

Business First

Insight and intelligence for leaders

Autumn 2011

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Efforts rewarded

When Gresham buys a portfolio company, the work starts long before a deal is done, says **Paul Marson-Smith**, and it doesn't stop there



WE RECENTLY announced the buy-out of Walker Technical Resources, a specialist repair services business to the oil and gas industry. There are many interesting elements to the deal (see page 3), but two themes are particularly salient.

First, the amount of time we dedicate to investigating a sub-sector and the companies within it before we invest. We call this business development, but it is effectively about the research we put into identifying investable companies in exciting sub-sectors long before we actually back them – companies that are niche leaders and poised for outsized growth.

We spent nearly three years analysing the oil and gas services sector – mapping the sub-sectors, identifying promising businesses and management teams – and through this process we pinpointed Walker. Now, following the deal, Walker is set to embark on a buy-and-build strategy under the rebranded ICR Integrity name.

Watch and shadow

Some may think it enough to invite business owners or leaders to a corporate golf day to get to know them. That is not our style. We watched the ICR Integrity team develop their business over time. We shadowed the company's activities and performance to gain a deep understanding about its direction and potential.

We built a strong relationship with the management team before our investment that allowed us to complete the transaction 'offmarket', dealing directly with the principals involved. This approach gives us much greater confidence for what is the essence of my second theme. Quite simply, we can grow the value of our assets far in excess of UK GDP growth because of the efforts that go into identifying, selecting and then building great businesses in attractive markets.

Of course, nothing is ever completely immune from macro influences. But smaller companies can be incredibly nimble; they can be managed tightly with up-to-the-minute, detailed, flash results tracking performance against the plan. Each of our portfolio companies has strong management, a diversified set of products and, for many, an increasing number of geographic markets behind their own strong performance levels.

To illustrate the point, let us look at the value of our fund performance since the third quarter of last year. Since then, Fund 4 performance is up 27 per cent and Fund III performance is up 47 per cent. This demonstrates an ability to handle all types of weather, which is largely down to these two core themes – the research effort that goes in before we invest and the operational effort that continues to go in once the deal is signed.

“ We spent nearly three years analysing the oil and gas services sector – mapping sub-sectors, identifying promising businesses and management teams

TTG's expansion plans get off to flying start

Telecommunications specialist Team Telecom Group's (TTG) recent acquisition of IT consultancy C&C Technology has significantly boosted its aviation expertise.

TTG's aggressive plans for growth follow its £32.8 million Gresham-backed management buy-out from Spice plc in May 2010. The company is looking to increase its presence in both UK and overseas markets through organic and acquisitive developments.

Mike Norfield, CEO of TTG, says the C&C Technology acquisition “is just the first step in our expansion and targeted growth in the aviation sector. For our customers it means



we can provide a more comprehensive range of cutting-edge IT, communications and related services,” Norfield adds.

C&C Technology is set to bring its 15 years of experience serving the aviation sector to TTG's growing portfolio, which includes AirRadio, a mobile radio solutions provider for airport and airline operations. Jason Colombo, managing director of C&C, comments: “This is the start of an exciting new era for C&C. TTG has gone from strength to strength since its management buy-out last year, and the expertise and customer focus it has complements our approach to business.”

Walker Technical Resources gives Gresham energy boost

Gresham has backed the buy-out of Walker Technical Resources, the Aberdeen-based specialist in oil and gas repair and maintenance. The buy-out is the first step in an ambitious strategy under the new corporate brand of ICR Integrity.

Within the integrity, corrosion and repair niche, the strategy will involve both acquisitions and organic expansion into overseas markets.

Willie Rennie, CEO of ICR Integrity, says: “This heralds an extremely

exciting time as we embark on our vision to create a group of companies around Walker on a global scale via acquisition and organic growth. We are already progressing opportunities with



“ This is an exciting time as we embark on our vision to create a group of companies around Walker

Gresham to achieve this.” Walker has achieved a 60 per cent growth in sales in the past 12 months and earnings have doubled. The demand for engineered composite repair technology is

strong, as ageing assets require safe, innovative and cost-effective solutions. Gresham has been looking to invest in the integrity, repair and maintenance niche of the energy sector for some time.



A revolution in teaching

When students sit the Chartered Financial Analyst (CFA®) exam this December, some of them will mark a milestone in the qualification's history. They will be the first students to have studied the exam curriculum using the Enhanced Learning product. Traditionally, the curriculum has been either taught using classroom methods or self-taught through books or online study. Enhanced Learning brings these elements together and includes studying using live tutor webcasts, online

questions and materials and direct interaction with teachers via a tablet.

The innovative course delivery is the brainchild of Gresham portfolio company 7city Learning, which delivers financial training primarily for investment bank employees from its centres in London, New York, Singapore and Dubai.

"We look for opportunities where we can change the game a little bit," says Kevin Poulton, 7city's chief operating officer. "We have a good track record

in delivering face-to-face training, but there's a move to online opportunities in our market."

James Barbour-Smith, a partner at Gresham, says the new offering has not only given students flexibility to study at a time that suits them, it has allowed 7city to teach many more students than its training centres physically allow.

Students who sign up for the distance-learning course receive a tablet loaded with 130 hours of video tutorials, course notes and several thousand multiple-choice questions (see box). They also have access through the tablet to a contextual helpdesk system that connects them to subject-matter experts in 7city's centres.

Poulton says there is evidence that delegates are signing up with the company because of its tablet offering. And many classroom candidates are taking the tablet for an extra cost.

Now, 7city plans to deliver other courses in the same way. Students of the Certificate in Quantitative Finance who sit their exams in January 2012 will receive a tablet. And the next graduate intake at a major European investment bank – where 7city delivers graduate induction training – will have their programme delivered partly via tablet.

Further tablet offerings may be in the pipeline. "We are looking at our portfolio of qualifications to see where it makes sense to include the tablet," says Poulton.

The United States gets Hotter



Hotter Comfort Concept, which produces one in three of all pairs of shoes made in the UK, is now exporting its shoes

stateside. In the 12 months since Hotter, the UK's biggest shoemaker, set its sights on testing its mail-order blueprint in the US market, it has experienced an unprecedented growth in demand, challenging and beating initial forecasts several times over.

Hotter produced and distributed half a million test catalogues based on the UK brand for the autumn/winter 2010 season, as well as launching www.hotterusa.com. Exceeding its initial target by 90 per cent, the company tripled its mailing run for spring/summer 2011 and plans to double this again for the current season.

"We are delighted with the response we have seen to our mail-order business in the US," says managing director Stewart Houlgrave. "Our product design and quality give us real standout in this market and we have found that our UK manufacturing pedigree, heritage and brand values resonate strongly with our US customers. We have successfully recruited a US team for our Lancashire headquarters, where our call centre advisers are answering calls from Arizona to Wyoming until 4am GMT every night, and our warehouse staff ship orders direct to the US."

The team spearheading Hotter's launch into the US market has had to overcome a series of challenges, from handling shipping and returns to changing the size and format of the catalogue from its UK equivalent. Now, with more than 25,000 US customers receiving monthly mailings, the company is constantly learning more about its US customers.

With a tried and tested acquisition and delivery method now agreed, and its design team looking at creating specific footwear for its US fan base, Hotter is in a strong position to march forward.



Gresham supports IND debt purchase

Gresham has backed debt purchase and collection business IND in its acquisition of three consumer debt portfolios from a UK financial institution.

As well as acquiring debts, IND enters into joint venture arrangements with other debt purchase firms to collect underperforming consumer debt portfolios.

Gresham has also provided investment to support these joint venture partnerships.

David Ivtsan, CEO of IND, says: "I am delighted with IND's most recent debt acquisitions. We look forward to continuing to generate significant value for existing debt purchasers in their old debt books in joint venture partnership agreements, as well as through primary purchase opportunities."

Gresham first made an equity investment in IND in December 2010 to support its growth strategy. It has significant experience in the debt purchase and collection sector, with previous investments including Ultimate Business Solutions and 1st Credit.

On track for 2012



West Cornwall Pasty Company (WCPC) is well on track to meet its target of 100 stores by 2012, following a new opening at Birmingham Airport.

This follows the company's recent partnership to target

captive customers with Moto, the UK's largest motorway service area operator. Eleven units have already opened this year, with a minimum of 17 additional kiosks to open over the next few years across Moto's estate of 55 sites.

The Moto partnership is WCPC's first foray into corporate franchising, and has been a huge success for both Moto and WCPC, according to Mike O'Brien, partner at Gresham.

"Our strategy over the medium term is to combine owned sites with corporate franchised sites across a variety of operating formats and locations," he explains.

WCPC has opened mobile units, kiosks, inline units and shops at a variety of locations including Twickenham Stadium and the Oval, railway stations, shopping centres and airports including Gatwick and Birmingham. WCPC is in advanced talks with several other corporate partners as it looks to expand.

“Our strategy is to combine owned sites with corporate franchised sites across a variety of operating formats and locations

Spread the word

Team Telecom Group is demonstrating that for companies with a clear growth strategy the communications sector is a vibrant place to be

Peeking through the post-recessionary mist is a ray of sunshine. Just as the city of Derby was reeling from the loss of more than 1,400 manufacturing jobs from just one employer this summer, Team Telecom Group (TTG), which is headquartered there, announced that it was increasing investment in research and development (R&D) by millions of pounds. TTG is also investing in UK talent through its apprenticeship schemes. What's more, the company is on an upward growth curve, with turnover having grown by 10 per cent to £46.2 million last year, and it is forecast to grow by a further 16 per cent next year.

Change of ownership

Much of this has been possible as a result of TTG's successful £32.8 million management buy-out from parent company Spice plc in 2010, supported by Gresham. Under the umbrella of utilities company Spice, TTG had prospered, buying a number of companies over a six- to seven-year period. Mike Norfield, CEO of TTG, says: "We wanted to continue that growth and saw the recession as an

opportunity to buy businesses at lower multiples and do good deals." However, within the Spice group other divisions were suffering, leading to consolidation and cost-cutting. "For us, it was the right time to be on our own and grow our business," says Norfield.

TTG attracted a number of parties interested in backing the MBO, and selected Gresham. The management team had first been approached by Gresham three years earlier. Although meetings with other VCs took place when looking

“We have big plans and these guys are dynamic thinkers – more entrepreneurial than staid old accountants

Mike Norfield, TTG

for investment, a rapport with Gresham had already been established. "We chose Gresham as we thought they were like-minded people who were enthusiastic about our business, shared our vision and understood our buy-and-build model," says Norfield. "They have gone that extra mile to understand the business and not just from a financial perspective. We have big plans, and these guys are dynamic thinkers – more entrepreneurial than staid old accountants."

Three into one

The MBO itself took five months. Given the complexities of the business, the due diligence was extensive. At the time, TTG comprised Simoco (UK) and ComGroup (Australia), which supplies communications solutions for emergency services, the utilities industry and the oil and gas sector; Air Radio, which provides communications systems at airports; and Indigo Telecom Group, which delivers a range of telecommunications engineering services.

Incorporating the three divisions with their international offices (now in

eight different countries) into the due diligence process made for an intense period, Norfield recalls. "I can recommend an MBO if you are confident in your business, but make sure you tell your family and friends that you will be away for six months."

Post-MBO, TTG is taking great strides across each of its divisions. At Simoco, new finance is being injected into R&D. Simoco essentially provides walkie-talkies for companies and emergency services in situations where normal mobile communications would not be appropriate. The R&D investment will accelerate the introduction of digital mobile radio technology globally. "This is an exciting development," says Norfield. "We have a good reputation, but if we get this right, this could be a step change for us. There are a lot of people waiting for this new technology, and we should be at the front of the wave, driving it."

Simoco, which has operations in the UK and Australia, is also looking to break into the American market. Through its network, Gresham has been able to "build a significant trading agreement with a US company", according to Gresham partner Paul Franks. The next stage will be full integration into the market through acquisition of a US business, and opportunities are currently being considered.

At Air Radio, the focus is on the buy-and-build strategy. Previously a network provider,

the company is diversifying and increasing its offering to clients by becoming a technology and consultancy services group. The recent acquisition of C&C Technology, a consultancy group that operates primarily in the aviation sector, is a major stepping stone in that direction (see further, page 3).

TTG's third division, Indigo, was hardest hit by the recession, but has come out stronger, according to Norfield. He believes the company is well placed to take on more work as the market evolves. "We have invested in people and are multi-vendor skilled, allowing us to get better use out of our engineers. The telco market is huge and there is a lot of growth, especially in wireless."

The next generation

For Norfield, however, the launch and growing success of TTG's apprenticeship scheme is equally as exciting. "We have found a skills gap opening in the radio communications sector, with the current engineers getting older, while the younger guys want to become software engineers. So we started our own scheme to get good, qualified radio programmers back into the field," he explains.

Over a three-year period, apprentices are put through college to obtain relevant qualifications, while gaining invaluable hands-on experience. At the end, there is the prospect of a job offer within TTG, in the UK or possibly overseas. The benefits are manifold, continues Norfield. "It promotes us as a business and puts some skills in the industry. And it's great for us and for the community to have a good company doing well."

A UK-based company, investing in the future, and succeeding in both domestic and international markets – now there's a tale worth telling.

Striking gold

Mid-market deals are starting to bounce back, but finding the best targets in the current economic climate requires killer origination instincts

Chancellor George Osborne said it was “positive news”. Shadow Chancellor Ed Balls claimed it was a sign that the economic recovery of 2010 had been “choked off” by the government’s VAT rise and spending review.

But what is clear is that the 0.2 per cent growth in GDP in the second quarter of this year – a fall on 0.5 per cent in Q1 – is open to varying interpretation. The economic challenges are intensifying by the day with recent poor UK and overseas data, together with an increased risk of a euro area crisis, pointing to a fluid and fragile situation.

This analysis is understood by all, but on the flip side there are other, clearer causes for optimism. A number of second-quarter surveys suggest business confidence is slowly edging up in the UK, and within the private equity sector deal volumes – particularly in the mid-market – are beginning to return. The latest ICAEW/Grant Thornton UK Business Confidence Monitor – a quarterly survey of 1,000 senior business professionals – reveals that business confidence increased in Q2 2011 after four consecutive quarters of decline.

Meanwhile, the Chartered Institute of Management Accountants’ latest Mid-Sized Business and Economic Outlook Survey, which covers the same period, revealed the number of businesses that felt extremely

confident of survival this year has more than doubled since March, from 34 per cent to 69 per cent. It’s the highest level recorded since the survey began three years ago.

“We might be seeing an uptick in confidence because we haven’t slipped back into recession,” says Colin Ellis, chief economist at the British Private Equity & Venture Capital Association (BVCA). “But 0.2 per cent GDP growth is very weak,” he notes. He attributes the weak economic recovery in the UK to public spending cuts and a disproportionately large banking sector reluctant to lend to small businesses.

The private equity sector, however, has been pretty resilient during the recession, says Ellis: “That’s a tribute to the active management model used to get portfolio companies through the downturn.”

“This has always been a more resilient market both in terms of more consistent deal volumes, and generally more stable pricing and gearing levels

Simon Inchley, Gresham

After hitting a low in 2009, management buy-out volumes in the UK have started to pick up again, according to KPMG figures. During Q1 2011, 38 MBO deals worth £10 million or more were recorded in the UK – a 100 per cent increase in volumes compared to the 19 deals recorded in Q4 2010. The change is the largest quarterly increase since Q2 2009. With average deal sizes dropping from £268 million in Q4 2010 to £119 million in Q1 2011, KPMG says it is the mid-market that is really driving deal activity at the moment.

Mid-market strength

Simon Inchley, head of investment at Gresham, reaffirms the strength of the mid-market. “While not immune from the cycle, this has always been a more resilient market both in terms of more consistent deal volumes, and generally more stable pricing and gearing levels,” he explains. “The steadier deal flow is a product of a number of factors including continuing plc refocusing together with the need to evolve and ultimately create succession within private companies.”

While there is still a lot of competition for quality businesses from both trade and private equity acquirers, generally company price tags are also starting to fall. “Deals volumes in our market fell away in the bad times because of a mismatch of vendor expectations although we maintained our investment heartbeat through our sourcing model,” says Inchley. “We thought values were lower than vendors wanted. Now, business owners are adjusting to the new environment and their more realistic expectations are starting to drive deal flow.”

Another factor playing in the mid-market’s favour has been its lighter exposure to the volatility of the banking sector, and this has particularly been the case at Gresham. “A significant part of the

Illustration: Darren Hopes





Business models with potential

In a subdued economic climate, some business models have greater growth potential than others. Good investment opportunities include businesses that are disrupting their markets or have scope for global expansion or market consolidation, says Simon Inchley (pictured), head of investment at Gresham.

LAS, an insurance claims handler backed by Gresham, is creating waves in its market with its award-winning live reporting system that has helped reduce an average claim cycle for insurers from 70 to 40 days.

At portfolio company Team Telecom Group (TTG), Gresham has been able to “build a significant trading agreement with a US company”, giving TTG a foothold in the US, says Paul Franks, a Gresham partner. TTG’s buy-and-build strategy includes overseas targets. (See page 3 for more.)

And in an innovative joint venture with US suit retailer Men’s Wearhouse, Gresham has acquired Alexandra to integrate it with portfolio company Dimensions. The companies are the second largest and largest in the UK corporatewear sector, respectively. “We are now in discussions with other targets about bringing them into the fold,” says Franks.

returns in big private equity deals is driven through introducing high debt levels,” he explains. “We are focused on paying the right price for a business and introducing low levels of gearing so as not to operationally hamper its growth plans. This means we do not struggle to achieve the gearing levels we want to.

“This approach of introducing limited debt levels is highly effective as long as you have a clear strategy as to how you are going to drive the business you are acquiring to be substantially more profitable. You need to engineer profit improvement as it is this growth, not the introduction of high leverage, that underpins your investment returns.”

Identifying submarkets

However, less favourable economic conditions mean that when it comes to finding the best investment targets, the old rules no longer apply. Inchley says that in the current environment, the most effective private equity investors continue to generate their own deal flow. They will be focused on identifying attractive sub-sector markets where growth conditions are specifically favourable, or will be looking within more mature lower growth markets

“There are sub-sectors that are attractive right now. We have to get down to that level of granularity to identify the jewels

Simon Inchley, Gresham

for companies that have particular opportunities for growth, despite generally subdued background market conditions.

“The companies operating within the economy are not the ‘average’; there will be winners and losers from the changes in the economy, driven by the recession and the anticipated recovery. An overall flat market will actually be the netting off of substantial change. We identify companies that will benefit

from either a growing or a changing market,” explains Inchley.

Attractive submarkets can be found where a traditional sector intersects with a current macro trend. Technological and demographic changes, globalisation, resource constraints, security and anxiety, and increased regulation are all macro trends taxing the UK’s companies and government right now.

In healthcare and pharmaceuticals for example, technological changes are opening up opportunities for telehealth – the delivery of health-related services via telecommunications technologies. Resource constraints have led to an explosion of comparison websites in the consumer and leisure sector. Major regulatory changes within the personal financial services market, and particularly the management and provision of personal pensions, will create new product and distribution opportunities. Furthermore, increased concerns about security mean the industrial products sector is seeing business growth in CCTV and biometrics.

The right model

Alongside investing in the right submarkets, identifying the right business model is crucial, says Inchley, particularly if you are to invest in more mature sectors. Businesses that are doing something different in their market, or have the potential to consolidate or expand globally, all offer growth potential, regardless of what’s going on in their domestic market (see box left).

“There’s no one huge sector that I would necessarily be targeting, but there are sub-sectors in virtually all areas of the economy that are attractive right now, and it is these that have underpinned our recent deal activity,” says Inchley. “We have to get down to that level of granularity to identify the jewels.”

Ellis adds a final cautionary note. “Central to any investment will be assumptions about growth over the investment period. The degree of economic uncertainty around the next three years is so large that it makes sense to build in more flexibility than in the past. Anyone who is building growth forecasts off the Bank of England forecasts will have a nasty shock.”



Stock tactics

Lack of effective inventory management will at best hinder growth, at worst stifle it completely. Small wonder it is seen as a critical component to any business

Inventory management may not grab headlines, but as a discipline that can affect margins, profitability and cash, it needs to be on every business agenda. In some cases it can be critical. “As a distributor of pneumatic and hydraulic products, stock is the lifeblood of our business,” says Sean Fennon, CEO of Flowtech, a Gresham portfolio company. “While cash is extremely important, our ability to maintain high service levels to our customers on a day-to-day basis is critical for our long-term future.”

The aim of stock control is to minimise the cost of holding stock (whether raw materials, work in progress or finished goods), while ensuring that there are enough materials for production to continue and customer demand to be met. It’s a fine balance. Too much stock, and costs can be increased by growing storage space requirements, stocks becoming obsolete, or diverting funds that could have been better spent elsewhere. Too little stock can mean loss of production and loss of sales.

Importantly, inventory management can be used to gain a competitive edge, explains Fennon. “In a recession, most companies take the view that destocking is the way to increase cash in the bank. Gresham, however, has supported our

strategy to maintain depth of stock. It has allowed us to increase our market share, and consequently we have continued to grow, with double-digit growth in both 2010 and 2011.”

It is an area that needs to be under constant review. At Flowtech, stock is monitored daily by teams analysing cycle times and sales forecasts, using

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Sean Fennon, Flowtech

sophisticated, constantly adjusted IT systems. The company has conducted a full process review of the procurement, and research into a possible logistics centre in China is at an advanced stage.

The reward for this constant monitoring and reviewing is, essentially, cash. “Unlocking cash tied up in stock is not an easy task, but by establishing an end-to-end systematic process to streamline the supply chain and improve inventory management processes, companies can significantly reduce their total inventory levels,” says Mark

Blower, a partner at Gresham. “That consequently frees up cash that can either be used to reinvest in further stock or for other strategic purposes to suit the business,” he continues.

Despite its importance, it’s an area that can be overlooked. “Fast growing businesses can be very focused on the top line,” says Blower. But as a

business becomes more competitive, it needs to invest to grow and create value for shareholders. “That is when a business can start to look harder at its component parts, be it sales and marketing, IT systems or stock control, and seek ways to be as efficient as possible and maximise its investment in these areas. One of the advantages of working with a private equity firm is that it can take the holistic view and draw on its wide-ranging experience to help management to deliver their aspirations,” concludes Blower.

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