Valuation:

What is a Business Worth When You Have Only One Bidder?

Recently, the CEO of a client firm came to us with a not-so-unusual situation. A valued customer/distribution partner of our client had offered to buy the company. They had gone so far as to put a price on the table and give the company a deadline to respond. The CEO (who owned a considerable portion of the firm) and his venture capitalist backers were ready to sell; the 'chemistry' between the parties was good – and they knew that this was the most likely buyer. Their questions to us: Is the price fair? Could they get more? How should they value the firm? Can we help bring the deal to conclusion?

> We took a three-pronged approach: we embarked on a quick test of the market; we began to formulate a rational opinion on value; and, finally, we tried to assess the strategic value to the buyer.

We prefer to answer these sorts of questions by running a disciplined sales process. In our view it's the best way to find out exactly who will buy and at what price. And, it gives the seller leverage with the prospective buyers. But here, the seller didn't want to lose time – or the offer. The CEO wanted us to answer the valuation question in the context of "multiples" and his VC wanted to know what the market would bear. They wanted our help to get the best deal done – quickly. Sounds easy; but, we know that it is not.

> We quickly identified the four most likely alternative purchasers.

We took a three-pronged approach: we embarked on a quick test of the market; we began to formulate a rational opinion on value; and, finally, we tried to assess the strategic value to the buyer – quantifying precisely how much value our client's company would bring to them.

We quickly identified the four most likely alternative purchasers. All four were operating in the industry and understood the space. Over the next few days, we put together a package of information on the company and invited each of the four firms to meet with our client's CEO. Three of them accepted the invitation. Within a few weeks, we had a sense that at least one of the three firms might participate seriously in an auction. We also had a sense that this one firm could not move fast enough and they were not likely to top the bid on the table. It was enough to confirm our direction.

While these discussions were proceeding, we also began to formulate a rational opinion of value based on financial metrics of the company, as a stand-alone entity. It would be worth the effort as a sanity check on the other approaches to value; and as a negotiating tool.

We looked at our database of 10,000+ transactions and identified 20-30 companies that had similar financial and product characteristics. We then calculated a series of valuations looking at things such as enterprise value as a multiple of factors such as trailing – twelve-months revenue, current run-rate revenue, expected revenue for the current fiscal year, etc. We then normalized each of the results for a variety of characteristics, including growth and leadership position. (Often, the revenue or profit multiple of the market leader is substantially higher than others in that same niche). With a single product line company, this analysis is not too difficult. With this company however, the exercise

> Their questions to us; Is the price fair? Could they get more? Can we help bring the deal to conclusion?

> We went through an exercise to assess the strategic value of our client's firm to the acquirer.

had to be performed for each of several revenue lines. Further, we had to adjust for the fact that the prospective buyer accounted for a significant portion of revenue. We went through a similar exercise, valuing the company on the basis of profit (EBITDA). In this case, we had to use expected future profit, as the company was reinvesting virtually all current cash flow into new products. Once we had gone through this analysis we applied a subjective weighting to the various results, in order to derive a reasonable value range. And then, we made adjustments based on the company's balance sheet.

> So as to not lose momentum, we pursued this three pronged approach, while simultaneously cooperating with a detailed due diligence review process.

Finally, we went through an exercise to assess the strategic value of our client's firm to the acquirer. This was an even more extensive exercise. Essentially we attempted to quantify the additional revenue and profit the buyer should be able to bring in, if they were to own the company. "Make vs. Buy" is sometimes part of this analysis. And, we did comment on that as well. But this exercise also attempted to value not-yet-developed products.

So as to not lose momentum, we pursued this three pronged approach, while simultaneously cooperating with a detailed due diligence review process by the prospective buyer that overlapped with some intense negotiating sessions.

A few months after we were engaged, we were able to help our client successfully sell the firm. The sellers, including the VCs and the holders of common shares (and Management), are all convinced that the price had been well vetted – and stretched; the employees are happy in a new environment with additional resources and opportunities to grow. Even the customers are happy with a more fully integrated support and service team. As a result of the process, the buyer better understood how much revenue and profit could be generated, once they owned the business. And they better understood how much they could pay and still have a deal that made sense. They are happy too. It is not the way we like to run a process. But, in the end it worked out. The buyer has since integrated the acquired business fully into their operations. The CEO was given a larger role in the parent company; and we have a new reference client.

> The sellers are all convinced that the price had been well vetted.

M&A
MARLIN & ASSOCIATES

Transaction Advisory for the Digital Information Economy
600 Lexington Avenue, 36th Floor ◆ New York, NY 10022 ◆ 212.257.6300
7720 Wisconsin Avenue, Suite 213 ◆ Bethesda, MD 20814 ◆ 301.469.0441
150 York Street, Suite 1900 ◆ Toronto, Ontario M5H 3S5 ◆ 416.619.4928 ◆ **www.marlinllc.com**

Ken Marlin
Managing Partner
Marlin & Associates