CLIENT ALERT

OSBORN MALEDON

Ready to Swim with the Sharks?

A Pre-Recession Guide to Successfully Exiting Your Business

1. Consider a Competitive Process
You are likely to get a higher price for your business if there are competing offers for it. Consider engaging an investment banker or reputable business broker to help you shop your company. These professionals can help you prepare pitch materials, canvass the market and manage a competitive bidding process. They tend to be more expensive than other deal professionals (lawyers, accountants) but they often don’t get paid unless the deal closes and their fee structures incentivize them to maximize the deal price. Try to find a banker or broker with expertise in your industry and, before you hire them, ask them for references.

2. Be Intentional About Your Letter of Intent
Selling your company is rarely as "simple and straightforward" as you anticipate. Negotiating an LOI with prospective buyers at the beginning of the process helps flush out whether there is a deal to be had before you invest significant time and money in diligence or negotiating definitive agreements. It is important to involve counsel as you draft an LOI so it serves its intended purpose (to outline the deal), but doesn't go too far (becoming a binding agreement).

3. Structure Your Deal Advantageously
There are basically three structures when you sell your business - a sale of equity, a merger or a sale of assets. Each has its advantages and drawbacks. The amount of taxes you pay, deal-related expenses and deal complexity can vary significantly depending on the structure you agree to. Buyers and sellers often have competing interests on how the sale is structured and there can be creative ways to reconcile those interests. You should seek advice from professionals (lawyers, accountants, investment bankers) when negotiating deal structure.

4. Have a Data Room Ready
About 90% of the information a buyer will ask for in diligence is predictable. Deal lawyers, M&A advisors and accountants can give you lists of the most common legal, operational and financial questions a buyer will ask. Grab those lists now, organize the documents they ask for and upload them by category to a data room so that you know where everything is when the buyer asks for it. This will save you a tremendous amount of time and aggravation when you go through the sale process. Seriously, a tremendous amount. And it'll help you avoid diligence related problems that could result in a lower purchase price.

5. Get Ready to Rep
When the buyer drafts the purchase agreement it will include a long section with "representations and warranties" about your company. The buyer is willing to pay the agreed-upon purchase price if these statements are true. Be prepared to review these statements thoroughly to make sure they are accurate. If they are, that will significantly reduce the chances of the buyer making a legal claim after closing to claw back some of the purchase price.

6. Don't Ignore Indemnification
The most boring (but arguably most important) section of the purchase agreement is the indemnification section. As a seller, you will agree to indemnify (or reimburse) the buyer for losses resulting from breached representations in the purchase agreement. While you can't get rid of this obligation, you can usually negotiate limitations to it such as limiting the length of time you must indemnify the buyer or placing deductibles or caps on the amount of the indemnity. Be prepared to negotiate this section and get a good deal lawyer to help.

7. Escrows vs. Holdbacks
Usually some amount of the purchase price is either placed in a third-party escrow at closing or "held back" by the buyer as a reserve for the buyer to collect against if it suffers damages because of the seller's breach of the purchase agreement. These funds are released to the seller after a negotiated time period post-closing, assuming they are not used to reimburse the buyer for damages. Buyers usually prefer to simply "hold back" the funds in their own accounts but it's better for sellers if the buyer places the funds into a third party escrow at closing. That way, the funds are segregated from the buyer's assets at closing and the seller is not taking a risk that the buyer might not have the funds when it's time for them to be released.

8. Seriously Consider Rep & Warranty Insurance
If the deal size is big enough, your post-closing risk can be significantly lowered by insuring the deal through rep & warranty insurance. These specialized policies generally insure the buyer, but they also protect sellers by insuring against damages caused by breach of the Seller's representations in the purchase agreement. Most deals with rep and warranty insurance have smaller escrow requirements (so more money goes to the seller at closing) and significantly limit claims that can be made directly against sellers after closing. The premiums are not cheap, but the benefits often far outweigh the costs.

10. Plan for Integration

Post-closing integration of your company with the buyer's company is often harder than getting the deal done. But successful integration minimizes the chances of buyer's remorse, which minimizes the chances of the buyer making post-closing claims to attempt recovering some of the purchase price. Well before closing, work with the buyer on an integration plan that outlines exactly how your company will operate with the buyer's company and how you will ensure that key executives and other personnel buy-in to the vision for the combined companies.

Aaron Harmon is a partner at Osborn Maledon. He has built a strong reputation in Arizona's entrepreneurial community as a lawyer who provides practical counsel to founders, executives and investors alike.

Aaron represents startups, established companies and investors in angel, venture capital and private equity financings, in mergers and acquisitions, in negotiating and drafting commercial contracts, and in general corporate and commercial matters.

602-640-9386 | aharmon@omlaw.com