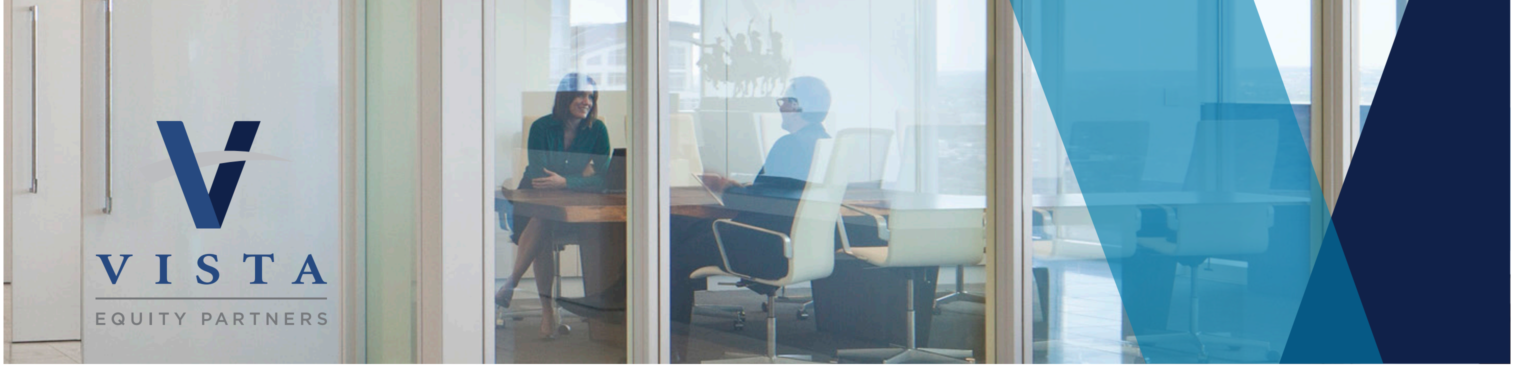

EVALUATING AN OUTSIDE INVESTOR

Bringing in an outside financial partner is a transformational decision that has the potential to yield many positive benefits. However, before doing so, this decision requires business owners to weigh a number of key considerations.

An investment partner has the power to help a business achieve tremendous growth. They can also bring a wealth of experience from previous investments, as well as the expertise needed to grow sustainably and successfully. However, with no guaranteed outcome, pursuing investment can be daunting to even the most seasoned entrepreneur. For this reason, it is important to understand exactly what a would-be partner can bring to the table beyond the capital gain.

PARTNERSHIP

TIPS

Value-add: It is important to understand exactly what the partner brings to the table in terms of value-add. The elevator pitch often sounds very similar, but the specific details are the key to understanding how they can help you take your business to the next level.

Interpersonal relationship: The strength of the interpersonal relationship is always a key building block. Trust, respect, and alignment are the foundation of a good partnership.

Mutually vested: An investor who is mutually vested in your long-term success will have a deep understanding of and interest in your company's idea and the industry; they will have experience growing a business with similar challenges and idiosyncrasies, and they will want to help grow your company beyond its monetary capabilities.

QUESTIONS

BUSINESS

- For inorganic growth, what value does the investment partner offer their companies beyond the transaction execution?
- Can they build out a holistic M&A strategy aligned with a broader vision?
- What track record does the partner have with successfully integrating add-on acquisitions to realize the intended value?
- Can the investment partner also help with organic growth?
- Can they help grow the business through new customers, help increase sales into your existing customer base, or assist with new product or service development?
- What is the partner's history of success in developing viable, sustainable growth strategies?
- Are there executives at portfolio companies that you can talk to? Would these executives work with the partner again, and have executives worked with the partner multiple times?
- Does the partner have a platform for operational innovation?
- Are there investment case studies available?

PEOPLE

- Does the partner have an operations team, and, if so, how many people are on it? What are their qualifications? Do they have functional experts as well?
- Does the partner assist with talent development? At what levels (C-level, VP, line manager, etc.)?
- Does the partner sponsor any cross-portfolio sharing, systems, or operational whitepapers?

MAJORITY VS. MINORITY INVESTMENT

TIPS

The pros and cons of majority vs. minority are not as straightforward as they appear. Often, it is not the type of investor you need to consider but the terms of the deal that is brokered.

Understand what you're agreeing to: When considering your options, be sure to understand the actual economic structures, operational covenants, and reporting requirements of each deal, as well as the effective implications.

Make sure you're on the same page: Having a strong alignment of incentives is critical to a strong partnership. It is important to be "eyes wide open" from the beginning.

QUESTIONS

MAJORITY

- Is the CEO on the board?
- How do the CEO and partner work together on long-term strategic goals, current year strategic plan, and tactical deliverables?
- What is the regular cadence of interaction with the partner?

MINORITY

- Does the partner have an operations team, and, if so, how many people are on it? What are their qualifications? Do they have functional experts as well?
- Does the partner assist with talent development? At what levels (C-level, VP, line manager, etc.)?
- Does the partner sponsor any cross-portfolio sharing, systems, or operational whitepapers?
- What is the regular cadence of interaction with the partner?

ACCESS TO CAPITAL

TIPS

A reputable investor: Seldom will an investor put all the money on the balance sheet. As a result, your investor must have the right connections and reputation within the market to continue to float your investment. The flexibility of your investor and their ability to continue investing in your company as the needs evolve can be a huge advantage.

Value Creation: Investors are subject to their own unique fund dynamics, and these can change the true incentives behind the capital committed to a deal. To be aligned on value creation, it helps to have a partner who takes the view of building a business for the long-term, views the deal as a significant investment in its portfolio, and has the available capital to drive organic and inorganic growth as needed.

QUESTIONS

EQUITY FINANCING SOURCES

- What is the largest check the partner can write?
- Will the partner need to "syndicate" or "club" its investment? Spread across different funds?
- What amount of uncommitted capital does the partner have?
- When was the applicable fund raised, and what is the remaining fund life?
- Will this be a significant sized deal within the portfolio?

DEBT FINANCING SOURCES

- What is the partner's philosophy on debt as part of the capital structure? Is it the only option?
- Who are the key lenders that the partner uses, and how long have they had those relationships?
- What type of debt does the partner use (senior debt, mezzanine debt, lender warrants)?
- Will there be any contingencies on debt financing in closing a deal?
- Has the partner ever missed or delayed an interest or principal payment?

CLOSING THE DEAL

TIPS

When dealing strictly with dollars, and not a partner's value-add or valuation, speed and certainty to close are key variables to consider.

Speed: Closing a transaction can take time and attention away from running a business. As a result, speed to close is important when assessing a possible transaction.

Certainty: Having a potential partner walk away at the end of a deal is the worst-case scenario. Pick a partner who knows you and your type of company extremely well (minimizing the chance of last-minute surprises) and has a track record of keeping their word.

QUESTIONS

VALUE AND FORM CONSIDERATION

- What price is ascribed to the business and how was that price determined?
- Is the deal all-cash or are there other forms of consideration (earn-outs, deferred payment, etc.)?
- Is there an opportunity for the management team to rollover and partake in additional upside?

  -What type of security would the rollover equity holders receive? Is it equal in all respects with the new investor?

  -What have returns been? Are they consistent? Has the partner ever not made its money back?

SPEED AND CERTAINTY

- How many platform software transactions has the partner done in the last three years? Are there similar companies in the portfolio?
- What timeframe does the partner need for business and confirmatory due diligence? What has been the timeframe from exclusivity to close on its most recent deals?
- How many deals have been in exclusivity in the last three years? How many did not close?
- What sort of regulatory or internal approvals are required?
- How large is the software-focused team (number and percent of professionals)?

ADDITIONAL CONSIDERATIONS

Board of Directors: Will the CEO receive a board seat, have required ownership thresholds, or participate in board meetings and on committees?

Liquidation Preference: Will there be a liquidation preference of a PIK (payment-in-kind) feature?

Transaction Rights: Will there be a "drag along," "tag along" and other transaction-related rights?

Call Rights: Will there be call rights and under which sort of scenarios?

Investment Security: Will there be different securities and a separate shareholder's agreement?

Reporting and Notice: Will there be access to financial statements, budgets and other corporate documents?

Transfers: Will there be restrictions on transfers and if so, what exceptions exist?

READ MORE INSIGHTS FROM TOP VISTA LEADERS

401 Congress Avenue, Suite 3100, Austin, TX 78701
512.730.2400
Vista@VistaEquityPartners.com
VistaEquityPartners.com