

MASTERING NET WORKING CAPITAL: KEY FACTORS THAT SHAPE THE DEAL



**as seen in Crain's Corporate Growth & M&A Section*

Net working capital ("NWC") is often a highly scrutinized component in M&A deals and can significantly impact the purchase price. NWC represents the liquidity a company needs to run its day-to-day operations and ensures the business can continue functioning smoothly after the deal closes.

The calculation for NWC is current assets less current liabilities and is commonly presented on a cash-free and debt-free basis in M&A deals; however, it is not that simple. The inclusion or exclusion of the following items can complicate the calculation and function of the NWC mechanism in an M&A transaction:

Deferred Revenue

This represents payments a company has received in advance for goods or services it has not yet delivered. This is often viewed as debt-like and excluded from NWC, but that is not always the case as it depends on the company's industry. This is a highly debatable component of NWC in subscription-based or SAAS businesses.

Gift Certificates

Similar to deferred revenue, this liability represents pre-payment for goods or services. Depending on the industry of the business and if it's viewed as part of the day-to-day operations or debt-like, it could be negotiated to be included or excluded in NWC.

Unbilled Receivables

These represent revenue that has been earned for goods delivered or services rendered, but for which an invoice has not yet been issued to the customer. This is generally seen in industries where billing happens on a milestone or time-based basis, like construction or consulting services. It can be included or excluded depending on many factors such as the cadence of the activity, verification and reliability, and the overall consistency of the company's billing practices.

Accounts receivable and/or accounts payable that are aged beyond a certain period of time (i.e., outside of normal trade terms).

Clear negotiation on subjective items is vital to ensure both parties agree on a fair NWC target.

Inventory Valuation

Depending on demand, there could be an argument that a higher valuation is needed to meet future demand or that there should be a discount on the valuation for slow-moving stock.

Proper negotiation and clarity around these subjective items are vital to ensure both parties agree on a fair NWC target, preventing post-closing disputes. It is recommended that the methodology for calculating the NWC target is agreed upon during the LOI stage, and clear definitions are outlined in the purchase agreement.

If you are involved in a transaction and need assistance in calculating or

negotiating a methodology for NWC, we have experts that can help.