

Working Capital Adjustment

The Working Capital Adjustment in a Stock Purchase Agreement.

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DEVELOPED IN PARTNERSHIP WITH KATTEN MUCHIN ROSENMAN LLP:

This document was prepared with help from **Katten Muchin Rosenman LLP** (“Katten”). The founder of ASimpleModel.com has worked on control-equity, non-control equity and preferred equity investments with partners who are now at Katten for 10+ years. They have always been excellent to work with.

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WORKING CAPITAL ADJUSTMENT

The working capital adjustment in a stock purchase agreement can have a direct impact on the price paid for a business. Given that price is arguably the most important variable in a transaction, it follows that the working capital adjustment deserves special attention.

This adjustment is required because it is impossible to know what a company's working capital (i.e., generally, current assets minus current liabilities) will be on a future date (specifically the date of the sale). It can take a business anywhere from a couple of weeks to a couple of months to close its books, making this an adjustment that can only take place after the transaction has closed.

Sequence for the Working Capital Adjustment:

On the closing date of the transaction, Buyer will pay to Sellers an initial purchase price, which is subject to an adjustment for working capital (*note: additional adjustments can be included, but this post will focus solely on the working capital adjustment*). The initial purchase price will include an estimate for working capital for the closing date (Target Working Capital).

Between 60 and 120 days after the closing date, the Buyer will then deliver a statement to Sellers with Buyer's calculation of working capital (Final Working Capital). If all parties agree that the calculation is accurate, then an adjustment will be made as follows.

1. If the Final Working Capital is greater than the Target Working Capital (Excess Amount), then Buyer shall pay directly to Sellers an amount equal to the Excess Amount, and Buyer and Sellers shall promptly deliver a joint written instruction letter to the Escrow Agent to release all funds in the Working Capital Escrow Account to Sellers.
2. If the Final Working Capital is less than the Target Working Capital (Shortfall Amount), then Buyer and Sellers shall deliver a joint written instruction letter to the Escrow Agent to release an amount equal to the Shortfall Amount from the Working Capital Escrow Account to Buyer.

Stock Purchase Agreement Language:

The pages that follow contain hypothetical language detailing the above sequence as it might appear in a stock purchase agreement.

WHAT FOLLOWS IS A HYPOTHETICAL EXAMPLE PROVIDED SOLEY FOR GENERAL INFORMATION PURPOSES.

STOCK PURCHASE AGREEMENT

**ARTICLE I
DEFINITIONS**

[Only definitions relevant to this post have been included. This is by no means a comprehensive example of the definitions that would otherwise be found in a stock purchase agreement. It is not uncommon to see a purchase agreement with 10+ pages of definitions.]

“GAAP” means United States generally accepted accounting principles in effect from time to time.

“Purchase Price” means an amount equal to \$XXX,XXX,XXX.

“Target Working Capital” means an amount equal to \$X,XXX,XXX.

“Working Capital” means (i) the current assets (excluding Cash and marketable securities) of the Company, minus (ii) the current liabilities (excluding Transaction Expenses, deferred income Taxes and the current portion of Indebtedness) of the Company determined as of the Closing Date.

**ARTICLE II
PURCHASE & SALE**

[Sections 2.1, 2.2 and 2.3 will address items related to the purchase and sale, closing deliveries, closing payments, etc.]

Section 2.4 Post-Closing Adjustment

- (a) Within [120] calendar days after the Closing Date, Buyer shall prepare and deliver to Sellers a statement (the “Closing Statement”) setting forth in reasonable detail Buyer’s calculation of Working Capital (the “Final Working Capital”). The Closing Statement shall be prepared [in accordance with GAAP] / [in a manner consistent with the preparation of the Balance Sheet / Audited Financial Statements].
- (b) After receipt of the Closing Statement, Sellers shall have [30] calendar days (the “Review Period”) to review the Closing Statement. If Sellers dispute the Closing Statement, Sellers shall notify Buyer in writing of their objections in reasonable detail prior to the expiration of the Review Period, together with a description of the basis for, and dollar amount of, the disputed Closing Statement. *[Language stating how a dispute would be resolved.]*
- (c) *[Language stating that Sellers auditors, accountants and other representatives shall be permitted reasonable access to the Company, its auditors, accountants, books and records during the Review Period.]*

STOCK PURCHASE AGREEMENT LANGUAGE

- (d) If the (i) Final Working Capital is greater than the Target Working Capital (the “Excess Amount”), or if (ii) the Final Working Capital is equal to the Target Working Capital, then Buyer shall pay directly to Sellers an amount equal to the Excess Amount, if any, and Buyer and Sellers shall promptly deliver a joint written instruction letter to the Escrow Agent to release all funds in the Working Capital Escrow Account to Sellers.
- (e) If the Final Working Capital is less than the Target Working Capital (the “Shortfall Amount”), then Buyer and Sellers shall deliver a joint written instruction letter to the Escrow Agent to release an amount equal to the Shortfall Amount from the Working Capital Escrow Account to Buyer.

[Note: It is common to have Seller deliver an estimate of working capital leading up to the closing to arrive at a better approximation of working capital prior to making the Post-Closing Adjustment. This step was eliminated for a simpler introduction to this topic.]