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The commercial imperative - what a difference a decade makes!

John Lutterloch writes about the changes in investor opinion towards leasing companies over the past 10 years



The ownership of leasing companies has seen many twists and turns since my first involvement in the industry in the early 1970s.

The major banks then dominated the market. It used to be stated that there were some 600 banks in London alone and many of those owned their own leasing

companies. There was then the development of "tax shelter" lessors – public and private companies which established leasing subsidiaries to enjoy the benefits of 100 per cent first year allowances under group relief rules.

Along came the Americans in the mid 70s. Where are they now? - Security Pacific, Continental Illinois, Chase, Bank of Boston, Riggs, etc. The answer, of course, is that they have merged with other banks, most of which choose not to compete in the current UK market, although the requirement of US vendors to achieve global markets and, therefore, a financial solution in all countries where they make sales, has led to a number of US players developing a global capability.

Building societies saw the light in the 90s when they took up full banking status encompassing the obvious benefits of deferred taxation and, therefore, a better return on capital. Alliance & Leicester is probably the only BS-owned lessor still making a major impact.

In 1999, after Industrial Investment Group had posted profits in excess of £1 million for the preceding year, we looked at the possibility of listing the company on the London Stock Exchange.

Two independent Leasing companies had previously floated – Baltic Leasing in 1981, on the then Unlisted Securities Market, followed by Combined Lease Finance a few years later. The rationale, then as now, was simple – if you were not owned by a financial institution then you needed to raise external capital in order to leverage your balance sheet.

After choosing a leading stock broker, my directors and our advisers toured the investment institutions that favoured the financial services sector. At that time, memories of the collapse of British & Commonwealth Bank after the acquisition of Atlantic Computers, as well as a couple of well-reported frauds in the leasing industry, were still major talking points.

We were being groomed for AIM, the UK's secondary stock market, and a fund raising of £5 million. The total costs of the flotation would have been around £500,000. Our conclusion then was to wait and attempt to grow the business with our limited capital base.

Interestingly, in November 2001, I visited Colin Davenport, then chairman of Davenham Group, having read numerous press releases regarding its AIM listing which had disappeared off the news stands. He explained that the flotation was planned for September of that year, but following 9/11 it was pulled at the last minute. Davenham was fortunate to have two large institutional shareholders to invest further capital at that time and Davenham continued its growth and successfully floated on AIM last year.

I spoke to David Coates, CEO of Davenham, who led them through the flotation process. He told me: "All options were examined including secondary buyout, flotation and trade sale and one day I hope to write a best seller because you need the wisdom of Solomon, nerves of steel and real tenacity to execute down any of these routes.

"We chose flotation, which probably got the shareholders the most money whilst enabling us to gear up and remain independent. In broad terms the stock market does not really understand finance companies looking at valuations from 1.5 to 2 times net assets with a P/E of about 10. The flotation did, however, give Davenham's banking group the confidence to support a £300 million RCF in late 2006 and later this year we will securitise making the group's transition to the international capital markets complete."

It's no surprise therefore that the largest leasing companies are bank owned, which with almost unlimited capital to support their growth, have dominated the leasing industry.

However, there have been many success stories of smaller companies that have developed specific niches and gone on to flotation or trade sale. A number of private companies continue to show good profits and have no intention of sharing their rewards with new shareholders.

In 2004, we co-founded St Helen's Finance plc, which listed on OFEX in September 2004 after raising £700,000 of private equity to develop the small to medium ticket sector. It was agreed that IIG would remain separate continuing with larger ticket transactions and vendor programmes.

In truth, raising equity for a brand new leasing business was not easy. It required substantial time and effort to produce a satisfactory business plan, leading to a series of investor presentations and a badgering of friends and family. Some shareholdings as little as £1,000 were received. Fortunately our story was aided by the excellent state of the industry where most of the public companies had shown good growth and profits and some notable trade sales at high P/Es had taken place; namely Cattles Leasing to Close Brothers, IEF to Hitachi and Broadcastle to Siemens.

Britannia Finance had already taken the OFEX route a couple of years earlier and was proudly boasting an increase in share price from 10p to 44p over that period and funding lines of £60 million. Ironically Britannia went into liquidation last year.

During one of the St Helen's Finance investor presentations, I distinctly remember one gentleman asking about our accounting practice and how it was different to Atlantic Computers. He was apparently one of the auditors involved in the winding up of the company some 17 years before, so memories remain vivid in some quarters.

In June 2006, we established Merchant House Finance Ltd as a joint venture with AIM-listed Merchant House Group plc. MHG's main operating company, Merchant Capital plc, is a member of the London Stock Exchange and helps emerging companies raise growth capital (typically £500,000 to £10 million). Most of the transactions end up with a listing on PLUS or AIM where Merchant Capital acts as corporate adviser.

In conjunction with our partners we are developing the Merchant House brand as a "one-stop shop" for equity and debt and I believe it gives us a unique position in the asset finance & leasing sector.

Raising capital for any business is not easy. Firstly, there are regulations from the FSA as to what you can "say, publish and do". Then, there are the questions related to source of capital, type of capital, structure, private or plc, etc. Once you choose the public company route there are then numerous compliance and reporting requirements. Not surprisingly, a number of well-known companies have de-listed in recent years describing the vagaries of the Stock Market as "not in the best interests of the business".

James Holmes, my co director at Merchant House Finance, has recently become chairman of 535x, which was established in 2003 and takes its name from an old Stock Exchange rule that permitted off-exchange trading. He comments: "We believe that 535x has great potential to help and nurture small companies that are looking for funding or need to sell or value their shares for whatever purpose. Many will be family run and will have no idea of the true worth of the investment they have built up over many years. Our market will allow them to realise that value or to take the first steps to becoming a properly listed company." For those who are considering the raising of external capital below is my personal summary of the options available.

<u>Type of Capital</u>	<u>Source</u>	<u>Estimated Cost</u>
Owner's capital	Friends & family	Nominal + professional advice
Private equity	Via professional adviser	£50k +
535x listing	Listing on 535 Exchange	£300 per month
PLUS (previously OFEX)	Corporate finance adviser	£150-200k
AIM	Adviser or nomad	£450k +
Full listing	Nomad/stockbroker	Circa £1m

Davenham, General Capital and 1PM have all listed their shares on AIM in the last 12 months and I have had meetings with other leasing companies that see a public listing as a valid route to increase their capital base.

As an industry responsible for financing around one third of all UK capital expenditure there is plenty of room for specialist players, and provided leasing maintains its "good news" profile, I am sure there will be other successful Stock Exchange entrances over the next few years.

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