

LEGAL ADVISOR



A PilieroMazza Update for Federal Contractors and Commercial Businesses

You've Decided to Sell Your Business— How to Be Prepared to Execute the Deal

By Dave Shafer



After years of building, growing, and investing in your business, there comes a point at which you start to think about an exit strategy. Perhaps your exit will be transitioning the ownership of your business to a family member or selling the majority of your ownership interest to an investor and taking a back seat going forward, or maybe it's selling the whole business enterprise. Regardless of the type of exit you contemplate, selling a business is not for the faint of heart. Preparing a business for sale can best be described as a second full-time job. Accordingly, it is prudent to start the process early, get truly comfortable with the idea of selling, build a team to assist, and be prepared for a curveball or two as the transaction progresses.

Teamwork is Key

The best course of action when approaching the sale of your business is to assemble a deal team to assist. The deal team should have two main components: (1) the Internal Team and (2) the External Team. The Internal Team should include a senior representative from each area of the company, notably accounting, operations, and human resources. While it is understandable that in the early stages you may want to keep a tight lid on any discussion related to the disposition of your business (after all, you want to preserve the ordinary course of business and wait for the right buyer at the right purchase price), it would be a mistake to shoulder the responsibility of managing the sale process on your own.

The External Team should include legal counsel, preferably versed in mergers and acquisitions, an accounting professional, and in some circumstances, an investment banker or broker. A seasoned mergers and acquisitions attorney can assist with sell-side diligence, as well as preparation of non-disclosure agreements and other documents that should be put in place before you allow a prospective buyer to view your business' proprietary information. Accounting professions can help identify any financial irregularities and provide insight into any tax issues that may arise. An investment banker or broker can assist with realistically evaluating your company's market valuation, as well as finding a qualified buyer.

Sell-Side Due Diligence

The term "Sell-Side Due Diligence" refers to a process by which the team you've assembled does a pre-sale, internal review of the key areas that a reasonable buyer would look to when determining whether to purchase the business. These areas are typically where the value of your business is found, and by understanding any issues in those value-generating areas and, to the extent possible, correcting them, you are preserving the purchase price, maintaining leverage equality in negotiations, and ultimately speeding up the sale process.

Key Value Concerns

While the precise nature of the industry in which your business operates and the manner in which it has thrived may vary, there are certain areas that are typically the focus of a prospective buyer's scrutiny.

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Employment Issues

In many businesses, there are key employees running the business, servicing a contract, or generally keeping the enterprise running smoothly. A prospective buyer will examine any and all agreements that are in place with such employees, particularly any invention assignments, non-competition, non-solicitation, and equity incentive agreements. They will also ask you if, to your knowledge, any of them intend to leave the company. The theme being, a reasonable buyer understands that the success of the business post-closing will depend on those key employees, so what tells the buyer that they will stick around? **Sarah Nash** gives tips on how to keep employment issues from holding up a sale in her article on page 6.

Intellectual Property

Again, depending on the business, intellectual property could comprise a significant amount of value in the company. If your business has trademarks, copyrights, patents, trade secrets, or other intellectual property assets, it is incumbent that you know and say with certainty that the company has taken all necessary steps to protect those assets and own them each outright.

Contracts

A reasonable buyer will want to review all of your material contracts and will pay special attention to make sure that they are in order. That means, among other things, that (1) the agreements are fully executed and copies are available for review; (2) amendments and term extensions have been properly documented; and (3) there are no prohibitions against assignment of change of control that are not waivable. For government contracts, this means an added layer of compliance with Federal Acquisition Regulations, registrations in government databases, and a novation package that may need to be presented to a contracting officer. **Katie Flood** addresses issues with novating GSA schedule contracts in her article on page 7 of this issue.

Litigation and Liens

Prior to a buyer's inspecting the books, records, and assets of your business, you will want to have comfort that the assets you own are not encumbered in any way. A great way to determine this is by conducting a lien, tax, litigation, judgment, and bankruptcy search in the jurisdictions in which the business is organized and those in which it has qualified to do business. Any erroneously filed liens should be identified and removed.

Structuring

Once the parties have materially progressed through the due-diligence stage, it is time to begin to draft the definitive agreement to consummate the transaction. The definitive agreement can take many forms, including (1) an asset purchase agreement; (2) a stock or membership interest purchase agreement; or (3) a merger agreement. There are various benefits to each party, depending on structure.

There are also innumerable deal points to be negotiated among the business principals and legal counsel. Relating back to the diligence efforts of both parties, one of the points will likely be the extent, duration, and amount of indemnification obligations that the seller will incur for third-party claims and any breach of the agreement. Simply put, the more irregularities found during the diligence stage, the stronger the position the buyer has for negotiating a higher indemnification obligation, or even an escrow of a portion of the purchase price that could tie up your sale proceeds for years. **Kathryn Hickey** discusses the different growth capital financing options in her article on page 4.

In sum, selling a business can be hard work, but with the right team in place and enough lead time, you can have a successful exit.

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