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Corporate and Commercial Lawyers

STRUCTURING THE DEAL

Considerations in a Business Acquisition

WA Club
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Mark Leaker
Director
Leaker Partners
E: markl@leakerpartners.com.au
T: 9324 8590
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STRUCTURING THE DEAL OVERVIEW

Purchasing Vehicle

Purchase Price

The Main Considerations in Structuring the Deed

PURCHASING VEHICLE

- Considerations in selection of Purchasing Vehicle include the following:

  (a) Taxation consequences;

  (b) Cost of creating and maintaining the vehicle;

  (c) Risk of failure of the business;

  (d) Nature and size of the business;

  (e) Potential for growth and need for additional capital;

  (f) Nature and extent of control and management required for business; and

  (g) Costs and complexity of retaining the business and the vehicle.

POTENTIAL STRUCTURES

- The potential structures include:
  - Sole trader;
  - Partnership/unincorporated joint venture;
  - Limited partnership;
  - Trusts (discretionary/unit/class/hybrid); and
  - Company.

FLEXIBILITY IN EACH STRUCTURE

- Sole proprietor;

- Company;

- Partnership;

- Trust.

CGT CONCESSIONS

- Sole trader:
  - Structure driven by tax considerations.

- Individuals and discretionary trusts:
  - Greatest access to CGT concessions.

- Fixed trusts (unit trusts):
  - Less effective to access CGT concessions.

- Companies:
  - Least favourable structure for CGT (but not necessarily income tax generally).

CARRY FORWARD LOSSES

- Whether a company can choose to carry a tax loss forward and utilise in the future income year depends upon satisfying either:
  - A Continuing Ownership Test (COT); or
  - The Same Business Test.
- COT:
  - Requires the company with a tax loss must maintain the same ownership with reference to majority voting rights – rights dividends and rights to capital from the start of a loss year to the end of the year in which the loss is deducted.
- SBT:
  - Allows a company to deduct a loss where it can be demonstrated that it carried on the same identical business from the time and merely prior to the change of ownership or failure of the COT into which losses are deducted.

RESTRUCTURING BEFORE SALE

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- A more common strategy;
- Duty considerations arise;
- Generally speaking, assets required by the purchaser are transferred to a "clean" vehicle controlled by the vendor;
- Purchaser then acquires some or all of the shares in the "clean" vehicle (and, depending upon jurisdiction, may avoid transfer duty); and
- Transfer duty normally borne by vendor in creation of "clean" vehicle with assets (or duty costs may be shared with the purchaser).

CORPORATE RECONSTRUCTION

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- Some corporate reconstructions are permitted under the *Duties Act* to take place without duty being incurred. Generally speaking, duty is not payable on a corporate restructure if it is a transfer of property from one number of a family to another member of a family;

- Preliminary ruling may be obtained before the transaction is carried out.

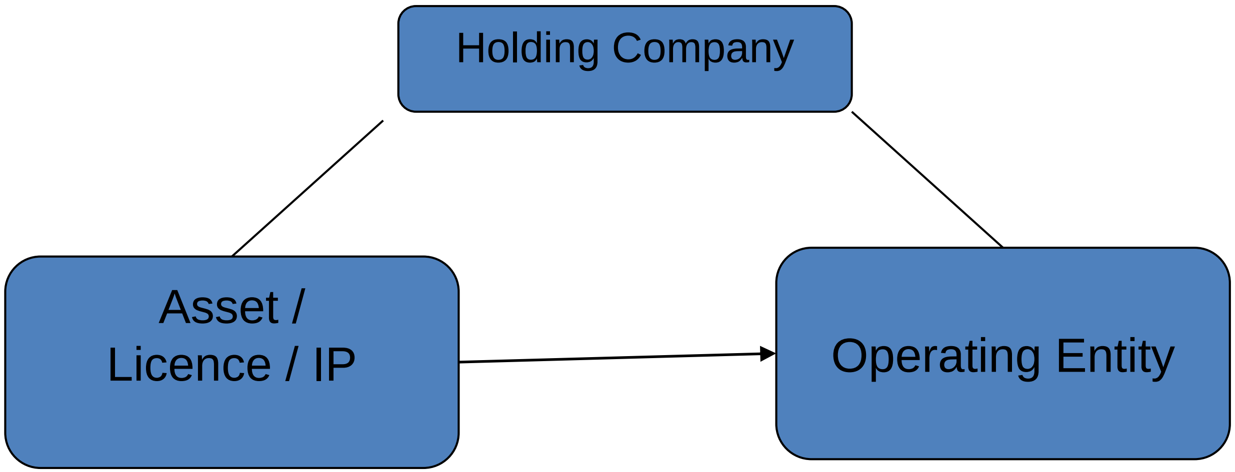
Note: duty relief is normally not available if the transfer agreement or the transfer of the property is not an arrangement under which any company involved with any of the transactions cease to belong to the same corporate group.

Note: Parent entity and its subsidiaries are members of a family

MORE THAN ONE VEHICLE?

- It may be desirable to place key assets in one vehicle to be leased/licensed by the operating vehicle.

- The asset vehicle and the operating vehicle may be controlled by the one holding company.



PURCHASE OF SHARES OR ASSETS

- The main distinctions are:
  - Share Sale:
    - The seller is an individual shareholder;
    - Existing and future liabilities remain with the company;
    - Material contracts remain with the company (but consent may be required for change of control);
    - Employees continue employment with the company;
    - GST is not payable on the transfer of shares;
    - CGT may be payable if seller of shares makes a profit or gain.

PURCHASE OF SHARES OR ASSETS (continued)

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- Asset Sale:
  - The seller is the company;
  - Existing liabilities remain with the seller;
  - Future liabilities transfer to the buyer;
  - Material contracts must be transferred to the buyer which generally requires consent of third parties;
  - Employment with the seller is terminated and employees re-employed by the buyer;
  - Stamp duty normally payable on the transfer;
  - GST payable on the sale (unless acquired as a going concern);
  - CGT payable if the seller makes a profit or gain on the sale of the assets (although small business concessions may apply).

STRUCTURING OF PURCHASE PRICE

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- Overview:

  - Two options:

    - Completion Accounts; and

    - "Locked box".

Note: Often variations on the theme

STRUCTURING OF PURCHASE PRICE

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- Completion Account method:
  - Requires Completion Accounts to be prepared post completion (typically, the bulk of the purchase price is paid at Completion on an estimated basis); and
  - Upon completion of accounts, adjustments are conducted in accordance with the agreement and a final payment is made either by seller or buyer, as the case may be.

STRUCTURING OF PURCHASE PRICE (continued)

- Locked Box mechanism:

  - Uses the same pricing structure as the completion accounts mechanism but, typically, three months prior to completion. The purchase price as at completion date is based on forecast cashflows with purchase price at completion date being calculated on the basis of those cashflows; and

  - The key is to ensure the box is “locked” ie, value/cash cannot leak out of the target. Often, “permitted leakage” is included in the agreement such that if at completion the completion accounts are within certain perimeters the purchase price is fixed and does not change.

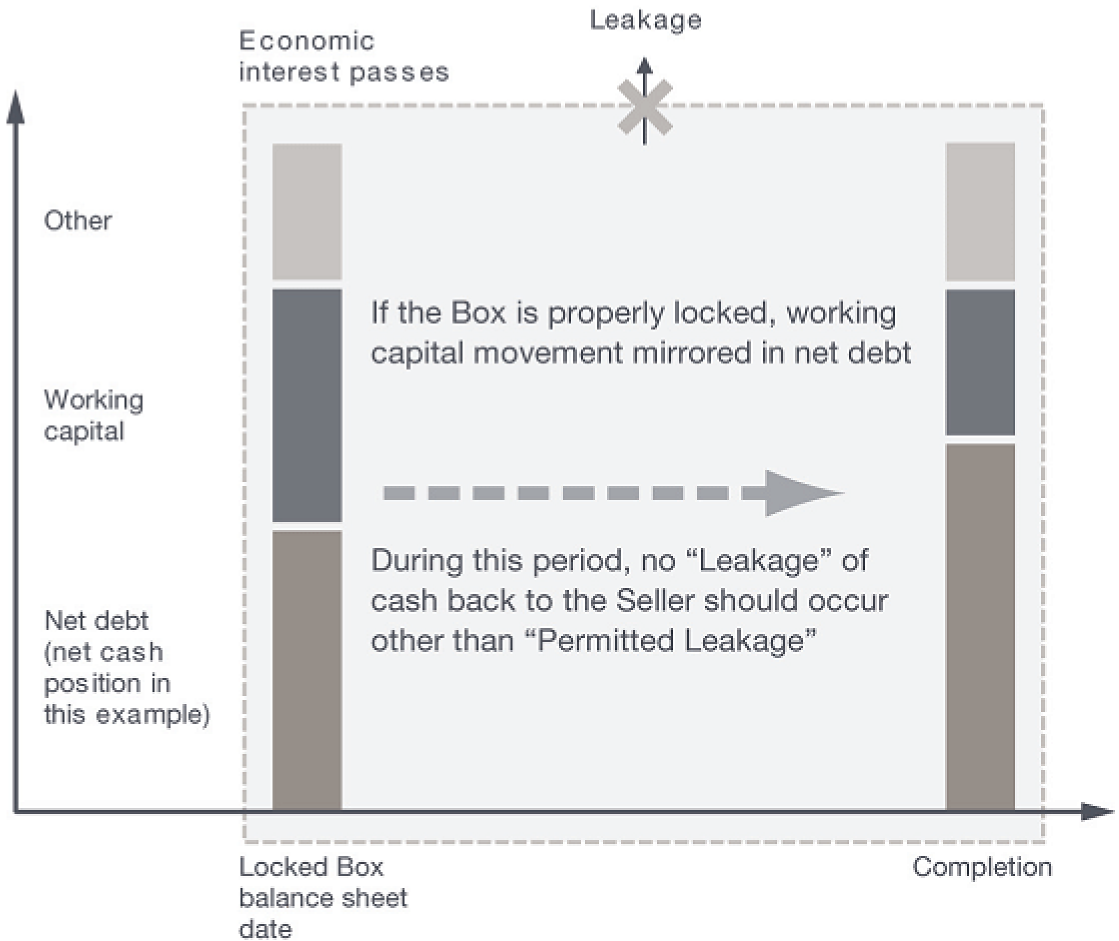
  - Buyer is entitled to the benefit of the cash flow once “box is locked”.

  - Target Shares valued on a debt free and cash free basis.

    i.e. Equity Value = Enterprise Value less Net Debt.

    Enterprise Value is multiple of Targets sustainable earnings

STRUCTURING OF PURCHASE PRICE (continued)



ISSUES OF "LOCKED BOX"

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- Evaluating cashflows when locked box date of completion;
- Valuing the opportunity costs of the seller for receiving the price after the locked box date; and
- How to incentivise buyer and seller to close without delay.
- "Leakage" is the subject of warranties and indemnities – usually on a $ for $ basis. "Leakage" may include dividend management fees, bonuses, waiver of rights against sellers, changes to trading arrangements.
- "Permitted Leakages" is defined. May include scheduled payments, scheduled dividends, remuneration in the ordinary course of business (e.g. agreed bonuses).

PROS AND CONS OF "LOCKED BOX"

- Pros - Seller:
  - Give certainty of price resulting in ability to distribute proceeds quickly;
  - Encourages less aggressive interpretation of potential debt items in an auction process;
  - Increases control over the process;
  - No debate about completion account policies and accounting policies; and
  - Removal of management time and expense in debating completion accounts.

PROS AND CONS OF “LOCKED BOX”

- Cons - Seller:
  - Difficult to apply when there is no anchored balance sheet ie, does not usually permit carve out of business.
  - Also requires relatively stable businesses to properly value future cashflows.

PROS AND CONS OF “LOCKED BOX”

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- Pros - Buyer:
  - Simplicity and no completion mechanism resulting in costs savings; and
  - Management time not tied up debating completion of accounts.

PROS AND CONS OF "LOCKED BOX"

- Cons - Buyer:
  - No completion mechanism to exploit. Need to rely on warranties;
  - Limited ability to get management onside;
  - Committing to price three months out;
  - Risk of the business deteriorating between locked box date and completion; and
  - Need to debate debt and working capital requirements early with perhaps less detail on limited business.

THANK YOU