New Time's Buyout
——Private Equity Add-on Acquisition Strategy

Contact us:
ibsghk@gmail.com

Abstract:

The number of transactions with the add-on strategy led by the Private Equity funds has rapidly increased in the challenging macroeconomic environment. In the United States, add-on acquisitions accounted for 77% of PE transaction value in 2022, significantly increasing from previous years. This report summarizes the events and additionally discusses the following perspectives:

- The history of the strategy in the United States.
- The future opportunity and implication to Chinese funds

Content:

1. Background

In 2022, under the backdrop of the pandemic, the world economy continued to decline, posing unprecedented challenges to PE firms' investments. The main impact comes from two aspects: firstly, the ECM is in a downturn due to the environment, with a sharp decrease in IPO numbers, making an exit difficult. Secondly, in 2022, the Fed's continuous rate hikes have significantly increased the financing costs of debt instruments, making it difficult to obtain bank financing and putting enormous pressure on LBO funds.

The number of transactions with the add-on strategy has rapidly increased in this environment. In the United States, add-on acquisitions accounted for 77% of PE transaction value in 2022, significantly increasing from previous years.

The add-on acquisition strategy involves acquiring smaller companies and integrating them into existing portfolio companies, aiming to achieve synergies and leverage the integration value of private equity firms. This approach typically uses fewer debt instruments due to a smaller size. Through these transactions, buyout funds can help the acquired company to realize profit growth and valuation increase while accelerating the portfolio company's development and bringing the exit forward.

Add-on acquisitions can be subdivided into tuck-in, bolt-on, and roll-up acquisitions based on integration strategies.

Tuck-in acquisitions refer to acquiring a smaller company and integrating it into a platform company with a similar business. The acquired small company, due to a lack of specific resources or management experience, has reached its expansion limit, and integration into the platform company can release its profit space.

Through horizontal acquisitions, Bolt-on acquisitions aim to enrich the platform company's product line. The price of the acquired company in bolt-on acquisitions is usually higher, and the company typically can operate and develop well as a standalone company. Therefore, these acquired companies generally retain a certain degree of independence after integration.

Roll-up acquisitions are horizontal and focus more on achieving economies of scale. In roll-up acquisitions, the platform company usually has a well-established business model and can implement it in the acquired company to achieve economies of scale.

2. History and Development Add-on Acquisitions

The add-on acquisition strategy almost emerged along with the PE industry, but in the 70 years of history, the add-on acquisition strategy has never been as popular as it is today. The add-on acquisition strategy has also achieved considerable success in the past few decades of development.

One of the classic cases is the Bahrain alternative investment company Investcorp's acquisition of the leading packaging company, Berlin Packaging, for $410 million in 2007. Over the next seven years, Investcorp conducted four strategic acquisitions and integrated the acquired companies into Berlin Packaging. In 2014, Investcorp sold the entire company to Oak Hill for $1.43 billion, achieving a return of 3x. Some buyout funds also attempt to implement the add-on acquisition strategy by targeting large companies as acquisition targets. In 2018, Optiv, a KKR company, hired a general manager with extensive integration experience in the cybersecurity industry and hoped to create more value for shareholders through M&A and integration with independent cybersecurity companies in Europe. In the following period, Optiv acquired four companies, including ClearShark, to expand rapidly across Europe and the United States.

3. Opportunities in China

China has been less affected by this wave of add-on acquisition strategy mainly because LBO funds are far less distributed in China. PE in China particularly adopt a growth investment strategy that seldom uses leverage, so they are less affected by this round of interest rate hike cycle. Therefore, there is no urgent need for a strategy shift. On the other hand, LBO funds in Europe and the United States have better control over the company than Chinese funds, and they are more motivated to conduct post-investment capital operations.

We believe there will not be large-scale add-on acquisition transactions in China in the short to medium term. Still, its unique integration value will be a choice for some institutions with platform companies and complementary professional capabilities. Such opportunities will increase, and we believe there will be more practices and explorations in China in the future.