

We've Got a Contract.....Now What ?

"Now is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning"

Winston Churchill 1942.

Churchill is of course famous for many an inspirational quote made all the more magnificent by virtue of the circumstances in which he found himself. I suspect somewhat more uplifting and motivating than the dross found on social media these days. Imagine addressing a population facing the existential threat that emerged in Europe in the late thirties and imploring the population to be the best they can be and to speak their own truth. Gimme a break!

But, as always, I digress.

Much has been written about selling accommodation businesses and it occurs to me that parties to transactions sometimes feel that the signing of the contract is, in fact, the end. If I put myself in a vendor's shoes, I can appreciate how this mind set comes about. The decision to sell is not an easy one and the emotional roller coaster that follows can be pretty stressful. It's totally understandable that once contracts are afoot a vendor might think that the worst is over, so to speak. Of course, as Winston knew, there's still a bit of water to go under the bridge before matters are successfully concluded. I would encourage vendors to remain "present" throughout the process and with a little bit of pre-planning the bumps in the road can be successfully navigated.

The sale will swing on three important outcomes. Each can throw up "surprises" which can be emotionally taxing for vendors and challenging for their advisors. Let's take a closer look:

Financial Due Diligence and Verification

The buyer's accountant will be instructed to prepare a verification of net profit report. The process is highly detailed and relies on vendors and their advisors being organised and ready for the information request that will surely come. I think it makes sense for vendors to find out who's doing the verification as soon as an offer is accepted and request a copy of that firm's information checklist. It should come as no surprise that the buyer's accountant will want complete and unfettered access to accounting software, copies of agreements and relevant leases and in the case of management rights, up to date letting appointments. If you derive income from any activity outside industry norms, be ready to justify that income and have relevant documentation to hand.

The buyer's accountant will also want to build a picture of the business, particularly if it's a management rights. To this end vendors should be ready with copies of the last AGM minutes, the CTS/CMS, sample owner statements and a copy of the BC budget. If there's been a recent review of the BC salary details will be required. The verifying accountant will be keenly interested in the composition of the letting pool and any trends insofar as pool numbers go. A clear and concise understanding of the dynamics in the building will go a long way to painting a positive picture, particularly if letting pool numbers are down.

Critical to the process will be the buyer's accountant's review of operating costs, particularly labour expenses. Vendors should be ready to justify in detail any inconsistencies between the P and L for sale purposes and the actual costs incurred in running the business. In our experience labour costs tend to be the most contentious area. If a vendor ends up in negotiations over a difference in verified net profit, I'd be prepared to bet it will boil down to labour cost allowances. There's always a "story" about labour costs and some are less than compelling. Be ready!

Legal Due Diligence

A lawyer friend of mine has a great saying.....you can fix most documentation errors but you can't fix dodgy numbers. He's right. That's why most prudent practitioners will not start the legal due diligence process in earnest until the outcome of financial verification is reasonably clear. Unlike analysis of financial performance, which can be open to interpretation, a legal document or compliance to process is generally either right or wrong. There are of course areas of legal ambiguity but it's very unusual for a transaction to fail as a result.

The buyer's lawyer will, for the most part, rely on the outcomes of searches and information provided by the vendor's lawyer. Key to the legal due diligence process is to establish that what is being sold is as presented and that contracts pertaining to the business are enforceable and reside with the seller. Establishing the chain of ownership since the business started is key to the process as is confirmation that any amendments to contracts or leases have been legally brought about. In particular, deeds of assignment and variation must be appropriately entered into to ensure security of tenure for the buyer.

The occasional challenge that arises from the due diligence process is the discovery of a documentation or process error which requires attention prior to settlement. On the one hand most vendors would want their paperwork to be squeaky clean. On the other hand, many will be less than enthusiastic about alerting a landlord or body corporate to a potentially fatal flaw. In these circumstances all those years of building positive relationships with the BC pays back in spades. Either that or convince the buyer to have the problem fixed post settlement. Good luck with that!

Finance

Here's where the rubber hits the road. While buyers can use all manner of spurious excuses to wriggle out of a contract on financial and legal due diligence grounds, once finance is approved and confirmed with the other side the deal is unconditional and there's no escape. Given that we pre-qualify buyers, finance approval should be a given and in most cases it is, albeit at glacial pace. It's the glacier that vendors need to be aware of. Nothing spooks a seller more than a finance extension request. Regrettably very few such requests come with an explanation and some context. I'm a big fan of the buyer explaining why the extension is required and giving the vendor enough information to make an informed decision. With our client's permission we will always brief their lawyers and provide enough information to put the vendors mind at ease. Some vendors do not take finance extension requests well albeit when faced with the prospect of jumping off the roller coaster so close to the end, more often than not cool heads prevail.

In summary being a highly organised and patient vendor is the key. I'm also a huge believer in using lawyers and accountants who pick up the phone and discuss potential issues with the other side. By all means send the billable hours confirming email but talk first.

Most important of all, choose the right agent. I've met them all over the years and some hold the deal together better than others. The ability to juggle the competing interests of vendors and buyers is not a skill to be taken lightly. The really great agents know that the real work starts once the contracts are signed.

I'll close with Winston again.....

"If you're going through hell, keep going"

Mike Phipps F Fin
Director | Phippsfin Pty Ltd



Mike Phipps. **0448 813 090**
mike@mikehippsfinance.com.au

Paul Grant. **0448 417 754**
paul@mikehippsfinance.com.au

Cameron Wicking. **0477 776 859**
cameron@mikehippsfinance.com.au

Head Office
4/31 Mary Street
NOOSAVILLE QLD 4566

Office. 07 5470 2194
Fax. 07 5455 6626
www.mikehippsfinance.com.au



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