Q4 2023

UK Private Company Director

Welcome to the January 2024 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 activity in buying and selling UK companies provides a clear insight into investor appetite for acquiring businesses.

As always, this issue tackles topics of relevance for directors of privately owned businesses:

- We look at the latest UK data on buying and selling companies and explain why we believe there are positive signs for stronger activity in 2024 (pages 2 to 3).
- However sound your business plan, it should always be accompanied by a meticulous exit strategy. That's essential to avoiding any unwelcome surprises (page 4).
- We assess some of the legal aspects of carve-outs, highlighting four key areas to analyse carefully before commencing any such deal (page 5).

All the best for the year ahead,

Megan Peel

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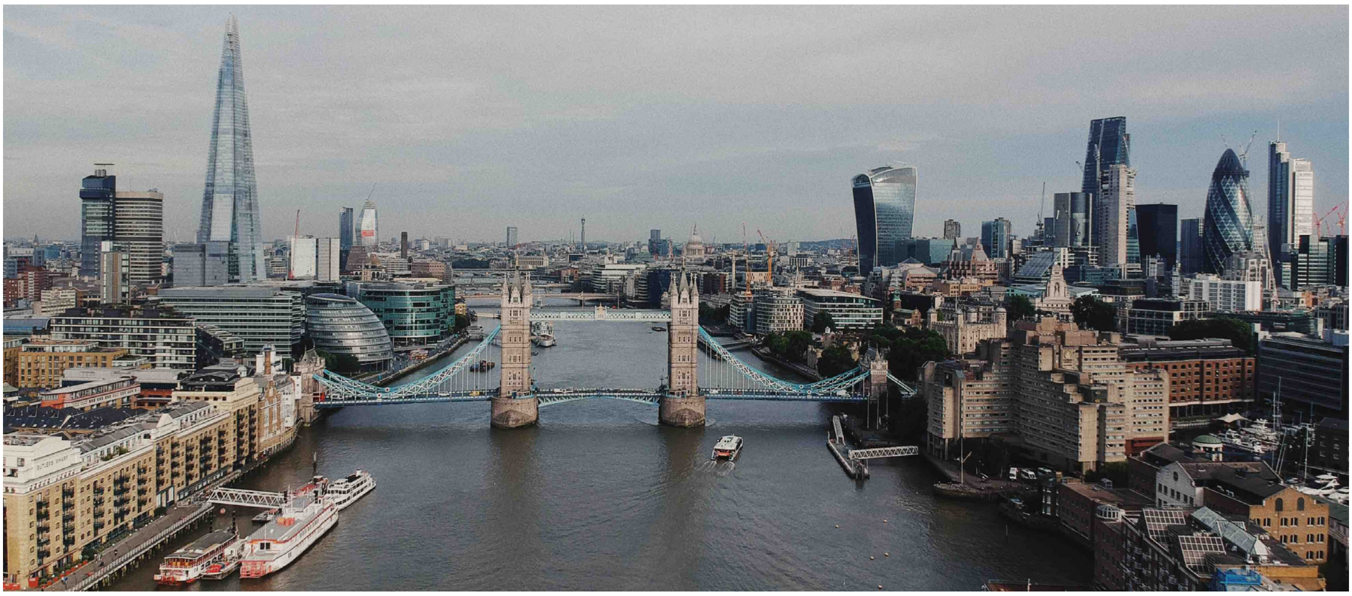

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Corbett Keeling
Corporate Finance

New year, new hope

Last year turned out to be slightly disappointing for the UK company mergers and acquisitions (M&A) market. However, notes Jim Keeling of corporate finance advisor Corbett Keeling, there are positive signs for an upturn in 2024.

It should perhaps come as little surprise that deal volumes and values weakened in 2023. The post-covid boom, which had driven activity to record levels in 2021 and 2022, inevitably ran out of steam.

On top of that, central banks were forced to raise interest rates to curb the wave of inflation that was unleashed by the ending of the pandemic restrictions and the Ukraine War. In the UK, rates rose further and faster than at any time since the European exchange rate mechanism crisis in 1992. Inevitably, this tightening of monetary policy made debt more expensive and less readily available for potential buyers.

But inflation is now coming down. Even after the slight rise in December, the downward trend is widely expected to continue. Barring any spanner in the works – such as a closing of the Suez Canal shipping route – interest rates are expected to follow (down), oiling the wheels for buyers looking to finance acquisitions.

There are other encouraging signs in the market. The positive sentiment expressed in our own market poll (see below) is for example, mirrored in a survey of European M&A that sees the UK and Ireland as the likely hotspot for activity this year.

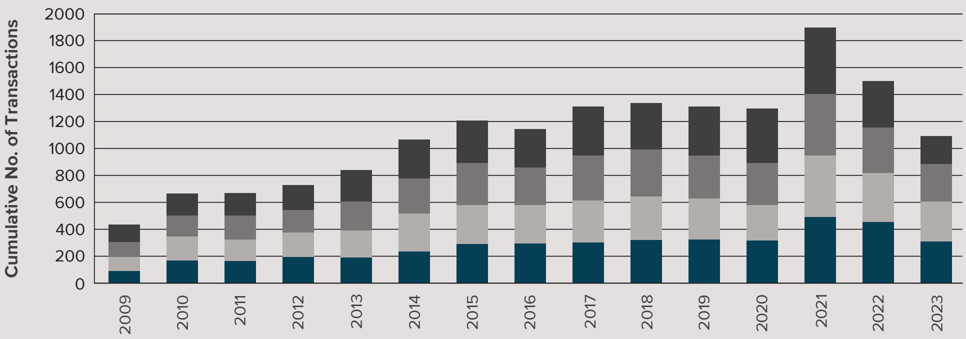
There is also growing optimism in the broader marketplace. A survey by PwC said almost half of UK CEOs it surveyed planned to increase their workforce by at least 5% this year, more than their G7 competitors. And in the construction sector, an industry some might not expect to be so buoyant in the current climate, one prospective client was putting off meetings because of an ‘incredibly fast start to the year’.

But, a final note of caution. If you are contemplating a sale, the next General Election is due no later than 28th January 2025. Depending on the outcome, this could be a precursor to higher Capital Gains Tax. So, just at the moment, a quick decision to commence a sale process might be a big tax saver.

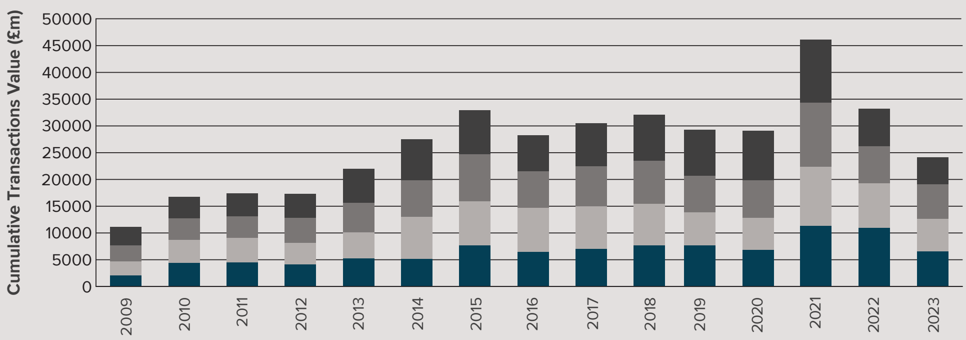
Assessing the deal data

Activity in the **smaller deals** sector (transactions with enterprise value of less than £150 million) was down compared to the prior quarter. The number of deals completed declined to 208, from 277 in the preceding three months. The value of transactions also fell, from £6.5 billion to £5.1 billion. The total for the year though were only a little below the “norms” for the period preceding the 2021/22 boom years.

Sub £150m Transactions by Volume



Sub £150m Transactions by Value



Key:

Q4 Q3 Q2 Q1

Data supplied by PitchBook.

The quarterly picture was slightly rosier in the **larger deals** sector (enterprise value of £150 million or above). The number of transactions rose from 42 to 45, while their total value also increased, up from £32.2 billion to £33.8 billion. Yet it was still the weakest year for the sector since 2020 by value and since 2013 by volume.

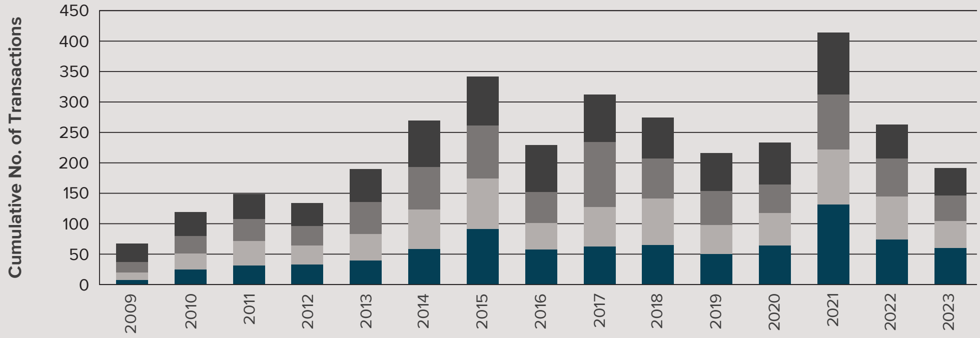
As we have commented before, larger deals generally get harder hit by interest rate rises, so it is little surprise that the comparison to pre 2021/22 boom is more adverse for larger than smaller deals.

Key:

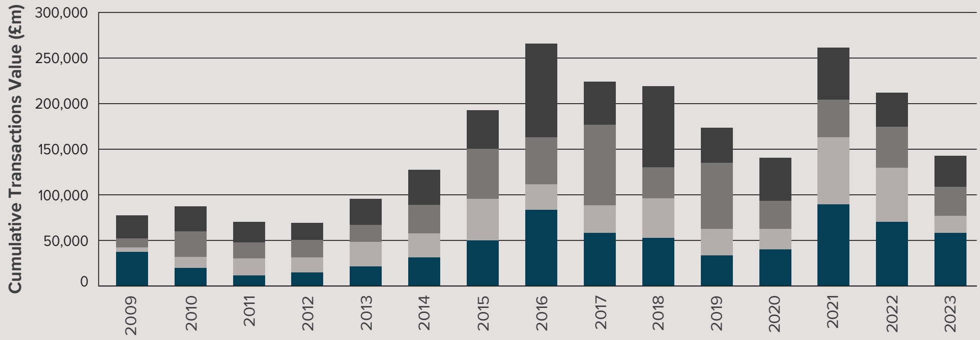
Q4 Q3 Q2 Q1

Data supplied by PitchBook.

£150m+ Transactions by Volume



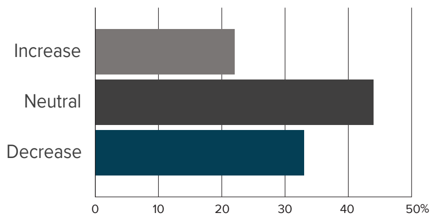
£150m+ Transactions by Value



So what does our latest survey suggest?

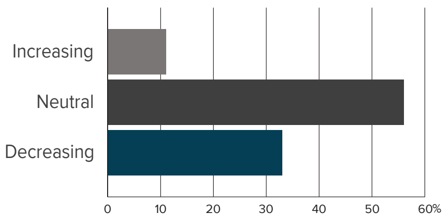
The market's mood, which had deteriorated somewhat in the third quarter of last year appears to have perked up noticeably, albeit with (understandable) remaining traces of caution.

1 Do you expect deal volumes to increase or decrease?



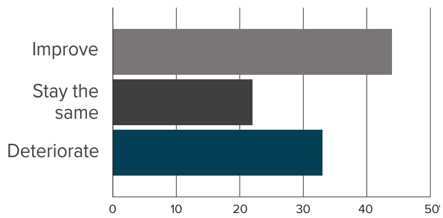
The percentage of respondents predicting an increase in deal volumes over the coming months rose from 13% to 22%, while those expecting little change increased from a quarter to 44%, and the proportion forecasting fewer transactions fell significantly, from 63% to one third.

2 Is debt availability increasing, decreasing or neutral?



Concerns about the availability of debt financing also abated. Some 11% of respondents reported an increase in availability compared with none the previous quarter, while those noting a decrease fell by 30 percentage points to 33%.

3 With a reduction in inflation and associated easing of interest rates are you confident the overall M&A environment will improve in 2024?



The most positive response was to the question whether the overall environment for M&A is likely to improve this year. Only a third thought it would deteriorate, while 44% thought it would get better.

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7IM

Surprise is a seller's worst enemy

If you're thinking of selling your business, you want to avoid any unexpected pitfalls. Daniel Wood of wealth manager 7IM explains why a meticulously planned and crafted exit strategy should live alongside any other high-priority strategies you might have for your business.

A business usually starts as an idea and revolves around plans focused on growth. Just as there are certain definable steps in the lifecycle of a business, there are also certain milestones that define the life of a business owner. One of those is succession.

Whether you would like to sell your business or keep it in the family, an exit plan is as important as a personal financial plan.

Just as a poor business sale plan can fail to do justice to your hard work and dedication, inadequate or late financial planning could compromise your retirement ambitions. You want to make sure you're fairly rewarded for your efforts.

But, when you're focused on growing your business, there is so much to look after. Prioritising tasks to see the business flourish often leads to neglecting tasks that impact your personal life, such as building a personal financial plan, pre and post business sale.

Engage a financial planner

The best strategy to prepare for any eventuality is to consult a specialist who understands your passion and can help you implement a structured personal financial plan.

This is what a financial planner does. Even if you don't yet have any plans to sell your business, a financial planner's expertise and experience can help ensure your personal finances are structured efficiently to meet your short, medium and longer term personal objectives.

A financial planner understands that your life changes significantly once you sell your business and can help you prepare for this change.

Before starting the sale process, you should have a clear understanding of the following:

- Rates and reliefs: make sure you're putting yourself in the most tax-efficient position when planning your exit, using your allowances for both personal and business benefits
- Retirement planning: take proceeds from the business sale that will allow you to sustain the lifestyle you would like when you retire, while making sure you can also leave a legacy for future generations if that is part of your ambitions
- Keep an eye on the business: if you'd like to keep the business in the family, a strong succession plan can help streamline the transition and help you understand the conversations you should have to make this happen.

This list should be much more comprehensive than the bullet points above. Speaking to a financial planner will help you refine your personal and professional goals and enable you to stress-test the scenarios around your ambitions, so you can make the best possible decisions.

Sometimes, during busy periods, you may feel like your business controls your life. But the last thing you want is for your business to control your decisions.

The best exit strategy will target what is best for you and the business. Working with a financial planner to achieve your long-term plans will enable you to avoid the worst possible scenario: an encounter with the unexpected.

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SIDLEY

Defining the scope of carve-outs

Carve-outs can be complicated. Pedro Sacadura Botte of law firm Sidley Austin LLP outlines some of the legal aspects anyone involved in such a deal should be aware of.

Corporate groups often use divestitures of business units to pursue a wide array of corporate objectives, from funding new strategies to optimising their existing structure or operations.

Frequently, the business being carved out will be conducted through both dedicated entities – which only undertake activities related to that business unit – and non-dedicated entities, which are involved in both the sold and the retained business units. For non-dedicated entities in particular, the seller should carefully analyse the exact scope of the business unit being divested.

Such analysis should involve several commercial and financial considerations. But it should also take into account certain legal aspects to determine the range of assets and liabilities included in the standalone business unit.

In our view, four considerations are essential to the success of a divestment:

- **Commercial agreements** – material agreements with both clients and suppliers should be analysed. Any entered into for the benefit of several of the seller group's business units would have to be adjusted or replaced in order to cover the parent and carved-out businesses separately. Those relating only to the carved-out business but entered into by a non-dedicated entity would need to have the interest transferred via assignment or novation. And, when other entities or business units within the seller's group are relevant clients or suppliers of the carved-out business, new agreements would have to be negotiated outlining the future relationship of the parties and offering protections to both. In addition, even when the party to the relevant agreement is a dedicated entity to be included in the carve-out, certain clauses may require the entity to notify its counterparties – or even obtain their consent – if control changes hands.
- **Intellectual property** – you should make sure any proprietary IP rights used exclusively by the carved-out business are included in the transfer. Where any proprietary IP rights will be used by both the parent and the carve-out, you should enter into an appropriate license agreement. If any third-party IP rights are used across the parent and carved-out businesses' operations, the parties should cooperate to obtain the additional licenses necessary.
- **Regulatory licences** – carve-out transactions in regulated sectors will include regulatory licences. The approach to the transfer of these licences will depend on the specific conditions governing each of them. Even when these are held by dedicated entities, you may have to obtain the licensing body's consent to the change of control. When the licenses are held by non-dedicated entities, the parties would be expected to cooperate to get the licensing body to clear the transfer of the license or issue a new one.
- **Property** – the parties will have to assess how facilities used by both the parent and the carved-out businesses – especially facilities that are not easily replaceable, such as industrial or R&D plants – will be shared after the carve-out. Often, this is done through a long-term lease or space use agreement.

Many other aspects are typically considered when scoping a carve-out (employees, pensions, litigation liabilities) and negotiating it (transitional services agreements, merger control concerns). But the analysis should always cover the four elements listed above.

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The '7' in 7IM refers to the seven original founders of the business. Back in 2002, they couldn't find a firm they trusted to manage their families' money properly – so they started the kind of organisation they'd like to invest with themselves. Today, we manage over £20 billion for a wide range of clients from our offices in London and Edinburgh. With our purpose of 'Succeeding Together', we foster long-term partnerships with our clients and colleagues.

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