

Improving your financial health



After many difficult months, a fundraising window is opening for ambitious private firms, says Deloitte's Cahal Dowds

Leisure firms have been feeling the burn through the downturn, but Fitness First, one of the world's largest gym and health-club chains, is poised to raise money for expansion.

The company, at No 77 on this year's Top Track 100, is in great shape to attract fresh investment, according to chief executive Colin Waggett. In recent years, the Poole-based business has turned its attention to Asian and Australian cities where economic growth remains strong. In Asia only 1%-2% of the population are members of a gym. Last month it agreed to sell all 45 of its clubs in the more mature markets of France, Spain and Italy to the European group HealthCity.

Waggett, who is funding expansion from cashflow, expects to have opened up to 35 new clubs — of which 12 will be in Asia and four in Australia — by October next year. He forecasts that global sales from the remaining businesses will improve on 2010's total of £687m, under the ownership of the private-equity firm BC Partners.

Fitness First and other successful private companies are discovering that opportunities to secure growth capital are reappearing after many difficult months. At Deloitte, we believe that a fundraising window is opening as bank

debt and institutional backing become more readily available, leverage multiples creep upwards and economic conditions improve.

Both private-equity firms and trade buyers — at home and abroad — have resumed spending, encouraged by the rise in bank lending and the strategic imperative to move forward and demonstrate a track record. After a first quarter in which European flotations raised less than €3 billion (£2.6 billion) compared with €10 billion in the previous three months, we believe IPO activity

could also pick up after the summer. Fitness First is weighing its fundraising options as it seeks support for further expansion, according to Waggett.

Deloitte is encouraged to find that more large private companies such as Fitness First are making growth their priority. Of the chief financial officers questioned in our first-quarter Deloitte CFO Survey, 42% said that introducing fresh goods or services, or moving into new markets, was their most important goal. Their appetite for financial risk is also increasing. A total of 41%



Showing its mettle: profits have leapt at steel trader Stemcor

believe now is a good time to take on more debt, the highest percentage since the survey was launched in the third quarter of 2007.

Yet the desire to expand contrasts with a dip in corporate confidence. Conflict in the Middle East, the earthquake and nuclear crisis in Japan and a new spike in oil prices have conspired to dampen optimism. Only 12% of chief financial officers are more positive about financial prospects for their firm than they were at the end of 2010, our research found.

We believe that stronger balance sheets and improving profits at successful companies such as those on the Top Track 100 are driving corporate expansion despite the tough trading conditions. Since the collapse of Lehman Brothers, ambitious firms have taken steps to cut costs, preserve cash and revise growth strategies as consumer preferences, global trading patterns and funding availability have all been transformed.

Many of this year's league-table businesses have emerged from the recession leaner and fitter than before. They have strengthened their balance sheets, improved their operational efficiency and competed more effectively by reviewing consumers' purchasing patterns and cross-selling products and services.

For example, the Top Track 100 research shows that Stemcor, the world's largest independent steel trader, which is at No 5 on the league table, has recorded a dramatic improvement in profitability by successfully responding to an upturn in demand, especially among emerging economies. The company, which has also benefited from rising steel



In good shape: Fitness First is poised for expansion in Asia and Australia where economic growth remains strong

prices, recently unveiled record profits of £115m as sales soared from £3.5 billion in 2009 to £5.1 billion in 2010.

House of Fraser, the department-store chain at No 82, has also worked to maintain earnings through the downturn. Sales, at £669m in 2011, have fluctuated in the four years since the business was taken private by a consortium of Icelandic investors. But innovations such as the relaunch of the iconic 1960s brand Biba last year have helped to lift profits to £70m, the highest since the company was delisted.

The construction-equipment manufacturer JCB, at No 16, has unearthed new customers after a very tough couple of years when the company was

obliged to cut its workforce and sell down its inventory while building projects were put on hold. The business has just enjoyed a record year in India where it sold 21,000 machines. It is also building a new £61m factory in Brazil.

Looking ahead, we expect that many companies seeking growth capital will shun flotations in favour of buyouts and other fundraising deals that allow them to remain in private ownership, where they can focus on long-term strategies rather than having to meet short-term investor expectations. They understand that stock-market investors have been suspicious of private-equity-backed IPOs ever since the department-store chain Debenhams was refloated

with substantial debts in 2006.

Selling a business to a private buyer, however, will in most cases remain harder than it was before the credit crunch. In a fragile market, both private-equity backers and trade buyers remain selective and cautious. They remain wary of auctions and recognise that financial engineering without a growth story is no longer a basis for a successful investment.

In this environment it is more important than ever to design an exit — or partial exit — strategy tailored both to the business and the prevailing market sentiment. For example, managers must identify potential buyers and consider why they might find the venture attractive. What strategic capabilities might attract

a higher multiple? If there are weaknesses, how might they be viewed by a purchaser? Are there any tax or compliance risks that might affect the value? Deloitte's experienced team of consultants can advise on shaping the company to attract potential buyers, and show how to minimise the risk of leaving value on the table.

Smart managers, like those leading many of this year's Top Track 100 companies, know that their future success depends on seizing the moment to expand again. As the fundraising window opens, they must prepare to take a good look at the market.

■ Cahal Dowds, Deloitte's head of private markets & advisory corporate finance, UK, was talking to Catherine Wheatley