CEO CLUB
POSTEN SUPERPAC
SATURDAY MAY 21, 2006
FOUR SEASONS SAN FRANCISCO
DEAL NOTES

Once you decide to sell, SELL!

But also remember you can always say NO. There is no deal until it is signed.

Remember it is an emotional process for us and generally not at all for buyer.

Never, ever take eye off of running the business. Biggest issue to protect against is deal distraction. Things will get disruptive. Must show growth, steady growth, during deal period. Show more backlog. Stay ethical. If not show growth, the buyer's going to beat us up.

Make a realistic "must have" list and stick to it. We need to stay at 40,000 feet and have someone negotiate for us. We want someone to say NO to. We need to stay objective.

Drive a stake in the ground on timing. Attorneys will stretch deal out forever. Time is on the side of the buyer.

Replace yourself. You can't work on the business if you are working in the business. Change titles to make you look like an investor

Make a good book. Buyers like track records and upside. Maybe restate earlier to show growth line. Talk success stories. Be passionate about what you are doing, but be cautious of passion running over into emotion. Emotions makes bad decisions.

Don't worry about looking smart. Worry about getting the money.

Remember, investment bankers are not your new best friends. Their job is to qualify a buyer, to make sure the buyer can bring the money to the table.
Set up tranches of disclosure. Have to pass certain waypoints before the next level of info is revealed. Some waypoints may require fees.

Speak with one voice to broker, buyer, attorneys, etc. Practice and rehearse answers to core questions likely to be asked. Assign role of key contact. Never,

ever voice different views in public. Have a script for all key questions and points of view.

If there are partners, decide who will be voice to buyer. Agree on what is and is not ok, but do not put a team of partners on firing line. Buyers look for crack, weakness, chink in the armor to lower value. Also, if partners, agree upfront on an arbitration mechanism/arbitrator to break deal impasse

Key questions

- Why are we worth what we say? Don't answer but put back to them why don't you think we are worth it. Never provide valuation formula. Too many places for buyer to challenge value.
- #1 why are we selling? Need a great script. E.g.(We need jet fuel to grow and realize scalable potential; need scalable partner, play into their need)
- #2 how much do you want. E.g. $20mm cash. Defend it.
- #3 how long wiling to stay. E.g. 1-3 years

Do not stumble, stutter. Stay cool. Be credible. With respect to future growth projections, act as if talking to bank. What would we bet farm on to bank. Then make sure everything we say will happen, does happen.

Educate yourself on exactly what the due diligence process is. Mock up a term sheet and go through issues/objections one by one for practice and to get own story straight.

Have in writing what partners agree to before things get too far along.
Play out different scenarios for different deal structure – asset sale, stock sale, tax implications of each, earn outs, etc. Decide what's most important and stick to it.

Be patient. Be prepared for failure.

Be reasonable and realistic. Don't fight over little things. Don't fight for every last thing, every last dollar. Keep eye on end result that is acceptable, not perfect. Most good deals fall apart because the seller, or one partner, wants everything.

Manage the downside. Upside takes care of itself. Lower projections. Lower expectations and really decide just what's enough. Trying to get the optimum amount will generally put you in a losing position

Get employees enrolled early. Brace employees for change. Be sensitive to employee's feelings and needs. Be clear on what is taking place and why it's important. Define ways to keep employees engaged. Security blanket and/or retention bonus. Protect with employment agreements.

Consider what extra value could a fully informed/engaged employee pool bring to deal? Add to the base deal value and then distribute if get. Make employees active positive participants in process.

Manage what info executive secretary has. The single best source for info, usually not intentionally disclosed, to employees, to buyer or buyer agent.

Protect IP at all costs. One way to protect technology is by making it obsolete. Also, require bond or some form of payment to look at technology. And, never expose the whole thing.

Likely the deal will have stock. Immediately collar, enter hedge transaction. For earn out, get security – letter of credit, stock, etc. Cap liabilities. There are set numbers that can be structured.

Buyers like to believe they can do things better than you. Play into that. But show track record, success stories, sales growth. Be as creative as need to be but show increasing growth.

Buyer will insist on exclusive. Not want us to shop. Need answer to that right up front why if we are not going to do that. One way is to tell them that unless they can show how they are going to spend a fortune in due diligence, no exclusive. Probably have breakup fee. Form of deal will structure best way for indemnification. Buying stock is different than buying assets.

Two types of lawyers: Deal makers or deal breakers. What type do you have and what type does the buyer have. If buyer has a deal breaker, that's an ugly buyer.

Caution: Beware of the buyer using charm as currency. Don't get distracted. Assess the reality of the picture they paint of their company's future. Again, job of investment broker is to bring a real buyer and the funds to the table.

Obvious, but make sure buyer can easily afford us and is fiscally healthy. Don't be distracted by large offer of cash, where there is in reality no cash.

Purpose of the LOI/term sheet is to tie us down. Avoid clawbacks, baskets, etc. What is timeframe. Do not leave things hazy as attorneys will spend time/add fees making the hazy clear. Instead, no LOI, use an APA, asset purchase agreement.

Big caution to watch the reps and warranties.

If earn out, define all aspect - the duties and responsibilities. Define what areas of control. What decisions can make. Define a realistic future, not a perfect future. Virtually all earn outs go bad. Be comfortable that the amount you get upfront will be enough if you never got the earn out. Avoid cliffs. Rather define % over defined value to avoid arguments.

Don't celebrate until the cash is in the bank. The *best time to screw the deal is when you think there is one*. Stay sharp. Don't lose vigilance.

Have all estate planning and tax options defined well before any deal is on the table.

Prepare for ugliness post closing. Deals get worse with time and buyers will change, try to change, everything.

Get comps, both high and low on specific deals. Just like buying house. Buyer will bring low comps, we want high comps.

Don't negotiate with yourself. Have no initial defaults. Don't limit your possibilities by assuming the deal structure going in, e.g. we will have an earnout. Assume, for instance, you can get cash with no earnout. May end up there but don't box yourself in mentally before things start.

Have attorney review all docs, even non-binding info docs, before they are sent to prospective buyer to ensure we are not promising something or obligating ourselves to something we can't do or that we don't in reality have. Again, be realistic and minimize exposure to chinks in the armor.

Set up a war room offsite for all due diligence. Sets the tone to the buyer. Let them know what they can take and can't take. What they can copy, not copy. Walk through ok, but maybe create a video instead. Manage who they talk to. After LOI/APA signed, to the degree possible, get in room and just pound out the docs to get deal done. Avoid giving to attorneys who will lengthen transaction time and add fees.