Beyond Cash at Closing

By Morgan Ownbey

When selling their company, business owners naturally focus on the headline purchase price and cash they will receive at closing. However, in many transactions, the total value a seller receives can look far different than an immediate lump sum. Various forms of consideration – ranging from stock options to long-term office leases – can significantly impact the seller's financial outcome. For a business owner to maximize their return upon a sale, it is essential to understand alternative types of compensation and how to structure the deal to align with their long-term financial goals.

The Upsides

The two most common ways we see buyers keep a seller financially interested in the future success of the combined businesses is (1) offering an owner shares in the buyer's company (e.g., rollover consideration) and (2) making a portion of the purchase price contingent upon the business achieving certain financial or operational targets after the sale (e.g., earnout). Accepting rollover equity can be a lucrative opportunity to participate in the buyer's future upside, but the equity may not be sellable in the near term, and the owner will be at the mercy of the buyer's larger organization and investment plans. Earnouts help bridge the gap between the seller wanting to maximize the purchase price and the buyer's concerns of future profitability. Owners should be careful in crafting the metrics, controls, timing, and documentation that prove their business is successful after the sale so that they can benefit from a post-closing payday.

Moreover, buyers often invite owners to remain involved after closing as the seller's expertise and camaraderie with employees aid in a smooth transition. While the owner just received a payday at closing, they are now an employee and should negotiate for a consulting or employment agreement, which may

Morgan Ownbey, Associate

include a base salary, target bonuses, benefits, and other perks. A biweekly paycheck and a truck allowance can be a breath of fresh air after years of making payroll and waiting to see what that year's distribution will be. Moreover, owners often negotiate a retention bonus if they and other top employees agree to stick around for a year or more after closing.

Finally, in some lending environments, a buyer may ask to finance a portion of the purchase price by issuing a promissory note to the seller (e.g., seller financing). During the deal, the parties will negotiate the interest rate, payment terms, and collateral for the promissory note. Seller financing can help facilitate deals by making acquisitions more affordable for buyers while providing sellers with a steady income stream after closing. However, it carries the risk that the buyer may default on payments, which is why sellers often request sufficient collateral for the financing.

The Side Deals

Many owners hold their company's real estate in a separate entity. Instead of selling the property, they may lease it to the buyer, securing ongoing rental income at market rent rates. The leases provide financial stability for sellers while allowing buyers to transition without significant upfront real estate costs.

For businesses with intellectual property or synergistic side businesses, sellers may negotiate a percentage of future sales rather than a fixed lump sum based on intellectual property usage, or long-term supply or services contracts with the interdependent business the buyer decided not to purchase, but wants the benefit of the continued relationship.

The Set Asides

Buyers regularly ask to hold back or set aside a portion of the purchase price in an escrow account to cover post-closing issues, such as warranty claims or undisclosed debts. After a certain period (ranging from 90 days to two years) or resolution of claims made, the remaining funds are released to the seller. Advisors carefully define the mechanisms for handling, claiming, and releasing the held-back funds.

In some situations, if the seller is in a financial pinch or the seller's existing debt interest rate is attractive, a buyer may assume certain business debts or obligations. Assuming the seller's liabilities reduce the cash received at closing, the parties will swap overall deal terms if it saves the buyer on their debt interest payments.

Conclusion

Every M&A deal is unique, and cash at closing will never leave the seller's attention, but finding the right mix of alternative closing consideration helps boost the seller's overall benefit. Understanding various structures empowers business owners to negotiate better terms and avoid common pitfalls. Whether you are considering a sale now or planning for a future exit, Chambliss can help you determine what deal matches your goals.

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605 Chestnut St. • Suite 1700
Chattanooga, TN • (423) 756-3000
chamblisslaw.com