

Valuation Is Only The Beginning



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MobileSolve Group is a boutique investment bank providing M&A, Capital Raising and Financial Advisory services to technology growth companies.*

This newsletter presents short articles on industry or transaction topics of current interest.

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Valuation Is Only The Beginning

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It's natural for entrepreneurs seeking a well-deserved successful exit to focus on valuation. It is an easy way to measure the success of a sale, everyone talks about valuation, and it makes a good headline in a press release.

Most people do not realize, however, with something as complex as selling securities or a company, the devil is in the details. If they do, they are not sure which details really matter. The following reviews important terms other than valuation that have a material impact on the quality of the deal made by a seller.

Form of Consideration

If all or a significant portion of the consideration paid for the Company is anything other than cash, usually stock, but also possibly IP or other assets, the transaction becomes more complicated. The stock or assets have to be valued by the seller's advisor.

If stock, a floor below or collar around the value should be negotiated where a certain number of shares is agreed. In addition, because the seller is in effect "buying into" the acquirer, the stock's current value and prospects for future gains should be determined. This can be difficult enough where the stock is of a sizable public company with extensive disclosure documents and is followed by analysts, but can be problematic if the stock is of a private company.

If indeed the buyer is a private company, other factors that must be taken into account are the stock's liquidity, agreeing to a pathway to liquidity if none such as an IPO is imminent, whether the ownership percentage justifies a Board seat, and other matters.

Adjustments to Purchase Price

The Purchase Agreement will usually include an adjustment to the sale price based on the Company's performance between execution and the closing date. The buyer naturally wants to protect itself from a possible decline in the business before it actually buys the Company at closing.

Adjustments are often based on trailing revenue or EBITDA at close and changes in net working capital. The seller will want to negotiate limitations to the adjustments.

If there will be a long time between the signing of the Purchase Agreement and the closing, a "Material Adverse Change" clause might be negotiated. The so-called "MAC" clause is usually found in larger transactions, but might arise with acquisitions of growth companies where regulatory approval, customer contract transfers, assumption or settlement of debt or other third-party approvals are needed prior to closing.

Earn-Out

An earn-out is a payment at a future date contingent on meeting certain performance criteria, usually financial such as revenue or EBITDA targets. Buyers want to use them to ensure the price paid matches the value of the Company. Sellers are rightfully usually wary of them, but they can also be useful to close a valuation gap with the buyer to complete a deal.

Unsurprisingly, earn-outs establish a contentious relationship between buyer and seller, which may be exacerbated by poor structuring of the deal or drafting of the documents. The seller should negotiate protections during the earn-out period, such as flexible goals, control over factors that affect the goals, revisions of the business plan if necessary, and other measures.

Indemnity

Indemnification is essentially insurance the seller provides the buyer in the Purchase Agreement that covers certain risks of the transaction. Examples of those risks are breach of contract terms or representations and warranties, fraud, undisclosed liabilities, taxes and environmental issues.

Because of the undefined nature of the risks and the possible amounts that might be involved in the case of a breach, they are typically the most complex and heavily negotiated provisions. The seller should negotiate limits on the indemnification liability in terms of a threshold for claims, total dollar amount and duration.

Escrow

The Escrow, sometimes called the "Holdback" is a portion of the purchase price that will be paid into a bank escrow at closing, and transferred to the seller when certain contingencies are resolved. The portion is usually ten percent of the total purchase price.

The Escrow typically lasts from one to two years. The Escrow can cover many types of contingencies, but is usually used to ensure payment of claims that arise from the Indemnification.

In addition to negotiating the amount held back and the duration of the Escrow, the seller should ensure the escrow agent's instructions are written such that the buyer cannot easily raid the Escrow for funds. A threshold on the size of a claim to be paid can be negotiated, for example.

Other Terms

There are several other key terms that affect the ultimate value of the deal to the seller. Some of them are:

- **Taxes:** Valuation is a pre-tax figure, yet it is the after-tax amount that should most concern the seller. After-tax proceeds are highly dependent on the structure of the transaction.
- **Employment Agreements:** The team of the selling company is often kept on by the buyer, and the management receives employment and sometimes non-compete agreements. These should be carefully negotiated to protect the seller's rights to receive severance and to avoid a punitive non-compete agreement so she may earn a living should a termination occur.

- **Fees:** The advisory, legal, accounting and due diligence costs of a transaction can amount to several hundred thousand dollars. Usually each party pays its own costs, but in smaller transactions where the buyer is a much larger company, the buyer might agree to pay some or all of them. This can have a substantial favorable impact to the net proceeds to the seller.

Conclusion

If you are a seller, be substantively aware of the major transaction terms other than valuation described above. They can have a material impact on the ultimate value of the deal struck. When engaged in a transaction, be sure to push beyond the "headline" items like valuation, and understand how these less well-known items might affect you.

Sources: Thomson Reuters, PitchBook and MobileSolve Group Analysis

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Most-Read Articles

[Deal Structuring in the LOI](#)

[Equity Crowdfunding - A Potential Revolution in Financing Startup](#)

[Enhancing Your Company's Valuation](#)

Transactions

The following are notable M&A transactions and capital financings announced or completed in the last month.

Notable M&A Transactions

[Cisco](#) Acquires - IOT company Jasper Technologies for \$1.4 Billion. [See details here ...](#)

[Ramus](#) acquires Smart Card Software - a secure mobile payment & ticketing solutions. [See details here ...](#)

[omNovos](#) acquires Canadian-Based Mobile Payment Solution Specialist MiniCheckout. [See details here...](#)

[Upsight](#) acquires Fuse Powered, a mobile monetization and ad mediation platform. [See details here...](#)

[Mosaik Solutions](#) acquires Sensorly, it develops products and services to help operators improve their network quality. [See details here ...](#)

Notable Capital Financings

[Zendrive](#) is a mobile technology that makes roads safer through better data and actionable insights. They have raised \$13.5 million in Series-A round of funding. [See funding details...](#)

[Minkasu](#), a mobile wallet service provider, raised \$1million in a seed funding round backed by Angel investors. [See funding details here ...](#)

[WorldRemit](#), a money transfer service that helps migrants transfer money all over the world, has raised \$ 45million from TriplePoint Venture Growth BDC Corp. & Silicon Valley Bank to grow its mobile-first money-transfer service globally. [See funding details here ...](#)

[ThinkingPhones](#) (now Fuze), a Massachusetts, cloud service that offers messaging, phone service & video streaming has raised \$112 million Investment led by Summit Partners. [See funding details...](#)

[Revolut](#), an app to seamlessly exchange or send money in multiple currencies, has raised [\\$2.3 million](#), for Its Mobile Foreign Exchange Service. [See funding details...](#)

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