

Business Update:

Buying a Business - Initial Steps & Considerations

Whether you have decided to acquire a business in order to complement and expand an existing business or branch out into a new market, there are a number of issues to consider when deciding whether a particular target business is a good fit.

Preliminary Considerations

Key issues to consider when assessing the suitability of a target business include:

- How easy will it be to integrate the target business with your existing business?
- Are there any directors or employees of the target business whose retention post acquisition is crucial to the success and growth of the target business?
- Will you be able to accommodate the target business employees in your existing premises or will you need to acquire some or all of the premises of the target business?
- If the premises of the target business are required, what condition are they in and will landlord's consent be required?
- Are the internal compliance procedures of the target business similar to your own?
- How different are the terms of employment of the employees of the target business (including the level of benefits, such as pension contributions) to your own?
- Is the client base of the target business compatible with your own client base and are you confident that there will be little or no client leakage resulting from the acquisition?
- How easy will it be to merge the IT system of the target business with your current IT system and will you require any post-acquisition IT support from the seller to assist with the integration process?

Due Diligence

You may have been given certain initial information about the target business in order to make a decision to submit a "subject to contract" offer for the target business. However, prior to entering into any binding agreement, you will need to gain as much comfort as possible that the initial information is, in fact, correct and that there are no other facts (as yet undisclosed by the seller) that might affect the terms upon which you are prepared to acquire the target business or, ultimately, whether or not you are prepared to proceed with the acquisition.

Whilst a seller may be reluctant to provide any access to the premises of the target business prior to the sale taking place, this position is undesirable and should be resisted. Provided that an appropriate confidentiality agreement is put in place, and the purchaser's advisers are instructed as to the sensitive

nature of the acquisition, there is no reason why a reasonable level of due diligence should not be conducted on the target business without breaching the seller's requirements for confidentiality.

At the very least, a prospective purchaser should have an opportunity to consider the following in respect of the target business:

- detailed financial information to back up any initial pre-offer information provided;
- terms and conditions of employment (including details of any pension arrangements);
- terms and conditions of engagement of clients and standard documentation used;
- access to client files;
- full information concerning the regulatory position of the target business;
- if premises are being acquired, the documentation relating to the occupation of the premises;
- copies of all compliance manuals, office manuals, internal procedures and the like;
- statutory records of all target companies being acquired;
- IT system details, together with the terms of any third party software licences;
- details of any intellectual property rights (including trade marks and domain names) used by the target business; and
- other matters specific to the nature of the business being acquired.

Valuation and Deal Structure

The valuation of a target business and the deal structure proposed for an acquisition (including the amount and timing of any consideration payments and whether you buy the company that carries on the target business (i.e. a share purchase) or whether you buy the assets comprising the target business (i.e. an asset purchase) are interrelated and should be considered together in conjunction with your legal and tax advisers.

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Heads of Terms

At the point where you shake hands on the deal, you may be asked to sign “heads of terms” (a basic summary of what has been agreed). This can be a useful tool, not only to remind the parties what they had previously agreed when they became heavily involved in the negotiations, but also to assist the lawyers in preparing the transaction documentation.

It is essential from both parties’ perspectives, however, that it is clear that this document is “subject to contract” and not legally binding. Without this caveat being included, the purchaser could be bound to buy, or the seller bound to sell, the target business (on the terms set out in the heads of terms) even before the due diligence has been conducted and both parties are satisfied with the legal documentation prepared.

With the best will in the world, it is not possible to include everything needed in the heads of terms and, even if it were, both parties should have the opportunity to reflect upon this once they are in a position to know exactly what they are buying or the terms upon which they are selling and having had the benefit of taking legal advice.

Summary

When looking at a potential target business, consider its compatibility, both in terms of size and culture, with your existing business and how you will “fit them together”. Find out as much about the target business as soon as possible before entering into any legally binding contract, and don’t bind yourself to buy the target business until you, and your professional advisers, are comfortable with the deal made.

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Please note that this guide is intended to provide an introduction to the Isle of Man and the possibilities that exist for establishing various types of structure in the jurisdiction. It seeks only to give the reader an overall view of the subject and is not a substitute for specific advice.

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