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READY FOR NEXT

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The Case

A brother and sister co-founded a growing flow controls software company 12 years ago. Both are now in their mid-40's. The sister is married with two kids who are approaching college age. The brother is going through an acrimonious divorce. His current spouse is publicly alleging he is having an affair and has purposely concealed assets she is entitled to.

The divorcing brother owns 51% of the S-corporation shares, but for voting purposes the two treat their equity as equal. Despite the brother and sister treating their equity as equal, indicating a close partnership, they often have differing views on control and decision-making. The sister is concerned her brother's ongoing divorce proceedings, including allegations of concealed assets, could be causing personal stress that may impact his focus and decision-making within the company.

The current valuation of the company, based on industry benchmarked EBITDA multiples for profitable publicly traded SaaS companies, is approximately \$220 million but they have not had a formal independent valuation. The owners have been discussing a potential exit at \$300 million, which they believe will provide them with the necessary liquidity to retire successfully but also potentially start another business. The sister, who has meticulously planned her finances, has very different financial priorities than her brother, who is facing an expensive divorce and financial strain.

They have had some early-stage conversations with investment bankers regarding selling their business now, but they remain undecided. Two weeks ago, they were approached by a reputable private equity group interested in taking a 60% preferred equity position and providing additional convertible debt capital to enable a series of potential acquisitions that could rapidly double the size of the company. The PEG floated an indicative value of \$105 million and will commit up to \$35 million to support leveraged acquisitions over the next few years. The owners have always bootstrapped growth based on available cash flow so the access to additional capital has their attention.



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Operationally, they feel the company is on sound footing, although sales have slowed slightly over the last 12 months. Their growth rate is still positive but it's a concerning development. According to their VP of Sales, it's a temporary blip that will be corrected in the near future. Unfortunately, revenue forecasts have been more unreliable than they would like. A fresh competitor has entered the race and in the next subscription renewal cycle they will find out whether their market share will take a hit. They have asked the CFO to prepare a scenario analysis that includes new capital investments that may be necessary to keep up with new technology. Their software may need significant upgrades, particularly the area of cybersecurity protocols and requirements.

These issues are a first for them and the leadership team. The brother sees some clouds building on the horizon but the sister is more confident if they have to pivot. She designed the software to be agile. Her brother is not a technician; he is far better at sales and operations. It has been a good partnership so far, but she has to wonder whether their team is prepared to manage effectively through a downturn in sales or big shift in the marketplace. Concerns have been raised by the sister about the strength of the company's leadership, succession planning and leadership development, but the brother has been dismissive of her concerns.

They are unsure whether to move forward with the PEG investment. Would it solve or create problems? They've never had an outside partner and the adjustments would be challenging. While the brother is considering selling the company for liquidity, the sister believes in its potential for growth and is hesitant to sell and has growing anxiety that a potential conflict of interest between personal and business objectives is on the horizon. They have always run the company as a family-owned business. A friend mentioned a Board of Advisors might be a helpful sounding board but they never acted on it.

A fellow entrepreneur who successfully exited her company has suggested they hire an advisor to conduct a deep pre-transaction analysis to identify potential risks and success factors (value drivers and killers) that may affect, for better or worse, price and terms. Ultimately, they want the advisor to help them make a decision about whether to pursue the PEG partnership.



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Fact Pattern

- S-corporation, owned 51/49% by two siblings, equal voting rights on certain matters.
- \$38 million revenue, 27% net profit margin.
- Revenue Compounded Annual Growth Rate averaged over the last three years has been 17% but is slowing modestly, possibly temporarily.
- 228 employees, all full-time. Independent contractors used as needed.
- Two customers together represent 30% of revenue, 15% of pre-tax profit.
- 45% of the customer base are approaching software three-year resubscription decisions within the next six months. Pricing negotiations are underway.
- Products and services include SaaS, solution design, installation and support.
- \$4 million cash on hand.
- Current assets are \$11.4 million.
- Current liabilities are \$12.6 million, including current portion of payroll/taxes, accounts payable and \$6 million in short-term debt. \$3 million of the short-term debt is due in six months.
- There are two material long-term liabilities: a loan from their father for \$2.5 million with no defined maturity, and a seven-year bank loan for \$15 million (which matures in three years). Both loans are personally guaranteed. The bank loan is also secured against the assets and stock of the company.
- On average, the owners each take \$2 million a year through a combination of shareholder distributions and salaries. Their salaries are below market for comparable positions.
- Their office space is rented. The lease matures in two- years and they anticipate a substantial rent increase due to the hot real estate market.



CASE STUDY

Industrial Flow Controls Software

Industry Benchmarks:

EBITDA multiples (NYU Stern)

- 21.33X (companies with positive EBITDA)
- Dataset: 390 comparables

Median EBITDA % benchmark (Revtek Capital)

- 37% for publicly-traded companies

Common SaaS Company Financial Health Metric ("Rule of 40")

- Add revenue growth rate + EBITDA margin
- Greater than 40 = doing well

Median rev per employee (for comparable revenue size)

- \$167,333

Median cash on balance Sheet (for comparable revenue size)

- \$1,318,517

Median Annual Growth Rate for "bootstrapped" SaaS companies

- 28.5%

Questions:

1. What risks do you see? Classify the risks into five categories: strategic, operational, financial, regulatory and reputational and complete the applicable online form.
2. What are the most impactful drivers of value in this case?
3. If the owners decide to pursue the PEG investment, what do you think would concern investors the most?
4. What personal issues might impact the decision whether or not to pursue the PEG opportunity?
5. Acting as their advisor, what would you recommend as a first next step?

