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Building and extracting the maximum value from your business

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David Montani
National Tax Director

Vito Interlandi
Managing Partner, Melbourne

Bruno De Simone
Senior Manager, Melbourne

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Introduction

- Pandemic delayed planned business exits, in particular:
  - Baby Boomers (≈59 yrs+)
  - Elders of Generation X (up to ≈58 yrs)
- Critical factor in maximising exit value: Time
  - Exit/succession ready
  - Tax planning
- Exit planning relevant at any stage in business lifecycle

Nexia Australia Corporate Advisory

Vito Interlandi
Managing Director, Melbourne

t (03) 8613 8888
e vinterlandi@nexiamelbourne.com.au

Bruno De Simone
Senior Manager Corporate Advisory, Melbourne

t (03) 8613 8888
e bdesimone@nexiamelbourne.com.au

Brent Goldman
Corporate Finance Partner, Sydney

t (02) 9251 4600
e bgoldman@nexiasydney.com.au

Hugh McPharlin
Partner – Forensic Accounting, Adelaide

t (08) 8139 1130
e hmcpharlin@nexiaem.com.au

Evelyn Tan
Director of Corporate Finance & Advisory, Perth

t (08) 9463 2463
e evelyn.tan@nexiaperth.com.au

Graeme Andrews
Principal - Management Consulting and Litigation Support, Canberra

t (02) 6279 5400
e gandrews@nexiacanberra.com.au

Grant Sawford
Director of Business Advisory, Brisbane

t (07) 3229 2022
e gsawford@nexiabrisbane.com.au

Noel Clifford
Partner – Audit and Assurance, Darwin

t (08) 8981 5585
e nclifford@nexiaem.com.au

Today's session

- Components that drive a business's value
- Compounding effect of small improvements in each component over time
- Different types of business exits
- Exit/sale/transition process
- Sell the assets or sell the company?
- Pre-sale restructuring
- Tax planning
- Maximising the after-tax sale proceeds

Components That Drive Business Value

What Drives Value?

- Cash Flow
- Profitability
- Market Position/ Competitive Advantage
- Strong Management Team
- Customer Base
- Barriers to Entry
- Proven Track Record

Valuation Methodologies

Valuation Approaches

- **Income Approach**
  - Discounted Cash Flow Method
- **Market Approach**
  - Capitalisation of Future Maintainable Earnings
- **Asset Approach**
  - Orderly Realisation of Assets and Liquidation Value

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“Normal” Earnings

- Consistent accounting policies in line with internationally accepted policies;
- Elimination of unusual transactions or one-off revenue/ expenses; think COVID!
- Excessive owners' remuneration or, conversely, inadequate owners' remuneration;
- Funding costs;
- The depreciation policy and whether it correctly reflects asset consumption.

The Value Equation

Market Approach

EBITDA × MULTIPLE = (EV – NET DEBT) – TAX – WARRANTIES = EVENTUAL PROCEEDS

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Compounding Effect of Small Improvements

How Do We Maximise Value?

- Cash Flow
- Profitability
- Market Position/ Competitive Advantage
- Key Person Risk
- Strong Management Team
- Customer Base
- Agreements and Relationships

The Roadmap to Success

- Business Appraisal
- Business Plan – Now / Where / How
- Budget
- Monitoring Goals and Objectives
- Sale Ready

Benefits of Small Improvements

	Base Case	Improvement
EBITDA	$1.0m	$1.1m
Multiple	4x	4x
Enterprise Value	$4.0m	$4.4m

- Increase in Revenue
- Increase in Gross Profit Margins
- Reduction in Overheads

Benefits of Small Improvements

	Base Case	Improvement
EBITDA	$1.0m	$1.0m
Multiple	3.75x	4x
Enterprise Value	$3.75m	$4.0m

- Decrease in working capital
- Better contract terms or customers
- Gaining market share
- New technology
- Strong management team
- Strong or exclusive supply agreements.

Types of Business Exits

Common Exit Options

- Trade Sale – Sale of Business or Shares/ Units
- Management Buy Out
- Family Succession or a partial sale
- IPO
- Liquidation / Deregistration

Exit, Sale & Transition Process

- Sale Ready, Marketing Materials, Transaction Team & NDA
- Identify and Secure Buyer
- Execute Non-Binding Indicative Offer (NBIO)
- Due Diligence (Financial, Tax & Legal)
- Purchase Agreement (including Warranties)
- Deal Close, Transition Period / Earnout

Taxation considerations

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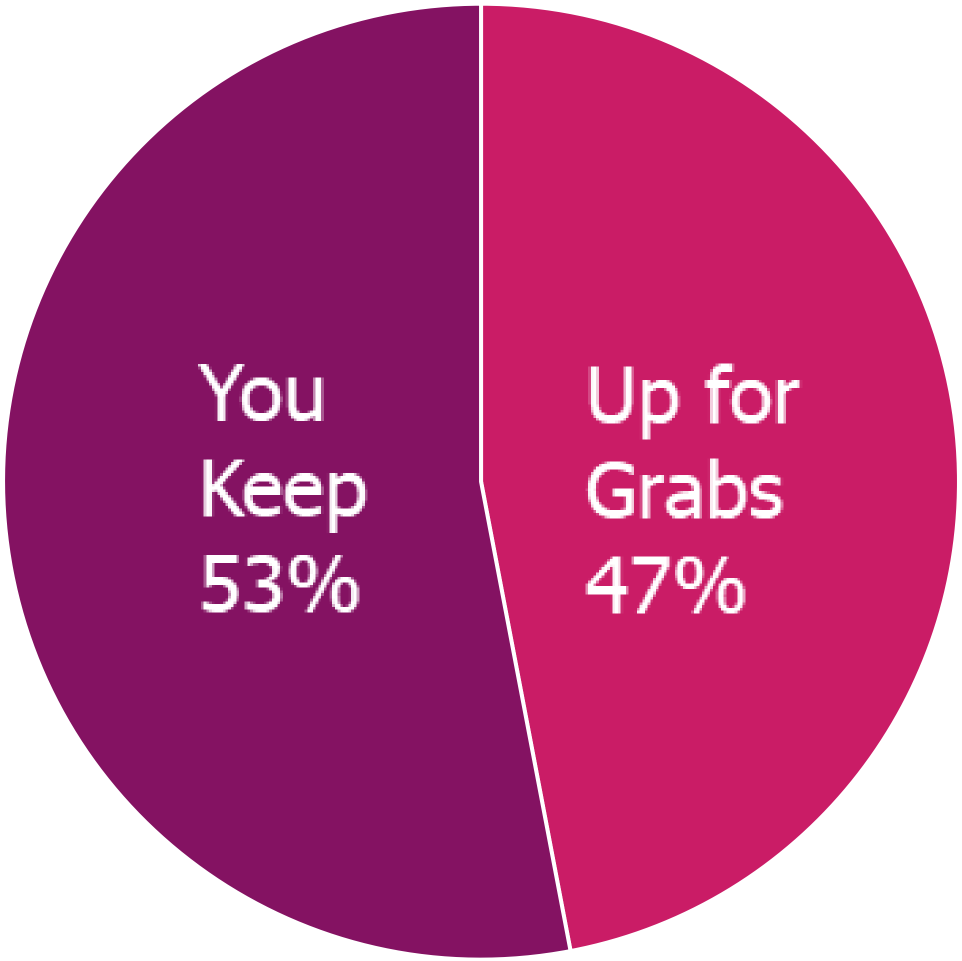
Tax concessions

- 50% general discount
- Small business CGT concessions
- Number of taxing points
  - Single?
  - Multiple?
- Pre-CGT (pre-20 September 1985)

Tax impost

0% – 47%

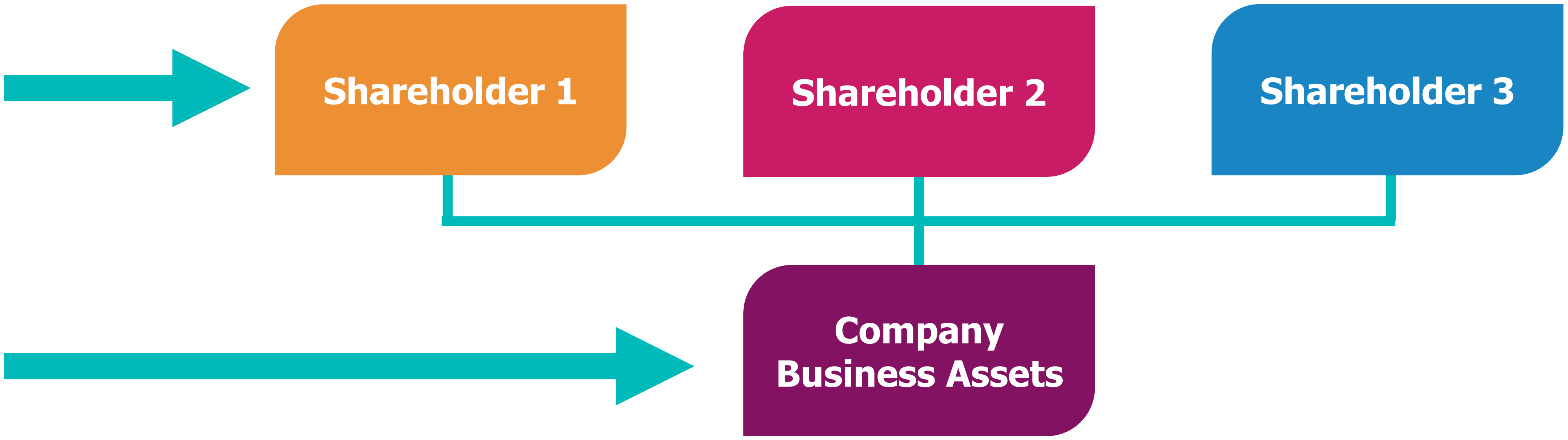
- Concessions have numerous qualifying conditions
  - Just before sale
  - Years leading up to sale
- Integrity rules
- $4 million x 47% = $1.88 million



Sell business assets or the company?

Sell business assets or the company?

- Sell here?
- Or here?



- Which will maximise the after-tax cash left in your hands?

Sell business assets or the entity?

- Unit trust
  - Sell units might be feasible
- Discretionary trust
  - Sell assets is only option

Sell business assets or the company?

- Which will maximise the after-tax cash left in your hands?
- Sale of company tends to achieve better result
  - But cannot assume will
- Model outcomes of each option
  - Two modelled piles of cash
- Seek to negotiate sale structure based on bigger one

Company sells business assets

- No 50% CGT discount
- Small business CGT concessions
- Extraction from company
    - Additional taxing point

Sell business assets
Allocation of sale price

- Capital gain on goodwill:
  - Might be reduced by concessions
- Gain on depreciating assets:
  - No concessions
  - Taxed at full rates
- Tax law generally does not interfere with outcomes from parties dealing at arm's length
  - Cautionary tale

	More allocated to:	Less allocated to:
Seller wants…	Goodwill	Depreciating assets
Buyer wants…	Depreciating assets	Goodwill

Transfer duty

- Still imposed on purchases of business assets:
  - QLD, WA, NT
  - ≈5% business value
- Incentive for buyer to buy company/unit trust

Sell the company

- Sale at shareholder level
- Possible pre-sale dividend
- Prepare the company, eg:
  - Remove non-business assets
  - Clear loans to/from related parties
  - Tax consequences

- Has company made an Interposed Entity Election?

Pre-sale restructuring

Pre-sale restructuring

- Separate part of business not being sold
- Not 100% sale – some owners staying on
  - Existing structure acceptable to incoming equity holders?
- Remove non-business assets
- Pre-sale dividend

Pre-sale restructuring

Where results in qualifying for a tax concession

- Discover after sale – too late
- Discover/act shortly before sale – anti-avoidance risk
- Discover/act well before sale – minimise risk

Other issues

Pre-CGT business

- Acquired/started before 20 September 1985
- Do not assume still has pre-CGT status
- Can be lost
  - Changes in business nature or character
  - Changes in ultimate owners
- After 38+ years, increasing risk

GST
Sell business assets

- GST-free?
  - Do not assume so
- Seller’s risk
- Claw-back clause

Pre-lodgement agreement

ATO

- Engage with ATO before sale, or before lodgement
- Confirm tax treatment
- Provides practical certainty
- Virtually eliminates any likelihood of being selected for review

Looking ahead for concession-ruiners

Key tax concession-ruiner

Time

- Primarily:
  - 50% discount
  - Small business CGT concessions
- Some qualifying conditions satisfied over time. Eg:
  - Active asset test – up to 7.5 years
  - 15-year exemption – 15 years+

Key tax concession-ruiner

Time

- If time-based condition not met before sale:
  - Too late
- Identify in advance
  - Mitigating action

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Business Concession Review

- Suitable anytime in business lifecycle
- Identify currently present concession-ruiners. eg:
  - Legal/equity structure
  - 50% discount
  - Small business CGT concessions
  - Pre-CGT status
- Asset protection
- Non-business asset extractions

[Business Concession Review]

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Ideal timing

- Tax advice – before sale/transaction
- Groom business for sale – 2 years minimum
- Business Concession Review – anytime (ie, now)

Pre-submitted questions

Conclusion

- Allow more time to maximise value
- What improvements can I make today?
- What will my exit look like?
- Exit options to suit circumstances
- Sell assets vs sell shares
- Pre-sale restructuring
- Look ahead for tax concession ruiners

Talk to your trusted Nexia Advisors

Vito Interlandi
Managing Director, Melbourne

t (03) 8613 8888
e vinterlandi@nexiamelbourne.com.au

Bruno De Simone
Senior Manager Corporate Advisory, Melbourne

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