INSIGHTS FROM THE BDO TECHNOLOGY PRACTICE

GUIDE FOR SOFTWARE COMPANIES BEING ACQUIRED BY PRIVATE EQUITY

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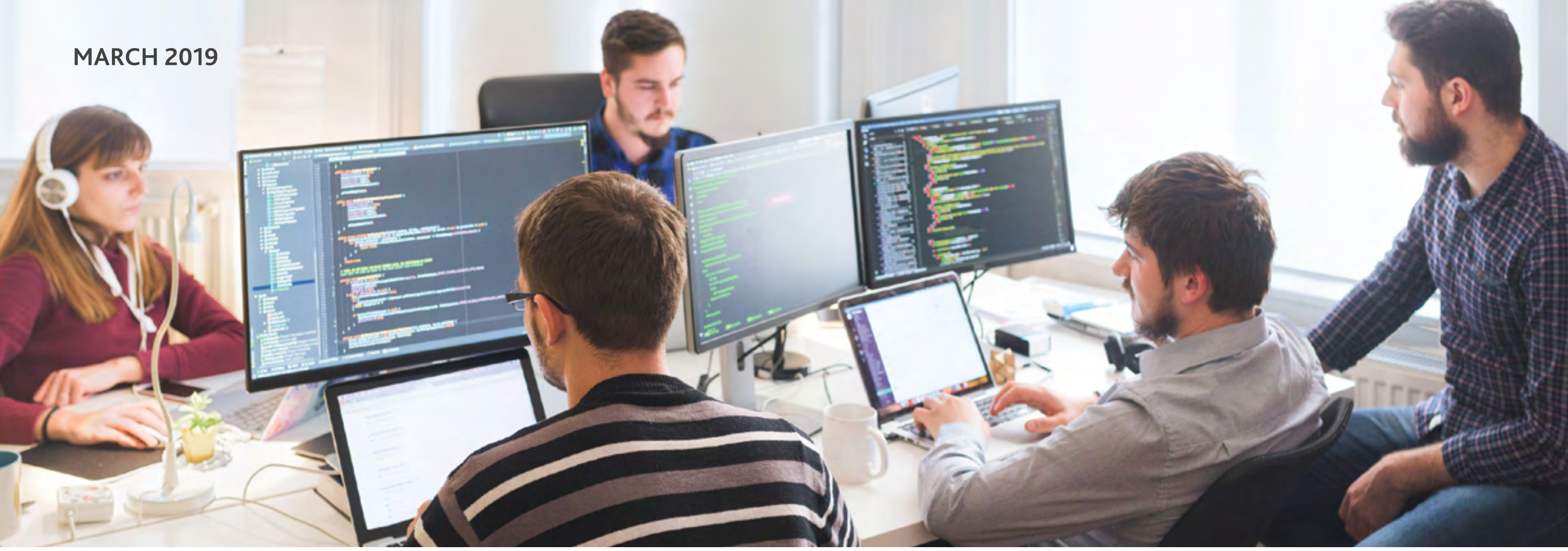

Introduction

Software company founders and CEOs often get inquiries from private equity (PE) firms interested in striking a deal to acquire or invest in their company. Depending on the offer, this could be the perfect opportunity to take their company to the next level or to achieve an optimal exit.

But how can they recognize such an opportunity? The answer to that question is, in part, what this guide aims to provide.

PREPARING FOR A DEAL

1. What are you looking for?

To decide whether you should pursue a PE deal, you should first look inward. Your current situation, strengths, weaknesses, opportunities, and near, medium and long-term goals can help you identify if, when and how much external capital you may need. Remember that private equity is not the only type of capital you can raise. Other options, such as loans and venture capital, also have their advantages and disadvantages. When considering potential PE deals, you should consult your business advisor and discuss the potential opportunities and challenges each investment avenue presents.

2. Know what a PE firm can offer

There are many good reasons why almost half of all investments in technology companies come from PE firms—and why those tech companies, including many in the software space, say yes to these investments. PE firms can help your tech company access new markets, assist with the organizational and financial sides of your business, provide objective data-driven insights, create efficiencies and increase profitability. However, optimizing your collaboration with a PE firm depends on both parties aligning their interests ahead of signing a deal.

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3. Know the PE ecosystem

The PE landscape has changed a lot over the last 10 to 15 years. Today, most software companies that are post-Series A will be able to find interested PE firms. Some PE firms are generalists, whereas others have a specific focus; all have different strengths. Understanding the focus and nature of specific PE firms will help you identify which ones will be the best to work with. Consultants can help you speed up this process, thanks to their vast business networks and PE contacts.

4. Know your worth

Before starting negotiations, you need to evaluate your company's worth. This valuation is necessary for establishing realistic negotiation targets. Many factors can affect your valuation positively and negatively, including your technology, IP, solutions, management team, industry trends, growth potential, ability to turn revenue into cash flow, sales and potential future exit opportunities. The valuation is not based solely on a picture of your current and past performance, but also on an analysis of what your material and immaterial assets (especially IP) will be worth over time.

NEGOTIATING WITH A PE FIRM

5. Know what PE firms are looking for (and at)

Traditionally, PE firms have a set goal for an investment: It should deliver a substantial return in three to five years. During negotiations, PE firms will primarily be focused on your products, services, technology, intellectual property, R&D, management team and future potential. Prior to negotiations, you should carry out an analysis and prepare arguments—based on detailed data and supporting documents—to help speed up the process and get the optimal deal.

6. Know your PE firm's situation

Another important factor in negotiations is knowing what the situation is like on the other side of the table, which makes it easier to discern your position and which tactics will be most effective. BDO's annual Private Equity Survey provides good insight into PE firms' current situation, which can help you during negotiations. According to its findings, PE firms are currently experiencing healthy competition. With access to a lot of capital, many are looking to make investments and keep their investments longer.

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7. Know PE firms' concerns

Software companies are attractive targets for PE firms. However, their interest can be tempered by some of the challenges the technology industry is experiencing overall. Respondents in BDO's Private Equity study point to identifying growth opportunities (42 percent) and finding and retaining management teams (33 percent) as some of their biggest challenges when acquiring target companies. PE firms may also be concerned about areas such as your IP and the future potential of your solutions.

8. Have all your documentation in order

The level of granularity in questions from PE firms often comes as a surprise to software companies. These questions can cover areas such as financial, legal and tax issues, as well as existing business processes, future earning perspectives, risks and more. You may also face very detailed inquiries regarding value created through non-financial activities such as sustainability programs. Documenting your strengths in the areas PE investors will likely focus on during a deal negotiation is a process you should start very early on.

COLLABORATING POST-DEAL

9. Plan for the post-acquisition

It is crucial to outline how you envision your company's collaboration with your PE firm will be post-deal ahead of sitting down at the negotiation table. Creating effective collaboration starts with both you and the PE firm explicitly stating what you expect to get out of the partnership, as well as how it should work in practice. Such plans and statements of intent should include everything from day-to-day collaboration to how you can work together toward a potential exit.

10. Set clear targets

Communication and collaboration issues often arise from misalignment of expectations and goals. Unrealistic plans for sales growth, cost cuts and/or a lack of foresight regarding future challenges can be a red flag for PE firms during a negotiation process and create doubts about your management team's business acumen. Collaboration starts during the negotiation process but should be a continuous effort. While the exact structure, form and regularity of communication between you and your PE firm will vary, communication should be proactive instead of reactive and follow established guidelines.

People who know Technology, know BDO.

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