



Guide to Selling Your Technology Business

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Introduction

Selling a technology company can be a complex and time-consuming process that requires careful planning, preparation and execution. In today's market, you're dealing with sophisticated buyers across the table and a myriad of due diligence requirements. Business owners must be well-prepared and well-advised to ensure a successful transaction.

Even the most seasoned and sophisticated acquirers, from private equity firms to large corporations with in-house M&A functions, approach each transaction with a team of professional services firms dedicated to various aspects of due diligence and deal execution. Business owners are frequently "outgunned" and overwhelmed by the process without their own team of advisors to help them navigate the complexities of the M&A process.

This guide explores the key elements of a typical sale process and provides practical advice on preparing for a transaction. Whether you are planning to sell your business in the near term or simply want to position your company for long-term success, this guide is an essential resource for any middle-market business owner in the technology space.



Assembling a Deal Team

To ensure a successful transaction, assemble your team of advisors well in advance of a sale. At the outset, it's best to bring on a recognized CPA firm that can prepare highly credible, GAAP-based financial and tax information that will serve as the bedrock for both internal and external evaluation of the business. It is also never too early to start cultivating relationships with leading middle market investment banking firms.

ACCOUNTING & TAX

Many middle market companies lack sufficient financial controls to provide quality information to prospective buyers in a timely manner during the transaction process. Talk to your investment banker and CPA firm about the appropriateness of reviewed vs. audited financials, as well as a Quality of Earnings (QoE) report. Accrual basis financial statements consistent with GAAP are table stakes in today's M&A processes and ensure both the buyer and your own advisors are all operating off reliable financial information. Tax and accounting deficiencies can derail an otherwise successful transaction.

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INVESTMENT BANKING

Your investment banker will quarterback the transaction from start to finish. Look for an investment banking firm with relevant transaction expertise, industry experience and a strong reputation in the marketplace. Your banker can share real-time market intelligence, identify areas for improvement in the business and help you determine the appropriate time to launch a process.

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TRANSACTION ADVISORY SERVICES

Sell-side due diligence has become standard for companies prior to going to market for a sales transaction. This process analyzes a business in the same manner a prospective buyer would conduct an evaluation of the company, preemptively allowing sellers and their deal advisors to get ahead of and control the narrative around key issues that may arise. Obtaining a sell-side QoE allows bankers to run a smoother overall process, prepares sellers for what is to come during the buyer diligence phase and enables buyers to make more compelling offers earlier in the transaction process.

In addition to sell-side financial due diligence, sellers often engage transaction tax, operations and data analytics teams prior to going to market to obtain insights in areas that could drive significant deal value.

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DEAL ATTORNEY

When it comes to selecting a deal attorney, consider someone who specializes in M&A transactions, rather than someone with a background in general corporate law. Find a lawyer who possesses a commercial mindset and understands the prevailing market standards for crucial terms in purchase agreements and other transaction documents. The best attorneys can explain intricate legal concepts in a way that helps you make well-informed business decisions while avoiding unnecessary delays.

It is best to choose a law firm that is appropriately sized for your transaction, with billing rates that reflect the scope of the work. Ideally, the law firm should have specialist attorneys who can assist the lead attorney on complex tax, environmental, intellectual property (IP) and other legal issues as required. Ask your investment banker for suggestions for attorneys that suit your specific needs and transaction.

Preparing Your Business for Sale

Whether or not you're considering the sale of your business in the near future, it is critical to understand the state of the market and capitalize on value-creation opportunities.

As market conditions fluctuate, there are numerous factors to assess in preparing your business for sale. Some of the changes your advisors recommend may not be achievable in the short term, which is why it is preferable to solicit objective, third-party perspective on value creation opportunities early and often.

TAX PLANNING

It is important to leverage your tax advisors to stay ahead of shifting tax policies and optimize your legal organizational structure for likely transaction structures. Choosing an advisor that has experience across a wide range of transaction structures can help you evaluate various structures buyers may propose.

Ask your advisor to prepare illustrative net proceeds analyses for likely transaction structures, ranging from stock vs. asset sale scenarios to F reorgs, 338(h)(10) elections and other commonly employed deal structures. Quantify the value of asset basis step-ups, NOL carryforwards and other tax assets that may enable certain buyers to pay more for the business.

INTELLECTUAL PROPERTY

Since technology companies are highly mobile and can often conduct business anywhere, they can create value around the world if they have operations in different countries. This means intellectual property may exist in different entities. It may be preferable to consolidate your IP in one entity prior to a sale. Ask your advisors to be proactive and look at the entire tax profile of the company across the globe. That means assessing potential tax risk, sales tax nexus issues, and doing an assessment.

An advisor can help you complete a review of your current business to help you identify quick wins that, if implemented, may significantly enhance the attractiveness of your business to potential purchasers.

However, a buyer's due diligence will almost certainly discover any last-minute changes that are unsustainable — particularly those relating to revenue and profit margins. There isn't an advantage in presenting a great-looking company to a buyer when it becomes evident during the due diligence process that the presented information or performance isn't sustainable. Develop practices and procedures that inspire trust from your stakeholders.

Key Points



**Planning ahead
can reduce your
tax bill**



**Improving the
attractiveness
of your business
may result in a
higher sale price**

Conducting an Operational Evaluation

An advisor will provide guidance on key valuation drivers, which can help determine a potential value range that the market may place on your business. As you're preparing for a sale, consider the following areas for evaluation from an operational perspective:

MANAGEMENT

If you're heavily involved in the day-to-day running of the business, the purchaser may be keen to retain your services for a period after the sale. Depending on your personal position, this may be something you wish to avoid.

Where possible, develop a complete management team and a succession plan for key positions or individuals nearing retirement. Key man risk, as it's often referred to, is a pain point for potential buyers. Do what you can to diversify key client relationships, R&D activities and other critical value enhancing activities across multiple individuals in the organization. Recruit a full management team with no obvious vacancies in key positions, where possible.



GROWTH

Demonstrating an ability to grow, both historically and in the future, is essential to maximizing value in a sale process. While growth is important, the quality, sustainability and profitability of that growth is equally important. Ideally, start tracking KPIs that help you quantify the sales efficiency of the business and ROI on growth-oriented investments. Talk to your investment banker about what KPIs are worth tracking and are most relied upon by potential buyers. Develop a growth strategy and believable financial projections that are supportable using transparent unit economics.



PROFITABILITY

Increasing sales and margins as well as controlling overhead spending before entering a transaction process are important and desirable. It's likely that this is exactly what you're already doing in the normal course of running your business. Easy solutions are rare and often need to be viewed with caution. You should attempt to capitalize on opportunities that exist to improve the profitability of your business. It is equally beneficial to identify potential future drivers of margin expansion and operating leverage that buyers can capitalize on under their ownership period.



CAPITAL EXPENDITURES

If you're considering a sale, deciding whether to incur significant capital expenditures in the run up to a sale is always difficult. A buyer will consider the quality, longevity and replacement cost of assets when determining valuation. If the business has been focused on maximizing distributions at the expense of reinvesting in critical infrastructure and operational resources, a sensible purchaser will focus on what remedial investment is required and factor this into its assessment of the value of the business. In most cases, it's sensible to continue operating and investing in the business as though you were going to continue owning it.



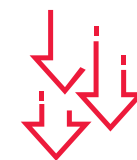
EBITDA ADJUSTMENTS

Identifying potential EBITDA adjustments is a valuable exercise. These "addbacks" may include excess owner compensation, non-recurring items, such as the costs of relocation, or unusual business disruption events, such as the COVID-19 pandemic. Work with a leading Transaction Advisory Services practice that can prepare a QoE report and provide input on market norms and whether management's proposed adjustments will withstand buyers' financial due diligence.



WORKING CAPITAL

Most buyers will ask sellers to deliver a "normal" level of working capital at closing. Working capital negotiations can take on a life of their own, and inexperienced sellers can suffer significant value erosion as a result. Agreeing on a working capital methodology is rarely as simple as reducing current assets by current liabilities. Sell-side QoE reports can include working capital analyses to help get buyers and sellers on the same page earlier in the process. Management should evaluate opportunities to lower working capital requirements of the business leading up to a sale, which may lead to lower working capital requested by the buyer at closing.



The Transaction Process

The sale of your business is the ultimate reward for the risk and the effort that you have put into your business over many years. Key objectives of the sale process may vary from seller to seller. However, they almost always include maximizing the sale price and finding the right new home for employees and customers. Achieving all of these objectives in today's market environment is extremely difficult without a high caliber deal team at your disposal. We recommend hiring an experienced investment banking firm to quarterback the transaction process and working with your legal, tax and accounting teams to ensure a coordinated effort and high degree of control over the process.

Any transaction, whether focused on one-off negotiations or a broad auction process, is extremely time consuming. Having advisors you can trust to help you achieve your objectives is vital. They can carry the administrative burden and manage your controlled exit so you can continue to run the business. This will alleviate much of the distraction that comes with an important transaction while ensuring that your other goals and objectives for the transaction are met.

Key Points



Selling a business takes longer than you might expect



Timing is a key element to consider in the transaction process



There are benefits to having trusted advisors



The Controlled Sale Process

The controlled sale process involves the following:

- ▶ Preparing the business for sale
- ▶ Understanding the likely value and preferred deal structure
- ▶ Completing thorough tax planning
- ▶ Conducting vendor due diligence to optimize financial positioning and identify risks
- ▶ Compiling due diligence information and preparing an information memorandum
- ▶ Identifying and contacting potential buyers
- ▶ Soliciting initial indications of interest (IOIs)
- ▶ Hosting management presentations with shortlisted buyers
- ▶ Soliciting letters of intent (LOIs)
- ▶ Negotiation and signing a letter of intent
- ▶ Facilitating confirmatory due diligence
- ▶ Facilitating legal documentation
- ▶ Signing and closing the transaction
- ▶ Post-closing support relating to purchase price adjustments and post-closing matters

Further information on key steps in the sale process is set out in the following sections.



Is Your Business Ready to Navigate the Process

The sale of a company creates a great demand for information. While an advisor can help coordinate and package the information required as part of the sale process, management is ultimately responsible for providing its advisors with accurate and timely information. Buyers may lose confidence and conclude that a company has inadequate financial controls, information systems and/or human resources if there are significant information gaps, delays or poor quality responses.

A typical controlled sale process led by a qualified investment banking firm can take 4-6 months or more from start to finish. During this period, the company must continue to operate effectively despite the diversion of management's time and attention. Your management team must be prepared to cope with the additional demands likely to be placed on it during the sale process.

As mentioned earlier, it's recommended that the planning process begins well in advance. This will give you time to address tax planning, human capital constraints and various legal and operational issues prior to engaging with potential buyers. As such, it's usually a good idea to start compiling information that potential purchasers are likely to require well in advance of any sale process. Building a comprehensive repository of all material contracts and performance data will save management considerable time during the due diligence phase. This should include all signed customer and supplier agreements, operating leases, license agreements, insurance and benefits documentation, tax returns and legal and regulatory documentation.

Ask your investment banker and deal attorney for sample data room request lists to ensure you're gathering the right information. It is easier and preferable to be gathering this information well in advance of a process, so management can focus its time on value creation, management presentations and responding to a narrower universe of due diligence requests as things start to progress.

During the sale process, your investment banker will manage a virtual data room, coordinate diligence responses and work to spend management's time wisely on only the most pertinent diligence requests as you move through the process. Further, your advisors can help ensure you are providing the appropriate level of disclosure without compromising the company's competitive position or confidentiality.

Key Points



The transaction process can last 4-6 months or more



Provide potential buyers with comprehensive information about the company's operations

Examples of the types of information you may need to put together for the benefit of potential buyers include:

- ▶ Corporate/legal information
- ▶ Management/organizational structure
- ▶ Product demo and product-market fit
- ▶ Tech stack and IT infrastructure
- ▶ Sales and customer-level data
- ▶ Tax, compliance and regulatory information
- ▶ Historical and projected financial information
- ▶ HR, insurance and benefits information

Structuring the Sale

Having a view on your preferred deal structure is important before starting the sale process. Informing buyers at an early stage will help ensure the offers you receive comply with your objectives.

If you plan to leave the business soon after the sale, you will most likely want your consideration paid at closing. If, on the other hand, you believe there are significant opportunities for additional growth under the new owners and/or you wish to stay on with the business, you may want to consider owning some portion of the new company's debt or equity through a seller note and/or rollover equity. Buyers generally perceive seller rollover appetite as a vote of confidence in the future of the business, which can lead to a higher enterprise value.

If you have private use of assets owned by the company that aren't required for carrying on the business, these should be identified early so that they can be transferred out of the business and the buyer is informed of this intention. For example, if your vehicle is owned by the company, it could be distributed prior to sale.

It's fair to say that almost every aspect of a sale has tax implications associated with it. As a result, it's crucial that you receive detailed tax advice early and often throughout the sale process to help ensure tax efficiency, avoid last minute surprises and maximize your net proceeds.

Pre-sale tax and estate planning is important to enable any pre-sale reorganization or removal of assets to occur in a tax-efficient manner. Doing this in advance helps ensure you give enough notice to a buyer of your requirements.

Planning may also be available to use your company's tax attributes that would otherwise expire on closing. In addition, similar planning may be available to deem dispositions of your company's assets, generating tax attributes that can be used to reduce the capital gain triggered on dispositions by your company's shareholders. This planning may result in an increased tax basis in the company's assets acquired by the purchaser for which it may be willing to increase its purchase price.

Key Points



There are tax implications with any sale



You should conduct pre-sale tax planning before a sale

In general, you will need to consider your requirements in relation to the:

- ▶ Sale of stock vs. assets or hybrid structures (e.g. 338(h)(10) elections)
- ▶ Form of consideration preferred (e.g., cash, stock, promissory note, earnout)
- ▶ Timing of the consideration (e.g. paid at closing, deferred or contingent)
- ▶ Assets you wish to keep and need to transfer out of the business (e.g., property, vehicles or surplus cash)
- ▶ Tax treatment of the consideration offered

Preparing an Information Memorandum

With your input, your investment banking firm will prepare a confidential information memorandum (CIM) to introduce the business to potential buyers. As a selling document, the CIM should present your business in a positive light. However, at the same time, it must be both factually correct and complete in all respects. Be upfront and transparent with your advisors from day one about any potential customer losses, litigation or other sensitive issues to ensure there are no surprises for either your advisors or potential buyers. Any aspect of the offering that is perceived as misleading could subsequently undermine the buyer's trust and interest in the transaction.

The CIM will provide enough information to enable buyers to form a preliminary assessment of your business and ascribe a point estimate or range of value. This could be reflected in an initial indication of interest (IOI) submitted by the first-round bid deadline established by you and your banker.

Consult your banker with respect to when and how best to disclose competitively sensitive information such as specific customer names, pricing details or unregistered intellectual property that may be better suited to later stages of the sale process and a more limited number of qualified parties.

Work with your banker to identify the key selling points of the business and substantiate these points with hard metrics and quantifiable results wherever possible. Ask your advisors to benchmark your company's performance against comparable businesses to demonstrate superlative aspects of the company's business model, customer relationships and overall value proposition.

Key Points



Offering materials should present the business favorably without compromising accuracy



Buyers should be able to easily assess the business

The information memorandum needs to clearly articulate the following:

- ▶ Key investment considerations
- ▶ Business model
- ▶ Management team
- ▶ Addressable market opportunity
- ▶ Growth strategy
- ▶ Financial performance

Should You Approach One Buyer or Several?

A controlled sale process will usually involve some form of confidential auction to a carefully selected, tightly controlled group of buyers. Hiring a recognized advisor signals to the marketplace that you're taking the sale process seriously and committed to closing a transaction.

While involving multiple parties in the process can certainly be more complicated than dealing with a single prospective buyer, a competitive process has many advantages over a one-on-one negotiation. Even the threat of competition and marketing the business more broadly can be a strong incentive for buyers to move up in price and help sellers avoid transacting well below a market-clearing price.

Today's buyers are sophisticated at capturing sellers' attention early on with a compelling price and promises of a swift and simple transaction. The reality of these non-competitive situations rarely lives up to expectations. The further down the path one proceeds with a buyer on a one-off basis, the more difficult it can seem to break away from that transaction given the considerable time and effort that has gone into the process with that party. Savvy buyers know how to leverage this dynamic to their advantage with last minute "re-trades" and changes to the original terms of a deal.

A qualified investment banking firm can help owners avoid these situations by designing and executing a sale process that maximizes competition, optionality and negotiating leverage. Despite buyers' promises of a quick closing when there are no other parties at the table, it is typically the controlled and competitive sale process that gets sellers to the goal line with higher speed and certainty of closing and fewer missteps along the way.

Key Points



Having multiple bidders at the table can lead to a higher sale price and higher certainty of close



Ask your banker to design a process tailored to your objectives

Indicative Offers, Narrowing the Field

To maintain momentum and an orderly sale process, the process letter distributed by your banker alongside the CIM should specify a firm deadline for submission of initial IOIs. These first-round offers are primarily based on the CIM and Q&A with your banker. Some parties may receive early access to management depending on the process designed by you and your banker.

Potential buyers increasingly expect to receive a sell-side QoE report or other vendor diligence reports early in the process, which helps buyers refine their preliminary bids and generally shortens the overall time to close. Discuss with your banker whether financial models, market studies, audited financial reports or other supplementary information should be provided at this stage of the process.

Once indicative offers are received, work with your advisors to narrow the field of potential buyers, typically to 10 or fewer parties, who will be invited into the next round to meet management and receive further diligence information in order to submit a more comprehensive letter of intent (LOI) in the next round of bidding.

It is important to understand that these first-round bids are non-binding, preliminary indications of interest, based on limited due diligence information. They are subject to change, and often do change (either up or down in terms of purchase price) between the first and subsequent rounds of bidding. Many owners develop biases towards high first-round bidders. Your banker can provide perspective and context as to how they expect each bid to trend and how to handle each party.

Key Points



Set a firm bid deadline for receiving indicative offers



Work with your investment banker to evaluate offers and narrow the field



Handling Meetings, Site Visits and Due Diligence Requests

Management presentations are typically the first direct form of interaction between potential buyers and target company management. Work with your investment banker to set clear meeting agendas and ground rules, and perform a “dry run” or several before your first meeting. Buyers’ interest and enthusiasm towards a transaction is highly dependent on their confidence in the management team and its strengths, weaknesses and capability of delivering on the company’s growth plans.

These meetings are also a great opportunity for management to learn more about the buyer’s organization, history of acquisitions, approach towards post-closing matters and integration and overall plans for the business. While sometimes stressful, owners usually find these meetings enjoyable as they are essentially a discussion about their business, something they know and care a great deal about, and owners get to view the business through the eyes of sophisticated investors and sometimes their competitors, often for the first time.

Keep in mind that the purpose of these meetings is to learn about each other’s businesses and for the buyer to assess strategic alignment and the strength of the target company management team. This is rarely the time or place for live negotiations or to discuss specific terms or economics of the transaction. Consult your banker to understand what is and is not appropriate for these meetings. The more you prepare, the more enjoyable and effective they’ll be.

A properly executed management meeting can significantly enhance buyers’ interest level in the transaction and willingness to not only potentially move up in value but to allocate more resources sooner in the process in order to differentiate themselves and offer higher speed and certainty of closing at the letter of intent stage.

Discuss with your investment banker the merits of offering facility tours, product demos or other ancillary meeting content. Following management meetings, your banker will gather feedback from each buyer group, explain next steps in the process and typically open a virtual data room containing detailed due diligence information upon which the buyer can formulate its second-round bid.

Your banker may advise further narrowing of the field and interim rounds of bidding or other process modifications. Additionally, your banker and deal attorney may advise posting a draft stock purchase agreement (SPA) to the data room in order for buyers to provide a comment memo of full markup as part of their LOI bid packages, which can be highly advantageous. biases towards high first-round bidders. Your banker can provide perspective and context as to how they expect each bid to trend and how to handle each party.

Key Points



Management presentations are a critical opportunity to build on initial interest



Careful preparation with your banker is critical and pays dividends

Final Offers and Closing the Transaction

If everything goes to plan, you're now receiving LOIs from multiple parties. This is often the time to pick one party to proceed with towards a closing and often on an exclusive basis, although there are exceptions to this approach, which you and your banker can discuss. This is where your banker's negotiating expertise comes into play, and they will work with you to formulate counter proposals and a bidding strategy that optimizes for your desired outcome.

Your banker should have distributed a process letter that tells buyers what they should include and address in their LOI so that you can evaluate proposals on an apples-to-apples basis. It is common for LOIs to include ancillary documents, such as comment memos or SPA markups, debt financing commitment letters, due diligence timelines to closing, references or other information requested in your process letter. Work with your banker to determine appropriate "asks" given the circumstances and deal dynamics in order to set clear and realistic expectations.

Selecting a final party with which to partner can be difficult given the number of factors to weigh across a variety of stakeholders involved. However, hopefully at this stage of the process you've had sufficient interaction with each prospective buyer to understand their plans for management, employees and operating the business post-closing. If you feel you have insufficient information, work with your banker to schedule subsequent buyer meetings in order to make an informed decision.

After signing a letter of intent, you and your advisors will typically be working around the clock to support confirmatory due diligence and provide your deal attorneys the information they need to finalize definitive agreements, such as the SPA, employment contracts and many ancillary agreements. This is where having a strong team of advisors can significantly improve speed to closing and prevent missteps that can jeopardize the deal from proceeding on the terms and timeline that were originally intended.

Key Points



Strive for comprehensive bid packages with few unknowns and a clear path to closing



Consider strategic fit, speed and certainty of closing alongside price and other terms



HOW BDO CAN HELP

The sale of your technology business is likely going to be one of the most significant financial transactions of your life. You deserve a team of experienced professionals, including your investment banking firm, deal attorney and CPA firm, all of whom should specialize in M&A transactions and have a proven track record of delivering premium outcomes for companies like yours.

At BDO, we understand business owners' objectives and specialize in developing and executing a transaction process that optimizes for our clients' objectives as shareholders, employers and individuals. We've helped thousands of business owners navigate the successful sale of their companies and are committed to supporting you every step of the way.

Our team of investment bankers, TAS, tax and accounting professionals can help you with virtually every aspect of preparing for and executing a successful sale process, from transaction process design to developing the right presentation materials, identifying and contacting potential investors, negotiating letters of intent, evaluating the tax implications of various transaction structures, providing fairness opinions and valuations, offering wealth advisory, assisting with tax planning, and ensuring you close the transaction in a seamless, efficient manner that minimizes disruption to you and your employees.

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