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OuterLink Corporation (B)

In January 2003, Wang and Chu weighed the options for OuterLink and decided there was sufficient runway to attempt the sale of OuterLink. The two potential acquirers with which the most advanced discussions had been held—Raytheon (NYSE: RTN) and Digital Angel (AMEX: DOC)—were contrasts in market valuation, scale and speed to close a potential deal. In 2003, Raytheon was one of the largest defense and aerospace companies, with 70,000 employees and a market capitalization of \$13 billion. Digital Angel had 100 employees and a market capitalization of \$60 million. With OuterLink projected to reach cashflow breakeven only in October 2003, they had to move quickly and decisively with negotiations.

Wang and Chu set out to secure a letter of intent (LOI) for the acquisition of OuterLink. While the technical team worked on improving the technology, a large number of discussions and emails ensued regarding the potential sale. In April, it became obvious that Digital Angel represented the best prospect for OuterLink. The value proposition to Digital Angel was to combine its core products based on radio frequency identification (RFID) with OuterLink's capability of instantaneous asset location and messaging to deliver a full suite of asset tracking products and services to industrial and defense customers. Up until August, Digital Angel's management team remained unconvinced of the value of OuterLink to their organization. Several intense face-to-face meetings with Digital Angel's management team and its Chairman & founder took place in the oppressive summer heat of Florida. The turning point in the negotiations came when Digital Angel's Board of Directors agreed that OuterLink presented a tangible strategic alternative to its current course, and that OuterLink's management team could deliver on the synergies of the acquisition. Digital Angel's stock, which had languished for the past 12 months, might benefit from the deal.

In September, Digital Angel submitted a LOI to acquire OuterLink. The Digital Angel deal terms were to acquire 100% of the outstanding shares of all classes. The purchase was to be paid for by 4,000 shares of zero-coupon preferred stock. Each preferred stock would be convertible into 1,000 common stock provided that shares traded above \$4.00 on a 20 day volume weighted average price basis. The logic was that this transaction would not be immediately dilutive to Digital Angel's shareholders and that there was alignment of interests. OuterLink was also able to secure redemption rights in the event of liquidation equal to \$1.00/share. The proposed closing date was October 2003 when Digital Angel's stock was trading at approximately \$2.00/share.

OuterLink was on the verge of being shut down in January 2003. By October, it had a putative valuation of \$16 million. The acquisition was closed in January 2004 after review and approval by the Federal Communications Commission (FCC). Digital Angel's stock price rose above \$4.00 in a sustained manner in Q4 2004. Zero Stage Capital's preferred stock was converted to common stock and disposed of.

Professor Josh Lerner and Brenda Chia (MBA 1996) prepared this case. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

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Chu stayed briefly on Digital Angel's management team while Wang turned his attention to the rest of the Zero Stage Capital portfolio companies that had characteristics similar to OuterLink: mature privately-held companies for which exits could be creatively and expediently crafted by repositioning the core businesses and technology applications.

Building the Team

Wang and a group of individuals external to Zero Stage Capital formed a team to execute the investment strategy. These individuals had a complementary set of expertise—company operations, investment banking, private equity and law—that proved essential to implementing the strategy on a larger scale.

The team that came together consisted of Edwin Wang, Theodore Tedeschi, Brenda Chia and Michael Robbat. *Edwin Wang* was an investment professional with 20 years of experience in private equity, principal investing, and cross border investment banking. *Theodore Tedeschi* was an attorney (who had represented Zero Stage Capital on legal matters for many years) with 30 years of experience representing private equity investment professionals and partners, diverse public and private companies, financial institutions, alternative asset managers and governmental and quasi-governmental authorities; *Brenda Chia* (MBA '96) had broad U.S. and international experience developing and executing business, marketing, and operational strategies for emerging and established companies. *Michael Robbat* was an attorney specializing in private equity and mergers and acquisitions.

The team articulated and implemented an investment approach for addressing the Zero Stage Capital portfolio: First, the team would identify portfolio companies with valuable technology whose board and management were interested in working with the team to plan a near-term (18–36 months) path to liquidity. Second, the team would identify potential acquirers for whom the company's technology might be attractive. Third, the team would act as activist shareholders to effect change in accordance with the plan, e.g., financial restructuring, cost cutting, management changes, and reconfiguration of business in order to drive realizable investment return. The changes would require cash infusion(s) targeted specifically at implementing the plan. Interests in companies that had neither valuable technology nor the willingness to work with the team were liquidated, typically to existing co-investors.

After 18 successful exits from 2004 through mid-2006, Wang and the team began to contemplate whether a fund could be raised to capitalize on a larger market opportunity: to create liquidity for what would be termed "orphaned" venture-backed companies in non-Zero Stage Capital portfolios. But first the team had to determine whether there would be a market for such a fund.

Off to Raise a Fund

As 2006 progressed, the team became confident that it could raise a fund based on discussions with potential institutional investors. Whether the team's confidence was misplaced would require overcoming three hurdles. First, the team would have to convince potential investors that they could access high quality dealflow to justify capitalizing a fund. Second, the team would have to convince potential investors that it would be able to generate attractive returns by executing on an investment approach that is distinct from typical venture capital. Third, the team had to prove it could scale itself by recruiting additional talent to source, execute and exit its investments.