

FRB's "Buying Or Selling A Business" Series

Offers, Contracts and Closing

Front Range Business, Inc.

*Offices In Boulder, Breckenridge,
Evergreen, and Fort Collins*

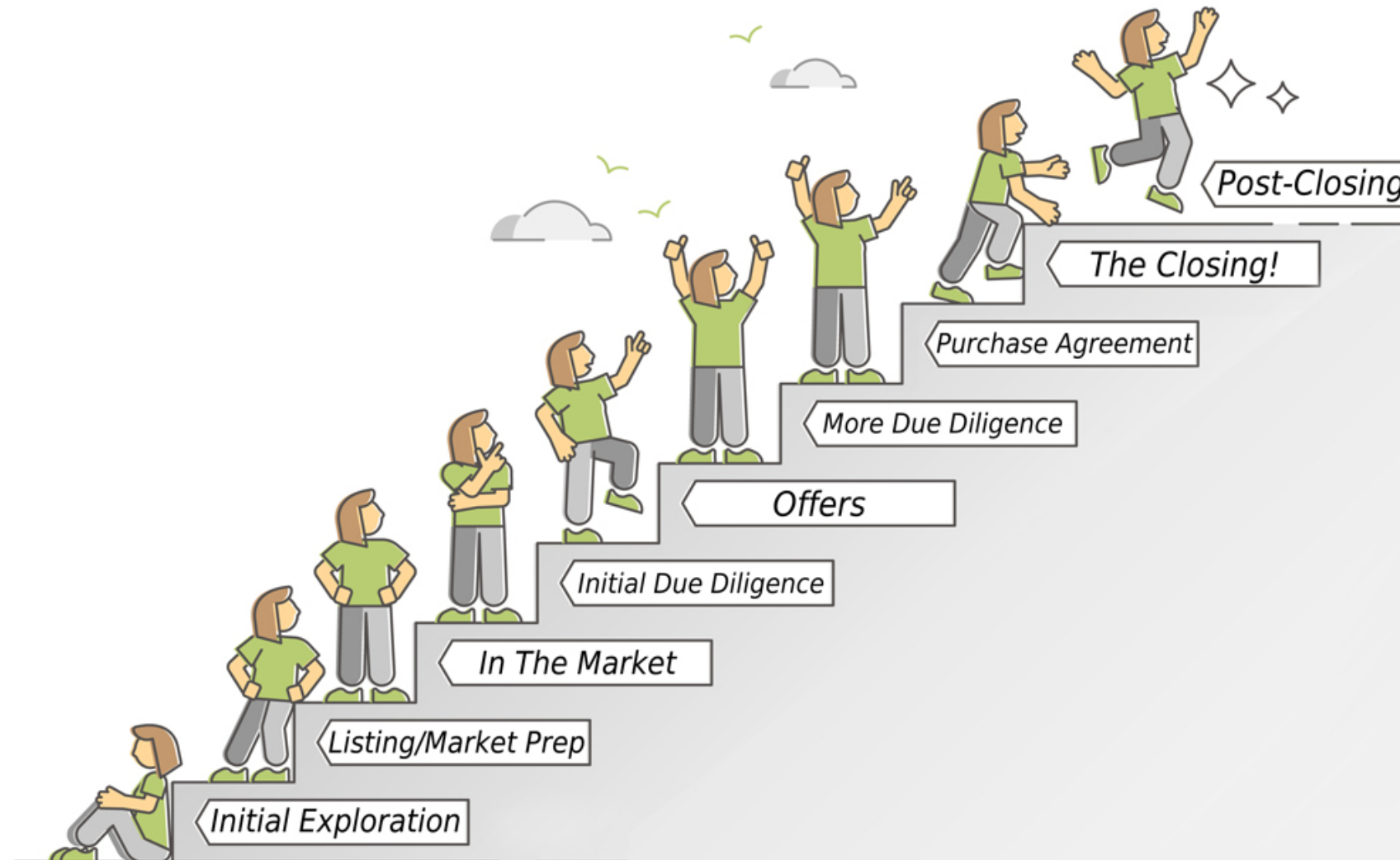


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Thursday, August 15, 2024*

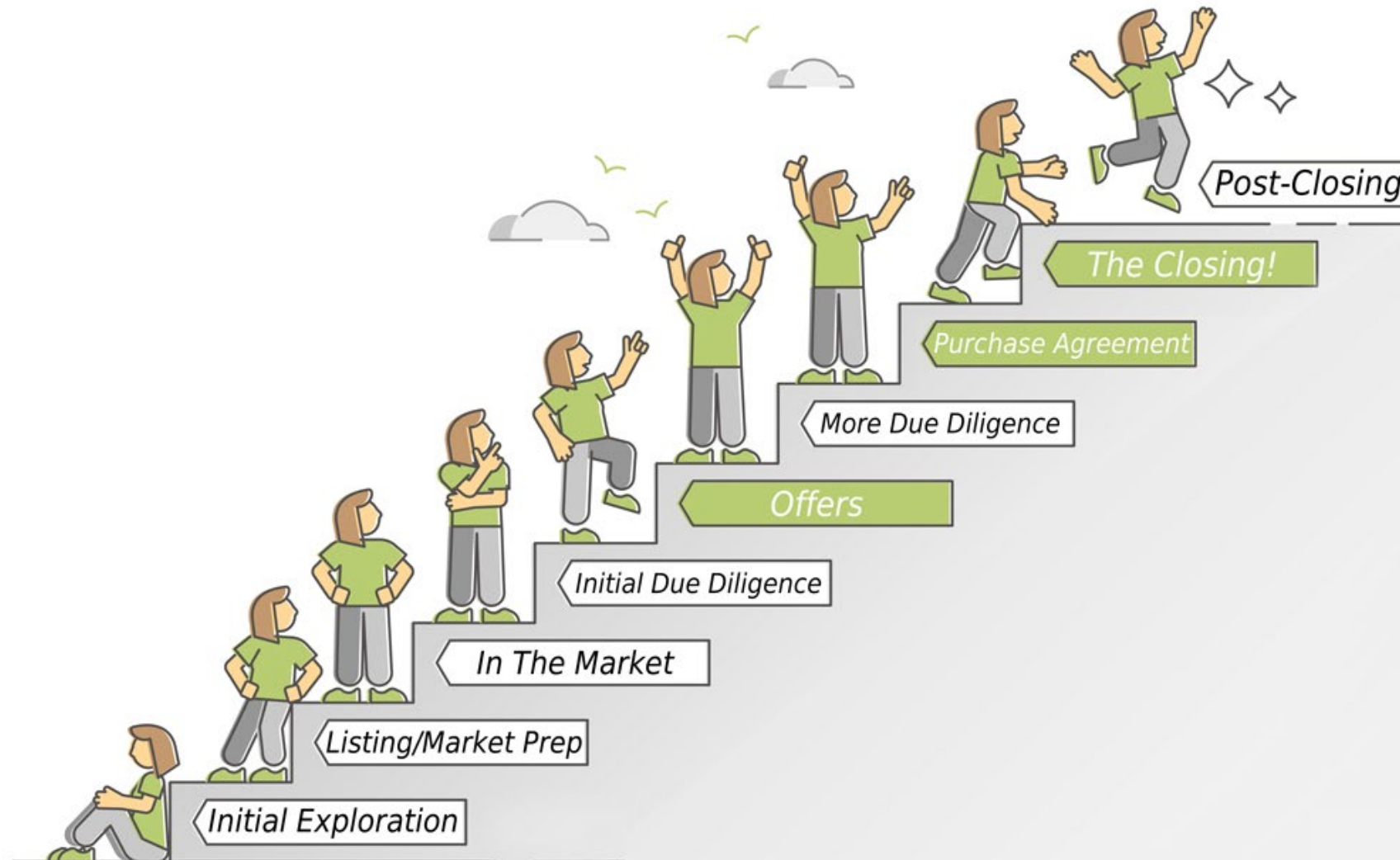
Program Overview

- *Not a “How To”, more of a detailed introduction*
- *Every transaction is a bit different, can’t cover every variable, focus on the most common elements*
- *Welcome your questions using the chat feature*
- *Encourage you to contact us after the program if you have any questions*

All Business Sales Have 9 Steps



There Are 3 Contract / Legal Steps



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Offers

What is a Letter of Intent?

- *A written, nonbinding proposal that outlines an agreement in principle between two or more parties before a legal contract is finalized*
- *Two-to-three-page document outlining the high-level **business terms** of a proposed transaction*
- *Attorneys are not necessary at this point since a legal document is not being created*

Before You Make the Offer

- *Know your resources and capabilities*
- *Be ready to provide evidence* (i.e., lender pre-qual) & reassure the seller you are serious
- *Think through it:* Timing, motivation, and characteristics of the business
- *Articulate why you* want to buy this business and why you are the right person to sell to

Good Buyers Know

- *Be prepared*
- *Don't submit an LOI you can't execute on*
 - *No favors here, earn the winning offer*
- *Seller is parting with a lifestyle, employee family, communal ties, etc.*
 - *Get beyond the numbers & build rapport*
- *Offers < the asking price should indicate why*
- *Sellers will need time to review offers and allow the market to inform them*
- *Deals move at the speed of trust*

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Components of an LOI

The Basics of an Offer

- *Setting expectations for both sides*
- *Often starts by reviewing the offer price & critical terms with the Broker to receive guidance*
- *Avoid loose ends that can lead to problems later*
- *A formal LOI is signed and submitted by the buyer*
 - *Often drafted with broker assistance*

Example Terms

- \$1,000,000 *Price*
- Asset sale *structure*
- Includes \$50,000 in *Inventory*
- Does not include *Working Capital*
- Does not include *Work In Progress (WIP)*
- No *earnouts or earn-downs*
- *Escrows: \$75,000 for Customer Retention metrics in 1st Year, & \$25,000 until proof taxes are paid*
- \$10,000 *Earnest Money*, fully refundable

Price & Deal Type

- ***Price:*** the total consideration (dollar amount) offered for the business
- ***Common Deal Types:***
 - Asset acquisition- APA (most common)
 - Stock purchase- SPA
 - Membership Interest Purchase- MIPA

Earnest Money

- *Flat dollar amount or a percentage of the price (i.e., 1-3%)*
 - *Funds held in escrow (i.e., closing attorney)*
 - *Demonstrates proof of interest and ability to access capital*
 - *Usually refundable if the deal is canceled*

Funding Strategy

Money comes from three places:

- **Buyer: Equity injection** (cash + earnest money)
 - Typical range = 10 - 30%
- **Lender: SBA, Commercial**
 - Typical range = 70 - 80%
- **Seller: Promissory note**
 - Typical range = 0 - 20%

Transaction Timeline – Key Dates

- *Buyer and seller sign the LOI*
 - *Buyer needs time to weigh the offers*
 - *Time to negotiate/refine an LOI*
- *The Purchase Agreement is signed*
 - *30-45 days from LOI signing*
- *Due Diligence is Completed*
 - *Similar to APA dates*
- *Closing*

Transition and Training

- *Training vs. Consulting vs. Management*
- *Duration: Days, Weeks, Months?*
- *Total Time Requested (# of hours or days)*
- *On-site vs. remote*
- *Buyers tend to ask for too much (risk mitigation)*
- *The initial request can be modified by the due diligence process*

Exclusivity

- *Provides the buyer with an unobstructed path to make the deal happen*
- *Full vs. partial exclusivity*
- *Typically, 30 – 45 days or the APA is signed*
- *Everything comes with an expiration deadline*

Due Diligence

- *Buyer looking “under the hood”*
- *Outline requirements*
- *Not an open-ended review in perpetuity*
- *Validate material facts that will either confirm or terminate the offer*
 - *Learn about the business, not how to run it*
- *Buyer has reasonable time to complete*
- *Seller determines buyer’s capability to execute*

Ex. Required Contingencies

- *Provide lender financing approval*
- *Establish landlord approval and execute a suitable lease*
- *Obtain Special Licensing (liquor, trade license, etc.)*
- *Receive Supplier or Franchisor approval*

Optional Contingencies

- *Key employee retention*
- *Non-compete*
- *Buyer's satisfaction with the books and records*
- *Material changes in the business*

LOI Deal Points

- *Payment:*
 - \$200,000 Buyer Equity
 - \$725,000 SBA Loan
 - \$75,000 Seller Note (5 years @ 7%)
- *Timing:*
 - LOI 10 Days
 - Purchase Agreement 45 days following LOI
 - Closing 60 days following Purchase Agreement
- *Training:*
 - 40 hours of onsite training 20 days after Closing
 - 20 hours of remote training next 30 days
 - 20 hours of remote training in the next 6 months

LOI Deal Points (continued)

- ***Exclusivity-*** Seller won't sign another LOI before expiration, extension, or APA is signed
- ***Due Diligence:***
 - Landlord meeting
 - Lender selection /commitment
 - Specialty license, supplier, or franchise approvals
- ***Contingencies:***
 - Getting a \$725,000 SBA financing commitment
 - Execute Assignment or new suitable lease
 - Buyer satisfied with books and records
 - No material change in business
 - 5-year non-compete, 50-mile radius, competing business

Sellers, Remember:

- *All offers/buyers will have their strengths and weaknesses*
- *Identify what is most important to you, such as timeliness, price, clean exit, employee retention, seller note, or personal connection with the buyer*
- *It's always a process of negotiation*
- *Some compromise and flexibility are always needed*
- *Only enter one LOI at a time*
- *Establish rapport; **Deals move at the speed of trust***

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Contracts

Contracts / Purchase Agreements

- *LOI is the non-binding intention to purchase*
- *A Purchase Agreement is the binding contract to purchase*
- *Asset Purchase Agreement is most common structure*
 - *We'll use the APA example today*

APA (Asset Purchase Agreement)

- *Legally binding agreement (Musk & Twitter Example)*
- *Attorneys are involved and important – deal experience counts!*
- *APA is the “playbook” for the transaction*
- *10-30 pages + exhibits*

Common Buyer Pre-APA Tasks

- *Confirm lender and loan commitment*
- *Confirm assignment or new lease with the landlord*
- *Establish a business entity*
- *Resolve any other contingencies*

Good Buyers Know:

- *Only change LOI price & terms due to material issues*
- *Expectation of “certainty” to complete the transaction*
- *Most of the due diligence and buyer advance preparatory tasks are completed*
- ***Deals continue to move at the speed of trust***

Common Revisions from LOI

- *Earnest Money: Adjust or make non-refundable*
- *Contingencies: Often reduced (always retain lending, lease, material change)*
- *Financing: Proof of lender commitment, loan in underwriting, lender requirements*
- *Closing Timeline: Adjust for practical realities*
- *Exclusivity: Often take business off the market*
- *Transition Support: Often tweaked/modified*
- *Exhibits added*

Financial Adjustments / Settlements

- *Division of customer deposits*
- *Retention of cash on hand*
- *Receipt of accounts receivable*
- *Responsibility for accounts payable*
- *Transfer of seller deposits (lease, utilities, etc.)*
- *Prorations (rent, advertising, web hosting, etc.)*

Assets to Transfer

- ***Tangible:*** Vehicles, equipment, fixtures, leasehold improvements, supplies
- ***Intangible:*** Trade names, websites, social media, customer lists, email lists, phone numbers, financial records
- ***Exclusions***

Purchase Price Allocation

- *Total price is broken into defined IRS categories with tax and accounting implications for both buyer and seller*
 - *Inventory: Methodology to value, target amount, when calculated, the settlement process*
 - *Tangible Assets: Furniture, Fixtures, Equipment (FFE)*
 - *Intangible Assets: Intellectual property, non-compete, training, franchise rights*
 - *Goodwill, Business tradename*
- *File IRS 8594 @ closing*
 - *Buyer and seller copies must match*

Example Allocations

- *\$1,000,000 total price*
 - *\$100,000 Inventory*
 - *\$100,000 FFE / Personal Property*
 - *\$5,000 Non-compete*
 - *\$5,000 Training*
 - *\$790,000 Goodwill*

Tax Obligations

- *Tax liability typically transfers with the business ownership*
- *Seller owns tax obligations up to closing*
- *Tax payments are often in arrears, and need a settlement value*

Debts and Loans

- *Typically, all debts are to be retired/paid off*
- *Buyer assumes no liabilities for outstanding debts/liabilities*
- *PPP declining as an issue of forgiveness*

Employees

- *Hardest first – Do any employees need to be terminated by the seller?*
- *Key employee retention plan*
- *Employee notification plan*
- *Payroll transition plan*
- *Employee raises before closing*
- *Accrued employee benefits and bonus plans being taken on by the buyer*
- *Employee policies for vacation, illness, etc.*

Possession

- *Specifies when the business transfers to the buyer*
- *Typically, 12:01 am on the day of closing*
 - *Buyer owns the day of closing*
- *Typically, buyer receives the keys at closing*

Representations and Warranties

- *Good standing*
- *Authority to act*
- *Ownership*
- *Involved brokers and fees*
- *Leases*
- *Disclosure of material facts*
- *Legal claims*
- *Product liabilities*

Boilerplate Info

- *Termination*
- *Indemnification*
- *Conduct of business to closing*
- *Confidentiality*
- *Timeliness*
- *Cooperation*
- *No governmental actions / restraints*

Boilerplate Info (continued)

- *Entire agreement*
- *Definitions*
- *Notices*
- *Governing law*
- *Fees and expenses*
- *Waiver in writing*
- *Method of signing*

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Closing

Overview

- *The legal transfer of the business from seller to buyer*
- *Highly detailed process with lots of checklists (closing & lender), so precision & a team effort is required*
- *Closing Attorney with escrow capability to receive and disburse funds. **Experience matters!***
 - *Competence is critical to a secure, complete transaction*
- *Buyer and Seller agree on the attorney and typically split the costs*

Pre-Closing Activities

- *Perform UCC lien search*
- *Obtain any payoff statements*
- *Check the status/amounts of personal property taxes*
- *Validate seller and buyer entities*
- *Coordinate with SBA lender (Seller note and SBA loan)*
- *Receive all inbound funds (buyer, lender)*
- *Prepare closing documents for advance review by both parties*

Key Closing Documents (1)

- *Closing instructions*
- *Settlement statements*
- *Entity resolutions*
- *Bill of Sale for tangible assets, vehicle odometer statements*
- *Assignments (intangible assets, equipment leases, premise lease)*

Key Closing Documents (2)

- *Non-competition agreement*
- *Seller promissory note & security agreement (if applicable)*
- *UCC financing statement*
- *Deed of Trust for real property*
- *Personal property tax agreement*
- *Escrow agreement*

Closing Location

- *Anywhere they can get their job done*
 - *Their office, remote, or a neutral location*
- *May also have additional closings on your deal*
 - *Loan, property*
- *Provide notary services*
- *Provide copier/scanner services*
- *Administrative support to get the deal closed*

Funds Disbursement

- *Receive funds*
 - *Wires, checks*
 - *From lender, buyer*
- *Distribute Funds*
 - *Seller proceeds*
 - *Payoff loans, UCC liens, etc.*
 - *Transfer in or out of escrow*
 - *Broker fees*
 - *Legal fees*
 - *Taxes due*

Post Closing – Filings

- *Articles of Amendment for seller entity name change*
- *Withdrawal of trade name(s) for seller*
- *Statements of trade name(s) for buyer*
- *Transfer of trademarks*

Post Closing – Celebrate!



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Key Takeaways

Keep These In Mind- LOI

- *The LOI isn't a toe-in-the-water trial balloon; it's a commitment to purchase with contingencies only for material issues*
- *Seller enters just one LOI at a time*
- *Non-binding so get to binding APA as quickly as possible*

Keep These In Mind- APA

- *The APA is legally binding*
- *Indicates certainty for all parties that the deal is moving forward*
- *The playbook by which the transaction and closing will happen....or not*
- *Both parties should use capable attorneys*
- *Watch out for the error of omission*

Keep These In Mind- Closing

- *Use an experienced attorney with an agreed-upon scope of work*
- *Get mutual agreement of buyer and seller on the attorney*
- *Circulate documents 5 days in advance for review*
- *Disbursement of funds may be delayed if not received in advance and cleared*

Offers, Contracts and Closings

Questions?

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*What's
My Offer?*

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*Is My
Contract
Solid?*

*Am I
Ready To
Close?*