

The Chairman, The Pension Risk, The Bribe and the The Pilot's Case

The spring thaw has arrived in force, and so has the surge in sales of BBQs. When I first moved to the UK nearly 8 years ago, I felt very popular when I was asked to countless barbeques. I smugly thought that my American

wit and charm (not an oxymoron for anyone sniggering) had suddenly become a necessary part of many London garden (or backyard as I would say) events. Very quickly my bubble was burst when I came to realize that Brits plan vast numbers of barbeques because so many get rained out; plan one for every weekend and hope that one out of four come through. I was also handed the spatula and fork often as not, perhaps expected routinely to churn out perfect steaks and burgers.

So too has the spring thaw continued in the private equity universe. Deal flow continues to improve, as money is being spent (often times having to be spent) amid a new enterprise value equilibrium that seems to have taken hold. And more work for PILOTpartners too, for which our thanks. Few outrageous bargains, but few over the top deals either.

One of the chief benefits coming from this protracted economic slump has been the way that many investment directors and partners have had to focus even more attention on existing businesses, in effect becoming firms of portfolio directors. This certainly cannot be a bad thing when new deals are analyzed and structured, particularly when leverage returns in force.

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The Pilot's Log Q&A

Peter Chappelow, a private equity portfolio chairman, offers some rather upbeat news about lending to private equity-backed companies and why just as he was ready to retire he chose this line of challenging, yet highly satisfying line of work. [Page 2](#)



Bribery and the Risks for Private Equity Investors

In 1995 the UK signed up to the OECD's Anti-Bribery Convention. 16 years later we attempted to comply with our obligations by passing the Bribery Act 2010. [Page 8](#)



Private Equity and Pension De-Risking

Kelvin Wilson, Associate Director with Grant Thornton's Pensions Advisory Practice focuses on critical issues for private equity investors, often forgotten in the first round of due diligence or the euphoria of looking at an exit. [Page 4](#)

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Peter Chappelow

Peter Chappelow, a private equity portfolio chairman, offers some rather upbeat news about lending to private equity-backed companies and why just as he was ready to retire he chose this line of challenging, yet highly satisfying line of work.

Peter Chappelow's enthusiasm for his portfolio companies is more a sign of pride than self-adoration.

He is the only chairman to have three companies listed in the most recent Sunday Times Fasttrack 100, which means he or the people he directs must be doing something right. We ask him how the chairman's role has changed since the onset of the credit crisis.

Peter, how did you get into the "portfolio business"?

At the age of 55 I was thinking of retiring. But then when I got to 55 a takeover of Thomson by TUI happened. I was on the main board at Thomson Travel at the time, but decided to leave after a few years. I thought at this point I might try a chairmanship, but what I didn't realise then was how difficult it is to get into this line of work. I thought I'd just make a few phone calls. Instead I had to start networking. I saw 156 people within the corporate finance and private equity side of things as well as banks specialising in leveraged buy-outs before I got offered my first chairmanship, which was for a turnaround for 3i. The reality is that people are only doing a couple deals a year and the chances of them having a suitable opportunity is relatively rare. Also, they often all

have relationships with proven Chairmen. I had to work hard at networking and then a lot of opportunities came all at once. At one time I had eight chairmanships.

What finally brought you over to the other side of the bridge?

I think it was that there are not that many opportunities, but there are many well established chairmen around, so when you first go in as a portfolio chairman you are just another grey haired middle aged guy who has sat on a few boards, so you have to persuade people. Once a couple firms give you a chance and you have something to put on your CV the others follow quickly. Even though I now have a few successful exits under my belt, I still do network.

What attracts you to a chairmanship on a private equity backed business over one at a PLC?

Everything is more attractive on a private equity chairmanship. There is no comparison since you can have equity, unlike a non-exec of a PLC. You have got your interests aligned with the private equity house. I have made very significant amounts of money working with private equity-much more than I could ever have made as a non exec for a quoted business. More importantly, as shareholders are my primary focus, my shareholders have done very, very well!

How are you finding your role in the current economic climate?

Many private equity-backed businesses are niche businesses that are capable of performing well, even if the economy is struggling. I have found that new businesses with private equity backing have the ability to raise debt, but not as much as they used to. I just had a lunch with a major private equity business and they have pulled off two deals in the last few months and are looking at 5 others. They say getting lending for quality businesses is not a problem.

That's a silver lining! Which sector are they in? What is attracting the lenders?

I know many of the leading bank lenders--good old organic growth is what they are looking for. Consumer-facing and service companies are attractive, especially if there is sustainability and there is a proven capability in growing the business; there is not too much risk of it going backwards--this is where the money is getting channelled to.

One of my chairmanships, for example, sells shoes to the 'grey' market and we are doing spectacularly well. Profits have surged forward and retail like for like sales are well ahead--up between 16 % and 20%. Niche markets can prove successful in any economic climate. But I can only speak from my own experience and in this moment in time. Having said that, I am also chairman of another company that sells escorted tours to the same market and that is more difficult. The problem is connected to travel rather than their personal liquidity.

Even if you have a good core operational business, how would the cost of capital have changed since the credit crisis?

You are not getting 6 times EBITDA, which I didn't like anyway since companies were too overleveraged and overstretched to work. Three to four times earnings is what you can get now, which shows that banks are more cautious, which I think is a good thing. Many private equity firms have taken on too many risks in terms of dependence on aggressive growth. Doing a restructure is a polite way to say that turnaround specialists are needing to get rid of a lot of debt or in other words: the investors are losing money.

Are PE shareholders particularly close/demanding?

The great thing about working with private equity firms is that there are no dummies in there--there are some very, very bright people in there. Those that are more hands-on are those that take on undervalued assets and quite rightly that is a different skill set and they do have to get their hands dirty. I think the bigger companies do tend to swamp the board and seem to discuss minutia until the cows come home rather than the problems that we are trying to find the solutions to.

But each firm is remarkably different. The ones I prefer dealing with are very supportive and attend the board meetings, but do not pretend that they have a lot of hands-on experience running businesses. They act as the finance folk per se. I value those relationships. They offer a different perspective and they are very valuable. However, the ones I prefer not working with and avoid now, are those that are very bright, yet think they are experts in every single business that they sit on the board of simply because they analysed it. I also prefer working with a private equity



investor over a private owner who has brought me to improve shareholder value. When a company is entirely privately owned they do not necessarily have to take your advice and the entrepreneur can be a little bit too powerful. I believe when private equity is involved you have a more reasonable debate.

How do you manage the need to be an independent chair with the fact that you are a shareholders' man?"

You never lose sight of the fact that you are an independent non-executive chairman. You must be aware that your corporate governance responsibilities are quite frightening and you have to put that first. You absolutely must not "go native" with either the management or the shareholders because you are valued for your independence, objectivity and primary responsibility for the company itself as a legal business entity. For example, I had to have a lawyer attend every one of the board meetings of one of the companies I restructured so he could assure the board that they were not guilty of unlawful trading at a time they were potentially going to make losses.

How "hands-on" have you needed to be?

The best answer I can give is to give you an example of one of my investments where the original owner sold more than half of his stake to a private equity firm and asked how involved the firm would be with the running of the company? The private equity manager said: "Put it this way, if you are not making the agreed targets then you will have two new best friends and that will be me and the chairman."

If a company is not doing well, I have to spend a lot of time there and may even have to replace a few executives. If a company is doing well it's a piece of cake and I can just focus on the exit, since my main job is creating shareholder value, which means achieving an exit that is beneficial to the shareholders.

Private Equity and Pension De-Risking



Kelvin Wilson

Kelvin Wilson, Associate Director with Grant Thornton's Pensions Advisory Practice focuses on critical issues for private equity investors, often forgotten in the first round of due diligence or the euphoria of looking at an exit...this is one area where that overused phrase: "you should take early professional advice" is essential.

Private equity (PE) firms that have, or are considering acquiring exposure to portfolio companies with defined benefit (DB) pension schemes, need to have an understanding of the financial risks associated with these funds.

For those who have already acquired exposure, there is an opportunity to realise additional value from their portfolio company through efficient risk management of the pension fund by de-risking. For private equity firms in the process of acquiring exposure, it is important that the due diligence process takes appropriate account of the size, quantum and risks associated with pension. The main risks are:

- i. Investment risk: the risk that the pension fund does not deliver the required or expected investment return
- ii. Economic risk: the risk that interest rates fall or inflation is higher than expected
- iii. Longevity risk: the risk that pension fund members live longer than had been assumed in the valuation of the liabilities
- iv. Cash contribution risk: the risk that the earnings of the portfolio company are less than forecast due to adverse movements in the above risks which, in turn, increases the cash contribution requirements of the pension fund

Crystallisation of these risks will increase pension liabilities during the investment holding period and this, in turn, is likely to result in a loss on exit. Unless the pension fund and the sponsoring company have a good governance framework around the management of these risks, private equity firms could find that they lose out in terms of extracting maximum value from their investment.

Trustees and sponsors of DB pension funds adopt one of three approaches to risk managing the fund:

- i. They immediately de-risk the fund (using one or a combination of the strategies described below) after they have identified the most pertinent risks and determined that the risk reduction to cost ratio(s)¹ is(are) sufficiently attractive
- ii. They agree on a framework to de-risk the fund gradually over time and in line with any deficit recovery plan and/or sponsoring employer business strategy
- iii. They do nothing with regard to de-risking and, in some cases, take on additional risk by investing in high yielding but volatile assets in an attempt to improve the funding ratio

When it comes to pension risk management, private equity investors should have a different focus from those of corporate pension sponsors. The difference will be around attitudes to risk (volatility), investment time horizon and the importance placed on the accounting valuation of the pension liabilities.



Short-term volatility and investment time frame

Corporate sponsors generally expect equities to outperform bonds over the long-term² and are prepared to tolerate some short-term³ volatility. However, this is not so compelling for private equity houses who typically hold portfolio companies for no more than five years. There is a disconnect between the short-term risk tolerance of corporate sponsors of DB pension funds and the short-term risk holding period of private equity investors. Whilst corporate sponsors might invest in equities and expect long-term outperformance over bonds, the short-term volatility expected from this strategy could eat into any profits made by investors exiting their investments at the end of their holding period.

1 This compares the costs saved, as a result of removing the risk, to the price paid to remove the risk.
 2 Usually a period over 10 years
 3 Usually a period between 3 to 5 years

FRS17 / IAS19 is not an accurate reflection of the pension problem

The accounting valuation of DB pension fund liabilities is established after discounting expected future benefit payments using yields on AA corporate bonds. Whilst this approach provides a consistent basis on which to compare the pension exposure of different sponsoring companies, it does not reflect accurately the investment strategy or performance of the pension fund.

To get an accurate picture of the size of the pension liability and therefore gauge what the cost of exposure will be, private equity firms will need two pieces of information; (i) an actuarial valuation of the liabilities on an ongoing basis and (ii) a buy-out valuation of the liabilities (i.e. what premium an insurance company would expect to be paid to take ownership of the liabilities). The former identifies the cost of operating the pension fund (assuming no volatility from investment, interest rate, longevity or inflation risks) and the latter gives an indication of what it will cost to fully de-risk the pension fund.

Opportunities for PE firms to reduce exposure

If pension de-risking tools are employed to value and manage pension risks, preferably as part of the due diligence exercise before investment or at least as part of a controlled exit strategy from a portfolio company, this will assist private equity firms in maximising their investment return on exit.

Below is a summary of the most popular de-risking strategies for pension funds:

- **Liability-driven investments (LDI):** removes unrewarded interest rate and inflation risks by matching liabilities with assets
- **Longevity swaps:** protects against demographic

longevity risk and allows employers to reduce pension fund volatility. It can be funded or unfunded; customised or index-based

- **Pension annuity buy-ins:** insurance policies regarded as an investment asset of the pension fund - it addresses all risks (longevity, investment, interest rate and inflation), except administration, for a specified group of pension fund members (usually pensioners in payment)
- **Pension annuity buy-outs:** removes all pension risks by transferring accrued pension liabilities to a regulated insurance company in return for a premium (the premium is often seen as prohibitively expensive)
- **Deferred premium pension annuity de-risking:** immediately or gradually removes all pension risks by transferring accrued pension liabilities to a regulated insurance company in return for a premium payment that is structured to reflect the corporate sponsor's funding ability

De-risking boosts enterprise value

Empirical evidence suggests that companies that have de-risked their pension funds benefit from either a rise in their share price (if listed) or an increase in valuation by potential investors. The table below shows examples of some of the major de-risking transactions that have taken place over the last few years, and how the share prices of these companies have moved following the transaction.

On the next page is an example of how de-risking a pension fund can assist in delivering the long-term strategic plan of the sponsoring company. Despite being saddled with an underfunded pension fund, the sponsor was able to unlock extra enterprise value by de-risking the fund using a pension annuity buy-in. The company was able not only to reduce the size of cash contributions it made into the pension

Company	Date	Type of de-risking	Transaction size	Share price (before)	Share price (after)	% change
Babcock	May 2009	Longevity swap	£1.9bn	412	480	16.5%
Dairy Crest	Jun 2009	BPA	£310m	280	325	16%
Royal Sun Alliance	Jul 2009	Longevity swap	£1.2bn	113	130	15%
British Airways	Jul 2010	BPA	£1.3bn	188	207	10%
Denso	Sep 2009	BPA	£140m	1900	2020	6%
BMW	Feb 2010	Longevity swap	£3bn	2870	3040	6%
Cadbury	Dec 2009	BPA	£500m	791	837	6%

10.2% Average

Case Study

Sector: Automotive

Annual Turnover: £40m pa

Technical Provisions (liabilities): £100m

Pension fund assets: £80m

Deficit/funding ratio: £20m/80%

Deficit contribution/recovery: £1.5m pa for 5 years

Market cap: £60m

Share price pre de-risking: £0.2783

Key issues

- Owners want to sell operating business and exit within three years
- DB pension deficit could undervalue the selling price of the business
- Proposed level of contributions is unattractive to new investors

De-risking strategy employed

- Partial de-risking through a pension annuity buy-in
- The strategy was implemented with a well capitalised, specialist UK insurance company
- £30m worth of liabilities were de-risked, with £32m of pension fund assets transferred to the insurer (the insurer valued the liabilities at £32m)
- The company paid an extra £5m into the pension fund to cover the £2m insurance cost and improve the funding ratio

Effects of de-risking strategy

- The company's share price rose by 15% from £0.28 to £0.32 post completion of the de-risking deal
- Market capitalisation increased from £60m to £69m
- Investment, longevity, inflation and interest rate risks were hedged for all the fund's retired pensioners
- The funding ratio improved from 80% to 83%
- Going forward, a higher discount rate was used to value the pension liabilities, given the perceived lower risk in the pension fund
- Annual contributions came down from £1.5m pa to £1m over a longer time period (10 years instead of 5 years)

fund, but also to improve its funding ratio. Positive reaction from analysts led to the company's market capitalisation increasing by some £9 million. This compares with the £5 million it cost the sponsor to employ the de-risking strategy⁴.

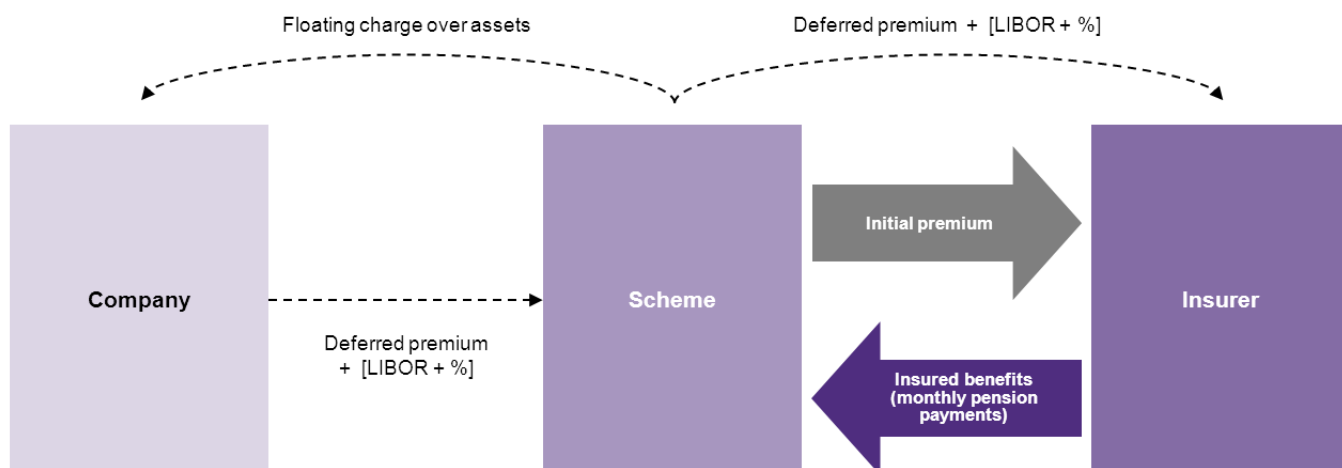
This case study shows the benefits of a developed, planned and well-executed pension de-risking strategy. Companies are exposed to over £1 trillion of DB liabilities in the UK. Unless Finance Directors, trustees and affected investors de-risk their exposures to DB pension funds, they will be left with the unenviable task of running the risk and bearing the cost of managing these liabilities on a loss-making basis. The issue for the above stakeholders is not that they do not understand the merits of de-risking; the issue is that

they believe the cost of fully de-risking, through a pension annuity buy-out, is prohibitively expensive. However, to experience the benefits of pension de-risking does not necessitate that you fully de-risk.

Partial and structured de-risking

The case study, above, is an example of a partial de-risking strategy, where risks relating to a part of the pension fund - in this case those relating to retired pensioners - were removed through a pension annuity buy-in. Partial de-risking, using swaps, is listed above. Innovation in the de-risking market has seen the development of a deferred premium annuity buy-out (DPB). Like a pension annuity buy-out, this product can remove all risks associated with

⁴ Does not include adviser costs



- 1 Scheme liabilities to be insured are defined → full buy-out or buy-in
- 2 Buy-out premium and deferred payment schedule agreed
- 3 Contract entered into guaranteeing insured liabilities to be met in full → providing payment schedule satisfied
- 4 Interest charge on deferred premium at competitive rate (based on LIBOR + %)

the pension fund by transferring them to a UK-regulated insurance company.

A DPB is structured to allow premiums to be paid over an agreed period of time, rather than as a single payment. Spreading the premium in this way addresses potential funding, liquidity and cost issues that might make annuity buy-outs or buy-ins unattractive. An illustration of how a deferred premium annuity buy-out works is shown above.

Not de-risking pension funds block M&A deals

BA and Iberia; J Sainsbury's and Qataris. These are just two of several corporate Mergers & Acquisitions (M&A) and private equity deals that have been derailed or hampered by the existence of an underfunded pension scheme that has not been de-risked. Trustees view pension deficits as debt owed by the corporate sponsor to pension members. M&A or private equity-driven restructuring of a DB sponsoring firm will require involvement of the trustees, especially if the pension fund has a deficit and the M&A/private equity deal is funded by debt. If the pension fund has not been de-risked, or the new sponsor does not have a clear de-risking strategy for post-deal completion, there is a real danger that the deal will not be agreed by all the relevant stakeholders.

Summary and steps to de-risking

Private equity firms with exposure, or who are about to gain exposure to pension funds should be mindful of adverse implications from pension risks and tailor management of these risks to their specific circumstances. An analysis of this situation should be at the heart of their due diligence process.

Private equity firms will have a time horizon to exit that is often shorter than the period over which pension fund trustees and sponsoring portfolio companies will look to fund the pension fund. This means that it is critical that PE investors have a complete strategy for tackling the risks in DB pension funds, either before (preferably) or after they have taken on risk exposure to the pension fund.

A good starting point for any de-risking objective is to identify and understand the risks to which the pension fund is exposed. These include:

- **Risk quantification:** determine the magnitude and quantum of risks in the pension fund
- **Risks to liabilities:** understand the sensitivities of the liabilities to changes in risks
- **Costs of risks:** identify the pertinent risks in the pension fund vis-à-vis funding volatility and costs to the corporate sponsor
- **Solutions, costs and counterparty:** identify de-risking solutions, their associated costs and negotiate with suitable de-risking providers to implement the most cost-effective solution

Key stakeholders in the de-risking process will include representatives from the pension scheme trustees, the sponsoring company, de-risking providers, advisers and the scheme members.



Bribery – No longer a “Conventional” way of doing business. Risks for Private Equity Investors



Richard Isham

In 1995 the UK signed up to the OECD’s Anti-Bribery Convention. 16 years later we attempted to comply with our obligations by passing the Bribery Act 2010 (the Act). The Act was due to come into force on 1 April 2011 (April Fool’s Day) 2011, but, perhaps for that very reason, it has been delayed and will now come into force on 1 July 2011.

The delay was due to the fact that the Ministry of Justice (MOJ) had failed to issue the guidance required on “Adequate Procedures”. There has also been a storm of protest from the business community because, although introducing very onerous criminal sanctions, the drafting of the Act itself is unclear (e.g. as to the meaning of “carry on a business or part of a business in the UK”).

Some fundamental questions remain. Is there a proportionality test in relation to corporate hospitality? Will even minor infractions of the Act result in permanent disbarment from public procurement lists? Will plea bargains be permissible? Will organisations have to carry out due diligence on their whole supply chain, or just agents? Will simply facing a charge under the Act equate to evidence that the organisation does not have “adequate procedures”? Furthermore, the Act contains no exemptions for facilitation (or so called “grease”) payments (compare the position under the US Foreign Corrupt Practices Act which has certain exemptions).

On 30 March 2011, the MOJ issued the long-awaited guidance (the Guidance) on the Act and on adequate bribery prevention procedures. It provides clarity with respect to some of the concerns mentioned above and enables businesses to take concrete steps to bring their house in order and revise their existing bribery prevention policies and procedures or consider and implement new ones reflecting the principles set out in the Guidance.

Offences under the Act

The Act introduces four new offences:

- i) offering a bribe (active bribery)
- ii) receiving a bribe (passive bribery)
- iii) bribing a foreign public official; and
- iv) failure by commercial organisations to prevent bribery – the “Corporate Offence”.

The Corporate Offence

The offence of failing to prevent bribery is a strict liability offence: the commercial organisation will be guilty if a person associated with it, bribes another person. The only defence will be the commercial organisation’s ability to show that it has adequate procedures in place to prevent bribery. The definition of “commercial organisation” includes limited and unlimited companies (whether limited by shares or guarantee), general and limited partnerships and limited liability partnerships (LLPs).

Example:

A performs services (e.g.: as an employee, consultant, or agent) for the commercial organisation C.

A bribes X intending to obtain or retain business for C.

C is guilty of failing to prevent bribery, subject to C having the adequate procedures defence.

The directors and senior managers of C, and C itself, do not need to have any actual knowledge of A's conduct, for C and its directors and senior managers to be found guilty.

**Risks for PE Investors**

Investors establish a PE fund and become the Limited Partners (LPs). Acquisitions of portfolio companies are made by the General Partner (GP) who holds those investments on behalf of the fund. If businesses/companies are acquired that have corruption issues, where will the Bribery Act buck stop?

Is it possible that the LP's could be prosecuted for the acts or omissions of someone associated with a portfolio company, or can liability for the corporate offence be contained at portfolio company or GP level only?

In the example above, "A" would have to be associated with the LP i.e. be a person who performs services on behalf of the LP. The capacity in which A performs the services does not matter; the fact that "A" is "labelled" as an employee of or agent for the portfolio company does not matter either. Rather, A's relationship with the LP and/or the GP will be determined by reference to all the relevant circumstances. Accordingly, the precise structure of the fund and the relationship between the LPs, GP and portfolio companies will be relevant. Furthermore, it is not unusual for the PE fund to hold a minority investment in a range of assets, and that accordingly, there might potentially be a number of distinct funds that could become tainted as a result of a **misdemeanour in one of the underlying businesses.**

On the face of it, on the basis that the individual "guilty" of corrupt practices, including offences under the Act, is an employee of the portfolio company, it should be possible to argue with some force the case that the liability for any such corruption is "ring fenced" within the portfolio company. That said, however, if a member of the GP is a director of the portfolio company, then, in that capacity (namely as a director of the portfolio company, or, indeed, as a shadow director/senior manager of such a company), the member of the GP will be exposed to potential liability in relation to the acts of anyone associated with the portfolio company.

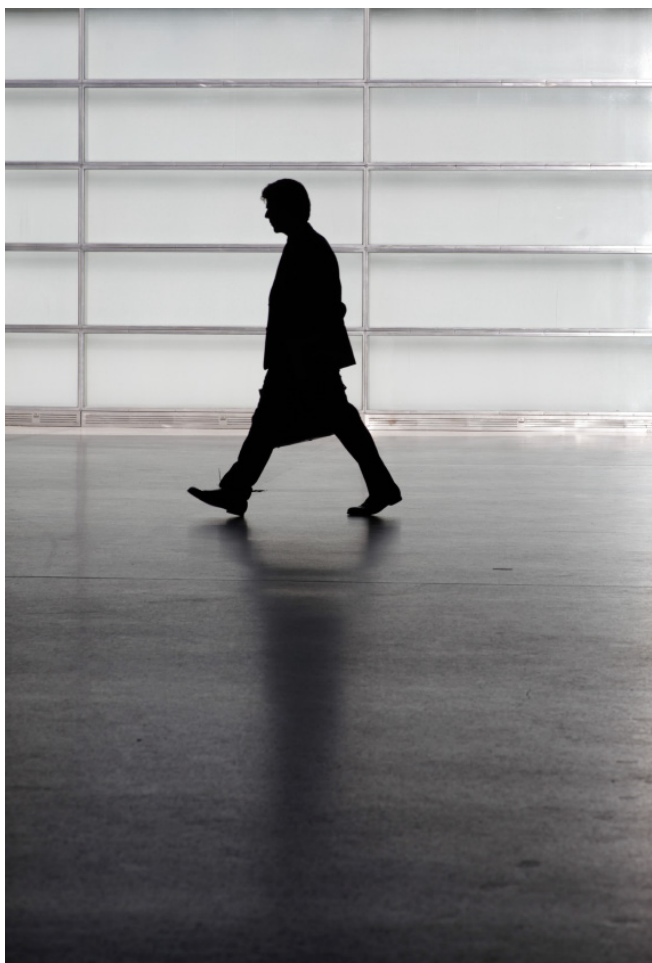
PE Investors must do DD

Thorough due diligence will become even more important in order to ensure that the reputation of LPs and the GP is not tarnished because a target portfolio company has a poor record in relation to corruption, including bribery, as widely defined under the Act. That said, finding out about the problems is likely to be difficult – perpetrators are likely to cover their tracks.

Red flags as far as the MOJ are concerned are:

- i **Geographical risks** – where is the country in which the portfolio company does business, in the corruption league tables?
- ii **Sector risks** – oil and gas, telecoms, IT, construction, pharmaceuticals and defence.
- iii **Use by the target company of third party agents** – how are they selected, are any of them public officials, or related to or connected with public officials?
- iv Does the target company have **transparent and ethical accounting practices?** Are there off balance sheet issues?





1. proportionate procedures – procedures which are proportionate to the bribery risks the organisation faces;
2. top level, board down, commitment;
3. a proper risk assessment of the nature and extent of the organisation's potential external and internal bribery risks;
4. thorough due diligence procedures in respect of persons who perform, or will perform, services for or on behalf of the organisation;
5. internal and external communication and training of its bribery prevention policies and procedures, including decision making, financial control, political and charitable donations, gifts, hospitality, promotional expenses, facilitation payments and whistleblowing procedures; and
6. a continuing process of monitoring and review.

The MOJ have made it abundantly clear that the development of adequate procedures must be a top down project, starting with a board commitment to eradicate corruption and ensure that the business operates in an ethical and corruption-free way. It will not be enough, to activate the defence to the corporate offence, simply to produce a beautifully crafted anti-corruption policy, rather, the commercial organisation will have to show that the policy has influenced the behaviours of those in the business and the processes of the business to effectively prevent corruption. Accordingly, the organisation will have to train its staff on the policy and also train any third party agents (on a weighted risk basis).

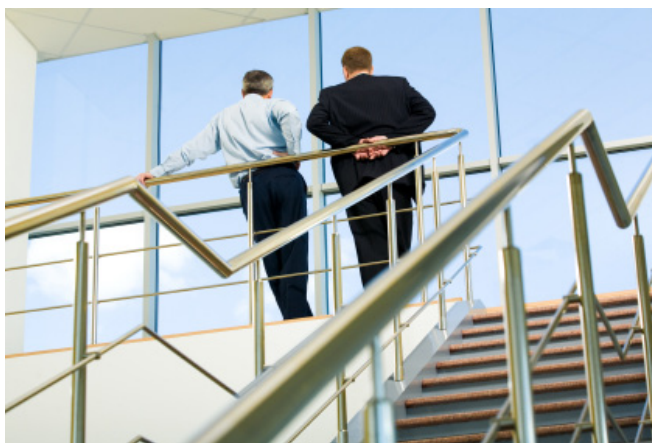
One of the concerns raised in relation to the draft guidance published in September last year was whether or not a commercial organisation would have to incur the expense of training its entire supply chain on its anti-corruption policy so that the supply chain is aware of the adequate procedures that the commercial organisation operates. The Guidance suggests that it may be appropriate to require associated persons to undergo training, and where a supplier is performing services for an organisation rather than simply selling goods, it may be an associated person. However, the Guidance also clarifies that, where a supply chain involves several entities, an organisation will only have control over the relationship with its immediate contractual counterparty. This suggests that, in such a case, it may be appropriate for the organisation to train only its immediate supplier/s, rather than the entire supply chain. The same applies in relation to due diligence (principle 4).

- v Are the **sums paid to third party agents** proportionate and properly accounted for in the books of the company?
- vi Does the company have anti corruption policies as well as **policies** governing gifts, charitable donations, political donations and hospitality policies?

The Act's Extra Territorial Application and the need for Adequate Procedures

The corporate offence covers commercial organisations, including all companies and/or partnerships and LLPs incorporated in the United Kingdom or which carry on business or part of a business in the United Kingdom; a business incorporated in a foreign jurisdiction could be prosecuted if that business has an associated person who is a UK national.

In order to have a defence to the corporate offence, adequate procedures have to be in place. The Guidance sets out six guiding principles for a risk based regime which is said to be "flexible and outcome focused" (MOJ Guidance, The six principles). The principles which the MOJ consider should inform and govern the development of a commercial organisation's Adequate Procedures are as follows:



Overall responsibility within an organisation for the initiation, development and implementation of bribery prevention procedures and bribery critical decision making will depend on the organisation's size, management, structure and circumstances. In smaller organisations this could require the personal involvement of top-level managers whereas in large multinational organisations the board should be responsible for setting bribery prevention policies but delegating to management the task of designing and implementing adequate procedures. The policies should include "whistleblowing" provisions so as to encourage employees and/or agents to "blow the whistle" on any corruption. The policies should also be subject to regular review and monitoring to ensure that they are "fit for purpose". The review and monitoring process, depending on the resources on the commercial organisation and its risk profile, may have to be undertaken using an external third party (for example the organisation's auditors or lawyers).

What Can Be Done?

Policies and procedures should be reviewed as a matter of high importance as the Act will now come into force on 1 July 2011. Effective due diligence, designed to ensure that PE investors and the fund manager knows their business partners – whether they be companies or businesses acquired or joint ventures – will be essential. If problems with corruption are uncovered as part of the DD process, consider obtaining warranties and/or indemnities from the vendor. Careful drafting may well be required so as not to invalidate any such provisions on the public policy ground that a party cannot be indemnified against its own wrong.

The alternative – take Iago's advice to Roderigo: "Put money in thy purse". The consequences of such a cavalier attitude to the intentions behind the Act, however, could be almost as tragic as Othello's death, namely 10 years at Her Majesty's pleasure.

Profile: Richard Isham, Partner, Wedlake Bell

Practice Area: Employment

Areas of Expertise

Richard advises on all aspects of employment law, both contentious and non-contentious. He is a member of the Employment Lawyers' Association and sits on their Legislative and Policy sub-committee which coordinates responses to the BIS consultations on proposed new legislation.

Summary of Experience

Richard joined Wedlake Bell in October 1988 and became a partner in 1996.

He mainly advises corporate clients on a broad range of employment issues, including collective cross-border issues, harmonisation of terms and conditions and policies, redundancies, dismissals, policies on discrimination, data protection and monitoring, bonus schemes and corporate governance. He advises on the applicability of TUPE to business sales and outsourcing contracts and advised the successful appellant before the EAT in one of the leading cases on TUPE, Michael Peters Ltd -v- Ian Farnfield and Michael Peters Group plc.

Richard's practice also involves providing advice to senior executives, senior bankers and sports organisations, both governing bodies and clubs.

Richard chaired the Employment Lawyer's Association working party responding to the DTI's consultation on Employment Agencies and was a member of the ELA working parties responding to consultations on genetic testing in the workplace, part time workers, directors' remuneration and "red letter" days for the introduction of new employment legislation. He is contacted regularly by the press for comment on topical employment and employment law related matters; speaks at seminars; presents training videos and has written the chapter on Age Discrimination for Tolley's Employment Law.

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Delivering value for our clients through successful operational turnarounds

pilot CASES

APRIL
2011

Whenever we meet clients as well as advisers and prospective candidates we are always asked and are delighted to explain our professional work in our niche markets through discussing case studies and the actions delivering successful outcomes.

Presenting summary case study extracts for PILOTcases has the approval

of the interim executives and the clients concerned but to preserve confidentiality, names have been changed or abbreviated.

INTERIM CEO

Logistics - Crisis management & preparation for sale or administration

- UK division of a global logistics group (mainly traditional warehousing, road & rail transport to multiple retailers) with £150m sales & NAV of €74.1m. The brief to PILOTpartners' interim CEO was to 'tidy up' a terminally failing entity with a view to a successful administration or quick sale.
- Ultimately achieved a 'soft landing' administration, with £100m greater creditor value compared to a forced sale.
- Enabled successful completion of four parallel sales processes; two via a pre-pack.
- Delivered full recovery to secured creditors and £20m funds available for preferred & unsecured creditors.
- Secured 2,000 jobs via TUPE to the new business owners.
- Managed smooth handover to administrator in waiting.

INTERIM CEO

Foods ingredients business – Central Europe

Cross border turnaround & restructuring programme

- PILOTpartners' interim executive hired to cover for incumbent following serious illness.
- €200m+ t/o group required financial restructuring of its business units in Central Europe following significant market downturn.
- Negotiated new bank facilities (€36m) and stakeholder equity (€12m).
- Managed operational turnaround of the group, PBIT €13.5m ahead of plan.
- Czech Republic business cash burn reduced from €1.5m/month to zero.
- Initiated several legal actions against fraudulent & corrupt activity, valued c.€100m.
- Strengthened senior management teams in each country.
- Secured clean, accurate & timely financial reporting to IFRS requirements.
- €13m 'old debt' court case resolved out of court for €2m.
- a year later, with flat revenues, it exceeded its positive EBITDA target with a profit swing of £1.3m. The business was then sold for a 2.5 x IRR.

CRO / CHAIRMAN

Specialist engineering group – Accelerated Sale

- MBO out of administration. The £15m company supplies capital equipment to the global chemical and pharmaceutical sectors. There had been two working capital cash calls in quick succession that triggered an external business evaluation.
- Interim CRO appointed through James Wheeler at PILOTpartners, with an initial brief from private equity investor to provide a rapid diagnosis for a recovery plan with a view to an accelerated sale of the business and to replace an underperforming management team.
- Having completed this review AT closed the year end one month later with a subsequent EBIT swing of £2m and an unforecast loss of £1m.
- Tight cash management controls were implemented and the business was restructured including the disposal of two out of the three manufacturing sites.
- A new board comprising best performing second tier team was appointed. CRO became executive Chairman.
- Gross profit margins were significantly improved, the breakeven point was reduced by 40% and a year later, with flat revenues, it exceeded its positive EBITDA target with a profit swing of £1.3m. The business was then sold for a 2.5 x IRR.

CHIEF RESTRUCTURING OFFICER

Food Manufacturer – Business assessment project

- Interim CRO appointed by Private Equity owner to assess this £30m business and its management in a refinanced company with fast declining margins, an expectation of impending covenant breaches and with a likely sale in view.
- The CRO reported to the investor on:
 - Assessment of management team
 - Assessment of business viability and potential
 - Validation of the sale decision
 - Detailed contingency plan to assume control of business in the event of abortive sale:
 - Stakeholder engagement plan
 - Customer engagement
 - Cost reduction and rationalisation
 - Supplier review and rationalisation
 - Management changes and interim contingencies
- He then worked with the management team in:
 - Assessment of product and customer viability
 - Assessment of cash projections and risk
 - Review and validation of profit improvement plan
 - Bank presentations and forecasts

Continues from page 1

Pieces within this issue of Pilot's Log include:

Peter Chappelow, a private equity portfolio chairman, explains how he side stepped retirement to become a very successful serial chairman, and the lessons he has learned along the way.

Kevin Wilson of Grant Thornton explains in great detail the need for private equity firms to have a thorough understanding of the financial risks associated with defined benefit pension schemes when acquiring new portfolio companies.

The first PILOTcases, a new feature going forward that will regularly show the type of work our executives perform. In fact this is at the specific request of clients who have said they want to understand more about assignments and projects in our niche. The inaugural piece touches on four cash-strapped turnaround / restructuring situations which resulted in significantly improved results and/or exits.

Richard Isham, a partner with Wedlake Bell who advises on all aspects of employment and human capital law, both contentious and non-contentious, provides us with a very concise and timely analysis of how the new Bribery Act will impact on private equity firms and their portfolios.

As always, please feel free to follow up directly with any of our contributors for further information. And on behalf of all of us at PILOTpartners we hope that you and your families have a peaceful and enjoyable Easter break.



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