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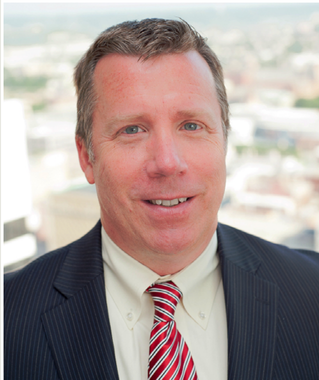
Business Briefs
Legal Update

Thinking of buying a business? Here's where to start.



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When I have the opportunity to sit down with an individual who is looking to buy a business, I am often struck by the earnest surprise shown by the prospective buyer when I go over what items we should request from the seller in determining whether or not to buy the business. The due diligence (or investigation) period is a critical part of any sale and purchase transaction, as it gives the prospective buyer the opportunity to dig into the target company to make sure it is worth the ultimate purchase price. It is the buyer's opportunity to "kick the tires" and "check under the hood" of the target business. When clients ask what items we want to ask for and review, my automatic answer is "***everything***," and then we pare it down.

The potential transaction often begins as a result of a discussion between the client and either the seller or a representative of the seller, such as a business broker. After the initial round of discussions, if the buyer is seriously interested in proceeding, they call their attorney and ask for advice as to what steps to take next. The first step is to put a confidentiality agreement in place between the parties. Before any seller is going to be willing to part with their proprietary information, a confidentiality agreement needs to be in place so that a seller has assurance that this sensitive data will be protected, and further, that the information is not then used by the prospective buyer for competitive purposes. In the event a prospective buyer is hesitant to execute a confidentiality agreement (also referred to as a "non-disclosure agreement" or "NDA"), a seller will likely terminate discussions. Presumably, any legitimate and earnest prospective buyer expects an NDA to be put in place.

After the NDA is executed by both parties, the initial phase of due diligence begins. The primary focus of this stage is usually on the financial condition of the targeted company. I recommend asking for comprehensive financial statements of the company, including profit and loss statements, balance sheets, and tax returns for the past three to five years. The focus of many buyers is to ensure that there is adequate cash flow in the business. These documents are necessary to determine the real picture. At this stage, be sure to request docu-

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ments that have been prepared by the target company's Certified Public Accountant. In a recent transaction, initial financials provided to my client were spreadsheets generated by the seller's broker with additional hand-written estimates of various revenue categories. We advised the seller and his representative that these were insufficient and that we really wanted monthly financial statements from the business as generated by their CPA. Not surprisingly, the actual documents prepared by their CPA were far less positive than the hastily prepared information provided by the seller and his broker. Furthermore, once the tax returns (and the information contained therein) were reconciled with the financial statements, the deal was terminated.

Upon completion of the initial financial review, if the prospective buyer is still interested in moving forward, the buyer often prepares a letter of intent (LOI) setting forth an initial proposal of the structure of the purchase, addressing not just the purchase price, but other conditions upon which the buyer is willing to buy the company. The standard LOI also contains language that the transaction proposed in the LOI is merely an indication of interest and is non-binding, and is subject to the negotiation of a more definitive purchase agreement. Although it is typically non-binding, the letter of intent is frequently viewed by the seller as an earnest step taken by the prospective buyer to invest time, energy, and resources towards a purchase of the company.

Once the LOI is executed, the next phase of due diligence starts. The inquiry will focus on things such as the employees (employment agreements, non-competes, benefits, identifying key employees), revenue sources (identification of customers, profit centers), contracts (leases, Franchise Agreements, supplier and vendor agreements, oral agreements), and litigation (tax, environmental, labor & employment claims, etc....). In the event any of the information provided raises more questions or issues, then we follow-up with more requests from the seller.

The due diligence period of any transaction is the time for the buyer to get a complete and earnest picture of the target company. This investigation can have one of several effects:

1. It may justify the purchase and the price;
2. It may result in a reduction of the purchase price; or
3. It may result in the prospective buyer deciding not to proceed. I'm a firm believer that sometimes the best deal a person can make is the one he doesn't make.

The length of the due diligence period varies with each deal, but I have seen a range of 30-90 days. Once it is complete, the next step is for the prospective buyer to declare whether they wish to proceed or if they are no longer interested. If the deal proceeds, the parties will then work toward putting together the final purchase document, with a goal of promptly closing the transaction. Along with maintaining an inquisitive attitude, a buyer should also surround himself with a team of advisors for this due diligence phase. While a business attorney is vital at this stage, so is the buyer's accountant and financial advisor. These professionals can help interpret the financial condition of the target company.

Bob Brown's practice focuses on Business Law, which encompasses real estate, corporate law and commercial litigation matters, fillin*g the role of "outside" general counsel for his clients. He assists businesses in all aspects of initial startup including entity selection and incorporation. His litigation experience includes prosecuting and defending non-compete lawsuits, contract disputes, and representation of financial institutions.*

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