

THE BREXIT ROUNDTABLE

At the table:

Louise Allen, GK Strategy

Michael Berreen, ClearlySo

Laurent Capolaghi, EY

Ilian Iliev, EMV Capital

Tristan Nagler, Aurelius Investments

Miles Otway, Connection Capital

Patricia Volhard, Debevoise & Plimpton

Andrea Williams, Intertrust

Moderator: *Nicholas Neveling, Real Deals*

Photography: *Richard Glead*

The Brexit situation is so uncertain. Is there any way to predict what may happen?

Louise Allen:

Uncertainty has become the new normal. We have the Withdrawal Agreement being discussed, but the long-term relationship with Europe is still very much a question mark. Aside from the macro machinations, we are focusing on more micro-technical questions, from which you can create clearer scenarios.

The focus from investors is on areas like tax, funding, policy, regulation staffing, migration and visas. We have looked more at the micro because those factors are more relevant to the deals GK are advising on, and it is where, from an advisory perspective, we are able to create clearer, more coherent scenarios to support investors to make judgements on risks and opportunities.

What is the degree of political





Clockwise from top left:

Ilian Iliev, *EMV Capital*
 Patricia Volhard, *Debevoise & Plimpton*
 Miles Otway, *Connection Capital*
 Louise Allen, *GK Strategy*



consensus domestically and internationally? How hard is something to change and how entrenched is it? When you look at those sorts of factors it is possible to create scenarios that are helpful to the investment case. When you start focusing on what No.10 is doing from one day to the next it can become a distraction.

The primary scenario we are being asked to look at more than anything else is the no-deal scenario because of the level of risk. A Labour change of government is the other key scenario, particularly regarding changes to state aid or procurement rules post Brexit, and attitudes to private provision.

Our firm view is that a general election is the least likely option because of the limited appetite within the Conservative party for that to happen. A second referendum is another scenario which must be factored in. The no-deal scenario should not be discounted, but it

certainly is not the preference of the majority of the political movement. There are a handful of political stakeholders who consider that to be a viable and preferable option, but they're very much the minority. On the Labour side some of the motions and amendments that are being made, and will be made over the coming weeks, will seek to avoid that outcome.

Even by the time this goes to print the national politics will have changed, so it comes back to focusing on specific technical questions that help investors to make judgements on short to long term risks and opportunities.

When investing for the long term, how do you manage uncertainty?

Ilian Iliev:

There are so many factors to negotiate. Many of the pan-European venture capital (VC) funds

are now less likely to invest in UK deals. There is also less continental European money available for UK high-growth deals. The European Investment Fund (EIF) has turned off the taps almost entirely for funds that have a UK focus. The British Business Bank has grown massively and could fill that gap, but it takes time to build up a fund of funds programme of scale.

From our point of view, however, we are in technology. Technology is exports and the customs aspect matters less for technology exports. If you look at Israel, where we do a lot of work, they have the worst politics and geographical location you can imagine, but around 40 per cent to 50 per cent of their exports are high-tech. So, whatever happens with Brexit, technology companies continue to have an opportunity.

Finally, what's been interesting is that many

of the corporates we talk to say, "Look, for us the UK remains a good source of deal flow, not only because the technology is strong but because we like the environment, we still like the common law aspect and we still like the management aspect of UK businesses."

Corporate venture capital has really expanded massively over the last six or seven years. A lot of the big tech deals are done with corporate VCs, and so they have a problem, because they used to have lots of European or pan-European funds involved in their deals and now they don't. For UK VCs that's an opportunity. It's a gap that we can fill out.

Michael Berreen:

At the end of this process business will bounce back, but in the meantime it does mean some investors will slow down or hold off.

However, less capital being invested over a



potentially long interim period will be damaging, especially to the smaller companies we raise capital for.

What would really help would be to see the various cooperation agreements with Europe come through. Once those agreements are in place dealmakers will be much more comfortable. The UK deals with many people outside of Europe on that basis already.

Miles Otway:

We simply have a harder cut off line for businesses. Your risk/reward profile has to look a lot better on the potential reward side, or a target has to have characteristics that make it more defensive. That, by definition, just brings down the breadth of opportunities to look at. It is the only thing that you can sensibly do at this juncture. Err on the side of conservatism.

That has two implications. One is that there

are good deals out there you don't do, which is immensely frustrating.

The other side of it is that there is this heightened risk of making a big error. So, we're still investing but the uncertainty creates an environment that makes it harder to assess risk, which means some companies don't get backed. That is the frustration.

Tristan Nagler:

Aurelius is a special situations investor, so factoring in uncertainty is a big part of what we do. We go into situations where customers are not committed to the business, employees have left, management are absent, or credit insurers are no longer there. Brexit is just another thing to add to the list.

The key thing for us is to stay patient and price for risk through this period. This sometimes means we miss out on deals in the

current environment because we have been careful about valuation, which is unfortunate, but we have been robust on price. We have also spent a lot of time looking at liquidity. In the worst-case scenario, and we go through a prolonged period of macro-economic uncertainty, we need to be able to fund a business through that, so we model that in detail.

But all that said, we are continuing to do deals in the UK because it is such an important market. No GP can ignore it.

Andrea Williams:

Tristan makes a good point there. Brexit has dominated the news so much, but there are so many other factors that GPs need to focus on that are not related to Brexit. You also have to look at where we are in the cycle and the challenges involved in deploying capital when

there is a paucity of assets. There are a lot of things to look at. Brexit deepens the challenge.

Laurent Capolaghi:

That is what we are hearing. Brexit doesn't seem to be the number one topic for managers any more. They have put contingency plans in place. The largest managers started quite early and mid-market players considered contingency planning extremely seriously after the summer. I think managers have accepted that the only certainty is uncertainty. They have contingency plans in place for the worst-case scenarios and they are getting back to doing deals and raising funds.

Is there any evidence that given the uncertainty people are sitting on their hands and waiting to see what happens?

Right, from the top:

Andrea Williams, *Intertrust*
Tristan Nagler, *Aurelius Investments*

Berreen:

We are slightly different in that we have an impact focus, which means we get different sorts of investors, who come at things from another angle.

Business angels account for most of the volume of our deals and they can be idiosyncratic because they are looking at their personal situation when deciding to do a deal.

For the time being we've been relatively unaffected. Impact doesn't go away and it remains a concern for corporates and investors regardless of any Brexit-related uncertainty we are facing.

When I look at what we have been working on, we are doing deals in Europe, typically with a UK focus, and we are also busy in emerging markets like Africa. Business carries on.

Capolaghi:

Different sponsors are approaching it in different ways. Tier one sponsors in the US, for example, have their platforms outside Europe so not much has changed for them when they are investing in the UK and Europe. Domestic UK managers have been relatively unaffected too. They are focused on the UK market now and will continue to focus on the UK market after Brexit.

For pan-European managers, contingency plans are in place. These could be very light plans using third-party AIFMs, so there is very little capex, very little investment, and no need to worry about talent acquisition. These plans have enabled firms to continue doing business with the flexibility to reorganise further down the line depending on the Brexit outcome.

Otway:

If you are starting a deal now I think it is unlikely that it will complete before the end of March because of the Brexit deadline. Why would you complete in February when you could hold on a few weeks and do it after the deadline? I expect that a number of deals that would normally have completed in February or March will now complete in April or May.

But I think we've got to move on from what's going to happen in the next three to four months because, ultimately, none of us know.

It's all going to come out with an answer that's still going to leave us with two years of uncertainty as to what the trade relationship is going to look like. You're into a world where you've got a long-term decision about the fundamentals of the company, within the context of a range of Brexit variables.

Williams:

I have seen the same thing. Dealmakers will rush to do deals that they can close now, but if a transaction is still in its infancy then GPs are waiting. The expectation is that in quite a few sectors there might be a really slow January and February, with deals deferred until after March.

Nagler:

Given the situations Aurelius works in, I am actually expecting a busy period because there are some things that won't be kicked down the road. Banks are not going to sit back if they see problems, so we're seeing plenty of accelerated M&A and insolvency situations.

If you then look at corporate carve-outs, Brexit is unlikely to change what is going on there either. Once a corporate decides that they need to sell something, and they announce it,



it's difficult for them to back track on that commitment. Just recently a company announced a divestiture. Even though it might be better to wait until April, they have to go ahead with it. When you are a c-suite executive with a division that isn't working for your business and you have pressure building from shareholders, it is difficult to put an announced sale on hold because you almost always have made a commitment to wrap up that sale by a given date.

Allen:

Finding the right deal at the right price has been key. GK is regularly asked what is immune from Brexit risk.

It is a complex question, but there are niches that are really interesting, where there is

potential Brexit upside arising from import substitution and regulatory changes.

If you look at agriculture from a Brexit perspective it can look more risky, but when you think about how the subsidies will change and how the sector will be reformed domestically, there are some really promising opportunities. This is the case across many sectors which initially appear highly exposed to policy, regulatory and funding risk.

Otway:

We recently looked at a business manufacturing agricultural machinery. The first time I looked at it I thought, "The common agricultural policy, oh God, what's going to go on there?"

But when we looked at it in more detail, the business takes out manual labour and it is

exporting to the US and New Zealand. It is in a great position. Passing the sniff test is harder, but that doesn't mean there aren't good businesses that will continue to perform through the uncertainty.

I wanted to move on to fundraising. This must be one of the biggest concerns for managers, especially if you are a UK manager raising money from European institutions or vice versa. Who will be the managers most affected?

Patricia Volhard:

The financial sponsors most affected are the UK managers with UK structures and a diverse investor base.



Left, from the top:
Michael Berreen, *ClearlySo*
Laurent Capolaghi, *EY*

third country access. If a manager wants to delegate back to the UK from Luxembourg or Ireland, then the Luxembourg regulator and UK regulator will have to agree on arrangements. Unofficially, we are hearing that an agreement like this is in the drawer if needed.

Iliev:

One interesting aspect is what European institutions will do post-Brexit, given that many of them are tasked with investing in Europe.

I am optimistic. The EIF, for example, does provide money to countries outside Europe, so there is no reason why it can't switch funding for the UK back on once Brexit is finalised. With the British Business Bank gearing up we could even find that there is more capital available than before Brexit.

Volhard:

On the regulatory side, the links between the UK and Europe are strong and robust enough to hold through Brexit. There may be short-term disruption, but business will continue at some point. People will find ways and governments will find ways, luckily.

Williams:

I share these sentiments. Once the disruption is over the UK will continue to serve as a gateway country for business. I don't see that changing.

What will change is how we do business. Yes, we won't have the formal political ties in place, but the UK is sophisticated and it will remain close to Europe, whatever form Brexit takes.

Allen:

That is absolutely right. The desire for convergence rather than divergence is overwhelming from all sides. The UK has always been an influential voice in shaping financial services legislation at European level, and it will continue to do so. For many policy areas it's just a matter of how, rather than if.

Nagler:

In this room there's an international element to all of our businesses. You're not a British law firm, you're an international law firm. We're an international investor with people in our London office who are European, and vice versa. Business doesn't limit itself to nation states.

Capolaghi:

I am based in Luxembourg and we will be very sad to see the UK leave Europe, considering the relationship. Our job now is to help businesses and investors through this period of transition. We have seen lots of business coming in. We take the responsibility very seriously and want to see this done properly.

Iliev:

We do need to keep things in context. I'm Bulgarian but I grew up in Angola, Mozambique and South Africa, and pretty much everywhere I've lived there's been a massive systemic change. The end of communism. The end of a civil war. The end of apartheid.

I have lived in a civil war environment, in a hyper-inflation environment and through a negative ten per cent recession. Brexit may not be ideal, but let's keep it in context.

I am also an optimist. The UK will sort out its relationship with the EU, and I think the EU will see the UK as a stable partner.

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A UK fund sponsor that fundraises in Europe may no longer have the benefit of the passport, and so they will have to apply under national private placement regimes. In some countries, like France, Italy and Spain, there is not really a private placement regime in place, so there is no way to market in those countries.

Perhaps even more significantly Europe is working on building up regulation for institutional investors. Consider things like ESG and Solvency II. European investors will want assurance that all managers they back are subject to the same European standards.

My hope is that in the long run, the UK will be the ideal pupil in its class and will adopt those standards, because that's what always

happened in the past with all these directives.

But in the short run it could be tricky. For a European investor a fund in Luxembourg is subject to exactly the same rules as that investor, so it's much easier to tick the box.

That said, UK managers are working through it. They can set up a fund in Luxembourg and delegate back to the UK. They are finding ways to stick to the rules.

In the worst-case scenario of a no-deal are these arrangements robust enough to survive?

Volhard:

If you're fundraising at the moment and you go

into 29 March 2019 as a non-EU UK manager and you have not set up a European structure there is uncertainty there.

The delegation question also has to be looked at. If you delegate from Ireland or Luxembourg back to the UK, that requires a cooperation agreement. That is the most important factor in a no-deal scenario. Will the UK be treated as a third country that requires managers to apply under third country regimes if they fundraise? Or will they delegate back to the UK through European structures?

Everything will require a cooperation agreement, and the question will be whether the other European member states are ready, because it's a bilateral matter when it comes to