# HOW TO PREPARE YOUR BUSINESS FOR A SUCCESSFUL SALE

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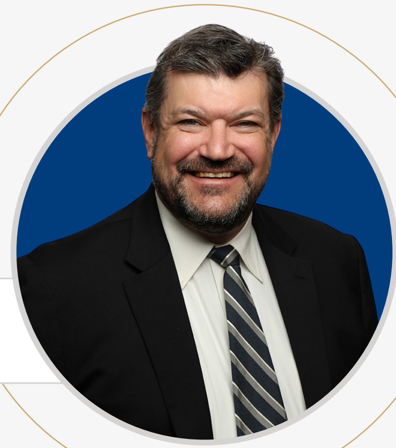

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**You have decided to sell your business.**

It should be simple, right? You identify a buyer; the buyer pays you the agreed-upon purchase price and you seal the deal.

Unfortunately, selling a business is hardly ever that easy. Even sophisticated business owners and managers are often shocked at the complexity of the process of selling a company.

Whether you have decided to sell your business or are contemplating doing so in the future, there are legal to-do's you can (and should!) put into motion now that may result in many benefits, including:

- making your business more attractive to potential buyers;
- increasing deal speed;
- ensuring a closing of sale;
- reducing your "deal shock" and fatigue;
- increasing your negotiating leverage;
- potentially reducing transaction costs;
- reducing risk of liability;
- facilitating a cleaner "walk away" after the closing; and
- most importantly, maximizing your value and protecting your purchase price.

In the information that follows, you'll gain practical insights and actionable steps to help prepare your business for a successful sale, ensuring you maximize its value while navigating the process with confidence and clarity.

## Investment in Your Value and ROI

As a business owner or manager, you carefully invest in and meticulously plan for your business' success — including maximizing your return on investment (ROI). You invest in and plan for your product and service offerings, your growth, your business and marketing strategies, and your people. It's common for owners and managers to forgo their own compensation so that profits can be reinvested in the business, meaning they will not fully realize their ROI until the business is sold.

Despite so much of ROI being dependent on the successful sale of a business, few owners and managers invest in and plan for the actual sale itself. When they finally get to the sale, they are often sorely unprepared and shocked at how much time, expense, planning, effort and stress are involved.

**PICTURE THIS INSTEAD**

**By taking the time to carefully invest in and meticulously plan for the sale of your business, you will directly realize your ROI in hard dollars — and save yourself time, money and headaches along the way.**

## The Importance of Prioritizing Legal Compliance

While legal or compliance costs can be viewed as a nuisance — especially when the costs are unexpected or because something "bad" has happened — the reality is staying on top of legal matters is key to maximizing your ROI when you go to sell the business.

If you address issues in advance of a sale, you can often budget and control time and expense and take action "in-house" (e.g., without the buyer looking over your shoulder). However, if the buyer identifies the issue or problem during a sale — and, trust us, it likely will be discovered — you will generally be required to "fix" it on an accelerated timeframe, with compromised negotiating power and a pesky buyer in the mix. In the end, it'll cost you — whether it comes out of your pocket or pulled from the purchase price.

## Overview of the Deal Process

At a high level, here's what you can expect from the process of selling your business:

1. **Letter of Intent:** When a seller and a buyer decide to do a deal, they often enter into a "letter of intent" (LOI), which sets forth the key terms of the deal, including the purchase price. The letter of intent is usually *non-binding* — meaning that until the purchase agreement is signed, the parties can still walk away from the deal, and the terms of the deal (including the purchase price and other key items) can be changed.[1]
2. **Due Diligence and Purchase Agreement:** Then, usually more or less in parallel with the LOI, due diligence (discussed in further detail below) begins and the parties negotiate the purchase agreement. The purchase agreement sets forth all the terms of the deal, and is *binding* — meaning once the purchase agreement is signed, the parties can no longer walk away (except as narrowly permitted by the agreement).
3. **Additional Signing and Closing:** After the signing of the purchase agreement, additional documents and actions must often be prepared and signed. Once complete, the buyer pays the purchase price, and the deal closes.

## The Buyer's Perspective: Risk and Due Diligence

Buyers generally want to start making money on the business and begin realizing their own ROI immediately after closing — and with minimal additional cost. But the reality of buying a business is that it can be risky. As soon as the LOI is signed, buyers frequently conduct a thorough investigation, often with the intent to either reduce the purchase price or shift the burden of risk or expenses to the seller. This investigation is known as due diligence.

During the due diligence process, the buyer (and/or its lawyers, accountants or other advisors) often

[1] Sometimes, parties enter into a "term sheet", "memorandum of understanding" or other similar instrument. These instruments are usually also non binding. For the purposes of this article, we use the term "letter of intent" as a proxy for all these instruments.

requests a tremendous amount of information and materials regarding the business, to which the seller responds with the requested items. This back-and-forth can continue for several "rounds."

Because the LOI is non-binding, buyers often walk away from the deal if they find insurmountable risks during due diligence. In addition, deal terms (including the purchase price and other key terms) are often changed or added during this period. These changes or additions are often due to risks identified in due diligence or a decrease in the company's performance or value after the LOI is signed.

**IF YOU'VE EVER SOLD YOUR HOUSE, YOU'VE SEEN SOMETHING SIMILAR.** Prior to the sale of a house, the buyer's inspector conducts a "walkthrough" of the house, and based on the results of the inspection, the buyer may have a list of demands to close the sale. However, due diligence in a mergers and acquisitions (M&A) deal is vastly more extensive and can take several weeks or months. Buyers often inspect every aspect of the seller's business — and may have teams of lawyers, accountants and other specialists scrutinizing each piece of information to identify risks.

So, how can sellers best prepare for the intensity of the due diligence process? Start by getting your disclosure schedules organized.

### Disclosure Schedules

In most M&A deals, the seller must prepare and deliver disclosure schedules. Disclosure schedules are schedules (or exhibits) to the purchase agreement in which the seller makes disclosures "against" the representations and warranties it makes in the purchase agreement. This is critical, as a seller can be liable to the buyer after the closing if a disclosure is inaccurate or incomplete.

**FOR EXAMPLE,** if the purchase agreement contains a representation and warranty that the seller is not in default of any leases, and the seller is in fact in default of a lease, the seller must disclose the lease default in the disclosure schedules. If the seller fails to disclose the lease default in the disclosure schedules, and, after the closing, the buyer suffers damages or losses due to that default, the seller could have liability to the buyer for those damages or losses.

Thus, it is important that your disclosure schedules be as accurate and complete as possible. Preparing disclosure schedules is a time-consuming and tedious process, and commonly occurs concurrently with due diligence (another time-consuming and tedious process). By preparing ahead of time, you can help to ensure complete and accurate disclosure schedules and speed up their preparation.

**NOTE:** It is generally not enough to say you have met your disclosure obligations in the disclosure schedules merely because you gave the buyer a document or told the buyer about an issue during due diligence. Clients frequently bring this up with us, and unfortunately it is usually incorrect. The disclosure schedules are part of the purchase agreement — and these comprise the final statement regarding the deal. While there are some exceptions, this generally means that if a buyer brings a lawsuit against the seller, the court will only look to the purchase agreement itself (including the disclosure schedules) to determine whether or how the disputed item was disclosed to the buyer. We realize that this can seem counter intuitive or outside the "spirit" of a "fair deal." ***However, this is how purchase agreements and disclosure schedules work, and you need to be ready for it.***

## Additional Preparations

While preparation for a sale is going to look differently for each company, here are a few things you can do today to make for a smoother sale process:

1. **Build Your Deal Team:** Having a proper team in place, with experience with the sale and purchase of businesses, can make or break a deal. This will include legal counsel and accountants. You may also consider a business consultant, business broker or investment banker.
2. **Prepare for Due Diligence:** A buyer's due diligence process is an intense scrutiny of your company, and gathering documents now will provide for a quicker and more fulsome diligence process. Typical documents include:
   - past tax returns (3-5 years);
   - financial statements;
   - licensing information;
   - regulatory compliance information;
   - employment information (employee handbooks, employment agreements, etc.);
   - contracts (such as supplier contracts, customer contracts); and
   - information regarding any litigation.
3. **Take Corrective Action:** Conduct your own due diligence on your company. Consider resolving legal, tax and business issues before entering the sale process. Once issues are identified, a cost-benefit analysis should be performed to determine what, if any, action should be taken.
4. **Understand Your Consent Requirements:** If you are the only owner of your company, then consent is simple. However, consent requirements become increasingly more complex among multiple shareholders. For example, it is not uncommon for a seller to come to us after signing an LOI only to learn they do not have the necessary shareholder consent to approve the deal. It's best to work through these consent issues before any signatures.
5. **Operate With a Future Sale in Mind:** It is important to consider how future actions will impact a potential sale. For example, a common mistake that we see leading up to a sale is signing new contracts that require consent for the sale or a change in management of the company. Often, these types of clauses are negotiable without tipping your hand on a potential future deal, and the new burden of obtaining consent can be avoided. Consider also working with legal counsel to prepare templates or standard terms and conditions for common agreements, including terms that provide consistency and protection, and that anticipate the sale of your business. These could apply to a wide range of contracts, such as customer, sale, purchase, supplier, vendor, employment, independent contractors, consulting, confidentiality/non-disclosure, or assignment of intellectual property/inventions agreements. As a general standard, any contract should be reviewed during this preparatory period.

While the sale process can be overwhelming, taking these types of proactive steps can help lead to a smoother transaction.

## Reap the Benefits of Successful Legal Preparation

We often hear from clients — especially those who wait until a deal is already made with a buyer to engage us — that if they knew an issue would have arisen, they would have resolved it before marketing the company. There are things you can do or put in motion now to identify, mitigate and possibly even eliminate risks that would likely concern potential buyers — and substantially decrease the likelihood of selling your business on your preferred terms.

Benefits of getting out ahead of any issues early include:

- **Attracting and Keeping Potential Buyers:** A company with the necessary documentation and processes is simply more attractive than a company whose records or processes are in disarray or that has compliance or legal issues. If a buyer discovers issues in due diligence that cannot be handled in a cost-efficient manner or that pose too high a risk — or if the seller simply "doesn't have its act together" — the buyer will often walk away from the deal. Having a "clean" company often results in a larger interested buyer pool and a smoother, shorter deal process — which typically translates to a higher purchase price.

- **Preserving the Purchase Price:** As a buyer identifies risks and due diligence drags on, buyers negotiate for the seller to bear the economic burden of risks identified during due diligence — which often reduces the purchase price realized by the seller.

This "burden shifting"/ "risk allocation" can take several forms. Sometimes, the buyer simply insists on reducing the overall dollar amount of the purchase price. Other times, the buyer requires the seller to pay to "fix" an issue prior to the closing. Often, at the closing, an amount is either deducted or "held back" from the purchase price to "fix" or "reserve for" actual or potential issues, costs or losses after the closing. (If the entire holdback amount is not used to pay for specified post-closing costs/losses, the balance is paid/released to the seller after a specified period.) In many cases, a seller may simply be required to pay directly for specified costs or losses incurred by the buyer after the closing. All the foregoing reduces the purchase price, whether through an actual price reduction, actual cost or opportunity cost.

While it may seem like it is better to "wait and see" what is found in due diligence — often the pressure to close the deal causes the seller to capitulate to potential liabilities that may not actually exist, or to agree to an overestimate of the cost or "value" of an issue or potential issue.

Getting ahead of potential issues decreases the likelihood of having to pay (or pay a premium) for major issues and increases the likelihood of successfully negotiating for lower holdback amounts, shorter holdback periods, and lower post-closing out-of-pocket costs.

- **Reducing Deal Costs:** A seller's deal costs can be expensive. Lawyers, accountants and other professional advisors will likely be involved. If the seller has to correct problems, other costs could be incurred, such as environmental remediation, delinquent tax or regulatory compliance issues, for example.

Getting your affairs in order now can significantly reduce your deal costs and keep you from losing the deal. Too often, we see companies delay getting their affairs in order and fail to address issues on the front-end for a modest cost — only to see those issues cost significantly more during a deal — or even result in losing the deal.

- **Increasing Deal Speed:** The time it takes to complete due diligence can impact the likelihood of the deal closing, the purchase price and whether you realize the maximum value of your company.

If due diligence takes an especially long time to complete — whether because a "new" significant risk item is identified, or simply because the seller's files and information are in disarray — the buyer may walk away from the deal or insist on a purchase price reduction. This is particularly likely if, during this time, the value of the seller or its performance (e.g., EBITDA, revenues, assets, etc.) softens, or an unexpected adverse event occurs (e.g., economic downturn, industry shock, accident, lawsuit, etc.).

**NOTE:** Buyers typically will not agree to a higher purchase price after the LOI has been signed. If the deal process moves slowly and your company's value or performance improves during due diligence, you may be ***"leaving money on the table."***

- **Maintaining Negotiating Leverage:** A seller's negotiating leverage erodes as legal risks stack up. A seller may find it difficult to stand firm on deal issues, particularly as the number of "risk issues" rises in due diligence — and as a result, panic to save the deal. By identifying potential risks now, the seller can get ahead of them to either resolve or mitigate them, or develop strategies regarding how to address risks in negotiations — that is, before the buyer uses them as leverage against you.

- **Reducing Stress and Minimizing Business Interruption:** A "sale of business" deal is stressful. Both sides are under pressure to close, there are often tight deadlines and time is precious. Every aspect of your business — including decisions and documents from long ago — is being scrutinized. In some cases, the deal at hand may be a seller's last best chance to make an "exit" with a solid ROI.

This can cause great professional and personal stress for everyone involved, especially for those leading their business in the sale. In addition, the deal process — especially due diligence — can severely strain and divert a business' resources and the focus of its people. It can be difficult to manage the needs of the sale while continuing to operate the business profitably.

Putting a plan in place now to address issues and requests that will likely arise can help reduce the stress and strain on you, your business and your people, and minimize the interruption to your business during the deal.

- **Minimizing Potential Errors:** Whether it's due to time constraints, pressure of the deal or "deal fatigue" — things can get missed. By planning ahead and working with an experienced team, you can ensure your business' affairs are in order and avoid errors during the transaction and thereafter. ■

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## THE LEGAL TEAM FOR YOUR BUSINESS TRANSACTIONS

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David is a corporate attorney focused on guiding emerging growth companies through critical stages of development, from formation to exit. WIth substantial experience in mergers and acquisitions, David helps clients grow through acquisitions and achieve successful exits with well-prepared sales processes. David provides practical guidance on complex investments, regulatory compliance and day-to-day legal challenges, leveraging deep industry knowledge to mitigate risks and foster growth. Dedicated to building lasting client relationships, David is committed to helping businesses achieve their goals and long-term success.

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Doug represents an array of clients in all stages of company lifecycles. He handles mergers and acquisitions, organizational reorganizations and restructurings, transactional matters, and venture capital investments and private offerings.

### ABOUT ARONBERG GOLDGEHN

Aronberg Goldgehn is a premier full-service business law and litigation firm with offices in Chicago and Wheaton, Illinois. The firm represents clients ranging from entrepreneurial individuals and middle-market businesses to Fortune 500 companies. Continuing its more than 130-year presence in the Chicago-area legal landscape, firm attorneys assist and counsel clients in a broad range of complex business transactions and commercial litigation matters, and offer a full suite of personal legal services, including estate and tax planning, and family law.