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A practical guide to selling your technology business

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Preparing your technology business for a transaction

The technology industry is one of the most dynamic and fastest evolving industries on the planet. It often redefines itself every five years or so. What was topical a short while ago is now legacy. The AI revolution will only serve to accelerate change - but it also will deliver immense opportunities. Irrespective of your exit time-frame, a deep understanding of prevailing market dynamics and value creation prospects remain crucial. They cast a spotlight on a variety of critical factors which demand consideration when positioning your business for sale.

Introduction

Selling your business is often the realisation of many years of strategic planning, investment, hard work and sacrifice.

As a vendor, you get one opportunity to make an impression on potential investors or acquirers, hence early preparation and planning are critical.

The more successful exits have often had the end-game in mind as they start a business, capitalising on gaps in the market and understanding who may be the best acquirers for the business.

Many exit options are available to vendors, including:

- Trade sale to a strategic party or a competitor
- Listing on ASX
- A sale to private equity, often allowing the management team to become significant owners of the business to drive the next phase of growth
- Merging with a suitable partner which can drive geographic diversity or scale.

Each process is different and the best option for you will be driven by your ultimate transaction objectives.

The most important thing for owners who are thinking of selling their business is to start preparing. Planning ahead (at least two years in advance) will make the process more focused and purposeful - which should translate to a shorter process and a higher valued outcome.

The sale process can be complex, so it helps to have a well resourced, seasoned team of professionals to advise you along the way. This will minimise business disruption whilst allowing you to focus on running your business.

I trust you find this guide both thought provoking and useful and I wish you every success in growing your business and securing a successful exit. If you would like to discuss any topics raised in this guide, please contact us - our team's details are listed on the back page of this guide.

Best regards

Tony Schiavello
National Leader, M&A

Great advantage can be gained by business owners who have an early grasp of a number of key issues which are largely unique to the technology sector. Several are considered below.

01 Start with the end in mind

Understand and capitalise on gaps in the market and emerging technology trends to build value and competitive advantage. This will create significant interest in your business from larger, sophisticated acquirers with deep financial capacity to complete a transaction.

02 Focus on recurring revenues

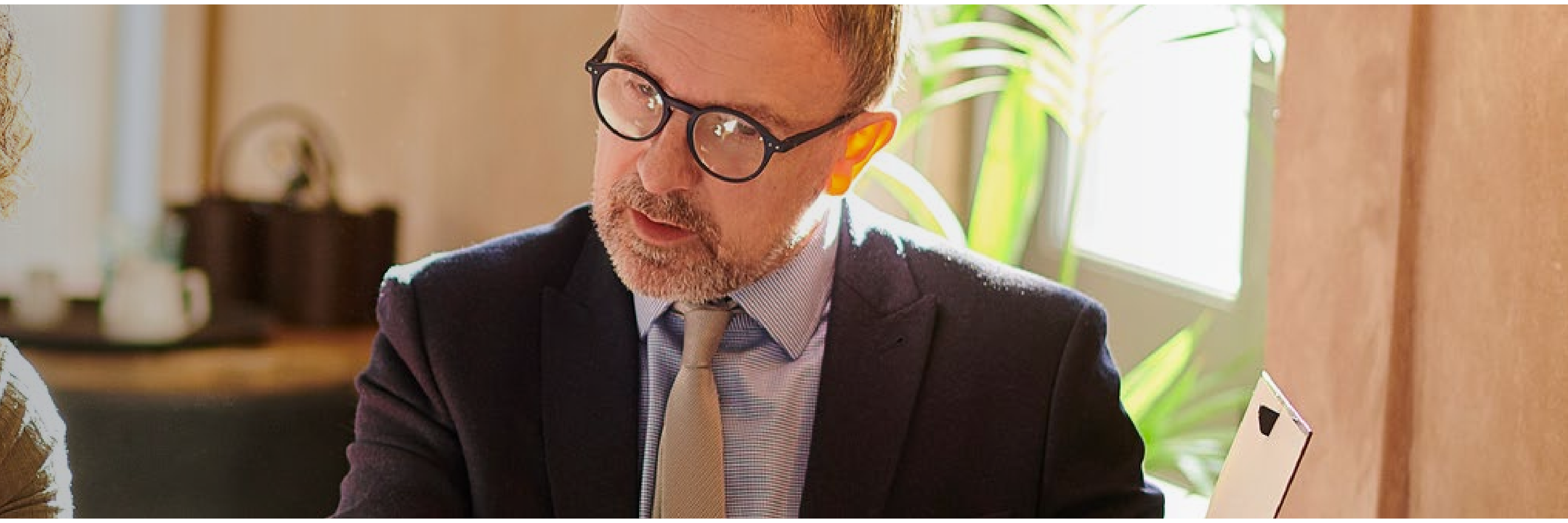
Recurring revenues attract premium multiples. While common in product businesses, even professional services businesses can enhance value by including managed services or other SaaS offerings post implementation of technology projects.

03 Deep ecosystem relationships

Build deep relationships with key ecosystem vendors (eg. Microsoft, Salesforce). This can lead to significant warm customer leads which in turn, shorten sales cycles and reduce cost of sales. Incentive income and global awards are also often available to leading partners.

04 Quality management team

Build a stable and incentivised management team, with a level of autonomy from the company's shareholders. This allows you to more effectively work on (and not in) the business and accelerate your exit post transaction.



05 Be famous for something

Avoid the temptation of growing revenues quickly by being all things to all people. A generalist with limited differentiation can become a commodity. Consider narrowing your focus and building a reputation for being famous at it. This will build your brand and credibility in the market.

06 Depth vs breadth

Less customers with significant spend or many customers with minimal spend? While managing customer dependency is critical, maximising the number of clients who annually spend >$1 million can improve operational leverage and attract premium values from large multi-national acquirers.

07 Strong financial hygiene

Monthly management accounts with clear measurement of KPIs against budget is key to timely decision making. Audited accounts also provide added confidence to a buyer who can rely on the information they are receiving. This often leads to a higher price and faster, more certain transaction process.

08 Scalable systems and processes

Scalable internal systems and process provide a strong foundation for profitable growth of a company, while managing operational, financial, commercial and legal risks.

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 maximising the sale price and finding the right new home for the employees and customers. Achieving a seller's objectives requires a significant amount of research and leveraging of information, rigorous planning, and maintaining a high degree of control over the process as well as strategic negotiation skills.

The structured sale process is time consuming.

Having advisers 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 sale transaction are met.

The structured sale process

The structured sale process involves the following:

- Preparing the business for sale
- Understanding the likely value and preferred deal structure
- Tax planning
- Undertaking vendor due diligence to mitigate any historic or tax issues
- Compiling information and preparing an information memorandum
- Identifying and contacting potential buyers
- Receiving initial offers
- Holding further meetings with shortlisted buyers and receiving revised offers
- Undertaking further negotiations
- Signing a letter of intent
- Facilitating the due diligence process
- Facilitating legal documentation and finalising the sale
- Post-closing support as it relates 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 manage the process?

The sale of a company creates a great demand for information. An adviser can help coordinate and prepare the information required as part of the sale process – building confidence with prospective buyers.

If you do ultimately decide to sell your business, it can take six to 12 months or more to complete a transaction. During this period, the company must continue to run effectively despite the diversion of your time. Your management team must therefore be strong enough 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 prepare for tax planning and clean up the company's balance sheet. Most buyers usually look at the last three years of the company's operations so the better shape the company is in, the more likely you can get a better price.

As such, it's usually a good idea to start preparing the information that potential purchasers are likely to require well in advance of any sale process. Also, ensuring the information that purchasers will want to review is comprehensive and well organised is essential to the smooth completion of any transaction.

Examples of the types of information you may need – supported by an adviser – to put together for the benefit of potential buyers include:

- Corporate/legal information
- Company information
- Management/organisational structure
- Details of products and technology
- Systems and financial reporting
- Tax information
- Historical and forecast financial information
- Insurance details.

Much of the information noted above is typically contained in key transaction documents to a buyer, including information memorandums, process letters, a draft sales and purchase agreement, due diligence reports, etc. A good adviser provides the appropriate level of disclosure and confidentiality. An adviser helps to ensure management focus on running the business.

Structuring the sale

Having a view on your preferred 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 on completion.

If, on the other hand, you believe there are significant opportunities for additional growth under the new owners and you wish to stay on with the business, you may want to consider an element of deferred consideration linked to future performance, usually called earn-outs. These are less risky for buyers and can increase the final value you receive for the business. However, they could be risky for you and are fraught with complications.

If you have private use of assets owned by the company that are not 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 property is owned by the company which is not part of the sale, 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 at the earliest possible stage of the sale process to help ensure any tax paid on the sale is minimised.

Pre-sale tax planning is important to enable any reorganisation 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.

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

- Sale of shares or sale of assets
- Form of the consideration offered (e.g. cash or shares)
- Timing of the consideration offered (on completion of the sale, deferred, or contingent consideration)
- Assets you wish to keep and need to transfer out of the business (e.g. property, vehicles, or surplus cash)
- Tax structuring of the consideration offered.

Preparing an information memorandum

The information memorandum is a key document that explains the business to qualified, interested parties. As a selling document, the information memorandum should present your business in a positive light. However, at the same time, it must be both factually accurate and complete.

You need to provide enough information to enable buyers to make a reasonable assessment of your business. However, sensitive information such as customer names, pricing, and details of unregistered intellectual property should be withheld until the later stages of the sale process. This avoids the potential damage to the goodwill of the business, which the distribution of this information may cause.

The document should be positive, emphasising the particular benefits that ownership could bring to a buyer. The profile must always be truthful, accurate, and complete. Any elements that are misleading could subsequently undermine the buyer's trust in you, their interest in the transaction, and the sale price.

The information memorandum needs to clearly articulate the following:

- Investment highlights
- Business model
- Management team
- Growth strategy
- Financial performance
- Transaction process.

Should you approach one buyer or several?

A structured sale process will often involve some form of confidential auction to a carefully selected, tightly controlled group of buyers. Having an adviser shows you're taking the sale process seriously and that other buyers may be interested, which you can use to your advantage to get a better price. While this is a more complicated process than dealing with a single purchaser, a competitive process has many advantages over a one-on-one negotiation. For instance, if you don't explore the market, you will never know whether you could have achieved a better deal and price.

Buyers also often try to use the results of their due diligence on the company to reduce the agreed price. Your preferred bidder is much less likely to do this if they know you're in a position to sell your business to someone else if they don't deliver on the agreed terms. A competitive sale process is likely to be the best way to realise the value of the existing business, but needs to balance the consideration of maintaining confidentiality. For those businesses/assets that have a unique element to them, however, it's often better to focus on finding the right buyer rather than trying to facilitate a competitive sale process. In many cases, finding the right buyer can help to unlock the true value of an asset in a relatively quick and less complicated way.

Trade buyer vs private equity?

In a sale process, sellers typically consider two types of buyers: trade buyers and private equity. Each have their unique motivations, strategies and funding sources. The choice between the two often depends on the seller's goals (e.g. 100 per cent cash upfront vs majority upfront sell-down and fully exit at a future point) and dynamics of the business being sold (private equity are often interested in businesses which have strong growth prospects compared to a steady state). We details some key points to keep in mind when selecting a preferred buyer.

Trade players

Trade or 'strategic' buyers seek 100 per cent ownership and often offer incentives to retain management, aiming for seamless integration of the acquired business into their own operations. Trade buyers are often able to pay a higher upfront premium to acquire a business (compared to a financial buyer) as they can extract synergies for duplicated services such as back-office functions, board or and other duplicated management functions. Their due diligence requirements are often more focused and streamlined as they have a strong understanding of the industry.

Private equity

Private equity (or other financial sponsors) typically acquire a majority stake, with key management retaining (or acquiring) a significant minority shareholding. In Australia, many private equity parties have exhibited a successful track record in acquiring businesses and playing a key role in driving further growth through bolt-on acquisitions and introduction of industry experts onto the investee board. This can lead to increased value and potentially greater returns for founders over the medium-term, where they retain a minority equity stake value over time. This can result in greater returns for founders if they wish to retain a minority equity stake.

Handling meetings, offers, and negotiations

Having reviewed the information memorandum, buyers are asked to submit an initial offer. The information memorandum aims to provide sufficient information for buyers to submit an offer, however, while it's not typical, some buyers may ask for a first-round meeting with management. Based on strategic alignment, you and your adviser may select to move forward with that meeting.

This is an opportunity for you and an adviser to establish a relationship with the potential buyers and learn more about them and their level of interest. The purpose of this meeting is rarely to start negotiations but to allow you to describe the business in greater detail and highlight the key issues.

An adviser can convene and chair these early meetings and explain to the purchaser the rules of the sale process and timetable. This may include structuring the transaction and the form of consideration to meet your tax-planning requirements.

All businesses have their more difficult issues to be considered. It's usually better to present these earlier while several buyers are interested and in competition to purchase your company, rather than later when you're in discussion with one potential buyer.

Indicative offers, first-round negotiations, and meetings

To maintain momentum and an orderly sale process, a deadline should be set for the receipt of indicative offers from all potential buyers. The indicative offers are based on the information memorandum.

However, in some cases, control over the sale process and value is enhanced by also providing potential buyers with a due diligence report (known as vendor due diligence) prepared by an accounting firm and a draft sale and purchase agreement before indicative offers are submitted.

This has three key advantages:

- Once exclusivity is granted, the vendor inevitably loses a substantial degree of negotiating leverage. Vendor due diligence can reduce the period of exclusivity with the final preferred buyer and therefore enhance your control
- Due diligence always comes up with some negative issues – early disclosure while there's competition between buyers will help negate their impact and reduces the scope for the buyer to attempt to renegotiate the deal
- Key issues such as warranty limitations, the scope of warranties, indemnities, and retentions are established early and these are more likely to be accepted while there's still competition.

Having received indicative offers, the field of potential buyers can be narrowed down to the top two or three. Without revealing their identity to other buyers, this is a good opportunity for an adviser to give the leading buyers a clear view as to what they have to deliver in order to purchase the company.

If necessary, a meeting can be held. Certain updated or additional information, necessary for a full and more informed offer for the company, may be required before revised offers are submitted.

Basis of final offers - the devil is in the detail!

Clearly define the basis of the offer

When calling for final offers, it is imperative to clearly define the basis on which you are asking acquirers to bid. The basis is often as important as the nominal dollar amount offered as they are interdependent and directly impact net sale proceeds available to the seller(s). There are a number of conventions typically used, but by far the most common is, '**on a cash-free, debt-free**' basis.

Cash free, debt free basis (CFDF)

In almost all transactions we advise on, we will call for offers on a CFDF basis. That means the acquirer offers to buy the shares (or assets) in the company for an enterprise value (**EV**). At completion of the transaction, the vendor must first apply sale proceeds to repay all outstanding debt. In doing so, the seller can use the cash on the balance sheet to repay outstanding debt as the seller retains the benefit of the cash at completion. The example below provides further insight:

Example: Party A offers to purchase 100 per cent of the shares in ABC for $20 million, on a CFDF basis, with a normalised level of working capital. ABC has $2 million cash and $4 million debt.

At completion, Party A has an obligation to pay $20 million to the vendor. The vendor must, immediately prior to the transfer of shares, repay the $4 million in debt. It does so by applying the $2 million of cash on the balance against the debt and repays the remaining $2 million in debt from completion proceeds. Hence, net proceeds in this example would be $18 million:

Net proceeds = $20M (EV) - $4M (debt) + $2M cash = $18M.

Normalised level of working capital

An acquirer will often include as a condition of their offer, that a normal level of working capital (**NWC**) is delivered at completion of a transaction. This protects the buyer from acquiring a company which has been stripped of working capital (**WC**) as would be the case where a seller, prior to completion, accelerated debtor collections (converting them into cash) and delayed payment of all creditors. This would artificially boost cash at completion, which remains for the benefit of the seller as discussed opposite. The following formula is often applied:

Net proceeds = EV - debt + cash + WC - NWC

Determining a 'normal' level of working capital can be complex as is dependent on a number of factors, including actual historical working capital trends, seasonality, the industry in which the business operates and forecast growth. Hence, it is advisable to seek professional advice on these matters.

Equity value basis

Another offer basis often used is an '**equity value**' (or price per share) basis and is typically used when making an offer for a publicly listed company. Essentially, it means that the acquirer will buy the company at a specified price per share and pay each shareholder that amount for each share they own. The price is inclusive of cash, debt and working capital at completion.

Final offers and letters of intent

Providing all material information has been disclosed, robust final offers should then be submitted.

Having selected the preferred buyer, the letters of intent sets out the agreed deal and the period and terms of exclusivity given to the purchaser must be negotiated and signed. If final offers have been submitted in light of a draft sale and purchase agreement, then any major legal issues can be agreed upon at this stage.

A conventional sale process will involve selecting the preferred buyer and granting a period of exclusivity in which it can conduct any remaining due diligence and agree to the sale and purchase agreement with you.

How BDO can help

The sale of your business is likely going to be one of the biggest financial transactions of your life. You want a team of experienced transaction professionals including financial and tax professionals who understand the processes and complexities of mergers and acquisitions (M&A).

First and foremost, we understand business owners' objectives and have designed a transaction process that best positions them as shareholders for success. We've helped thousands of business owners sell their companies every step of the way.

Our team of M&A advisers and tax professionals can help you with the sale of your business by developing the right presentation materials, negotiating legal agreements, providing valuations, determining the optimal purchaser population, finding potential buyers, offering wealth advisory, and assisting with tax planning. Contact us to find out how we can help.

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