

*Merging two software companies held by different partnerships within the same venture firm required outside valuations to validate that the deal was fair*

## Merger of Two Private Companies Enabled by Independent Valuations

A venture capital firm with investments in two companies believed that it made sense to merge them. But, the firm needed assistance in overcoming concerns about conflict-of-interest voiced by its limited partners and by other venture investors in the companies. Professionals from Teknos provided valuation reports to support the proposed exchange ratio and overcome skepticism.

### CHALLENGE

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A leading venture capital firm had made investments in two companies in the same industry. The investments were made several years apart and from different funds.

The older company had done well and had accumulated some cash on its balance sheet. But, lately, its growth had slowed. The younger company seemed to have more potential. But it needed funds to continue its rapid growth and turbulent market conditions were making it impossible to raise new money.

The venture firm had introduced the two companies to one another and the managers of the companies liked the idea of a merger. On their own, they had worked out many of the terms of a combination: location, product strategy, management succession. But they were unable to agree on a price.

### SOLUTION

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Teknos was hired by the venture capital firm to set a range of values for each company in the private-to-private merger and to provide comfort about those values to the venture capital firm's limited partners and syndicate co-investors.

## *Analysis of Situation*

Initially, counsel for one of the companies had suggested hiring two investment banks and obtaining two fairness opinions. The fairness opinions would have provided comfort to the limited partners and co-investors, but fairness opinions would not have helped establish the value of each company and the resulting exchange ratio. Plus fairness opinions would have been many times more expensive than valuation reports.

Instead, Teknos proposed providing two valuation reports, each to show the value of one company. After a suitable time, to ensure that management and investors of each company agreed with the results of the work, the reports could be exchanged and used to determine relative value.

## *Process and Outcome*

We created two separate valuation teams and staffed them with different Teknos vice presidents and analysts. They met separately with the two companies to obtain information. Each valuation process was different, in recognition of the different stage each company had reached. The valuation of the older company relied primarily on an asset approach, noting the substantial cash and intellectual property that had accumulated. The valuation of the younger company relied primarily on an income approach, calculating the present value of projected high future cash flows, appropriately risk adjusted.

The reports were ready in less than a week and presented to each company's management team and board of directors. Shortly after that, the reports were swapped. After some negotiations, an exchange ratio was fixed at a number for each company within the range of values suggested by Teknos.

After the closing we were available to help the management of the acquiring company with valuing the intangible assets of the acquired company, as required by FASB Accounting Standards Codification Topic 805, *Business Combinations* (ASC 805, formerly FAS 141R).

*Teknos Associates is a valuation firm which serves emerging growth companies and their venture capital backers. We are a team of experienced and credentialed valuation professionals with backgrounds in appraisal, accounting, investment banking, and venture capital.*

*We provide appraisals to facilitate compliance with a variety of tax and accounting requirements, including option issuance and portfolio valuation. We support merger and acquisition activities with independent fairness opinions. And we offer valuations of intangible assets and liabilities after an acquisition.*

*We have produced hundreds of valuation reports quickly and economically, without sacrificing quality. Our reports have stood up to scrutiny by Big Four audit firms, the IRS, and the SEC. Contact us at to see how we can help you.*

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