

Earn-out or not? Lessons learned from earn-out and put/call structure in 250 M&A transactions

Deal analysis 2010-2019

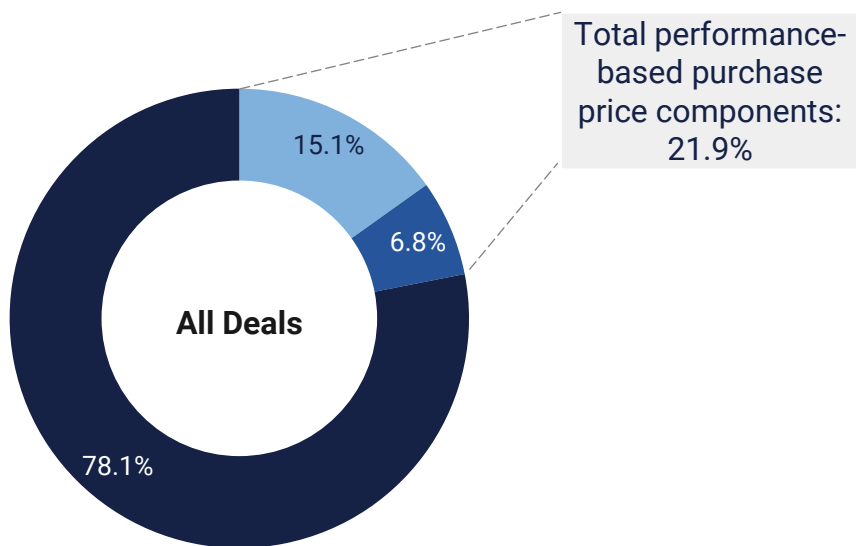
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In 20%+ of our deals, earn-outs and put/call options were part of the final transaction structure

Transaction structure of deals with performance-based purchase price components



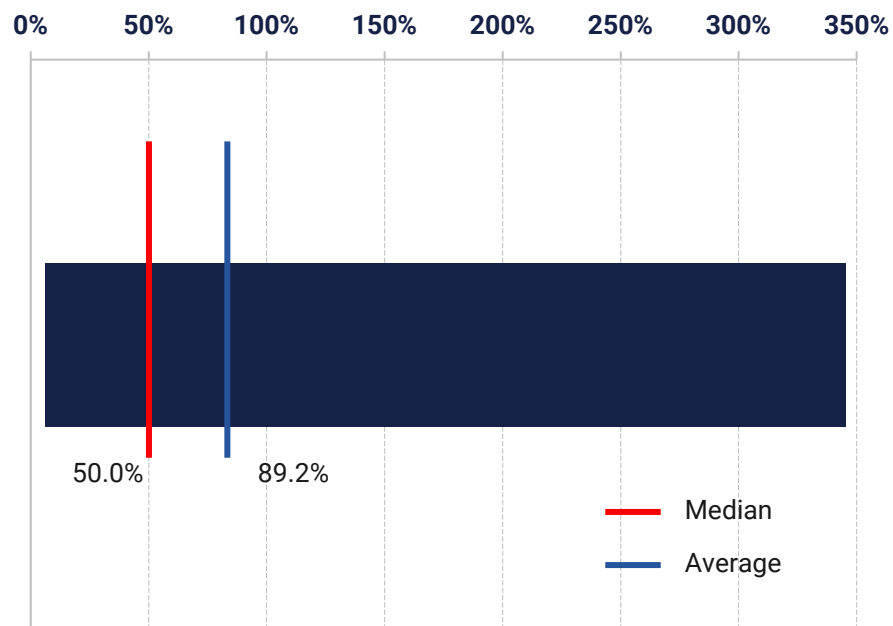
- Deals without performance-based purchase price components
- Deals with put/call option
- Deals with earn-out

Comment

- 22% of all deals were structured with a performance-based purchase price component (15% with an earn-out agreement and 7% with a put/call option)
- Particularly in business services, consumer internet and software transactions an increase of performance-based purchase price components can be observed

Within transactions containing a performance-based purchase price component, the earn-out payment was 90% of the initial payment

Ratio of earn-out or/and put/call option to initial payment

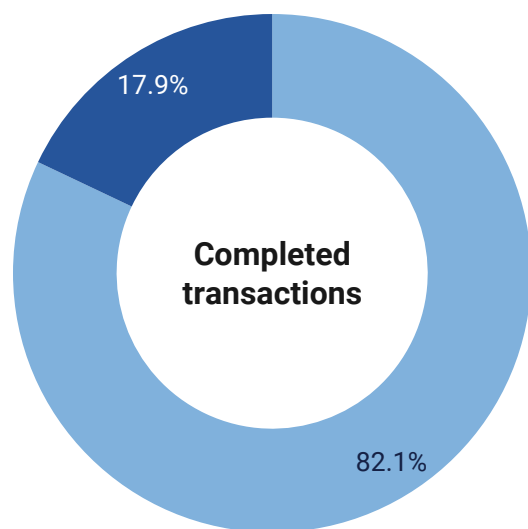


Comment

- On average, the performance-based purchase price components in relation to the initial payment was 89.2% and in median 50.0%
- With the largest value of 345.5% and the smallest value of 6.3%, the range is very broad and shows the different design possibilities

With 82.1% realisation rate of the earn-out or put/call option, our clients mostly achieve their performance-based goals

Evaluation of completed earn-outs



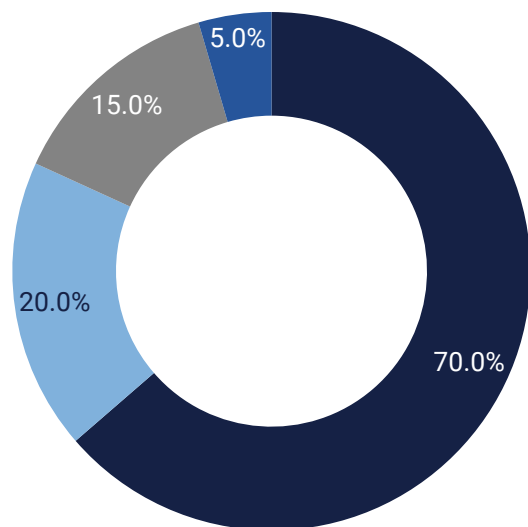
■ Earn-out / option achieved
 ■ Earn-out / option not achieved

Comment

- 82% of 39 completed performance-based purchase price components were achieved

In the case the earn-out was not achieved, the main reason (c. 70%) for failure was the non-achievement of the business plan

Reasons why the earn-out was not achieved



- Business plan failure
- Customer loss
- Management attention on M&A process
- Financial adjustments



Clear failure to meet the business plan (around 70%)



Loss of an important customer post transaction, due to change of control (around 20%)



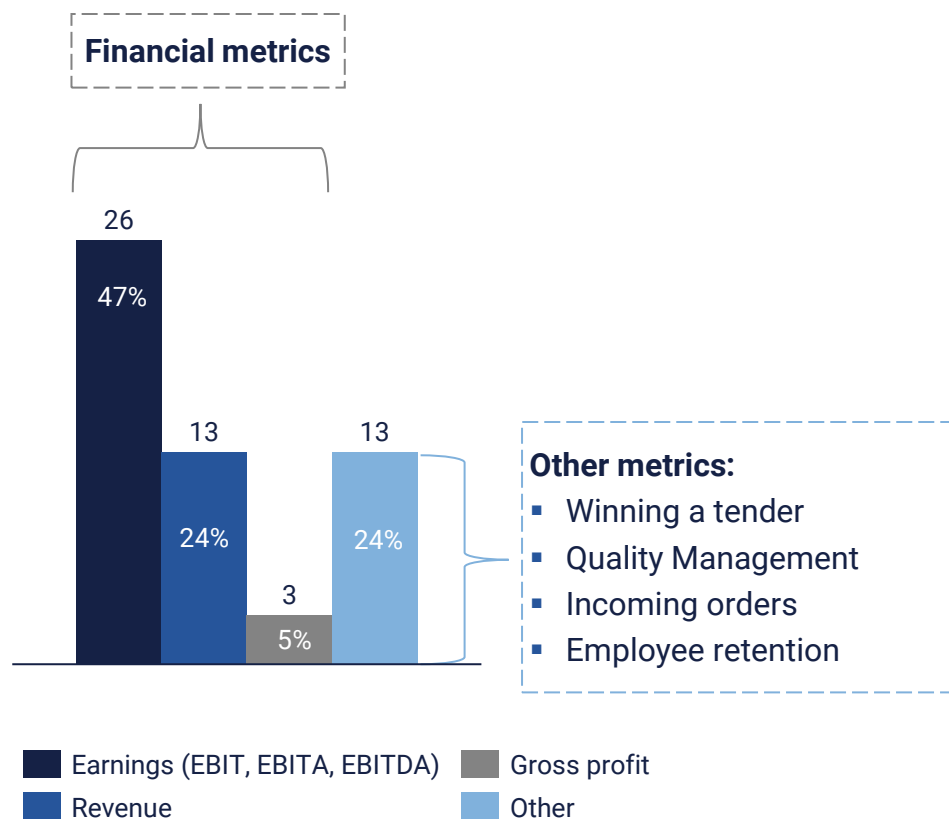
Management was too distracted due to heavy M&A process (around 15%)



Subsequent adjustments of the financials through auditing due to incorrect accounting by the former owners (around 5%)

With 75% proportion, financial metrics are the major basis for valuing the earn-out or put/call option

Metrics of performance-based purchase price components

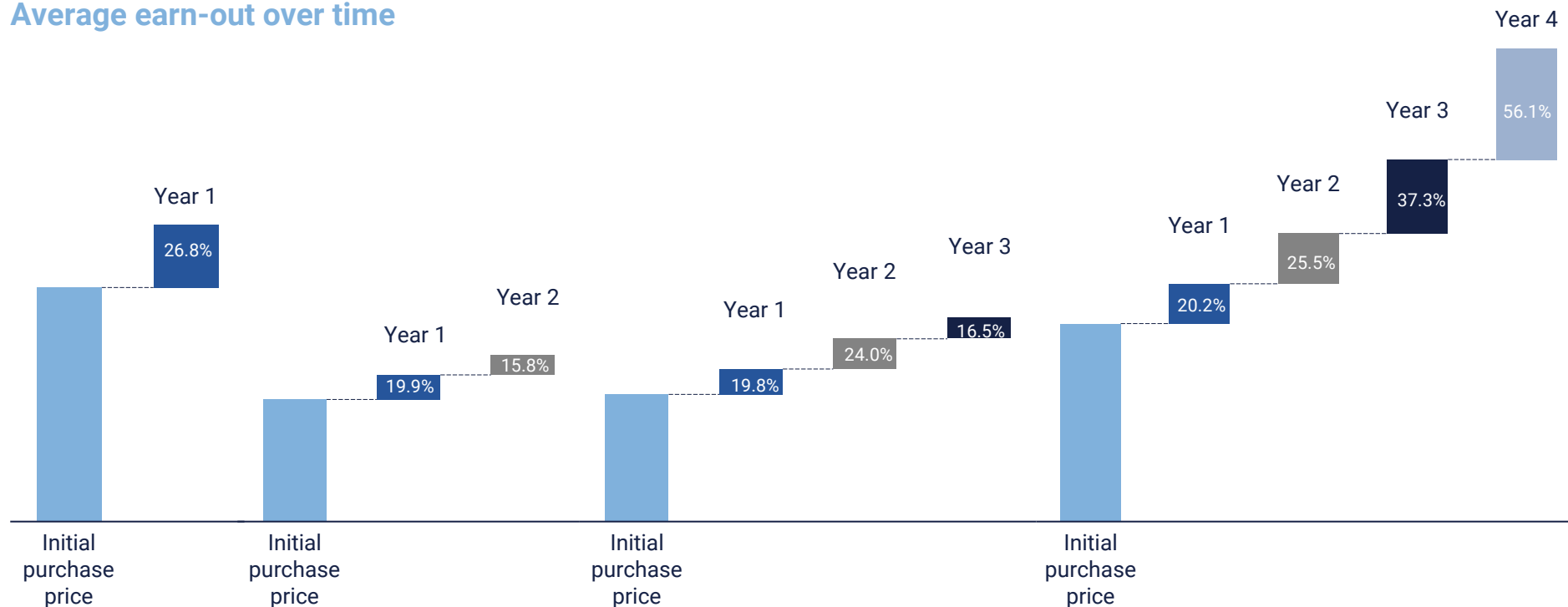


Comment

- 15% of 55 transactions revealed a combination of performance-based metrics
- The most frequent combination with over 50% was revenue and EBIT/D/A

Staying onboard can increase value significantly – some scenarios reveal that valuation can almost quadruple over the earn-out period

Average earn-out over time



Comment

- Especially in consumer internet transactions, there are cases in which the founders have earned up to 3.5 times the initial purchase price tranche over the earn-out period
- On average, our clients have agreed on an earn-out over approximately 1.5 years; put/call options usually have a slightly longer term with an average of 2 years

Our lessons learned from past transaction designs containing performance-based purchase price components

Carlsquare's lessons learned

- ✓ Link your earnout only to goals which you can influence exclusively
- ✓ Avoid cliffs and binary hurdles, rather go for linear earnout distributions
- ✓ Earnings goals are most popular, but a sales goal might also be a good option as it is less manipulable and focusses on growth
- ✓ Include a protection that the acquirer cannot “kill” your earnout with extra costs and preventive actions
- ✓ Include a ‘right to shift’ to be prepared for a sudden crises or black swan-event
- ✓ Make sure that the interests of the acquirer are aligned with yours – the acquirer should be happy to pay out the earnout
- ✓ If you are convinced about short-time success, go for a one-year earnout
- ✓ If you believe in long-term success rather add a year to the envisioned duration to have more time so scale
- ✓ Only agree on an earnout if you have trust in the transaction partner



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