

How to value a business & maximise your deal

Guide 1

Avondale Business Guides Series

How to value a business and maximise your deal

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This Guide is not intended to be definitive, and the accuracy of its contents can not be guaranteed. Professional legal and financial advice from your regulated advisors should be taken on all aspects of transactions.

Business Valuation

Introduction

Valuations of businesses are a matter of opinion. A business is worth as much as a buyer is prepared to pay for it, and as much as a seller is prepared to sell it for. A valuation will normally seek to measure the trust a market has in a business and in its ability to create wealth (the goodwill). A professional valuation should establish the fair market value a willing and informed buyer would purchase a company for in normal open market conditions. Goodwill is intangible, although the accounting definition is the difference between the purchase price and the company's balance sheet assets (net assets).

The Formula

There are many different techniques for calculating the value of a business. Typically in unquoted smaller businesses the most usual method is to use a multiple of one year's maintainable profits. The chosen multiple is the number of years it is considered acceptable to generate a payback on the investment. This can be expressed as a formula:

$$\text{Multiple} \times \text{Maintainable Profit per annum post tax (pa)} = \text{Likely Valuation}$$

Or to work the equation, backwards if you know the price paid then;

$$\text{Price paid/Maintainable Profit post tax pa} = \text{Price Earnings ratio (number of years to generate payback)}$$

Or if you know the price paid/agreed and you want to work out the return on capital employed (normally used to compare return against other possible investments)

$$\text{Net maintainable profit post tax pa/price paid} \times 100 = \% \text{ Return on capital employed (ROCE)}$$

The Multiple

A multiple for smaller private businesses is based on its desirability dependent upon market forces, perceived risk and buyer's individual circumstances. The higher the multiple the more desirable and sustainable the business is thought to be. This means the acceptable pay back period is longer, or the acceptable earnings per share/equity are lower. Individual circumstances can have a significant affect. A buyer offering a linked product with cross selling opportunities, client synergy and the ability to benefit from economies of scale is likely to attach a higher multiple to a business than a buyer that reaps no obvious direct benefits. Multiples are also dictated in comparison to the return other investments can make.

How is a market's perception and therefore multiple decided upon? The following list is not exhaustive, nor in any particular order. It provides some examples of the aspects that should be taken into consideration when choosing a multiple.

1. Industry sector
2. Assumed level of profits
3. Business size
4. Quality and sustainability of earnings
5. Track record of growth
6. The strength and value of the asset base/debt levels
7. Growing market trend/demographics
8. Cost of expansion (high or low investment required to create growth)
9. Location, pleasant business environment
10. Brand strength
11. Customer loyalty (strength of contracts if any)
12. Strength and reliability of cash flow
13. Ability to finance
14. Research and development
15. Intellectual property (patents, ideas, copyrights, research and development)
16. People, desirability of (skilled staff and management)
17. Fad (the in thing)
18. Market comparison (listed companies quoted current value and other SME deals recently done).
19. The level of risk in a business

Other Methods

Other methods used to value businesses include industry specific formulas, asset based valuations, discount cash flow forecasts (DCF) and dividend formulas. However, a multiple calculation is by far the most common method used.

What Multiple?

In recent years smaller business multiples have run from as low as 1 to as strong as 14 times (post tax) net profit earnings. The high multiples quoted here only relate to the largest businesses within the small to medium size (SME) sector and includes private companies converting to public status (floatation's). This reflects the strength of their earnings and in the case of floated businesses, the availability of their shares to the public providing an accessible ongoing trading market. In general terms, as private companies get larger with higher profits and more infrastructure they are worth more. This is because larger businesses usually offer:

- More economies of scale enhancing a potential buyers likely profit.
- A better infrastructure, systems, management and asset base.
- A higher quality and sustainability of earnings.
- A wider appeal to global buyers with deeper more accessible pockets.
- A strong brand, established customers and goodwill behind their profits

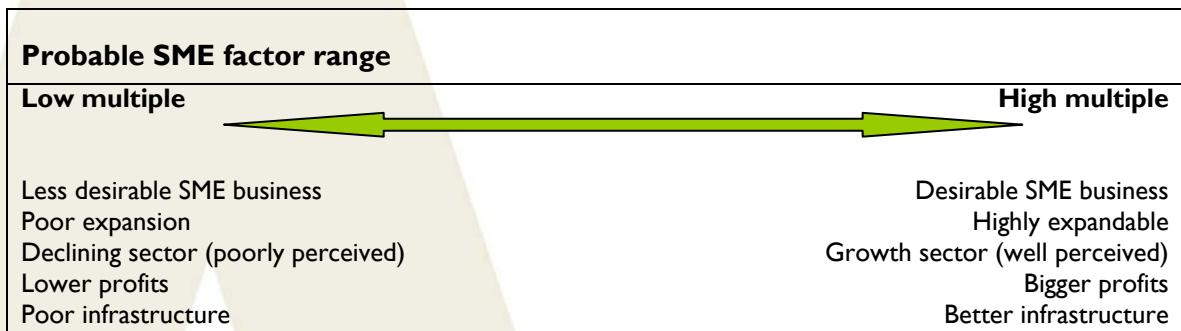
The average multiple in the SME market is at the time of writing in the low to mid range of these figures e.g. 2 – 8 (pre tax). Of the factors given previously, it is usually, the size of a business, level of profit, asset base, sector and market conditions that are the most significant factors involved when choosing a multiple.

Size - Whilst there are some 3.2 million business in the UK, most of these are one-man operations or quasi- jobs and therefore very difficult to sell. 2001 DTI statistics estimate that there are some 600,000 UK employers earning in excess of £75,000 net profit. The following table shows a possible formula for these businesses based on the market at the time of writing. It takes no account of specific sector trends or adjustments that may need to be made to the net profit.

Asset base - Multiples are principally about the treatment of goodwill; the intangible asset reflected ultimately by how much profit a business makes, but what about the tangibles, such as the fixtures, equipment, plant, freehold or the stock? Depending on the size of a deal, these tangibles are usually accounted for in the total for goodwill. This may sound harsh but ultimately, there is, in general no point to business assets unless they generate a return, thus the multiple should take into consideration these assets. However, some adjustments can be made to the multiple, for companies with highly saleable fixed assets such as a freehold, desirable plant or vehicles. A common adjustment with freeholds is to strip them out of the equation all together, and to value the business on a leasehold basis after accounting for a rent. Cash assets over and above the working capital requirements of the business are also usually stripped out before a sale.

Sector - Different sectors command different multiples reflecting the markets perception of a specific sector. Perception normally reflects demographic, environmental, social, competitive, and economic trends. It is also usually dictated by the expected lifecycle of a product, the size of it market, expandability and level of risk. Strong sectors are generally expanding, well perceived and sustainable. Businesses in the sector will generally have a low cost of expansion and enjoy good trading conditions and prospects. Occasionally a sector's perception can be influenced by fashion or 'fads'.

Market conditions - Multiples will also be dictated by market conditions. In general SME businesses have robust multiples whatever the economic conditions. Acquisitions can be attractive alternatives to organic growth. Indeed in some highly competitive sectors organic growth (internal investment) bears little fruit, making acquisition the only option to increase market share whilst maintaining margin. Even in an economic slowdown many buyers struggle for margin and by combining two operations economies of scale can be reaped (1 plus 1 = 3 otherwise known as synergy). If interest rates are low the purchase may be financed cheaply.



		Profit in £000							
		50	250	500	750	1000	1500	2000	2500
Multiple range	10								
	9								
	8								
	7								
	6								
	5								
	4								
	3								
	2								
	1								
Likely							Least likely		
The higher the multiple the more likely a sale structure will include an earn-out.									

What Profit?

An acquirer is buying the ability to create future profit, but what is the underlying level of true profit? The historic net profit has been spent. The accounts may be unaudited and were probably produced for the Inland Revenue. One person's costs may be different to another. What can we do?

The net profit used for a valuation is usually based on last year's maintainable pre-tax net profit. This is the profit a buyer is likely to maintain after taking account of the seller's personal and extraordinary costs. Questions will need to be asked and assumptions made. To name a few these might include:

- What is the quality of the earnings?
- Is an average of past profit realistic or is last year's profit more reflective of future earnings?
- Has the profit historically been reliable at this level?
- Is the cost base sustainable?
- Is there any one off costs likely to be incurred in the future?
- What is next years realistic forecast?
- Are the forecasts realistic and how expandable is the business?

- Will the customers stay with the business?
- Is the market or business expanding or contracting?
- Will the contracts continue?
- Is the market changing?
- Are there any environmental, demographic or social trends likely to affect future earnings?
- Is the business competitive and likely to remain competitive?
- Are the customers high or low risk?

A sustainable profit figure will be assumed, often using last year’s net profit as a base. It is then normal to make specific adjustments to this figure to obtain the net profit to a buyer, rather than the one the previous owner may have enjoyed. This is called calculating the adjusted net profit. An adjusted EBIT or EBITDA may be used depending on sector. This is calculating the earnings before interest and tax (EBIT) or depreciation and amortisation (DA). The below list is by no means exhaustive but shows the sort of adjustments that might be made.

- Salary.
- Extraordinary or personal costs.

Adjustments to the net profit might include ‘add ons’ such as:

- Costs for placing the business under management.
- Additional premises cost if requiring relocation.
- Investment required replacing old equipment.

Typically, in smaller private companies the adjusted net profit will be calculated:

- Using the last full financial years profit figure.
- On a ‘stand alone’ basis, without the economies of scale or synergies a buyer may bring, being taken into account.
- Under management basis rather than a working owner.
- Post tax.

Sale Structure

A valuation will also be affected by the sale structure. Before valuing a business it is important to ascertain what is and isn’t included. With a limited company it is normal to sell the shares of a business. This means the buyer assumes all the liabilities, and assets in the company. It is possible however for just the business goodwill and certain assets to be sold (an asset and goodwill deal). See the table below for some of the advantages and disadvantages. An asset and goodwill deal makes the company the vendor. It is then up to the shareholders to work out how to take the proceeds out of the company, perhaps by dividend or liquidating the company. Sole traders or Partnerships own their assets and goodwill personally (as individuals) and therefore are always sold on an asset and goodwill basis.

Asset sales	<i>Advantages</i>	<i>Disadvantages</i>
Buyers	Can amortise goodwill, reducing profits saving tax. Creates a clean purchase avoiding hidden or contingent liabilities (skeletons in the cupboard), Less due diligence and faster completion Lower professional fees	Contracts may not transfer easily Transfer of undertakings and protection of employment (TUPE) legislation can be difficult for buyers seeking to change staff contracts for integration reasons after purchase. Any leases will need ‘assigning’ which is time consuming
Sellers	Less legal costs or onerous contracts due to clean break Less due diligence and faster completion Can rollover the proceeds to off set double tax charge	Sellers can face a double tax charge, as the company is the vendor, it pays corporation tax on profit on sale of goodwill. Then the sellers pay more tax when taking the proceeds out of the company.

Under the current tax regime, assuming contracts are transferable, most buyers will prefer to buy assets and goodwill rather than shares, and sellers will prefer to sell shares to avoid a potential double tax charge. Usually sellers win because even buyers can see that sellers will not tolerate a double tax charge. Both parties should refer to their professional advisers as early as possible in the deal making process before making any assumptions.

Whatever the sale structure the valuation technique is the same although the type of sale whether assets or shares will have a bearing on the assets and liabilities being included in the deal and will therefore have a bearing on the multiple chosen.

The optimum purchaser, the optimum valuation

In order to value a business and to obtain the best price it is essential to have in mind the likely buyer. Better still several buyers in order to obtain maximum market appeal. The optimal purchaser is one who has a ‘we want, we need’ motivation:

- Willing to pay a premium
- Can add value by synergy or economies/management
- Has vision for the business
- Does not have regulatory/monopoly constraints
- Has the funds and the strategy today
- Understands the business and has the people to run it
- Is sensible about their ‘investigations’ into the business (due diligence) and the sale contract they will require

So who will pay the most, and what motivates each type of buyer?

<i>Acquirer type</i>	<i>Positive</i>	<i>Negative</i>
Direct competitors	Understands your value Will benefit from economies of scale Will have management to run it Organic growth is slow Funding usually accessible	Confidentiality May be ‘researching’ rather than buying Requires board approval and strategies change leaving risk of a last minute reversal
Companies in related industries	Value knowledge of target Could enjoy economies of scale Could enjoy synergies Should have management to run it Funding usually accessible	May be ‘researching’ rather than buying Requires board approval and strategies change risk of last minute reversal
Suppliers/customers	As above	May damage your goodwill if the process goes wrong
Overseas buyer	Wants foothold in your country	Does not have cultural understanding
MBI/MBO (Management buy in/buy out)	No ‘research finding process Understand the business more Managements track-record can help funding	Existing management may end up damaging business if MBO fails Pay less as leveraging the cash Entirely subject to the financier’s decision
Financial Purchasers (Private equity houses/Venture Capitalists)	Will look at all types of trade Can leave vendors significant stake	No synergies Looking for low risk Don’t understand the trade
Individuals	Can act quickly (no board strategy/politics to consider) Take risks	Will buy for the enjoyment of the job/business rather than just the financial return Investing their savings or borrowing so can be conservative and unreliable/whimsical Pockets are usually not deep No economies or synergy

Should I Be Selling and at what price?

Many professionals will say a business is worth what someone will pay for it. This is true, but it is also worth what someone will sell it for. A business may be worth more to the seller than to the buyer. Most valuations are carried out assuming a sale has been decided upon and that there is a reason to sell. In other words assuming there is a willing seller. However our experience is that the motivations and willingness of sellers vary and this does have a bearing on the value to them. For many sellers, their business is often their largest asset and only income source.

As a seller prior to accepting a deal it is vital to consider in detail your objectives. It is important with your own strategic, and if you are an owner manager, personal, financial, and lifestyle position in mind, to have a clear bottom line. Your bottom line is where it is worth selling versus keeping the business. This bottom line should be based on the net proceeds, which is the total sale price less tax and professional costs/fees. In the case of an owner manager the decision to sell might balance the following:

Net proceeds on sale

Post sale financial position.

- Will the mortgage be paid off?
- If so can I live on less?
- What is investment yields
- Am I relocating and is the cost of living cheaper or higher there?
- Will I continue working?
- Have I a pension?

Motivation/strategy for sale

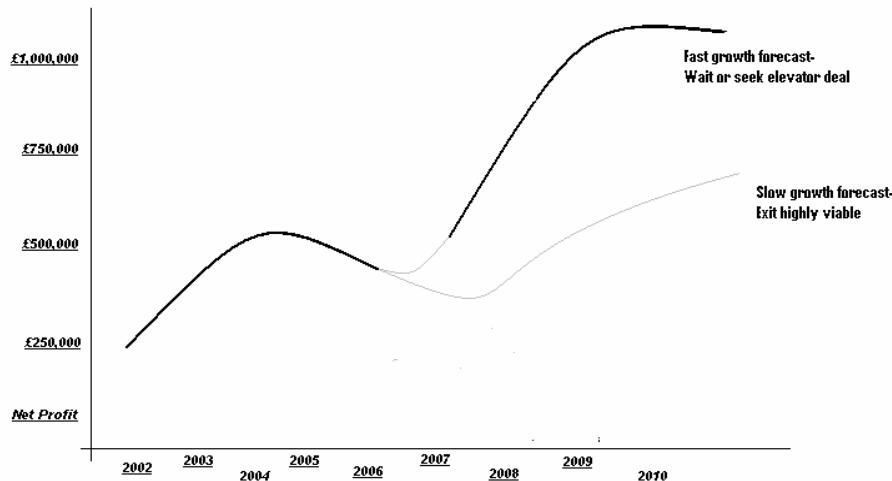
- Is it the right time to sell
- Have I/We had enough?
- Am I retiring?
- What will I do next?
- Am I opting for a different lifestyle?
- How is my health?
- Will I need as much money in my 'after sale' lifestyle?
- What do the family need/want?

Current motivation in business V Risk/decline/increase in business

Small companies usually generate a good investment return. This means there usually needs to be a reason for sale over and above the financial return. Sellers should value their time wealth.

Timing your transaction

Ideally an outright sale will be sought before business has plateau in growth but where fast growth is not envisaged. If fast growth is envisaged seek an elevator deal (see guide deal structures) which working with the buyer will maximise the proceeds over time.



Tax

Tax on any capital gain you make will probably be your biggest cost. The rule here is get professional advice early on to secure the most profitable sale. Currently ‘taper relief’, an Inland Revenue allowance, makes selling an attractive option. Taper relief reduces a chargeable gain according to how long you held the asset before you disposed of it. The relief is given after all other reliefs and allowances. The amount of the reduction depends on how long you held the asset (the qualifying holding period), and whether the asset was a business asset or a non-business asset. Taper relief creates a significant argument for entrepreneurs to make money through capital gain rather than through ongoing profits.

Taper relief on business assets on or after 6th April 2002	
Number of whole years in the qualifying holding period. This is from the date on which you acquired the asset, or 6th April 1998	Gain remaining chargeable
Less than 1 year	100%
1 year	50%
2 or more years	25%

Based on tax rates at the time of writing the above could mean paying tax of 10% or less on any capital gain made, but please refer to your professional tax advisor before making an assumption as taper relief is not always as straightforward as it first seems. In order to protect your sale proceeds for your family in the future it is also sensible to take advice regarding your inheritance tax position.

Costs

Sellers also need to allow for professional costs including a merger and acquisition advisor, a tax advisor, accountant and a lawyer. These costs vary but you get what you pay for. For smaller companies professional costs are usually between 5-10% of the proceeds. Some of the costs will be prior to the sale.

Net proceeds calculation

Current Earnings (profit and or salary/benefits)	£
Divided by no of vendors	
Equals Earnings per vendor	£
Less Income tax & National Insurance	
Equals Net income per head	£
Price achieved	£
Less Capital Gains tax less taper relief (10%)?	
Sale advisors fee (if any)	
legal and accounting costs	
Equals Net Proceeds (capital sum)	£

Once you calculate the net proceeds a financial planning exercise needs to be undertaken. For example:

- Will I save on the mortgage? (Pay it off if any)
- What will the investment return be on a capital sum invested
- Will I continue working and have other sources of income
- What will my costs be after sale and any changes in lifestyle that may occur.

Art Not Science

The adjustments that are reasonable and acceptable to make to the net profit are a matter of opinion. The multiple or length of time acceptable for pay back are also a matter of opinion. They depend on the buying and selling parties point of view. No two organisations or individuals are the same and therefore opinions will differ.

Consequently, valuations are an art not a science. Knowing the formula to value a company is not enough. Having an instinct and a comparison (past experience) is also vital. Knowing the market and the way the likely buyer will operate is essential. Only an organisation or someone that is constantly completing deals can therefore hope to give a near accurate forecast of valuation. Even then, a true professional will always admit that their valuation is a forecast of what the market will assume and that markets are notoriously fickle both upwards and downwards. It is also important to remember that a valuation is an estimate at a given point of time. Profits change and so do market conditions, perceptions and assumptions.

Good negotiators buy cheaper businesses and sell more expensive ones; it's that simple. So if you are buying or selling it is also important to understand how to negotiate, as well as how to value a business. Timing also plays a crucial part... buy near the bottom and sell near the peak. If you know when that is please call us!

The Valuation Steps (A Summary)

1. Guess estimate whom your buyer/seller will be
2. Calculate an adjusted sustainable net profit that buyer/seller is likely to make.
3. Be reasonable and conservative on adjustments to the profits.
4. Normally, work on a business under management (staff run) basis.
5. Rationalise/review assets. Work out what will be included in a sale and likely sale structure. Will it be a share transfer or an asset deal?
6. Talk to an experienced active dealmaker who understands the sector to obtain a multiple appropriate for the size and type of business.
7. $\text{Multiple} \times \text{Adjusted Profit per annum (pa)} = \text{Likely Valuation}$
8. Check the final Return on capital employed. If you spend £1 will you get back profits in a year of 10 p, 20p, 25p, or 50 p? If its 20p it's a five-year pay back pre finance/tax.
9. Ask yourself would you pay this, in comparison to other investments?
10. If you are acquiring, balance your return on capital employed to strategic need to buy.
11. If you are selling, balance your final net proceeds (after tax and costs) to willingness/strategic reason to sell.

The value of a private business is the price achieved by a willing seller and willing buyer for the controlling interest on the day of completion

Minority Shareholder valuations

If a minority Shareholder in a private limited company wishes to sell his shares he may well find that it is impossible to sell them on the open market and he may be as a result at the mercy of the continuing Shareholders who may or may not be prepared to pay a "fair price". It is often not appreciated how little a minority shareholding may be worth in the absence of an arrangement (in the Articles of Association or by way of Shareholders Agreement) that such shareholding shall be valued at a pro rata fraction of the value of the Company as a whole. For majority stakeholders seeking a transaction, minority shareholders can form a major barrier and it is well to examine their position early on. Whilst every valuation must depend on its own factors so that it is impossible to generalise nevertheless case law suggests minority shareholders not valued pro-rata in a shareholders agreement be valued at:-

- A 25% shareholding in a Company may be valued at 5% of the value of the Company as a whole.
- A 49% shareholding in a Company may be valued at 20% of the value of the Company as a whole.
- A 55% shareholding in a Company may be valued at 44% of the value of the Company as a whole.
- A 75% shareholding in a Company may be valued at 75% of the value of the Company as a whole.

We suggest that anyone who is considering becoming a minority shareholder in a private limited company should consider the following questions:-

1. Do the majority of the Shareholders agree that each of you will exercise your voting power in the Company to ensure that certain named individuals will be the directors of the Company?
2. Is it agreed that the appointment of any new Director will require the approval of all of you?
3. Is It agreed that every Director of the Company shall be a Shareholder?
4. Is it agreed that any Director who ceases to be a Shareholder shall forthwith cease to be a Director?
5. Should any Director who resigns his directorship or who becomes disqualified from being a Director be forced to sell his shares to the other Shareholders.
6. Should all Directors be paid the same and if not should the Directors by majority vote be able to decide upon the remuneration to be received by each Director?
7. Should each of the Directors devote his full time and attention to the business of the Company?
8. Will the Directors all have Service Contracts with the Company?
9. Will any Managing Director or Chairman have a casting vote at Directors meetings?
10. How many Directors will need to be present at a Directors meeting to constitute a quorum?
11. Will the Directors agree not to compete with the Company nor poach its customers nor divulge its trade secrets both during the time that they remain Directors and during a period of say one or two years thereafter?
12. If any Director has to give personal guarantees to the Company's Bankers or Landlords do the other Directors agree that any liability will be shared by them all equally?
13. Is it agreed that no party will seek to quit as a Director/Shareholder for a minimum specified period?
14. Is it agreed that the consent of all will be required before the Company can launch into any new business venture which is substantially different from that presently proposed or before Company can increase its share capital or borrowing in excess of a specified sum?
15. On the occasion of any future allotment of new shares in the Company should each existing Shareholder have the Option to subscribe for shares pro-rata to preserve his relative voting power?
16. Should any Shareholder be free to transfer his shares to whom so ever he pleases or should the continuing Shareholders have the option to buy the shares of any Shareholder wishing to sell?
17. Bearing in mind that a Shareholder may find it impossible to sell a minority shareholding on the open market should the continuing Shareholders be obliged to purchase the shares of any Shareholder wishing to sell his shares subject to the proviso that if the continuing Shareholders cannot afford the shares themselves or cannot find Purchasers for the shares they will concur in a sale of the Company as a whole or the liquidation of the Company if necessary?
18. On what basis should the price to be paid for a shareholding be calculated? Should a 25% shareholding for example be valued at 25% of the value of the Company as a whole? If shareholdings are to be valued by reference to the value of the Company as a whole should the value of the Company as a whole be determined by the Company's Auditors as experts or by a more specific formula related to the profits and/or assets of the Company?

19. If the price to be paid for a shareholding is likely to be substantial should the purchasing Solicitors be allowed to pay the price with interest by way of instalments over a specified period?
20. A transmission of shares occurs when a Shareholder dies or becomes insane or bankrupt. On the occasion of a transmission should the continuing Shareholders have the option or the obligation to buy the shares in question? The same considerations as are mentioned in paragraph 17 above with regard to Share Transfers are relevant to the question of transmissions.
21. Do You agree that the consent of all of You should be required for any alteration of the rules of the Company i.e. the Articles of Association?
22. Can you agree now on a dividend Policy for the Company or are you happy for the Directors to decide the matter from time to time? You could decide now that a specific Percentage at least of the Company's profits after tax shall be distributed each year by way of dividend to the Shareholders.
23. It is agreed that all Contracts to be entered into by the Company will be negotiated on an arms length basis and at competitive prices?

Having considered the above questions, one needs to look at the existing Articles of Association of the Company to check the present provisions with regard to such matters as Share Transfers, pre-emption rights, transmissions and allotments of new shares. The security of a minority Shareholder will depend on a satisfactory interplay between the provisions of the Company's Articles of Association and the provisions of a Shareholders Agreement.

Grooming to maximize your exit

A sale strategy should be devised some time before the anticipated sale date. A few practical steps can be taken to increase value and marketability. These factors do not solely relate to profitability but include reducing uncertainty, complications and risk to the acquirer. The following are the more common issues:

Market presence	Differentiate yourself from your competitors by establishing a core area of strength within your market sector. Perhaps intensify your marketing strategy to raise the company's profile. The market leader or threat to market leader in a sector is the most valuable in a sector.
Tidy up	Present the business in the best possible light. This may mean tidy offices, or a smart corporate brochure.
Rationalise	Consider separating any part of the business that will not add value to the sale. Ensure all elements of trading are visible.
Management	Either recruit a suitable successor to run the company or consider a hand over period with some form of consultancy or employment.
Formal contracts	Including trading, employment and agency agreements to ensure they are transferable to a new owner.
Litigation	Conclude any litigation, either by or against the company.
Profitability	Maximise profitability and reduce non-core business expenditure.
Private assets	Remove private assets that are not used in the business. E.g. cars. Consider also the most appropriate treatment of assets, loans to the company by yourself or the pension scheme.
Ownership of tangible/intangible assets	Ensure all assets and intellectual property are properly vested in, or licensed to the company. Secure trademarks and patents where possible.
Balance Sheet	Streamline the balance sheet. In particular review; slow moving or obsolete stock; the ability to recover debts; and status and value of property or other fixed assets. Considering hiving off non core activities to separate companies.
Reduce dependency	Dependency on key customers or suppliers can, on occasion, significantly reduce marketability of the business especially where there is a close relationship with the owner.
Environmental Health and Safety Issues	Ensure the company possesses all appropriate licenses and complies with all required procedures. Ensure environmental concerns associated with the business premises, production process or products are understood and minimized. An environmental audit may be appropriate to establish areas of concern. A similar review should be undertaken for the health and safety aspects and fire risks of the company.
Property	Leases can be a liability if the buyer wishes to relocate. Try and keep terms flexible. Look also at any dilapidations liabilities you may have associated with your lease, particularly for multi site businesses. This can be costly. If Freehold secure up to date valuation. This may have significant tax implications.

Taxation	Take advice on the tax considerations; e.g. capital gains tax, reinvestment and rollover relief. Also consider any unused capital allowances particularly where freehold business premises are owned. Both company and personal taxation issues must be considered.
Information	Ensure information is available and properly recorded to enable a potential acquirer to fully assess the business. This may mean changes to the way information is being recorded and presented.
Advisors	Identify your strategy early on by involving an experienced corporate advisor at the earliest stage.
Minority shareholdings	We have already examined above how minority shares may be valued differently. It is worth considering a buy-out pre-sale. Alternatively dealt dialogue should be had with the minority stakeholder prior to undertaking a transaction to examine their attitudes and create a plan as to how to bring them with an exit. They may of course and often do continue working with the new owners.

What are you going to tell prospective purchasers?

The initial approach:

A confidential sales letter or sales details would be the first document to be sent to any prospective purchaser - this should only be a taster 'dangling the carrot' of the company together with a request that they complete and sign a 'non-disclosure agreement' for a further more detailed information memorandum on the company for sale.

Information memorandum

This is a document that needs to stand out from the numerous proposals active purchasers will be receiving. Therefore it has to be made as easy as possible for any potential purchaser to decide to buy this business. So when preparing a sales pack '**Information memorandum**' remember this is a crucial document that must be prepared and polished long before contacting any interested parties as it can be the main cause for a purchaser to determine whether they want to buy the business or not and also how much they are prepared to pay.

Therefore it has to be an accurate and true documentation disclosing any material facts. A discovery of anything during the due diligence process could undermine the buyers confidence in you and the worst case scenario will most definitely damage their trust in sellers honesty which may lead to a collapse in negotiations later on. There is a balance between presenting the company positively and in a way that will attract buyers, while taking the opportunity to present main weaknesses and risks of the business in its best light. '**Honesty is the best policy**'

Initial contents of a basic information memorandum:

- Business Background
- Market
- Operations including schedule of employees
- Assets
- List of trademarks and patents (any other important contracts)
- Detailed lists of land and properties and any other major items
- Up to date financial information including up to date management accounts and forecast
- Company structure and staff schedule (not showing names) including ages, length of service
- Details of shareholding, reason for sale and handover
- Breakdown of sales and gross profit (not mentioning customer names)

Golden rule the information memorandum must be an easy to read and follow giving a well-directed account of the positive aspects of the business not boring its reader.

Tax

The Capital Gains Regime is changing dramatically in April 2008. At the time of writing the full details are not known (Feb 08) and therefore we have left any references to the previous regime in these guides pending further edits when all the details are known,

New Regime (post April 2008): Tax considerations when selling a company are complex but need to be understood as they have a huge bearing on the sale and the amount of cash you will either pay or come away with. Ideally planning should take place before signing heads of agreement. There are various ways in which tax charges can be mitigated, or even eliminated. Here are some examples of the things that vendors might need to look at:-

- Be clear about what you are selling.
- Check your entitlement to Entrepreneur's relief which reduces the 18% Capital Gains Tax to 10% on the first £1 million capital gain.

To contact a specialist tax adviser please contact your local Avondale office.

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