Guide to Selling Your Technology Business

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GUIDE TO SELLING YOUR TECHNOLOGY BUSINESS

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Introduction

Selling a technology company is a unique undertaking. The technology industry is often defined by non-physical products, a continuously changing business landscape and rapid innovation. All can add complexity to an already intricate and time-consuming sales process.

Preparing for and carrying out a sale that maximizes your business' value requires careful planning, preparation, and execution. In today's market, you're dealing with sophisticated buyers. Business owners should be well-prepared for and well-advised on the many due diligence requirements and potentially complex deal structures.

Even the most sophisticated acquirers, from private equity firms to large corporations with in-house M&A functions, approach transactions with a team of professional services firms. Business owners may become overwhelmed by the process without their own team of advisers to help tackle the sales process.

This guide explores the key elements of a typical sale process. It provides practical information on preparing for an M&A transaction. Whether you are planning to sell your business or want to prepare the company for a possible sale, this guide is a useful resource for any middle-market business owner in the technology space.

Assembling a deal team

A team of advisers should be assembled well in advance of a sale. At the outset, it's best to involve a recognised M&A adviser and audit firm that can prepare credible sales, financial, and tax information. This will serve as the foundation for internal and external business evaluations. You may also want to engage a tax adviser, a business attorney, and M&A specialists to help bring the transaction to a successful close, and possibly operations and data analytics specialists.

ACCOUNTING & TAX

Many middle market companies lack sufficient financial controls to provide quality information to prospective buyers in a timely manner during a transaction process. Reliable financial information is key. Accrual basis financial statements consistent with applicable financial reporting standards are a starting point in today's M&A processes. Tax and accounting deficiencies can derail an otherwise successful transaction. Talk to your adviser and audit firm about the relevance of reviewed vs. audited financial statements, and a Quality of Earnings (QoE) report.

M&A ADVISER

Your adviser will lead the transaction from start to finish. Look for a firm with relevant transaction expertise, industry experience and a strong reputation.

Your adviser can share real-time market intelligence, identify areas for improvement in the business and help you decide the appropriate time to launch a sales process. An experienced M&A adviser with technology expertise can help maximise the sales value and reduce. They may also have experience with and connections to potential buyers.

TRANSACTION ADVISORY SERVICES

Sell-side due diligence has become standard for companies before going to market for a sales transaction. This process analyses a business in the same manner a prospective buyer would. Such an evaluation allows sellers and their deal advisers to get ahead of and control the narrative around key issues. A sell-side QoE report will enable advisers to run a smoother overall process, prepares sellers for the buyer diligence phase, and enables buyers to make more compelling offers earlier in the transaction process.

In addition to sell-side financial due diligence, sellers often involve transaction tax, operations and data analytics teams before starting the sale process to obtain insights into areas that could drive significant deal value.

LEGAL

When it comes to selecting a deal lawyer, consider someone who specialises in M&A transactions. Find a lawyer who has a commercial mindset and understands the existing market standards for key terms in purchase agreements and other transaction documents. A specialist lawyer can explain complicated legal concepts. They can also identify and prioritise matters that are significant in technology M&A transactions to help you make well-informed business decisions while avoiding unnecessary delays.

It is best to choose a law firm that is appropriately sized for your transaction, with billing rates that reflect the scope of the work. Ideally, the law firm should have specialist lawyers who can assist the lead adviser (the M&A adviser) on complex tax, environmental, intellectual property (IP) and other legal issues as required. Ask your M&A adviser for suggestions for lawyers that suit your specific needs and transaction.

Preparing your business for sale

Whether or not you're considering the sale of your business in the near future, it is critical to understand the state of the market and value-creation opportunities.

As market conditions change, many factors must be considered in preparing your business for sale.

TAX PLANNING

Your tax advisors should be up to date on and understand relevant tax policies and legislation. They should be able to help navigate any tax and transaction issues that can arise as part of the sale process, for example, transaction structures, terms of the sale, tax consequences of the deal structure, etc.

Ask your tax advisor to prepare illustrative net proceeds analyses for potential transaction structures, including stock vs. asset sale scenarios. Quantify the value of asset basis step-ups, NOL carryforwards, and other tax assets that may enable certain buyers to pay more for the business.

INTELLECTUAL PROPERTY (IP)

Since technology companies are highly mobile and can often conduct business anywhere, they can create value around the world if they have operations in different countries. This means IP may exist in various entities. Consolidating your IP into one entity before a sale may be preferable. Ask your advisers to assess the company's tax profile across the globe, including potential tax risks.

An adviser can help review your current business to identify any key financial drivers, including tax initiatives, that may increase your business' attractiveness to potential purchasers.

A well-established deal team will help you create a strong, well-documented sales pitch, identify key deal drivers, and mitigate risks that can prolong a sales process. Without the right advisers and preparation, you may find that a buyer's due diligence discovers last-minute issues — for example, relating to revenue and profit margins. There is no advantage in presenting a great-looking company to a buyer when it becomes evident during the due diligence process that the information or performance isn't sustainable.

Work with your adviser team on developing practices and procedures that inspire trust from your stakeholders.

KEY POINTS

- Planning ahead can reduce your tax bill
- Improving the attractiveness of your business may result in a higher sale price

Conducting an operational evaluation

An M&A adviser will provide guidance on key valuation drivers that help determine a potential value range the market may place on your business. As you prepare for a sale, consider the following areas for evaluation from an operational perspective:

MANAGEMENT

If you're heavily involved in the day-to-day running of the business, the purchaser may be keen to retain your services for a time after the sale. In such cases, you will need to decide whether to remain involved and, if so, the level of involvement. Where possible, develop a complete management team and a succession plan for critical positions or individuals nearing retirement before planning to sell the business. Key person risk, as it's often referred to, is a pain point for potential buyers. Do what you can to spread key client relationships, R&D activities, and other critical value-enhancing activities across multiple individuals. Where possible, recruit a full management team with no obvious vacancies in key positions.

GROWTH

Demonstrating past growth and future growth potential is essential to maximising sale value. The quality, sustainability, and profitability of your growth are equally important. Ideally, track KPIs that help you quantify the business' sales efficiency and ROI on growth-oriented investments. Talk to your adviser about what KPIs are worth monitoring and are most relied upon by potential buyers. Develop a growth strategy and credible, supportable financial projections using transparent unit economics.

PROFITABILITY

Increasing sales and margins and controlling overhead spending before entering a transaction process, are important and desirable. You're likely already doing this in the normal course of running your business. Attempt to capitalise on opportunities to improve the company's profitability. Also, try to identify potential future drivers of margin expansion and operating leverage that buyers can capitalise on during their ownership period.

CAPITAL EXPENDITURE

Taking on significant capital expenditure up to a sale is always difficult. A buyer will consider the quality, longevity, and replacement cost of assets when determining valuation. Supposed the business has focused on maximizing dividends ahead of reinvesting in critical infrastructure and operational resources. In that case, a buyer may wish to look at what remedial investment is needed and factor this into its assessment of the value of the business. In most cases, it's sensible to continue operating and investing in the business as though you were going to continue owning it.

EBITDA ADJUSTMENTS

Identifying potential EBITDA adjustments is a valuable exercise. These "addbacks" may include excess owner compensation, non-recurring items like relocation costs, or unusual business disruption events,

such as the COVID-19 pandemic. Work with a practice that can prepare a QoE report, provide input on market norms and whether your businesses' proposed adjustments will withstand buyers' financial due diligence.

WORKING CAPITAL

Most buyers will ask sellers to deliver a "normal" level of working capital at closing. Working capital negotiations can take on a life of their own, and inexperienced sellers can suffer significant value erosion. Agreeing on a methodology is rarely as simple as reducing current assets by current liabilities. Sell-side QoE reports can include working capital analyses to help get buyers and sellers on the same page earlier in the process. Your management team may consider opportunities to lower working capital requirements leading up to a sale, which can lower the working capital requested by the buyer at closing.

The transaction process

A successful and seamless sale of your business is the ultimate reward for your efforts. While key sales objectives may vary, they typically include maximising the sale price and finding the right new home for employees and customers. Achieving all these objectives in today's market environment is extremely difficult without a high-calibre deal team at your disposal.

Any transaction, whether focused on one-off negotiations or a broad auction process, is time-consuming. Front-loading the process is key to a timely sale. Having advisers understand your industry that you can trust to help you achieve your objectives is vital. They help carry the administrative burden and manage your controlled exit. This should alleviate some of the distraction that comes with an M&A transaction while ensuring that your goals and objectives are met.

KEY POINTS

- Selling a business can take longer than you might expect
- Timing is a key element to consider in the transaction process
- There are benefits to having trusted advisers

The sale process

The sale process involves the following:

- Preparing the business for sale
- Determining the likely value and preferred deal structure
- Assessing the tax consequences of various structures
- Conducting seller due diligence to optimise financial positioning and identify risks
- Compiling due diligence information and preparing an information memorandum
- Identifying and contacting potential buyers
- Soliciting initial indications of interest (IOIs)
- Hosting management presentations with shortlisted buyers
- Soliciting letters of intent (LOIs)
- Negotiating and signing a letter of intent
- Facilitating confirmatory due diligence
- Facilitating legal documentation
- Signing and closing the transaction
- Post-closing support relating 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 navigate the process?

A company sale creates an information demand. While an adviser can help coordinate and package the information required for the sale process, your management is ultimately responsible for providing advisers with accurate and timely information. Buyers may lose confidence and conclude that a company has inadequate financial controls, information systems and/or human resources if there are significant information gaps, delays, or vague responses.

A typical controlled sale process led by a qualified advisory firm can take 4-6 months or more from start to finish. During this period, the company must continue to operate effectively despite the diversion of management's time and attention. Your management team must be prepared to deal with the additional demands during the sale process.

As mentioned earlier, it's recommended that the planning process begins well in advance. This gives you time to address all the legal, HR, tax, etc. issues before engaging with potential buyers.

It's usually a good idea to start gathering information that potential buyers may require well before a sale process. Performing vendor due diligence helps identify and address any information gaps early on, allowing you to remain proactive throughout the process. Building a comprehensive repository of all material contracts and performance data will save considerable time during the due diligence phase. This should include all signed customer and supplier agreements, operating leases, license agreements, insurance and benefits documentation, tax returns, and legal and regulatory documentation.

Ask your adviser and deal lawyer for sample data room request lists to help you compile the right information. Having this documentation at hand will allow you to focus on value creation, management presentations and responding to less due diligence requests.

During the sale process, your adviser will manage a virtual data room, coordinate diligence responses and try to spend management's time wisely on only the most important diligence requests. Your advisers can also help you provide the appropriate level of information disclosure.

KEY POINTS

- The transaction process can last 4-6 months or more
- Provide potential buyers with comprehensive information about the company's operations

Examples of the types of information you may need to pull together for potential buyers include:

- Corporate/legal information
- Management/organisational structure
- Product demo and product-market fit
- Tech and IT infrastructure
- Sales and customer-level data
- Tax, compliance and regulatory information
- Historical and projected financial information
- HR, insurance and benefits information

Structuring the sale

Considering your preferred deal structure is important before starting the sale process. When prospective buyers are aware of a seller's preferences at the outset, their offers can more easily match seller's objectives.

If you plan to leave the business following the sale, you will likely want the purchase price paid at closing. Supposed you believe there are significant opportunities for additional growth under the new owners and/or wish to remain active in the business. In that case, you may consider owning part of the new company's debt or equity. Buyers often see a seller's appetite to retain an equity stake as a vote of confidence, which can lead to a higher enterprise value.

If you have private use of assets owned by the company that aren't required for carrying on the business, these should be identified early on so they can be transferred out of the business and the buyer is informed of this intention. For example, if the company owns your vehicle, its ownership could be transferred before the sale.

Almost every aspect of a sale has tax implications. It is crucial that you receive clear and detailed tax advice early and often throughout the sale process. This will help avoid last-minute surprises and maximise your net proceeds.

Pre-sale tax and estate planning is important to enable any pre-sale reorganisation or asset removal to occur tax-efficiently. Doing this in advance helps ensure you give enough notice to a buyer of your requirements.

You may want to explore opportunities to use your company's tax attributes that would otherwise expire when the deal closed. Similar opportunities may be available for deemed disposals of company assets, generating tax attributes that can be used to reduce the capital gains arising on disposals by your company's shareholders. These factors can result in an increased tax basis in the company's assets acquired by the purchaser that may increase its purchase price offer

KEY POINTS

- There are tax implications with any sale, so conduct pre-sale tax planning
- Decide sale goals at the start of a sale process

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

- Sale of stock vs. assets or hybrid structures
- Form of consideration preferred (e.g., cash, stock, promissory note, earnout)
- Timing of the consideration (e.g., at closing, deferred or contingent)
- Assets you wish to retain and need to transfer out of the business (e.g., property, vehicles or surplus cash)
- Tax treatment of the consideration offered

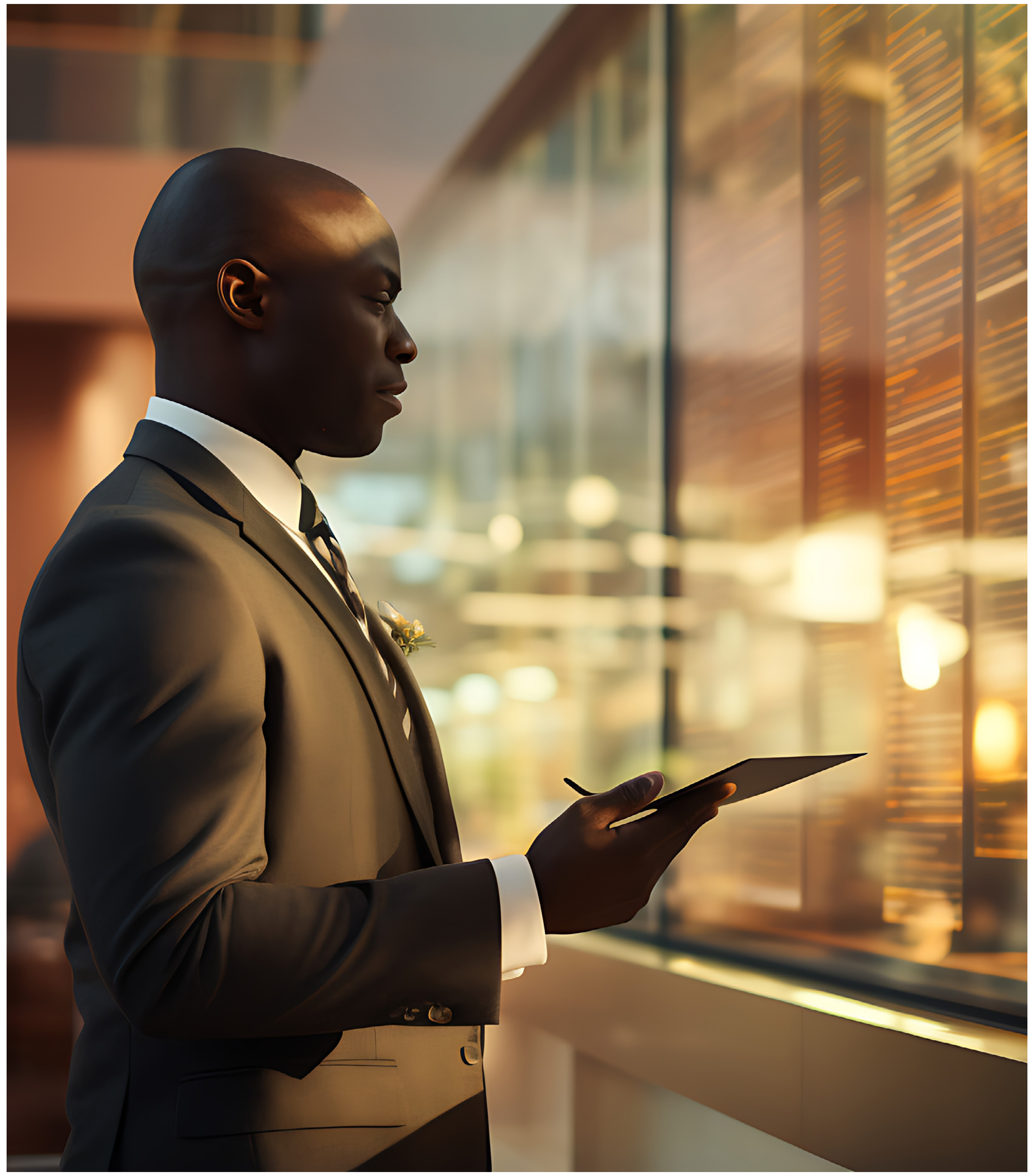
Preparing an information memorandum

With your input, your adviser will prepare an IM (information memorandum) to introduce the business to potential buyers. The IM should present your business in a positive light. However, it must be both factually correct and complete. In this context, having a technology specialist adviser with deep finance knowledge can be key. Be upfront and transparent with your advisers about potential customer losses, litigation, or other sensitive issues to avoid any unwelcome surprises for your advisers and potential buyers. Any aspect that is perceived as misleading could undermine the buyer's trust and interest.

The IM will provide enough information to enable buyers to make a preliminary assessment of your business and ascribe a point estimate or range of value. This could be reflected in an initial indication of interest (IOI) submitted by your first-round bid deadline.

Consult your adviser on when and how best to disclose competitively sensitive information such as customer names, pricing details or unregistered IP that may be better suited to later stages of the sale process.

Work with your adviser to identify the key selling points of the business and demonstrate these with hard metrics and quantifiable results, wherever possible. Ask your advisers to benchmark your company's performance against comparable businesses to showcase positive aspects of the company's business model, customer relationships and overall value proposition.



KEY POINTS

- Offering materials should present the business favourably without compromising accuracy
- Buyers should be able to easily assess the business

The information memorandum should clearly articulate the following:

- Key investment considerations
- Business model
- Management team
- Addressable market opportunity
- Growth strategy
- Financial performance

Should you approach one buyer or several?

A controlled sale process will usually involve some form of confidential auction to a carefully selected group of buyers. Appointing a recognised adviser signals to the marketplace that you're taking the sale process seriously and are committed to closing a transaction.

While involving multiple parties in the process can be more complicated than dealing with a single prospective buyer, a competitive process has advantages over a one-on-one negotiation. Even the threat of competition and marketing the business more broadly can be a strong incentive for buyers to increase prices and help sellers avoid transacting below a market-clearing price.

Today's buyers are sophisticated at capturing sellers' attention early on with a compelling price and promises of a swift and simple transaction. The reality of these non-competitive situations rarely lives up to expectations. The further down the path one proceeds with a buyer on a one-off basis, the more difficult it can seem to break away from that transaction, given the considerable time and effort invested. Smart buyers know how to leverage this dynamic with last-minute changes to the original deal terms.

An experienced adviser can help owners avoid these situations by designing and executing a sale process that maximises competition, optionality and negotiating leverage. Despite buyers' promises of a quick closing when there are no other parties at the table, a controlled and competitive sale process typically gets sellers to the goal line quicker and with fewer missteps along the way.

KEY POINTS

- Having multiple bidders at the table can lead to a higher sale price and higher certainty of closing a deal
- Ask your adviser to design a process tailored to your objectives

Indicative offers, narrowing the field

To maintain momentum and an orderly sale process, the process letter distributed by your adviser with the IM should specify a firm deadline for submitting initial indications of interest. These first-round offers are primarily based on the IM and questions presented to your adviser. Some parties may receive early access to management depending on the process. Questions from potential buyers can provide insight regarding what buyers value and need information on to confirm or improve their offer.

Buyers increasingly expect a sell-side QoE report or other vendor diligence reports early in the process. This helps them refine preliminary bids and can shorten the overall time to close. Discuss with your M&A adviser whether financial models, market studies, audited financial reports or other information should be provided to buyers at this stage.

Once indicative offers are received, work with your advisers to narrow the field of potential buyers, typically to 10 or fewer parties. They will be invited into the next round to meet management and receive further diligence information to submit a more comprehensive letter of intent (LOI) in the next round of bidding.

These first-round bids are non-binding, preliminary indications of interest, based on limited due diligence information. They are subject to change, and often do change, between bidding rounds. Many owners develop biases towards high first-round bidders. Your adviser can provide perspective and context as to how each bid will likely trend and how to handle each party.

KEY POINTS

- Set a firm bid deadline for receiving indicative offers
- Work with your adviser to evaluate offers and narrow the field

Handling meetings, site visits and due diligence requests

Management presentations are typically the first direct interaction between potential buyers and your company management team. Work with your adviser to set clear meeting agendas and ground rules, and perform at least one trial before your first meeting. Buyers' interest and enthusiasm for a transaction depend considerably on their confidence in the management team and its strengths, weaknesses, and capability of delivering on the company's growth plans.

These meetings are a great opportunity for management to learn more about the potential buyer's organisation, history of acquisitions, approach to post-closing matters and integration and overall plans for the business. These meetings are generally enjoyable as they are essentially a discussion about the buyer's business, and you and your team can view the business through the eyes of sophisticated investors and sometimes their competitors.

In the case of software businesses, a site visit is often complemented by a product demo, showcasing beneficial characteristics for customers and developers.

The purpose of the meetings is to learn about each other's businesses and for the buyer to assess strategic alignment and the strength of your management team. Live negotiations or discussions on specific transaction terms or economics are outside the meeting scope. Consult your adviser to understand what is and is not appropriate for these meetings.

A properly executed management meeting can significantly enhance buyers' interest levels. It may increase their willingness to move up in value and to allocate more resources sooner in the process to differentiate themselves and offer a quicker and certain closing at the letter of intent stage.

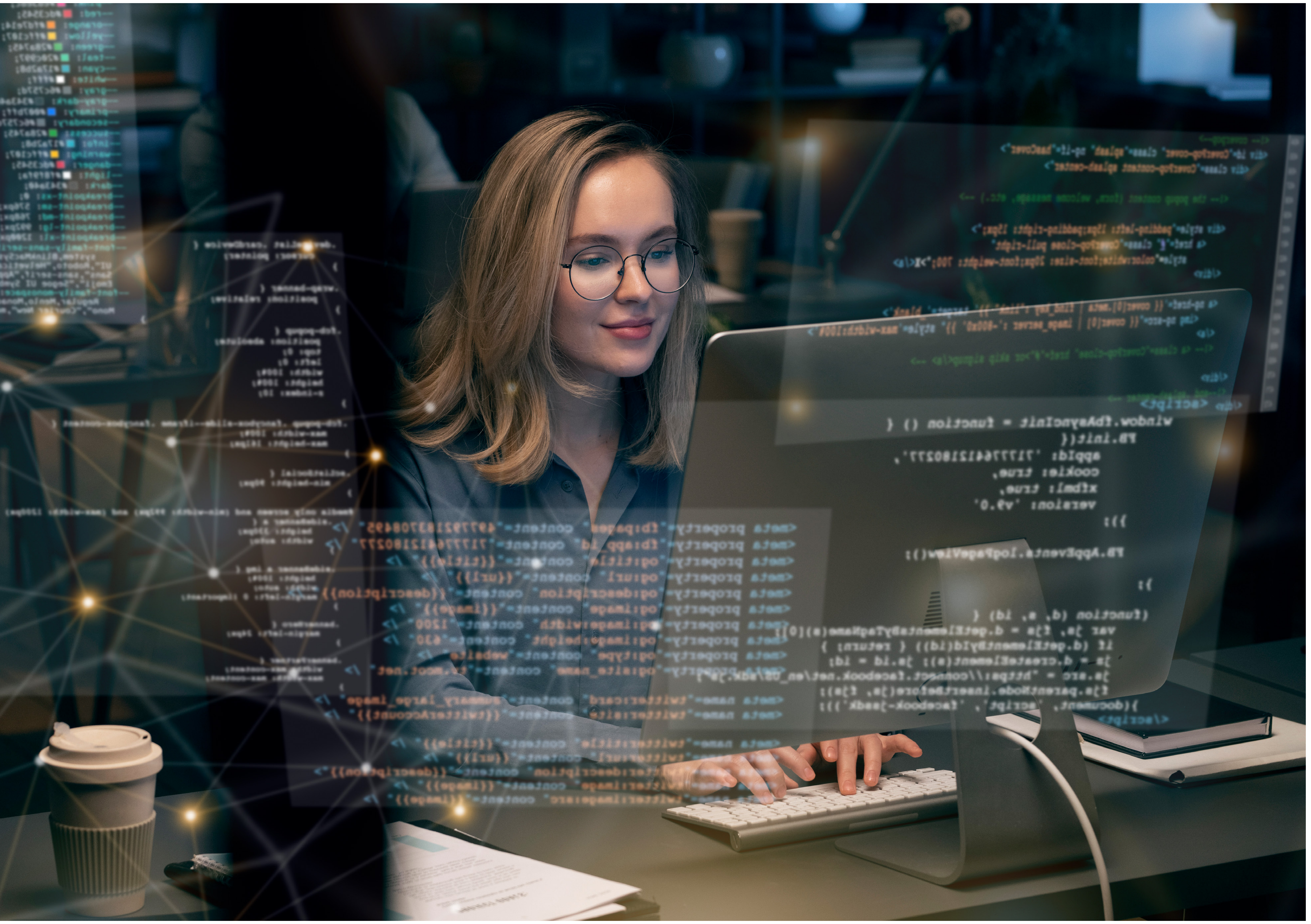
Discuss with your adviser the merits of offering facility tours, product demos or other ancillary meeting content. Following management meetings, your adviser will gather feedback from each buyer, explain the next steps and typically open a virtual data room containing detailed due diligence information upon which the buyer can formulate its second-round bid.

Your adviser may advise further narrowing the buyer field, interim bidding rounds or other process changes. Additionally, your adviser and lawyer may advise posting a draft stock purchase agreement to the data room for buyers to provide a comment memo of full markup as part of their LOI bid packages, which can be highly advantageous.

KEY POINTS

- Management presentations are a critical opportunity to build on initial interest
- Careful preparation with your adviser is critical and pays dividends

Final offers and closing the transaction



If everything goes to plan, you'll receive LOIs from multiple parties. This is often the time to pick one party to proceed with, often on an exclusive basis. There are exceptions to this approach, which you can discuss with your team of advisers. This is where your adviser's negotiating expertise comes into play. They will work with you to formulate counter proposals and a bidding strategy that optimises your outcome.

Your adviser should have distributed a process letter that outlines to buyers what they should include and address in their LOI; this will allow you to compare various proposals easily. LOIs commonly include supplementary documents such as comment memos, stock and purchase agreement markups, debt financing commitment letters, due diligence timelines to closing, references, or other information requested in the process letter. Work with your adviser to determine appropriate action, given the circumstances and deal dynamics, and to set clear and realistic expectations.

Selecting a final party with which to partner can be challenging, given the number of factors to weigh across a variety of stakeholders involved. However, by this stage of the process, you've hopefully had sufficient interaction with each prospective buyer to understand their plans for management, employees, and operating the business post-closing. If you feel you have insufficient information, work with your adviser to schedule subsequent buyer meetings that will enable you to make an informed decision.

After signing an LOI, you and your advisers will typically be working around the clock to support confirmatory due diligence and provide your lawyers with the information they need to finalise definitive agreements, such as the stock and purchase agreement, employment contracts and many ancillary agreements. Having a robust team of advisers can significantly improve the speed to closing and prevent potential missteps that could jeopardise the deal from proceeding on the terms and timeline that were originally intended.

KEY POINTS

- Strive for comprehensive bid packages with few unknowns and a clear path to closing
- Consider strategic fit, speed and certainty of closing, in addition to price and other terms

How BDO can help

The sale of your technology business will likely be one of the most significant financial transactions you will undertake. You should consider having a team of professionals that are specialised in M&A transactions and have a proven track record of delivering premium outcomes for companies like yours.

At BDO, we understand technology business owners' objectives and specialise in developing and executing a transaction process that is optimised for our clients' objectives as owners, shareholders, employers and individuals. We've helped thousands of business owners navigate the successful sale of their companies and are committed to supporting you every step of the way.

Our team of advisers, tax and accounting professionals can help you with virtually every aspect of preparing for and executing a successful sale. Services include transaction process design, developing the right presentation materials, identifying and contacting potential investors, negotiating letters of intent, evaluating tax implications of transaction structures, providing fairness opinions and valuations, offering wealth advisory, assisting with tax planning, and ensuring you close the transaction in a seamless, efficient manner that minimises disruption to you and your employees.

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