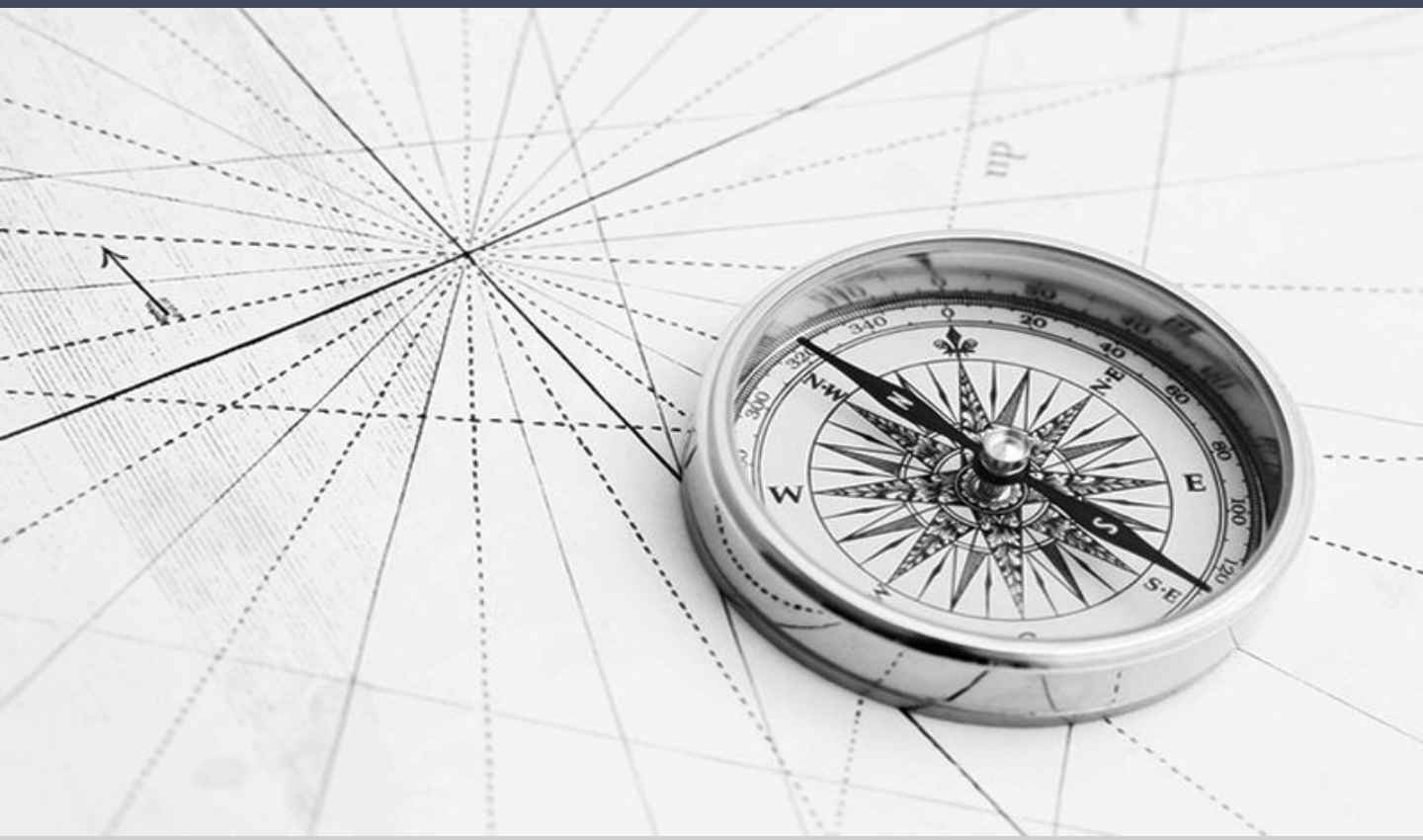
gambit CORPORATE FINANCE

Succession Planning

Preparing for an Exit

December 2020



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Alternative Exit Routes

An element of panic has built up amongst company owners contemplating or pursuing transferring ownership of their businesses. Exit options and valuations have been curtailed by the Covid-19 pandemic and tax efficient timeframes condensed by the rumoured Capital Gains Tax ("CGT") reform in the forthcoming budget announcement in March 2021.

Ignoring the external route of selling to trade or financial buyers, we anticipate that the internal alternative via a management ("MBO") or employee buy-out will be a popular choice in appropriate circumstances but dependent on affordability and owner value expectations. The rumoured CGT implications may realign vendor's priorities.

MBOs can fulfil a number of scenarios whether leveraged, buy-in, buy-out, vendor instigated, or employee led. The vendor instigated option or VIMBO, generally appeals to the business' wider stakeholder classes including customers, suppliers, and existing funders.

As a word of caution, if you are relying on external funding to enhance the extraction it might be worth discussing with funders the timing of their intervention post the company sale as time to effect due diligence and other requirements with institutions may overshoot the tight deadline of March 2021.

Another option which might suit certain types of businesses, fulfil owner's legacy ambitions or preserve community employment benefits is to sell the company to an Employee Owned Trust ("EOT") which would hold the shares on behalf of the employees of the company. Again, external finance can be introduced subsequently to allow the EOT to pay for any deferred consideration (held as an I.O.U.) albeit the funding would be secured against the operating company rather than the EOT.

So, in light of this review, some of these options might work for your particular circumstances and aspirations whilst time to transact is of the essence which requires a defined and tested approach.

MBO/EOT – Key Considerations

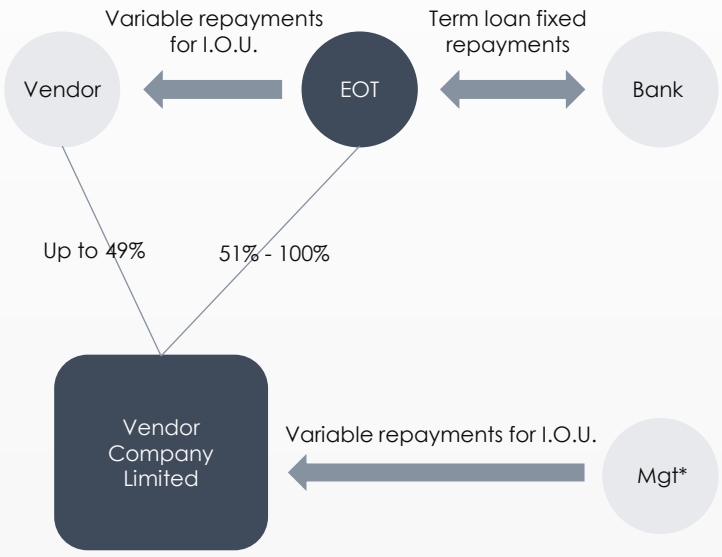
	MBO	EOT
Management team/employees		
Management team wants to invest and take control	🟢	🔴
Owners do not want management to take over	🔴	🟢
Management need to be incentivised	🟢	🟢
Owners objectives		
Owners want to pass the business on to the next generation	🟢	🔴
Tax efficient disposal	🟡	🟢
Not all shareholders want to exit	🟢	🟢
Realise value over several years whilst retaining control	🔴	🟢
Other sale options have not been successful	🟢	🟢
Company culture		
Company to remain independent	🟢	🟢
Employees would value ownership	🟡	🟢
High employee turnover	🟢	🔴
Company Profile		
Few employees	🟢	🟡
Start-up business	🔴	🔴
Limited growth potential	🟢	🟢
Non-cash generative	🟢	🟡

EOT - Typical Funding Structure

Overview

- The vendor can sell between 51% and 100% of the share capital to the EOT for a consideration preferably supported by an independent valuation.
- Owners will hope to gain comfort that the future profits of the business will be able to service the deferred consideration and future growth whilst the control of the business decisions now largely sits with the EOT/new management.
- The consideration can incorporate an earnout element which is useful to overcome difficulties in establishing value in an uncertain market.
- Incentive schemes are often set up for the new management team, agreed in advance with the EOT trustee.
- Disposal of a vendor's ownership to an EOT attracts no CGT (uncapped limit). This is favourable in comparison to the business asset disposal relief (formerly entrepreneurs' relief) CGT rate of 10% (subject to a £1million cap).

Deal Structure



*Management

Case Study – Project Faith

Executive Summary

- A leading UK based international consultancy firm
- Vendors implemented a leadership succession plan, safeguarding the future of the business for the benefit of the current and future leaders and employees
- A growth incentive created by ownership culture for employees
- Released full market value (tax free) from the business with no external buyer required

Background

- The vendors were looking to reduce their day-to-day involvement in the company
- The existing management team were risk adverse to obtaining external capital to fund an MBO, having been given a period of two years to pursue the option
- Ownership by an EOT would enable the company to retain its independence and unique position in the market-place

Transaction

- Gambit reviewed and appraised an external advisor's business valuation of £6.0m Enterprise Value
- Analysed the company's business plan and financial projections
- Selected leading legal and tax advisors
- Recommended an appropriate financial structure
- The initial consideration was paid using the company's cash reserves
- The company did not require drawing down any external finance but had agreed terms with its bank
- Deferred consideration of £4.2m to be paid over 7 years using an I.O.U. structure
- Reviewed HMRC tax clearance for commercial rationale and deferral settlement
- Advised on governance arrangements of the EOT with a trustee company set up for the purpose
- The Sellers sold their entire shareholdings in the company to the EOT for an agreed price of £6.0m

Outcome

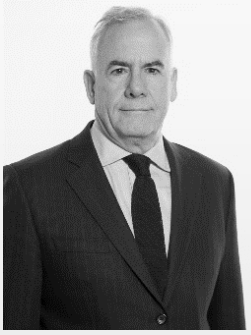
- Successful ownership transfer to the EOT
- £1.8m paid to vendors on completion
- No additional bank debt introduced

Succession Planning – Preparing for an Exit

Gambit's Key Value Drivers

- Advising on external valuations of the business
- Liaising with the company's accounting, taxation, and other advisers
- Co-ordinating legal, commercial or accounting due diligence process
- Structuring a deal that achieves shareholders' aspirations
- Leading commercial negotiations
- Recommending an appropriate financial and funding structure
- Securing suitable funding
- Enable management to focus on running the business

Project managing all aspects of the transition to affect an efficient transaction



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Gambit Corporate Finance

Established in 1992, Gambit is an independent corporate finance advisory firm specialising in advising private and public companies on mid-market transactions in the UK and overseas. With offices in London and Cardiff, Gambit is widely recognised as a market leader in M&A advice having built up detailed industry knowledge and an enviable track record in deal origination and execution.

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