

Working Capital, Explained Simply

Why this number matters at closing — and who it favors.

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How it works

Every deal like this one includes a working capital adjustment. It sounds complicated, but the idea is simple. Here it is, using a pizza shop instead of the actual business.

The Tank

WHAT WORKING CAPITAL ACTUALLY IS

To run a pizza shop, you need dough, cheese, and toppings on hand, money customers already owe for orders taken on credit, and you might owe suppliers for ingredients you haven't paid for yet. All of that together — what you have, minus what you owe — is working capital. Think of it as fuel in a tank that keeps the shop running day to day.

The Agreement

THE RULE BUYER AND SELLER AGREE TO

Buyer and seller agree on one simple rule: when the keys change hands, the tank should have about as much fuel as it normally does — not empty, not overflowing. We look back over the last year, find the normal level, and that becomes the agreed number, called the Target.

The Formula

WHAT ACTUALLY GOES INTO THE NUMBER

Net working capital is accounts receivable, plus inventory, minus accounts payable. That's it — the same three ingredients for a pizza shop or any other operating business. What you're owed, what you're holding, and what you owe, netted together.

Negotiated, Not Fixed

THERE'S NO SINGLE "CORRECT" ANSWER

There's no universal formula that applies to every deal. Buyer and seller negotiate the exact calculation, which accounts are included, and the lookback period used to set the Target — all before the purchase agreement is signed.

Measurement day

On closing, someone checks the tank and compares it to the Target. There are two possible outcomes.

Quick example: Accounts receivable of \$40,000, plus inventory of \$50,000, minus accounts payable of \$33,000, comes to a net working capital of \$57,000 on that day. Compare that figure to the Target, and the difference is the adjustment.

Tank has MORE than the Target

The buyer got extra fuel for free. The buyer pays the seller for the surplus.

→ **Seller gets paid more.**

Tank has LESS than the Target

The buyer will have to spend their own money right away just to restock. That's not fair to them.

→ **Buyer gets money back.**

Why the number moves around

A shop's fuel level shifts naturally with the season, and with ordinary bill-paying and collecting. It can also look temporarily fuller or emptier if a lot of bills get paid, or a lot of cash gets pulled out, right around the day someone happens to check the tank. That's exactly why we push to measure it fairly — against a normal average — instead of relying on a single lucky, or unlucky, day.

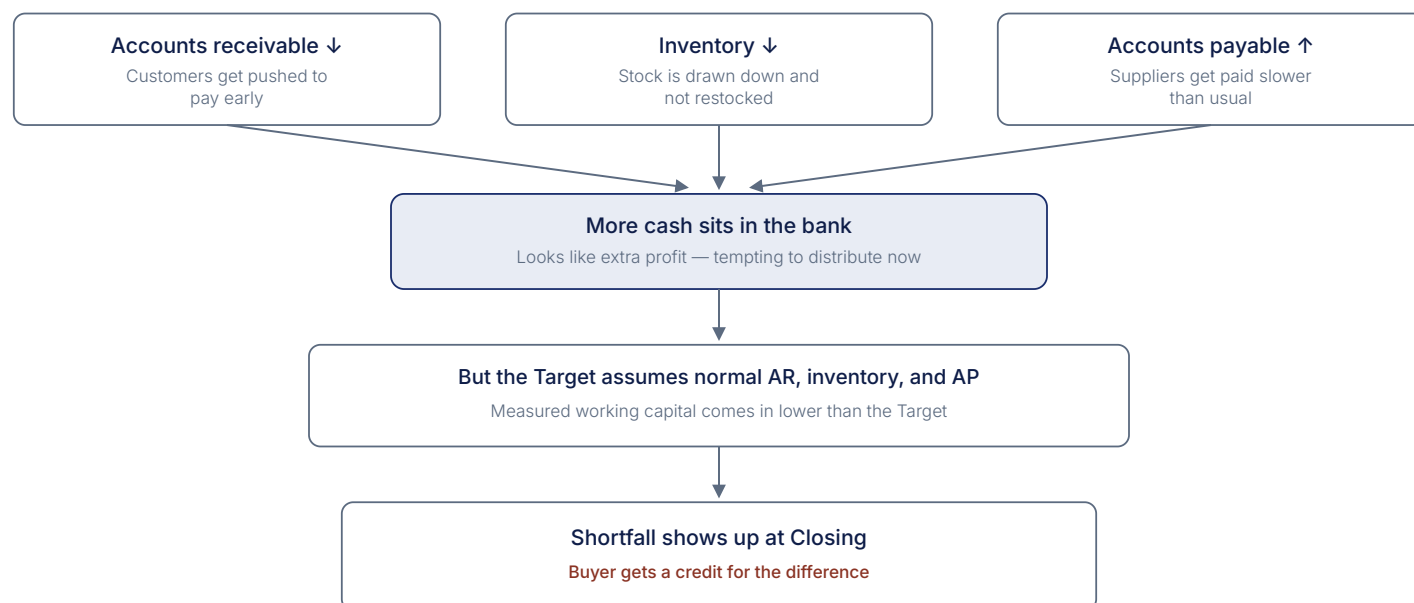
Who checks the tank

In most deals, the buyer's accountants prepare the closing statement showing the actual number, and the seller's advisors review it against the agreed method before it's finalized. If the two sides land in different places, the purchase agreement usually spells out a resolution process — often a neutral accountant who settles just the items still in dispute. It's a routine, well-worn process, not a negotiation from scratch.

Bottom line: neither outcome is good or bad — it simply trues up the price so the business changes hands with a normal, working amount of fuel in the tank. We're watching this closely on your behalf and will walk you through the actual number as soon as it's finalized.

A common (and self-defeating) move

It's tempting to try to squeeze extra cash out of the business right before closing. Here's why that doesn't actually work.



Collecting receivables early, letting inventory run down, and stretching out payables all pull cash into the bank account — but all three also push measured working capital below the Target, so the credit the buyer receives at closing claws back what was pulled out.

Net effect: the cash didn't actually get made — it got borrowed from the tank. The buyer isn't the one who has to pay down that stretched-out AP or restock that thinned-out inventory after closing; that falls to the business either way. So whatever comes out this way flows right back out of the seller's proceeds through the working capital adjustment. It's a wash, not extra money in pocket.

Do's and don'ts while under LOI

Keeping the fuel tank fair — protecting your side of the working capital number.

Most of what determines whether you end up with a credit or a holdback at closing isn't decided at closing — it's decided by how the business is run during the LOI period, month by month, right now. A few simple habits protect you.

DO

- ✓ Keep paying suppliers on your normal schedule — the same timing you'd use with no deal happening.
- ✓ Keep collecting from customers on your normal schedule, neither rushing nor delaying.
- ✓ Keep buying and restocking inventory the way you always have.
- ✓ Write down the business reason for any large cash movement at the time it happens (e.g., "distribution for Q2 estimated taxes").
- ✓ Loop in your advisor before taking any distribution, even a routine one, so it can be timed and explained properly.
- ✓ Ask your advisor early which month is likely to be used as the reference period, so you know what "normal" needs to look like when it counts.
- ✓ Keep books current and reconciled every month — no "we'll clean it up later."

DON'T

- ✗ Don't take a large, one-off distribution and pay down a big chunk of bills in the same month — that combination is the fastest way to look unusual to a buyer's accountant.
- ✗ Don't let inventory run artificially low to "look lean" right before closing — an empty shelf raises the same flags as an overstuffed one.
- ✗ Don't push customers for early payment or offer one-off discounts to speed up collections right before a likely measurement date.
- ✗ Don't sign new contracts, take on new debt, or make other out-of-the-ordinary moves without checking with your advisor first.
- ✗ Don't let bookkeeping fall behind and then "catch up" all at once — irregular entries invite scrutiny.
- ✗ Don't assume pulling cash out is risk-free — even when it's legitimate, timing and documentation matter.
- ✗ Don't wait for the other side to ask about something unusual — get ahead of it with your advisor first.

Questions about any specific transaction or cash movement? Call us before you act, not after.

Semper adde valorem — always add value in everything you do.

Published by Crassus Partners as a general educational resource on the working capital adjustment mechanics and recommended conduct during the pre-closing period of a private company sale. See the disclaimer above.