Presentation to FICPI

Motivations for IP firms listing or seeking private equity investors.

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ShineWing
AUSTRALIA

What we are going to cover today

1. Why we are here
2. Strategy Strategy Strategy
3. Structural issues to consider
4. Private Equity / IPO/ Trade Sale
5. Questions

Why we are here today

- IPH (Spruson and Ferguson) IPO has created significant interest. They are cashed up and have announced to the market they are looking at acquisitions. They have just acquired Fisher Adams Kelly and Practice Insight and Wisetime in the last 6 months.
- The other listed legal firms, ie Slater and Gordon and Shine are also outperforming the market and are at all time high share prices. It is an Australian phenomenon.
- Not all listings have been a success. Rockwell Olivier. All of the traditional accounting firms
- The IP firms are under attack from digital disrupters. It appears the market is in a consolidation phase.
- Generally profitability of legal firms is compressing
- Industry segments over time go thorough rationalisation, corporatisation and consolidation. We would contend the IP legal segment is in the midst of change.

Strategy Strategy Strategy

- Listing or seeking private equity must fit within a well defined, achievable strategy and the firm must speak with one voice and stick to it, albeit, with ability to react quickly to market opportunities.
- Is the strategy to make the firm the largest, the most profitable, to expand somewhere, to disrupt the market, or to provide a liquidity event for partners?
- There are a number of questions we would ask in assessing the appropriateness of the strategy

- Before embarking on any “liquidity event” (merger/IPO etc) ensure it is consistent with strategy

Structural Issues to consider

Before embarking on liquidity event beware of the hidden costs of "management / partnership" time allocated to the event

- **Partnership to Equity/Corporatisation –** taxation issues both inwards and outwards

  What are the tax differences/advantages of operating through an incorporated entity.

  What other differences arise if operating as a company?

  What does the ATO think of incorporated entities and other structures for professional practices?

  What are the costs of restructuring.

  Are there any options in deferring these costs.

- **Corporate Governance –** A Board with independent directors, managing director/CEO, ASX public reporting requirements, annual financial audit (additional costs)
- **Salaries and dividends –** Partners become employees and shareholders. Employees may also become shareholders.
- **Accountability –** changes in performance measurement
- **Disclosure –** accounts and operational strategy become public
- **Valuations** - IPH profitability and value

Structural Issues to consider

- **Partnership to Equity/Corporatisation** – taxation issues both inwards and outwards

Tax differences/advantages of operating through an incorporated entity.

Company rate of tax payable (30%) at corporate level and a fully franked dividend paid out. The top up tax (currently another 19%) can be deferred if the profits are retained in the company for business use/expansion. May be able to defer the top up for a period as well. May be easier to finance business. Using a trust structure with a corporate beneficiary will probably achieve the same thing.

No CGT discount in a corporate structure and small business concessions probably not available.

Other differences that arise if operating as a company

PAYGW compared to PAYG quarterly

Payroll tax and workcover payable on salaries

Structural Issues to consider

- **Partnership to Equity/Corporatisation** – taxation issues both inwards and outwards

  What does the ATO think of incorporated entities and other structures for professional practices?

  Where these structures achieve income splitting the ATO is unhappy!

  Latest Ruling;

  Partner receives at least the same as the highest paid employee

  50% of the income is received by the partner

  All income is taxed at least at a rate of 30%

Structural Issues to consider

- **Partnership to Equity/Corporatisation** – taxation issues both inwards and outwards

  What are the costs of restructuring.

  – Capital Gains Tax
  – Assuming the asset has been held for more than 12 months Capital Gains Tax at a rate of 24.5% will be payable on the transfer of assets to a new entity subject to rollover relief being available.
  – Pre 1985 Assets?

  – Stamp Duty
  – There may be duty payable on the transfer of business assets (including goodwill) depending on the State in which the assets are located as follows:

	Vic	NSW	QLD	SA	WA	Tas	NT	ACT
Stamp Duty	Nil	7%	5.25%	Nil	5.15%	Nil	5.45%	Nil

  – There will be duty on all States where land and/or motor vehicles are transferred.
  – Corporate reconstruction relief may be available for movement of assets between companies, not trusts.

Structural Issues to consider

- **Partnership to Equity/Corporatisation** – taxation issues both inwards and outwards

  Are there any options in deferring these costs.

- CGT Rollovers
  - Individual to fully owned Company
  - Scrip for Scrip Relief (From Company or Fixed Trust)
  - Partnership to fully owned Company
  - Company to fully owned Company
  - Trust to fully owned company
  - Demerger Relief
  - May be available for a small business individual to a trust (from 1 July 2016)

Trade Sale

- Usually the outright sale to a third party, but can be majority interest with buyout over time.
- Could take the form of selling to (say) IPH or other listed law firm for shares and/or cash or a merger with another private law firm.
- Possibly need to run formal sale process to ensure competitive tension but will ultimately deal with one party on a private treaty basis.
- **Advantages** – Could sell without any changes to structure and corporate governance thereby limiting cost. Could run “dual track” process where you auction off POF to buyers and IPO at same time. Ability to realise some value for goodwill built to date. Ability to retain some privacy.
- **Disadvantages** – Loss of control and culture. Potential discount (but maybe premium) from fully priced IPO.

Private Equity

- Funds used to grow the business for resale or IPO – usually from an institutional investor.
- Private Equity will want the firm to articulate growth story (which can be organic and acquisition) and achievability thereof. Will use leverage and growth story to ascertain whether they can double their money in 3 to 5 years time. At time of investment a firm plan for exit (IPO/trade sale/sale to another P/E) is determined.
- Generally some money may be able to be taken off the table but likely to require sufficient funds be left in the business to incentivise partners to grow the firm. Like IPH maybe 50% off table now.
- Valuation will be less than IPH due to unlisted nature and size and for investor to make money on turn/exit
- **Advantages** – dealing with one party, no public disclosure, both existing and new investors are aligned with making money, will bring experienced external skills to strategy and running/growing business, have finite investment period, potential for access to more funds
- **Disadvantages** – loss of control, reliant on P/E firm to drive value (they will require board representation), bad leavers are penalised, ruthless when things are not going to budget

Initial Public Offering

Advantages

- Provides a partial exit strategy
- Priced (value) at “listed levels” but will be discount to IPH
- Ability to attract retain and reward staff
- Enhances reputation/profile
- Allows utilisation of scrip (shares) or access to funds to make acquisitions
- Attracts better talent in Boardroom

Disadvantages

- Partners become shareholders and employees and have less (negligible) influence
- Salaries are significantly below drawings and must rely on dividends and initial sale of capital to finance lifestyle. Focus needs to be on maximising returns for investors.
- IPO window must be open and expensive process if deferred or unsuccessful
- Higher cost structure to support more rigorous, public, corporate governance
- Can be lengthy and costly process with no guarantees of future value on remaining share ownership

IPO continued

Aaron will address these issues but the slide is here for reference:

Process of undertaking an IPO

- Investor ready
- Structure of entity
- 2-3 years audited financials
- Attract independent directors and appoint Board
- Management Structure
- Corporate Governance
- Professional advisers, legal, accounting, underwriter, PR
- Roadshows
- Pricing (value) of IPO – size of raising/ free float
- Escrow

Costs of IPO – in the order of 5%-7%

Questions