LANE POWELL

Planning for Exit: Beware of the Deal Killers

LEGAL PERSPECTIVE FROM JEFF BIRD

Baby boomers make up the largest entrepreneurial generation in history, and they are retiring at an unprecedented rate. According to the Exit Planning Institute, over the next 10 years 75 percent of baby boomer business owners plan to transition their businesses, and most have no business transition plan. Also, many of these business owners have little income-asset diversification, and the value locked inside the business often represents 80 to 90 percent of the business owner's net worth. Consequently, closing on the sale of the business (or not) will have a huge impact on the retirement and financial independence of the business owner. With so many businesses coming to market over the next 10 years, business owners need to know what the common deal killers are and how to avoid them.

Unrealistic View of Value

Business owners have a tendency to overvalue their business. An unrealistic view of business valuation by the business owner will quickly crater a transaction — emotion sets in and an overwhelming desire to get top dollar can cloud judgment and destroy market opportunities that exist today but will not exist tomorrow. Obtaining an expert third-party valuation that is market and data driven is key to setting a realistic asking price and serves as an important objective benchmark. Setting realistic expectations at the onset of the transaction will help keep the deal on track. Also, business owners should be prepared to accept an earnout as a means to bridge the value gap. Calculating a reasonable earnout portion of the sale proceeds and securing a written plan agreed to by the parties on how the business will be operated post-close are reasonable ways to keep the deal from falling apart and deliver needed sale proceeds to the seller.

Failure to "Professionalize" Records and Documents

Shoddy recordkeeping and haphazard or incomplete financial statements inspire a lack of confidence in the business and the seller, which can quickly derail the sale process and cause buyers to terminate negotiations. Sellers should conduct a presale review of corporate records, historical financial statements and contracts to ensure that they meet professional standards. Being organized and providing the documentation that a buyer expects to see will keep the transaction on track.

Retrades on Price After Due Diligence

The letter of intent sets the tone and describes the basic terms of the proposed sale. Sellers are well advised to use letters of intent that are fulsome and detailed with regard to important deal terms, risk allocation, and scope and timing of due diligence. Once the letter of intent is signed, leverage shifts to the buyer. If not constrained by the letter of intent, the buyer can use the due diligence process to retrade on price — a common tactic used by the buyer to pay less — which is often part of the buyer's strategy from the outset of the deal. After a drawn out, exhaustive due diligence process, either the seller is so weary from deal fatigue that the seller will accept the retrade on price just to get the deal done, or will blow up the deal out of frustration with the buyer.

Failure to Conduct Presale Due Diligence and Risk Assessment

No one likes surprises, especially when it creates added risk or contingent liability. Sellers should independently conduct their own presale due diligence to uncover risks and contingent liabilities applicable to the business. Rest assured, the buyer will do the same thing, and the process will be rigorous. By conducting presale due diligence, the seller has the opportunity to remedy any discovered problems and mitigate risks, which could include environmental liabilities, employee misclassifications and ownership of assets, especially intellectual property. Full disclosure at the outset of the sale process will head off a price retrade by buyer at a later stage of the transaction.

Picking the Wrong Team

As the old adage goes, "There are deal makers and deal breakers." Having the right team of advisors is critical to consummating a successful deal. Some transaction M&A attorneys are so detail and minutia driven that they lose sight of the real objective. This type of attorney becomes an obstacle to helping a client understand the larger risks involved in the deal and reaching a reasonable compromise necessary to close. Likewise, a financial adviser that lacks creativity and problem solving abilities can equally be an obstacle to a successful close. It's critical to select a team that possesses the knowledge and experience necessary to help guide you and your business toward a successful outcome on your terms and at the time of your choosing. ■

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