

Guide to
Mergers & Acquisitions



Table of Contents

Overview of M&A Considerations	2
Overview of the Sale Process	6
Overview of Potential Buyers	8
Role of an Investment Banker	10

This guide will help senior executives, entrepreneurs and directors understand their options for M&A and shareholder liquidity transactions. Some of the questions that are answered inside include:

What are the options for selling shares? (see page 3)

How is a company valued? (see page 4)

What are the types of transaction consideration that can be used? (see page 5)

What are the steps in a sale process? (see page 6)

How long does the sale process take? (see page 7)

What is the difference between a strategic buyer and a financial buyer? (see page 8)

What role does an investment banker play in the sale process? (see page 10)

OVERVIEW OF M&A CONSIDERATIONS

In most companies, founders and shareholders will want to unlock the value of their holdings and create liquidity for themselves at some point. The decision to tap into this store of value is often a complex and challenging one for many founders, shareholders and board members. This guide helps senior executives and entrepreneurs evaluate the various shareholder liquidity alternatives.

WHAT SHOULD I CONSIDER IF I AM UNCERTAIN BETWEEN GROWING MY COMPANY FURTHER AND SELLING? HOW DO I DETERMINE WHEN THE TIME IS RIGHT TO SELL MY COMPANY?

Among the factors that founders and management may need to assess in deciding whether or not to monetize an equity stake include:

- Future growth prospects and current financial resources of the company
- Long term competitive positioning
- Valuation trends for similar companies
- Investment time horizons and return expectations of other shareholders
- Desire for an on-going management role
- Personal wealth and lifestyle influences

Analyzing a company's growth prospects, internal resources, competitive positioning, and industry valuation metrics can help ascertain whether a firm's value may be peaking. Making a practice of reviewing these issues with an investment banker can help a firm stay on top of valuation trends and evaluate the risk/reward of being an independent entity. Since buyers pay significant premiums for companies in industries that are perceived to have strong growth prospects, it is better to monetize an investment before growth begins to slow.

Non-valuation considerations such as liquidity needs of other investors, desire to maintain a continuing management role, and personal wealth and lifestyle issues may lead a firm to consider liquidity events independent of what valuation trends may indicate. When such non-valuation factors are driving the decision-making process, it is useful to understand that shareholder liquidity is not strictly an all-or-nothing proposition. Under the right conditions, transaction structures such as recapitalizations can be used to allow a portion of a firm's shareholders to sell their holdings while other shareholders retain their interests.

WHAT ARE THE OPTIONS FOR SELLING SHARES?

There are several alternatives for generating liquidity for shareholders, including:

- A sale of some or all of the company to another company for either cash or stock of the acquirer
- A recapitalization (a repurchase of shares funded by VC or private equity firms and/or debt)
- A sale of stock to the public via an initial public offering.

Buy-side M&A

Acquiring other firms is a viable growth strategy in many sectors. In industries where growth rates are slowing, acquisitions can be a more attractive growth vehicle than organic growth. In growing markets, targeted acquisitions can establish market leadership for the combined entity. The valuation environment in a firm's industry, the positioning of potential targets, and a firm's internal resources must be evaluated before approaching any targets. By engaging an investment banker before embarking on buy-side activities, a firm can increase its success rate.

U.S. Tech M&A Grows in 2007

According to PwC Corporate Finance, M&A activity in the tech sector grew in 2007 with \$476 bn worth of overall transactions, up 5% from 2006. There were 72 deals valued at 1 bn+ in 2007. Midmarket activity drove approximately 98% of the 3,559 deals during the year being valued at less than \$1 bn.

SALE OF COMPANY

A sale of a company to another firm for cash is the most common method of providing shareholder liquidity. Stock-for-stock mergers (when a firm exchanges all of its shares for shares of the buyer) can also be an effective means of generating shareholder liquidity if the buyer is publicly traded. By receiving stock in a public company, individual shareholders of a seller can liquidate their holdings on their own timetable and may qualify for more favorable tax treatment. In certain cases, a firm may also benefit from a merger with a privately-held competitor of similar size as a prelude to a liquidity event such as a sale, venture capital investment, or public equity offering. However, unless plans for a liquidity event are in place, mergers with private firms should only be considered if clear strategic benefits exist.

RECAPITALIZATION

A recapitalization involves the repurchase of a portion of a firm's shares using borrowings from a bank and, frequently, an equity infusion from a private equity firm. Occasionally, a recapitalization may involve the payment of a dividend to all shareholders from the proceeds of bank borrowings rather than the repurchase of shares. Recapitalizations are most effective for profitable companies whose founders or management wish to give liquidity to their outside investors but want to retain their own ownership interests.

Later stage venture capital firms are also usually open to buying shares from existing shareholders in tandem with a new round of venture capital fundraising. Usually the amount of shares the venture capital firms will buy from existing shareholders is limited to no more than 50% of the total size of the round. This option is generally available to fast growing companies that have proven business concepts, substantial revenue and are profitable.

INITIAL PUBLIC OFFERING

A firm that has the size and scale to generate a public equity valuation of at least \$250 million may consider an initial public offering or IPO. An IPO is a registered sale of stock to public investors. In practice, most of the buyers of an IPO are institutional investors such as mutual funds, pension funds, and investment management firms. To execute an IPO, a firm needs to go through the securities registration process with the SEC and must comply with governmental reporting and accounting rules. Current shareholders typically do not sell significant amounts of stock during an IPO and often are subject to a lock-up period of at least 180 days. Thereafter, current shareholders may be free to sell stock at any point, although there are some limitations for executives and directors

IS IT POSSIBLE TO SELL LESS THAN 100% OF THE OUTSTANDING SHARES OF A COMPANY?

Besides selling stock via an IPO, there are two feasible alternatives for selling less than 100% of a company's stock. One possibility is a recapitalization. The other instance is the purchase of a limited amount of existing shareholders' stock in connection with a venture capital investment.

A recapitalization involves purchasing an interest in a firm using borrowings from a bank or mezzanine debt lender. In most cases, recapitalizations also involve partnering with a private equity investor to purchase a significant interest. In this type of transaction, existing senior managers retain a significant minority stake in the company and continue in their leadership roles. Recapitalizations are only possible for companies that have a track record of positive cash flow. Without the additional equity support of a private equity firm, recapitalizations can be difficult to effect as commercial banks and other lenders are often reluctant to fund share repurchases or special dividends, even for companies that have strong cash flow.

Later stage venture capital firms are also comfortable purchasing minority interests in technology and high growth business services firms under the right conditions. Venture capital firms usually do not like to invest in transactions that are made purely to facilitate shareholder liquidity; they want to see their funds invested to fund a company's growth. However, in the context of a venture capital investment of \$10 million or more in a profitable company, venture capital firms may be willing to buy stock worth up to 50% of the total value of the round from existing shareholders.

HOW IS A COMPANY VALUED?

The value of a firm is usually determined via three analytical methodologies: comparable public company valuations, comparable M&A transaction valuations, and discounted cash flow analysis. For both public company and M&A transaction comparisons, the valuations of a variety of similar companies are analyzed in comparison to their specific financial metrics such as revenues, growth rates, margins, operating cash flow, or net income. In public company comparisons, values reflect the up-to-date company valuations and financial results. In M&A transaction comparisons, values reflect transactions that occurred at specific times in the recent past. A discounted cash flow analysis is based on the projected financial results of the company discounted by the average investment rates of return for companies of comparable industry, size, and financial condition. In practice, investors and buyers rely most closely on comparable company and M&A transaction comparisons rather than discounted cash flow analysis due to the uncertainties of projecting future results. An investment banker will be able to provide an analysis of the most recent comparable public company and M&A transaction comparisons and help develop a realistic valuation estimate of a firm.

HOW WILL POTENTIAL BUYERS EVALUATE A COMPANY?

In addition to the valuation techniques mentioned above, particular groups of buyers will also conduct specific analyses that will influence their offers. Strategic buyers, especially those who are publicly traded, will be sensitive to earnings per share accretion and dilution. An acquisition is accretive if it yields an increase in earnings per share. Most strategic buyers will not make an offer that will cause earnings per share dilution in the long run.

Financial buyers, on the other hand, usually rely on an internal rate of return or IRR metric to evaluate a potential investment. An IRR analysis assesses the potential cash-on-cash rate of return of an investment over a period of time, usually between 5-10 years. The higher the initial cash investment made by a financial buyer, the lower their expected IRR. Most financial buyers expect an investment to yield an IRR of at least 20%-30% per year over several years. To lower their initial cash investment and increase the IRR, financial buyers often borrow against the target company's cash flow. Thus, firms acquired by financial buyers often have to operate with leverage.

IPOs Create Challenges

An IPO provides an exit path for existing shareholders as well as new ways of financing growth. Yet, the demands on a public company are rigorous. Annual SEC compliance costs can exceed \$1 mm. Analysts expect the firm not only to produce earnings growth every quarter but also to forecast its growth precisely. Investors demand consistent stock price improvement. Executive pay and perks are closely monitored. To avoid these issues, more firms are now exiting via M&A rather than an IPO.

Valuation: Art and Science

Determining a firm's value is both rigorous and subjective. Valuation methods provide analytical frameworks for assessing values. In fairness opinions, such methods are widely applied and accepted as legally-binding appraisals. But a firm's true value also depends on what buyers are willing to pay at a given point in time. This can be influenced by subjective factors such as the buyer's resources, the firm's competitive positioning, industry dynamics, deal terms, etc. Thus, analytic methods can only approximate the outcome of the sale process.

WHAT ARE THE TYPES OF TRANSACTION CONSIDERATION THAT CAN BE USED?

Sellers most commonly receive cash or common stock as transaction consideration in a sale. Seller notes (a pledge by the buyer to pay a specific amount with interest to the seller in the future), earn-outs (a series of contingent payments based on future performance), as well as an assumption of the seller's liabilities are also forms of consideration. Each form of consideration can be used to the benefit of the seller, depending on the company's goals as well as the personal needs of selling shareholders.

Cash is the most common and straight-forward type of transaction currency. However, the range of strategic alternatives and breadth of potential buyers increases significantly if at least a portion of the consideration can be taken in some form other than cash. Cash also triggers immediate personal and corporate tax consequences for sellers. In many instances, sellers can experience significant tax deferral by accepting some or all of the transaction consideration in a form other than cash, such as common stock.

Taking common stock as consideration, however, also creates complications. Except for a sale to a buyer that is close to completing an IPO, common stock is only a viable liquidity alternative if the buyer is a publicly-traded company and has a robust market value. Otherwise, sellers have no clear means of liquidating a minority stake in a private company. Publicly-traded stocks that have a market capitalization of less than \$250 million also have liquidity issues and sellers may find it difficult to divest large blocks of shares without creating downward price movements in the stock. Shares of public companies are also usually subject to a lock-up period of 180 days or more post-transaction, thereby forcing the seller to hold onto the shares until the lock-up period expires. In this time, those shares may trade down in price, thereby diminishing the value of the consideration received.

Accepting other forms of consideration may help in maximizing valuation and bridging gaps between the seller's asking price and the buyer's offer. Seller notes can bridge a gap between the cash resources of a potential buyer and the seller's asking price. However, the seller must be willing to take on the credit risk of the buyer and be confident in the buyer's ability to repay the note in a timely manner. Earn-outs are particularly useful when the seller would like to continue managing the firm or when there is a difference of opinion between the buyer and seller on the firm's near term growth prospects.

WILL THERE BE A MANAGEMENT ROLE FOR ME AFTER THE COMPANY IS SOLD?

Senior executives are often concerned with their post-transaction status if their firm changes owners. In general, buyers will prefer to have existing management stay with the company. In many cases, especially with financial buyers, retaining existing management is essential to supporting the highest valuation for the firm. In these circumstances, existing management will also have considerable freedom to set and execute strategy and likely will have a sizeable incentive compensation package as well. With some strategic buyers, however, an orderly transition of six to twelve months to a new management team may be a required element for a sale. In situations where existing management holds a majority position in a firm and wishes to liquidate that position in its entirety, it would be recommended that those managers plan to step aside post-transaction. Many buyers believe that managers who have substantially cashed-out lose focus and motivation. As such, buyers usually prefer to work with a team whose interests are more closely aligned with their own. To ease concerns that the company will not have qualified management post-transaction, retiring executives should build an internal succession plan and involve the next generation of managers in the selling process.

Synergies Can Increase Value

One premise for strategic buyers to make acquisitions is that the combined operations will generate synergies. Synergies can take the form of either revenue increases or cost reductions. As part of the sale process, firms should discuss opportunities for synergies with potential buyers. As the potential for synergies with a seller increases, buyers may be inclined to increase their offers. By identifying synergies during the sale process, sellers have the opportunity to capture additional value that buyers may otherwise keep for themselves.

Currency Risks and Rewards

By accepting non-cash transaction currency in return for an increased overall pay-out and/or the potential to lower personal taxes, sellers also accept risks. A seller note's value is dependant on the buyer's creditworthiness, which can be poor or difficult for a seller to evaluate. An earn-out is contingent on a company's near term results, which may lag during a transition. Stock in a public company can fluctuate significantly in price while stock in a private company is illiquid. These risks should be evaluated before accepting noncash consideration.

Change of Control Clauses

Some key contracts may have "change of control" clauses. The definition of a change of control often varies by contract, but may be defined as the sale of as little as 51% of a company's stock. A change of control can cause stock options to vest immediately, enabling employees to cash out and requiring the firm to provide extra retention incentives. Other contracts with banks, landlords, customers, suppliers, and executives may have "escape" clauses if a change of control occurs. Sellers must assess the reaction of such stakeholders to a new owner before selling.

Internal Affairs

Employees can get nervous if they learn that their employer is being sold. Firms need to prevent the transaction process from becoming a distraction. One option is to be transparent with employees about the process. Another approach is to manage the process entirely on a "need to know" basis. If job cuts are unlikely post-transaction or stock options are widely held by employees, transparency might be a good option. If not, a confidential approach is needed; executives need to take care that due diligence requests do not cause distractions and sensitive discussions take place offsite.

OVERVIEW OF THE SALE PROCESS

WHAT ARE THE STEPS IN A SALE PROCESS?

There are two stages to the sale process, a planning stage and an execution stage. The planning stage begins with a strategic review of the company in which a preliminary valuation is developed and a variety of transaction alternatives are considered. Based upon a recommended course of action and valuation, a firm's board of directors authorizes senior management to pursue a specific transaction. This mandate is the starting point for the execution phase.

The execution phase begins with preparing a detailed business plan or information memorandum, a thoughtful set of financial projections, a management presentation, and a due diligence package. Once these documents have been developed, a list of relevant strategic and financial buyers is identified. Strategic buyers should have the requisite level of financial resources and strategic fit whereas financial buyers should actively invest in companies that are similar in size and in similar industries to the seller. Once contacted, potential buyers sign confidentiality agreements and receive the initial information memorandum and due diligence materials. After a period of review and a preliminary meeting or call with the seller's management team, potential investors are asked to submit an initial indication of interest. Based on these indications, a select group is invited to a series of meetings to discuss the firm's business further. Depending on the content of the initial due diligence package, additional due diligence trips may be necessary. If a buyer would like to make a formal offer after this due diligence review, it will provide a preliminary offer outlining the general business terms for the transaction. The company, in conjunction with its board of directors and professional advisors, and the buyer negotiate the conditions of the offer. If the parties reach an agreement, they sign a letter of intent. This usually provides for closing the transaction subject to a more exhaustive due diligence review period of 30-60 days and any necessary regulatory approvals.

Insights for Strategic Plans

Firms often review their strategic plans annually, establishing the coming year's objectives as well as a long term agenda. Investment bankers often are informal advisors in this process, especially in competitive markets with changing dynamics and business models. Offering insight on the competitive landscape and investor sentiment, an investment bank can help prioritize resource allocations and strategic initiatives. This input enables a firm to capitalize on the prevailing market conditions most effectively.

Fiduciary Duty of Management

Managers have a fiduciary duty to protect shareholder interests. Their mutual interests can diverge in the case of an unsolicited offer. Managers may reject an offer out of hand due to employment concerns but directors expect to be promptly notified so that they can explore an offer fully. Managers who don't present an offer to the board quickly risk repercussions and legal exposure. Investment bankers can compare the offer to a range of strategic alternatives, enabling managers to fulfill their fiduciary duties while presenting viable options to the board.

WHAT IF NOT ALL OF THE SHAREHOLDERS WANT TO SELL NOW?

Several options can be explored when selected groups of dissident shareholders do not want to sell, depending on the size of the dissident group's holdings. If only a minority of shareholders is seeking liquidity, alternatives such as a recapitalization, an IPO, or selling shares in conjunction with a venture capital investment may be appropriate. Should a minority group of dissident shareholders be reluctant to sell, corporate governance measures could force them to sell, depending on the rights granted to the company's board of directors under the company's by-laws and state laws. Such tactics are used to facilitate the complete sale of a firm to a strategic or financial buyer. Some strategic and financial investors also allow dissident shareholders to roll their holdings into stock of the buyer.

WHAT IF THE FIRM RECEIVES AN UNSOLICITED OFFER?

Unsolicited offers are frequently received, yet many management teams do not take full advantage of them. Companies often react to unsolicited offers either by rejecting the offer out-of-hand or by immediately beginning negotiations. However, an unsolicited indication of interest can be taken as an opportunity to assess the true value of the company in a competitive environment. Even if selling is not currently a priority, companies can often benefit by shopping an unsolicited offer to other potential buyers. Doing so can reveal other offers that may be more compelling. At minimum, a firm should retain an investment banker to negotiate directly with any party making an unsolicited offer. Having an active relationship with an investment bank enables a firm to launch a competitive process expeditiously in response to an unsolicited offer.

HOW LONG DOES THE SALE PROCESS TAKE?

If a company attempts to run a sale process itself, it should budget at least six to nine months. The CEO and CFO should expect to be highly engaged for the duration (30 or more hours per week) with other managers involved on an as-needed basis. Using an investment banker can cut management's time commitment roughly in half and reduce the timetable to three to five months.

WILL COMPETITORS BE INVOLVED IN THE SALE PROCESS? ARE THEY JUST GATHERING COMPETITIVE INTELLIGENCE?

Involving competitors in a sale process is a source of concern for many companies. Often, the most logical buyers for a company are its direct competitors. To generate the best valuations and most competitive bidding process, it is usually best to include direct competitors in the selling process. However, this does not mean that a direct competitor should get significant competitive information without demonstrating a serious level of interest and the means to make a competitive offer. An investment banker can help a company make a preliminary assessment of which competitors to include in the process and the capacity of the selected competitors to provide a solid bid at a reasonable valuation. Based on this preliminary assessment, a company can decide if including a specific competitor in the bidding process makes sense. With an investment banker managing the process, sensitive information is made available only on a selective basis in a carefully controlled environment and is protected via confidentiality agreements.

The Process of Due Diligence

Buyers conduct due diligence to learn as much as possible about the seller. Each will have unique views, making the due diligence process complex. In a well-managed process, all bidders get the same preliminary information initially. Only after the bidders have been narrowed down should detailed due diligence occur. Answering customized requests is often crucial to improving bids. Confirmatory due diligence occurs after a letter of intent is signed. Since LOIs are non-binding, significant due diligence discrepancies can lead buyers to back out.

Timing Impacts Buyer Interest

Timing plays a material role in getting bidders involved in a sale process. Strategic buyers have slow internal evaluation processes and may also need to get board approval. Many set annual budgets for investments and may need to secure extra resources or delay their bids to the next budget cycle. While financial buyers can act swiftly, a fund's age may dictate its willingness to bid. Newer funds may be aggressive about making investments while older funds often reduce investment activity to focus on harvesting prior investments.

OVERVIEW OF POTENTIAL BUYERS

WHAT IS THE DIFFERENCE BETWEEN A STRATEGIC BUYER AND A FINANCIAL BUYER?

A strategic buyer is a company that is primarily engaged in selling products and services. Strategic buyers have a variety of rationales for acquiring other companies such as consolidating product lines, gaining new markets or customers, accessing new technology, cutting operating costs, developing complementary products or distribution, or achieving economies of scale. Strategic buyers may compete directly with the seller, operate in a complementary product category, operate in other localities, or manage a broad portfolio of products and services related to the seller's business. Strategic buyers can create revenue enhancements and costs savings from consolidating operations that financial buyers generally cannot achieve. As a result, strategic buyers typically tend to be more aggressive bidders in the sale process than financial buyers.

Financial buyers are private equity or venture capital firms that manage funds of capital for major institutional investors. They use a combination of bank borrowings and their fund's capital to acquire majority ownership stakes in firms with strong cash flow. The bank borrowings are supported by the cash flow of the acquired company. Since financial buyers prefer to use as much borrowed money as possible, they tend to bid most aggressively for companies that have strong positive cash flow. For companies that are not very profitable, a selected group of venture capital firms may still have interest, depending on the seller's industry sector and future prospects. Unlike strategic buyers who each have unique ways to extract additional value from an acquisition through synergies, financial buyers typically have limited means to extract additional value from an acquisition. As a result, they bid solely on the investment return potential of the seller.

Unprofitable Companies

An unprofitable firm may still attract buyers under certain conditions. Losses due to increased marketing or R&D may be acceptable if such investments will lead to proven revenue streams. A loss from discontinued businesses or strategies can also be manageable, if the core business is profitable. Firms that have yet to reach breakeven but are growing revenues rapidly also can generate interest, especially ones that address a large market. Unprofitable firms may attract strategic buyers if synergies will lead to profitability for the combined entity.

Acquisition Integration

A buyer needs a detailed plan for integrating an acquisition. Swift decisions regarding redundant personnel, sales coverage, and facilities consolidation can keep productivity from declining. Intermediate tasks may include streamlining technology platforms, financial systems, product development teams, sales channels, and compensation and benefit plans. Longer term objectives may involve brand unification and product line rationalization. An integration team well-supported by senior executives can keep the entire integration process on track.

WHAT FACTORS INFLUENCE WHICH POTENTIAL BUYERS TO APPROACH?

A coherent strategy needs to be employed in order to develop an appropriate set of potential buyers. The pool of candidates can be influenced by the following factors:

- Competitive positioning of the company and the dynamics of its industry
- Growth prospects for the company's industry
- Overall size of the company
- Current profitability of the company
- Form of transaction consideration acceptable to the company's shareholders
- Internal resources of potential buyers
- Timing of the selling process
- Valuation expectations of the sellers

COMPETITIVE POSITIONING AND INDUSTRY DYNAMICS

A company's competitive positioning and the dynamics of its industry will have an impact on the number of strategic buyers a seller may be able to attract. A company that operates in a fragmented sector with many direct competitors often has a better chance of successfully attracting a strategic buyer than a firm with relatively few competitors. Also, a firm's position within that industry may dictate its options. For instance, a clear industry leader would need to target market leading firms in related sectors and larger, multi-line companies because no direct competitor will have the resources to buy it. Conversely, a firm with a relatively small market share would need to position itself as an attractive niche competitor that would round out another industry participant's product portfolio. The likely buyer in this scenario is another firm within its industry.

INDUSTRY GROWTH

Companies operating in sectors with strong growth potential can often attract a greater range of buyers. Not only will direct competitors have a keen interest in the firm, but a range of companies with adjacent products will want to gain entry into the industry. Further, a larger range of financial buyers will be attracted to the industry as both traditional private equity firms as well as venture capital firms actively invest in high growth sectors.

FIRM SIZE

The size of a firm will impact the range of buyers it might attract during the sale process. For smaller companies, large strategic buyers may not have interest unless the firm has some unique quality such as cutting edge technology. Similarly, larger financial buyers likely will forego smaller deals because they need to invest large amounts of capital per transaction. Conversely, larger sellers will find that strategic buyers that are not at least of similar size as well as smaller financial buyers will not have the internal resources to make a competitive bid.

PROFITABILITY

The seller's profitability has a significant impact on the ability to add financial buyers to the selling process. A firm that has not established a clear history of positive cash flow will likely not attract interest from traditional financial buyers. However, firms with a track record of strong revenue growth but limited profitability may attract interest from selected venture capital firms.

TRANSACTION CURRENCY

The more flexible a seller is willing to be with respect to monetary consideration, the greater the potential pool of buyers. Non-cash consideration such as stock and seller notes can enable strategic buyers that otherwise would not have the liquidity to provide competitive offers. Also, the ability for management to defer consideration via contingent payments such as earn-outs can create flexibility for strategic and financial buyers alike.

INTERNAL RESOURCES OF BUYERS

The availability of internal funds for acquisitions is a key factor in assessing potential buyers. A buyer must have an adequate amount of liquidity, through a combination of cash and credit line availability, or an appropriate acquisition currency, such as publicly traded stock. Without this liquidity, a buyer will need to develop creative solutions with the seller, including seller notes and earn-outs.

TIMING OF SALE PROCESS

Timing can impact the interest that a company receives. More buyers can be attracted when the seller can demonstrate a recent positive trend. Strategic buyers can be constrained due to budgetary and strategic planning issues at certain times. Financial buyers must be approached when they are actively seeking new opportunities.

VALUATION EXPECTATIONS

The valuation goals set by a seller impacts the pool of potential buyers. Premium valuations are likely to be extracted from strategic buyers, providing that buyers with both good strategic fit and sufficient internal resources exist. To the extent that seller expectations reflect a premium valuation, it may become difficult to attract financial buyers or strategic buyers that do not have significant opportunities for operating synergies.

Does the Offer Fit the Seller?

While price is usually the focus of any M&A transaction, sellers accepting noncash currency also have nonprice factors to consider. For stock deals and seller notes, sellers must be comfortable with the risks associated with the buyer's operations. For earn-outs, existing management needs to have a clear understanding of the strategic views of any buyer; divergent views portend poor future results. In all cases, if management is staying, buyers should provide executives with an incentive plan. Lack thereof suggests limited commitment to management.

Financing Contingencies

In addition to uncertainties surrounding non-cash consideration, cash offers can have significant contingencies as well. Offers based on third party financing should be accompanied by a fully-committed term sheet or other proof of credit line availability. In situations where financing is subject to the lender's due diligence, a sizable non-refundable cash deposit can align the buyer's interest with the seller's. When speed to closure is paramount, buyers should seek bridge financing first before approaching slower-moving financing sources.

WHY USE AN INVESTMENT BANKER TO SELL MY COMPANY?

Selling some or all of a firm without the advice of an investment banker places a company and its shareholders at a significant disadvantage, even if members of the management team themselves have prior M&A experience. An investment banker will know exactly what information strategic and financial buyers will expect to receive and will package it to the maximum benefit of the company. Further, an investment banker can bring many more potential buyers to the table; this yields a greater chance of completing a transaction and getting the highest possible valuation. Investment bankers, since they are not principals of the selling company, often can have a more productive and open dialog with strategic buyers than if a company approached such a buyer directly. An investment banker will also run a consistent and efficient process, significantly cutting down the time and effort managers will need to dedicate to the process and speeding the time to closing. An investment banker also protects a firm from agreeing to off-market deal terms that can limit its strategic and financial flexibility.

WHAT ROLE DOES AN INVESTMENT BANK PLAY IN THE SALE PROCESS?

Investment banking firms perform a range of activities during the sale process and provide vital market intelligence before and during the sale process. In preparation for a sale, an investment bank will help a company develop an initial perspective on its current valuation and its future potential as well as provide insight into transaction structuring and a preliminary set of prospective buyers. During the sale process, an investment bank will refine the valuation parameters, prepare the appropriate marketing documents, develop a comprehensive list of strategic and financial buyers, schedule meetings with potential buyers, manage the due diligence and bidding processes, and negotiate term sheets and closing documents.

Consolidation Strategies

Fueled by private equity, many fragmented industrial and service sectors were consolidated in the 1990s. This strategy is now being applied to the technology and business services sectors by a variety of buyers. The basic premise is to use a single firm as a vehicle for making a series of small acquisitions in related industries at reasonable values. Additional profits are then generated from overhead reductions and cross-selling products. Consequently, private equity firms seek out managers with strong M&A track records.

Dual Process Strategies

A company's shareholders often can be torn between growing the firm and selling out. One solution to this dilemma is to conduct a dual process of simultaneously marketing a venture capital round while approaching selected strategic buyers. If the company can attain a valuation that is compelling from a strategic partner, the firm is sold. If not, it continues on its path with a venture capital round. Since the two processes are similar, a firm benefits from significant efficiencies and creates additional negotiating leverage.

ON WHAT BASIS SHOULD A FIRM EVALUATE AN INVESTMENT BANK?

There are several areas on which to focus when evaluating investment banks, including:

- Deep understanding of industry valuations and M&A opportunities
- Knowledge of company's market and competitive positioning
- Strong relationships with relevant strategic and financial buyers
- History of successful transactions for companies of similar size and industry
- High level of senior banker involvement
- Banker responsiveness to client needs
- Development of creative alternatives

An initial meeting with a senior banker should enable a company to determine if a particular investment bank has the necessary qualifications and track record to meet its needs. If so, a follow-up meeting where the banker makes a formal presentation regarding the company's potential buyers, valuation expectations and a tentative marketing plan should be arranged. These two meetings should provide the basis for deciding on the appropriate investment bank for a company and its strategic needs.

HOW MUCH DOES IT COST TO USE AN INVESTMENT BANKER TO SELL A COMPANY?

Retaining an investment bank to create shareholder liquidity is very cost effective. The vast majority of the fees associated with a shareholder liquidity transaction (roughly 90%-95%) are payable only upon the consummation of a successful transaction. The balance of the fees is paid as part of a nominal up-front or monthly retainer.

Madison Park Group is an investment banking firm focused on providing financial advisory services to technology and business services companies.



Innovation & Growth

Madison Park Group is comprised of an experienced team of investment bankers. Our banking team has closed over 150 corporate finance transactions with a total transaction value in excess of \$30 billion. The Madison Park Group team has been involved in M&A, strategic advisory, private placement, IPO, secondary public offering and debt financing transactions for companies in a range of industries including:

- Enterprise Software
- eCommerce
- Transaction processing
- Business Process Outsourcing
- IT Services
- Online Services
- Healthcare Technology and Services
- Financial Technology and Services

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