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Pigs Get Fat, Hogs Get Slaughtered…Always and Forever

I can't tell you how many times in my investment banking careers – the first doing Wall Street deals in the 1990s and my current serving the small and middle market with sell-side and capital-raising advisory services – I have seen companies try to get everything perfect in their own house before accessing the capital markets or pulling the trigger on a sale process, only to have the whole plan backfire when the markets correct and every potential investor runs for the exits like in a theatre on fire. The timeless capital markets maxim is that an ideal situation for a company seeking an exit or capital is when the company is perfectly positioned and there is a tailwind in the capital markets. But those times are relatively rare. The more common situations are that (1) the company is not in tip-top shape but the market tailwind is strong, and (2) the company is ideally positioned but the market is blowing a headwind. In the first situation, deals are still very doable and often at very good valuations. In the second, they aren't, at least at anything above a fire sale price. Every good investment banker is constantly advising companies to always work on improving the situation they can control, but don't let the lack of improvements keep them away from selling or financing – if that is what they need or want - when a market tailwind exists.

We have intimate knowledge of a situation right now that is a perfect example. A fast-growing company in highly fragmented but rapidly consolidating industry – one that was fueled by exciting, disruptive technology that in turn drove the major disruption of a number of huge, well established industry players – entertained the idea of selling about 14 months ago. Given the pace of consolidation and the high valuations accorded those companies with the best, most disruptive technology and market strategies, we advised them to immediately initiate a sale process that we estimated, based on market comparables, could produce a sales price of approximately $60MM, and possibly as high as $90MM. We advised that market frenzies in which it was immersed are infrequent and the company should hurriedly capitalize on the favorable conditions. The company and its investors, some of whom are name brand VCs and should have known better, decided to focus instead on polishing the company's business model and execution, hoping that the company's improved performance and an even frothier market would produce an even higher valuation. Well, you know how this story goes.

Fourteen months later, the company is now finally involved in a sale process – one that was started about 6 to 9 months after our advice was rejected. But market conditions have changed dramatically. A full-blown industry shakeout is happening, public company comparables have plummeted, and no one wants or is able to go out on a limb and pay anywhere near what the company was worth just over a year ago. Granted, the company is much stronger today from both earnings trend and technical risk standpoints, but it is irrelevant to the market. The market headwind is strong and a sale above $20MM is unlikely. In fact, sale may be impossible. If so, the company needs cash if it is going to stay independent, but raising cash will be very difficult given market conditions. In sum, the company's future, indeed its existence, is at great risk as a result of its decision to wait and try for a nine-figure (or about a 10X multiple of investment) outcome when it easily had a $50MM (or about a 5X MOI) exit in its reach.

David M. Traversi

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