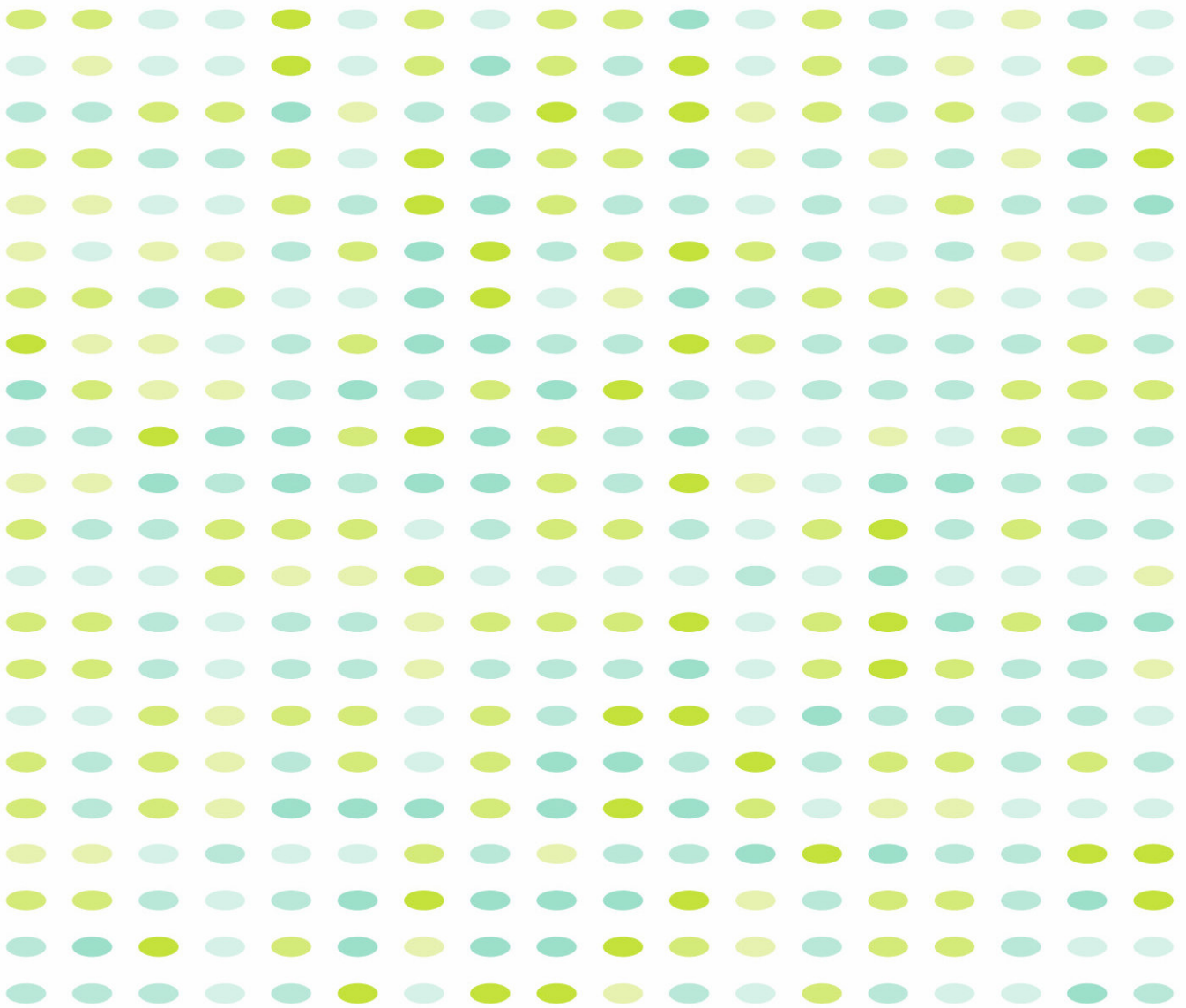


# The SWAIN guide to becoming transaction ready



In conjunction with:

# The SWAIN guide to becoming transaction ready

The South West Angel and Investor Network (SWAIN) connects private investors or “Business Angels” with companies looking for investments.

SWAIN specialises in helping small and medium sized companies to find equity finance, and assists private investors in the South West to search for investment opportunities in businesses with growth potential.

The buying or selling of a business can be a very complicated and often difficult process for the parties involved.

Typically, you will only undertake such a transaction once or twice in your working life and it is therefore absolutely crucial that you properly prepare for the process, taking advice from professionals (whether accountants, lawyers or non-executive directors) who are used to managing transactions and who are able to guide you through the various stages.

There are a number of key considerations that need to be dealt with very early in a transaction process, whether you are preparing your business for a potential sale or looking to acquire another business.

## Sale and Succession

The South West business community has a significantly higher proportion of owner managed businesses than most other geographical areas of the UK. The typical owner manager will be the key decision-maker and driver of the business, and will have no natural successor to the business.

In order to maximise value in the sale of a business, it is vitally important that a proper succession plan is put in place so that your withdrawal from the business does not impact significantly on day-to-day operations, profitability and ultimately price.

It can take a considerable length of time for owner managers to properly extract themselves from their own business with minimum disruption, and thought about the process in the two to three years prior to an intended sale will benefit the owner considerably.

### Step One - Establish what the exit options are for the business

There are various exit options for the owner manager and the particular route taken will depend on what opportunities are available:

- You can sell the business to a family member or members (often sons and daughters);
- In the absence of family members, identify another manager or managers within the business who can be developed to a position where they are able to take over, facilitating a management buy-out (MBO);
- If there are perceived weaknesses in the existing management team, bring in a new general manager or managing director for a period to strengthen the team;
- Sell the business to an individual by way of Management Buy-in (MBI);
- There might be the possibility of a trade sale to either a UK company or an overseas company, looking to expand market or geographical share.

- Other possibilities include listings on the PLUS market, AIM or the Full List of the London Stock Exchange, although these rarely provide an early exit to the majority shareholder.

In most cases there will only be one or two options available.

## Step Two - Identify the driving force behind the exit route

This could be retirement, or the desire to use capital locked up in the current business to start a new venture. Part of the exit strategy process is to identify the value that needs to be realised. Many owners have unrealistic expectations of the value of their business, and an early appraisal of likely value will often shape the timing of the exit.

## Step Three – Develop an action plan to tidy up the business

The Action Plan should focus on areas which will add value to the business. Create clear action statements with responsibility for each statement allocated to an individual. Agree timelines for delivery of each of the action points identified that fit in with the overall exit timetable.

Monitor progress against the agreed Action Plan. As each action is completed, consider what impact that has on overall value of the business. Constantly monitor the value of your business against similar organisations to ensure that your expectations are realistic.

Some examples of possible action plan points are as follows:

- Development of existing management or recruitment of new management;
- Introduction of proper monthly or quarterly management accounts;
- Rearrangement of property leases. Personal guarantees given to landlords, or leases held by the owner, not the business, can cause significant problems at the point of sale;
- Do you have proper title to all your Intellectual Property? Do you have patent protection in all current and future territories in which you trade?
- Is all your plant and machinery properly maintained? Do you have maintenance contracts in place?
- Do all your employees have up-to-date employment contracts, reflecting current employment rights?
- Is all software properly licensed and up-to-date?
- Is your corporate constitution up-to-date and properly documented? Lost share certificates, previous share capital transactions and out-of-date Articles all cause uncertainty for any purchaser;
- Consider some early stage due diligence. Ask your accountant and lawyer to look at your business as if

they were acting for a purchaser, and report any matters that they think would cause problems.

- Prepare a brief strategic plan for the business. Identify the opportunities that might be open to a purchaser. These can all be used to talk the price up in negotiation;
- Does the current level of profitability support the exit price you want to achieve? If not, what do you need to do to get this price? Ask your accountant to value the business as it stands, and see if your current strategy will get the price you want.
- Identify your competitors and any complementary businesses. Many businesses are bought by organisations already known to that business. If there is a group of likely purchasers, can you shape the business so that it is more attractive to those organisations?
- What is the current status of the company pension scheme? For example, is there a significant funding deficit on a defined benefit scheme?
- Do you have any current or pending litigation? Settle and close any litigation wherever possible; purchasers do not like open-ended liabilities;

You will need to make some potentially difficult decisions at an early stage to enhance the value of your business. Some of these decisions will involve increased cost or investment but if this makes the business more valuable, or easier to sell it will have been worthwhile.

The key message is to plan early, and be prepared for a sale even if you have no current desire to sell.

## Mergers and Acquisitions

Expanding through acquisition is done for a number of reasons: commercial gain, financial gain, or for other specific reasons (for example to acquire a strategic customer or supplier relationship, or a sought after management team). Clearly all acquisitions are carried out to increase or protect profit. No-one sets out to lose money through an acquisition, although this is frequently the unintended result.

Mergers or acquisitions are often unsuccessful when undertaken without adequate professional guidance and appropriate planning. This generally occurs where:

- insufficient research into the target company or industry, or an unanticipated change in the target industry results in the acquisition failing commercially;
- the management team do not have the necessary expertise to complete the transaction;
- the management team do not have the capacity to manage the transaction process, which is often long and can take considerable management time and input;

- the management team do not have the spare capacity to properly integrate the acquired company into the existing business post acquisition.

The key to success is an effectively implemented acquisition plan. The management team should consider appointing corporate advisers as early as possible, who will advise and assist with the formulation and implementation of the plan.

The acquisition plan should cover a number of key areas.

### The acquirer's attitude to risk

An acquirer's attitude to risk will affect the selection of potential targets and may well drive the rationale behind the intention to acquire. A business with a long record of good and consistent profits might be less risky but it is likely to cost more than a young business without this track record. A young and growing business might have the prospect of much larger future profits but this will come with more risk. The second business might be cheaper to buy, but it might require much more investment later on to deliver those future profits.

The key transaction risks that an acquirer faces are that of:

- Overpaying for the target: The management team should take external advice on valuations for the target and likely strategies in negotiating on price to be paid.
- Overgearing: The acquisition of a company will almost invariably increase substantially the borrowings of the acquirer. This places additional pressure on both companies, particularly in the early stages post-acquisition when potential economies of scale or growth opportunities have not yet materialised.
- Inadequate due diligence: Proper due diligence should be carried out to identify any critical problems before completion.

Management should prepare robust financial forecasts and business plans in support of the acquisition. These plans are not just for the benefit of the bank; they should be used to manage the business against expectations. Any variances against plan can be identified early and tackled promptly.

The financial controls will need to be good. Acquisitions come with debt, and good cashflow management will be crucial.

### Size of the Target

A pre-determined deal size which is too specific can result in good potential targets being overlooked.

However, it is sensible to establish an upper limit based on limiting factors, such as management capacity. A lower limit can usually be established by considering the size of the target in relation to the acquirer (for example, if the purpose of the acquisition is to increase market share, it would not make sense to target a company so small it would have little overall effect). Furthermore, targets below a certain threshold will generally add less value to the existing business than the cost of acquiring (both in professional fees and management time).

### Management Capacity

Consideration should be given to the time that the existing management team has to manage the acquisition process. Even where external advisers are engaged to manage part of the process, a significant amount of the management team's time will be required, at the very least in liaising with the advisors throughout the process.

Identify an individual with overall responsibility for managing the transaction from the acquirer's point of view. If possible, put plans in place to ensure that some of that individual's day-to-day management responsibilities are passed to others during key stages of the transaction process.

The existing management team should ensure that they have enough capacity to properly and effectively integrate the newly acquired business into existing operations. For example, it might be appropriate to appoint additional members to the team and these individuals may well come from the target company.

You should not underestimate the importance of retaining key employees in the target business. In all cases they should be identified and interviewed as part of the due diligence process.

### Integration post acquisition

One of the key factors in an acquisition is the successful integration of the new business into the existing company or group. An acquisition which is not properly integrated into existing operations will not maximise the opportunities presented by the acquisition and inevitably take up an excessive amount of management resource, drawing this away from existing operations.

## Raising finance

Acquisitions will very often require considerable external financial input. The most appropriate form of finance for a transaction will depend on a number of factors, such as the industry the business operates in, the need for finance, future plans for the business, and ultimately the availability of each source of finance.

It is very important to obtain buy-in from potential providers of finance at an early stage in the transaction process. It is also very sensible to have several potential sources of finance in place, in case one or more of them withdraws from the process, and to obtain the most cost-effective overall finance package.

Preparation for meetings with potential financiers is crucial.

- Have a clear and concise message. Why do you need funding?
- Support your proposals with detailed business plans and financial forecasts, backed up with detailed research on the target and its market;
- Consider the impact of sensitivities on your financial forecasts. What are the downsides to your proposition and what impact will they have, both commercially and financially?
- Anticipate likely questions and therefore reduce the perceived risk of lending.

## Finance options

There are a number of alternative finance options, which can be used as part of an overall finance package:

- Bank debt. The traditional source of finance, whether secured against assets of the acquirer or the target, or unsecured. Bank debt can take many forms, for example term loans, asset backed finance, invoice discounting or stock loans, overdraft facilities, equity or quasi-equity investments or letters of credit.
- Management equity. The shareholders will often be required by funders to introduce their own capital. This demonstrates the belief of management in their own proposition.
- Business Angels. These are wealthy and experienced entrepreneurs who look to invest both money and experience in higher risk ventures, often at an early growth stage. These can be accessed through SWAIN in the South West.
- Venture Capitalists. These are investors who provide equity capital together with managerial and technical expertise, generally to businesses anticipating high growth.
- Internal funding. Consider to what extent the resources of the acquirer or indeed the target can be used to fund the acquisition.
- Grant funding. There are various regional, national, and European grant programmes and business support activities. They are usually targeted at assistance with capital projects, or business development such as diversification or job creation.

## Summary

The acquisition or sale of a business is without doubt the most important single business decision that a company or owner manager will make.

If you are thinking about selling your business (and you should be making plans now even if there is no intention to sell at the moment) or acquiring another business, take early advice from an experienced corporate adviser.

Details of such firms, who are associate members of SWAIN can be found at:

[www.swain.org.uk](http://www.swain.org.uk)

Or if you would like to discuss any of the topics or issues raised in this guidance note, please contact any of the following at Bishop Fleming Corporate Finance, who prepared this guide.

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