

pilot's log

leadership in challenging times

pilot
PARTNERS
WHEELER GEBAUER LLP

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Welcome to the first edition of Pilot's Log.



The PILOTpartners team truly believes in the power of communicating industry news you will not have read elsewhere together with serious (and sometimes less serious) comment on the big issues of the day.

In its relatively short life thus far, the PILOTpartners team has already made a big impression in the two marketplaces we serve – the portfolio businesses of private equity and venture capital investors and turnaround and restructuring in the wider world – with some really stretching searches and placements of senior independent directors for client projects in both the UK and Europe.

We are in a central and privileged position to disseminate newsworthy material given the variety of people we meet every day who seek our advice and access to our network, but always respecting the confidentiality of all concerned. In this edition of *Pilot's Log* we focus on our survey of interim management trends, interviews with an interim CEO just returned from a tough assignment in China and a well known stressed equity specialist, not to mention the great CompAir turnaround war story.

In this and succeeding editions of *Pilot's Log* we aim to change your preconceptions of the interim management industry and the real value of its providers in the PILOTpartners team. Enjoy the journey.

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[In Profile – With Ross Stuart](#)

When Ross Stuart was hired for a six month turn-around assignment by the European parent of an established China-based plastics manufacturer, he wasn't expecting a life changing experience. According to Ross, an interim CEO since 2002, all of his assignments are different, but in some form or another he gets thrown the same issues. By the end of this assignment, 'the Foreigner', as he was commonly known, could look back at his experience as "unusual, yet all the more gratifying for it." [Page 2](#)



[On the Record - Alan Thomas](#)

PILOT's James Wheeler talks over lunch with Alan Thomas, stress equity investor specialist at Grant Thornton's reorganisation and recovery practice, to find out 'where have all the distressed deals gone?' Alan tells us of the mysteries of the current deal climate and how there is always scope for value to be written back by stakeholder deals... [Page 4](#)



[On the Case - Graham Roberts](#)

Picture what was going through the minds of a management team trying to uphold 200 years of company legacy that had gone from successful global brand to basket case by 2002. Something drastic had to be done, so CEO Nick Sanders led a resuscitation plan that involved an MBO backed by Alchemy Partners, which closed for just £1 plus debt. [Page 6](#)



[The interim picture in 2009](#)

While previous recessions have had a plethora of distressed deal opportunities, this recession has proven mysterious in terms of deal flow, as readers will find out in James Wheeler's interview with Alan Thomas. Interim placements often work in parallel with distressed and growth equity transactions, which experienced a standstill in activity in the second half of 2008. [Page 7](#)



In Profile – With Ross Stuart

When Ross Stuart was hired for a six month turn-around assignment by the European parent of an established China-based manufacturer, he wasn't expecting a life changing experience. According to Ross, an interim turnaround manager, all of his assignments are different, but in some form or another he gets thrown the same issues. By the end of this assignment, 'the Foreigner', as he was commonly known, could look back at his experience as "unusual, yet all the more gratifying for it."

He knew it wouldn't be easy. The company had lost its General Manager just months before Ross set off to Shanghai in the second half of 2008. The situation was made more complicated when the former GM, along with other senior managers who had left, set up a similar facility a few miles away. This together with accounting discrepancies focussed the mind.

"At the time of my appointment the business had started to incur losses, working capital had nearly doubled and the systems were breaking down," Ross remembers.

"As you would expect the new management team was struggling to get up to speed and there were still major gaps to fill. But I had to go in there and understand what the problems were and find what was causing them, I had to come up with a fast action plan just days after arriving. Companies do not go wrong in two minutes, it can take some time for hidden issues to pop out, and then when you find

one problem you can be sure that there will be others." From what Ross has learned, financial discrepancies are not uncommon in China and authorities often turn a blind eye.

The to-do list

The first task on his action list was to understand the accounting problems, along with exactly who and what were behind them. Within the first six weeks, through James Wheeler now at PILOTpartners, he brought in a French financial controller who spoke fluent Mandarin, this helped in finding the financial problems. The next item on the list, literally changing the mindset of the employees, was much more difficult.

Ross explains: "I soon found out that if you confronted a member of management they may not tell you the sum total of all the issues. They did not want to own up to problems."

This lack of communication led to mounting unsolved problems ranging from unsent invoices to crippling pricing margins. Ross had to instill the ideas of honesty and solidarity. There didn't necessarily have to be a loss of face if something went wrong.

Ross was able to do this with the support of new local talent, many of whom had multinational experience and had earned MBAs in Europe. These new hires started to share his proactive approach and it soon began to filter down to all levels of the business.

But the problems did not stop there. "As you can imagine," Ross says, "language was a major barrier. What we found most productive was communicating by email. No matter how well management spoke English, their written English was much stronger, leaving less room for misunderstanding and error."

Controlling the uncontrollable and forming partnerships with dominant customers

In addition to internal changes, uncontrollable external factors, such as raw material price increases had started to put severe pressure on margins. Traditionally, management did not believe that they could justify passing raw material increases to customers and thought the right thing to do was to absorb the costs, says Ross.

"Much of the staff had not experienced market forces working in favour of oil prices. In some cases we had to justify 50% price increases. I had to teach them to be dogged about it; to be firmer with dominant customers, while retaining quality. And to approach customers when necessary as partners."

Ross says it was their first experience of putting the company's livelihood before the customer's favour. "We had to establish the real margins and put through appropriate price increases to recover raw material price increases; tackle the high levels of stock, by amongst other things, having a make-to-order policy; put in place systems to manage the business; while strengthening the management team."

"Towards the end of 2008 the market started to downturn substantially, adding further pressure. Lower raw material costs, so higher margins, and better efficiency offset some of these issues, but nevertheless a decision was taken to make redundant about 25% of the employees as the market did not look like it was going to pick up in the near future."

When it was announced that job cuts would be made, many of the staff asked for voluntary redundancy. "They had never seen a recession before and at the time thought they could easily get another job. Coinciding with the voluntary redundancies, many of the staff's first fixed-term contracts were coming to expiry. In the end, the expiry of contracts and voluntary redundancies made his rationalisation of the headcount not such a bugbear after all. "It all came down to timing and luck," says Ross.

Those that did stay on soon learned that they could have a hand in turning the business around. The company's success was their success—a foreign concept to them until Ross' arrival. But in order for Ross to do his job, management had to stop running to him for all the answers and to sign off every paperclip order. The management had to start seeing their department's problems as their problems - not just Ross'.

"When they came to me with a problem, I had to keep asking them: 'What do you think you should do?' It took a while, but eventually they had answers," he says.

Change for the good

The implementation of a new fully integrated computer system was started, which forced in a great deal of new processes and systems. Before this, 24 hour order requests would turn to 48 hours. "I had to convince them that tomorrow wasn't good enough. Eventually, margin information by SKU was obtained and prices increased. A robust system of ensuring price increases were put through, which meant the old culture to absorb raw material increases was eliminated."

The make-to-order system also soon started to have an impact on stock and as a result some machines were deliberately left idle. This was a hard concept for factory



workers to understand, says Ross. "They felt they had to fill time. I had to re-educate the operations manager to stop running machines for stock and, for example, make staff take holidays. We had to be strict. They were slow to accept change."

By the end of Ross' contract, he was still referred to as the 'Foreigner', a man that worked seven days a week, but had earned a mutual respect among his employees. The company had returned to profitability and had generated cash in the second half of the year; as working capital initiatives based around substantial stock reductions and improved debtor control paid dividends.

When he arrived back in the UK, he came home to an Inbox full of thank you letters. "When I left, all bar one of the management team had sent me a personalised letter of commendation. In all my assignments, I had never come across this before. They were genuine letters, which was unusual and above all gratifying. We all had a tough six months, but it was worth it."



The Pilot's Log Q&A with Alan Thomas of Grant Thornton's Reorganisation & Recovery Practice

PILOT's James Wheeler talks over lunch with Alan Thomas, stress equity investor specialist at Grant Thornton's reorganisation and recovery practice, to find out 'where have all the distressed deals gone?'

Alan tells us of the mysteries of the current deal climate and how there is always scope for value to be written back by stakeholder deals.

Alan, I know you have an interesting perspective on the market given your broad focus on specialist "stress-equity" investors, interim turnaround managers and the more vanilla PE house investors. What's going on out there at the moment, according to your various contacts?

Well, it's something of a mystery. As we drop more deeply into this recession with the unavailability of new credit, the rapid contraction of demand in key sectors, such as property, construction, automotive, luxury products and so on and so forth - you have to ask yourself - where are the distressed deals? Where are the assignments for turnaround specialists?

So, there isn't as much activity as you would expect?

In recent weeks a number of investors who specialise in backing turnaround projects have made exactly the same comment to me. Essentially, that they would never have thought that they would be struggling to access investment opportunities in times like these.

Is this the same across the board?

No. To be fair, some specialist investors have been busier than others. But, generally speaking, more money is out there than deals in the stress-equity space. There is a lot of frustration and biting -at- the- bit to get things moving.

Where are the deal opportunities? Why aren't they finding their way into the market?

Nobody knows for sure although I think that the speculation is somewhat irrelevant at the moment. One thing that is sure is that at some point in the near future the tide will turn and there will be more do-able deals than there will be investors to do them.

So what does this mean to existing investors? Say, for example, a PE house with a few difficult shareholdings in the portfolio where they have lost enthusiasm for continuing to expend valuable time and money.

It means that there is a short window of time to look at recycling some languishing investments where the shares are currently underwater and the debt-funders are possibly questioning their own position.

But if the shares are valueless, what's in it for the investor?

Several things. Firstly, a specialist investor comes fresh into the situation where the existing investor may have become stale. Secondly, a new money requirement creates a bargaining position against other stakeholders. Value can be written back by stakeholder deals and space created in the shareholder structure for the existing PE house to preserve the prospect for a future recovery.

Why would the incoming investor share value with the existing equity investors?

They won't do it out of gratuitous generosity. But if bound by NDAs, so they can't go around the existing PE house, they will make space if they think the deal is good enough.

And why wouldn't the existing investor do the same deal for themselves?

Well, perhaps they should. But the reality is that investors who really understand turnaround - perhaps including the use of pre-packs and other radical processes - have the particular expertise to see how to release additional value and the experience to be confident in the outcome of a turnaround.

I interrupted you as you explained what was in it for the original investor...

Right - the next thing on the list was this specialist management expertise. Turnaround investors are often very well connected with the kind of big, hairy and scary people needed to get such deals to work.

Are you talking about people like my excellent turnaround manager candidates?

Exactly those kinds of people. In many cases, such individuals are part of the permanent personnel of the specialist investor. They are culturally similar and this is why their attitude towards the risks of the turnaround challenge may lead to a different valuation being put on the opportunity than the incumbent investor would support from his own perspective.

So, what's the problem? What's stopping existing investors from trying out this approach?

At scales of, say, £100m or more, investors are more visible, deals are better understood and there is enough cash moving on the transaction to justify lots of advice and investigation. This is a more familiar area where much of the experience gained and equity investor contacts used in recent years still have a part to play.

And at smaller scales?

Life is very different. It has taken me more than two years to build a base of around eighty specialist investors. And you need a big pool of investors or you simply won't be able to close a deal - time is short, investment interests and enthusiasms are very specific and management capacity is limited. For any decent deal you may only have ten potential investors where the fit as to scale, geography and sector appears to be good. By the time you have explored their appetites for doing that deal on that day you may find you only have a couple of players.

What does that all mean in terms of getting a deal done and preserving some value in a languishing investment?

It means that you need to pursue the right people in the right way. For example, the impression that an opportunity has been very broadly marketed, with a glossy brochure can sometimes be a turn off. The specialist investor wants a deal to feel like it's off-market and exclusive. They want someone to call them and give them a quick sketch of the opportunity, on a no-names basis, if required, rather than send impersonal e-mails. They want to feel like they have a stakeholder partner on the deal that can get them inside and help make it happen.

So, just to recap, there is a population of specialist investors out there with money to invest and a willingness to do deals that could write back value to an existing investor's shares. But you need to treat them in the right way and know enough of the right people to get your deal done.

That's right. Just make sure when taking advice on who to go to that you are speaking to someone who has enough connections with the right investors to give the real prospect of a deal getting done... James, isn't it about time we ordered some pudding?

Profile: Alan Thomas, Director, Grant Thornton

Alan works in the Recovery & Reorganisation Practice, specialising in corporate restructure and turnaround. His expertise covers distress-specialist investors, corporate restructuring and turnaround and private equity.

With over 10 years' experience as a recovery and reorganisation specialist, Alan manages "ITEx" - the firm's panel of interim turnaround executives. He also has particular expertise in the field of distressed - situation specialist investors, where he maintains relationships with a substantial base of such investors. Prior to joining Grant Thornton, Alan pursued entrepreneurial activities and gained further private equity experience before returning to the profession in October 2006.

Bringing a business back to life The CompAir Turnaround

Imagine being part of a management team trying to uphold the 200 year old reputation of a company that has gone from successful global brand to basket case. Interim manager, Graham Roberts, was hired for three months. However, three months turned into six years, by which time the business was transformed and sold for more than £200m.

CompAir's CEO Nick Sanders knew something drastic had to be done. So, after an MBO backed by Alchemy Partners, he hired Graham Roberts for an initial interim assignment of three months.

Graham was assigned to the Cornish subsidiary Holmans, which had lost heavily for many years. "Similar plant closures had taken place in the UK and the US to centralise the German business, so the decision to wrap up and close the business was straightforward," Graham says. "But what wasn't so straightforward was the myriad of interfaces and commercial deals that had to be tackled with local and national government agencies. I saw that we would have to lead with a socially responsible outcome while cleaning up any likely exit issues when the business would need to be sold."

After the successful completion of the sale of Holman's, Graham's time at CompAir wasn't over. "Nick asked me to join the board full-time and run the core portable compressor business in Germany. It was easily the largest single statutory business and the natural spider's web from which CompAir could evolve."

"The company then faced a crossroads," Graham continues. "The team had to make a decision on whether or not the loss making portables business should be closed. I managed to convince the board that by concentrating on both product and customer development the losses could be eradicated. This took a year of hard commercial decision making and rapid product development across all European marketplaces, leading to more products released in two years than the previous 10 years combined."

Following a hands-on approach to sales that Graham promoted throughout the business, large scale orders were starting to be won in Italy, Germany, Spain and the UK.

"By 2004, the portables business was trading successfully with market share in excess of 35% in most territories," says Graham.

At that point, Nick asked Graham once again to change management hats. "Nick asked me to combine running the portables business with running the industrial division.

In total, 75% of group business still emanated from Germany. The division's strategy had already been set, but had stalled because previous management could not embrace a global culture, particularly in Germany. I then proceeded to direct a whole series of radical attitude shifts to make the organisation fast and focused."

To change historical processes and ways of thinking Graham says a multi-functional approach had to be put in place to change the profit dynamics in four key areas:

1. Sales: we needed to provide excitement to the sales channels through a dramatic increase in new product development including new global sales promotion packages with the message "we are back".
2. Production: production costs had to be reduced quickly and permanently by value engineering and the adoption of low cost sourcing from zero to 40% in two years. Graham made regular visits to China and India to ensure that the correct partners were found and that projects were being driven quickly.
3. Aftermarket revenues: turn the dial up on aftermarket revenues by enhancing customer retention and product recapture programmes across the entire business.
4. Manufacturing: we had to concentrate on customer delivery targets, not month end financial results. We set aggressive customer delivery targets to drive down order book lead times and establish Germany as a single logistics hub for Europe.

Graham says that each of the above projects was pushed forward positively and as a result the company's revenue grew by over 30% in 2004-05 and profits grew "exponentially". The combined business became established as the third largest entity in the global compressor marketplace and, in an external validation of all their hard work, CompAir's management was awarded Company Turnaround of the Year in 2006.

By the time Alchemy came to sell the business, trade and institutional interest was huge. Graham says an important task for him was to continue to run the business throughout this period of intense speculation so it could be matched with the right buyer.

In October 2008, Graham's six year stint paid off when CompAir was acquired by Gardner Denver for over £200m. A corporate life well and truly saved.

PILOT Interim Management Placement Survey

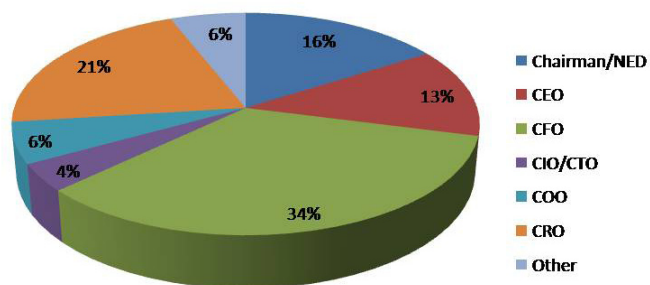
While previous recessions have had a plethora of distressed deal opportunities, this recession has proven mysterious in terms of deal flow, as readers will find out in James Wheeler's interview with

Alan Thomas, a stress equity investor specialist at Grant Thornton's reorganisation and recovery practice. Interim placements often work in parallel with distressed and growth equity transactions, which experienced a standstill in activity in the second half of 2008. But things are expected to slowly come around, however, no one can put their finger on why (yet a bit of luck, dedicated networking and an opening of the lending markets could be probable causes.)

According to our survey, since the third quarter of 2008, there has been a discernible trend for private equity in particular to seek to change non executives including chairmen. Important to note here is that many clients prefer to look for non-executive directors with special sectoral experience above all because they need to access talent quickly. Those surveyed said that they see the value in using interim networks where top quality skills are instantly available compared to their experience with traditional executive searches. They also were able to quantify results at a much more rapid pace, reflecting interims' recognised ability to not only implement change, but to make things happen quickly.

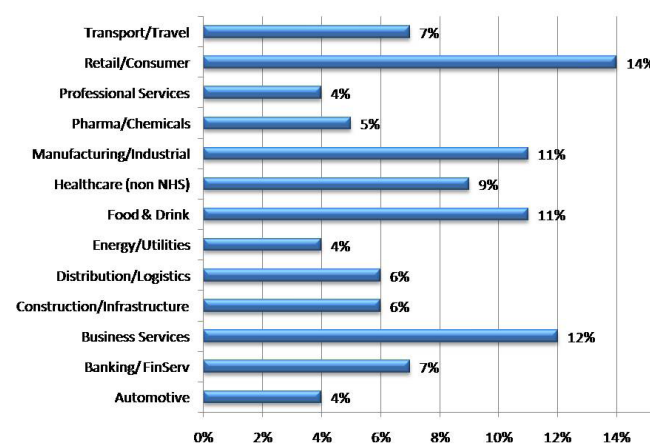
More than 50% of placements in Q1 & Q2 2008 related to turnaround situations and major change projects as opposed to growth, for which CRO and CFO placements alone accounted for 55%. In Q3 and Q4, however, very few placements took place in non-turnaround/transformation situations. Furthermore, the total volumes of placements differed considerably – 67% occurring in the first half and 33% only in the second half. However, 2009 has started busily – at about the same level as Q1 in '08.

Placements by Functional Discipline



CAPTION: Gov't/Quangos/NFP account for between 30-40% of interim executive market; the above data covers the balance. Government will continue to be a major user of interims in 2009—the same in every recession—especially as NHS returns to use turnaround specialists once more, 2-3 years on from the last big change programme started by Patricia Hewitt (remember her?). This begs the question as to whether the last programme achieved its objectives. Local government and education are down to start major overhauls of their costs base and VFM delivery in 2009.

Interim executives placed during 2008 across all sectors, excluding Government and Not for Profit



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