

life science **FINANCE**

Avoidable deal-breakers: Anecdotes from the trenches

There are more ways for a deal to be broken than to be made, and from one industry to another, certain issues have a higher relative importance in making or breaking transactions.



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In deals involving life sciences companies, three of the most common deal-breakers are ineffective intellectual property (IP) management, "micro-niche" company syndrome and underestimating the importance of GAAP accounting. All are avoidable.

Every life sciences company has IP — and how it is managed can have a significant impact on the due diligence process. Beyond technology and know-how, most life sciences companies and certainly biotech companies do not have many other assets, so one would think that management of IP would be of paramount importance.

The basic premises are to know and protect the company's IP, know and understand your contractual obligations and be

able to articulate an IP strategy. Many companies, however, do not follow these simple rules and make common mistakes that are ultimately uncovered in ordinary buyer due-diligence.

We were involved in a situation with a life sciences company that after years of joint development efforts, licensing deals and collaborations with multiple parties, simply lost track of the various contractual obligations it had on its lead compound. One aspect of the problem was the use of the trial data, and the potential buyer learned quickly that the target could not transfer these rights.

Other common IP management mistakes include selling overarching rights to new developments (and not knowing it); not protecting the use of the technology internationally; sloppy and inconsistent invention, assignment and confidentiality agreements with employees; and not knowing all of the developments and projects underway at the company.

The micro-niche syndrome

Another common deal-breaker involves the micro-niche syndrome. Being a micro-niche company is not bad, but it may limit the company's attractiveness to larger strategic buyers, partners and investors.

As a practical matter, many small companies need to focus on key products and customers and preserve capital. The micro-niche company is one whose products or services are directed to such a small amenable market that few buyers would have any sincere interest.

It is not uncommon for the management of a micro-niche company to rationalize why "MegaCo" will want to pay top dollar for their company. After minimal due diligence, MegaCo quickly determines that the micro-niche company will not have any meaningful impact. The unfortunate result is that micro-niche companies tend to waste their time and money — while exposing some of their proprietary information to potential competitors.

There is not much that a business can do about being a micro-niche company in the short-term, other than to recognize that they are one by completing an honest assessment as to their product, technology and markets. Evolving from a micro-niche company can best be addressed by a long-term strategic plan.

In a deal setting, being a micro-niche company impacts value and the number of realistic buyers. If the decision is made to "go-to-market," approaching potential buyers should be done with a sound game

plan and a willingness to disengage from a dialog that is not progressing.

GAAP accounting matters

GAAP accounting matters to the companies that can pay top dollar, i.e. public companies, large private companies, and venture-backed companies that want to be public companies.

Another tale from the trenches: We were working for a public company that had made an offer to buy a smaller medical device company for nearly \$100 million. The deal fell apart after accounting due diligence uncovered revenue recognition problems. The buyer learned that the earnings of the seller were not going to materialize on their income statement under "full-GAAP" accounting.

The lesson here is that if as a company a major transaction is in your future, hire a strongly qualified SEC accounting firm.

Other common deal breakers include the key person discount, guilt by association, too many shareholders, nothing is as advertised, and poor time management.

Closing a transaction is usually a difficult, complex, time consuming and expensive undertaking. If there is a transaction in your company's future, take the steps necessary to avoid common and avoidable deal-breakers.

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