



What lies over the horizon?

For all those people who predicted a year ago that the private equity universe would have (at least partially) recovered by the end of 2011, I'm wondering who is now pointing at the end of 2012... or 2013... or whenever the debt refinancing tsunami is going to hit...

Aside from over-analysing the continuing malaise within private equity, it is interesting to look behind the curtains

and see what drives events. For example, a number of exits being trumpeted as signs of a recovery are really nothing more than some houses trying to convince reluctant LPs to invest in new funds by demonstrating that investments in the old funds are not completely illiquid. It's the "here is a small cheque, now please give me a big cheque" strategy. Some have commented that the bulk of secondary sales are nothing more than churn, again to give the appearance of activity.

On the positive side, however, the emphasis on stronger management teams (particularly those with turnaround skills), coupled with the invaluable experience being gained by investment directors tasked with working ever more closely with (or within) their portfolio businesses, should position the industry with a solid foundation once a new market equilibrium is reached. One day, hopefully very soon, today's investment directors (who bemoan their lack of positive carry and feel that they unjustly 'missed out') will see this period as the principal reason why their future carry will truly have value.

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Pilot's Log Q&A

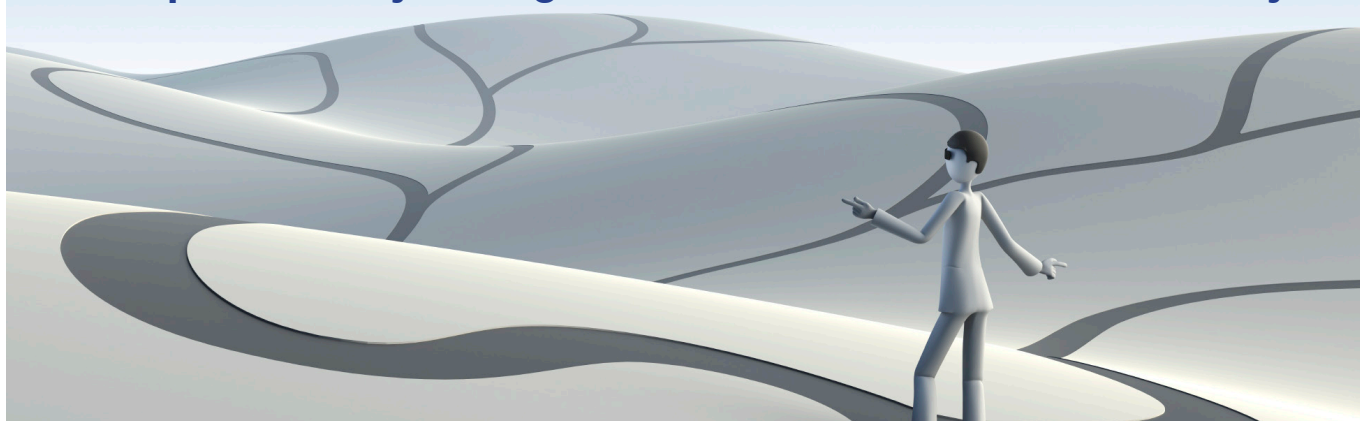
James Wheeler sat down for a spot of lunch and a chat with [Andy Etherington](#) a distinguished interim CEO with an individual approach to complex change, turnarounds, acquisitions and disposals for private equity investors. [Page 9](#)



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IFRS update – key changes on the horizon that will affect you



Chris Smith is the Partner who heads up Grant Thornton's Financial Reporting Advisory Group ("FRAG") which specialises in helping companies find their way through the myriad of different accounting rules and standards. FRAG can help with training or providing accounting assistance and advice and has particular expertise in IFRS, UK GAAP and Japanese GAAP.

Financial reporting never stands still so nobody should be surprised by the relentless charge towards further change over the next few years to both UK GAAP and International Financial Reporting Standards ("IFRS"). Covering each change would probably require a book as large as the accounting standards themselves. In this article, therefore, we highlight some of the key changes that private equity firms should be looking at, both from an investor and an investee's perspective.

Say goodbye to UK GAAP

Broadly speaking, UK GAAP as we know it is likely to disappear, to be replaced by a cut-down version of IFRS otherwise known as the FRSME ("Financial Reporting Standard for Medium Entities"). The standard is currently being finalised and is likely to be somewhat different to full IFRS – for example previous drafts would have prevented entities from capitalising R&D costs which was an issue for many technology companies. A final draft is to be published later this year/early next year with an implementation date likely to affect 2014 December year-ends first.

Further details of the project's status can be found at:
<http://www.frc.org.uk/asb/technical/projects/project0072.html>

I would strongly recommend that you read the next draft and respond to the ASB with any of your concerns. Throughout the consultation period to date there has been vigorous debate and the ASB has recognised the concerns raised and the next draft is expected to take many of those concerns into account – i.e. the next draft will be different.

Once the final standard is published investee companies will need to assess whether they should be looking to adopt the FRSME or whether they should be moving towards full IFRS as used by listed companies.

Key considerations will be the impact of the FRSME compared to full IFRS on reported earnings and the balance sheet. Companies will need to consider, for example, tax and dividend implications – as well as the impact on loan covenants. For some companies who already report internally to parent companies under IFRS for group consolidation purposes, full IFRS might seem the easiest option. All I would say is it's best to review the options first as once one form of GAAP has been adopted it is very difficult to change it at a later date.

New rules on consolidation

Under IFRS – IAS27 to be precise, shortly to be replaced by IFRS10 - private equity companies often get caught by the concept of control and are required to consolidate their investments – usually on the basis that they either have a majority shareholding or have strategic control, or both.

Interestingly, when drafting IFRS10 the IASB listened to feedback from the investment community and recently published an exposure draft for investment entities which, if certain criteria are met, may mean that investments instead of being consolidated are measured at fair value with movements being taken through profit and loss.

Clearly this introduces a level of complexity around the measurement of fair value – and associated disclosures - but from the simple perspective of preparing financial statements, not having to consolidate investments should make the year-end process a lot easier. It should make the financial statements more useful to users as well which must be a good thing.

The qualifying criteria that are being discussed to get out of consolidation are currently as follows:

1. the entity's nature is such that its only substantive activities are investing in multiple entities to achieve capital appreciation, earn investment income, or both;
2. the entity's business purpose is investing to earn capital appreciation, investment income, or both and it makes an explicit commitment to investors about this;
3. investors own units of investments (e.g. shares or partnership interests) in the entity;
4. the entity pools the funds it receives from its investors, so that the investors can benefit from professional management;
5. the entity manages and evaluates the performance of its investments on a fair value basis; and
6. the entity provides financial information about its investment activities to its investors.

For the enthusiasts out there I would strongly recommend

that you read the Exposure Draft and respond by way of letter to the IASB as it's best that they know your concerns at the drafting stage rather than after the final standard is released. <http://www.ifrs.org/Current+Projects/IASB+Projects/Consolidation/IE/Investment+entities.htm>

Lease accounting for lessees – everything's coming on balance sheet

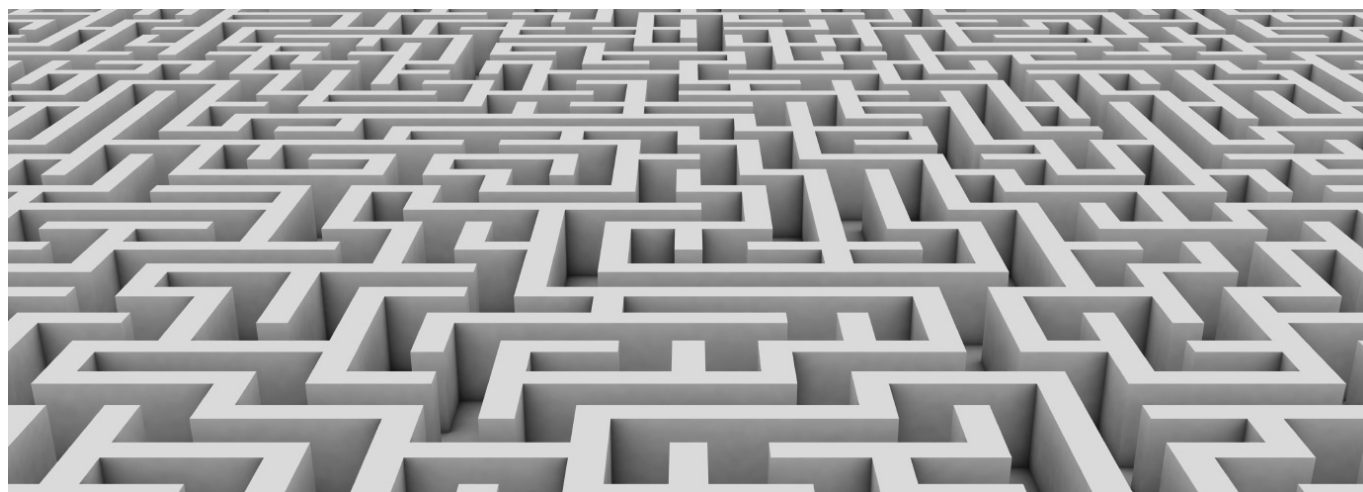
Currently IFRS requires lessee companies to consider whether for lease agreements substantially all the risks and rewards incidental to ownership have been transferred. If the answer is yes then it's a finance lease, if it's no then it's an operating leases.

The proposed new standard removes this concept, replacing it with one based on a right of use. Simplistically, where there is a right to use an asset an entity is required to recognise an asset and with that asset comes a liability.

This fundamental change to lessee accounting means that the majority of leases will come on balance sheet which will have a significant impact on companies who have a number of leases (there is an exemption for certain short-term leases, being 12 months or less).

Sectors likely to be particularly affected include retailers (property leases) and airlines (aircraft). If you think that the lease commitments of the major supermarkets alone, for example, are estimated to be £45bn it is clear how significant the impact will be and how it will affect key performance indicators, e.g. debt-to-equity ratios, returns of capital as well as borrowing facilities and loan covenants.

Following numerous rounds of consultation a revised Exposure Draft is expected later this year with a final stand-





ard sometime in 2012. It should be noted that the debate on lessor accounting continues as the original proposals raised a number of concerns and at this time it is not clear whether the model based on right of use will be used or whether the current model based on risks and rewards will be retained.

Further details of the project's status can be found at: <http://www.ifrs.org/Current+Projects/IASB+Projects/Leases/Leases.htm>

To date this fundamental change, whilst much debated within the profession and amongst lessors, has not been on the radar of many lessees. It should be.

Revenue recognition – when can revenue be recognised?

Proposed changes to the recognition of revenue under IFRS could have a significant impact on a number of companies, particularly those in the technology and service sectors.

Simplistically, the current underlying principle to recognising revenue under IFRS is whether significant risks and rewards have passed. The proposed standard requires that revenue should only be recognised once control has passed. This might sound like a small change but it could have a material impact on the timing of revenue recognition as it isn't always easy to define when control has passed, for example, when a product or a service is being delivered over a period of time.

The current plan is for a revised draft standard to be issued later this year with a consultation period of 120 days. The final standard should then be issued in 2012.

Again, I would strongly recommend that the document once published is reviewed and responded to. The current status of the project can be found at the following link: <http://www.ifrs.org/Current+Projects/IASB+Projects/>

Revenue+Recognition/Revenue+Recognition.htm
With all of the above changes the key is to understand not just how they will affect you once effective, but what it is that needs to be done in advance. For example, long-term leases being negotiated now will in the short-term continue to be accounted for using the old methodology. That accounting, however, will look very different in a couple of years time. When negotiating that lease, therefore, is there anything that can be now to mitigate the impact over the next 5, 10 or 15 years? Also, changes to accounting standards often require retrospective adjustments – i.e. adjusting previously prepared financial statements – giving rise to a material change in financial track records.

Whilst I wouldn't quite say, to borrow a phrase, everything you know is wrong, everything is going to look different and you need to be on top of the changes before they get on top of you.

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Chris can be contacted at:
T: +44 (0)20 7728 3446
E: chris.smith@uk.gt.com

When a good plan comes together



David Hall

Dave Hall, Managing Director of YFM Equity Partners, speaks to Katherine Steiner-Dicks on how the firm's re-branding exercise was not as painful as expected, but rather useful; how the firm empowers management teams from the start and how a portfolio of 200 companies has lent a broad sector outlook on deal opportunities across the UK.

Interview by Katherine Steiner-Dicks

Formerly known as Yorkshire Fund Managers, the firm has been re-branded YFM Equity Partners. What did the re-branding process teach you and the team about the firm's ethos and investment strategy and how both of these have transformed over the past three decades?

The re-branding process was not as painful as I thought it would be. I didn't spend nearly as many thousands of pounds or millions of hours looking at logos as I expected and the process was actually instructive. It gave us a chance to talk to all our stakeholders, investors, advisors, non-executive directors to name a few, which was very useful because it informed us about our business.

We learned that whilst the finance we provide is important to people, this is only a part of what makes a company decide to select us as an equity partner. Chemistry, in addition to the way that you and your staff interact with

a company's management team, is crucial. In fact, the chemistry developed in the initial stages has a huge impact on their decision process when it comes to selecting an equity partner.

If you were to encapsulate your firm into identifiable qualities, which would people associate with YFM?

The first quality would be empathy - the ability to listen rather than to talk. Another quality that has also been identified through the re-branding process is our team's ability to show a demonstrable interest in a company's business. People also place importance on speed of reaction. But that doesn't mean it has to be quick, just getting back to them in the time that you have committed to.

The other thing that came through in the process was that management teams feel that they are dealing with real people who understood their business; people that can bring the necessary long-term experience in maximising the value of a small and fast growing company.

YFM Equity Partners has a wide-net sector approach. What benefits does this greater flexibility have? And what challenges can arise for your regional teams?

We do have over 200 investments, across a diverse range of sectors. Having this number of investments alongside more than 100 successfully realised investments brings a wealth of experience to any deal, which is recognised by small businesses. We have dealt with pretty much every sector and also have specialists that we can bring in. For example, we introduce a non-executive chairman that will already have operational experience in their sector. This adds a layer of confidence for the management team since they

have someone to turn to who will not only understand what the operating market risks are from day one, but also know how to respond to those market changes and challenges.

However, marshalling all the knowledge throughout our regional offices has been a challenge. We now have specialists throughout the country whose expertise can be brought to bear on any investment opportunity we receive. In fact, one of our own investments, Chippenham-based VQ Communications, has been instrumental in enabling our regional teams to interact internally and with investee companies when specific operational or sector expertise is required through video conferencing, a technical investment that has really paid off.

Where in your opinion are the best sources for proven interim or permanent senior talent in your early and later stage investments?

Clearly, being around for 30 years means we have made and realized a lot of investments. Because of that we have close to 400 direct contacts from whom we can draw sector experience. We also run specialist sector events in healthcare, telecommunications, software and retail where we encourage contacts to 'bring a buddy'. Over the years we have also used organisations such as Pilot, when we have very specific sector requirements.

Given the number of investments, how are you ensuring milestones and targets are being met while at the same time empowering management to take the reins from the onset?

The first way we can empower the management is by ensuring that they have more than adequate finance to support what they want to achieve. All of our deals are about giving companies equity headroom to enable them to cope with structures, such as covenants, that the banks can place on them. Our early talks with businesses are a



lot to do with how they are going to maximise the value of the business and how our money can be best utilised to achieve that.

The second thing we do is introduce non-executive chairmen from their industry, i.e., people that have already done what the management team sets out to achieve. We like to help the management team look six months ahead, rather than six months behind so they are prepared for the tough decisions, which usually entails management changes. Lastly, we make sure that we are aligned with their objectives, which we find can be done through open discussions that address not only their objectives, but ours.

And is this early process usually the time that you might bring in interims?

We usually bring in interims for project-based work. For example, if the company was going to be sold quickly or is considering a change in the direction of the business, you could put in an interim to handle a particular role.

In the current environment does YFM look for deals where there is a turnaround or major structural change to engage with?

We don't generally use the phrase turnaround in our business. There are times when businesses are further away from realising their value than others. There are also times when management must go through changes they didn't anticipate and this is when an interim could help.

We do have a bit of money aside to invest in turnarounds. We put that money into vehicles so we can invest quickly. We set up a fund about nine months ago, but we have not found any takers for the money. I have three people assessing turnaround opportunities on a geographic rather than sector basis. It is however a very small part of our business and accounts for less than 3% of what we have under management.

If deals are hard to come by, which market drivers do you believe will put more deals into the marketplace?

There is not a pattern in terms of deal flow. It has a lot to do with the fact that to get the deal done, you need the banks to write off some of the money. At the moment, that just isn't happening. What we need is a good tick up on interest rates, which we won't get for a while. But when we do, the banks may be more inclined to have more people defaulting due to the rise in interest. For the time being, the interest rate situation is benign, so most people can service the interest even if they cannot repay the capital.

Are you seeing companies struggle if they have a high dependency on government funded supply chains? If so, are they being pushed to reconsider targeting new markets for survival?

There has been a real mix in terms of dealing with the public sector, which is not a homogenous entity. We have a business that, for example, supplied into the Ministry of Defence. When there were government changes in early 2010 there was an MOD spending review. At that point of the investment we anticipated there would be a four month hiatus. In the event the MOD didn't place any orders for nine months therefore the company proactively decided to re-examine its strategy. But after the nine months was up, the MOD turned the taps on and there were orders coming out of their ears.

How did the company prepare itself in the hiatus period?

At some point the MOD spending review had to finish, and it would produce something, the question was just how much. The company started to look at other companies in their sector either to merge or to acquire. In an economic slowdown it is often an ideal time to build market share, especially if you are taking a five year view. The company went down that road, but in the end they had to re-focus on hiring and re-hiring people to take up the slack from the new MOD orders that were coming through.

As another example, we have an investment supplying the NHS, which is effectively supplying to the PCTs (primary care

trusts) and GPs. That has been a very difficult landscape to plot though. The spending was always going to change hands from the PCTs to the GPs, but this change over was slowed down due to yet another review. This hiatus and lack of commercial commitment has resulted in the company trying to expand its customer base overseas.

We also manage a small fund in the public sector and the contract was frozen since it was through the development agencies. The assets in that fund are now frozen, which are all in non-listed companies.

The overall level of NHS spending in four years' time is likely to be the same level it is today due to all the moratoriums. The public spending won't be going away, it's just being deferred. Businesses need to ask themselves how long they can survive while working through the hiatus.

The bigger challenges can emerge where there are policy changes. For example, in the case of the Department for Work and Pensions, which historically has had something close to 400 suppliers, could soon bring this number down to as low as six national contracts. This will be done through a large sub-contractor, most likely one of the big multinationals. Rather than the government working directly with the supply chain, the relationship has been watered down through the sub-contractor. The government's process of procurement streamlining is creating a lot of change in small businesses since they are unsure where they sit in the supply chain.



Has public sector exposure to any of your portfolio companies meant that you have had to pad up existing investments to keep them afloat during this period of uncertainty?

I have given you some of the most extreme cases of economic or public sector changes on company profits. In many cases, companies have gone through a challenge, but it has not been unmanageable. Many of these companies have come through it and become stronger businesses as a result. It makes them look at how they manage themselves and actually how efficient they really are.

Across the board we have not had to put in significant money into portfolio companies for, say, breaching bank covenants. We have been funding the portfolio over the past two years so that our investees can go out and buy other companies in their sector while pricing is attractive. By not over-leveraging our portfolio the management teams are more able to focus on building market share and value in their businesses than re-negotiating the terms of their borrowing.

You are in the business of building SMEs to greater levels of growth via international expansion, management development, etc. Therefore, as a natural progression of a company's lifecycle does this mean your exit strategy includes the private equity secondary buy-out market?

We haven't done many, probably a smaller proportion compared to other firms in the market. We did, however, sell a third of our stake in one of our more high profile investments, Go Outdoors, to 3i - a business that we had held for 13 years. We are still sticking with it with the prospect of more value to be created in the medium term.

The realisations that we did last year equated to the same amount of money that we invested. This year our realisations are 25% higher than our investment rate, at £25m and £20m, respectively.

When, in your firm's experience, have interims within private equity backed companies been truly successful? Can you offer an example of how they achieved or exceeded your expectations?

Well, I always try to manage my expectations down, but there have in fact been a number of times that expectations have been exceeded. We did have a business service logistics investment whereby we brought in a new chairman and then six months later brought in a new CEO. The business was poised for growth, but that growth had exceeded

its existing management. It was a close call whether to sell the business or manage the risks at that point and pursue even more expansion. In the end, we decided to keep with the company.

What was exceptional about this CEO was his capacity to take a complicated series of problems and distill them down to two bullet points that everybody could understand. That brought immense clarity to the issues in the business around which the decision making could be focused. That set for him the operational strategy. He was complemented by the chairman's strength in recruiting the right management to see those strategies through.

Have management consultants or interims been more effective in your portfolio companies?

An interim rather than a management consultant is a person that can come in and listen to the problem and implement the changes to solve the problem, which is highly effective. We get much better use out of an additional non-executive director or chairman since they will have some skin in the game.

Dave Hall runs the YFM business and chairing Investment Committees and Portfolio Panels. He has been Managing Director of YFM Equity Partners since 2003 after heading the Manchester office for three years. He was previously a Director at Enterprise Ventures, the investment arm of Enterprise plc. He is a Wigan Athletic supporter and real ale enthusiast.



PILOTpartners sat down with busy turnaround CEO **Andy Etherington** in between assignments for a quick but quiet City lunch.

Andy Etherington is a distinguished interim CEO with an individual approach to complex change, turnarounds, acquisitions and disposals for private equity investors – both in the early stages

of sorting out the mess as well as the recovery into growth and delivering optimal value for stakeholders. His experience since he became known to PILOTpartners has encompassed successes especially in retail/consumer and specialist healthcare after an earlier career in oil & gas, consumer electronics and leisure. Andy is bi-lingual in German and when he is not camped out on assignment somewhere he lives in rural peace and quiet in Suffolk.

You have been a successful interim for some eight years now. How did you start your freelance career turning round private equity owned businesses?

Almost by chance. I came out of corporate life to bring my business building and change management skills to a private equity leveraged company in the healthcare sector. After a successful exit of this business, I was invited to undertake some advisory work, which in turn led to turnaround roles. What I enjoy most, is the variety of situations I am parachuted into.

You have done a lot of work recently in specialist healthcare and retail. Are there any links in these markets as far as managing a turnaround are concerned?

There are. Turnaround skills are like a briefcase full of tools, which are easily transportable and transferable across industries. Healthcare and retail have similarities and dissimilarities. Both are multi-site, open all hours, deliver a product or a service through many people, have reasonably high barriers to entry, have high capital expenditure and are fiercely KPI driven. The environment is, of course, utterly different. One sector is highly regulated, and does not respond to the advertising and promotions ‘tap’ in the way that the other might. In the healthcare sector the staff are dealing with highly vulnerable people, consequently personal levels of responsibility that the staff carry are far greater than in retail. A different management style is therefore required in the healthcare environment than in retail and consumer. The turnaround manager must be highly sensitive to this and must have the ability to adapt accordingly.

I have heard it said that all turnarounds are basically the same: you need cash, management and a plan. One knows what they mean, but do you think this is true?

In general, turnarounds work with universal principles; they all need analysis, careful cash management, cost control, a defined strategy, income generation and strong directional management. The questions are always:

- What’s gone wrong?
- How long is the ‘runway’?
- Can costs be substantially reduced and quickly?
- What is the desired outcome and what is the plan?
- Where are the untapped and undeveloped opportunities to generate extra cash quickly?

- Is the management team part of the problem or part of the solution?
- What is the customer base, fragmented or consolidated and what is the creditor profile?

In all cases decisions need to be good and they need to be made fast. Each situation, however, has its quirks, so your plan in Company “A”, is unlikely to translate in a linear fashion to Company “B”.

As a provider of turnaround expertise I am sometimes baffled by the stakeholders' expressed absolute requirement for an executive with a matching sector background. Your experience across many broad sectors would seem to run against this...

I genuinely believe that an executive's background gives him or her a briefcase full of skills and experiences, which are transferrable across industry sectors. My experience demonstrates this: consumer electronics, retail, leisure and the healthcare sector. The individual has to be flexible, adaptable, resilient and able to assimilate information quickly. A turnaround manager must be highly financially literate and financially focused. He must have a solid understanding of sales and marketing, and HR. Crucially, he must be able to manage and motivate people. Turnarounds may be led by one individual but he must have the ability to bring people along with him. One person alone cannot accomplish the turnaround, you need the workforce to act. If the manager has these pre-requisites then he should be able to stretch his expertise across industries.

It helps if the sectors have parallels in common; this allows the turnaround manager to move up the learning curve of the new sector quickly. For example, a multi site funeral services business has parallels with a multi site retail chain, an hotel chain with a multi site serviced office business.

Whereas I am often asked to provide a shortlist for a turnaround very early on, I know you have an issue about being brought in too late. When is the right time for you to step in? Too early and there will be too many intractable management or shareholder issues to resolve. Too late and...

Technically, a turnaround situation may be defined as a company that has become loss making and is on a downward spiral. There are usually signs of stress long before the company becomes distressed, by crossing the line from profit to loss. However, management is often in denial of the situation, sometimes the investors are too. This hinders the recognition



of reality. If the shareholders or debt provider could recognise the signs early and act, by putting in a CRO quickly, then there would be a far longer “runway” to effect a sustainable turnaround. The returns would thus be greater for all parties.

All too often this decision is delayed, by management engaging in rebuttals of the gravity of the situation, probably because they have a lot to lose: their jobs, pensions, their investments and reputations. This can lead to irrational and increasingly risky decisions. Like the gambler who fervently believes that the next role of the dice, or spin of the wheel, will be in his favour, management continue to fudge the numbers, because (they believe) salvation is just around the corner. The problem is: the corner is never turned and tomorrow never comes!

Sometimes the decision to put in a CRO comes so late, that a sustainable turnaround is no longer a realistic proposition. Understandably the debt provider starts losing patience, they need to recover their investment, rather than an unplanned administration. The best possible outcome for creditors is an accelerated M&A, often by way of a breakup of the business, a trade and assets sale close to a ‘fire sale’ price, or a pre-pack sale, with all stakeholders losing something.

Recognise the signs early. Same as when sailing yachts, the time to put a reef in, is when you first think of it. As the wind strength increases, do not delay until the tempest is upon you! The time to put a CRO in is when you first think of it! Do not wait until the slippery slope has taken you to the edge of the abyss.

From your recent experience, can you describe some of the different ways you have managed to resolve seemingly intractable management or operational issues?

Once you have a plan, you deal with intractable issues with firmness, but not arrogance, with constructive not destructive criticism. You need clear guidelines with defined targets

and timelines. Once the direction is set, it is surprising how well people tend to respond and how anxious they are to make a positive difference. There are occasions, when you have to be firm and resolute in your approach, as there simply is insufficient time available to debate matters.

In one of my assignments management were clinging to a recent acquisition, which turned out to be loss making due to reasons which should have been identified during due diligence. Two years later, they were still trying to resolve the problem, unwilling to accept that their original decision to purchase was flawed. They poured effort into the acquired business, not concentrating on the core business in which cracks had appeared. As the independent manager I had to clear the fog, and help them see that the only realistic solution was to divest them of this ill fated acquisition, enabling them to concentrate on the greater prize: the core business.

I know you have had experience of handling cases where there have been multiple stakeholders with opposing views and seemingly entrenched positions. Can you give examples of these and explain how you have resolved these issues?

The usual stakeholder groups tend to be the major investor, the bank debt provider, staff, senior management/directors (who may have some of their own money at stake), customers and sometimes trade unions. As I have mentioned earlier, management are often in denial of the gravity of the situation.

As an independent outside manager, you have no entrenched position to defend, you do not have to pay heed to internal politics, you owe no favours and neither are you worried about job security. Consequently you can be dispassionate. It is easier for the independent manager to remain focussed, calm, take a detached view and call it how it is.

If a division should be closed, the independent manager can call it, he has no vested interests, there is no loss of face, it is a business decision in the light of the facts. Often it can be very difficult for the incumbent management team to take such a dispassionate view.

Slightly outside the normal ambit of an interview in these pages, Andy, and because the sector is currently very much in the public eye, could you talk through one of your most recent case involving your role as interim CEO of a provider of elderly residential and domiciliary care? As I recall this was completed under serious time pressures. And are there lessons here for other similar businesses currently in similar difficulty?

Yes there are. This was a business which had been established for a number of years, operating in the elderly care sector. Mistakes had been made, the business was under invested in, and poor financial controls had led to little visibility of the underlying financial performance.

The management team had not kept abreast of developments in the market place, placing too heavy reliance on one customer group, running at manpower plans (care hour plans) that were no longer sustainable. So, instead of generating profits to invest in the buildings and sales and marketing, what little profit was generated, went to fund inefficiencies.

Instead of "grasping the nettle" early, by restructuring the care hour plans and indeed closing inefficient and inoperable homes, management "fudged" the numbers, until the house of cards came tumbling down.

The money was going to run out in 120 days, so radical steps had to be taken. Care hour plans had to be drastically reduced to get close to industry norms, leading to redundancies. Homes had to be closed to increase the overall efficiency of the business and head office costs had to be slashed.

The various stakeholder groups were pulling in different directions. Staff were unhappy about the new processes and procedures, the main trade union was extremely hostile to any redundancies. The principal customer was not minded to agree to fee increases linked to cost inflation and local politicians were unhappy about job losses and home closures. Yet, costs were rising, occupancy was reducing and the company was making losses. Something had to give!

The lesson here is that the seemingly impossible can be achieved if you have a vision, if you can communicate the vision to the stakeholder groups and if there is strong leadership and direction, then management can be enthused to do something that ordinarily they might not wish to do.

Andy, many thanks for giving Pilot's Log readers the opportunity to look at the reality behind the CV. It seems to me that everything you have been talking about – your experience over the past couple of years – remains distinctly and poignantly the same right now. In a world of constant change some things never do...

Andy Etherington can be contacted at:
andy.etherington@tiscali.co.uk

Case Studies demonstrating how executives have contributed to successful exits

Whenever we meet clients as well as advisers and prospective candidates we are always asked, and are delighted to explain, our professional work in our niche markets through discussing case studies and the actions which have delivered successful outcomes.

Presenting summary case study extracts for PILOTcases has the approval of those concerned but to preserve confidentiality, names may have been changed or abbreviated.

It started as a business review and ended up as a fully blown, complex restructuring lasting 3 years

Having just completed a three year stint as interim turnaround FD of a £400m iconic leisure business PILOT's interim FD thought this one would be a brief walk in the park...

Private equity backed and FSA regulated, the group offered outsourcing solutions in general insurance to leading insurers, financial institutions and corporates, from seven locations with 600 staff.

Initially the task was to spend a few days to review the adequacy of financial management and reporting. This led to supporting the board in the development of a new business plan which would support a significant new fundraising from third parties and/or self sufficiency should the fundraising be unsuccessful.

The review also uncovered serious management malpractice so the interim FD was then the only man left standing and was tasked with implementing this turnaround plan. Prior year loss of £10m turned into operating profit and positive cash flow within six months. This was achieved through:

- renegotiation or cancellation of loss making contracts;
- closure of loss making subsidiary and developing a new operating model for another subsidiary;
- re-engineering of business processes and significant headcount reductions.

However, substantial legacy liabilities were then discovered forcing much of the group into administration. Further investment was made by the private equity fund to repurchase the profitable operations via a pre-pack. A new group was formed with the interim becoming semi-permanent (by now) CEO.

- Parts of the previous group's central services and IT infrastructure were purchased;
- Key staff were rehired and head office functions rebuilt (finance, HR, IT, compliance);
- Client contracts were renegotiated (not one client contract was lost).

With the group stabilised, profitable and cash generative, the private equity fund decided to realise their investment. After extensive due diligence the group was sold to an overseas investor delivering a fivefold return. The 'interim' CEO mentored the COO to take over as CEO.

And the moral of this one?...interim executives should never take a turnaround assignment at face value – the job will nearly always turn out be radically different to the way it was described at the initial interview (not PILOTpartners' fault...honest...)

And...when is an interim assignment a permanent job by another name? (No answer to that one yet...)

The CompAir Turnaround

Global compressor manufacturer, MBO bought for £1, sold to US corporation for £204m. Turnover £260m, PBT £18m.

An extraordinary six year turnaround by a well known management team in which the interim divisional MD assumed the key operational role. Annual losses of £20m converted into profit of £18m. This industrial division represented 75% of CompAir's worldwide business.

Ultimately the turnaround and successful exit was down to management, sales development, cost reduction and production efficiencies on an international scale...supported by a visionary stressed investor...

- Led radical and industry leading product development programme to create world class portfolio;
- Regained lost market share in European territories and grew new territories in East, Asia and North America;
- Rapid aftermarket growth through focused re-capture programme and enhanced direct service business model;
- Low cost sourcing to over 40% within 3 years; setup Chinese sourcing company;
- Loss making businesses and product sectors eliminated;
- Improved manufacturing efficiency through consolidation of capacity into Germany and China;
- Initial tasks in UK division: sold off 17 acre 'brown field' site; closed down facility resulting in 200 redundancies and transferred business to German subsidiary; disposed of all redundant stock and plant.

An object lesson for all investors and management teams who can't see their way through an intractable mess...

A sign of things to come?... how to keep a cool head and achieve a decent exit in spite of the world of fashion in turmoil

In this case it is interesting to note the role played by the interim FD in a failing mail order and internet fashion retailer where the management team all round him seemed to be hell bent on losing their heads...

This is a high quality Italian ladies fashion business, with gross turnover of £30m and 120 employees operating through its core iconic brands.

Working with the private equity owner and the bank's workout team, the role involved positioning the business for sale whilst ensuring that it traded profitably and generated cash throughout the process.

Given the disarray he found upon joining, it is not surprising that the interim FD took control of the warehouse and logistics function, IT as well as the finance team.

He led the sale process, commissioned PwC to produce the sale brochure, handled all the due diligence from prospective buyers and led sales presentations. Resulting in:

- A successful sale achieved within very tight timescales laid down by the private equity fund;
- Introduced revised commercial metrics into the business to reflect the growth required from internet retailing;
- Produced a fully integrated 3 year business plan and cash flows.

Interim FDs are not merely the stewards of the cash book and purveyors of impenetrable reports to stakeholders...they understand the dynamics of a failing business outside the finance function and manage short term plans to improve and stabilise it so that an exit is optimised.

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PILOTpartners is again grateful to the contributors to this edition of Pilot's Log:

Dave Hall, Managing Director of YFM Equity Partners, shares with us the experience of rebranding Yorkshire Fund Managers, how they interact with management teams and how having portfolio of 200 companies gives them a unique insight into the UK marketplace.

Chris Smith, Partner with Grant Thornton who heads up their Financial Reporting Advisory Group, provides us with a timely update on IFRS and the ramifications of UK GAAP being phased out - key changes that private equity firms should be looking at, both from an investor's and investee's perspectives.

Andy Etherington, a well known and very successful interim CEO, explains how he stumbled into becoming an interim executive, how he sees being multi-sector experienced as a huge positive, and how he tackles turnaround.

In this issue of **PILOTcases**, we summarise three great private equity backed exits through varied turnaround processes and what made them successful – other than the fact that they were all driven by interims known to PILOTpartners of course...



Michael Gebauer
Partner – Private Equity Practice

A handwritten signature in black ink, appearing to read 'Michael Gebauer', written over a white background.

E: m.gebauer@pilotpartners.eu
T: 0783 423 5458

Wheeler Gebauer LLP
1-3 Frederick's Place
London EC2R 8AE

info@pilotpartners.eu
Tel. +44 (0)7834 235 458

Company No. 0C340896

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PARTNERS
WHEELER GEBAUER LLP