

## **SELLING YOUR BUSINESS – CASH VERSUS STOCK**

This has been a year in which there have been a number of sales of companies in our industry. In this article I will discuss the various ways that a seller may be paid for its company by way of cash and/or stock. As will be explained below, there is a big difference in being paid say \$15 million in cash for a company versus being paid stock that is worth \$15 million in a privately held company. In addition, I will also analyze the issue of performance clauses and their relation to the sale price in the sale of a business.

### **Cash is King**

Of course, most sellers would like to receive all cash for the sale of their business. This is the desired way for the seller to receive the purchase price but many times is not a possibility for the purchaser. When the purchaser and the seller are fairly close in relative size, the purchaser may not have sufficient cash to fund the transaction. In addition, a seller of a company may want to have some stake in the purchaser in the hopes that the purchaser may sell for a higher relative value in the future. Although possible, the all cash sale is not usually the way that sales transactions occur. Often the sale will involve a mixture of consideration part cash and some in the form of stock of the purchaser.

### **Stock as Consideration**

In many circumstances the purchaser of a company will want to pay the seller in whole or in part with the stock of the purchaser. The purchaser can benefit by providing its stock as part of the consideration paid for the seller, to the extent that it does not have to part with cash it may need to run its business or for other purposes. From the perspective of the seller, the value of the stock it is being “paid” is dependent in a large part upon the financial strength of the purchaser and whether the shares of the purchaser are privately held or traded on a public stock exchange.

If the purchaser is privately held, for the most part, the ability to sell any shares in the company is very limited. If you own shares in a private company there are very few buyers willing to purchase the shares. In addition, there are usually restrictions that will keep you from selling shares in a private company in the form of a shareholder agreement that requires the consent of the other shareholders in order to sell your shares. For this reason, it is hard to justify, as a seller, taking shares in a private company as the entire proceeds for the sale of a company. There are notable exceptions to this general rule such as the successful public offering of iPayment, Inc. However, for the most part the road to taking a private company public is very difficult.

Even with a public company, there are a number of issues that can make it less beneficial to take shares in the purchaser as part or all of the purchase price in the sale of a business. Some companies that are publicly held may be traded on a public stock

exchange, but the lack of activity in the shares may not allow a seller to sell the shares it receives. For smaller public companies, the average dollar value of shares traded on a given day may be very low, for example \$10,000 a day. If a seller is paid millions of dollars for its business, it would take a very long time to sell the shares at \$10,000 a day. Also, such thinly traded shares are subject to large price swings if a large number of shares in the company are sold. So, even if a seller were to try and sell shares it would quickly drive down the price of the stock, reducing the amount that the seller of the company receives for its shares.

That is not to say that all sellers should reject stock of the purchaser as a way of funding the sale of a company. There are many large businesses traded on the New York stock exchange and the NASDAQ wherein the stock of those companies is as good as cash. In our industry, First Data stock is widely traded and the company has a large market capitalization. A company purchased by First Data, given a purchase price that is small relative to the market capitalization of the company, would likely be able to sell their shares in the open market fairly easily without impacting the share price.

One thing to be concerned about as a seller receiving shares as part of the payment of the purchase price is the holding period for the shares. Often a purchaser will require that the seller not sell the shares it receives for 12 to 18 months after the sale closes. The danger is that if the price of the shares falls during the holding period then the purchase price that is paid, as far as the seller is concerned, will also fall. For instance, if the share price fell 50% between the time when the sale takes place and the seller can sell its shares, the seller in effect will only be getting one half of the purchase price that it thought it would get when the sale took place.

This leads to another issue related to taxes and the shares that are received in the sale of a business. If you are granted shares outright in a business, there is a value associated with those shares. For instance, if a seller received \$1,000,000 in shares in a publicly held company, the seller would be taxed on the \$1,000,000 it received in the year that it received the stock. This is true even if the seller decided not to sell the shares but instead held them for a time. So, if a seller received all the consideration for the sale of its business in stock, if the seller cannot sell the shares it will be faced with paying taxes on the value of all the shares it received without having any way to pay the tax bill until the shares are actually sold.

### **Performance Based Sales Price**

Another way purchasers try to reduce their risk when buying a company is to link the payment of some of the purchase price to certain performance goals. During the sales process, the seller will provide the purchaser with financial projections for the company that is being sold. The purchaser is able to determine the price it is willing to pay for the business in large part based upon these financial projections. So what happens in the

seller does not perform as expected? That is where the purchaser can protect itself by tying payment of the purchase price to the performance of the seller.

These performance clauses are often tied to the amount of revenue or profit made by the seller after the purchase. The purchaser may provide for only half of the purchase price to be paid upon the close of the sale of the company. The other half of the purchase price will only be paid if the selling company hits certain revenue or profit targets over a period of time, typically 3-5 years. If the selling company never hits the performance objectives, the seller does not get the balance of the purchase price. This allows the purchaser to be protected if the seller does not perform as expected.

There are a number of variables to consider when selling a company with the form of the purchase price being one of the most important. It is important to compare the overall package that is being offered to ensure that you are getting full value for your company.

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