Effective Measures and Critical Points to Accelerate the Business Angel Market in the Mediterranean

MACC BAM Toolkits
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17th June 2011
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How the Investment Process works

Introduction

This guide is written to help companies and entrepreneurs looking for funding to understand how the investment process works, what to do if seeking funding, and explains what Investors and lenders look for in a proposition and how they like propositions to be presented to them.

This guide should be used in conjunction with other MACC BAM\(^1\) guides and tools which explain greater depth in each of the processes, such as Business Plan preparation, profit and loss forecasting, legal and so on.

The aim of this guide is to give entrepreneurs an outline of the process and points that need to be considered when raising finance and investment. It is suggest seeking the helps and advices from a Business Angel Network Manager available through the MACC BAM support centres. The centre managers are responsible to give advice on the process and some are able to provide, or sign post, Investment Readiness training programmes that could help companies seeking funding, prepare their business models, written business plans, and pitches to go forward for Investment.

This guide is divided into various stages to work through or consider from the outset through to the eventual sale or exit of the company.

Business plan preparation

Before starting out on the search for funding, it is imperative to draw up a business plan detailing all aspects of the business which include three main parts, executive summary, product & market and financial data.

- the companies’ aims and aspiration
- details of the company products and services
- potential customers or the end users
- market analysis with market position and competitor analysis
- how the products and services will reach the market
- Financial forecast of profit and loss for the next 4 years
- cash flow forecasts showing the worst and best balances for three years
- detailed month by month cash flow forecast for year one
- details of how the Investor will exit his/her investment.

Most importantly, and this cannot be emphasised enough, is the need for a good executive summary. Many investors will not go on to read the Business Plan unless the executive summary grabs their interest. It is also a document that is frequently passed around by business Angel Network Managers to their Investors. If Investors are interested they will then call for the full business plan and meet with the entrepreneurs.

It is a selling document as much as anything else. It should be remembered, when looking for Investment that Investors are buying part of the company – not the product it delivers! Investors are interested in profits, markets etc. not necessarily in depth details of the products or services. They need convincing that there is a market for the products or services, the company can make profits, and

\(^{1}\) MACC BAM is the projected funded by the EU to build and test a coherent framework for planning and implementing joint sustainable measures in order to accelerate the Business Angel’s Market in the MED regions.
the management team has the capabilities and skills to deliver against the plan. Help and guidance relating to business plan preparation are available in the MACC BAM Business plan preparation guide.

**Drawing up a profit and loss forecast**

As part of the business plan, the entrepreneurs will need to provide a set of financial projections which translate what they have said about their business into numbers. They will need to look carefully at:

- how much capital you need if you are seeking external funding
- the security you can offer lenders
- how you plan to repay any borrowings
- sources of revenue and income

Entrepreneurs may also want to include their personal finances as part of the plan at this stage. The forecast should include Sales forecast, Profit and Loss forecast and Cashflow statements.

As mentioned above, the profit and loss (P&L) forecast should cover a four-year period and their level of sophistication should reflect the sophistication of the business. However, the first 12 months' forecasts should have the most detail associated with them. The P&L should include a statement of the trading position of the business: the level of profit they expect to make, given the projected sales and the costs of providing goods and services and the expected overheads.

Worth noting here, the P&L account should not be confused with the cash flow forecast. The P&L account measures actual profits made rather than the cash coming in and going out of the business. For example, it would contain details of depreciation where the asset may have been purchased in a previous period (year) but written off over a period of time.

Help and guidance on drawing up of this document can be obtained from the MACC BAM guidance notes, and spreadsheet template relating to the profit and loss forecasting.

**Draw up a Cash Flow Forecast**

Cash is the oxygen that enables a business to survive and prosper and is the primary indicator of business health. While a business can survive for a short time without sales or profits, without cash it will expire. For this reason the inflow and outflow of cash need careful monitoring and management.

Cashflow forecasting enables the business to predict peaks and troughs in their cash balance. It is important to base initial sales forecasts on realistic estimates. A cashflow forecast can be an invaluable business tool if it is used effectively. The Cashflow forecast should be for the first three years. The cash balance and monthly cashflow patterns for at least the first 12 to 18 months and the years 2 and three should show worst and best cash positions. The aim is to show that the business will have enough working capital to survive so make sure the entrepreneurs have considered the key factors such as the timing of sales and salaries.

Worth noting here, a cash flow statement or forecast represents the flow of payments and receipts over a period - not the formal accounting transactions, which are based on invoice date or tax point.

From the cash flow forecast an Investor can see exactly how much money is required and when it is required and by analysing the document see what the cash (or the Investment) is being spent on.
Often an investor will make an agreement to inject monies as and when required in accordance with the Business plan and forecasts and agreed milestones are reached.

Help and guidance is available from the guidance notes and template relating to cash flow forecasting available from MACC BAM Support centres.

It suggested that **constructing the cash flow forecast** include the following items:

- Generate the cash flow from the P&L, not vice versa
- Copy down the sales and cost categories from the P&L projection
- Delete depreciation line and include other cash flow-only items
- Estimate average expected collection period for credit sales
- Link cash inflows to sales forecast, allowing for the collection period
- Add additional income from VAT on sales
- Add appropriate lines for capital injections
- For each cost category, estimate expected payment period
- Link each cost line to that on the P&L, allowing for payment period
- Enter capital injections and repayments
- Add additional payments against VAT on purchases
- Include repayments of VAT to tax authority at appropriate intervals
- Calculate net cash flow and generate rolling bank balance
- Identify funding requirement - and reiterate!

2 VAT can be added to cash inflows from sales and outflows from purchases, or (better) 'VAT on sales' and 'VAT on purchases' treated as separate entries on the cashflow.
Establish funding requirement

The cash flow forecast or plan allows the calculation of funding requirements and demonstrates how these may vary over time. Based on the established cash flow forecast, the entrepreneurs will need to decide how much funding is required in the next three years. This will be the worst case cash position shown on the cash flow forecast.

This is the cash injection that will be required by the company to achieve its goals and plans as detailed in the Business Plan and will be the amount (in all probability) that will be required from an investor.

Consider source of finance

When the amount of finance is known consideration needs to be given as to the most suitable source of finance. If it is only a short term, pending say receipt of monies coming into the business, it could be that a bank may make funds available. Banks however normally only lend to companies with a track record of profits and also often require security (something that can be sold if the company fails to repay its loan).

 Normally with high growth companies, or early stage companies there is no track record or security available. In this case, the only source of finance is by way of Equity Investment, by way of an Angel Investor or Venture Capitalist (VC).
An Angel Investor is not an investor with golden wings and a halo but rather an individual who provides start-up capital to a new business and expects a percentage of ownership equity in return. Angel investing is a common business practice in the United States and Europe but will often take on different names depending on the country. If a prospective entrepreneur is unsuccessful in borrowing money from a bank, s/he may often resort to an angel investor to raise capital. Due to the risks associated with investing in a new company, an angel investor will often expect a very high return on investment (ROI). Since it is a proven fact that many new companies will fail, an angel investor will expect a return up to ten times his/her investment within several years. Angel investors believe that this amount will balance the large risk of losing their invested money.

Business Angels (BAs) are the informal end of the Equity market normally are private individuals, because they carry out their own due diligence (research into the company, its books and records by visiting the company themselves) and inspecting the books and contracts etc. They will also make research into the products and the market. An experienced Business Angel can provide valuable knowledge and skills to an entrepreneur on how to run their business during its early stages of development. They may also be a good source of useful contacts, allowing the entrepreneur the opportunity to network with others in their industry.

Venture Capitalists (VCs) invest pooled money from other people, and therefore have to carry out formal due diligence conducted by lawyers and accountants. In addition to the percentage of equity interest in a company, VCs usually desire an active say in the invested company’s business decisions. They cannot, unlike Angel Investors, “follow their instincts”. Formal due diligence is costly and for this reason VCs will not invest in amounts less than 1 Million Euro. Formal Venture Capitalists do not get involved in the running of the business themselves. Instead, they monitor activities and progress by way of formal reports and meetings.

Business Angels on the other hand often like to be very involved in the business; assist in companies day to day operation and contribute skills and contacts to help the company succeed. For this reason Angel Investment is often referred to as smart money (Skills + Contacts + Cash).

It is important to decide exactly who to target before setting out on the funding route. In addition, it is vital for a company and their angel investor(s) to form a sound relationship with one another before any investment takes place in order to make sure they share the same goals and values. A company and their angel investor(s) must feel comfortable with one another in order to maintain good lines of communication and to ensure a successful business.

Consider skills required if seeking an Angel Investor

As mentioned in last section, most Angel Investors wish to be involved in the running of the business. The skills and contacts they bring vary enormously and it is a good idea to be able to articulate what skills would be helpful to the business. It is best to aim for an investor with complementary skills to those of the existing management team. There is little value for example getting an investor with good marketing skills if those already exist in the business. If the entrepreneurs lack certain skills then it is suggested that they should be linked up with Angel Investors who can fill the appropriate skill gaps.

Most Angel Networks will ask what skills would be add-value to the business, in addition to the cash required, in order that they can make appropriate introductions for the benefit of both the company and investor. It is important to be prepared for that question.
Approach Business Angel Networks

When the requirements of the company have been clearly established as outlined above it is almost impossible to find an investor without the help of the Business Angel Networks (BANs).

These are organisations established to help companies find Investors and Investors locate suitable companies into which to invest. They keep a register of both and effect introductions and assist in the facilitation process. They can also offer helps and advices along the way.

When approaching one it is good if the company can be precise in their requirements, have a good business plan, a very compelling Executive summary and a good idea as to what they want an investor to bring to the company in addition to cash i.e. skills and contacts. It is also helpful if they have some idea as to the % of the company that they are willing to share. This is usually between 30% – 40% for an early stage proposition. They should also have an idea as to what they value the company at. This is a very difficult to do as future profits depends upon the level of sales that can be achieved – an unknown figure and also for a company that has not fully developed the product and is looking for development finance as there is uncertainty if the product will in fact ever work!

Good Business Angel Networks have a network manager who can advise and give guidance on these matters.

Agreement with an Investor

When an Investor has been located and they have indicated that they wish to invest, and wish to carry out due diligence, it is normal for an investor to be asked to sign a non disclosure agreement before they start investigating the company’s books and records. This document is an undertaking that they will not disclose to any third party any information or facts about the company which they have been provided with or discover in the course of their due diligence.

If the Investor likes what he sees and wishes to proceed to Investing cash into the business it is imperative that the Investor and Directors of the company get on well and have shared views in the future running of the company and long term strategies, particularly regarding exit strategies.

Investors will not invest into life style businesses. There is nothing worse than having an Investor who disagrees with the original entrepreneur on the day to day operations and timing and route of exit.

It is a good idea for the company to check out the Investor. It is a two way agreement. Points to check – the investor’s track record in his/her business activities, confirmation that they have the funds available and most importantly he is who he says he is - ID checks.

Heads of Terms

When both parties are happy with the terms of their agreement it is a good idea to draw up a heads of terms agreements (please find details in the Legal Guide). This details what has been agreed and whilst not normally legally binding is a good document for both parties to instruct their lawyers in drawing up the investment agreement (please find details in the Legal Guide).

Depending on the legislations in different counties, an LLC gives you the flexibility to make just about any arrangement you agree on. For example, the entrepreneurs may offer the investor a fixed percentage of the investment, a fixed percentage of your total profits, or even an agreed-upon the amount each month. In addition, Entrepreneurs may make the investor a general partner, meaning that they have partial ownership of the company, or a limited partner, meaning that they share in the profits, but not the business decisions.
It is important to have considered what % of the company that the Investor will have, the class of shares, board representation voting rights etc. It is good practice to keep the document simple in order to avoid protracted discussion on this document in itself. It will be very useful to seek professional instruction from lawyers and advisers.

**Instruction of lawyers**

At this stage in the process lawyers should be instructed to take care of legal documentation required to ensure that the agreement that the Investor and Entrepreneur have is legally binding. This is put into a shareholders’ agreement which is what it says – an agreement between the parties. The details of this agreement and other legal documentation are contained in the Legal guide. In any event it is essential for the parties to follow the advice of their lawyers.

It should be remembered that it is good practice to instruct a lawyer who is experienced in this area of work, rather than a lawyer who one may have used previously on other transitions. It is a specialised field and good advice should be obtained.

**Investment made**

When the Investment agreement and legal documents have been signed the monies are transferred to the companies’ Bank account and the appropriate share certificates are issued to the investor. At this stage all of the terms of the investment agreement become operative and the Investor and directors of the company work together to achieve the agreed goals and outcomes to build a profitable business which is capable of being sold at a good profit in the future.
Pitching skills and practice

Background

One of the most important aspects for Companies looking for equity is the ability to be able to pitch compellingly and convincingly to investors in order for them to part with their cash and Invest in your business.

Many Entrepreneurs invest considerable time and effort in developing their business models, writing the business plan and preparing spread sheets with the financials etc. but often let themselves down by not preparing and practicing a good pitch that will attract the interest of Investors and ultimately funding. This is not to say that those tasks are not important but writing and practicing a good pitch is just as important.

The aim of this guide is to give entrepreneurs tips, guidance and a template for use in formal presentations to pitch effectively to Investors and obtain the required funding.

It also gives a list of questions that Investors often ask.

Normally at Investor events Entrepreneurs are given 10 or 15 minutes to pitch followed by questions from the Investors. There is a lot to cover in 10 or 15 minutes and therefore it is only possible to cover briefly all of the points that the entrepreneur wishes to get across and more importantly what the Investor wants to hear.

It is therefore essential to not go into detail but to skim over all points that Investors will be interested in – a helicopter view of the Business. This gives Investors confidence that the entrepreneur has considered everything and is on top of the business.

Overview

It is imperative when pitching for funding to have a well rehearsed presentation with a structure that will immediately grab an Investors attention and make him/her want to hear the whole of the presentation, rather than lose interest in the first few minutes. (Whether it is because the investor does not understand the proposition or he/she is fails to be convinced that there is an opportunity to make money from the company).

Many Entrepreneurs forget that when they are pitching for Investment they are selling the company (or rather part of it) not the product. Whilst an Investor may well be interested in how innovative, well designed, and clever a product is, and the benefits it brings to an end user, he is more interested in how that product will attract sales and how those sales will be converted into profits. In other words is there a market for the product, will it achieve sales, will those sales make money – generating cash and profits.

Most Investors are interested in taking equity stakes in companies for a period of three to five years and then selling those shares at a very substantial gain - the exit, as it is called in the Investment world.

This guide lists the key points that an Investor will be interested in and explains the key issues to be covered in any pitch. It is not just a repeat of the business plan. It takes points from the business plan which must obviously be well thought out and reliable.

Investors should be ready willing and able to answer questions about their proposition and answer them convincingly. Investors back the entrepreneurs as much as the product. Indeed most of them will
say that they would rather back good entrepreneurs with a poor product than poor entrepreneurs with good product. They say that however good a product that if it is in the hands of a weak team it will never make money.

It is therefore essential that during the pitch, and any question and answer session, that the entrepreneur gives a good impression and that he is seen as being “on top” of the business - has thought everything through, knows the strengths and weaknesses, opportunities and threats to the business and how he will deal with them. It cannot be stressed too much that presenters must know the business plan inside out and be able to answer fully any questions that the investors may ask. The points raised in the presentation are of course taken from the business plan but is only a brief summary.

Experience has shown that Investors interest is greatest if the presentation is started with the problem (demand/market) and followed by the solution. This is perhaps the most important part of the pitch, as if the Investor cannot be convinced that there is a demand for the product he/she will not be attracted as however good the product and the team etc., if there are few sales no profits will ensue. It is extremely important therefore to get the Investor bought into the fact that there is demand for the product at an early stage.

It is suggested that a PowerPoint slide be prepared to cover each point of the presentation as a separate issue. Attached to this guide is a PowerPoint template with headings, for the use of presenters.

Listed below are the key areas that need to be addressed in a pitch and the order in which to approach them. Many presenters start with details of the company, the product and then go onto talk about the market and demand for it. Under each heading in this guide are detailed the points that need to be considered and the points to get across.

**Important 9 steps to be considered**

1. Market
2. The Product/Service
3. Present Situation
4. Implementation Plan
5. Team
6. Financials
7. Investment required
8. Exit
9. Summary
1. The Market
(The problem/demand that needs to be addressed).

Important that it is seen that there is a market for a product rather than a product looking for a market. Therefore start with the problem and move on to the solution in the next slide. Convince Investors of the problem and that there is a great demand for a solution. Use research findings to back up statements. E.g., there is a great demand for computers that run fast and buyers are always looking for faster models. (Back up with any research carried out e.g., articles and papers). It has to be current, it is no use quoting a market report 2 or 3 years old. It is a rapidly changing market. Investors will not value it at all and the presenter will lose credibility. The more that can be said about the problem/demand to get credibility the better.

2. The Product/Service
(The Solution)
In this slide state what the solution to the problem is. How it works or rather what it does. In the computer example state that the company has invented a new chip that works at twice the speed and the company has a patent on it. No one can copy. Don’t go into technicalities of how it works unless you can skim over it in few minutes. Let the investor ask the technical questions later but make sure you can answer them! Talk about trends in the market. Why your product is better and unique. Why there will be many buyers. Does it work or is money required to develop, complete or test it?

3. Present Situation of Company
(Where the company is now)
- When was the company established?
- Income stream? (If any)
- Any intellectual Property Rights owned (IPR)
- State of product/service (In development? Income producing?)
- Established customers (Under contract?)
- Potential customers identified?
- Barriers to entry of others to the market?
- Any Unique selling point (USP).

4. Implementation Plan
(What when and How)
- Develop product?
- New products?
- Marketing strategy?
- Recruit staff?
- Move premises?

5. The Team
- Show organisation chart with job titles.
- Show job vacancies, if any, and talk about why extra staff needed and the cost.
- Strengths of the team and experience (sell the team to the investors).
- Highlight any weaknesses in the team (Sales? Marketing? Financial? and plans to address them).

6. Financials
6.1 P&L forecast
- Show summary of P&L past 2 years and projected for next 4 years (please find the sample format from the Presentation Template.)
- Be prepared to discuss very briefly how the figures are going to be achieved (e.g. new product range/new customers from marketing campaign etc.)
- Investors will be particularly interested in the profit forecast and be prepared for intensive questioning as to how the income will be achieved.

6.2 Cash flow forecast
- Show cash flow forecast for next 3 years indicating worse position in each year.
  (Detailed cash flows should be in the Business Plan and this is a summary extract)
- Again be prepared to explain when deficit if any will occur why and when.

7. Investment required
- Amount /purpose
- Explain what it will be used for (be prepared for questions on costing etc for investment).
- Will it all be needed at once?
- Can it be drawn in tranches fed in as the need occurs and milestones are met?
- Is this featured in the cash flow forecast?
- Skills – would the company benefit from an Investor with a particular skill or contacts (If so state that such an Investor would be welcome).
- Explain existing shareholding of the company.
- Explain what the new shareholding will look like – what % of the company will the Investor obtain for the Investment.
  (Investors will often expect 30%- 40 % for early stage)
  A company with an existing income stream will manage to negotiate a lower % as the risk is less than say a company with a product still in development.

8. Exit
- What is the planned exit (sale of the company). When and how?
- Trade sale - to a competitor or flotation?
- Any particular target buyer.

9. Summary
A brief summary covering:-
- Market (Demand for the product/service )
- Product (Solution to the problem)
- Implementation Plan (to carry out actions)
- Investment Required – the total amount and where the money will be spent on?
- Seeking an Investor with money and any skills/contact desirable
- The percentage of company share to offer.

Frequently asked Questions

- You say the size of the market is X amount, how much of that market are you aiming to achieve and how will you go about it?
- What does that equate to in Income figures and what gross margin will you make?
- You aim is to go from sales of from X to Y. That is a big increase how will you achieve that?
- Can I go and buy the product/service now today?
- Does the product/service satisfy any regulations – Health and Safety, ISO9001 and so on.
- Do you have any testimonials about the product?
• If it is high technology product- Do you have patent on your product?
• If it is a specifically designed product- Have you applied Industry design for your product?
• If it is a brand magazine with a special name- Have you applied trade mark for your name?
• What do you see as the major challenge to your business?
• What arrangements do you have in place for distribution and do you have staff available to meet any increased sales?
• How have you valued the company?
• What is the Exit strategy?
• How much will you be drawing from the company in fees and salary? Don’t you think that is high for a growing company?
• Will there be staff options scheme?

Useful Tips

• Keep to time
• Introduce yourself and co presenters - names and roles – no more
  Later in the pitch your roles will be seen in the organisation chart and explained as appropriate.
• Keep it to a few slides – say 10 see template
• Are you sure of the format of the event - time available and time for questions.
• If you are nervous try to familiarise yourself with the stage
  (There is nothing worse than stumbling up there for the first time and being dazzled by the lights). If you have been there before it builds confidence.
• Think about Dress - dress as you want to be seen.
• Body language - This is as important as the words. Aim to appear confident and in control.
• Speak clearly and slowly.
• Ensure you know how the equipment works (microphones, lap tops etc).
• Research the Investors if possible.
• Don’t use Industry jargon and acronyms. Use straight forward Language all investors will understand.
• Don’t try to cover too much in the time. You will rush it all and not cover convincingly what you want to say and appear unprofessional.
• Let Investors ask the questions regarding the parts you don’t have time to go in to detail on.
• Practice the presentation.
• Pitch to an honest friend – does he/she understand it?
• Get a friend to challenge you on everything.
• Investors will challenge all assumptions and statement so be prepared. Investors can be very blunt and appear very harsh and unfriendly when questioning. Be prepared for this.
• Ensure that you know your way round the headline figures.
• Have the P&L and Cash Flow Forecast with you so if you are asked deep questions you can quickly look it up.
• Have post it notes on the page to access it quickly. Nothing looks worse than no answer- or a guess at the answer!
• Be clear as to what you want from Investors- arms length cash? Investor cash and involvement in the business day to day? Investor cash and skills and contacts? If you know one of the Investors has those contacts dwell on the point for a minute or so. It may well be attractive to him/her.
• If you are presenting as a team get one person to present – others to answer technical questions. Allocate the sectors they will answer on. It makes it look like a professional “team” with specific tasks and roles.
• Ensure that your contact details are on the final slide. It can be left on the screen whilst answering questions.
• Slides - use Bullet points if possible- not a script.
• Don’t try to use clever PowerPoint fly in graphics unless you are good at it. You are there to convey your business idea as simply as possible so they understand and remember it.
• Use Pictures where possible.
• Try to stay calm and in control and looking confident (Practice makes for confidence!).
• Before pitching to Investors try to contact a Business Angel Network manager or a deliverer of Investment Readiness programmes. They often provide intensive training and Dry Run opportunities where you can practice your pitch in front of experts who will often ask very difficult questions in a blunt style. This is good preparation and experience for the real event.
• Ensure you have comprehensive Business plans and executive summaries to give out.
• Take along any sample of the product so they can see it. Don’t however get carried away with it. You are there to sell Shares in the Business not the product.
Profit and Loss Accounts

Introduction
This guide is written as an overview of the importance of profit and loss forecasting and the measurement of progress against original plans and forecasts. It is not intended to be an exhaustive guide to the regulations as to what should be put into profit and loss accounts for legal accounting and taxation purposes. It is intended as a guide to assist companies and entrepreneurs who are considering approaching lenders and Investors for cash injections to their business.

The guide comprises an explanation of the principles, examples of what should be included, and at the end a spread sheet to assist companies in preparation of a profit and loss forecast.

What is it
A profit and loss account measures a company’s sales revenues and expenses over a period, providing a calculation of profits or losses during that time. Generally all businesses have to run a profit and loss account in order that tax authorities can calculate how much profit that they have made and levy appropriate taxes. Most businesses regard the keeping of such records as a task that they have to undertake in order to keep the authorities happy. However the records are extremely useful for a business to measure how much profit that they have made, analyse where income came from and what expenses were incurred.

Why is it important
Reading a profit and Loss account is the easiest way to tell if a business has made a profit or loss over a period of time. The most important figure is it contains is net profit; what is left over after revenues are used to pay expenses and taxes. Companies typically issue profit and loss report monthly. It is customary for reports to include year to date figures as well as corresponding year earlier figures to allow for comparison and analysis.

How it works in practice
A profit and loss account adheres to a simple rule of thumb; revenue minus costs equals profit. It should be remembered that the more lines that are inserted, breaking down income and expenditures then the more useful the document is as it enables the reader to be able to study exactly where the income comes from (by product or territories, customers etc) and also where expenses are incurred.

Points to note
It should be remembered that it only measures a given period. It could therefore be misleading to read one month’s figures in isolation. For example if looking at a company’s account in the winter it may show a loss where by all of the income comes in the summer. It is important therefore to understand the business before reading and trying to interpret a company’s profitability.
It should be remembered that the bottom line – profit does not necessarily equal cash. It can if it is a simple business say a sole trader who buys stock for cash and then shortly after sells for cash. It definitely does not where a company buys for cash and then sells on credit of say 90 days. In this scenario the company may well show a very good profit month by month but the Bank balance will be showing a very different picture as the cash flows out on purchases and has no income coming in for three months. It is important to fully understand this and in addition to a profit and loss account to also construct a cash flow forecast – showing how the cash moves in and out of the bank account in real time.

The importance of P&L accounts for Investors and Lenders
An Investor will want to be able to form a view on the company’s existing profitability (if the company is already trading) and also very importantly be able to take a view of future profits.
Investors will therefore require a profit and Loss account normally for a three year period showing annualised figures.

They will expect these figures to be broken down month by month for a period of the next 12 months. They will go through the forecast line by line challenging the figures for both Income and expenditure and form their own views on what they think the company will make in terms of profit. It is important that all companies prepare a forecast of what they think they will achieve in terms of income and expenditure year by year and also monitor progress against actual results and figures. This will enable the directors of the company to make strategic decisions if figures vary from forecast. It also enables Investors to keep a track of progress of a company and how their Investment is doing. Investors often make monies available against a specific profit and loss forecast and frequently release their investments in tranches against the results of the profit and loss account against target figures agreed at the outset. It is very important therefore to have realistic figures entered into the profit and loss account.
**Investor Exits**

An exit is the process by which Angels may realise a substantial capital gain by selling their shares in the investee company for a higher value than their initial investment. Investor Exits is the last phase of Business Angel investment and it is the start of next investment. The three main types of exit event are as follows:

1. The sale of the entire issued share capital to a third party, often a trade purchaser, although occasionally by way of a “buy-out”, where the investee company is acquired by an entity funded by a private equity investor, a bank and/or a management team;
2. The buy-back of the Angel’s shares by the company itself from its own resources, or perhaps by a fellow investor or by the entrepreneur; or
3. The flotation of the company on a public market, such as the Alternative Investment Market (AIM), by way of an initial public offering.

In each case, these will be critical events for the Angel Investor and will give rise to a considerable number of legal issues, a selection of which are outlined below. It is therefore vital for Angels to obtain, either independently or as part of the wider seller group, the best legal advice from lawyers who are experienced and skilled in these types of transactions so that the prospects of achieving the desired financial return from the exit are maximised and ongoing risks are minimised.

Understanding the different types of exit opportunities that are available to an angel investor is important, but an entrepreneur should also consider what types of Limited Company shares in different country that should be offered to an Angel Investor, as transferring the wrong types of shares can have serious repercussion on an Angel Investors ROI from you.

**Sale to a third party**

Firstly, the Angel should fully understand the nature of the proposed deal and ensure they are happy with the way it is structured. Key questions are likely to be:

- Will the consideration be fully paid at completion, or is there an element of deferred consideration, for example, an earn-out?
- Is the buyer proposing a retention fund, through which some of the consideration is reserved to deal with post-completion issues, for example, warranty claims?
- Is the consideration all cash, or is the Angel (and their fellow sellers) being offered loan notes or shares in the buyer (the creditworthiness or value of which could change after the deal completes)?

These issues go to the core of whether the deal will actually deliver the anticipated return on investment and need to be carefully evaluated at the outset.

On the basis the Angel is happy with the proposed deal; the key transaction document will be the sale and purchase agreement between the Angel, their fellow sellers and the buyer. This will contain a number of contractual protections in favour of the buyer which need to be considered and negotiated carefully.

The buyer is likely to require a fairly comprehensive set of warranties, which are contractual promises about the state of the business, for example, that it is not involved in any litigation, which if later proved to be incorrect when given, enable the buyer to sue for damages if they have suffered loss (i.e. the value of the company is diminished).
If the Angel has not been closely involved in the investment, warranties may be difficult for the Angel to provide, since their knowledge of the business will be based only upon the information provided by the management team. There is a natural tension between Angels wishing to limit their contractual risk (i.e. by not giving warranties where they feel unable to do so) and purchasers wishing to have contractual recourse for the full amount of the purchase price. This is where the position of the Angels and the management team can begin to differ and careful consideration (and possibly independent advice) will be needed to resolve this issue.

Another area of possible tension is restrictive covenants – a buyer may demand an undertaking from all sellers that they will not, for a period following completion, compete with the business or solicit its customers, suppliers or employees, or indeed invest in a competing business. Whilst this may be viewed as a reasonable request for the management team, who clearly have the potential to undermine the goodwill acquired by the buyer if they engage in such activities, the Angel Investor will not want to be “locked out” of a particular sector if they feel this is ripe for further investment, or if it is the sector they always invest in as it matches their own area of expertise.

**Buy-back of shares**

If a third party purchaser is not yet available or the other shareholders do not wish to sell at that time, the Angel can achieve an exit through having their shares acquired by the company itself. However, the company can only legally do this by:

1) Funding the acquisition through its retained profits;
2) Funding the acquisition through the proceeds of a fresh issue of shares (i.e. a new funding round);
3) Having exhausted its retained profits and in limited circumstances only, funding the buy-back out of existing share capital.

The company will therefore need to be on appropriate financial footing in order to effect this type of transaction, and the entrepreneurs leading the venture may be reluctant to divert company funds to an Angel seeking an exit if funds are still needed to finance growth.

Alternatively (or possibly in conjunction with a buy-back), the Angel can sell their stake to existing investors, for example, the management team, who may be prepared to buy the shares now in anticipation they can be sold at a higher price at a later stage. The company’s articles of association will usually require the Angel to make an offer to all shareholders to purchase their shares, with their entitlement being determined by the size of their existing holding.

The Angel would likely only be able to sell their minority stake to an independent third party if rights of pre-emption were not taken up or waived by the existing shareholders. In any event, the acquisition of a minority stake in a private company is unlikely to be appealing to anyone who is not already a stakeholder in the business.

**Initial Public Offering**

If the company is of sufficient size and strength, the shareholders may seek to convert the company to a public limited company and arrange for it to be listed on a public market by way of an initial public offering (IPO). In the UK, these markets are generally either the Official List of the London Stock Exchange or the Alternative Investment Market (AIM), with AIM being the most likely exchange for the IPO in light of its less demanding regulatory regime and suitability for small capital companies.

An IPO should deliver a number of benefits to the company such as increased profile, additional money for expansion (since new shares are likely to be issued as part of the IPO) and future
acquisition currency, as it will be able to issue publicly traded shares as currency to fund transactions. However, Angels should note that an IPO is unlikely to deliver the full “exit” they may be seeking - the immediate sale of shares by those closely associated with the company will send out a signal to the markets that the company is overvalued, leading to a decline in share price and unhappy investors. As a result, existing shareholders will be subject to a “lock-in” period in which they are restricted from selling their newly liquid shares. This is likely to be more onerous for the management team given their more detailed knowledge of the state of the business, although will depend on market conditions and is a key issue for Angels seeking a true “exit” by way of an IPO.

This information has been obtained from The British Business Angels association (BBAA) based in London. They have written various guides to assist those involved in the Private Equity Investment Market.
Legal Guide

Introduction

Please be aware that this guide has been produced by the British Business Angels association in England (BBAA) and should be read as a guide and not considered to be legal or technical advice. Clearly each country has its own legal systems, laws, rules and precedents that need to be considered. This has been written within the laws of England.

The guide does however outline the process to be followed. Please note that the BBAA macc - bam or any other contributor or party involved in the writing or distribution of this can be held liable to any party relying on the content.

Specific professional advice should be sought by all parties in the context of any Investment

Set out below are frequently asked questions relating to the process- and set out in the order that they are encountered when working through the process of Investing.

How long should I allow concluding a transaction once terms have been agreed in principle?

As a rough guide, a period of around eight weeks from reaching agreement in principle should be sufficient to conclude an investment, although the actual length of time required will vary from transaction to transaction – the factors listed below can all be relevant:

- The amount being raised – a smaller investment may result in shorter legal documents and therefore less time being devoted to that aspect of the transaction;
- The amount of due diligence which the investor wishes to undertake – again, with a small investment, an investor may spend less time on due diligence. Generally, the longer the trading history of the target company, the more due diligence will be required;
- The number of investors participating in the funding round – the process can be easier to manage with a smaller number of investors. It is also important to remember that lengthy negotiations may have taken place in order to reach an agreement in principle, so the entire process from first contact through to receipt of the investment can easily take 3 – 4 months to conclude.

I have been told that it can be helpful to produce ‘heads of terms’ – what are they?

The heads of terms (also known as a term sheet, letter of intent or memorandum of understanding) is a document which sets out the main terms of the proposed investment and any pre-conditions to the making of the investment (such as satisfactory due diligence, confirmation of the availability of EIS relief or Keyman insurance for key employees). Except for confidentiality restrictions and exclusivity periods, heads of terms are usually not legally binding. Heads of terms help to provide clarity for all parties (and their respective advisers) as to the main terms of the deal at an early stage of the process, and as such they can be very beneficial. However, in the context of a Business Angel Investment it is important to keep the heads of terms as simple as possible in order to avoid being drawn into protracted negotiations on that document. Please see Appendix 1 for a standard form term sheet.

What due diligence is commonly undertaken by an investor?

From an investor’s perspective due diligence is particularly important, as it provides an opportunity to investigate the target company before committing to an investment. The actual level of due diligence
undertaken will vary depending upon a number of factors such as the size of the investment, the nature of the business and its prior trading history. The due diligence exercise will commonly cover some or all of the following:

- **Legal** – for example, checking that the company has been properly incorporated; reviewing any major commercial contracts which may be in place; checking whether employees have appropriate employment contracts in place; and ascertaining ownership of intellectual property (particularly important for companies operating in the technology sector).
- **Financial** – ensuring that there are no “black holes” in the accounts and assessing the company’s future projections and forecasts.
- **Commercial** – understanding the company’s target market and possibly speaking with key customers.

Perhaps equally important from an investor’s perspective is due diligence on the management team. Ultimately, an investor will be backing the founders/management to deliver returns on the investment made and from the commencement of discussions an investor should be focusing on whether the right people are in place to achieve this.

There are a number of potential warning signs for investors, including founders who have committed little of their own money to the business, management teams lacking key individuals (and with little or no awareness of the deficiency) and businesses which appear to be more of a lifestyle choice.

In the rush to launch a business, and when money is tight, many businesses are tempted to spend less time addressing legal issues than they ideally should. In the medium term, this can prove to be a false economy since any shortcomings are likely to be flushed out by the legal due diligence process undertaken by Angel Investors. Where problems are revealed, then at the very least this is likely to impact upon the timing of the investment whilst they are thoroughly investigated and potential solutions are explored. In a worst-case scenario, problems revealed during due diligence can impact upon the willingness of an investor to proceed with the investment.

The founders of a company are likely to be asked to stand behind the information provided in response to the due diligence exercise, through warranties given to the investor in the investment and shareholders’ agreement (which is dealt with in more detail elsewhere in these FAQs).

**Should an investor be required to sign a non-disclosure agreement (NDA) before the entrepreneur discloses any confidential information in connection with the investment opportunity?**

From the target company’s perspective an NDA in its favour can be helpful. In practice many Business Angels refuse to sign them (at least in the early stages of a transaction), largely due to the number of business plans which they receive. (Normally the NDA is required after the agreement has been reached in principle but before detailed due diligence has started.)

**Legal documents required**

**(a) What legal documents are likely to be required in order to finalise the investment?**

In addition to heads of terms and possibly an NDA, you will almost certainly encounter the following documents:

- **Investment and shareholders’ agreement** – this document sets out the terms of the investment and regulates the relationship of the shareholders once the investment has been completed. It will address the specific rights of the Angel Investor(s), such as rights to appoint directors, to receive information on the business and to veto certain actions of the company. A model form
investment and shareholders’ agreement (can be found in Appendix 2) and further information on this document is outlined in more detail elsewhere in these FAQs.

- Articles of association – a company’s articles of association set out its internal regulations and deal with its management and administration. They deal with matters such as transfers of shares, dividends and voting rights, and complement the investment and shareholders’ agreement. Again, precedent articles of association can be found in Appendix 3, further information on this document is set out in other FAQs.

- Disclosure letter – the disclosure letter sets out disclosures against the warranties contained in the investment and shareholders’ agreement. It is a very important document and is dealt with in the following section.

These documents may also be required:

- Assignments of intellectual property – due diligence enquiries often reveal that key items of intellectual property are owned by one of the founder shareholders rather than the company. Most Angel Investors will insist, as a pre-condition to completion that the intellectual property in question is assigned to the company.

- Service agreements – these may be required if the senior management team either do not have employment contracts in place, or if those which are in place are no longer considered appropriate.

- Share option agreements – share options may be granted if it is important to incentivise other senior members of the management team who do not currently hold shares. There are a number of different ways of structuring options, although Enterprise Management Incentives (EMI) options are often used.

(b) What is the disclosure letter and why is this required?

The investment and shareholders’ agreement will contain a number of warranties relating to the business and affairs of the company. These will usually be given by the management shareholders and the company itself (the warrantors), in favour of the investor(s). If any warranties are not true, and this is not brought to the attention of the investor(s) prior to completion of the investment, the investor(s) will potentially have a claim against the warrantors for losses which they suffer as a result. The disclosure letter, from the warrantors to the investor(s), is the document which details any exceptions to the warranties. It is an important document both from the perspective of the warrantors and the investor(s) for the following reasons:

- From the warrantors’ perspective, to the extent that exceptions to the warranties are “fairly” disclosed in the disclosure letter (i.e. in sufficient detail to enable the investor(s) to make an informed assessment of the matter in question), this should prevent a claim for breach of a warranty subsequently being brought against them.

- From the perspective of an investor, it fulfils a very useful confirmatory function in relation to the target business. As warranties and disclosure are key elements of the transaction documents and will be contractually binding on the parties, this can help to ensure that specific and detailed disclosures are made by the warrantors – as opposed to the often rather general responses which due diligence flushes out. The disclosures usually fall into two categories, general disclosures (i.e. information which an investor will be deemed to have knowledge of whether or not it undertakes the necessary enquiries, such as information recorded at Companies House or the UK Intellectual Property Office) and specific disclosures against the warranties contained in the investment and shareholders’ agreement.

(c) Should I be insisting that the company signs a new service agreement?

The investor is backing the people behind the business and will want to ensure that the terms on which they are employed by the company are clearly documented and offer appropriate protections to the company. Many companies do not put service agreements in place until they obtain their first external investment; where employment contracts are already in place investors often find that they
are inadequate and need to be strengthened. Apart from the obvious commercial terms such as salary and bonus levels, investors will look for:

- A sensible notice period, ensuring that if a key member of management gives notice the company has a reasonable period of time in which to search for a replacement and that the period when the post in question will not be covered is minimised;
- Obligations restricting the disclosure of confidential information by the employee;
- Post-termination restrictions designed to protect the goodwill of the company (for example, restrictions on being involved in competing businesses or poaching customers or employees).

(d) Who will control the company on a day-to-day basis after the investment?

The company will continue to be run on a day-to-day basis by the executive directors, with larger or strategic decisions being made by the Board. However, it may be a condition of the investment that the investor has the right to appoint a director to the Board, usually in a non-executive capacity. A fee may be charged by the investor for monitoring their investment in this way.

In addition, the Shareholders’ Agreement may specify certain actions which the company/board cannot take without the consent of the investor. These “consent matters” tend to include: the company borrowing more than an agreed limit; issuing new shares; adopting share option schemes; and taking actions which would jeopardise the investor’s EIS relief. Please see Schedule 6 of the BBAA Shareholders’ Agreement for a full list of consent matters that are commonly discussed. Matters requiring a resolution of the members will need to be put to the shareholders at a general meeting or by written resolution in the usual way, and of course both managers and the investor will be able to participate in these matters by virtue of their shareholdings in the company.

(e) What provisions of the Shareholders’ Agreement bind directly on the entrepreneur?

The Shareholders’ Agreement is not just a contract between the investor and the company setting out the terms of the investment. The entrepreneur managers are almost always parties too. The obligations they assume are:

- To use their votes as directors and shareholders to ensure that the company abides by its obligations under the Shareholders’ Agreement;
- Alongside the company, to give warranties to the investor as explained in the answer to the question “what is the disclosure letter and why is it required”. Example warranties that may be sought by the investor are set out at Schedule 4 of the BBAA Shareholders’ Agreement;
- To ensure that the company provides the investor with key information, for example statutory and management accounts, business plans and budgets etc. An example of these information rights is set out at Part 1 of Schedule 7 of the BBAA Shareholders’ Agreement;
- To abide by restrictive covenants. As well as any restrictive covenants in the managers’ employment agreements, the Shareholders’ Agreement is also likely to contain similar restrictive covenants, but here given to the investor rather than the employing company. It is also likely that the courts will enforce restrictions in a Shareholders’ Agreement more readily than those in an employment agreement. These restrictions will cover non-competition, non-solicitation of employees and non-solicitation of customers, as set out in Schedule 8 of the BBAA Shareholders’ Agreement.

(f) For how long will the Shareholders’ Agreement stay in place?

The Shareholders’ Agreement is likely to bind each of the parties to it for as long as they remain shareholders. Even after a manager ceases to be a shareholder they may still remain bound by provisions such as confidentiality, restrictive covenants and potentially the warranties. The
Shareholders’ Agreement will usually only terminate in its entirety upon a sale or listing, when all of the existing shareholders achieve an exit.

Most investors have a time horizon for their investment and managers should be aware that many Shareholders’ Agreements contain provisions that the managers will assist the investor in achieving a sale or listing of the company if an exit has not been achieved within a certain period from the date of investment, for example, those set out at clause 11 of the BBAA Shareholders’ Agreement.

(g) What are the Articles of Association and what key commercial issues do they contain?

Unlike the Shareholders’ Agreement, the Articles are not a contractual document signed by all the parties. They are in fact the constitution of the company, in accordance with which the company has to act. They are binding on all of the shareholders as the “rules” of the company, of which each shareholder is a member. The precedent BBAA Articles of Association can be accessed at www.bbaa.org.uk.

The Articles may cover some of the provisions which are also dealt with in the Shareholders’ Agreement. For example, it is not unusual for both documents to deal with the right for the investor to appoint a director, other board matters, and matter requiring investor consent.

The key commercial issues which would usually be found only in the Articles are: Anti-dilution protection, compulsory transfer provisions (including good leaver/bad leaver) and forced exit provisions (drag-along and tag-along).

(h) What sort of anti-dilution protection can I expect to see in an Angel-backed deal?

Anti-dilution protection is the name given to provisions, usually in the Articles, to protect an investor from suffering dilution of his/her shareholding, which would otherwise occur when additional shares in the company are issued after the date of such investor’s investment.

Such protection can take the form of a ratchet mechanism which retrospectively re-prices the investor’s investment if further shares are issued by the company at a lower price, but more usually in Angel-backed business, antidilution protection takes the form of pre-emption rights over the issue of new shares, such that no new shares can be issued until they have first been offered to the existing shareholders, pro-rata to their existing shareholding. An example of such pre-emption rights is set out at Article 5 of the BBAA Articles of Association. In addition the issue of new shares is likely to be an action for which investor consent is required.

(i) Will managers be forced to sell their shares if they cease to work in the business?

It is very typical for investors to require managers to sell their shares in the event that they leave the business. It is generally thought that allowing individuals who no longer have a relationship with the company to remain as members makes the administration of shareholder matters more difficult and may be an obstacle to an exit. In addition, it is felt that there is no reason why a manager should benefit from further increases in the value of a business that they are not contributing to by working in that business.

If a manager’s shares fail to be sold, the price at which such sale occurs must be set. Angel Investors commonly make a distinction between managers who have chosen to leave (for example, to pursue an opportunity elsewhere, or to take early retirement) and those who have been forced to leave (for example, through ill health, redundancy or death). The former, referred to as “bad leavers” may be required to sell their shares at the lower of fair value and the price the manager originally paid for such shares. As managers tend to subscribe for their shares at par, a “bad leaver” price could therefore yield very little by way of consideration.
A price paid to a “good leaver” is likely to be market value. Assuming this is higher than the original price paid by the manager, that manager will therefore get their share of the increase in the value of the company which they have helped to achieve before their departure. Example “good leaver” and “bad leaver” provisions are set out at Article 10 of the BBAA Articles of Association.

(j) Other than cessation of employment, in which other circumstances can a manager be forced to sell?
Investors often require the ability, when selling their own shareholding in the company, to require that the managers also sell their shares to the same acquirer. The rationale for this is that many more purchasers are likely to be interested in acquiring the shares if they can buy the whole company, rather than a minority interest in it. This right, known as “drag-along”, usually means that the managers will get the same price per share as the investor.

Whilst some managers baulk at the prospect of being forced to sell “their” company at a time other than their own choosing, in reality, prospective purchasers will not be interested in buying a company in the teeth of fierce opposition from management. The process is inevitably more consensual than the mechanism of the drag-along may suggest.

Drag-along rights are also softened by the offering of equivalent “tag-along rights” giving managers the right to sell alongside the investor in the event that the investor has found a buyer for their shares, and has not invoked the drag-along. Example “drag along” and “tag along” rights are set out at Article 9 of the BBAA Articles of Association.

**Intellectual Property (IP) considerations**

Getting proper IP protection in place can be crucial to a company in ensuring that competitors cannot freely take advantage of the company’s innovations. IP protection can take a number of forms, including patents in the case of technical inventions; trademarks to protect a brand; design rights and copyright; and confidential information.

Moreover, it is important to understand if IP owned by third parties may be relevant to a company’s activities, and if so the risks to the company that are posed by that third party IP.

The following IP due diligence questions are designed to give an understanding of the value of a company’s IP to the business as a whole, and the risks posed to the company’s business by IP owned by third parties.

The most important due diligence questions to ask will vary from one investment opportunity to the next, and may give rise to further questions beyond those set out below. Consequently, it is important to seek professional legal advice on a case by case basis.

1. **General Intellectual Property (IP) Considerations**
The questions in this section should be answered for all IP that the company has rights to, regardless of whether the company owns the IP (in whole or in part) or is licensed under that IP.

(a) **What intellectual property rights does the company hold rights to?**
This includes patents, trademarks, registered designs and applications for the same; copyright material (e.g. software, brochures, manuals and details of databases), unregistered design rights and confidential information (in particular technical information that the company has chosen to keep confidential rather than publish).
(b) Does the company have an IP policy?
This is important in determining how the company goes about identifying, recording and protecting its intellectual property. For example, the company may have important IP that has not been identified (e.g. due to lack of IP awareness training) or that has not been protected (e.g. an invention may not have been filed as a patent application for budget reasons).

It is also important to understand what procedures the company has in place to deal with confidential information that has been provided to the company, or confidential information that the company has provided to third parties.

(c) What areas does the company’s IP lie in?
This question serves to understand who are likely to be direct and indirect infringers.

(d) For each registered right, is the right a pending application or is it a granted right?
Only granted rights can be enforced in the courts; although it may have value as a saleable asset, an application for an intellectual property right cannot be enforced.

(e) What is the geographical scope of IP protection?
If the scope of IP protection is geographically limited then third parties are free to use that IP outside protected jurisdictions. For example if patent protection exists in the US only Also, the ability to enforce IP rights effectively does vary from jurisdiction to jurisdiction.

(f) Is the IP relevant?
Is the IP relevant to:
(i) The company’s current activities; or
(ii) The activities of third parties?

An application for an IP right may have broad, commercially relevant scope but the corresponding granted right is often narrower and may not be as commercially important.

The following are key considerations when making an investment about assignment of IP to a third party.

(g) Does any third party have a right or interest in any of the company’s intellectual property, for example by way of a licence or a security agreement?

(h) Is the company prohibited from assigning any IP that it has rights to, for example under the terms of a loan agreement?

(i) Will purchase of the company result in termination of any provision in an agreement relating to IP rights that the company has with a third party?

Questions (g) – (i) are important in determining the freedom the company has to sell or licence its IP. Additionally, if there are change of control restrictions on third party software used by the company this will need to be addressed as, from the investor’s perspective, it may have a material impact on the value of the transaction.

(j) Has any of the company’s IP been the subject of threatened or actual litigation?
This includes but is not limited to:
• Alleged invalidity (for example, through opposition, interference, revocation or re-examination proceedings);
• Alleged infringement of the intellectual property (for example trade mark, copyright or patent infringement, passing-off or breach of confidence);
- Entitlement disputes;
- A claim by an inventor for compensation in respect of a patent or patent application owned by the company.

It is important to know if there is any actual or threatened litigation associated with the company’s IP, which may incur significant costs and/or put the validity or ownership of the company’s IP in doubt.

(k) What are the annual costs for maintaining all registered IP, including official fees and agents’ fees? Filing and maintaining registered IP can be vitally important, but can also be expensive – it is important to know the cost of this IP protection in order to understand cost vs. benefit of the company’s IP protection.

1.2 IP owned by the Company

(a) In the case of intellectual property rights owned by the company, what is the basis for the company’s ownership? This will usually be by way of an employment agreement assigning rights to the company as employer of the inventor, or an assignment in the case of IP that the company has acquired from a third party. It is important to note that IP generated by a consultant or contractor will not automatically vest in the company.

(b) Are there any restrictions on the company’s rights to use or licence its owned IP? The company may own IP, but may not have the right to use or licence it – for example as the result of exclusive licensing arrangements.

(c) Are there any registrable IP rights for which applications have not been filed, in particular IP disclosures? This question serves to identify potentially important IP that has not yet been protected.

1.3 IP arising from collaborations

(a) Copies of all agreements relating to collaboration with third parties should be provided. This includes university collaboration or sponsorship, consulting, joint development, joint venture and nondisclosure agreements.

(b) Identify all IP arising from these collaborations.

(c) Are there any restrictions on the company’s right to use IP arising from collaborations?

(d) Are there any joint ownership issues that require consent of the third party for the company to exploit the IP?

(e) Does the company have the right to grant licences to IP arising from collaborations? For example, the company may be a sole or joint owner of a patent arising from a collaboration, but the collaboration agreement may divide use and licensing rights, for example, by technology field.

1.4 IP licences

(a) Does the company have licences to third party IP? Provide copies of all such licences. This should include licences to “off-the-shelf” software such as Microsoft Office, in addition to licences more directly related to the business of the company.
(b) Has the company either:
i) licensed IP that it owns in whole or in part, or
ii) sublicensed third party IP? Provide copies of all such licences.

(c) It is important to understand if the company has restricted its rights to use or licence IP it has rights to.

1.5 Infringement

(a) Has any of the company been alleged to infringe third party IP, and if so has there been any threatened or actual litigation?

(b) What clearance searches and opinions does the company have?

(c) What searches and analysis have been conducted with respect to the IP position of competitors?
It is important to ascertain if competitors hold key IP that the company would need access to.

(d) Has the company given any third party a representation, warranty or indemnification with respect to infringement of third party IP?

(e) Has any third party been alleged to infringe IP owned by or licensed to the company, and if so has there been any threatened or actual litigation?
This does not have to be formal legal notification. For example a third party may have sent an e-mail or notified the company by telephone. All such instances should be recorded and information regarding them provided.

*As mentioned at the head of this document Specific professional advice should be taken in the context of any particular investment

Please see separate appendix for the legal guide

- Legal Guide Appendix I- Term Sheet
- Legal Guide Appendix II- Investment Agreement
- Legal Guide Appendix III- Articles of Association