T.V. METZ & CO., LLC
Boutique Investment Banking

www.tvmetz.com
September 2008

TECHNOLOGY ACQUISITION UPDATE

Responding to an Unsolicited Offer

This article is intended to help CEOs, entrepreneurs and boards of directors make the best decision when an offer comes in out of the blue. The company should review its growth plan, examine the market, and make a judgment about the buyer. Then it can decide how to best respond and it may reach out to additional buyers.

An offer to acquire the company may come in out of the blue. This is not an uncommon occurrence in the service and technology industries. The offer may be a specific dollar amount or it may be an exploratory call from the CEO of the buyer asking if they would be open to discussing a sale of the company. When a strategic buyer knocks on your door it is smart to take them seriously.

An intelligent strategic buyer will keep an eye on all the companies in its market space, particularly those that could be strategic acquisitions. An intangible company could fill a gap in a strategic buyer's product line or it might have technology that could be an excellent fit with the buyer.

"Intangible company" is a term I coined to describe a company whose value is based on its strategic assets rather than on its earnings. An intangible company has special sauce of some kind—technology, software, patents, intellectual property, know-how, development team, etc. For an intangible company, the value of the strategic assets is greater than the financial value based on the firm's profits.

Unsolicited offers come in several varieties, typically three. The first is an offer that is extremely good. The target has an instinctive sense that this is clearly an excellent price and the best buyer. The target company is quite sure that they should accept the offer. The second situation is one in which the offer appears to be pretty good and the target thinks they should seriously consider it; but, perhaps they should seek other offers as well. The third situation is one in which the seller is pleased but suspects that the offer is lower than what another buyer might offer. Now the seller is curious about what other companies might be willing to pay and they begin to consider the idea of a sale more seriously.

Everyone is flattered, of course, when a buyer is interested in your company. But how do you handle the situation? How should a company respond to an offer out of the blue? Should you scramble to get competitive offers? Is there time to bring in another offer? How should you reach out to other buyers? These are questions that a company should be prepared to answer.

One of the mistakes that I see, and it occurs fairly often, is that a company's management will convince themselves that this buyer will pay the most money even though they have no real basis for that opinion. It saves them the time and hassle of having to go down the road with other buyers. Sometimes the unsolicited offer is the best offer, but sometimes the only way to know is to reach out to other potential buyers.

The first response is simply to accept the offer. A company may accept the first offer because they do not know what else to do. They think bringing in additional offers is a difficult process, or will take too long, or will displease the buyer, or it will upset the company's business.

There are three steps that a company should take in responding to an unsolicited offer:

1. Look internally
2. Examine the market
3. Assess the buyer

Look Internally

The first step is to assemble the management team and review your growth plan. Where is your company in its development plan or life cycle? Has the technology been perfected? Is significantly more work required to build out the core technology and products? Could being part of a larger firm with distribution power be a good way to enhance your marketing and sales capabilities? Sometimes a company will know the answer to these questions immediately. If it is still early in the process of developing its technology, then most likely a sale of the company is not the right move.
On the other hand, if the technology and products are sufficiently developed and the company's primary emphasis is on building market share, this could be a good time to sell. Rather than spending a massive amount of time and effort building out your own sales force, it may be smart to team up with a larger company that already has an established sales force and distribution channels.

Remember the three stages of growth for the intangible company—technology development, early market traction, and broad market rollout. If the company's software or technology has been substantially developed and the company has had good initial market traction then the company is ready for the broad market rollout. It is at this point that the company shifts from being technology driven to being sales driven. Building the sales force now becomes the primary focus of the company. At some point, all companies will become sales and marketing driven companies. IBM is an excellent example of a company that started off in the technology business and as it matured it became a sales and marketing powerhouse.

Examine the Market

The second step is to examine the market. Sketch out a market map of your market space and the adjacent markets. Is the buyer one of three or four competitors in the market space? Is it the only company in its market space? Are there adjacent markets with additional buyers that could benefit from the acquisition of your company in order to enter your market?

Now go back and look at your marketing and sales plan. Are you ready to attack the market? Or have you already been out in the markets slugging it out with your competitors? Are you winning the competitive battles, the product comparisons, the bake-offs? If you are winning these contests perhaps you should continue down this road and capitalize on your success as an independent company. If a company is struggling with these market battles it may be wise to seriously consider teaming up with a larger player that has stronger sales capabilities.

Okay, now you have reviewed your company, you have looked at the market, and let us assume your sales are growing adequately—not too bad but not great either. It is probably worthwhile to begin a dialog with the buyer that approached you and see where the conversation goes. One of the dangers is that this process can be a major distraction to management. Not only is it time consuming, it is also emotional. Selling the company could mean wealth now, or wealth later, and certainly a big reduction in risk. At this point it is usually wise to bring in an outside adviser or an investment banker. An adviser can outline your alternatives and help you weigh them appropriately. An adviser can also give you an independent market perspective and help delineate your courses of action.

Assess the Buyer

Is the buyer perfect, reasonably good, mediocre, not particularly good, or poor? Judge the buyer by the quality of the fit, how badly the buyer seems to want the acquisition, and the company's ability to pay an attractive price. The next step is to make a short list of likely buyers and contact those buyers. It is best if a third party makes these contacts. The process comes across as more professional and it is likely to get a better response.

Given any of the three initial states, my recommendation is almost always to generate an additional offer or two. The key question is how much time the seller can afford to take in generating other offers. Now decide which of the three response alternatives makes the most sense for your situation. These response alternatives include:

- The Rapid Response
- The Measured Response
- The Extended Response

The Rapid Response

The rapid response involves immediately contacting a handful of likely candidates. The number may range from three to six and certainly less than 10 companies. This process can be handled fairly quickly. The point is to get competitive bids as soon as possible so as not to hurt the relationship with the first bidder.

At this point the company needs to move rather quickly. The rapid response involves reaching out to a handful of companies quickly in order to ensure that you are getting the best price and terms. With a high-quality buyer in hand, you do not want to dally very long in responding to them.

Some buyers will not be able to respond quickly for a variety of reasons, but you do not have the luxury of waiting two months for a potential buyer to give you its full attention. So you must let that one go and concentrate on the others.

The Measured Response

The measured response reaches out to more potential buyers. In this situation the best advice is to begin discussions with the first buyer and then reach out to a handful of other potential buyers. Seek out 10 to 20 companies, some of whom are in adjacent markets. In other words, they are not just the likely candidates. If one buyer is highly interested, it is likely that another buyer will be interested too. You never know what another company might offer. The value of competitive bids can be significant.

Quickly draft a memorandum that describes the company. It does not need to be lengthy but it should accurately portray the firm and its strengths. This document is an excellent tool for putting the company's best foot forward. The measured response typically lasts between four and six weeks.

The Extended Response

An extensive search to identify more potential buyers is the third response. In this case we might contact 25 to 75 companies. The time line for this approach is longer but it leaves no doubt that the best buyers have been contacted. This response takes on many of the aspects of the normal proactive search to identify buyers. The time line for the extended response typically ranges from six to ten weeks.

Summary

If an offer comes in out of the blue, a company needs to review its growth plan, examine the market, and make a judgment about that particular buyer. Then it can decide how to best respond to the opportunity. The company may reach out to a few buyers or to many buyers depending on the situation.

This article is excerpted from my book, *Selling the Intangible Company—How to Negotiate and Capture the Value of a Growth Firm* (John Wiley & Sons, 2008.)
www.intangiblecompany.com