



Sale or succession of businesses

- How to implement a successful exit strategy

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Commercial

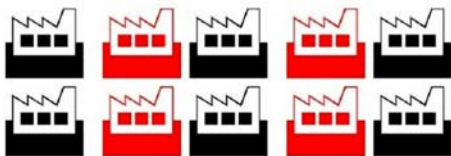
Graham Wilson
Corporate Services Contact Partner
Waterworths Chartered
Accountants

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A few statistics...

- **40%** of all UK businesses are expected to transfer ownership some time within the next ten years

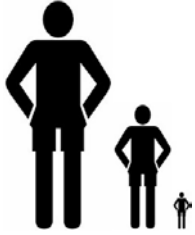


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A few statistics...

- **30%** of businesses pass to the second generation, and...



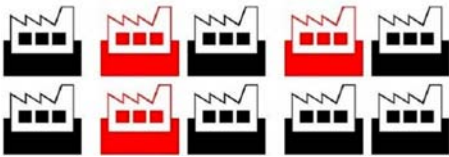
...less than half of those go on to the third generation

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A few statistics...

- **30%** of business failures were found to be viable businesses that simply closed for want of a suitable successor.



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Succession today

- Succession is no longer the natural order
- The available pool of successors is changing

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Why is succession such a difficult subject?

- Strong leader
- Strong opinions



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Why is succession such a difficult subject?

- Putting the business first
- Let go!
- Acknowledge your mortality



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Why is succession such a difficult subject?

- Difficult decisions
- From first to second generation, and...
- From second to third generation
- Introducing outsiders

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Why is succession such a difficult subject?

- Where to start?

Businessman killed in Malawi plane crash

21 June 2007
A HAMPDEN businessman was among five British tourists who died in a plane crash in Malawi.
Father of two Nigel Clout, a sales director for a stock company, was part of a group of about a dozen keen cyclists and mountaineers.
The 52-year-old was on holiday with two friends, who had been members of Cambridge Health Club in St Albans since it was a squash club more than 10 years ago.

US adventurer Fossett is missing

An extensive search has been launched for missing American US adventurer Steve Fossett, who went missing in the Pacific Ocean.
Fossett was reportedly last seen taking off from the island of Hawaii on his solo flight on Monday evening.
He was flying a blue and white single-engine Cessna plane.
A call for help came from Major Cynthia Ryan, said 10 planes were searching for the 52-year-old.
The authorities were alerted when the Fossett's family reported his missing plane. It took 10 hours for a ship which should have found him in two hours.
His plane was confirmed for Mr Fossett's flight had been "normal" with one or two engine



TIMES ONLINE
Rally ace Colin McRae dies in air crash

Colin McRae, the former world rally champion, died along with his five-year-old son James when his helicopter crashed near a house in Scotland yesterday. Two other people on board, believed to be close friends of McRae, also died, said the BBC. The death of a young child, confirmed that a solo pilot and his family were not to blame.
The helicopter was flying from a house in Perth, about 100 miles from Glasgow, and was on its way to a house in Perth. The helicopter was flying at 100 feet when it crashed. The helicopter was flying at 100 feet when it crashed. The helicopter was flying at 100 feet when it crashed.

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Why is succession such a difficult subject?

- What form does the succession plan take?

- Letter of direction
- Formal plan

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Why is succession such a difficult subject?

GUCCI

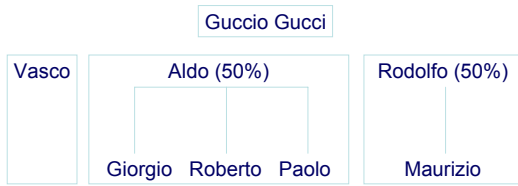


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Why is succession such a difficult subject?

- The Gucci story



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Grooming for sale

- **Demonstrate a good financial record**
- Management information systems
- Present the assets in good condition
- Make the business less risky

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Grooming for sale

- **Demonstrate a good financial record**
- Concentrate on short-term results
- Avoidable expenditure
- Improve working capital

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Grooming for sale

- **Management information systems**
- Buyers will want information at short notice
- Show you are in control
- Document systems

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Grooming for sale

- **Present the assets in good condition**
- Premises and equipment should look well maintained
- Stock should be neat and orderly
- Have a tidy up!

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Grooming for sale

- **Make the business less risky**
- Customer or supplier dependence
- Formalise the informal

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Grooming for sale

- **Fixed Assets**
- Review depreciation policies
- Dispose of redundant assets
- Revalue appreciating assets
- Realise investments or revalue them

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Grooming for sale

- **Debtors**
- Debt provisions
- Pay for your own bad debts!

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Grooming for sale

- **Debtors**
 - Debt provisions
 - Pay for your own bad debts!
- | | |
|-------------------|----------------|
| Profit | 100,000 |
| Bad debts | <u>5,000</u> |
| | 95,000 |
| Earnings Multiple | 5 |
| Cash | <u>475,000</u> |

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Grooming for sale

- **Debtors**

- Debt provisions

Profit	100,000	100,000
Bad debts	5,000	0
	<u>95,000</u>	<u>100,000</u>

- Pay for your own bad debts!

Earnings	5	5
Multiple		

Cash	475,000	500,000
Bad debts	0	5,000
	<u>475,000</u>	<u>495,000</u>

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Grooming for sale

- **Stocks**

- Are all stocks recognised?
- Are all overheads recognised?

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Grooming for sale

- **Creditors**

- Resolve any known disputes
- Make sure provisions are adequate but not overly prudent

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Sales Memorandum

- Make the business sound attractive
- Source of hard information for buyers
- Give impression that the business can be improved
- Avoid detailed confidential information



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Marketing the business

- Targeted approach – the six steps
 - 1. Identify potential buyers
 - 2. List them
 - 3. Approach them
 - 4. Confidentiality agreement
 - 5. Sales Memorandum
 - 6. Shortlist



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Weighing up the offers

- Can the buyer afford?
 - Ask for evidence
- What form will payment take?
 - Cash, deferred or contingent consideration
- What will your responsibilities and liabilities be?
 - Consultancy arrangements
- How will the business be run in future?
 - Rationalisation or redundancies

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- Choose a buyer

- Agree Heads of Terms

- Complete the deal



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Taxation

Bill Campbell
Tax Partner

Waterworths Chartered
Accountants

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Taxation

- Sale

- Succession

- Key Employees

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Sale

- Primary focus –
 - Corporates, &
 - Tax on gains

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Sale - Basics

- Assets
- Shares
- Substantial shareholdings

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Sale - Basics

- Asset sale
 - Potential double taxation
 - Warranties/indemnities
- Shareholder sale
 - Single level taxation
 - Potential to defer tax – QCB's/shares
 - Warranties/indemnities
 - Taper relief !!!/ 18% CGT
- Substantial shareholdings
 - No CT/traders

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Consideration

- Cash
- Loan Notes
- Shares (in purchaser)
- Deferred consideration

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Consideration

- Cash
 - immediate tax on gain
- Shares (in purchaser)
 - no gain/no loss (= no immediate tax)
- Loan Notes(= no immediate tax)
 - QCB calculate gain now tax later
 - NQCB no gain/no loss

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Consideration

- Deferred consideration
- Fixed deferred
 - (full immediate tax)
- Variable formulae
 - (tax on value)

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Purchaser

- Trade sale
- Purchase of Own Shares
- MBO

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Purchaser

- Purchase of Own Shares
 - Uses company's own cash / borrowing capacity
 - Minority/majority exits
 - Trading Co' = Capital Gains > 5 year
 - Sell majority of holding
 - Limited loan backs

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Purchaser

- MBO
 - Structure – newco
 - Funding
 - shares
 - debt personal/corporate
 - institutional
 - financial assistance from target

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Sale – Taper Relief

- Pre Budget Report Oct 07 !!
 - Recap
 - BAT & Non-BATR
 - Indexation Allowance
 - Winners
 - Losers
 - Generic advice
 - Do the numbers

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Sale – Taper Relief

Sale of 1,000 acres	Pre Apr 08 £	Post Apr 08 £
• Proceeds	2,800,000	2,800,000
• Cost	1,200,000	1,200,000
• Indexation	1,260,000	NIL
• Gain	340,000	1,600,000
• Tax rate	10%*	18%*
• Tax Due	£34,000	£288,000

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Sale – Taper Relief

- NEWS FLASH – w.e.f. 6 Apr 08
- Retirement Relief - £100,000
- ‘Farmer’ example gain £1.6m
- IF retirement gain = £1.5m
- Tax due £270,000 (today £34,000)

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Sale – Inheritance Tax

- Shares – the IHT cliff edge
 - Before sale
 - After the sale

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Succession

- Primary focus –
 - Corporates, &
 - Inheritance Tax

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IHT – Business Property

- IHT advantaged assets
 - trades
 - 2 years ownership
 - Businesses – sole traders/partnerships
 - Unquoted shareholdings – traders
 - Assets used in company/partnership

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IHT – Business Property

- Relief
- 100% - sole traders , partnerships
- 100% - unquoted shares – traders
- 50% - assets used in a
 - partnership
 - **controlled** trading company

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IHT – Business Property

- Traps
 - Sale – relief 100% to 0%
 - Investment Companies
 - Loan Accounts
 - Personal assets & control

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IHT – Business Property

- Traps - escapes
 - **Loan accounts** = BPR nil%
 - Convert to BPR 100% by capitalisation issue
 - **Personal assets** = 50% or nil%
 - Consider – pension scheme transfer sale at full/undervalue to Co' new trading partnership

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IHT – Business Property

- BPR = 100% (50%)
- CGT rebasing on death
- Why not leave these assets by Will?

- May inhibit next generation
- May not be practicable
- Will it always be as good (PBR !)

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IHT – Trusts

- Vehicle to hold value outside of estate
- Benefit from minority valuations
- No IHT on transfer if value > £300k*
- No IHT on transfer if value is BPR'd*
- Gifts - current value (above*) future growth!
- Retain control

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IHT – Trusts

- Principle
 - Gift now –growth outside estate
 - Gift within £300k or BPR
 - Keep control

- Parking charge every 10 years
 - Max 6% - probably less
 - If still BPR - nil

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IHT – Alternatives

- Parallel company
- Freezer shares
- Deferred shares

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IHT – Alternatives

- Parallel company
 - New ventures/ lines of business
 - New contracts for existing business
- Conduct in new company in alternate part-next generation ownership

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IHT – Alternatives

- **Freezer or Deferred shares**
 - Amend the Articles
 - New share class issue
 - Gift new shares whilst value low

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Key employees

- Relevant to both Sale & Succession–
- Focus –
 - Lock-in
 - Piece of the action

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Key employees

- Issues
 - Not full equity now
 - If equity – unable to pay
 - Taxes on exit

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Key employees

- Issue
 - ‘not full equity now/unable to pay’
- Consider
 - Options
 - Alternate share ideas

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Key employees

- Options – legal right to acquire
- Simple option
 - Set own terms-when/how many/price
 - Grant = no Income Tax
 - Exercise = Income Tax on underpayment (values – at grant £10/ at exercise £20),or
- Even better an EMI option

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Key employees

- Other Alternates
 - Freezer shares
 - Nil paid shares

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Key employees

- Freezer shares (as before)
 - Amend the Articles
 - Issued shares - current value/no more
 - New share issue - future growth
 - Shares acquired by key employees at new low value

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Key employees

- Nil-paid shares
 - Issue ordinary shares
 - At current market value
 - With no/low calls to pay at present!

- Shares acquired by key employees at current value (without payment now)

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Key employees

- Tax on exit
 - Aim CGT (18%)
 - on post acquisition growth
 - Delivered by EMI/Freezer/Nil-paid

- But 'restricted' shares
- Can result in some growth at 41%

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Legal Issues in Business Succession

Daniel Milnes
Head of Business Law
Forbes Solicitors

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Wills

- Succession in the simplest form
- Intestacy – what happens if you do nothing?
 - No control
 - Circumstances may change
 - Unwanted in-laws
 - Inheritance (Provision for Family and Dependents) Act 1975

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Wills

- Making a will – good plan anyway
- Consider:
 - What are you leaving?
 - What about the Articles of Association?
 - Is there a Shareholders Agreement?
- Co-ordinating multiple wills
 - Can't make assumptions
 - Contracts are better in that case

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Ownership Agreement

- Partners & Members Agreements
- “Pre-Nuptial Agreement” & “Business Will”
- Covers:
 - Ongoing management
 - “What if..?” scenarios
- Can be addressed in the Articles of Association of a company
 - Entrenched provisions in Articles?
 - Automatically covers new shareholders

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Ownership Agreement

- How does it handle succession?
- Trigger Events and Consequences
- Trigger Events:
 - Death (or serious ill-health)
 - Retirement
 - Termination of Employment/Partnership
 - Flotation?
 - Sale of Business?

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Ownership Agreement

- Consequences:
 - Pre Emption
 - First Refusal
 - Right to Match
 - Drag Along and Tag Along provisions
- Valuation
 - Good Leavers and Bad Leavers?
 - Formula or FMV?
- Payment Terms

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Buy-Backs

- Effectively what happens in a partnership or LLP
- Can happen in a company
- Can be written into a Shareholders Agreement or Articles of Association
- Watch out for Companies Act compliance

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Management Buy-Out

- A specific type of business sale
 - MBO
 - MBI
 - BIMBO
- A “sell” not a “give”
- Not determined in advance by Will, Articles of Association or Ownership Agreement

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Management Buy-Out

- What are the likely issues?
- MBOs in particular
 - Strained relationships
 - Distraction
 - Funding and Deferral
- Usual Issues with an MBO effect
 - Price
 - Risk
 - Warranties and Indemnities

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Legal Aspects in Grooming for Sale

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Business Structures

- Any re-organisation to do?
- Hiving, Enveloping and Demerging
 - Tax advice
 - Timing
- Ownership and Management
 - Who will have to sign up?
 - Who will get the money?
 - Any historic changes to be resolved?
 - Directors/Members/Partners

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Contracts

- Anticipate the Due Diligence
- Lock in Earnings and Resources
- Head Off Problems and Price Cuts

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Contracts

- Examples:
 - Executive Service Agreements
 - Other Employment Contracts
 - Intellectual Property Licences
 - Supply Chain Contracts
 - Agency and Distribution
 - Major Customers
 - Leases

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Legal Issues in the Sale Process

Pauline Rigby
Business Law Department
Forbes Solicitors

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Legal Issues

- Job creation for lawyers?
- Is the cheap way always the cheap way?
- What are the contracts for?
 - Setting the price
 - Clarifying obligations
 - Apportioning risk

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The Start

- Decision to sell the company
 - Different Reasons for Selling
 - Different Possible Buyers (MBOs etc)
- Obtain independent tax advice
 - Is a Share Purchase the best way forward?
- Contact with Solicitor
- Draft Confidentiality Agreement
 - Ensure that Seller/Buyer's secrets remain so

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Heads of Agreement

- Heads of Agreement - Not contractually binding
 - Or are they?
 - Get legal advice
 - Identify potential problems from the start
 - Share or assets?
 - Cash or paper?
 - Layman's terms
 - More cost effective!

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Due Diligence

- Pre-Contract enquiries
 - "Shopping List"
 - Detailed Enquiries
 - Property, Employees, Accounts etc
 - Request information not covered in sale agreement
- Replies to Enquiries
 - Seller bound by contents?

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The SPA

- Sale Terms
 - From whom?
 - To whom?
- Price
 - Earn-Out?
 - Completion Accounts and NAV adjustment?
 - Payment terms
 - Security for payments?
- Practicalities
 - Resignations and appointments
 - Share transfer approval
- Restrictions
- Warranties
- Indemnities
- Vendor Protection
 - Thresholds

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Other Documents

- Disclosure Letter
 - Watering down the warranties
 - Full and fair?
- Deed of Indemnity (The Tax Deed)
 - No qualification
 - No limits?

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Other Documents

- Service Contracts
 - May be relevant if management staying in place
- Completion Agenda
 - List of documents required for completion
- Bank Documents
 - Releases
 - Letters of Non-Crystallisation

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Completion (at last)

- Purchaser transfers money
 - To solicitors
- Signature of Documents
 - The Big Meeting
 - Or not
- After Completion
 - Filing requirements
 - Dealing with the proceeds

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Asset Sales

- Sell the business not the company
- Avoid the “warts and all”
- Process generally the same
- Except for
 - TUPE
 - Bank documents essential
 - Novation of third party agreements

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Hints and Tips

- Take specialist advice
 - Don't leave it too late
 - Tax
 - Corporate Finance
 - Legal
- Think it through
- All contracts can be changed
 - Unless you're really desperate

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Questions

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Thank-you

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