The Perfect Trade Sale

Whilst we do not believe that **the** perfect sale, whether trade or otherwise, exists, in this insight we share some ideas that will help you get as close as possible to **your** perfect sale. Although predominantly written for sellers, there are a few points that are relevant or even specific to buyers.

The Decision to Sell

Critically and frequently overlooked – it is important to understand that selling your business is a means to an end and there must be a driver or an ultimate goal behind selling. Whether creating 'time wealth', freeing up capital for another purpose, de-risking, or another reason, be clear about what you are trying to achieve and communicate that to key individuals such as co-shareholders, family and professional advisors.

Only once this is clear can we understand whether a sale is the right route. For example, if time wealth is the goal (and your character will allow you to do so), could this be achieved by restructuring management to reduce or even remove you completely from any role within the company whilst retaining ownership and an income?

Viability & Strategic Preparation

Engage a good M&A advisor as early as possible. They will be able to advise on the likely value range, probable deal structure, the likelihood of you needing to remain involved for a period post-sale, timing, potential pitfalls and areas where value might be enhanced. In short, they should be able to tell you if goals are **viable**.

Strategic preparation is a more involved process. As well as preparing an anonymous business summary 'teaser' and an information memorandum presenting the business in the best realistic light, it is also important to collate a data room that provides the supporting information buyers want to see to get comfortable so that they will not get nasty shocks during due diligence. This should include a detailed financial analysis that is summarised and presented clearly and concisely. This also maintains momentum once you are live in the process, which is important in maintaining buyer interest.

Do you and should you have projections and a business plan? Although not essential they can be helpful, particularly if you have done them historically and can show a track record of delivering against a plan. Avoid the 'hockey stick' growth projections unless you can provide incredibly robust evidence to support them. Buyers just do not believe it.

Stay in control of your debtor book and use the maximum creditor days available to you. This improves cash flow which ultimately increases the equity value. Avoid the trap of not collecting debt on time because you do not need to - a buyer will and may be concerned that if they impose contractual payment terms post-completion and you have not historically done so, it may strain customer relationships leading to loss of business.

As well as uncovering the key selling points it is important to stress test the business. For example:

- Can you provide the information required quickly and easily?
- Are your management accounts written to GAAP or are there discrepancies between the management accounts and the statutory accounts that need addressing?
- Can you provide a detailed sales analysis, by product or service, customers, key salespeople, region, etc? Are they available to gross profit level?
- Is there a customer concentration that puts the business at risk?
- Are there any relationships with customers or suppliers that might be impacted by a change of ownership?
- Are contracts legal and up to date?

"Whilst we were very experienced businessmen, we had no experience of selling a successful company. It quickly became apparent that Avondale's reach in the business world and their high level of competency managing the transaction were crucial to us achieving a successful exit from the business."

Nick Adcock, Kingswood Group

Do not hide skeletons in the closet. They might stay hidden during the preparation phase and even the negotiations with buyers, but they will not go unnoticed through due diligence where the buyer and their advisors will look under every stone.

Often, they can be dealt with or presented in a way that will not get in the way of a sale, but if a buyer finds the problem rather than being told about it, at best they will renegotiate and at worst they will pull out.

We also need to consider which buyers we should approach - so now is the time to decide whether a trade buyer is the best fit and if so whether it is likely to be someone operating in the same sector as you or a complementary one. The right trade buyer might offer and benefit from:

- Economies of scale.
- Provision of a management solution to allow shareholders to exit quickly and cleanly post-sale.
- Creation of synergies and cross-selling opportunities for both buying and selling companies.
- Greater opportunities in a larger organisation for the remaining management and staff.

There are, however, some pitfalls to consider which may or not be important to you:

- Economies of scale can often include redundancies.
- Is the cultural fit between the two companies going to work?
- Where the seller remains for a significant period post-sale there can sometimes be diverging agendas which can be problematic.
- Will your customers like the buyer and want to do business with them?

Whilst this insight focuses on trade deals, our advice is usually to also consider other buyer types such as private equity investors and family offices.

They may not offer all the benefits of a trade deal, but rarely come with the pitfalls that some trade deals can create.

It may even be worth considering a management buyout - although this is rare if management has not previously raised it - or selling the company to the employees through an Employee Ownership Trust.

Researching Buyers

The key part of this is developing profiles of the likely characteristics of the best buyers. Statistically, less than 2% of the time, the eventual buyer will not be a company you have considered.

Sellers often believe the buyer will be a key supplier of customers, but upstream and downstream deals can often create difficulties with other suppliers or customers, so the buyer runs the risk of losing business as the supply chain may be compromised and competing against itself. For example, Morrisons supermarkets will not buy Heinz as it will no longer be able to sell beans to Tesco, Asda, Sainsbury's, etc. Competitors are a possibility, but they do not always get the full benefit of an acquisition in the way a trade buyer in a complementary sector might.

We need to consider the '4 corners of M&A'. These are the factors that create the best acquisitions for a buyer and consequently the best deal for a seller.

1. Economies of scale - this is usually the easiest win, and most deals will see it. It is normally not repeatable as once duplication has been cut it cannot be done again.
2. Synergies - there is a difference but relevance between the products or services of each company which can be cross-sold between the two companies' customers. This is typically ongoing and usually has a higher value than economies of scale.
3. Positive disruption - the coming together of two companies changes the way a sector operates and creates an advantage over the competition. Perhaps it brings technology into a sector where it was not previously present or similar. This is by far the most difficult to achieve and most transactions will benefit from points 1 and/or 2 above but not 3.
4. Shareholder value – this is everything coming together to enhance shareholder value - the holy grail of M&A.

Understanding the above is how to decide what types of buyers to target.

Launch to Market

Typically, this is done in an anonymised way to protect confidentiality. Advertising in trade, national, or business for sale media rarely works. Direct approaches need to be made to research and target buyers using specialist databases and your M&A Advisors contacts and network of buyers and investors.

Meeting Buyers & Negotiations

You want to meet buyers who have already decided they want to buy your business. You want to understand their motivations, the fit between the organisations, the cultures of the organisations and their plans for the future of your business.

You will be asked why you are looking to sell and probably what you want for the business - answer the former truthfully and divert the latter to your advisors.

Where possible, get into the habit of referring to 'your team', the 'management', the 'business' but not yourself. Unless you intend to remain with the business for an extended period after the sale and/or retain a stake, you want to avoid painting a picture that suggests too much reliance on you.

Avoid being 'sweet hearted'. This is where a buyer or their advisors want to meet you for a coffee or have lunch. Make sure you are chaperoned by your advisors and there is an agreed agenda. The buyer wants to make you think what wonderful people they are and why you should sell to them for less than someone else!

Do not fall into the trap of saying that it is not about the money. That is just giving the buyer a negotiating angle. It is fine to let a buyer know that you care about staff and/or customers, but they also need to understand that your priority is to maximise the value of what is probably your largest asset.

Be fair and polite but firm in your dealing and negotiations with buyers. An M&A transaction is just business and as most of us know, people do business with people they like.

Remember your original motivations for selling and what you are trying to achieve. Do not get caught up in the 'game' and remember do not fight small points at the risk of losing out on the points that really matter.

"After deciding to sell our ecological consultancy business, which my wife and I had built from scratch almost 20 years ago, we approached a number of agencies to assist with the sale. We selected Avondale as it was clear from the start that they understood our business and what we were hoping to achieve with the sale. Avondale negotiated an excellent deal for us and found buyers who were a perfect fit for our business. We could not recommend Avondale highly enough, once you have taken the huge decision to sell your business."

Simon Colenutt, ECOSA

You do not want to meet buyers to explain your business to them. This should have been done on your behalf.

Your time is too valuable. You do not want to meet buyers to talk them through spreadsheets, statistics, lease terms, contracts, etc.

This should be handled via the data room and on your behalf by your M&A Advisor.

Remember your original motivations for selling and what you are trying to achieve. Do not get caught up in the 'game' and remember do not fight small points at the risk of losing out on the points that really matter.

Do not be afraid to walk away from a deal, but not as a knee-jerk reaction to something or for the wrong reasons.

Try and create a competitive environment with multiple interested parties. Even if you are negotiating with only one, keep in mind you always have the option not to sell - at least not today.

Never try and negotiate by using the buyer's economies of scale or potential synergies to inflate the profits you are basing the value on. You do not know with certainty what they are and even if the buyer does, for example, have a payroll department that can simply absorb the entirety of your business at no additional cost the buyer will rightly say 'we've already paid for that'. You are far better off saying 'we believe a multiple of 6, not 5 is appropriate as this is a great business because...'

This part of the process should ultimately lead to agreeing to non-binding headline commercial terms with one party which is documented in a 'Heads of Terms'.

Due Diligence & Deal Documentation

Be under no illusion, this is a long and often complex process.

During due diligence (DD) the buyer will want to review in minute detail all aspects of your business including, financial, banking, tax, legal, employment, commercial, environmental, property, litigation, compliance, IT, intellectual property, and increasingly, cultural aspects. They may want to meet key staff and management and you will need to decide what is the appropriate stage in the process to allow that and what you are going to tell your staff. They may also want to talk to key customers and suppliers which can often be done as a 'survey' rather than by stating the actual reason for doing so. You should insist you are in control of this process.

Make sure you have the capacity to deal with the questions and provide the required information. Also be aware that it can be frustrating, and many questions may seem irrelevant and even be duplicated, particularly where the buyer is using different DD providers for the different aspects. Remain pragmatic and try not to get overwhelmed. Some sellers like to break this down into small chunks of information, whereas others like to clear their diary and focus on nothing else for a period.

Equally the deal documentation can seem excessive and overwhelming. A simple transaction probably has around 10 separate documents that need to be negotiated and agreed and complex transactions can be far more. The share purchase agreement alone can sometimes exceed 100 pages of legal terminology.

Be careful not to confuse commercial and legal points and always let the commercial points take the lead. The legal documentation is there to protect the commercial agreement and apportion risk between the parties.

In the heat of negotiations, it can often be useful to refer to the Heads of Terms to remind all parties of what was originally agreed and get everyone back on track with the end goal in mind.

If, however, the buyer has uncovered some material points during DD, they may be within their rights to want to re-negotiate the terms of the deal.

Avoid falling into the trap of switching buyers halfway through because the other buyer, whilst not offering the best price, seemed so reasonable and assured you the process would be smooth. It will not be any different. Bear in mind the buyer will almost certainly be answerable to other shareholders, investors, banks, or other financial institutions, possibly a parent company, which may be regulated and might be listed on a stock exchange. They will not take shortcuts during the process and need to be seen to have been thorough. The risks for the buyer of getting it wrong are just too great.

Keep reminding yourself they are just doing their job, and again stay focused on your original objectives and reasons for selling in the first place.

Two final points aimed specifically at purchasers. M&A is a very financially driven environment, and it is easy to get blinded by theoretical formulas, statistical profit multiples, and artificial often self-imposed restrictions on deal structures and acquisition models. Think about the 4 corners of M&A previously referred to. It is far better to pay a stronger price than you would like, or your normal models dictate for the right business that fits the 4 corners than the wrong business because the price is lower. Buying the right business today for a multiple of 7 is better than waiting a year to find the one you can get for a multiple of 6. You will have had an extra year of benefitting from the economies of scale and synergies which is ultimately worth far more. Buying the wrong business because it is cheaper is a 'discount to disaster'.

Do not use the negotiating tactic of telling the seller what they are doing wrong and how you will make a better job of it. It simply does not work - you just alienate the seller and they will not sell to you.

"The team at Avondale made a complex and difficult process as smooth and painless as possible. Whilst we had to kiss a few frogs to get there, we are very happy with the fit found with EMW. This was only possible due to the volume of interested parties brought to the table. Sally was proactive and contactable throughout and the Avondale team were a pleasure to deal with every step of the way."

Andrew Stanley,

So, what does the perfect trade sale look like? Probably one where the seller feels they could have sold for £1 more, and the buyer thinks they could have paid £1 less – but more importantly, the parties have maintained a good business relationship during and post the transaction.

Avondale's bespoke approach to selling companies has secured maximum value for hundreds of business owners and shareholders. Our dedicated lead advisory team provide a personal service throughout, building a deep understanding of your business to optimize the presentation and deliver the right buyers. Contact us today to discuss your business sale in confidence.

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