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Deal Structure

mergers & acquisitions

M&A transactions generally result in a buyer owning the business or assets of a target company. The buyer and seller may structure the transaction in different ways, depending on tax and legal issues. The three most common structures are asset purchases, stock purchases, and mergers.

Asset Purchase

In an asset purchase, the buyer purchases some or all of the assets of the target company. The main benefit to an asset purchase is that the buyer has the flexibility to pick and choose the assets and liabilities it wishes to acquire, leaving behind those assets and liabilities it does not want. This structure is often used, for example, when acquiring a single business unit within a company, such as a division. An asset purchase may also allow the buyer to exclude liabilities the buyer does not want to assume; however, some liabilities (including some environmental liabilities) may transfer with the business by law even if excluded by contract.

Structuring a transaction as an asset purchase generally involves a greater amount of legal work compared to a stock purchase or merger. Some assets, such as machinery and inventory, may be easily transferred via a simple bill of sale. Certain other assets, however, require considerably more effort. Intellectual property, such as trademarks and patents, often requires a separate assignment and recordation with the appropriate government office. Transfers of real estate usually require title insurance and recordation of a deed. The buyer may need input from legal experts in these areas and others to ensure that its ownership rights are protected.

Third-party consents may also be required in order to properly transfer certain assets from the seller to the buyer. If the buyer wishes to acquire a contract that contains a “no assignment” provision, the contract counterparty must give its consent before the transfer can be completed. Considerable time and effort can be spent in trying to obtain these consents. Contract counterparties may even view this as an opportunity to renegotiate the terms of the contract or extract concessions. In addition, certain licenses and permits may require government approval prior to being transferred to the buyer. Identifying all required third-party consents at an early stage will help avoid delays at closing.

Stock Purchase

In a stock purchase, the buyer acquires all or substantially all of the stock of the target company from the stockholders. In contrast to an asset purchase, all of the target company’s assets and liabilities will transfer with the stock of the company—with the buyer unable to pick and choose the assets and liabilities it wants—and the buyer will also receive any unknown and undisclosed liabilities of the target. The buyer in a stock purchase transaction will try to reduce this risk through protections in the stock purchase agreement, such as representations and warranties about the target.

The primary benefit of doing a stock purchase deal is its simplicity. Because the target company is simply moving to a new owner, all of the assets remain with the target company. Most of the assignment and third-party consent procedures that can cause delays in an asset purchase transactions are unnecessary in a stock purchase transaction. However, the buyer should identify any contracts with “change of control” provisions, as these agreements may terminate upon a change in ownership of the target company.

Stock purchases are more complex if the target is a publicly traded company, in which case the buyer must launch a tender offer for the targets shares. The buyer may also need to “squeeze out” minority shareholders, who may have “appraisal rights” to request a court to determine the fair value for their shares.

Merger

In a merger, the buyer enters into a merger agreement with the target company causing the two entities to be merged by operation of law. The shareholders of the target company will receive the shares of the buyer company, cash, or a combination of stock and cash. This is often done using a new subsidiary created by the buyer to be merged with the target. This is called a “triangular merger” because there are three parties: the buyer, the buyer’s subsidiary, and the target.

A merger is similar to a stock purchase in that assets transfer automatically without the need for third-party consents (except in the case of “change of control” provisions as mentioned above). Also as in a stock purchase, the buyer acquires all liabilities, known and unknown, of the target company.

One advantage of a merger transaction is that it can usually be accomplished with the consent of the holders of a majority of the target company’s shares. This is in contrast to a stock purchase, in which each shareholder must consent to a sale of its stock. Dissenting shareholders, however, may have “appraisal rights” to request a court to determine the fair value for their shares.

A merger is a more complex process if the target company is a public company. The buyer will require the shareholders’ consent to the merger. To obtain this consent, a shareholders’ meeting must be held so that the shareholders can vote for the merger, and the buyer and seller will have to coordinate the preparation for that meeting and the solicitation of shareholder proxies to vote in favor of the merger.