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Acquiring a Business

Preliminary Issues for Consideration

You may not want to hear this, but buying a business is complicated. It's a process that has a lot of moving parts, so if you are considering a business acquisition, you would be wise to assemble a team of advisors that will work on your behalf to make the transaction move forward as smoothly as possible. While each transaction is unique (sorry, but no such thing as a cookie-cutter), there are some common issues that you will need to consider in the initial stages of all acquisitions that you undertake.

1. Are you buying assets or equity? Generally, sellers want to sell their equity and buyers want to buy assets. There are advantages and disadvantages for the buyer that come with each acquisition structure:

Asset Purchase

Some Advantages for the Buyer include:

- Selection of the specific assets you want to acquire.
- Selection of the leases, contracts and other liabilities that you are willing to assume.
- Exclusion of specific liabilities of the seller from your transaction.
- "Step-up" in the tax basis of the company's assets.

Some Disadvantages for the Buyer include:

- Need to obtain consent of third parties to transfer certain assets.
- The buying company may have to established new credit with suppliers.
- Advantageous tax assets and rights (e.g. net operating loss carryforwards) may be lost.
- In transactions involving healthcare organizations, unless specifically refused by the buyer, the Medicare provider agreement of the seller is automatically assigned to buyer making the buyer subject to the liabilities associated with the provider agreement.

Equity Purchase

Some Advantages for the Buyer include:

- Not required to obtain third party consents for most contracts/leases.
- Don't need to "re-hire" company employees.
- Continuity of company operations.

Some Disadvantages for the Buyer include:

- Inherit the liabilities of the business (both known and unknown).
- Required to take on all contracts and performance obligations of the business.
- Assets may be fully depreciated.

2. How will the "Due Diligence" process be conducted? Every buyer must perform thorough and competent due diligence on the acquisition target. In the context of an acquisition, "Due Diligence", means the investigation of the target and its operations for purpose of identifying the risks of the transaction. For small businesses it is advisable that this process be done discreetly, to avoid having customers, vendors and employees question their future and the company's future. Once the Due Diligence process is concluded, the potential buyer will have the ability to walk away from the deal if it uncovers information adverse to the acquisition target or the deal.

A Due Diligence investigation will generally include review and analysis of, among other things:

- Accounting and financial information;
- Material contracts;
- Intellectual property;
- Litigation;
- Organizational documents;
- Customers;
- Employees; and
- Regulatory compliance for those businesses that are subject to regulatory oversight.

3. Will you spend time negotiating a Letter of Intent (LOI)? As a buyer, having a LOI can benefit you in several ways. If you are seeking financing for the acquisition, it may be critical for you to have a LOI to submit to your financing source. Also, a LOI containing a "no-shop" eliminates the ability of the seller to entertain competing offers for its business for a designated period of time. From a psychological standpoint, a seller that has signed a LOI may feel morally compelled to proceed with the deal (even though the LOI is non-binding).

A LOI sets out the fundamental terms of the transaction, which can include:

- The type of purchase (equity or assets);
- A list of assets to be purchased and liabilities to be assumed (if it is an asset purchase);
- The purchase price (or method to be used to determine the purchase price);
- Description of the due diligence process and length of time for the buyer to conduct its investigation;
- Confidentiality;
- A "no-shop";
- Timing of closing;
- Closing conditions; and
- Employment arrangements (if principals are expected to stay on after closing).

Typically, a LOI will be non-binding except for certain agreed upon provisions (confidentiality, exclusivity, certain covenants, governing law, etc.).

The issues discussed above are only the tip of the iceberg in the acquisition process. As a buyer, it is in your best interests to collaborate with your advisory team to ensure that you proceed efficiently.
