M&A for High Tech Start-ups

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Rob Schultz, Managing Partner, Serra Ventures

• Venture capitalist for last 14 years
• Has been involved in numerous M&A processes both as a buyer and seller; venture capitalist, entrepreneur and advisor
• Founder and former CEO of DigitalWork, Inc.
  – Grew company from zero through an IPO process
  – Hired 140 employees
  – Raised over $60 million in capital from top tier venture firms and strategic investors
  – Made one strategic acquisition grow the company
• Named 2000 Ernst & Young Entrepreneur of the Year Finalist
• Former consultant with McKinsey and Deloitte and Touche
• BA, Northwestern University; MBA, University of Chicago
About Serra Ventures

• An emerging growth technology venture capital and advisory firm located in the University of Illinois Research Park.
• Ranked #8 in list of Biggest VC Deal-Makers in the Great Lakes region
• Approximately $40 million under management across three funds
• Invested in over 50 companies across the Midwest
  – 6 exits
• Have led 6 companies through sale process as an advisor
• Partners are experienced consultants, entrepreneurs and venture capitalists.
• Strong partnerships with the Midwest venture community
The Data: 2015 was great. 2016?
The Data: 70% of deals are under $100M

Median price range $30-55M over last 3 years
The Data: Software/IT Dominates M&A

M&A activity (#) by sector

Source: PitchBook

Serra Capital
Why Companies do M&A?

• All or a combination of these reasons:
  – Enter a new and complementary market
  – New product to sell to existing customers (build vs. buy)
  – Accretive revenue and profits (aka “roll-up”)
  – New customers
  – Irreproducible network effects
  – Best-in-class technology
  – Protected intellectual property
  – Team
Two Ways to Be Acquired

1. You are Bought  
   (Happens naturally)
2. You are Sold  
   (Forced through process)

Which one do you think tends to have a better outcome?
Getting Bought: Biz Dev -> Corp Dev

• Dance with the elephants
• Understand how your company fits into the industry ecosystem
• Invest early on in building partnerships with potential acquirers
• Use your unique assets to add value to the partnership
  – Product, distribution, IP, technology
• **CAUTION:** Dancing with elephants can get you killed!
## Top Tech Acquirers in 2015

<table>
<thead>
<tr>
<th>Rank</th>
<th>Company</th>
<th>Notable Acquisitions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Microsoft</td>
<td>Adallom, Inc., Equivo</td>
</tr>
<tr>
<td>2</td>
<td>IBM</td>
<td>Merge Healthcare, Inc., The Weather Channel Companies</td>
</tr>
<tr>
<td>3</td>
<td>Google</td>
<td>Jibe Mobile Co. Ltd., Bebop Technologies, Inc.</td>
</tr>
<tr>
<td>4</td>
<td>Apple</td>
<td>Mapsonso, FoundationDB</td>
</tr>
<tr>
<td>5</td>
<td>GRAVITY4™</td>
<td>Triggit, Inc., Ezike, Inc.</td>
</tr>
<tr>
<td>5</td>
<td>MARLIN EQUITY PARTNERS</td>
<td>AdvancedMD Software, Fidelis Security Systems, Inc.</td>
</tr>
<tr>
<td>5</td>
<td>CISCO</td>
<td>OpenDNS LLC, Acano Ltd.</td>
</tr>
<tr>
<td>5</td>
<td>twitter</td>
<td>Bounty Labs. Inc. (Periscope), TellApart</td>
</tr>
<tr>
<td>9</td>
<td>accenture</td>
<td>FusionX LLC, Brightstep AB</td>
</tr>
<tr>
<td>9</td>
<td>amazon</td>
<td>Elemental Technologies, Inc., 2lemetry, Inc.</td>
</tr>
</tbody>
</table>

Know who in your industry is acquisitive and why!
Reasons to Enter into a Managed Sale Process

Thelma, I think we are out of options

Louise, let’s hire an investment banker
Getting Sold: Prepare for a Long, Arduous Process

• The process can take 6 months to well over a year!
• Most processes are unsuccessful
• Pre-market activity (1 month)
• Marketing activity (3-4 months)
• Buyer diligence (2-3 months)
• Negotiation (1-2 months)
• Closing (2-4 months)
Documents Needed to Conduct a Sale Process

• Well thought out, prioritized target buyer list
• Anonymous teaser document (you need a secret code name)
• Complete financial information package and key metrics
• NDA
• Confidential Information Memorandum (CIM)
• Data room for DD with above information plus more info
  – Market research
  – Employee contracts i.e., non-compete agreements
  – Technical/product information
  – Customer contracts
  – Customer cash studies
  – And much more
Typical 10 Steps in a Managed Sale Process

1. Anonymous teaser document sent to target list
2. Interested parties sign an NDA
3. Company name is revealed, CIM is sent out
4. Management presentation is delivered
5. If additional interest, buyer is invited to the data room
6. Site visit, customer calls, site visit and other buyer specific due diligence is completed
7. Term sheets are received and negotiated (hopefully multiple)
8. Buyer is selected by the company - integration planning begins
9. Legal closing process is started; Legal docs and fine details are further negotiated (working capital adjustment, escrows and other land mines are out there)
10. Shareholder approvals and signatures are obtained. Close!
Hire an Investment Banker

• Valuable in both types of M&A
• Cost
  – Monthly retainer plus % of total transaction ($5-10K/month, 4-6%)
  – Retainer is credited against transaction fee
• Value
  – Run sale process
  – Drive up price through competitive process
  – Serve as a buffer between management and the company. It will get ugly!
Elements of a Deal

- All Cash (best)
- Cash plus cash earn out
- Cash plus equity in acquirer
- All the above
What is My Company Worth?

• Banker answer: “What the market says it is worth”

• Traditional metrics
  – EBITDA multiple (median 9x in 2015)
  – Revenue multiple
  – Growth drives the multiples higher
  – Recurring revenue valued more than service or transaction revenue

• Non traditional
  – Users
  – Value of network
  – Technology/Patents
  – Number of PhDs 😊
Fictitious Transaction Example: LICKI Brush, Inc.

The Situation:
• Device that enables you to lick your cat
• Raised $10M in venture capital
  • $1M Seed Preferred
  • $3M Series A Preferred
  • $6M Series B Preferred
• Investors own 60%, Founders and employees own 40%
• Company reached $25M in sales, and $5M in EBITDA
• LICKI Inc. has an all cash offer for $50M from a large pet company
# LICKI Inc. Waterfall Analysis (simplified)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase Price</td>
<td>$50,000,000</td>
</tr>
<tr>
<td><strong>Less Adjustments to Cash Consideration</strong></td>
<td></td>
</tr>
<tr>
<td>Less: Debt on balance sheet</td>
<td>$0</td>
</tr>
<tr>
<td>Plus: Cash on balance sheet</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>Less: Working Capital Adjustment</td>
<td>$2,500,000</td>
</tr>
<tr>
<td>Less: Transaction Fees</td>
<td>$3,000,000</td>
</tr>
<tr>
<td>Less: Indemnification Escrow Funds</td>
<td>$5,000,000</td>
</tr>
<tr>
<td>Less: Sellers Reps and Warranties Escrow Funds</td>
<td>$2,500,000</td>
</tr>
<tr>
<td><strong>Upfront cash available for distribution to shareholders:</strong></td>
<td><strong>$38,500,000</strong></td>
</tr>
<tr>
<td><strong>Preference Paid to Preferred Shareholders</strong></td>
<td><strong>$10,000,000</strong></td>
</tr>
<tr>
<td><strong>Cash available to common and preferred</strong></td>
<td><strong>$28,500,000</strong></td>
</tr>
<tr>
<td>Cash to Preferred (60%)</td>
<td>$17,100,000</td>
</tr>
<tr>
<td>Cash to Founders and Employees (40%)</td>
<td>$11,400,000</td>
</tr>
<tr>
<td><strong>Cash to shareholders after escrow (18 months)</strong></td>
<td></td>
</tr>
<tr>
<td>Cash to Preferred (60%)</td>
<td>$4,500,000</td>
</tr>
<tr>
<td>Cash to Founders and Employees (40%)</td>
<td>$3,000,000</td>
</tr>
<tr>
<td><strong>Total Payout</strong></td>
<td></td>
</tr>
<tr>
<td>Preferred Shareholders</td>
<td>$31,600,000 (63%)</td>
</tr>
<tr>
<td>Founders and Employees</td>
<td>$14,400,000 (29%)</td>
</tr>
</tbody>
</table>
Top M&A Myths

1. If I fail, someone will buy my company for the technology
2. I can wait until I am out of cash to sell
3. Traditional metrics don’t apply to my business
4. Revenue in my market is more valuable
5. Any banker will take on my project
6. My Kickstarter did well, so I will get bought
QUESTIONS?