Key Elements for a Successful Management Buy-Out (MBO)

Most MBOs turn out to be successful for all parties involved, but occasionally a transaction fails to close. A failed MBO can be costly for sellers, as they can demotivate the management team who may have to be relied upon to continue operating the business. Having a proper process in place can mitigate these risks. The following are the logical steps that should be followed to assure a successful transaction:

Fair Market Value: Before starting out on an MBO process, both management and the vendor should have a fair assessment of the business' market value; this will avoid disappointment, wasted time, effort and money.

Confirm Payment Structure: Vendors should be ready to help finance the MBO by taking a greater balance of sale, and usually, for a longer period. Payments may have to be postponed to sufficiently repay a senior lender.

Feasibility Assessment: Does management have the motivation and wherewithal to conclude a deal? Is there a clear leader accepted by all members of the management buyout team?

Deposit: In order to make sure the buying group is serious, it is not uncommon to ask that their financial contribution be deposited into a trust account at the beginning of the process. This goes a long way in proving that everyone in the buyout group is fully committed and affords valuable credibility with the vendor and lenders alike.

Option or LOI: It is always preferable to agree to the initial deal terms in writing via an option to purchase or a letter of intent. This provides confirmation to outside parties of both management's and the vendor's seriousness. The option or LOI should provide for an exclusivity period to give management sufficient time to raise the required financing. This also prevents lenders from trying to "re-engineer" the deal.

Transaction Cost Budget: The seller should consider providing the management team with a reasonable refundable allowance to bridge closing costs. Reimbursement by the buyer at closing is good practice.

Two Types of Vendors – Two Different Motives

Corporate MBO:
The seller being a large private or public company will seek to dispose of a division, a plant or operating unit in a timely, confidential and relatively trouble-free transaction with minimal representations and warranties.

Transition MBO:
The seller being a business owner, will prefer selling to management rather than going through a full-scale selling process and possibly sharing intelligence with competitors. The process avoids a lengthy outsider-driven due diligence. Under this option, the seller prefers to "help" his management team transition into ownership.

Confidential Information Memorandum (CIM): Before embarking on the financing effort, the buyer should prepare a CIM with financial projections to present to potential lenders and financial partners. Financial projections will ensure that the financial structure is optimal and viable in the long run.

Deal Structuring and Incentives: The management group should consider and agree on their relationships as shareholders (i.e. Shareholders' Agreement), short and long-term management incentives as well as future tax considerations.

Committed Financing: Management must secure its financing ahead of the deal closing in order not to incur legal and other closing costs should they fail to raise funding.

Due diligence and Quality of Earnings Reports: MBOs typically require a "lighter" due diligence process than a conventional sale because management should be intimately aware of the company's situation. Time and money will be better spent on a "Quality of Earnings Report" which most lenders will require.

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Legal process: While buyers often typically “hold the pen” in an acquisition, we often see sellers’ counsel hold the pen in MBOs. Corporate sellers will always want their counsel to initiate drafting while business owners will do it to reduce costs for management.

Closing the Deal and Implementation of the First 100 Days Transition Plan: Closing the purchase is just the beginning. The management team must have developed a transition plan before closing the deal in order to keep the business running smoothly.

Other thoughts:

Current Financial Lender: When seeking financing it is often best to first approach the company’s current lender with a tight window to present an offer. Other than being familiar with the company and its management, the current lender will prefer keeping the account rather than lose it to the competition.

Balance of Sale: A vendor’s subordinated balance of sale can improve the odds of finding the financing required for the MBO. On top of serving as “quasi-equity”, it sends a strong message to lenders that the seller has a high degree of confidence in management’s ability to succeed and repay the debt.

Timeline: A normal MBO process can take from three to six months assuming all parties are cooperating to make it happen.

Cafa has been involved in numerous MBOs, acting either for the senior management team or on behalf of the seller. All too often owners (and management) are unaware that an MBO can be feasible. Whether you are a business owner or management, we would be pleased to discuss how the Cafa team can help. For management, we can evaluate the business, help you structure the transaction, prepare the offer, find the required financing and guide you to a successful closing. For business owners, or if you are the person in charge of disposing of a business unit, Cafa can help you create the winning conditions to sell to management.

Recent MBO Transactions:

Matériaux innovants RAYONIER Advanced Materials

Rayonier Advanced Materials Inc. (NYSE: RYAM)

has sold its resins business to

LRBG Chemicals

a group of companies held by the resins business’ management

US$16,500,000

The undersigned acted as financial advisor for this management buyout and its financing

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VISTECH PIEUX

9357-6767 Québec Inc.

has acquired the shares of

Pieux Vistech Inc. / Postech Screw Piles Inc.
and
Gestion Nuarogha Inc.

The undersigned acted as financial advisor to 9357-6767 Québec Inc. for this management buyout

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les attaches VISCAN INC

9329-6390 Québec Inc.

Has purchased the shares of

Les Attaches Viscan Inc.

The undersigned acted as Financial Advisor to 9329-6390 Québec Inc. for this Management Buy-out

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