BUSINESS ACQUISITIONS AND MERGERS

EXAMS – JUNE 2024

PROBLEM QUESTION

A is negotiating the purchase of a majority shareholding of company B. B is the owner of large warehouses and leases warehouse space to other companies. The shareholders of B is C and D. C and D are also leasing warehouse space from B. A major part of B’s revenue comes from rents paid by C and D. Another major customer for B is the State. The State is also leasing warehouse space from B; however, such agreements are signed after a public bid process where other companies with warehouses participate and make offers to the State. The State is choosing the lowest offer. The next public bid is scheduled for next year and it will lead to a long term five years contract with the company offering the lowest offer. Although B has financial continuous losses during the past three years, however, the general prospects in the market for warehouses are very good and the demand for ware house space is expected to triple in the next years. However, in order to catch up with the increasing demand, B will be required to make substantial and immediate investments in expanding its warehouse space and in purchasing modern warehouse equipment. C and D are aware of the increasing demand and the good prospects of the business. Therefore, although they are willing to sell A a majority control, however, they do not wish to abandon the company; in particular, C and D wish to keep a shareholding of about 20% each in company B. B has a very broad and diversified customers basis (i.e., many customers). While some customers are very large and reliable enterprises, it seems that other customers owe to B rents which are already overdue for more than 18 months.

Advise A how to go on with this transaction.

*Answer in brief*

*Check leasing agreements for warehouse space. Are there termination clauses? Are the rents fair? Is it easy or difficult to terminate?*

*Ensure that C and D will continue their leasing agreements and will pay the same volume of rents. This can be achieved through a shareholders agreement. Bear in mind that the contracts with C and D is a major factor for the valuation of B.*

*Since there is a public bid to take place in the near future and this represents a major part of B’ revenues, it is advisable to rely to future profits in order to make the valuation of B. It is also advisable to fix the purchase price on the basis of completion accounts.*

*Since B is required to make new investments, it is advisable to arrange for acquisition by way of capital increase and not only by way of purchasing shares from C and D.*

*Since demand is expected to rise, it is advisable to check if it is easily possible to increase the rent charged to customers under the existing lease contracts and/or whether it is easily possible to terminate existing lease agreements.*

*There are bad debts. Bad debts must be taken into consideration in fixing the purchase price and the valuation of B.*

*Since C and D intend to remain with the company, they may wish to have some minority protection, i.e., by way of reserved matters in decision making or by way of appointing members to the BoD.*