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Considering a Sale of Your Business… ***What's the Process of a Sale??***

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This is the second of a series of brief articles I'm writing as general information for business owners contemplating the eventual sale of their business. In the first article, I simply encouraged business owners to get the conversation started by speaking with a professional advisor; in this article, I provide an overview of the basic process most sales of small to mid-sized businesses go through, with the caveat that each business and transaction is unique and may deviate from the below.

1. Pre-Deal Analysis. The sale of a house serves as a good analogy for the sale of business. When selling a home, most owners will look around at their well lived-in home, frequently with the aid of a sales agent, and identify various measures they can take to make their home more appealing to a prospective buyer. The same concept can apply to the sale of a business. When selling a home, the process is referred to as "home staging"; in the context of a business sale, this process can be referred to a "proactive due diligence," and while it's not a necessity and is commonly overlooked or simply skipped, I believe it's well worth the effort. The process of proactive due diligence involves taking a careful look at your business, much like a prospective buyer will, for issues that might make your business more (or less) attractive, or could even derail a deal if not addressed. While you are likely the most qualified to review the physical facility of your business and identify if there ways to spruce it up, it usually takes the assistance of outside assistance to review the financial and business aspects, such as (i) reviewing key contracts and financing arrangements to identify any potential issues that could be triggered by a sale, (ii) reviewing historic corporate records to make sure they're up to date and current ownership is properly documented, and (iii) analyzing financials and, if necessary, identifying appropriate adjustments for items that may not apply to a third-party buyer. This can be a time consuming undertaking, but just like good home staging, I think it's worth the effort.

2. Offer/LOI. We jump ahead now to the point where an interested buyer (or ideally, buyer*s*) are on the scene. (I've skipped over the process of how a buyer or buyers come into the picture. There are numerous paths to that point and it's beyond the basic overview intended for this article.) After the signing of a confidentiality agreement (also referred to as a nondisclosure agreement- same document, just different names) and disclosure of some limited information (typically, basic financial information) and some preliminary conversations, most acquisitions are led off with an interested prospective buyer making a non-binding offer in the form of a Letter of Intent (or "LOI"), sometimes referred to as a non-binding Term Sheet or a Memorandum of Understanding (or "MOU"), in this context these terms are used interchangeably. An LOI will serve as the roadmap of the transaction, addressing the most material terms of a proposed deal and serve as a guide for the attorneys in drafting the purchase agreement (which is frequently referred to within an LOI as the "definitive agreement".)

At a minimum, an LOI should address each of the following:

- confidentiality (which is one of the few binding terms within an LOI);
- structure of deal (i.e., an asset sale, stock sale, or merger- but typically an asset sale);
- purchase price;

- payment terms (for example, 100% cash or stock at closing, or some portion paid over a period of time);
- due diligence timing and grounds for terminating the deal once a purchase agreement is signed; and
- terms relating to post-closing (such as employment agreements, non-competes, etc.)

A huge benefit of a negotiated thorough LOI is early agreement on major deal points, before spending the time and expense of having counsel prepare a purchase agreement. Personally, I'm a fan of a fairly comprehensive LOI covering as many substantive key terms of a deal as reasonably feasible, for example, flushing out details of a non-compete and/or post-closing seller involvement.

I strongly encourage you to loop in your business attorney at the early stage of negotiating the LOI, if not already engaged by that point. (Actually, I recommend you bring them in to the conversation as soon as you begin to consider a sale.) I suspect many owners figure an LOI contains only "business" deal points, so it's unnecessary to have their attorney advise at that point, or maybe they assume their attorney will revise issues when negotiating the purchase agreement; however, I think both are mistakes. Even if you're working with an experienced business broker, an attorney with experience in buying and selling businesses is likely to provide additional insight and propose additional issues to cover in an LOI. Additionally, it's considered "bad form" for an attorney to renegotiate deal terms stipulated in an LOI, and I'd say most attorneys are reluctant to do so absent some glaring concern.

3. <u>Purchase Agreement</u>. Once an LOI is signed, the parties will begin negotiating the definitive purchase agreement, typically either an "asset purchase agreement" or a "stock purchase agreement." (I'd estimate 95% of the time for typical, privately-held businesses, it'll be an asset purchase agreement. In a nutshell, per a stock purchase, ownership of the actual business *entity*, typically a corporation or limited liability company, is sold; whereas, in an asset purchase, the entity sells nearly all of its *assets*, both tangible and intangible, however ownership of the actually entity remains unchanged.) It is customary that the buyer's attorney will prepare the initial draft within a relatively short period after the LOI is signed. Depending on the complexity of the deal and the urgency of the transaction, this can take anywhere from a week to a couple months to negotiate and finalize.

4. <u>Due Diligence</u>. "Due diligence" is the term used to refer to the parties' respective investigations of each other, with the emphasis being the buyer's investigation of the seller's business. Depending on the nature of a business and a buyer's preexisting familiarity with your business, this can be as simple as you providing some recent financials, to an extensive and detailed review of financials, physical facilities and equipment, corporate records, key contracts, intellectual property rights and more. The due diligence process often begins on a very limited basis prior to an LOI being signed- *though <u>always</u> **<u>after</u>** a confidentiality agreement is signed (Please!)*, and then continues in a more comprehensive manner after the purchase agreement is signed. For the seller, due diligence on a prospective buyer, to make sure they're someone the seller is comfortable entering into the transaction with, will need to occur prior to a purchase agreement being signed, ideally before an LOI is prepared.

Even though a confidentiality agreement in place, I still recommend sellers remain as guarded as possible with proprietary information that could be detrimental or provide a strategic advantage to another party if the information is disclosed and then the deal not go through- such as the identity of key customers or suppliers, and any trade secrets. Even if you're able to keep certain key details undisclosed, don't be surprised if the due diligence process feels intrusive, but if you've done the proactive due diligence discussed above, the process should go much more smoothly. It's also typically during this time that a buyer may need firm-up their source and details of financing for the acquisition.

5. Closing. Once the buyer has completed its due diligence and is satisfied with its investigation, their financing is in place or otherwise agreed upon, and all the ancillary agreements are completed (this includes agreements such as employment or consulting agreements, various assignments, maybe a lease, etc.), the parties will close on the deal. Historically, this typically took place in the offices of the seller's attorney, but anymore the documents are usually simply signed and exchanged electronically and there's no in-person closing. (Alas, I miss them.)

As mentioned above, not every deal will follow the above process exactly, but hopefully this article will provide some sense of the basic process, as well as some key terms used, if you sell your business in a third-party sale.

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