THE MBI IS BACK IN VOGUE

Insider's round table brought together some of the region's leading corporate financiers to discuss why management buy-ins (MBIs) are coming back as a valid exit strategy

SPEAKERS

Paul Dolyniuk origination and structuring lead, Caple
Sean Brophy country manager, Caple
Edward Gale director, mergers and acquisitions, EY
Jeremy Cole partner, Cole Associates
Adrian Gare partner, FRP Advisory
Andrew Feeke head of corporate finance, MHA Moore and Smalley
Gerard Lucas director, Dow Schofield Watts Corporate Finance
Paul Griffiths director, Auxilium Advisory
Sam Davies partner, Cowgills

How are you shaking up the market?

Paul Dolyniuk Many secured lenders, asset-based lenders, aren't equipped to deal with the complexity of the approach required to get comfortable with cashflow lending to management buy-in-type transactions. It requires a different emphasis towards business plans, forecasts, strategy, management experience, assessment of management and alignment of the parties involved in the transaction. Our operational model is designed specifically for cashflow lending. In March this year we launched a credit offering for MBI transactions, exclusively focused on funding MBIs. This includes anything that looks and feels like an MBI in terms of its dynamics. We are lending between £1m and £10m to SME-based MBI transactions. We believe we are the only ones in the UK proactively looking for MBI opportunities.

Ed Gale Undoubtedly one of the strengths of the region is the ability of advisers to come together and find solutions. When we are looking at sell-side mandates in particular, there is another option that we can consider. At this point in time, I think there has been a lack of MBIs. That is in part due to it being more complex. I think the hurdles to execute an MBI are that bit more challenging. It adds additional transactional risk. I think for the team looking to come in and invest, there's more risk, and ultimately that plays out in valuation. But I think it is also a result of there being a lack of products with a solution.

Typically when there's a management team in situ that is a large part of the investment story. If you are looking at an MBI-type solution, I think that almost doubles the amount of work that you need to do in certain aspects, because not only do you have to do diligence on the fundamentals around the company, it also means you've got to get comfortable with the management team.

Jeremy Cole We're a bit different to a lot of corporate finance boutiques and CF teams within the big firms in that we do more buy-side advice than sell-side. Our perspective on MBIs is often about how we raise the funding for this team from outside the business and we all know the concern funders would genuinely have. That preparation phase is vital around how you pre-empt and address the concerns. On the sale side, an adviser is very sceptical about MBIs, mainly from the funding point of view. But where we're on the buy side, with an MBI we're careful to not take on too many of them. We typically work on two or three MBIs a year. In the right vendor situations, where they haven't got a trade purchaser ready, MBIs are coming back in. I think they went out of fashion because investment returns were terrible for the PE funds over the years.


Paul Dolyniuk


Ed Gale


Jeremy Cole


Paul Griffiths


Sam Davies

Are PE funds put off MBIs because they like to invest where there's a strong management team?

Cole Yes, but a strong management team doesn't just mean strong incumbent management team. If you've got a division coming out of a non-core division or a family-owned business where there's no kids to take over, an MBI can be the best option. It think that Caple's strategy is very clever, not just in the fact that they'll get a lot of really good MBIs coming to them, but by putting it out there that they are braver than the average lender, they're going to get other types of non-MBI transactions coming to them. I think the other reason why MBIs are coming back into the mainstream is because private equity are so desperate to find deals and homes for the money.

There has to be a very good sector match between the experience of the MBI team and the target business and sometimes, what's overlooked is the cultural match. Where MBIs have gone wrong often isn't about the sectors it's about personality clashes.

Paul Griffiths We work exclusively on the buy side. Probably 80 per cent of our buyers are private individuals. In size of transaction it's sub £1m, where traditional private equity has not really been interested. In the lower levels of EBITDA – we are looking at £250-£300k upwards – the owner and the MD is probably still pretty crucial to the business. An MBI is a great transaction. If we come back from the very extreme of MBI to buy-in management buyouts or even to working with an MBO team that just needs an additional leader, that's the space we're in. I think it's really exciting that there's a product out there that's genuinely pitched at MBIs.

Sam Davies We have pretty much doubled the firm in the last three years, principally driven through our corporate finance activity. I think a lot of [CF advisers'] deals pipelines are very good and we just see a vast demand but it is a peculiar market. Trade is fickle. Where you might have got four or five offers, you are getting one or two at best. That has driven a bit more interest in doing an MBI. I think there are also lots of people who have sold their businesses a few years ago and are bored thinking what can I do next?

Our experience has been wholly negative of MBIs as a firm. We've done six MBIs in the last ten years and three of them have gone bust. And of the others, in three of them the management candidates have left. It's not really a rousing endorsement of MBIs.

I think there have been some challenges in the deals that were done; they were done because there was no other buyer. And that has been the history, where the MBI market came from. So everyone pulled out of that market.

Adrian Gare An MBI is quite a good way of a vendor de-risking. You control your stake but you still leave some equity going forward so you are getting two bites of the cherry which can be a good thing. You can have something off the table now and also some future growth. The other side of that if you've got a vendor who's still there, he's still operating as if he owns the business, it makes it very hard for that buying candidate to affect that culture change.


Adrian Gare


Gerard Lucas


Sean Brophy


Andrew Feeke

Gerard Lucas MBIs, I think everyone agrees, have been difficult to fund. Because traditional funders' view of risk is higher and there's lots of really good businesses we see that probably aren't that attractive to private equity. They might be good, steady traditional businesses and I think this product can unlock transactions from a couple of angles. You get a position where a vendor would quite like to sell to his management team, but he doesn't feel they are quite up to it.

Management teams are really good operationally, but they may not have the confidence to say, 'one day this will all be mine and he won't be here anymore'. The ones that have worked best, and often you see them at the back end when you sell the business in four or five years are the ones where the management team or the vendor – usually both – have good relationships with good quality people and large corporates who they would like to work with.

The most important thing is bringing in somebody with a large corporate background who would help a good quality, steady business move forward.

Because if it carries on as a steady business, when the vendor leaves, it will deteriorate. But if you bring in someone from a large corporate who doesn't have an existing relationship with the management team or the vendor or both, it can be a disaster because you can try and change things too quickly.

Lucas I think a lot of MBI candidates are people who have probably left whatever they were doing and are looking for something to buy. This product will help in this. It will also encourage those people who aren't in that situation, they may be in large corporate businesses. It's very hard for those people to make the leap into a private business. That equity incentive is the thing that will make them make the leap.

Andrew Feeke We tend to work longer-term with clients, planning and understanding what's driving the deal, what the management team wants and what the vendor wants. We sit down and help them get aligned. Part of that involves identifying the gaps and bringing the right people in, generally at the at the end of the transfer. You don't want to do it too early because that can upset the transaction.

Sean Brophy MBIs have a bad track record generally speaking especially with lenders. You've got candidates who try to use the assets of the business to buy a job versus candidates who have had experience in corporate or who have made some money and want to reinvest, want to grow something themselves. That's the type of people we're trying to work with. ■