Management Buy-outs
Selling a business you have spent years building is one of the most important decisions you will ever make. Maybe you want to retire or spend more time with your family, move on to a new challenge or simply reap the rewards of your hard work. Whatever your aspirations, getting the right deal is vital.

A Management Buy-Out (MBO) is one way this can be achieved. Put simply, this is when a business is acquired by its management team, with the help of a finance partner or investor.

With around 15 per cent of all exits involving some MBO element, it’s an option often favoured by business owners who want to secure their legacy instead of seeing the business swallowed or broken up by a larger rival.

For an ambitious management team, an MBO can be the route to unleashing your entrepreneurial flair and the growth potential of the business you are running.

A successful MBO can bring long term rewards for both parties, though equally the process is not without its potential pitfalls. This guide provides an overview of the deal process and offers some tips on the key issues to bear in mind when deciding whether an MBO is right for you.
From a seller’s point of view, reasons why an MBO may be preferable to a traditional trade sale include:

> The buyers – the management team – already know the business intimately, meaning there is less chance of the deal becoming derailed or the price being dropped following the due diligence process.

> The seller does not have to disclose confidential information about the business to competitors who may be interested in a trade sale, only to walk away if it does not proceed.

> It can allow the founder’s legacy to be maintained rather than facing a restructure by a corporate buyer or group of companies.
To acquire a controlling stake in the business, the MBO team will typically set up a new company. The management team will normally invest their own money in this new company, but they will almost always need external funding too. This might come from:

- Private equity or venture capitalist investors
- The seller, via a loan note, agreeing that some of the purchase price is paid on different terms
- Debt finance, such as a bank loan

Often the longest part of the deal process is the time it takes the MBO team to secure funding.

Before making an offer in earnest, we would advise the management team to at least have an expression of interest from funders.

Once the MBO process starts it typically lasts about six months, though every deal is different. Sound legal advice is crucial for both buyer and seller throughout the process. The earlier advisers are involved the better as this means they can structure the deal for your benefit.
Businesses helped by Stephens Scown’s corporate and commercial team*

*Figures for 2016

775
WHO'S WHO?
THE KEY PLAYERS IN A SUCCESSFUL MBO

The MBO team will usually include the current managing director, finance director, sales director and operations director. They will be assisted by financial advisers, accountants and lawyers, as well the seller.

An MBO is a complex and often time consuming process. It can be easy to take your eye off the business so to ensure a successful transaction it is important that everyone is committed at the outset to ensuring the deal goes through. Having legal, tax and financial support is key to this. This diagram shows the key people involved.
MBO TEAM

Key questions for the MBO team to consider:

> Is there a willing seller?
> Do you have the financial backing needed to acquire a controlling stake in the company?
> Is there a chance of growth and profits from the company?
> Are you comfortable with a lesser standard of commercial warranties, given your in-depth knowledge of the business?
> Are you ready to put in the time and effort to conduct a thorough due diligence procedure?
> Are you prepared to devote time to the deal while continuing to manage the day-to-day running of the business?
> Have you thought about the tax implications of buying shares in the business?
> Are you comfortable with the risk of being a business owner rather than an employee?
> How are you going to pay the professional fees of the transaction as it is unlikely that these will be covered by the company?

SELLER

Key questions for the seller to consider:

> Is there a competent management team with sound financial backing?
> Are you prepared to accept a lower price than could potentially be achieved by marketing the business?
> Would you be prepared to retain an interest in the company and be repaid over time? Or would you prefer a straightforward trade sale?
> Are you willing to devote time to ensuring the deal is a success?
> Have you thought of an alternative plan if the sale does not come to fruition? What will be the impact of an unsuccessful MBO?
> Have you sought legal and financial advice?
> Have you considered the tax implications of selling your shares and potentially deferring payment of the purchase price?
The UK MBO market fell by 44 per cent to £11.9 billion in 2016, with the total number of buyouts down six per cent on the previous year, to 398. The decline has been partly blamed on economic uncertainty in the wake of the Brexit vote. Just eight MBOs with a value above £250 million were completed in the UK in 2016, down from 22 the previous year.

Source: cmbor/Equistone Partners Europe/Investec Bank
“The South West has seen 595 deals announced in 2016, representing a 3.8 per cent upturn on the 573 deals recorded for 2015. This is the busiest we have seen the region in the last decade, and represents the sixth consecutive year of rising transaction volume.”

Experian UK and Republic of Ireland M&A Review 2016
Like any major transaction, buying a business is a complicated process. Our supportive team of corporate and commercial solicitors are experienced at making sure it goes smoothly, leaving you to concentrate on what you do best – running the business.

Our approach is always to ensure your interests are appropriately covered whilst seeking to preserve the goodwill between the parties involved in the transaction. Experience shows that this goodwill can be lost - and deals jeopardised - by professionals getting overzealous.

THE MBO PROCESS: KEY LEGAL DOCUMENTS

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Key documents you are likely to come across in the course of an MBO deal include:

- **Non-Disclosure/Confidentiality Agreement**: this ensures confidential information about the business is kept secret throughout the negotiations – and after any abortive sale.

- **Heads of Terms**: this sets out the basis on which the parties are willing to proceed. It should address all key issues, meaning there is less chance of the deal collapsing later on.

- **Exclusivity Agreement**: giving the MBO Team time to prepare for the transaction and safeguard against the seller losing patience and seeking a trade sale instead.

- **Share Purchase Agreement**: the key transaction document encompassing the terms of the sale.

- **Disclosure Letter**: the seller’s opportunity to identify any matters relating to the company which may be inconsistent with the warranties.

- **Tax deeds**: aimed at ensuring the selling shareholders are liable for any pre-completion tax.

- **Articles of Association and Shareholders Agreement for the new company.**

- **Finance documents**: contracts and agreements relating to the finances.
Transfer of intellectual property and assignment of contracts to the new company.

Directors service agreements: terms and conditions as well as employment contracts for the new directors of the organisation.

Companies house filing documents: copies and proof that changes to the organisation have been registered with Companies House.

Stock transfer forms: detailing the transfer of shares.

Director guarantees: personal obligations taken on by the directors as additional security for company liabilities.

Legal charges on property assets.

Professional engagement letter with lawyers, accountants and, in the case of the MBO team, their private investor.

Good, timely advice on these documents can make the difference between the MBO succeeding and failing.
More MBO opportunities are considered than are converted into deals. To ensure a successful deal, both MBO team and seller should carefully consider their respective risks.

In our experience there are certain common pitfalls that arise during the MBO process which it is useful to know about in advance. But don’t worry. We can help you navigate these issues to ensure you end up with a deal that works for you.

Potential deal breakers can include:
Not having the right MBO team in place with the correct balance of skills

Beware a disgruntled senior executive who is not invited to form part of the MBO team

Becoming consumed in the deal and taking your eye off the day-to-day running of the business

The MBO team need to ensure the profits and prospects of the company remain good. A deterioration in performance could scare off your financial backers. At Stephens Scown we can take care of the complexities of the deal, allowing you to remain focused on the day-to-day

Failure to ensure sufficient investments are in place

The MBO team will need to ensure that they understand the terms of any agreements to provide finances from either a third party investor or bank. Personal funds may be needed to invest in the new company. Be aware too of any abort fees if the deal fails and consider how these will be paid

Not investing sufficient time in negotiating the Shareholders’ Agreement for the new company

Although this can prompt difficult discussions, it is vital the Shareholders’ Agreement is agreed as soon as possible following the incorporation of the new company. This agreement will deal with issues such as what decisions require majority shareholder consent and is crucial to the future running of the business

Not being realistic about timescales

Going public with the deal too soon could create uncertainty for employees, which in turn can threaten performance and profitability

Trying to do it all without professional advice

Underestimating the complexities of an MBO can have disastrous consequences, so it is vital to seek legal, financial and accountancy advice to ensure the deal protects your interests and future
MBOs, like the companies themselves, vary significantly in terms of size and complexity. Add more parties and more financial sources, and more time will be expended in concluding the deal.

We work very closely with all parties in MBO transactions and offer commercial pricing options. For budgeting purposes, the cost of legal work for the MBO team on a modest-sized transaction is likely to be in the range of £25,000 - £35,000 plus VAT.

**WHAT WILL IT COST?**

Typically MBOs take around six months to complete, although they can be done quicker. There are a number of key stages to complete.

### HOW LONG WILL IT TAKE?

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“Personal legacy is an important concern for business owners, and market changes have signalled a significant rise in the frequency of Management Buy-Outs (MBOs). With this in mind, forming an exit strategy is not something that should be taken lightly. Succession planning for many businesses can be complex and planning can pay dividends when trying to find the right person or people to take responsibility.”

Duncan James, RealBusiness
“There seems to be a great culture in the organisation where staff exhibit a friendly, open and can-do attitude. They have an excellent local reputation.”

Chambers UK guide, quoting a client of Stephens Scown’s corporate and commercial team
CASE STUDIES

Martyn Stroud,
Sands Civil and Structural Chartered Engineers

Sands Civil and Structural Chartered Engineers work across the South West on a wide range of projects, from domestic surveys to major schemes like the extension of the Exeter Chiefs’ Sandy Park stadium and up to 1,000-plot housing developments.

Since December 2015, the Exeter-based business – also informally known as Sands Consultants – has been owned and run by Martyn Stroud, Matthew Cridge and David Backway, following a successful management buyout.

The three directors had worked for the company for many years, so were the logical successors when Alun Sands, who founded A.J. Sands Ltd in 1991, and co-director Peter Jackson began planning for retirement.
Succession planning

“We were having conversations with the directors about succession planning for quite a long time,” said Martyn. “We were lined up as potential successors and became more and more involved in running the business from 2010 onwards.

“I joined pretty much straight out of university and helped build the business, so it just felt like a natural progression. If it wasn’t going to be us, it would be someone else and we didn’t know what position that would leave us in.”

During a protracted period of negotiations, the MBO team was advised by Simon Morris, partner at Stephens Scown, and a local accountant.

“There was a low point where the process stalled due to a technical issue, which Simon helped us to resolve,” said Martyn. “And he worked extremely hard in the couple of weeks leading up to completion in order to hit the target date we had set.”

Negotiation process

“We had never been through this process before and neither had the vendors,” Martyn added. “It was quite a stressful process for both sides – that’s why it’s important to make sure you get the right advice. For the uninitiated, it seems like an expensive process and there was a temptation to see if there was a cheaper option, but in hindsight, getting that proper advice has been invaluable.”

The deal that was eventually reached involved an upfront payment with deferred payments over a short period, meaning the MBO team was able to partly fund the acquisition through future profits without the need for external finance or a private equity partner.
Elephant in the room

Martyn’s advice to prospective MBO teams is to be prepared for the challenge of balancing negotiations and the day-to-day running of the business.

“As employees, going into negotiations means putting a different hat on,” he said. “In quite a small company, it can be very personal. You are concerned about upsetting people who are still your current bosses.

“The trickiest bit is separating the negotiation process from your day-to-day work. We relied on the experience of our advisors, who were really helpful in terms of how to approach it.

“There’s no getting away from the fact you are negotiating with people you see every day. It’s the elephant in the room while that’s going on in the background. Having that independent advice from someone who is outside the process is really useful.”

Clear and efficient legal advice

Sands employs 25 people and business has been going well for the new owners since the MBO was completed.

“The time has flown by as we’ve been getting used to our new roles,” said Martyn. “We aim to consolidate and keep making steady progress by providing a high quality service.”

Stephens Scown have continued to advise Sands on other legal matters since working with the MBO team.

“They are very clear and very efficient,” said Martyn. “I would certainly recommend them.”
Case Studies B

Peter Ash, Matford Arable Systems

Matford Arable Systems was founded by Peter Ash in 1991. The Exeter-based business sells agricultural chemicals and seeds.

In 2014, Peter and his wife Susan sold the business to his three fellow directors. He was advised on the management buy-out by Stephens Scown partner David Culshaw.

The deal enabled the MBO team to achieve their ambition of running the company, while Peter, who was planning to retire within the next five years, was able to realise the value of the business he had built up over the years.

Structuring the deal

Peter and his fellow directors had been discussing their future plans for a couple of years before deciding to go down the MBO route.

"Once we decided what we were going to do, the process took five or six months, but there was a lot of talking before we arrived at the deal we struck," said Peter.

"With David’s expert guidance we structured a deal where I will be repaid over a period of ten years, thereby enabling the MBO team to continue the business without the need for external funding."

Establishing the value of the business was probably the most difficult part of it. Once the price had been agreed, it was really fairly straightforward."
Business legacy

Peter, who now concentrates on farming and other business interests, is pleased that the MBO meant Matford Arable Systems remains an independent Devon business.

“One of the things we prided ourselves on was that it was completely independent from any large national companies,” he said. “I valued that and I think our customers did too.”

Quick response

Stephens Scown has advised Peter on a range of issues over more than 20 years.

“I have nothing but praise for Stephens Scown,” he said. “They are so attentive, and if they say they are going to do something, they get it done.

“David’s advice was always clear and queries were resolved quickly. His whole approach complements Stephens Scown’s very professional offer.”
WHY STEPHENS SCOWN?

Stephens Scown is the UK’s Law Firm of the Year. We were awarded the accolade at the British Legal Awards, the leading awards for the UK’s legal community.

Our corporate team has earned the top ranking for serving SMEs and owner-managed businesses from Chambers & Partners, the independent national guide to the legal profession. We’re particularly happy about this because these rankings are based on quality of work and feedback from clients and contacts.

More and more business owners are turning to our friendly, down-to-earth lawyers for advice. Over the last year, we helped 775 businesses* – up 57 per cent* on the year before.

Our corporate team saw a 107 per cent* year-on-year increase in deal related activity, including business sales, acquisitions, refinancing, equity investment and MBOs.

We hope this guide has been a useful introduction to the MBO process. If you would like to discuss any of the issues raised, please visit:

www.stephens-scown.co.uk
email: solicitors@stephens-scown.co.uk

*Figures for 2016