AN EXPERT VIEW – CORPORATE FUEL

Summary of a Four-part Series of Articles on Working Capital in Merger & Acquisition Transactions

An expert view on how it works and what you can do to protect your interests through an M&A transaction process.

John C. Simons
Founder, Partner

This series of articles is intended for Sellers and Buyers of businesses, as well as for professionals who are assisting in the transaction process. A huge amount of effort and anxiety is expended to manage this aspect of a transaction – some that is appropriate and some that is a consequence of poor planning and transaction management. Through these articles, we will help the reader sort through a great many issues and to think ahead to minimize risks and disruption.

The premise of a working capital covenant (or promise) and the related adjustment mechanism in the purchase agreement is that the Seller is selling the business with a normalized level of working capital in the business – so that the Buyer, who knows less about the business, will not be surprised to have to invest further in the immediate term to operate the business.

Transaction Stages

Letter of Intent Stage	Due Diligence Stage	Closing Stage	Post Closing Stage	Settlement Stage
Agree that WC included in deal. Agree on LTM* or other Method for determining the "Target" Scope, Measurement and other special circumstances. (*Last Twelve Months)	Set Working Capital "Target" or "PEG".	WC estimated for Closing calculations. (Estimated vs. Target)	Within 60-120 days of Closing, WC Reconcilliation Process. (Actual Received vs.Target)	After Agreement on Reconciliation, $ Settled betweeen Parties.

The covenant that exists requires reaching agreement on a "Target" level of working capital to be conveyed along with the business, an agreement on what constitutes working capital & how it is calculated and a description of the post-closing reconciliation process – which typically results in a post-closing purchase price adjustment. There are pitfalls in the process that can trip-up the best-intentioned.

In this series, we address the following aspects of this topic:

PART 1:
Working Capital and M&A Transactions.
An explanation of why working capital is most often included in a business when it is sold.

PART 2:
Working Capital and M&A Transactions.
The mechanics of including working capital in an M&A transaction & how changes in working capital between an agreement on a Letter of Intent (LOI) and closing impact the Buyer and the Seller.

PART 3:
Working Capital and M&A Transactions.
Setting the working capital target and our recommendations on the best ways to document agreement on what constitutes working capital and the calculation methodology for the purposes of reconciliation.

PART 4:
Working Capital and M&A Transactions.
Best practices and other important working capital issues to be mindful of in transaction management.

Feel free to share this material with clients and friends.