

Industry Observation

'Selling Out' Is Difficult, but not Impossible

Kenneth A. Epstein, NewCap Partners Los Angeles

One of my colleagues wrote in this space last year (see *Semiconductor International*, March 2000, p. 168) about the problems that semiconductor capital equipment companies face in attempting to go public. He suggested that selling out might be an acceptable alternative when an IPO isn't possible.

Since then, though, it has become apparent that small, private companies in this field are in a double bind. Not only is the IPO route closed to them, they're also having trouble finding anyone who is interested in acquiring them.

As an investment banker who has worked with many semiconductor equipment companies, I agree that it is indeed difficult for smaller companies to find buyers. However, it's not impossible if a company goes about it the right way.

Let's begin by noting that there are hundreds of companies in the group I'm describing. Most of these companies have only one product line, and they have no desire to expand into new or even related fields. The familiar refrain goes something like this: "I just do optical lithography; that's my whole business. I don't do anything on wafers, I don't do anything on inspection."

These owners have difficulty strategizing on how to expand their immediate product lines for several reasons: They are preoccupied with tactical problems in servicing their existing markets; they have limited cash and limited marketing and technical services; and they must cope with cyclical markets.

As a consequence of these and other factors, there is a big disparity between the valuations of small, private semiconductor equipment companies and public companies in the same field. It might seem that the logical buyer of a small semiconductor capital equipment company would be a larger, better established company in the same business.

However, these companies are reluctant to buy companies with sales of less than \$25M and earnings below the \$5M mark. And they will seldom even look at a company with sales of less than \$10M-\$15M – a range that includes a majority of the firms in this field.

How can a small company overcome such resistance?

Quite possible by positioning the business not as a company, but as a product line. In exploring this alternative, management of a small company should be aware of two major concerns of their larger brethren.

First of all, the product of the company that is trying to sell out must be compatible with the prospective buyer's own line and customer base. As a rule, a larger company will be reluctant to diversify into new market with a smaller company's single product line and a limited sales force.

Second, larger companies do not want to dilute their sales efforts by adding products that are in a much lower price range than their own. This being an industry in which the compensation of salesmen and sales reps is based all or in part on commissions, sales forces of companies with products priced at \$500,000 to \$1.5M will be reluctant to spend their time selling products in the \$50,000 to \$100,000 range.

It might be argued that the larger company could create a separate sales force to sell the product of the smaller company, or augment a smaller company's sales group. However, that would deprive the buyer of the synergy of the acquisition.

Thus, the best strategy of a small company seeking to sell out is to emphasize that, in buying a smaller company, a larger company will benefit by obtaining a new product without adding any overhead. So much the better if the larger company has products that would appeal to a seller's customers.

Convincing a large semiconductor capital equipment company to buy a one-product company in its field will require a lot of time and creative strategy. But there is reason to make that effort. My firm's studies indicate that larger semiconductor companies are looking for ways to solidify their market position in preparation for the next growth cycle in the semiconductor and microelectronics markets.

We believe their strategy for achieving this objective will include broadening their product lines and acquiring new technologies. That spells opportunities for many small companies, and those that follow the suggestions I have made should be rewarded for their efforts.