Texada Capital Corporation

Divestiture: Choosing a Buyer and Closing the Sale ©

Toward a Letter of Intent

Most buyers prefer a site visit before submitting a Letter of Intent ("LOI"). Many Investment Bankers prefer to schedule site visits after receipt of LOIs (or at least some indication that the buyer will consider something close to what is being asked). Your sale process may entail one approach or the other, or some combination. Bankers tend to accommodate a really attractive buyer! A site visit prior to receipt of an LOI must, by necessity, be more limited in scope.

Only certain people at your company know that it is for sale. The buyer's representatives have to be discreet and limit their discussions to those individuals who are aware of the pending sale. The buyer may not speak openly to your clients, vendors or employees at this stage in the process.

Still, for many buyers, an early site visit enables them to determine if this really is a company that they want to buy. The buyer can spend time with key management, see the facilities during the workday and have some preliminary conversations with the sellers. Both sides have an opportunity to get a sense of whether or not there are shared values, work ethics, drive, skill and ambition. The facilities and the existing technology can be viewed first hand. A pre LOI site visit is usually a half-day to a full day event (unless there are multiple facilities or the selling company is quite complex). The bankers will likely want the two sides to have at least one meal together—added time for getting a sense of each other.

The Letter of Intent

If you have never been through a sale process before, you will be amazed at how heavily a letter of intent is negotiated, especially since it is a non-binding agreement. An LOI is usually five to seven pages long. I have seen longer ones, rarely shorter. It is prepared by the buyer and delivered to your investment bankers and then to you. Though the LOI is a gentlemen's agreement, it is used as the basis for the draft of the purchase agreement, which ***is*** a binding document.

The LOI spells out what the buyer wants to buy and what he wants to pay for it. Is it a stock purchase or an asset purchase? It usually specifically excludes those assets the buyer does not wish to purchase. The LOI also clearly states what the buyer is willing to pay, what form the consideration will take and when it will be paid.

An LOI might also include a paragraph discussing the employment of certain senior management. It will likely include a non-compete paragraph to prevent any key managers from competing with the acquired entity for a specific period of time post closing, usually 12 to 18 months, and within a specific geographic area. The LOI will refer to a formal purchase agreement, which will be negotiated, and to certain other conditions which must occur at or prior to a closing date. The LOI will usually state an anticipated closing date with an opportunity to extend in writing, if needed.

The LOI will also refer to the "due diligence" period, the period during which the buyer does its homework on your company, described in detail below, and request that the buyer's team have access to material Company information during that period.

An LOI will usually contain "standstill" language precluding the seller from negotiating with any other third party for the duration of the standstill, usually 45-90 days. Some require the seller to obtain permission from the buyer for transactions during the standstill period that are not "in the ordinary course". Some preclude public announcements of discussions, particularly important for public companies that have disclosure requirements for material events.

The more clearly the LOI spells out key terms of the sale, the easier the negotiations are over the purchase agreement.

Information About the Buyer

When the buyer is a public company, it is easy for the seller to get a great deal of information about the buyer from its public filings with the Securities and Exchange Commission. When the buyer is a private company, it can be difficult for a seller to obtain adequate information about the buyer. I think it would be wise for the seller to put language in the LOI that clearly tells the private buyer what kind of information the seller is going to require to satisfy itself about the buyer's financial wherewithal, the tone and capability of the management team, and the like.

If I were counsel to the seller, I would put some teeth into the seller's information request from the private buyer by including specific language in the purchase agreement described below. Alternatively, seller's counsel could draft a separate, contractual information request.

The key is this: while the buyer is busy doing its due diligence on your Company, you should be busy satisfying yourself that this is the kind of company you want taking over your business. Inquire of industry associations. Use your network. Talk to the buyer's vendors. If the feedback is negative, you can still back out at this point, usually without penalty.

Due Diligence

Since the LOI named a specific closing time, the buyer's team will now begin its due diligence process in earnest. Due diligence usually takes between three to eight weeks, depending upon the complexity of the acquisition. The buyer's team will usually include key senior managers, its accountants, and its lawyers. During this time period, the buyer's chief financial officer and the accounting team will give your Company's books and financial records a thorough review. Sometimes an audit occurs at this time, if none exists, or the buyer has audited numbers. Detailed schedules are requested and delivered. Accounts payable and accounts receivables schedules are reviewed. All contracts with clients, vendors, employees and others are reviewed. All corporate documents are reviewed (make sure your corporate filings are current). All tax filings and all other regulatory filings are reviewed. Any litigation files or regulatory matters affecting your Company are reviewed. Equipment is appraised and, as closing approaches, inventory will be taken.

Some of this work occurs at your Company; some of this work is done via email and overnight courier. Your management team is doing double duty at this point. They MUST keep their eyes firmly on your business. At the same time, their future employer is knocking and they feel a compelling and understandable need to perform. As the seller of your Company, your role at this point in time is critical. Since you should not be involved in the day-to-day due diligence issues, the burden of keeping your team focused on the Company, while getting through the due diligence process, really falls on you.

The Upside Surprise

Whenever I have an opportunity to counsel a potential seller about its numbers, I always advise them to be somewhat conservative in their projections, meet those projections and, if possible, show some upside surprise. Deliver some numbers during the course of the transaction that show better than projected results! It's OK to "haircut" your projections a bit. That kind of surprise from the selling company really gets the buyer motivated.

The Purchase Agreement

Simultaneously with the due diligence process, buyer's counsel will draft a purchase agreement. The purchase agreement (the "Agreement") is a legally binding document that outlines the sale of your company. It is often executed at the closing. It is sometimes executed in advance of closing, i.e. if the seller refuses to let the buyer meet or hold discussions with clients until the Agreement is executed.

The Agreement describes what the buyer is buying, what is excluded from the sale, what the buyer is paying and how it will be paid. The Agreement will often refer to the employment of certain of the seller's key personnel with employment agreements as exhibits.

The Agreement will spell out the:

a) documents to be delivered by the seller at closing;
b) representations, warranties and covenants of the seller;
c) documents to be delivered by the buyer at closing;
d) buyer's representations, warranties and covenants;
e) allocation of taxes related to the sale;
f) indemnifications of both parties, usually with a minimum and a cap, though this is often heavily negotiated;
g) conduct of the business prior to the sale;
h) conditions precedent to the obligations of buyer and seller; and
i) details of the closing.

After the buyer and its counsel are satisfied with the draft Agreement, it is forwarded to the seller and its counsel. Generally, two experienced deal lawyers can resolve most of the outstanding issues in the Agreement in a couple of rounds of negotiations. At some point, principals and/or bankers will need to resolve any final business points. Failure to have two experienced deal attorneys in the process can really make this part of the transaction unpleasant, costly and time consuming. Sometimes it can kill the sale.

Once the purchase agreement is signed, you are a lot closer to closing a sale of your company.

The Closing

Often all the documents are executed and monies are wired on the same day, which is called the "Closing". The purchase agreement is sometimes executed before the closing, in which event the closing usually follows within two weeks. Money changes hands at the closing and the sale process is complete.

Deal attorneys run closings. Physical closings are less common today where everyone appears in a conference room, usually at one of the law firms, and the documents get executed. "Virtual closings" are common now: no one is present, documents are executed in advance or by email, and monies change hands by wire transfer. If there are very few outstanding issues as the time for closing approaches, it is easy to have a "virtual closing." Saves everyone a few dollars.

If the sides agree on a physical closing, the buyer gets to pick where the closing will be: he's putting up the cash.

A myriad of issues may hold up a closing: environmental work, closing certificates, UCCs, equipment lien releases, required assignments, bank releases, wire transfers, audits---something which should be available, is not, and the closing may need to be rescheduled. Historically, closings were two days to accommodate last minute details. Generally, the attorneys will know as the closing date approaches whether or not the transaction is ready to close. The attorneys generally don't let the parties set a closing date unless the deal is fairly ready to close.

When to Reschedule the Closing

The exceptions to what I've just said about closings are what cause deal people to get gray hair. Many of us have been to the closing from hell where none of the key documents was finished or fully negotiated. Sometimes it is possible to get the sale completed, even in such difficult circumstances. Often it is best to pull back, put the attorneys back to work, and give the transaction a bit more time to close.

Usually, your transaction is not in jeopardy because a Closing is postponed. It's often a timing issue, not a deal breaker.

If the major documents have not been fully negotiated, I would postpone the Closing. The attorneys are busy enough at Closing trying to get all the required sign-offs and closing schedules together. If they are still negotiating major agreements, it is almost impossible for them to focus on the myriad of details that must occur for your transaction to close.

Closing is Not the End: Transition Planning

You may be continuing with your Company for a time beyond its sale, sometimes for a number of years. The new owners may feel that you are a critical part of a successful transition. Part of the proceeds for the sale of your company may be paid after the Closing. There are many reasons to want the new owners to succeed. You play a very important role in that process.

Transitions are key to a successful acquisition. Stories abound in merger and acquisition annals of the acquired company that lost all of its employees on the first day after Closing. Needless to say, that is a tragic result. Sellers really play a very critical role in the success or failure of a transition. What attitude do you reflect to your staff about the acquiring company and its management? Are you positive? Do you show excitement about the future prospects for your employees and managers? The point I want to stress is that your staff is taking in all of your cues, from the time they first become aware of the pending sale. Make sure you give your buyers every opportunity to succeed in their purchase of your company. Consider your efforts on the buyer's behalf as "ethical consideration".