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NAVIGATING A MANAGEMENT BUY-OUT

Another means of exiting from a business is to pass on leadership and ownership to the current management team or employee group.

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MBO

A Management Buyout (MBO) is a form of acquisition where an employee or group of employees acquires a percentage or all of the company from the existing shareholders.

They are effective because they bring many advantages to business owners looking to sell:

- Confidentiality of the sale
- Business continuity (relationship management with existing customers, employees and suppliers
- Pace at which a transaction can take place
- Familiarity of the team

Equally, they hold many benefits for the new owners as their familiarity with the business eases the transitionfrom employee to owner. That said, the process still requires transparent communication and planning.

CONSIDERATIONS FOR

OWNERS AND MANAGEMENT

THE OWNER

1. Crucial Conversations

Don't be afraid to talk to your key employees/ management group about your succession plans, after all it's your job as an owner to worry about the business risks and its continuity. Being open with them early on will allow you to explore and understand your exit options.

2. The Opportunity

Just because your team has worked with you doesn't mean they understand the opportunity presented to them. You need to be able to clearly show them the value and potential of the business. Often times this will include normalized financial statements, and adjusting for any out of the ordinary and personal expenses (vehicles, above market owner's salaries, family salaries, etc.).

3. The Opportunity

In one respect an MBO can be easier as you "know the parties involved"; on the other hand, it can be more difficult because you "know the parties involved". This personal relationship puts both owners and managers in an awkward position. For example, your management team might be afraid to initiate negotiations with you due to potential negative reactions or fear of losing their job. Remember, whether the deal goes through or not, you or an external buyer may still need to work with the team in the future. For this reason, it is strongly advised to engage a third party that has no bias to facilitate the deal.

EMPLOYEE TO OWNER

1. Due Diligence
Just because you've worked in the business, doesn't mean that you know the business, which is why it's important to undergo your own due diligence process before buying the company. That includes a review of the company's valuation, financial performance, market, and operations. By properly analysing all the "what-ifs", you can establish a realistic vision of the future, which will allow you to tailor a proper strategic plan that will reduce your ownership risk.

2. Function vs. Ownership
Your ownership is separate from your current role in the company, especially if there are multiple employees looking to buy into the business. This may mean different compensation levels depending on the roles, new accountability practices based on the organizational structure, and different measures of performance. This can be a difficult concept for new owners, as being a shareholder means that you directly benefit from the success of the company, but it does not mean that you have equal say on how the business is run day-to-day. Defining these new parameters will be crucial to your success and can be laid out in your shareholders agreement, business plans, etc.

3. Financing
Many employees see financing the business as an impossible roadblock, but given that it is an MBO usually the terms are more flexible and a solution can be found. Involving a professional who has structured deals in the past is invaluable. They can help you present the opportunities to the bank, negotiate financing withthe existing owner, and create an overall package that will limit your financial risk.

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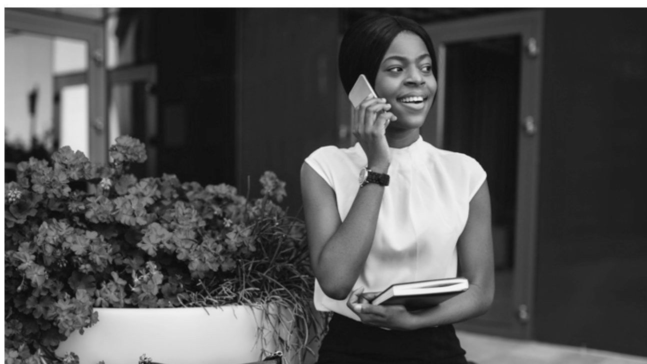
BUSINESS FIRST **DEAL SECOND**

Management will often focus more on the deal than the business itself. This shift in focus can negatively impact the performance of the company and its valuation. Engaging an advisor who understands the opportunity, negotiation process, and deal structures can greatly benefit both parties, allowing you to keep your eye on the business and ensure a smooth transition for all.

ROLE OF AN ADVISOR

- Assess feasibility of MBO
- Propose business valuation and determine purchase price
- Prepare and manage confidentiality of deal
- Identify financial lenders / investors
- Advise vendor and management on the potential deal structure
- Negotiate and structure financing
- Set up the data room
- Manage the due diligence process
- + much more



ISSUES WITH MBOs

1. Alignment of Expectations
Agreement on who will comprise the new ownership group, what processes will be followed to consumate the deal (i.e. who will pay for what costs, timeframe, etc.), and the levels of investment by each shareholder.

2. Management
Management negotiates directly with the owners which may destroy relationships, certain individuals may not be taken seriously.

3. Funding
Management may not be able to secure funding for a variety of reasons including lack of credibility or a weak business plan.

4. Trust
Owner may have unrealistic expectations, and management can downplay company strengths to negotiate a better deal.

5. Agreements
Not enough thought has gone into shareholder's agreement which protects all parties.

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PROCESS

Step		Description
Initial discussions between owners and management	1	Set clear rules of engagement, as it can be awkward negotiating against your employer or employee
Business valuation	2	More likely to be successful if the owner has realistic valuation expectations and engages an independent valuator to determine fair market value
Preparing the confidential information memorandum	3	This document contains sufficient information about the company to allow the management team and prospective lenders to make a financial decision
Financing the Management Buyout	4	Can include any combination of debt and equity lender/investor
Due Diligence	5	Analyze the financial statements for the last 5 years, year-to-date internal financial statements, financial projections and underlying assumptions, organizational chart, andmaterial contracts (i.e. employment contracts, major vendors, clients, banking, property leases, etc.)
Negotiate the terms of the deal	6	Purchase price, timing of deal, post-transaction involvement/roles, and more

GET IN TOUCH WITH US TO LEARN MORE ABOUT OUR MANAGEMENT BUY-OUT SERVICES

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