Mergers and acquisitions: overview of a transaction

Many startups dream of going public, but, in today's environment, being acquired is often a more likely (and in some cases, more desirable) exit for many companies, venture backed or otherwise. For first-time entrepreneurs, however, the process of getting all the way to the altar with a suitor may seem overwhelming.

To help you understand this process, in this article we provide an overview of the typical stages in an M&A transaction. Though the actual process may vary depending on the circumstances of any given courtship, most transactions have certain aspects in common.

When should you call your lawyer?

Call your lawyer as soon as possible. Your lawyer can not only help to negotiate the terms of the deal but can also work with you to have the company positioned to be ready for an M&A transaction. For more on how to prepare your company for an exit, please see our article.

What are the stages of a typical transaction?

1. **Preliminary discussions**

A transaction usually begins with informal, preliminary and high-level discussions with one or more potential buyers. Some companies may also engage a banker to provide introductions to potentially interested buyers who may be interested and to guide you in these discussions. Deal structures are usually not been decided at this stage, which are more focused on value exploration, fit and feasibility.

2. **Executing non-disclosure agreements**

Before engaging in any serious discussions with potential buyers, you will need to provide sensitive confidential information, and it is a best practice to require buyers to execute a non-disclosure agreement before providing. What you want to avoid is disclosing your sensitive information to prospective buyers, who suddenly walk away from the deal and then use your sensitive information for their own benefit. For more about non-disclosure agreements, please see our article. You should also consider requesting a non-solicit agreement, so that a prospective buyer does not seek and recruit any of your team.

3. **Letter of intent / term sheet**

Once prospective buyers determine that they wants to move forward with a transaction, they will typically propose the terms of the acquisition in a term sheet or letter of intent. The letter of intent is a non-binding outline of the significant terms of the transaction, including structure, purchase price (and its adjustments), earnout structure, indemnification and escrow, special closing conditions and treatment of employees after closing. Often, the letter of intent may also contain an exclusivity or "no-shop" provision, meaning that the target may not engage in discussions with other potential buyers for a certain period of time. Legal review is crucial at this stage, because it may be difficult to reopen agreed deal points once the letter of intent has been signed. Upon signature of an LOI with exclusivity, a significant amount of leverage moves to the prospective buyer.

4. **Pre-signing period**

(a) *Negotiation of definitive documents* – Buyer, target and their respective legal counsel negotiate the terms of the definitive document. Sometimes, deal structures and terms agreed to in the letter of intent may be renegotiated. This process typically takes a few weeks, sometimes longer.

(b) *Completion of diligence* – During this period, the potential buyer circulates a diligence list requesting certain documents from the target, including, among other matters, corporate formation documents, financing documents, key commercial contracts and a description of the intellectual property portfolio. The target typically provides this information in a virtual data room organized in folders that correspond to the requests in the buyer's list. This is the stage when the potential buyer is looking for skeletons in the closet that may impact the purchase price, result in closing conditions being added and special indemnities negotiated.

(c) *Population of disclosure schedules* – The definitive document will contain pages of representations and warranties about the operation of the company (such as that it has no ongoing lawsuits or that it is not in breach of any of its material contracts), and if these representations are found to be untrue after closing, the potential buyer of a private company may have an indemnification claim. The disclosure schedules are designed to qualify these representations and warranties.

5. **Signing**

After the definitive agreement and the forms of certain important ancillary agreements are agreed upon, the documents are signed. Closing may occur simultaneously or, if certain actions must be taken prior to closing (such as obtaining government approvals or obtaining consents to assignments of key agreements), on a later date.

6. **Pre-closing period**

If there is a period between signing and closing, the target and the buyer will prepare all closing deliverables and satisfy all closing conditions (eg, obtaining government approvals and third-party consents, getting key employees to sign employment agreements with the buyer). The length of the pre-closing period can vary, depending on the closing conditions that need to be satisfied.

7. **Closing**

When all the closing conditions are satisfied, the deal is ready to close and funds are exchanged. This is the moment when the transaction actually occurs.

8. **Post-closing**

After a deal closes, the buyer goes into full-scale integration of your business and all this entails. As you consider your next move, pay your taxes, make an estate plan if not already done and thank the people around you who helped you along the way.