Prep Work Is Key for Companies Courting Buyers
Counsel for sellers need to complete a checklist of tasks before a suitor comes calling.
David Goldenberg and Conrad Everhard
The National Law Journal, November 3, 2014

Mergers and acquisitions have made headlines this year as large corporations and private equity firms utilize record amounts of cash. Companies of all kinds — private, public or institutionally held — are looking for ways to quickly enter new markets or acquire key positions in strategic areas.

Attorneys representing companies that are considering being acquired should make sure their clients are ready so that they can capitalize on an offer when the time comes. Planning the exit properly can help smooth the transition and may increase the value of the business remarkably.

In addition to taking a hard look at valuation, owners and their attorneys considering selling the business should take stock of certain fundamentals. These include the best time to sell, the value of the business today, the status of preparatory steps to make the company an attractive acquisition candidate and whether the founders want a continuing role after the sale.

Once the decision to sell is made, it is advisable to conduct an in-depth examination of key corporate operations or "sell-side due diligence." Most effective when undertaken well in advance of the sale, this exercise often identifies areas that may need corrective action. The following checklist includes some of the critical matters to address when an exit is on the horizon (or when the business is planning a financing round).

- Make sure legal documents are updated and organized. As with many significant opportunities, in acquisition discussions, first impressions are important. Nothing will prejudice a company's credibility more with a potential buyer than the appearance that it doesn't have its act together. It is important to have key legal documents in order, up-to-date and these days, posted (or ready to be posted) in an electronic due diligence room.

- Protect intellectual property. It is crucial to ensure intellectual property rights are all properly protected, registered and duly transferred from employees and consultants to the company — this means every person who touched the code or other technology. For portions of technology acquired from third parties, each item must track back to a license in good standing. Counsel should work with owners to ensure documentation is up to date well in advance of any acquisition discussions. The company should also have policies in place to cover the protection of trade secrets and confidential information.

- Project a professional financial profile. Good, accurate financial statements maximize a company's marketability. Ideally, it will have a professional set of financial statements covering at least two full fiscal periods and the applicable stub period. The financials should be prepared in accordance with generally accepted accounting principles, consistently applied. For larger companies, having audited financial statements prepared in advance is always recommended.

- Have forecasts and business plans. A key element of creating potential high valuation is the ability to articulate the company's future growth, strategy and prospects. When current business is a key factor in the valuation, buyers will certainly ask about the strength and current status of customer relationships, as well as which third-party relationships would be at risk in the event of a sale.

- Understand the closing landscape. Typically, in a merger and acquisition transaction various parties must provide consent. For example, a manufacturing company will need governmental consents to transfer key operating permits. Technology companies may need consent from key vendors, customers or technology collaborators. These parties may object to working with the buyer for competitive or other reasons. The company and its counsel should have a high comfort level that they can manage key relationships.

- Clean up messes. Disputes arise all the time in the ordinary course of business, but buyers are often very hesitant to buy a company with active problems, and they may reject the entire transaction because of even a relatively minor dispute. Whenever possible, resolve litigations, contract disputes, employee lawsuits or fights with former partners before approaching potential acquirers.

- Manage the skeletons. Every seller has skeletons. Buyers know that. In general, it is often best to be up front about issues that cannot be solved. If the company has not been up front about issues, its credibility will be shot. Get in front of the issue, and don't let buyer control the agenda.

- Communicate with constituents. Sometime during the course of the initial preparations, it will become necessary to discuss the process with employees and existing investors in the company. The nature and timing of these communications should be well thought out to assure they are not premature.

- Choose advisers wisely. Financial and outside legal advisers will play a key role. In-house counsel may have helped run the company for years, but this may be the first time they have worked on an acquisition. Putting a strong team in place can support the company's efforts and provide trusted advice.

- Negotiate the key deal points from a position of maximum leverage. A seller's leverage drops dramatically as soon as it signs a term sheet containing a lockup. It can't talk to other buyers any more. In addition, while terms are nonbinding, the parties often rely substantially on the term sheet as evidence of agreement. Purchase price is important, but many other issues are critical for the seller to consider, including personal liability for breaches of representations and warranties, escrow holdbacks, indemnities, employment terms and noncompetition covenants. Sellers should negotiate those items at the time of the term sheet.

The sale of businesses often represents the end of one chapter and the beginning of another, and the quality of the new chapter can depend significantly upon thoughtful preparation well before the sale process began.