Prepare for a smooth sale in fast waters

By Jeffrey Woodcox, Tonkon Torp LLP

The drive for companies to expand, diversify, or consolidate is keeping M&A activity moving along at a fast and steady pace. Of course we need to keep a diligent eye on how the business community reacts to changes in local and global market conditions, but we aren't currently seeing signs of any significant change in the pace of buy/sell activity. Deals are being entered into and closed quickly to take advantage of continuing favorable opportunities.

In most respects, M&A is as simple or as complex as it has always been. The x-factors for our current environment include ever-evolving regulations, emerging industries, and new generations of customers. What remains the same are the categories buyers will scrutinize when considering a purchase – regardless of the company or industry. It's important for sellers to be aware of these categories.

Advanced preparation and planning in the following five areas can help a seller start negotiations on solid ground and maximize value.

#1: Structure

The M&A structure (asset sale v. stock sale v. merger) will in many instances be driven by tax implications, but the type of business, its reliance on third party agreements, and state regulations are also drivers of deal structure and can have a significant impact.

Understanding in advance the tax consequences and the regulatory and third party consent requirements involved will inform the structure of any transaction and allow the seller to have a point of view from which to discuss the transaction structure with its advisors and the buyer.

#2: Agreements

Buyers generally want to examine all of the active contracts of a target to evaluate whether third-party consents are required and to understand the impact the terms and conditions of those contracts will have on post-closing operations and performance. Maintaining complete contract files is important, especially when preparing for a possible transaction.

When a strategic buyer is involved, disclosing contracts should be handled carefully since the contracts may provide the buyer with insight into the seller's customer list, pricing, and other confidential or competitively sensitive information. Sellers should work with their lawyers to develop and maintain strict procedures and restrictions on when and to whom such highly confidential seller information is disclosed in the diligence process.

#3: Intellectual property

Trademarks, copyrights, patents, proprietary technology, trade secrets, licensing options, and other intellectual property are often key to a business' ability to thrive and differentiate itself. So it's no surprise that intellectual property plays a significant role in a company's valuation.

Depending upon the industry, the most prized assets of a business are often its IP license agreements, both incoming and outgoing. Before going into conversations about a transaction, sellers should organize a licensing portfolio so the buyer can clearly understand license terms and rights and how those rights will (or will not) transfer to a new owner.

To protect IP assets, companies commonly require employees and independent contractors to sign non-disclosure agreements and invention and assignment agreements. A seller should be prepared to:

- Explain who holds rights to inventions created or conceptualized by an employee of, or independent contractor to, the company.
- Provide evidence that the seller possesses those rights.
- Explain how or if the rights will transfer to a new owner.
- Explain what will happen if an employee leaves the business.

#4: Employees

Buyers want to understand the company's workforce – whether it's acquiring employees of the company or if the business is highly dependent on independent contractors. Properly classifying a business' workforce – as employees or independent contractors – is critical and satisfying payroll requirements should be a priority.

This often overlooked obligation in the startup world can negatively impact deal negotiations and reduce value. Making sure it's properly handled from the start can save time and money in a transaction.

#5: Buyer diligence

For various reasons, a buyer may ask a seller to take consideration in a form other than cash – for example, a buyer note or buyer equity. In that case, the seller must investigate the buyer. Seller's due diligence of the buyer should include reviewing all publicly accessible information and requesting non-public information (under an NDA if necessary).

Knowing the financial health and business prospects of the buyer will help the seller value such non-cash consideration and reduce the risk of post-sale surprises.

Other factors that can impact the value of equity consideration include trading restrictions, other limitations or restrictions on buyer equity, and fluctuations in price.

The Oregon business environment is dynamic, varied, and healthy. Investors and companies are drawn to our state's general stability, vibrant communities, and strong workforce. When used as a tool to grow, M&A holds great opportunity for business owners in Oregon.

On the sell side, a business prepared for M&A starts its negotiations from a stronger position, is perceived as a less risky acquisition, and ultimately navigates a smoother transaction process with fewer chances of falling apart.

Tonkon Torp has guided businesses in a wide variety of industries through strategic buy and sell transactions. Contact us to learn more about how we can help your company.

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