

Guide to

GETTING THE MOST FOR YOUR COMPANY WHEN YOU DECIDE TO SELL

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PRACTICAL SERVICES
for
BUSINESS DIRECTORS

EXIT PLANNING

is perhaps the most difficult yet most important period in the life cycle of Small Medium Enterprises (SMEs). It is an event that probably only happens once, yet has a profound effect upon the future life, particularly in retirement, of the owners. Research clearly shows that many owner managers fail to achieve full or fair value for their business during the exit process. The key reasons for this failure are:

- Unrealistic value expectations and timescales
- Poor preparation within the business prior to the sale
- Unwillingness to use professional advisors
- Inadequate resources allied to the exit process

PLANNING FOR YOUR EXIT STRATEGY

Planning a strategy to maximize the value of your business on sale requires careful advance planning. You should start considering the issues several years before you plan to sell. The actual exit process will take 6 to 12 months and may require varying degrees of preparation of up to several years, depending on the condition of the business prior to sale.

EXIT ROUTES

There are several different types of exit routes open to owner managers:

- **Trade Sale** – selling the business to another company. It is difficult to retain confidentiality during a Trade Sale. The trade buyer will probably seek to consolidate the acquired business into an existing operation, therefore leading to increased employee uncertainty.
- **Management Buy Out (MBO)** – Existing management within the business acquires the Company. MBO team often have difficulty in raising the funding required to complete the transaction. The MBO process is very draining on the Company's management resources.
- **Management Buy In (MBI)** – Outside investors acquire the company and place their own management into the business. Requires the company to be financially secure with a minimum valuation of c£500,000.
- **Buy In Management Buy Out (BIMBO)** – The most favoured exit route for the providers of debt funding. This is where the Management Buy Out team (MBO) are unable to either raise the equity or debt funding package and seek an outside investor to strengthen the credibility of the debt lending proposition.

- **Partial MBO/MBI** – Where the shareholders agree to sell their shareholding in the company in stages.

VALUATION

The valuation of your company is not a science, but is driven by market forces and your ability to present your business as a significant investment opportunity. There are a number of principles that can be applied to valuing your business:

- **Earning Multiples** – Normally based on historic and possibly forward projections for earnings, measured before depreciation, interest and tax, but adjusted for "average Directors" drawings. The range for this earning multiple can vary from less than 4 to greater than 10 and is dependent on many factors, some of which are mentioned below.
- **Net Asset Value** – The book value of the company as declared in the balance sheet. In many cases owners may expect to achieve a premium when using this approach to valuation.
- **Cash Flow** – Normally based on historic and possibly forward projections for cash flow. Debt funders will focus on historic performance, whereas investors may include forward projections, discounted to reflect timings and risk.

Premium valuations are achieved where the business can demonstrate one or more of the following attributes:

- **Size** – larger businesses attract higher valuations than smaller businesses.
- **Strong historical financial performance and projections** always attract higher valuations. Remember that every £ invested or spent and not fully recovered in the 2 years prior to selling your company WILL REDUCE the company's valuation.
- **IPR/Technology that is protected by patents, copyright, etc.**, will enhance the valuation.
- **A business operating in a growing market** will attract a higher valuation than a similar business in a market that is flat or declining.

INFORMATION MEMORANDUM (IM)

The IM is a document that you and your advisors produce which will set out for interested parties all the salient financial, operational, legal entity and other legal issues that a potential bidder will need, in order to make an Indicative Offer for your company, subject to Due Diligence and Contract. This IM will need to include the previous 2-year's historical financial performance, the current year forecast and 2 year's projections for profit, cash and balance sheet. The IM is provided under a "Non Disclosure" agreement to

interested parties, thus protecting its confidentiality.

DEAL TEAM

You will need to appoint a Deal Team to include:

- Specialist Corporate lawyer
- Tax Accountant
- Corporate Financial advisor

The fees relating to these advisors will normally be paid from the proceeds on completion and cannot be charged to the company.

NEGOTIATE DEAL STRUCTURE

When you come to negotiate the deal structure remember the following principles:

- Competitive negotiations — Retain a competitive bidding environment. Your business will always be worth more when two or more parties are actively involved in the bidding process.
- Cash is King — Maximise the cash on completion as part of the deal structure. Earn-outs or deferred considerations are always a risk.
- Short time scales — Keep any period of “preferred bidder” exclusivity to no more than 2 to 3 months.

HEADS of TERMS

Confirm the deal structure in a Heads of Terms, normally prepared by the purchaser. This document is non-binding, but never the less should be reviewed by your lawyer.

DUE DILIGENCE

The purchaser and their financial backers will undertake a process of verifying the financial, operational and legal information you have provided in the IM.

This process is called Due Diligence and will require you to provide hard copies of a wide range of documents related to your company and its activities.

The Due Diligence process will either be covered by the “Non Disclosure” agreement previously signed by the bidder prior to receiving the IM, or by the more detailed Confidentiality clauses included in the Heads of Terms.

The purchaser will normally require 1/2 copies of these data files, with you retaining 2 copies, one of which will be used by your lawyers to create the “Disclosure Letter”. Due Diligence will normally take 2 to 4 weeks and need to be completed 2 weeks prior to completion.

SALE & PURCHASE AGREEMENT (SPA)

The SPA is normally prepared in draft form by the purchaser’s lawyers. This is the legal document or series of documents, which cover all aspects relating to the sale and purchase of your company. The SPA will set out the basis under which the assets of your company are being purchased and by whom.

The warranties section will cover those warranties that you are prepared to provide to the purchaser, normally 2 years for non-tax warranties and 7 years for tax warranties, against which you will disclose any known breaches in the Disclosure Letter.

The SPA will also include any management handover, which is normal in this kind of transaction and possible restrictive covenants, preventing you from competing against your company post completion.

COMPLETION

This is the formal signing of the SPA and other legal documents and the point at which the purchaser will transfer the funds agreed on completion to your lawyer’s bank account. This is also the time when you will be required to pay the fees of your professional advisors.

There may be further payments relating to the consideration post completion depending on the nature of any earn-out or deferred consideration.

DO’S

- Prepare business for sale
- Appoint specialist advisors
- Ensure accounting and legal entity records are accurate and current
- Be conservative with financial forecasts
- Protect IPR
- Remember cash is king
- Maintain competitive bidding position

DON’T

- Have unrealistic view on value and time scales
- Hide skeletons or bad news
- Incur/invest in non productive costs/assets before sale process starts
- Over sell your business
- Agree to large earn outs or deferred consideration

The Christopherson Associates Exit Planning and Strategy Services work with business owners to help them achieve maximum value for their business – first planning and then helping carry through the planned exit strategy.

Our extensive contacts include a significant number of people, who already having funding arrangements in place and who are looking to buy independent SME businesses.

If you are interested in any of our Exit Planning and Strategy Services please telephone us on 01225 480325 or complete the contact form on our website www.practicalservices.co.uk to arrange a free discussion.

The author of this article is available for group presentations to your business or organization. If interested, please call us on 01225 480325 to arrange.

See the downloads section of our website for similar guides for small business owners.

About Christopherson Associates

Christopherson Associates help business owners achieve their goals by providing a whole range of practical services.

These services include boosting profits, increasing sales and marketing activities, streamlining operations, installing Quality or IT systems, ensuring compliance with Health and Safety regulations or Employment legislation, raising finance, planning and implementing an exit strategy or helping with any business problem outside of the experience of the business owner.

All our associates are seasoned and mature business professionals with decades of relevant business experience either at board or director level of major companies or have run their own businesses.

They are well trained in working with business owners and take a highly practical approach to solving problems and enhancing your business by working closely with you every step along the way.