

Private Equity News

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Client Alert: Portfolio Company Maintenance — Why It Is So Important

You chased that target company for a long time, or went through a time consuming and expensive auction process. You received committee approval and you finally made the investment. In the back of your mind you hope that when it's time to sell, you will be able to sell quickly, at a good price, and move on. For several years now you have been investing your time and energy in growing that portfolio company and now it is time to sell. Mid-way through the sale process you or your counterparts discover a legal issue that becomes bigger than it should be. You are now faced with several options, and unfortunately none of them are great for you:

- You are asked to take action to correct the issue when you don't have a lot of time to do so;
- You need to think about and then negotiate workarounds which may be too complicated and require you to spend more time and attention post-closing;
- You may need to agree to or offer a purchase price adjustment, in some cases, taking into account the cost to fix the issue and the sale multiple;
- Or, in some extreme cases, you and/or your counterpart may decide to walk away from the deal and the process is terminated without you selling the company.

How can you prevent this from happening to you? In most cases, the answer is maintenance. Yes, the same concept you use to keep your car running should be used for discovering and addressing legal issues that your portfolio company comes across or could potentially come across.

In so many cases, we have seen that the "significant issue" raised by a buyer in a sale transaction could have been very small or prevented with minimal cost and effort. Often times, it is the form separation agreement that was poorly drafted by the portfolio company's local counsel or HR team, the failure to record issuances of incentive equity or options, the failure to obtain signature pages or to have the final execution copy of a document, the failure to have the company's privacy policy or classification of employees reviewed, and so on. Those are all simple enough items that can be handled appropriately and efficiently if the portfolio company has a system in place. The system needs to include up-the-chain reporting that keeps the private equity fund principals in the loop on legal matters as soon as they are discovered, coupled with a dedicated team of high quality counsel who understand your business, time constraints and goals, and can help you maintain the legal condition of the portfolio company. Once the system is established, a little preventative maintenance can translate into real dollars, both in the form of future cost savings and increased sale value.

At Sheppard Mullin, we have identified this as a significant issue for our private equity clients and have established a designated Private Equity Portfolio Company Program for the benefit of our private equity clients and their portfolio companies' management teams. The Private Equity Portfolio Company Program offers a dedicated team of senior experts in all practice areas assigned in advance to handle any legal matters of the portfolio companies during the private equity fund's ownership period, making it easier for the portfolio company management to handle day-to-day legal matters and more cost-efficient for the private equity fund, translating into an increase in the portfolio company's bottom line and sale value.

Our Private Equity Practice

Sheppard Mullin has a thriving private equity practice with a proven track record of providing top-level service to private equity sponsors and their portfolio companies in leveraged buyouts, growth equity transactions, restructuring and recapitalizations, going-private transactions and funds formation. Our talented private equity team members prioritize client objectives to deliver the best results. We efficiently deploy the resources and broad practice expertise of our over 750-lawyer international law firm to timely address our private equity clients' needs and objectives.



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