

## Star names stoke interest in cash shell comeback

### News analysis

**High-profile hires help to convince investors to back companies that have no assets and no earnings, writes Lina Saigol**

At the height of the 1720 South Sea bubble, a company “for carrying on an undertaking of great advantage; but nobody to know what it is” floated on the Stock Exchange.

Nathaniel Rothschild has inherited that principle.

The financier announced plans last week to raise £600m by listing a “cash shell” called Vallar on the London market to fund acquisitions in the metals and mining industry.

The move comes four months after entrepreneur Hugh Osmond raised £417.7m through the initial public offering of his Horizon Acquisition Company, which intends to buy a single company.

Vallar aims to target companies with an enterprise value of up to £5bn, while Horizon is looking at companies worth between £1bn and £3bn, including debt. In April, Horizon said it was in talks with a number of companies, including house-builder Crest Nicholson.

“These structures are designed to take advantage of the dislocation in the markets to acquire asset-rich companies in the aftermath of the financial crisis,” said George Maddison, vice-chairman of Credit Suisse, the bank that created Vallar and Horizon.

Cash shells are purposebuilt vehicles with a stock market quote and a board of directors, but no active business.

They were originally used for husks of old public companies that had lost their purpose, but still retained a public quotation. To revive the flagging shares, management were told to find a successful private company the shell could reverse into.

“Investors seeking access to above-market returns are backing proven asset managers and operators through their cash

shells. Expect more to come,” says Philip Noblet, head of multi industries mergers and acquisitions at Bank of America Merrill Lynch.

The structure gives managers a ready made stock market listing and creates an acquisition currency at a time when the cost of bank debt is high.

To convince investors to back a company with no assets and no earnings, cash shells typically have strong management teams with specific sector expertise and a proven record.

“Cash shells are a really interesting form of fundraising because they allow industry figures to compete with private equity by generating cash in hand,” says Tom Franks, corporate finance partner at KPMG.

“However, it is likely that

‘Cash shells allow industry figures to compete with private equity by generating cash’

they will be rare because they need high-profile names behind them and the capital in place to float the vehicle,” Mr Franks cautions.

Mr Rothschild, for example, co-founded Vallar with James Campbell, who has 35 years of experience in the mining sector, having been a managing director at diamond group De Beers and a former non-executive director at Ferrous Resources, the developer of Brazilian ore mines.

Similarly, Mr Osmond recruited Michael Fairey, formerly deputy group chief executive of Lloyds TSB and Denise Kingsmill, a former deputy chair of the Monopolies & Mergers Commission, to the board of Horizon.

Hiring such high-profile names, however, can prove costly. Both Horizon and Vallar are charging an annual management fee of 0.5 per cent, with a 15 per cent share in any upside once investors have seen a return of 25 per cent over four years.

Critics of cash shells argue that they are nothing more than a fee structure in search

of a business model.

But the fees are still much cheaper than those charged by private equity groups and hedge funds, which typically take a management fee of 1-3 per cent of the fund and a profit-sharing or “carry” structure of 20 per cent of the proceeds.

Still, a strong management team does not guarantee success for cash shells. Some investors remain wary of relying on the intangible talents of managers, rather than more traditional accounting metrics, when looking to do deals.

Knutsford is a case in point. In 1999, shares in the Aim-traded cash shell rose from 4p to 240p after a group of rain-makers including Archie Norman, Nick Leslau and Nigel Wray joined its board.

Investors had hoped that Mr Norman, who led a recovery at Asda, would perform an encore on ailing retailers such as Marks and Spencer or J Sainsbury.

But when the dotcom bubble crashed, so did Knutsford’s dreams.

Experiences such as Knutsford have forced shareholders to become more vocal and the stock market rules were changed to require all cash shells to publish their business strategy in flotation documents.

Transparency will help financiers looking to launch cash shells, but timing could matter more. When asset valuations start to rise, the opportunity for these acquisition vehicles will disappear.

### Tentative revival under way

Cash shells were all the rage on Aim five years ago, arriving in such numbers that the Stock Exchange was forced to tighten the rules to safeguard the junior market’s reputation, **writes David Blackwell.**

While they have started to make a comeback, the numbers remain small when compared with the boom times. In March 2005, 31 cash shells rushed to market to beat the introduction of the rule changes in April.

The rules stipulate that a cash shell must raise a minimum of £3m, a figure deemed high enough to require at least some institutional interest. In the first quarter of 2005, 68 cash shells joined the market, but only four raised more than £3m.

The LSE watered down plans to suspend shares in shells if no deal was completed within 12 months of the float. Instead, if 12 months pass without an acquisition, shareholders must vote whether the shell should continue to exist.

One of the most recent arrivals is Q Resources, which raised £3m in April and has ambitions to build an African mining group. It

is the second vehicle backed by Gazprombank-Invest, the investment bank that brought Cove Energy to market last year at 12p a share. Shares in Cove, an African oil and gas group, closed yesterday at 55½p.

Others include Digital Barriers, which raised £20m in March and has made a £2.5m acquisition as it starts to build an IT security business, and Northwest Investment, incorporated in the British Virgin Islands, which raised £3m and is looking to invest in the hydropower market in western China.

However, the king of the Aim cash shell is Marwyn, which last year launched its 13th and 14th versions in Marwyn Capital I and Marwyn Capital II. This month Capital I, which initially raised £5m at 10p a share, announced its reverse into Fulcrum, the gas transporter arm of National Grid, and plans to raise up to £11m at 12p a share. Marwyn’s past investments include Melorio, the vocational trainer that is being acquired by Pearson, the owner of the FT, and Entertainment One, the television and film group that is joining the main list.

### Recent shell company floats

Vallar	Horizon	Sherbourne Investors	Digital Barriers*	Marwyn Capital I**	Marwyn Capital II	Q Resources
Market cap <b>To be confirmed</b>	<b>£416m</b>	<b>£105m</b>	<b>£34.7m</b>	<b>£9.9m</b>	<b>£6.1m</b>	<b>£8.9m</b>
To float <b>Jul 2010</b>	Floated <b>Feb 2010</b>	<b>Mar 2010</b>	<b>Mar 2010</b>	<b>Dec 2009</b>	<b>Dec 2009</b>	<b>April 2010</b>
Intends to raise <b>£600m</b>	Money raised <b>£418m</b>	<b>£105m</b>	<b>£20m</b>	<b>£6.2m</b>	<b>£4.9m</b>	<b>£3m</b>

Sources: companies; Bloomberg

\* Acquired Security Applications Limited for £2.5m in March 2010

\*\* Has conditionally agreed to acquire Fulcrum Group

Photo: Reuters