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SPECIAL REPORT

BUYING A BUSINESS: SHARES OR ASSETS?

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Buying a Business: Shares or Assets?

THIS MONTH, you will learn:

- The difference between buying the shares and buying the assets of a business
- The pros and cons of buying the shares
- The pros and cons of buying the assets

I always think that the more tools you have at your disposal, the more methods, the more strategies, the more tactics you have up your sleeve, then the more likely you are to get a good deal, and to get the deal done. That's because the more you know, the better the outcome is going to be. I think that the people who really struggle with buying a business are the people who know very little – or who think they know a lot but actually don't.

Shares or Assets?

When you buy a business you have a choice between buying the shares or buying just the assets, and knowing which is the most appropriate approach is really important. I'm going to show you the differences between them, and later we'll look at the pros and cons of both options, so you can make up your own mind in each situation whether you should be buying the shares or buying the assets.

Buying shares

When you buy shares:

- You buy everything — the good, the bad and the ugly
- You get the property lease
- You have to create completion accounts
- You have to pay stamp duty
- The legal work is more expensive
- The deal takes longer to complete

The good, the bad and the ugly

However many shares there are in the business, when you buy them, you own the company, and when you own the company you own everything in it. It’s all yours – all the good stuff, all the bad stuff – and sometimes some downright ugly stuff. We’ll look at this in more depth when we look at pros and cons.

The property lease

Most businesses operate from a property, offices or a factory or warehousing or whatever it might be. One advantage of buying the company is that the property lease automatically becomes yours. You get the lease because the lease is with the company, and that's quite a big time saver – provided you want it. If you don’t that’s that's obviously a different matter.

Completion accounts

One of the things you have to do when you buy a company is to create completion accounts, which are usually due sixty or ninety days post deal completion. They are a set of accounts showing the company as it was on the day it was sold to you. Most standard sale and purchase agreements say that the seller should compile the completion accounts and I always change this to the buyer, because I want to be in control of that process.

Completion accounts are an element of your protection, because it's very easy for the seller to overstate financials in those months leading up to completion and you only discover the true state of the financials when you own the company and you've got your feet under the desk. By identifying key figures and comparing the actual to what you were told, completion accounts can be used as a basis for either justifying or adjusting the price.

Case study

One of the deals I'm currently involved in is a share purchase and the seller – or rather, their lawyer – is avoiding my question about a sum of money that needs to be left behind in the business bank account. This is money intended to cover the corporation tax incurred between the start of the financial year and the date of completion. The business has made a profit and therefore there's going to be tax associated with that profit and that amount of tax – even though it might be estimated at this stage – needs to be left behind as it's the seller's responsibility to pay it. The completion accounts will make sure the amount they ultimately pay is absolutely to the penny what they owe.

Now, to be fair, even though completion accounts are there as a protection method preparing them is a pain. You've got to pull together some accounts based upon the previous owner's bookkeeping, which is often tragic. However, although it is a nuisance, it's a good nuisance and you can benefit from it.

Stamp duty

You have to pay stamp duty on a share purchase that involves property, although if you're buying it for a modest sum, then the stamp duty will also be modest.

Legal work

the legal work on a share purchase is more expensive – it's just the nature of the deal.

The deal

The deal typically takes longer, too – typically at least twelve weeks. You actually have to do more due diligence when you buy shares because, don't forget, you're buying the bad and the ugly as well as the good. You want to make sure that it's not too bad and it's not too ugly and if it is, then you can renegotiate the price that you're paying for the business.

Buying assets

When you buy the assets:

- You can choose what you buy
- And leave behind what you don't want — HP contracts, HMRC liabilities, etc.
- Due diligence and the deal are faster, typically less than six weeks, and the legal work is cheaper
- You will have to get an assignment of the property lease, or a new lease — this can take time

Choose what you buy – leave behind what you don't want

Say, for example, you are interested in the business because you really want the customer contracts and nothing else; you aren't likely to be interested in occupying the premises that the business operates out of and you won't want liabilities like a long property lease. When you buy the assets, you can choose what you want and what you don't want. You only buy what you want, so you can leave behind, for example, hire purchase contracts and software contracts. And, of course, you leave behind HMRC liabilities, because you're just buying the assets – you're not buying those ugly parts of the business.

Due diligence

Conducting your due diligence and agreeing the deal is typically faster because your due diligence is going to be focused on the assets, not the liabilities. It's not split absolutely equally, but you're effectively leaving around 50% of the due diligence work behind.

As an example, in our case, the key assets of the nurseries we buy are the customer contracts so we just want to make sure that there really are children in our nursery businesses and to be clear on how much they're paying and how much the local authority pays. That's just an hour's work, it's not a big deal at all. As far as the staff are concerned, when you're buying shares they stay in role, where they are, and if you're buying the assets, then the staff transfer with the assets, that's a protection staff have in the UK.

Property lease

Regarding the property that the business occupies, whether it's an office building or a factory or something else, you now have to get what's called an assignment of the property lease, or a new lease, and that typically takes longer than it would take you just to buy the assets. The reason for this is that the whole property land registry lease side of the law in the UK is archaic, and it's a very lengthy process. That assignment can take time, and a brand-new lease obviously takes even longer.

As far as the lease is concerned, what you might want to do is to take this opportunity to extend the term. In many businesses, for example a shop or a veterinary practice, the location's really important and the value of the business is partly determined by the years remaining on the lease. So if I've got a seller who's got three years remaining on the lease then that absolutely crushes their value. I'd want to talk to the landlord and say, 'Look, there are three years remaining on the lease, we'd like to extend this up to twenty years.' If they agree, we get an extension on the lease – it's called a deed of variation – of seventeen years in this example and immediately the business that we buy is more valuable because now it's got a twenty-year lease.

In practice you probably wouldn't ever want to do this because you could buy the business at a low value if there's just three years remaining, then you get an extension on the on the lease, or a brand-new lease, and now you've got a business with a twenty-year lease that you could sell to someone else for more, because it's now more valuable. The question in your mind might be, why doesn't the owner do that themselves? Well, the fact that someone's in business does not necessarily make them business-like or business-minded, and quite often people just don't know how to do something, or someone told them that it was difficult to do or it was expensive, and so they don't even try. That's where you having this knowledge gives you the edge.

Which is best?

My preference is for asset purchases, because they're faster, I know exactly what I'm buying, and it's a clean break with the past.

Businesses hide secrets and when you buy the shares you get all the secrets. You're protected in your share purchase agreement by what are called **warranties** and **indemnities.** These are designed to protect you from anything that's been hidden away. The reality is that the extent to which you can make a claim against the seller of the business is limited to the amount that you pay for the business. Let's say you're paying half a million pounds for the business, the most you can ever claim is half a million pounds and to get that you've got to go to court and be successful in your claim.

If the nasties being hidden by the business owner equate to a million pounds you're still going to be half a million pounds down, so you've got yourself a problem. Indemnities are typically pound for pound. You're indemnified against certain issues and if an issue is a ten-thousand-pound issue, then you claim ten thousand pounds back. There is a better way of doing this which is the **right of offset**. The right of offset allows you to reduce the deferred consideration by the amount of the claim. It's a bit of a grey area, to be fair, and getting it into the contract depends how on the ball the seller's solicitor is. The seller's solicitor typically wouldn't want you to include that in the contract, which is why you need to know what you're doing and to push that clause through.

You sometimes need to buy the shares to obtain licenses and accreditations, for example.

I'm looking at buying in a different sector where I need to buy the shares because the company has various government accreditations, so sometimes you have to do a share purchase even if it wouldn't be your first choice.

When buying assets it's worth getting an asset valuation by a professional valuer to ensure that you are paying at least the market value for them. This protects you from the administrator if the company from which you've bought the assets goes into administration.

A valuation might cost you £500, £600, £700 – it depends how big the company is. If you're buying a company with lots of assets then you want to get those assets valued to make sure that you're paying at least the market value and you have proof in writing from a professional valuer with all the qualifications after their name to say that you have paid the market value and this protects you from the administrator because If the company from which you bought the business assets then goes into administration, which it is likely to do because the seller has sold you the assets, they've now just got this the shell of a company with some liabilities in it, the administrator's first job will be to make sure the assets were sold correctly. When you are able to produce the valuation report the administrator goes away, job done.

I'm teaching you how to do this properly and that's exactly what you should do. I think it's fair to say that some of my private clients cut a corner there, and they are taking a risk by doing that. The worst-case scenario is the administrator unwinds the transaction with you and takes those assets back, meaning you've lost your money, you've lost your assets. However, that's unlikely to happen if you paid a fair price – no one's going to quibble over a few pounds, but it needs to be fair.

Light Bulb Moment 6

Fully equip yourself with all the knowledge you can now — as it will **save you time**, later …

You might think okay well I can learn all this stuff later when I'm actually doing it, but no. You need to make sure you're really knowledgeable beforehand, because the more knowledge you have the less time it's going to take you to do a deal. If you've got to figure out each step by trial and error it's going to take you so much longer, so being on this programme will save you a lot of time later on.

Key points

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