Management Buy-Out (MBO) - Takeaways

Cafa Corporate Finance has been involved in several Management Buyouts (MBOs) acting either on behalf of the senior management team or on behalf of the seller.

Further to our previous newsletter entitled “Key Elements for a Successful MBO”, here are a few important takeaways from our past experiences. These may be helpful whether you are the buyer or the seller:

- **One way street:** You need to realize that an attempted sale to management is a one-way street from which you can seldom return if you change your mind. Expectations will have been created, and if the vendor changes his mind or if the operations are sold to a third party afterwards, management may well be disappointed, demotivated and may decide to leave the company soon afterwards.
- **Competition (Corporate MBO):** If you are selling to management but will be retaining a part of your operation (even if it is not located in the same country) you should consider this will create an additional direct competitor who is intimately knowledgeable of all of your clients and trade secrets. On the other hand, selling to management avoids sharing information with existing competitors.
- **Liquidation (Corporate MBO):** Selling to management can often be less costly than liquidating the business. You should consider this alternative even if it means providing a large balance of sale or the bulk of financing.

  Commitment #1 – Putting up Cash: While team members might say they have no problem putting their share of a deposit, reality often reverses initial verbal bravado after a discussion at home or when it comes time to actually cutting the cheque. One of the very first steps a management team should take is for all participants to put up a cash deposit to be held in trust by a lawyer or notary. In addition to assuring other team members that everyone is committed, the cash in trust confirms to the vendor, as well as lenders and advisers, that the buyers are prepared to go the distance.

  Commitment #2 – A proper LOI: If you are the acquiring management team, you must obtain exclusivity for a reasonable period of time with a price confirmation in order to commit the time and financial resource to the MBO. A “handshake deal” will be insufficient to get financing.
- **Current Lender:** As you begin shopping around for financing, begin by approaching the current lender with a tight window to present an offer. This might be the best alternative in trying to finance the MBO as the current lender already “knows” the company and will most likely not want to lose the business to competitors.
- **Vendor Involvement:** Unlike in a sale to a third party, when selling to management, you should get regular updates of the financing process. As a vendor, you don’t want to discover two or three months down the road that management is incapable of finding the money.
- **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 the lenders that the seller has a high degree of confidence in management’s abilities to succeed and repay the debt.

Cafa Mergers & Aquisitions, Financing, Business Advisory Services

Cafa Corporate Finance

Montreal:
+1 (514) 989-5508

Toronto:
+1-416-721-5779

Paris:
+33 66 808 809 5

Madrid:
+34 722 18 68 50

www.cafa.ca

Management Buy-Out (MBO) Takeaways

- **Vendor Financing the Sale Process:** Upfront costs in putting a MBO together can be considerable (i.e. legal costs, commitment fees to financial institutions, quality of earnings reports, a phase I environmental report, tax structuring, etc.) It is not uncommon for the vendor to front part or all of these costs by allocating a financial envelope to the management team. Depending on the size of the deal, the envelope can range from $100,000 to $300,000. Once transaction closes the costs will be reimbursed by the management team at closing; otherwise they become a sunk cost to the vendor.
- **Transition Service Agreement:** Unless the MBO is for a fully autonomous stand-alone operation, a Transition Services Agreement may be required of the vendor. This agreement serves as a bridge to give sufficient time for the new owners to put all the services in place to run independently. In our experience, both sides tend to underestimate the required services commonly handled by head office. Such services can be categorized as follows:
  - ✓ Accounting, Treasury, Payroll and Benefits
  - ✓ IT Services and Software Applications
  - ✓ Purchasing Services
  - ✓ Shipping Services to Customers
  - ✓ Interim manufacturing or supply
  - ✓ Use of permits
  - ✓ Brand Transition*

*A brand transition agreement may be required to allow the purchaser to use existing inventory of shipping materials, product packaging and/or packaging supplies bearing the seller's names or trade-marks for a transition period. The seller may also choose to sell the 'brand' on a royalty basis for an interim period.

Cafa has helped successfully close numerous MBOs acting either for management teams or sellers. For management: we would be pleased to learn about your aspirations of owning the business you work for and help you structure the transaction, prepare the offer and find the required financing. For company owners, whether it be disposing of a plant, a division, a subsidiary or the entire business, Cafa can help you create the winning conditions to sell to your management.

Recent Transactions:

AEIB VENTILATEURS INDUSTRIELS

9379-0137 Québec Inc.

a subsidiary of Ventilateurs AEIB, has purchased the shares of

Les Aciers Monaco Inc.

The undersigned acted as financial advisor to Ventilateurs AEIB for this transaction.

Cafa Corporate Finance

MTI

ALVEST Group

has acquired

MTI Masking Innovations Inc.

The undersigned acted as financial advisor to the shareholders of MTI Masking Innovations Inc. in the sale to ALVEST Group.

Cafa Corporate Finance

Fyonas inc.

9375-7433 Quebec Inc.

has acquired 100% of the shares of

Les Spécialistes Fyonas Inc.

The undersigned acted as financial advisor to 9375-7433 Quebec Inc. for this transaction

Cafa Corporate Finance

Jacques Gagnier
Montreal
jgagnier@cafa.ca
+1-514-989-5508 ext 29

Lucio Di Clemente
Toronto
ldiclemente@cafa.ca
+1-416-721-5779

Dany LaRochelle
Paris
dlarochelle@cafa.ca
+33 66 808 809 5

Marc-Lionel Gagnon
Madrid
mlgagnon@cafa.ca
+34 722 18 68 50

Rios-Karim Mercier
Montreal
rmercier@cafa.ca
+1-514-989-5508 ext 28

Philippe Rodrigue
Montreal
prodrigue@cafa.ca
+1-514-989-5508 ext 32

Jacques Savard
Montreal
jsavard@cafa.ca
+1-514-794-1373

Antoine Tronquoy
Montreal
atronquoy@cafa.ca
+1-514-989-5508 ext 33

Christian Tylko
Montreal
ctylko@cafa.ca
+1-514-989-5508 ext 22