2010 M&A Report

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Market Review

The sharp decline in M&A activity that began in 2008 continued, though at a more gradual rate, in 2009. Global M&A deal volume decreased from 23,589 transactions in 2008 to 19,127 in 2009, a 19% decrease. Similarly, global M&A deal value decreased by 27% to $1.12 trillion in 2009, down from $1.54 trillion in 2008. These numbers stand in stark contrast to the 31,833 transactions with a record $2.69 trillion deal value in 2007. The global totals for 2009 represent the smallest M&A deal value since 2003 and the lowest annual deal volume in at least a decade, as world economies struggled to resume growth and credit conditions remained tight for much of the year.

Average global deal size based on M&A transactions where the price was disclosed edged down to $155.4 million in 2009 from $166.0 million in 2008 (compared to $201.9 million in 2007). On a brighter note, the number of deals showed sequential quarterly increases in each of the last three quarters of 2009 after declining for seven consecutive quarters. Aggregate deal value rose in the first quarter of 2009, only to fall sharply in the next two quarters before rebounding in the fourth quarter of the year.

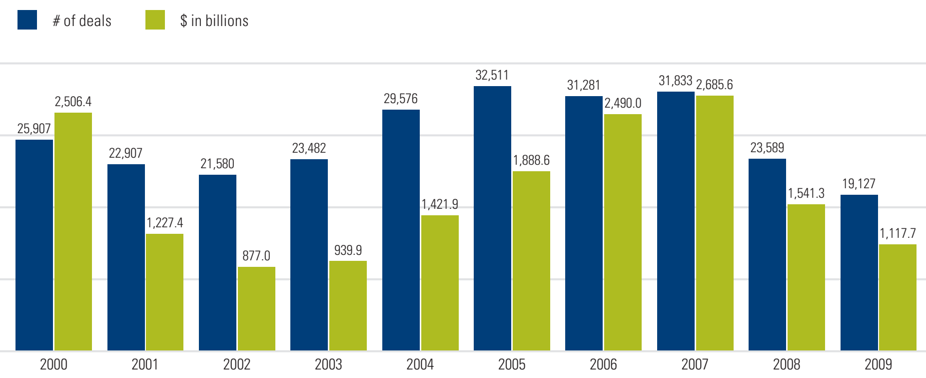
In the United States, the volume of M&A activity decreased 16%, from 8,144 transactions in 2008 to 6,853 in 2009. US deal value decreased by 18%, from $690.2 billion in 2008 to $564.3 billion in 2009.

In Europe, both deal volume and deal value decreased even more dramatically from 2008 levels. Deal volume decreased by 27%, from 10,139 deals in 2008 to 7,371 in 2009. Total deal value decreased by 51%, from $773.9 billion in 2008 to $379.0 billion in 2009.

The Asia-Pacific region also experienced a decline in deal volume and value. The number of Asia-Pacific deals decreased 14%, from 7,342 transactions in 2008 to 6,285 in 2009, while aggregate deal value fell 21%, from $392.4 billion in 2008 to $308.1 billion in 2009.

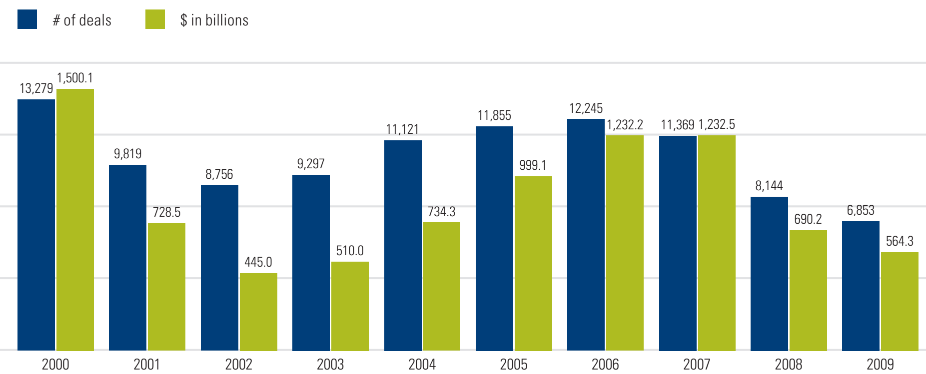
The decreases in average deal size were primarily due to the worldwide decline in the number of billion-dollar transactions, which fell 30%, from 262 during 2008 to 184 during 2009. Aggregate global billion-dollar deal value decreased by 26%, from $975.0 billion in 2008 to $721.1 billion in 2009. The number of billion-dollar transactions involving US companies experienced a 19% decline, dropping from 97 in 2008 to 79 in 2009. The aggregate value of billion-dollar US deals decreased 13%, from $483.9 billion in 2008 to $420.3 billion in 2009. The number of billion-dollar transactions involving European companies fell by more than 44%, from 146 in 2008 to 82 in 2009, and aggregate deal value decreased 51%, from $496.0 billion to $241.7 billion. Billion-dollar transactions involving Asia-Pacific companies fell 14%, from 64 deals to 55, and aggregate deal value decreased 30%, from $215.8 billion in 2008 to $151.4 billion in 2009.

M&A Activity – Worldwide



Source: MergerStat

M&A Activity – United States



Source: MergerStat

Sector Analyses

Unlike 2008, in which all principal industry sectors experienced a decline in both deal volume and deal value, results varied across sectors in 2009:

- The global financial services sector saw a 19% decrease in deal volume, from 1,145 transactions in 2008 to 931 in 2009. Aggregate global financial services sector deal value dropped a whopping 62%, from $237.4 billion in 2008 to $91.3 billion in 2009. In the United States, financial services sector deal volume dipped 3%, from 359 deals in 2008 to 350 deals in 2009, but aggregate deal value decreased dramatically from $122.0 billion in 2008 to $35.5 billion in 2009.
- The technology sector experienced a decline in both deal volume and deal value, with the total number of IT deals decreasing 17%, from 3,393 in 2008 to 2,808 in 2009. Global IT deal value decreased 18%, from $87.4 billion in 2008 to $71.3 billion in 2009. US IT deal volume decreased 12%, from 1,735 deals to 1,523, while US aggregate IT deal value dropped by 9%, from $64.1 billion in 2008 to $58.2 billion in 2009.
- The telecommunications sector also felt the impact of the global decline in deal activity, with deal volume decreasing 17%, from 687 deals in 2008 to 569 in 2009. Global telecommunications deal value decreased by more than 33%, from $89.6 billion in 2008 to $60.2 billion in 2009. US deal volume fell 9%, from 201 in 2008 to 183 in 2009. Despite this relatively modest decrease in deal volume, however, US aggregate telecommunications deal value experienced a 14% increase, from $15.9 billion in 2008 to $18.1 billion in 2009.
- Relatively speaking, the life sciences sector fared better than most in 2009. Global M&A transaction activity in the life sciences sector decreased by 19%, from 862 deals in 2008 to 700 in 2009. Global life sciences deal value, however, saw a 22% increase, from $137.2 billion in 2008 to $166.9 billion in 2009. The US life sciences sector saw a 7% decrease in deal volume, from 397 transactions in 2008 to 371 in 2009, while aggregate US life sciences deal value increased 44%, from $105.8 billion to $152.7 billion.
- The M&A market for venture-backed companies saw a 10% decrease in deal volume, from 381 deals in 2008 to 344 deals in 2009. Total deal value dropped 31%, from $25.3 billion in 2008 to $17.4 billion in 2009.

Outlook

M&A activity has picked up in 2010 with improving economic conditions and large cash holdings by strategic acquirers. Through September 30, transaction and dollar volumes were up across many regions and sectors and already exceeded the global totals for all of 2009. For the first nine months of 2010, global M&A deal volume reached 19,347 transactions with global deal value of $1.44 trillion—US tallies through September 30 were 6,690 transactions with an aggregate value of $637.5 billion.

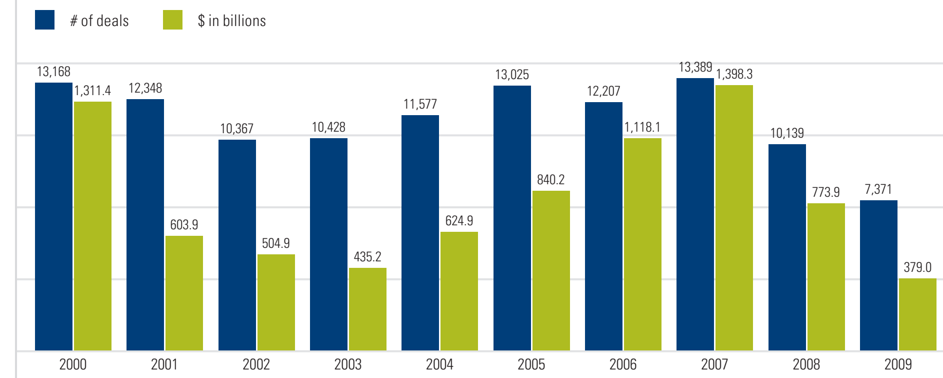
Technology companies are once again in vogue as acquisition targets, as evidenced by Intel's acquisition of McAfee for $7.7 billion, SAP's acquisition of Sybase for $5.8 billion and IBM's acquisition of Netezza for $1.7 billion. The number of contested transactions has also increased, as exemplified by the takeover battle between Hewlett-Packard and Dell for 3PAR (ultimately won by Hewlett-Packard for $2.4 billion).

Expectations for the coming year are generally optimistic, particularly for deal activity by strategic acquirers who have stockpiled large cash balances. Further improvements in economic conditions and easing credit conditions should also boost the strategic acquisition market. Technology companies—including those in the life sciences—are likely to remain attractive targets.

The role of private equity remains somewhat less clear. On the sale side, many private equity firms are looking to dispose of companies acquired in the past several years as original debt financings become due. On the buy side, private equity funds are still facing challenging debt markets and may be at a competitive disadvantage with strategic acquirers in valuing available targets.

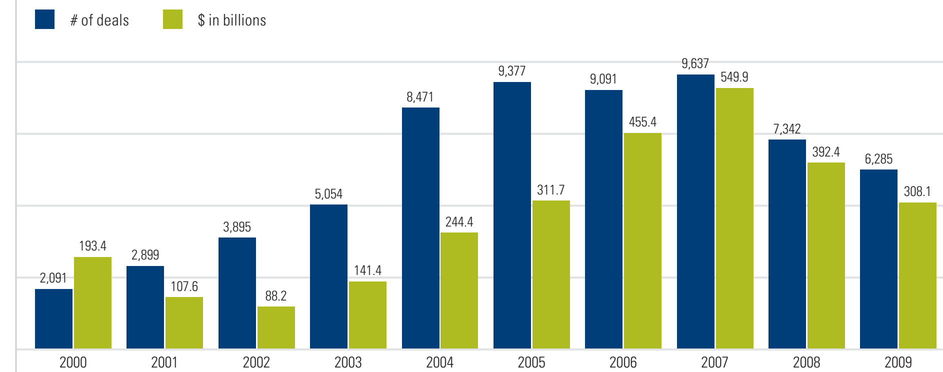
Overall, 2011 should see an increase in deal activity from the levels of 2009 and 2010. The extent of that pickup is likely to depend on the health of the capital markets and the strength of the economy as a whole. ■

M&A Activity – Europe



Source: MergerStat

M&A Activity – Asia-Pacific



Source: MergerStat

Public and private M&A transactions share many characteristics, but also involve different rules and conventions. Described below are some of the ways in which public company deals differ from private company deals.

General Considerations

The M&A process for public and private companies differs in several respects:

- *Structure:* An acquisition of a private company may be structured as a stock purchase or a merger. A public company acquisition is usually structured as a merger or a tender offer, since stock purchases are impracticable with public stockholders.
- *Letter of Intent:* If a public company is party to an acquisition, there usually is no letter of intent describing the proposed terms. The parties typically go straight to a definitive agreement, due in part to concerns over creating a disclosure obligation for a deal that is not yet ripe to announce.
- *Timetable:* The timetable before signing the definitive agreement is often more compressed in an acquisition of a public company, because the existence of publicly available information means due diligence can begin in advance and all parties share a desire to minimize the period of time during which the news might leak. More time may be required between signing and closing, however, because of the requirement to prepare and circulate a proxy statement for stockholder approval (unless a tender offer structure is used), and the need in many public company acquisitions for antitrust clearances that are less likely to be required in smaller, private company deals.
- *Confidentiality:* The potential damage from a leak is much greater in an M&A transaction involving a public company, and accordingly rigorous confidentiality precautions are taken.
- *Director Liability:* The board of a public company target has more practical exposure to stockholder claims than a private company board and is much more likely to obtain a fairness opinion from an investment banking firm.

Due Diligence

When a public company is acquired, the due diligence process differs from the process followed in a private company acquisition:

- *Availability of SEC Filings:* Due diligence typically starts with the target's SEC filings—enabling a potential acquirer to investigate in stealth mode until it wishes to engage the target in discussions.
- *Speed:* The due diligence process is often quicker in an acquisition of a public company, reflecting the availability of SEC filings and a higher materiality threshold, thereby allowing the parties to focus quickly on the key transaction points.
- *Section 280G:* The stockholder vote procedure to avoid the 20% penalty tax on "golden parachute" payments under Section 280G of the federal tax code is not available for a public company target, so additional inquiry is necessary to understand the tax consequences of any such payments.
- *Virtual Data Room:* The target usually utilizes a virtual data room to manage due diligence, especially if an auction process is employed with multiple bidders.

Merger Agreement

The merger agreement for an acquisition of a public company reflects a number of differences from its private company counterpart:

- *Representations:* In general, the representations and warranties from a public company are less extensive than those from a private company, are tied in many respects to the accuracy of the public company's SEC filings, have higher materiality thresholds, and do not survive the closing.
- *Closing Conditions:* The closing conditions in the merger agreement, including the "no material adverse change" condition, are generally tightly drafted and give the acquirer little room to refuse to complete the transaction if regulatory and stockholder approvals are obtained.
- *Post-Closing Obligations:* Post-closing escrow or indemnification arrangements are rare, and earnouts are unusual.
- *Deal Protections:* The negotiation battleground is the deal protection provisions—the exclusivity, voting agreement, termination and breakup fee provisions.

SEC Involvement

The SEC plays no role in a private-private M&A transaction, but when a public company is involved, various SEC filings, and possibly a full SEC review process, result:

- *Form S-4:* In a public-public deal, if the acquirer is issuing stock to the target's stockholders, the acquirer must register the issuance on a Form S-4 registration statement that is filed with (and possibly reviewed by) the SEC.
- *Stockholder Approval:* Absent a tender offer, the target's stockholders and sometimes the acquirer's stockholders must approve the transaction. Stockholder approval is sought pursuant to a proxy statement that is filed with (and possibly reviewed by) the SEC.
- *Public Communications:* Elaborate SEC regulations govern public communications by the parties in the period between the first public announcement of the transaction and the closing of the transaction.
- *Multiple SEC Filings:* Many Form 8-K and Rule 425 filings are often required by public companies that are party to M&A transactions. (Rule 425 requires most written communications in connection with a business combination transaction to be filed with the SEC.) ■

Set forth on the following page is a comparison of selected deal points in public and private acquisitions, based on the 2009 deal points studies published by the Mergers & Acquisitions Committee of the American Bar Association's Business Law Section.

Comparison of Selected Deal Terms

The accompanying chart compares the following deal terms in public and private acquisitions:

- *"Full Disclosure" Representation:* A representation to the effect that no representation or warranty by the target contained in the acquisition agreement, and no statement contained in any document, certificate or instrument delivered by the target pursuant to the acquisition agreement, contains any untrue statement of a material fact or fails to state any material fact necessary, in light of the circumstances, to make the statements in the acquisition agreement not misleading.
- *Standard for Accuracy of Target Reps at Closing:* The standard against which the accuracy of the target's representations and warranties is measured for purposes of the acquirer's closing conditions:
  - A "MAE/MAC" standard provides that each of the representations and warranties of the target set forth in the acquisition agreement must be true and correct in all respects as of the closing *except where the failure of such representations and warranties to be true and correct will not have or result in a material adverse effect/change on the target.*
  - An "in all material respects" standard provides that each of the representations and warranties of the target set forth in the acquisition agreement must be true and correct *in all material respects* as of the closing.
  - An "in all respects" standard provides that each of the representations and warranties of the target set forth in the acquisition agreement must be true and correct *in all respects* as of the closing.
  - The "hybrid" standard provides that each of the representations and warranties of the target set forth in the acquisition agreement *that is qualified by materiality must be true and correct in all respects* as of the closing and each of the representations and warranties of the target set forth in the acquisition agreement *that is not qualified by materiality must be true and correct in all material respects* as of the closing.
- *Inclusion of "Prospects" in MAE/MAC Definition:* Whether the "material adverse effect/change" definition in the acquisition agreement includes "prospects" along with other target metrics, such as the business, assets, properties, financial condition and results of operations of the target.
- *Fiduciary Exception to "No-Talk" Covenant:* Whether the "no-talk" covenant prohibiting the target from seeking an alternative acquirer includes an exception permitting the target to consider an unsolicited superior proposal if required to do so by its fiduciary duties.
- *Opinion of Target's Counsel as Closing Condition:* Whether the acquisition agreement contains a closing condition requiring the target to obtain an opinion of counsel, typically addressing the target's due organization, corporate authority and capitalization; the authorization and enforceability of the acquisition agreement; and whether the transaction violates the target's corporate charter, by-laws or material contracts or applicable law.
- *Appraisal Rights Closing Condition:* Whether the acquisition agreement contains a closing condition providing that appraisal rights must not have been sought by target stockholders holding more than a specified percentage of the target's outstanding capital stock. (Under Delaware law, appraisal rights generally are not available to stockholders of a public target when the merger consideration consists solely of publicly traded stock.)
- *Acquirer MAE/MAC Walk Right:* Whether the acquisition agreement contains a closing condition permitting the acquirer to terminate the agreement if an event or development has occurred that has had, or could reasonably be expected to have, a "material adverse effect/change" on the target. ■

"Full Disclosure" Representation		
Public	2%	
Private	67%	
Standard for Accuracy of Target Reps at Closing		
Public	"MAE/MAC"	90%
	"In all material respects"	1%
	Hybrid	9%
Private	"MAE/MAC"	34%
	"In all material respects"	58%
	"In all respects"	8%
Inclusion of "Prospects" in MAE/MAC Definition		
Public	2%	
Private	38%	
Fiduciary Exception to "No-Talk" Covenant		
Public	98%	
Private	25%	
Opinion of Target's Counsel as Closing Condition		
Public	1%	
Private	58%	
Appraisal Rights Closing Condition		
Public	Cash deals	9%
	Cash and stock deals	25%
Private	57%	
Acquirer MAE/MAC Walk Right		
Public	97%	
Private	98%	

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Netezza	*Acquisition by*	IBM	$1,700,000,000	November 2010
SkillSoft	*Acquisition by*	Berkshire Partners, Advent International and Bain Capital	$1,200,000,000	May 2010
NewRiver	*Acquisition by*	Broadridge	$77,000,000	August 2010
BAE Systems	*Acquisition of Atlantic Marine Holding from*	JFL-AMH Partners	$352,000,000	July 2010
PerkinElmer	*Sale of Illumination and Detection Solutions business to*	Veritas Capital Fund III, L.P.	$500,000,000	Pending*
Starent Networks	*Acquisition by*	Cisco Systems	$2,900,000,000	December 2009
Sepracor	*Acquisition by*	Dainippon Sumitomo Pharma	$2,600,000,000	October 2009
Unica	*Acquisition by*	IBM	$480,000,000	October 2010
Broadcom	*Acquisition of digital TV business of*	AMD	$141,500,000	October 2008
Akamai	*Acquisition of*	acerno	$95,000,000	November 2008
SS&C	*Acquisitions of*	Evare, MAXIMIS software, TheNextRound, thinklink and Tradeware Global	Undisclosed	Various dates 2009–2010
Staples	*Acquisition of*	Corporate Express	$4,400,000,000	July 2008 (co-counsel)
EqualLogic	*Acquisition by*	Dell	$1,400,000,000	January 2008
Camiant	*Acquisition by*	Tekelec	$130,000,000	May 2010
Aspect Medical Systems	*Acquisition by*	Covidien	$210,000,000	November 2009
Arbor Networks	*Acquisition by*	Tektronix	Undisclosed	August 2010
Teradyne	*Acquisition of*	Eagle Test Systems	$250,000,000	November 2008
ING	*Acquisition of CitiStreet from*	Citigroup and State Street	$900,000,000	July 2008
Red Hat	*Acquisition of*	Qumranet	$107,000,000	September 2008
CuraGen	*Acquisition by*	Celldex Therapeutics	$94,500,000	October 2009
BioSphere Medical	*Acquisition by*	Merit Medical Systems	$96,000,000	September 2010
TUI Aktiengesellschaft	*Sale of Hapag-Lloyd to*	Albert Ballin Konsortium	€4,450,000,000	March 2009
Alnara Pharmaceuticals	*Acquisition by*	Eli Lilly	$180,000,000	July 2010
Penwest	*Acquisition by*	Endo Pharmaceuticals	$170,000,000	September 2010
The Medicines Company	*Acquisition of*	Targanta Therapeutics	$137,000,000	February 2009
Stream Global Services	*Acquisition of*	EGS	$185,000,000	October 2009
Discovery Communications	*Combination of ownership interests of Discovery Holding Company and Advance/Newhouse Programming Partnership*		$6,800,000,000	September 2008 (counsel to Discovery Communications, Inc.)
NYFIX	*Acquisition by*	NYSE Euronext	$144,000,000	November 2009
Thermo Fisher Scientific	*Acquisition of*	Fermentas International	$260,000,000	July 2010
Millennium	*Acquisition by*	Takeda Pharmaceutical	$8,800,000,000	May 2008
Airvana	*Acquisition by*	S.A.C. Private Capital Group, GSO Capital Partners, Sankaty Advisors and ZelnickMedia	$540,000,000	April 2010
Gloucester Pharmaceuticals	*Acquisition by*	Celgene	$640,000,000 (including milestone payments)	January 2010

*As of November 15, 2010

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In August 2010, the Federal Trade Commission (FTC) and the Department of Justice (DOJ) issued a revision of the Horizontal Merger Guidelines that serve as a template for the US agencies' reviews of proposed horizontal mergers. The guidelines, which last underwent a major revision in 1992, are the product of an FTC and DOJ joint effort that began with the solicitation of feedback through five public workshops.

The 2010 guidelines are largely designed to describe more accurately the reality of the agencies' current practice, given the significant evolution of their approach in the 18 years since the last revision. In addition, the revisions incorporate concepts previously discussed in the agencies' "Commentary on the Horizontal Merger Guidelines" document, circulated in March 2006.

A major theme of the revisions is that the agencies have moved away from a rigid, structured market analysis in favor of a more fluid approach, tailored to each transaction. The new guidelines stress that merger analysis "is a fact-specific process through which the agencies use a variety of tools to analyze the evidence to determine whether a merger may substantially lessen competition." Accordingly, the revisions emphasize that merger analysis need not begin with, nor focus on, market definition or concentration in the relevant market.

To underscore this new, more flexible analytical framework, the revised guidelines include a new section addressing evidence of adverse competitive effects. This section outlines the wide variety of types and sources of evidence that an agency might gather to build its case. In addition to assessing market shares and concentration, the agencies typically search for historical "natural experiments" to compare market behavior before and after changed conditions; evidence of direct competition between the parties; the potential for the loss of a "maverick" party through the merger; and, if the merger has already been consummated, any evidence of actual adverse effects on competition.

Typical sources of this evidence include the merging parties, their customers and any other industry participants, such as competitors, industry associations or firms that sell complementary goods.

The revised guidelines include several other notable changes, including:

- A streamlined discussion of how the agencies evaluate market entry, although the analysis continues to focus on timeliness, likelihood and sufficiency of entry. Notably, the revision does not include the 1992 Horizontal Merger Guidelines' explicit presumption that entry will be considered timely only if it can be achieved within two years.
- An expanded section on unilateral effects, including a discussion regarding the evaluation of industries in which sales are conducted through formal or informal auction processes. Among other things, the agencies will examine the frequency with which one of the parties to the merger had been the runner-up when the other party won the business. This has been the agencies' practice, but was not explained in the previous guidelines.
- A recognition that one of the potential consequences of a merger is a loss of variety because the merger may result in cessation of one of the party's offerings. The agencies will examine whether this will lead to a "demonstrable loss of significant value to customers over and above any price effects," and consider whether a merged entity would spur or impair product innovation. The guidelines also note that not all variety reductions should be considered anticompetitive because some simply may reflect efficient consolidation.
- A loosening of market categories as measured by the Herfindahl-Hirschman Index (HHI): "unconcentrated" markets are now those with an HHI below 1,500 (formerly 1,000); "moderately concentrated" markets extend to an HHI of 2,500 (formerly 1,800); and concentrated markets are where the HHI measures above 2,500.
- A new section that elaborates on the approach the agencies will take to considering whether powerful buyers would prevent the merging parties from raising prices. Although the guidelines observe that the existence of powerful buyers, standing alone, will not dispel concerns about anticompetitive effects, the agencies will consider whether large purchasers could serve as a bulwark against anticompetitive behavior. The section also notes that "even if some powerful buyers could protect themselves, the Agencies also [will] consider whether market power can be exercised against other buyers."

The proposed revisions do not appear to signify any revolutionary departure from current merger analysis. Rather, the changes generally seem to memorialize the methodologies already implemented at the agencies. The revised guidelines should serve as a more useful guide to parties seeking to understand how the agencies are likely to evaluate a proposed merger.

The revised guidelines were approved with an FTC vote of 5-0. ■

HSR Filing Thresholds Decrease for First Time

If an acquisition involves a US company, or meaningful US revenues or assets of a foreign company, and meets the minimum size threshold prescribed by the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act), the parties must report the transaction to the FTC and DOJ and observe a waiting period before closing. The threshold transaction size for HSR Act reporting is subject to annual adjustment based on changes in the US gross national product.

Effective February 22, 2010, the filing threshold was reduced from $65.2 million to $63.4 million. All of the notification and exemption dollar thresholds in the HSR statute, regulations and reporting instructions that are subject to annual adjustments were also reduced. This is the first time that the HSR thresholds have decreased. ■

Private companies often make acquisitions before pursuing an IPO. Some deals occur in the ordinary course of business, before a company has given much thought to the possibility of an IPO, while others may be specifically intended to achieve critical mass in the company's revenues or to fill a gap in its product line in anticipation of going public.

In most situations, an acquisition demands significant time and attention from the acquirer's management. In the context of an IPO, many of the business challenges associated with M&A transactions are exacerbated:

- ***Management Distraction:*** IPO preparations alone give company management a full platter. Layering on an acquisition can make it overflow. Thoughtful allocation of management's time is needed to avoid doing a disservice to both the acquisition and the IPO, not to mention the company's business. Even with careful planning, pursuing a significant acquisition and an IPO concurrently is likely to slow down the IPO process.
- ***Integration:*** Business integration takes on a heightened importance in the crucible of an IPO. Many IPO companies are already in the midst of rapid organic growth. The additional challenge of simultaneously integrating a separate organization will increase the strain on the company—even more if product integration, facility closings or employee layoffs are involved. A pre-IPO acquisition may also create additional risk during the first quarters following completion of the IPO, when the company must crisply execute its business plan and achieve its forecasted earnings.
- ***Structuring:*** The issuance of private company stock as part of an acquisition purchase price can influence the manner in which an acquisition is structured. For example, stock cannot be issued as part of the acquisition unless exemptions from registration are available under federal securities laws. Whether stock or cash is used in an acquisition, the accounting treatment may make earnouts impracticable for a company going public. If the target is a venture capital–backed company, additional challenges may be posed.

The accounting aspects of any proposed acquisition are vital considerations in deal timing, structure and even feasibility. This is especially true when an acquisition is undertaken on the cusp of an IPO. Key accounting issues arising in pre-IPO acquisitions include:

- ***Financial Statements:*** SEC rules may require a company going public to include in its Form S-1 registration statement separate financial statements and pro forma financial information for completed and probable acquisitions. Depending on the significance of an acquisition, the required financial information may include audited historical financial statements for the target, as well as pro forma combined financial information for the acquirer and the target. If concurrent M&A activity is underway, the unavailability of all required financial information of the target could lead to significant delays in the company's IPO plans.
- ***Acquisition Accounting:*** The new "fair value" acquisition accounting standard has a number of implications for companies engaging in M&A activity, including new P&L charges and the possibility of additional and unpredictable P&L charges in future periods. Companies going public must be attentive to these matters, because of the need to demonstrate strong earnings at the time of an IPO and the desire to produce steady earnings growth in the period following the completion of the IPO. As a result, more extensive due diligence, by both the acquirer and the underwriters, is often required.
- ***SOX 404:*** Section 404 of the Sarbanes-Oxley Act poses several challenges in the pre-IPO M&A context. For example, the acquirer and target are likely to have systems of financial controls that differ from each other, especially in the area of information technology. After the transaction is completed, the acquirer—once it becomes subject to Section 404 (generally upon filing its second Form 10-K after the IPO)—will have to evaluate its internal control over financial reporting (ICFR), report on the results and have its ICFR audited. If the combined company's system of controls is not fully integrated, it may be prone to a material weakness of ICFR that has to be disclosed. For a private acquirer that does not yet possess a fully developed internal control system, integration may require the acquirer not only to convert the target's systems but also to design or upgrade new systems.

M&A activity also has several other potential consequences for the IPO process:

- ***Disclosure to Target:*** The company's IPO plans may constitute material information, requiring disclosure to the target's stockholders, or the company may wish to share this information—in a balanced manner—to make its stock more attractive to the target stockholders. The company's disclosure of its upcoming IPO to an acquisition target poses at least some risk of premature public dissemination of the company's IPO plans.
- ***Form S-1 Disclosure:*** The company will be obligated to disclose its acquisition activity in the Form S-1 if a completed or probable acquisition triggers a requirement for separate target financial statements or prompts MD&A disclosure, a significant portion of the IPO proceeds will be used to finance an acquisition, or a large potential transaction is otherwise material for securities law purposes.
- ***Due Diligence:*** M&A transactions during the IPO process will result in additional due diligence by the underwriters and their counsel and can affect the timing of the IPO.

Pre-IPO acquisitions can present significant complications for the going-public process. The company must balance the strategic benefits of a proposed acquisition against its potentially detrimental impact on the IPO. Although proceeding with both plans at the same time is usually feasible and sometimes necessary, the company must be prepared for the possibility that doing so will require extra effort and create incremental risk or delay for each. ■

We reviewed all merger transactions between 2004 and 2009 involving venture-backed targets (as reported in Dow Jones VentureOne) in which the merger documentation was publicly available and the deal value was $25 million or more. Based on this review, we have compiled the following deal data:

Characteristics of Deals Reviewed		2004	2005	2006	2007	2008	2009
The number of deals we reviewed and the type of consideration paid in each	Sample Size	54	39	53	33	25	15
	Cash	43%	69%	68%	48%	76%	60%
	Stock	41%	10%	8%	0%	4%	0%
	Cash and Stock	17%	21%	24%	52%	20%	40%

Deals with Earnout		2004	2005	2006	2007	2008	2009
Deals that provided contingent consideration based upon post-closing performance of the target (other than balance sheet adjustments)	With Earnout	24%	15%	17%	39%	12%	27%
	Without Earnout	76%	85%	83%	61%	88%	73%

Deals with Indemnification		2004	2005	2006	2007	2008	2009
Deals where the target's shareholders or the buyer indemnified the other post-closing for breaches of representations, warranties and covenants	With Indemnification						
	By Target's Shareholders	89%	100%	94%	100%	96%	100%
	By Buyer[1]	37%	46%	38%	48%	48%	36%

Survival of Representations and Warranties		2004	2005	2006	2007	2008	2009
Length of time that representations and warranties survived the closing for indemnification purposes[2]	Shortest	6 Months	9 Months	12 Months	6 Months[3]	12 Months	6 Months
	Longest	36 Months	24 Months	36 Months	36 Months	24 Months	18 Months
	Most Frequent	12 Months	12 Months	12 Months	12 and 18 Months (tie)	12 Months	18 Months

Caps on Indemnification Obligations		2004	2005	2006	2007	2008	2009
Upper limits on indemnification obligations where representations and warranties survived the closing for indemnification purposes	With Cap	85%	100%	100%	97%	95%	100%
	Limited to Escrow	72%	79%	84%	78%	81%	71%
	Limited to Purchase Price	7%	5%	2%	9%	14%	0%
	Exceptions to Limits[4]	74%	73%	84%	97%	62%	71%
	Without Cap	15%	0%	0%	3%	5%	0%

[1] The buyer provided indemnification in 48% of the 2004 transactions, 25% of the 2005 transactions, 41% of the 2006 transactions, 53% of the 2007 transactions, 50% of the 2008 transactions and 40% of the 2009 transactions where buyer stock was used as consideration. In 65% of the 2004 transactions, 17% of the 2005 transactions, 35% of the 2006 transactions, 56% of the 2007 transactions, 25% of the 2008 transactions and 40% of the 2009 transactions where the buyer provided indemnification, buyer stock was used as consideration.

[2] Measured for representations and warranties generally; specified representations and warranties may survive longer.

[3] In two cases representations and warranties did not survive, but in one such case there was indemnity for specified litigation, tax matters and appraisal claims.

[4] Generally, exceptions were for fraud and willful misrepresentation.

Escrows		2004	2005	2006	2007	2008	2009
Deals having escrows securing indemnification obligations of the target's shareholders	With Escrow	83%	97%	96%	94%	96%	93%
	% of Deal Value						
	Lowest	4%	2%	3%	3%	3%	10%
	Highest	23%	20%	20%	43%	15%	15%
	Most Frequent	10%–20%	10%	10%	10%	10%	10%
	Length of Time						
	Shortest	6 Months	6 Months	12 Months	6 Months	12 Months	12 Months
	Longest	36 Months	24 Months	36 Months	60 Months	36 Months	18 Months
	Most Frequent	12 Months	12 Months	12 Months	12 and 18 Months (tie)	12 Months	12 and 18 Months (tie)
	Exclusive Remedy	64%	84%	90%	73%	83%	46%
	Exceptions to Escrow Limit Where Escrow Was Exclusive Remedy[5]	72%	66%	86%	100%	85%	83%

Baskets for Indemnification		2004	2005	2006	2007	2008	2009
Deals with indemnification where a specified "first dollar" amount did not count towards indemnification, expressed either as a "deductible" (where such amount can never be recovered) or as a "threshold" (where such dollar amount cannot be recovered below the threshold but once the threshold is met all such amounts may be recovered)	Deductible	39%	38%	48%	48%[6]	43%[7]	43%
	Threshold	51%	62%	52%	39%[6]	48%[7]	57%

MAE Closing Condition		2004	2005	2006	2007	2008	2009
Deals where the buyer or the target had as a condition to its obligation to close the absence of a "material adverse effect" with respect to the other party or its business, either in condition explicitly or through representation brought down to closing	Condition in Favor of Buyer	81%	82%	98%	97%	88%	100%
	Condition in Favor of Target[8]	30%	13%	23%	44%	21%	20%

Exceptions to MAE		2004	2005	2006	2007	2008	2009
Deals where definition of "material adverse effect" for the target contained specified exceptions	With Exception[9]	78%	79%	85%	91%	92%	93%

[5] Generally, exceptions were for fraud, intentional misrepresentation and criminal activity.

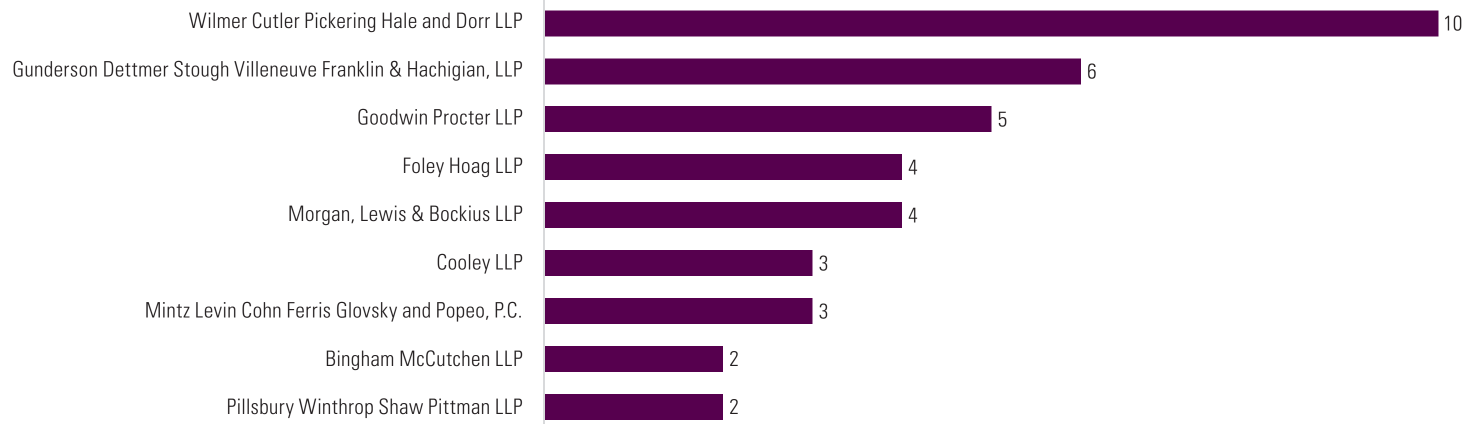
[6] Another 13% of these transactions used a "hybrid" approach with both a deductible and a threshold.

[7] Another 4% of these transactions used a "hybrid" approach with both a deductible and a threshold and another 4% had no deductible or threshold.

[8] In 50% of these transactions in 2004, in 80% of these transactions in 2005, in 83% of these transactions in 2006, in 86% of these transactions in 2007, in 60% of these transactions in 2008 and in 100% of these transactions in 2009, buyer stock was used as consideration.

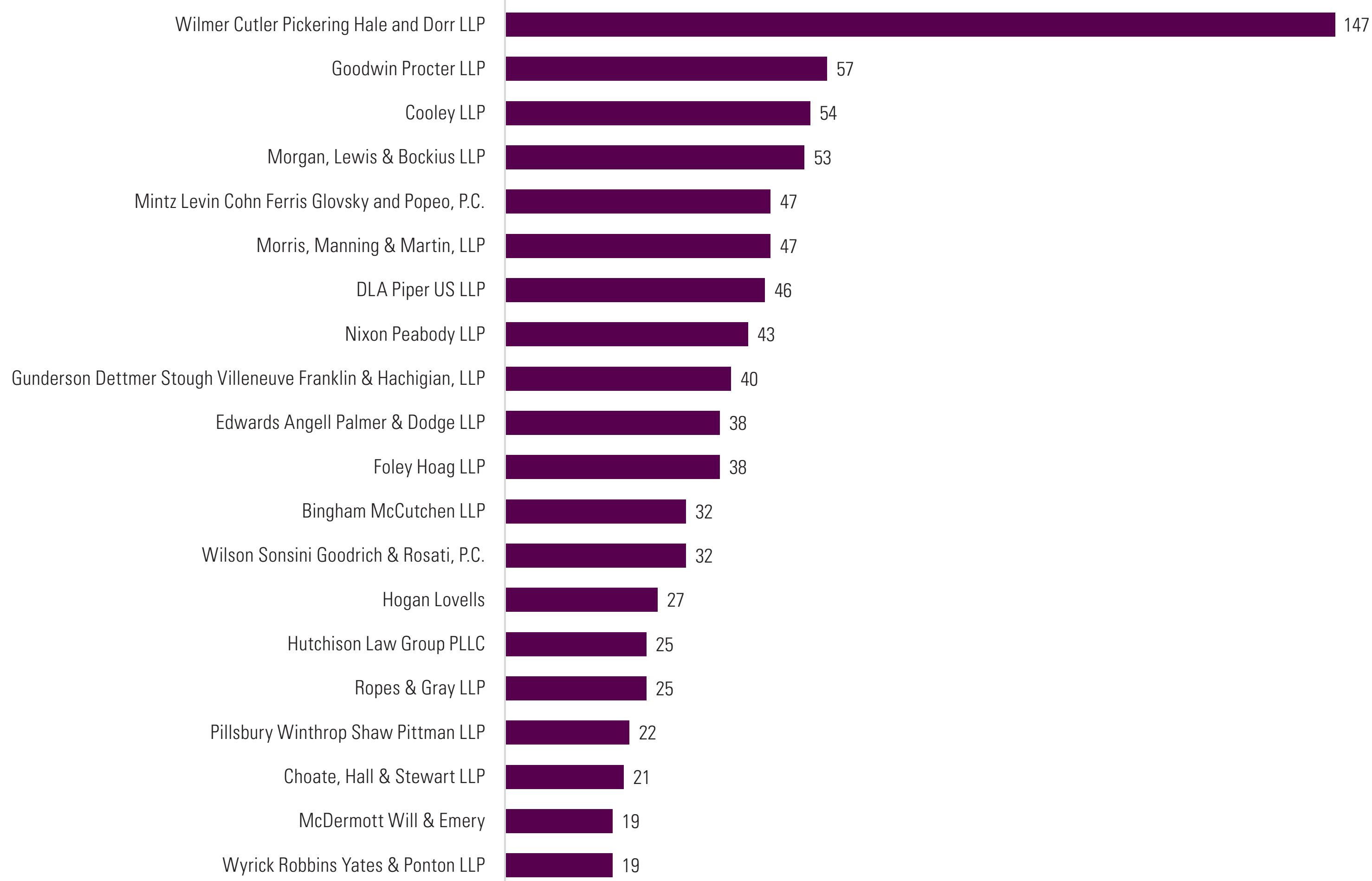
[9] Generally, exceptions were for general economic and industry conditions.

Company Counsel in Sales of Eastern US VC-Backed Companies in 2009



Source: Dow Jones VentureOne

Company Counsel in Sales of Eastern US VC-Backed Companies – 1996 to 2009



Source: Dow Jones VentureOne

The above charts are based on companies located east of the Mississippi River.

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Data Sources

M&A data is sourced from MergerStat. Data for sales of VC-backed companies is sourced from Dow Jones VentureOne. Private equity–backed M&A data is sourced from Thomson Reuters. For law firm rankings, sales of VC-backed companies are included under the current name of each law firm.

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