

## What happens after the Deal closes?

Just because your deal closed and you have received the bulk of your purchase price, this does not mean you are home free. Most sellers will have several other concerns that are part of almost every deal that they will have to pay attention to:

1. Honoring the reps and warranties contained in their agreement of purchase and sale
2. Living up to the terms of the non- compete or non- solicit that are part of most deals
3. Most importantly collecting on the rest of your purchase price.

My advice to seller about the reps and warranties contained in the purchase and sale agreement is to have a good lawyer working for you on the agreement. They will weed out any rep or warranty which is unreasonable. To the best of my knowledge I have never had a deal come back on my clients regarding a broken rep or warranty.

Regarding the non-compete or non-solicit almost all sellers have to sign off, this clause is important to the buyer and a reasonable request. Some buyers get over zealous in the scope of the non-compete and need some push back. I personally like non-solicits for sellers better than non-competes because they are more specific about what the Seller cannot do. I.e. approach any customer that they sold to the buyer. However buyers tend to use non- competes more than non-solicits. When all is said or done, if a Seller is careful and ethical they should not have a problem with their non- compete

As you might expect the area where the real issues can develop is # 3 **getting paid the rest of your purchase price**. Some sellers are lucky enough to get 100% of their purchase price at the closing. This does not happen very across most industries although more often in the sale of guard or fire companies than alarm companies.

If you have **not** been paid 100% of your purchase price up front, the remaining amount owed fits into one of 3 categories all of which have risks attached:

- **Vendor Take Back (VTB)** - As a seller, you willingly agreed to take part of your purchase over time after the deal closes. VTBs are often done because the Buyer did not have all the cash available to pay for 100% up front. Lots of deals are done with VTBs. Technically the only thing preventing you from being paid with a VTB is time. As the Seller neither you nor your company has to perform in any way to get paid the VTB. Some VTBs come with interest paid on them. Some with no interest. VTB can range from 10% of the total purchase price all the way to 40% and can be paid out over 1-5 years.

But let there be no doubt. VTBs represent risk to the Seller. I have had 2 deals where the VTB was not paid out. In one case the Seller got the shares of his company back almost immediately and was able to re-sell the business to make himself whole. In the other case, even after inserting clauses in the Share Purchase Agreement to protect the Seller, the Seller still got burned by an unscrupulous buyer. Sellers and their advisors need to look at your buyer's ability to pay and their track record on other deals. Having the right to get your assets or shares back in case of non-payment is obviously desirable.

- **Earn-outs** – Earn-outs are often used in deals to help bridge a purchase price gap between what a Buyer is willing to pay and what a Seller wants. They can make up anywhere from 10- 25% of the final purchase price and usually are paid out over the first 2 years after the deal closes. *I am personally* integration of the Seller’s company. I have never seen such a terrible job done on an integration.

If an earn-out is the only way to get the deal done, then the big issues Sellers have to pay attention to is on what basis will the earn-out be paid and will the company being sold be run in a manner similar to how it was run before the buyer bought it. Is the earn-out paid on the basis on meeting a target such as revenue or something more complicated like gross margin? I strongly recommend basing any earn out on the simplest variable possible such as revenue only. Secondly the Seller needs to make sure as best they can that in the integration process of their company that the buyer does not completely mess things up.

Where I see earn-outs used most of the time is by Private Equity firms. It is their way of making sure the owners stays involved and also to help meet the PE firms return on equity on the deal.

- **Hold-backs-** Occasionally a buyer of shares of any kind of company will ask for a small holdback - 5% - to cover off the possibility of undisclosed liabilities attached to the purchase of the shares. Here we are referring to items like more HST owing than originally planned. As the buyer of the shares is taking on all future liabilities of the company, such a holdback is reasonable as long as it is small in size, short in duration (3 – 6 months) and defined specifically. There can also be a hold back related to fulfilling working capital requirements.

As most of you know, holdbacks of 10-20% for a period of a year are very common in the sale of monitored accounts. It is just the way deals in the alarm industry are done. It is hard to do an alarm account deal today without one. The holdback is designed to protect the buyer from a large number of account cancellations in the early going. I personally think holding back more than 15% in an account base sale is unreasonable unless the buyer has real reason to believe the attrition is going sky-rocket– in which case I have to ask why they bought the account base in the first place. My fear is that larger hold backs indicate to me that the buyer is trying to shed all risk in the deal which is unfair. Large holdbacks allow the buyer to treat the newly purchased accounts with reckless abandon. I saw a large deal done this past year (I was not brokering it) this past year with a 20% hold back supposedly because of covid. This was unjustified in my view nonsense and the Seller should never have accepted it. This was more about the buyer’s being over neurotic about the virus

There are some steps sellers can take to protect themselves on attrition holdbacks such as attrition buy downs.

The important point to note for sellers here is you will seldom get 100% of your purchased price paid up front. Buyers will use any one of these well- established 3 tools to pay the Seller out. Each of them presents their own risks.

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