Sikich™ Investment Banking

Technology Industry M&A Report

Providing expert insight to all things technology

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Sikich Investment Banking

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Inside this issue:

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Dear Clients, Friends and Colleagues:

Sikich Investment Banking is proud to present the inaugural Technology Industry M&A Report. Readers will note that activity in this sector remains robust—as evidenced by Google's announcement to purchase Motorola Mobility and their recent acquisition of Zave Networks, as well as high profile deals by other strategic buyers.

This quarter's report examines the Technology Market from a broad perspective and features two articles written by industry experts who provide insights on M&A as well as emerging technologies. The first is authored by Fredric Tannenbaum, a Managing Partner at the Chicago-based law firm of Gould & Ratner. Mr. Tannenbaum is a recognized expert in Venture Capital and Private Equity transactions of all types—having advised on over 750 transactions over 20 years. Mr. Tannenbaum's article provides insight to M&A in the technology arena from a legal perspective.

The second article is authored by mobile commerce pioneer, Kevin Bailey. I had the pleasure of working with Kevin at Motorola where he championed product development efforts in the emerging Near Field Communications (NFC) ecosystem. He was heavily involved with the NFC Forum—a key industry association promoting NFC technology standards and adoption—where he provided insight through workgroup participation and panel discussions. His article offers key insights on NFC relating to integration on mobile devices.

Respectfully,
Kurt A. Estes

Key Legal Issues in M&A Technology Deals

By Fred Tannenbaum

As entire books have been written on the subject of deals in the technology space, this article will attempt to hit only some highlights and, hopefully, provide some insight on this explosive topic. First, some perspective: 85% of technology deals by tech giants in 2010 involved small to mid-market private companies. 75% of the targets of serial acquirer Google were angel or venture capital backed. Deal volume in the technology space in the U.S. doubled from 2009 to 2010, to $107.1 billion. Mid-market deals dominated as 138 deals closed in 2010 with values between $100 million and $1 billion, with the average size around $275 million. Most of the deals were in IT services and software, followed by internet, hardware and then semiconductors.

Many of the issues in an M&A transaction involving technology are similar to those in M&A in other industries. Therefore, I will just discuss the M&A battleground areas that are more elevated and sensitive in technology transactions.

1. What is being Sold/Retained. Buyers generally assume they are receiving untrammeled rights to all seller assets, particularly in merger or stock sale situations. Acquirers, however, need to make sure that the seller owns all of the assets they are actually using. Often third parties, whether licensors, developers, founders, employees or others claim licenses to or other rights in key algorithms, code, trade secrets, and other key intellectual property. Proper invention assignment agreements from all past and current contractors and employees is critical, among other myriad protections, to assure the buyer is receiving all that has been paid for. In addition, any license agreements under which the seller is the licensee for items included in the seller's technology should be reviewed to determine any restrictions or limitations on use. Furthermore, scrutiny of each of the seller's license agreements with its customers

(Continued on next page)

Legal Issues *(cont'd)*

is also imperative to understand if the seller granted exclusive licenses to anyone, whether in a vertical, geographic market or otherwise, or other conflicts abound.

2. What is the Real Consideration? The nominal purchase price just begins to tell the story of the actual value being transferred. Post-closing license payments and working capital adjustments tied to the collection of receivables from customers can meaningfully alter expectations of both parties. Earnouts tied to hitting sales, EBITDA, or other objective benchmarks is a frequent component of technology M&A transactions.

3. Due Diligence. Since many technology sellers are early-stage companies often founded by young and inexperienced entrepreneurs, they have not always realized the importance of proper record keeping and documentation, nor do they have the financial resources to engage meticulous counsel. The proverbial chickens come to roost when a large company acquirer with its team scrutinize (or desperately seek to find) every necessary scrap of paper. Items we all take for granted, like maintenance of proper minute books, key action approval records from shareholders and directors, adherence to federal and securities laws in raising capital, ownership documentation of intellectual property, and documentation of stock option grants and ownership of shares are all key areas where tens of thousands of dollars of "clean-up" expenditures have been required to restore the seller to passable condition. Finally, it is essential to investigate whether consents to transfer of customer, developer, license, and other critical agreements may be required and whether the consenting party may hold up the transaction or try to use its consent rights as leverage to re-negotiate the terms of an agreement that had been favorable to the seller.

4. Key Representations and Warranties. This is a common legal battleground in any M&A deal. The following are most germane to technology transactions. First and most obvious relates to the ownership, development, non-infringement and functionality of the seller's intellectual property. Financial condition of the seller takes on a whole new meaning in a technology deal since many early-stage companies have not always used generally accepted accounting principles or been consistent in applying whatever in-house accounting standards they did employ. Revenue recognition is often a critical area of creativity. Further, as a public company, the buyer is subject to the rigors of the Sarbanes-Oxley Act, while many of the governance and accounting practices of the seller may not be quite compliant. At their own risk, buyers will often demand sellers to represent compliance. It will fall on the buyer to ensure that compliance is being maintained going forward. A final, germane representation involves compliance with immigration and related employee laws. Many tech companies have relationships with persons whom they may classify as independent contractors, when in fact, the IRS could classify them as employees. Many such persons are highly trained immigrants whose status in the U.S. may be open to question. This representation is often hotly contested. The breadth and/or qualification of these representations are a function of due diligence and the negotiating leverage of the parties.

5. Structure. The unique structural feature of technology M&A transactions involves the form of the seller's ownership. Often a seller is structured as a limited liability company for a myriad of sound tax and financial reasons. Careful analysis of state merger statutes is critical to assure that a merger transaction of a corporate acquirer and LLC seller is permissible. Analysis of state law dissenter and appraisal rights is also critical. Sellers often have a myriad of earlier investors whose interests may be "under water" and, therefore, do not have any incentive to vote in favor of the transaction, but every impetus to be a nuisance to extract consent. Finally, careful analysis of governance requirements is also essential. For example, assuring that the board follows proper assessment and validation of the fairness of the transaction is a common source of litigation. Another frequent area of scrutiny involves director conflict of interests in approving transactions when the director represents a particular constituency, such as a series of preferred shareholders or a certain group of common shareholders, who will not be receiving much or any of the sales consideration. Recent case law in Delaware heightened this risk of director approval.

6. Indemnities. Technology M&A deals raise the same panoply of contentious issues -- survival period and exclusions, types of excluded damages, deductibles, baskets, tipping baskets, caps and materiality readouts. The main nuance in a technology transaction involves whether the IP representation is a "fundamental" representation and, therefore, survives for a longer, if not indefinite, period and whether the deductibility/basket and cap apply to this representation.

Any one of the foregoing topics merits many more pages discussing the crucial, legal features unique to technology M&A deals. A further examination would also discuss covenants between signing and closing, conditions to closing particularly the infamous material adverse change condition, and post-closing transition and integration issues. The latter are exacerbated in technology M&A deals due to the inevitable culture clashes between large company acquirers on the one hand and entrepreneurial and/or engineering-led sellers on the other hand.

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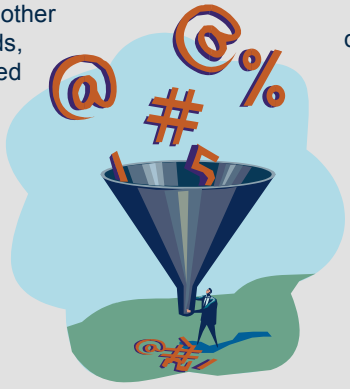
TECH TRIVIA

Did You Know...

By Jeff Rudolph

Technology over the last ten years has made texting, emailing, social media, blogs, PDAs, websites and other information delivery methods, ubiquitous. We are inundated with so much information and disruption that it is becoming clear that the productivity benefits we once derived from this technology is now decreasing our productivity, if not adversely affecting the quality of our lives. This paradox is known as Information Overload. Consider this sobering tidbit: Hewlett Packard conducted a study demonstrating that workers who were distracted by delivery of electronic information scored 10 points lower on an IQ test, doubling the average decline of those taking an IQ test under the influence of marijuana (Harvard Business Review, September, 2009, *Death by Information Overload*, Paul Hemp).



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