

Applied Private Equity and Venture Capital



Course 2

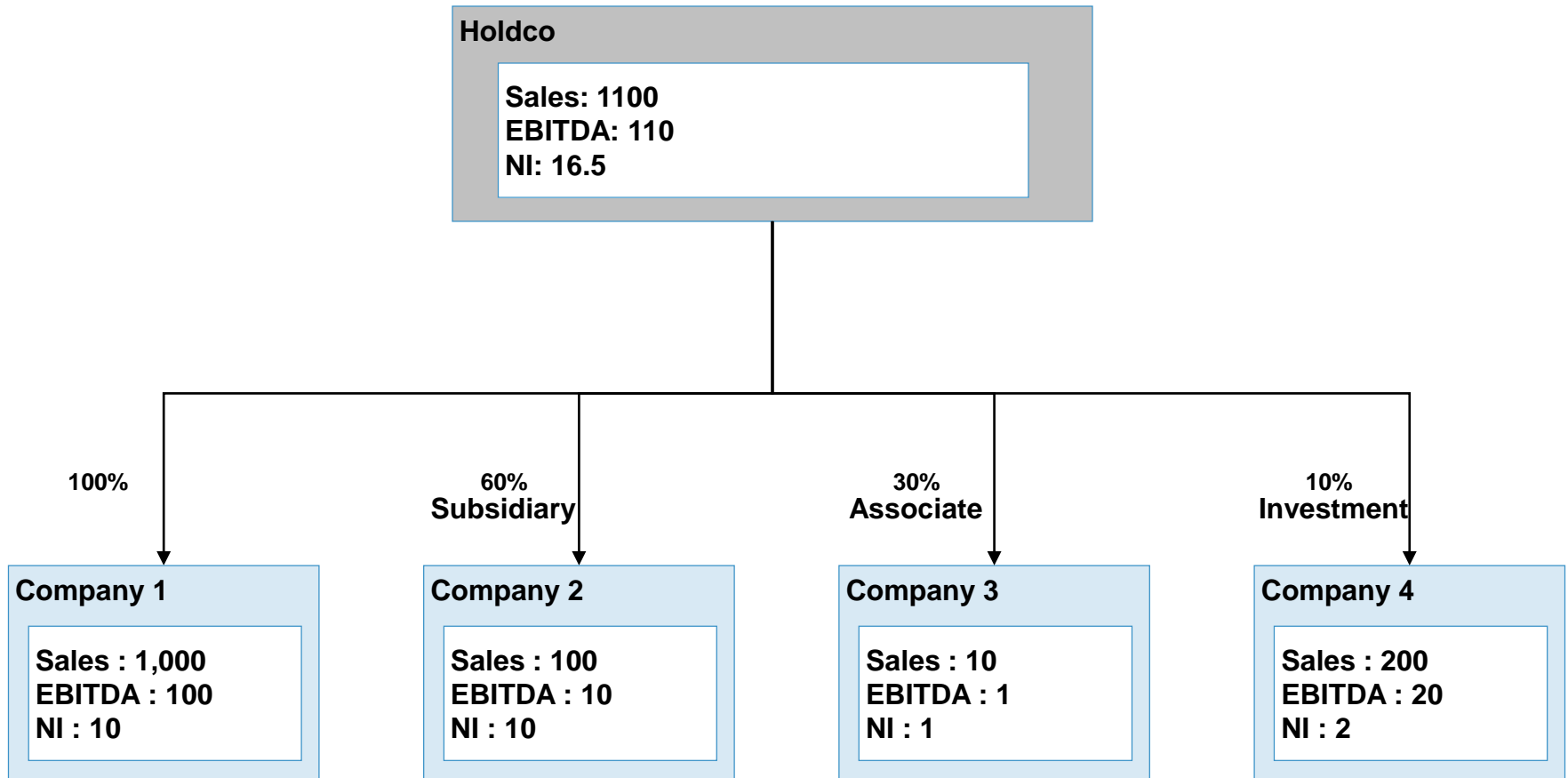
Nicolas Renaud

And Now for Something Completely Different...

Basic Financial Concepts

Consolidation

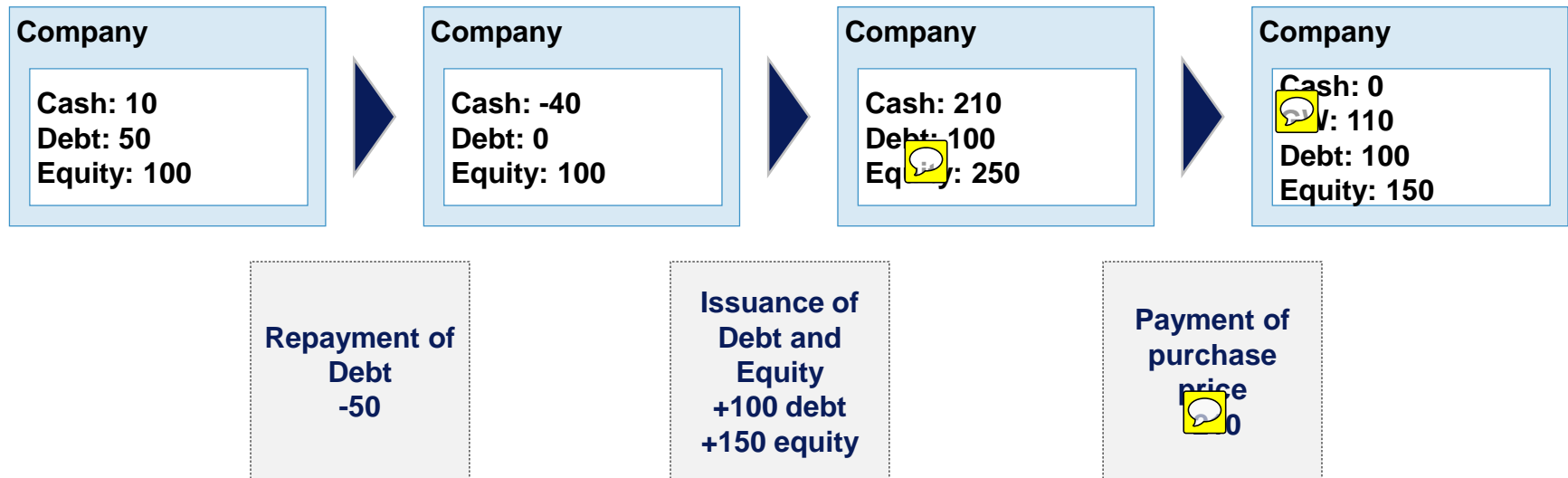
- Please see any good accounting book



Note: for all, assumes full amortization

Acquisition accounting

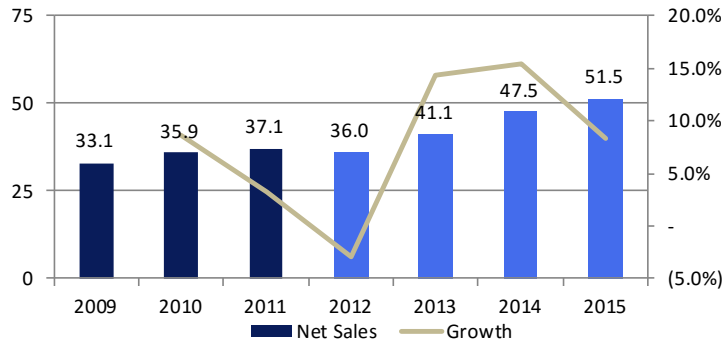
- Please see any good accounting book
- Assumes acquisition for EV of 250 financed by 100 of debt and 150 of equity



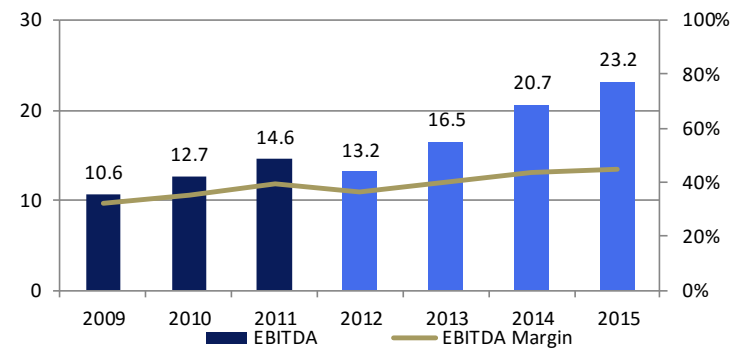
Note: under Canadian GAAP, acquisition costs are no longer capitalised

P&L Overview

Evolution of Sales



Evolution of EBITDA



Summary P&L

As of December-31	Historical							Projected		CAGR	
	2009	2010	2011	2012	2013	2014	2015	09 - 11	11 - 15		
\$ M											
Revenue	33.1	35.9	37.1	36.0	41.1	47.5	51.5	5.9%	8.6%		
<i>Growth</i>		8.6%	3.2%	(2.9)%	14.3%	15.5%	8.3%				
COGS	(13.6)	(13.8)	(13.3)	(13.8)	(15.3)	(17.2)	(18.2)				
Gross Profit	19.5	22.1	23.7	22.2	25.8	30.3	33.2	10.3%	10.8%		
<i>Gross Margin</i>	59.0%	61.6%	64.0%	61.7%	62.7%	63.9%	64.6%				
SG&A	(4.4)	(4.8)	(4.3)	(4.5)	(4.6)	(4.9)	(5.2)	(1.3)%	4.9%		
Overhead Costs	(4.5)	(4.5)	(4.5)	(4.5)	(4.6)	(4.8)	(4.9)				
EBITDA	10.6	12.8	15.0	13.2	16.5	20.7	23.2	18.6%	11.6%		
Adjustments vs Special Purpose Financials	-	(0.1)	(0.4)	-	-	-	-				
EBITDA adj.	10.6	12.7	14.6	13.2	16.5	20.7	23.2	17.2%	12.3%		
<i>EBITDA Margin (excl new inv.)</i>	32.2%	35.5%	39.4%	36.6%	40.1%	43.5%	45.0%				
Net income adj.	10.6	12.7	14.6	3.9	4.4	6.6	8.0	17%	(14%)		
Capex	2.3	5.5	1.4	3.3	6.6	4.6	5.1	(21%)	38%		

Summary Balance Sheet

- Balance sheet is always divided between short and long term
- Balance sheet present a Photography of the company

Summary Balance Sheet

\$ '000 - As at 31 Dec 2011

Assets		Liabilities	
Accounts Receivables, Net	2,405	AP & Accrueds	1,635
Prepays & Other Current Assets	397	Accrued Capital Expenditures	116
		Other Current Liabilities	625
Total Current Assets	2,802	Total Current Liabilities	2,377
Property & Equipment, Net	60,639	Other LT Liabilities	13,236
Other Assets	416	Advances from Parent	482
		Shareholders' Equity	47,763
Total	63,858		63,858

Note: under Canadian GAAP and IFRS, GW does not amortize

Cash Flow Statement

CASH FLOW STATEMENT

<i>(in US\$'000)</i>	<u>2012F</u>
Net income	3,667
Depreciation and amortization	5,519
Capitalized Interest	-
Working Cap Requirements	27
Operating Cash Flow	9,213
Sale of Fixed Assets	-
Capital expenditures	(3,292)
Investing Cash Flow	(3,292)
Purchase of Performance Shares	-
Repayment of new senior debt	(1,267)
Repayment of new subordinated debt	-
Capex Financing (net)	300
Financing Cash Flow	(967)
Total cash flow	63

Balance Sheet & Cash flow Statement

SUMMARY BALANCE SHEET

\$ '000 - as at 31 dec 2011

Assets	Liabilities
Cash	Overdraft etc
Accounts receivables	Accounts Payables
Inventory	ST Debt
Prepaid & other	Other
Current Assets	Current Liabilities
PP&E	LTD Debt
Goodwill	Equity

BS and CF can be summarized using:

- P&I items
- Debt items
- C items
- Capex items

SUMMARY CASHFLOW STATEMENT

\$ '000 - as at 31 dec 2011

Net income
Depreciation and amortization
Capitalized Interest
Working Cap Requirements
Operating Cash Flow
Capital expenditures
Investing Cash Flow
Repayment of debt
Issuance of debt
Dividend
Financing Cash Flow
TOTAL CASH FLOW

Note: under Canadian GAAP and IFRS, GW does not amortize

Forecasting through Schedules

- All important items can be adequately forecasted using simple schedules

Debt Schedule:

Senior Debt - Beginning

Senior Debt Issued

Senior Debt Repayed

Senior Debt - End

Interest on Senior Debt

Investment Schedule

PP&E Beginning

Maintenance capex 

Growth capex

Depreciation

Ending Balance

Working Capital Schedule

Days of

Accounts Receivable  Sales

Inventories COGS

Accounts Payable COGS

Enterprise Value



Enterprise Value

- **Not Debt**
(all debts – Operating cash & cash equivalents)
- Off balance sheet items
(unfunded pension liabilities, leasing obligations etc)
- **Minority** interests
- + Investment in associate (at market value)

= EQUITY

Exercise

Which bank loan is best :

\$1.0 M , capital payments of \$200 k for 5 years and interest of 5% calculated on opening balance

\$1.0 M , no capital payments until term and interest of 5.3% calculated on opening balance

Quick Questions:



Define WC

Define GW

If risk free rate go up how are valuation affected?



The Different Financing Sources Available

- In Canada / Us true Mezzanine is not available due to absence of Mother – Daughter fiscal integration
- The goal of the entrepreneur is to lower as best as he can his cost of capital
- Main strategy involve delaying as much as possible capital raising to optimise leverage
- Some variation include:
 -  **TRK**
 - Revolver
 -  **Convertible**
 - Mandatory convertible
 - Hybrid
 - Bullet
 - Sukuk

1 Equity

- Most expensive type of capital
- The only one available at the beginning and the cushion for debt investors

2 Subordinated Debt

- **13% - 18%+ fairly expensive type of capital**
- Similar to equity but with a tax shield effect
- Used primarily for tax reasons, to increase leverage, to avoid diluting entrepreneur

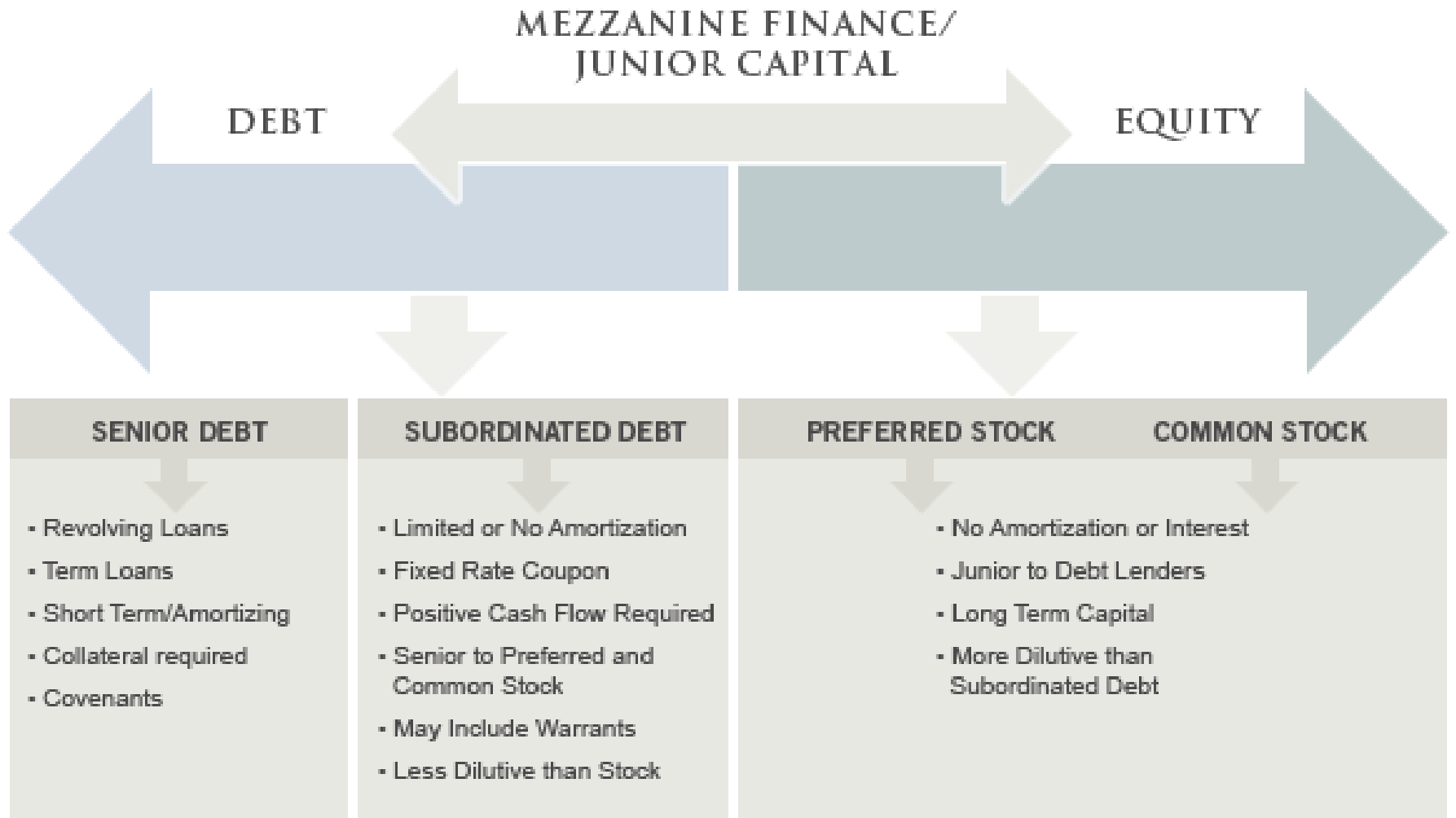
3 Senior debt / bonds:

- Cheapest source of capital
- Bank financing, subject to strict covenants
- Usually amortizing term loan, can be a Bullet or very fashionable currently reducing revolving facility
- Typically require a minimum equity cushion of 40%

4 Subventions



The different Financing Sources Available





What is Value

- Value exclusively comes from economic profit
- Value is not price

- 1 Companies create value by investing capital at rate of returns that exceed they cost of capital**
 - Spread between cost of capital and ROIC
 - Invested capital is CAPEX + WC
- 2 Economic profit is the true measure of a company value:**
 - **(ROIC-cost of capital) * capital deployed**
 - The goal is to maximize capital economic profit
- 3 Value of a company is the present value of economic profit:**
 - + invested capital of course
- 4 This is very different than price:**
 - Demand meets offer
 - Sum of different expectations
 - No equilibrium in markets + future based pricing



Cash Flow?

- Income is not the primary goal per-se cash is the real factor

Net Income Overview

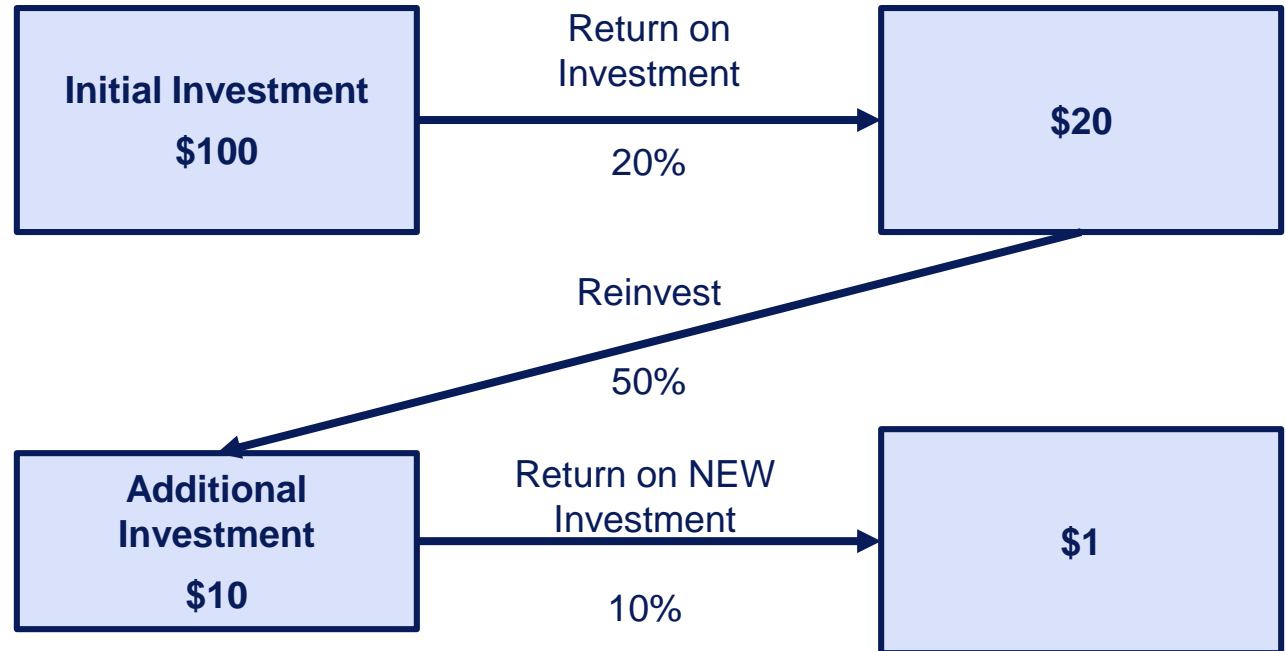
	2012	2013	2014	2015	2016
Company 1	100	112	125	140	157
Company 2	100	109	119	130	141

Cash Flow Approach

	2012	2013	2014	2015	2016
Company 1 earnings	100	112	125	140	157
Net investment	25	28	31	35	39
Earnings - Investmnet	75	84	94	105	118
Company 2	100	109	119	130	141
Net investment	12	13	14	16	17
Earnings - Investmnet	88	96	105	114	124

Cash Flow vs. ROIC

- If return on investment is constant, growth is essentially a factor of RONIC and investment rate



$$\text{GROWTH} = \text{RONIC} * \text{Inv. Rate}$$

Cash Flow vs. ROIC (Cont'd)

Cash Flow Approach					
	2012	2013	2014	2015	2016
Company 1 earnings	100	112	125	140	157
Net investment	25	28	31	35	39
Earnings - Investmnet	75	84	94	105	118
<i>Implied RONIC</i>	48%	48%	48%	48%	48%
Company 2	100	109	119	130	141
Net investment	12	13	14	16	17
Earnings - Investmnet	88	96	105	114	124
<i>Implied RONIC</i>	75%	75%	75%	75%	75%










Note: Returns favor higher reinvestment

Cash Flow Approach

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Company 1 earnings	100	105	110	116	122	128	134	141	148	155	163
Net investment	25	26	28	29	30	32	34	35	37	39	41
Earnings - Investmnet	75	79	83	87	91	96	101	106	111	116	122
RONIC	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%
Company 2	100	102	105	107	110	113	115	118	121	124	127
Net investment	12	12	13	13	13	14	14	14	15	15	15
Earnings - Investmnet	88	90	92	94	97	99	101	104	106	109	112
RONIC	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%

Main valuation Methods

Main Valuation Methods

 Multiples	 Transaction multiples	 DCF	 LBO
 <ul style="list-style-type: none">• Easy to implement• Less room for manipulation•  Inprecise / wrong• Sometimes difficult to find true comparables	<ul style="list-style-type: none">• Easy to implement• Difficult to obtain data for non listed companies• Skewed  by time	<ul style="list-style-type: none">• Precise• Theroretically corect• Difficult to implement• Lots of room for manipulation	<ul style="list-style-type: none">• More of an investment criteria than a valuation criteria

Free Cash Flow Formula

- To measure the cash provided by the company it is important to remember that you want it free of the capital structure of the company

EBITDA

-

**Reinvestment into
the business**

-

Tax

Free Cash Flow Formula

EBITDA

- Closest measure to operational performance
- least subject to manipulation

-

Reinvestment into
the business

- Capex
- Working cap 

-

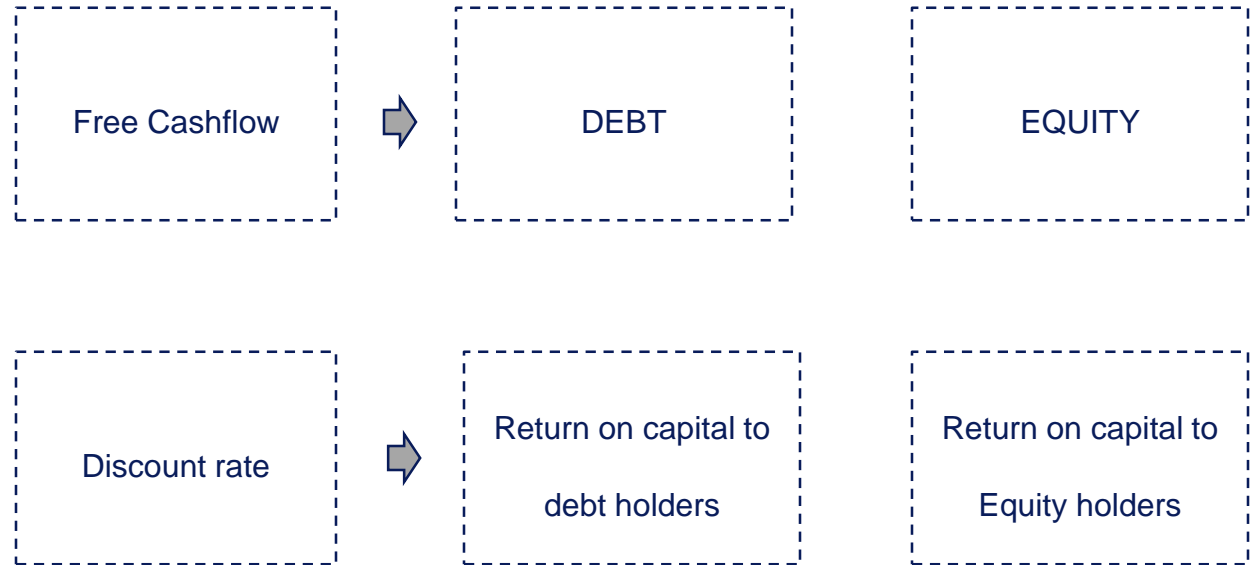
Tax

- Don't forget  depreciation tax shield

$$(1-T) \text{ EBITDA} + T \text{ D\&A} - \text{CAPEX} - \Delta \text{WC}$$

Discount Rate: WACC

- The WACC is the best way to reflect for the structure of capital in the discount rate



$$\text{WACC} = \frac{D}{D + E} (1 - \tau) k_d + \frac{E}{D + E} k_e$$

Discount Rate - Risk

- Risk is a measure of uncertainty
- As private equity investors we are not concerned about systemic risk but only about company specific risk

In finance, risk is a measure of the probability and magnitude of a difference between actual returns and expected returns

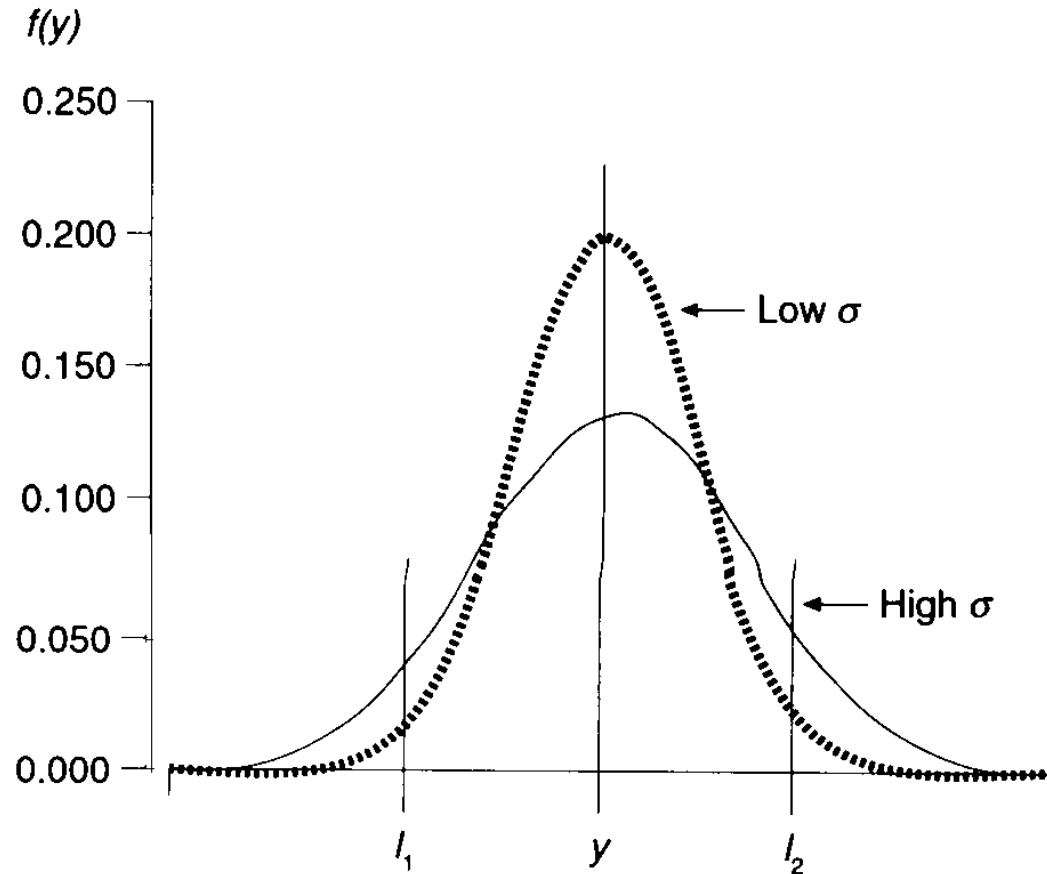
- There is 2 type of risk:

Systemic risk

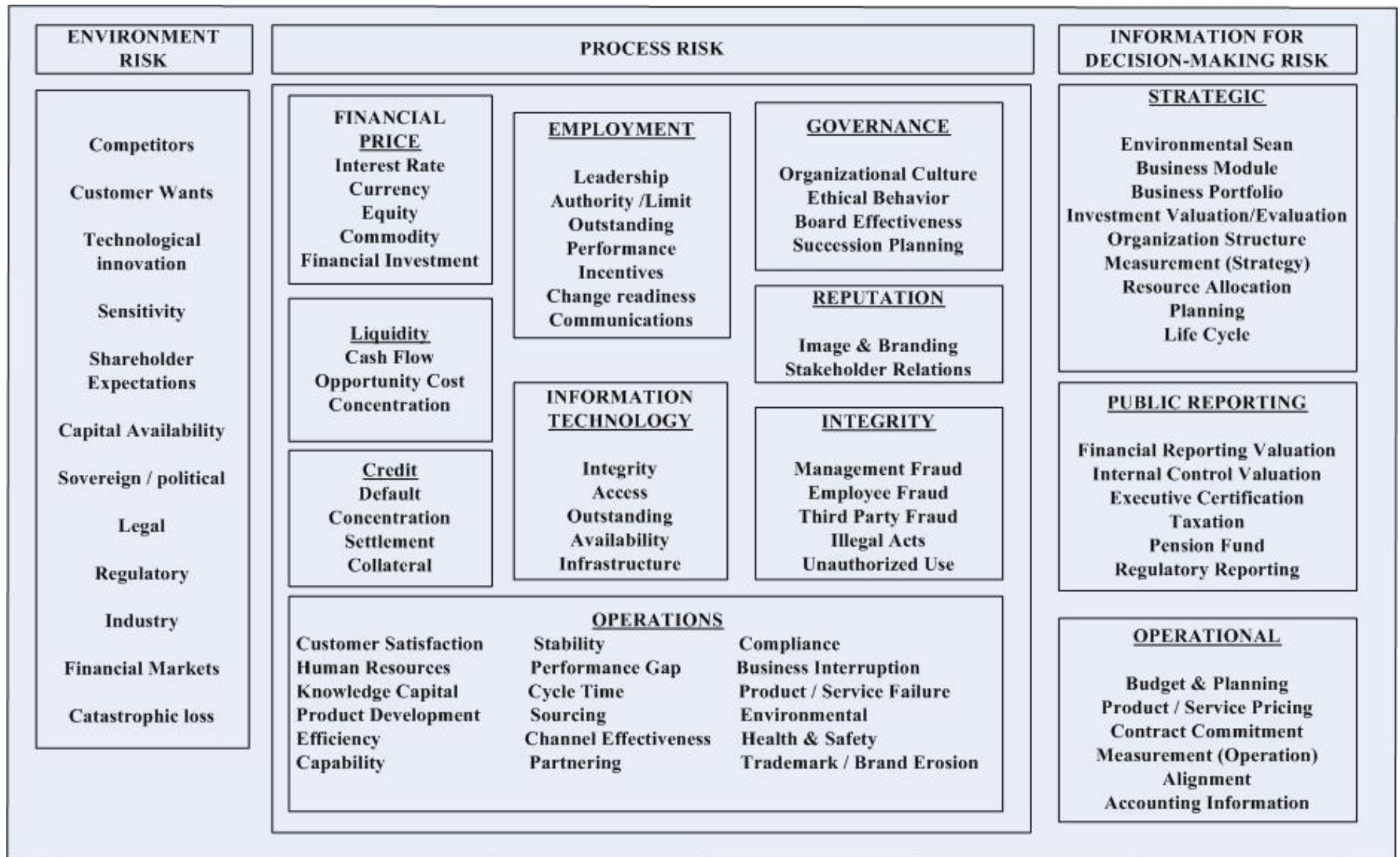
Company specific risk

Variance

- Note: risk is as much a question of perception as a question of actual risk
- The measure of the actual risk of a company is unavailable to investors
-



Types of risk



How to measure risk

Bank risk K_d :

- Given to you by the bank who will measure ability of business to repay debt and add the specific risk (+ a margin) to systemic risk (LIBOR)
- Ex: LIBOR +300bps

Equity risk K_e :

- Most used model is CAPM : $K_e = r_f + \beta$ (specific return)
- Empirical evidence suggest specific return to be at 4% in equity markets
- Not really relevant in practice and more arbitrary measures are used
 - 9% for equity markets
 - 15 – 25% for private equity
 - More for VC

Continuing Value

- Can represent most of the value of the DCF
- Very sensitive to small changes in assumptions

1

Exit multiple

- Simple
- Can be misleading and should be adjusted if the entry multiple incorporate synergies or significantly different state than forecasted at exit (remaining capacity etc)

2

Perpetuity:

- $CF_{t+1} / (WACC-g)$
- effectively implies that $RONIC = WACC$

Exercises for next time

- Can represent most of the value of the DCF
- Very sensitive to small changes in assumptions
- Demonstrate NPV formula given AoA
- Demonstrate Perpetuity formula
- Assuming a company worth \$1.0 Bn has \$500m of debt what is the value of the Equity. Demonstrate given AoA
- Find a public company with Investment in associates and minority interest



Publicly Traded Comparables

key market comparables that are engaged in network and application optimization activities for telecom and other (DC, enterprise, WAN). These were split into 3 categories for valuation metrics discussion

(in USD)

	Trading Information		Fundamentals		Valuation						Operating Metrics		Margins			Growth						
	Stock Price		Market Cap.	Ent. Value	EV/Revenue			EV/EBITDA			Revenue	EBITDA	EBITDA			Revenue			EBITDA			
	27/06/2014	LTM			LTM	CY14E	CY15E	LTM	CY14E	CY15E	LTM	LTM	LTM	CY14	CY15	LTM	NTM/LTM	14/13	15/14	NTM/LTM	14/13	15/14
Hyper Growth																						
Palo Alto Networks	\$81.21	65.8%	\$6,259	\$5,891	11.1x	8.7x	6.6x	NMF	NMF	40.3x	\$532	(\$28)	NMF	12.3%	16.4%	73.5%	35.9%	39.6%	32.2%	NMF	78.0%	76.4%
A10 Networks	\$12.43	NA	\$746	\$624	4.0x	3.2x	2.6x	NMF	NMF	NMF	\$158	(\$2)	NMF	(3.0%)	2.4%	76.7%	26.9%	35.6%	23.0%	NMF	NA	NMF
Gigamon	\$19.30	(50.3%)	\$616	\$473	3.2x	2.7x	2.2x	NMF	19.8x	11.2x	\$146	(\$38)	NMF	13.7%	19.3%	76.7%	27.5%	24.1%	25.9%	NMF	(6.5%)	77.2%
Array Networks	\$1.55	126.2%	\$117	\$91	2.2x	1.7x	1.3x	37.0x	12.5x	NA	\$41	\$2	5.9%	13.9%	NA	77.2%	34.5%	30.8%	37.3%	NMF	734.8%	NA
	Median:	65.8%	\$681	\$549	3.6x	3.0x	2.4x	37.0x	16.2x	25.7x	\$152	(\$15)	5.9%	13.0%	16.4%	76.7%	31.0%	33.2%	29.1%	NMF	78.0%	76.8%
	Mean:	47.2%	\$1,935	\$1,770	5.1x	4.1x	3.2x	37.0x	16.2x	25.7x	\$219	(\$16)	5.9%	9.2%	12.7%	76.0%	31.2%	32.5%	29.6%	NMF	268.8%	76.8%
Developing EBITDA																						
Aruba Networks	\$17.78	0.4%	\$1,933	\$1,633	2.4x	2.1x	1.8x	NMF	9.5x	7.8x	\$679	\$16	2.3%	21.9%	23.1%	69.4%	19.9%	23.7%	14.7%	NMF	39.5%	20.9%
Barracuda Networks	\$31.50	NA	\$1,620	\$1,489	6.4x	5.7x	4.9x	NMF	23.7x	22.2x	\$234	(\$0)	NMF	24.2%	21.9%	77.0%	15.6%	14.9%	17.8%	NMF	NA	6.7%
Radware	\$17.13	17.2%	\$775	\$608	3.1x	2.8x	2.6x	21.2x	15.6x	11.7x	\$199	\$29	14.4%	18.0%	22.0%	81.1%	10.7%	11.6%	9.5%	46.8%	33.9%	33.5%
Infoblox	\$13.17	(67.7%)	\$718	\$456	1.8x	1.8x	1.6x	NMF	20.5x	10.8x	\$248	(\$4)	NMF	9.0%	14.7%	77.9%	1.9%	0.8%	16.4%	NMF	(34.8%)	90.8%
Sandvine	\$3.30	28.1%	\$496	\$375	3.3x	2.9x	2.4x	12.3x	10.6x	8.3x	\$113	\$30	27.0%	26.9%	29.4%	75.8%	18.7%	23.3%	16.5%	9.5%	45.0%	27.1%
Allot Communications	\$13.31	1.0%	\$439	\$317	3.1x	2.7x	2.3x	NMF	18.6x	12.9x	\$101	\$1	0.6%	14.5%	18.2%	71.9%	19.5%	21.8%	14.8%	NMF	151.4%	44.3%
Procera Networks	\$9.71	(36.2%)	\$198	\$91	1.2x	1.1x	0.9x	NMF	NMF	8.2x	\$75	(\$14)	NMF	2.1%	11.5%	56.1%	17.9%	12.6%	16.1%	NMF	NMF	7.0%
	Median:	0.7%	\$718	\$456	3.1x	2.7x	2.3x	16.7x	17.1x	10.8x	\$199	\$1	8.4%	18.0%	21.9%	75.8%	17.9%	14.9%	16.1%	28.1%	39.5%	27.1%
	Mean:	(9.6%)	\$883	\$710	3.0x	2.7x	2.4x	16.7x	16.4x	11.7x	\$236	\$8	11.1%	16.7%	20.1%	72.7%	14.9%	15.5%	15.1%	28.1%	47.0%	32.9%
Mature EBITDA																						
Cisco	\$24.70	10.6%	\$126,530	\$96,970	2.1x	2.0x	1.9x	7.5x	5.9x	5.7x	\$47,202	\$12,871	27.3%	34.5%	33.9%	59.2%	2.7%	(0.2%)	4.6%	34.0%	3.9%	2.7%
Juniper Networks	\$24.47	16.6%	\$11,593	\$9,984	2.1x	2.0x	1.9x	12.3x	7.7x	6.6x	\$4,780	\$813	17.0%	25.9%	28.8%	62.9%	5.4%	6.7%	5.2%	73.8%	18.8%	17.0%
F5 Networks	\$111.11	18.7%	\$8,414	\$7,790	4.9x	4.4x	3.9x	15.9x	11.5x	10.0x	\$1,592	\$489	30.7%	38.4%	39.1%	82.4%	14.4%	16.3%	12.6%	43.7%	16.3%	14.6%
Riverbed Technology	\$20.43	30.8%	\$3,280	\$3,327	3.1x	2.9x	2.7x	20.4x	9.1x	8.4x	\$1,060	\$163	15.3%	31.9%	31.9%	73.3%	10.4%	10.2%	8.2%	96.4%	31.5%	8.1%
	Median:	17.6%	\$10,003	\$8,887	2.6x	2.5x	2.3x	14.1x	8.4x	7.5x	\$3,186	\$651	22.1%	33.2%	32.9%	68.1%	7.9%	8.4%	6.7%	58.7%	17.6%	11.3%
	Mean:	19.2%	\$37,454	\$29,518	3.0x	2.8x	2.6x	14.0x	8.5x	7.7x	\$13,659	\$3,584	22.6%	32.7%	33.4%	69.4%	8.2%	8.3%	7.6%	62.0%	17.6%	10.6%

Precedent Transaction Analysis

Precedent Transaction Analysis

(Figures in US\$ millions)

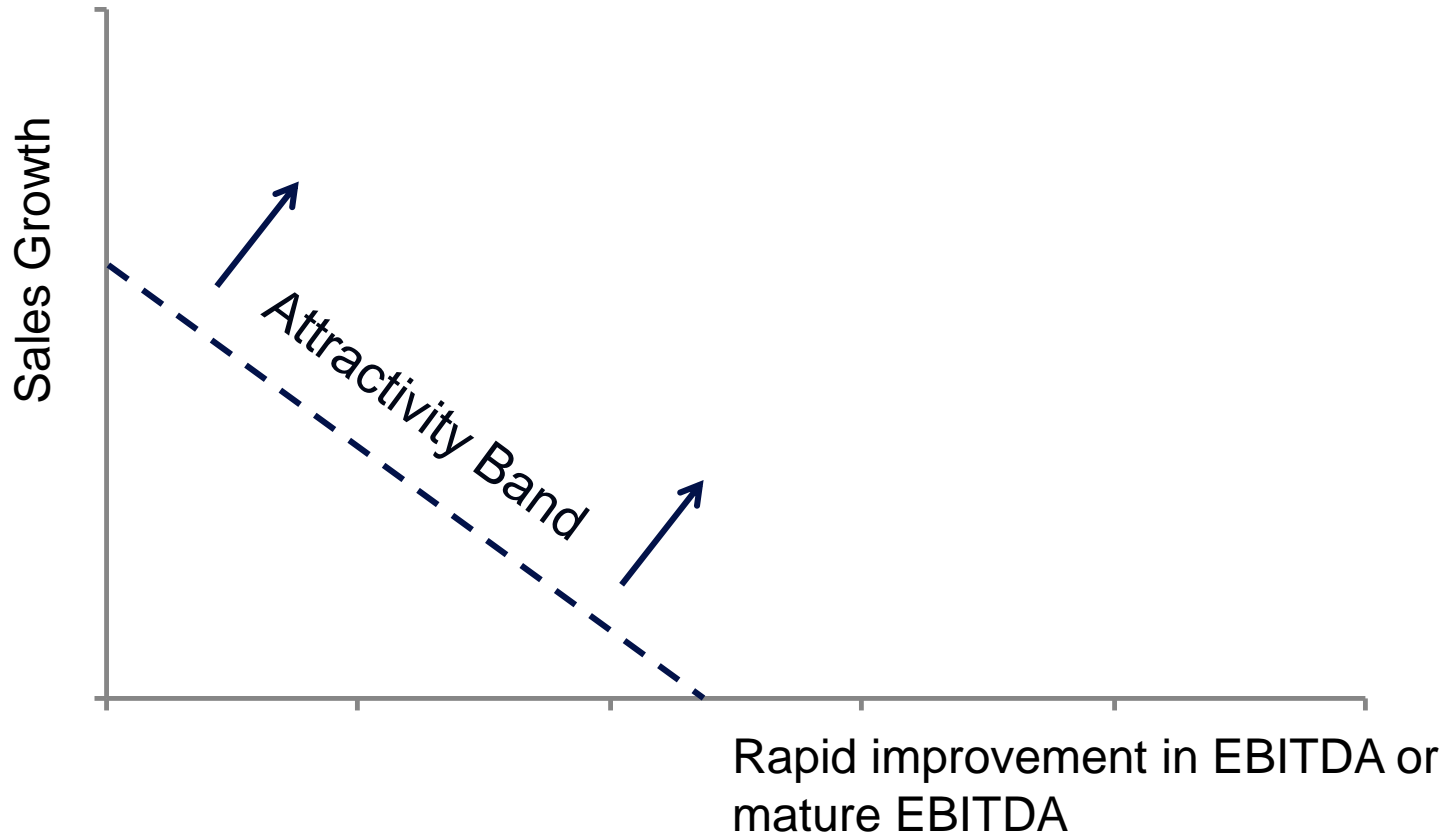
Date				Enterprise	EV/LTM		LTM EBITDA
Announced	Acquirer	Target	Business Description	Value	Revenue	EBITDA	Margin
03/25/13	Oracle	Tekelec	Telephone service management software	na	na	na	na
02/15/13	Opera Software ASA	Skyfire Labs [fka DVC Labs]	Mobile video traffic software	\$155	37.8x	na	na
02/04/13	Oracle	Acme Packet	Session border controllers provider	\$1,687	6.1x	27.3x	22.5%
12/18/12	Cisco Systems	BroadHop	Policy control platforms for telecom	na	na	na	na
12/05/12	Redknee Solutions	Nokia Siemens Networks (BSS business)	Telecom carrier software assets	\$52	na	na	na
11/29/12	Cisco Systems	Cariden Technologies Inc	Telecom network design software	\$141	na	na	na
07/31/12	Allot	Oversi Networks	Caching and content delivery solutions	\$21	2.6x	na	na
07/16/12	CSG Systems International	Ascade AB	Telecom OSS software provider	\$19	1.2x	16.0x	7.5%
06/07/12	Citrix Systems	Bytemobile	Mobile traffic management software	\$435	8.7x	na	na
05/01/12	Allot Communications	Ortiva Wireless	Wireless infrastructure systems provider	\$11	1.4x	na	na
04/16/12	Marlin Equity Partners LLC	Openwave Systems (mediation & messaging)	Telecom management software assets	\$55	na	na	na
02/20/12	F5 Networks	Traffix Systems	Telecom signaling systems provider	\$128	na	na	na
12/09/11	Thoma Bravo	Blue Coat Systems	Network application delivery optimization	\$856	1.8x	9.8x	18.7%
11/07/11	Siris Capital Group LLC	Tekelec	Telephone service management software	\$491	1.2x	9.2x	13.3%
06/17/11	Amdocs Limited	Bridgewater Systems	Telecom service control software	\$130	1.5x	8.0x	18.3%
12/10/10	PAETEC	Formula Telecom Solutions	Telecom billing software provider	\$13	1.6x	na	na
09/24/10	CSG Systems International	Intec Telecom Systems	Telecom billing software provider	\$267	1.1x	6.7x	16.1%
07/30/10	Redknee Solutions	Nimbus Systems SL	Telecom billing software provider	\$15	na	na	na
05/06/10	Tekelec	Blueslice Networks	Telecom data management software	\$35	na	na	na
05/06/10	Tekelec	Camiant Inc	Telecom network management software	\$127	na	7.6x	na
10/13/09	Cisco Systems	Starent Networks	Wireless infrastructure systems provider	\$2,389	7.8x	19.7x	39.4%
04/30/09	Acme Packet	Covergence	SBC & SIP trunking hardware	\$22	2.8x	na	na
Average				\$353	3.2x	11.0x	19.4%
Median				\$128	1.7x	9.2x	18.3%

Precedent transactions have typically occurred in the range of 1.2x to 2.8x TEV / LTM revenue or 6.7x to 16.0x TEV / LTM EBITDA

Note: Light grey figures excluded from calculation of average and median

Private and Confidential

Attractivity Band Concept



- 1 Attractively is a balance between growth and EBITDA maturity

Analysis of Valuation Categories

- Market is Segmented in 3 clear categories

Hyper-Growth Unprofitable Companies

- 1 Revenue Growth: ~30%
- 2 Long-term path to profitability

Comments

Unforgiving reaction to deceleration

Valuation

Valuation based on growth and sales multiples

Growing Companies with Clear Path to Profitability

- 1 Revenue Growth: 15% - 25%
- 2 Clear path to profitability and significant operating leverage

Comments

More stable market momentum

Valuation

Valuation based on a mix of sales metric and forward EBITDA multiples

Low Growth but Highly Profitable Companies

- 1 Revenue Growth: ~8%
- 2 Currently profitable and mature EBITDA margins

Comments

Less demanding valuations

Valuation

Valuation based mostly on EBITDA multiples

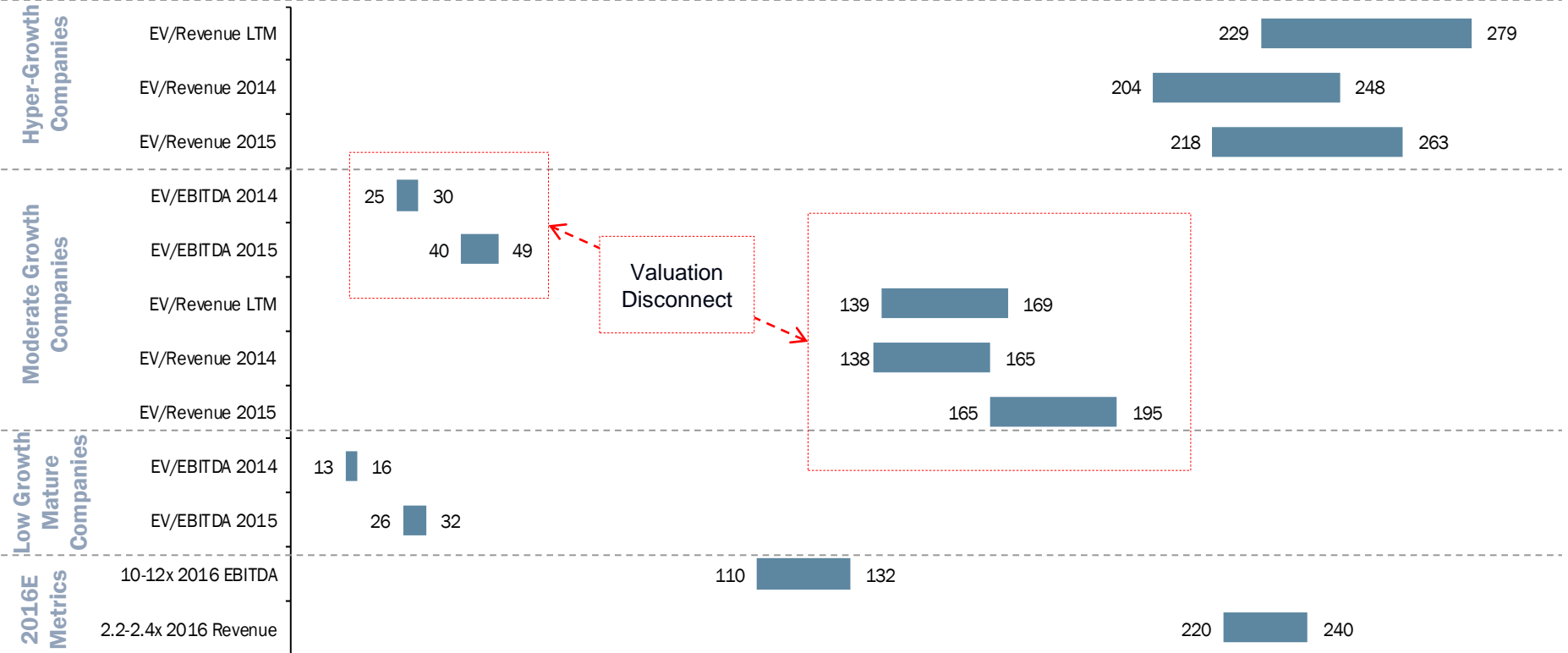
Preliminary Value Benchmarking

- Company is likely to be valued in the moderate growth category but currently there is a significant disconnect between its EBITDA-based and Revenue-based implied valuations
- Assuming current valuation environment continues, an IPO in Q2 2015 based on 2016E metrics would suggest a range of 220-240 based on Revenue multiples and 110-132 based on EBITDA multiples

Methodology

Implied Enterprise Value

(in US\$ mm)

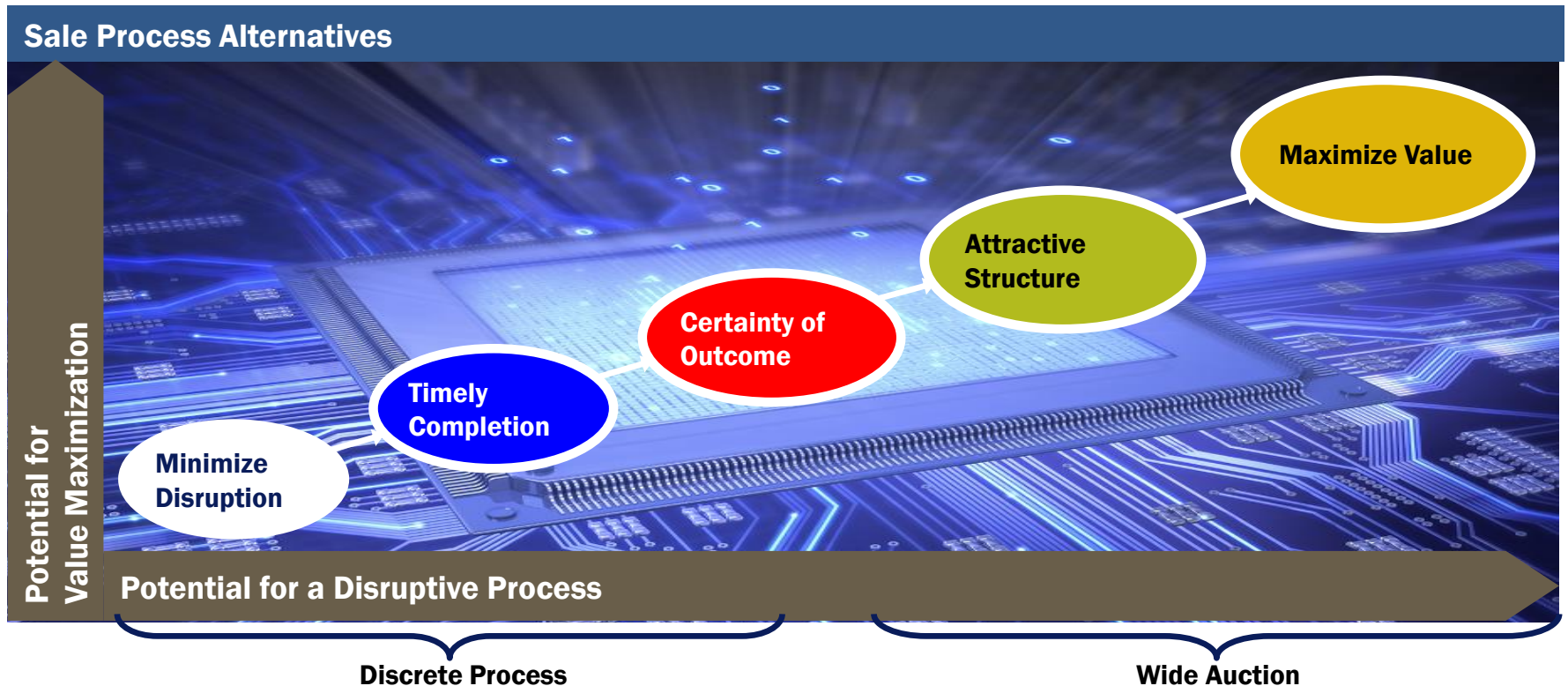


Note: LTM calculated as the average of CY2013 and CY2014

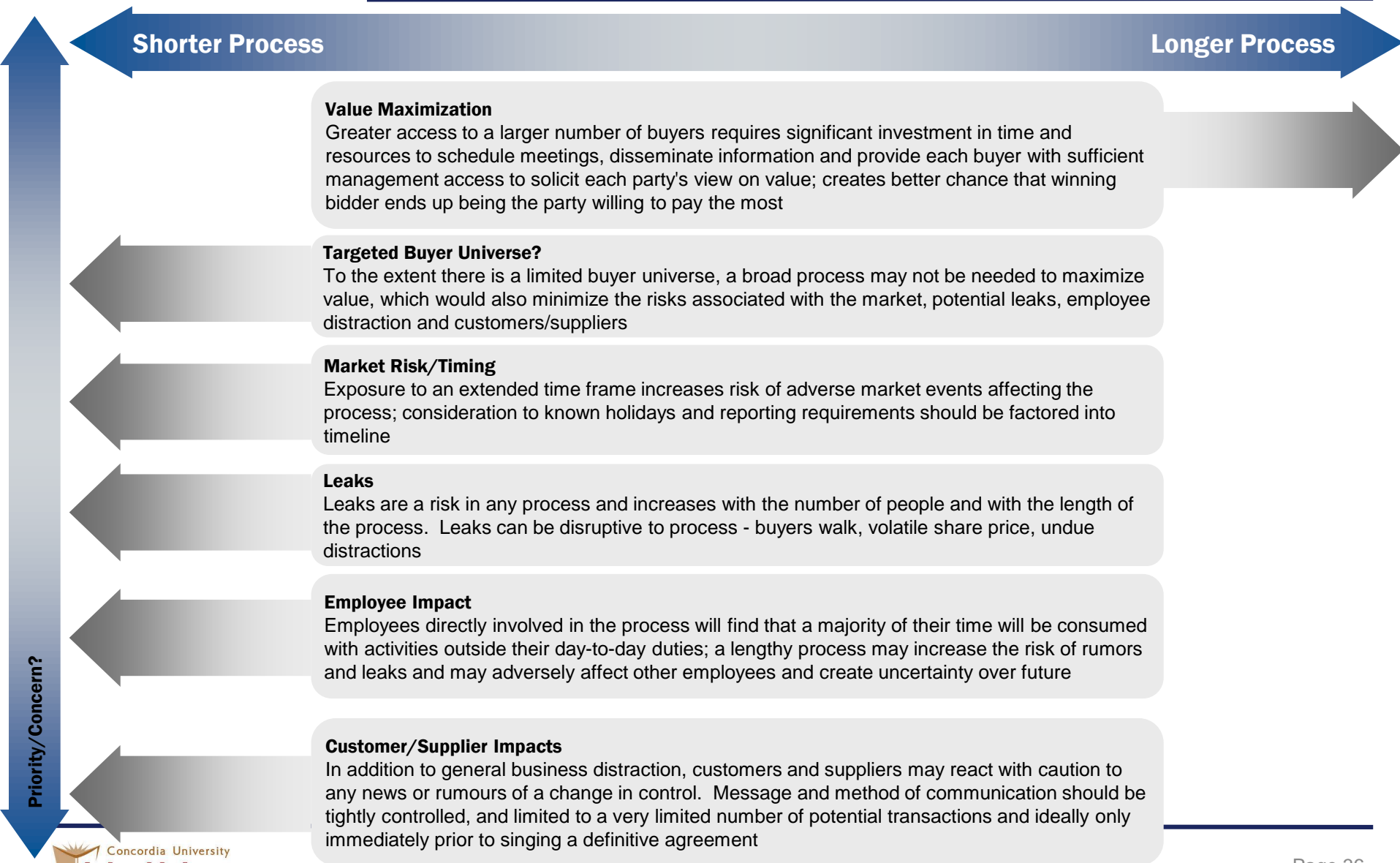
V. Process Considerations

Process Objectives

- Should a process subsequently and/or ultimately be undertaken, a successful process is typically expedient, minimizes disruption and realizes fair value for shareholders
- In addition to achieving a high value for the assets, one may also desire a discrete and timely process
- Critical to prioritize and find the proper balance between these objectives



Process Considerations



Process Alternatives

- The duration of a process depends on the overall objectives and ultimately the type of process undertaken

Sale Process Alternatives

	Discrete	Controlled	Wide
	<i>(Discussions with one interested party)</i>	<i>(Simultaneous discussions with a group of interested parties)</i>	<i>(Wide open process with closed-bid deadline)</i>
Advantages	<ul style="list-style-type: none"> ■ Very limited disclosure ■ Minimize the uncertainty to employees and customers ■ Minimize ‘widely-shopped’ stigma ■ More control over process and timetable ■ Preferred approach of buyers (i.e., exclusivity) 	<ul style="list-style-type: none"> ■ High value for the business while maintaining manageable scope of process ■ Early indications of interest and price level for the business before proceeding with full process ■ Flexibility to change process, particularly with regards to selling the business to one buyer or several buyers 	<ul style="list-style-type: none"> ■ If sufficient interest, likely to obtain maximum value ■ Fairly expeditious process with uniform deadline ■ Widest exposure to potential buyers
Disadvantages	<ul style="list-style-type: none"> ■ Negotiation tends to be sequential and can drag on ■ Difficult to create bidding tension 	<ul style="list-style-type: none"> ■ May not attract complete universe of buyers 	<ul style="list-style-type: none"> ■ Confidential data must be broadly disseminated ■ Considerable commitment of management time ■ Requires credible ‘walk-away’ alternatives ■ Possible employee disruption

Overview of a 2-Stage Auction Process

Stage 1 Surface Initial Indications of Interest

Preparation Stage

Sun	Mon	Tue	Wed	Thu	Fri	Sat
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	31				

3 - 4 weeks

- Organize process
- Collect data
- Develop potential purchasers list
- Prepare Broadcast Letter/Teaser
- Prepare CIM
- Prepare form of CA

Approach Stage

Sun	Mon	Tue	Wed	Thu	Fri	Sat
			1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28	29	30		

3 - 4 weeks

- Initial contact made to prospective purchasers
- Signing of CAs/distribution of CIMs
- Management presentation preparation
- Data room preparation
- Solicit non-binding expressions of interest

Due Diligence Stage

Sun	Mon	Tue	Wed	Thu	Fri	Sat
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30
31						

3 - 4 weeks

- Determine a short-list of partners
- Short-list candidates
- Reciprocal management presentations
- Reciprocal due diligence
- Pre-acquisition agreement

Stage 2 Finalize An Agreement With A Selected Party

Negotiation/Closing Stage

Sun	Mon	Tue	Wed	Thu	Fri	Sat
	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30	31			

3 - 4 weeks

- Negotiate final proposals
- Select winning partner
- Finalize definitive agreements
- Execute definitive agreements
- Closing

Appendix

Unsolicited Considerations

Early preparations for an unsolicited takeover bid can significantly enhance the effectiveness of a defence strategy

- **Front Door Approach First** - Buyers prefer to go through the 'front door' in order to source the target's co-operation, the board support on price, and the opportunity for due diligence
 - However, unsolicited offers tend to occur in situations where the bidder may be perceived to be the 'enemy' or where front door overtures have been rebuffed
 - Most initial unsolicited bids are unsuccessful, but ultimately cause a change of control
- **Best Defence** - The best defence against any unsolicited proposal is to have the Company's "full value" already reflected in the marketplace – thus avoiding opportunistic advances
- **Advance Preparation** – When a Company finds itself in a vulnerable position, it would be prudent for the Board to prepare for a potential unsolicited bid
- **Proxy Contest** – Activist shareholders may also see opportunities to push the Board into actions to augment value in short term
 - Not necessarily aligned with all shareholders as their interests are short term in nature

Defence Preparation

- **Understanding Alternatives** – An appropriate Board response will only be possible if the Board has a full understanding of all of the company's alternatives as early in the defence contest as possible
 - Ideally prepared in advance of receiving a hostile bid
 - *Time* to respond to an unsolicited bid can be very limited
 - True alternatives to an offer must be more favourable to shareholders
- **Preparation** – An appropriate defensive strategy prior to receiving an unsolicited bid would include a preparation stage to establish key elements of the current environment:
 - Clearly understand value proposition
 - Communicate message to market
 - Identify likely suitors and White Knight candidates
 - Be prepared to review business in detail

Shareholder Value Team

- **Shareholder Value Team** - Identify legal and financial advisors to work with senior management and the Company's Board or independent committee (a "Shareholder Value Team") to carry out the necessary analysis and planning functions
- The Shareholder Value Team should undertake certain initial preparations, including:
 - Review existing protection mechanisms (shareholder rights plan, key contracts, etc.);
 - Consider structural initiatives and their role in any hostile take-over attempt;
 - Identify and analyze potential strategic partners; and
 - Initiate a "share watch" program to monitor trading of the Company's shares
- In addition, the Shareholder Value Team should participate in the Company's business review and initiatives to maximize value
- The Shareholder Value Team should have the confidence of the Board of Directors and the authority to respond quickly in the face of an unsolicited bid or proposal
- In response to an unsolicited bid or proposal, the Shareholder Value Team should quickly assess the strategic objectives of the offeror, estimate its maximum price payable, and analyze all aspects of any proposals

Defense Preparation

Before any bid is received, the Shareholder Value Team can take considerable steps towards an unsolicited defence review, and save valuable time should an unsolicited bid surface

Identify Shareholder Value Team

- Key management, legal, financial, and PR advisors
- Consider potential candidates for a special committee

Establish Market Intelligence Program

- Monitor share trading to detect unusual activity; may provide early warning
- Identify key relationships: regulatory, political, customer, supply, lender notification/briefing requirements
 - Relationships should be established in advance to be able to act immediately, if and when required
- Review shareholders' rights plan
 - Buys time

Proactive Investor Relations Program

- Receive and respond to calls, record source and nature of calls, monitor catalyst groups
- Ensure shareholder sentiment is communicated to Shareholder Value Team

Update Business Plan

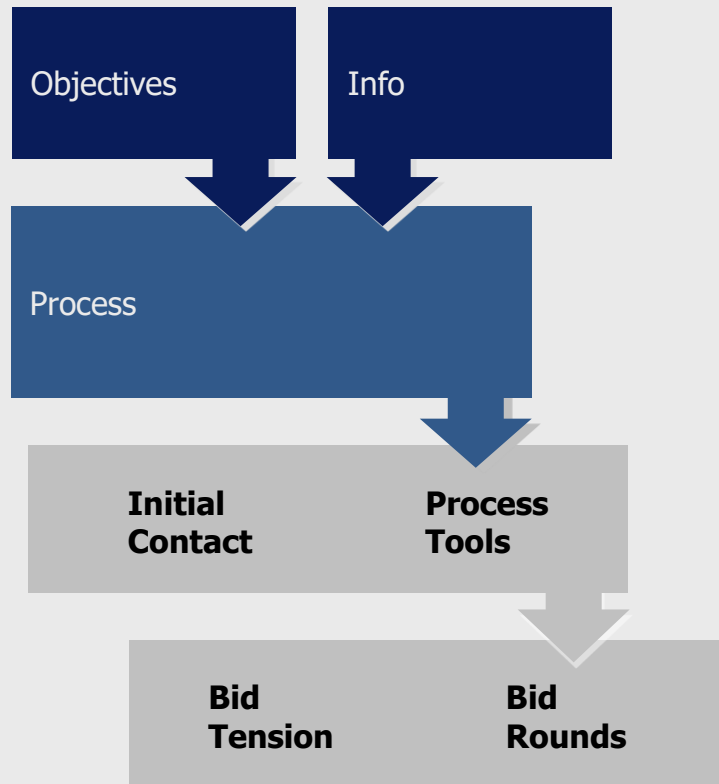
- Update business plan and conduct detailed business and financial review
- Due diligence will be done both by the Company and a White Knight to assess value
- Effective data rooms take time to assemble, which should be spent pre-bid

Identify Potential White Knights

- Refine list of potential White Knight candidates and determine the Company's value proposition to each (ability to pay/synergies, financial capacity analysis, strategic value)
- Focus on the most likely White Knight candidates to maintain credibility and efficiently manage time demands
- Potentially maintain non-threatening dialogue with industry leaders (facilitates first call)

Planning Stage

- **The initial solicitation and screening will be structured to produce a sufficient range of qualified bidders so as to establish a competitive process**



- **Tactical Objectives**

- Once a group of prospective purchasers has been selected, the objectives become:
 - Solicit expressions of interest
 - Create urgency and tension by controlling buyers and maintaining a parallel process
 - Develop negotiating strategies
 - Pursue most serious buyer
 - Verify candidates' financial capacity
 - Engage in negotiations

- **Information**

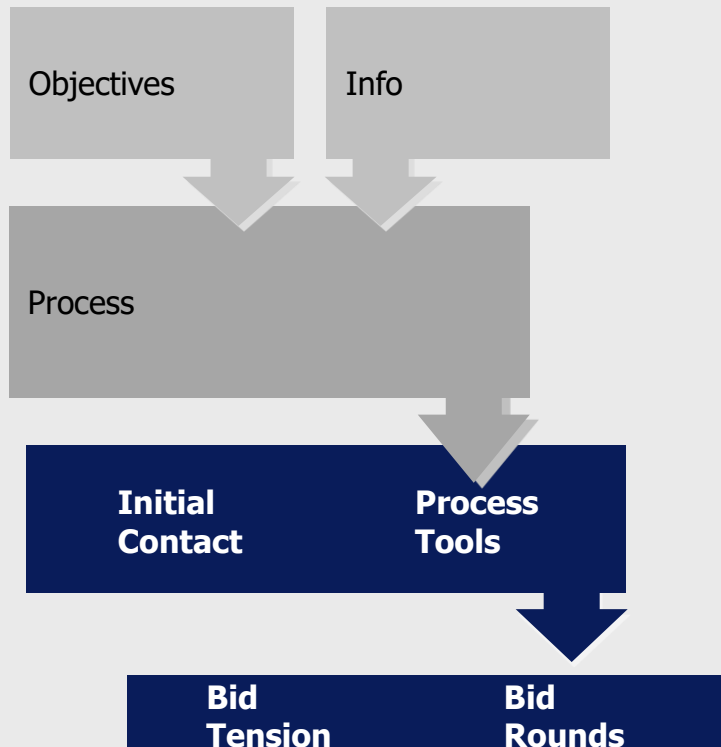
- Information is a tool used to motivate the buyer to bid with confidence
- The seller should produce high quality and accurate information
- It is materially more difficult to motivate a buyer to submit an aggressive offer when the quality and accuracy of the information cause the buyer to be less confident and less certain about the prospects of a business

- **Process**

- Process should not impair the buyers' willingness to bid aggressively
- The sale process should be honest, fair and equal to all participants
- All qualified bidders should receive the same information, should have adequate time to evaluate the information and equal access to the key participants in the process. Otherwise, certain bidders may choose not to participate to the full extent, or not aggressively
- Management conflicts need to be addressed prior to launching the auction

Approach Stage

- The approach will be made once the planning stage is complete, and solicitation will be done in a manner to facilitate a process consistent with tactical objectives



- **Initial Contact – Canaccord Genuity will initiate**
 - Approach approved buyers at senior level, as appropriate
 - Focus attention on opportunities presented by the Company
- **Process Tools**
 - If a prospective buyer's level of interest is sufficiently high, the initial call from Canaccord Genuity will be followed by a selling packet containing:
 - Broadcast Letter/“Teaser”;
 - Confidentiality Agreement; and
 - Procedures Memo
- **Bid Tension**
 - Competition is a critical ingredient to developing full value for an asset
- **Bid Rounds**
 - A multi-phased process generates more aggressive bids
 - A process which requires multiple indications of interest coupled with greater selectivity can generate incremental levels of aggressiveness with each phase (need to weigh against perception of a “never ending” auction)
 - Clearly the appropriateness and extent of employing this approach is function of the level of interest

Process Tools

