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Roundtable: Building value and planning the right exit

Our key takeaways

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INTRODUCTION

Hay & Kilner, Ryecroft Glenton Corporate Finance and NEL Fund Managers hosted an engaging and insightful roundtable event at The Lumen titled “Building Value and Planning the Right Exit”. The event was attended by twelve entrepreneurs, founders and CEOs / MDs, each bringing an open and unique perspective to a range of subjects relevant to all business owners. The attendees covered sectors from technology to engineering and manufacturing to recruitment and beyond, with the common aim to create meaningful discussion and share knowledge and experience.

The roundtable was hosted by representatives from Ryecroft Glenton Corporate Finance, Hay & Kilner and NEL Fund Managers. Each host offered their expertise and insights from advising a wide range of businesses and shareholders, particularly in the context of building and protecting value, obtaining funding to scale and planning and executing an exit or succession plan.

The discussion focussed on the levers you can pull to generate and retain value in the lead up to an exit event, whether that be a sale to a strategic trade buyer, private equity, a management buy-out or buy-in or a transition to employee ownership, before progressing to improving sale readiness, including the commercial and legal intricacies of deal structures and transacting.

This report covers the key insights and headlines from the roundtable and serves as a tool for you to consider your strategy and next steps when it comes to driving value and the most executable options available.

VALUE

A key theme of the early discussion was around valuing a business, specifically how to drive and demonstrate value and the attractiveness of a business to a potential buyer or funder. The discussion covered the myriad of factors relevant to valuation, whilst offering practical advice on the levers to pull:

“In most instances, a business is valued on an earnings basis, applying a market-driven multiple to its maintainable earnings / profit to arrive at its Enterprise Value (“EV”), then adjusting for cash, debt and working capital to derive its Equity Value (“EQ”). It is important to understand what your business is worth, and why, well in advance of any exit discussions. When calculating maintainable earnings the adjustments you can make to reflect and maximise earnings and therefore value include adding back any excessive shareholder and director remuneration, along with any exceptional, non-recurring costs / expenses, such as bad debts, legal and professional fees, refurbishment or upgrade costs, FOREX costs, redundancy costs, to name a few. Being equipped with knowledge and understanding going into these conversations, so you can present a fully adjusted profit number to be used for valuation purposes is vital.”

It was clear from the discussion that early consultation with advisers, ideally two years or more before an exit, is crucial to both understanding and “moving the needle” on value. The discussion covered the importance of being clear on reference period when it comes to valuation (i.e. the 12-month period a

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buyer uses for the purposes of valuing a business), as well as ensuring any forecasts are based on sensible assumptions and a degree of precision, supported by a clear narrative. This demonstrates credibility to a buyer and enables a valuation to be based on future earnings, potentially driving up the valuation.

A further key point discussed when looking at value was the positioning and sustainability of the management or senior leadership team. Having a capable and incentivised management team expands the options available to a business owner, such as potentially attracting a private equity investor when combined with the ability to scale. The question of timing was again seen as being vital to achieving this and the credibility of the management team would naturally be scrutinised by any buyer or investor when it comes to future value and succession.

The discussion explored practical solutions for securing, motivating and retaining a strong senior leadership team:

“An under-utilised mechanism for recruiting, incentivising and retaining senior management is employee share option schemes, granting employees options that convert into shares upon exercise, which is usually linked to an exit event. This can be a tax-efficient method to not only incentivise employees to drive forward the growth of the business, but to also maintain interest post-completion where the deal structure involves an earn-out mechanism. This is beneficial both for the employees and any exiting shareholders, along with the buyer who is looking to ensure that the adjusted profits being used to value the business can be at least maintained post completion.”

From a legal perspective, the discussion highlighted the need for such arrangements to be carefully documented in conjunction with a tax adviser:

“We are seeing more employee share option schemes and the headline is to ensure the documentation is carefully drafted and clear on exercise and lapse events, whilst complying with the relevant legislation. Commercially, it is equally important that the nature and mechanics of the scheme are clearly communicated to employees. In some instances, senior employees are given shares long before an exit, rather than share options, and this necessitates bespoke shareholders’ agreements protecting the business and the wider shareholder group. The important point is to seek structural advice early. When appropriately tailored, these mechanisms can be a fantastic way to drive value before and after a transaction.”

The discussion on value progressed to the concept of concentration risk, exploring the inherent risks in being overly reliant on one or two clients generating a high percentage of your revenue. This is an area a buyer will naturally take a keen interest in. Even with a well-drafted framework agreement or contract, change of control provisions need to be carefully considered, including communicating any imminent exit with such clients to ensure a smooth transition. Diversification of the client base was discussed as a potential solution, whilst accepting the realities of certain sectors and business models make this a challenge. The key point was to be alive to this risk and to frame it from a buyer’s perspective.



It was clear from the extensive discussion points that value was an understandably key area of interest for attendees. There was broad agreement that value is inherently linked to timing and the importance of having conversations with advisers as early as possible to establish and ultimately demonstrate that value to a buyer or investor.

FUNDING

The discussion explored how the factors a potential buyer may consider in valuing a business are consistent with what funders and investors look for when identifying and working with potential investees:

“The two British Business Bank funds we operate at NEL, investing up to £2 million, cover a variety of options, including acquisitions, management buy-outs and buy-ins, and supporting shareholder exits. Naturally, when considering an investee, we look at all of the factors we are discussing today. These include cash flow generation, ability to service debt on both a historical and look forward basis, strength of finance function, management structure, quality of earnings and the USP of the business.”

The key conclusion was that preparing your business for an exit event can be aligned with preparing your business to attract funding and scale. There was agreement that this framing presented business owners with flexibility and encouraged a focussed approach to growth whilst allowing agility and broadening the strategic options available.

“Information and documentation are key when we work with an investee, both in terms of demonstrating a narrative of growth and cash generation, as well as credible forecasting to show financial covenants can be complied with. Timely, transparent provision of accurate information is key to getting a deal over the line and ensuring that investor confidence is built in both the target and the incoming management team.”

DEAL STRUCTURE

The discussion moved onto exploring the options available to business owners when considering an exit, from a strategic sale to a trade buyer or private equity through to a management buy-in or buy-out or a transition to employee ownership. A key theme was that the profile of a potential buyer was fundamental to both deal structure and the factors relevant to enhancing deal readiness, given that different buyers will have different priorities.

The discussion explored the key exit options available to shareholders and management teams.

The deal structure that can be achieved when selling a business to a trade buyer is very different to the deal structure that can be achieved if the same business is sold to private equity or management.

Typically, when selling 100% of a business to a strategic trade buyer who is acquiring the business to gain access to a new client base, products, services or software and benefit from synergies or cost



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savings, a buyer will often look to implement change post-acquisition whilst realising operational efficiencies. This can mean earn-outs running for 3–12 months post completion and linked to turnover or gross profit rather than profitability, given the seller's reduced ability to control profitability post completion.

When selling to a well-funded strategic trade buyer, any earn-out will often equate to approximately 20–30% of the enterprise value, with the remaining 70–80% being paid in cash on completion. In some instances where a trade buyer plans to make considerable changes to the business post acquisition, advisers may instead agree deferred consideration rather than an earn-out. This enables the buyer to make operational changes without impacting deferred payments owed to the sellers.

When selling a business to a private equity investor, who will not typically seek to operationally run the business day-to-day, there is usually a requirement for an experienced and committed senior management team to remain in place. A private equity buyer will often seek to acquire a majority stake while retaining a meaningful equity position for management to ensure alignment and incentivisation for future growth.

Private equity investors may also expect sellers to defer part of the consideration through vendor loan notes, earn-outs or reinvestment into equity. A key point discussed was that shareholders selling to a trade buyer will typically receive a greater proportion of consideration in cash on completion than when selling to private equity.

Another route discussed was funding a management-led transaction (MBO) without private equity investment, through a combination of term debt and deferred consideration. Whilst this can result in lower cash proceeds on completion for the seller, it can better protect the legacy and independence of the business by enabling the existing management team to acquire control.

Selling to an existing management team can also reduce confidentiality concerns and commercial sensitivities that may arise when marketing a business to third-party trade buyers, who are often competitors. Equally, where management already has extensive knowledge of the business, the scope of warranties, due diligence and associated liabilities may often be reduced.

There was clear emphasis throughout the discussion on advisers working closely together to protect value, particularly where deals involve an earn-out or deferred consideration.

From a legal perspective, the discussion highlighted the importance of ensuring appropriate protections are agreed early in the transaction process:

"We often discuss with sell-side clients the optimal time to raise protections for deferred consideration with the buyer's team. Our view in general is that these conversations should happen early at the heads of terms stage to ensure the parties are aligned, particularly if we are looking for formal security, post-completion restrictions or accelerated payment provisions. In the context of an earn-out, we work closely with corporate finance and tax advisers to ensure that the metric by which the earn-out is being measured cannot be inadvertently suppressed. By way of example, where the earn-out is measured by



EBITDA, we would want to be explicit about the nature of the exceptional items that should be added back and any high-level restrictions on funds leaving the business. The key with protecting deferred consideration is to communicate your expectations to the buyer early and be clear internally on what is a priority.”

TRANSACTIONING

The discussion was rounded off with attendees sharing their experiences of transacting and the key considerations when looking to enhance sale readiness, including the practical challenges of the due diligence process.

A key theme throughout the discussion was the importance of preparation and documentation. Being able to respond efficiently and comprehensively to buyer or funder enquiries was identified as an important factor in maintaining momentum during a transaction process and demonstrating credibility to counterparties.

The due diligence process will typically involve a broad range of areas including company records, insurance, employees, pensions, property, commercial contracts and financial information. Having information readily available, alongside clarity on which internal teams are best placed to support the process, can help reduce the burden on management teams and improve the overall efficiency of the transaction.

There was also discussion around the relationship between the due diligence process and the negotiation

From a legal perspective, the discussion highlighted the importance of providing clear and comprehensive responses to due diligence enquiries in order to support negotiations around liability protections and risk allocation:

“The more comprehensive the responses to the due diligence enquiries, the stronger the negotiation position can often be when it comes to warranties and indemnities in the share purchase agreement. A significant part of the legal process when acting on a sell-side transaction is protecting the purchase price by ensuring warranties and indemnities remain proportionate and appropriately limited. This can include negotiating financial caps on liability, de minimis claim thresholds and time limits for bringing claims.”

CONCLUSION

This event highlighted the variety of factors relevant to exit and funding strategies, from the practical levers you can pull to drive and demonstrate value to the material considerations when exploring exit options right through to the intricacies of transacting.



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The meaningful contributions from our attendees generated an insightful and lively discussion, drawing on their experiences across a variety of sectors, whilst linking the conversation to common challenges and opportunities faced by all business owners.

Key themes from the event were timing and being empowered by information and knowledge, working hand-in-hand with your advisers from an early stage to best understand, drive and retain value with a view to being equipped to achieve the best outcome.

ABOUT THE HOSTS

Hay & Kilner is one of the North East's leading full-service law firms, trusted by businesses, individuals and families for 80 years. We combine exceptional legal expertise with a genuinely people-first approach. That means clear advice, straightforward conversations and support you can rely on at every stage. Whether you're protecting your business, resolving a family matter or planning for the future, we're here for you.

Ryecroft Glenton is an independent firm of Chartered Accountants and Business Advisers based in the North East, with a heritage dating back to 1901. The firm provides clear, practical and commercially focused advice to businesses, entrepreneurs and individuals across all aspects of accountancy, tax, audit, wealth management, outsourced | FD and corporate finance. With a strong belief in creative thinking and long term relationships, Ryecroft Glenton works closely with clients to help them navigate change, make informed decisions and achieve sustainable growth.

NEL Fund Managers is a leading business investor in the North East, specialising in tailored financial solutions and strategic support for small and medium-sized enterprises. With over 30 years' experience and more than 1,000 investments completed, NEL works with ambitious businesses seeking funding from £25,000 to £2 million, often alongside other investors. The team is committed to bespoke guidance, connecting clients with a network of sector experts to help them achieve their growth ambitions.

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