



WOOLLY WAYS NEGOTIATION

Attorney for AllSheep

General Information

WiseWool, Inc., is a large privately held company that manufactures and sells wool and wool blend clothing products to health conscious and environmentally concerned consumers. While their target customers have long been affluent outdoorsy types, they would like to expand their sales to younger urban buyers with disposable income. WiseWool is aware that those buyers demand “on trend” styling and WiseWool presently struggles to get upscale retailers to feature anything but their socks. WiseWool management is also painfully aware many customers browse on their retailers’ sites but go to Amazon or discounters to purchase. Still, brands sold by pricy retailers gain status from being featured there.

WiseWool decided to purchase AllSheep, a company that launched a decade ago with high style and high-priced wool-based shoes that were immediately popular among young urban buyers – exactly WiseWool’s target customers. Since then, AllSheep has also created a small but moderately successful line of “base layer” undergarments and athletic wear. Originally in Australia, AllSheep moved some of its sheep farms and all of its manufacturing and design operations to the U.S. during the Obama years. The four AllSheep founders recently became open to selling the company.

After some negotiations, WiseWool agreed to purchase AllSheep at a price of \$36 million. Two of the four AllSheep founders agreed to stay on during a transition period. As part of the deal, WiseWool is permitted but not required keep the AllSheep brand name. WiseWool has stated its intent to retain most AllSheep employees and properties, at least for a transition period, and plans to expand its sales and product lines.

Once the businesspeople had outlined the deal, attorneys for the two companies began negotiating and drafting contract documents. They were able to reach tentative and reasonable agreements on most of the usual terms. However, before completing the negotiations, WiseWool’s senior attorney was called to an emergency assignment at the DOJ and AllSheep’s senior attorney was forced to leave to deal with a family emergency. Both law firms are confident, however, that their highly competent associates can handle the outstanding issues.

The only items left to negotiate now are the amount of the purchase price to be held in escrow and a possible purchase price adjustment (PPA). The proposal for a hold-back was agreed upon in principle, but the amount was not. The parties have not determined whether there should be a purchase price adjustment at all, but both accept that any PPA would be based on changes in cash balances, quarterly revenues, and debt incurred since the date of the letter of intent.



Confidential Information

You are an experienced associate representing AllSheep in their deal with WiseWool. Together with the partner on the deal, you provided advice to the client's executives as they were putting together the basic deal terms. You also did significant behind-the-scenes drafting, research, due diligence, and number crunching for much of the contract language. It's safe to say that you are very familiar with parameters of the WiseWool-AllSheep deal.

The only items open for negotiation now are the escrow amount and a possible purchase price adjustment (PPA). In your call with the AllSheep CEO about the handover of responsibilities for the negotiation, the CEO made it clear that the amount of an escrow is just not that important. The AllSheep team is entirely confident that its reps and warranties are clean. Based upon WiseWool team's reputation and dealings to date, AllSheep trusts that WiseWool would not try to steal or hold back from the escrow when it is due to be released. AllSheep would be happiest with a zero escrow; in that case each founder/25% shareholder would immediately end up with \$9 million immediately. However, WiseWool can buy RWI insurance if they don't trust your client.

Having said that, AllSheep's founders are eager to make this deal happen quickly. They would agree to an escrow of up to \$8 million, to be held not more than 2 years, and bear interest at market rates. Each of the four founders would then receive \$7 million up front, and \$2+ million more in two years or less.

AllSheep is not at all worried about PPA reductions –its assets are maintaining value. When the deal was struck AllSheep's cash balances were \$5 million and inventory values were \$10 million between sheep, raw and spun wool, and finished product. Total debt was \$3 million and gross revenues had averaged \$2 million per month over the past year or so. You know that purchasing companies typically worry about sellers taking on additional debt or taking cash out of a company before closing. AllSheep wouldn't stoop to anything like that and its CEO would be insulted if WiseWool suggested they would.

The prospect of a PPA adjustment recently became more important to your clients, but on the upside. We've all heard of "buyer's remorse." In fact, AllSheep has a case of seller's remorse, with good reason. Recent business developments suggest that the \$36 million purchase price is quite a bargain for WiseWool. A month ago, AllSheep landed enormous contracts with two military manufacturers for garments and athletic wear. The ink isn't yet on the pages, but the deals are going to happen and AllSheep estimates that average monthly revenues will double over the next four years. Ideally, AllSheep would like a PPA to stretch out that long and *increases* based upon average monthly revenues for current products. On the other hand, a deal is a deal, a price is a price, and the founders are ready to move on. If necessary AllSheep would agree to go forward with no PPA adjustments.