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Buyers are now imposing tough terms by linking payment to future profits. Report by **Rachel Bridge**

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Eyes open: Ben Davies sold his advertising agency for an upfront payment of £10m but the recession killed his earn-out deal

Selling a firm is as hard as starting it

If you think that selling your business will mean sailing off into the sunset the next day waving a fat cheque, think again. In these uncertain economic times, buyers are increasingly looking at ways of taking the risk out of their purchases, which means they are paying a smaller proportion upfront and demanding that the vendor stays on to run the company for three years or more and earns the rest by hitting tough performance targets.

Put bluntly, the rules have changed. It's goodbye instant wealthy freedom, hello hard slog. Business advisers say the three years spent trying to get out of a business could end up being more stressful than the three years spent setting it up.

Tony Walford at Green Square, the corporate-finance adviser, said: "The deal structures have changed. There is a lot of nervousness among buyers and they want to de-risk acquisitions as much as possible. So they are paying a modest multiple upfront and more of the consideration is being geared toward post-acquisition performance. And these days buyers expect the seller to be involved in the business after the sale, and in many cases running it."

Walford said that while a few years ago someone selling their business would normally expect to get 80% of the price upfront and 20% as a deferred payment linked to profit performance, otherwise known as an earn-out, these days the split is more likely to be 50:50.

Duncan Skailes at Price Waterhouse Coopers, the accountants, said that deals were becoming increasingly complex as purchasers tried to protect themselves. He said that in some cases deferred payments were being linked not only to profit targets but to cash-flow levels too.

"Purchasers are getting more sophisticated and, for example, making deferred payments not just profit-dependent but also cash-flow-dependent. It is a way of encouraging the seller to make sure that any profit he has promised turns into cash."

He added that other measures were also being used to tie in vendors and so reduce the purchaser's risk, such as being asked to immediately reinvest some of the payment into the business in return for shares or a loan note.

"Five years ago a typical deal would have had a simple earn-out structure of some payment upfront and maybe some more in the future based on profits," said Skailes. "But a much more normal deal now, especially for financial as opposed to trade buyers, will be based on a combination of some cash upfront, some cash being reinvested in the deal and potentially the vendor keeping an equity stake in the business as well."

Skailes warned, however, that if a vendor remained in the business, the earn-out period could be hard work for entrepreneurs used to running their own show.

"In today's markets, particularly when businesses have run into trading or debt problems, entrepreneurs sometimes struggle to adjust to the new corporate world around them."

And not only can staying on to work for a company they have relinquished control of be really hard to adjust to, but vendors may not hit the targets set and get the deferred payment they had been hoping for.

Walford said a vendor should never rely on getting the earn-out payment. "You should never sell your business if you are unhappy with the upfront payment because, no matter how attractive the earn-out looks, you never know if another September 11 is around the corner.

"A catastrophe could happen that will stop you getting the earn-out and it could be totally out of your control."

Ben Davies, 44, sold his specialist healthcare advertising and communications agency, Pan, three years ago in a deal that involved an upfront payment to him and the other shareholders of £10m and a deferred earn-out payment over 28 months, which could have reaped an additional payment of several million pounds.

He stayed on with the purchaser, Creston, to run his former business within the larger group in the hope of achieving the earn-out targets, but failed to meet them because of the economic climate and so got no further payment.

He said: "We continued to outperform the market but when the economy fell off a cliff it proved impossible to meet the targets. But I knew that when you sell a business you need to make sure you are happy with the upfront payment because you cannot rely on getting the earn-out payment."

Fortunately for Davies, he enjoyed the experience of working with the new owners so much that when the earn-out period ended in March he decided to stay on and now has an enhanced role in the larger group. He said: "The deal has given me access to a whole range of different services and consumer skills within a larger group that I can use to both enhance the business and also my own development.

"I wasn't looking at the end of the earn-out as being goodbye, I am off. I am very much involved in moving the company forward. I am very happy."

Keith Hunt at Results International, a business adviser, said that the pressure to achieve high earn-out targets was even prompting some vendors to ask for the period to be extended from three to four years to give them more time to hit the targets.

"If the first year of the earn-out period does not go well, it can be difficult to recover from that in just two years. Four years gives them more time," he said.