INSIGHTS FROM THE BDO PRIVATE EQUITY PRACTICE

PRIVATE EQUITY'S GUIDE FOR SOFTWARE COMPANIES EVALUATING WHETHER TO PARTNER WITH PE

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Private equity (PE) firms often approach software company founders and CEOs to explore sales of, or investments in, their companies. Could this be the optimal time for such a transaction? How can PE firms help guide and inform their decisions? The answer to these questions is, in part, what this guide aims to provide.

PREPARING FOR A DEAL

1. What are you looking for?

To decide whether a software company should pursue a PE deal, they should first look inward. Understanding their current situation, strengths, weaknesses, opportunities, and near-, medium- and long-term goals can help the software company identify if, when and how much external capital they may need. Remember that private equity is not the only type of capital they can raise. Other options, such as loans and venture capital, also have their advantages and disadvantages. When considering potential PE deals, they should consult their 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 that almost half of all investments in technology companies come from PE firms—and why those technology companies, including many in the software space, say yes to these investments. PE firms can help a tech company access new markets, assist with the organizational and financial sides of a business, provide objective data-driven insights, create efficiencies and increase profitability. However, optimizing collaboration with a PE firm depends on both parties aligning their interests ahead of signing a deal.

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 aim; all have different strengths. Understanding the focus and nature of specific PE firms will help them identify which ones will be the best to work with. Consultants can help software companies speed up this process, thanks to their vast business networks and PE contacts.

4. Know your worth

Before starting negotiations, software companies need to evaluate their worth. This valuation is necessary for establishing realistic negotiation targets. Many factors can affect their valuation positively and negatively, including their 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 their current and past performance, but also on an analysis of what their 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: to deliver a substantial return in three to five years. During negotiations, PE firms will primarily be focused on software companies' products, services, technology, intellectual property, R&D, management team and future potential. Prior to negotiations, they 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 for software companies to discern their position and identify the tactics that will be most effective. BDO's ***Tenth Annual Private Equity PErspective Survey*** provides good insight into PE firms' current situation, which can help software companies during negotiations. According to the survey's findings, PE companies are currently experiencing healthy competition. With access to a lot of capital, many are looking to make new investments and keep their investments longer.

Read more

7. Know PE firms' concerns

Software companies are attractive targets for PE firms. In fact, PE firms expect the technology sector to see the greatest rise in deal activity this year, according to survey respondents. However, when acquiring target companies, PE firms may continue to find it challenging to identify growth opportunities and retain management teams.

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. Software companies may also face very detailed inquiries regarding value created through non-financial activities such as sustainability programs. Documenting their strengths in the areas PE investors will likely focus on during a deal negotiation is a process they should start very early on.

COLLABORATING POST-DEAL

9. Plan for the post-acquisition

It is crucial for a software company to outline how it envisions its collaboration with a PE firm will be post-deal ahead of sitting down at the negotiation table. Creating effective collaboration starts with both parties explicitly stating what they 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 both parties 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 a 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 a software company and its PE firm will vary, communication should be proactive instead of reactive and follow established guidelines.

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