How to negotiate a Letter of Intent (LOI) that closes a startup acquisition offer on your terms

Picture this for a moment...

A buyer is interested in your startup.

You've spent days chatting back and forth via email.

You might even have met in person.

Now, your buyer is ready to send you a Letter of Intent (LOI) to buy your business.

This is a moment you've spent the last 5+ years working towards and you can finally see the finish line.

Your smartphone vibrates. An email from the buyer has landed in your inbox.

You open the email, which is courteous and enthusiastic, and the attached draft LOI.

Wait a minute, you think. Your smile fades. The terms of the LOI aren't what you expect, with most items skewed in the buyer's favor.

This a typical example of what can go wrong during an LOI negotiation.

The LOI is the first sign of serious interest, but it's also an invitation to the negotiation table. Deferring tough conversations might speed up an acquisition, but failing to negotiate early puts you at a disadvantage.

And believe me, everything on an LOI is negotiable – regardless of what the buyer might argue.

When you enter the exclusivity period, power shifts from you to the buyer. It's therefore crucial you negotiate everything in advance and have a solid legal framework from which you can proceed with the sale with confidence.

To help, here are a few things to consider.

Get your house in order

Finish as much pre-sale due diligence as possible. A little hard work now pays dividends further along the acquisition process, leaving fewer surprises or kinks to iron out later. Yes, it might take longer to close the deal, but if your buyer is talking LOI, you know they're serious, and it makes sense to get your house in order to make the sale go through smoothly.

LAWYER UP

Preparation is a powerful ally in the acquisition process. You won't be the buyer's first acquisition nor will you be their last, so don't underestimate them. They'll test you for weaknesses, and unless you happen to be well versed in M&A law, it'll be legal. Buyers will have an M&A lawyer or even a whole team working to secure the best outcome for them.

Hire counsel to escort you through these legally choppy waters. Not every buyer will use the law to exploit you, but there will be elements of the negotiation – the definition of company debt, for example – that are open to interpretation and they'll push their interpretation over yours.

NEGOTIATE A TIMELINE AND EXCLUSIVITY PERIOD

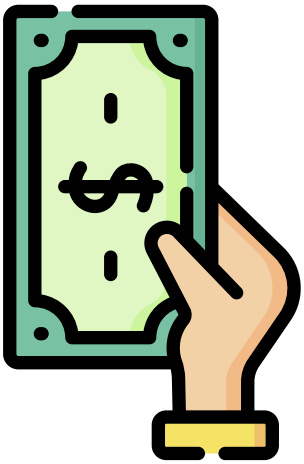
Deadlines manage your and the buyer's expectations, but you don't have to set your time by the buyer's watch.

For example, your buyer might want due diligence done quickly, but also a long exclusivity period so they can scrutinize your business without the pressure of competing offers. They might even bulldoze through negotiations to pressure you into accepting terms in their favor.

Set an appropriate timeline that includes an exclusivity period of 30 days or less (seven days if you can get it!) and ample time to complete due diligence and other negotiations.

WHAT'S THE PURCHASE PRICE AND HOW WILL THEY PAY?

Once you've agreed upon a reasonable number, cash settlement is better for you and the buyer, unless your buyer is another company. In this case, you might want to swap stock to own equity in this new entity (the buyer may resist this, however).



For the avoidance of doubt, negotiate a final number without conditions, such as financing, conditional pricing, or stock swaps when you've no interest in the new entity. You don't want to waste time on a deal if the buyer can't give you what you want.

If price is a sticking point, consider an earn-out to close the gap. A buyer might agree to the purchase price plus a percentage of revenue on future sales for a limited time, for example. Buyers don't usually like earn-outs, however, as it creates uncertainty and restricts what they can do with the business.

If you need an earn-out, apply it to revenue only. Profit will likely suffer in the short term given the costs to transition to a new owner. To avoid losing out on something no longer under your control, calculate earn-out on something steadier like revenue.

MINIMIZE EXPOSURE ON REPS AND WARRANTIES

Beware of your buyer weaponizing fundamental representations and warranties.

Your buyer wants to avoid any nasty surprises such as misrepresentation or fraud. In this case, you'll return 100% of the purchase price. But they also don't want to protect intellectual property or other important assets that might affect the value of the business post-sale, and this is a negotiation point.

For SaaS businesses, for example, your IP is everything, but competitors' products, cyberthreats, regulatory or market conditions can thwart even the best intentions. To avoid over-exposing yourself post-acquisition, limit your reps and warranties survival period to 10% or less for a period of no more than 12 months.

Obviously the more robust your IP, the better placed you'll be to negotiate. This is why doing as much due diligence before signing the LOI is so important.

DECIDE HOW MUCH YOU'LL LEAVE BEHIND

Most buyers will expect you to leave the business cash-free and debt-free. This affects working capital, too. Positive working capital will appeal to the buyer, but a negative figure isn't always a bad thing. However, buyers won't ignore consistent negative capital as this could indicate a deeper problem.

You might, therefore, need to negotiate working capital before the sale completes. Just remember that this is a point of negotiation and not always a judgment on the long-term potential of your business.

Think of LOI negotiations as going a few rounds in the ring. You'll take a punch here and there, but if you've prepared, studied your opponent, and can stand your ground under punishment, you'll emerge tougher and ready to close on your terms.