Price Bailey
CHARTERED ACCOUNTANTS

Strategic Corporate Finance

2022: Newsletter

At Price Bailey - **It's all about you**
The right advice for life

pricebailey.co.uk

2021 - 2022 in numbers

18
Team members

Advised on
141
projects

Specialising in
deals worth
£5-25m

37
M&A and MBO
advisory projects

6
EOT
deals

46
Due diligence
assignments

28
Growth capital
lead advisory
projects

35
Valuations
completed

Transacted
in
UK
US
Dubai
Netherlands
Poland
Turkey
Israel

Working on **29** live transactions

A note from our Partners

Since our last newsletter in the Autumn of 2021, we have been fortunate that life, from a Coronavirus pandemic perspective, has continued to return to normality. In many ways, the owner-managed business community has moved beyond the pandemic and now focusses on the new opportunities and challenges existing in the post-pandemic environment. As a team, the last 12 months in particular, has seen us adapt back to hybrid working patterns which has allowed us to enjoy some time together as a team and celebrate the fantastic period of performance that the last financial year has bought us.

Reflections on the last 12 months

The Strategic Corporate Finance (SCF) team has had a record year, which is testament to the hard work and dedication of the team and my fellow partners. In addition, we are delighted to have welcomed a number of fantastic members to the team who brought with them a variety of skills, experiences and perspectives that has added valuable breadth to the team.

During the last financial year, we have supported our clients through a mixture of M&A, growth capital, due diligence, valuation, EOT and advisory services on 141 projects. It has been a particularly busy year for our FDD team who have supported the successful completion of 46 deals for a combination of trade and Private Equity buyers.

Thoughts on the year ahead

As we head towards 2023, we will continue to invest in supporting owner-managed businesses in the lower-mid market. As specialists in this space with a growing team of fantastic advisors, we are excited to continue committing our attention to clients in this space and be the advisors trusted with driving value for owner-managers across the market.

The buoyancy we experienced in the M&A and capital funding markets has continued in 2022. During this time, there have been some interesting deal structures and mechanisms used in order to mitigate the risks of uncertainty, and further highlighted to the growing precedence of expected future performance, over historic. Going forward, we only see signs that this will continue, with the significant divergence in valuations to also follow suit.

In respect of funding, equity providers still have significant amounts of dry powder to invest that they have struggled to fully deploy over the past decade. We expect that the debt market will continue to fragment as traditional lenders become more cautious as risks of recession and inflation impact businesses, and challenger banks grow, fuelled by the liquidity recently released by global Governments which needs to find a home somewhere.

From economic, environmental, political and social perspectives, there are a number of competing forces at play that will impact different businesses to varying degrees. From materials and labour shortages that continue to blight numerous industries, huge spikes in energy costs and high inflation with rising interest rates, and the War in Ukraine that is creating significant humanitarian and consequent economic problems globally; the pandemic may be in its last days, but times of uncertainty look like they are here to stay. For those privileged business owners among us who have been fortunate enough to thrive in these times, the current environment brings to immediate reality the paramount importance of ESG to the entire business community; no business can remain immune from the responsibilities to our wider communities for much longer.

Simon Blake
Strategic Corporate Finance, Partner

A note from our Partners

"The SME M&A marketplace appears to be weathering yet another period of uncertainty pretty well, based on the activity levels we continue to see. Despite the initial impact of the Pandemic and the various lockdowns/ restriction periods that followed, deal activity has remained strong across the board and the more recent cost of living crunch, rising inflation, war in Ukraine and the resultant escalation in the energy crisis fuelling fears of a global recession, doesn't appear to have dampened things down either."

Stephen Reed
Strategic Corporate Finance, Partner

"The past year has continued to be strong for the M&A mid-market and many businesses have outperformed compared to previous years with both profits and cash at record levels. That said, in the post-COVID world, inflation and interest rates are at a level higher than the current generation have experienced. If history is anything to go by, consumers will look to trade down and buy cheaper, but also treat themselves on occasions. The B2C market will need to be either cost down value driven or focused on low volume premium products. Companies will look for opportunities to automate, so expect increased investment in machine learning and robotics."

Phil Sharpe
Strategic Corporate Finance, Partner

A note from our Partners

"This year we have seen major growth in M&A and Private Equity advisory work across all sectors. This has produced exciting, engaging and frequently complex assignments. In particular, negotiating and advising on the protection instruments that have accompanied the well documented increase in valuations has been enjoyable. Valuations continue to be polarised and I suspect they will remain so into the future. This is being driven by a mix of market factors, business leader decisions – or indecision - on operating models, and the quantum and use of debt that has been absorbed by many businesses during the pandemic. In an era of volatility, agile business models will continue to be critical to maximising value."

Chand Chudasama
Strategic Corporate Finance, Partner

Visit our Content Hub for further detail and insights on current challenges and opportunities facing owner-managed businesses.

Case studies
Root Solutions

Tailored technology service provider Root Solutions Ltd. announced that it has joined PDSVISION Group in a move that sees the Swedish entity expand its UK operations.

The Cambridge-based technology company, Root Solutions, provides engineering-based software to companies across the UK. This includes Computer Aided Design, Augmented Reality (AR) and Product Lifecycle Management (PLM). These solutions help clients improve their engineering processes and product quality and is backed up by comprehensive technical support and training.

PDSVISION are a global provider of solutions and services focused on enabling their digital transformation journey from product development to aftermarket services. PDSVISION's solutions are centred on the portfolio of products provided by NASDAQ listed PTC and ANSYS. PDSVISION also develop their own range of software applications. The group is headquartered in Sweden and has operations in Finland, Denmark, Norway, Germany, United Kingdom, South Africa and the USA.

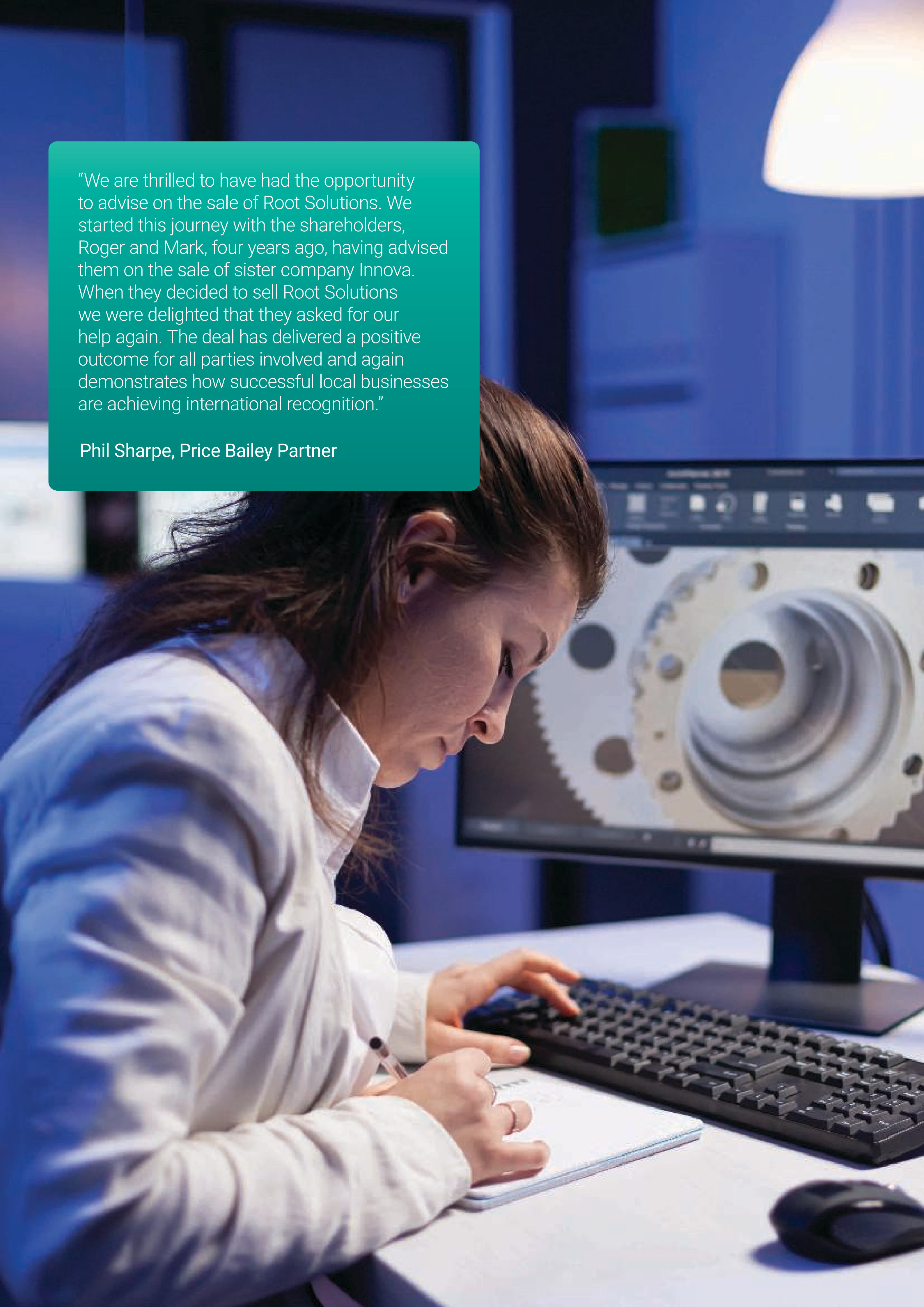
Roger French Co-Founder and Managing Director of Root Solutions commented, "Root Solutions and PDSVISION complement each other perfectly. We have the same business goals and same team culture. We will now be part of a global organisation in which our collective know-how and experience will give customers an even broader solution portfolio and fuel future growth. It is the foundation of a strong partnership which will benefit both customers and employees."

Roger French commented further, "Anyone considering the sale of their business should get advice from an experienced professional. Even if you have already received an approach or offer there is a lot of work and complexity in getting the deal completed. Phil Sharpe and his team at Price Bailey were a perfect partner to walk that journey with us. Your guidance and experience was vital but more than that it was a pleasure working with the Price Bailey team."

Mark Bradford, co-founder added, "We are extremely grateful for your ability to make a complex process understandable for us and helping to get the transaction done. It has been an enjoyable process with your team by our side. This is the second transaction you've completed for Roger and I over the past few years and we've been very happy with both outcomes. We really appreciate the support you have given us throughout the process.

"We are thrilled to have had the opportunity to advise on the sale of Root Solutions. We started this journey with the shareholders, Roger and Mark, four years ago, having advised them on the sale of sister company Innova. When they decided to sell Root Solutions we were delighted that they asked for our help again. The deal has delivered a positive outcome for all parties involved and again demonstrates how successful local businesses are achieving international recognition."

Phil Sharpe, Price Bailey Partner



£880m worth of FDD deals | What we have learnt

46
Completed transactions

£21m
Average deal size

£34.5m
Largest single transaction

£880m
Total deal value

18
Current live/ pipeline deals

DD completed on UK targets for clients in:

UK
US
Dubai
Netherlands
Poland

Sectors include: **Property, Software & Tech, Professional Services, Manufacturing, Leisure, Food & Beverage, Retail & Beauty, Healthcare**

£880m worth of FDD deals | What we have learnt

The Strategic Corporate Finance team at Price Bailey has delivered more FDD work in the last financial year than in any year previously. It has been a very busy time for lenders, investors and acquirers and it looks like this is only set to continue in the near future. Over the last year, we have undertaken a significant number of FDD projects, across a wide variety of industries, each of which has helped to strengthen our team from the many learnings coming from these experiences. Stephen Reed sat down to tell us more.

1. What have been the biggest learnings on financial due diligence (FDD) assignments during the last 18 months?

A key learning? Take turnaround time promises from third parties with a pinch of salt! Ordinarily, we expect that a reasonably sophisticated and well-prepared management team could pull together the information we request of them in one to two weeks. This can take a lot longer, so we work with management to find ways to streamline this exercise as much as possible. Information flow from targets and their advisors is notoriously difficult because the information that we request from them is increasingly comprehensive, and so extracting that information is not always easy. This has increased as investors and acquirers have become more commercially aware, and with that, more stringent in their demands of a DD exercise too. Also, the target is likely to be subjected to any combination of Due Diligence work-streams across Management, Commercial, Tax, Environmental, Technology and Legal DD alongside our own Financial due diligence, so target management teams have to be very reactive. It is a very busy and challenging time for them with multiple demands on their time whilst also trying to run the business of course, so we have to empathise.

To expedite this, we like to get involved as early as possible and be part of the scoping discussion to affirm what information will be available from the target in the time available. There is no point in a buyer going through all the process of agreeing the scope of the DD review without asking the target's management what information is available, especially if it is then apparent that they are not able to produce it. If we can get involved earlier, we can match expectations between investment directors and acquirers, their investment or credit committee, and the targets' ability to produce the necessary information on a timely basis.

2. Has anything in the FDD process changed in the last year?

Focus by investors and acquirers has been on trying to understand the true underlying earnings of the business, as it may have been positively or negatively affected by COVID. Additionally, identifying whether the business has made use of any of the pandemic business support schemes and debt packages has been important in order to highlight where there may be concerns re fraud/ mis-use of that funding or any clawback/ early settlement risks.

Sensitivity analysis on financial models is a big item now – there was a time when we would have been leading the client more in the directions we require in terms of agreeing the 'what if?' scenarios that our clients wanted us to assess, whereas now our clients are coming with much more specific and clearly defined model scenario flexing requirements.. It has been a very buoyant M&A market in the last couple of years, but in general, the FDD scope has become the most extensive it has ever been, so we find we are being asked to undertake ever more work, albeit in more specific areas of risk mitigation. We always welcome the opportunity to play a key role in determining the risk areas and, thus, in defining a suitable scope of review to be undertaken on any given target.

£880m worth of FDD deals | What we have learnt

Acquirers and investors want to understand a lot more about how the business operates and how that is translated into the financial outputs. Fortunately though, businesses are rising to this challenge. The forecasts are over longer periods; most targets used to have 2-3 year forecast models and often no more than a cash flow forecast or simple budget, whereas now they are typically 3-5 year fully integrated profit and loss, cashflow and balance sheet models, with detailed supporting assumptions. As finance products have become more sophisticated, so too have the borrowers through necessity – there is a lot more information and advice available to businesses now, which is resulting in them being a lot more sophisticated and better equipped.

3. How can target businesses make FDD advisors' lives easier?

As both an M&A and FDD advisor, when we're speaking to clients considering an exit or growth capital raise, for example, we really emphasise how busy this period is going to be and that the best thing that they can do is invest the time early to prepare for the process, and get their information in the best shape it can be. This will enable them to produce the required information quickly and easily, not to mention that it's a good practice to do anyway (!), as this will impress any investor or acquirer. Equally, by being prepared there is likely to be an advantage going into discussions around warranties and indemnities.

4. On the flipside, what should lenders, acquirers and investors be thinking about?

It's a good question, particularly as we don't always have direct contact with the investor or acquirer as early as we would like during the more formative part of the dialogue. If we did, I would advise introducing target management to the purpose of the DD exercise early, including introducing the chosen advisers and their information checklist early. The sooner they are aware of the requirements of DD, the better. Equally, don't be shy to share with us the nature of some of the conversations they will by then have had with internal credit, whether they are a lender, investor or board of directors of a corporate acquirer – we need to understand what attracted them to this business, but also what concerns they have. Even if they think they've eliminated all of their concerns, still tell us about that journey as it's really good for us to be aware of the challenging discussions they've already had as, if nothing else, this can help us to build some empathy around those points with the target management at a time when they may feel that we are there to find fault in their business.

£880m worth of FDD deals | What we have learnt

5. Have there been any unique challenges or commonalities in some of the transactions that we have provide diligence reporting on?

Growth capital opportunities are far more predicated on the future financial performance of the target business and the emphasis of our scope of review is focussed on the ability to hit that future performance. As a result, far more of our work is now done in conjunction with external Commercial DD providers as it is very much a two-pronged process of us reviewing the target's financial model and interrogating the data that leads from the under-pinning assumptions in the model, while the CDD providers investigate the rationale behind that and how realistic that is based on their stronger understanding of the market and the underlying, sector-specific, data that helps us to collectively determine whether the model outputs are realistic or not. By working closely with the CDD experts, the conversation on these assignments has become a far more thorough and iterative process, resulting in some successful outcomes for our clients, sometimes following re-negotiations.

6. Why consider PB for your FDD requirements?

At Price Bailey, we take a red flag reporting approach to FDD so, if in the instance that acquirers don't want to spend significant money on DD, and don't need a long form report that walks through all findings, we can either provide high level findings only and highlight the major issues for addressing, or alternatively, we can do that part first to highlight the key risks, and follow up with a more detailed report.

We provide opinion-led reporting as we don't sit on the fence and only report on what we observe. Instead, we take a view and make a comment on the significance of our findings; reporting in a way that is to the point but with the detail sitting behind it.

Finally, as both M&A and FDD advisors with experience across a number of sectors and transaction types, we ensure this experience is intrinsic in our FDD approach. We act for Venture Capital, Private Equity, Banks, significant serial trade acquirers, as well as serving the 'S' end of the SME sector. An M&A influenced approach means we seek to understand as much about the Target, the deal, the offer, the concerns and conversations had to date as possible. Additionally, we like to speak with the target management team in advance of scoping and starting the FDD work as it enables us to better scope the work involved and ensure that the output is completely fit for purpose.

Stephen Reed
Partner

stephen.reed@pricebailey.co.uk
+44(0) 7778 490973

Case studies
Foresight Group LLP's investment into SafeGuard

Foresight Group LLP's East of England fund invested £4.5m to back the management's buyout of S.G.S (Peterborough) Holdings Limited, trading as SafeGuard from BCF Equity Partners. Price Bailey's Strategic Corporate Finance team has been working with Foresight to provide financial due diligence services on transactions for a number of years now.

The Strategic Corporate Finance team was engaged to carry out financial due diligence (FDD) on Safeguard, a Peterborough based glass and glazing company. Our work focussed on historical trading, balance sheet, cash flow and financial projections. We carried out a detailed review of the target's working capital position to ascertain what the true 'normalised' position was, taking into account some recent changes in supplier trading conditions in 2021, and the impact of recent energy price rises. Working closely alongside their commercial due diligence (CDD) providers to establish current and ongoing expected demand levels for glazed products and whether the DIY and home refurb "bubble" that was experienced during the COVID-19 pandemic is expected to continue, we were able to ascertain sensible sensitivities to apply to the financial model for down side testing.

Combined, this provided assurance to Foresight on the recent performance of the business and also on the assumptions underpinning the future financial performance documented in the financial model that was prepared by Safeguard's management. As a result, the transaction went ahead successfully and Safeguard can now focus on the continued growth and success of their business.

Case studies
Bernard Sims Associates

Fullbrook Ventures Limited, an independent health and safety consultancy, were first introduced to us by their lawyer, Christian Wilson, in April 2020. Headquartered in Guildford, Fullbrook Ventures Limited trades as Bernard Sims Associates and has offices in Leeds, Manchester and Staffordshire with other locations in Scotland, Wales and the South West of England.

Initially, the Strategic Corporate Finance team at Price Bailey, led by Simon Blake, were engaged to conduct a valuation of the company to help the founders consider their future succession plans. On completion of the valuation in July 2020, the founders decided to pursue their desire to future proof their business to enable them to start their plan to step back from so much of the day-to-day running of the business and to concentrate on the future succession.

Working alongside their lawyer, we advised the founders on structuring the sale of 60% of the shares in the company to an Employee Ownership Trust (EOT). Having already conducted the valuation for the company, we worked with their management accountant to assess the current financial position, to understand the cash and funding available for the EOT, and what future performance was expected. In addition, we conducted scenario planning with the founders in order to assess the impact of different structures for the EOT both for the business and with regard to the repayment of vendor loans. Meanwhile, their lawyers ensured that the management team and employees understood the structure and meaning of the intended sale.

Once the terms of the EOT scenario were agreed, the Strategic Corporate Finance and Tax teams at Price Bailey supported the company in applying for HMRC clearance for the EOT transaction and received confirmation of clearance within three weeks; this was a quick turnaround, with clearances typically taking up to 28 days to be confirmed, and some taking slightly longer if HMRC has queries. Following completion of the transaction, we were able to introduce the founders to our personal tax colleagues who have subsequently engaged Price Bailey to look after their personal tax requirements.

"We are seeing more and more founders turn to EOTs as a solution for succession and exit. It's a fantastic mechanism that can reap significant rewards for both vendors and the new employee owners when the future growth prospects of the business are so promising – as we have seen here. We thoroughly enjoyed assisting Bernie, Jackie and the team at Bernard Sims Associates in what promises to be a very exciting next step for their business and we look forward to seeing what the future holds for them all."

Eleanor Lothian

Strategic Corporate Finance Manager

Case studies
Harlequin Childcare

The Strategic Corporate Finance ("SCF") team has provided sell side advisory assistance to family owned nursery Harlequin Childcare Ltd ("Harlequin Childcare") in the sale to Busy Bees Day Nurseries Limited ("Busy Bees").

Harlequin Childcare specialise in caring for children aged 3 months to 5 years, and offers full day care of two or more full days a week. Most notably, the nursery has held an outstanding Ofsted report since 2011, recognising the exceptional standards of care and development provided. Busy Bees has recognised the nursery's safe and nurturing environment, where children are encouraged to explore and discover continually throughout their day, and individual interests and achievements placed at the heart of their learning.

Price Bailey SCF Partner Phil Sharpe who led the sale advisory process to Harlequin Childcare commented: "I really enjoyed working with the Harlequin team, and helping them to achieve an exit they are pleased with. Clearly, Busy Bees recognised the value that they have established in the business over the past 18 years.

On Price Bailey's deal involvement, Thor Thomassen and Jayne Chapman commented further, "The sale process sounded straightforward but there were new challenges almost daily, and we leaned heavily on Price Bailey to handle many complex technical items, and to guide us through our decisions, not least because we were still running the business throughout the sale process.

Price Bailey have been our accountants since we established over 18 years ago, and their understanding of our business, and how we manage it, was so valuable to us. Phil and Chris worked closely & tirelessly with our broker and lawyer and the buyer's lawyers and accountants, making sure that we understood, and bringing in other Price Bailey experts as needed to help us to optimise the outcome.

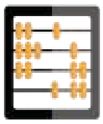
From that first 'sale preparation' session, through reassuring and productive weekly meetings, until literally the last minute of the sale - and even post-sale - we will always appreciate their support, expertise and kindness."

Recent deals

Date: June 2021

Sector: Food & Beverage

Role: Provided Financial Due Diligence services in respect of a £2.5m investment into Big Drop Brewing Co by Panoramic Growth Equity



Date: July 2021

Sector: Financial Services

Role: Valuation of a commercial finance provider to assist with the establishment of an employee-ownership trust.

Date: July 2021

Sector: Consultancy

Role: Company valuation for the health and safety consultancy business prior to the establishment of an EOT.

Date: August 2021

Sector: Restaurant & Leisure

Role: Production of a court report to assist with the valuation of fast food franchises.

Date: October 2021

Sector: Business Services

Role: Undertook a feasibility study focused on achieving strategic objectives including the exit of an existing shareholder (Project Link).

Date: October 2021

Sector: Manufacturing

Role: Provided Financial Due Diligence support on Kartell UK's acquisition of Vogue (UK), a leading designer and manufacturer of heated towel rails and radiators.

Date: November 2021

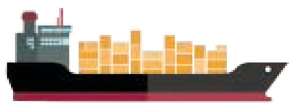
Sector: Education

Role: Lead advisor, funding and financial modelling services provided to support on subsequent sale of experiential bar franchise Boom Battle Bar to XP Factory Plc for £17.38m.

Date: November 2021

Sector: Education

Role: Provided due diligence and advised PSI International Holdings Limited on the acquisition of Propel International LLC, an award-winning global talent assessment and development consultancy.



Date: November 2021

Sector: Logistics

Role: Valuation of an international freight forwarder ahead of a planned acquisition.

Case studies
BrightGen

Tailored technology service provider BrightGen has joined Omnicom's Credera after the US listed entity acquired the company.

The London and Essex-based technology company, BrightGen, primarily partners with CRM aggregate software Salesforce which aims to help marketing, sales, commerce, service, and IT teams synergise more effectively. Award-winning BrightGen focuses on enabling clients to provide optimal experiences to their customers. It has grown significantly in recent years and now one of the largest implementers of Salesforce's software with many global clients. Their management team will continue to lead the company and provide utmost autonomy at the benefit of clients and customers.

Price Bailey's SCF Partner Phil Sharpe helped negotiate the sale commented: "We are thrilled to have had the opportunity to advise on the sale of BrightGen. The deal has delivered a great outcome for all parties involved. BrightGen's acquisition by Credera again demonstrates how successful local businesses are achieving international recognition."

Rob and Martin commented, "We were delighted to have engaged the Price Bailey team who supported us through this exciting and fast paced sale process."

Anna Bowes, Finance Director added, "Good advice and lots of preparation before you embark on your sale is key to a smooth journey through the process and achieving a successful outcome. Having a team around that you trust and who you know are on your side proved invaluable to us. It is important to not under-estimate the amount of time, effort and emotion it will take to get through due diligence! The PB team were on hand whenever we needed them, with a calm voice and their collective experience helped guide us through this complex and challenging process. I cannot thank them enough for their support."

Case studies
Biz Group

Biz Group, a long standing client of Price Bailey's, are a go-kart manufacturing business based in Enfield. Manufacturing fleets of go-karts for clients all over the world, the family-run business has a separate engineering subsidiary that both produces the chassis required for the go-karts, alongside serving a roster of other businesses.

While the business has understandably faced a number of external hurdles over the last couple of years, as a result of Brexit and COVID-19 impacts, the business has continued to thrive and the business recently developed electric go-karts, to meet the growing demands for more environmentally friendly solutions to such leisure activities.

Over recent years, the two owner-managers took the decision for one of them to step back from the business. The Strategic Corporate Finance team at Price Bailey, led by Simon Blake, were appointed to advise the shareholders on facilitating this transaction.

We worked with the shareholders to agree a suitable valuation for the business and its assets, which included a non-trading investment that existed within the group. Upon agreeing a valuation, the Strategic Corporate Finance team sought to find a suitable funder for the transaction that was effectively structured as a Management Buy-Out (MBO) and project managed the entire deal through to completion. The deal was funded by HSBC through a combination of mortgage re-finance on the business' property and transference of the non-trading asset to the exiting shareholder.

Alongside the deal, we were also able to secure working capital facilities to support ongoing operations. Despite a thriving post-COVID performance environment due to increased domestic and overseas demand, the nature of the go-kart sector meant that the business is exposed to increasing currency risk, logistics issues through both import and exporting issues, and increasing raw material costs. While the pipeline of work is growing rapidly, their supply chain and clients working capital positions are squeezed. The working capital facility will work to alleviate some of this pressure for the Group, but in addition we are now working with the business to consider some enhanced working capital solutions to offer to their major clients.

Other future work with the Group includes providing accounting support work as part of the deal, and the development of management and covenant reporting for the business going forward.

Simon Blake, Strategic Corporate Finance Partner commented: "We've known the business and its Shareholders for many years now – it was a great to be the advisors supporting them through this transitionary moment in the business and look forward to the continued support we can provide as the business grows into the future."

2
5
8
11
14
17
20
13
16
19
18
15

How to value growth shares

Growth shares are a fantastic mechanism that enables a business to incentivise senior management to drive growth, in return for receiving some of the value of a company over and above set valuation hurdles. The shares granted through a growth shares scheme have specific economic rights attached to them, which means that, in the event of a sale, the shareholder only benefits if the value of the company exceeds the predetermined hurdle. Typically, this hurdle is set as a premium over and above the market value for the company's shares on the date that the growth shares are granted.

One of the key appeals of growth shares is that, in contrast to EMI options or other option-based incentive schemes, shares are issued to employees immediately, and the economic or structure limits that constrain EMI do not apply. Growth shares are particularly useful in circumstances where options schemes (such as EMI) are not suitable for the business, but they can also be used in conjunction with EMI options too.

Some key characteristics of growth shares:

- Growth shares are typically used by private limited companies and are particularly popular among high potential, early-stage (and often Private Equity or Venture Capital backed) businesses, given the high growth expectations characteristic of those businesses.
- Growth shareholders only share in any capital value growth from the date that they were issued – meaning that current value for existing shareholders is ring-fenced and protected from dilution.
- They are governed by the company's Articles of Association, which will likely be amended as part of the issuing process, and, therefore, subject to the same treatment and requirements as other share classes on the sale of the business.
- Any gains on growth shares are subject to capital gains tax (CGT) charged at the standard rate of 20% (or 10% if the conditions for lower tax reliefs are met).
- They are not limited to incentivising key members of staff; growth shares can also be used for inheritance or succession planning through awarding growth shares to family members. This allows existing owner managers to transfer the future growth in value of the company to their family while they retain the current value.
- Due to the lack of economic rights of growth shares, their market value tends to be relatively low, as the current value of those shares reflect "hope value" only. The cost (or initial tax charge) to employees acquiring their growth shares is, therefore, usually lower than existing ordinary shares. It is important that this point is understood by both the acquiring employees and your existing shareholders.

How to value growth shares

Valuing growth shares

There are a number of methods for calculating valuations for growth shares. The Black-Scholes model is the most common and popular mechanism used. However, alternatives relating to Discounted Cash Flow and Hybrids also exist. These are evaluated in turn:

Black-Scholes model

The Black-Scholes method of valuation was once most commonly used as a pricing model for valuing call options on a stock exchange. Today, it is also used to determine the value of growth shares due to the similarities between both mechanisms; if share price does not hit the strike price level, then there will be no payoff on the options, but if the share price goes beyond the strike price level then any payoff increases linearly.

In simple terms, the model works by considering the various potential future scenarios for business performance, applying a probability weighting to each of those scenarios and then discounting the outcomes from them back to get today's present value. In order to calculate this, a valuer will require the following inputs: current share price, the exercise price/ valuation hurdle, the risk-free rate, the expert term (i.e. time before exercise), the volatility and dividend yield (if applicable).

People generally get nervous about using the Black-Scholes model for valuing growth shares for a few reasons, including:

- A general fear of the model as it appears confusing and the inputs, outputs, and workings are not intuitive;
- Confusing a model which includes vs excludes dividends;
- Not intuitively understanding how a business' plans for growth relate to the inputs;
- Misunderstanding over what acceptable inputs are, and;
- Not knowing the extent to which the valuation 'answer' or output is acceptable.

The critical step for any valuer using the Black-Scholes method to value growth shares is to make sure they understand how the planned choices around growth connect to commercially justifiable inputs (which may include adapting the formula or structure of the inputs into the model itself) in order to form an answer.

For example, volatility is a critical input that can be at risk of being poorly appraised and can lead to erroneous or commercially suspect valuation outputs. What this means is that the actual understanding of the different scenarios that could or could not lead to growth in value, and how those different scenarios relate to one another (i.e. it is possible that more than one scenario, or aspects of different scenarios, could occur) is often quite limited, which could subsequently expose the shareholders and company to unexpected risks.

How to value growth shares

To use the Black-Scholes method effectively, a valuer needs to be able to understand:

- The growth plan and the key drivers of growth;
- The reasoning behind the resultant performance increases in your model and the evidence sitting behind those assumptions;
- The identified challenges to this plan and where other, similar businesses have gone wrong previously;
- Alternative growth scenarios in the event that these challenges are realised; and,
- Finally, taking this all together, they will need to be able to step back and assess what all of this means for the true risk factor to growth.

Discounted cash flow

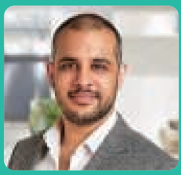
In one sense, all a Black-Scholes model is a complex Discounted Cash Flow model. If you do not have the relevant information to do a Black-Scholes calculation, other methods can be used, such as a more traditional Discounted Cash Flow (DCF) with scenario planning covered by an accompanying method. The accompanying method can take many forms, but the most robust might be a real options analysis.

The real options approach is, simply put, the cost of doing vs not doing something based on assumptions on how a market will operate. However, it forces both the company and the valuer to think strategically about the things that a company could or could not do, or that the competition is like or not likely to do, and then use this to generate ideas on how any of these occurrences could impact future performance and, ultimately, overall value. This methodology is particularly relevant for a business where the possible growth scenarios are either completely perverse to one another and/or completely binary (because of things not under their control that could blow a plan completely in or out of water), or when the business exists in a dynamic market with competition that could create polar opposite outcomes. A great example of these sorts of market conditions exists for rights-based businesses, such as film, sports, 5G networks and music rights businesses.

Hybrid

For robustness, it can also be comforting to undertake both approaches and consider if the answers broadly align, or, if they do not, then what the commercial and economic reasons for the difference might be. Given that at the time of writing, it is not possible to seek statutory clearance for Growth Shares valuations and that the Revenue are quite rightly pursuing cases where growth shares have been undervalued, an additional level of comfort may be desirable.

The right methodology and structure for a growth shares scheme will depend on the particular circumstance and whether there are other interactive tax reliefs or dilutive instruments, such preference shares. It is our experience, however, that these alternative methods are rarely considered or used on their own, and sadly, we often find the Black-Scholes model is used ineffectively – resulting in potentially significant value disadvantages to both the company issuing the growth shares and those set to benefit from them. However, by combining strategic awareness with technical robustness, a credible Growth Shares valuation can be formed by a valuer.



Chand Chudasama
Strategic Corporate Finance, Partner

Case studies
Flip Out

Flip Out Ltd., the UK's leading trampoline and adventure park operator, first began working with Price Bailey back in 2018 following the owner-managers', Dave White and Rich Beese, acquisition of the master franchise business from its original founders. Since then, teams across the Price Bailey practice have worked with Dave and Rich to support them and the business with its growth and development opportunities. Subsequently, at the end of 2021, we supported them in selling their Boom Battle Bar business, little more than a year after it was established, for an enterprise value of c£18m.

When COVID-19 hit the UK in early 2020, and the Government introduced the requirement for all non-essential businesses to close their doors, threatening the leisure, hospitality, and retail sector's survival, Flip Out had some big decisions to make in regard to the future of its business. It is testament to Dave, Rich, and their franchisees that Flip Out remains as successful as it is today in 2022. Choosing not to let uncertainty define them, the management team, in partnership with Price Bailey's Strategic Corporate Finance (SCF) team, worked quickly to help execute a variety of assignments over the next two years including; numerous financial model iteration projects, a bank refinancing/CBILs project, a cost-structure review to ensure that the business could remain viable for the duration of the pandemic (and the regional variations in trading restrictions imposed during part of the period) and, subsequently, as operations re-opened. This involved the business cutting discretionary spending, reviewing the business model, de-gearing, and improving cash flow prospects. While this improved the cash available in the business, further funding was required and we were successful in securing a loan via the CBIL scheme in the summer of 2020.

With the comfort that was provided by reviewing the company's finances and getting in place additional financial support, the owner-managers were able to use some of the space that the operational restrictions of COVID-19 created in order to step back and review growth opportunities for the future beyond the pandemic. One such opportunity, which had been previously considered prior to the pandemic, was to create a similar business to Flip Out that would appeal to an older market. And so Boom Battle Bar was born. The idea for Boom Battle Bar was conceived prior to COVID-19, in early 2020, but was quickly suspended with the onset of the pandemic. During this time, the SCF team, in conjunction with our Insolvency & Recovery and Tax colleagues, supported Dave and Rich to restructure the existing business to both better prepare it for the re-opening of non-essential businesses, and for the creation of this new endeavour within the group.

From the end of 2020 through to Q2 2021, as COVID-19 restrictions eased, both Flip Out and Boom Battle Bar experienced a period of significant revenue growth and wider interest. Subsequently, the owners received interest from potential buyers of Boom Battle Bar and entered into conversations with XP Factory Plc. We supported Dave and Rich in negotiating and executing the sale of the Bar franchise part of the business to XP Factory plc – supporting with deal negotiations, the buyer's due diligence and with negotiating final terms in the SPA. The business was eventually sold in November 2021 for c£18m.

Our relationship with the client has remained strong and supportive throughout this challenging period, and we look forward to supporting them on their entrepreneurial ideas and growth opportunities in the future.

Recent deals

Date: November 2021

Sector: Financial Services

Role: Provided a valuation of a minority shareholding in an accountancy firm to assist with planned director succession.

Date: November 2021

Sector: Industrial

Role: Valuation for a construction company, to assist with a shareholder dispute.

Date: December 2021

Sector: Recruitment

Role: Company valuation in preparation for the introduction of an EMI scheme.

Date: January 2022

Sector: Insurance

Role: Lead advisory support on the sale of Automated Insurance Solutions to Verisk, a leading global data analytics provider.

Date: January 2022

Sector: Industrial

Role: Supported Kerslake Construction Ltd, in its transition to becoming a majority employee-owned business through the establishment of an EOT.

Date: 21 March 2022

Sector: Insurance

Role: Price Bailey provided financial, tax due diligence and related advice to the Purchasers and W&I Insurers.

Date: April 2022

Sector: Technology

Role: Lead Valuation and then follow on sale to key customer. Support on negotiating terms and key financials.

Date: April 2022

Sector: Financial Services

Role: Financial and tax due diligence services provided in respect of the lending to support an acquisition of a complimentary sales and lettings agency by a local estate agent.

Strategic corporate finance - Management team


SIMON BLAKE (FCA, CF)

Head of SCF, Partner
Cambridge and London

M: +44 (0)7702 665342
E: simon.blake@pricebailey.co.uk


STEPHEN REED (CF)

Partner
Norwich

T: +44 (0)1603 708466
M: +44 (0)7778 490973
E: stephen.reed@pricebailey.co.uk


CHAND CHUDASAMA (MBA, CF)

Partner
City of London

T: +44 (0)2038 291739
M: +44 (0)7824 145475
E: chand.chudasama@pricebailey.co.uk


PHIL SHARPE (FCA)

Partner
Cambridge

T: +44 (0)1223 607124
M: +44 (0)7798 662609
E: phil.sharpe@pricebailey.co.uk


NATHAN YOUNG (ACA)

Manager
Cambridge

T: +44 (0)1223 941344
M: +44 (0)7825 735351
E: nathan.young@pricebailey.co.uk


MARK ROWNTREE

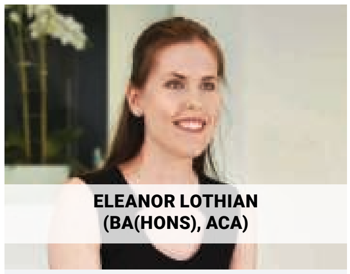
Manager
City of London

T: +44 (0)2038 291705
M: +44 (0)7342 054819
E: mark.rowntree@pricebailey.co.uk


SEBASTIAN HUMBERSTON (ACA)

Manager
Norwich

T: +44 (0)1603 708465
M: +44 (0)7818 508981
E: sebastian.humberston@pricebailey.co.uk


ELEANOR LOTHIAN (BA(HONS), ACA)

Manager
Cambridge

T: +44 (0)1223 941358
E: eleanor.lothian@pricebailey.co.uk


MOLLY RUSHWORTH (MSc)

Manager

M: +44 (0)7828 022512
E: molly.rushworth@pricebailey.co.uk

Price Bailey
CHARTERED ACCOUNTANTS

Our offices

Bishop's Stortford	T: +44 (0)1279 755888
Cambridge	T: +44 (0)1223 565035
Caribbean	T: +44 (0)8004 346460
Channel Islands	T: +44 (0)1481 715669
City of London	T: +44 (0)2070 652660
Dubai	T: +971 (0)4878 6360
Ely	T: +44 (0)1353 662892
London Mayfair	T: +44 (0)2039 090480
Newmarket	T: +44 (0)1638 666160
Norwich	T: +44 (0)1603 709330
Sawston	T: +44 (0)1223 578787

At Price Bailey - **It's all about you**
The right advice for life

pricebailey.co.uk