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GROWTH
OPPORTUNITIES
EXPERTISE
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Corporate Financier

ENERGY EVOLUTION

How M&A is changing the mix of oil, gas and renewables in global power production

November 2017 Issue 197

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Syndicated loans total for Q1, Q2 and Q3 2017 backing global M&A – the highest level in nearly a decade

DONG – AND THE LONG VIEW

What's in a name? At the end of October, Dong Energy changed its name to Ørsted. Perhaps one small step for Danish Oil & Natural Gas (Dong) and a giant leap for renewables.

Dong's – sorry, Ørsted's – chairman Thomas Thune Andersen explained that the company had undergone a "profound strategic transformation". Indeed it had. Its carbon emissions have been more than halved since 2006 as it shifted from oil and gas to renewable energy. And it plans to go further, cutting them by 96% by 2023.

In this month's cover story (pages 16-21), we look at how M&A is playing a leading role in the transformation of energy companies as they reposition themselves in response to a changing market and growing demand.

About 10% of global GDP is accounted for by energy production. In September, the US Energy Information Authority predicted a 48% increase in energy consumption globally by 2040. Demand per capita shot up between 1945 and 1970, but then it plateaued for three decades. Since 2000 it has been on the rise again – partly driven up by consumerism and China.

M&A is also on the rise as new entrants disrupt markets and incumbent giants reposition. Deals are being boosted by oil and gas prices that are predicted to be 'lower longer', plummeting prices for wind production that can now be 'subsidy free', and the continued dash for gas, largely in Russia, but also the Middle East.

The UK's first pilot offshore wind farm became operational off the coast of Northumberland 17 years ago. The Blyth scheme cost £4m and comprised just two 2MW turbines. Shell Renewables was part of the E.On-led consortium, so the relatively paltry investment saw Shell accused by environmental campaigners of a 'greenwash'.

Ørsted's shift to renewables certainly isn't just PR. In September, it was awarded the contract for the Hornsea Project Two wind farm in the North Sea. Producing 1.4GW – enough to power 1.3 million UK homes – it will be the biggest offshore wind farm in the world. That could be a game-changer, not a name-changer.

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NEWS & EVENTS

LORD CLEMENT-JONES BRINGS POLITICAL EXPERIENCE TO FACULTY BOARD

Lord Clement-Jones CBE has joined the Corporate Finance Faculty's board. A senior corporate partner at law firm DLA, as well as chairman of its China and Middle East desks, he is also a Liberal Democrat peer.

His particular interest is in cutting-edge digital technologies, and he co-chairs the all-party group on artificial intelligence. He is also LibDem spokesman on the digital economy, honorary president of Ambitious About Autism, a member of council at University College London and a trustee of the Barbican.

He was previously legal director at Kingfisher and Grand Met. As chairman of the Liberal party in the late 1980s, he oversaw the largest merger of two political parties in the late 20th century, of the Liberals and the Social Democrats.

On joining the faculty board, he said: "I am delighted to be joining. The faculty plays such a vital role in representing the corporate finance community and in contributing its crucial knowledge and expertise into the government's industrial strategy and public policy on the economy."

Over recent years the faculty has greatly expanded its profile and influence, and now has many of the City's leading law firms, such as Slaughter and May and Linklaters, on its corporate membership roster.

DLA is one of the largest global firms headquartered in London in terms of partners and the reach of its offices.

At the start of the year, Lord Clement-Jones stepped down as managing partner of the firm's London office, after six years in the role. He spent the previous 10 years as co-chairman of the firm's government affairs practice.

THE FACULTY, CFOs AND THE PATIENT CAPITAL REVIEW

The Corporate Finance Faculty and senior government officials organised the ICAEW/HM Treasury business roundtable in Whitehall on 18 September to discuss patient capital from the perspective of chief financial officers (CFOs) and finance directors (FDs). Andrew Jones MP, Exchequer secretary, and senior Treasury officials hosted the event, which was chaired by David Petrie, ICAEW's head of corporate finance.

10 experienced and knowledgeable founders and CFOs/FDs from a range of high-growth sectors across the UK, who have raised various forms of growth capital, took part at the faculty's invitation. They included directors from Ashwoods Lightfoot, Biorbyt, Bladon Jets, Brand Addition, Captify, Defenx, Geospatial Insight, Rolls-Royce, Random42 Scientific Communication, and Ultrahaptics.

ICAEW has published its formal response to the UK government's Patient Capital Review, Representation 102/17 (see tinyurl.com/CF-Rep102-17). The Corporate Finance Faculty has led the response.

The response has highlighted the fact that although Britain has a relatively sophisticated and diverse growth-finance market, boosting investment in genuinely innovative, capital intensive, high-growth companies in high-tech sectors and emerging industries will be needed (see 'High-tech capital call', page 25).

CORPORATE FINANCE FACULTY MEMBERSHIP RENEWAL 2018

Corporate Finance Faculty members can renew their membership for 2018 at icaew.com/cff to ensure that they continue to receive *Corporate Financier* 10 times a year, can utilise the faculty's extensive online resources, take part in its networking events and be represented to government and regulators by the 'voice of corporate finance'. Big upcoming themes for the faculty include major trends in international M&A, a 'debt for deals' programme, corporate finance in the age of artificial intelligence, and deal origination across the UK.

The faculty's membership is drawn from major professional services groups, specialist advisory firms, companies, banks, private equity, venture capital, law firms, brokers, consultants, policymakers and academic experts. More than 40% of the faculty's membership is from beyond ICAEW.

To find out more, contact owen.waite@icaew.com, visit icaew.com/cff or call +44 (0)20 7920 8689.

ALAMY

SAUDI ARABIAN PUBLIC-PRIVATE PARTNERSHIPS

More than 100 ICAEW members and other senior business representatives from major global and regional financial organisations met in Riyadh on 18 September for a roundtable about public-private partnership (PPP) prospects in Saudi Arabia. Organised by ICAEW's Middle East Office and the Saudi Organisation for Certified Public Accountants (SOCPA), the discussion focused on how the government and businesses could work together to address the challenges and successfully implement PPPs.

Panellists at the event, held at the Saudi Standards, Metrology and Quality Organization, included Shaun Johnson, general counsel in the PPP unit at ACWA Holding, Richard Paton, head of infrastructure advisory and PPP for the Middle East and South Asia at KPMG, Nabil Al-Mubarak, CEO of Saudi Credit Bureau, and Leroy Levy, projects and infrastructure partner at King and Spalding. Irfan Said, corporate finance and investment banking head at Samba Capital, moderated the discussion. ICAEW president Nick Parker and Dr Ahmad Almeghames, secretary general of SOCPA, introduced the event.

Michael Armstrong, ICAEW regional director for the Middle East, Africa and South Asia, said: "Adopting a PPP model for future infrastructure spending would mean the Saudi government can save valuable public finances during the current challenging period. It brings the public sector a number of benefits including the transfer of expertise, innovation and efficiency from the private sector. It also transfers many risks typically borne solely by the public sector, to the private sector.

"Saudi Arabia must establish a strong legal and regulatory framework to support the PPP model in order to ensure its success. Although the framework for large-scale PPP projects in the kingdom is yet to be developed, a well-structured national PPP strategy will represent a significant and positive change."

FACULTY OUT AND ABOUT

ICAEW's head of corporate finance David Petrie (left) was a panellist on 28 September at the British Business Bank's (BBB's) head office, when it announced the findings of its latest research about the diversity of small business funding in the UK. He spoke alongside Graham Olive, OakNorth deputy CEO, Matthew Davies, director of policy and communications at UK Finance, and Alice Hu-Wagner, BBB managing director for strategy, economics and business development.

The report states that while the BBB has increased diversity of funding for SMEs, there is still more to do, in particular to increase smaller businesses' awareness of the full range of available finance options, which remains relatively low.

"The problem now is actually less one of supply, it is more one of choice and cost," said Petrie. "There was a recent report by Market Invoice about the rise of fintech – SMEs are now making extensive use of financial software provided by banks to manage working capital."

Shaun Beaney (also pictured above) was a panellist at Central Saint Martins, London, for a discussion about innovative finance for the creative sector on 8 September. The event was part of the art school's MA in Arts and Cultural Enterprise, a course led by Charlotte Bonham-Carter.

He also spoke about ICAEW's publication *Creative industries – routes to finance* at Enterprise Europe Network's seminar at the Imperial College White City Incubator on 2 November, and about raising capital at the start-up essentials forum organised by Creative Entrepreneurs at the Design Museum in London on 6 November.

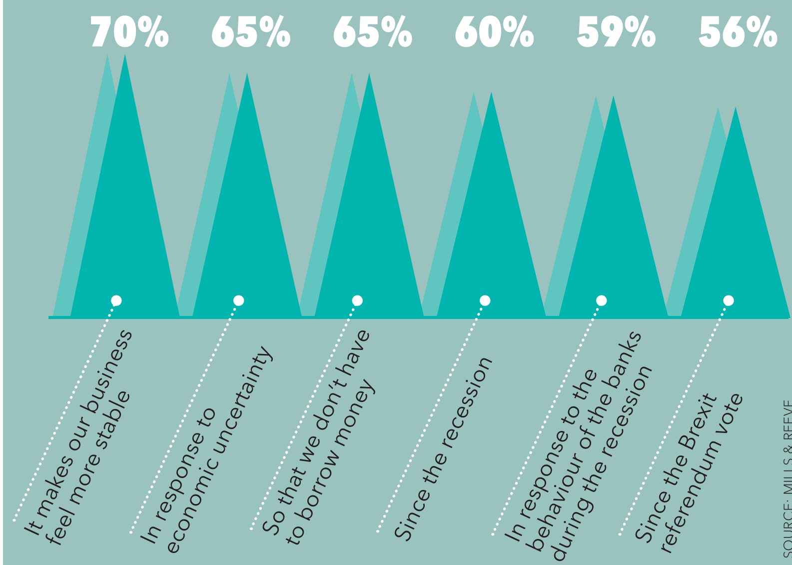
Beaney also represented the faculty at the Praxity UK conference in Coventry on 28 September.

You can keep up with the faculty's participation in initiatives and events by following @ICAEW_CORP_FIN on Twitter or by joining the ICAEW faculty's LinkedIn group.

IN NUMBERS

Why UK mid-market companies are hanging on to cash, Chinese outbound investment growth, plus the largest ever private equity fund

WHY ARE UK MID-MARKET COMPANIES HOLDING ON TO SO MUCH CASH?



SOURCE: MILLS & REEVE

$92bn Private equity-backed deals globally in Q3 2017 — **953** DEALS

$95bn Private equity funds closed globally in Q3 2017 — **181** FUNDS

$25bn Apollo Investment Fund IX closed in Q3 — LARGEST EVER FUND

SOURCE: PREQIN

$172bn

Value of syndicated loans backing global M&A in first nine months of 2017 – highest level since 2008

SOURCE: THOMSON REUTERS

2007-2016 | 2017 | 2018-2027

$880bn Outbound investment from China

$1.5trn Chinese outbound investment forecast

SOURCE: LINKLATERS

£795m Secondary fundraising by mining companies on AIM in 2016/17...

...UP 108% ON 2015/16, WHEN **£382m** WAS RAISED

£13.4m

Average amount of secondary fundraising by AIM-listed mining companies

FROM 58 FUNDRAISINGS

SOURCE: BDO

Q3 2017

£2.9bn

raised on the UK Main Market and AIM by 30 IPOs

LONDON WAS THE BIGGEST IPO MARKET ACROSS EMEA IN THE QUARTER

56% of the total proceeds from London IPOs in the first three quarters of 2017 were generated by 12 non-UK companies (out of 50 IPOs in total)

SOURCE: EY

LENDING CERTAINTY TO EVERY DEAL

JML

Global Consumer Products

INVOICE DISCOUNTING AND STOCK

£15,000,000

"Shawbrook Bank, like JML, has very ambitious growth plans, and the move is a good cultural fit. JML has a strategic plan to double the size of its business over the next three years. Shawbrook will be instrumental in helping us to achieve this. We are looking forward very much to working together and are confident that this will be an excellent partnership."

Ken Daly, CEO, JML

HALO FOODS LIMITED

Cereal Bars and Snacking Products

INVOICE DISCOUNTING, STOCK, PLANT & MACHINERY

£4,964,000

"There were two essential elements to this transaction. It was important to ensure that there was sufficient headroom to achieve our key objectives and there were strict timelines within which to execute the deal. Shawbrook stepped up to the mark and delivered on both counts."

Alexander de Haas, Investment Manager at Nimbus

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LANCASTER HOUSE, LONDON

CORPORATE FINANCE FACULTY ANNUAL RECEPTION 2017

More than 200 senior representatives of the faculty's 80 member firms and partner organisations attended the Corporate Finance Faculty's Annual Reception at Lancaster House in London on the evening of 12 October. The stunning setting was the backdrop for guest speaker Dr Ruth McKernan CBE, chief executive of Innovate UK, to give a fascinating speech about how the government, industry and academia are supporting the development of new technology businesses in the UK.

ICAEW's head of Corporate Finance David Petrie welcomed the faculty's guests to the hall in St James's, before faculty chairman Mark Pacitti introduced Dr McKernan.

She outlined all of the areas where Innovate UK is supporting businesses through finance and mentoring and helping replace other funding that will change with Brexit, a subject she did not dwell on, except to say: "We have to use every source of skills we have, because it will get very complex."

As is traditional, the speeches were followed by the opportunity for members to network.

Dr Ruth McKernan CBE, guest speaker

"We have to use every source of finance and skills we have, because the UK will get very complex. The best way to predict the future is to create it"

More than 200 guests attended the faculty's Annual Reception at Lancaster House

PHOTOGRAPHY: ERROLL JONES, PA IMAGES

CORPORATE DEVELOPMENT AWARD

Chris Hunt, head of M&A at Rentokil Initial Plc, received the 2017 Corporate Development award, on behalf of the FTSE 100 business services group. During 2016 it invested £107m in 41 acquisitions, which helped its profits increase 31% during the year. From the beginning of 2016 its share price has grown from 159p to the 305p it was on the day of the Annual Reception.

Hunt joined the business in 2012 from AstraZeneca, where he was director of M&A and business development. Hunt said that since he joined the company it had introduced a process that accelerated "deal delivery". Crucially it had also improved how it communicated its M&A strategy to investors and corporate finance advisers.

Rentokil has recently disposed of non-core businesses, and through acquisitions invested in more profitable pest control businesses in existing and new territories. In 2016 it made acquisitions in Australia, Austria, Brazil, Canada, Chile, China, Denmark, French Guiana, Germany, Guatemala, Honduras, Hong Kong, Malaysia, New Zealand, Republic of Ireland, Spain, Switzerland, the UK and the US. During 2017 it is on schedule to invest £150m in M&A, with a similarly focused approach.

David Petrie, ICAEW's head of corporate finance

"We know that businesses are facing uncertainty, but it is vital that dynamic businesses are continuing to drive forwards and grow"

L-r: David Petrie, Chris Hunt, Andrew Rutherford (of Shawbrook Bank) and Mark Pacitti

WORDS FROM THE CHAIRMAN OF THE FACULTY

Mark Pacitti, chairman of the Corporate Finance Faculty and global leader of corporate finance advisory at Deloitte, set out the two key themes for the evening – innovation and international investment:

"Innovation-led companies are not only crucial for the development of our economy – but they also represent the next generation of corporate finance opportunities for many of us in this room. In the past year, under David Petrie's leadership, our faculty has made significant representations to the UK government about its industrial strategy. Something called the Patient Capital Review may not sound very exciting. However, because it has the potential to boost investment in Britain's high-growth companies – all of which need expert corporate finance advisers – it is something the Corporate Finance Faculty has taken very seriously this year.

"The faculty continues to tackle the issues that face those of us involved in cross-border M&A deals, international capital markets, private equity deals and multi-billion-dollar infrastructure projects. For example, the faculty's magazine *Corporate Financier*, has recently highlighted both the risk of protectionism across the world to multinational business, as well as the big opportunities for inbound and outbound investment for ambitious acquirers."

Mark Pacitti, chairman of the Corporate Finance Faculty

DIPLOMA PRIZE WINNERS

Sarah McIlroy (far left), Dean of BPP Business School, and Mark Pacitti (far right) presented Charalampos Marinos (middle left) and Nick Hawkins (middle right) with prizes for the Diploma in Corporate Finance. Faris Maqdah, who also picked up the December 2016 prize jointly with Marinos, will be presented with his prize in Dubai in November. See pages 30-31 for a profile of all three winners.

Chris Hunt, head of M&A at Rentokil Initial Plc

"M&A is one of our core levers to drive profitable growth and at the heart of our strategy to increase our presence in higher growth markets and businesses"

L-r: Lord Clement-Jones CBE, Azhic Basirov of Smith & Williamson, Dr Ruth McKernan CBE and Lord Leigh of Hurley

VALUE OF *everything*

Michael Weaver, head of valuation advisory services for the UK, Ireland and the Middle East at Duff & Phelps, recounts setting up an advisory service line and explains why demand is still increasing

"Highly," laughs Michael Weaver, now the head of valuations advisory at Duff & Phelps for the UK and Middle East, when asked how he valued Gravitas - the valuation advisory business he co-founded after leaving PwC in 2003. Two years later, he had sold it to global valuations firm American Appraisal (see his CV, right).

It was not a traditional valuation, even for an expert with a vested interest. Being a partnership, partners were taking out cash that the business was generating but wasn't needed for reinvestment. The key thing for American Appraisal was to agree market salaries for Gravitas management, and then for both parties to settle on a price for the business. "American Appraisal was keen to get a stronger presence in London, and the Gravitas deal offered them just that," says Weaver. "They were valuations specialists, which matched our core skill. American Appraisal had some advisory in London, but not much. Effectively, in the UK it was a reverse takeover. It was a positive move for us. We could have carried on growing the business, but who knows? The deal gave us genuine global reach - despite American Appraisal's name it was a truly global business, but with a gap in London."

BUILT BIGGER

That deal was done in November 2005. Fast forward to February 2015, when American Appraisal was itself being acquired by Duff & Phelps. American Appraisal had spent the past few decades growing its global valuations business, while Duff & Phelps had focused on growing its other service lines - compliance and regulatory, transfer pricing, restructuring and M&A. Duff & Phelps had the capital for the acquisition after a group of investors led by Carlyle Group took the New York-listed advisory business private in April 2013. ▶

case study

MINER VALUATION

The valuations team worked very closely with the Duff & Phelps restructuring team on New World Resources (NWR), a Czech coal-mining business. It was listed on the London Stock Exchange until its subsidiary OKD filed for Czech insolvency in May 2016, at which point NWR's shares were suspended. NWR formally filed for liquidation in October at the request of international bondholders, who were also the primary shareholders.

Duff & Phelps' restructuring team worked closely with its mining industry practice to understand the value of OKD during a period of extreme coal price volatility. Due to an increase in global GDP growth, Chinese coal regulation and Australian flooding, the price of coking coal had increased from below \$100/t in 2016 to more than \$300/t in early 2017. This change increased interest in the company's supersenior credit facility, senior notes and convertible bonds when special situation funds saw the opportunity for a potential restructuring (as was previously done at NWR in 2014).

Duff & Phelps worked with the new special situation funds to understand the value of the group and to lobby in the Czech Republic to find a solution. Although an agreement was not reached, the situation remains ongoing as a value-enhancing solution is sought.

"For this business, a coal miner, the key variable from a valuation point of view is the assumptions around future coal prices," says Weaver. "We worked with our restructuring practice to help them understand how various coal price scenarios would affect value."

MICHAEL WEAVER CV

After graduating from St Andrew's University with a degree in mathematics, Weaver joined the audit team at Coopers & Lybrand (now part of PwC) in 1995. After qualifying as an ACA and being made manager he joined the growing valuations team: "I wasn't in love with auditing. In valuations, there's much more analysis, much more added value, and, crucially, clients really wanted to talk to you."

He advised on big international deals – one was acting for Unilever on the sale of DiverseyLever for $1.6bn to Johnson Wax. But in 2002, when Sarbanes-Oxley came in (restricting the work that auditors could do for their clients in other parts of their professional practices), Weaver and some colleagues saw a massive opportunity, as they expected the Big Four to hold on to valuations in the UK, but not in the US. That would mean they could definitely compete in some practice areas with less of a global reach.

In December 2003 he co-founded Gravitas. "We didn't pay ourselves for six months," says Weaver. "We learned so much over that time – setting up offices, signing leases, getting phones and licences – everything that was done for us at PwC. Doing valuations was actually the easy part, as I knew what I was doing. I knew that in six months, even if it failed I would have learned and developed so much that if I wanted I could go back to the Big Four. It was the most important thing I have ever done. I was being an entrepreneur."

In November 2005, Gravitas was sold to American Appraisal and Weaver became managing director, heading up the London office. In April 2014 he was made head of Europe, leading the practices in Russia, Germany, Netherlands, Hungary, Czech Republic, Kazakhstan and Ukraine, as well as the UK. And in February 2015, when Duff & Phelps acquired American Appraisal, Weaver was appointed managing director for the valuations business in Europe and the Middle East.

£1.6bn

Unilever's sale of DiverseyLever to Johnson Wax, which Weaver acted for on behalf of Unilever

case study

IT'S ONLY FAIR

In September 2017 the valuations team provided a fairness opinion on the share valuation in relation to Klöckner Pentaplast's combination with Birmingham-based Linpac Group. Strategic Value Partners owned both, and the transaction was required to support the relative shareholdings in the combined business.

The combined business had £4-5bn turnover. It was a huge combination of two global shrink-wrap businesses. It is suggested in the press that the business is being readied for an IPO.

"Once we provided an independent relative valuation of both companies, the deal was separately negotiated between the parties," says Weaver. "The principle basis was EBITDA multiples that were adjusted to reflect the relative growth profiles of the two businesses."

case study
OXFORD INSTRUMENTS

In April 2017 Duff & Phelps acted as financial adviser to Oxford Instruments (OI) on the divestment of its Industrial Analysis Business to Hitachi High-Technologies for £80m on a cash and debt-free basis. There was a pre-sale reorganisation prior to the carve-out of the business.

The valuation team assisted the M&A team in understanding the possible value of the business, making use of the global reach of their advisory services by linking in with their 400-strong team in Asia.

While valuation practices in China and Japan are well developed, the challenge, says Weaver, can be deliverability of a deal. "Often Asian acquirers looking to diversify into Europe are willing to pay more than local acquirers because they are getting an extra element of value from the deal. Our Asian team is vital in all our processes now. Not only do they help significantly in the identification of acquirers in their markets, but usually they know them already, and so they can direct the deal to exactly the right people and pitch it appropriately."

Paul Teuten, Duff & Phelps managing director and senior member of its global M&A advisory business, who advised OI on the sale, said: "The OI industrial analysis business was a global market leader with a strong brand. Hitachi High-Technologies (HHT) is also a leader in this niche and chose to pursue OI to strengthen its own business. HHT's value reflected its long-term vision and the strategic importance of the deal. The process did take longer than it may have with a non-Asian acquirer, but they remained consistent throughout."

"We [American Appraisal] knew what we had to do, but didn't have the firepower of Duff & Phelps," explains Weaver. "The rationale is that they would be able to sell their expanded service offering to our expanded network. In Asia it is principally the American Appraisal platform, in Europe it is 50/50, and elsewhere it's Duff & Phelps. In the valuations team here it's a partnership, where both sides brought different things to the table."

In 2005 Duff & Phelps acquired Standard & Poors' Corporate Value Consulting - which was PwC's legacy valuation business. In London Duff & Phelps now has 50 managing directors and 300 staff, 60 of whom work in valuations. Weaver says being able to offer M&A, restructuring, regulatory and transfer pricing advice to clients has been "a game-changer".

£80m

The value of Oxford Instruments' divestment of its Industrial Analysis Business to Hitachi High-Technologies

WHAT FOR?

Duff & Phelps' valuation advisory business combines finance and accounting expertise - Weaver is a chartered accountant, a member of ICAEW and a long-standing member of the Corporate Finance Faculty - with the latest valuation methodologies. On transaction engagements, the team offers 'fairness' opinions on sell-side and buy-side M&A, spin-offs or divestitures, take-privates or related-party transactions. They have also given 700 solvency opinions ($3trn in deal value) related to dividend recaps, debt refinancings, intercompany restructurings and spin-offs, and divestments.

"Turnarounds have been quiet. So what is Brexit going to do? If GDP drops and interest rates go up, there will be a lot more restructuring"

"Fairness opinions don't so much de-risk the deal itself as de-risk the people. Acquirers are competing for the deal based on price. But if you are on the board of directors and are paying a fairly high price, you need to consider the possible consequences. If the goodwill in a deal is quite quickly marked down people will start to question the deal. Getting fairness opinion assists the board in its decision-making and supports the board should a challenge arise."

On restructurings, valuations expertise is mostly brought in pre-deal. "Perhaps the value breaks in the senior debt, so there is no value for equity or mezzanine, and so the senior lender takes control of the business and sells it on. You may have to defend the bank's position against the mezzanine provider, who might be in dispute because they are getting nothing."

In terms of the current pipeline of work, Weaver suggest this type of engagement may increase: "Turnarounds have been quiet. So what is Brexit going to do? If GDP drops and interest rates go up, there will be a lot more restructuring."

The dispute and investigation work is typically for arbitration, fraud inquiries, global investigations and information and cybersecurity. Weaver says the business is naturally hedged because of its broad mix of services. Duff & Phelps has been recruiting since the American Appraisal acquisition, and Weaver sees the business continuing to recruit in order to grow: "The market has doubled in size and now independents have taken a strong position and, like us, they are looking to grow their practices. Clients today have more understanding of how the valuation profession looks at deals. That may help de-risk a transaction." ●

OILING THE WHEELS

OIL PRICES HAVE STABILISED. MORE DEALS HAVE BEEN DONE IN THE PAST 12 MONTHS THAN FOR A WHILE. MARC MULLEN EXPLORES WHETHER THESE FACTORS WILL CONTINUE TO FUEL M&A ACROSS THE WHOLE ENERGY SECTOR

In the six months between the summer of 2014 and January 2015, the price of a barrel of Brent Crude oil plummeted from about $115 to $46. It rallied to around $65 by mid-2015, but fell again below $29 in January 2016. M&A in the sector stalled. But that was only temporary. In October 2017 the oil price had crept up to $56 then again at the start of November to $62. Crucially for investors, the forward price curve suggests stability in the medium term.

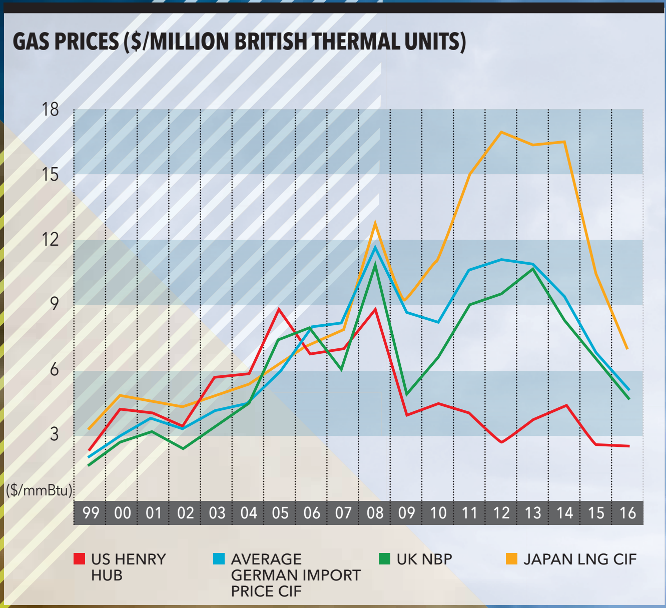
"It is important for the sector to have some confidence in oil prices, particularly when it comes to M&A," says Slaughter and May corporate partner Sally Wokes. "Even if the recent oil price increase doesn't continue, then the hope is that recent lows have set a base. Oil companies have gone through tough times, done what needed to be done to survive, and can now begin to concentrate again on strategy and planning for the future."

There is much going on in the North Sea: new investors are looking at the oil sector; the energy giants are reassessing their portfolios; and oil services businesses, having borne the brunt of the crash in oil prices, are assessing opportunities.

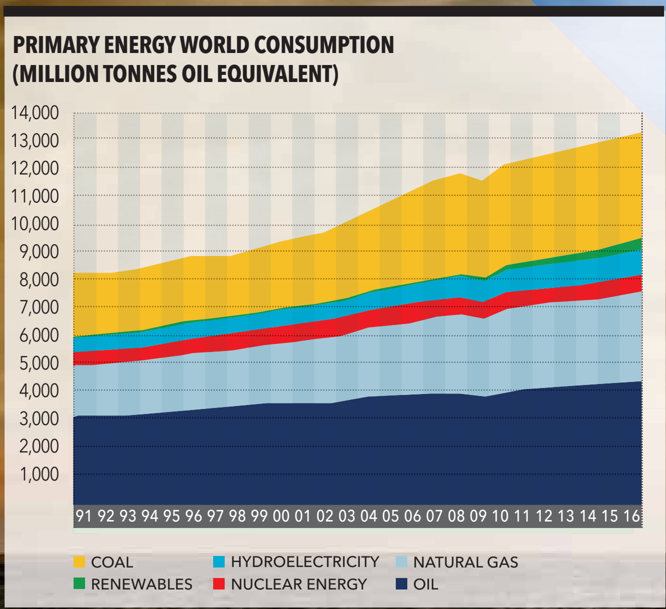
"It is hard to focus on M&A when businesses are wondering if they will survive," explains Jon Clark, partner and EY's head of oil and gas transaction advisory services for the EMEA. "The oil sector has largely come through that phase. Management is focusing on operational resilience and how it can operate and succeed in a $50-a-barrel world, rather than a $100-a-barrel world."

CHANGE IS AFOOT

Of course, oil is just one piece of the energy jigsaw. The dash for gas has not run out of steam - it is now focused on China. And renewables M&A is on the increase. All told, there is something of a perfect storm for investing in energy production and



GAS PRICES ($/MILLION BRITISH THERMAL UNITS)



PRIMARY ENERGY WORLD CONSUMPTION (MILLION TONNES OIL EQUIVALENT)

ABOVE SOURCES: BP

FRACK IS NOT A FOUR-LETTER WORD

Private equity has long been involved in energy and oil and gas in North America – as typified by energy sector specialists such as Warburg Pincus and Blue Water Energy, general firms with energy funds, such as Carlyle, and more traditional generalist funds, such as CVC and KKR investing on the infrastructure side.

“Historically, there has been a more diverse investor base in North America,” says EY’s Jon Clark. “Outside of North America they ask: ‘Why would we do that deal when we’ve got plenty to do in our back yard?’ The North American market has got hot for valuations, but outside North America valuations are still potentially depressed compared to historic levels, and now we have a number of willing sellers of fairly big portfolios.”

Mark Kerr (pictured, right) of LDC identifies one significant reason for the newfound stability in oil prices: “North American shale has fundamentally changed the landscape. As soon as oil price goes up, it is easy to turn on the supply of shale and push the price back down – far easier than off-shore.”

Politically contentious in the UK, hydraulic fracturing (or ‘fracking’) for shale oil is booming in the US. The Energy Information Administration estimates about 4.25 million barrels of shale oil were produced each day in 2016 – 48% of total crude produced in the US.

And it’s creating M&A too, as producers look to gain scale and reduce production costs. Wood Mackenzie estimates the breakeven cost for the Permian Basin, a Texan hotspot for shale, at $67. With long-term oil price lower than that, efficiencies must be found.

services businesses. According to Thomson Reuters, through to the end of September 2017 there were 863 deals globally in the oil and gas sector, valued at $223bn, (compared to $175bn from 917 deals in the first nine months of 2016). The last quarter of 2016 saw a whopping $180m of transactions. The year may not pan out higher than 2016, but the last 12 months' run rate has certainly increased.

In April, the $51.4bn merger of the US pipeline companies Energy Transfer Partners and Sunoco Logistics was completed. In July, General Electric and Baker Hughes completed their $17.1bn merger - the latest among international oilfield services businesses. In April 2016, Schlumberger paid $14.3bn for Cameron International. And closer to home Wood Group completed its $2.2bn takeover of Amec Foster Wheeler last month, after the latter sold its North Sea division to Australian engineering firm WorleyParsons.

"There has been consolidation in oil services at the top end," says Barry Fraser, Grant Thornton's corporate finance managing director in Aberdeen. "We will see more of that as competition look at who they can acquire. The strategy has been to expand product and service offerings, so they can compete for major projects. Stability in the oil price is most important - it brings together buyer and seller valuations. Volatile oil prices make it difficult to get deals done."

And for smaller deals in the sector, Mark Kerr, director of LDC in Scotland, which has invested around £200m in the sector over the past eight years, says: "We are a generalist investor, but have a long history of oil services. We are happy to invest in the sector, but we will be pretty selective. Just like everyone else, we will invest in the right opportunity."

INTERNATIONAL M&A

In the Middle East the two largest deals saw China National Petroleum Corporation paying $1.8bn and the China Energy Company $0.9bn for onshore concessions in Abu Dhabi. Pencilled in for next year is the flotation of Aramco. It is expected to value the Saudi Arabian oil company at $2trn, and raise $100bn.

In terms of UK-target deals, $12.2bn M&A deals (55 transactions) were announced during the first three quarters this year - a nine-fold increase on the same period last year. European-target M&A has doubled in the first three quarters to $55.5bn from 202 deals.

According to Office for Budget Responsibility statistics, UK North Sea oil and gas production was about 91 million tonnes for 2016/17 - around the same as 2015/16, which was 20% up on 2014/15. This mini-rally (185 million tonnes was produced in 1999/2000) does not mask the fact that economically extractable North Sea oil reserves are in decline.

A number of deals have seen the oil majors selling down positions in the North Sea, often to a new breed of investor (of sorts). In November 2016,

"Oil companies have gone through tough times"

Sally Wokes, corporate partner, Slaughter and May

"There will be a real focus on climate change"

Mark Andrews, UK head of oil and gas, KPMG

"It is hard to focus on M&A when businesses are wondering if they will survive"

Jon Clark, head of oil and gas transaction advisory services for EMEA, EY

GREEN GAUGE

In the first nine months of 2017 there has been $58bn of deals globally (from 494 deals), 63% up on the same period in 2016, according to Thomson Reuters. The geographic split is something of a different story to the oil and gas sectors. UK targeted deals have remained static at $2.3bn, but European target M&A has increased 35% to $19.5bn. And in North America, deals have more than trebled in the first nine months of 2017 to $28.2bn (in 91 deals), from $6.1bn from 98 deals.

Last month, Danish Oil and Natural Gas (known as Dong Energy) was set to change its name to Ørsted after Danish scientist Hans Christian Ørsted who discovered electromagnetism. According to the company, the move was to reflect its "profound strategic transformation from black to green energy". In 2016 Dong decided to dispose of its oil and gas business and move wholesale into offshore wind. In September, INEOS completed its $1.1bn purchase for Dong's oil and gas assets.

Hywel Davies (pictured) the corporate partner who heads up the energy practice at Slaughter and May, says there are many dynamics affecting renewables: "While there are signs of increased interest in oil and gas from private equity and new entrants, groups like RWE, Eon and Dong have moved the other way. Centrica has sold some of its conventional power assets, is putting its oil and gas assets into a joint venture and sold out of wind recently as it moves to a more customer-facing business. Total has announced some renewable deals, and reports are that other oil majors like BP and Shell are looking to make renewables a bigger part of their business mix."

In September, two contracts for offshore wind won UK government contracts after bidding for a guaranteed price of £57.50/MWh, around half the last price awarded for such contracts in 2015. Established infrastructure has cut the cost as has bigger and more efficient turbines. The Ørsted Burbo Bank extension scheme, just off the coast of Liverpool, has 195m-tall turbines that each generate 8MW.

"We are at an important juncture in the global industry" argues Oliver Holder, head of Deloitte's energy and resources financial advisory business in London. "With the increasing pace of development across energy technology, companies are focused on how to adapt and incorporate this into their business models."

Siccar Point Energy paid $1bn for OMV's North Sea oil assets. Siccar also has stakes in three of the largest new UK oilfields, with BP, Chevron and Statoil. Based in Aberdeen, and founded in 2014 and backed by US private equity giants Blue Water Energy and Blackstone, Siccar headhunted Jonathan Roger as chief executive officer (CEO) and Doug Fleming as finance director, from Centrica. Both worked for oil company Venture Production, which Centrica acquired in 2009.

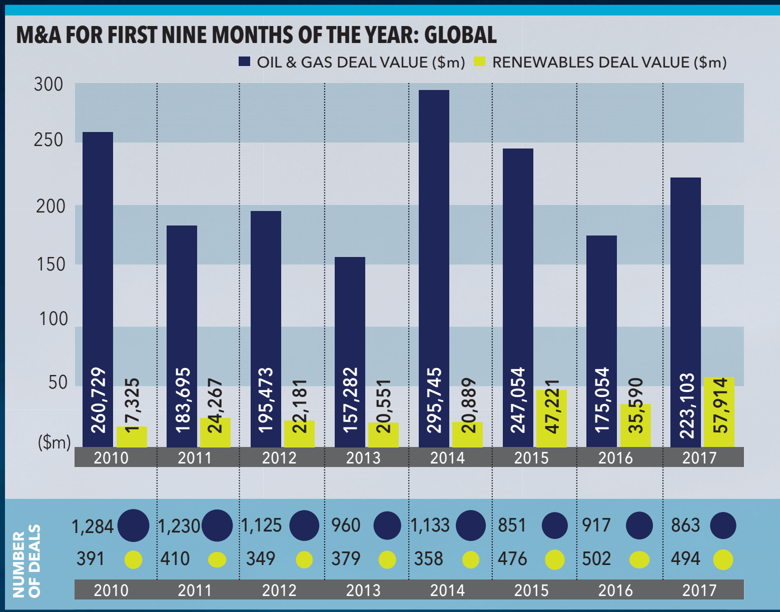
One-third owned by the Austrian state, OMV's strategy is to shift production capabilities to lower cost territories and gas. Its average cost of production was $16.60-a-barrel in 2014 - CEO Rainer Seele has set a $7-a-barrel target. Between 2015 and 2017 North Sea cost of production fell 42% to $17-a-barrel. In March OMV paid $1.9bn for a 25% stake in a Gazprom-operated gas field in Western Siberia, and announced it is joining Gazprom in development projects in Iran.

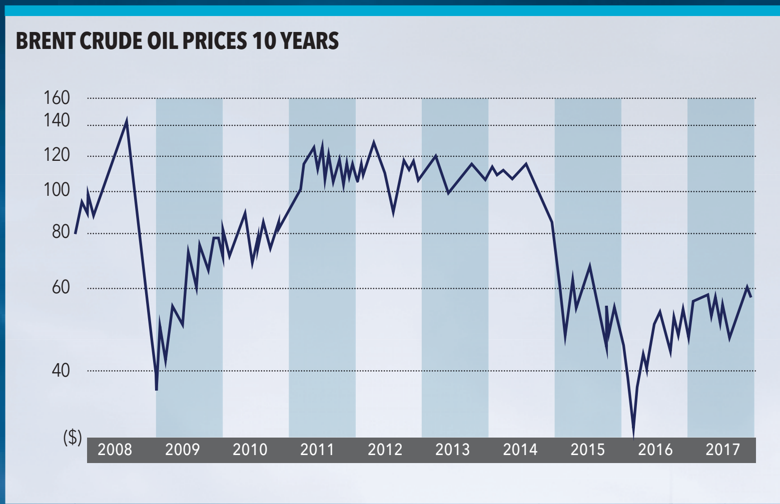
PRIVATE EQUITY PLAYERS

In January, Chrysaor - the EIG and Harbour Energy-backed platform - acquired around half of Shell's North Sea portfolio for a price that could reach $3.8bn (see *From pipeline to completion*, opposite). Private equity is clearly anticipating less competition from trade, prices are reasonable and some operational efficiencies can be brought to the assets. With a lower longer oil price almost universally forecast, private equity has visibility of earnings and cash flows, despite oil production hitting a low in 2014.

In May Neptune Oil & Gas - backed by Carlyle and CVC - announced a $3.9bn deal for French group Engie's exploration and production assets, including those in the North Sea. It is a pretty audacious deal for Neptune, which is headed up by former Centrica CEO Sam Laidlaw. The assets are in five continents, and the deal will involve China Investment Corporation, which has a 30% stake in Engie's oil & gas business, and is taking a 49% stake in Neptune.

Of course, oil is not used to any great extent in the production of electricity, and the UK's dash for gas may be nearing an end. Last year coal-fired power stations produced just 9% of the UK's electricity. By 2025, coal will be gone from the UK energy landscape. But globally gas remains on the rise, as there will be pressure to replace the use of coal in economies, such as China. "Renewables will compete much more with gas going forward," says Clark. "Natural gas has a role in shifting to a lower carbon future for generating electricity. There are regional variations on gas prices as well. If we have more gas, but demand doesn't change we have a downside price





ABOVE SOURCES: THOMSON REUTERS

FROM PIPELINE TO COMPLETION

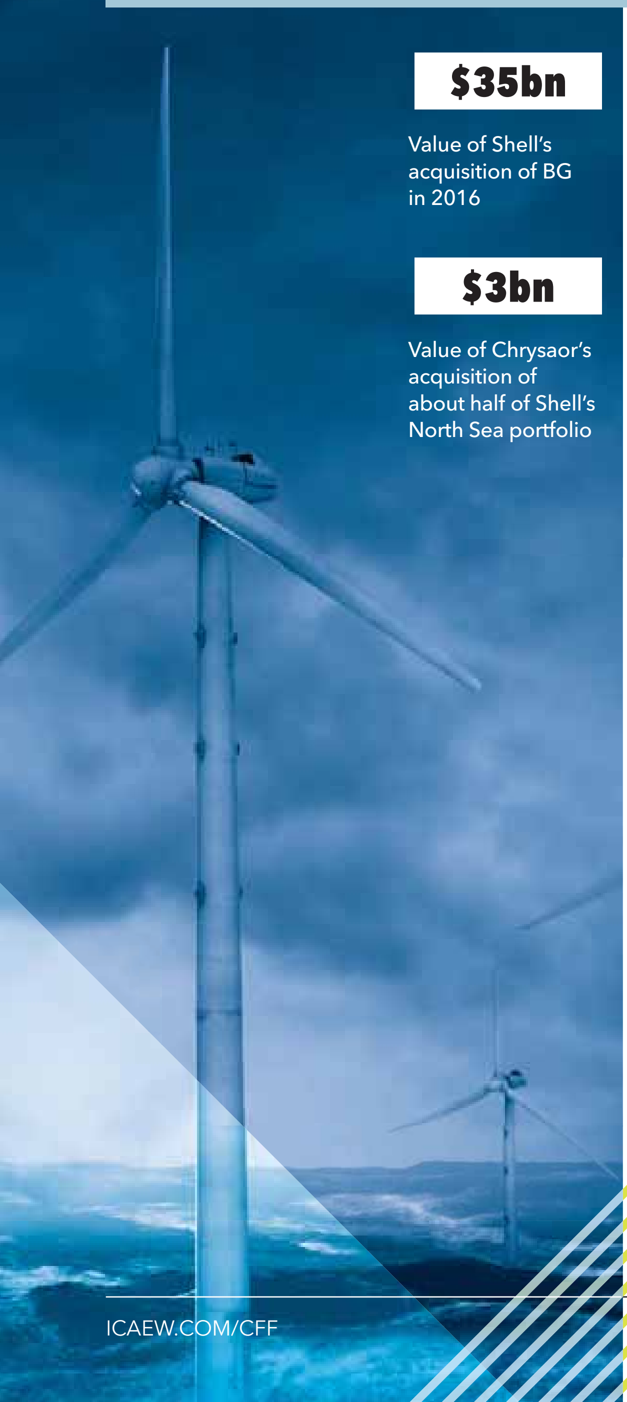
After Shell completed its $35bn acquisition of BG in 2016, the oil giant announced it would be making $30bn of disposals to pay down the debt it had taken on board, as it refocused on how its capital is deployed. At the start of this year, Chrysaor acquired about half of Shell's North Sea portfolio in a $3bn deal that could rise to $3.8bn.

"Private equity firms have gone out and put money and investment behind industry veterans to build oil companies," says Mark Andrews, UK head of oil and gas at KPMG. "They have a lot of money to put to work, and now there is more pragmatism on pricing, the deals are happening. In three to five years they may want to sell down those companies."

Linda Cook, Chrysaor's chairman, spent 29 years at Shell, which no doubt helped see the deal through. The CEO is Phil Kirk, an ICAEW member who co-founded the 3i-backed oil company CH4. To mitigate oil price risk, both parties agreed to a price ratchet – Chrysaor will pay an additional $600m if Brent crude goes above $60 a barrel in 2018/19 and above $70 in 2020/21, and Shell would repay consideration if it averages less than $52.50 a barrel, up to $100m. With successful exploration, Chrysaor will also pay up to a further $180m. Shell has also retained liability for up to $1bn of decommissioning costs too.

Cook outlined to the *FT*: "Just about every major oil company has been refocusing investment since the oil price drop and because of that basins like the North Sea are being neglected."

"We are seeing innovative deal structures," says Andrews. "The most common is around 'decom'. Oil companies are reasonably indifferent whether they sell or hold the liability as the decom cost can be estimated pretty accurately. Oil companies have looked at it, and decided the decom liability may be coming back to them, so they may be better off just holding onto it."



$35bn

Value of Shell's acquisition of BG in 2016

$3bn

Value of Chrysaor's acquisition of about half of Shell's North Sea portfolio

"You cannot afford to have a short-term memory in this industry"

Jon Hughes, corporate finance transaction services partner, Deloitte

"We are at an important juncture in the global industry"

Oliver Holder, head of Deloitte's London energy and resources financial advisory business

"Volatile oil prices make it difficult to get deals done"

Barry Fraser, corporate finance MD for Aberdeen, Grant Thornton

risk, but if demand increases there is an upside. Forecasting gas prices is more difficult and some majors have made a bigger bet on gas than others."

North America has the cheapest gas, Europe middle and Asia most expensive. Prices have been converging as all have been coming down over the past three years. When (or if) Gazprom's 3,000km pipeline across Siberia delivers its first gas to China in 2019, we will be seeing a game-changer.

"There is clearly a lot of thought being put into the new energy environment and oil company majors and others are looking at things and thinking where we want to be in 10, 15 or 20 years time," says Mark Andrews, UK head of oil and gas at KPMG. "Will we see some start to go to renewables? There will be a real focus on climate change. Gas will still be used for electricity long-term because it is still used a lot for electricity, oil for transport, and there will be a real focus on climate change. The majors will be wanting a much more balanced portfolio, and renewables will play a part in that."

M&A will clearly have an enormous role in the reshaping of energy company portfolios. Stable oil and gas prices are key to the majors making those decisions. Jon Hughes, corporate finance transaction services partner at Deloitte, who focuses on the oil and gas sector, says: "We have seen some big deals being done in this $50-$60 environment. Stress-tested valuations still need to be net present value positive in the $40-$50 range. Reduced volatility is at least supportive of buyers and sellers agreeing around a price.

"But you cannot afford to have a short-term memory in this industry. You haven't got to go back too far to see $140 and $20 – with that caveat there is some medium to longer term convergence in outlook right now, which is also reflected in the forward curve." ●

GETTY

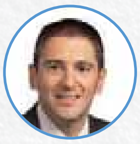
THE ART OF SQUEEZING OUT VALUE

With private equity price multiples and leverage multiples at dizzying heights where, asks Grant Murgatroyd, are the returns to come from?

Private equity investors make money in three ways: selling a company at a higher multiple than they bought it; using debt finance to boost the equity return; and improving financial performance. It is a formula that has delivered outstanding returns to limited partners (LPs) for decades (see box, opposite page). However, the big question today is: where will the value come from?

PE acquisition multiples are worryingly high. At 12.8x, average price-to-earnings multiples on UK PE acquisitions in the second quarter of 2017 were higher than multiples on the FTSE All-share, according to BDO's Private Company Price Index. If you're paying a higher multiple than a booming stock market, then your opportunities for multiple arbitrage would certainly be limited.

Leverage? There is no shortage of buy-out debt. Analysis of US leveraged buy-outs by PitchBook found average debt-to-Ebitda multiples of 6.2x in the first quarter of 2017, up from 5.4x in 2016, and higher than the 6x suggested as a maximum by the US Federal Reserve.



"You have to go in with a value hypothesis"

Robert Ohrenstein, global head of private equity, KPMG

BOOST BOTTOM LINE

"You have to go in with a value hypothesis," explains Robert Ohrenstein, global head of private equity at KPMG. "You have to be able to say I'm going to take this business and make it go from A to D, or E or G through a series of steps. It might be performance improvement around margins and supply chains, manufacturing processes, sales pricing, better segmentation of products, or anything else. There has to be a specific hypothesis and five or six levers. If you sit back and let the business go sideways or grow by its historical trend, your leverage and arbitrage are not going to make up the difference."

No one would disagree with Ohrenstein's prognosis. The question is how you deliver it. The largest private equity firms have money to invest in the required resources. KKR, for example, manages $80.2bn of private market funds. In the first quarter of 2017, management, monitoring and transaction fees totalled $464m. The firm has a 50-strong in-house consulting unit, KKR Capstone, and an advisory board of some of the world's most successful executives.

"The larger end of the market is more competitive, so there's been more of an imperative to be really focused on the value creation stuff," says Jim Strang, managing director of the European investment committee at Hamilton Lane. "That's filtered all the way down the market

and the thinking and capability go from tip to toe. Private equity has attracted brilliant people who can do brilliant things but are difficult to manage because they're brilliant. One of the challenges is how you capture that and build an organisation that gives you the best chance of the best outcome at a cost you can manage."

One way of managing cost is to outsource, and general partners (GPs) have long been heavy users of advisory services. The big professional services firms cut their corporate finance teeth on management buy-outs in the 1980s and 1990s and continue to devote substantial resources to it. "We look at private equity holistically, including portfolio companies," says Chris Hyams, partner and global private equity leader at Deloitte. "Our UK private equity business is pretty nicely spread across our tax, financial advisory and audit practices."

PE firms may be covering all bases, but that leaves them open to accusations that they are merely ticking boxes. "A large proportion of the private equity market has adopted a herd mentality when it comes to deal due diligence regardless of costs," argues Gary Partridge, who left PwC after 10 years to set up Lexington Corporate Finance. "What's sometimes lost is a fundamental appreciation of risk and where the real risks lie. If the industry doesn't get a grip on this, it doesn't bode well. Deal costs will continue to rise and smaller deals won't get done, which

"We look at private equity holistically"

Chris Hyams, partner and global private equity leader, Deloitte

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HOW MUCH IS TOO MUCH?

Advisers to private equity limited partners (LPs) have a simple message: commit to general partners (GPs) every year right through the economic and investment cycle. First, you need to access top-performing funds whenever they are in the market and, second, access to someone who can call where we are in the cycle.

But, if you were brave (or foolish) enough to time the market, would you be putting your funds in through 2018 and 2019? The simple answer is yes. LPs made money right through the global financial crisis. Median internal rate of returns (IRRs) have been in double digits every year since 2007 and even 2005 and 2006 generated positive, single digit, returns, according to Preqin. By contrast, the S&P 500 gained 5.5% in 2007, lost 37.0% in 2008 and recovered 26.5%.

IRRs for public pension funds (the only LPs that publish performance data) from private equity reported returns of 11.4% over the five years to December 2016, compared with 9.1% for listed equities, 11.3% for real estate and 5.2% for hedge funds.

LPs are continuing to invest in private markets, with the value climbing 7% in 2016 to $4.59trn, according to Preqin. Private equity remains the largest segment at $2.58trn, though real estate ($785bn), private debt ($605bn); natural resources ($501bn) and infrastructure ($388bn) are also growing.

Long-term performance data has always shown that the best time to invest in a private equity fund is on the way out of a recession, but during the global financial crisis GPs were able to hold onto companies, and deliver acceptable money multiples north of 1.5x, even if longer hold times held IRRs back. However, the consensus is that the next (or past) few years are unlikely to prove the best vintages.

SO SPECIAL

Keeping the customer happy is as important for a private equity fund as any other business. "Funds have been pushed very hard by limited partners (LPs) to define what they're going to be," says Chris Hyams, global private equity leader at Deloitte. "Generalist funds are coming under greater pressure, with many funds looking to do deals that very specifically tick the boxes for their LPs. People are looking at where they can find sustainable growth in this macro environment and trying to match that to the boxes that they've told their LPs they're going to invest in."

Mark Redman, global head of private equity at OMERS Private Markets, is one of the few general partners who is happy to call himself a generalist. "We don't choose to have a specific sector approach, but within our generalist approach we are focusing on specialist niche sub-sectors, for want of a better term. We're building an operations team and recently recruited Matt Baird from Alvarez & Marsal as partner in London, and we have a reasonably extensive operations team in North America."

Redman has just one investor, Canadian pension fund OMERS. The structure allows for a longer term approach, which Redman says is a strong selling point with management teams. If he had to raise money from other LPs, Redman says he would "nuance our strategy articulation to take account of the fact our North American business already operates on a sector basis and we would probably accelerate such an approach in Europe".

There are all sorts of metrics for calculating fees, though broadly speaking they are either time-based or scale-based. Few mechanisms exist to determine fees on subjective criteria

means good growth businesses will be starved of capital and the sector will continue the rush towards larger secondary and tertiary buy-outs."

The Big Four have long been organised along sector lines, but more recently have focused on the cross-border element of deals.

"Internationalisation is not just when we're selling businesses, it's over the course of their ownership, helping businesses with international M&A," says Richard Parsons, partner and head of private equity in Deloitte's UK corporate finance advisory team. "There is multiple arbitrage to be gained from buying a business that's UK centric, and then selling a business which is international, particularly if it's able to access the North American market."

A big development in the private equity space has been the emergence of new pools of money.

"There are all sorts of pockets of money, families, high-net-worth individuals, funds in large corporates, sovereign wealth, pension funds and so on," says Ohrenstein. "We're recruiting hard because we know that the private investment market is expanding.

"We've got a very large dedicated private equity group looking at these private direct investors and even we struggle to cover all of the new sources of capital. We recognise that and we try to review market developments and do our best to cover the breadth and depth of the mid-to-upper end."

"The really good private equity firms don't do deals anymore"

Jim Strang, managing director investment committee Europe, Hamilton Lane

PRICE OF INSIGHT

Insight is valuable. Information and analysis today perhaps less so. "If advisers can really bring insight to a deal, then that's definitely going to be valued." says Strang. "However, the really good private equity firms don't do deals anymore. They look for really interesting businesses and they hope that some of them will turn into deals. They'll build relationships, knowledge and insight way in advance. This changes the role of the adviser, because the firm's going to know the angles, the assets, the industry and the management team. If you're thinking about where the value is going to be in the future, you need to identify where the insight is going to come from in a world where more people are more informed and more connected."

There are all sorts of metrics for calculating fees, though broadly speaking they are either time-based or scale-based. Few mechanisms exist to determine fees on subjective criteria.

"The private equity industry has fallen into a reward arrangement linked to the size of the transaction, which is a very crude measure of value added," argues Partridge. "I have seen discretionary payment of a 'satisfaction fee', but that is certainly not the norm.

"Perhaps we should be seeing more of these types of payment clauses to reward premium corporate finance advice?" ●

SHAUN BEANEY

HIGH-TECH CAPITAL CALL

ICAEW has published its formal response to the Patient Capital Review – the latest government initiative to boost SME finance

Whatever you think about the political state of the UK (and, yes, the 'B' word), and whether you think the government should be doing more (and better) or less (but better), there's no doubt that Westminster and Whitehall have pushed out plenty of reports about business and investment in 2017.

In January the government published the 132-page *Building our Industrial Strategy* (see 'Investors in industry', *Corporate Financier*, May 2017). Since then, we've also seen a Scale-Up Taskforce, an Entrepreneurship Review (now quietly shelved), and many discussions across British commerce about 'sector deals'.

All this activity is even reaching parts it wouldn't have traditionally reached under a Conservative government. When Sir Peter Bazalgette called for £500m state support for creative clusters on 22 September, he was flanked by not one, but two government ministers – on a day that prime minister Theresa May was making another set-piece speech (the 'B' word again), this time in Florence.

In this mix, something called the Patient Capital Review (PCR) may sound about as exciting as sensible shoes. But because it has the potential to boost investment in advanced technology high-growth companies – which need expert advisers – it's something the Corporate Finance Faculty has taken very seriously.

WITH A PURPOSE

The aim of the PCR was to find ways to stimulate public and private investment in the UK's high-growth (or scale-up) companies.

In August, HM Treasury published a 72-page consultation paper, *Financing growth in innovative firms*. The paper included questions and background information about many aspects of patient capital, about a potential new National Investment Fund (possibly managed by the British Business Bank), and about the effectiveness of current tax incentives such as the Enterprise Investment Scheme (EIS) and research and development (R&D) tax credits.

As part of its response, the faculty organised an ICAEW/HM Treasury business roundtable in Whitehall on 18 September, to which we invited 10 experienced and knowledgeable business founders and CFOs/FDs from a range of high-growth sectors across the UK, all of whom have raised various forms of growth capital. Andrew Jones MP, Exchequer secretary, and senior HM Treasury officials hosted the roundtable, which was chaired by David Petrie, ICAEW's head of corporate finance.

Many businesses, advisers and investors have contributed their time and expertise to our formal written response to the consultation. In summary, we've suggested:

- The UK has a sophisticated and diverse quoted companies market, one of the biggest private equity sectors, many sources of growth finance (such as the British Business Bank and venture capital trusts), and expert corporate finance advice is widely available for high-growth companies.
- There is evidence of a specific need (and demand) to boost investment in genuinely innovative, capital-intensive, high-growth companies, in particular high-technology sectors and emerging industries where the capital requirement may stretch well beyond three and five years.
- These sectors include several that are likely to emerge from the new industrial strategy where, for example, the initial commercialisation of R&D (including corporate and university spin-outs) may have been supported by the Industrial Strategy Challenge Fund.
- These 'fourth industrial revolution' industries – such as AI, robotics, materials sciences, alternative energy, advanced engineering, augmented reality/virtual reality and life sciences – should be the focus of the new National Investment Fund, whichever fund structure is chosen.
- The new fund should provide incremental capital, not displace or supplement existing institutional investment by private equity or quoted funds – but there is also a pressing need to selectively replace some investment by the European Investment Fund.
- Incentives such as EIS and R&D tax credits play a vital role in encouraging investment in high-growth companies.

ICAEW published its formal response to the UK government's Patient Capital Review as Representation 102/17 at tinyurl.com/CF-FinGrowth ●

Shaun Beaney works on the Corporate Finance Faculty's communications, public policy and advisory projects, specialising in access to finance, high-growth companies and venture capital

LEGAL HEAD START

In the latest in our series on de-risking deals, **Andrew Rosling** of Addleshaw Goddard explains how addressing legal issues early can help companies and corporate finance advisers to mitigate risks

GOOD HOUSEKEEPING

The more confidence a buyer has in a target business and how it is run, the more attractive a prospect it will be, creating more value, and more certainty around completion. Ill-prepared sellers will hit problems in the process that could go to the value of the sale, or jeopardise completion. A seller should stand in the buyer's shoes, anticipate the process and find solutions to problems, taking control of the deal.

From a legal perspective some of the questions a business should address, prior to embarking on the sale process, would include the following points:

- Are key customer and supplier contracts in place and in writing? Are any contracts about to terminate or difficult to terminate? Will the transaction create termination rights or other business risks?
- Can the business being sold be run as a separate entity? Does it depend on wider group services and synergies, particularly IT platforms? If so, without these benefits, how do you separate it without continuity risks and how do you show the 'true' picture of its standalone performance?
- Does the business have all the licences and regulatory permits it needs? Are they compliant? (See later in the article).
- Are key assets, (including IP rights), owned by the correct company with up-to-date registrations?
- How does the business acquire, use and store data in respect of suppliers, customers and employees?
- How old are properties and do the business activities pose a high risk of contamination?
- Has there been any recent transactional activity – acquisitions, disposals,

reorganisations or joint ventures?

- Are there any surviving terms or potential impact from the proposed transaction?
- Are there large numbers of self-employed people? Do employees participate in a defined benefit pension scheme?

Whether the answers to the questions lead to a transaction being completed or create a value risk depends very much on the nature of the issue. Uncertainty about a critical customer contract might go to value, but could end up being an execution risk if a buyer will not complete unless the uncertainty is removed.

One example of a problem is defined benefit pension schemes, which often carry a deficit and have related challenges around future liabilities. But solutions can be planned in advance and explained effectively to prospective buyers – for example proactive planning with the pension trustees and preparation of a performance bond can help the buyer to understand and navigate the risks.

DEFINING EMPLOYMENT STATUS

Another current risk for some businesses, as evidenced by Uber and Deliveroo, is the employment status of individuals identified as self-employed consultants or contractors. The correct classification of these individuals will have consequences, including potentially conferring employment rights on the individuals and imposing PAYE and national insurance contribution obligations on the target business. Therefore, sellers should focus on employment status at an early stage.

Remember that most warranty claims centre on the warranties given about the target's financial information and

MIND THE GAP

Whether Brexit-driven or otherwise, general market uncertainty will currently be a major factor in your M&A deal, especially when a gap between signing and completion is needed – for instance to obtain shareholder or regulatory approvals. In managing that gap, the following matters require consideration:

First, how might currency volatility impact on the 'value' of the price being paid or the financial performance of the target? Hedging might be an available option.

Second, who bears the risk of adverse change during the gap and should the change result in a price change or warranty claim, or can the buyer walk away if it is sufficiently material?

Finally, what controls should the buyer have over the target in the gap, without the risk of becoming a shadow director of the target and infringing competition rules?

One common example of a problem is defined benefit pension schemes, which often carry a deficit

performance. So sellers might consider a pre-signing specialist stress test of the warranted financial information.

OTHER SIDE OF THE TABLE

The identity of the counterparty can give rise to specific risks and is being scrutinised harder (not least since the BHS debacle). Of course, covenant strength (will the buyer have the money at completion, or the seller be able to pay any warranty claims?) is one concern. But there are others that should be assessed at an early stage.

- Do they have a particular transactional reputation (price-chips, aborted deals, warranty claims)?
- Do they bring any reputational or credibility risks? Sellers are increasingly placing material disclosure obligations on bidders in an auction process to enable them to evaluate this risk.
- Do any specific execution risks apply to the counterparty? They may need shareholder approval (under Listing Rules or otherwise), competition clearance, or funding for the deal.
- Where founders are selling the business, is the goodwill of the business inextricably tied to them? Are there personal guarantees that need replacing, business assets still in the founders' names or consultancy or other arrangements with family members? Will an entrepreneurially grown business fit in your corporate culture?

360-DEGREE VIEW

Perhaps the most important aspect of a buyer's de-risking of an acquisition is to build a 'nose-to-tail' process, to translate due diligence and deal negotiation into efficient or successful integration, to deliver the business plan goals.

Corporate Financier's de-risking deals series has so far covered: warranty and indemnity insurance - June; political due diligence - July/August; investigative due diligence - September; environmental due diligence - October.

- The deal team must have a clear strategic view, with buy-in from all stakeholders that will have to make the acquisition work.
- The process must drive efficiency, allowing the team to concentrate on the key issues, and understand any important nuances and details in the enormous volume of information that will inevitably be created – simple but effective IT platforms can assist here.
- The deal and integration teams need to be joined up – it is surprisingly common for there to be some dysfunction, losing corporate memory, creating duplication of diligence and planning.
- Simple organisational and logistical challenges may need to be overcome in creating such a process (especially if M&A is not a regular business activity) – where do your team work? Who does their day job? How is confidentiality maintained?
- Cultural integration (sympathetic to the changes faced by the target and its people) is often as critical as the pure legal, financial and operational mechanics of absorbing the business.

REGULATORY TRAPS

Regulatory compliance is an ever-increasing burden, not just for financial services or other heavily regulated sectors. Consumer businesses might not think of themselves as needing financial regulation but frequently they will provide some financial service to customers (or employees) and will need FCA authorisation. If not obtained already, there might be a risk of fines and authorisation will be needed before completion, creating execution risk, timetable delay and giving the buyer leverage to require indemnities.

Similarly, competition clearance should not only be thought about where there is an obvious overlap in the activities of buyer and target. While the UK has a voluntary regime, the EU and other jurisdictions operate a mandatory regime, requiring pre-completion clearance, triggered by turnover or market share thresholds, which can be surprisingly low.

MORE PROTECTIONS

Warranties and indemnities (W&I) are traditional contractual protections for a buyer, as a backstop to due diligence (see 'Rising to it all' by Lorraine Lloyd-Thomas of Marsh, *Corporate Financier,* June 2017). Sellers, and especially private equity vendors, increasingly offer only minimal contractual assurance, and buyers do need to think differently around this critical area of risk management. Other options to think about include:

- W&I insurance is an increasingly common solution, in particular for private equity-driven deals (PE to PE deals are virtually certain to be backed by insurance). Corporates are less frequent users, but this is changing and of course managing risk through insurance aligns with how corporates manage many other business risks. It may be (or feel) easier to make an insurance claim than to sue for breach of contract? W&I insurance is not a panacea however. Insurance claims are not straightforward, and W&I insurance is still a 'young' product with an emerging picture around payouts. Cover is also likely to be hard to come by for some risks, such as pensions or environmental liabilities, regulatory compliance or some areas of tax.
- Where there is structural uncertainty around future revenue or costs, say an upcoming tender with a key customer, the outcome of a supplier dispute or regulatory reform, there are various holdback approaches. Deferred consideration, earn-outs or retentions might allow a deal to complete, with clear parameters around future value swings – but beware the likely contractual complexity and potential negotiation challenges and delays.
- Where a particular risk is inherent in a target's business, such as product liability, it may well have insurance policies in place that can form part of the overall deal risk mitigation strategy.
- Generally, rigorous due diligence that is effectively focused on the buyer's strategic priorities and quantifies both risk and impact remains the best way to manage risk in a deal. ●

Sellers, and especially private equity vendors, increasingly offer only minimal contractual assurance

Andrew Rosling,
M&A partner, and head of retail & consumer sector group and Africa business group, Addleshaw Goddard


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TOP STUDENTS

This year three students were awarded prizes for their performance in ICAEW's Diploma in Corporate Finance. **Charalampos Marinos** and **Faris Maqdah** were joint high-scoring students in the December 2016 sitting, while **Nick Hawkins** posted the highest mark in June 2017. They spoke to Marc Mullen about the qualification and their work

FARIS MAQDAH

FARIS MAQDAH

WHAT'S YOUR CURRENT ROLE?

I work at Atkins Acuity in Dubai as a senior consultant in the financial and business advisory group. I joined Atkins, which is an engineering advisory group, in June. Our team is part of the urban cities and infrastructure team. I work on financial modelling and feasibility studies to get debt and equity into the real estate deals.

Previously I worked at EY in the real estate transactions group in Oman and Jordan on valuations, due diligence, feasibility studies and market studies focusing on the GCC and MENA regions.

HOW USEFUL WAS THE LEARNING IN YOUR DAY-TO-DAY WORK?

The diploma was very relevant, especially when I was back at EY. My work experience was extremely complementary to the study. I found the course a very practical experience. It definitely wasn't a case of reading the book and getting tested on what you've read. It was far more about experience and your own judgement. That was the main factor that helped me with the qualification.

HOW PRACTICAL WAS LEARNING?

When working on specific engagements, what I learned was very applicable. The exam itself is very practical, as you do the exam on actual companies, which makes a huge difference.

It goes two ways - someone who actually has experience can apply that, and equally you can take what you learn from the course and apply that. It bridges the gap between technical knowledge and practical experience much more quickly.

WAS THE COURSE TECHNICALLY DEMANDING?

Yes, particularly in areas I hadn't touched a lot, like leveraged buy-outs. Maybe it could be even more technically challenging, but overall I found it perfectly in line with my expectations.

HOW MUCH TIME WAS REQUIRED?

It took about two months for the first and second levels, and that was about balancing work and study.

I worked weekends and then whenever I could leave early I'd take the chance to study. Our job is not 9-5 - sometimes you have to work late and then still find the time to focus on studying.

WOULD YOU RECOMMEND THE DIPLOMA?

Absolutely - another member of my team took it and passed too. Hopefully more of my colleagues will.

CHARALAMPOS MARINOS

WHAT'S YOUR CURRENT ROLE?

I work for Eurobank Ergasias in Athens, one of the four systemic banks in Greece, with an international presence in central and south-eastern Europe. I qualified as an ACA in 2014 and joined the subsidiaries support and restructuring unit within the group finance department.

I deal with business transactions of a strategic nature, supporting subsidiaries, CFOs in finance, accounting and regulation-related issues, and monitoring group investment exposures and special purpose vehicles.

I'm involved in a wide range of transactions, both in the local and international markets, providing transactional and advisory work in divestments, corporate restructuring, loan portfolio transactions, buy-sell side of M&As and debt to equity swaps.

HOW USEFUL WAS THE LEARNING IN YOUR DAY-TO-DAY WORK?

The course had a very good, in-depth technical framework, which was applicable to everyday issues. It equipped me with useful knowledge and allowed me to enhance my soft skills. I also feel that it improved my ability to assess various aspects of finance projects, and provided a clear path for me as to how things should be done and why.

CHARALAMPOS MARINOS

NICK HAWKINS

HOW PRACTICAL WAS THE LEARNING?

The syllabus and exam process are structured so as to provide a clear link between theory and practice. Moreover, the diploma is transaction-oriented, so from day one the learning is applicable and transferable to the working environment. It's not just a typical exam, but a valuable learning process.

WAS THE COURSE TECHNICALLY DEMANDING?

It was quite demanding, as it technically focuses and drills down on aspects such as valuation methods, restructuring and business recovery models, and how these are applied in practice.

HOW MUCH TIME WAS REQUIRED?

Ideally 200-300 hours are needed for each module. But looking back at my exam preparation, the amount of time spent - even if it's useful as a benchmark - doesn't guarantee success. Key elements, starting with employer's support, were planning, sticking to a study plan and practicing until you feel confident and comfortable across the whole syllabus. Balancing work and study commitments is crucial in order to keep disruptions to a minimum.

WOULD YOU RECOMMEND IT?

I highly recommend it. As expected for such a highly regarded qualification, the exams were quite challenging, but this shouldn't put you off. Instead, think of it as motivation, knowing that in the long run the diploma is highly rewarding and can boost your career potential. Adding value to yourself and your organisation is what really matters.

NICK HAWKINS

WHAT'S YOUR CURRENT ROLE?

I work in the growth finance team at Grant Thornton, within G by Grant Thornton - our newer offer to early-stage, smaller, fast-growing businesses - often in technology, but also across all sectors. I focus on angel investing and venture capital rounds. It's growth capital rather than pure M&A.

I've been with Grant Thornton for six years now. I trained as an ACA in audit for three years, and moved into the growth finance team three years ago. My experience is primarily equity and debt fundraising for expansion capital.

HOW USEFUL WAS THE LEARNING IN YOUR DAY-TO-DAY WORK?

As I'm in a niche area, it was very useful to get an overview of everything else to do with corporate finance: carrying out M&A, doing an IPO or selling up to trade or private equity. It's really helped me in advising clients on how to be prepared for those next stages. A lot of the work on the more disciplined rules around valuations for later stage companies was very useful too, as it's very difficult to value early-stage business.

The case study was about general management, strengths, weaknesses, opportunities and threats and a bit of strategic thinking. I can consider applying that to companies we're working with, so that was particularly practical.

WAS THE COURSE TECHNICALLY DEMANDING?

Being a qualified ACA meant I had studied a few aspects of the diploma before. Certain areas of regulation - such as the listing rules and the the City Code, as well as the valuation techniques that I don't see day to day - were a steep learning curve.

HOW TOUGH DID YOU FIND THE EXAMS?

The case study was especially tough. Often exams fit a pattern, but the diploma exam had a different structure. Trying to absorb all the information in the case study was hard - we had 180 pages of text to get through, to work out what was important and what was not and allocate our work across four hours, which required a lot of concentration.

WOULD YOU RECOMMEND THE DIPLOMA?

It was really good to codify what you know, and it gave me a wider view of what corporate finance is, which was really beneficial in my day job. ●

APPOINTMENTS

CATALYST JOINS ALANTRA AS PART OF £30M DEAL

Catalyst Corporate Finance has teamed up with Alantra in a £30m deal that will see Catalyst rebranded as Alantra UK. Following the deal, 15 Catalyst partners and directors will take a shareholding in the Spanish-listed investment bank, with further equity set aside for future incentivisation.

Alantra chairman Santiago Eguidazu said: "The UK is the most important M&A market in Europe and, as such, for a number of years we have had the strategic target to strengthen our M&A and debt presence in the country."

The deal is still subject to Financial Conduct Authority and shareholder approval.

Alantra has 400 staff in 21 countries across Europe, the US, Asia and Latin America, and has advised on 650 transactions in the past five years. There is increased international consolidation among mid-market advisers.

Founded in 1998, Catalyst has 70 professionals advising on mid-market M&A and debt advisory services, based in three UK offices – London, Birmingham and Nottingham.

RSM RECRUITS AND PROMOTIONS

Martin Athey (1) has been promoted to director and head of financial due diligence in Yorkshire and the North East in RSM's corporate finance team.

James Atkinson (2) and Umito Choji (3) have both been promoted to manager in the advisory team in Yorkshire and the North East.

Mark Leyland (4) has joined the due diligence team from NewDay, and Matt Reed (5) has joined from the audit practice, while Mikey Goodwin (6) and Rich Winter (7) have joined as trainees – all in RSM's Yorkshire team.

Chris Hardy (8) has joined RSM as partner in London in its its restructuring advisory practice.

NEW HEAD OF CF IN SCOTLAND AT BDO

Rory McPherson (1) has joined BDO to head up its corporate finance practice in Scotland, from Royal Bank of Scotland, where he spent the past five years in structured finance.

Specialising in M&A, he has more than 15 years' experience advising entrepreneurs and private equity-backed businesses.

McPherson joins newly promoted transaction services partner Craig Martin (2) to co-lead BDO's practice in Scotland.

Paul Eagland, BDO managing partner, said: "Rory brings a wealth of experience in advising high-growth, entrepreneurial and private equity-backed companies, and add further weight to our offering in this area."

PE SHORTS

Healthcare sector-focused private equity firm **Apposite Capital** has recruited Rory Pope (1), the Business Growth Fund's former co-head of healthcare and life sciences. Alexander Cunynghame (2) has joined as investment executive.

Inflexion Private Equity has recruited Simon Tilley (1) as partner in its partnership capital team and Ben Long (2) as investment director in its enterprise fund team. Tilley joined from DC Advisory, where he was head of European financial sponsors. Long has joined from Duke Street. James Wigglesworth (3) has joined the firm's Manchester office as assistant director from Rothschild's M&A advisory team. Saloshnee Nightingale (4) has joined from Gleacher Shacklock as investment executive.

YFM Equity Partners has recruited Steve Harrison as portfolio director in Leeds, from Santander Corporate Bank, where he was a director in its growth capital team for five years. Prior to that, he worked with Endless Private Equity and in corporate finance at Andersen and EY.

Palatine Private Equity has recruited Tom Ross-Jones as portfolio director in Manchester from EY.

Victoria Daly (1) has joined **Tosca Debt Capital** as portfolio director from Lloyds Banking Group, where she was director of strategic debt finance. Thomas Chappell (2) has joined as investment analyst from EY's capital and debt advisory team. Oliver Reece (3) has also been promoted to investment director.

Henrijette Richter has been appointed managing partner of **Sofinnova Partners**, the Paris-based life sciences investor. She joined the firm in 2014 from Novo Seeds.

Andy Watts has joined the **Business Growth Fund's** talent network team, moving from Boyden UK.

MARION BERNARD JOINS MCLARTY CAPITAL PARTNERS

Marion Bernard has joined McLarty Capital Partners (MCP), an established investment platform, which invests in small businesses across the US, with offices in New York, Dallas, Little Rock and Los Angeles.

She has joined from the Business Growth Fund (BGF), where she was head of strategic investments. She will take on the new role of UK managing director at MCP. Based in London, she will work with Ted Wong, who has recently relocated from New York to London, to establish MCP in the UK with a new debt capital fund focused on supporting small- and medium-sized companies.

Prior to BGF, Bernard worked for NorthStar Ventures, 3i and Barclays Bank.

DELOITTE HOSPITALITY AND LEISURE M&A EXPERT

Andreas Scriven has been recruited to head up UK hospitality and leisure at Deloitte, replacing Nick van Marken. Based in the London office, Scriven has extensive international experience in consultancy and M&A across the EMEA region and North America.

Scriven is an expert in commercial due diligence, strategic advice, bank support, feasibility studies and market analysis.

Before joining Deloitte, he was international managing director at Christie & Co, where he had responsibility for 16 offices across Europe, the Middle East and China. Prior to that, he worked for Andersen and Deloitte in the US and Europe, and has operational hotel experience in the USA, Switzerland and Hong Kong.

"This is an exciting and challenging time for the hospitality and leisure industries," said Scriven. "It is a competitive sector that has to adapt to changing consumer habits and disruptive technology."

LEGAL BRIEFS

Simmons & Simmons has opened an office in Dublin with the hire of Fionán Breathnach as partner from Mason Hayes & Curran. Prior to that, he was an associate at Landwells and legal counsel to HSBC in Dublin. In Munich, Robert Alan Heym (pictured above) has joined the firm's corporate and commercial practice as partner from CMS Cameron McKenna Nabarro Olswang.

Kirkland & Ellis has promoted Mark Thompson (1), Jacob Traff (2) and Rebecca Villarreal (3) to partner in its M&A and private equity team in London. James Simpson (4) has been made up to partner in the London capital markets team, and Christopher Wall in debt finance.

Claire Wheatley has joined **Pitmans** in London as banking partner from Hill Dickinson, where she was a partner.

Amy Comer has joined **Crowell & Moring** as partner in the firm's corporate group in London from Morgan Lewis.

NEWS IN BRIEF

Mazars has launched the Catalyst programme, a university incubator for early-stage businesses, partnering with Cranfield and York universities. Elisabeth Maxwell, partner and head of innovation at Mazars, said: "The Catalyst programme will offer start-ups support and opportunities to reach their full potential. It demonstrates our commitment to innovation and to building long-term relationships with start-up businesses."

Tomas Freyman has joined **Grant Thornton's** valuation services as a partner from investment bank Lincoln International.

Matteo Turi has joined boutique investment bank **Invenio Corporate Finance** as a partner. An ACA and M&A specialist, he previously held senior positions at Lanco Solar, Rengen Energy, K2 Partnering and Vanco, and was also part of Severn Trent Water's senior management team.

Barry Sheehan (1) has been promoted to director, and Will Evans (2) and Tom Reece (3) to associates at **Livingstone**, the mid-market M&A and debt advisory firm.

Sheehan specialises in business services and industrial sectors and joined in 2014 from Deloitte. Evans works in business services and joined from Deloitte in 2015. Reece joined in 2016 from KPMG, and is in the industrial sector team.

Richard Fleming has joined **Alvarez & Marsal** as European head of restructuring, one year after he left KPMG.

Martin Lay (1) and Richard Womack (2) have become joint heads of the London capital markets team at **Cushman & Wakefield**, following the departure of James Beckham to CBRE.

Elizabeth Stone has replaced Mark Pugh as head of **PwC's** asset and wealth management practice in the UK. She has been with PwC for the past 17 years.

THE CV

Brian Livingston is head of M&A at Smith & Williamson. Before joining in 2003, he was a director at 3i, working in deal origination. He has a law degree from the University of London and is an ACA. As well as M&A, he advises on fundraising and private equity, and gives strategic advice to family-owned and entrepreneurial businesses.

Recent deals

- Sale of UK technology consultancy Excelian to US-listed company Luxoft.
- Software company, Semafone on BGF fundraising.
- B2B software as a service platform provider, Appscatter's AIM flotation.

A CLEAR EXPLANATION

Brian Livingston, managing director of M&A at Smith & Williamson, says that clearly explaining where a company's going creates deal value

WHAT WAS THE DEAL?

Sumeru Equity Partner's (Sumeru's) investment in MDSL, a UK-based software as a service (SaaS) and technology expense management (TEM) business. The deal completed in July 2017, but the value was undisclosed.

Founded in 1995, MDSL's annual turnover was about £30m. Sumeru is a California-based and technology-focused private equity firm. It had acquired Telesoft, another TEM provider, a year earlier. The combined businesses are trading as MDSL.

MDSL founder Ben Mendoza is now chairman. His son, Simon Mendoza, is chief technology officer. From Telesoft, Charles Layne is now chief executive officer; and Tamara Saunders is chief financial officer.

HOW DID YOU FIRST MEET MDSL?

I met Ben, who was not a Smith & Williamson client, at a conference around five years ago and really liked the vision of the team. We did a small share buy-back deal for them, and then worked closely with them readying the business for this bigger deal. The business was going well, and had built up a good roster of blue chip clients. MDSL had also strategically expanded into the Internet of Things market. Ben knew he had something special that could go places, but knew he needed help.

WHO WERE THE ADVISERS?

We were lead adviser for MDSL. The legal adviser was Squire Patton Boggs. Sumeru used Kirkland & Ellis for legal due diligence, Deloitte for tax, and undertook financial due diligence with focus on customer trending detail. Sumeru took very fair positions on issues. It was complex from a legal due diligence perspective, but to smooth the process, we agreed that it would be a UK transaction for legal purposes.

WHAT WAS SUMERU'S FOCUS?

The key for them was the quality of the software and customer retention rate. They used a small firm to review the software and completed it in two days. They knew the market and focused on the big picture, and the legal and financial due diligence was tailored accordingly.

WHAT WERE THE CHALLENGES?

We knew what the pipeline was for new contracts, but we could not influence the timing of the signature. That made it a challenge to hit the run rates they wanted to see, but nonetheless MDSL executed upon their plan.

Balancing management team time between visits to New York and completing due diligence, and the crucial job of running the business as usual was also a challenge.

WHAT WERE THE LESSONS LEARNED?

Key to the transaction was understanding exactly where MDSL sits in the market and where it can get to, and then getting an investor to buy into that vision.

We needed an investor who had the maturity to understand the commercial opportunity, and how to exploit it. I have seen this with other US private equity houses, and I saw it with Sumeru – they want to accelerate go-to-market and product roadmap to create durable franchise value. Could they turbocharge MDSL and turn it into a world-beating business? ●

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