

Deal prep

Tips for selling a business in an evolving M&A environment

INTERVIEWED BY ADAM BURROUGHS

The U.S. is coming off of two years of historically low interest rates and a tremendous amount of liquidity, factors that created a very strong sellers' market in 2021 and 2022.

This year, while there is still a lot of dry powder looking to be put to work in the right opportunities, liquidity has tightened in the face of macroeconomic headwinds and a higher interest rate environment. Top-tier companies will still command strong values and favorable terms, but companies outside that belt will need to take steps to maximize their valuations and properly minimize risk in a transaction.

Smart Business spoke with Dustin J. Vrabel, Corporate Partner and Chair of the M&A Group at Buckingham, Doolittle & Burroughs, LLC, about steps sellers can take to improve their outcomes in an M&A transaction.

HOW HAVE CURRENT MARKET CONDITIONS AFFECTED BUYERS?

Buyers are being more methodical and patient in how they due diligence risk in a transaction and underwrite the valuation of companies, taking their time as they evaluate whether earnings from '21/'22 are sustainable in light of inflationary pressures and a potentially cooling economy. Sellers need to demonstrate earnings sustainability and should conduct their own internal due diligence to explain and anticipate any issues that might arise during a transaction.

HOW SHOULD SELLERS PREPARE FOR A SUCCESSFUL TRANSACTION?

Far too often, inexperienced parties to an M&A transaction approach a deal as if it is a zero-sum game — and that could not be any further from the truth. In transactions where we see the best outcomes for both buyers

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and sellers, the parties share a philosophy that there are many opportunities within a deal to reach a win-win outcome. Look for solutions that benefit both parties. In lower middle market deals, reps and warranties insurance is being used much more often to provide buyers the benefit of coverage for unknown risk while allowing sellers to exit without having to tie up significant proceeds in escrow. It also helps the parties properly allocate risk and can make the negotiation of reps/warranties and indemnification provisions much more efficient.

If or where there's a difference of opinion on a particular issue, be creative. There are options such as earnouts and milestone payments to bridge the gap where valuation differences arise — and this really helps to align buyer's and seller's incentives as long as it's properly structured. Efficient tax structuring such as the use of 338(h)(10) or 336(e) elections that give buyers the benefit of stepping up the tax basis of a company's assets while allowing parties to structure the transaction, for legal purposes, as an entity sale should be evaluated.

Sellers should understand their historical working capital needs ahead of a transaction. Too often, buyers and sellers discuss purchase price, then midway into a deal the negotiation of normalized working capital and an appropriate working capital peg is used to try to negotiate an increase or decrease of the purchase price, or worse

yet, a post-closing adjustment that wasn't consistent with the original deal. Working capital adjustments are meant to ensure that buyers receive the business on day one with the right amount of working capital needed to run it. Making sure buyer and seller understand that issue before negotiations get too far along helps make the process much more efficient.

WHO CAN HELP SELLERS MAXIMIZE VALUE IN A TRANSACTION?

Sellers should assemble an experienced deal team very early in the process. Having a CPA firm experienced in the QoE process, a seasoned investment banker and M&A lawyer that understand deal pace and what is 'market' is vital to maximize value and get to closing.

An experienced M&A lawyer can help identify potential buyer concerns and fix or structure around the concerns to keep the deal on track. Issues with contract change in control and termination provisions, entity records, cap table/share records and real estate title matters should be addressed by the seller before the buyer raises the issue to build trust with the buyer and keep the deal on track for closing. This is especially important in this environment, so the better that sellers can anticipate issues by conducting internal diligence, the more likely it will be that sellers can achieve good outcomes for themselves and their buyer. ●