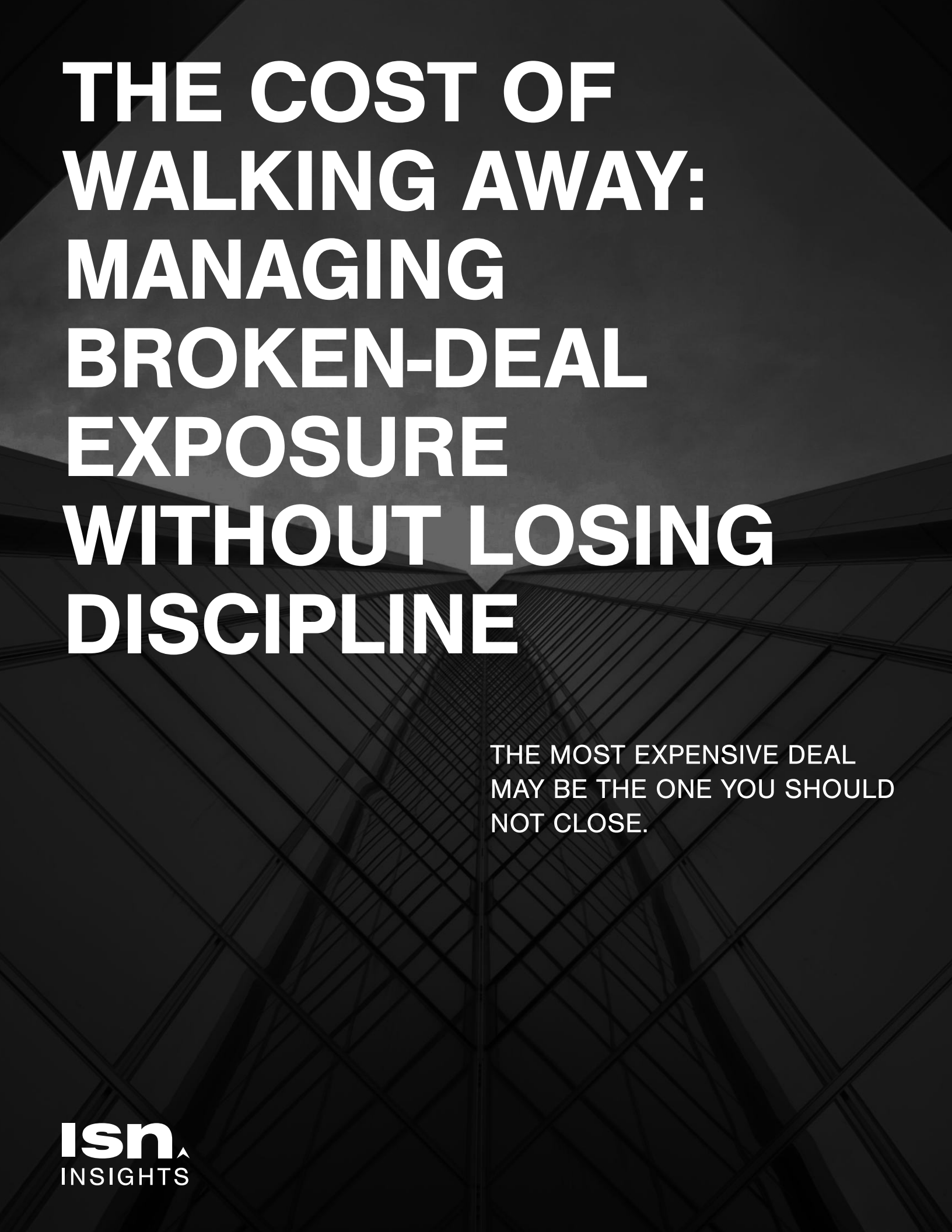


THE COST OF WALKING AWAY: MANAGING BROKEN-DEAL EXPOSURE WITHOUT LOSING DISCIPLINE

THE MOST EXPENSIVE DEAL MAY BE THE ONE YOU SHOULD NOT CLOSE.

isn INSIGHTS

EXECUTIVE SUMMARY

Every acquisition process carries the risk that the transaction will not close.

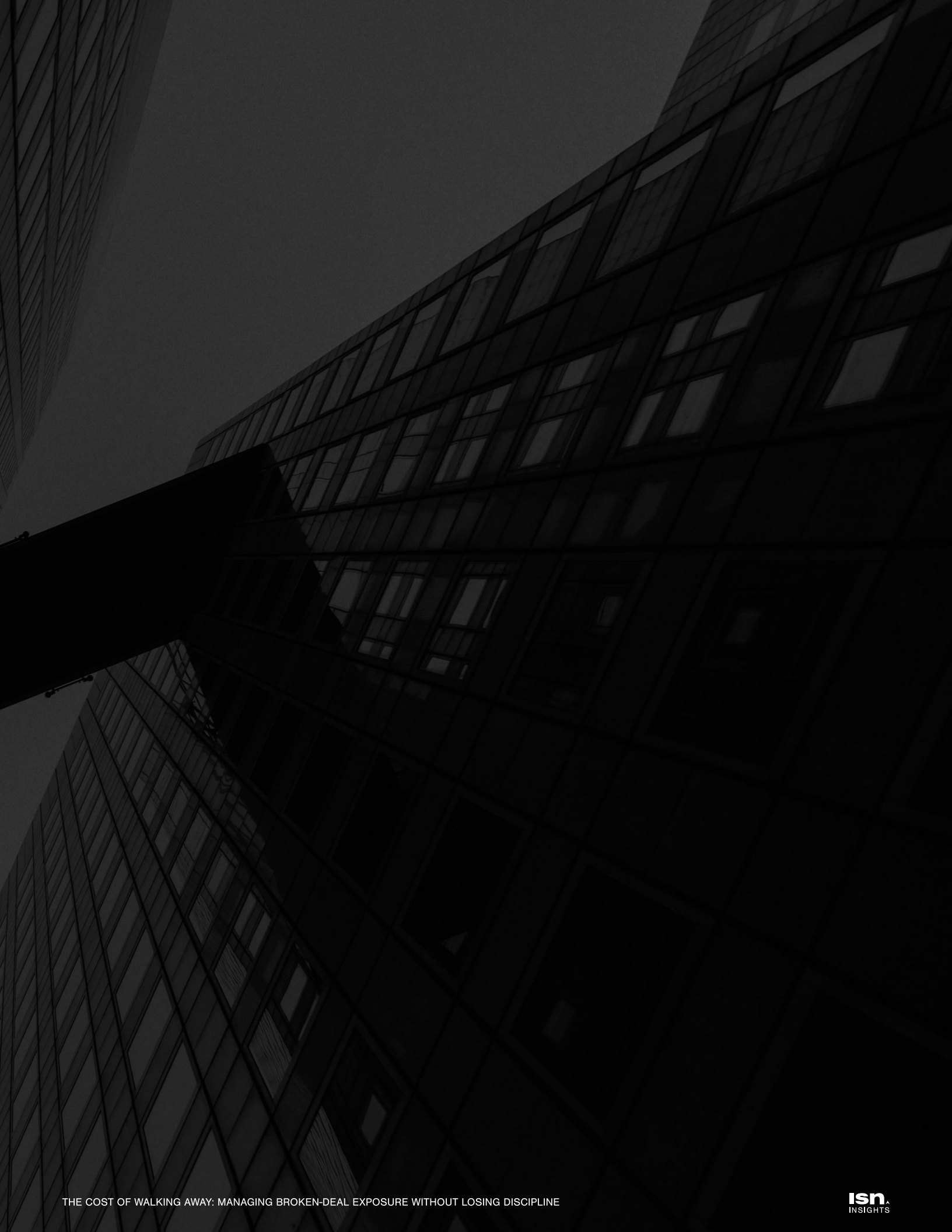
For an Independent Sponsor, that risk is personal.

Traditional funds can spread unsuccessful pursuit costs across committed capital and recurring management fees. Independent Sponsors often fund legal, accounting, commercial, and operational diligence before they know whether equity capital will ultimately be available.

Citrin Cooperman's 2026 Independent Sponsor Report found that Sponsors continue to bear or share broken-deal costs in most transactions. However, only 24% now cover 100% themselves, down from 32% in 2025. Twenty-eight percent share costs with equity partners, while another 20% fund costs until a capital partner is engaged and then shift responsibility to that partner.

The changing allocation reflects a maturing market. It also exposes a fundamental tension.

Sponsors need to spend enough to validate the deal, but not so much that accumulated costs begin influencing the decision to proceed.



CLOSING SPENDING BEGINS BEFORE CERTAINTY

Many of the expenses that matter most arise before the Sponsor has secured equity capital.

Legal counsel may be needed to negotiate the LOI and exclusivity. Financial advisors may need to assess earnings quality. Industry specialists may be required to test the thesis. Management assessments, insurance reviews, and tax structuring can begin well before the capital stack is finalized.

These expenses are not optional simply because the Sponsor lacks a committed fund. Cutting diligence to protect the Sponsor's personal capital transfers risk into the investment.

The better response is to sequence spending around the questions most likely to change the investment decision.

STAGE DILIGENCE AROUND KILL ISSUES

Not every diligence workstream needs to launch on the first day of exclusivity.

Sponsors should identify the few issues capable of invalidating the thesis and investigate those first. That might include customer concentration, recurring-revenue quality, regulatory exposure, management retention, or the actual sustainability of adjusted EBITDA.

Only after those questions are sufficiently resolved should the Sponsor expand into broader confirmatory work.

This sequencing protects capital without lowering the diligence standard. It also creates earlier opportunities to exit a weak transaction before expenses compound.

ENGAGE CAPITAL PARTNERS EARLIER

A credible capital partner can do more than fund the acquisition.

If engaged early enough, the partner may help shape diligence, recommend advisors, validate the proposed structure, and share pursuit costs.

McGuireWoods' capital-provider interviews show that some investors are willing to shoulder diligence expenses when they are brought into the process early and expect to fund a meaningful portion of the equity.

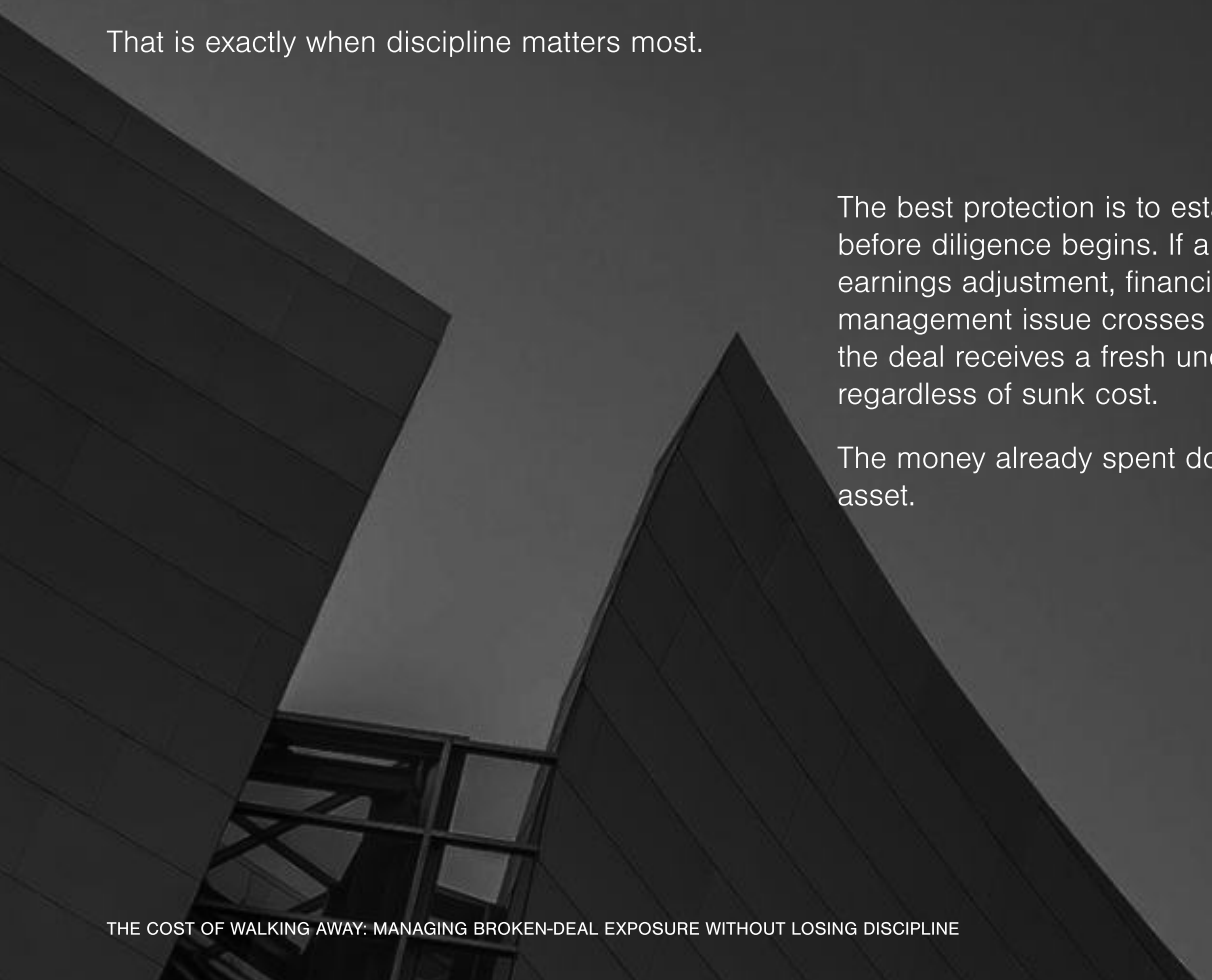
That support should not be assumed. It needs to be discussed directly, including which expenses are covered, when the obligation begins, and what happens if either party decides not to proceed.

SUNK COSTS CANNOT BECOME PART OF THE THESIS

Broken-deal costs create a behavioral risk.

Once a Sponsor has spent significant personal capital and months of time, walking away becomes harder. The question quietly shifts from “Is this still a good investment?” to “Can we solve enough of these issues to avoid losing what we have already spent?”

That is exactly when discipline matters most.



The best protection is to establish kill criteria before diligence begins. If a customer loss, earnings adjustment, financing constraint, or management issue crosses a defined threshold, the deal receives a fresh underwriting decision regardless of sunk cost.

The money already spent does not improve the asset.

WHAT ACTUALLY MATTERS NOW

01

Identify the issues most capable of killing the deal and test them before launching every diligence workstream.

02

Discuss broken-deal costs with capital partners early and document when responsibility changes.

03

Negotiate phased scopes, fee caps, discounts, or rolled fees with service providers where appropriate.

04

Establish objective kill criteria before personal capital and time begin influencing judgment.

Broken-deal costs are not simply an expense-management issue.

They are an investment-discipline issue.

Sponsors need enough conviction to spend money before certainty exists. They also need enough independence to walk away after that money has been spent.

The ability to stop is not evidence that the process failed.

Sometimes it is the most valuable outcome diligence produces.

Citrin Cooperman, 2026 Independent Sponsor Report
McGuireWoods, Independent Sponsor Deal Survey
McGuireWoods, Capital Provider to Independent Sponsor Spotlight
Ropes & Gray, The Rise of Independent Sponsors

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