DOIDA CROW LEGAL

MERGERS & ACQUISITIONS: A STRATEGIC BLUEPRINT

This 6-part series provides a comprehensive introduction to the critical role that a well-structured process plays in achieving successful outcomes in mergers and acquisitions.

Behind Every Deal

In the world of business, mergers and acquisitions (M&A) are not just transactions but strategic decisions that can redefine the future of the companies involved. Welcome to our 6-part series devoted to the importance of process through the complexities and nuances of M&A.

While the economic terms and transaction structure are crucial, the process followed to get to the closing is often misunderstood or overlooked. We aim to offer a deeper understanding of the M&A process in middle-market and small-market deals and its impact on both buyers and sellers. A well-planned and executed M&A process contributes to a smooth and efficient transaction, maximizes value for sellers, and ensures a seamless transition and future growth. Conversely, a poorly executed process can lead to misaligned expectations, value deterioration, and operational inefficiencies.

Join us as we explore each stage of the M&A process, from assembling a deal team to post-closing deliverables.

Part 1 – The Importance of Process: Crafting Success in M&A Transactions

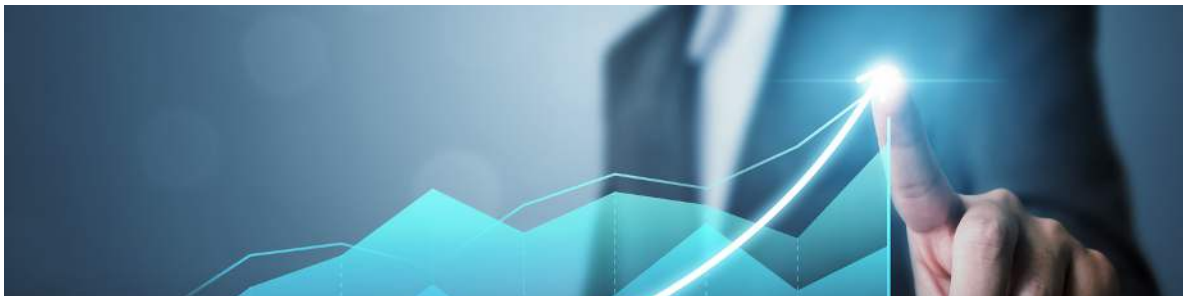
Part 2 – The Art of NDAs, Initial Discussions, and LOIs

Part 3 – The Power of Letters of Intent and Term Sheets in M&A

Part 4 – Bringing it Home: Negotiating the Deal Documents

Part 5 – The Last Lap: Strategies for a Smooth M&A Closing Process

Part 6 – After the Ink Dries: Understanding Post-Closing Deliverables



1 The Importance of Process: Crafting Success in M&A Transactions

In the world of business, mergers and acquisitions are not just transactions but strategic decisions that can redefine the future of the companies involved. The most important elements of a deal are the economic terms and transaction structure; however, an often misunderstood or ignored aspect of a strategic transaction is the process the parties follow to get to the closing. This post is the introduction to a series that will seek to offer a deeper understanding of the importance of the M&A process in middle-market and small-market deals and its impact on both buyers and sellers.

A well-planned and executed M&A process is a contributing factor to a smooth and efficient transaction, maximum value to the sellers, seamless transition, synergy realization, and future growth. On the other hand, a poorly executed M&A process can lead to a rocky transaction, misaligned expectations, value deterioration, cultural mismatch, and operational inefficiencies.

The process of buying or selling a business begins before a seller takes their company to market or a buyer identifies a potential acquisition target. Once a decision to pursue a strategic transaction is made, the first step for both buyers and sellers is to assemble a deal team. The sell-side team typically includes an investment banker or business broker, legal counsel, and tax advisors. The buyer's team tends to be larger and is composed of legal counsel (both M&A counsel and specialists), financial and tax advisors, subject matter experts for areas like HR and insurance, and industry experts. Each member of these teams brings their expertise, providing insights into legal matters, financial valuation, operational issues, and industry trends, thus ensuring a holistic approach to decision-making.

For sellers, the next step in this initial stage involves conducting preemptive due diligence, which should ideally cover both financial and legal aspects. The investment banker digs into the company's financials and operations, as part of its preparation of marketing materials, commonly referred to as a confidential information memorandum (CIM) or pitch deck.

If deal counsel is engaged at this stage, they begin their own due diligence process, working with the other members of the deal team. This proactive approach involves a thorough review of the company's operations, ownership structure, legal issues, regulatory matters, employment practices, and any other matters that are unique to the company and/or its business. This process helps to identify potential issues that might affect the valuation or the transaction itself and hopefully gives the seller's team the opportunity to address material issues before they become deal-breakers.

For buyers, the initial stage focuses on identifying potential acquisition targets. This process involves detailed market research, competitor analysis, and evaluation of strategic fit. The aim is to identify businesses that align with the buyer's strategic objectives, offer potential for growth, and add value to the existing operations.

2 The Art of NDAs, Initial Discussions, and LOIs

Initial discussions in M&A transactions play a pivotal role in setting the tone for the entire process, and should ultimately manifest in a signed Letter of Intent. They enable both parties to begin to align their expectations, understand each other's strategic objectives, and build a foundation for trust and cooperation.

In a banked or brokered deal, the first point of contact is typically between the banker/broker and the buyer. If a banker or broker is not engaged, then the parties will begin discussions directly. The first order of business should be a Non-Disclosure Agreement (NDA). These agreements can be mutual (both sides are obligated to hold each other's information confidential), or they run in one direction (only applies to the buyer). NDAs are crucial in M&A transactions as they allow both parties to share confidential information with the assurance that it will not be misused or disclosed without permission.

The first due diligence materials provided to the buyer usually consist of the CIM from the banker or broker, or if the seller is marketing the company on its own, basic financial information such as year-end income statements and balance sheets. These initial evaluation materials provide a sense of the company's value and assist the buyer in determining an appropriate offer price.

At this point, there can be some variation in the process. If there are a number of potential buyers, a banker/broker may elect to solicit Indications of Interest (IOIs), which come before a Letter of Intent or Term Sheet. IOIs usually only include some details about the purchase price and transaction structure without venturing into other deal terms, and they may also include commentary from the prospective buyer describing why they are best suited to acquire the company and continue its business in the future.

Entering into a Letter of Intent or Term Sheet (we'll lump them together as LOIs) is a critical step in M&A transactions. Despite being largely non-binding, these documents set the stage for the terms of the definitive deal documents; they outline the key terms of the transaction, such as the business valuation, purchase price, payment structure, transaction structure, certain important legal terms, due diligence process, and post-acquisition plans. The few legally binding provisions typically include confidentiality obligations and no-shop provisions.

One of the most important benefits to the LOI process is the identification of true deal breakers at an early stage, before either side has committed significant resources towards pursuing the transaction. In addition to key deal terms, a well drafted LOI should include the assumptions the buyer is making in arriving at the valuation of the acquisition target. This is important for setting expectations between the parties, and if both sides understand the basis for the valuation it will lead to less friction if those assumptions turn out to be incorrect, and the buyer is forced to alter the purchase price.

It's important to include both legal counsel at this stage in order to propose a transaction structure that will meet both the buyer's and the seller's requirements and to be certain that all key deal terms will be included in the LOI. Employing a DIY approach can lead to a host of problems, including completely starting from scratch after the parties believed they had an agreement in principle.
In an auction process, the investment banker or broker may solicit LOIs from all suitors, or if it has already solicited IOIs, it may only request an LOI from a small number of finalists or the chosen

buyer. In any event, only the buyer that is chosen by the seller will actually sign an LOI with the seller. Once the LOI is signed, activity picks up significantly on both sides. Due diligence requests are sent by the buyer, and a virtual data room is established and the seller's team begins to populate it with due diligence materials. In addition, non-legal due diligence streams begin. While this is occurring, buyer's counsel begins drafting the purchase agreement.

LOIs and term sheets are not merely preliminary documents. They are critical negotiation tools that lay the foundation for the final purchase agreement. By setting out the main terms of the deal and the expectations of both parties, they guide the negotiation process and keep both parties aligned on the transaction's key aspects.

3 The Power of Letters of Intent and Term Sheets in M&A

Let's take a look at letters of intent (LOIs) and term sheets and their importance. For simplicity, we'll lump both together under the term LOI.

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One of the most important benefits to the LOI process is that true deal breakers are typically identified at this early stage, before either side has invested significant time and resources towards pursuing the transaction. It's important to include both legal counsel and tax advisors at this stage in order to propose a transaction structure that will meet both the buyer's and the seller's requirements and to be certain that all key deal terms will be included in the LOI. Employing a DIY approach can lead to a host of problems, including completely starting from scratch after the parties believed they had an agreement in principle.

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4 Bringing it Home: Negotiating the Deal Documents

In parallel with due diligence, the purchase agreement is drafted. The buyer's team almost always prepares the initial draft. Purchase agreements in M&A transactions tend to include a combination of highly customized and boilerplate terms. Depending on the complexity of the transaction, purchase agreements in middle market deals can be lengthy, in some cases reaching nearly 100 pages. The initial draft of the purchase agreement should track the terms agreed to in the letter of intent.

The delivery of the purchase agreement signals the beginning of what can be a lengthy negotiating process, but if the parties have invested their time and effort into a fleshed out and well drafted letter of intent, those efforts will pay off and reduce the number of issues that are open to negotiation.

The negotiating process largely follows a back-and-forth process. The seller receives the initial draft and it and its lawyers review and discuss recommended revisions. There may be one or more "internal" drafts that are distributed just to the seller's team, and once the seller is satisfied with the revisions, it is passed back to the buyer, who in turn may follow the same process of generating a new draft back to the seller. This process may be iterated numerous times before the closing. The goal with each "turn" of the purchase agreement is to whittle away at open issues until the parties agree that the purchase agreement is final.

While the purchase agreement is the primary document in the transaction, there may be other agreement that are nearly as important. Examples can include the operating agreement of the buyer if the sellers will be rolling equity into the company post-closing, agreements related to stock consideration, and employment agreements for sellers that will continue with the business. The process described above applies to these transaction documents as well, however, buyers may be less willing to negotiate many of the terms.

All of the transaction documents are negotiated in parallel with the goal of finalizing all of the agreements prior to the target closing date. That being said, sometimes key agreements are negotiated up to, and on the closing date. While not ideal, organized deal teams can handle these situations and stand ready to close on time.

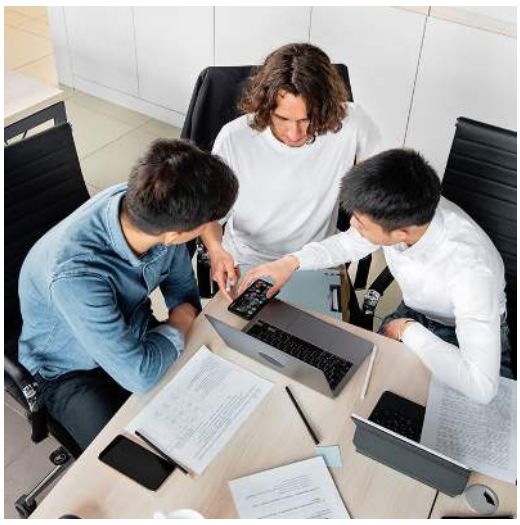
5 The Last Lap: Strategies for a Smooth M&A Closing Process

While most of the parties' focus tends to be on the purchase agreement and other key contracts related to the overall transaction, in many deals there are a number of other agreements and documents that must also be drafted and negotiated. In asset sales, these ancillary agreements include bills of sale, assignments of intellectual property rights, and assignments of the seller's

contracts to the buyer. In equity deals, there are documents evidencing the transfer of stock or the termination of options. In addition, most deals will include a host of closing deliverables from both sides (but more so from the seller's side), such as evidence from both parties that the transaction has been authorized, resignations from officers and directors of the company, tax documentation, escrow agreements, and estimated balance sheets as of the closing where there is a purchase price adjustment.

Keeping track of all the moving pieces can be extremely challenging. Experienced M&A attorneys frequently use a tool called a closing checklist to make sure nothing falls through the cracks. This is the lawyers' most important document in the M&A process. Good closing checklists track all of the documentation, actions, and filings required to close, the party that is responsible for each document, and the current status of each document and activity. The closing checklist should be frequently updated, and in the days approaching the closing, the checklist is often updated multiple times per day. Many clients never see this document, but it's the roadmap for the entire transaction.

As the closing date approaches, activity is often fast and furious to finalize all documentation and due diligence. Due diligence typically doesn't end until right before closing, because a business is always in motion and the sellers must continue running the company's business as the deal moves forward. Sometimes, the purchase agreement is negotiated right up to, or even on, the closing date. That's not an ideal scenario, but M&A transactions can be complex and involve a number of different issues for the parties to resolve.



Closings can take several different forms. Many times, the closing is handled remotely, but some deals require in person closings, such as SBA-financed transactions. If the closing is handled remotely, there are usually two methods.

The first involves the parties signing the transaction documents through a service like DocuSign on the closing date.

In the second method, the lawyers for each side collect executed signature pages from their respective clients, and send those signature pages to opposing counsel to be held in escrow until the closing. The latter method is more popular and generally results in less closing day surprises.

The closing itself can be handled through the parties releasing signature pages via email, but more often than the parties will schedule a closing call. These calls can be formal, but many times the calls are relatively brief and are focused on congratulations for a major milestone achieved by both the buyer and the seller. Immediately following the formal closing by exchange of signature pages, the buyer will initiate a wire transfer of the cash to be paid at the closing to the sellers. While the vast majority of the work is completed at the closing, the deal process isn't truly over at this point.

6 After the Ink Dries: Understanding Post-Closing Deliverables

The completion of an M&A deal does not mean the end of responsibilities for the parties involved. The post-closing phase involves several tasks, from delivering the final transaction documents to meeting agreed-upon milestones.

After the deal is closed, both parties must deliver on their post-closing commitments. Aside from legal matters, these tasks might also involve operational tasks such as integrating IT systems, merging teams, and communicating the changes to stakeholders. Immediately after the closing, the attorneys on each side typically prepare a closing binder for their client. This is usually a large pdf file that includes executed versions of every transaction document for future reference. In addition, there may be regulatory filings that must be made shortly after the closing.

Post-closing requirements related to the purchase agreement usually include a working capital true-up that is delivered by the buyer to the seller, and if an earnout is involved, documentation related to those contingent payments. Unfortunately, some transactions will include one or more post-closing claims for indemnification by the buyer. In many instances these claims are based on a breach of a representation or warranty by the sellers in the purchase agreement that has lead to liabilities that the buyer is required to satisfy. These claims can be costly depending on the subject matter, and may take an extended period of time to resolve. If the sellers dispute the validity of the claim, litigation counsel may be necessary.

Good M&A attorneys check in with their client after the deal has closed. This is usually done prior to a post-closing milestone such as the delivery date for the working capital true-up, the date that earnout payments may be deemed earned, or prior to the expiration of the survival period for representations and warranties.

Practical Solutions for Complex Matters

Doida Crow Legal is a preeminent M&A corporate boutique law firm that represents all categories of participants in mergers and acquisition transactions, including buyers, sellers, major stockholders, management team members, investment bankers, individual investors, and others. We problem-solve instead of merely identifying roadblocks. This makes us uniquely qualified to assist you with M&A transactions of various structures involving any form of consideration.

Our team has worked on public and private merger and acquisition transactions with aggregate deal values ranging from half a million to several hundred million dollars. Our typical M&A transaction is $1M or more for buy-side engagements and $5M – $100M for sell-side engagements.

We assist clients in all aspects of merger transactions, including preparation and review of due diligence materials, preparation and negotiation of the pertinent agreements, post-closing issues and other related matters. We work closely with your entire team, including investment bankers, tax advisors, in-house counsel and financial advisors.

Contact Doida Crow Legal

We're the team that Colorado owners and entrepreneurs trust when it comes to guiding your business in the right direction. Let us do the same for you. Our collaborative, thoughtful lawyers provide cost-effective, practical solutions across a wide range of industries. Click here to meet our team.

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