

SOUTH EAST REGIONAL FOCUS

The South East of England is one of the most successful economic regions in Europe. It has the highest employment rate in the UK at 79.6%, the second highest GVA per head and the second highest household income per head, according to figures from SEEDA and the UK government.

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High value manufacturing has become an increasingly strong part of the South East's economy, with a higher value of output than any other English region and a manufacturing workforce of over 320,000 people, only marginally smaller than that of the West Midlands. The region is home to a wide variety of manufacturers, from major multinationals and global market leaders through to smaller, specialised engineering businesses.

Whilst times may be harder over the coming months, there is no doubt that the many strengths of the South East economy will help it through this difficult period. The tougher economic conditions we are now seeing will have an impact on all businesses, although the effect will vary in different places and sectors.

Deals in difficult times

Andrew Trigg, of Thompsons Corporate Services, advises SME business owners across a wide range of sectors. He commented: "Clearly the volume of transactions has declined during 2008. Completions are taking longer, some deals, particularly in the financial sector, are suffering lower prices and purchasers ability to leverage deals has been eroded."

However, within specific sectors, and where senior management are getting the business fundamentals right, Thompsons' recent experience is reasonably encouraging in advising both vendors and purchasers.

"My own recent impression, based upon Thompsons' experience, is that there is significant company transaction activity within the Defence Sector, Facilities Management, Companies selling into the BRICs economies as well as the Manufacturing Sector, provided they have strong management teams.

"Demand remains strong from appropriate trade purchasers for good businesses and particularly where purchasers are not heavily dependent upon external finance.

As to bank finance in support of deals, there appears to be polarisation at present; some banks are lending to bankable deals while others appear to be closed to new business," Mr Trigg added.



The South East's services sector has continued to grow over the last decade, with private sector services now accounting for around 60% of the region's total output and employment. Financial and business services alone account for almost a third of output and a quarter of employment.

Stephen Bayfield of PKF Accountants & business advisers has witnessed no noticeable change in the volume of potential transactions, although there was a significant spike in the first quarter of 2008 as vendors sought to sell before CGT rates increased. However, there has been a change in factors driving deal activity.

Mr Bayfield said: "The main factors affecting current deal activity include the length of time taken to complete deals – buyers are taking longer, and in some cases failing to source, adequate funding (if funding is not readily available) and there is evidence of buyers seeking to renegotiate the price at a late stage."

"The profile of sellers is changing too. A larger proportion of deal activity is arising as a result of pressure on the vendor to sell – either companies are seeking to sell off subsidiaries or divisions to raise cash to support remaining activities, or businesses that are struggling are offering synergies to a consolidator. Some prospective vendors under no pressure to sell are holding back, waiting for conditions to improve," he said.

"There remains a large pool of potential purchasers. Particular emphasis is being placed on the purchasers' ability to fund the offer, when comparing rival bids for a particular business," Mr Bayfield added.

Businesses are finding it harder to raise the capital they need to fund investment, while raw material prices and running costs (especially energy) are rising. This means that expansion plans are sometimes being delayed, while, at the same time, profit margins are being squeezed and prices of finished goods and services are being pushed up.

A challenging climate

So far the South East economy has held up well to the new challenges, although overall growth has been slowing since the second half of last year.

There are now signs of a more significant impact, with growing evidence of slowing order books especially among businesses that are more dependent on UK markets.

Kevin Byrne, head of corporate at Clarkslegal is cautiously optimistic. He said: "The South East in general remains in a stronger position than most parts of the UK. The region will always attract quality people because of the higher salaries that are on offer in the South East."

Mr Byrne added: "There is no doubt that we have seen a slow down in general M&A activity caused by a variety of factors including the availability of debt finance. However, we have recently advised on two significant transactions, one being a reverse takeover on AIM of our client GamingKing (now renamed Sceptre Leisure Plc) and advised the University of Reading on its merger with Henley Management College."

Clarkslegal has a smaller corporate department compared to some other firms, but this has certainly not held them back. "We have, compared to our size, completed some of the largest deals of the last two or three years during the last six months" Mr Byrne said.

Smaller businesses in particular are tending to become less confident about economic prospects, although this has not yet translated into a decline in business activity or performance. Looking ahead, it will be vital for businesses to resist the effects of the slowdown over the rest of this year and into next year.

Russell Bell, senior partner at asb Law, specialises in corporate finance, banking and company law. He said: "One of the sectors we are still heavily involved in is, strangely, aviation and travel. In spite of all the headlines there are deals still being done, the market is still consolidating. In IT, as well, we have a number of clients who are buying and building."

Mr. Bell is also seeing activity in insurance and financial services, again because of the consolidation in the marketplace that is continuing. "It may not be as fast and as hectic as it was a year ago, but it's still there and clients in these areas are still trying to build significant businesses," he said.

Manufacturers in the South East continue to report resilience and growing order books. Mr. Bell said: "The South East is an interesting place. The last major blip back in the early 90s lasted for four or five years nationally but it was not until the third and fourth years that this region was badly hit. That was because it was a gradual process. This time around, because of the speed of this slowdown, reactions have been quicker. We got through to September and October of last year and the banks lost confidence in each other. They stopped doing business together, so a lot of the larger financing deals that were going on just stopped dead in the water," he said.

"For a time, mid-corporate transactions carried on regardless, certainly to the middle of this year. That is the market we deal in, but confidence in the mid-corporate sector is also beginning to wane as businesses are coming up to their facility renewals. They are concerned about what's going to happen next. They think, 'Will the banks continue with us on the same terms as before, or are they going to squeeze on margins, fees and covenants?' So they are starting to look around at other finance options as they go forward and are not waiting for their bank to turn the screw," Mr. Bell added.

The South East is also particularly strong in financial and business services. To date, consolidations within multinational service businesses, including some site closures, are

likely to be connected less with credit and liquidity problems, than with the normal business cycle and restructuring.

Increased demand for advisory and consulting services is being experienced but alongside lower numbers of transactions, particularly in housing and related markets. Insurance services have been among the first to experience the effects of reduced liquidity and tighter credit because they are exposed by banks looking to offset risk.

Simon Arthur, Head of Corporate at Horsey Lightly, hasn't encountered any significant negative trends in the firm's core corporate practice; transactions of between £5million –£25million for companies engaged in the manufacturing,



technology, services and environmental sectors. "These sectors remain relatively buoyant, with a steady deal flow throughout the last twelve months, and we anticipate that they will not be as severely affected by the economic slowdown as some other sectors. We recently advised the board of Bennet Property plc, a commercial property investment/management company, on a rule 3 takeover offer by Pye Properties plc. We also acted for South Essex Insurance Group Limited on the sale to Ecclesiastical Insurance Office plc of its core trading activity, as the largest specialist equestrian insurers in Europe, and so it is reasonable to assume that even the larger SME deals are still there to be done," he said.

Attracting quality corporate-commercial lawyers, particularly at the more recently qualified end of the spectrum, continues to be a challenge, but Mr Arthur added: "We anticipate though that this may improve a little as the City firms have a reduced requirement for trainees and newly or recently qualified lawyers, while the Thames Valley continues to be an attractive, first choice alternative."

And so to the future

Businesses have predicted a much more mixed outlook for the remainder of the year. The South East's property and development sector has experienced a strong period of growth during the last decade, with high land values, resulting in many town and city centre regeneration projects successfully completed. However, there are signs that land values in the South East, which have held up until now, are following other regions and starting to fall. Both the commercial and residential markets have felt the effects, but the residential sector has been particularly hard hit by the current economic climate.

"We expect that the next 12 months or so will be difficult for some sectors. Although areas such as private equity and the capital markets have been difficult for a while now, our core transactional market remains relatively buoyant, not least because sellers and financiers tend to be more entrepreneurial and flexible on key terms at these deal values," Mr. Arthur concluded.

The South East's jobs market remains remarkably strong with employment rates higher, and the unemployment rate lower, than a year ago. Employment is at a record high of 4.24 million, up 83,000 over the year to May, having grown for 34 consecutive months. Meanwhile unemployment in May stands at 171,000 (3.9%), 20,000 lower than in December 2007.

Despite the fundamental improvements of recent years, the challenges of the current economic conditions will require a coherent and comprehensive response. While it is

not possible to alter global economic conditions, it is possible to mitigate their impact on individuals and businesses. The South East appears well equipped to respond and to take advantage of the consequences.



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Despite the credit crunch there remain really strong reasons why owners should consider selling to their management teams.

Banks are still lending to good opportunities and private equity firms still have a wall of cash to spend. Owners of a business should not discount bids from strong management teams and should look to initiate MBOs themselves as the most confidential way to sell their businesses.

Often such businesses have shareholders who are linked by family ties or long term friendships and such relationships need to be handled carefully by specialist advisers.

Peter Counsell at Meta Corporate Finance Limited recently completed the MBO of James Villa Holidays, the specialist holiday company, based in Maidstone.

Mr. Counsell said: "I am very pleased for Tony Wheble and his colleagues. James Villa is the leading brand in its sector, due in no small part to the skills and experience of the management team. The pragmatic approach of the team and its funders will stand the business in good stead as it embarks on its next phase of growth under new ownership."

Bank of Scotland and Investec Growth and Acquisition Finance provided the debt capital to back the very experienced management team. The equity for the transaction came from a small group of private investors. The deal recently won the Gatwick Deal Awards deal of the year 2008.

Whilst a relatively large transaction for the region, this is an ideal example of how money is available to back good management teams and businesses with strong growth stories. It is fairly frequent that incumbent management teams can better deliver the pregnant growth rather than a trade buyer upsetting the chemistry of the business and disincentivising the management team.

Corporate finance activity in the South East has a strong pipeline that does not seem to have been distracted either by a less clement banking market or recent tax changes. People still have to sell their business, often for overriding personal reasons, and a structured sale to management often allows shareholders more than one bite at the cherry.

In the first quarter of 2008 alone, of the order of 100 deals were reported in the South East (excluding London). Probably the most prolific activity is in financial services transactions with insurance being the focus of that area. However, again in this area strategic investment is still available for good management teams. We recently completed a complex transaction in financial services combining money out to shareholders, meeting differing personal objectives and to match a trade offer, with a strategic partnership with a wealth management business. We expect to work alongside the team to achieve a significant exit in the next two to three years.

The South East is well served by local transaction specialists and there is little reason to go to London except for the money! There are also a number of regional investors, some of whom have specifically targeted the equity gap, who should not be forgotten.

The South East region has both the deal pipeline and the money; it is simply a matter of putting the two together!