GV LAW

POST-CLOSING ADJUSTMENTS:
HOW WORKING CAPITAL MISUNDERSTANDINGS RESHAPE DEAL ECONOMICS
GV LAW INSIGHTS

Working capital is one of the most negotiated yet misunderstood components of middle-market transactions. Buyers view it as a safeguard ensuring the business has the resources to operate on Day 1 without requiring an immediate cash injection. Sellers, on the other hand, often perceive it as a mechanism that reduces the purchase price after terms have already been agreed. Misaligned expectations routinely shift significant value between the parties after closing, often at a stage when neither side expected further negotiation.

In this Insight, we outline the structural issues that cause these disputes and explain how disciplined drafting and preparation can prevent value erosion on both sides.

Working Capital as a Deal Concept

Parties frequently begin with the assumption that working capital is simply current assets minus current liabilities. While technically accurate, the definition in a financial statement does not govern the economics of a transaction. Working capital in an APA is a negotiated concept, tailored to the business and defined expressly in the agreement. Whether certain items count toward working capital (e.g., customer deposits, related-party receivables, inventory reserves, prepaid expenses, and deferred revenue) meaningfully impacts the final adjustment.

Buyers often rely on the company's historical accounting, assuming those classifications will carry over into the deal. Sellers assume long-standing practices will control the calculation. Neither assumption is safe if the agreement defines the components differently. Only when the post-closing statement is prepared does the disconnect become apparent, usually at a point where the adjustment materially alters the economics of the transaction.

Setting the Target Without Understanding the Company's Normal Operating Rhythm

The working capital target is the benchmark against which the post-closing adjustment is measured. Yet targets are frequently set using a single month-end snapshot or an average that does not reflect the company's true operating cycle. Seasonality, customer payment patterns, revenue recognition practices, vendor payment terms, and inventory turnover all drive fluctuations that must be understood before selecting a target.

A target derived from an atypical period, whether unusually strong or unusually weak, creates distortions. Buyers may find themselves funding an unexpected shortfall even though the business historically operated with higher working capital needs. Sellers may be required to credit the buyer for a “deficit” that would not exist in the company’s normal course. In both situations, the lack of normalization converts a financial metric into an unintended renegotiation of price.

Assuming True-Up Mechanics Are Standardized

There is no uniform industry method for conducting the post-closing true-up. Every purchase agreement creates its own framework, and seemingly minor drafting choices carry significant economic consequences. Whether the parties use the seller’s historical methodology, a new GAAP-consistent approach, or a hybrid model can lead to different results even when analyzing the same financial data.

Disagreements frequently arise over how inventory is valued, whether reserves must be adjusted, whether receivables should be aged using strict criteria, how accrued expenses must be recorded through the moment of closing, and how customer deposits or deferred revenue are treated. These issues determine whether the seller delivered the required working capital and whether the buyer is entitled to a payment adjustment. Ambiguity leaves room for interpretation, and interpretation invites disputes.

Operational Decisions Before Closing and Their Impact

The period immediately preceding closing is operationally intense for both sides. Sellers may accelerate receivable collection, delay vendor payments, or adjust purchasing decisions, either for normal business reasons or to prepare for transition. Buyers may evaluate the business with the intention of integrating quickly after closing. Without clear contractual guidance, actions taken during this period are frequently scrutinized during the post-closing true-up.

Buyers may view certain decisions as manipulation designed to inflate working capital. Sellers may view the same decisions as ordinary-course management consistent with past practice. A purchase agreement that lacks clear interim covenants and explicit financial standards leaves both sides vulnerable to disagreements that arise only after the final numbers are calculated.

Why Misunderstandings Resurface After Closing

Post-closing adjustments rarely produce minor variances. In middle-market transactions, adjustments of several hundred thousand dollars are common, particularly in industries with fluctuating customer deposits, uneven revenue cycles, or discretionary inventory management. What initially appears to be a routine financial mechanism often becomes a driver of tension between parties who believed the deal was complete.

For buyers, a poorly defined working capital framework can mean starting operations with less liquidity than expected. For sellers, it can mean surrendering value long after they believed the purchase price was fixed. The true-up process is meant to ensure fairness, not to reprice the transaction. When definitions are imprecise, the process does the opposite.

Practical Takeaways for Buyers and Sellers

Working capital must be treated as a core economic term, not a post-closing formality. Definitions should be negotiated with precision, the target must reflect a normalized view of the business, and the methodology should be described clearly enough to eliminate interpretive gaps. Both parties benefit from aligning expectations in advance rather than reconciling them through dispute after closing. Proper structuring transforms the true-up from a source of conflict into a predictable and neutral calculation.

GV LAW Capabilities

GV LAW advises buyers and sellers across middle-market transactions in structuring, negotiating, and implementing post-closing adjustment mechanisms, including working capital targets, quality-of-earnings integrations, and dispute-avoidance frameworks. We support clients in preparing for diligence, evaluating transaction economics, and protecting value through disciplined contract architecture.