Q3 2021

UK Private Company Director

Welcome to the October 2021 issue of UK Private Company Director, the quarterly newsletter for directors of owner-managed, family and private equity backed businesses.

We cover financial, legal, tax, wealth management and similar issues crucial to both building and realising the value of your business. Corbett Keeling's report on deal activity in the private equity markets also provides a clear insight into financial investor appetite.

In this edition, Corbett Keeling, the oldest independent and privately owned generalist corporate finance firm in the City, analyses the remarkable strength of the M&A market, which shows no sign of abating with many sectors on course for a record year (pages 2 to 4).

Leading global law firm, Dechert, reviews the possible implications for business owners of probable changes in corporate criminal liability law (page 5).

And our new contributor, the renowned private bank, Arbuthnot Latham, explains how business owners can protect their business from the unexpected by putting in place the right business protections (page 6).

If you would like to explore any of these topics in further detail, please don't hesitate to get in touch directly with our contributors, whose contact details are on the final page.

Best wishes,
Megan Peel, Editor

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Corbett Keeling Corporate Finance

Dechert LLP

Arbuthnot Latham
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Corbett Keeling
Corporate Finance

"Never seen anything like it"

After a first six months that set records for volumes and values in some sectors of the market, transaction activity maintained a rapid pace during the third quarter, with buyers still prepared to pay high prices for attractive businesses. Here, Jim Keeling of corporate finance advisor Corbett Keeling looks at the data and assesses the outlook for the rest of the year.

Deal making among UK private companies remains exceptionally strong. While rising inflation and potential Capital Gains Tax increases may eventually slow the current brisk pace of activity, that seems a distant prospect at the moment. And the strength has been broad-based, with some sectors already beating their previous annual records for volumes or values after only nine months of the year.

I believe this remains very much a "win-win" market. Cash-rich trade buyers and private equity funds are scouring the marketplace for ways to put their money to work, while many owners of private companies are keen to take advantage of this opportunity to exit their business, particularly after a tricky last 18 months. The result: a large number of deals are being done at prices that are good for buyers and sellers alike.

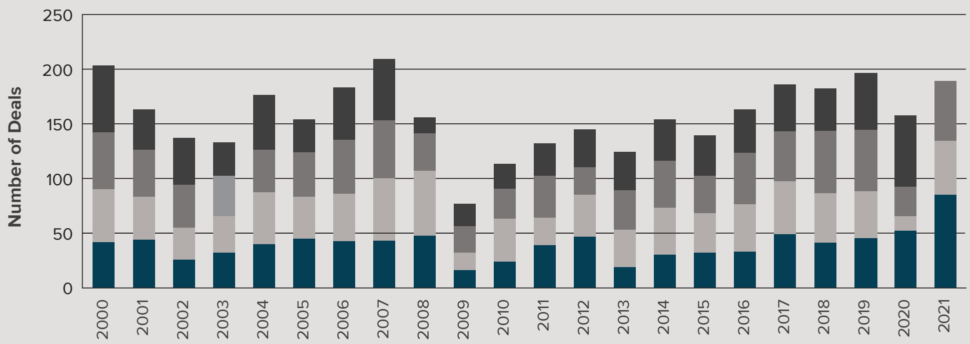
We have certainly been very busy at Corbett Keeling, and we are not alone. Indeed, advisors in the US M&A market, where we are currently advising on a deal with our US partner firm, say that they have never seen anything like it. As a consequence, we have sometimes faced a shortage of due diligence and legal professionals to help us with deals we are working on. This is one shortage which is definitely due to strong demand, rather than disrupted supply chains!

And, judging by the results of our latest survey of market participants, the pace of deal making activity is unlikely to slow over the remainder of 2021. But market conditions can change quickly, while sales are invariably time-consuming processes. So any owners of private companies who are contemplating a sale may wish to move promptly to make the most of this buoyancy.

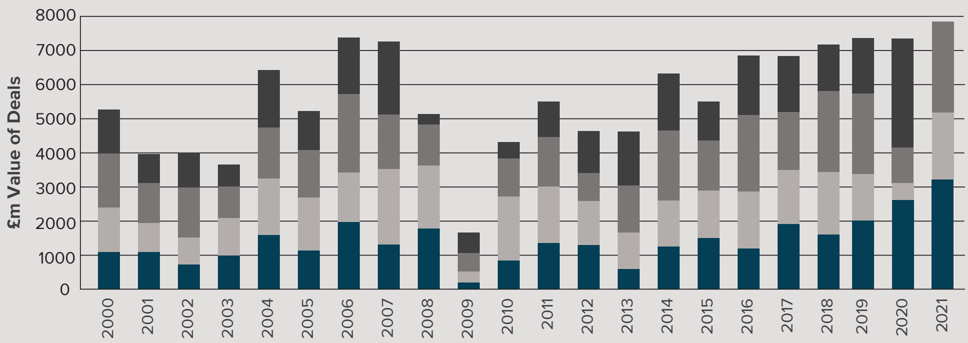
Assessing the deal data

Activity in the **smaller buy-outs** sector (transactions with enterprise value of less than £150 million) increased over the three months. The volume of deals rose from 49 in the second quarter to 55, while their value climbed from just under £2.0 billion to £2.7 billion. Although below the first quarter's total of £3.2 billion, that is still the third highest quarterly valuation figure since our data began, and it takes this sector to its annual record after only nine months of the year.

Sub-£150m Buyouts by Volume



Sub-£150m Buyouts by Value



Key:

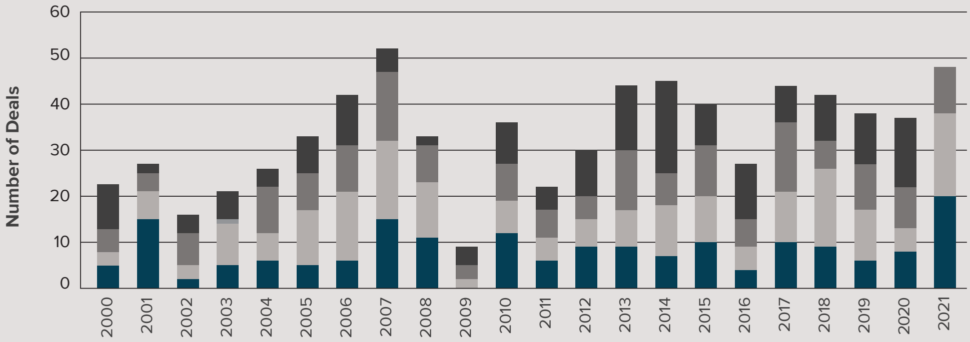
- Q4
- Q3
- Q2
- Q1

It was another impressive quarter for the **larger buy-outs** sector (enterprise value of £150 million or above). While the number of transactions fell from a very strong 18 to a still respectable 10, the prices achieved were very strong. Overall valuations held up remarkably well, dipping from £10.7 billion to £8.2 billion. Looking at the first nine months of the year, the valuations for this segment were the third highest on record, and the volume of deals set an all-time high.

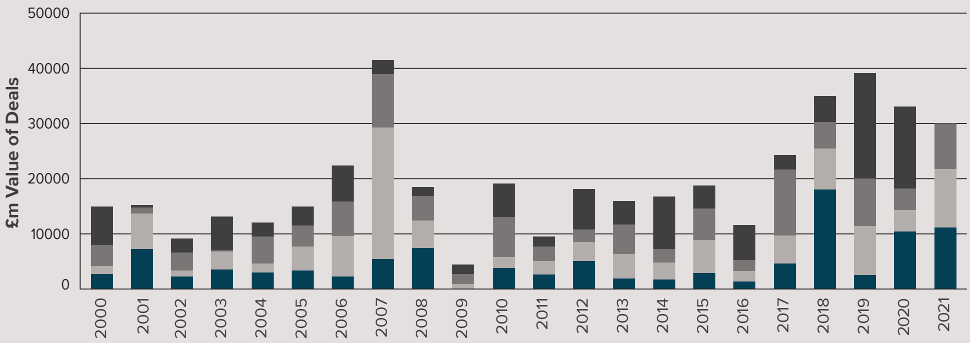
Key:

- Q4
- Q3
- Q2
- Q1

£150m+ Buyouts by Volume



£150m+ Buyouts by Value



The strength in the **early-stage and expansion capital deals** continued. The number of transactions held steady at 128 compared with 129 in the second quarter, still appreciably below the first quarter's total of 168. But the value of deals remained exceptionally strong, rising from £5.8 billion to £7.8 billion, not far off the first quarter's record total of £8.4 billion. So it's no surprise that this sector has already smashed the previous highest annual total for values, with three months of the year still to come.

Key:

- Q4
- Q3
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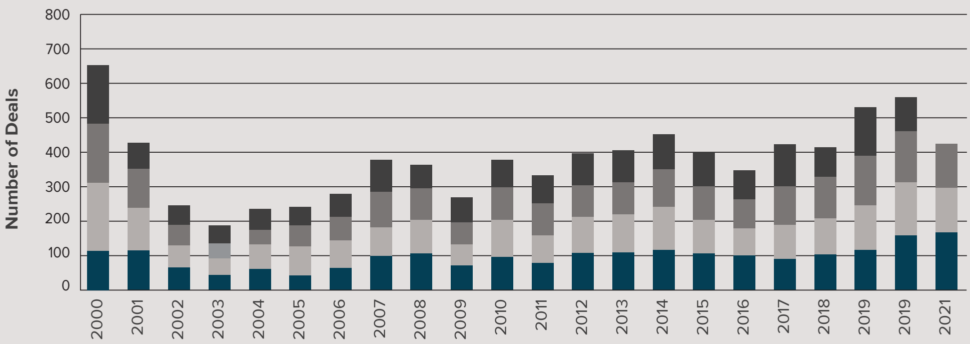
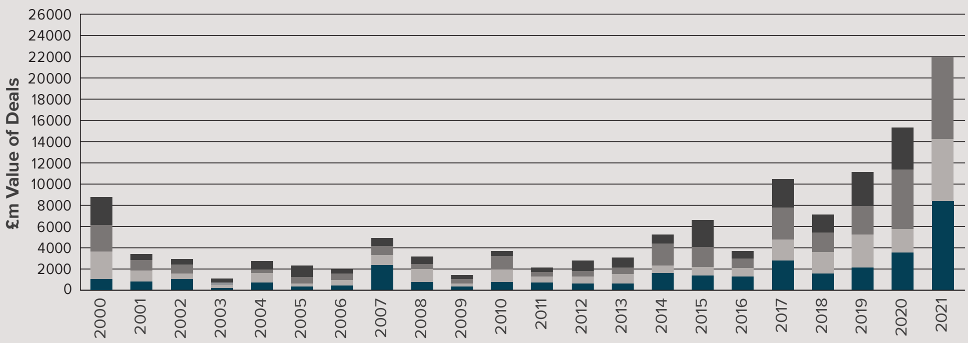
Volume of Early-Stage / Expansion Deals



Value of Early-Stage / Expansion Deals

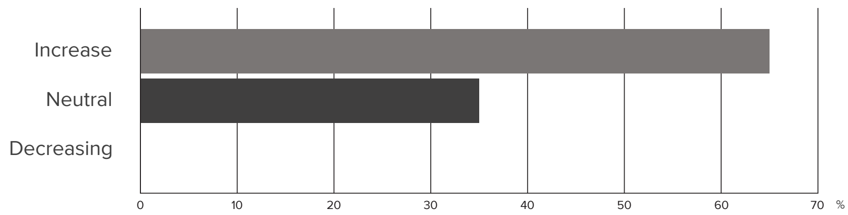


So what does our latest survey suggest?

Market participants appear to be in a buoyant frame of mind. Although they acknowledge that the recent disruption to supply chains has had a near-term impact on the businesses they own, that has certainly not dented their optimism – indeed, far from it.

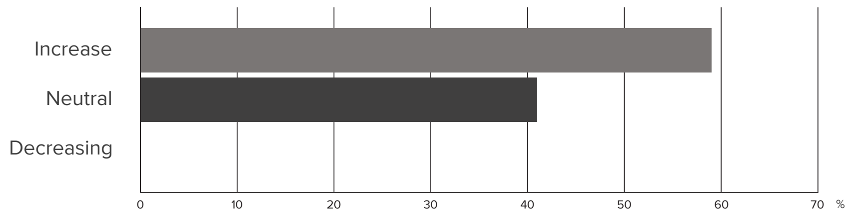
1 Do you expect deal volumes to increase or decrease?

Asked whether deal volumes were likely to increase or decrease, nearly two thirds of our respondents said they expected volumes to rise, while the remainder expected no change. That is far more positive than last quarter, when the clear majority predicted no change or a decrease in activity.



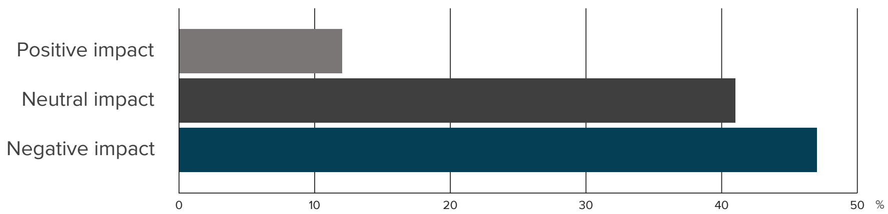
2 Is debt availability increasing, decreasing or neutral?

Similarly, any lingering concerns about debt availability seem to have vanished. Nearly 60% say they actually expect debt to become more freely available, and the rest are neutral. By comparison, one eighth of respondents in last quarter's survey expected debt availability to decrease while three quarters said it would be little changed.



3 Have recent supply chain constraints had an impact on your portfolio businesses?

As noted above, supply chain constraints are biting, with almost half of respondents reporting some impact on their portfolio companies. While that is a burden on businesses, we are encouraged that it shows no signs of dampening the market's overall enthusiasm.



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Dechert LLP

Corporate criminal liability: what's changing?

The Law Commission's recent public consultation paper aims to address long-standing issues with corporate criminal liability in England & Wales. Craig Watson and Caroline Black of law firm Dechert LLP argue that probable changes to the law will make it vital for company boards to have more proactive compliance processes, to undertake financial crime prevention health checks on employees', agents' and suppliers' conduct and to ensure policies and procedures are in line with best practice.

The identification principle

In general, companies can be convicted of a criminal offence in England and Wales only where prosecutors can prove the criminality of an individual who is also considered a part of the "directing mind and will" of the company. The English courts have tended to limit the scope of a company's "directing mind and will" to individuals who are considered executives or very senior managers.

As a result, prosecutors typically find it hard to successfully convict large companies, where decisions are often delegated to more junior employees. So "larger corporations whose actions will often have the most serious social and economic consequences"* are less likely to be successfully prosecuted for criminal acts than smaller companies with flatter hierarchies. The Law Commission's paper seeks to address this imbalance.

"Failure to prevent" offences

Parliament has in recent years created two specific "failure to prevent" offences focusing on corporate liability for bribery and tax evasion. These make the company legally responsible for the actions of all employees and third parties acting on its behalf to win or maintain business or give it an advantage. There is no seniority threshold and no requirement for the individual to be an employee.

However, the "failure to prevent" offences were accompanied by a defence of "adequate" or "reasonable" procedures. They also required the government to provide guidance on the steps companies should take to avail themselves of these defences. This model, accompanied by a series of enforcement actions, has successfully placed the emphasis on compliance and changed the mindset of corporate Britain in these particular fields. However, there is now considerable pressure on the government to introduce additional legislation beyond bribery and tax evasion, to better reflect the need to hold large, modern multi-national companies to account.

Future expansion of corporate criminal liability

Reform of the law for corporate criminal liability now appears inevitable, and the Law Commission's consultation paper proposes two possible routes:

i) expanding the scope of "failure to prevent" offences to include a wider array of corporate wrongdoing; or

ii) revising the identification principle to attribute corporate criminal liability to a broader group of individuals within businesses.

Either option will require stronger oversight and compliance procedures for executives and employees with managerial responsibilities.

If a "failure to prevent" model is rolled out to a wider array of economic crimes, the experience with the Bribery Act has shown that companies will need robust and documented compliance procedures if they are to defend themselves. One particular area which seems ripe for enforcement focus is ESG impact statements. If these don't accurately represent a company's ESG efforts, they could result in a case of "failure to prevent" a fraud on investors.

History shows that times of economic stress have typically led to increased levels of corporate criminal behaviour, as managers and employees come under greater commercial pressure. So now is the time for a redoubled focus on compliance and remediation efforts throughout corporate life to ensure that the soon to be expanded net of criminal liability is avoided.

*Chapter 1, para 1.8, Law Commission discussion paper "Corporate Criminal Liability", 9 June 2021.

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ARBUTHNOT LATHAM
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Protecting your business

You can't stop the unexpected from happening, and a sudden loss will always have consequences. But you can ensure it doesn't completely derail your business. As Spike Godwin of Arbuthnot Latham explains, by putting in place the right business protections, you can create a financial cushion to reduce the impact of unforeseen events.

At a glance

Area of risk	Protection available
• Control/ownership risk • Operating/business continuity risk • Default risk • Retention/staff benefits • Executive benefits	• Shareholder protection • Key person protection • Business loan protection • Relevant life cover • Executive income protection

Understanding risks

It is important to think in advance about how your business might be affected and what controls you need in place to protect the value of your shares and the people who matter most to the business's operations.

Control/ownership risk

Surprisingly, six out of ten business owners have no financial protection in place to cover the cost of purchasing shares should a business owner die, a time when share ownership and the associated voting rights can pass outside the company.

Shareholder protection can be a good solution if the company is unlikely to have sufficient capital or retained profit to purchase those shares directly. This protection can ensure that control of the business remains with its directors.

Operating/business continuity risk

Sometimes the effect one individual has on turnover or profit is so great that the business would struggle to survive without them. Losing such an individual could cause a loss of confidence in the business. In turn, that could lead suppliers to request payment upfront, financial providers to limit credit lines, the share price to fall, the brand to be damaged or customers to seek alternatives.

Key person protection insures against profit and debt risk and can help you to meet the financial needs of the business while a replacement staff member is found. This cover can help your business to meet its ongoing financial obligations and provide stability for customers, employees and shareholders during an uncertain time.

Default risk

To support their growth plans, many businesses borrow via commercial loans, overdrafts, mortgages or directors' loans. Should a key person become critically ill or die, creditors may suddenly seek repayment of debts.

Business loan protection differs from key person protection as the amount insured is typically in line with a specific loan repayment term.

Retention/staff benefits

Attracting and retaining quality employees is fundamental to the success of a business, and offering a benefits package beyond salary and bonus is important to staff retention. Relevant life cover allows businesses to offer a death in service benefit to employees.

The tax advantages to the employee are myriad and may fall outside the employee's estate for the purposes of Inheritance Tax. Importantly, premiums paid are not considered a benefit in kind for income tax, nor are they subject to National Insurance (NI) contributions. Furthermore, an employee's pension lifetime or annual allowance is not impacted. There are tax benefits for the business too.

Executive benefits

Senior staff remuneration is usually made up of more than pay and bonus and will often include pension contributions, dividends, commission and even overtime. If executives are unable to work due to illness or injury, they may not be able to meet their basic income needs. Executive income protection is designed for owners and high-earning employees. Cover can include employer pension contributions and NI contributions, providing financial stability when needed most.

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Dechert is a leading global law firm with 22 offices around the world, 900+ lawyers and a top-ranked PE and M&A practice offering clients innovative solutions to deal-specific issues and on the legal and technical aspects of complex, cross-border transactions.

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