

Anatomy of a Sale:

Common Elements of Acquisition Agreements

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Overview

- Timing/Structure
- The Purchase Agreement
 - Price and Adjustments
 - Certainty to Closing
 - Reps and Warranties
 - Indemnification
- The Management Team

Timing/Structure

- Is there a need for speed? What's driving it?
- Simultaneous Signing and Closing vs. Delayed Closing
 - Common Preference: Simultaneous Closing
 - Reasons for Delayed Closing: Financing, HSR or regulatory approval, third-party consents, integration matters, internal and external confidentiality
 - Impact on Company / Deal
 - Interim operating covenants
 - Conditions to Closing
 - Termination risk
 - Publicity

The Purchase Agreement

- Purchase Price and Adjustments
 - Type of consideration (e.g., cash, equity, debt, mix)
 - Timing of payment (bridging the valuation gap)
 - Milestone Payments
 - Earn-outs
 - Purchase Price Adjustments
 - Working Capital
 - EBITDA
 - Net Worth
 - Escrows (e.g., general, working capital, deal-specific)

The Purchase Agreement

- Certainty of Closing
 - Pre-Closing Covenants
 - Operation of the Business
 - No-shop
 - Closing Conditions
 - “Bring Down” of Reps/Warranties/Covenants
 - Shareholder, Third-Party and Governmental Consents and Approvals
 - Ancillary Agreements (employment, rollover, pay-off letters, etc.)
 - Financing
 - Termination
 - When
 - Break Fees

The Purchase Agreement

- Reps/Warranties
 - Statements of fact regarding a past or existing event that is made to induce Buyer to enter into contract
 - Not common to make forward looking statements
 - Purpose
 - Informational – confirming accuracy of diligence
 - Closing Conditions – when can a Buyer walk away?
 - Indemnification – when can Buyer claw-back proceeds
 - Key topics include: financial information, taxes, affiliate transactions, contracts, compliance with law, litigation, and deal-specific representations (e.g., IP, healthcare, environmental)

The Purchase Agreement

- Indemnification (generally)
 - A right entitling a party to make claims against one or more other parties for breaches of the agreement, and to recover the costs of doing so
 - Indemnification often covers:
 - Breaches of representations/warranties (most common)
 - Pre-closing covenants (if applicable)
 - Post-closing covenants (e.g., non-compete; non-solicit)
 - Other specific matters (e.g., pre-closing litigation, pre-closing debt, deal-specific risks)
 - Whose proceeds are at risk?
 - Joint and several – all sellers are liable for indemnification
 - Several – each seller is liable for that seller's pro rata share of indemnification

The Purchase Agreement

- Indemnification (limitations)
 - Survival – Indemnification claims based on breaches of reps and warranties (but not of covenants) may be brought only for a limited time after closing. 12-18 months is normal, with exceptions for “fundamental” reps
 - Minimum Claim Size; Baskets/Deductibles – weeding out small claims; Buyer only has rights if claim(s) exceed certain thresholds. Often only applies to breaches of reps/warranties and exceptions often apply
 - Caps – may be (i) larger in small deals so that it is enough to cover e.g. a serious litigation matter against the company or (ii) smaller in large deals because the absolute amount of the cap is substantial. Exceptions often apply but are subject to ultimate cap (e.g., purchase price or proceeds)

The Purchase Agreement

- Indemnification (other concepts)
 - Additional Limitations – “materiality scrape”, anti-sandbagging, third-party recoveries, no consequential or indirect damages or lost profits
 - Exclusive Remedies – Critical for seller - indemnification rights under the agreement should be the exclusive remedy. In most states, fraud is excepted by law.
 - Rep/Warranty Insurance – Increasingly popular and often lead to beneficial terms for sellers. Buy-side policies are more common than sell-side policies

The Management Team

- Continued Employment – transitional or long-term?
- Sale Bonuses
- Retention Bonuses – management and key employees
- Rollover Equity – common in financial sponsor deals

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