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M&A: WHY LOWER AND MIDDLE-MARKET M&A DEALS FAIL TO CLOSE - KNOW THE WARNING SIGNS

by William L. Rosin

Trade journals are full of articles discussing the plethora of M&A deals that have recently closed. However, for every closing there are far more deals that begin the process but are not completed. Each year, hundreds of thousands of dollars, if not more, are spent by buyers and sellers on deals that go nowhere. How can you avoid being a party to a doomed deal or, at least minimize your losses? What are the red flags to watch out for? Here are 4 of the more common reasons why lower and middle-market M&A deals fail to close:

1. Unprepared Seller.

First and foremost, failing to take the necessary steps to prepare a business for a sale is the most common reason a deal does not close. At minimum, a prospective seller considering the sale of its business should: (i) engage experienced M&A counsel and accounting professionals early to help prepare for and navigate through the sale process, (ii) identify and understand the seller's objectives in pursuing the sale, and (iii) undertake a pre-going-to-market review of the business (e.g., corporate records, financial records, material contracts, litigation, cyber matters, regulatory compliance, etc.) so that the seller knows the current status of its business (warts and all) to avoid surprises down the road and to ensure that the seller's information provided to the buyer is as accurate and complete as possible. Red flags: (i) seller has not engaged experienced M&A professionals to assist in the transaction, (ii) seller's deal materials are inaccurate, incomplete, or incoherently presented, and/or (iii) buyer's due diligence reveals one troubling surprise after another.

2. Seller's Cold Feet or Diverse Sale Objectives.

The sale process is an emotional roller coaster ride particularly for family businesses and closely held companies with multiple owners. While an M&A deal may start off smoothly with such sellers, as the deal progresses and they realize that a sale is *really going to happen*, the family member(s) and/or diverse equity holders may have second thoughts, personality clashes and/or non-aligned objectives, any of which can derail the closing process. Experienced M&A legal and financial advisors can help a seller coordinate and manage the diverse personalities and the emotional ups and downs to prevent a deal collapse. Red flags: (i) seller is a family business and there is a lack of clarity as to the seller's objectives and/or who speaks for the seller on key deal terms, or (ii) seller is owned by two or more equity holders and there is a lack of clarity as to the seller's objectives and/or who speaks for the seller on key deal terms.

3. Buyer's Failure to Obtain Financing.

Obviously, if suitable financing is not available to the buyer, the deal will not close. Whether or not financing is available depends on many factors, some of which are within the buyer's control and some are not. Sellers should perform some preliminary due diligence review of potential suitors to screen out high-risk buyers and to otherwise confirm that their selected buyer has the ability to secure the funds necessary to close the transaction. Whenever possible, a seller should seek out buyers with a demonstrated track record of being able to secure financing and close deals. Similarly, it is critical that the buyer receive reliable information about the target. If there are repeated material and adverse surprises regarding the target, the buyer's ability to obtain financing will be compromised. Red flags: buyer has been shopping the deal to many lenders with no commitments and/or the buyer has a history of failed deals.

4. Time Kills Deals.

Even with the best of intentions of a ready, willing, and able buyer and seller, the longer the deal process drags on the more likely bad things will happen that will adversely impact the deal and jeopardize closing. A change in trade policy, a geopolitical event, a health issue, or some other major event, is always looming just around the corner, waiting to disrupt and, potentially, cause the death of, the deal. Delays can be attributable to the seller's lack of preparation or buyer's challenges in obtaining financing (as discussed above). Delays may also be caused by the need for additional and time consuming due diligence activities. Whatever the cause, the effect is usually not helpful nor conducive to ultimately getting the deal closed. Experienced M&A advisors on both sides of the deal can help keep the transaction moving forward at an appropriate cadence and manage the impact of extraneous factors should they arise. Red flags: (i) agreed upon deal milestones keep getting delayed, (ii) conditions or facts are discovered which require extended and protracted due diligence, and/or (iii) closing gets extended materially beyond what was originally anticipated.

While there are myriad of reasons deals do not close, this Client Alert presents some of the more common reasons lower and middle-market M&A deals fail to successfully cross the finish line. As a practical matter, it is often a combination of two or more of the above that sink the deal because when one is present, one or more of the other reasons are present as well thus ensuring the deal's demise. While the old adage, "*the best deal I did is the one that I didn't*" may be true, nobody wants to waste time and money on a deal that is destined not to close. The sooner you can recognize the warning signs of a doomed transaction, the sooner you can exit and minimize your losses.

FOR MORE INFORMATION CONTACT:

William L. Rosin is a Member in Dickinson Wright's Troy office. He can be reached at 248-433-7246 or wrosin@dickinsonwright.com.