CRITICALEYE

How to Mastermind an MBO

A management buy-out poses a unique test of diplomacy, timing and sharp negotiating skills, but if executed correctly, the rewards for success can be considerable. ***Criticaleye*** *finds out how an executive team can rise to the challenge*

Cash-rich private equity firms are hungry to invest in good businesses at a time when corporates are restructuring to focus on core operations, which means the market is ripe for MBOs, carve-outs and divestitures.

As long as the management team has a willing seller, adequate finance, the gumption to spy the growth opportunity in the business – and doesn't pay too much for it – a successful buy-out is there for the taking. Becoming a business owner means a new sense of freedom and offers the chance to earn potentially life-changing sums. But for the foolhardy and underprepared, there's also plenty that can go wrong.

The following tips will help you understand what to look out for when conducting an MBO.

1 Be realistic

"You have to go into a buy-out with open eyes," says **Rob Crossland**, CEO of HR services provider Optionis Group, who led an MBO of the business in November 2006 with PE firm Inflexion.

"It's extremely fatiguing, especially if it's a long and protracted process, and you should appreciate that once the deal is done then the real journey starts. You're going to be entering a highly focused, growth-orientated environment and you must be able to respond to that by hitting your milestones as quickly as possible, as it will make your life much easier in the long run."

One of the trickiest aspects of a deal can be establishing if the owner or parent company wants to sell (making the approach for a buy-out can be one of the quickest ways to find yourself out of a job). "You need to be wary," says **Martin Balaam**, CEO at IT services concern Jigsaw24, who completed a reverse takeover of Redstone plc in 2005 with his VC-backed company Xpert Group. "There are lots of owners who are happy to let you go through the process of pulling together an MBO and then don't want to do the deal for emotional reasons.

"Also if the current owners are private individuals and have never sold a business before… then ensure they know what the process will entail and the types of warranties and indemnities they will need to sign up to."

The market conditions and competitive landscape within which the business operates should also be taken into account. "Consider why your business is set to grow against this backdrop over the next five years," says **Martin**. "Ensure that your business plan is based on pessimistic/realistic assumption for revenues growth and cost growth – on the balance of probabilities you need to be comfortable that you will exceed the business plan."

2 The right team

An MBO is a gutsy move and management will often be putting everything on the line, so you'll need to trust implicitly those who are entering the process alongside you.

Roger Buckley, M&A Partner at professional services firm BDO, who leads the corporate finance business in the Midlands, says: "As an MD who's going to lead the MBO, there comes a cold shower moment where you have to decide whether you've the right team to drive the business forward, and if these are the people you'd want to go into business with… Quite often, management has been brought together by someone else and therefore you need to make sure you start from the right place."

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Martin comments: "Just because they are your mates doesn't mean that they will cut the mustard, so it's important to have decided when you approach a backer who in your management team will be aware of the potential MBO and who will help you to succeed in it."

3 Seek good advice

Putting a deal together is rarely a simple process, which means advisors have an important role to play.

Andrew Vaughan, Chairman of online discounting business Asperity Employee Benefits, who led a 3i-backed buy-out of network services group Workplace Technologies from computer firm ICL in 1995, comments: "When I was CEO of Workplace, I was relatively inexperienced, in my thirties and had only worked in the corporate space for a while – I was certainly no entrepreneur.

"We found a good quality investor and an excellent advisor, and without either of those the MBO would never have

happened. They held our hands through the process, understood which buttons to press, had good banking contacts, made the introductions to the right people in the private equity community and found us a good lawyer."

Rob says: "You really have to understand which side of the fence the corporate finance advisors sit on. If you've got part of the management exiting and part of it buying, it can be a bit more difficult, so you must do your homework on the quality of advisers, taking references and making sure you're happy with their style. If you get the right advisers they can be hugely helpful."

4 Know your source

The management team need to know what they're getting into when accepting backing from a private equity firm. **Bertie Aykroyd**, Investment Manager at private equity firm LDC, who was part of the team which successfully backed the recent £50 million MBO of premium restaurant group D&D London, comments: "For us, it's all about alignment and a genuine partnership with the incumbent management team.

"In D&D's case, they required a new partner in their drive for achieving the next stage of growth, particularly around international expansion, and we feel we can assist them on their journey."

Ian Stuart, Chairman of Aspen Pumps, which produces air conditioning accessories, has been involved in several buy-outs, with the most recent being the £17 million ECI-backed BIMBO of Stewart Plastics. He says: "You need to project a credible business plan to show a value build over three to five years, with a credible management team, especially the CEO.

"Clearly, if the team is already in place, recent performance history is critical, as PE houses will inevitably see the past as a predictor of the future. Most conventional PE houses, especially in the mid market, will only back projects that show high certainty of growth potential."

If there are any lingering doubts, management must ask the right questions as early as possible. **Rob** comments: "You can become frustrated by the concept of 'value add' and what the PE firm actually means by this, so absolute clarity about where the PE firm can and can't help is important, as is understanding some of the detail around introductory fees, for example, which ultimately comes out of the business's wallet…

"Be very clear about what you're being asked to do and how you're being asked to support it. Let's not forget that the PE firm is backing the management team and therefore expects the managers to deliver their returns, so you've every right as management to ask those questions and seek honest answers."

5 Keep your eye on the ball

All mid-market M&A deals are a huge drag on resources. In a buy-out, management cannot afford to get distracted so that the value of the business declines.

Rob says: "If you are doing a buy-out with a fairly light top team, or you haven't got additional support, then there's always the problem that when you're in the process the underlying business, which you've worked really hard to build up and maintain a track record of growth, starts to falter a little bit. Now, if you're reliant on those results early into the process, it could make the whole thing stumble and fall as a result of the resources being tied up in the deal."

It means defining roles and responsibilities. **Roger** comments: "Typically, you've got people who are 99 per cent focused on the business and delivering the profit number and you've others who are taken away from day-to-day responsibilities in order to do the deal. You can't always do it but it's often a good discipline to create a deal team which is able to focus significant amounts of time on the deal knowing that people are looking after everything in hand. Just don't underestimate the time it takes to consummate a successful MBO or the hard graft afterwards." ■

Featuring Commentary From:

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