

INVESTMENT BANKER VETTING QUESTIONS

Engaging with Investment Bankers: Angels who are not Board of Directors (BOD) members should keep the pressure on their portfolio companies to make progress toward a lucrative exit. Regardless of whether the BOD decides that engaging an investment banker is essential to fulfilling their fiduciary responsibility to shareholders, they should at least engage with a few on a regular basis to assess market conditions. And, what if suddenly such a lucrative “bear hug bid” comes in over the transom that Directors feel a superior offer simply cannot be found? Will they want to engage a banker for a fast fairness opinion? This is an easier decision if they have already established banker relationships. I’ve personally never left an investment banker conversation without some new insights about what acquirers are valuing today.

Although experienced angel directors have long standing relationships with several investment bankers, they may lack the vetting questions they should be asking once the BOD decides to interview several and engage one. Below are both conversational topics and some pointed questions I have used when leading the investment banker selection project on behalf of the BOD.

Angels might share this document with the angel director if they sense that lack of experience in engaging investment bankers might be an issue. Regardless, they should at least suggest that any Director other than the CEO conduct the banker vetting process. Finalists will be presented to the full BOD, but the initial contacts should be handled by a non-management director so the CEO can avoid these time consuming initial interviews. After visiting the banking firm’s website, that Director can choose the most relevant questions from the list below to generate a template for comparing the finalists.

- **Licenses & Legal Questions:**

- 1) Is your firm a registered broker dealer? Are all your intermediaries securities licensed? Are you registered in the state where this venture is headquartered? Will you become registered in the acquirer’s state before the close of our contemplated transaction? Do you think this is important? Are you a member of SIPC, FINRA or other Self-Regulatory Organizations (e.g. NYSE)?
- 2) If the investment banker we engage is ***not*** affiliated with a FINRA broker/dealer, is the BOD putting our venture and its investors at risk of rescission? Why does your firm’s counsel think we can take adequate comfort in the SEC No Action Letter? Can you provide instances of disasters in which deals have been unwound at the small end of the spectrum (i.e. M & A price tag of about \$50 MM?) due to a FINRA problem? Or, are we being too cautious in avoiding all non-FINRA bankers? (NOTE: I do not think that avoiding non-FINRA bankers is being too cautious.)
- 3) Please divulge any litigation (settled or in process) which has been brought by clients in the last five years against any member of our deal team.

- **Your Firm’s Focus, Capabilities, Scope & Success:**

- 1) What portion of your firm’s revenues comes from sell side engagements versus your capital raising services?
- 2) Do you specialize in sell side engagements, or do you also represent buy side clients? If both, what has been the relative importance of each over the last two years?

- 3) What is the profile of your firm's ideal sell side engagement for ventures of our size?
- 4) What do you tout as your firm's most important defining difference which could impact the success of our engagement?
- 5) Does your firm have a professional research department? What proprietary databases do you use/prefer?
- 6) What industries do you avoid?
- 7) Financial & Private Equity Bidders: Does your firm focus on these bidders? Are you aware of any roll-ups being orchestrated in our industry segment by private equity firms?
- 8) International Bidders: Tell us about an engagement you have personally completed with an international purchaser. Does your firm have any affiliations with foreign investment banking firms?
- 9) What percentage of your engagements with young ventures being positioned today to sell to strategic bidders would you estimate end up being failed engagements (i.e. no exit occurs at any price during your initial engagement period)? What has been the primary cause of these failures? How can we best work with you to avoid such a disappointing outcome for our venture?
- 10) What percentage of your firm's engagements has closed above or below your estimated valuation range?
- 11) Discuss a successful transaction about which you are extremely proud. What made you so effective? What issues did you overcome? What strengths did you bring to bear? What aspects are applicable to our engagement?
- 12) Describe one of your transactions which encountered a seemingly insurmountable obstacle. How did you overcome it? Are there similarities to this engagement? How can we work together to minimize them?
- 13) Describe one of your failed engagements.....i.e. you failed to sell the company, or the price was woefully below your target range. Why did you fail? What would the venture's CEO say about the causes and your personal efforts? Your firm's efforts? May we call him/her?

- **Your Firm's VC Experiences & Relationships:**

- 1) Which VCs have engaged you to sell one of their portfolio companies?
- 2) What percentage of your sell side engagements involve VCs on the cap table?
- 3) Would you prefer VC-led exits or angel-led exits?

- **Your Firm's Process:**

- 1) Explain your methodology for establishing our venture's enterprise value and the likely price range.

- 2) Explain your firm's transaction methodology, process, and typical project plan.
- 3) If we track your typical project plan, what timeline do you foresee for this engagement?
- 4) Please summarize your likely work plan for our project.
- 5) When in the process do you plan to contact our direct competitors? When must we provide our approval for you to do so?
- 6) Explain how you typically manage confidentiality. What's your timing for requiring NDAs?
- 7) Does your process involve any unique way to move potential bidders from their initial "Indication of Interest" to submitting a "Letter of Intent?" In your personal experience, what has been the most frequent cause of attrition (when a bidder ceases to move forward)?

• **Market Intelligence Questions:**

- 1) What's your sense of the IT/software/SaaS M & A market today in terms of momentum/trends; Recent interesting transactions?
- 2) What factors today seem to determine the price-tag for an IT/software company with revenues <\$10 MM and insignificant EBITDA? What specific KPIs (Key Performance Indicators) do you think drive value in our industry?
- 3) What's your market outlook for the next 4 – 6 quarters of M & A activity? Is this a good time to sell or will it be more of a "sellers market" in a year or two?
- 4) What do you perceive to be our venture's most valuable strategic assets and capabilities?
- 5) Please explain current market terms regarding personal indemnifications requested of the founder/CEO. What tactics have you found to be successful to minimize such personal exposure and potential liability?
- 6) Reviewing the purchase documents' terms & conditions from my most lucrative exits reveals that the items below seem to be the major factors of "a deal". Please comment on any noteworthy recent market trends for them:
 - Price
 - Paid How? (stock or cash)
 - Type of purchase transaction (buying our venture's assets or stock)
 - Reps & Warrants & Covenants
 - Founder/CEO personal indemnification of Reps & Warrants
 - Escrows & holdbacks
 - Earn-outs
 - Integration Plan for people (Who is essential?)
 - Integration Plan for the IT systems
 - Employee Communications Plan/timeline
 - Stay Bonuses/Options Vesting
 - Approvals needed (Governmental bodies/Regulators, Major Suppliers and Customer Communications)

- Drop Dead/Break-up Fees
- Timing: Exclusivity/No Shop/Go Shop period; Closing

- 7) For ventures like ours how often have the CEO's remained at the helm six months post-closing?
- 8) Let's discuss escrows versus holdbacks: Which do you prefer? If the former, which escrow agents do you use?
- 9) What should we expect in a deal today regarding likely escrows, holdbacks and earn-outs, based on your recent deal closings? How do we avoid earn-outs which are unlikely to be achieved?

• **Questions Regarding the Deal Team on our Engagement:**

- 1) Please provide the bios of our deal team members. Highlight their past engagements which are most similar to ours and the outcomes.
- 2) Do you have any conflicts of interest/other relationships which prohibit your bringing forth any specific bidders?
- 3) Please enumerate for each of our deal team members the other engagements in which they will be simultaneously involved.
- 4) Do you plan to approach any financial buyers? Why? Are you in contact with any private equity firms seeking to lead a roll-up in our industry? Could our company be a keystone/anchor for such an initiative?
- 5) Will you approach any international bidders? If so, with which ones do you have an historic relationship from prior deals? Has anyone on your team attracted an international bidder previously for an ABC like ours?
- 6) Which previous bidders in your teams' past transactions might view us to be a fit? Can you get them to the table again?
- 7) Who will actually draft the Confidential Information Memorandum? With whom on our management team must they interact? What is the earliest date this must occur?
- 8) What electronic data room do you use? Who is expected to deliver our due diligence materials into it? What is the earliest date this must be accomplished?
- 9) Discuss the regular progress reporting you will provide us.
- 10) When must our CEO become deeply mired in this project? Same question for our C-level officers. How long can you keep this off their plate so they can stay focused on growing sales momentum?
- 11) What do you envision to be the most likely cause of your failing to consummate a transaction for our venture within your proposed range of values and timeline? How can we work together to avoid this outcome? What likelihood of success would you assign to our transaction being consummated within your target price band?

- **Compensation Questions:**

- 1) Explain your fee structure (success fees + work fees + expenses). Are your work fees netted against your success fees at close? Do you have a minimum fee?
- 2) We prefer a “Lodestar Fee” arrangement that will reward you exceedingly well for the amount by which the transaction value exceeds our agreed upon target. What is your view of this pricing approach?
- 3) What is your engagement tail? Over the last two years how many times have you divorced a client, thereby bringing the tail into potential play?
- 4) Do you allow the portion of success fees related to contingency/note/earn-out payments to be paid as those contingency/note/earn-out payments are made? We want to avoid “cash negative” payments to our banker. By this we mean paying them fees on amounts our venture has not yet received from the acquirer. The most prevalent examples are deferred payments such as escrows, holdbacks, earn-outs, milestone payments, Contingent Value Rights, and royalty payments.

- **Miscellaneous Discussion Questions:**

- 1) I don’t want to waste your valuable time so please tell me how mature my venture must be before I should routinely keep you apprised of our momentum and progress.
- 2) What has been your experience regarding the banker selection/vetting process being driven by an angel or VC Director versus the CEO? Any comments and suggestions?
- 3) What upcoming industry conferences/conventions/symposia do you think our venture’s management team should regularly attend? Can you assist in getting them podium time?
- 4) If in the future we expand our BOD would you be willing to recommend some exceptional candidates?
- 5) Could you please share some worst practices or “Hall of Shame” stories to illustrate behavior our venture’s CEO and Directors should avoid during our M & A sale process?

- **Angel Directors’ Concerns:**

- 1) All my fellow Directors are concerned about their fiduciary responsibility if they unanimously recommend to our shareholders that a bid from a single suitor be accepted, regardless of how attractive it might appear. In your experience, how likely are they to suffer litigation for not even attempting to get other bidders to the table? What steps should they take to diminish this possibility (e.g. Enhanced “Side A” coverage in our D & O policy)? What deal factors increase their exposure (e.g. lucrative employment contracts for the CEO and C Level executives)?
- 2) All my fellow Directors have invested personally in our Series A shares and have mentioned they are concerned about “insured vs. insured” lawsuits in the situation above if one Director is extremely opposed to accepting an offer. However, buying additional “Side A” D & O insurance is costly. And, buying off the usual “insured vs. insured” D & O exclusion is even more expensive, if it can be obtained at all. Can you share any war stories or insights about litigation arising in successful exits which nonetheless caused some investors, and especially dissenting Directors, to litigate?

- 3) Presume that this venture suddenly receives a surprise “pre-emptive strike/indication of interest letter” offering an attractive all-cash purchase price with minimal holdbacks and no earn-outs. Please provide your suggestions regarding these possible actions:
- Seek a fairness opinion? If so, does your firm provide them? If not, whom do you recommend, and what will they charge?
 - Rush to engage a banker to try to swiftly attract other suitors? If so, are many of your firm’s engagements of this “emergency” nature?
 - Engage a banker to merely vet and negotiate the terms & conditions? Would your firm take such an assignment? If so, please explain your typical fee structure (presuming sourcing bidders will not be involved in this case).
- 4) Some of the most grizzled angels Directors I know posit that the best bankers share at least one common skill: The ability to exude the sense that an auction is underway when actually just one bidder seems interested. Do you agree that this is a highly critical and differentiating skill? If so, let’s discuss examples of where you have displayed it in previous engagements (on a fully confidential basis, obviously).
- 5) Reflect on your decades of experience selling companies similar to our venture. Presume you are now the Independent Director of a venture that has just engaged an investment banker to run an M & A process. What guidance, insights, and wisdom would you share with your fellow angel Directors?