



BDO CORPORATE FINANCE

AN INTRODUCTION TO succession strategy

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AGENDA

INTRODUCTIONS

WHAT IS SUCCESSION?

DRIVERS FOR SUCCESSION STRATEGY

COMMON OPTIONS

VALUATION PRINCIPLES

TRANSACTION STRUCTURES

TAXATION

SUMMARY

QUESTIONS ?



INTRODUCTIONS



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A Director in the national M&A team focusing on independent, entrepreneurial businesses



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TAX PRINCIPAL



A Tax Principal based in our Birmingham office specialising in tax planning for owner managed businesses, including advising on succession and exit planning.

BDO UK

8 Offices **250** Partners
7 **3,500** Staff

no. 1 for exceptional client service¹

95% of our clients would recommend us² | **77%** already have²

1. Independent research (Mid Market Monitor 2012-2015) undertaken by Meridian West shows BDO has the highest client satisfaction rating among its peers

2. Client Listening Programme 2014/15



BDO INTERNATIONAL

US\$7.3 billion
2015 REVENUE

154 Countries **1,400** Offices
64,500 Staff

1 of the world's most active advisers

840 completed deals globally in 2016

>\$35.6bn deal value

An **AWARD WINNING** Corporate Finance business

100 countries providing dedicated corporate finance services



What is succession?

What is succession?

- The transition of business ownership or control
- A strategy to plan and manage change
- Alignment of personal and business interests



Drivers for succession strategy

Drivers for succession strategy

- Age or retirement – removal of day to day involvement
- Sickness or ill health – dealing with unplanned events
- Capital return – maximising personal wealth
- Strategic partner – securing the future of the business
- Family – the next generation
- Reward and opportunity – management and key employees
- All of the above.....



Common options

Common options

- Multiple options for delivering a change in ownership or control
- Matching shareholder objectives with transaction viability
- Multiple options can be explored simultaneously although careful thought needed

common options

Transaction	Benefits	Risks/issues
Trade sale	<ul style="list-style-type: none">• Potential to unlock value / deliver synergies• Strategic valuation• Understanding of business	<ul style="list-style-type: none">• Commercial risk• Cost savings and restructuring• Loss of control
Partial sale	<ul style="list-style-type: none">• Flexibility of approach• Continuity of management• Benefit from future growth	<ul style="list-style-type: none">• New stakeholder• Financial leverage and risk• Loss of overall control
Management	<ul style="list-style-type: none">• Continuity and control of transaction• Reward for key staff• Maintains independence	<ul style="list-style-type: none">• Lack of synergies or costs savings - lower valuation• Change in relationship• Financial leverage and risk



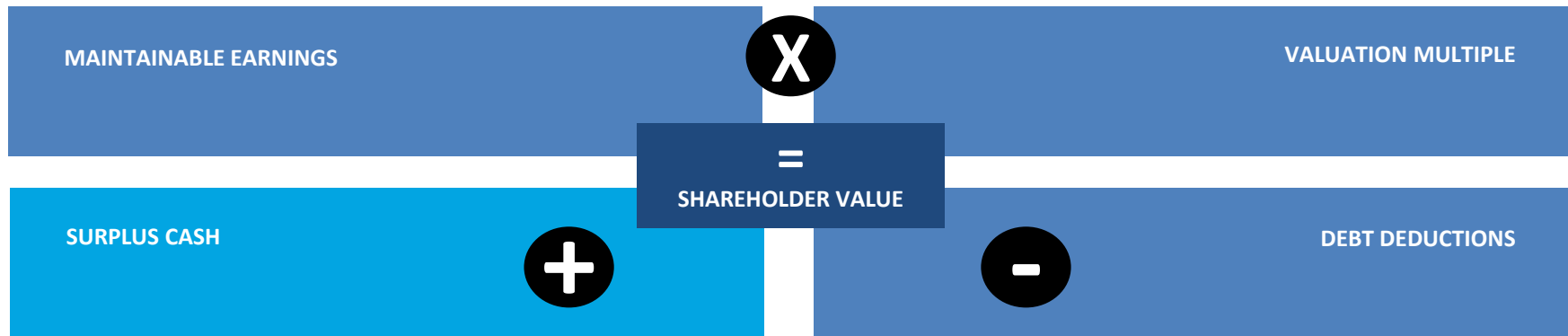
Valuation principles

Valuation principles

- Different valuation methodologies – income / earnings multiple, discounted cash-flows, net asset value etc
- Most applicable methodology based upon individual circumstances of the business and the nature of the financial returns
- A valuation is a guide and not an answer
- An agreement between a buyer and a seller

Valuation principles

COMMON METHODOLOGIES – EARNINGS MULTIPLE



MAINTAINABLE EARNINGS

- Profile
- Add-backs and adjustments
- Historic vs forecast
- Ongoing cost structure

VALUATION MULTIPLE

- Market parameters and comparable transactions
- Available information
- Strategic premiums

SURPLUS CASH

- Cash retained from historic trading
- Available for withdrawal
- Not required for ongoing operations

DEBT DEDUCTIONS

- No standard approach
- Non-trading debts
- Bank debt
- Hire purchase
- Corporation tax

OTHER CONSIDERATIONS

- Contingent liabilities
- Capital investment
- Transaction structure



Transaction structures

TRANSACTION structures

PAYMENT OPTIONS

CONSIDERATION TYPES	CASH	DEFERRED / EARN-OUT	EQUITY
ADVANTAGES	<ul style="list-style-type: none"> • Crystallises immediate value for the seller • Does not dilute the ownership of the buyer • Decreases risk for the seller 	<ul style="list-style-type: none"> • Potential upside for the seller – bridges expectation gap • Aligns interests • Reduces immediate funding requirement • Decreases risk for the buyer 	<ul style="list-style-type: none"> • Aligns interests • No financing requirement • Potential upside for the seller • Decreases risk for the buyer
DISADVANTAGES	<ul style="list-style-type: none"> • No upside for the seller from growth and future performance • Immediate funding requirement for the buyer • Increases risk for the buyer 	<ul style="list-style-type: none"> • Continuing involvement / interest of the seller • Resistance to change • Increases risk for the seller • Decreases risk for the buyer 	<ul style="list-style-type: none"> • Lack of influence or control • Deferred value realisation • Increases risk for the seller



taxation

Capital gains tax - ENTREPRENEURS' RELIEF

- Capital gains tax rate on qualifying gains reduced to 10%, from normal 20% rate
- Sale to family rather than gift to extract value tax efficiently?
- Lifetime limit of £10m gain per individual
- Qualifying conditions
 - Shares must be held for at least one year
 - Shareholder must be employee or officeholder in company/group
 - Shares must:
 - » Carry at least 5% of votes
 - » Represent at least 5% of nominal value of ordinary share capital
 - Company/group must meet substantially trading (80%) test for the year up to disposal

Inheritance tax – business property relief

- Shares in trading company/group likely to qualify business property relief, at up to 100%, if mainly trading and shares held for two years
- Relief can be restricted – for instance through surplus cash or investment subsidiaries
- Sale of business will significantly increase IHT exposure
- Consider IHT planning options/alternative shelters? Settle shares into trust pre-sale?

Common TAX issues

- Structure of consideration:
 - Upfront cash
 - Cash withheld in ESCROW
 - Earn outs
 - Shares issued by the purchaser
 - Loan notes issued by the purchaser
- Previous aggressive/artificial tax planning – will be scrutinised as part of the purchaser's due diligence process and may lead to price reductions/retentions
- Retain cash within the business in the run up to sale, to extract value with the benefit of entrepreneurs' relief?
- Extraction of non-core assets pre-sale – often property, options are available to mitigate the extraction costs (including SDLT)
- Exit bonus commitments to employees – unapproved share options significantly improve the position for both the employee and company

POST SALE TAX and financial planning

- Don't rush to reinvest – take time to take stock
- Personal financial planning – can you afford to sell? Can you afford to gift?
- Asset diversification, with the assistance of an IFA?
- Role of pensions – now an IHT free means of passing on wealth
- Inheritance tax planning – given no longer have BPR shelter
- Tax efficient investment options:
 - Deferral of gains through reinvestment – EIS and Seed EIS
 - Income tax reliefs – EIS, Seed EIS and VCTs
 - Continuing inheritance tax relief – AIM trading companies, EIS, Seed EIS
 - Deferral – offshore bonds, unit trusts, OEIC and investment companies



summary



a successful succession strategy

- One chance to transfer the value of your largest personal asset
- Success requires planning, comprehensive execution and strong management





QUESTIONS?

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