

Corporate Financier

GROWTH | OPPORTUNITIES | EXPERTISE



CORPORATE
FINANCE
FACULTY

ISSUE 164
JULY/AUGUST
2014
ICAEW.COM/CFF

HITTING

THE SALES

RETAIL SECTOR IN THE SPOTLIGHT




THE £600M DEAL SOMPO OF JAPAN HEADS WEST SOURCE MATERIAL THE PE ORIGINATION QUESTION



Cyber security in corporate finance

Cyber security is vital for the UK's reputation as a global hub for corporate finance and to ensure confidence in corporate transactions – for companies, their advisers, investors and stakeholders.

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Shop 'til you drop



**CORPORATE
FINANCE
FACULTY**

In the middle of June, Moody's downgraded Tesco's unsecured long-term ratings from Baa1 to Baa2 – the credit rating agency's second lowest investment grade. The one-time darling of the



London Stock Exchange has seen its share price slump to under £3 a share – roughly the price they were at 10 years ago.

The supermarket giant's trading profit fell 6% in the financial year 2013/14 and the challenges to trading have continued – for the quarter to the end of May underlying sales fell 4%.

While there seems to be trouble at the top – and particularly in the food multiples – the UK retail sector in general has seen more flotations on the London Stock Exchange in the past six months than there had been in the previous six years.

This month we look in detail at what is going on in the sector. There are many dynamics at play, and with flux there are deal opportunities. Innovative businesses will be looking to grow, and that may involve strategic M&A opportunities. Equally, they may find themselves targets of the bigger retailers, in need of a shortcut to innovation.

Almost every type of corporate finance deal is either happening or mooted in the sector. There are innovative start-ups a-plenty in the online retail area, some funded by angels or VC, some by corporate venturing.

With this month's issue of *Corporate Financier*, you will also find enclosed the new *Business Finance Guide*. Launched by UK business minister Vince Cable at the House of Commons in June, this unique guide brings together the know-how of no fewer than 19 business, professional and representative organisations in an initiative led by the Corporate Finance Faculty.

The guide is aimed at businesses from start-ups, to 'micro-businesses', to SMEs and growing mid-sized companies and, we hope, provides clear and accessible pointers to the many types of finance available to them – debt or equity. The guide also underlines the importance of professional advice throughout the business journey.

To grow from the smallest shopkeeper to the greatest international retail chain, the strategy must be funded – something no doubt Jack Cohen was aware of when he opened his first Tesco store in the London suburb of Barnet 85 years ago. And something current group CEO Philip Clarke will be all too aware of.

Marc Mullen
Editor

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Faculty news

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Stephen Welton, chief executive, *Business Growth Fund*

BROADER PROFESSIONAL BASE FOR FACULTY'S BOARD

The Corporate Finance Faculty's continuing expansion to include members from a wide range of professional backgrounds has been highlighted by the appointment of two new recruits to the faculty's board

Jackie Bowie, chief executive of financial risk consultancy JC Rathbone Associates (JCRA), has considerable experience of risk advisory and debt structuring mandates across the firm's client base, and also oversees all engagements in the private equity sector. Prior to JCRA, she managed equity investments at Aegon Asset Management, Murray Johnstone, and Britannic Asset Management, having trained as an investment analyst. JCRA became a Corporate Finance faculty member organisation in 2011.

Selina Sagayam is a partner in the London office of law firm Gibson, Dunn & Crutcher and has worked on several very large and high-profile takeovers. She has particular experience in the financial services and TMT sectors and has also been a secondee to the UK Takeover Panel. Sagayam began her legal career as a barrister. Prior to joining Gibson Dunn in January 2007, she was a partner at Simmons & Simmons.

Giles Derry, chairman of the Corporate Finance Faculty, welcomed the new board members following the faculty's annual general meeting in May. He also thanked **Marc Fecher** and **Mark Hammond**, both long-serving members who have stepped down from the board.

Finally, he thanked **Richard Green**, who as a former vice-chairman represented the faculty on ICAEW's council and in several important policy and technical forums. He has also retired as chairman of August Equity.

Jackie Bowie



Selina Sagayam



See
p7
for Jackie Bowie's
first column
for *Corporate
Financier*

You can find
Jon Moulton's regular
column *Moulton Steel*
on

p11

REGULATION – CHANGES TO LISTING RULES

The Financial Conduct Authority (FCA) has brought in new rules on the UK listing regime in response to investor concerns over the governance of premium listed companies with a controlling shareholder, to protect the interests of minority shareholders.

If a premium listed company has a controlling shareholder and wishes to apply for a cancellation it would have to both:

- obtain a majority of at least 75% of the votes attaching to the shares of those voting on the resolution; and
- gain approval by a majority of the votes attaching to the shares of independent shareholders.

In takeovers, an equivalent requirement based on acceptances will apply, except that when an offeror has acquired more than 80% of voting rights no further approval would be required to cancel the premium listing.



CORPORATE FINANCE QUALIFICATION DEADLINES

Professionals who would like to sit the **2 December 2014** round of exams for the Diploma in Corporate Finance are reminded that they need to register either by **22 September** (non-UK candidates) or by **13 October** (UK candidates).

The deadline for applications for the 'experience route' to the 'CF' designation is **3 October**.

To find out more, please visit icaew.com/cfq or phone +44 (0)1908 248 250 or email cf@icaew.com

SANJAY VIG TO CHAIR FACULTY'S MIDDLE EAST GROUP

Sanjay Vig has been elected as the new chairman of the Corporate Finance Faculty's network in the Middle East. He takes over from Declan Hayes of Deloitte.

Sanjay is managing director of investment banking at Alpen Capital, based in Dubai. He has more than two decades of corporate and investment banking experience in the Gulf and India. Prior to joining Alpen Capital in 2005, he

was head of capital markets at Emirates Bank Group.

Matt Benson, a Dubai-based partner at EY, has become the Middle East network's vice-chairman.

To find out more about the Corporate Finance Faculty's projects and events in the Middle East, please contact faculty head David Petrie, or Vanessa Heywood, ICAEW's regional business development manager, at vanessa.heywood@icaew.com or on +971 (0)4 408 0004.



FACULTY SUPPORTS SPEEDY GROWTH

ICAEW head of corporate finance, David Petrie, presented specialist healthcare business Embryonix with the 'funding champion' award at GrowthAccelerator's inaugural The Brave & The Bold awards.

The company was recognised for its success in raising funds, and for ensuring finance was used effectively to secure growth. This enabled it to work on Happy Legs, a patented technology to aid circulation in elderly and disabled people.

"Embryonix's thrifty use of early stage funding, combined with leveraging retained cash from initial orders that swayed the judges," said Petrie. "It was able to create Happy Legs and

launch it onto the market with only modest initial investment – and that's impressive."

UK skills and enterprise minister, Matthew Hancock, said: "It is part of our long-term economic plan to ensure Britain is the best place for small businesses to start up and scale up.

Government-backed services such as GrowthAccelerator help to create the right environment for enterprise. These awards celebrate the best of British businesses that are vital for our economy."

GrowthAccelerator supports more than 15,000 high-growth businesses in England.



David Petrie speaks at The Brave & The Bold Awards

Future tense

M&A values and volumes have been on the rise, with megadeals at the fore. **Jackie Bowie** says more than a steer on interest rates is needed to maintain confidence



JACKIE BOWIE is CEO of JCRA, having joined in 2004 as director. She has experience of risk advisory and debt structuring mandates, and oversees all engagements in the private equity sector. Prior to JCRA, she worked for Aegon Asset Management, Murray Johnstone Limited and Britannic Asset Management. She has a 1st in economics, a masters degree in investment analysis and was recently elected to the board of the Corporate Finance Faculty.

The past 12 months have produced the perfect mix of ingredients for global M&A activity: liquid debt markets providing cheap funding, cash-rich corporates, strong equity returns and a stable macro-economic environment. As the economic recovery gathers momentum, the outlook for further deal activity looks rosy.

Pfizer's seemingly doomed takeover of AstraZeneca reflected one characteristic of the current boom - the über-merger. The number of M&A transactions may remain below that frenzied 2007 peak, but values are at least at those 2007 peaks. GE-Alstom, SFR-Numericable and Facebook-WhatsApp were all worth over \$15bn, while Holcim-Lafarge and Comcast-Time Warner were both valued above \$20bn.

Although banks' enthusiasm for lending remains diminished, 'alternative' lenders and private debt funds are fast-developing. But it is the re-rating of the equity market that has probably had the biggest influence on transaction activity. Compared with 2007 many more transactions are being funded with a combination of stock and cash. Any continuation of the deal flow may require further increases in equity values.

The Fed and Bank of England's quantitative easing programmes have successfully supported the banking sector without generating the inflation so confidently predicted by many doomsayers. In an ideal world, we would now see the Bank of

England use its new macro-prudential powers like a rifle, to accurately remove the threat rising property prices brings to the UK economy. Without action, the danger is that the somewhat blunter tool of interest rate rises will have to be deployed.

The markets believe base rates will start to rise from late 2014. Latest Libor forecasts predict a steady increase to 2.4% by March 2017. However, Mark Carney, governor of the Bank of England, maintains a very dovish stance.

A perceived danger is that an early hike surprises markets - or by the Bank dropping hints at an earlier move. The latter would move the yield curve anyway, and increase the cost of funds across the market.

The question is whether an early interest rate rise would have less of a negative impact than a delay

NO SURPRISES

Unexpected increases in interest rates dent confidence. The question is whether an early rate rise, even if somewhat unexpected, would have less of a negative impact than a delay that the market may view as the Monetary Policy Committee (MPC) taking risks with inflation. It may therefore be better to surprise the

market by raising rates early. But, with a stronger pound helping keep consumer price inflation benign, this will doubtless be more of a concern for the M&A market next year than it is currently.

Economic growth boosts corporate confidence, which will determine the appetite for further M&A. Despite the increase in equity indices, revenue growth has not kept pace - in fact it has been declining since 2012. M&A therefore is the only way to further enhance revenue growth.

So, what might be the bump in the road? Lack of clarity from central banks on their interest rate intentions? Fears of 'too much recovery much-too soon'? Or deteriorating equity values? The Scottish independence referendum in September is already denting confidence for transactions with any Scottish element. This year will see over 20 major elections across the world - so a few other issues may add the odd greenfly to the rose garden. ■



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In numbers

IPO overvaluations, alternative sources of capital and the cost of financial regulation

ALL ABOUT EQUITY VALUE FOR MONEY?

**"EQUITY MARKETS
ARE HELPING
BUSINESSES GROW"**



58% of small and mid-cap quoted companies believe **equity markets are helping their business to grow**, compared with **14%** in September 2011. Just **12%** believe they were a hindrance

Companies say:

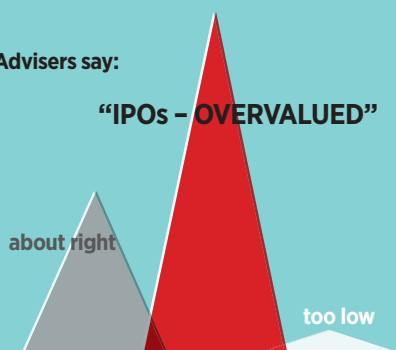
**"IPOs
ARE OVERVALUED"**



54% of companies think **IPOs have been overvalued**, (18% about right, 6% too low and 22% had no opinion)

Advisers say:

"IPOs - OVERVALUED"



59% of UK advisers think that **recent IPOs have been overvalued**, (28% about right, 4% too low and 9% had no opinion)

QCA/BDO SMALL & MID-CAP SENTIMENT INDEX

COST OF KEEPING WATCH REGULATION

\$2.4bn
↑ **59%**

The cost of regulation in 2012/13 – the SEC in the US, the FCA in the UK and the SFC in Hong Kong – a **59% increase** since the start of the financial crisis in 2006/07 when the three regulators cost \$1.5bn

48.8%

The increase in the cost of the FCA (previously FSA) in those six years

KINETIC PARTNERS' RESEARCH

FEELING ENERGISED

\$16bn

The value of worldwide leveraged buy-outs in the energy and utilities sectors by end of May 2014, (compared with \$10bn for the 2013 full year)

S&P CAPITAL IQ GLOBAL MARKETS INTELLIGENCE

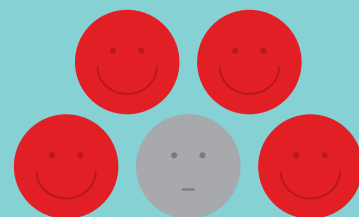
TECH: 2014 SO FAR

758

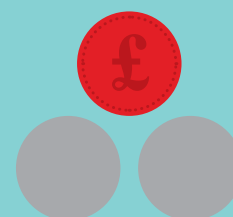
The number of tech M&A deals in Q1 2014 worldwide – the highest quarterly total for six years

EY GLOBAL TECHNOLOGY M&A UPDATE

LEND US A HAND WHERE TO GO FOR CAPITAL?



4/5 of UK companies are **positively inclined** towards non-bank lenders



1/3 say **access to capital is most important factor** in looking to debt providers other than banks

*"I believe this is a once in a generational change in the financing market. The proliferation of **non-bank lenders** has been a key driver of innovation and these firms are an exciting source of funding for mid-market companies. For firms yet to use non-bank lenders, there still seems to be **some education required** on what benefits non-bank lending can bring and it is worth keeping in mind that corporate respondents in our study had resoundingly **positive experiences** with them."*



SHAUN O'CALLAGHAN, UK head of debt advisory, Grant Thornton

GRANT THORNTON'S AGENTS OF GROWTH

We let our clients do the talking . . .



Antler luggage

Asset Based Lending
Funding Growth | **£Undisclosed**

"Vitality, with the funding support provided by Centric, we are able to move from a volume discount brand to a high value proposition. We had direct access to the senior team at Centric. They took the time to understand our business and worked closely and effectively with us to get things done."

F J Church

Asset Based Lending
Funding Growth | **£7,500,000**

"From day one, Centric's level of interest in our business was very evident and this made all the difference. They delivered against a clearly defined critical path, which they stuck to throughout and completed the deal quickly. Centric's appetite to do the deal, right from the CEO level, was the driving force to completing the transaction within the given timeframe."



Blackrow Engineering

Asset Based Lending
Funding Growth | **£4,000,000**

"Centric's personal approach to lending is markedly different from the company's previous providers. In contrast to a rigid, yet inconsistent rules-based approach, Centric has demonstrated real flexibility. As a result of the funding in place and with a supportive lender by our side, we are confident of taking advantage of the significant market opportunities."

Crystal balls

A disconnect between standard setters and real users of accounts is a serious issue for the FRC, says **Jon Moulton**



Writing a monthly column has its obvious drawbacks - most notably looking for a subject to write about that stimulates the readers and me. Happily, this month I was sent the latest surreal document from the UK's Financial Reporting Council (FRC).

Before I share with readers (and likely victims) the latest missive from the team in the dark, academic cells at the FRC, let me explain the modern process to you.

First of all, they generate lots of lengthy and tough-to-read papers addressing problems that most people could not even care about. Over time, this ensures that generally only those with a vested interest in the production and implementation of said proposals have the will and depth of knowledge to respond to consultations. Normal people and users (if in fact there are any actual users of the FRC enforced output) are extremely unlikely to respond to consultations.

So do not believe that consultations are effective communication with potential users. Respondents are largely people and organisations that owe their existence to increasingly complex sets of requirements for corporate governance and reporting.

Fifty four responses were sent in about the wide-ranging, dense 28-page consultation issued last autumn on *Risk Management, Internal Control and the Going Concern Basis of Accounting*. ICAEW tried hard and put in 60 comments. The Institute of

Chartered Accountants of Scotland managed just the one. However, real life users of accounts were not really represented.

I can safely assume that most readers have no idea about the proposals. There is too much for me to cover, so I'll give just a couple of examples.

There is a proposal that a company board, instead of having to consider the nature and extent of significant risks, have instead to consider "principal" risks. Oddly, for a body that is trying to make accounts more

How naïve can you get? Virtually no company can produce five-year financial projections of even moderate accuracy

user friendly, it then helpfully says: "The FRC considers that the words 'principal' and 'significant' are interchangeable for the purposes of applying the Code." Is GCSE English required for FRC employment?

That is just irritating, but the next issue bites. The Code is to contain a new provision: "The directors should state whether, taking account of the company's current position and principal risks, they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due, drawing attention to any qualifications or assumptions

as necessary. They should indicate the period covered by that statement and why they consider that period to be appropriate."

DEATH BY DISCLOSURE

This is supposed to provide relevant and meaningful company-specific information for users of annual accounts. How naïve can you get? Virtually no company can produce five-year financial projections of even moderate accuracy. Over five years, the economic and technical background to a business is immensely variable. Evidence-backed views for "survival" periods over five years? Mystic Meg for audit chair?

The likely lists of assumptions and qualifications will add many more futile pages to the accounts of British companies.

Now consider a company with real issues about viability or financing. The directors will presumably struggle to state a period of likely survival of over a couple of years. Publication of this will obviously seriously impact the actual likelihood of survival as customers and suppliers see a weak partner and move their business to safer homes.

There is no cost-effectiveness review of these proposals and the proposed guidance about process is daunting. It includes using "reverse stress tests", starting from presumed failure and finding out why it could have happened. Does the FRC understand the need for British companies to be competitive? ■

NINE-POINT PLAN

IP is crucial when it comes to valuing and raising capital for a technology-based business. *Corporate Financier* asked three experts about putting a price on it



1 DEFINE THE PURPOSE/ TYPE OF TRANSACTION

Putting a valuation on intellectual property (IP) proves particularly useful when looking to raise equity finance, particularly when looking for early-stage and growth funding. It can also be used to raise certain more specialist forms of debt - venture debt, pension-led funding and specialist asset-based lending against IP. It is less useful (at present) for mainstream lending. This has the potential to change.

Martin Brassell of intellectual property identification and valuation specialists Inngot: "As rules of thumb: equity investors are interested in barriers to entry and freedom to operate. For grant funding, adjudicators are concerned with the ability of a company to deliver in a collaborative partnership. With debt funding it's more difficult: if you can show a relationship between assets and cashflow, specialist routes like pension-led funding can take IP as security, but you can't (yet) approach a bank manager asking for a loan against IP."

2 DON'T START WITH THE BALANCE SHEET

Valuing IP is almost always a process of determining the value of non-balance sheet assets. Any intangibles already on the balance sheet are probably capitalised development costs or the result of a prior acquisition or transfer. They might reflect cost, but not value. When it comes to raising finance, banks are inclined to draw a red line through them all.

Brassell: "You often find a young company in the science, tech or creative sector can have thin fixed-balance sheet assets, so they're tempted to put intangibles on a balance sheet. My view is that it's not particularly helpful to do this, and may actually harm the valuation when banks discount them, as they invariably do."



3 CLEARLY DEFINE THE INTANGIBLE ASSET

Pin down what there is to be valued and measured. Specialist intangible valuation advisers deploy proprietary identification systems to identify different asset types. The key thing is to be precise about what the company has in terms of IP. The range and diversity of the intangibles that can be looked at may surprise companies. It ranges from registered rights and copyrights through to contracts (including licensing and franchises), internal resources (trade secrets, proprietary processes) and even relationships and endorsements.

4 QUALITY CHECK THE ASSETS

If value is to be attributed to these, it is important to ensure that the company really owns them and that any rights have been renewed and are up-to-date. There should be a thorough review to uncover any disputes around rights. Many companies can be surprisingly ignorant about IP protection. Well-protected IP is a lot more likely to be valuable than unprotected IP.

5 DOES THE INTANGIBLE GENERATE CASH?

It is easier to persuade others that IP has value if it is obvious that it contributes to the revenue or the profitability of the business. The ability to illustrate this is key. Some IP contributes directly to the business's top or bottom line. Some may have defensive value. And some may have little demonstrable cash use to the business at all.



Adrian Nicholls, EY UK leader, valuations & business modelling: "IP analysis needs to be grounded in commercial reality. You need to work out whether you're valuing for existing use or for something like maximising the value of a trademark to a third party."

Mike Thornton, head of the business valuations group at Grant Thornton:

"With IP, what you've spent doesn't always relate to what it's worth. It's worth what you get back, and with tech moving on, it might not even be worth that much. Raising finance against IP means someone needs to be asking, 'Well, how can I get my money back?'"

6 QUALITY OF FORECASTS

Generally forward-looking methods of valuation are preferred, because they want to benefit from future cashflows. So forecasts will be needed, underpinned with clearly-defined assumptions that can withstand a sense check.

Brassell: "For exit valuations in a growing business, normal methods frequently undervalue a business by focusing on profit multiples. IP valuation can look at the accumulating value of a business and achieve more: a key benefit of IP valuation is to put back value that the balance sheet leaves out."

8 CHOOSE VALUATION METHOD

Cost, market and income are the three main types of valuation method. Cost is generally agreed to be a poor predictor of value. Ideally you'd be able to make comparisons with transactions from transparent marketplaces where IP is bought and sold, but these are only just starting to emerge. Generally, you'd use an income-based valuation, taking a forward-looking view. The most popular income method is 'relief from royalty', which involves thinking about how much someone else would pay to license the IP and intangibles. The main consideration with other methods is making sure a clear distinction is drawn between the contributions made by tangible against intangible assets.

Nicholls: "The key commercial questions are about growth potential, income potential, and the lifespan of the IP. Within that context, you come to the methodology. The valuer will perform their primary methodology, but it is good practice to crosscheck that with other methods wherever possible. There's a lot of common ground in the fundamentals of approach and guidance set out in international valuation standards but some difference in the application of the process."

7 LIFESPAN OF THE IP

The economic lifespan of the assets may bear no relation to the legal lifespan. A patent may have 10 years remaining, but the technology may become obsolete well before that time. This is important when using forward-looking estimates, as they must not go beyond the reality of the useful life of the assets.

Thornton: "Working out the lifespan of a piece of IP involves understanding the market: doing research, gaining knowledge and being absolutely clear on the market and competition."

Thornton: "IP is often, by its nature, unique and doesn't have comparables, meaning a market valuation approach can be redundant. Using an income-based method focuses on cashflow."



9 MANAGE EXPECTATION

IP valuations may not generate the telephone-number returns some tech businesses can generate, but they will at least provide a number as a conversation starter. Getting a valuation will also show that a business is taking its IP seriously, which plays well with both acquirers and investors.

Brassell: "People get very excited about tech businesses attracting massive premiums, but IP valuation is about taking a sober, hard-headed accounting view. It will not come up with the stellar, incredible multiples you occasionally witness in the marketplace."

Brief encounters

Legal services have been ripe for consolidation for some time, but since ownership regulations have been relaxed, law firms have put M&A at the heart of their plans, says Brian Bollen

All the stars have been aligned for an increase in M&A in the legal services sector for several years, be it for local consolidation in the UK, or to gain an international footprint. But probably the biggest kick-start to M&A in the sector came from the economic downturn itself.

“The economic conditions of the past four or five years have had a big impact,” says Deloitte partner Jeremy Black, who works with professional services and, at the moment, with legal firms. “Pre-Lehman there was growth in legal services, leading to an excess of demand over supply, enabling law firms to become very profitable, thereby removing any pressing need for transactional activity. Post-Lehman, demand fell, putting firms under pricing pressure, leading to a fall in profitability.”

Black says the number of M&A transactions the sector is witnessing is far greater than in the past. And while it remains an extremely fragmented market the change already seen is “massive”. There is a number of other key drivers to this upsurge in M&A.

The changes in UK regulations, allowing alternative business structures, which came into effect in 2011, has enabled firms to raise finance from non-partners. That perhaps began the process of market consolidation. “Succession has been a challenge for some law firms as partners have grown older,” adds Black. “Where there is no feasible succession inside a firm, partners can sell on to other market participants.”

BEYOND THE FIGURES

Getting beyond the anecdotal to hard statistics on the level of M&A in the sector is not easy. The details of many deals are not disclosed. According to Thomson Reuters, there were 146 deals announced globally in 2013, worth a disclosed \$107m. Transactions have taken place across the globe - in the US, UK, India,



Spain, France, Germany, Colombia, Ecuador, Costa Rica, Australia, New Zealand, Canada, Denmark, Latvia, Russia, the Netherlands and Switzerland.

The trend towards internationalisation has also developed, mirroring that same trend among clients of the big law firms. Big legal firms perhaps see greater growth opportunities in overseas territories.

Perhaps the most eye-catching was the tie-up between the UK's SJ Berwin and King & Wood Mallesons, the Asia Pacific-focused law firm, in November 2013. M&A is clearly not simple when it comes to partnerships - the combination consisted of four partnerships: Australia; mainland China; Hong Kong and legacy SJ Berwin in the UK and Europe and Middle East. While the value of the deal was not disclosed, combined turnover was estimated at \$1bn with 70% of that in the Asia Pacific region. The network has more than 2,700 lawyers in 30 locations.

London senior partner Stephen Kon says that the merger was completed, because "clients were increasingly looking east either for capital or for developing their own business in China as it liberalises and opens up significantly. We have always had incredibly strong relationships with US law firms but the more we've looked at it the more we've concluded that for us, looking east is right."

MODERN WORLD

In May, Charles Martin, senior partner at Macfarlanes, wrote in *The Lawyer*: "Getting the governance and structure of the providers of legal services right is part of achieving the change clients want. Alternative business structures, listed law firms, larger groupings of providers (such as by the Big Four accountancy firms) and changes to the nature of the relationship between firms and those who work in them are all part of the answer."

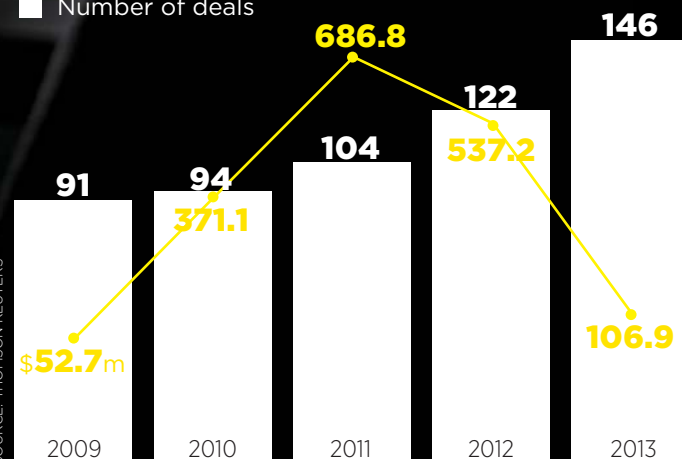
The Big Four accounting firms are growing legal services business. In February this year, EY took over Shanghai-based law firm Chen & Co, and announced it planned to double its legal services footprint in the region. The previous December the firm hired former Herbert Smith Freehills partner John Dick to start a legal services offering in Singapore.

In March this year, PwC legal global legal services leader Leon Flavell told *The Lawyer* that the firm was targeting revenues of £596m (\$1bn) - doubling from 2013's almost £298m (\$500m) across the firm's legal offering - with particular growth earmarked for Asia and Africa. Deloitte also says it is planning to expand its legal services team. And closer to home Nick Roome has joined KPMG from DLA Piper, to lead its legal services arm in the north of England.

GLOBAL LEGAL SERVICES TARGET M&A

— Value inc. net debt of targets - \$m

■ Number of deals



SOURCE: THOMSON REUTERS

“Access to significant equity funding is likely to be critical to take advantage of the market”

Andy Pedrette,
partner, Smith & Williamson



Andy Pedrette, partner at Smith & Williamson, cites two major changes in M&A in the legal sector since non-lawyer ownership was allowed through the Alternative Business Structure (ABS) legislation effective since 2012. First, the acquirers of law firms are much more varied; and second, the new acquirers are bringing access to greater resources, both in terms of funding and in management expertise.

“The underlying drivers of change are likely to continue to be the economic climate and increasing sophistication in buying legal services,” says Pedrette. “External finance enables law firms to evolve more quickly to address the changing environment. The evolution has accelerated where regulation has forced the pace, with the Jackson reforms effective from April 2013 particularly driving consolidation in the personal injury space. It may be difficult to predict accurately how the market will develop and there may be upheavals along the way, but access to significant equity funding is likely to be critical to take advantage of the opportunities in the market.”

Peter Dawson, partner and head of transaction services at Grant Thornton, points out that the list of interested acquirers for law firms is long. He cites the example of Manchester-based Halliwell's. Its component parts were sold to four different firms after it fell into administration in June 2010.

BIGGER, STRONGER

The issue of scale is a major driving force. Smaller firms can not only work more cost-effectively if they bulk up, but they can also retain places on bank and insurer legal panels that they might otherwise risk losing.

Black points to Slater & Gordon's acquisition spree at home in Australia and in the UK as an example that might well be followed by other ambitious firms looking to take advantage of the economies of scale that are available. Slater & Gordon acquired the personal legal services practice of leading UK consumer law firm Pannone Solicitors; this included compensation law, family law, wills & estates and private client practices.

Pedrette agrees: “Slater & Gordon has shown

“Where there is no feasible succession inside a firm, partners can sell on to other market participants”

Jeremy Black,
partner, Deloitte



how skillful execution of a clear strategy to utilise external capital can benefit all stakeholders.”

Client service has remained paramount, as revenues and profits have increased around seven-fold since its IPO in 2007, when Slater & Gordon became the world's first publicly-traded law firm, on the Australian Stock Exchange. Slater & Gordon was the best-performing share in the ASX 200 index across all sectors in 2013.

Pedrette expects the variety of owners of law firms will continue to increase and that the pace of change is likely to accelerate. One new driver for this may be if more jurisdictions in the world follow the Australian and UK changes to allow external investment in law firms. “We expect further consolidation in the UK market and a greater emphasis on brands, with possible new entrants like Which? coming into the market more seriously,” he adds.

“Traditional law firm mergers are likely to still occur, such as the recent examples of Wragge & Co and Lawrence Graham, Penningtons and Manches, and the reported possible merger of Charles Russell and Speechly Bircham,” he concludes. “We believe that traditional mergers are difficult to complete, however, with many exploratory discussions falling away when issues of integration and cultural differences are examined in detail.” ■

VARIETY SHOW

Insurance related legal firms and intermediaries are targeting the legal sector, partly driven by the desire to protect significant revenues from case referral fees paid by law firms. Admiral, Direct Line, DAS and Abbey Protection have been acquiring firms or entering into joint ventures. BGL, best known as the owner of comparethemarket.com, acquired Minster Law.

Outsourced service providers are primarily targeting the high volume claims work from the insurance market. Quindell acquired Silverbeck Rymer and Accident Advice Helpline/ Abstract Legal; while Helpline is planning to acquire NewLaw.

Private equity firms have spotted an opportunity to bring capital to bear following regulatory changes. Duke Street has made an investment in Parabis; LDC in Keoghs; JZ in Winn Group; and Hamilton Bradshaw in Knights.

‘High street brands’ look to provide additional services. Co-op Legal Services has gained an ABS licence, while the AA and RAC have been entering into joint ventures or investing.

Specialist financial services businesses are seeking to broaden their offerings. Fairpoint has acquired Simpson Millar.

Slater & Gordon, the Australian publicly quoted law firm, plans to build its independent consumer law brand in the UK market.

Big Four firm PwC gained an ABS licence and its legal business in the UK is reportedly large enough to rank in last year's Top 100 law firms.



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Impetus supporter

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WE'RE SHOPPING

With 12 flotations already completed, 2014 is proving to be a boom year for the retail sector. Rebecca Thomson asks why tables have turned and why investors have been out shopping again

Having languished in the doldrums since at least 2008, retail is well and truly back in favour. The past six months have seen more retailers floating on the London Stock Exchange (LSE) than the previous six years, with retailers rushing to make the most of their moment in the sun.

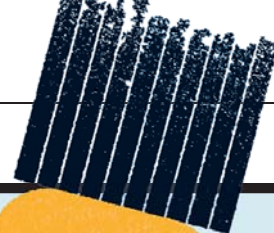
There have been nine retail flotations on the LSE Main Market or AIM in the past 12 months. Retailers from Boohoo to Poundland have made their stock market debuts. In May, Card Factory and Shoe Zone floated, with market caps of £766m and £80m respectively. B&M Bargains and Made.com followed suit, as did Game Digital just two years after the computer game retailer went into administration. Others in the pipeline include Bridgepoint-owned sports goods e-tailer Wiggle.

So what has made retail suddenly so attractive to investors? EY partner and retail specialist Jessica Clayton says the fact that the past few years have been quiet for retail on financial markets partly accounts for the rush: "There have been pretty unfavourable conditions in the past few years. There's a pent-up backlog of exits that have been waiting to happen." Three of the 12 main stock market IPOs so far this year have been retailers - e-tailers Boohoo and Koovs, and Shoe Zone floated on AIM.

Why the listings? While growth has slowly edged up - EY expects the UK economy to grow 2.9% this year and 2.3% next - consumer confidence has increased. More buoyant capital markets have helped. "All that coming together at the same time leads to a surge in retailers wanting to take advantage," says Clayton.



ARON VELLEKOOP LEON



David McCorquodale, head of retail at KPMG, agrees: “We have an interesting situation with increasing consumer confidence, and while we’re not back into huge growth, the public markets are putting a lot higher valuations on retailer businesses because those stock markets are factoring in longer-term growth.”

The far-from-distant memory of a tough recession for the sector means there is some degree of caution. “The stock market is willing to spend again, although not with the abandon of 2007,” says McCorquodale. “But they want to invest.”

Retail is a sector everyone has an opinion on, and well-known brand names mean that interest is generated as soon as there is a spark. Clayton says: “Retailers are names people recognise. Everybody knows what Poundland is. So retail gets talked about a lot, and it becomes self-fulfilling. There’s other activity going on, but IPOs have stolen the march.”

FOR A LIMITED PERIOD ONLY?

Will this fortuitous set of conditions stick around? Of course, it won’t continue forever. Retail is notoriously exposed to any blips in consumer confidence or wobbles in growth. Clayton says the outlook is pretty robust for now. “The outlook is ‘steady as she goes’,” she says. “And if these economic conditions don’t unwind, you can see consumer confidence continuing to improve. It is consumer confidence that has been spurring the spending at the moment.”

Clayton does caution, however, that any perceived fall in wealth will send consumers running. “We do see real wages starting to keep up, so the economic conditions underpinning the transactional activity look like they’re going to continue. At the moment we see the transaction market continuing to be increasingly buoyant for retailers and a lot more IPOs are mooted.”

McCorquodale says the door will remain open if the current batch of recent IPOs can deliver on their first financial updates. “It looks like the window of opportunity will be open for the whole of this year, provided the new entrants perform. If they report ahead of expectations that will keep it open for a bit longer. But it will take one slip, and others will catch the backlash.”

Of course then there is the i-word. An interest rate rise will hit UK households’ disposable incomes. Many economists and commentators have attributed the robustness of consumer spending to benign interest rates.

Next year, however, political forces may act to stymie the flow of flotations. “There is political risk because of different things happening [the general election next year and the Scottish referendum this autumn],” says Jonathan Buxton, head of consumer and retail M&A at Cavendish Corporate Finance, adding that retailers should strike soon. “If I was the chairman of a retail group, I would be

IPO OR NOT TO IPO

There were a number of retailers poised to take advantage of 2014’s welcoming financial environment, but over the summer the appetite seems to have waned somewhat.

Menswear fashion retailer **Blue Inc** had an eye on a £60m float this summer. It planned to use the flotation proceeds for growth. Chief executive Steven Cohen said: “We’ll reinvest to supercharge growth over the next three to five years.” The plan was to double the number of stores to about 500, but by mid-June the listing had been shelved.

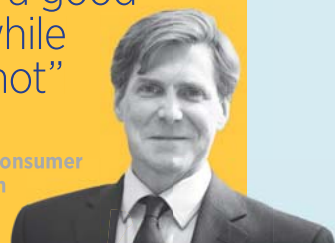
Other retailers eyeing or planning an IPO include **Photobox** and **Wiggle**. Photobox’s float has been delayed as at the start of July, while investors were eagerly awaiting the pricing of sports goods retailer Wiggle.

In May, outdoor fashion retailer **Fat Face** pulled its plans to raise £110m from a £440m float. It had come perilously close to collapse in 2008. Chris Searle of BDO suggests this may indicate some of the frothiness is coming off the retail IPO market.



“If I was the chairman of a retail group, I would be thinking this is a good time to float while the market is hot”

Jonathan Buxton, head of consumer and retail M&A at Cavendish Corporate Finance



thinking this is a good time to float while the market is hot.”

Not all of retail is benefiting from the current improvement. McCorquodale says there is a clear divide between two distinct parts of the sector. “In the first three months of the year, non-food retailers’ shares went up 14%. It was the best performing sector on the stock market.” Food retailers, however, saw their value fall 10% over the same period. “They’re having a very difficult time,” he says. “It’s an extremely competitive market and price wars are starting.”

THE ASIA CONNECTION

While IPOs are flavour of the month (or year) now, before that private equity ruled the roost in retail when the stock market was not interested. One of 2014’s most high-profile IPOs, Pets at Home, was bought for £955m by KKR in 2010. Other high-profile deals made in 2010 included Cath Kidston, Mountain Warehouse and Hobbycraft.

Private equity deals seem to have dried up in the past couple of years. McCorquodale attributes that to banks’ unwillingness to provide the funding required. “Private equity isn’t ignoring retail, but stock markets pay more than private equity is able to pay at the moment. That will balance out as banks become more willing to leverage the deals, but it’s taking banks a little bit of time to find the ability to leverage retail businesses.”

Clayton says many businesses looking for investment are considering a “dual-track strategy”, with at the very least a couple of options being considered. “What I actually think will happen is people will dual-track. They will look at an IPO but also private equity, and also other retailers, or trade purchases.”

Cavendish’s Buxton, says some more IPOs were expected before summer, but that a slow-down in floats will inevitably come. “I think there’s going to be two or three more and

THE NUMBERS

12

Number of retail flotations so far this year

2

Number of retail IPOs still on the immediate horizon

14%

Non-food retailers share value increase in Q1 2014

2.9%

EY prediction for economic growth in 2014

“Everybody knows what Poundland is. So retail gets talked about a lot, and it becomes self-fulfilling”

Jessica Clayton,
retail partner, EY



then a slow down to a more regular pattern.” He agrees that businesses will follow a twin-track strategy, preparing for a float while also dropping hints that sale is an option.

Clayton points to House of Fraser and Cath Kidston, both strong British brands that have attracted the attentions of overseas retailers and other businesses. Chinese conglomerate Sanpower bought a majority stake in House of Fraser for £480m in April, in what is China’s biggest foreign retail investment so far. The Chinese company plans to expand the brand into China, and this is exactly what retailers are after. Uniqlo owner Fast Retailing – one of Japan’s biggest retailing groups – is reported to be targeting Cath Kidston, which has already started a successful overseas expansion.

“We are seeing more Far Eastern players looking at the UK. From the retailer’s point of view, quite a lot of UK retailers have saturated their UK footprint,” says Clayton. “Growth will come from overseas, but it can be difficult to deliver profitable growth internationally. If you have an offer for your business from someone operating there, they know the market and can help you achieve your growth aims.”

CHANGING FORTUNES

The number of turnarounds in the retail sector has fallen off. Perhaps the wheat has been sorted from the chaff. But, for a while, it seemed difficult to get through a month without another retailer hitting the buffers. Big names from HMV to Jessops to Comet to Republic entered administration, and while a few brands, such as Blockbuster, couldn’t be saved, most represented some form of opportunity for other retailers and investment firms.

When Clinton Cards went into administration in May 2012, US firm American Greetings swooped in to buy 400 stores, saving 4,500 jobs in the process. Sports Direct picked up 20 stores from its former rival JJB Sports, although the brand itself was not retained. And the privately-owned Edinburgh Woollen Mill bought 388 of Peacocks’ 612 stores after the chain went into administration in February 2012.

Clayton says: “In 2012, there were lots of businesses getting into trouble. We saw the impact of difficult economic conditions and the changing retail environment. The private equity activity that we did see was partly on this more stressed side.” Now, the market is beginning to see more strategic M&A activity. The real headline-grabber is obviously Carphone Warehouse and Dixons, due to merge in a £3.6bn deal.

The better economic conditions of 2014 mean much of the structural turnaround work that is needed can be done in privacy, without having to ask banks for help. Clayton

THE TURNAROUND SUCCESSES

One example of a retail turnaround that stands out for Deloitte’s Lee Manning is that of hardware chain **Robert Dyas** by Theo Paphitis. The former *Dragons’ Den* panellist acquired the business in the autumn of 2012 for about £10m after the retailer was hit hard by the recession. “He has been running it for over a year now and it’s doing extremely well.”

Similarly, the fortunes of **Game** seem to have improved massively since OpCapita bought it in 2012. This is largely due to the launch of a new Xbox and PlayStation devices and the games releases that come in the aftermath of this, but Game has managed to capitalise on the products. In June, Game Digital floated on the LSE Main Market with a market valuation of £340m.

Manning adds there are improvements across the board in retail at the moment. “Even **French Connection** seems to be doing much better than it was in the last year. It has picked up considerably from last year when it was really struggling – the market thought it might be on the verge.”

Leaner, meaner retail businesses have been improving their fortunes. Outdoor clothing retailers **Blacks** and **Millets**, purchased by **JD Sports** in 2012 and 2013, have improved in performance “significantly” in the second half, according to executive chairman Peter Cowgill. “A lot of these things are down to the strength of management strategy, such as rationalising the store portfolio,” he said when announcing the results.

“The fundamentals of underperforming retail businesses tend to be that they’re losing touch with their marketplace and there’s better competition”

Lee Manning, partner,
restructuring services,
Deloitte



says: “The improving market gives a good opportunity for businesses that have not been performing to their full potential to get their houses in order. They may have the cash to fund those kind of measures without having to go to lenders to look for it.”

Lee Manning, a partner in the restructuring services team at Deloitte, says public turnaround activity has indeed dropped. But he warns that new forces – oversupply of retailers and stores in the value market, for instance – may eventually lead to M&A in subsectors not observed en masse to date.

Manning says that even though conditions have improved, turnarounds are still possible. “The fundamentals of underperforming retail businesses tend to be that they’re losing touch with their marketplace and there’s better competition. They might have under-invested in stores and might not have the right products, or have management who are a bit jaded and faded. The brand might still be salvageable, but that all takes time and money.”

INNOVATIVE SECTOR

It is far too simplistic to put the upturn in the retail sector’s fortunes down to economic conditions. One thing that has happened through the downturn is that retailers have innovated into more clearly defined markets – value and luxury, and of course into online offerings.

And that has continued. The structural change going on in the retail industry at the moment as businesses adjust to an omnichannel environment means there are both opportunities for those who respond effectively – such as Pets at Home and House of Fraser – and challenges for those who have been slower. These forces will be among those continuing to shape the retail sector, leading to a range of activity expected in the coming months.

While the signs continue to be positive, the recovery is by no means guaranteed to carry on at its current level. Retailers who have managed to create a bit of breathing space may find themselves newly under pressure if confidence or growth slips. In May, it was reported that Montagu was lining up a second attempt to sell Maplin, which has more than 200 stores. The private equity firm pulled its 2011 sales process and is said to be accepting that it will take a big hit on the sale.

There are two messages in that mooted deal. The first, in very simple terms, is perhaps that retail is trading near the top of its range. The second is that retail is a far more sophisticated sector now, and without a clearly defined USP, retailers will not be able to sell themselves to investors. ■



RETAIL LISTINGS

AO.com, Boohoo.com, Pets at Home, McColls and **Poundland** have all now listed.

David McCorquodale says **AO** and **Boohoo** were successful floats for the same reasons: “They’re both pure plays and they both have what looks like terrific prospects. They had eye-watering valuations, but both will run and both will do what they say on the tin – there’s the potential to drive significant growth. The story looks quite compelling at the moment.”

Pets at Home, by contrast, is a category killer, he says. “They manage their business very, very well.” Its customer insight and work on its omnichannel systems are exemplary, he adds.

Poundland, meanwhile, has “great systems.” McCorquodale says: “It has been able to change the perception of being cheap. Plus, it has great products.” The strength in its business systems, such as payment and stock systems, means Poundland has been able to keep pace with its own growth.

The biggest opportunities for other IPOs are likely to be either at the value or luxury end of the market, and management will need to consistently deliver “excellence in many territories” to convince the stock market.

“People shop expensively, cheaply, or online.” But he adds there is always room for innovators. “Retail is full of opportunities for someone to steal a march on the competition through innovation in customer service and product. The key is finding the management team that can cope with the strains.”

But it is not all seemingly innovation around the customer experience. Convenience store chain **McColls** floated in February, valued at £200m when it was first listed on the stock exchange. Charterhouse-owned **Card Factory** set the wheels in motion for its float in April after revealing it generated EBITDA of £80.4m last year. It was listed in May at a market cap of £766m. Chief executive Richard Hayes said: “The scale, resilience and continued growth of this market reflects the fact that the giving of physical cards is and will remain ingrained in UK culture.”

“Public markets are putting a lot higher valuations on retailer businesses because those stock markets are factoring in longer term growth”

David McCorquodale,
head of retail at KPMG



LIGHTEN UP

With its recent investment in Harvard Engineering, ECI is the latest private equity firm to show an interest in the sector. Jason Sinclair shines a light on the deal and looks at what the future holds for the British manufacturer

Just over 20 years ago in Normanton, an old coal mining town south east of Leeds, John McDonnell set up Harvard Engineering. A small success story for British manufacturing, Harvard set off a feeding frenzy for private equity houses when it recently sought investment to develop its business.

McDonnell, an engineering graduate, originally spotted a gap in the market for compact electronics for 2D lamps and, in his kitchen, started production on a design based on an old university project.

David Hardless of Park Place Corporate Finance in Leeds advised on the deal completed in November 2013, which saw mid-market private equity firm ECI Partners invest in Harvard. "We developed a relationship with Harvard over three or four years and discussed a range of options. They concluded on moving to minority partnership."

Hardless describes a well-planned deal: "The formal decision to seek a deal was made 12 months in advance. Planning was put in place and the actual deal took about six months [to complete]. It was a competitive process.

We had contact with 30 private equity houses. Private equity is always interested in finding growth businesses, and this is one - and one that also has entrepreneurial management."

GROWTH DRIVERS

McDonnell ascribes the fluid deal process to ECI and the advisers. As well as Park Place, PwC and LEK provided due diligence services for ECI, Pinsent Masons legal advice to ECI and Squire Sanders the legal advice to Harvard.

"The deal process, which was planned

to take about six months, ran very smoothly and largely to timetable. We completed only one week after we had planned," says McDonnell. "There weren't any dramas as we had spent a long time preparing for the process."

Hardless continues that given the competition "the key to the proposal was finding someone who understood what we wanted from a minority investor. In a business with growth opportunities it's positive to have the ability to help develop and where appropriate challenge management strategy. But with the caveat of not behaving like they own the company." While the deal value was not disclosed, Hardless says that ECI took a "significant minority holding" of more than 20%. Existing shareholders also took cash from the table.

For McDonnell, it was key that the investment came from a private equity firm with an understanding of the sector and the business: "ECI demonstrated that it had understood the business better than the other bidders. It has a dedicated resource, which helps its investee businesses to deliver on the strategic plans, and we liked that too. I think we have benefited already from that work. We also thought

HARVARD ENGINEERING FACT FILE

Established: 1993
Based: Yorkshire
Offices: France, Italy, Germany and USA
Employees: 300+
Turnover: £26.7m
Lead advisers: Park Place Corporate Finance
Due diligence: PwC and LEK
Legal advice to shareholders: Squire Sanders
Legal advisers to ECI: Pinsent Masons
Consultants to ECI: KPMG and AT Kearney
Tax advisers: EY

50%

Harvard's expected turnover from exports by end of 2015

20%

minority stake in Harvard taken by ECI



A Harvard innovation, the EyeNut Dash Adapter wireless control and interior lighting monitoring system

that we could work with the team.”

Over the past three years, Harvard has seen employee numbers and turnover more than double. It has also opened offices in France, Italy, Germany and USA, and has a five-year growth strategy to increase export business from 25% of turnover, at the end of 2011, to 50% by the end of 2015.

The new capital is earmarked for that development of the business. The investment will allow the Queen's Award-winning manufacturer to build on its strategic growth plans, including into export markets. Employee numbers will increase from 300 to 500. The company's range of products will expand and construction of a new R&D and manufacturing facility will begin.

For ECI partners, investment director Mark Keeley, said: “As a growth-focused investor we look for businesses which have strong management teams who have driven growth despite the global recession and in particular have expanded successfully overseas. Harvard has met all of our growth criteria.”

Harvard's product range includes LeafNut, a multi-award winning wireless control and monitoring system for street lighting and the CoolLED range of switchable drivers for LED lighting.

The company moved into its current premises in February 2011, but has already outgrown the facility. Harvard has committed to manufacturing all its

products in the UK and has identified a new site close to its current location. Its ambitions to increase exports to 50% of turnover by 2015 are to be channelled through its international offices.

Hardless adds: “Harvard has moved in a big way into overseas markets in a direct sell model, which needs recruitment of salesmen. They'll also need the new premises as they grow.”

M&A AND MANUFACTURING

A new report from Deloitte, *Manufacturing and Industrials M&A Predictions*, notes a prediction of increased M&A activity over the next 12 months. Some 70% of interviewees said they were in “acquisitive” mode. Nearly 44% of M&A chiefs identified PE activity as the primary driver for M&A

“Manufacturing in Yorkshire is right for us. Up to now it has been, and we don't expect that to change in the near future”

John McDonnell,
founder of Harvard
Engineering



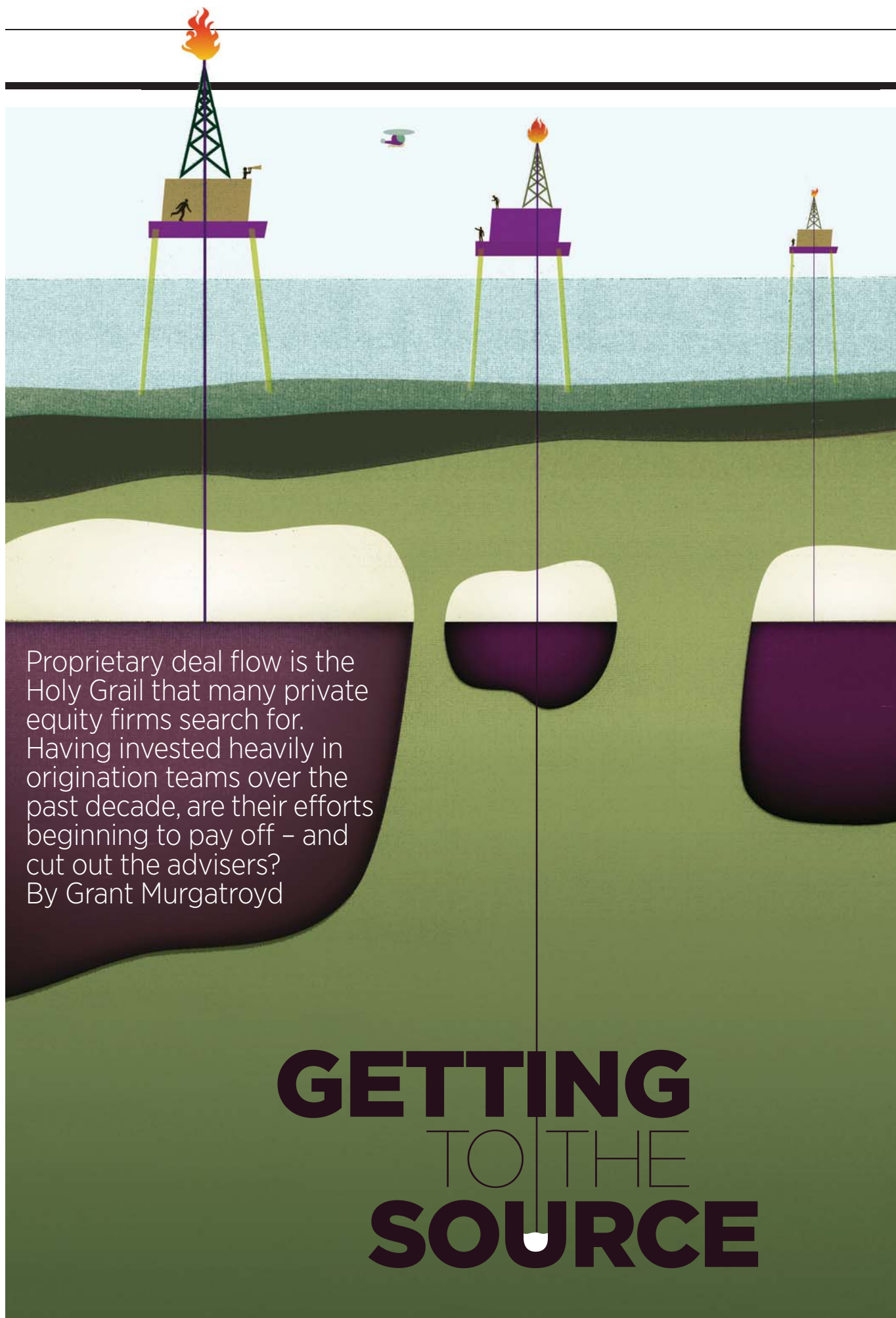
in the coming months, up 12% from 2013's study.

The challenge of working with a PE investor on board is not something McDonnell is daunted by. “ECI was very clear that it expects us to run the business and its involvement will be at a strategic level. We have big plans and are busy working to deliver them,” he says.

And when it comes to the strategy of maintaining its Yorkshire manufacturing base, McDonnell says there are clear positives: “There is still a lot of competition in our sector, and we have to continually check that manufacturing in Yorkshire is right for us. Up to now it has been, and we don't expect that to change in the near future.

“We benefit by manufacturing locally and we get business because of it, but manufacturing in Yorkshire is not really the reason behind our recent growth. Continual innovation has been key to our growth and we invest heavily in R&D.

“The proximity of the manufacturing plant to the R&D facility is certainly of benefit though.” ■



Proprietary deal flow is the Holy Grail that many private equity firms search for. Having invested heavily in origination teams over the past decade, are their efforts beginning to pay off – and cut out the advisers?
By Grant Murgatroyd

GETTING TO THE SOURCE

CORBIS

It's a simple enough concept: origination is a way of unlocking a transaction, by coming up with an original approach to an opportunity, putting it together and completing the deal off-market. Private equity (PE) firms have been building in-house origination teams to source better opportunities than are available in a competitive process. But it would be a big mistake to think these efforts completely sideline the advisory community.

"It is very positive for our relationship with advisers," says Giles Derry, partner at Dunedin responsible for origination, and chairman of the Corporate Finance Faculty. "When you track down a business outside of a formal sales process it has not had the preparation a corporate finance adviser would normally bring to the exercise. As such, the information can be less pre-packaged and require more input from our side. This provides an opportunity for us to take deal flow to advisers to turn the raw opportunity into a deal."

Dunedin has been hard at work sourcing its own transactions for the past eight years, effort that is now being rewarded. Derry points to the examples of engineering company Formaplex, which was sourced through Dunedin's industrial network and completed off-market in 2012, and Weldex, which the PE firm had identified and tracked for two years prior to a buy-out in 2010.

Why all the effort? The obvious answer would be that if something is bought without competition, it can be bought at a better price, but this is not always the case. "Doing a deal off-market doesn't necessarily mean you can get it at a lower price, but it does mean you have greater certainty over your ability to execute," says Derry.

STEADY FLOW

Charlie Johnstone, head of the origination team at ECI Partners, says his job is to ensure a steady flow of winnable deals that fit ECI's growth strategy, then to help the team win those opportunities. In practice, sector teams pick up the baton once the opportunity has been identified.

"I don't believe in our team doing all the cold calling, getting to know businesses and then passing on to sector teams," he says. "It is better that the person with the sector knowledge makes the approach - they will be more credible. They may be the tenth person to meet that company, but they can blow them out of the water with their sector knowledge. The origination function has become a support function to the sector teams, rather than an isolated function within the business."

PE executives are keen to push the reciprocity angle. "The reality is that our focus remains on developing relationships with advisers because they are our primary source of deal flow," says

HgCAPITAL: NOT LOOKING FOR DEALS

If you look at its website, HgCapital has a straightforward investment approach. It is a sector specialist that backs industrials, TMT, services and renewable energy. But talk to managing partner Nic Humphries and you soon get a clear idea of how the firm's approach is different.

"Most private equity funds spend their time hunting for deals and, when they find the most interesting deals of 2014 or 2015, they sift them, based on their criteria. They are typically trying to get deals 12 to 24 months away - but they are primarily interested in the deal and not the company," he says.

"We are trying to do the opposite. We lead with the sectors and we are thematic. We spend our time thinking about what is

"We look for an interesting sectoral trend and when we find one we understand it in depth"

Nic Humphries, partner, HgCapital



a good segment or sector with good macro trends that persist over many years and - if we understand that - that will generate multiple types of companies we can back under that theme."

Humphries adds: "We look for an interesting sectoral trend and when we find one we understand it in depth, then we go and meet every company from large to tiny. The crucial difference for us is that we haven't got a bloody clue when those companies are going to do a deal. And frankly I don't care. If I meet enough good companies in enough good sectors, build relationships with them, over time if I am meeting enough of them, 10% to 15% of them will do a deal. We need a pipeline of 100 to 200 companies for each of our sector teams."

Humphries quips: "I've tracked a publicly-traded software company for 14 years and I'll probably be dead before someone at HgCapital does a deal with them." But he claims it is just one of 200 companies Hg Capital knows intimately in Europe. He says that 10% of those companies will do deals in the next one to two years: "And when they do, we will be intensely competitive on the three to five of them that we know best."

"Usually we win two to three of these, and a 50%-plus hit ratio is what we are after when we spend three to four months of intense time on a serious deal."

"It provides an opportunity for us to take deal flow to advisers to turn the raw opportunity into a deal"

Giles Derry, partner, Dunedin and chairman of Corporate Finance Faculty



"If you're a corporate finance adviser, you can have a multi-dimensional conversation with a company"

Ashley Broomberg, partner, Mobeus Equity Partners



Ashley Broomberg, partner at Mobeus Equity Partners. "If we do come across a company on our own, we absolutely try to recycle it through the advisory community with a view that it comes back to us. We believe it is extremely difficult for a PE firm to find a company and get it to a completed deal. It is quite a one-dimensional conversation that a PE firm can have with a company, whereas if you are a corporate finance adviser you can have a multi-dimensional conversation, about succession, tax, bank funding, etc."

NURTURE, NOT NATURE

Howard Leigh - recently appointed Lord Leigh of Hurley - is founder of sell-side adviser Cavendish Corporate Finance. He says his firm gets its deals through word-of-mouth and a track record built over many years. "The big question the PE firms have to ask themselves is, 'Is it counterproductive?', because they might be damaging relationships with people who bring them deals. It might be better to put their effort into nurturing relationships with people who have a fistful of deals."

Very few PE funds have pure origination teams that are mining Companies House data. The origination team at a UK mid-market firm tends to consist of three or four individuals or FTEs (full-time equivalents). Advisory firms, especially the integrated professional services firms, have the critical mass necessary to generate a steady flow of transactions.

"We try to provide the relationship that is going to unlock the transaction," says Leon Gillespie, KPMG corporate finance director. "It might be that we already have a relationship in the wider firm: KPMG is a big organisation. Our sector teams invest a huge amount of time building relationships in industry and private equity firms are increasingly prepared to invest time and resource years ahead of a transaction, so we work with them to build relationships until the timing is right for a transaction."

Others, including CF advisers, have been investing heavily in origination to deepen their relationships with the PE community - a source of regular, repeat advisory fee income.

"Overall, it's about building relationships with these firms who are serial transactors and building a relationship over time," says Bridget Walsh, head of UK private equity at EY. "We have much more regular contact with PE firms, who have become much more specialised in what they are investing in."

"Instead of going and meeting the senior team once a quarter, it is very much the sector teams interacting on a very regular basis or simply picking up the phone and having a discussion." ■



"It might be better for PE firms to nurture relationships with people who have a fistful of deals"

Howard Leigh,
founder, Cavendish
Corporate Finance

"PE firms are increasingly prepared to invest time and resource years ahead of a transaction"

Leon Gillespie,
corporate finance
director, KPMG

OPENING CHANNELS

For private equity firms, origination means building a relationship with the management team ahead of any potential transaction. "PE funds are better than ever at developing relationships over the long-term with management teams," says KPMG's Leon Gillespie. "More often than not, the successful bidder will have built a relationship with the management team prior to the deal going to market."

"There is an awful lot of dry powder in the £20m to £100m range, so part of it is getting comfortable enough with the business to pay the kind of multiples they have to pay nowadays to deploy capital. There is competitive advantage in going into a presentation and knowing the people you are speaking to. You don't have to do a pitch as such - the dynamic is different."

Funds are looking at transactions earlier because they want to get an angle before something goes to auction, though most are realistic that the majority of transactions will go through a competitive process. "We have really beefed up our origination capability with high-calibre ex-bankers with sector expertise," says EY's Bridget Walsh. "We have a sector focus that helps us build strong relationships with our clients, because it gives us really strong talking points and insights that opens regular dialogue with the increasingly sector focused deal-doers in the funds. Our origination team works hand-in-glove with our sector specialists to create innovative ideas for PE houses."

Walsh points to EY's flagship 'Entrepreneur of the Year' programme, where the professional services firm introduced one of the CEOs to a PE fund, which then went on to work with the CEO and buy an asset from another PE fund before embarking on a buy-and-build strategy. She says: "As a professional service firm we are here to service private equity firms. One way is to take a deal and win the M&A or lead advisory work. On other occasions, we find ourselves taking a gem of an idea to the fund and then supporting it on all the elements to help them successfully get the deal over the line, for example, transactions support, due diligence, tax structuring work."

"We take a gem of an idea to the fund, then support it on all the elements to get the deal over the line"

Bridget Walsh, head of UK PE, EY





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CHANGING GEAR

In light of the Corporate Finance Faculty's unique analysis of the UK's Enterprise Capital Funds, published in the May issue of *Corporate Financier*, **Ross Butler** explores the challenges of designing and measuring schemes to support innovation finance in Europe

The assertion that the state should just stay out of the way of markets, once a mantra among the big business elite, isn't something you hear so much these days. But on the threshing floor of capitalism, where new ideas and innovative start-ups are pounded, discarded, tested and pounded some more, the reality of state intervention has been ever-present for decades.

Take Silicon Valley. The received wisdom a decade ago was that the Valley's success was driven by an entrepreneurial 'spirit' and a pleasant working environment where boffins, entrepreneurs and investors could cycle to each other's offices and share ideas over a skinny frappuccino. Today, the notion seems as quaint as attempting to reproduce Silicon 'topographies' across Europe by subsidising baristas. It was a realisation worthy of *Freakonomics* that the success of US venture capital might just have something to do with America's colossal military and science spend.

Technology clusters do not spontaneously emerge, nor do venture capital markets self-seed. There have always been significant levels of government support, whether explicit or more discrete. If you want a tech cluster, the question is only how best to administer such support.

For European countries, unable to enter a space race or spend 10 times their GDP on weapons systems, nurturing an innovation ecosystem is necessarily a demand-driven exercise, with a sharp focus on goals and value for money. This is where the difficulties begin.

GOOD, BAD OR UGLY?

How do you measure success? Again, the US sets the tone: a 1982 Government Accounting Office report found that "the experience of 1,332 companies started with venture-backing during the 1970s demonstrate benefits to the nation's economy and productivity that are disproportionately large when compared with the amounts of capital invested". It went on to list the impact on sales, exports, jobs and tax receipts. This was the blueprint for the European political argument on venture capital.

There are many problems with this approach. Assuming you can get a decent data set (which is very tough, if not impossible), which aspects do you prioritise and over what time frame? A home-run financial return that disrupts a labour-intensive industry – take Skype for example – would score pretty poorly on job creation.

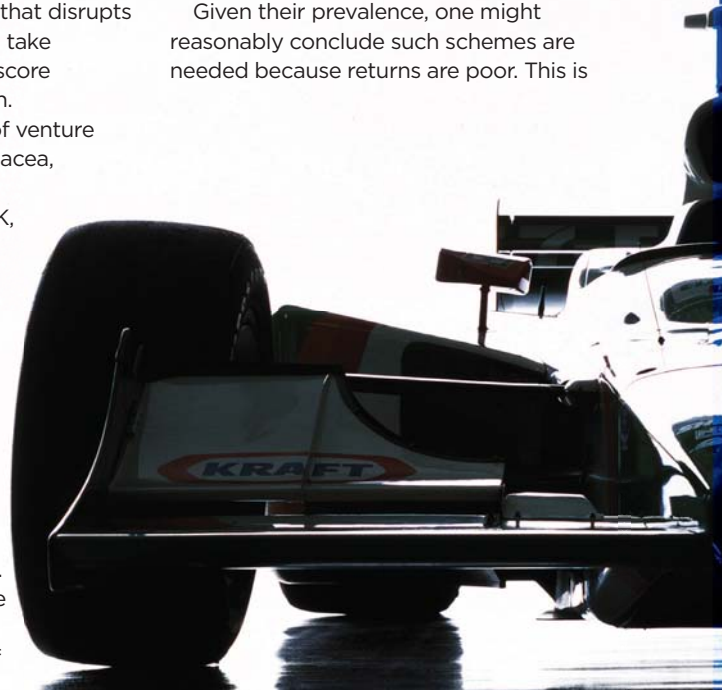
Linked to this is the idea of venture capital as an equity gap panacea, rather than the reality of extreme selectivity. In the UK, 3i once had more than 5,000 portfolio companies. The various 3i successors have sought to paper over the equity gap rather than encourage innovators to leap over it. The problem is further compounded by the industry holding itself out as a super-tool rather than just one component in the innovation ecosystem. Whatever the difficulties, the political argument has been won for now, but this lack of

clear success metric is one that must eventually be tackled.

EUROPEAN SONS

In the meantime, the European Investment Fund (EIF) has been the EU's weapon of choice in the form of a state-backed fund of funds, supporting European venture capital managers. On top of this, every EU member state has at least one national scheme. In fact, far more funding from European structural funds and national governments goes to regional schemes than to pan-European programmes. There is zero chance of creating a tech cluster of global relevance without some concentration of resources and bringing to bear a European single market.

Given their prevalence, one might reasonably conclude such schemes are needed because returns are poor. This is



“Providing less funding to venture capitalists and thus to entrepreneurs on stricter terms for something ‘prizeworthy’ may provide a stronger incentive to the industry”

only partly true. An even greater difficulty is structural, with smaller investors less able to bear the uncertainties and the very long time horizons of venture investing. Large investors meanwhile suffer a scale mismatch with the amounts that can be deployed effectively in startups. It works for a few investors, such as US endowments but, by and large, venture capital is a misfit.

Over the past decade, and in the wake of the dotcom crash, the EIF increasingly stepped into the breach by investing hundreds of millions of euros each year, amounts which go a long way in European venture funds. It has effectively kept the industry on life support. The challenge in recent years has been how to get the patient back on its feet.

A consensus has slowly emerged that the right medicines are bitter. One idea put forward in a 2010 paper by the

European Private Equity & Venture Capital Association (EVCA) and still being explored by the European Commission is a privately managed fund of funds programme, investing public money alongside private. This would bridge the size mismatch for investors, and mean investing on a strictly commercial basis.

That it invests on a commercial basis is both essential to its viability and terrifying to European bureaucrats who have relied on picking winners and approving innovation to demonstrate political accountability. But time and tide is catching up. An *Economist* article in April, ‘Innovation by Fiat’, finally blew the lid, citing endowment managers’ complaints about public funds deterring the re-emergence of the private sector into European venture capital. In the corridors of Brussels, it is being referred to as a “PR disaster”, but venture capitalists I deal with seem rather relieved the topic is being aired.

SCHOOL OF THOUGHT

The private-sector consensus emerging is not for more venture capital but for better quality. Thomas Meyer, formerly of the EIF, co-author of the EVCA whitepaper and now of LDS Partners, thinks this is about moving the policy mindset away from supporting venture capital activity in a way that resembles grants, incentivising effort rather

than results. Instead it should reward successful venture outcomes.

“Venture capital is mainly an incentive-based structure, conceptually closer to a prize for successful innovation,” says Meyer. “Providing less funding to venture capitalists, and thus to entrepreneurs, and on stricter terms for something ‘prizeworthy’ may provide a stronger incentive to the industry.” In other words, raise the hurdle for success, the best will jump higher and the others will move aside.

Most of the people I’ve spoken to about this topic are pessimistic that private sector needs and political realities can be reconciled. With a general political headwind of less Europe not more, at least in terms of budget, reversing the tide of funding fragmentation will be difficult. It all comes back to the tricky question of how to measure success. There can only be one answer: schemes that attract more private sector participants and gradually displace the role of the state. In time, such pan-European funds of funds would engender not only experienced and skilled venture capital managers, but also a roster of informed and experienced investors who get a taste for such a challenging and exciting asset class. ■



Ross Butler is a partner at JRBButler, a communications services firm for the investment industry

Appointments

PwC CORPORATE VENTURER



Former director of Unilever Ventures, Mark Muth (left), has joined PwC as director in its London-based corporate finance team. He is central to PwC's plans to build a practice advising European-based corporate venture capitalists on strategy, structure (tax and legal) and M&A.

Muth was with Unilever Plc's venture capital team, from its creation in 2002 until 2013. Prior to that, he was a managing director of GE

Equity, the private equity business of GE Corporation.

"While an increasing number of businesses recognise that corporate venturing has an important role to play in promoting innovation and growth, managing value creation within the portfolio is the key to long-term success," said Muth.

Michel Meert has also joined the Big Four firm as investment advisory director in its London office. He was previously a senior investment consultant at Towers Watson.

JAMES COWPER BOOSTS RESTRUCTURING



Julia Branson (left) has joined James Cowper's insolvency and business restructuring team as partner, having spent the past two years running her own SME-focused consultancy

business, Branson Restructuring.

She previously led the restructuring and insolvency teams at PwC and then Deloitte in the Thames Valley, and is on the southern region council of R3, the Association of Business Recovery Professionals.

CYBER SECURITY HIRES AT KPMG

KPMG has made four senior-level appointments to its growing cyber security practice. Phillip Hodgins has joined from the Cabinet Office, where he helped develop the national cyber policy. James Fox has joined as director from Booz Allen Hamilton's Middle Eastern practice, where he launched the cyber security service offering. Richard Krishnan joins as director, from KPMG's own global justice and security team. And Tom Burton joined as director, after working as Detica's global head of managed security services.

"We are still on the front edge of the change we're going to see in the cyber security space and the only certainty is that these changes are happening more rapidly than ever before," said Charlie Hosner (left), KPMG cyber security partner.



In January, the Corporate Finance Faculty published its *Cyber-Security in Corporate Finance* guide.

NEWS IN BRIEF



BDO has promoted Tomas Freyman to partner in its valuations practice in London. He trained with PwC in Toronto and then Moscow, before joining EY in 2007. He joined BDO as a director in 2012.

Corbett Keeling's **Globalscope** has further expanded its international network of corporate finance firms into China and Africa. Centres in Shanghai and Jiaxing, as well as Namibia and Botswana, take the network up to more than 25 countries.



Former Corporate Finance Faculty board member Mathew Kirk has joined Hampshire-based

Southern Communications as commercial director from Carphone Warehouse. He previously worked in corporate finance at BDO and Grant Thornton.



OMERS Private Equity, the private equity arm of the Canadian pension fund, has recruited Cognetas founder Jonathan Musselwhite as a managing director in its London office.



Spring Ventures has appointed Alex Brebbia (left) as managing partner to co-lead the business alongside John Hudson. Brebbia was previously joint head of Barclays Ventures, having joined

it as director in 2003 from 3i.

The Bristol team at YFM Equity Partners has spun out to form a new venture capital fund manager – **Technology Venture Partners**.

SME Wholesale Finance has been rebranded as **Funding London**. The organisation, whose CEO is Corporate Finance Faculty board member Maggie Rodriguez-Piza, attracts European and UK capital to London-focused equity and debt funds.



Christelle Fink has joined **JCRA** as director of business development in Europe from Société Générale, where she specialised in

MILLAR HEADS LSE PRIMARY MARKETS

John Millar (below) has joined the London Stock Exchange Group as head of primary markets. Based in London, he will focus on IPO origination globally, working closely with the Milan- and NY-based teams as well as the team in London.

He has joined from Espirito Santo Investment Bank. He has more than 25 years' capital markets experience. Prior to Espirito Santo, he worked for Merrill Lynch, and Kidder Peabody. He has an MBA from Stanford University.

John will be based in London and will focus on IPO origination, working closely with the Milan and NY-based teams



PRIVATE EQUITY BUOYANT AT 3i



3i has promoted 10 private equity investment professionals, after the firm recently announced its PE business had

delivered a 30% gross investment return across Europe and North America, and generated £1.1bn proceeds to the end of March 2014.

Three have been promoted to partner: Xavier de Prevoisin in France, Richard Relyea in North America and Pete Wilson in the UK; three to director: Guillaume Basquin

in France, Giovanna Maag in Germany and Olivier van Riet Paap in Benelux; three to associate director: Alexandre Chaton in France, Andreas Gold in Germany and Allard Jacobs in North America; and Javier Onieva has been promoted to senior associate in Spain.

"We have had a very successful year, in which we've made several new investments and numerous bolt-on acquisitions across the portfolio," said Alan Giddins (left), co-head of private equity.

SHARIFI LEADS GT CORPORATE FINANCE



Ali Sharifi has been appointed head of Grant Thornton's UK corporate finance practice. Based in

Manchester, Sharifi will lead the 95-strong UK team, based in eight dedicated corporate finance centres

- London, Reading, Birmingham, Manchester, Leeds, Cambridge, Bristol and Scotland.

While Sharifi said he would still be executing transactions, a particular focus would be on developing Grant Thornton's international network with its global partner firm.

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Challenger bank **Shawbrook** has acquired Centric Commercial Finance,

with plans to significantly grow its invoice discounting and asset-based lending business. Centric's individual facility limit has been increased to £25m. "It is a natural match, both in terms of our product offering and because we share the same values and customer service ethos," said John Onslow, Centric CEO and founder (pictured above). "Shawbrook can broaden its range of lending services and be a more prominent business lending bank in the SME space."

THE LEGALS



Corporate lawyer Richard Norbruis is joining **EY** in September from Freshfields

Bruckhaus Deringer, to lead the Big Four firm's global transaction law practice. Norbruis has been partner at Freshfields for 14 years and has more than 30 years' legal experience. He was previously a partner at NautaDutilh. EY's legal services business now has more than 1,100 lawyers in 52 markets across the globe.

M&A specialist Jocelyn Ormond has joined **Simmons & Simmons** as partner from DAC Beachcroft. He previously worked for Allen & Overy and Slaughter and May.



Claire Armstrong has been promoted to corporate partner at **MacLay Murray & Spens** in Edinburgh.

DLA Piper has recruited private equity specialist Tim Wright as corporate partner from King & Wood Mallesons SJ Berwin. He made partner at Clifford Chance in 2001 before joining SJ Berwin seven years ago.



Lucy Frew has joined **Kemp Little** from Gide Loyrette Nouel to launch the technology-focused law firm's financial regulatory practice.

Stephen Lucas has joined **Kirkland & Ellis International's** London office as debt finance practice partner.

Foothold in the West

When a Japanese insurance company wants to make a game-changing acquisition of a Lloyd's market underwriter, market knowledge is crucial, says **Ian Sparshott** of Deloitte



THE CAREER

WHAT IS THE DEAL?

Sompo Japan Insurance's £594m acquisition of Canopus Group from private equity firm Bregal Capital and other minority shareholders. Bregal first invested in the London-based Lloyd's market underwriter in December 2003.

WHAT WAS THE TIMESCALE?

Between October and December 2013, the due diligence was carried out and negotiation around price and contractual terms completed. Prior to this, Sompo had spent some time getting to know Canopus management, before the books were opened up and they were allowed to have a run at the transaction. And after the due diligence was completed there was a change of control process to go through with the regulator, so the deal was completed on 1 May 2014.

WHO WERE THE ADVISERS?

Deloitte provided Sompo with commercial, operational,

actuarial and financial due diligence, as well as tax, pension, regulatory, HR, IT and ERM due diligence. We also provided SPA advice and negotiation support. Macquarie was the financial adviser and Freshfields legal adviser to Sompo. Clyde & Co provided Canopus with legal advice.

WHAT WERE THE CHALLENGES?

There were the cultural differences and the language barrier. We had bilingual team members in every meeting, people on secondment from Tokyo. Canopus is a Lloyd's business and so has unique structures and processes, and there needs to be a deep understanding of the regulation, rules and accounting of the Lloyd's market. Being relatively inexperienced in the Lloyd's market, Sompo needed advice on how those areas would likely evolve once they owned the business. It needed to understand the current requirements of the

regulators around capital and governance, as well as have a view of future regulatory developments.

WHAT WAS SOMPO'S ACQUISITION STRATEGY?

Sompo has been acquisitive, but this is the single largest transaction it has undertaken to date. It is a game-changer. Sompo will make available a very substantial balance sheet to Canopus management to expand that network in the western hemisphere. Sompo and Canopus are highly complementary businesses, and the transaction gives Sompo a substantial presence in specialty insurance. The acquisition has given it a strong management team in the West.

WHAT WERE THE KEY LESSONS LEARNED?

It was critical to this transaction that advisers with extensive experience and knowledge of the Lloyd's market supported Sompo. They also needed to have global network capability.

Ian Sparshott qualified as an ACA with accountancy firm Neville Russell in 1997, and in 2003 was made partner in the merged firm Mazars Neville Russell. In 2006, he joined Deloitte as transaction services partner. He has specialised in the insurance sector throughout his career and is the corporate finance insurance sector lead at Deloitte. Ian studied biology at Bristol University.

Recent transactions

- Goldman Sachs investment in Hastings Insurance: £150m
- BC Partners acquisition of Sabre: \$285m (£168m)
- Lorica Employee Benefits, acquired by AON: undisclosed

It is crucial to maintain close and good relationships between the principals and the advisers throughout the process. You need the advisers to work closely and pull together to give the best advice to the client and help get them through that process. ■

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