Winner of Corporate Law Firm of the Year
Welcome

Welcome to the second edition of the Michelmore MBO Guide. As one of the most active corporate finance teams in the region, we thought in 2013 it would be useful to share our experience of the MBO process for the benefit of potential management teams, sellers and their advisers. Since then we have acted on a large number of transactions and market practice has evolved, so it is time to update the Guide.

Pursuing an MBO opportunity can be one of the more complicated ways of acquiring an equity stake in a business, but a well put together MBO can be extremely rewarding for all involved.

In this Guide we will map out the process, the people involved, the type of MBO opportunities that are most viable and share the latest thoughts and perspective of some of our MBO team clients and advisers.

We have also included a glossary of terms used in MBO transactions and our private equity checklist, which can be used to compare different funding proposals.

Please do not hesitate to contact us if you would like further information on any of the topics in this Guide.

Richard Cobb – Partner & Head of Corporate Finance
The team has always been of a very high standard, providing high quality advice

Chambers 2015
What is an MBO?

A classic management buy-out (MBO) is a transaction where the owner of a company sells some or all of the shares in that company to a new company which has been set up by the management team, paid for by the management team, private equity investor(s) and a bank. Around 15% of exits are thought to have some MBO element. Smaller MBOs can work without private equity or bank support, especially if owners are willing to accept payment in part over time.

It is still quite common for the seller to retain an interest in the company in the form of debt in this way, which is repaid by the company over time – this is called vendor financing. In some cases, often with a next generation aspect, we have seen transactions where all of the MBO is vendor-financed (in other words the seller is prepared to transfer ownership of the company but only receive payment if and when the company is in a position to pay back the debt). In these circumstances, a seller will typically require security or other rights of priority to ensure payment is made.

An MBO traditionally delivers value over time to the equity held by the management team and private equity provider in two ways:

- repayment of debt
- increase in enterprise value
Differences between an MBO and a trade sale

Owners of a Company have several routes to sell their interest in the Company if they choose to do so. Typically these are a public flotation or IPO (only suitable for certain categories of Company and usually not an outright exit), a trade sale, an MBO or a liquidation or break up, which will typically generate the smallest return.

Both an IPO and a trade sale typically require the seller to give a range of warranties and indemnities to the potential investors/buyer and the Company having to undergo a detailed due diligence process.

Advantages of an MBO

The advantage of an MBO is that the buyers of the Company are already very familiar with it. In many cases they are more familiar than a seller who has deliberately moved away from running the Company on a day-to-day basis as part of the succession planning process. This means that in an MBO transaction, the seller can fairly argue that he should not give detailed commercial warranties and that the MBO team should rely on their own knowledge.

Apart from reducing exposure under warranties, the fact that the management does understand the business and is already in situ generally means that the ‘execution risk’ of an MBO is reduced. Unexpected due diligence findings are less likely to derail the process if any potential backers have been informed by the MBO team at the outset of commercial concerns that would affect a third party backer.

MBOs are also favoured by sellers wishing to maintain a legacy rather than have their company swallowed by a large group or dismembered by a trade buyer.

Disadvantages of an MBO

From a seller’s point of view, an MBO can provide a willing purchaser who understands the business already, as well as an opportunity for valued management team members to take over the Company “in the natural course”.

The downside of an MBO from a seller’s perspective is that MBO teams are rarely self-financed and, even with bank and private equity backing, cannot afford to pay a premium price for the Company. Nor are they buying the Company due to a significant strategic fit (which can sometimes mean a Company commands a premium on a trade sale). There is also the important shift in the relationship between an owner and the potential MBO team, and the related downside risk if a deal goes badly or fails to complete.
What makes a good MBO opportunity?

There are far more MBO opportunities considered than there are completed transactions. A successful MBO needs a carefully crafted combination of target company, management team, financial backing and growth story in order to be successful. The following features are generally accepted as necessary for an MBO to have a chance of success:

**Competent and complete management team**

Apart from the pure quality of the incumbent management team, it is important that all key positions are filled – usually managing director, finance director, operations or IT director and sales director. It is possible to bring in team members as part of an MBO (a BIMBO), but backers will question any unproven members, particularly on the finance side, and most banks require a stable pre-existing team in place. It is sometimes said that the hallmark of a good management team is that they spot the opportunity and present a compelling case for the deal to the seller in the first instance.

Bear in mind the risk to the business of disgruntled senior executives who have not been invited to join an MBO team. This can be damaging whether a deal proceeds or not.

**Profitable growing Company**

Apart from the management team itself, the key factor is the quality of the Company itself. A Company should ideally show some or all of the following attributes:

- sustainable increasing profits
- growth story for the future
- strong cashflow
- sector of interest for the investors
- brand and/or competitive advantage
- untapped potential markets/products

**Flexible and willing seller**

It is essential that the seller is confident in the ability of his current management team to take on the Company effectively and, to the extent the Company will still owe money to the seller after completion, the ability to run the Company so as to support the payments to the seller. A seller willing to sell at the price the MBO team and its backers can afford is the most important element.
Cost to Management

In some cases the management team already owns a stake in the Company and is simply required to ‘roll-over’ this stake into the Newco. In other cases, the management team will need to subscribe for ordinary shares in the Newco. Depending on the size of the transaction, the management team equity can typically cost between £100,000 and £500,000. In most cases the contribution required per team member is in the order of one or two times their annual salary, which is enough to convince the PE House (and bank) that the management team are wholly committed and aligned with other investors in terms of protecting and growing the value of the equity.

In some cases, the seller may lend or even gift the initial funds required from management to members of the management team if they are not able to raise the funds from their own resources. It is important to note that it is only once all the bank debt, vendor finance, and preference shares or other priority equity has been paid for, that the ordinary shares owned by management have the prospect of accruing value above and beyond the price subscribed for them.
Performance incentives for management

The management equity is sometimes tied to an incentive scheme which allows the management team to increase their stake according to certain performance criteria or exit values. One way of achieving this is for management to have ‘flowering shares’, which themselves increase in value as the performance criteria are achieved (rather than additional shares having to be issued under a share option scheme). This can be a tax efficient method also used to incentivise management in a normal exit scenario.

It is quite common for the management equity to need to vest over time, typically two to four years. This means that a management member must continue to work for the Newco throughout that period before they are entitled to the full economic value of the shares they have subscribed for. Usually, after an initial period, the vested shares that have accrued during that period are retained if the management team member leaves in ‘good leaver’ circumstances during the two to four year period.
Who is who on an MBO

A typical MBO will have a large cast in terms of core transactional players and their advisers.

In summary these are as follows:
Typical timetable and process

Each MBO is different. Some can have a gestation period of several years, particularly if new MBO team members need to be recruited and become proven before the MBO team can initiate the process. It can be a difficult first step for a potential MBO team to raise the idea with owners, and vice versa. Generally it makes sense for the MBO team to have at least expressions of interest from funders before raising it, and getting to this stage can take some time. Once an MBO team is together and the underlying Company is a viable target, the process typically lasts six months.

Each of the following stages are usually required:

- appointment of lead adviser and lawyers to management team
- approach to Seller (now or once funding is in place in principle)
- agreement of outline terms with Seller in heads of terms
- preparation of information memorandum by lead adviser
- discussions with potential PE Houses and Bank backers
- selection of PE House and Bank
- agreement of detailed heads of agreement with Seller, PE House and Bank
- commencement of due diligence
- preparation of investment agreements and share purchase agreements
- due diligence/disclosure process
- agreement of MBO team contracts and share options
- completion

The assessment of the terms offered by PE Houses is particularly important. To assist lead advisers and MBO teams with this, we produced a Private Equity checklist which PE Houses can be asked to complete when they make an offer. This Private Equity checklist is included in this Guide in the Appendix.
Once the heads of agreement and funding terms have been agreed, a typical MBO will involve over 100 individual documents. The key documents amongst these are usually as follows:

<table>
<thead>
<tr>
<th>Document</th>
<th>Parties</th>
<th>Issues</th>
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<tbody>
<tr>
<td>Share purchase agreement</td>
<td>Management, vendors and Newco</td>
<td>Warranties, commercial issues</td>
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<td>Disclosure letter</td>
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<td>Subscription/investor agreement</td>
<td>Management and outside investors</td>
<td>Management warranties, conduct of business, restrictive covenants, NEDs</td>
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<tr>
<td>Articles of Association</td>
<td>Newco</td>
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<tr>
<td>Loan Notes</td>
<td>Outside investors, Newco and possibly vendor</td>
<td>Interest, repayment, security, interaction with financial covenants</td>
</tr>
<tr>
<td>Family agreements, security documents, inter-creditor deed and cross guarantees</td>
<td>Bank, outside investor, Newco and possibly vendor</td>
<td>Security ranking of creditors</td>
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<tr>
<td>Directors service contracts</td>
<td>Management and Newco</td>
<td>Terms &amp; conditions</td>
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Tax Considerations

The tax aspects of an MBO are an important structural and commercial feature of most transactions. The following key areas usually need to be investigated, alongside others which are situation specific.

Seller’s tax position

A seller will want to minimise the capital gains tax payable on the disposal of shares. Ideally a seller will be entitled to entrepreneurs’ relief, reducing the effective rate of tax to 10%. A number of factors may mean that this is not possible, particularly if the seller retains a significant interest in the Company going forwards.

Deferred consideration and contingent consideration, such as earn outs, need to be carefully structured as these could potentially attract higher rates of tax.

MBO team tax position

The MBO team will have tax issues relating to the shares or ‘sweet equity’ that they acquire in the Newco. It is important not to trigger any income tax liabilities as a result of acquiring the shares which occurs when they are seen to be acquired at less than their market value. There are ‘safe harbour’ provisions that have been agreed between HMRC and the BVCA, which mean that if the managers’ shares fall within those provisions, they will not be attacked.

Equity ratchets sometimes offered to MBO teams to incentivise performance also need to be structured carefully, so as not to create income tax liabilities. If the manager borrows to make an investment into the company, tax relief should be available on the interest, provided that the loan is structured correctly.

PE/VC funders tax position

Funders may have particular tax driven requirements for the transaction which may, for example, drive the debt:equity mix. Another requirement could be that the target needs to satisfy VCT requirements and if the venture capital investor is a VCT fund, this will also limit the stake that they can take in the business.
Newco tax position

There are several areas that the company needs to be alert to in relation to the transaction and these include:

Options

An MBO company that becomes a subsidiary of another company such as a private equity house will be unable to issue EMI share options to its employees.

VAT recovery on costs

This is an increasingly complex area, but in summary, it is imperative to get the MBO Newco vehicle created as soon as possible and for that company to undertake some activity.

Tax deductibility of costs

Broadly, if the costs relate to the acquisition of shares there will be no revenue deduction for the costs but if they relate to accessing financing, they will normally be allowable. However, as with VAT there is case law on this point and specialist advice should be sought.

Interest relief

By their nature, MBOs are normally leveraged. It is important to ensure that the interest relief is deductible against profits and does not get ‘stranded’ in a holding company. It is normally possible to work around this issue, but it does need some thought upfront.
Corporate Finance considerations

As lawyers we tend to work with expert corporate finance advisers and accountants on the financial aspects of putting an MBO together. We have set out below some thoughts on planning, financial and corporate finance considerations – kindly provided by some of the MBO specialists with whom we have worked recently.

“As with all corporate finance transactions, preparation is an important part of a successful management buy-out. An early focus on those areas important to investors (management team, growth strategy and exit potential) will enhance value for the management team and increase the likelihood of a successfully completed management buy-out.”

Mark Champion, Isca Ventures

“Three elements are essential for any MBO: the quality of the management team, thorough preparation and finally the right timing. Quality of management is the first item on any investor’s checklist when considering the funding of an MBO – quality in terms of breadth as well as depth. Preparation is key given the complexity of the MBO process and the risks involved. It is essential that management teams are well prepared. Timing is the last ingredient, executing the deal during the (sometimes narrow) window of opportunity when the vendors price expectations are fair, but can be met based on good visibility of future growth.”

Rob Crews, Momentum Corporate Finance

“Carefully chosen private equity advisers will help spread the load, perhaps by introducing new systems or ways of working. Unlike a bank, a private equity partner will offer advice, judgement and momentum, as opposed to mere liquidity.”

Guy Davies, Westbridge
“Think about the long game and do not just focus on short term targets. Prepare the exit strategy early and ensure you have a clear plan for long term sustainable earnings growth. Do not hide things from your investors. Remember they are your partners. Share your issues with them as often as possible. Disclose all news, even bad news: they will find out anyway, and they hate surprises! ”

James Finnegan, Bishop Fleming

“A successful MBO can bring great rewards (financial and other) to the participants. However, although each MBO is different, they are all hard work for those involved. For the management team it is even harder: the completion of the deal is only the start of the process – they then have to produce the results they have promised in the business plan and post the EU Referendum the projections will be subject to more sensitivity analysis and will need to be even more robust to down-side risks. The use of experienced advisers before, during and after the MBO can therefore help to alleviate part of this burden, whilst minimising the distraction of the deal to the normal operations of the business. ”

Mark Greaves, PKF Francis Clark

“Be sure that you take references on the Private Equity firm(s) you are considering working with. Do they have a reputation for ‘chipping’ the deal at the last moment, what are they like when the deal has been done? Ask particularly to speak to the management teams whose companies have underperformed. The relationship with your investor could be a long one, make sure that they are right for you. It is worth trading the odd percentage point of equity for a supportive partner. ”

Bob Henry, Mobeus
“MBO teams often don’t realise until very late in the process that they are absolutely critical to the success of the deal – both for the seller and for the incoming providers of finance. The key to a successful deal is being aware of this power and then wielding it appropriately.”

Andrew Hodgson, KPMG

“The feasibility of an MBO hinges on the vendor’s price expectations meeting the underlying value of the business to management and their financial backers – and these expectations are often miles apart at the start! Vendors have aspirations based upon multiples of earnings, similar transactions and comparable quoted companies. Whilst these measures helpfully set the envelope for negotiation, management are the ones that have to raise the money – to them business value hinges on its future cash flow generation and the returns for the banks and financial institutions backing them. Before embarking on detailed negotiations, management must understand the level and appetite of its backers to support an offer and, importantly, what equity percentage management are going to have in Newco. With all these moving parts in place, it’s then down to the vendor and management to get in the ring and agree a deal – sometimes going the distance!”

Gary Partridge, Lexington Corporate Finance
Our MBO: Aero Stanrew

Interview with Clive Scott, Managing Director of Aero Stanrew Limited

Aero Stanrew is one of the UK’s leading designers and manufacturers of specialist electronic components for the global aerospace industry.

Aero Stanrew supplies complex electromagnetic modules and electronic systems to blue chip customers, including Rolls Royce, GE and Goodrich and Thales from its headquarters in Barnstaple, Devon.

In February 2012, Michelmores helped a four-strong management team, led by managing director Clive Scott, acquire a majority stake in the company via a £8.5m MBO which was backed by WestBridge Capital and Momentum Corporate Finance.

Clive Scott and his team - Chris Evans, Owen Rolfe and Peter Vaughan - mounted the buy-out after being with the company for a combined total of forty years. At the time of the purchase Clive Scott said: “Although Aero Stanrew is already in a very strong position with a strong order book and recession resistant business model, this deal provides us with the opportunity to pursue ambitious plans for further growth.”

In 2015, Aero Stanrew was sold to a UK Listed plc, TT Electronics, for in excess of £40m in cash and shares in an award-winning transaction. Michelmores advised on the original MBO and the subsequent sale.

Clive has remained with the business and having seen the process from MBO to the ultimate sale that private equity backers are looking for happen in such a short time, is well placed to comment.

What were the key changes for Aero Stanrew after the management buy-out took place?

It was pleasing to deliver performance ahead of our original business plan and to see our increasing critical mass allowing us to take on larger programmes. Our outperformance has allowed us to reinvest in further business development. One of my personal goals at the time of the buy-out was to raise our profile to more accurately reflect what the business has become – a leader in several areas of business. As such, we were very proud to have won a number of awards soon after completing the MBO, including South West Insider Company of the Year and Aerospace/Defence Company of the Year at the Made in the South West Awards.

We were featured in a national advertising campaign undertaken by HSBC soon after the MBO. The campaign highlighted the support the bank has given in support of our overseas expansion. As well as appearing in various national titles such as the Daily Telegraph, the Daily Mail and the Sunday Times, the advert also ran on national radio stations such as Classic FM and Talk Sport.

How did you find working with a private equity investor?

We were pleased to have backing from WestBridge Capital because the team there already had a proven track record in our
sector and had a refreshing approach to investment. WestBridge Capital have a network of industrial investors who deliver practical, hands-on advice and guidance that is borne out of experience. There were also challenges, and a constant focus on financial performance that applied real pressure to me and the team.

Through WestBridge, I was able to compare experiences with other like-minded businessmen who understand the challenges and benefits of working in a fast moving and high growth environment.

**What are your plans for the company going forward?**

We are a business that has experienced significant growth over the last few years, even at a time of economic uncertainty. Our plans for the business under new ownership are ambitious but realistic, and I have a vision as part of TT Electronics of us being a global leader in our specialist field. To achieve this, we have to continue to perform to some very demanding standards and be tuned in to what our customers want from us.

Our growth has involved us in significantly increasing our workforce, we now have over 460 employees, up from 155 the year of the MBO.

Much of the work we do is highly specialised and as a result we have to invest a lot of effort in employee training and development. We are very lucky in that we have a very dedicated workforce – it is great for them to receive external recognition for the hard work they have contributed to our ongoing success.

One of the benefits that we have reaped as a result of our success is that we can now more readily attract a high calibre of new employee. This is very important to us, as our growth has meant that we are constantly looking for additional staff who are capable of developing as we develop.

“**The buy-out process will involve a lot of hard work and personal sacrifice to get the deal done, but the potential rewards make the whole process worthwhile.**”

**What advice do you have for any other management teams who are considering making a management buy-out?**

Our buy-out has been a success because we were very clear at the outset what we were looking to achieve and agreed clear and realistic plans with our partners. A buy-out inevitably means a relationship with your backers of several years, so it is important to ensure that you are able to work effectively together. This was a key attraction of WestBridge over alternative funding sources.

The buy-out process will involve a lot of hard work and personal sacrifice to get the deal done, but the potential rewards make the whole process worthwhile. I cannot over-emphasise the importance of getting good advisers on board to help you complete the process as you will come across many situations that you will not have dealt with before.

My main advice would be that if you have a clear vision for the growth of the business – go for it!
Conclusion

We hope that this MBO Guide has provided some useful information. Having been involved in numerous MBO and M&A deals, we have strong relationships with a number of key advisers, PE houses and banks. We are always willing to have initial discussions with potential MBO teams and their sellers, and make introductions to help you put together the best possible team for a potential deal.

Some recent MBO deals

- **£20m MBO of MK Test Systems**
  - Acting for the management team on the £8.5m MBO of Aero Stanrew

- ** (£8.5m MBO of Aero Stanrew**
  - Acting for the management team on the MBO of EMC Advisory Services

- **MBO of Pathfinder Homes**
  - Acting for the management team in the MBO of Gro Group

- **Sale of Nordic Cinema Group backed by Bridgepoint**

- **MBO of Hollaroo backed by angel investors**

- **Buy out of founder shareholder with change of control**
Equity

*Equity split*

What percentage of equity will be allocated to:

- Institutional Investor?
- Management?
- Vendors?

What percentage (if any) of the equity will be reserved for additional Management team members or chairman?

Will warrants be issued to debt providers?

- [ ] Yes
- [ ] No

*Further Equity Funding*

Will Management have the right to participate in any further equity funding?

- [ ] Yes
- [ ] No

If available, how will further subscriptions by Management be priced?

- [ ] Yes
- [ ] No

If available, will Management be permitted a period of time to raise subscription funds?

- [ ] Yes
- [ ] No

What will this be?

Will the ability of the Institutional Investor to exercise powers to allot additional shares be dependent on conditions having been met?

- [ ] Yes
- [ ] No

What conditions?
Exit

Will Management equity be subject to a Ratchet?

What will be the basis for calculating the Ratchet?

On an exit, will any unissued equity shares be available to Management?

If so, how will the price be calculated?

Will Management have an absolute right to subscribe for these shares or will this be subject to veto by the Institutional Investor?

If permitted, how will the allocation of the unissued shares be determined amongst Management?

Debt

Senior Debt

Form of debt instrument?

Interest/coupon rate?

Will interest be accrued and capitalised?

When will principal be repayable? On fixed dates?

Will early repayment be permitted?

Subordinated/Mezzanine Debt

Form of debt instrument?

Equity/warranty element?
Interest/coupon rate?

Will interest be accrued and capitalised?

When will principal be repayable? On fixed dates?

Will early repayment be permitted?

Will debt be convertible into equity? If so, under what circumstances?

Debt

Shareholder Debt

Form of debt instrument? (e.g. preference shares, loan notes)

Interest/coupon rate?

Will interest be accrued and capitalised?

When will principal be repayable? On fixed dates?

Will early repayment be permitted?

Syndication

Will the debt providers have the ability to syndicate?

Will there be restrictions upon whom debt may be syndicated to?

Will there be a maximum number of syndicatees?

Will warranties be repeated to incoming syndicatees?
**Transfers**

*Permitted transfers by Institutional Investor (without tag along or pre-emption rights applying)*

- To members of the Institutional Investors’ group?  
  - Yes  
  - No

- To other financial institutions?  
  - Yes  
  - No

- To trade interests?  
  - Yes  
  - No

*Permitted transfers by Management (without tag along or pre-emption rights applying)*

- To other members of the Management team?  
  - Yes  
  - No

- To family members?  
  - Yes  
  - No

- To family trusts?  
  - Yes  
  - No

**Drag-along rights**

- What percentage will trigger drag-along rights?  
  - Yes  
  - No

- Proportional drag-along?  
  - Yes  
  - No

- Will Management have the right to match a third party offer?  
  - Yes  
  - No

**Transfers**

*Tag-along rights*

- What percentage will trigger tag-along rights?  
  - Yes  
  - No

- Proportional tag-along?  
  - Yes  
  - No
Capital / Distributions

Dividends
Will there be a total restriction on declaration of dividends prior to repayment of senior debt?

Will there be a total restriction on declaration of dividends prior to repayment of Institutional/shareholder debt?

Will dividend payments be paid to the Institutional Investor in priority to other shareholders?

Return of Capital
Will capital be returned to Institutional Investor in priority to Management?

Management
Compulsory transfer of Management shares on cessation of employment
How will a bad leaver be defined?
Will a good leaver include:

- Death?
- Incapacity?
- Retirement at ordinary retirement age?
- Wrongful dismissal?
- Unfair dismissal?
- Redundancy?
- Disposal of division/subsidiary taking employee with it?
- Removal from board?
- Dismissal on any other ground not justifying summary dismissal?
- Any others?
Management

What will be the order of pre-emption in respect of transfers of Management shares?

When and how fast will value of Management shares vest?

Will ownership of Management shares vest? (i.e. will Management be able to retain some of their vested shareholdings if they leave)?

Management warranties

Basis upon which Management warranties will be given? (i.e. joint, several?)

Subject matter to be covered:

- Information provided by Management?
- Due diligence report?
- Management Business Plan?
- Knowledge of breach of vendors’ warranties?
- Others?

Will Warranties be able to be qualified by awareness other than in relation to personal information?

What will be the caps on warranties?

What will be the de minimis level (i.e. the level below which claims will be completely discounted from the cap)?

What will be the threshold for warranty claims (i.e. the aggregate level which must be reached before a claim can be brought, ignoring claims below the de minimis level)?
Can claims be brought for the threshold excess only?

- [ ] Yes  - [ ] No

Duration of Management warranties?

- [ ] Management service agreements

Notice period for termination?

Will existing benefits be maintained?

Will a performance bonus be paid?

- [ ] Yes  - [ ] No

Will bonus be discretionary or contractual?

What will be the basis upon which bonus will be calculated?

- [ ] Management

Management

Removal/Dismissal

Summary dismissal to include:

- [ ] Any breach of the investment agreement/articles?
- [ ] Breach of banking covenants?
- [ ] Any others?
**Management Restrictive Covenants**

**Duration?**

**Geographic/sector definition?**

Will garden leave count towards restricted period?

**Swamping Rights**

Will swamping rights apply to Management shares?

Under what circumstances will swamping rights be triggered?

Will swamping rights only be triggered in the event of material breaches?

Will there be a period of time to rectify breaches before swamping rights are triggered?
Directors / Employees

Board Constitution

Number of Institutional Investor Directors?

Will Management have rights in relation to Institutional Investor Director appointments?

Will an independent Chairman be appointed?

Will Management have rights in relation to independent Chairman appointment?

Directors / Employees

Remuneration committee

Who will the remuneration committee consist of?

What will the committee’s remit cover?

Which employees/officers will the committee’s remit cover?

Fees

Arrangement fee

Ongoing Institutional Investor Director’s fees

Syndication fee

Ongoing monitoring fee
## GLOSSARY OF TERMS

<table>
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<th>Term</th>
<th>Description</th>
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<tr>
<td>Articles of Association</td>
<td>The legal constitution of Newco.</td>
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<td>BIMBO</td>
<td>A combination of management buy-in and buy-out where the team buying the business includes both existing management and new managers.</td>
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<td>BVCA</td>
<td>British Venture Capital Association.</td>
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<td>Bought deal</td>
<td>Where an Institutional Investor buys the target company as principal, later allowing either the existing management or a new management team to subscribe for equity.</td>
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<td>Deferred consideration</td>
<td>An element of the purchase price that is to be paid at some time in the future. Payment can be contingent upon the outcome of defined future events.</td>
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<td>Enterprise value</td>
<td>The debt-free value of a business equivalent to the business valuation, plus the level of debt to be absorbed by the purchaser.</td>
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<td>Equity Kicker</td>
<td>A mechanism whereby holders of debt or mezzanine finance are given the option of subscribing for shares, usually at Exit.</td>
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<td>Exit</td>
<td>The point at which the Institutional Investors realise their investment. Venture capitalists may, depending on the business and their own situation, look to achieve an exit in anything from a few months to over ten years.</td>
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<td>Fixed or floating charge</td>
<td>A legal mechanism whereby security over the assets of the business is granted.</td>
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<td>Goodwill</td>
<td>The difference between the price which is paid for a business and the fair value of its assets.</td>
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<td>IBO</td>
<td>An institutional buy-out. This is when the PE House acquires a business directly from a vendor and incentivises management with equity – some time post completion.</td>
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<td>Institutional Strip</td>
<td>A proportion of the total finance provided by Institutional Investors, which may include some or all of ordinary shares, preference shares and loan stock.</td>
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<tr>
<td>Term</td>
<td>Definition</td>
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<tr>
<td>IRR</td>
<td>Internal rate of return. The average annual compound rate of return received by an investor over the life of their investment. This is a key indicator used by institutions in appraising investments.</td>
</tr>
<tr>
<td>Loan stock</td>
<td>Subordinated debt which carries fixed interest and is repaid in a defined period, typically on Exit.</td>
</tr>
<tr>
<td>Newco</td>
<td>A new company formed to effect the buy-out by acquiring the operating subsidiaries.</td>
</tr>
<tr>
<td>PE ratio</td>
<td>Price Earnings ratio. This represents the multiple of profits implicit in a valuation of the business. Thus, if a group making post-tax profit of £2m has a market capitalisation of £24m, it would be trading on a PE ratio of 24/2 = 12.</td>
</tr>
<tr>
<td>Pre-tax multiple</td>
<td>Similar to a PE ratio, except the ratio is calculated as market capitalisation divided by pre-tax profit, rather than post-tax profits.</td>
</tr>
<tr>
<td>Ratchet</td>
<td>A mechanism whereby management’s equity stake may be increased (or decreased) on the occurrence of various future events, typically when the institutional investors’ returns exceed a particular target rate.</td>
</tr>
<tr>
<td>Senior debt</td>
<td>Debt provided by a Bank, usually secured and ranking ahead of other loans and borrowings in the event of a winding up.</td>
</tr>
<tr>
<td>Subordinated loan</td>
<td>Loans which rank after other debt. These loans will normally be repayable after other debt has been serviced and are thus more risky from the lender’s point of view.</td>
</tr>
<tr>
<td>Subscription or investment agreement</td>
<td>A legal agreement binding the various shareholders of the business. The primary purpose of the agreement is to safeguard the rights of the passive shareholders – the Institutional Investors.</td>
</tr>
<tr>
<td>Sweet equity</td>
<td>A term used to describe ordinary shares.</td>
</tr>
<tr>
<td>Upside</td>
<td>A positive outcome over and above the expected result. Managers will typically invest in the sweet equity.</td>
</tr>
<tr>
<td>Warranties and indemnities</td>
<td>Legal confirmations given by the Seller, regarding matters such as tax or contingent liabilities, to assure the MBO team - Institutional Investor that any undisclosed liabilities that subsequently come to light will be settled by the Seller.</td>
</tr>
</tbody>
</table>
Our Reputation for Business

Corporate finance is at the heart of the Michelmores success story. The award-winning team boasts a number of Partners that are ranked amongst the top corporate finance lawyers in the region.

Our success is built on a reputation for intuitively sound commercial advice. People recommend us because of the quality of our people and the depth of experience across the whole team. This experience gives real weight to our views on the commercial pressure points of a deal and a reputation in the market for getting deals done.
<table>
<thead>
<tr>
<th>Logo</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Digi SECURITY</td>
<td>Acted for the founding shareholders of Digi Security on the sale of the company to Chubb Fire &amp; Security.</td>
</tr>
<tr>
<td>aerostanrew</td>
<td>Advised on both its MBO of a new four-strong management team and its subsequent sale to TT Electronics.</td>
</tr>
<tr>
<td>magicseaweed</td>
<td>Acting for Magicseaweed, the world's largest surf content network, on its acquisition by SurfStitch Group.</td>
</tr>
<tr>
<td>St Austell Brewery</td>
<td>Acted for St Austell Brewery on its acquisition of Bath Ales Limited, including the brewery, its portfolio of beer brands and its 11-strong pub estate.</td>
</tr>
<tr>
<td>JS</td>
<td>Advised on a MBO and acted for the company on its refinancing and share buy back transactions.</td>
</tr>
<tr>
<td>Succession Group</td>
<td>Acted for Succession Group on its acquisition of Clay Rogers and Partners Limited</td>
</tr>
<tr>
<td>clarity</td>
<td>Acted for joint venture backed by Clarity and Maven Capital Partners on purchase of two debt management businesses.</td>
</tr>
<tr>
<td>Dalepak LIMITED</td>
<td>Acting for the incoming and incumbent management team on the buy out backed by Sovereign Capital.</td>
</tr>
<tr>
<td>Baigrie Davies</td>
<td>Sale of the IFA to 1825, Standard Life's national financial planning arm, subject to regulatory approval.</td>
</tr>
<tr>
<td>GRP</td>
<td>Advised on the buy out backed by Global Risk Partners of Plum Underwriting, Lloyd’s broker and MGA.</td>
</tr>
<tr>
<td>TUI Travel PLC</td>
<td>Sale of TUI's i-To-i business of providing online and classroom based TEFL courses and TEFL internships placements.</td>
</tr>
<tr>
<td>mobeus</td>
<td>Advising Mobeus on its debt and equity investment in the Tushingham Sails paddle boarding business.</td>
</tr>
</tbody>
</table>