

▶ funding & transaction news

MAY 2011



Pictured is the Boringdon Hall Hotel, acquired by the Nettleton Group with plans to create the country's best spa.

Introduction

Back in November 2010 we produced 'Funding News' and this is effectively a sister newsletter focusing as it does on the other main aspect of work performed by me and my colleagues in Winter Rule's Corporate Finance team – Business Transactions.

Since its establishment in 2006 the Corporate Finance team has handled the majority of business transactions in which Winter Rule has been involved. These have included a number where the client has come to Winter Rule specifically for the transaction – a recognition not only of the Corporate Finance team but more particularly the specialist tax expertise to be found at Winter Rule. Anyway, given that we have just completed on the 8th transaction for 2011 we thought it opportune to share with you not only some recent experiences but also feedback some interesting comments from the wider Corporate Finance community.

Richard Wadman, Editor
Director of Corporate Finance

'For whom the bell tolls'

The Corporate Finance team at Winter Rule are very proud to assist both Vendors and Purchasers in completion of business transactions.

These transactions can often be described as 'roller-coaster rides' for all concerned and that includes the advisers. We have recently acquired a little bell to announce the Completion of a business transaction which the team has 'led' on to those within earshot in the office. Since the start of 2011 the bell has sounded out on 8 occasions. Details of most of these deals can be found on our website at www.winterrule.co.uk/recent-deals/ and broadly summarised as follows:

- One share sale preceded by separation out of trade and assets not required by Purchaser
- One business and asset purchaser – from two separate entities
- One share sale with part of the purchase consideration being in the form of Earn-Out
- One Grant for Business Investment offer letter

- One investment by SW Cleantech Co-investment Fund
- Two disposals of trade and assets
- One 'simple' share sale!

There was also the transaction where we did 90% of the work but then, due to a change in composition of the purchasing team at the 23rd hour, we lost out on seeing this through to Completion!

We are now actively seeking more deals to work on so please do not hesitate to contact us...

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'Locked Box'

In a 'Locked Box' clause the Vendor effectively agrees and warrants/indemnifies the Purchaser that the Net Assets at Completion will be £x."

The Locked Box and the [Big] MAC – and other tales from the City

In March I attended a seminar entitled 'Mergers and Acquisitions 2011' at a conference facility in London.

This was a grand affair with speakers including Corporate Finance representatives of three of the top four Accountancy firms and the Takeover Panel amongst others. Presentation material included:

- Proposed changes to Takeover code of practice (following Craft acquisition of Cadbury's)
- Emergence of BRIC nations as forces in global transactions market
- £300bn of private equity funding currently looking for investment opportunities
- Analysis of legal implications of current perceived 'balance' in negotiating power between Vendor and Purchaser (see separate article)
- General upbeat analysis of value and number of transactions

Among the phrases used by the presenters were two that caught my ear as not being immediately recognisable: Locked Box and MAC clause. On further thought I recognised the concept of one if not the acronym. Anyway, for those of you who may be interested this is what they mean:

1. Locked Box – Alternative to the £ for £ adjustment for Net Assets in Completion Accounts which I am more familiar with. In a 'Locked Box' clause the Vendor effectively agrees and warrants/indemnifies the Purchaser that the Net Assets at Completion will be £x. This £x being based on the latest balance sheet or pro forma prepared specifically for the purpose. The Purchaser will look to prevent 'leakage' from this figure agreed pre-completion by getting the vendor to covenant no dividends etc between the date of the base balance sheet and completion. Additional buyer protection is often sought on matters such as accuracy of base balance sheet and ability to recoup excessive leakage. Regardless, this is a clause more likely to feature in a 'bull market' for vendors.
2. MAC clauses – used in acquisitions (or loan agreements) give the right of the Purchaser (or Financier) the right to withdraw from the acquisition (or lending agreement) if there is materially adverse change in the circumstances of the Target (or borrowing Company). The prevalence of these clauses in the City has lessened over the past 2 years, as the pendulum moves away from Buyers being in the complete ascendancy. If used, this an area where I see solicitors

acting for the Vendor (or the borrower for financing arrangements) earning their keep: to get some degree of certainty over what will constitute "materially adverse change" and what redress there may be to a breach (specifically for borrowers; short of repayment of sums borrowed).

["The prevalence of these clauses in the City has lessened over the past 2 years, as the pendulum moves away from Buyers being in the complete ascendancy."](#)

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Legal implications of current balance of negotiating power?

As referred to elsewhere in this newsletter the perception of the City based advisers is that the upturn in transactions has resulted in a shift of negotiating power back from Purchasers to Vendors: and that the scales are now roughly in balance.

In this context the presenter also outlined the 'Key Deal Terms' Pre Crunch and Now and the Limitations (on Warranties etc) for a [more] Seller Driven Sale. Below I have copied extracts from the table presented on 'Limitations' as I found this particularly interesting.

I will include comments from any SW region based corporate solicitors on the above and specifically with relevance in terms of trends seen in deals in this region, in the next edition of Transaction and Funding News.

Limitation	Seller Driven Sale
Cap	30-50% of purchase price
De minimis	c.01% of purchase price
Time limits	1-2 years Sellers starting to request 4-year limits for tax claims (previously 6 was universal), but purchasers still cautious (6 years if "carelessness" involved) Environmental – variable
Title warranties	Usually outside limitations (although often capped at purchase price)
Environmental/ decommissioning indemnities	Purchaser indemnifies, subject to Seller awareness disclosure
Knowledge qualification of warranties	Most management warranties qualified by actual knowledge having made "due and careful enquiry". For corporate sellers, knowledge qualifiers are less widespread
Disclosure	"Fair disclosure" concept still standard practice Disclosure of data room was standard, but practice may now sometimes vary depending on competitive tension and other factors (e.g. data room poorly run, huge amounts of information and not enough time to review)

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Faisal Islam reports...

I was very interested in the coverage on Channel 4 news on 21 April 2011 on bank lending to small businesses.

Key highlights are contained in the accompanying blog <http://blogs.channel4.com/faisal-islam-on-economics/small-businesses-still-suffering-ongoing-credit-squeeze/14125>:

- Stock of lending to businesses shrank by around £5 billion in the three months to February.
- The cost of lending for new borrowing (Spreads over reference rates) narrowed for larger businesses, but increased for small businesses in Q1.

- SMEs reported banks seeking to replace overdraft facilities with alternative, more expensive, credit products.
- Only 16% of small businesses were actually applying for credit, and half of those were getting turned down.
- More credit is going more cheaply to larger businesses, and less credit is going more expensively to small businesses.
- The BoE report points to BIS data showing that applications for SME

credit were 19% down in the six months to February than in the same period a year earlier.

- The Banks also say that many SMEs have had their equity wiped out and need equity investors rather than larger overdrafts.

On the last of these points Faisal comments that the Business Growth Fund should help. The latest position on this Fund per the BGF website: "Welcome to the Business Growth Fund (BGF) website. This is a temporary holding page until our full website goes live". So watch this space...

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'open for business'
Cornwall is open for business... New funds are being introduced and old one retained.

Pictured is a Rustler 44: Rustler Yachts Limited are one example of a business expanding its activities in Cornwall with the assistance of Convergence Funding

Finance Update

On 19 May 2011 we host an event entitled 'Finance in Cornwall 2011'. We will, following this event, issue an updated version of the one page summary document which outlines the current funds and business support potentially available to Cornish SMEs.

Whilst it is dangerous to second guess the content of an event on funding in the region – the situation is so fluid – we have done so and here are our tips to the 5 main themes that will emerge from the 19 May 2011 event:

1. Cornwall is 'open for business' - We are fortunate in this county to have Convergence funding which is underpinning not only infrastructure projects and business support programmes (including Invest In Cornwall, Grow Cornwall and Partner to Succeed) but also has enabled some funding programmes, such as Grant for Business Investment, to continue in this county when these programmes have closed elsewhere in England.
2. (Belated) recognition that this country needs SMEs – We are hoping that Seb Aslan from the government's Business Innovation and Support (BIS) team, who has agreed to come from the BIS offices in Westminster to present, will start the event by saying the country needs the SMEs growth and outline a number of means put forward in the Budget to (hopefully) stimulate investment by and into this sector.
3. The government has no money and no love of RDAs! – The former will be implied at least through the rationalisation, for example, of services provided by Business Link. This will presumably create a vacuum for 'business support' (although in this county see 1 above). We currently have only an inkling as to who may move into that space. The lack of love for RDAs is self evident through their closure including our own SWRDA. This has led to, at best, confusion to the operation of several grant and support schemes – but fortunately specifics have now been resolved for delivery of RDPE and GBI for example.
4. The future is equity funding and the LEP – we are hoping to get the newly appointed Chair of the LEP present at the event so he can hear first hand about the funding and Convergence business support currently available in the county and get an indication of the likely future situation (specifically post Convergence) and this may shape deliberations on approach to applications to the Regional Growth Fund. Also, we remain convinced that 'equity' from all sources from Friends and Family through to Business Angels and Venture Capital Firms is going to play an increasingly important role in the finance package for growing businesses in the future. In this context we are very pleased that Alistair Brew of Octopus PE will be visiting us for the May event. We will also have coverage of recent changes to EIS legislation that should encourage investment.
5. Cornwall is open for business... New funds are being introduced and old one retained. We cannot afford to waste this opportunity.

On a related note I was particularly pleased to be informed that LMAS funding is available to growing businesses looking to invest in professional services. Our clients have accessed this funding previously, for example, enabling us to work alongside them in the preparation of financial projections.

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