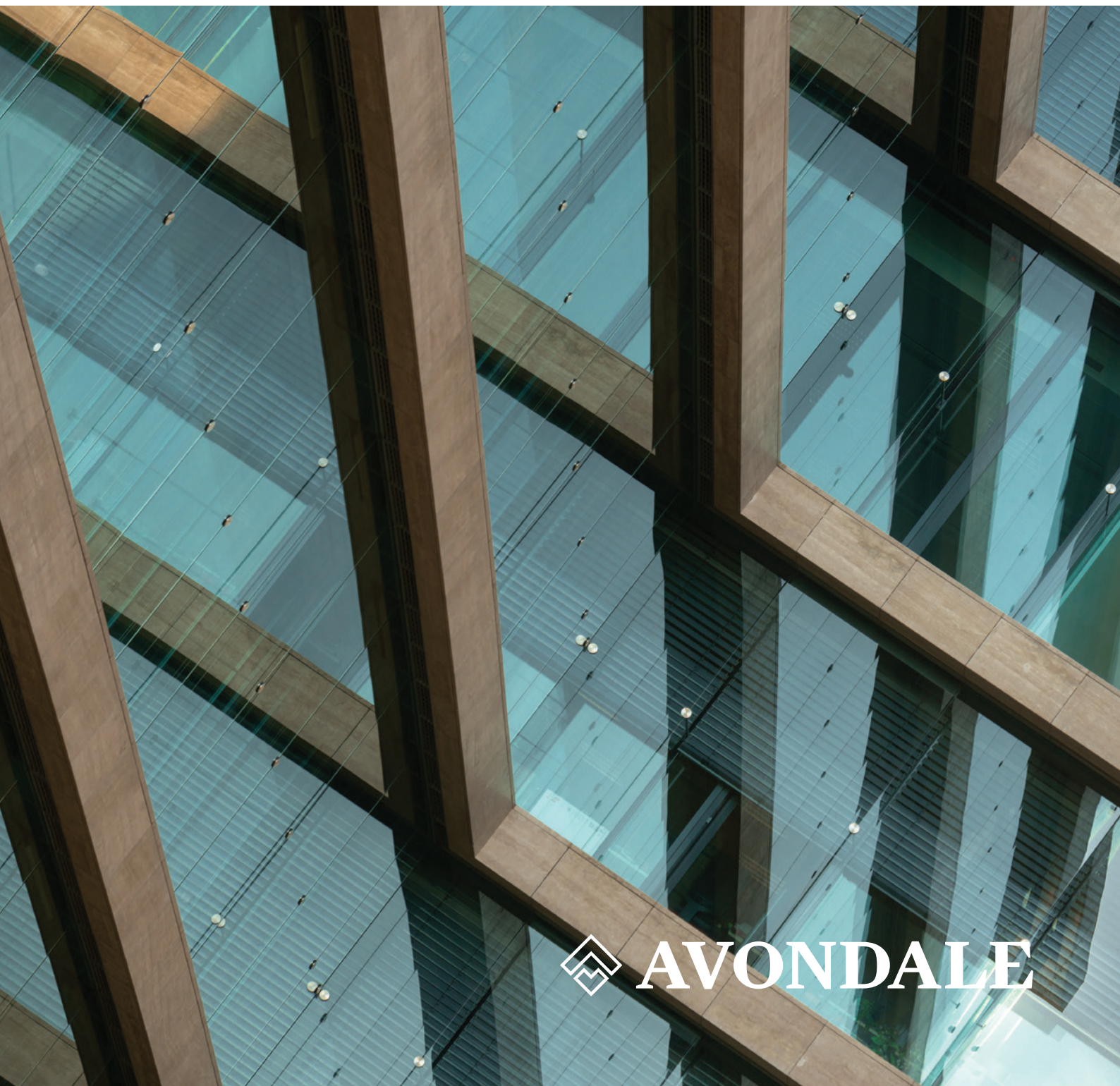


Guide 3

Exit Strategies by Design



Guide 3

Exit Strategies by Design

Avondale is a leading Mergers & Acquisitions strategy consultancy. We have been working with the best entrepreneurs and companies for over 30 years. Operating both locally and globally, the firm has offices in the UK and Central Europe. We provide a fully integrated service from business sales and acquisitions to business growth, strategy and employee ownership. Solutions-led, we combine our expertise with ambition, resource and vision – partners that drive value and deliver your goals.

In this Guide we examine the main types of exit and the types of buyers, and bring to the fore some of the timing considerations around an exit strategy to assist shareholders.

Please contact av@avondale.co.uk if you have any questions

EXIT ‘RIGHT’

An exit strategy is a plan to create succession or liquidate the value of shares. A successful exit will focus on profitable value and ideally realise the goodwill inherent in a business; that being the customer loyalty that results in both current and future profitable revenue. Some corporates will also divest non-core assets to realise capital and create focus in their strategy. Exits can be driven by shareholders, retirement, investors or corporate strategy. The method, approach and strategy employed are an important part of the entrepreneur’s journey and are equally important in corporate divestment.

Business owners or shareholders will exit their businesses at some point, that is certain. For some, inheritance is the route by which shares change hands. However, with regard to planned business exit strategies, there are a myriad of options. Every business, business model and shareholder team is different in its aspirations, outlook and approach. Some are happy to run a business long-term and rely on family inheritance or handover as succession, others prefer to start up and then, via the tax breaks usually available to shareholders on a sale, ‘cash-in’ at some point on their journey. Some of the more ambitious and focused recognise the many tax breaks available on shareholder value in many countries and will therefore start a business solely with the end in mind, securing a highly profitable sale and thus time wealth and capital in the bank. In order for these start-ups to exit, the aspiration can in turn help them secure seed investors wanting to share the spoils. Most of the truly wealthy got there with capital and by carrying out deals as opposed to relying on income.

Plans also change. The entrepreneur

seeking a long-term ‘hold’ with the skills to build a business – which usually means breaking rules and deliberately seeking to be different – may not have the discipline to run the business when it moves from the agile cultural village many start-ups are, to the highly commercial rules and process driven mid-tier, or even later, corporate enterprise. A long-term ‘hold’ owner may become worn down or recognise they themselves are the barrier to growth, being unable or unwilling to shift their mindset – perhaps from maverick to manager.

Whatever the reason or motivation for a sale, when it comes to investments and exits, usually only the most noteworthy ones break through to the media. The confidentiality process employed in the sale of private companies can leave a shroud of mystery over both exit process and final deal terms. The consequence: exit strategies receive too little attention and there can be significant misconceptions. The best reason to understand exit strategies is to enable positive approaches that leaders and entrepreneurs can choose from to plan their exit, rather than being beholden to market forces which may enforce an exit which is not of their choosing. Planning exits positively is essential to ensure sustainability, succession and a successful transition. Understanding and aiming at a clear route to exit can also be more effective than hoping one or other method will work or waking up one day with the thought ‘right we’ve had enough’!

When planning an exit there are many steps involved to prepare which, as we examine in the Shareholder Value Guide, are in fact good business practice anyway. These steps can range from reducing the dependence on an owner to creating an effective management



team, designing better reports, stronger financial systems and creating stronger growth prospects. Businesses with strong growth prospects, that are team driven, will invariably be more valuable than others and therefore easier to exit.

An exit may also require a ‘leap of faith’. We will look at this in more detail later in this Guide but essentially far too many exits are poorly handled as owners choose what is right for them rather than decisions that are right for the business. Often this is because their personal outlook is over-influencing the thinking, or they have misconceptions about the value of their business and thus miss the window. Occasionally, value expectations are further distorted either by advisers seeking large engagement fees and therefore over inflating values, or some exceptional headline deals that make the press. However, not selling the business at the right time is market disruptive.

Many owners or shareholders may be concerned about how life will look after a sale, particularly for the hours-driven entrepreneur whose business is their ‘baby’ and who has limited hobbies. The loss of esteem from a sale and lack of business game play after a deal can also lead them to hold on to a business asset too long. An exit strategy always involves a leap of faith into a new journey which can be uncertain. Whilst maximum value should be sought via a process, sellers should listen to the market on actual offers and value rather than compare value to the rare ‘headline’ deals. Premium exit deals can and are secured regularly with the right approach but defining what is ‘premium’ is subjective and should also take account of the present value of money.

EXIT STRATEGY TYPES

Different people start companies for different reasons, and that invariably influences their exit strategy. Each owner's

journey is different as every company's shareholder dynamics are different and therefore there are many different exit options. The right exit strategy or option

depends a lot on the objectives of the people who own the business. Strategies to exit might, in no particular order, include one, or a blend, of the following:

| | |
|---|--|
| Wind down and liquidation | Whilst this may at first seem negative, building reserves up and liquidating can be tax effective. Further if there is recurring revenue creating an annuity the business can be left in stasis building up reserves before the eventual liquidation. Liquidation can, of course, also unfortunately occur when things go wrong. |
| Family Succession | Gifting shares to the next generation or a sale to family, often over time, usually occurs as family members develop within the business. |
| Family Inheritance | Shares in a private company can be inheritance tax free so passing on shares on death, depending on the family, can form an important part of succession planning. The thinking; why sell to secure cash we might not need only to then find the family later pay large amounts of inheritance tax. There is family tax planning scope on shares in most countries. |
| The Managed Business | Moving an enterprise from owner driven to team driven enables significant time freedom for the owners, whilst they still enjoy an income from the business. This may create an initial limited exit, perhaps followed later by a full sale. Team driven businesses with a good growth track record and ongoing prospects can be highly valuable. The strategy requires investment in training the management team. Just delegating to the team with insufficient information can create a void in leadership. |
| Flotation. An Initial Price Offering (IPO) | From the Alternative Investment Market to the FTSE or NASDAQ there are myriads of publicly listed businesses controlled by management but with shares on the listed exchange, enabling a sale and realisation of the business direct to the public. This approach usually only suits larger businesses prepared to deal with the significant responsibilities and administration that goes with a flotation. They are rarely full exits as owners are expected to share the risks when a business 'floats'. |
| Management Buy Outs (MBO) | Where management acquires the business: usually assisted by leveraged debt and the vendor, but there can be a conflict of interest in the process. This is because management working to grow the business are increasing the price against themselves as they work. A strong strategic trade deal will normally beat the value, which may be held in check by the amount which needs to be borrowed by the buyout team. The management team know the business and can be agile, a seller more flexible on deal structure and due diligence is usually less arduous. |
| Management Buy In (MBI) | As above, a management buyout but where the management is brought in specifically to carry out the transaction. |

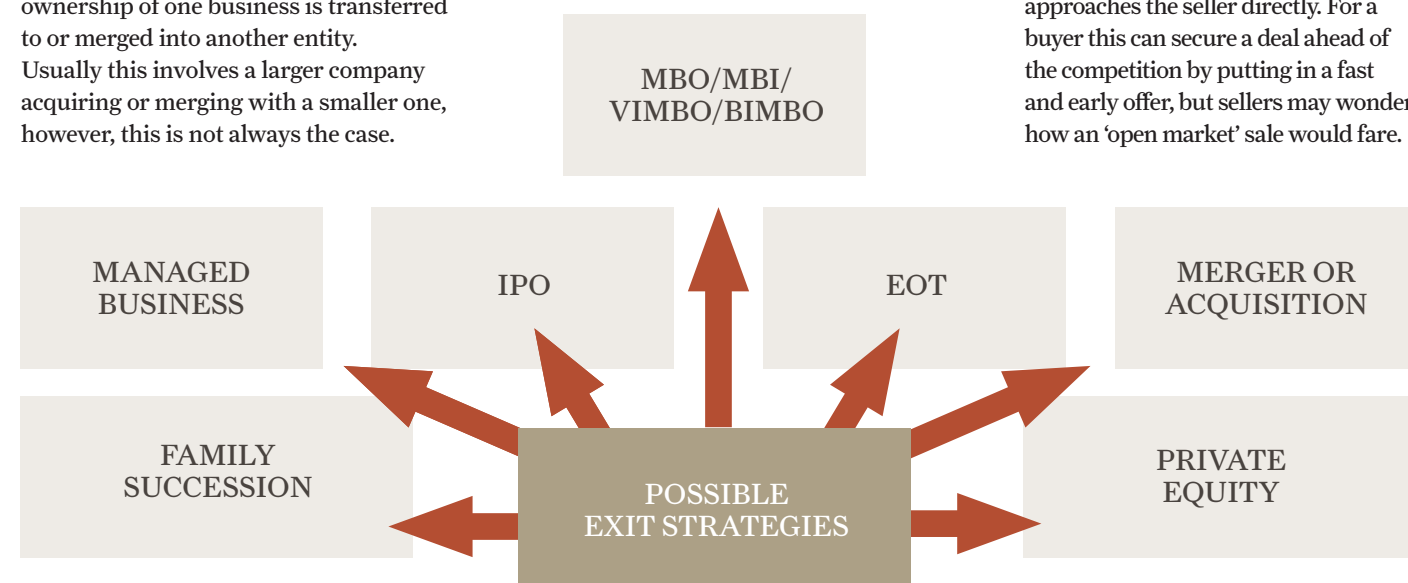
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|---|--|
| Vendor Initiated Management Buy Out (VIMBO) | As above, a management buyout but initiated by the vendor who usually drives the process, both starting the dialogue and, usually with advisers, coaching the deal through. |
| Brought In Management Buy Out (BIMBO) | As above, a management buyout, but on this occasion initiated by external management or possibly by an investment house backing external management. |
| Employee Ownership Trust-UK (EOT) Employee Stock Ownership Plan – USA (ESOP) | Following the lead of companies like John Lewis with its Partnership approach to ownership, many countries have developed employee ownership company structures. If you own a trading company, you exit by selling the business on to all the employees via a Trust. It is different to an MBO in the way that it is sold to employees, although a management board may be established with greater incentive and shares. The sale will be at arm's length with the value set by an independent analyst. The approach works well where management is capable of an acquisition but do not want to fully take on the debt personally required to effect a buy-out. The vendors, along with banks, will normally help finance the transaction. |
| Merger or Acquisition (M&A) - Trade Sale or Merger | From outright trade sales to mergers, the approach is to secure a transaction via research usually to a larger or similar company. A deal that aims at the four corners of M&A: shareholder value gain for the buyer, synergy, economies of scale and positive disruption to the market will nearly always secure the best value for the company. For the acquirer it is often a quicker way to grow their revenue than creating new products. Sales may also be motivated by multiple arbitrage – the idea of a future sale of the combined companies at an even greater value than each may get individually. A trade sale is often considered the pinnacle of exit strategies as with the right buyer and process in place, the premium is usually the highest and the deal structure the simplest. |
| Financial Sale and/or Private Equity | Businesses create yields and there are many good buyers who are happy to buy and hold a company because of it. In recent years, as investors seek returns, this approach has increased, particularly with the advent of Private Equity houses. They are usually seeking fast growth businesses where they can triple their initial investment or more, using their capital and knowledge of how to develop the business. The attraction for sellers may be to stay involved and enjoy a second exit of a smaller retainer but often a more valuable percentage. |
| Planned Partial Exit | In this approach we may have a blend of others, although the key basis is that the sellers are actively choosing to retain a stake, either passively to perhaps enjoy their 'retirement' as a Chairman, or proactively whilst they retain an involvement and work with a new team, possibly with Private Equity backing to grow the business to the next level. |

POSSIBLE EXIT STRATEGIES

Choosing which exit is right depends on the circumstances, market conditions, your business and any future role you may seek in the business. Good advice is critical. Many approaches also have sub-elements of each other; therefore, I have only covered the main ones below in more detail.

MERGERS AND ACQUISITIONS (TRADE SALES)

A merger or acquisition is where the ownership of one business is transferred to or merged into another entity. Usually this involves a larger company acquiring or merging with a smaller one, however, this is not always the case.

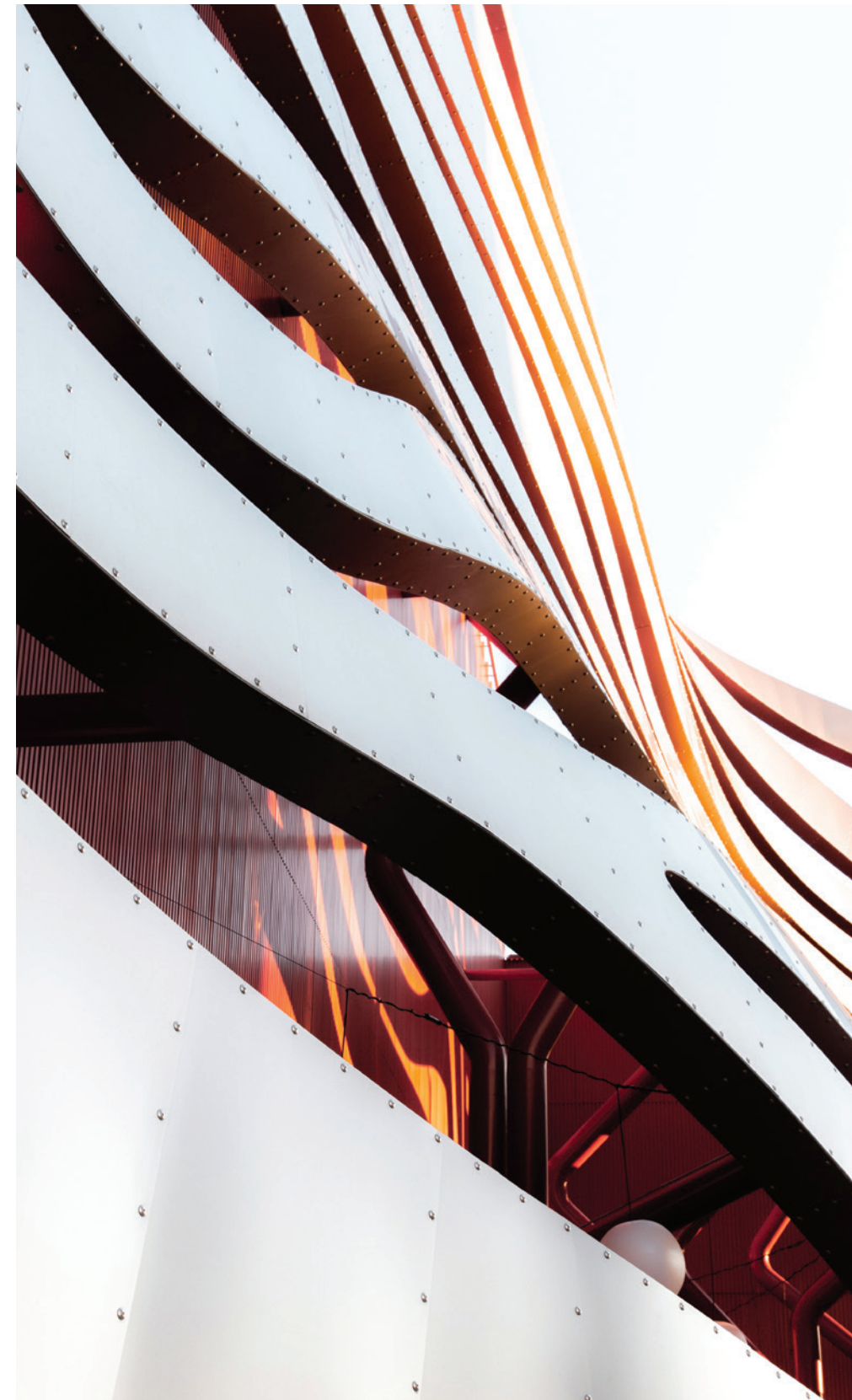


In the context of exit strategies, the most commonly sought and considered transaction is the strategic trade sale or merger. That is a sale to a buyer who 'strategically' extracts more value from the business than can be done on a standalone basis and therefore they are prepared to pay a premium above financial valuation. In the next chapter we will explore specifically how to maximise this type of sale approach as a strategic trade sale is often considered the pinnacle of exit strategies. With the right buyer and process, the premium is usually the highest and

the deal structure the simplest. All mergers and acquisition approaches are bespoke, as each company, culture, sector, value driver and shareholder objectives are different. A merger can be considered a sale as usually there is a controlling and leading party, albeit deal terms are more likely to be shares for shares than cash out. Be warned that share prices can go up as well as down and in private companies they are illiquid and so future value may not be easily ascertained. Buyers or merger partners may be secured either by:

- A 'sweetheart' approach – a buyer approaches the seller directly. For a buyer this can secure a deal ahead of the competition by putting in a fast and early offer, but sellers may wonder how an 'open market' sale would fare.

- A private sale – a full auction process can be off-putting to certain buyers and therefore it may be more preferential to market the business in a private sale to a carefully selected few and ask for a premium in doing so.
- A full auction process – the market is confidentially researched in full by targeted multi-channel approaches to key decision makers with strategic buyers, alongside Private Equity investors.



Research will carefully identify the best strategic acquirers using a combination of global intelligence tools and tacit knowledge of buyers. Through the synergies and economies of scale available, the business will be worth differing amounts to different buyers, and often it is not the obvious buyers who will gain the most value from a purchase. The optimal purchaser is one who has a "we want, we need" motivation.

In all approaches, confidentiality is maintained by a non-disclosure legal agreement before a company name is given. Furthermore, the business is best presented on an 'offers' basis to enable the market to decide on value. Ideally a competitive process will be secured with many buyers bidding in an 'auction' which will secure the best price. To create the mergers and acquisition environment a crafted Information Memorandum (IM) is the key selling document, backed by a real-time data room with the key financials, performance indicators and product details including any Intellectual Property. This creates the transparency to present the business in the best light to the right buyers and therefore to unlock the equity value. Information may be phased to protect confidentiality.

A good corporate M&A adviser will bring research, tacit buyer knowledge, project management, negotiation, confidentiality and orchestration of all the parties to deliver the successful merger or acquisition. By creating an auction, they can also help leaders secure the best price without being distracted by the process or getting deal fatigue. This fatigue is a law of deals; the longer they take the less likely they are to happen.

Today, there are increasingly complex deal structures in sales, with earn outs and deferred payments (see

deal structures). Considering how best to protect these positions is also critical, and expert advice from the start will be crucial. There is also a trend in partial exits or elevator deals which enables owners to both capitalise on their exit and keep a stake and stay in the business game. Partially retaining the seller can also help the buyer take the company to the next level on a de-risked basis, which could result in owning shares with a greater value in the future. Deal structure and financial backers can help make or break a deal.

Public Companies’ M&A has its own vocabulary. To name a few: a ‘White Knight’ is a friendly takeover to protect a target company from a hostile takeover; a ‘Dawn Raid’ is a buy-side strategy to buy shares to a point of control across stockbrokers early in the day to surprise the target; a ‘Golden Parachute’ is an offer of lucrative benefits to executives to fend off a takeover; a ‘Reverse Take Over’ is when a private company takes control of a public business to become listed. As public shares are widely available, most assume that the management controls the business and whilst this is true on a day to day basis, if a party in either a Private

or a Limited Company gains more than 25% of the shareholding, they have the right to prevent the passing of a special resolution, and above 50% typically control the appointment of directors.

Mergers, acquisitions and takeovers are part of business life. In today’s dynamic markets the job of management is to maximise shareholder value. For the founder leader it may also be to realise this value via the right exit strategy. Acquisitions can both realise value and create competitive advantage to ultimately increase shareholder value. (See Maximising Exit and Shareholder Value Guide).

EMPLOYEE OWNERSHIP TRUSTS (EOT)

The concept is simple; employees ‘may’ make better owners of companies than shareholders because they work in the business and, as owners, they may care more than they did as staff, thus enhancing growth prospects. In the UK over 200,000 people are employed by employee owned companies and in the United States the figure is closer to 1 million.

Globally there are variations on the technical structure. However, to examine the UK: the current approach, the Employee Ownership Trust (EOT), was established under the Finance Act 2014 to provide an alternative to third party sales and encourage greater employee ownership which, if tackled correctly, can be a great contributor to both companies and the wider economy. A qualifying EOT is established with a corporate as the trustee of the EOT (the Trustee Company). The shareholders sell their shares to the Trustee Company under a share purchase agreement at market rate, usually with some of the valuation and purchase funded by the company from profits over a period of time.

In the UK the benefits and characteristics are as follows:

- All employees are included as beneficiaries. A formula may weigh the allocation towards longer serving, more highly remunerated staff. A qualifying period of up to 12 months can apply for new employees and, at the time of writing, all employees can receive an annual income tax-free bonus of up to £3,600.

EMPLOYEE OWNERSHIP TRUST – KEY POINTS



- The company is run by the management/board which means that the business and brand can stay the same to maintain the shareholders’ legacy. The EOT is entitled to more than 50% of the profits; usually waiving dividend rights, especially until the shareholders have been paid the valuation price.
- The valuation is open market and therefore can compete in ‘headline’ number to, for example, a trade sale to a competitor, although the deal structure may be weaker with some of the money paid over time from profits after tax in the form of vendor loans. Third party debt may also be used. In the UK any sale to an EOT is, at the time of writing, 100% Capital Gains Tax free. Costs are similar, but the process can be less distracting than finding a trade sale.
- An EOT is an exit by sale for the shareholders, however, they may still need to create succession for their roles and for an employee owned business to be successful, investment in cultural transition is also critical. The approach can otherwise be seen purely as a tax exercise by employees. (See EOT Guide.)
- Note: Avondale’s Guide No. 2 covers Employee Ownership Trusts in detail.

INITIAL PUBLIC OFFERING (“IPO”)

An Initial Public Offering, or ‘flotation’, is a transaction in which the company decides to finance further development from capital raised on a public stock exchange like the NASDAQ, AIM or FTSE.

The shareholders sell shares to the public which may realise some of their value, but may also be used to bring in investment and is therefore more suited to a partial realisation of value. The company has access to public investment via the Stock Exchange which can bring significant sums of capital and a constant and real market valuation. With increased regulation, a floated company often has increased credibility and thus easier access to debt, expertise, recruitment and contracts.

The costs of flotation are significant, as are compliance and regulation, so the process is not for the fainthearted and its ongoing maintenance, from profit updates to fending off hostile takeovers, requires some skill. However, the sums available for valuation are potentially significant. A crafted flotation brings substantial liquidity to the shares and value in just the process itself, as well as demonstrating a high level of positive ambition by the leaders. An IPO rarely provides executive shareholders with an exit in the short- to medium-term as the market is backing those individuals in planned growth.

MANAGEMENT BUY OUTS (“MBO”)

A Management Buy Out occurs when the managers of the business take over its ownership in order to create an exit strategy for existing shareholders. There are subsets in the buyout approach including VIMBOs (Vendor Initiated Management Buy Outs), MBIs (Management Buy Ins) and BIMBOs

(Brought In Management Buy Outs). Each has subtle differences in the type of management team and the way in which finance houses see them from a risk perspective, predominantly preferring management buyout candidates who have both the most experience and can put in their own ‘risk’ money. That is, they are prepared to put their own capital on the line alongside lenders which ensures their commitment.

The method can be overlooked as an exit strategy in favour of the trade sale. This is usually because the management have not been prepared for succession and there is a perception of a higher value from a trade sale. This will be the case if a strategic buyer is found but not always, particularly if the management can secure private equity to aid the transaction. Naturally management may not have the capital that a trade buyer has, and this may limit affordability; a good headline price can be secured by relying on the headroom in the profits of the company. Shareholders may have to ‘loan’ some of the money typically in the form of loan notes, effectively deferred payments, however, a well put together MBO can be extremely rewarding for all involved. It can reward the central managing team and secure the culture of the business as an independent.

For many managers an MBO will be their first step as entrepreneurs and to becoming owners. The mindset of leadership is different, the risks and technicalities greater. Confidence and the right advice are essential to manage the transition. Finance can be derived from many sources ranging from venture capital and private equity, to banks and alternative finance providers. Cost and structure will be criteria with debt cheaper than equity; however, a bank may not be as patient as the equity would be, particularly if growth investment is also required. A corporate finance house will model the debt structures;



typically, however, funding may be two to three times EBITDA on a loan which also requires a blend of vendor loans, management risk money and company reserves to fund the rest of the valuation.

It is also important that management teams understand that a well governed board will be needed after the deal. In order to succeed in dynamic markets, most businesses require a clear leader and an accountable CEO or MD, even if each manager may have contributed equally to the buyout and have equal shares. A quality shareholders’ agreement will better help the board govern and answer future questions like how shares will be valued in the future, what will happen on a future exit strategy, for example, whether shares will be offered to management first, or how a dispute between the managers will be handled.

Companies which have the cashflow to service debt with headroom but are slowing down as shareholders lose drive, are prime targets for an MBO. The management team will need a cohesive plan to drive growth, otherwise with the increased cost of debt, slow growth becomes stagnation. Teamwork is

critical as change requires cohesion. Any exit strategy or buy out is complex and time consuming. Management may get distracted and therefore a strong advisory team is needed to create alignment between all the parties quickly. Transactions should be fast, otherwise management seeking to buy can end up working against themselves in the day to day improvement of the team performance.

- It takes courage for a management team to leave the security of management for the risks of ownership, however, done correctly the financial rewards and personal satisfaction are significant.
- Understand the different types of debt and choose carefully. Equity partners are more patient than banks and will support you, but they are demanding. Banks, whilst cheaper, will require you to guarantee the payments and have strict rules.
- Management needs to remember that they are employees first, and shareholders second. MBO companies typically have excellent cultures, however, they still require capable leadership.

- Business requires tough decisions, and this may involve managers that were ‘brought in’ being tackled, regardless of ownership, when performance is not strong enough.
- The process is time consuming; get the right advisers to aid with both fundraising and creating a quality shareholders’ agreement.
- Returns will be low for managers in the early years and their ‘risk’ money or initial capital is tied up. Debt may take 4-5 years to pay off before dividends are received.
- Corporate owners can use MBOs to divest non-core operations and raise cash.
- Business owners can use MBOs to retire, thank the team and secure value from a sale. Whilst a deal may be more structured than a trade sale, its culture and entity are preserved.
- An MBO may be an opportunity for management to commercialise a cultural or family run business. Clearer roles, responsibility, openness and accountability may help drive growth. If a seller stake is retained, like a planned partial exit, such growth may give further upside for a seller.



TYPES OF BUYER

As well as many types of exits there are many types of buyers; being able to understand the best type and the approach of each is important when assessing the transaction and how you handle negotiations on each exit strategy. Each buyer will have different characteristics; overall they can be categorised as follows:

Trade ‘strategic’ buyers or mergers – the word ‘strategic’ is used as beyond gaining the financial value of your business, the buyer should also secure some other ‘strategic’ play which adds a premium value to the transaction. It is this aspiration of a premium which many sellers seek. Strategic buyers should feel that there is a natural ‘fit’ and the combination of the two creates totally new opportunities. There may be downsides such as redundancies and perhaps loss of the brand, but usually the sum of the two create better businesses, therefore there should be far greater upsides than downsides to this type of transaction for both buying and selling parties.

Private Equity (“PE”) – this can actually mean that an individual’s wealth is used to acquire a business but more typically it is used to refer to more specialist ‘partnership firms’ which collectively, via both high net worth individuals and intuitional investors, have raised a ‘fund’ to acquire usually pre-stated types and characteristics of businesses. The fund may therefore have a theme, for example, buying or investing in environmental businesses. Limited partners (“LPs”) invest their money into funds that general partners (“GPs”) of the PE firm use to buy companies, typically within a specific industry. The aim of Private Equity is to seek to maximise the growth of the acquired companies over, let’s say, five or more years and ideally to secure a future sale at three to five times the initial purchase price, less debt taken, to get a return for themselves and their investors.

Private Equity firms usually look to maximise the profitability of the business. They should bring capital, financial expertise and corporate acumen. They almost always seek to retain the

management team, often the founders, for continuity and industry expertise, usually with these parties retaining a stake to gain further value at the exit. Private Equity works well for high growth potential businesses that need capital to expand. Private Equity will often also add ‘bolt on’ acquisitions to further accelerate growth and value, as they have access to capital which most private companies do not. Some good trade buyers may also be Private Equity buyers, led by the nature of their shareholding. Such companies have both the funding and expertise to acquire via their access to the equity firm.

Many sellers dismiss Private Equity transactions too quickly. Their focus is the trade deal where they realise all the value on day one. Trade buyers can, however, be cautious, and will always compare organic growth to a purchase. So for many trade deals values can still be ‘feet firmly on the ground’. Private Equity valuations may compare although a deal may be more structured, and more interestingly there may be a material uplift on the later sale. A Private Equity deal may be the best way to secure a

significantly higher value than a trade sale today.

The potential benefits are as follows:

- As with a trade sale, reduced hours for the sellers while a new and existing team pick up the growth strategy. Or, the choice to stay on and drive growth, securing salary and pensions for longer, as well as later value realisation.
- Additional financial resource and expertise as required.
- Well-funded motivated buyers. Today, there are more Private Equity buyers looking for placement than there are opportunities due to the yields which the right investments secure.
- Higher Valuations, possibly significantly higher with the right growth achieved. Private Equity also has a very strong track record of growth. Recent research by the BVCA found that more than two thirds of Private Equity backed deals grow by more than 20% annually.
- Experienced professional buyers. If a deal is struck it is usually delivered. Many trade buyers can be ‘amateurs’ and a deal process lacks resource or expertise. They do not have the experience and risk may create additional anxiety. Private Equity manages the daily risk.
- Teamwork. The perception of Private Equity as ‘suits’ is incorrect. Yes, they are good with spreadsheets, but most investment managers work across sectors at high levels so they have a very strong business acumen to help facilitate even stronger business plans and boards.
- Investment by a Private Equity fund also creates incentive; they, like you and your management, want to achieve growth and create value.

CASE STUDY – TRADE AND PRIVATE EQUITY

SOLD: North Downs Specialist Referrals, South East, Turnover £7m

Avondale managed the completion of the multi-discipline veterinary referral hospital, North Downs Specialist Referrals (NDSR), to Sovereign Capital for a significant undisclosed sum.

They were appointed to oversee the sale of the business after initially meeting the Client at a conference run by Avondale at the Institute of Directors. The NDSR Directors believed Avondale’s approach to business sales would both achieve the best deal and also maximise the chances of completing the transaction.

An exclusive number of relevant acquirers were approached which attracted significant offers. Following negotiations, Sovereign Capital was chosen as the best fit for NDSR due to their track record of investing in companies to achieve growth. The UK buy and build specialists (Sovereign Capital) recently acquired Willows (also a veterinary referral practice) and saw the strategic fit of the two businesses.

“Avondale delivered on its promise to complete the deal. They were professional, approachable and prepared to listen. A great team to work with”
Myra Forster-van Hijfte, director, NDSR.

CASE STUDY – TRADE

Established in 1985, Stokvis is an innovator and knowledge leader in the field of environmentally-friendly and energy-efficient heating solutions in the UK and internationally.

Stokvis’ directors wanted to appoint a professional M&A advisor who could identify a suitable investor to grow the business and drive the project forward to a successful completion. Drawing on their extensive research capabilities, Avondale generated interest from a large number of potential acquirers.

Initial discussions with Rare Rockets Limited

(which includes JBC Industrial Services Ltd), the UK’s leading industrial boiler and burner aftercare provider, revealed clear synergies between the two companies in their service and maintenance operations and a potential sale became a possibility.

The transaction secured by Avondale saw the transfer of 100% of Stokvis’ shares in a well-structured deal. The acquisition allows Rare Rockets Limited to add a thriving business to its group, enabling both businesses to improve the products and service offerings available to their customers.

Private Equity usually takes a majority stake, and the reins of the business, so they can generate serious value from it. Current shareholders can significantly benefit from this value uplift, which is typically three or four times the current value over five years.

Family Offices – Family offices act on behalf of high net-worth individuals or a single wealthy family. They usually have a trade preference of acquiring in sectors they already know or that initially generated their wealth and the focus is usually low risk, highly sustainable businesses. The objective is typically to ensure the family’s wealth for future generations. Family offices are becoming more common as more people achieve ultra-high net wealth status and the tax breaks on family investment are positive in many countries. Values may not be as high as strategic trade deals or Private Equity as often the transaction is designed for long-term holding and securing long-term yield on the business. The office is usually represented by a strong corporate team who have worked with the family for many years.

CASE STUDY – HOLDING GROUP

Peck and Strong a well established and successful food business, established for over 30 years, was sold to Bridgwater and UK Foodhall. The sale was advised and led by Avondale Corporate.

Peck and Strong Limited was established in the 1980’s, when John Peck, a self-taught baker, started baking flapjacks and vegetarian flans from the kitchen in his Devon cottage to supply the students’ coffee bar at Exeter University. Today, this unique bakery, which continues to bake every cake, flan and pie by hand, from their own recipes, operates out of a bespoke 14,000 sq ft warehouse in Crediton and is one of the UK’s leading Cake manufacturers. John Peck, who retains part ownership, stayed as Managing Director to ensure the business maintains its exceptional year on year growth.

The acquisition increases Bridgwater Bros Holdings (BBH) portfolio of companies which includes UK Foodhall, which Avondale oversaw the sale of in 2012. George Reynolds Group director of BBH said *“We invest carefully in UK manufacturing and with a number of food businesses in our portfolio we have both synergy and scale to develop the formidable Peck and Strong brand even further, whilst maintaining its absolutely exceptional reputation for authenticity and quality. Both Peck and Strong and John are welcome additions to our dynamic team”*.

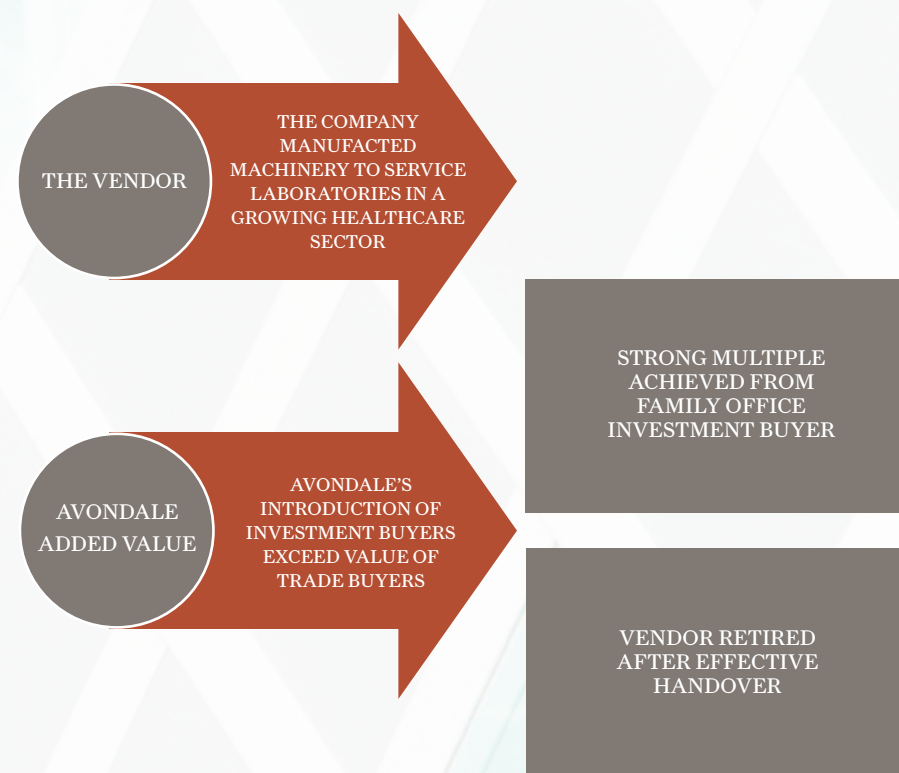
CASE STUDY – FAMILY OFFICE

SOLD: Europtica to Bridgwater Brothers Holdings

Established in 1990, Europtica manufactured machinery to service laboratories in a growing healthcare sector. The business had a strong, unique, product range and experienced technical staff for design, installation and support. The machines were considered best in class and have essentially become ‘standard’ specification in laboratories around the world. The majority of orders were repeat or by referral clients reflecting the quality of its products and service excellence.

The business enjoyed continuous healthy growth with 80% of sales being export, and substantial further growth showing in Asia. Through brand strength and reputation, the clients approached Europtica directly.

The owner was seeking to retire after an effective handover. The business presented an ideal springboard for further growth from the well-established market position, strong product design and methodologies to meet the considerable vertical and horizontal growth potential. Avondale introduced a significant number of interested parties and were able to achieve a price in excess of expectations.



Holding Groups – These organisations tend to fall somewhere between strategic trade buyers and Private Equity in their characteristics. They are commercial groups that are founded and built to hold and own companies. Once a transaction is mostly paid for, they look for the next, and therefore build up a multitude of assets. Transactions, as leveraged, may have high levels of deferred payments to help the acquisition of multiple companies. The most famous example of a holding group is Warren Buffett’s Berkshire Hathaway. The company started in 1889 as a cotton manufacturer but Buffett invested in 1962 and converted it into a holding company. At the time of writing, with stocks held all over the world, the business is the third largest conglomerate, owning over 5% of Apple, 10% of Coca Cola and nearly 18% of American Express (AMEX).

The goal of a holding company is usually to generate revenue from dividends and profit over time. The holding business will usually add additional management expertise to the venture. Owners can exit but retainable management is usually critical for these transactions.

Entrepreneurs and Strategic

Investors – These are individuals who see potential in your market or business and are prepared to take on the financial risks of funding a deal in the hope of profit, usually by securing a better deal after growing the venture hands-on. The category can include a lot of people who can tell a great story but need careful vetting; at the same time there are some exceptional entrepreneurs who really know how to buy great companies. Track record and references are essential. If an investor, rather than an outright sale, is sought, leaders and founders should keep in mind that strategic investors buying shares usually leads to reduced control and the investors’ agenda will need to be considered.

Management – These individuals are typically your ‘senior team working in the sector’ who ideally will have been prepared in a succession plan to take over. Their ambition is to buy the company then take the business further. Sometimes they are external and brought in specifically for the buy-out purpose. Whichever type of buyer, it is also important to understand their motivations. We will examine this more in the chapters on negotiations, but a lot of sellers believe it is their job to

CASE STUDY – TRADE

SOLD: Support Force to Enables IT Group Plc, South, Turnover £2m.

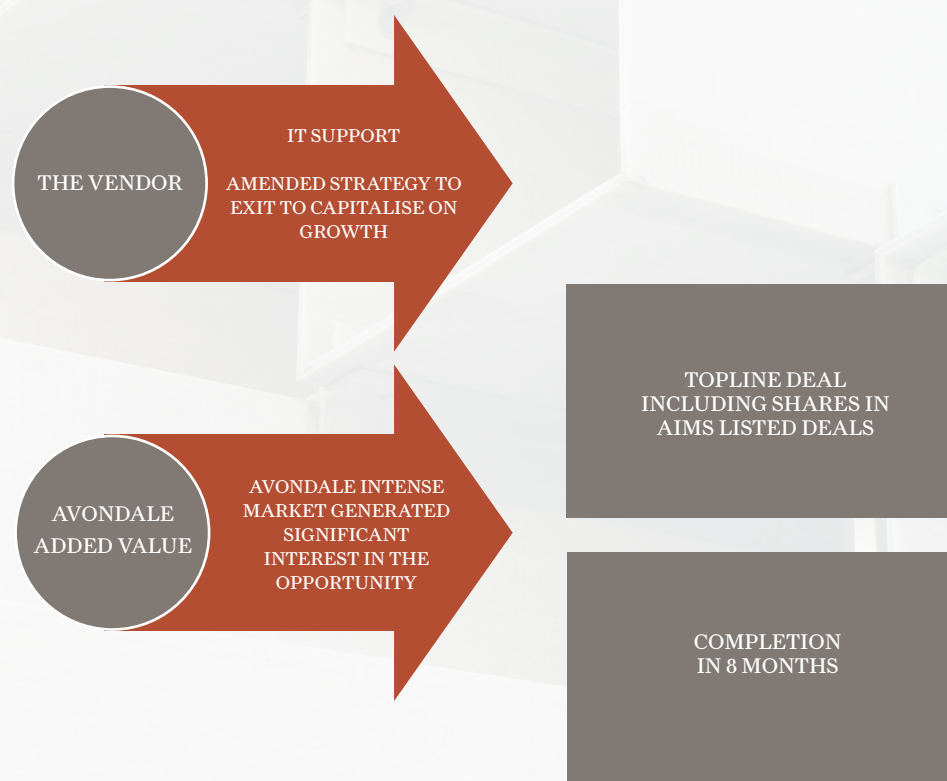
After initially looking to acquire through Avondale, Support Force Group revised their strategy and returned seeking an exit in order to capitalise on their growth over recent years.

Through previous successful sales within the IT industry Avondale has a significant purchaser database to generate a large amount of interest in this opportunity, alongside

bespoke specialist sector research.

After rounds of discussions, Avondale entered into negotiations with one of several PLCs that showed interest and produced a mutually agreeable offer which contained shares in the AIM listed company.

This secured an ownership in the future of the group, providing the opportunity of an increase in the total consideration paid. The timeframe of this project was eight months from engagement to completion.



CASE STUDY – EMPLOYEE OWNERSHIP

Could you sell your business to your staff? And why would you want to? Arbuckles restaurant chain owners John and Maxine Murphy have done just that thanks to the creative thinking of Avondale Corporate.

Arbuckles restaurants had grown significantly since its beginnings in the wake of the financial crisis, with its first restaurant more than tripling in size and a second boosting growth even further over the intervening period. But, with such a significant amount of work behind them the owners began to look at ways to step back from the business and this led them to consider a sale. However, John and Maxine recognised that many of the loyal staff had been hugely instrumental in the success of the business and there was a risk the great reputation of Arbuckles may disappear under new ownership. With this at the forefront of their minds they turned to Avondale to help them find a solution.

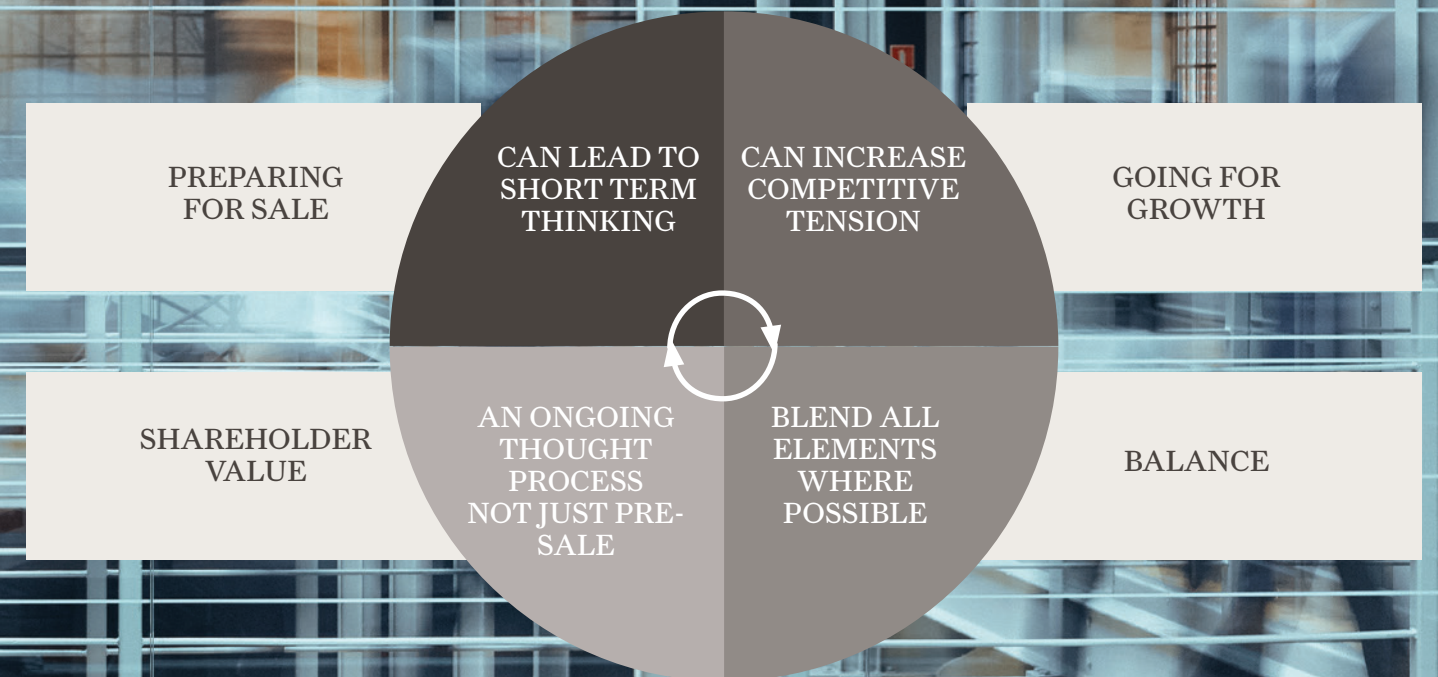
The solution came in the form of an Employee Ownership Trust (EOT). Whilst sceptical at first, selling the business to their employees through an EOT allowed John and Maxine to secure the future of the business and safely place it into the hands of the people who knew how

to build on their past success. It also provided a highly tax efficient way to sell Arbuckles. But how did this work for both the owners and the employees? Avondale Chairman Kevin Uphill provides an insight *“An EOT is not a frequently used solution in the business sale arena but this is becoming an increasingly desirable option for our clients. The business retains its good name and loyal staff by giving them a significant financial stake in the company, which is held in trust.*

It offers a very efficient tax solution for owners and, in the case of Arbuckles, could be as much as 5% and worth £350,000 to an individual.” John and Maxine contributed £1.5m to the ownership trust from current profits and will continue to be on the board of directors. A management team has been appointed who will oversee the transition and future of the business. Kevin Uphill said. *“The Arbuckles business was a great candidate for an EOT. Not only has this structure optimised the return for John and Maxine, but it secures the future of the business they have built, in the hands of those who understand it best.”* The sale of Arbuckles to its employees created considerable media interest, from ITV news to the Easter Daily Press.

talk and to present the opportunity to acquire their companies and shares. They are also rightly proud of their achievements and ideally excited about what the company can do next. This can lead to them forgetting the basic rules of consultative selling, which is listening and then fitting the needs of the presentation to the buyer’s key criteria. Whichever type of buyer is identified, it is very important to a buyer to understand the motivation of the seller. Not all motivations are the same and sometimes, even though the merger or the acquisition seems perfect from the outside, the motivations and goals of both parties might not align. When analysing possible trade buyers, assessing the four corners of strategic M&A can be useful to analyse the buyer’s motivations (see Valuation Methods and Multiple Arbitrage Guide).

Employee Ownership – Different to management in that all employees are the buyer in a Trust. Great recent examples of sales to employees include 60% of the retailer Richer Sounds and 100% of Aardman Animations, the creators of the ‘Wallace and Gromit’ series, to employees and Arbuckles restaurants (see case study).



WHICH EXIT STRATEGY?

With a significant number of exit strategy types and further buyer types, no one sale, merger or acquisition is ever the same. They all have their own characteristics and often it is only after detailed research of the market and opportunity with careful preparation of the business that we can definitively say which route is right. There is no such thing as the perfect exit as one person's definition of perfect may seem failure to another. Consider the case where the sale is secured at a premium price, only to find the company continues to surge and on reflection the seller struggles to adjust to

not having ownership? Some would say the 'premium' is enough, others would say the deal was flawed.

Creating the right exit strategy starts with a broad range of options which is then narrowed down via research; all the time both preparing, and 'not preparing', for sale. Yes, 'not preparing' for sale. A strategy that creates shareholder value, actively preparing only for a sale, may undermine future profit growth as the focus can move to short-term cost savings with the misconception that bigger profits always mean higher values. These 'prepared' companies end up being less attractive than those businesses which

go for long-term growth and therefore have better platforms, brands, people, recurring revenue and positioning. As ever, the equation is one of balance. The aspirations to sell can shift focus from a long-term strategy to simply tactical short-term thinking. Sometimes businesses which are not prepared but are starting to fast track, and scare the competition, creating a 'we want, we need' motivation in the buyer, can be the most valuable, whatever the profits are.

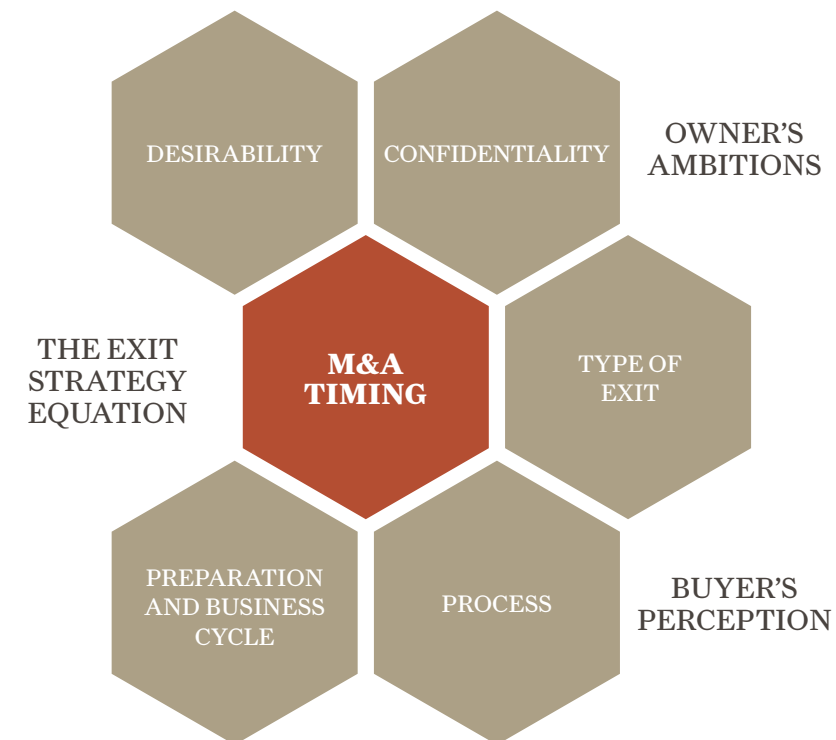
Both creating shareholder value and choosing the right exit strategy typically require a blended approach; a balance of each element. Knowing

what is right requires objectivity and a deeply researched understanding of the threats and opportunities, line of probability and dynamics for your market and business. Many leaders are too 'hands on' in the day to day operations of a business and lack the corporate commercial contacts to build this deep understanding or carry out the necessary research. This can therefore result in poorly thought out decisions and consequently less considered, or worse, failed exit routes. Expert advice can really add value here.

Interestingly, not only can such research be used to build the best

exit strategy, it can also influence the strategy. We see this when we have a competitive environment which comes via appropriate research to create competitive bids from buyers. Deeper than this is the ability to show the buyer the market dynamics and properly researched opportunities which they may not have thought through yet. It is quite surprising how often leaders who are seeking an exit do not have, for example, analysis on how big their market is or what percentage they might have which is of course critical to understanding growth prospects. In one recent transaction we led, a direct buyer was struggling to 'value'

a company. As advisers we researched the reasons why they failed to see the value of the business. Following this research, we created a professional and expertly prepared proposal which, amongst many other important elements, included future revenue pipeline information, forecast revenues, marketplace developments and several other opportunities for the business going forward. When presented with such compelling and expertly prepared information, the buyer agreed to meet our client's original sale price, doubling the price they initially offered; fear of open market competition may also have played a part.



such as trade or Private Equity and often keeping an open mind as to when to do a deal is critical.

It is important to know your business and understand the trends and the potential, and therefore come up with a realistic valuation. This can perhaps help you avoid both the undervalued 'sweetheart' approach, whilst embracing the 'we want, we need' buyer, which may require a more opportunistic approach. It is important to understand your own biases in decision-making when examining timing and ideally the best exits will be company led not individually led; the key being to secure a transaction just before you peak on a cycle. See Diagram.

BUSINESS CYCLES AND WHEN TO EXIT

What do we mean by 'cycle'? Every business goes through different cycles and phases and understanding where we are, as leaders of our business, is objectively important. For example, a plateau cycle is usually highlighted by slow growth and flatlining profit over a few years. Our internal business view will signpost when the time is right to exit.

Our external view will also have a bearing. What is happening in the economy and our sector? There is also a new rule; let's call it the rule of ten. Once upon a time the business you started might look pretty much the same thirty years later when you chose to exit. Today, however, due to technology and knowledge share, product life and design cycles are getting shorter. Competition is also becoming cross sector; for example, mobile phones effectively destroyed the digital camera sector. Lifecycles are reducing and models are changing faster than ever. The business you start today may look completely different in ten years' time in both size and model. The prognosis is that many business cycles today sit around a ten-year lifecycle.

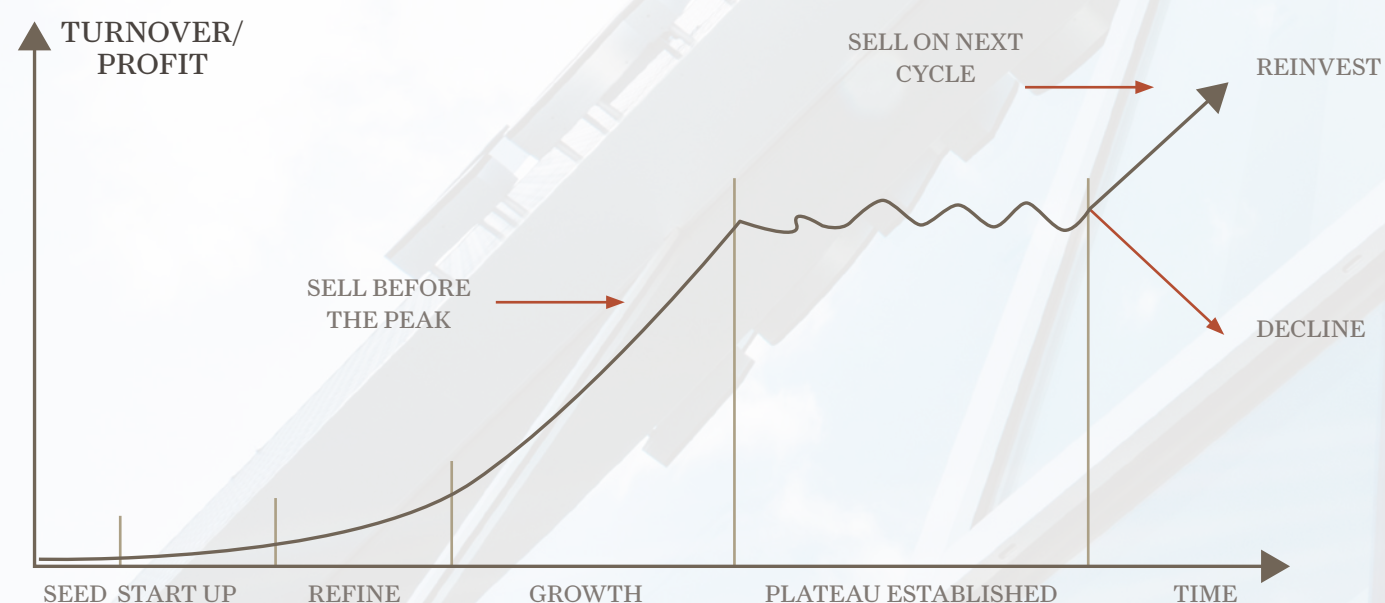
TIMING AND VALUATION

Timing can be everything in life. Business success usually requires the right ideas, in the right place, at that right time and, if the truth be known, sometimes that is achieved more by luck than design. Leaders will typically reject this statement because, of course, they do significantly influence the elements and always believe they make the biggest difference; so it is with exits. We can influence, plan and control and this can place us in the best position to create the best exit strategy but timing and perhaps some luck may also prevail. Nonetheless, how do we design our luck?

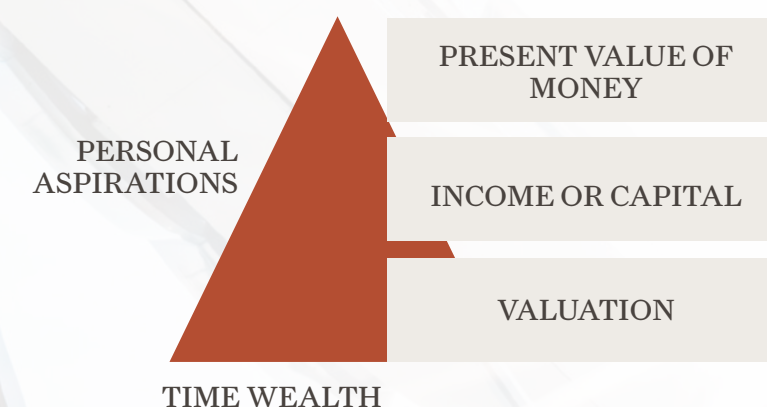
The type of exit strategy chosen will affect both valuation and timing. An 'earn out' deal may create a 'lock in' to secure key management for a period, yet at the same time structured correctly by the sellers may afford an uplift on ultimate deal value. An 'offers' approach to the market can also determine the best exit strategy

An open mind as to when to do a deal is critical.

TIMING AN EXIT



THE VALUE OF AN EXIT



To further extend the rule of ten, ideally we will also sell when the economy is on an upturn and economic cycles also typically sit on ten years. A recession or downturn is a period of temporary economic decline during which trade and industrial activity is reduced, generally identified by a fall in GDP in two successive quarters. In the UK, where I am based, there have been seven recessions since 1955, so there is a recession, on average, once every 10 years. Considering the rule of ten then:

where on the ten-year average business model cycle and ten-year average recession model do we sit today? The loose concept of the rule of ten may therefore give us perspective in our view of when to make the decision to exit or to choose to miss the window and push on through the next cycle.

Always remember that investors appreciate and assign value to a purpose-driven company, long-term strategy, and strong culture. An exit is best when the business is in good

shape but with plenty of expansion prospects, making it attractive to buyers.

THE VALUE OF AN EXIT

The price and deal structure of the exit should meet the aspirations of the shareholders to create future options for their journey, whilst also perhaps increasing time wealth. All personal aspirations are different and therefore judging value against 'when to exit' is notoriously difficult. Many seek an exit so that they do not have to work again yet

often they do so, simply for the pleasure of it so the question 'when is enough, enough' is a difficult decision. It is important to be objective and here we also need to remind ourselves of the value of capital and money. In our decisions as to when is the right time, we are reminded:

1. Money today is worth more than its equivalent tomorrow. Money today has an opportunity value and money tomorrow is eroded against inflation.
2. In many countries, the sale proceeds on shares are usually

highly tax effective compared to earning income, which is typically taxed at between 40% and 50% once both corporation tax and dividend tax have been applied. In the UK at the time of writing, entrepreneurs selling their business can claim entrepreneur's relief, reducing the Capital Gains Tax payable to just 10%. To be eligible, a shareholder must have a 5% or more shareholding in a qualifying business and have been involved with a company as an employee or

3. Money in the hand today is worth more compared to money promised tomorrow as there is a risk that tomorrow's money may not arrive. Therefore, 'capital is more certain than income' and with capital we have the opportunity to create other yields and invest in other businesses which should further compound over time.

THE LEAP OF FAITH

Many entrepreneurs and leaders are often told by biased advisers that a successful exit is the ultimate end goal. Certainly, with significant tax breaks on a sale in many countries, building shareholder value and exploring exit options is a vital part of any strategy. Many will seek partial or full retirement, some will move to other interests, such as property, golf, or investment in private companies. One inspiring entrepreneur we worked with has got her golf handicap down to 5 and learnt the cello, as well as taking a small stake and executive directorship in another growing business.

With the tax breaks on a sale and correct investment under the principles we have examined on our journey establishing money makes money, successful exits are lucrative. The leap of faith is being open and flexible about what comes next. Flexible people will usually thrive, however, a cautionary note; for some, a sale may not be right. A partial exit or family succession, perhaps via the creation of a Family Investment Company may make more sense to succeed, but why?

Business leaders are ‘full on’ and secure a lot of relationships in their work. Many work sixty hours a week and do not have significant interests outside of work. They get so entrenched in the work habit and thrive on the dynamics of work. Remove this and they can flounder. Some can really struggle. At the time of writing Kate Spade, a fashion leader, recently took her own life following a highly successful exit. This may be over-dramatic, and the sale was some years before her death, but she then started to struggle with depression and this may have been linked to a lack of purpose after the success, despite being a wife and mother.

A successful exit may be seen in terms of creating a winner. It is often ‘sold’ in this light; who wouldn’t want financial

freedom, time, wealth and the removal of the leadership pressure? Well, those who get their self-esteem and relationships largely from business life and who have not taken the time to nurture other interests may need to be forewarned that personal preparation before an exit will also be needed.


An exit is a leap of faith into the unknown and a large part of this is psychological. This is of course not intended to put people off having a successful exit as a goal. The pursuit is creating better businesses, and acquisitions also have a material role in taking some companies from good to great. Not doing a transaction or accepting an exit can be market disruptive and leave too many sub-scale businesses in the market and perhaps leave owners in place who have passed their prime. The timing for the company may be right and great leaders know when the time is right, we do however need to acknowledge that creating capital and time wealth in the exit can be a material jolt, and hard as some people may find it to hear; money isn’t everything. A sale can create mental chaos and its own set of problems. To quote one vendor *“I have realised that once you are no longer in business, how quickly life goes and the extent to which having challenges in your life keeps you sharp.”*

Founder entrepreneurs are often not reasonable people. Their goal is to change the status quo. Retirement can feel ordinary, and too reasonable or easy living. It can lead to a sense of a lack of purpose. A sale with strong capital wealth can also lead them to feel different, indeed they are different, and this can also lead to jealousy. Many societies secretly seek to undermine wealth as we are told that greed is selfish. But success is success and as Andrew Carnegie the great Industrial Magnate said, *“No man can become rich without himself enriching others.”* Fortunately, there are things one can do to prepare for an exit.

- In shareholder value we discuss creating team-driven businesses that are not leader businesses. This de-risks the venture for acquisition. The process can leave the leader with time to spare to build other interests.
- Private company investing is important in the economy. Do the research as to how to get involved in private equity, which tends to be lower risk than business start-ups.
- Many start-ups and emerging small and mid-market businesses actively seek experienced entrepreneurs. Mentoring or taking a non-executive Director role is a well-trodden path.
- Starting all over can be an effective strategy. Start-ups may, whatever the previous success, suck capital as environments change. Also remember that trade sales will usually have anti-competition restrictive covenants for many years.
- Starting again can hold surprises for entrepreneurs. Successful businesses can require the right people, ideas and time. Creating this alignment requires talent and luck.
- For those who have significant financial outcomes from the sale of their business, their problems are not relatable to most people. It can be lonely and isolating, but if you research you can find others in the same situation.

Research has been carried out on lottery winners and many really struggle with the wealth, to the extent that more lose it all than keep it. This is psychological. They perhaps unconsciously feel undeserving of the spoils. The same cannot be said for founders, leaders and entrepreneurs who, for the clear majority, have had the ideas, taken the risks and worked hard. In theory at least, the self-made may better understand the wealth they achieve and it may also be less sudden.

A leap of faith, in its most commonly used meaning, is the act of believing in or accepting something outside reason. Reason says that after a successful exit we have plans and with wealth should always be happy. However, having undertaken the journey, these plans may turn out to be wholly different, which is fine if we keep the perspective that in our lives the journey is far more important than the destination. In an exit leap we believe that it is the right decision and with a positive, flexible mindset we will secure new meaningful routines, adventures and relationships.

An aerial photograph of the London skyline, featuring numerous skyscrapers and dense urban development. The Gherkin (30 St Mary Axe) is prominent on the right side. A semi-transparent orange rectangular box is overlaid on the right side of the image, containing a quote in white serif font. The quote is flanked by two horizontal lines, one above and one below.

*An exit is a leap of
faith into the unknown
and a large part of
this is psychological.*

IN CONCLUSION

Undertaking a business sale or succession is one of the most important financial decisions a business leader or owner will ever make; companies too will carefully analyse when divesting.

Experts may help you to select the right route for your journey, and to achieve maximum value and the optimum exit structure. Research and choose advisers based on their track record, understanding and fees linked to deliverables. Seek advice early on. As company owners age, many entrepreneurs are finding that they are ill-prepared for succession. Many do not have a business or succession plan as they fight for survival in dynamic markets. Consequently, owners may fail to realize the full value of their business during the exit process, struggling with taxation and other corporate technicalities or worse, failing to secure an exit altogether.

Expertise should be built early on by business leaders and founders in both how to create shareholder value and by understanding in depth exit strategy options, investment and market conditions in the sector for both acquisitions and exits. From start-ups, family businesses and mid-tier businesses, the full business planning process should also examine the horizons; where, how and when to exit or create succession successfully. Preparing and securing an exit is an

important part of an entrepreneur or leader's journey. This may also require some personal preparation to ensure both capital and time wealth is secured and enjoyed in the right way.

For many business owners selling a business to exit is the ultimate reward for years of hard work. Most of the wealth in the world is capital wealth and not income, realising this wealth can be an important part of a company owner's journey and the peak of an ambition. There are lots of questions to be answered before you even enter the exit and/or business sales process; is it the best time to sell, is your company worth what you want it to be, do you need to wait until it is?

As all exits are different so is the journey after a sale, so with every exit strategy there is a leap of faith; a move from the known to the unknown and that is always exciting.

LEADER QUESTIONS

1. How much Board expertise do you have on shareholder value and exit strategy?
2. What is your business and economic cycle?
3. What research are you doing to look at options early on?
4. What are your personal ambitions and how does an exit fit them?

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