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10 Steps To A Crisis-Free Exit Strategy:

It's Called Corporate Housekeeping

By Mary Josephs

The middle market mergers-and-acquisitions world remains strong, with plenty of financing available for transactions and many buyers ready to pay multiples not seen since before the financial crash of 2009.

If you're a founder, owner or CEO of a middle market company, you should read on – regardless of whether you're getting ready to formulate an exit plan, years away from considering an exit or planning to keep your company in family hands indefinitely and have no interest in an exit. That's because good corporate housekeeping – maintaining up-to-date corporate records and other legal niceties often overlooked by busy middle market companies – is essential to the long-term success of any business.

Even companies not planning to sell will need to satisfy lenders' demands for accurate records, for instance. And controlling owners, sadly, do sometimes die suddenly or otherwise become unable to run their companies. Leaving a paperwork mess behind is no way to treat your heirs. I've seen poor corporate housekeeping impact both absolute value and perceptions of value. It impacts debt capacity, and reflects on the strength and professionalism of a company.

Especially for those mulling an exit now or within a few years, corporate housekeeping is urgent. During a career advising some 1,000 business owners on exits, I've repeatedly seen deals delayed and, worse, devalued, due to poor recordkeeping. In today's fast-paced M&A world, a buyer can easily grow restless and move on to another target when due diligence is stymied by a seller's poor corporate housekeeping. Time is money for buyers. Don't expect a buyer to be as patient as you might be with the foibles of your private business. Poor housekeeping can also cause a buyer to question what else might be wrong at a target company, introducing second thoughts no seller wants to deal with.

Buyers wonder, "What else has been happening that we don't know?" says Meridith Cannon, a partner at the law firm Clark Hill in Chicago. "If you're for sale and the buyer's counsel and the investment bankers keep seeing holes, it looks bad." Keeping great records, "hopefully you can maximize the price if and when you do choose to sell the company," Meridith adds.

So, I've asked Meridith — she advises a wide range of middle market clients on transactions, financings and other matters — to help me identify the most commonly ignored corporate housekeeping tasks. The time and money spent fixing these problems is tiny compared to the pain and cost of a delayed transaction or financing. You will be surprised at how simple these seem. Similar to selling your house, little things make a big difference. Don't be dismissive of their importance.

1. **Corporate Minute Books Not Current:** "I've seen them completely empty, or spotty at best," Meridith says. Corporations need to keep minute books; need to hold annual meetings of shareholders and directors where required by law (or obtain written consents from directors and shareholders in lieu of an annual meeting); need to document the comings-and-goings of officers and directors; and need to properly record changes in bylaws. "You want all your ducks in a row before a third party or potential purchaser looks at your records," Meridith says. Middle market CEOs, in her experience, "are busy running the business" and, if not in regular contact with corporate counsel, their minute book maintenance may be lacking.

Clark Hill attorney **Meridith Cannon**

2. **Proper Authorizations Not Current or Accurate:** Too many companies likewise don't document who is empowered to make commitments on behalf of the company and at what level. Beyond recordkeeping, this is a useful risk-management tool and one that buyers like to see documented.

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3. **Stock Certificates Missing, Stock Ledger Out-Dated:** Who owns the joint? "Shareholders lose stock certificates, especially if they are not maintained in a corporate minute book, in one location," Meridith says. She recalls a deal a few days from closing and a scramble to recreate stock certificates and sign lost-certificate affidavits because the seller had lost them. "You have to re-create the paper trail," she says. "It's a big hassle, correctable but not the situation a seller wants to be in or a buyer wants to see a few days before closing."

4. **Insurance Not Up-to-Date:** Policies lapse, or they're outdated, providing coverage for what was a smaller, less-complex company. Meridith says the coverage areas often given too little attention are directors-and-officers (D&O) policies and commercial general liability policies. An annual update and review – and records showing you did so — is a must.

5. **Subsidiaries Lost Track Of:** Long-lived corporations often create subsidiaries for geographic or lines-of-business expansions, then for whatever reason stop needing the legal entities. Companies need to either dissolve the subsidiaries or at the very least annually check on their status; subsidiaries have annual reporting requirements, too. Bank accounts and other financial arrangements are often attached to these units and you don't want added risk lurking there.

6. **Failure to File Annual Reports With States:** States have various requirements for companies doing business within, and companies often lose track of these, especially when operating in multiple jurisdictions. Penalties and other complications can result. Meridith says that a typical closing delivery in the sale of a business is a good-standing certificate issued by the states where the company is organized and qualified to transact business, and the seller won't get the certificate if it is behind on filings. Registered agent information needs to be accurate and up-to-date, too.

7. **Management Compensation and Non-Compete Agreements Non-Existent or Out-Dated:** A handshake might have sufficed under your regime, but buyers need assurance that your team is committed. Meridith says that a question for the owner and his/her corporate counsel is, "Are written employment and non-competition agreements in effect in a jurisdiction that will enforce restrictive covenants, and are they assignable to the buyer?"

8. **Failure to Compile a Well-Organized Guide to Any Litigation:** It won't cut it to say, "Oh yeah, there are three lawsuits, I think, and our lawyers have the files." Such potential liabilities should be clearly and concisely disclosed and explained in materials accompanying financials, so buyers grasp that you have a handle on legal matters. Included in this would be any workers compensation and environmental claims. Meridith says that a purchase agreement for the sale of a business typically includes a schedule of litigation matters, whether pending or threatened, and it is in the seller's best interest to disclose all such litigation matters to avoid a breach-of-representations-and-warranties claim post-closing.

9. **Failure to Call Out Special Contracts:** You know which legal agreements underpin your business. Key supplier and customer agreements are among the contracts any buyer will want to review, and these, too, should be kept up-to-date and ready for perusal. Meridith says that if these material agreements are handshake agreements, often in place after years of doing business together, a seller should be prepared to make a list that provides a summary of the material terms for the buyer to review.

10. **Off-Balance-Sheet Obligations Not Gathered Together and Comprehensible:** The financial, legal and other commitments your business has made belong in a well-organized and up-to-date file, so a potential buyer, lender or investor can fully evaluate business risk and opportunity.

These are just ten often-seen problems. Meridith, like any good corporate counsel, uses a ready-made checklist and annual questionnaire to keep clients' houses in order. Whether you've got in-house counsel, or rely on outside counsel, keeping track of who's responsible for corporate housekeeping is crucial. Companies that change law firms frequently often see things fall between the cracks.

We don't tend to think of corporate housekeeping as M&A work, but completing the sale of your company with outdated records can be impossible. Likewise, as I've written, the single greatest determinant in maximizing after-tax proceeds from selling your business occurs long before the sale, with a sophisticated estate plan.

Meridith Cannon is a member of the firm's Corporate Practice Group. Her practice focuses on a variety of business transactions, corporate and contract matters. She is a trusted advisor and counselor to companies and their management teams across a wide range of industries. She regularly advises privately held businesses regarding mergers and acquisitions, strategic business and succession planning, formation of business entities, corporate governance, buy-sell agreements, commercial contracts and employee relationships. **Contact her at mcannon@clarkhill.com or 312-985-5936.**

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