VMS Ventures (“VMSV”) M&A initiative structure

A new VMS strategy to help acquire business with an embedded, loss-making initiative.

Motivation

We have encountered several situations where there is an initiative embedded within an M&A target. These initiatives are often canceled post-acquisition to increase profit, even if the initiative has strong growth potential. Furthermore, even the strong initiatives are usually valued at $0 or less by the businesses looking to acquire them. The goal of this structure is to allow the strong initiatives to proceed, while providing a means to have the initiatives positively valued prior to the acquisition, without increasing the risk to the Operating Group or Portfolio.

Please note that all the criteria below are meant as guidelines rather than inflexible rules. We are always happy to have a discussion on the specific circumstances of an acquisition.

Criteria

- The initiative must be capable of reaching at least $5 million in annual revenue within 10 years. Note that this is lower than the usual VMS threshold of $10 million.
- The initiative must have a leader or leadership team that will continue to run the initiative.
- The initiative must either be revenue generating or have sunk costs of at least $1 million. In other words, it should be more than just a PowerPoint presentation.
- The acquisition target’s management team or vendor must be willing to co-invest in the initiative. This generally means reinvesting some of their proceeds from the sale of the company back into the initiative.

Deal Structure

- The deal will take place on completion of an acquisition. The initiative will be set up as an independent legal entity. Both VMSV and the vendors will inject cash into the new entity in exchange for an equity stake. The remaining equity stakes will be held by the initiative’s employees and the CSI Operating Group or portfolio.
    - The exact capital structure will depend on the amount of cash required and the specifics of the initiative. However, we would expect that both the management team and VMSV would end up with at least a 25% stake.
    - The Operating Group will have the option to invest their own capital as well, in exchange for a higher equity stake. We do not expect them to do this often. If the Operating Group was willing to fund the initiative, they could simply do this without involving VMS.

- The deal will include a call option for the Operating Group on the 6th anniversary of the initial closing date. The call options will be at a preset multiple of the previous year’s revenue.

- If future investments are necessary, both VMSV and the Operating Group will have the opportunity, but not the obligation, to participate in future funding rounds.
    - Realistically, the round would be led by VMSV, with the Operating Group having the option to participate.
    - The call options would apply to these shares as well.

Advantages for the Operating Group or Portfolio

- If the vendor is keen on their initiative, this will make our acquisition package more enticing to them.
- Provides a less risky way for an Operating Group to invest in acquired initiatives. The Operating Group would not be paying for the initiative as part of the M&A transaction, and they would not be required to invest further in the loss-making initiative.
- There is no immediate impact on the P&L (and bonus) of the Operating Group.
- The Operating Group still has an easy path to own the entire business if the initiative succeeds.
- One piece of feedback we’ve received is that the operating group would not want to lose any employees to the initiative on closing while the business is being integrated into CSI. In these cases, we could consider a 6 month “transition period” for the relevant employees.