

## Navigating an Acquisition by a U.S. Buyer

Selling your business is a common path to liquidity, but the process is not always simple or common. Sale processes in the United States are often bespoke to fit the risks of the parties. The following tips are important to consider as you begin evaluating future exit events for your company.

### Preparing for the Transaction

- 1. Understand how the crew will fare:** Anticipate how your employees will react in a sale, and consider whether steps should be taken to retain them during the sale process and, if needed, following the closing. If employee stock options are “underwater,” they may have little incentive to remain with the company during a sale process, particularly if their position is one that is likely to be eliminated post-closing (e.g., support staff and administrative personnel). If you have promised option grants to employees, but not made them yet, discuss with counsel before granting options. Once you have a term sheet for a sale of the company, it is often economically equivalent and more efficient to plan to give the impacted employees cash bonuses.
- 2. Turn your customers and suppliers into potential buyers:** Create optionality by asking your key customers and suppliers to introduce you to their corporate development colleagues if you think they are a potential buyer. Try to develop those relationships with corporate development teams before a sale process begins in earnest to provide a broader pool of potential suitors and secure greater leverage.
- 3. Know your weaknesses in a sale:** It is the business of all entrepreneurs to be optimistic and respond “why not?” when told “you can’t do that.” Before meeting with potential buyers, find your company’s strongest internal critic, or ask someone to play the role, to help identify areas of potential weakness that buyers will focus on. Prepare to respond to those areas of weakness and/or why being acquired by a potential buyer will help address them.
- 4. Clean up capitalization early and save money:** If there are any ambiguities as to ownership of company securities, clear those up as soon as possible. Resolving these issues becomes much harder once the value of the company becomes more defined. Buyers will expect that the seller bears responsibility for any cap table mistakes, which can reduce the purchase price and/or lead to purchase price having to be repaid to a buyer.
- 5. Get organized:** If you are considering pursuing a sale in the next 36 months, evaluate whether your corporate records, contracts, and other important documentation are well-organized and accessible. Once a sale process starts in earnest, it can be difficult to find the time to organize materials. Having a standing dataroom is useful for financings and later for a sale, and employees are less likely to expect unusual activity if maintaining it is ordinary course.
- 6. Talk to your investors and board members:** Understand your key investors’ and board members’ views on the ideal timing and price of an acquisition as they develop over time. If key constituencies are pushing for, or resistant to, a sale, work to align those perspectives so that you present a united front to potential buyers and aren’t distracted by internal politics.
- 7. Is the intellectual property (IP) in good order?:** Clear protection of IP rights is key to most U.S. buyers. This can range from simple actions like confirming all employees have assigned any interest in their IP to the business to patent, trademark, and copyright issuances. Ambiguity as to ownership will result in price reductions or even broken deals.
- 8. Understand implications of data privacy laws:** Sharing personally identifiable information is often challenging cross-border. Because of the differing standards of managing data, particularly personally identifiable information, in the U.S., UK, and European Union, you should consult with counsel before sharing data.
- 9. Anticipate accounting needs:** U.S. public companies (or companies that are seeking to go public in the next one to two years) may require several prior years of audited financial statements within 75 days of closing a transaction. This may require a conversion of your existing financial statements to U.S. Generally Accepted Accounting Principles (GAAP) and is evaluated by comparing your assets, revenues, and net income against the buyer. Be prepared to facilitate this analysis early in the process. In addition, non-U.S. accountants may seek a release of claims from the buyer before participating in due diligence; such a release would not be customary from a U.S. accounting firm and may appear unsettling to your buyer. Make sure that your accounting firm clearly identifies up front what they need from the buyer to participate in due diligence before you commit to due diligence activity with the buyer.

- 10. Retain the right advisors:** In addition to outstanding legal counsel, there are other areas that require careful attention. Working with experienced financial and tax accountants, financial advisors and bankers, and other specialty consultants is critical to a successful deal. For example, a particular deal structure may result in substantial tax burdens to you, your investors, and your employees if not discussed carefully in advance with advisors, which will greatly diminish the value of the deal.

## Negotiating, Managing, and Closing the Transaction

- 1. Beware of waterfalls:** Understand how proceeds would be distributed at various sale prices among the company's security holders, taking into account change of control premiums on convertible debt, liquidation preferences on preferred stock, and exercise prices of convertible securities such as stock options. Transactions where there are insufficient proceeds to provide at least some consideration to all security holders could be more complicated and the relevant issues should be explored with external advisors early in the process.
- 2. Get to know the terms:** Many buyers are repeat players who are familiar with numerous deal structures and "market" terms. Spending time with your advisors educating yourself about the process before engaging will reduce the information asymmetry between you and potential buyers that often leads to lost leverage in a deal process.
- 3. Decide on the deal team:** A sale process with all hands involved is often disorganized and distracting to the business. Having a small team of management and support employees that can address diligence matters and prepare for the sale will minimize disruption and also reduce negative effects on morale, both in the event that the sale is not a positive development for employees or if the deal ultimately does not proceed.
- 4. Make sure key relationships do not cause obstructions:** Many key customer and supplier contracts and leases have change of control provisions that require consent of another party. Be sure you understand those and can get necessary consents.
- 5. Understand and define which assets are being sold:** Selling cross-border often results in selling various functions that may not all be contained in a single entity. Clearly carving out the assets into a standalone unit is helpful to a quick and efficient acquisition.
- 6. Address compensation issues:** Many companies have made compensation promises or commitments to executives and employees that are not fully documented. Worse, implementing those promises in close proximity to a transaction may also cause substantial tax issues. Identify those early with tax advisors and be sure to fully document the arrangements such that there is clarity for the parties.
- 7. Prepare for regulatory delays:** Cross-border sales may implicate several areas such as export control laws, limitations on foreign ownership of certain types of companies, restrictions on transfers of businesses under certain types of government contracts to which the company may be a party, and antitrust laws of multiple jurisdictions. All of these can delay closing while regulators review the transaction and may result in changes or blocking of the transaction. Consult with U.S. and UK counsel to understand how those factors can change your timeline.
- 8. Plan for the tax implications:** Be sure to consult with your tax preparer early about the transaction structure. Failure to do so can result in unintended consequences for you. This will also help you appreciate the proposals from buyers.
- 9. Expect noncompetition and nonsolicitation restrictions:** U.S. buyers typically seek restrictions on the competing behavior of a selling stockholder after they sell or exit the business. These can often be multiple years of restrictions. Make sure you understand the proposed limits along with your expected proceeds, so that you are not stuck in a position of having to potentially breach a noncompetition provision to continue to generate revenue.
- 10. Prepare for indemnities, escrows, and representations:** U.S. buyers generally expect sellers to provide numerous explicitly factual statements, known as representations, as a part of the purchase agreement. If found to be inaccurate, these are the typical basis for a claim for indemnity from the buyer. Most U.S. buyers will expect a transaction to include a portion of the purchase price be held with a third-party escrow agent for several months or years after closing to support the representations. Be prepared for an extensive discussion, often at the term sheet stage, about how much of the deal proceeds will be at risk for indemnification and what amount will be held back in escrow to indemnify claims.

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