

EXITING: THE LEGAL ANGLE

There are myriad issues surrounding the marketing and sale of a business. To ensure the smooth running of the transaction, from conception to completion, it is essential to obtain the right legal advice from the right legal adviser. Corporate UK caught up with some of the leading legal advisers in the UK, specialising in this area.

Succession is often a central concern for exiting owner-managers, but with the right legal advice, vendors can achieve some peace of mind in what is one of the most momentous decisions they are ever likely to make.

Daniel Milnes, head of business, Forbes Solicitors, says his firm's approach to advising vendors is all about accessibility.

He said: "We have four solicitors who specialise in business law, as well as colleagues specialising in property and employment. Together we have extensive knowledge and experience in dealing with the vendors of businesses of all shapes and sizes. At Forbes we also use up-to-date technology in order to enhance our accessibility to clients."

One of the main objectives of a business law team is not to confuse clients and make things unnecessarily complicated by using legal jargon. It is important not to blind clients with science, but instead answer their questions in a way that makes sense to the clients in the context of their business.

Mr. Milnes added: "The business law team at Forbes is friendly and approachable to all clients and, more specifically, they ensure that they fully understand the vendors' businesses and also what their key objectives are in selling the business. This includes what they would like to achieve in the sale process for themselves, their relatives and in many cases employees."

Keith Dempster, partner, Kerman & Co which acts primarily for owner/entrepreneur vendors in the mid-cap market said: "Our expectation is that we will need to assist the vendor's team to prepare for the sale. This vendor's focus is on growing and managing his business up to completion so he will expect his lawyers to take a "hands on" approach to the sale process and drive it to completion. We therefore consider effective deal management as crucial and the way to minimise the vendor's deal costs." Mr. Dempster added: "Kerman's prides itself on understanding its clients' business issues, delivering high service levels and on being approachable, empathetic and pragmatic lawyers."

Mr. Milnes is keen to point out that legal advice is only one factor in the vendor's decision.

He said: "We understand that vendors are more than qualified to make commercial decisions throughout the sale process and that our advice is only one factor in them determining their commercial needs and obtaining their key objectives. We take a pragmatic approach to the drafting and negotiation of documents required to effect the sale of the vendors' business and we ensure that the effect and function of all documents are explained to the vendors and wherever possible we ensure that the documents include within them contractual protection to safeguard the proceeds of sale."

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The Options

Management buyouts have always been a popular route of exit for owner-managed businesses. The option brings with it a sense of 'business as usual' to remaining staff and customers alike. Although it may be harder to find backing for MBOs in the current economic climate it is still a popular choice.

"MBOs are almost invariably debt and/or equity backed. It is nearly always worth an owner-manager thinking in terms of an MBO as an exit option, because it provides the ability to plan the exit with the potential buyers over a longer period and to plan the consideration structure," said Robert Cherry, partner at Morgan Cole.

He added: "The management team needs to be given its head in the business and needs to demonstrate that they can run it profitably, because that is a prerequisite to attracting funding. When sellers come to us they usually know what they want, but we regularly meet with owner-managers to discuss the right time to retire and one of the things we will talk about is whether a management buyout is an option."

Mr Cherry says he has seen quite a number of owner-managed business sales, particularly MBOs and MBIs, put on hold for the time being. He believes this is largely due to the current climate and the difficulty in obtaining the right level of debt to fund the transaction.

He said: "It's not that the management team doesn't agree with the underlying valuation it's just that the funding package to support that valuation is not available, so the options appear to be to structure the consideration over a longer period so that it can be funded out of the business as cash flow or simply delay the process. We are seeing more delaying of exits and a battenning down of the hatches by owner-managers rather than just accepting a lower valuation."

Michael Stace, Partner and Practice Area Leader, Morgan Cole elaborated: "In a way it's an indication of the way the market is given who usually fund these transactions and the credit crunch. In my practice I have two MBOs that are proceeding very slowly because of issues with the bank funding. However, subject to the ability to be able to fund a transaction and the quality of the managers, an MBO is a very good option. Employees, customers and other third parties will tend to see it as business as usual. In the current climate, when this may prove difficult, a trade buyer may be the best option."

Mr Cherry believes there is a better chance of getting a higher valuation from a well funded trade purchaser, because there's no particular indication that trade buyers have lowered their valuations.



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As the largest law firm on the Channel Islands with over 130 lawyers based in Jersey, Guernsey, and London, Carey Olsen is well experienced in providing legal advice on AIM. Our expertise extends to exits, including share sales (both third party and management buy outs) of private companies and takeovers of public companies.

Historically, Jersey has always been attractive to international businesses looking to list on AIM due to its tax neutrality and its similarities with the British legal system, which has been complemented through flexible laws regarding dividend payments, share buybacks and reductions of capital. In relation to listed company acquisitions, Jersey law also offers the same choices as English law, in particular schemes of arrangement and tender offers.

Unfortunately, the credit crunch has had an adverse effect on new AIM listings. Jersey has been an extremely popular jurisdiction for incorporation of holding companies listing onto AIM, but reflecting the effect of the credit crunch world wide, since the beginning of 2008 the volume of new listings on AIM has been down.

Interestingly, Jersey has also been the jurisdiction of choice for incorporation of the new holding company on the various UK to Ireland migrations which have recently been announced, including Shire, UBM, Henderson, Charter and Regus, and so we are experiencing an upsurge of business due to this which to an extent compensates for the fewer AIM listings happening right now.

We are also experiencing work flows related to potential takeovers of existing listed entities, perhaps reflecting buyers seeking acquisitions of lower cost assets and more general consolidation pressures in the market. Recent deals we worked upon included the disposal of Sandpiper's of its Channel Islands pub estate, drinks and tobacco distribution and micro brewery business to LGV, the private equity arm of Legal & General. Sandpiper are ultimately owned by private equity funds Duke Street Capital and Europa Capital. The transaction involved a private auction with the preferred bidder taken through to a final negotiating round. This deal completed in July 2008.

Prior to that, we also acted for Duke Street and Europa when they acquired Sandpiper by public takeover under a City Code governed scheme of arrangement. We assisted with the Channel Islands elements, which were considerable as the target group was the largest private employer in the Channel Islands.



"We act for a lot of corporate serial acquirers and I am not aware that they have changed their valuation criteria. So owner managers who are looking to retire might find it a better bet to try to get a trade auction of the business going, rather than try to achieve an MBO. MBOs can be beneficial to the seller, but in the current climate the lack of funding can make it more difficult," he concluded.

Daniel Milnes of Forbes commented: "Negotiations in MBOs where funding is available can be tricky because of the change to established relationships between owner managers and their employees who now negotiate as equals in the sale process. Where a vendor is staying on as an employee or consultant the change of status can be a big thing to deal with and can require careful production of appropriate contracts. Trade sales, especially to main players in a sector, can produce hard bargaining by a buyer with no emotional involvement in the target and very clear financial objectives."

Vendor Awareness

There are many factors that a vendor needs to be aware of in the lead up to making a sale. The stumbling blocks that lie ahead may make for a lengthy and somewhat irksome and trying time if the proper legal advice is not in place.

Tracey Seath, head of Commercial and Corporate Finance at Birkett Long says she is very conscious of the emotional side of a transaction and understands the work that owner managers have put into building a business.

She said: "For some, the sale of their business is an emotional time and once they have made the decision to sell they want to get the matter completed, but can find it difficult to deal with enquiries, sometimes seeing this as a challenge to their own integrity. Helping them understand the sale process and ensuring it is progressed efficiently usually overcomes this."

"Vendors need to be clear about the value of their business and how that can be enhanced or maintained during due diligence by having everything in apple pie order. If when they are asked to produce information about their business they can do so in an efficient and ordered fashion and that information is current and relevant, it will indicate a well run organisation where the associated risks will be minimised. In the current economic climate, a vendor needs to ensure that it does not give its buyer any room to negotiate on price," she added.

Ben Moorhead, senior partner and co-founder of Moorhead James believes that a legal team needs to thoroughly understand the client's business and structure as a first step to advising on a sale.

He said: "One needs to know what the vendor hopes to achieve and then make sure that they have realistic expectations of the exiting process and what they are likely to achieve. If a vendor says that they are not going to give warranties and indemnities at the very outset, we remind them that this is not the industry-norm, nor is it likely to be sustainable."

He added: "The vendor needs to get the company, its administration and all legals into good order, including the company books. They must consider likely or potential exposure under any warranties. They should also get the files ready for due diligence checks – e.g. contracts with key customers, employment, etc. and ensure that all the share options have been properly dealt with. It is also important to consider tax planning at an early stage, especially if there is a group structure and particularly if there is an individual vendor."

Revision of Values

Vendors are naturally keen to get the best price they can for their business. Many are unaware of the costs incurred through the process, yet need to factor these in to their overall return. The changes brought about to Capital Gains Tax (CGT) in April of this year have had little effect on exit transactions, but the credit crunch is having an effect, as many parties are reluctant to take the final step at the moment.

Julian Goulding, founding partner, Cheyney Goulding believes that face to face interaction is very important in helping vendors understand the sale process.

He said: "We believe, very firmly, that you get more done face to face with the client and the other side, all around a table, discussing matters directly rather than sending e-mails all over the place, though they are very good for sending documentation. We are very keen to see people direct and talk it through; it's the only way to get to know what they really want and what the other side wants too."

He added: "We still seeing quite a lot of activity in the market place, but people are loathe to sign on the dotted line, while purchasers are looking for a bargain. There is money out there and there are deals out there but there seems to be a lack of urgency. A few years ago people would say 'I've got to get this deal done by the end of the month', but now they don't and buyers are being more pushy with what they require from a deal. We've had a couple of vendors walk away because they were not prepared to give in."

Roger Talbot of Pictons sees the credit crunch as a far more pressing concern than the tax regime changes.

He said: "The economic downturn has had a generally depressing effect in most, but not all sectors. It has made buyers more cautious, even those with freely available funds, particularly when freehold property is involved. In the very short term the business sales marketplace will be relatively quiet."

The Immediate Future

With harbingers of doom spreading their tales of woe across the pages of our newspapers and across the screens of our TVs it is indeed refreshing to hear that with the correct legal advice, thorough due diligence and a strategic exit plan, vendors are still considering a sale.

Tim Jobson of ORJ Solicitors thinks the expectations of

a lot of clients are too high when it comes to price.

"If the banks are lending and open for business but change things only slightly it can still make a do-able deal undo-able. If you are a high flying business we are saying don't revise your expectations, but if you're not and your proposed deal is bank funded then buyers are going to be very careful. Even if buyers are talking the right talk they might not be able to come up with the goods because it is all being led by the funders," he said.

Mr Jobson continued: "Buyers are reassessing the multiples they are willing to pay. Right now it's a buyers market because there are bargains to be had and they are concentrating on those. Vendors who are justified in thinking that their business is worth more than that are not getting the buyers and so they are keeping their heads down. Until the banks sort themselves out it will remain very much a buyers market because the people with money want to spend it to get bargains."

In their quest for the right buyer and the right price, vendors need the knowledge of legal advisers now more than ever.

Mr Dempster, thinks the question a potential seller must ask himself is "must I sell now?" and if the answer is no, then he should wait. He said: "Although trade buyers, where they have or can raise the necessary acquisition finance, are still making acquisitions, speculative finance driven deals based on a leveraged structure have disappeared. Buyers' expectations of being able to drive a hard bargain in the current climate are likely to depress valuations. Property valuers are also taking an increasingly conservative approach to real estate. So where property is a component of a business's valuation the value will come out considerably lower than what could have been obtained prior to the start of the credit crunch."

The lower volume of sales is likely to have a significant impact on the immediate future of the marketplace for exits. Mr. Dempster believes the level of activity will continue to remain depressed for some time.

Conclusion

It seems that buyers are still out there, regardless of the lack of funds available in the market, but they are looking for a good deal. The challenge of the legal adviser is to get owner manager vendors into a position where their business is an attractive proposition for buyers. In short, only the best organised and well advised firms will attract a vendor's desired sale price. In a buyer's market owner managers must be flexible about the value of the firm if they want to make a sale, otherwise they could be well advised to wait until the credit crunch storm blows over.



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PURCHASING FROM TRUSTEES

Where an exit involves the sale by Trustees of a significant holding of shares, it is vital that early consideration is given to the particular issues relating to ownership of shares by Trustees. The Buyer will need to satisfy itself that the Trustee has the capacity to transact and that it will be able to enforce its rights against the Trust assets. The Trustees will be concerned to avoid personal liability and generally to safeguard the Trust assets for the benefit of the Beneficiaries. Key considerations may be summarised as follows:-

The Buyer will want to know that the Trustees are validly appointed, own or control the shares which are being sold and have the power to sell those shares. The Trustees may need to disclose all relevant Trust documents and the Buyer will generally require legal opinions, particularly where the Trust or Trustees are offshore.

The Buyer will also need to consider the extent to which the Trustees can or will give warranties and indemnities. Even if the Trustees have the requisite power under the Trust instrument or general law, as they are rarely themselves directors or involved in the day to day management of the business, they will generally not give warranties other than as to title and capacity to sell. For various tax and other reasons, any warranties given by Trustees will be given on a several basis and any liability assumed in respect of the transaction must be proportionate to the Trustees' shareholding in the target. As the Trustees will be personally liable in the event of a successful claim, they will need to be able to indemnify themselves from the Trust assets and their liability must further be limited to the amount of Trust assets under their control at the time when any claim is settled.

Thought must be given to whether there are alternative ways for the Trustees to preserve access to the sale proceeds forming part of the Trust assets to cover their proportionate share of any liability claims, without giving full commercial and tax warranties and whilst retaining the flexibility to invest and distribute Trust assets and to ring-fence those Trust assets which do not represent the proceeds of sale.

Rooks Rider has advised many Seller-Trustees on their options in this highly complex area and the solution in each case must be tailored to the structure of the particular transaction. In certain circumstances we have used indemnity or retention mechanisms combined with certain restrictions on the Trustees. Any solution must be carefully crafted so as not to give rise to any unlawful fetter on the Trustees' discretion.

Many of the deals on which Rooks Rider has advised have been private company acquisitions which have not been reported. However, we recently advised the Seller-Trustees on the MBO of the Avanta Managed Offices Group on their sale of shares in the Group and reinvestment in the MBO vehicle.