Sale Process Overview

2018
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I. Frequently Asked Questions

Question: Why do buyers acquire companies?
Answer: To make money
Explanation
In most transactions, the rationale for the buyer to acquire another company is to generate shareholder value. While there are always unique circumstances, especially in non-public markets, most buyers of companies like yours are doing so in an effort to create shareholder value.

Question: How is shareholder value created?
Answer: Usually through increasing profits
Explanation
Share prices for public companies, and the value of private companies, usually increase when the profits of the company increase. This is because increasing profits enable a company to distribute more money to its owners (in such form as dividends or distributions).

Question: How will buyers determine the value of a company?
Answer: By analyzing projected profits
Explanation
Most sophisticated buyers will analyze your financial projections and make assessments about your prospects for future profits. If a buyer has plans that it believes can increase your profits even higher in the future (such as scope expansion or customer penetration) then they should be willing to pay a “premium” for your company relative to the other potential buyers.

Question: What is Alderman’s role in selling a company?
Answer: To prepare you for, present you to, and defend you before the buyers
Explanation
The role of a professional investment-banking firm is to get the best deal for the client. This may be defined by the client as the highest price, or some other measure, such as ‘a good price from the most prestigious buyer’. As discussed in the following pages, this is done through an orderly process that consists of: preparation, solicitation, and negotiation, and due diligence. Our primary work is to help you develop your projections and prepare for buyer due diligence. Our secondary work is to present you to the right buyers in the best possible light so you can get the best deal for your business.

Question: What are the most common reasons deals fall apart?
Answer: 1) Poor preparation in building and defending the financial projections
Explanation
Because buyers typically price deals based on future profits, most sophisticated buyers spend substantial time and effort in due diligence, studying the seller’s projections. Buyers will usually walk from a transaction late in the process, if the seller is unable to satisfactorily defend their projections during due diligence.
II. Communications Protocol

GOVERNANCE & MANAGEMENT
You should decide who is ultimately in charge and what authority they have. You should also determine who is on the deal team, how communications will be handled, and define team member responsibilities and authorities (shareholders, officers, professionals, etc.).

LOGISTICS
If you expect to have Alderman & Company staff in the building during the initial phase of our work together, how do you want to handle logistics so that confidentiality is maintained? One way to handle this is for all of our meetings to be off-site (such as in a conference room at a near-by local hotel or the offices of your attorney or accountant).

SECURE COMMUNICATIONS
You should also determine how the team should communicate, and the security of each communication mode including but not limited to:

A. Telephone and Voicemail
B. Data (email)
C. Physical delivery (courier, US Mail, etc.)

We suggest you review your internal voicemail and email security before authorizing their use in this capacity.

CONTINGENCY PLANNING
You should also develop a contingency plan in the event Team Members are confronted by employees, suppliers or customers about the sale process. A response often used by our clients is: “We have been approached by a number of companies over the years about joining forces in terms of joint ventures or mergers and we are exploring a few possibilities at this time but nothing is very serious”

III. Due Diligence Preparation

The next step in our work together is to gather all contracts and documentation related to the Company (“Due Diligence”). The information collected through our Due Diligence process will be compiled into a set of documents referred to as the “Data Room.” The Data Room will be presented to select bidders later in the process, and will ultimately be used by the buyer of the Company during Buyer Due Diligence and in the negotiation of a definitive purchase agreement. The Data Room will also serve as the basis for our drafting of the Confidential Information Memorandum (as discussed in section IV). Almost all of our clients are now choosing to use Virtual Data Rooms, which securely store and make
your due diligence files accessible via the Internet. At your request, we provide a secure Virtual Data Room to you at no additional cost. The following is an example of an access menu from a typical Virtual Data Room:

While some of the documents to be placed in the Data Room will be more sensitive and more important than others, all documents must be in the Data Room in order for us to complete our due diligence. Accordingly, the Data Room is to be completed before we finalize the Confidential Information Memorandum. We will work with you and your legal counsel and accountants to ensure the Data Room is complete. The following is the cover page of our standard Due Diligence Check List. For each client, we tailor our due diligence check list based on the unique attributes of their business.
PROJECT STELLER

DUE DILIGENCE CHECK LIST

Table of Contents

1. Incorporation
2. Ownership & Governance
3. Licenses and Permits
4. Accounting and Taxes
5. Employment Matters
6. ERISA
7. Contracts and Commitments
8. Inventory
9. Sales and Marketing
10. Financial Projections
11. Information Technology
12. Intangibles
13. Real Estate & Equipment
14. Competitors
15. Corporate Insurance
16. Litigation and Claims
17. Consents
18. Environmental Matters
19. Customer Approvals and Quality
While we are gathering the Data Room documents, we will also assist you in analyzing your historical financial statements and building detailed financial projections to be used in the sale process.

**HISTORICAL FINANCIAL STATEMENTS**

We will start the financial analysis process by working with you and your accountants to model your historical GAAP financial statements, including the analysis of owner-related expenses, in each of the past 3-years. These past owner-related expenses, often called “Add-backs”, are expenses of the business that are exclusively related to the current shareholders and would not be incurred in the future if the business was owned by a public company. Examples of some of these expenses that your accountant might classify as Add-Backs are: personal automobiles, vacation property, boats, certain entertainment, certain travel, and salaried family members. It is very important that you be able to document and substantiate all Add-Backs and so that you can successfully win the argument that all of these expenses will be eliminated completely and immediately at the time of sale.

**FINANCIAL PROJECTIONS**

**THE ROLE OF PROJECTIONS**

In most third-party arms-length transactions, the rationale for buying a company is to generate income, often expressed as Cash Flow or EBITDA. While there are always unique circumstances, especially in non-public markets, most buyers of companies are doing so in an effort to create wealth for themselves (where ‘they’ are shareholders), which is usually expressed as earnings, income, cash flow, or EBITDA.

While “your” projections may not be the ultimate set of projections that the buyer uses to make their price assessments and set their bidding, buyers in almost every case will look to your projections as an integral part (or starting place) for their own projections. While they may include various opportunities to increase revenues or decrease costs (commonly referred to as synergies), the basis of their work will almost always be your projections.

**YOUR PROJECTIONS ASSUMPTIONS**

Listed below are the primary business assumptions that we will need to provide to us so that we can build-out the detailed financial projections that will be included in the Information Memorandum (for each of the 5-years in the forecast period):
DUE DILIGENCE - TESTING YOUR PROJECTION ASSUMPTIONS

The purpose of buyer due diligence is to provide the buyer an opportunity to test the validity and accuracy of everything that has been conveyed during the sale process, whether in writing or made orally (e.g. in person during the Management Presentations). Your financial projections will be the focus of due diligence for most all buyers. While many buyers will accept your projections at face-value early in the sale process (such as during initial bidding), almost every buyer will go to extended lengths to test and challenge your projections during buyer due diligence (typically following the execution of a Letter of Intent and an agreement to a 30-90 day period of exclusive dealings with that buyer).

In due diligence, you should expect the buyer to use their in-house staff and/or retained third party experts (such as industry consultants, operations experts, accountants, and attorneys) to go through your projections in an extremely detailed manner. While not all buyers will go into the same level of analysis and depth of challenging your projections, almost all will make “testing your projections” one of their highest priorities during the due diligence phase.

In due diligence, most buyers typically use some form of the following process to test the reasonableness of your projections:

REVENUES

1. Comparing revenue growth to past years and current industry trends

2. Building bottom-up forecasts based on the following:
   - Reviewing pricing in all of your major customer contracts
   - Confirming firm/committed orders in hand
   - Studying historic release trends and release dates
   - Reviewing outstanding purchase orders
   - Analyzing material, WIP, and finished goods on hand (and on order)
   - Assessing your capacity and historic through-put
   - Studying historic sales for each major class of revenue, such as: i) true (legal) backlog, ii) expected (likely) backlog, and iii) unproven backlog (speculative) or spot sales.
3. Analyzing historic unit sales and unit pricing by: i) customer and ii) product (line) and comparing these to projected sales by: a) customer and b) product line.

**GROSS MARGINS**

1. Comparing past years Gross Margins and competitor margins

2. Any changes in forecast gross margin will be specifically tested for
   - Documented changes in purchasing or in-house costs to prove a reduction in the cost of goods sold

3. Documented changes in customer contracts to support specific price increases and a modeling of each line item by forecast units under each contract to support the forecasted rise in pricing

**SELLING GENERAL & ADMINISTRATIVE EXPENSES**

1. Comparing past years SG&A and competitor SG&A levels

2. Any changes in forecast SG&A levels (as a percentage of sales) will be tested for specific line items against revenues and detailed cost analysis to study the reasonableness of your forecast.

**INVENTORY LEVELS AND TURNS**

1. In almost every case, the buyer will seek to prove that your stated inventory is too high and that you have excess and obsolete inventory.

2. In almost every case, they buyer will also seek to argument that your inventory cannot move any faster than history levels.

3. If your projections include a reduction in days inventory (e.g. an improvement in inventory turns), the buyer will want to see substantial documentation and analysis supporting your argument.

**ACCOUNTS RECEIVABLE LEVELS AND TURNS**

1. In almost every case, the buyer will seek to prove that your stated Accounts Receivable is too high and that you have some level of uncollected receivables.

2. If your projections include a reduction in collection days receivable (e.g. a decrease in days receivable), the buyer will want to see substantial documentation and analysis supporting your argument.
DEFENDING YOUR PROJECTIONS

There is no better way to defend the projections than with detailed financial analysis and specific written factual supporting data. The greater the level of detail that you can provide to support your projection assumptions the better you will be able to “defend them” in due diligence. If you are projecting essentially flat revenue and stable margins, then it is easier to “defend” your projections. If you are forecasting a meaningful increase to any one of: i) revenue, ii) EBITDA or income, or iii) cash flow (e.g. working capital improvements), then you will need to produce credible substantial detailed analysis, facts, and figures to support your assumptions.

The following are a few good examples of how to support projection assumptions:

“We are forecasting a $12MM increase in revenue next year because we just won a major contract with customer XYZ. Under this contract, we start shipping on January 1 and ship $1MM per month through December - on a firm committed backlog basis. The contractual pricing in the contract provides to us a 30% Gross Profit Margin based on our standard costing from last year with a 3.5% escalation included for increased labor costs. An analysis of our costing for this contract is set forth in schedule A1. A copy of the contract with customer XYZ, including unit shipment dates and unit pricing is set forth in schedule A2.”

“We are forecasting a reduction in Days Inventory from 145 days last year to 141 days next year as a result of changing our procurement practices whereby we are no longer sending the major assemblies 1526-7, 1345-8, 1456-9, and 1877-9 out for anodizing. This is because we have just completed the construction of our in-house anodize line. While the total cost of anodizing is expected to remain constant (see cost analysis schedule D3), our in-house time studies show that this in-sourcing will result in a net savings of more than 21 days saved on these 4 major items which will have an aggregate impact on system-wide inventory turns of 4 days. A detailed analysis of this time savings and its impact on aggregate inventory turns is set forth in schedule C3.”

DEFINING FAILURE AND SUCCESS

Failure in this regard is losing the argument that your projections are reasonable. Failure is having the buyer convince you that there are meaningful flaws in your projection assumptions and that it is unlikely that future actual results will match your projections. This would typically result in the buyer demanding a reduction in the purchase price - which all too often results in the buyer and seller walking away from the deal (after spending considerable time and money).
Success in this regard is winning the argument with the buyer that your original set of projections is fair, balanced, and reasonable. If you win this argument with the buyer, than it is likely that the buyer will remain committed to buying your company at the price they set forth in the Letter of Intent and you are likely to consummate a successful sale of the business.

V. Confidential Information Memorandum

While you gather and scan your corporate documents for the Data Room, we will also assist you in drafting the Confidential Information Memorandum (“CIM”), which we will use in marketing the Company. Content of the Information Memorandum will include, but not be limited to, a description and analysis of the Company’s market, historical financial performance, competitive strengths, products and programs, customers, executive management, employees, facilities, and shareholder rationale for pursuing a transaction. The Information Memorandum is to be comprehensive and complete and objectively present all meaningful information about the business for the past 3-years and most importantly - its prospects for the next 5-years.

The Confidential Information Memorandum (“CIM”) drafting is typically one of the longest lead-time items in the overall sale process. However, substantial time can be saved if the client can produce major sections of the CIM from existing computer files, such as recent board, bank or customer presentations. We typically begin with the client forwarding to us files that apply to the relevant sections. We ask that you provide to us these files digitally, to help expedite the process. Of note, recent CIM’s by our firm have been as short as 12 Powerpoint® slides and as long as 140 pages of single-spaced text. The exact format and length of the CIM is determined based on the situation and the preferences of the client. We will ask that your M&A legal counsel and accountants formally review the CIM prior to distribution, to ensure that issues pertinent to their areas of expertise have been addressed appropriately.
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VI. Solicitation

BUYER LIST AND SOLICITATION
As the Information Memorandum is being completed, we will work with you to develop a list of potential buyers that might find the Company to be highly attractive. For the avoidance of doubt, we will not contact any potential buyers without your explicit prior consent. Depending on the situation and the desires of the client, the list may have as few as 10 or more than 50 potential buyers.

We will manage the entire process of soliciting interest from those buyers that you have approved in advance. Once the buyer list is completed and approved, we will distribute the Executive Summary, as discussed below. This is typically done through a combination of in person meetings, phone calls, and emails. We will provide to you continual real time updates regarding the status of all activity with each potential buyer.

EXECUTIVE SUMMARY
We will distribute to each potential buyer a copy of the approved Executive Summary. This document is typically one-page document that provides an overview of your business, without disclosing the name of your business or any other identifying details about your company. The document below is an example of an Executive Summary. This document is written after the Confidential Information Memorandum has been drafted and is only released to potential buyers after it has been formally approved by you.
EXECUTIVE SUMMARY
PROJECT STELLAR

Sale of Aviation Engineering and Manufacturing Company

Business Description and History
Located in the Southeastern United States, Stellar is a world leader in the design and manufacture of the following proprietary components and systems for the military and commercial aviation industry:

- Fuel
- Lubrication
- Water and Waste

The Company is privately owned and has approximately 250 employees. The Company has no defined benefit plans and its workers are not party to any collective bargaining agreements.

Sale Rationale
The owner of the business is 65 years old and is seeking to retire.

Financial Summary
The following financial data has been adjusted to eliminate certain non-recurring and shareholder related expenses. The projections are rounded to the nearest $100,000.

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue ($000)</td>
<td>31,494</td>
<td>29,330</td>
<td>33,927</td>
<td>38,245</td>
<td>45,338</td>
<td>58,600</td>
<td>65,200</td>
<td>73,200</td>
<td>82,900</td>
<td>91,100</td>
</tr>
<tr>
<td>Growth %</td>
<td>0%</td>
<td>-7%</td>
<td>16%</td>
<td>13%</td>
<td>19%</td>
<td>29%</td>
<td>11%</td>
<td>12%</td>
<td>13%</td>
<td>10%</td>
</tr>
<tr>
<td>EBITDA ($000)</td>
<td>3,292</td>
<td>2,852</td>
<td>4,209</td>
<td>4,624</td>
<td>4,566</td>
<td>6,700</td>
<td>8,300</td>
<td>10,100</td>
<td>12,000</td>
<td>13,200</td>
</tr>
<tr>
<td>Margin %</td>
<td>10%</td>
<td>10%</td>
<td>12%</td>
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</tbody>
</table>

Process
Parties interested in a potential acquisition of Stellar are invited to contact Alderman & Company, the exclusive financial advisor to the Company.

Alderman & Company Capital, LLC
35 Warrigton Round
Danbury, CT 06810
CONFIDENTIALITY AGREEMENTS

Those parties that express sincere interest in the Company, based upon the Executive Summaries, will each be afforded the opportunity to enter into a Confidentiality Agreement with the Company (which may be further negotiated between your legal counsel and the interested parties). We ask that you work with your legal counsel in advance to develop a form of confidentiality agreement for this purpose. Because of the legal nature of these agreements and the importance of their content, we ask that you have your legal counsel negotiate these agreements with each potential buyer, in the event they want any changes to your form of agreement.

DISTRIBUTION OF CONFIDENTIAL INFORMATION MEMORANDUM

Once an interested party has entered into a confidentiality agreement with you, we will provide to them a copy of the Confidential Information Memorandum (“CIM”). Given that most of our clients are using Virtual Data Rooms (“VDRs”), we usually distribute the CIM’s by granting users access codes to the VDR. The benefit of this form of distribution is that we can track user access and know definitively who has accessed the CIM.

SOLICITATION OF NON-BINDING BIDS

Once the recipients of the CIMs have had sufficient time to review the material and develop a view of price and obtain internal corporate approvals, we will then solicit non-binding bids. Key to our process is obtaining all of the bids on the same date; this gives you optimal visibility into market pricing and the greatest possible negotiating leverage. Depending on a number of factors, including but not limited to the level of interest in your company, we will adjust the timing of the bidding process, to generate the greatest number of qualified bids at the highest possible prices. We will communicate regularly with you (often daily) during the bid solicitation process. A form of letter for the solicitation of non-binding bids is shown on the following page.
The following is a form of letter for the solicitation of non-binding bids:

[Date]
[Addressee]

Dear [Addressee]

Thank you for your client’s continued interest in a potential purchase of [client] (the “Company”).

Alderman & Company Capital requests that interested parties submit non-binding written indications of interest by 5:00PM EST on [Date]. Based upon initial indications of interest, our client will invite a limited number of interested parties for one-day due diligence meetings (the “Management Presentation”), which will include meetings with management, tours of the Company’s facilities, and provide access to the Company’s principal business documents (the “Data Room”).

Should you elect to submit an Indication of Interest, we ask that you include the following information in your letter:

<table>
<thead>
<tr>
<th>1. Buyer</th>
<th>State the name of the acquiring entity and the name, address and telephone number of the individual who will be the authorized representative of that entity in regard to this potential transaction during this phase of discussions.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Consideration</td>
<td>Include as much detail as possible regarding the price and form of consideration offered. The shareholders will look most favorable upon all cash offers.</td>
</tr>
<tr>
<td>3. Structure</td>
<td>The Shareholders of the Company are seeking to sell 100% of the stock of the Company.</td>
</tr>
</tbody>
</table>
4. Financing
If any funds to be used in the acquisition will be from a source external to the acquiring entity, include: i) the amount of financed funds necessary, ii) a description of the source of financing, iii) an estimate of the timing required, and iv) the status of buyers discussions with those external financial sources.

5. Approvals
Include information regarding the acquiring entity’s approval process, including requisite corporate governance, and regulatory approvals and expected timing.

6. Advisors
Include the name and contact information for those professional advisors that will be utilized in the due diligence process, including but not limited to legal counsel and accountants.

During the current phase of the sale process, the shareholders have requested that all inquiries be directed to Alderman & Company Capital.

Of note, the following schedule is planned for the next phases of the sale process:

- [Date]: Indications of Interest due
- [Date]: Management Presentations & Visit to Data Room
- [Date]: Final bids due
- [Date]: Selection of winning bid

Upon selection of a winning bid, the shareholders will make available all available information concerning the Company.

Should you have any questions, please do not hesitate to call me.

Sincerely,

William H. Alderman
President
MANAGEMENT PRESENTATIONS & BUYER DUE DILIGENCE
We will next advise you in regard to the selection of a small number of qualified bidders to be invited to tour your facilities, attend a formal presentation made by management (the “Management Presentation”) and be granted access to additional information posted in your Virtual Data Room. We will assist the management team in the production of their formal presentation and assist you in determining what information to make available, and when to make it available.

The following is an agenda from a standard Management Presentation:

<table>
<thead>
<tr>
<th>Agenda</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Introductions</td>
</tr>
<tr>
<td>2. Process review</td>
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<td>3. History of the company</td>
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<tr>
<td>4. Products &amp; services</td>
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<tr>
<td>5. Operational excellence</td>
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<tr>
<td>6. Review of historical financial performance</td>
</tr>
<tr>
<td>7. Presentation of baseline projections</td>
</tr>
<tr>
<td>8. Closing remarks</td>
</tr>
</tbody>
</table>

We will provide coaching to your management team in regard to the presentation process. We will advise your management team in preparing for the most likely questions and issues that will be raised by the potential buyers. We will also manage the necessary logistics for the Management Presentations. Typically, a half-day is allocated for each of the bidders invited to attend the Management Presentations. We will be in attendance in person for each Management Presentation.
The following is our standard Management Presentation invitation letter:

Date
Via Email
Addressee

We are looking forward to seeing you and your colleagues in CITY on DATE. The following information is being provided to aid you in planning for your upcoming management presentation and assist you with your due diligence efforts.

Management Presentation
Because we are having two sessions each day, it is important that we start and end on schedule. Please note that all information provided in the management presentation is "confidential" for purposes of the previously signed confidentiality agreement.

Date:
Time: Start 1:30 p.m.; End 5:30 p.m.
Location: Location
Ask for Mr. William Alderman when you check in at the reception desk

Agenda: The meeting will include a presentation by management, a plant tour, and a time for general discussion and questions.

Dress Code: Business attire

Virtual Data Room
Your designated due diligence team should now have access to all of the Level 2 files in the Virtual Data Room (VDR). Should your team have any problems accessing the VDR or you want to add members to your team, please let us know.

Letter Of Intent
As set forth in our letter dated DATE our client’s goal is to enter into exclusive negotiations with one party on (or about) DATE. Prior to DATE, we will be asking you to submit a detailed Letter of Intent and provide a mark-up to the form of Purchase Agreement that the Company’s legal counsel, Foley & Lardner, will be posting to the Virtual Data Room not later than DATE.

Please let us know if you have any questions regarding the above. I am looking forward to the opportunity to work with you and your colleagues.
VII. Letter of Intent and Buyer Due Diligence

Letter of Intent
The end goal of the solicitation process is to identify the best buyer, which in most cases is the buyer offering the best price with the greatest certainty of closing in a timely manner. The solicitation process culminates in a Letter Of Intent (“LOI”) between the buyer and the seller. The LOI usually includes the most significant basic terms, such as price. The LOI will typically not be binding on either party, other than one provision – which is referred to as the Exclusivity Period. This provides that the seller afford the buyer to conduct exhaustive due diligence and the seller will not talk with any other buyer (typically for a 30 - 90 day period).

Buyer Due Diligence
During the Exclusivity Period, the buyer and its retained professionals will conduct exhaustive due diligence. Most buyers will focus on those issues that could impact the future earnings of the business. Depending on their findings, the diligence may cause the buyer to modify the financial model that they used in the bidding process. The preparation work that we did together, when we started the sale process, will now be tested. In the event the buyer loses confidence in the financial projections that they used to price the deal, they will most likely demand a reduction in the purchase price. Because the LOI is not binding, in such as case a seller has just once choice – agree to a lower price or the buyer will deal. This is why we tell our clients that there is nothing more important to the sale process than our preparation work together and the quality and “dependability” of your 5-year financial projections.

Role of your M&A Legal Counsel
Assuming the buyer is satisfied with their due diligence, they will instruct their legal counsel to prepare a Purchase Agreement towards the end of the Exclusivity Period. This is where your M&A legal counsel will transition from having a relatively minor role in the process to being the deal process lead manager.

Negotiating Leverage
While it is the responsibility of your legal counsel to advise you in regard to all legal matters and in negotiating the Purchase Agreement, it is the responsibility of your investment banker to run a sale process so there will be numerous highly motivated buyers wanting in to acquire the business, so you and your legal counsel can negotiate not only the best price, but also the best terms and conditions. In regard to negotiations, a seller typically has very little negotiating leverage after they sign an LOI. In contrast, if there are multiple interested buyers, a seller should have substantial leverage pre-LOI. If our sale process has been successful, you and your legal counsel should be able to negotiate the most significant legal issues upfront in the LOI, on terms that are favorable to you.