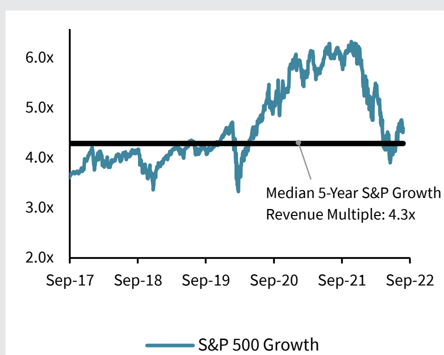
William Blair

# Structured Equity Solutions: Capital for Growth, Tuck-In Acquisitions, and Shareholder Liquidity

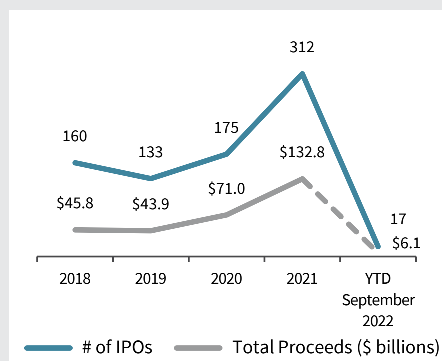
## Despite market volatility, a constricting IPO window, and tightening credit, a wide range of capital options is available for growing companies.

The growth-at-all-cost, cheap equity environment of the past two years is over, and public and private market valuations have regressed significantly from the 2021 peak. As a result, the IPO window has materially narrowed, and debt markets have tightened (see charts below). Despite these market challenges, there has been an influx of new capital from investors that play at the intersection of debt and equity. This hybrid approach, structured equity, often includes both equity and debt components and can be used for growth capital, acquisition financing, and shareholder liquidity needs. Shareholders and management seeking capital will benefit from state of the market insights on key structural and governance components of these securities.

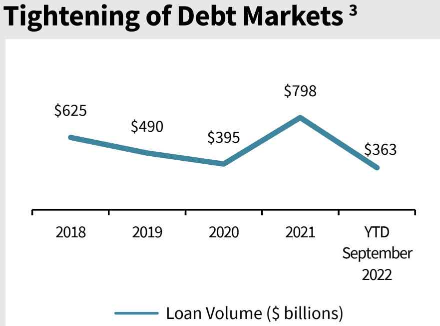
### Multiples are Reverting to the 5-Year Mean (EV/LTM Revenue) [1]



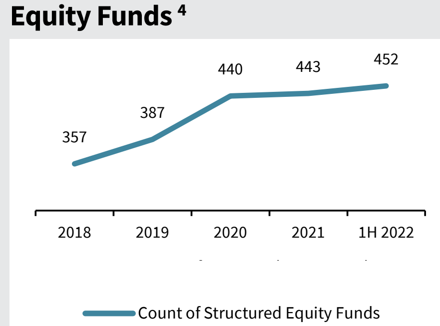

### Lowest Level of IPOs in 5 Years [2]




### Tightening of Debt Markets [3]




### Increasing Number of Structured Equity Funds [4]

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1. Source: CapitalIQ
2. Source: Dealogic and FactSet
   Includes IPOs with proceeds greater than $50 million and excludes SPACs
3. Source: LevFin Insights and LCD, a part of PitchBook
4. Source: PitchBook Data, Inc.

## The Convergence of the Capital Markets Fosters a Wide Range of Available Structures

As the debt and equity markets continue to converge, companies can benefit from a wider range of financing structures than ever before. This environment fosters many new structures that effectively bridge the gap between debt and equity, bringing to bear the best of both types of securities. Shareholders and management should consider a wide range of structural options to maximize proceeds and minimize dilution:

| | | Flexibility of Proceeds | Cost of Capital | Governance Requirements | Covenant Restrictions |
|---|---|---|---|---|---|
| **Convertible Preferred Stock** | Prices the equity today and will include downside protection in the form of a liquidation preference and/or dividend |  |  |  |  |
| **Convertible Notes** | Prices the equity based on future defined events in return for current yield and downside protection |  |  |  |  |
| **Mezzanine Capital** | Less dilutive capital that can avoid setting a valuation and acts more like junior or unsecured debt |  |  |  |  |

## Growing Diversity of Structured Equity Investors

The proliferation of public equity, private equity, venture capital, and debt financing has increased competition for risk-adjusted returns, compelling investors to deploy capital in new ways. Over the past several years, this capital markets convergence was demonstrated as public-focused mutual and hedge funds became active in the private markets through pre-IPO crossover rounds. Furthermore, many traditional high-impact buyout funds have launched minority growth funds with flexible mandates. Lastly, many large credit-focused funds seeking alpha returns turned to convertible and structured securities with an equity component. Collectively, this multi-pronged convergence has dramatically increased the variety of capital alternatives for growth, liquidity, and acquisition financing:

| | Overview | Considerations |
|---|---|---|
| **Dedicated Structured Equity Funds** | • Willing to be flexible with their capital and create a bespoke solution to meet capital objectives<br>• May be open to optimize valuation with downside protection<br>• Usually take a relatively passive approach on company operations | • Often require board representation or board observer seat<br>• Not as value-add operationally as some investor groups<br>• May require financial covenants |
| **Crossover Investors** | • Typically invest one or two years before a traditional IPO, establishing a baseline value<br>• Fairly hands off, providing flexible, growth-oriented capital<br>• Seek to become long-term public shareholders and provide enhanced credibility for the IPO | • Highly dependent on public market returns<br>• Typically require an IPO within 12-24 months of the initial investment<br>• May need governance and protective provisions |
| **Private Equity and Growth Equity Investors** | • Significant amount of value-add industry and operational expertise<br>• Vast network to provide introductions to strategic relationships and partners<br>• Can offer support to accelerate inorganic growth | • Often have high ROI expectations<br>• Require board representation or board observer seat<br>• May have a proactive approach to partnership and working with the company |
| **Family Office, Sovereign Wealth, and Pension Fund Investors** | • Tend to take a long-term, true partnership approach to investing<br>• Offer flexibility and a light hand on corporate governance and day-to-day operations<br>• Deep pockets capable of helping with organic and inorganic growth | • Finding the right partner fit may take time, as each firm is unique with its approach<br>• Board representation requirements are possible<br>• Often don't have the value-added support resources like private equity firms |

## Crucial Steps for Finding Private Capital in this Market Environment

Armed with this information about available investors and securities, here are four best practices to help your company as it seeks outside investment:

1. **Plan in Advance—and Tell a Good Story:** While good advice for businesses in any economic climate, it is critical in an environment where investors are taking a more discerning approach. Companies should devise a plan that links their business strategy and execution with financial needs and communicate that plan in an air-tight narrative to investors. This detailed and compelling story is a must because today's investors are faster to move on to the next potential target.

2. **Focus on Fundamentals:** Last year the focus was almost singularly on growth. Investors today heavily diligence fundamentals, including go-to-market strategy, market dynamics, and unit economics (e.g., customer acquisition costs and customer retention rate). This change happened quickly, and managers of some companies were (understandably) caught off guard. Investors are not likely to alter their current mindset anytime soon.

3. **Understand the Structural Components:** There is a balance between valuation and guaranteed rate of return. Investors will utilize multiple structural considerations to find the right mix for each potential investment. Companies need to understand the current market terms on a variety of critical components, including: valuation, cash interest, PIK dividends, warrant coverage, redemption, covenants, governance, and liquidation preference.

4. **Work with the Right Advisor:** Companies seeking outside investment should work with an advisor with expansive reach among the diverse categories of capital providers, deep industry expertise, and dedicated capital markets capabilities. The aforementioned capital solutions are bespoke and need to be thoughtfully tailored to fit within an issuer's capital structure. Management teams are understandably focused on running their businesses each day. This makes having an advisor with a clear-eyed, real-time view of a constantly changing market—and extensive experience working with private investors—crucial.

Finding capital can be a challenging endeavor, especially given the tumultuous market of recent months. But companies looking for capital can still find the right partner—provided they deploy a smart approach further sharpened by expert guidance. Please feel free to contact William Blair's Private Capital Markets team if you have questions about navigating this evolving landscape.

## Select William Blair Transactions

| | | | |
|---|---|---|---|
| $108,000,000<br>Prime Trust<br>has received a Series B equity investment led by an<br>**UNDISCLOSED INVESTOR**<br>with participation by other new and existing investors | $100,000,000<br>fictiv<br>Series E financing from<br>Activate capital, ANGELENO GROUP, CROSS CREEK, THE WESTLY GROUP | $108,000,000<br>johnnie-O<br>has received a capital investment from<br>WASATCH GLOBAL INVESTORS, ARES | $115,000,000<br>IntelyCare<br>Series C financing led by<br>Janus Henderson INVESTORS<br>with participation from Longitude Capital, Leeds Illuminate, Endeavour Vision, Revelation Partners, and Kaiser Permanente Ventures |
| Not Disclosed<br>ubiquity<br>has received a significant strategic investment from<br>bv INVESTMENT PARTNERS SINCE 1983 | $93,000,000<br>LUMICKS<br>has received a growth equity investment led by<br>FARALLON ESTABLISHED 1986, LAUXERA CAPITAL PARTNERS, SoftBank, T.RowePrice | Not Disclosed<br>MIELLE<br>has received a growth equity investment from<br>Berkshire Partners | $62,400,000<br>fluidtruck<br>has received a growth equity investment<br>BISON CAPITAL, IKEA |