Questions to help assess an offer

Some useful questions and insights to use when attempting to understand a proposed transaction.

Where are we now?

A). Why do they want to buy and how will they go about it?

You should establish the following:

- Primary corporate objective of the organisation (for example, growth towards capital event, growth to a particular milestone, target profit generation for owners etc)?
- What is their primary strategy to achieve the corporate objective? (so, if their primary strategy is growth through acquisitions, is that a hub and spoke approach and if so, what does the profile of a hub or a spoke look like, what is the acquisition model etc)?
- What is their pipeline of transactions? (how many active transactions do they have on the go right now and what stages are they at)?
- Can you speak to the former owners of an acquired firm and if so, can you select the firm?
- What is their post-transaction integration strategy? (remember, the deferred consideration could be contingent on post-transaction performance, so the integration plan is central to this issue).
- What are their assumptions for revenue generation and cost-cutting and other changes to be made in the business post-transaction? (how does the day-to-day change across the entire acquired entity after the deal is done; trading name, proposition, staff, processes, premises, IT systems, bookkeeping etc).
- What are their current functional strategies for proposition, marketing, recruitment and retention, productivity, business model and cashflow for organic growth etc?
- What is their preferred long-term ownership model and how will they get there? (is their current ownership model a means to an end; i.e. private equity funded on the way to becoming a public company; what debt facilities do they have; and do they have an exit plan they are already working towards?).

While an acquisition effects every aspect of a firm, considering an offer and negotiating terms, focusses attention on finances.

FAQ cont

B) Why do you want to sell?

You should communicate the following:

- You don't need to sell right now.
- There are certain conditions that must be met in order for you to complete a transaction (i.e. structure of transaction and consequent tax treatment; amount of cash at completion; security of deferred consideration post-transaction; roles and levels of autonomy post-transaction etc). You should be clear on these parameters before continuing negotiations.

C) What stage do they feel negotiations are at?

You should:

- Get broad agreement on the overall process to complete the transaction.
- Make sure milestones and timelines have been discussed and agreed, to avoid any meandering in the future.

What is proposed?

A) How have they reached their valuation of the business?

You want to know the following:

- Do they have accurate data and have they interpreted it correctly?
- Are they basing their valuation on historic, current or future performance?
- What assumptions have they made in reaching their valuation and are they reasonable?
- Is the valuation contingent on post-completion activities and if so what are they?

B) Are they proposing the acquisition of equity or assets?

- Equity may attract entrepreneur's relief (subject to all conditions being met), whereas an asset-based transaction will create a capital gain inside your business and will count towards your corporation tax liability for that year.

C) Full or partial acquisition of either of the above?

- If it's a full acquisition, they will have complete control of the business and everything in it, so your ability to control any outcome post-completion depends entirely on the level of control you have in the purchaser's business. If it's all cash, assume none, but if it's a partial acquisition, then control must be clearly defined.

D) How will the initial consideration be paid?

You want to know the following:

- Proportion of initial consideration to be paid in cash at completion?
- Method of payment for balance of initial consideration?
- If equity in the purchaser's business is being offered, you should establish the class of equity, owners' rights attaching & detail of proposed vesting schedule?

E) How will the deferred consideration be paid?

You should establish the following:

- The proportion of the deferred consideration to be paid in cash and the frequency and duration?
- Interest to be paid on deferred consideration and terms?
- Security of deferred consideration (i.e. loan notes, preference shares or cash)?
- Contingent element of the deferred consideration (i.e. what will you need to do post-completion, in order to achieve 100% of the deferred consideration)?
- Option of a pre-nuptial allowing for both parties to return each other to pre-transaction status, if the acquisition doesn't work?

F) How will the owners of firm's they acquire, manage the inherent risk associated with the transition from business owner to employee?

You should ascertain the following:

- Will you be a shareholder post-transaction and if so on what terms? (will good/bad leaver provisions apply to you and the balance of your deferred consideration and if so how?)
- If you won't be a shareholder post transaction, will you need to rely on the share purchase agreement (in the event of a dispute) to recover the balance of your deferred consideration, if your employment contract is terminated for any reason?
- Is retirement with full payment of deferred consideration acceptable, within the period of payment of deferred consideration and if so, would such a change to employment trigger a change in the quantum or frequency of deferred consideration payments?

G) What are the anticipated terms for warranties and indemnities?

You should ascertain the following:

- Do you have a shared understanding of the difference? (warranty is a statement by the vendor and the purchaser needs to prove a quantifiable loss, whereas an indemnity is a promise to pay in specific circumstances).
- What are the specific terms; maximum claims, timeline to extinction etc?

H) How does the offer change if some or all the above factors are altered?

You should ascertain the following:

- What aspects of the offer will change; headline price, ratio of initial to deferred consideration, ratio of cash vs other security iro initial and/or deferred consideration, term for deferred consideration, contingency targets, warranties and/or indemnities, your role post completion etc?
- Which aspects are non-negotiable? (it can take a few attempts to get something from non-negotiable to negotiable and it often depends on what else changes).
- Which aspects mean the most to you and can you get the deal shape you ultimately want/need?

Timelines and next actions?

It usually looks like this:

- Plan: the groundwork that helps either party make an informed decision to take action.
- Prepare: building a deal team, acquiring resources, communicating the plan etc.
- Search: finding each other (marketing, networking, initial conversations).
- Negotiate: getting down to specifics and working towards a non-binding offer.
- Heads of terms: reaching a basic agreement and planning the resource to get to completion.
- Due diligence: checking the detail and clarifying understanding.
- Legals: the documentation that clarifies the transaction.
- Completion: exchange of consideration – the end, or just the start?
- Which aspects mean the most to you and can you get the deal shape you ultimately want/need?