TECHNOLOGY IN M&A TRANSACTIONS:
WHAT PARTIES CARE ABOUT WHEN BUYING AND SELLING TECHNOLOGY

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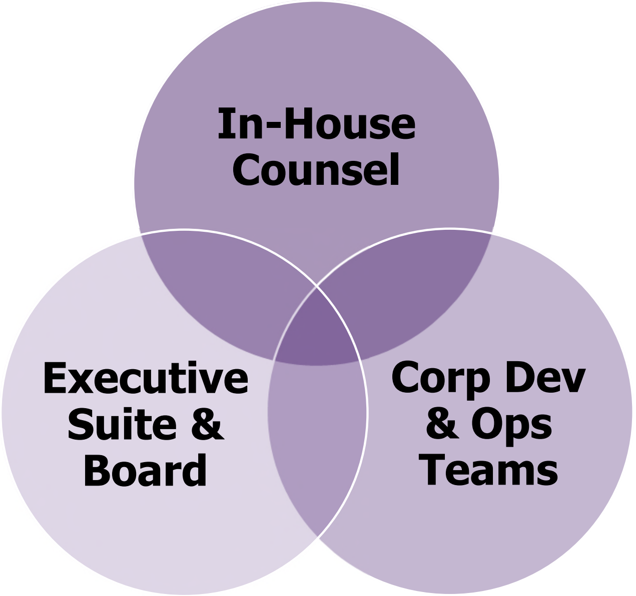
Overview

- The Opportunity
  - M&A is becoming an ever more critical means to achieve growth and strategic objectives
  - In-house counsel are expected to take a deeper role in strategic transactions
  - Your role in strategic transactions can serve as a springboard for your career
    - Access to top executives and the Board
    - Increase your connections across the organization
    - Chance to shine on a big stage
- The Challenge
  - Skills required to succeed—project management, risk assessment and allocation, integration planning, etc.—are not covered in law school
  - Deal environment is emotional, dynamic is tense, incentives may be misaligned, and information is imperfect—a perfect storm!

Understand your Constituencies



- All the other players in a deal (everyone from plant managers to field engineers, HR to real estate) are typically <u>non-lawyers</u>
- Understanding their roles is critical to managing your role successfully
- Two key constituencies: Corp Dev/Ops Team and Executive Suite/Board

C-SUITE AND THE BOARD

What does the C-Suite and Board expect of you?

Variety of Perspectives

• Persuasive Counselor?	Advocate who uses personal relationships to steer things to the right result?
• Lawyer-Statesman?	Technically proficient advisor who uses diplomacy and personal integrity to reach a consensus?
• Gatekeeper?	Protector of the realm?

What does the C-Suite and Board expect of you?

- No "one size fits all"—depends on size, resources, culture, context
- Trend is to a <u>gatekeeper</u> role
  - Conduct <u>Risk Triage</u>—including non-legal issues
  - Provide <u>Voice of Reason</u>
  - <u>Advocate</u> for what is best for the company
    - Balance business objectives with risk to the company
    - Reputational, as well as transactional, risks
- <u>Practice Tips</u>:
  - <u>Personally</u>, invest in transparency, communication, information
    - No agendas
    - No heroes
  - <u>Procedurally</u>, help create 'risk protocols' that permit the CEO/board to do its job
    - <u>Your job</u>: Identify risks and mitigation strategies and apply your experience, judgment to identify a reasoned position
    - <u>Their job</u>: Armed with that information, they can decide what is best for the company

CORPORATE DEVELOPMENT & OPERATIONS TEAMS

Who is Corporate Development

- Typically, “deal junkies”
  - Former investment bankers, consultants or lawyers with heavy deal experience
  - Their value at the company is often seen solely as a deal-closer
  - This can create large incentives to give in or “problem solve” to make a deal happen, regardless of the risks

How is Corporate Dev Different than Bus Dev?

Corporate Development

Strategy Driven: Larger, needle-moving transactions

- Mergers and Acquisitions
- Major joint Ventures
- Spin-offs
- Larger and strategic IP portfolio asset acquisitions

Business Development

Markets/product-driven: smaller, frequent transactions

- Marketing, sales tie-ins
- Smaller license deals
- Partnerships/ channel sales

Who Drives Corporate Development?

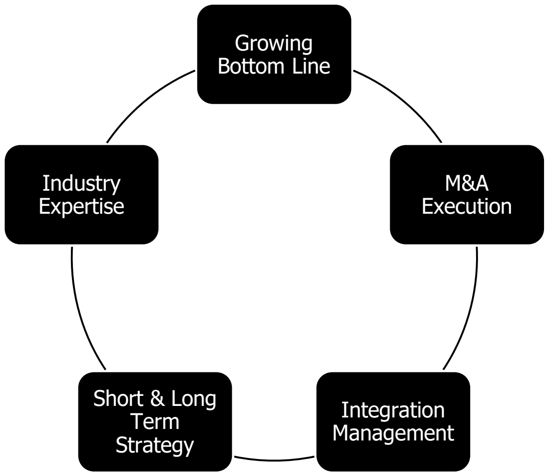
Key Constituencies and Considerations

- CEO / CFO
- Business sponsor (i.e. Product Development) or business unit leader
- Tax
- Legal

Other Constituencies: LoB's

- Sales
- Marketing
- Support
- Professional Services
- Human Resources
- Finance/Accounting
- IT
- Real Estate
- Depending on Company's structure, these lines of business can be broken down by region, product segment, etc.

What Drives Corporate Development?

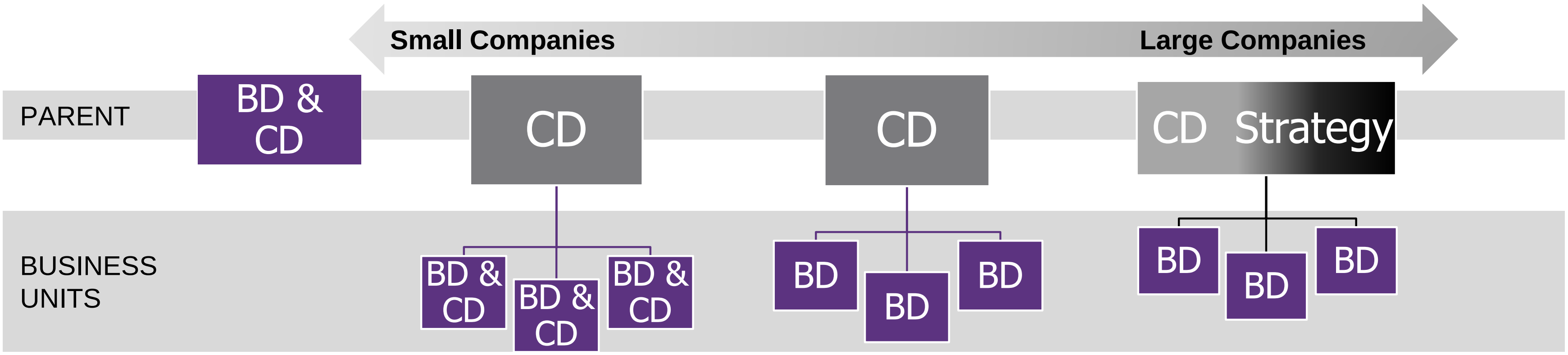


The Bottom Line: How will the company continue to grow its business?

Corporate Development's Goals Include

- Understanding the industry and competitive landscape to source transactions
  - Working with external investment bankers
  - Tracking and forecasting industry changes and trends
- Completing transactions to grow the bottom line
- Ensuring successful integrations
  - Tracking the progress of each acquisition to ensure long term success

How Does Corp Dev Find Growth?



- Depending on the size of the company, deals can come from top down (Parent → Business Unit) or bottom up (Business Unit → Parent)
- Corporate Development considers a three-prong analysis with each deal
  - Does the company **build**? (Builds go to R&D or Product teams)
  - Does the company **buy**? (Buys go to Corporate Development)
  - Does the company **partner**? (Partnerships go to Business Development)

The Role of Corporate Development on the Deal

- Corporate Development begins working on a deal at its inception
  - Building the business case for the acquisition
  - Identifying and obtaining buy-in from the key sponsors that will be responsible for running the business post-acquisition
  - Building the financial model for the acquisition
  - Building the operational and organizational models for the acquisition

- As the transaction lead, Corporate Development is also responsible for overall execution from inception through integration, including:
  - Organizing various lines of business (LoB’s)
  - Managing diligence
  - Directing negotiations
  - Integration planning and execution

Corporate Development's Traditional View of Legal

- Gatekeeper = Dream-killer – there is no upside for legal if the deal closes, only risk that something goes wrong or something was missed
  - Only Corporate Development takes the victory lap
  - Legal takes the blame when something goes wrong
  - In-house counsel can have big incentive to say "no" when there is any risk or doubt

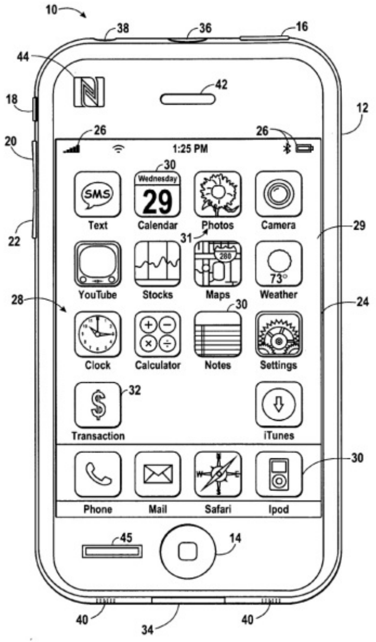
What is Wrong with “No”?

- Corp Dev (the ones saying yes!) may have the ear of the CEO or the Board in high-profile transactions
- Just saying “no” can leave you marginalized and the risk unaddressed

What do I do? Seize the Opportunity

- Understand how your role changes in the deal context
  - Everyday risk management involves implementing protective rules and procedures
    - ➢ Using the power of "no" can be an important part of your everyday vocabulary
  - In the deal context, the stakes are different and you are not the final voice
- Become a project/risk manager
  - Rather than saying "no," present choices and consequences and lead the consensus to the right result
  - Manage the risks and get the best possible deal –outside counsel can present risk mitigation options
- Use the deal as an opportunity to establish your own value proposition
  - Establish yourself as a trusted advisor, not a Hobbit
  - "Save them from themselves"
  - Become the source of wisdom and knowledge

Hypothetical: Addressing IP Ownership Risk



- IP Ownership: Target assumed it owned all of its intellectual property rights, but the diligence confirms that certain IP may not be owned by the target
- Response: determine the actual, not theoretical risk
  - What function does the IP perform? How critical is the IP to the functionality of the product?
  - How many customers use the feature or product? How important is the feature or product to customers?
  - How is the product deployed (i.e., on premise or over SaaS)?
  - How easily can the feature or product be replaced or substituted?
  - Work with your counterpart lines of business with responsibility for the issue post-acquisition to find a path to managing (as opposed to eliminating) risk

TIPS OF THE TRADE

Tips of the Trade: Thinking Like a Business Leader

Understanding the rationale for the acquisition can shape your approach to the transaction

- Diligence
  - Product/technology deals require heavy IP focus
  - Acqui-hires require attention to CIC/retention packages
  - Customer driven deals require broad diligence with a focus on contracts and future revenue and commitments
- Definitives
  - Understanding the rationale allows you to focus on protecting the core assumptions for the deal
  - Holistic view allows you to remediate problems earlier
- Integration
  - Tax planning may require reallocation or transfer of IP, revenue-generating contracts or employees
  - Acqui-hires may require careful evaluation of a target's existing business and its go-forward operations

Hypothetical: Maintainability of Software Code

- Target has a small technical staff
- Product is highly complex or has been built over a long period of time and requires specific, accumulated knowledge
- If even a small portion of the staff leaves, a buyer's ability to maintain the product could become significantly impacted
- <u>Response:</u>
  - Conduct a controlled, independent code review to assess the maintainability of the code
  - Structure incentives to retain key individuals (with holdback arrangements or retention agreements providing additive bonuses)
  - Maintain a flexible R&D environment to ensure the acquired team continues to flourish despite cultural differences
    - Carefully consider staffing changes, even transitional ones (i.e., to train up buyer's sales or support functions on target products)
    - Alternatively, keep the teams separate and devise an effective reporting structure

Thinking Like a Business Leader: Build vs. Buy vs. Partner

Compare the cost of organically building products, services, brand credibility, distribution networks, geographic coverage, customers, etc. against partnering or acquiring

BUILD	BUY	PARTNER	MINORITY INVESTMENT
▪ Lower upfront acquisition costs ▪ Flexibility to design product with desired features	▪ Shorter time to market ▪ Immediate access to talent and credibility	▪ Lower risk and upfront cost ▪ Access to complementary expertise	▪ Lower risk and allows for monitoring ▪ Possible first step to acquiring majority interest
▪ Delays in market entry, lost revenue and opportunity ▪ Organic build-up of talent & credibility required	▪ Upfront acquisition capital required ▪ Possible lack of exact features desired	▪ Limited/no control on major decisions ▪ Limited knowledge of partner's long-term viability ▪ Brand/image division issues	▪ Limited control other than voting rights ▪ Limited technology exchanges and organizational linkages

Thinking Like a Business Leader: Valuation

- Understanding valuation can shape your focus in the deal
- How does Corporate Development value a target?
  - Discounted Cash Flow
  - Valuation Multiples
  - Comparable Transactions

Valuation: Discounted Cash Flow (DCF)

- The DCF is the most widely used tool to determine the value of a business
  - The target's financial statements are used to derive projected future free cash flows
  - Future free cash flow projections are then adjusted to account for the time value of money
- **<u>The DCF is only as accurate as the forecasts it relies on</u>**; inaccuracies can become magnified as you project further into the future

	2012	2013	2014	2015	2016	2017
Revenue	518.0	564.6	609.8	652.5	691.6	756.2
Growth Rate		*9.0%*	*8.0%*	*7.0%*	*6.0%*	*5.0%*
EBIT		50.8	54.9	58.7	62.2	65.4
Less (Income Tax)		(18.8)	(20.3)	(21.7)	(23.0)	(24.2)
Less (Net Investment)		(3.7)	(3.6)	(3.4)	(3.1)	(2.8)
Less (Investment in NWC)		(4.7)	(4.5)	(4.3)	(3.9)	(3.5
Free Cash Flow (CF)		**23.6**	**26.4**	**29.3**	**32.2**	**35.0**

Growth rate is forecasted

Terminal Value is used to calculate the value of the discounted cash flows in perpetuity

$$\textbf{DCF Valuation} = \frac{CF_1}{(1+WACC)^1} + \frac{CF_2}{(1+WACC)^2} + \frac{CF_3}{(1+WACC)^3} + \frac{CF_4}{(1+WACC)^4} + \frac{CF_5}{(1+WACC)^5} + \text{Terminal Value}$$

"WACC" is the weighted average cost of capital used to discount the cash flows to present value

Valuation: Comparables

- Valuation Multiples:
  - Use of various metrics (e.g., revenue, EBITDA, EBIT, etc.) to compare the target with other comparables
- Comparable Companies:
  - Use multiples to compare the target to similar publicly traded companies
- Comparable Transactions:
  - Uses multiples to compare the target to recent M&A deals involving similar targets
- Considerations:
  - Limited data set of publicly traded companies and material/disclosed transactions may make finding a good comparison difficult, especially in smaller transactions
  - Multiples are impacted by a multitude of specific or general market factors, some of which are unknowable or unquantifiable

Valuation: Comparables

Acquiror	Target	Transaction Value (m)	Equity Value (m)	Enterprise Value (m)	Multiples (times)	
					Revenue	EBITDA
Buyer 1	Target 1	2,266	2,395	2,266	10.2	155.7
Buyer 2	Target 2	2,296	2,351	2,296	7.9	146.5
Buyer 3	Target 3	1,206	1,261	1,206	4.3	35.1
Buyer 4	Target 4	1,810	1,921	1,810	5.9	121.1
				Mean	7.0	114.6
				Median	6.9	133.8
				Deviation	2.5	55.0

Thinking Like a Business Leader: Integration Planning

Understand all aspects of the transaction as if you were the business owner so you can plan for it in the deal

- Operation Model – How will the business be run post-acquisition?
  - Pricing, packaging, product integration milestones and timelines, sales quotas, accelerators, etc.
- Organizational Model – how will team structure and reporting change post-acquisition?
  - Mapping the target's lines of business to the buyer's lines of business
  - Understand the impact of splitting up existing teams, training new teams, etc.
- Sales Model – how will compensation, pricing, and revenue interplay?

Hypothetical: Getting Ready to Operate

- Target is a product (post-revenue) company
- Business justification for the acquisition is to utilize buyer's sales force and cross-sell target's tuck-in offering.
- Goal is to get the business ready to start selling target's products immediately after closing
- Response:
  - Train your LoB's to avoid "gun jumping" (i.e. wait until closing before operating buyer and target as one company)
  - If the product is not ready or needs to be integrated into the buyer's product, then have R&D create a development plan/timeline for selling the product to give product integration a running start post-closing
    - Coordinate technical teams to ensure that the development plans include remediation of IP (e.g. tainted code)
  - Prepare new SKUs, train buyer's (and seller's) sales force(s) on the other's products, and create sales incentives for sales teams
  - Design a plan to update channel/reseller agreements and transition target's contracts to buyer's paper
    - Address conflicts between the target's and buyer's customer contracts; determine under which terms your future sales will take place

Tips of the Trade: Get Involved Early

Embrace drafting the NDA

- The NDA is one of the first documents in the life of a deal and sets the tone
- Note: in M&A, NDAs have small but important differences from general NDAs (e.g., no hires, no solicits, and stand-stills can get jammed into NDAs)

Embrace reviewing the PPM

- Get to know the target and its business

Attend the initial meetings

- Make connections with Corporate Development and your counterparts at the target at the outset of the deal
- Understand the strategic rationales for the deal
    - Keep these in mind – they will help you immeasurably in making risk calls later

Tips of the Trade: Know Your Stuff

Embrace the due diligence process

- Establish relationships with the other side's General Counsel and CFO
  - The GC and CFO may want to make you their friend post-closing, so they may be willing to tell you where the "bodies are buried" in diligence
  - Use this to your advantage; outside counsel will never have this kind of VIP access to information

Know the major contracts yourself

- Regardless of what the GC and CFO may have already told you, do the diligence yourself
- Know well and get comfortable with the major diligence items; your CEO and Board may ask you directly about them
- You don't have to read everything; prioritize and delegate smaller tasks to others and outside counsel

Tips of the Trade: Adopt a New Strategy

Give your team choices and consequences

- Write them down in a clear and concise format (they don't have to be and shouldn't be buried in long memos)
- Use bullet points and subparagraphs
  - Know your audience (i-bankers love puzzles and checklists!)

Form an opinion as project/risk manager

- You met all the players…You read all the important materials…You engaged and corresponded with outside counsel…You outlined the choices and consequences…Now, decide what your opinion is!
  - Trust your training; information is never perfect and decisions cannot be made in a vacuum
  - Don't be caught flat-footed when asked by an executive, the Board, or Corporate Development how you would decide – have an answer and a reason for it ready to go

Tips of the Trade: Negotiations

- Negotiations and leverage
  - Understand the background of the transaction (e.g. target's financial situation / competitive bidding process / terms of exclusivity)
  - Be aware of "deal fatigue" and target management's frustration
- Understand your role: bad cop (in-house Counsel) versus good cop (Corporate Development)
- Align your message with Corporate Development
  - When you need to be the "heavy" in the negotiations, make sure that Corporate Development knows to hold firm
  - Misaligned messages can undercut your authority
- Manage your relationship with the target to preserve mutual respect, but make sure that Corporate Development has your back when playing hardball

Tips of the Trade: Negotiations (continued)

- Distinguish between “deal asks” versus “integration asks”
  - Understand how the business will be run so you know the difference between integration planning and deal-related asks
  - Generally, integration-related matters do not affect the key transaction terms, but there may be exceptions
- Guide Corporate Development in negotiations
  - Work with Corporate Development to strike a balance and avoid asking for integration fixes that are “nice to haves”
    - Each “ask” increases deal fatigue and must be weighed against the pressure it imposes on the transaction and target’s management

Tips of the Trade: A word about outside counsel

- They should make you look good
  - Get to know outside counsel before the deal, so that outside counsel sees you as the client
  - Maintain the relationship with outside counsel and know the key players
  - Avoid being saddled by outside counsel if possible – you will be on the hook for failing to manage outside counsel
- Outside counsel loves great in-house counsel
  - Bring up issues early and begin dialogues before disaster
  - Communicate expectations and priorities clearly
  - Coordinate closely with outside counsel in playing good cop / bad cop roles
  - Identify the principal business contacts and clarify protocols for communication
  - Update outside counsel on changes in planning and deal personnel

Key Takeaways & Conclusion

In-house counsel should treat strategic transactions as valuable career opportunities to work with top executives and increase their value to the company

Grasping this opportunity requires you to understand:

- Your Corporate Development counterparts and your role as a project/risk manager
- Your ability to serve as a bridge between groups speaking different languages and taking actions driven by different incentives

Help your team get the best deal and plan for the seamless integration

- Leverage your position to obtain information unavailable to outside counsel
- Understand how the business rationales impact your diligence and negotiation
- Don't just say "no," instead provide your team with choices and consequences so that they can make informed decisions
- Distinguish between deal and integration concerns, but plan carefully for integration to enable the new business to start running from day 1!

Biography

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Christopher Rose has a diverse transactional practice, regularly representing global public and privately held companies in a variety of matters.

Chris's practice focuses on mergers and acquisitions (M&A), initial public offerings (IPOs), investments, joint ventures, and venture capital and private equity investments. He also advises on public filings under federal securities laws; compliance with Sarbanes-Oxley, New York Stock Exchange (NYSE), and NASDAQ requirements; and further corporate governance matters.

Additionally, Chris represents boards, investors, and their portfolio companies, and helps investors and issuer companies successfully navigate complex legal and business challenges. Chris has a specific focus on the technology and automotive industries.

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Biography

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Eric Hwang advises global public and private technology and life sciences clients on diverse strategic transactions, including complex cross-border mergers and acquisitions (M&A), corporate governance matters, joint ventures, and corporate and venture capital, private equity, and corporate investments.

Drawing from a background in both in-house, business-side leadership and private practice roles, Eric has a deep understanding of the type and scope of services that companies seek from outside advisors. Over the course of his career, he has completed more than 60 transactions, representing an aggregate value of more than $30 billion.

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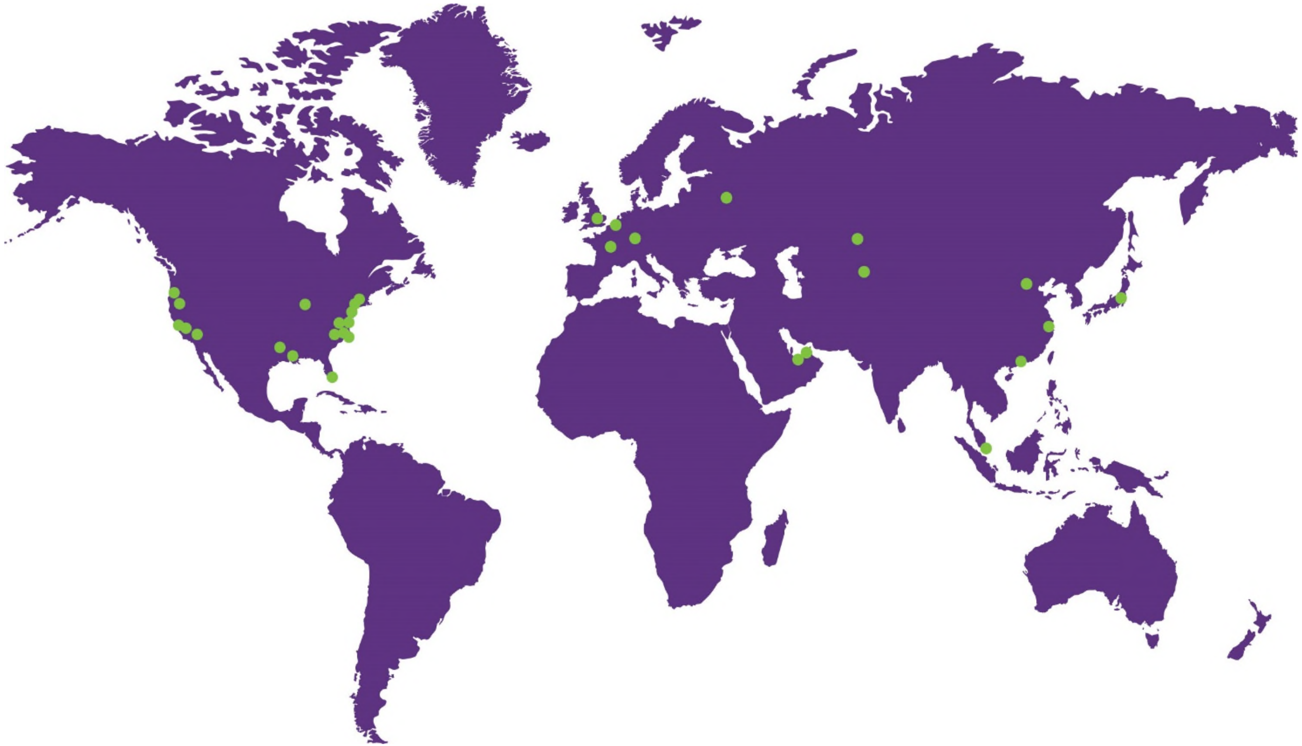

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