



Growth and Exits



Presentation for
TCN: The Capital Network

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- Investment Banker's Perspective – Tim McMahon
- Founder's Perspective – Murat Kalayoglu, MD, PhD
- Investor's Perspective – Roger Walton
- Lawyer's Perspective – Paul Sweeney



- Emphasis on the “Exit Event”
- Two categories:
 - 1) Transactions where consideration runs to company or the investors
 - 2) Transaction where investors get access to liquidity



Basic Types of Exit Events

- Merger
- Stock Acquisition
- Asset Acquisition
- Initial Public Offering

Note: Most exits are of the “M&A” variety, as opposed to an “IPO.”



The Investment Banker's Perspective – Tim McMahon

- Investment Banker with Covington Associates
- Long-time investment banker with over 20 years experience
- Has personally advised over 100 client engagements
- Served as President and CEO of Adams Harkness Inc.



The Founder's Perspective – Murat Kalayoglu

- Founder and Chief Science Officer of HealthHonors Corporation
- Sold HealthHonors to Healthways last year
- Currently serves as Medical Director at Best Doctors, Inc.
- Board-certified practicing Ophthalmologist in the Boston area.



The Investor's Perspective – Roger Walton

- General Partner at Castille Ventures
- Investment focus on advanced computing and components and subsystems.
- Currently serves on boards of Sandbridge Technologies and Whaleback Systems.



- Corporate Partner at Foley Hoag LLP
- Acquisition of **Interactive Supercomputing** by **Microsoft** (\$(undisclosed) / asset purchase)
- Acquisition of **Color Kinetics** by **Philips Electronics** (\$791 million / cash merger)
- Acquisition of **J. Jill Group** by **Talbots** (\$517 million / cash merger)
- Acquisition of **Meetinghouse Data** by **Cisco** (\$48 million / cash merger)
- Acquisition of **PRI Automation** by **Brooks Automation** (\$536 million / cash merger)



Legal Do's and Don'ts

Do: get things organized before starting M&A process

- Engage lawyers, accountants and investment bankers at the earliest possible time to position the company and to identify and clean up problems
- Collect due diligence material (use a “buyer’s” form of checklist)
- Make it easy for the buyer to make bids
- Look at your company through the eyes of a buyer



Don't: lose track of your equity holders

- Make sure your stock ledger and capitalization table are complete, correct and up-to-date
- Limit number of unaccredited investors
- Avoid grants of “percentage of the equity”



Legal Do's and Don'ts

Don't: ignore 409A problems

- Granting options below fair market value can have a very ugly result
- IRS always sees with 20/20 hindsight
- Safe harbor if rely on 3rd party independent valuation



Don't: be sloppy with your Intellectual Property

- Obtain assignment of inventions from EVERY founder, employee and consultant, starting on day one
- Make sure licensing agreements are crystal clear on who owns what, and what ownership rights are transferrable
- The question isn't just "How clear does this need to be for me to feel comfortable when growing my business?" It's also "How clear does this need to be for the future buyer to feel comfortable paying money for my business at the time of an exit event?"



Legal Do's and Don'ts

Don't: change your story on troublesome due diligence issues

- Clean up problems before-hand, take follow-up seriously, and get your facts and your story straight
- Your credibility is your most valuable (and fragile) asset



Legal Do's and Don'ts

Do: plan to spend considerable time on this process

- Delegate, delegate, delegate (but only what's appropriate!)



Do: Stand your ground at the Letter of Intent stage

- Difficult (if not impossible) to revisit terms
- Once an announcement is made, you can't put genie back into the bottle
- Momentum tends to grow, and seller's leverage tends to shrink, after LOI is signed



Legal Do's and Don'ts

Do: pay close attention to key LOI terms

- Purchase price calculation
 - Avoid complicated adjustment mechanisms to purchase price, if possible
- Is your consideration liquid? (Worry about tax treatment now.)
- Signatories to, and terms of, non-competes and employment agreements need to be identified and engaged
- Limit indemnification
 - Make clear what is covered (and limit exceptions)
 - Limit term of exposure
 - Limit amount of exposure (cap at escrow, if possible)
 - If stock consideration, clarify valuation if forfeited



Legal Do's and Don'ts

Don't: give away "veto" rights unless absolutely necessary

- Preferred Stock investors should be only non-founder player with right to block transaction
- Lenders are possible exception



Don't: ignore “change of control” provisions in your contracts

- Sometimes require notice to, or consent of, 3rd party in connection with a change of control.
- Customer, supplier, license agreements commonly problematic
- Even mergers are sometimes covered



Legal Do's and Don'ts

Don't: freely grant Rights of First Refusal or Rights of First Offer

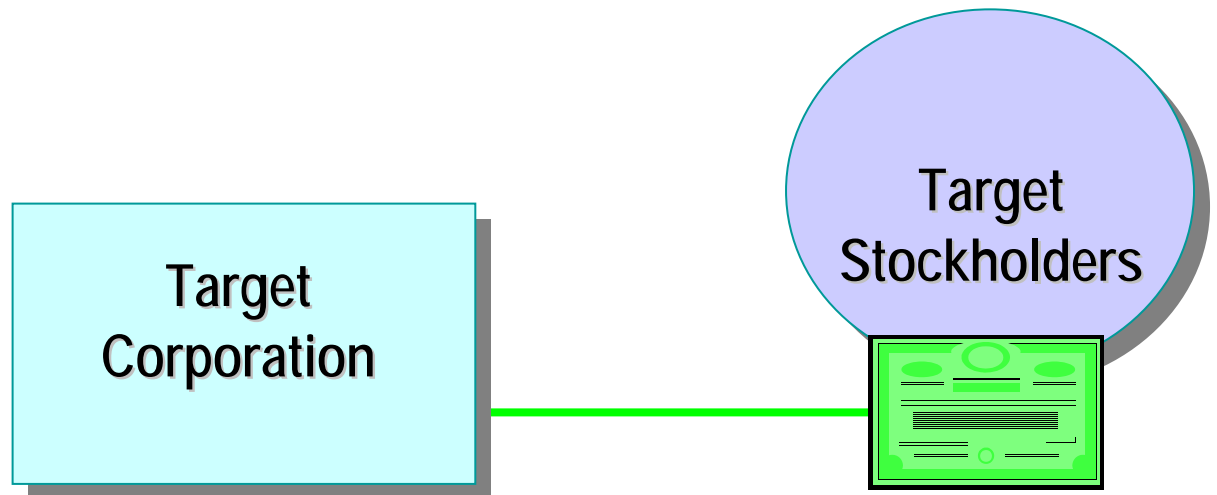
- ROFR – Creates chilling effect



Acquirer approaches
Target with transaction
proposal



Holder of Right of First
Refusal comes in to
acquire company at same
price/terms



Don't: freely grant Rights of First Refusal or Rights of First Offer

- ROFR – Creates chilling effect
- Often slip into Distribution Agreements, Joint Venture Agreements, Sponsored Research Agreements
- ROFO – Can be just as problematic
- Keep in mind “Drag Along” and “Tag Along” rights



Legal Do's and Don'ts

Don't: lose track of complicated liquidation waterfalls

- Calculation problems are difficult to avoid, but virtually impossible to undo
- Common stock can be left value-less



Legal Do's and Don'ts

Don't: ignore your fiduciary duties to corporation

- Learn to compartmentalize if you are a member of the Board of Directors
- Seek out, engage, and use top level advisors





Questions?