Coutts

A special kind of exit

WHAT REALLY HAPPENS IN A MANAGEMENT BUYOUT
AND WHY EVERY ENTREPRENEUR SHOULD CONSIDER ONE

INTRODUCTION BY DYLAN WILLIAMS

It's a Friday afternoon there's one last thing to do before the weekend: a short meeting you've been invited to by a senior manager. What happens over the next thirty minutes is unexpected and exciting. Choosing her words carefully your colleague says she knows you're planning to exit the business. She asks you to consider an offer from the management team.

Let's assume the timing is right. How do you respond to this exploratory proposal from inside the company? Do you welcome and perhaps even relish the prospect of passing on the business to people you know and trust? Or do you consider the offer to be a complicating factor – a situation that needs to be handled with care as you work towards your preferred goal of trade sale? One thing's certain, you're going to have a lot to think about over the weekend.

Variations on this scene are played out all the time in offices across the UK. Sometimes the management will make the first approach. In other cases the owner will sound out interest amongst key managers. Alternatively, the proposal may be driven by a third party adviser.

The common factor is that once an MBO becomes a topic for serious consideration, two big questions have to be answered. First, is a sale to management the best possible outcome for the entrepreneur? And then there's the issue of how to proceed with the current management and the sensitivities that a deal might bring - whether it goes ahead or not.

The MBO represents a truly different type of exit for an entrepreneur and this report - through its insight from those who have been through the process before - will give you unique insight into the risks and opportunities that accompany the deal.

Dylan Williams | *Managing Director, Coutts*

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EXECUTIVE SUMMARY

A management buyout (MBO) can be a very effective means to sell a business and yet it is an exit which only a minority of entrepreneurs – just 19% – are prepared to consider.

There is no doubt that an MBO is a sensitive process which requires a delicate balance between hard-headed commerciality and pragmatism. This comes out clearly from the experiences of the entrepreneurs we spoke to for this report.

They also told us that this is no different from any other deal. Each route has a complexity of its own and when it comes to exit through MBO there are a raft of benefits which come with selling to management which are harder to come by through any other exit route.

Drawing on the experience of individuals planning an exit or who have exited already through an MBO this research makes a compelling case for every entrepreneur to consider the MBO as part of their exit planning and delivers unique insight into the practicalities of this exit route.

The key themes in the report around exit through MBO include:

- **An MBO should be considered as part of any exit plan:** Many entrepreneurs may not plan an MBO but 55% of entrepreneurs who had sold a business through an MBO said that they chose the route because it offers the best deal or it was the only way they could exit their business
- **MBOs deliver high deal satisfaction:** The MBO option is a first choice option for relatively few entrepreneurs who have yet to undertake a sale to management. However, a big majority of those who have sold out via an MBO are very satisfied with the outcome
- **Preparation is key:** Given that raising finance and having a sufficiently strong management team in place to take the business on are pre-requisites for an MBO, preparing for the deal and creating the right environment for the deal to take place are critical success factors but ones which are frequently overlooked
- **It's a different type of deal:** Negotiations towards an MBO are very different from those surrounding a trade sale. Maintaining trust between the vendor and the management bidders is vital - particularly where Private Equity backers are involved who will typically do most of the negotiating as needed, to keep the business on track
- **MBOs may deliver less money but more long term value:** An MBO can offer the vendor the best available deal but that doesn't always mean the best price. It can offer a very attractive deal structure and, an important factor for many, an opportunity to keep continuity in the business, preserve the entrepreneur's legacy or simply take money out of the business over a longer term

The defining issue around the MBO is how the owner manager approaches the personal nature of the deal and the changing dynamic between the purchasing management team and the business as the deal progresses.

This report provides insight into this critical area of the MBO which will help any entrepreneur planning an exit make the right decisions at the right time both before and during the deal.

Only 19% put a sale to management at the top of their list with 55% favouring a trade sale.

| 01 | THE MBO JOURNEY: WEIGHING THE OPTIONS

Many entrepreneurs rule out an MBO altogether. Our research found this closes down a highly attractive route for business exit.

The sale of a business is a once in a lifetime opportunity to acquire real wealth after years of hard work and usually the priority for the entrepreneur is to secure the best deal possible from a credible buyer.

The list of potential buyers may include a competitor, a new management team or a private equity house. And while taking a business public isn't usually considered an 'exit' route in the true sense, the entrepreneur may also be tempted by the cash realisation possibilities of an IPO.

However, our research shows that in around 15% of exits the potential acquirer will sit much closer to home in the form of the existing management team, backed by finance from a bank or private equity.

There are some good and compelling reasons for at least considering selling to an incumbent management team. After all, they know the business, they've helped make it what it is and they will be intimately familiar with the market and your customers.

If you have a capable group of managers in place, in many respects they will be ideally placed to take the company forward.

But entrepreneurs do not see it that way when it comes to selling up: Only 19% put a sale to management at the top of their list with 55% favouring a trade sale.

With some 27% of entrepreneurs telling us they were only prepared to consider an MBO as a last resort, it is clear that there is an ingrained element of antipathy towards this exit route among many owner managers.

Our entrepreneurs reported this antipathy stems from two concerns. The first, according to Andy Currie of Catalyst Corporate Finance, who advises managers on buyout opportunities, is around the ability to maximise the price in the exit. "If the vendor is looking for the maximum price, he or she is more likely to sell to a strategic buyer. In nine out of ten cases, a trade buyer will pay more because of the synergies the acquisition can offer," he says.

The second concern comes from the risks attached to entering into discussions with people they have worked with and know well.

Dan Wright has been involved first hand with a number of MBOs in the furnishing sector. "There is a fear - a perceived risk - that once you begin talking about a management buyout the relationship between the owner and the managers, changes" he says.

And while that's not necessarily a bad thing in itself, any souring of the relationship if the negotiations go badly could damage the business and its prospects if managers become disillusioned.

As well as revealing this rump of 'MBO-sceptics' our research also showed that the significant majority of entrepreneurs are able to see beyond the negatives and understand some of the upsides an MBO will offer.

When entrepreneurs were asked if they would consider an MBO if the right terms and conditions were in place the number prepared to go down that route rises from 18% to 27%. A further 30% said they would be motivated to support an MBO if it maintained continuity in the business.

Significantly for 'MBO-sceptics', when we asked a group of entrepreneurs who had completed one or more MBO about the deal, the overwhelming majority (85%) said both vendor and buyer were satisfied with the deal.

Interestingly, it also emerges that the number of owner managers prepared to consider an MBO is in itself on the rise from just 6% according to our original research on business exits in 2008 to the current 18% in 2011 – a threefold rise.

Taking these findings together, there are important implications for an entrepreneur weighing their options around a business exit.

First of all, it is clear, that entrepreneurs should leave aside perceptions around the MBO being a more difficult deal to execute. All deals have their difficulties, the MBO merely presents a different set of challenges.

Secondly, any entrepreneur planning an exit should actively consider the possibility of an MBO. Leaving aside the fact that it may be the only option, it could be the best option for a successful exit, particularly in these volatile times.

And finally, if you commit to an MBO you are highly likely to be happy with the deal that emerges at the end of it.

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INSIDER INSIGHT- WEIGHING YOUR OPTIONS

Mike Smith is currently a non-exec director and has experience of MBOs in the industrial pipeline industry. He shares his views on MBOs versus other methods that could be considered for the sale of a business.

"Alternatives to the MBO don't necessarily offer better value. For instance, in the case of a trade sale, the chances are that it will be a consolidation and if that's the case the potential buyer will know the market and your businesses very well indeed. In these circumstances, buyers are often prepared to negotiate very hard and you may not achieve the price you expected.

IPOs (initial public offerings) are really only open to businesses of a certain size. And if you are weighing the possibility of an IPO, one thing you have to consider is that you're going to need a lot of help.

So you may find that selling to your managers offers the most attractive deal but you have to be aware that it's not necessarily an easy option. If the deal is to succeed, the management team will have to raise money and undertake a massive amount of strategic planning and that won't happen overnight. So as an owner you have to suss out the management and establish whether they will be in a position to close the deal."

In our panel of entrepreneurs only a slim majority – 54.4% – thought that they should initiate the MBO process as opposed to management.

| 02 | STARTING THE CONVERSATION

The first hurdle and most sensitive stage of an MBO is getting the possibility of a deal on the table between owner and management team. The success of that conversation is about timing and preparation on both sides.

There is no doubt that the issue that most entrepreneurs find most difficult about the MBO is how to broach the potential for a deal.

Before anything happens, someone has to place the MBO option firmly and squarely on the table. In our panel of entrepreneurs only a slim majority - 54.4% - thought that they should initiate the MBO process as opposed to management.

Those who have been involved in an MBO agree there is no golden rule and the approach can come from either side. “The starting point for any buyout is the point at which the managers realise there is an opportunity,” says Andy Currie. “That may be because the owner manager has raised the issue or because members of the management team decide that the time is right to make an offer.”

Either way, the choreography that surrounds that initial approach is nearly always delicate.

Some in our panel of entrepreneurs who had been through an MBO are resolute that it was not for the owner manager to make the running and suggest a deal to the management team. The reasoning goes that a hallmark of a good entrepreneurial management team who can see through an MBO is one who can spot the opportunity and present a compelling case for the deal to the owner manager in the first instance.

Mike Norris has owned a number of small businesses and is currently the Manchester Facilitator for the Alternative Board, an organisation that provides peer-to-peer board-level advisory services. He says in his experience “It has now become much more acceptable for management to make the first move.”

But as Dan Wright observes, managers – no matter how ambitious - may be equally reluctant. “They are often wary of opening a dialogue that could be seen as them trying to get ahead of themselves.”

There is a third scenario. The approach may come from a private equity house or advisory firm that has identified that a business is ripe for a management buyout.

INSIDER INSIGHT- STARTING THE DIALOGUE

Andy Currie is managing partner at Catalyst Corporate Finance where he advises on MBOs, fund raising and company acquisitions. In MBO situations, Catalyst usually advises the management team.

"There is a point in time when the management realises that there is an opportunity to work towards a buy out. There are a number of ways you can get to this point. The owner may broach the subject or the management may decide it would like to make an offer for the company and make the first approach. Alternatively, the initial proposal may come from a third party.

For instance, at Catalyst, our business team will identify and target businesses where there is a likelihood of a buy out opportunity arising. It may be that a business owner will go public with his intention to sell. We will organise a meeting and propose the MBO option. It's really a case of saying: 'You want to sell so why don't you consider selling to the management.'

During these early discussions you can begin to assess whether an MBO offer is likely to succeed. If the intention of the owner is to maximise the price it is more likely that he or she will opt to sell to a strategic buyer. If on the other hand, one of the main considerations is selling to a good team then there is an opportunity for an MBO."

While 70% of entrepreneurs see an early discussion of an MBO as important to deal success only 22% have discussed it with managers.

Where there is unanimity is that as soon as the MBO option is put on the table, it is a game changer for all parties and not without its risks.

Regardless of who makes an approach, the future of the company depends on the management team being on-side and, by extension, on a good relationship between the owner and the senior people. If the subject is broached by one party and the other party says 'no' there are immediately questions over the future of that relationship. At the very least, feathers will be ruffled.

However, an initial rejection should not be the end of the matter. Citing his experience in a buyout from the management side, Stephen McKuhen owner of Smith and Bateson, says a flat rejection may be followed by more positive responses once the owners have considered their options.

"When I knocked on the chairman's door I had everything in place – lawyers, finance and advisers," he says. "The chairman said no and I thought I had lost the plot. Six weeks later he came back and said yes."

So what does this mean for the entrepreneur planning to sell a business?

First, that it is important to remain open minded about an approach from management about the sale of the business.

Second, if a business exit is on the horizon it's worth creating an environment for the approach to be made. Starting to flag your intentions around a planned exit from the business early on.

Although entrepreneurs appear to understand the importance of this early discussion – 70% of the entrepreneurs we spoke to, pre-exit, saw it as a critical success factor – few progressed the issue with only 22% having discussed it with managers.

Given the critical role that the availability of finance plays in the MBO and the time it can take for the management team to raise the finance it is clear that there is an opportunity for entrepreneurs to make sure they do more to get a viable MBO in the frame as an exit route for the business.

Nearly every entrepreneur we spoke to who had been through an MBO rated the issue of finance as critical to the success of the deal: 37% say it is important that managers can put up money at the start of the process and 55% say the finance should at least be in place before the discussions begin.

| 03 | FINANCING AN MBO

For an MBO to have the best chance of succeeding both entrepreneur and management need to have realistic ideas about where the money will come from and when.

Once the possibility of an MBO is out in the open, the key question for both sides to answer is whether or not the deal is viable. The prerequisite for any MBO is availability of finance.

Nearly every entrepreneur we spoke to, who had been through an MBO, rated the issue of finance as critical to the success of the deal: 37% say it is important that managers can put up money at the start of the process and 55% say the finance should at least be in place before the discussions begin.

Of the entrepreneurs we spoke to amongst those who were planning an exit, the issue was also very much to the fore with 87% of respondents citing management's ability to raise finance as critical to the success of any deal.

As very few buyouts are funded from the resources of the managers themselves, serious negotiations can only begin once the prospective buyers have the backing of either a bank or – most likely in the case of medium sized companies - a private equity house.

By definition this requires a degree of pre-planning. "If an MBO is to work the funds need to be in place," says Mike Norris. "Getting funding can take a long time and in many cases the search can be fruitless so it's something that managers really have to address as early as possible."

Mike Smith agrees. "You need to go out and raise the money," he says. "That requires a plan with detailed financials and it won't happen overnight." And here again the challenge arising from the unique choreography of the MBO becomes apparent.

Until they raise the topic with the owner, the management team won't know if a deal is possible. Once the subject has been raised, the first thing the owner will want to know is whether the buyout offer is underpinned by sufficient financial backing. This particular variation on the Catch 22 theme can be a problem but it shouldn't be insurmountable.

Norris says managers should be able to put a case for funding to the appropriate financier before any formal negotiations have begun. "You can get the backing in principle from a PE House without necessarily getting terms. Private Equity investors should be able to give you an indication of whether they are prepared to help."

What we can take away from this is that for the management team to be credible in any approach for the business they need to have done the groundwork before raising the prospect of the deal.

For the entrepreneur planning an MBO as an exit route it means the complexities and availability of finance for the management team need to be factored into both the timeline of the deal and the structure of the deal itself.

| 04 | THE ANATOMY OF THE DEAL

When it comes to getting a deal to completion, understanding what to leave to the professionals and drawing on the experience of those who have been there before are critical success factors.

78% of our post-MBO respondents sought advice from people outside the management team before going ahead with the sale and 58% said the advice received was critical to the success of the deal.

The importance of planning

One of the most striking themes which came through from the panel of entrepreneurs we spoke to was the level of planning for an MBO in their businesses.

On the owner side of the equation planning for a potential MBO was at best limited and at worst non-existent.

Even though 24% of pre-MBO respondents said sale to management was the preferred mode of sale and with 27% taking the view that it was the best way for the business to grow post exit, none of the businesses we questioned had any plans in place to move forward with a buyout option when the time came. And while 42% said they knew what do, less than a quarter (22%) had ever sought advice on the topic.

Those planning an MBO can learn from the experience of entrepreneurs who have completed a deal: 78% of our post-MBO respondents sought advice from people outside the management team before going ahead with the sale and 58% said the advice received was critical to the success of the deal.

If you accept the premise that the MBO should be at least considered as part of the wider exit preparation process then the lack of planning on this front suggests that many businesses are likely to be ill-prepared if a sale to management turns out to be the best option.

Managing the deal

Despite the relative shortage of formal planning, pre-MBO owners had clearly given some thought to the issues associated with management sales.

Maintaining value was - understandably – at the forefront of their thinking, with 80% citing any attempt by managers to reduce the price as a key deal breaker. Deadlines were also an important consideration for some, with 44% citing slippage in the timetable as an important negative factor. Just under a third of respondents said they would be concerned if there were no competing bids as this would make it difficult to assess whether they were getting the best available deal.

Of these, the most fundamental issue for an owner manager to consider is the extent that they want to bring competition into the MBO deal. And here, those who have been through the process are divided on what is the best approach.

On one side there are those who believe that the MBO should be a single track process.

Catalyst's Andy Currie says MBOs are a very different beast from the trade sale and it may not be possible to keep MBO negotiations on track while simultaneously inviting bids from trade buyers.

He advises managers on buyouts and from that perspective he argues that once an owner decides to bring in alternative bids he is signalling that

INSIDER INSIGHT - MANAGING THE DEAL – CRITICAL SUCCESS FACTORS

A qualified accountant, Mike Norris has owned a number of small businesses and is currently the Manchester Facilitator for the Alternative Board, an organisation that provides peer-to-peer board-level advisory services.

"The key to a successful MBO is having the right management team. You have to ask not only if they are capable of running the business but also if they would be suited to the challenge of owning a company. Another key question is whether they will be acceptable to PE owners. If the PE House feels there is a gap in the management team it doesn't necessarily mean that the deal won't happen. What you can do is take the BIMBO (Buy in Management buyout) route and bring someone in from the outside.

Pre-planning is very important. And that means taking a decision sooner rather than later to become less owner-centric and thus put people in place who can run the business.

Very few deals are self-financed so once negotiations begin what tends to happen is that the vendor is negotiating with a Private Equity backer rather than the management team itself. This can be a good thing because what you often see is that the management and the vendor work together to present a deal to the Private Equity house.

The vendor should be prepared to negotiate on structure. Very often the buyer will say I won't give you all the money on day one. Many owners like this as it means they can remain invested in the business."

the goal is to secure the highest price and the MBO is unlikely to succeed against that backdrop. "So if I'm advising managers and the owner brings in 20 other bidders, it would be a waste of my time to continue."

In Currie's experience, the price for an MBO tends to be agreed up front - usually after a meeting between the owner, the managers advisers and backers. It is subject to very little negotiation after that point. The managers themselves play a very small part in these negotiations so the likelihood of a downward chipping at the agreed price is unlikely, unless something emerges at, or during the due diligence process.

The alternative view from those who have sold businesses before is equally strident: the MBO should always exist in a competitive vacuum. "The management team shouldn't be the only bid in town," says Dan Wright.

Mike Smith echoes this point and says that an MBO should be treated in the same way as an exit to an external party. "You need to get the business ready for a sale, not just an MBO," he says. "You should be running your business in such a way that you are always in a position for a business sale. It's not an issue of looking for an exit but of good governance."

And as Michael Norris sees it, vendors should always bear in mind the inescapable truth that the MBO may fall through. "You also need to get a seller's memorandum out to other buyers," he says. "You have to assume they will pull out, so you have a need to keep something in the background and keep some competition in there."

What is clear for the entrepreneur planning an exit, is that there is no single right approach and the decision to bring competition into the deal is likely to be defined by the importance of value in the exit, the desire to pass on the business to the management, the availability of other deals at the time and the desired speed of exit.

You need to get the business ready for a sale, not just an MBO, you should be running your business in such a way that you are always in a position for a business sale.

Assessing the management team

If one of the reasons for taking the MBO route is the scope it gives to leave money in the business while also preserving the founder/owner's legacy, then the vendor will want to be assured that the management team is up to the job of taking the business forward.

By definition, an owner/manager should begin paying attention to succession issues as soon as (or better still, well before) a decision is made to groom the business for sale. The classic wisdom is that in order for a business to have value, the owner/founder must begin to make himself less essential while nurturing the management talent that will allow the company to trade successfully post-exit.

But in an MBO situation, the ability of the management is particularly crucial. Private Equity backing will inevitably mean at least some debt in the business. Thus when the MBO team become owners they will be in a situation where the imperative is to grow the business rather than simply keeping it ticking over. Growth is essential not simply to provide the backers with a return but also to generate the revenues required to service debt. "And for the managers to make it work, they must be leaders", says Mike Smith.

While the vendor will certainly take a view on the qualities and capabilities of management before deciding on an MBO, it is important for entrepreneurs to be aware that the final decision is unlikely to be down to them. It is usually made by the bank, the private equity backers or their advisers.

Particularly in the case of private equity, it is they who will decide on the shape of the buyout team before agreeing to put up the cash. Andy Currie describes the process, "It starts with finding the right potential CEO in the management team," he says. "What we're looking for is a CEO who really understands strategy and we take a view very quickly if someone is fit for purpose."

After that, the backers and the advisers will look at the rest of the team and sound out who is fit and willing to be part of the ownership structure. The FD is often a casualty – largely because the decision-making mindset that suits, say, an owner managed business may not adapt well to the different pressures of a private equity backed company.

Any gaps in the management team will have to be filled. And if a suitable candidate isn't available internally the MBO may evolve into that hybrid beast known as BIMBO (Buy in Management Buyout). "What often happens is that in addition to the existing managers we bring in a 'buy in' candidate who can fill the gaps," says Mike Norris.

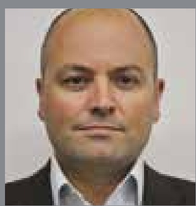
In other words, once the MBO process begins, particularly in the case of larger deals it is the financiers who have a large say in the management team who takes the deal forward – a fact for which any vendor will need to be prepared.

The due diligence process

Due diligence can be more straightforward in a management buyout situation than it would be in a trade sale, simply because the managers and owner have long been party to much of the same information and probably share a common set of assumptions about future prospects.

Nevertheless, Dan Wright says owners shouldn't assume that a close relationship with management will mean that due diligence is nothing more than a formality. "One of the big dangers inherent in a buyout is that the owner will lose trust in the management team," says Dan Wright. "For instance that can happen when the owner doesn't fully understand why there is so much due diligence when the managers are already party to so much information about the company. What has to be made clear is that the due diligence is for the benefit of the private equity backer and not the management team."

INSIDER INSIGHT - RELATIONSHIPS MATTER



Dan Wright is a serial buyer of businesses from managers. He has made 9-10 acquisitions for his soft/hard furnishing distribution business and has also sold via MBOs.

"Once an MBO has been proposed, the relationship between the owner and management changes. Indeed, even before any discussion has taken place, concerns over the impact on the owner/manager relationship can be a stumbling block. Owners can be reluctant to raise the matter because of the perceived risk that the relationship with managers will be damaged if the deal falls through. Equally managers can be concerned about being seen as too pushy.

Assuming discussions do get underway, the biggest risk is that the trust built up between the vendor and the buyout team will be exhausted. On the face of it, the fact that there is already a relationship in place should make things easier as there is likely to be more trust between parties who know and work closely with each other than there would be in the case of a vendor selling to trade a buyer. However, you have to be aware that trust can be broken down by the sale process.

To take an example, an owner may expect the due diligence process to be very fast and straightforward, given that the buyers are familiar with the company. So if the process drags on the owner may begin to feel frustrated. In cases such as this, it is important to know that the due diligence is being carried out on behalf of the PE backers. More widely, all parties should be aware that it's important to be mindful of circumstances that could undermine trust and ultimately the deal itself."

The MBO option won't be for everyone. In some cases, the potential to maximise value – if possible – via a trade sale will outweigh all other considerations.

| 05 | SEALING THE DEAL

An MBO won't always achieve the best price for a business but it gives entrepreneurs the opportunity to apply more control over when and how an exit is achieved.

An MBO isn't necessarily an easy option. From the initial conversation through all the subsequent negotiations, it's a process that fundamentally changes the relationship between the owner/vendor and the managers. There is always a risk that the deal will go wrong and the relationship will sour.

And yet if the process goes ahead according to plan, the outcome is often very positive, with around 30% of post MBO respondents to our survey saying the MBO represents the best form of exit.

This outcome is unlikely to be based on price alone. As we've seen, a desire to see the business continuing as a distinct entity – rather than being dismembered by a trade buyer - certainly colours the thinking of some entrepreneurs, but the advantages stretch beyond legacy.

According to Andy Currie, an MBO tends to offer a clean break for the one time owner. In contrast to a trade sale where the owner is often required to be present during a period of transition – still attached to the business, but stripped of any executive influence - the MBO typically sees the seller packing up and leaving on completion. In that respect, it's an opportunity to move on cleanly. However, as Currie adds: "What you often find is that the owner stays in the business, but as an investor rather than as a manager."

In the short term, this can mean the vendor accepting less. In the longer term it can mean a higher return. "In these cases, the seller is rolling over value, usually until a second exit event that can ultimately result in a better price for the business." says Dan Wright.

The MBO option won't be for everyone. In some cases, the potential to maximise value – if possible – via a trade sale will outweigh all other considerations.

Equally, some owners may feel that the prospect of personal and emotional fault lines emerging from negotiations with close colleagues presents too great a risk for the relationships and the business itself.

However, the positive responses of business owners who have gone through the MBO process suggest that a sale to the management team should at the very least be on the entrepreneur's list of exit options. That in turn will mean factoring the possibility of a buyout into the extensive pre-planning that should form part of any exit timetable.

In the final analysis, the decision on whether to begin the MBO process, will depend on whether the deal can achieve a combination of value, deal structure and continuity for the business and whether that is in line with the entrepreneurs own aspirations and ambitions. If the deal on offer ticks the right boxes, an MBO can provide a satisfying, lucrative and effective exit route.

| 06 | STAYING IN CONTROL – BEING READY TO WALK AWAY

Negotiating with people you know and work with (your existing managers) is no guarantee that an MBO will go through to completion. Both sides in the negotiation should be aware that there is a possibility of failure, even when a price and structure have been broadly agreed.

"You always need to be aware of the seller's remorse," says Michael Norris. "This always happens at some point of the deal when the seller has second thoughts. Those second thoughts can be triggered by just about any aspect of the deal, from concern about the price - particularly if the buyer is seeking to chip it down, through to the structure of the deal. Looking at 'sellers remorse' from the point of view of management."

Norris advises that parties in the negotiation should be prepared to walk away. "As a buyer you need to be clear about what you want," he says. And if you need the seller to stay on for a little while, if he won't do that, you need to be prepared to walk away or push for a lower price.

Owners should be aware that the failure of a management buyout can damage the company. "You need to be aware that when an MBO goes on the table, you are in opposition with the managers of the business," says Nicholas Owen. "That can mean contracts can slip, which impacts on the value of the business."

From the owner's perspective, it is vitally important to ensure that the business continues to operate effectively during negotiations.

| 07 | CONCLUSION

As an adviser on personal wealth for business owners and entrepreneurs, understanding the world of our clients is critical.

The business is often their main asset, preserving and realising its value is at the heart of their personal wealth strategy. As advisers we need to both understand the exit journey and also do what we can to ensure its success, drawing on both our own expertise and the experience of our clients.

With business and personal affairs so often intertwined for business owners, personal planning is as important prior to sale as it is after, whether it be around protection, funding or tax.

This is particularly the case for the MBO which can bring a different set of financial needs to the table pre and post-deal.

We hope you have found this research informative and of use. It is a call to action as it highlights the fact that while the MBO might be perceived as the most complex form of business exit, it can also present the best outcome for the owner-manager in terms of satisfaction and financial value. The power of both good preparation and timely advice from those who have been there before cannot be underestimated.

Methodology

The contents of this report are based on research conducted on behalf of Coutts by Communications Management.

The research consisted of three phases:

- Quantitative research from a randomly selected sample of entrepreneurs consisting of 127 respondents
- Qualitative research from two separate focus group discussions among entrepreneurs who had exited at least one business
- In-depth interviews with six entrepreneurs with direct experience of the exit process based on the findings of the research

The research was completed in August 2011.

To find out more please contact your Wealth Manager or Private Banker.

Calls may be recorded.

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