

## **A Short Guide to Selling your Wholesale or Manufacturing Business**

The sale of a manufacturing or a wholesale business will generally give rise to different legal issues to the sale of a retail business due to the nature of the assets being sold, the structure of the sale, and the financing and valuation of stock.

### **Asset or Share Sale**

It's important to determine from the outset whether your business is to be sold by way of a sale of the business' assets (**Asset Sale**), or a sale of the shares in the company which owns the business (**Share Sale**). This can have important implications for both parties.

By acquiring the shares in a company, a purchaser indirectly becomes the owner of everything that the vendor company owns, but it also inherits its liabilities. For this reason, it's not necessary to specify all of the assets and liabilities in the sale agreement in order to effect a change of ownership.

Conversely, if you are selling the assets of a business, the sale agreement (which will take a different form to a share sale agreement) will need to clearly stipulate which assets are to be sold. In most instances, historical debts and liabilities of the vendor will not transfer to a purchaser.

In theory, at least, a share sale merely involves the signing of share transfer forms from the existing shareholder(s) to the purchaser. However, in practice, the issues associated with due diligence and obtaining consent from third parties with respect to key contracts can make the transaction as convoluted as an asset sale.

Whether the sale proceeds as a Share Sale or an Asset Sale will have a significant bearing on

how the transaction is conducted, and will result in a different tax outcome. As such, you should discuss this with your selling agent, lawyer and accountant from the outset of the transaction.

### **Confidential Information**

The protection of confidential information is of critical importance to a vendor during any sales process. It's for this reason that your selling agent should seek your consent before releasing any confidential information to a prospective purchaser, and require them to enter into a confidentiality agreement. This is designed to protect you from the improper disclosure or reliance on confidential information.

### **Contract Documents**

Once the basic commercial terms have been agreed, the selling agent will generally require the parties to enter into a **heads of agreement** which sets out the principal terms of the proposed sale.

Once a heads of agreement has been signed, and the due diligence has commenced, the vendor will usually engage a lawyer to prepare the **sale agreement**. The form of agreement will depend upon whether it is structured as a Share or an Asset Sale.

The sale agreement should be carefully negotiated by your lawyer. The lawyer's role is to ensure that the agreement accurately reflects the agreed terms and protects your legal interests. Your lawyer will need to carefully consider the following issues:

- are the assets of the business accurately defined in the sale agreement? What assets are subject to leasing or hire purchase arrangements?

- What intellectual property is to be transferred? This might include patents, industrial designs, trademarks, copyright.
- are the proposed warranties and indemnities appropriate having regard to the interests of the vendor?
- Are all licences and permits in order? If a licence is to be transferred, what conditions need to be met?
- How are employee entitlements (e.g. annual leave, long service leave, personal leave) to be dealt with at settlement?
- can the lease and any key contracts (e.g. management agreements, licence agreements, supply agreements etc.) be validly assigned to the purchaser? Or is consent required?
- Will the sale be subject to GST? Or will it qualify as the sale of a going concern?
- Is all plant and equipment in good working order and compliant with all applicable occupational health and safety regulations?

Unlike a tenant under a retail lease, a tenant under a non-retail lease is not entitled to an automatic release on the assignment date. For that reason, it's important for your solicitor to specifically seek a formal release on your behalf.

If structured as an Asset Sale, it's important to determine what assets are to be transferred with the business. Whilst each business is different, most business sales would include:-

- the business name
- all licences and registrations required to operate the business
- all rights attaching to the Lease
- goodwill
- work-in-progress or stock-in-trade
- customer/supplier lists
- intellectual property (e.g. trademarks, patents, copyright etc.)
- the plant and equipment

### **Stock**

There are two main ways that stock-in-trade and work-in-progress (WIP) are dealt with in the context of a business sale:-

- “Walk-in, walk-out” – this means that the business is purchased inclusive of any work-in-progress or stock; or
- “Plus WIP/Stock-in-trade” – this means that the business is purchased without the WIP or stock included in the purchase price. It is usually the case that stock will be payable in addition to the purchase price and capped at a specified value.

Stock will generally include raw materials, materials used in manufacture, packaging materials, components, work-in-progress, finished goods, goods under manufacture, inventories and other stock in trade owned by the Vendor, including goods in transit and stock ordered and paid for by the Vendor but not received by Completion. A clear definition of what is “excluded stock” should be included.

The procedure for valuing stock is a critical issue in most wholesale/import businesses given the relative value of stock to the overall sale price.

Unlike most retail businesses, which only require for stock to be valued based on the last invoiced cost price of goods, an importer/wholesaler will typically need for stock to be valued at its “landed cost”, which includes the last invoiced cost price to the Vendor converted to \$AU (including GST) plus duty, freight and landing charges. The standard form contracts do not generally provide for this.

### **Vendor Finance**

The provision of vendor finance in the context of wholesale and manufacturing businesses is relatively common, particularly with respect to the purchase terms for stock.

Vendor finance occurs when a vendor agrees to fund (usually a part of) the purchase price and/or the value of the stock. An initial amount will be paid by the buyer at settlement, with the balance, plus interest, repaid over an agreed period.

The provision of vendor terms provides risks to a vendor. It is for that reason that it is important that all terms are properly documented, and that adequate security is provided for the repayment of the monies. This might include:

- a mortgage over specific assets of the business (e.g. chattel mortgage);
- a charge over the assets of the purchaser’s company (also known as a registered security agreement); or

- a mortgage over the lease or other freehold owned by the buyer

The terms will typically be contained in the sale agreement, or documented in a separate loan/security agreement. However, it’s important to ensure that any potential form of security is adequate in the event that it needs to be relied on by the vendor.

There are a significant number of issues which need to be addressed in the sale of a wholesale or manufacturing business. The above represents but a sample of the issues. A lawyer and selling agent who have experience in selling wholesale and manufacturing businesses should always be engaged to assist you to navigate the complexities of the transaction and to complete the sale process.

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### **Disclaimer:**

The information contained in this article is intended to provide general information only and is not legal advice or a substitute for it. You should always consult your own legal advisors to discuss your particular circumstances.