



Asset & Share Purchase Agreements

By

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This is a general overview of the subject matter and should not be relied upon as legal advice or opinion. For specific legal advice on the information provided and related topics, please contact the author or any member of the Mergers and Acquisitions Group.

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ASSET & SHARE PURCHASE AGREEMENTS

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ASSET & SHARE PURCHASE AGREEMENTS

➤ **Article focused on CFO**

- ▶ Given my experience as a partner in conventional law firms and at a “big 4” accounting firm I can attest that they are equally relevant to counsel in Mergers & Acquisitions transactions
 - *independence and objectivity*
 - *identify issues that may have been missed*
 - *more frequent access to “deal flow” and new developments*

ASSET & SHARE PURCHASE AGREEMENTS

Why Share or Asset Acquisitions work (M&A)

- ▶ consolidation
 - *Economics of scale*
- ▶ gaining broader market share
- ▶ satisfying need for growth
- ▶ buy vs. build
- ▶ regulatory change/impact
- ▶ divestiture of non-core businesses
- ▶ effective due diligence
- ▶ independent financial review
- ▶ management of material contracts/lack of same

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Why Share or Asset Acquisitions don't work

- ▶ Overpayment
 - *synergies slower to develop*
 - *stock price retreats*
 - *unreasonably high confidence in unproven "blue sky"*
 - *unjustified assumptions*
 - market penetration
 - available synergies

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- ▶ Overpayment, continued
 - *expensive financing*
 - disconnect between operational results and debt repayment obligations
 - *poor due diligence*
 - operational
 - financial
 - material contracts
 - latent liabilities/obligations
 - *continuity of management, staff, suppliers, customers (bid lists) etc.*

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Due Diligence, Covenants, Representations & Warranties

- ▶ each designed to :
 - *minimize risk*
 - *facilitate closing*
 - *afford remedies to each party*

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Areas of Focus

▶ Financial

- *accurate recording of revenue*
 - recorded too early
 - services/products still due
 - exchange for non-cash consideration
 - one time transactions
 - reduction of debt/not real revenue

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▶ Financial, continued

- *accurate recording of expenses*
 - improperly capitalizing expenses
 - extended amortization/depreciation
 - carrying impaired assets/inventory
 - failure to record liability/obligation upon receipt of funds (e.g. up front franchise or license fee)

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▶ Labour & Employment

- *employment contracts with senior management, middle management, employees*
- *actual or carried severance obligations (Labour Standards & common law) effect of share sale vs. asset sale*
- *exposure to existing or anticipated union activity/demands*
- *pension obligations*

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▶ Tax Matters

- *potential tax exposure – share sale indemnification, clearance certificates, advance rulings*
- *GST, PST exposure – asset sale indemnification*
- *CPP, EI, Workers Compensation – current liabilities and future obligations/rate increases post closing*

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▶ Material Contract Issues

- *continuing vs. terminated at or prior to closing*
- *conflicts with acquirers current contracts*
- *adjustment/allocation of in-process contracts*
- *change of control or assignability clauses—
impact, consent, rights of first refusal*

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▶ Regulatory Considerations

- *approvals* – e.g. Competition Act, industry specific regulators e.g. CRTC, operating business authorizations/permits/licenses
- transferability – share vs. asset sale
 - *qualification of purchaser*
 - *approval period*

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▶ Insurance

- *adequacy – insurance advisor/broker*
- *transferability*
- *outstanding or intervening claims*

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Purchase Price

- *generally (i) balance sheet based formulations or (ii) earnings based formulations*
- *balance sheet approach focused on net book value of business (or underlying assets) less redundant assets retained by Vendor plus, if agreed, value of intangibles such as goodwill*
- *earnings based approach usually an agreed multiple of EBITDA less long term debt or equivalent e.g. capital leases, etc.*

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▶ Purchase Price, Continued

- *Balance Sheet approach requires attention to all material items i.e. inventory (valuation)*
- *Earnings approach must still consider balance sheet*
 - all items needed to generate earnings
 - » *working capital, machinery, repair & maintenance*

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▶ Purchase Price, Continued

- *Interim Operation Covenants (Positive and Negative)*
 - necessary for interval to obtain financing, third party consents and regulatory approvals
 - operate business in normal course
 - maintain assets as prudent owner
 - not incur unusual obligations/liabilities
 - seasonal adjustments in some cases

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▶ Earn Outs

- *extension of interim operation*
- *addresses failure to agree on fixed purchase price*
- *still all the considerations of balance sheet or earnings based formulation*
- *positive and negative covenants*
- *cap or floor?*
- *acceleration on the occurrence of material events*

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- ▶ Representations and Warranties
 - *Ludmer's Top 25*

Questions?

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