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Houlihan  
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# Contingent Consideration

Spotlight on Trade Tariffs



# 01 | Introduction

In uncertain market conditions, contingent considerations can be an effective tool to mitigate risk in M&A transactions.

Contingent considerations (or earnouts) are utilized in M&A transactions when a portion of the purchase consideration is contingent on the future performance of the target. Contingent considerations are a popular means to:

- Reconcile different expectations regarding the future performance of the acquired business to the performance delivered post-close,
- Provide seller financing, or
- Incentivize certain employees post-acquisition.

Since 2009, contingent considerations have been present in approximately 25%–30% of public-buyer transactions.

Trade tariffs may impact an M&A transaction, introducing uncertainty into the expected future performance of a business, which can lead to valuation gaps between buyers and sellers.

Contingent considerations can be a useful tool in helping bridge these gaps by linking the purchase price to delivered performance.

Sources: S&P Capital IQ, internal research.



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Contact Us

If a contingent consideration may be beneficial to your engagement, please reach out to us to discuss how we can assist.

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# 02 | Typical Structures

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Most common contingent consideration structures fall within one or a combination of three categories.

#### Technical Milestones

- The contingent consideration is earned based on the achievement of pre-defined operational goals.
- Typically, technical milestones are sector-specific and tailored to the target's stage of development.
- Payments can be binary (only if the milestone is achieved) or progress-based (partial payment upon partial achievement at the end or upon progress).
- Examples include:
  - Achieving certain stages in the FDA approval process in biopharma.
  - Implementing a certain number of software engines in IT.
  - Reaching a certain number of retail locations.
  - Replacing a tariff-impacted supplier with a non-impacted one by a certain date.
- Contingent considerations can be paid in cash or through the target's/buyer's equity.

#### Performance Milestones

- The additional consideration is contingent upon achieving certain performance levels of revenue, gross profit, EBITDA, or net income.
- Typically, structures are sector-agnostic.
- Payments can be dependent upon performance in one or multiple periods (often two to four years after close), are typically capped, and may contain catch-up provisions.
- A contingent consideration would incorporate the tariffs' impact on the target's performance.
- Examples include:
  - A pre-determined amount is paid once the trailing-12-month (TTM) revenue reaches a certain level.
  - A contingent payment of \$3 for every \$1 of EBITDA excess over contractual thresholds for each of the three years following the closing, up to an aggregate payment of \$X million.

#### Onward Exit-Linked

- The contingent consideration is earned when the buyer exits the target and is typically dependent upon the buyer achieving a certain MOIC or IRR threshold.
- Structure specific to sponsor-backed M&A transactions and directly aligned with the sponsor's goal of maximizing return upon exit.
- Structure akin to seller retaining a rollover equity position with nonlinear payoff.
- Examples include:
  - The seller receives a minority rollover equity stake.
  - A certain percentage of exit distributions will be paid to the seller after the buyer has achieved a MOIC of 2.0x or an IRR of 15%.

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# 03 | How Houlihan Lokey Can Help

Houlihan Lokey's team has assisted clients with more than 300 contingent considerations.

Houlihan Lokey can help you with the following matters:

- Structuring the contingent consideration to fit the specific needs of a transaction.
- Analyzing contingent consideration value and comparing multiple structures across various scenarios and sets of financial projections.
- Valuation of contingent considerations for tax, financial reporting, and management planning purposes.



If you have any questions or would like to discuss how a contingent consideration can help get your deal over the finish line, please reach out to [Michael Mulkerin](#) or [Yan Taumin](#).

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