

# Planning Now For Your Exit

Joseph Perkins  
Orrick, Herrington & Sutcliffe



April 2012



# Overview

- I. Incorporation Considerations**
- II. Proper Documentation and Record Keeping**
- III. Review and Align Incentives**
- IV. Building your Network**
- V. Right before you Exit**

# Incorporation Considerations

# Incorporation Considerations

## Understand Your Likely Exit

- a. Asset Sale – Single product company, easy to sustain platforms, content companies
- b. Acquisition/Merger – companies where the organization is required to maintain the value of the company.
- c. IPO – High growth potential, dominant company

# Incorporation Considerations

## Understand Your Funding Sources

- a. Friends and Family
- b. Angel Investors
- c. Venture Capital Investors
- d. Private Equity
- e. Government Grants

# Incorporation Considerations

## Get Incorporated Properly

- a. Type of Entity (LLC, C-CORP, etc.)
- b. Jurisdiction of Incorporation – where you incorporate will determine how easy it is to exit (take advantage of corporate laws)
- c. Assign the IP from the start – IP in exchange for equity

# Proper Documentation and Record Keeping

# Proper Documentation and Record Keeping

## Keep Corporate Records

- a. Incorporation Documents (Certificate of Incorporation, Bylaws, etc.)
- b. Board and Stockholder Actions (minutes, actions, special meeting notices)
- c. Forms of Documents (Stock Plan, NDAs, etc.)

# Proper Documentation and Record Keeping

## Employees and Independent Contractor Documents

- a. Offer Letters/Employment Agreements
- b. Consulting/Independent Contractor Agreements
- c. Confidential Information and Invention Assignment Agreements (properly filled out)

# Proper Documentation and Record Keeping

## Other Material Agreements and Documentation

- a. Research Notes and Records
- b. Any and all licenses and IP assignments (no matter how small)
- c. Leases and real property related documents
- d. Notes: All agreements you enter into should contemplate assignment upon a change of control

# Review and Align Incentives

# Review and Align Incentives

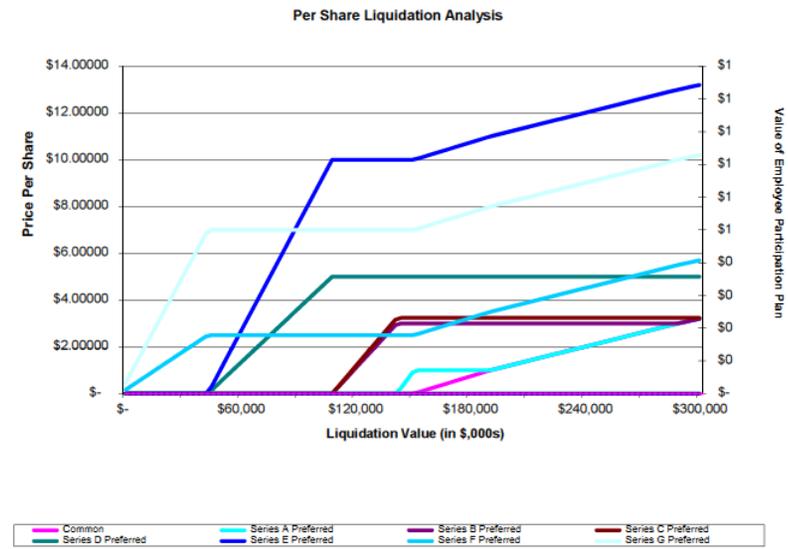
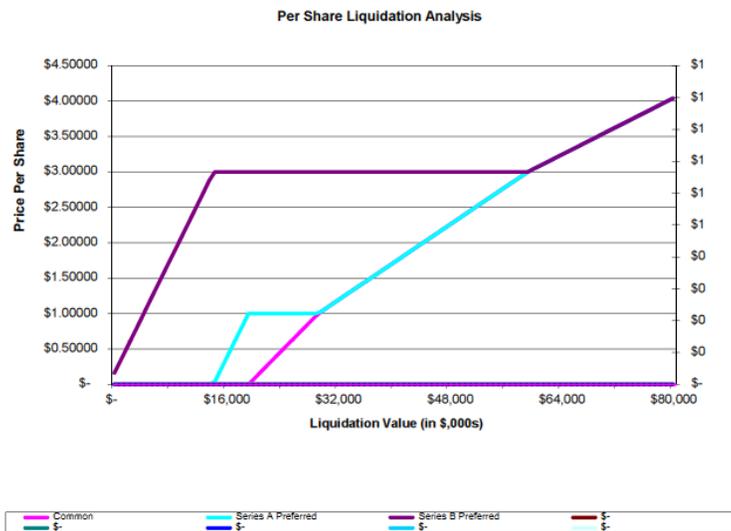
## Vesting Acceleration

- a. What is Vesting?
- b. Single Trigger Acceleration – Acceleration on a single event (Change of Control **or** Involuntary Termination)
- c. Double Trigger Acceleration – Acceleration on two successive events (Change of Control **and** Involuntary Termination) What is Vesting?
- d. What is the cost of acceleration? Who pays for acceleration?
- e. Know what your Stock Plan states

# Review and Align Incentives

## Liquidation Preferences

- What is Liquidation Preference?
- Preferences complicate incentives at the inflection points



# Review and Align Incentives

## Examples of Liquidation Preferences

- a. Typical Preferences
- b. Participating Preferences
- c. Participating Preferences with a Cap

# Review and Align Incentives

## Funding Scenario

- a. 10,000,000 Shares of Common Stock issued at incorporation
- b. Series A Financing - \$10M pre, \$5M raised, \$15M post – 5,000,000 shares of Series A Preferred Stock issued at \$1/share.
- c. Series B Financing - \$45M pre, \$15M raised, \$60M post – 5,000,000 shares of Series B Preferred Stock issued at \$3/share.

# Review and Align Incentives

## Liquidation Scenario 1

Series	Outstanding Shares	Liquidation Preference	Seniority	Participating
Common	10,000,000	n/a	3	n/a
Series A	5,000,000	\$1/share	2	No
Series B	5,000,000	\$3/share	1	No

At \$15M exit:

- Series B gets \$15M (\$3/share), nothing for other Series

At \$20M exit:

- Series B gets \$15M (\$3/share)
- Series A gets \$5M (\$1/share)
- Common gets \$0

# Review and Align Incentives

## Liquidation Scenario 2

Series	Outstanding Shares	Liquidation Preference	Seniority	Participating
Common	10,000,000	n/a	3	n/a
Series A	5,000,000	\$1/share	2	Yes – 2x cap
Series B	5,000,000	\$3/share	1	Yes – 2x cap

At \$40M exit:

- Series B gets \$20M (\$4/share)
- Series A gets \$10M (\$2/share)
- Common gets \$10M (\$1/share)

At \$90M exit:

- Series B gets \$30M (\$6/share – capped)
- Series A gets \$20M (\$4/share - converted to Common)
- Common gets \$40M (\$4/share)

# Review and Align Incentives

## Liquidation Scenario 3

Series	Outstanding Shares	Liquidation Preference	Seniority	Participating
Common	10,000,000	n/a	3	n/a
Series A	5,000,000	\$1/share	2	Yes – no cap
Series B	5,000,000	\$3/share	1	Yes – no cap

At \$60M exit:

- Series B gets \$25M (\$5/share)
- Series A gets \$15M (\$3/share)
- Common gets \$20M (\$2/share)

At \$120M exit:

- Series B gets \$40M (\$8/share)
- Series A gets \$30M (\$6/share)
- Common gets \$50M (\$5/share)

# Building your Network

# Building your Network

## Identify Your Target

- a. Who is in your space?
- b. Who would like to do what you do?
- c. Who has the resources to acquire/purchase your Company?

# Building your Network

## Build Strategic Relationships

- a. Use your target list to pursue strategic relationships
- b. Research and Development Agreements – be very careful about IP ownership
- c. Don't poison your water – your strategic relationships may deter others from offering to acquire you

# Right before you Exit

# Right before you Exit

## Non-Disclosure Agreements

- a. **Must** enter into an NDA with potential acquirers
- b. Disclose confidential information in layers
- c. Do not reveal key components of IP regardless of whether an NDA is in place.

# Right before you Exit

## Accounting considerations

- a. Do you have audited financial statements? (note that if you will need audited financials, this process can be very time consuming, especially if they are needed for several prior years)
- b. Do you comply with reporting company regulations?

# Right before you Exit

## Timing

- a. Depending on your exit, you may need anywhere from 48 hours to 1 year to exit
- b. For long term processes, be careful not to let the process interfere with your ability to run the Company
- c. Determine how much work you will do on your own, and how much advisors, bankers, etc. will do for you

## Right before you Exit

### Should you use a Banker to “Shop the Company”

- a. May widen the field of possible exits
- b. Provides strategic insight into the process
- c. May help with diligence review, production, and coordination
- d. Typically takes a hefty fee for their services (a specific percent of the transaction proceeds rather than a flat fee)

# Right before you Exit

## Diligence Review

- a. Look at all agreements, licenses, contracts, etc. and determine which, if any, need to be amended
- b. Confirm that all corporate documents are in order – go through ratification process to fix anything that can be fixed
- c. Understand where your employees are with respect to vesting, salary, etc., and what their intentions are
- d. Review indemnification agreements and D&O insurance policy (consider tail coverage)

Thank You

**Joseph Perkins**  
**Managing Associate**  
**Orrick, Herrington & Sutcliffe LLP**  
**[jperkins@orrick.com](mailto:jperkins@orrick.com)**  
**(650) 289-7188**

- Attorney Biography and Contact Information

# Joseph Z. Perkins



**Managing Associate, Corporate**  
**Silicon Valley Office, (650) 289-7188**  
**[jperkins@orrick.com](mailto:jperkins@orrick.com)**

Joseph Z. Perkins, a corporate associate in Orrick's Silicon Valley office, is a member of the Emerging Companies Group, which advises emerging companies and venture capital firms. Mr. Perkins's practice focuses on providing private venture financing and merger and acquisition services to Internet, bio-tech, and clean technology companies.

Some of Mr. Perkins's current and former clients include:

- **APTwater** (funded by Kleiner Perkins, XPV Water, and others)
- **Bleacher Report** (funded by Oak Capital, Crosslink Capital, and others)
- **Greenplum** (funded by Meritech, Sierra, Mission and others)
- **Handmark** (company-side acquisitions)
- **Hara Software** (funded by Kleiner Perkins, Nth Power, JAFCO and others)
- **Instagram** (acquired by Facebook)
- **Kona Medical** (funded by Essex Woodlands, Morgenthaler, and Domain Partners)
- **LS9** (funded by Flagship Ventures, Khosla Ventures and Lightspeed Venture Partners)
- **Ooma** (funded by Worldview and others)
- **Ora Therapeutics** (funded by Essex Woodlands, Domain Partners, and Synergy Life Science)
- **SAY Media** - fka VideoEgg (funded by August Capital and others)
- **Xobni Corporation** (funded by Khosla Ventures, First Round Capital, Baseline Ventures, Blackberry Fund and Cisco)
- **WellnessFX** (funded by Javelin Venture Partners, Floodgate and Voyager Capital)

#### Related Practice Areas

Emerging Companies  
Venture Capital and  
Strategic Investments  
Mergers and Acquisitions  
Corporate

#### Education

J.D., Harvard Law School  
B.S., summa cum laude,  
Philosophy, University of  
Utah  
B.A., summa cum laude,  
Japanese, University of Utah

#### Honors

Phi Beta Kappa

#### Languages

Japanese

# Global Office Locations

## BEIJING

Orrick, Herrington & Sutcliffe LLP  
Beijing Representative Office  
22<sup>nd</sup> Floor, South Tower  
Beijing Kerry Centre  
1 Guang Hua Road  
Chaoyang District  
100020  
Beijing  
People's Republic of China  
Tel: +86 10 8595 5600  
Fax: +86 10 8595 5700

## BERLIN

Orrick Hölters & Elsing  
Kurfürstendamm 185  
10707 Berlin  
Germany  
Tel: +49 (0)30 885742-0  
Fax: +49 (0)30 885742-20

## DÜSSELDORF

Orrick Hölters & Elsing  
Heinrich-Heine-Allee 2  
40213 Düsseldorf  
Germany  
Tel: +49 (0)211-36787-0  
Fax: +49 (0)211-36787-500

## FRANKFURT

Orrick Hölters & Elsing  
Friedrichstrasse 31  
60323 Frankfurt  
Germany  
Tel: +49 (0)69-71588-0  
Fax: +49 (0)69-71588-588

## HONG KONG

Orrick, Herrington & Sutcliffe  
43rd Floor, Gloucester Tower  
The Landmark  
15 Queen's Road  
Central, Hong Kong  
Tel: +852-2218-9100  
Fax: +852-2218-9200

## LONDON

Orrick, Herrington & Sutcliffe  
(Europe) LLP  
107 Cheapside  
London  
EC2V 6DN  
United Kingdom  
Tel: +44-20 7862 4600  
Fax: +44-20 7862 4800

## LOS ANGELES

Orrick, Herrington & Sutcliffe  
LLP  
777 South Figueroa Street  
Suite 3200  
Los Angeles, CA 90017-5855  
U.S.A.  
Tel: +1-213-629-2020  
Fax: +1-213-612-2499

## MILAN

Orrick, Herrington & Sutcliffe  
Corso G. Matteotti 10  
Milan, 20121  
Italy  
Tel: +39-02-4541-3800  
Fax: +39-02-4541-3801

## MOSCOW

Orrick (CIS) LLC  
7 Gasheka Street  
Moscow 123056  
Russia  
Tel: +7-495-775-4805  
Fax: +7-495-775-4806

## MUNICH

Orrick, Herrington & Sutcliffe LLP  
Rosental 4  
80331 Munich  
Germany  
Tel: +49 (89)383980-0  
Fax: +49 (89)383980-99

## NEW YORK

Orrick, Herrington & Sutcliffe LLP  
51 W 52<sup>nd</sup> Street  
New York, NY 10019-6142  
U.S.A.  
Tel: +1-212-506-5000  
Fax: +1-212-506-5151

## ORANGE COUNTY

Orrick, Herrington & Sutcliffe LLP  
2050 Main Street, Suite 1100  
Irvine, CA 92614-8255  
U.S.A.  
Tel: +1-949-567-6700  
Fax: +1-949-567-6710

## PARIS

Orrick Rambaud Martel  
31, avenue Pierre 1er de Serbie  
75782 Paris Cedex 16  
France  
Tel: +33-1-5353-7500  
Fax: +33-1-5353-7501

## PORTLAND

Orrick, Herrington & Sutcliffe LLP  
1120 NW Couch Street  
Suite 200  
Portland, OR 97209-4129  
U.S.A.  
Tel: +1-503-943-4800  
Fax: +1-503-943-4801

## ROME

Orrick, Herrington & Sutcliffe  
Piazza della Croce Rossa, 2  
00161 Rome  
Italy  
Tel: +39-06-4521-3900  
Fax: +39-06-6819-2393

## SACRAMENTO

Orrick, Herrington & Sutcliffe LLP  
400 Capitol Mall  
Suite 3000  
Sacramento, CA 95814-4497  
U.S.A.  
Tel: +1-916-447-9200  
Fax: +1-916-329-4900

## SAN FRANCISCO

Orrick, Herrington & Sutcliffe LLP  
The Orrick Building  
405 Howard Street  
San Francisco, CA 94105-2669  
U.S.A.  
Tel: +1-415-773-5700  
Fax: +1-415-773-5759

## SEATTLE

Orrick, Herrington & Sutcliffe LLP  
Columbia Center  
701 Fifth Avenue  
Suite 5700  
Seattle, WA 98104-7097  
U.S.A.  
Tel: +1-206-839-4300  
Fax: +1-206-839-4301

## SHANGHAI

Orrick, Herrington & Sutcliffe LLP  
Shanghai Representative Office  
47/F Park Place  
1601 Nanjing Road West  
Shanghai 200040  
People's Republic of China  
Tel: +86 21 6109 7000  
Fax: +86 21 6109 7022

## SILICON VALLEY

Orrick, Herrington & Sutcliffe LLP  
1000 Marsh Road  
Menlo Park, CA 94025-1015  
U.S.A.  
Tel: +1-650-614-7400  
Fax: +1-650-614-7401

## TAIPEI

Orrick Foreign Legal Affairs  
Attorneys at Law  
Suite G, 12th Floor  
No. 167 Tun Hua North Road  
Taipei 10549  
Taiwan  
Tel: +886-2-2714-8100  
Fax: +886-2-2714-8101

## TOKYO

Orrick Tokyo Law Offices  
*a gaikokuho joint enterprise*  
Izumi Garden Tower, 28th Floor  
6-1 Roppongi 1-Chome  
Minato-ku, Tokyo 106-6028  
Japan  
Tel: +81-3-3224-2900  
Tel: +81-3-3224-2901

## WASHINGTON, D.C.

Orrick, Herrington & Sutcliffe LLP  
The Orrick Building at Columbia  
Center  
1152 15<sup>th</sup> Street NW  
Washington, D.C. 20005-1706  
U.S.A.  
Tel: +1-202-339-8400  
Fax: +1-202-339-8500