



# Exit Planning & Exit Strategy



**Bristol Office :**  
**130 Aztec, Aztec West**  
**Almondsbury**  
**Bristol**  
**BS32 4UB**

**Birmingham Office :**  
**Cornwall Buildings**  
**45-51 Newhall Street**  
**Birmingham**  
**B3 3QR**

**0845 270 0345**

**[www.m3cf.co.uk](http://www.m3cf.co.uk)**

**Contents**

M3 Corporate Finance ..... 3

Introduction ..... 4

What is an Exit Strategy ..... 5

Formulating an Exit Strategy..... 6

Timeframes ..... 7

The Business..... 8

The 'Rat Holes' ..... 8

Valuation ..... 9

The Exit Strategy ..... 11

Why Use M3 Corporate Finance ? ..... 12

Contact us ..... 13

## **M3 Corporate Finance**

M3 Corporate Finance is an independent corporate finance house focused exclusively on mid-market transactions.

M3 offers specialist corporate finance advice to shareholders and managers / directors of companies and private equity houses concerning:

- Exit strategy and company sales
- Management buy outs
- Management buy ins
- Corporate acquisitions
- Development & replacement capital
- Corporate divestments and restructuring
- Recapitalisation equity release ('cash out')
- Vendor roll-over

Our services are always led by an owner partner guaranteeing our commitment to your deal.

## Introduction

This guide has been written for all owners of businesses – entrepreneurs who have spent their lives building successful owner managed businesses, management teams and their equity partners who have bought their own businesses with a view to selling them on for a capital gain, and corporate owners of businesses looking to divest particular subsidiaries.

In all cases owners are linked by one simple fact – when they decide to exit their business they want to make sure that they get the best deal, and getting the best deal involves planning for the final exit and presenting the business in the best possible light.

Exiting businesses should not be seen as a game of chance. Planning allows the business owner to remain in control of any process, and focuses the business on the most important, value enhancing strategies prior to an exit. At M3 we believe that all business owners, where an exit is likely at some point in the future, should formulate an Exit Strategy.

The **Exit Strategy** documents the following:

- current value of the business and the key value drivers for the business
- an evaluation of the possible exit options available at that time
- information on the types of buyers who may be interested in buying the business and why (including details of recent transactions)
- what may be unattractive about the business today and what may restrict the exit options and/or have a detrimental effect on exit values
- What should the owners be doing to put these things right before exit

## What is an Exit Strategy

Establishing an Exit Strategy can start at any time, but the sooner the better. For most owner managers, exit planning can often be left very late, though increasingly owner managers are becoming much more aware of the benefits of early planning. For MBO teams and their private equity partners, formulating a credible Exit Strategy takes place before they invest their money. One key benefit of formulating an Exit Strategy 12-24 months prior to an exit is the time it allows an owner to “Groom” the business for sale by focusing on improving areas in the business that are key value drivers to a buyer.

Generally speaking, the longer an owner has to groom the business, the greater the benefit. But one thing is for sure - by identifying and implementing a Grooming Strategy, the final exit will be improved.

There are several key areas to address when formulating an Exit Strategy:

1. What are the exit alternatives and which one is best for the owners of the business
2. What is the current value of the business and how does this compare with the owners price expectations. Is there a gap?
3. What are the future prospects for the business and what are the threats to a successful exit
4. What does the business need to look like to be attractive to a trade buyer, an institutional investor or would the business appeal to the existing management team
5. What are the opportunities for improving the value of the business and how is this achieved
6. How should the exit strategy be implemented.

## Formulating an Exit Strategy

There are many reasons why owners of businesses start to think about seeking an exit.

- the owner may be seeking retirement
- for an MBO or MBI the exit is part of the original investment plan
- the business may require significant investment and hence a sale of all or part of the business is appropriate to mitigate an owner's risk
- the owner may feel the market is as good as it is going to get, or even worse, they may feel it could deteriorate
- key employees may be seeking to retire within a couple of years and would be difficult to replace
- for large corporations, particular subsidiaries may become non-core through changes in group strategy, or there may be a need for additional cash

There are an increasing number of ways for owners to exit their businesses.

**Trade sale** – whereby the business is sold to an existing trade purchaser either in the same markets or a buyer who wishes to enter the target's markets or products

**Institutional purchase** – whereby a private equity house (venture capitalist) or bank purchase the business, usually backing existing (management buy-out - MBO) or new (management buy-in - MBI) management, with a view to selling the business on in a 3-5 year period

**Cash Out or Recapitalisation** – whereby the owner takes out part of their equity but retains an ongoing stake in the business, often alongside management, for a second, future pay day, funded by a bank or private equity house

**Flotation** – whereby some or all of an owners value is floated on a UK or overseas public market

In deciding on the best exit strategy for a particular owner the starting point is to identify what the shareholders are trying to achieve. For instance, a weak management team may restrict opportunities to do an MBO, but may be less problematic to a competitor who has their own management, or a private equity house that have their own external MBI candidate.

Therefore the first step in formulating an exit strategy is to conclude what are the realistic exit options open to you.

## **Timeframes**

Any owner looking to divest within 2 – 3 years should start to formulate their Exit Strategy now. Assuming 6 months to complete the sale process and 6 –12 months of employment with the purchaser to facilitate an orderly handover of the business, in most cases this will only leave 6 – 18 months to get the business into shape.

For any manager considering putting money into an MBO or MBI, they will need a clear view of how an exit could be achieved, prior to the deal completing. By necessity this will of course evolve through the life of the MBO/MBI, but it is important to start knowing that at the time there are credible exit options open which are acceptable to both management and their financial backers.

For many owners it is the threat that the business's performance may deteriorate that starts them thinking about an exit. If this is the case then the exit may come too late to get the best price.

## The Business

Very often, businesses have no real competitive advantage in the market place but exist either through long-term personally built relationships or a degree of price competitiveness linked to hard work in servicing the customer base.

During the grooming process, you should seek to develop some unique selling points that are sustainable. These might include better trained managers who are then multi-functional, an increase in product development, re-branding or even a series of partnership relationships that enable a wider, differentiated and more guaranteed market penetration.

When exiting a business it is always important to sell some upside to the new owners, so that they can see continued growth once they have control of the business. An important part of the Exit Strategy, therefore, is to identify the immediate and medium term prospects of the business and be able to sell them as benefits. These may include, for example, the following:

- exploiting a new product range;
- new geographical markets;
- new legislation supporting growth in a company's products or services.

It may be beneficial for a company to have realised some upside in these areas by the time of exit to put some substance behind the claims of growth. Again this may take time to accomplish which emphasises the need to start the planning process early.

## The 'Rat Holes'

It is not just upsides owners need to think about when planning an exit – possible threats to a business can impact on the attractiveness and therefore value of a business.

What might go wrong ?

- new and competing technology in a company's markets
- an adverse change in legislation
- consolidation of its customers

Some of these threats may not be defensible, though many will be. Again, the defence strategy may take time to implement and 'bed in' (eg an acquisition prior to exit to acquire a desirable technology). Where a defence strategy is too risky or too costly, the answer may be to bring the exit forward before the threat becomes more visible to possible acquirers / investors.

Nothing turns a prospective purchaser away from a business more than inaccurate, incomplete or delays in receiving information. Consider the information you would wish to see if you were purchasing a business and ensure that this has been recorded for at least two years prior to the sale. This should include: robust monthly management accounts; customer and product concentration details; margin analysis etc; all reconciled through to the statutory accounts.

The structure of a business should be as tidy as possible to prevent complications and additional costs arising. The area is complex both commercially and tax wise and ideally should be addressed with your advisor as far in advance of the sale as possible. Areas that sometimes cause problems are: minority shareholdings held by potentially problematical parties; over complicated group structures; inter-company or related party trading; and underlying results not visible from statutory or management accounts.

## Valuation

The Exit Strategy will drive out many important aspects of the exit decision.

- is there an optimum time to exit?
- what is the current estimated exit value?
- does the business currently look attractive to new investors?
- will the business exit on a rising level of profitability?

If it is apparent that the owners wish to sell as soon as possible and the current market is strong, it may be attractive to market the business sooner rather than later.

For many other owners the exit decision is more complicated, and involves balancing up competing objectives.

Quite often these revolve around the current valuation, in particular being less than what the owner would like to achieve. In many ways this can act as a catalyst to the grooming process as an owner looks to pursue a strategy to improve the exit valuation.

As we have stated the conclusions of the Exit Strategy can potentially influence both the timing and likelihood of any exit. It will also, importantly, identify any gap between the current valuation of the business and the value sought by the vendor.

For the vast majority of business valuations the following formula is used:

*Earnings Before Interest and Tax (EBIT) x Price Multiple*

Determining an appropriate Price Multiple for a private company is a subjective process. Price multiples are only readily available for quoted companies. However, EBIT multiples can be calculated for comparable quoted companies and then a discount applied. It is important to use the normalised earnings of a business. This calculation gives an 'enterprise value'. Deducting any debt from the enterprise value and you have the value of the equity in a business.

Certain types of businesses need significant amounts of capital to operate efficiently. This maybe in the form of capital equipment or working capital. This will affect the price multiple (both positively and negatively), but in all cases it is important that the business is as efficient as possible with its resources compared with similar companies.

Increasing the value of a business can be achieved by either increasing the profits, enhancing the value of the price multiple and/or resource use improvements.

Some examples of these various methods are detailed below. Obviously the lists on each could be very long and would need tailoring to specific businesses:

**Profit Improvement**

- Increase turnover eg small bolt-on acquisitions
- Review of selling prices eg start to lose less profitable work
- Review of margins / overheads eg increase or decrease level of sub-contract

**Price Ratio**

- Reduce reliance on key customers /suppliers
- Prove the business has growth opportunities in new markets or products
- Legally tie in key employees, intellectual property rights...etc

**Resource Use Improvements**

- Reduce working capital to free up cash for the owners at no cost to the buyer
- In the short term (only) delay capital expenditure and increase return on capital
- Generate cash from the sale and lease back of major assets

Each grooming opportunity has a timescale and therefore one of the key things to consider at this point is the desired exit horizon of the owners. It may be impractical to consider a bolt-on acquisition, for example, if the business does not have time to fully merge the two businesses to gain the synergies of the merger.

Essentially, an owner is left with a list of what they believe to be achievable targets that becomes the Exit Strategy of the business prior to exit. Without proper implementation of course, the likelihood of any significant change (and consequently of any benefit) is small.

## **The Exit Strategy**

The Exit Strategy needs the full support of those allocated the responsibility of delivering the targets set. This may be restricted to the owners of a business, but very often involves non-shareholding management. Most owners prefer not to disclose their intentions of exit, whilst others may be more forthcoming. The pro's and con's of disclosure need to be weighed up and potentially incentive arrangements put in place to tie management in, but all of these aspects should be discussed with an adviser first.

Implementation is not a one-off process, and the Exit Strategy needs to be reviewed on an ongoing basis to ensure value benefits are been delivered. In the main this is an internal process, though in our experience the process can be significantly improved by involving an external adviser or appointing a suitable non-executive to the board to bring their experience and external point of view to the business.

## Why Use M3 Corporate Finance ?

Your advisor needs to be an experienced corporate finance adviser with wide experience in advising owners on exit strategies and a proven record at selling businesses in all sectors to all types of investors.

M3 Corporate Finance are an ideal partner to take owners through the initial exit planning and grooming exercise that ultimately leads to a successful exit. We work alongside many of our clients as they seek to groom their businesses for exit.

<b>M3 differentiators</b>	<b>So what...?</b>
Owner managed business	Its more personal We understand deals as Principal & Advisor Entrepreneurial in outlook
Our people	Senior partner / director – led advice throughout the deal Experienced team who know how to acquire & sell businesses & understand the dynamics of transactions Mix of backgrounds from accountancy, banking, private equity & industry
Track record	Regular contact with funders Activity creates experience Vast pool of accessible knowledge
Creative & innovative	Creative deal structures that work for our clients We get the job done
Independent & focused	This is all we do – no conflicts of interest Team hungry to deliver We focus on our deals
Excellence & commitment	We strive for excellence in our work Strong research capabilities Committed to client satisfaction, standards & performance

## Contact us

For more information and / or a confidential discussion please contact:

**Bristol Office :**  
**130 Aztec, Aztec West**  
**Almondsbury**  
**Bristol**  
**BS32 4UB**

**Birmingham Office :**  
**Cornwall Buildings**  
**45-51 Newhall Street**  
**Birmingham**  
**B3 3QR**

**0845 270 0345**