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July/August 2018 Issue 204

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PRIVATE EQUITY SPECIAL

This issue features several articles on the theme of private equity – look for the bars of gold shown above

Thanks for the memories?

Like great comedy, choosing when to get out is all about timing. In May Arsene Wenger left Arsenal FC after a record-breaking 22 years as manager. His early success was not replicated latterly, and for many that was how he was judged in the end.

In April Sir Martin Sorrell left WPP Plc under a cloud, some 33 years after he took shopping basket manufacturer Wire & Plastic Products and turned it into the £15bn turnover global advertising agency it is today.

Time will tell if Arsenal can be tweaked to compete with the best clubs in England and Europe, or if Sir Martin has left a corporation agile enough to be able to compete in a digitally disrupted global advertising market. Get the timing wrong and what is left behind becomes the legacy, rather than anything achieved while there.

Private equity is in the spotlight in this month's issue. On pages 14-16 Jason Sinclair looks at the IPO of UK games company Sumo Digital's listing earlier this year, which grew under two periods of private equity ownership. And in our cover story Grant Murgatroyd looks at private equity portfolio directors, and how they do the crucial bit of delivering returns to limited partners.

Private equity may have unprecedented dry powder, but research published in June by the Centre for Management Buy-Out and Private Equity Research with Equistone and Investec, revealed that in the first half of 2018 there was £6bn of UK private equity exits, compared to £21bn in the first half of 2017. European private equity exits also fell from €57bn to €40bn.

Anecdotally some softening of multiples might be pushing out completion timelines. Economic and political uncertainty may be having a similar effect.

Unlike Wenger or Sir Martin, private equity puts exit options front of mind before they even complete an investment. As sure as death and taxes, private equity will at some point exit an investment. To whom, when and how is the question.

Often lazily characterised as being an industry of massive egos, the irony is that private equity must persuade a prospective buyer that there is an opportunity for them to be successful too. I am not sure Wenger or Sir Martin hold out completely the same hopes for their successors.

Marc Mullen
Editor

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ICAEW

Corporate Finance Faculty

Mo Merali
Chairman

David Petrie
Head of Corporate Finance

Katerina Joannou
Manager, capital markets policy

Shaun Beaney
Manager, Corporate Finance Faculty

Elizabeth Price
Services manager
+44 (0) 20 7920 8689

Grace Gayle
Service and operations executive
+44 (0) 20 7920 8656

firstname.surname@icaew.com

Marc Mullen
Editor
marc.c.mullen@gmail.com

David Coffman, Rebecca Guerin, Selina Sagayam, Victoria Scott
Editorial panel

For details about corporate and individual membership, please visit icaew.com/cff
or contact the faculty on:
+44 (0) 20 7920 8689

To comment on your magazine, please email:
publishing@icaew.com

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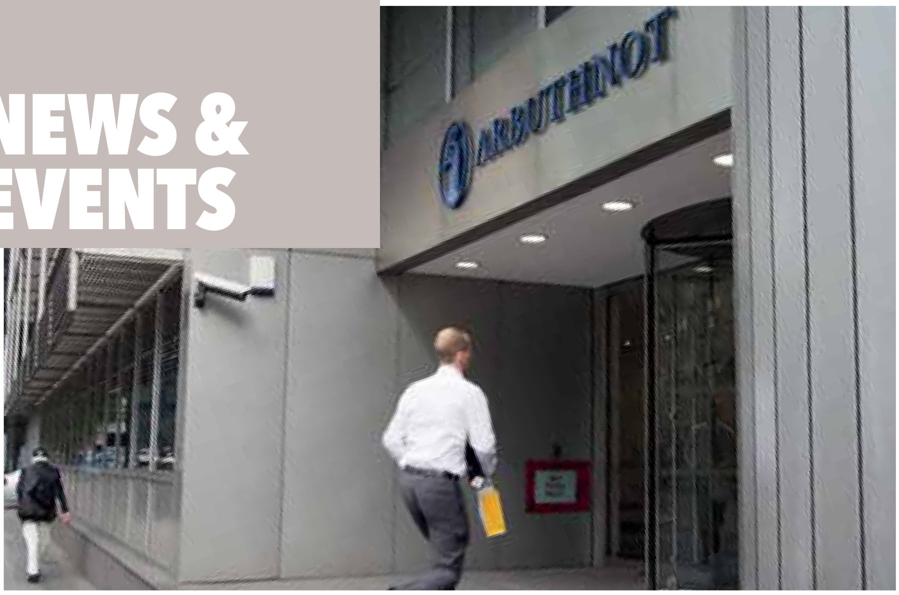

ASSET BASED LENDING

Arbuthnot Commercial Asset Based Lending (ABL) is the newest firm to join the Corporate Finance Faculty. Tim Hawkins (1) is managing director, Andrew Rutherford (2) is commercial director and James Shaw (3) is operations and risk director.

"We are delighted to join the ICAEW Corporate Finance Faculty," said Hawkins. "As the go-to source of experience and guidance for corporate finance practitioners, it made absolute sense for us. We focus on delivering facilities to SMEs and mid-market corporates, and the faculty will enable us to stay connected.

"We launched Arbuthnot Commercial ABL at the beginning of 2018 and have brought together a hand-picked and highly experienced team. Our clients benefit directly from the commerciality, commitment and creativity of a market-independent asset-based lender, aligned with the strength, stability and heritage of the Arbuthnot Latham brand."

In May, the firm announced its first two deals since launching as Arbuthnot Commercial ABL: a £12m ABL facility for Sullivan Street's acquisition of ISS Facility Services Landscaping and its growth plan; and a working capital facility to support OSET Bikes growth plans.

Most of the new division's business will be to fund transactions – it offers ABL facilities with the ability to do cash flow lending.

Rutherford and Hawkins co-founded Centric Commercial Finance in December 2007 before selling to Shawbrook in 2014. Shaw joined in January 2018 from RBS. All three had previously worked together at GE Capital.

NIBS

Corporate Finance Faculty board member Selina Sagayam has joined the editorial panel of *Corporate Financier*. Sagayam is an expert in cross-border takeovers and M&A, and is partner and head of UK transactional practice development at international law firm Gibson Dunn. The other members of the editorial panel are David Coffman, Rebecca Guerin and Victoria Scott.

Immerse UK – a major collaboration for the development of innovation, business and investment in augmented reality, virtual reality and haptic technologies – has produced the first ever in-depth report about the nascent sector. *The Immersive Economy in the UK* was commissioned by Jon Kingsbury and Fiona Kilkelly of the Knowledge Transfer Network, and written by Juan Mateos-Garcia, Konstantinos Stathoulopoulos (from Nesta) and Nick Thomas (from MTM London). Shaun Beaney, manager of the Corporate Finance Faculty, chairs Immerse UK's Access to Finance working group.

The full report is available at tinyurl.com/CF-ImmerseUK

MIDDLE EAST NETWORK WELCOMES NEW CHAIR

Sam Surrey (1), a transaction services partner at Deloitte in Dubai, has succeeded Matthew Benson as chair of the Corporate Finance Faculty's Middle East network. Surrey joined Deloitte in 2013, having worked for BDO and EY. He has advised private equity houses, sovereign wealth funds and corporates in the region, and spent over a year on secondment at Barclays in Dubai.

Raj Mehta (2), a KPMG partner and head of restructuring and performance improvement, has joined the network's board. Mehta is an ACA and holds ICAEW's Diploma in Corporate Finance. He joined KPMG last year from Dubai International Capital, where he was a managing director in its private equity group, leading the portfolio management team. Prior to that he worked for Deloitte in Dubai and London.

Richard Dingle (3), EY transaction support associate partner based in Dubai, has replaced fellow EY partner Benson on the network board. He trained as an ACA at Critchleys, Oxford.

ALAMY

JACKIE BOWIE

MAKING HAY?

M&A is in rude health. But there is caution in the air – economic and political indicators are breaking with tradition and making 2018 and 2019 difficult to call

Globally, M&A activity has defied many expectations in 2018 as circa $2trn worth of transactions have been racked up so far, keeping many corporate finance advisers and lawyers very busy. Buoyed by strong global growth and plenty of cash, M&A is maybe being further persuaded by the loud voices of activist shareholders. At the time of writing, Barclays was rumoured to be in talks with Standard Chartered – no coincidence that this is just two months after it came to light that Edward Bramson had built a 5% stake in Barclays.

But there have been plenty of drivers behind big-ticket M&A – demergers (Costa from Whitbread), hostile deals (GKN-Melrose), or simply very large-scale consolidation (Asda-Sainsbury's).

Whether corporate M&A or private equity-backed transactions, the buying bonanza has left record amounts of debt on the balance sheets of businesses, and the quality of that debt – measured either by credit ratings or the covenants and protections it affords the lender – has deteriorated. All these indicators point to us being at, or near, the top of a cycle.

TRADITIONAL NARRATIVE?

However, the economic story does not quite match the traditional top-of-the-cycle pessimistic narrative. Global economic growth and labour markets are in good shape. The US economy has yet to feel the full impact of the tax cuts. Inflation risks are very real, but the Federal Reserve is split on their permanence. While inflation will likely breach the Fed's target over the next few months, they are expecting this to be transitory. Another interest rate hike was duly delivered in June as expected, and the Fed's guidance guidance remains clear on the increases that they are expecting for the rest of this year and next.

A stronger than expected European economy throughout 2017 looked like it was running out of steam in the early part of 2018. Economic survey data turned south. But, at the risk of sounding like a train operator, bad weather definitely had an impact in Q1, and the strong euro took its toll on eurozone exports.

However, the domestic demand situation is good in Europe. Core inflation is very subdued, so there is no reason for the European Central Bank to diverge from its extremely cautious tiptoe towards interest rate normalisation. The Italian political situation and the plan, which was outlined by the new Italian government, included a request for debt forgiveness (ie, asking the rest of Europe to pay off their debt), and chatter that Italy should look to exit the euro. This is rocking market confidence for sure.

MEANWHILE, IN BRITAIN...

In the UK, the oscillation of the Monetary Policy Committee – or more specifically Mark Carney – on whether the UK will see a rate rise this year has had most impact on sterling. Combined with some weaker economic data – Carney blames snow, while the Office for National Statistics disagrees – the message is now definitely one of 'on hold'. Rate increases priced into the market have quickly dissipated, and the chances of an August hike are looking less likely than they did just a month ago.

Diverging views about the current stage of the economic and market cycle can also be witnessed in the bond market. The critical benchmark rate, the 10-year US treasury yield, hovers around the 3% level, but more noticeable is the flattening of the yield curve – a narrowing between short and long-dated bond yields – which is traditionally an omen of a coming downturn.

But it seems that it will neither be rising interest rates, nor economic downturn – which is the biggest threat to the cycle and deal activity – this year, but the possibility of a trade war. Donald Trump's aim is to close the American trade deficit, which is difficult to imagine with the potential of slower global growth, the ongoing stimulus in the US, and a strong US dollar driving more demand for imports. How this develops is the story to watch, as will be its influence on the appetite for deal-making in general. ●

Jackie Bowie, chief executive, JCRA and a member of the Corporate Finance Faculty's board

IN NUMBERS

UK foreign direct investment projects in 2017, bank lending to small businesses, and the proportion of women in private equity

EUROPEAN FOREIGN DIRECT INVESTMENT GROWTH

+6%

Increase in number of FDI projects in the UK in the calendar year 2017 over 2016

+10%

Increase in total number of European FDI projects in the calendar year 2017 over 2016

SOURCE: EY

+9.51%

Average equity incentive pools offered to management in global survey of mid-market buy-outs

Down from
12.6% in 2013
11.3% in 2015

SOURCE: EY

WHERE THERE'S MUCK...

50

The number of M&A transactions in the UK waste and resource management sector in 2017

THE HIGHEST NUMBER SINCE 2010

SOURCE: GRANT THORNTON

PERCENTAGE OF PAN-EUROPEAN PRIVATE EQUITY TEAMS THAT ARE WOMEN

Junior	Middle	Senior	All firms as at December 2017
27%	15%	6%	14%

SOURCE: BVCA AND LEVEL 20

NOT SO CONFIDENT

103.5

Global investor confidence index at the end of May 2018

Down **11.8** points from the end of April 2018

SOURCE: STATE STREET

LEVERAGE ON THE RISE

Q2 2018

6.57x

HIGHEST LEVEL SINCE Q2 2007

Average debt to EBITDA multiple on large corporate and institutional mid-market deals syndicated

UP FROM **6.39x** IN Q1 2018

SOURCE: THOMSON REUTERS

BIG VS SMALL BUSINESS

SMEs

£165.9bn

UK bank lending to SMEs as at end of February 2018

Down from **£166.1bn** in February 2017 and **£188.3bn** in February 2012

BIG BUSINESSES

£300.8bn

UK bank lending to big businesses as at the end of February 2018

Up from **£286.4bn** in February 2017 – highest amount since February 2012 when **£309.7bn** was lent

SOURCE: HADRIAN'S WALL CAPITAL

RIPPLE EFFECT

US corporate tax reform may well give a short-term boost to the US economy. But what will it mean for international M&A? **Bridget Walsh** assesses the potential opportunities in corporate finance

Much of the commentary about US corporate tax reform has focused purely on the implications for US-based companies. But it is more far-reaching than that. Across the globe, reform has the potential to create new capital and deal dynamics for non-US companies – even those without US operations.

Clearly, most US companies will benefit from the headline tax cut. Very few companies had a 35% tax rate under the old regime, and we need to add local taxes and the impact of other changes to the new 21% headline rates. Nevertheless, US companies and non-US companies with American operations are almost universally signalling a drop in their effective tax rates. Early indications are that companies will take a blended approach to their extra cash flow, splitting this between returning cash to shareholders through buybacks and dividends, investment (including M&A) and enhancing employee benefits.

CONFIDENCE IN CAPITAL

EY's recent *Capital Confidence Barometer* asked global executives for their views about the tax changes. It's fair to say the response was fairly neutral – the majority of US and non-US respondents saw no overall effect on global dealmaking as a result of the US tax changes.

Taxation levels, in and of themselves, do not drive deal-making. They are part of the calculations on valuations, and future growth potential, but deals are always done for strategic reasons. In today's environment of loose monetary policy, strong corporate earnings and elevated stock prices, the ability to fund deals has not been an impediment to M&A.

Where there may be an uptick is in inbound deals into the US. Nearly a quarter (22%) of non-US executives responding to our survey said they are reconsidering deals they had previously decided not to pursue, or had on pause, in the light of recent changes.

There may also be an increase in domestic combinations in the US itself, more driven by the boost tax reform will have on the overall economy and expectations of higher growth.

We may well see an increase in US outbound deals, as US companies no longer have to worry about having overseas profits trapped due to double taxation, as was the case historically.

There is a good chance that cash available for M&A is spent in the US, augmented by previously trapped overseas cash due to wide-ranging multinational tax reform. We may see big changes in corporate financial management, especially in life sciences and technology, where companies have typically accumulated large pools of offshore cash and investments, while using debt to finance domestic investments, share buybacks and dividends. The reforms free up this cash and provide a strong incentive to choose domestic over foreign investment.

COMPLEX SITUATIONS

This issue underlines the complexities of M&A in a world where changing growth rates, volatile exchange rates, technological advance and policy changes are just a few variables in the deal maths. US tax reform is just one part of the deal equation – albeit now a much more important one. Ultimately, deals still need to make sense strategically, and the need for companies to transform their portfolios in a changing world will be the overriding rationale for doing a deal – both in the US and globally. ●

Bridget Walsh, **global transaction tax leader, EY, based in London**

WISE WORDS

Grant Thornton's **Mo Merali** became chairman of the Corporate Finance Faculty in May. He speaks to Marc Mullen about his new role at the faculty, his career at Grant Thornton, and more

In May, Mo Merali, corporate finance partner and head of private equity at Grant Thornton, succeeded Mark Pacitti as chairman of the Corporate Finance Faculty. Merali has spent his entire career with Grant Thornton, joining the advisory firm in 1992 and qualifying as an ACA. Initially assigned to special projects, he began to concentrate on IPOs and M&A, then particularly private equity. In 2001 he was promoted to corporate finance partner, and then became head of private equity in 2009.

PERSONALLY, WHAT DO YOU TAKE FROM BEING AN M&A ADVISER?

I come to work not just to make money, but to learn, to help and to support the business. The most tangible long-term rewards can often be the intangible. Work should be fun - not in a frivolous way - it should be challenging and stretch you. That makes it all the more interesting. I don't consider myself someone who just writes due diligence reports. I am there to make deals happen in terms of deal execution.

HOW DO YOU DEAL WITH PRIVATE EQUITY FIRMS?

You have to remember that private equity firms are not the untouchable colossal beasts that they are often made out to be. They are human beings that run a small business, just like I do. I run a team with 10 partners. Most private equity firms are less than that - just four to five partners in some cases. They may sound big in terms of assets under management, but it is often down to having a relationship with a few key people. You must have chemistry with them, as it's not just about staying with the deal.

It's also about staying with the client, as private equity firms are serial investors. I can't work with them all and I don't want to. I am lucky that I can pick and choose those I do want to work with, those who challenge me, those I can learn with and who I can build and develop my business with. I can very much understand the mindset of the private equity professional who faces similar challenges to me in terms of building his or her business.

SINCE BECOMING HEAD OF PE, HOW HAS YOUR BUSINESS GROWN?

At the depth of the financial crisis we deliberately did not pull down the shutters. We continued to selectively hire and develop our people. Our focus was always on quality, and improving our talent pool when it came to recruitment. While many of our competitors retrenched, we recognised that relationships would be key for the growth of our private equity business. Our leadership team had a long-term view - they were not particularly interested in what we did in the next 12 months, but in the business we were looking to have built in five years' time. Through 2010 to 2012 we really invested in relationships and we're reaping the rewards now. Of course, technical knowledge and deliverability are crucial, but in our market relationships are key.

WHICH SECTORS DO YOU HAVE EXPERIENCE IN?

Private equity tends to invest in asset-lite, repeatable service businesses, companies with recurring revenues or intellectual property that can be monetised. As a result, I've worked on a lot of deals that involved technology businesses, software or IT services, and a lot in media. There is a real conflation of technology and services businesses. I do a lot of business services, healthcare services and of course, in London, by definition, financial services. Technology-related and services deals make up about 80% of my work.

WHAT WAS THE MOST SIGNIFICANT TRANSACTION FOR YOUR TEAM?

Back in 2006, a corporate finance boutique put me in touch with Lehman Brothers Merchant Banking's private equity arm, which was successfully spun out as Trilantic Capital Partners after the collapse of Lehman. We pitched for one project, but they came back with another. They were looking to acquire the tuna business, John West, out of Heinz. The deal would be a landmark deal for us.

It was a complex deal - the John West business had trawlers in the Seychelles and Ghana, processing operations in Portugal, Spain and France, and distribution channels across the world. The transaction predated by several years the ethical concerns regarding tuna fishing, so that was not an issue at the time. It was a €500m transaction and we had never done anything over €100m. The deal straddled Christmas and there were points when I thought, 'what have I got us into?' But they got the deal, we executed it and supported the set-up of MW Brands as a standalone business. It was a defining deal for us, as we proved we could do larger deals - nothing was unachievable. All the big brand professional services firms are great businesses that I respect, but that transaction proved to me we were no lesser a brand.

WHAT PUBLIC COMPANY EXPERIENCE HAVE YOU HAD?

I have led numerous IPOs on AIM and on the Full List as the reporting accountant - many with

significant overseas operations. These included the IPOs of Sports Direct and Eros International – both market leaders in the respective fields.

But the most notable example is a recent FTSE 100 entrant – GVC led by CEO Kenny Alexander. We first started working with GVC when it was a sub-£30m market cap minnow on AIM with big ambitions. Through a series of key transactions that we advised on, GVC has successfully acquired and transformed larger businesses such as Sportingbet, bWin Party and most recently Ladbrokes Coral. We have supported that business through its growth, and now GVC and Kenny Alexander have reached the top of a rapidly expanding sector.

HOW HAS THE MAKE-UP OF YOUR TEAMS CHANGED?

A lot of my career was about getting a rounded experience early after I qualified as an ACA. Then I was able to specialise and build relationships. Now we recruit qualified accountants, non-accountants and specialists to bolster our services – strategists, operational advisers and lawyers specialising in sale and purchase agreement advisory.

Our teams look very different to how they did 10 years ago when we only had qualified accountants. Now we've got the whole blend, offering commercial, operational, tax and financial due diligence.

We now run a programme where we put graduates through the ACA qualification while their experience is run in rotation across specialist advisory units – deal advisory, forensic, restructuring or insolvency and business consulting. We still take on qualified accountants from audit and are big supporters of the Corporate Finance qualification.

This new approach is something of an experiment, replicating to an extent what I did after I qualified. The graduates have the chance to learn many skills. They want that breadth of experience. They don't want to go in at a single point of entry and find they don't want to do that role. That experience also helps the firm with its peaks and troughs in demand.

"You have to remember that private equity firms are not the untouchable colossal beasts that they are often made out to be"

WHAT ABOUT DEALS THAT DIDN'T GO PERFECTLY?

One or two not-so-good ones teach you that you should never take anything for granted. I did one deal – and five years, 11 months and 23 days later I got slapped with a lawsuit. It was completely without any merit, but you have to defend yourself. That was quite early in my career. It makes you ask yourself: 'Have I done my job properly? Did we get it wrong?' Sometimes you do get it wrong and you have to own up and say so. It was a salutary lesson. You learn through your mistakes or things that haven't gone well.

HOW DO YOU SEE CURRENT MARKET CONDITIONS?

We are definitely in a seller's market as long as there is liquidity or uninvested capital – fortunately or unfortunately, depending on your perspective. There is a lot of capital out there to be spent on deals, and it's not just the amounts being raised but dry powder. It's not surprising it's a seller's market because there are a lot of buyers out there. And there is a scarcity of good assets, so it's a double whammy. If you've got a good asset delivering consistent growth, good revenue and profit, buyers will bite your hands off.

HOW IS TRADE COMPETING WITH PRIVATE EQUITY?

What has surprised a few people is how trade buyers have competed so effectively with private equity buyers. After the crisis, corporates spent a huge amount of time deleveraging and sorting out their balance sheets. Now they have a lot more flexibility with what they can do, how they do it and what they spend. And their shareholders are demanding growth. To get it, you have to do something different.

Recently trade outbid a private equity client of ours on a deal by 15%. Trade can achieve synergies or ratings arbitrage, which automatically gives them value uplift. Trade can perhaps be more creative on structures. In the short term sterling is weaker, so international trade buyers are looking at UK businesses.

WHAT ARE YOUR VIEWS ON THE AMOUNT OF LEVERAGE IN DEALS?

I don't see an enormous difference between how capital is invested – debt and equity is blended. Debt effectively brings lower returns for hopefully lower risks. The risk in investing equity at a certain level may be higher, because of the leverage in the deal, and the valuation. But for me it is not a leverage issue, I just think of it as 'gap' finance. It depends on the returns and how one fills the gap.

WHAT IS THE STRENGTH OF THE CORPORATE FINANCE FACULTY?

The fascinating thing about the faculty is that you have such a diverse group of people on the board and such a diverse membership base – non-accountants, lawyers and investors. The question is what more can we do with that? ●

PHOTOGRAPHY: DOMINIC TYLER

P11D	BIK	CO_2	COMBINED MPG
£22,065 - £13,495	28% -22%	139-97g/km	46.3-74.3

WORLDWIDE WRESTLER

Having delivered knockout returns for NorthEdge, games developer Sumo Digital listed on AIM last year valued at £145m. Jason Sinclair takes a look at its track record

"One of the reasons we got involved with Sumo is that I've been playing video games for a long time," says Richard Darlington, Manchester-based partner with investment banking boutique Zeus Capital. "It's always been a sector I've followed closely. I've seen some of the dynamics and transition in terms of the bigger publishers – the Rockstar Games of this world – and they're producing hundreds of millions of pounds in revenue. The global video games market is larger than the film and music industries combined."

Last December, the Sheffield-based games studio Sumo Digital floated. The studio, which celebrated its 15th anniversary this June, is responsible for best-selling games such as the critically acclaimed Forza Horizon 3, Hitman and Outrun 2. It raised almost £78m in an AIM initial public offering (IPO) that valued the company at £145m. Private equity firm Perwyn sold the stake it acquired in September 2016 from its previous private equity backers NorthEdge Capital. Zeus was nominated adviser.

Rewinding a little, NorthEdge had led the first Sumo buy-out in 2014. The sale of the games company to Perwyn gave NorthEdge a healthy 4.4x multiple on exit. And Sumo continued to expand.

It was during this exit that Darlington and Zeus first made contact with Sumo. "With the NorthEdge transaction we got into the process very late," he recalled. "I knew they were selling to private equity, but we told management they should look at the public markets. We opened their eyes to different routes that they hadn't really thought of before. Everyone is very well advised on private equity options, but they don't always have visibility on what public markets are like."

"Sumo is a great example of a northern business delivering digital services to a global, blue-chip client base"

Andy Ball,
partner, NorthEdge

Darlington says Sumo's CEO, Carl Cavers, was taken with the idea of an IPO: "Shortly after the investment from Perwyn, we were having further discussions with the company about how they should position the business going forward to optimise valuation in the future – and how they might shape their strategic points so they could be perceived as attractive in public markets."

Explaining his role at Zeus, Darlington says he covers "private equity in terms of looking at different funding options for their portfolio assets. What you'll typically find is private equity is very good at selling businesses to private equity or trade. What they're not so great at is thinking early on in the process about IPOs."

He adds that public markets recognise that the video games sector has completely changed in the past decade. Valuations have increased as people

"Generally we will not pull the trigger on the float until we've actually raised the money"

HERE'S THE DEAL

IPO date:	**December 2017**
Share price:	**100p**
Placing:	**£38.45m**
Vendor Placing:	**£39.70m**
Total fundraise:	**£78.15m**
Market cap:	**£145m**
Nomad and sole broker:	**Zeus Capital**
Lawyers to Sumo:	**Addleshaw Goddard**
Lawyers to Zeus:	**Eversheds Sutherland**
Reporting accountant:	**Grant Thornton**
Due diligence:	**Grant Thornton**
Commercial due diligence:	**PwC**
Tax structuring:	**PwC**
Banker to Sumo:	**Yorkshire Bank**

scramble for exposure to the sector, and "there are very few ways for mid-market investors in the UK to get exposed".

"A few of our guys worked very closely with Sumo for 12 months," says Darlington. "But we agreed very quickly what shape the business could be - in terms of size, customer base, board, what they need to achieve between investment and IPO to show some value has genuinely been added by private equity."

A combination of the market conditions and Sumo's performance made it clear quite early that management and Perwyn would be looking to float faster than the traditional three years. There was confidence from the start that minimum valuations would be met. The fact that Sumo did not have the boom and bust cycle some other games developers have was likely to be well received by investors.

"It was a message we could present. They have recurring work, but are a third-party developer who grow as the demand for content grows - as it is doing at an exponential rate," says Darlington.

Video games were released on discs as little as a decade ago. Now game titles last several years through digital distribution and downloadable content with ongoing revenue. Given the potential demand, who did Zeus target when building its book?

4.4x

ROI generated on the sale of Sumo Digital to Perwyn by NorthEdge

£23m

Revenue generated by Sumo Digital during NorthEdge's time as owner

NORTHEDGE RETURN

In November 2014 NorthEdge Capital supported Sumo Digital's management team, led by CEO Carl Cavers, in acquiring the business from US-based Foundation 9. Holding the company for just under two years, NorthEdge sold to private investment house Perwyn in September 2016, achieving a 4.4x return on investment and internal rate of return of 127%. Following the first NorthEdge buy-out, Sumo increased headcount from 240 to 350 across its UK and Indian offices.

In March 2016 it launched a new Nottingham studio. In NorthEdge's time as owner, revenues increased by 60% to £23m, and profits more than doubled. NorthEdge partner Andy Ball and director Phil Frame led the investment.

On the sale to Perwyn, Ball said: "Sumo is a great example of a northern business delivering digital services to a global, blue chip client base. The business has developed into a genuine market leader, and the quality of the current project pipeline is testament to the creative and technical expertise of its people."

"Rather than announcing in advance an intention to float, we typically will not pull the trigger on the float until we've actually raised the money," Darlington notes. "So we took it to the type of blue chip investors you would expect to see. They were interested in it because they've seen some of the exponential growth from similar sector businesses."

Zeus talked to hedge funds and private client broking services as well to make sure the register was shaped into something that would successfully trade. Darlington says that has been seen in the after-market. The deal completed just before Christmas at £1 a share - at the top of the price range. Since Sumo announced its results at the start of May, the share price has been as high as 180p. "That shows the strength of the book we created with really strong cornerstone investors."

GIANT STEP

Sumo's CEO Cavers, who co-founded the company in 2003 with 12 colleagues - mainly recruited from software house Gremlin - saw the company's AIM listing as "a significant step forward in our journey to become a global leader in the video game and entertainment industries". The company, which has expanded to 480 employees and has bases in Sheffield, Nottingham, Newcastle and Pune, India, says: "Being a quoted company in the fast-growing tech sector will allow us to execute our strategy."

That strategy is likely to include some M&A. Last year, Sumo acquired Atomhawk - a globally renowned high quality art producer - in a key action prior to the IPO to demonstrate they could do that. They are broadening their existing skills. At the moment Sumo is very strong in driving and strategy titles, along with puzzle games and some others, but it has never had a big multiplayer online game.

"The global video games market is larger than the film and music industries combined"

Richard Darlington,
partner,
Zeus Capital

SUMO CEO

Carl Cavers (pictured above) has been one of the mainstays of the British gaming industry for more than three decades. After a successful career with pioneering games software companies Gremlin Interactive and Infogrames, he co-founded Sumo Digital in 2003. The business went on to develop award-winning titles of their own, as well as major projects for Sega and Sony, and on the Marvel and Harry Potter franchises.

Having steered the business through a trade sale to Foundation 9 in 2007, Cavers led a management buy-out with NorthEdge Capital in 2014. A secondary Perwyn-backed MBO followed this in 2016. Perwyn said it valued Sumo's 'longstanding customer partnerships', which can be read as reliable income stream. Perwyn backed Cavers' acquisition plans for Atomhawk, a visual design company, in June 2017.

In December 2017 Sumo Group floated on AIM, with the company valued at £145m. "Admission to AIM marks a major milestone in our journey," said Cavers. "We have always strived for excellence within the business and our aim is to deliver the same excellence to the company's investors, creating value in this exciting, fast-growing industry."

Sumo's managing director, Paul Porter, adds: "It gives us the opportunity to invest in things we'd like to invest in, that we might not have been able to in the past." The cash raised from the IPO was also used to deleverage the business, moving from a leveraged balance sheet to £5m in net cash.

Darlington sees opportunities for more IPOs in the sector: "If you look at the competitive landscape, the UK is steaming ahead in this sector. It's becoming a much bigger employer in the UK. What differentiates a video games developer is not your ability to code, but your ability to come up with creative ideas. The ecosystem is being constantly fed and developed. And it's not a coincidence that after Sumo has been done you've got a number of different businesses in the video games sector coming to market in the next six to 12 months."

"I'd be surprised if private equity don't start to take a different view on it as well, because there's been a perception in that arena of potential boom and bust. But the successes coming through will probably put some of those fears to rest," he adds. ●

"If you look at the competitive landscape, the UK is steaming ahead in the video games sector. It's becoming a much bigger employer in the UK. The ecosystem is being constantly fed and developed"

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FROM START TO FINISH

IF PRIVATE EQUITY INVESTORS WANT TO MAKE MONEY, THEY HAVE TO IMPROVE PORTFOLIO COMPANIES. THAT MEANS BETTER MANAGEMENT, INFRASTRUCTURE, MARKET POSITIONS, GEOGRAPHIES, FINANCIAL STRUCTURES AND GOVERNANCE. GRANT MURGATROYD LOOKS AT THE INTRIGUING WORLD OF PORTFOLIO MANAGEMENT

FROM ACQUISITION TO EXIT

Private equity investors proved that they were able to navigate their way through the financial crisis, though at the most turbulent times it looked like they might struggle, with many pundits calling time on the model. According to Preqin, funds raised globally plummeted from $408bn in 2008 to a low of $173bn in 2010. Some buy-out firms did not survive the Great Recession. But, by 2016 private equity funds raised climbed back to $400bn, and $453bn was raised last year. As well as new capital, limited partners (LPs) have been reinvesting capital that had been returned from investments and been through an extended hold period.

The pre-boom years were not private equity's greatest moments. But even 2005 funds - the worst performing vintage - generated a median internal rate of return (IRR) of 7%, according to Preqin. The 2009 vintage funds were nudging 15%.

The secret of private equity success is creating value from portfolio companies by improving them. Leverage accounts for 31% of the gain, but operational improvements are far more important, accounting for 69% of the return - according to research by Capital Dynamics and the Technical University of Munich. The research found that in large caps (>€500m), 40% of the gains came from leverage, but this fell to 27% in small caps, meaning more than three quarters of gains came from operational performance improvement.

"Outperformance is now coming from faster profits growth," says Harry Nicholson, partner at EY-Parthenon. "It's hard to prove the effect of private equity interventions, but some of that growth is from private equity becoming more active investors in portfolio companies, pursuing targeted value creation initiatives, and making bolt-on acquisitions."

EY's 2017 *Annual report on the performance of portfolio companies* paints a nuanced picture of large private equity-owned companies' performance against public-market benchmarks. On measures of revenue, profit growth, compensation and employment there is little difference, but private equity-owned companies use capital more efficiently.

The level of involvement in portfolio companies very much depends on the type of investor the private equity firm is. For a passive investor, portfolio management might just amount to checking the management accounts.

"At LDC we are active and so work with the management team," explains Chris Hurley, head of portfolio at LDC. "Our main interaction is at the monthly board meeting, but we would also speak to the finance director or managing director every week or fortnight. That depends on whether there's an acquisition in the pipeline or not - it could be more regular in that case. It can be calls or meetings or over dinner. We have off-site days with management teams, where we can revisit the strategy, and make sure they're on the right track with their value creation plans and the roadmap to exit."

THE BEST WAY OUT

It's easy to spot a private equity investor when they walk into a meeting - they enter the room backwards, so their eyes are always on the exit. There's more than a grain of truth to that old joke, and it is nothing to be ashamed of. Private equity investment is a form of ownership that suits particular stages of a business's lifecycle. In the right situation it works very well. And with private equity, exit is always on the agenda. So what is the role of the portfolio manager in readying the business for exit and in the actual exit?

"We focus on making sure the company is as best prepared as it can be for exit," says Jane Vinson, portfolio specialist at the Business Growth Fund (BGF). "That needs to start about 18 months to two years before the earliest date planned for the sale. As board members, we have to make sure we are on top of everything. Managing an exit is a massive time drag on management, so if we can add any support in finance or other areas of the business that will help them through that process, we'll make those introductions. That's our role as portfolio managers."

As serial acquirers, private equity houses can obviously be relied upon to potentially be a regular source of income for corporate finance advisers. With the 2008 financial crisis 10 years behind us, advisory firms have positioned themselves to advise far more through the life cycle of private equity investments, as the portfolio manager and investment director work with the business through the evolution of its strategy. Hold times may range from three to seven years, or maybe even more.

$453bn

PE funds raised globally in 2017, according to Prequin

15%

Median internal rate of return on 2009 vintage funds, according to Preqin

"We're very much focused on helping management teams through the journey, and that's not just helping them with an M&A or vendor due diligence on exit, it's about considering the broader business advisory role," says Andrew Howson, a corporate finance partner at BDO, who advises private equity portfolio companies.

"There are so many different scenarios when it comes to exits," says Hurley. "Our aim is always to have the exit in mind from the very start - it is central to our strategy. At LDC we are all experienced corporate financiers. We probably get more involved by helping management think about how they present the business to market. But at the end of the day we encourage management to build relationships with the next buyer - whether that is through an IPO, or through a trade or secondary sale. They cannot just put the business on the market and sell it. The buyer has to be comfortable with the management team and vice versa. We back the management team and appoint a corporate finance adviser to make sure the deal works."

Over time private equity houses have moved much more towards seeing investments as a continuum. "The resource intensity varies quite significantly

Jane Vinson

Jane Vinson is portfolio specialist at the Business Growth Fund (BGF). Having started her career with Wellcome and then Enterprise Oil, she joined Bridgepoint Capital in 1996. She spent 10 years at the private equity investor, becoming portfolio manager. In 2006 she joined Octopus Investments as portfolio director before joining the BGF in 2016. Vinson has been involved in almost 100 exits during her career. She has a degree in accountancy from the University of Portsmouth. She is a member of the Corporate Finance Faculty's board.

"Managing an exit is a time drag on management, so if we can add support in finance or other areas of the business that will help them through that process, we'll make those introductions"

Jane Vinson,
Business Growth Fund

over the life of an investment," says Jonathan Crane, 3i's head of industrial for the UK. "In the first three to six months, it's usually quite intense for the deal team. They are getting to know the business, getting the alignment right and thinking about strategy. A couple of years in, and if the business is going well, with good first- and second-tier management, it would likely take up 10% of your time. But when there's a tougher situation, a lack of management bandwidth or of course an exit in the pipeline, our involvement increases dramatically."

Sell-side advisory is about preparing the business, having the answers to questions buyers might ask and using sector knowledge to identify the right buyers. The portfolio director will work with management to decide which corporate finance advisers are best suited to the business.

Clive Austin, head of portfolio at Mobeus Equity Partners, says investors are placing more emphasis on exit than they were a decade ago: "I would argue that it's best practice to understand how, when and why you will get out of a deal before you write the initial cheque. Obviously there are no guarantees, but you would like to know who the likely acquirers are, what they're looking for, the sort of prices they will pay, what aspects of a company they value and to what extent you can build something that matches that profile. That's where we look to the advisory community to add value."

Market positioning

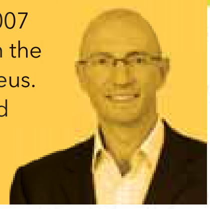
A CLOSE EYE ON THINGS

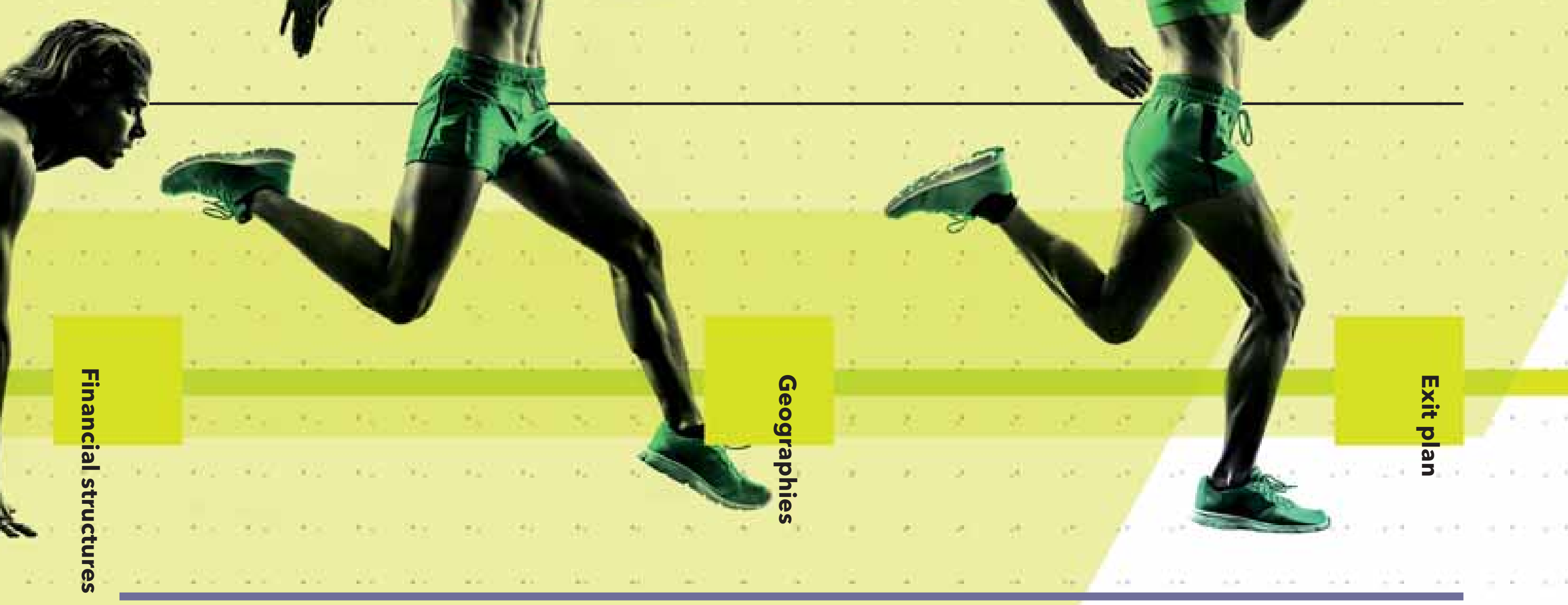
The role of portfolio manager involves monitoring, as well as the need to be there when input is required from management. It is a subtle balance that has to be struck.

"Having real depth of understanding of an issue or a lever is one ingredient, but there is also the more subtle understanding of how to work with the management team," says 3i's Crane. "Lots of experts will come in and tell management that they're running the plant completely wrong and that there are billions of missed opportunities, but when they leave the manager will put that straight in the bin. It works better when you work in partnership and management absolutely own the opportunity. One thing that is consistent across all successful investments in management is the people that need to own the value creation. Some external advisers are very good at helping that."

Clive Austin

Clive Austin is head of portfolio at Mobeus Equity Partners and "responsible for all aspects of institutional and venture capital trust fund asset management and portfolio performance". He was a management consultant at Arthur Andersen before joining 3i as an investment director. In 2001 he set up 3i's Dublin office. He joined Catapult Venture Partners in 2015, setting up their Birmingham office. In 2007 he joined NVM Private Equity to manage their business in the north of England. And at the end of 2013 he joined Mobeus. He has a first class honours degree in applied physics and electronics from the University of Durham, and an MBA from Warwick Business School.





STRATEGIST NOT ALCHEMIST

While all value creation opportunities will be explored, most private equity investors focus on a particular strategy, such as growth by bolt-on acquisitions or entry into new geographic markets. Once the first port of call for equity capital for any purpose, 3i has now positioned itself as a partner for businesses looking to expand internationally.

"We're very focused on helping businesses internationalise, improving their infrastructure, bringing in expertise and increasing management bandwidth" says Crane. "As well as increasing earnings, opening more markets and making a business more diverse geographically can definitely lead to multiple arbitrage. If you're making the business better, you're going to attract a more strategic multiple."

In 2010 3i invested in Element, a laboratories testing business carved out of oil and gas company Stork. Five years later it sold the business to Bridgepoint for a reported €900m. The 4.5x return was the result of a transformation led by Element CEO Charles Noall and Peter Regan, former CEO of 3i-backed ERM, who joined as chairman. They invested in new testing facilities; there was a sector-focused approach to win and retain business; 10 acquisitions were funded; a new pricing strategy was rolled out; the number of labs doubled; and EBITDA quadrupled.

"If you're relying on market growth there is more risk if something goes wrong as it's outside your control," explains Crane. "If you've got other levers - whether they are operational improvement, buy-and-build, digitisation or internationalisation - you can control the direction, which helps de-risk the investment and means you can grow even in a downturn in the market."

Time has also strengthened the general relationship between investors and company directors, who are now much less suspicious of the process. Initially, commercial due diligence ran the risk of offending management teams, as it could be perceived as questioning their commercial wisdom. But now it is commonplace, and often its findings underpin the strategy.

For the portfolio manager, having a clear strategy, a management team that can implement it, and open channels of communication to that team is absolutely crucial to effecting change.

Some private equity firms separate new investment and portfolio management teams, but LDC doesn't subscribe to that school of thought. "We use a relationship model, whereby the person who leads the deal sits on the board of the company," says Chris Hurley. "It means there's a continuity of relationship and it maximises our knowledge of the asset. We think that is a better approach than doing the deal and then someone new turns up and asks management to start again. People want to do deals and do portfolio management as well. It's a fantastic experience for them working with CEOs and chairmen, seeing the deal through the whole life cycle. It benefits the company, the individual and us."

Another part of LDC's approach is to appoint a chairman. It might be to help fill a functional gap, or the chair might have specific industry knowledge or relationships, or it might be a good old-fashioned chairman with private equity skills to drive value.

LDC also has a 'value enhancement' team - IT, lean manufacturing, digital, procurement, pricing and sales force effectiveness - that is a shared resource available to 90 portfolio companies on specific shareholder value projects. "There's more than one way to skin a cat," says Hurley.

Repositioning the business as part of the strategy is also a key part of the private equity value creation model. "We don't completely rule out multiple arbitrage because you can do things that create it," says Mobeus's Austin. "It's an important part of our job now. We like to make things better as well as bigger. We think about what would make this asset easier or more desirable to acquire. A core part of the private equity portfolio director's job is to identify very clearly what it is that's going to get this business re-rated."

Private equity's mechanism for keeping everyone on the same page is pretty simple: align incentivisation with capital gain. Management should therefore drive the business to the private equity house's desired destination.

"The management incentivisation model works," argues Jamie Austin, head of private equity at BDO. "If everyone's on the same page of the strategic plan from an early stage, you're better positioned to achieve alignment. Plus, you don't have to worry about quarterly reporting and can invest steadily through the cycle."

€900m

Price 3i sold lab testing business Element to Bridgepoint for

4.5x

Rate of return the Element sale generated for 3i

DEVELOPING SPECIALISATION

While sector specialisation can be as much about who a private equity firm knows as who it employs, it needs to be more than a sales pitch. It's been at least 20 years since the first UK private equity houses branded themselves as sector specialists. That novel approach provoked some scepticism at the time, but it was always clear that increasing specialisation was how the market would evolve.

"Improving businesses is going to become more and more important and we can take our experience and learning across the portfolio," says Crane. "Digitisation has been a big area as a commercial and operational lever in the consumer and services sectors and now we're talking to industrial businesses about digitisation, data and software."

BGF provides support to portfolio companies through access to its Talent Network of more than 5,000 experienced non-executives and sector experts. It also has an in-house team of investors and support staff covering legal, finance, HR, marketing and compliance.

Some private equity firms use operational partners to work with management. BGF use portfolio specialists. "They are employees, working with people continuously," says BGF's Vinson. "Having them as part of the team and understanding the way BGF works is a real advantage. They are a trusted resource, as opposed to third parties, who might have other motivations. There's definitely an advantage to that, but I think it has to be a hybrid depending on the particular company."

"People want to do deals and do portfolio management as well. It's a fantastic experience for them, working with CEOs and chairmen, seeing the deal through the whole life cycle"

Chris Hurley,
LDC

20

Years since first UK PE houses branded themselves sector specialists

5,000

Number of experts in BGF's Talent Network

Chris Hurley

Chris Hurley is chief portfolio officer at LDC, responsible for realising shareholder value across LDC's 90-strong portfolio. He trained as an ACA with Robson Rhodes before joining the firm's corporate finance team. In 1999 he joined Murray Johnstone Private Equity as an investment director. Five years later he joined LDC. Between 2014 and 2017 he was co-chief executive of LDC with Martin Draper, before taking on the role of chief portfolio officer. He is a member of the LDC investment committee. He has a first class honours degree in business economics from Salford University. He is a member of the Corporate Finance Faculty's board.

Jonathan Crane

Jonathan Crane manages the UK industrial sector portfolio at 3i. He is a London-based director, having joined the private equity firm in 2010.

He previously spent 11 years at Bain in both London and San Francisco, managing the private equity team as well as working on strategy, performance improvement and turnaround assignments for public and privately-owned companies.

He currently sits on the board of 3i portfolio company Aspen Pumps.

He has a masters degree from Cambridge University in natural sciences and management studies.

"Improving businesses is going to become more important and we can take our experience across the portfolio. Digitisation has been a big area as a commercial and operational lever"

Jonathan Crane,
3i

MONEY FROM TREES?

How you react to things depends on how you view them. Take due diligence. Is it just a necessary tick-box exercise or a treasure map to hidden value? London-headquartered Anthesis Group is a global sustainability consultancy that was founded in 2013 on the premise that the fashion for ESG, CSR and sustainability was going to grow and last. Through private equity ownership, ESG improvements can add value. Investors are slowly looking at sustainability strategically.

It may be a tough sell to cynical private equity investors, but they are acutely aware of the need to please LPs who are demanding real detail. "Private equity houses can no longer bluff it," says Tim Clare, director of transaction and corporate services at Anthesis. "LPs are able to ask really, really good, detailed questions. It's forcing firms to go to the next stage now. LPs want to see that the GP has sat down with the portfolio company and set targets for key performance issues in the ESG space. It's still early days, but they're going to want to see feedback on what performance has been made against those targets." ●

READY STEADY GROW!

WISH YOU WERE HERE

The UK's south coast may boast a number of large companies, but the real opportunities for its local corporate finance community lie in the region's growing businesses. Vicky Meek reports

Port entrance to Portsmouth

IBM Offices, Portsmouth

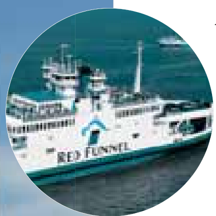
Home to some of the UK's best sailing spots and the setting for some of the country's most popular holiday destinations, the south coast is considered by many as a highly attractive place to live and visit. The city of Southampton has a container port and cruise ship terminal. Portsmouth has its naval docks and associated industry, as well as being home to IBM's European headquarters. The seaside resort of Brighton is something of a media hub, as well as hosting American Express's European headquarters.

The Body Shop

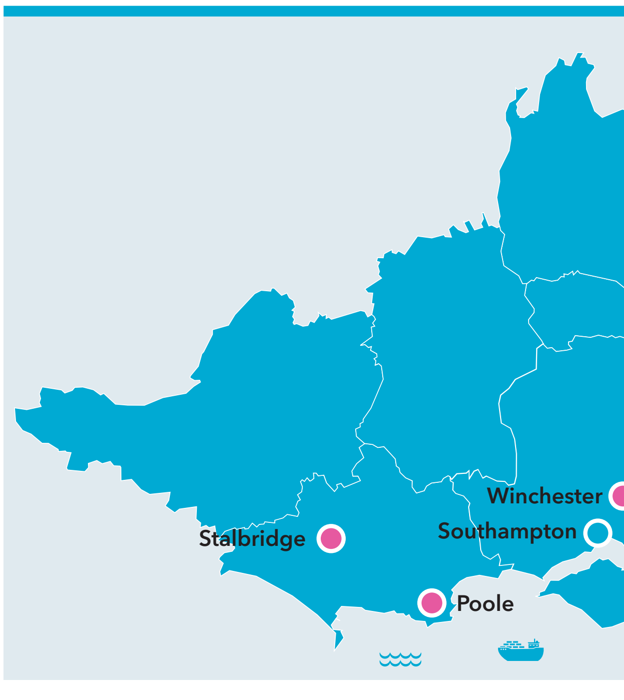
The south coast is also the location for an active corporate finance community, with hubs in its major conurbations. Its proximity to London, Reading and the wider Thames Valley region means that teams based along the south coast inevitably work alongside colleagues based in other areas, as Peter Vandervelde, RSM corporate finance partner, explains: "Corporate finance on the south coast tends to work closely with other cities, such as Reading, Gatwick and Bristol and we work across the UK and Europe, rather than concentrating solely on the local area. That means that we also source quite a lot of work from London and work with our London teams."

Natura Cosméticos

This is particularly the case with some of the larger deals involving the bigger businesses located in the region. Littlehampton and Croydon-headquartered cosmetics retailer The Body Shop was sold by L'Oréal to Brazilian cosmetics group Natura Cosméticos in June 2017 for about £880m. In July 2017, Southampton-based ferry operator Red Funnel Group was sold to a



Red Funnel Group



consortium of UK and Canadian pension funds for an undisclosed sum. And Sumitomo Group snapped up Micheldever Tyres, based in Winchester and backed by Graphite Capital, for £215m, in January 2017.

COMMUNITY VALUED

Nevertheless, a little further down the deal size spectrum, the region can claim to be relatively self-sufficient. Meridian Corporate Finance director Darren Thompson states that around 90% of the work his firm does is local. "We are Solent-focused," he says.

Smith & Williamson's Southampton office also generates most of its work through contacts with local companies. "We have a full-service office in Southampton. So our work from here is largely focused on south coast-based businesses, although we will obviously follow these around if, for example, they make an acquisition in the north or raise capital from investors based elsewhere," explains Amanda Phillips, head of corporate finance at the firm's Southampton office.

She adds that the region is well served by the full range of corporate finance services required by local businesses. "There is a local corporate finance community and we know each other well," explains Phillips. "That includes networks across banking, corporate finance advice and lawyers. This keeps the region pretty active and means clients can access high quality advice on patch."

Given its coastal location, the region may be best known for its marine-related businesses, but its economy covers a diverse range of sectors. "There are some good deal-doers based here, in particular as many have chosen to locate here as it is a nice place to be," says Vandervelde. "We see a lot of financial services activity as well as defence, electronics and IT." Added to this is leisure, healthcare-related businesses, including care homes and equipment and service providers and business service and construction companies.

New American Express building in Brighton

"There are some good deal-doers based here, in particular as many have chosen to locate here as it is a nice place to be"

Peter Vandervelde, corporate finance partner, RSM

The presence of two major UK universities - Southampton and Sussex - boosts the region's technology and engineering business quota, sectors in high demand on a global stage. "Southampton University is part of the SETsquared Partnership and that creates a good opportunity for spin-out businesses, often with an IP or tech focus," says Phillips. "There are around 36,000 students here, with a strong academic focus in areas such as engineering and marine technology."

This is feeding into opportunities for local advisers, adds Adrian Alexander, Brighton-based corporate finance partner at FRP Advisory. "There is an increasing number of transactions from media

RECENT DEALS

The large corporates may capture the national headlines, but it's in the smaller transactions where activity is really making waves. These are just some of the recent deals completed along the south coast.

- Dorset Village Bakery (AKA Thomas J Fudge), based in **Stalbridge**, acquired by Livingbridge in 2016 (food & beverage)
- The Laine Pub Group, based in **Brighton**, acquired by Patron Capital in 2018 (leisure/food & beverage)
- Paladone, based in **Brighton**, received £13m investment from LDC in 2018 (consumer & retail)
- Bluebird Care, based in **Petersfield**, acquired by US-based Interim Healthcare in 2013 (healthcare)
- MDSL, based in **Tunbridge Wells,** acquired by US-based Sumeru Equity Partners (IT)
- ProcessFlows, based in **Winchester**, acquired by Konica Minolta, in 2016 (technology)
- CEGA Group, based in **Chichester,** acquired by Charles Taylor in 2016 (insurance)
- Deverill, Based in **Poole**, acquired by 365itms in 2016 (IT services)
- The Quarr Group, based in **Fleet**, acquired by management in 2018 (construction services)

ALAMY, GETTY

Southampton retail quarter skyline at night

and IT companies, with Brighton being home to many growing firms in the sector," he says. "The Sussex Innovation Centre has also been key in helping to foster new businesses. We also see deals in the waste sector and other parts of the TMT sector here, too."

OVERSEAS INTEREST

It's perhaps this technology and technology-enabled services aspect of the region's economy that is driving increased interest from overseas buyers and investors. In Brighton, Asian buyers top the list of international acquirers. "We are seeing more overseas acquirers in the market, especially Indian buyers - in some cases they are considering smaller businesses to acquire than they may have a few years ago," says Alexander. "Plus, they see the UK as a good place to invest - the weak sterling is also contributing to this."

Southampton, meanwhile, is seeing deals with a more American flavour, following on from The Carlyle Group's £500m acquisition of Fareham-based insurance claims business Innovation Group in 2015. "There have been more US buyers looking to the region over the last two years," says Phillips. "Currency may be part of the reason, but it's also down to the fact that they still see the UK as a good stepping stone to Europe. Many are already familiar with the south coast - there is a good awareness of the area and the businesses located here."

The attraction of the UK's lower valuations comes at a time when technology businesses in the US are fetching very full prices. "International trade buyers have become increasingly important in our M&A work, with US and Asian buyers looking over here in recent years," says Thompson. "Technology here in the Solent and the UK more generally is well known on the global stage - the UK has a reputation for developing high-quality technology and building companies that are technology enablers."

Overall, the region looks set to remain active for some time to come, with work stemming from a healthy mix of M&A, growth capital investment, MBOs and more strategic planning. With liquidity in the domestic market, too, the pipeline for regionally based advisers is healthy. ●

"We are seeing more overseas acquirers in the market, especially Indian buyers"

Adrian Alexander, corporate finance partner, FRP Advisory

"Buyers are looking for management teams that are prepared to work through uncertainty and the issues that Brexit may throw out"

Amanda Phillips, head of corporate finance for the South, Smith & Williamson

POSTCARDS FROM THE COAST

It certainly seems that international interest in the South of England is not waning as a result of the uncertainty surrounding Brexit. "Last year, I think there was more circumspection around the UK among international buyers, but there seems to be more appetite this year," says Smith & Williamson's Amanda Phillips. "Buyers are looking for management teams that are prepared to work through uncertainty and address the issues that Brexit may throw out."

For their part, local businesses are doing just that – getting on with managing their operations. "Businesses are generally doing well and most recognise they just need to carry on in the face of Brexit – there is little they can do to influence the outcome," says FRP's Alexander. "It does mean that decision-making is taking longer, as the uncertainty weighs on both buyers and sellers."

Nevertheless, some are acting with an eye to what may come of the current negotiations. "Brexit isn't creating a great deal of M&A here, although many businesses are starting to set up contingency plans," says RSM's Vandervelde. "We're seeing some look at establishing Dublin headquarters or subsidiaries in the EU if they lean more towards Europe. But I'd say these are more contingency arrangements than wholesale relocations. The UK-focused businesses are adopting more of a wait and see approach as they don't want to carry out work unnecessarily."

There are also signs that some owners who are facing succession issues are bringing their plans to sell forward on the basis that there is a ready market currently for high quality businesses. "We're seeing a number of business owners coming up to retirement looking to de-risk now in the belief that market conditions won't be better in a few years than they are now," adds Vandervelde. "And the tax environment is generally benign for business sales currently, for example."

Southampton Docks at night

Weir there's a way…

Weir Group, the first winner of the Corporate Finance Faculty's corporate development award in 2012, has since hit some lows. But the Glasgow-based engineering business is now back on track and making acquisitions again

US SHALE SHINES

In April 2018 Weir announced a $1.3bn offer for US industrial equipment manufacturer Esco. The deal would bolster its business in minerals and fuel extraction – and run against the trends for US corporates to snap up.

Esco produces a lot of machinery for the US shale industry, which has been revitalised thanks to a rally in the oil price to its highest level in three years.

Weir had been reinvigorated in 2017. Its profits were up almost 50%. As it announced the deal, Weir also announced it would be selling its flow control unit. The Esco acquisition should complete next quarter.

CEO Jon Martin said it planned to be a consolidator in the sector. Russ Mould, AJ Bell investment director, told the *FT* the market seemed "pleased" with Weir doubling down on resources exposure.

HEADING EAST

In June last year Weir announced the acquisition of Singapore-based KOP Surface Products from Norwegian oilfield services investor Akastor for $114m. Weir's oil and gas division had been hit hardest by the low oil price, naturally, but the deal was a sign of returning confidence.

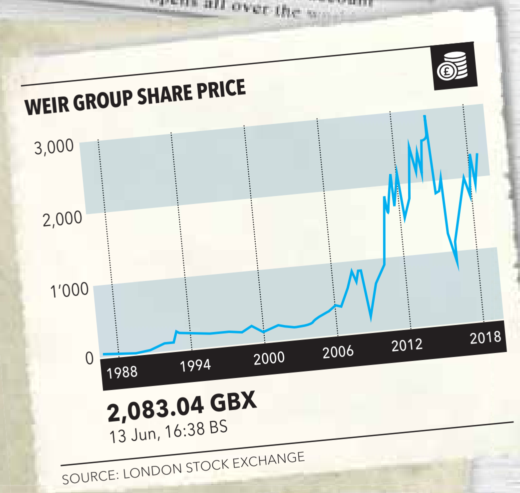
"You get a sense they're coming through the curve," Peel Hunt analyst Harry Philips told the *FT*. New shares were issued to fund the deal.

PAY REFORMER

In March 2018, Weir announced it was taking the lead in dropping long-term incentives plans (LTIPs) associated with excessive remuneration.

It revealed a new annual system of restricted shares incentives, with payouts delayed up to seven years. Awards for the CEO are now restricted to 125% of base salary, and 100% for the CFO – half of what was set up previously.

The board now can withhold payouts. In eight of the previous 10 years, the LTIP scheme either paid maximum or nothing.



Nick Martin (right) receives the faculty's corporate development award on behalf of the Weir Group in 2012

SHAKE IT UP

After 17 years with the company, Weir's head of corporate development Nick Martin left in 2014 as part of a wider management and boardroom shake up.

After a period of retrenchment when it came to M&A, in 2016 Edward Pears, who had spent 10 years in corporate finance with PwC, was poached from Whyte & Mackay as head of corporate development.

Jon Stanton, an ex-EY partner and an ACA, joined the company as FD in in 2010. He was appointed CEO in October 2016, succeeding Keith Cochrane. John Heasley, an ex-PwC Scottish chartered accountant, who'd been a divisional MD, became CFO the same month.

Chairman Charles Berry paid tribute to Cochrane's efforts – which saw the share price double from its lows of 2014 – before he left.

Non-execs were bolstered last August by the recruitment of Alcoa's former head of corporate development, Barbara Jeremiah, and former BT director Clare Chapman. In January 2018, former Meggitt Plc CEO Stephen Young joined as non-exec.

ALAMY

PROTECT YOURSELF

While it is common practice for a public company's board to get a fairness opinion during their sale, they are increasingly used in the context of private company transactions. **Jeff Schiedemeyer** details the importance of fairness opinions to company boards

Fairness opinions (FOs) carried out by an independent financial adviser assist boards of directors and other fiduciaries in their decision-making process. With changing European legislation, boards need to protect and support their decisions, which can be aided by an independent FO from a reputable and experienced financial adviser. Historically, FOs have been more prevalent in the US, but there is a growing trend in Europe for companies to obtain an independent FO when contemplating a major corporate transaction.

PRIVATE COMPANY PERSPECTIVE

The private equity community has grown dramatically and increased its global presence over the last 20 years. Generally, private equity corporate governance responsibilities and practices are similar regardless of jurisdiction. Since general partners (GPs) have fiduciary duties to their limited partners (LPs), private equity funds that find themselves engaging in related-party transactions have certain conflicts of interest to keep in mind.

When portfolio company transactions, which are private in nature, are between funds under the same GP, the GP has a fiduciary duty to the LPs of both funds to ensure that the transaction price is 'fair' to both funds. To address issues or concerns related to asymmetric information and the appearance of self-dealing in related-party transactions, an independent FO adviser will be brought in to mitigate any seeming conflict of interest, whereby one fund may be favoured over another.

Some private equity funds will avoid related-party transactions altogether because they simply do not want to be perceived as engaging in potential self-dealing. However, GPs who are comfortable engaging in related-party transactions, as a matter of good governance and best practice, will seek an independent FO from an experienced financial adviser to determine that the price being paid and/or received is fair.

INSIDE THE PROCESS

Ideally, the FO provider will have about a month to complete its analysis, but this can vary as transaction timelines typically have a life of their own. At the onset, the independent adviser will conduct a due diligence meeting with the executive management team. The adviser also provides the client with an information request regarding the subject company – historical financials and financial projections prepared by management, and other information related to the business and the transaction. The information is then analysed, a valuation analysis is executed and the opinion is rendered.

The adviser's financial analysis typically results in a range of values

Historically, fairness opinions have been more prevalent in the US, but there is a growing trend in Europe for companies to obtain one when contemplating a major corporate transaction

used to assess where the transaction price falls relative to the range. If the transaction price falls within the range, or even below or above the range depending upon the perspective of the opinion, then the FO supports the price.

If the financial analysis does not support financial fairness regarding price, then feedback provided to the client may be used to negotiate on price, which can be the difference between a deal getting done or not. In certain instances the fairness analysis may provide additional leverage for the client to negotiate a better price.

MORE THAN A LETTER

There's more to an FO than a four-page letter indicating a transaction price is fair from a financial point of view - a robust and thorough financial analysis ultimately underpins the written opinion letter. A summary of the financial analysis is presented to the board, explaining the conclusions of the analysis and the opinion. Ultimately the board relies on the financial adviser's FO and the supporting financial analysis to make its own informed decision regarding a transaction. In relying on the financial adviser's advice, it is imperative that the board receive enough detail to understand how the adviser came to its conclusion, but not so much detail as to be overwhelmed.

In a private company context, the litigation risk and thus need for a third-party FO varies by situation. A private company may have a large shareholder base with divergent views, or a transaction may be between related parties where there are conflicts of interest (see box, above). An independent third-party FO can help mitigate conflicts of interest and the inherent litigation risk. Good corporate governance practices and transparency help reduce investor scepticism, and ultimately reduces the risk of litigation. ●

FAIRNESS OPINION – A WORKING EXAMPLE

For a private equity (PE) sponsor, one of its funds was mature and approaching the end of its term. The general partner (GP) determined the timing was not right to sell to a third party the remaining unrealised private investment (ie, one portfolio company) held by the maturing fund. Instead, the GP decided to sell or transfer the ownership interest in the portfolio company from the maturing fund to a new continuation fund managed by the same GP. Since such a transaction is related-party in nature, the PE sponsor engaged Duff & Phelps (D&P) to provide an independent valuation range for the subject portfolio company and a fairness opinion (FO) on the valuation of the subject portfolio company to be used in the transaction.

The solution

D&P was engaged collectively by the GP, the selling fund and the continuation (buying) fund, to provide a FO on the valuation at which the portfolio company would be sold or transferred from the maturing fund to the continuation fund. The GP did not run a third-party sale process to solicit bids from potential new investors so there were no third-party indications of value.

One of the first tasks was to determine a range of enterprise values for the portfolio company. The GP was then advised of the valuation range and the GP chose the midpoint of the valuation range for purposes of the buy/sell price for the transaction.

The FO provided was two-sided – meaning it addressed fairness to the selling fund as well as the continuation fund. The fund investment committee (IC) and LP Advisory Committee (LPAC) were each provided with a copy of the FO, as well as the supporting valuation analysis. The IC and LPAC approvals were received and the transaction completed.

THE STATS

Duff & Phelps was ranked number one in 2017 for the number of announced fairness opinions in the US and globally, according to Thomson Reuters. The firm rendered nearly 100 fairness opinions with an aggregate deal value of more than $38bn last year. Over the past decade the firm has rendered 800+ fairness opinions worldwide, representing more than $250bn in deal value.

A recent study by Duff & Phelps on the value of fairness opinions for boards and special committees looked at more than 3,000 publicly disclosed fairness opinions in the US. It found:

- the vast majority of fairness opinions deliver a range of valuations that are 10% to 15% either side of a midpoint;
- of the fairness opinions reviewed, 91% used multiple methodologies to arrive at valuations while 75% used three or more; and
- discounted cash flows provided the narrowest range of values of the methodologies reviewed.

Duff & Phelps is a member firm of the faculty.

800+

Fairness opinions made by Duff & Phelps in the last decade globally

$250bn

Deal value of Duff & Phelps' 800+ fairness opinions

Jeff Schiedemeyer, managing director in the corporate finance practice, and a senior member of the transaction opinions practice at Duff & Phelps. He is based in Chicago

APPOINTMENTS

Satvir Bungar, managing director of M&A and head of the facilities management sector at **BDO**, has been awarded an MBE for services to corporate finance in the Queen's Birthday Honours. Based in Birmingham, he joined BDO in 2005 from Homeserve Plc, where he was M&A director. Prior to that, he worked for EY, and before that PwC, where he qualified as an ACA.

"Receiving an MBE for services to corporate finance is a tremendous honour – a testament to the many talented clients and team members that I have had the pleasure of working with over the years at BDO," said Bungar.

Alantra (formerly Catalyst Corporate Finance) has promoted Tom Cowap and Ali Robertson to director. Based in London, Cowap joined Catalyst's healthcare team in 2013 from PwC, where he worked in transaction services, having qualified as an ACA. Birmingham-based Robertson joined the industrials team in 2013 from Grant Thornton in London. Prior to that, he trained as a chartered accountant with PwC in Aberdeen.

David Slater has joined **KPMG**'s team of trade specialists, advising businesses on overseas market strategies. He joins from London & Partners, where he was director of international trade and investment.

Slater will work with businesses to understand where and how they should establish a base overseas and evaluate the benefits and risks of 'going global'.

Kreston Reeves has strengthened its corporate finance practice with its merger with Surrey-based boutique SamCorp. This has been further bolstered by the appointment of Jack Clipsham (1) as corporate finance partner.

SamCorp directors Peter Samuels (2) and Darren Hurdle (3) will move into the Gatwick office of Kreston Reeves.

Clipsham had recently been working as CFO at Western Thermal and iGene Digital Autopsy, and was head of corporate finance for East Asia at Mazars prior to that. He previously worked in corporate finance at BDO, Pannell Kerr Forster, Beavis Walker and Guinness Mahon.

PE SHORTS

Keven Parker and Andy Tupholme have joined **NorthEdge** as portfolio directors. Parker has joined from construction firm Shepherd Group, where he was a main board director and group CFO. Tupholme was appointed after a period as an independent non-executive director on a number of boards, including social investment fund The Key Fund, and HR tech business Tribepad. He has 20 years' investment experience.

Rutland Partners has recruited Will Southgate as investment manager from PwC, where he qualified as a chartered accountant in 2012 before spending five years in the corporate finance team. And Gessica Howarth has joined from Goldman Sachs, where she worked in both the investment banking division – focusing on financial institutions M&A – and the investment management division as a junior portfolio manager.

John Butterworth has joined **Connection Capital** as investment manager from KPMG, where he was associate director in its deal advisory practice. He joined KPMG in 2010, specialising in TMT and qualified as an ACA in 2013.

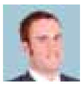
Julian Masters (1) has been promoted to managing partner at **Bowmark Capital**. He joined the firm in 2008 from European Capital.

The private equity firm has also promoted Luca Mastrodonato (2) to business development director. He joined from EY in 2011 to develop the firm's research and direct origination activities.

And Tom Keen (3) has joined the firm as investment manager from Lyceum Capital. Previously, he spent four years at CIL Management Consultants.

Daniel Szabo has joined **Sanlam UK** as portfolio manager from Oxford Capital, where he worked with high-net-worth private clients. He has more than 17 years' experience in the wealth management industry.

Private equity charity **Impetus-PEF** has appointed Hanneke Smits as chair.



James Cowper Kreston has promoted Tom Russell to business recovery and insolvency director. He joined the firm 12 years ago.

Grant Thornton in Chelmsford has promoted Doug Bentley to corporate finance director. He has been with the firm seven years, having initially joined the Cambridge office from Peters Elworthy & Moore.

Adrian Nicholls, a partner in EY's valuation and business modelling practice, has been appointed chair of the **Royal Institution of Chartered Surveyors**' business valuation group. Activities will include influencing UK government policy and encouraging more diverse talent into the industry. He is an ACA and was formerly a member of the ICAEW's valuations special interest group.

Crowe Horwath International global has rebranded as **Crowe**.

Kroll has been taken over by **Duff & Phelps**. The combined advisory firm now has 3,500 professionals in 28 countries.

LEGAL BRIEFS







Dentons Rodyk has recruited Roderick Howell (1) to its banking and finance practice in Singapore.

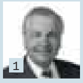
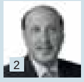
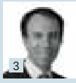
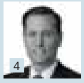
Maria Livanos (2) was appointed co-chair of the Denton's US Women LEAD committee, which focuses on supporting and building the success of women in the firm, joining litigation partner Christina Carroll. Courtney Burton (3), partner in the firm's Calgary office, will be Canada region head for Women LEAD.

In Italy Gianpaolo Garofalo (4) has been recruited as structured finance partner in its banking and finance practice. Junyi Bai (5) has been recruited as co-head of its China desk in Italy.

The firm has also promoted two new corporate partners in the US: Amanda Leech (6) in Atlanta and Curtis Stefanak (7) in New York.




Travers Smith in London has promoted Mohammed Senouci (1) to corporate finance partner. Ian Keefe (2), Genevieve Marten (3), George Weavil (4) have been promoted to private equity partners.

Gibson, Dunn & Crutcher has recruited George Stamas (1), Mark Director (2), Andrew Herman (3), and Alexander Fine (4) as partners from Kirkland & Ellis. All will work in the firm's New York and Washington DC offices.

Jinsong Zhang has joined **Orrick** as partner in its M&A and private equity practice in China, from King & Wood Mallesons, where he was a partner based in New York. He will split his time between the firm's Beijing and New York offices.

Simmons & Simmons has recruited Gabriele Röhl as counsel in its capital markets practice in Frankfurt from Allen & Overy.

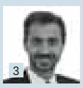
Smits is currently chief executive of Newton Asset Management. She has been trustee of Impetus-PEF for four years, and is co-founder and a former chair of Level 20, the organisation set up to encourage more women to join private equity. She previously worked for Adams Street Partners and Pantheon Ventures.


European SME investor, **Idinvest Partners**, has recruited Nicolas Debock as investment director in its venture capital team from Balderton Capital. Prior to that, he worked for XAnge Private Equity. Idinvest has also recruited Guillaume Santamaria as investment director in its growth capital team from Apparius Corporate Finance. He previously worked for Quilvest Group.

Nord Holding has recruited former Quadriga Capital partner Andreas Bösenberg as head of direct investment for Germany, Austria and Switzerland.

Investec has recruited Galina Markova to its corporate and acquisition finance team in London from Sumitomo Mitsui Banking Corporation, where she was executive director in the leveraged finance team. She previously worked for GE Capital.





Ambienta has promoted Daniele Gatti (1), who joined the European private equity firm in 2012 from EY, to CFO. The firm has also promoted Giancarlo Beraudo (2) and Francesco Lodrini (3) to partner. Beraudo joined in 2010 after two years at Bain in Milan. Prior to that, he worked for Rhône Capital in London. Lodrini joined the firm seven years ago from Equistone. He previously worked for Goldman Sachs and Monitor Group.


Blossom Capital, the venture capital firm founded by Ophelia Brown in February 2018, has recruited Brett O'Farrell as the firm's fifth partner. He has joined from Schroder Adveq where he was investment manager. He trained with KPMG in South Africa.

BlackFin Capital Partners has recruited Kai Franzmeyer as managing director from Senacor Technologies, to lead the expansion of its financial services market in Germany, Austria and Switzerland.

THE CV

David Wilson is an investment partner at Panoramic Growth Equity. Based in London and Glasgow, he trained as a chartered accountant with Moore Stephens in Edinburgh before joining the firm's corporate finance team. He joined Bank of Scotland Growth Equity in 2001 and in 2009 started Panoramic with his two business partners. He is a graduate of St Andrews University.

Recent deals

- Investment in Edesix (2014)
- Sale of Specialist Tours (2015)
- Sale of Concorde Solutions (2015)

RIGHT CHEMISTRY

The right team for a buy-out is vital. But building trust with unadvised vendors can make or break a deal, says **David Wilson** of Panoramic Growth Equity

WHAT WAS THE DEAL?
It was the fifth investment from our Panoramic Growth Fund 2 – a buy-in management buy-out of Doncaster-based specialty chemical manufacturers Majestic Polymers and DSA Chemicals, which was run as one company, but in different markets. Majestic specialises in pressure-sensitive adhesives, such as those for airport baggage labels, while DSA is in the petrochemical arena, helping oil producers extract oil in the most efficient way.

WHO WERE THE BUY-IN TEAM?
We took a significant minority stake. The new incoming management team – managing director Mark Briscoe and operations director Peter Weaver – were significant co-investors. The focus is on organic growth, and the new funding will enable the businesses to increase capacity, and grow domestically and internationally. Briscoe was previously managing director of Saffil (a high temperature materials manufacturer) when it was sold to Unifrax in the US in 2011. Weaver previously worked for FMC Corporation and Astra Zeneca. HSBC in Liverpool provided the debt for the deal.

WHAT WERE THE TIMESCALES?
It took quite a long time to complete. Jeremy Cole introduced us to the deal in February 2017. He runs Manchester-based corporate finance advisory business Cole Associates. After seeing the information on the business in early 2017, he asked Briscoe to look at its forecasts and plans. We were then introduced as backer, met with the various parties, and in early summer agreed heads of terms. We ended up completing the deal in October 2017. It was more complicated and intricate than we thought or hoped for.

WHAT WAS THE OPPORTUNITY?
The business was started over 35 years ago, and had been through various reorganisations throughout its history. Success had been achieved through word of mouth, carving a niche as an expert in the design and manufacture of speciality chemicals. Part of our plans include investing in sales and marketing, as part of a programme to win new business and grow the top line organically.

WHO WERE THE ADVISERS?
Sean Kelly and Jennifer Evans from Pitmans in Reading were our legal advisers, and David Holt and Linzi Wilson from Consilium carried out financial due diligence. TL Dallas in Glasgow carried out insurance due diligence for us. The management team was advised by Cole Associates, and DAC Beachcroft provided their legal advice. Led by John Gibson, HSBC in Liverpool provided debt funding.

WHAT WAS THE KEY CHALLENGE?
Keeping momentum in the deal was critical. Different worlds were coming together. We had retiring vendors who were not familiar with private equity, so there was a natural suspicion. Alongside management, we focused on maintaining a positive relationship throughout the process and tried to break down the myths that perhaps surround what we do. It takes time and isn't the easiest thing in the world. There were then some intricacies to the deal, including commercial supply agreements and the property which was owned by the vendor. We had to show him that he could trust us or the deal would have failed. ●

PHOTOGRAPHY: ROB WHITROW