Selling Your Information Technology Company
Avoid Some Common Mistakes

By Dave Kauppi, CBI – President MidMarket Capital

Selling your information technology business is the most important transaction you will ever make. Mistakes in this process can greatly erode your transaction proceeds. Do not spend twenty years of your toil and skill building your business like a pro only to exit like an amateur. Below are ten common mistakes to avoid:

1. Selling because of an unsolicited offer to buy – One of the most common reasons owners tell us they sold their business was they got an offer from a competitor or more often these days, an Indian company looking to buy a customer base in the United States. If you previously were not considering this business sale, you probably have not taken some important personal and business steps to exit on your terms. The business may have some easily correctable issues that could detract from its value. You may not have prepared for an identity and lifestyle to replace the void caused by the separation from your company. If you are prepared, you are more likely to exit on your own terms.
2. Poor books and records – Business owners wear many hats. Sometimes they become so focused on the next version release that they are lax in financial record keeping. A buyer is going to do a comprehensive look into your financial records. If they are done poorly, the buyer loses confidence in what he is buying and his perception of risk increases. If he finds some negative surprises late in the process, the purchase price adjustments can be harsh. The transaction value is often attacked well beyond the economic impact of the surprise. Get a good accountant to do your books.
3. Going it alone – The business owner may be the foremost expert in GUI interfaces, but it is likely that his business sale will be a once in a lifetime occurrence. Mistakes at this juncture have a huge impact. It is especially critical to have a good M&A advisor if you are selling an information technology company because these companies do not fit traditional company valuation metrics. If an owner does not get the right representation and have several qualified buyers that covet his technology, he possibly can leave a lot of money on the table. Selling a technology company is complex. Is it a better deal to structure some of the transaction value as an earn out based on post acquisition sales performance? Do you understand the difference in after tax proceeds between an asset sale and a stock sale? Your everyday bookkeeper may not, but a tax accountant surely does. Is your business attorney familiar with business sales legal work? Would he advise you properly on Reps and Warranties that will be in the purchase agreement? Your buyer's team will have this experience. Your team should match that experience of it will cost you way more than their fees.

102 S Quincy Street Hinsdale, IL 60521
PH: 630-325-0123 • FAX: 630-325-9879 • Mobile: 630-215-3994
davekauppi@midmarkcap.com www.midmarkcap.com

4. Skeletons in the closet - If your company has any, the due diligence process will surely reveal them. One of the key issues in information technology companies is the clear title to intellectual property. Are your employee agreements well written? If you hired outside programmers, was their agreement specific in ownership of their output? The concern of the buyer is that once it becomes public that the deep pockets company is owner, previous disgruntled employees or contractors may resurface looking to bring legal action. Before your firm is turned inside out and the buyer spends thousands in this process and before the other interested buyers are put on hold – reveal that problem up-front. We sold a company that had an outstanding CFO. In the first meeting with us, he told us of his company's under funded pension liability. We were able to bring the appropriate legal and actuarial resources to the table and give the buyer and his advisors plenty of notice to get their arms around the issue. If this had come up late in the process, the buyer might have blown up the deal or attacked transaction value for an amount far in excess of the potential liability.
5. Letting the word out - Confidentiality in the business sale process is crucial. If your competitors find out, they can cause a lot of damage to your customers and prospects. It can be a big drain on employee morale and productivity. What if your head of systems development gets skittish and entertains offers from other companies and leaves while you are selling? The buyer wants your top people and they represent a significant portion of your future transaction value. If word you are for sale gets out, your suppliers and bankers get nervous. Nothing good happens when the work gets out that your company is for sale.
6. Poor Contracts – Here we mean the day-to-day contracts that are in place with employees, customers, contractors, and suppliers. Do your employees have non-competes, for example? If your company has intellectual property, do you have very clear ownership rights defined in your employee and contractor agreements. If not, you could be looking at meaningful escrow holdbacks post closing. Are your customer agreements assignable without consent? If they are not, customers could cancel post transaction. Your buyer will make you pay for this one way or another. If you are tempted to sign that big deal at bargain rates to pump up your business selling price, think again. Locking in a contract at below market rates could actually cause a discount to your selling price.
7. Bad employee behavior – You need to make sure you have agreements in place so that employees cannot hold you hostage on a pending transaction. Key employees are key to transaction value. If you suspect there are issues, you may want to implement stay on bonuses. If you have a bad actor, firing him or her during a transaction could cause issues. You may want to be pre-emptive with your buyer and minimize any damage your employee might cause.
8. No understanding of your company's value – Business valuations are complex. A good business broker or M & A advisor that has experience in your industry is your best bet. Business valuation firms are great for business valuations for gift and estate tax situations, divorce, etc. They tend to be very conservative and their

102 S Quincy Street Hinsdale, IL 60521
PH: 630-325-0123 • FAX: 630-325-9879 • Mobile: 630-215-3994
davekauppi@midmarkcap.com www.midmarkcap.com

results could vary significantly from your results from three strategic buyers in a battle to acquire your firm. Where a services business may sell for between 75% and 100% of last years sales, for example, technology companies are all over the map. One of our clients had a coveted piece of software technology and was able to get 8 X last years sales as his purchase price. We certainly could not have and would not have predicted that at the start of the engagement, but what a nice surprise. When it comes to selling your company, let the competitive market provide a value.

9. Getting into an auction of one – This is a silly visual, but imagine a big auction hall at Sotheby's occupied by an auctioneer and one guy with an auction paddle. "Do I hear $5 million? Anybody $5.5 million?' The guy is sitting on his paddle. Pretty silly, right? And yet we hear countless stories about a competitor coming in with an unsolicited offer and after a little light negotiating the owner sells. Another common story is the owner tells his banker, lawyer, or accountant that he is considering selling. His well-meaning professional says, "I have another client that is in your business. I will introduce you." The next thing you know the business is sold. Believe me, these folks are buying you business at a big discount. That's not silly at all!
10. Giving away value in negotiations and due diligence – When selling your business, your objective is to get the best terms and conditions. I know this is a shocker, but the buyer is trying to pay as little as possible and he is trying to get contractual terms favorable to him. These goals are not compatible with yours. The buyer is going to fight hard on issues like total price, cash at close, earn outs, seller notes, reps and warranties, escrow and holdbacks, post closing adjustments, etc. If you get into a meet in the middle compromise negotiation, before you know it, your Big Mac is a Junior Cheeseburger. Due diligence has a dual purpose. The first is obviously to insure that the buyer knows exactly what he is paying for. The second is to attack transaction value with adjustments. Of course this happens after their LOI has sent the other bidders away for 30 to 60 days of exclusivity. If you don't have a good team of advisors, this can get expensive

As my dad used to say, there is no replacement for experience. Another saying is that when a man with money and no experience meets a man with experience, the man with the experience walks away with the money and the man with the money walks away with some experience. Keep this in mind when contemplating the sale of your business. It will likely be your first and only experience. Avoid these mistakes and make that experience a profitable one.

102 S Quincy Street Hinsdale, IL 60521
PH: 630-325-0123 • FAX: 630-325-9879 • Mobile: 630-215-3994
davekauppi@midmarkcap.com www.midmarkcap.com