



Yes, It Has Great Potential But When Do You Walk Away?

CASE STUDY – PESS2

Service:

Product Diligence and Independent Verification & Validation (IVV) for a target market.

Client:

PE firm making controlling investment in mature company.

Requirement:

Provide diligence to assess the products, technology, people and target market.

Situation:

A near \$ 100 Million term sheet to purchase control of a physical security video and data technology firm had been signed. The PE investor's market analysis showed a potentially large growth opportunity for the company's product lines in larger volume clients. The company had a track record of producing profits and increasing revenues at smaller clients. Customers seemed to be pleased with the products, implementation and customization process. The staff had skills in the existing product domain. Initial findings and discussions concluded that the products appeared sound and there was a reasonable road map to move forward. New executive management was sitting in the wings to take the reigns once the investment was made and take the products to larger clients across multiple domains.

The investor had a concern regarding the company's 'professional services-like' approach to customer deployment. They had a post investment goal of full productization, a streamlined sales strategy and larger unit sales. As a result, the investor desired a deeper investigation into the technical and

organizational impact of such a transition on the organization and on the products appeal.

Scope:

Staffing: 2 people 15 person days
Deliverable: A verbal presentation with follow up PowerPoint of the findings.

Discovery:

Semaphore began the engagement by reviewing engineering, HR and marketing documentation. It became clear that deeper diligence was required since the materials presented did not match either the information received during initial interviews or the investor's diligence.

During the onsite visit, each of the product lines and all individual 'products' (approximately 10) were examined. Competitive products were reviewed and best practices were compared to current state. Each of the current 'product' offerings consisted of loosely coupled code segments combined as needed to satisfy client and sales requests. Performance tests were run to determine the limits of scalability. Existing roadmaps to merge code bases to produce a smaller number of platforms/products and larger unit sales was not possible without significant rewrites of existing artifacts-at great unplanned cost. It became increasingly clear that the investor's goal of productization and scalability was not a reachable goal despite its own diligence that the goal could be met. There was immediate client resistance to the Semaphore conclusions. The investment committee met to determine what action to



take—close on the deal and trust internal diligence or step away from the transaction.

Outcome:

1. The transaction process was suspended.
2. The designated 'new' management was informed of the findings and assisted the investment committee in its deliberations.
3. The investor concluded that its plan to change the products marketplace was not sustainable at a cost it wished to support.
4. Future investment consideration would be given if the company addressed the technology and market issues that would allow for a successful migration to larger markets with appropriate products.
5. The company found new investors to take control of the business upon similar terms as our client with the same market intent.
6. The company was sold back to management at a 40% discount to the initial investment.