

Buying a Repair Station

The Legal Dimension – What to Worry About in Twelve Areas

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"If it flies and it's not a bird, we can do the legal work."

- **Area 1: Preparing To Buy**

- You're on the hunt for one or more good MRO businesses
 - To acquire, or
 - To merge into your company.
- You've confirmed the key attributes of what would attract your buying eye:
 - Size.
 - Repair products and services.
 - Location.
 - Other “must have” or “nice to have” features.

- **Area 1: Preparing To Sell**

- You're ready to start looking for targets.
- Before you start your quest, there are three steps you should take right after you've decided to become a "buyer".

- **Area 2: Assembling Your Team of Experts**

- **First**, assemble your team of experts, in-house and outside:
 - Your inner circle from your senior/BD management team.
 - Your outside financial advisor (if you have one) and an aviation M&A advisor, to target MRO businesses for sale now and in the future, and to do key market research.
 - An aviation M&A lawyer to advise on what's worth worrying about legally, and what's not worth the bother.
 - An FAA regulatory lawyer to assess the “health” of a repair station's chief asset – the regulatory approvals – and how to rehabilitate them for “purchase” (rehabilitation is always needed).
 - An aviation tax accountant to optimize tax treatment.
 - Foreign local experts if target operates outside the USA.

- **Area 2: Assembling Your Team of Experts**

- ***Second***, pin down who else from your senior and middle management teams should be “read in” to the buy process.
- Determine if you’ll be functioning as a “strategic buyer” or a “financial buyer” for this acquisition.
- If you’ll even consider a “union shop,” add a labor lawyer with union expertise onto your team of experts. The union may be on the top of your list of legal things to worry about. Tackle it early.

- **Area 2: Assembling Your Team of Experts**
 - ***Third***, make everyone sign an short oath of secrecy and acknowledge that they will probably be fired if they violate the oath.
 - May sound offensive, childish even, but nothing will get you into legal trouble with a seller faster than a premature leak that your target is up for sale.

- **Area 3: Initiate the Acquisition Quest**
 - What's next? You're ready to start looking.
 - Where?
 - Places that your M&A advisor will suggest.
 - Here is where the quality of your selection will pay off.
 - Brian Karpriel will tell you more about this.

- **Area 4: “Teaser,” “CIM,” and Bridge to DD**

- To evaluate the target’s Teaser and Confidential Information Memorandum, buyer will focus on target’s documented:
 - Audited financials (esp. footnotes).
 - Revenue projections & expected profit margins.
 - Regulatory approvals.
 - Proprietary repair processes.
 - Proprietary parts made by target.
 - Data licensing agreements with OEMs.
 - Other assets that differentiate target from its competitors.

- **Area 4: “Teaser,” “CIM,” and Bridge to DD**
 - Buyer’s documentation focus (cont’d):
 - Target’s management team, key employees, and their contracts (IP rights; non-compete).
 - Customer revenue under contract (sole source).
 - Supplier spend under contract (dual source).
 - Intelligence about target’s competitors.
 - Minutes of board and shareholder meeting & like company records (key processes).
 - IT systems.
 - Real estate.

- **Area 5: Finding Right Target – Legal Worries**

- Brian will walk us through how to find the right MRO business to buy. Here are three things to worry about from the legal end.
- **Should you participate in auction?**
- Sellers think an auction brings best price for them.
- So make a case that you are a discrete (cash) buyer who can close the deal that seller wants as fast as it's possible to do, and that you'll just need a short period of exclusive negotiation to demonstrate how a deal can be struck.
- Are you being used as a stalking horse?

- **Area 5: Finding Right Target – Legal Worries**

- *What if seller is a competitor of yours?*
- You'll have to worry about receiving info that the antitrust laws will not want you to have, like seller's product-level pricing, profit margins, and costs.
- Even if antitrust is not a consideration, seller will worry about giving you a better means of competing against seller if you don't consummate the purchase of his business.
- Use a "clean team" or "aggregate info" so DD does no reveal competitively sensitive info.

- **Area 5: Finding Right Target – Legal Worries**

- *When acting as a “strategic” buyer,* you’ll be looking for synergies like:
 - Vertical integration on key inputs.
 - Improve economy of scale.
 - Reach customers you don’t have which the target does have.
 - Acquiring IP that you don’t have.
 - Eliminating a competitor by buying him.

- **Area 5: Finding Right Target – Legal Worries**

- So you may be willing to pay a higher price than a “financial” buyer.
- But will you agree to “IP Acknowledgments”, when you find that target’s IP is not shorted up?
- What if there are no non-compete agreements with target’s management? Too late to amend without legal consideration, so haircut on price justified.
- Are you like other “strategics” who eliminate key EEs, and are you willing to negotiate a “keep target EEs x months” clause (if target were to agree to a partial haircut in price in exchange for that clause)?

- **Area 5: Finding Right Target – Legal Worries**

- *Are you more like a “financial” buyer for this deal?*
- If so, you won’t pay premium in price like “strategics,” because you’re probably more worried about hitting their investment metrics than getting synergies.
- So as a “financial” buyer, you’ll have an exit strategy, and you’ll worry more about target’s reps & warranties, esp. IP gaps and false or misleading DD statements.

- **Area 6: The NDA(s)**

- M&A NDAs come in many varieties. As buyer, focus on **five** things from legal end for Confidential Information:
 - 1—Include usual exceptions to CI definition.
 - 2—Insert “knowledge” exception for TP crooks who pass CI to you.
 - 3—Destroy CI but get to keep archival copy.
 - 4—Get ordinary course exception to rule barring your contact with target’s shareholders and privies.
 - 5—Get general advertisement exception to rule barring solicitation/hiring of target’s people.

- **Area 7: Management Presentation / DD / VDR**
 - With signature of the NDA(s) will come the management presentations.
 - Look for statements that are false in a literal sense or true but misleading in a material way.
 - Keep track of everything you download from VDR so you can prove chain of custody and destruction.

- **Area 7: Management Presentation / DD / VDR**

- For the deep-dive DD, get all info you can get on:
 - Regulatory approvals that Sarah walked us through.
 - Pay special attention to “related party” debts and dealings.
 - Don’t do IP DD via VDR; do it offline at target’s premises.
 - For IP DD, beware of target’s fingers in OEM cookie jars.
 - Focus on contract breaches from target’s customers.
 - Focus on contract-breach claims by target against suppliers,
 - BUT: Think about “wedge” DD requests – 5 top things you really need to know in order to proceed. Less spook factor.

- **Area 7: Management Presentation / DD / VDR**
 - Questions and requests for additional information (cont'd):
 - Investigations by FAA or other governmental agencies?
 - ADs?
 - SBs?
 - “Quality escapes”?
 - Previous offers to buy target’s company?
 - Any other target wants that you can think of?
 - Employee claims or promised bonuses to them?

- **Area 7: Management Presentation / DD / VDR**
 - Questions and requests for additional information (cont'd):
 - Footnotes in target's audited financials?
 - What cap ex will be needed to realize target's projections?
 - Are there improperly allocated overheads?
 - Real estate lease or other Ks recently re-negotiated?
 - CoC clauses in target's customer agreements?
 - Anti-assignment clause in target's contracts (cust or supp)?
 - All these are huge areas to justify price haircuts.

- **Area 8: The LOI**
 - LOI is prepared in parallel with management presentation and DD in earnest.
 - Use LOI to tell what deal will be struck (or if no deal will be possible) by mapping out each major deal point.
 - Ask for exclusive negotiation period.

- **Area 8: The LOI**

- **Stock versus asset deal**

- Seller wants stock deal so that seller's shareholders only pay capital gains taxes.
- Buyer wants asset deal to get a step-up in basis.
- Buyer also wants to minimize assumed liabilities.
- So seller and buyer can agree to bridge gap by:
 - Agreeing to the transaction structure that minimizes taxes, and
 - Then adjusting purchase price to share advantage.

- **Area 8: The LOI**

- **Stock versus asset deal** (cont'd)
 - “Personal goodwill”: buyer acquires assets from company and “personal goodwill” of equity owners directly from owners.
 - Other structures with S-Corps and LLC conversions.

- **Area 8: The LOI**
 - **Company attributes at closing**
 - Stock deal:
 - Will Buyer acquire the company cash-free, debt-free?
 - Will seller be permitted to do a cash sweep? Declare a dividend? Will company have a threshold amount of working capital at closing (Working Capital Peg)?
 - Asset deal:
 - Parties list each of the assets transferred in the sale, and the seller needs to make representations and warranties about each of the assets.
 - Which debts/obligations will buyer assume?

- **Area 8: The LOI**
 - **Employee retention & non-competes:**
 - Are there key individuals who must stay with company?
 - Does seller require buyer to keep certain individuals for a period of time or offer certain terms of employment to the retained employees?
 - What non-competes will bind people who will exit at closing?
 - **Reps, warranties, indemnities:**
 - Will there be a “knowledge” qualifier?

- **Area 8: The LOI**
 - **Earn-out:**
 - Use revenue-based.
 - Huge source of litigation.
 - **Escrow:**
 - How long will funds be escrowed.
 - Plan tight/objective rules for money release.
 - Sunset for claims except title/fraud/non-compete.

- **Area 9: Definitive Agreement & Deal Docs**

- If you've done a detailed LOI, the main body of the definitive agreement should not be difficult for the lawyer on your team of experts to draft.
- Much negotiation ("what's market"?), but pressure points are well known. Key here is **speed**: Frame open item, decided it, and move on. Longer it takes, more chance there is of deal fatigue and deal bust.
- Focus efforts on Schedule preparation which should be easy if DD done correctly. Tie Schedules to VDR info.

- **Area 9: Definitive Agreement & Deal Docs**

- Overriding tension during negotiation of deal docs:
 - Buyer will push seller to “represent and warrant” that seller has told buyer everything that a reasonable buyer would want to know about the company or business being bought and that seller should indemnify buyer for anything suffered by buyer post-closing if he learns something that seller should have disclosed but didn’t.
 - Seller will push for a rule saying that buyer is a sophisticated investor and that he needs to make his own decision on whether or not to buy.
 - Find happy medium.

- **Area 10: Between Signature and Closing**
 - **Business must proceed**: Company still has to operate, but target should notify buyer of any major decision that buyer would reasonably want to know after signing the definitive agreement and before the closing. Require that buyer's agreement or at least his non-objection be obtained.
 - **Customer meetings**: Prepare minutes of all meetings.
 - **Regulatory filings**: Submit HSR & regulatory filings.
 - **Dividends?** Monitor all dividends.

- **Area 11: Closing the Deal**

- Sweetest part of the drama.
- Use closing checklist you started when you signed LOI to choreograph everything -- who, what, when, where – and think of all closing documents as props on the stage for the drama:
 - Money wire transfers esp. when foreign banks are involved.
 - Stock transfers on books of corporation.
 - Cancel old stock certificates & issue new ones.
 - Asset sale – contract assignments & third-party consents.
 - Sign & deliver all docs, esp. regulatory approval docs.

- **Area 11: Closing the Deal**
 - Use closing checklist to choreograph everything (cont'd):
 - Loan payoffs.
 - Bank account closings.
 - New director appointments.
 - Indemnity for departing directors.
 - Deliverables at closing.
 - Test and retest all reps & warranties.

- **Area 12: Post-Closing**

- Monitor audit through closing date so you can do true-up of metrics for post-closing price adjustments.
- Complete transfers/transitions on regulatory approvals.
- Carry out earn-out.
- Be ready with your team of experts to address target's effort to pull money out of escrow by meeting conditions of release.
- This is where good escrow agreement and "rocket docket" arbitration will pay off.

READY FOR QUESTIONS