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GUIDE 7: TYPICAL DEAL STRUCTURES

Between all the headlines and emails promising great riches, there are a few simple principles that can serve as useful tools to help determine what's actually being offered and why. Here are some pointers:

Components of a deal

- Initial consideration – the amount to be paid at completion.
- Deferred consideration – the amount to be held back and paid out after completion.
- Cash vs equity – the proportion of either initial or deferred consideration, to be paid in either cash or equity of the acquiring firm (or an associated legal entity in their group).
- Risk management mechanisms - indemnities and commercial warranties and the conditions and potential consequences attaching to them.

Typical combinations

- Earn-out – an initial payment and a series of deferred payments based on the future performance of the acquired business, once owned by the buyer. Adjustments to deferred consideration can be down only (vs forecast), or down and up. The initial payment can sometimes be adjusted such that the entire consideration is based on future performance. These structures are typically used by consolidator firms.
- Fixed consideration – an initial payment and a series of deferred payments, based on an agreed price and terms and only altered where indemnity or warranty claims are successfully made.
- All initial – rarely used for anything other than a distressed sale, where the seller must sell and the level of urgency is reflected in the terms. The price is generally a fraction of the open market value, were the circumstances different.
- All deferred – no initial consideration and the entire consideration paid over a number of years after the deal completes. These are typically earn-out structures with upside included to compensate for the lack of initial consideration.
- Staged sale – sometimes used in internal situations, but rarely used by third parties due to the challenges associated with owning multiple (often minority) stakes in different businesses and the control issues that go with it.

Factors to consider

- Fit – if there are strong similarities between the two firms, there is less requirement for structure.
- The objective – as a seller it is vital to remember what you are trying to achieve from the sale of the business and negotiate accordingly.
- Cash- the more of it you have available, the better.
- Indemnities and warranties are legitimate tools to manage inherent risk, but they should be proportionate to the possible risk. If they appear onerous, the buyer may view risk in a different way to you. Investigate further, as fit may not be good in this situation.
- Much of the value in financial advice firms exists in intangible assets, like the goodwill inherent in the relationships the advisers have with clients. Buying a legal asset, doesn't necessarily secure that goodwill, so buyers will need to manage risk. That said, some deal structures can be appear onerous and this is often the reason.
- A high headline price, with excessive structuring, can lead to a worse outcome, than a lower headline price with limited structure.

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