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Preparing to exit your business: It's your life's work. Value it.

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Introduction

Selling your business or taking investment from Private Equity (PE) via an M&A sales process can be a complex and intimidating process.

In our short guide we review the steps and considerations to achieve a successful deal.



We'll be providing guidance on these three main areas:



What are you looking to do?



What can you do now?

Going through the process

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What are you looking to do?

Careful consideration is needed in deciding your aspirations from an M&A process. Are you looking to exit in full or partially exit?

The full exit

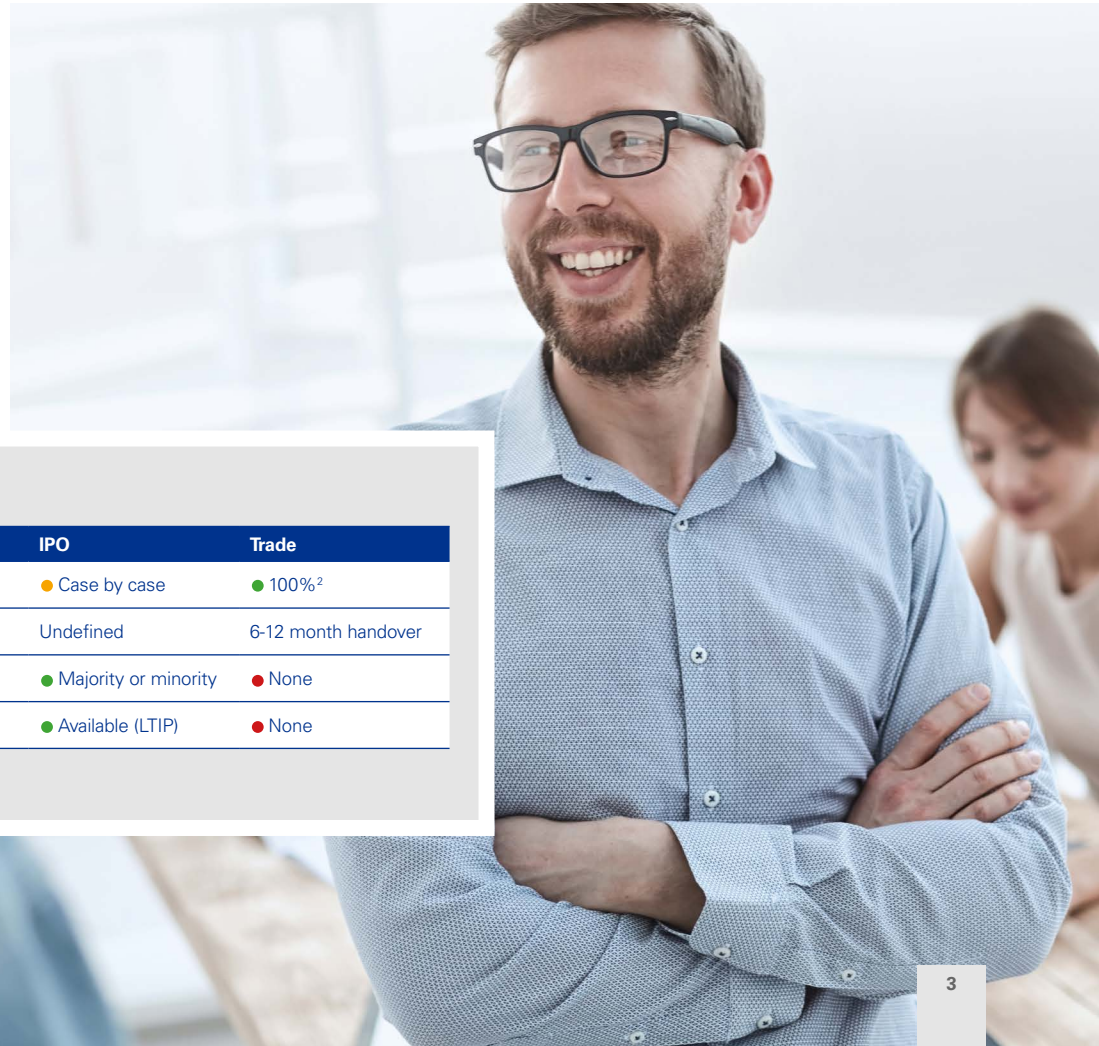
Exiting in full is realising the full value of your shareholding through selling 100% of the equity. You'll be passing on the responsibility of running the business and looking after its staff to a new custodian.

The partial exit

A partial exit involves de-risking your position, by selling a stake in your business to a Private Equity (PE) fund which provides you with some cash realisation at Capital Gains Tax rates. It also allows you to reinvest alongside the PE house to share in the value created from the continued growth of the business, which can be realised when they then exit (or you can reinvest and go again with another PE fund).

Taking PE investment can be achieved in either a minority or majority PE deal, depending on the stake that you choose to sell. Investment can also be taken into the business from the PE house, to be used to turbo-charge growth through strategic acquisitions, to fund new product development or market entry as examples.

Sweet Equity will also be created and distributed to your wider team, aligning them to you and the PE house's goals.



Comparison of exit types

	Debt refinance	Minority PE	Majority PE	IPO	Trade
Day 1 Cash out	● Limited	● Increased	● Up to 50% cash out[1]	● Case by case	● 100%[2]
Ongoing involvement	As before	3-5 years +	3-5 years +	Undefined	6-12 month handover
Share of future growth	● All	● Majority stake	● Minority stake	● Majority or minority	● None
2nd tier management participation	● Available	● Sweet equity	● Sweet equity	● Available (LTIP)	● None

1 For key management 2 Subject to deferred or earn outs

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What can you do now?

The role of the M&A sales process is to fully investigate your exit options, providing you with the clarity to make an informed decision based on the best possible positions.

However, before commencing a process you have the opportunity to make changes to your business, its model and how it will be perceived by buyers or investors to help maximise the value they're willing to pay. To properly assess how to do this, you will need to understand and consider the following areas:

How much is buyer likely to pay for your business – the Multiple & Earnings Measures



How to maximise the value of your business



What types of buyers will you be approaching – Exit Types and Buyer Comparisons



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How much is buyer likely to pay for your business – the Multiple & Earnings Measures

Ultimately, the value of a business is what the best bidder is willing to pay for it. The most common form of arriving at a valuation is through a multiple of earnings:

Enterprise Value = Multiple x Earnings

The Multiple

The multiple is informed by considering multiple characteristics and areas in conjunction. They broadly fall under two categories – resilience and growth.

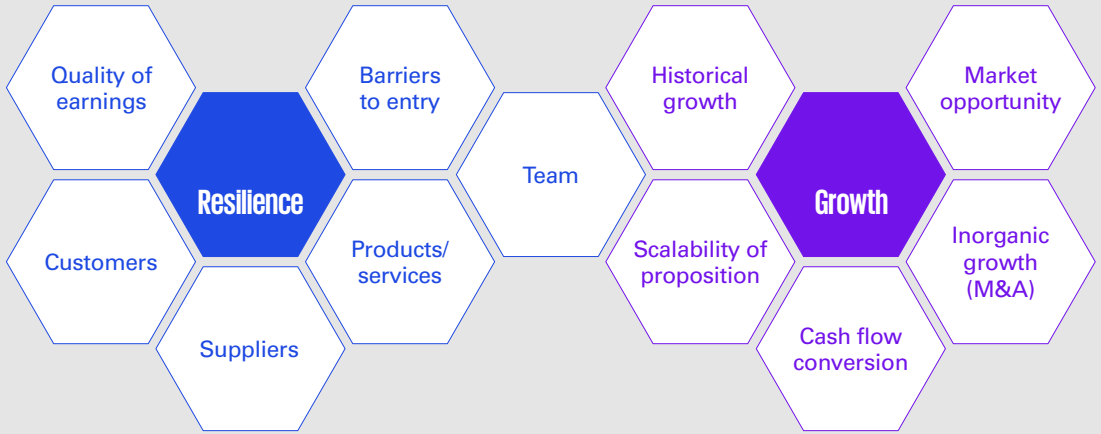
Resilience focuses on the factors that are needed to maintain a business's performance, such as your customer base, your team and what is referred to as the barriers to entry – which is essentially the difficulty a new competitor would have in entering your market.

A resilient business means new customers won will be largely incremental to what you have.

Growth focuses in on an assessment of the opportunity for growth and the company's ability to realise it. PE investors will be looking closely at this, as they are typically looking to double the earnings of the business over a 4-year period to realise their target return on their investment.

Deriving the multiple – key drivers

The majority of characteristics fit within one of two buckets:



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How much is buyer likely to pay for your business – the Multiple & Earnings Measures

There are a multitude of terminology used in conjunction with an EBITDA...



Reported EBITDA – As per the reported results of the business – typically as per management accounts

Adjusted EBITDA – Adjusted for one-off items/ definitional adjustments

Normalised EBITDA – More subjective adjustments (e.g. where assumptions/estimations are required)

Run rate EBITDA – Aims to quantify the benefit from how the business is currently trading (e.g. significant new contracts/customer wins)

Proforma EBITDA – Takes into consideration the benefit from events such as new acquisitions or new contracts/customers that are yet to commence

More subjective

...your advisor will guide you through identifying the most appropriate EBITDA

Earning measures

The second part of the equation, following the multiple, is earnings. This could be Revenue, EBITDA or EBIT depending on the nature of your business.

Revenue multiples are generally used where revenue is recurring in nature (and therefore secure and predictable) and where the business' profit is being suppressed by sustained investment to drive future growth. Revenue multiples are most typically associated with the technology sector. EBITDA is the most widely used measure in the M&A market, whereby it's applied as a proxy for cash generated from trading. EBIT, meanwhile, is used for those businesses that are more capital intensive, where the assets of the business are required as part of delivering the service.

Whatever the measure used, it needs to be robust, sustainable and free of one-off factors, and it will be scrutinised closely by buyers.

In arriving at the right earnings figure to apply the multiple too, a number of earnings figures will be assessed by your advisors, due diligence providers and the buyers.

Equity value in your pocket

It's important to remember that the Enterprise Value driven by multiple of earnings calculation is not actually what you will receive. You will be selling the business free of debt, cash and with a normal level of working capital. Once these factors have been considered, the result is the Equity Value – the actual cash consideration you'll receive for your shares in your business.



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How to maximise the value of your business

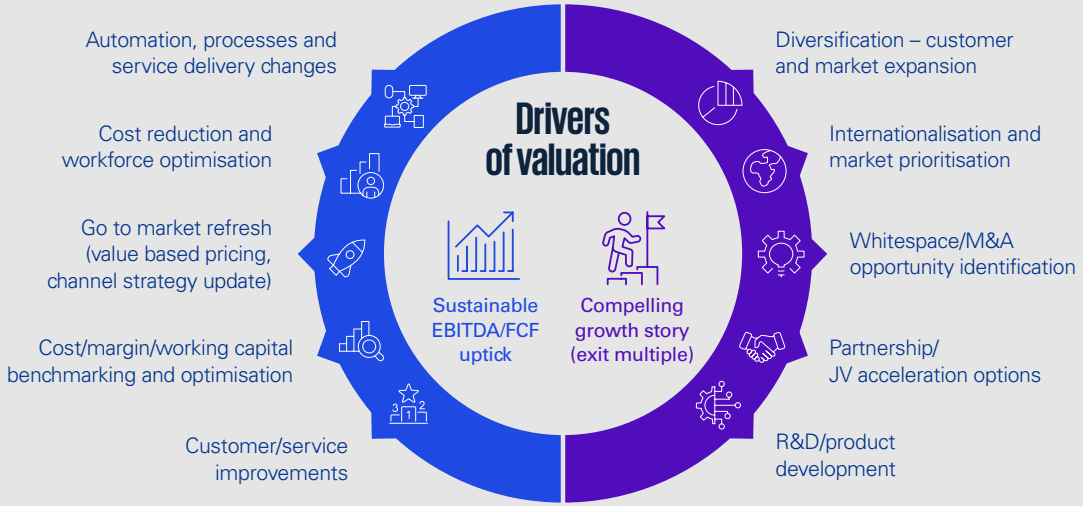
If you are starting to consider your options, you will undoubtedly want to maximise the value you can earn.

Value creation is the catch-all term referred to a series of levers that you can pull to increase value. Broadly speaking they fall into two main categories: **building earnings strength and developing a compelling growth story.** Combining both sides of the value creation story will offer the best outcome for your business.

How we go about creating value

Building earnings strength

- How has underlying performance tracked historically and relative to ambitions?
- How robust is the Operating Model? How effective is the commercial engine?
- Is the pricing architecture optimised?
- How does the business benchmark relative to its peers? (Commercial, Financial, Operational)



Developing a compelling growth story

- Is there a clear, compelling equity story?
- Are there pipeline opportunities in high growth, structurally attractive markets?
- Does the business have the people, resource and capability to support growth plans?
- Has the business successfully executed on previous growth/ expansion opportunities?

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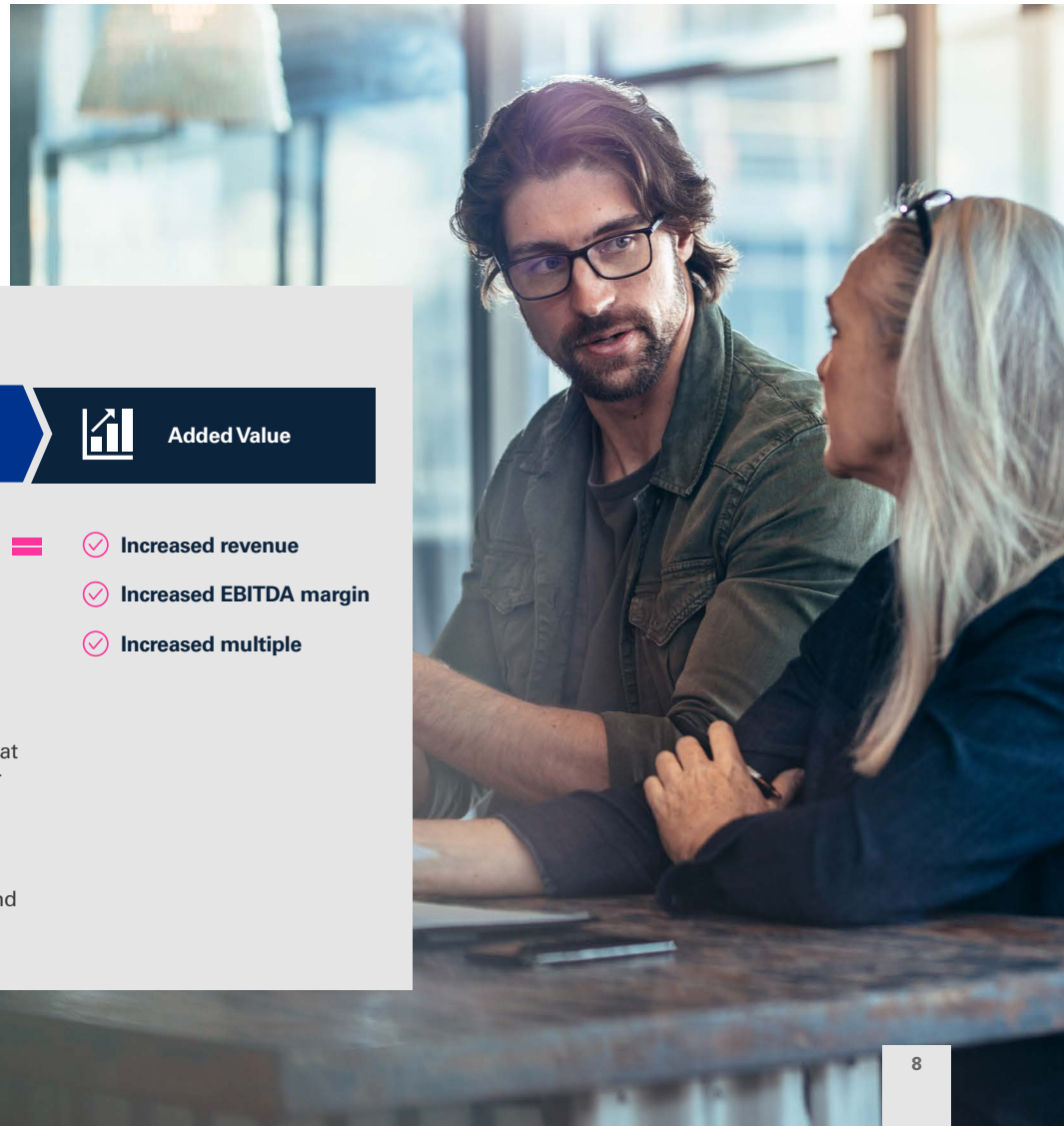
How to maximise the value of your business

However, it's not just a case of pulling all the levers at once and hoping for the best! There's a strategy that comes to maximising business value and being able to deliver it within a reasonable time frame to benefit the sales process.

You should be asking yourself these questions before you pull a lever, as some of them may not be the right lever for your business to pull at this time:



How do we make Value Creation happen?

Identify what will improve your existing business + **Consider where to drive Strategic Direction** = **Added Value**

Tactically maximise existing performance +

- Where can we operationally improve in the time available?
- Where can we find new ways to expand our existing business?

Identify value adds +

- What can we bring rapidly that is new or disruptive?
- What new customers could exist?
- What is our innovation and NPD pipeline?

Evidence value generating opportunities +

- What can be trialled to work in 6-12 months?
- What is your action plan?
- What are the KPIs we need to track to prove they work?
- What data will investors need to see?

Compelling investment case and equity story =

- Demonstrate your improved performance
- Embed the pilot opportunities that allow for further growth
- Show the post-deal investment opportunities and returns

- **Increased revenue**
- **Increased EBITDA margin**
- **Increased multiple**

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What types of buyers will you be approaching?

Once you're ready to launch a process you and your advisors will need to conclude on which buyer or investor audiences you'll be approaching. So what's the differences between them and what can you expect the process to be like?

Buyer comparisons

PE – Private Equity are professional buyers of businesses and so can mobilise and move quickly. However, by their own admission they are not always sector experts. They are happy to receive full suites of vendor commissioned Due Diligence (DD) reports to assist their appraisal of the opportunity. While commissioning DD as the vendor (sell side) does create extra work, it enables you to retain control and streamlines the process further down the line, and as such are commonplace and generally recommended.

Trade – Trade buyers conversely can in some cases by slower moving the Private Equity, as corporate entities with their own approval processes. As a result, any M&A process should take account of this through "premarketing" to help them understand the business, the opportunity and anticipated process timescales. Trade buyers will take and consider vendor-led Due Diligence but do not always need to nor do they rely on it to the same extent, particularly in the case of Commercial DD given they themselves are likely to be well acquainted with the market dynamics as participants within it.

Differing approaches: PE vs Trade

		Trade	PE (UK & EUR)	PE (US)
Pre-deal	Quality of information	✓	✓	✓
	Early deal preparation	?	?	?
Deal execution	Speed of execution	?	✓	✓
	Vendor due diligence	?	✓	✗
	Buy side due diligence	✓	✓	✓
	Debt financing	?	✓	✓
	Commercial understanding	✓	?	?
	Synergy case	✓	?	?
Post-deal	Reporting requirements	?	✓	✓
	Bolt-on M&A	?	?	?

The tax factor

When making any decision, tax is naturally something that always needs to be considered.

On a sale of shares, a shareholder will expect to pay capital gains tax on their sale. However, in the case of earn-outs – which are common in trade deals – these will need to be structured to be subject to capital gains tax, rather than income tax.

PE deals can also bring an income tax risk where the sellers (and/or management) receive equity either – rollover or 'sweet' equity. HMRC advance clearance is generally recommended to make sure specific anti-tax avoidance rules will not apply.

A competent advisor, and seeking local tax advice, is preferable to be able to navigate the complexities of Tax and maximise the post-tax proceeds.

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What types of buyers will you be approaching?

Deal types

Minority PE deal – There has been a notable growth in the volume of minority deals recent years, given that it represents an attractive option for those looking to de-risk personal wealth and take on investment, but still maintain a majority equity holding in their business while it continues to grow. While you'll be retaining an economic majority stake, your incoming partner will however want some protections for its investment, gained through the legal documents.

Majority PE deal – These deals are what they sound like - you'll be giving up the majority of the equity to the PE house in exchange for taking more cash off the table than in the minority PE deal.

In both the minority and majority PE deal, sweet equity will be made available to be distributed to your wider team to align them with you and the incoming investor to drive growth. Equity incentive mechanisms and structures can also be put in place before any deal to align interest pre deal and thereby create value ahead of a process.

Private Equity are not looking to manage your business post deal – they are backing a management team to deliver a plan. Adequate consideration and planning should therefore be undertaken pre-process to ensure an appropriate team is in place.

Private Equity as an asset class for investors (Pension Funds, Funds of Funds, High Net Worth Investors) has grown exponentially over the last decade, resulting with an ever-increasing population of PE funds, and volume of capital raised which they need to deploy. Relationships, as always, are key, and so finding the right partner with shared values and approaches, as well as value-add, requires careful consideration and navigation.

Potential buyers

	Minority PE	Majority PE	IPO	Trade
Day 1 Cash out	● Increased	● Up to 50% cash out[1]	● Case by case	● 100%[2]
Ongoing involvement	3-5 years +	3-5 years +	Undefined	6-12 month handover
Share of future growth	● Majority stake	● Minority stake	● Majority or minority	● None
2nd tier management participation	● Sweet equity	● Sweet equity	● Available (LTIP)	● None

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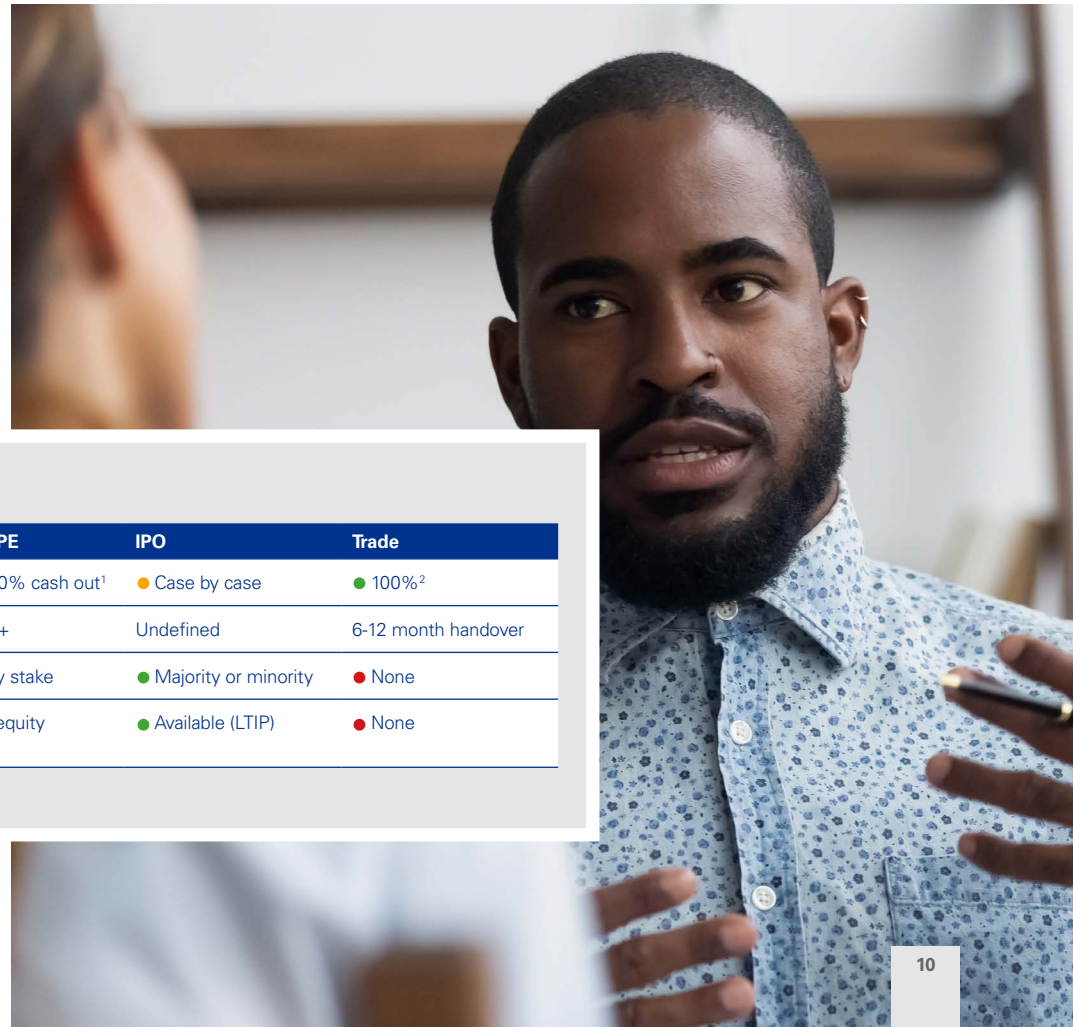

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What types of buyers will you be approaching?

Trade deals – A trade sale is typically the way to maximise your day one cash. A trade buyer will look to acquire 100% of the equity in the business to be able to fully integrate it and benefit from the realised revenue and cost synergies. While you will likely be required to remain in the business in some form for a handover period, this is likely to only be for 6-12 months post deal.

Earn outs and deferred consideration may be used to protect for the potential of lost income post deal, retain key employees and bridge option valuation gaps.

While this option provides a means for a clean exit, naturally the team that has helped build the business will largely be remaining in situ, and so finding the right home is key.

IPOs – As an option, this is only really viable when the markets are 'open' – which has not always been the case over the last three years. It does provide a credible alternative and means to potentially maximise value so should be carefully appraised.

Due consideration should be given too to the scrutiny and the expectations that will follow from being a listed entity on the public markets.

The legal rights

In any deal, there will be a strong legal element, with lawyers representing both sides and drawing up contractual agreements.

The legal aspects tend to be more complex in PE deals than trade sales. There are four principal legal rights a PE investor will look to obtain when investing into a target business:

Board rights – Here the PE investor will want the right to appoint an investment director to the Board, as well as the ability to nominate a Chairman (usually in consultation with the founder/owner). This allows PE representation and a conduit directly to them as investors. Any deal with investor shares over 10% will normally have these included.

Investor consents/reporting rights – These rights are to assess situations outside of business as usual which they need to be consulted on before a decision is made (and they can veto). Both minority and majority investors will request these rights and often minority investors will have the longer list of situations to be consulted on as they have less day-to-day control.

Exit event/Drag along rights – Investors' whole purpose in investing in a business is to make a profit by exiting over a given time horizon (usually 3-7 years). As a result, they want the ability to shape the exit process and to trigger an exit event when the time is right. This ability is enshrined in their legal rights including the ability to force all shareholders to accept an exit (drag along rights). Majority investors will always seek these, and minority investors will look to do the same. However, thresholds can be applied to stop the 'tail wagging the dog' when it comes to minority investors.

Step in/Swamping rights – This is the ability to safeguard the investment, particularly as they have a duty to their investees (who are often pension funds). In reality this means having the ability to step in and take control of the company if there is a serious issue. The rights will 'swamp' those of other stakeholders as they work to stabilise the business. Once the business is stable, the rights switch off and investors should have the right to add more money to re-establish their stake.

For **trade sales**, there will also be lawyers involved on both sides and comprehensive legal documentation will be drawn up. However, there will generally be fewer areas of detailed legal negotiation required. Instead, this will apply in cases of earnout provisions or deferred consideration. Here, it is obviously key to ensure that terms are carefully and fully recorded in the agreements so that they are watertight and not open to dispute or manipulation further down the line.



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Going through the process

As you begin to move towards launching a process, you should ensure that your house is in order through careful assessment of any legacy issues, while also challenging yourself on whether you can readily articulate the strength of your business and the opportunity ahead of it.



KPMG has developed an interactive Exit Readiness tool to support you on your assessment of preparedness for an event or sales process. In our experience, by distilling strengths and weaknesses from the outset, the right preparation will ultimately drive value maximisation.

We will support you identifying key existing strengths, whilst examining areas that need bolstering and development, with key focus areas clearly identified and incorporated into an outcome-orientated report.

Please reach out to any member of the KPMG Deal Advisory team to find out more about the Insite Exit Readiness sessions.

Business plans

At the heart of the process will be your business plan. So why do you need one? This is a key piece of documentation will support the entire process, which will be stress-tested in due diligence, with assumptions and outputs assessed. It tells the story for your buyer or investor – of the business now and what it can become. The business plan can also become a compelling internal document, to generate employee engagement and incentivisation for the process and their role within it.

It also needs to be accompanied by robust financial information. This is the data to back up your story. An integrated P&L, balance sheet and cash flow containing the next four years of forecasting results will also be required, with outputs clearly displayed and with the ability to sensitise for scenarios.

Key elements are likely to include:

Understanding and protecting value – showing the key areas of value in the business and what buyer synergies are likely to exist

Equity story and growth plan – setting out a clearly defined growth strategy with robust evidence around value drivers and selling messages

Management – demonstrating that you have the right management in team with the relevant skills and experience to deliver against the business plan; also setting out any mitigations if appropriate against 'key person risk'

Market dynamics & competition – showing that you understand key trends in your market, your CAM and TAM, and your strategy to exceed the competition

Customers and products – evidencing that you understand your customer base and customer portfolio (buying habits, satisfaction levels, longevity of relationships, customer churn etc), you know where the business makes its profits, and have a coherent strategy around existing and new product development

Workforce & operations – showing how the workforce is optimised to the current and future shape of the business, how staff are remunerated, developed and incentivised, and operational capacity and utilisation rates

Other key information – such as incentive plans for the sale, relevant tax and legal information (especially if there are any tax matters/investigations or legal disputes outstanding, although of course you should make every effort to resolve these before getting to the sale stage)

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