Q3 2022

UK Private Company Director

Welcome to the October 2022 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.

This issue tackles some of today's pressing concerns for directors of privately owned businesses:

- Deal making activity has slowed, but will this turn out to be a temporary lull after recent strength – or the start of a longer-lasting slowdown (pages 2 to 4)?
- More and more deals are now subject to regulatory scrutiny, so business owners need to be aware of the rules and, if necessary, build more time into transaction timelines (page 5).
- Many business owners worry how the proceeds of a sale may affect their children. We share some tips on how to help children be financially fit for their new future (page 6).

All the best!

Megan Peel

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Corbett Keeling
Corporate Finance

A time of change?

After a strong first half of the year, the pace of activity in the UK private deals market faded in the third quarter. Jim Keeling of corporate finance advisor Corbett Keeling considers whether this lull is likely to be temporary and what it means for company directors who are looking to sell.

There's been a lot of change over the past three months. For the first time since the 1950s, the United Kingdom has a new monarch. We also have a new Prime Minister – not such a rare event, it seems. And the tide of war appears to be turning in Ukraine.

We've also seen considerable change in the private M&A market. In the last issue, I wrote that the market was then still in an unusually sweet spot, with cash rich buyers paying good prices to a large number of sellers.

Buyers still have plenty of cash. But, as I noted last quarter, their appetite for deals can turn quickly, and that seems to have been the case over the past three months.

Perhaps that's not surprising. The economic outlook is clouded by concerns about a recession, interest rates are rising, making debt funding more expensive, and Putin is threatening an escalation of his war. All of this is reflected in our latest survey of market sentiment.

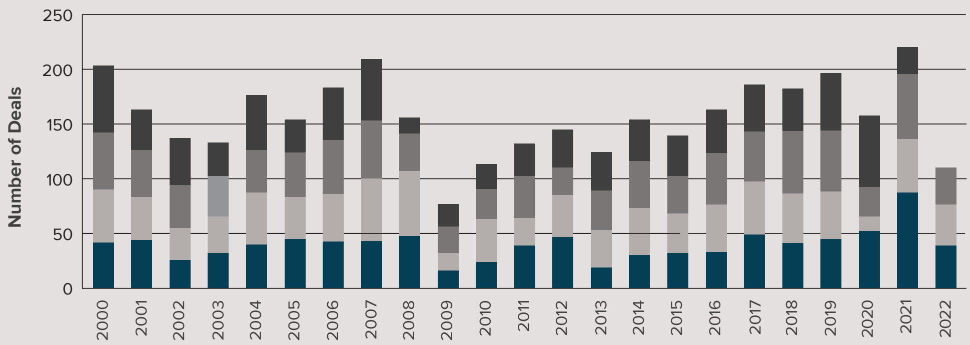
On the other hand, we have seen some positive developments. For example, the new government has shown that its key economic target is higher growth. Despite the market turmoil it caused, the mini-Budget was pro business, and we can expect further supportive measures in the coming months. In addition, the decline in the pound has made UK businesses look temptingly good value, especially to buyers from the US.

But, if business owners are worried by the possibility of a longer-lasting downturn, they need not be put off from selling. The value of any deal may not be quite as high as we have seen over the last two years, but plenty of buyers are still in the market. And our long experience of the market has taught us that many sectors continue to do well – and achieve good prices – even in an outright recession.

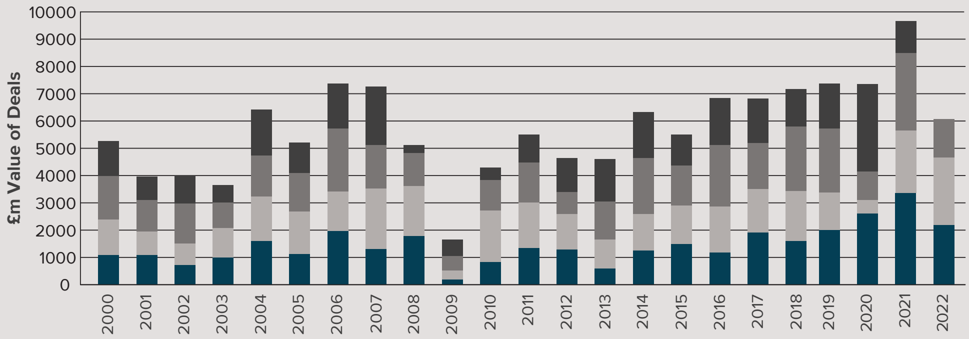
Assessing the deal data

Activity in the **smaller buyouts** sector (transactions with enterprise value of less than £150 million) remained broadly flat in the third quarter, with the volume of deals edging down to 34, from 37 in the previous period. However, their aggregate value fell significantly, from £2.5 billion to £1.4 billion, still a perfectly respectable figure.

Sub £150m Buyouts by Volume



Sub £150m Buyouts by Value



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Q3

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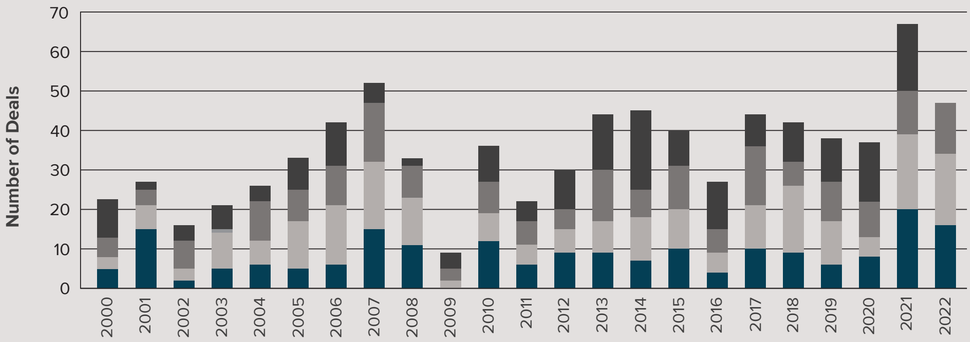
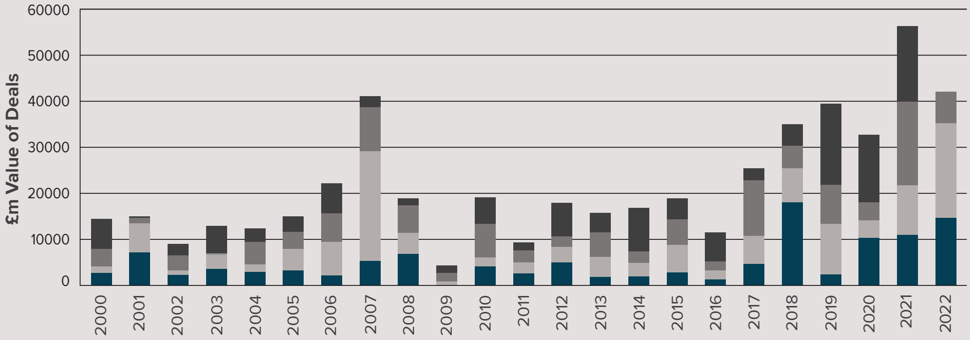
In the **larger buyouts** sector (transactions with enterprise value of £150 million or above), the number of transactions fell from 18 to 13, but the larger decline was in their overall value, which tumbled from the previous quarter's bumper £20.9 billion to £6.9 billion, the lowest quarterly figure for two years. Nevertheless, the total value of transactions for the first nine months set a new record.

£150m+ Buyouts by Volume



£150m+ Buyouts by Value



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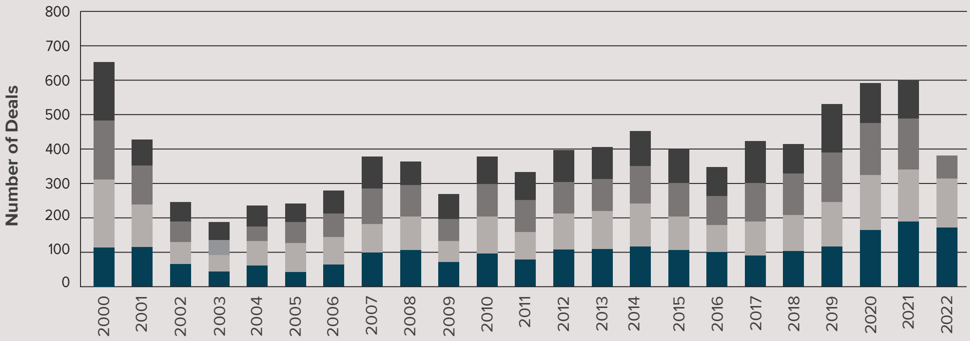
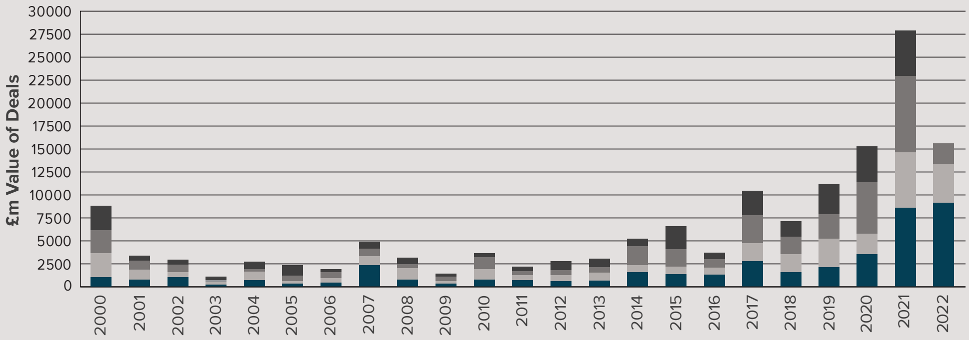
Early-stage and expansion capital deals also experienced a decline in both the volume and the value of transactions. The number of deals more than halved, down from 141 to 68, while the total value of deals fell from £4.3 billion to £2.2 billion.

Volume of Early-Stage / Expansion Deals



Value of Early-Stage / Expansion Deals



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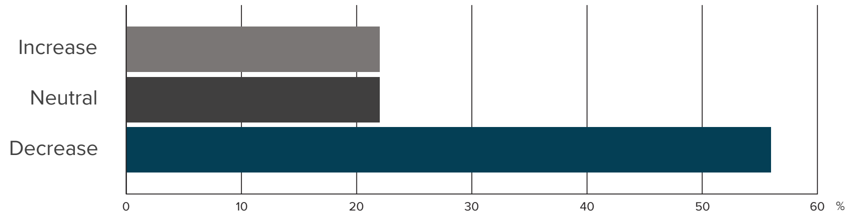
So what does our latest survey suggest?

With a backdrop of high inflation, rising interest rates and continuing concerns over weakening global growth, not to mention the ramifications of the Russo-Ukraine war, it's not surprising that market sentiment – usually so upbeat – has turned more negative.

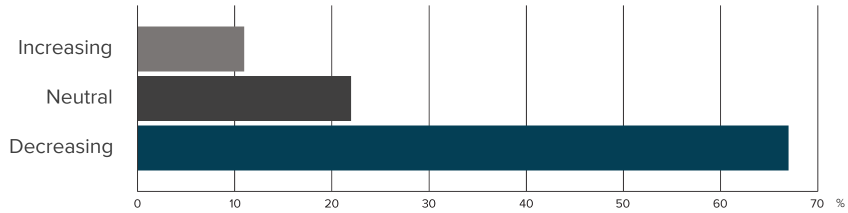
1 Do you expect deal volumes to increase or decrease?

The number of respondents expecting deal volumes to increase over the next few months fell from one third to 22%, while those forecasting a decrease rose from 11% to 56%. The remainder expect little change.



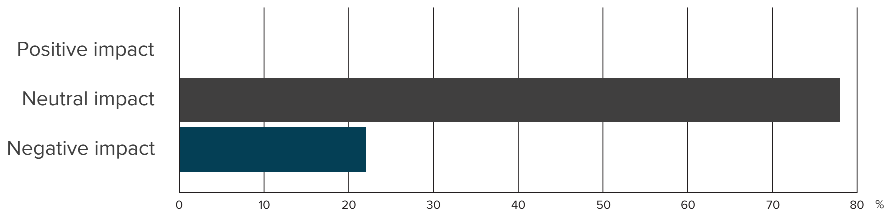
2 Is debt availability increasing, decreasing or neutral?

Concerns about debt financing rose significantly. The proportion of respondents observing a reduction in the availability of debt increased from 22% to two thirds.



3 Has Russia's invasion of Ukraine had an impact on your portfolio companies?

Even as the war in Ukraine escalates, respondents have become marginally less worried about the impact on portfolio companies. The proportion reporting a negative effect has fallen from one third to 22%, with the remainder seeing little or no impact.



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Foreign direct investment controls are increasing transaction complexity

Until recently, transactions involving small and medium-sized enterprises usually didn't require regulatory approval. However, new governmental investment control regimes, known as foreign direct investment (FDI) rules, here and abroad, are adding cost and uncertainty to transactions of all sizes. As Mark Jones and Jason Beer of law firm Jones Day warn, businesses and advisors must be aware of these regimes – and navigate them carefully – if they are to avoid the significant costs and transaction uncertainty that can result from falling foul of the laws.

The new UK regime

The UK National Security and Investment Act 2021, which came into force on 4 January 2022, has two main requirements. First, the government must be notified of investments in businesses conducting specified activities in 17 strategically sensitive industry sectors in the UK. These include military and defence, transport, synthetic biology, data infrastructure, computing hardware, artificial intelligence, energy and civil nuclear. Second, a broad 'call-in' power allows the government to intervene in a range of acquisitions of both companies and assets in all sectors if sufficiently important to the UK's interests. To pre-empt the risk of a call-in, the parties to the deal can voluntarily choose to notify upfront.

The regime applies irrespective of the acquirer's nationality, so even investments by UK owned businesses in other UK businesses can still be subject to mandatory notification requirements or a call-in.

What's more, the regime can apply to a broad range of transaction types from relatively small minority investments (including additional notification requirements for further increases in shareholdings or voting rights between thresholds) and internal corporate restructurings, to some types of financing arrangements.

The disruption is already being felt among businesses. In just the first three months of operation, 196 mandatory notifications and 25 voluntary notifications were made to the government, while the government issued call-in notices in relation to a further 17 transactions. A number of reviews have now resulted in significant regulatory interventions including prohibition orders, the imposition of information controls and security requirements, and ongoing obligations on businesses to continue servicing certain contracts and maintain operational capabilities within the UK.

What is happening outside the UK?

This proliferation of FDI regimes is a global trend. In Europe alone, 18 countries now have FDI rules, with Ireland and Belgium expected to introduce new regimes in early 2023. Five further EU countries have initiated reviews which could result in the introduction of further FDI regimes.

On top of this, a new EU regulation establishing a European screening mechanism for FDI came into force on 11 October 2020, requiring far greater co-operation and information sharing between EU member states and the European Commission. This increases risks for multi-jurisdictional deals, so parties will need to plan more carefully and have a coherent overall regulatory strategy across the countries affected.

What can I do to manage investment control risks?

It's important to consider early on in a transaction whether investment controls might apply and what notifications need to be made. Where clearances are required, you should allow plenty of extra time to obtain clearances before completion. And, in some cases, the need for FDI notifications might also influence the seller's choice of buyer, given the additional risks if the potential buyer is associated with jurisdictions not seen as friendly to the UK's national interests.

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Raising financially fit kids

Money can be a tricky conversation at the best of times, and the larger the amount, the trickier it can become. Spike Godwin of Arbuthnot Latham shares his thoughts on how to develop healthy financial habits with children.

One common concern among clients after a liquidity event is how their new wealth will affect their children. Might their ambition be dampened? Do they have the necessary skills or mindset to manage their finances effectively?

Raising children to understand the value of money can seem a daunting task. But the earlier you start, the better. Here are our top tips on helping your children make financially fit decisions.

Young children

1. **Start saving**
   There are many ways you can save for your children's – or grandchildren's – futures. We suggest four pots to show them the different purposes of cash: spending, saving, donating and investing.

2. **Talk about currency**
   Travelling abroad can help you introduce children to different currencies and exchange rates. A thousand rupees might sound a lot, but talk about what it can buy compared with £1,000.

Teenage children

1. **Let them earn money**
   This could be pocket money for chores or babysitting, or it might be to encourage them to develop skills. Perhaps they could teach you something and you pay for their expertise.

2. **Interest**
   If you have a savings pot, you might want to negotiate an interest rate with your child. Maybe they're saving for a bike, or another big purchase. Once a week, you can review their savings pot and add interest on top, showing them that the more they put in, the more they get out.

3. **Support the entrepreneur in them**
   If they have a business idea, offer to invest in their business. But they need to do the work to bring in the profit – and pay back their shareholders!

4. **Let them set the budget**
   Give your children a set amount to manage the household finances for a week. They can shop for food, choose the entertainment and decide what to spend on miscellaneous items. While you might eat some interesting meals, this can teach them how much things really cost.

5. **Investing**
   Choose something your child enjoys. Look at related companies and build a pretend portfolio, with ideally a balance of dividend paying and growth stocks. Review your investment performance regularly and decide whether to buy, sell or hold.

Adult children

1. **Borrowing**
   Overdrafts and credit or store cards can be tempting for young adults. Discuss the difference in price between a purchase today and the true cost over time when interest rates are taken into consideration. Equally, talk about when borrowing might make sense – mortgages, for example.

2. **Map out your family finances**
   Each take a sheet of paper and draw a simple timeline for the next few months or years. Ask your children to think about what they will need at different stages and how much things will cost. Where will the money come from? Compare the results and make plans to ensure you reach your goals.

3. **Family boardroom**
   More and more families have an annual meeting (like an AGM) to discuss key financial considerations for the next year. Agenda items might include holidays or wealth transfer over the long term.

As children grow, they are exposed to advertising and social pressures to spend. Talking about financial topics from an early age can make them far less daunting.

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