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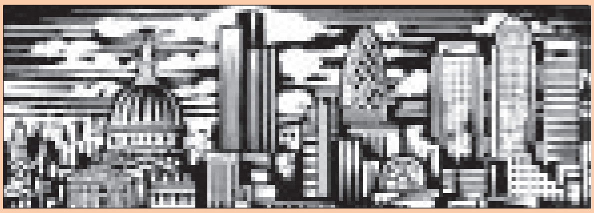
Melrose's Place



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One man's loss is another's gain. The government's new pensions legislation, making it harder for companies to duck out of funding responsibilities, has created an unusual arbitrage opportunity for Melrose, the cash shell led by Christopher Miller and David Roper: two characters in search of underperforming businesses to buy.

It launched a hostile bid last autumn for lacklustre Novar but was pipped by Honeywell. Now it has bounced back to buy two engineering companies - Dynacast and McKechnie - from private equity house Cinven and others for an enterprise value of £429m, or a reasonable 10.9 times historic earnings.

Cinven, booking a profit on Dynacast but a write-off on McKechnie, will be largely getting cash but will hold 15 per cent of the equity for the upside. For deal anoraks, this is salivating stuff, combining elements of a reverse takeover, a management buy-in and an accelerated initial public offering. But the most interesting aspect of the deal is the way it solves a pensions problem for Cinven at McKechnie.

When it bought the company, the scheme was in surplus. Now it is some £60m in deficit under the FRS 17 standard and the trustees have strong powers to set the contribution rate.

Cinven originally intended to sell off the various divisions to trade buyers but the government's pensions legislation has put a damper on that: the resulting liquidation of the holding company would have required the pension fund to be financed on an extremely expensive buy-out basis.

Selling to Melrose solves the problem. It has agreed with the trustees to double the contribution rate over next five years. In return for that, and the greater comfort of the sponsor being a quoted and not heavily leveraged business, the trustees have agreed to the company having a say in contribution rates.

It is a neat deal but it underlines how much harder the pensions legislation has made it for private equity houses to do deals involving companies with pension issues.