

QuickLaunch University Webinar Series

Planning for Exit—Why It's Never Too Early



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Webinar Guidelines

- Participants are in listen-only mode
- Submit questions via the Q&A box on the bottom right panel
- Questions will be answered as time permits
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Goals of Presentation

- Overview of basics of M&A Deal Structures and Issues
- Identification of things that you can be doing now to make a future sale faster and smoother



Overview

Exit Scenarios

- Acquisition of Assets
- Acquisition of Stock
- Merger

Timeline of the Deal

- Confidentiality agreement
- Term sheet
- Due diligence
 - IP issues
 - HR issues
 - Other issues

- AcquiHire
- Initial Public Offering (IPO)

- Definitive agreement
 - Representations & warranties
 - Deal certainty
 - Escrow & indemnity



Exit Scenarios



Exit Scenarios *Overview*

- Acquisition of assets
- Acquisition of stock
- Merger
- AcquiHire
- Initial Public Offering (IPO)



Exit Scenarios *Acquisition of Assets*

Acquisition of specified assets and assumption of specified liabilities

Advantages

- Allows the buyer to “cherry pick” assets and leave behind unwanted and undisclosed liabilities
- May only require action by the seller





Exit Scenarios *Acquisition of Assets*



Disadvantages

- Mechanical difficulty of identifying what goes and what stays
- Consent of third parties to assign certain assets and contracts
- Manual transfer of employees (i.e., the buyer must hire each employee directly)
- Transitional services may be required if certain assets must be shared between the buyer and seller post-closing
- Additional requirements may apply to the transfer of certain classes of assets (e.g., patents, motor vehicles, real property)
- Operations of the seller will continue pending satisfaction of obligations under the definitive agreement, followed by winding down of the seller
- Potential double taxation of sale proceeds



Things You Can Do Now To Be Ready

Keep all your corporate documents in one place (PDFs on a computer is best)

Get a diligence request list form from your outside counsel and organize your files in folders according to the list (this will also help you for VC funding and IPOs)



Exit Scenarios *Acquisition of Stock*

Acquisition of shares directly from the target company's shareholders



Advantages

- Does not affect corporate existence of target company
- Generally no assignments needed, thereby reducing the number of third party consents

Disadvantages

- Requires cooperation from every holder to get 100% ownership (often including option and warrant holders)
- Typically suitable only for smaller, closely-held entities



Things You Can Do Now To Be Ready

Keep track of Change of Control (CoC) clauses, special severance arrangements and other provisions in agreements that would be triggered in an acquisition

Try not to sign a lot of CoC clauses...



Exit Scenarios *Merger*

Acquisition of target company through combination of entities pursuant to state law



Advantages

- Can be accomplished by a vote of less than all shareholders
- As with an acquisition of stock, third party consents are needed only when specifically required

Disadvantages

- Creature of statute – must comply with statutory requirements



Things You Can Do Now To Be Ready

Make sure as you issue equity that you are getting people signed up to DRAG agreements

Avoid “operation of law” language in your anti assignment causes



Exit Scenarios *AcquiHire*



Acquisition of talent by the buyer, often accompanied by a license of all valuable IP and a wind down of the target company's existing business

Advantages

- “Softer landing” for a startup struggling to raise funding
- Fast way to hire groups of technical talent versus one-off hires

Disadvantages

- Assets, liabilities and equity remain with the target, who then bears the burden and risks that accompany the winding down of the entity post-closing
- Often low-value to shareholders



Exit Scenarios Initial Public Offering (IPO)

Initial sale of stock to public investors



Advantages

- Maintaining independence of the company
- Access to capital markets

Disadvantages

- IPO window dependent on strength of capital markets
- Time to liquidity
- Expense
- Required public disclosures
- Dilution



Things You Can Do Now To Be Ready

Keep up on your comps & industry stats and add them to that files folder (will be key to backing up your S-1 someday)

Get to know the I-Bankers in your space early (may also help you with M&A later)



Timeline of the Deal





Timeline of the Deal *Overview*

- The Confidentiality and
- Non-Disclosure Agreement
- The Term Sheet
- Due Diligence
 - IP issues
 - HR issues
- The Definitive Agreement
 - Representations & warranties (“R&W”)
 - Deal certainty
 - Escrow & indemnification





Timeline of the Deal *The Confidentiality and Non-Disclosure Agreement*

- Entered into prior to discussions and preliminary due diligence
- Protects the confidentiality of the target's proprietary information (one-way), but may also protect a Buyer who also shares its confidential information (mutual)
- Agreements in the M&A context typically address:
 - Scope of information to be treated as confidential
 - Non-use and non-disclosure (limitations on disclosure and use of the confidential information)
 - Exceptions and carve-outs to scope and non-use / non-disclosure obligations (e.g., residuals clauses, public disclosure)
 - Duration of obligations
 - Obligation to return or destroy information if discussions terminate
 - Non-solicitation of employees / customers



Things You Can Do Now To Be Ready

Keep all your confidentiality agreements in that file system (impossible to find later & will hurt your representations)

Know the difference between an M&A form and other forms and don't sign the wrong one

Make your confidentiality agreements mutual



Timeline of the Deal *The Term Sheet*

- Consideration
 - Deal price and type of consideration (e.g., cash or stock)
- Deal structure
- Anticipated conditions to signing and to closing
 - Agreement of key employees
 - Regulatory approvals or key third party consents
 - Remediation of identified IP deficiencies
- Liability package
 - Escrow
 - Scope of indemnity
 - Limitations on recovery (e.g., caps, baskets)
- Exclusivity





Things You Can Do Now To Be Ready

Read a few term sheets to understand the basics

Get your go-to team identified (Board Member, VC, Lawyer)



Timeline of the Deal *Due Diligence* – Overview

A buyer's level of diligence depends on its sophistication and the relative leverage between a buyer and seller



High Priority Review

- Capitalization of the company, equity plans and employment agreements
- IP chain of title, sustainability of key products and/or code bases
- Key in- and out-bound license, supply, manufacturing or similar agreements
- Material contracts for change of control issues and commercial terms (e.g., MFNs) and liability issues (e.g., uncapped indemnities)
- Pending or threatened litigation, investigations or third party claims



Other Areas of Review

- Key and key transitional employees
- Product and cost-savings synergies
- Target's compensation and benefits plans
- Financial statement diligence and analysis of AR/AP and revenue recognition policies
- Related party transactions



Timeline of the Deal *Due Diligence* – IP Issues

- In due diligence
 - Inventory of owned and in-licensed IP
 - Chain of title to owned IP (e.g., invention assignments, liens, etc.)
 - Scope of protection for key products and technologies (e.g., breadth of claims, geographic scope, expiration)
 - Appropriate limitations third party rights to out-licensed IP
 - Compliance with terms of in-licensed IP
 - Use of open source
- Pre-closing remediation of problematic IP
- Scope of IP protection in the R&W
 - Ownership and non-infringement
 - Disclosure of material risks, threatened / pending litigation
- The indemnity package – is IP “Fundamental?”



"You have to admit that your cbip looks a lot like their cbip."

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Timeline of the Deal *Due Diligence* – *HR Issues*

- Identifying and negotiating retention packages for key employees and key transitional employees
- Impact of change of control provisions and payments waterfall on retention of employees
- Mapping of target's employee base to buyer organizational structure
- Mapping of target's compensation and benefits to buyer's own plans



Timeline of the Deal *Due Diligence* – *Other Areas to Keep in Mind*

- Regulatory / Antitrust
- Anticorruption Compliance
- Privacy
- Data Security & Cybersecurity
- Labor & Employment
- Executive Compensation & Benefits
- Tax
- Environmental





Questions?



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