

RoNewMedia Presentation

M&A / Corporate

***“Structuring an IT/On-line Business
for Future Investments and
What to Expect during the Investment Process”***



When to hire an attorney?

- No golden rule, but need to ensure that a proper structure set up (i.e., if two or more founders) and to protect IP rights
- A rule of thumb: legal costs should not exceed 5% of initial investment
- Depending on founders' previous "legal" experience, may be able to use contracts from sites such as www.onecle.com and <http://www.techagreements.com> for agreements between founders themselves & services providers
- A very important consideration: a website's "Terms & Conditions" also need to be prepared by qualified and experienced legal counsel (i.e., see <http://www.desprefirme.com/termeni.php>)
- An attorney is a must once begin to negotiate with foreign investor



Off-shore or On-shore (Romania)

- What does “off-shore” really mean?
- For off-shore yearly costs are approximately between EUR 4,000 - 6,000 (to set up, yearly administration fees and filing of financial statements so that “certificate of fiscal residency” may be obtained)
- Thus from cost point of view not recommended during initial / start-up stage if initial investment is less than EUR 100,000 as these costs most likely would exceed 5% of said amount
- On-shore (Romania) options: SA (in Romanian, “societate pe acțiuni”) and SRL (in Romanian, “societate cu răspundere limitată”)



SA v. SRL

- SRL requires less money to incorporate (i.e., RON 200 in share capital) and fewer formalities (i.e., only one shareholder may set up an SRL)
- SA requires RON 90,000 (approximately EUR 20,000) and at least two (2) shareholders
- Nonetheless, contributed share capital may be used after incorporation thus no “practical” difference between SA and SRL with respect to the required share capital



SA v. SRL (cont'd)

- Two major drawbacks to using an SRL:
 - a) current requirement that if desire to sell shares to a new shareholder then need to wait at least one (1) month (OUG 54/2010) -- this is not an issue with an SA since transfer of shares effectuated based on shareholders' registry and not trade registry registration, and
 - b) inflexible corporate governance mechanism -- specifically difficult to implement "board of directors" governing structure, since certain competencies may only be discharged / approved by the shareholders' general meeting and may not be delegated to the board of directors. The use of a board of directors is a typical corporate governance structure used in the EU, the UK and the US



SA v. SRL (cont'd)

- Major advantages to using an SA:
 - a) possible to implement “board of directors” governing structure
 - b) shares transfers effectuated pursuant to entries in shareholders’ registry
 - c) may also issue bonds (in Romanian, “obligațiuni”) as possible means of financing
 - d) may also issue preferred shares up to 25% of share capital (to be first in line for dividends)



Corporate Governance Issues

- shareholders' agreements explained:
 - a) between shareholders / investors
 - b) more detailed than Romanian legal entities' articles of organization (in Romanian, "act constitutiv")
 - c) sets forth ALL rights and obligations of shareholders / investors
 - d) standard clauses: put & call options, drag-along & tag along rights, buy-me-buy-you clause (although still no certainty that such a right would actually work if Romanian governing law would be stipulated, since not possible to issue an "irrevocable" power of attorney in Romania – in any event should stipulate a large penalty in case of early withdrawal of power of attorney)
- major corporate decisions taken by board of directors and not shareholders' general meeting



Stages of Investment

- There are many different ways to label the stages of investment and this often causes confusion. A basic road map often looks like this (although NOT all these stages will necessarily apply):
 - a) Family & friends
 - b) Seed / start-up
 - c) First round / development stage
 - d) Second round / expansion
 - e) Merger, acquisition, initial public offering (IPO)



Stages of Investment (cont'd)

- And confusion is also caused by the words used to describe these funds or those who provide them. Here is a basic road map:
 - a) Private placement
 - b) Angel
 - c) Venture capitalist (VC)
 - d) Financial / strategic
 - e) Equity (stock classes, including preferred, convertible preferred, common, options)



Angels v. VCs

- generally angel investors are individuals or a group of individuals who fund start-ups that they believe are likely to be profitable
- while obviously angel investors are concerned with investing so that they can profit, they are also interested in helping small, non-established businesses get off the ground, thus they are often willing to provide mentorship and training along with the funds to help the fledgling new entrepreneurs
- thus, if you have an idea for a business or your business is very new (i.e., a start-up or less than 1 year old), the focus should be on angel investors



Angels v. VCs (cont'd)

- venture capitalists may be individuals or groups of individuals who are generally interested in investing to grow their own portfolio
- unlike angel investors, VCs are more interested in going concerns where the risk is less -- in other words, they are looking to invest in ***established businesses*** that need additional funding in order to expand and for which the future financial outlook is almost certain to be profitable
- VCs may also offer mentorship but are usually less concerned with that than are angel investors
- Interesting link on approaching VCs:
<http://floridaventureblog.com/2009/12/how-to-approach-vcs.html>



LOI / MOU

- business terms & conditions
- confidentiality
- exclusivity
- usually non-binding (or if binding then usually subject to due diligence)



Legal Due Diligence Explained

- in short, potential investors will verify everything about the target in order to ensure that they know what they would be investing in
- a very intrusive and disruptive procedure thus requires lots of preparation in order to minimize impact (i.e., should set up physical or online data room)
- as far as the process is concerned, generally the potential investors' legal counsel provides a legal due diligence checklist requesting a large number of documents and information about the target



Legal Due Diligence Explained (cont'd)

- Below are some of the main documents which usually are requested:
 - a) key contracts (clients & suppliers)
 - b) employment, consultancy and independent contractor agreements, including work-for-hire & confidentiality/non-disclosure agreements
 - c) shareholders' general meeting resolutions and board of directors decisions (if applicable)
 - d) articles of organization
 - e) litigation-related documents (if applicable)
 - f) copyrights and other intellectual property-related documents
 - g) tax and financial documents



Vendor Due Diligence to Expedite Process

- this is a due diligence investigation commissioned at the beginning of a contemplated transaction and is undertaken by the vendor (the sellers or founders) to review the target's business that is to be offered for sale
- the main objectives are to carry out an investigation and to report the findings to the sellers / founders prior to the commencement of discussions with potential investors
- a vendor due diligence report may also be provided at a later stage to potential investors, alternatively it may be prepared for the sellers' / founders' benefit only



Vendor Due Diligence to Expedite Process (cont'd)

- two main advantages:
 - a) the sellers' / founders' will know the target's problem areas and thus would be able to correct them before the commencement of discussions with potential investors, and
 - b) if a report is also provided to the potential investors then this would drastically reduce the transaction's duration and related costs (i.e., if five interested investors then no need for each of them to carry out a legal due diligence)
- the main consideration to providing a vendor legal due diligence report to potential investors: they will surely require that a "reliance" representation and warranty be included in the sale-purchase agreement (SPA); nonetheless, in any event most foreign investors in Romania will require full representations and warranties even if they themselves carry out a legal due diligence thus in fact not a major disadvantage to the sellers / founders



“Terms of Art” ... The Lingo

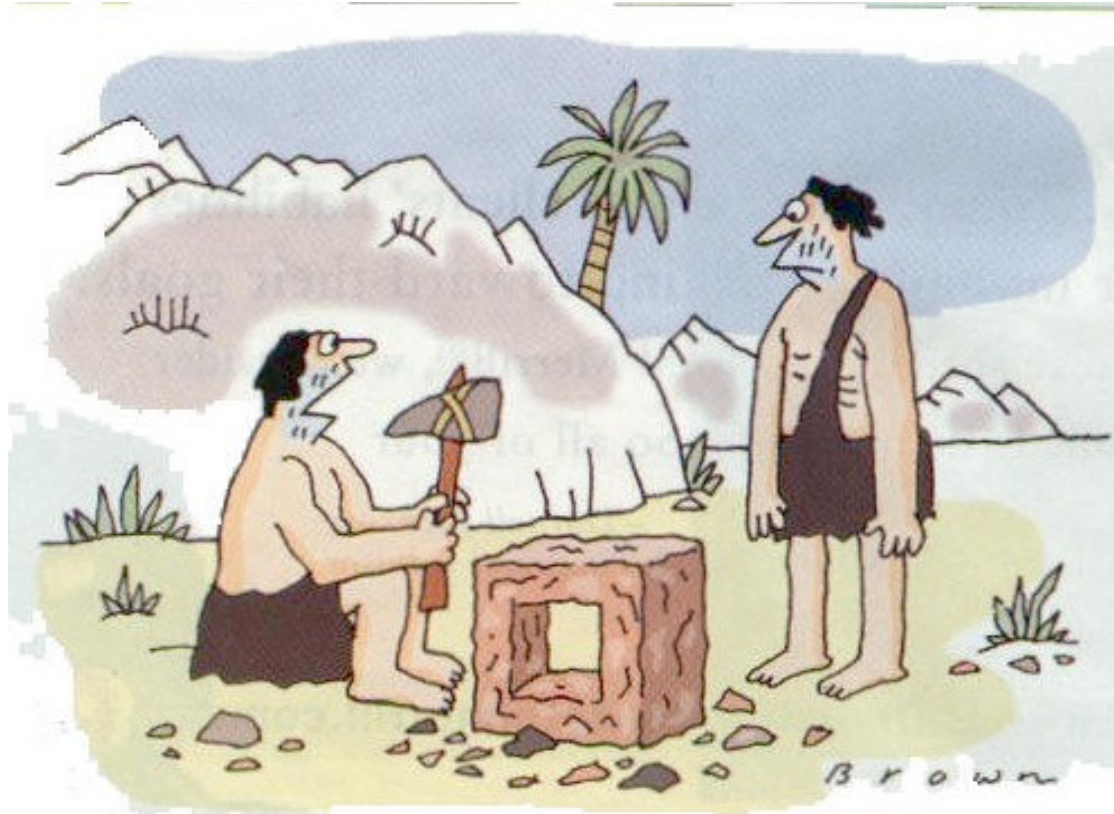
- Some examples:
 - a) “representations & warranties”
 - b) “disclosure letters”
 - c) “holdback amounts”
 - d) “liquidation preference rights”
 - e) “indemnity clauses”
 - f) “multiples” within context of EBITDA & earn out formulas
 - g) “non-competition undertakings”, etc.



DOs

- elevator pitches
- short and to-the-point presentations
- network, network, network ...
- interesting link <http://floridaventureblog.com/2009/03/investor-pitch-excite-engage-exit-with.html>

.... and DON'Ts



“I call my invention ‘The Wheel,’ but so far I’ve been unable to attract any venture capital.”



.... and DON'Ts (cont'd)

- unreasonable or unjustifiable projections which generally show that the entrepreneur really does not get it (see previous cartoon)
- saying that you have no competition usually shows that you actually don't know the market or lack real vision
- continuously “talking over” a potential investor during a private discussion which shows that you are really not listening
- Three Things You Should Never Tell a VC Investor When Fundraising: < <http://www.freddestin.com/blog/2009/11/three-things-you-should-never-tell-a-vc-when-fundraising.html>>
- Seven Things Entrepreneurs Must Not Do: <http://under30ceo.com/7-things-entrepreneurs-must-not-do>



Interesting Links

- **VentureConnect on Facebook:**
<http://www.facebook.com/pages/VentureConnect/164455656914971>
- **How Seven Start-ups are Building Their Online Communities:** <<http://mashable.com/2010/10/07/startup-communities>>
- **The Internet Enterprise:**
http://www.icta.ufl.edu/projects/publications/Internet_Enterprise.pdf



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