Business Readiness for Sale

Tax and Corporate Finance Case Studies

Webinar

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10am – 11am

Business Readiness for Sale

Dara Kelly

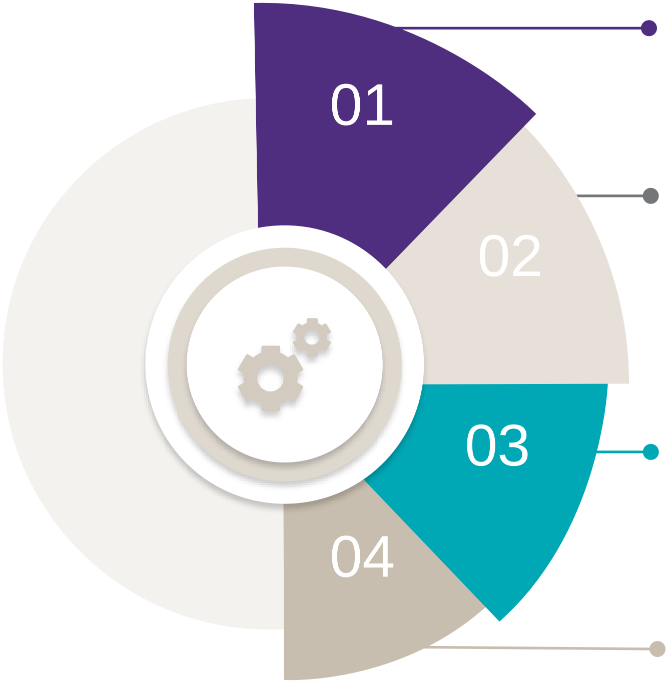
Partner, Corporate Finance

Grant Thornton

T +353 (0)1 680 5799

E dara.kelly@ie.gt.com

Vendor Due Diligence Key Outcomes



Identify early warning signs

Control of the process

Minimise Vendor disruption

Protect transaction value

The important advantages of Vendor Due Diligence

- Vendor Due Diligence should communicate the key value drivers for the business being sold, as well as dealing with likely areas of concern to prospective purchasers and their funders. Any transaction issues should be reported on in a balanced and comprehensive manner.
- Effective Vendor Due Diligence will also consider the likely investment rationale of prospective purchasers. This might include a particular focus on revenue trends.

Prospective purchasers will require comfort in numerous areas……

…..some of which might ultimately put pressure on the transaction price

- Adjustments to profit for one-off and non-recurring items
- Latest trading results and expected full year outturn
- Basis of preparation of forecasts including key assumptions
- Vulnerabilities and illustrative sensitivities to the forecasts *
- 'Normal' level of working capital including any intramonth swings
- Comfort on latest balance sheet
- Key accounting policies and robustness of systems
- Tax liabilities and risks

Effective Vendor Due Diligence anticipates and explains these areas…...

…..the timely disclosure of transaction issues can help to protect shareholder value

- Explanation of adjusted profits and cashflows
- Explanation of recent KPI trends
- Analysis of key growth drivers, cash flow and AuA
- Scenario analysis of key vulnerabilities *
- Explanation of 'normalised' level of working capital
- Assessment of balance sheet and any provisioning issues
- Assessment of systems, controls, procedures and reporting
- Report and recommendations on taxation issues

* Where required, not necessarily part of scope of VDD

Enterprise value - QoE

EV to Equity Value

$'000	FY20
EBITDA	
Reported EBITDA	1,156
QoE Adjustments	10
Adjusted EBITDA	1,166
Multiple	15.00x
Enterprise value	**17,492**
Adjustments at Dec-20	
Cash	1,589
Debt and debt-like items	(172)
Normalised w orking capital adjustment	(34)
Equity value	**18,875**

Quality of Earnings Adjustments

$'000	QoE Adj.	FY18	FY19	FY20
Revenue		628	1,230	2,248
Reported EBITDA		(257)	161	1,156
EBITDA adjustments				
Employee recruitment fee	QoE-01	-	30	-
Cost of sales	QoE-02	-	16	10
Covid-19 w age support	QoE-03	-	-	(107)
New revenue booked in YTD21	QoE-04	-	-	107
Family member expenses	QoE-05	???	???	???
Legal fees (non-trading related)	QoE-06	???	???	???
Management team leavers	QoE-07	???	???	???
Under/ over accrued staff bonuses	QoE-08	???	???	???
Discontinuation of business line/ product offering	QoE-09	???	???	???
Professional fees (one off)	QoE-10	???	???	???
Capex not capitalised	QoE-11	???	???	???
Normalisation for Senior Management/ Shareholder remuneration & pension	QoE-12	???	???	???
IFRS 16 (property leases)	QoE-13	???	???	???
Bad Debt normalisation	QoE-14	???	???	???
Total adjustments		**-**	**46**	**10**
Adjusted EBITDA		**(257)**	**207**	**1,166**
KPI:				
Reported EBITDA margin		(41.0%)	13.1%	51.4%
Adjusted EBITDA margin		(41.0%)	16.8%	51.9%

Equity value – Debt & Debt-like

EV to Equity Value

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Debt & debt-like items

$'000	Adj.	As at Dec-18	As at Dec-19	As at Dec-20
Director's loan		(5)	(0)	(20)
Intercompany loan		(10)	(10)	(10)
Client deposits		23	64	86
Adjustments to debt and debt-like items				
Income tax payable *	DL-01	n/a	n/a	55
Additional provision for income tax payable	DL-02	-	-	61
Term Debt	DL-03	???	???	???
Legacy creditors (out of terms)	DL-04	???	???	???
Related Party debt	DL-05	???	???	???
Accrued Bonuses	DL-06	???	???	???
Deferred Income	DL-07	???	???	???
Deposits/ Advance Payments	DL-08	???	???	???
Corporate Tax	DL-09	???	???	???
Credit Cards	DL-10	???	???	???
Additional Tax DD items	DL-11	???	???	???
Finance leases & hire purchase	DL-12	???	???	???
Debt & debt-like items		**8**	**54**	**172**

Equity value – Working Capital

EV to Equity Value

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Normalised working capital adjustment

$'000	FY20
Working capital at Dec-20	136
Peg - w orking capital at TTM	170
Difference over/(under)	(34)

Working capital at year end

$'000	WC adj.	As at Dec-18	As at Dec-19	As at Dec-20
Assets				
Trade receivables (net)		115	220	437
Other receivables		5	14	12
Prepayments		5	-	49
Total assets		**124**	**234**	**497**
Liabilities				
Prepaid revenue		(18)	(111)	(213)
Trade and other payables		(238)	(215)	(106)
Accrued Expenses		(10)	(5)	(59)
GST Payable		(8)	(17)	(38)
Total liabilities		**(275)**	**(349)**	**(416)**
Reported working capital		**(150)**	**(115)**	**81**
Normalisation adjustments				
Income tax payable *	WC-01	n/a	n/a	55
Legacy creditors (out of terms)		???	???	???
Related Party debt		???	???	???
Accrued Bonuses		???	???	???
Deferred Income		???	???	???
Deposits/ Advance Payments		???	???	???
Credit Cards		???	???	???
Bad Debt provision normalisation		???	???	???
Normalised working capital		**(150)**	**(115)**	**136**

Tax Issues

Brian Cronin

Associate Director, Tax
Grant Thornton
T +353 (0)21 245 8839
E brian.cronin@ie.gt.com

Discussion topics

1. Opportunities and pitfalls
2. Maximisation of reliefs
3. Treatment of and access to cash in companies.
4. Disposals by non-residents

Opportunities and pitfalls

Participation exemption

Mary is a serial Entrepreneur. In 2016 she established a Software Company with seed capital of €0.5m. The company is the 100% subsidiary of a Holding Company in which Mary is the 100% shareholder.

In 2021 Mary receives an offer of €5m for the trading company + an earn out of 25% of EBITDA over the next 5 years.

Opportunities and pitfalls (cont.)

- Hold at least part of shareholding through a holding company from the start.
- No CGT on disposal by corporate shareholder on disposal of shares in trading subsidiary where 5% shareholding held for more than 12 months.
- More difficult to implement structure when sale is close
- Stamp duty cost?
- Bona fide issue re reorganisation on insertion of Holding Company
- May not be able to meet 12 month criterion.
- Does the company derive its value from Irish land and buildings?

Opportunities and pitfalls (cont.)

- Can the Holding Company avail of the participation exemption?
- *Marren v Ingles*

  "*where future consideration is wholly uncertain in amount and not merely subject to contingencies, the amount that has to be brought into account on the making of the disposal is the value of the right to receive the future consideration and the right itself is treated as a separate asset for CGT purposes which is the subject matter of a separate disposal when the future consideration is paid, giving rise to a chargeable gain/allowable loss as the case may be".*
- The earn out payment is in respect of the right to receive a sum rather than in respect of the disposal of shares therefore it would appear that participation exemption does not apply.
- The future consideration on the earn out must be estimated.
- A loss may become stranded in the company.

Opportunities and pitfalls (cont.)

Possible solution – place a ceiling on the potential size of the earn out.

- *Marren v Ingles* does not apply as the consideration if not wholly uncertain.
- Tax on full amount payable upfront with possibility of a refund. No issue where participation exemption applies.
- Impact on other shareholders?

Maximisation of Reliefs

John owns a profitable widget manufacturing company. He has worked hard for many years and is now looking to transfer sell the business to his niece. He is 54 years of age.

- Participation Exemption?
- Entrepreneur Relief?
- Retirement Relief?
- Where a holding company and a sale to his niece are implemented before he reaches 55 it may be possible to avail of all three by claiming Entrepreneur relief before he is 55.

Maximisation of Reliefs (cont.)

- Possible pitfall
  - *Section 135(3A)* –

    where a close company *enters into arrangements directly or indirectly with another close company …..whereby a member…….. of the first-mentioned company disposes of an interest in shares or securities of the first-mentioned company and the consideration for the acquisition of those shares or securities is paid or to be paid directly or indirectly out of the assets of the first-mentioned company.*

  - Capable of very wide application.

  - Even where outside finance is being acquired important that the target company gives no assistance to the acquirer in obtaining finance by way of security etc. until the deal is complete.

Treatment of and access to cash in companies

Tom has been manufacturing widgets for many years and his company makes significant profits.

As Tom lives a modest lifestyle rather than pay tax on salary or dividends he has allowed cash to build up in the company.

He now wishes to transfer the company to his children.

Treatment off and access to cash in companies (cont.)

Effect on business relief and entrepreneur relief

01

Section 100(2) CATCA

An asset is an excepted asset in relation to any relevant business property if it was not used wholly or mainly for the purposes of the business concerned throughout the whole or the last 2 years of the relevant period

Revenue may argue that some or all of this is surplus cash which is not in use for the purposes of the trade thereby reducing entitlement to business relief.

02

Section 93 CATCA

A business carried on by the company consists wholly or mainly of one or more of the following, that is, dealing in. currencies, securities, stocks or shares, land or buildings, or making or holding investments is not relevant business property.

Is holding cash a business. On current account? On deposit account?

Could lead to the whole value of the company being disallowed for business relief purposes.

03

Entrepreneur Relief

“qualifying business” means a business other than - the holding of securities or other assets as investments

Treatment off and access to cash in companies(cont.)

Dealing with cash balances

- Reducing cash balances
- Identify true working capital requirement
- Pay cash into Holding Company?
- Back fund occupational pension scheme
- Pre sale termination payment
- Transfer trade to NewCo leaving cash behind (bona fide requirements etc.)

Disposals by non-residents

Brian has run a profitable financial advisory company for many stressful years.

At age 60 he retires and moves to Portugal.

The company continues to trade profitably without him but now he wishes to sell his shares.

Disposals by non-residents (cont.)

- An individual who is non resident and non ordinarily resident is usually only liable on gains from specified assets.
- Non domiciled individuals – remittance basis.
- Section 29A - Exit charge where an Irish domiciled individual disposed of 5% shareholding worth at least €500,000.
- Applies unless the individual has been out of the Irish tax net for at least 5 years prior to return.
- Interaction with Tax Treaties
- Principal Purpose Test

Thank you

Any questions?