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**This Exit Strategies Newsletter
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Three Phases of a Management Buyout

Dear Client,

Management buyouts are very special and sensitive transactions that are becoming more and more popular in exit planning as more business owners realize that outside buyers may not be available to purchase their business as part of their exit.

For your key employees, this management buyout will likely seem like both a once-in-a-lifetime opportunity, as well as a large burden of assuming ownership. Since your managers are being invited to assume the role of ownership, it is natural that many questions will arise for all parties involved. Accordingly, these three (3) phases of a management buyout will assist you in determining the proper steps to take in moving ahead with this type of exit plan.

Phase #1: Financing & Deal Structuring

The first phase of a management buyout goes to the financial aspects of the transaction. At the core of the transaction is a sale of a business from owner / investor to another. The company needs to provide a return on investment to its new owners. And the exiting owner

needs some level of comfort that the business will continue to operate effectively once the sale is completed. There are a few questions related to the financing and deal structuring that surface immediately.

What is the company worth, and what is the manager (or the management team) able to render in down-payment?

Will the managers secure any bank financing with their own personal guarantees and the value of the company's assets.

What is the owner willing to take in a note in order to bridge this rather large gap between the value of the company and the employee's available capital?

How is the owner's note going to be secured?

On the point of value, if an owner wants too high a price or too many personal benefits or a salary that continues for too long into the future, the managers will get resentful as they feel that the fruits of their labors are not going to them (particularly since they have just increased the risk in the relationship). Owners need to remember that despite the fact that these employees worked for you

all these years, there needs to be a financial return for them in order for this transaction to make sense. Beyond that, the particulars of financing the transaction will need to be detailed as part of the deal structuring.

Unfortunately, financing and deal structuring is the easiest part of this transaction. Far more delicate is the communications inside and outside of the firm.

Phase #2: Intra-firm Communications

The second part of a management buyout is internal communications – discussions within the firm about succession of the business.

Too many owners of privately-held businesses feel pressure to engage in a conversation about the future of the business with their managers. This naturally comes from the desires of managers to want to know about their own futures and their potential for greater income and/or ownership. When these conversations occur, it is important that clear communication is used so as not to excite the expectations of the managers.

There is a delicate balance in these communications. On the one hand, in order for your exit to be a success, the managers need to ‘buy in’ to the idea of ownership. However, in order for their ‘buy in’ to occur, it is necessary that you communicate your intentions to them about the transfer of ownership.

Beyond the communications between you, the owner, and your managers, there is also the issue of communication with the other employees at your firm. Which

ones will not make the grade and be offered future ownership? Will they feel alienated? Slighted? Threatened? All of this needs to be communicated in a transparent manner so as not to interrupt the already delicate employer / employee relationships between owners, managers and employees.

How these communications are handled is critical and often can occur over many years as the responsibilities are detailed, defined, and transferred from the owner to the manager and the management team. Also, over a number of years, managers are able to naturally assume leadership positions within the company. This is much more favorable than simply anointing a successor.

In the long-run it all comes down to people respecting other people. It is not enough for you to believe that your choice for successor(s) is the right one – your other employees must also feel the same way. Seek inputs from other employees in a casual manner over a number of months or years so that you can confirm whether or not you are making the right choice for successor.

Once the choice is made, keep communication clear and open as to the future of your company.

Phase #3: Communicating the Change Outside the Firm

The third phase is that of communications with the outside world. The customers, the vendors, the bank, and everybody else who comes in contact with your business needs to know about the transition. Again, it is best if this occurs over a period of time to make it appear as

smooth and natural a transition as possible. In essence, this is a public relations campaign for your firm's transition.

Nobody likes surprises, particularly when it concerns a valuable business partnership. Accordingly, you need to realize that all of the customers, vendors, and other people associated with your business need to be apprised of this succession plan. Once again, a well designed communications strategy with the 'outside world' is appropriate and optimal if it is performed over a long period of time.

Conclusion

These three phases together provide for a foundation to begin to design a management buyout for your business. These are helpful steps in starting a conversation with your team and for you as the business owner, to begin to consider what's involved, how long it will take, and exactly what you're able to get out of the business, net of taxes and net of fees over time in order to meet your post-exit goals. Therefore, management buyouts can be very helpful to a business owner in a tough economy who is trying to construct and design a customized exit plan from their business utilizing the resources that are available to them, namely, their existing management team.

If you have any follow-up questions or wish to provide feedback, please contact me.

Also, feel free to share this newsletter.



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