

Welcome to the December edition of Pilot's Log.



As we head into the last days of 2009, it would be tempting to commiserate about the difficulties endured by almost everyone in the private equity market (aside from turnaround gurus for whom the year has been busy if not as fantastic as some had predicted). Instead I thought to build upon several positive developments and

highlight comments made by several contributors to this year ending Pilot's Log

The upside from deal flow being a mere fraction of the bonanza days of 2-3 years ago is that almost every sponsor group has taken advantage of the down time to focus on existing portfolio companies. Creating value through operational improvement instead of relying upon high multiples and deal hungry advisory firms will result in stronger companies, better able to compete in the challenging marketplace.

Many firms are enhancing their portfolio management teams, seeing the clear advantages that come from introducing a central reservoir of knowledge, best practice implementation skills and sharing the best management teams across their portfolio. Indeed, several firms are adding operating partner / senior advisors to further improve their internal capabilities.

With Christmas upon us we have included pieces by several retail experts in this month's Pilot's Log.

Andy Meehan, who is well known for the very pro-active roles he takes on boards when appointed to help sort out messes, points out that private equity will need to seek out and embrace chairmen who are capable of being much more involved in portfolio businesses, mentoring both the CEO and board at large.

[Continues on page 7](#)

In this issue...



Turnarounds and the NXC
We chat with **Andrew Meehan**, non executive Chairman of PILOTpartners and a number of private equity backed businesses, to find out how you can get the most out of a turnaround specialist in a recession and why he thinks being upfront is often the best medicine. [Page 2](#)



The changing supply and demands on the Chief Restructuring Officer
There are CROs and then there are CROs. The debate is out as to exactly how many top notch CROs are really out there and what will happen in 2010 when all those CROs are tied up. After musing this question, **James Wheeler**, managing partner -

PILOTpartners thought a chat with **Ian Gray**, one of the busiest and best known CRO's, could lend us a few pointers as to how he and his peers will have to adapt to meet today's economic and resource challenges. [Page 4](#)



Choosing a good CRO - an instant checklist by James Wheeler

"The CRO is the best job in the world..." says **John Darlington**, MD of restructuring services with KPMG. Is it? I don't believe that private equity investors would necessarily agree with this statement. And a cynic might add that it all depends if

the job works out better than expected. [Page 5](#)

Turnarounds and the NXC A Q&A with Andrew Meehan



Katherine Steiner-Dicks chats with non-executive chairman **Andrew Meehan**, to find out how private equity backed businesses can get the most out of a turnaround specialist in a recession and why he thinks being upfront is often the best medicine.

Andrew is non executive Chairman of PILOTpartners and a number of private equity backed businesses, he is on the board of Fortnum & Mason and has enjoyed board positions at Burton Group, Sears plc, Storehouse plc and, most recently as CEO of Co-Operative Retail Services and Gordon Brothers International.

How has the non-executive chairman's role changed post-Lehman?

The role hasn't changed. I'm agnostic about changing behaviour on a macro level in a recession. Each company, regardless of a recession, is at their own stage of economic cycle. You have to play the situation based on the level the company is on. However, the recession has made it harder to raise finance, from banks in particular, which means it is not easy to persuade CEOs or MBI teams to take a risk by making a first move into private equity.

What kind of Independence or proximity to the company or the stakeholder do you take when things get tough?

One of my specialisms is turnarounds, so in my eyes things are always tough. The number one priority is usually a rapid assessment of issues facing the business followed by regular and open communication with all of the stakeholders.

Can private equity expect a new breed of chairman?

For the most part, yes. I think there used to be a breed of non-executive chairmen that were in it for the nice lunches while not contributing much to the business. They were hoping to buy their 3 per cent stake, make a million and assumed all would go well.

Then there are people such as myself who are prepared to go into difficult situations and not always get an easy return. Plus, the idea of "touching" a business once a month is no longer appropriate. It is very common for the chairman to be much closer to the management team, especially if the team is inexperienced in dealing with private equity investors in difficult situations. This tends to lead to the chairman having more involvement in day to day trading matters.

Given the changing demands and personal indemnity involved for today's NXC's, can private equity houses expect NXC's to make more demands?

If a private equity house hires an NXC they have to accept that he or she sets the rules with both parties then mutually agreeing to them. That's why I often do a short piece of consultancy before, so I know what I am getting into. If the private equity guys start getting involved half way through the project they can cause a conflict of interest, confuse the agenda and even cost the company money.



It may also be necessary to reconsider how the chairman is remunerated; by example, straight forward equity participation may not be appropriate.

What should private equity investors expect to be different as a result of the recession?

Operational firefighting takes the place of grand strategic planning. In a recession, the private equity investors will also have to be more decisive in choosing senior management and strategy.

They should also expect the management to work at a lower level of detail. Management must have a better sense of urgency and get things done today rather than tomorrow.

In the current environment is it best for the chairman to replace a non-executive director or CEO or to mentor them?

Replacing NXDs and CEOs is a major issue in turnarounds. I have had both experiences. You have to make a judgment call as to whether they can handle a refinancing within a turnaround. But sometimes a key part of a bank proposal is to get rid of, for example, the chief executive, so you have little choice. This is a key area where the chairman has to make the independent decision and not be tempted to make change for change's sake.

Are headhunters any good at selecting chairmen? Or should PE investors use 'their own man' by preference?

A headhunter will be more comfortable in putting a generalist turnaround specialist forward as they have a wide skill set. But people in private equity often try to look for exact sector skills. They have a tendency to put you in a box. They also can make the mistake of overlooking an NXC with turnaround experience when the business is doing well. What's wrong with trying to make a business even stronger?

People can also make the mistake of confusing executive skills with non-executive skills. An NXD can have sector expertise, but if they don't have chairman experience they will be lost once the sector issues are dealt with.

Specialist headhunters who really understand the private equity investor's issues and modus operandi do make the difference. That's why I am happy to be chairman of PILOTpartners.

What is your usual stance when deciding a new strategy for a company: External consultants or internal discussions with senior and mid-level sales staff? When are external consultants worth the cost?

I prefer to solve and create a new strategy internally. But if the company is taking a new direction, then I am all for external consultants for specific and highly focused pieces of work.

What I am against is if banks want to do an independent review and charge the company £50,000 for information that I have already compiled. It seems to be in the banking manual to do a review, even if it unnecessarily costs the company time, resources and money. In my experience negotiating with the bank to avoid these reviews is well worth it.

In your opinion, how can board meetings become more productive?

Not all directors in a company are statutory and in many cases a company will run meetings under a two tier system with one for management and the other for the board. When I run a board meeting I think everyone should be around the table. It's also a good way to give people a reality check about the business.

Board meetings are important and everyone should do their homework before they arrive. One of the characteristics in a company in difficulty is that management information in general, and board reporting in particular, is often inadequate. Therefore it is important that this is corrected mainly to run the business properly, but also to have meaningful board discussions.



What message would you like to get out there?

In the area I work in, which is with small to medium sized businesses, most relationship managers in the private equity companies are relatively young people and therefore may not have experience in dealing with recessions in their working lives. Therefore, the role of an independent chairman with a head of grey hair can be particularly productive.

The changing supply and demands on the Chief Restructuring Officer. Who will pick up the slack in 2010?



There are CROs and then there are CROs. The debate is out as to exactly how many top notch CROs are really out there and what will happen in 2010 when all those CROs are tied up. After musing this question, [James Wheeler](#), managing partner - PILOTpartners thought a chat with [Ian Gray](#), one of the busiest and best known CRO's, could lend us a few pointers as to how he and his peers will have to adapt to meet today's economic and resource challenges.

In 2009 Ian Gray hit the headlines with not one, but two ground breaking retail turnarounds— Stylo plc and Robert Dyas – both requiring entirely different treatments to ensure survival.

Earlier successes of his have included Golden Wonder, Texon International, PNC Telecom, GEI International and large NHS Trusts (different class of stakeholders, but just as complex to turn around). His is often the first name in the frame when I am asked to shortlist...I usually have to reply: 'unfortunately for now he is tied up elsewhere.'

Ian won't be the only CRO with an active schedule in 2010 as it is highly anticipated that the year will be an active year for CROs overall. In a recent conversation with Ian, I asked: 'what happens when all the top CRO's are tied up next year? Who will be left to take up the reins?'

This is what he had to say:

"Much will depend on how banks respond to the increased number of good quality businesses, which become stressed. I believe there are less than 20 independent CRO's with substantial experience in the country," he says.

"Excluding the senior advisers working for boutiques and advisory firms, that doesn't leave stakeholders with much choice. In 2010, this means that CRO's will need to spread themselves much more thinly across the market, taking on more than one appointment concurrently.

"The CRO role will therefore need to change sharply with less heavy lifting and taking a less time intensive, more strategic overview of the turnaround solution with a higher level of supervision and mentoring of the actions of the board and second tier management together with the maintenance of close relationships with external stakeholders.

"As a result the banks will demand that the CRO carries more authority and has an even higher level of expertise. The best restructuring boutiques provide a high level, but expensive resource for larger turnarounds where there tend to be multi-bank and complex shareholder groups. They will take a chunky payment up front as well as weekly fees at premium rates and probably a success fee.

"However, they cannot behave independently; nor on grounds of cost are they the appropriate solution for mid-sized and SME turnarounds – say £30m-£300m turnover.

"This is the preserve of the independent CRO where as often as not the individual will be asked to take on a board position. He/she will probably not take a fee up front when cash flow is under stress and will usually accept a reasonable day rate and a well deserved success fee and then, as often as not, be asked to stay on as chairman or NED afterwards.

"The banks are demanding," he admits, "but conservative stakeholders have high expectations of their chosen CRO's. Unsurprisingly they prefer to appoint people they trust and have worked with before, failing which they use experienced individuals who are introduced by the Turnaround Panels of the top four restructuring firms [PwC, Deloitte, Grant Thornton, KPMG].

"Then they may use the Institute for Turnaround, some of whose members cover the ground very well. It is otherwise very difficult to break into this circle. And that is just in regards to the UK. When it comes to the Continent, it is obviously made more complicated by the different legal and insolvency frameworks prevailing in each jurisdiction.

"But there are a number of senior UK-based independent CRO's with excellent international track records who understand the bi-cultural issues involved in achieving successful consensual restructuring outcomes, however, always with a team of local lawyers very closely involved."

The next big question

While 2010 will be an active year for CROs it will also be one that shapes the CRO's role within private equity backed companies for years to come.

This is why I had to ask Ian about his thoughts on the issues of CRO quality in an unregulated environment and where will the next generation of CRO's / Turnaround Directors come from?

"If I am bold enough to upset a few embedded opinions on this subject," says Ian, "I will put pen to paper in a future PILOT's Log..."

Choosing a good CRO: an instant check list - by James Wheeler



“The CRO is the best job in the world...” says John Darlington, MD of restructuring services with KPMG.

Is it? I don't believe that private equity investors would necessarily agree with this statement. And a cynic might add that it all depends if the job works out better than expected.

In the context of annus horribilis 2009 it is fair to say that many investment directors have turned their hands to taking on the CRO / Turnaround Director role in portfolio businesses themselves, often with considerable success given the unwillingness of banks to behave consistently.

And then some stressed businesses have had the capability to handle a restructuring largely by themselves.

There are only a small number of highly skilled independent CRO's operating in the UK and Europe right now – in my view no more than 100 of them are out there in and out of recessions.



They do not suddenly emerge into the market when times get tough, although there are many interim managers who will present their CV's to me with significantly changed histories when it suits them.

Handling and aligning the disparate needs of all those involved in a restructuring is complex. The challenge demands serious expertise and strength of character.

Who are these paragons? What qualities separate the good from the very good? Here is my instant check list when I am asked to provide a CRO:

- Independence
- Technically strong with a track record of success in consensual restructuring
- Credibility at building relationships with management and lenders, which will win early trust and stand up to pressure
- An ability to understand where quick wins can be made and to focus on the tough issues quickly
- A truly professional approach to resolving intractable issues in a non-adversarial, balanced, measured and structured manner

To avoid an insolvency process and a further write down of debt, the banks often facilitate the appointment of a CRO to support the incumbent management team rapidly to deal with the issues of running a stressed business.

It is clear that the banks' attitude to customers in stress and their own exposure has now shifted to seeing them work through their problems wherever possible. A CRO is key to this process and invariably appointed as a condition of support and to ensure that the company delivers on the pain involved.

In the same breath the CRO has to create the optimum solution for the business, the lenders and other creditors.

The outcome, if successful, will ensure the survival of the business and jobs saved but probably considerable hurt for stakeholders and creditors. Even though the banks encourage the appointment of a CRO he/she must exercise a high level of independence and have an overriding duty of care to the company.

Early intervention with the right CRO leadership in place is essential to increase the options available to stakeholders. Private equity is good at this; banks are not necessarily



as quick off the mark given the volumes of declining businesses sitting in workout groups at present, slowing up decision making.

Worse still, company management, often in various levels of denial, will often balk at letting a CRO anywhere near the business until all other options have faded.

The CRO's remit will cover four core areas of activity:

- Stabilisation and management of cash;
- Restructuring the balance sheet to handle the debt issues in the business;
- Operational restructuring – usually unpleasant, but critical for survival, and
- Managing the expectations and issues of stakeholders and actions of management.

However, not all projects will require all of these core activities, especially if there are other advisers on hand.

In some cases, there is just one issue that could potentially tip the company over the edge. Something as simple, yet all the while crippling, as the renegotiation of onerous leases.

Continued from page 1

Tony Lahert of Step Solutions, arguably one of the leading barometers of the UK retail economy, has been kind enough to allow us to reproduce his 2009 Q3 Review. Tony rightly points out that retail/consumer tendencies continue to be the best barometer of the 'real' economy, which is critical for the UK as we move into the ever important Christmas and New Years selling season. Retail/consumer behaviour remains the bell weather sector for private equity, especially within the stressed and distressed side of their portfolios.

Ian Gray, one of the best known independent CRO's with some major feathers in his cap this year including Robert Dyas & Stylo, is interviewed by my better half, James Wheeler. Gray is very clear that 2010 will bring many more challenging and interesting opportunities for top level CRO's, though he questions whether there are enough truly talented CRO's available to take on all of the messes that will continue to arise. These CRO's will need to sort out bank relationships, balance sheets, leases, creditors and deal with the ramifications from the outcome of Christmas trading.

One of the most important outcomes of the Turnaround Management Association's annual conference chaired by James on November 19th was their timely and most welcome announcement that in 2010 TMA (UK) will be setting up their 'Certified Turnaround Practitioner' programme, a formal qualification for the pan European turnaround industry based on the already successful US model. This is distinct from the Institute for Turnaround's recent statement that they will be establishing a policy framework for an IfT 'Practising Certificate' and 'Professional Licence'. The IfT proposals whilst well intentioned, appear to wish to restrict the practice of turnaround management only to those holding some form of licence. Given the need for professionals engaged in turnaround to have the widest possible range of skills, and indeed the way the market in UK at

least actually works, in PILOTpartners' view this will be counterproductive and has the potential to restrict the very flexibility and transparency that turnarounds often demand. Furthermore the increasing requirement of turnarounds to need pan European credentials makes a UK focused programme half baked at best.

Then we thought we'd have a bit of fun with the friends and enemies of private equity in our crystal ball gazing piece at the end of Pilot's Log. Don't sue us...we'll be long gone...Marakesh looks nice...

Enjoy the holidays!



Michael Gebauer
Partner – private equity practice

E: m.gebauer@pilotpartners.eu

T: 0783 423 5458

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

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

Company No. 0C340896

Pilot's Log is published on behalf of Wheeler Gebauer LLP trading as PILOTpartners by Equinet Media Ltd. All rights reserved. The views expressed by contributors and correspondents are their own. Reproduction in whole or in part without permission from the publisher is strictly prohibited. Equinet Media Ltd. 0207 554 8888, info@equinetmedia.com, www.equinetmedia.com

pilot
PARTNERS
WHEELER GEBAUER LLP