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BEST PRACTICES IN FUNDRAISING AND M&A DUE DILIGENCE

Avoiding Nightmares and Optimizing Value

By James Burden, President, Dorset Capital and John Pennett, CPA, EisnerAmper

Everybody loves surprises, unless it's in an M&A context. Surprises during M&A transactions usually cause delays, require remediation, erode value and trust, and often derail deals completely.

The following discourse between an entrepreneur, a buyer, and an expert in virtual data room technology is designed to offer practical suggestions to help dealmakers avoid stumbles and nightmares during the due diligence process and enable a positive outcome to M&A transactions.

Earl the Entrepreneur: I'm going to start with a story about a transaction that went poorly because I think it's a story that entrepreneurs and founders can learn from. There once was an early-stage technology company that was being sold into a public company for a nine-figure price tag. In the course of this journey it was necessary to hire an accounting firm to catch up on unfiled tax returns and to provide an audited financial statement.

The accounting firm very quickly realized that the company's cap table was a "Where's Waldo" of various stock options and share issuances. There was mismatched supporting documentation issued to hundreds of employees and consultants. There were board resolutions that didn't match offer letters, which didn't match the cap table, which didn't match the actual option or share agreement that the employees had signed. Many of these options and shares contained a variety of unique terms and conditions, all of which created a myriad of tax and accounting consequences, which had previously been ignored. **The acquisition process ended up getting stalled for almost two months while the company and their attorneys tried to figure out who actually owned the company. This ended up costing them almost a quarter of a million dollars in legal fees.**

In the end, they wound up having to rescind issuances of shares and options to employees that were below fair value for various tax reasons then reissue them at less advantageous terms to employees. That resulted in a lot upset employees. The company wound up having to book millions of dollars in expenses through their PNL and because they had to reissue these options and shares, they had to reformulate the allocation of these purchase prices to the shareholders.

In short, it was a mess. The lesson here is that entrepreneurs may be great at creating novel technology but might not be so great at understanding the details of founding a company. **My advice to entrepreneurs is to surround yourself with experienced and knowledgeable professionals early so that these kinds of things can be done correctly as early as possible in the lifecycle of the corporation.**

Bert the Buyer: I know of a company that was founded by very talented doctors and scientists. They filed Articles of Incorporation and they created what they thought was a cap table describing who owned what number of shares. They started maintaining minutes of their meetings and they changed the cap table from time to time as they hired new advisors and offered to give them shares. **As it turned out, nothing had actually been done. They had filed a certificate of incorporation, but nothing else. There were no bylaws, no stock issued, even to the founders, no equity incentive plan, nothing.** Apparently, the founders were operating under the mindset that when they got some money later that these were details that a lawyer could sort out. That created a terrible mess and delayed things considerably.

It's important to note that the company side and the buy side have different perspectives. **From the company side, the important thing is to show the buy side that the founders are competent and know what they're doing.**

From the buy side, it's important to do comprehensive due diligence on the target company. Most people are undoubtedly familiar with the Theranos story where the company claimed to have a simple blood test from a small finger stab and the capability of running hundreds of different tests. Millions of dollars were lost and the company crumbled, criminal complaints were filed. That scenario raises three due diligence red flags.

First is in the regulatory area. Their failure to deliver FDA requirements is what later triggered the downfall of the company.

Secondly, there were people issues. A little checking about litigation would have revealed that management had sued several employees who had quit and were seeking to keep them quiet.

The third area is IP. It was discovered later that there were IP lawsuits relating to similar technology and there were new patents being filed at midstream changing the underlying basis of the IP.

All of these examples highlight the importance of good due diligence.

Stan the Security Guy: Let me talk about some of the tools that are available to facilitate the due diligence process. **First and foremost, it's paramount to have a first-rate secure document sharing platform, or virtual data room, at your disposal.** A good virtual data room is critical for providing efficiency and streamlining the due diligence process. It's important that the data room you choose doesn't get in the way but is tailored to increase efficiency and lower risk in these high-value complex multi-party asset-centric business transactions.

These solutions, if they're well designed, bring the level of security, control, traceability, ease of use and auditability that the due diligence process requires and can go along way in preventing a lot of these nightmares.

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1 DECIDING WHEN TO SELL OR RAISE CAPITAL

Earl the Entrepreneur: If I'm thinking about getting investors or an equity infusion I have to think about a couple of key factors. **First I must decide how much control I'm willing to give up.** Do I want active or passive investors? That has a huge impact especially as we're seeing more investment from foreign investors into US companies who tend to be more passive in terms of their management style and their sophistication. Sometimes that lack of sophistication can create problems down the road as they initiate terms and conditions that make things more complicated.

I also have to think about how much money I need and what I plan to do with it. This is always one of the most critical factors when I compose pitch decks and company presentations. **It's important to present a comprehensive understanding and clear narrative of what I'm going to do with those funds.** What kind of story do I have to tell an investor to get them to open up a file on my company?

Bert the Buyer: **Before I will even begin to talk to you I have to decide on the vetting criteria I'm going to use.** Our group has to agree on the target we're after, what stage of growth the company is in, how much revenue or EBITDA needs to be generated, or if we're okay with pre-revenue or close to revenue. Where are we on inventive research? Does it have to be completed? Where are we on all regulatory approvals? Do they all have to be obtained? Will we require evidence of consumer acceptance or recurring revenue?

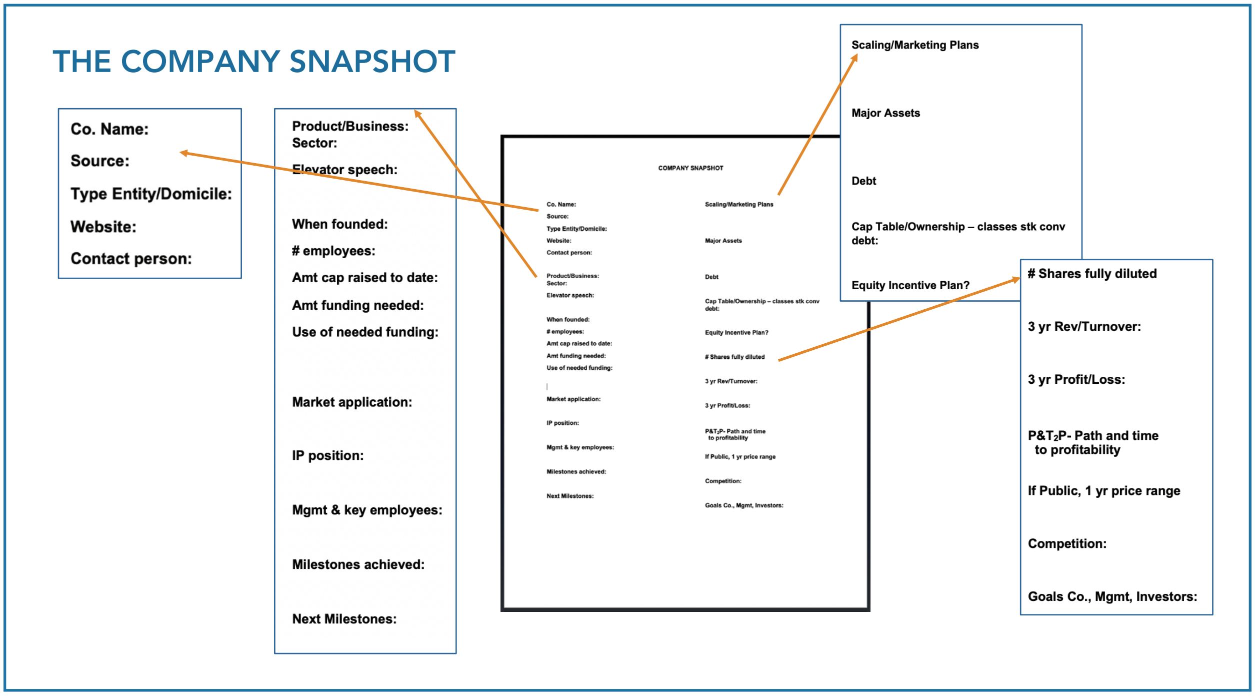
The next question is what are our criteria for manufacturing and scale up capabilities? Every buy-side entity will have different vetting criteria. But I emphasize it's very important for the buy-side to do their homework and come up with their criteria before they start looking at targets.

Earl the Entrepreneur: That goes for the company side as well. **Companies need to vet investors and do some homework so they're not wasting everybody's time.**

Bert the Buyer: Exactly. Both sides can do things to help avoid wasting time. **As a buyer, I'm going to want to see three documents from the target. First is an executive summary that clearly sets out four or five main pitch points and describes the company.**

The second thing is the slide deck. There's an old adage that says that if you can't tell your company's story in 10 to 12 slides, you don't know your company or you don't have a focused business model. I also suggest you have four or five slides held back for questions that I might ask. The important thing during this stage of the process is to establish a dialogue; this shouldn't be a non-stop monologue.

The third document I want to see is the company snapshot. This document evolved over many years of attending investor conferences and spending time talking to CEOs, CFOs and COOs.



Once we've got a grasp of what the company's product and technology is, we will want to look at the business part. Sometimes when we present this document we get a blank stare, but this document really puts forth all the information the buy-side needs to know in order to evaluate and open the file on your company. **This makes the due diligence process run much more smoothly because I don't have to sit there and take the seller through it all.**

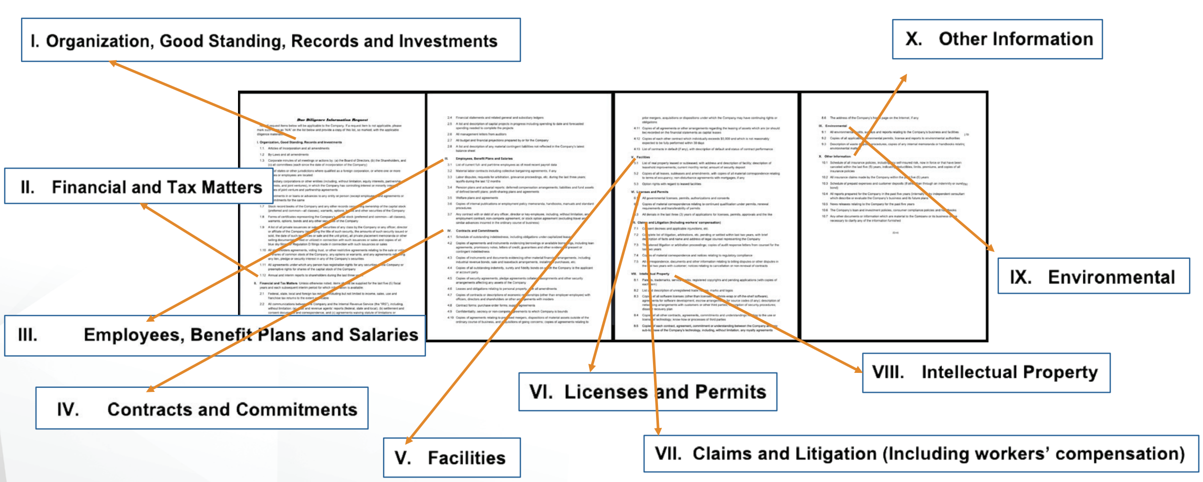
Earl the Entrepreneur: The company snapshot asks for a lot of information, but it's a pretty handy way to summarize a lot of the key facts and figures of the business in one place. All this information exists in my company, but it's probably in disparate systems and in disparate places. I agree it would be helpful to pull it all together in a concise location before we get too far into the due diligence process. **Doing this will also help us identify areas that we need to look at and where we might anticipate we're going to get some challenging questions.**

Stan the Security Guy: When I think about companies responding to a buyer's request for a company snapshot, I think about the way these cloud file sharing platforms enable companies to tell that story in a hyperlinked way and thus very compellingly and concisely. When a document's hyperlinks are preserved in the cloud it makes it very easy to weave multiple documents together making it very easy for counterparties to understand that narrative and really understand where your value resides. An example might be having some prized intellectual property that contains a link to a patent, or perhaps to a partner contract. Maybe it's someone who's licensed your technology and brought it to market all the way through to a successful commercial product. Maybe there are links to documents showing sales results from that. Being able to do that in a way that's really easy for the counterparties to consume can be very advantageous.

2 THE DUE DILIGENCE CHECKLIST & THE IMPORTANCE OF PREPARING EARLY

Burt the Buyer: **Each buy-side entity will have its own due diligence checklist.** There will be differences based on the company, but they're all basically after the same kind of information. You'll see categories that are similar to the broad categories in the company snapshot. **As a buy-side entity, I will always provide the seller with a due diligence checklist and ask them to upload all that information to a cloud-based file sharing platform, like ShareVault, where I can easily and securely review it.**

THE DUE DILIGENCE CHECKLIST



Earl the Entrepreneur: A buyer's request to populate a virtual data room with all the materials on their due diligence checklist can often seem daunting, especially when on a day-to-day basis you're still trying to run the company. **That's why it's important to plan early. It's not a bad idea for companies to compile this information in a virtual data room long before they ever anticipate making an exit.** It's a valuable exercise that will inevitably highlight some of the things that are working out well for the company as well as some things that are in need of remediation. Throughout this process the company's mantra should be preparedness and transparency.

Some companies might even want to consider having a QoE (Quality of Experience) put together by a third party in advance of the due diligence process. Going through the sell-side QoE report can be very valuable, especially if you don't have an audit complete or if the audit you have is dated. A sell-side QoE can help companies better understand and document why certain trends occurred and what business activities resulted in what type of outcomes. A QoE can also help companies identify potential issues and start to develop possible solutions.

Finally, one of the things I want to do is identify some carve-outs and adjust by historical financials to an EBITDA from recurring operations. This is identifying non-cash items, non-recurring items from a private company, or perhaps some personal expense type items that we often see in financial statements.

If a company can extract those and come to a recurring basis EBITDA, they will be in good shape. Sometimes during this process the carve-outs result in increased expenses. There are other cases, such as startups, where the executive team is taking a reduced, or in some cases, no salary. There are also cases where the company has a related party that's giving them a more favorable benefit than the market would. Those all can be adjusted through that EBITDA exercise and create the picture of what a normal profitable business will look like.

The last thing I need to think about as a company executive is who within my organization I want to bring into this conversation and what needs to be done to prepare. Hopefully much of that preparation has already been done. In any case, this is a project plan and a project management assignment that needs to be carefully managed. It's important to think about whom in the organization should be brought in because, ultimately, the buyer is going to want to talk to some of the company's key executives. It's a lot of preparation, but it gives the company a unique opportunity to create a library of documents across all verticals and in the process assess strengths and weaknesses.

Stan the Security Guy: That due diligence checklist can seem like a big homework assignment but it doesn't have to be because a lot of that work can, and should, be done in advance. That's why I always recommend to any company that they always be ready for due diligence, even if they don't think an exit or fundraising is on the horizon. **Because almost all documents are electronic these days, maintaining an updated and organized electronic repository of the majority of a company's business documents is easier than ever.** A robust data room allows you to quickly and effortlessly upload documents, modify the due diligence checklist over time, cater to a buyer's checklist when it arrives, and automatically renumber and reorganize documents and folders as needed while not getting in the way of the business as it evolves.

We also recommend when looking at a due diligence list to add another column with a description of what is expected in that folder. Oftentimes, due diligence lists are constructed in Excel and then dragged into the data room automatically creating a hierarchy of categories. Imagine adding one more column with the detailed description of what's in that index point in the due diligence list. What documents belong there? That then informs the internal team to make sure that the right documents are included. It also informs the reviewing party, or parties, specifically what's included in that area. Doing that provides a high degree of clarity as far as what information is available. Taking advantage of some of these capabilities can help at any time.

In addition, being able to securely share those sensitive documents during the course of business, whether with partners, investors or other third parties provides a great deal of efficiency and allows you to enter into and manage those discussions confidentially. Also, it telegraphs to all the parties that your team engages with externally that your company really does care about information custodianship. In the long run, that accrues to value.

3 SETTING REALISTIC EXPECTATIONS

Earl the Entrepreneur: **Setting realistic expectations is important in order to gain credibility with buyers or investors.** As entrepreneurs, we all see what our competition is doing. We read about funding and M&A deals on TechCrunch and PitchBook and we listen to some of the urban legends to get an idea of what people are doing and what their pre-money valuations are. Sometimes these 8 to 10x EBITDA multiples just don't apply to every business and they need to be adjusted for each unique risk that's embedded in each company.

I know of a company that was in the biosimilars business and was comparing itself to a large and fairly successful public company. The public company had a single biosimilar that it was developing and was using outsourced manufacturing. Their valuation was close to $1 billion. The other company had two biosimilars and they had their own manufacturing facility so they naturally concluded that their company should be worth at least $4 or $5 billion. But they weren't taking into account their unique risks and how far along they were in the process. **You've got to pull your own story together. You have to honestly assess how similar your company is to others including the IP, the command of the markets, the strength and the depth of the management team.**

In that case, they would not have fared very well on any of those points compared to the competitive company. These comparisons to the marketplace and enterprise valuations are useful, but ultimately you need to paint your own story with realistic assessments and your own vision of the future.

Bert the Buyer: One of my greatest concerns is a company's projections. I want everyone on the sell-side to be very aware and cautious about revenue projections, especially beyond three years. Projections of revenue are going to be the equivalent of building a stick to beat yourself with or building a stick that I can beat you with. **We've all seen pitch decks that show hockey stick revenue projections, or what I like to call acres of corn.**

This is based on the fundamentals that if you plant one acre of corn, it generates so many bushels and those bushels can be sold for X dollars per bushel. The next year your projection shows that the company plants 10 acres of corn so the revenue is simply 10 times X. The following year, it's 1,000 acres of corn and 10,000 acres and on and on.

Each year, the revenue is calculated based on a multiple applied to more acres of corn without further explanation.

That's not how a business scale-up works. **My advice is to prepare detailed defensible projections for three years and then after that describe in words, not necessarily numbers, your marketing plan, and your scale-up plan.** The marketing plan will tell how you intend to increase sales. Your scale-up plan will tell how you intend to scale-up production, increase personnel, recruit people, expand facilities, deal with larger supply chain requirements, what additional equipment you need and all the CapX issues. The unexplained hockey stick or acres of corn projections are not a sound thing to do.

Stan the Security Guy: **When I think about expectation setting I think about a company's need to be able to substantiate any of the points they're putting forth.** What is the buyer really going to appreciate and understand? Are the claims being made substantiated by data and hard facts? A virtual data room is the ideal place to store that type of supportive information. **Note that you may have more information than you ultimately need to make available, but at least you have it.** If the buyer wants to dig in on any particular topic, you can readily provide that information to him on an as-needed basis. The data room gives you the flexibility to share what needs to be shared in the context of the buyer's interest. **During due diligence it's always better to have everything ready and organized rather than disrupting the business by having to scramble for it.**

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4 IDENTIFYING TRANSACTION GOALS & OTHER NEGOTIATION TIPS

Bert the Buyer: **Before ever beginning the complex negotiation process, it's important to get your team together and agree on the personal and company goals you want to get out of the transaction.** What do you want to end up with and what does that look like? Once you've identified your goals, you can start a dialogue with the other side. Find out what they want to get out of the transaction. If those goals are largely compatible, the two sides can shake hands and agree to move forward. But if there's not a basic understanding of goals and expectations at the beginning you could just be wasting everyone's time.

Earl the Entrepreneur: **As we go through this process, it's always important to keep in mind that dilution is inevitable, but it's also an opportunity to get ownership in the hands of key management.** It also gives us an opportunity to make sure that we've formalized a lot of the key agreements that we've put together through the years, which may not have been formalized between some of our key suppliers and our partners.

As an entrepreneur, I have to think about a couple of my goals. After this transaction, do I want to have a job? There's almost always a two-year lockup, but what really happens on day one after this transaction? I've never really worked for anybody before. I'm not sure if I like that idea yet. Will I still like that in two years? It's hard to tell. A lot of times entrepreneurs, especially in the tech world, are not used to working for someone else.

I have to think about whether I still want to have control of the company. There's lots of examples of companies who take on a relatively small partner ownership-wise but that partner almost always has the ability to say, "We cannot accomplish our collective goals together unless I bring in a better CEO." Even though they don't have the authority, you've just been fired.

I also have to think about how much control I want to have. Do I want to take some money off the table? Over the last couple of years, this has become a very popular topic, especially in the tech world where venture capitalists are allowing entrepreneurs to take some money off the table. **Finally, am I looking for a smart money partner or am I just looking for money?** Again, with the influx of some of the foreign investors coming into the US and funding US companies, I would say, in many cases, they are not necessarily smart money investors. They tend to be less involved in an organization like some buyers would be.

5 IDENTIFY YOUR VULNERABILITIES & PLAN TO ADDRESS THEM

Stan the Security Guy: **It's important for sellers to identify their weaknesses or vulnerabilities and prepare in advance for how they're going to handle them. I often suggest to fellow entrepreneurs that they do a SWOT analysis on their own company.** That's a Strengths, Weaknesses, Opportunities and Threats assessment. It's a comprehensive assessment that is done from the perspective of a buyer or a partner. Put yourself in the shoes of a buyer, scrutinize your business from that perspective then build fact-based responses to address any weaknesses or threats in advance of any questions coming up. All red flags don't have to be remediated, but they do have to be identified and responded to.

The ShareVault platform has a unique feature that we call a mock Q and A that facilitates this process. Questions from counterparties are received my internal moderators then routed to internal or external domain experts. For example, a legal concern from a counterparty might be routed to an external tax counsel and then the response can be internally reviewed and vetted before sharing the response with the counterparty.

Having the right people, whether internal or external, available to quickly respond to any questions, concerns and potential vulnerabilities, and having the process for that is very important. These types of electronic tools allow you to navigate that process efficiently.

As an example, the ShareVault Q&A module has a feature for anonymizations. If a question comes in from one party that you realize is something that all the parties in the conversation, perhaps multiple bidders, would find relevant, there are ways to anonymize that question and the answer and then share it with whichever parties need to have access to it. That's just one example, but software is moving quickly to provide great methods to lower the risk of vulnerabilities.

Earl the Entrepreneur: Vulnerabilities can be present across the organization but are especially prevalent in finance. **Obviously, GAP record keeping is important, especially in light of new revenue recognition and other standards that are in place. Corporate structure, especially where there's an international subsidiary, needs to be examined.** The Tax Reform Act has changed some of the rules with respect to corporate structure so things like transfer pricing and how you've set up your corporate organization and tax positions becomes really important. It has created a lot of changes in the tax pictures and cash outlay of funds.

Sales tax, especially in the technology world, is almost always identified as an exposure item. It's low-hanging fruit for identification of risk. I recently saw a deal which was requiring a company to do voluntary disclosure filings for certain states where they had not previously filed as a condition to closing. Ultimately that was negotiated in a different way. Instead, they put a larger amount of money into the escrow accounts to deal with that particular exposure.

Another exposure is being to completely capture the fully burdened cost of goods sold. An investor wants to know what the true gross profit margin is to deliver the goods or services, especially in the tech world where it's a combination of data, platform and services. What is the true gross profit? That becomes important as investors think about how to scale the business.

Finally, it's important to understand the uniqueness of the cash flow cycle of the business. Consider things such as seasonality, extended payment terms, rates of returns and other sales rates that are often given in agreements, especially around peak seasons.

Ben the Buyer: **One vulnerability we see a lot is the issue of how a company defines employees versus independent contractors.** One thing we always do during due diligence is look at how many 1099 forms the company has issued. Just recently, the California Supreme Court changed how independent contractors and employees are defined. **Three criteria have to be satisfied in order for a worker to be designated as an independent contractor.** First, they operate free from the control and direction of the company. Second, the worker has to perform work that is outside the usual course of the core business of the company. And third, the worker has to be doing the same kind of activity for others, not just the company. **This distinction is important because it affects tax filings such as employee taxes, withholding taxes, social security contributions, etc.**

The other vulnerability we are starting to see involves foreign investors and foreigners involved in certain types of companies. In August of 2018, a bipartisan Congress passed legislation that expanded CFIUS (Committee of Foreign Investment in the United States). That's an agency that's been around for years but it never used to bother anybody because it was related to rocket science and military technologies, etc. Last August, Congress expanded that scope. Then in November of 2018, the CFIUS committee adopted pilot program regulations that listed 27 sectors that will fall under CFIUS regulations. One of those is biotechnology.

That means that if you have non-US investors making equity investments into certain biotechnology companies or other companies on the list, they may be required before closing to file a notice giving details of their investments to CFIUS. The same rules apply to acquisition of US companies by non-US people.

6 THE IMPORTANCE OF BEING TRANSPARENT

Bert the Buyer: Business partnerships are much like marriages; there are going to be good days and bad days. It's important to put in the work. But even so, there are going to be times when the company's goals may not completely align with the partner. Just like any relationship, it's important to listen as much as possible and try to understand what the other party is conveying. But be prepared; there will be surprises. **Nobody likes surprises because they can cause delays and throw off momentum. However, when there are surprises, don't sweep them under the rug. Be transparent.**

7 THE IMPORTANCE OF PEOPLE ISSUES

Bert the Buyer: No matter what, people are running a company. **It's very important to feel comfortable with the people and interact with them, especially the people that are going to stay on after the closing.** Throughout the whole due diligence process you're going to get a feel for the people. The question is, do you respect them and do you feel that you can work well with them?

I was involved in a deal once and was having dinner with my counterpart in the transaction. At one point he mentioned that he'd had a disagreement with his former partner and there was a big lawsuit. Ten minutes later he mentioned a lawsuit with a supplier. Then he mentioned a pending lawsuit with a group of employees. That's when it became clear that I didn't want to be involved with these types of people.

Earl the Entrepreneur: **During an M&A transaction, I have to think about the people in my organization. How do I get them to buy into the vision of the transaction and what it means for the company?** This is an opportunity to reset expectations, ownership, compensation, impact and perhaps even the responsibilities of some of the key employees. This should be a propelling event and I want everyone to buy into the vision.

I also want to spend some time with the buyer. I want to know who he is and how our business goals are aligned. Does he share the same vision that I do? Have we taken care of the employees to allow them to have an ownership mentality and approach?

8 HOW TO ENSURE THE SECURITY OF DUE DILIGENCE MATERIALS

Earl the Entrepreneur: After identifying an investor or purchaser, hopefully more than one, it's time to think about how much information we want to disclose. **Initially, I'll prepare a non-confidential slide deck and a one-pager for general discussion.** What I won't share at this point are customer names with specific dollar amounts and terms, market strategies, marketing strategies and other proprietary information.

I always assume that my competitors are in the room during the initial presentation. I don't want to give away too much. I need the buyer to be interested in my company, but at this point the specifics are not disclosed.

Stan the Security Guy: **Let me tell you a story about what not to do. I had a company approach me in a panic because that company had used a general purpose, file sync and share solution, the tool any of us might use to have documents on a work computer synced on our home computer.**

This company used that tool for due diligence and then the transaction didn't move forward. This company was horrified to find out that those documents had been synced onto the computers of the other party in the deal and were irretrievable. **I was quick to point out that there are more secure ways of sharing documents, such as a virtual data room that employs bank-grade security and the ability to "remotely shred" documents, even after they've been downloaded.**

I also have a number of companies come to me with concerns about the rampant threats in the digital world from hackers. **Part of the role of any top tier, virtual data room solution or secure document sharing solution is to make sure that everything is encrypted— when it's stored, when it's transmitted, even when it's stored outside the cloud on the desktops of any reviewer's desktop or laptop.**

If a laptop were stolen or left in an airport you need to know that all the information is encrypted at all times. **In some cases, with extremely security conscious organizations, ShareVault provides an extra level of encryption where the customer actually controls the encryption keys themselves.** Even if ShareVault were to receive a subpoena for that documentation they would not be able to provide it. When the system looks at that information all it sees are ones and zeros. Only the customer using those customer-managed encryption keys has the access to that information.

9 STAGING THE REVIEW OF DOCUMENTS

Stan the Security Guy: The due diligence process is a process of gaining trust between the parties. Customer lists, employee names, manufacturing processes and IP are information that is disclosed when the seriousness of the buyer warrants it. There is a sequencing that takes place and a virtual data room is the perfect repository to stage this information. Everything a buyer will ever want to see can be populated in the data room but it's not available to the buyer until the seller flips the switch. This keeps sensitive information secure, but it's also a great tool for driving efficiency. Also, different bidders will be in different stages of the due diligence process. A virtual data room makes it easy to customize who sees what and when.

Earl the Entrepreneur: As we move into due diligence I'm going to decide what we're going to share during Level One and Level Two. Specifically, I'm concerned about sharing details about my IP, the buyer contacting my customers, and how and when I should communicate the pending transaction to my employees. I want to defer many of these topics until I'm assured that the deal is going to happen and my board has approved the transaction.

10 NEGOTIATIONS AND ELEVENTH HOUR DEAL STRUCTURES

Bert the Buyer: Toward the end of a transaction we're going to look at the company's updated financial statements and compare actuals to what we saw six months earlier. There is likely going to be some slippage. In that case, we will likely add some deal structures such as earn outs, look backs, ratchets, escrow, etc. Our goal at this point is to mitigate our risk as much as possible.

Earl the Entrepreneur: As these deal structures are implemented I have to evaluate how confident I am that those milestones can be achieved. These creative deal structures can be a very effective way to bridge the gap between the buyer's expectations of value and my own. But sellers need to be realistic. Throughout this process I've been bragging about my company trying to make it as attractive as possible to the buyer. But can I really meet these projections? I always tell the owners of companies to think about the worst-case scenario. What if for some reason the projected growth doesn't work out as planned and the earn out is not fully achieved? Is the deal still attractive?

Stan the Security Guy: During this entire process it's important to fully communicate. I would encourage buyers to be very inquisitive and for sellers to welcome questions. **Sellers should review the data room's activity reports to see who's spending time in the data room and what they're spending time with.** Be aware of their concerns and make sure they're getting their questions answered. Bring relevant subject matter experts to meetings so that the buyer can be impressed with all the organizational knowledge that's in place. **Then the seller can cater their due diligence priorities to the other side making it easy for the buyer and their attorneys to navigate through the mass of numbers being provided.**

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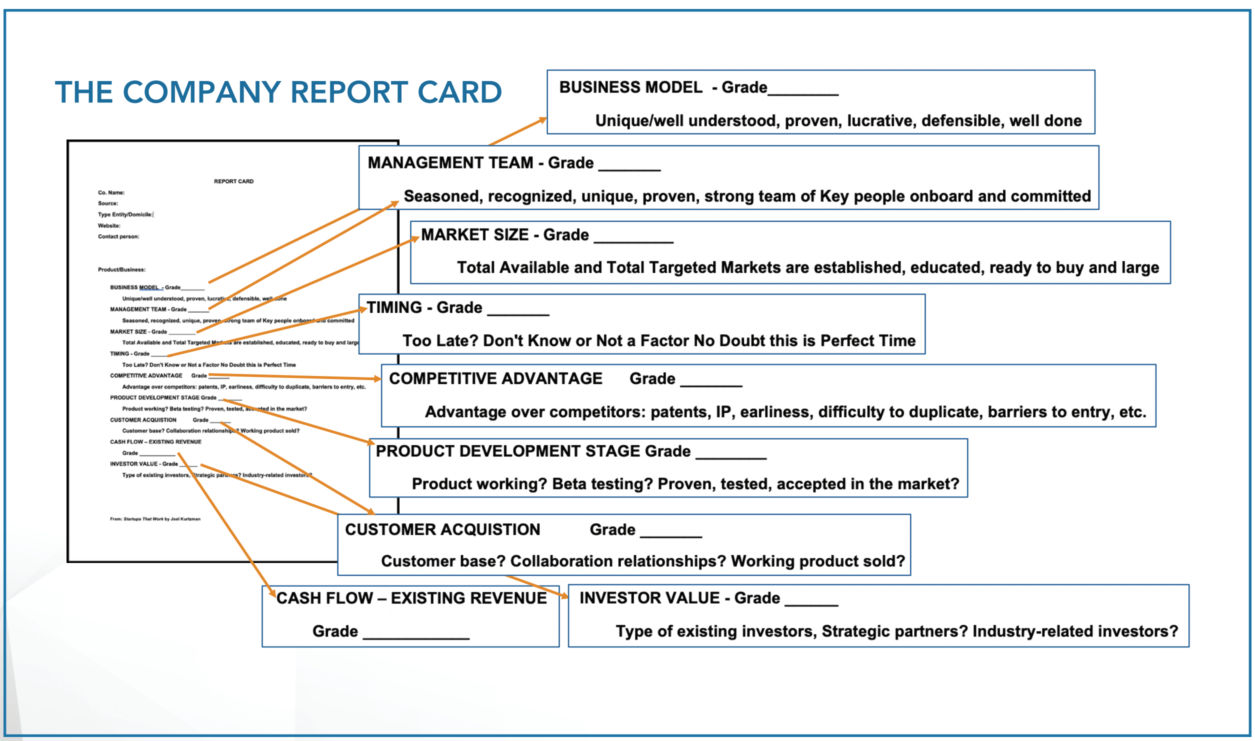
11 CLOSING THE DEAL

Bert the Buyer: **One of the last things I'm going to do before providing a term sheet is grade the target company using the following Company Report Card.**



This comes from a book called *Startups That Work* by Joel Kurtzman. **The author and his research team from some accounting firms spent four years studying 350 companies and they figured out what characteristics there were of companies that failed and those factors that made them successful.** These are the issues, and that's how I'm going to grade.

If we've done proper and significant due diligence our confidence has grown as we've moved forward. We've reviewed all the documentation on the ShareVault platform, we've double-checked the company's marketing strategy and customers and maybe supplier relationships by making some calls and inquiries. We've checked out their IP position and their freedom to operate in the space.

At this point, if the company report card generated the company high marks and we've agreed on the deal structure, I'm going to go talk to my colleagues and the other members of the investment committee and get authority to do a term sheet.

Earl the Entrepreneur: At this stage, I'm comfortable with the relationship I've built with the buyer and his team. I believe they'll provide me with guidance and advice as needed. They're going to help us to grow our business, so we all make a healthy profit. I'm also comfortable that the culture built in the company will not be disrupted and my employees will be excited and invigorated by the deal. We'll be able to get things done that we weren't able to do before because we didn't have the resources.

Stan the Security Guy: As a security guy, I deal in bits and bytes, but I think at this point, we should talk about you guys having successfully managed your due diligence process and come to a mutually beneficial agreement that should be a different kind of bite: **you should be planning a fantastic celebratory dinner.**

About James Burden

President, Dorset Capital LLC

James E. Burden has over 40 years of experience in corporate finance, law practice, and business operations and is President and majority owner of Dorset Capital, LLC.

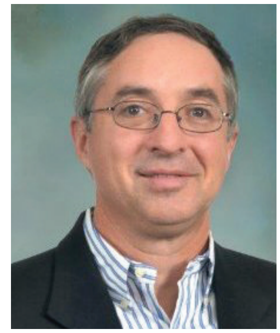
Mr. Burden's involvement with co-founding, financing and operating companies in the U.S. and United Kingdom commenced in the 1980s when he was elected an Underwriting Member/Name of Lloyd's of London. Through his Lloyd's connections in the City of London, he began working with Small and Medium Enterprises in the U.K.

In 2001, Mr. Burden was a founding director of EuroGen Pharmaceuticals Ltd., a U.K. company formed to seek European regulatory approvals of a NASDAQ-listed company's drug portfolio. He also was a founding director of Gloucestershire Innovation Centre, which was formed to develop and manage incubation facilities in the Bank of England's Southgate House in the center of Gloucester, England. Partners included St. John's College Cambridge Innovation Centre, the University of Gloucestershire, and HSBC Bank.

In 2005, he was a founding director of Emiliem, Inc., a Delaware corporation. Emiliem, Inc is a private biotechnology company currently focused on all aspects of the drug discovery and development process. This includes understanding the molecular determinants of target modulation as it relates to the efficacy of therapeutics and to potential adverse drug reactions, and diagnostic markers for rare diseases and the computational aspects of predicting both positive and negative patient outcomes.

Mr. Burden received a B.S. degree from the School of Business Administration, University of California, Berkeley (Haas School of Business), a J.D. degree from the University of California, Hastings College of Law, and did post-J.D. studies at the Graduate School of Law, University of Southern California. He is an active member of the California State Bar, a member of The Faculty Club, University of California, Berkeley, and a Fellow of the Institute of Directors, London.

About John Pennett



Partner-in-Charge of the Life Sciences Group and Technology Group, EisnerAmper

John Pennett has 30 years of public accounting experience, with a strong emphasis on public and private life science and technology companies. John is a frequent writer and speaker on topics related to issues impacting businesses in the life sciences and technology space. He is the publisher of Catalyst, a magazine focused solely on issues related to life sciences and pharmaceutical companies. John supports entrepreneurial organizations around the country with content and program development, and serves as a mentor to several early-stage companies.

John has led the accounting, auditing and strategic advisory work for more than a hundred IPOs, private financing and mergers and acquisitions with an aggregate valuation in excess of $1 billion. In addition, he has served as the interim lead of the firm's Risk Advisory Practice, leading internal audit, contract compliance and Sarbanes-Oxley implementation and testing. John previously worked as an Audit Partner for an international accounting and consulting firm.

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Headquarters
16795 Lark Avenue, Suite 210
Los Gatos, CA 95032