

MA

MANAGEMENT ADVICE

for
buying or selling businesses



Selling to private Equity

Tim Luscombe



Who are we?

- Management Advice was setup in 2006 to provide

“Unbiased and independent advice to principals considering merger or acquisition activity and to owners seeking to realise the value of their hard work”

- We are commercial business people with extensive M&A experience



Who are private equity?

- Private equity is medium to long-term finance provided in return for an equity stake in potentially high growth unquoted companies. Some commentators use the term “private equity” to refer only to the buy-out and buy-in investment sector. Others, in Europe but not the USA, use the term “venture capital” to cover all stages, i.e. synonymous with “private equity”. In the USA “venture capital” refers only to investments in early stage and expanding companies.
- There are more than 200 firms listed on the BVCA website.



How strong is the UK Sector?

- The UK industry is the largest and most developed in Europe accounting for 51% of total annual private equity investment, and is second to the USA in world importance.
- The UK private equity industry has invested over **£80 billion** (over £60 billion in the UK) in around 29,500 companies since 1983.
- £11.7 billion was invested in 2005, in over 1,500 companies, of which over £6.8 billion was invested in over 1,300 companies in the UK.



What do they want?

- Sustainable profits
- The opportunity to add value through
 - Increased access to finance
 - Financial reengineering
 - Building a market leading position
- An exit route within 3-5 years



What do other buyers want?

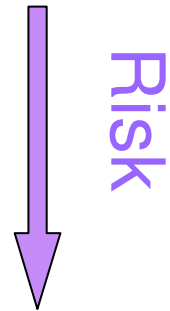
- Sustainable profits
- The opportunity to add value through
 - Better systems, processes and procedures
 - Better management
 - Cross selling customers and / or products
- No fixed timescale for exit



Trade Buyer Motives

■ Diversification

- new product/service range
- new customer base, distribution channel
- new market sector
- market share



- Acquire Intellectual Property
- Geographic expansion



And the difference is?

- Most Private Equity buyers do not buy business that need fixing ...unless the fix is financial
- Trade buyers may take on a “fixer-upper”
- Trade buyers don't like businesses that need significant additional finance

All generalisations are invalid, including this one

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The private equity model

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Profits		100	100	100	100	100
Interest		56	52	49	45	40
Purchase	1000					
Loan	700	656	608	557	502	442
Equity	300	344	392	443	498	558
						86%





EBITDA

- Earnings before interest, tax depreciation and amortization
 - Effectively Cash-Flow
 - This is how the buyer pays off the loan and interest
 - Benchmark most often used by financial buyers



Sustainable Profits

- **Buyers will look at history as a guide to the future**
- **Track record of 3+ years, most heavily weighted in favour of the last 12 months**
- **Assess risk factors:**
 - **Markets**
 - **Customers**
 - **Product Lifecycle**
 - **Suppliers**
 - **Technology**



Market Risk

- The future prospects of the market in which the business operates
- Fewer buyers for a business in a declining market – but consolidation plays a part
- Ideally, an established but still relatively early-stage market with plenty of growth.



Customer Risk

- Customer dependency – anything greater than 20%
- Customer quality – blue chip is best – use bad debt record to assess
- Customer type – akin to Market Risk



Product Lifecycle Risk

- Products / services with growth still possible
- Need to be proven and established – not too early a stage
- Cash cows might be attractive in a consolidation play



Supplier Risk

- Dependency – not greater than 20% with one supplier / group
- Quality
 - Financial stability
 - Product quality – returns / rejects
- Alternatives



Technology Risk

- Is the need for the companies products / services endangered by technology?
- Who wants to setup a business selling Videos today?



Track Record

- Key Events in Company History
- Any major milestones in development
- Key ownership, MD or FD changes
- Past acquisitions or divestments
- Black holes & skeletons



Track Record continued...

- Supplier gains or losses
- Recent changes of Bank or Auditors
- Exceptionally good or bad years
- New products/services launched or developed Supplier gains or losses



What size of business

- “Bolt-on” acquisitions as small as £0.5m value
- Typically, transaction value greater than £3m
- No upper limit for the equity industry....but individual funds will have limits



And now the plug!

We're giving a Mastercourse

“Making successful acquisitions in the
SME sector”

www.managementadvice.co.uk

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