Guide to Management Buyouts

What is a Management Buyout?

A management buyout, more commonly referred to as an MBO, is the purchase of a business from its owner by its existing Management Team.

- The circumstances which give rise to an MBO opportunity can include:
- Some or all of the owners of a private company may want to retire or focus on other opportunities
- A Group may wish to sell a non-core subsidiary to raise finance or to focus on its core activities
- An investor may wish to realise their investment
- Shareholder conflicts may necessitate an exit of some of the shareholders
- A public company may wish to become a private company
- An administrator may want to sell a business

What do I have to look out for to spot an MBO opportunity?

- There are a number of core attributes that make an MBO attractive to investors and these include:
- An effective Management Team with capability of delivering the growth opportunity for the business and the drive and commitment necessary to make that happen
- A commercially viable business
- A clearly demonstrable growth strategy for the business
- Cash flow capable of supporting an MBO financing structure
- A willing vendor with a realistic price expectation
- A suitable and realistic exit opportunity for investors and the Management Team to realise their investment

The most important of all of these attributes is the Management Team.

The Management Team

A typical MBO team will comprise of 3 or 4 individuals:

- Managing Director
- Finance Director
- Sales Director
- Production/Operations Director

The Management Team will need to convince the Investors that they have the necessary experience, can demonstrate a successful track record, have a well-balanced range of skills and can manage the business independently without the input of the existing owner. If there is a skills gap, potentially it can be plugged by introducing an external candidate. Your Corporate Finance Advisor and your potential Investors may know of suitable individuals if need be.

Management will also need to convince the potential Investors that they have a deliverable growth strategy and that they are capable of implementing it. It is also vital for the smooth running of the deal to appoint a corporate finance adviser at the outset who will work very closely with the Management Team to project manage the MBO on a day to day basis, co-ordinate the various parties involved and drive the timetable through to a successful conclusion.

Why are exit opportunities so important in an MBO?

Equity providers need to be able to realise the value of their shareholding at a significant capital profit typically over a 3 – 5 year time horizon. They can achieve this in a number of ways:

- a sale of the company to a trade buyer;
- sale of the company to another venture capital private equity house;
- management may occasionally be able to buyout the shareholding of the private equity house through a secondary fund raising (‘Secondary buy-out’);
- a flotation of the business on the London Stock Exchange or AIM

The most likely exit route will be a sale of the business to a trade buyer and your Investors will want to be satisfied before investing that a pool of likely buyers exists and that your business will be an attractive proposition to a trade buyer at some future point in time.

How are MBO's financed?

The bulk of the finance required to undertake an MBO will normally be provided by financial institutions, primarily from banks and venture capital/private equity houses and the Management Team will be expected to contribute as well.

Banks

Banks typically provide 50-60% of the total funding needed. The bank will have security over the assets of the business acquired and will require to be repaid in priority to the other investors. That security means that the bank's risk profile is lower and therefore will command a lower reward structure.

Venture Capital

Venture Capital / Private Equity Firms typically put in 40-50% of the finance required for the MBO. They will rank in priority of payment behind the bank and therefore require a greater level of return. They will achieve this by subscribing for a percentage of the ordinary share capital of the business alongside management.

Management Team

Management typically put in the smallest amount of funding but stand to make the greatest capital gain. The financial characteristics of an MBO provide management with the opportunity to acquire the business they are running, financed largely by other peoples money with repayment of that money coming from the profits generated by the business acquired and/or on its ultimate sale.

How much money will the Management Team need to Invest?

External investors are looking for the Team to demonstrate a high level of commitment to the transaction and that will have to be backed up by their personal investment. Financial institutions will expect each member of the core Management Team to invest personally. The amount of that investment will be dependent on personal circumstances and the extent of any existing shareholding in the business.

The 'rule of thumb 'is an amount of money which equates to one year's salary for each team member. It is common for members of the Management Team to borrow that money from a bank in a personal capacity to finance their investment and your Corporate Finance Advisor can assist you with this.

Will we need a Business Plan?

In a word – Yes. The business plan is the most important document. It serves a number of purposes but its main purpose is to 'sell' the MBO opportunity to the Investors whose support is being sought. It should be completed as soon as the owner has granted permission to pursue the buy-out. Management must take full ownership of the plan. However, your corporate finance adviser will give invaluable input and guidance on content. Please take a look at Park Capital's Guide to Writing a Business Plan available on our website under information. They will provide a framework for the plan and a critical and constructive review of the plan and the financial projections incorporated therein.

A typical business plan will include the following:

- Executive summary covering a brief overview of the business and the rationale for the transaction
- Concise history of the business
- Description of the products and services
- Profile of the Management Team
- Analysis of the business's top clients and also its key suppliers
- Analysis of the market and key competitors

- The company's operations – its premises, systems and employees
- strategy for growth
- Historic financial analysis (typically the last 3 years)
- Analysis of the projections and their assumptions. Remember the funders will monitor your performance against them.

When should we talk to the Vendor?

Without the Vendors support an MBO cannot happen so they need to be approached at an early stage in the process. The individual circumstances will dictate whether you or your Corporate Finance Advisor makes the first approach to the Vendor. Before that happens though it is crucial that your Corporate Finance Advisor undertakes an initial feasibility study to confirm to you that any proposed deal will be viable and supportable by financial backers.

Dealings with the vendor need to be handled carefully as the team will be employed by the business during the MBO process and possibly thereafter should the deal not complete. Sensitivity is paramount. Until vendor approval to progress the MBO opportunity has been obtained care should be taken to observe your fiduciary duties to the shareholders of the business. The timing and nature of the approach is a critical area and one on which your financial advisers will guide you.

How will a Corporate Finance Advisor help and when should they be appointed?

A Corporate Finance Adviser should be appointed at the outset and will be wholly involved in all aspects of the transaction right through until completion. The role of the Corporate Finance Adviser in assessing whether an MBO is viable is crucial. Any Management Team would be well advised to ensure than an MBO is feasible at what should be a mutually attractive price before entering into detailed discussions with the vendors.

In deciding whether or not the MBO is credible, the Corporate Finance Adviser will consider the following:

- the likelihood of securing financial backing (by being satisfied that all the 'key ingredients' for an MBO are in existence)
- the maximum purchase price
- the returns available to the MBO team for their investment in the deal
- the probable financial structure of the deal
- the likely funders who will have an appetite for the proposition

Once the Corporate Finance Adviser has decided that it is a viable proposition they will then advise on how best to handle the negotiations with the vendor and may often approach the vendor on the team's behalf depending on the circumstances.

The Corporate Finance Advisors role covers the following:

- assessing the feasibility of the MBO
- advising on the format and content of the business plan
- valuing the business
- deciding on the nature of the approach and negotiating the best deal with the vendor
- ensuring Stock Exchange regulations are addressed if the vendor is a quoted company
- selecting suitable financial backers
- arranging and attending meetings with the proposed financial backers and helping to prepare presentations to them
- negotiating the best possible funding structure and packages
- introducing the Management Team to other advisers such as lawyers and tax advisers etc;
- monitoring deal costs generally
- project managing the entire transaction through to legal completion

The MBO process can be an emotional roller coaster and management will need to work very closely with their Corporate Finance Adviser often on a daily basis. It is therefore vital to select an adviser you feel you can work with and who will provide the necessary experience and support when times get difficult.

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In selecting your Corporate Finance Advisor you should consider the following:

- Are they capable of giving the Management Team truly independent advice? (are they trying to sell other services off the back of the MBO or do they regularly work directly for the potential funders so there independence might be compromised)
- Have they direct experience of the process as a Principal (like you) and as an Advisor
- Do you like them – you will need to get on with them
- Will the team who presented to you be the team who does the work with you?
- Are their interests truly aligned with yours? Will they co-invest alongside you?

Why should we choose Park Capital as our advisors?

- Park Capital are truly independent we only act for Management teams and we do not act for funders or receive commissions from them for the introduction of opportunities, nor is our advice tempered by the need to sell other non corporate finance services either to you or the potential funders
- Park Capital are very experienced having advised on and funded many MBO's and we have been in the Management Team's position having led a successful MBI team
- They are committed to ensuring that the Park Capital Team you meet will be the Team that works with you throughout the MBO process and beyond
- Park Capital's interests are aligned with your interests in that not only are we prepared to be paid only upon the successful conclusion of the MBO but also we are prepared where appropriate to co-invest alongside the Management Team

Will other Advisors be required?

MBO's are complicated transactions and the Management Team will be taking on some financial risk. It's imperative that they are properly advised. In addition to your Corporate Finance Advisor, Management Teams will need legal advice and tax advice. The legal advisors ensure that the investment documents that the Management Team will have to sign up to are fair and balanced. The tax advisors will give guidance on issues such as:

- Income tax relief on the Management Team's loans for investment in the business
- The transaction structure and any necessary tax clearances
- Capital gains, stamp duty and inheritance tax advice
- Tax indemnities from the vendor on the purchase of the business

Further Information

For further information or a confidential discussion on the options available to you please contact Park Capital.

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