

How to Structure a Transaction

Key steps to achieve the best outcomes ...



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Supertrac Bulletin

Welcome to the Supertrac Bulletin!

Supertrac is a corporate advisory firm specialising in business divestments, mergers and acquisitions to medium and large organisations. Supertrac has provided advice on clients' businesses totalling more than \$600M.

This edition covers key aspects of preparing for the sale of a business and an update on market conditions.

These articles, along with previous ones, can now be downloaded FREE from supertrac.com.

We look forward to hearing from you when you or others need our services.

Supertrac Expands

NEW OFFICES TO OPEN

Supertrac's network continues to expand with a Darwin-based office due to commence soon.

This follows the addition of Brian Hill CA of SupertracNexus earlier in the year. Brian's Sydney-based operation already has more than \$30 million of clients.

Brian is a former director of several ASX listed companies. He can be contacted direct at brianh@supertrac.com or via 1800 700 111.

Market Update

The M&A market has continued to strengthen, with client financials generally showing improved performance, more active buyers in the market, greater accessibility to finance and higher business confidence than 12 months ago.

Supertrac's performance in FY10 returned to FY08 levels, with the current financial year shaping up to be the strongest ever.

Several transactions have already been completed and many others are in negotiation or due diligence (DD).

A notable recent transaction involved the sale of a substantial manufacturing company to a Sydney-based private equity firm for an undisclosed sum. The transaction was relatively complex, with company shares and trust units changing

hands. DD was completed by Tier 1 accounting and legal firms.

Supertrac is currently managing client projects with a total Enterprise Value (EV) of close to \$200M in various stages of the M&A process.

Preparing for Sale

SELECT THE RIGHT TEAM

Buyers of medium sized businesses often lament that their greatest concerns revolve around the lack of experience of sellers and their advisers regarding the transaction process. This may manifest itself in pricing expectation, quality of the information provided, integrity of financials and the speed and quality of responses to questions. Further into the process it involves the quality and sophistication of the seller's team of advisers regarding contractual matters.

Most business owners generally only sell one business in their lifetime. They don't know what they don't know and are often amazed at how much they learn along the way. Having the best-suited team of M&A, accounting/tax and legal advisers is of critical importance to a successful outcome.

Supertrac's experience and credibility has sometimes been the deciding factor as to whether investors decide to engage in the process.

TRANSACTION STRUCTURE

Determination of the optimum transaction structure can be a complex process.

Early in the sale process, Supertrac liaises with clients and their tax and legal advisers to determine the optimum transaction structure from the seller's perspective. In many cases, there are pro's and con's and no clear cut advantage either way.

Although Supertrac's team includes qualified accountants, we do not provide specialist tax advice to clients or anyone else. We have sufficient knowledge to recommend to our clients that they seek appropriate advice and are ready to lead negotiations through to resolution of the various components.

When large transaction values are

involved, it makes sense to obtain a second opinion from a tax specialist, in the same way as you would consult a medical specialist and even obtain a second opinion about a significant medical condition.

Where applicable, Supertrac can refer clients and their advisers to specialist tax advisers to ensure the seller's team is equal in sophistication to that of the buyer. The same applies to legal advice. Supertrac has worked with many quality legal firms whom we can and do recommend to clients if and when appropriate.

ASSET VS SHARE SALE

In the medium size Australian M&A market, business sale transactions are structured either as Asset or Share Sales in roughly equal proportions. There are many reasons for and against the sale or acquisition of assets vs shares.

Features Common to Both

- The valuation and price negotiation is usually based on the unencumbered EV regardless of the final transaction structure.

Asset Sale

- An asset sale describes where the assets of the business are sold, comprising plant and equipment, stock and WIP, business name and other IP, goodwill etc.
- Although trade debtors and trade creditors are not usually sold, they are almost always included in the net working capital calculation as part of the overall EV.
- Equipment is normally sold unencumbered, but occasionally the finance arrangements may be assigned to the buyer with the consent of the financier. It may be attractive to the buyer to do this depending on the term of the loans and how mature the loans are. A loan where the interest is calculated on the 'rule of 78' may favour buyers taking on these loans.
- Buyers may also seek to acquire the existing trade debtors if part of their funding facility includes debtor finance, because to qualify, the buyer must hold title to the assets against which the finance is secured.

- If the assets to be sold are held by more than one entity, the seller may comprise a number of entities, all listed in the sale agreement.

Share Sale

- Share sales may involve the sale of the shares in the trading entity, related entities and occasionally units of a unit trust.
- It may be easier to sell the shares than re-assign or novate large numbers of contracts or licences.
- Even where shares are sold, the existing business loans are usually paid out at or before settlement.
- Share sales are usually more complex and require more sophistication all round. In general, there are more 'moving parts' to a share purchase agreement.
- In some instances, where there are multiple vendor entities, included assets may need to be transferred in or sold separately, and other assets transferred out. These preparatory transactions may result in stamp duty being payable by the seller's entities before the ultimate sale to the buyer.
- There may be more flexibility to structure the transaction to optimise the after-tax outcome for the seller.
- There may be franking credits or tax losses to consider and to forego, use or transfer to the buyer.
- There may be future tax liabilities resulting from the adoption of tax effect accounting. These may need to be negated by the parties agreeing not to adopt this particular accounting principle in the completion accounts.
- There is increased risk to the buyer due to acquiring additional contingent liabilities from the past.
- Stamp duty on the acquisition of assets in some States may make it more attractive to acquire the shares. If the shares are being acquired in an 'asset rich' company, stamp duty may still be payable on the tangible asset component.
- Share acquisition transactions require more extensive DD overall, and in particular tax DD, leading to greater acquisition cost to the buyer.
- More stringent requirement for the entity to be 'cleaned up' before being

handed over, eg all issues need to be scrutinised and rectified or provided for before the company is handed over. These may include unpaid FBT liabilities, Payroll tax and restructure costs. It may even become more costly to clean these up than sell the assets and later liquidate the entity.

- If the seller requires a share sale transaction, they and their advisers should undertake a more comprehensive vendor DD review prior to going to market to ensure the entity is 'clean' so there are no hold-ups or show-stoppers later.
- More extensive warranties are required of sellers by the buyers.
- Where the shares are to be sold, allowance needs to be made for income tax for the previous and current YTD's trading, just as it would be payable by the seller if they had retained the entity.

CONTRACTUAL PROCESS

Most buyers of medium businesses would prefer to enter into conditional contracts than 'sign and settle' on the same day. Conditional contracts contain conditions precedent that need to be satisfied or waived before completion.

However, listed companies (ASX, NASDAQ etc) generally work on the basis of signing unconditional contracts and settling on the same day. When dealing with high level credible organisations, this process is favoured by buyers. A primary reason is so they may not have to make a public announcement until it's already a done deal. In those situations, a Term Sheet or Heads of Agreement (HOA) would normally be signed early in the process as soon as key terms are agreed. Such a Term Sheet or HOA would normally be non-binding as to the commercial terms.

An Exclusivity Deed (either standalone or incorporated in the Term Sheet) would also normally be entered into to protect the buyer's position while the transaction process continues. There are two basic levels of exclusivity, 'no negotiation' or the more extensive 'no shop' whereby all promotion of the business for sale must cease.

There are drawbacks in this 'sign and settle' process from both the seller's and buyer's point of view.

As a seller, can you imagine trying to conduct an orderly handover in those situations when you don't even have a signed contract? You could be telling staff, lessors and others with nothing tangible at all in your hand.

As a buyer, there is also little security without a formal binding commitment from the seller to complete. Occasionally a buyer may require the inclusion of a break fee to discourage the seller from changing their mind to match and cover the cost the buyer is incurring during the DD process.

Overall we prefer a contract to be signed before settlement whenever possible.

Baby Boomer Business Owners need to retire

OPPORTUNITY AWAITS YOU ...

THE OPPORTUNITY

- Baby boomers are getting older and keener to retire.
- In recent years, an even greater backlog has been building.
- 80% of Australian businesses are privately-owned, with a total value of \$3.6 trillion.
- An estimated \$1.6 trillion worth of family businesses will change hands as baby boomers retire over the next 10 years.
- Outright sale is by far the most common way for owners to exit their business.
- This presents a significant opportunity.

WHAT SUPERTRAC OFFERS

- Supertrac offers intending new M&A market participants the opportunity of becoming a Supertrac Franchisee.
- Supertrac offers a means of entering the M&A market quickly and efficiently, saving many years and hundreds of thousands of dollars in setup costs.
- Supertrac has invested millions of dollars and more than a decade building the database, systems and procedures, templates, expertise and credibility to enable you to hit the ground running and capitalise on the market opportunity.
- Supertrac's marketing resources enable you to offer your business network a credible and effective way to sell their businesses.
- Supertrac's target market is businesses worth \$1M-50M. The buyer network comprises public companies, private equity firms, medium and large private companies in the same industry and private investors. Supertrac's database contains all these groups and this is how most buyers are sourced.
- Operate your own business associated with the Supertrac brand and with Supertrac's full backing.

To find out more, please call, email or visit supertrac.com under partnering options

The 3 Circles

Activities must meet these criteria to qualify as a core activity:

1. Can we be World Best at it?
2. Are we passionate about it?
3. Will it drive our economic engine?

Source: Jim Collins - Good to Great

Supertrac Articles

Supertrac's website contains a wealth of free articles. To download these and other articles please visit:

www.supertrac.com/articles.asp

Recommended Reading:

- Exiting Your Business
- How To Prepare a Business For Sale
- Selling Your Business - Who Are The Buyers
- Who To Tell When You're Going To Sell

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