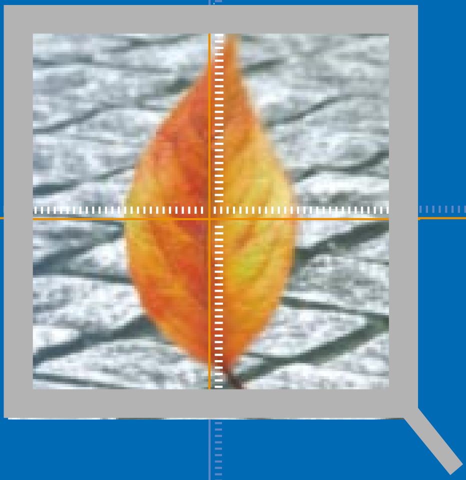
Entrepreneurs



BVCA *investing in enterprise*

Entrepreneurs

Entrepreneurs are the lifeblood of business. Whether creating new companies or rejuvenating established businesses, they provide the crucial driving force that creates growth and success. The private equity community plays a key role by facilitating access to the necessary capital and expertise.

These special people have special qualities. The confidence and commitment to take a leap into the unknown. The commercial acumen to spot a good idea. And the dynamism to run with it.

This publication features just a few of the UK entrepreneurs whose vision has become reality thanks to private equity.

entropic

ENTROPIC

STEVE YOUNG

Amadeus Capital Partners Limited

Entropic Cambridge Research Laboratory (ECRL) was formed in 1995 as a joint venture between Cambridge University and Entropic, a small Washington DC-based software company, to exploit speech recognition technology developed by Professor Steve Young and his team at Cambridge University Engineering Department. A first round of investment totalling US$3 million was led by Amadeus Capital Partners in early 1998. A further round was almost complete when Microsoft swooped to buy the whole of Entropic in November 1999. Entropic is now a wholly-owned Microsoft subsidiary based in Redmond, and Steve Young has returned full-time to Cambridge University.

The art of engagement

Steve Young can vividly recall the first piece of advice Hermann Hauser gave him when Amadeus Capital Partners decided to invest in Entropic in 1998. 'He told me that you always have to be the best of breed at something,' says Steve. 'It doesn't matter how narrow it is. Just be the best at it.'

As Steve freely admits, such thinking marked a step-change for ECRL, whose engineering team he had previously managed as a part-time sideline. With Amadeus on board, the venture became far more focused – and Steve has no doubt that the eventual exit to Microsoft was a direct result of that change of mindset.

'As a start-up, ECRL was extremely unusual,' say Steve. 'It was not a situation where somebody had a great idea and started chasing private equity providers to back it. We had developed some software, and Entropic asked if they could handle distribution and maintenance. That was how things got started.'

Industry standard

The software in questions was HTK – now an industry standard for building speech recognition systems in laboratories worldwide. For three years ECRL continued to develop its software tools business, but for Steve this remained an adjunct to his day job. 'As an academic, my main ambition was to excel in scientific research, not to sell software,' he recalls. 'While it was nice to know that people were using our technology, and that we were bringing in money and building our reputation, I really didn't have time to be fully committed.'

By 1998 Amadeus had spotted the commercial potential, and led the first round of financing, pulling in backers including OAK Investment Partners to help develop the company's US networks. The joint venture partners in Cambridge and Washington DC were merged, and the IP rights were transferred from the University in return for a shareholding. Steve got leave to join Entropic effectively full-time as chief scientist and VP engineering.

This was one of the decisions that ultimately drove Entropic's success. 'Trying to run a business part-time just doesn't work in the long run,' he says. 'We were distancing ourselves by bringing in technical management. What I really needed to do was get fully engaged and let my brightest PhDs manage their own tight-knit groups.'

Getting focused

Once Amadeus came in, that was precisely what Steve did. The product range was pared down, and former Bay Networks executive Paul Finke was drafted in as CEO – 'he made a huge difference,' says Steve. By mid-1999 Entropic was focused on the Voice Gateway, a device enabling internet access through speech over the phone. 'It hardly seems like rocket-science now, but at the time we had a job explaining the concept to people,' he laughs. The second financing round was going well, but was dropped when Microsoft made 'an offer we couldn't refuse.'

Steve stayed on after the exit, working for Microsoft until January 2001. But he was unwilling to relocate to Redmond and ultimately Entropic's Cambridge office was closed. He is now back full-time with the University, as Professor of Information Engineering and Head of the Information Engineering Division. He is also Chairman of the School of Technology.

Steve learnt a lot from his Entropic experience, especially about the need for management engagement, commitment and clear product focus. 'First, you won't make a success of a business by running it part-time,' he says. 'Second, don't worry about giving the CEO a bigger slice of the company than you've got yourself. If they are good, they will more than earn it. Finally, always ask the private equity providers for more money than you need. Don't try to scrape along on as little as possible.'

JUNGLE ONLINE

STEVE BENNETT

Steve Bennett founded Software Warehouse in Birmingham 1989 with the help of a £40 a week Government grant. By 1999 he had a thriving mail order software business, and an internet channel accounting for 4% of sales. As internet fever heightened, the company decided to spin off its internet arm as Jungle Online, funded by £4 million of private equity led by 3i. By mid-2000, nine months after launch, Jungle was turning over £3 million a month and planning an IPO at valuations up to £700 million. Then the internet bubble burst, reality returned – and Jungle was bought by GUS in September 2000 for £37 million.

Learning the right notes

Steve Bennett was sixteen when he realised he would never make it as a professional saxophone player. So he took a Youth Training Scheme course to learn about computers – and started on the road to entrepreneurial success.

However, the road had several twists. After the YTS course, four years as a junior engineer at ICL turned Steve into a frustrated salesman. When he finally got the sales job he craved, selling word processors for a Wang dealership, it went bust three months later. 'Then one of the guys I worked with said we should set up a software business – he'd organise the stock and I'd sell it,' he recalls.

So, in 1989, Steve set up a mail order retail business called Software Warehouse with a weekly enterprise allowance and a £4,000 loan guaranteed by his father. The first few years were slow, and his original partner left. But between 1994 and 1998 the business took off, largely thanks to its exclusive rights to sell the Superstore compression utility.

Getting on the web

Software Warehouse also had one other fast-appreciating asset. In 1996, the company had become one of the first UK retailers to start selling software over the internet. At first, three order represented a good month, but web-based sales picked up steadily. It was when a US rival offered to buy the business in 1998 that Steve knew they were really onto something. 'We realised it was time to take the internet business more seriously,' he says. 'We saw how exaggerated share prices had become in the US, and decided to start our own web business.'

To do it properly, they would need capital. Up to that point Software Warehouse had been completely self-funded, but extra money would be needed to develop and market a consumer internet business in a tight timeframe. So Steve approached 3i, and worked with them to create a separate team to compile the detailed business plan and raise independent funding. 3i also introduced a local entrepreneur with experience in internet businesses to support the spin-out and help develop Jungle's market penetration.

In August 1999 Jungle Online was launched, backed by £4 million of 3i-led funding and a national TV and radio advertising campaign. Sales surged. 'We probably could have done it ourselves slowly, but the timing was crucial,' says Steve. 'It was vital to get in first, grow the business quickly, and get the flotation away.' The first two parts of the plan went swimmingly, with sales rising month on month and valuations rocketing to stratospheric levels. But one week before the IPO roadshow was due to start, boo.com collapsed – taking the internet bubble with it.

Heading for the exit

The flotation was pulled, and the future was cloudy. 'We were different from most internet companies because we had significant sales and cashflow,' he recalls. 'But the problem was that our suppliers' insurers would no longer cover them for doing business with us. 3i had to keep bailing us out – not because we were in trouble, but because we kept losing our credit lines.' A trade sale was the only option, and Steve clinched a £37 million sale to GUS which provided an excellent exit – though clearly a fraction of the unreal valuations earlier that year.

Looking back, Steve's advice to would-be entrepreneurs is to put their own money where their mouth is before expecting private equity providers to back them. 'You've got to see it from the private equity firms' point of view – and what they want to see is commitment on your part,' he says. 'Private equity companies will come and fund you if you have already exhausted everything else, such as mortgaging your house. You have to show you are prepared to back the idea yourself.'

LANDMARK Information Group

LANDMARK INFORMATION GROUP

BOB FAIRCHILD

GLE DEVELOPMENT CAPITAL

Exeter-based Landmark Information Group was founded in 1994 to develop information products using high-specification Geographic Information System (GIS) software. Several financing rounds led by GLE Development Capital and 3i saw Landmark develop potentially market-leading products, yet its financial performance remained disappointing. In late 1997 the investors asked Bob Fairchild, to review Landmark's strategy. His recommendations were accepted and he became Managing Director in early 1998 via a Management Buy-In. Bob's strategy proved successful, and later that year Daily Mail and General Trust Group bought Landmark, providing an attractive exit for investors. Bob Fairchild remains Managing Director of Landmark, which has grown rapidly within DMGT.

Profile – Striking the right balance

According to Bob Fairchild, every business is subject to a number of competing internal forces – and the successful companies are those that manage to keep these in balance to give the customers what they want.

'The production guys typically want every product to be black and sell a million of them,' says Bob. 'The sales and marketing guys want them all different colours and personalised to each customer. The finance guys want to take no risks and get paid up front. A good business manages these conflicts. A bad one gets skewed too much towards one or two of these functions – so the company becomes unbalanced.'

When Bob took the helm at Landmark Information Group in early 1998, he found a business that had failed to strike the necessary equilibrium. 'The technical guys had produced an excellent database, but the financial and selling and marketing requirements were not receiving sufficient attention,' he recalls. As a result the company was not realising its true potential.

A wealth of experience

Bob got involved with Landmark thanks to his wide-ranging experience as an manager and financier. A civil engineer by training, he had worked on a range of construction projects in the UK and Hong Kong before taking an MBA at Cranfield and joining a global bank. After ten years in the City he then moved on to work on turnarounds in banking, property and manufacturing, and got to know the private equity community. As a result, when Landmark was experiencing problems, it was Bob who got the call.

LANDMARK INFORMATION GROUP

Within six weeks he put together a report highlighting Landmark's current problems and future potential, and setting out the steps needed to turn it round. In response the investors offered him a chunk of equity and the role of Managing Director in an MBI. He took the job, invested his own money, saw the buy-in through, and set about sorting out the finance and marketing requirements by restructuring the organisation and bringing in new blood.

'It was a good business that was not yet delivering on its potential,' says Bob. 'For example, up to then it had been 100 per cent debt-financed, which is very risky in a start-up. We also needed new sales and marketing expertise to get our sales moving. So now we had the right products, funds to grow and a stronger balance sheet. We simply started to get everyone doing the right things, and began to sell the company's products and create a winning atmosphere.'

Something from nothing

The effect was dramatic and the market began to sit up and take notice. Suddenly a queue of potential purchasers were knocking at the door. 'At first I told them it was too early,' says Bob. 'But the knocking got louder and louder, so I told our backers that there were some serious offers emerging. The most serious was from DMGT.'

That offer presented the private equity investors with a good return on an investment that they had been considering writing off barely six months earlier. Bob stayed with Landmark through the acquisition, and now runs a 135-person company turning over around £25 million a year. Before he took over in 1998, Landmark employed 75 people and turned over just £2 million.

'I'm not a classical entrepreneur with fantastic new ideas,' says Bob. 'But if you've already got a fantastic new idea and it's not working, then I can help. It all comes down to making sure you've got the right people doing the right things. I am very pleased with the progress we have made at Landmark, and the company has a bright future.'

LUMINAR

STEPHEN THOMAS

HgCapital

In 1987 Stephen Thomas founded Leadwise Leisure to buy discotheques and manage them more efficiently. The first business was acquired in King's Lynn in 1988. By 1990 the company had eight discotheques, and a £1.4 million financing round led by HgCapital (then Mercury Private Equity) enabled the newly-renamed Luminar to open its first Chicago Rock Café theme bar. Expansion continued, and in May 1996 the company floated in London at a capitalisation of £30 million. HgCapital supported a £15 million rights issue the following year, and exited completely in 1999. Luminar is now the UK's largest operator of licensed late-night venues.

After leaving school in his native Cardiff, Stephen Thomas was working as an apprentice motor mechanic for Ford when he took a part-time job at the Top Rank suite in the town to make a bit of extra money. He's glad he did.

Thirty years on, Stephen is Chief Executive of one of the UK's leading quoted leisure companies. Luminar plc has 283 venues in 164 towns across the country, and a portfolio of market-leading brands that have redefined the theme bar and night-club market – including Chicago Rock Café, Liquid Nightclub, Jumpin' Jaks and the London Hippodrome.

'When I started working at Rank they told me I was quite good at it, and offered me a course a as trainee manager,' he recalls. He jumped at the chance, and rose to deputy manager before teaming up with an entrepreneur to run night-clubs in Cambridge and Luton. Stephen stayed with that business when it was bought by Whitbread in the mid-1980s, but by 1987 another change of ownership was looming – and Stephen was ready to put his venue management skills to work on his own account.

Setting a lead for the leisure sector

He formed Leadwise Leisure with a £200,000 bank loan and £24,000 of private capital, and the business proved an instant success at turning round underperforming night-clubs. By 1990 it had a string of eight clubs, and Stephen was talking to private equity providers about expansion finance. 'We bumped into HgCapital (then Mercury Private Equity),' says Stephen. 'They said they liked us as management, but that we should come up with a new idea. So we did.'

Renamed Luminar, the company used HgCapital's £1.4 million investment to launch the Chicago Rock Café concept. As a pub, the first venue in King's Lynn had been turning over £1,700 a week. The new format saw this rocket to £12,000 – and a major success story was under way. By 1996 Luminar had 13 Chicago Rock Cafes, and was receiving repeated takeover approaches from quoted companies.

HgCapital could have made a good exit at that point – but its advice was for Luminar to go for a flotation. 'Whenever HgCapital did due diligence on the people trying to buy us, it found that we were a better-managed and more solid company than the potential acquirers,' says Stephen. 'So it said we'd be better off going public ourselves.'

Luminar takes off

The flotation on the London Stock Exchange in May 1996 was oversubscribed seven times, and valued Luminar plc at £30 million. HgCapital's support for a £15 million rights issue the following year helped fund a further 21 Chicago Rock Café sites. HgCapital continued to have a stake in Luminar until 1999, since when its expansion has continued both by organic growth and acquisitions – including the purchase of Northern Leisure in July 2000

Stephen sums up HgCapital's role in Luminar's success as 'fantastic.' He adds: 'To be frank, at the start we were not very good businessmen. But the opportunity to observe them in action, their contributions at board level, and their training and coaching turned us into what we still consider to be the best businessmen in the industry.' He shared HgCapital's joy at its final successful exit, because he felt both parties had done a good job for the other.

Stephen's advice to budding entrepreneurs is to have investors you can bond with on a personal level. 'You have to like the people who are investing in your business,' he says. 'You have to be sure that they're honest and open. They have to share your passion for the business. And the same goes for your employees: don't employ anyone who doesn't care.'

INCISIVE MEDIA

TIM WELLER

Experienced publishing executive Tim Weller formed City Financial Communications (CFC) in 1994. The company experienced rapid organic growth thanks to its expanding portfolio of successful financial services titles. By 1999 CFC was highly profitable with over £5 million in the bank, so Tim decided to seek a private equity investor to bring expertise in acquisitions. He approached Kleinwort Capital, suggesting that it buy a stake in CFC and merge it with one of Kleinwort's existing investee companies, Timothy Benn Publishing. The deal went through in July 2000, creating Incisive Media. Five months later Incisive floated in London at a market capitalisation of £71 million.

Seeking expertise – as well as equity

Imagine the scene. Your business reaches its fifth anniversary with revenues of £12 million and £5.5 million cash. You have grown organically, but feel the time has come to start acquiring. What do you do?

For Tim Weller, who reached this position in 1999 with City Financial Communications, the answer was clear. It was time to tap the private equity community. Not just for capital, which his company already had. What CFC needed was expertise in making and integrating acquisitions.

'We had grown exponentially and organically without any borrowing,' recalls Tim. 'So we faced the question of how to continue growing at pace – and the answer was new expertise at board level in acquiring companies. The obvious place to look for it was in the private equity community.'

Success story

So Tim found himself in the happy position of interviewing a shortlist of private equity providers queuing up to invest in his business. As Tim observes, these were 'slightly different circumstances from most other companies.' But this turn of events was no more unusual than CFC's remarkable success story over the previous five years.

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Lloyd's named in slavery lawsuit

By Marcus Alcock

LLOYD'S has been named as a defendant in the latest round of lawsuits to be filed in the US seeking compensation from companies alleged to have profited from slavery.

one of the defendants (PM, 28 March, p1).

Mr Barkhead's lawsuit names eight corporations as defendants from the banking, insurance, transportation, textile, and tobacco industries – including Lloyd's.

in March this year against against insurer Aetna, railroad firm CSX and financial services firm Fleet Boston.

Ms Farmer-Paellmann told *Post Magazine* that no dollar amount is being requested – the complaints ask for an

Lutine line-up: This year's Lutine Lineslip Regatta, sponsored by *Post Magazine*, saw Ace's European Group sail to victory over the weekend at Cowes, Isle of Wight. Ace was both winner of its class

INCISIVE MEDIA

Tim had been Managing Director of Reuters Publishing before founding CFC in 1994 with £275,000 of privately–sourced capital – including some from his father-in-law. But this was no family business. 'From day one we applied big company standards,' he says. 'We were a tiny company, but we were going to play by the big boys' rules. For example, we had three Non–Executive Directors from the start.' These hand–picked people brought invaluable board–level experience and knowledge, a formula that Tim has stuck to ever since.

CFC's chosen market was the UK's rapidly – growing financial services sector, where it set about addressing the information needs of both the B2B and consumer markets. The company grew rapidly, launching six business-to-business titles including market leaders such as Investment Week, International Investment, and COVER, and two specialist consumer titles, Bloomberg Money and Investor's Week. Such was their impact that Tim was voted 'Publisher of the Year' by the Periodical Publishers Association in both 1997 and 1998 – and, after the flotation, Ernst and Young's 'Entrepreneur of the Year' in 2001.

Heading for the exit

An equally striking sign of success was that CFC never spent its initial £275,000, but turned cash–positive with its account still safely above £100,000. By the end of 1999 Tim was talking to private equity firms, and had some interesting responses. 'Some of them didn't like our internet strategy,' he recalls. 'Our approach was softly softly and bottom–line focused. We were making money on–line, but very slowly. They thought we would lose out to people investing much more heavily.' History has shown it didn't work out that way.

By mid–2000 Tim was working with Kleinwort Capital to put together the merger with Timothy Benn, which had strong titles such as Post but significant debts. The merger – in July 2000 – saw Tim take the role of CEO and brought Kleinwort's Andrew Hartley onto the board as a 35% shareholder, bringing with him access to Kleinwort's wealth of knowledge and experience across the publishing sector. Five months later the IPO enabled the private equity investors to double their investment and the merged company to pay down most of its debt. Mike Masters, who had built up Trinity Group, joined as Chairman.

Tim's advice to people following him is not to underestimate their strengths. 'If your business is generating cash, you are in stronger position than you think,' he says. 'If you have got good management you should really stand firm. That's what the private equity firms are really buying into – not a product or business, but management. My other advice is make sure you have an extraordinarily strong Finance Director.'

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