Exit Strategies for the Technology Company

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Roadmap

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Big Picture – Commonly Used Terms

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- **Merger**: a transaction in which two or more corporations combine under state corporation law resulting in all but one of the participating corps losing their identities
- **Acquisition**: a broader term that can mean any general purchase of all or part of a business– can be stock or asset purchases
- **Consolidation**: two or more organizations are combined into one new legal entity
- **Liquidation**: disposition of assets of a business to raise cash; covers a spectrum of business transactions; can include a Chapter 7 bankruptcy
- **Restructuring**: generally, any transaction in which a company's ownership, assets, or operations are rearranged to increase profitability; can include Chapter 11 bankruptcy reorganization

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Big Picture – Strategic Buyers vs. Financial Buyers

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- Strategic Buyers
  - Typically in a similar line of business
  - Objective is to "buy low and hold"
  - Generally, the strategic buyer is a large company that has the capital and managerial know-how to take the target to the next level of corporate development; this synergy is what makes the deal attractive
- Financial Buyers
  - Often what people think of when they hear "M&A" objective is to "buy low and sell high"
  - Perform the function of putting target's assets to their most profitable use
  - Targets are attractive not because of synergies with acquirer's business, but because of the target's financial characteristics

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Big Picture – 10 Exits (John Huston)

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1. **Grand Slam Homerun**
   Exceeds a 10X in five years (>58% IRR)
2. **A Lucrative Exit**
   <58% IRR, but at least a 1-10X return
3. **The Harry Houdini**
   Escaped with a 1X return; No loss
4. **Lost a Little**
   Didn't lose it all (<1X but not a 0X)

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Big Picture – 10 Exits from John Huston

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5. **My Grandkids' Company**
   Company is successful but there's no exit in sight. Maybe it will occur after my grandchildren inherit the portfolio?
6. **The Zombie**
   A walking dead venture which will never become a great company, nor will it die so I can declare the loss
7. **Deductible Loss**
   It died without a tail and I got to declare the loss (or sold my shares for $1.00 to record the loss)

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Big Picture – 10 Exits from John Huston

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8. **Funeral Expenses**

   Not only did I lose all my original investment, but I had to also cover the costs of winding down the venture, plus pay accountants to provide the final accounting needed so I could take my tax deduction

9. **The Worst Gets Worst**

   "The loss that keeps on losing" due to ongoing litigation expenses even after the company has no value

10. **Angel Hell**

    In addition to losing all my investment and a considerable amount of my time, media coverage tarnished my reputation, plus damaged my relationship with co-investors

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Big Picture – 10 Exits from John Huston

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- **The Perfect Loss:**

I merely lose 100% of my investment; take the tax deduction; suffer no on-going tail of litigation; no wind-down expenses, no media coverage, no damage to my reputation or my relationships with co-investors… and it was a "productive failure" because the entrepreneur, the management team and the investors all learned lessons which will increase their likelihood of success in their next venture

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Sample M&A Data

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The following slides summarize recent data and exits in the tech industry

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ExitRound 2014 Report

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- The ExitRound Report focus on M&A exits below $100 million
  - 88% of tech M&A deals happen below $100 million
  - Used data from more than 200 exits that have happened between 2006 and 2014

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ExitRound 2014 Report

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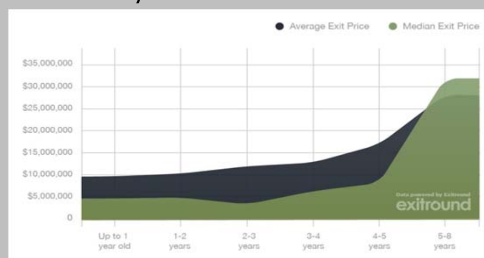
- Key Findings:
  - Companies that generate substantial exits are usually at least 4 years old
    - Companies below 4 years generally did not show a substantial variation in price
    - Those more than 4 years old increased substantially in price



Source: Exit Round (2014 Report)

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ExitRound 2014 Report

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- Key Findings:
  - Raising more capital does not necessarily result in a larger exit price for the company
  - Exit prices varied among companies in different sectors – cloud and mobile showed the best return on invested capital

Source: Exit Round (2014 Report)

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ExitRound 2014 Report: Exit Curve

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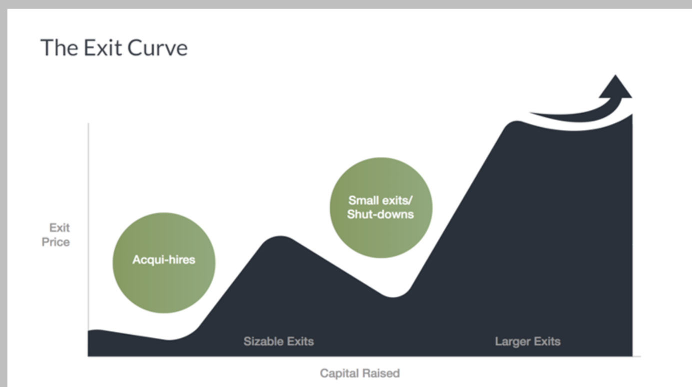
- The Exit Curve shows the best exits from a return-on-capital perspective form a pattern



Source: Exit Round (2014 Report)

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ExitRound 2014 Report: Exit Curve

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- It was found that the best average exits tend to be around companies with total capital raises of between $2 million to $3 million and between $5 million to $10 million
  - Exit prices tend to drop after companies raise more than $3 million and $10 million

Source: Exit Round (2014 Report)

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Sample Local M&A

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American Analytical Chemical Laboratories, Inc

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- Inception
  - 1994: American Analytical Chemical Laboratories (AAC Labs) founded by biologist Charlie Li in Savoy, IL
  - 2004: AAC Labs moves to Champaign's Mattis Commercial Park
- Core Technology
  - Analysis and testing of nutritional supplements for presence of residues, pesticides, antibiotics, and verification of nutritional content
- Market
  - Dietary Supplement Health and Education Act (2006) requires supplement testing to ensure identity, potency and safety
  - As a result, AAC Labs does testing for ~ 500 customers in the United States and worldwide
  - Major clients include a nutritional supplement company in New York, and two sizeable customers in Salt Lake City

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American Analytical Chemical Laboratories, Inc

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- Growth
  - 1994: AAC Labs opens in Savoy
  - Revenue increased every year since inception
    - Grew 11% in 2010, during height of economic downturn
  - 2004: larger facility, 15 employees
  - 2010: 23 employees
- Exit (2011)
  - Acquired by Intertek Group for $6.9 million cash
  - Strategic Buyer
  - Founder Charlie Li to remain in charge of Champaign lab, which expects to grow employee count by 50% to about 35 employees within next 2-3 years
- Sources
  - The News Gazette and London Stock Exchange RNS

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iCyt Mission Technology, Inc.

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- Inception
  - 1995: Cytometry Services, Inc. founded in Champaign/Urbana
  - Renamed iCyt Mission Technology, Inc. in 2002
- Core technology
  - Advanced flow cytometry analysis and sorting technology for use in life science research
- Market
  - Private and public research institutions
  - Pharmaceutical and biotechnology companies
  - Large medical centers

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iCyt Mission Technology, Inc.

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- Growth
  - 2000: first full-time employees hired
  - 2004: 30 employees
  - 2005: larger facility, 44 employees
  - 2007: first commercial instrument system
- Exit (2010)
  - Acquired by Sony Corporation
  - Wholly owned subsidiary, with founder as executive
  - A strategic acquisition
- Source:
  - Company website and Sony press release dated 2-10-2010

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Isotech Laboratories, Inc.

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- Inception
  - 1985: founded by Dennis Coleman, Jerry Benson and Kerry Riley
  - Based in Champaign, IL
- Core technology
  - Isotope testing for the oil and the gas industry: helps reduce risk in oil and gas exploration and checks integrity of underground storage fields
  - IsoTube®, IsoJar®, IsoBag® and IsoPak™
- Growth
  - 42 employees
  - Sales: from $1.1 in 2001 to $4 in 2006 and almost $9 million in 2008
  - Now operates three satellite labs in Cairo (Egypt), Rio de Janeiro (Brazil) and Perth (Australia), in the process of setting up another one in Oman
  - Works with almost all oil and gas companies

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Isotech Laboratories, Inc.

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- Acquisition
  - Isotech reached the point where going forward on its own would be too risky as its technology was becoming widely used and competitors were emerging
  - 2011: acquired by Weatherford Laboratories, subsidiary of Switzerland-based Weatherford Laboratories
  - SEC filing by the buyer implies a sale price of $28 million
  - Weatherford employs more than 50,000 employees worldwide, and operates in more than 100 countries
  - Weatherford entered the isotope analysis market through this acquisition
- Remains local
  - Isotech remains in Champaign and operates under same management
- Source
  - News Gazette, SEC

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Carle Foundation Hospital

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- Carle Foundation Hospital acquired Carle Clinic Association and its subsidiary Health Alliance
  - $ 250 million sale
  - Carle Foundation is a not-for-profit organization
  - Carle Clinic Association a for-profit, physician owned multi-specialty group practice
- Strategic acquisition – creation of an integrated system for health care
  - The deal positions Carle to remain under local control
  - Hospital had been seeking to acquire the Clinic off and on for the past thirty years – parties' familiarity with each other

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Carle Foundation Hospital

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- Most of the actual purchase price was allocated to the Clinic’s subsidiary Health Alliance Medical Plans
- 80% of key employees (physicians) signed employment contracts to continue employment after the transaction
- Purchase price paid through borrowing
- Required regulatory approvals included
  - Heath Facilities Planning Board
  - Federal Trade Commission
  - Department of Justice
- Source
  - News Gazette, December 11, 2009

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Players: Sell-side

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At least three groups of people will be involved in the acquisition process—either because they are owners or because of their management role

- Exiting owners
  - Often the founders; view the acquisition as a successful outcome for their entrepreneurship
  - May also include angel investors and venture capital firms who made their investment with the goal of an exit
- Continuing owners
  - Includes key equity-owning executives and other personnel, including possibly the founders, whose continued management is desired by the buyer
- Non-owner management
  - Includes managers whom the 1) buyer wishes to continue to employ after acquisition and 2) those who will be replaced

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Acquisition Criteria

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An acquirer will generally formulate criteria regarding the type of business it is looking to purchase before beginning its search, for instance:

- Industry/Type of business
- Size of business
- Profitability
- Management/Board of Directors style
- Target's market characteristics
- Product lines
- Tech/R&D activities
- Purchase price payment options

How acquisition can benefit the acquirer's bottom line

Knowing these acquisition criteria can help a target identify legal and business steps to make the company more attractive to a potential buyer

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Acquisition Criteria: Industry/Type of Business

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- The most easily understood of the acquisition criteria
- The usual acquirers of early-stage tech companies are much larger conglomerates
  - It could also be the end result of a successful joint development agreement or joint venture
- Nevertheless, there are legal issues to be mindful of: will the acquisition give rise to any antitrust or anticompetitive concerns?
  - Unusual in the context of early-stage tech companies

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Acquisition Criteria: Size and Profitability

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- Size
  - Metric: annual sales or annual revenue
  - Companies will look for targets within a specific range, neither too small nor too large
- Profitability
  - Return on equity
  - Price-earnings ratio
  - Return on sales
  - Sales growth trends
  - Early stage tech company may not yet be profitable but may still be an attractive target for a strategic buyer

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Acquisition Criteria: Management Style

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- Management/Board of Directors style
  - Has the target been well-managed so far, and is that likely to continue?
    - Are there middle-rank management who are ready to succeed following the departure of owners and high-level executives?
    - What system is in place to continue to recruit and train qualified management candidates?
    - Does management match the acquirer’s desired attributes, such as for business aggressiveness or conservative management?
    - Will management be replaced upon closing of the acquisition?

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Acquisition Criteria: Market Characteristics

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- Are there any peculiarities to the target's market characteristics that need to be considered?
  - Does a single customer account for a large proportion of the target's sales?
    - This may not be especially problematic if the customer is a government agency
  - Has the target developed a business niche that sets it apart from it competitors?
  - Similarly, has the target developed a geographic niche that makes it attractive to the potential acquirer?

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Acquisition Criteria: Product Lines and R&D

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- Product Lines
  - Some acquirers may not consider single product line companies for acquisition; strategic buyer may roll the product line into its existing company and be very comfortable with one product line
- Research and Development
  - What are the prospects for the tech it has developed?
  - What legal protections for its IP are in place?
    - Will there be any difficulties in transferring the IP to a new owner?
  - Who drives innovation at the target? If it is a small number of employees, what would happen if they left the company?
  - What has the target's R&D track record been like?
  - What are the projections for R&D expenditures in the short-term and the long-term?
  - See IP audit checklist

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How Acquirers Identify Targets

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- Internal
  - Some acquiring companies have an internal department whose role (or one of its roles) is to identify potential acquisition targets – commonly called "Corporate Development"
  - Often the companies know each other through trade shows, a joint development arrangement or some other preexisting relationship – the ________ industry is a "small world"
- External
  - Selling companies may retain external professionals to help with the sale
  - Brokers or finders sometimes handle smaller acquisitions – "main street" businesses – these often sell through word of mouth without a broker
  - M&A advisory firms or investment banks may advise on very large deals
  - Fees for these groups might range from a 2% "finder's fee" to the more complicated "Lehman formula" – 5% on the first million, 4% on the second million, 3% on the third, 2% on the fourth, and 1% on the remainder over four million dollars, although Lehman formula fallen in disfavor

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Nondisclosure Agreement (NDA)

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- Often the first agreement to be entered into and an early first step in M&A transaction
- Use a nondisclosure form that is specifically drafted for M&A activity

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Some areas of the NDA that may be unique to M&A

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- Confirms language clarifying that discussions between parties about the transaction are confidential, for instance:
  - identity of the parties
  - terms of any bid if the recipient is the acquiring company (if recipient is the acquiring company and needs financing for the transaction, obtain a carve out allowing information to be disclosed to financiers)
- Limits use of the confidential information to evaluation of the specific transaction and for no other purpose
- Non-solicitation/Employment of Disclosing Party's Employees (important to provider/seller)
- Sets the terms of the NDA (limited or perpetual) (consider unlimited term for trade secrets)
- Privilege – confirms disclosure is not deemed to have waived or diminished attorney-client privilege, attorney work-product protection, etc

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The Buyer Visit

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- Typically occurs very early in the acquisition process
- Discretion is important
  - No need to tip off customers, vendors, employees, competitors, and others that an acquisition is being contemplated
- Preparation is important
  - Buyer is looking for hidden risks and unexploited opportunities
  - First question buyer will ask is "Why are you selling the business?" — Make sure you have a good answer
    - The best answer typically focuses on what the buyer brings to the table that the seller doesn't have (greater capital, larger sales and distribution networks)
    - Positions the company as ready to take-off once those advantages are brought to bear

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The Buyer Visit

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- Know your company inside and out
  - Know your costs, your margins, and your ratios
  - Be able to explain the market your company operates in and provide a forecast for your operations
- How to handle the company's weaknesses
  - Part of knowing your company is knowing its strengths and weaknesses
  - Naturally seeming forthright will build more confidence in the buyer than appearing cagey
  - Position the company's weaknesses as capable of easy correction — a weakness then appears to be an untapped opportunity
    - *Example:* A company has an 8-week backlog on orders, which causes lost sales.
    - The acquirer has the resources to handle order fulfillment more efficiently and recapture the lost sales

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The Buyer Visit

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- Remember that the buyer visit is a two-way exchange of information
  - Seller should also question buyer
  - Seller should use buyer's responses to identify what matters to the buyer — and weave this information into making the case for acquisition and drive up your perceived value to buyer
  - Seller should get a sense whether the buyer understands your business and the industry and market it operates in
    - Many acquisitions involve earn-outs
    - Need to be confident that buyer has the capability of meeting the earn-out benchmarks

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Letter of Intent ("LOI") / Term Sheet

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- Sets forth key business terms before definitive legal documents are prepared
- Legally binding vs. non binding vs. binding only as to particular terms (confidentiality, no shop)
  - Best to avoid "no shop" provision, which would prohibit any discussion with another possible buyer
  - If "no shop," cannot be removed, negotiate a better purchase price, break fee, or limit it to a "window shop" - cannot solicit buyers but can talk to them if they come to you

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Conducting Due Diligence

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- **Due Diligence: What is it?**
  - Fundamentally, it is the investigation of a business in connection with a possible transaction
  - Usually performed by someone who is considering whether to purchase or make a significant investment in a business (buy-side due diligence)
  - Sellers can and should engage in (sell-side) due diligence to uncover any problems that may be presented by a sale to a suitor
  - Although both parties should engage in due diligence, because of the seller's information advantage, buy-side due diligence tends to be much more intensive

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Conducting Due Diligence

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- **Due Diligence: What does it cover?**
  - Legal issues
    - This is only a small portion of due diligence
  - Valuation issues
    - Financial data
    - Market and industry forecasts
  - Due diligence is not designed only to uncover risks (although it is meant to do at least that), it can also help uncover untapped opportunities
    - Due diligence can drive a buyer away when unacceptable problems are found or it may encourage a buyer when it appears that the problems are solvable

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Conducting Due Diligence

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- **Due Diligence: How is it conducted?**
  - Traditionally, lawyers for the buyer would prepare a list of documents required from the seller
    - Usually, this list would encompass all the subject areas of due diligence, not just the legal due diligence
    - Depending on the bargaining position of the parties, due diligence demands may (or may not) be negotiated
  - Seller would then be given a generally short amount of time to assemble the requested documentation and present it for buyer's examination in an on-site (seller) "data room"
    - The data room is a famous feature of the M&A process, but the online data room is replacing the physical data room
  - Buyer's M&A team would then review the requested material at the data room over the course of a few days or longer and make a report to the buyer concerning their assessment

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Conducting Due Diligence

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- Due Diligence: What are its objectives?
  - As mentioned, *one* objective of due diligence from the buyer's perspective is to uncover latent risks in the acquisition
- But it is also meant to provide insight on other questions as well, such as …
  - Can seller effectively integrate the newly acquired business?
  - Have the representations that have been made been accurate?
  - What is the true value of the business, both stand-alone and as a unit of the potential acquirer?

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Conducting Due Diligence

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Due Diligence: The seller's team

- Clearly, a due diligence can be disruptive to seller's business
  - The additional administrative burden of meeting due diligence requirements
  - The risks of disclosures
- Minimizing this disruption begins with the formation of a due diligence team
  - Team leader from the company
  - Operations personnel
  - Accounting personnel (internal and/or external)
  - Legal personnel (internal and/or external)
  - Other experts from within the company or external consultants (valuation experts, environmental consultants, risk managers), as needed

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Conducting Due Diligence

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- **Due Diligence: The seller's objectives**
  - Uses its initial information advantage to obtain better terms and less burdensome representations and warranties
  - Minimizes the adverse effect of due diligence mandated disclosures
  - Controls the marketplace's knowledge of the pending deal and perform effective damage control if the deal falls through

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Conducting Due Diligence

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- **Due Diligence: How seller achieves its objectives**
  - Impose certain conditions on the due diligence process
    - Only responds to written due diligence requests
    - Uses staggered due diligence to prevent premature disclosure; more sensitive disclosure occurs later in the process
    - Imposes distribution restrictions — agree that material designated as "Attorneys' Eyes Only" will only go to buyer's lawyers and not their operations personnel
  - Addresses adverse facts
    - Remedies defects before closing
    - Notifies buyer; carries the risk that indemnification will be sought
    - Ignores them and sees if buyer discovers; as with any negotiation, seller should be candid but does not need to fall on its sword
    - Sells off problem assets

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The Data Room

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- The Data Room Defined
  - Before, due to the amount and sensitivity of the documentation requested, seller's responses to buyer's due diligence requirements were kept on site at seller's premises in a location known as the "data room"
    - A customary component of the M&A process even as technology alleviates some of the cost and confidentiality concerns
  - The data room is part of the "beauty pageant" – if the data room is lacking or looks too hastily and unintelligently put together, the buyer's confidence in the seller may take a serious hit

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The Data Room

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- Creating a Data Room
  While the data room is important for maintaining buyer's confidence, it can be time-consuming and expensive to create
- Here are some typical facts about putting a Data Room together:
  - Many of the documents will be located throughout the company's premises and offices; the personnel charged with locating them may have to ask persistently to ferret out the needed documents
  - Due to time constraints, it may not be possible to review all documents before they are included in the data room
  - Some sellers don't index anything and let buyer figure it out; others provide comprehensive indexes. Because you don't necessarily want to provide a map to embarrassing disclosures, the best result is probably to identify what top-level portion of the due diligence list a given document is responsive to
  - Be prepared for follow-up requests and to determine how much access to your employees you will grant to buyer

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The Data Room

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- Running the Physical Data Room
  - Whether you have one potential buyer or several, there are some common rules to running a Data Room that help ensure confidentiality and responsiveness are maintained:
    - Have a sign-in procedure for visitors to the data room
    - Develop a check-in/check-out procedures for documents
    - Determine whether copies will be allowed, and if so, how copying will be performed and what restrictions will be imposed on use of the copies
- Similar protections should be in place for an electronic data room

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Deal Structure – Stock Sale

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- Stock sale – buyer buys the stock of the target
  - Target corporation realizes no gain and so there is no corporate tax paid by target
  - Target shareholders pay only the capital gains tax rate on the sale of their stock
  - All assets and liabilities are still the assets and liabilities of the target
  - Buyer may leave target as a separate entity or integrate it into buyer over time in by taking additional measures

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Deal Structure – Stock Sale

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- Advantages
  - Target structure is not altered by the deal and remains generally intact
  - Need for third-party consent (as to assignments of contracts, leases, etc.) is reduced
  - Buyer can still get stepped up basis if the target is an S corporation and 338(h)(10) election made
- Disadvantages
  - Agreement of every selling shareholder needed
  - Buyer does not get stepped up basis in assets unless 338(h)(10) election made (limited to S corporations)
  - Target still has all of its liabilities

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Deal Structure – Asset Sale

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- Asset sale -buyer purchases substantially all of the target's assets
  - Buyers prefer this route because:
    - it has favorable tax implications (buyer gets a step up in basis in the underlying assets)
    - cuts off liability for existing target debts
    - facilitates buyer hiring less than all of target's employees and buyer need not take on employee benefit plans
  - NOT favored by sellers structured as a C corporation (most VC funded firms) because the target/selling corporation will realize a gain, pay tax on that, and the shareholders will pay tax again when the proceeds are distributed
    - This adverse tax treatment mitigated for S corporations
  - Both C corp. and S corp. still may prefer to avoid having to deal with leftover liabilities and so may prefer asset sales for this reason

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Deal Structure – Asset Sale

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- Issues
  - Buyer and seller will need to agree how to allocate the purchase price among different IRS categories
  - Non-assignment clauses in target's contracts will be triggered so buyer may have to renegotiate these contracts
  - Buyer may not end up with a standalone business
  - Stockholders of target may still be required to sign the sales contract and be on the line personally for certain obligations under the contract

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Deal Structure – Merger Types

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- Two-party merger
  - Acquiring corporation acquires the target by merging target directly into acquiring corporation
  - Can be tax-free if the requirements of IRC §368 are met
- Multi-party merger
  - Although the two-party merger is the simplest and most frequently encountered, a company can acquire several independent targets

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Deal Structure – Merger Types

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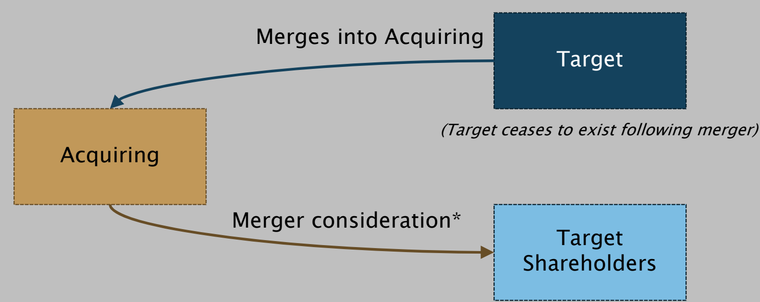
Two-party merger diagram



* *Consideration is acquiring stock and possibly cash or other property (boot)*

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Deal Structure – Merger Types

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- **Forward triangular merger**
  - Acquiring corporation forms a subsidiary corporation (“Sub”)
  - Sub acquires the target by merging target into Sub
  - Can also be tax-free if the requirements of IRC §368 are met
  - Since Sub is a corporation, the acquiring corporation (which is the sole shareholder of Sub) enjoys some limitation of liability—a feature not shared by the two-party merger

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Deal Structure – Merger Types

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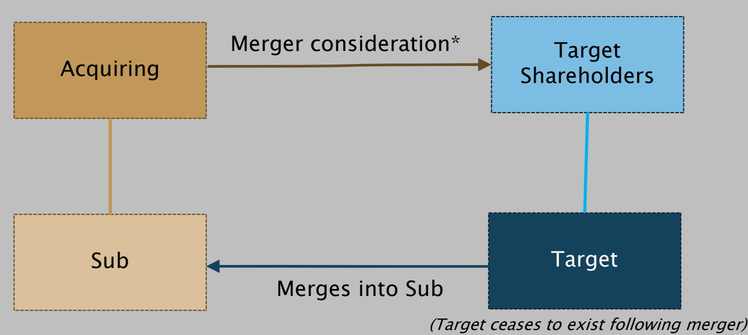
Forward triangular merger diagram



* *Consideration is acquiring stock and possibly cash or other property (boot)*

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Deal Structure – Merger Types

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- **Reverse triangular merger**
  - Acquiring corporation forms a subsidiary corporation ("Sub")
  - Sub is acquired by the target by merging Sub into target
  - Can also be tax-free if the requirements of IRC §368 are met
  - Since target ends up as a wholly-owned corporate subsidiary, the acquiring corporation enjoys some limitation of liability—a feature not shared by the two-party merger
  - ***Because target continues in existence, assignment or transfer of contract rights and licenses can be less problematic***

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Deal Structure – Merger Types

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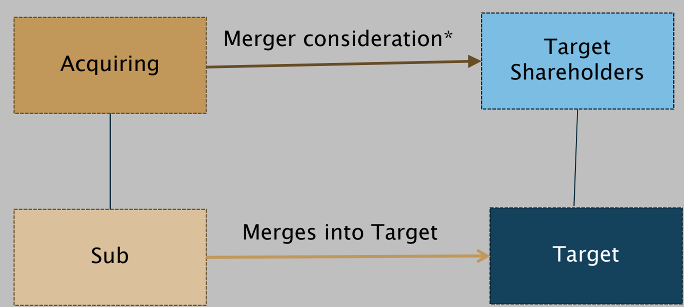
Reverse triangular merger diagram



(Sub ceases to exist following merger)

* *Consideration is <u>acquiring</u> stock and possibly cash or other property (boot)*

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Deal Structure – Hybrid Acquisition

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- The hybrid acquisition involves the larger company taking a large, but not complete, stake in the smaller company, together with the right to purchase the company at a later date according to agreed-upon valuation metrics
  - Sometimes used in the tech industry
- Why acquirer’s sometimes like this approach:
  - Allows diversification; instead of acquiring one company for $30 million, the hybrid buyer can take less-than-total stakes over several companies
  - Access to new products and technology is obtained at a smaller cost
  - Key personnel are likely to remain in place, but now they also have capital infusion from the larger hybrid buyer to take company to its next level
- Owners of selling company may like this approach as it lets them “take some money off the table” now (their entire net worth may be locked up in the company stock) while still owning a portion of the company going forward

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Deal Structure – Recapitalization as an Exit Strategy

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- **Recapitalization**: company raises funds through taking on debt; this money is then used to either buy back stock from exiting shareholders or by paying a "super dividend"
- **Partial exit**: usually, recapitalization represents a partial exit. The shareholding owners retain some equity in the company and managerial responsibility; these continued investment and management by the original owners makes the recapitalization deal attractive to the lender
- **Positive cash flows required**: because a recapitalization will create a debt that needs to be serviced, it is a more appropriate strategy for mature businesses with a positive cash flow

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Preferred Stock

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- Equity that has preferences over common stock
- Preferred stock holders may have the right to receive dividends before common stock holders
- In case of liquidation, preferred stock holders are paid before common stock holders
  - But after creditors
- Preferred stock may be convertible
  - Convertible preferred stock can be exchanged for common stock
  - Conversion is one-way

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Participating Preferred Stock in M&A

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- Form of convertible preferred stock
  - Often the type of stock provided to VC investors
- Provides investor with extraordinary rights if company is sold or liquidated
  - Investor receives return of its purchase price paid for the stock
  - Investor may also receive guaranteed return on investment
  - Investor receives pro rata share of remaining proceeds
  - Holders may enjoy additional benefits over common stock holders
    - Enhanced voting rights
    - Dividend preferences
- The liquidation preference has a greater effect proportionately in a "modest" exit

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Participating Preferred Stock in M&A

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	Non-participating preferred	Participating Preferred
Shares of common stock	8 million	8 million
Shares of preferred stock	2 million	2 million
Preferred stock purchase price	$10 million	$10 million
Company sold for $20 million		
Common stock proceeds	$16 million	$8 million
Preferred stock proceeds	$4 million	$12 million (10 + .2x10)
Company sold for $50 million		
Common stock proceeds	$40 million	$32 million
Preferred stock proceeds	$10 million	$18 million (10 + .2x40)
Company sold for $100 million		
Common stock proceeds	$80 million	$72 million
Preferred stock proceeds	$20 million	$28 million (10 + .2x90)

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Employee Stock Ownership Plan (ESOP) as an Exit Strategy

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- An ESOP is a kind of employee benefit plan, similar in some ways to a profit-sharing plan
- Company sets up a trust fund, into which it contributes new shares of its own stock or cash to buy existing shares
- Alternatively, the ESOP can borrow money to buy new or existing shares, with the company making cash contributions to the plan to enable it to repay the loan
- Company contributions to the trust are tax-deductible, within certain limits
- Shares in the trust are allocated to individual employee accounts

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Employee Stock Ownership Plan (ESOP) as an Exit Strategy

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Why ESOPs are used as an exit strategy

- Owners of privately held companies can use an ESOP to create a ready market for their shares. Under this approach, the company can make tax-deductible cash contributions to the ESOP to buy out an owner's shares, or it can have the ESOP borrow money to buy the shares.
- ESOPs are unique among benefit plans in their ability to borrow money. The ESOP borrows cash, which it uses to buy company shares or shares of existing owners. The company then makes tax-deductible contributions to the ESOP to repay the loan, meaning both principal and interest are deductible.
- Capital gains taxation on owners' sale of stock to ESOP can be deferred if sale proceeds are reinvested in qualifying U.S. stocks and bonds
- However, an ESOP requires a corporate form, either an S corporation or a C corporation
  - ESOPs in S corporations can be a little tricky—S corporations have limitations on the number of shareholders and who is eligible to be a shareholder
  - ESOPs in S corporations have greater limitations on tax deferred capital gains than C corporation ESOPs

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CU Area Companies with ESOP Exits

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- At least three local companies have used ESOPs as exit strategies
- Human Kinetics
  - 1973: Sports and leisure publishing firm founded by U of I kinesiology professor Rainer Martens
  - 1985: Martens left the university to operate HK full-time
  - 2000: HK was doing $20 million in sales and employed about 250 people
  - 2005: Martens sold HK to his employees through an ESOP
  - 2008: The employees proved to be able stewards of Martens' legacy: HK had revenues over $37 million and a work force of 320

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CU Area Companies with ESOP Exits

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- Hobbico
  - World's largest manufacturer and distributor of model hobby products
  - Hobbico resulted from the 1986 consolidation of two other model hobby companies that were founded in the early 1970s
  - 2000s: Hobbico employs about 800 people in facilities of over 600 thousand square feet in Illinois and Nevada
  - 2005: Clint Atkins, one of Hobbico's owners, mentioned that the then 20-year-old company had "never had an unprofitable month"

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CU Area Companies with ESOP Exits

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- SAIC
  - Federal contractor that works on military and security projects
  - 2005: Went public
  - Before that, SAIC was one of the country's largest employee-owned companies … and the IPO in 2005 proved to be very lucrative for them
    - IPO raised over one billion dollars, which was distributed as a special dividend to employee and retiree shareholders
    - Employees retained 80% ownership of company following the IPO
  - Privately held companies have to repurchase the employee-owned stock when employees leave the company; by going public, SAIC used the market to supply the buyers and the funds, rather than company cash

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The M&A Agreement

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- The M&A Agreement (Stock Purchase Agreement, Asset Purchase Agreement, Merger Agreement) is the primary document that governs the terms and conditions detailing the merger of two companies or the acquisition of one company by another
  - It implements the LOI in more detail
- There are many legal and business issues involved
  - This presentation addresses just a few of them

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M&A Agreement Key Provisions

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- Purchase Price and Purchase Price Adjustments
- Representations and warranties
- Buyer and seller covenants
- Indemnification provisions
- Closing conditions
- Termination provisions

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Purchase Price – Determining the Sales Price

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- Best valuation is the one that comes in the form of a check (or better yet – a wire transfer)
- Measure the value proposition in the acquirer's terms
  - How will the acquisition benefit the acquirer's bottom line?

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Purchase Price –Approaches to Business Valuation

71

- Income approach
  - Present value of expected future cash flows
- Market approach (comparable sales)
  - Transaction prices of similar companies
  - See industry specific sales summarized at end of these slides
- Asset approach
  - Market value of liabilities deducted from market value of assets

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Purchase Price – Post-Closing Earnout Provisions

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- Prospective parties to a M&A deal typically have different views as to the value of the subject company making agreement on the purchase price difficult
- Sometimes buyer is unable to afford target company, but nevertheless remains very interested in doing so
  - One way to bridge the gap in the above situations is to have a portion of the purchase price based on the future performance of the target company
  - Such provisions, often referred to as “Earnouts”, entitle the seller to receive additional payments if the business meets certain contractual targets post-closing

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Earnout Characteristics

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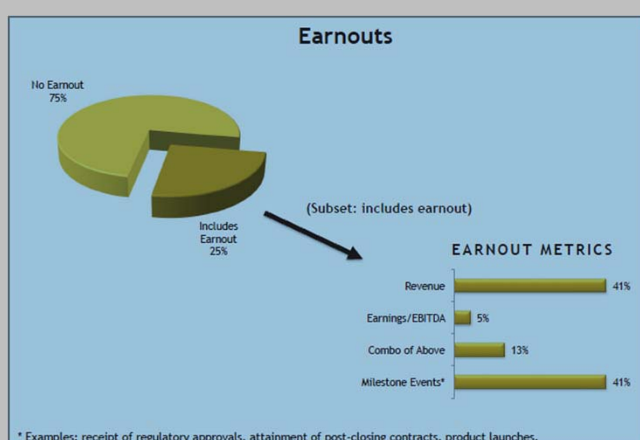
- Earnout provisions allow parties otherwise unable to agree to a purchase price to nevertheless reach a deal
  - Earnout provisions are important and often times represent a substantial portion of the total consideration
- Achievement of the earnout necessarily depends upon the buyer's management of the business post-closing, and how the buyer accounts for the post-closing financial performance of the business
- In light of this potential conflict between the buyer and seller, disputes often arise relating to earnout provisions

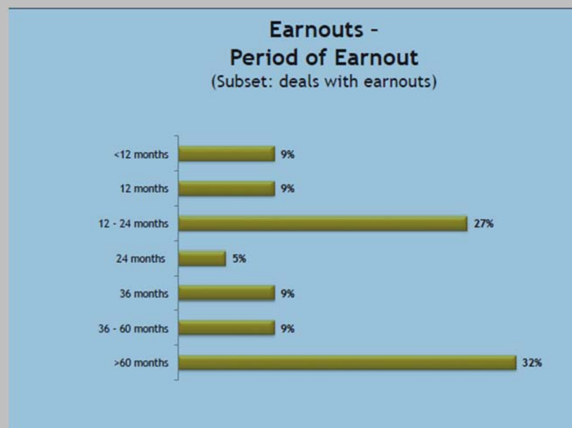
Inclusion of Earnout Provisions – SRS Study

74



Average Periods of Earnout – SRS Study

75



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Typical Earnout Disputes

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- Two primary disputes that arise in relation to earnout provisions include:
  1. Disagreement as to whether the applicable target(s) for the earnout payment were met (––i.e., whether the EBITDA target was met)
  2. Disagreements as to why the earnout targets were not satisfied (––i.e., whether the buyer adequately supported the business after the closing)
- These issues can be addressed within the earnout provisions themselves through a variety of covenants and provisions

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Earnout Dispute Avoidance

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- The parties' rights and obligations with respect to earnout provisions are contractual
- The resolution of an earnout dispute often turns to the specific language negotiated by the parties
  - Courts will not rewrite the agreement in the name of "fairness", but will instead focus and enforce the "plain language" of the contract itself
- Careful drafting of the contract is key – clearly define salient points with the agreement itself

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Earnout Covenant to Run Business in Accordance with Past Practice

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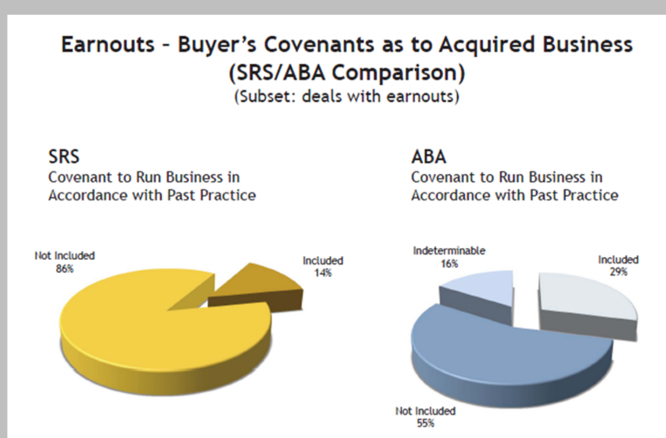

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Covenant to Run Business so as to Maximize Earnout Payment

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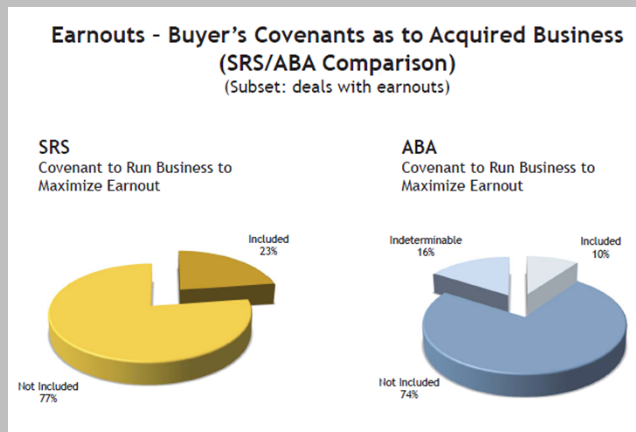

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Earnout Dispute Example

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Comet Systems, Inc. Shareholders' Agent v. MIVA, Inc. presents a typical dispute relating to whether the earnout was met:

- MIVA acquired Comet pursuant to a merger agreement
- The agreement included an earnout provision where the earnout payment was based upon relative to performance goals
- When calculating performance, the agreement allowed for the exclusion of "one-time, non-recurring expenses" , but did not further define this term
- Comet paid an approximately $800,000 bonus to its employees
- MIVA calculated the bonus payment as an ordinary expense resulting in revenue targets *not* being met and therefore a significantly reduced earnout payment
- Comet calculated the bonus as a "one-time, non-recurring expenses" whereby revenue targets were met and a much higher earnout payment due

- The Court found the bonus to be a "one-time, non-recurring expense"
- Lesson: Parties would be well-served to carefully draft the agreement to clearly define how the earnout should be calculated (and determine the earnout consistent with the agreement) in order to reduce the likelihood of litigation

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Purchase Price – Closing Adjustment Provisions

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- Delays, sometimes significant, invariably exist between the Negotiation of the Purchase Price and the Closing of the Deal
- During that period of time, numerous events can and do occur affecting the reasonableness of the negotiated Purchase Price
- Closing Adjustment Provisions provide an opportunity to allocate risk during this time period
- While the determination of the Closing Adjustment appears straightforward, it is not
- Closing Adjustments can have a significant impact on the Purchase Price
- Disputes often arise surrounding Closing Adjustments

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Purchase Price – Net Working Capital Adjustment

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- Net Working Capital Adjustment
  - Targets a closing balance sheet net working capital amount
  - Usually based on an interim net working capital, average annual net working capital or forecasted net working capital amounts
  - To the extent the actual closing net working capital value deviates from the target ***an adjustment to purchase price may come into effect***
  - These adjustments may be structured as one or two way adjustments to purchase price

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Purchase Price – Closing Adjustment Provisions

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- The 2013 Private Target Merger & Acquisitions Deal Points Study from the American Bar Association (ABA) found that 85% of deals analyzed included Adjustment Provisions
  - Working capital was the most common adjustment (in 91% of the relevant deals)
  - Other metrics used in calculating adjustments include: earnings, debt, assets, cash or other

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Sample Post-Closing Purchase Price Adjustment Provision (per ABA)

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- The "Adjustment Amount" (which may be a positive or negative number) will be equal to the amount determined by subtracting the Closing Working Capital from the Initial Capital. If the Adjustment Amount is positive, the Adjustment Amount shall be paid by wire transfer to Seller to an account specified by Buyer. If the Adjustment Amount is negative, the difference between the Closing Working Capital and the Initial Working Capital shall be paid by wire transfer to Buyer to an account specified by Seller.

…

- "Working Capital" as of a given date shall mean the amount calculated by subtracting the current liabilities of Seller … as of that date from the current assets of Seller … as of that date. The Working Capital of Seller as of the date of the Balance Sheet (the "Initial Working Capital" was _______ dollars ($__________)

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Purchase Price – Escrow

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- Escrow of a portion of purchase price can last in excess of 12 months
- Percentage of purchase price varies but can run from five to fifteen percent

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Representations and Warranties

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- Intended to disclose all material legal, and many material financial, aspects of the business to the buyer
- Seller also gives assurances that the transaction itself will not have adverse effects upon the property to be conveyed, such as any limitations on transfer or assignment of rights
- Lenders providing acquisition financing will require the buyer to make extensive representations and warranties about the target as a condition to funding
- Like any other part of the deal, representations and warranties are negotiable. There are some representations that buyers typically try to include—but by no means does this mean that these provisions *must* be included

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Representations and Warranties

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Common representations and warranties include the following:

- **Financial statements**: closing audit is imperative to verify the authenticity of all the items, particularly inventory, receivables, and payables. Then a post-closing adjustment is factored into the final floating payoff at closing
- **Assets**: buyer wants to be sure he is gaining full title to the assets, particularly as it pertains to items such as intellectual property and patents. Also, the buyer wants assurances that the machinery and equipment are in good working order
- **Taxes**: not only is it critical to verify any tax liability if it is a stock purchase, but in the case of an asset purchase, the owner wants to be sure there are no liens on assets due to failure to pay taxes

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Representations and Warranties

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- **Environmental**: can be especially important because environmental liability can be difficult to limit. Liability follows the asset, so even that mode of transfer provides minimal liability protection
- **Pending and potential litigation**: seller will want to place a time period or cap on his or her total responsibility. Usually, the buyer ends up sharing some of the risk for previously made products
- **Authorization**: selling the company from stockholders, directors, or third parties such as the bank the owner will require authorization. Seller will be expected to ensure to the buyer that all liabilities are represented; all contracts are disclosed; all wages, taxes, and insurance are current; and all bonus plans are disclosed

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Pre-Closing Covenants

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- Apply after signing the M&A Agreement and before closing
  - Seller generally required to operate the business in normal fashion, with some restrictions
  - Buyer will have complete access to seller's records
  - Seller required to notify buyer of certain developments

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Post-Closing Covenants

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- Seller not allowed to compete with buyer or solicit buyer employees
  - Cooperate regarding assignment of contracts, transfer of real estate, vehicle titles, etc.
  - Coordinate regarding accounts receivable collection
  - Earnout monitoring and payments

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Closing Conditions

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- Not included in sign and close deals
- Bring down of representations and warranties
  - Qualifiers: materiality or MAE
- Third-party consents
  - All required consents or agreed-upon list of material consents
- Employment agreements with key employees remain in place
- Real estate - no MAE
- Legal opinion

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Indemnification

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- Indemnification is the follow up to representation and warranties
  - it establishes what remedies will be available for breach
  - Can be in the form of escrow or insurance policy
- Indemnification provisions related to M&A transactions (mergers, asset purchases and stock purchases) are some of the most complex and heavily negotiated provisions in M&A agreements

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Indemnification

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- Indemnification provisions can become a "contract within a contract" having its own term, payment provisions, notice provisions, governing law and dispute resolution
- There are a few reasons for this complexity:
  - The indemnitor is always trying to limit indemnification liability while the indemnitee wants as much indemnification protection as possible
  - Parties attempt to anticipate every conceivable indemnification event
  - Everything is negotiable, so there is no one "right" answer concerning indemnifications

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Indemnification

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Indemnification parameters include:

- **Time limitations:** Establishing a period in which a claim for indemnity must be raised
- **Subject matter limitations**: What counts as "material"? Whose knowledge can be considered company knowledge? What warranties will have long post-closing periods and which warranties will end soon after closing?
- **Dollar limitation:** What is the maximum seller will pay out? What minimum must be reached before any claims are paid (the "basket" or "deductible")
- **Identities**: Who precisely is indemnifying whom? Are they jointly and severally liable or not?
- **Defense of third party claims**: If a third party sues, what obligation do seller and buyer have to assist in the defense of the suit?
- **Dispute resolution**: Will claims go to court? Or to an expedited arbitration panel?

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Representation & Warranties

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- Only apply when closing is not held simultaneous with signing of the M&A agreement
- Reps and warranties must be true as of date of closing
- Third-party consents must be obtained or accounted for
- No material adverse change in the business
- Employment agreements with key employees in place

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Termination of M&A Agreement

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- Sellers typically want to close quickly
- Buyers typically want to take enough time to make sure they know what they are buying
- If buyer not ready to close on time, buyer can typically terminate, subject to certain restrictions
- Financing contingency sometimes included that allows buyer to walk if it cannot obtain financing

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Additional Local M&A Events

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More local M&A cases….

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Caterva, Inc.

98

- Inception
  - 2008: Caterva, formerly known as Yottaclick, Inc., was formed in Champaign, Illinois, by Hieu Li while he was a University of Illinois doctoral student
- Core Technology
  - Caterva's main product is the *Mirror.me,* a real-time social media platform that looks at activity on online social networks
- Market
  - People spend a quarter of their online time on social networks and blogs, and companies with an online presence are interested in targeting their audience
  - *Mirror.me* was the first online product to craft individualized social signatures for its users based on the interests they express on social media

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Caterva, Inc.

99

- Growth
  - 2010: 5 full-time employees and received funding from IllinoisVENTURES in the amount of $600,000
  - 2011: Caterva received $1.2 million in seed funding
  - 2012: Caterva secured a new funding round of $490,000 from an undisclosed venture investor
- Exit (2013)
  - Infochimps acquired the assets of Caterva, Inc. from IllinoisVENTURES, RPM Ventures, Serra Capital
- Sources
  - The News-Gazette, and Clear Sight Advisors

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TetraVitae Bioscience, Inc.

100

- Inception
  - 2006: TetraVitae Bioscience, Inc., formerly known as Advanced Biofuels, Inc., was co-founded by Hans-Peter Blaschek, director of the UI's Center for Advanced BioEnergy Research
- Core Technology
  - TetraVitae is a leading developer of bio-butanol with a patented bio-catalysis technology
- Market
  - The growth of renewable chemicals has been spurred on by a volatile marketplace for oil
  - TetraVitae proprietary technology and expertise in the fields of industrial fermentations, process engineering, microbiology, and cellulosic feedstocks aim to lower the costs of production

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TetraVitae Bioscience, Inc.

101

- Growth
  - 2008: funding from Harris & Harris Group, IllinoisVENTURES and RPM Ventures totaling $6,300,100
  - 2010: funding from IllinoisVENTURES and RPM Ventures totalling $2,869,000
- Exit (2011)
  - Eastman Chemical company acquired TetraVitae
  - Tetravitae operates as a subsidiary of Eastman
  - Eastman serves customers in approximately 100 countries and had 2013 revenues of approximately $9.4 billion. Eastman employs approximately 14,000 people around the world.
  - Terms of the transaction were not disclosed
- Sources
  - Eastman Chemical's website, Bloomberg Businessweek, and The News-Gazette

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ByteMobile, Inc.

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- Inception
  - 2000: founded by Constantine Polychronopoulos, a University of Illinois Professor
  - 2002: by this year, it had already attracted nearly $30 million in venture capital
- Core Technology
  - ByteMobile focuses on optimizing high-bandwidth data services on wireless networks designed for low-bandwidth voice services
- Market
  - Provides video and multimedia optimization software
  - ByteMobile uses its own Smart Capacity technology both its Unison and T3000 series platafforms
  - By 2006, Bytemobile's products "touch three-quarters of a billion mobile subscribers around the world"

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ByteMobile, Inc.

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- Growth
  - 2001: customers included cellular operators Vodafone, Sprint and Nextel
  - 2002: 100 employees
  - 2005: Bytemobile acquired ProQuent Systems and absorbed its 30 employees
  - 2011: Joint Venture with China Comservice
- Exit (2012)
  - ByteMobile was acquired by Citrix Systems for $435,000,000
  - Citrix plans to build on ByteMobile as the center of its go-to-market strategy for 3G and 4G LTE wireless operators
- Sources
  - Privo, Citrix's website, and The News-Gazette

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Volition, Inc.

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- Inception
  - 1993: Mike Kulas co-founded Parallax Software with Matt Toschlog
  - 1996: Parallax Software split into Volition Inc. and Outrage Entertainment
- Core Technology
  - Volition develops games, including the "Saints Row" line of videogames
- Market
  - In 2012, total U.S. consumer spending on video game content amounted to 14.8 billion dollars
  - In November 2014, physical video game software sales in the United States amounted to 1.06 billion U.S. dollars
  - Volition makes games for the "core gamer" market, which are intended to appeal to the avid player, include action, fighting, racing, shooting and strategy games. Its other areas are "online games" and "kids, family and casual games"

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Volition, Inc.

105

- Growth
  - 1998: Volition had grown to 30 employees
  - 2000: approximately 40 employees
  - 2004: approximately 100 employees
  - 2011: grows to 220 full-time employees
- Exit (2000)
  - 2000: THQ Inc. acquires Volition for 1 million shares of THQ of common stock
  - 2013: Koch Media, headquartered in Germany, wins a bid by offering $22.3 million for Volition
- Sources
  - The News-Gazette and Statista

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Argus Systems Group, Inc.

106

- Inception
  - 1993: founded and headquartered in Savoy, Illinois, and continues operation in Savoy until this date
- Core Technology
  - Argus operates the system enhancing software PitBull
- Market
  - There is an increased reliance on internet-based business architectures that support core business processed and require advanced security mechanisms
  - International vendor of security software and engineering services, providing security solutions for servers
  - Argus software is used by financial services companies, utilities and government agencies around the world

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Argus Systems Group, Inc.

107

- Growth
  - 2003: Argus filed for liquidation and its assets are acquired by Open Prairie Ventures for $1.5 million
  - 2006: announced PitBull Foundation and PitBull Foundation Suite for Linux
  - 2011: approximately 15 employees working in Savoy, IL
- Exit (2011)
  - General Dynamics acquires Argus
  - Value of the transaction was not disclosed
- Sources
  - The News-Gazette and the Washington Post

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Adrenaline Mobility, Inc.

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- Inception
  - 2012: Adrenaline, formerly named Valkyrie Computer Systems, Inc. was founded by a team from the University of Illinois engineering school
- Core Technology
  - Adrenaline uses military-grade end-to-end encryption to protect user's data before storing it on a mobile device and before sending it to cloud servers
- Market
  - Adrenaline operates a platform for creating cross-platform, pure HTML5, and enterprise-class applications
  - It also provides cloud-based application services that turn distributed services into Web services, and enterprise services to host enterprise applications on mobile devices without vendor lock-in

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Adrenaline Mobility, Inc.

109

- Growth
  - 2012: seed investment from IllinoisVENTURES
  - 2013: investment Serra Ventures, and a National Science Foundation Small Business Innovation Research grant
- Exit (2014)
  - Adrenaline joined Twitter
- Sources
  - University of Illinois website and Business Week

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RiverGlass

110

- Inception
  - 2003: Formed to commercialize eight years of grant-funded research at the National Center for Supercomputing Applications (NCSA) at the University of Illinois
- Market
  - RiverGlass is the leading provider of advanced, intelligent web information collection and analysis solutions
  - RiverGlass provides application solutions to government agencies and commands in defense; intelligence; law enforcement; and major corporations
- Exit
  - 2011: RiverGlass was acquired by Allen Systems Group (ASG)

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Traco Labs

111

- Inception
  - 1985: local company
- Market
  - Bulk nutritional goods, including nutritional lipids
- Exit
  - 2000: sale to publicly traded German company – SKW/Degussa, renamed Degussa Bioactives
- Source
  - Company press release

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Chromatin, Inc.

112

- Inception
  - 2000: founded by University of Chicago professor Daphne Preuss with post-docs Gregory Copenhaver and Kevin Keith
  - Headquartered in Chicago, IL
- Core technology
  - Mini-chromosomes for simultaneous addition of multiple genetic traits to plants
- Market
  - Agricultural, energy, chemical, nutritional, and pharmaceutical sectors
  - Plant growers, seed producers, and bioprocessors

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Chromatin, Inc.

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- Growth in part through an acquisition
  - 2007: License agreement with Monsanto Company
  - 2007 – 2009: License agreements with Syngenta Biotechnology, Inc.
  - 2009: Technology alliance and license agreement with Bayer CropScience
  - 2009: Research and license agreement with Dow AgroSciences, LLC.
  - 2010: Research agreement with ACGT Sdn Bhd
  - 2010: acquired Sorghum Partners, Inc. and Milo Genetics, LP

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Biodisplay Technologies

114

- Inception
  - Founded by U of I biochemistry professor David Kranz and former U of I faculty member Dane Wittrup
- Market
  - A "virtual company" with no physical location
  - Yeast display technology that shortens time to get experimental drugs to clinical trials
- Exit
  - 2001: sold for $7 million to Abbott Labs
- Source
  - The News-Gazzete

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Kuck & Associates (KAI)

115

- Inception
  - 1979: headquartered in Champaign, Illinois
- Core Technology
  - Intel and KAI were leaders in the development of OpenMP™, the industry standard for multithreaded software development
- Market
  - KAI is a leading provider of performance-oriented compilers and programming tools used in the development of multithreaded applications
- Exit
  - 2001: Sale to Intel
  - Resulted in Intel having presence in our community
  - Strategic acquisition
- Sources
  - Intel News Release

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Demaco

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- Sold to SAIC some time back
- Resulted in SAIC having a presence in the Research Park
- Dennis Andersh continued as an executive with SAIC after the transaction
- SAIC an ESOP for period of time, then went public
- Strategic acquisition

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Gill Athletics, Inc.

117

- Exit:
  - Purchased assets of Porter Athletic Equipment Company
  - Both companies early innovators in sports equipment
  - Porter's activities now moved to Champaign after transition period
- Inception
  - Gill is a local company; Porter had local ties but based in Broadview, IL
  - Porter, founded in 1868, was one of first manufacturers of basketball goals and gymnasium equipment

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SourceGear, Inc.

118

- Inception
  - 1997 founded by Eric Sink and Corey Steffen and based in Champaign, IL
- Core technology
  - Programming tools for software development
- Growth
  - 2002: 36 employees
- Exit
  - 2009: Microsoft acquired the Teamprise division of SourceGear
  - 2010: The main product was rebranded by Microsoft: Visual Studio Team Explorer Everywhere
  - Rest of SourceGear still locally owned

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A-1 Alarm Service, Inc.

119

- Inception
  - 1968: founded by Cecil Byrnes and based in Champaign, IL
- Market
  - Residential and commercial alarm/monitoring service
  - Customer base: 65% residential, 35% commercial
- Growth
  - 2002: Diane Ruedi, the founder's daughter, took over as president of company after the founder's death
  - 2010: 20 employees
- Exit
  - 2009: Friendly acquisition by local competitor F. E. Moran Alarm
    - F. E. Moran Alarm had 130 employees, and 50% commercial customers
    - All A-1 employees retained, to move to F. E. Moran Alarm's HQ
  - Customers of A-1 Alarm perceived no change
    - Contact numbers not changed, familiar operators
    - No change in fees for 15 months
- A strategic acquisition

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Intersymbol Communications, Inc.

120

- Inception
  - 2001: founded by University of Illinois professors Naresh Shanbhag and Andrew Singer and based in Champaign, IL
- Core Technology
  - High speed optical devices for digital communications
- Exit
  - 2006: acquired by Kodeos Communications
    - A strategic acquisition
    - Operated as subsidiary of Kodeos
  - 2007: Kodeos Communications acquired by Finisar Corporation
    - Intersymbol continues as subsidiary of Finisar

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M&A Activity in Specific Industry

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The following slides summarize M&A activity in the coatings industry

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Rust-Oleum Corporation

122

- A leading manufacturer and marketer of specialty coatings in the United Kingdom
  - Annual sales of approximately $45 million
- M&A activity since 2006
  - 1994: Rust-Oleum acquired by RPM International, Inc.
    - Purchase price of $178 million
  - 2006: acquired Watco Group
    - Based in Godalming, UK, a manufacturer and marketer of industrial coatings and leading supplier of concrete floorings in the UK
    - Annual sales: approximately $20 million
  - 2007: acquired Tor Coatings Limited

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Rust-Oleum Corporation

123

- 2009: acquired FibreGrid Limited
  - A supplier of fiberglass anti-slip safety products based in the United Kingdom
  - Annual sales: approximately $3.5 million
  - 2010: Rust-Oleum Netherlands BV acquired Chemtec Chemicals BV
  - A manufacturer of specialty cleaning and maintenance products based in Rotterdam, Netherlands

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Akzo Nobel (AKZOY)

124

- M&A activity since 2008
  - 2008: acquired Imperial Chemical Industries (ICI)
  - Purchase price approximately €11.5 billion (EUR)
  - 2010: acquired Dow Chemical Company's powder coating activities
  - Annual global sales: approximately several hundred million dollars(USD)

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Hentzen Coatings, Inc.

125

- M&A activity since 2005
  - 2005: acquired Batavia, IL coatings manufacturing site and non-core drum and pipe coatings business from BASF

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Diamond Vogel Paint, Inc.

126

- A Lincoln, NE based industrial-coatings producer
- M&A activity since 2004
  - 2004: acquired certain assets of David-Frost Paint Co.
    - Assets associated with the industrial-coatings business and based at the company's operations based in Minneapolis, MN and Tulsa, OK
  - 2004: acquired Four Seasons Paint

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The Sherwin Williams Co. (SHW)

127

- M&A activity since 2007
  - 2007: acquired Nitco Paints
    - A Mumbai headquartered, privately owned manufacturer and distributor of exterior specialty paints and coatings used in the construction of office buildings, high rise, apartments, shopping malls, hospitals, and schools.
    - Annual sales: approximately $18 million
  - 2007: acquired Napko, an industrial-maintenance coatings company in Monterrey, Mexico
  - 2007: acquired S.A. de C.V.
  - 2007: acquired Pinturas Industriales S.A., an industrial paint company headquartered in Montevideo, Uruguay

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The Sherwin Williams Co. (SHW)

128

- 2007: acquired M.A. Bruder, a Philadelphia based company with 132 paint stores
- 2007: acquired Columbia Paint & Coatings based in Spokane.
- 2007: acquired VHT Paint Lines, an aerosol coatings company in Scottsdale, AZ
- 2008: acquired Becker Powder Coatings, Inc., a producer of powder coatings applied to appliances, metal furniture, fixtures, and electronic products headquartered in Columbus, OH
  - Annual sales: approximately $14 million

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The Sherwin Williams Co. (SHW)

129

- 2008: acquired the Liquid Coatings Subsidiaries of Inchem Holdings which produces coatings applied to wood and plastic products in Asia
  - Annual sales: approximately $30 million
- 2008: acquired Euronavy–Tintas Maritimas e Industrials S.A. of Portugal
  - A leading innovator of marine and protective coatings applied to ships, off shore platforms storage tanks, steel, concrete, and flooring
  - Annual sales: less than $25 million

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The Sherwin Williams Co. (SHW)

130

- 2010: acquired the Industrial Wood Coatings business (Sayerlack) of Arch Chemicals, Inc.
  - A technology leader in polyurethane, water, and UV coatings
  - Annual sales: $147 million - 2009
- 2010: acquired Becker Acroma Industrial Wood Coatings
  - A technology leader in water, UV, and other wood coatings
  - Annual sales: approximately $300 million

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Tennant Company (TNC)

131

- M&A activity since 2006
  - 2006: acquired Hofmans Machinefabriek B.V.
    - Annual sales: $7 million – 2005
  - 2007: acquired Floorep Ltd.
    - Annual sales: $5.6 million – 2006
  - 2008: acquired Applied Sweepers—makers of Green Machines® brand cleaning equipment
    - Deal valued at $68 million
    - Annual sales: $40 million – 2007

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Tennant Company (TNC)

132

- Mar. 2008: acquired Sociedade Alfa Ltda.—maker of Alfa brand commercial cleaning machines.
  - Annual Sales: $9 million – 2007
- Aug. 2008: acquired Shanghai Shen Tan Mechanical and Electrical Equipment Co. Ltd.
  - Annual sales: $1.6 million – 2007

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The Valspar Corporation (VAL)

133

- M&A activity since 2005
  - 2005: acquired Samuel Cabot Incorporated
    - Annual sales: $60 million
  - 2006: acquired 80% interest in Huarun Paints Holdings Company Ltd.
    - Annual sales: $200 million – 2006
    - 2008: owns 85.8% of outstanding shares
  - 2006: acquired H.B. Fuller Company's powder coatings busines.
    - Net sales: $75 million – 2005

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The Valspar Corporation (VAL)

134

- 2007: acquired majority voting shares in Tekno S.A.
  - Annual revenue: $10.7 million – 2006
  - 2008: acquired remaining shares of Teknos
- 2007: acquired Teknos Nova Coil TNC Oy
  - Annual revenue: €31 million (Euros) – 2006
- 2007: acquired control of Aries Coil Coatings S.A. de C.V. (Aries)
  - Annual sales: $40 million – 2007
  - 2008: acquired remaining shares

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Honda Motor Co., Inc.

135

- Inception
  - 1948: Founded by Soichiro Honda
  - 1959: Founded in the US, American Honda Motor Company, Inc.
- Market
  - World's largest manufacturer of motorcycles and internal combustion engines, and 6th largest automobile manufacturer in the world
  - Also manufactures garden equipment, marine engines, personal watercraft, power generators, robotics research

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Honda Motor Co., Inc.

136

- M&A activity since 2005
  - 2005: Suzuka Circuitland Co., Ltd., became wholly owned subsidiary of Honda Motor Co., Ltd. Through summary exchange
  - 2006: Honda Express Co., Ltd. and Komyo Co., Ltd. became wholly owned subsidiaries of the Company (Honda Motor), through acquisition of all shares of stock
  - 2007: Yachiyo Industry Co., Ltd. Became a consolidated subsidiary of Honda Motor Co., Inc

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Caterpillar Inc.

137

- Inception
  - 1925: Founded in California, as Caterpillar Tractor Co., currently based in Peoria, IL.
- Market
  - World's largest manufacturer of construction and mining equipment and diesel and natural gas engines.
  - Worldwide network including 220 dealers in nearly 200 countries
- Growth
  - As of 2009: Caterpillar employs nearly 100,000 employees

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Caterpillar Inc.

138

- M&A activity since 2006
  - 2006: Caterpillar Inc. acquires privately held Progress Rail in a $1 billion cash and stock deal
  - 2008: Mitsubishi Heavy Industries Ltd.and Shin Caterpillar Mitsubishi Ltd. Signed definitive agreements that include a share redemption plan which will result in Caterpillar owning 67% of SCM
    - First phase of the share redemption is estimated at 50 billion JPY
  - 2010: Progress Rail Services signed definitive agreement to purchase Electro Motive Diesel for 820 USD from Berkshire Partners LLC and Greenbriar Equity Group LLC
    - Progress Rail Services is a wholly-owned subsidiary of Caterpillar Inc.

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PPG Industries, Inc.

139

- Inception
  - 1883: Founded as the Pittsburgh Plate Glass Company.
  - Changed name to PPG Industries to better reflect its diversity
- Market
  - Global supplier of paints, coatings, optical products, specialty materials, chemicals, glass and fiber glass
- Growth
  - Net income of 336 million USD in 2009
  - Employed nearly 40,000 employees in 2009

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PPG Industries, Inc.

140

- M&A activity since 2006
  - 2006: Ameron International announced it will sell its Performance Coatings and Finishes business to PPG Industries for 115 million
  - 2008: PPG acquired SigmaKalon Group, a Dutch based coatings company, for 3.2 billion

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United Technologies Corporation

141

- Inception
  - 1929: founded as United Aircraft and Transport Corporation by a multi-business merger
- Market
  - Researches, develops, and manufactures high-technology products in numerous areas, including aircraft engines, helicopters, heating and cooling, fuel cells, elevators and escalators, fire and security, and industrial products
- Growth
  - As of 2010: employs over 200,000 employees

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United Technologies Corporation

142

- M&A activity since 1999
  - 1999: United Technologies Corp. agreed to acquire Sundstrand Corp., maker of internal systems for airplanes, for $4.3 billion
  - 2005: Crowell & Moring LLP client, United Technologies Corporation's Pratt & Whitney Division, has completed the acquisition of Boeing's rocket engine unit, Rocketdyne Propulsion & Power for about $700 million
  - 2010: United Technologies completes $1.82 billion acquisition of General Electric Co.'s fire detection and electronic security business

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ArcelorMittal

143

- Inception
  - 2006: formed by merger of Arcelor and Mittal Steel
- Market
  - The largest steel company in the world
  - Leader in all major global steel markets, including automotive, construction, household appliances and packaging as well as supplies of raw materials and distribution networks
- Growth
  - 2009: employed over 280,000 employees with revenue of 2009 being $65 billion

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ArcelorMittal

144

- M&A activity since 2006
  - 2006: merger of Arcelor and Mittal Steel
  - 2006: ArcelorMittal acquires Sicartsa, producer of long steel, for $1,439 million
  - 2008: ArcelorMittal announced acquisition of Bayou Steel, producer of structural steel products in the U.S for $475 million
  - 2008: ArcelorMittal announced agreement to acquire the Kippers' Monessen Coke Plant from Koppers Inc. for $160 million

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Carboline Company

145

- M&A activity since 2005
  - 1985: Carboline Company acquired by RPM International, Inc.
  - 2005: acquired AD Fire Protection Systems,
    - An international provider of fireproofing products for the protection of structural steel
    - Annual sales: approximately $18 million (USD)
  - 2006: acquired certain assets of Nu-Chem
    - An international provider of fireproofing products for the protection of structural steel
  - 2007: acquired the marine and industrial assets of Finnaren & Haley
    - A privately-held paint manufacturer and retailer headquartered in Conshohocken, PA

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Big Dollar Tech Exits

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Top Tech Exits in 2014: MICROS Systems

147

- Inception
  - 1977: founded in by Louis Brown, Jr, the son and grandson of Maryland dairy farmer
- Core Technology
  - MICROS Systems provides various cloud-based, mobile and on-premise application tools for customers in the food and beverage, hospitality and retail industries
- Growth
  - 1978: $1.4 million in revenue
  - 1981: first initial public offering
  - Micros has more than 6,600 employees and its products are in use at more than 330,000 sites around the world
- Exit
  - 2014: sale to Oracle for $5.2 billion (largest deal of the year)
- Source
  - Oracle Press Release and Funding Universe

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Top Tech Exits in 2014: OpenTable

148

- Inception
  - 1998: after founder, Chuck Templeton, observed the difficulty his wife faced while trying to book a dinner reservation by phone
- Core Technology
  - OpenTable allows users to search for restaurants and reservations based on parameters including times, dates, cuisine and price range and it provides restaurant owners with a reservation management
- Market
  - OpenTable helps restaurants to fill tables by offering online reservation services to diners
  - OpenTable's business caters to about 24,000 restaurants out of its total customer base of 31,500

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Top Tech Exits in 2014: OpenTable

149

- Growth
  - 1999: the website began operations serving a limited selection of restaurants in San Francisco.
  - Today: it covers more than 30,000 restaurants in most states as well as in several cities around the world.
- Exit
  - Open table was acquired by Priceline
  - Priceline has the resources and the expertise to grow OpenTable globally. There is a lot of scope for cross-promotion and cross-selling activities
    - Significant cost synergies from the merger of the two companies
- Sources
  - Open table website and Forbes

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Top Tech Exits in 2014: Trulia

150

- Inception
  - 2005: founded originally only serving properties in California
- Market
  - Trulia provides price trend information by using listing and public data showing how the price of a home has changed over a period of time as well as comparing that house price with other homes

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Top Tech Exits in 2014: Trulia

151

- Growth
  - 2006: Trulia services offered nationally
  - 2012: Trulia reported 22 million monthly visitors
  - 2013: approximately 437,000 active real estate professionals
- Exit
  - Zillow announced a deal to buy Trulia for $3.5 billion
  - All stock deal
  - Together, the two will dominate the traffic for online home listings and they expect to realize about $100 million in cost savings by 2016
- Sources
  - Trulia's website and The Mercury News

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Top Tech Exits in 2014: Shopkick

152

- Inception
  - 2009: created
- Core Technology
  - Points program called "kicks", which are usually awarded when customer-users walk into the participating stores. Shopkick receives a fee for each kick a customer earns
- Market
  - Shopkick created a shopping app that offers customers rewards for walking into stores

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Top Tech Exits in 2014: Shopkick

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- Growth
  - 2010: Shopkick app was released, initially with 5 retail partners (Macy's, Best Buy, Sports Authority and American Eagle Outfitters) and reached its first million users within six months
  - 2011: added Target, Crate and Barrel, Old Navy, and Gap
  - 2012: Shopkick drove $200M in revenue for its partners
  - 2015: Shopkick has 200 brand partners
- Exit
  - 2014: acquired for over $200M in cash by SK planet, part of SK Group and SK Telecom
- Sources
  - The New York Times & The Wall Street Journal

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Top Tech Exits in 2014: Caviar

154

- Inception
  - 2012: founded in San Francisco by 5 people
- Core Technology
  - Mobile payments startup that partners with highly-rated restaurants that don't normally offer deliver – it offers a "premium delivery" service
- Market
  - Food delivery service
  - Caviar allows buyers to get delivery from top-rated, popular local restaurants that do not offer delivery

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Top Tech Exits in 2014: Caviar

155

- Growth
  - 2012: service in San Francisco
  - 2014: Caviar's couriers have delivered more than 1 million meals
  - Today: offered in many cities such as Boston, Chicago, New York, Seattle, Los Angeles, and Washington D.C.
- Exit
  - Square purchases Caviar for a reported $90 million
- Source
  - Business Insider

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Exit Strategies for the Technology Company

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