# Strategic Exits

LINK Corporate Division
Mid-Market Sales & Acquisitions

# Strategically Exiting a Significant Business

When it comes time to divest a major asset, the first step should be planning. While there has been perhaps an overemphasis on drawn out "Exit Planning", it is sensible to determine the most appropriate method of sale.

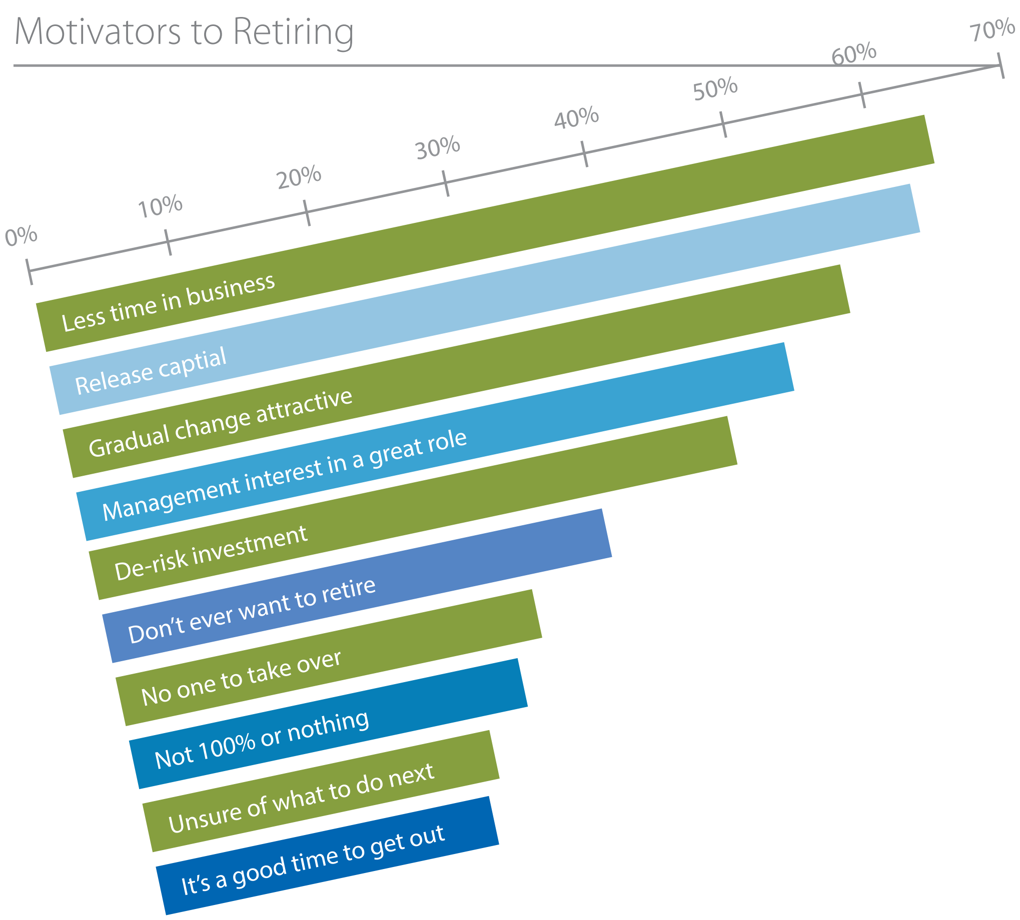
Market research and business owners like you are telling us that when you are planning to exit your business, you want more options than just the all or nothing approaches of:

1. Selling all of your shares for cash upfront (Outright Share Sale); or
2. Selling all of your business assets for cash upfront (Outright Asset Sale).

## Is there another way to exit your business, or free up capital and time without going to the extent of an Outright Sale? **Yes!**

The option many business owners are asking for is a "Staged Exit" from their business. A Staged Exit often ultimately leads to a complete exit from your business, but it is also possible for you to partially exit your business and retain a financial interest and/or working involvement in your business indefinitely. In other words you can free up both capital and time, continue to be involved in the business in whatever capacity you desire, and share in the future potential of your business.

There are many different options for achieving a Staged Exit and each gives rise to different issues. We have assembled a team of leading experts in law, accounting/finance and banking/capital solutions to help outline your options, explain how to resolve any issues that might arise and to help you achieve a truly Strategic Staged Exit.





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# What are My Options for Achieving a Staged Exit from My Business?

The options for achieving a Staged Exit are endless, limited only by the imagination of those structuring the deal. However, the majority of these options can be grouped into three main types of transactions.

**1 STAGED SALE**

Sell part of your business now and sell part(s) later and get paid in instalments for each part as it is sold. Typically this is done by selling shares, but it can be done by asset sale if the business assets are capable of being sold in parts.

**2 VENDOR FINANCED SALE**

Sell all of your business now and get paid in instalments over time. This can be done by either selling the business assets or shares.

**3 OUTRIGHT SALE**

Sell the business outright and be paid a full settlement figure and retain no control or responsibility.

## 1 Staged Sale

A Staged Sale involves selling part of your business now and part(s) later and getting paid in instalments for each part as it is sold. If you want to retain an ownership interest and involvement in your business indefinitely, the correct deal structure will allow this.

There are various reasons why you might choose a Staged Sale, including the following:

- The best buyer may not have sufficient funding for 100% of the business now.
- You may want to retain an ownership interest in the business for a period (or perhaps indefinitely) and share in the upside of the business following the sale of the first part of the business. The purchase price formula can be designed so that any subsequent payments would increase to reflect business growth and result in a greater total purchase price than would have been paid in the context of an Outright Sale.
- By selling part of your business, you can free up some capital for other things.
- Often the introduction of the buyer as your business partner allows you to transition out of a hands-on management role to a less involved role as, say, a director, consultant or investor and free up your time for other things whilst minimising disruption to the business.
- You may want to retain a certain level of control over the business following the sale of part of your business and keeping an ownership interest entitles you to some level of control.

# 1 Staged Sale continued

Two key risk management issues which arise in the context of a Staged Sale which do not arise (or are less important) in the context of an Outright Sale are Control and Enforcement / Security.

**CONTROL**
As you transition from being a 100% owner of your business to a part owner and perhaps ultimately to exiting altogether, you need to consider what level of control and input you want to have in the business and what level of control and input you want the buyer (your new business partner) to have. It is also important to consider from a buyer's perspective what level of input and control the buyer will want. A buyer may be put off if their level of input and control does not match their investment. We know that it can be hard to loosen your grip on the reins, but there are many ways to share control with a buyer without relinquishing control altogether. Issues of control can be agreed and documented in a number of ways and together with your legal advisers LINK can help you choose the best way to maintain your desired level of control.

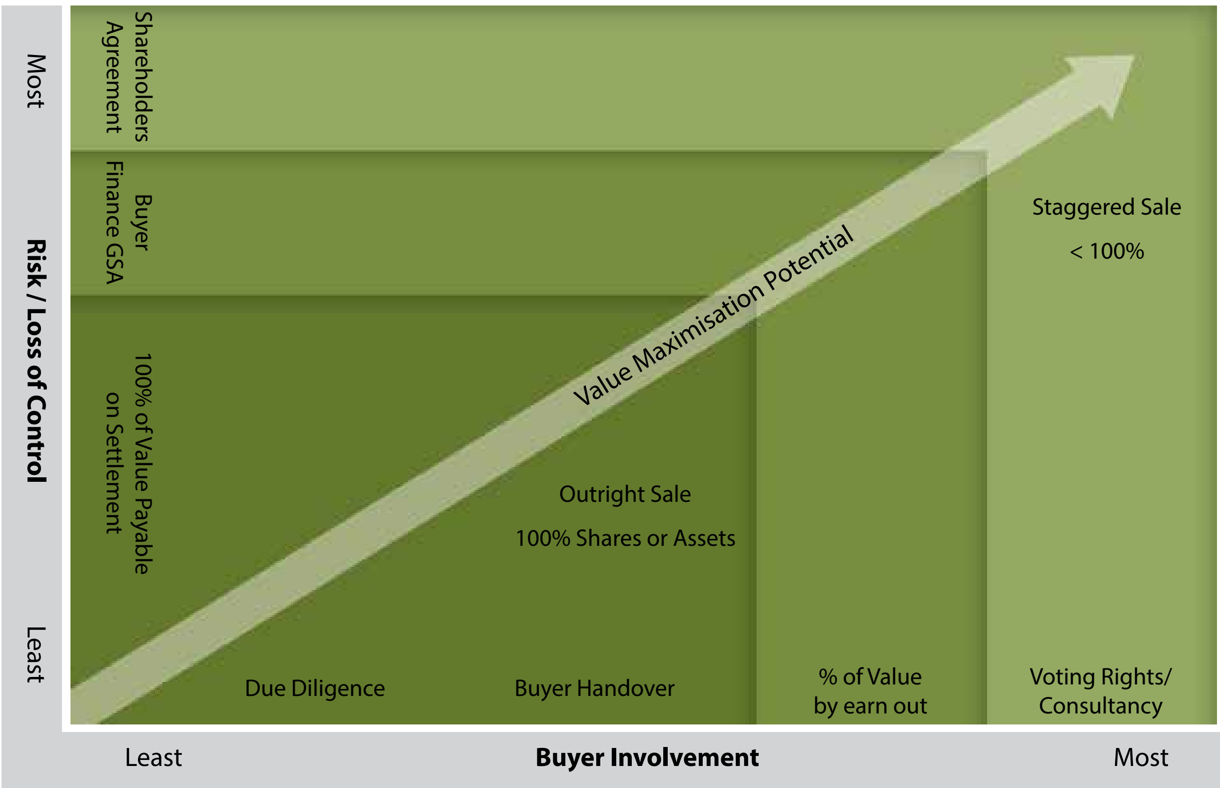
**ENFORCEMENT / SECURITY**
Because you would not complete the sale and receive all of the purchase price upfront, you need to think about what should happen if the buyer fails to complete any future steps or make any future payments. There are a number of ways to ensure this is done. We note below just three examples of how you might protect yourself against buyer default, but together with our team of expert advisers, we can help tailor the best way for you to do this depending on your circumstances.

**Buy Back Right** - If the buyer defaults you could have the right to buy the buyer's share of the business at a pre-agreed price and take back full control and ownership of the business.

**Security** - You could take a security over the buyer's assets and if the buyer defaults you could exercise your rights under that security to sell those assets in order to recover the balance of the price and complete the sale.

**Control** - You could agree with the buyer that the buyer's control right in respect of the business are suspended for so long as the buyer is in default.

## Strategic Divestment




The level of risk and the degree of control that a buyer is willing to sacrifice, combined with the level of ongoing involvement, affect the potential exit value. Whilst an outright sale has certainty, the least risk and little ongoing involvement, it comes at the price of foregoing future upside. It is the balance between these issues of risk, security, control and value that determines the correct divestment strategy.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# 2 Vendor Financed Sale

A Vendor Financed Sale often involves selling all of your business now and getting paid in instalments over time. These are some of the reasons why you might choose a Vendor Financed Sale;

You may want to retain a certain level of control over the business following the sale and having a financial interest as lender gives you leverage to demand such control.

You may want to retain a financial interest in the business as a lender and share in the upside of the business following the sale.

The buyer might demand that he or she buys 100% of the business now, but he or she may not have enough money to pay the full purchase price now.

The similar risk management issues of Control and Enforcement / Security are also important in a Vendor Financed Sale.

**CONTROL**

Until you are paid the full purchase price, (even though you do not have an ownership interest in the business), you need to consider what level of control and input you want to have in the business in order to protect your remaining investment. Unlike the situation of a Staged Sale where you retain ownership rights, in a Vendor Financed Sale you do not have an ownership interest in the business to justify having control over the business. You need to find a different way to achieve this control. Again, issues of control can be agreed and documented in a number of ways and together with our team of expert advisers we can help you choose the best way to maintain your desired level of control.

Together with our team of expert advisers and bankers, we can help tailor the best way for you to protect your interests depending on your circumstances.

**ENFORCEMENT / SECURITY**

Because you do not receive all of the purchase price upfront in a Vendor Financed Sale, you need to think about what should happen if the buyer fails to complete the purchase in the future. Similar protection mechanisms can be adopted to those noted above in relation to Staged Sales. Using those same examples of protection mechanisms as above, the key differences from a Staged Sale include the following:

**Buy Back Right** - A buy back right may be less appropriate in this context, as the buyer would be the 100% owner of the business, compared to a part owner of the business in the context of a Staged Sale.

**Security** - Taking a security is more important in the context of a Vendor Financed Sale, as you would have transferred an interest in the business to the buyer before you get paid for that interest, compared to a Staged Sale where you only transfer parts of the business when you get paid. Taking security is important, but you also need to ensure your security by understanding if the purchasers bank has ranking security over the same assets.

**Control** - Suspension of control rights is less appropriate where a buyer is the 100% owner of the business.

## 3 Outright Sale

Despite the increasing demand for Staged Exits, Outright Sales are still the preferred option for most business owners who want a complete exit from their business in a shorter period of time. On the surface, this is the simplest form of divestment and involves the following steps;

**1** The first step is to contact us for a no obligation initial consultation; naturally this will be treated with total confidentiality. A senior specialist broker will meet with you to discuss your goals, timeframes and reasons for exiting so we understand the issues that are important to you.

After gaining a general understanding of your business, we will discuss with you in detail the process and the various options available to you.

**2** Once you have decided to proceed with divesting of the business, we prepare a comprehensive "Market Appraisal" document detailing every aspect of the sale process, including a financial summary of past years' performance and financial calculations to establish the initial appraisal and strategies that will be used to find the right buyer so you are fully informed.

**3** When the advance planning is completed we then require a mandate for a specified period of time from you, authorising us to proceed.

We then begin compiling specific information required by potential purchasers to include in the information memorandum. This document summarises the various aspects of the business. When completed this will be submitted to you for your approval, ensuring all the information accurately represents the various aspects of your business.

**4** We will consult with you on how the business will be marketed. In many cases buyers are found from our database of qualified buyers which can result in a sale being concluded expeditiously. When your business is mandated with us we firstly look for potential matches in our database.

Should we mutually decide to market the business, advertising conducted will not identify your business and interested parties are pre-qualified and required to sign a confidentially and indemnity agreement before receiving any information. Maintaining confidentially is of paramount importance and no information is given out until the interested party has been qualified.

Part of this qualification process is to identify the integrity of the buyer, not only must they be able to finance the acquisition but they must also be suitable candidates for the acquisition. We spend considerable time qualifying buyers as it is important that only buyers who can complete the transaction are given the details on your business.

Throughout the process we control the information potential buyers are given commercially sensitive information will be withheld until a written offer has been presented thereby restricting disclosure of certain information until the prospective purchaser has indicated they wish to proceed with a purchase.

**5** At this point a "Sale and Purchase Agreement" is required detailing the purchaser's offer along with the conditions to be fulfilled prior to the agreement becoming unconditional.

The preparation of the sale and purchase agreement is one of the most important aspects of the sale process. After negotiating and concluding many mergers and acquisitions of SME's we have considerable experience in this process and will recommend to you various situations to be aware of and to ensure these are incorporated into the agreement. We will work with your legal advisors or conveyancers in preparing an agreement to minimise your legal exposure.

**6** Once negotiations have been completed the purchaser will, under due diligence, require verification of information supplied, this gives them a specified period of time for themselves or their financial adviser to inspect certain records and documentation. In preparing your business for sale we will identify with you what records will be inspected so you can ensure these are ready at the appropriate time. We use a highly specific "Virtual Deal Room" for the document sharing aspect of the due diligence process. Our deal room is built on Citrix Sharefile and is very secure, maintains a complete audit trail and limits access to only those approved.

Throughout the due diligence process we liaise between both parties to ensure the conditions of the agreement are satisfied.

Ask your LINK Corporate Broker if you want more information about Outright Sales, an area of absolute expertise for the LINK team who have sold hundreds of SME businesses outright. Having sold over a $2 Billion in Enterprise Value, nobody can put a deal together like LINK.


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# Establishing the Enterprise Value

The first step in the process of divestment, establishing the true value of a business is a complex process where financial performance is considered in context with many other, more subjective factors. Identifying and quantifying these factors can have a significant impact on buyer appeal, greatly affecting the final sale price.

Determining a fair market value is not a precise science, and can vary depending on the type of business and the reason for a request of a valuation appraisal. There are a wide range of factors to consider – from the book value of the assets, to a host of intangible elements. In general, the value of the business will rely on an analysis of the company's cash flow, its past and current earnings, and the sustainability of those earnings. In other words, its ability to generate consistent profits will ultimately determine its worth in the 'marketplace'.

We have a focus on acquisition, divestment and facilitation of the sale of private companies, with enterprise values of between $1 million and $20 million. We have facilitated the sale of well over 300 businesses with sale prices in excess of $1 million.

Our comprehensive database and the statistical evidence derived therefrom, together with our involvement with various industry statistical databases, indicates the value of those businesses with sound profitable history by using an 'industry' multiplier – the PE (Price to Earnings) Ratio. This multiplier fluctuates and is highly market sector driven, and influenced by a series of weighting factors.

However, whilst earnings history is key to most business valuations, the PE Ratio may not necessarily be the best indicator of value. Strong, but under-performing assets and revenue strengths, where price to sales will have an influence on the methodology used, can be equally important.

An industry specific formula has been devised by LINK, based on the 'real world' in the market. Most business valuation methodologies should recognise market evidence and industry specific practice.

- Identify Risks, Barriers to Entry
- Market Evidence
- Multiple Methodologies
- LINK's Own "Best of Class" Valuation Tool
- Add-Backs and Account Normalisation
- Multiple Weighting Factors

# Who are the Likely Buyers of My Business?

Because you must agree the terms of any deal with a buyer, a key preliminary step in planning any exit strategy is to identify who the possible buyers of your business might be and what terms they might want. Potential buyers come with varying levels of expertise, knowledge, and financial resources. They also often have different objectives and expectations. As a result, exactly what you offer to sell and how you go about selling it (ie. Outright Sale, Staged Sale or Vendor Financed Sale) will often vary depending on the nature of the buyer. We illustrate this point below by listing some examples of common types of buyers and some common attributes of such buyers.

**TRADE BUYERS**
Trade buyers often look for synergies with their own business which may justify a premium price, but care needs to be taken to carefully pre-qualify such buyers (especially competitors of the business) and protect your confidential information.

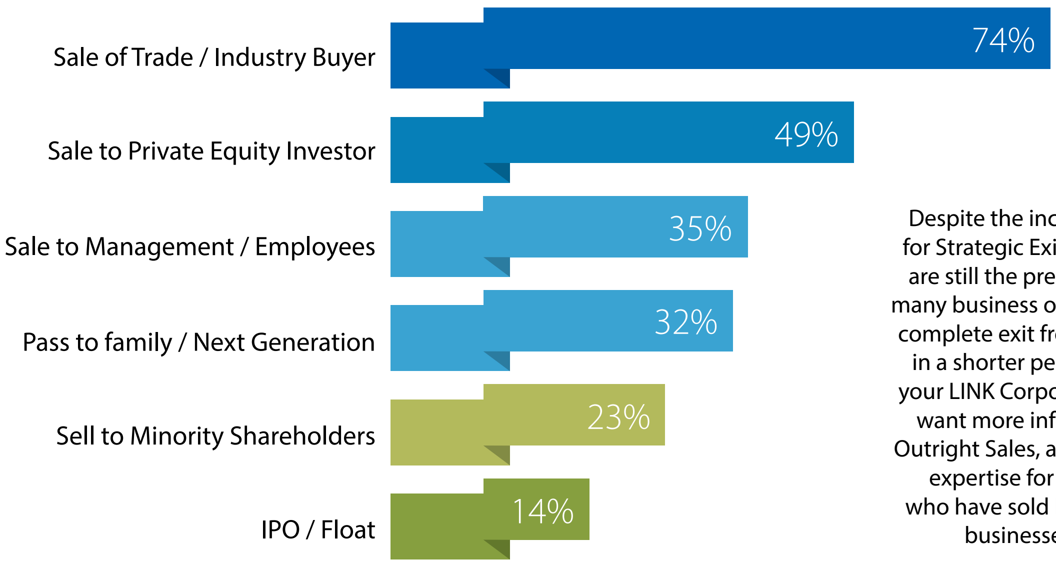
**FINANCIAL BUYERS**
Financial buyers often have a fixed term focus and are looking to minimise financial risk and maximise return on investment. They often use a variety of financing options to balance their risk / return profile. As they will probably not be actively involved in management, financial buyers typically focus on the quality of management and often want to incentivise management to stay and perform.

**FAMILY**
Often business owners are concerned that family members cannot afford to buy them out, or do not want to buy them out, or are not capable of running the business. There is no easy answer to the relationship issues that arise, but creative deal structuring can mitigate some risks and financing options can often overcome a lack of financial resources.

**MANAGEMENT / BUSINESS PARTNERS**
Similar to family buyers, many business owners are concerned that management cannot afford to buy them out, even though management are often considered to be a preferred buyer. Management buy outs (MBO's) often involve creative financing options to make up for management's lack of financial resources. Management buy outs or sales to fellow shareholders can often be easier to complete due to the buyer's existing knowledge of the business, but they also give rise to other unique issues such as potential conflicts of interest.

LINK maintains a large database of qualified buyers seeking businesses in all sectors and your LINK Corporate Broker is experienced in helping identify and pre-qualify the right buyer for your business. Working together with your advisers and your bank, LINK can also structure any sale to suit the unique needs of different buyers.

Preferred form of Succession

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# What are the Options for Financing My Exit and How does this Affect My Exit Options?

In a situation where both you and the buyer want an Outright Sale and the buyer has significant financial resources to complete the purchase, traditional bank financing solutions are usually sufficient. However, if you want a staggered exit, or if the buyer has limited financial resources, or if any party wants to use alternative financing sources for any reason, there are a number of other financing options both you and the buyer should consider.

**BANK DEBT**
Bank debt consists of traditional bank loans and facilities. Bank debt is often secured against the assets and/or shares of the business and ranks first in priority. Because this debt is often first ranking and secured, the interest rate payable is low relative to other forms of debt.

**HYBRID SECURITIES**
A hybrid security is a type of security which has elements of both debt and equity. Examples include convertible notes and redeemable preference shares. Common characteristics include set dividend/interest rates and an ability to convert into another type of security on certain events occurring. Hybrid securities allow investors to balance risk and return and are typically used by financial investors in conjunction with other financing options.

**PRIVATE EQUITY**
(See Financial Buyers)
Private equity in this context means where a financial investor buys shares in your business, usually for a fixed term. The financial investor will look to add value via their expertise in investing in and governing similar businesses to maximise growth and then exit at a profit. Financial investors often require other forms of debt and equity to optimise the capital structure.

**MANAGEMENT EQUITY**
Management equity is provided by management investing in the business. Often management do not have sufficient equity to complete a purchase alone, and so management equity is often combined with other forms of debt or equity.

**MEZZANINE DEBT**
Mezzanine debt is often subordinated (i.e. it ranks in priority behind other debt) and unsecured lending. Because this debt is often subordinated and unsecured, the interest rate is usually higher than bank debt interest rates.

**VENDOR DEBT**
(See Vendor Financed Sale)
Often referred to as "Vendor Finance" or "leaving money in", vendor debt arises when you sell your business, but don't get paid the full purchase price until some point in the future. Interest on vendor debt is often similar to bank rates, but if it is secured, it typically ranks second behind bank debt.

**VENDOR EQUITY**
(See Staged Sale)
Vendor equity is where you sell some of the shares in the business, but also retain some shares.

LINK together with input from its expert partners can help you choose and implement the financing structure that works for you and the buyer. We've summarised some key financing options which can be tailored and combined depending on the needs of you and the buyer, the size (and value) of your business, the financial resources of the buyer and the type of transaction being contemplated.

# Growth Through Acquisition

A unique LINK offering, our acquisition service delivers growth options for aspirational companies. Acquiring another enterprise can often help fast track growth in your own company, but it is fraught with challenges.

Working with our specialist team at LINK we will take you on a journey that could encompass:

- Reviewing your existing operations and discussing whether growth by acquisition is the best alternative. Organic growth may also be an achievable option.
- Determining the greatest opportunity for growth – vertical or horizontal integration, diversification, geographic expansion, synergies and economies of scale – many and varied ways to create additional future cash flows.
- Desk and field research on companies – national or international- fitting into that criteria
- Project management of the sale transaction process – approaching potential sellers, negotiation and deal structuring and ensuring that all of the financial, legal and due diligence specialists perform their roles efficiently and without delay.

We can accept mandates that are fixed-fee, success based or a mixture of the two. Regardless, our goal is to ensure that our professionalism and dedication to your growth opportunity surpasses your expectations.


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## When You are Planning to Exit Your Business, there are More Options Available to You than an Outright Share Sale or an Outright Asset Sale.

Your LINK Corporate Broker together with leading experts can help you work through the options, identify potential buyers, structure the financing options and ultimately identify and implement an exit strategy that works for you and your business.

# Who Are We?

LINK Corporate is a division of New Zealand's largest business brokerage; LINK. Founded in 1996, LINK has enjoyed considerable growth since becoming an international network of brokerages. While LINK deals with businesses of all sizes and from all industries, LINK Corporate specialise only in larger more significant businesses, typically with enterprise values in excess of $1 million.

LINK Corporate are New Zealand's foremost networked team of professionals mandated by our clients to sell and acquire companies in the $2-20m value range.

The LINK Corporate team are experienced, capable business intermediaries with varied and extensive backgrounds. Most have owned their own businesses or alternatively have held significant senior corporate positions – all our corporate brokers have their profiles available on this site. Our specialist team know how important confidentiality is to our clients, and we take this responsibility seriously.

Experience is earned, and our team has sold literally hundreds of high value businesses, with a combined value of over $2 billion. Handling larger transactions requires specific skills and with the quality of our people we are proud to say that we set the benchmark. LINK Corporate also has the largest team of mid-market business brokers in the Southern Hemisphere.

# The LINK Network

We have offices with dedicated business sales professionals across Australia, New Zealand, Philippines, South Africa and the United States.

Corporate Division
Mid-Market Sales & Acquisitions


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