EDUCATING YOURSELF ON THE WORKINGS OF AN M&A TRANSACTION

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Businesses will always utilize acquisitions to accomplish a variety of strategic objectives, with sales being the most common means of monetizing an investment. Currently, the market is ripe for M&A activity as:

- Public companies with deflated stock prices become more susceptible to takeovers, and
- Those seeking financing for expansion do not have the same access as they once did.

Ultimately, many business owners will be involved in some M&A transactions. Although the process is time-consuming and demands careful attention, it's also fairly standard in structure to not be looked at with trepidation if you're not familiar with it.

Consult a VR business intermediary in your area to help educate you on how an M&A transaction works, which will allow you to avoid unnecessary anxiety and expense.
This process:

- A confidentiality agreement;
- A Letter of Intent;
- Due diligence, and
- A definitive agreement.

CONFIDENTIALITY AGREEMENT

This is signed by the two parties looking to explore a possible transaction opportunity. Before either party goes deep into negotiations, the buyer will want to perform thorough due diligence of the seller and vice versa. Per the confidentiality agreement, the buyer is required to retain that information, and negotiations cannot be disclosed to any outside parties.

LETTER OF INTENT

Before a definitive agreement can begin to be negotiated, it is recommended that both parties draft and agree to a letter of intent (LOI) on the main terms of the agreement – i.e., financials, inventory, and real estate.

In most cases, the LOI is a non-binding clause that outlines the structure of the agreement, sales price, method of financing the deal, and closing contingencies.

Normally, a LOI contains a no-shop clause that prohibits the seller from negotiating with other potential buyers through an agreed-upon period of time. This protects the buyer from using their resources to negotiate a transaction, only to have the seller work with another party instead.

Although non-binding, a LOI forms the basis for the definitive agreement between the buyer and the seller. Any VR business intermediary will be able to assist you in drafting an LOI as you proceed with an M&A transaction.

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DUE DILIGENCE

Both the buyer and seller parties should perform due diligence as they work through the negotiations. Due diligence identifies legal issues to be addressed and helps the buyer examine every aspect of the transaction in the works.

Many times in the process, a buyer will discover information that will change the structure of the transaction and/or the pricing.

For example, if real estate is involved, the buyer will want to conduct an environmental review since environmental law requires property owners to inform the regulatory authorities of any contamination discovered on the property. Both parties will have to decide how the review will be conducted.

Although due diligence is a time-consuming process, both parties must perform it. Taking the process lightly by either party can have costly consequences. For the buyer, neglecting due diligence could result in costly expenses after the acquisition is complete. For the seller, they could lose the deal or have the selling price readjusted.

DEFINITIVE AGREEMENT

The acquisition agreement is the step that will bring about the transaction. Every VR business intermediary will facilitate the process of negotiating between the two parties – understanding the intentions of both sides and the various supplementary agreements such as dealing with non-compete clauses, employment, consulting and leases.
Generally, the definitive agreement will have four main sections:

- Purchase price;
- Representations;
- Indemnification; and
- Covenants.

PURCHASE PRICE

In this section, you will specify:

- What will be purchased – ie, stock or assets;
- The amount to be paid, and
- The form of payment.

If part of the consideration is buyer stock, the agreement must address how and when the stock can be resold. Some transactions will have conditions that occur post-closing, such as if an earnout is involved, where the seller will be paid more.

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REPRESENTATIONS

Typically, this section is heavily negotiated with the buyer seeking as expansive language as possible and the seller looking for limitations such as knowledge or materiality qualifiers. Matters concerning the seller's business are contained in the representations section, such as whether the financial statements are accurate and whether there are no liabilities that are not undisclosed.

INDEMNIFICATION

Here, this lays out the potential liability if any of the representations are breached. This is a critical section, where typical provisions will include:

- A survival period for the representations – how much time the buyer has to discover a breach and bring an indemnification claim against the seller;
- A basket – an agreed upon amount of damages the buyer must be held accountable for due to the seller's breach of its representations before the buyer is entitled to any amount from the seller;
- A cap sets the seller's maximum liability for breaches of its representations, and
- The procedural mechanics for indemnification.

In most cases, the buyer will desire wide-spreading indemnification provisions aimed at making the seller responsible for any pre-closing liabilities and the buyer responsible for any post-closing liabilities. The seller will strive to make sure that the purchase price will remain in the seller's pocket.

COVENANTS

This section sets forth the actions that both parties are required to take and prohibited from taken prior to the closing. The covenant section requires the seller to continue the regular operation of the business prior to close, and requires that both parties use their best efforts to satisfy all conditions.

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