Forethought®

To: Rob Campbell, Dick Kramlich, Phil Lamoreaux

From: Bob Gaskins

Subject: What to Do About the Microsoft Offer, and Why

Because there was some surprise at my recommendation during our last Forethought board meeting, and because I will be out of town during the week June 15–19, I wanted to provide Forethought's directors now with a more careful explanation of what reasoning has led to my conclusion.

The Restart is Complete

In June of 1984—almost precisely three years ago, at the same time I joined the company—Forethought began its restart plan. This business plan was in outline very simple:

(1) Immediately acquire marketing rights to software products developed by others, and use these products to build Forethought marketing, sales, and operations into a delivery vehicle for software, even though not immediately profitable;

(2) Meanwhile, and in parallel, begin to develop our own first product (PowerPoint) internally, consciously designing it for high profitability.

Executing that plan took three years of hard work, on all of our parts, and a lot of investment capital—about $1 million left unspent in June 1984, plus another $3 million raised since the restart. The details of how the plan was executed are instructive, but for our purposes here all that is important is that we have now, finally, finished it.

PowerPoint is widely acknowledged as a great product, and the first entrant in a giant market. Forethought was able to sell and ship over $1 million worth of PowerPoint in the first month, with a net profit of over $400,000. And as a result of both the product and its sell-in, we have raised the potential value of Forethought above the amount of invested capital. At our last Preferred C round in 1986–87, the pre-money valuation of Forethought was $1.8 million. Today, we have valuations of the company in the range of $12 million to $18 million, or 6 to 10 times the valuation only months ago.

We have delivered what we said we would deliver.

Options

What we did *not* have, in any detail, was a plan for what to do next. Having reached the successful end of our first plan, we must decide what to do now. We have discussed four options:

(1) Accept the Microsoft offer;
(2) Restructure Forethought for longer-term growth;
(3) Consider other merger/acquisition possibilities;
(4) Do an IPO within 60 to 90 days.

Note that just continuing on pretty much as we have been operating is not one of the options. Our success with PowerPoint has presented opportunities which rule out that choice.

For convenience, I'll discuss these four options in reverse order.

Do an IPO Within 60 to 90 Days

It would be very advantageous to do an IPO right now, in the current market and with the "Aldus influence" present, to build a war chest of $5 million to $10 million on favorable terms. We all understand the appeal of this option.

Unfortunately, despite the recommendation at the May 27th board meeting, no one at Forethought (including Rob) believes that the company can successfully accomplish an IPO this Fall.

Forethought is still structured and staffed as when it was an unprofitable start-up, and we have not put in place the foundations needed for future growth. Hence, we do not believe that we can deliver success with this strategy. Obviously, we wish that this were not true.

Consider Other Merger/Acquisition Possibilities

Xerox, on lengthy further talks, has decided that it wants to take over exclusive world-wide marketing rights to PowerPoint on IBM, but is willing to guarantee only a $2 million royalty (on 40,000 units) for those rights. It has further unrealistic aspirations about introduction timing which make even those guarantees speculative. This would be a very poor deal—capping our opportunity, but removing none of the risk (perhaps even making it riskier).

Ansa would like to swallow us to create a mini-conglomerate with sufficient revenue (never mind strategy) for an Ansa IPO this Fall. The offer is to merge for Ansa stock, in an amount not yet determined. Since Ansa's last year was $8 million revenue and unprofitable, with the plan for this year at $16 million with only 3% profit, this is unattractive. Ansa is higher risk than we are, in a colder category, and the resulting company is unfocused and has much poorer profitability than we have alone. It is reasonable to think that our Ansa stock would be worth less than we are worth alone, today.

Apple and its new software company are even more unlikely to produce a successful result, and they have already refused to make an offer.

There are other less-probable partners, but in common with the ones listed above they are all less attractive than either strengthening Forethought to go on alone or accepting Microsoft's offer.

Restructure Forethought for Longer-Term Growth

The option of restructuring Forethought to go on is the one which really has to be compared to the Microsoft offer. It is what we would have had to do if Microsoft had not appeared, and it is what we would still have to do if the Microsoft deal cannot for some reason be concluded. So it merits careful consideration.

We would need to make major changes in our company to reach the next level of successful growth—as would any company in our position. A major need is to recruit additional management.

What we would probably decide to do is to first hire a new President and CEO, someone with a track record. Then we would let the new President hire a new CFO who would also take over operations, and hire a new Vice President of Marketing. This new team would restructure and re-position Forethought to be a sharply-focused presentation company and the pre-eminent competitor in that category (an "Aldus" strategy). With this done, they would complete the infra-structure for an IPO to take place as soon as possible.

While these changes take place, the people who are already here would try to keep up the momentum: Glenn would try to keep sales on track, during a major expansion of international sales and corporate sales; Bob would try to keep new products coming as we enter the new world of IBM; and Rob (probably as Chairman) would keep up evangelizing the category and the product in his uniquely-effective style.

This is not a bad plan, and if we had no better offer we might well pursue it.

Evaluation of Risk/Reward in Restructuring

Restructuring Forethought has the possibility to raise the company value by perhaps another factor of five (from $12–$20 million to $50–$100 million). But it is also very possible that we would encounter problems in execution, very strong competition, and a much weaker IPO market in a year or two, and that we could be worth no more than we are today, or substantially less. Part of the calculation is to decide what are the chances of these two outcomes.

Nor would the strategy be free. It would cost about 10% of the company to attract a new President/CEO, new CFO/Operations, and new VP of Marketing. In addition, it will very likely take some further investment to enter the IBM marketplace next Spring ($5 to $10 million?) before an IPO could take place.

Timing would be critical. It is imperative to have most of our full team in place early enough to do the work to introduce our IBM product, say in a year. We would have to hire a search firm, locate a CEO and hire him, get him in and teach him the business. He would have to hire a CFO and a VP of Marketing through similar steps. Then each of these would have to hire two or three senior people.

Realistically, the risks in the restructuring option are *very* high.

The whole plan depends critically on hiring many new senior people, who are not yet identified. It is not clear that this much rebuilding can be done in the time remaining before we have to face strong competitors. Even if it could, we cannot afford to make one error in our initial selections, because there is no time to try-out and replace anyone. Also, a thorough restructuring of the ways we have operated for so long would have to take place without any divisive internal conflict.

We have very strong competitors poised to move while we rebuild. If everything does not go perfectly, then they will have an excellent chance to out-distance us. And one of the lessons we absolutely know is that our value today as the potential category leader is higher than our value would be a year or two from now as an also-ran product and also-ran company, behind another established category leader.

For these reasons, I conclude that restructuring Forethought would be too risky to undertake, compared with the Microsoft offer we have.

Accept the Microsoft Offer

We now have the Microsoft offer of Friday, June 12. It offers $9 million in cash (not stock) now, plus up to $3 million in cash for sales of up to 40,000 units of PowerPoint ($75 each) by March 31, 1988, plus $2 million in cash for releasing PowerPoint IBM on Windows by June 1988 and $1 million in cash for releasing it on OS/2 Presentation Manager by a month after IBM ships. Forethought would be integrated into Microsoft, not run independently for a year. (The sales targets seem reasonable, and so do the development targets—but depending, of course, on what resources are available.)

The Microsoft offer gives our shareholders $12–$15 million in cash. I judge it is possible but very unlikely that they would be able to do better under the restructuring option at any time in the future.

Microsoft already has a plan and a strategy to succeed in presentations, and they understand the category and product requirements. This is the reason that they are willing to purchase PowerPoint and Forethought for cash, assuming all risk, because they feel more confident than others in judging its value. Microsoft values both the Macintosh and IBM versions of PowerPoint, which also contributes to their willingness to pay for all of PowerPoint's value.

The acquisition will be very positive for both companies. It will be perceived as a coup by Forethought, to have established the first product that Microsoft was willing to buy a company to obtain, and to be the nucleus of a Microsoft Product Center in Northern California as the first expansion of Microsoft outside their operations in Redmond and in Japan. There is also an excellent chance that the result will be wildly successful for Microsoft, with PowerPoint established as the clear leader in its category. This is an important outcome for both sides.

I recommend that we accept the Microsoft offer.

Next Steps

The Microsoft opportunity is open for a short time only. We have been told the name of the Microsoft product manager ready to start on a competing product, and that a development team of six people has been identified and is ready to start work. If Microsoft cannot buy a product, they must develop one. They have studied PowerPoint closely enough to know what to do. They would need to get started.

For this reason, having decided that our best interest is to accept the Microsoft offer we should do so promptly.

We should not delay looking for other potential acquirers who are only vapor. We also should not worry at all about trying to negotiate any terms on which this location is to be run after the acquisition—once the purchase is made, Microsoft should do whatever they think is best. The only negotiation should be to make the deal as rich as possible and as risk-free as possible for our shareholders.

I would suggest that Dick and Phil handle the negotiations from here on out, with Dave Marquardt of Microsoft's board or with Microsoft's management. I believe that they can argue that the simplest and cleanest deal for everyone is to pay essentially the full price in cash up front. It might be reasonable to have some fairly small amount depend on the success of the product's sales over the next year, but the degree of that sales success will be pretty well up to Microsoft during the year and not the momentum from what we've done. Similarly, it makes little sense to give the former Forethought shareholders incentives to finish development projects—they have no way to influence Microsoft's development team. It would make more sense for Microsoft to provide incentives to the development group for timely completion.

I would hope that a letter of intent could be signed in the next week or so, with the acquisition complete by the end of June.