ASSET SALE OR STOCK SALE?

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Asset Sale or Stock Sale?

There are two main ways of selling your business, either an asset sale or a stock sale. So what is the difference between the sale of assets and the sale of stock? Basically, selling of assets involves a transaction where assets are sold along with agreed liabilities. The selling of stock is the transfer of ownership of the business.

Both the seller and the acquirer need to think through the trade-offs between each of these two types of transaction. So first we will first take a look at the key differences between the two transactions and then highlight the pros and cons of each.

Key differences between asset and stock sale

- In a stock sale there is a transfer of ownership of the business to the buyer, which includes all the assets and liabilities, whereas the asset sale is only selling the chosen assets and liabilities.
- The asset purchase transaction is relatively simple compared to a stock purchase
- Transfer tax needs to be paid in asset purchase, but not in stock purchase
- When intangible assets, such as goodwill, amortization is calculated as a straight line over 15 years, giving tax benefits that cannot be gained in a stock sale. There are also tax deductions on depreciation of tangible assets.

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Asset Sales

As stated above in an asset sale the acquirer can choose specific assets that they want to buy along with the liabilities. They can then use these assets to set up their own business or they can become part of an already existing business. The seller continues to own their business and carries on running it with the unsold assets and liabilities.

Assets can include equipment, licenses, goodwill, customer lists and inventory. Net working capital is normally included; this comprises, for instance, accounts receivable and payable.

Depreciation on the fixed assets and amortization of intangible assets reduces taxable income into the future. The seller has a tax disadvantage as ordinary income of the gains on the assets is taxed higher than capital gain. For tangible assets with a short depreciation process, such as equipment there is a higher value. For assets with a slower amortization, such as goodwill there is a lower value. The gain that the buyer gets through tax reduction is normally approximately equal to the loss of the seller through increase in tax.

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Advantages

• Flexibility for the buyer to buy only those parts of the company that they want and to only take on the liabilities they are happy about.

• There is less need to carry out so much due diligence as there is a limited amount of liabilities associated with the specific purchase made.

• If the purchase price is higher than the tax basis of the assets, the buyer can' step up' the basis and get tax deductions for depreciation and amortization.

• Amortization of goodwill can be worked out over 15 years, along with tax deductions rather than waiting for it to be sold for tax deductions.

• Avoids the problem of shareholders being unwilling to sell their shares

Disadvantages

• The buyer will normally need to renegotiate contract with customers and suppliers

• The purchase price may be higher as the seller has to cover the cost of higher taxation.

• There is a need for renegotiation of employee agreements.

• When you change the ownership of an asset, it needs to be re-titled

• Assets that are not sold will need to be liquidated and liabilities paid off etc. by the seller

• Higher tax for the seller as ordinary income of the gains on the assets is taxed higher than capital gain.

Stock sales

Stock sales are in general simpler and less complex than an asset sale. The stock of the business is bought as is, with both assets and liabilities. Contracts including leases and permits normally do not need to be remade and transfer over automatically.

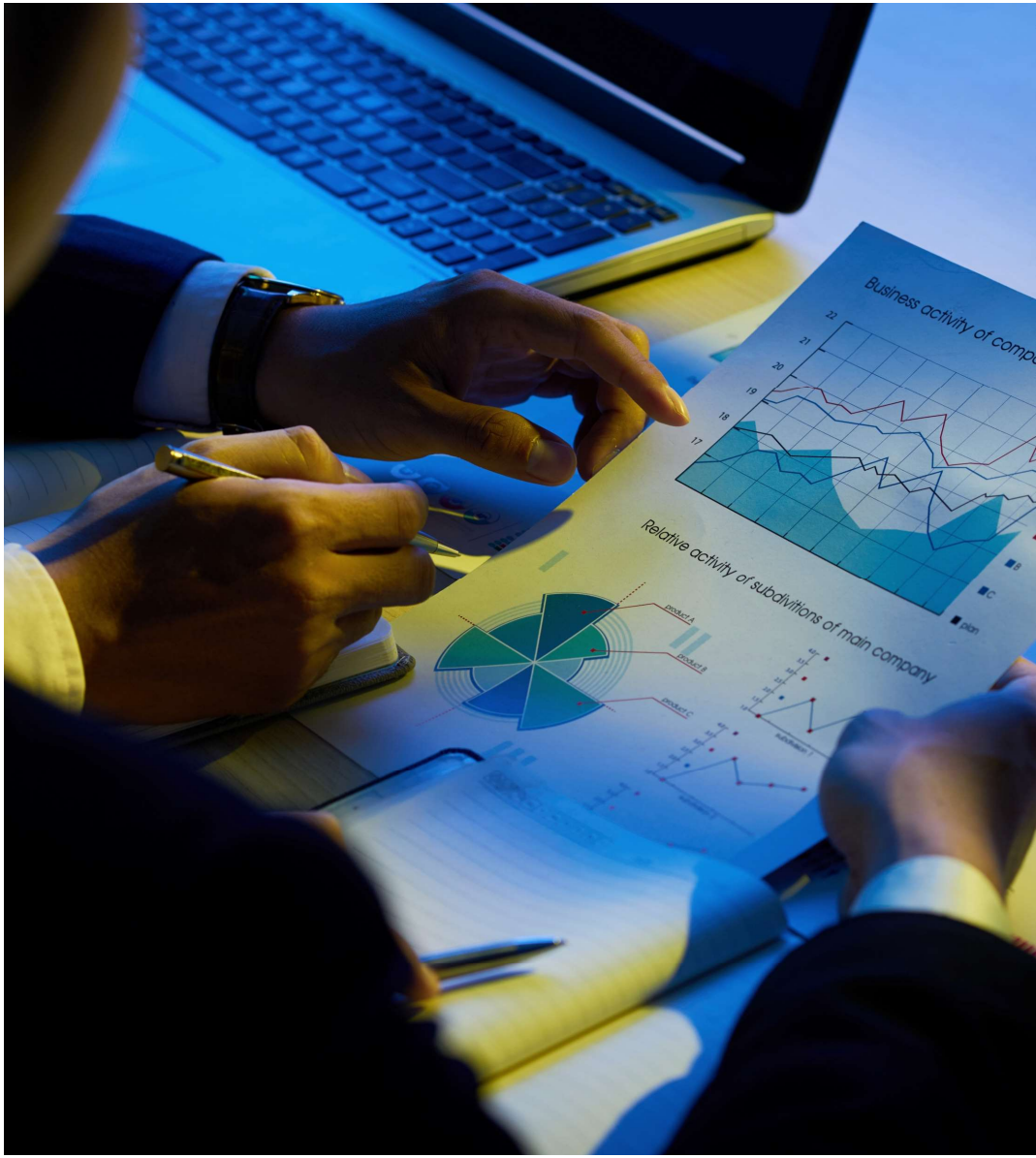
Since equity is treated as capital gain, it usually receives a lower tax rate so in the case of a stock sale the tax advantage goes to the seller.

Advantages of a Stoke Sale

- Individual assets don't need to be revalued nor do they need to be re-titled
- Licenses and permits are usually transferred over
- No transfer taxes
- Simpler transaction

Disadvantages of a Stock Sale

- The buyer does not gain from the 'step up' tax
- There is not choice for the buyer, all assets and liabilities are part of the deal, although other agreements can be made where the seller buys liabilities back.



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➢ Shareholders may not want to sell, which can prolong the process and increase the price.

In making a decision about whether to go for an asset purchase or a stoke purchase, the acquirer should think about the purpose of the acquisition and the type of company they are acquiring. If the business has a lot of liabilities compared to assets, a stock purchase is better. However, for a company with a lot of liabilities, but also assets which are valuable to the buyer, an asset purchase will be more beneficial over the long term.

In summary, there are various considerations to bear in mind concerning the type of sale made, whether it be an asset sale or a stock sale. These can affect the buyer and seller alike. Both parties need to look at the trade-offs between the various options and negotiations should be carried out to get the deal that brings the best benefits to both sides. These negotiations are best carried out with the help of a professional advisor who has experience in these transactions and can help structure them most favourably for all concerned.

Our M&A Process

TARGET APPRAISAL	APPROACH	DUE DILIGENCE	NEGOTIATION & CLOSE	POST MERGER INTEGRATION (PMI)
Key Areas				
▪ Target & market analysis; ▪ Initial assessment of synergies & value drivers; ▪ Indicative valuation; ▪ Go or No-Go decision; ▪ Preparation of transaction documents (NDA – Non-disclosure Agreement/LOI-Letter of Intent); ▪ Select Transaction team; ▪ Appoint advisors; ▪ Consider funding ability.	▪ Initial approach letter; ▪ Signing of NDA; ▪ Prepare & share initial information requests; ▪ Formulation of LOI (Letter of Intent) & possible negotiations; ▪ Initial meeting and Q&A; ▪ Circulate information on the Target to the Transaction team.	▪ Set scope of due diligence; ▪ Set up VDR (virtual data room); ▪ Coordinating of due diligence, further meetings and Q&A sessions; ▪ Consider points relevant to the Post-Merger (PMI) phase;	▪ Revisit indicative valuation & prepare detailed valuation based on due diligence findings; ▪ SPA negotiations with the seller; ▪ Development of final structure (share/asset deal) and final valuation; ▪ Approvals; ▪ Signing of SPA & Close.	▪ Consider the extent of integration; ▪ Development of 100 Day PMI Plan; ▪ Consider short & long term objectives; ▪ Estimate requirements to capture synergies; ▪ Determine resource needs & optimal allocation.
Parties Involved				
▪ CFO; ▪ Head of M&A; ▪ Accountants; ▪ Corporate finance advisors; ▪ Consultants.	▪ Senior management; ▪ CEO, CFO, CTO; ▪ Strategy director; ▪ Head of M&A; ▪ Head of Business Development; ▪ Consultants.		▪ Company general counsel; ▪ Lawyers; ▪ Senior management.	▪ Company general counsel; ▪ Lawyers; ▪ Senior management/HR.


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