STONEHAGE FLEMING

KNOW HOW BULLETIN

SELLING THE FAMILY BUSINESS

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A family business is a journey – challenging, rewarding and often unpredictable. Should you decide to sell the business – often a daunting decision – careful planning and skilled execution are required to ensure a successful outcome.

Perhaps the hardest decision for any family business owner is when, or if, to sell the family business. Selling a family business is like no other sale. It requires an approach which addresses both the family's issues and the business' issues as one, with the two often closely intertwined. It needs extensive preparation and great judgement, with timing and stakeholder management often critical.

Most owners have strong family and emotional ties to the business – part of their family heritage and their collective identity. They may also wish to achieve specific outcomes for wider stakeholders, including highly valued staff and long-standing customers. The challenge is even greater when family members are actively involved in the company. Some family members may take a purely commercial view, whilst others believe the business should be handed down to their children and grandchildren and be part of their livelihood and collective identity.

The business is often the most valuable family asset, so the sale should not be considered in isolation from the wider interests and future intentions of the family. The use of proceeds and future careers of family members are important considerations in the long-term success of the family.

OWNERSHIP CONSIDERATIONS

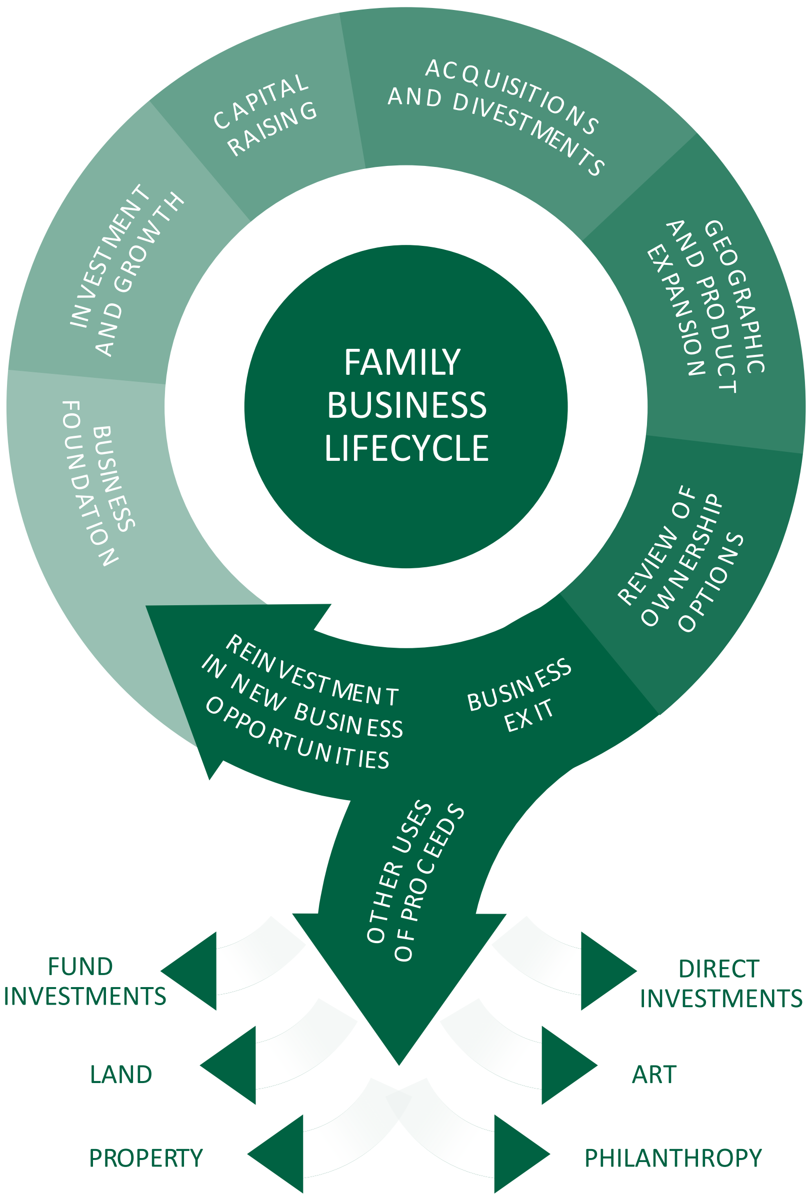
It is highly advisable for family businesses to regularly assess their ownership and corporate strategy, both from a business and market perspective, but also with reference to the changing circumstances of the family.

A recent Fleming Family & Partners survey of 90 Ultra High Net Worth ('UHNW') families and their advisers (source: 'The World in 2043: Wealth Strategies for Intergenerational Success' report), found that they view a lack of strategic planning for the family as the greatest destroyer of wealth. After capital preservation, succession planning was seen as the second most pressing concern. Business owning families need to consider a broad range of factors, including successors to the current owner-manager(s), implications of growth in the next generation family shareholder base and the benefits of wealth diversification.

Individual family members will have additional personal considerations, including their own career aspirations and preference for income, capital returns or long-term investments.

From a business perspective, family owners will regularly monitor and assess market and business developments. Long-term trends such as the impacts of globalisation, increasing regulatory burden or rapid technological change may influence their desire to retain ownership. These developments may also drive wider market consolidation and the family will need to consider whether it has the appropriate resources, expertise and willingness to become an industry consolidator.

THE FAMILY BUSINESS LIFECYCLE AND OPTIONS FOR USE OF PROCEEDS ON EXIT



An essential element when considering the sale of the family business will be planning for events post completion, including use of the proceeds, as illustrated above. This may include re-investing in new business opportunities, acquiring a more diversified investment portfolio, investing in property or satisfying philanthropic objectives. This is discussed further in the Post Sale section.

PREPARING THE FAMILY

It is imperative that the ground work is done well before there is any question of a sale. The more distant the prospect, the greater chance of rational discussion which gives everyone the opportunity to air their views, without the debate becoming too emotionally charged. The objective must be to work out some parameters and a 'road map' which will help those responsible for making the decision when the time comes. No-one can predict the precise circumstances, but if some broad principles have been agreed by the family at an earlier date, the potential for a destructive conflict is greatly reduced.

These principles will help define what factors should influence the decision. They should include a clear statement of the purpose of continuing family ownership, which may or may not include active involvement of family members in the management team. They should also include broad guidelines for the sort of circumstances in which the business should be sold, if it is not purely a commercial decision, and suggest a decision making process which involves all relevant family members.

Ideally, such parameters will be drawn up by the founding entrepreneur, at least 10 years before retirement, preferably in consultation with the family. Failing that, if the business is already in the hands of the second or subsequent generation, it is in the best interests of all for a family agreement to be initiated as soon as possible.

PREPARING TO SELL A FAMILY BUSINESS

From a business perspective, positioning and preparing the business well ahead of the initiation of the sale process are key to a successful outcome. However, whilst families should be prepared and proactive, they should also be responsive to more immediate developments, whether this is an increase in sector valuations or receipt of an unsolicited approach.

Advance preparation is especially important if an owner-manager or other family members in senior management positions intend to exit the business. Their knowledge and expertise will need to be disseminated to other members of the management team and replacements may need to be recruited and integrated into the business. It is often wise to engage advisers at any early stage to assist with these preparations, to help with identifying any specific areas to be addressed pre-sale, developing a roadmap and positioning the business to maximise its value to a variety of potential purchasers.

Crucially, the family must discuss and agree whether the sole measure of success is price maximisation or if other factors should be considered, such as ensuring the business is transferred into 'good hands', to preserve its identity, to safeguard the family brand or to protect the future of the management or staff. There may be strong differences of view among family members and a valuation exercise should take account of these preferences, so that the family can debate the trade-off between price maximisation and other factors.

There may also be disparate views regarding the structure of any disposal. This could relate to the timing of the sale or the degree to which family members wish to remain involved post sale. Some family members may be willing to give warranties and indemnities or receive deferred consideration based on an earn-out in return for potentially higher overall proceeds. There may also be differing views with regards to the form of consideration and whether it will be cash, shares in the purchaser or a combination. Generally, the sooner these issues are discussed, the better.

Once a decision has been made regarding long-term ownership, the family should position the business appropriately to maximise its attractiveness to potential acquirers. This could include operational matters such as where to focus business investment, exiting loss making sectors or improving cost efficiency. They may also wish to develop relationships with decision makers at certain potential acquirers.

Timing is often critical. Sell too early and the family may sacrifice substantial gains; leave it too late and the business may have lost value, perhaps because of sector decline or because the company is losing market share to competitors. In certain circumstances, it may be appropriate to seek outside investment or a strategic partner, for example where finance for additional growth is required. For the purposes of this document we have only considered a full sale; however, in certain situations a partial sale may be more appropriate.

The main areas to be considered are summarised in the diagram:

KEY FOCUS AREAS

STRATEGIC POSITIONING

Optimise the strategic positioning from a potential purchaser's perspective, e.g.

- should unprofitable non-core divisions be sold to focus buyer on core business?
- should actions be taken to initiate entry into new markets?
- should focus be on revenue growth / market share or profitability?

OPERATIONAL ENHANCEMENTS

Enhance profitability through cost saving or improved efficiency, e.g.

- should IT systems be upgraded to position the company for future growth?
- should corporate governance structures and procedures be improved?

INTANGIBLE ASSETS

Review intellectual property and ensure it is properly protected

Ensure key employees adequately motivated and remunerated through the sale process, given that the process will potentially increase uncertainty for some

VALUATION

A thorough valuation exercise key to understanding the potential value

A range of valuation methodologies should be critically examined from the perspective of different purchasers

PROCESS AND TIMETABLE MANAGEMENT

Proposed transaction timetable with key milestones

Seller more likely to retain control of process if it is clearly communicated to buyers at outset, including key milestones, timing and expected format / content of initial bids

POTENTIAL PURCHASER IDENTIFICATION AND POSITIONING

The potential purchaser universe should be assessed in detail, as this may well impact the necessary focus of the marketing

Key selling messages are to be agreed in light of individual potential purchasers

Early engagement with a small number of potential purchasers may deepen their understanding and interest in certain circumstances

INFORMATION PREPARATION AND PRESENTATION

Intelligent presentation of information vital to ensure buyers understand value drivers

Well-structured information gives buyers confidence that management properly informed

Historical financials scrutinised for any one-off costs or revenues distorting trends

Key assumptions used in financial forecasts should be examined and challenged

Data room to allow the sharing of company data with a potential acquirer

- any business sensitive information is only shared at the appropriate time

Short (2-3 page) teaser document and longer more detailed information memorandum

- agree key selling messages and ensure they are consistently applied

A management presentation for presenting to potential purchasers and to facilitate discussion

TRANSACTION EXECUTION

Selling a business is often highly demanding of senior management, distracting their attention from the day-to-day requirements of running the business, perhaps for a lengthy period. This is especially the case where there is a small senior management team with limited experience of corporate finance transactions. The Chief Executive and Finance Director are normally key team members, usually with a corporate finance adviser who preferably has deep experience of family businesses and can help manage the family perspective as well as the business issues.

It is important to design a streamlined and structured sale process, which minimises the burden on senior management's time.

The corporate finance adviser will work with management and shareholders across all the work streams to maximise shareholder value. They will also advise on numerous practical issues such as whether to commission independent due diligence which can be sent to bidders (known as 'vendor due diligence') or if the seller should pre-arrange financing packages to offer to bidders (known as 'staple financing').

TRANSACTION EXECUTION STAGES

1 BUYER APPROACH AND TACTICS

- Marketing the business to a wide number of bidders can drive up the value attainable. Some sellers may, however, be uncomfortable with the risk of confidential information being too widely distributed and potentially falling into the hands of competitors. At the other end of the spectrum, an approach to a single party is more discreet, but can result in a greater completion risk and the risk that a higher price could have been achieved elsewhere.
- The team will also need to discuss the respective merits of trade buyers versus financial investors and overseas buyers and how these tie in with the objectives of the sale, particularly in the event that the family wants to ensure the business continues to trade as an independent brand with its own management.
- The timing of any approach to potential purchasers and the manner of that approach will be determined on an individual basis, depending on a number of factors such as the nature of the existing relationship, the nature of the company (e.g. direct competitor, vertical industry consolidator, financial investor) and the decision-making speed of the entity. It is vital to ensure in the initial screening process that any buyer identified has the resources, appetite and management decision making capability to see through the transaction, and again, this is a key role for the corporate finance advisor.

2 DUE DILIGENCE AND INFORMATION PROVISION

- The due diligence process (covering commercial, financial, legal, tax and other matters) needs very tight management, including the format and level of detail of initial information to be provided and the process for responding to buyer questions. Managing a buyer's due diligence requests can often be time consuming, but delays in responding can cause loss of confidence.
- Every business has sensitive issues which need to be disclosed with care and, to the extent possible, these should be identified in advance. However, a seller should also be prepared to deal with unforeseen issues that come to light. Any buyer concerns that cannot otherwise be alleviated may result in additional warranties or indemnities.

3 NEGOTIATION

- Negotiation strategy starts with close analysis of the business from a buyer's perspective. Equally important is an understanding of the acquisition rationale of each buyer, their specific requirements and concerns, and the motivations and constraints of their lead negotiators.
- Central to the negotiation strategy will be increasing the competitive tension throughout the process, which requires careful planning as well as expertise and experience. A holistic and consistent approach is essential from pre-execution planning, initial buyer engagement, and buyer communications strategy through to the detailed negotiation stage.
- Momentum is key. Delays, for example in provision of information, must not be allowed to derail the process. Each buyer will have multiple concerns and a number of practical developments could also affect their appetite to proceed, such as a deterioration in business performance, a decline in the political or macroeconomic backdrop, or a change in the buyer's strategy or management team.

4 LEGAL DOCUMENTATION

- Reviewing the legal documentation must not be left entirely to the lawyers! There is no substitute for the detailed involvement of someone at the centre of the team who fully understands the business and the transaction and will be able to spot any potential oversight, inconsistency or misunderstanding. It is vital to ensure terms agreed are accurately incorporated, particularly seller representations and associated warranties, non-compete clauses, covenants and undertakings and any conditions precedent to closing (e.g. regulatory approval) and commitments post sale.

5 COMMUNICATIONS

- Communications with the family, staff, customers and suppliers are often given too little consideration until late in the day, by which time damaging rumours may have spread. The timing of communications is vital, but can be complicated by the specific nature of a family owned business. For example, family members involved in the business may be required to have a greater level of detail and more updates than those family members not actively involved.
- The nature of the message will need to be tailored for each recipient. Family owners may be more focused on the long term brand reputation and the immediate impact on their wealth and roles, while employees may be more concerned with the purchaser's ownership and business strategy, any impact on the company's culture and their own employment and remuneration prospects.
- Confidentiality will be a major constraint, but a leak strategy should also be prepared to manage any unauthorised disclosure.

POST SALE

The closing of a well-planned transaction can be highly rewarding for the shareholders, business and management. For the family this can often be a major liquidity event which allows for new strategic direction and flexibility - consideration and determination of which should ideally be agreed well ahead of initiating the transaction. However, this liquidity event can also remove some of the glue that holds the family together and to some extent can cause a loss of purpose and collective identity, especially if family members, including future generations, are no longer involved in the business post completion.

Once the transaction has been completed individual family members often find themselves in very different circumstances with regards to wealth options and personal tax situations and often need to ensure a smooth transition to the next stage of their family journey. Some families may decide to set up a family office to manage their wealth collectively or set up trust (or alternative) structures to manage and protect current and future generational wealth (whether managed directly or via professional advisers), whilst others are happy to transfer wealth to individual family members immediately following the deal.

Defining a common set of family values and objectives can act as a foundation for the family's new wealth management strategy and help with making decisions regarding specific investments. For example, the focus could be on capital preservation or appreciation; dividend income or capital growth; wealth retention or philanthropy. The collective knowledge and experience built up within the business can also be applied to future business opportunities and investment decisions.

Those families who have a clear plan for the subsequent use of proceeds are most likely to preserve the benefits for subsequent generations.

On the 15th January 2015 Stonehage Group Holdings Limited completed a merger with Fleming Family & Partners Limited ('FF&P'), a London-based Multi-Family Office.The combined company is called Stonehage Fleming Family & Partners Limited ('Stonehage Fleming') and is the leading independently-owned multi-family office in Europe, Middle East and Africa. Its advisory division provides corporate finance and direct investment advisory services as part of a holistic approach to advising wealthy families.

FOR MORE INFORMATION

Wiebe van der Laan
Senior Associate – Corporate Finance

Wiebe is a Senior Associate in our Corporate Finance Division. He has been instrumental in the establishment and management of Stonehage Fleming's Corporate Advisory Division. This division primarily assists business owning individuals or families with a need for growth capital, when looking to obtain a strategic investor, planning an exit, or who are in search of new acquisition opportunities.

Wiebe joined the Group in 2011, prior to this he qualified as a Chartered Accountant and completed his articles in 2010 at PriceWaterhouseCoopers in the Alternative Investments and Banking divisions in Cape Town and Johannesburg.

Richard Hill
Partner

Richard heads Stonehage Fleming Advisory, he advises clients on a wide range of advisory, investment and capital raising mandates in various sectors, including financial services, real estate, technology and natural resources.

Prior to joining the Group in 2002 where he helped establish the advisory business, Richard worked at JP Morgan, he previously qualified as a Chartered Accountant with PwC and then joined the investment banking business of Robert Fleming.

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