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An MBO involves the purchase of an existing business by the current management team from its existing owner(s). It is often a once in a lifetime opportunity, so it’s vital to get the deal right the first time. There are no second chances.

The whole process is often analogised to riding a rollercoaster, with many ups and downs. Without an experienced adviser steering the route the transaction will simply fall off the rails. Remember your advisers will have lived through more than one MBO!

It is important that you continue to devote quality time to managing your company – you don’t want to buy a business that has evaporated whilst your attention was diverted elsewhere. The advisers know how to run the deal, you know how to run the business. Don’t get the roles confused.

You probably have a vision of how your business will look, and feel, on the first day you own it. Before you can achieve that vision you will go through a management buy-out process which is demanding, frustrating and confusing.

This guide is intended to help you understand the MBO process. It outlines what to expect, who is involved and explains the key stages and requirements.
A process which on the face of it may seem relatively simple, can spiral out of control if not managed properly.

The diagram below shows the three main parties involved in an MBO transaction; the Vendor, the Management Team and Funders. What most MBO teams often fail to appreciate when embarking upon a transaction is the number of advisers that are involved: tax and legal for the vendor; legal and corporate finance for management and then the funders often have a legal adviser each as well as the due diligence team (financial and commercial). The vendor pays their own advisers but all other advisers are paid by the Newco set up for the MBO.

The benefit of engaging a corporate finance advisor early on is self-evident. They are like the ring master of a three ringed circus, co-ordinating all the parties and their respective advisers whilst allowing the Management Team to concentrate on running the business. This is the only way to ensure the smooth running and ultimate completion of the transaction.
Founded in 1999 by Mark-Ledger-Beadell and Peter Counsell, Meta Corporate Finance has established and maintains an enviable reputation for getting deals done, acting on behalf of entrepreneurs and corporates alike.

In contrast to larger corporate finance institutions, our boutique, professional approach enables excellent service standards facilitated by strong, personal relationships with our clients.

We work alongside management teams to ensure they remain focused on core business, whilst we initiate the M&A transactions and co-ordinate the wider advisory team. All activity centres around the delivery of corporate transactions, whether they be:

- MBOs
- Company Disposals
- Development Capital
- Acquisitions
- Strategy Planning
- Business Turnaround

Whilst Meta has and continues to work across a broad range of business sectors, over time a certain expertise has been developed in a number of particular areas. These include:

- Financial Services
- Manufacturing
- Recruitment
- Software
- Food & Beverage
Preparation: Why Prepare?

Whilst your MBO may seem obvious to you, its qualities will have to be explained to others providing the finance.

Good quality preparation is therefore important so that the first impression is a good one.

Amongst the areas to consider are:

- Industry Sector
- Vendor Reaction
- Management Team
- Finance
Preparation: Industry Sector

We should all consider what are the long term prospects for your industry sector and you should certainly demonstrate a high level of knowledge of your sector.

You can expect to be asked how your company is performing against others in the same sector, how it has performed historically and how you think it will perform in the future with you in control. You should be sure that this is based on real data, not just a hunch. If you are in an industry that suffers from cycles – how are you going to maximise the ups and manage the downs? Is your business an attractive investment opportunity and can it produce the growth in value that your investors will require?

Preparation: Vendor Reaction

You may have identified the opportunity, but is there a willing vendor? Sometimes the vendor has already put the company on the market. Sometimes it has not, and, what’s more, it could be the last thing on their mind. By starting this process the owners may regard your action as a sign of disloyalty and consequently your job may be in jeopardy. It is always difficult for the team to know when and how to make the approach.

Meta, as experienced deal managers, will assess your initial proposal and advise on when, how and indeed, whether or not to proceed. We can approach the owners on your behalf. This will diffuse any emotion on either side and reduce the chance of possible conflict.
Preparation: Management Team

The quality of the management team is critical to the success of an MBO and investors must be convinced that the team is efficiently experienced, enthusiastic, entrepreneurial and committed to the buy-out before they invest their funds. The successful team should have:

- a strong leader;
- managers experienced in all the business functions;
- a well thought out plan with achievable strategic objectives;
- a strong financial director with a firm grip on the numbers; and
- experience of running their business with the ability to roll up their sleeves if necessary.

The team should make an honest assessment of their strengths and weaknesses. Weaknesses should be addressed and, if necessary, the team strengthened by recruitment, which can be pre- or post- completion.

Financially, the team will be expected to make a significant commitment to the funding. The precise level depends on a number of factors and varies case by case. It is best summarised as "sufficient to concentrate the mind but not so excessive as to cause sleepless nights".
Preparation: Finance

Using your projections we will model the possible financing structure of a deal to evaluate the feasibility of the proposal.

This will incorporate the possible sources of finance, their servicing and repayment profiles. At the core of it will be the trading forecasts and projections of your business. Be prepared to give an honest appraisal of your business’s performance and how it might be affected by both internal and external factors. The core figures must be credible as everything else hangs off them.
Your MBO business plan is the **KEY DOCUMENT** to raising finance. The plan is the first impression a potential financier will have of your business and MBO proposal – if it does not sell the deal, you may not get past first base.

In short, it provides a summary of the business, its market position and its potential. It deals with the opportunity and the people responsible for delivery. It majors on the financial forecasts and incorporates the deal structure.

We will provide you with an example business plan and work alongside you to prepare a plan that properly explains the investment opportunity.
Your Advisory Team

Don’t be put off by the number of people who suddenly seem to have a role in your deal. They have a vital part to play and can prove to be of financial benefit.

The deal will be led by Meta but we will orchestrate the advice required by other professionals. On your team you should have:

A Solicitor

An experienced commercial lawyer is a key component of a successful MBO. Involved right from the start, solicitors make a valuable input to vendor negotiations including the legal implications of your offer letter and the confidentiality duty to the company. They will fight your corner (you can be sure that other parties will have experienced solicitors fighting for them) and they will ensure that all legal documentation is correctly drafted and protects your position. Of fundamental importance is employing a solicitor that knows how MBOs work and what is and is not negotiable.

A Tax Adviser

Taxation is a difficult subject at the best of times, and is a prominent feature of all MBO deals and skilled professionals should be used to advise on the implications of any deal structure. Always introduced at an early stage to assess the proposals and highlight any potential dealbreakers, their involvement can mean a considerable cost saving in the long term. Sometimes a deal which seems difficult can be made possible by effective and timely tax structuring.
Identifying and approaching potential financiers is one of our key roles. We will ensure you are introduced and marketed to the right financiers allowing you to devote as much time as possible to running your business. The financing principles and key issues to consider are:

**Management Team Stake**

The MBO team injects relatively little financial capital for what can be a significant shareholding, (albeit in a vehicle which will be leveraged). Remember though that all your human capital will be committed.

**The VC**

The VC is investing equity funds (in a mixture of pure equity and either preference shares or loan stock), and is looking for an equity return. Their focus will be on the upside potential in the business, whether it be organic growth, acquisition or the ability to buy the business cheaply and sell for an arbitraged profit.
The Banks

We will consider what funding banks are likely to advance based on assets you propose to buy and the strength of your projected profit and cash flow forecasts.

Banks will lend at a margin and look for comfort in the security available in assets, with strong gearing ratios and cash flow to cover interest and capital repayments.

Mezzanine

Mezzanine loans are used in deals to bridge the gap, if there is one, between the price and what is achievable through bank and venture capital sources. Whereas senior debt providers initially look at security, lenders of mezzanine finance look to the strength of future cash flows. Because of this they are more at risk than senior debt providers – and therefore require a sweetener in terms of either any equity kicker or a redemption premium.

Other Sources of Finance:

Whilst management, bank, VC and mezzanine are the normal sources, increasingly other sources are utilised. These can include:
- Invoice Discounting
- Equipment Leasing
- Vendor Loans
Due Diligence

A term you will hear many times is due diligence. It simply means the investigation that the VC and bank will carry out to vet your proposal. This will include areas such as independent market reviews by industry experts, property valuations, environmental reports, pensions and references on key management members.

The most significant item will be an accountant’s report on the MBO plan and the future prospects. This exercise will provide the institution with an independent opinion on the numbers to support their investment decision and normally covers:

- nature of business;
- historic trading performance;
- accuracy of previous forecasts;
- forecasts and assumptions included in management’s business plan;
- sensitivity of the plan to changes in key assumptions;
- management and employees;
- systems of control; and
- taxation.

Remember that, whilst due diligence seems intrusive, it also serves as protection for the MBO team. You wouldn’t want to buy a business with unknown liabilities and neither would your backers.

Due diligence will not, with the possible exception of initial reviews of the marketplace to support an initial offer of funding, be carried out until the deal is agreed and the Heads of Agreement have been signed with the vendor.
Negotiations will invariably become long and drawn out – often into the night – no matter how simple or well planned the deal. You will have two negotiations:

**With the Funding Institutions**

This is where we can really add value. By dealing with institutions and banks on a daily basis we are able to identify their particular requirements. We know what is acceptable in an often changing market and can quickly identify whether the terms offered to you are reasonable.

It is important to get these negotiations substantially completed at an early stage. It then enables you and your funders to sit shoulder-to-shoulder as the new company (Newco) in the critical negotiations with the vendor.

**With the Vendor**

An area that can be difficult and prone to emotions. If appropriate we will handle the negotiations with the vendor and their advisers on your behalf – we are independent and unemotional about issues that to you might imply criticism, mistrust or lack of integrity. Some owners feel that the management team is a threat, especially as the team is close to the business and can identify hidden potential. By us handling the negotiations on your behalf, you are able to better preserve your relationship with the vendor. This will be important if the MBO does not proceed.
The Legal Process

The legal process is often complex and can appear daunting to the management team. Whilst we, as deal managers, provide commercial input to the negotiations, it is here where you rely on your legal advisers to undertake negotiations regarding detailed legal points on your behalf. You will have agreed the broad commercial detail in the Heads of Agreement, it is essential that the areas such as warranties and indemnities are carefully negotiated to ensure that your deal is watertight.

At a minimum your solicitor (in conjunction with the deal managers) would usually prepare and/or negotiate the following:

1. **Sale and Purchase Agreement between Vendor and Newco**

   This will reflect the deal agreed and contained in the Heads of Agreement but detailed terms and warranties will appear here for the first time.
2. **Investment Agreement between Investor and MBO Team**

This document governs the shareholder relationship in Newco between the managers and the venture capitalists. It contains detailed warranties by the management on certain aspects of the business and their business plan and other undertakings regarding the future running of the business.

3. **Articles of Association**

The statutory detailed rules of how the company will be operated.

4. **Financing between Bank and Newco**

Much of this documentation is standard but exact details of facilities and covenants will have to be carefully negotiated.
Other aspects that may require legal consideration include:

1. **Property title**
   Searches will be needed to ensure you can obtain good title to assets you are buying.

2. **Lease assignments**
   Often difficult when landlords are asked to swap the covenant of a large group for a new MBO team.

3. **Pensions issues**
   Large sums can be involved and warranties and undertakings from the vendor regarding transfer values are vital.

4. **Service contracts**
   New service contracts for all the MBO team will be required.

5. **Intellectual property rights**
   If patents and trademarks are important to your business, it is vital that legal title is secured. An interesting area, particularly if the MBO team wants to retain use of a name used by the vendor.
The total fees involved in an MBO will depend upon its complexity and size. The types of fees will include the following:

**Fee Structure**

| Management Team Advisers: | • Corporate Finance advisers  
• Lawyers  
• Pensions  
• Tax advisers |
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<td>Institutions &amp; Banks:</td>
<td>Arrangement fees</td>
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| Institutions & Banks Advisers: | • Independent market reports  
• Investigating accountants  
• Lawyers |

It is worth stressing that most fees are paid by Newco on successful completion of the deal and are allowed for in the total funding package. In the event that the deal does not complete, the vendor may be asked to contribute reasonable professional costs incurred by the management team or alternatively there may be circumstances where a commitment fee, is obtained from the Management Team.
Post Completion

As you sit back and celebrate with your advisers and enjoy the customary sound of popping champagne corks (often in the middle of the night), don’t think for one moment that that marks the end of the hard work. It is where the hard work really begins.

Having done the deal the management team now has to deliver the promises and profits as set out in its business plan.

Often completion is not the end of the buy-out process. Completion accounts may have to be prepared (and agreed), inter group arrangements unravelled, disputes warranted at completion but still to be resolved and many other minor points all need to be finalised.

Post completion you are on your own. No longer is there anyone else to blame for your performance. It is now up to you! Completion does not end our involvement. We like to remain involved as corporate advisers to the team so that you can continue to seek our advice as the MBO company develops. We will be on hand to advise on refinancing, future acquisitions and ultimately the sale of the business.