

Livingstone



PRACTICAL GUIDE SELLING UNQUOTED COMPANIES

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Livingstone

Livingstone has set the standard for mid-market mergers and acquisitions advice since the organisation was established in London in 1976. Today Livingstone employs 65 staff across three offices in the United Kingdom, United States and Spain.

Our exclusive focus on unquoted corporate finance advice and experience of completing over 400 transactions has enabled us to build the leading M&A and private equity advisory house specialising in cross-border transactions with values of between £10 million (\$20m) and £100 million plus (\$250m).

We deliver creative corporate finance solutions to successful entrepreneurs, major corporations and private equity investors around the world from our teams in Europe and the United States. We offer strategic guidance and practical support regarding:

- Exit strategies
- Company sales and divestments
- Corporate acquisitions
- Capital-raising
- Buy-outs and buy-ins
- Debt restructuring

Livingstone focuses on five core sectors and has dedicated teams operating in the Business Services, Consumer, Industrial, Media & Marketing and Technology markets.

We deliver an outstanding service to our clients by creating dedicated, partner-led teams drawn from the significant resources and expertise of our offices in London, Madrid and Chicago.

Our ability to provide clients with a seamless infrastructure for trans-Atlantic deals is unique in the mid-market and supported by an exceptional pedigree for completing cross-border transactions all around the world.

1 Preparing for a sale

Why sell?

There are various reasons why shareholders in successful unquoted companies are prompted to consider a sale. These range from individual shareholders wishing to retire or facing a succession problem, to a strategy by listed groups of selective divestment to focus on core businesses. Whatever the reasons for sale, however, there is one common and compelling priority – to achieve the best possible price for the company, structured tax efficiently, from an acceptable purchaser.

What are the alternatives?

It is important that all the alternatives are considered before committing to a preferred exit route. Alternative exit routes which may be appropriate include:

- a stock market flotation on either the Alternative Investment Market (“AIM”) or the London Stock Exchange;
- the sale of a minority equity stake to a financial institution to unlock some capital for private shareholders, whilst retaining management control of the company;
- the sale of the company to a management buy-out or management buy-in team, or alternatively directly to a financial institution; and
- the purchase of shares by the company to enable, say, a retiring shareholder to realise cash without the company being sold.

For shareholders who wish to maximise the value of their business and find a strategic partner to continue the company’s development, however, the right trade buyer can offer a large number of attractions. This guide is designed to help vendors gauge the right time to sell, to open a dialogue with attractive strategic partners in a discreet and confidential way and to ensure that they achieve the best possible deal for shareholders, management and employees.

The sale process – an overview

Every sale exercise is different; however, the process always involves:

- a preparatory stage;
- a marketing stage; and
- a deal management stage.

These stages are addressed in greater detail in this guide. In general, vendors should allow about six months from commencing the sale process to achieving legal completion.

Appointing advisers

Vendors recognise that they can only sell their business once and the likelihood of achieving the best possible deal will be significantly enhanced by the appointment of experienced corporate finance advisers.

The principal function of any corporate finance adviser should be to take on the burden of project managing the sale, so that the vendors focus on what they do best – managing the business and maximising profit. When selecting their advisers, vendors should seek the following:

- a track record of successfully completed unquoted deals structured tax effectively for the vendors;
- a world-wide potential purchaser research capability;
- an experienced deal leader committed to making the deal happen; and
- the opportunity to obtain personal references by telephoning clients for whom the deal leader has sold businesses.

The corporate finance market is a competitive one and fees are largely comparable amongst advisers. Your adviser should be incentivised to deliver a successful deal by making a large proportion of any fee contingent upon achieving a legal completion.

Grooming a business for sale

By ‘grooming’ a company for sale, vendors can significantly improve both the likelihood of a sale and the total price achieved. Steps which vendors can take which will influence value include:

- maximising and managing profitability to demonstrate a steady and sustainable year on year increase in profits;
- actively implementing opportunities for cost reduction which will not damage the commercial well-being of the business;
- ensuring that the company’s statutory and tax affairs are in order; and
- extracting tax effectively any surplus property assets with development potential from the company.

The best “grooming” programmes focus on a sustainable improvement in the business’s financial and commercial performance. Changes that rely upon the assumption that the business will be sold should be avoided.

Finding the right partner

A key to maximising shareholder value is to identify purchasers world-wide who have the most to gain from acquiring the company. The greater the potential benefits likely to flow from the deal, the greater the premium price which a buyer may be prepared to pay.

Vendors should identify buyers with:

- complementary products or services but with a gap in their offering which the company could fill;
- an incomplete distribution network which the company can complement; and/or
- a geographical gap in their product or service offering.

Purchasers with any of the above qualities, together with adequate financial resources, should be short-listed as worthy of approaching. Before doing so, the vendor's corporate finance advisers should have established which of those purchasers are committed to acquiring companies such as the vendor's without letting it be known that they are handling a sale.

A large number of prospective purchasers are located outside the UK, and it is essential to devote considerable time and resources to research on a world-wide scale to produce a short list of known serious buyers.

Valuation

There is no single correct answer to the question of how much an unquoted company is worth. A number of factors which will affect valuation include:

- the recent, current and forecast profits and cash flow of the company;
- the scope for the purchaser to derive significant synergistic benefits;
- the scarcity value of the company; and
- the value being placed on comparable unquoted and quoted companies in the sector.

An independent valuation may provide an important comfort level for vendors who are uncertain of the likely achievable value of their company.

The true value of any unquoted company is not what the vendor or a single purchaser thinks that it is worth; rather, it is the most attractive offer received as a result of several serious purchasers submitting written conditional offers to the vendors.

If a vendor or his/her adviser can create a competitive bidding situation among a short list of purchasers, the highest offer received is likely to be significantly higher than the lowest.

2 Marketing the opportunity

Marketing & confidentiality

The active marketing of any company to a short list of purchasers is a highly sensitive process. Maintaining confidentiality within and outside the company is of acute concern to every vendor.

However, the risk of a breach of confidentiality can be minimised by careful management control. Emphasis should be placed upon:

- restricting talks to a short list of serious purchasers who are known to be interested;
- requiring every purchaser to enter into a legally binding confidentiality agreement;
- drip feeding information to purchasers on a 'need to know' basis to allow meaningful offers to be submitted; and
- not informing employees, customers and suppliers until the sale has been completed.

A purchaser's first impressions of a company are frequently based upon the initial information provided by the vendors. Particular care, therefore, needs to be taken to present the company in the most favourable light at the outset.

An information memorandum which provides an upbeat, pithy introduction to the company should be prepared and released to the relevant decision maker. Its principal purpose should be to prompt a meeting between buyer and seller – and no more.

Initial meetings

Initial meetings with purchasers should be held on 'neutral' ground at your adviser's offices or a nearby hotel to avoid prejudicing confidentiality. Initial meetings serve two equally important purposes: purchasers should have an opportunity to meet the vendors and understand more fully the business and the opportunity it represents, and vendors should assess each purchaser to gauge their interest and decide whether or not the chemistry is right.

Site visits

Vendors should normally be prepared to allow serious purchasers to conduct a 'whistle stop' tour of their facilities. Purchasers are often reluctant to make a written offer without having viewed the premises. However, such access needs to be carefully controlled by the vendors.

Vendors should accompany one or two members of the purchaser's team around the premises. Questions should be saved until a meeting is convened off-site immediately following the visit.

Following the site visit and provided the purchaser is still interested, limited further information should be made available on the understanding that a written conditional offer will be made. A key part of this information is likely to be the latest management accounts and a forecast for the next financial year.

Offer letters

At this stage, purchasers should have an adequate understanding of the business to enable them to submit a written indicative offer, setting out:

- the price to be paid;
- the form of consideration;
- details of any deferred consideration linked to future profit performance;
- any unusual conditions; and
- a timetable to completion.

Once written offers have been received from all the likely buyers, time should be taken to fully understand each one, requesting explanations where necessary.

Vendors should then decide with their advisers which is the preferred purchaser. This decision may not simply be based upon price and may include assessments of:

- structure of the offer;
- finding the best partner for the business;
- deliverability of the offer;
- chemistry with the purchaser; and
- timetable.

Negotiations

The preferred purchaser should be invited to meet with the vendors with the specific intention of agreeing a mutually acceptable deal. It is vital for the purpose of the meeting to be made clear and for decision-makers with the necessary authority to attend it.

Many vendors prefer their advisers to lead the negotiations as this gives them the flexibility to distance themselves from the 'heat' of the negotiations.

The outcome of a successful negotiation meeting should be 'heads of agreement' (sometimes known as a 'letter of intent'). The heads are a written record of the key features of the agreed transaction set out in commercial language, which can be used by both parties to brief the lawyers and other advisers to be involved in legally completing the deal.

Heads of agreement are not intended to be legally binding, with one important exception. Most purchasers will require the vendors to enter into an exclusivity period with them, barring them from talking to other purchasers.

3 Steering the deal to completion

Due diligence

Due diligence is the process whereby the preferred purchaser and its advisers undertake a detailed investigation of the business in order to verify that it is as the vendors presented it.

The due diligence exercise normally involves the following areas:

- commercial performance;
- financial performance;
- accounting controls;
- property and asset valuation;
- tax issues;
- legal issues; and
- environmental issues.

It will involve the purchaser and its advisers spending some time at the company's premises reviewing original documentation, but as much work as possible should be carried out off-site.

The due diligence process must be controlled carefully by the vendors in order to guard against it being used as an excuse for renegotiating the deal and to ensure that confidentiality is maintained within the business.

Lawyers

At the same time as due diligence commences, the purchaser's solicitors should be circulating a first draft of the legal documentation. It is in every vendor's interest to secure the best possible legal advice and time should be taken to select solicitors who:

- are specialists in the legal aspects of buying and selling companies;
- are willing to commit a seasoned partner to lead the deal from the front; and
- are prepared to offer competitive fees.

If the vendors' current solicitors have the requisite depth and breadth of expertise, their existing knowledge of the company will be valuable.

Legal negotiations

Vendors should request first drafts of the necessary legal paper work at an early stage, to ensure that the purchaser is not being unreasonable.

Negotiation of the legal documentation may take between three and six weeks. Buyers and sellers often believe that, once they have 'shaken on the deal', their lawyers can take care of everything. This is a dangerous misconception and it is vital that both parties, and especially their corporate finance advisers, keep totally involved in the latter parts of the deal.

A large part of the legal negotiations will focus around the warranties to be given by the vendors to the purchaser about the company. This will require the detailed attention of the vendors, considering each warranty carefully and, where necessary, making disclosures against the warranties in a 'disclosure letter'.

Completion

Completion cannot come soon enough for many vendors. If the sale process has been managed effectively, vendors can be confident that they have truly maximised the value of their business whilst delivering it to a purchaser which will continue to develop it.

