MobileSolve

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MobileSolve Group, Inc. is a boutique investment bank providing M&A, Capital Raising and Financial Advisory services to technology emerging and growth companies.* This newsletter presents short articles on industry or transaction topics of current interest, and a summary of recent notable transactions.

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Should You Work With A "Fundless Fund?"

A MobileSolve client recently received a takeover inquiry from a firm that described itself as a "Fundless Sponsor." The obvious question put to us was how seriously should our client take the inquiry as their very description implied they did not have the funds to complete an acquisition.

Fundless Sponsors are a relatively new phenomenon on the private equity scene that should be understood by anyone considering a sale of their company. The following explains Fundless Sponsors and the results of our evaluation.

What are Fundless Sponsors?

As the name implies, a Fundless Sponsor, also known as an Independent Sponsor, typically is a small group of professionals that seeks acquisition targets without having arranged the financing to complete the transaction. They raise funds on a deal-by-deal basis. The number of Fundless Sponsors has increased substantially over the last few years for several reasons explained below.

The group usually consists of operating executives with substantial industry experience combined with former investment bankers or consultants that bring strategy and transactions skills. Their knowledge of and connections in the industry allow them to develop proprietary deal flow the large private equity firms don't get to see. To get equity financing once they have a deal, the group usually has close relationships with private equity funds, family offices, traditional limited partners and the like.

There are two types of Fundless Sponsors. Most are focused on one-off deals, while others seek to build a track record that will lead to raising a fund of their own. The latter will use deals to showcase transaction execution ability and the skills of the team, and to build relationships with a variety of limited partners for that future raise.

As niche players, Fundless Sponsors typically search for deals in the lower middle market. Their targets tend to be in the range of $10M - $200M in revenues, and $2-$20M of EBITDA.

How Do They Work?

The Sponsor will often set up a LLC or LP to serve as an investment vehicle for the deal. In the Letter of Intent, they will ask for 90 days to complete the due diligence and to raise the financing. They will then "sell" the deal to their sources of equity. Of course, they have very good knowledge of the types of deals their sources will finance, but there is no guarantee the equity will be raised.

The Sponsor's compensation comes in several forms: the opportunity to invest its own funds in the deal, closing fees, management fees for services provided after closing, and a carried interest in the profits upon sale. Sometimes they will exchange their closing fees for additional equity in the LLC to defer taxation and to convert what would have been ordinary income into more favorably taxed capital gain.

The equity interest of the Sponsor is typically junior preferred or another security that is subordinate to the capital invested by the private equity fund or other type of investor, but higher in the capital structure than the common stock. That provides them with some protection in a bankruptcy, and the possibility of receiving a dividend that is not paid to the common.

Why Have They Emerged?

To a great extent, Fundless Sponsors are creatures of our times. Recent economic conditions and monetary policy have substantially raised equity prices, and stiff competition among a large number of private equity funds have made deals at reasonable multiples hard to find. This has led to a huge "capital hangover" of uninvested amounts that some estimates place at more than $1 Trillion.

Thus Fundless Sponsors as industry-specific niche players are a channel for private equity funds to gain access to smaller, less competitive, but still potentially lucrative deals. They act independently of the private equity funds through their own networks and provide their deal flow to established funds, enabling the funds to deploy more capital.

Under the right circumstances, the model works for each of the parties involved. The portfolio company obtains the capital it needs to grow, and expertise through an ongoing mutually beneficial relationship where the Fundless Sponsor provides managerial and operational expertise. Fundless Sponsors get their deals financed, and private equity funds invest more capital.

An important fourth potential participant is benefitting from the emergence of Fundless Sponsors. They are Limited Partners that normally invest in private equity funds, but may consider direct investment in acquisitions led by a Fundless Sponsor with which they have an existing relationship. For Limited Partners, the advantages of working with a Fundless Sponsor are investing only in deals they like, negotiating fees and investment terms specific to the deal that may be less than the industry standard, and paying fees only when the capital is actually invested.

How To Evaluate Fundless Sponsors

It is crucial to carefully evaluate a Fundless Sponsor in deciding how to respond to an inquiry. Their lack of confirmed financing is an obvious disadvantage in working with them. A company will want to avoid giving a Fundless Sponsor an exclusive (ie, no-shop) period unless it has high confidence in the Fundless Sponsor's ability to raise the financing.

Your due diligence should ask:

- What types of investors do you work with, and which do you intend to approach?
- What are your personal relationships at those investors?
- What is your track record of financing and exiting deals?
- What operating value will you add to the company?

In the situation with our client, after conducting some due diligence, we turned down the opportunity to work with that particular Fundless Sponsor. Their short track record gave us concern about their ability to raise the funds.

But under other circumstances, we would work with a Fundless Sponsor who gave us confidence in the financing, and who brought strategy and operating expertise that would enhance the exit value of the company.

Note: This newsletter if for informational purposes only, and not for the purpose of providing legal, financial or other advice.

Transactions

The following are notable M&A Transactions and Capital Financings announced or completed in the last month.

Notable M&A Transactions

Artilium acquires Wbase a Belgium based web development agency, for €410,000. See details here …

AT&T announced it will acquire Straight Path Communications, a provider of licenses to wireless spectrum, for $1.25 billion. See details here …

Baidu announced it will acquire xPerception a U.S. startup specialized in computer vision. See details here …

Digital Republic Media has acquired Gamesrocket, a leading distributor of video games. See details here …

SpotHero has acquired Parking Panda, a mobile application and optimization platform for parking. See details here …

Warren Equity Partners acquires SSP Innovations, a provider of geographic information systems (“GIS”). See details here …

Windstream announced it will acquire Broadview Networks for $228 million. See details here …

Notable Capital Financings

Aeriandi, an Oxford, UK-based provider of voice security solutions, raises £1.5M in growth financing. See details here …

GoTenna, maker of a device that enables smartphone users to communicate without cell towers, WiFi routers or satellites, raised $7.5m in Series B. The round was led by Union Square Ventures. See funding details here …

Peloton, a connected and automated vehicle technology company, raises $60 million in Series B. The round was led by Omnitracs. See funding details here …

SlashNext, a cyber security provider raises $9M in Series A. The round was led by Norwest Venture Partners and Wing Venture Capital. See funding details here …

Upskill, provider of wearable technology raises Series B funding. The round was led by Boeing and GE Ventures. See funding details here …

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