

## ALERTS

## Left at the Altar: Best Practices if COVID-19 Delayed or Cost You Your Sale

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The COVID-19 pandemic is having a ripple effect across private financial markets. 2019 and the opening of 2020 set records for fundraising for private equity firms, and the market for investment in, and acquisition of, private companies. Many founder-owned companies which, not 3 weeks ago, were within less than a month of closing a deal have been informed by their prospective acquirers that their transactions are “on hold”. Others no longer have a deal, as investment committees and management teams re-evaluate purchase price, financial covenants and their responsibilities to existing portfolio companies and limited partners.

Business owners who have lost their suitors have to ask, “Now what?” This memo provides some suggestions.

Hold Your Head High – and ensure your fundamentals stay as strong as possible.

- Consider pulling down a portion of an existing revolver to stabilize your cash position.
- Evaluate employee usage in a remote environment and make decisions about layoffs, furloughs, etc.
- Consider relief options which may be available under the CARES Act or through your state government, but plan for operations without a legislative lifeline.
- Stay in touch with key vendors and customers. Personal relationships may help ensure flexibility on terms from vendors and the return or continuation of business.

“Refresh your Dress” (aka Spring Cleaning) – Consider whether you or your prospective buyer identified any issues during the quality of earnings or diligence process which impacted negotiations or price. Your buyer may have asked you to fix these matters prior to transaction closing or required a specific indemnity to address potential losses. Now is your time to address these issues, whether for your go-forward business or to put the business in the most favorable possible position for this or a future sale. For example:

- Tax obligations.
  1. Do your service offerings include SAAS? Complete an analysis of your entity’s exposure if you’ve not been filing sales tax returns in jurisdictions beyond your physical locations. Determine whether you should/should not begin filing and/or whether you’d wish to seek relief from one or more states by filing a VDA.
  2. Any other issues around reporting or audits? Talk with your accountant on how best to address.
- Corporate records.

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1. Are there former business partners whose ownership you've redeemed but where there is no paper trail for that redemption beyond a notation in the financials?
  2. Are your capitalization tables up to date for all investments/redemptions/incentive unit issuances?
  3. Are key agreements with third parties still under an old dba or formally with the name of an entity whom you've acquired?
  4. Do your organizational documents have holes? Should you be qualified to do business in additional states?
- Financial records.
    1. Did the absence of an audit cause issues? Consider engaging an auditor for this year and, possibly, one or more of the prior years.
    2. Is deferred revenue a significant line item for your business? If you do not have a written policy regarding the impact of service termination, put one in place. If you do offer full or partial returns, track experience for prior years to enable a fact-based argument for the portion of deferred revenue which should/should not be treated as debt.
  - Environmental Issues. Resolve any identified issues that can be easily resolved without significant expense.
  - Employee misclassification. Was there some question as to the exempt/hourly status of a portion of your workforce?
  - Litigation. See if you can reach a settlement with respect to pending or threatened litigation. Without the pressure of an imminent closing (and the associated expectation of your counterparty that you are flush with cash), disputes may more easily be resolved and at less cost.

Make the Future Bright (Strategic Planning). If your sale is not just postponed for a month or two, but on "indefinite hold" or truly dead, consider your next steps.

- Will you continue to run the business for the foreseeable future?
- Do you plan to go back out to the market this year? Next year? In 5 years?
- Have you or other key owners or managers already committed to retirement? Who can step into your shoes? What training is necessary?
- If your next sale is unlikely to occur for 12 months or more, consider whether there are estate planning opportunities or opportunities to incentivize employees which you had not implemented in advance of the original transaction. For example:
  1. Would it benefit you or your family to move a portion of your equity ownership into trust? Do you need structural change to ensure that voting control remains with you notwithstanding such transfers?
  2. Would you like to award incentive equity to key employees such that they could obtain capital gains treatment on an exit payment instead of paying ordinary income on a transaction bonus? [Note that this may also help retain good people despite furloughs or temporary pay cuts].

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- Have you been considering a new strategic direction or a launch from physical sales to online sales, for example?
  1. Use this time to plan.
  2. Ask employees working from home to engage on setting up a virtual presence.
  3. Work business development for clients – whether existing or new – who would have an interest in a new offering.

Second Chances. Your second “bite at the apple” may prove better than the first.

- Lessons Learned.
  1. What insights did you gain through the negotiation process? Were there aspects of your business that the buyer either valued more significantly or discounted when analyzing business value?
  2. If there were a line of business or a location that could be emphasized or trimmed, would a future buyer pay more? What would it take to make that change?
  3. Balance your decisions in these areas. There is no assurance of a sale, and one buyer’s approach may not be representative of the priorities of all buyers. If you had to continue to run the business, would you also be happy with the new areas of emphasis?
- From Seller to Buyer. Are you in the fortunate position of being in a business for whose services demand has spiked in light of COVID-19 (e.g. hand sanitizer, digital capabilities)? Consider whether others may be an acquisition target for you in an industry which has been less fortunate. Their challenges may create an opportunity to go from seller to buyer once the crisis passes.