

Information Pack

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Could your management be your purchaser?

This pack contains the following information:

- What is an MBO?
- Pros & Cons of selling to your management
- The MBO team
- Making the approach

Appendices

1. Sample letter to give to management teams

Guidance & Seeking Professional Advice

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What is an MBO?

Many acronyms can be used in this area, so here are some definitions of terms that are commonly used:

A management buyout is where some of your employees buy the shares (MBO)

A management buy-in is where a 3rd party individual/s buys the shares (MBI)

A combination of some employees & other individuals is called a Buy-in-Buy-Out (BIMBO)

A vendor-initiated MBO is called a VIMBO.

Pros & Cons of selling to your management

Pros

- Team know most areas of the business
- Can be ambitious to grow the business further
- Team members know the new owners & there is a comfort of some continuity
- Less onerous due diligence usually required than by 3rd party buyers
- Could provide a willing buyer when other trade buyers are not willing to purchase business on a going concern basis & therefore avoid winding up upon retirement
- Owner can exit in more gradual way
- The negotiations are often less confrontational when both parties know each other
- Can be satisfying for the vendor to handover to a 2nd generation of owners who are now benefiting from the business

Cons

- The team may not know all the areas of the business & it needs to be balanced across all business areas
- May want to make rapid changes/investments
- If some key team members aren't included, it may affect morale & the team need to ensure their own transition to employers from employees is smooth
- Current owner needs to be willing to share confidential information with his/her current employees who are part of the team
- May not have a great value of readily available funds or assets on which to secure potential borrowings
- Can be difficult for the team to take over if the exiting owner is still involved in some way
- Managing the deal process with an employee team can be difficult if not managed properly, with boundaries agreed early on
- If the deal aborts, there is a risk that the employees will leave the business

Could your management be your purchaser?

Minimising the Risks

The rest of this document aims to assist you in understanding how to minimise the disadvantages of selling to management, and maximise the advantages. The key issues covered in the later sections are:

- Who could the MBO team be? Keep your options open in the early stages. An MBO is only one option. Other options are an MBI, a trade sale, an EOT (employee ownership trust) or a private equity backed investment, which may all be possible alternatives for you to achieve your exit. Discuss how likely these are with your professional advisers as soon as possible so that any necessary exit planning can be started.
- If there are gaps in skills in any potential MBO team, these can be addressed, so don't immediately dismiss the option of an MBO because you don't think your team is capable of running the business.
- Discussing this possibility with employees, and the subsequent deal negotiations which may happen in due course, can be difficult to navigate without upsetting the balance of the employer/employee relationship. Maintain boundaries throughout and keep communication clear. Making the initial approach correctly is critical and is covered later in this document.

Please note, whilst you may be concerned that the price obtained for the business and/or the structure of the deal may not be as lucrative as with some other types of purchasers, other things should also be taken into account when deciding if an MBO is a possible route for your exit, including:

1. You may be able to structure a partial exit of the business if that is preferable to you;
2. If handled correctly, the deal process should be less confrontational than with 3rd parties or competitors;
3. It can be very satisfying to know that you have handed the business onto another generation that you have had a hand in developing.

The MBO Team

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The MBO Team

Who is in the team?

Unless there is a natural Managing Director, it may be worth considering several members of your team to make up this potential MBO team, so that their skills are wider and balanced. They will have to allocate roles and responsibilities to running the business between themselves. After consideration, it may be advisable to supplement the team with either outside MBI candidates or an Interim Manager to provide any skills that are lacking. This may be their decision to act on, or these additional skills may be something you agree to source between you.

Capabilities & resolving skill gaps

Some 2nd tier management teams in owner managed businesses already assist in running the company. They have responsibilities for autonomous areas of the business and would make the transition to full ownership relatively seamlessly.

Other businesses may not operate in this way and therefore, a potential MBO candidate or team may have gaps in their skills such as:

- Understanding accounts and finance
- How to win work and sell
- Dealing with suppliers and buying
- Legislation and regulatory issues affecting your sector
- HR and staff management
- Building a strategy and leadership

You may decide to resolve skill gaps with training and/or the recruitment of a manager with the capabilities that are lacking in the current team. This new manager may take a 'General Manager' role, allowing you to work less hours and start your gradual exit from the business. You may wish to instruct a firm of executive headhunters to carry out this search.

Who to approach in the first instance

You may decide to approach several potential members of this MBO team (esp if there are several managers at similar levels and responsible for different areas of the business) or if there is a natural Managing Director as discussed above, it may be more appropriate for you to approach just one member of the likely team, and invite them to make the approaches to the other potential team member colleagues if they choose to.

If you want any further assistance with this, you should discuss your own circumstances with your professional advisers who ideally will also know your team and their personalities.

How you make the initial approach to one or more of your management is critical, and is discussed in the next section.

Making the Approach

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Making the Approach

The earlier this possibility can be discussed with a potential MBO team/candidate, the better. Having a 'matter of fact' approach to succession planning over several years is key, so that there is no nervousness, suspicion or misunderstanding within the business.

However, having said that, opening discussions about a possible MBO with any of your key staff has to be handled very carefully. Introducing such a potentially life-changing idea to them, and then giving them only a few months to make a decision and act upon it, will generally not result in a happy conclusion for anybody!

You should not mention anything about price or deal structure at this stage. Using a letter (see later) can help you maintain a structure to the way you handle the approach. Having a verbal conversation can often lead into other areas and questions that may be unwise to discuss at this early stage. However, should that situation arise, bear these things in mind:

- Stress any potential deal would be in the medium term – try not to be specific about timescales;
- They mustn't think their job security depends on them doing this or even just taking discussions further;
- Introduce the team to an independent adviser as soon as possible – ask your professional adviser for recommendations for an adviser that will understand the situation, works in this market, and will want to work in a similar way to your advisers;
- Any future discussions (and ultimately negotiations) should be done at arms-length and off the premises, which will maintain the boundaries of employer/employee relationships during working hours

Appendices

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Appendix 1

Sample letter for business owners to give to potential MBO teams

Note for business owner: This letter has been checked by lawyers to ensure compliance with employment regulations and the only other point to note is that if it is to be disclosed who the other invitees are, it is important that you make sure there is no discrimination or what might appear to be discrimination, for example you shouldn't leave anyone out who is in a similar position of seniority (eg a woman or a part-time employee). It is for the employees to decide who may be part of any ultimate MBO team making offer, and not for you to influence.

Dear [xxxxxxx]

FUTURE PLANS

As I'm sure you realise, at some point I will want to retire from running the business. My objective is to ensure that the business continues and thrives under the new owners.

My thoughts are at a very early stage, and I don't have any set date for exit. However, it would be remiss of me not to give you the opportunity to consider buying the business yourself at some point.

I appreciate that you probably haven't run a business yourself before, and may not have even thought of doing so. I wondered if you wished to have a discussion about it?

Should you wish to, there will be no commitment on either side for us then to progress to more formal negotiations. This is just a very early stage discussion to explore if there is a potential opportunity for you and if you may have some interest.

If this does progress, I would also recommend that you seek your own independent advice and my accountants can make some suggestions of other professionals in the region in due course, so that you can meet with someone independent, but also with suitable experience in corporate finance transactions.

I'm sure you understand the potential sensitivity of this situation, and therefore I'd appreciate it if you didn't discuss this with anyone outside of your immediate family. [For information, I have also sent this letter to xxxxxxx and xxxxxxx, so I'm happy for you to discuss this with them as well].

Please let me know if you would like to discuss to meet, out of hours and off-site is probably more appropriate. Please also say if you don't want to discuss any further, as I'll completely understand, and it won't in any way affect your future prospects within our business.

Look forward to hearing your thoughts,

Yours sincerely,

[usual sign off]