

Mergers & Acquisitions

Taxable Transactions (Stock or Asset Purchases)

Part II

In our last newsletter we discussed the pros and cons of buying assets or stock. Taxable purchases of another company are similar to transactions accounted for as purchases under generally accepted accounting principals (GAAP).

From a tax perspective, the sale of many assets at the same time is similar to the sale of a single asset. Only the magnitude of the transaction and the need to allocate the purchase price among the assets differ. In addition, non-income tax considerations related to transfer of title and transfer taxes enter into a bulk sale.

Whenever assets are purchased in a taxable transaction, their tax costs (the basis) is the amount paid (cash plus any assumed liabilities).

When something other than cash is paid, the basis is the fair market value of the assets transferred. **A sale of assets by a corporation is taxable to that corporation.** The same result occurs regardless of whether the sale is made by the corporation in contemplation of liquidation.

SELLER'S SHAREHOLDERS IN A TAXABLE ACQUISITION

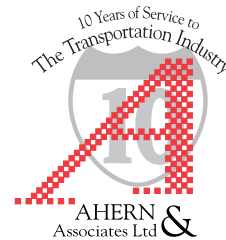
In any acquisition the buyer must be mindful of the seller's tax status. Because a taxable acquisition will likely result in a tax liability for the seller, **its shareholders will frequently want a higher price** in a taxable transaction. Thus, tax costs will affect the acceptable purchase price.

For example, assume a sale of a going business is being negotiated. The buyer wants a minimum cost. The selling stockholders own stock in a corporation that, in turn, owns land (for purposes of this example, the selling corporation is assumed to own just one asset).

The fair market value of the land is \$200.00, and its original cost was \$20.00. Assuming that \$200.00 is agreed upon as a purchase price, the sale of corporate stock would clearly be preferable, as is illustrated in the following comparison:

	Stock Sale	Asset Sale
1. Gross Proceeds	\$ 200	\$ 200
2. Corporate basis in land	-	20
3. Corporate-level gain	-	180
4. Corporate tax @ 34 percent	-	63
5. Proceeds to shareholder (item 1-item 4)	200	117
6. Shareholder basis in stock	20	20
7. Shareholder-level gain	180	97
8. Shareholder tax @ 33 percent individual rate	60	38
9. Net proceeds to shareholders		

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ATA FOCUS: SAFETY ISSUES, INTERMODAL

Although the American Trucking Association is not opposed to the split-up of Conrail, it urged the Surface Transportation Board to impose "common sense" requirements on Norfolk Southern and CSX to make them responsible for keeping intermodal equipment in good repair and improving rail-highway grade crossings.

ATA Deputy General Counsel Kenneth E. Siegel, testifying for the association, told the board that railroads have no responsibility for chassis or trailers that they interchange with trucking companies. That situation is akin to forcing car rental customers to thoroughly inspect a vehicle and make any necessary repairs before using it, he said.

According to CSX and NS officials, one of the significant benefits of the transaction is the potential to shift one (1) million truckload shipments a year from the highway to railroads. Those shipments eventually will be put on the roads, though, usually in congested urban areas and by companies that are not subject to any federal or state motor vehicle safety standards, Mr. Siegel said.

The acquiring railroads also should be required to undertake an "extensive" program of rail-highway grade crossing improvements, according to ATA. That would include ensuring that warning signals are in place and working, and providing clear identification and emergency communication devices at each crossing.

(Excerpts taken from Transport Tropics)

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A. W. Ahern, CEO and Founder of Ahern & Associates, with daughter, Megan.

How To Handle Pressure

At some point, everyone experiences a sudden inability to perform at peak effectiveness. From time to time, even highly trained athletes freeze up just when they need their skills most...and Wall Street analyst and traders, too.

The risk of “choking” is greatest when we are under real or imaginary pressure to perform flawlessly. When personal stakes are that high, negative thoughts...sudden noise...or any other distraction can break our concentration and cause us to do less than our best.

Some people, though, bounce back from distractions or regain the balance and poise while others “choke” and under-perform. If we understand why these type of emotions happen then we can understand how we can avoid these distractions in the future.

Why do people choke? Personality type plays a key role in determining how an individual recovers in difficult situations. **For example:**

- a. **Introverted types** typically are at a high stress point when performing, since they are most comfortable when they are isolated rather than when they are drawn out. Added pressure can be too much for them.
- b. **Extraverted types** are chronically stimulated and usually can ignore – or even enjoy – the extra pressure.

“...understand why these type of emotions happen then we can understand how we can avoid these distractions in the future.”

Most people who freeze up under pressure do so when they feel a loss of control or something goes astray – a contingency that

they had not anticipated or perhaps never encountered before, even seemingly minor.

Anything out of the ordinary can be a distraction...distractions cause the mind to wander, which in turn causes subpar performance. If there is a break in concentration, even highly skilled people can be thrown off rhythm and perform poorly.

To avoid choking there are certain guidelines that can be helpful:

- a. **Don't expect everything to go according to plan.** If you assume there will be distractions during your performance, you will be prepared for deviations or set backs. It is helpful to practice skills in advance with distractions.
- b. **Develop cues for yourself.** Since we are most likely to choke when we lose our train of thought, it pays to have a system prepared to get back on track.

Visual aids can be great cues. Many people use slides during their speeches to better deliver their messages to the audience. Slides work well to keep you on track.

- c. **Recognize your weaknesses.** Many people are predisposed to lean heavily on their strengths in high pressure situations. But that can leave you open to greater problems – and panic.
- d. **Connect with the opposition, make eye contact** with your audience before a speech or open with a joke. You will see that the audience is not really your enemy. They are on your side. **Such a reality check can help reduce the pressure.**

In an adversarial situation, introduce yourself to your opponent and shake hands before beginning. Once you assure yourself that you're just dealing with another human being, you're less likely to feel overwhelmed – and panic.

- e. **Flash back to when you succeeded** in a similar situation. Call to mind a moment when you successfully handled a uniquely daunting task. That can be a great way to create confidence and prevent choking.

If its your first try at what you're doing and you have no track record to think back on, call to mind a positive role model who you most admire for his/her skill in this type of situation. That can help you focus on success...not fixate on the possibility of failure.

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QUESTIONS TO ASK A SURGEON

I am amazed that when faced with a serious medical problem, why many people don't thoroughly review their situation/options. They take the doctor "at face value" and believe that what he states is fact. To protect yourself against unnecessary surgery you should always ask your physician the following:

- What are the risks?
- What is the mortality rate for this operation?
- How long will it take to recover?
- What is the likelihood of complications? What sort, if any?
- Are there alternative ways to treat this condition?
- How many people have you seen with similar symptoms who have chosen not to have surgery?
- How many of these types of operations have you done in the past year?

In all instances, get a second opinion. In this age of information, it is possible, with a little persistence, to find out what choices are available and then you can act accordingly.

(Excerpts taken from Bottom Line Personal)



Developing A Financing Proposal

When you go to a bank for a loan, you are seeking debt money, which you will repay over a period of time at an additional cost (interest). The money you invest in your business is ordinarily equity, that is money that will not be repaid to you unless you sell a portion of your ownership. **Debt financing does not lead to sharing ownership** of your business with a financier. Equity financing does.

Control is another matter. Your banker may exert substantial control over your business through a legal document or through suggestions – but he or she does not own your business. **Debt pays interest**, usually for finite time. **Equity pays profits forever**. It is important when developing a financing proposal to recognize that banks are not venture capitalists, not risk-takers, not gamblers. They should not be. **Their business is investing other people's money, and they have to be cautious**. The distinction between debt and equity is important to your banker because the more debt there is in relation to equity, the higher the risk. **A high debt-to-worth ratio** (worth being roughly equivalent to equity, but may include some kinds of subordinated debt) **indicates high risk** – and high risk costs high interest if you can find new debt money at all. Why? Because debt money is rented money and the rent must be paid no matter what the business is doing. **If you can't meet your debt payments, you go out of business.**

Not only that, but a highly leveraged business (higher than normal debt-to-worth ratio for that kind of business) must earn more money. Sometimes it is impossible to find so much debt money that the business can never get ahead. **Without capital** (permanent non-repayable money invested in the business), **you can spin you wheels forever, a problem called over-trading**. Sales-to-worth ratios are guidelines to this and can help you pinpoint your capital needs relative to projected sales.

From a banker's viewpoint, the higher the debt, the riskier the deal.

The longer the term, the riskier the deal. Short-term loans are less hazardous than long-term loans because if the deal goes sour, it does not in a hurry and can easily be detected,

while a long-term decline can almost be imperceptible. The underlying issue – performances at the near-term – can be predicated with much greater certainty than longer times allow.

Risk, the odds against an expected happening in the future, is just one of the elements in a credit decision.

Most bankers have been trained in the "Three C's of Credit": Character, Capacity and Capital.

Character reflects the willingness to pay (a record of non-payment or a prior personal bankruptcy, for example, might cause a banker to view a person's character as too risky).

Capacity and Capital reflect the ability to carry out the intent to pay. Experience is a factor here; your experience in a given business affects your banker's perception of your abilities to successfully run the business.

Capital is obvious; a well-capitalized business is inherently less risky than an under-capitalized business. Costs will be lower, for example, and a capital cushion makes for sounder decisions.

Two other "C's" are often cited: Condition (of the economy and of the business) and Collateral. If the economy in your area is rolling off the cliff, the risk of your deal will be magnified. **Collateral is used as a means**

of tying you to the deal. Experience has shown that people who have their own assets on the line try harder to make a deal work than people who are working with little of their own money at risk - **collateral also serves as a comfort factor for the banker.** Bankers have no desire to be second-hand equipment dealers or to sell out your stocks and bonds. But they like to have some recourse just in case your business fails.

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STOCK OPTIONS & HOW THEY WORK

- * Employee stock option programs are typically authorized by a company's Board of Directors (and have historically been approved by the shareholders) and give the company discretion to award options to employees equal to a certain percentage of the company's shares outstanding.
- * Options give employees the right to buy a certain number of their company shares at a fixed price for a certain period of time, usually ten (10) years.
- * That price, usually the market price of the stock on the date the options are granted, is called "strike price".
- * Options usually begin vesting after one (1) year and vest fully after four (4) years. When an employee leaves a company before his/her options vest, they are cancelled.
- * Once an option is vested to the employee, the employee can then "exercise" it – that is, purchase from the company the allotted number of shares at the strike price – and then either hold the stock or sell it on the open market.
- * The difference between the strike price and the market price of the shares at the time the option is exercised is the employee's gain in the value of the shares.
- * When the option strike price exceeds the market price of the stock, the option is technically worthless or "under water".
- * When the market price of the stock exceeds the strike price of the vested option, the option has value or is "in the money".
- * When an employee exercises an option, the company must issue a new share of stock that can be publicly traded. While the employee pays the company the strike price for that share, the company's market capitalization grows by the market price of that share.
- * Having more shares outstanding dilutes (or reduces) earnings per share – and thus the value of shares held by investors who already own the stock.
- * To forestall delusion, one of two things must happen:
 1. Earnings must increase, commensurate with the increase in outstanding shares; or
 2. The company must repurchase shares on the open market to reduce the number of shares outstanding;

(Excerpts taken from Inc. Magazine)



Establishing an Employee Loan Program

Allowing employees to borrow from pension plans or directly from the company is one of the least expensive ways to enhance the company's benefit offerings. And experience shows that the cost is usually offset by improved morale.

Loans Against Stocks and Pensions - Federal law allows employers with qualified tax deferred pension plans, 401 (K) plans, stock options, or profit sharing plans to let participants in those plans borrow money against their savings or stocks.

“Allowing employees to borrow from pension plans or directly from the company is one of the least expensive ways to enhance the company's benefit offerings.”

The Restrictions

- * **The maximum loan to an employee cannot exceed one-half (1/2) the present value of the vested amount in his/her pension account or fifty thousand dollars (\$50,000), whichever is lower.** (The highest loan balance during the previous year, minus the loan balance on the day the new loan is taken out.
- * **The company must require payment in five (5) years** to level payouts, and installments cannot be less frequent than quarterly. Employers must charge an interest rate based on current market conditions. It is recommended that the Applicable Federal Rate is utilized, which is based on an average quarterly rate of Treasury securities...
- * **Federal rules permit employers to set a \$1,000 minimum limit** on borrowing. To protect the company from default, require payments to be made by payroll deductions.
- * **To guard against the possibility that employees may leave the company without repaying,** warn them that if the loan is not repaid within sixty (60) days of their departure, the loans are deducted from their pension accounts and become subject to tax.

Another way in which to establish an employee loan program are direct loans from the company. Many companies provide direct loans to managers who are being relocated and need extra cash to buy a house in the new location until they have sold the house they are moving from. But loans can also be made for other purposes.

However, be cautious: It is illegal to make an interest-free loan to an employee if it is over ten thousand dollars (\$10,000). And, interest must reflect actual market rates, such as the Applicable Federal Rate.

But the company can save its employees a lot in interest payments by following IRS rules that allow the company to return interest charged to a borrower in the form of additional compensation. The employee thereby pays nothing out of pocket except income tax on an additional compensation. For example: A company lends a manager fifty thousand dollars (\$50,000) at ten percent (10%) a year. Instead of actually collecting the \$5,000 of interest, it records a \$5,000 interest receipt in its books and at the same time adjusts its books to record a \$5,000 pay increase for the employee. The company thereby comes out even, with no interest money changing hands. **The borrower, however, pays income tax on the extra \$5,000 in “salary”.** Though the interest deduction has been phased out, the reduced tax on income still makes borrowing from the company much cheaper than borrowing at market rates from a commercial bank.

(Excerpts taken from Israel Press, Tax Partner, Deloitte & Touche Financial Services Center, One World Trade Center, New York, NY 10048)



TRANSPORTATION NEWS

INTRENET LOGISTICS, INC. ACQUIRES RAMS TRANS, INC.

Inet Logistics, the logistics subsidiary of Intrenet, Inc., Milford, OH, acquired the assets of Rams Trans, a Denver-based logistics and truck brokerage business on June 1st, 1998.

The purchase will double the sides of Intrenet's brokerage and Logistics operation and it will also broaden the customer base and have a positive impact on revenue and profit, said Intrenet President, John P. Delavan.

"This is a strategic fit that makes sense not just from an economic standpoint but from both the geographic and demographic perspectives as well." Ahern & Associates, Ltd., assisted Intrenet in a management-consulting capacity and acted as acquisition advisor.

U.S. XPRESS TO BUY P.S.T. VANS

U.S. Xpress Enterprises, Chattanooga, Tennessee has agreed to acquire Salt Lake City-based P.S.T. Vans for \$12.5 million in cash and \$1.1 million shares of stock.

The deal was approved by directors of both companies, but is subject to negotiation of the definitive merger agreement and approval of P.S.T. Vans' shareholders and regulatory agencies. U.S. Xpress Co-Chairman, Patrick Quinn, said P.S.T. Vans will be operated as a division of U.S. Xpress.

YELLOW CORPORATION TO SELL PRESTON TRUCKING COMPANY TO TOP EXECUTIVES

Yellow Corp. agreed to sell Preston Trucking Company to three top Preston executives, restoring the company to its long-time status as an independent regional less than truckload carrier.

The transaction is contingent upon negotiation of a new five-year labor agreement with the Teamsters Union and Preston management securing financing for future working capital needs. Under terms of the sale, Preston will start out debt-free.

PONY EXPRESS IS PURCHASED BY INVESTORS

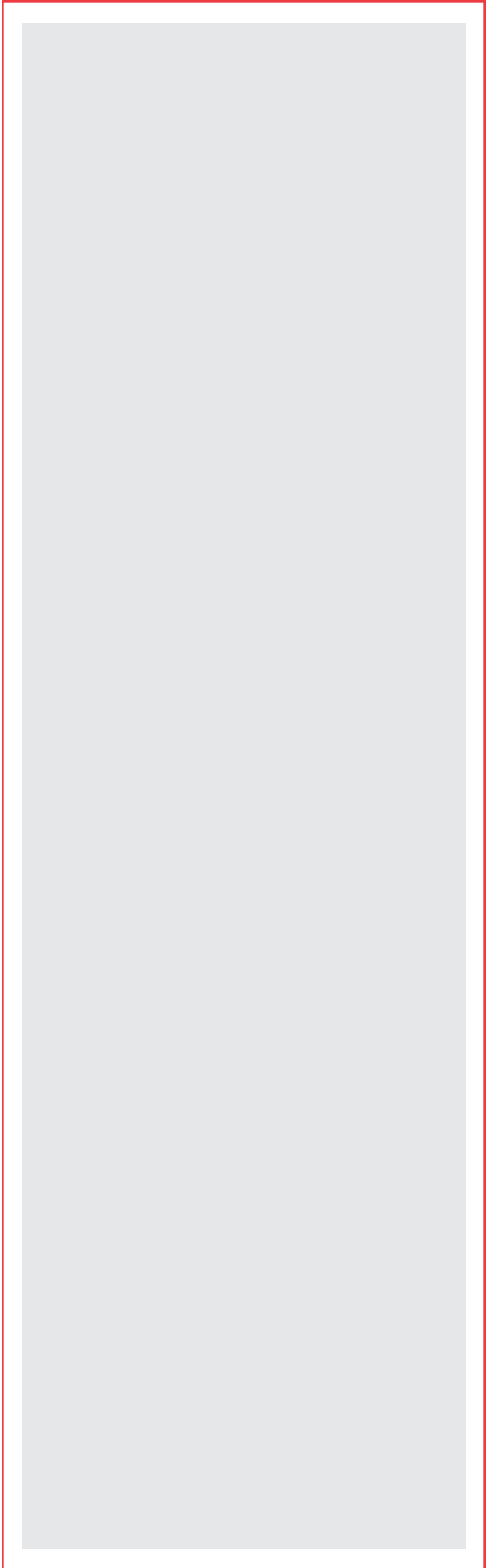
Pony Express Delivery Services, an Atlanta-based courier and small-package carrier, has been sold to Mustang Holdings, an entity formed by Greenstreet Capital and Merit Capital Management, two investment funds based in Prairie Village, Kansas.

In March, Borg-Warner Security Corp., the parent of Pony Express, had announced an agreement to sell the business to Heico Companies, a firm that operated more than 20 businesses in a variety of industries.

There was no explanation for the change in buyers.

Pony Express provides document and package delivery service in 36 states and employs about 4,000 people.

(Excerpts taken from Transport Topics)



For the seller's shareholder to net the same amount of cash (\$129) from the land sale as from a stock sale, the price for the land would have to be \$293.

	Asset Sale
1. Gross proceeds	\$297
2. Corporate basis in land	20
3. Corporate-level gain	277
4. Corporate tax @ 35 percent	97
5. Proceeds to shareholder (item 1 - item 4)	200
6. Shareholder basis in stock	20
7. Shareholder-level gain	180
8. Shareholder tax @ 38.6 percent the maximum individual rate	71
9. Net proceeds to shareholder (item 5-item 8)	\$129

In effect, the asset sale would transfer the cost of all tax burdens relating to the sale from the seller to the buyer. The buyer in that case, would have a higher basis for the acquired assets, representing the amount paid. However, the benefit would be result in future cash savings owing to a lower capital gain at the time of resale, whereas the cost would be more cash paid now.

Accordingly, it is difficult to predict the circumstances under which the parties would willingly agree to a sale of assets instead of stock – unless, it is noted the selling corporation had tax attributes such as loss carry forwards that could offset the corporate-level gain, in such tax attributes would otherwise become limited if the stock of the selling company was sold.

An acquisition of the stock of a selling company for cash or for other property, also results in a taxable gain or loss to the seller's shareholders. The buyer's basis in the acquired stock equals the amount paid. However, the buyer get no other advantage until the stock is sold because no depreciation is allowed on stock costs.

In our next newsletter, we will review Section 338 of the Internal Revenue Code and the tax consequences thereof.

(Excerpts taken from Mergers & Acquisitions, Ernst & Young)

How To Handle Pressure cont'd from page 2...

- f. **Set aside a few second to think before you begin.**
When people speak or act without time to compose their thoughts, they are likely to choke and not show their true skills.

If you're in front of a group and faced with a tough question, repeat the question before answering; this will buy you some time. Or ask the questionnaire to repeat it in a louder voice and use the time to think through your response.

If you're truly in a jam, you're better off saying that you don't know the answer – rather than fabricating one.

(Excerpts taken from Bottom Line Personal).

That's as it should be. Bankers are not in business to take risk or shoot for a long shot. Nor should you be. Most studies of successful business owners show a profile of moderate risk-taking. Not too conservative, but certainly not too eager to run unjustified risks.

Another way that bankers and other financiers look at a deal is to consider the personal financial and economic factors that are involved. The personal factors include many tangibles (integrity, for example, try to define it) but your personal track record provides a clue. **This is why a full resume has to be part of your financing proposal.** If your banker has known you forever, fine – put it in anyway. Other bankers may not know you as well. Your education, experience and history are important. The saying that “There are not small business loans; just loans to small business owners” is true. You probably have to sign personally for a loan when your business is small.

Financial factors will have been covered in some detail in your financial statements, and if they are based on clearly spelled-out, rational assumptions, will provide additional evidence of your personal commitment as well. Financial factors include products/service, marketing, competition, personnel and management elements.

Economic factors may be beyond your control, but once again, will affect your banker's decision. Your business idea might be poor today, but wonderful tomorrow – and no banker would do you a favor by launching you into a business at the wrong time. If times are tight, think carefully about a new venture (that doesn't mean not to pursue it, just to think is through carefully).

Assuming that you pass the rough sorting criteria, what comes next? Your business plan, tailored to the banker as a financing proposal, gains added credibility if you ask for the appropriate financing to fit you needs. You can research this ahead of time by involving your banker in your planning any by asking your accountant.

The key here: Fit the Financing to the Need.

When you projected your cash flow, you did two things that helped determine the right financing mix for your business. The deepest negative cash flows, both the net cash flow and accumulative cash flow, indicate how much money you need and when you need it. Projected cash receipts give you an inkling of how you will generate money to repay the loan or make good the investment. If you don't arrange for enough financing, you deal will be dead. **If you borrow more than you can service, your deal will also be dead.** If you borrow at the wrong time, for the wrong reasons, you aggravate the risk of being in business, risks that are already high.

In preparing your financing report, a final word may be helpful. Friday night financing never works. Always make sure your banker knows your needs well in advance. Then you won't get caught in a cash squeeze. **Borrowing in a panic is dangerous. Don't do it.** Tell you banker what you need the money for, how it will be repaid – and why the deal makes good business sense. Your financing proposal should do just that and if it's based on your business plan and careful analysis, you should get the right financing. **PLANNING IS THE KEY TO SUCCESS.**

Excerpts taken from The Business Planning Guide, David H. Banks, Jr.