M&A TRANSACTIONS

Winning wisdom garnered from the Cavs for corporate buyers

BY JAYNE E. JUVAN AND ILIRJAN PIPA

The hottest deal in Ohio last year occurred when Dan Gilbert signed LeBron James, the most sought after free agent in the NBA, to the Cleveland Cavaliers. Similar to the NBA, in today's marketplace, the competition is intense for the best corporate deals. The availability of cash, low interest rates and overall positive economic conditions have contributed to the return of numerous bidders. What, then, can corporate buyers learn from the deal Gilbert and James struck that will help them close on an enviable transaction that everyone will be talking about for years to come?

JUVAN

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CONSIDER CONTRARIAN APPROACHES

Gilbert and James were both buyers — Gilbert added James to his roster, and James bought into the team and Cleveland. James took a contrarian approach, knowing that the path to a championship could be more difficult with the Cavs. But winning in Cleveland, a city with a 40-year drought, could cause James to be recognized as an all-time great who helped turn a city around. Similar to James, when looking at targets, buyers should review the whole range of options — the obvious opportunities others are chasing, but also those less popular with hidden potential. Taking the path less traveled can lead to the greatest victory in the end.

DON'T LET THE PAST DERAIL THE FUTURE

After James announced his "Decision," Gilbert expressed bitter disappointment in an open letter. The two could have allowed their egos and emotions to get in the way of a new deal, but they put the past behind them. Corporate negotiations can also become heated, but parties should avoid letting insignificant disputes get in the way of a major breakthrough.

MAXIMIZE ECONOMIC VALUE

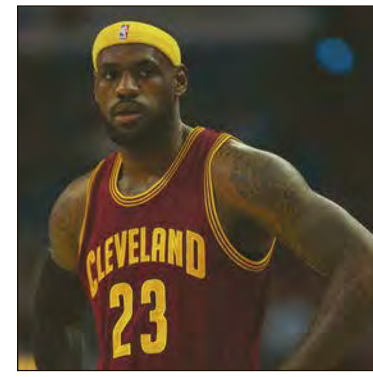
James struck a two-year deal because a future television contract could increase the maximum value of players' contracts. Similarly, buyers should consider pricing structures that mitigate risk and maximize benefit. For example, when parties do not agree on economics, buyers can negotiate earn-outs (contingent post-closing payments). With an earn-out, sellers could capture additional purchase price post-closing, but buyers only pay if the target achieves agreed-upon financial goals.

CRAFT A MEMORABLE DEAL ANNOUNCEMENT

James used his "I'm Coming Home" announcement not only to inform the public of his decision, but as an opportunity to tell a compelling story to win hearts and minds. Corporate buyers should likewise use announcements to communicate their vision for the target and gain buy-in from the marketplace.

BEFORE THE INK DRIES, FOCUS ON THE TEAM'S DYNAMICS

Getting to closing is difficult, but ensuring post-closing performance is aligned with expectations can be even harder. Cleveland hyped the first game with James, but the Cavs lost and experienced a four-game losing streak not long thereafter. Similarly, integrating corporate cultures can be difficult. Buyers should expect a few bumps in the road and begin planning to deal with them right away.



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Creating value through tax diligence

BY RUSS DANIEL AND NICK FANOUS

When you talk to a tax professional about a potential deal, we typically have a standard set of opening questions:

Are you buying assets or stock of the target company?

Is the target a C corporation, an S corporation, or an LLC taxed as a partnership?

What is the target's footprint, i.e. where does the target have operations?

These questions are critical for tax because they drive our planning for the transaction, both risk assessment and planning for the future.

DANIEL

FANOUS

Due diligence

In a stock purchase, all of the target's historic tax liabilities are part of the deal — you can't leave them behind. On the other hand, in an asset purchase, certain tax liabilities may be "carved out" and left with the seller. An exception in this area is sales tax, which often attaches to the business regardless of the form of the transaction.

If the target is a passthrough entity, such as an S corporation or an LLC, the income tax liabilities may be isolated to the sellers, but all of the non-income tax liabilities of the entity come with the target, so full due diligence is necessary.

The complexity grows exponentially when you leave the U.S. shores. Many countries have tax regimes that are inconsistent with the U.S. tax code.

Two important items to note if the target is a C corporation or an LLC taxed as a C corporation:

First, an asset purchase may not be negotiable, since it would trigger two layers of tax for the sellers. The buyer may have to purchase stock in order to make the deal economics work.

Second, the target's historic income tax liabilities are coming along in the deal, so a thorough due diligence plan is critical to identify historical risks and exposures. Even if the target has historically lost money, there are a number of unexpected ways in which the company might end up owing taxes.

Understanding the target's footprint helps to focus state and international tax diligence. Every jurisdiction is different, and while one state may exempt sales of certain products or services from sales tax, another may not. The complexity grows exponentially when you leave the U.S. shores. Many countries have tax regimes that are inconsistent with the U.S. Tax Code — and some countries view U.S. companies as fertile ground for audits.

Planning opportunities

There are also planning opportunities to consider. If the target is a passthrough entity, you should try to secure a tax basis stepup, which will allow the buyer to shield future income with depreciation and amortization deductions. This is often a tricky negotiation, but in the right circumstances, it can create significant value for the buyer at minimal cost to the seller. For a larger deal there may be other structuring alternatives, including tax-free transactions and leveraged buy outs where the debt is placed in a favorable jurisdiction.

Managing the tax exposures on a deal is complex, but with the right advisors and good information, you may create unexpected incremental value.

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