



Gridley & Company_{LLC}

Considerations for Selling a Private Company

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I. Private Company Sale Considerations

Summary

- **Management and Shareholder Objectives (Price, Ongoing Involvement Post Transaction, etc.)**
- **Purchase Price and Valuation Methodology**
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- **Transaction Structure (Asset vs. Stock Transaction)**
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- **Type of Sale Process (Exclusive Negotiation, Limited Auction, Full Auction)**
- **Timing of a Sale Transaction**
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- **Tax Considerations**
- **Potential Legal Considerations**
- **Change of Control Provisions**

Management and Shareholder Objectives

- **Shareholders and management may have different priorities regarding the sale of the business**
 - Price vs. right buyer – maximize price vs. find the right “home” for the business and the employees
 - Timing – take advantage of market timing vs. CEO’s personal objectives
 - Decision making process – investors may own more shares, but CEO’s often want equal control / influence in the transaction decision
 - Ongoing CEO involvement – buyers often need this as part of transaction
 - Sometimes causes a conflict between shareholders and company management

Purchase Price and Valuation Methodology

- **Price is often the most heavily negotiated point between buyers and sellers**
- **Factors that affect price include:**
 - Financial performance of the business
 - Revenue
 - Earnings
 - Cash flow
 - Strength of market positioning and potential barriers to entry
 - Management (strength, depth, experience)
 - Client relationships (strength, depth, concentration)
 - Proprietary technology, methodologies, or other unique characteristics
 - Other strategic relationships
 - Economic and market conditions
- **Several valuation methods exist including:**
 - Discounted cash flow analysis
 - Current trading multiples of comparable public companies
 - Transaction multiples of recent comparable M&A deals
 - Leveraged buyout analyses

Form of Consideration

- **Type and method of payment is dependent upon a wide variety of factors, including taxes, accounting, and regulatory issues**
- **Cash**
 - Least complex type of consideration
 - Buyer may hold back a portion of the cash purchase price (or place it in escrow) to be used as an offset against undisclosed liabilities or misrepresentations or breaches of warranties by the seller
- **Common stock – privately held company**
 - Valuation can be challenging
 - Liquidity issues
- **Common stock – publicly traded company**
 - Must decide when to value the stock of a public company
 - Changes in the market after the value is calculated but before the stock is delivered at closing will affect the price paid for the business
 - Sellers want consideration measured in dollars, rather than shares, while buyers prefer a fixed ratio so that it has control over the number of shares to be issued and the effect on its earnings per share
 - Collars can be used to limit the risk of volatility, with a right of termination or an adjustment when the collar thresholds are reached or exceeded

Form of Consideration (continued)

- **Preferred stock**
 - Form of financing for the buyer
 - Provide dividends to the seller

- **Payment deferral (e.g. escrow account)**
 - Acts as an offset against undisclosed liabilities or other breaches by the seller

- **Earn-outs and contingent payments**
 - Post-closing payments based on the performance of the business after the closing
 - Typically used when
 - Buyer and seller are unable to agree on the value of the business
 - Business is subject to significant future developments affecting value
 - Buyer plans to retain the seller to manage the business after the closing and wishes to provide a performance incentive
 - Enables sellers to defer some taxes on gain from the sale

Transaction Structure

- **Stock sale**
 - Selling corporation continues to exist and maintains all of its assets, liabilities, and contractual relationships
 - If the stock is owned by more than one shareholder, each must agree to the sale for the buyer to acquire all of the outstanding stock
 - A buyer that acquires at least 90% of the stock may be able to effect a merger which will eliminate any minority shareholders
- **Asset sale**
 - Buyer acquires certain assets and assumes specified liabilities and contractual relationships
 - Permits and licenses of the selling corporation generally must be reissued to the buyer, and the buyer may need to obtain the consent of contracting parties to the assignment of contract rights
 - The documents required to effect an asset sale are typically more involved than those for a stock sale or merger
 - Despite this, asset sales are often attractive to a buyer because it acquires only specified liabilities and may be able to avoid assuming unwanted or unknown liabilities
 - Allocation of the purchase price among the various assets is required

Transaction Structure (continued)

- **Merger**
 - One corporation remains intact or “survives”; the other corporation ceases to exist as a separate entity or “disappears”
 - Selling corporation’s permits, licenses, leases of real and personal property, and other legal and contractual rights generally will continue in force without separate action
 - The disappearing corporation’s assets, including legal and contractual rights, automatically vest in the surviving corporation

Potential Effect on Customer Relationships

- **Most of the time customers are amenable to a new owner**
 - Customers want assurance the level of service they have received will not diminish under new ownership

- **Occasionally, customers are excited about the prospects of working with the new owner**
 - The new owner may offer additional services that the customer sees as beneficial

- **Occasionally, customers express concern over the buyer**
 - The buyer may have conflicting client relationships
 - The customer may have had a bad experience with the buyer during a past relationship

Type of Sale Process

Process	Advantages	Disadvantages	Works Best
<p>Full Scale Auction</p> <ul style="list-style-type: none"> ● Intended to create maximum interest & competition among multiple potential buyers ● Likely announcement for public companies: "Evaluating strategic alternatives" ● Contact broad number of potential buyers ● Highly structured process: <ul style="list-style-type: none"> – Dissemination of information – Solicitation of bids – Negotiation of Purchase & Sale contract 	<ul style="list-style-type: none"> ● Intended to maximize value to Seller by maximizing competition among potential buyers ● Broadest cross-section and largest number of potential buyers are given opportunity to participate ● Highly structured process is intended to increase the Seller's ability to compare and evaluate all bids from potential buyers on the same basis and timetable 	<ul style="list-style-type: none"> ● Typically is the lengthiest and most complex process ● Typically requires public disclosure of process if public company (or risk unauthorized disclosure or rumors of sale) ● Broad dissemination of Seller information may be problematic ● Loss of credibility if process does not result in satisfactory outcome ● Some potential buyers may refuse to participate in auction process 	<ul style="list-style-type: none"> ● Seller is an attractive company with moderate to large number of potential buyers ● Most likely or preferred Buyer is not readily identifiable ● Public or internal disclosure of sales process to employees, customers, and others is not problematic ● No significant due diligence problems ● Seller is committed to the process and outcome of selling the business
<p>Limited Auction</p> <ul style="list-style-type: none"> ● Intended to create competition among a limited number of potential buyers ● Optional public announcement for public companies: "Evaluating strategic opportunities" ● Contact a carefully selected numbers of potential buyers ● Highly structured process <ul style="list-style-type: none"> – Dissemination of information – Solicitation of bids – Negotiation of Purchase & Sale contract 	<ul style="list-style-type: none"> ● Intended to maximize value to Seller by creating competition among limited potential buyers ● May not require public disclosure if confidentiality of process is important ● Limited distribution of confidential information ● Highly structured process is intended to increase the Seller's ability to compare and evaluate all bids from potential buyers on the same basis and timetable 	<ul style="list-style-type: none"> ● May not maximize value if certain potential buyers are excluded from process ● May be a lengthy and complex process ● Risk of unauthorized disclosure or rumors of sale if public disclosure is not made ● Potential loss of credibility if process does not result in a satisfactory outcome ● Some potential buyers may refuse to participate in auction process 	<ul style="list-style-type: none"> ● Seller is an attractive company with multiple potential buyers ● Most likely or preferred Buyers are reasonably identifiable ● Seller seeks a competitive sales process but wants to limit the number of potential buyers to maintain confidentiality of process and Seller information ● No significant due diligence problems
<p>Exclusive Negotiations with a Single Buyer</p> <ul style="list-style-type: none"> ● Exclusive discussions/ negotiations with a single potential buyer (or very limited number of potential buyers) ● No public announcement ● Process is highly customized to meet the desires of Seller and potential buyer(s) 	<ul style="list-style-type: none"> ● Often is the most direct process which minimizes time and other requirements on Seller ● Maximizes confidentiality of process ● Maintains flexibility to pursue other sales alternatives 	<ul style="list-style-type: none"> ● Lack of competitive process may not result in maximum value to Buyer ● Greater possibility of no transaction if the selected potential buyer loses interest (but can always restart process with other potential buyers) ● Can be significantly longer process and time commitment if transaction falls through and need to go to other potential buyer(s) 	<ul style="list-style-type: none"> ● Preferred Buyer is readily identifiable ● Confidentiality of process and Seller information is critical ● Seller seeks to complete a transaction as quickly as possible ● Significant due diligence problems require a heavily negotiated or structured transaction

Timing of a Sale Transaction

- The time from the initial consideration of a decision to sell until the closing of a transaction may range from a few months to more than a year
- The following time line illustrates the scheduled timing of a full auction sale process using a financial advisor
 - A negotiated transaction with a single buyer could be shorter or longer than this

Timing	Full Auction
Weeks 1-5	<p style="text-align: center;"><u>Phase I: Initial contact and Qualification</u></p> <ul style="list-style-type: none"> • Agree on broad group of potential strategic acquirers (10-30 candidates) • Draft "teaser" letter (2-3 pages) and Descriptive Memorandum (25-35 pages) • Begin to contact potential acquirers; negotiate confidentiality agreements <ul style="list-style-type: none"> • Contact potential acquirers; negotiate confidentiality agreements • Distribute Descriptive Memorandum • Receive preliminary indications of interest on designated deadline • Select/invite best candidates to Phase II of the process
Weeks 6-12	<p style="text-align: center;"><u>Phase II: Due Diligence</u></p> <ul style="list-style-type: none"> • Conduct management meetings and data room visits • Distribute draft purchase agreement
Weeks 13-14	<p style="text-align: center;"><u>Phase III: Bid Process</u></p> <ul style="list-style-type: none"> • Receive offers together with marked up purchase agreements • Negotiate offers/purchase agreements with select candidate(s) • Sign purchase agreement with winning party
Weeks 15-18	<p style="text-align: center;"><u>Phase IV: Closing</u></p> <ul style="list-style-type: none"> • Satisfy closing contingencies and audit requirements • Close

Role of Outside Advisors

- **Outside advisors should be retained to assist in evaluating, planning, and effecting a sale**
- **Key advisors include:**
 - Financial advisor
 - Outside legal counsel
 - Accountant
- **It is important that the advisors work well together and collectively have the expertise to properly guide the seller towards a successful transaction**
- **Roles of advisors**
 - *Financial advisor:*
 - Identify a list of potential buyers
 - Prepare a descriptive memorandum
 - Contact potential buyers, negotiate confidentiality agreements, and distribute the descriptive memorandum to potential buyers
 - Manage a broader due diligence, bidding, and negotiation process
 - Assist in the negotiation of the terms of the transaction
 - Evaluate the attractiveness of offers relative to alternative strategies

Role of Outside Advisors (continued)

- *Outside legal counsel:*
 - Coordinate corporate and legal due diligence for the company
 - Provide legal advise regarding transaction structure issues
 - Draft and assist in the negotiation of a Definitive Sale Agreement
 - Assess any other potential legal considerations in the transaction

- *Accountant:*
 - Preparation of financial statements
 - Provide audit work papers for audited financial statements to potential buyers
 - Assist in preparation and coordination of financial due diligence

Tax Considerations

- **Tax issues for the seller and buyer can be critical in the sale of any business and will be a driving force in structuring the transaction**
- **Seller's accountants should calculate the amount of gain to be recognized on appreciated assets and whether the gain will be taxed as capital gain or ordinary income**
- **The initial choice facing corporate sellers, from the standpoint of the federal income tax, is between a taxable and a tax-free (tax deferred) transaction**
 - Decision dictated largely by the amount of gain or loss to be recognized by the shareholders and by the form of payment of the purchase price
- **Taxable transactions may involve two levels of tax**
 - Corporate level tax on the sale
 - Shareholder level tax when the proceeds of the sale are distributed to the shareholders
- **Taxable transactions**
 - Stock acquisition by purchase or merger
 - Asset acquisition by purchase or merger
 - Stock acquisition treated as an asset acquisition under Section 338(h)(10) of the Internal Revenue Code

Tax Considerations (continued)

- **Stock sale**

- Seller generally will recognize gain or loss measured by the difference between the consideration received and the seller's tax basis in the shares
 - Gain or loss will generally be long-term capital gain or loss if the shares are held as capital assets for more than one year
- The tax attributes of the target, including the basis of the assets, are generally unchanged, subject to the limitations on the buyer's use of any net operating loss or credit carry-forward

- **Asset sale**

- Buyer and seller each file a form with the Internal Revenue Service that allocates the purchase price in a taxable transaction among the various categories of assets acquired
- Selling company will recognize gain or loss on an asset-by-asset basis, and the gain or loss will be taxed as ordinary income or loss or capital gain or loss, depending on the character of each asset

Tax Considerations (continued)

- **Section 338(h)(10) sale**
 - Treated for corporate law purposes as a stock acquisition but for tax purposes as if the target had sold all its assets and then distributed the proceeds to its shareholders in liquidation
 - Amount of gain or loss, and the character of the gain or loss as capital or ordinary, would be determined on an asset-by-asset basis
 - Qualifying target companies include members of a selling consolidated return group, members of a selling affiliated group filing separate returns, and S corporations
- **Tax free (deferred) transaction**
 - Shareholders receive no more than 50% to 60% in cash or other non-qualifying consideration (commonly called “boot”)
 - Remainder in stock of the acquiring company
 - To achieve a tax-free transaction, sellers must be willing to accept some exposure to market volatility, i.e., the risk that the value of the stock received will decline

Potential Legal Considerations

- **Securities laws**
 - Sale of shares of a closely-held business usually will be exempt from registration, but registration becomes an issue when the consideration being offered includes securities of a publicly traded buyer
- **Antitrust laws**
 - Hart-Scott-Rodino Antitrust Improvements Act of 1976
 - Prohibits acquisitions that “may substantially lessen competition, or tend to create a monopoly”
 - Notice must be sent to the Federal Trade Commission and the Department Of Justice
 - No transaction is reportable unless it results in the buyer holding more than \$50 million of assets or voting securities of the acquired business
 - For transactions valued from \$50 million to \$200 million, one party to the transaction must have sales or assets in excess of \$100 million and the other party must have sales or assets in excess of \$10 million
 - Transactions valued in excess of \$200 million must be reported regardless of the size of the parties

Potential Legal Considerations (continued)

- **Exon-Florio**
 - Allows the US government to determine the national security effect of proposed acquisitions of US enterprises by foreign persons and mandate such investigations when a foreign buyer is controlled by or acting on behalf of a foreign government

- **Worker Adjustment and Retraining Notification Act of 1988**
 - WARN requires employers to give at least 60 days advance written notice of certain office closings and mass layoffs to the affected employees
 - Applies to any employer with at least 100 full-time employees

Change of Control Provisions

- **Change of control provisions should be identified and assessed prior to entering into negotiations with a prospective buyer**
- **These provisions represent potential risks to a buyer and should be addressed early on in the process**
- **Change of control provisions may exist in one or several business contracts including:**
 - Employment agreements
 - Client contracts
 - Leases
 - Vendor agreements
 - Bank debt / line of credit

II. How to Affect the Value of Your Business

Summary

- **Surround yourself with an experienced, broad management team capable of running the business without you**
- **Position your company effectively in the market place**
- **Differentiate your service offerings from those of your competitors**
- **Develop and utilize proprietary technology for your core service offering**
- **Evaluate the proper time to sell in order to meet both your business and personal objectives**
- **Consider making complementary, strategic acquisitions that help grow and diversify your business**
- **Establish a Board of Directors / Advisory Board**
- **Choose advisors that are knowledgeable, trusted, and respected in order to get the deal done efficiently**



Surround Yourself with the Right Team

- **Your senior management will play a key role in the sale of your business**
- **Don't let your business be a "one-man band"**
 - Buyers need to know that business will be sustained once the owner has left the company
 - A significant portion of sales should be generated by team members other than the company's owner
- **Broad, experienced management team**
 - A broad management team provides comfort to a buyer that the business can sustain the departure of a senior team member
 - Each management member should be seasoned in his/her field to provide assurance of capability
- **Depth of management**
- **Management that will present well to buyers**
 - Perception is reality
 - Buyers will gain confidence in management's ability if they appear confident and knowledgeable about the business and their respective role with the organization

Position the Company Effectively

- **Positioning your business properly is essential to maximizing value**
- **Positioning the company entails identifying its key attributes and issues**
- **Determining how to properly position the company is an iterative process between the company and its financial advisor**
- **Different ways to position a company include:**
 - Industry leader
 - Industry innovator
 - High growth
 - Stable performer
 - Proprietary technology / information
 - Marquee client relationships
- **It is also important to give careful consideration to the positioning of a company's weaknesses**

Differentiate Your Service Offerings

- **Uniqueness adds value**
- **Differentiated offerings include:**
 - Proprietary technology
 - Proprietary information
 - Proprietary relationships
- **Buyers will not pay a premium for a commodity service offering**
 - Barriers to entry is a key factor



Develop Proprietary Technology

- **Investments in research and development can pay off substantially when selling your business**
- **Companies that utilize truly proprietary technology sell at a premium**
- **Development and utilization of proprietary technology adds value to your business because it:**
 - Differentiates the business from competitors
 - Provides a valuable asset to a buyer
 - Demonstrates that the service offering is not a commodity
 - Adds a dimension of “stickiness” to the service offering

Be Flexible in Evaluating the “Right” Time to Sell

- **Business owners must balance personal and business objectives with existing market conditions when considering selling their business**
- **The right time to sell from a personal and business perspective often do not align**
 - Business owners often want to sell their business and retire or start a new venture
 - Economic and market conditions may not be optimal at that time
- **Sellers must be flexible and opportunistic in order to maximize valuation**
- **Optimal time to sell is 2 – 3 years prior to retirement objective**
- **It’s always good to consider transactions in optimal market conditions (i.e., internet bubble in the late 1990s)**

Consider Making Strategic Acquisitions

- **The right acquisition can increase the value of your business quickly**
- **Benefits to strategic acquisitions include:**
 - Add additional clients and decrease client concentration
 - Add new vertical market experience
 - Broaden the experience and capabilities of your senior management team
 - Fuel top-line and potentially bottom-line growth
 - Expand geographic presence
 - Enhance cross-selling opportunities
 - Add / enhance service offerings
- **The wrong acquisition can be devastating to your business**
- **Risks to acquiring a company include:**
 - Unexpected poor financial performance
 - Unforeseen law suit
 - Bad chemistry between senior management

Establish a Board of Directors / Advisory Board

- **A Board adds an additional level of credibility to your company**
- **The Board should be made up of respected industry veterans with diverse experiences**
 - This will help you assess issues from multiple perspectives
- **The Board will help to:**
 - Provide insight on a variety of business issues, including emerging issues in a dynamic world
 - Make “tough” decisions
 - Institute financial discipline and accountability
 - Generate potential new business opportunities given their interest in and updated knowledge of your company

Choose Your Advisors Wisely

- **Selecting an advisor remains a relationship driven activity**
- **It is beneficial to meet with several prospective advisors before making a selection**
 - This will enable you to not become familiar with different bankers, but also with different styles and approaches
 - Also, this process will help you find the “right fit” for you and your company
- **When selecting an advisor, the following should be considered:**
 - Reputation
 - Industry expertise
 - Relationships with relevant companies (e.g., prospective buyers)
 - Senior level resources to devote to the transaction

Appendix A

Exclusive Sale Process Summary

Summary Sales Process

<u>Timing</u>	<u>Full Auction</u>
Weeks 1-5	<p style="text-align: center;"><u>Phase I: Initial contact and Qualification</u></p> <ul style="list-style-type: none"> • Agree on broad group of potential strategic acquirers (10-30 candidates) • Draft "teaser" letter (2-3 pages) and Descriptive Memorandum (25-35 pages) • Begin to contact potential acquirers; negotiate confidentiality agreements <ul style="list-style-type: none"> • Contact potential acquirers; negotiate confidentiality agreements • Distribute Descriptive Memorandum • Receive preliminary indications of interest on designated deadline • Select/invite best candidates to Phase II of the process
Weeks 6-12	<p style="text-align: center;"><u>Phase II: Due Diligence</u></p> <ul style="list-style-type: none"> • Conduct management meetings and data room visits • Distribute draft purchase agreement
Weeks 13-14	<p style="text-align: center;"><u>Phase III: Bid Process</u></p> <ul style="list-style-type: none"> • Receive offers together with marked up purchase agreements • Negotiate offers/purchase agreements with select candidate(s) • Sign purchase agreement with winning party
Weeks 15-18	<p style="text-align: center;"><u>Phase IV: Closing</u></p> <ul style="list-style-type: none"> • Satisfy closing contingencies and audit requirements • Close

Description of Exclusive Sale Process:

- **Phase I: Initial Contact and Qualification (Weeks 1-5)**
 - Prospective purchasers identified
 - Identify key investment considerations
 - Prepare/update valuation analysis
 - Historical and projected financial data
 - Industry and transaction comparisons
 - Discussion of dynamics
 - Other considerations
 - Prepare two page summary (“teaser”)
 - Prepare confidentiality agreement
 - Update descriptive memorandum
 - Review candidates with management
 - Rationalize strategic fit
 - Prioritize candidates
 - Approach candidates, evaluate level of interest and send “teaser”
 - Distribute confidentiality agreements (CAs)
 - Provide Descriptive Memorandum after CA is returned

Description of Exclusive Sale Process:

- **Phase II: Due Diligence (Week 6-12)**
 - Candidates provide initial indication of interest. If an indication is acceptable They will be invited to the data room and to meet with management:
 - Assemble data room material for due diligence
 - Refine management presentations for one-on-one meetings with potential purchasers
 - Prepare draft purchase contract
 - Select best candidate(s)
 - Schedule site visits within a proximate time frame
 - Schedule remaining due diligence sessions
 - Remaining information requests satisfied
 - Information deferred to post contract, pre-closing stage
 - Distribute draft purchase contract
- **Phase III: Bid Process (Weeks 13-14)**
 - Receive binding offers and marked purchase contract on designated deadline
 - Select best package/candidate with whom to negotiate exclusively
 - Negotiate final purchase contract
 - File regulatory documents, if necessary
 - Public announcement

Description of Exclusive Sale Process:

- **Phase IV: Closing (Weeks 15-18)**
 - Satisfy remaining diligence
 - Satisfy closing contingencies
 - Closing financials/audits (if required)
 - Await regulatory clearance
 - Finalize documents

Appendix B

Exclusive Sale Memorandum Outline

Sale Memorandum Table of Contents

- **Executive Summary**
- **Investment Highlights**
- **Industry Overview**
- **Company Overview**
 - Background
 - Products and Services
 - Target Markets and Clients
 - Business Development
 - Technology and Intellectual Property
 - Competition
 - Growth Strategies
- **Legal Structure**
- **Management and Employees**
- **Facilities**
- **Financial Overview**

Sale Memorandum- Information Requests

I. Executive Summary

II. Investment Highlights

III. Industry Overview

- Industry statistics

IV. Business Overview

A. Background

- Descriptive background on the Company's business
- Graphics / flowcharts depicting the Company's evolution and key events

B. Products And Services

- Descriptive information on the Company's services / products
- Graphics depicting services / products
- Articles written about the Company's business
- List of partners

Sale Memorandum- Information Requests

IV. Business Overview (cont.)

C. Targeted Markets and Clients

- List of clients
- Provide contracts for major clients

D. Business Development

- Descriptive information on business development efforts
- Provide sales pipeline
- Graphics depicting sales cycle

E. Technology And Intellectual Property

- Descriptive information on technology and intellectual property
- List of technology and its capabilities
- List of intellectual property (e.g., patents, etc.)
- Graphics depicting technology and its capabilities



Sale Memorandum- Information Requests

IV. Business Overview (cont.)

F. Competition

- Descriptive information on competition
- Graphic depicting the competitive landscape

G. Growth Strategies

- Descriptive information on growth initiatives
- Quantitative information on new market opportunities (sizing, penetration rates)

V. Legal Structure

- Graphic on organization structure of the company

Sale Memorandum- Information Requests

VI. Management and Employees

- Organization chart by function
- List all employees by organization function and location
- List compensation of each employee including salary, bonus, and other items
- Detailed description of compensation plan for sales staff, i.e. salary, draw, commission, bonus, etc.
- Provide all senior management employment contracts
- Biographies / resumes for key employees

VII. Facilities

- List of facilities, square footage, purpose, annual rent, and lease expiration of each facility

Sale Memorandum- Information Requests

VIII. Financial Overview

- Provide audited, reviewed, or compiled financial statements for the past 3 years.
- Provide historical internal financial statements for the past 3 years on a quarterly basis.
- Provide historical internal financial statements for the monthly periods since the close of the prior fiscal year.
- Provide projected financial statements on a quarterly basis (2008 & 2009, if available).
- Provide a schedule of all clients and revenue per client for the past 3 years.
- Provide a schedule listing all shareholder names, number, and type of shares owned.
- Describe reasons for significant fluctuations in the Company's income statements over the past 3 years.
- Provide a schedule of all non recurring items which appear in the Company's last 3 fiscal year income statements and year to date income statements.
- Provide budgeted forecast compared to actual performance and a description of variances for the past 3 years.

Appendix C

Due Diligence Checklist

Due Diligence Checklist – Corporate Matters

- Certificate of Incorporation and all amendments thereto.
- By-laws, as amended to date.
- All corporate books and records containing minutes of all meetings (and written consents in lieu of meetings) of the board of directors (and committees thereof) and shareholders of the Company since its date of incorporation.
- All stock transfer and stock certificate books.
- All voting trust, proxy and shareholders' agreements.
- All indemnification agreements between the Company and/or its affiliates and its officers or directors.

Due Diligence Checklist – Corporate Matters

- All stockholder and other agreements, instruments and other documents which in any way restrict or may restrict any sale, transfer, assignment or other disposition of the assets or capital stock of the Company.
- All agreements relating to outstanding subscriptions, options, warrants, rights or privileges, preemptive or contractual, and all stock option plans to acquire any shares of capital stock of the Company, or any securities or obligations of any kind convertible into any class of capital stock of the Company.

Due Diligence Checklist – Financial Matters

- All written business plans, budgets and projections, and all written comparisons of actual results of operations and plans, budgets and projections, for the Company prepared during the last three years.
- All currently effective loan agreements, indentures, credit agreements, factoring agreements, letters of credit and any other instruments pertaining to indebtedness incurred by the Company and all related material documentation including, without limitation, all agreements and documents evidencing bank lines of credit currently available to the Company.
- All documents and agreements evidencing other financial arrangements currently in effect including guarantees, sale and repurchase or leaseback arrangements, capitalized leases, real estate and other installment purchases and any other similar arrangements.
- All audited and unaudited financial statements of the Company and reports of accountants thereon for all periods in the last five years and all interim financial statements thereafter.

Due Diligence Checklist – Financial Matters

- All monthly financial information for the current fiscal year.
- Information as to quality of accounts receivable, including age of such receivables and collectability experience.
- All management letters from accountants received during the past three years.
- Information with respect to any liens, encumbrances, security interests and other charges on the real and personal property owned or used by the Company and all related material documentation.
- All significant correspondence during the past three years with lenders and other debt security holders (including all consents from lenders required for borrowings by the Company).

Due Diligence Checklist – Contracts, Agreements and Related Documents

- All franchise, development and license agreements.
- All personal property leases, including, without limitation, all material leases of office and other equipment and all related service agreements.
- All agreements and licenses for software, trademarks and other intellectual property (whether the Company is the licensor or licensee) including any and all maintenance and services agreements related thereto.
- All joint venture, partnership and other material management and operating agreements, and any other agreements or arrangements for the sharing of profits, including, without limitation, any agreements between the Company and affiliates.
- All non-compete and non-disclosure agreements.
- All employment agreements.
- All consulting agreements.

Due Diligence Checklist – Contracts, Agreements and Related Documents

- All contracts with any labor union or other collective bargaining group or settlement or conciliation agreements with any federal, state or local governmental authority administering fair employment practice laws or orders.
- All contracts with customers for products and services provided by the Company.
- All advertising contracts; all marketing materials.
- All distribution, supply, reseller, sales representation, sales agreements or similar agreements or arrangements with customers, suppliers or distributors.
- All other contracts entered into or proposed to be entered into by the Company not otherwise listed herein and the term of which exceeds one year or under which any amounts payable by or to the Company exceeds \$2,500.
- All contracts which have been completely performed but as to which the Company may have contingent liabilities.

Due Diligence Checklist – Contracts, Agreements and Related Documents

- A description of all significant oral contracts, commitments and arrangements.
- All guarantees with respect to the payment or performance of obligations of third parties.
- All outstanding loans or advances made by the Company to any of its officers, agents, employees or third parties.
- A schedule of all insurance policies maintained by the Company setting forth the type of coverage, annual premiums therefor, name of insurer and term, together with copies of all insurance policies listed on such schedule.
- A list of all contracts and commitments under which a default has occurred or is claimed to have occurred.

Due Diligence Checklist – Intellectual Property

- A list of all software owned or licensed (except software not used in or with the Company's Products (e.g. routine office software such as word processors, accounting, etc.)) by the Company (the “Software”), a description of the functions and features of each program, and a chronology of each program's respective development.
- A list of all agreements with third parties, whether now in effect or terminated, for the design, development, programming, enhancement or maintenance of any and all Software.
- A list of all employees and consultants of the Company who have performed services related to the design, development, programming, upgrading, enhancement or maintenance of the Software. Include the current status of each such person and if any such person has been terminated by the Company, set forth the reasons for such termination.
- A description of the instances in which the source code for any the Software has been disclosed to persons outside the Company and any confidentiality, escrow or other agreement involving disclosure of such source code.

Due Diligence Checklist – Intellectual Property

- All policies and practices followed by the Company to protect the copyright, patent, trade secret and other intellectual property rights in the Software, related technology or other intellectual property owned by the Company
- A complete list and brief identification of all United States and international patents, patent rights, trademarks, trade names, service marks, copyrights or applications therefor used by the Company in the conduct of its business or owned by or registered in the name of the Company or in which the Company has any rights as licensee or otherwise, and which are presently or were, within the last three years, used by the Company in its operations or business.

Due Diligence Checklist – Business Information

- A list of significant suppliers of goods, services and personnel to the Company (representing in excess of 5% of annual purchases).
- All privacy policies of the Company or other information relating to the Company's procedures for preserving the privacy of personnel information and/or complying with related federal, state and foreign laws, rules and regulations (including anti-spam regulations).
- A list of the name and location of each bank with which the Company has an account, lock box or safe deposit box and the number of each such account or box and the names of the authorized signatories thereto.
- All standard forms of contracts for goods, services and personnel which are currently in use or still in effect.
- All information as to sources of software and electronic data processing, including related service contracts.
- A list of names under which the Company does business.

Due Diligence Checklist – Business Information

- All sales and promotional brochures, pamphlets and other literature relating to the business of the Company currently in use or used in the past two years.
- All documents relating in any way to the acquisition or disposition during the last three years of the Company, including any documents relating to expressions of interest in an acquisition at any time during the last three years.
- All documents relating in any way to the acquisition or disposition within the last three years of any assets or group of related assets not in the ordinary course of business and in which the consideration paid or received for such assets exceeded \$50,000.

Due Diligence Checklist – Legal Matters, Permits, Regulatory Compliance

- A list of all material permits, licenses, orders, certificates or approvals of any federal, state or local governmental authority held by the Company for its business or products.
- Information with respect to all material claims, litigation, administrative proceedings and regulatory matters, including, without limitation, any claims or proceedings by or against any employees, consultants, contractors or customers of the Company, pending or threatened during the last three years, to which the Company (or any of its officers or directors in their capacity as such) was, is or may be subject or a party or to which the assets or business of the Company may be subject (including copies of all court papers, correspondence and other documents in connection therewith).
- All currently effective judgments, orders, decrees, injunctions, stipulations or consent orders of or with any court or other federal, state or local governmental authority to which the Company or any of its assets or businesses are subject.
- All agreements entered into within the past three years to settle or compromise any proceeding pending or threatened against the Company.

Due Diligence Checklist – Legal Matters, Permits, Regulatory Compliance

- A list of all states and jurisdictions in which the Company is qualified to do business or is otherwise operating.
- All correspondence, reports and notices relating to laws and regulations of any federal, state or local governmental authority for the last three years not otherwise listed herein.
- All letters from counsel to the Company or to accountants with respect to litigation or contingent liabilities, for the last three years.

Due Diligence Checklist – Real Estate Matters

- Deeds to all real estate owned in whole or in part by the Company.
- All real property leases to which the Company is a party, whether as lessor or lessee.
- All guarantees given by the Company or any affiliate of the Company on real estate mortgages or leases.
- All executory contracts for the purchase or sale of real estate to which the Company is a party.
- Certificate of Occupancy or equivalent for facilities owned or used by the Company and any notices that such facilities are in violation of local zoning or building codes.

Due Diligence Checklist – Employment, Labor, Pension Matters

- All plans, programs, arrangements, agreements or policies relating to employee relations, severance benefits, vacations, sick pay, hospitalization and other medical insurance, life insurance, welfare and any similar plans or trusts providing for employee benefits, covering any present or former employee (within the last three years), including all plan documents, descriptions, trust agreements, insurance or annuity contracts and other material documents related thereto.
- All plans, programs, arrangements, agreements or policies relating to employee stock purchases, employee stock options, fringe benefits, bonuses or incentives (or other perquisites or inducements), deferred compensation, pensions and retirement and any similar plans or trusts providing for employee compensation, covering any present or former employee (within the last three years), including all documents, descriptions, agreements, insurance or annuity contracts and other material documents related thereto.
- The three most recent certified financial statements with respect to each such plan.
- The most recent determination letters, (including copies of any outstanding requests or determination letters) and any and all materials relating thereto, with respect to any such plan which is an employee pension benefit plan (as such term is defined in Section 3(2) of ERISA) intended to qualify under the Internal Revenue Code of 1986, as amended.

Due Diligence Checklist – Employment, Labor, Pension Matters

- The three most recent actuarial reports (including the three most recent Forms 5500 and attached Schedules B) with respect to any such plan.
- The most recent attorneys' response to an auditor's request for information with respect to any such plan.
- A statement setting forth the accrued and projected liabilities under each such plan and a statement of the projected annual costs of maintaining each such plan.
- A list of all employees, including officers and consultants, and their respective compensation and dates of hire, with breakdown by duties.
- A list of all persons with outstanding options or warrants with respect to any class of capital stock or other securities of the Company or its affiliates.

Due Diligence Checklist – Tax Matters

- A list of states, territories and jurisdictions (whether foreign or domestic) to which any tax is properly payable.
- All agreements with the Internal Revenue Service (the “IRS”) or any state, local or foreign taxing authority as to tax or accounting matters; all extension agreements.
- Information regarding outstanding disputes with the IRS or any state, local or foreign taxing authorities.
- All federal, state and local tax returns for the last three years.
- All information with respect to any IRS or any state, local or foreign taxing authority audits conducted within the last three years of the returns of the Company and the results of such audit(s).
- All documents relating to any claims, audits, actions, suits, proceedings, or investigations now pending or threatened against or with respect to the Company in respect of any tax or assessment.

Due Diligence Checklist – Tax Matters

- All documents relating to any requests for rulings in respect of any tax pending between the Company and any federal, state, local or foreign taxing authority.
- All documents relating to any obligation of the Company to indemnify any other person with respect to taxes and any obligation for payments with respect to taxable income.
- Any tax sharing agreements to which the Company is a party relating to the Company.

Appendix D

Definitive Agreement Outline

Definitive Agreement

- **Deal provisions**
 - Price, structure, and terms of the transaction
 - Employment or consulting agreements, covenants not to compete, leases or promissory notes, time and place of the closing
- **Representations and warranties**
 - Organization, corporate authority, and title
 - Financial statements and taxes
 - Assets, liabilities, and intellectual property
 - Contracts and obligations
 - Litigation and compliance with laws (e.g., environmental)
- **Covenants**
 - Limits the activities of the seller between signing and closing
- **Conditions to closing**
 - Seller's representations and warranties are true and correct
 - Seller has performed all covenants required under the agreement
 - All necessary third party consents have been obtained (e.g., leases, customer contracts)
 - No pending litigation restrains the transaction
 - No material adverse changes have occurred in the seller's business
- **Indemnification provisions**
- **Termination / Break-up fees**

