Spinout to Exit:
Exiting the technology business (Trade Sale)

The majority of successful technology businesses will be looking to achieve an exit for the investors in the short to medium term. This will typically be by way of either a trade sale or flotation.

Planning to exit the business

It is common that in technology businesses the potential trade purchaser(s) will have been identified almost at inception. If this isn't the case, the management team should start to plan for exit as soon as possible. Such a plan will ensure the business is ready for sale at the appropriate time. For example, if a business is not properly structured, does not produce regular and reliable management information and is unable to produce signed copies of key documents, any potential purchaser is unlikely to be reassured that the business has been well managed. This will increase the level of perceived risk attached to the company and will reduce the price any purchaser is willing to pay.

Some of the key areas to address during the planning stage are considered below:

The people running the business add value for a buyer

Ensure the management team is structured so that the business will be able to operate effectively post sale. Having a strong second tier of management in place will make the business more attractive to any potential buyer.

Being organised promotes credibility

Ensure that the company's internal documents (especially those relating to intellectual property) are complete, up to date and easily available so that they can be provided to third parties during the sale process. This will need to include board minutes and up to date service contracts for all key employees etc. Presenting the company as well managed and organised will help build the buyer's confidence in the company and hence its perception of the company's value.

The value of information

Any potential buyer will want to understand how a business has been performing and what its respective assets and liabilities are. Having an appropriate management information system in place to produce this information will show that your business places value on good financial management, reducing the level of perceived risk.

Part of the process of ensuring that good, reliable information is produced is to review the systems which operate over the company's key business cycles, such as debtors, creditors and stock control.

Finding and approaching prospective buyers

Having made a decision to sell the business the management team will need to find prospective buyers. The main ways to find a buyer are networking through your own business contacts and by using the networking skills and contacts of corporate finance professionals.

Having identified prospective buyers, an initial approach will be made which will generally take the form of a one or two-page teaser clearly and concisely setting out the acquisition opportunity. It is often useful to use someone to act as an intermediary in this process.

The information memorandum

A key tool in marketing the business is the information memorandum. This document will be prepared by the management team and their corporate finance advisors to attract the attention of potential buyers. commercially sensitive information should not be included in the information memorandum as some of the companies approached as potential buyers may be direct competitors of the business.

The key to producing a successful information memorandum is to present the business in the best possible light. First impressions are very important and the business needs to be presented in such a way that prospective buyers will appreciate its value and be interested in entering a more detailed sale process.

Form of consideration

There are three main types of consideration, cash, shares and loan notes, and the consideration may well comprise a combination of the three. There might also be an element of deferred consideration.

Cash - The advantage of cash is that it is known exactly how much will be received, and that it can be a clean separation from the business as there are often no remaining ties.

Share capital - Share capital is often used to tie in the existing business owners where it is anticipated their involvement will be required after the business is sold. This is particularly the case where the business is unquoted and therefore a ready market for the shares does not exist.

Loan notes – Loan notes are instruments which are usually either redeemed for cash or converted to shares at some time in the future (the redemption date). Interest is usually paid on the value of the loan notes although the return on loan notes will depend upon the precise terms.

It is usual for an element of consideration to be deferred until some time after the deal. The amount may be dependent upon the future performance of the business (an 'earn-out') and is, therefore, not known for certain at the date the contract is signed.

Heads of terms

Initially several bidders may be negotiating with the company, but at some stage a preferred bidder will need to be selected. Whilst competition may drive the price up, purchasers are unlikely to be prepared to incur the costs of a detailed due diligence exercise unless they know that their offer has been accepted, subject to contract.

At this point, it is usual to agree ‘heads of terms’. These are an agreement in principle of the key terms of a possible sale of the business, and form the starting point for detailed contractual negotiations.

Due diligence and contract negotiations

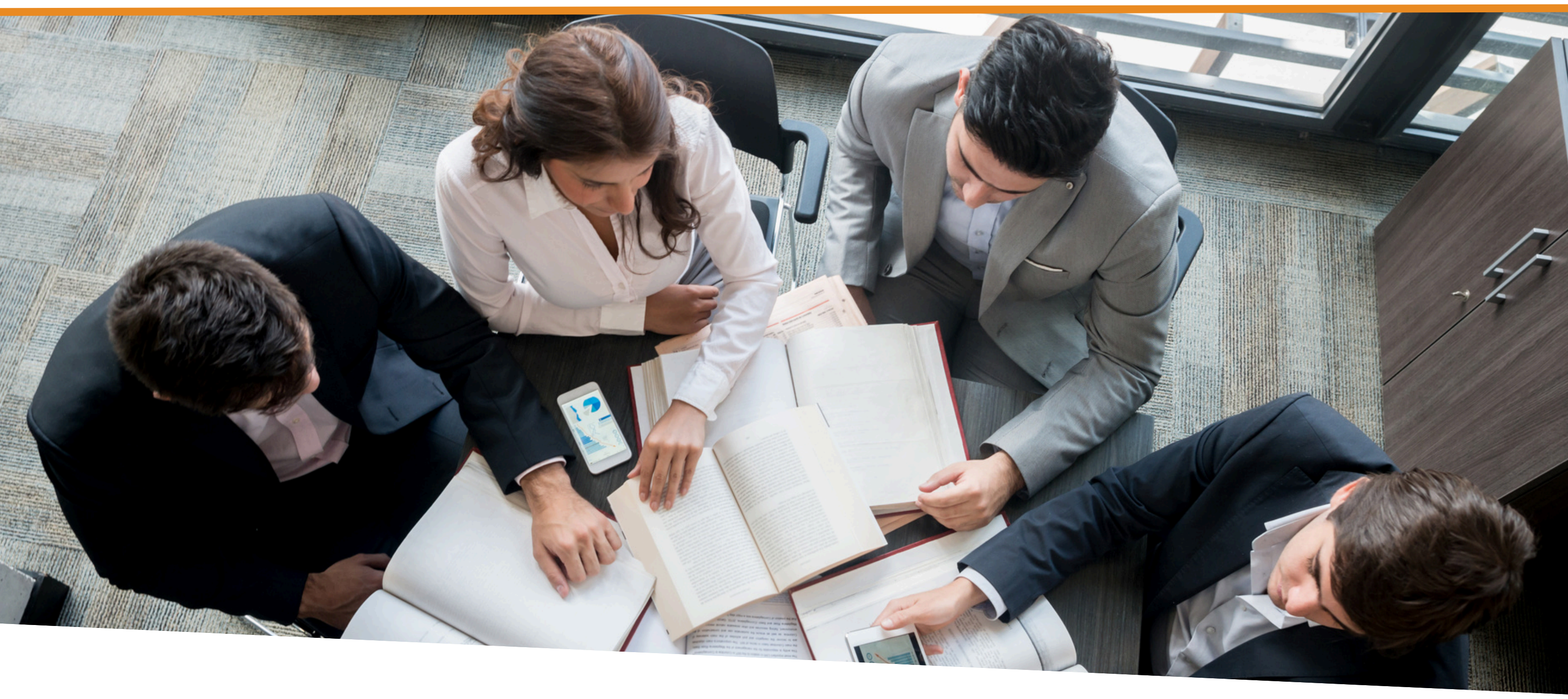
Before prospective purchasers commit to buying the business, they are going to try and find out as much as they can about it in a process called ‘due diligence’. The scope of due diligence will be agreed between the prospective purchaser and their advisors.

Where the due diligence process highlights any possible problems, these will usually be resolved by warranties or indemnities in the final sale and purchase agreement.

Warranties

Warranties are used as a way ensuring that the sellers of a business confirm the full details of a certain element of the business, or risk being in breach of contract. If it is found that the sellers did not disclose their full knowledge and the purchaser suffers financial loss as a result it is likely they will be the subject of a claim for breach of contract. The amount of damages payable is determined by the purchaser's loss.

Maximise your potential



Indemnities

Indemnities are promises that the seller will make payments to the purchaser in certain circumstances. Common tax indemnities include promises to pay any tax liabilities which arise in the acquired company because of the previous relationship with the vendor, or underpaid tax, interest or penalties relating to returns filed by the vendor.

It is necessary to be extremely attentive to detail to ensure that the contract that will be signed accurately represents the terms that have been agreed. This process should involve not only lawyers in agreeing the contract but also tax advisers, who will be aware of the tax implications of any proposed changes to the terms or structure of the deal.

Completion

When the day of completion is over, there will still be things to be done;

- Completion Accounts or Locked Box;
- Calculation of any deferred consideration;
- Negotiation and settlement of any amounts claimed under warranties and indemnities.

Taxation

In order to maximise the returns from a trade sale it is crucial to consider the tax implications for the company, its employees and its investors. Early planning is recommended.

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