

The art of the sale

At some point business owners will look to sell, that may be to realise the value of the business or to retire.

One avenue is a trade sale, although there are downsides to this course:-

- the business transfers into unknown ownership and the legacy of the business is lost
- the sales process exposes sensitive information to the market
- potential for disruption to staff and customers as new owners roll out their plans
- the process is lengthy, potentially time is spent with specious buyers

• a partial sale, if desired, is unlikely
It is for these reasons that owners of Small and Medium Sized Enterprises may offer their business for sale to the existing management team in what is termed a Management Buy Out or MBO.

It's unusual for the MBO team to be able to pool sufficient cash from their own resources so while a meaningful cash contribution will be required, the balance must be borrowed.

Often these borrowings are a combination of funding from a lender and deferred consideration (funds due to the vendor on completion but agreed to be paid over a period).

All the usual considerations apply, critically there needs to be agreement on price! There are many ways to value a business and particularly for smaller businesses, it's not terribly productive to get too hung up on multiples of EBITDA. Stick to the art of the possible.

Basically, this means finding out what the MBO team could afford to pay and looking to structure an agreeable transaction with the vendor. Inevitably the amount that can be paid is coming from commercial funding (loan), the cash the management team can put on the table and the loan, if any, made by the

vendor by way of deferred consideration – less deal costs.

Loans are usually unsecured or only partially secured and are therefore regarded as relatively high risk. Commercial Funding for these transactions on the face of things is available from several sources but not all lenders have an appetite to fund all transactions.

The High Street Banks have specialist teams which they deploy to deal with these transactions and therefore focus only on the larger transactions which can withstand substantial fees.

The smaller deals are funded via specialist lenders in the Alternative Finance Market and again different lenders will only consider transactions of a particular size and or nature. For the smallest transactions, deals often have to be structured around other funding products from asset-based lenders that are not necessarily looking for full security cover or have access to the Government Recovery Loan Scheme.

It's worth noting that professional fees don't necessarily scale. For example, the legal work and hence fees for a £300,000 deal will not be 10% of those for a £3m transaction. The fees for smaller transactions can simply make them unviable.

So what makes an MBO attractive to a Lender?

- A strong proven management team is essential – ideally with some experience of operating the business in the absence of the vendor
- Business operating in a stable sector
- Consistent track record of year-on-year cash generation at a level sufficient to service and repay the borrowing sought
- No reliance on a single supplier or dependence on key customers



David Griffiths

- Good quality financial systems providing reliable management information
- A period of handover/consultancy
- No key relationships reliant on the vendors continued involvement

The Lender will also focus on the financial information and work to specific parameters for example profitability/EBITDA, or the amount of free cash available to service debt.

Typically, an MBO team will be doing their first deal so getting support through the process is invaluable.

At Sterling Commercial Finance, we offer a full end to end service where required, in fact we pride ourselves in being able to put the missing pieces in place to complete a transaction. This can include, business valuation, assistance with shaping the deal, making an offer, and producing the Heads of Terms. We are also able to introduce legal teams with appropriate experience which is critical to getting a deal over the line. In addition, we can produce the financial forecasts and raise the funding, a combination which amounts to a unique offering.

For further information or to discuss an MBO opportunity, please contact David Griffiths on 0115 984 9800 or email david@sterlingcommercialfinance.co.uk



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