

COMPLETION

Getting deals done with Baker Tilly Corporate Finance

Issue 5 | Spring 2010

THE NEXT DECADE

**Predicting the future of
financial markets**

SPEAK UP

**Why small firms need
non-executive directors**

ON THE REBOUND

**M&A makes a
cautious comeback**



**TEN WAYS TO MINIMISE
YOUR TAX BURDEN**

**THE DOS AND DON'TS OF
OVERSEAS EXPANSION**

FEET FIRST

**How Jane Winkworth is selling
French Sole to the world**



BAKER TILLY

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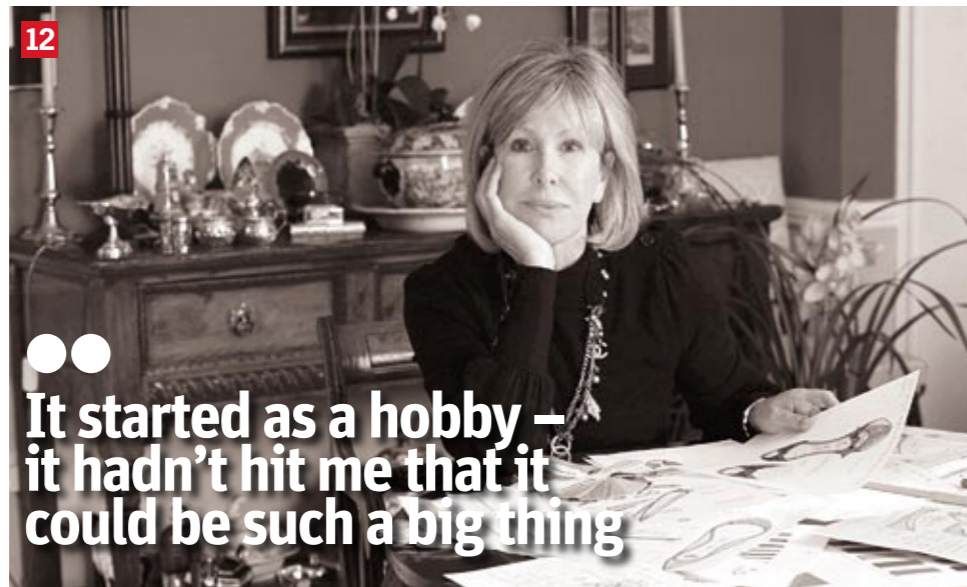
Getting deals done with Baker Tilly Corporate Finance

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WELCOME

How times have changed. As we enter a new decade, the exuberance of the boom years already seems a distant memory, and uncertainty reigns among investors and business owners. As David Giampaolo of Pi Capital notes in our look ahead to the next 10 years on page 18: "We will not see 2005-2007 levels of activity for a considerable time, if ever again. Patience and caution will remain key themes for a considerable period."

In this issue, we explore what those watchwords mean in the medium and long term. With signs that deal activity is slowly, but surely, picking up, we examine the options for would-be acquirers (page 6). We also hear from three experts on the long-term prognosis for private equity, capital markets and deal flow (page 18).

While the downturn continues to dull growth prospects domestically, we consider the potential and

pitfalls of entering new markets (page 10). How do you know that the time is right? You could ask your non-exec, if you have one of course. On page 14, we highlight the growing contributions NEDs make in private equity-backed firms compared with those in publicly listed companies. The results make interesting reading for any SMEs still operating with a silo mentality.

The latest Baker Tilly CFO survey (page 4) shows that, despite a gruelling 2009, optimism is building. But keeping a close eye on costs remains paramount. With this and the forthcoming 50% supertax front of mind, we reveal 10 ways in which businesses can reduce their tax burden (page 16), and start the new era as they mean to go on. **C**



BAKER TILLY CORPORATE FINANCE LLP

Lindsey Thompson Business Development Manager • Tel: +44 (0)20 7002 8763 • email: lindsey.thompson@bakertilly.co.uk • www.bakertilly.co.uk

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INCOMING

Insight and advice for business leaders

IN NUMBERS CFO CONFIDENCE

Chief Financial Officers (CFOs) in the UK are cautiously optimistic about an end to the recession, according to the latest Baker Tilly Finance Director Survey, but there remain major concerns over costs, cash flow and trading conditions



↘GROWTH

86%

EXPECTED A RETURN TO QUARTERLY GDP GROWTH OF 1% OR MORE BY THE END OF 2010

However, the majority expected a return to growth to be delayed until the last quarter of 2010, with a sizeable minority of 11%, not expecting sustainable recovery until 2011 or later.

The findings echo the latest CBI report, which states: "2010 should start with very weak growth of only 0.1% in Q1 2010, and 0.3% in Q2."

↘PERFORMANCE

54%

EXPECTED NO IMPROVEMENT IN TRADING CONDITIONS FOR THEIR BUSINESS OVER THE NEXT 12 MONTHS

Asked about trading conditions in their industry sector as a whole, 40% of respondents expected trading conditions to worsen over the next 12 months, while 35% of CFOs cited lack of consumer or buyer confidence as the most significant issue.

Access to credit was a problem but this was down to 29% from 35% who cited it as an issue six months ago.

↘CASH FLOW

41%

OF RESPONDENTS REPORTED A PROBLEM WITH DELAYED COLLECTIONS FROM CUSTOMERS

This is a significant increase on the 19% who reported this as an issue in the March survey, indicating that firms are funding working capital by stretching credit terms with suppliers.

Availability of credit and access to credit insurance continue to be concerns. Perhaps as a result of continuing difficulties in accessing credit, 31% of those surveyed felt that their banks were unsupportive

↘MANAGING COSTS

66%

EXPECTED TO MAKE FURTHER COST REDUCTIONS OVER THE NEXT 12 MONTHS

Employees appear likely to bear the brunt of this burden. More than 60% of CFOs were considering some form of restructuring, with a similar number looking to cut recruitment and 43% expecting to make redundancies over the next 12 months. The planned reductions are in addition to jobs lost during the past six months.

Renegotiating lease and tenancy agreements with landlords (18%) and supplier trade terms (41%) were also seen as cost-saving measures.

Risk and governance

The majority (57%) of CFOs surveyed believed that the risk to their businesses from fraud had increased as a result of the recession. Many companies (45%) had consciously made improvements to their risk management processes in response to this increased risk. A significant minority (13%) of businesses had also tightened controls over IT systems and physical security over assets.

●●
29% indicated that their strategy in the next 12 months would include looking at acquisitions

Investment and divestment

Some 20% of companies surveyed were looking to cut costs by exiting non-core activities either by simply withdrawing from the market or looking for a buyer for part of the business. Meanwhile, 29% indicated that their strategy in the next 12 months would include looking at acquisitions.

Just over half (51%) of respondents expected lower like for like sales than in the same months in the previous year.

More positively, 33% of those surveyed expected an increase in like for like sales, albeit against a weak comparative period.

Only 34% of businesses expected to benefit from increased overseas sales in 2009 compared with last year.

although very few had changed or intended to change banks, possibly because they are not in a position to do so.

Government response

Of those surveyed, 28% felt that government action in responding to the needs of business had been good or better, while 33% thought that it had been mixed and 39% characterised it as poor.

FORWARD THINKING

Direction microsite helps businesses take the right path

↘BUSINESS ADVICE

New resources at bakertilly.co.uk offer businesses fresh insight and advice, whichever direction they're heading in.

The articles and case studies are housed in three distinct sections, each representing key stages in a

firm's development.

'Manage' aims to help you deliver on your strategy, whether that is streamlining, restructuring or keeping productivity high in the face of change.

'Grow' explores some of the current opportunities your business may be

considering, such as making acquisitions, establishing joint ventures, expanding overseas or growing organically.

And 'exit' helps you to decipher what type of exit you should plan for, how to enhance your chances of achieving it and what to do if your plan fails to materialise.

The site also features in-depth sector analysis, research, events, briefings and a detailed archive, so you can find relevant advice, whatever your business challenge.

www.bakertilly.co.uk/direction/Pages/Direction.aspx



↘WHERE ARE THEY NOW?

Ed Macnair, CEO, Overtis Systems



Last year didn't pan out how Ed Macnair had expected. The IT industry veteran had intended to take a year off, but an opportunity arose which he couldn't resist: an investor asked him to advise on strategy at IT security firm, Overtis.

"The products and approach that Overtis was developing were so completely different, it blew me away. I had never seen anything quite like it. So when they asked me to head up the company, it was a very easy decision," he says.

Overtis combines virtual and physical security systems to monitor and protect high-value and sensitive information. Education is central to its unique offer. "The majority of security breaches are accidental, so if you can educate users and warn them when they are about to do something that is potentially dangerous, you really do reduce the number of breaches."

Before becoming CEO of Overtis, Macnair had spent 20 years in the IT industry, in senior management positions at companies including IBM, Symantec and MessageLabs and, most recently, software firm Marshal. He joined the latter in 2002 to run its European arm and three

●●
Overtis's products and approach were so completely different, it blew me away

years later led a management buy-out advised by Baker Tilly.

"I had a very positive experience working with Baker Tilly on the last MBO," he says. So good, in fact, that he is working with the firm again. "I'm just starting a fundraising round to finance Overtis's expansion," he explains. Currently, Overtis operates in the UK and Europe, but Macnair plans to extend further into Europe, the Middle East and Africa and then into the US.

Are these expansion plans an indicator that the IT security sector has weathered the downturn? Although the technology industry endured a rough ride last year, security remained buoyant, says Macnair, "because security threats haven't diminished. If anything, they have increased. Security is not optional; it's a must have."

CV

Name: Ed Macnair
Age: 49
Greatest achievement: riding my motorcycle solo down to West Africa
Greatest challenge: growing the business successfully
Next career move: to own a pub chain, already own one!

SET YOUR SIGHTS

With experts optimistic that the M&A market is starting to recover, *Completion* explores the best options for would-be buyers

MERGERS AND ACQUISITIONS (M&A) always dwindle in a recession and the current downturn is a striking example. But economic slowdowns also bring opportunities to take advantage of low valuations and, after a very bleak 12 months, resourceful buyers are thinking again about how to fund new deals.

“We’re seeing pipelines starting to grow and there’s now a solid base of transactions happening for good commercial reasons at realistic prices,” says Paul Johnson, Head of Due Diligence at Baker Tilly. “The funding lines are starting to open again.”

Figures compiled by independent M&A intelligence service Mergermarket show that European mergers and acquisitions fell from €1.1 trillion in 2007 to less than €200 billion (£180 billion) in the first nine months of last year.

“It’s been very severe,” comments Giovanni Amodeo, Mergermarket’s Editor for Europe, the Middle East and Africa. “Buy-outs have been particularly badly affected. In the third quarter of last year, private equity-backed deals totalled just €2.7 billion, compared with €90 billion in the second quarter of 2007. ↘

The figures are barely comparable.”

In the mid-size M&A market, a global total of deals worth between \$100 million and \$1 billion, compiled by Dealogic, shows a 32% fall to \$667.7 billion (£408.7 billion) in the year to the end of August 2009 – the lowest level since 2003.

However, this size of deal has accounted for about 22% of all M&A activity over the past three years and, while few people expect a quick return to the heady days of 2007, experts say they’re seeing a revival of interest. According to Dealogic, deal value for global mid-market M&A rose between the third and fourth quarters of 2009, from \$170.6 billion (£104.4 billion) to \$217.9 billion (£133.4 billion).

“We’re seeing a slight recovery,” says Mergermarket’s Amodeo. “The hottest area is Central and Eastern Europe, especially in the consumer, industrial, chemicals, technology, media and telecoms sectors. In the UK, we expect particular interest in technology, media and telecoms, energy and financial services.”

Buyer’s market

Trade buyers with cash and knowledge of their industry are in a particularly strong position. “There are still plenty of private equity houses with money, but they struggle to raise any debt,” says Rob Donaldson, Baker Tilly’s Head of M&A and Private Equity. “Right now, private equity houses are finding it difficult to compete with trade buyers who have cash. If your business is stable and you are well funded, it’s a great time to be thinking about acquisitions,” he continues.

Johnson says the tightening of the credit markets means that buyers are having to put more cash or equity into transactions. “The amount of leverage is less, but in some ways that makes for a more solid structure,” he explains.

With valuations estimated to be up to 25% lower than a few years ago, buyers can increase the likelihood of getting a good price by being clear

●● **We’re seeing pipelines starting to grow and there’s now a good solid base of transactions happening for good commercial reasons at realistic prices**

Paul Johnson, Corporate Finance Partner, Baker Tilly

about their acquisition criteria. Priorities may include the scale and profitability of their target, entering a new market or expanding in an existing one. Building a rapport with key shareholders or directors at your acquisition target can also increase the chances of a successful deal.

ACCELERATED M&A ON THE UP

Mergers and acquisitions in distressed circumstances, known as accelerated M&A, are becoming more common as distressed companies on the brink of collapse look for a quick sale. An accelerated M&A process involves the sale of a business with major problems, such as too much debt, heavy losses or untenable liabilities such as property leases.

Such deals have been particularly popular in the industries hit hardest by the recession, such as leisure and retail, notes Paul Elliot, Baker Tilly Corporate Finance Partner. One example is where businesses have fallen into the hands of banks.

In this situation, there are three common scenarios. The first is to sell the whole business for a fairly low price, with some or all of the debt rolled over or refinanced. The second is to sell the assets of a business through a pre-packaged administration, when advisers put a company into administration quickly, wipe out its debts and sell it on immediately. The third is for banks to sell a company’s debt so that the buyer becomes the major creditor.

Another form of accelerated M&A can occur when a group sells a struggling subsidiary to a private equity firm. Completion times for deals can vary from two weeks to a year, says Elliot. “Buyers are facing situations where vendors are very keen to exit, and if a buyer reckons it can implement a restructuring plan or buy a business it can see value in, then it can get some pretty good deals at the moment.

“In a normal sale, price is top of the list, but [in accelerated M&A] getting the business off the books is at least as important as getting a fantastic price,” he adds.

VENDOR FINANCING: A WIN-WIN SITUATION

Under a vendor financing arrangement, a buyer effectively borrows money from the seller by withholding part of the proceeds – the buyer will only pay part of the asking price on day one. An example is The Carlyle Group’s €749 million buy-out of Greek chemicals business Neochimiki last year.

This makes sense for both sides. The lack of availability of bank finance has stopped many deals from happening. With these types of arrangement, the vendor gets their sale and the buyer gets the finance they need to complete the deal. However, there is a risk for the seller because it is in effect becoming a bank and faces the possibility that the buyer may default on the loan.

Donaldson says vendor financing has become more common over the past year, estimating that about one in four mid-market deals are now vendor-financed, compared with about 5% a couple of years ago.

“We’re doing a [vendor-financed] deal at the moment,” he says. “It is a £22 million transaction and we’ll pay the vendor £12 million on day one. The vendor will lend us the remaining £10 million. They get interest on the money they’ve lent us, and security over the business. If we don’t pay them back, they can take the business back. It helps us as we don’t need to raise bank finance.”

WHEN MBOs APPEAL

One exit route which should always be considered is a sale to management or management buy-out. During the boom, private equity would have been considered alongside trade buyers as a matter of course. Debt was in plentiful and cheap supply and as a result private equity could match or even better the prices achieved by a sale to trade. One of the biggest areas to suffer during the credit crunch has been the buy-out market. As leverage has been reduced, so too have the valuations that private equity can achieve. “MBOs are being done but the volumes are right down,” says Kirsty Sandwell, a partner in Corporate Finance at Baker Tilly.

However, it’s not all doom and gloom and there are signs of life that for the right sort of opportunity MBOs are back on the agenda.

Indeed, Mergermarket’s figures show that the number of private-equity buy-outs jumped by 33%, from 21 to 28 transactions, between the first and second quarters of last year. Private equity-backed MBOs in 2009 included the £71 million buy-out of Formula 1 racing team BAR Honda and the £30 million purchase of Denby Pottery Company.

As ever, there are some sectors that are more fertile than others. “Things that were considered steady and boring in boom times are now thought to be quite exciting,” says Sandwell. □

●● **In the UK, we expect particular interest in technology, media and telecoms, energy and financial services**

Giovanni Amodeo, Editor for Europe, the Middle East and Africa, Mergermarket

Diligent due diligence

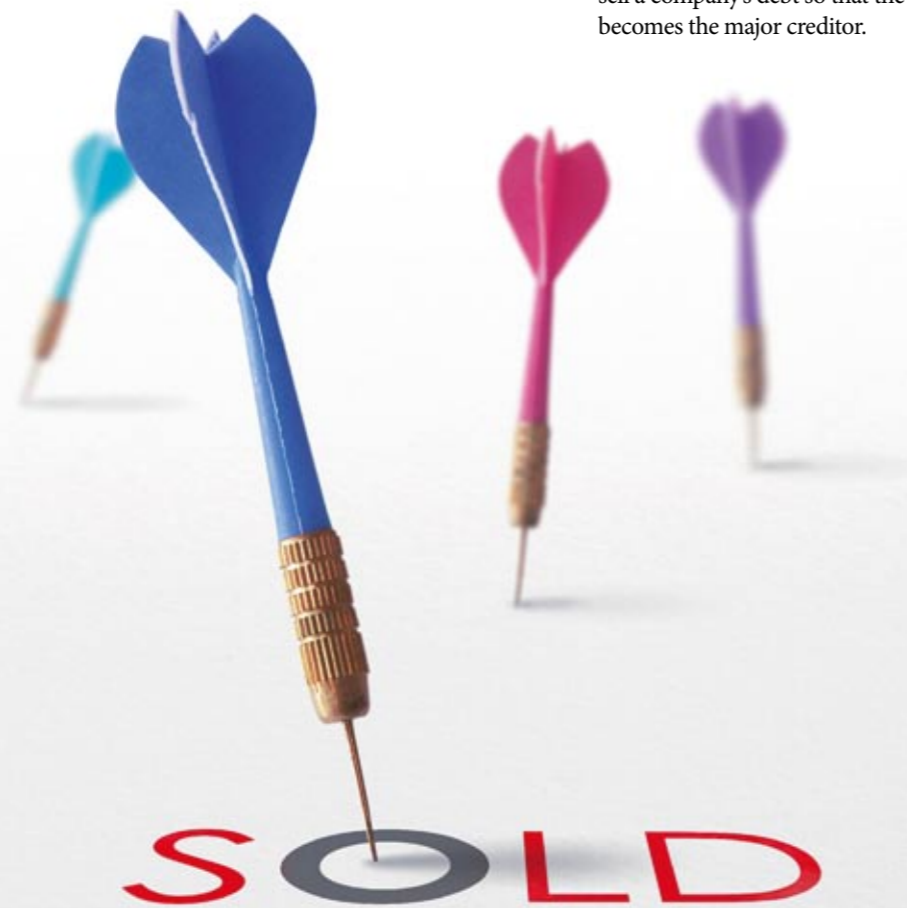
Due diligence is crucial for all deals but even more so in a recession when markets, values, order books and trading can be highly volatile in the period between a deal being mooted and finally agreed. Deal-makers say that an increasingly common problem is a need for forecasts of key measures such as profits, sales and cash flow to be scaled back while due diligence is taking place, because of dramatic changes in economic conditions. Such an occurrence will often kill a deal.

Paul Johnson, Head of Due Diligence at Baker Tilly, says that timescales for due diligence and lengths of forecasts have therefore

both been increasing. He suggests three to six months is usually a sensible time frame, while cash flow should now be projected for a minimum of two to three years.

“What you’re doing is measuring the managers’ view of the future [at the target company],” he says. “Do they have a strategy and the ability to understand the business and take it forward?”

Judging the soundness of a company’s financial forecasts can be tricky, though analysing working capital projections, previous and current trading and the pipeline of orders can give some clues about whether forecasts are sensible.





TOKYO



BEIJING



PARIS



LONDON



NEW YORK

FOREIGN AFFAIRS?

Looking overseas for growth opportunities could be one way to ride out the downturn, but there are risks involved

By Christian Doherty

Expanding overseas can mitigate the worst effects of the recession for some firms. It's surprising, then, that in the midst of the current downturn, so few of the UK's small businesses are considering exporting goods or services, despite the relative weakness of sterling being in their favour.

According to the British Chambers of Commerce,

exporting doesn't feature in the business plans of 43 per cent of firms. UK Trade and Investment (UKTI), the government body set up to promote overseas expansion and inward investment, wants to turn that around, adding that it has plenty of evidence to back the benefits of exporting overseas.

"A recent survey of ours showed 42% of our exporters had increased their turnover in the last year," says Martin Cook, International Trade Director

for UKTI's London office. "Compared with 23% overall, that shows exporters are proving to be a lot more robust."

Venturing overseas is not without its risks, however. Matt Therrien, Consultant with Baker Tilly Virchow Krause in the US, says firms thinking of expanding abroad often fail to answer one simple question: "What are we trying to accomplish?"

Historically, many companies have been unrealistically optimistic, especially when it comes to emerging markets. "The mentality of 'China has 1.3 billion consumers – if we can get one-tenth of 1% of the market, then we're made' just does not produce results."

If only things were that simple. Many firms fail to comprehend what they can realistically achieve before taking the plunge. They need to develop an understanding of the local market, culture, currency trends and competitive landscape before any investments are made, says Therrien.

Underestimating regional differences is another common mistake. "Companies talking about international expansion look at whole countries like they're one entity," says Jeff Horein, Partner at Baker Tilly Virchow Krause. "Even in

the US, the difference between having a company in Wisconsin versus a company in New York is as big a difference as having it in Scotland or London."

A few critical questions also need to be answered early on. How do customers differ from our home market? What's the competitive landscape like? What do we need to know about local intellectual property laws and other regulation? And which channels do we need to go through to get things done?

UKTI's Cook agrees: "The key is research. You simply cannot know too much about the market you're entering or the partner you'll be working with."

Baker Tilly, through its international network, helps clients to conduct due diligence, identifying risks and opportunities, and clarifying what the business requires before any deal or expansion goes through. "Whether it's emerging or developed markets, it's much more expensive to go back and fix your mistakes than it is to do it right the first time," says Therrien.

Knowing when to expand globally is also important. Three questions to consider when going global include: do we have the data to show this is a

●●
42% of exporters had increased their turnover in the last year

Martin Cook, International Trade Director, UKTI

positive long-term opportunity? Do we have the management skills to expand? Do we have the full commitment to expand and work through the challenges we will face?

You should also ensure your business is fit for purpose. For many firms, Horein says, a successful transaction across borders involves a combination of internal resources that have expertise in those regions and insights from external advisers.


There are numerous ways to expand into overseas markets, from finding a local distributor to sell your product to owning a standalone

operation. Now could be a good time to grow by acquisition. "There is so much opportunity because prices are down worldwide," says Horein.

How a business accesses a new market is critical to controlling the level of risk it may be exposed to. You need to consider not only financial risk, but also the IP (intellectual property) risk of geographical expansion. When looking to do a joint venture, you need to be careful that the distributor has the right capabilities, not just the right relationships, and that you manage your IP risk by choosing a trustworthy partner.

"To succeed, companies need to be dedicated to a rigorous process rather than simply putting a toe in the water," says Therrien. "Now more than ever it's about front-end due diligence and a full operation and ownership," he adds.

It is clear the landscape has changed. Opportunities, especially in growing markets, have developed to such an extent that ignoring the possibilities is a risk in itself.

But whatever route a firm chooses, one thing is clear – determining clear objectives and understanding the local market are absolute musts before any dotted lines are signed. 

NEAT FEAT

French Sole started as a hobby for Jane Winkworth but soon flourished into a global footwear company with a formidable client list

By Alex Elliott



Jane Winkworth knew she was on to something after an over-zealous holiday shopping spree as a teenager. She returned from France with a suitcase full of ballet pumps that didn't fit, but found that friends snapped them up. Some years later, inspired by a lifelong love affair with ballet, Jane began designing her own shoes, and in 1989, French Sole was born.

"It started as a hobby," she says. "I'm not very competitive and it hadn't hit me that it could be such a big thing." But her simple, stylish ballet pumps soon captured the attention of Diana, Princess of Wales, whose interest, in turn, caught the eye of *Vogue*. Today, French Sole's devotees include Madonna and Kate Moss.

Following the success of the traditional ballet shoe, French Sole has expanded its product range and has become famous for being a luxury flat shoe brand. There are now four London stores, a mail order business run from the head office in Reading and a sister company, London Sole, with stores in San Francisco and Santa Monica. The shoes are trademarked around the world and sold to more than 500 outlets.

An eye for minutiae

Jane believes attention to detail has been crucial to the firm's success: "The highlight of my day is when a letter arrives and the stamp hasn't been franked so I can peel it off and reuse it," she says. "I've taken the very minimum myself and I'm meticulous about watching money. I can spot wastage 100 yards away and I hate it; if I see that things aren't going well or that one style is not selling, I am very quick to move it to another store."

She has, however, started to step back: "I used to get up, sweep the pavement, make coffee for customers, make calls to order leathers. But I realise now that you have to delegate."

Fortunately, she is able to rely on a very close-knit team, who share her passion. She now plans to spend a quarter of the year designing shoes from a new studio in Portugal while she leaves the day-to-day running of

If I see that one style is not selling, I'm quick to move it

the business to her three other directors, including her husband John, Finance Director, and her Managing Director, Lucy Choi.

Choi joined French Sole seven years ago to look after press, PR and marketing. "She was so involved straightaway and wants to see French Sole become as big as Jimmy Choo," says Winkworth – Choi is the niece of the legendary shoemaker. "We work brilliantly together; she is my rock. I see her as one of the family."

Choi is equally enthusiastic: "I love the whole cycle: we start with the research, Jane designs all of the product, we have a meeting where we look at some of her designs, we get the shoe made, decide whether to go into production with it, then go about getting it into the press."

She is very proud both of the quality and workmanship in the shoes themselves and of their international reputation. Fans come to London from all around the world. "They are so excited to see the colour combinations that they don't see in their own countries, they end up

buying 10 pairs at a time. We already sell to stores in Japan, Australia, Hong Kong, Korea, Dubai and Singapore, but people see maybe 15 colour combinations per season. We want there to be freestanding stores in these places where there are 500 colour combinations."

The company is now seeking investment for


expansion plans that involve building up to 10 new shops internationally over the next five years, in areas where the brand already has an established reputation.

Larger footprint

"French Sole is fantastic at what it does," says Rob Donaldson, Head of M&A and Private Equity at Baker Tilly, who has been appointed to guide it through the next stage of its development. "The attention to detail in the product itself but also how they present and package it, even where they pitch the price – it is all very well thought through."

Nonetheless, these are tough times for smaller, private businesses. "Banks are under pressure to lend but where they are lending is to large corporates," he says.

"You need to be careful when tapping into equity capital because you don't want to end up damaging the culture that made the business such a success. So, it's our job to approach the right investors and negotiate the terms of that external funding, which will allow French Sole to accelerate the roll-out of stores."

It is French Sole's biggest challenge thus far but Winkworth and Choi exude quiet confidence. "We've seen how far people come to see our full range – the overseas PR has already been done," says Choi. "A lot is at stake," adds Winkworth. "But I'm quite instinctive about knowing when the time is right." As founder of the firm responsible for making ballet pumps a fashion staple the world over, she probably has a point. 



French Sole: the essentials

- Sells an average 6,000 pairs per month
- Stores generated revenue of £7.5k/m² to March 2009 (during a tough climate)
- Worn by Princesses Beatrice and Eugenie, Kate Middleton, Kate Moss and Madonna
- Core ballet flats sell for £70-£125 with premium collections and new boots ranges retailing for up to £400
- Over 60% of wholesale revenue is outside UK
- All shoes handmade in Europe

WORD FROM THE WISE

Non-executive directors can tell small companies what they don't want to hear. And the evidence suggests their advice adds significant value

By Matt Farquharson

ONE CLEAR LESSON from the global credit crunch, according to Financial Services Authority (FSA) Chief Executive Hector Sants, is that non-executive directors (NEDs) failed. In a speech given in May last year, he said they “struggled to fulfil their role of providing strong independent oversight of executive management”.

But his comments come with caveats. He was speaking solely about companies in the financial industry, the vast majority of which are publicly listed. For smaller, private equity-backed firms, the situation is a little different.

Research released in 2008 by the London Business School found that boards in private equity-backed companies are significantly more effective than those of public companies. In lengthy, structured interviews, the researchers spoke to 20 chairmen and CEOs who had served on both kinds of board. Some 15 of these 20 felt that private equity-backed boards were superior in the value they added. So, what could explain the differences?

Angela Toner is a Partner with Baker Tilly Corporate Finance. “Listed businesses need to follow The Combined Code on Corporate Governance,” she says, “which stresses that their boards are required to have independent, non-executive directors, whereas a private company can choose to have them.” A firm that voluntarily brings in an NED is perhaps more likely to be open to their suggestions.

Sticking to the strategy

Bob Stott is the former CEO of Wm Morrison, one of the largest supermarket chains in the UK. Now semi-retired, he holds a number of non-executive directorships, including seats on the board of Leeds Building Society and two sports governing bodies. Another of the companies he works with shows a good example of the difference non-execs can make. It is a food manufacturer with turnover of around £70 million, which was founded in the nineteenth century.

Its shareholders are all family members, who, says Stott, “haven't

always agreed on the best way forward.” In 2008 they brought in a non-exec chairman who, “has been instrumental in convincing the family that they are fortunate in having their current MD and management team”. But more significantly, the Chairman, supported by Stott, has changed the board's way of working by agreeing a clear strategy and introducing an inclusive culture that sees the board “constantly cross-referencing decisions against the strategy to see if they are being consistent, rather than every decision being a one-off.”

The Institute for Family Business reckons that family companies account for 65%, or three million, of the 4.6 million private sector enterprises in the UK. Most are SMEs, with board membership often coming down to a family link rather than industry experience. It's here that independent advice can make a real difference, and is perhaps one reason why SME non-execs are more effective.

The area where plc boards seem to outperform their private equity counterparts is in corporate governance. While NEDs with private companies only have to satisfy the board that employs them, reporting for plc NEDs is much more strict. The London Business School report found that, “given the need in public companies to protect the interests of arm's length shareholders and to ensure accurate and equal information flow to the capital markets, governance issues such as audit, compliance, remuneration and risk management inevitably (and appropriately) loom much larger in the minds of plc boards”.

Whatever the impact, hiring non-execs is a big investment for smaller companies. Paying someone five figures a year for what might only be 20 days' work can seem counter-intuitive. But David Clipsham, who was named 2008 NED of the Year at the North East Business Executive of the Year Awards, suggests that small companies should hire an NED, “as

soon as they can afford it”.

He explains: “One of the most difficult parts of managing any business is the process of managing growth, and management needs someone to talk to who has been through that process.” And in the current climate, having the advice of someone who has been through a couple of recessions can be hugely useful and reassuring.

It's important that firms know what to expect from their new NED. “Non-execs will attend board meetings,” says Angela Toner, “but it's not just about that. A non-exec will be particularly useful in an SME, where their skills will help complete the board's skill set. A lot of SME

Will the post credit crunch world bring extra regulations for private equity NEDs?

businesses are family owned, and you can't expect a board of an SME to cover all the bases in terms of skills. Non-execs bring a fresh set of eyes, they'll be independent, and challenging. They're there to ensure the success of the business and that tends to come at the higher strategic level,” she says, “and often, a good non-exec will bring contacts in the same sector.”

There are questions, too, about whether the post credit crunch world

will bring extra regulation for private equity NEDs, but Toner considers it unlikely, given the governance rules already in place. “What we don't want,” she says, “is stricter corporate governance meaning that NEDs aren't able to do their job and add that fantastic value that they do”.

But NEDs will have expectations of the firms they come into as well, explains Clipsham. “Routine communication is important, and honesty – admitting to problems or

lack of experience – makes the whole process so much easier than when it has to be dragged out of management by confrontation.”

For an SME to achieve value from a non-exec, honesty is key, even if it means some painful truths. These advisers are paid, often very well, to improve your business. Hiding information from them would be like lying to the doctor about where it hurts. **C**

Which NED?

The Combined Code on Corporate Governance suggests smaller companies should have two independent NEDs, paid a salary only, and with no direct involvement in running the business. However, for companies which are not subject to the Combined Code, the Quoted Companies Alliance (QCA) also produces useful guidance for listed SMEs, which may be a good starting point for private companies. But what more should you look for?

Absolute impartiality – an existing relationship can be counterproductive, suggests David Clipsham. “The worst kind of non-exec appointments are old school chums.”

Strong character – Non-execs can't be afraid to speak their mind. “A good non-exec will make sure the board listens to them even if perhaps the board doesn't agree with what they're saying,” says Angela Toner.

Industry experience – Grey hairs aren't enough, and smaller firms need someone who knows their industry, says Clipsham. “Relevant background, certainly in smaller businesses, is pretty vital, I think.”

To read The Combined Code, go to www.frc.org.uk. To obtain a copy of the QCA's guidance booklets on Corporate Governance, go to www.quotedcompaniesalliance.co.uk/guidance_booklets.asp

IT ALL ADDS UP

With the forthcoming 50% supertax, tax is even more prominent in the minds of entrepreneurs. With planning and an in-depth knowledge of the rules, you can streamline your liabilities. Nigel Gleaden, Baker Tilly Tax Transaction Manager in Birmingham, explores 10 ways to reduce your bills

1 Restructure property ownership

If you are considering selling your company in a few years' time, but would like to retain the property, then the sooner you arrange for the transfer the better. Many family-owned businesses are taking advantage of the current depressed market by restructuring their companies. This usually means that the property is transferred to the pension fund or another company within, with the aim of minimising tax liabilities. It is a complex process, but the tax savings make it worthwhile.

2 Beat the supertax

A new 50% top income tax band is scheduled for April 2010, and prudent entrepreneurs will want to manage their affairs swiftly to avoid getting hit. Indeed, if you take into account national insurance (which is also being increased by 1%), the real rate of tax on profits distributed to shareholders in the form of remuneration can be as high as 57.2%. Such is the impact, you might want to bring forward the sale of your business – allowing you to cash out and pay as low as 10% capital gains tax rather than continuing to extract cash from the business.

3 Avoid the loan note trap

Entrepreneurs selling a business often agree to a deferred consideration. To avoid immediate tax charges on the deferred consideration, it is normal for it to be paid in the form of a loan note. However, if the loan notes aren't redeemed because the buyer goes bust or can't find the cash, the vendor may be charged tax. The issuing of loan notes delays the tax liability until redemption, but even if the buyer can't redeem there may still be a liability. To avoid this, vendors must ensure loan notes are non-Qualifying Corporate Bonds.

4 Give shares to employees

Many family-owned companies include among their shareholders senior employees who are not members of the family. Giving shares to employees usually brings with it a tax charge, but this can be avoided by using an HMRC-approved share scheme. The most popular is the Enterprise Management Incentive Scheme (EMI). There is no tax to pay when employees receive the shares, and the company can claim relief from corporation tax for the difference between the amount paid by the employee and the market value of the shares.

5 Look to the future

If a company sells a division, it will pay tax on the gain. Selling a subsidiary company will avoid that tax completely. However, dividing your firm into separate entities can be tricky, particularly if it occurs purely for tax purposes (HMRC will regard it in a dim light). Don't be discouraged though, as there are big benefits to hiving off a division before it is sold, and there is a way to do it with the approval of HMRC. Early planning is vital to minimise taxes and is likely to be more successful if achieved before any buyers are on the horizon.

6 Relief for costs of a transaction

The costs of all corporate transactions have to be reviewed so that the correct amount of tax relief may be claimed. Not all costs qualify for relief from tax and the VAT paid may not be fully recoverable. The rules are particularly complex and can appear unfair. As an example, in many transactions the company will bear the cost of the bank's legal fees and the VAT on these fees is not recoverable. Specialist advice should always be obtained in order to improve the amount of tax relief available for costs incurred during a transaction.

●● Such is the impact of this supertax, you might want to bring forward the sale of your business

7 Entrepreneurs' relief

If you have family members working in the business, think about giving them an equity stake to maximise the claim for capital gains tax entrepreneurs' relief. This valuable relief reduces the capital gains tax rate from 18% to 10%, but only applies to the first £1 million of gain. Sharing the gain around the family can increase the amount taxed at the reduced rate of 10%.

8 Pay early to avoid the 50% rate

Many are considering bringing forward payment dates for dividends and bonuses in order to pay tax at 40% rather than 50%. If the company needs the cash, the entrepreneur can always loan it back to the company (perhaps with interest), only drawing it down when the company can afford it.

9 Act early on capital gains tax

Many entrepreneurs expect the government to raise capital gains tax (CGT) above its current rate of 18% at the next Budget in order to close the gap between CGT and income tax. Acting early may help minimise the CGT burden.

10 Pension contributions

In his latest Budget, the Chancellor announced sweeping changes to the tax relief available for contributions to pension funds. Before 6 April 2010, there is scope, albeit restricted, to pay contributions this year and obtain tax relief which may not be available after that date.

The DECADE of UNCERTAINTY

What a tumultuous decade the first 10 years of the 21st century has been for financial markets, with the boom years of 2003 to 2007 followed by one of the biggest market crashes in history. For investors and traders alike, however, the pressing issue is how the trends of the past 10 years will compare to those in the next decade

By Andrew Cave

WILL WE SEE AGAIN the mega-buy-outs, large-scale public to private deals and dominance of private equity that characterised the “noughties”? Or will investments be different in nature, shape, size and structure in the more risk-averse and more heavily regulated financial environment following the downturn? Like any future projections, analysis must start with understanding recent history, when capital markets reached new peaks and there was an explosion of deals, many of which were fuelled by private equity.

In terms of smaller companies, the most noticeable trend was a boom on AIM, with a stream of international companies choosing to float on the market, attracted by its lighter regulatory requirements, compared with New York and other major Western markets. The volumes of companies listing on the market transformed its credibility, and institutional investors began participating much more fully. Only a handful of institutional investors regularly invested in AIM companies when it launched in 1995, but by 2005, nearly all the major institutions were investing in the market.

When it came to the recent downturn, however, AIM was no hiding place. The number of companies on AIM fell from a peak of almost 1,700 in 2007 to just over 1,300 at the end of October 2009.

Almost 500 companies have delisted since the beginning of 2008 for various reasons (and not all bad ones) but more significant has been a distinct lack of initial public offerings

(IPOs). In the 10 months to October 2009, there were only 22 admissions to AIM. Of these, seven admissions were IPOs, with the rest being through introductions. However, the £4.2 billion funds raised on AIM in this period are almost at the level raised for the whole of 2008 (£4.3 billion), which has been underpinned by £3.6 billion raised for existing AIM companies.

Figures from the Centre of Management Buy-out Research show that only 31 private equity buy-outs were completed in the third quarter of last year – the lowest volume for 25 years. The number of businesses acquired from family and private owners fell by 73% from the previous year, while public to private transactions declined by 67%. The number of investments realised in the first nine months of 2009, excluding receiverships, dropped to less than a third of their 2008 level.

David Giampaolo, founder of private equity group Pi Capital, says: “We will not see 2005-2007 levels of activity for a considerable time, if ever again. Patience and caution will remain key themes for a considerable period.”

The downshift has also seen new funds raised for new venture capital trusts fall from £800 million in 2005/06 to less than £150 million in 2008/09. Whether these figures represent little more than an extreme point of a particularly vicious cycle or something more sustained is the subject of much conjecture.

Completion speaks to three experts – in capital markets, M&A and private equity – for their perspectives. ➤

>CAPITAL MARKETS
Chilton Taylor
 Head of Capital Markets,
 Baker Tilly

“THE BOOM years were fuelled by an abundance of funds to invest in businesses but as belts were tightened in 2008, AIM, in common with all small cap markets across the world, suffered more than the major markets. But there now seems to be grounds for cautious optimism. By October 2009, the AIM All-Share Index had rebounded by 65% since 1 January 2009 (albeit from a low base) compared with the FTSE All Share of 16%.

Between January 2008 and the end of October 2009, nearly 500 companies had left the market, leaving just 1,335 companies – 20% less than the peak of almost 1,700 at the end of 2007. However, this is not all bad news; more than half the companies that delisted had a market cap of less than £3 million, leaving the market smaller but stronger, with an average market cap of £43 million compared to £28 million at 31 December 2008. There was also an increase in liquidity in the third quarter of 2009, and the number of departures from AIM appears to be slowing down.

In spite of this recovery, the AIM All-Share Index is still only just over half the value it was during its peaks in 2006/07. These relatively low valuations mean there’s tremendous potential for investors, but it’s important to recognise that AIM is a stockpicker’s market.

The IPO market has remained depressed with only seven IPOs on AIM and four on the Main Market at the time of writing, with investors clearly favouring further investment in existing listed companies rather than in unproved companies seeking an IPO. Indeed, secondary fundraisings for existing AIM companies are 25% higher than in

the same period in 2008, and 86% of all funds raised to date.

When the IPO market returns fully, the emphasis will be on quality. There have been some concerns about a few overseas AIM companies, unable or unwilling to cope with the demands of the market. As a result, institutions are likely to focus on quality UK companies, with overseas firms having to work harder to show they have heeded these lessons.

It is always difficult to predict which sectors will attract investors, but the initial focus will remain on those which are currently proving resilient in the downturn, such as the extractive industries, clean technology and healthcare.

Government help will be required to stimulate the smaller end of the market because there is a real equity funding gap. Some £1 billion of assistance through various funding schemes would make a huge difference and, in particular, relaxation of the recently tightened VCT and EIS restrictions would go a long way to assisting the growth of SMEs, whether private or on AIM.

Clearly, there will be calls for increased regulation and companies will have to accept demands for a higher degree of corporate governance and transparency.

There will be potential competition to AIM from ‘standard’ listing on the Main Market, which is now open to UK as well as overseas companies, and other markets in

●●
Government help will be required to stimulate the smaller end of the market

Chilton Taylor

●●
It is clear that the days of the multi-billion pound deal seemingly every other week financed by easily available credit are over

Simon Havers

the AIM mould are setting up across the world to serve local demand.

Companies seeking to IPO not only have to be suitable for listing but also be prepared, and as the markets are sure to return, now is the time to make those preparations.”

>PRIVATE EQUITY
Simon Havers
 Chief Executive of Baird Capital Partners Europe and Chairman of the British Private Equity and Venture Capital Association

“PRIVATE EQUITY will carry on doing what it has done for the past 30 years, which is buying companies, investing in their improvement and selling them on at a profit.

At the end of the last cycle, the market became overheated and some of the large private equity

deals were seen to be driving the market.

It is clear that the days of the multi-billion-pound deal seemingly every other week financed by easily available credit are over. Who knows when or whether they will return, but the private equity industry needs to return to refocus on what it is good at: using the benefits of having direct control of businesses and incentivising management to increase value.

Historically, this is something that the private equity industry has done extremely well, and it now needs to adapt itself again to the demands of operational improvement, particularly while the markets remain closed to mega-deals.

At Baird, we have 20 people in China who are there solely to help the US and European firms that we back to take advantage of opportunities in Asia. I can think of a number of underperforming companies whose performance we have helped improve in this manner, whether by procuring components more cheaply or by winning business in China itself.

Private equity firms will have to put more emphasis on this kind of operational improvement, although it would be a foolish person who said that a deal such as the takeover of Alliance Boots will never happen again. It may be a long time before we return to that, however, not least because of the reduced amounts of leverage we’re seeing at the moment.

Going forward, it’s inevitable that there will more focus in the private equity industry on sectors and geographies. The days of the generalist firm focused on a single country are probably numbered.

Longer term, however, I expect the market to recover. For the moment, it is the trade buyers who are starting to lead activity, but this is good news for private equity firms too because it will provide them with exits from some of their existing investments.

We may see some private equity firms take part in deals where they

get only minority control. The industry also needs to continue to engage with the banks to ensure that they treat their portfolio companies properly and are prepared to come in alongside private equity partners in new investments.”

>M&A
Rob Donaldson
 Head of M&A and Private Equity, Baker Tilly

“IT’S AN INTERESTING time because we’ve not seen such a severe downturn since the late 70s. We will have much more choosy investors, both private and public, than has been the case in the recent past.

The private equity market, in particular, will change. Over the five years up to 2007, there was a lot of financial engineering: businesses acquired using high leverage. Investors relied on a cocktail of cheap debt and rising prices to generate equity returns. Most of these transactions were buy-outs, as private equity players backed change of control deals.

You’ll still see plenty of buy-outs but an increasing proportion will be development and growth capital, with existing owners retaining businesses and using private capital to fund growth because they can no longer use bank finance or the public markets, and they are not prepared to sell out at today’s prices.

There will also be a reduction in the number of private equity investors. There are probably too

many players in the middle market and some will not make it. As for the debt markets, the banks will remain only semi-open for business for a few years. And there will be fewer players. Debt availability will remain tight and cost will remain high.

The market dynamics will create opportunities for well-funded private equity players. Already we have seen a very high level of ‘all equity’ deals in the first six months of this year and this will continue. Another feature will be a renewed emphasis on M&A among business. Companies will be more prepared to do deals that consolidate market share because it may be more difficult to grow organically.

The role of governments will be important. There are many schemes aimed at guaranteeing bank assets, some of which offer value. These will continue to be reasonably successful, but they’re helping firms at a small level. Then there are other schemes aimed at helping the banks to provide working capital. These sorts of things will be helpful but they won’t replace the private equity market or AIM as a source of funds. All this does not necessarily mean that fee income for advisers such as Baker Tilly will shrink, but we will have to work harder and be more flexible.

I still have as many deals on as in 2007, but now some are distressed deals and some are people selling because they are scared about the future. The types and reasons for deals will change, but this does not necessarily mean there will be fewer deals done; just different.” **C**

●●
We will have much more choosy investors, both private and public, than has been the case in the recent past

Rob Donaldson

DEALS DONE

Headline deals completed by Baker Tilly

↘ **Andrew Martin Associates**
Sector: Planning/urban design
Deal type: Sale
Deal value: Undisclosed
Baker Tilly: Kirsty Sandwell

Baker Tilly's M&A and Private Equity team has completed the sale of town planning and urban design consultancy Andrew Martin Associates (AMA) to the Capita Group Plc, the UK's leading outsourcing business.

AMA is best known for its promotion of large strategic residential developments through the UK planning system.

Baker Tilly advised the shareholders throughout the transaction, led the international sale process and delivered the deal. Despite the difficult economic situation, Baker Tilly managed to get Capita Group to increase its initial offer for AMA.

Andrew Martin, Chairman of AMA, said: "Baker Tilly got us a fantastic result. We have nothing but the utmost praise for their invaluable advice and determination in getting the deal done in such a difficult market."



↘ **KeTech**
Sector: ICT
Deal type: Funding solution
Deal value: £4.5million
Baker Tilly: Ali Aneizi

The M&A and Private Equity team at Baker Tilly has successfully closed the first private equity deal to come out of the Government's Capital for Enterprise fund (CfE), jointly managed by Octopus Investments.

The CfE is a key part of the Government's 'Real Help for Business' programme, launched by Lord Mandelson last year. It aims to provide finance to well-established UK SMEs that are experiencing cash-flow problems as a result of the recession.

KeTech provides communication systems to the rail industry, detection services to the security forces and building management systems to corporates and the public sector.

The Baker Tilly team originated the transaction, introduced Octopus and negotiated a £4.5 million funding solution in a tight timescale of 12 weeks.

↘ **Limehouse**
Sector: Software
Deal type: Sale
Deal value: Undisclosed
Baker Tilly: Rob Donaldson

Baker Tilly's M&A and Private Equity team has successfully completed the sale of Limehouse Software to Objective Corporation Limited, the Australian quoted enterprise content management group. Limehouse is a leading software solutions provider for document publishing, collaborative content creation and online stakeholder consultation.

Baker Tilly advised the shareholders, led an international sale process in a challenging economic climate and delivered a deal with a strategic purchaser.

"After working with Baker Tilly in 2005 on the sale of my first business, I had no reservations when appointing them as my adviser this time around," said Giles Welch, Managing Director of Limehouse. "The Baker Tilly team guided all of the shareholders through the process and were always on hand when we needed them."

↘ **Ionix Holdings Ltd**
Sector: Manufacturing
Deal type: Acquisition
Deal value: Undisclosed
Baker Tilly: Adrian Gare

Baker Tilly's Manchester Corporate Finance team recently completed its second successful high-profile deal involving North West-based plcs in a month.

The team advised the management of Ionix Holdings Ltd on its buy-out of Volex Group Plc's wiring harness business. As lead adviser to management, Baker Tilly obtained funding, negotiated the deal with the vendor and project managed the transaction through to completion.

Ionix Holdings Ltd has factories at Leigh in Lancashire and in Croatia and Estonia. Last year the company reported a turnover of £36 million. The new business will be led by Bill Taylor, former Vice President of Global Operations at Volex.

The company will focus on growing commercial revenue, as well as securing additional military and aerospace business. Bill Taylor commented: "There were many bumps on the road that they managed to smooth over to get to completion. I am pleased that I selected Baker Tilly from the shortlist that I visited."

↘ **Sabel Cosmetics Ltd**
Sector: Manufacturing
Deal type: Management buy-in
Deal value: Undisclosed
Baker Tilly: Stephen Mason

The Baker Tilly Transaction Services team recently performed financial due diligence on Sabel Cosmetics Ltd, a manufacturer of hair care products, on behalf of Hotbed and its investor members.

Sabel Cosmetics has a strong reputation and client base, including many of the UK's leading hair care companies. It offers a complete service from product research to manufacturing, and also has its own brand of hair care products, which are sold to independent salons.

Hotbed and a new management team have now successfully completed the management buy-in to Sabel Cosmetics.

Tim Lawrence, Investment Director at Hotbed, said: "Hotbed used the Baker Tilly Transaction Services team to provide the financial due diligence on this transaction as we have worked with the team before and we find them to be professional and proactive."



↘ **Nuclear Engineering Services Ltd**
Sector: Engineering services
Deal type: Shareholder buy-out
Deal value: Undisclosed
Baker Tilly: Simon Chapman



Nuclear Engineering Services Ltd (NES) is a niche Tier 2 provider of engineering services primarily to the nuclear industry, in particular the UK civil decommissioning and defence sectors, and is now developing its presence in Europe.

Baker Tilly advised the management team of NES on the buy-out of its existing investor shareholder. The transaction team originated and negotiated the deal, raising a multi-million pound equity and debt funding package from Lloyds Development Capital and The Co-operative Bank, before managing the deal to its successful completion.

NES CEO Brett Cooper said: "The Baker Tilly team was integral to this deal. This is a complex business, operating in a highly regulated industry with a unique client base. It was vital that the Baker Tilly team understood this in order to source and negotiate the best deal for management."

↘ **Sweet Squared Ltd**
Sector: Cosmetics
Deal type: Securing development capital
Deal value: Undisclosed
Baker Tilly: Hamish Morrison

A team from Baker Tilly has successfully secured development capital from HSBC to ensure future growth for Leeds-based company Sweet Squared Ltd.

The husband-and-wife team of Samuel and Samantha Sweet own the exclusive UK distribution rights for the full range of products developed and manufactured by Creative Nail Design. These include nail and beauty products worn by some of the world's best-known celebrities including Madonna, Angelina Jolie and Jennifer Lopez.

Managing Director Samuel Sweet said: "Baker Tilly provided a first-class service. Based on their thorough understanding of our business, they were able to identify the funders that would be keen to help our business grow."

The new facility will be used to help drive future growth in sales to UK beauty salon professionals.



●● Baker Tilly originated the transaction, introduced Octopus and negotiated a £4.5 million funding solution



BAKER TILLY

Lindsey Thompson

5 Old Bailey

London

EC4M 7BA

Tel: (020) 7002 8763

Email: lindsey.thompson@bakertilly.co.uk

