Sell-Side M&A:
Smart Moves and Deal Killers

Firmex Webinar Series - M&A Master Class
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1:00 p.m. to 2:00 p.m.

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About Firmex

Joel Lessem
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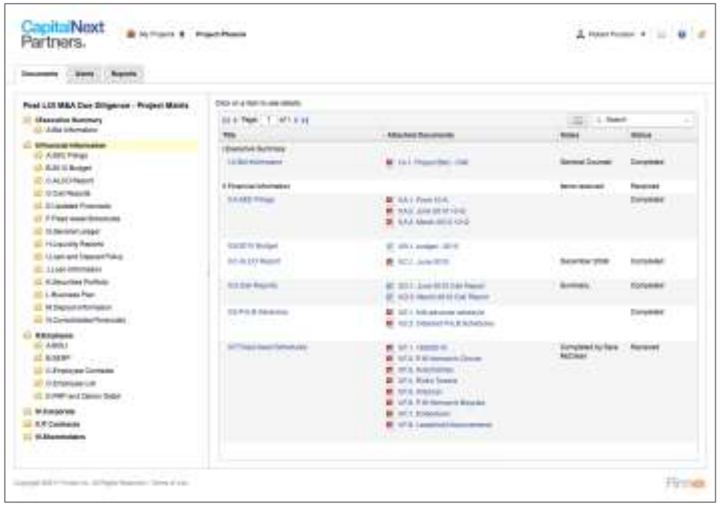
Firmex is focused on providing the best virtual data room solution for managing corporate transactions and financial compliance



Who uses Firmex?

- Firmex community includes over 125,000 users worldwide
- Conducted over 10,000 deals

Why offer an M&A Master Class?

- As part of our value-added service, we believe it is important to offer educational resources to our expanding community

Andrew J. Sherman

Mr. Sherman is a partner in the Washington, D.C. office of Jones Day with over 2,500 lawyers worldwide.

He is the author of 23 books on business growth, capital formation and the leveraging of intellectual property, including **Mergers & Acquisitions from A to Z** and **The AMA Handbook of Due Diligence**.

He has appeared as a guest and a commentator on all of the major television networks as well as CNBC's "Power Lunch," CNN's "Day Watch," CNNfn's "For Entrepreneurs Only," USA Network's "First Business," and Bloomberg's "Small Business Weekly." He has appeared on numerous regional and local television broadcasts as well as national and local radio interviews for National Public Radio (NPR), Business News Network (BNN), Bloomberg Radio, AP Radio Network, Voice of America, Talk America Radio Network and the USA Radio Network, as a resource on capital formation, entrepreneurship and technology development.

He has served as a top-rated Adjunct Professor in the Masters of Business Administration (MBA) programs at the University of Maryland for 23 years and at Georgetown University for 15 years where he teaches courses on business growth strategy.

He has served as General Counsel to the Young Entrepreneurs' Organization (YEO) since 1987. In 2003, *Fortune* magazine named him one of the Top Ten Minds in Entrepreneurship and in February of 2006, *Inc.* magazine named him one of the all-time champions and supporters of entrepreneurship.

Motivations of the Parties

Contrasting & Understanding Buyer and Seller Motivations

Seller Motivations

- Founder health/retirement
- Legacy issues
- Serial entrepreneur burn-out or lack of focus/strategic infidelity
- Shareholder liquidity
- Competitive necessity
  - Scale & distribution
- Capitalize on innovation
- Industry consolidation
- Economic conditions
- Opportunities for advancement for employees
- Access to larger contracts, global markets and opportunities

Buyer Motivations

- Growth
  - Use of shares as currency
  - Typically harder to build than buy
- Competitive response and pressures
- Lack of internal innovation
- Industry consolidation
- Economic considerations
- Diversification
- Opportunities for advancement for team

Key Issues Regarding Motivations

- Understand the motivations and deal drivers for both sides as an effective advisor
- Motivations may dictate terms, roles, structure and consideration
- Motivations may dictate pace and timetable of transaction

Understanding the M&A Process and Timetable

Understanding Typical Sales Processes

	Auction Process	Controlled Sale	Targeted Solicitation	Closed Negotiation
Level of Disclosure	• General public disclosure with wide range of potential buyers contacted	• Limited disclosure of existence of sale process with a wide range of logical buyers contacted	• Limited disclosure of existence of sale process with high-level contact approach to select range of buyers	• Limited disclosure with few parties contacted, focus on limited parties who have shown interest in the past
# of Potential Buyers	• All buyers	• All probable buyers	• All logical buyers in Tiered Approach	• Most logical buyer(s)
Approximate Time Period	• Four month minimum	• Typically 4 - 6 months	• Typically 4 - 6 months	• Typically 2 - 4 months
Advantages	• May identify unexpected buyers • Stimulates sense of competition among buyers	• Maintains confidentiality • Stimulates sense of competition among buyers • Reasonable market test • Limits perception of a broader auction process	• Speed of execution • Maintains confidentiality • Limits perception of a broader auction process • Perception of competition created	• Speed of execution • Maximum confidentiality • Avoids perception of a broader auction process
Disadvantages	• Delay in execution • Greater risk of access to confidential material by uninterested parties • May create perception of over shopped deal or interfere with business	• May cause some delay in business execution • Risk of access to exposing confidential material, under NDA, to parties that may have limited interest	• May not reach full sphere of buyers	• May not realize maximum value • Will not reach full sphere of buyers

Typical Sale Process Timeline

Phase I — Weeks 1–2: Plan strategy and conduct due diligence

Phase I — Weeks 2–4: Prepare marketing materials

Phase II — Weeks 5–12: Conduct formal marketing effort

Phase II — Weeks 13–16: Monitor buyer due diligence

Phase III — Weeks 16–24: Receive final bids and negotiate

Phase I – Preparation

Phase I

Weeks 1–2

Plan strategy and conduct due diligence

- **Define objectives**
  - Develop strategy
  - Determine timing
  - Identify assets for sale
- **Review operations**
  - Assess strategic positions
  - Review historical and projected financials
- **Develop preliminary valuation analysis**
  - Comparable public companies
  - Precedent transactions
  - Discounted cash flow analysis
- **Develop preliminary strategy**
  - Potential buyers
  - Sale process
  - Sale of stock or assets
  - Timing

Phase I – Preparation (Cont'd)

Phase I

Weeks 2–4

- **Define key selling points**
- **Prepare marketing materials**
  - Executive Summary
  - Information Memorandum
  - Management presentation
- **Prepare NDA and initial bid process letter**
- **Gather intelligence on potential buyers; motivations/concerns**
  - Presumed level of interest
  - Financial strength
  - Buyers' perspectives on value
  - Ability to execute a timely transaction
- **Finalize buyer list**
- **Complete marketing strategy**

Phase II – Marketing

Phase II

Weeks 5–12

Conduct formal marketing effort

- **Contact buyers**
- **Distribute marketing materials**
  - Executive Summary
  - NDA
- **Finalize management presentation**
- **Send Descriptive Memorandum upon execution of an NDA**
- **Continue gathering market feedback**
- **Prepare data room and due diligence sessions**
- **Receive preliminary indications of interest**

Phase II – Marketing (Cont'd)

Phase II

Weeks 13–16

Monitor buyer due diligence

- **Select participants based on:**
  - Price
  - Terms
  - Fit
- **Arrange due diligence visits**
- **Coordinate response to buyers' questions**
- **Confirm financing arrangements (as appropriate)**

Phase III – Closing

Phase III

Weeks 16–24

Receive final bids and negotiate

- **Receive and evaluate final bids**
- **Handle exclusivity requests**
- **Negotiate Definitive Agreement**
- **Coordinate confirmatory due diligence**
- **Expedite signing and execute Definitive Agreement**
- **--**
- **Closing**
- **Post-closing obligations and covenants**
- **Integration and shareholder value**

Overview of the Seller’s Preparation Process

M&A Process Overview
A Seller's Perspective

Preparation	Marketing	Closing
• Hire an investment banker • Identify key strengths and weaknesses • Determine sales strategy and process • Identify key targets and segment into tiers and waves • Prepare marketing materials and timeline	• Execute sales process strategy • Initiate contact with targets • Manage buyers through management meetings • Provide preliminary due diligence • Solicit and negotiate offers	• Manage legal and financial due diligence • Negotiate definitive purchase agreement • Manage through deal risk including pitfalls, due diligence, employment agreements, financing, operational performance, etc.

Strategic Assessment Of Growth/Exit Alternatives

Strategic Options

Status Quo: Organic Growth

Run the current course, focusing on customer portable power solutions and continued industry adoption of lithium battery solutions

- Ensures Company does not lose focus during ongoing rapid growth
- Limits financial exit for investors and managers

IPO

A public offering would provide shareholders liquidity

- Would provide shareholders a compelling financial exit
- Will require scale sufficient to merit a $50-100 raise
- Typically $500 million valuation required

Strategic Sale

Pursue a strategic sale, capitalizing on current sales growth and market momentum

- Capitalize on revenue performance and market share acquisition
- High growth rates and large target markets are the key drivers of higher transaction multiples

Buy-Side M&A

Create increased momentum by acquiring select technology assets and market access

- Further revenue scale would drive higher future transaction multiples
- Cash position and private stock may limit feasibility of potential acquisitions

Key Steps to Preparing for an M&A Transaction

- Getting your house in order
- Legal/Financial/Governance and IP Audits
- Anticipating the due diligence needs/concerns of a prospective buyer
- “Don’t call my baby ugly” Syndrome
- Time to get Uncle Henry off the payroll (Anticipating the needs of a public buyer in a post-Sarbox world)

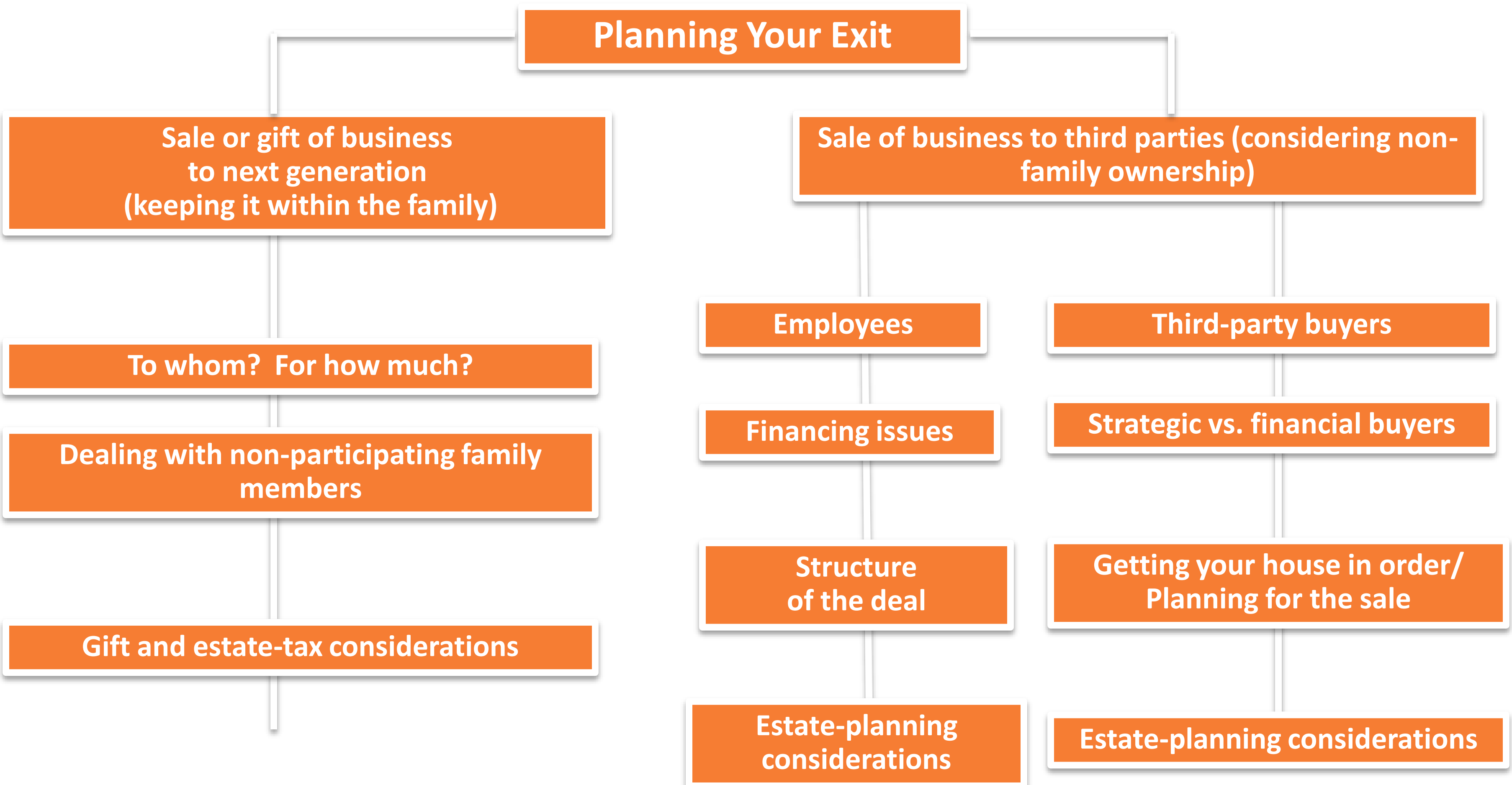
Key Steps to Preparing for an M&A Transaction (Cont'd)

- Recasting and Positioning
- Understanding a buyer's value drivers
- Due diligence is a two-way street (especially if the deal is structured with a heavy back-end or with the seller holding notes on buyer stock)
- Assembling the advisory team
- Determining the role of investment bankers and intermediaries
- Preparing the offering memorandum

Understanding the Buyer's Strategic Motivations

- Your IP is getting in the way of something they want/need to do
- They have spotted a much larger opportunity and need you technology/skill sets to seize the opportunity
- It will take them too long to develop what you already have and the window will not be open long enough
- You have been just irritating enough fly in their underwear that they want to eliminate a competitor
- You present an excellent beachhead or strategic entry point into a high growth marketplace

The Exit Strategy Planning Flow Chart



The Selling Process and Seller's Decisional Path

Reaching the Decision to Sell

1. Understanding Your Motivations and Objectives
2. Building the Foundation for Value
3. Timing and Market Factors

Getting the House in Order

1. Assembling Your Advisory Team
2. Legal Audit and Housekeeping
3. Establishing Preliminary Valuation
4. Preparing the Offering Memorandum
5. Estate and Exit Planning

The Selling Process and Seller's Decisional Path (Cont'd)

Marketing Strategy

1. Targeting Qualified Buyers
2. Use of Third Party Intermediaries
3. Narrowing the Field of Candidates

Choosing a Dance Partner

1. Selecting the Most Qualified and Synergistic Candidate (or Financial Candidate, depending on your objectives)
2. Preliminary Negotiations
3. Execution of Confidentiality Agreement
4. Preliminary Due Diligence

The Selling Process and Seller's Decisional Path (Cont'd)

Fighting It Out

1. Execution of More Detailed Letter of Intent or Memorandum of Understanding
2. Extensive Negotiations and Strategic Adjustments
3. Structuring the Deal
4. Accommodating the Buyer's Team for Legal and Strategic Due Diligence
5. Doing Due Diligence on the Buyer

The Selling Process and Seller's Decisional Path (Cont’d)

Preparing for the Closing

1. Preparation and Negotiation of the Definitive Legal Documents
2. Meeting Conditions to Closing
3. Obtaining Key Third Party Consents

The Closing

Post-Closing Issues

1. Monitoring Post-Closing Compensation/Earn-Outs
2. Facilitating the Post-Closing Integration Plan
3. Post-Closing Challenges

Preparing for the Sale of the Company

- From the seller's point of view, the key to the process is preparation, regardless of motivation for selling. This means taking all the necessary steps to prepare the company for sale from a corporate housekeeping perspective. A seller must anticipate the questions and concerns of a prospective buyer and be prepared to provide the appropriate information for review. In addition, a seller should understand the pricing parameters for selling the business in preparation of discussing the financial terms and conditions.
- We suggest that the preparation process begins with a strategy meeting of all members of the seller's team. It is the job of the team to:
  - Identify the financial and structural goals of the transaction.
  - Develop an action plan and timetable.
  - Understand the current market dynamics and potential pricing range for the business.

Preparing for the Sale of the Company (Cont'd)

- Determine who are the logical buyers of the business and why the business for sale would be a compelling asset to each of the specific the target buyers
- Identify the potential legal and financial hurdles to a successful transaction (e.g., begin thinking about what problems may be "transactional turnoffs" to a prospective buyer), such as unregistered trademarks, illegal securities sales, or difficulties in obtaining a third-party consent.
- Outline and draft the offering memorandum.
- Develop a definitive "to do" list in connection with corporate housekeeping matters, such as preparation of board and shareholder minutes and maintenance of regulatory filings.
- Identify how and when prospective buyers will be contacted, proposed terms evaluated, and final candidates selected.

STEP 1: Selecting the Seller's Team

One of the most important steps in the preparation process is the selection of a team of advisors to orchestrate the sale of the business.

The team will help the company’s internal preparation and create the offering memorandum which summarizes the key aspects of the company's operations, products and services, and personnel and financial performance.

In many ways, this offering memorandum is akin to a traditional business plan, and serves both as a road map for the seller and an informational tool for the buyer.

STEP 1: Selecting the Seller's Team (Cont’d)

- When selecting members for the team, a seller should choose people who:
  - Understand the seller's motivation, goals, and post closing objectives.
  - Are familiar with trends in the seller's industry.
  - Have access to a network of potential buyers.
  - Have a track record and experience in mergers and acquisitions with emerging growth and middle-market companies.
  - Have expertise with the financing issues that will face prospective buyers.
  - Know tax and estate planning issues that may affect the seller both at closing and beyond.

STEP 1: Selecting the Seller's Team (Cont'd)

At a minimum, the team should include the following members:

1. **Investment banker/financial advisor.** An investment banker or financial advisor counsels the seller on issues relating to market dynamics, trends, potential targets, valuation, pricing, and deal structure. He or she assists the seller in understanding the market, identifying and contacting prospective buyers, and in negotiating and evaluating offers. Finally, in many cases, multiple offers may have divergent structures and economic consequences for the seller, so evaluation of each offer is conducted by the banker.
2. **Certified public accountant**. A certified public accountant (CPA) assists the seller in preparing the financial statements and related reports that the buyer (or buyers) inevitably request. He or she advises the seller on the tax implications of the proposed transaction. The CPA also assists in estate planning and in structuring a compensation package that maximizes the benefits associated with the proposed transaction.

STEP 1: Selecting the Seller's Team (Cont'd)

3. Legal counsel. The transactional attorney is responsible for a wide variety of duties, including:
   a. Assisting the seller in pre-sale corporate "housekeeping," which involves cleaning up corporate records, developing strategies for dealing with dissident shareholders, and shoring up third-party contracts
   b. Working with the investment banker in helping evaluate competing offers
   c. Assisting in the negotiation and preparation of the letter of intent and confidentiality agreements such as Exhibit 2-1, which should be signed by all potential buyers who are provided access to the seller's books and records
   d. Negotiating definitive purchase agreements with buyer's counsel
   e. Working with the seller and the CPA in connection with certain post closing and estate and tax planning matters

STEP 2: The Target List

- A key step in any merger or acquisition process is generating a list of the potential buyers. The first step in generating the target list is determining the set of categories of companies that would be likely interested in the selling entity. Once all of the potential categories are determined, it is a relatively straightforward exercise to determine which companies belong in each of the categories.
- After the initial target list is created the next step is applying a logical filter to reduce the set to a more focused set of buyers. Companies that clearly cannot afford to purchase the company for sale, were recently acquired themselves, or have never purchased a business before, are inferior acquirers than companies with strong balance sheets (or buoyant stock) that have a history of successfully buying and integrating companies.

STEP 3: The Legal Audit

- The next step in the preparation process is to get the company ready for the buyer's analysis and due diligence investigation. A pre-sale legal audit should be conducted in order to assess the state of the company; it is critical to identify and predict the problems that will be raised by the buyer and its counsel. The legal audit should include corporate housekeeping and administrative matters, the status of the seller's intellectual property and key contracts (including issues regarding their assignability, regulatory issues, and litigation.

STEP 3: The Legal Audit (Cont’d)

- The goal is to find the bugs before the buyer's counsel discovers them for you (which would be embarrassing as well as costly from a negotiating perspective) and to get as many of the bugs out as possible before the first buyer is considered. For example, now may be the time to resolve any disputes with minority shareholders, complete the registration of copyrights and trademarks, deal with open issues in your stock option plan, or renew or extend your favorable commercial leases.
- It may also be a good time to set the stage for the prompt response of those third parties whose consent may be necessary to close the transaction, such as landlords, bankers, key customers, suppliers, or venture capitalists. In many cases, there are contractual provisions that can prevent an attempted change in control without such consent. For those bugs that can't be exterminated, don't try to hide them under the carpet. Explain the status of any remaining problems to the prospective buyers and negotiate and structure the ultimate deal accordingly.

STEP 3: The Legal Audit (Cont'd)

- The legal audit should include an examination of certain key financial ratios, such as debt-to-equity, turnover, and profitability. The audit should also look carefully at the company's cost controls, overhead management, and profit centers to ensure the most productive performance. The audit may also uncover certain sloppy or self-interested business practices that should be changed before you sell the company. This strategic reengineering will help build value and remove unnecessary clutter from the financial statements and operations.
- Even if you don't have the time, inclination, or resources to make such improvements, it will still be helpful to identify these areas and address how the company could be made more profitable to the buyer. Showing the potential for better long-term performance could earn you a higher selling price, as well as assist the buyer in raising capital needed to implement the transaction.

STEP 4: Preparing the Offering Memorandum

- The fifth step in the preparation process is to identify a marketing strategy to attract prospective buyers. This strategy should include developing a profile of the "ideal" buyer, identifying how and when buyer will be identified, determining who will meet with potential buyers, and gathering a set of initial materials to be given to potential buyers and their advisors. These initial materials are often referred to as the offering memorandum.

STEP 4: Preparing the Offering Memorandum (Cont'd)

- This offering memorandum should include the following information:
  - Executive summary
  - Market opportunity
  - History
  - Business overview
  - Products, services and pricing
  - Manufacturing and distribution
  - Sales, marketing and growth strategy
  - Competitive landscape
  - Management team and organizational overview
  - Risks and litigation
  - Historical financial information
  - Projected financial performance
  - Supplemental materials

STEP 5: The Game Plan

- Once the transaction preparation and Offering Memorandum are complete, the process can be managed any number of ways. A major decision at this stage is in determining how closely the process should match a formal auction.
- A formal auction typically is based upon sending standardized company materials to a large audience, providing the targets with specific dates of management meetings and timing for which offers are due.
- This formal process can lead to very positive results; however, no buyer likes an auction. An auction ensures that the "winner" values the deal more than other auction participants, and as such, some companies refuse to participate in auctions, thus closing the door to potential buyers.

STEP 5: The Game Plan (Cont'd)

- A less formal approach, however, can yield similar if not better results to an auction. In this approach the investment banker coordinates more informally with identified buyers, and ensures that each of the target buyers are contacted simultaneously. In addition, each of the targets are examined more closely for strategic fit, and often the communication and marketing materials are tailored to underscore the strategic rationale of the proposed transaction.
- There are multiple benefits to this approach. First, each buyer is different, and providing a tailored message may be better received. A likely buyer may review a large number of potential deals (even if few are done), and helping the evaluator come to the proper conclusion can be best accomplished in more focused communication. Second, for each pairing of buyer and seller, there are different synergies to be had. If a seller truly wants to maximize the value obtained from the buyer, then understanding the synergies available is critical and necessary. Finally, investment bankers typically have interacted with many of the target buyers in the past.

Common Seller Preparation Mistakes

- Impatience and indecision. Timing is everything. If you seem too anxious to sell, buyers will take advantage of your impatience. If you sit on the sidelines too long, the window of opportunity in the market cycle to obtain a top selling price may pass you by.
- Telling others at the wrong time. Again, timing is critical. If you tell key employees, vendors, or customers that you are considering a sale too early in the process, they may abandon your relationship in anticipation of losing their jobs, their customer or supplier, or from a general fear of the unknown. Key employees, fearful of their jobs, may not want to chance relying on an unknown buyer to honor their salary or benefits. A related problem for companies that are closely-held (or if one person owns 100% of the shares) is how to reward and motivate key team members who may have contributed over time to the company's success and will not be participating in the proceeds of the sale at closing. It is critical that their interests are aligned with the seller and that they work hard and stay focused on getting to the closing table.

Common Seller Preparation Mistakes (Cont'd)

- Retaining third-party transactions with people you're related to. If there are relationships that will not carry over to the new owner, shed these ghost employees and family members. They should follow you out the door once the deal is secured.
- Leaving loose ends. Purchase minority shareholder interests so that the new owner won't have to contend with their demands after the sale. Very few buyers will want to own a company that still has remaining shareholders, who may present legal or operational risks. It's akin to the real estate developer who needs 100 percent of all of the lots in a development to agree to sell before proceeding with its plans--a lone straggler or two can break the deal.
- Forgetting to look in your own backyard. In seeking out potential buyers, look for those who may have a vested interest in acquiring control of the company, such as key customers, employees, or vendors.
- Deluding yourself--or your potential buyers--about the risks or weaknesses of your company. Your credibility is on the line--a loss of trust by the potential buyer usually means that he will walk away from the deal.

Selling the Proforma

- The price that a buyer may be willing to pay depends on the quality and reasonableness of the profit projections you are able to demonstrate and substantiate. The profit and loss statement, balance sheet, cash flow, and working capital requirements are developed and projected for each year over a five-year planning period.
- Using these documents, together with the enhanced value of your business at the end of five years, you can calculate the discounted value of the company's future cash flow and develop a recasted set of financial statements and projections. This establishes the primary economic return to the buyer for their acquisition investment analysis.

Stay In Control Of The Process

- Integrate your planning, goals, and decisions prior to offering your business for sale
- Have specific goals and objectives for the transaction, both for your business and yourself
- Third party transactions are vastly different than other types of transfers already discussed
- It’s a marathon, not a sprint, and it’s not over until the check clears

You Still Have A Business To Run

- You are still in charge until the sale, and may be involved afterwards as well
- You need to continue to manage profitably and increase value
- The same principles that make the transaction easier also increase the valuation
- If you let the situation alter your management actions you may unwittingly put yourself in a detrimental negotiating position

Watch Out For These Mistakes

- Distraction – don’t spend too much time on the transaction and not enough time on the business
- Altering plans – proceed with managing, growing, and investing as if there is no transaction
- Mentally spending money – don’t plan your vacation until the check has cleared

Look At Your Business Like The Buyer

- How would you improve your business if you weren't resource constrained
- Market conditions may affect your timing decision or value potential
- Strategic and financial buyers have different value drivers
- The Offering Memorandum will communicate your business in the best light

How Does Your Business Stack Up Against Others In The Industry?

- Financial
  - Revenue and profitability
  - Compensation and cost structure
- Market position
  - Strategic value
  - Customer base
- People
  - Skills
  - Culture

Summary

- Show your business to its best advantage
  - The buyer doesn't know you or the business the way your family does
  - The whole process is more adversarial
- Make it easy for someone else to take over
  - No surprises, hidden skeletons, or complicated relationships
  - Operations should be smooth and well documented
- Advance planning pays huge dividends

Questions & Answers

Thank You

Next M&A Master Class is October 20th, 1pm Eastern.

Buy-side M&A
Qualifying your Seller & Finding Value

Found a prospective acquisition or out looking? How will 2011/2012 post-recession values affect your acquisition strategy? How to assemble your acquisition team and approach the seller? What are best practices in valuating, structuring, and financing the deal. Most importantly, learn how to overcome common roadblocks and keep your deal on track.

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