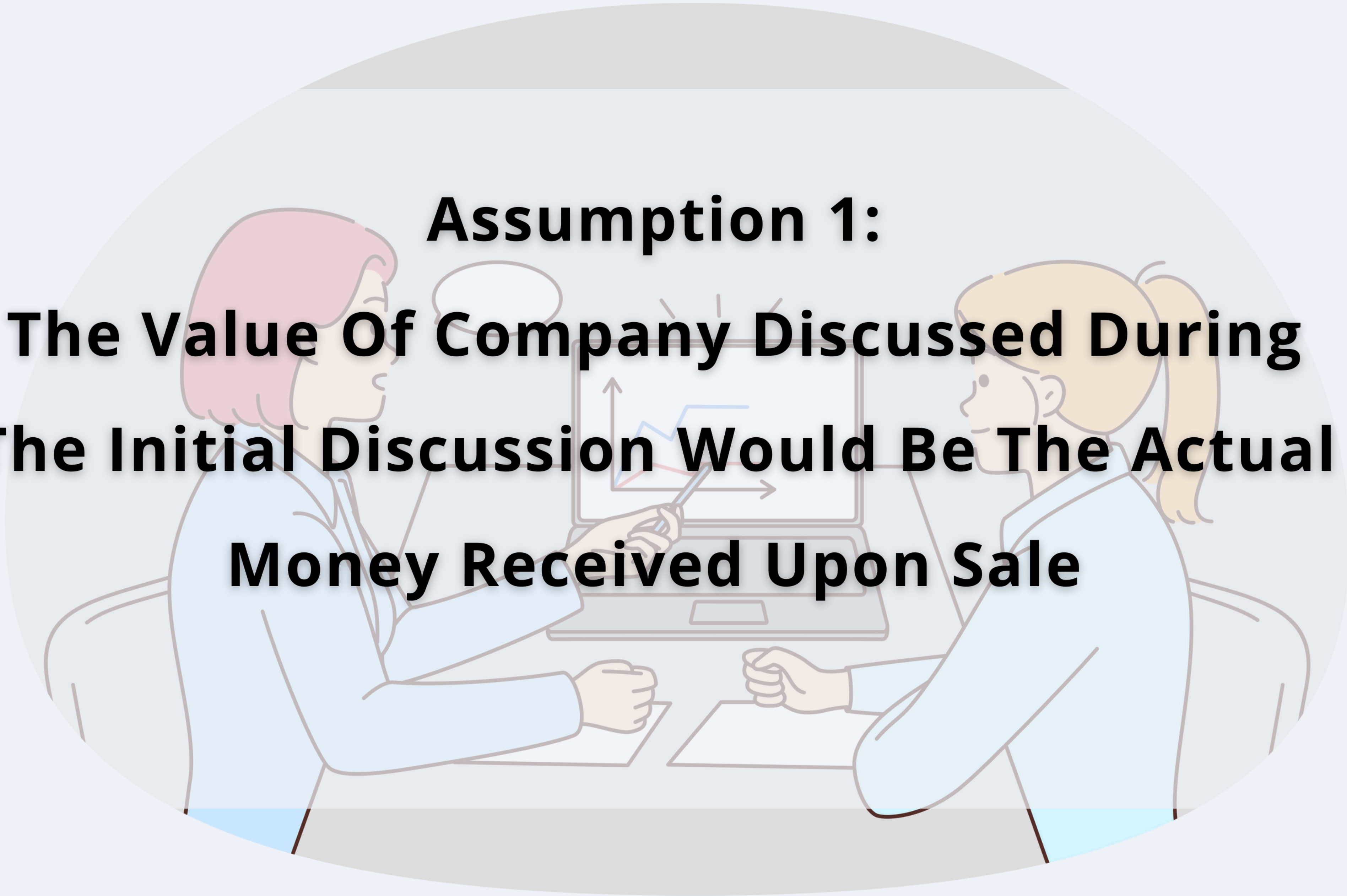
YNZ GROUP

DE-MYSTIFYING 5 COMMON ASSUMPTIONS OF BUSINESS OWNERS IN THEIR SHARE-TRANSFER/EXIT DEALS

Share transfer transactions are mainly entered into by the business owners while having built their business over the years and planning their exit by way of sale of shares to competitors/other investors or by serial entrepreneurs after scaling up the business for a lucrative sale opportunity. While promoters have a broad level understanding of their exit strategy, there might be lack of clarity or certain assumptions on their part on some critical aspects. Some of these aspects include,[1]

[1] The article reflects the general work of the authors and the views expressed are personal. No reader should act on any statement contained herein without seeking detailed professional advice.

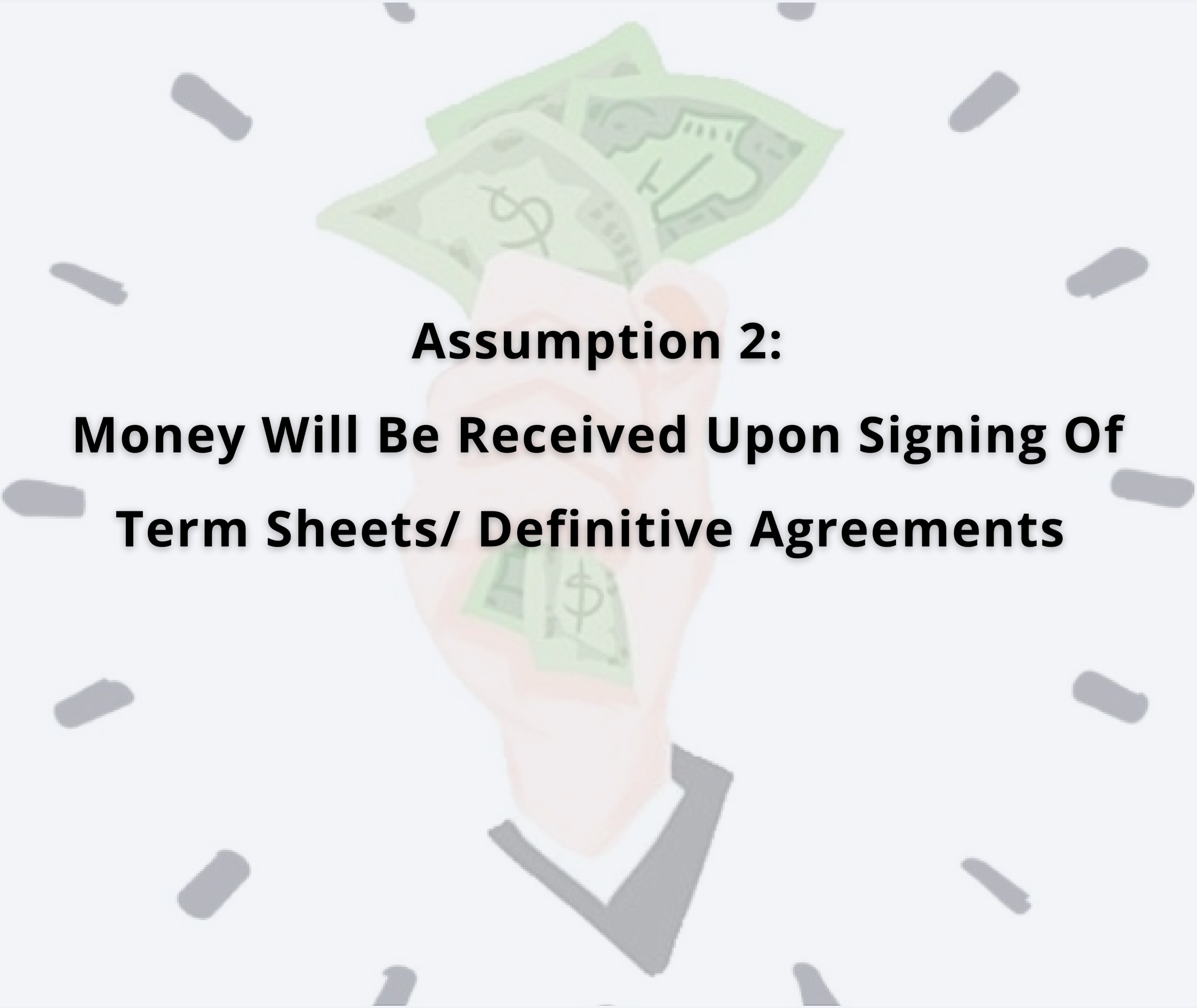


Assumption 1:

The Value Of Company Discussed During The Initial Discussion Would Be The Actual Money Received Upon Sale

REALITY CHECK

While the Parties to the transaction initiate the discussion with value of the business in mind, it is pertinent to note that the final purchase consideration towards the promoters' shares could be an amount derived after adjusting many factors as per the valuation method applied for obtaining the same and any items deducted and/or added during due diligence process. It is important for promoters to have clarity on the potential additions/deletions that could be made by investors from their advisors.

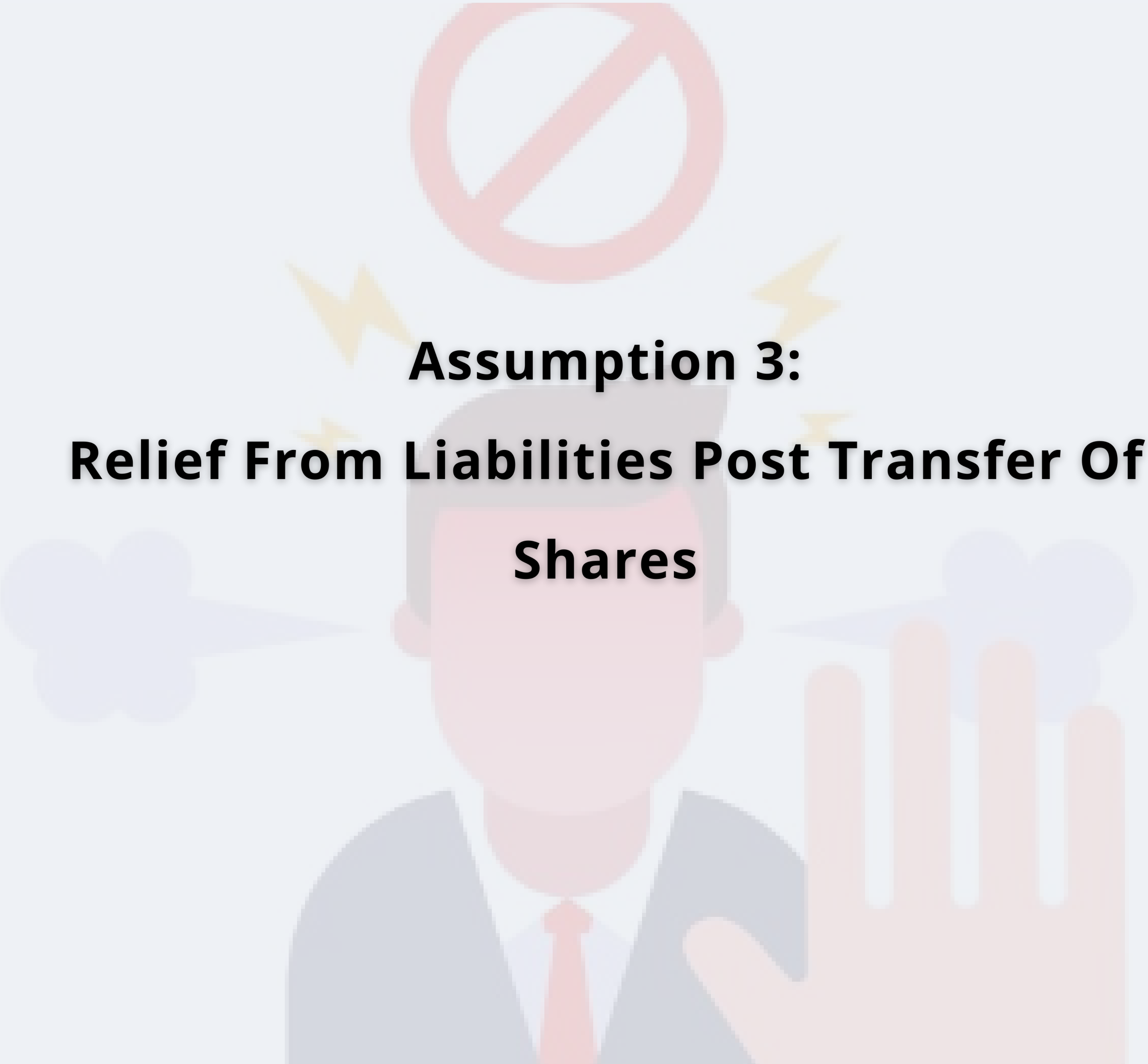


Assumption 2:

Money Will Be Received Upon Signing Of Term Sheets/ Definitive Agreements

REALITY CHECK

While the definitive agreements such as share purchase and shareholders agreement bind the parties to the transaction, there is a time period for signing of such agreements and the actual closing i.e. completion of the transaction. Upon execution of the agreements, there are certain actions which are to be fulfilled by the promoters and target company before the actual transaction takes place. Only upon completion of such actions (typically referred to as conditions precedent) that the transaction is consummated by the parties.

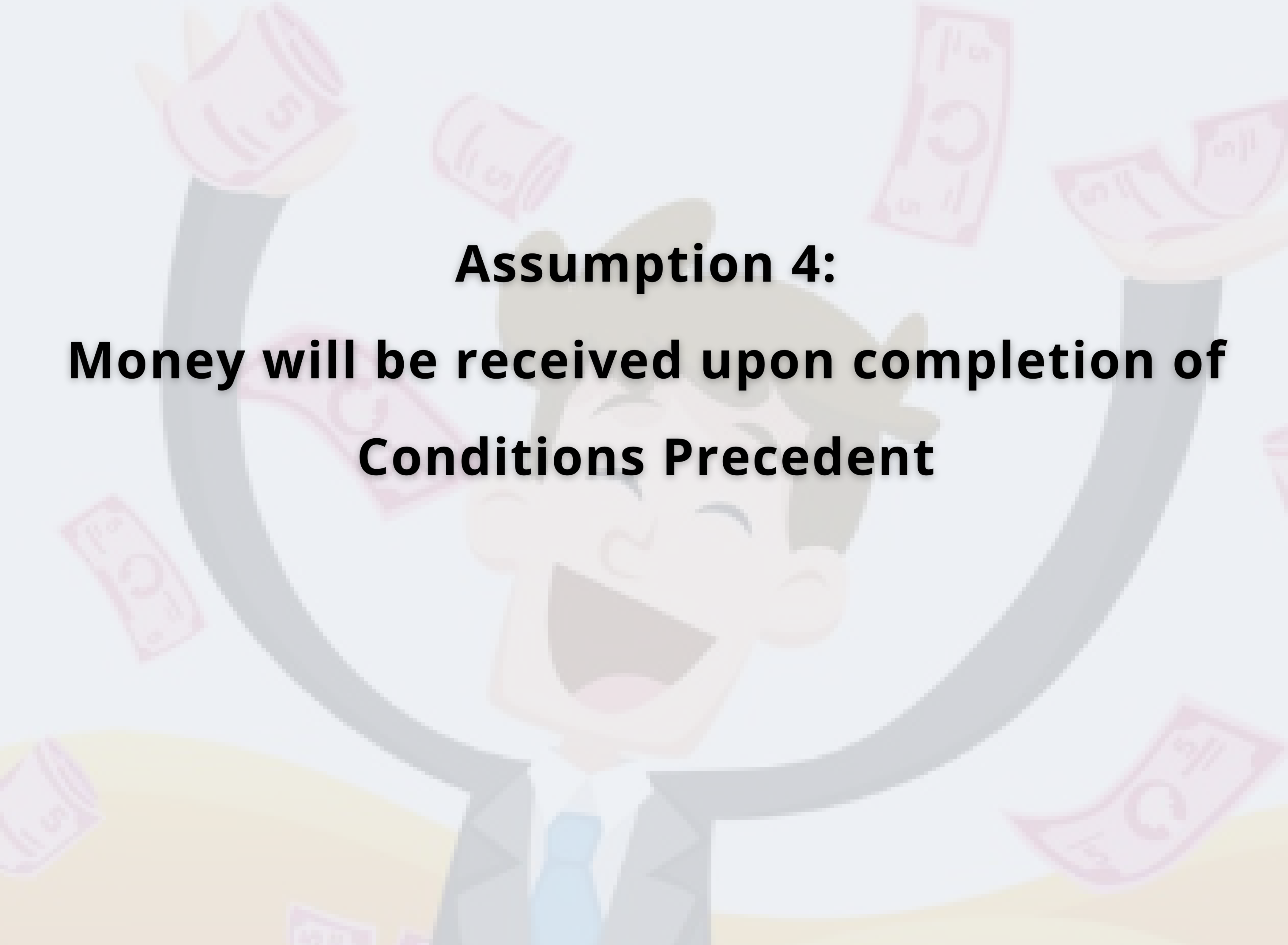


Assumption 3:

Relief From Liabilities Post Transfer Of Shares

REALITY CHECK

Under share transfer transactions, especially for 100% exit of the promoters, it is commonly assumed that the liabilities towards any claims will be absolved upon transfer of shares. However, it is a general practice that indemnities are to be provided post completion of the transaction as well. This is mainly towards any potential claims that may come after the transaction pertaining to the period prior to the transaction. The most common examples are taxation or litigation related claims or labour law non-compliance. It is important that the promoters carefully review and accept the indemnities relevant to the transaction and business and to propose appropriate limitations to their liabilities.



Assumption 4:

Money will be received upon completion of Conditions Precedent

REALITY CHECK

It is very critical to establish, especially under the definitive agreements, that there is a commitment on the part of the investor post completion of pre-closing actions for making the investment. In most of the cases the agreements are proposed by the investor team where there is an obligation on promoters and company to fulfil specific conditions for the transaction which is supported by a remedy of termination for investor in case the conditions are not fulfilled. However, there might not be an obligation on investor to mandatorily make the investment especially once all pre-transaction covenants are fulfilled by the promoters for the transaction. The most common reason could be that conditions precedent are not fulfilled to the satisfaction of the investor. This is a very subjective term.

Assumption 5:
Partial Shareholding Absolves The Promoters From Liability

REALITY CHECK

An investment transaction where the promoters are seeking exit can be structured in a way that the shares of the promoters are purchased in tranches. In such events investors might acquire majority of the shareholding of the company in the first tranche and take over the control of the operations. Even if the Promoters collectively have a minority shareholding, they will continue to be liable towards the acts and omissions of the company and the investor. It is important to critically evaluate the liabilities imposed in the definitive agreements and agree to only those which are directly caused by acts/omissions of promoters.

CONCLUSION:

The promoters should be very careful while executing any legal documentation, whether it is a Term Sheet/LOI, Share Purchase Agreement, Shareholders Agreement etc. Any agreement shall be entered into only after thorough review and clear understanding of the terms therein.

For any feedback or response on this article, the authors can be reached on ayushi.kalelkar@ynzgroup.co.in and charusheela.vispute@ynzgroup.co.in

Author: Ayushi Kalelkar

Ayushi is experienced in corporate legal and heads the investment and deal advisory at YNZ Legal. She is also a member of Bar Council of Maharashtra & Goa. By qualification she is a Master in Commerce and Bachelor of Law from Mumbai University.

Co-author: Charusheela Vispute

Charusheela is heading Estate planning and trademark, having specialisation in property and testamentary matters. By qualification she is Bachelor of Arts and Bachelor of Law from Mumbai University.