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Acquisitions—Getting a Good Deal

Is Microsoft's bid for Yahoo a good deal? Was JP Morgan's Bear Stearns deal a win? Did YouTube score big with their $1.65B acquisition by Google? The answers depend, on whom you ask and their perspective. Getting a good deal also has a lot to do with business decisions that are made in advance of the deal.

At a recent Northwest Entrepreneur Breakfast meeting former CleverSet CEO Todd Humphrey did something few executives ever do. He lifted the curtain on CleverSet's acquisition by ATG earlier this year. In the process he shed light on the varied and complex issues to consider when planning an exit and determining if a deal is good, or not.

An entrepreneur at heart, Todd Humphrey spent most of his career leading early-stage technology companies in a variety of executive management roles. Prior to running CleverSet he was part of the management team at Apex Learning. He also has an investment background, spending time as a VC insider while working with two different Venture Capitalist firms. Earlier he was on the founding team of Triax Capital, a private financial services firm that managed assets of $1.8 billion prior to its acquisition.

Fast forward to 2008. In less than three years Humphrey led CleverSet on a path to turn a $3 million investment into an $11 million exit. These are the behind the scenes decisions that drove the deal, and key considerations for any entrepreneur considering a future exit strategy.

VC vs. Angel Funding

Funding choices directly impact the business and exit options. Todd Humphrey cautions, "If at all possible, be selective with your investors." If you have your exit it mind at the start, it can help drive the right decisions. For example, CleverSet looked at both Venture Capitalist (VC) and Angel investment options. Ultimately they chose Angel funding. Although the choice broadened their exit options, the decision came with trade-offs.

Executive Insights

Cheryl Isen ▼

The pro's of working with VC's were hard to walk away from. They included more money for growth; the ease of managing one firm and easier follow on investments. However, the con's were critical. VC's tend to exert more control over the team and gain financial control of the company, strategy and exit. Ultimately a larger VC investment can also narrow exit options.

For example, most VC's that choose to invest in a business look for a 5-10 times return on their investment. Given that most minimum VC investments start at $5 million, when an investment return is estimated at 7.5 times investment (the middle point between 5-10X), a $5 million dollar VC investment requires an exit offer of $37.5 million. Company executives need a clear understanding of their market to determine whether exit numbers reflect realistic market acquisition prices.

Humphrey's experience with Angel's was significantly different. First, Angels provided overall better investment terms, had more realistic outcomes and timeframe expectations, and were involved as needed with the business, including offering critical connections. However, working with a pool of Angels took considerable time. Both in terms of managing their involvement and the time required to gather funding. With Angels be aware that time will be taken away from the business to manage the people behind the investment, including their ideas and expectations. Nonetheless, the math behind an Angel investment can create broader exit strategy options.

For example, the 1.5 times investment return that most Angels expect from an investment is significantly smaller than that of VC's. Doing the math, if a company collects $3 million from a pool of Angels, a 1.5 times return means that a good exit can start at as little of $4.5 million. The trick of course is being able to grow your business on a shoe string.

Obviously business growth is impacted by funding choices. Before selecting a funding option, Humphrey advices knowing what the critical exit strategy drivers are in terms of evaluation or valuation. For example, do you need to acquire customers, users or visitors? Is building revenue most important. Or is it most critical to rise above the competition with market and PR momentum? How much will it cost to fund these growth drivers? Although big growth on a minimal budget is hard, it can be done.

Deal or No Deal

Like the TV show, knowing whether to take the deal or not isn't easy. CleverSet considered three critical questions:

1. Does the math work?
2. Could/will competitors do this deal?
3. Why shouldn't we do this deal?

CleverSet determined that the math behind the $11 million dollar offer worked--especially after less than three years spent building the business. However, determining if the deal was good relative to market opportunities was also critical. Humphrey considered five crucial competitive questions:

- How is the business scaling compared to competitors?
- How much runway (time and money) do we have vs. them?
- How many new competitors are there now?
- Could the competition do the deal today?
- What if they do the deal and we don't?

In assessing their answers CleverSet felt strongly that they could impact the market more as part of ATG vs. alone. So, even though they didn't make Google-like headlines, was the deal good? Humphrey's answer is a resounding yes. His proof: happy investors, employees and an excellent transition into the ATG fold which is providing even greater opportunities to impact the market.

These "Executive Insights" are based on monthly presentations provided by leading entrepreneurs at the Northwest Entrepreneur Network (NWEN.org), a non-profit organization dedicated to helping entrepreneurs succeed. The column is written by Cheryl Isen, founder of Isen & Company, a strategic marketing and public relations firm that helps emerging companies increase corporate visibility and brand awareness Contact Cheryl at (425) 222-0779, Cheryl@IsenandCo.com or on the web at www.IsenandCo.com.