

Case Study – Abaco

Background

- In Germany, Abaco is the leading independent aftersales automotive service provider to consumers and B2B with 646 branches including neighbouring parts of northern Europe such as the Netherlands and Belgium.
- In FY13 Abaco generated a loss of c.€0.5bn from total revenues of c.€1.1bn.
- Abaco operates in two main channels to market:
 - **Consumer** (split into consumer services and shop/e-commerce)
 - Represents sales generated from repairs and servicing (inc. parts) – c.63% of revenue
 - Shop/e-commerce represents sales generated from product sales such as tyres sold in branches and over the internet – c.20% of revenue
 - **B2B** (predominantly recycling and trading of car fleet services) – c.17% of revenue

Ownership and domicile

- Abaco was acquired by Exuma Holdings LLC in 2004 for €1.45bn and in the subsequent years its development can be summarised by three distinct phases:
 - **Expansion:** from FY04 to FY07 the number of branches grew from 449 to 603
 - **“Back to the roots”:** restructuring and cost-cutting measures were implemented in reaction to the economic downturn
 - **“Meister Program”:** exploration of further sales opportunities (including e-commerce, windscreens and further B2B business)
- More recently, significant secondary trading of Abaco’s senior debt has resulted in a large distressed investor (Cable Investments LLC) owning more than 50% of the senior debt
- Despite substantially all of Abaco operating out of Germany, it can be considered to be subject to several jurisdictions due to its international financing structure:
 - The Group’s key entities are domiciled in Germany
 - The bond documentation is governed by New York law
 - The inter-creditor agreement is governed by English law

Financial Background

P&L

- Abaco reported turnover of €1.16bn for the financial year ended 30 June 2013 compared with €1.25bn in the previous 12 months.
- Abaco has been loss-making for the majority of Exuma Holdings’ ownership with an equity injection of c.€140m needed in 200 to keep the business afloat. More recent lower activity has been driven by unfavourable weather conditions and lower customer throughput in branches in general. This has been only partially offset by growth in the e-commerce sector which has itself come under pressure from competition for market share.
- Abaco has achieved some loss mitigation through cost-cutting measures but overall, the large fixed cost base has translated decreasing sales into increasing losses on the bottom line.

Balance Sheet

- As a servicing company Abaco is a relatively asset light business with the majority of its premises occupied on a leasehold basis. Historically large fixed asset balances have been dominated by goodwill from the 2004 acquisition by Exuma Holdings. This has been written down more recently to reflect the impairment to the brand from poor customer feedback and a lack of investment in up to date technology and training.
- Financial debt is significant, including senior loans of (€600m notional) and an RCF of a further €45m (close to fully drawn).
- Following Cable Investments’ acquisition of a large proportion of senior debt, they have injected a further c.€25m as an interim facility to stabilise Abaco’s short term liquidity and provide headroom whilst a financial restructuring can be completed.

Historical background and recent developments

- The management team has recently been shaken up with the previous CEO displaced
- Cable Investments has gained a reputation recently in Europe for adopting a “loan to own” strategy – buying senior debt to take control, restructuring to equity and funding operational turnaround. It can be assumed that this is their aim in this circumstance.

- Several key trends have recently impacted the performance of Abaco
 - Decreasing service and inspection frequencies of modern cars
 - Aggressive competition from OEMs looking to retain the servicing of older cars through extended warranties and other offers
 - Recent mild winters resulting in lower throughput of customers seeking tyre changes and other servicing whilst in the garage
 - Recent quality control issues resulting in a brand impact
 - A large fixed cost base including financing costs, rent on premises and personnel costs
 - High staff turnover and low morale amongst staff
 - A confused recent strategic direction resulting in Abaco being squeezed from all directions by competitors resulting in a decreasing market share
 - Ongoing losses challenging group liquidity and increasingly dominating management focus

Questions

- What are the key issues faced by Abaco and what is the order of priority?
- What is the stakeholder landscape?
- Amongst this, who are the key players and what are their respective motivations?

Competitive backdrop

- The German aftersales market is extremely competitive and fragmented. Abaco can be classified as a “fast fitter” offering a selected range of (the more basic) services to a broad range of car brands.
- Abaco faces aggressive competition from OEMs (who are expanding their target group from new cars to moderately old models) and independent workshops (joining broader service groups and expanding their target focus from the oldest models to include moderately old cars). In addition, the penetration of online sales threatens to impact Abaco’s growing e-commerce business as the independent workshops (in particular) grow more technically able and take advantage of relatively low barriers to entry.
- Customer perceptions rank Abaco ahead of OEMs on price-performance ratios and service speed / convenience. However, more recent poor service records and the growing complexity of modern cars results in Abaco still having substantial room for improvement on customer satisfaction.

Opportunities for growth

- Notwithstanding the competitive marketplace in which Abaco operates – there remain growth opportunities for the business – mainly in relation to testing, inspections and repair. Although this work can be highly complex (particularly for newer cars) and require specialist equipment/training, the margins achieved can be high and the combination of competitive price and speed of service are a very attractive proposition to consumers, particularly where service can be offered within 1-3 days of initial contact (compared with 2-3 weeks for OEMs).
- A key element of the German car market is the requirement for winter tyres in snowy or icy conditions. Between October and Easter, much of Germany can be subjected to prolonged low temperatures and insurers are increasingly unlikely to pay out in the event of an accident where winter tyres have not been fitted. As a result, recent years have seen significant growth in the sale of winter tyres, as well as growth in other aspects of servicing as customers take advantage of other service offerings whilst attending a workshop to have tyres fitted/switched.

Selected information (Strategic):

Extract from BCG review: The European Automotive Aftermarket Landscape (2012)

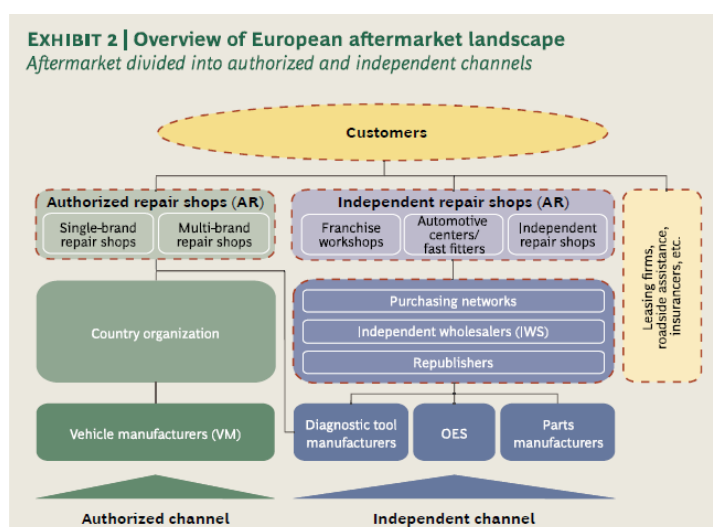
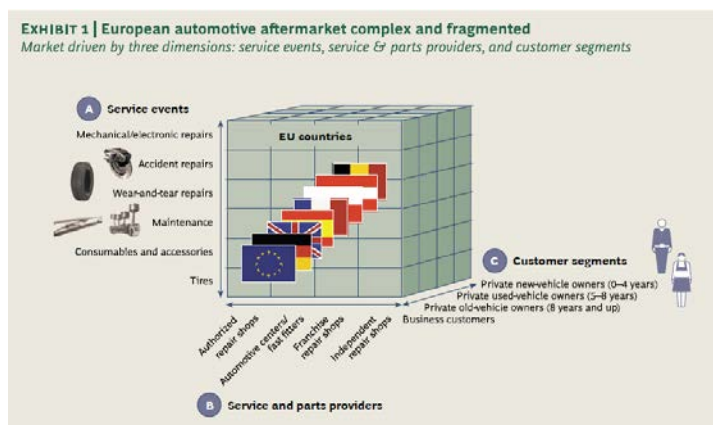
“Introduction

Since June 19, 2011, the automobile industry in Europe has been subject to EU Regulation 566/2011, according to which manufacturers are obligated to release electronic data enabling the exact identification of replacement parts for vehicles. This will further strengthen the position of independent service providers in the after-market sector, a sector that includes automotive services, parts and the maintenance business. In the future, independent operators will have the same access to electronic repair and diagnostic information enjoyed by authorized repair shops.

...The goal is to create a competitive landscape in Europe in which independent repair shops and authorized repair shops compete to serve different customer needs and segments. The idea is to strengthen the customer’s position and to encourage intense competition on all levels of the repair and parts value chain.

So far, the Commission seems to have been successful in realizing this goal: Independent service providers have in recent years further expanded their parts and service businesses at the expense of OEM; traditional authorized repair shops are experiencing (price) pressure from large independent service providers; and in the meantime, non-traditional players have also entered the market: Insurers, fleet operators, and leasing firms have long since begun to strike exclusive agreements with independent repair shops, effectively lowering their costs and channelling customers to contractually agreed independent service providers.

...On the retail level, independent service providers can be broken down into three types of repair shops: (1) franchises that offer a full range of services and are part of a dealer network or franchise system; (2) automotive centers and “fast fitters,” i.e., repair shops with standardized and often limited service offers that frequently include parts retail; and finally, (3) small, “corner” repair shops that offer the full range of services and function completely independently.”



Extract from Roland Berger Automotive Insights Magazine (Feb 2013)

“The car industry has entered a fierce but hitherto largely unnoticed race to win the maintenance, repair and parts business. Bosch, the world’s biggest automotive supplier, took over US shop equipment provider SPX Service Solutions for more than USD 1 billion, while competitor Continental laid its hands on British diagnostics specialist Omitec, and PV Automotive bought pitstop, the German repair shop chain.

The aftersales market is a safe haven with strong margins for suppliers and independent repair shop chains, and also the OEMs. Manufacturers already generate 75 to 80% of their profits from aftersales products and services although they account for no more than 20% of sales – and the profit share is rising. Big corporations like VW and BMW long ago included “aftersales” in the official title of their board members in charge of the area.

Why is aftersales becoming so important? It’s because the rules of the automotive game are undergoing a fundamental change. Current trends will shake up the industry between now and 2025: Supply and demand are increasingly shifting to Asia, competition along with consolidation pressure are intensifying, and the increasing demand for well-affordable vehicles is giving rise to an entirely new segment.

While alternative new powertrains will even speed up the pace of change, young urban consumers are challenging the very concept of car ownership, a trend we call demotorization. They call for new mobility services such as carsharing and carpooling, which are already experiencing rapid growth.

To survive in the market, aftersales players must carefully listen to their customers and provide the goods and services they really want. This must be clear from their approach to communication and product portfolio design. Micro-marketing – with a service offering tailored to each individual customer – would be the ideal solution.

The extreme complexity in today’s repair shops, however, rules that out. The task at hand is to identify the individual target groups and put together suitable – and profitable – service offers. The first step for every aftersales player therefore is a detailed product, service and customer segmentation.

Aftersales is the most important profit driver

The aftersales market is huge but difficult to grasp. In 2011, sales in Germany alone were a whopping EUR 38 billion. The players range from OEMs and OES-players to independent parts suppliers, wholesalers, retailers, repair shop chains and independent repair shops. What’s more, current trends allow players from other industries to enter the market with innovative business ideas. Just think of the information & communication technology (ICT) companies that will provide all the Internet and cloud services that are becoming standard in cars. The interactions among the individual players are very complex, however. This lack of transparency allows the providers to charge nice markups without anybody noticing, but it also leads to uncertainty among customers.

New car registrations in Germany are leading to moderate aftersales growth even in times of crisis. In 2009, Germany’s cash-for-clunkers scheme led to a peak in new car registrations. After a dip, the figures have been on the rise again since 2010, and this trend should continue – although the 2009 record of 3.8 million newly registered cars will not be achieved again in the foreseeable future.

Along with the number of new car registrations, the number of cars on the road is also continuing to rise in Germany. The figure today is 42 million, set to rise to 44 million by 2015.

Overall, Germans register more new cars than they scrap, export or no longer use. This drives up average car age. In 2003, the average German car was 7.4 years old, in 2012 the figure was up to 8.5 years according to Germany’s Motor Vehicle Authority. In particular, the share of cars aged between seven and ten years is on the rise.

Older cars need more servicing, which is speeding up aftersales growth. With 1.2% anticipated annual sales growth for all players by 2016, it will continue to be a source of stable income. Spare parts and accessories account for the lion’s share of that business, with over 30% and 20% respectively.”

Franz W. Rother

Automotive News - September 13, 2004 - 12:01 am ET

German car magazine "Auto, Motor, Sport" recently tested four workshops belonging to Auto-Teile-Unger, a German service chain. The result was a small catastrophe: an oil change was charged twice, faults on the car that put safety at risk were not noticed, schedules were not kept and staff were rude to customers.

"The terrible performance of the repair workshop chain in Weiden crowns a service no burger stand would want to offer," the magazine's tester said about one location.

The members of Abaco's board of directors are probably just as shocked about the result of the repair workshop test as investors at Exuma Holdings, who took over the company in August.

Automobile manufacturers and operators of authorized garages, on the other hand, are probably quite pleased as the fast expansion of the repair workshop chain has been troubling them for quite a while.

Abaco now has 484 branches in Germany and is planning to expand its network to 800 locations by 2014.

Other chains such as Autofit, Carat and AutoCrew also have ambitious expansion plans.

Of a total of 42,500 repair shops in Germany only half are authorized ones, and their number continues to decrease.

At the same time the number of repair contracts with authorized garages is falling.

No wonder. People don't want to spend too much. Low-cost chains' tempting offers are no longer noticed just by owners of old cars. Tests, after all, show that authorized repair shops don't always shine, despite car manufacturers' qualification measures.

There is no doubt that the European service sector, along with the entire industry, is in the middle of a major change.

This will be most obvious at the Automechanika fair, which starts in Frankfurt this week. It is the world's largest show for the aftermarket and fast-fit chains have a larger exhibition space this year than ever before.

The independent aftermarket will most definitely be the main subject at this year's show.

Auto manufacturers are concerned. Some of the carmakers that were not interested in the exhibition two years ago have returned to Frankfurt this year full of remorse. They will either introduce their own fast-fit concepts or they will try to keep their remaining partners happy.

In many cases the well-meant advertising campaigns might have come too late. Automobile manufacturers complicated matters for no reason during negotiations over standards and minimum requirements. Some experts even believe that the contracts that were negotiated under a lot of pressure are unethical.

Manufacturers now have to pay dearly for the tough course they set during negotiations that were triggered by the need to comply with new Europe-wide retail rules last year. Car companies will feel that where it hurts most: on their bottom line.

Some of them will be even more affected by this, as the new-car business in Germany and elsewhere in Europe is not living up to expectations. New distribution channels are opening up for the spare parts trade, with business moving away from carmakers to spare parts suppliers and independent chains.

In that respect, the terrible test result of those four Abaco garages is only a small consolation for those who try to maintain the system of authorized garages. However, the disintegration of traditional structures within the aftermarket can no longer be stopped. And that is good.

Kwik Fit set for European expansion - Franchising is how Kwik Fit plans to expand in Europe. Steve Banner reports.

In the UK it is rolling out 25 centres upgraded to the new "Plus" standard, all of which should be trading by the end of the year.

Best-known for its presence in the UK and the Netherlands, fast-fit specialist Kwik Fit is planning to use the franchise route to expand into other European markets with the aim of having over 500 additional outlets in place by 2019. Both its British and Dutch operations are wholly owned, with over 600 and some 200 branches respectively. Its ambition is to establish a master franchisee for part or all of each target country, which will in turn appoint sub-franchisees to run local centres.

Countries being targeted include Poland, the Czech Republic, Slovakia, Austria, Norway, Sweden, Finland and Slovenia, with Denmark, Belgium, Luxembourg, Romania and Croatia in the pipeline.

All these countries are relatively small markets and at least have the virtue that they are manageable. What about bigger ones such as France and Germany?

Kwik Fit has already been in both, admits UK fleet director, Peter Lambert; and the experience was not a happy one.

'We sold our Pitstop operation in Germany back in 2009 because we found that customers went to franchised dealers for their tyres,' he says. Its Speedy operation in France was not a success either, because of the fragmented nature of the aftermarket and the strong loyalty shown by customers to small local garages, he adds.

'Every village in France still has a Renault dealer,' Lambert remarks.

Kwik Fit's experience has not put it off tackling larger and more challenging new markets however, he says. 'We are looking at appointing a Master franchisee for Russia but it's early days,' he comments.

In the meantime Kwik Fit's branches in the Netherlands are benefiting from the established Dutch practice of switching to winter tyres before winter sets in then back to summer tyres in the spring ready for the holiday months. In the UK it is rolling out 25 centres upgraded to the new "Plus" standard, all of which should be trading by the end of the year.

'We're hoping to have 150 Kwik Fit Plus sites in place nationwide by the end of 2015,' says Lambert.

"Plus" branches are geared up to handle quite complex mechanical and electrical repairs, using what Kwik-Fit refers to as slow-fit technicians, as well as the more usual activities of fitting tyres and replacing batteries.

The company also has an operation in Hungary under the Speedy banner with a dozen outlets which were being switched to the Kwik Fit brand at the time of writing. Despite tough economic conditions, Speedy Hungary has seen turnover and pre-tax profits increase every year for the past five years, says Kwik Fit.

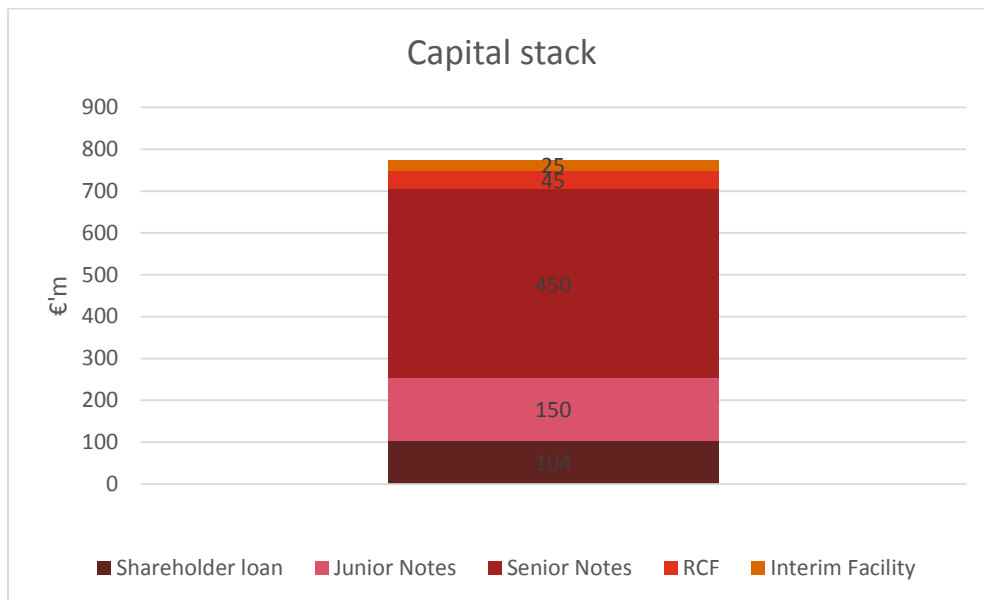
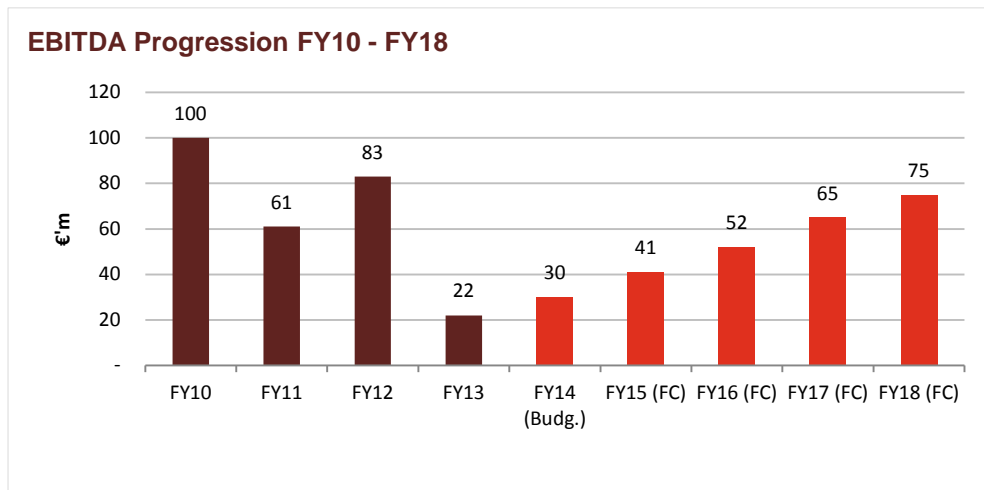
Kwik Fit's acquisition by Japan's Itochu Corporation in July 2011 for €740 million meant that it became part of a vast, multi-faceted, trading conglomerate with other automotive interests. They include working closely with Suzuki on a variety of projects in Hungary.

Over half the Isuzu commercial vehicles sold worldwide are handled by Itochu and it has stakes in Isuzu distributors in the USA, Vietnam and Turkey. It holds a 25% share in Isuzu Motors Sales in Japan, which has just set up an auto leasing operation under the Isuzu Leasing Services banner.

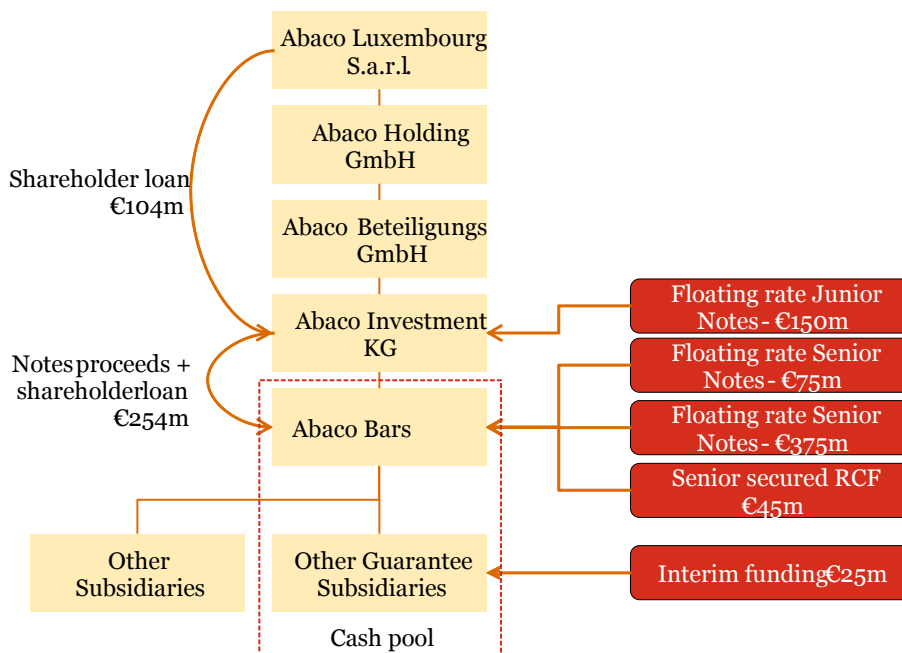
Itochu has also invested in Century Tokyo Leasing Corporation in Japan as well as in brake manufacturer Akebono and in Yanase: a specialist importer of luxury cars.

Selected information (Structuring):

NB – some of the information provided has been sanitised or altered for the purposes of this case study and does not represent the precise structure of the company or its financial position



Group Structure:



US Bankruptcy code:

- Chapter 11 is a well tested procedure for restructuring companies subject to US laws
- The procedure is regarded as very “debtor friendly” with extensive moratoria and obligations upon creditors to allow companies to keep trading whilst a restructuring is implemented
- Key elements of the procedure include:
 - Debtor in possession
 - Substantive consolidation is possible amongst groups of companies
 - Extensive powers to deal with contracts and leases
 - Court approval required for actions outside of the usual course of business
 - Plans with creditors accepted by class vote and may be confirmed by the court on request provided at least one class votes in favour, dissenting/junior classes are dealt with fair and equitably, realisations exceed liquidation expectations and that the plan is feasible

UK restructuring landscape

- The UK is well known as a jurisdiction providing flexible tools for restructuring companies. These include formal filing for administration, as well as non-insolvency routes such as schemes of arrangement.
- Schemes of arrangement provide for an arrangement between a company’s members or creditors and has the following key characteristics:
 - Approval required from a majority in number representing >75% by value of creditors
 - Approval required from the relevant UK court
 - The result is legally binding on all creditors (even dissenting)
 - Falls outside of EC insolvency regulations as it is not an insolvency process
 - Foreign companies are required to demonstrate “sufficient connection” to the UK
- Administration is a formal insolvency process which is regarded as “creditor friendly” in comparison with US and many European equivalents.
- Key elements of administration include:
 - Appointment in or out of court, depending on security position
 - Moratorium over actions taken on the company
 - Insolvency practitioner appointed to run the administration as an agent of the company and officer for the court
 - Provides mechanism for (e.g.) turnaround, business sale, pre-packaged solutions (including sales), realisation of assets and winding up.
 - The insolvency practitioner also has the ability to seek court approval for instances where creditors are not aligned on strategy (e.g. to release security or to approve a particular strategy)

German insolvency code:

- Proceedings may be directed either at a liquidation or a reorganisation of the business.
- Creditors act as a group to determine the direction of proceedings
- Proceedings managed by an administrator who is appointed by the court
- Historically, reorganisations have been focused on going concern sales, however the code has recently been updated (2012) in add new mechanisms as a reaction to various forum shopping examples, where German companies have sought other jurisdictional tools to restructure. New elements include:
 - An initial “protective shield” proceeding to provide a moratorium and allow an insolvency/turnaround plan to be formulated
 - Aspects of debtor in possession management
 - Improved creditor influence over the process, including choice of insolvency administrator
 - Facilitation of debt-for-equity swaps within insolvency proceedings
- Whilst the new elements of the insolvency code aim to provide significantly improved flexibility to allow companies to restructure successfully, the law is relatively untested.

Exercises:

You are advising Abaco. Your ultimate goal is to guide management through the next few months to leave Abaco on a stable footing and moving in a positive direction.

In your table groups, complete the following exercises (timing guidance in brackets):

- 1.** Consider the strategic positioning of Abaco and draw up an outline of the main elements of a suitable strategy to take the company forward (10 mins)
- 2.** In order to implement the strategic approach above, a financial restructuring is needed:
 - i.** Assess a sustainable level of debt for the company based on the EBITDA figures provided (5 mins)
 - ii.** Make a proposal for an implementation mechanism which would result in the company being (majority) owned by the senior lenders and the existing debt restructured down to the level assessed in (i) above. Provide a rationale for the mechanism chosen and any other payments you might make to get the restructuring agreed (15 mins)