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C O M P A N Y

the report on transaction issues

CK BUSINESS CONSULTANTS, INC.

is your Merger and Acquisition Specialist! We represent clients in their search to sell or acquire companies, divisions, or product lines. We handle all phases of the project including valuations, marketing strategies, and execution of the transaction in a confidential and professional manner.

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Negotiating the Deal

Negotiating the purchase of a business is the most dramatic segment of the transaction. Inevitably, the buyer ends up paying more for the company than originally planned, and the seller ends up receiving less than expected.

There are basically three ways to negotiate it:

- 1. Take it or leave it.** Regardless of the seller's price and terms, a buyer makes an offer, perhaps the best and only offer, and lets the "chips fall where they may."
- 2. Split the difference.** An over simplification to negotiation is to split the difference between the buyer's price and the seller's.
- 3. This for that.** With this strategy, it is really very important that the buyer finds out what the seller really wants in the deal, specifically in the non-monetary aspects. The seller may really want contracts for key employees or his own son to remain in the business.

It is not unusual for a verbal offer to be discussed as soon as the third meeting. It is better to get some cards on the table fairly early on. Many sellers are reserved about discussing price, waiting for the buyer to go first.

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The Closing

The closing is the formal transfer of the business. There are four key elements which must take place prior to closing:

1. Both parties agree to the price and terms, and the seller has shown evidence that he or she has legal authority to sell the business.
2. Due diligence has been completed by the buyer, and the seller's representations and claims have been substantiated.
3. The financing is secured and the proper liens are in place so that the lender can release the funds for the acquisition financing.
4. Remedies are available to the buyer if the seller breaches the representations and warranties.

Clearly the closing is not the time to cut corners financially. Both the buyer and the seller need expert legal advice, as a foolish mistake at this juncture could cost ten times the amount in the future. As a buyer, it is the lawyer's prerogative to control the drafting of the Purchase and Sale Agreement. It is customary for the buyer's attorney to draft the original agreement. Then the seller's lawyer handles the revision and, finally, the buyer's attorney completes the agreement.

Emotions can run high at the closing. Hopefully, a mutual trust has developed between the buyer and seller during the many months of meeting and negotiating. The buyer will have spent thousands of dollars on inspections, due diligence and obtaining the proper financing. The seller will have spent money for appraisals and consulting fees. The experience of selling a

business is often very taxing and the seller will most likely be affected by this. It is important for both sides to maintain a positive attitude, approach problems reasonably and resist the urge to hold out for the last dollar.

There are two major elements of the closing which happen simultaneously:

◆ **Corporate Closing**

This is the transfer of stock or assets pursuant to the acquisition agreement. Representations and/or warranties should be true in all material aspects. All covenants and required agreements have been performed. All stockholders' approvals have been obtained. Litigations have been settled, non-competes have been signed, and where appropriate, all resignations of officers and directors have been obtained. Also, all third party consents such as insurers, landlords, intermediaries, etc., have been obtained.

◆ **Financial Closing**

Unless all the conditions of the deal which affect the lending institution are met – all the loans are in place, there is an enforceable sales contract with all terms and conditions spelled out, etc. – the lending institution will not release the funds. Alternatively, the funds will be held in an escrow by the title company or an escrow attorney, until all the contractual conditions are met. Upon meeting these conditions, escrow can be closed (transfer possession) and titles and assets are passed from seller to buyer.

A Sample Closing Checklist

A stock transaction is so much easier than an asset deal because buying the company is like getting on to a moving train. In a stock transaction, the company is sold “lock, stock and barrel” including all assets and all liabilities. With an asset purchase there are the following items to contend with:

- ◆ Purchase price adjustments
- ◆ Utility and tax pro-rations
- ◆ Vacation accruals
- ◆ Deposits
- ◆ Lease and insurance transfers
- ◆ Bulk sales law compliance
- ◆ Transfer of telephone numbers
- ◆ Patent assignments
- ◆ Bill of Sale and/or deeds
- ◆ Licenses to be transferred

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The best way to ensure a smooth closing is to set up a checklist to avoid any last minute mishaps.

The following includes items that should be part of such a checklist to make sure all necessary issues are appropriately addressed.

Questions to Ask:

- ◆ Where and when will the closing take place?
- ◆ Who should attend the closing?
- ◆ What documents are necessary?
- ◆ What amount of funds are to be disbursed and specifically how will they be disbursed?

Items to Address:

- ◆ Corporate tax and employer identification numbers
- ◆ Licenses transferred or obtained, e.g., liquor license
- ◆ Pro-rating calculations for taxes, wages, utilities, etc.
- ◆ Adjustments for landlord, utility, or other deposits
- ◆ Transfer of banking arrangements
- ◆ Transfer of keys, alarm, and computer codes
- ◆ Transfer of telephone number
- ◆ Customer lists
- ◆ Handling of outstanding liens or encumbrances
- ◆ Compliance with legal issues
- ◆ Assumption or discharge of leases or mortgages
- ◆ Provisions for any seller's obligations in business transition
- ◆ Providing for transfer of insurances
- ◆ Adjustments for inventory and receivables at closing
- ◆ Provisions for uncollectable receivables
- ◆ Disposition of outstanding claims
- ◆ The real estate lease or transfer of property if included
- ◆ Consulting, employment and non-compete agreements
- ◆ Allocation of the purchase price to assets, goodwill, etc.
- ◆ Provision for intermediaries fees
- ◆ Representations and Warranties
- ◆ Buyer's security for seller's notes

Purchase and Sale Agreements

Purchase and Sale agreements usually have four sections:

1. Description of Transaction

This section clarifies the type of transaction, such as a stock or asset sale.

2. Terms of Agreement

This section outlines details such as price and method of payment, i.e., cash, notes, stock, etc. Also, it includes the agreed upon role of the remaining management team such as corporate position and remuneration.

3. Representations and Warranties

This section often includes the most heavily negotiated items after the Letter of Intent is signed. Each party wants protections against any misrepresentations. A warranty is a guarantee or assurance that the property or item is, or shall be, as represented.

4. Conditions and Covenants

The Conditions and Covenants section includes non-competes, identifications and promises to do, or keep from doing, a specific act.

It is advisable to have a pre-closing one week in advance in which all the documents have been distributed, all conditions have been satisfied or waived, and any open matters have been negotiated to conclusion. If all the conditions are not met, or if any vital signature or important document is missing, then an escrow closing takes place. Instead of a euphoric high of a successful closing, the closing becomes conditional.

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