How to Get to the Finish Line with Investors

Closing the Deal

By Alicia L. Goodrow and Michelle Nickel

Working for months with or without an investment banker, you find the perfect match—THE buyer who will purchase assets or stock to expand your business. It's exciting to plan how to spend the money already burning a hole in your pocket. Your current investors are also excited, and your loyal management team will be on-board when they learn about the bonuses and new equity packages they'll receive. But before everyone orders their new toys and counts their change, you have to close the deal.

With historically high prices for oil and natural gas and super-heated demand for quality service and supply chain companies, Texas' core private businesses are hot commodities for private equity and venture capital investors. Many private owners have patiently built solid businesses on a shoestring, leveraging their work ethic, business smarts, and reinvested capital into a collection of valuable Master Services Agreements with loyal, large customers. These quiet, mind-their-manners, private companies have grown quickly in recent years and may have paid little attention to "back of the house" operations.

Closing the deal can be painful, slow, and more expensive than you imagine, especially if there's significant clean-up to do. Following the right path of team building, proper vetting, disclosure, negotiation, and structure will lead to the finish line faster than taking short cuts, which can kill the appetites of lenders and investors who have many companies to choose from right now.

Putting Together the Team

Investment bankers (IBs) are often the first members of the outside team. Skilled IBs smooth the deal flow because they perform the following:

- Excel at running numbers
- Make the package look attractive
- Get the first level of discussions of a term sheet underway
- Provide the tools to put together an informative data room and pitch book
- Vet prospective investors to determine if they are serious and have the capacity to close
- Advise on preliminary discussions with your existing equity group and your key employees
- Keep buyers honest and true to the spirit of the deal as it progresses.

IBs are paid on commission if the deal closes, often as much as 10 percent of the total transaction value. Sometimes the incentive to close creates a conflict of interest as the deal matures and gets complicated. IBs may recommend unnecessary compromises to accelerate and close a deal that is struggling through legal, logistical, tax, or financing difficulties.

Accountants/CFOs from inside and outside are key from the start of negotiations. Now is the time to upgrade to an outside advising firm if your existing accountants lack deal-closing experience. If your in-house controller is great at handling the day-to-day business, let him/her keep doing that so the lights stay on, but consider bringing in an accounting group to prepare the specialized financial statements, reports, balance sheets, post-close adjustment estimates, and other historical and projected numbers required for close. An outsourced CFO may also be necessary to manage negotiations of financial details and quarterback disclosures if there is no IB. Don't forget to budget a nice bonus for the loyal in-house accountants who will pull their weight and then some, responding to the frustrating and duplicative requests of the due diligence team.

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Lawyers/Experts are essential to get to closing. Beyond the technical role of legal eagle, your lawyer will be cheerleader, coach, quarterback, and the designated bad guy playing an important leadership role in group dynamics and logistics. Make sure you find a legal team that has the right skills AND fits your style. If you do not have an attorney who helps with your every day business, pick lawyers that know your industry and have worked with companies similar to yours not just on acquisitions and mergers but on tax structuring, compliance matters, employment, real estate, environmental matters, insurance, etc. Negotiate rates up-front, but don't ask for a quote until your lawyer has done some of the diligence. Get in the habit of asking for estimates and for bi-weekly billing reports to avoid surprises. Remember, though, that thorough legal work mitigates your risks. If your lawyers are working smart and hard, trust them.

After closing, your lawyer may also recommend specialized experts including human resource professionals, tax advisors, and wealth management/estate planners to address seller concerns and help lay the path to your successful personal transition.

Diligence on the Buyer

The best buyers are ones with a track record of buying businesses like yours. This is especially important if you are keeping some equity ownership as part of the post-close transaction. All deals are industry specific in some way, and it can be difficult to educate the buyer and his/her legal team on the normal business practices, customers, complexities, and challenges of your business. If a non-U.S. buyer is involved, complete an Office of Foreign Assets Control (OFAC) screening and consult with your lawyers to determine if there are reporting requirements (anti-trust concerns under the

Be prepared to analyze proposals in a sophisticated way and understand your underlying goals. Then, ask if the deal assigns appropriate value to supporting but not core assets. Tax lawyers armed with good data about your tax basis, fair market value, and goals can save you quite a lot of money if they are invited to the team early.

Hart-Scott-Rodino Act). Also, get legal advice on regulatory issues that could impact the deal. For instance, release of technical data or know-how to any foreign nationals is a "deemed export" for which an export license must be obtained.

Structuring Details and Negotiations

The original term sheet is unlikely to look anything like your closing structure. Even the simplest asset or stock sale evolves as all parties look at their tax and financing structures. Ask your advisors whether your structure allows you to preserve family values of asset protection, succession planning, and gifting.

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Data Rooms

Initially, the buyer will send over a due diligence checklist, which is the buyer's shopping list of questions and, data based on your business operations. The seller's team—typically, your investment banker or internal accounting group—will provide boxes and boxes of data that will become part of a Data Room, an online database accessible to authorized team members of the seller and buyer. The buyer, its accountants, lawyers, and other advisors examine documents for weeks or months during this initial phase. Unfortunately, sellers who have informal or disorganized "back of the house" records will find due diligence very painful. Ask yourself:

- Could I deliver copies of all of my corporate minutes, material contracts, and a list of my top 100 customers in the next 24 hours?
- Do I have leases, employment contracts, and a record of all of my litigation readily available?
- Are any of my contracts just "handshakes" with people I know and trust?
- Are there side deals with my key employees or investors? Are those documented?
- Are my financials reviewed or audited? If not, why not?

If you answered NO to any of these questions, allow more time, money, and aspirin to get everyone through the due diligence process. If you answered YES to these questions, the Data Room seems complete and the accountants have stopped calling every two hours asking for stuff. Now you can let the lawyers get to negotiating while you get back to work... right? NO!

Disclosure Schedules

In addition to creating a Data Room, you will make representations and warranties under the purchase agreement. These representations and warranties are backed up by Disclosure Schedules: potentially a hundred separate statements backed up by facts, lists, and attachments that are all culled from the Data Room. Some examples include the following:

- List all insurance policies.
- List all employees, wages, bonuses.
- List all Material Contracts.
- List. List. List...

Sure, you just finished populating the Data Room, but now they want MORE, and they want you to sign off that each list and representation is all absolutely correct. Even the most patient sellers lose their temper and sleep over the disclosure process. Your employees will want your head, or your money, for dragging them through this process. Pick your lawyers carefully. They can make it more or less painful depending on their experience and personality and depending on your risk tolerance. Disclosures are the key to managing your post-closing risk.

Communications—Outside and Inside

Selling a company can rattle your employees into complete dysfunction. Early on in the sale, decide who is on the "need to know" list and keep others behind the scenes. Find a way to tell your employees before the public finds out, and think about how you can avoid scaring everyone: don't let the lawyers, accountants, and bankers invade in their scary, dark suits; be mindful of perceptions and story lines; and avoid telling customers or suppliers about a deal until it is sure to close. Seasoned lawyers and investment bankers can help you craft a communications strategy to follow over the course of the transaction.

Closing

Congratulations! You made it to closing. Don't forget to share champagne with the whole team when the deal closes! Know that your due diligence before the transaction starts, and a great team will minimize frustration and get you to the finish line with investors. **N**

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