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Navigating buyer and seller challenges in middle market deals

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The bottom line

Middle market deals, especially lower middle market, often come with extra challenges that require greater attention to risk management.

Transaction costs should reflect deal size while ensuring protections that safeguard value.

Valuation gaps between seller and buyer are common, so a primary goal is to manage the differences while protecting price.

Early planning and preparation for a deal can help strengthen a company's position during a sale process.

The challenge

Today's middle market deals—typically involving companies worth less than $500 million in enterprise value—demand early, disciplined preparation, with the seller's counsel positioned to influence whether the transaction ultimately succeeds.

These businesses frequently lack formal infrastructure. Financial statements may be unaudited and not tied to generally accepted accounting principles, year-over-year variability is common, and key functions often sit with a single founder.

These challenges are greater in the lower middle market, generally deals with a purchase price less than $100 million. Even with strong investment bankers, the seller's counsel must navigate resource constraints and position the seller to seize the advantage when a credible offer surfaces.

That requires focusing on the deal levers that truly matter and purposefully managing risk. Counsel can act proactively to ensure that when an offer meets or exceeds expectations, the seller is ready to close on terms that protect value.

Maximizing seller value

In the middle market, particularly within the lower middle market, transaction costs often represent a disproportionately high percentage of deal value, which can erode net proceeds if not managed carefully. While some law firms may dismiss a $50 million deal as "uneconomical," seasoned counsel recognize these transactions demand a different kind of focused attention.

Mark Greenfield is a partner at Norton Rose Fulbright who advises clients in a wide range of industries on complex corporate transactions.
Katherine Andreeff is an associate at Norton Rose Fulbright and focuses her practice on corporate, M&A and securities matters.

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Legal fees should reflect deal size while ensuring protections that safeguard value. Professional advisers, especially law firms, should scale the advisory budget without thinning out essential workstreams by deploying a lean but experienced deal team, restricting work to material issues, and managing a timetable that avoids rush premiums and costly deal reworks.

Thoughtful planning and sequencing prevent duplicative spend when the inevitable "shift" arises. Fee caps or success-weighted billing can offer predictability, but they often come at a trade-off.

To protect against unknowns, law firms may build in a cushion ultimately paid for by the client. Although these structures offer greater predictability, they can be less favorable to the client than hourly billing—especially when the deal closes quickly or runs smoothly.

Hence, counsel should discuss with its client how fee economics can be managed to properly weigh predictability against true value. Cutting corners on tax structuring or key contract reviews typically costs more in retrades—renegotiated price or terms—or post-closing disputes than it saves upfront.

Shaping the deal narrative

Whether the deal is $50 million or $500 million, pre-sale readiness provides measurable sell-side advantage. Buyers react more favorably to a business that presents well, and the seller's counsel can provide meaningful input in shaping the narrative.

The seller's financial presentation is a good place to start. While a three-year audit history may be unnecessary, gaps in financial information often invite aggressive valuation adjustments.

We recommend sellers invest, within a reasonable budget, in a sell-side quality of earnings, reviewed quarterly and annual financial statements that are GAAP compliant, and pro forma adjustment of expenses to eliminate unique charges that will not be normal for a new owner. Also, a well-organized data room demonstrates seller discipline and speeds buyer diligence.

Detailed disclosure of key customers and pricing should be deferred for competitive reasons, but counsel can engage a third party to verify critical data and keep the deal moving without early sharing of sensitive information. Where the business has issues material to the buyer, experienced seller's counsel will manage the transaction so the seller can disclose them with a corrective action plan rather than hold out false hope that they go unnoticed.

Bridging valuation gaps

Valuation gaps are common in middle market mergers and acquisitions even when both sides are acting rationally. Sellers generally have well-founded expectations based on recent growth, brand strength, or intangible value, but buyers often apply different metrics and risk assumptions.

The goal is to bridge that divergence without conceding initial deal price. The seller's counsel should recommend structures that narrow the gap, such as earnouts tied to simple, auditable metrics, which can align timing and risk.

Fewer hurdles, well-defined terms, and shorter measurement windows are best practice. Also, deferring a portion of the price with a seller note reduces the buyer's front-end cash load and provides the buyer leverage to enforce indemnities without requiring a separate holdback.

Maintaining some ownership for a seller who will continue with the business, commonly referred to as rollover equity, allows the seller to keep skin in the game and provides the buyer with invested management going forward. If there is a rollover, the seller's counsel should secure baseline market protections for the invested seller. The seller's counsel shouldn't overlook waterfalls, as evaluating them properly avoids surprises and protects upside. Used correctly, these tools preserve value and create a path for sellers to participate in future growth.

Working capital

The working capital adjustment is often where value leaks and purchase price erodes. Working capital targets are typically based on a 12-month historic average to smooth seasonal fluctuations and avoid distortions from short-term spikes or troughs, such as inventory build-ups.

If a buyer proposes a shorter lookback period to make the working capital target more favorable to them, the seller's counsel should push back and advocate for the 12-month norm. Seasonality, deferred revenue, and inventory build cycles should be modeled explicitly and embedded in the working capital definition.

Many middle market companies don't maintain GAAP-compliant financials, and accounting policies may even vary from period to period, so agreeing on accounting | policies is essential.

Providing for a method to resolve any dispute if an adjustment becomes necessary reduces friction and preserves relationships post-closing, especially if the buyer is relying on the seller to stay involved in the business. A short, seller-prepared memorandum explaining historical movements in receivables, payables, prepaid expenses, inventory, and customer deposits defuses misunderstandings before they turn into price bargaining chips.

Securing talent

Human capital issues often surface late in diligence, but the seller's counsel should address them as early as possible to avoid the higher risks inherent in middle market deals, where the business may lack a sophisticated human resources function and often lacks formal retention pools.

Beyond maintaining confidentiality from rank-and-file employees, the seller's counsel should help the seller identify a group of key personnel who will know about the transaction. Retention incentives, such as transaction bonuses or updated employment agreements, should be implemented where feasible to prevent departures that could jeopardize closing.

Formalizing employment terms through employment agreements can provide an important incentive, but experienced seller's counsel will push back on allowing retention of key personnel to be a condition of closing. Instead, buyers should negotiate directly with key personnel before signing to avoid giving any one individual leverage to delay the deal.

The seller's counsel should also evaluate whether employee benefits will carry over post-closing if the buyer intends to keep the workforce intact. Aligning on benefit continuity and documenting obligations upfront avoids surprises and protects deal value.

Helping buyers close

Tighter credit conditions can constrict buyer financing, often exacerbated in lower middle market deals, putting downward pressure on the purchase price. To prevent any erosion of price and facilitate the certainty of closing, the seller's counsel can employ various financing tools. These include seller notes for a portion of the purchase price–with reasonable security, short-duration,interest-only periods, and certain acceleration rights–or modest deferred payments that sit behind senior debt but provide greater certainty than earnouts.

Leveling the risk

Representations and warranties insurance (RWI) significantly reduces post-closing risk and can streamline negotiations. If the parties are willing to share the additional incremental cost, RWI can be used in place of a seller indemnity rather than just being supplementary. And, more recently buyers have been willing to absorb the entire cost.

RWI was once considered uneconomical for lower middle market deals, but, with expanded capacity and experience, underwriters are now willing to issue policies for these deals, making RWI a viable tool.

If RWI isn't viable due to cost or deal dynamics, a pragmatic indemnity package can keep buyers comfortable without overburdening the seller. The objective is certainty, not subsidizing the buyer's capital structure.

The seller's counsel should also address baskets, i.e. deductibles, early. Sellers benefit from full deductibles, while buyers push for tipping baskets that provide 100% recovery once the threshold is met. Evaluating these trade-offs upfront helps avoid post-closing friction.

Planning the transition

The transition plan often determines whether the deal closes smoothly. If the buyer is a strategic acquirer, that is

already a player in the industry, it typically doesn't require the full executive team, just the value-driving personnel who made the business attractive, such as the founder or a key marketing lead for a brief transition period.

If continued involvement from the seller's key people is required, the parties should define a short consulting period and a realistic handoff timeline. If the buyer prefers a full exit, they should work to institutionalize knowledge.

Document core processes, prepare customer-by-customer transition plans and introductions, and identify internal successors with authority to act. To retain critical employees, the seller's counsel should negotiate a discrete retention pool or stay bonuses that align incentives without turning the seller into the buyer's HR department.

Adding transition services that match the integration plan facilitates post-closing success without slowing the deal.

Structuring the deal

Deal form drives tax outcomes, liability allocation,and operational burden. Sellers typically prefer stock sales for simplicity of exit and tax consequences, while buyers often seek step-up in asset basis for tax purposes and the isolation from liability provided by an asset sale.

Although asset deals are more common in middle market deals, parties can achieve common ground if structure is addressed early. The seller's counsel can align interests by giving the buyer a tax basis step-up without requiring a full asset transfer and by using targeted indemnities for pre-closing tax issues.

Preparing early

Early preparation consistently strengthens a company's position in a sale process. The most successful transactions often begin with disciplined planning two to three years before the company formally goes to market.

Preparation can include important financial matters such as reformation of accounting or sell-side legal diligence to assess the critical contractual, employment, or other legal points that will inevitably be reflected in the buyer's diligence. The company should rid itself of third-rail activities—buyers are not interested in the entrepreneur's hobbies or lines of business that aren't essential to the success of the underlying core business.

The seller's counsel should help the seller identify non-negotiables, prioritize speed and certainty, and avoid burdensome commitments that enhance the headline price but increase long-term risk.

If a company doesn't prepare for a deal early, however, proper engagement with experienced seller's counsel and financial advisers can bridge the gap once a sale seems likely.

The middle market deal playbook is clear: Start early, scale costs without cutting critical workstreams, and structure intelligently to bridge valuation gaps and secure certainty. Organized data rooms, aligned accounting policies, retention strategies, and clear RWI and indemnity mechanics all play a role in protecting price and minimizing risk.

Authors



Mark Greenfield
Head of Corporate, M&A and Securities, Los Angeles
Tel +1 213 892 9207
mark.greenfield@nortonrosefulbright.com

Mark Greenfield is Head of Corporate, M&A and Securities, Los Angeles at Norton Rose Fulbright. He focuses on corporate transactions, advice and counselling for clients in a broad range of industries. Mark has had extensive experience with mergers, acquisitions and divestitures, representing private equity and venture capital sponsors, family offices, corporate entities and sell-side entrepreneurs. He also regularly provides expert testimony in the areas of corporate governance and healthcare, and he has served on numerous corporate boards, including audit committee assignments.



Katherine Andreeff
Associate
Tel +1 213 892 9245
katherine.andreeff@nortonrosefulbright.com

Katherine Andreeff is an associate at Norton Rose Fulbright. She focuses her practice on corporate, M&A and securities matters for clients in the energy, life sciences, healthcare, technology and financial services industries.

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