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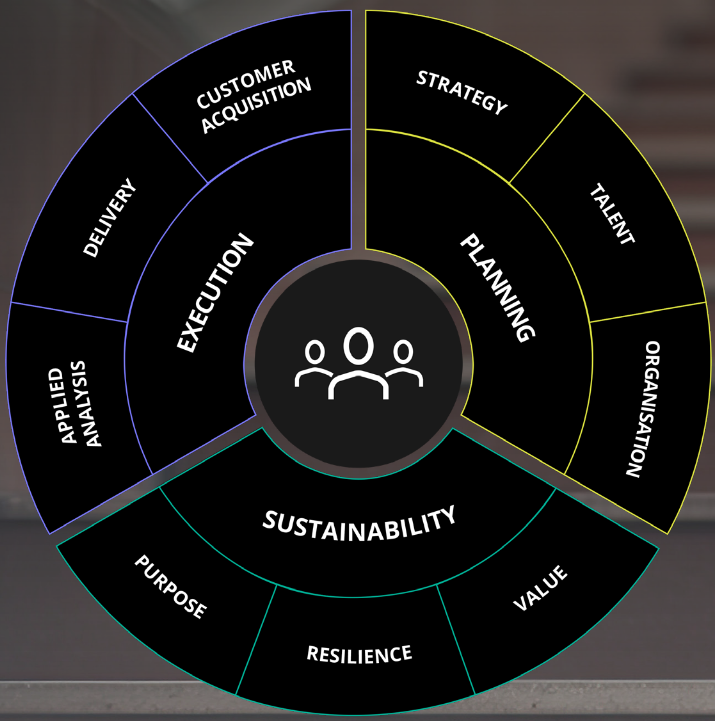
Scale-Up Toolkits



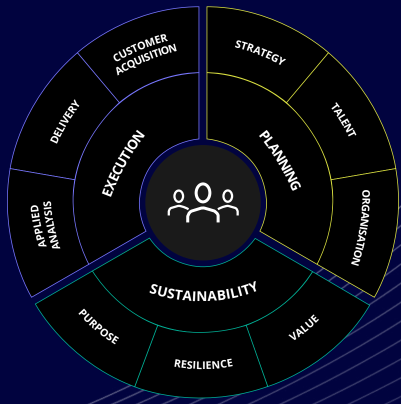
11 steps to being successfully acquired

This toolkit includes:

- A step-by-step guide to successfully being acquired
- The CEO’s M&A Timetable

www.frogcapital.com/scale-up-methodology

Introduction



Though at times mistaken for an objective in its own right, in reality, value creation is an outcome of building a successful business. A business that is sustainably growing, profitable and cash generative has intrinsic value, whether as an independent private company, a public company or integrated into a larger group. Whilst there is benefit in pursuing early alignment between stakeholders on valuation ambition and exit timing, realising the value created is often difficult to manage to a specific timetable; aim to give yourself options wherever possible.

The scale-up phase is a great time to reassess this thinking. Debate around exit expectations and alignment between investors, founders and other executive management is something that scale-up investors will actively encourage. This leads to the first and most important lesson in realising value: most exits are well planned years before they happen.

About the author

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Mike Reid is a senior partner at Frog. He founded the business in 2009 after 12 years at 3i. He works across deal origination and investor relations and runs the marketing and fundraising disciplines at Frog.

Scaling innovative organisations from 50 to up and beyond 500 people is seriously hard. Mike passionately believes senior scale-up leaders need and deserve excellent, proactive and professional growth investors through this phase.

What is most important for Exit Value Creation?

Mastering Due Diligence

The discipline of the scale-up methodology assists the business in growing from a start-up to a mature business; it is the same process that makes you fit for exit. The basics of executing on good customer acquisition and retention are still vital to providing visibility on future growth but building a forward-looking value proposition also requires actionable strategy, a growing pool of talent and a scalable organisational structure.

Many of the risks that a due diligence process would focus on become very easy to address if the company already holds these documents and adheres to good corporate governance procedures. The key to both scale-up and exit fitness is being ahead of the curve in investing in high level capacity to spread the load, reduce individual reliance and provide succession planning.

Investor or purchaser due diligence is often seen as a test to pass with the equivalent of last-minute cramming. This runs the risk of distracting key people from running the business and leaving gaps that can be exploited in the M&A game. Equally, significant time and resources are invested in creating important documentation and structure to the extent that it becomes a separate exercise from helping the trading of the business. Start the process early by overlaying a dataroom request list and identifying what is available to build an in-house dataroom. Next, prioritise filling in the gaps in a methodical way based on the assessment of where the changes will have the most positive impact on trading, employee welfare and productivity or legal risk.

Steven Dunne, Frog Capital

"When I was CFO for a contingent debt collection business, we differentiated ourselves by the integrity and quality of the process. But only by introducing Total Quality Management techniques did we succeed in creating a comprehensive documentation of what we did differently. This made it easier to ensure consistent adherence and provide a simple confirmation of the difference in due diligence. Preparation is vital because purchaser due diligence is an order of magnitude tougher than for fundraising. You will be very exposed if you haven't developed sufficient capacity in your senior team and resilience in the business to continue high-level performance amidst distractions."

Building Value Sustainably

Many growth businesses become focused on the valuation of the next funding round and treat each uplift as a success in its own right. Of course, it is important that investors see progress, but they must look forwards, not backwards, as high valuations put large expectations on a business.

An easy way to assess progress is to understand the minimum growth needed after a funding round to justify the post-money valuation excluding cash. Based on some heuristics on the relationship between growth and multiple, a £10m round on a 7 times revenue multiple for a £5m revenue business requires revenue to grow by 43% to justify the post-money valuation, whereas a £15m round would require 54%. This calculation provides the theoretical minimum required to have a next funding round at an increased valuation.

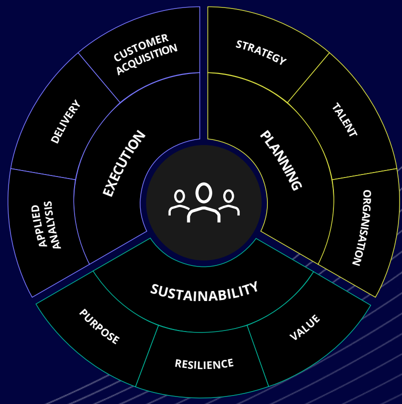
If you don't yet have visibility on sustainable, profitable growth, then the journey from one funding round to the next becomes the whole focus. If growth isn't sufficient to demonstrate a value uplift, there is a good chance that the previous value creation is impaired and, in an extreme (but unfortunately not that rare) scenario, lack of funding could see the company fold with zero value. Being in control of your own destiny is the only way to ensure that value creation is sustainable and not a bubble.

Forging the Right Relationships

For small businesses, it will be rare for large purchasers to make an inbound approach unless you make a strategic decision to build your profile and relationship with them. Corporate communications are important for raising profile but should be targeted at specific audiences (i.e. customers, potential acquirers or market influencers).

For many corporates, a commercial relationship will be required before a transaction can be justified but too heavy reliance on one potential purchaser may put others off acquiring. They might also see different characteristics in the business that they value, e.g. scale in a new merging market, new products, market share or proof of international expansion. Building multiple relationships keeps options open and gives the best rounded insight on routes to realising value.

11 Steps to being successfully acquired



Building a great business

01 Recognised as a serious potential market leader

02 Impressive KPI momentum (financial & non-financial), ahead of budget

03 Strong, referenceable customer satisfaction metrics

04 Strong, operational senior team in place

Getting on the radar of your acquirers

05 Clear marketing with effective targeting towards M&A

06 Building direct relationships with acquirers

Preparing for an exit

07 Solid cash process through the process

08 Comprehensive dataroom and no hidden skeletons

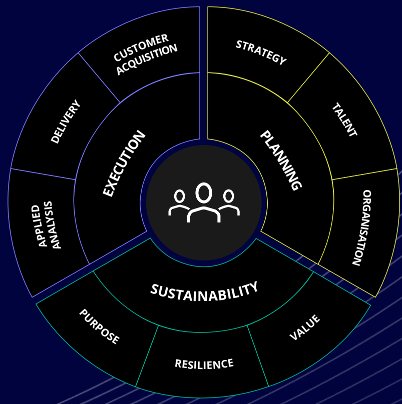
Running a great process

09 Aligned Board and Investor base

10 Strong reputation with Investment Bankers

11 Urgency in the final process

The CEO’s M&A Timetable



Execute against your business plan

T-18/24 months

Establish a list of creditable acquirers and key decision makers.

Meet with these people to determine the strategic fit, the synergy with each, and to build rapport.

Meet with investment bankers active in your space, not to say you are for sale but to gather market intelligence.

Get a realistic sense of what the market will pay for your company and on what basis (e.g. revenue multiple, EBITDA, tech)

T-12 months

Establish a list of creditable acquirers and key decision makers.

Do a due diligence readiness test across the business
(e.g. legal, finance, tech).

Start pulling together the data room.

Ensure increased level of marketing activity and PR (e.g. constant flow of good news, customer wins, deployment, customer testimonials).

Shortlist bankers and appoint one if and when appropriate. (You may not want or need a banker.)

Ensure the banker can pitch the business as well as you can. Ensure your corporate lawyer is good enough to lead you through M&A or select another.

Get alignment of the board and key share-holders, and set realistic expectations on M&A price. Ensure you will be well funded through the duration of the process.

T-3 months

Try to get a term sheet, even if you don’t love the price.

Ensure the banker does their job in terms of maximising the value.

Have a regular weekly or bi-weekly call to keep everyone informed, and to hold your advisors to account.

Sign term sheet with one party.
Ensure any sensitive issues are discussed with the buyer to avoid them being surprised during due diligence.

Complete due diligence.

Close the transaction

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