ASH ST.

Corporate and M&A Team

Growing Your Business Series

HOA, LOI, MOU … is web speak for?

What do these letters stand for?

HOA, LOI and MOU stand for heads of agreement, letter of intent and memorandum of understanding. They all refer to a document that sets out **the basic understanding between the parties to a proposed transaction**, such as a purchase/sale, contractual arrangements or an investment in shares. Another common name is "**term sheet**", which is used generally below.

When considering a proposed transaction, often the first step will be to document how the main issues will be dealt with. Preparing a term sheet can be a useful exercise because it focuses everyone on the key commercial and legal issues and gives each party a degree of certainty that a commercial deal is possible before the parties incur the expense of due diligence and drafting a formal binding agreement. However, a term sheet can also be a trap. What should be a framework for the final agreement can sometimes lead to extensive negotiations.

Drafted properly, a term sheet should be concise and deal with broader fundamental issues and the key steps required to get to a binding deal, rather than every detail that will eventually be included in the final agreement. As well as issues which are unique to your transaction, you should consider the following when preparing a term sheet:

- **Should it be binding?** – the term sheet should clearly state whether it is intended to be binding or if a binding arrangement will only exist once a formal agreement has been signed. Even if the term sheet is non-binding generally, you may wish to make certain provisions binding, such as any exclusivity and confidentiality obligations. If it is intended to be binding, the term sheet needs to be sufficiently clear and certain to be enforceable – expressions such as "on the usual terms" are not enough.
- **When can it be terminated?** – if the term sheet is intended to be binding there should be a clear set of provisions dealing with the term and termination. Frequently, a term sheet will terminate on a specified date or when the formal agreement is entered into (whichever happens first). You should consider whether any obligation to engage in the negotiation process should be included and also if, and when, a party may be required to reimburse the other party's costs.
- **Is exclusivity required?** – a term sheet will commonly specify a period of exclusivity prohibiting a seller from negotiating with other proposed buyers while the initial buyer is assessing the deal. You should agree an appropriate timeframe, which is usually anywhere from a few weeks to several months. The longer the timeframe, the more attention should be paid to prescribing what exclusivity means.
- **Should there be any conditions?** – you should consider whether any conditions are necessary or desirable - for example, securing finance, board or regulatory approvals, performance of satisfactory due diligence, consents to the assignment of leases being obtained, or other contracts being entered into with key employees, suppliers or customers. Such conditions should be specifically referred to in the term sheet.
- **Where should the detail be?** – it is important to decide where the term sheet needs to be specific and where it can be a little more general. For example, the purchaser of shares or assets would usually want to be very specific about the price and how it can vary, but possibly more general about warranties and indemnities, perhaps by saying: "warranties and indemnities typical for an arms-length purchaser for value will be given by the vendor".
- **Are regulatory approvals required?** – if any regulatory approvals are required before the term sheet can be signed (such from FIRB or the ACCC) then these will need to be addressed.
- **Are there potential tax issues?** – tax issues can arise from the execution of term sheets (even if the deal subsequently changes). Please seek specialist tax advice.

Like to know more?

Before signing any term sheet we strongly recommend that you seek legal advice to ensure the general issues in this note and the specific terms you wish to deal with are properly addressed to protect your interests. Click here to contact a member of our Corporate and M&A team or visit our website, to find out more.

IMPORTANT NOTE

This publication contains general information only and does not take into account specific circumstances. It does not constitute financial advice.

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Private company share buy-backs: What are they and when should you use them?

A share buy-back occurs when a company purchases shares in itself from a shareholder or a group of shareholders. The shares are then cancelled by the company, reducing the number of shares it has on issue. Unlike other forms of share capital reductions, private company share buy-backs require an agreement between the company and the shareholder or shareholders whose shares are being bought back. As such, shareholders cannot be forced to have their shares bought back. A buy-back is simply an offer that a shareholder can either accept or reject.

Share buy-backs increased in popularity when the regulatory regime was simplified around 25 years ago. While most of the attention around buy-backs has been focussed on publicly listed companies, many of the same benefits for conducting a share buy-back apply equally to private or proprietary companies.

Set out below are some real-life examples of private company buy-backs that we have been involved in.

Reasons for conducting a buy-back

Whether a company should conduct a buy-back of its shares will depend on the company's circumstances. Reasons for doing so include the following:

- **To remove instability amongst shareholders and/or differentially provide a return to investors:** Where a company has a number of shareholders and one shareholder either wishes to exit or has defaulted in its obligations, it may be in the company's interests for it to assist in the exit or removal of the shareholder (particularly where the other shareholders do not have the funds to purchase that shareholder's shares). In these circumstances, the company could buy-back the shares to the shareholder in order to provide a benefit or obtain stability. The right to conduct a buy-back could arise from a pre-existing agreement (such as a shareholders' agreement) that covers such an eventuality.

'We recently assisted a growing company with a number of shareholders when one of the founding shareholders wished to exit for health reasons. The company ran a pre-emptive rights process in accordance with its shareholders' agreement but a large percentage of shares were not taken up by the existing shareholders. The company proceeded to buy-back the remaining shares resulting in a positive outcome for both the exiting shareholders and the company.

Janna Parfenova, Associate Director

- **To bolster earnings per share:** By reducing capital in the company, a buy-back can increase the return per share on the remaining capital, consolidating the company's equity and improving key financial ratios. This has the potential to make the company more attractive to investors.

- **To return surplus funds to shareholders:** If a company has excess funds and no long term investment projects on the horizon, a buy-back of shares from existing shareholders can be used in place of a dividend to distribute the extra cash and return some value to the shareholders.

- **As part of a corporate restructure:** Corporate restructure can take many forms, and one possible step in a restructure is a share buy-back. In this context, buy-backs are typically driven by the tax benefits that may flow from the company and/or shareholders, but other motivations, such as simplifying the company's ownership and structure, can also be relevant.

'We acted for a client where a group of investors wanted to exit the company and a buy-back was agreed to, allowing the group to divest. This was ultimately beneficial for the stability of the company and the remaining shareholders.'

Shaun McGushin, Director

- **To provide employees with a means of earning a return on holding shares in the company:** Where an employee or salaried director have previously entered into an employee share scheme and is leaving the company for whatever reason, the company can conduct a buy-back of the shares held by the employee or director under the scheme. The benefit of a buy-back in this situation is that it retains ownership of the company among those who have a direct interest or work in the company.

- **Return capital tax effectively:** Share buy-backs can be driven purely by the desire to return capital tax effectively.

'We have acted for a number of clients in relation to employee share schemes. A couple of issues to bear in mind are that the means for determining the prices at which the shares are to be brought back should be very clear and transparent. In addition, in order to ensure a relatively smooth and timely buy-back, it is useful for the company to have a power of attorney from each employee so that the company can sign the relevant documents on the employees' behalf.'
Shaun McGushin, Director

Types of buy-backs for Private Companies

Share buy-backs come in a number of forms, with different notice, disclosure and approval requirements applying to each. Within these types, **a distinction is made between**:

- equal access schemes which apply to all shareholders and selective schemes which do not (with private company buy-backs generally being selective); and
- buy-backs that involve 10% or less of the company's voting shares within any 12 month period, and those that involve more than 10% in the same period. This is referred to as the '10/12 limit'.

  The requirements that apply to buy-backs above the 10/12 limit are more onerous than those which are within it. Similarly, the requirements that apply to selective buy-backs are more onerous than those for equal access schemes.

The following types of buy-back are available to private companies:

- **Equal access scheme buy-back:** the company makes the same offer to all holders of ordinary shares to purchase the same percentage of their holding. Shareholder approval is required if the proposed buy-back exceeds the 10/12 limit.

- **Employee share scheme buy-back:** the company offers to buy back shares held by current or former employees, or salaried directors, under an employee share scheme. Shareholder approval is required if the proposed buy-back exceeds the 10/12 limit

- **Selective buy-back:** the company offers to buy back the shares of a particular shareholder or group of shareholders. Approval by a unanimous or a special resolution of shareholders is required. The 10/12 rule does not apply to this form of buy-back.

Like to know more?

Share buy-backs are subject to a strict legal regime that includes compliance with specific rules set out in the *Corporations Act 2001* (Cth) and adherence to ASIC guidance. If your company is considering undertaking a share buy-back, please contact Ash St. Legal & Advisory. Our team has many years' experience in this area, and continues to provide our clients with superior solutions in order to achieve the best possible outcomes.

IMPORTANT NOTE

This publication contains general information only and does not take into account specific circumstances. It does not constitute financial advice. A buy-back of shares may have tax implications. If you have any concerns about the consequences of a proposed buy-back, please seek appropriate advice from an independent financial advisor, solicitor, accountant and/or other professional advisor.

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Reach out to Ash St. today to find out how we can help you convert the complex into opportunities.

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