:

- Who is in the potential buyer universe, and who are the most likely buyers of this business?
- What is achievable in this holding period versus what can be left on the table for the next buyer?
- What must be done before planning for an exit versus what needs to be started before then?
- Has all of this been properly thought through and costed in the business plan?
- Does management have the capacity and capability to deliver the business plan?

Please contact a member of the Armstrong team if you would like to hear more about how we've helped investors and management teams develop expansion strategies this year, and to discuss how we can help you. ●

Simon Hemsley

