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# Selling your business in the care sector

An introductory guide

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## 1. Introduction

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Most business-owners will be looking to sell at some point. The reasons for selling are many and varied, but the main reason is that they want to realise the value of many years of hard work that have gone into building up their businesses.

Selling a business, usually, is a once-in-a-lifetime event and therefore can be a very unfamiliar process.

This note explains the sale process.

## 2. What are the main exit options available?

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There are a number of exit options, the most common are:

- a. **Sale** – where a business is sold, usually by way of a company share sale, but possibly also by way of a business and asset sale.
- b. **Management buyout (MBO)** – another form of trade sale, but where the buyer is the incumbent management team, usually backed by external investors.
- c. **Sale to an Employee Benefit Trust.**
- d. **Going public** – floating on a stock exchange.

## 3. When to sell?

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- 3.1 Most businesses will be sold after a number of years of proven profitability, but that is not always the case.
- 3.2 Various tax reliefs may be available, depending on whether or not the seller is an individual, a corporate or a partner in a partnership.
- 3.3 Many business owners will qualify for **entrepreneurs' relief**, which can, if the seller qualifies, reduce the effective tax rate on the capital gain arising from the sale to 10%. This may change after the government's budget at the end of October 2024

#### 4. Are you all in agreement?

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- 4.1 Where a business has multiple owners, it is important to understand at all times what the attitude of your fellow shareholders will be to an exit, both in terms of timing and valuation expectations. This should be addressed before going to market, as most buyers will expect to acquire the entire business. In a last resort, it might be necessary to establish which shareholders can be "dragged along" under provisions in your articles of association or shareholders' agreement.
- 4.2 If your business comprises a group of companies, the same applies to any minority interests in your subsidiaries.
- 4.3 If there are several shareholders with potentially conflicting agendas, it may make sense to get all shareholders to enter into a formal memorandum that outlines key issues in advance of the sale, as this can help flush out any potential areas of dispute. It is far better that these issues are discussed and resolved before the sale process starts.

#### 5. What is your business worth?

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- 5.1 There is only one true answer to this question: your business is worth what someone is prepared to pay for it. You should obtain advice from an expert valuer on what your business may be worth, which might be calculated on one of the following bases:
- a. **Multiple of earnings basis** – a valuation method used by buyers, especially for people businesses which have little in the way of tangible net worth.
  - b. **Discounted cashflow basis** – this method of valuation converts the anticipated future operating cashflows of the business into a present day value using an appropriate discount rate to reflect the risks inherent in the business. This is a complex valuation technique and one which relies on a number of assumptions and estimates.
  - c. **Net assets basis** – for most private companies, this is unlikely to be appropriate on its own (except perhaps for property or investment holding companies) as most of the value will be in the goodwill of the business.

Needless to say, every business is unique and there is no "one-size-fits all approach" to valuation. You are likely to get the most realistic valuation range if you take professional advice from a valuation specialist who understands your business and the market sector in which you operate.

## 6. The information memorandum

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- 6.1 One of the first and most important tasks for the corporate finance adviser is the preparation of the information memorandum (IM). This is essentially a sales document designed to attract buyer interest.
- 6.2 The IM has to be fully accurate. Any exaggerations or inflated claims about the business will inevitably be picked up as part of the buyer's due diligence.

## 7. Managing the process

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### 7.1 The initial offer

The initial offer will typically be made in a (subject to contract) letter or email, which will set out the basic terms that the buyer would be prepared to agree to. The offer will not be detailed at this stage, as the buyer will not want to commit too much resource to the offer before it knows whether it is likely to be accepted in principle.

### 7.2 The letter of intent (LOI)

The next step is usually for the buyer or its advisers to draft a LOI (also known as "heads of terms" or a "term sheet") setting out the key terms of the deal that have been agreed in principle. This letter, which is usually non-legally binding, should ideally set out:

- a. The financial terms, including the formula for arriving at any earn-out or deferred payment.
- b. The form that the purchase price will take if any of it is to be in non-cash forms, such as loan notes or shares in the buyer.
- c. The deal timetable and target completion date.
- d. Whether the buyer is to be granted a period of exclusivity, and if so for how long. Exclusivity does not mean there is any commitment on either side to complete.
- e. Any conditions to which the buyer's offer is subject, typically legal, commercial and financial due diligence, board approval, satisfactory tax structuring and agreement of definitive transaction documents.

## 8. The due diligence process

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8.1 Once a LOI has been signed and exclusivity granted, the buyer will embark on its due diligence process, which can be time consuming. The basic legal principle underlying a company purchase is caveat emptor (buyer beware). In other words, once the buyer has bought the business, it can't complain afterwards. The vast majority of buyers are therefore keen to find out everything they possibly can about their target business. Due diligence will usually comprise:

- a. **Commercial due diligence** – focussed on the strength and quality of customer relationships, contractual terms of business, internal business processes and anything else the buyer considers important commercially.
- b. **Financial due diligence**
- c. **Legal due diligence**
- d. **Tax**

It is therefore helpful to put your house in order prior to the due diligence commencing.

Typical things that can be done in preparation for a due diligence exercise include:

- Ensure important contracts are in writing
- Check that all compliance requirements are up to date
- Write up the statutory records
- Check that you have access to all such information
- Ensure access to all company policies and related procedures and documents
- Others

## 9. The detailed documentation stage

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9.1 While due diligence is progressing, the buyer's lawyers will usually be working on the detailed documents, of which the sale and purchase agreement (SPA) will be key. This will set out the definitive terms of the purchase, and include all the protections sought by the buyer to safeguard its investment. The SPA will include the following:

- a. **The price and all payment terms**
- b. **Any price adjustment mechanisms agreed**
- c. **Seller restrictions**
- d. **Warranties and indemnities** – typically comprising the bulk of the SPA, warranties are a series of statements by the sellers about the condition of the business at the

date of sale. If these turn out to be untrue, the buyer has a means of redress by way of a claim for breach of warranty. These will cover everything from the accuracy of the accounts used by the buyer to value the business, to the absence of disputes with staff and relationships with customers.

Because the warranties are so extensive, it is invariably the case that they will not all be true. This does not mean that the warranties cannot be given, just that the seller must make disclosures, so that the buyer is aware of the true position before completion. Before the SPA is signed, the seller and its advisers produce a list of all the areas where the warranties do not accurately describe the business in a letter known as the disclosure letter. The more comprehensive the disclosures are, the less risk there will be of the buyer making a warranty claim after the deal has completed.

## 9.2 Other principal documents

At the same time that the SPA and disclosure letter are being negotiated, the parties and their lawyers will be negotiating the other deal documents, which are likely to include some or all of the following:

- a. **Tax covenant** – this can be either a standalone document or a schedule to the SPA. It is designed to ensure that the buyer is able to recover pound for pound from the seller(s) if it transpires that the target company has not paid (or provided for) all the tax it is liable for at the date of the sale.
- b. **Service agreements** – if the sellers are to remain with the business as employees following the sale, they are likely to be required to sign new service agreements.
- c. **Loan notes** – in certain cases, when there is a deferred element to the purchase price, the buyer will offer to satisfy this in the form of loan notes.

## 10. Deferred consideration and earn-outs

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10.1 Part of the purchase price may be deferred because:

- a. The buyer and seller cannot agree on a valuation and therefore a common solution is to make part of the price dependent on the financial performance of the business after completion of the sale. This is known as an earn-out.
- b. The buyer wishes to lock in some or all of the selling shareholders after the sale. This is commonly done in people businesses where the continued involvement of particular

individuals is seen as critical to the success of the company in the period immediately following sale.

- c. The buyer cannot afford the whole of the purchase price upfront.

**10.2** Sales that include an earn-out element are invariably more complex than those that don't, as both buyer and seller need protecting in different ways during the earn-out period.

## **11. Seller financing**

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**11.1** Increasingly, seller finance is being used to fund sales of independently owner managed businesses in the care sector. What is seller financing?

Seller financing is a form of loan that a seller grants to the buyer to facilitate the sales process. It works in a similar way to a bank loan, with the terms of the loan being officially documented in a legally-binding purchase agreement. The buyer will usually make a down payment, followed by monthly repayments at the agreed interest rate and over the timescale set down in the arrangement. As security for the loan, the vendor can repossess the business in the event of default.

From a sellers' perspective, this type of financing has the potential advantage of opening the door to more buyers, particularly those who may be unable to get a large loan from a bank. This could lead to the payment of a higher sale price.

On the downside, if the buyer defaults on the loan and the seller doesn't have the proper protections in place, the seller will lose that money with no ability to recoup the loss. This may not be seen as being fair in circumstances where the buyer has taken little risk and has funded the majority, or all, of the purchase price via seller financing.

## **12. Completing the deal**

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**12.1** If the buyer is happy with everything its due diligence has revealed, and the negotiations over the SPA and accompanying documentation are successful, the deal can be signed and contracts exchanged. Exchange may take place simultaneously with completion (and payment of any purchase price due) or at an earlier date.

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