

# How to maximise the value of your business on exit

A Guest Article by Christopher Jenkins  
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### **Is it a good time to sell your business?**

So, the storm clouds are passing, there is a scent of optimism in the air and you have managed to guide your business through the worst part of the recession. Do you now feel an unbreakable bond with it, or are you just simply itching to get rid of the damn thing?

Whatever might prompt you to consider selling your business, try to resist the impulse to accept the first offer you get, and be wary of the persistent advances of your friendly corporate finance broker. Making a quick and unplanned decision is rarely the right move when it comes to exiting your business.

Timing is one of the key elements here, so let's look briefly at the background. Although there are some new signs of life in the small to mid-market private sector, at the time of writing it is still a buyer's market out there.

More to the point, with savings interest rates that, at the time of writing, were at near or virtually nothing, is it actually worth selling when the cash you receive will yield nothing and is therefore worth very little – other than peace of mind, of course?

### **Will the sale of your company meet your expectations?**

Capital yields far less than you think. So why bother to sell when the net proceeds often do not even pay the mortgage? Try doing this sum:

- Sell for £10 million a business of which you own half.
- Pay tax after Entrepreneurs' Relief at 10%, pay off your mortgage and some personal loans you made to the business, buy yourself the car you always wanted, and you will be left with about £4 million.
- Invest it wisely in the bank at, say, 2%.

After 50% income tax what do you end up with? Just over £3,000 a month – hardly what you might expect. And then try life without your company credit card and your company car!

The fashion nowadays seems to be to "flip" businesses every three to four years. Everyone nowadays seems to scoff at "lifestyle businesses". If a business is not capable of doubling in value, we don't really want to invest in it. But what's wrong with a company that consistently puts out a decent income and one that probably yields ten times what you would get at the bank?

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Before you do decide to sell, just consider whether it would be possible to replace yourself with a trusted manager, incentivised by a nice little Enterprise Management Incentives (EMI) scheme, who will run the business for you.

### How much can you sell your company for?

So, after careful consideration, you have decided that selling is the right option. What is your business worth? The short answer is, almost certainly, less than you think. This is something that a lot of would-be sellers have great difficulty in coming to terms with. As a result, they usually blame their corporate advisers for being too conservative, and are often tempted to go to someone else who promises more.

Resist choosing advisers based on the headline price they quote you. Make sure that they understand your industry and, most importantly, that they have experience in dealing with businesses of your size.

Find the right type of buyer and more than half the job is done. Doing your research well, or better still taking the advice, is the key to everything.

### Options for selling your company

Once you have decided to sell your company, there are a number of alternatives to choose from.

#### 1. Trade sale

First of all, ask yourself whether a trade sale is on the cards. It is quite possible to achieve some spectacular results here, given that a trade buyer will often use a completely different valuation method.

For example, they might ask: "What would it cost me to capture the market share you already have, and what would I pay for the certainty and time advantage of having it all **now**?" Deduct £1 for luck and there is a price that the buyer will willingly pay.

#### 2. Flotation

Should you go for a flotation or not? Well there are three major issues you should confront. Be careful whom you listen to here, and ask yourself whether you are the right sort of person to run a public company. Not everyone is, and you may not be either.

The most important thing is to understand that floating your business is not just a cute way to realise its value. "A" Day is not the day you can retire

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with loads of money in the bank. It is the first day of the rest of your life as CEO of a listed company, and not everyone enjoys that. Find out how many CEOs currently on AIM are glad they are on it and how many would be happy to de-list tomorrow if they could.

At the end of the day, the key to whether AIM would be right for your business, and the only real way to justify the cost, is whether you will be able to use your "paper" to acquire other businesses once you are listed.

### **3. Sale to a venture capitalist**

One of the most well trodden routes to exit is a sale to a venture capitalist (VC). However, before you embark on this option ask yourself how many owners who have been through the experience have a happy tale to tell about a VC. While they are all lovely people, their agenda is not yours and never can be.

So, to maximise the value of your business with a VC as your new bedfellow, you must understand what their agenda is before you decide to accept their money.

### **4. Management buy-outs**

Management buy-outs (MBOs) can be a wonderful way of achieving a price way above market value, and can often be a much safer route to realising the full value of an earn-out based on subsequent performance.

What's so good about them? For a start, you are selling to a team of people whom you know and trust and also to people who understand the business perfectly. Given that the sale price will almost certainly be funded out of future profits, you may have to wait longer for your money. But the great thing is that it's much easier to create exactly the sort of deal you want when you are dealing with people you know and trust.

### **5. Mergers/joint ventures**

Mergers or joint ventures are not necessarily an exit route in themselves, but are very useful as a means to an eventual exit. Sometimes it needs a two-stage process to get to where you need to be. One way of making this a reality is to consider merging (or joining up) with one of your competitors as a means towards an exit.

So, where you can, talk with your competitors! You have a lot in common with them (the same business, the same marketplace) and you can learn a lot just by swapping information. Don't worry too much about giving away trade secrets. Form alliances, make friends, and see what happens next!

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### **Preparation is the key**

Giving yourself time to prepare for a sale is crucial. If you want to maximise the price the buyer will pay, your business will have to scrub up well. Buyers normally insist on looking back over several years, so don't leave your preparations until the final week before completion. It really doesn't do to stay up all night rewriting the books.

One good rule of thumb is to always keep the sale option open in your mind. Preparing for a sale should maximise profits anyway, and this approach also helps avoid the emotional trap of becoming too attached to the business.

### **What buyers will want to know**

Some of the process of grooming has to do with technical presentation and accounting concepts such as consistency and acceptability of accounting treatments, mainly around the recognition and matching of income. So do talk to your accountants/auditors about this one – and listen to what they have to say for a change.

It also has to do with knowing what the buyer wants. The buyer will quite naturally want to kick the tyres before handing over a cheque, so what will they be looking for? It depends.

A trade buyer interested in buying up your market share may be interested only in the quality of your customer contracts. But a buyer who is focused on your earnings will naturally want to look at "the maintainable earnings in his hands" post deal.

Therefore they will want to know whether you have inflated profits by not charging a proper management salary for your involvement, or else what they can add back to profits in terms of – what shall we call them? – the "little extravagances" that you have been used to putting through the books.

The most important thing here is to get some decent advice on what an Information Memorandum (IM) should look like. Don't try to invent your own: it's not worth getting it wrong, given what is at stake.

### **Are you indispensable?**

Make yourself dispensable to your business. If you are so important that it cannot survive without you, then stop being so at once. Remember that all successful businesses are sustainable and scalable, and that businesses that depend on one person are not!

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### Tax strategy for the sale of your company

The main problem is that what suits the seller very rarely suits the buyer, so think about tax and how the deal might be structured very early on in the sale process.

If you are selling out on a valuation based on earnings, make sure you negotiate to be paid out on the net assets as well. Usually this is achieved by agreeing a “dividend strip” whereby the buyer acquires the balance sheet once it has been reduced to nil net worth. The key thing here is to agree that the dividend that strips out the reserves is taken as part of the purchase price and so subject only to capital gains tax rather than income tax.

Think about how to reward the key people in your business on the sale of it, and do so early on. Just handing over a lump of shares or cash the day before you sell can cause problems, as the employee may get taxed at the top rate of income tax. An EMI scheme planned well in advance will often do the trick here.

Lastly, ask yourself whether you really do want to leave the UK and move to Belgium for five years and whether it really is worth the tax you would save. Tax is critical, but do think about the decision with your personal circumstances in mind as well. Don't listen to everything you hear down the pub because it is not that easy and it is not that good! And don't necessarily listen to everything your accountant tells you if that means “letting the tax tail wag the dog”!

### A few “do's and don'ts”

If you are sure you want to sell your company, and that this is the right time for a sale, here are a few final tips.

- **Don't get involved!**

Don't get too emotionally attached to the business. Be dispassionate when considering whether that precious business you have created should be sold off to the highest bidder. The sad facts of life are that there is only one person who will look after you, and that's you!

- **Look after No. 1**

And so look after yourself – distinguish between you and your business, and put your personal interests and those of your family first. That is why it is always worth discussing such an issue as the sale of your business with your wife/husband/better half. Many people don't dare to do so because of the complications it causes: it's so much easier to avoid dealing with your own personal issues at the same time, is it not?

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This is one occasion on which it really is important to mix business with your personal life. Many deals that are done don't look that good on paper but they were done for much more important reasons than trying to screw down the buyer for the best P/E ratio.

- **Always leave something for the buyer**

When asked about the secret of his success, one of Wall Street's greatest investors replied that he had always "bought too late and sold too early". Think about it: your business will not be attractive to a buyer unless they think they can increase its value, so it's not always possible to sell your business for as much it is actually worth.

- **Carry out due diligence on the buyer**

If you start negotiations with a buyer, it is essential to identify other businesses that they may have bought previously. Talk to them and see if the synergy promised did materialise after all. Ask them what their experience of the deal was like.

- **Don't just concentrate on the headline figure**

Be prepared to give away something from the headline sale price in order to get the type of deal you want, the conditions that suit you, and warranties that will not come back and bite you. The Devil is in the detail here, and things can still go wrong after the deal is signed. Remember, it isn't all just about the money!

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**This information was correct to the best of our knowledge and belief at the time it was submitted. It is, however, written as a general guide, and is not intended to apply to specific circumstances. The content should not, therefore, be regarded as constituting legal advice and should not be relied on as such. Accordingly, we recommend that specific professional advice be sought before any action is taken.**

If you would like more information on any of the points covered in this Guest Article, please contact **TCii** on **020 7099 2621**.