Selling Your Business

A specialist guide

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Foreword: Selling Your Business

David Parkin - Editor
TheBusinessDesk.com

Welcome to our guide to selling your business in association with Deloitte and Walker Morris.

As the region's leading business news website, **TheBusinessDesk.com** charts the deals done across Yorkshire and acknowledges the skill and vision of the people who make them happen through our **Deal of the Month** award. This supplement is an opportunity to get beyond the headlines and examine in greater depth the anatomy of business sales and uncover the keys to success.

> **...the appetite for well run businesses in sectors with bright futures remains undiminished.**

Expert advice is critical to the completion of sales that meet the needs of both vendor and buyer, which is why I am pleased that we have been able to draw on the expertise of our partners **Deloitte** and **Walker Morris**. As leading business advisory and law firms thoroughly engaged in the deals business, they are perfectly placed to offer advice and point out the pitfalls.

The current economic conditions have reduced business sales activities but the appetite for well-run businesses in sectors with bright futures remains undiminished.

From valuation to completion, **'Selling Your Business'** seeks to demystify the sales process and help vendors feel far more confident at securing the best possible value for their companies.

I hope you find it useful.

David Parkin
Editor

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Challenging markets will reward strong businesses

Martin Jenkins
Practice Senior Partner
Deloitte Yorkshire

The M&A market has stepped into 2011 with cautious optimism.

At the time of writing stock markets are at post Lehman highs, reflecting a generally improving corporate economy. Those same companies are increasingly sensing opportunities to grow not just organically, but through careful, well thought through acquisitions. The availability of bank credit continues to improve and private equity is increasingly demonstrating its willingness to compete hard for the compelling growth opportunities.

But that optimism is tinged with caution. The impact of deep cuts in the public sector has yet to be fully felt in the wider economy in what has been to date a manufacturing led recovery. Certain other sectors continue to struggle and within individual sectors themselves there can be significant variation between the stronger and weaker performers. Retail is perhaps a particularly good example of the latter.

> **...Deloitte's track record of completed and current business sales reflects these improving market conditions**

Despite these challenges we believe there are attractive opportunities for shareholders to realise value through disposal or accessing capital markets. But to do so requires careful planning and execution. Businesses with a compelling business strategy in growth markets will be in strong demand and will trade at good prices.

> **...we believe there are attractive opportunities for shareholders to realise value through disposal or accessing capital markets.**

In Yorkshire and the North East, Deloitte's track record of completed and current business sales reflects these improving market conditions and the requirement for advice from highly experienced senior practitioners. Nationally we have just completed our 200th disposal since the beginning of 2007, which firmly establishes our credential as the leading M&A adviser to the UK mid market.

In this supplement we have detailed our thoughts on some of the key issues any potential business vendor will likely have on their agenda. But the best advice is bespoke advice and we would be pleased to discuss any of these or other issues on a confidential basis. Just contact one of the team.

Martin Jenkins
Practice Senior Partner & Head of Corporate Finance,
Deloitte, Yorkshire

Deloitte.

Timing is key to successful sale

John Hamer
Partner, Walker Morris

As a major provider of legal advice on selling businesses, Walker Morris is delighted to be associated with this supplement.

Like so much in life, timing is critical to the achievement of an optimum result when selling your business. There are certainly plenty of experienced professional investors who wished they had realised their investment before the financial crisis and its aftermath.

We continue to face turbulent economic times and a rapidly changing world, as witnessed by recent unrest in North Africa and the Middle East and so questions of 'when to sell' and 'how to sell' are more critical than ever. Whether you are preparing for a sale,

> **Like so much in life, timing is critical to the achievement of an optimum result when selling your business.**

or just at the start of formulating a strategy, it is essential that owner-managers have experienced advice. We will not only explain how to overcome any issues you face at the start of the process, but also try to foresee any potential problems or pitfalls that may arise in the future.

The Walker Morris Corporate Department is one of the largest and most respected legal teams in the region. With each of the partners being leaders in

> **We advise on all aspects of corporate law and regulation to guide a company through its development...**

their field, there is real strength in depth and a reputation for commercial acumen and legal expertise. We have a hugely experienced team of lawyers, so whatever issue may arise, we will have 'been there before' and will be able to guide you through the transaction.

We advise on all aspects of corporate law and regulation to guide a company through its development from inception, to acquisitive growth, debt and equity fundraising and eventual exit through succession, sale or IPO.

Whilst we don't believe there is any substitute for face-to-face advice, this supplement will go some way to answering the questions that you may face when deciding to sell your business.

John Hamer
Partner and Head of the Corporate Department
at law firm Walker Morris

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Preparing to Sell Your Business

PREPARATION has always been key when readying a business for sale, but has become even more essential during the economic downturn. Ian Briggs reports on the major steps vendors should take to maximise value from transactions.

THE recession has made it difficult for both buyers and sellers of businesses to complete transactions.

Market forces such as the well-documented lack of bank liquidity has certainly hindered progress and the preservation of cash by corporate organisations has been noticeable.

> **'Many businesses continue to review their strategic options'**

However, the downturn has also presented opportunities, one of which has been for organisations that have shown resilience and profitability through the tough times of the past two years to have as a consequence become more attractive propositions to buyers, triggering the appropriateness of reviewing strategic options. And an appropriate option might be exit for reasons including retirement, selling a subsidiary to generate funds or to provide the business with new expertise. In all these situations, securing maximum return for stakeholders is likely to be paramount and to achieve this, preparation is key.

How do you place a value on the business?

Richard Naish, Corporate Partner, Walker Morris says: "There are different ways in which a business can be valued and accounting advice will be necessary. Relevant considerations may include, for example, asset value, financial history, cashflow, sustainable profit, the customer base, the state of the market, the sector in which the business operates and any competitive tension in the sale process."

However, he warns that businesses placing unrealistic prices on themselves is a common reason for deals not being agreed, while Hamer stresses that buyers will want to check that there are no "hidden nasties" lurking within the business.

A business owner looking to sell must be realistic about the timescales involved in the preparation.

John Hamer, Partner and Head of Corporate at Walker Morris, says: "A business owner should consider preparing the business for sale a period of years before the intended sale date in order to position the business properly."

The formal sale process when launched can be equally underestimated.

Matt Henderson
Director in Transaction Services, Deloitte

Matt Henderson, Director of Transaction Services at Deloitte, says whatever the size and complexity of any disposal, significant pressure will be placed on employees' workloads and owners should be prepared for the added pressure these demands will make.

"This pressure is accelerated when a disposal is combined with the requirements of managing a business in uncertain market conditions," explains Henderson.

"Added to the challenge of maximising returns, the ongoing but

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critical nature of the finance function's 'business as usual' duties, often combined with a lack of depth

'Evaluation should be made of the best exit option or options for a business'

of resource in certain skill sets, can result in value being lost and in some cases deal failure.

"Whether private equity-backed, public or private companies, as potential sellers, businesses do not always consider an outsider's view of the assets to be disposed of and are less familiar with the breadth and volume of buyer demands."

Dan Renton
Director in Corporate Finance Advisory, Deloitte

"There is usually between six months and a year required to market the business, prepare information, negotiate with prospective purchasers and then complete the sale agreement." says Hamer.

"However, the time-scale can reduce very considerably for smaller businesses and/or where there is no need to market the business for sale."

Deloitte's Richard Marlow, Director in Transaction Services, agrees, stating that advanced planning is crucial when preparing for an initial public offering (IPO) and that flotations can fail because of a lack of preparation.

Paul Roberts, Director in Corporate Finance Advisory for Deloitte, adds that deal timescales can be dictated by the complexity of the transaction, the nature of the buyer or population of potential buyers, and the extent of urgency on both sides.

Evaluation should be made of the best exit option or options for a business and in that context, the marketplace they are in should be analysed.

"The key thing is to see your business from the perspective of your potential buyers - what is the unique selling point that they will want.

The other key is to focus on the future potential of the target business (i.e. its best days are ahead of it rather than behind it). Also, make sure your accounts and other records are tidied up, if they are not already so that potential buyers get a good feeling about the business when they start due diligence."

John Hamer
Partner and Head of the Corporate Department, Walker Morris

Deloitte's Dan Renton, Director in Corporate Finance Advisory, believes the appointment of a corporate finance advisor is "one of the single most important decisions an owner has to make" when entering the sales process.

Roberts, who says advisors should be appointed early in the sale process, agrees: "An advisor should give a credible independent perspective, which may include advice the vendor would rather not hear such as the potential flaws and risks in the business."

Hamer adds: "Word of mouth recommendations are still as good a criteria to use as any, but the professionals must have experience in corporate transactional work.

'...it is clearly vital to ensure adequate patent protection'

"This is a specialist area and sellers must appoint professionals with the appropriate expertise. Advisers should be appointed early to assist with the process of preparing the business for sale."

Vendors should also ensure they make their business attractive to potential buyers as various factors can affect the price which a buyer is willing to pay.

These factors include areas of uncertainty such as litigation, tax disputes, contracts due for renewal, volatility seen to defined benefit pension schemes, and any unresolved issues will need to be disclosed to potential purchasers or investors.

Naish comments: "Getting your house in order is very helpful in ensuring that the deal proceeds smoothly - particularly during the due diligence stage."

Richard Naish
Corporate Partner, Walker Morris

There are a number of variants which will make a business attractive. They include: profitability, growth potential, differentiated market positions and evidence of a strong management team.

One other element in maintaining the value of a business is protecting intellectual property (IP).

"A company's ability to protect its competitive advantage is highly important to maintaining buyer interest and protection of IP and patents is one such route, and is common in certain industries - for example software and IT - but does

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not have to be the only one where alternative barriers to entry can be demonstrated," explains Roberts.

"These might include management expertise; regulation and accreditation; or significant start-up investment requirements."

Naish adds: "If the business relies on technology it has invented then it is clearly vital to ensure adequate

'Opening up access to such stakeholders before closing the deal has its risks'

patent protection. Similarly, if the business has a well-known trade mark, then this must be protected."

Although the business itself and the market it operates in will often dictate the list of potential buyers, owners should understand this buyer landscape and focus the sales process toward the most likely buyers.

John Hamer
Partner and Head of Corporate, Walker Morris

"However, sometimes the final buyer is an unexpected one so keeping options open might maximise the chances of success or the price ultimately achieved," Roberts says.

Hamer agrees: "Sometimes an alternative buyer can be identified who may see the target as presenting a strategic opportunity to enter a new sector of the market or a new geographic market."

Given sales processes often involve competitors, confidentiality during the sales process is crucial.

Avoiding common mistakes is key to a successful sale

As well as market conditions often dictating the success of a sale, businesses can help themselves by avoiding a number of fundamental mistakes when preparing for a disposal.

According to Paul Roberts, of the corporate finance team at Deloitte in Leeds, objectivity can be key.

However, Roberts says many vendors can find it challenging to maintain objectivity when discussions revolve around a business they have built up over a number of years.

"Every company owner believes - or at least claims - his business outshines its competitors and is completely free from risk," he says.

"Rarely, however, is this the case and rarely can problems be swept under the carpet indefinitely. Even in the unlikely event not picked up in due diligence, such issues will leave the vendor exposed for a period after completion by way of the legal warranties and indemnities included in the sale agreement to protect the buyer."

Richard Marlow, of Deloitte's transaction services team, says that a common mistake when companies prepare for a flotation is the lack of a clear business strategy.

Marlow believes a clear strategy from management - delivered in a *"compelling manner"* - is essential for Initial Public Offerings (IPOs) to succeed.

He added: *"In particular, what are the proceeds being used for? The more attractive opportunities will be using funds to drive growth, for example for transformational acquisitions and capital projects.*

"Investors will be sceptical of an IPO being used to provide an exit to existing owners or to de-leverage. In particular, institutional investors are nervous about certain private equity exits."

Other common mistakes which can lead to deals collapsing include:

- A lack of preparation
- Unrealistic pricing
- Selling for the wrong reasons
- Inadequate financial records and information
- Business owners trying to sell themselves
- Not using professional advisers
- Over negotiating.

However, as Roberts says: "At some stage second tier management, customers and suppliers are all likely to be of interest to potential buyers."

But he warns: "Opening up access to such stakeholders before closing the deal has its risks - the prospect of a sale might create uncertainty and therefore the risk of the loss of a key member of staff or customer.

"Buyers are typically restricted from contacting such parties under the terms of confidentiality letters they sign up to as part of a process."

If access cannot be avoided, it is usually only at a late stage when the risks of the deal failing have been minimised and should be vendor controlled and carefully planned and scripted.

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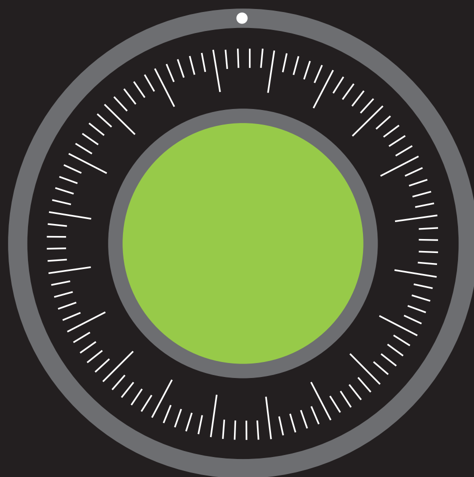

The right combination

A business sale on the boardroom agenda raises challenges. When is the right time to sell and what is the optimal exit strategy? Deloitte helps you find the right combination. www.deloitte.co.uk/corporatefinance

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Routes and Timings

A NUMBER of routes are available to owners selling their businesses. Ian Briggs explores the market options.

MBO, MBI and IPO.

They're all abbreviations commonly associated with the deals market and available to those looking to maximise value for themselves and other shareholders in businesses they've built up, in many cases over a number of decades.

> **'There is a fine balance in selecting the most appropriate route'**

But which of the above options - and the many others available - is the most appropriate for a successful outcome?

As ever, individual factors will often dictate the best course to take.

"Where a business owner wants to sell outright, a number of routes might be available," says Deloitte's Paul Roberts, a Director in Corporate Finance Advisory.

"A management buyout (MBO) is possible if the business has the dynamics which would make it attractive to private equity funders and there is a sufficiently credible, backable management team in place to lead the business's future development.

"Management buy-ins (MBIs) are a little less common as an exit route due to the increased risk from a funder's point of view of introducing new management who do not have the knowledge and experience of the business.

"As such, succession planning and an objective assessment of the strength (or weakness) of your second tier team are both important as exit horizons approach."

He adds: "There is a fine balance to be drawn in selecting the most appropriate route, taking account of such factors as the owner's proceeds requirements and desired continued involvement, management succession, growth prospects and forecasts, the breadth and nature of the population of buyers, and impact of the proposed deal on all other stakeholders."

Companies considering an initial public offering (IPO) to raise funds through the issue of shares to raise capital should consider which market is most appropriate for their business, argues Richard Marlow, Director in Transaction Services at Deloitte.

He explains: "In the main, the likely options are AIM and the Main Market, though certain businesses may see overseas markets as attractive for certain sectors or other reasons.

Richard Marlow
Director in Transaction Services, Deloitte

"Key factors to consider over whether to list on AIM or Main Market include: the size of the business, the size of any free float, tax planning considerations and whether you meet the eligibility requirements, with the requirements for the Main Market being more onerous than for AIM."

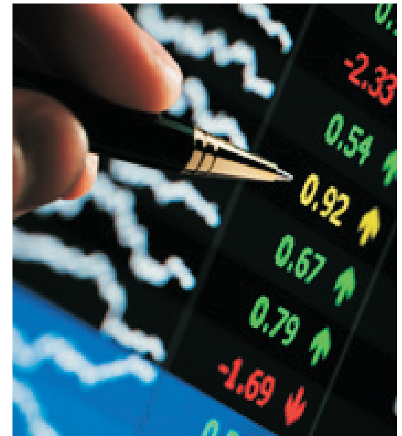
He says that for a shareholder considering an exit by IPO, it is "fundamental" that the existing management team is retained and, if necessary augmented.

For owner-managed businesses, an IPO is unlikely to be an appropriate way of selling their business outright but conversely, an IPO is a good way of retaining a stake in the business or attracting new investors.

Quoted markets expect to see significant levels of lock-in by vendors on retained stakes, often for several years.

For those looking to retain a stake in their businesses there are several options.

Dan Renton, Director in Corporate Finance Advisory at Deloitte, says: "Many private equity investors would



view a retained vendor stake as a sign of confidence in the business and its opportunities.

"Commonly this is balanced with a degree of change and repositioning the management of the business over the longer term - perhaps to additionally incentivise a new leadership to continue the growth story. If properly put together this can be a powerful and highly valuable platform.

> **'For those looking to retain a stake in their businesses there are several options'**

"Trade buyers are more likely to seek 100% ownership though of course there is always the potential to create joint ventures or take shares in an enlarged group."

Market conditions should set the "backdrop" for any sale, but should not be the main driver, cites Renton.

"Presently we have seen some renewed stability and predictability across public and private markets. Taking into account the prediction of only a modest underlying recovery, many vendors are concluding that now is a sensible time to explore value if an exit is to be contemplated over the medium term," he adds.

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> ***"A management buyout (MBO) is possible if the business has the dynamics which would make it attractive to private equity funders and there is a sufficiently credible, backable management team in place to lead the business's future development."***
>
> **Deloitte's Paul Roberts**
> a Director in the firm's Corporate Finance Advisory Team

Debbie Jackson, Corporate Partner at law firm Walker Morris, says of the present market conditions: "Despite the economy remaining fragile, and it is still early days, there does seem to be a greater appetite to do deals at the right price.

Debbie Jackson
Corporater Partner,
Walker Morris

"Companies are now looking at acquisitions to expand and counteract low growth. Greater buyer confidence coupled with a shortage of good businesses for sale should keep prices up.

"Even the private equity market, which is facing investment deadlines seem more willing to do deals at lower debt to equity ratios and at lower returns than previously seen.

> **'A change of control of a business can bring uncertainty to employees...'**

"Cash-rich purchasers who are not dependent on third party funding are very attractive for sellers and it is these deals which are proving easier to complete."

Timing

Those businesses with seasonal trading cycles should take account of it when designing the timetable of any sales process as buyers often seek comfort on the trading prospects of the target.

Roberts said buyers would reflect any perceived risk to those prospects in their valuation of the business.

"If a business has a peak trading period, a process which allows buyers to confirm delivery of results during that key period should mean full benefit of those results is factored into valuation," he explains.

"Conversely, a process designed to close in advance of such peak trading period might leave buyers wondering why - is it because the seller has concerns about hitting budgets and plans?"

Another timing consideration is a businesses communication strategy.

Perhaps surprisingly, in many cases it is a facet left until late in the deal and - in the absence of a legal or regulatory requirement to do so earlier - often only at the point of completion.

As ever, sound management is needed as Roberts acknowledges: "A change of control of a business can bring uncertainty: to employees, customers, suppliers and other stakeholders, and this should be sensitively managed.

"In the closing stages of a deal careful thought should be put to the communication strategy and the implementation of this should be carefully coordinated so that key stakeholders receive news at the same time and have the opportunity to ask questions and allay concerns."

Jackson agrees, and says: "External and internal communications need to be handled carefully. There are legal obligations regarding communications with employees, particularly where there is a union involved, and these must be followed.

"Sensitivity is the key requirement and this matters more than the way the sale is communicated. Key suppliers and customers may feel aggrieved if they are not informed of an impending sale (even if they have no legal right to know about it) so may need to be bought into the loop before the sale completes."

On the flip-side, communication can also be a great boost for morale.

Roberts adds: "A change of ownership can equally bring many positives; the opportunity for employees to flourish under a larger organisation; new owners bringing access to capital for accelerated growth; the implementation of an exciting new strategy."

"The business's attractiveness, evidenced through achieving the support of a new backer, should be a great accolade and once stakeholders are in the loop, wider press coverage of the transaction can act as a very positive marketing tool."

The Market

THE number and size of private equity deals completed increased in 2010 compared to the previous 12 months, according to Deloitte's latest Northern Private Equity Confidence Survey 2011.

The survey, entitled 'Growth Returns', found that the proportion of deals greater than £50m increased significantly from 9% in 2009 to 36% last year, suggesting a stronger recovery of the larger deals market in the North.

Over three-quarters of the deals opportunities considered by respondents to the survey were in family owned / private businesses, subsidiaries of groups and secondary buy-outs.

The Deloitte research also found that the proportion of stressed situations considered fell from 15% to 12%.

And more than half (55%) of respondents believe that public sector spending cuts will have no impact on the deals market in 2011 and 95% expect deal volumes in 2011 to at least remain at 2010 levels.

The survey was completed by more than 100 leading professionals in the North of England's private equity market, including private equity investors, bankers and lawyers.

Top sector deals in 2011 are expected to be in manufacturing, healthcare, retail and technology, media and telecommunications.

The research also found private equity investors to be the most optimistic about economic recovery.

Commenting on the market, Renton

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of Deloitte said: “Over the last 12 months we have seen a general and consistent improvement in market conditions. Underpinning this are a number of factors, including a greater stability and predictably in corporate earnings, and improved liquidity in debt and equity markets.”

Deloitte’s Roberts agrees that things are looking up: “Private equity investors have the investment and return expectations of their underlying funds to manage and a number of successful companies have demonstrated both the appetite to acquire and either retained cash or facility headroom to finance the deal.

“We have seen a particular strengthening in the mix toward corporate acquirers - for example the local sale of AMCO Group to AIM-listed Renew Holdings - and a resurgence of UK acquisition activity from overseas acquirers, including the disposal of Davy Markham to the Indian giant, Hindustan Dorr Oliver.

“Private equity does continue to compete strongly too, as evidenced with the list of recent local PE-backed transactions including Zenith, Card Factory, Andrew Page and Republic.”

Commenting on the IPO market, Richard Marlow, of Deloitte, says: “Although, the IPO market in 2010 did not reach the heights of 2006/07, it was significantly favourable to 2008 and 2009. In Yorkshire, customer assistance specialist CPP and healthcare software supplier EMIS were both successful, high profile IPOs.

“The boom in commodities prices has fuelled an interest in natural resources businesses, but the opportunity to IPO is not constrained to this sector. Institutional investors are also keen to invest in businesses like CPP and EMIS - i.e. businesses with good growth stories, limited leverage and strong management teams.”

He said sectors including energy, and in particular renewables, technology, support services and life sciences, remain favourites for investors.

“Other areas of interest to investors are those companies with management teams with a strong track record on public markets,” he concludes.

Sellers look to minimise tax cost

STUART Cottee, Partner in Corporate Tax at Deloitte, highlights the key issues for sellers to keep tax costs down when disposing of their business.

Stuart Cottee
Partner in Corporate Tax, Deloitte

MOST sellers will want to minimise their tax cost on the transaction as far as possible.

For individuals, disposals of shares in a business are usually taxed under the capital gains rules - at 28% on the net gain, after taking off the original cost of the shares.

However, Entrepreneurs’ Relief allows individuals with qualifying capital gains to benefit from a tax rate of 10% on the first £5m of lifetime qualifying gains as opposed to the current headline capital gains tax rate of 28%. As such, the maximum tax benefit of successfully claiming Entrepreneurs’ Relief is £900,000 per individual.

Additionally, Entrepreneurs’ Relief applies principally to the disposal of shares in an unquoted trading company but can also apply to sole traders or partnerships selling their businesses, as well as certain interests held by trustees (see below). There are also provisions relating to the disposal of assets used by a business.

Two key conditions for claiming Entrepreneur’s Relief when selling shares in unquoted trading companies are that the shareholder must hold 5% of the ordinary shares and voting rights of the company for a continuous period of 12 months prior to the disposal, and they must be employed by the company in which the shares are being sold at the date of disposal.

It’s vital to check out qualification for Entrepreneur’s Relief more than 12 months before any sale - to give the chance to put something right, if it seems that any of the detailed rules aren’t being met.

Trustees can also qualify for Entrepreneurs’ Relief on behalf of any qualifying beneficiaries of a trust although any claim will reduce the beneficiary’s lifetime limit for Entrepreneurs’ Relief. For a beneficiary to qualify they must have a life interest in the trust and the beneficiary themselves must hold 5% of the share capital and voting rights in the company personally outside of the trust for any similar shares within the trust to qualify for Entrepreneurs’ Relief.

The Enterprise Incentive Scheme is another important tax relief that could apply when selling. If an individual with a capital gain invests in a company which qualifies under the scheme, the capital gain may be deferred. EIS won’t apply to all companies, but is there to encourage business angels, or serial investors, to keep investing.

In cases where the buyer may offer its own shares in exchange, or possibly a loan note, instead of cash, these have their own tax issues - not least because it’s possible to lose the benefit of Entrepreneurs’ Relief. Therefore it’s essential to take advice early on.

> **‘It’s vital to check out qualification for Entrepreneur’s Relief more than 12 months before any sale’**

In conclusion, prior to disposal of any company it is important that as many uncertainties are resolved as possible to avoid risks around warranties and indemnities and to limit the amounts of proceeds which may be held within escrow accounts to deal with potential liabilities.

This means that where possible correspondence/disputes with HMRC over tax treatments should be resolved and settled as far as possible. It can be worthwhile undertaking a review of the PAYE/VAT compliance processes in advance of the decision to sell.

Finally, a review of the tax position of the business can identify tax assets which are valuable to a potential purchaser and hence their availability should be reflected in the price.

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Important decisions require solid support

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Completing The Sale

James Reed looks at how a handshake is turned into a completed deal.

THE company has been rigorously prepared for sale and a well-placed buyer found. The deal is done - or is it?

Now is the moment when the vendor's preparation is tested with buyers likely to react to any unwelcome surprises with a lower valuation of the business, or worse still, a decision to walk away.

"A lot can happen between that initial handshake and actually completing the deal and a great deal of the negotiations will focus on risk allocation and value," says Debbie Jackson, Corporate Partner at Walker Morris.

"The key from a seller's perspective is to be prepared, to address any issues in advance to avoid last minute surprises and ultimately minimise the risk of value reduction."

In an uncertain market environment,

> **'Now is the moment when the vendor's preparation is tested'**

maintaining the confidence of buyers through to the completion of the sales process is more important than ever.

Bringing potential obstacles to the fore early so they can be taken into account in the way the transaction is carried out is key.

"The exercise of converting an agreement in-principle into the various legal documents associated with a sale is where surprises and

disagreements sometimes arises," according to Paul Roberts, Director in Deloitte's Corporate Finance Advisory business.

He stresses the value of a set of "Heads of Terms" in documenting a headline deal as a way of avoiding differences of opinion arising late in the deal.

Paul Roberts
Director in Corporate Finance Advisory, Deloitte

"There are many areas outside of pure price and it is helpful to capture as much of this as early as possible," he says.

Areas for agreement might include deductions to the price, the form and payout date for consideration and conditions on the deal.

Buyers will have already done their homework before making an approach but once a deal in principle is on the table the forensic examination of the firm begins.

Experts would expect buyers to want reassurance on company finances, its tax and legal position but they may also want a closer look at a host of other areas including its property, pension obligations and IT systems.

> **'Few sales involve a clean break for the vendor'**

Due diligence poses a particular dilemma for those selling their business, according to Matt Henderson, Director in Transaction Services at Deloitte.

"Since you may have courted a number of potential suitors in the disposal process and some of those may be trading competitors, assessing the appropriate level of access to your people, sites and financial information needs careful consideration."

Many disposal processes include "vendor-initiated due diligence" where independent accountants prepare a report that will be relied on by the purchaser. In addition to restricting access to confidential information, this process also gives vendors and their advisors the chance to flag up potential issues.

Beyond small businesses, few sales involve a clean break for the vendor with investors keen to retain the company's existing management because it is precisely their success

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that has made taking a stake in the firm an attractive proposition.

Even where control is being relinquished, the seller may be retained on a consultancy basis or may have a financial interest in the continuing performance of the company.

Paul Emmett, Corporate Partner at Walker Morris, says: "The advantage of staying involved is the continuing income and satisfaction of continuing involvement in the business. The disadvantage is that it is not the seller's business any more and he or she may feel aggrieved at the decisions taken by the new management.

Paul Emmett
Corporate Partner,
Walker Morris

"Also, without adequate contractual safeguards, their continuing participation in the business can be marginalised.

"If further consideration for the sale relates to the performance of the business then the seller will need to ensure that there are restrictions on what the buyer can and cannot do with the business after completion.

"This is an area that can get quite heated as the buyer is keen to integrate but the seller wants to continue the business in its current form."

Retention of an interest, particularly an informal one, is most often seen in transactions that see family businesses handed over from one generation to the next.

On the face of it, that would seem to be the most straightforward of business sales but, however amicable, it is important that all sides know their responsibilities.

Jackson says: "Despite their family connection, both parties should be independently advised. Clear lines of responsibility and involvement post sale should be drawn up - letting go may be more difficult than first thought.

"Outgoing family members who continue to be involved and whose advice is followed by the incoming members also needs to be wary of becoming 'shadow directors' as they could then be held liable for breaches of the directors' statutory duties".

Even where there is to be a clean break, vendors have to consider their future plans to ensure they will not face conflicts of interest with the business they are exiting.

"It is important for a seller to have a clear expectation on their future plans in the early stages of planning for a transaction. The price a buyer will be prepared to pay for a business inherently includes its goodwill, for example the client relationships it holds," says Roberts.

"An important area for buyer focus will be upon protecting those relationships and that will include ensuring that the seller is unable to immediately solicit customers or restart trading under a different name."

Emmett adds: "If the seller knows their plans they should ensure that they are not restricted from pursuing it by the buyer of their business. If the new venture will compete with the current business any well-advised buyer would prohibit the seller from pursuing that venture for a period, possibly up to two years, from the date of the sale."

Dan Renton, a Director in Deloitte's corporate finance advisory business, also warns of the need to manage other potential conflicts of interest, such as when managers are both buyers and sellers, typically in the case of secondary buyouts.

"Commercially, it may be beneficial to agree key parameters such as price aspirations and acceptable bank levels such that the business can be marketed with the confidence of an acceptable outcome objective.

"We have worked with clients who have engaged in multiple buyouts of the same company. A good example would be Zenith where we have acted for certain shareholders including management on four sequential occasions."

The Sale of DavyMarkham

SHEFFIELD engineering firm DavyMarkham was sold last year to Indian group Hindustan Dorr Oliver.

The company was owned by TH Global when, in 2006, Kevin Parkin and Duncan Hay were brought in to oversee the turnaround or disposal of the firm. Within a year they had completed a management buyout backed by Endless and became managing director and finance director respectively.

It was always a case of trying to maximise the business and to ensure we were building a business that would be sold on the way up rather than peaking or on the way down.

The formal moves towards selling the business began in summer 2009 with the appointment of Deloitte as advisors.

"From day one it was important that we all knew what we were doing and that we could forecast any issues that might come up so we could deal with them at an early stage rather than being derailed later by something like a minor legal issue.

"We chose Deloitte because of their network around the world. My view always was that we were unlikely to get a UK purchaser to pay the value an overseas purchaser would.

"Of the potential purchasers identified, between 25% and 33% of those were from the Indian sub-continent. I don't think we would have come up with a lot of those people ourselves."

Hay remains a consultant with the company while Parkin recently left, a year after the deal which realised a 10.5 times return on the original investment for Endless.

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Round Table Discussion

'Good businesses still command high prices'

Attendees:

David Parkin - Editor TheBusinessDesk.com

Paul Trickett - Partner in Corporate Finance Advisory, Deloitte

John Hamer - Partner and Head of Corporate, Walker Morris

Dan Renton - Director in Corporate Finance Advisory, Deloitte

Richard Burgin - was the commercial director of SigmaKalon, with responsibility for mergers and acquisitions. The company was itself sold by its private equity owners in 2007.

John Swarbrick - Director of leading mid-market private equity house LDC.

Steve Wainwright - Chief Executive of Profiled.com. He was previously chief executive of ICM Computers and led an attempted management buyout of the firm.

Curtis Wright - sold kitchen manufacturer Rixonway to a team backed by private equity in 2006 and is now director of Liquid Accounts.

Chris Clegg - Managing Director at Endless, the highly regarded private equity house specialising in turnarounds.

Joel Rosenblatt - led the management buyout of Christy Towels from then owner Courtaulds in 2000 backed by LDC. The management bought out LDC in 2004 and a majority stake in the firm was sold to Welspun India in 2006.

Richard Doyle - founded Esteem Systems in 1985 and sold the business in 2004 to a management buyout backed by private equity. He went on to start Radish Investments and is chairman of Connect Yorkshire.

Round Table: Wednesday 2nd March 2011

M&A activity might have slowed overall but there is a wall of money ready to be invested in well-run businesses with room to grow.

That was the key message to emerge from a Round Table discussion of advisers, financiers and business people with recent experience of buying and selling firms, held at the Leeds offices of Walker Morris.

Corporates that were deterred from investing from the large multiples being demanded before the recession but are now cash rich and private equity firms under pressure to invest funds were highlighted as likely buyers in the current market.

"What's surprising to many people is the desire to purchase is very high both in the financial investor world, also in the banking world and corporate world there is a very strong desire to invest and buy," said Paul Trickett, a Partner in Corporate Finance Advisory at Deloitte.

"On the downside, however, reflecting where the world has been and where most businesses have also been, demonstrating a credible and strong track record is quite challenging. In addition to that the level of scrutiny being put on businesses by purchasers is significantly higher.

> **'If you've come through the recession robustly now is actually quite a good time...'**

"If you've come through the recession relatively robustly now is actually quite a good time because there is considerable appetite to do deals."

There was agreement that businesses in growing sectors, such as green technology and digital, were likely to be attractive targets.

John Hamer, head of the corporate team at Walker Morris, said: "You

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can see that there will be corporate buyers looking to buy into areas where there is going to be a lot of public investment, so energy would be a classic example where over the next 10 or 15 years there is going to be massive public investment.

"So you can see a big construction company finding anyone operating in that sector and has that expertise as being a very attractive buy. People will try and identify where there is going to be some investment in the coming years because clearly the public sector is going to be far more limited than it has over the last 10 years."

'...there was a firm consensus around the table that ensuring a business is properly prepared for sale is essential...'

That is not to say that there is no market for businesses outside what might be considered fashionable sectors. Indeed, any company that has managed to prosper in the last few years will be an attractive proposition.

And in the view of Dan Renton, a Director in Corporate Finance Advisory at Deloitte, there are owners and managers ready to sell.

"There's a whole bunch of managers and owners in the market who have had a difficult time over the last few years and are wondering whether they've got the stomach for another three or four years and therefore wondering, in what is an increasingly stable M&A market, whether they should do something over the next 12 months."

Whatever the sector and whatever the motivation for sale, there was a firm consensus around the table that ensuring a business is properly prepared for sale is essential if a good value is to be realised.

"I would heavily encourage anyone selling their business to divert a lot of internal resource to preparing the business for sale," said Richard Burgin, now a director at Zin.

"I've been mostly involved in the buyer side and what I saw was that sellers generally hadn't prepared sufficiently which enabled the buyer to take advantage. The way the company was presented, basic things like working capital, hadn't been optimised in a lot of businesses."

John Swarbrick, Director of the Leeds office of LDC, added: "Part of our thought process as investor is if your management team are in state of semi-readiness for exit they will probably be running the business in a more effective way than if they are moving the business forward year to year without an endgame in sight."

The consequences for failing to properly prepare a business for sale were graphically illustrated by Steve Wainwright, now chief executive of Profiled.com.

"We were doing an acquisition, we had heads of terms agreed, we lasted three-quarters of an hour on due diligence because of a yacht and a plane in America that were on the books because we said 'if this is what we can spot in three quarters of an hour this is not the kind of business we want to buy'."

'...people want the multiples of 2006, 2007 but that era has gone and people have got to readjust'

At a time when businesses are not commanding the multiples witnessed before the credit crunch, there is a significant temptation on the part of vendors to extract maximum value from the sale. But recognising the need of the buyer's goals for the acquisition is central to making a deal happen.

Curtis Wright, who sold Rixonway in 2006, said: "One of the things you've got to be careful of is not being too greedy because ultimately whoever buys it is going to want to make some money and perhaps ultimately sell it on.

"There's got to be a perception and reality that they are buying that business at a price that is right for you but leaving enough in it for the next person to turn a profit and sell it on."

His point was underlined by Chris Clegg, Managing Director at Endless. "A lot of people have been greedy and the reason there has been stagnation the last two or three years is people want the multiples of 2006, 2007 but that era has gone and people have got to readjust."

A major challenge facing all managers and owners is the extent to which they should involve staff, and even senior colleagues in the dealmaking process.

Talking about the management buyout he led of Christy UK from Courtaulds, Joel Rosenblatt said: "I actually kept the management team out of the process until about six or seven weeks before completion so they didn't even know I was thinking about an MBO because I was worried they might start playing with the figures, start talking to customers and I just wanted a straight process with Courtaulds and a straight process with LDC."

"Keeping your business on track through the sale process is critical because its often in the interests of the buyers to distract you," said Richard Doyle, who sold Esteem systems in 2004.

"In my case I sold to a buy-in-management-buyout (BIMBO) team and of course your management team is completely distracted so I ended up running the business and doing the jobs of three of my directors. My advice to anyone thinking of selling is this is going to be the toughest time of your life."

Tough, perhaps, but for growing and innovative businesses there are deals to be done that produce benefits for buyer and seller alike.

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