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GROWTH
OPPORTUNITIES
EXPERTISE

Corporate Financier

NOTHING IS PRICELESS

The art - and the science - of putting a value on businesses

Dec 2017 / Jan 2018 Issue 198

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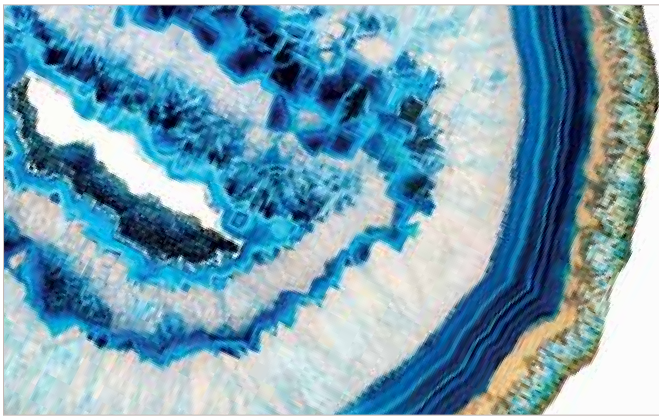

WILDEAN VALUES

"A man who knows the price of everything, and the value of nothing," according to the Lord Darlington, a character in *Lady Windermere's Fan*, is a cynic. And in the 125 years since Oscar Wilde penned this insightful comment, it has become a badge often pinned on accountants.

Of course, precious few businesses would not want healthy scepticism to be part of the culture of their finance departments. A happy-go-lucky CFO is highly unlikely to inspire confidence in any investors – or tick boxes on banks' lending sheets.

Business valuation is the subject of this month's cover story (see pages 18-23). There is an ever-increasing abundance of data to inform the valuation of a company – nowadays information goes way beyond the mere financial statements. But it is only useful in the right hands, and in the wrong hands it can be a dangerous thing.

As Jonathan White, a KPMG corporate finance partner and co-author of the Corporate Finance Faculty's new best-practice guideline *Contemporary Valuation Issues in Deals*, put it: "Today the information you can use to guide your valuations is much more useful, but of course it remains subjective as to how you interpret it." At the risk of going all Wildean myself – beauty is in the eye of the investor or acquirer. Where is the value?

More information can prove to be just more noise. What's crucial for an investor and how they value a company is the key market drivers, potential opportunities and, of course, the ability of a management team to deliver on plans.

Just to prove that everyone has a Wildean side, the "Oscar of Omaha", Warren Buffett, sagely sums up valuing a business: "Everything that can be counted does not necessarily count. Everything that counts cannot necessarily be counted."

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NEWS

Adam Ringer, AMP Capital

Marion Bernard, McLarty Capital Partners; Chris Hunt, Rentokil Initial

Mark Gallagher, KPMG, welcomes the faculty audience

Serena Martin, BBC Worldwide; Jonathan White, KPMG

VALUING DEALS: GUIDELINE LAUNCHED IN MAYFAIR

The Corporate Finance Faculty published its latest guideline – *Contemporary valuation issues in deals* – last month. The best-practice guideline was comissioned by the faculty and co-authored by KPMG partner and head of valuations Jonathan White and KPMG valuations manager Adam Brouwer.

It was standing room only at the guideline's launch at KPMG's meeting centre, Number Twenty in Mayfair.

Mark Gallagher, private equity group partner, gave the welcome address, while ICAEW's head of corporate finance David Petrie chaired an expert panel discussion.

"Business valuations are a vital aspect of successful corporate finance transactions – whether multi-billion-dollar takeovers or early-stage investments for high-growth companies," said Petrie. "Expert corporate finance advisers are at the heart of transactions and of the valuations that inform business decision-making. And in order to be useful, business valuation in fact requires great technical skill, detailed financial analysis, mastery of data and not a small degree of experience."

The expert panel comprised White; Marion Bernard, UK managing director, McLarty Capital Partners; Chris Hunt, group M&A director, Rentokil Initial; Serena Martin, head of commercial finance and business development, BBC Worldwide; and Adam Ringer, investment director, AMP Capital.

The cover story in this issue of *Corporate Financier* (pages 18-23) looks at the major challenges in business valuations, from the viewpoint of expert advisers, and those at the sharp end in corporates.

ICAEW's capital markets manager Katerina Joannou commissioned and edited the publication, with review by the faculty's technical committee. The guideline is enclosed with this issue of *Corporate Financier*.

DEAL COMPLETIONS

Last month, ICAEW's head of corporate finance David Petrie chaired a webinar about sale and purchase agreements (SPAs). Petrie was in discussion with with Nick Andrews and Patrick O'Brien, co-heads of the Grant Thornton SPA advisory team (pictured above). They looked at the latest findings of Grant Thornton's international SPA research – a survey of over 550 practitioners worldwide on completion mechanisms internationally – and current market practice around pricing mechanisms in SPAs.

O'Brien pointed to increasing use of warranty and indemnity insurance: "Part of the reason for that is similar to the 'locked box' – it is allowing people to walk away having sold the business without the risk of subsequent adjustments or claims. Buyers make any claim against an insurance policy rather than against the sellers, which can also be useful when management are staying with the business."

Andrews said it's best to look at insurance at an early stage in the deal process. He added: "It helps to facilitate deals and speed up deals, particularly if you have got risks you cannot quantify and value easily. We see it benefiting both parties and deals going ahead as it helps deals get done."

In 2016, Andrews and O'Brien co-authored the Corporate Finance Faculty's best-practice guideline on completion mechanisms.

The webinar can be viewed at tinyurl.com/CF-GrantWeb

IN NUMBERS

M&A and IPO forecasts for 2018, geopolitical risks, corporate culture, investor confidence and US M&A in Donald Trump's first year as president

EUROPE Vs THE WORLD – 2018 FORECASTS

GLOBAL M&A

$3.2trn

23% up on the **$2.6trn** expected for 2017

BUT BELOW THE **$4trn** PEAK RECORDED BEFORE THE 2008 GLOBAL FINANCIAL CRISIS

EUROPE M&A

$856bn

to be followed by a drop in line with an economic slowdown in the following years

GLOBAL IPOs

$290bn

up on the **$187bn** expected in 2017

SOURCE: BAKER MCKENZIE

CONFIDENCE IN THE FUTURE

60% of UK companies (all sizes) surveyed plan to make an acquisition over next 12 months

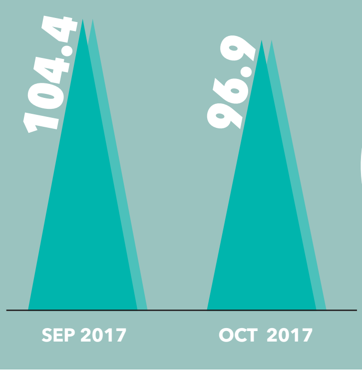
57% of UK business executives are focusing on deals under $250m

20% on deals up to $500m

47% of UK companies have a higher level of concern for geopolitical risks and economic uncertainty compared to the global average of **43%**

SOURCE: EY GLOBAL CAPITAL CONFIDENCE BAROMETER

CONFIDENCE INDEX: GLOBAL INSTITUTIONAL INVESTORS



7.5 point fall in October to a six-month low

SOURCE: STATE STREET INVESTOR CONFIDENCE INDEX

£1.35bn

GROWTH CAPITAL INVESTED IN 330 UK SMEs IN FIRST THREE QUARTERS OF 2017

ON COURSE TO EXCEED THE RECORD **£1.53bn** INVESTED IN ALL OF 2016

SOURCE: KINGSTON SMITH

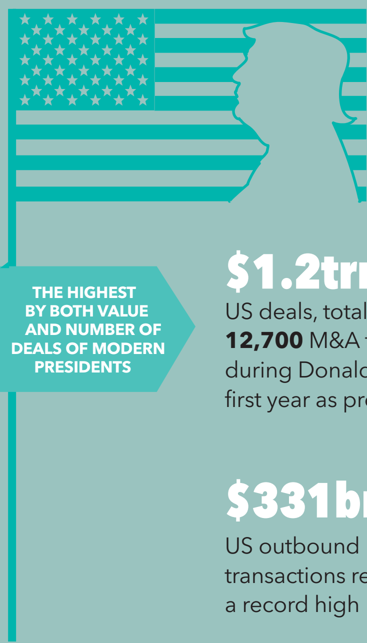
SMALL BUSINESSES, BIG MONEY

£1.3trn

Small businesses' contribution to UK private sector turnover

SOURCE: BRITISH BUSINESS BANK

STATESIDE M&A BOOM



THE HIGHEST BY BOTH VALUE AND NUMBER OF DEALS OF MODERN PRESIDENTS

$1.2trn

US deals, total from **12,700** M&A transactions during Donald Trump's first year as president

$331bn

US outbound transactions reached a record high

SOURCE: PREQIN

1/5

Only 20% of UK board directors believe that they spend enough time working on improving their business culture

SOURCE: MAZARS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Official fuel consumption for the Volvo Cars range in MPG (l/100km): Urban 28.0 (10.1) – 70.6 (4.0), Extra Urban 40.9 (6.9) – 85.6 (3.3), Combined 34.9 (8.1) – 155.2 (1.8). CO2 emissions 184 – 48g/km. MPG figures are obtained from laboratory testing intended for comparisons between vehicles and may not reflect real driving results.

DEALS ARTICULATED

How many British road haulage firms are a household name? Emerging from the troubled Stobart Group in 2014, Eddie Stobart Logistics floated on AIM in April. Jason Sinclair looks at where the iconic business is heading next

The green and red lorries of Eddie Stobart are a common sight on Britain's motorway network. Eddie Stobart Logistics (ESL) delivered the largest AIM IPO of the year (so far) when it floated in April with a £572.7m valuation, at 160p per share. Three years earlier DouglasBay Capital acquired a 51% stake in the transport and distribution business for £280m, from the FTSE-listed Eddie Stobart Group, which wanted to focus on its infrastructure and support services.

Alex Laffey, ESL's chief executive since 2015, explained that the company had spent those three years readying itself for the offering by "investing in technology and developing management and workforce to support growth in new business sectors".

"An IPO is an exciting next step," he added. But why now? And what does it mean for the company's future? The prospect of Brexit has previously been downplayed by the lorry-spotters' favourite - its main operations are on British motorways rather than *péages* or *autobahns*.

"To date, with all of the discussions around Brexit, we've seen no impact," says Laffey. "Clearly, we don't know what's going to come out of Brexit yet, because no one does, but what I am confident in is that we will be allowed to move across borders. Our European business is an important part of the network, and it's something we plan to leverage.

"Yes, there might be some restrictions moving back and forwards across the Channel, but we've

had them before, and this business has worked through them. I'm confident that, whatever is put in place, it will still facilitate free movement back and forwards."

Uncertainty about the Brexit deal hasn't hit the share price, although to be fair nothing has - it has hovered around issue price since the flotation. The latest results from the end of August show underlying revenue up 13% to £286.8m, and EBITDA to £16.9m. The company's £6.3m loss was put down to "£12.6m worth of exceptional items, mostly as a result of our IPO". The stability of the share price can be attributed to a low volume of trades of what seems an illiquid stock.

FUNDING GROWTH

The £122m of new funds raised allowed the company to pay down debt and "provide a stronger financial platform for them to grow the business, whether organically or through selective acquisitions".

Jim Durkin, co-founder and former chief executive of Cenkos Securities, handled the ESL flotation. He said the IPO, had "been worked on for some time" and it was "good timing to press the button". "There is always capital for good ideas," commented Durkin, in what proved to be his swansong for the nomad.

Philip Swatman, chairman of corporate finance advisory firm Wyvern Partners, joined as non-executive chairman.

Laffey said the company plans to back up the float with acquisitions, to capitalise on the demand

"What I am confident in is that we will be allowed to move across borders"

Alex Laffey, CEO, Eddie Stobart Logistics

MODEL TRUCKING FIRM

Eddie Stobart Logistics was taken private in 2014, when parent company Stobart Group sold a 51% stake for £280m. The divestment came after Stobart Group dramatically fell out of the FTSE 250, as a series of boardroom fights and legal battles hit its share price.

The group's largest shareholder, Invesco (with Neil Woodford, its star fund manager), agitated for a series of boardroom changes that ultimately saw the logistics arm being spun out of the group. William Stobart became CEO of Eddie Stobart Logistics.

The Stobart brand has an unlikely cult status. The fun of spotting the firm's individually named trucks as they travel up and down UK motorways spawned a fan club, with an estimated 25,000 members at its peak, but which has closed since the AIM flotation. The company was the subject of a seven-series documentary and a one-off festive special *Eddie Stobart's Christmas Cracker,* all of which went out on Channel 5 in the UK. Eddie Stobart model trucks are popular with children, and there is even an Eddie Stobart app.

When Edward Stobart founded the business in 1970, he sought to clean up the image of road haulage by requiring drivers to wear a shirt and tie. Today the firm competes in a fragmented market with large companies such as DHL, and hundreds of smaller, privately held businesses throughout the UK and the rest of Europe.

£280m
51% stake in Eddie Stobart sold in 2014

£122m
funds raised to pay down debts and grow the business in April 2017

DEALS ON WHEELS

Deloitte acted as reporting accountant on the IPO. Deloitte partner, Richard Bell, said: "Our work blended a mixture of compliance and advisory work to meet the requirements of the nomad and group reporting accountants. We also provided due diligence based on our experience in the sector to make sure the deal delivered value."

As part of the IPO, Stobart also acquired the iForce business, seen as complementary to the core. Damien Harte, who took on the role of CFO on flotation, said: "The iForce transaction was completed under extremely compressed timescales.

"Deloitte's ability to mobilise a top-quality team and provide detailed levels of analysis and insight under pressure provided us with the confidence to move forward to complete the transaction."

Deloitte director Daniel Wright said: "Having provided financial, tax and IT due diligence for the £45m iForce acquisition, and acted on the flotation, we were in a strong position for any subsequent acquisitions."

Deloitte then worked on Eddie Stobart Logistics' first deal as a listed company, the acquisition of 50% of Speedy Freight in July 2017.

"We were in a strong position for any subsequent acquisitions"

Daniel Wright,
director, Deloitte

"Deloitte's ability to mobilise a top-quality team ... provided us with the confidence to move forward"

Damien Harte,
CFO, Eddie Stobart Logistics

PERFORMANCE

5,500
employees

£549m
revenue 2016

2,200
trucks

£41m
EBIT 2016

£572.7m
AIM Valuation

£155m
Woodford Investment Management stake

160p
Opening price

from consumers for online retailers offering door-to-door shipping. Laffey joined Stobart as CEO from Tesco in May 2015, replacing William Stobart, the youngest son of Eddie Stobart, who founded the business in 1970. William Stobart, had been in charge for a year after the DouglasBay Capital buy-out, and after Laffey joined moved into the role of executive chairman.

BUYING SPREE?

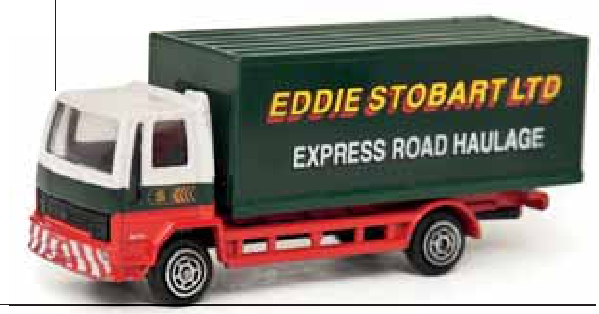
In July, Stobart bought a 50% stake in Speedy Freight, and in August it paid £6m to increase its shareholding in The Logistics People from 50% to 100%. Laffey says they will continue to buy up other businesses to complement existing operations, "without adversely affecting profitability". The focus will continue to be in online retail, as well as manufacturing, industrial and bulk sectors. M&A advisers will be taking note.

As part of the float, Eddie Stobart Logistics' existing investors - DouglasBay Capital and Stobart Group - sold down their stakes to 14.9% and 12.6% respectively. Neil Woodford is now the largest shareholder. The fund manager invested £155m in the flotation for a 19.9% stake.

The Stobart brand is leased from the Stobart Group by the logistics company, in a deal lasting until 2020, when they can begin renting the brand on an annual basis for £3m, pay £15m for a perpetual licence or rebrand. "We'll consider all options as we move forward," says Laffey.

As would be expected, he is bullish about prospects: "The market in the UK and Europe is £70bn and still growing. We are now active in additional sectors of that market. I would fully expect us to grow, and grow not just within transport, but grow right across the supply chain in terms of the customers we serve today, and adding new customers."

David Buckby, an economist at the consultancy Transport Intelligence, explains: "Road freight is especially known for having razor-thin margins. The market is full of very small operators. There's long been a compelling rationale for consolidation." ●



ALAMY

JON MOULTON

POWER PLAYER

When it comes to investing in the energy sector, the advice is to do what I say, not necessarily what I have done

Corporate Financier's November cover story about the energy sector got me reminiscing. Over the years, I've invested in a wide range of energy-related deals with both success and failure. It's not easy. The consistency of my returns has been very poor and, besides my usual blunders, there were other factors to blame.

My experience of investing in coal was quite lucrative, but environmental pressures have more or less wiped out the opportunity to invest in the UK. A few very strong characters that were, in my experience, untrustworthy or worse, dominated this industry. But my skills in this area are no longer of much use.

I have invested in a number of small oil exploration and production businesses, only to find that mostly optimists or highly-skilled promoters ran them. Dry holes or "unexpected" geological problems competed as sources of loss with good old-fashioned fraud. The most dire frauds were where the (relabelled) geological report was for a different area than the company's claim and another, which paid a dividend in year one and went bust in year two. With some painful digging, I uncovered that the company had paid the dividend out of a miscalculated and very unrealised foreign exchange gain. But the real fun was discovering that the company owned nothing but a bogus set of documents giving a (non-existent) claim on some Texas land.

Another deal proved an accidental bonanza when the business's exploration team drilled into a very large gas field – it was supposed to be a secondary oil reclamation deal.

Investing in oil and gas processing equipment has stood me in much better stead. The trade is honest, it seems, and the need for safe and robust equipment, sometimes of considerable complexity, is relatively constant. The only real problem is that quite a few other people are aware of these nice characteristics, making deals hard to find.

Another deal proved an accidental bonanza when the exploration team drilled into a gas field – it was supposed to be a secondary oil reclamation

CHANGE IN THE WIND

In tidal energy equipment I am proud to say I may be the most successful investor in the UK… though this is based on investing in the only successful exit that I know of in the UK!

Generally, alternative energy has been good to me. The surge of environmental pressure has driven solar energy, wind and various forms of biomass power production into becoming large activities in the UK. But beware: relying on consistency is a fool's game. The activity depends on government support to get going and to prosper, and government policies are as variable as the wind itself. UK energy regulation is in parts fiendishly complex, so you have to know what you are doing. Investments are affected by taxation, which has changed a lot over the years, definitely to the disadvantage of investors, and will doubtless do so again.

Solar has seen serious drops in its equipment costs. It typically offers lowish but very stable returns. Onshore wind is more complex, but done well has given strong returns. Offshore wind is for deep pockets – projects need to be very large to make economic sense, so I have never invested here. New projects in all these areas are getting a lot less government support these days.

However, you can never avoid the big variables of energy investing. The market for energy is affected by government policy, economic growth, geo-politics, foreign exchange and changing technologies. Demand and future pricing are very uncertain. Industry soothsayers are sadly unreliable. Energy types thrive and fail as they compete for their places. ●

Hauser Forum, new state-of-the-art focal point for entrepreneurship in Cambridge designed to stimulate innovation

BRAINS, BRAWN AND UNICORNS

Cambridge is the undisputed UK leader in the commercialisation of knowledge. It has produced numerous gorillas that have been caught by international hunters. But, asks David Prosser, can the city find a unicorn?

The champagne flowed to celebrate the sale of Aveva to France's Schneider Electric in September 2017. With the Cambridge company commanding a £3bn price tag there was much to be happy about. But some mourned the passing of the city's last large homegrown independent technology business.

Aveva is another chapter in the long-running Silicon Fen success story. Cambridge was identified as a cluster of high-growth businesses long before it was fashionable to put the word "silicon" in front of any location that has at least a couple of start-ups and an expensive coffee shop. The Cambridge Phenomenon was brought to prominence in a landmark 1985 study.

Since then, successive generations of world-class companies emerged, starting with Acorn Computers in 1978 and including Autonomy, ARM Holdings, Cambridge Antibody Technology, CSR (acquired by Qualcomm in 2015), and Domino Printing Sciences. In the past six years, however, all of these companies have been sold for a combined price of more than £50bn, but none remain in the city. The question now is can Cambridge find a next-generation unicorn?

COMPARE OR DESPAIR?

On the face of it, the city is in good shape. Tech City's *Tech Nation 2017* report suggested over 350 start-ups have been launched in Cambridge over the past five years, that the city's digital sector turns over more than £2bn a year, and that 15% of local technology companies can be described as high growth.

Suranga Chandratillake, a partner of Balderton Capital, which has a number of investments in Cambridge companies, says the city's commercial performance is somewhat disappointing: "From an academic perspective, Cambridge University is the peer of Stanford or Massachusetts Institute of Technology (MIT) in the US. But if you consider the commercialisation of the technology developed in each university, Cambridge is drastically behind the curve. There have been isolated hits, but nowhere near the volume of success that Stanford and MIT have spawned."

ARM's head office campus in Cambridge

When comparing Cambridge with its US rivals you are not comparing like for like. "The comparison between Cambridge and places such as MIT isn't entirely fair, because there is a smaller marketplace for our businesses to grow into," argues Peter Cowley, serial entrepreneur, angel investor and chairman of Cambridge Angels. "But it is true that in Cambridge we generally don't grow gorillas. Our founders will accept £20m-£30m, whereas their US equivalents wouldn't be satisfied until the figure was $200m or even $2bn."

PLUG IN

If Cambridge is as strong as its US rivals on intellect, there must be other limiting factors. It isn't early-stage funding. It is very difficult to fault Cambridge on the access it provides to seed capital, with several well-organised networks operating in the city.

Cambridge Enterprise, spun out of the university 20 years ago to provide academics with support to commercialise their best ideas, has a proud record of funding local companies. The fund now supports ventures from both town and gown. It has a mandate from the university to invest up to £1m in any one business, though typically provides funding in chunks of £250,000 and currently has 60-70 companies in its portfolio. Some of its investments are made solo, but Cambridge Enterprise also has close links with a handful of venture capital firms alongside which it will co-invest.

"In Cambridge we generally don't grow gorillas"

Peter Cowley, chairman, Cambridge Angels

"Cambridge is drastically behind the curve"

Suranga Chandratillake, partner, Balderton Capital

The city boasts two networks of business angels: Cambridge Angels and Cambridge Capital Group. Their members, some of whom have very deep pockets, largely comprise previous generations of local entrepreneurs who now want to give something back. "The thing that makes Cambridge different to anywhere else is that there is a sizeable number of people who have been successful entrepreneurs and who have stayed in the city," says Cowley. "They're now committed to helping the next generation."

Struan McDougall, founder and chairman of Cambridge Capital Group, agrees, but also points out that both networks bring in money from outside the region: "We provide a platform for private investors wherever they may be to access the best intellectual property-backed tech companies in Europe."

Seed and start-up capital are so widely available for technology, electronics and biotech that one local angel says: "If you can't find support for your idea, there's probably a very good reason for that." But what happens next? The UK has a long-standing problem with supporting companies as they scale up. The government's Patient Capital Review, published this year, is the latest report to draw attention to this issue (see 'High-tech capital call', in the November issue). Appropriately for a city steeped in innovation, Cambridge is developing a new approach (see 'Community interest', below).

Amadeus Capital, founded 20 years ago by Herman Hauser, one of Cambridge's best-known technology entrepreneurs, has maintained a presence in the city. Hauser is the father of

COMMUNITY INTEREST

Cambridge Innovation Capital (CIC) was launched in 2013 to help local companies scale up through multiple funding rounds. CIC operates as a sister fund to Cambridge Enterprise (see 'Planting season', in the June 2017 issue of *Corporate Financier*). Financed initially with £50m, including £10m from the Cambridge University Endowment Fund (CUEF), it has since secured a further £75m.

"CIC was established to create a trusted local entity to support and foster intellectual property-rich initiatives emerging from Cambridge," says Rob Sprawson, chief financial officer of CIC.

"Businesses were being founded with local seed capital but the more successful ones were having to look beyond Cambridge for follow-on financing. There was a perception that outside investors did not necessarily get the idea of acting for the 'good of Cambridge'. Founders, academics and angel investors felt that they weren't always being fairly rewarded for their efforts and the risks that they'd taken."

CIC aims to fill the gap. In many cases it has pre-emption rights to Cambridge Enterprise portfolio companies raising money and it can co-invest with its sister organisation at seed stage. Investments are made in the form of non-participating stock, so CIC gets its money back first if the business fails, and shares in the growth of the value of the company.

"Our business model is very different from the traditional venture capital fund," explains Sprawson. "We're focused on building category-leading global businesses, which requires patience, rather than positioning a business for sale within a few years."

£10m
Amount of CUEF's initial investment in CIC

£75m
Amount CIC has since secured in funding

SILICON FEN'S ADVISERS

The traditional corporate finance adviser lurks on the fringes of the start-up cluster. Cambridge companies tend to turn to external advisers from the large London firms, all of which have offices in the city, when they are well established and looking at some kind of transaction event.

PwC, for example, has 200 staff at Abacus House in the city, providing assurance, tax and advisory services. These plug into the firm's sector experts nationally and internationally. The model is replicated at KPMG, Deloitte and EY. KPMG has 140 staff in Cambridge and says it leverages its international network and global presence to serve the office's local client base.

Smaller accountants and independents are also on the ground, including PEM Corporate Finance, BKL and Price Bailey, which has a 50-year track record providing advice to local companies, entrepreneurs and investors.

The Cambridge ecosystem is a product of its own unique conditions. Traditionally, start-up and early-stage companies have benefited from specialist support from the likes of Cambridge Enterprise, Cambridge Innovation Capital and local angel networks, where contact books have been as valuable as their capital.

Cambridge's technology scene, having co-founded Acorn Computers in 1978, helping the spin-out of Arm from Acorn in 1990, and been closely involved with Solexa, Plastic Logic (see photo, below right), Cambridge Display Technology and the Cambridge Network. "We're continuing to see attractive opportunities across the technology space," says Amelia Armour, an investment manager at Amadeus.

The Cambridge phenomenon has not gone unnoticed in Silicon Valley, adding to the M&A that has been a constant feature in recent years. Apple's swoop on VocalIQ two years ago gave it a presence in the city. Last year Microsoft bought Swiftkey, a company with several prominent angels and a large base in Cambridge, while Amazon moved into Cambridge with the purchase of artificial intelligence specialist Evi Technologies in 2013. Amazon now has a substantial research and development centre in the city where much of the technology for its Alexa personal assistant was designed.

It is not just tech companies that are being snapped up. Cambridge is a centre of excellence in biotechnology and healthcare, both sectors that businesses have been targeting. In July, General Electric took a stake in Horizon Discovery, a gene editing, diagnostics and contact research organisation company. Cambridge's businesses have sat on the same side of the table, while those with an appetite for deal making have struggled to compete. "Almost all the deal activity involves an outsider coming into Cambridge and making an acquisition," says Armour. "That may well accelerate because those big US tech companies have all developed their acquisitions into a more substantial local presence and could look to pick off more local businesses."

What is holding Cambridge businesses back? "A key issue does appear to be ambition, not necessarily for the entrepreneurs themselves, but often in the local investment community," says Chandratillake. "Historically this was dominated by smaller, local angel investors who often focused on profitability and low dilution rather than growth and trying to build bigger businesses. As more professional investors, such as Cambridge Innovation Capital, have appeared on the scene, this looks set to change."

On the plus side, companies making acquisitions in Cambridge have not moved the businesses they bought away from the supportive cluster that played such an important role in getting them off the ground. Cambridge's business and biotech parks are thriving, with communities of like-minded enterprises - some independent, some owned by much bigger players - working side by side. "I don't think it matters that these companies have been sold," says Cowley. "The wealth and the skills almost always remain in the city."

That is encouraging for Cambridge's prospects of finding that elusive unicorn. "This is a business-to-business city with less of the hype you see elsewhere around the business-to-consumer model," says McDougall. "But if you're looking for the next big thing in deep tech, you're more likely to find it here than anywhere else in Europe." ●

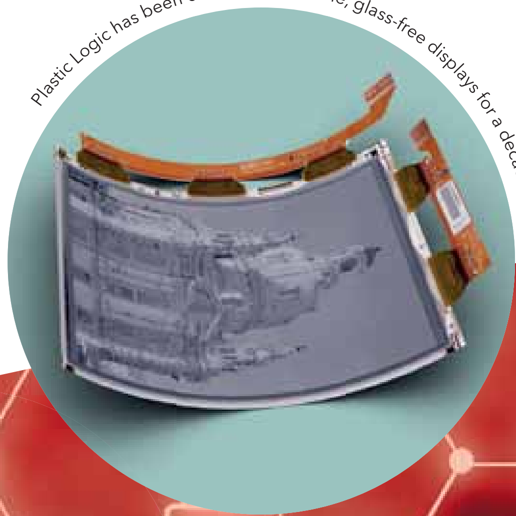
"You're more likely to find the next big thing in deep tech here than anywhere else in Europe"

Struan McDougall, founder and chairman, Cambridge Capital Group

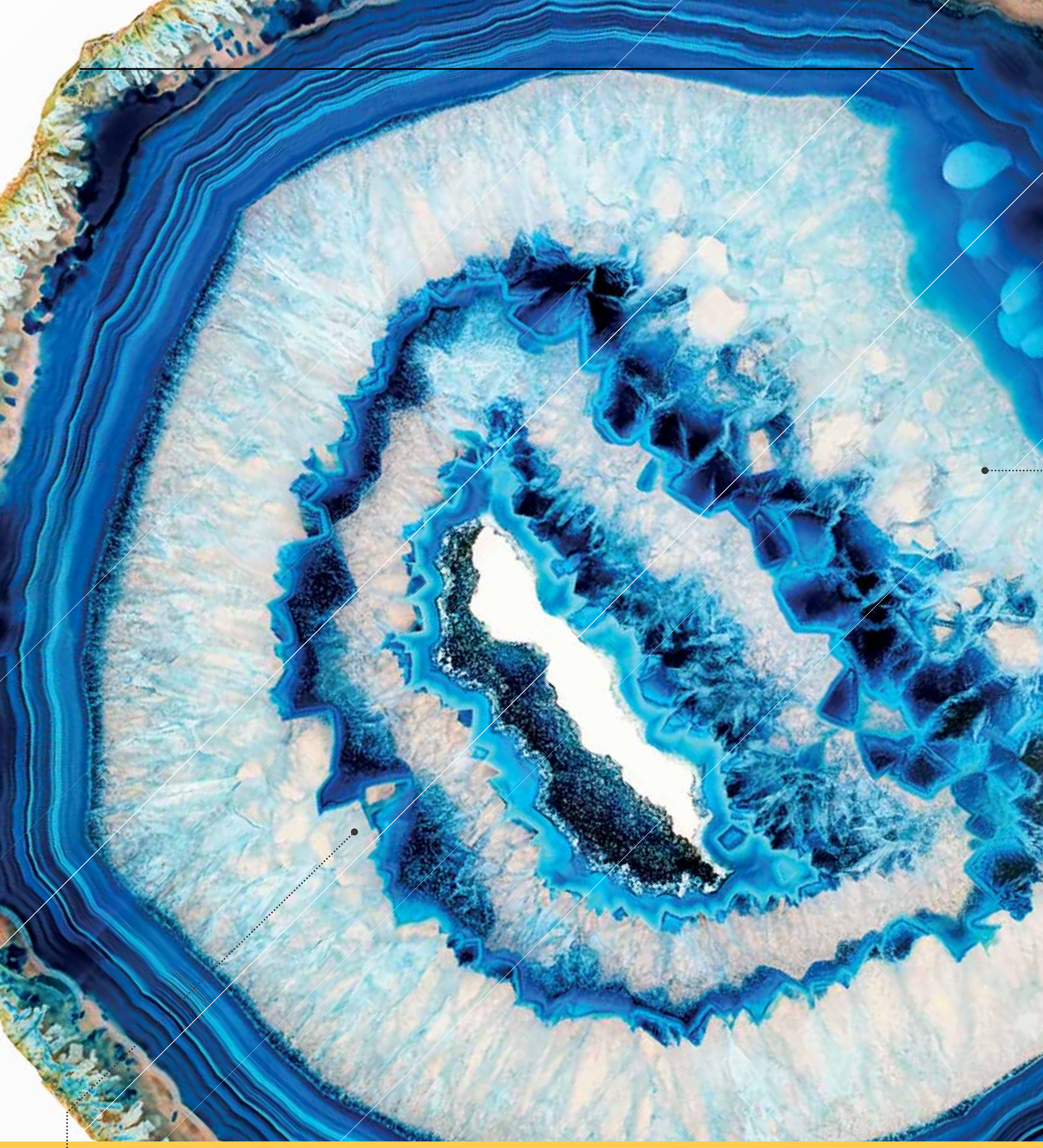
"We're continuing to see attractive opportunities across the technology space"

Amelia Armour, investment manager, Amadeus

Plastic Logic has been developing flexible, glass-free displays for a decade



ALAMY



HI

VALUING A BUSINESS IS BOTH SCIENCE AND ART. WHAT TECHNIQUES ARE DEALMAKERS USING TO HARNESS THE EVER-INCREASING AMOUNT OF DATA ON COMPANIES, MARKETS AND CUSTOMERS? AND IS IT LEADING TO MORE RELIABLE BUSINESS VALUATIONS? GRANT MURGATROYD REPORTS

300p+

Rentokil Initial's current share price, which has more than tripled in four years

When it comes to predicting the future, a corporate financier has their own crystal ball. The starting point for most business valuations lies several years ahead. "We have a standard model that we apply to each and every business that we look at," explains Chris Hunt, group head of M&A at FTSE 100 pest control and hygiene giant Rentokil Initial. "The model projects out the underlying profitability of the business for 10 years. We then apply a terminal value beyond the 10 years, bring it all back to today and then look at that value relative to the return we require for that type of opportunity."

It's a model that works. In October 2017, Hunt collected the Corporate Finance Faculty's Corporate Development award on behalf of Rentokil Initial, which recognised the contribution M&A had made to shareholder value. Since 2013 Rentokil's share price has risen from 95p to over 300p.

NUMBER CRUNCHING

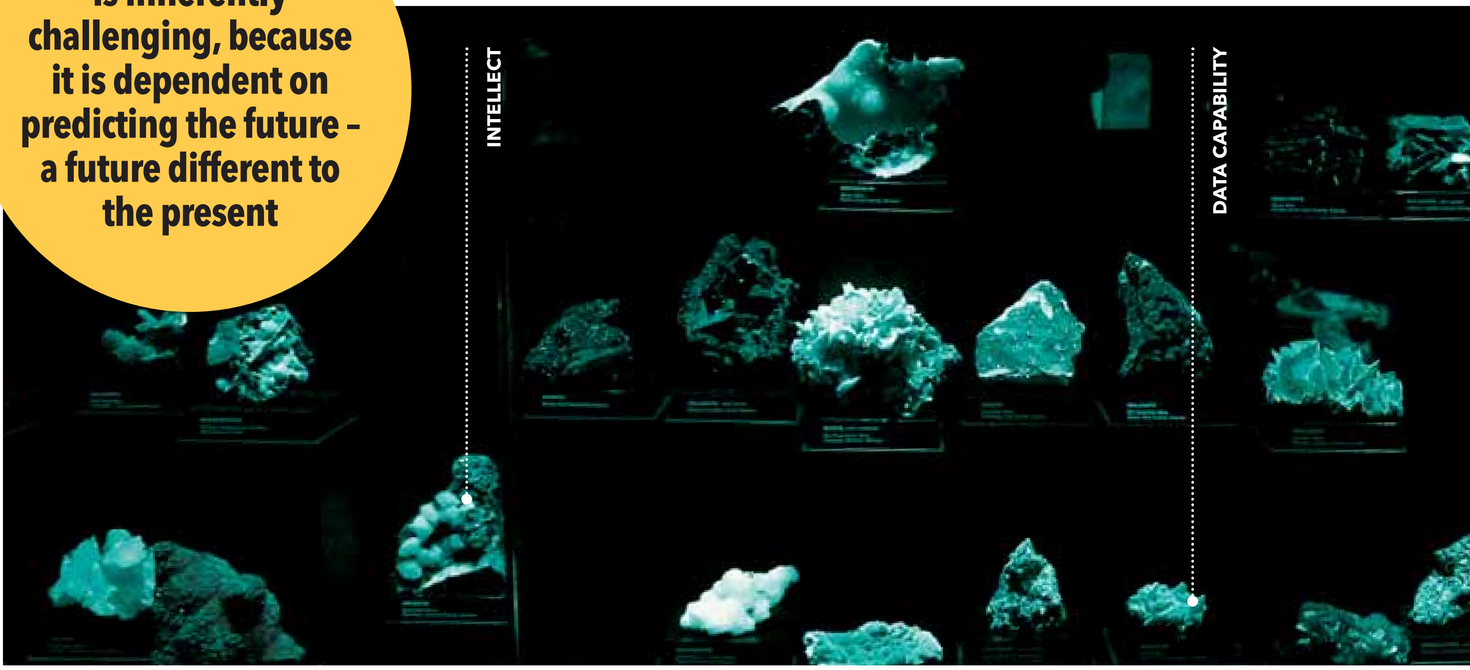
There are many ways to value a business, the most common methods being discounted cash flow (DCF), market multiples and net assets. In a transaction process, buyers and sellers need to be aware of the methodologies that competitors may or are most likely to use in order to win auctions or to maximise value when selling respectively.

"Forecasting events is notoriously tricky," says Jonathan White, a corporate finance partner at KPMG, co-author of the ICAEW Corporate Finance Faculty's best-practice guideline, *Contemporary valuation issues in deals*, which was published last month (see 'Ticks from Guideline 66', overleaf). "While forecasting the weather has noticeably got better, forecasting significant shifts in the economy hasn't. Historically there was less information to go on. Today the information you can use to guide your valuations is much more useful, but of course it remains subjective as to how you interpret it."

There's a simple reason we have not got significantly better at predicting economic behaviour - it's just not rational. Since Daniel Kahneman won the Nobel Prize for Economics in 2002, economists have increasingly applied psychology to economic decision-making, a field known as behavioural economics. You would be forgiven for thinking that irrationality should be

GH VALUE

Valuing growth is inherently challenging, because it is dependent on predicting the future – a future different to the present



DCF VERSUS MARKET MULTIPLES

Two of the main valuation methodologies are discounted cash flow (DCF) and market multiples. The Corporate Finance Faculty's new best-practice guideline examines the relative merits of each.

Arguments for DCF:

- values a business based on future cash flows and not reported profit, and therefore excludes the effects of accounting conventions and estimates;
- forces companies to consider the underlying characteristics of the target company and to understand its business;
- can account for multiple years, complex financing and Capex; and
- the value impact from separate components, including cash flows and growth rates, and risks can be separately quantified and analysed through scenario and sensitivity analysis.

Arguments for market multiples:

- relatively straightforward to apply;
- widely understood;
- it reflects market sentiment by providing values based on direct market evidence of what investors are paying in the market; and
- it can be applied to historic and prospective earnings. It has the advantage of being applied to earnings that have been achieved, and to prospective earnings which reflect future performance. It is not, therefore, solely reliant on estimates of future performance.

£922m

Taxpayer gain from the 1989 privatisation of Thames Water

£4.3bn

Amount RWE paid for Thames Water in 2000

weeded out of forecasting models, but remove irrationality and you remove profitable opportunities. In the late 1990s Warren Buffet's Berkshire Hathaway avoided technology stocks because the Sage of Omaha didn't understand the business models and the valuations. History may have proved Buffet right, but from August 1998 to February 2000 Berkshire Hathaway underperformed the Nasdaq Composite by a staggering 189%.

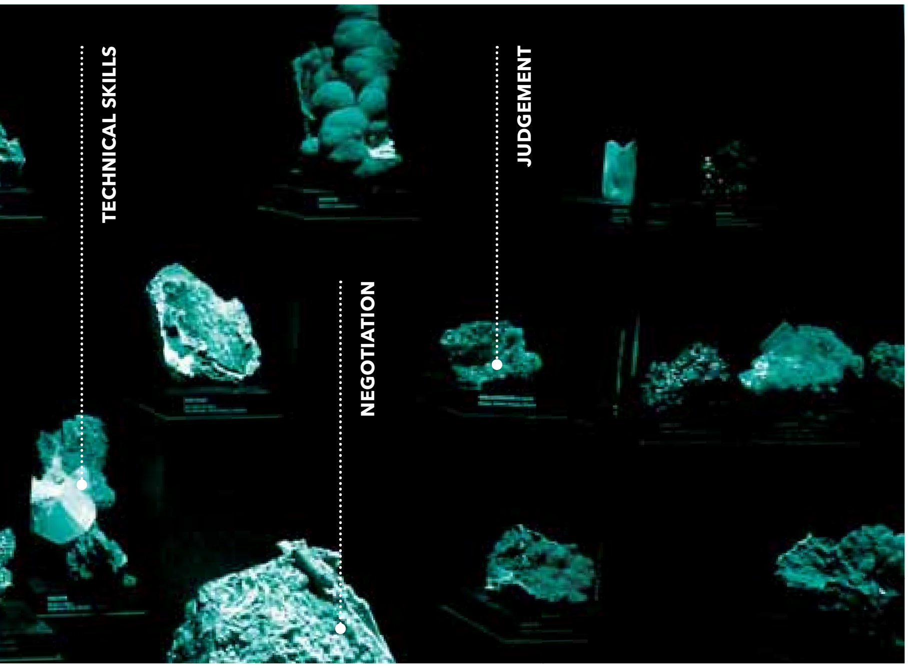
HIGH COST OF LOW GROWTH?

The 1989 privatisation of Thames Water netted the taxpayer £922m. In 2000, Germany's RWE paid £4.3bn for the UK infrastructure company, which it sold to Australia's Macquarie in 2006 for £8bn and issued a securitisation a year later. Macquarie completed its exit earlier this year, selling its remaining stake in Thames Water to Borealis, a unit of Canadian pension fund OMERS.

Macquarie has faced criticism in the UK press and from parliament about the company's borrowings, dividends, tax strategy and the public money invested in infrastructure improvements. Whatever your view on that, the fact is that this is a private company being criticised for maximising its profits.

Macquarie's private equity unit, AMP Capital, has shifted its investment focus away from low-growth infrastructure assets. This decision is largely based on the value being placed on such assets and Macquarie's perception of both operational and regulatory risk.

"We have focused on mature businesses with stable, predictable cash flows, such as utilities," explains Adam Ringer, investment director at AMP Capital. "Prices are high now and it's just about your cost of capital and return targets. We've been selling these types of assets and targeting opportunities that are not so predictable, but



where we can get an angle that enables us to get comfortable with a winning valuation. That doesn't mean we wouldn't invest in mature utilities again in the future."

PRICING GROWTH

Valuing growth is inherently challenging, because it is dependent on predicting the future - a future different to the present. "As a financial investor I'll be assessing businesses, looking at their performance and prospects in terms of achieving a risk-adjusted return for the funds that I'm investing," says Marion Bernard, newly recruited as principal, and UK managing director at McLarty Capital Partners, a US investment fund that is building a European presence. "Valuation is important in that the entry valuation needs to be priced appropriately bearing in mind the future growth of the business and the expected exit valuation so an appropriate return can be made." Bernard has seen every stage and style of investment in a career that started at Barclays and has taken in 3i, Impax Asset Management, Northstar Ventures and the Business Growth Fund, before joining McLarty this year.

With early-stage companies actual financial performance is rarely a significant input into the investment valuation. Bernard says the most important success factor is the calibre of the management: "When you're checking the key assumptions behind the forecasts, you're trying to assess the risks, the opportunities and the challenges. You look at their track record and ability to deliver the forecast they've set out in front of you. The valuation is more about the financial forecast, the potential to deliver those numbers and your confidence based on the team's track record and ability."

The same goes for more mature businesses, where management and execution are key. "We are

"We have a standard model that we apply to every business that we look at"

Chris Hunt,
group head of M&A, Rentokil Initial

"Forecasting events is notoriously tricky"

Jonathan White,
corporate finance partner, KPMG

TICKS FROM GUIDELINE 66

In November, the Corporate Finance Faculty published best-practice guideline number 66: *Contemporary valuation issues in deals*. The guideline provides professionals with the latest thinking about the inputs, outputs and methodologies of business valuation.

The guideline's author, Jonathan White, a corporate finance partner at KPMG, has more than 20 years' experience. He specialises in transactions around infrastructure (transport, utilities and social) and energy (particularly renewables such as wind, solar, biomass) and leads KPMG's valuation business in the UK.

Covering pre-, during and post-deal situations, the guideline includes: a selection of deal-specific valuation considerations and nuances for different types of companies; how valuations are used to support strategic decision-making; valuation of synergies, contingent and non-cash consideration and tax losses; valuation adjustments from enterprise value to equity value; valuation adjustments for minority interests and control premiums; and discussion on valuations for financial reporting purposes.

ALAMY

MORE THAN A TICK IN A BOX

Company pensions have become increasingly important in M&A. At the extreme end, pensions liabilities can swallow up a company's value.

In September 2017, British Airways (part of IAG) slipped out a notice that it was closing its final salary pension scheme. Despite pouring £3.5bn into the scheme since 2003, the deficit had grown to £3.7bn. BA's moves followed similar announcements from Tesco, BT and Royal Mail.

Pensions are not an issue that can be ignored. Retail entrepreneur Sir Philip Green came under fire after his BHS Group went into administration with a pension deficit of £571m, with attention focused on the £580m-plus paid out to the Green family before it sold the business to Dominic Chappell's Retail Acquisitions for £1. When Green bought the business for £200m in 2000 the pension scheme was in credit.

In October 2016 MPs voted to strip Sir Philip of his knighthood, although it was a non-binding vote. In February 2017 Sir Philip agreed a deal with the Pensions Regulator to pay £343m into the BHS scheme, which the regulator said was a better deal than pensioners would have got from the Pension Protection Fund.

£571m

BHS Group's pension deficit when it went into administration

reliant on delivering an agreed plan to make our targeted return," says Hunt. "After we've evaluated a deal in due diligence we have a plan that's signed off by the local management team who 'own' the deal - myself and the investment committee - which is a sub-committee comprising the chief executive officer, the chief financial officer and the group financial controller. That plan will then be baked into that business's numbers so their numbers become the group numbers and their budget is increased accordingly. That incentivises them to hit those numbers and we do a lot of work post-acquisition to check that the deal is on track."

"Just because you've got big data doesn't mean you're going to get better at predicting the future"

Andrew Brouwer,
manager, KMPG

COMPUTER SAYS NO

The past decade has seen explosive growth in the data available to potential investors and the emergence of big data. More - or at least better - data should give greater insight into the future. Deeper data can allow investors to get under the company's skin to understand the opportunity, and in particular an opportunity available to them specifically as an acquirer. "We're looking at a business where the macro picture isn't that interesting in terms of opportunities for growth or price increases," says Ringer. "But there are significant differences in the different regions it operates in. Drill past the headline numbers and there is scope to grow profits in different ways in different areas. Analysing the data allows us to reach a higher valuation."

DEAL FEVER

It's increasingly accepted that economic decisions are not rational. If the decisions are not always rational, then neither are the decision-makers. Deal fever is a blessing or a curse, depending on which side of the table you're sitting.

"In a deal there's actually an awful lot of emotion because the decisions are taken by individuals," explains Andrew Brouwer at KPMG. "The behaviour, the messaging and communications around price are really important. That's why the whole financial PR industry has built up around it, because the way it plays across affects people's memories and perceptions."

For many acquirers, there is a balance between taking risks and being disciplined. Private and family-owned companies have more scope to be cavalier. As an FTSE-listed company, Rentokil Initial has to be clear about its deal-making objectives. "A public company requires a set of very well articulated strategies," says group head of M&A Chris Hunt. "We're in relatively mature markets, our hygiene business is growing at 2-3% organically and our pest business 5-6%, yet we want to grow faster. M&A adds the difference between that organic growth and what we report to the markets. But we're not under pressure to do any deal. We're very financially disciplined and we've walked away from a number of deals because the price got too high or we were torturing ourselves over delivering synergies."

Advisers are, however, cautious about placing too much reliance on large data sets that are becoming available. As the saying goes: "Garbage in, garbage out."

Andrew Brouwer, manager at KPMG in the UK, says: "Just because you've got all this wonderful big data, it doesn't mean you're going to get better at predicting the future. People take big data and derive an algorithm from it. But that doesn't mean you're going to get the right answer."

The judgement of an acquirer, informed by their advisers, is always going to be critical.

PRICE ON VALUE

Corporate financiers will often tell you that the value of any business is simply what someone is prepared to pay for it. Those that lose an auction often claim that the winners paid too high a price, but it is in fact almost always too early to tell. In September 2015 Rentokil announced the acquisition of Steritech Group, a leading pest control business in North America, for $425m cash. At 42.5x earnings the price looked rich, but Hunt says the company is on track to hit its targets and has delivered synergies.

Hunt qualified as a chartered accountant (and ICAEW member) and worked in transaction services at KPMG before joining AstraZeneca in 2005. He moved to Rentokil in 2012. Rentokil does much of its M&A work in-house, with dedicated people in each of its regions, but regularly brings in advisers.

"When I joined Rentokil there was a variant of the model but it wasn't enforced as rigorously as it is now," he says. "Now we have a slightly better model but far better governance around the assumptions that go into that model and the sign off that's required, first by my team and then by the investment committee or our board."

Rentokil has been rewarded by the market for strengthening its position in the US market, with the share price doubling since September 2015. As the much admired Mr Buffet once said: "Price is what you pay, value is what you get." ●

"We have focused on mature businesses with stable, predictable cash flows, such as utilities"

Adam Ringer,
investment director, AMP Capital

"The valuation is more about the financial forecast"

Marion Bernard,
principal and UK managing director, McLarty Capital Partners

$500bn+

Facebook's valuation in June 2017

$19bn

price paid for WhatsApp by Facebook in 2014

THERE BE UNICORNS

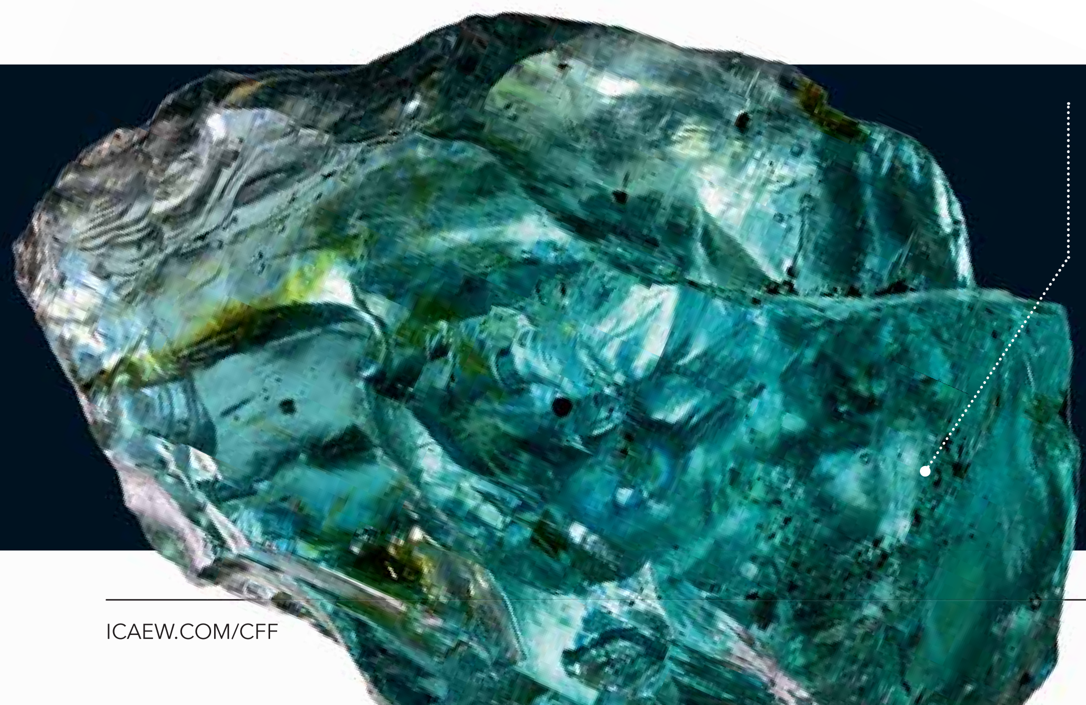
A "unicorn" is a private company with a valuation of more than $1bn. The phrase was coined by venture capitalist Eileen Lee, who used it to highlight the statistical rarity of such companies. Unicorn status is bestowed during financing rounds, where investors are betting that there will be a significant increase in future value.

Often that value comes through an acquisition, with the technology giants buying start-ups to keep up with technology and market developments.

In the past five years, social media leader Facebook has bought WhatsApp ($19bn in 2014), Occulus VR ($2bn in 2014), Instagram ($1bn in 2012) and a host of smaller companies. It has bought to improve the core offering and website, to develop mobile technology, to get a photo library, to develop revenue generation models and to enter new markets.

The increase in Facebook's share price had covered the acquisition cost of WhatsApp in six months. Facebook listed shares in January 2012 at a valuation of $104bn. The *FT* quoted Jay Ritter, professor of finance at the University of Florida, as saying: "There's an awful lot of optimism built into this valuation. The company really has to perform in order to avoid the stock price declining due to these lofty expectations."

Facebook has, at least in the eyes of investors, performed and exceeded those lofty expectations. In June 2017 its valuation passed $500bn, taking it past Amazon to be the world's fourth most valuable technology company. In turn this took it into an exclusive club of Alphabet (Google), Amazon and Microsoft.



"In a deal there's actually an awful lot of emotion because the decisions are taken by individuals"

CLEAR & CREDIBLE

The Corporate Finance Faculty is preparing to update ICAEW's guidance on prospective financial information. Marc Mullen looks at the issues for business

Over the past 10 years, the range of funding options available to businesses has grown. Irrespective of size or stage of growth, there is a requirement for businesses to prepare high quality, credible prospective financial information (PFI) to maximise their chances of getting the financing they need.

In October the deadline closed for responses to the faculty's consultation document: *Consultation paper on prospective financial information*. A working group set up by Katerina Joannou, ICAEW's manager of capital markets policy, will incorporate issues raised in responses to the development of new guidance.

Robert Hodgkinson, ICAEW technical director, said: "Preparing PFI to effectively communicate a business's prospects can be like spinning plates. To be useful, such information must be relevant, reliable, understandable and comparable and, we are proposing, aligned and not misleading.

"What's key is that new guidance is practical and useful, which is why we've had a process for seeking input and drawing on a wealth of experience from directors of public-listed corporates, regulators and the capital market advisory community. We are still gathering views as we start drafting."

The plan is for final guidance to be published in the first half of 2019 - 16 years after ICAEW published the previous guidance.

"There's an opportunity to align forecasts with management information"

Katerina Joannou, capital markets manager, ICAEW

"For public listed companies, PFI is used externally in IPOs, but beyond that only really internally," explains Ken Lever, non-executive chairman of LSE-listed energy and environmental consultancy, RPS Group. "From an internal perspective, managing a business, PFI is used a lot more extensively than it was. Companies are more active in developing financial models." Lever was previously CEO of XChanging, Alfred McAlpine CFO, Albright & Wilson CFO and Tomkins CFO, and sat on the working group that developed the 2003 guidance.

ADDING TO THE PRINCIPLES

Four principles were set out in the 2003 guidance that PFI should be relevant, understandable, reliable and comparable. Two additional principles are proposed for the updated guidance: that PFI is aligned and not misleading.

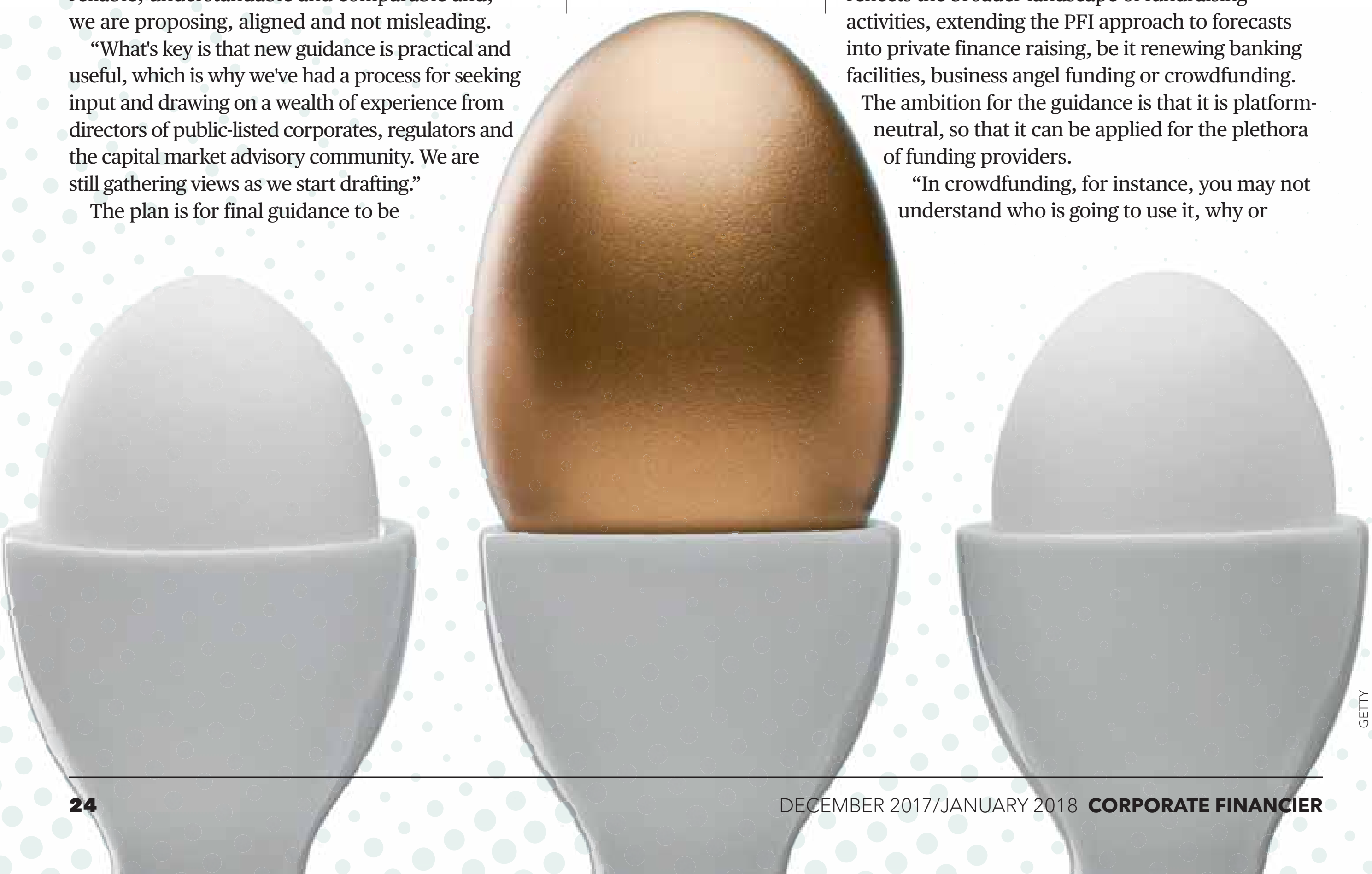
"The proposals still cover the core capital markets' activities - IPOs, placings and further fundraising. The first initiative is to address principles underpinning PFI and produce up-to-date guidance for the quoted company sector aimed at people preparing forecasts and statements," says Joannou.

Lever expands: "First, what is critical for market expectations is knowing that management have a credible forecasting system, and can effectively manage market expectations. Second is that management has an understanding of what variables impact forecasting. Can they communicate these things to the market? Then the real test is whether they deliver results in line with market expectations."

And the second initiative is that the new guidance reflects the broader landscape of fundraising activities, extending the PFI approach to forecasts into private finance raising, be it renewing banking facilities, business angel funding or crowdfunding.

The ambition for the guidance is that it is platform-neutral, so that it can be applied for the plethora of funding providers.

"In crowdfunding, for instance, you may not understand who is going to use it, why or



GETTY

how," says Jonathan Symonds, non-executive director of HSBC Holdings and chairman of HSBC Bank, its European subsidiary. "You need to look at what minimum data set is required to form an opinion. Crowdfunding is perhaps an exception - in 'normal' private companies, investors are largely pretty experienced and have their own checklists of what they want to understand. In formal fundraising, you qualify the potential investor and know where they are on the spectrum from sophisticated investor to novice."

Symonds was also on the 2003 working group. He is chairman of Proteus Digital Health and non-executive director of Genomics England. He was previously CFO of Novartis AG and of AstraZeneca.

"There is an opportunity to make forecasts align with financial management information more generally," says Joannou. "They should be underpinned by the same system. There will always be assumptions within forecasts, but the point about forecasts is that if they are based on these guidelines they will be justifiable and comparable."

"From an internal perspective, managing a business, PFI is used a lot more extensively than it was"

Ken Lever, non-executive chairman, RPS Group

Cost and proportionality are big challenges addressed in the new guidance, and the working group has been keen to explore this with the banking, crowdfunding, business angel and private equity sectors. The aim is certainly not to add to the complexity of PFI preparation or to prescribe how a business should portray its prospects.

"It's not the intention to displace or preclude the ability of a private finance provider to question a business's forecasts or challenge the assumptions," according to David Petrie, ICAEW's head of corporate finance. "That wouldn't happen quite so often if information was prepared in a way that everyone expects. The outcome should be an up-to-date framework, which is proportionate and essentially reflects current market practice."

While there has been much development in the fundraising landscape, technology and big data are beginning to affect the key information the markets need - perhaps in the tech, retail and pharma sectors above all, but also in some elements of financial services.

"Nowadays, the scope of information from which opinions are formed has grown," says Symonds. "The demands on board members are immense, but it always comes back to whether directors really understand the business drivers, how the business makes money, the business model and the quality of data on which they form their opinions."●

PFI AND PROFIT WARNINGS

One, perhaps rough, indicator of the quality of PFI being used by public companies is the number of profit warnings issued. EY tracks Plc statements that say profits will be materially below management or market expectations. Between 2002 and 2006, the average yearly total for UK profit warnings was 313, versus 274 in the period after the financial crisis from 2009 to 2016. But the total number of UK listed companies has fallen dramatically – from 2,407 companies on the Main Market and AIM at the end of 2008 to 1,890 companies at the end of 2016. So the percentage of companies warning in recent years is similar to the peak of the crisis – 16% in 2016, compared with 18% in 2008.

"If expectations run ahead of a slower than expected recovery, as they have, forecasts are continuously being reigned in, triggering profit warnings when they are too far out of kilter," says Kirsten Tompkins, capital market analyst at EY. "Warnings also spike when expectations have no time to adjust; this recovery has seen shocks, from the fall in the oil price to Brexit."

The drop in oil price saw profit warnings hit 100 in Q4 2015, with 7.3% of UK listed companies warning in one quarter – the highest since Q4 2001.

Structural factors have also contributed. One example is support services, which had benefited from the economic recovery; but has also issued the most profit warnings every year since 2008, bar one.

In a typical quarter, 60% of companies issuing profit warnings haven't warned over the previous year; 25% are warning for the second time in 12 months; and 15% are warning for a third time or more. Statistics show that companies in the last category have seen a 22% median drop in share price on the day of the first warning, compared with 12% for those that don't warn again. "Multiple warnings clearly stand out and investors have a nose for trouble," explains Tomkins. "This all underlines the importance of directors having relevant, reliable and understandable PFI available."

RPS Group's Kenneth Lever adds: "Management have to be sure they are comfortable with the external estimates around their business. They need to know they are within market expectations and so need a good forecasting model that takes account of the key drivers of business."

Detailed sensitivity analysis of PFI, underpinned by a clear understanding of the variables and assumptions behind businesses' forecasts, are very important.

"This way forecasts can be updated quickly to enable them to signal a clear and timely change in guidance when forecast variables change," says Tomkins. "Sometimes companies face events that are beyond the normal – the 'unknown unknowns' – but having processes in place to respond to changes provides a clear structure for companies to follow and to keep investors properly informed."

313
average number of annual profit warnings in the UK from 2002 to 2006

274
average number of UK profit warnings post-crisis, 2009 to 2016

BUY UP, BUY IN, BUY OUT

Global private equity dry powder is at record levels. Vicky Meek looks at the UK buy-out market, which remains buoyant despite increasing competition from international buyers, high multiples, the prospect of rising interest rates and the still unclear form that Brexit will take

For the past decade a low interest rate environment has prevailed. Private equity has been one of the main beneficiaries as institutional investors have sought higher returning asset classes. During the first three quarters of 2017, private equity funds raised $338bn globally, already not far off the full-year 2016 figure of $394bn, according to Preqin. That in turn was 63% up on the $241bn raised back in 2012.

UK mid-market private equity has not been left out, even with Brexit on the horizon. Some 22 mid-market UK firms raised a record €6.4bn in 2016 - far higher than any other European country - according to Acanthus Advisers' European Mid-Market Fundraising Review. Livingbridge 6 closed at £660m, Tenzing's debut fund exceeded its target by £50m to close at £200m, and CBPE Capital raised £459m for its ninth fund.

HIGH MULTIPLES

A vibrant fundraising market may be good news for the industry overall, but it can create headaches for investment professionals. According to Preqin, private equity dry powder (committed, but uninvested capital) globally stood at a record $942bn in September 2017. As a result, the highly competitive UK mid-market has become even more competitive over the past few years.

"There is more dry powder in the mid-market than there are deals on the ground," argues Andy Morgan, partner and head of corporate finance advisory at Grant Thornton. "While activity levels have been reasonable over the past six to 12 months, there has been a high level of fundraising over the same timeframe. This means there is a lot of capital chasing the right deals."

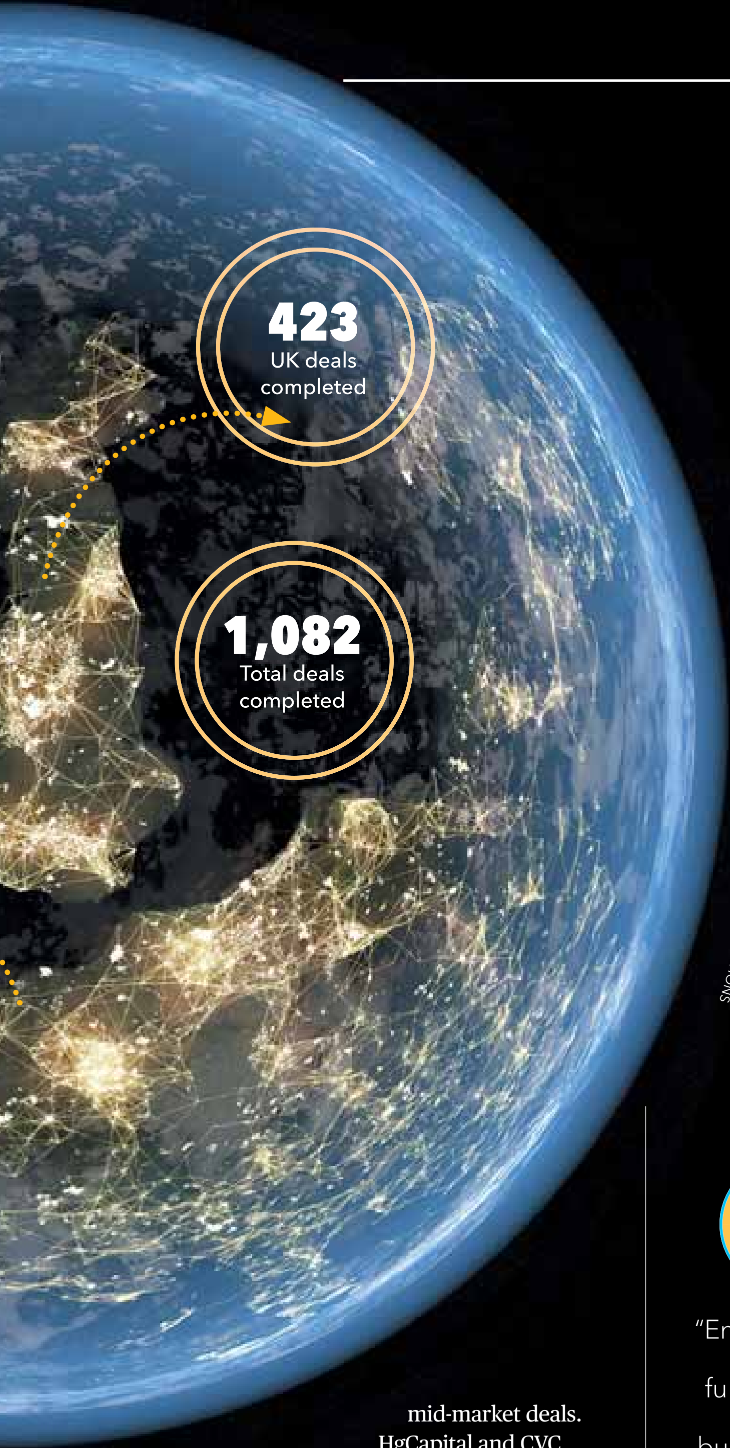
"The UK economy won't disappear in 2019. And neither will the deal opportunities"

Andy Powell, managing partner, Rutland Partners

The effect on pricing is inevitable. "Valuations are high," says Mo Merali, Grant Thornton's head of private equity and a member of the Corporate Finance Faculty's board. "Entry multiples are pretty fulsome, even for some businesses that are not stellar. The multiples being paid by private equity are often in line with trade and in many cases higher - it's not currently the case that trade will pay more for strategic reasons."

Indeed, BDO's latest Private Company Price Index, for Q2 2017, finds that while trade is paying 10.7x enterprise values to EBITDA, the figure for private equity is much higher at 12.8x, which according to BDO reflects "the high levels of competition for quality businesses".

As a result, a number of the larger firms are moving into smaller deals, most commonly UK-wide



SOURCE: DELOITTE ALTERNATIVE CAPITAL SOLUTIONS

mid-market deals. HgCapital and CVC Capital Partners have each recently raised vehicles focused on smaller deals, largely in the technology and technology-enabled sectors, which they would consider to be over £100m. Overseas players are eyeing the market. Canadian firm Ardenton, for instance, opened a Manchester office earlier this year. "We are seeing some of the larger sector-focused funds dipping down into our part of the market," says David Ewing, managing partner at ECI Partners. "This is happening in TMT in particular, where there are often US-based funds flying over to scope out businesses that are £100m-plus enterprise value. This sector tends to attract a wide variety of interest, often because TMT businesses tend to be international."

ELEPHANT IN THE ROOM

Strategies for dealing with elevated pricing have been several years in the making. But since 23 June 2016, when the UK voted to leave the EU, mid-market firms have also had to consider how they will adapt to Brexit. Sterling's devaluation in the following year has added to competitive pressures for new deals from overseas buyers. Yet overall, most players say the effect so far has been benign, with portfolio companies largely continuing to grow.

"In our market, the macro picture - and in this I would include Brexit - sets the context, but the investments are not heavily correlated with the wider market," explains Ewing. "The companies we tend to invest in are growing regardless of GDP growth because they tend to be niche businesses offering customers advantages such as an ability to do things more efficiently. The companies in our portfolio are growing at 20% or more per annum."

However, there are signs that some private equity firms are looking to de-risk their business models, in what has become a more uncertain market, as the outcome of Brexit remains unknown.

"Some funds with UK headquarters, and a mandate to invest a proportion of funds outside the UK may be considering whether they should plant an outpost in continental Europe, as a means of

"Entry multiples are pretty fulsome, even for some businesses that are not stellar"

Mo Merali, partner and head of private equity, Grant Thornton

"The companies we tend to invest in are growing regardless of GDP growth"

David Ewing, managing partner, ECI Partners

DEBT FUNDS IN THE MID-MARKET

One of the biggest trends in the UK mid-market over the past few years has been the arrival of debt funds. Previously such funds focused on the upper end of the mid-market deal spectrum. But now they are on the funding table for many mid-market buy-outs.

"There are now myriad debt providers in our market," argues Powell. "There used to be a handful of clearing banks but with the growth of debt funds, private equity houses can shop around for the right structure and flexibility for the business you're backing."

That is clearly good news for structuring. "It's a borrower's market," says Reed Smith partner, Monica Barton. "There is a high concentration of liquidity and it's possible to get a higher quantum of debt than previously, as many funds are now well enough capitalised and they don't need to sell down."

While mid-market houses may value the quantum and the flexibility the debt funds can offer, there is a sting in the tail. Greater liquidity in the debt markets is contributing to higher pricing, both as firms are able to secure more acquisition finance and as private debt becomes a viable alternative to equity financing for some businesses.

Many firms in this part of the market also remain circumspect when it comes to the debt funds, as Powell explains: "The acid test will be how these funds behave when the environment gets tougher. We just don't know at this stage. Sponsors may not always like the way that banks react in more adverse circumstances, but at least they are a known quantity."

accessing deal flow and investors," says Merali. He points out that this is far from a straightforward strategy, given the different market characteristics and jurisdictions. Others are looking at alternative options such as partnership agreements with firms based in continental Europe.

Many do believe Brexit will provide new deal flow. Interest in recruitment and HR-related businesses is up among private equity houses, for example. "They are seeing opportunity here, given the prediction of skills shortages after Brexit," says Morgan.

It seems likely that the attractiveness of some other sub-sectors will increase once the shape of Brexit becomes clearer, particularly if, in the short term at least, there is some economic volatility once negotiations are concluded. UK mid-market players, most of them with experience of at least one economic cycle, are well positioned to capitalise on opportunities that may emerge from disruption.

As Rutland Partners' managing partner Andy Powell puts it: "The UK economy won't disappear in 2019. And neither will the deal opportunities."

HIRING DEALMAKERS

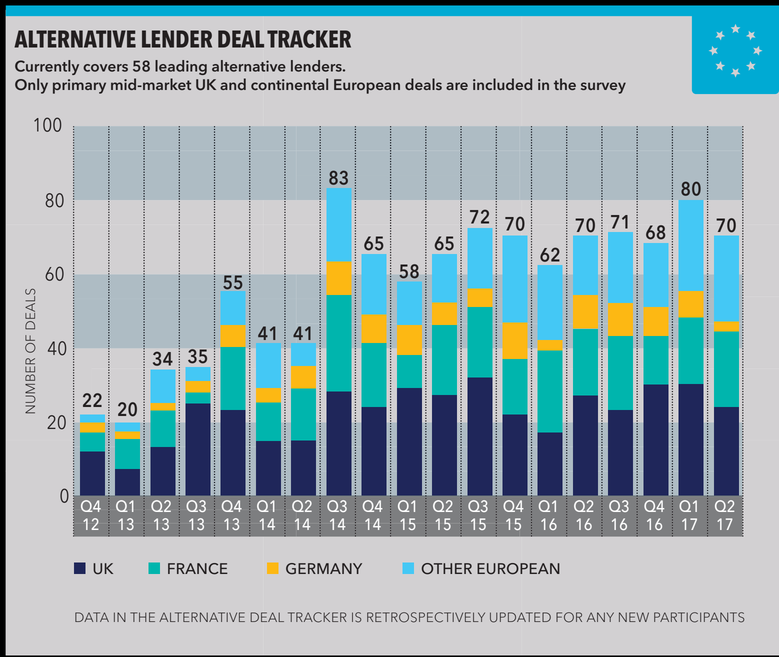
Many firms have been boosting origination capabilities, with new hires and promotions in this role at Inflexion, Livingbridge and CBPE Capital over recent months. This is allowing firms to refine the way they target deals. Professionals with a background as chartered accountants and as corporate financiers are in demand. "We still see auctions involving numerous firms crowding around assets," says Laura Brunnen, private equity partner at Reed Smith. "But many mid-market firms are now being far more mindful about how they differentiate themselves from management teams who will often have a major role in deciding who to partner with."

As a result mid-market firms are being more proactive in sourcing, and they are spending more time getting to know companies and management teams to help them identify the right strategic path for the business well ahead of any transaction. Private equity firms are trying to set up bilateral deals to bypass auction processes, but advised deals with completion from several financial buyers are still the norm.

"The mid-market is having to be creative about how it deploys capital," agrees Morgan. "Firms need to find unusual angles and develop their value creation plans well in advance of acquisitions to ensure the numbers stack up. We're seeing more buy-and-build platform deals, where houses will pay up for the platform and build value through scale and multiple arbitrage on bolt-on acquisitions."

ADD IT UP

Strategic M&A is helping many private equity firms, particularly in the mid-market, mitigate against the aforementioned high entry valuations. Buy-and-build has become a major element of many firms' value creation processes over the past 15 years. Last year was a record year for buy-and-builds across



SOURCE: DELOITTE ALTERNATIVE CAPITAL SOLUTIONS

"There is more dry powder in the mid-market than there are deals on the ground"

Andy Morgan, partner and head of corporate finance advisory, Grant Thornton

"Corporates are under pressure to offload non-core or underperforming parts of their business"

Laura Brunnen, private equity partner, Reed Smith

Europe, according to Silverfleet Capital's *Buy & Build Monitor* - there were 537 add-ons across Europe. The UK and Ireland accounted for the largest share of these - 111, which was up 9% on 2015.

ECI Partners is one of many firms that has built up its support capability for portfolio companies to help drive such buy-and-build strategies and gain maximum value from their investments. Ewing says the firm is increasingly working with companies to provide "a fuller service around developing their acquisition strategy, mapping out and identifying the best targets".

The result is a more formalised and rigorous approach to value creation. "We've done this in part through a natural evolution as we strive to improve the way we do things, but also in recognition that we have to pay high prices," Ewing explains. "If you buy a number of smaller bolt-ons, for example, these are likely to be less competitive and it's therefore possible to average down an entry price of, say, 10-12xEBITDA to closer to 7x or 8x."

CARVE UP

Firms are increasingly targeting trickier deals. Carve-outs are notoriously challenging, given the often complex nature of attempting to separate business units, negotiate transition service agreements and the lack of a distinct set of accounts.

"Corporates are under pressure to offload non-core or underperforming parts of their business," explains Brunnen. "Many mid-market private equity houses are looking seriously at this area because there's less competition from trade, and because their experience of buying and reshaping companies means they can make a compelling case for acquiring these businesses." One example of this trend is the acquisition of Capita's public sector recruitment business Affinity Workforce by Endless earlier this year. ●

GETTY

FAIR PLAY

In the latest in our series about de-risking deals, **Nick Fenn** of Beechbrook Capital explains why good corporate finance advice minimises the execution risk for borrower and lender

The road of lending to private equity houses is a well travelled one. They are pretty clear what they are looking for. We and other lenders know what they generally require. And advisers know what we are all likely to be doing in a sponsored deal. However, managing an unsponsored process, dealing with an owner-managed or a family-owned business is somewhat different.

To achieve a successful outcome, we see considerable value for both borrower and lender in any potential (unsponsored) borrower given proper corporate finance advice. Such good advice can take the completion risk out of a transaction.

BORROWER VALUE

In theory, a borrower taking bad advice or no advice will put the lender in a stronger negotiating position. However, in practice, an unadvised client is actually more likely to end up with a failed process, resulting in a significant amount of wasted time for everyone involved.

From our point of view, it is important that businesses we engage with are clear about what they are getting into from an early stage. We don't want them to realise late in the process that terms were not what they expected. That can be

CASE STUDY 1: HIGH FLYING

Specialist aviation engineering business 2Excel Aviation appointed Grant Thornton to raise growth capital in 2016. The business, founded by former RAF pilots Andy Offer and Chris Norton, is based in Northamptonshire. In December 2016, Beechbrook provided a £14.5m unitranche loan.

Grant Thornton helped management prepare the necessary information, including financial due diligence. It identified potential funders, both debt and equity, and managed initial presentations. It helped shareholders evaluate and compare several offers received.

It negotiated with the prospective lenders, helped management choose Beechbrook and managed the process through to successful completion on time.

avoided by an adviser mapping out the potential financing options, what the pricing is likely to be and the likely terms and conditions, as well as how negotiable they may be. The adviser can then qualify different proposals.

We are not trying to undermine our own negotiating position, but simply feel more comfortable dealing with businesses that are well advised. We do not want a 'deal-stopper', so would rather negotiate with an experienced adviser – and make concessions on some of our terms – in return for a well managed process, with a higher probability of successful execution.

COMPLEX MARKET

Companies looking for funding have a wider range of potential options to consider. Major banks' products are relatively commoditised and easily understood. But beyond the banks, there are an increasing number of specialist lenders and equity investors. Generally less well known, their products are also less well understood.

The lending industry has become much more diverse and complicated as a result of the emergence of many new alternative lenders. Such lenders have filled the void in SME lending following the 2008/09 banking crisis, when many clearing banks became more risk averse.

Owner-managers of SMEs cannot be expected to keep track of all the relevant developments in the alternative debt market, as their focus is on running their business. As a result they are very unlikely to be able to identify the most suitable funder or funders for their business.

VALUE OF ADVICE

Advisers can guide prospective borrowers in a number of areas:

- various different types of debt that might be available, and which would be most suitable;
- typical costs and other commercial terms for each of these types of debt
- the various lenders operating in each area of the debt market, and their relative strengths and weaknesses;
- the information likely to be needed by potential lenders, and how to produce it, if it is not readily available;
- ensure prospective borrowers are well prepared before approaching potential lenders. Preparation can take time, particularly for a company that hasn't raised institutional funding before;
- they can smooth the due diligence and documentation processes by taking on some of the burden of dealing with potential lenders;
- advisers can triage potential issues as they arise – they can answer or deflect questions and only get management involved when they need to be, freeing them up to run the business;
- how the process works from initial discussions through to completion of the loan, and how long it might take;
- they can maintain momentum through to completion. Delays in responding to information requests from lenders do not reflect well on the business, and can cause lenders to lose interest in a deal, particularly with high demand for funding;
- act as diplomat, defusing tensions between the two sides that can arise under pressure to complete a fund-raising; and
- explain how an on-going relationship would work, and what information would be required on an on-going basis.

If SME owners are not experienced in fundraising, the role an adviser can play is invaluable. Companies should not pick an adviser based simply on their fees, but on their experience and reputation. Advice that might seem expensive will prove its worth, when the potential costs (including opportunity costs) of a failed process are considered. Good advice de-risks a deal and will pay for itself. ●

CASE STUDY 2: ENGINEERING GROWTH

Voltcom provides design, construction and maintenance services to the UK electricity transmission and distribution industry. In early 2017 the company appointed Gambit Corporate Finance to assist with a fundraising round, to refinance existing facilities and support working capital expansion to finance growth. In October Beechbrook provided a debt and equity funding package.

It then assisted management in compiling the investment thesis through an information memorandum and investor presentations. It helped ensure the company's financial model was in line with institutional investor expectations. Gambit then introduced the investment opportunity to six investors, four of whom offered funding.

Gambit assisted management in evaluating the detailed and complex offers, project-managing the due diligence process and then working alongside Beechbrook. As the deal structure was changed, we were able to ensure the revised structure met Voltcom's requirements.

During the negotiation of complex debt and equity agreements, Gambit acted as a helpful bridge, explaining legal concepts to management and advising them on what was really important. This helped unblock matters that might otherwise have become emotive or delayed progress, enabling the deadline to be met.

The *Corporate Financier* de-risking deals series has so far covered: M&A warranty and indemnity insurance; political due diligence; investigative due diligence; environmental due diligence; and legal issues.

Nick Fenn,
co-founding partner of Beechbrook Capital and Corporate Finance Faculty member

APPOINTMENTS

NEW CAVENDISH PARTNER

Jon Edirmanasinghe has been promoted to partner at sell-side M&A adviser Cavendish Corporate Finance. He joined the firm in October 2013 as an executive from EY, where he had been manager at its financial services office in the Cayman Islands for three years.

Howard Leigh, co-founder and senior partner at Cavendish, says: "Jon's international experience means he has a strong understanding of cross-border M&A, which is one of our core strengths." Edirmanasinghe has a bachelor of commerce in accounting and entrepreneurship from the University of Manitoba, and is a Canadian qualified chartered accountant. He also has an MBA from Saïd Business School, University of Oxford.

WEST GOES SOUTH AND EAST

Corporate Finance Faculty board member Ian West has joined IT and outsourcing company Civica as international M&A director from Capita. He spent 15 years at Capita PLC, the last 12 as head of M&A. During this time, he completed more than 100 acquisitions, with an aggregate spend of more than £1bn.

Prior to this he spent over a decade with PwC, where he trained as an ACA and had a three-year secondment to the company's Brisbane office. His new role will see him return to Brisbane, which is where Civica's international division is based.

PE SHORTS

Philipp Bruchmann (1), Jamie Supple and Karel van der Voorden (2) have joined the private equity team at **3i**.

Bruchmann has joined as director in Frankfurt, from Deutsche Telekom, where he was vice president of group corporate development and M&A execution.

Supple has joined as senior associate in London from Duke Street, where he was an investment manager in the healthcare and services sectors.

Van der Voorden has joined as associate in Amsterdam from Morgan Stanley.

Alex Marsh has joined **Maven Capital Partners** in Newcastle as investment manager, from Northstar Ventures. He previously worked in PwC's corporate finance team in Newcastle.

Buy-and-build investor **Waterland** has opened a permanent office in London, led by Andy Scaife, former chief executive of Quantum

LEGAL BRIEFS

Richard Lewis (1) has joined KPMG from Eversheds to lead its corporate legal services team in London. And former national head of corporate at Shoosmiths, Emma Gibson (2), has joined KPMG in Reading.

Nick Roome, partner and UK head of legal services at KPMG, said: "We recognise that we are a challenger brand in the legal sector and disruption, not least from technology, is rife within our market. Having such quality talent will help us further embrace that change and provide the best support for clients."

Malcolm MacDougall has been promoted to head of corporate at Charles Russell Speechlys, and continues as head of private equity. He joined the firm as partner almost seven years ago from DLA Piper, where he was also partner. He previously worked for Corrs Chambers Westgarth (in Australia) and Hogan Lovells.

MacDougall acted for Elysian Capital on the Wellbeing Software Group and Raymond Brown MBOs as well as the sale of the Landscape Group; for FPE Capital on the MBO of Software Generation and Masstech Innovations (as featured in *On my CV* in September's *Corporate Financier*); for management on the Risk Capital-backed Neilson Active Holidays BIMBO from the Thomas Cook Group; and for the Business Growth Fund on its investments in Cass Art, Renal Services, Four Communications, Good Care Group, Virtual1 and Milk Visual Effects.

Ed Stacey has taken over from Shirley Brookes as head of legal services at PwC.

Gibson, Dunn & Crutcher has recruited Jeremy Kenley to its real estate private equity practice from Mayer Brown International.

Gunnercooke has launched Operating Partners, a 25-strong team of business leaders to work with private equity firms and portfolio companies on performance improvement. The team includes Jan Ward CBE, CEO of metals supplier Corrotherm International; Christopher Baldock, chairman of 6G Internet, Tute Education and Simply Mail Solutions; and Tom Knight, former CEO of JJB Sports.

Dentons has combined with Maclay Murray & Spens in the UK. Maclay Murray & Spens has lawyers in Aberdeen, Glasgow, Edinburgh, Milton Keynes, London and Watford.

Pharma. The firm is the UK arm of Waterland Private Equity Investments, a European-wide Dutch-based private equity fund manager, which recently closed its seventh fund (WPEF VII) at €2bn – with backers from Europe, the US, the Middle East and Asia.

Scaife was previously head of corporate finance for the North East at KPMG, and was MD during Quantum's period of private equity ownership until after its AIM flotation.

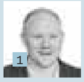
There are five investment professionals in Waterland's UK team and they expect to add two more in the coming months.

"The interest in the fund and our differentiated offering has been strong and we are using our market-led approach to identify opportunities in the UK and Ireland," said Scaife. "We have the ability to really deliver on market consolidation opportunities, use our operational skills sets, and have a more flexible approach to investing."

Sebastien Leusch has joined **Equistone Partners Europe** as investment director in the firm's Manchester office from Montagu Private Equity. Prior to spending nine years at Montagu, he worked for PwC and UBS.

Equistone senior partner Steve O'Hare said: "Sebastien is well known in the northern deal community and also has expertise across a range of sectors and geographies, which will add value to the team at Equistone."

Former Bowmark partner Mark Salter has founded a new firm **Apiary Capital**. The ACA, who trained with PwC, is joined by Bowmark's former chief operating officer (COO) Nikola Sutherland, who will be Apiary's COO, and Rob Simpson as partner, who was previously at August Equity.



Tenzing has recruited John Messer (1) and Mike Reynolds (2) to its investment team from Alchemy Partners and Rutland Partners respectively.

Pan-African private equity firm **Development Partners International** has recruited Takudzwa Mutasa from KKR as principal.

Ex-ECI Partners investment manager Oliver Gee (1) and ex-LEK Consulting manager, Alex Lazare (2), have teamed up to found **Hillwood Partners**, which will invest in UK-based SMEs. A qualified ACA, Gee worked in Deloitte's corporate finance division.

Stanhope Capital has recruited Nigel Spray as partner and head of the investment firm's merchant banking division from Kleinwort Hambros, where he was head of private merchant banking. He founded Frontiers Capital, which invested in and advised high growth businesses in the consumer sector.

Justine Colley has joined **Sanlam UK** as portfolio manager.

NEWS IN BRIEF

Sami Fairris (1), who leads **KPMG**'s corporate finance practice in the Thames Valley, has been promoted to director. And head of restructuring for the South West, David Pike (2), has been promoted to partner.

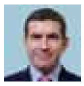
Andrew Morgan, senior partner for the firm's Thames Valley office, said: "These promotions reflect the investment the firm continues to make in the region, and our new directors will help us to further strengthen our local corporate finance and pensions offerings."

Veteran M&A banker Tom Cooper has joined **UK Government Investments**, which manages UK government assets. He left Deutsche Bank earlier this year, where he was global co-chairman of M&A. Previously he worked at UBS and KPMG. Candida Morley has also joined UK Government Investments from HgCapital, where she was an operating partner. She previously worked at LDC, Elementis and 3i. And UK Government Investments has promoted Michael Harrison and Henry Lloyd to director.

Crowe Clark Whitehill has promoted Mitesh Patelia to partner in its corporate finance team. Having joined the firm in 2008, his focus is on entrepreneurial and growth clients, as well as IPOs and capital market transactions for both UK and international clients.

Duff & Phelps has recruited former PwC valuations partner Peter Clokey as senior adviser in London. Greg Hely Hutchinson (1) has also joined the firm as a managing director in its M&A practice from HSBC Bank.

Deloitte has recruited Richard Kibble as partner in its financial services team from RBS. He will specialise in digital transformation projects for the firm's banking clients.



Johnston Carmichael corporate finance partner Mark Stewart has taken over as managing partner of the advisory firm's Edinburgh office from Andrew Shepherd, who will continue as chairman.

ThinCats has recruited Alison Whistance as origination manager for the South West from RBS, where she was the South West and Wales asset-based lending business development director.

PHOTOGRAPHY: CHRIS MCANDREW

THE CV

A media sector specialist, Mandy Merron joined Kingston Smith from Spicer & Oppenheim in 1991. She was promoted to partner at Kingston Smith in 1995. Her advice on deals includes fundraising and preparing businesses for sale. She has served on the board of the Direct Marketing Association for 10 years and is a director of the Telephone Preference Service.

Recent deals

- Sale in November 2016 of House PR to W, which was named mid-sized consultancy of 2015 by *PR Week*
- Management buy-out of Space & Time from Emerge Group in 2016
- Acquisition of Dare Digital by Oliver Marketing in 2015

CULTURAL EVOLUTION

Businesses in the media sector are talent-heavy. Kingston Smith corporate finance partner **Mandy Merron** says that's why getting a 'culture fit' is key

WHAT WAS THE DEAL?
The sale of MJ Media. Its founder Martin Jones engaged us to act as corporate finance adviser and find a buyer for the business.

MJ Media is a specialist youth, entertainment and technology media buyer, with a turnover of about £16m. In September 2017, we completed its sale to the creative agency Once Upon A Time.

HOW WERE YOU INTRODUCED TO MJ MEDIA?
A number of years ago, Martin Jones handed over day-to-day management of the business to a team headed up by managing director, Matt Fuller. Our tax team helped them introduce a share option scheme to incentivise management.

This was always with a view to selling the business in the future. My tax colleagues introduced me to Matt and the team on that basis. Then, in the summer of 2016, we won a beauty parade of advisers to sell the business.

WHO WERE THE ADVISERS?
As well as being corporate finance advisers, we advised on the tax aspects of the deal, and carried out some vendor due diligence. Management took legal advice from Lewis Silkin, while Once Upon A Time used Osborne Clarke. Hirst carried out the financial due diligence for the acquirer.

WHAT WERE THE TIMESCALES?
We produced the technical, financial and legal information, and carried out research on potential acquirers ahead of our approaches. In October 2016, we went to market.

In February 2017, Once Upon A Time was selected as the preferred bidder, and we entered into heads of terms and exclusivity. Keeping momentum going through the summer of 2017 was a challenge because of holidays.

We kept talking to all parties, chased the latest iterations of the due diligence reports and the sale and purchase agreement, and drove the process, sometimes nudging and sometimes pushing it.

WHAT WERE THE CHALLENGES?
Finding an acquirer who would structure the upfront cash requirement and earn-out appropriately was important – 100% of the business was to be acquired up front, with all shareholders selling on equal terms.

Finding a way to articulate the particular characteristics of MJ Media was a challenge. Revenue for media paid up front means cash flows are not like a creative agency, which normally would have a working capital gap.

Finding a way to help buyers structure the transaction in a way that recognised those benefits was key.

AND A LESSON FOR MEDIA DEALS?
Once Upon A Time was offering real strategic benefits, and the response from MJ clients and staff was very positive, because it is such a good fit.

The media sector is made up of people businesses. For a deal to be successful, getting a culture fit is absolutely vital. Therefore it is important to research that thoroughly before approaching any potential buyers. ●

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