



MID-STATES ADVISORS
A Private Placement and Business Brokerage Firm
Newsletter

Mid-States Advisors, Inc. Monthly Article & Updates

Good Morning,

2021's high pace for transaction activity has carried into 2022 as activity in the M&A market remains strong, regardless of the size of the transaction. We continue to see aggressive multiples driven by significant amounts of capital and lenders anxious to put money to work. The need for equity funds, family offices and private buyers to earn returns, especially with the stock market in its current downward trajectory, has maintained activity. We don't expect these trends to change this year and advise sellers who are considering retirement in the next couple of years to take advantage of the current market conditions.

Lenders are still aggressively pursuing loans needed to complete transactions. Many bank balance sheets are afloat with cash deposits, and there are too few new lending prospects to balance it out. At this point, many lenders and workout departments are working with their clients, trying to return them to the loan floor. Many of the lenders, bankruptcy attorneys and workout groups we talk to are expecting workout activity to pick up at some point this year, but we are not seeing signs of it yet. Mid-States continues to locate funding for any client or client advisor that needs assistance in locating a new lending relationship. Although not yet a significant part of our business, we have developed private lending sources that can be of assistance in tight time frames.

As we continue to see M&A activity driving the markets, we thought it a good time to update our newsletter on Letters of Intent, their purpose and how to effectively use them to achieve transaction goals. LOIs are very effective tools when used properly and our newsletter article this month focuses on the potential pitfalls and how to mitigate the risks involved with any LOI. We believe this quick read can help our network reach their transaction goals more effectively.

As always, if you are interested in learning more about this volume's content or if we can help you or a client in any way, please feel free to reach out to one of our team members.

Best Regards,
The Mid-States Team

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An Update on Letters of Intent (“LOI”) Sellers Beware!

A Letter of Intent can be used for many purposes. In this brief discussion, we will address its use by the owner of a business, the Seller, and a potential Buyer.

Both Buyers and Sellers have an interest in assuring that after signing a Letter of Intent and following due diligence a closing occurs! Some years ago, we commented on the large number of these transactions that failed to close. Let’s update and revisit this topic.

The key provisions in a **Letter of Intent**, sometimes referred to as a **Term Sheet** or **Memorandum of Understanding**, can impact the closing rate after submission and acceptance. There is another document in common usage, an **Indication of Interest**, but it falls short of being a LOI and Sellers should be wary when it is the only document presented prior to Buyers due diligence.

Sellers should be particularly on guard, since they incur disclosure risk, as well as significant cost in going through the due diligence process. Once committed, they and their advisors must do everything they can to assure the closing of the transaction. In today’s market, there are many more Buyers than Sellers, so a properly advised Seller can insist that the Letter of Intent be drafted in the manner most likely to result in a closing. How?

The seller needs to make sure he/she has an experienced transactional team in place. First and foremost, this means an experienced transactional attorney. Your attorney may or may not have the background necessary, but in any event, you should be properly represented. There is a lot of money involved, and you have only one chance to sell your business. To repeat, it is important that you have an experienced transactional attorney!

The Seller should take the necessary steps to ensure that the information provided to prospective Buyers is accurate to the best of their knowledge. Prior to due diligence, the Buyer is wholly dependent on information provided by the Seller. CPA prepared audited or reviewed statements (not compiled) with full footnote disclosure must be in accordance with Generally Accepted Accounting Principles (GAAP). Many Buyers are engaging experts to perform a **Quality of Earning Review**. Please refer to (or request) an earlier MSA Article for an explanation of what this Review entails. Deviations from GAAP will be reported upon in this process and can give the Buyer cause to withdraw from the transaction. In fact, many of the transactions that fail to close do so because this report picks up serious changes in reported earnings. Sale price is of course, significantly dependent on reported earnings. A Seller will save time

and money by having a qualified CPA review its financial information for compliance with GAAP before presenting it to the Buyer.

We further suggest that you have your financial advisors rigorously review your forward-looking financial information (projections and forecasts) and the assumptions supporting them. It is well worth the money.

Today's Buyers, whether entrepreneurs or Private Equity Funds are significantly different from those of ten years ago. Private Equity (PE) funds have people running them that are experienced Buyers with years of transactional experience. It is in their interest to insert as many "escape clauses" into the LOI as they can. It is the Seller and his advisor's responsibility to resist and mitigate these attempts.

The Letter of Intent should spell out in detail the major points in the transaction. Leaving them for the final Purchase Agreement exposes the Seller to the risk that there may be disagreement regarding key provisions including: employment contracts and who will have them, post-closing roles and responsibilities of the former owners, non-compete agreements, the representations and warranties expected by the Buyers, the purchase price and terms of any seller note, earn out provisions, the amount of any hold backs that the Buyer will have to insure the accuracy of the representations and warranties, and other key provisions. The more detail in the LOI, the less chance there is of a transaction failing because of the parties' inability to agree on an important point.

While it is usually impractical and even undesirable to sign a binding LOI, any contingencies that the Buyer requires should be clearly spelled out. The most frequent contingency we have encountered over the years, particularly with non-fund buyers, is a financing contingency. In today's market, most Sellers can assume the availability of financing, and so should consider this clause as potentially no more than an opportunity for the prospective Buyer to withdraw from the transaction. We have less frequently seen contingencies for the outcome of environmental studies, for the successful awarding of a key customer order, for completion of a related transaction, and for the verification or achievement of financial results.

Because of the significant fees and internal resources consumed in the process of buying or selling a business, either the Buyer or the Seller may require a breakup fee from the party withdrawing from the transaction. This is sometimes referred to as a Termination Fee if due from the Seller, or a Reverse Termination Fee if due from the Buyer. Some of the most successful transaction people we have worked with employ this device to assure their success in closing a transaction. This is part of the executed, detailed Letter of Intent which clearly defines the terms of the entire transaction.

For potential sellers, good luck! If you heed the advice offered in this article, it is much more likely that a Letter of Intent executed by the parties will result in a closed transaction.

Feel free to call any Mid-States team member if you have any questions or if you need a referral to an experienced transactional attorney.

We welcome discussion and comment on this or any of our Newsletter articles.

If you would like to discuss our services in more detail or to discuss the content in today's newsletter, please contact us to learn more about how we can assist your company or client. Below are the direct phone numbers and emails for a Mid-States team member who can answer your questions (yes, we answer our own phones):

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