

This presentation introduces the current mechanics and common issues of the M&A process

Transaction Structures

1. Asset Purchase and Sale
2. Stock Purchase and Sale
3. Forward Merger
4. Reverse Merger
5. Triangular Merger

Transaction Timeline

1. Non-Disclosure Agreement
2. Letter of Intent
3. The Definitive Agreement
4. Due Diligence
5. Closing the Deal

Asset Purchase and Sale

- Buyer purchases assets only
- Buyer assumes liability only for specified assets
- Target company unaffected



Asset Purchase and Sale

Upsides

- Flexibility – buyer can choose assets and liabilities

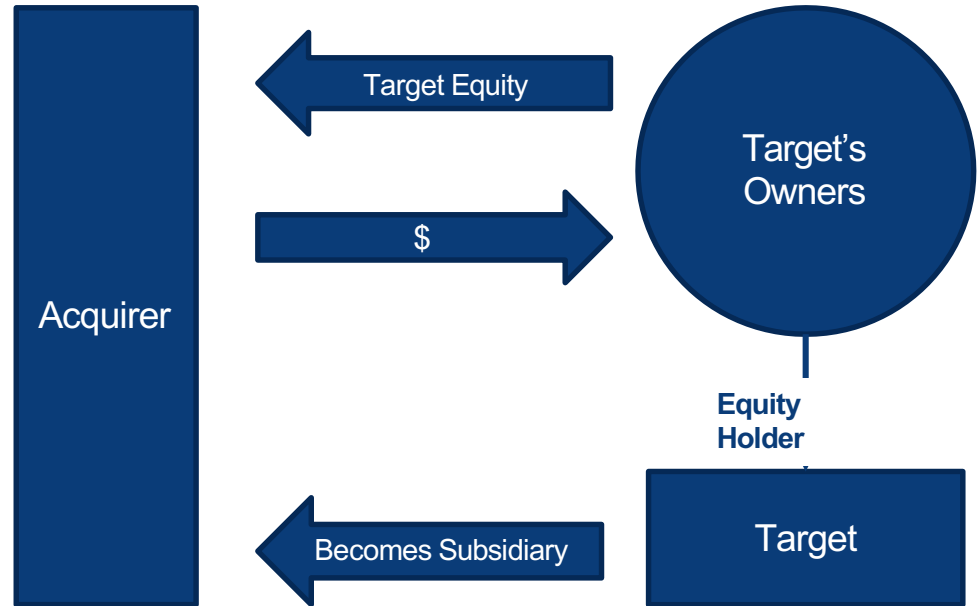
Downsides

- Possible negative tax consequences for seller
- Tends to be more time-consuming and complex



Stock Purchase and Sale

- Buyer purchases target's equity from its stakeholders
- Buyer assumes all assets and liabilities of target
- Target structure unaffected; only ownership changes



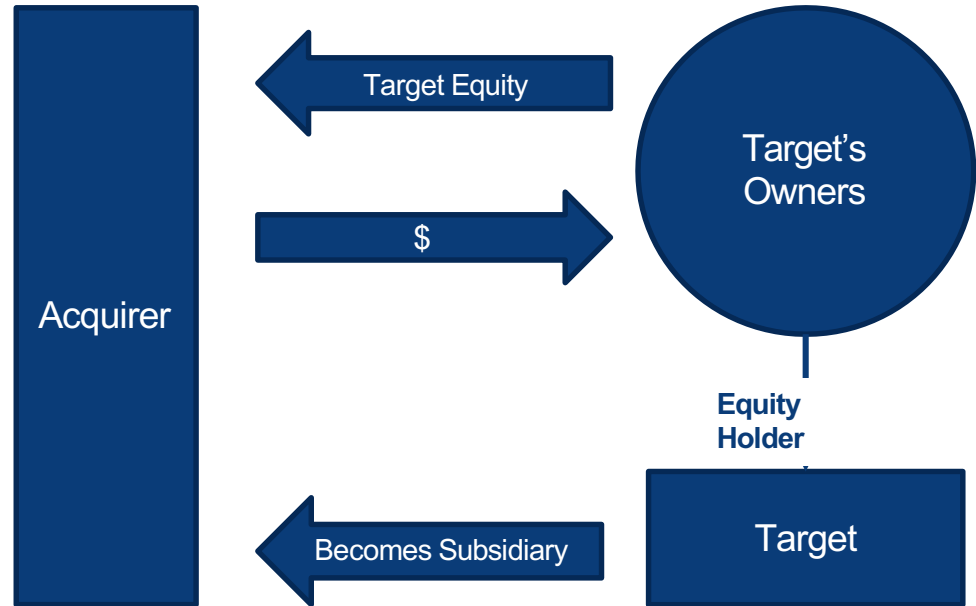
Stock Purchase and Sale

Upsides

- Tax advantages for seller – proceeds taxed usually taxed at lower rate
- Less operational disruption – immediate value

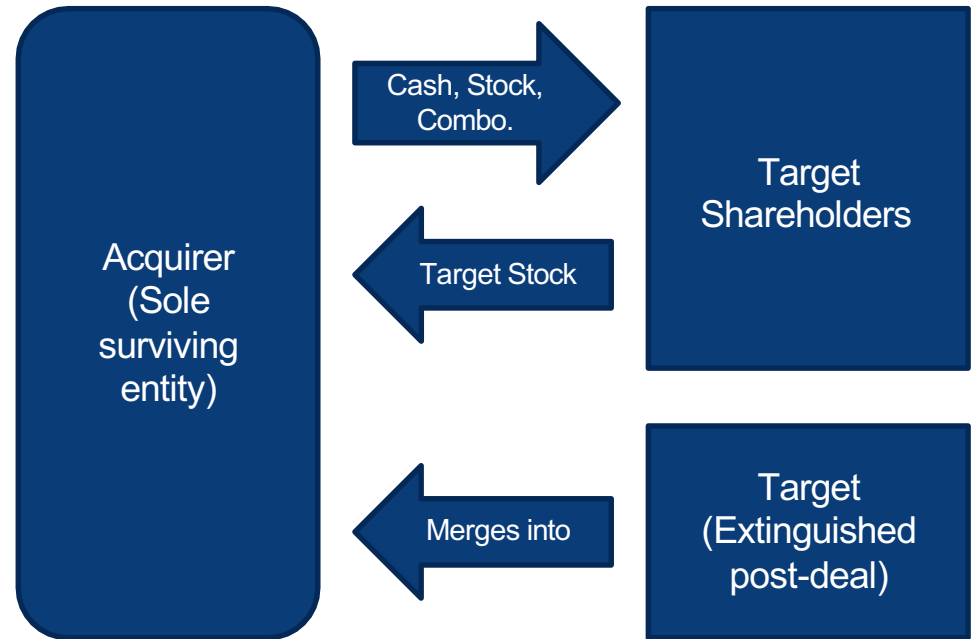
Downsides

- Buyer inherits all liabilities
- Lengthy negotiation of reps and warranties



Forward Merger

- Target shareholder receives cash, stock or combination
- Target merges into acquirer
- Target is extinguished and acquirer survives



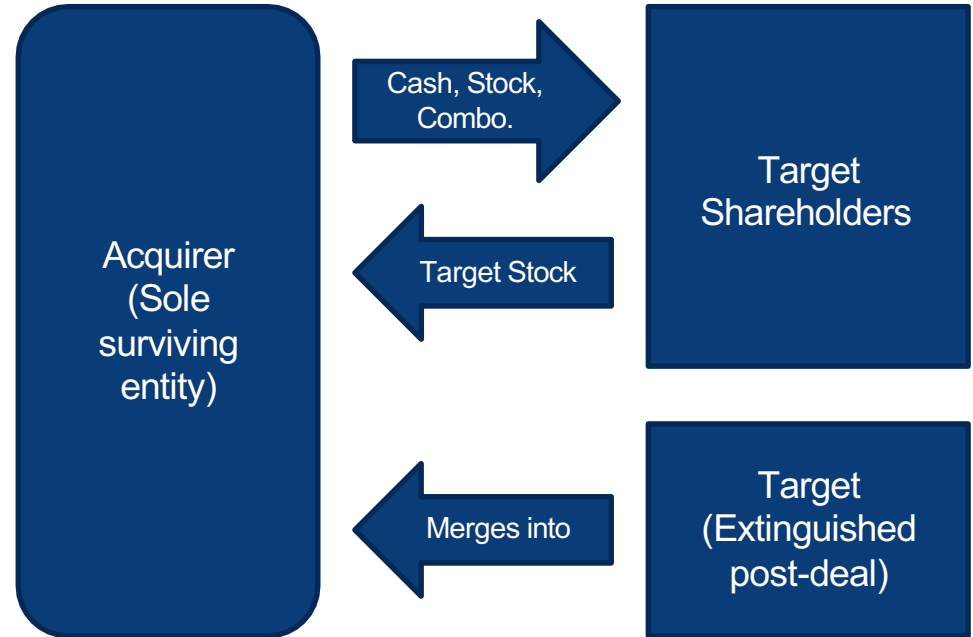
Forward Merger

Upsides

- Business continuity for acquirer

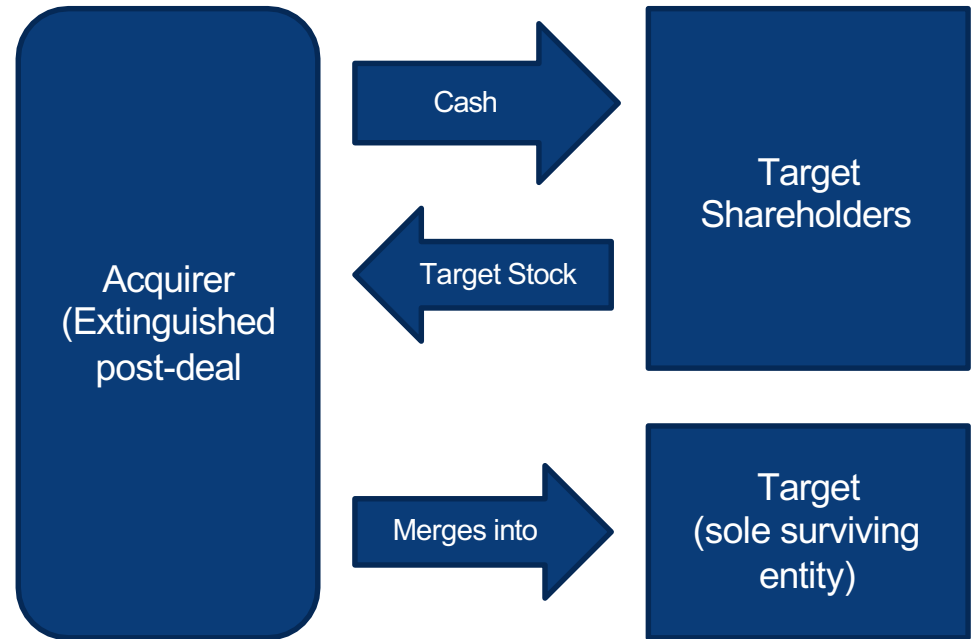
Downsides

- Acquirer directly assumes all target liabilities
- Acquirer stockholder may have approval rights



Reverse Merger

- Investors of acquirer purchases target equity
- Target merges with acquirer
- Target survives
- Often used by private companies to go public



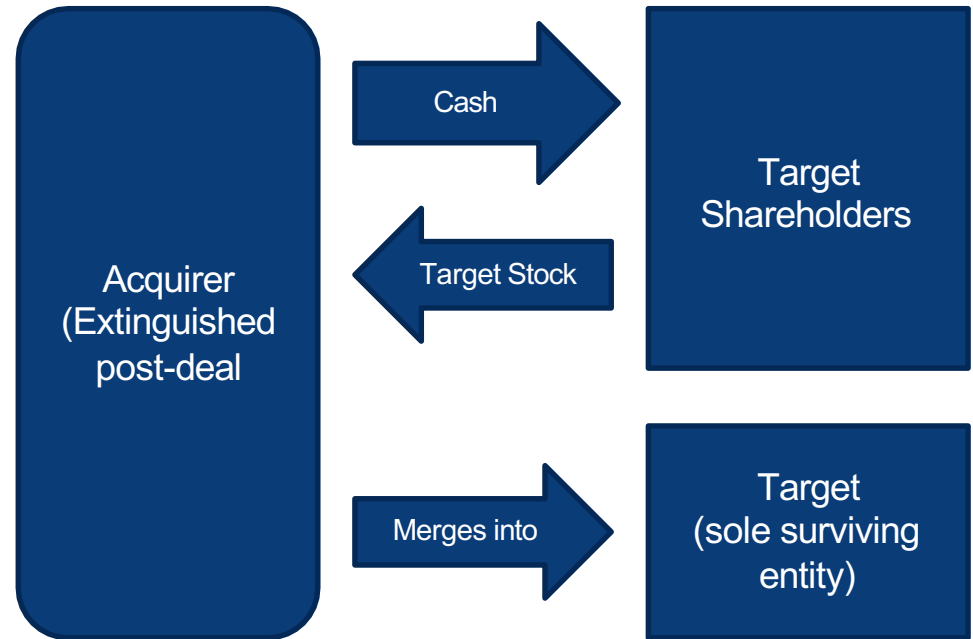
Reverse Merger

Upsides

- Relatively swift process
- Forego IPO formalities

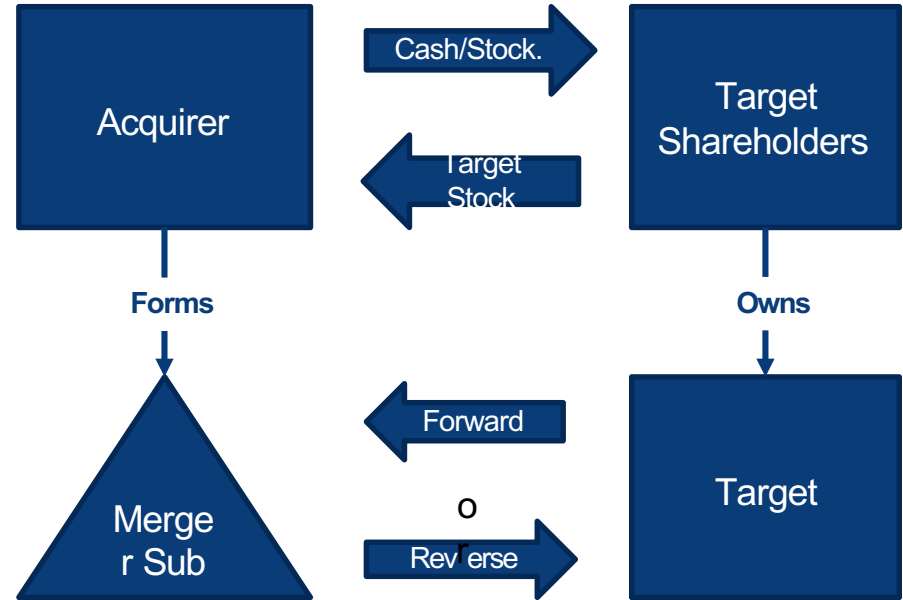
Downsides

- Requires extensive vetting of target – acquirer inherits all target liabilities
- May require reverse stock split
- May lead to lower valuation than IPOs



Triangular Merger

- Acquirer forms a merger sub
- Target merges with the merger sub
- Target becomes subsidiary of acquirer
- Can be forward or reverse



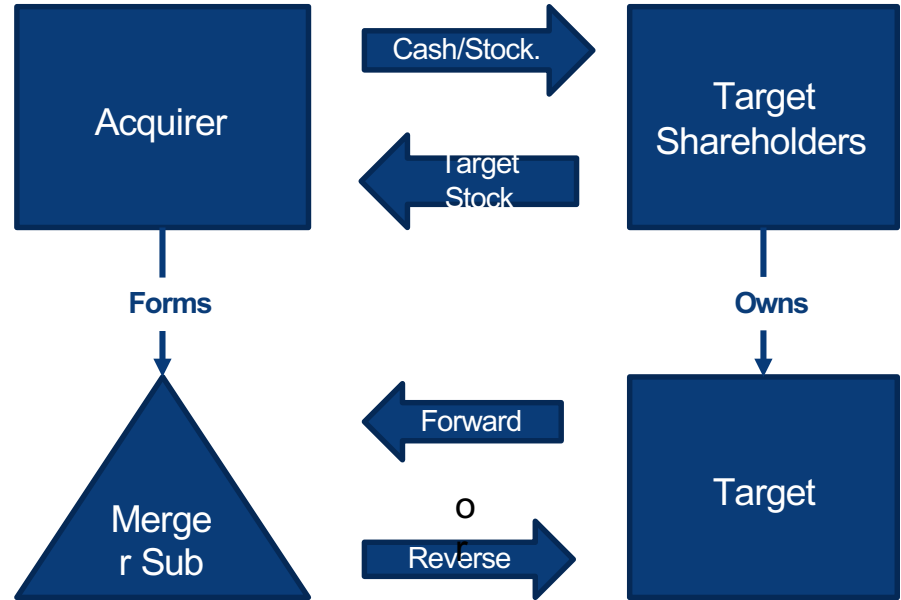
Triangular Merger

Upsides

- Contractual continuity
- Streamlined shareholder approval process
- Acquirer does not directly inherit target liabilities

Downsides

- Acquirer still inherits any unforeseen liabilities of target
- Possible complications organizing new subsidiary to be tax-free



The Non-Disclosure Agreement

- Often the first agreement in a transaction
- Legally binding (vs. LOI and Term Sheets)
- Insulation against unwanted publicity
- Protects the exchange of information during negotiation and due diligence review
- Unilateral vs. mutual NDAs

Scope of NDA

- Important to negotiate what is included and excluded
- Buyer vs. Seller Needs

Buyer will want

“Confidential Information” to be narrowly tailored so *less* is covered by the Non- Disclosure Agreement

“Confidential Information” to *exclude as many* types of information as possible, so *less* is covered by the Non- Disclosure Agreement

Seller will want

“Confidential Information” to be broadly defined so *more* is covered by the Non- Disclosure Agreement

“Confidential Information” to *exclude as few* types of information as possible, so *more* is covered by the Non-Disclosure Agreement

NDA – Exclusions

Common Exclusions from Confidential Information

1. Info generally available to the public (other than as a result of unpermitted disclosure by buyer)
2. Info that is available to buyer from an independent third party who is not restricted from sharing such information
3. Info already in buyer's possession at the time of disclosure
4. Info independently developed by buyer without reference to or use of any protected information
5. Info approved for release by authorization of seller

NDA – Common Issues

1. Accuracy/Completeness of Information
2. Oral disclosures
3. Marked as Confidential
4. Sharing with “Representatives”
5. Nonsolicitation
6. Return/Destruction of Information

Letter of Intent

- LOI sets forth preliminary, non-binding deal terms based on which the parties will proceed with negotiations on an exclusive basis.
- Letter of Intent Stage is when *seller has the most leverage*
 - It is at this stage that buyer is anxious to secure exclusivity and seller can exploit that to its advantage

LOI – Competing Tensions

Buyer will want

- a *less-detailed* Letter of Intent
- to wait until due diligence has been concluded before significant deal terms are negotiated and decided
- extended exclusivity

Seller will want

- a *more-detailed* Letter of Intent
- to lock in the most favorable deal terms possible while it still has maximum leverage
- if a public company, to consider disclosure obligations

LOI – Binding vs. Non-Binding

Generally, deal terms of LOIs are specifically agreed *not* to be legally binding; the parties cannot be required to proceed with a transaction based solely on the LOI. Certain provisions of the LOI will specifically be designated as being legally binding.

Typical Non-Binding Terms

- › deal structure
- › scope and timing of diligence
- › purchase price, subject to diligence
- › required closing conditions:
 - employment agreements
 - key consents or approvals
 - non-compete duration
- key reps and warranties
- key covenants
- scope of, and parties to, indemnity

Typical Binding Terms

- › exclusivity / no-shop period
- › no public announcements
- › each party bears own expenses
- › governing law
- › re-affirmation of Non-Disclosure Agreement
- › standstill, if not covered in NDA

LOI – Common Issues

1. Access to due diligence
2. Exclusivity period restrictions
3. Obligation to proceed
4. Public vs. private companies

The Definitive Agreement – Purchase Price

Form of Consideration

1. Cash
2. Promissory Note
3. Equity of Buyer
4. Earn-out

Buyer will want

- some portion of the purchase price to be held back to secure indemnification obligations
- often held in third-party escrow for 12–24 months

Seller will want

- all consideration paid at Closing
- *But* third-party escrow is market

The Definitive Agreement – Seller's R&Ws

In this Section of the Purchase Agreement, Seller makes certain statements to Buyer about the state of its business, operations, financials, etc.

Reps and warranties must be true and correct as of both the time the purchase agreement is signed and the closing

In the event that reps and warranties are breached, buyer can seek indemnification for damages it suffers

Buyer will want

- *robust* reps and warranties with very *few* materiality and knowledge qualifiers
- 10b-5 rep

Seller will want

- *limited* reps and warranties with *many* materiality and knowledge qualifiers
- As-is/where-is rep
(although this is not market)



The Definitive Agreement – Seller's Disclosure Schedules

The Disclosure Schedules afford Seller the opportunity to:

qualify the statements made in the reps and warranties to the extent they are not fully accurate or complete

provide further information that the reps and warranties require

The general rule is that items disclosed in the Disclosure Schedules are deemed to qualify the related Reps and Warranties

This means that, generally, buyer cannot seek indemnification for items disclosed in the schedules

Accordingly, it is in **seller's best interest** to create Disclosure Schedules that are **as detailed as possible** and disclose all possible issues (no matter how unpleasant)



The Definitive Agreement – Conditions to Closing

In deals where there is an executory period between signing and closing, there is often a portion of the Purchase Agreement that lists “conditions” that must be met before the parties can be compelled to proceed to closing

Typical Conditions to Closing include:

- Accuracy of representations and warranties
- Compliance with covenants and agreements
- No lawsuits exist that would prohibit the deal
- All governmental and third-party consents received

Special Buyer Closing Conditions:

- No material adverse change shall have occurred
- Satisfactory completion of due diligence (heavily negotiated)
- Buyer has secured financing (heavily negotiated)

Due Diligence – Overview

1. Review LOI
2. Scope of Review
3. Access Data Room
4. Due Diligence Memorandum
5. Disclosure Schedules

Due Diligence – Scope of Review

- **Corporate Documents**
 - Ownership/capitalization table
 - Minute books
 - Organizational documents
 - Rights and obligations of target's shareholders
- **Material Contracts**
 - Key customer contracts
 - Key supplier/vendor contracts
 - Debt documents
 - Lease agreements
 - Employment agreements
- **Key Assets (e.g., intellectual property, real estate)**
 - IP
 - Real Estate
- **Labor and Employment**
 - Collective bargaining
 - Benefits
 - Employment Agreements
- **Litigation**
- **Governmental Permits**
- **Environmental**

Due Diligence – What to Look for

Consents & Notices

- Reverse Merger/Stock Sale: general prohibition on assignment not applicable
- Asset Sale: any prohibition on assignment
- Other Provisions: change in control

Liabilities & Potential Liabilities (Litigation, etc.)

- Reverse Merger/Stock Sale: buyer inherits all
- Asset Sale: negotiated between buyer and seller

Due Diligence – Recommendations

- **Flag missing signatures, amendments, exhibits, schedules and referenced documents that aren't included**
- **Note any contract provisions that create any:**
 - contract conflicts
 - material liabilities
 - payment obligations
 - material risks
 - diminishment of asset values or revenue streams
- **Provide target with a legal due diligence list**
- **Involve subject matter experts**

Closing Documents

Bringdown Certificates

In the context of a deal that has an executory period between signing and closing, the parties must certify to one another in writing that the representations and warranties that were made as of the signing of the purchase agreement are still true, accurate and complete as of the closing date

- In some cases, buyer might have the right to terminate the purchase agreement and walk away from the deal if seller's reps and warranties are no longer true as of the closing

Closing – Mechanics and Organization

Closing Checklist

Internal and external guide for getting a deal closed — use it to keep track of:

- Important deadlines
- Specific closing conditions
- Signatories of documents
- Threshold tracker (i.e., shareholder approval, number of required consents, etc.)

Closing File

- All deal documents (bonus points if you keep markups)
- Original signature pages
- Notes to file (i.e., critical emails, actual internal memos, etc.)
- Executed documents that may

Closing – Documents

Secretary's Certificates

This requires the Secretary of Seller/Buyer to certify to the other party that certain attachments to the Certificate are true and correct, including:

- Articles of Incorporation
- Bylaws
- Authorizing resolutions of directors and/or shareholders
- Incumbency signatures of officers

Closing – Documents

Legal Opinion

Sometimes buyer will request that seller's law firm provide a legally binding opinion as to certain aspects of the transaction, such as:

- organization and qualification of seller
- capitalization of seller
- authority of seller to consummate transaction
- absence of litigation pending against Seller that could prohibit the deal
- absence of significant contracts that would prohibit or restrain the deal

Legal opinions used to be common in M&A transactions, but are becoming less and less so