



MERGERS & ACQUISITIONS WITH A FINANCIAL GUARANTEE

Financial Guarantee

A Financial Guarantee is where a portion of the acquisition consideration is deferred over an agreed time period.

The Vendor is provided a non-cancellable, irrevocable guarantee for the deferred payment portion of the acquisition consideration. The maximum period is 5 years.

How does a Financial Guarantee Work?

A Financial Guarantee is created by using a Bond that provides the vendor with security. It provides an irrevocable undertaking to promptly pay any deferred amounts should the Purchaser default.

The Underwriter of the Financial Guarantee will honour the financial obligations of the Purchaser solely in favour of the Vendor, providing commitment to pay the Vendor's Financial Guarantee if the Purchaser fails to do so.

The Vendor is given an Financial Guarantee underwritten by an A rated insurance company, an irrevocable non-cancellable undertaking to indemnify the Vendor should the Purchaser default.

In view of the Vendor to be able to fully rely on the Financial Guarantee in the event of a claim, Financial Guarantee are only arranged with insurers with credit rating of A or higher.

Where can a Financial Guarantee be used?

There are a number of areas in which Equilinx can structure a transaction utilising the Deferred Payment concept, namely:

- ❖ Management Buy Outs (MBO)
- ❖ Management Buy Ins (MBI)
- ❖ Spin Outs (pubic companies selling off a subsidiary or business entity)
- ❖ Business Exits
- ❖ Business Succession Planning
- ❖ Owner Retirement
- ❖ Enhancing Owner's Exit Strategy

What is required to qualify for a Financial Guarantee?

To qualify, businesses need to be able to satisfy the following:

- ❖ The target business must be a going concern with a history of positive cash flows able to meet obligations.
- ❖ The Purchaser must be able to demonstrate that it has the knowledge, skills, competencies and industry experience to be able to manage the target business.
- ❖ The acquisition strategy and structure does not contravene international insurance treaties



What are the benefits associated with using a Financial Guarantee?

The benefits are substantial and apply to both the Vendor and the Purchaser.

Benefits to the Purchaser

A Financial Guarantee brings significant cost efficiencies for the Purchaser. Where the Financial Guarantee is provided for 100% of the acquisition consideration cost advantages are superb. However, most transactions are based on part debt/equity and part deferred finance.

This means that the Vendor has some cash on day one and an adequate cash headroom is made available.

Further benefits to the Purchaser

- ❖ Reduces purchaser finance requirements
- ❖ Works in conjunction with or a replacement for private equity and mezzanine finance.
- ❖ Releases valuable cash to fund the acquired business's working capital requirements
- ❖ It allows the Purchaser to pay the acquisition consideration out of future cash flows generated by the acquired business
- ❖ Increases ROI (Return on Investment)
- ❖ Increases Purchaser's personal ROE (Return on Equity)

Benefits to the Vendor

- ❖ Guaranteed payment regardless of the business's success in the future
- ❖ Usually the Vendor can negotiate a higher acquisition price
- ❖ Vendor does not need to take a second charge over the business and its assets behind financiers and or creditors



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EXAMPLE OF A RECENT TRANSACTION

The following is a real life transaction completed by Equilinx for and on behalf of both the Vendor and Purchaser:

The Transaction

Current owner wished to retire, however next generation family members working in the business were not interested in purchasing the business.

Strategy

External acquisition and or Management Buy In.

Acquisition Consideration

\$2.5 million.

Objective

The Purchaser wanted to purchase the business but did not have the required funds to meet the headline price as well as the working capital requirements. In addition, the Purchaser wanted to defer a portion of the headline price subject to agreed performance hurdles.

Solution

Equilinx negotiated an increase in the purchase headline price from \$2.5m to \$3.0m, where \$1.0m would be paid on settlement date with an additional \$500,000 being paid before the end of the first year, while the balance (\$1.5m) would be paid in equal instalments over the next three years.

The Vendor was secured with an Financial Guarantee guaranteeing the deferred payments should the Purchaser default.

Benefits of Using Financial Guarantee

1. The Vendor received a guaranteed higher headline price.
2. The Purchaser now had the ability to fund working capital requirements and future growth.
3. The Purchaser saved \$1.394m in immediate cash outlay.
4. The Purchaser increased ROE% by 2.5 times.
5. There was a reduction in debt funding requirement that would have otherwise occurred if the full headline price was paid on settlement.
6. Improved cash flow through savings on interest payments due to reduction in debt funding.
7. Access to 100% of the cash flow generated by the business even though the Purchaser had only paid for 33.33% of the business on settlement.

- ❖ Only limited action is required to be taken by the Vendor. The Insurance underwriter is responsible for salvage once they have paid the due amounts to the Vendor.
- ❖ The Bond can be accounted as an asset on the post acquisition entities balance sheet with resultant improvements in financial ratios.

The Role of Equilinx

Equilinx acts on behalf of the Purchaser and or the Vendor to achieve a mutually beneficial outcome for both parties in the transaction.

Equilinx structures, negotiates and assesses the risks of each transaction and designs and creates the security required with an A investment graded insurance company.

To do this Equilinx must undertake a thorough examination of the risks including due diligence, management risk, execution risk, business risk, financial risk and investment risk.

Having successfully completed the above activities, Equilinx will structure and complete the raising of the security instrument with an A rated insurance company.

Funding Limits

Financial Guarantee can be secured for repayment programs between \$1.0m – \$150m.

Costs

Equilinx fees and charges associated with structuring a Financial Guarantee will be provided on a case by case basis.