

Sector Insight

## ARE WE AT THE 'TIPPING POINT'?



The acquisition of the Vasanta Group in July 2009 represents a landmark deal for Endless, but Investment Directors Chris Clegg and Mat Deering investigate whether it could also mark a watershed in the way banks and other stakeholders deal with excessive debt levels in leveraged buyouts.

### The Perfect Storm

The current economic situation is bringing together a number of factors which are creating a perfect storm for many businesses. But throw in already excessive levels of leverage facing many buy-outs which were a feature of the bull markets of 2006 and 2007 and you have a very toxic mix. So far many businesses have gone to the wall but to a large extent these have been the weaker players in their respective markets. But as the recession continues even successful and profitable businesses which happen to be over-gearred will start to fall victim. As such we predict there will be a notable increase in high profile restructurings in the latter stages of 2009 and through 2010.

### The Tipping Point

So why the sudden change? Chris Clegg, Managing Director of Endless in Leeds, comments: "In the first half of 2009, Banks were in shock from their own internal funding crises and reluctant to take actions or make decisions. Further HMRC has been forced by the government to be aggressively supportive in accepting deferral plans and providing some additional liquidity which has helped to a limited degree. As a consequence many over leveraged businesses have battled through but remain extremely fragile."

Economic recovery will be protracted and we are approaching a 'tipping point' for many leveraged transactions. The re-scheduling of debt, deferral of tax and the cost cutting measures many businesses have taken will no longer be enough to avoid the need for new money. The 'tipping point' comes much earlier for over leveraged companies. This is not necessarily to service the debt itself but due to the fact that credit insurers do not like leveraged situations. As profits and cash flow decline credit insurers may pull cover quickly as was evidenced prior to our acquisition of Vasanta which is featured below.



The same fate has been experienced by the furniture retailer SCS and many others. Naturally as the recession continues credit insurers will increase their focus on risk management and reduce cover accordingly increasing this trend.

So the 'tipping point' is imminent. Stakeholders will be forced to take some tough decisions over the forthcoming months. But it is not all bad news. As the Vasanta transaction has shown, realistic options to preserve value exist. Endless has the capital to meet such funding requirements and the expertise to deliver it quickly and with certainty.

### **Spotlight on Vasanta**

Vasanta is a Sheffield based, £0.5 billion turnover supplier of office products, serving both the indirect channel to resellers and retailers and the direct channel to end users. The group had been created in 2007 through the merger of Kingfield Heath (now renamed VOW), ISA Retail and Supplies Team in a £300 million leveraged buyout led by Electra Partners. The deal had been funded with a debt package of c£200 million provided by a large lending syndicate. Following the 2007 deal, and the successful integration of these three businesses, the group generated EBITDA of £29 million on sales of £518m. However, as recession took hold in late 2008, trading began to weaken. Credit insurers then began to scrutinise the sector and took a dim view of the group's gearing, resulting in the withdrawal of £40 million of credit insurance in a matter of weeks and placing strain on cash flow.

With its banks concerned but unable to agree terms on a consensual restructuring, new funding was required from an external investor and quickly. In the meantime lack of cash was starving the group of stock and delaying investment in the business. In less than 3 weeks, Endless was able to agree heads of terms, carry out focused due diligence and complete a transaction that achieved a full debt restructuring and recapitalisation of the group.

The transaction saw the Banks "roll-over" £50m of existing debt, with Endless and the banks providing a £30m new funding commitment. Endless became the significant majority shareholder, while in return for contributing some part of the new money requirement the Banks took a minority equity stake, giving them the prospect of recovering further value through a share of future upside.

### **The Future**

Investment Director Mathew Deering commented: "The deal represents a partnership between Endless and the Banks where risk and reward have been shared. Vasanta can move forward with a more appropriate level of debt and new funding. But most importantly, Endless was able to act swiftly and decisively, so avoiding further damage to the business."

Vasanta may have experienced a financial restructuring and well publicised trading difficulties but one fact is starkly evident - Vasanta remains a strong business and, more importantly, a profitable one. Endless has now appointed Alan Barclay as Interim Executive Chairman to lead the group going forward. Alan brings an extensive knowledge of both the office products sector and the VOW business in particular, having formerly been the CEO of Kingfield Heath.

Alan is in no doubt that the deal averted a potentially fatal funding crisis, commenting, "The challenges facing Banks who funded highly leveraged buyouts are well documented. But perhaps in these straightened times the difficulties of trying to provide a compelling business case to a distressed syndicate, each with their own priorities, is less well reported. The Endless team's decisive and professional approach was the key that unlocked the solution. The investment climate has recently begun to show some signs of optimism returning, none of which was evident when Endless engaged in negotiations in June. The imaginative structure of the deal and the ability of the Endless team to deliver on their promise to close a sale process in record time made the difference and resulted in the successful refinance."