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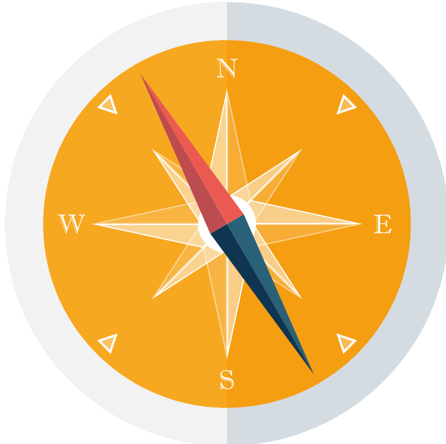


Plotting a new course

Brexit – The Financial Advisory Perspective

Uncertainty

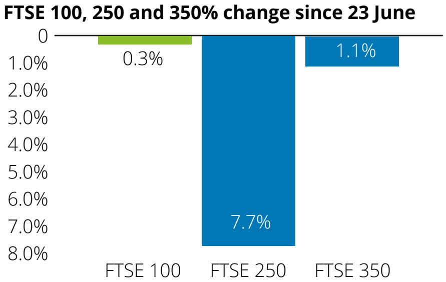
The obvious statement is that the UK's vote to leave the EU creates a period of uncertainty. That period could be quite long as detailed negotiations are unlikely to start until September 2016 and once Article 50 is triggered there is a two year negotiation period (unless all EU countries agree to extend it).

The key uncertainties are the lack of clarity over the UK's future trading relationships in goods and services (including financial services) with Europe and the rest of the world, the changes required to UK legislation where it has followed EU laws and the changes in rules on freedom of movement of people.

There are many potential models which are being discussed and until there is some political stability and importantly a new Prime Minister to set a negotiating strategy the picture will not become clearer.

It is likely that the period of negotiation and preparation for Brexit will cause significant distraction for the Government and businesses which will result in other issues receiving less attention. This will only be compounded if there is a second Scottish independence referendum.

FTSE 100, 250 and 350% change since 23 June



Source: London Stock Exchange

Confidence

The Deloitte quarterly CFO tracker showed that business confidence was already falling ahead of the vote and it is likely to fall further now the vote is confirmed. The declines in the stock market point to that effect and the expectation of lower growth in the UK. A week on from the vote the FTSE 100 has recovered its losses but the FTSE 250 is down 7.7%, with substantial variations by sector (see below).

Strong consumer confidence has been an important growth factor for the UK economy. There are some early signs that consumer confidence has been dented by the aftermath of the vote. If that develops it would be negative for economic growth.

M&A Activity

The immediate impact of a reduction in confidence and increase in uncertainty is likely to be a pause in investment activity, including some M&A. Our clients' views on the impact on M&A are evolving. There is inevitably some macro reaction to investing in the UK at this time but clients are trying to look through that and understand the more nuanced issues about how targets will be impacted.

In general more domestic situations are seen as less likely to be affected whereas those with large overseas supply chains or significant overseas trade are more likely to be affected. Whilst we have seen some deals pause we have closed a number of M&A deals in the past week and the current pipeline of mandates appears robust. There is some evidence that overseas purchasers may see the decline in sterling as an opportunity to buy cheaper UK assets.

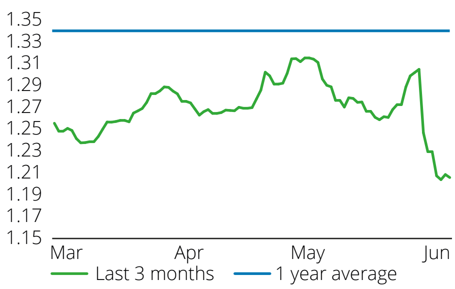
Debt markets

A key issue for how significant the implications of Brexit will be for the economy is the reaction of debt markets. If the availability of credit for consumers or corporates change significantly then the near term impact on corporates will be much more severe. Immediate feedback from our team is that the debt markets remain open for business and we are moving forwards to complete a number of mandates. Indeed some alternative lenders see this as a further catalyst for the move towards non-bank lending.

Currency markets

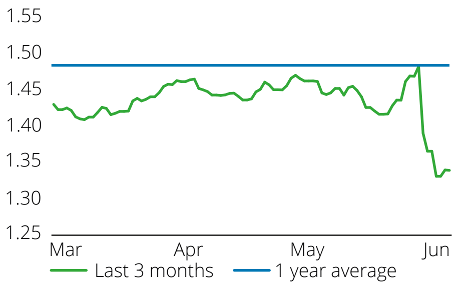
The foreign exchange markets have also reacted strongly. Against their last 12 month average the Sterling to Euro and Dollar exchange rates both closed down c. 9.8% on 29th June 2016 (see below). We would expect a decline in sterling to lead to higher inflation which could be countered by interest rate rises. A rise in interest rates at this time would be very challenging for the economy and it actually appears that the Bank of England is more minded to cut rates. There is also talk about policy responses to support the economy to limit contagion type issues.

GBP EUR FX Rate



Source: oanda.com

GBP USD FX Rate



Source: oanda.com

Impact on different sectors

Not all sectors will be significantly impacted by Brexit and we believe that the impacts will be felt over a number of time horizons. In particular in terms of whether distress emerges we believe that:

- In the next 3-6 months businesses are most likely to encounter distress either if they are exposed to unhedged forex risk that impacts trading or financial covenants or alternatively if they were progressing a stressed/distressed M&A transaction or debt refinancing that has been halted.
- In the following 24 months as Brexit is negotiated the trading impacts of any weakness in consumer confidence or business investment will be felt through covenant issues or liquidity challenges. There will of course be export led businesses which see strong benefit from sterling depreciation.
- Post Brexit implementation the impacts of different trading regimes in goods, services and financial services will be felt alongside any changes in EU subsidy arrangements.

We have analysed the share price share price movement of different sub sectors or constituents of the FTSE all share between the close on the 23rd June 2016 and 29th June 2016.

In the travel sector airlines have shown substantial falls (c.30%). This illustrates the exposure to exchange rates as airlines pay for aircraft leasing, maintenance and fuel in $ but earn revenue in £ or € and to consumer demand. Other travel and leisure companies also show falls (c.6%) but this is more likely to reflect the changed sentiment towards the domestic UK economy.

Similarly retailers that source product in $ but earn in £ and cannot pass the cost increases through to customers will be impacted if unhedged. The declines in the stock market point to these affects with general retailers (c.13%), which frequently source overseas in $, falling further than the food retailers (c.2%).

As evidenced by the substantial share price falls the financial services industry and banks in particular (c.25%) are likely to be most affected by the changes in regulation as a result of Brexit because of potential changes in passporting rights, regulation and capital requirements, the impact of lower interest rates on their lending margins and lower domestic economic growth. However, without a clear view on the future framework it is impossible to judge the extent of the impact.

The real estate sector has seen substantial falls in share prices (c.17%) particularly amid concerns over London commercial and residential development and investment valuations given Brexit risk. Critically developments not yet started have the potential to be delayed pending greater clarity around the political and economic landscape with consequential impacts on construction. The decline in sterling does appear to create an opportunity for some overseas investors which acts as a counter-balance.

Other businesses will be impacted by changes in EU funding, for example agriculture is a major recipient of EU subsidies which will cease on exit with no clarity on any replacement funding. That uncertainty is likely to impact investment and land prices prior to exit.

The automotive sector is heavily exposed to the future trade arrangements. There is unlikely to be immediate impacts given investment cycles but medium term there could be a real impact on automotive activity and the associated supply chain. There are, however, very few quoted UK companies in the automotive sector.

Priority responses

Our conversations with clients are covering a broad range of areas. The key themes we expect to emerge are:

- *Treasury Management* – Responding to the impact of changes in exchange rates and hedging costs.
- *M&A Outlook* – Responding to the changed circumstances and its impact on existing M&A activity or strategy.
- *Performance Improvement* – Where an M&A process has stalled companies are focusing on improving cash flow to growth value or in some circumstances avoid distress.
- *Supply risk mitigation* – Groups are assessing their exposure to the risk that elements of their supply chain may be exposed by Brexit.
- *Location strategy* – Brexit is causing companies to assess whether the UK is the right location for their business or future investment.
- *Managed exit* – Where companies are considering exiting an element of their activities which may require evaluating and implementing a solvent wind down.
- *Financing Options* – Addressing debt raising requirements or managing the impact of financial covenant breaches or liquidity shortfalls.
- *Financial distress* – Where the direct or indirect consequences of Brexit are causing a threat to survival.
- *Investigations and disputes* – Where as a result of the various changes leading to re-writing and re-negotiation of contract and resultant disputes.

Key Contacts

Please speak to your local or sector contact or alternatively speak to the following leads.

- Treasury Services – Karlien Porre
- M&A Outlook – Paul Lupton, Ross James
- Performance improvement/Value creation services – Jason Caulfield, Mo Habbas, Jas Sahota
- Supply risk mitigation– Dom Wong, Angela Lloyd-Taylor
- Location strategy – Nigel Shilton, Martin Laws
- Managed exit – Richard Hawes, Rob Harding
- Financing options – Fenton Burgin, Henry Nicholson
- Financial distress – Nick Edwards, Dan Butters
- Investigations and disputes – Mark Tantam, Simon Cuerden

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