RESOURCES UNEARTHED

Case Study

We needed an accountant with specialised advice who could help us prepare our business for sale.

Our client owns a well-established allied services firm that develops custom software for the mining and resources industries. The business has built significant goodwill and brand awareness that recognises their Intellectual Property (IP) and capability for complex problem solving in unique circumstances. Based in Brisbane, the business services clients around the world.

The business owners are a couple, let's call them Steve (50) and Jane (52), and when we met them they were looking to their future, beyond work.

After many years of toil in developing their business Steve and Jane wanted to investigate how they might realise the potential value of their firm, implement a plan to achieve that value upon selling the business, and in doing so, maximise their retirement savings.

Steve and Jane engaged us as they recognised the complex nature of their circumstances required specialised advice that was not available from their existing accountant.

Their most pressing questions included:

- Which of five exit options would realise the optimum business value – a share sale vs asset sale; trade sale (to a firm within their industry); IPO listing, management buy-in; or a staged sale vs immediate sale approach? And, did their current business structure allow them to take advantage of those options?
- What changes were needed within the business to make it more attractive to a purchaser?
- What was the current value of their business and what needed to be done to increase that value?
- What were the likely capital gains tax and income tax consequences for each selling option?
- Could they utilise small business CGT retirement concessions to minimise tax consequences?
- What information would need to be supplied to a purchaser in the preliminary stages and then later during the due diligence stage? And
- What specific clauses would need to be included in a sale contract to ensure that they extracted the full value entitlement?

Initially Steve and Jane had set a timeline of three to five years to take advice and implement recommendations. However, an unexpected trade sale approach then led to the consideration of each question in context of that specific offer.

Overview

A trade sale offer effectively hit the fast forward button and brought Steve and Jane's concern about selling their business below market value sharply into focus. They were also concerned about how much of the sale proceeds would be left after paying tax to fund their retirement plans.

In our assessment, the key matters to be addressed to progress the sale offer were:

1. Assessing the value of the business in consideration of the price offered;

2. Aligning the interests of the seller and buyer and demonstrating to the buyer that the best tax outcome for Steve and Jane was also the preferred sale method; and

3. Applying the small business CGT retirement concessions and utilising superannuation to minimise tax consequences.

We also identified a number of requirements that needed to be actioned to create the foundation necessary for achieving those outcomes. These included:

- Adopting specific accounting policies that would maximise sales proceeds;
- Developing a methodology for calculating net working capital adjustments[1]; and
- Managing pre-completion dividends to produce a better tax outcome[2].

Our Process

The keys to achieving a successful outcome included providing Steve and Jane with a meaningful understanding of the business numbers; coordinating closely with Steve and Jane's financial adviser and lawyer to ensure all aspects of their financial and legal affairs were considered; and liaising with the purchaser's advisors to ensure they were informed of the pros and cons of each proposed selling strategy.

To work through critical decision making matters, we implemented a clearly articulated and structured process based on the trade offer document.

Our advice included:

- Recommending the sale contract be a share sale rather than an asset sale
- Presenting the historical trading figures to maximise EBITDA[3];
- Presenting clear framework to document cash-free/debt-free sale price[4];
- Recommend and document appropriate accounting policies that needed to be adopted to progress the sale
- Develop a strategy to manage pre-completion dividends.
- Evaluating and providing advice on income tax, capital gains tax and small business CGT retirement concessions; and
- Recommending mechanisms for utilising superannuation to minimise tax obligations on the sale proceeds.

[1] Working capital adjustment – If the business typically runs with $100,000 of cash for working capital and at sale it holds $150,000 the price paid would be adjusted by +$50,000.
[2] Dividends paid prior to completion of a sale to either more tax effectively or make adjustments to working capital or cash held in the business structure.
[3] (Earnings before Interest tax depreciation and amortisation)
[4] Cash Free/ Debt Free means if all cash and debt was not in the business structure the sale price is the amount offered. Ie if there was $1million of cash in the business then the price paid would be +$1million. Conversely if there was $1million of debt on the business balance sheet at sale then the price paid would be $1million less.

On Steve and Jane's behalf, we led discussions with the purchaser's accounting, finance and legal team. Our involvement throughout the sale process allowed us to consider the merit of requests and amendments raised in negotiations and convey the benefits, disadvantages or consequences to Steve and Jane. Our involvement extended to liaising with Steve and Jane's lawyer and providing advice on specific clauses when drafting the sale contract.

Importantly, our involvement enabled us to gain a clear understanding of the purchaser's requirements, allowing us to formulate responses to advance negotiations and achieve the best outcomes for Steve and Jane in a timely manner.

The Outcome

Steve and Jane received timely advice which enabled them to sell their business within 12 months, extract maximum value AND pay the minimum tax.

This was in part due to our recommendation to structure the sale as a sale of shares, and set up the appropriate framework to facilitate sale negotiations.

For Steve and Jane, enacting the small business CGT concessions meant their entitlement was significant, including:

- The standard 50% CGT discount plus an additional 50% Active Asset CGT discount;
- $1 million from the sale was contributed to superannuation with no CGT payable on the gain;
- An effective tax rate on all same proceeds of less than 7%; and
- An after-tax outcome of approximately $9.5 million.

For more information about this case study and how we, as Accountants and Business Advisors for businesses in the mining and resources sectors, can make the positive difference you need to achieve your business goals, please contact Resources Unearthed on 07 3007 2000.

Resources Unearthed is a solutions hub that provides integrated financial, business and legal services for executives, professionals and business owners in the mining and resources sectors.