Q2 2023

UK Private Company Director

Welcome to the July 2023 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.

As always, this issue tackles some of today's pressing issues for directors of privately owned businesses:

- We explore why the smaller deals segment of the private M&A market is holding up so much better than larger deals (pages 2 to 3).
- Given increased competition and capacity in the warranty and indemnity insurance market, we look at some of the latest developments in how buyers and sellers use it to facilitate transactions (page 4).
- A well-defined exit strategy can help keep a business plan on track, but it's also important to consider the keys to success after the sale (page 5).

Best wishes,
Megan Peel, Editor

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Corbett Keeling
Corporate Finance

A varied landscape

While the larger deals segment of the private M&A market remains in the doldrums, activity in the mid and smaller segment has held up well. Jim Keeling of corporate finance advisor Corbett Keeling looks at the drivers behind the varied landscape.

The post pandemic boom in transaction activity has slowed. While the volume of deals in the larger transaction segment of the market has declined appreciably since the fourth quarter of 2022, the collapse in values has been little short of dramatic.

And yet we at Corbett Keeling have never been busier in the thirty years since our founding. So what's going on?

It appears to be a combination of factors. First, now that the post pandemic backlog of deals has been cleared, private equity firms seem to be turning their attention to smaller companies, which require less funding and give lower exposure to any one larger deal.

At the same time, owners of independent private companies, having survived the challenges of the last three years, now face further uncertainty in the form of stubbornly high inflation, rising interest rates and weakening economic growth. It's little surprise, then, that many are looking to find an exit.

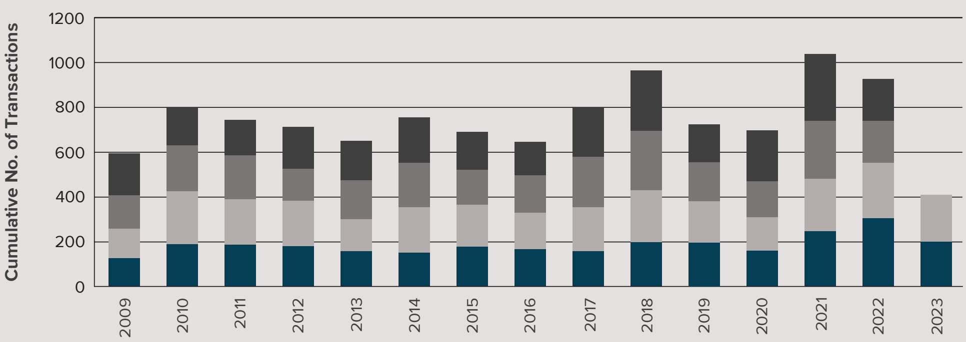
As a result, a large number of deals are still getting done in this segment of the market. And the more sanguine mood of market participants revealed in our latest survey suggests that the pace of activity should remain brisk in the coming months.

However, anyone looking to sell may wish to get the wheels in motion sooner rather than later. Deals normally take longer than you would think, and that's particularly true now with buyers in the current market often requiring greater due diligence, which can be very time-consuming, along with more extended earn out periods. And, with a general election due by the end of next year, the odds currently seem to be on a change of government which might well see increased capital gains tax as a source of additional revenues.

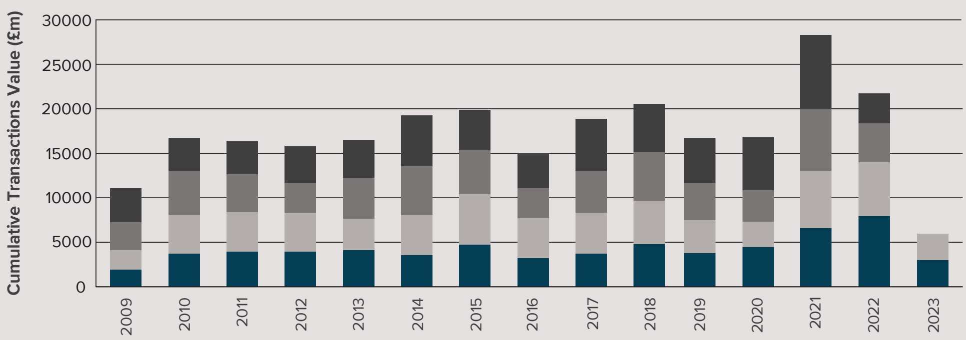
Assessing the deal data

Activity in the **smaller deals** sector (transactions with enterprise value of less than £150 million) continued to increase, with 211 deals completed, up from the previous quarter's 198. That represented a solid first six months of the year in volume terms and an improvement on the second half of 2022. The aggregate value of transactions in the second quarter held remarkably steady at £3 billion, reflecting a slightly higher number of smaller deals.

Sub £150m Transactions by Volume



Sub £150m Transactions by Value

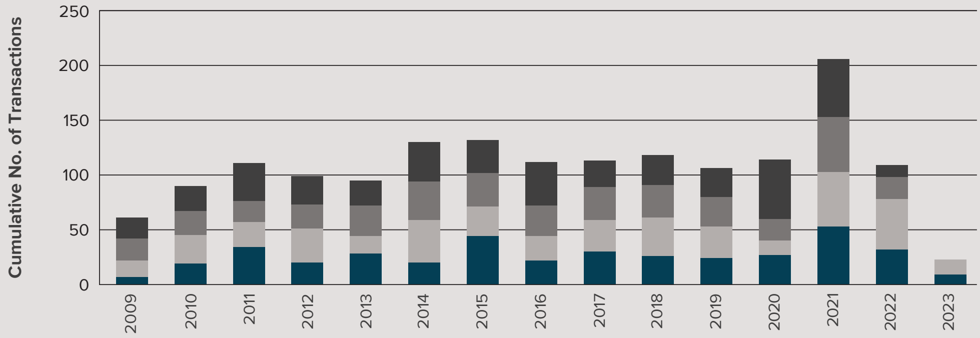


Key:
Q4 Q3 Q2 Q1

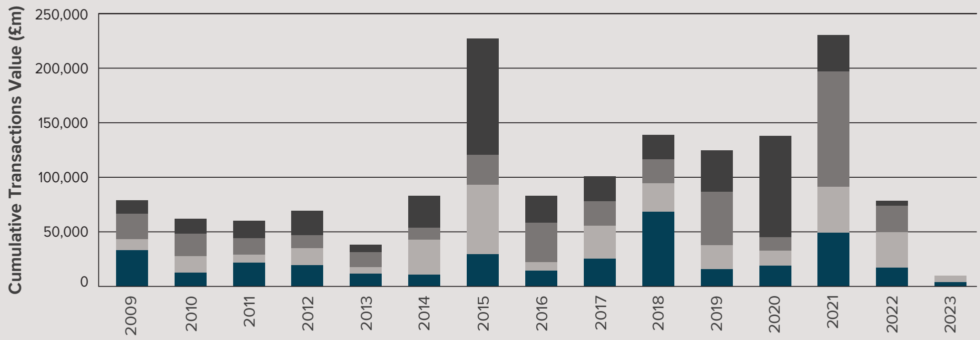
Data supplied by Thomson Reuters Eikon.

It's very early days yet, but the **larger deals** sector (enterprise value of £150 million or above) shows some signs of turning the corner. The number of transactions rose from nine to 14, and their total value was up from £3.9 billion to £5.8 billion. Nevertheless, this is by some margin the weakest first half of a year since our data began.

£150m+ Transactions by Volume



£150m+ Transactions by Value



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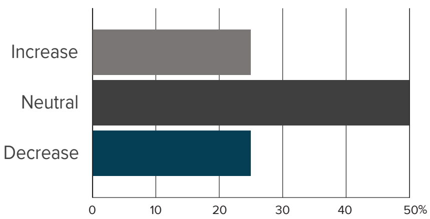
Q4 Q3 Q2 Q1

Data supplied by Thomson Reuters Eikon.

So what does our latest survey suggest?

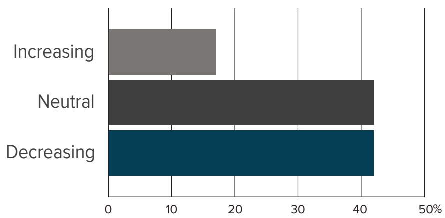
The mood of market participants, though still far from optimistic, seems significantly less downbeat.

1 Do you expect deal volumes to increase or decrease?



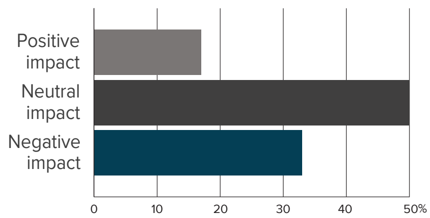
A quarter of respondents are now forecasting a pick-up in deal volumes over the next few months, up from a fifth last quarter. Meanwhile, the proportion expecting a decrease fell dramatically, from 60% to 25%. Half predict no or little change.

2 Is debt availability increasing, decreasing or neutral?



With the Bank of England still raising interest rates, debt financing remains an area of concern. That said, 17% of respondents reported an increase in debt availability, and only 42% said it was becoming less available, down from 60% in our previous survey.

3 What impact has the current economic climate had on your portfolio companies overall?



Asked to evaluate the effect of the current economic climate on their portfolio companies, 17% of respondents reported a positive impact, up from 10% in the first quarter of the year, while the percentage observing a negative impact fell from 40% to 33%.

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Warranty and indemnity insurance – a buyer's market

Warranty and indemnity (W&I) insurance is an established tool for M&A transactions, facilitating the path to completion to the benefit of buyers and sellers alike. Jessica Edwards and Tom Jelly of law firm Sidley Austin consider the outlook for some key W&I insurance trends.

The flurry of M&A activity during the COVID-19 pandemic naturally strengthened a growing W&I insurance market. The pandemic boom outpaced the organic growth of many insurers, who reached their yearly underwriting capacities before the end of 2021.

Part of the reason for this robustness is the growing recognition in the M&A market of the utility of W&I insurance. For sellers, W&I insurance can facilitate negotiations and provide a virtually clean exit on completion by removing escrows, retention agreements and contractual claims under transaction documents. For the buyer, W&I insurance can provide increased warranty coverage and additional or alternative forms of recourse.

Given the current reduced pace of activity in the larger deal segment and the growing competitiveness and capacity of W&I insurers, we expect insurers to offer a wider range of cover on a greater number and variety of transactions. With this in mind, some of the W&I insurance trends and developments we see continuing include the following:

Distressed transactions: As the competitiveness of the W&I market increases, there will be greater scope for distressed transactions to obtain W&I insurance despite the obvious risks of a limited and swift sell-side disclosure process. More broadly, we may see a greater willingness from W&I insurers to accept light touch due diligence processes such as red flag reports (subject to a more diligent underwriting process).

Competitive premiums and customisability: In the fourth quarter of 2021, the average UK premium rate was over 1.4% (of the policy limit) for operational businesses and over 0.8% for real estate businesses. Since then, these rates have dropped to as low as 0.8% and 0.4%, respectively. Insurance providers are also more likely to be receptive to combined policy enhancements, with insurers developing products to target specific risks (e.g., environmental risks).

Asia-Pacific growth: Around 60-70% of M&A transactions in Europe and the US include some level of W&I insurance. In the APAC region, the equivalent figure is estimated to be 15%. However, this gap is expected to narrow, with a number of insurers opening for business in the region in 2023.

SME coverage: The lower-mid market has been an area of concentration for W&I insurers. The notification rate for SMEs has more than doubled from 2021 to 2022, suggesting a growing acceptance of W&I insurance across the market spectrum.

IT and cyber security: A growing reliance on IT platforms has led to an increase in high-profile cyber-attacks and data-breaches. We expect cyber and IT security to become an area of greater scrutiny for insurers across many sectors, not only in technology-related transactions.

Given the increased competition and capacity in the W&I insurance market, as well as cheaper and more bespoke policies, we believe both buyers and sellers should consider how W&I insurance can facilitate their M&A transactions.

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SG KLEINWORT HAMBROS

The aftermath of a successful exit

The decision to sell a business is arguably the toughest thing an entrepreneur will work through. While you have the satisfaction of realising your ultimate goal, you are also losing control of everything you have worked so hard to build. Here, Ben Whitworth of SG Kleinwort Hambros argues that it's important to have the right team of advisers to guide you through the many issues of the process – and its aftermath.

It's important to think of an exit plan for a start-up even if you have no current intention to sell. A well-crafted exit strategy is a vital element for any business looking to grow and succeed. It serves as a roadmap, outlining specific goals and milestones for the business and providing a clear path to follow and measure progress against. It can also have a major impact on how your business is run, including its legal structure and revenue models.

Regular reviews of the exit strategy can help to ensure that the business remains firmly on track and to identify any areas where remedial action is needed. An exit strategy is also a sign of fiscal foresight and responsibility that makes your business more attractive to potential buyers.

For you as the business owner, it will allow you to plan for your long-term future and prepare for any unexpected events.

Life before and after a business exit

A lot of private banks and even luxury goods vendors will want to get to know you after you've sold your business. But the best private banks will find ways to get to know you and add value well before the transaction.

This often means understanding your personal motivation and objectives to help develop strategies and provide the appropriate wealth planning. For example, a good advisor may help you with cash flow analysis, pension advice, shareholders' structures, key person insurance, family investment companies and trusts. It is in the value realisation phase that trusted advisor relationships are truly forged.

After a liquidity event – whether a full or partial sale, a public offering, a merger or a liquidation – it is crucial to reflect on your personal goals and circumstances, as well as the structure of your wealth. This is especially important if it is your first liquidity event, as you just won't know what it feels like until you have been through it.

In our view, there are three essential things to prepare for the aftermath of a successful business exit:

- **Securing your family's future**
  Build a plan that will aim to provide for you and your family for many years to come.
- **Enjoying your success**
  Having worked hard to build your business and bring it to a successful exit, you should reward yourself for the years of effort and all the expertise you have devoted to it.
- **Establishing a lasting legacy**
  Consider establishing your legacy by finding ways to pass on your wealth to your family or, through philanthropy, to wider society.

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Corbett Keeling guides owners of private companies on selling their business, raising capital and acquisitions. For 30 years our bespoke, personal service has delivered the optimal mix of Cash, Certainty and Chemistry for our clients. On average we achieve >40% uplift in sale value for our clients compared to initial expectations and we are proud to have a >90% deal completion record. Our broad sector expertise combined with access to global trade and financial buyers means we will find the best investor or buyer for you.

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SG Kleinwort Hambros has over 200 years' experience in British banking and a network of offices across the UK and Channel Islands. It offers its clients individually tailored wealth management solutions delivered with a highly personal service.

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