

The Makings of the M&A Purchase Agreement



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Every M&A deal is different. As a deal moves down the funnel, from [IOI](#) to [LOI](#) to [due diligence](#) to a signed purchase agreement to closing, negotiations become highly specific to the individual goals of the company and buyer. Still, as you're considering selling your business, it's important to understand what lies ahead. In this article, we'll provide a general overview of what's contained within a typical purchase agreement, and a few tips to keep things running smoothly as the deal progresses toward the finish line.

The Components of an M&A Purchase Agreement

The purchase agreement is a fully fleshed out version of the letter of intent — it includes all the terms agreed upon there, often in more detail, as well as additional terms and conditions. Here are some of the most common sections included in the document, though of course the specifics will vary by transaction.

Definitions

Well-written definitions are crucial to avoiding problems down the line. This is the place to nail down exactly what all the terms in the agreement mean — for example, does Adjusted EBITDA include “market” adjustments to retained seller's salaries or not? Does Net Working Capital include only trade receivables? Many common terms in a purchase agreement are subject to highly varied interpretations depending on who is reading it and where their interests lie, which is all the more reason to make sure the definitions reflect your understanding before signing the agreement.

Execution Provisions

These vary by transaction but include the purchase price (usually a combination of cash, buyer's stock, seller financing, and perhaps other items), payment mechanics, earnout targets/timing, escrows, purchase price adjustments, and more. Some of these may have appeared in your LOI but some of them may be new. [Earnouts](#) are one example of a common addition at this point in the process, especially if the buyer uncovered any new concerns during due diligence.

Representations, Warranties, and Schedules

As part of a purchase agreement, buyers ask sellers to state that certain conditions and facts are true at the time of sale. These statements might include things like the accuracy of the financial statements; the existence of any important contracts, physical property, and/or environmental liabilities; sufficiency of assets; condition of accounts receivable; employee benefits; taxes; and more. Your attorney can help you negotiate issues such as who will make the representations on your behalf, for what period, as well as definitions of “materiality” and “knowledge.” While buyers often try to pin down individual executives and shareholders, it's in the seller's interest to try to avoid opening up these individuals to liability after the deal closes. The reps and warranties section will generally include a disclosure schedule that includes information like employee benefit plans, any ongoing litigation, and material contract employees. Such schedules can be very time-consuming and a hot topic when it comes to negotiations.

Indemnifications

Indemnification provisions help define who should be liable for issues that arise after the deal closes. Of course, sellers hope they'll be able to walk away with their money and minimum liabilities — but the buyer wants to shift liability to the seller in cases where the business was described inaccurately and/or the problem germinated under the management of the seller. Common points of conflict when negotiating these provisions include what actions are covered, who must provide the indemnification, how long the period laps, caps on damages, relationship to escrow, and materiality of claims.

Interim and Post-Closing Covenants

Covenants provide a guide for how buyers and sellers are expected to act during and after the transaction. Interim covenants can be very specific and may include clauses prohibiting new hires, bonuses, raises, and purchases above a certain amount. Post-closing covenants might include non-compete agreements, any transition services, and directors and officers liability insurance (D&O).

Closing Conditions

The closing conditions detail requirements for buyer and seller between signing the purchase agreement and the ultimate closing date. This might include regulatory approvals, written third-party consents from all seller landlords and/or customers/vendors as needed, provisions stating reps and warranties have been met by all parties and are valid, etc. If a buyer needs to raise money for the acquisition, there can be a financing condition. It is common to include a material adverse change clause, which says that the transaction will still go forward in the case of minor changes to the business before the closing date.

Break-Up Fees

A typical purchase agreement will also include termination provisions, which detail in what circumstances either party has the right to terminate the deal and by what date. Many agreements include break-up fees which specify that the party terminating the transaction will pay a set fee to the other side. These fees aim to reduce liability and cover the costs associated with the transaction, and can also be a strategy for buyers to reduce the risk of the seller accepting a higher bid down the line.

Tips for Sellers

Negotiating the purchase agreement and navigating the stages that come after can be stressful, and it's easy to let this stress overtake the responsibilities that come with running a business. However, keeping the business on budget and performing well during negotiations and leading up to the deal closing is crucial. The potential buyer will be scrutinizing the business' every move during this phase and if your financial results are off, it could make the buyer think twice about their offer or reconsider the deal altogether.

As you work toward a deal, tensions will inevitably arise — after all, everyone is looking to protect their own interests and secure the terms that are most favorable to them. [Understanding the basics of negotiation](#) can help ensure you advocate for your interests most effectively (with the help of your deal team). Remember that price isn't everything. The terms matter too, often a lot — how much control will you have, what stake is being transferred, is there any seller financing, what are your liabilities post close? (Here are some of the [most important terms to consider](#) in any M&A deal.)