



JOANN LOMBARDI
PRESIDENT

VR Business Sales
Mergers & Acquisitions

jlombardi@vrbb.com
954-565-1555 ext. 24

VALUED REPRESENTATION

DEAL STRATEGY: SALES AND EARNOUTS

By: JoAnn Lombardi, President VR Business Sales / Mergers & Acquisitions

Price is what gets announced. Structure is what determines who keeps the money, who inherits the risk, and whether the deal still looks smart two years later. In privately held M&A, two transactions with the same headline enterprise value can produce radically different after-tax proceeds and post-closing exposure.

Sellers often fixate on the multiple. Sophisticated buyers negotiate the form of the transaction, the allocation of purchase price, the survival of representations, and the portion of consideration that is contingent. Understanding those levers before you go to market is as important as understanding valuation.

ASSET SALE VERSUS STOCK SALE

Most lower-middle-market deals are asset sales. The buyer purchases selected assets and assumes selected liabilities. That structure lets the buyer step up the tax basis of depreciable assets and leave behind unknown liabilities. For a C-corporation seller, an asset sale can create a painful double-tax result. For an S-corporation or LLC, the tax outcome is usually more manageable, but still requires modeling before the letter of intent is signed.

A stock sale transfers the entity itself. Buyers take the company as it sits: contracts, licenses, employees, and historical liabilities included. Sellers generally prefer stock sales because they are cleaner and often more tax-efficient. Buyers generally resist them unless the licenses, contracts, or customer relationships cannot be assigned any other way.

There is no universally “correct” structure. There is only the structure that matches the company’s legal form, the assignability of its contracts, the buyer’s tax posture, and the owner’s after-tax objective. That analysis belongs in the first planning conversation not in the last week of due diligence.

WHAT ACTUALLY MOVES NET PROCEEDS

Beyond the headline price, these terms routinely change what the seller takes home:

- Purchase-price allocation among goodwill, equipment, inventory, and non-compete.
- Working-capital, who funds the normal operating cash at closing.



DEAL STRATEGY: SALES AND EARNOUTS

EARNOUTS: BRIDGING THE VALUATION GAP

When the seller believes the next 24 months will prove a growth story the buyer will not fully pay for today, an earnout can close the gap. Used well, it aligns both sides. Used poorly, it becomes a second negotiation that never ends.

A workable earnout is simple, measurable, and hard to manipulate. Revenue-based earnouts are easier to administer than EBITDA-based earnouts, because EBITDA can be moved by allocation of corporate overhead, add-backs, and one-time charges. The document should specify the accounting principles, the definition of the metric, who operates the business during the earnout period, and what happens if the buyer sells the company again.

- Cap the earnout period, usually 12 to 24 months, not an open-ended hope.
- Define the metric in one paragraph a bookkeeper can apply without a debate.

GET THE STRUCTURE RIGHT BEFORE THE LOI

Letters of intent that are silent on structure invite expensive surprises. The LOI should at least address asset versus stock, expected tax treatment, working-capital construct, amount of holdback or earnout, and the intended role of the seller after closing. Ambiguity at this stage is not flexibility. It is unpaid negotiation moved to the moment when both sides have the least patience.

Structure is strategy. Get it right, and the price you agreed to is the price you keep.

If you would like to discuss how VR can help you navigate your next transaction, please reach out.