Finance Matters

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Management buy-outs (MBOs)

Management buy-outs (MBOs) are becoming an increasingly effective exit mechanism, with owners putting the business in the control of a trusted management team. Although a trade sale may realise more money, owner managers are often concerned about a trade purchaser asset stripping and dismantling the work force.

MBOs usually happen because:

- An owner wishes to retire
- A business is in financial distress and needs cash
- Certain parts of a business become non-core

Selling to existing management is often a way of securing a company's future. Other advantages (as compared to a trade sale) include:

- Increased probability of successful completion – known quantity
- Less time consuming sale process than a trade sale
- Potential for higher overall proceeds, depending on future performance
- Rewards key employees; incentivises management, secures employment for existing employees
- Continued involvement for vendor in business post-transaction

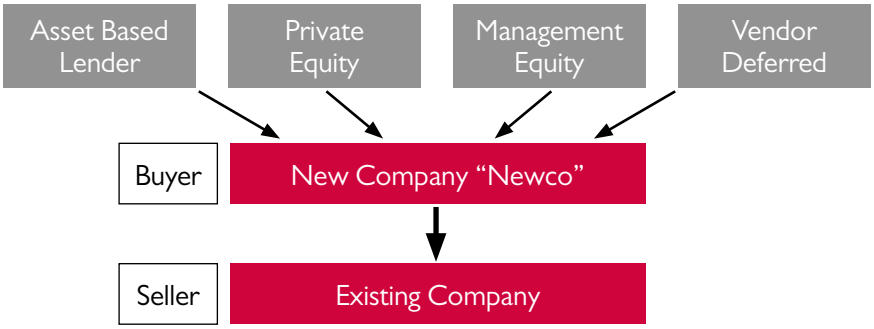
The key requirements for an MBO are:

- A competent management team, with a track record of delivering profits and growth
- An attractive company in a relatively stable sector
- Realistic vendor price expectations
- A credible business plan and forecast model – clear vision is essential
- MBO must be capable of supporting an appropriate funding structure
- Appropriate tax planning to minimise tax

An MBO is often structured by forming a new company ('Newco') to acquire the shares of the existing company. The MBO team normally invests the equivalent of one to two years' salary, with the balance of funding usually being provided by banks / asset based lenders, private equity investors and vendor loans / equity.

Continued overleaf...

MBO illustration:



Asset Based Lenders

Asset based lenders ('ABLs') typically provide funding against assets, including stock, debtors, plant and machinery and freehold property. Debt is secured and, as such, tends to be cheaper than private equity and vendor debt. Facilities will usually come in two forms:

- a revolving facility, similar to bank overdraft, with availability changing daily as debtors and stock levels vary; and
- a term loan based upon the professional valuation of a company's fixed assets.

ABLs are less focused on the ratio of debt to equity than traditional lenders, more important to them is the quality of the underlying assets.

Private Equity

Private equity firms will usually take a mixture of debt and equity in the Newco and look to realise their equity investment within three to five years. A clear exit plan is therefore required. Historically, the success rates of MBOs with institutional funding have been encouraging. Management teams, however, are often concerned at the amount of control that may be exerted by the new private equity partner. There is also the perception that private equity funds are too rigid in terms of their funding structure and exit strategy.

Advantages of securing private equity include:

- Access to large sums of equity finance
- Private equity board representatives can bring a wealth of expertise to your business
- Attracting a private equity fund will potentially make it easier to secure further funding from other sources

Vendor Finance

Vendor financing structures vary considerably; some leave part of the consideration in the company as a vendor loan, while others take a minority equity stake in the MBO company, as well as providing vendor debt.

Investors and loan providers normally undertake extensive commercial, financial and legal due diligence to confirm the merits of the business. Depending on the outcome of the due diligence, certain terms may have to be varied and negotiated. Furthermore, during the lifetime of the relationship, regular reviews of the company's systems and assets funded should be expected.

The role of corporate finance advisers in the fundraising process is vital, not only because of their experience in raising finance, but also because of their knowledge of certain sectors and family owned businesses. It is the role of the adviser to facilitate discussion with appropriate financial institutions and to prepare management teams for investor questions and procedures.

In order to assist a smooth transaction, it is important that the vendor grooms the business for sale, to the second tier management by handing over key customer and supplier contacts and encouraging the management team to play a more active role in the business.

In addition, there may well be a need to strengthen the management team's operational expertise with an outside investor or non-executive director. These could be individuals with a good mixture of corporate governance, financial reporting and/or marketing experience, as well as sound technical and commercial skills.

The Hazlewoods Corporate Finance team have completed numerous MBOs in a wide range of sectors. We offer hands-on partner support from initial planning to post-deal support.

For further information, or to arrange a free initial meeting, please contact:

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