

Why sell? When to sell & Who to use

Guide 5

Avondale Business Guides Series

Why sell? When to sell & Who to use?

Contents

- **Why sell?**
 - **At what price and when?**
 - **Choosing an advisor**
 - **The Avondale formula**
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This Guide is not intended to be definitive, and the accuracy of its contents can not be guaranteed. Professional legal and financial advice from your regulated advisors should be taken on all aspects of transactions.

Why sell?

Introduction

You probably started your own business because you wanted to be the boss. You wanted control, recognition and money. You also probably started the business around a job you enjoyed and were good at. That job became the business. You made it a success by being passionate, enjoying getting the deal and thriving on the challenge of creation and thinking big. You mixed this with a bit of bloody mindedness and hard graft. Your long hours and hard work have led to high self-esteem and an enviable social position. People look to you. They believe in you and they want you to show them the way. You are responsible. The buck stops with you. Happy days...

However, success means a mature business. This means you have probably stopped doing 'the job'. Now you are running the business, designing systems, dealing with personnel, financial and legal issues and battling with red tape. It seems the business is controlling you and once again you have a boss, albeit it in the form of your customers, staff, accountants and the Government. The challenge of creation has also gone. No doubt life is frantic and you have a demanding schedule. You don't have the time to take as many holidays as you might like and the family are a bit fed up with the long hours which makes your relationships rather strained. They cannot understand why you can't stop thinking about the business and just enjoy life a bit more.

With the long hours and responsibility for others naturally you don't have time to do the other things you'd like to do. You would like more time with your friends or on the golf course. You want to travel for six months. Perhaps you did get that holiday but then because your self-esteem comes from being responsible for people, you didn't really enjoy the second week because you felt guilty about being away from the business. Also you like to control, so you worried that others were not up to the job whilst you were away.

Of course one answer would be to bring in a management team, but that would contradict one of the principal reasons for going it alone and starting a business. Didn't you say when you started that you wanted control of your destiny and to be beholden to no one? Besides you can't delegate. No one does it as well as you do or cares as much...

Letting go

The other option is selling. Shocking isn't it? Many entrepreneurs find the prospect of selling a business very frightening. They are often aware they should explore an exit for the reasons we set out above or maybe because of health, succession or age issues however they can't let go. Why?

There is never one sole reason, however our experience leads us to the conclusion that virtually all owner managers fail to obtain objectivity and clarity over the decision. This is primarily for emotional reasons but is also due to the mass of conflicting advice and information available. We have listed below the main reasons people fail to achieve objectivity over the decision to sell and offer some advice on each.

- Fear of losing the self-esteem, power, respect and control that an owner derives from a business.
Remember that self-esteem comes from internal thoughts. Switch your link to: 'I am even more successful because I chose to get out at the right time.'. Remember control is an illusion.
- Fear of change. What next? Will I enjoy it as much?
Take time to list all the things you could do and start working towards them. Have you always wanted to learn to sail, start another venture, build a house, read more? Many others lead very different lives to you, it's simply getting used to it.
- In the comfort zone
The order and structure the business can give your life is also a tie that can control you. Embrace the challenge, wisdom and experience that change can bring. It will be different but different is often good. Change can reinvigorate.
- Desire for too high a price, mainly driven by drive for financial security.
When is enough enough? Do you really need a big house and new car every year? Does it make you happy? Or is it fear that is driving you to always have more than enough?
- People hearing what they want to hear or wishful thinking.
Don't lie to yourself or believe your own legend. Do a pros and cons list and be real. Tell it how it is. Do you work too many hours?. What do you like and hate?

- Poor self-awareness as a result of workload creating a lack of time or stress.
Take time out in a retreat (no distractions) for reflection. Selling is a life changer. Get it right.
- Conflicting advice from advisors.
Research for the right expert with a track record, experience, expertise and knowledge of the market then rely on them. Listen to everybody but form your own judgments. They can't all be right. Remember too many cooks spoil the broth.

Selling will always boil down to two basic questions which should be asked

- Can I fill my time and live life **more** fruitfully?
- Is it a fair price?

A sale exit is a gateway and mechanism to achieve the next adventure in your life, it is a beginning not an end

At what price and when?

What price are you going to get for your creation? Many professionals will say a business is worth what someone will pay for it. This is true, but it is also worth what someone will sell it for. A business may be worth more to the seller than to the buyer. Most valuations are carried out assuming a sale has been decided upon and that there is a reason to sell. In other words assuming there is a willing seller. However our experience is that the motivations and willingness of sellers vary and this does have a bearing on the value to them. For many sellers, their business is often their largest asset and only income source.

Net Proceeds

As a seller prior to accepting a deal it is vital to consider in detail your objectives. It is important with your own strategic, and if you are an owner manager, personal, financial, and lifestyle position in mind, to have a clear bottom line. Your bottom line is where it is worth selling versus keeping the business. This bottom line should be based on the net proceeds, which is the total sale price less tax and professional costs/fees. In the case of an owner manager the decision to sell might balance the following:

Net proceeds on sale

Post sale financial position.

- Will the mortgage be paid off?
- If so can I live on less?
- What is investment yields
- Am I relocating and is the cost of living cheaper or higher there?
- Will I continue working?
- Have I a pension?

Motivation/strategy for sale

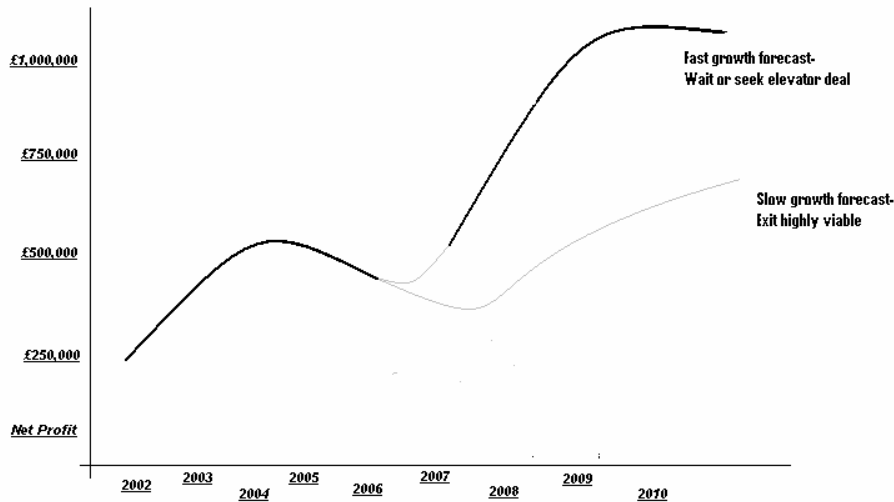
- Is it the right time to sell
- Have I/We had enough?
- Am I retiring?
- What will I do next?
- Am I opting for a different lifestyle?
- How is my health?
- Will I need as much money in my 'after sale' lifestyle?
- What do the family need/want?

Current motivation in business V Risk/decline/increase in business

Small companies usually generate a good investment return. This means there usually needs to be a reason for sale over and above the financial return. Sellers should value their time wealth.

Timing your transaction

Ideally an outright sale will be sought before business has plateau in growth but where fast growth is not envisaged. If fast growth is envisaged seek an elevator deal (see guide deal structures) which working with the buyer will maximise the proceeds over time.



Tax

Tax on any capital gain you make will probably be your biggest cost. The rule here is get professional advice early on to secure the most profitable sale. Currently ‘taper relief’, an Inland Revenue allowance, makes selling an attractive option. Taper relief reduces a chargeable gain according to how long you held the asset before you disposed of it. The relief is given after all other reliefs and allowances. The amount of the reduction depends on how long you held the asset (the qualifying holding period), and whether the asset was a business asset or a non-business asset. Taper relief creates a significant argument for entrepreneurs to make money through capital gain rather than through ongoing profits.

Taper relief on business assets on or after 6th April 2002	
Number of whole years in the qualifying holding period. This is from the date on which you acquired the asset, or 6th April 1998	Gain remaining chargeable
Less than 1 year	100%
1 year	50%
2 or more years	25%

Based on tax rates at the time of writing the above could mean paying tax of 10% or less on any capital gain made, but please refer to your professional tax advisor before making an assumption as taper relief is not always as straightforward as it first seems. In order to protect your sale proceeds for your family in the future it is also sensible to take advice regarding your inheritance tax position.

Costs

Sellers also need to allow for professional costs including a merger and acquisition advisor, a tax advisor, accountant and a lawyer. These costs vary but you get what you pay for. For smaller companies professional costs are usually between 5-10% of the proceeds. Some of the costs will be prior to the sale.

Net proceeds calculation:

	Current Earnings (profit and or salary/benefits)	£
	Divided by no of vendors	
	Equals Earnings per vendor	£
	Less Income tax & National Insurance	
Equals	Net income per head	£
	Price achieved	£
Less	Capital Gains tax less taper relief (10%)?	
	Sale advisors fee (if any)	
	legal and accounting costs	
Equals	Net Proceeds (capital sum)	£

Once you calculate the net proceeds a financial planning exercise needs to be undertaken. For example:

- Will I save on the mortgage? (pay some or all of it off)
- What will the return be on a capital sum invested
- Will I continue working and have other sources of income
- What will my costs be after sale and any changes in lifestyle that may occur.

When to sell

As well as looking at your likely sale proceeds versus your personal situation questions you should be asking when considering a sale are:

- Should I groom the business to maximise the price?
- What grooming is relevant and how should I carry it out?
- Have I the capability/will to carry out grooming and will it affect significantly my value?
- What is the market for my sector today or in the likely near future?
- Who should I talk to for advise?

The Grooming Equation

Current ongoing
business success

Realistic grooming
results



Choosing deal advisors

In building your business, you have undoubtedly made invaluable contacts within the industry. Most probably you have also had numerous occasions to develop your negotiating skills, perhaps even acquiring a company yourself. You would therefore not be surprised to learn that many business owners decide to attempt to sell their businesses by themselves. Yet, as the old saying goes, a doctor who performs surgery on himself has a fool for a patient! Selling a company is a huge task to undertake and despite the DIY route appearing a cheaper alternative, it carries many pitfalls and shortcomings:

- The time and paperwork involved is significant and can have a damaging effect on the very asset you are seeking to maximise - your business
- Lack of experience, contacts and understanding of the market place will hinder your progress and could limit your sale proceeds
- Lack of suitable resources such as effective marketing solutions, data sources and comprehensive, targeted research will mean an inability to create relevant buyers and a competitive environment around your sale

The sale of your business is likely to be one of the most important economic decisions you make. There are many legal, tax, accounting and regulatory issues to address. In addition, there is the matter of finding the appropriate buyer for your business and then negotiating and structuring the most advantageous deal. To help you secure the best deal, you should consider using an experienced professional to guide you through the sale process. In addition, it is vital that you engage the services of an experienced legal and accounting team to assist in these aspects of the transaction.

The Role of a Good Intermediary

An intermediary will act on behalf of a seller and frequently both seller and purchaser will engage their own advisors. The basic role of the seller's intermediary is to search for an appropriate purchaser for a business and then negotiate and structure a deal for the sale. Intermediaries will work with their clients throughout the process, from preparing the initial valuation right through to the close of the sale.

You will always need to stay active and informed throughout the sale process because, in the end, you will make all of the decisions. Although each sale is different, an intermediary will generally handle the following functions:

- Grooming advice (often charged separately to sale service)
- Determine a target sale price and valuation of your business using comparative and financial techniques in order to help you with your financial planning
- Prepare sales documentation, including an information memorandum detailing your business's operations and activities, ensuring no specific information as to the company name, specific location or specific activities are released without confidentiality agreements being in place
- Identify and contact potential acquirers through research and marketing
- Vet and approach prospective purchasers and schedule and attend viewing meetings.
- Keep you informed at every step of activity and of companies that are interested, particularly at information release stages
- Manage information releases to purchasers, including managing confidentiality documentation
- Sell the benefits of an acquisition
- Secure more than one interested party
- Attend and chair viewing and negotiation meetings
- Create a competitive environment with more than one buyer to maximise price
- Negotiate your transaction to the best price and deal structure
- Aim to exceed target price and minimise your tax bill/costs
- Act as the leader throughout the transaction, including preparing written 'heads of terms' and exchanging these between all parties prior to passing over to solicitors for formal contracts to be agreed
- Work with solicitors and all other parties to ensure the sale process follows through to completion

Do I need an intermediary?

Here are a few of the benefits of engaging the services of an intermediary

Experience and expertise	It has probably taken you years to develop the skills necessary to build a successful business. Likewise an intermediary has spent a great deal of time developing an understanding of the processes involved in selling a business with a substantial understanding of current market trends. This enables them to accurately price your company, handle the technical aspects of the sale and avoid pitfalls.
Objectivity and advice	Business owners often have large emotional stakes in their businesses which hinder their objectivity in both valuing their business and negotiating a sale transaction. It is sometimes difficult for the owner to separate himself from his emotions in selling the business. A good advisor will bring objective best advice to the owner throughout.
Business Intelligence	You may believe that you already know a likely purchaser for your business. Surprisingly much higher values come from buyers outside your specific industry. An intermediary can provide you with exposure to a much broader range of potential purchasers including larger and small business, personal investors and investor groups. A professional will have contacts with different types of buyer and can get your information through to decision makers of such companies. They will also employ key research methodologies and resources well beyond the access of most companies. One of the keys to securing the best price is good Business Intelligence.
Confidentiality	Most owners contemplating the sale of their business want to be certain that the matter is handled as discreetly and confidentially as possible because a leak to staff, customers or suppliers could cause significant disruption. An intermediary would initiate and maintain all contact with potential purchasers and ensure that prior to releasing specific information about your business all potential purchasers complete a confidentiality undertaking. By orchestrating and controlling a sale from a remote site they will insulate you from any direct exposure until the correct time. Through the screening of all potential purchasers and the use of non-disclosure agreements they are able to maintain confidentiality throughout the sale process.
Negotiation	An intermediary will act on your behalf to ensure that the best possible deal is agreed between a potential purchaser and yourself for the sale of your business. They will negotiate the best terms but also structure the transaction to meet your personal and financial needs. As a third party has no legal authority to commit on your behalf, they are able to give assurance that all information will be passed on to you. This also allows you to preserve your flexibility and gives you the 'upper hand' in negotiations.
Buffer	Because buyers and sellers often work together in some form of handover period after any acquisition, it is important to develop and maintain a positive relationship throughout the sale process. Yet this is often difficult to do when two people are negotiating for themselves. An intermediary will act as a buffer between the two parties allowing negotiation to take place whilst avoiding direct confrontation. If negotiations reach a seemingly difficult and irresolvable point, an intermediary can suggest alternative solutions to keep the process going. The presence of a third party can lessen tensions between you and any potential purchaser.
Time savings	The sale of a business can be a very time-consuming process. An intermediary's role is to relieve you of most of the burdens and pressures associated with the sale of your business.

Picking the Team

Lining up a synergistic team of experts from the outset will certainly save you time, stress and perhaps more surprisingly in the long term: money! This team will include, in addition to an intermediary, a lawyer and a tax accountant. When making your selections, ask other business contacts for their recommendations - much as you might when selecting a trades person for example. Research web sites and seek references on the credentials, experience and track record of the advisors concerned.

Remember the cheapest is not necessarily the best, and whilst you might feel significant loyalty to the family lawyer/accountant, ask yourself if they are really the right people for this particular job. The answer is likely to be 'no'. As with many other professions, beneath a broad umbrella sit many different areas of specialism. If you have a back problem, chances are when picking a doctor you will select an osteopath over a cardiologist!

Choosing Your Intermediary

There is an upward trend in the number of SME businesses selling each year. At present the number stands at approximately 4,300 deals per annum. As might be expected, this growth has been mirrored by a growth in the number of companies servicing the SME owner, most notably mergers and acquisitions intermediaries which doesn't make the job of picking the right one any easier. Broadly speaking sale intermediaries fall into four categories:

1. Corporate Finance	Regulated advisors who provide equity and financial investment advice in the value of money, investment, forecasting and deal making. There are a number of PLCs, merchant banks and boutiques who offer this level of service as well as major accounting firms. Firms with this level of financial expertise handle highly complex deals which are typically of sizeable value. For this reason they usually limit the sale value they handle and their fees are reflective of their market. Due to the size of their businesses, SME owners are more likely to select from the categories below:
2. Mergers & Acquisitions Brokers	Act predominantly as introducers and consultants in the sale of (or sale of the controlling interest in) SME businesses. An example of this type of broker is the Avondale. A number of companies sit in this category and the range and level of service differs quite significantly making it particularly important to research them carefully.
3. Business Transfer Agents	Agents who sell businesses which are typically retail or property orientated. These tend to offer an 'estate agency' type service and may not be suitable for businesses which require specialised marketing and consultancy services. These companies are regulated by the National Association of Estate Agents.
4. Listing Services	Publishers both in virtual and paper form of 'businesses for sale' listings, usually direct to the consumer.

There is a confusing array of companies who offer services which facilitate the sale of businesses. If there is no urgency about your sale and you are merely testing the market place, you may wish to employ the services of a category four agency. If you want to handle the more complex aspects of your business sale yourself, you might opt for a category three type company. Unless your business is retail based, the chances are you will be seeking to select from companies in category two. The real key is to understand your own requirements and compare those against the types of services being offered.

As a general rule you get what you pay for although we will look at how intermediaries charge later. It is not essential for a broker to specialise in your particular trade. The key is that they have the skills and knowledge in business transactions within the SME market. As for size of business, you should be able to tell from the intermediaries existing portfolio the types of businesses they usually handle. If you are a larger business international research is relevant. Typically Avondale completes c 10% of its transactions to international buyers.

Choosing an intermediary Checklist:

Before talking to your short-list of intermediaries, do a bit of research on them individually. Be cautious of companies who appear keen to meet with you without having understood your financial model in a little more detail. A good intermediary will usually request full management accounts in preparation for a meeting which indicates that they are giving careful consideration to not only whether your business is suitable for them but also about their own suitability for the project. Following the initial phone calls arrange to meet with two or three intermediaries once you have agreed on project feasibility with them. During the meeting, make sure time is allotted for you to ask them questions about how they work. Ask questions to establish the following:

Item	Notes	√
Do they inspire trust and confidence? How well do they listen to your needs?		
Are they a specialist in transactional work and passionate about your project?		
Are they a proven advisor with a track record?		
Have they asked relevant questions and demonstrated that they have an understanding of your business?		
Are they highly contactable?		
Do they have expertise and experience?		
Do they have a focus on maximising deal value?		
Do I like the team (you will spend a lot of time with them!)		
Have they a strong website and brand?		
Do they understand the range and complexity of deal structures?		
Do they offer a complete, personal start to finish service (not just introducer/finders but advisors who will structure and manage the deal for you)?		
How do they handle the confidentiality process to protect your goodwill?		
Do they have national (and if you are big enough international) resources?		
What steps do they take to market your business?		
What 'proactive' steps do they take over and above advertising?		
Do they have a strong research and marketing focus to find the right buyers?		
Will they define and create a clear and detailed project plan for you?		
Do they offer practical, objective and realistic advice?		
Will they seek strategic buyers and create a competitive environment?		
Do they have a straightforward, keep it simple approach?		
What is their case load like? Low and high numbers should give equal cause for concern. An average of 5-6 transactions per year is normal and manageable		
Can they recommend other professional services?		
Do they offer a cost effective (not cheap) results driven service?		
What references can they offer?		
Are their fees structured mainly on success?		

Intermediary fees

Fees will vary depending on the advisor (and % depending on the currency) but as a rule of thumb you get what you pay for. A good advisor will have a flexible approach to fees to meet your needs, however they will also want to ensure that there is strong incentive for them to deliver the result you want profitably. This can mean that cheaper firms will not be dedicating the resources or service levels to deliver the maximum sale for you. Most firms will charge the majority of their fees on a success commission basis usually a percentage of the sale price achieved payable on completion, a few will work on a time billed basis only.

Nearly all the quality firms will charge some form of initial fee at the time of your instruction to sell. This fee should be reasonable, maintaining the majority of the sale fee on success to ensure their motivation is driven by your needs. This initial fee will provide them the confidence of your serious intent to sell, enabling the advisor to spend the significant amount of time and provide the dedicated resources that selling for maximum value requires. Selling is neither a short nor easy job and requires professional, expert, intelligent, and capable people to be done right.

The success fee can be structured in a number of ways. It can be a flat percentage of the sale price, or a scaled percentage rising or declining. Sellers keen to provide incentives to the Broker to exceed initial forecast valuations and secure top dollar usually negotiate a rising scale, although this will need to be balanced by the advisors base costs which they will need to cover to ensure getting involved in the transaction is profitable for them.

When negotiating fees, remember there is a careful balance to maintain and whilst you want to ensure you are not paying above the market rate equally, low fees may not be synonymous with quality. Pick an intermediary for their knowledge of the market, research skills, database, buyers, marketing and negotiating skills in completing a deal. The fee they charge you will be offset by the higher price and the deal terms they obtain.

Selecting Your Legal and Financial Teams

As with choice of intermediary, it is vital that you select legal and financial teams who understand your needs and who have the expertise and track record to deliver. Seek to appoint firms who specialise in transactional work, understand your needs and who have the experience, resources and vitally the passion to complete the process.

Do not dither when making decisions about appointing advisors. The earlier on in the process you do this, the better for all parties. If you have already appointed your M&A intermediary, ask them for recommendations and pointers also.

Working with your intermediary, chose legal and tax advisors who:

- Specialise in those aspects (legal or tax) of buying and selling companies
- Offer competitive yet effective services and fees
- Are able to commit an experienced partner with the time and resources to lead the deal

It can be extremely helpful to build a team with an established relationship between them i.e. an intermediary, lawyer and tax accountant who have worked with one another previously and who trust and understand each other. This aids punctuality, communication, and saves many headaches.

The Avondale formula

More Leadership

Having been 1st to the market, we recognise the importance of leadership. This means you can be assured we will lead your deal from the front, from start to finish, placing you first.

Realising the Best Deal

Significant investment in databases and systems ensure we have the market knowledge and processes to drive the best deal for you.

More Track Record

Avondale are a market leader in commercial SME deals. More deals gives you the comfort you have more knowledge and more experience working for you, saving you time.

More Teamwork

Teamwork utilises different strengths to ensure results. As a National specialist, we place our full resources at your disposal, delivering the result you want.

More Exclusive

Avondale are selective about the projects we undertake and place quality at a premium. This means working with us you can be assured of the best chance of success.

More Success (70% Ratio)

Avondale complete the lion's share of the projects we undertake. In 2005, 82 sale mandates and 55 deals completed.

More Listening

Our philosophy is people first. This means you can be assured we take the time and care to listen to you and deliver your needs. No judgement, no territory.

First

Avondale were first to specialise in the SME commercial market, offering a national corporate service. Recognising the importance of being first guarantees we put **you** first.

Realise Your Dream

Avondale recognise it's about delivering your personal vision as well as the deal. This means we support your human issues and your business metrics.

More Reliable

Most of our business comes from referral, so we understand the importance of getting it right. You can be assured we do what we say and tell it how it is.

Tax

The Capital Gains Regime is changing dramatically in April 2008. At the time of writing the full details are not known (Feb 08) and therefore we have left any references to the previous regime in these guides pending further edits when all the details are known,

New Regime (post April 2008): Tax considerations when selling a company are complex but need to be understood as they have a huge bearing on the sale and the amount of cash you will either pay or come away with. Ideally planning should take place before signing heads of agreement. There are various ways in which tax charges can be mitigated, or even eliminated. Here are some examples of the things that vendors might need to look at:-

- Be clear about what you are selling.
- Check your entitlement to Entrepreneur's relief which reduces the 18% Capital Gains Tax to 10% on the first £1 million capital gain.

To contact a specialist tax adviser please contact your local Avondale office.

Contacts

Birmingham

+44 (0)121 446 5151

Bristol

+44 (0)117 905 5007

Cambridge

+44 (0)1223 370 068

Chester

+44 (0)1244 893 159

Glasgow

+44 (0)141 427 7821

Leeds

+44 (0)113 242 5712

Oxford

+44 (0)1235 771 444

Reigate (HO)

+44 (0)1737 240 888

Southampton

+44 (0)2380 302 014

Watford

+44 (0)1923 431 650