

Investing in Ideas Shani Zindel



Though many lenders have closed their doors in the crippling climate, entrepreneurs should continue to believe that their product can be a success, and private equity must continue to provide the platform for their talents.

Another week, another sad story; yet again, a company boss has had the rug pulled out from underneath him as the economic downturn has continued to take its toll. While many blame the media for focussing on the bad news, and therefore turning the economy into a self-fulfilling prophecy of doom and gloom, the reality is that small companies are finding it harder to tap the funding they need to grow. And this is far from good news when Britain's economic engine is powered by Small and Medium-Sized Enterprises (SMEs).

Most of the traditional avenues for lending are either clogged up coping with the high volumes of company restructurings, or paralysed altogether - the stockmarket and bond markets are shut to all but the biggest companies. All this leaves private equity as one of the few players in town able to offer finance.

Our industry has not been immune to the economic climate, and it is going through something of a shake-out with a number of firms effectively closing to new business by handing back money to investors or looking to consolidate themselves with rivals. But at the sub-£75m market-cap arena, where we at ISIS invest, there are a range of houses keeping their doors open and looking for new companies in which to place their money and more importantly, their knowhow.

The downturn is certainly hitting business hard, but this recession could be one of the best times to start or grow a company. Why? Because entrepreneurs thrive in this environment. Weaker businesses will fail, leaving the strongest to survive and prosper. And those are the firms where private equity can really make the difference.

“While the downturn won't end any time soon, it should not spell the end of ambitious people striving to grow their companies”

In 1998 when the last downturn was looming, ISIS supported the management buyout of Tricom, a builders' merchant specialising in plumbing and heating equipment, out of German owner Mannesmann. A risky investment because of it serving a highly cyclical industry, we were unable to use traditional funding means, but were convinced by management that they knew their sector inside out. While the trend at the time was for consolidation, Tricom, run by chief executive Brian Gray, was growing market share by taking advantage of plumbers' unwillingness to travel far for their tools, so they instead focussed on selling to small, local merchants.

ISIS created a funding package specific to the deal, using invoice finance rather than traditional senior debt. Over the course of our almost five-year investment, we supported the company in its business plan which included establishing a range of own-brand products, as well as providing customer credit options and culminating in 1999 in the bolt-on acquisition of Fry & Pollard, a secondary distributor. Turnover grew from £65 million to £124 million.

In 2003, we sold the company in a trade deal to product distributor BSS, for £31.8 million. Not only did the deal signify an IRR of over 50% over the time of the investment, but it was completed when the effects of the dotcom crash were still a significant hurdle to M&A activity.

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More recently, we found a similarly like-minded individual in the form of Alastair Parker-Swift, the founder of Crew Clothing, who started his business selling rugby shirts in the French Alps to pay for ski-ing trips. He eventually opened a single shop in Devon in 1993. By the end of 2005, when we first got into contact, Parker-Swift had already risked his home to grow his business and was looking for the security of having a partner who could hold his hand and help him take the next step. With our success with Fat Face at the front of his mind (which we had sold to Advent International earlier that year having grown turnover by eight times), Parker-Swift was keen to work with us and together, we developed a detailed business plan before signing the deal. This meant we could hit the ground running when we led a £7.75m fundraising for the business in 2006 - a time when retail was already proving to be challenging as a sector. Crew opened its first international store in Dubai only months later.

Today, Crew Clothing has almost 50 stores in its portfolio as well as a successful wholesale and direct mail order business which is still growing. It is also able to invest in the business at a time when many of its competitors cannot do so, and will therefore benefit from a future recovery in the sector. We are delighted with the close and open relationship we have established with the company which perfectly reflects the way we like to work with our portfolio.

Entrepreneurs often tell us how nervous they are about selling a stake to a private equity firm. They worry about the culture they have fostered disappearing and being pushed out of the way by corporate suits who relentlessly drive the company to meet targets. But that is not what we are about. Firstly, we are comfortable taking minority stakes – something that some of our competitors will rarely do. And secondly we have the benefit of our “Three ‘P’s” methodology, by which we refer to a company’s People, Platform and Positioning. That means that when we find a company with a stable and profitable business model, we will work hard on all three levels to ensure that the people that we back are the successful entrepreneurs of tomorrow.

In reality, this could mean understanding the management capabilities and building on them by bringing on a chairman or other executives with relevant experience, committing investment and infrastructure during the early years to establish a scalable platform, and developing or adjusting the growth strategy to take advantage of all the opportunities on offer.

And while the headlines are dominated with news that private equity deals have come to a standstill through inability to raise debt, some firms, including ISIS, are prepared to be flexible and fund a deal entirely without debt if that is appropriate.

Ultimately, we want to help entrepreneurs realise their full potential and while we agree that the economic downturn is certainly not going to end anytime soon, the recession should not spell the end of ambitious people striving to grow their companies. It is all about risk management rather than risk avoidance, and private equity, with the experience and skills that can go with it, might just be the answer that these individuals are looking for.