

From One Basket, for readers

Rollover Equity Term-Sheet Checklist and One Basket Score

From One Basket: The Business Owner's Guide to Selling Your Business to Private Equity, Rollover Equity, and Concentrated Stock by James R. Ustby, CFP®.

Part A: Rollover Equity Term-Sheet Checklist

Bring these 25 questions to your M&A attorney, investment banker, and tax advisor **before you sign a letter of intent**, and again when you receive the draft equity holders agreement. Not every question will apply to every deal, and the answers are negotiated by counsel. The chapter where each topic is explained is in parentheses.

Educational only. This checklist is not legal or tax advice and does not recommend accepting or rejecting any offer.

Size and household fit

- 1. How much is the sponsor asking me to roll, as a dollar amount and as a share of my proceeds?** What share of the new company's total equity will that be? (Chapter 3)
- 2. Does my household plan still work if the rollover is worth zero?** What are my comfortable and stretch maximums? (Chapter 6)
- 3. What else in the deal depends on the buyer:** escrow, earnout, seller note, real estate lease, acquirer stock? What is the total? (Chapters 4 and 6)

The security

- 4. Will my rollover equity be the same security as the sponsor's, with identical economic rights?** If not, how is it different? (Chapter 5)
- 5. Does any class have a liquidation preference or preferred return ahead of mine?** At what rate, and does it compound? (Chapter 5)
- 6. Can I see a waterfall example at low, middle, and high exit values, including a value below the original equity invested?** (Chapter 5)
- 7. How much debt will the company carry at closing?** What are the key covenants? (Chapter 3)

Dilution

- 8. What incentive equity pool is planned, and how does it dilute me?** (Chapter 5)
- 9. Will I have preemptive rights to buy my share of new equity?** What are the exceptions? (Chapter 5)
- 10. How will add-on acquisitions be financed, and with what kind of equity?** (Chapters 3 and 5)

Transfers, tag, and drag

- 11. What transfer restrictions apply?** Are transfers to family trusts and charities permitted? (Chapters 5 and 11)
- 12. Do I have a tag-along right if the sponsor sells part of its stake?** (Chapter 5)
- 13. Under the drag-along, will I receive the same form and amount of consideration per unit, and is my liability capped at my share of proceeds?** (Chapter 5)

Leaver terms

- 14. If I leave the company, can my rollover equity be called?** At what price, by reason for leaving? (Chapter 5)
- 15. Is my rollover equity, as opposed to incentive equity, protected from bad-leaver pricing?** (Chapter 5)
- 16. How is fair market value determined for a call, and can it be paid with a note?** Do I have a put right on death or disability? (Chapter 5)

Information and governance

- 17. What financial information will I receive, and when:** audited annual, quarterly, budgets, material events, valuations? (Chapters 5 and 14)
- 18. Will I have a board seat or observer seat?** (Chapter 14)
- 19. What consent rights will I have over actions that affect my class differently?** (Chapter 5)
- 20. What fees will the sponsor charge the company, and are they capped or offset?** (Chapter 5)

Taxes

- 21. Is the rollover intended to be tax-deferred, and under which provision (\$721, §351, §368)?** What could make part of it taxable? (Chapter 7)
- 22. If the holding company is an LLC, will the agreement require tax distributions, and on what assumed tax rate?** (Chapters 5 and 7)
- 23. Does any part of my payment risk ordinary income treatment, and how does the structure affect state tax, the net investment income tax, and any qualified small business stock?** (Chapter 7)

Exit and liquidity

24. What is the sponsor's expected hold period and fund life? What happens if it holds longer, or proposes a continuation fund? (Chapters 3 and 14)

25. Will I have any opportunity for partial liquidity before a full exit, such as in a recapitalization, secondary sale, or IPO with registration rights? (Chapters 5 and 14)

After you sign

Keep a copy of this checklist with your answers, the letter of intent, and the final equity holders agreement. It doubles as a monitoring checklist for your annual rollover review (Chapter 14).

Part B: One Basket Score Worksheet

Use this worksheet to measure your concentration (Chapter 1) and test how much of your future depends on one company or one stock. Complete it now, again when you receive an offer or letter of intent (one copy per offer, as if it had closed), and again each year after closing. All figures are your own estimates. Your CPA and financial advisor can help you refine them.

Educational only. This worksheet does not value your business, calculate taxes, or recommend any action.

Part 1: Sort your balance sheet by dependence**Column 1: Depends on the company or the stock** (net of related debt)

Item	Estimated value
Ownership interest in the company (use the midpoint of a range)	
Rollover equity in the buyer's holding company	
Acquirer stock, or other single-stock position	
Real estate leased to the company (net of mortgage)	
Notes receivable from the company or the buyer	
Deferred compensation, bonuses, or distributions owed	
Earnout (use zero in the base case)	
Escrow or holdback not yet released	
Other assets that depend on the company	
Total, Column 1	

Column 2: Correlated with the company (separate but likely to move with it)

Item	Estimated value
Stock in customers, suppliers, or competitors	
Other investments in the same industry or local market	
Total, Column 2	

Column 3: Independent of the company

Item	Estimated value
Retirement accounts	
Diversified investment accounts	
Cash and cash equivalents	
Home equity	
Other real estate not tied to the company	
Other independent assets	
Total, Column 3	

Contingent liabilities

Item	Amount
Personal guarantees on company debt or leases	

Item	Amount
Indemnification exposure beyond escrow (estimate)	
Total contingent	

Part 2: Your concentration ratios

Total net worth = Column 1 + Column 2 + Column 3	
Concentration ratio = Column 1 ÷ total net worth	%
Concentration ratio including correlated assets = (Column 1 + Column 2) ÷ total net worth	%
Independent assets if guarantees were called = Column 3 - total contingent	

Part 3: The independence test

Household number (independent wealth needed to support your household for life under conservative assumptions, set with your financial planner)	
Column 3 today	
Column 3 after a hypothetical sale (Column 3 plus after-tax cash at closing, excluding rollover, escrow, and earnout)	
Does Column 3 cover the household number? Today: Yes / No. After a sale: Yes / No.	

Part 4: Business concentration snapshot

Largest customer, share of revenue	%
Top five customers, share of revenue	%
Largest supplier, share of key inputs	%
Key relationships that depend on you personally (list)	
Contracts with change-of-control clauses (list)	
Lenders with personal guarantees (list)	

Part 5: The zero test

Answer in a few sentences.

1. If Column 1 went to zero, what would change for your household?

2. If your rollover or single stock lost half its value, what would change?

3. Which of your plans (retirement, gifts, education, a home, charitable goals) depend on Column 1?

Part 6: Your target

Concentration ratio you are comfortable with after a sale	%
Target date to reach it	

Main tools you will discuss with your advisors (check all that apply)

- | | |
|--|---|
| ☐ retirement plan contributions | ☐ distributions |
| ☐ real estate separation | ☐ minority sale |
| ☐ rollover size and terms | ☐ staged selling |
| ☐ 10b5-1 plan | ☐ exchange fund |
| ☐ charitable gifts or trusts | ☐ hedging |
| ☐ diversified core and IPS | |

Next review date

Want help applying this to your situation? Schedule a conversation: oncehub.com/jamesustby · jamesustby.com

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