

Issues to Consider Before Signing an LOI



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Takeaway: Is the LOI really all it's cracked up to be? Here are 14 things to consider before getting into bed with a buyer.

OK, so you've made the decision to sell your business. You've gone through a process and multiple buyers are pursuing you to sign their letter of intent (LOI). You're done, right? You've just got pick the deal that gives you the most money. Easy! Well... not really.

Signing an LOI does not mean you've closed the deal. In many ways, you've only just begun. LOIs usually include a lockup period of exclusivity which prohibits the seller from talking with other potential buyers. This results in a power shift to the buyer's favor.

Revealing Too Much

Once the LOI is signed, the due diligence process begins. Due diligence means providing the buyer with intimate details of the business, including, but not limited to, financials, customer information, pricing detail, sales pipeline, contracts, employee compensation and more.

What happens if a buyer—especially if that buyer is a direct competitor—walks away after reviewing all this sensitive data?

Evaluating Initial Offers

Prior to signing that LOI, a seller should take time to determine if the buyer is “real” and whether that buyer can close the offered deal. Since that’s a rather subjective comment.

Here are 14 issues a seller should consider when selecting a buyer:

1. Is the deal too good to be true? That great deal may be nothing more than a Trojan horse, setting up a scenario where the buyer says, “I want to do the deal as we agreed, but my bank/investors are balking...”
2. How is the buyer planning to [finance](#) the transaction? Do they have the cash, are they planning to tap a bank line or are they asking you to help with the financing?
3. Will the buyer— especially a buyer already in your industry and market—re-crunch the numbers during due diligence and decide investing that same money in his existing business will be easier (or wiser) than overpaying for your company? Will the buyer use this as a cudgel to renegotiate the deal?
4. What is the form of the offer? Will 100% of the proceeds be paid at closing? Any hold back? Any contingent payments or seller note or earn out? Are you swapping stock?
5. How much of the proceeds will be placed in an escrow account? What are the reps and warranties associated with that escrow? Who controls the release of that escrow?
6. Does the buyer need to raise cash from outside investors to finance the deal? Will outside investors balk at the deal the buyer has on the table? See #1.
7. Is it a stock or asset deal? Does it make a difference to you? Have you talked with your accountant about your specific tax situation?
8. Who takes accounts receivable? The accounts payable? Are your current assets and current liabilities all within terms, or are you facing a substantial post-closing adjustment?
9. Is your inventory 100% salable? Will the buyer claim some inventory is unsalable and use that as a means to reduce price?
10. Does the deal include a working capital adjustment? What is the basis of that working capital amount? Any other post-closing adjustments?
11. Who pays off your company’s long-term debt: you or the buyer?
12. What happens to the line of credit? Is it assumed by buyer? Do you pay it off? Is the buyer going to take over the company, but leave you on the hook for some/all of the company’s debts? This is more common than you may think.
13. What are the tax implications of your accounts receivable? Will this amount be taxed as ordinary income? Have you talked with your accountant about this issue?
14. Are you signing a non-compete agreement with buyer? What does that limit you from doing in the future and are you being compensated for signing that non-compete?

Conclusion:

Analyzing offers from multiple buyers can often involve alchemy. Total deal value is a key concern, of course, but so are many, many other issues. An owner seeking to sell a business is wise to retain capable, professional and experienced counsel—investment bankers, accountants, attorneys, wealth advisors—to help negotiate the best deal possible and safely land that deal. Remember, it's not a deal until the wire transfers clear.