The anatomy of a management buyout

Demographics would tell us there is a clamor of baby boomers looking to exit their business, and the question often pondered is how.

Management buyouts are part of the mix. You might be an owner wondering if there is one (or some) in your management team with the aspiration and capability but wondering how do you make that happen? You may be in management wondering if the owner is interested in a MBO exit and if so how do you do it?

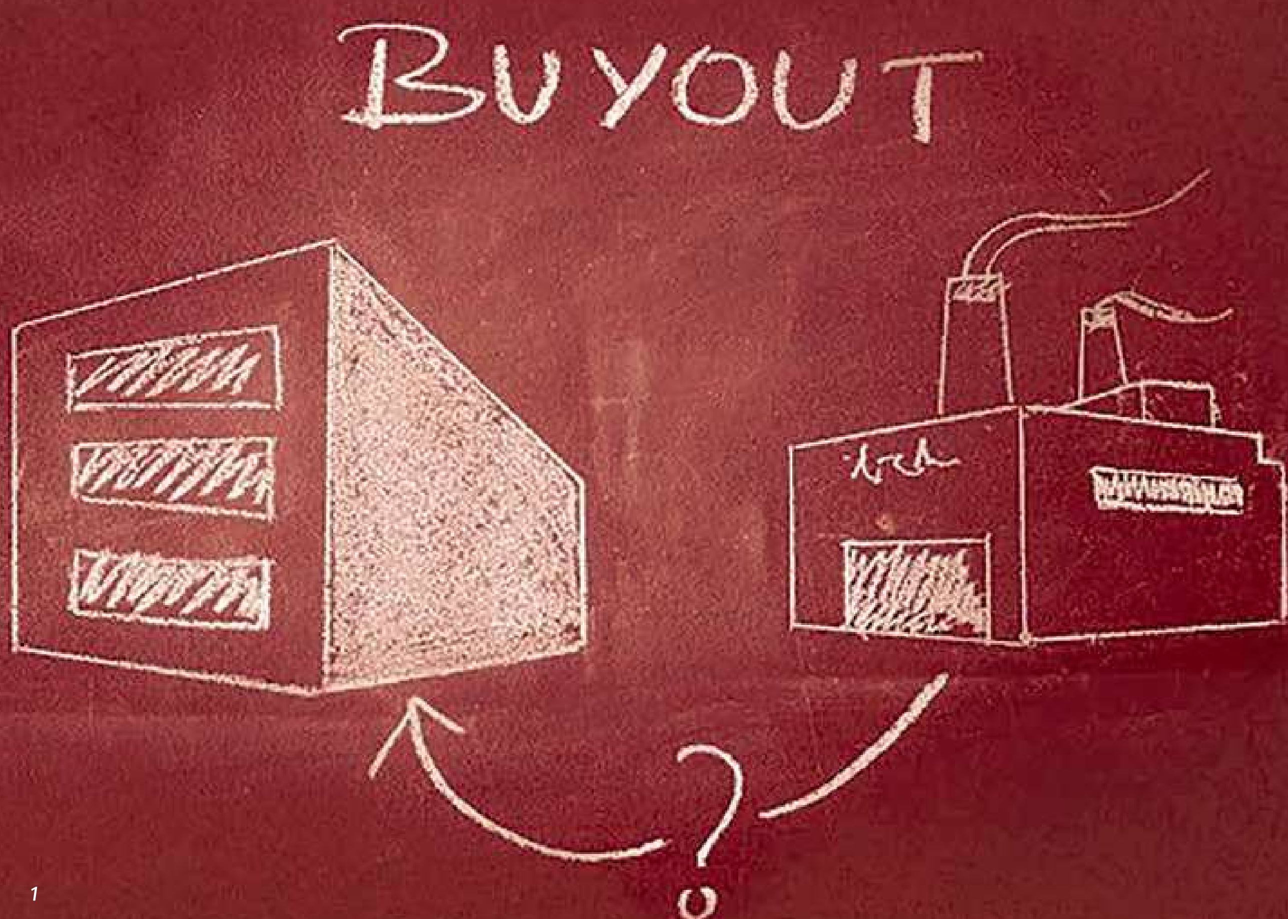
Let's take a management perspective

Opportunity

You are working in a management role but with no shareholding. By investing in an MBO transaction you could stand to significantly increase your personal wealth in a short period of time. You have aspiration, some equity, but are not immune to risk. You can see the business you are in has opportunity and you can see how to make it happen.

You may have doubt as to your capability to run the business from the "ownership and leadership" perspective, or you may have doubt in being able to fund an all out acquisition, and you may not know much about MBO's, but you do know:

- You and your team have the experience
- You have the internal aspiration and fortitude
- You know where the business can go and how to get there
- You have or can access some capital



The Process

So what is the process?

sounding out

You have to engage with ownership and sound them out, start a conversation and a relationship that is about a MBO transaction and not your routine line management relationship. You will each know each other so apart from the initial fronting up this should not be difficult. You let them know you have the aspiration, they will soon enough let you know if your timing is right and they want to engage with you.

advice

If there is interest get an experienced MBO advisor on your team. You want to know how it might play out from here. You are obviously a high quality manager so reconnaissance and planning is instinctive. No different here. Your advisor will talk you through every stage of the MBO process and be able to give you a view on valuation, transaction structure, financing, and work with you to get the transaction to the finish line. In the first instance this is a reality check to get comfortable on what is achievable within whatever constraints you have.

headline terms

Its now time to approach the vendor seriously and negotiate the terms of the deal. There is no standard formula here. Value is important but your and the vendors interests extend beyond just price. There are payment terms, the style and dignity of exit, key risk points and how mitigated, customer supplier or key staff transition matters to think through. You need to consider acquisition of shares versus acquisition of the business and assets. Focus on the transaction. Once a transaction is agreed in headline terms you can then think about structure and financing.

when to go legal

Depends. In some cases a non binding or binding but conditional heads of agreement logically follows agreement of headline terms. Sometimes you go straight to a formal complete (albeit conditional) agreement for sale and purchase. This is very transaction specific.

funding

You have headline terms agreed, you have a post transaction plan to a decent level of formality, now it time to get the funding sorted.

Funding comes down to

- The equity portion
- The debt portion

You will need a comprehensive articulation of the post settlement business strategy, the process to de risk the market impact of the transaction, multi year enterprise forecasts and a comprehensive bio of all management participants.

If you are the leader of a management consortium then the group will have the ability to provide some level of equity. Perhaps you have an equity partner in your mix.

The basics of debt funding the purchase of an asset apply equally to an MBO. There is a debt cap provided by you (the new owner) only wanting to leverage your asset to a certain level to therefore hold risk at a level you accept. A senior lender will have some form of LVR constraint on the level of debt, however it is your appetite for risk that counts.

A senior (bank) lender will therefore be comfortable to finance a portion of the price but up to and no more than your personal maximum level of leverage.

So there is the debt and equity. Is there a gap? If so do you involve another equity partner, obtain vendor finance (debt, convertible debt), stage the share purchase? This is a multifaceted process with no prescribed solution, limited only by your appetite for risk in the manner of financing, and you and your advisors imagination in solving the issue.

due diligence

Even though you are management there will still be some level of DD required, or a lender or equity partner may require formal DD as part of their participation requirements.

settlement

Make sure you have your lawyer and advisor on speed dial, let them deal with the transaction mechanics and you focus on what happens in the business.

no limits

MBO's are evolving transaction that often end not exactly where participants anticipated at the beginning. We have concluded substantial MBO's that began with a group of management and concluded with a different mix of participants, owners that were averse but were converted, seemingly un bankable transactions with minimal available equity concluded with a 100% day one buyout.

An MBO cannot occur without aspiration, beyond that do not be dissuaded by any other perceived constraints.