Wire Harness Business & Strategy

ABCs of an LOI

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A recent exchange with a prospective buyer of a harness company we were representing surprised me. After we had provided her the usual amount of initial information, she requested additional information that included a number of items normally disclosed only after both the buyer and seller sign an LOI (letter of intent). When I explained we would need a signed LOI before disclosing the extra information, she asked us to define what an LOI was. That's when I realized that although the potential buyer owned a US$20 million harness company she had founded, she had never made an acquisition.

And that, in turn, led me to conclude that maybe many otherwise seasoned folks who might want to explore an acquisition growth strategy would benefit from an explanation of the intricacies of an LOI.

At what point in the deal process does a prospective buyer provide an LOI?

A Letter of Intent is submitted to the seller of the company at the point when the buyer has had the opportunity to see enough information to verify that he or she wants to pursue the acquisition.

What information will the buyer have typically seen before signing an LOI?

Usually this will consist of historical financials, some information about customers and probably a plant tour.

What does the buyer need to include in the LOI?

The central ingredient is the price and terms the buyer, subject to due diligence, agrees to pay for the company. Other information often stipulated includes, but is not limited to, source of funds, how the buyer intends to finance the acquisition, whether it's an asset or stock sale and other boilerplate legal matters.

How does a signed LOI obligate the buyer?

Once both parties have signed the letter of intent, the buyer proceeds with due diligence, which requires time and money. During the course of the due diligence process, if a buyer discovers a reason to modify the price or terms—or even to walk away from the deal—he or she has that option.

How does a signed LOI obligate the seller?

With an LOI in hand, the seller must take the company off the market and refuse to speak to prospective buyers for the due diligence period, customarily 60 to 90 days. Meanwhile, the seller often needs to respond to requests for vital information such as legal and financial documents. Also, many buyers want to have some direct dialogue with the selling company's key customers.

What risks are presented by the LOI?

The LOI sets the due diligence period in motion. During this stage, the prospective buyer is not vulnerable to risk (unless the due diligence is conducted shoddily, and important facts are not discovered) because if some untoward information surfaces, the buyer can ask for a modification of terms or halt the process altogether.

But because the buyer is now carefully trying to confirm that the business is worth the agreed-upon sale price, the seller can encounter a few complications:

- Material changes from the initial disclosures such as a lawsuit or environmental liability that was not revealed during the initial information exchange, could be a reason for the buyer to modify or terminate the deal.
- Changes occurring during the due diligence period itself such as a minor drop in sales might be used as a buyer reason to request a reduction in the sale price specified in the LOI.

How can an M&A adviser help the buyer or seller with the LOI?

Quite obviously, a firm specializing in mergers and acquisitions can counsel a buyer or seller in many aspects of deal-making such as the content of the LOI or the conduct of due diligence. But one particular situation that demands expertise may not be so obvious: That is when the seller receives more than one LOI.

In that case, an experienced M&A adviser can help the seller rank order the probability that each potential buyer will move through the diligence process without either modifying the LOI or walking away from the deal. Helping the seller recognize a "good buyer" who has a solid background, a high motivation to buy the company—and the steadfastness to avoid being thrown by a minor negative development—markedly lowers the stakes during the due diligence phase and markedly raises the prospects of the deal being consummated.

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Author & Company Profile...Loren M Smith is CEO and sole shareholder of **Blue Valley Capital LLC**, a position he has held since 2001. From 1976 to 2001, he was CEO and majority shareholder of **MWC**, a manufacturer of electrical wire harness assemblies. During that period, by acquiring and integrating a number of mid-market wire harness manufacturers, MWC became the world's leading supplier of electrical wire harness assemblies serving the construction equipment industry. Loren eventually sold MWC to a private equity group.

As CEO of MWC and Blue Valley Capital, Loren has spearheaded the sale and purchase of dozens of mid-market (US$2M-US$200M) manufacturing companies.

Early in his career, he was with **Texas Instruments (TI)**, rising to general manager of TI's connector division. Smith earned a BS degree from **Miami University** in Oxford, OH, USA, and an MBA from **Northeastern University** in Boston, MA, USA.
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