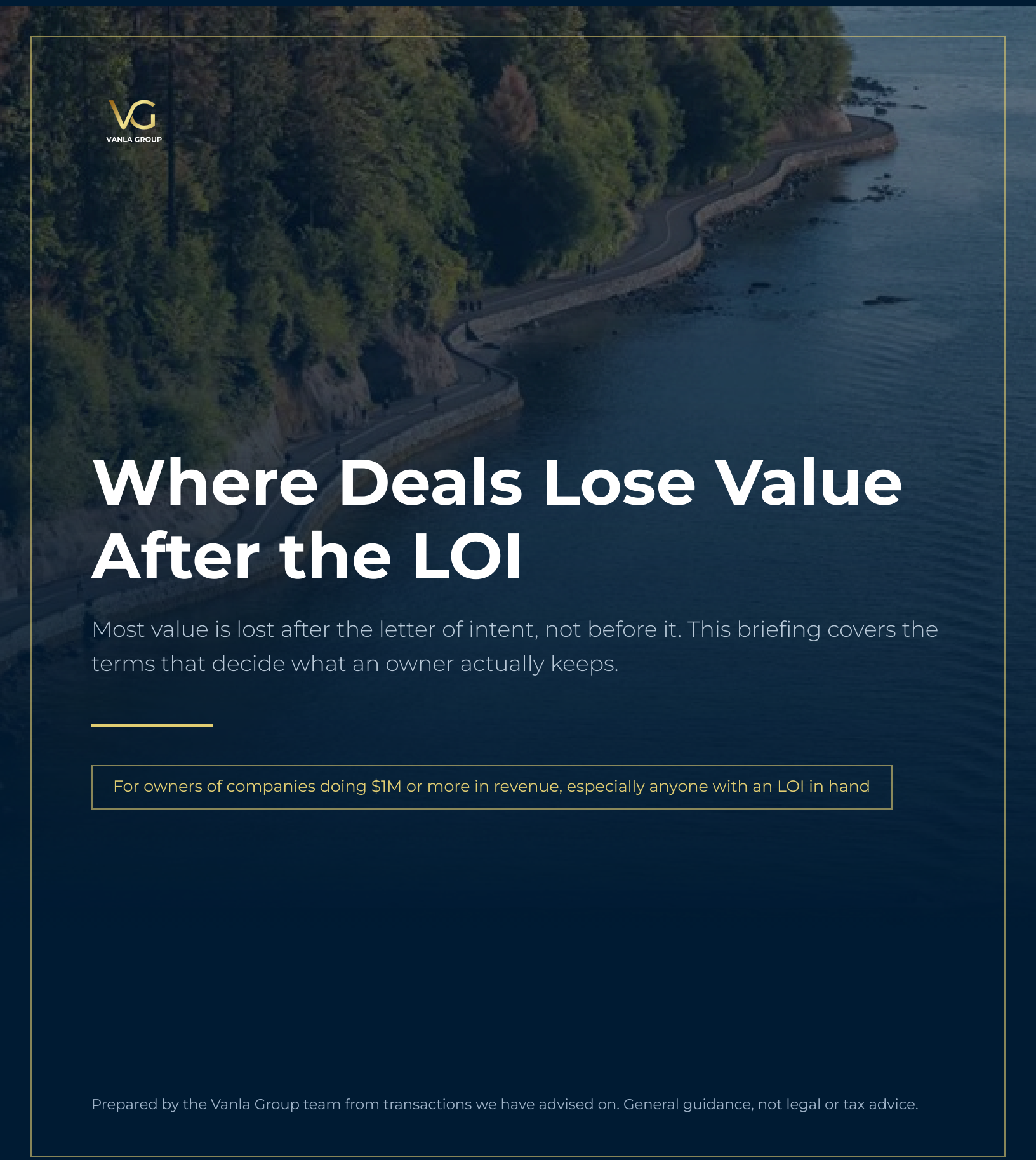


VANLA GROUP

Where Deals Lose Value After the LOI

Most value is lost after the letter of intent, not before it. This briefing covers the terms that decide what an owner actually keeps.

For owners of companies doing $1M or more in revenue, especially anyone with an LOI in hand

Prepared by the Vanla Group team from transactions we have advised on. General guidance, not legal or tax advice.

By the time a letter of intent arrives, most owners feel the hard part is behind them. In our experience it is the reverse. The letter sets a ceiling; everything that follows decides how far beneath that ceiling the owner's proceeds land. This briefing covers six provisions to examine in the letter, how a retrade begins in diligence and how preparation prevents it, and a worked example of headline price against net proceeds.

The letter of intent is the midpoint, not the finish

A letter of intent is a short, mostly nonbinding document. The price and structure are not binding. In nearly every letter the only binding provisions are exclusivity, during which you agree not to talk to other buyers, and confidentiality. On the day you sign, the buyer gains weeks or months in which the company is off the market, and you gain a stated intention.

A precise letter, negotiated while other buyers are still in the room, settles the terms that matter while you still have alternatives. The competitive stage is when terms get set, which is why our advisors treat the letter as the most important negotiation of the sale. Most of our clients reach it within 60 days of going to market.

Six provisions to examine before you sign

1. Price and structure

The headline number is the sum of several parts: cash at closing, deferred payments, an earnout, a seller note, rolled equity, and sometimes assumed liabilities. Ask for the letter to state each component separately. A purchase price of $10,000,000 tells you little. $7,500,000 in cash at closing, a $1,000,000 seller note and up to $1,500,000 in earnout tells you what you are being offered: $7.5M certain and $2.5M contingent. Also confirm what counts as debt on a cash free, debt free basis. Buyers sometimes include deferred revenue, accrued bonuses or capital leases, each of which reduces your cash at close.

2. The working capital peg

Buyers expect to receive the business with a normal level of working capital: the receivables, inventory and payables needed to operate. The peg is the agreed target. Closing below it cuts the price dollar for dollar; closing above it adds. A peg set at the high point of the year, or one that includes cash you expected to keep, takes back a share of the price without reopening the headline number. Agree the method in the letter: a trailing twelve month average, defined line items, and how the true up is calculated after closing.

3. The earnout

An earnout pays part of the price later, if the business hits targets. It can bridge a real gap between what you believe and what the buyer can verify, or inflate a headline number the buyer never expects to pay. Examine the metric (revenue is harder for the buyer to manipulate than EBITDA), the period, the threshold and whether payment is all or nothing or scaled, what happens if the buyer sells or restructures the company, and how much operating control you retain over the result. An earnout you do not control is a hope, and should be valued as one.

4. The seller note

A seller note is a loan from you to the buyer for part of the price, repaid over several years with interest. Ask about the rate, the term, whether it is subordinated to the bank (it almost always is), whether payments are current or deferred, and what security you have. A seller note is real value if the buyer is sound, and a different asset from cash; the letter should treat it that way.

5. Exclusivity and timing

The exclusivity period is the buyer's protection and your exposure. Keep it as short as the work genuinely requires, typically 60 to 90 days, with any extension conditional on the buyer demonstrating progress: a quality of earnings report delivered, a draft purchase agreement circulated, financing committed. A buyer who wants 120 days with no milestones is asking for an option on your business.

6. Allocation and tax

In an asset sale, and often in a stock sale with the relevant tax elections, the purchase price is allocated among categories of assets, and each category is taxed differently to the seller. Goodwill is generally taxed at capital gains rates. Amounts allocated to a covenant not to compete, to a consulting agreement or to depreciation recapture on equipment are generally taxed as ordinary income, at higher rates. A letter that is silent on allocation leaves one of the largest numbers in the deal to be settled after exclusivity has begun. Have your CPA model the allocation before you sign, and put the agreed principles in the letter.

How a retrade starts, and how preparation prevents it

A retrade is a reduction in price or a worsening of terms after the letter of intent, justified by something found in diligence. Some are legitimate. Many are not. They start with a finding that is true but immaterial, presented late in exclusivity, when your alternatives have gone cold and your attorney's bills have mounted.

The quality of earnings review arrives in week six and disagrees with two of your add backs, taking adjusted EBITDA down by $100,000. At a 5x multiple that is a $500,000 price reduction. Or the working capital analysis lands and the peg is set higher than your trailing average because the buyer excluded a slow month. Each is a small conversation. Together they can move a tenth of the price.

Preparation prevents most of it, because a retrade needs a surprise, and a prepared seller has none to offer. Before any buyer sees the business, we build the recast so that every add back is documented to the invoice, so the quality of earnings report confirms the number rather than contesting it. We analyze working capital over the trailing twelve months and put our method in the letter of intent, so the peg is a calculation, not a negotiation. And we identify every contract, lease and license with a consent or change of control clause, and disclose them in the memorandum, so nothing arrives in week six that was not on the table in week one.

During diligence we manage the process: a tracked request list, answers on a schedule, and a standing call with the buyer's team so that any concern surfaces while it is small. When a buyer attempts a retrade without a genuine finding, a seller who has been precise throughout, and whose competing bidders are only weeks removed, is in a strong position to decline. The $7.5M equipment rental company in Texas that we closed went through diligence this way and closed on the terms agreed in the letter.

Headline price versus net proceeds: a worked example

Take a hypothetical company with $2M of adjusted EBITDA that accepts a letter of intent at a headline price of $10M, or 5x earnings. The letter, negotiated loosely, puts $7.5M in cash at close, a $1M seller note over five years and up to $1.5M in an earnout based on EBITDA over two years. Every figure below is illustrative.

Item	Amount	Running total
Headline purchase price	$10,000,000	$10,000,000
Earnout, valued at half, since the buyer controls EBITDA after closing	($750,000)	$9,250,000
Seller note, discounted for subordination and five year repayment	($150,000)	$9,100,000
Working capital shortfall against a peg set above the trailing average	($300,000)	$8,800,000
Retrade after the quality of earnings review disputes $90,000 of add backs, at 5x	($450,000)	$8,350,000
Debt and capital leases repaid at closing	($400,000)	$7,950,000
Advisory, legal and accounting fees, combined	($600,000)	$7,350,000
Additional tax from $500,000 allocated to a covenant not to compete rather than goodwill	($100,000)	$7,250,000

Before income tax on the remainder, the owner's expected proceeds are $7.25M against a headline of $10M. Now take the same company with a letter negotiated precisely and a managed diligence. The working capital method is in the letter and the shortfall is zero. The add backs survive the review and there is no retrade. The allocation puts the covenant at a nominal figure, with the balance in goodwill. The earnout is based on revenue, with scaled payments, and the owner expects to receive most of it. The note and fees are unchanged. Expected proceeds are roughly $8.4M to $8.5M, before income tax, on the same headline price.

The difference, more than a million dollars on a $10M deal, did not come from a higher offer. It came from terms settled while the owner still had leverage, and from a diligence that produced no surprises. Terms decide what an owner keeps. That is what we mean when we say most value is lost after the letter of intent, not before it.

Run your own net proceeds calculator on our site.

What to do next

If you have a letter of intent in hand, or expect one, one of our advisors will walk through the six provisions against your document.

Talk to an advisor

The team behind this guide

Vanla Group is an M&A advisory firm and business brokerage for owners selling companies. We are paid a success fee at closing, with no retainer and no upfront fees.



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$182M+
Closed, US and Canada

8,100+
Buyers in our network

6 to 9
Months to close, typical

Questions about your own business? An advisor will talk them through with you.