WARD AND SMITH, P.A.
ATTORNEYS AT LAW

Five Things to Consider When Selling Your CBD Business

Written By **Merrill G. Jones, II** (mgj@wardandsmith.com)
August 28, 2020

For many business owners, the intended exit strategy is to sell to a competitor or a larger company, thereby taking advantage of the upside on the value they have created through years of diligent and hard work building a successful business.

While selling a business can be an exciting process, both financially and personally, there are important issues to consider prior to reaching the point of being able to sell your company. Below, we have outlined five important issues that business owners need to consider prior to engaging in a company sale transaction.

1. Get Your House in Order.

A very common issue in company acquisition transactions, especially with small businesses, is a lack of accurate corporate record keeping. During almost every company sale, the buyer will engage in a due diligence process, during which the buyer or its attorneys will examine all of the corporate records of the company, in order to determine valuation, as well as to make sure there are no unknown issues that may cause problems after the closing of the sale. Due diligence can be a painstaking and burdensome process, but it is made easier if the company being purchased has maintained its corporate records in an organized and thorough manner. During almost every due diligence process, the types of documents that a buyer will want to see consist of the company's articles of incorporation or formation, bylaws or operating agreement, shareholder agreements, organizational charts, stock ledgers, capitalization table, minutes of the board of directors or managers, resolutions or written consents of the board of directors or managers, material contracts by which the company is bound, employment agreements, employee handbooks, consulting agreements, licensing agreements, financial statements, tax returns, insurance policies, securities offering materials, subscription agreements, option agreements, and employee stock option plans. While this is not an exhaustive list, it does give an example of why it is crucial to plan ahead and make sure that your corporate records are detailed, easily accessible, and kept in a format that will be easy to produce to a potential buyer. Maintaining organized and complete corporate documents can drastically reduce the time, expense, and overall burden that can be associated with due diligence prior to a company sale.

2. Protect Your Intellectual Property.

If your company uses trade names, brand names, logos, specific phrases, patents, or various processes that are crucial to the company's business, it is imperative to ensure that those intellectual property items are protected. Intellectual property protection should be done at the federal level, through trademarks, copyrights, or patents. While some states do allow for state-level intellectual property protection, federal registration provides broader protection and can be looked at more favorably by a potential buyer. With respect to a company sale transaction, a lack of federally registered intellectual property can result in a lower valuation for your company. Regardless of whether the consideration in the company sale transaction is being paid in cash or equity, a buyer will more than likely negotiate for a lower purchase price for your company (or the assets of your business), if you do not have your intellectual property federally registered.

An additional important point, with respect to your company's intellectual property, is that if your company has officers, managers, directors, shareholders, members, employees, or consultants who have developed intellectual property on your behalf, such as an officer who has created and owns the rights to various domain names or trademarks that are used by the company as part of its business, a buyer will almost always require that such individuals assign the rights to such intellectual property to the company prior to consummating the acquisition of the company or its assets. It is important to make sure, prior to beginning discussions with a potential buyer, that anyone who has developed or holds the rights to any intellectual property used by the company will agree to assign such intellectual property rights to the company prior to, or in connection with, a company sale.

Additionally, most businesses use some intellectual property that is owned by others. The right to use another party's intellectual property is established through a license granted to your company. If licensed intellectual property is essential to the operation of your company, you need to make sure that it may be assigned to a potential buyer. It is far better to determine in advance what it takes to assign any licensed intellectual property than to wait until you are trying to close your sale transaction and be at the mercy of the third party intellectual property owner.

3. Secure Retention of Key Employees.

Ensuring retention of key employees is a great way to build value in your company. The right mix of human resources can make the difference between a successful company and a failed company. Key employees can be essential to maintaining the goodwill, reputation, relationships, and institutional knowledge in the business. Certain key employees may have helped start and grow the company. A potential buyer may require that one or more key employees, officers, managers, or directors continue to work for the business following the sale, for at least some period of time. Some buyers request that the key employees work for short periods of time, such as a year or two, while other buyers require that the key employees remain employed, or work as consultants, for longer periods. In many cases, a buyer will require that key employees agree to covenants not to compete with, or solicit the customers of, the company for a certain period of time in a certain geographic region after the sale of the business. You can build value in your company by securing such covenants before trying to sell it, and a combination of employee incentives (such as equity ownership or incentive compensation) and restrictive covenants can be an effective way to achieve this. You do not want to be in the unhappy position of negotiating with your employees at the same time you are negotiating with the buyer.

4. Ensure you can Obtain Necessary Consents from Your Owners and Third-Parties.

Failure to communicate with your company's members or shareholders can cause many problems during

a company sale transaction. For companies with a handful of members or shareholders, this is not as big of a problem, but if your company has ten or more members or shareholders, it is very important to maintain contact with them and apprise them of what is happening during the negotiation of a company sale transaction. Your members or shareholders will more than likely be required to sign multiple documents at or before closing, including, but not limited to, shareholder or member consents, shareholder agreements, lock-up/leak-out agreements, joinder agreements, intellectual property assignment agreements, and in some cases the merger or purchase agreement itself. Even with the technology available now, the process of obtaining signatures can take time and can delay the closing of a transaction if not organized properly. Most buyers will not agree to close a purchase transaction if even one member or shareholder has not signed the required closing documents, which can be frustrating for both the buyer and the seller. The inability to obtain signatures also can result in a buyer terminating the purchase transaction if the process takes longer than the buyer is willing to wait. Additional items that may also need to be signed prior to the closing of a purchase transaction are consents from third parties, such as consents to assign agreements that are not assignable without the prior written consent of the other party to the agreement. Common examples of such agreements are debt instruments, supplier agreements, processing agreements, manufacturing agreements, and licensing agreements.

5. Know What Your Company is Worth.

You are not ready to negotiate the best deal for the sale of your business without a thorough understanding of its value. If you are planning to sell your business, you should either obtain a reliable valuation from an expert or determine a reliable method of calculating its value on your own. A valid, reliable valuation will help establish the expectations of your company's owners and with negotiating the purchase price with the potential buyer. After establishing the value of the business, you should engage your tax professional to help you understand the tax effects of the various ways a deal to sell your business may be structured. What initially may seem like a very good price for your business may not produce enough after-tax cash for the sale to be worth your while. It is also important to perform thorough due diligence on the buyer, especially if your transaction involves your receiving equity in the buyer. Examples of such due diligence would be examining the buyer's financial statements, capitalization table, convertible securities, and organizational documents. The due diligence process conducted by you will assist in determining what the actual value and organizational structure of the buyer are, prior to the closing of the acquisition transaction. The goal with a company sale is to create maximum value for the company's members or shareholders, so it is important to have complete knowledge of the current financial and business position of your company, as well as the buyer. A methodical approach to investigating the buyer will also help ensure that you are not rushing into a transaction that could end up not being as profitable or beneficial as it may seem at first.

Due to the complex issues associated with a company sale, it is important to consult an attorney and a tax professional before beginning any company sale or acquisition transaction. Ward and Smith's Business and Hemp Law attorneys are actively helping individuals and businesses navigate corporate transactions such as mergers and acquisitions, as well as the complex and rapidly changing state and federal regulations governing the hemp and CBD industry.

--

© 2021 Ward and Smith, P.A. For further information regarding the issues described above, please contact Merrill G. Jones, II.

This article is not intended to give, and should not be relied upon for, legal advice in any particular circumstance or fact situation. No action should be taken in reliance upon the information contained in this

article without obtaining the advice of an attorney.

We are your established legal network with offices in Asheville, Greenville, New Bern, Raleigh, and Wilmington, NC.