Q4 2019

UK Private Company Director

Welcome to the January 2020 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.

The current issue highlights:

- Private company deal making rounded off a very strong year, led by early-stage / expansion deals, which set a new record for deal values (pages 2 to 4).
- With so many transactions involving a disclosure process, we highlight four key steps to ensuring a successful outcome (page 5).
- After a slowdown during 2019, the global economy appears to be gathering momentum once more, which should be positive for equity markets (page 6).

Best wishes for a happy and prosperous 2020!

Megan Peel

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Corbett Keeling Corporate Finance

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The market is open for business

Deal making in the final quarter of 2019 remained strong, with plenty of activity and good values obtained across all segments of the market. But what of the year ahead? Jim Keeling of corporate finance adviser Corbett Keeling takes the temperature of the market and finds it in very good health, which augurs well.

Despite the uncertainty caused by a General Election and a looming Brexit, the private company transactions market stayed very buoyant in the last three months of 2019. Once again, the early-stage / expansion deals segment of the market led the way, but the strength was very broad-based.

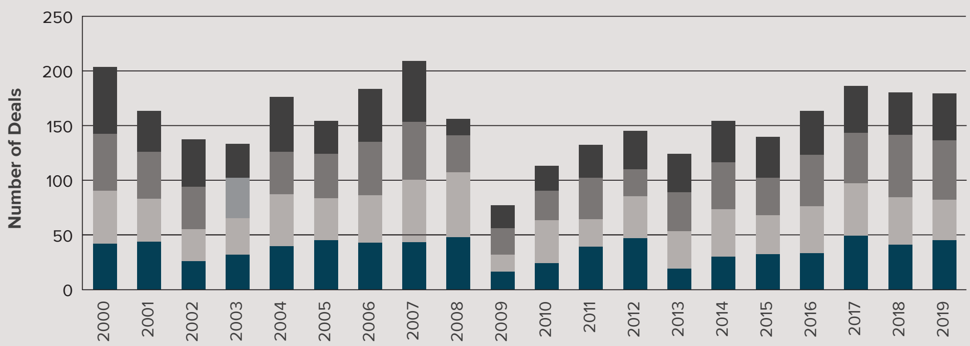
The question is whether this is a welcome indication of further activity to come or evidence that market participants were desperate to get deals completed before a Labour government under Jeremy Corbyn could throw a spanner in the works. Of course, only time will tell. But, in my view, the signs are largely positive.

Not only is the mood of the market upbeat, as the results of our latest survey confirm, but conditions remain supportive for deal making. Debt is cheap and freely available, and it is hard to see the Bank of England wanting to raise interest rates significantly during the Brexit process. Demand from overseas buyers remains strong, as they take advantage of the weaker pound to purchase UK-based businesses which offer long-term value. The global economy appears to be picking up momentum once more, helped by progress in talks to resolve the US-China trade conflict. On top of all that, the strong Conservative majority should help to reduce uncertainty and provide a more favourable regime for business owners. In short, I see plenty of reasons to believe that 2020 should be another strong year for the market.

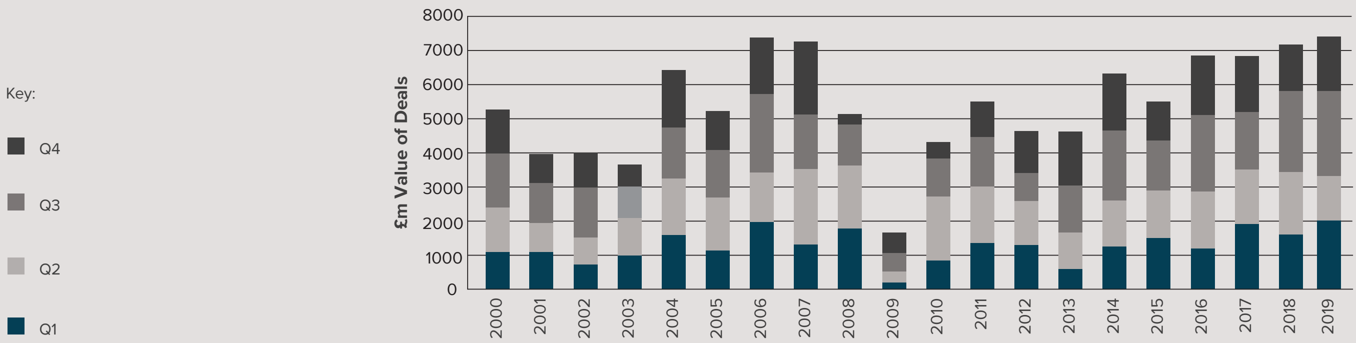
Assessing the deal data

Activity in the **smaller buy-outs** sector (transactions with enterprise value of less than £150 million) eased slightly from the strong pace of the third quarter. The volume of deals declined from 54 to a still respectable 43. The value of deals also fell, from £2.3 billion to £1.5 billion. That said, both the total value and the final quarter volume exceeded last year's robust numbers.

Sub-£150m Buyouts by Volume



Sub-£150m Buyouts by Value



The **larger buy-outs** sector (enterprise value of £150 million or above) rounded off a strong year with another impressive quarter. Ten deals were completed this quarter, the same total as the previous quarter. However, their value soared from an already strong £8.7 billion to a remarkable £18.8 billion, the second highest total of the past two decades. For 2019 as a whole, the volume of transactions was slightly down on the previous two years, but their value was significantly higher than last year and only just below 2007's very strong figure.

Key:

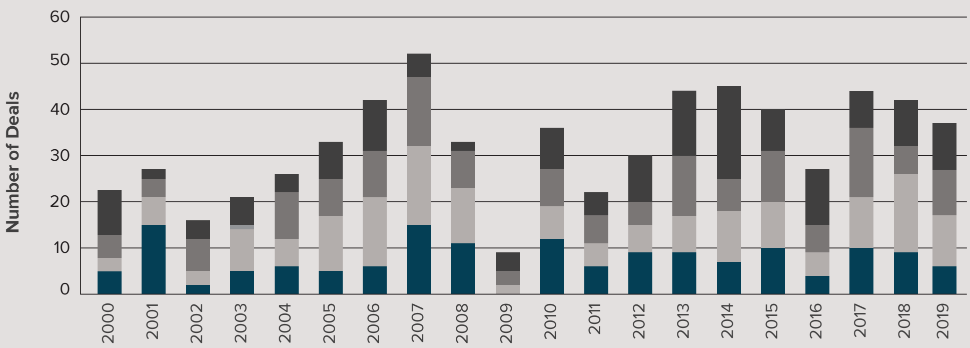
Q4

Q3

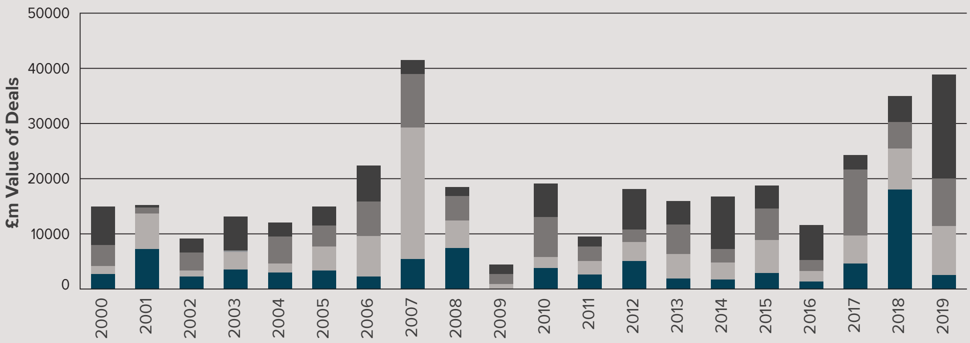
Q2

Q1

£150m+ Buyouts by Volume



£150m+ Buyouts by Value



Early-stage and expansion capital deals showed further strength in the final quarter, confirming that 2019 was a vintage to remember. The number of transactions, at 128, held very close to the previous quarter's 134, bringing the annual total to the highest since 2000. Meanwhile, the value of deals leapt from £2.7 billion in Q3 to £3.2 billion, a record quarterly number. That took the annual figure above £10 billion, comfortable surpassing the previous record of just over £8 billion, set two years ago.

Key:

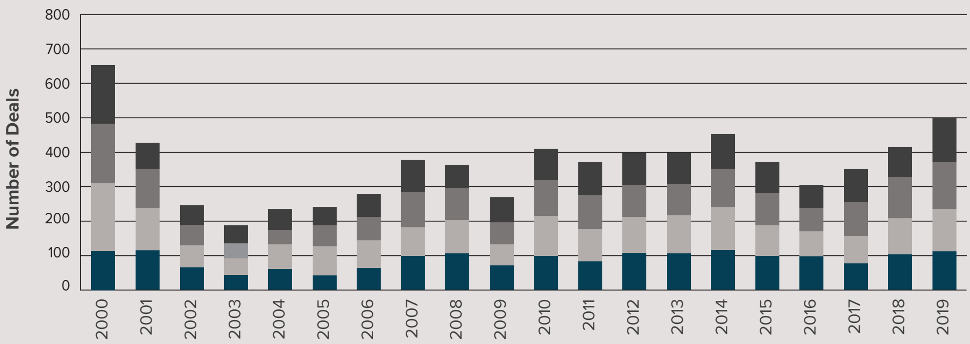
Q4

Q3

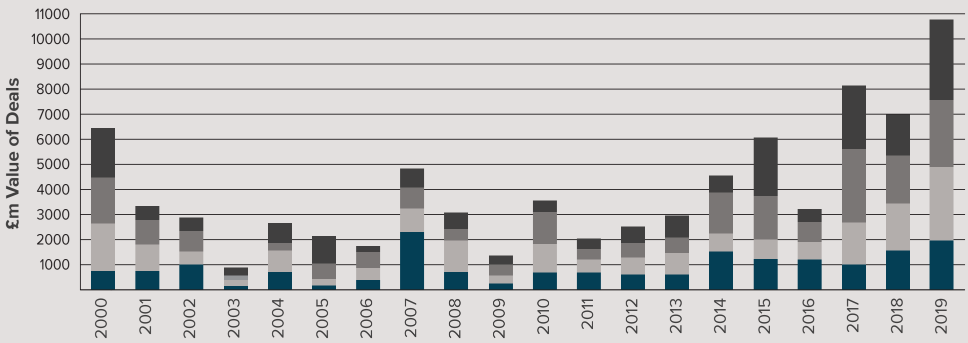
Q2

Q1

Volume of Early-Stage / Expansion Deals



Value of Early-Stage / Expansion Deals



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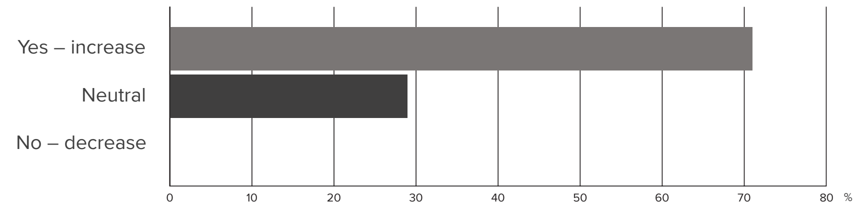
So what does our latest survey suggest?

Market participants appear to be in a confident frame of mind. Our respondents expect a further pick-up in deal making activity from already strong levels, and they clearly welcome the decisive outcome of December's General Election.

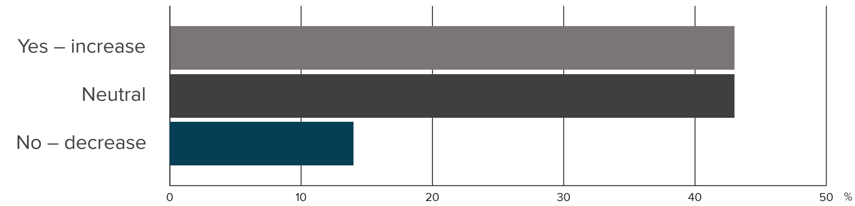
1 Do you expect deal volumes <£100m to increase or decrease?

For the smaller value segment of the market, the percentage of respondents predicting a rise in volumes over the next six months has more than doubled, up from 33% to 71%, with the remainder expecting no change.



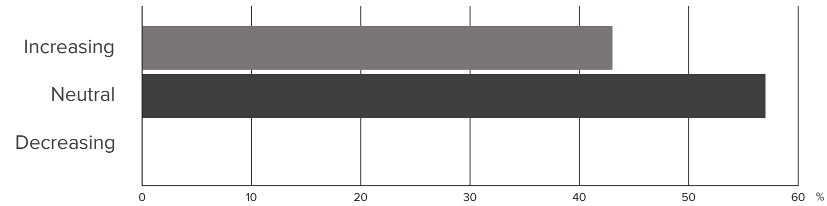
2 Do you expect deal volumes >£100m to increase or decrease?

Even after a strong quarter – and year – for the larger value segment, sentiment remains buoyant. The percentage forecasting an increase has soared from 17% to 43%, though 14% expect a decline in volumes over the first half of the year.



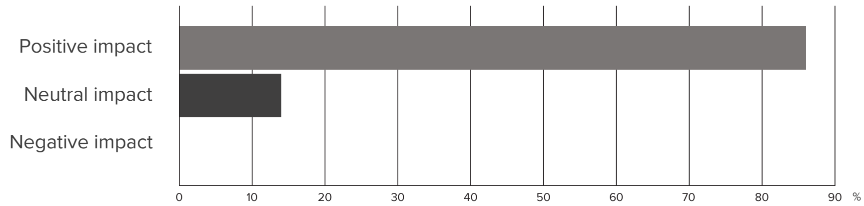
3 Is debt availability increasing, decreasing or neutral?

There is little change in expectations for debt availability. None of our respondents are yet forecasting availability to decrease.



4 How will a Conservative government affect business confidence?

It's little surprise that the election of a majority Conservative government – and the dashing of the Corbynites' hopes – has given the market a boost. Some 86% of survey participants said they thought the election result would support business confidence, while the rest expected little impact.



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Dechert LLP

Disclosure: Practical tips for a smooth process

At some point, many private company directors will be involved in a transaction that involves a disclosure process, such as an equity fund-raising or the sale of a business. Tom Clarke of Dechert LLP outlines how to ensure a disclosure process runs smoothly.

Warranties are statements of fact about a company or its business, usually given in a sale contract. That contract could relate to newly issued shares (a subscription or investment agreement) or the sale of existing shares or an existing business (a sale and purchase agreement). Generally, an investor or buyer who suffers a loss because a warranty is inaccurate can bring a claim for breach of contract against the party that gave the warranty.

Disclosure is the process by which the seller (who is giving the warranties) makes a buyer or investor aware of facts or circumstances that might otherwise make a warranty inaccurate. Such disclosure limits the seller's liability by preventing a warranty claim in relation to the facts or circumstances disclosed.

A well run due diligence and disclosure process will facilitate a smooth transaction delivered to the parties' agreed timetable. Conversely, a poorly organised process can lead to delays, additional costs and, in the worst case, unnecessary liability for the seller under the warranties. So what makes for a well run process?

Pick the right data room provider

Most due diligence processes focus on materials uploaded to an online data room, usually hosted on a third party platform. Make sure that you choose a data room provider which is responsive, can deliver copies of the data room materials promptly on request and doesn't require an ongoing subscription for those copies to remain accessible after the transaction. It is a competitive market and platform functionality is continually improving, so ask your lawyers for the names of a few recommended providers and shop around.

Start early

For the seller, preparing the disclosure letter or schedule is the culmination of the due diligence process. The latter stages of any transaction can take up a great deal of time and energy for the seller's senior staff. By starting the disclosure process several weeks before the planned signing date, you can ensure the process is thorough and that the buyer is given enough time to assess the matters disclosed.

If in doubt, disclose

If unsure whether to disclose a document or issue, discuss it with your lawyers sooner rather than later. Broadly speaking, transactions run more smoothly when you avoid last minute disclosure of significant issues. Wilful non-disclosure can amount to fraud, so it is important to be thorough and to discuss possible issues openly with your lawyers.

Maintain momentum

If your company expects to undertake successive rounds of equity financing, keep the materials that form the core of a disclosure package up to date in between rounds. By having many of these materials organised and available before a transaction starts, you can relieve some of the time demands and pressure otherwise caused by having to gather diligence and disclosure materials when a transaction starts, on top of maintaining your business as usual activities. For example, update your disclosure bundle when you renew your company's insurance, lease or standard form employment contract.

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Is the global economy back on track?

Stock markets experienced some bouts of volatility during 2019 as concerns about geopolitics – most notably, the trade war between the US and China – ebbed and flowed. Here, Fahad Kamal, Chief Market Strategist of Kleinwort Hambros, looks to the year ahead and argues that the current economic backdrop calls for investors to favour equities within their portfolios.

Despite the slowdown in the manufacturing sector this year, global economic growth has held up fairly well, thanks to strong consumer spending on goods and services. Manufacturing has been hit by three main factors: the US-China trade war; sluggish investment by businesses; and problems in the European car industry.

However, signs are emerging that economic conditions have begun to stabilise and are likely to improve in 2020. Moreover, US and Chinese negotiators appear to have made progress towards a phase one trade deal. If that deal is ratified, it would reinforce the pick-up in activity, especially for major exporters such as the euro zone, China and Japan.

In addition, markets continue to receive powerful support from central bankers. The European Central Bank is now back into full-scale quantitative easing, as is the Bank of Japan. Meanwhile, the US Federal Reserve lowered interest rates three times in 2019, and the Bank of England may well also join the party in 2020. Admittedly, monetary policy is suffering from diminishing returns. However, there is evidence that politicians will become increasingly active in fiscal policy during 2020 – and a significant increase in government spending could prove to be a game-changer.

Politics caused considerable consternation in the UK during 2019. But now the General Election is over, and UK equity markets are surging, given the clear mandate for the Conservative Party. We have always maintained that geopolitics tends to be a red herring when it comes to investments and is thus best ignored when deciding which assets to favour within portfolios. But it does have implications for sterling, and that can have a serious impact on portfolios referenced in that currency. As always, instead of guessing at unknowable political outcomes, we have chosen to position our portfolios so that they can deal with – or indeed benefit from – large swings in sterling. Depending on the portfolio, this may include hedging selectively or maintaining a higher than usual global exposure. We expect sterling to remain volatile, but with no clear move in any direction.

In our positioning of portfolios, we still have a preference for equities. The business cycle has undoubtedly drifted from the expansion phase to the slowdown, but slowdowns can last for years. More importantly, history shows that, during slowdowns, riskier assets (such as equities) tend to outperform defensive assets (such as investment-grade bonds). In contraction phases, riskier assets tend to do less well, but we are not in a contraction at present. Indeed, it looks as if we may well be ticking slowly back into expansion.

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