M&A term sheets 101

The first step in a typical M&A transaction is for the buyer and target to sign a term sheet or letter of intent. This article provides an overview of some of the key terms that often appear in a term sheet for an M&A transaction.

What is a term sheet?

A term sheet is a mostly non-binding document signed by the target and the prospective buyer that describes the major terms of the proposed acquisition. While most term sheets are non-binding, they often contain binding provisions regarding non-soliciation, exculsivity and confidentiality.

Why are the terms in a term sheet important if they are non-binding?

Besides the purchase price, many deal terms (see chart below) affect the timing and certainty of closing and post-closing matters, that ultimately determine how much and when you will actually receive proceeds, and your risk exposure. As these are usually negotiated at the term sheet stage, it will be difficult to renegotiate them later.

Why do the parties want to sign a term sheet (instead of proceeding directly to definitive agreement)?

Because the parties will spend significant costs and effort in negotiating the definitive agreement and other related documents, having an outline of the key terms ensures that the parties have an agreement on the principal terms before proceeding further. The term sheet instructs the drafts persons, counsel and advisors of the documents to draft.

What is typically included in a term sheet?

Some term sheets contain more deal terms than others. Below are examples of commonly negotiated deal terms that typically appear in a term sheet:

Issue	**Buyer's hypothetical position**	**Company's hypothetical position**
Structure – purchase assets only vs purchase the stock of the company or merge?	Asset purchase – so that the buyer can exclude liabilities it does not want to assume	Entity purchase – buyer will purchase the whole business and its liabilities; and stock purchase generally will get done faster.
Purchase price	Business point – sometimes there may be other adjustments (eg, for working capital) and milestone payments too.	
Holdback - Certain % of purchase price to be held back at closing for post-closing indemnification obligations.	20% of the purchase price will be kept by the buyer for indemnification obligations until 1 or 2 years later. 79% of all deals have a holdback/escrow provision.	This portion should be deposited with a bank as opposed to being held by buyer; lower % withheld (eg, 10%).
Indemnification cap – Whether		Stockholders should only be liable to the

there is a cap on the stockholders' potential liability for breaches of representations after closing.	Each stockholder will be liable for such breaches up to the full amount of purchase price it receives.	holdback/escrow amount except for a narrow range of exceptions. In 81% of the deals, the cap is lower than 15% of the purchase price.
Survival period – the period of time after closing which the buyer may make claims of breach of representations.	Buyers may make claims during the 24 month period after closing.	Too long; cut back to 12 months (30% of the deals have 12 months or shorter survival period; 52% of the deals have survival periods between 12 to 18 months).
Exclusivity – The company may not enter into discussion with other potential buyers during a certain period.	The longer, the better (*eg*, 90 days). This is additional comfort for the buyer to pursue the deal.	The shorter, the better (*eg*, 30 days).

**Statistics referenced above are taken from the 2015 Private Target Mergers & Acquisitions Deal Points Study released by the American Bar Association – Business Law Section*