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Rob Painting of Early Equity talks to M&A's Patrizia Rossi about plugging the Midlands equity gap



Early Equity's Rob Painting has a rolled-up-sleeves approach when he talks about the funding problems faced by small businesses poised for growth. The loquacious CEO, who spent two decades as finance director at global construction services group Keller, has no problem getting down to what he sees as the nitty-gritty.

"No matter what the Government says it has done, is doing or plans to do for small businesses, there's a real sub-£2 million equity gap," he explains. "That's where Early Equity comes in. We are able to provide support to businesses in the Midlands, and further north, with strategic thinking and a cash injection of £500,000 to £1 million."

Painting's 'equity gap' is backed by recent government figures that show lending to fledgling businesses through the Government's Small Firms Loan Guarantee Scheme (SFLGS) more than halved in 2006. The largest business aid scheme that injected vital funds into the early days of the Body Shop and Waterstone's has seen a 56 per cent fall in takers because of a lack of publicity and reforms restricting loans to businesses that have traded for more than five years.

The scheme, which was set up to help small businesses that lacked the collateral needed to secure bank loans, backed 2,700 loans worth £210 million from 2006 to 2007 compared to almost 6,000 loans worth £422 million in the previous year, according to the Department for Business, Enterprise and Regulatory Reform.

Painting is keen to fill the funding gap with his new Birmingham-based venture, Early Equity. "The average size of our direct investment would be between £50,000 and £100,000. We would then raise the funds for the company from a number of corporate sources, high net worth individuals and sometimes funds," he explains.

"The investment would be made at the establishment stage and we would raise the balance of the cash required to take the company to PLUS - £600,000 to £850,000. Ideally this would give us somewhere in excess of 20 per cent of the equity post-listing."

Painting has surrounded himself with a credible management team and notes that the Early Equity board was designed with common directorships in mind to tap into deep-pocketed investors and high net worth individuals. Painting is one of the largest shareholders alongside AIM-listed

investment company Addworth plc, which holds a 30 per cent stake in the business. Sir Bernard Zissman, a well known figure in the Midlands, is also a major shareholder together with Neil Mackay of angel group Advantage Business Angels (ABA).

The connection with Zissman and Mackay provides access to a network of investors, and the latter to a database of funds and individuals looking for exits. "ABA has a number of sophisticated investors and high net worth individuals on its books that we can tap into," he adds.

Target practice

Early Equity typically invests in Midlands businesses with owner-managers looking for a partial exit. It also backs innovative entrepreneurs that need strategic thinking in order to generate sales.

Painting is not restricting his search for investment-ready opportunities to markets he is comfortable in. "My comfort zone is construction services and facilities management and I tend to gravitate towards the down-to-earth types of businesses. However, investments don't have to be today's 'sexy' businesses. You can take a basic business and with the application of the right strategic thinking and resources, you can move it on and grow it. Sector is less important than the ability to grow and solid management."

Painting is currently in talks with a number of early-stage businesses, one of which is an Internet-based start-up looking for acquisitions to achieve scale. "The owner has been running the business for two years, but is having difficulty achieving critical mass. He wants to make acquisitions, but doesn't have the cash. This is where Early Equity would come in. It's a good proposition and the scale is within our investment range," says Painting.

"Our approach is to make pre-IPO investments in companies and then take them to PLUS. Once we have identified a company, we might invest directly or set up a special purpose vehicle, with nothing but cash in it, to make acquisitions."

Painting has a detailed shopping list for target companies, with high growth potential, strong business strategy and solid management right at the top. He says: "Although I have a background in operational management, Early Equity is a financial partner, so we are looking for the management team to run the companies. Early Equity will provide the cash injection, strategic input and a PLUS listing."

Key to Early Equity's 'sustainable capital gain' strategy is the concept of partnership, which involves working with the existing management to retain expertise and limit risk. "We remain a holder with board representation and work with management to grow the business and increase value," he adds.

"It's a partnership, not an acquisition. The existing management team takes shares in the new vehicle as the largest shareholder and we give them a cash injection, a PLUS listing and take it forward together."

On the returns he is expecting, Painting outlines the high level of risk facing investors at the establishment stage. Namely that if the deal were to abort it would leave investors picking up the tab for the fees incurred.

He says: "As we are going in at an early, high risk stage, we expect a high return. In terms of a percentage return it is difficult to say because it depends on the individual investment and the scale and speed of the growth strategy involved. We would aim to double our money as an absolute minimum, and probably to improve on that in most cases."

Something a bit different

Painting believes Early Equity provides a relatively unique approach to deal-making. "We're not into setting up speculative special purpose vehicles (SPVs). We have to have clearly defined acquisition targets and feel confident that we can deliver an acquisition," adding, "the last thing I want to do is to set up a business with £500,000 of someone else's money and then have difficulty finding anything to do with it."

"We're financial investors making strategic investments, getting involved in the strategic running of the business and providing funds to allow companies to grow - In the same way that venture capitalists are supposed to, but we're slightly friendlier," he laughs.

Painting's business model is to raise funds, invest in companies and promote them on to PLUS to raise finance or make acquisitions. "PLUS isn't a perfect environment, but it's not bad. PLUS doesn't offer the liquidity or interest in the stocks from the brokers compared to the main market or better AIM-listed stocks, but that's changing. PLUS is getting stronger and with Recognised Investor Exchange status we expect more companies to join PLUS, press coverage to improve and, more importantly, that brokers and institutions will start to look at PLUS in a way that they currently do not," Painting says.

In October Early Equity listed on PLUS, raising £500,000 on a pre-IPO basis. The market cap on listing was £2 million, which has dropped slightly since. Painting doesn't see this as a problem as it was "expected".

"We floated, we raised cash and now we can start moving forward. We have a sufficient pipeline of deals to suggest six to eight investments over the coming year is certainly feasible."

The early days

The seeds of Early Equity can be found in Painting's desire to replicate and improve on what he terms the "Addworth model". As non executive director of financial services company Addworth, which has a 30 per cent stake in Early Equity, Painting is keen to stress that there is no management input from Addworth's executive chairman Mark Watson-Mitchell.

"Addworth was the forerunner of Early Equity - we didn't invent the model, it was just exported north - and is a stand-alone business. There is no hands-on involvement in Early Equity from Addworth to avoid a conflict of interests," he stresses.

Despite the line drawn between the two, an overlap exists as Painting talks about a "good opportunistic investment" in a recent Addworth deal: The PLUS listing of Three's a Crowd, an events management company and lifestyle portal with Tara Palmer-Tomkinson as one of its directors.

"Addworth took Three's a Crowd to PLUS and we got in at the pre-IPO stage. You either love or hate Palmer-Tomkinson, but the one thing you have to accept is that she has the best address book in town and is using her connections to get work. We're expecting a high return on a good underlying business."

Although Early Equity shares the same profile as Addworth of taking companies from its early stages to market, the latter has been laser-focused on central London deals. "I've always thought life didn't end at Watford Junction," adds Painting.

"I'm a Birmingham lad and there's a big world outside of London and the investment opportunities in the Midlands are definitely as big as the opportunities down south." □