

Selling a business





Foreword

For many the sale of their business is a daunting and often scary process, but moreover whatever the feelings it is a significant watershed in terms of securing 'the family silver'.

Preparation and planning is key to any disposal process as it:

- presents the business in its best light thereby improving value
- reduces the risk of due diligence price chipping
- allows the purchaser to thoroughly understand the opportunity
- makes for an easier and smoother transaction.

At the end of the day the price of anything is what someone is willing to pay. The identification of the right purchaser and the timing of any approach is therefore crucial to maximise the interest received. Where there is competitive tension normal valuation parameters can often be exceeded.

We have considerable expertise in sales mandates of this nature and have immediate credibility with and access to potential listed UK and international acquirers as well as institutional investors who might be potential financial acquirers. Through our databases we also have the ability to identify and research potential acquirers including the identification of would-be acquirers in vertical or other sectors to which you may not have given consideration.

As a full service accountancy practice we offer joined-up access to other areas in which you might require advice and can draw upon the expertise of our in-house tax and financial planning experts, if required, in structuring and planning transactions.

Critchleys corporate finance team can draw on specialist expertise to provide you with comprehensive financial advice. Our experts in corporate tax, VAT, accounting, audit and financial planning are on hand to advise on broader issues affecting the success of your business. This multi-disciplinary approach provides a level of service which stand-alone corporate finance boutiques find hard to match.

We offer a full range of services to help you achieve your business ambitions and measure our success by your success. Critchleys' experienced corporate finance professionals have the expertise, contacts and commercial acumen to effectively negotiate and conclude deals - and an impressive track record to prove it. We are committed to providing sound commercial advice to the mid-market, and have particular expertise in owner-managed businesses and SMEs.

Justin Ray
Corporate Finance Partner



Key thoughts

The best time to sell is when you don't have to. The ability to say no and walk away from the table is a powerful tool!

Maintain confidentiality wherever possible

A well planned process will improve value and make for a smoother ride

A transaction should be examined objectively from all aspects – purchasers, vendors, investors and management – and work out what each party needs

Get the right advice at the right time!!



Exit Options

Before determining what exit options are valid, you should ask yourself: Why am I planning to sell?

From a buyers perspective they need to understand the driver behind the process and be comfortable with the reasons. Any mixed messages will confuse and is likely to affect interest and ultimately value.

Some of the typical reasons may include the following:

- Realising value
- Forced sales
- Retirement sale
- Need to be part of a larger group
- Need for finance to grow
- Need for additional technology or support
- 'Now's the time'

A) Partial Sale

In some instances it may be possible to secure a partial sale of the business such that the Sellers are able to take some cash off the table but still retain control or a stake in their business.

- Equity release, for example is where a bank or venture capitalist supplies funds for the company to purchase some of the Sellers shares. It may well be the case that the Seller uses this opportunity to incentivise their management team by inviting them to participate in a partial Management Buy-Out.

B) Trade Sale

The trade sale is often the route preferred by Sellers, since finding the right trade purchaser that has the appetite, ability and reason to acquire your business is the way to secure optimum value. Such trade buyers can often see the benefits of putting two businesses together be it cross selling; cost savings; market share; or other synergies and it is these benefits that drive their compulsion to purchase.

Such a trade buyer may actually be a direct competitor, which adds to the complexity of the process. Competitors may feign interest to secure as much proprietary information as possible before backing out at the last minute. For this reason any Seller needs to be careful about how such buyers are dealt with and only release sensitive information about customers; employees; contracts; and intellectual property as late as possible in the process.

The flip side is that a direct competitor may well be the one who can generate the most synergies through consolidation and therefore be the one to generate the highest value.



C) Selling to your Management Team

Through any sensibly run 'grooming' preparation process there should be a second tier management team in situ that has the knowledge and experience to run the business in the Seller's absence. With such succession planning the Seller's exit will be made all the smoother as the buyer recognizes that the control and client relationships doesn't rest with the Seller but more with the team being left behind, reducing perceived risk and shortening the length of any handover period.

Any 'decent' second tier management team are likely to have their own ambitions and desires and this may well take the form of putting together a Management Buy-Out.

From a Sellers perspective there are a number of key issues to consider before granting them permission to do so:

- Your management team owe you a fiduciary duty of care, in other words they need to act in your best interests. Your explicit permission should therefore be sought from the outset before they explore any Management Buy-Out
- Great demands will be placed on their time through the need to meet with advisers, banks and venture capitalists. This process will therefore potentially conflict with the demands of running your business. You must therefore ensure that the business (and hence value!) is not damaged by their activities
- The price a MBO team can offer will be restricted by the amount of external money they can raise, be it debt or equity
- It may be the case that if higher offers are received from elsewhere and the MBO abandoned putting the 'Genie' back in the bottle and re-incentivising your management team can be difficult
- Where there is a valuation gap it will be down to you to be flexible in approach and timing of the consideration received (see earn outs and deferred consideration later in this document)

D) Flotation

Flotation through listing on the stock exchange or junior market such as AIM or Plus can raise funds and provide a way for the Seller to exit. However, under such scenarios it will usually only involve a partial exit for the Sellers and there may well be other restrictions placed in relation to the future sale of retained shares.



Process

A) Preparing the business for sale

A large number of disposal processes are triggered by a direct approach from a trade buyer. Therefore any well managed and run business should always be prepared for this eventuality and contemplate what 'preparation' needs to be done to portray the business in its best light and thereby attract the highest value.

The keys areas are often around:

- Identifying and building on those key KPI's that will attract the right buyer
- Management structure
- Group structure
- Succession planning
- Non-core assets
- Financial
- Formalize supplier and customer relationships
- Systems and operations
- Pensions schemes
- Environmental issues
- Taxation
- Litigation

B) The Information Memorandum

The Information Memorandum is a key selling document for both Seller and Buyer. Its purpose is to provide enough information about the business to allow the Buyer to make an informed decision about their interest and to come up with an assessment as to value.

As previously mentioned care should always be taken to ensure that at this stage any sensitive information is either removed or anonymised such that it is protected.

Typical contents of the Information Memorandum would include

- Important notice (covering a number of regulatory provisions)
- Executive summary
- Background to the Business
- Markets and marketing strategy
- Operations
- Management and employees
- Financials
- Overview of future plans and opportunities



C) Identifying the buyer

The way to view this part of the process is a funnel concept. The key is to get all the possible names in at the top and then through a process of elimination and filtering, gradually whittle the list down to create your 'A' list being those targets that have the appetite, ability and reason to acquire your business.

There are many different ways of identifying buyers for your business, some of these include:

- Prior approaches made to the business
- Database research
- Trade associations
- Professional networks
- Internet
- Review of venture capital portfolios
- Your knowledge of the sector

There is no right number of companies to approach; it is simply down to judgement of what is right in each case. What should not happen is where all and sundry are approached as this will only breach confidentiality and detract from value.

D) Making the approach

Any approach should be made through your Advisers on a no names basis, and only after receiving a firm response expressing interest should confidentiality letters be exchanged and the Information Memorandum sent out.

E) Negotiation

The key to any negotiation is two-fold:

- Understand what it is that the other side is after
- Having the ability to say no

Having, or indeed creating, the illusion of competitive tension is the best tool to have in any negotiation discussion.

F) Heads of Terms

Once one bidder has been selected their offer is 'migrated' to Heads of Terms.

Heads of Terms is simply a document laying down the key terms of the transaction such that it avoids any misunderstanding later on and gives the lawyers enough information to draft the necessary legal documentation. It is not a legally binding document and a 'deal has not been done'.

Heads of Terms is usually the point at which exclusivity is given to one party.



G) Closing the deal

Post Heads of Terms the Buyer will want to do their detailed due diligence financial, legal, and commercial aspects of the business.

Along side this Due Diligence process the lawyers on both sides will be drafting and negotiating the legal documentation on their respective clients behalf. Be warned that when the time comes to complete any transaction there will be an inordinate number of documents to be signed!

The key things to bear in mind during the closing period are:

- Manage the due diligence process
- Ensure that confidentiality is preserved right up to completion
- Concentrate on running your business. There is nothing worse than a downturn in trading or profitability during due diligence.
- Rely on your advisers to do what they do best
- Respond to requests for information otherwise the transaction can be delayed
- Tell your advisers everything! If there are any skeletons or issues they need to know about it as soon as possible to protect your interests.



Structuring the deal

A) Cash

There are many old adages; 'Cash is King'; 'A bird in the hand is worth two in the bush'.

Other points to bear in mind include:

- Offers are usually made on a debt and cash free basis subject to normalized working capital. This means that non-trade related company debts (eg bank loans, directors' loans etc) are 'repaid' prior to sale and excess cash can be retained by the Seller. This may mean that there will be an adjusting mechanism through completion accounts to ensure that the Buyer is protected. Where there is excess cash on the balance sheet it is usually through this mechanism that the Buyer will pay for this cash.
- Similarly certain amounts may be put in Escrow and held by the lawyers until the Buyer has satisfied itself that there are no warranty claims.

B) Deferred Consideration

Deferred consideration is a pre-agreed amount of consideration that rather than being paid at completion is paid at some agreed future date. It may or may not be guaranteed by the Buyer or indeed their bank.

Care should be taken as the payment of any deferred consideration (unless it is guaranteed by a bank) is dependent on the Buyer having the funds available when the time comes to pay it.

C) Earn Out

Where the business for sale is forecasting high levels of growth the Buyer is often reluctant to pay for all that growth on completion as the future is rarely known with any certainty. In these scenarios the valuation gap may well be bridged by structuring an element of consideration linked to the future performance of the business.

There are many issues linked to earn outs but the main one is the fact that you as Sellers have no control over how the business is run going forward and therefore have no control over the future performance of the business.

D) Paper

A listed Buyer will usually try and include an element of their own shares in any structure as this represents relatively cheap funding for them. From a Sellers perspective there is risk here as the price of listed shares can go down as well as up.

E) Retained Equity

In some instances, particularly where a Management Buy-Out is concerned, the structure may involve the 'roll over' of a certain percentage of your share back into the business. This may or may not be attractive to you as it gives you a share of the 'cake' going forward and therefore the right to share in the future growth plans. But your rights as a minority shareholder are limited and your Advisers need to ensure that your position is adequately protected.



Role of the adviser

The role of your adviser is to lead and manage the complex process and advise you on the issues at each turn.

They are there because they are experts in what they do and through their use a great deal of the onus can be moved from you onto them. This releases your time to allow you to do what you do best, in other words run your business.

The key advantages of advisers can be summarized as follows:

- Offering commercial advice of every element of the transaction
- Identifying potential issues and resolving them
- Acting as lead negotiator
- Co-ordination of all parties involved
- Assisting with paperwork and documentation
- Providing a buffer between Buyer and Seller – essential when negotiations get heated!

Taxation

The sale of a business will hopefully create a large pile of cash. However, on the back of this, there will also be significant tax issues:

- There will probably be tax to pay on the sale itself. Even that isn't necessarily simple. The way the deal is structured can have an effect on the amount of the tax payable. Our objective isn't necessarily simply to minimise the amount of tax but to maximise the amount you get to keep. Tax will often therefore have a major impact on the transaction, and the tax adviser will need to be involved in the sale process from an early stage.
- Where there is deferred consideration, taxation can be especially complicated, and it's important to get it right from the start, or you might end up paying Income Tax on what you thought were capital gains.
- Once you've got your money, you may well have created a further tax issue you hadn't even considered. Your business was quite probably exempt from Inheritance Tax so that if you'd died while you owned it there would have been no tax to pay if you left it to the next generation. Once you've turned it into cash, it's no longer exempt. Addressing the Inheritance Tax issues will be something you should consider as part of the sale process.



Financial Planning & Wealth Management

It will be important to decide and consider how best to invest any sale proceeds on receipt. Consideration should be given to the following points:

- What are you trying to achieve with this capital sum. Is it growth / income or both?
- What is your time horizon?
- What is your appetite for investment risk?
- How will this capital fit in with any other investments that you may have?
- How much active involvement will you want in the investment process?
- What is the target rate of return required to meet your objectives? For example, there is no point investing in cash assets that might generate say, 4% per annum if, in order to achieve your goals, you need to achieve a return of say, 7% per annum. In the same way, why take the risk that your portfolio might fall in value by chasing a return of 8% per annum, if you only need a return of 5% to achieve your goals.
- How will this capital sum fit into the “bigger picture” discussions when considering the wider aspects such as budgeting and saving, taxes, estate and retirement planning?

For further information on Financial Planning and Wealth Management, please visit www.critchleys-fp.co.uk.

Testimonials and Recent Transactions

“Critchleys were key to the whole deal happening. They carried out an extensive marketing campaign, followed up on all interested parties, found a suitable buy-out candidate and managed all negotiations.

Their determination to drive the deal through whilst at the same time achieve the optimum value for me as well as the best package available resulted in the deal completing successfully within the timescale I had set. The Corporate team I worked with offered in-depth quality advice through their years of experience in handling such deals, the result being that I was able to over-achieve my initial objectives.”

Ian Hay, Director and Shareholder of Amtech Power Software Limited

“This was a complex transaction with lots of potential and opportunity to go off the rails. Critchleys were thorough and consistent throughout, covering a lot of ground and keeping the deal on track.”

The Management Team, Kingsclere Nurseries

“Throughout the process, Critchleys have shown tenacity and patience in getting us the right deal – they understood our requirements from the outset and have been excellent and knowledgeable advisers and mediators along the way. We are delighted with the result.”

Joanna Bowerman, Director and Shareholder of Inspired Selection Limited.



“Critchleys were recommended to us by our bank and after speaking to several other companies we were confident that Critchleys was the right choice for us. They put together a very good information pack about the company despite receiving only a minimal amount of input from ourselves. Critchleys found us a buyer that suited the long term future of the company, negotiated the price and terms on our behalf and then helped us through the financial and legal due diligence process, providing advice, figures backup and the momentum to get the deal through. We found Critchleys professional, helpful and friendly throughout each stage of the process and would highly recommend them.”

David Cooper

Critchleys led, negotiated and advised on the following transactions:

 <p>Critchleys acted for:</p> <p>the shareholders of AMTECH Power Software Limited in respect of the £15 million Buy-In Management Buy-Out.</p>  <p>Software Solutions</p>	 <p>Critchleys acted for:</p> <p>the shareholders of specialist publishing recruitment firm Inspired Selection Limited on the sale of the company to Steppingstone Associates Plc, a recently formed recruitment group.</p> <p>Transaction Value £2.7 million</p>  <p>Permanent recruitment consultants</p>	 <p>Critchleys acted for:</p> <p>Kingsclere Nurseries Limited who operate a chain of seven nurseries around the Reading area. The Group was acquired by a NewCo. Downing VCT supplied £3.3m fully integrated funding.</p> <p>Transaction Value £4 million</p>  <p>Childcare Nursery</p>
 <p>Critchleys acted for:</p> <p>the shareholders of Golden River Traffic Limited in their disposal to Astucia (UK) Limited</p>  <p>Traffic Data System Supplier</p>	 <p>Critchleys acted for:</p> <p>the shareholders of HM Air Cooling Limited in their disposal to Four Seasons Control Limited.</p>  <p>Design, installation, service and maintenance of air conditioning systems</p>	 <p>Critchleys acted for:</p> <p>the partners of Nightingale Associates in their disposal to the business to Tribal Plc.</p> <p>Transaction Value £15.5m</p>   <p>Architect Practice</p>