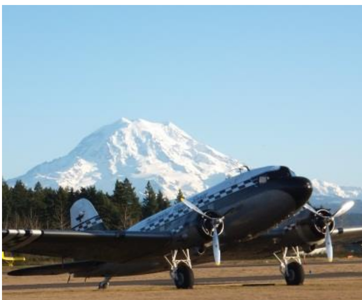
TECHNOLOGY ACQUISITION UPDATE

The Right time to Sell



Selling a company at the right time can make a big difference in the price that the shareholders receive. The reason for selling can also affect the timing. Companies sell for a variety of reasons—some are personal and some are business reasons.

On the positive side, a good reason to sell is because the company is experiencing solid growth and potential acquirers clearly need the company's technology. On the other hand, if a company is still early in its market development and buyers are not yet ready to move, it may be wise to sell later rather than sooner. One of the primary reasons that a technology company sells is because it has reached an inflection point in the marketplace. The company may not be able to grow fast enough with its current resources; it simply can't get enough traction. The business may be getting low on cash and cannot raise more capital for growth. The shareholders may not wish to contribute additional capital.

A company may require greater sales and marketing capabilities to effectively address its market. A long sales cycle can impair the company's ability to hang in there until sales come in. In some markets the sales cycle can last nine months or longer. Many firms cannot survive such a long sales cycle.

Personal reasons can also motivate a desire for liquidity. Personal reasons include the founders wanting to move on and try something new, or perhaps retire. Health problems or disputes among the founders or shareholders may also impact the decision to sell.

Strategic or Financial

Financial transactions are different from strategic transactions. If a transaction will be valued on the seller's financial metrics, such as EBITDA (earnings before interest, taxes, depreciation and amortization), then a company should sell when EBITDA is high and the projections are rosy. These projections must be realistic and defensible, not pie-in-the-sky. If the market has matured and growth is tapering off, you will not get as high a price as you would have when the market was growing more rapidly. Buyers will know that the market growth has slowed down.
A strategic transaction is one in which the value is based on the

strategic fit with a particular buyer. This strategic value is different from one buyer to the next. When is strategic value the highest? It depends on who the value is strategic to. Strategic value is extrinsic, not intrinsic. Strategic value does not exist by itself or within the selling company itself. Strategic value exists only in the minds of the buyers and it is different for each buyer.

A Few Myths

A few myths persist regarding the best time to sell. One is that a company should sell when it is at the top of its game. Another myth is that the company should sell when revenues have peaked. Contrary to what many think, the best time to sell may not be when the company is at the top of its game. Rather, it is when the market realizes that it needs your technology, IP or other key assets. This is when a buyer will pay the maximum price for your company. Market timing is the primary driver for receiving the optimum price when selling a company.

The market may be on a different time schedule than your company's growth curve. If a firm waits to sell until its profits or revenues have peaked, there may be little growth left in the company. Buyers will eventually figure this out and will not pay top dollar. Paying attention to the reality of the market is not only a good business skill; it has more influence on price than any other factor.

What about Selling When Revenues Peak?

There are several problems with planning to sell when revenues peak. One is human nature. No one knows when the peak is. Or, the peak keeps changing. Having worked with entrepreneurs for many years, I have observed no lack of optimism in the minds of entrepreneurs. They believe that revenues will always improve. As a result, companies delay the sale, which can be detrimental to getting the best price.

Revenue multiples are bogus most of the time in strategic transactions. It is profit that counts in business, not revenues. In strategic deals it is the technology, intellectual property or other key assets that count. People love to talk about multiples of revenues. It makes them sound smart. Even investment bankers perpetuate this myth. (Investment bankers like to sound smart too.)

People do not enjoy the uncertainty of not knowing what something is worth; they crave numbers for value. Sure, you can calculate the multiple in your head. But in a strategic transaction it is the strategic assets that matter. Yes, higher revenues are better. They prove that the market exists and that customers are willing to part with their cash to purchase your products. Revenues give credibility. But your technology is the same whether your revenues are $4 million or $8 million.

Talking Versus Thinking

Buyers may talk in terms of revenue multiples, but buyers do not think in

such terms. Buyers think in terms of how much value they can create with an acquisition. What additional operating profits can they produce if they make this acquisition? How will the acquisition speed up entry into an adjacent market?

Sometimes revenue multiples are interjected as a negotiating ploy. A buyer may cite the revenue multiple to make his offer appear attractive. Don't be fooled by a buyer who quotes multiples of revenue. Valid comparisons cannot be made from one transaction to another using revenue multiples.

A buyer is not going to have an internal meeting with its acquisition team, discuss the merits of your acquisition and then decide what to pay by asking—what is the current multiple of revenues for this industry sector? And then use that number as the price they're willing to pay. No way. A buyer will figure out what it is worth to them. They will calculate the cost to develop the technology themselves and add a time premium. They may generate three scenarios—best case, worst case and most likely. They will project the additional operating profit that your company can generate and work backwards (usually by discounting) to a range of values that make sense for them.

A recent example is Intel's acquisition of CognoVision for $17 million in 2010. CognoVision had revenues of about $1 million. Was 17 times revenues the appropriate revenue multiple? Were similar transactions completed at 17 times revenue? Did Intel ask its investment bankers what the appropriate revenue multiple was? Of course not; Intel determined the price by figuring out how much value CognoVision would contribute to Intel’s operations. Multiples of revenues had nothing to do with it.

Deciding When to Sell

So, back to the question—when to sell? The answer is external to your company. It is all about the market and the needs of the buyers. You want to sell when you can get the best price. You get the best price when buyers desire your company the most. When will buyers desire your company the most? It is when a buyer can take your products and services to the market in a big way.

Large firms need to acquire technology, market knowledge and expertise. For a speedy market entry, these firms often prefer to acquire rather than develop their own technology. They also want to acquire companies that have a team of people in place; a team that understands the market and the customers' concerns. The best time to sell is when the larger companies decide to enter your market sector.

How can a company know when this situation exists? How can a seller know the mindset of the buyers? The buyers may be in the market already or they may be in an adjacent market with plans to move into your sector. Try to develop a deeper awareness of your market, of the players in your market, and pay very close attention to the big companies. Ask yourself some key questions:

- Is a bigger firm expanding into your market sector?
- Do you see a gap in their product line?
- Are they missing a complementary service that your company provides?
- What if they developed a product or service similar to yours?
- Has one of your competitors been acquired recently?

The acquisition of a competitor may indicate the first move by a large company into your market sector. If a big company with sales and marketing muscle acquires your competitor, it will likely be a potent force in the market, even if your technology is superior. If two competitors are acquired, that is a signal to seriously consider selling.

Selling too late can have a negative impact on value. If the best buyers have already acquired targets or developed their own technology, there is less of an incentive to acquire your firm. Pay close attention to the nuances of the market. When selling a company, the market situation is the primary driver for obtaining the best price.

For a more in-depth discussion about optimal market timing, please see my book, *Selling the Intangible Company—How to Negotiate and Capture the Value of a Growth Firm* (Wiley & Sons, 2008).

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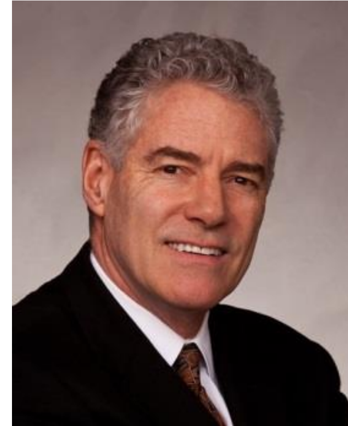

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