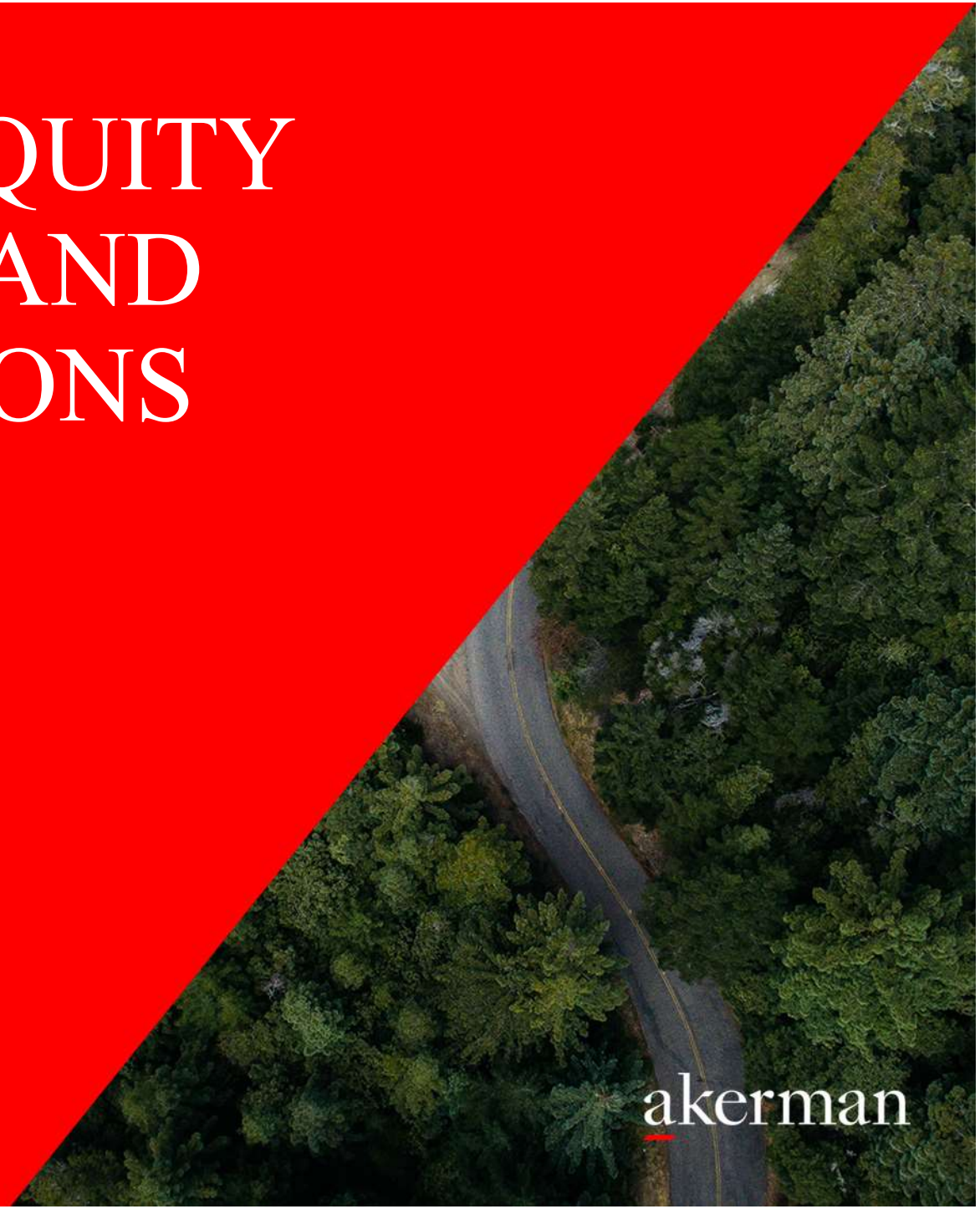
PRIVATE EQUITY MERGERS AND ACQUISITIONS

Session 1:

Acquisition Process

March 24, 2021



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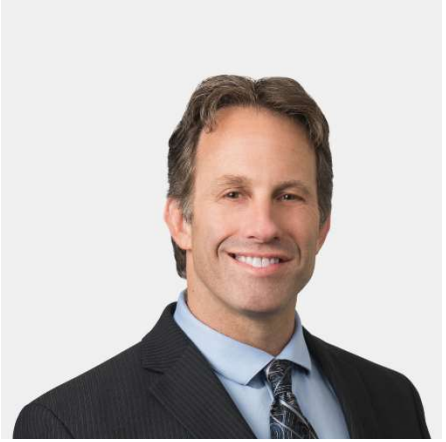
About Akerman

Akerman is a client-driven enterprise, recognized by *Financial Times* as among the most forward-thinking law firms in the industry. We are known for our results in M&A and Private Equity, complex disputes, and for helping clients achieve their most important business objectives in the financial services, real estate, and other dynamic sectors.

We collaborate with the world's most successful enterprises and entrepreneurs to navigate change, seize opportunities, and overcome barriers to innovation and growth. Within our communities, we work to create better opportunities for the future.

Your Presenters:

David Birke serves as co-chair of Akerman's M&A and Private Equity Practice Group. David's practice focuses on representing private equity funds, family offices and their portfolio companies in complex acquisitions, divestitures, recapitalizations, restructurings, growth capital investments, and debt and equity financings. David brings a unique, pragmatic and solutions-oriented perspective to his client's transactions; an approach shaped through numerous complex transactions coupled with his experience counseling clients as a certified public accountant at Arthur Andersen.



With more than two decades of experience, Paul Quinn represents private equity funds and their portfolio companies in leveraged acquisitions and dispositions, corporate governance, and restructurings. Paul also represents management teams in employment and compensation arrangements, distressed-focused private equity funds in acquisitions in bankruptcy court and out-of-court processes; and private equity and venture capital funds in minority growth equity investments. Ranked by *Chambers USA*, he is commended by peers who note that "he is very commercial in his negotiation style."

SESSION 1: Acquisition Process

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1. Acquisition Process - Overview

- Auctions vs. Proprietary
  - **Auctions**
    - Confidential Information Memoranda ("CIM")
      - Marketing document vs. legal
      - Early identification of risks and bid strategy
    - Indications of Interest ("IOI")
      - Description of the fund and industry experience
      - Range of values – no specifics about amount or composition of purchase price
      - Non-binding
    - Management Meetings
      - Mutual interview for buyer and sellers
      - Who attends sends message to seller (e.g. senior vs. junior people; lenders)

1. Acquisition Processes – Overview (cont'd)

— **Auctions (cont'd)**

- Final Bids – Letter of Intent
  - To due diligence or not to due diligence
    - Financial and industry vs. legal due diligence
  - Preemption of process
  - Distinguish bid
  - Rep & warranty insurance

— **Proprietary**

- Usually no CIM unless failed process
- Move to letter of intent and exclusivity
- Staging due diligence
  - Industry
  - Quality of earnings ("Q of E")
  - Legal

2. Confidentiality Agreements ("NDA") – Pro-Recipient's Perspective

— **Parties**

- Agreement should not bind affiliates or portfolio companies that don't receive confidential information
- Include target as a party, rather than just the I-Banker

— **Definition of Confidential Information**

- Excludes information that:
  - Is already in recipient's or their representatives' possession
  - Is independently developed
  - Is generally available to the public or industry participants
  - Is received from third party not known to be subject to confidentiality obligations
  - Is disclosed by target to third party without a duty of confidentiality
- Only includes information received after the date of the agreement

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2. Confidentiality Agreements – Pro-Recipient's Perspective (cont'd)

— **Term**

- 1-2 years maximum – all obligations should terminate at this time if not earlier terminated
- The term for confidentiality obligations may differ from the term for non-solicitation provisions

— **Disclosure**

- Disclosure should be allowed to any representatives that will be involved in the transaction, including current and potential financing sources and equity partners
- Do not agree to keep a list of representatives or make them execute agreements
- Recipient should have right to disclose as required/requested by law or legal process
  - If recipient is required to give advance notice and attempt to limit scope of disclosure, any required actions should be at the disclosing party's expense
  - Recipient should not have to give advance notice as part of routine supervisory examinations
  - If "representatives" will include regulated financial institutions, resist such notice or protective action obligations for such representatives, as they will have trouble complying
  - Recipient should not have to provide a legal opinion that disclosure is legally required

2. Confidentiality Agreements – Pro-Recipient's Perspective (cont'd)

— **Non-solicitation of customers and employees**

- Carve out from non-solicit:
  - General, untargeted solicitations and advertisements
  - Employees that were terminated
  - Seek to limit to management level employees or employees that were first introduced during process
- Carve out from non-hire:
  - Hiring resulting from permitted solicitations
  - Persons who independently approach recipient
  - Anyone not in the C-Suite
  - Non-hire provisions are not enforceable in all states
  - Time period between 1 year and 2 years is common
  - Should not include PE Fund affiliates or portfolio companies unless they were provided with confidential information

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2. Confidentiality Agreements – Pro-Recipient's Perspective (cont'd)

— **Standstill/Non-Circumvention Provisions**

- Standstill common in public company deals, but should not be required for private companies
- Non-Circumvent provisions serve to limit recipient's ability to accomplish transaction in a manner that circumvents disclosing party or to collude with other buyers (club deals). Avoid if possible.

— **Contact Limitations**

- Should only prohibit discussions regarding the potential transaction. Carve out ordinary course communications between the parties.

— **Return of Information**

- Recipient should have option to destroy rather than return information (only upon request)
- Recipient should have right to retain copies in accordance with standard recordkeeping procedures or legal compliance but disclosing party will likely ask that anything retained must be kept confidential
- Recipient should not be required to modify electronic data systems to remove information

2. Confidentiality Agreements – Pro-Recipient's Perspective (cont'd)

— **Breach of NDA**

- Recipient should try not to be subject to any indemnity obligations
- If recipient is responsible for a breach of the NDA by its representatives, limit it to a breach of confidentiality obligations only (e.g., not non-solicitation, standstill, etc.)
- Try to eliminate recipient's liability for any representative that it gets to sign a joinder to the NDA

— **Other**

- Be careful with restricting portfolio companies. Affiliates not receiving information should not be subject to the agreement. Ensure that portfolio companies are not deemed to receive information merely because PE Fund employees who receive information also sit on the board of a portfolio company.

3. Letters of Intent – Private Company – Objectives

— **LOIs Generally**

- Sets forth initial agreement regarding material terms of transaction
- Typically non-binding, except for certain provisions, most importantly exclusivity, non-binding provision and disclaimers
- Buyer typically drafts LOI

— **Goals are context-specific**

- Best value add by Akerman if we are involved – a quick review can potentially save material dollars and significant time
- General versus detailed coverage of deal terms
  - As leverage generally shifts to buyer once LOI with exclusivity is signed, sellers often prefer extensive detail on key issues (e.g., indemnity terms, escrows, working capital criteria and earn-outs)
  - With unsophisticated sellers, buyers may wish sufficient detail to clearly identify expectations for key terms (e.g., non-compete)

3. Letters of Intent – Private Company – Pros and Cons

— **Advantages of Letters of Intent**

- Avoids “costly” surprises
- Identify deal breakers
- Focus negotiations
- Increased efficiency in drafting definitive documents
- Illustrates commitment to the deal
- Third-party and regulatory approvals (e.g., HSR filing, CFIUS filing and lenders)
- Binding provisions – locks up deal for some period of time
- Strengthen negotiating leverage

— **Disadvantages of Letter of Intent**

- Impair deal momentum, especially if for a simple small deal or if the LOI process becomes lengthy
- Unintentionally create, despite non-binding language, binding obligations including obligation to negotiate in good faith or close
- Weaken negotiating leverage for Seller
- Disclosure obligations exist if one party is public – often only an exclusivity agreement in public context

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3. Letters of Intent – Private Company – Binding Provisions

— **Unintentionally Binding Provisions**

- Due to certain Delaware case law, be clear that it is the parties' intent that no agreement (including an agreement to negotiate in good faith) exists among the parties. No obligation whatsoever based on such things as parol evidence, detrimental reliance, extended negotiations, "handshakes," oral understandings, or courses of conduct, except as provided in the expressly binding provisions. This provision should survive a termination of the LOI.

— **Intentionally Binding Provisions**

- Exclusivity 60-90 days often desired by buyer (sometimes with automatic extension)
- Confidentiality
- Expenses and Reimbursement (upon breach of exclusivity)
- Jury trial waiver, governing law and venue
- Operation of the target in the ordinary course; information and access for diligence
- Disclaimer

3. Letters of Intent – Private Company – Non Binding Provisions

- **Structure**
  - Asset, stock, or merger
  - Rollover equity
    - Helps to align buyer and seller interests
    - Taxable vs. non-taxable
- **Sources and availability of funds**
  - Debt financing
  - Equity financing

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3. Letters of Intent – Private Company – Non Binding Components (cont'd)

— **Purchase Price – methodology, amount, composition and timing**

- Most common enterprise valuation is a multiple of EBITDA, plus cash, minus debt, minus company transaction expenses and plus or minus closing working capital compared to a target NWC number
- Valuation methodology (e.g., multiple of EBITDA, historical financials, and projections)
  - Useful if target misses metrics prior to signing purchase agreement
  - Useful to demonstrate damages in a post-closing dispute
- Cash at closing (GAAP Cash)
- Earnouts
  - Bridge the valuation gap (e.g. future synergies, ramp up of company investments)
  - Different metrics – revenue vs. EBITDA
  - Difficulties – corporate carveouts, avoid earn-out covenants, and definitions
- Rollover equity – Pari-passu or subordinate? Tax efficient or not?
- Seller Notes
  - Subordination
  - Contingent payments
  - Interest – cash pay or PIK

3. Letters of Intent – Private Company – Non Binding Components (cont'd)

— **Purchase Price Adjustments**

- Typically net of cash and debt
  - Indebtedness – consider capital leases (careful re: ASC 842), performance bonds, letters of credit, deferred revenue, unpaid bonuses, excess PTO, and other transaction-specific items
  - Consider minimum and/or maximum cash requirements in addition to working capital
- Working capital
  - Detail desired or to be avoided in letter of intent depends on circumstance
  - One way (buyer obtains income between signing and closing) – less common
  - Two way (seller keeps income between signing and closing) – most common
  - Closed Loop/No leakage (buyer keeps income or loss if no leakage) – more common lately but still not seen often
  - Consider other items that impact working capital (e.g., deferred cap ex, seasonality)
  - Company Transaction Expenses – seller pays its own expenses (e.g., legal, accounting, transaction bonuses-single or double trigger, escrow agent, split RWI cost)

3. Letters of Intent – Private Company – Non Binding Components (cont'd)

— **Expectations for Management**

- Compensation and equity terms as a sales tool
- Employment Agreements
- Rollover amounts
- Equity plans – whether to include – tax friendly or not

— **Conditions to Closing**

- Thoughtfully limited, but candid
- Identify consents and approvals required
- No MAE

3. Letters of Intent – Private Company – Seller's Perspective

— **Seller's "asks" to minimize surprises**

- Detailed pricing terms
- Seek to negotiate all material terms of transaction in the letter of intent if no markup of purchase agreement from Buyer
- Indemnification
  - Rep & warranty Insurance – currently very common
  - Survival of indemnity
  - Indemnity basket: Deductible vs. Hurdle ("Tipping Basket")
  - Eligible claims threshold (mini basket)
  - Indemnification caps
  - Indemnification carve-outs for caps, basket and survival
  - Escrows – indemnification vs. purchase price adjustment
  - No materiality scrapes

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3. Letters of Intent – Private Company – Seller's Perspective (con't)

- Anti-sandbagging
- Definition of losses
- Clarity on timing and certainty issues
  - Regulatory
  - Financing
- Management rollover – detailed terms
- Non-competition matters
- Limited exclusivity – terminates early if buyer proposes a change in material terms or doesn't achieve other milestones (e.g. confirm price, completion of QofE, full markup of acquisition agreement, etc.)

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Thank You

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Contact Us

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About Akerman

About Akerman

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- Strategic growth in New York, Chicago, Dallas, Denver, Houston, Los Angeles, Washington, D.C., and throughout Florida
- Known for our results across the U.S. and Latin America in middle market M&A and complex disputes, and for helping our clients achieve their most important business objectives in the financial services, real estate, and other dynamic sectors

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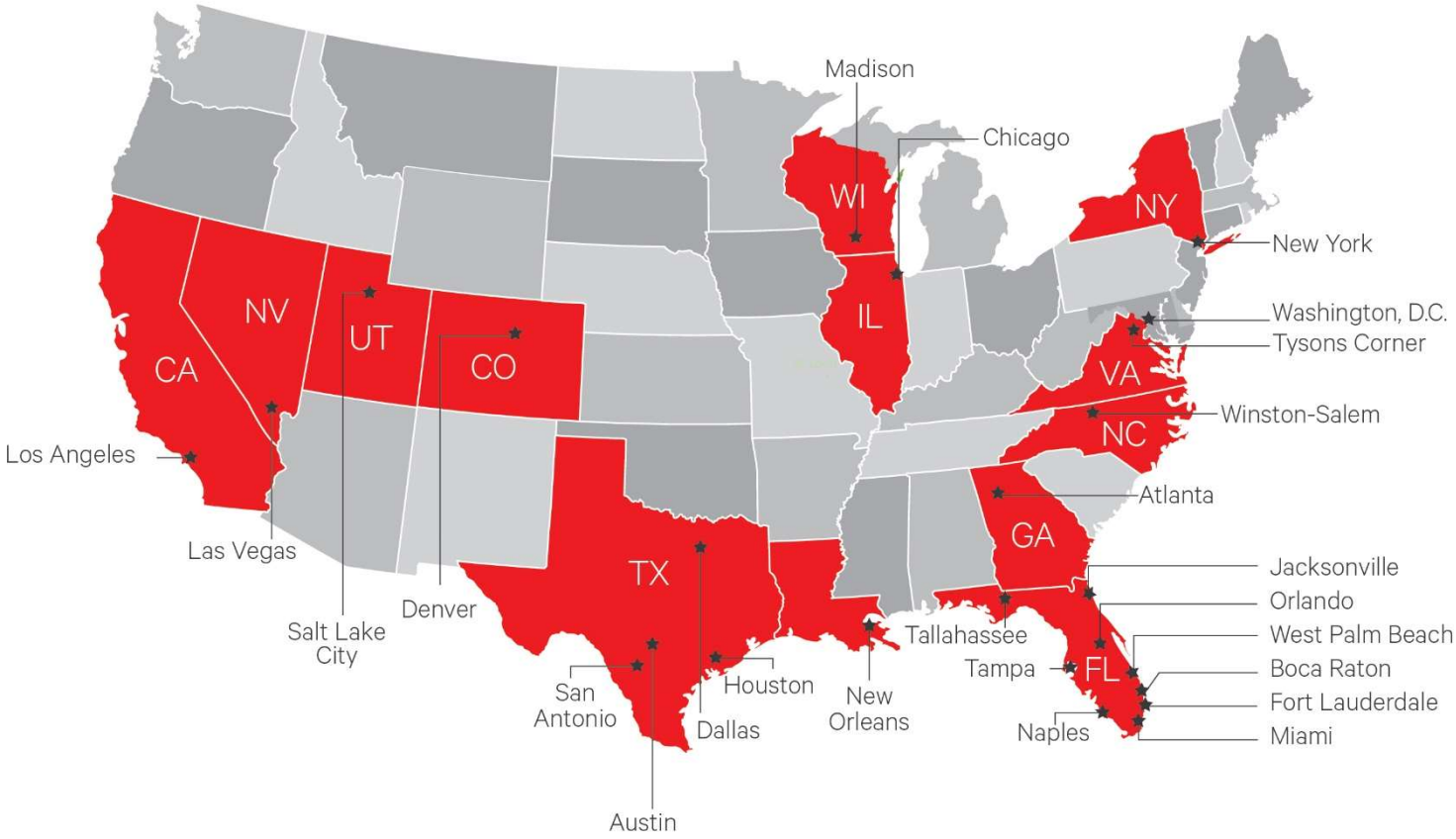
Nationwide Reach



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- Tax
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