"The Contribution of Management Buy-ins to Corporate Restructuring: Concepts, Characteristics and Performance"

by Ken Robbie, M.A.

Thesis submitted to the University of Nottingham
for the degree of Doctor of Philosophy, October 1993

APPENDIX

APPENDICES

APPENDIX TABLES

APPENDIX. 1

THE CENTRE FOR MANAGEMENT BUY-OUT RESEARCH

INSTITUTIONAL INVESTMENT RETURN

Company Name ....
MBO or MBI ....
Head Office Location ....
Vendor ....
Completion Date ....
Main Activity ....
Transaction Value (£mn) .... Turnover (£mn) ....
Profit Before Interest & Taxation (£mn) .... Number of Employees ....
Name of MD ....

Lead Equity Provider ....
If lead provider please give names of other participating institutions ....
....
Lead Mezzanine Provider ....
If lead provider please give names of other participating institutions ....
....
Lead Debt Provider ....
If lead provider please give names of other participating institutions ....
....

Accounting Adviser to Management ....
Legal Adviser to Management ....
Reporting Accountant ....

Information supplied by
Institution .... Respondent ....
Telephone .... Date ....

STRUCTURE OF TRANSACTION

	Management	Vendor	Own Investment	Total
EQUITY	....	....	....	....
Straight ordinaries* (£mn)	....	....	....	....
Other ordinaries (£mn)	....	....	....	....
Preference shares (£mn)	....	....	....	....
Total Equity (£mn)	________	________	________	________
DEBT **				
Senior Debt (£mn)	....	....	....	....
MEZZANINE ***				
Subordinated Debt (£mn)	....	....	....	....
LOAN NOTES (£mn)	....	....	....	....
OTHER **** (£mn)	....	....	....	....
TOTAL FINANCING (£mn)	________	________	________	________

* Of which Management % share of voting equity .... %

Ratchet Provisions (if applicable) Min .... % Max .... %

Dependent on ....

....

** Type of Senior Debt ....

*** Mezzanine - Number of Layers .... Equity Warrants ....

**** Other - please specify ....

....

Please return this form to: Ken Robbie, Research Fellow, Centre for Management Buy-out Research, School of Management & Finance, University of Nottingham, University Park, NOTTINGHAM NG7 2RD. Telephone 0602 515494. Fax 0602 515503.

THE CENTRE FOR MANAGEMENT BUY-OUT RESEARCH

APPENDIX. 2

MANAGEMENT BUY-OUT / IN
Realisation and Refinancing

Company...

Buy-out/In
(Month/Year)..Realisation/Refinancing(Month/Year)..

Method of Realisation (Please tick)

Stock Market	☐	USM	☐
Trade Sale	☐	Share Buy-in	☐
Management Buy-out	☐	Management Buy-in	☐
Refinancing	☐	Receivership	☐

Value on Exit £....................mn

FOR TRADE SALES OR BUY-INS

Name of Buyer...

Payment Method(s)

Cash	☐	Share Exchange	☐
Cash + Shares	☐	Other	☐
Loan Notes	☐	Please Specify..................................	

Deferred Element	Yes	☐	No	☐
Price Escalation Clause	Yes	☐	No	☐

If Yes, maximum payable £....................mn

FOR REFINANCING OF BUY-OUTS/INS

Total Funds Injected £..............................

Of which Equity £..............................

Reasons for Refinancing

For Expansion	☐	Performance Difficulties	☐
Asset Sale Programme agreed	☐		

FOR RECEIVERSHIPS

additional funds injected before receivership	Yes	☐	No	☐
Were significant asset sales made before receivership	Yes	☐	No	☐
Did management successfully bid for any of the assets	Yes	☐	No	☐

If Yes, please state name(s) of successor company..
....
....

Please Turn Over

APPENDIX. 3

THE CENTRE FOR MANAGEMENT BUY-OUT RESEARCH

MANAGEMENT BUY-IN QUESTIONNAIRE

CONFIDENTIAL

Institute of Financial Studies
University of Nottingham
University Park
Nottingham NG7 2RD

Telephone: 0602 484848
Extn 3287/2600

THE COMPANY

Name of Company: Now ....

Prior to Buy-in ....

Address ....

....

....

Phone ....

Name of vendor: ....

Initial activities of buy-in: ....

Year target company originally founded			
Date acquired by vendor			
Completion date of buy-in (month/year):		/198	
Number of employees at time of buy-in:			
Turnover	£		mn
Operating Profit (pre Head Office Costs)	£		mn

THE TRANSACTION

1 How long did the search for the target company take? [ ] Months

2 How long were the actual negotitations with the target vendor? [ ] Months

3 Why did the previous owner wish to sell?
Please rate each factor out of 5 where 5 = very important and 1 = very unimportant and n/a = not known to be relevant

	Very Important				Very Unimportant	
Poor growth prospects of company	5	4	3	2	1	n/a
Lack of profitability of company	5	4	3	2	1	n/a
Redefinition of group core activities	5	4	3	2	1	n/a
Parent needed to raise cash quickly	5	4	3	2	1	n/a
Vendor found "difficulty" controlling company	5	4	3	2	1	n/a
Vendor required finance for acquisitions	5	4	3	2	1	n/a
Retirement of owner	5	4	3	2	1	n/a
Other (please specify)	5	4	3	2	1	n/a
....						

4 Were there other serious bidders seeking to buy the company? Yes or No
If yes, was there a buy-*out* team bidding Yes or No
Did the vendor retain some shares in the company after the sale? Yes or No
Do(es) an institutional investor(s) hold shares in the company? Yes or No
Was the final price partially dependent on subsequent performance? Yes or No

Why was the vendor prepared to sell to a buy-in team? ....
....

5 BUY-IN ADVISERS
Legal adviser ....
Accounting adviser ....
Reporting accountant ....

6 BUY-IN FINANCING

Type of Finance	Name of Lead Institution	Funds Raised £ mn
Equity	....	[ ]
Mezzanine Debt	....	[ ]
Senior Debt	....	[ ]
Other Forms of Finance	....	[ ]
	Total	[ ]

7a Were you satisfied with the performance of your advisers and financiers?
Please rate each out of 5

	Very Satisfied				Very Dissatisfied
Accounting advisers	5	4	3	2	1
Legal advisers	5	4	3	2	1
Financiers	5	4	3	2	1

b Were there any particular aspects of performance which impressed you by the main advisers?
Accounting adviser ....
Legal adviser ....
Financiers ....

c Or you were dissatisfied with
Accounting adviser ....
Legal adviser ....
Financiers ....

d As a result of their performance, have you taken a decision to retain the advisers for further work? Yes or No
If not which type of adviser ....

e Approximately, what fees were charged by:

Accounting advisers	£ ,000
Legal advisers	£ ,000
Financiers	£ ,000

f Please state any difficulties during the purchase that created significant or time consuming problems
....
....
....
....

---

8 Were any conditions imposed on you in finalising the transaction which you considered unnecessarily restrictive? Please rate each of the following out of 5 or state if such conditions not required

	Very Restrictive				Found to be useful	Not Required
Regular (monthly) financial reports	5	4	3	2	1	x
Board representation	5	4	3	2	1	x
Change of auditor "requirement"	5	4	3	2	1	x
Change of banker "requirement"	5	4	3	2	1	x
Restrictions on capital expenditure/ acquisitions/diversification etc	5	4	3	2	1	x
Purchase of other financial services "requirement"	5	4	3	2	1	x
Type of Financial Structure advised	5	4	3	2	1	x
Size of equity stake of financier(s)	5	4	3	2	1	x
Requirement not to approach other advisers/financiers after buy-in	5	4	3	2	1	x
Banking covenants	5	4	3	2	1	x
Personal guarantees	5	4	3	2	1	x
Other (please specify)	5	4	3	2	1	x

9 What is the percentage of equity held by:

Buy-in Team	Existing Management/ Employees	Institutions	Vendor	Other	Total
%	%	%	%	%	100%

Cost of buy-in team shares £ ,000

Does this depend on a ratchet mechanism enabling management's proportion to change? Yes or No

If no go to Question 10

If yes:

a What are the limits of the buy-in team/management's equity stake under this mechanism?

Minimum % Maximum %

b On what performance criteria does the ratchet operate?

Profits only	Yes or No
Capitalisation - on flotation or on sale to another company	Yes or No
Cash flow/redemption of financial instruments	Yes or No
Profits/capitalisation	Yes or No
Cash flow/capitalisation	Yes or No
Financiers internal rate of return	Yes or No
Other (please specify)	

c Over what period of time does the ratchet operate? Years

10a Is there a share option scheme? Yes or No

If yes, does it appply to:

Only buy-in team	Yes or No
Senior Management	Yes or No
All Employees	Yes or No
If no, is it intended to introduce a scheme?	Yes or No

b Is there an ESOP Scheme? Yes or No

If no, is it intended to introduce a scheme? Yes or No

and if so when Years

THE NEW OWNERS

11 Number in buy-in team when originally approaching financier: [ ]

Final Number in buy-in team at time of purchase [ ]

Were there any major professional/skills gaps in the original buy-in team in terms of

Finance	Yes or No
Marketing	Yes or No
Production	Yes or No
Other	Yes or No

[Please specify] ....

Number of *existing* senior managers taking voting equity: [ ]

Number of other employees taking voting equity: [ ]

Total Number of Directors [ ]

Number of Non-Executive Directors [ ]

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12 What were the main motivations for buying-in?
Please rate each reason out of 5 where 5 = very important and 1 = very unimportant

	Very Important				Very Unimportant
To do kind of work you wanted to	5	4	3	2	1
Frustrated by head office control	5	4	3	2	1
Lack of opportunity in existing company	5	4	3	2	1
Avoid working for others	5	4	3	2	1
Develop own strategy	5	4	3	2	1
Recognition of a specific commercial opportunity	5	4	3	2	1
Vehicle for future acquisitions programme	5	4	3	2	1
To Build a successful organisation	5	4	3	2	1
Earn significantly more money	5	4	3	2	1
Personal Capital Gain	5	4	3	2	1
Made Redundant	5	4	3	2	1
Other (Please specify)	5	4	3	2	1

....

---

13 Had the buy-in team known each other before? Yes or No

If no go to Question 14

If yes,

Had worked in same organisation	Yes or No
Professional contact	Yes or No
Social contact	Yes or No

How many members of the buy-in team had worked together before? [ ]

14 To establish a profile of a typical buy-in team could you please indicate the personal background of yourself and your "Number Two"

		Chief Executive	"Number Two"
a	Age		
	26-35	☐	☐
	36-40	☐	☐
	41-45	☐	☐
	46-55	☐	☐
	Over 55	☐	☐
	Sex	M / F	M / F
b	Immediately previous employer:		
	Top 500 UK Company	☐	☐
	Other UK plc	☐	☐
	UK Private	☐	☐
	UK Public Sector	☐	☐
	Overseas Company	☐	☐
c	In Same Sector as buy-in company	☐	☐
d	Years of employment with previous employer	☐	☐
e	Educational Achievement		
	MBA	☐	☐
	University Degree	☐	☐
	Other Higher Education	☐	☐
	Professional Qualification	☐	☐
	'A' Levels	☐	☐
	'O' Levels	☐	☐
	No formal qualifications	☐	☐
f	Nationality	☐	☐
g	Occupations of parents		
	Manual	☐	☐
	Semi-skilled	☐	☐
	Skilled	☐	☐
	Professional	☐	☐
	Small business owner	☐	☐
	Other	☐	☐
h	Managerial Background		
	General Management	☐	☐
	Sales/Marketing	☐	☐
	Production	☐	☐
	Finance/Administration	☐	☐
	Other	☐	☐

		Chief Executive	'Number Two'
i	Number of previous management jobs	☐	☐
j	Previous experience of		
	Owning at least a significant share of a company	Yes or No	Yes or No
	Participated in earlier buy-in	Yes or No	Yes or No
	Participated in earlier buy-out	Yes or No	Yes or No
	If yes to any one of these, was the reason for leaving?		
	Sold out	☐	☐
	Receivership	☐	☐
	Disagreement with colleagues	☐	☐
k	Participated in earlier unsuccessful buy-out attempt	Yes or No	Yes or No
l	Contributions to finance for personal stake		
	Golden handshake from previous employer	☐	☐
	Re-mortgage of house	☐	☐
	Sale of other personal financial assets	☐	☐
	Loans from friends/family	☐	☐
	Other cash resources	☐	☐
	Other	☐	☐
	....		
m	Did the buy-in involve moving to a different region?	Yes or No	Yes or No

15	For the leader of the buy-in team, did initiation of the buy-in come from:	
	Your own general approach to a financing institution	Yes or No
	A specific company proposal made by you to a financing institution	Yes or No
	An institution approaching you for an existing project	Yes or No
	An institution approaching you for a potential project	Yes or No
	'Head hunters' acting for an institution	Yes or No
16	How many financing institutions were approached?	☐
17	How long before completion of the buy-in did you leave your previous job?	mths
18	Did you set up your own consultancy company in this period?	Yes or No
19	Was financial help for this period offered by the financing institution?	Yes or No

THE TARGET COMPANY

20 How long had you been actively looking for a target company?

Less than 6 months	6-12 months	1-2 yrs	2-3 yrs	>3 yrs
☐	☐	☐	☐	☐

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21 During the search period did you bid for any other companies? Yes or No

If no go to question 22

If Yes, number of unsuccessful bids ☐

Reason(s) for unsuccessful bid

Offer price bettered by trade buyer	Yes or No
Offer price bettered by MBO team	Yes or No
Vendor decided not to sell	Yes or No
MBI team withdrew offer	Yes or No
Other (please specify)	Yes or No

....

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22 While searching for a suitable target company, how important did you rate (out of 5) each of these criteria?

	Very Important				Very Unimportant
Location	5	4	3	2	1
Industry	5	4	3	2	1
Particular technology	5	4	3	2	1
Sales turnover	5	4	3	2	1
Potential market growth	5	4	3	2	1
Competitive strength	5	4	3	2	1
Customer base	5	4	3	2	1
Asset value	5	4	3	2	1
'Shell' Potential	5	4	3	2	1
Turnround Potential	5	4	3	2	1
Other (please specify)	5	4	3	2	1

23a What was your planned target price range? £ ☐ mn to £ ☐ mn

b What was the final price? £ ☐ mn

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24 How was the successful target company originally identified?

Buy-in team's industry knowledge	Yes or No
Suggestion by your financial institution	Yes or No
Suggestion by your accountants	Yes or No
Suggestion by your bankers	Yes or No
Suggestion by personal contact/friends	Yes or No
Suggestion by customer/suppliers in your previous employment	Yes or No
Personal Research	Yes or No
Other (please specify)	Yes or No

....

25 In your search for the target company, did you make use of any of the following?

Specialist courses/seminars/conferences	Yes or No
The 3i MBI programme	Yes or No
"On Line" company data searches	Yes or No
Trade directories/reference books	Yes or No
Newspaper/media reports/searches	Yes or No
Trade Associations	Yes or No
Government programmes	Yes or No
Specialist consultant/company broker	Yes or No

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26 Did any member of the buy-in team have special knowledge of the target company prior to the bid? Yes or No

If no go to Question 27

If Yes, was this

Professional contact	Yes or No
Earlier employment	Yes or No
Relationship with previous company	Yes or No
Competitor	Yes or No
Supplier	Yes or No
Other contact (please specify)	Yes or No

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27 In terms of the industrial sector(s) of the buy-in company how did you perceive the following at the time of the buy-in?

Very stable demand	5	4	3	2	1	Very unstable demand
Industry size declining	5	4	3	2	1	Rapidly growing industry
Very stable technology	5	4	3	2	1	Very unstable technology
Low exposure to import competition	5	4	3	2	1	High exposure to import competition
Highly cash flow positive	5	4	3	2	1	Significant cash requirements

---

ACTIONS POST BUY-IN

28 Since the buy-in have you done any of the following

Identified new markets	Yes or No
Added new products/services	Yes or No
Dropped existing products/services	Yes or No
Increased prices relative to competitors	Yes or No
Reduced prices relative to competitors	Yes or No
Changed advertising/promotion arrangements	Yes or No
Increased customer base	Yes or No
Changed a significant number of suppliers	Yes or No
Moved main company location	Yes or No
Changed the name of the company	Yes or No
Re-organised administrative/financial systems	Yes or No
Reduced stock level	Yes or No
Reduced average period of credit for debtors	Yes or No
Significantly increased capital expenditure	Yes or No
Sold surplus assets	Yes or No

29 Have you acquired any new companies? Yes or No

If no go to Question 30

If yes, are they in the same industrial sector? Yes or No

If not, same sector please state new sector(s) ....

Please give acquisition number [ ]

Total value £ [ ] mn

Value of largest £ [ ] mn

---

30 Do you intend to make purchases over the next 12 months Yes or No

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31 Since buy-in, have you closed down any activities? Yes or No

If yes number [ ]

net asset value £ [ ] mn

Have you sold any activities? Yes or No

If yes number [ ]

value £ [ ] mn

Were these sales/closures part of an original programme agreed at the time of buy-in? Yes or No

---

32 Have there been managerial changes since the buy-in? Yes or No

If no go to Question 33

If yes, has this involved

Any of the buy-in team leaving	Yes or No
Recruitment of specialist senior staff	Yes or No
Resignation of previous senior management	Yes or No
Recruitment of own previous colleagues/contacts	Yes or No
New senior managers taking equity	Yes or No

Other (please specify) ....

....

---

33 Have major changes been made to incentive systems? Yes or No

If no go to Question 34

If yes, do these relate to

All employees	Yes or No
Direct labour	Yes or No
Sales	Yes or No
Admin/finance	Yes or No
Senior management only	Yes or No
Directors only	Yes or No

Are they based on

Productivity	Yes or No
Sales turnover	Yes or No
Profits	Yes or No
Return on capital	Yes or No

---

34 Were any job losses effected on buy-in? Yes or No

If yes, how many jobs were lost? [ ]

What were the reasons for the losses? ....

....

35 Were any job losses effected after buy-in? Yes or No

If yes, how many jobs were lost? ☐

What were the reasons for the losses? ....

....

---

36 Over the next three years is employment likely to:

- Increase ☐
- Remain the same ☐
- Decrease ☐

PERFORMANCE POST BUY-IN

37 How do actual turnover and operating profit (before interest) compare with *forecast/budget* figures at the time of the buy-in?

	Turnover	Operating Profit
More than 50% worse	☐	☐
10-25% worse	☐	☐
0-10% worse	☐	☐
0-10% better	☐	☐
10-25% better	☐	☐
25-50% better	☐	☐
over 50% better	☐	☐

---

38 Since the buy-in, please rank the following in terms of seriousness of problems which may have emerged?

	Serious				No Problem
Decline in overall market	5	4	3	2	1
Competitive pressures	5	4	3	2	1
Attitudes of employees	5	4	3	2	1
Availability of credit/finance	5	4	3	2	1
Cost of credit/finance	5	4	3	2	1
Family/personal demands	5	4	3	2	1
Discovery of "skeletons in the cupboard" type of problems	5	4	3	2	1
Exchange rate fluctuations	5	4	3	2	1

---

39 Has further finance been required since the buy-out? Yes or No

If no go to question 40

a If Yes, has this been because of:

- Greater sales volumes Yes or No
- Higher capital expenditure? Yes or No
- To make an acquisition? Yes or No
- Failure to meet original targets? Yes or No
- Other (please specify) ....

....

b Has further funding been obtained through

Retained Earnings	Yes or No
Personal Equity subscription by MBI team	Yes or No
Institutional Equity subscription	Yes or No
Introduction of New Investors	Yes or No
Mezzanine Debt	Yes or No
Overdraft	Yes or No
Other bank loan	Yes or No
Better Working Capital Management	Yes or No

c Has additional funding resulted in the dilution of the MBI team's share of the voting equity — Yes or No

---

40a If the buy-in was not initially quoted on the Stock Market, what form of exit (realisation of investment by managers and investors) was envisaged at the time of the buy-out?

Stock Market flotation	Yes or No
Sale to a third party	Yes or No
Re-structuring/Second buy-out/Releverage	Yes or No
Family succession	Yes or No
No particular exit method favoured	Yes or No
No Exit intention at all	Yes or No

b What time scale to exit/realisation was envisaged (approx)? [ ] yrs

---

42 Has realisation already taken place? — Yes or No

If no go to Question 42

If yes

- When [/19]
- Which method ....
- Price/Market capitalisation £ [ ] mn
- Have you retained a stake in the company — Yes or No

---

42 If an exit has not yet been achieved, but the favoured method for realisation has changed, please state what is *now* the most likely method of realisation

....

'PUBLIC BUY-INS'

If your buy-in involved acquiring a stake in or a complete acquisition of a company which was already quoted on the stock market, we would be grateful if you could also answer the following questions
If not please go to Question 48

---

43 Was the initial stake in the company bought from

Existing directors	Yes or No
Significant other private shareholding group	Yes or No
UK Pension Fund	Yes or No
UK Investment Trust	Yes or No
Overseas Company/Investor	Yes or No
Other	Yes or No

---

44 What % of the share capital was initially acquired

5-25	25.1-29.99	30-49.99	50-75	76-89.99	90+

45 What was

The Cost £ [ ] mn

The total market capitalisation £ [ ] mn

---

46 Did you make an offer for the remaining equity — Yes or No

If no, was special Stock Exchange dispensation given for not doing so? — Yes or No

---

47 Did a major part of the motivation for the buy-in involve

Prospects for the unbundling of assets — Yes or No

Use of the company as a shell — Yes or No

---

48 Do you have any other observations about the buy-in process?

May we contact you in the future to discuss the progress of your buy-in? **Yes or No**

Completed by ....

Position ....

Date .... Telephone number ....

Thank you very much for helping us by completing the questionnaire

We would appreciate any company brochures and a copy of your Annual Report and Accounts. Please put us on your mailing list for receipt of your future Annual Report and Accounts.

Please return this form to Ken Robbie, Research Fellow, Centre for Management Buy-out Research, in the pre-paid envelope provided. If there are any queries please do not hesitate to contact him at the address/telephone number shown overleaf.

THE CENTRE FOR MANAGEMENT BUY-OUT RESEARCH

SCHOOL OF MANAGEMENT & FINANCE
PORTLAND BUILDING
UNIVERSITY OF NOTTINGHAM
UNIVERSITY PARK
NOTTINGHAM NG7 2RD

Telephone: 0602 484848
extn 3287/3301/3345
Fax: 0602 500664

Directors:
BRIAN CHIPLIN
MIKE WRIGHT

Research Fellow:
KEN ROBBIE

APPENDIX. 4

^F1^

24 February 1990

Dear ^F2^

CMBOR Management Buy-In Survey Questionnaire

Management Buy-Ins have attracted considerable attention over the past few years but as yet their longer term economic, financial and organisational effects have not been examined fully. To help remedy this situation the Centre for Management Buy-Out Research is carrying out a study of these issues which complements earlier research on buy-out companies. The Centre is the only independent research institution in the UK with full-time involvement in the study of Buy-Outs and Buy-Ins.

The current survey aims to increase significantly the knowledge of Buy-Ins providing information which will be useful for future managements seeking a Buy-In and helpful for those who have recently completed one.

The enclosed questionnaire asks questions about various aspects of the business bought into and the process of identifying the target company. Most questions require you simply to tick an appropriate box or circle an answer. However, in places we are asking for your opinions and impressions. Do not feel constrained by the size of the spaces left as there is space at the end of the questionnaire which can be used to expand on any of your answers. As full a reply as possible is welcomed.

We appreciate the many demands on your time, but hope you consider this study important enough to justify your attention. Your replies will be treated in strictest confidence and any resulting report will make reference only to aggregated results to ensure that individual companies cannot be identified. A stamped addressed envelope is enclosed for your reply.

Yours sincerely,

Ken Robbie
Research Fellow

THE CENTRE FOR MANAGEMENT BUY-OUT RESEARCH

SCHOOL OF MANAGEMENT & FINANCE
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Directors:
BRIAN CHIPLIN
MIKE WRIGHT

Research Fellow:
KEN ROBBIE

APPENDIX. 5

^F1^

30 March 1990

Dear ^F2^

CMBOR Management Buy-in Survey Questionnaire

Earlier in the year we wrote you concerning a survey we are carrying out into cases where new management with financial backing have bought into quoted companies and gained effective management control. So far the response to our questionnaire has been very encouraging. To ensure that we have as large a sample as possible we are now re-contacting people who originally were sent the questionnaire but whose replies we had not received at the time of writing.

We are enclosing a duplicate copy of the questionnaire and hope that you will find time to complete it. May we again stress that the survey is being done on a confidential basis and reports on the results of the survey will make reference to only aggregated results.

Yours sincerely

Ken Robbie
Research Fellow, CMBOR

APPENDIX. 6

MANAGEMENT BUY-IN SURVEY: COMPLETED QUESTIONNAIRES

CMBOR CODE	BUY-IN NAME
85286	Tattersall Alloy Castings*
86055	United Wine Products**
86126	Haleworth
86344	Reads Garage (Honiton)
86347	Spotnails
86349	Brays of Glastonbury
86351	Harrison & Turner
86375	Gestetner***
87043	Chase Products
87123	Medallion Upholstery
87294	Goodlands Holdings
87300	Weedon Holdings
87302	Crown Industrial Group
87338	Wright Pugson
87348	G & AE Slingsby
87360	Queensway Guarantee Corporation
87361	Goodman Gibbs
87407	McCulloch Holdings
87474	Continuous Stationery***
88076	Wipac
88130	Autoguild
88131	Optical Supplies
88133	Cricklade Motor Company
88142	Orechan (Nias of Newbury)
88154	Mann Mechanical Group
88187	European Brands Group
88189	Bellingham Industries
88196	Keighley Laboratories
88198	Kongsberg Drafting Services**
88201	KMS Coatings
88209	Martin Electrical
88263	Wassall***
88278	Hollybush Holdings
88316	Hedges L 260 Snuff Company
88322	The Marketing Consortium
88325	BMV Associates
88354	Ideal Timber Products
88390	Diagonal
88484	Breakwell Freight Services
88493	Just Tyres
89028	Innoxa (Suriplan Holdings)
89083	Court Cavendish
89086	Exide
89134	Barton Handling and Storage Systems
89174	Metalliform
89186	Country Casuals
89192	Frametec (Turner Aluminium)

89195	Prime Food Products
89203	FTT
89217	Heathfield Construction Equipment
89233	CEC-Time
89234	AGK Civil Engineering
89242	Essex Motors
89269	Process Engineering
89274	Lindhall (Christie Malcolm)
89275	Highwood (The Hornsey Group)
89327	East Anglian Electrical
89360	James Neill***
89383	Zenith of Stevenage
89394	Keysan
89396	Energy Facilities Management
89406	Bentley Engineering
89415	Kingford
89461	Widney***
89489	The Maids
89517	Coombs of Guildford
89522	Ross Group***
99101	The Lobster Pot Hotel**

* 1985 buy-in
** Effectively non-UK mainland operations
*** Public Buy-in

APPENDIX A7

MANAGEMENT BUY-IN CASE STUDIES

The Maids: A Buy-in of part of a loss-making privately owned company

A7.1 Introduction

The Maids represents a rather unusual management buy-in case in that the target company was the holder of the UK franchise rights for a service rather than being a conventional manufacturing or service company. It was relatively small and required a significant improvement to operating performance. Incoming management had extensive franchise experience in the same sector and had worked together for sometime. Following the buy-in the business was relocated and considerable initial problems were experienced through 'skeletons in the cupboard' types of problem highlighting their cost and time consuming nature. Despite this the first year's profits of the buy-in were marginally better than the Business Plan.

A7.2. The Team and Motivation for the Buy-in

The team of three had previously been employed by Servicemaster, a US owned service company involved in domestic cleaning and hospital/healthcare sectors. The leader of the team who originally had a finance/accountancy background had recruited the other two to the company to Servicemaster in Finance and Sales and Marketing positions; they had worked together for a period of about three years with average employment of 4 years with Servicemaster. Of the three one had a university degree and all had professional qualifications. None of the three had participated in any earlier management buy-out or buy-in or had experience of owning a significant share of a company.

The US parent had a generally successful growth record but in the mid to late 1980's following cutbacks in margins in the US healthcare sector some restructuring became necessary, the UK subsidiary coming under increasing pressure to perform. This effectively meant the sale of the business as well as changes to the basic philosophy of the way in which business was done. In particular the person who emerged as leader of the team found himself disagreeing in principle with the changes being made to business and commercial methods operated by Servicemaster.

A7.3 Identification of the Target

Having decided to leave Servicemaster and look for another opportunity, the team had to identify potential sectors and then possible companies. It was agreed early on that, as the team had most experience of the franchise sector, they should look for franchising companies which might be for sale. Within this general sector, it was not strictly necessary that the franchising activity should be closely related to Servicemaster's product, cleaning, as it was felt that many of the skills required in attracting and managing franchisees were the same no matter what the actual industrial/service activity was. What was important was the quality and viability of the products. The team with its balance of general management, sales, contract and finance experience would be able to handle any product, assuming that the product could be demonstrated initially to be viable. As well as the actual target three other franchising companies were identified through industry contacts and the informal use of business consultants although none of the investigations into the three led to offers being made.

The team leader had previous experience of The Maids in that its owner had originally approached Servicemaster several years previously with a view to The Maids being acquired. An investigation was carried out at the time by the team leader but the proposal rejected by Servicemaster's US parent. Although in the same sector (cleaning) the activities of The Maids were different; Servicemaster specialised in one-off cleaning while the target was orientated towards domestic contract cleaning- aimed principally at both dual income and elderly households.

This would normally consist of scheduled cleaning but there was also some more flexible/occasional and specialist cleaning activities performed, eg spring cleaning or moving house services. Income was derived form an up-front license fee, the sale of cleaning product and a management fee directly related to turnover. The Maids was part of a UK privately owned company, Global Cleaning, which had a market position more towards the commercial sector and in particular office cleaning. Domestic cleaning accounted for only eleven of the fifty franchisees controlled by Global and was seen as having significantly different attributes. The vendor, based in Sutton, saw poor prospects for the company within the group, had found general difficulties in control and was concerned at the lack of profitability.

The management buy-in team, frustrated by US control, saw the opportunity to do the kind of work they wanted to, being able to develop their own strategy and build a successful organisation while also recognising a specific commercial opportunity in a sector known to them. They felt there was good scope for market growth as well as the obvious turnround potential inherent in certain loss-makers where serious management problems have been identified. They also saw the need to ensure that a basic franchisee once selected would be fully supported and produce results which were significantly better than currently being achieved by the existing franchisees. There was also an opportunity to help existing franchisees to improve their business.

A7.4 The Management Buy-in

The actual identification of the company was essentially organised by the team with the informal use of a specialist consultant. With Servicemaster's UK base and two of the team living in the East Midlands, the advisers chosen had a heavy East Midlands bias. The accounting adviser was Ernst & Young (Leicester office) where a consultant had previously worked in a senior position at Servicemaster. The Leicester office for Edge & Ellison was selected for legal advice. Three main sources of finance locally were sought, the final arrangements being a combination of 3i and Midland Bank. The third potential source, a clearing bank, while initially appearing aggressive in the search for new customers in the franchise industry turned out despite these impressions not to be interested in taking an equity position and not to be prepared to offer specific support. In the selection of Midland, the team were helped by earlier contact they had through their employment at Servicemaster. In many ways what was key in the selection of the bank was the relationship with the branch manager rather than the actual bank. 3i were chosen essentially through their position as the only major source of venture/development capital in the East Midlands with the Leicester office being more convenient than Nottingham. All three main advisers were highly rated by the team providing the necessary degree of support during negotiations and acting promptly, the actual negotiations taking 4 months to completion.

TABLE A.1: THE MAIDS: FINANCIAL STRUCTURE OF THE BUY-IN

	£'000
Equity:	
•Ordinary shares (management)	100
•'A' ordinary shares (3i)	33
Total Equity	**133**
Debt:	
•Directors' loan	50
•3i loan	100
•Midland bank overdraft	20
Total Debt	**170**
Total Finance	**303**

The equity subscription in a mixture of different types of ordinary shares gave the incoming management team 75 percent of the voting equity (Table A.1). Unlike many buy-out financing structures there was no layer of preference shares. Instead there was a significant loan element totalling £150,000 provided by both the venture capitalist (on a 7 year basis) and the in-coming team with the involvement of the clearing bank relatively insignificant. The high level of finance provided by the team, virtually 50 percent of the total financing illustrates the personal commitments expected in the smaller management buy-in. Each director personally guaranteed the sum raised, the main sources for their finance being second mortgages (through the Midland) with certain other personal cash resources topping these up. The finance provided by the clearing bank was in the form of an overdraft.

During this period the team had left Servicemaster to avoid the obvious problems of conflict of interest but decided not to set up a consultancy company during this period.

Two main difficulties which emerged during the negotiations were typical of those which occur in many management buy-ins- attempts by the vendor to change the terms of the acquisition prior to completion but at a point when the team had already left their previous employment and secondly access to accurate information relating to the financial strength of the target. The first problem was successfully solved while the experience of the legal advisers ensured that significant attention was paid to limit the downwards risk. At the time such details seemed incidental to the management but later proved vital to have been covered through warranties. In the period up to completion considerable difficulty was encountered in verifying accounting information and also in assessing the strength of the individual franchisees. During the negotiations a degree of trust which could prove to be unwarranted had to be placed in statements made by the vendor, the potential damage which could be created by doing so being covered through as extensive a use of warranties as possible.

A7.5 Action and Performance Post Buy-in

Following the completion in June 1989 of the buy-in, the new management were able for the first time to look at the state of the company and assess in more depth the realism behind the business plan which had been the basis of the buy-in finance. It quickly became apparent that while the team retained their long term faith in the franchise, the actual state of the franchise network in the UK was worse than had been expected. Much of the first year after buy-in had to be spent on revitalising the existing network rather than selecting, appointing and helping new franchisees. Concentration was on operating matters rather than implementing the strategic aspects of the original business plan. A key element of the new management was to ensure that they centrally were able to provide the support and back-up services which may not always be provided by the franchiser. As a result a much more active supervisory and training programme was implemented highlighting the need for business reviews, forward planning of both cash and human resources, the provision of book-keeping and tax advice, meetings with other franchisees, help with advertising and promotion, more effective training, improved employee selection and a willingness to provide immediate assistance with day-to-day problems. Centrally the company were able additionally to help in the identification of new markets, new products and services were added and administrative and financial systems were improved.

Another key change was to relocate the business from Sutton in Surrey to Loughborough, close to the homes of two of the team in the East Midlands, away from the previous owners and of course more geographically central for a franchise network which stretched from Scotland to the south coast of England although there was a high concentration in the Thames Valley. While relocations as such are relatively unusual in buy-ins and indeed the majority of new ventures and can lead to serious problems, it did allow the company to move from a more high cost location to a relatively low cost one and resulted in some small employment loss; this had been agreed in advance with the previous owner who absorbed the surplus staff in his operation.

In addition to the urgent need to improve the existing franchise network the fears over the problems of access to relevant information which had been noted during the information period became real as the 'skeleton in the cupboard' type of problem emerged. These centred around commitments made by the company before acquisition which should have been revealed during the negotiations as well as failure by the previous auditors to correctly verify certain end-year accounting figures. Although such items are covered under warranty arrangements, much management time has had to be absorbed in pursuing these claims with the inevitable high legal costs involved. This has therefore led to the need to fund items which were not included in the business plan. To protect against the possibility of warranty claims having to be pursued through the courts, buy-in teams should consider limiting these potential costs through taking out legal expenses insurance. Management felt that alternatively or even additionally further safety could be obtained through insisting on the purchase price being met through staged payments or significant retention.

TABLE A.2: THE MAIDS:[a] FIRST TRADING PERIOD	
	£'000
Turnover	177
Operating profit	57
Interest	40
Profit after interest	17
Goodwill amortisation	14
Profit before tax	3
Profit retained	3
[a] Refers to Gophone, the holding company, and covers the period June 1989-March 1990.	

Despite these pressures on the company, the first year's operations resulted in a pre-tax profit of £2,000 after provisions, very close to the original plan of break-even and a significant improvement on the loss of £75,000 made under the previous ownership (Table A.2). Two new franchisees were appointed while two existing operations were transferred to new franchisees shortly after the year-end.

In terms of institutional involvement, the team had been allowed to operate on an essentially independent basis with no non-executive board members being appointed. Nevertheless the need to maintain good contact with both 3i and the Midland was understood by the team and as well as providing the financial backers with accounting information meetings held with them thrice a year to update them on the development of the business.

A7.6 Long Term Intentions

With much of the efforts of the first eighteen months of operation directed at strengthening the existing franchisees and sorting out serious problems which had not been discovered during the due diligence process, attention is now being placed on how the company should be allowed to develop. Over the next year efforts are being made to expand the franchising network in two ways- first by the recruitment of more franchisees and secondly by the establishment initially in major East Midlands town of directly owned operations. (Company owned activities are now carried out in both Loughborough and Nottingham while a third location in Derby is planned for later in 1991). Although this will not generate franchising fee income for the company, it will provide some regular operating profit. Unlike many other service sector orientated buy-ins, management at the time of interview was not too concerned over the impact of recession although foreseeing some danger of scaling down of the level of activity of individual franchisees. Many of the professional couples who take the service are likely to need to continue work to cover mortgage costs while demand from more elderly clients is likely to continue basically unchanged. Actual staff availability may even improve.

For the long term the team have as yet no real exit intention and are expecting no problem assuming satisfactory performance in their institutional backers accepting that they should remain in independent ownership for at least ten years. After that point, there is always the possibility that exit may be by family succession rather than a conventional trade sale.

A7.7 Conclusions

While the sector for The Maids buy-in may appear not to be typical, it does illustrate many of the characteristics and problems of relatively small management buy-ins. Crucial to the success has been a well balanced team who have worked well together in a similar activity before and are well aware of their fellow directors' strengths and weaknesses. The identification of the target has essentially been done through personal contact without reliance on the institution. The funding package has required a significantly high personal financial commitment. Major problems have been encountered in access to correct accounting information on which to base both the future business plan and assess a reasonable purchase plan. Advisers and the team correctly covered this through warranties but the underestimation at the time of the buy-in of these problems has probably put the team one year behind their original company development plan and meant that the management had to concentrate on operating rather than strategic aspects in the first year of the buy-in. Considerable attention must be placed by management into ways of reducing these risks through the negotiation of comprehensive warranties, deferred payments and legal insurances.

APPENDIX A8

AGK Civil Engineering Ltd: A buy-in relying on a significant change in business direction of a profitable part of a subsidiary of an overseas controlled company

A8.1 Introduction

AGK Civil Engineering represents a small to medium sized management buy-in by a team of three who had worked together in the same sector as the target company but in a different part of the country. Potential success of the buy-in was dependent on the ability to rapidly gain new contracts: without this there could be no major turnaround of the business and it would be likely to be barely viable. Such contracts however proved slower than originally expected and one of the main sectors in which the target was involved contracted sharply around the time of the buy-in. Additionally the team has had to cope with working from the same site as the previous owners. Despite considerable progress since buy-in original projections of profits have not been achieved and consequently it is likely that the ratchet targets will not be met.

A8.2 The Team and Motivation for the Buy-in

The team of three had worked together in a Durham based privately owned mining company for several years. The team leader had extensive general management background and was educated to both university and professional qualification levels and had recruited the other two. The leader had been with the previous employer for 5 years and his number Two for three. As in many buy-ins, his number Two was one age band younger and one educational qualification less. While overall the team of three had good general management, marketing and production experience there was a finance gap.

The team had previously been managing Mangham Shaw, a mining company in the North East of England which was privately owned. The problems of succession which face privately owned companies appeared in late 1988 to be creating a management buy-out opportunity with one director of the two owner directors retiring and the possibility that the other might be persuaded. Approaches were made at this stage to several financiers to determine the feasibility of a buy-out but a mutually acceptable price could not be agreed with the remaining owner. While management were prepared to stay in the interim, they clearly had become very interested in the idea of owning the company for which they worked. They had also had an introduction to advisers, most notably the 3i office in Newcastle, who were to help with the opportunity for a buy-in.

Although none of the team had previous experience of significant ownership of a private company, they were clearly motivated (having gone down the buy-out route unsuccessfully) to find a company which would provide a suitable opportunity for their skills and experience. They felt in particular a lack of opportunity in their existing company and the need to develop their own strategy and build a successful organisation.

A8.3 Identification of the Target

Having had substantial experience in the open cast mining business, the team felt that the industry of the target was extremely important followed by potential market growth, asset value and turnround potential. Location was to be only a minor consideration. The search was conducted very much through personal knowledge of the industry using professional contact and knowledge of companies gained as a competitor. One small company in the sector was initially approached again on the basis of personal knowledge following the death of the principal but the bid was unsuccessful, the vendor deciding not to sell; the widow had apparently started to enjoy running the company.

The actual target company, Norwest Holst Mining, then appeared as an obvious target. Norwest Holst, itself a 1985 buy-out, was now controlled by Societe Generale des Eaux. The vendor felt the subsidiary had relatively poor growth prospects and requiring finance for other purposes, sale could prove attractive. The target had a significant plant hire side which was not of prime interest to the buy-in team while the mining and contracting side which was the main attraction was believed to have considerable more potential than was being realised; this was the area where the team believed they had specific expertise and contacts to generate new business. The target was based in Chesterfield, a significant distance from their existing employment.

A8.4 The Management Buy-in

The buy-in process was considerably influenced by the learning experience of their earlier unsuccessful buy-out attempt and the various contacts which had been made during this. While originally the team had looked to London for providing the finance and expertise required in the buy-out, they had been unable to identify a sympathetic financier in whom the team had confidence. They had then been introduced to Coopers and Lybrand Deloitte in Newcastle by their previous employer's bankers. The accounting advisers were able to provide a complete package on a 'no deal no fee' basis and played a key part in introducing interested potential investors. The 3i Newcastle office which had been prepared to support the buy-out attempt were keen to back them again in a buy-in attempt. This faith in the management team through this earlier buy-out relationship was clearly an important factor in their selection, a rival financier dropping out at a relatively late stage. From the institution's point of view, good management who have been unable to effect a buy-out are often a suitable source of managers for buy-in targets. The solicitors used were Walker Morris Scott Turnbull.

While the actual identification of the target had taken two months, the negotiations with the vendor took another four before completion, the team leader leaving his previous employer two months before completion. Norwest Holst acted as reasonable sellers, the price inevitably being subject to some haggling and management believing that they had not got the company cheaply. Nevertheless the team's offer for the company was the only one on the table. Besides price, a very important negotiating factor was that only about 80 percent of the business was being sold and other Norwest Holst activities would be remaining on site. Consequently arrangements for rental, meeting of site overhead costs, etc had to be made with the vendor with the obvious concern that if the correct structure for these was not agreed, there would be potential for further friction between vendor and purchaser. The business taken over had a turnover of £4.7 mn, employed 30 and had an operating profit of £0.4 mn. A new company, AGK Civil Engineering, was set up to act as the vehicle for the acquisition.

The financing structure of the deal had to reflect the particular nature of the plant hire and mining/contracting industries. Equipment with a high initial capital value was required some of which will normally be provided for and hence written off in an individual contract of several years duration. Against this commitment the award of contracts was likely to lead to significant up front payments which will help cash flow. Clearly failure to obtain new contracts would cause major cash flow gaps. A major concern was to assess how stable any contracts obtained by previous management were, the condition of the existing equipment and analysing realistically the prospects for obtaining new contracts to expand the business using the team's expertise. Compared to a management buy-out, the buy-in team was likely to find it more difficult to obtain current indications of the business trend- eg audited accounts which may be available may show a different trend from more up to date management accounts while the actual policies used in assessing the realisable value of plant and equipment may not be those favoured by the team. In this particular case, the incoming team had been told that the company were not being successful in obtaining new mining/contracting business but that the plant hire business (in which they were not so interested) was still providing a satisfactory profit. For the expansion of the business, they budgeted on the basis of their knowledge of the business and their own capabilities to obtain two major new contracts in the following two years.

TABLE A.3: AGK CIVIL ENGINEERING: FINANCIAL STRUCTURE OF THE BUY-IN	
	£'000
Equity: •Ordinary shares (management) •'A' ordinary shares (3i) Total Equity	 75 40 115
Debt: •NatWest bank overdraft	 1,000
Subordinated loan stock (3i)	496
Plant lease (Lombard North Central)	1,000
Total Finance	2,571

The financing of the large value of plant clearly had a very important role to play in the overall financial structure (Table A.3). This proved to be a difficult factor in that there were competing claims by various financiers for the effective first charge over the fixed assets. In the leasing element there was also a limited guarantee required which was considered by the team to be unhelpful. Surplus plant and equipment were identified by the incoming management; part of the banking facility involved the requirement that £300,000 be obtained within a set period from liquidating this surplus. The clearing bank selected, Nat West, had been introduced by 3i and Cooper & Lybrand Deloitte.

In the equity arrangements, a small ratchet was included which could increase the management's share percentage from 60 to 65 over a three year period if certain profit targets were met. Additionally 5 percent of the equity was reserved for existing management. The team's equity was obtained through the remortgage of houses and loans from family/friends.

A8.5 Actions and Performance Post Buy-in

Following the completion of the buy-in in July 1989 management had first to carefully analyse the strength of the company in terms of its existing business and employment of assets and secondly to ensure that the expansion of activity which had been assumed in the business plan was achieved on schedule. It quickly became clear that while in terms of historic statutory accounting information, the plant hire side had been a significant profit earner, the period since the end of the previous accounting year had masked a very serious decline in profitability and strength of the business which had not been brought out in negotiation with the vendor. Furthermore the actual value of plant acquired given this downturn in activity could be questioned- with some of it not having been used for a period of time, the costs involved in commissioning it for future contracts in some cases was excessive. Consequently there were serious questions to be asked about the realistic value of the assets required and the prospects, if any, of the plant hire side. With the recession beginning to bite, management had to accept that the run down of the plant hire activities had already started quite dramatically and there would be little profit from that activity. A programme which involved strong measures of both strategic and operating turnaround strategy was required.

During the autumn and winter progress was made on expanding the contracting side of the business with the aim to use the open cast mining experience of the team as well as developing pure earthmoving and civil engineering activities, but the major contracts necessary for generation of turnover and profits in line with the business plan were still elusive. Furthermore most new work was gained through acting in a sub-contractor capacity for the main contractor for a project reducing targeted profit margins and giving unsatisfactory stability in deteriorating market conditions. By the end of March 1990 contracts worth £875,000 for reclamation, roadwork and earthmoving projects had been won principally in an indirect basis from Leicestershire County Council, Evered Quarries and ARC Eastern. Additionally the company took over a £1 mn contract for earthworks from Blue Circle Cement, Shoreham. It was not until April 1990, nine months after the buy-in, that the breakthrough came with the award of a £12 mn contract from the South Wales region of British Coal for opencast coal mining at the Derlwyn Opencast Site.

The difficulties faced by the buy-in team in gaining new contracts derived from several factors. First Norwest Holst had no real track record in the chosen area for expansion and clearly the newco AGK Engineering had none either. Consequently credibility relied not on previous corporate performance but the personal one of the team. Secondly in a market which was new geographically to the team, the company had to gain intimate experience of the tender procedures administered by potential customers, a process which can be fraught with difficulties. Thirdly problems were experienced with the financial credibility of the company- with the high degree of leverage involved there was concern by potential customers as to the long term stability of the buy-in. This was particularly relevant to local authority contracts.

As well as the need to generate new sources of turnover, management had to strengthen the team to cover areas of specialisation which were missing. A new Finance Director was appointed and an existing manager was appointed as Plant Director. Both were given the opportunity to acquire equity amounting to two and a half percent each. In the longer term, three to five years, management is interested in extending employee involvement possibly through the introduction of an ESOP scheme. In the short term no major changes have been made to incentive systems. The incoming team believe that the change in direction of the company especially the move back to opencast mining has been positively welcomed by employees. No job losses were effected on buy-in and the award of new contracts resulted in a subsequent increase in employment to fifty.

Relationships with the financing institutions remained satisfactory. 3i is effectively represented on the Board of six by a non-executive director (who is not Chairman) and was suggested to the team by the institution. Clearly the executive directors hope that the experience and contacts which he brings will contribute to the expansion of the business. Each month management accounts and a short report are sent by the Managing Director/Chairman to the institutions for their monitoring purposes but there is little other direct contact.

Financially expansion of the company has been dominated by the speed at which new contracts can be won. Despite the longer periods than expected in doing this, the company has been essentially significantly cash flow positive. While £300,000 of the Nat West facility had to repaid in a relatively short time schedule from asset disposals, agreement was reached for this to be extended, the revised schedule being met. For the major new contract in South Wales, additional project finance had to be raised. This was mostly done through off-balance sheet finance using both finance brokers to seek finance from (overseas) finance houses and also through arrangements made with equipment manufacturers and their distributors.

A8.6 The Outlook

The winning of only one rather than two major contracts in the first eighteen months following buy-in has made the prospects of achieving the ratchet conditions which were dependent on profits over a three year period unlikely. This would have allowed the team to increase their share of the equity from 60 to 65 percent. Nevertheless the team will remain as the majority equity holders.

The immediate task ahead was seen as continuing effort to win a second major contract, investors believing that the company has a timing rather than any fundamental business problem over winning such a new contract. The decline in the level of UK economic activity was making the business of increasing turnover considerably more difficult while high interest rates affect the financing and hence and competitiveness of equipment for new projects. The team have no intention of expanding through acquisition in the short term.

In the longer term management have yet to decide on a method for exit. There was none particularly favoured at the time of interview and management would appear to want to keep the company private for a significant period.

A8.7 Conclusions

The AGK Engineering case has demonstrated a well balanced and typical team who had attempted but failed in an earlier buy-out attempt subsequently moving within the same industry from a privately owned company to part of another company where a critical part of the initial effort has been to apply their skills to considerably expand business. In a declining economic environment this resulted in failure to achieve Business Plan levels of turnover or profitability. Additionally the case has demonstrated that the fortunes and business mix of a company can change significantly during the relatively long period which elapses between identification of a target company and completion of the buy-in resulting in the type of post buy-in action being significantly different from that originally envisaged.

APPENDIX A9

G & AE Slingsby: A buy-in of a fourth generation family owned company with subsequent performance below expectation resulting in a trade sale

A9.1 Introduction

The buy-in of G & AE Slingsby was carried out by an experienced management team who had worked together in a privately owned company for a long time. Personal industrial contact provided the means of target identification. Moving to another region and a company with significantly different problems although in an identical market posed considerable problems. Within two years of the original buy-in, two of the team of four had left and in the third year against a background of failure to achieve profits target the company was sold to a major plc.

A9.2 The Team and Motivation for the Buy-in

The team consisted of four managers and directors who had previously been employed in the industrial equipment division of T Crossling & Co, a privately owned Newcastle-upon-Tyne company. All four had worked there for a considerable time, the minimum period being seven years. The leader of the team had joined the company from a management consultancy in 1974 as director in charge of a very small industrial piping activity and had expanded that activity to employing over 40 with a turnover of about £2 mn by 1987. The other members of the team included the General Manager of the industrial division (to become Sales Director) and a Personal Assistant who was also secretary of a trade buying co-operative (to become Company Secretary/Director). The fourth member of the team with warehouse and transport experience was appointed as a Manager rather than Director. The team was therefore comprehensive in terms of skills other than Finance.

The industrial equipment division of T Crossling & Co had been built into a major part of the company's operations. Part of the success had derived from the founding of a buyers' co-operative with nine other similar companies which had enabled the members to buy from major manufacturers on terms which were close to those that the large quoted companies in the sector were able to. The successful establishment and subsequent operation of this was very much in the hands of two of the team.

Motivation for the buy-in appeared to come from the feeling of the team leader that it was time for him to make a move from the private company; this would enable him personally to build a successful organisation. He had earlier been offered a senior position at a chemical company, had declined it but accepted a non executive directorship. At this point he had become interested in the prospects of buying a company.

A9.3 Identification of the Target

The team leader's position as chairman of the buying co-operative was key in the identification of the target. Through regular contact with the nine other members, he was able to assess other businesses in the same sector which could be potentially up for sale.

One of the companies in this co-operative buying group was G & AE Slingsby, a family owned company based in Hull which was involved in the supply of industrial pipes, pipe fittings and valves to the engineering industry. At the time the company had a turnover of about £1.3 mn, was making a small operating loss and employed 44 people. The company had been founded in 1888 and had remained within the Slingsby family, the third generation managing it. The company history highlighted key problems facing privately owned companies- family who may not particularly enjoy managing the business permitting it effectively to decline reversing the efforts of a previous generation and who then may be followed by the next generation who were not interested in it. Consequently the initial approach made to the third generation Slingsby was well received and it was quickly apparent that there was the prospect of a deal being made. Given this quick response, no other targets were effectively considered.

A9.4 The Management Buy-in

Having identified the target company, the team leader had to set in motion the preparation of the Business Plan followed by the raising of funds. Initially he approached an old friend in 3i whom he had known some years earlier in their Newcastle office. He stressed the need to obtain an independent financial adviser and indeed provided an introduction to the Leeds office of the accountants Robson Rhodes. Almost simultaneously the team leader was offered help in this on a personal basis from another source and decided not to go ahead using the major accountancy firm. This proved to be a major mistake as after four months the buy-in proposals and financing had hardly moved. The leader decided then to revive contact with Robson Rhodes and within a week had reached the stage where there were financing offers on the table.

The team leader wrote the business plan, making use of the computer projections that the accountants were able to provide to supplement his own data and rewriting any submissions by the accountants in his own words. Arrangements were done on a 'no deal, no fee' basis. The accountants introduced a legal adviser, the Leeds office of Walker Morris Scott Turnbull.

The quick and positive response by the financing institutions to the Business Plan highlights the use of good independent advisers to management teams, their ability to be able to pinpoint likely sources of finance and in particular the local stature which some buy-in accountants have. Although clearing banks were approached in the Leeds area, the accountants felt that London based equity institutions should be approached. This involved the advisers and team leader spending 36 hours in London presenting the plan to three institutions. For clearing bank finance the Leeds office of Bank of Scotland responded impressively on the same day with a conditional letter of intent. MIM DC also provided a quick response following the visit to London on equity funding, liking the business plan and management. The other institutions approached were considerably slower and less impressive to management.

The actual structure of the deal was different from many other buy-ins because it was the business rather than the company which was for sale, the team acquiring the working assets. In particular the various properties were not bought, an agreement being reached with the vendor for renting them. Consequently while the purchase price of the assets was only £477,000 there was effectively an overall financing commitment approaching £1 mn. Although the initial decision not to take on property significantly reduced the initial financing requirements, it could have proved useful later; it would have provided an additional source of asset backing as well as opportunity for rationalising old surplus stock held in some of them. The asset backing of the company would also have been helped by the considerable increase in local commercial property valuations in the late 1980's.

TABLE A4: G & AE SLINGSBY - FINANCIAL STRUCTURE OF THE BUY-IN	
	£'000
Equity	
•Ordinary shares (management)	68
•Preferred ordinary share (MIMDC)	80
•Cumulative redeemable preference shares (MIMDC)	100
•Cumulative convertible redeemable preference shares (MIMDC)	19
Total Equity	**267**
Debt	
•Bank overdraft	**350**
Loan Note	
•13% unsecured, 1990/93 (institution)	**100**
Finance Leases	**70**
Deferred payments (Vendor)	**177**
Total Finance	**964**

The financing structure (see Table A4) comprised equity, bank loans, a loan note, the taking over of finance leases and a deferred payment to the vendor. In the equity, the various normal classes of shares use in venture capital transactions were employed although the two classes of ordinary shares were issued at a premium over par; this arrangement gave the buy-in team 60 percent of the voting equity for a subscription of £68,000. A ratchet dependent on profits and with a trigger period of six years was used which could reduce the management equity stake to 51 percent.

The use of loan notes by an institution in this instance was rather more unusual. However it should be noted that some institutions, eg 3i, have frequently provided loans to buy-ins as well as conventional equity and the provision of facilities by clearing banks. The Bank of Scotland provided a £350,000 facility under relatively attractive terms, the main covenants being linked to net current assets and debtors, and discussion centring on the debtor cover, management being able to persuade the bank to adopt a more lenient attitude than they had at first wanted. The vendor provided a deferred payment element of £177,000 repayable over five years, an item which was a significant negotiating difficulty in coming to a satisfactory agreement. The Bank of Scotland were also able to assist in providing the personal loans which some of the team required to finance their equity commitment, a particular problem as not all the team possessed a house to re-mortgage.

The buy-in process was undoubtedly helped by the positive and speedy performance of the accounting and legal advisers and the financiers. Nevertheless the whole process took nine months from initial approach to completion in May 1987 reflecting the time wasted with the initial adviser and the technical and personal problems which occur in negotiation with privately owned companies. The most important negotiating difficulties were agreement of the stock values and deferred consideration. The team leader left his previous job two months before completion.

A9.5 Actions and Performance Post Buy-in

The buy-in was accompanied by significant personnel re-organisation agreed with the vendor to take account of the departing management and the incoming skills of the team. Eleven of the workforce of forty four were made redundant, all of the old family and five others. Within the first month it became apparent that the business had been run down to a greater extent than had been thought both before and during the lengthy period of negotiations. The first month's sales at around £60,000 were well short of the £100,000 which had been expected. Additionally there was a certain lack of credibility among customers as to the ability of the company to be able to supply equipment- stock levels of fast moving items were low and the company was frequently in a position of not being able to supply. It was clear that major changes were required to ensure the success of the buy-in.

The previous pricing and selling policy was seen as being too rigid and it was necessary to adopt an approach of matching competition to be able to regain the lost sales. More effort and people were put into field sales so that the company was being aggressively sold for the first time in over ten years. Administrative, paperwork and financial systems were similarly rigid and required to be improved. A new computer system was installed. Stock was also out of balance, there being a general shortage of fast moving parts while there was a lot of old stock, some being more than ten years old. A very careful stock evaluation had been carried out by the team prior to purchase so that the problem was more having to make the financing commitment of stock which might take several years to clear rather than having to make significant stock write-offs.

Not only was the team having to start from a lower sales base than they had expected but it became apparent that individual performance within the team was mixed which in turn was not allowing the quick recovery to Business Plan levels. The first to leave after six months was the Transport/Warehouse Manager who had not been able to adapt to the changed environment. He was the only member of the team who had not been under the direct control of the team leader in their previous company, being under another director who had in fact retired about the time of the buy-in. The Sales Director left after two years. In his previous position as General Manager of the Industrial Division he had proved very competent in that particular environment. The change to a position where field sales experience and action was essential brought out weaknesses which had not been evident before. There are important questions to be answered about the selection of a team- performance in the existing environment may not be a good guide to the future abilities of management in a buy-in. While wider equity involvement by management is to be welcomed, the team leader has to ensure that he has the right team. In this case the position was further complicated by advisers encouraging a larger team.

Clearly the departure of two of the four members of a buy-in team is a traumatic experience and inter alia results in problems over the allocation of the departing members' shares. Coming so soon after the team had to leverage their personal financial positions with interest rates moving higher, the remaining directors were in a difficult position to effect a purchase. However in the first instance MIM DC bought the departing member's shares with the two remaining directors having an option to buy them back within 12 months. In the second case the remaining management bought the shares, borrowing from the Bank of Scotland to do so. Independent valuation of the shares had of course to be obtained, this resulting in further cost.

TABLE A5: G & AE SLINGSBY - POST BUY-IN PERFORMANCE			
	1988 (£'000)	1989 (£'000)	1990 (£'000)
Turnover	1,385	1,806	1,969
Operating Profit/(loss)	(38)	40	(25)
Interest (net paid)	(34)	(61)	(93)
Pre tax profit/(loss)	(72)	(21)	(118)
Exceptional item	(12)	0	(70)+
Tax	0	0	0
Post tax profit/(loss)	(84)	(21)	(188)
Extraordinary item	(6)	0	0
Loss for the financial year	(90)	(21)	(188)
Shareholders' funds	129	108	(80)
Employees (numbers)	33	37	37
+ Balance of goodwill written off			

The performance of the company (see Table A5) reflects the problems encountered initially on transfer of ownership and the changing financial environment. In the first year an operating loss was made although in the second there was a major improvement in turnover and operating profit. However by this time interest rates had risen significantly from the historically low levels of 7 and 8 percent at the time of the buy-in resulting in a second year of net loss. Had interest rates remained low, it is probable that the company would have managed to be profitable in its second year. Given the losses, net assets/shareholders funds had reduced to £108,000 despite the initial significant equity capital injection.

A9.6 The Trade Sale

During the third year of the buy-in, it was apparent that to finance future expansion and ensure financial stability in the approaching recession, a further round of finance would be required. Proposals were made to the equity institution which declined to provide further finance. For the long term prospects of the company, management felt that there was now no option other than to sell out. Originally management had hoped that they would exit through a float, trade sale or through a second buy-out/releverage in about 15 years. They believed that the institutional exit intention was probably about half of this, to some extent being conditioned by the six year period of the ratchet.

Initially with MIM's approval efforts were made to see if there was any other institution which was willing to buy them out and provide additional funds. Help from Robson Rhodes was used in this process but no suitable institution could be found. The clearing bank continued to be supportive in this. Management therefore had to look towards a trade sale and initially approached three members of the original purchasing co-operative. Two were prepared to make offers but not within the price limits which MIM had indicated would be acceptable to them. The sale was then widened to major companies, of which only one, British Fittings Group which lacked distribution coverage in the North East, came up with an offer which satisfied the institutional equity holder and would allow management to pay off the debts involved in financing their equity subscription.

The complexities of the original buy-in deal were yet to cause problems. The purchaser was keen to buy the properties rather than rent them and do this simultaneously with the share purchase. Although the deal was agreed in principle in March 1990, it was not until September 1990 that it could be completed because of delays in property negotiation. Within this six months, the British Fittings Group share price had fallen resulting in the institution effectively not being able to realise the return it had expected because of the share exchange nature of their arrangements with the purchaser. The two remaining members of the team received 45 percent of the value of their ordinary shares in cash and had an earn out opportunity over two years related to profit. If that is achieved they will lose even on their buy-in investment; if not they will at least have managed to limit their losses.

A9.7 Conclusions

This case has shown a combination of important problems which are relatively common in management buy-ins: the possibility that management may not react satisfactorily to the new business environment; delays caused by inappropriate choice of initial advisers; divergence between management and institutions over the long term direction of the company; the need to analyse the underlying strength of the business and assess the corrective action which needs to be taken initially; the optimum leverage; and the competing advantages of buying a whole company or just the trading assets. Despite having the positive advantages of knowing both the target and industry well, the buy-in still failed to perform to expectations. The case also raises the serious issues of institutional attitudes to buy-in longevity.

APPENDIX A10

Metalliform: a buy-in of a subsidiary of a quoted company, the buy-in on divestment

A10.1 Introduction

The management buy-in of Metalliform involved the purchase of the last company to be sold in the divestment of the furniture division of a quoted company by managers who possessed experience of the sector and had worked elsewhere in the Division. In the first year of the buy-in the company performed significantly better than under the previous ownership and in line with the buy-in plan, much re-organisation being carried out. In the second year government privatisation arrangements resulted in 75 percent of the immediate customer base being lost and brought substantial losses and indebtedness problems, resembling the abnormal conditions which may trigger special turnaround action. A financial re-structuring involving new investors and the dilution of the original institutional and management equity stakes narrowly prevented the company from being placed in receivership. Subsequent short term improvement in sales strengthened the company's financial base. This case illustrates a buy-in completed at the height of the buy-in market in 1989 with associated aggressive financing structures where, despite the absence of skeleton in the cupboard type of problems, management still faced grave difficulties in achieving medium term success.

A10.2 Identification of the Target

The management team was typical comprising a team of two, with the Number 2 having specific skills (Production) rather than the more general ones possessed by the Team Leader. Both had stable employment histories and considerable experience of the furniture manufacturing sector as well as first hand knowledge of the target. Unlike the standard team both moved region to join the target.

The Team Leader worked for Hollis Industries in the mid 1980's and subsequently for the Maxwell Pergamon AGB company when Hollis became part of Pergamon. He was retained by Maxwell following the management buy-out of Hollis Industries from Pergamon and was given specific responsibility for the Furniture division of the company. Following the decision by Pergamon to divest this division on the grounds of redefinition of core activities as well as the need to obtain finance for acquisitions, the Team Leader sought buyers with four of the division's subsidiaries being sold to incumbent management. The Team Leader had always wanted to own his own business and saw another, Metalliform, where existing senior management was too old to be able to receive financial backing, as a suitable target for a management buy-in. Metalliform was a manufacturer of office and educational furniture based at Hoyland, near Barnsley in South Yorkshire. Metalliform was seen as a company in a sector with good potential for market growth while Metalliform itself was backed by significant asset value. The Number Two, a Production Director, had 12 years relevant experience.

Clearly Metalliform is an imperfect form of buy-in because of the role of the Head Office/divisional management. However the transaction could be expected to provide an interesting alternative to the normal incumbent management buy-out with expectations of a more satisfactory risk level for the institution. The new management were proven to be of high calibre with good knowledge of the target and with consequently less likelihood of unseen factors emerging after the transaction to jeopardise subsequent performance.

A10.3 The Management Buy-in

Management nevertheless had to ascertain the true nature of the company despite its existing knowledge and employed Cooper and Lybrand Deloitte as accounting adviser. Although Coopers were group auditors, Chinese walls were employed by using a regional branch's corporate finance department (the Leeds office) for this role. The proposal and Business Plan were jointly prepared by the Team Leader and a Coopers partner. The Plan was then sent to twelve financing institutions of which seven replied positively. County NatWest Ventures were chosen as the preferred equity provider through providing management with the most attractive equity share package. County NatWest Ventures then brought 3i in as equity partner and bank finance was provided by the Bank of Scotland.

TABLE A.6: METALLIFORM: FINANCIAL STRUCTURE OF THE BUY-IN

	£'000
Equity	
•Ordinary shares (management)	10
•Cumulative convertible participating preferred ordinary shares (CNWV and 3i)	50
•Cumulative redeemable preference shares (CNWV and 3i)	750
Total Equity	**810**
Debt	
•Term loan and overdraft (Bank of Scotland)	2,200
Total Debt	**2,200**
Loan Notes	
•Management loan note	90
•Vendor loan note	600
Total Loan Notes	**690**
Total Finance	**3,700**

The timing of this transaction in June 1989 was close to the height of the buy-out and buy-in market and was reflected in the aggressive financing structure (Table A.6). Management had initially a relatively high equity stake of 65 percent. This however was subject to a 2 part ratchet allowing management's share to fall to 49 percent on under-performance or rise to 75 percent on achieving all targets. The first stage was achievement of the ambitious first year plan and the second on a satisfactory exit value. This relatively aggressive equity percentage was additionally achieved not only on a relatively small amount of total management financial contribution (only £100,000 of the total £3.7 mn) but with the majority in the form of Loan Notes, ie most of management's contribution being able to be returned to them at some point in the future.

The second main financial feature was the high ratio of debt to equity. Thus whereas the average under £10 mn buy-out in 1989, which could be expected to be less conservatively geared than a buy-in, had only 46.4 percent debt, this buy-in, an inherently riskier proposal, was able to obtain debt amounting to 57.5 percent of total financing. The ability to do this was partially attributable to the favourable Business Plan projections, confidence in the capability of management and the asset backing. Additional finance was provided in the form of loan notes, principally for the benefit of the vendor, rather than mezzanine. The use of loan notes involved an interest rate significantly below what would have been obtained on mezzanine finance. Repayment was between September 1990 and December 1991- no interest being charged until September 1990 but interest then being paid at a rate of 4 percent.

A10.4 Action and Performance Post Buy-in

Management through its earlier knowledge of the company had extremely clear ideas as to how the business could be re-organised and expanded. At the time of the buy-in Metalliform employed 183 and had an operating profit of £400,000 on a turnover of £6.2 mn. The company was believed to be capable of much better profit generation; this would be required as financing charges would hardly cover operating profit. The Plan envisaged turnover increasing to £8.5 mn in the first year and over several years to £12 mn.

The new management saw profitability increases coming from two main sources- reorganisation and expansion of existing activities and secondly acquisitions. In terms of expansion of the organic business, emphasis was to be placed on expanding customer networks and entering different market sector. Before completion management had identified certain areas for immediate attention in terms of re-organisation to improve operational efficiencies. These included stock levels, standard costs which were questionable and the existence of many unofficial practices including private bonuses. In the first year of operation actions to raise profitability included improvement of working practices and significant redundancies to improve productivity and reduce overheads. Thirty three (18 percent of the work force) were made redundant but productivity levels improved from 67 to 87 percent. The number of pay rates was simplified with a reduction from 27 to 3. A significant amount of new capital equipment was installed to improve manufacturing efficiency. Financial control (despite the absence of a Finance Director in the Team) was also significantly improved, debtor days reducing for instance from 70 to 45 while stock levels were reduced from £1.2 mn to £700,000. A significant amount, £800,000 was spent in the first year on the purchase of fixed assets including £231,000 on fabrication equipment, £198,000 on a new paint line, £198,000 on factory space and £49,000 on new computer systems.

The second major area for improvement in company performance was through the benefits to be derived from selective acquisitions. A major operational problem was that the company occupied a large site which was effectively under utilised. The Team Leader believed that this had capacity to manufacture £12 mn of product, virtually double the level immediately before buy-in, and his strategy was to acquire other companies for their product line and equipment, closing down the acquired company's factory and transferring manufacturing and sales activities to the Metalliform factory. By doing this the additional costs of operating on more than one site would not threaten the long term viability of the acquisition while the efficiency of the existing factory would be improved.

During the first year of the buy-in one significant acquisition was made which fulfilled the aims of this policy. The target was the fabrication division of Lock International plc, a Manchester based company involved in manufacturing electronically controlled food testing equipment. While this may seem removed from the manufacture of furniture there was a strong logic in that the testing equipment went inside a fabricated steel and aluminium box which was not being manufactured to adequate quality standards. The terms of the agreement involved the purchase for £320,000 of the business and assets of the fabrication division including the relevant equipment, the manufacturing designs, know-how and rights and the negotiation of a long-term understanding with the vendor for the supply of boxes for installation in his food testing equipment machine. Thus the Team were able to improve sales by £300,000 and plant operating levels but without the disruptive influence of having another location.

A second acquisition was almost completed. This involved the purchase of a second furniture manufacturing company, Hostess Furniture, from the BSG Group in competition with a management buy-out team. The deal was not completed at the last moment after contracts had been drawn up and significant sums spent on due diligence because of concerns over the ability to sell Hostess's main property in the West Midlands at a satisfactory price; incumbent management subsequently bought the company.

As a result of implementation of sales, production, financial and other reorganisation plans, the new management had a successful first year of trading slightly improving on their plan. This resulted in operating profit after exceptional items rising to £559,000 with profit before tax of £30,000 on a turnover of £7.596 mn.

A10.5 Restructuring

Problems however emerged very soon into the second year of buy-in trading. The company's main customer was the Crown Suppliers which purchased over 70 percent of turnover and then supplied individual government departments and state controlled entities. As part of the Government's privatisation and efficiency moves the Crown Suppliers were closed despite attempts to initiate a management buy-out. Consequently a very difficult period emerged from August 1990 when the Crown Suppliers ceased to purchase but the end-user in Government Departments was also not purchasing from the manufacturer because of the Crown Suppliers' existing stock levels. Matters were made worse by the Crown Suppliers holding a large auction in December 1990 to liquidate remaining stocks and it was not until February and March 1991 that small orders started from the end-user. Additionally the second major market, educational supplies, was also subject to major re-organisation because of changes in government policy. With schools being subject to local management from July 1990, Local Education Authorities were no longer placing significant orders while schools delayed in ordering new equipment.

Two main questions were seen to arise from the debacle: was the possibility of such events envisaged in the due diligence procedures and secondly what required to be done by institutions and management to save the company from collapse during the period while the sales pattern re-adjusted.

Before the buy-in Coopers and Lybrand Deloitte had indeed noted the possibility of the change in the Crown Suppliers although clearly little attention had been paid to this element in the due diligence report. While the buy-in in its first year had suffered little from the skeleton in the cupboard type of problem, management viewed it as being somewhat ironical that an issue which had been raised but then largely neglected should bring the company to virtual bankruptcy in the second year of buy-in.

The issues relating to action which required to be taken by management and the institutions as the crisis deepened brought a rapid deterioration in relationships between management and the equity institutions. County NatWest Ventures had not initially sought to control their investment through the appointment of a non-executive director, instead relying on other control devices in the Articles of Association and Shareholders Agreement. Management did seek regular meetings to appraise investors of developments. The success of the first year had however led to some liberalisation of even these, eg the prior authorization capital expenditure limit had been doubled. It had also led to a very substantial dividend under the participating terms of the institutional ordinary shares which did not reflect the problems which had then faced the company by the time the dividend was due to be paid.

Management for their part had to continue running the business to minimise the effects of the curtailment of these two major sectors of activity as well as take the initiative in proposing restructuring plans. Despite the clear achievement of financial targets in the first year and carrying out the letter of the re-organisation plan there was uncertainty created in the minds of the financial backers as losses mounted, the economic recession deepened and no clear way forward in reviving sales volumes was evident: during this period the effect of the incentive element to perform on management through the possibility of wiping out the equity value of the company followed by receivership was felt by management to be very large and threatening. While the bonding effect of debt may at times be seen to be paramount, management feel that it was the equity arranger who provided the greatest threat to the survival of the company in terms of taking precipitate action whereas the debt provider was more supportive.

Towards the end of the second year (when a loss of £790,000 was incurred), management produced a plan for the longer term stability of the company against a still uncertain background. The main features of this were the closure of the wood work and upholstery departments with Metalliform now subcontracting these activities; reduction in employment from 130 to 80; the closure of one factory unit clearly separable from the rest of the site and its sale; the development of retail superstore markets (such as Texas and B&Q); confirmation of the expansion into fabrication (eg food testing machinery work); and the distribution of other manufacturers' products. The result would be a company capable of a turnover of £4 mn, one third of the original long term projection, and budgeted to achieve a net margin of 10 percent.

The financial side to the plan had to agreed by the beginning of August to avoid the collapse of the business. While the business side of the rescue plan was accepted by the banker, the lead equity institution was not willing to support it except with a large number of conditions which management felt were impractical (eg agreed sale of the surplus factory site within a week). The institutional analysis was felt by management to have been completed by young accountants rather than arrangers with industrial experience. Consequently without further equity support from the institutional equity providers (the co-investing institution following the line of the lead investor although it gave the impression to management of a more constructive atmosphere) alternative equity support had to be obtained. This was found through an approach to a private individual investor (Mr W G V Hall) and the South Yorkshire Pension Fund. Against a background of creditor writs an agreement was reached which included:

Injection of a further £125,000 equity comprising £100,000 from the new investors and £25,000 from the management; the provision by the new investors of 5 percent, 8 year loan notes totalling £500,000; continuation of overdraft facilities for 12 months against an initial 6 months (the overdraft at the beginning of August 1991 had in fact reached £1.4 mn against a limit of £1.2 mn); moratorium on payments on the £1 mn term loan; writing down the original vendor loan note from £600,000 to £100,000; writing off £750,000 of the original institutional preference shares to £250,000 and of £226,000 accrued dividend; the appointment of two non-executive directors, one being the private investor; and reduction in the management equity stake from 65 to 25 percent and the original institutional equity investors from 35 to 15 percent.

A10.6 Developments Post Restructuring and Long Term Intentions

The restructuring appeared to provide the basis for at least short term survival of the company but the process of negotiation had revealed the tensions which exist between equity and debt providers. Although in this case the equity providers had appeared as basically unsympathetic to a business plan which at the time of writing was to have proved at least viable in the short term, clearing banks have often proved to be the institution seeking the appointment of an administrator. The restructuring however involved the appointment of non-executive directors which the management felt would also strengthen the company; a major criticism that had been made was the lack of non executive directors before making the job of Team Leader particularly lonely and without this potential sounding board making it more difficult to gauge a rescue plan acceptable to the equity institutions. Control without the use of nominated directors is a major departure from the classic LBO Association model.

A major change made shortly after the rescue was the appointment of a new Finance Director. Financial skills had been seen initially as a major weakness in the team: nevertheless it had been decided at the time of the buy-in to retain until retirement the incumbent, a 62 year old book keeper style accountant. This added significantly to the problems of restructuring, the Team Leader having to prepare the basic financial plans although being helped by Coopers. The appointment of a younger Finance Director with financial management skills will significantly strengthen the management of the company.

The business side of the Plan was swiftly put into effect and at the time of the case study visit an offer had been received for the vacated factory unit. Just as the market had collapsed so suddenly in 1990, during the autumn of 1991 it started to revive unexpectedly as government departments and schools started to order for the first time. As a result of the sales improvement and the implementation of the rescue plan Metalliform was expected to have returned to profitably. Management are taking further action to cope with particular problems of this order improvement including the re-hire of labour which had been shed and revived pricing structures and debtor control policy to reflect that new orders came from many sources rather benefitting from the efficiency resulting from the very large orders which were placed in the past by the Crown Supplies and LEAs.

In the longer term the Team Leader is not seeking an early exit. His motivation appears to be enjoying the running of the company which he finds stimulating. He would like to buy out the other equity investors at some point and to retire at the age of 55. A floatation could however precede retirement by about two years.

A10.7 Conclusions

This case has illustrated a divestment buy-in where due diligence could be carried out much more satisfactorily than in many cases of purchase from private owners. Even so circumstances sometime after the buy-in resulted in a catastrophic period of trading which combined with high gearing led to necessary restructuring of the company to prevent it being placed in receivership. This brought serious tensions between management, equity providers and debt suppliers with management being faced with personal financial disaster despite having taken many measures to correct the trading deterioration. With equity providers not making full use of the powers of control available in the form of representation on the Board of Directors, failure to use all of the LBO Association style of control may be thought to have unnecessarily widened the gap between the interests of investor and management. While the buy-in had initially managed to adopt a more strategic approach to improving performance, considerable emphasis had to be placed on operating aspects in the second year.

APPENDIX A 11

EUROPEAN BRANDS: A buy-in providing an exit from a management buy-out with performance and managerial problems

A11.1 Introduction

The management buy-in has been seen as a valid option for restructuring a management buy-out when the buy-out faces succession problems, management or institutions wish to engineer an exit or institutional disquiet with management involves the replacement of key members of the original team but the need to incentivise new managers through giving them the opportunity of significant equity ownership. Despite the logic of this rationale the number of such transactions has been limited, the largest being European Brands. This case illustrates the problems involved in such a deal and the performance and financing aspects of a rapid acquisition programme.

A11.2 The Team

The European Brands management team had been involved in similar marketing and distributing arrangements but in different product areas. The Team Leader had in 1980 formed Crombie Eustace Limited with the intention of creating a major sales broker to the fast moving consumer goods market. By the time of the buy-in, this included products such as Biro BiC and its disposable razor blade business, Spa Comidel SA, the European mineral water company, Alka-Seltzer and Autan pharmaceutical brands from Bayer and Cirio/Bertolli, Italy's leading olive oil and tomato producer. He had turned down offers to be acquired but was aware of the need to have significant own brands and had identified BIF as a company with suitable brands.

The team combined many skills obtained in the grocery trade with marketing skills. The addition of the BIF cosmetic distribution skills was seen to coincide with general moves in cosmetic distribution towards the grocery trade. The Team Leader's earlier experience had involved working for companies well known for consumer marketing abilities such as Mars, Procter and Gamble and Revlon where he had been General Manager of Toiletries while the Number Two had extensive Marketing experience first in Beecham then following the Team Leader as General Manager Toiletries at Revlon before being Managing Director of Dixons and then Comet. The Finance Director had been FD of Crombie Eustace from 1984. Thus the Team met important criteria of having worked together before in related product areas.

The company was also considered to be strong through the employment of senior managers who had grown in companies such as Mars, Revlon, Max Factor, RHM, Nabisco, and Colgate Palmolive. As well as the Chairman of the development capital institution being a non executive director, another non executive director was employed with extensive sales and marketing experience in Beecham and Unilever including having responsibility for developing the Beecham's proprietary medicine and branded toiletry products, a process which included the acquisition of activities such as Yardley Lentheric Morny.

A11.3 Identification of the Target

Beauty International Fragrances (BIF) was a buy-out in December 1985 of a privately owned company involved in the manufacture and distribution of fragrances. At £6 mn it was a significant buy-out for the time and the equity leaders, Citicorp VC, CIN and ECI, had syndicated the equity to six other institutions with Barclays Bank providing banking facilities. The principal business activity was the ownership of Goya and an agreement for marketing Coty products under license from the Pfizer Group of the US in the UK and 50 other countries. With management incentivised by ratchet arrangements, low gearing and in a favourable stage of the economic cycle, initial performance of the buy-out was promising with a profit before tax of £2.016 mn being recorded in the first full financial year, 1986/87, on turnover of £11.718 mn.

In the following financial year however management accounts showed operating profits falling considerably. Clearly the company was not performing as well as initially expected, the Managing Director was under pressure and the institutional backers were unhappy. There was believed to be a closed style of management and poor communications within the company. Institutions unlike many buy-outs were in a strong bargaining position having 80 percent of the shares although the Managing Director of BIF was unwilling to sell and significant pressure had to be mounted by the institutions on the basis of poor performance and certain questionable accounting practices which had been used to crystallise the ratchet. (For a subsequent example of a buy-in conducted by the BIF Managing Director, see Innoxa in Wright, Normand, Robbie, 1990). Institutions had thought that there had been an obsession by management to obtain the ratchet leading for instance to unrealistically lenient stock write-off policies and questionable practices over foreign exchange losses. The company was clearly not suitable for a stock market flotation as had seemed probable at one stage and a sale to a third party seemed the most appropriate alternative.

A11.4 The Buy-in

The buy-in, completed in June 1988, involved the creation of a new company to be called European Brands Group which acquired Beauty International Fragrances and then Crombie Eustace. Of the total purchase price of £17.4 mn, £15mn referred to the purchase of BIF, the balance of £2.4 mn being for Crombie Eustace.

Funding (Table A.7) was provided in a standard form of equity and debt with equity being syndicated in units of 180 'A' Ordinary shares, 450 Redeemable Ordinary shares and 6,450 Preference shares.

TABLE A.7: EUROPEAN BRANDS: FINANCIAL STRUCTURE OF THE BUY-IN	
	£'000
Equity:	
•Ordinary Shares (management)	420
•'A' ordinary shares (institutions)	180
•Redeemable ordinary shares (institutions)	450
•Redeemable preference shares (management)	1,400
•Redeemable preference shares (institutions)	5,050
Total equity	**7,500**
Debt:	
•Long term loans	9,500
•Revolving credit	2,450
Total debt	**11,950**
Total finance	**19,450**

A significant ratchet effect was built into the structure through the redemption of the redeemable ordinary shares. Should an exit not be achieved before September 1994 or a trade sale or stock market listing before then result in an internal rate of return for institutions of less than 37.5 percent then the shares could not be redeemed. If the IRR exceeded 105 percent then all the redeemable ordinary shares could be redeemed. In between these levels a proportional arrangement was applied.

Preference shares were structured to keep interest payments low in the early years of the company. Thus in the first year no interest was to be paid, but rates of 6, 8 and 10 percent were set respectively for 1989/90, 1990/91 and subsequent periods. Redemption started in 1993 and finished in 2000. In contrast to the BIF buy-out, the deal was not syndicated. The advent of large Buy-out Funds enabled Charterhouse to fund the entire purchase from the Charterhouse Buy-out Fund.

Senior debt was arranged by Chase Manhattan Bank in the form of a term loan and revolving credit facilities. Chase Manhattan, who were new entrants to the UK buy-out debt market, were extremely keen to participate in the structuring, and replaced Charterhouse Bank at the eleventh hour when they pulled back from funding the debt.

A11.5 Actions and Performance Post Buy-in

The immediate post buy-in period was disrupted through the need to install new systems, the discovery of major operational problems within the BIF group and confirmation of certain warning signals in the Due Diligence reports. When final audited accounts for BIF's 1987/88 were made available, they showed, with more prudent accounting policies, a loss before tax of £133,000.

Considerable post buy-in re-organisation was instigated by the management team with a mixture of strategic and operating methods employed. The strategy to be employed involved improving the Marketing and Sales force; increasing gross margin by adding value to the brands handled; and introduction of new products along with new sales, marketing and distribution systems. To do so involved improving administrative resources to provide a better service, reducing Head Office overheads through a move to cheaper premises (but with a better environment) and changes to warehouse arrangements and the composition of the sales force involving the loss of 40 jobs. The company intended to develop into the major brokerage to the chemist and drug store market as well as operating on behalf of higher margin toiletry, personal care and fragrance companies in the grocery trade assigned to previous low margins food items. Products covered would have relatively high costs but mass appeal, marketing would be highly promotional and price based and all products would be sub contract manufactured.

This re-organisation coupled with the disruption caused by the discovery of 'skeleton in the cupboard' type of problems led to disappointing first year profits with a loss after financing charges being incurred (Table A.8) £566,000 was detailed in the Report and Accounts for

TABLE A.8: POST BUY-IN PERFORMANCE OF EUROPEAN BRANDS			
	Year 1 1988/89 £'000	Year 2 1989/90 £'000	Year 3 1990/91 £'000
Turnover	10,644	16,422	16,573
Operating Profit	152	1,780	287
Net Interest Paid	1,473	2,416	3,153
Net Loss Before Taxation	(1,371)	(636)	(2,866)

integrating the businesses. It also proved extremely difficult to take advantage of warranties which had been given.

Acquisitions were a major part of strategy and, despite the loss recorded during the first year, a major expansion was made in April 1989 through the purchase of the hair care business of Warner Lambert which included brands such as Henara and Richard Hudnut. These brands were the seventh largest in the UK hair care market and were seen as helping the company to expand its European distribution network. Warner Lambert were to continue manufacturing the products for six months, beyond which they were to be subcontracted by European Brands.

TABLE A.9: FINANCE SOURCES FOR THE HENARA ACQUISITION	
	£'000
Equity: •Redeemable ordinary shares •Preference shares •'A' preference shares **Total equity**	 1,050 2,150 5,720 **8,920**
Debt: •Senior debt	 **2,000**
Total finance	**10920**

The total purchase price for the hair care business was £10.565 mn, funded through a mixture of equity and senior debt (Table A.9). The participation of Charterhouse again reflected the confidence which had developed in the management team helped by good communications between management and their equity providers. In particular the non-executive directors were felt to have been extremely supportive. Despite this Management did feel that some items of the control exercised by the institutions were highly restrictive. While board representation was found to be positively useful, the submission of monthly reports, restrictions on capital expenditure and acquisition discretionary limits, banking covenants and the type of financial structure advised were considered subsequently to be highly restrictive.

The refinancing inevitably involved the renegotiation of management equity stakes and ratchet arrangements. The original structure had allowed an initial management stake of 40 percent rising to 70 percent dependent on a high exit valuation over a 4 year period. The second phase because of the addition of considerably more equity allowed a management range from 20 percent up to 70 percent, again on a 4 year life cycle basis. Management were not averse to this lower initial level, feeling that the addition of the new brands made achievement of the new projections more certain. Additionally the relatively short term nature of involvement in the company did not concern the Team. They were motivated significantly by the prospects of capital gain and were prepared to retire at the age of 45 although they might subsequently carry out another buy-in. They were strongly in favour of a trade sale exit rather than a stock market flotation. While as owner managers they found the dialogue with their financial backers supportive and constructive, they considered that being shareholders and managers in a quoted company (eg after floating the company) would be untenable.

Subsequently the company was affected by the recession and further refinancing was necessary in February 1990. This took the more unusual form of the issue of an Unsecured Subordinated Deep Discount Loan Note raising £3.2 mn for the company. While it offered inexpensive immediate relief for the company, it had its cost in the longer term: interest on this was zero until end 1994 but was at 17 percent from then until term in 1999 at which point it had a redemption value of £7.1 mn.

Although the Henara acquisition brought significant additional turnover and an overall improvement in operating margins, it was still not enough in terms of the financing costs which were incurred, a loss of £636,000 for the 1989/90 year being incurred (Table A.8). This was partially caused by the heavy integration costs involved (£2.153 mn) following the acquisition. The company found itself not being able to pay the dividend on institutional preference shares. Initial restructuring in October 1990 led to the Team Leader leaving the company's employment. Further financial crisis led to a capital restructuring of the company becoming necessary in September 1991 when virtually all the 'A' Ordinary and Ordinary shares of the company were converted into deferred shares (at the rate of 1 deferred ordinary share for 100 of the original types), and most 'A' and other Redeemable Cumulative Preference shares into Deferred Ordinary shares.

A11.6 Conclusions

European Brands represents a buy-in by aggressive and pro-active managers, one of whom had experience of starting a major new venture, of an under-performing buy-out in a consumer sector of the economy. Buy-ins of companies where there has been considerable institutional dissatisfaction with management and consequent need for rapid turnround in performance can theoretically be expected to be a useful route for exit by one institution. At the same time it allows another to inject necessary skills to restructure the company and produce satisfactory returns for the new institution. Success should be helped by a highly professional Team with extensive experience in the sector and previous entrepreneurial experience. In this case the practice appears different. The initial institutions in its monitoring of the BIF buy-out failed to control it satisfactorily while the buy-in management underestimated the extent of problems in the initial turnround, thereby delaying the recovery. A reasonably leveraged acquisition virtually doubling the size of the company was concluded at the height of the M & A and consumer expenditure cycles leading to instability as the economy deteriorated. This case study has highlighted the high risk factors involved in turnround buy-ins even where management have proven entrepreneurial and managerial backgrounds.

APPENDIX A 12

JAMES NEILL HOLDINGS PLC: A buy-in by a dedicated Buy-in Fund of an under-performing quoted company

A12.1 Introduction

James Neill Holdings is an example of a public buy-in which was arranged by a specialist management buy-in fund, along the lines of a US LBO Partnership, with the aim to re-organise an under-performing business and expand it significantly over a medium to long period of time. Incoming management who were well qualified had been employed by the institutional backer and conducted an extensive search for the target on their behalf. After fifteen months with major re-organisation complete and a series of acquisitions made, the incoming team moved to a more non-executive role, preparing themselves for identifying and running another target and handing management control over to some of the incumbent management as well as specialists who had been recruited since the buy-in.

A12.2 The Team and Motivation for the Buy-in

The MMG Patricof European Buy-in Fund was established in March 1989 to manage a fund raised by Alan Patricof Associates, a leading British independent venture capital firm, to acquire majority stakes in well-established British and French companies and to provide them with both management and capital support so that they can take advantage of the single European market. Parallel internal teams in Paris and London consisted of three partners (Operational, Financial and Strategic) and five Associates who were partly functional but also provided general help and support to the managers. In the initial stages they looked for and analysed companies; following acquisition there would be a 12-18 month period providing management support and the executive leadership of the company before handing over to the team which had been built up following the acquisition.

The team was thus extensive involving both members who would be there on a full time executive basis but also being able to call on support from the London office of the venture capital firm. Two partners of the fund were to become executive directors of James Neill, the Fund's first target company: one who had formerly been a partner in an international firm of management consultants and another who had been Group Finance Director of a major quoted plc.

A12.3 Identification of the Target

Target company identification was done on a much more sophisticated basis than many other management buy-in case studies with the central team being able to spend their working time carrying out this study rather than combining this with working loyalties to another employer. To do this ranges of basic parameters sought in target companies were first agreed and extensive use then made of on-line and other performance research services to seek out an initial collection of appropriate companies. While there were few sectoral limitations (other than for instance gambling, films, finance/insurance, property) the team were essentially looking for substantial UK companies with a relatively undeveloped European side but with strong strategic positions in its markets and possibly underperforming brands. The financing structure would not be excessively leveraged.

From initial searches on rates of return and size ranges between two and three hundred companies were identified. They were then subject to a more in-depth analysis with one of the team spending about half a day on each. This reduced the number of potential targets to between forty and fifty companies. A much more intensive investigation was then carried out by the team involving about one man week on each looking at the market, competition, placing within the market, and the industry. The results of these investigations were carefully discussed within the

Fund and a list of ten serious candidates derived. The availability for sale of these companies had then to be determined and contacts sought with the targets.

One of the ten companies was James Neill Holdings plc, a quoted company with its headquarters in Sheffield specialising in consumer hand and garden tools, contractors' and maintenance tools, industrial handtools, industrial saws and magnets and magnetic components. Under family ownership until it was floated in 1970, the company was celebrating in 1989 its centennial. James Neill Holdings possessed several extremely well known brand names (eg Spear & Jackson acquired in 1985 after a difficult take-over battle) and was a strong market leader in the business of garden and hand tools and circular saws. It had moved into Europe with operations in France and more recently in Germany as well as having longer established significant subsidiaries in Australia and the United States.

TABLE A.10: JAMES NEILL - PROFITABILITY PRE-BUY-IN

	Years ended 31st December					
	1984 £'000	1985 £'000	1986 £'000	1987 £'000	1988 £'000	1st half 1989 £'000
Turnover	52,805	51,959	82,964	79,903	80,033	39,405
Profit on ordinary activities before taxation	3,629	5,020	4,523	7,605	6,159	28
Tax on profit on ordinary activities	(603)	(718)	(942)	(1,483)	(1,409)	(554)
Profit after taxation	3,026	4,302	3,581	6,122	4,750	(526)
Extraordinary item	(2,025)	(1,877)	2,337	(1,423)	3,392	-
Dividends	(865)	(1,268)	(2,011)	(2,224)	(2,369)	(867)
Retained profit	136	1,157	3,907	2,475	5,773	(1,393)
Earnings per share	16.8p	23.9p	13.0p	22.1p	17.1p	(1.9)p
Dividend per ordinary share	4.75p	7.00p	7.30p	8.00p	8.50p	3.1p

Although considered to be at the bottom end of the size range (turnover was £80 mn), the company appeared to have potential for the added skills and value type of operation which the Patricof Buy-in Fund was seeking. Performance during the mid and late 1980's had been erratic (Table A.10) with earnings per share in 1988 only marginally ahead of 1984 levels and was followed in the first half of 1989 with a loss after taxation of £526,000, implying the existence of under-performing management. Although efforts had been made to create growth in Europe and for instance in the UK through a tool van sales operation, costs and levels of demand and interest rates had been misjudged. Management changes were reported to belatedly being implemented and efforts made to reduce overheads and increase productivity, but by September 1989 management's ability to correct the position had not been established. Research confirmed the strength of the underlying market, the strong brand names and the general fragmented nature of the European markets for their products. James Neill Holdings, if helped by incumbent management's industry knowledge and experience, offered the possibility under new management leadership and financial backing of returning to acceptable levels of profitability and being the focus for a larger European grouping.

A12.4 The Management Buy-in

Although a quoted company, the Neill family still were significant shareholders in the company. Some predator attention had been seen in the past by groups such as Suter and BM Holdings. Additionally James Wilkes had a 9.3 percent share holding in Neill following a divestment made by Neill and paid for in terms of Wilkes shares, a holding which was seen as not necessarily being friendly. Approaches had been made from other companies such as Sandvik who however would not engage in a hostile bid. To be successful in their approach Patricof would have to ensure that a bid was recommended by the directors and they were able to prevent a contested bid developing.

Through the use of a contact who was a director of the company, the buy-in team were able to open discussions with Neill. In the event discussions were reasonably short and the directors were able to recommend acceptance against a background of the disappointing interim results (which had been announced on 29 September 1989) and assurances given by Patricof that they shared a determination to build a British based international business to which their particular management skills would help to provide new opportunities and benefits. The issue of independence was seen as being of particular importance to the family shareholders of James Neill who controlled 12 percent of the equity and were asked to give irrevocable undertakings to accept the Offer.

Following an initial approach to Neill in August 1989 MMG Patricof went on to buy a 3.2 percent stake. On 9 October the James Wilkes stake was acquired and a further tranche of shares in the market, the shares then being suspended at 202 pence. On 10 October a formal bid was made at 280 p in cash (with a loan note alternative) by the MMG Patricof Group through an intermediary company, Markoffer, for the ordinary share capital valuing James Neill at £77.8 mn. By this point Patricof owned or had irrevocable undertakings for acceptance of 51 percent of the Neill ordinary share capital.

TABLE A.11: JAMES NEILL HOLDINGS: FINANCIAL STRUCTURE OF THE BUY-IN

	October 1989 £'000	September 1990 £'000
Equity:		
•Ordinary shares (MMG Patricof Fund)	100	100
Debt		
•Working capital (NatWest/Midland)	22,500	
•Term facility (NatWest syndicate)	-	87,550
•Term facility (S G Warburg & Co)	22,500	
Total Debt	45,000	87,550
Subordinated debt (MMG Patricof Fund)	58,000	48,000
Total Finance	103,100	135,650

The actual structure of the deal was different from many buy-ins of quoted companies in that the equity was kept to the one fund and the degree of group leverage low (Table A.11). This structure was to be employed for about a year following which a revised one with perhaps higher leverage would be employed to take account of the changing nature of the group and the acquisition and investment plans which had evolved. The large subordinated debt package was provided by the fund. Incoming management however did not participate in the equity of the target company; their role was in the partnership running the fund where they had equity rights and where the performance of other companies in which they might subsequently invest would play a role. Equity incentives for both new and some existing management would however be provided through James Neill Holdings.

A12.5 Actions and Performance Post Buy-in

Following the buy-in two members of the Patricof buy-in team moved into the company on a full time executive director basis, one as Chief Executive, and a third joined the Board as Chairman. Hugh Neill, grandson of the founder of the company, remained on the Board as President to give his considerable industry and company knowledge and experience. Significant use was made on an ad hoc basis of the talents of the remainder of the buy-in team based in London.

During the first year after buy-in considerable changes were made managerially, organisationally and in the approach to markets. While changes to management were known to be inevitable following the original analysis of the company, care was taken not to take any precipitate action, management being retained in the interim but with generous and friendly packages being agreed at an appropriate point for the few actual changes which had to be made. As a result two of the executive directors and one of the non-executives left during this period but encouragement was given where deserved with some promotions taking place, eg an appointment to be the MD of the Garden Tools division. Additional to the management skills which the Patricof buy-in team were able to offer, an intense period of recruitment of high calibre specialists ensued to support the company. For example new appointments included four people to central accounts functions and five to central marketing.

Major changes were made to the organisational structure to provide better reporting lines and avoid competition between members of different divisions. Before the buy-in the company had been organised through divisions for each major product area for the UK and one division for all overseas markets. There was competition between divisions for customers and in tenders with significant customer overlap. Hand and garden tool had been handled by the same sales force but the changing nature of this market and the different buyers for these products within the same organisations had resulted in considerable sales opportunities being missed. Activities were separated and a new sales force for the garden tools division was started. Additionally some of the markets were international in nature while others were not while the range of products in international markets varied considerably. Divisions were re-organised on a product basis.

Management information systems were also revised to provide more meaningful information. One of the first external major appointments was the recruitment of a new Group Finance Director who started in February 1990.

Major changes occurred in management education and the encouragement of existing and new management to combine their product and industry knowledge with the other management abilities which the Patricof buy-in team introduced. Management who may have showed concern and caution initially were able over the first year to become a major support realising that with the MMG Patricof buy-in team able to apply thought and analysis in a considerably different way, they could do other things very successfully. Part of the process has involved the development of longer term product and market strategies for one, three and five year periods.

The look at the underlying markets and products led to one major divestment, the Britool operations, in February 1990 at an attractive price. Although having a good brand name and reputation Britool was competing against manufacturers with much larger manufacturing capacity (and hence much lower unit cost base) and was both loss making and consuming a significant amount of cash. While this part of the business would over a period have returned to profitability, the cash requirements and management time involved in doing this were not attractive in comparison with an offer of £8.5 mn from a French company. In a more positive direction the desire to grow the business in a major European grouping was confirmed by a series of acquisitions made during 1990 which expanded the turnover of the company by over a third. These include a manufacturer of hand tools, garden fork manufacturers in both Germany and France, a secateurs and shears business in Germany and a company in Australia. This expansion helping to diversify the product and geographical base was undoubtedly a major factor in reassuring employees as to the future direction of the company.

A12.6 Longer Term Performance Implications

The original strategy for the MMG Patricof Buy-in Fund envisaged that following acquisition there would then be a period of 12 months intensive management effort followed by a running down in executive time with the revitalised existing management and new appointments being able to carry out more important executive director functions. This would then be followed by the withdrawal of the team from executive functions to pursue a further buy-in but retaining involvement on a non-executive basis.

The transfer from the original management team went to plan. A new Chief Executive was recruited externally and appointed in late 1990, the original team member being made Deputy Chairman. The French parallel buy-in team made its first investment in July 1990 and the British team in 1991 started investigation for their next buy-in.

In the autumn of 1990 MMG Patricof was able to refinance the company as planned introducing a higher degree of external leverage (Table A.11). £20 mn of the subordinated debt package provided by Patricof was retired and the senior debt facilities replaced by Nat West through a new £87 mn facility. While this new funding was very complex, it was achieved despite the deteriorating circumstances facing the buy-out debt market. Furthermore while the facility allowed the refinancing of the business, it also provided some finance for the acquisitions programme.

Operating performance improved significantly although because of the softening of markets as a result of the recession operating profit in 1990 did not quite reach plan. While expectations at the time of the case study interviews were that 1991 would produce a result close to original projections, helped by the considerable progress made since the buy-in, new market diversification, organic growth and the benefits of the acquisitions made in 1990 and further ones planned for 1991, subsequent discussion with the venture capitalist partnership have indicated a more disappointing outcome.

The original team maintain close contact on a non-executive basis thereby applying their knowledge and abilities but with a different type of monitoring. In the longer term some form of exit will be achieved, probably through a flotation on the Stock Market when conditions are appropriate allowing partial realisation to be achieved.

A12.7 Conclusions

The buy-in of James Neill Holdings is distinct from other UK buy-ins involving much higher degrees of sophistication of target identification and management than has commonly been seen and also affording the opportunity for owners of large divisions or private companies to sell to independent organisations who with their skills in conjunction with existing internal market knowledge and experience can develop and expand the company to create a much more viable and successful group.