

4. GET out Successfully

THE ART OF THE EXIT

NEOLINEAR CASHED IN; YOU CAN, TOO, BY PAYING ATTENTION TO DETAIL. . .AND PLANNING NOW

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When Pittsburgh's Neolinear, Inc., was acquired last April by Cadence Design Systems, Inc. for \$90 million (plus certain earn-out consideration), it's likely that tech entrepreneurs throughout the region sighed deeply, gazed heavenward and said, "Wish we could get that lucky."

An understandable reaction, but the score of Neolinear, a developer of rapid analog chip design technology, was anything but luck. Rather, it was the product of determined company-building, far-sighted planning and sufficient mettle to ride the roller coaster of pressure-packed negotiations.

Here's a look inside Neolinear's coup courtesy of the key architects of the deal — Tom Beckley, then Neolinear's CEO; Jim Cappucci, CFO for Neolinear at the time; and Eric Kline of Morgan, Lewis & Bockius LLP, Neolinear's counsel — and some first-hand advice on shaping your exit strategy.

Consider your exit options now.

Pondering your cash-out while still developing your business can be a dangerous distraction. Yet as soon as you take on investors and employees with stock options, your key players are already anticipating their liquidity opportunity. So, too, should you.

"You have to think about it from the very get-go," Beckley advises. "When Jim first interviewed here, we were already thinking about what the exit strategy would be, either going public or getting acquired."

Adds Cappucci: "Tom and I tracked our competitors and the market generally. We didn't know what the exit strategy would be, but we monitored what companies went public or were acquired in our space. We did downplay it for employees because we didn't want them to focus on, 'OK, we'll all make lots of dollars on this.'"

Thinking now about your exit will help you prioritize the detail work that can be vital to a successful deal. This includes fully executing and preserving employment and nondisclosure agreements and all other documents relating to protection of intellectual property. Cappucci was particularly fastidious in this area.

"Although we didn't know it at the time, it was one of the best decisions we made," he confirms. "It's a good lesson for startups that don't take record-keeping seriously. They think they'll catch up on it, but you never do."

Finally, if you're planning your exit now, you won't load up on employees who may have to be jettisoned as duplicative in a merger or acquisition. At the time of its acquisition, Neolinear had no more than three employees in administration out of a total of 75; that kept them a lean, attractive target.

Your partner may be your most likely buyer.

An acquisition offer may be an eight-figure bolt from the blue. Chances are, though, it will come from a company that already knows you well, perhaps

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through a partnership. That was the case with Cadence, which already owned 12 percent of Neolinear when it purchased the balance.

"Some startups fall into a trap," Beckley says. "They're so in love with their own technology that they fail to realize that everything has to fit into a

larger design solution or design flow. They don't understand that they have to partner and integrate before they can really become strong."

Not only was Cadence a Neolinear investor, but it also distributed Neolinear products and was well positioned to view the widespread customer satisfaction with those products. Neolinear's customers became a source of credible, independent endorsements.

Thus, the fortunes of Neolinear and Cadence were intertwined well before the ultimate acquisition.

Keep growing your business.

It's tempting to drop everything to focus on your exit, but what if you neglect your business and the merger or acquisition fails? You're left with a faltering company that may struggle to regain momentum. Notes Beckley:

"One of the things that commonly happens is, you hiccup on your numbers during the negotiation phase. Your sales can fall off because people get distracted." Neolinear, though, never let that happen, approaching its negotiations with Cadence on the heels of several strong quarters that left it with \$11 million in cash.

"We tried to keep it as business-as-usual as possible," Cappucci says. "Besides, Tom and I and one other person in the company, nobody else knew about the deal. If the whole thing failed, we didn't want everybody in the company to stop working."

Timing can be everything.

With its huge cash reserve, Neolinear was in a favorable position to attract a buyer, but quite capable of continuing on its own. Several factors made exiting now an appealing strategy. For one, Neolinear's early investors were antsy.

"There was angst at the board level regarding a return on their investment," Beckley says. "They knew they would get it, but they were looking for a liquidity event sooner rather than later. The post-dotcom years had seen few successes for venture capitalists."

At the same time, Neolinear's distribution agreement with Cadence was ending, providing the perfect entree for acquisition discussions. "Cadence was dependent on us for technology; we were dependent on them for their sales channel," Beckley says. "As our agreement with them neared its end, it forced a discussion."

Pick the right negotiating team.

Beckley, Cappucci and Kline, with the aid of several Neolinear board members, handled all negotiations. They were a compact, senior-level team, able to respond to most questions without summoning assistance. That did wonders for their credibility.

"There were no mixed messages," Kline says. "We developed an issues list and positions to support our arguments in advance of any discussions. The investors' participation, using Sean Sebastian as their representative in negotiations, was invaluable to articulating a unified position."

There also was no investment banker providing outside expertise that acquisition targets sometimes deploy. Though Neolinear interviewed several candidates, the team decided to forego that advice — and save the fee, which can reach one percent of the deal.

"Investment bankers can make connections for you," Beckley explains. "Had we not been so well-connected in our industry, that might have been useful. But we concluded we would pay them a large percentage

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for little value."

Prepare for big-time due diligence.

Cadence was in an acquisition mode, averaging about one purchase per quarter, so it brought an experienced due diligence group to the Neolinear deal. They dispatched teams to evaluate Neolinear's software code and financial and human resources documents, scanning all those records into their own computers. They scrutinized nondisclosure agreements for all cur-