

Business *first*

Gresham
Private Equity

The Gresham Monitor

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Steering a steady course in a choppy market



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A steady course in turbulent times

What impact will the credit crunch have on the UK mid-market? Paul Marson-Smith says a steady hand on the tiller is needed

The current turmoil the credit markets are experiencing is a result of other people’s mistakes in countries and markets far away from the lower mid-market where Gresham operates. But the inevitable fall-out is a reality and its consequences are something we will all have to deal with.

As a result, high-quality firms that are disciplined and focused will use this time as an opportunity, balancing upside, risk and reward. Others, who have been raising money on little more than a promise, will be feeling exposed.

Naturally, it is impossible to predict exactly what direction the market turbulence will take. But one point is certain – and that is investors should always focus on the fundamentals. We have been here before, of course, when too many investors rushed headlong into dot.com businesses that had no substance. As a direct result, risk was mis-priced because investors ignored the fundamental disciplines they should have been applying.

At Gresham we travel hundreds of thousands of miles across the UK each year to identify companies with strong management teams, who are keen to become leaders in their fields, deliver rising profits and operate in growth markets.

Executives in these companies are reading about the credit crunch every day even though they have not really been affected by it. The UK economy remains strong and is getting stronger. Indeed,



Paul Marson-Smith,
Gresham managing partner

the opportunities are great so long as investors are disciplined and have a strong understanding of the upside, the risks they are willing to take and the level of return they are seeking.

The perceived catalyst for the current credit market woes has been the unravelling of the sub-prime mortgage market in the US. But, in fact, the root cause was an extended period of market buoyancy and greed. The thirst for higher returns in a benign environment meant that many investors became far too tolerant of risk. Consequently, an exotic set of shelters were built for the rickety investments that promised high returns. Sadly, they were built on weak foundations.

It is too early, however, to predict just how exposed banks and lenders have been to the turmoil. Currently, the larger leveraged buy-out end of the market is facing the bulk of the market's indigestion and reluctance to lend. Compliance teams are trying to pick up the pieces from past errors in judgment – and, in the meantime, many banks have no clear idea of exactly how much more risk they can pile on.

So what does that mean for us in the UK mid-

market? So far, there has been minimal impact but it would be naive to suggest there will be no ripple effect, which may ultimately make it a little tougher to raise debt in support of buy-outs. But who can predict the psychology of the markets?

What I can say with confidence is that our existing portfolio is performing well. This is encouraging and demonstrates Gresham's ability to select winners, whatever state the over-arching market may be in.

Our philosophy is based on looking at business fundamentals and working with the very best UK managers to build better mid-market companies. It is our belief that by consistently producing results and generating returns for our investors – through good times and bad – we will continue to enjoy their long-term support. We are proud of our long track record and fully intend to

navigate these choppy markets on behalf of all our stakeholders.

One thing is for sure, though: the recent turbulence has reminded us of the fundamental importance of a well-capitalised business. Ever increasing debt brings risk – and this may be extremely expensive, in more ways than one.

“The recent turbulence has reminded us of the fundamental importance of a well-capitalised business”

New energy at Gresham

Gresham has established a dedicated energy team that aims to build on the successful investments the firm has already made in the sector. The team will be headed up by Andy Marsh and James Barbour-Smith.

The UK has a wealth of leading businesses with an international reach in the sector and this global outlook is one of the key attractions for Gresham. “One common characteristic of our investments in this sector has been how they have grown through international expansion,” says Marsh. “For instance, Swift, our oil and gas recruitment business, has offices in 13 countries now, compared to eight when we initially invested.”

A number of positive changes are also driving growth in the sector. Oil and gas reserves are being discovered in what were once deemed to be inaccessible hostile environments – and companies with leading technology and know-how are set to benefit from this. The number of national oil companies is increasing, too. They outsource many of their operational requirements to third parties, such as skilled UK-based businesses.

In addition, the viability of mature oil fields has risen, thanks to higher energy prices and improved sub-sea technology.



“We want to increase our level of investment in companies that benefit from the structural and technology changes currently being experienced in the sector,” continues Marsh. “We are particularly attracted to firms that have an exposure to sub-sea oil and gas production.”

The team will also focus on companies that are involved in issues arising from climate change. “It is becoming increasingly important for all companies to source alternative forms of energy to establish their green credentials, as the issues of climate change and corporate social responsibility climb up the world agenda,” says Barbour-Smith. “Companies Gresham has invested in, such as Olaer, which produces hydraulic components used in wind and wave power generation, are reaping the rewards of the ever-increasing need for sustainable energy.”

The drugs do work for Penn

Penn Pharmaceuticals sale gets money multiple of 12.

Gresham has sold drug business Penn Pharmaceuticals, achieving a 12 times return on its investment.

Gresham first invested in Penn, which develops and manufactures pharmaceutical products, in September 2000. The company was de-merged into Penn Pharmaceutical Holdings and Penn T and, following the sale of the latter in 2004, Gresham worked with Penn to restructure

its core business. Since then, 100 new jobs have been created by the South Wales-based firm and Penn’s international presence was confirmed when it received the Queen’s Award for Export. Growth and profitability at Penn are well in excess of sector averages, with turnover and profits increasing fivefold and tenfold respectively since 1999.

“The business has been transformed into a strong international trade brand with an excellent infrastructure,” says Gresham partner Simon Inchley. “We wish the team well in the future in maximising the potential growth platform created.”



It Allfitts for Flowtech

Since Gresham first invested in Flowtech three years ago, turnover has almost doubled, growing both organically and through acquisitions.

Flowtech has now expanded into Continental Europe by acquiring the Dutch business Allfitt.

Flowtech supplies independent distributors with hydraulic and pneumatic components, providing clients with branded catalogues, marketing and logistical support and back office services. Allfitt has a similar business model and currently works with 42 distributors across the Netherlands.



Titley scoops industry award

Gresham partner Mitch Titley has been named Young DealMaker of the Year at the prestigious Insider DealMakers awards dinner held in Birmingham this September.

The event focuses on dealmaking professionals who have distinguished themselves in the Midlands region.

Titley has been part of the Gresham team since 2005 and operates from the firm's Birmingham office. He specialises in the industrial products sector and has been involved in a number of successful deals over the past few years, including the management buy-outs of Esterform this spring and Just Trays last year.

Esterform packs a punch

Gresham backs high-growth bottle business.

Esterform Packaging, a leading supplier of plastic bottles, has received a funding package in excess of £30 million from Gresham.

Esterform manufactures and supplies a range of bottles for the soft drinks, speciality drinks and alcoholic drinks markets. The UK soft drinks market is expanding fast as a result of the move towards healthier drinks. Esterform intends to capitalise on this trend.

It is already well represented in the highly popular water, juice and smoothie sectors and is involved in some pioneering work around the development of environmentally friendly materials. It is also in the advanced stages of a project to replace traditional steel beer kegs with lighter, cheaper and more ecologically sound versions.

"The business has had considerable success since its formation in 1998," explains Paul Franks, Gresham partner in the Midlands. "But we are providing the funding to grow the business further and to take advantage of the commercial opportunities in the sector as they arise."

Mark Tyne, Esterform's managing director, is also confident about the future. "Gresham's support and financial firepower will enable us to invest in our manufacturing facility and provide the resources and capability to undertake further acquisitions in the future."

Since 1998, Esterform has combined strong organic growth with two acquisitions: Able Industries in 2001 and Petplas Packaging in 2005. The company's revenues last year were close to £50 million. Esterform also employs more than 200 people in its two manufacturing facilities in Tenbury Wells and Leeds.

Ian Woodhead, whose food and beverage experience includes his recent role as chairman of Gresham-backed Whitworths, the leading UK brand of healthy eating and snacking products, will join the Esterform board as chairman. Whitworths was sold last year in a deal that generated a return on investment of 6.4 times.

Perfect chemistry

Penn Pharmaceuticals was an underdeveloped business in South Wales when Gresham first invested in it. By the time the company was developed and sold, it had increased profits tenfold, had become a leader in its field and had won the Queen's Award for Export.

Drug specialist Penn Pharmaceuticals turned over £26 million last year and generated core earnings of £13 million. Predominantly working with pharmaceuticals companies around the world, deciding whether their products should be turned into tablets, pills, medicines or other formulations, the company also helps with clinical trials. If these are successful, the company will manufacture the drugs for small-scale and niche distributors.

The company's strong and highly profitable position was not achieved by accident. It was the result of a focused growth strategy devised by Penn chief executive Craig Rennie, his management team and Gresham.

Winning team

Gresham first became aware of Penn in 1999. The company's founders were looking for an exit and had recruited Rennie to help them. Both Gresham and Rennie realised the business had huge potential but it needed a lot of work in the meantime.

"We approached the vendors in 1999 and took an option on the business. We put our people in alongside Craig Rennie and took some time assessing the company and putting in better systems. This gave us the confidence to go ahead and buy it the following year," says Gresham partner Simon Inchley.

"I did speak to a few other private equity firms, but what struck me about Simon was that he was such a lovely guy. I think it is very important to have a good chemistry between private equity firm and chief executive – and with Gresham it was like the perfect marriage. They were head

and shoulders above the rest," says Rennie. "Simon knew enough about the business to be really supportive but they never interfered with the day-to-day management, instead focusing on the key strategic areas where they added huge value in their knowledge of scaling businesses and ultimately managing them for exit," he adds.

Realising potential

When Gresham first invested in Penn, it had two divisions: the services business and a "specials" business. The latter allowed it to manufacture unlicensed drugs, including Thalidomide, which, despite its controversial history, is extremely beneficial in treating certain conditions.

"We divided Penn into Penn T (the specials business) and Penn Pharmaceuticals. We then

“I think it is very important to have a good chemistry between private equity firm and chief executive – and with Gresham it was like the perfect marriage. They were head and shoulders above the rest”

formed a joint venture with two big US firms to go for a licence for Thalidomide," says Inchley.

In 2004, Penn T was sold to one of the US partners, Celgene, for \$110 million. "The entry price for the whole of Penn was £12 million, so this was an extremely good deal," says Inchley.



The sale also allowed Rennie and his team to focus on Penn Pharmaceuticals – with Gresham’s help. “Gresham invested in the infrastructure and helped us establish a development team to go out and look for business,” says Rennie.

“We put in state-of-the-art systems. We substantially invested in the site to create the right image for the business and increased the number of staff from 120 to 210. This was especially good because Penn is headquartered in a rather depressed area of South Wales,” says Inchley.

With the right systems and the right people in place, Penn went from strength to strength. “We attracted a lot of high-quality clients. We did high-quality work and we could therefore charge higher margins,” says Rennie.

A royal occasion

The company now has around 200 clients, including many from overseas. Its expertise in this field was recognised when it won the Queen’s Award

for Export in 2003. “During our partnership with Gresham, this business grew beyond all recognition,” says Rennie. “From the start, we identified the company’s position in the marketplace, worked out where we wanted to take the business and stuck rigidly to our growth strategy.”

In 2006, Rennie indicated that he wanted to retire, having worked hard at Penn since 1999. Chief operating officer Peter George was recruited and quickly brought up to speed. Gresham then helped Rennie and George to find the right new partner for Penn, appointing Ernst & Young as their advisers.

Earlier this year, the remainder of Penn was sold to private equity firm LDC in a deal worth £67 million, bringing the total Gresham return on investment to 12 times. “This has been a classic Gresham deal,” says Inchley. “We spotted Penn’s potential and we focused on growth.”

Rennie also recalls the partnership fondly: “Gresham was a superb partner for us and really understood the business.”



Partners in time

Successful private equity investment is not just about buying and selling businesses. It is about partnering with companies and helping them to grow – a job that falls to Gresham’s portfolio partners, Ken Lawrence, James Barbour-Smith and Neil Scragg.

P rivate equity investment may look simple from the outside but it is a complex, multi-layered process, requiring a variety of different skills. Finding good businesses to invest in is the first link in the chain. But acquiring a business is not the end. These companies need to be nurtured and supported. This is where portfolio teams step in.

“Our job is to manage our investments, not look for new deals. We get to know businesses extremely well and keep in regular touch with the chairman, chief executive or finance director. The amount of contact depends on what is going on at any point in time,” says Neil Scragg.

This approach has a number of benefits. “The key advantage of portfolio teams is their focus. They work with management to maximise value over the lifetime of an investment. This requires consistency and a different skill-set from identifying and winning deals,” says David Silver, managing director of Robert W. Baird. Whereas deal teams are constantly looking for the next transaction or the next opportunity, portfolio teams are patient, diplomatic and commercially minded. “We achieve results by influencing people,

not by telling them what to do, and this can only be done by earning managements’ respect,” says James Barbour-Smith.

“We look forward and can take a more dispassionate view of the businesses that we are involved with. We also make sure that management teams’ compensation is structured in the right way so they are motivated to deliver the business plan,” says Ken Lawrence.

Valuable experience

Portfolio teams have a wealth of experience that can prove invaluable, as Mike Lord, chief executive of stair and bath-lift manufacturer Minivator, recalls: “Shortly after Gresham invested in us, we went through a bit of a difficult patch. James and Gresham helped us to analyse the situation and find a way forward. They encouraged us to take a longer-term approach which enabled us to maintain our headcount and concentrate on growing sales. James was excellent at focusing the business and he drew on previous experiences.” Minivator is now in rude health and delivering record sales.



(l-r) James Barbour-Smith, Ken Lawrence and Neil Scragg, Gresham's portfolio partners

The all-seeing eye

Typically 80 per cent of the issues that arise are common to all businesses” says Lawrence. “Through regularly speaking to the management and monitoring KPIs – cash, profit & loss and business target plans – we can identify early on where there is a problem and quickly decide on how to address it.” But portfolio teams do not just provide a service when companies are experiencing problems. “When I was chairman of an earlier Gresham investment, Warner Howard, James introduced me to a number of value-adding processes. It was almost as if he was a conduit to the wider corporate marketplace,” says Stewart Cantley, now chief executive of Swift.

Gresham invested in Swift just over a year ago and introduced Cantley to the business.

“Ken and James were there from the beginning and they added real value to the due diligence process. I am quite experienced in private equity, but they multiplied that by the thoughts and challenges they brought to the transaction,” he says.

Generally, the Gresham portfolio partner is introduced to a business at the time they are acquired

or very soon afterwards and there is a transition period during which they work alongside the dealmakers.

“We always take a seat on the board of our companies, but there is normally a handover period of around six months. The management team will have got very close to the new deal team and we have to make sure the transition is sensitively handled,” says Barbour-Smith.

This sort of transition is easier, clearly, if the management team already knows the portfolio team, as was the case, for instance, when Stewart Cantley joined Swift. However, management soon come to value the input of the portfolio partners regardless. “The relationship works extremely well. We know what we want from them and they know what they want from us. We speak to James regularly and we really appreciate the continuity – we know that he is going to

“Portfolio teams maximise value over the lifetime of an investment. This requires a different skill-set from identifying and winning deals”

be at every board meeting and we know he is on hand to help us if we need it,” says Lord.

“At other private equity firms, where the same people do the deals and look after the businesses, they will miss board meetings because they are doing other stuff. But when the same guys turn up every month, it really strengthens the relationships,” says Silver.

On hand

Portfolio teams focus on improving businesses, encouraging growth and keeping an eye on the exit. “The exit planning starts, ideally, before you even buy the business. You are not heavy-handed about it, but you just make sure that every decision made by the business is going to add value in the broadest sense – for employees, for managers and for investors,” says Barbour-Smith.

The time spent with portfolio companies can be anything from a short telephone conversation each week to several hours a day to 24-7 if there is a problem. “When things are going well, we are just in the background for help if need be,” says Scragg. “When things go wrong, we urge management not to panic and we handle potentially difficult conversations with the banks. The point is that management has to focus on the business and we provide them with the support they need to do their job,” says Scragg.

Working in harmony

The balance between a private equity firm and a management team is fundamental to the success of an investment. Enter the serial chairman, who provides all the qualities to get the best out of both parties.

Casual observers of private equity sometimes suggest that participants make money by simply buying assets cheaply, leveraging them and selling them on at a profit a few years down the line. The truth is that it is not that easy. In the mid-market private equity firms focus on making companies bigger and better and one of the principal ways in which they do this is by ensuring there is an effective team at the top.

Clever, commercially-minded, diligent and driven managers are clearly crucial. But no senior

“The right mix of personality, knowledge and skills are essential in selecting the right chairman”

team would be complete without a strong and committed chairman. “The chairman stands between the management team and the private equity firm,” says Ian Woodhead, chairman of bottle manufacturer Esterform, which is part of Gresham’s portfolio. “He makes sure both parties work together and their interests are aligned.”

The chairman’s role varies, however, according to the private equity firm that has appointed him and the company in which he has been placed. “Some private equity firms merely want you to rubber-stamp what the management does but this can only work if the management teams are experienced,” says David Callear, chairman of Swift and R.P. Martin.

In most cases, though, the chairman has an important role to play, so much so that private

equity firms spend considerable time and effort looking for candidates who can do the job properly. Once they have found their man, they do not want to lose him – and this is where serial chairmen come into their own. “Gresham has a wide network of chairmen. The right mix of personality, style, knowledge and skills are essential in selecting the right chairman for the job as it is key that they ‘gel’ with the management team and are able to add value,” says Gresham partner Ken Lawrence.

Mr Motivator

For private equity firms, serial chairmen can be an invaluable resource. They will motivate management, make sure a business is moving in the right direction and generally offer the sort of advice that comes with years of commercial experience.

The other pivotal point about serial chairmen is that they are a known quantity. Private equity firms do not have to spend months explaining what they want and how they operate. Serial chairmen already know because they have been there before. They can move in and get on with the job straightaway – and this can be particularly

SERIAL CHAIRMEN: THE FACTS

- They motivate and empathise with management teams
- They understand private equity investors’ needs and help deliver them
- They are diplomatic
- They are flexible
- They are patient
- They are experienced

useful when a company is experiencing problems. “I was appointed chairman of Whitworths 18 months after Gresham had invested in it, at a time when the business was running well behind its plan,” says Woodhead. “I had a good look at the business and talked to management to identify what the problem was. The company was doing what it said it would but the results were coming through more slowly than expected. I suggested patience. As an independent chairman with experience of other businesses, I had the confidence to say that we should sit and wait. And Gresham respected my opinion.”

The strategy paid off and Whitworths flourished. But Woodhead was able to offer effective counsel, partly because he had chaired other private equity businesses before. Gresham, for its part, listened to him.

The flexible friend

“A good chairman has to be patient and a good listener,” adds Callear, who has chaired private equity-owned businesses for five years, including several Gresham investments. “You need to listen to lots of people who are driven, highly motivated and very strong-minded so you have to be an effective leader and diplomatic. As a serial chairman, you want to make a difference. You need to be able to communicate openly and fully with the executive team and the private equity house. Often you will act as a sounding board for both sides. Management may come to you with an idea

they would like you to bounce off the private equity firm and vice versa.”

Callear believes flexibility is important too. “Different situations require different responses,” he says. “R.P. Martin is a people-dependent business, for instance, so one of the key challenges is retaining and motivating the team. Elsewhere, the job may be more focussed on strategy: what we are doing with the business and where we are adding value.”

Woodhead adds that flexibility and diplomacy are key. “You have to relate to management and investors. You cannot be too self-important. It is not about you,” he says. That does not mean a laissez-faire approach will suffice, he warns. “You have to understand how the business works and you have to demonstrate that you understand it. You have to show you are there for a reason and help make sure management functions effectively as a group. As a result, you get to know individual strengths and weaknesses so you can help with decision-making.”

One of the most important decisions a serial chairman has to make is the type of private equity firm they want to work with. Some firms are more demanding than others, some are more impatient. “The Gresham team is open and pragmatic and, importantly, they respect good management,” says Callear. Woodhead agrees: “When you think about firms, you think about people and you ask yourself whether you want to work with these individuals. Gresham is a professional outfit and I like the way they operate. If there is an issue to debate, you know they will act sensibly and rationally.”

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Gresham

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