

## Lower Middle Market Monthly – February 2026

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### Why So Many LOIs Die on the Vine

On paper, a signed LOI looks like “deal done, lawyers to follow.” In practice, a large share of lower-middle-market transactions never make it from LOI to close, even when the business is fundamentally sound. The pattern is remarkably consistent: deals don’t blow up from one dramatic event; they erode as confidence, clarity, and momentum leak out of the process.

In other words, the non-binding LOI isn’t the finish line; it’s the start of the riskiest phase of the deal.

### The Data: What Actually Kills LOIs?

Recent broken-LOI analyses in the sub-\$250M segment consistently show the same top reasons deals fail post-LOI.

#### 1. Due Diligence Surprises (The Silent Deal Killer)

Most sellers think deals fail because buyers “chip the price.” In reality, they fail because diligence converts confidence into doubt.

Common post-LOI red flags include:

- Undisclosed or under-disclosed liabilities (litigation, tax, regulatory, environmental) that contradict earlier representations.
- Customer concentration with shaky contracts or upcoming renewals that wasn’t fully framed in the marketing narrative.
- IP ownership gaps, regulatory non-compliance, or other issues that make operating riskier or more expensive than expected.
- Deteriorating performance or a material adverse change during exclusivity.

Why this breaks the LOI:

- The buyer underwrote a risk profile that no longer exists; their lender and IC did too.
- Even if you solve the specific issue with a price change or special indemnity, credibility damage often lingers and poisons everything else.

**Prevention:** push “confirmatory, not exploratory” diligence. Fully scrub corporate, legal, and financial issues before going to market so the buyer is validating a story, not discovering a new one.

#### 2. QoE and EBITDA Gaps: When the Numbers Move

In the lower middle market, a surprising share of broken LOIs stem from the buyer’s QoE coming in meaningfully below the earnings story that drove the headline price.

Typical friction points:

- Aggressive add-backs: owner salary normalizations, “one-time” expenses that recur, personal perks, or deferred maintenance the buyer won’t treat as add-backs.
- Revenue recognition: timing differences, upfront recognition on long-term contracts, or project accounting that inflates short-term EBITDA.
- Pro forma and “run-rate” optimism: cost savings or growth that the buyer views as speculative

rather than bankable.

What happens post-LOI:

- The buyer's QoE team recalculates EBITDA; lenders and IC underwrite that lower figure.
- If the gap is modest, you renegotiate structure; if the gap is big, the buyer questions not just the number, but the narrative and the seller's judgment.

Once the buyer believes the story was oversold, most LOIs don't survive—even if the business itself is still attractive.

### 3. Financing Falls Apart

Even with strong businesses, deals can simply out-run the buyer's capital stack.

Why financing fails post-LOI:

- Bank-calculated EBITDA comes in lower than seller-marketed EBITDA, shrinking debt capacity.
- Lenders get spooked by customer concentration, cyclical risk, or regulatory risk and cut leverage or walk away.
- Market conditions tighten during the process, especially for non-sponsored or thinly capitalized buyers.
- Equity partners or IC balk at the final risk/return profile after full diligence.

In a competitive process, this is where you see the "winner's curse": the highest bidder at LOI later discovers they can't actually finance what they put on paper.

For sellers, this usually looks like repeated "we're working through credit committee" delays, followed by either a re-trade or a quiet withdrawal.

### 4. Vague, Sloppy, or Buyer-Biased LOIs

A poorly drafted LOI is a time bomb; it just doesn't detonate until the purchase agreement stage.

Problematic LOI patterns:

- No clear definition of cash-free, debt-free, and normalized working capital, leaving room for painful closing statement fights.
- Hand-wavy language on earn-outs, escrows, or indemnity caps ("to be mutually agreed" everywhere) that gives the buyer maximum leverage later.
- Ambiguous treatment of rolled equity, seller notes, or key employment/non-compete terms, which later become emotional flashpoints.
- Overly broad exclusivity and one-sided conditions that allow the buyer to drag diligence while the seller burns clock and leverage.

These issues rarely appear as a single "deal killer." Instead, they create a slow grind where trust erodes, lawyers dig in, and one or both sides eventually decide the pain isn't worth the prize.

For a seller audience, this is the place to emphasize that sharpening the LOI is not "legal overkill"; it's how you buy deal certainty.

### 5. Trust, Momentum, and "Deal Fatigue"

Many lower middle market deals don't explode; they drift until one side quietly exits.

Classic symptoms of a drifting deal:

- Data room that keeps changing—new uploads that materially alter the picture, or missing items that never seem to arrive.
- Inconsistent answers across management, advisors, and documents.
- Missed diligence, QoE, or legal milestones; slippage on exclusivity deadlines without clear reasons.
- Escalating friction between outside advisors who move from problem-solving to point-scoring.

Once trust is questioned, every normal negotiation point (escrow size, survival, MAC language, WC peg) becomes a referendum on character, not risk allocation. At that point, walking is often easier than fixing the relationship.

### 6. How Sophisticated Sellers Improve Close Rates

For founder-owners and first-time sellers, the takeaway isn't that LOIs are fragile; it's that the work to protect them starts well before the first IOI.

Tactically, deals are much more likely to close when sellers:

- **Institutionalize the business before marketing.** Clean financials, defined processes, and clear governance dramatically reduce diligence surprises and buyer anxiety.
- **Pre-underwrite their own EBITDA.** Run a sell-side QoE or at least a mock review to see how an independent party will treat add-backs and revenue recognition.
- **Draft tighter, clearer LOIs.** Lock in the key economic and structural terms—especially WC, treatment of cash/debt, indemnity framework, and major conditions—while leverage is highest.
- **Qualify buyers on capital and process.** Understand how the buyer is funding the deal, their lender relationships, and their track record of closing at or near LOI terms.
- **Protect momentum. Set a detailed post-LOI timeline, hold weekly check-ins, and make responsiveness a priority across management and advisors.**

For lower middle market owners, the most important mindset shift is this: the LOI is not a promise, it's a hypothesis. The more disciplined and transparent the seller, the more likely that hypothesis survives contact with diligence, lenders, and lawyers.

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