PD Law

BUYING A BUSINESS

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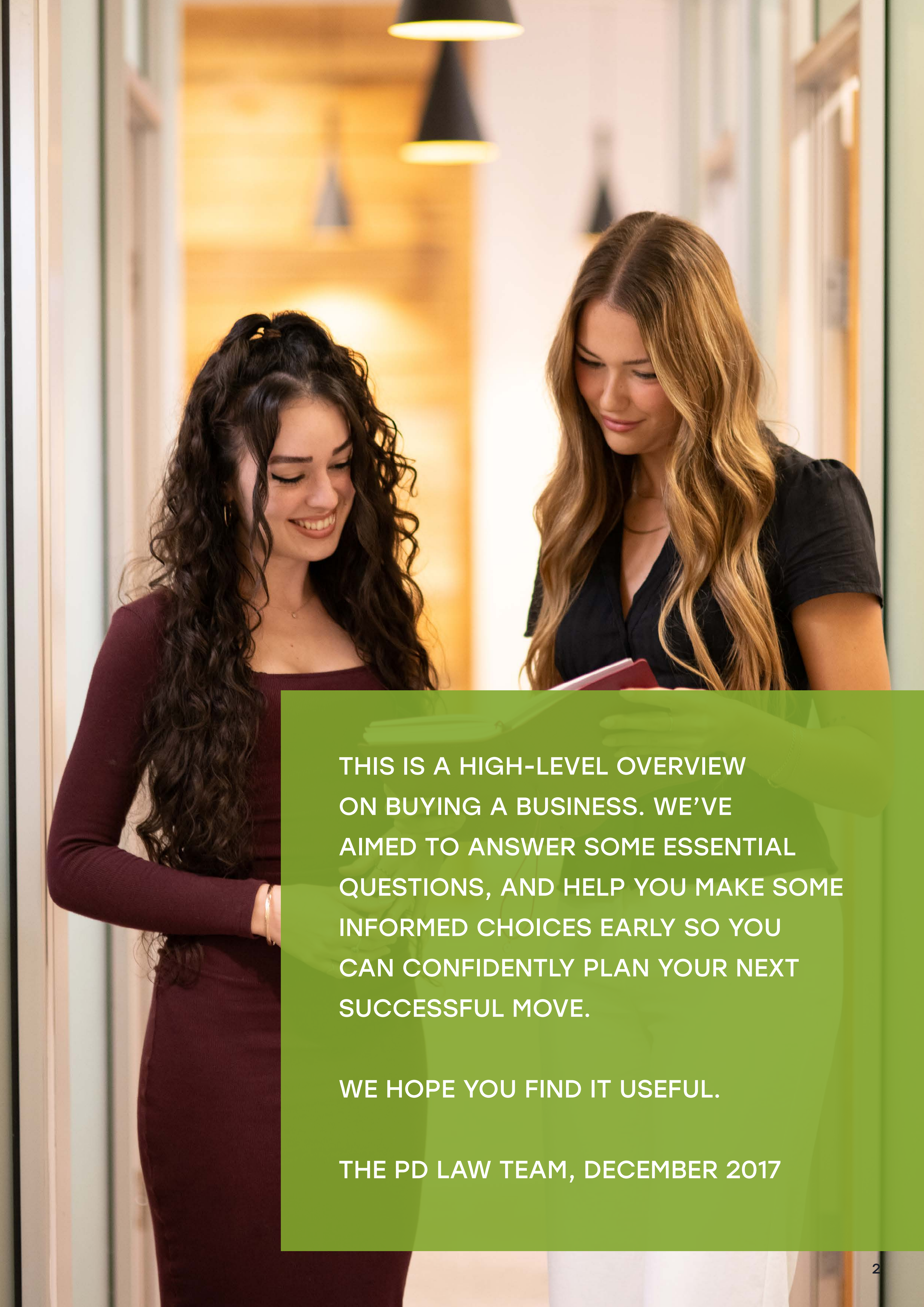


THIS IS A HIGH-LEVEL OVERVIEW ON BUYING A BUSINESS. WE'VE AIMED TO ANSWER SOME ESSENTIAL QUESTIONS, AND HELP YOU MAKE SOME INFORMED CHOICES EARLY SO YOU CAN CONFIDENTLY PLAN YOUR NEXT SUCCESSFUL MOVE.

WE HOPE YOU FIND IT USEFUL.

THE PD LAW TEAM, DECEMBER 2017

THE ENTREPRENEUR WITHIN

Have you got it?

If you're reading this then yes, you most certainly have.

To be honest, it's a blessing and a curse all in one: if you're born with that can-do attitude and you've been waiting for the right time to unleash it, you're just as likely to leave scorched earth behind you as you race ahead watching your turnover soar, as you are to find that the return on your investment a little more elusive than once expected. (That term elusive can range from 'disappointing profit outcome' to 'penniless'!)

Now no-one can promise they can help you avoid all the pitfalls owning a business brings, but there's no argument that the more prepared you are, the better you'll fare.

Which hat do you wear?

Until now, you might have fulfilled many roles in different businesses and industries, ranging from intern to foreman. Some may have been technical in nature, others more in sales, and others again more of a management style.

Although it's a great advantage to be skilled in one or more areas, business ownership is not for everyone. For example, the wizard technician might be lousy at sales, the gun sales person could be atrocious at managing, and of course the entrepreneur could have some cracking ideas but be rubbish at following through, leaving colleagues disillusioned.

Owning and running a successful business requires all these skills, so before you do anything, before you spend any money, work out who you are, what hat fits you best, and whether others around you might also be valuable contributors.

Well I already run the place. I may as well buy it.

Maybe, maybe not.

We've all seen it: the employee harbouring unspeakable thoughts about her boss while she's grinding out the hours, seemingly carrying the weight of the business singlehandedly. She dreams of flexible hours, a Scrooge McDuck style swan-dive into silos of cash and exotic holidays.

Although the ideal business should deliver on these, failure to:

- ✓ recognise your motivating reasons for entry into a business venture;
- ✓ establish your role in that venture (see Hats above) and
- ✓ test the viability of that venture (more on this below)
- ✓ will (not may) end badly.

Like we said, just because you might rock as the one doing the work, you might be terrible at getting the work to come in the door, or calling people back, or calling suppliers, or balancing the books, or planning for the quiet months, or collecting debts, or paying creditors, or dealing with employees, or setting up the systems, or managing your existing customers so they come back again and again.

Arguably the biggest difference between running the place and owning it, is risk. If it all goes south and you're the boss, you go down with the ship, and the legacy you're left with can be financially and emotionally crippling. If you're not the boss but an employee, you abandon ship and go find another job.

Ok, so what happens next?

Get informed. The price of professional assistance as a value proposition should speak for itself. None of us should ever pretend we know enough about a business we've never run or owned to go it alone. Even if we've been involved in that industry, or even as an employee of that business.

Yes it'll depend on the value of the business you're buying but you need to ask yourself a very simple question.

If by getting professional advice for $x I avoid losing $y, or I can save $z, is it worth it?

DON'T BET THE FARM

ASSET PROTECTION

Here are some key considerations to start with:

- ✓ are you going into business on your own, or in partnership with others?
- ✓ How do you own your personal assets now, and what's at risk if things do go bad?
- ✓ Are you buying a business from someone else, and there's a clear 'line in the sand' where their risk ends and yours starts? or
- ✓ Are you buying into the entity that runs the business where you'll be inheriting all the good and the bad things that might have happened to that entity already?
- ✓ How can you best manage (not evade!) your exposure to tax while you run the business and then when you sell it?

Options range from trading personally, through to a comprehensive company and trust structure, or a partnership of trusts, or any mix of these.

Everyone's circumstances are different and it's best to meet with your lawyer and accountant at the same time to decide the most practical, cost effective and safe way forward.

PRESSURE TESTING THE VENTURE

It starts with the numbers

‘Don’t believe half of what you see, and none of what you hear’ (Lou Reed – Last Great American Whale).

When someone’s selling their business, they’ll present it in the best possible light.

So if the price you’re being asked to pay is based on the business accounts, then you need to test those accounts. A little effort and investment in expertise up front could enable you to cut a better deal before you’re bound, or even avoid a disaster.

Line up a good accountant a long way out, and unless you’re that good accountant, don’t pretend you know how the books look. There are many colourful ways accounts can be presented, some better than others, and some more lawful!

Either way it’s money well spent.

DIY Due Dil, SWOT and other weird acronyms

It’s not all about getting professional advice. A serious buyer will start their own homework well before making first contact with their banker, lawyer or accountant.

To kick off your own due diligence, make a start on a SWOT analysis of the venture and your own internal capabilities (Strengths, Weaknesses, Opportunities and Threats). There are literally thousands of tools you can get hold of online that will get you on the right track to making an informed choice.

As a spin off benefit, the SWOT analysis will bring into sharp focus exactly what you’ll need from your professional advisors when it comes to committing to the deal or deciding to keep looking.

LINING UP YOUR A TEAM

Invest in some quality professional advice before making any decisions and most definitely before signing any contracts.

TEAM MEMBER	THEIR ROLE IN THE DEAL
Lawyer	Your lawyer advises on: ✓ the contract, due diligence and how to protect your interests; ✓ asset protection, entity issues and succession planning.05
Accountant	Your accountant will: ✓ analyse the 'books' and isolate what's missing or what doesn't belong or make sense; ✓ advise on how the business price should be apportioned; and ✓ provide tax planning and structure advice
Financial Planner	✓ Your financial planner helps with setting up personal insurances – life, total permanent disability – for you and other key staff if needed.

BUYING IN, BUYING OUT AND START UPS

Buying in or starting up

It might be smart for some to buy an existing business while others might choose to invest time and money starting one up. It comes down to a matter of opportunity cost – is it better to borrow and buy a proven business, using profits to pay down debt, or is it better to start from scratch, carry less debt and grow organically?

These are personalised decisions and the answers will depend on you, the kind of business you want to buy, the market it's in, the profit it makes and the competition it faces.

Share sale -v- business sale?

There are many ways you can buy in to an existing business and again it will depend on many things. For instance, it might be better to buy a business from an existing owner, drawing the proverbial line in the sand, on the date of settlement between old and new owner, ensuring the rights and obligations of each never overlap.

On the other hand, it may be preferable to have the shares in a company (the company that owns the business) transferred from outgoing owner/shareholder to incoming owner/shareholder to preserve valuable agreements, licences and the like.

Each option (and there are more) has its pros and cons, which can all be covered when you gather your consultants together for advice.

Entities and Risk

See our table above on Betting the Farm. The structure you use to buy and run that business needs to be the best fit for your circumstances, having regard to:

- ✓ asset protection and personal liability;
- ✓ tax considerations (income and capital gains);
- ✓ cost of ongoing management; and
- ✓ succession planning/exit strategies.

Comparing Structures

This is where we'll work closely with your accountant, your financial planner and other advisors. Structure options are many and varied including:

- ✓ Sole trader,
- ✓ partnerships (this could be individuals, companies, trusts),
- ✓ company,
- ✓ discretionary trust or unit trust,
- ✓ a mix of these.

Each needs to be considered in the context of asset protection, tax and succession planning, and once we cover off what your plans are the option that suits you best will make itself known.

Partnering up?

Remember our comments above about hats, and which one you should wear? It might be that your skills alone won't get you where you want to go, but your skills, coupled with someone else's, could be the winning combination that will be the difference between failure and raving success.

That said, the opposite can also apply so before landing on a partnership, remove the emotive bits and choose based on what skillsets each prospective partner can bring to the business, and how well you can all get along.

Stakeholder Agreements

The Business Will

Just as important as choice of partner, is the agreement that sets out the rules. A good stakeholder agreement (whether it be a partnership agreement, shareholder agreement, unit holders agreement) should cover:

- ✓ Management - who's the boss (CEO) who manages sales, production, delivery?
- ✓ Debt and equity - how much is everyone comfortable borrowing, and how much must everybody contribute?
- ✓ Salaries – How much can each partner draw? Is it even / equitable? What about silent partners and investors?
- ✓ Exit Strategies - what kind of levers can partners pull to exit without destroying the business? Rights of first refusal, options, share buyouts, valuations?
- ✓ Key person Insurance – what happens to the business if the key person is permanently incapacitated or even killed? Will you end up in business with your partner's family?

DOING THE DEAL

What are you buying?

In short, you're buying goodwill and assets. What they're worth is reflective of the strength of that goodwill and the market value of those assets.

What will you get?

Intellectual Property – stuff like trademarks, patents, logos, systems and knowhow, and to a limited extent business names.

Services – you'll want the same numbers, email addresses, domain and web names transferred so, from the outside looking in, the business is continuing flawlessly.

The social medias – There is enormous goodwill generated in social media accounts and so it's crucial that these accounts are transferred, or at least the login, password and admin details are delivered.

What's WIWO?

"Walk in Walk out" means the price you're paying for the business includes all stock on hand. The alternative to this is that a stock take is carried out (usually the day before settlement) and stock is paid for in addition to the purchase price, usually up to a maximum amount.
There are pros and cons to each approach so get informed as to what might suit your circumstances and budget. The last thing you want is to go broke buying old stock, but the last thing you also want is to buy a business with half a day of stock left on hand to trade with.

What about GST?

As a very general rule, GST is not payable in a business transaction as it is exempt under the going concern provisions of the GST law. That said, always check this with your A Team before committing so you don't get any short term budgetary 'surprises'.

The Premises lease

So you pay market price for your business, assuming you can continue to trade from the same location the business has been successfully run from for the past 10 years. Your customers all know where it is and the location is great.

One week in, the landlord's lawyers drop you a line referring to some clause of your lease, informing you they are entitled to terminate and need you out within 30 days.

Suffice to say, getting your lease reviewed, and properly assigned to you, is vitally important. Your lawyer will check over the lease to make sure there are no 'breaker' clauses, the rent review mechanism is fair, there's plenty of time left in the term, and that you've got some options available to extend, leaving you something to sell when you're ready to move on.

Employees

Part of the sale may involve the transfer of existing employees' employment contracts. Before you settle your transaction, you'll need to consider:
which of the seller's team are critical for the viability and profitability of the business going forward;
whether it's important to restrain any of those employees from going to competitors, canvassing business customers or disclosing confidential information;

whether you can afford to retain them under their current pay rates and conditions.

Risk

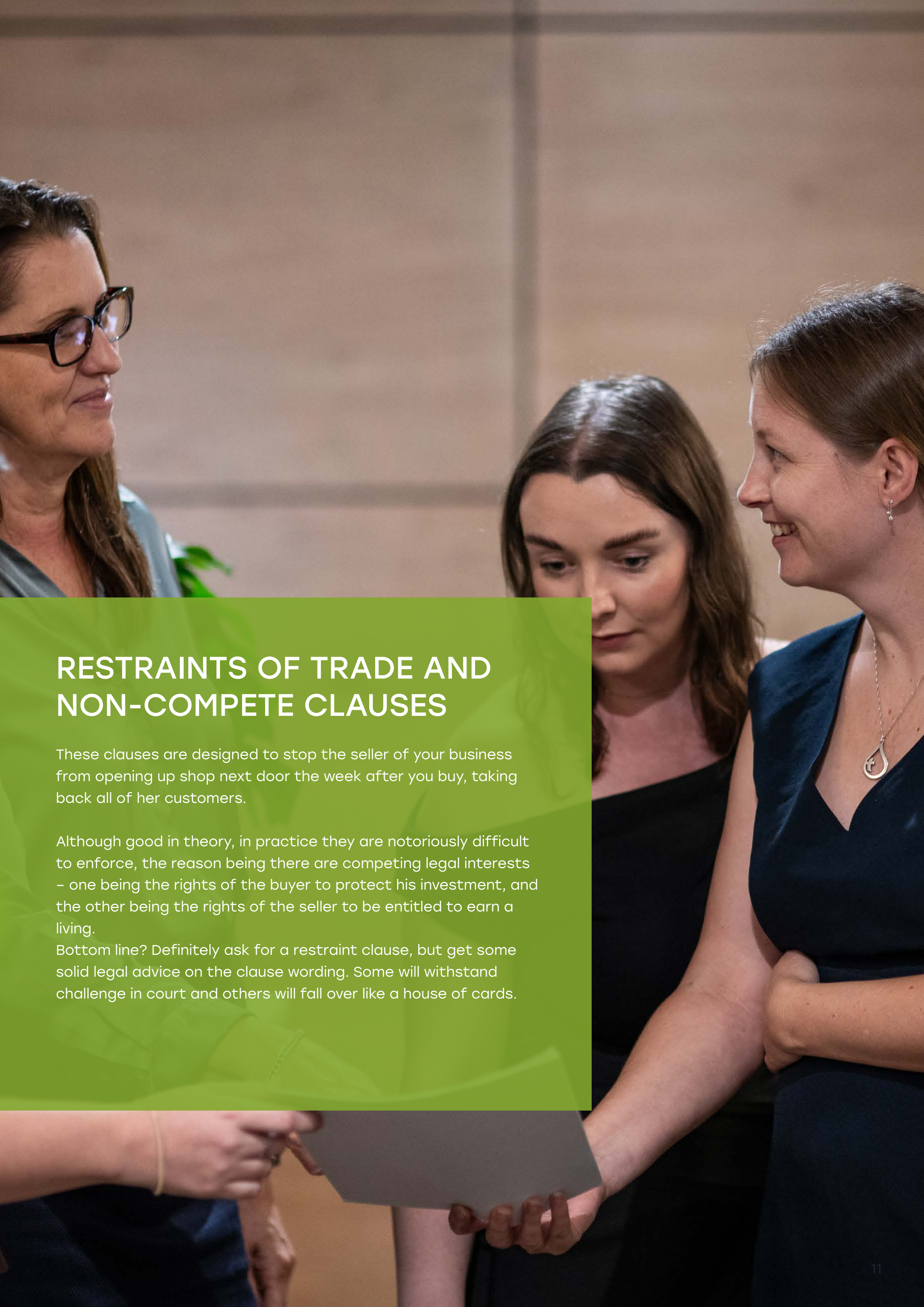
Usually, risk passes to the buyer only on completion of the transaction (when the purchase price is paid at settlement). It's at this point that you need to make sure you have spoken with your insurance broker and have all necessary insurances in place when risk passes.

On this point, it's a good idea to hand a copy of the relevant provisions of your lease to your insurance broker to make sure that any insurances required to be taken out under your lease are also covered at the same time.

The Settlement Day – who does what?

We generally share the load with you on the settlement date. There are some things lawyers simply can't do for you (such as transfer telephone electricity and other utility accounts, take out insurance policies etc) but we do provide comprehensive checklists to ensure nothing falls between the cracks.

There are also a bunch of registrations that will occur after the settlement date and these will depend on the type of business being bought. For example, a retail food outlet will have different requirements from a health and fitness centre, a dry cleaner from a motel or a taxi licence. Rest assured though, no matter what the business, we can specify what needs to happen and when.



RESTRAINTS OF TRADE AND NON-COMPETE CLAUSES

These clauses are designed to stop the seller of your business from opening up shop next door the week after you buy, taking back all of her customers.

Although good in theory, in practice they are notoriously difficult to enforce, the reason being there are competing legal interests – one being the rights of the buyer to protect his investment, and the other being the rights of the seller to be entitled to earn a living.

Bottom line? Definitely ask for a restraint clause, but get some solid legal advice on the clause wording. Some will withstand challenge in court and others will fall over like a house of cards.

LAST WORDS

Don’t worry

People think they will be charged the very moment they call a lawyer. Although that may be the case in some firms, (and TV dramas), it’s not here. We’d much rather hear from you beforehand, when we have time to make suggestions and help, rather than afterwards, when it may be too late, or more expensive to try to fix.

Where we can we will give you a fixed price quote so you can immediately assess value for money in one of the most important transactions of your life. In short, what you want to spend on professional assistance is entirely within your control.

With literally decades of experience in handling all types of business matters, we know what we are doing, and we’re professional.

So benefit from our experience.

ABOUT PD LAW

PD LAW is a dynamic, progressive law firm offering a broad range of business and personal legal services.

We’re dedicated to ensuring:

- ✓ our service is prompt
- ✓ our advice is clear, straightforward and
- ✓ represents excellent value
- ✓ you’re a client of ours for life.

We look forward to working with you

Disclaimer: We think our Business Guide is really good and very accurate, but it’s intended as a general guide. Call us for specific advice before relying on the contents of this guide, as everyone’s circumstances are different.

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