

# What are the challenges – and opportunities – for mergers and acquisitions in this new economic era?

Which are the sectors providing glimmers of hope? Are we going to see more cross-border deals (the UK as target or acquirer?) or is there more of a focus on establishing operations in emerging markets?

Who are the deal makers (cash rich trade buyers or PE houses?) and what might emerge as funding models as a consequence of the banking crisis?

At a symposium hosted by law firm Rawlison Butler, leading advisers and financiers discussed the issues.

Ian Barton, Partner, Deloitte: "Before 2008 an 'okay' business could still attract interest and a good price. Today it has to be a good business to achieve that, and it will have plenty of people chasing it. There are fewer banks in the market which means it is harder to find the right level of finance for a transaction. It's out there but the criteria is a lot sharper."

Gordon Rennie, Clydesdale Bank: "The key is the quality of the business. We always look at the management structure, especially in this market, because we rely on those key people to do what is required."

Rupert Rawcliffe, Director, Grant Thornton: "You could argue that it's a buoyant market for good quality assets. One of the things happening is that private equity is prepared to fund the transaction themselves in order to remove uncertainty, and will look to bank involvement afterwards."

Peter Hodson, Director, NVM Private Equity: "We are looking for growing independent companies in niche markets with good management teams, which is a tough combination to find. That said, we have invested more this year than previously, and have completed more deals in the last twelve months than ever before. We have moved away from bank finance because of uncertainties; it also reduces our risk where covenants put businesses under pressure."

Andrew Hoad, Partner, Rawlison Butler: "The key is to find market sectors where organic growth isn't going to be sufficient or where consolidation is going to take place."

Charles Whelan, Managing Partner, HW Corporate Finance: "A deal happens when there is a compelling reason rather than before when it could be based on a good idea. Corporates have de-leveraged over the last year and have more fire-power."

Matthew Katz, Partner, Roffe Swayne: "The problem with a number of owner-managed businesses can be a fundamental weakness in terms of management and a reliance on two few customers."

Abigail Owen, Partner, Rawlison Butler: "To enable the transaction to happen, and to preserve value, vendor-assisted finance has become a mainstream option."



Steve Brown, Director, RSM Tenon: "What deals are getting done? Where the company has robust earnings, clear demonstrable growth, and good management; otherwise it's the equivalent of trying to flog the proverbial dead horse. There is a dysfunction in the debt market. It's hard to get less than £8million or above £35million where the banks need to trust each other."

Simon Davies, Partner, Spectrum Corporate Finance: "There is polarisation, so as advisers we have to be creative to earn our corn - cashflow lending on top of asset lending for example; there has to be more packaging."

Mike Grayer, Partner, Menzies: "I don't think we have been involved in any deal in the last nine months or so which didn't have an asset-based lending element. For sub-£10million deals, if they're sensibly priced, and needless to say there's a strong management team, vendor-assist can be the bridge."

Nick Standen, Corporate Finance Partner, KPMG: "I think a lot of deals can be done actually if they are corporate-focused. It de-risks the transaction process because the corporate is likely to have deeper pockets and wants to have the asset. I think private equity finds it tough to compete against corporates. And perhaps it should be mentioned that overseas buyers are finding assets in the UK very attractive because of the exchange rate."

Adrian Alexander, Partner, Mazars: "An overseas company can afford to pay a premium because of exchange rates, but for the owner-manager, indecision rules. Deals on the sale side have been opportunistic."

Paul Smith, Partner, BDO: "We're seeing more overseas-led transactions, but not just because it's cheaper to buy a UK company. We sold two businesses to India this year because of their technology. The Chinese are looking to the UK where they can acquire a company and take on its manufacturing."

Nick Standen, Corporate Finance Partner, KPMG: "Is it sterling or the dollar on the table - who takes the risk? Usually the overseas buyer is the larger of the parties, with their in-house treasury function, so if they are acquiring a private company, they should take the responsibility."

Charles Whelan, Managing Partner, HW Corporate Finance: "Or go halves on the hedge to lock in the dollar premium."



Steve Brown, Director, RSM Tenon: "Business culture has an impact. A US company is less likely to buy a business in Belgium and Germany for example because it can't cope with how employment makes it difficult to make people redundant. But they get how it works in the UK."

Simon Davies, Partner, Spectrum Corporate Finance: "We've always had currency risk, but what is more apparent now is political risk; that creates uncertainty which is difficult to manage."

Nick Standen, Corporate Finance Partner, KPMG: "Which means the UK does appear to remain an attractive opportunity compared to other countries."

Paul Smith, Partner, BDO: "There are specific sectors where there is more activity – oil and gas support services, technology in the area of connectivity and where there is something buzzy, but it tends to be niche."

Kirsty Sandwell, Corporate Finance Partner, Baker Tilly: "Where the money is flowing to has changed. It wasn't that long ago that PE was focused on care homes and retail. Today there is more interest in manufacturing, but technology is still seeing some unexpected prices being realised. What I would say is that the changing tax regime doesn't help. It adds a layer of uncertainty."

Mike Grayer, Partner, Menzies: "There are commercially viable transactions which are put at risk because of the time taken to get clearance from HM Revenue and Customs."

Adrian Alexander, Partner, Mazars: "I can see owner-managed businesses having a two-step exit plan. The vendor maintains a controlling stake while the management brings the business on for two to three years, at which time they buy the vendor out completely or they jointly sell it. The controlling interest means that in theory the vendor has the power to replace management, but in addition to employment rights they would have shareholder protection."



Charles Whelan, Managing Partner, HW Corporate Finance: "Remember the time when the old 3i had offices in each of the major locations in the south? They were little powerhouses, making deals happen. If the Business Growth Fund works in the way it has been portrayed by government, then it could be a 3i mark two and will make the market more dynamic."

Rupert Rawcliffe, Director, Grant Thornton: "What has gone away is the buyer's fear that they might get gazumped on a deal, so they are taking more time to get to understand the business. Due diligence is more belt and braces than in the not too distant past, and arguably it should have always been so thorough. If the purchaser wants to see next month's management accounts, that won't cost them the deal now."

Peter Hodson, Director, NVM Private Equity: "I don't think that a more intense due diligence process takes away the sense that it's the right deal. The purchaser still has to make a judgement call, and that hasn't changed."

Ian Barton, Partner, Deloitte: "You can't due diligence everything. What has changed in the last five years is that if five issues are raised, the purchaser wants five copper-bottomed answers rather than taking a view. Looking at the last few years, most businesses will have a story which isn't completely straightforward so diligence will throw up issues that need a view to be taken on."

Gordon Rennie, Clydesdale Bank: "If everything is right and is as the vendor makes out for the business, then due diligence will be a smooth process."

Nick Standen, Corporate Finance Partner, KPMG: "The consequence of issues arising in due diligence in today's market is not that the buyer uses it to chip the price but as the reason to walk away."

Adrian Alexander, Partner, Mazars: "A problem is that everything happens in sequence now rather than the elements which make up the deal process happening in parallel."

Simon Davies, Partner, Spectrum Corporate Finance: "A lack of competitive tension means that the deal process will take longer. We can create greater tension by preparing vendor due diligence which really keeps the pressure on buyers by keeping more parties in play until the last moment."



Peter Hodson, Director, NVM Private Equity: "Delay tends to have a negative effect, certainly in terms of confidence in the deal."

Rupert Rawcliffe, Director, Grant Thornton: "Issues which are normally discussed in drawing up the share purchase agreement are coming up much earlier; there is a lot more detailed negotiation taking place with the heads of terms agreement which used to be about the spirit of the deal rather than the precise detail."

Mike Grayer, Partner, Menzies: "There is this desire to have everything on the table at the earliest opportunity."

Charles Whelan, Managing Partner, HW Corporate Finance: "Bank credit committees are more painstaking than ever before. Advisers will get a phone call to say this item on page fifty-three, can you talk it through with us? We've had experience of credit committees wanting to meet management teams, which I think is a good thing."

Gordon Rennie, Clydesdale Bank: "If all the stakeholders are communicating, it means there is more likelihood that a deal will get done."

Matthew Katz, Partner, Roffe Swayne: "Except of course it extends the deal timeframe."

Kirsty Sandwell, Corporate Finance Partner, Baker Tilly: "That can depend on the vendor; it could be their position softens when they realise they are nearer to the money."

Paul Smith, Partner, BDO: "All the parties have to get something out of a deal; there has to be something on the table for everyone if the deal is to happen."

Kirsty Sandwell, Corporate Finance Partner, Baker Tilly: "I think it comes back to the old adage that you need to prepare early."



Nick Standen, Corporate Finance Partner, KPMG: "And don't go to the market until you're ready."

Paul Smith, Partner, BDO: "If your company has a USP then you've got something to sell. The question is do you really want to sell?"

Steve Brown, Director, RSM Tenon: "You might think that things are going well during the transaction process, but the deal isn't done until it's over the finishing line. Don't get emotionally involved with the deal itself."

Simon Davies, Partner, Spectrum Corporate Finance: "Timing is crucial in coming to market. More than ever that old adage is true – leave something on the table for a buyer; a win-win situation. If you get distracted, if trading starts to fall or level off, the power in the negotiation shifts to the buyer and in the current market they can take all the time in the world to get what they want if the deal tension and momentum is not maintained."

Andrew Hoad, Partner, Rawlison Butler: "I always look for signs that a purchaser or seller is beginning to lose sight of their own business during the transaction. So much time goes into the deal process that the company's operations can lose momentum and efficiency."

Rupert Rawcliffe, Director, Grant Thornton: "I think you should always have a Plan B in case the deal doesn't happen, and that means maintaining your focus on the what the business is doing day-to-day during the negotiations and transaction."

Ian Barton, Partner, Deloitte: "It's important to know what you really want from the transaction, and that when you get momentum during the transaction to exploit it rather than wondering if just a bit more could be gained. Take advantage of the momentum and do the deal."

Matthew Katz, Partner, Roffe Swayne: "Understand the purchaser and their motive from the outset, otherwise you could be sucked into something which is a fishing expedition rather than a serious intention to buy."



## CHAIRMAN'S SUMMARY

Tim Sadka, Partner, Head of the Corporate Team  
Rawlison Butler

The main drivers for mergers and acquisitions will always be there. Companies led by leaders with ambitious plans to grow or owner managers recognising, possibly as they close on retirement, an exit needs to happen while they have some control of their own destiny. Unexpected events or an untimely death may also prompt a transaction. Changing marketplaces can also be a force for change and consolidation. Experience tells us that, regardless of the ups and downs of the economy, events and opportunity will generate transaction activity. This will not necessarily be straightforward because funding may be difficult to source and seller price expectations may need to be aligned with market conditions and prospective buyers view of what is value.

Getting the debt market interested in MBOs and acquisitions continues to be difficult. Private equity is evidently in strong supply at present, always chasing the best opportunities. Private equity does not offer an open cheque book and the best deals will happen when there is a clear understanding of the risks and projected returns sufficient to prompt activity. Conversely, bank sourced debt is in short supply; this position will likely continue for an extended period of time as World markets adjust to the changing environment that has developed over the last two to three years.

It is too early to gauge the impact of the Business Growth Fund, but it is a little disappointing that it will provide just equity-based finance for essentially business development rather than (with some exceptions) a specific transaction, for example to facilitate an exit. That brief will mean it can only address some of the funding gap. What SMEs and the market need is the equivalent of the old ICFC, originally set up by the banks to provide capital to SMEs. 3iplc used to perform this role but has for many years not been in this market as it follows a different agenda.

We operate in uncertain times, with local and international markets changing ever more quickly and with a resultant lack of certainty and loss of confidence increasingly evident. The challenge is to be able to respond to these challenges and to take the opportunities they present. A confident and well organised professional and banking community is a pre-requisite if UK plc is to rise to the challenge.

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