THE INSTITUTE FOR TURNAROUND

Supporting productivity, transformation and business rescue in a post-pandemic world

THE-IFT.COM

Contents

From the Chair

The directors behind UK businesses large and small, having risen to the manifold challenges of the Covid Pandemic and associated lockdowns might have expected a period of calm to recover and rebuild.

Andy Leeser
Chief Transformation Officer and Chair of The IFT

The aftermath of the lockdowns combined with political and economic instability have combined to burst the bubble of liquidity and low inflation. Supply chain disruptions caused by repeated lockdowns in China throughout 2022, continue. Labour shortages also persist, partly due to fewer migrant workers post-Brexit, and also to the steep rise in the over-50s leaving paid employment, resulting in around half a million fewer people in paid work than before the pandemic.

On top of this, Russia's illegal invasion of Ukraine has been a tragedy for the Ukrainian nation, and had widespread secondary impacts right across the world. Most notably, energy costs have risen dramatically, fuelling inflation and putting further pressure on business finances.

Against this volatile backdrop, and for reasons well beyond their control, many firms and directors will be struggling to stay afloat. When a business faces existential challenges, its directors have a duty to respond. Seeking professional advice to help navigate the increasingly complex, and sometimes contradictory, legal and regulatory framework should be a priority. The consequences of even innocent mistakes can be personal and severe for directors.

By contrast, involving experienced turnaround professionals early, can transform a firm's prospects, saving jobs and protecting value – as this report shows. The IFT's members continue to transform the prospects of many companies in distress – allowing us to continue to contribute to the economic prosperity of communities across the UK.

"Our members have worked incredibly hard to help businesses navigate the immediate financial and operational difficulties arising from the pandemic."

From the CEO

It is a real privilege to lead The IFT because I get to see daily the extraordinary work done by our members - the turnaround and transformation directors and advisers who specialise in helping distressed businesses not only get back on their feet but to thrive.

Milly Camley
CEO, The IFT

The IFT enjoyed its 20th anniversary year in 2021 and we remain true to the Institute's roots in our emphasis on working on the side of businesses and promoting turnaround as an important and socially valuable alternative to unnecessary insolvency. To this end, the IFT supports and encourages its members to deliver excellence at all times.

This is the third year we have commissioned a survey of our members and attempted to quantify the value of turnaround and transformation. That value is not just economic, although the £3.6bn that turnaround directors have protected is clearly very important. The value is also human: turning around a viable business saves people's jobs and livelihoods – some 81,800 jobs were protected in the last year. And as we can see from the case studies in this report, successful turnaround also protects vital services that might otherwise be lost to a community.

There are lots of lessons to draw from our survey, but perhaps the most important is that companies and directors need to be honest with themselves about their problems when they fall into trouble, and to take action. A cultural resistance to seeking professional advice, or the misplaced belief that it is an expensive luxury, prevents too many firms from seeking help before it is too late.

This is particularly relevant when you consider the succession of economic shocks that businesses have had to navigate over the last few years, as Andy has mentioned. While some sectors are suffering more than others, including retailing, casual dining, manufacturing and automotive, many more sectors face an explosive cocktail of rising energy costs and markedly higher interest rates, alongside supply chain disruption and labour shortages. Whatever the reason for a business falling into distress, the first step on the road to recovery is to acknowledge the problem and seek professional help. It can be the difference between keeping control, savings jobs and losing the value created by those businesses.

"Successful turnaround creates direct positives for owners, shareholders, employees, suppliers and creditors."

Executive summary

Last year was another demanding period for businesses in the UK. Just as Covid-19 restrictions were being lifted, companies faced climbing energy costs, rising inflationary pressures (and interest rates) as well as supply chain disruptions.

The result was an increase in the number of distressed companies across most regions of the UK and with it a spike in demand for turnaround expertise. Many companies that sought out turnaround managers were able to save jobs, deliver enhanced shareholder value and embark on new strategies for growth.

In this latest survey of its members, the IFT highlights the trends that distressed companies and turnaround managers faced in 2022 and the challenges that await them in 2023.

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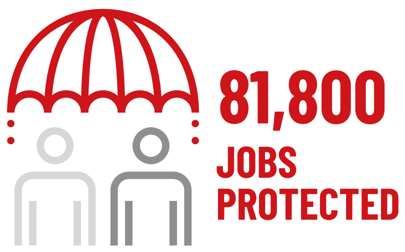
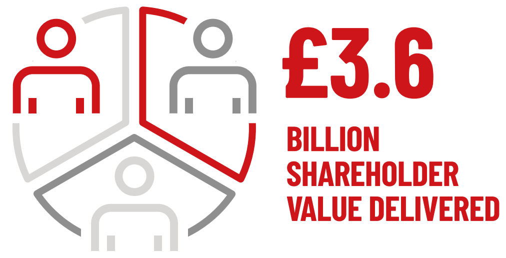
1. Independent members of the IFT helped save 81,800 jobs in 2022



Distressed companies which sought out the turnaround advice of IFT members saved an estimated 81,800 jobs in 2022 as initiatives to fix finances and revamp growth strategies bore fruit. However, if more UK companies had turned to turnaround specialists, more jobs could have been saved. The IFT estimates that with just a 4.5% increase in businesses seeking out turnaround specialists, in excess of 800,000 jobs could have been saved last year.

2. IFT members continue to add shareholder value

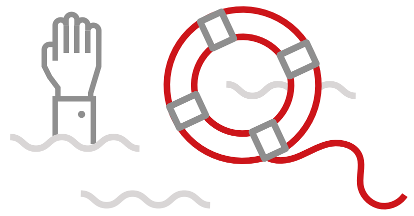


IFT members helped UK companies deliver in excess of £3.6bn of shareholder value in 2022, setting a new record, latest IFT survey analysis shows. The rise came in spite of increased risks of compulsory and voluntary liquidation for UK businesses in the wake of the Covid-19 pandemic. The figures were based on survey responses from IFT members.

3. Demand for turnaround expertise to continue to grow

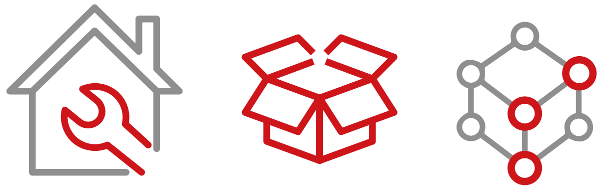
Official figures from Companies House have revealed that the number of distressed companies in the UK continues to grow. This is increasing demand for turnaround expertise. According to a survey of IFT members, almost 89% of those questioned said they found the current period to be as busy – or busier – than the same period last year. More than 93% of respondents predicted the next 18-24 months would prove busier than the current period.

4. Cultural resistance to turnaround support remains a major obstacle



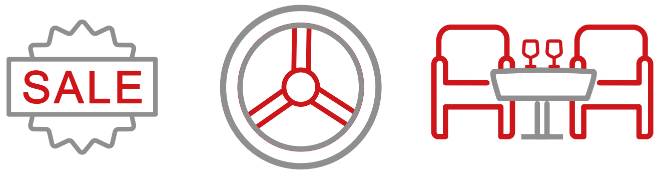
While there is clear evidence that turnaround specialists can add significant value to distressed businesses, many companies that could benefit from help still fail to seek it out. The main reason for this, according to 71% of IFT members, is a cultural or psychological resistance from businesses to pursue external advice.

5. Construction, manufacturing and tech - the three sectors which required most input from turnaround specialists in 2022



Construction, manufacturing and tech were the 3 sectors with the largest increases in the number of companies in distress from 2021 to 2022. They were also the sectors where IFT members conducted their most projects over the period. Manufacturing held the top spot and is expected to remain the most in demand industry next year according to IFT members.

6. Retail, automotive and casual dining sectors to feel the strain in 2023

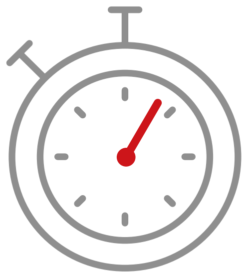


As rising interest rates and climbing energy costs continue to hit both business costs and consumers' pockets, personal consumption is expected to suffer in 2023. Retail, automotive, and casual dining are those sectors likely to be hit hardest with these three sectors predicted to see the strongest demand for turnaround management over the next 12 months, the latest survey of IFT members has found.

7. South East and London lead in number of distressed companies

The South East (1) and London (2) were home to the largest number of distressed companies in the third quarter of 2022, maintaining a clear lead over other the North West (3rd), the South West (4th) and the West Midlands (5th). Apart from the Isle of Man and the Channel Islands, all areas of the UK recorded rises in the number of distressed companies.

8. Short-term survival most popular focus area during pandemic



The Covid-19 pandemic required many companies to review their business and staffing models as consumer and business behaviours in many sectors underwent dramatic change. For distressed businesses, this saw them seeking out turnaround advisers to focus first and foremost on short-term survival (62%) or transformation strategies (60%) with advisers most frequently supporting boards to create strategic change (67%).

9. Inflation is the biggest challenge for distressed businesses

IFT members have predicted with 81% identifying inflation as a key test for businesses. It trumped energy prices coming second at 61% and supply of labour at 41%. This challenging environment is likely to result in a rise in bankruptcies with 81% of IFT members predicting an increase in insolvencies next year.

10. Governance key focus for turnaround advisers

Improving governance and controls at distressed businesses was the central focus for turnaround advisers in 2022 with two thirds citing it as a major driver of turnaround transformation. It came ahead of changes to organisational structure (64%) and cost reductions (58%) as the most favoured initiative to breathe new life into troubled companies.

Positive impact of turnarounds

The UK already has among the highest number of distressed companies in Europe. Perhaps more worrying is that this number is rising at its fastest pace in seven years. It is clear then that the conditions are being met for a rise in company insolvencies and all the problems that come with them from destruction of shareholder value and lost jobs to negative social impacts on local communities.

That is unless these companies can be turned around, livelihoods protected and jobs saved. Already in 2022, IFT members played an important role in helping protect jobs.

Yet these numbers would be far larger if there was just a modest increase in the numbers of distressed companies seeking out turnaround expertise. Assuming just 4.5% more of distressed companies turned to turnaround specialists, it is estimated that the total number of jobs saved would increase over ten-fold, underlining the importance of turnaround advisers to continue to market their services to companies.

IFT members have played a crucial role in increasing the shareholder value of companies too. Last year, surveyed IFT members reported creating £904m in shareholder value for the companies that they advised. Extrapolating these figures across the entire IFT membership, IFT members helped created shareholder value of in excess of an estimated £3.6bn in 2022, marking the third year in a row that this figure has increased. The amounts of shareholder value added ranged from sums under £1m for some smaller companies to over £65m in 8 recorded cases.

There are obvious benefits for the owners and employees of these companies. But there are often clear advantages for local communities too. Thriving businesses help shore up demand for local companies in sectors as diverse as hospitality to transport and logistics. Increasingly we are also understanding the importance of company resilience to wider supply chains too.

Distressed businesses that are saved during turnaround often also in turn preserve vital services for their local communities. Two of the case studies in this report show the unquantifiable value that successful turnarounds bring.

Take Hovertravel, a hovercraft operator which provides a fast transport service between the Isle of Wight and the UK mainland, and serves 140,000 residents on the island. Yet, facing a near total loss of revenues as the first Covid-19 lockdown hit, management – with the help of turnaround advisers – found a new path, providing relief to the NHS and emergency services and ensuring Hovertravel's survival during the pandemic. Today the company continues to offer life-line services for the emergency services and local authorities as well as for the thousands of residents and visitors to the Isle of Wight. Read the full case study on pg23.

Another example is Archant, the national and regional press company that has been providing news to UK residents in one form or another for over 170 years. Hurt by falling print advertising revenues, the Norwich-based publisher had begun cutting costs. Despite this, the survival of the business was in doubt. So, in 2019, in conjunction with expert advisers, it began a radical transformation plan, restructuring its divisions and promoting new management before completing a sale in 2022. Now many of its key brands, including the Eastern Daily Press which serves the residents of Norwich, face a brighter future ahead of them. Read the full case study on pg14.

Saving distressed companies saves jobs and creates value for owners. But, with many businesses also providing vital services to their communities, the benefits of successful turnarounds often go much further than that.

Distressed businesses that are saved during turnaround often also in turn preserve vital services for their local communities.

Trends in turnaround

Companies have come under mounting challenges in the last few years. Covid-19 brought with it successive lockdowns, increased employee absenteeism and temporary closures of large parts of the economy. Combined, these had significant negative impacts on economic growth.

But widespread government help in the forms of grants and job furlough schemes, coupled with a temporary stay on insolvency processes meant that many companies survived the Covid-19 pandemic intact. Indeed, in 2020, insolvencies actually decreased and, since the first quarter of 2020, average quarterly insolvencies remain lower than the average during 2015 to 2019.

By contrast, 2022, with rising inflation, climbing interest rates, sky-rocketing energy prices and disruptions to supply chains has already proven a more difficult trading period for many businesses. In the second quarter of 2022, total company insolvencies in England and Wales reached their highest quarterly level since the third quarter of 2009 when they spiked in the wake of the global financial crisis.

Drilling down into the figures, it is clear that rising energy prices have been the greatest current worry for companies. In August of 2022, 22% of businesses said energy prices were their biggest concern, up from 15% in late February. Also in August of 2022, 1 in 10 UK businesses reported a moderate-to-severe risk of insolvency.

Kelly Jones, a transformation director at Kingsgate, said that many companies have found it difficult to pass on higher prices to customers so instead have focused on cutting costs within the business.

"Now companies tend to be hunkering down rather than expanding into new markets. They are saying 'how can we get more profitable from the business we already have?'"

However, she said many companies delayed taking such action until the latter half of 2022 as, in the very early months of 2022, funding and lending conditions remained favourable and inflation was still subdued.

However, as interest rates have continued to climb and lending conditions have deteriorated, zombie companies – businesses which are continuing to operate but are only just managing to service their debts – face increasing challenges, particularly as bank base rates have climbed from just 0.25% at the beginning of 2022 to 3.5% at the beginning of 2023.

But rising borrowing costs are by no means the only problem. Peter Charles, a turnaround specialist who acts for companies, often as an interim CFO, highlighted several key negative themes for companies in 2022. He said Brexit was in effect "a piece of deglobalisation" as it had added incremental costs for companies trading with Europe. He similarly cited lockdowns in China "as companies could no longer rely on supply chains".

"Now companies tend to be hunkering down rather than expanding into new markets. They are saying 'how can we get more profitable from the business we already have?'"

Source: Rising business insolvencies and high energy prices
https://www.ons.gov.uk/businessindustryandtrade/changestobusiness/bankruptcyinsolvency/articles/risingbusinessinsolvenciesandhighenergyprices/2022-10-07

IFT MEMBERS PROTECTED SOME 82,000 JOBS AND £3.6 BILLION IN SHAREHOLDER VALUE IN 2022

	Jobs protected	Increase in shareholder value
2019-20	55,200	£2.6 billion
2020-21	84,300	£2.9 billion
2021-22	81,300	£3.6 billion

"That reduction in just in time delivery meant people had to keep higher stocks and it created a level of uncertainty as products didn't arrive," he said.

In England and Wales, the sectors most affected by this challenging trading environment were construction, manufacturing, accommodation and food service activities as well as wholesale and retail trade industries, according to the latest data from the Office for National Statistics.

These sectors accounted for more than half of total business insolvencies in the first half of 2022.

Regionally, all areas of the UK except the Isle of Man and the Channel Islands saw an increase in the number of distressed companies in the 12 months to the third quarter of 2022 with the South East and London showing the greatest number of distressed companies.

This looks set to translate into increased demand for turnaround expertise. Indeed over 93% of respondents in the IFT survey expect the next 18 to 24 months to be busier than the current period.

With interest rates expected to continue rising in 2023 and inflation, despite expected falls, likely to remain well above the Bank of England's 2% target, the trading environment for businesses in 2023 will remain challenging. This means that demand for turnaround specialists will also remain strong.

SECTORS MOST IN NEED OF TURNAROUND SUPPORT
LAST 12 MONTHS

1. **Manufacturing**
2. **Construction**
3. **Technology**
4. **Retail**
5. **Distribution**

SECTORS MOST IN NEED OF TURNAROUND SUPPORT
NEXT 12 MONTHS

1. **Manufacturing**
2. **Retail**
3. **Construction**
4. **Automotive**
5. **Casual dining**

Case study 1

Archant transformation keeps the regional press alive

Few sectors have undergone as much disruption in recent years as publishing. Digital transformation has hurt print advertising, the bedrock of revenues for many publishers, forcing groups to invest in new online offerings to appeal to a new breed of consumer. At the same time, publishers have had to cut costs in a bid to maintain profitability in the face of falling revenues.

Archant was no exception. Founded in Norwich 170 years ago, the group had been suffering from declining advertising revenues so, in April 2019, it embarked on a business transformation plan supported by Interpath Advisory, a financial advisory business specialised in turnarounds.

The aim was to renew the group's emphasis on quality local journalism, focus on producing paid-for content and create a revived marketing services offering aimed at local businesses.

"Unfortunately, everything changed in March 2020 because of the pandemic and the subsequent lockdowns," said Chris Pole, Managing Director at Interpath Advisory. "The drop in revenues across the entire industry was precipitous, and although the company outperformed its peers in the subsequent recovery, some areas of the business experienced a 70% decline in revenues."

Supported by Interpath, Archant undertook significant steps to mitigate the financial impact of the Covid-19 pandemic:

- placing around a quarter of staff on furlough;
- closing all offices to staff and customers with non-furlough staff working remotely;
- curtailing all discretionary spend and semi-variable spend; and
- making use of overdraft facilities in place with HSBC.

"Covid-19 placed significant strain on the cash position. There wasn't enough cash to meet the agreed payments to the Pension Trustee," said James Portwood, Associate Director at Interpath Advisory.

As a result, Interpath in conjunction with Archant, the firm's pension trustee and the Pension Protection Fund and the Pension Regulator came up with a restructuring proposal for the scheme, the company's creditors, and the business using a company voluntary arrangement (CVA). This ensured the survival of the business and led to the Pension Regulator and the Pension Protection Fund receiving minority stakes in Archant.

Archant then struck a deal with Rcapital, a turnaround investor, which was identified for its technical restructuring capability and that could commit to the necessary and complex deal negotiations. With the backing of its creditors and the support from Rcapital, in January 2021 Archant embarked on its most ambitious transformation plan to date, appointing a new top team that was going to make the business a success. Like many successful transformations, this drew on existing talent, including promoting Chief Client Officer Lorna Willis to CEO and creating new COO and CFO positions through internal promotions.

The business was also restructured into three divisions: newspapers, magazines and marketing services, giving absolute transparency on the performance of these separate divisions.

Archant has emerged from the transformation stronger

and more operationally streamlined. In March 2022, Archant was sold to Newsquest Media Group, the second largest publisher of regional and local newspapers in the UK with 205 online and print brands. The turnaround and subsequent sale to Newsquest Media returned value to Archant stakeholders including the Pension Protection Fund and the Pension Regulator which were compensated for their minority stakes. Today, Archant, now part of Newsquest Media Group, looks forward to building an exciting future for regional media that speaks to growth, innovation and sustainability, built on local journalism.

"Our story is so much bigger than Archant," said Ash Reek, chairman of Archant. "Our responsibility is to keep regional press alive – and we believe that we have delivered a business model that works, [with] the commitment from our people to deliver it and the demand from our customers and communities to be thriving for the next 170 years."

"Covid-19 placed significant strain on the cash position. There wasn't enough cash to meet the agreed payments to the Pension Trustee."

Firms faced a ‘perfect storm’ of challenges in 2022

Following on from the Covid-19 pandemic, with its negative impact on global supply chains and economic activity, many businesses had hoped that 2022 would be much less challenging than 2020 or 2021. Such hopes proved largely short-lived.

Having been kept at modest single digits for many years, inflation returned with a vengeance in 2022 as the war in Ukraine drove up both energy prices and the cost of food as grain crops were disrupted. According to the Consumer Prices Index (CPI), UK inflation hit 11.1% in October, the highest level for over 40 years, although there are signs that price rises may have now peaked. By November, CPI had fallen to 10.7%.

Interest rate rises probably have further to go, however. The Bank of England raised interest rates nine times in 2022 taking the base rate to 3.5% from just 0.25% at the start of the year. Analysts expect more interest rate hikes in 2023 even if, as expected, inflation continues to fall. Not all companies are prepared for the normalisation of rates. “The cost of money is going up,” says Ian Parker, independent turnaround director. “For most businesses, rates of two, three or four per cent won’t break the bank, but a loan at 6-8% is something that many businesses might not have considered.” Macfarlanes’ head of restructuring and insolvency, Jat Bains, concurs: “Over the next 16-18 months, some businesses will just run out of road.”

Nor is there any immediate relief on the horizon, as the Bank of England fears skills shortages might drive wages higher, impeding its efforts to achieve its 2% inflation target and requiring it to keep interest rates higher for longer.

Labour supply certainly remains tight in the UK. “Every firm I speak to is having a labour problem,” says Ian Parker. “There aren’t enough people to go round, and not enough with the right skillsets.”

As interest rates continue to climb, energy prices remain elevated and wage pressures mount, 2023 looks likely to prove another challenging year for businesses.

Labour shortages are increasing employers’ wage costs, and these are unlikely to dissipate any time soon given low unemployment, high vacancies and many workers struggling under rising living costs.

The combination of rising inflation, wage pressures and increased borrowing costs is piling further pressure on businesses which, according to Jat Bains, will find it hard to pass on higher costs as many of their consumers are feeling the pinch too. He points to the fact that many businesses have eroded their cash reserves during the pandemic, and new pressures are “piling on more pain on top of the pain they’ve been through already”.

Independent turnaround director Nick Alexander concurs, “In an ordinary environment, businesses might face one or two of these challenges, but currently they are facing all of them – it’s like drinking through a firehose”.

After the challenges of the last few years, with Covid, the microchip shortage, war in Ukraine and the mini-budget, Ian Parker urges Boards to think about the potential for new ‘black swan’ events and how to prepare for them. As interest rates continue to climb, energy prices remain elevated and wage pressures mount, 2023 looks likely to prove another challenging year for businesses.

Most importantly, should a business begin to struggle, acting sooner, rather than later, is the key.

Successful turnaround directors bring a wide range of practical financial and operational experience, and are able to help management define a pathway to success. This starts with diagnosis of the problems, progresses through building stakeholder confidence, stabilising the company finances and restructuring the cost base, through to developing a sustainable strategy for future growth. By seeking the support of a turnaround specialist early, troubled businesses maximise their chances of getting the business back on an even keel – protecting jobs and value.

LOWEST LEVELS OF CORPORATE DISTRESS

	Distressed companies	%
London & South East	63,620	4.07%
Wales & West	23,219	4.16%
Midlands	16,046	3.86%
North	28,576	4.05%
Scotland	7,628	3.97%

Viewpoint:
Succession of 'black swan' events challenge even the best businesses

By Ian Parker, independent turnaround director

The last three years have been particularly challenging for many SMEs. Brexit, the Covid pandemic, labour shortages, rising energy costs, serious supply chain disruption and now a return to more normal levels of interest rates.

Although businesses have suffered a series of 'black swan' events, the reasons they get into difficulty are more ordinary – usually due to a lack of liquidity (cash). Successful businesses have employees to pay, debt to service, working capital to finance, assets to finance, landlords to pay and other fixed costs like insurance, rates and taxes.

Signs of trouble are not always easy to spot in a world where events happen faster. A lost order from a regular customer, below par operational outcomes for quality, delivery and productivity, delays to new projects, the resignation of key employees, suppliers being late or unable to fulfil requirements, like chip shortages ... and declining or negative cash flow.

These can quickly tip a successful business into a downward trajectory and without swift action, a business can very rapidly progress down the decline curve towards the medical equivalent of intensive care.

At this key moment in a business's lifecycle, there is a finite period of time in which to act and regain control – the turnaround window. This is the time to bring in external advisers to help nurse the business back to health.

Signs of trouble ahead

Internal factors

- declining sales, lost order from regular customer
- growing demand for working capital: rising inventory, extended/falling debtors
- rising overdraft and stressed short term cash flow: IBR
- declining margin, EBITDA, PBT
- operational challenges: delayed projects, poor SQCD
- inadequate governance
- product: market fit, pricing
- people retention: particularly key skills

External factors

- sudden change in customer or market demand
- technology change
- labour availability: skills & people
- black swans: economic, pandemic, tsunami, war...
- supply chain shock: producer capability/cost, logistics
- rising interest rate
- exchange rate movement
- cyber attack

Inadequate governance

- functioning and structure of board
- unstructured decision making
- inadequate controls
- weak/untimely MI
- poor MIS: software and hardware not updated
- sketchy or no rolling 13 wk cash flow forecasting
- overly dominant business leader
- light ESG

Weak stakeholder engagement

- distant or disengaged owners
- surprised funders
- unaligned customers
- suppliers hand to mouth
- disengaged employees
- no contract local and national authorities
- low or no participation with industry bodies

Finding the pathway to success

Turnaround professionals start with a clear-eyed assessment of the business's financial, commercial, operational and strategic health. What are the challenges? Is there a pathway to success? Are stakeholders aware, engaged and on board? Are management and key employees up for the hard yards ahead?

Once the immediate challenges are identified and understood, it is necessary to stabilise the business; principally, its finances and core activities. Often that can mean agreeing additional bank or alternative funding to support the turnaround pathway, addressing the root causes of any operational underperformance and eliminating all non-business critical spend.

The next task is to map out a way forward by developing a three-year turnaround plan for the business. If the current owners have no appetite or access to resources to fund the plan, then a sale may have to be considered. In any event the business plan needs to be sufficiently detailed to support going to the owners or the markets for funding support.

Once all are agreed on the plan, the final task is to execute it. The key is empowering management and employees to deliver the new plan, keep stakeholders up to date, and also able to take some hard decisions about people, products, customers and processes.

Those decisions could save jobs, improve profitability or cash generation, or ready a business for sale. Whichever route, the business has another chance and hopefully a better trajectory - and the turnaround director's work is done.

Ian Parker is a Fellow of the Institute for Turnaround and a member of Make UK. In the past 10 years he has undertaken 12 projects for corporate, family and private equity clients.

This is an edited version of an article which appeared in the December 2022 edition of The Manufacturer.

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Viewpoint:
Funding options in 2023: could distressed businesses be spoilt by the choice available?

Jat Bains, Head of the Restructuring & Insolvency group and a Banking & Finance Partner Macfarlanes

Businesses have never had more choice in funding sources than they do currently.

The biggest change in the debt market since the 2007 financial crisis has been the growth of credit funds, who stepped in to provide debt to businesses when many of the banks were grappling with the impact of tighter regulations and the need to focus on their existing loan portfolios. According to Deloitte's Private Debt Deal Tracker, in Europe there were 193 alternative credit leveraged deals completed in Q3 of 2022 versus just 22 deals in Q4 of 2012. Private credit assets under management globally exceeded $1.2 trillion by the end of Q3 2022 and some projections forecast that number doubling over the next five years. That global growth will favour Europe rather than the US too, as private credit is already a mature market across the Atlantic.

Notwithstanding that spectacular growth, mainstream financial institutions have retained an important role: bank lenders' ability to provide working capital and revolving facilities for operational purposes remain vital to most businesses, and private equity funds obviously also retain a very significant amount of 'dry powder' to help support those businesses where the level of risk is such that an equity return is required by a funder. Syndicated loans and the bond markets have also been accessible for larger corporates in recent years.

> The biggest change in the debt market since the 2007 financial crisis has been the growth of credit funds.

On top of this, hedge funds, sovereign wealth funds and the family offices of high net worth individuals/families are also all competing to acquire stakes in businesses, and specialist ABL providers, insurance companies, pension funds and those PE funds who have adopted a multi-strategy approach are all competing as potential providers of debt to those situations which meet their investment criteria. Looking ahead, credit funds which focus on the provision of revolving facilities are a very likely evolution as a further competitor to the banks.

But whilst distressed businesses needing funding in 2023 have potential recourse to a wide range of funders, they still face real challenges in getting new money in time. Alternative providers of funds to distressed businesses will almost certainly require significant due diligence prior to agreeing to release funds, and if the transaction involves multiple layers of debt and equity, there is considerable documentary complexity which takes time to work through and brings greater execution risk. More 'traditional' lenders will also want to be thorough in their due diligence, especially in the current climate, potentially also involving a pre-closing syndication process, and will be unwilling to be rushed into a deal. Fund lenders generally have a reputation for offering greater leverage, documentary flexibility, speed of execution (as they will tend to want to provide all the debt and hold it to maturity) but will charge a higher cost as a quid pro quo for those benefits.

The choice and complexity of funding available can be another stress on already stressed firms, who should consider engaging a good financial adviser to help them navigate their refinancing choices.

Case study 2

It's a wrap: packaging company secures its future

Camvac has a long and respected history stretching back to the 1930s. The company's founders invented the process of Vacuum Metallisation and went on to pioneer the use of metallised films and laminates for a diverse array of uses and markets from electrical capacitors to gift wrap, food packaging and insulation. Based in Thetford in Norfolk, the company employs 100 people with sales to the EU and the rest of the world accounting for 60% of its output.

Following a period of ownership by Amcor, the company was purchased by GIL Investments in 2008. But in recent years it had begun to suffer from falling sales and profits had turned to losses, partly as a result of its dependence on the Bag-in-Box market which had become increasingly competitive. The company was losing market share to rivals and it had begun cutting sales prices in order to remain competitive.

In response, management cut staff and manufacturing costs but these moves were not enough to restore the group to profitability. The company was further hit by Brexit, which had caused complexities and shipment delays for its European customers, as well as Covid-19, which had increased absenteeism and led to shortages of key raw materials. Further, energy costs were on the rise.

So GIL, Camvac's owner, decided to appoint a new chairman with turnaround expertise, IFT Member Keith Chapman, who in turn hired a new CEO and Operations Director. Two long-serving members of the management team, the Finance Director and the Technical Manager, were retained – ensuring continuity during a period of change. The team was now ready to embark on a number of changes – both tactical and strategic – designed to turn around the flagging business.

First, in conjunction with IGF Group, an independent and entrepreneurial lender that funds growing UK businesses, and Haslehursts, chartered accountants based in Sutton Coldfield, new management conducted a full review of business performance. This led to several strategic actions including: investing in a new product development team with significant opportunities for higher margins; investing in the development of environmentally sustainable product ranges to tap into growing demand for alternative 'green' packaging; and developing new plastic laminates for use in high volume domestic test kits.

To counter business headwinds such as supply chain constraints as a result of the Covid-19 pandemic as well as trade obstacles following Brexit, the company introduced a range of tactical changes. These included identifying new suppliers of raw materials to reduce supply chain risks; introducing several rounds of price increases to improve gross margins; and signing new energy contracts to hedge against rising energy costs.

The result is a much stronger business than before the turnaround. While Camvac's latest sales are similar to the prior financial year, gross margins are much higher as a result of its new product ranges. In particular, the successful development and commercialisation of new products in the packaging, medical and transportation sectors have transformed Camvac from a lossmaking to a profitable business, helping secure its long-term future for its customers and its employees.

> The result is a much stronger business than before the turnaround

Agents of change

Businesses are, at heart, a human endeavour which is why the human side of turnaround is so important. This plays out in both the qualities and characteristics of turnaround directors themselves, and also in their ability to lead a diverse group of people through the stages of a turnaround journey.

Agents of change

In a study with international consulting firm Korn Ferry, we found that the best turnaround professionals were change agents who could go beyond delivering cashflow and cutting costs and also manage the human side of a business, including leading cultural change, energising teams, and engaging employees in a new strategy.

In other words, good turnaround directors are successful 'change agents', who combine a range of business experiences and competencies on the one hand, and personality traits and drivers on the other.

Using Korn Ferry's Four Dimensions Assessment (KF4D) tool on a turnaround group of IFT members and other turnaround professionals, we were able to identify the most important attributes of these change agents.

This found strong competencies in persuasion, courage and delivery. The ability to win people over, the courage to take tough decisions, and to identify the objectives, milestones and resources to deliver the turnaround were all highly developed.

Some personality traits also seem to be hardwired into turnaround directors. They are tolerant of ambiguity – able to make decisions and create confidence in uncertain situations. They are adaptable – ready to consider alternate ways of doing things, and welcoming experimentation. And they are also focused – able to identify and fix problems.

Two final character traits of turnaround directors are independence and being motivated by a challenge. Independence of thought is critical to business that need to rethink their operating model and strategy, as is the ability to navigate significant obstacles and deliver a solution.

It seems that being a successful change agent is as much as about who you are, as what you do.

Case study 3

Hovertravel – a critical lifeline for Isle of Wight residents

When the first pandemic lockdown hit, Hovertravel, a hovercraft operator providing a fast transport service between the Isle of Wight and the UK mainland, faced conflicting pressures. Anticipating a near total loss of passenger revenues, the firm could have chosen to mothball its operations and survive on government support schemes.

Instead, recognising Hovertravel's unique role as a 'lifeline' connecting the Isle of Wight's 140,000 residents to the UK mainland, management chose the more difficult path of finding new ways to operate and prevent the island community becoming more isolated, including from medical services, during the pandemic.

Putting a viable plan in place meant getting a wide range of stakeholders on board – from the UK government, the Isle of Wight Transport Infrastructure Board, local authority councils and the local MP, to the unions, the NHS and their bankers, Barclays. Working with all these stakeholders, Hovertravel's management was able to secure agreement not only for an emergency timetable between the island and the mainland, but also for the provision of new and essential services.

These services were designed to relieve the immense strain on the emergency services at the start of the pandemic, to give Isle of Wight residents access critical care facilities that are not available on the island and to ensure Hovertravel survived as a viable business post-pandemic.

Working with the NHS, Hovertravel's management agreed two contracts. The first was to take critically-ill cardiac, non-Covid, patients to the mainland. With a travel time of just eight minutes, the cost was just a third of that of a helicopter service. The second contract was to provide a stretcher service, which involved working with the NHS and Health and Safety Executive, to adapt their craft so that patients could be transported safely. In addition, other services were agreed including carrying NHS workers and emergency firefighters, transporting PPE, blood and organs, as well as freight and online shopping.

At the start of the pandemic, Hovertravel's management decided it was the right thing to do to support the Isle of Wight community by changing and adapting to lockdown.

As a commercial operator, this approach was not without risks but, thanks to collaboration with stakeholders and thinking creatively about the needs of the local community, the financial performance of the firm now outperforms its pre-pandemic performance. The more diverse income streams developed to replaced lost passenger volumes during the pandemic have largely remained, and some have increased. Indeed, Hovertravel is now viewed as a critical life-line operator by the emergency services, local authorities and the Department for Transport.

No wonder Hovertravel has been scooping up accolades, including Best Passenger Transport Provider 2020 from the Chartered Institute of Logistics and Transport, a 'Community Recognition' award from Ryde Town Council, the Freedom of the City from the Lord Mayor of Portsmouth – and The IFT's 2022 Community Impact Award. More importantly, Hovertravel has received a vote of confidence from island residents who rely on the service they provide and appreciate the company's support for the local community during a difficult period.

Case study 4

Turnaround expertise delivers SIGnificant return to growth

SIG plc has a long-standing reputation as a leading supplier of specialist insulation and sustainable building products, successfully responding to the need for rising demand for greener and more sustainable building materials. From 1991 to 2007, the company increased revenues at a very respectable compound annual growth rate of 20%. With margins of 5-7%, the group grew fast and made acquisitions most years. It was a well-run, profitable business.

But this was not the business that IFT Fellow, Steve Francis, the current Group CEO at SIG inherited from the previous CEO and CFO in February 2020. A series of poorly executed strategies by consecutive management teams had led to a 30% fall in UK market share and revenue decline by as much as 14%. EBIT margin had fallen from 2.5% to -2.2%. Net debt had climbed to £100m and a covenant breach with lenders was looking likely.

There were a number of reasons for this dramatic change in prospects. Previous management had attempted to centralise commercial functions without putting in place sufficient support systems. Branches had been rationalised, damaging customer relationships at local level and resulting in a loss of customers to competitors. In addition, a decision to uniformly increase prices had adversely impacted trust and confidence in SIG and further impacted sales, and certain initiatives had compromised the specialist nature of SIG's offering, further undermining customer relationships.

Customers as well as key employees and suppliers had begun "voting with their feet" choosing to work for, with or buy from SIG's competitors. IFT Fellow Steve Francis, supported by the Board of SIG plc, was determined to restore the business to its former self and generate value for shareholders. So, on taking the reins in early 2020, he quickly began grappling with the issues plaguing SIG plc and started putting in place processes needed to improve and strengthen financial systems and controls.

A new leadership team was brought in encompassing the MDs of the UK and German businesses and a number of new Group Function heads. Of seven market-facing directors in the UK business, five joined in 2020, with on average twenty-seven years' industry experience. Most importantly, all but one were former SIG plc employees. This meant they brought a deep understanding of the business and industry, and were respected within the group, amongst customers and suppliers.

SIG UK now has 150 specialists with, on average, fifteen years' industry experience. Knowledgeable staff and strong relationships with market-leading suppliers enabled SIG to provide technical advice and support specification across a wide range of products.

The management team also took vital steps to strengthen the group's capital structure for the long-term. In June 2020, SIG plc announced a large (one for one) emergency rights issue for approximately £150m, corner-stoned by an £85m investment by PE firm, CD&R, to take a 29% stake and a refinancing of the debt. SIG also had successful discussions with key lenders to reset covenants and agree other amendments to its facilities. This was pivotal in ensuring the group had the right platform to grow, both organically and inorganically.

Since 2020, SIG has completed acquisitions which have added £140m of annualised sales at attractive margins and also enhanced group expertise and market positions.

SIG's seven pillar strategy was developed with the business heads, by listening, understanding the business and recognising its levers. It endeavoured to restore the Group's historical differentiators, reprioritising strong customer-centric values and commitment to proximity, expertise and service. The business was restructured to shift from a centralised generalist to a decentralised specialist. It harkens back to the business' roots, but also focuses on innovation and modernising practices - making SIG easier to work for, buy from and sell to. SIG made £4m in overhead savings, not by traditional cost-cutting, but through streamlining processes and reinvesting for growth, creating 400 specialist managers and salespeople positions. SIG recruited 240 people and redeployed another 140.

Its success is evident in the improved financial performance of the business. Management has so far exceeded its targets to improve margins and grow revenues back to 2019 levels. So much so that, in November 2021, the group was able to issue its maiden Eurobond of €300m in five-year bonds, helping put the group's financing onto a stable, long-term footing.

SIG's recent performance, particularly in 2022, demonstrated the resilience, flexibility and diversity of its pan-European business. Thanks to strong employee and customer engagement, the Group has continued to drive strong profit growth. SIG now has strong foundations for the future, and the Group remains well-positioned to benefit from the need for governments and end-customers to increase the sustainability and energy efficiency of buildings over time.

SIG's recent performance, particularly in 2022, demonstrated the resilience, flexibility and diversity of its pan-European business.

Instilling a turnaround mindset

Turnaround directors cannot rescue a business alone – taking the management and employees of a troubled business on the journey with them is essential for success. But it can be a tricky sell. “There is still a suspicion of turnaround,” says Jat Bains.

“People fear they will lose control, whereas in a turnaround you really need to work collaboratively to enable change.” In fact, firms are more likely to retain control of their destiny if they recognise their business is in trouble and engage a turnaround professional to help resolve their difficulties.

Helping instil a turnaround mindset in troubled firms is, says IFT member and turnaround director, Ian Parker, “about empowering individuals, mentoring people through the improvement process, and spotting those people who are up for the fight”.

> “Mainstream lenders in the UK can be wary of directors who have been through an insolvency, whereas in the US it is seen as part of being an entrepreneur”

Often the most valuable employees are the ‘young Turks’ prodding their elders to do something new. They need mentoring and encouragement to take their ideas and make them happen.

Another obstacle to adopting a turnaround mindset is the UK’s approach to insolvency and troubled firms, which tends to punish rescue efforts – and the directors who lead them – if they fail. Directors risk personal liability for decisions they make if they do not turn out well. This approach is diametrically opposed to that taken in the US, where restructuring rather than closing businesses down is the norm. “Mainstream lenders in the UK can be wary of directors who have been through an insolvency, whereas in the US it is seen as part of being an entrepreneur,” explains Interpath’s Lee Swinerd. Fears among directors that if they take a decision to try to save the business “they might get criticised or worse, their reputations will be tarnished if it all goes wrong” breeds an excess of caution among directors. “Reform around this area, so there are fewer punitive measures, would enable more businesses to pursue a turnaround plan.”

The Government has responded quickly to support business viability and rescue during the challenging circumstances of recent years, particularly with the introduction of new business recovery skills through the Corporate Insolvency & Governance Act 2020 (CIGA), which introduced new procedures and measures to seek to rescue companies in financial distress as a result of the COVID-19 pandemic. This legislation has been beneficial in many respects and has been seen as a welcome step towards a more ‘debtor in possession’ process and provides the potential to promote a turnaround culture in the UK. Now is the right time to look at the impact of the new tools and the operating environment seeking to improve the profitability and productivity of viable businesses.

Reluctance to seek external advice remains the key barrier to seeking turnaround advice, with almost three quarters of members encountering this problem

Viewpoint:
Does the UK restructuring regime put UK automotive suppliers at a disadvantage?

Lee Swinerd, Director, Interpath Advisory

Post Brexit stresses, supply chain vulnerability, including a shortage of semiconductors, and the demands of a shift to electric vehicles continue to provide intensified challenges for the automotive sector. In this article Lee Swinerd, Director at Interpath Advisory examines whether the UK insolvency context is conducive to enabling turnaround in the automotive supply chain.

In a truly global industry like automotive, where a company is located can influence customers' sourcing decisions. Of course, there are many other factors including price, capability, capacity and logistics but do the experiences of local restructuring practices influence sourcing decisions as well?

In our view, the answer is "partly".

If we compare and contrast three core markets, you can see why the UK may be considered less favourable than, say, the USA or Germany.

If we compare and contrast three core markets, you can see why the UK may be considered less favourable than, say, the USA or Germany which also have well-established restructuring procedures.

The USA is a debtor friendly regime where the expected outcome is that a business is restructured and will survive a period of financial or operational distress. The Chapter 11 process results in limited disruption to the day-to-day operations of the Tier 1 supplier, and OEM (and other) customers will not feel overly concerned about continuity of supply.

In Germany, while the long-term outcome is less certain than in a Chapter 11 process, if a Tier 1 supplier enters administration proceedings, then the principle of continuity of supply remains embedded within the local legislation. Suppliers need to continue to supply materials and products on existing terms and conditions. Customers will need to fund production losses incurred throughout the period of administration. But fundamentally, customers can remain reasonably confident their production lines will continue with minimal disruption.

In contrast, the most likely procedure in the UK, an administration, provides less certainty to the OEMs (or any customers) regarding ongoing supply. And there is certainly that perception with global automotive supply chain.

Here, administrators can continue to trade the business in insolvency but require all future costs/liabilities to be covered. Historically, the senior lenders often provided this certainty to the administrators in order to protect or enhance the going concern value of the business as it was sold. However, these days, some secured lenders are reluctant to provide such surety to the administrators and so the pre-pack has surged in popularity, whereby the business is sold immediately at the point of the insolvency proceedings taking effect.

8/10 Cars

PRODUCED IN THE UK ARE EXPORTED OVERSEAS, REPRESENTING **10% OF TOTAL UK EXPORTS**

Source: Rhttps://www.smmt.co.uk/industry-topics/uk-automotive

However, even a pre-pack provides some elements of risk. The administration process will often trigger contractual clauses that allow both customer and supply contracts to be terminated. They can also provoke difficulties with landlords, and there is no obligation on a trade (or other) supplier to continue to provide product to the "Newco". While it is usually anticipated the new owner will provide sufficient working capital to resolve any short-term supplier problems, our experience indicates this can still be quite a difficult process.

OEMs and other customers can, and often do, agree to fund the administration to ensure parts continue to be made and reach their production lines. Ideally this should be agreed prior to the appointment in order to minimise disruption risk. Such an agreement will cover ongoing trading losses during the administration period but, and more importantly, can also deal with supplier ransom risk, whereby pre-appointment liabilities are covered by the customer funding should they need to be settled by the administrators in order to maintain a flow of product or services from the supplier.

Despite changes to the insolvency regime under CIGA whereby a supplier ought to be obligated to continue to supply products (the ipso facto rule), the practical implications of this look to be difficult to implement in the UK. There seem to be a number of loopholes where the potential remedies for the administrators take time and, therefore, production is likely to have been disrupted by the time a remedy is granted by a court.

But the most challenging element of the UK regime is that each stakeholder has the ability to leverage its position differently which creates an uncertain environment for the OEM to operate in and can run the risk of operational disruption and increased costs of protecting supply. Given c.80% of all components manufactured in the UK are exported, then the contagion effect of a relatively small supplier in the UK can be significant across a global OEM.

We believe this perceived risk is a contributory factor to customers choosing to source parts away from UK-based suppliers.

To reduce this risk, we advocate a collaborative approach between customers, their suppliers and key financial stakeholders to work through the potential solutions and reach a consensual outcome while keeping the financial cost to the customers as low as possible. When this approach is adopted a UK administration process can be an effective tool to help a business restructure and put itself back on a stable platform.

In summary, we believe UK automotive suppliers are at a possible disadvantage when competing with European or global counterparts, but it is still possible to reach a workable outcome providing the stakeholders cooperate throughout a UK based restructuring process. It is important for the UK's restructuring community to help change the perception that the UK's processes are more detrimental compared to those of other jurisdictions.

Outlook
for 2023

The directors behind UK businesses large and small, having risen to the manifold challenges of the pandemic and associated lockdowns might have expected a period of calm to recover and rebuild. Instead, while inflation is predicted to continue falling from likely peaks reached towards the end of 2022, it is still expected to end the year well above the Bank of England's 2% inflation target.

So borrowing costs – and borrowing conditions – will most likely remain challenging. And rising prices and wage pressures – a major feature of the business environment of 2022 – will remain big headwinds for business in 2023.

Indeed, IFT members expect demand for their services to continue to grow in 2023 and this coming on the back of what was an already strong year in 2022. 89% of respondents to the IFT survey said that 2022 had been as busy or busier than 2021. But, when looking at the next 18 to 24 months, over 93% of respondents predicted this period will be even busier still.

The first quarter of 2023 is set to see the biggest spike in demand for turnaround expertise, according to those surveyed who predicted that increased insolvencies would mark the biggest future trend. 81% of respondents saw increased insolvencies as the biggest challenge, ahead of rising inflation (73%).

"Everyone went through a rollercoaster in 2022," said Maria Pombo, a turnaround specialist who focuses on microbusinesses. "We had not even got over the disruptions from Covid when material costs started rocketing and supply chains were disrupted. 2023 is starting off with the same distress."

In terms of the biggest challenges affecting distressed businesses over the next 6 months, inflationary pressures came top with 81% of respondents seeing this as the biggest hurdle facing UK businesses. This came ahead of energy prices (61%) and labour supply issues (41%).

Among IFT practitioners, retail, automotive and casual dining are expected to see the biggest increases in demand for turnaround management over the next 12 months, in part reflecting consumers squeezed by rising energy bills, higher food prices and increased mortgage costs. This was backed up by data from Companies House that showed that the same sectors saw steep increases in the number of distressed companies in the last quarter of 2023.

Jat Bains, head of the restructuring and insolvency group at Macfarlanes, said the retail, hospitality and travel sectors were being hurt by cuts in discretionary spending while retail was also being hit by changes in customer footfall.

TOP TURNAROUND STRATEGIES IN 2021-22

1. **Improve governance/ controls (66%)**
2. **Change organisational structure (64%)**
3. **Reduce costs (58%)**
4. **Secure additional short-term funding (47%)**
5. **Reduce workforce (44%)**

As a result, the number of empty retail units was continuing to rise – creating a cost-of-doing business crisis. One solution, passing on rising borrowing costs and increased costs of labour and energy, was not always easy, he said, as customers' finances are also under intense pressure.

Another short-term option is to cut costs – and therefore capacity – but this risks putting the long-term viability of whole sectors at risk. Lee Swinerd and Mark Raddan of Interpath warn that it is important to protect capacity in certain sectors, such as automotive, as failure to do so could see those capabilities and skillsets never return as other countries fill the gap.

Certainly 2023 looks set to be as challenging a year for businesses as 2022. One lesson that companies can take away from the last few years, according to Ian Parker, a turnaround specialist, is to prepare for any future unknown challenges.

"We had not even got over the disruptions from Covid when material costs started rocketing and supply chains were disrupted. 2023 is starting off with the same distress."

"We've already had Covid, chip shortages, the war in Ukraine and the mini-Budget," he said. "What all boards need to think about is what are the potential next 'Black Swan' events? This would be a good thing to discuss at a company away day."

Despite the distinct benefits turnaround experts can bring, many companies remain resistant to appointing a turnaround adviser. According to surveyed IFT members, 71% of companies had a psychological barrier to seeking external advice and 56% of companies had limited understanding of turnaround. If 2023 proves as challenging as the last couple of years, the skillset of the turnaround adviser will be as important as it ever has been, and companies would do well to swallow their pride and engage with turnaround professionals early, to turnaround and transform their firms.

TOP THREE CHALLENGES FOR FIRMS OVER THE NEXT SIX MONTHS

1. **Inflation (81%)**
2. **Energy prices (61%)**
3. **Labour shortages (41%)**