



The rules of attraction

2011 has already seen one major broking private equity deal involving Towergate. Rachel Gordon assesses whether this is likely to be a one off, or the start of a broader movement within the intermediary market.

BROKING pundits are predicting a rise in private equity deals in 2011, but who are the winners in these deals and is this really such a smart option?

Since the consolidation frenzy of a few years ago, a number of brokers have found banks unwilling to lend — despite their continued need for investment. One fact is clear, however, signing up to a PE deal requires a lot of careful thought.

The pros of PE are well-documented and include being able to generate substantial liquidity and growth capital without having to sell up. Businesses can also benefit from outside expertise as a PE provider can place an individual on the board and may have first rate contacts to assist the broker.

The downsides though include the costs of repaying PE funds, which can be a large burden on earnings. And independent brokers may disagree if outsiders start making decisions. Do they want to be controlled and pressurised into a short-term strategy that is geared only towards profit and an exit strategy at a defined point down the line?

Clearly though, deals are happening. Already this year, Towergate has secured £200m from Advent International, while broker Igo4, which specialises in personal lines products for aggregators, has agreed

an investment deal with Dutch-owned IVM Intersurer. Meanwhile, Lloyd's broker Besso is said to be in talks with Lloyds Development Capital, the PE arm of UK bank Lloyds TSB.

Tough terms

Two years ago, it was reported that Towergate had breached its banking covenants with Lloyds TSB. Executive chairman Peter Cullum was quoted in the *Eastern Daily Press* as saying: "We are all under the cosh. And we can only guess what 2009 will hold."

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However, it was later reported that Towergate weathered the storm and Mr Cullum said he was "very pleased to confirm that we have concluded our renewed banking arrangements and have been delighted by the positive and supportive role played by our lead bank Lloyds TSB. The agreement provides further financial stability and ensures we are

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well placed to continue our strategy of organic growth and value adding acquisitions".

Yet, Towergate was not prepared to sit back; last year it aborted a bond issue due to worsening market conditions and last month Boston PE firm Advent International made a \$200m investment in the firm. Although it is a giant among intermediaries, Towergate has made some plum niche acquisitions in the past, has a leaner central structure than some and has retained some good people — characteristics PE providers like.

Olly Laughton-Scott, partner with Imas Corporate Advisors, is among those who believe there are going to be more such deals within broking — if the model is right. "PE companies are well aware there are no horror stories in broking and are seeing this as a safe place to invest if they can find the right time.

"They know they will have an easier regulatory burden than investing within an insurer and they are not just interested in the big players. But, relatively few brokers are going to succeed — if they don't have a unique selling point then there won't be any interest — and there are many brokers that don't offer anything different. Those likely to be in demand are scheme-based brokers that would benefit from a buy-and-build strategy. At the same time, this is often expensive money."

Main source of funding

Imas advised on last year's PE deal involving Inflexion and Fish Insurance, a niche broker focused on the disability sector. Inflexion also announced it had appointed seasoned insurer and broking specialist Tim Ablett onto its management board.

Damian Guly, Pricewaterhouse Coopers' UK financial services deals leader, comments: "It is notable that PE providers are bringing on people with financial services expertise. This is good for brokers as they will benefit from the knowledge and will also be necessary if the regulator is to approve any change in control."

In a similar manner, Admiral chairman Alastair Lyons has joined the Towergate board in the wake of its deal with Advent, a man with notable IPO experience.

Mr Guly adds that brokers that are already highly leveraged with bank debt may well see PE as their main source for funding. "We will continue to see a wave of activity and are working on more deals. There have been some good success stories — brokers generate cash and if the PE provider can see growth and achieve the right lock-in deals, this is an attractive sector — although certainly not all deals have made money," he says.

Mark Flenner, partner with KPMG, says he also has a number of deals in the pipeline: "PE providers are looking at brokers with interest. Notably, brokers tend to have weathered the downturn — which is not over — well. But, they are looking specifically for brokers that have proven profitability and have picked the right niches. Certainly property brokers are not in favour, for example, but there are still some interesting businesses out there that might have good technology. If brokers also have an ambitious team, then they have prospects."

One PE provider with an interest in brokers is Connection Capital, which is backed by a range of private investors that

<21 can access deals with sums from £25 000 as part of a managed syndicate.

Connection Capital finds the investment opportunities, negotiates the terms and, eventually, the exit process. Partner Claire Madden says a number of these individuals have a strong interest in brokers because of their backgrounds. Ms Madden previously co-founded private investor syndicate Hotbed, which backed a travel broker and also Home & Legacy, which was sold to insurer Allianz — both successful deals, she says.

“Around 80% of our investors are entrepreneurs and they have assisted us with their broking knowledge,” Ms Madden adds, explaining that brokers seeking PE must have a clear exit plan in mind — typically three to five years. It is not a case of taking the cash and coasting. “We can tell from the people if it is going to work or not and we look for something different.”

She stresses that the people within a business carry significant influence when it comes to Capital Connection deciding whether or not to provide funding — and says a concise business plan showing realistic growth prospects will go down better than fancy graphs or swathes of advisers. The company will take a stake from 10% to 49% and its investment criteria is focused on growth capital, management buy-outs, or replacement capital, with an equity requirement of £1m to £7m.

Relationship realism

However, John Holm, director with Clydesdale Bank's corporate and structured finance team, who advises both on bank funding and PE warns: “It could be a marriage made in heaven but both sides should ensure they are going into it with their eyes wide open.”

He says the question PE providers have to ask is whether the timing is right to invest, given the current soft market. And, for brokers, a key issue is that PE is not the only piece in the funding jigsaw — and to consider all the options.

Mr Holm explains: “A PE house will want to exit a business

after a specified period of time, but achieving this may not be so easy in the broking sector where fortunes may fluctuate, particularly with smaller firms. Brokers are also people businesses and, no matter how much they may try to tie in key staff, there is always the risk that their assets will walk out of the door.”

There are also unlikely to be any quick decisions: PE providers will probe a broker carefully to ensure the money-making potential is there. Artur Niemczewski, managing director of Xchanging Broker Services, which provides outsourcing and other services, comments: “PE providers are highly selective — they want the winners of the future. This is why brokers that are serious often bring in specialist advisers to make sure they are correctly positioned before they start talks and strip out areas that are not profitable, in addition to bringing on more managers. A restructure could make the difference to obtaining funding.”

The interest from PE is going to be in the big brokers that have a strong track record, typically consolidators. Cornes

Meanwhile, David Coupe, partner with law firm Clyde & Co, cautions against seeing PE as an easy option: “Many brokers may be too small and it is possible that if they have a relationship with their bank, they might find conditions have eased a little. But, from my experience, some banks are saying they are open for business, even if they are not.”

Heath Lambert refinanced recently with Santander — and this can be a cheaper option, he says: “It very much depends on whether a bank feels it is overexposed to broking and remains risk averse. Typically though, a bank might charge around 6%, whereas PE would be 10%.”

Mr Coupe agrees that PE houses are highly selective. “Brokers vary — some are not a great risk and are weighed down with expensive property and pension costs. PE providers may want to bring in new management and do a lot of work. It very much depends on what they think the returns are going to be,” he explains.

And, for brokers believing PE is going to make them cash rich, Barrie Cornes, equity analyst at Panmure Gordon, says they need to think again. “The interest from PE is going to be in the big brokers that

have a strong track record, typically those that have done some consolidation. But there are still far too many out there who cannot accept they have missed the market peak. PE providers won't be paying over the odds. That said, those that have accepted their business is worth a reduced price and that have the potential should see some interest — and I think we'll see rising volumes of deals.”

No easy option

Although PE does not have massive exposure within broking, there are a number of examples out there. A-Plan Insurance linked up with Barclays PE in 2008, which was also a backer for Admiral Insurance.

A-Plan's chief executive officer Carl Shuker says his company turned to PE to facilitate a management buy-out. The company, which specialises in the local provision of personal lines, now has in excess of 60 branches and is planning further acquisitions.

“PE has helped us move to the next level and we had detailed meetings about what we could achieve — we worked with advisers Grant Thornton,” Mr Shuker explains. “We certainly did not see it as an easy option: you have to deliver the goods. We have a member of Barclays PE on the board as a non-executive who has provided some excellent ideas and been supportive. They are pleased with progress so far — we are providing good, steady growth.”

His advice to brokers is to seek advice from professionals and, should funding be secured, to ensure there is honest dialogue. “If you have a problem, share it. If you face challenges be open and make sure you remain focused on your strategy. We are aiming for this to be a long-term relationship.”

For his part, Lyndon Wood, chairman of broker Moorhouse Group, is currently mulling options as to how best to grow his Constructaquote business. “The aim would be to have this as a standalone business with a dedicated team — currently, existing Moorhouse people share the work. There is plenty of cash out there, but I am in no rush. I haven't needed to bring in PE in 20 years of doing business so, if I do, I want to make sure I get it right.”

He says he is considering talking to a range of PE providers and is certainly not just interested in “cheap money”. Mr Wood comments: “I would want to see some real expertise and for Constructaquote to really take off. I provide consultancy services myself to a range of businesses and am struck by the amount of times it is not cash that is needed, but a change in organisational strategy.”

Mr Wood stresses that he favours organic growth in most cases: “We've seen in broking the problems caused when brokers have bought too many businesses and not successfully integrated them. People have left because they are disgruntled — they aren't consolidators, they have failed to consolidate.”

Aside from the fantasy world of winning the lottery, there is no such thing as easy money. PE seems to have more interest in broking than ever before and, for a chosen few brokers, this is either going to mean a winning ticket or five years of intense pressure to achieve that essential payback. **POST**

