Metapath Case Harvard Case Solution & Analysis

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Background

Metapath formed in '95 out of JV between Securior Telesciences Inc. & Networks Northwest. MP would be run by CEO John Hansen (formerly of NN)

Mission: Build a software product that allowed wireless carriers to see what calls were on their networks at any point in time

At time of acquisition offer (1997), Metapath had four major customers, including recent $19MM contract with Sprint

Emerging as premier company in its' market space; looking at going public within TWO years

Recent Public Offerings had gone well in this space; market paying 3-5X Revenue

Acquisition Offer Details

Unsolicited offer from CellTech for $115MM in Common Stock

CellTech - hardware-based vendor of wireless technology

- value-add products to wireless service providers
- recently went public months prior to bid
- market cap = $260MM
- since IPO, stock traded up from $15 to $19-$22 range

Lockup for 90 days of CellTech stock upon completion of acquisition

At time of offer (1997), Metapath's prior quarter revenue was $6.4MM, projecting annual revenue of $22MM

Pros

Liquidity for shareholders at an attractive price without having to wait for IPO; no further dilution

Analysts bullish on CellTech - large addressable market, rapid forecasted growth in EPS; could trade between 40x-45x forward earnings; suggest near-term price target of $21-$24 per share

12-18 month price target above $30 is reasonable

Operating Synergies - fully-formed marketing and sales organizations, selling to same customers as Metapath

Talent Synergies - CellTech engineers would be useful to Metapath dev. group

Cons

Financial upside out of their hands - based on how CellTech stock performs

Based on rev. growth + similar recent IPO's, $115MM could be on lower end in two years

CellTech not profitable; Net Loss of approx. $15MM in 1996

RECOMMENDATION

#1 - Pass on Acquisition from CellTech

Red flag - offering 45% of their market value to acquire Metapath

Recent IPO = "Hot tech stock;" all stock acquisition says equity is their best currency

Metapath not extremely synergistic to CellTech

#2 - Pass on Proposed RSC Financing

IPO window is fickle and Metapath is still one year, at best, from an IPO

If at the time they are ready to go public but IPO window is closed and they are forced to sell, all of the early-stage investors would be extremely diluted

Recommendation: Find new financing

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Equity Financing Offer

Metapath goal of next round of financing was to get to cash break-even, smooth of Quarter-to-Quarter revenue, and attract more customers - necessary to make an attractive IPO

Metapath history of Equity Financing

Raised $9MM to date from four rounds

Elements of Term Sheet

Term Sheet proposed by RSC (Robert Stephens Omega Fund) & Technology Crossover Ventures (TCV) - Series E Preferred

RSC & TCV to purchase $11.75MM of stock at $76MM pre-money valuation

Proposed instrument of investment was **Participating Convertible Preferred Stock**

PCPT - Differs from Convertible Preferred - in event of a sale, owner of PCPT still has right to "participate" in further consideration as if they had converted into common stock

Essentially - holder of PCPT gets both liquidation preference AND equity participation

RSC wants PCPT because it protects them in event of sale to a company at a small step-up from current round

Note - only relevant in a Sale of the company, not an IPO

Pros

Great valuation for a young, private company w/ a few customers and an uncertain future

Allows team to maintain control, stick to their vision, and potentially reap bigger rewards

If Metapath achieves it's goal of IPO, then the PCPT becomes irrelevant

Cons

PCPT is bad deal for Metapath - more dilution than normal convertible preference; transfers virtually any optionality away from founders

PCPT is also unfavorable for previous investors - reduces overall funds available to previous four tranches

IPO = best possible scenario, which means lowest probable outcome; therefore, PCPT likely to take effect

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Date	1/20/95	1/20/95	9/30/95	4/30/96
Amont	$600,000.00	$1,000,000.00	$1,000,002.00	$7,000,00.00
Participants	Securicor Telesciences	BVP	BVP	BVP, USVP, NVP
Price/common share	$1.05	$1.05	$1.05	$1.62
In event of liquidation or sale	Paid out after Series C and D, pro rata with Series B	Paid out after Series C and D, pro rata with Series A	If not converted, paid out after Series D	If not converted, paid out first
In event of IPO	Gets redeemed	Gets redeemed	Conv. To CS	Conv. To CS
Voluntary conversion to common	Not convertible	Not convertible	Convertible with > 66 2/3% vote of round	Convertible with > 80% vote of round
Dividend	**Immediate quarterly payments of LIBOR + 1%**	After January 1, 2000, annual payments of 8% face value	After January 1, 2000, annual payments of 8% face value	After January 1, 2000, annual payments of 8% face value
Mandatory redemption?	Yes: 3 equal annual increments beginning January 17, 2000	Yes: 3 equal annual increments beginning January 17, 2000	No	No
Anti-dilution	Yes	Yes	Yes	Yes