

NJ BUSINESS SOLUTIONS



How To Acquire a Business

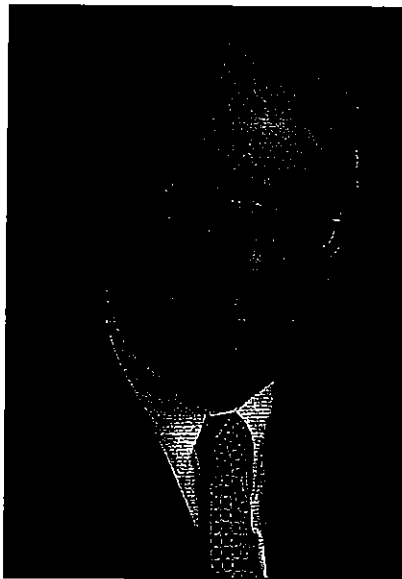
NJ BUSINESS SOLUTIONS is a service to the members of the New Jersey Business & Industry Association and the readers of New Jersey Business Magazine. These articles are intended to help New Jersey employers deal with practical issues affecting their business operations.

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The idea of acquiring a business can be stressful. However, in reality, the process of acquiring the local delicatessen is similar to acquiring a multi-million dollar manufacturing facility. In this article, we will provide an overview of the basic steps taken in the acquisition of a business.

Before beginning the process, the purchaser must have its "team" in place. In addition to representatives of the acquiring group, the team will likely consist of an attorney, an accountant and, if financing is required, a lender. Identifying the purchaser's team before the process starts helps the transaction move in a smooth and efficient manner.

The first step is the due diligence activities of the purchaser relating to the business. Due diligence is the process through which a potential purchaser learns of the business by reviewing its books, records and operations, including



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its financial statements, assets and liabilities. The assets of a business may include customer information, tangible assets (such as equipment and furniture), intangible assets (such as trademarks), goodwill, cash, accounts receivable, leases, agreements and employees. The liabilities might include lines of credit and accounts payable. As a result of this process, the purchaser



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determines what it believes to be the actual value of the business.

The purchaser must next determine whether it desires to acquire the assets of the business or the ownership interests owned by the individual sellers. The discussion focuses on two factors: (a) the tax treatment of the payment and the receipt of purchase price and (b) the liabilities, which the

purchaser acquires or assumes. If the purchaser acquires specific assets of the business, the purchase price will be allocated to the assets, which will be depreciated by the purchaser and will provide a deduction for income tax purposes for the purchaser. On the other hand, the receipt of the purchase price by the seller will primarily be treated as ordinary income. Conversely, if the transaction is structured as the acquisition of the ownership interest of the individual sellers, the payment of the purchase price will not be deductible, while the receipt of the purchase price by the individual sellers is afforded capital gains treatment.

In the event that the transaction is structured as the purchase of specific assets of the business, the purchaser only acquires the specified assets and, unless otherwise provided, generally does not assume any liabilities. On the other hand, in the event the transaction is structured as the acquisition of the ownership interest of the individual sellers, the business will remain as a going concern owned by the purchaser (and the purchaser will indirectly assume the liabilities to which the business may be exposed).

The next step is the negotiation of the purchase agreement, which is the binding document that evidences the acquisition. The purchase agreement will, among other things: identify the item(s) being purchased and sold, e.g. the ownership interest or specific assets; set forth the purchase price and the manner of its payment; and contain representations and warranties of the seller. Representations and warranties relate to the condition of the business which, if discovered after closing to be inaccurate, potentially give the purchaser recourse against the seller. Other customary topics addressed are the possible continued employment of the individual sellers after the closing and a post-closing restrictive covenant, which prevents the seller from engaging in a competing business or soliciting the business of the customers, referral sources or employees.

Typically, the final step in the acquisition process is the closing. At this event, the purchaser pays the purchase price and the seller transfers title of the acquired business to the purchaser. This can occur simultaneously with the execution of the purchase agree-

ment or at some later date after certain stated conditions have been satisfied, such as the purchaser obtaining financing.

In the end, entering into a transaction with a basic understanding of each necessary step will hopefully result in a transaction with fewer surprises and fewer insurmountable complications. ¶

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