A Winthrop & Weinstine blog dedicated to bridging the gap between legal & marketing types.

Consolidation in the Cloud: Some Factors to Make Your Company an Attractive Target

Posted on February 11, 2011 by Brad Walz

Verizon Communications Inc.'s recent acquisition of cloud-computing company Terremark Worldwide Inc. caused some analysts to speculate that there may be more consolidation in the cloud-computing industry. Consolidation in the cloud-computing industry would not be surprising since, according to Gartner's Hype Cycle, cloud computing is at the top. This means there are many market participants in the cloud-computing industry.

If you're a market participant in the cloud-computing industry and your company's exit strategy is to be acquired, what should you be doing to standout from the crowd? Generally, technology acquisitions fall into three categories: (1) Talent or Technology; (2) Product; and (3) Business. Likewise, there are different categories of buyers: (1) Bargain hunters; (2) Financial buyers; (3) Corporate and Industry buyers; and (4) Strategic or Synergistic buyers. Each category of buyer has its own acquisition objective.
A company in the cloud-computing industry is most likely to be acquired for its product by a Corporate or Industry buyer that wants to add capacity or products to its business. Corporate and Industry buyers tend to consider valuation approaches based upon future earnings and market comparables. The list below includes some focal points for a company to consider that will help increase valuation of the company to a Corporate or Industry buyer:

1. Register your intellectual property. If the acquiring company is purchasing a product, they most likely are looking for something that differentiates your company from the competition. Registered intellectual property, whether it's a trademark, copyright, patent, or all three, can make it more difficult for a competitor to successfully compete against you, which can guarantee the value of the company remains high.
2. Watch your margins. The acquiring company wants to know that it can take over selling the product and make a good profit. A way to improve your profit margin is to get control of your costs. A higher profit margin indicates a more profitable company that has better control over its costs compared to its competitors.

3. Demonstrate wise investment of accumulated earnings. Higher future earnings support higher acquisition premiums. Accumulated earnings offer the potential for higher earnings in the future by, for example, reducing debt and investing in necessary equipment or new technology. Companies can achieve better financial performance and ensure the company's stability into the future through the wise investment of accumulated earnings.
4. Demonstrate the capacity to support additional debt. The Debt-Service Coverage Ratio ("DSCR") is the amount of cash flow available to meet annual interest and principal payments on debt. A DSCR of less than 1 would mean a negative cash flow. Therefore, even though your profit margin would suggest you are making money, in reality, you may not be making enough to pay the company's bills. No acquiring company wants to step in those shoes.