LETTERS OF INTENT AND PURCHASE AGREEMENTS

The key terms in a business sale, how the price is really paid, and what to watch before you sign.

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AT A GLANCE

- A **letter of intent (LOI)** sets out the main terms of a sale. It's mostly not binding, but it shapes everything after.
- The **purchase agreement** is the binding contract. It covers price, payment, promises about the business, and what happens if something goes wrong.
- **How** the price is paid matters as much as the number: cash at closing, seller financing, earn-outs and holdbacks.

WATCH OUT

Always use a lawyer experienced in business sales, and an accountant for the tax side. This guide is general education only.

Why it matters

Two offers with the same headline price can be worth very different amounts to you. One might pay most of the price in cash at closing. Another might pay much of it later, only if targets are met. Understanding the terms protects what you've built.

Key terms in an LOI

Term	What it means
Price	The total value offered
Structure	Asset sale (buyer buys the business's assets) or stock or membership sale (buyer buys the company itself). See **X-10 Taxes When You Sell**.
Cash at closing	What you receive the day the deal closes
Seller financing	Part of the price you lend to the buyer, repaid over time with interest
Earn-out	Part of the price paid later, only if the business hits targets
Escrow or holdback	Part of the price held back for a period to cover problems found later
Working capital	The cash, inventory and receivables that must be left in the business
Exclusivity	You agree not to talk to other buyers for a set period
Due diligence period	How long the buyer has to investigate
Your role after	Transition period, consulting or employment
Non-compete	Limits on you starting a competing business

Example: what $2 million really means

> EXAMPLE
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> A buyer offers **$2,000,000** for **Rosa's** company:
>
> - **$1,400,000** cash at closing, with **$100,000** of it held in escrow for 12 months
> - **$300,000** seller note, paid over 3 years with interest
> - **$300,000** earn-out, paid only if EBITDA reaches $450,000 next year

At closing, Rosa receives **$1,300,000** (before fees and taxes). The escrow comes later if no problems arise. The note depends on the buyer paying. The earn-out depends on hitting a target she may no longer control. Her lawyer negotiated a lower earn-out target and clear rules for how EBITDA would be calculated.

Key terms in the purchase agreement

- **Representations and warranties**: your promises that facts about the business are true, like the financials, taxes, contracts and legal issues
- **Indemnification**: what you must pay back if a promise turns out to be untrue, and limits on that amount and time
- **Conditions to closing**: what must happen before the deal closes, like financing, approvals and lease transfer
- **Transition services**: your help after closing
- **Employee matters**: what happens to your team

Step by step

1. **Compare offers on cash at closing**, not just price.
2. **Model each scenario**: what you get if earn-outs are or aren't hit.
3. **Negotiate the LOI carefully.** It's hard to change terms later.
4. **Keep exclusivity short**, often 45 to 90 days.
5. **Have your lawyer negotiate** representations, indemnification and caps.
6. **Plan for taxes** before you sign. See **X-10 Taxes When You Sell**.

Common mistakes

- **Comparing headline prices only.**
- **Vague earn-out terms.**
- **Unlimited indemnification.**
- **Long exclusivity** that lets the buyer stall.

Your checklist

☐ Break each offer into cash at closing, notes, earn-outs and holdbacks
☐ Model best and worst cases
☐ Have a lawyer review the LOI before signing
☐ Ask your accountant about taxes on each structure
☐ Negotiate limits on indemnification

Key words, explained

Word	What it means
LOI	Letter of intent: a summary of the main deal terms.
Earn-out	Payment that depends on future results.
Seller note	Part of the price paid later by the buyer, as a loan from you.
Escrow / holdback	Money held back to cover future claims.
Indemnification	Repaying the buyer for losses from untrue promises.

Where to go next

- **X-10 Taxes When You Sell**
- **X-08 Selling to Private Equity**
- **R-17 Reading a Term Sheet**

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