NAVIGATOR

A business overview and financial guide for stakeholders in the SME market

BCD Limited (“the Company”) - Report for VWX Bank (“VWX”) 23 July 2013

CORPORATE STRATEGIES
A FRESH APPROACH TO CORPORATE TURNAROUND

Introduction & Scope

Background and letter of engagement

BCD Limited ("BCD" or "the Company") is a registered Charity and is the holding company of DCB Limited ("DCB"), and EDC Limited ("EDC"). BCD and its subsidiaries ("the Group") provide specialist training and consultancy services especially in the Apprenticeships, Industrial Safety, Supervisory and Skills Development areas, for a number of blue chip clients.

We are advised that BCD was formed to deal with the issue surrounding the Charitable status of BCD and it being a not for profit company. In addition we are advised that EDC is a trading entity required to enable BCD to resource clients based in xxxx. Given these circumstances, coupled with the fact operations are undertaken from the Citytown premises, for the purposes of this report we are treating the Group as one trading entity.

VWX Bank ("VWX" or "the Bank") provides BCD with an overdraft facility of £xk, and two Term Loans amounting to c.£xk. The Bank is secured by way of:

- Two legal charges in relation to premises from which the Company trades;
- A cross guarantee from DCB in favour of BCD; and
- A debenture containing fixed and floating charges created on 26 October 2006 registered against DCB.

Given our understanding of the security arrangements and the lack of assets in EDC, for the purposes of this report we have assumed that the Bank's lending to BCD is secured against all the assets contained within the Group by way of legal charges on the trading premises and by way of the debenture containing fixed and floating charges on all other assets.

The Group is currently experiencing cash flow pressure as a result of the impact that the economic downturn had on BCD's clients in 2009, when the Company was immediately faced with a very low request for apprentice starts in September of that year.

Given that 25% of the funding for an Apprenticeship is withheld until completion of the framework training, which takes a period of between 36 and 42 months, the 2009/2010 intake is affecting BCD's 'completion payment income' in the current financial year for 2012/2013.

Given the anticipated cash flow difficulties, the Company has requested an extension to the existing overdraft facility by £150k.

It is against this backdrop that we have been engaged by the Company to undertake the scope of works contained in our letter of engagement attached at Appendix 1.

Sources of information, Scope of Work and Limitations

The information contained in this report is based primarily on explanations provided by management, management accounts and management's forecasts attached at Appendix 2.

As stated in the terms of reference, the scope of work is different from that of an audit and it cannot therefore be relied upon to provide the same level of assurance as an audit. We have relied upon explanations and information provided to us by the Group's management.

Unless specifically stated we have not sought to establish the reliability of information presented to us by reference to independent evidence. However, we have reviewed the information and sought explanations for key trends and salient features identified. We have also satisfied ourselves that the information presented is consistent with other information available to us.

Whilst we may comment on the Group's projections, we have not prepared them. Consequently, management remain solely responsible for these projections and the underlying assumptions on which they are based.

This report is issued on the understanding that management have drawn our attention to all matters of which they are aware concerning the financial position of the Group which may have an impact on our report.

Contacts

Julien Irving	0161 835 1900 / 07715 755 260 julien.irving@leonardcurtis.co.uk
Stephen Hartshorne	0161 835 1900/ 07738 182 721 shartshorne@corporatestrategiesplc.com

Trading review and performance risks

The Group forecasts an increase in the Net Movement of Funds (profit and loss) to £127k in 2013/14 and £178k in 2014/15, principally due to the increased level of NVQ3 Apprenticeships. Modest growth is also expected in the provision of short courses.

Historic trading (Y/e 31/08/11, Y/e 31/08/12, P/e 31/05/13) - Consolidated

- The Group's main source of income is received from the Skills Funding Agency (SFA) to fund the provision of level 2 Apprenticeship ("NVQ2") and Level 3 Advanced Apprenticeship ("NVQ3") Training. The NVQ2 training lasts 12 months and attracts significantly less funding than the NVQ3 Apprenticeships which takes between 36 and 42 months to complete. The number of NVQ3 Apprenticeships starts can therefore have a major impact on the funding received over 4 financial years. We estimate that NVQ3 Apprenticeships account for c.27% of turnover in 2011 and c.38% of turnover in 2012 (circa 50% of turnover forecast in 2014).

- NVQ2 Apprenticeship is a 12 month course. Two payments are received in month one, and the balance is received by way of ten monthly 'on programme' payments.

- The downturn in the economy in 2009 had an immediate impact on BCD's clients, with a very low number of NVQ3 apprentice starts being requested in September of that year. The intake of 12 was a c.70% reduction when compared to the annual average of 42 apprentices recorded in the six year period between 2007/2008 and 2012/2013.

- The financial result for 2011 was net incoming resources of £18k, however a revaluation in the property resulted in an unrealised loss of £333k, resulting in a loss of £315k (loss).

- The financial result for 2012 was a profit of £10k. Income increased by £25k mostly due to a large increase in income from members services and increased apprentice numbers which more than offset a drop in short course and adult training. Costs also increased by £33k mainly due to increased staffing levels.

- The financial result for the period to 31 May 2013 was a profit of £63k. There was a significant increase in NVQ3 apprentices; the principal reasons for this being that the Company won a significant tender and a number of apprentices completing NVQ2 in 2012 opted to undertake NVQ3 immediately thereafter.

Forecast trading (P/e 31/08/13, Y/e 31/08/14, Y/e 31/08/15)

- Forecasts have been prepared based on 45 NVQ3 apprentices and 15 NVQ2 apprentice starts during the year to 31 August 2014. The intake of NVQ3 apprentices is forecast to increase to 50 the following year. The Company currently has a total of 59 confirmed vacancies to be filled for the September 2013 intake in relation to NVQ3, and 7 in respect of NVQ2. It is anticipated that this figure will increase, with there being 16 unconfirmed NVQ3 vacancies and 9 in respect of NVQ2. The Group expects all vacancies to be filled given there are currently 300 Apprentices that are registered to fill the vacancies.

Statement of Financial Activities	Y/e 31/08/11 Consolidated Audited £'000	Y/e 31/08/12 Consolidated Audited £'000	9 Months to 31/05/13 Consolidated Mgmnt £'000
Incoming Resources	1,279	1,304	1,172
Resources Expended	(1,261)	(1,294)	(1,109)
Net Incoming/(Outgoing) Resources	18	10	63
Loss on Revaluation of Fixed Assets	(333)	-	-
Net Movement in Funds ((loss)/profit)	(315)	10	63
Add: Depreciation & Revaluation	360	41	33
Cash from operating activities	**45**	**51**	**96**
No. of NVQ3 Apprentices Intake	46	35	75
	Forecast 01/05/13 to 31/08/13 £'000	**Forecast 01/09/13 to 31/08/14 £'000**	**Forecast 01/09/14 to 31/08/15 £'000**
Incoming Resources	439	1,599	1,707
Resources Expended	(460)	(1,531)	(1,587)
Net Movement in Funds ((loss)/profit)	(21)	68	120
Add: Depreciation	19	59	58
Cash from operating activities	**(2)**	**127**	**178**
No. of NVQ3 Apprentices Intake	45	45	50

- Modest growth has been incorporated in relation to short courses being offered, including NEBOSH Oil and Gas Certificate for which accreditation has recently been attained. The Company is the only training provider in xxxxx accredited to deliver the NEBOSH Oil course.

- Overheads are expected to increase principally as a result of there being an increased requirement for B-TEC lecturers, an additional maintenance assessor (part-time), and a dedicated Learning and Skills Academy Manager. A 3% pay-rise has been provided for from April 2014.

Trading review and performance risks (cont.)

The Group forecasts appear achievable given that the number of NVQ vacancies that have been secured in 2013/14 exceed forecast. The number of NVQ3 vacancies to be secured for the 2014/15 intake are consistent with recent and existing levels.

Performance risks on base forecast

- The forecast increase in incoming resources for the year ending 31 August 2014 appears reasonable. The forecast has been prepared on the basis of there being 45 NVQ3 Apprenticeships. However, 59 vacancies have already been secured for the year, and approximately 300 applications have been received from prospective Apprentices to fill the positions.

- Incoming resources are forecast to increase further in the financial year ending 31 August 2015, although the likelihood of this is less certain given that intakes are generally only quantified in the immediate months leading up to a new training year. However, whilst the forecast assumes there to be 50 intakes relating to NVQ3 Apprenticeships in 2015, this is not deemed unreasonable when considering the number of annual intakes recorded in each of the past six years which averages 42. When removing the anomaly recorded in 2009, the five year average is 48.

- BCD's sales and marketing team consists of five individuals. The strategy encompasses an active, multi-platform approach which addresses each element of the marketing mix, with both on-line and off-line channels being targeted by way of media campaigns, direct marketing initiatives and digital activity. Target markets include engineering, manufacturing, construction, food, aviation, pharmaceutical, education, institutional, transport, health, public sector, oil and gas, ranging from SME's to multinational companies. The sales and marketing functions should ensure that the Group remains focused on NVQ intakes each year.

- The Group now runs its own B-TEC Technical Certificate, which has resulted in a significant reduction in the amounts paid out to colleges. For the financial year 2013/2014 the Group will be completing the full B-TEC in 12 months rather than over two years and therefore the full funding will be claimed over 12 months, which is a further contributory factor to the SFA income increasing between the financial years 2012/2013 and 2013/2014.

- Overheads are forecast to increase, predominantly due to the escalation in wages and salaries costs which will be in accordance with the increase in the intake of learners. There will be a requirement for extra B-TEC lecturers, an additional maintenance assessor and a dedicated Learning and Skills Academy Manager.

- The Company has recently achieved OFSTED Grade 2 – Good in February 2013. Without this the Company would not have been considered by the SFA to run 'Traineeships'. This award will enable the Company to take on several funded unemployed learners and train them whilst attempting to gain them employment. The minimum grading that the Company requires in order to obtain funding from the SFA is OFSTED Grade 4.

	Assumption in Forecasts	Performance Risk
Incoming Resources	↑ 22.6% (2014) ↑ 30.9% (2015)	**Low/Medium risk** – • A significant proportion of incoming resources relates to ongoing NVQ Apprenticeships. • Secured job vacancies and apprentice applicants for NVQ2 and NVQ3 for 2014 are in line with forecast. Forecast intakes for 2015 are not deemed unreasonable when considering the annual average recorded in the last six years. • A significant low level of historical attrition rates should ensure the courses are completed.
Resources Expended	↑ 18.3% (2014) ↑ 22.6% (2015)	**Low/Medium risk** – • The increase in overheads is predominantly due to increased salaries and wages, which are controllable. • There are minimal variable costs within the business.

- We have not been made aware of any impending regulatory or legislatory changes which may have a detrimental impact on the trading ability of the Group.

Cash Position and Funding Requirements

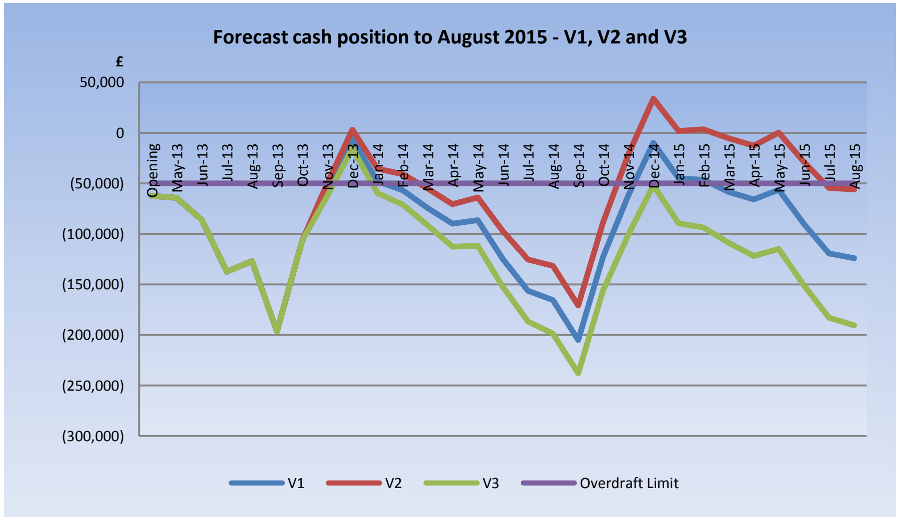
The Group forecasts that it will be unable to operate within existing overdraft limits. An additional £150k facility would be required to meet the working capital requirements in September 2013 and September 2014. A restructuring of the lending to the Group would therefore appear appropriate.

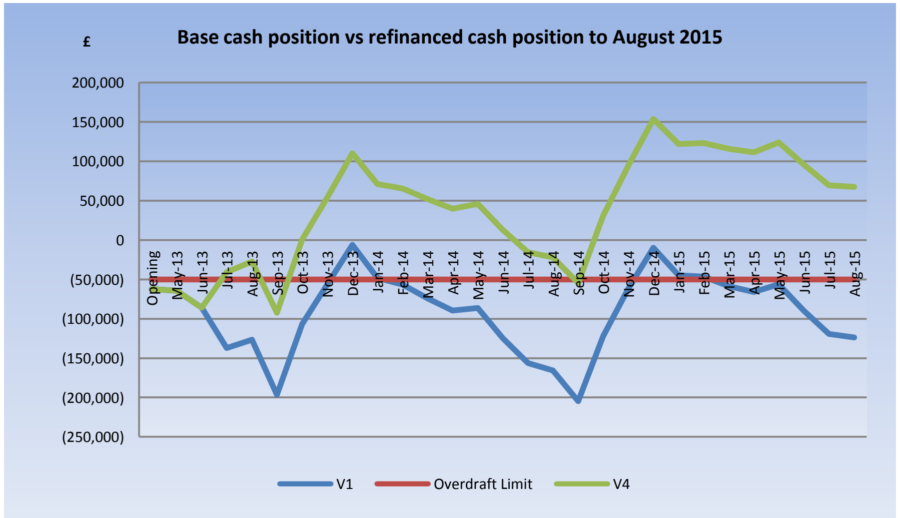
Forecast cash requirement

- There are a number of cash flow forecast scenarios modelled, these are:
  - Base Case – as per forecast assumptions on page 4 - v1;
  - Increase in the number of NVQ3 Apprentices by 5 individuals compared to that incorporated in the base case model. Hence, 50 intakes in the year to 31 August 2014, and 55 intakes in the year to 31 August 2015 - v2; and
  - Reduction in the number of NVQ3 Apprentices by 5 individuals compared to that incorporated in the base case model. Hence, 40 intakes in the year to 31 August 2014, and 50 intakes in the year to 31 August 2015 - v3.
- The Group currently has an overdraft facility of £50k, but each scenario shows an increasing need for additional borrowing for much of the period to August 2014. The cash requirement is greatest in September of each year when the Group is forecast to be overdrawn by c.£200k.
- The peak cash flow requirements in September for each year returns to credit by December. This is due to the initial SFA payments which are payable following the commencement of the apprenticeship schemes in September. The schemes tend to run from September to February, although the Company is seeking to eradicate the seasonality associated with the business by staggering the commencement of various learning programmes throughout the year.

Long term funding

- The cash flow forecasts include repayment of two existing Term Loans. The combined monthly repayment is £5.8k plus interest of c.£1.1k. The levels of the cash from operating activities in 2011 (£45k) and 2012 (£51k) have been insufficient to meet the capital repayments on the term loans each year (c.£70k). This has exacerbated Group cash flow together with the reduced final payments relating to the 2009/10 NVQ Apprentice intakes.
- An additional cash flow forecast has been prepared, scenario v4, based on refinancing which is secured on the property at Citytown, in order to convert a proportion of the short term debt into longer term.
- Scenario v4 is based on a restructure of current lending, replacing the two existing term loans with a single property based loan of £518k (LTV 70%), assuming a property value of £740k, from July 2013. Borrowing has been estimated over 20 years which would equate to repayments of c.£2,822 per month based on similar interest rates as the current loans. The cash flow indicates a peak overdraft of £92k in September 2013, following which the Company is not then overdrawn until the period between July and September 2014, peaking at £55k.





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Current Financial Position – Consolidated Balance Sheet

The Consolidated Balance Sheet as at 31 May 2013 shows that the Group has net assets of £282k.

Balance Sheet

Opposite is the consolidated balance sheet as at 31 May 2013. Specific details are as follows:

- The Bank has security registered against the Company by way of two legal charges registered against the property occupied by the Company, Citytown. The property was valued in March 2011 by professional valuers and has a vacant possession value of £740k, and a net book value of £715k. The valuation indicated that if only a period of 6 months was available to market the property then a forced sale may realise £675k, after costs.
- Other fixed assets include plant and machinery, computers, office equipment and motor vehicles, with a combined net book value of £174k
- Stock relates to various materials utilised by the learners as part of their apprenticeship tuition which is conducted at the Company premises. Minimum stock is held by the Company.
- Trade debtors consist of a combination of Government based bodies and corporate sponsors. 75% of NVQ3 funding is received across the duration of the apprenticeship, ranging between 36 and 42 months, and the balance is received on completion. A starting payment is received in advance in the same month as commencement of the course, and monthly 'on programme payments' are received on the 15th or 16th date of the month, after the Company has submitted a claim for payment on 5th date of the same month.
- NVQ2 schemes take 12 months to complete. Funding is received by way of 11 payments, two of which are received in month one, with ten monthly payments being received thereafter.
- Trade Creditors relate to registrations and college fees.
- The Company has a bank overdraft limit of £50k.
- There are two bank loans, details of which are as follows:

  Loan 1: Balance outstanding of £360,007. Repayments of £3,886 per month, interest rate base +2.00%, circa 103 monthly repayments remain (assuming current base rate).

  Loan 2: Balance outstanding of £66,605. Repayments of £1,931 per month, interest rate base +5.50%, circa 38 monthly repayments remain (assuming current base rate).
- Social Security and Other Taxes relate to payments due to HMRC and are up to date.
- Hire Purchase – Relates to four vehicles, purchased in 2012, and a milling machine which has 12 months payments outstanding.

Balance sheet as at 31 May 2013		
		£000
Fixed Assets		**889**
Current Assets		
Stock		6
Trade Debtors		173
Prepayments, Accrued Income & Other Debtors		104
Petty Cash		3
		286
Current Liabilities		
Trade Creditors		(91)
Bank Overdraft		(52)
Bank Loan – Property		(37)
Bank Loan – Misc.		(19)
Social Security and Other Taxes		(41)
Hire Purchase		(39)
Accruals, Deferred Income & Other Creditors		(190)
		(469)
Creditors Due > 1 Year		
Bank Loan – Property		(327)
Bank Loan – Misc.		(49)
Hire Purchase		(48)
		(424)
Net Assets		**282**

Current Financial Position – Estimated Outcome to the Bank

Based on the most recent valuation of the property in 2011 the Bank appears to be fully secured on its lending to the Group. Any increase in lending to the Group would have to rely on the equity value in the Property as security, as minimal recoveries would be expected from the other assets of the Group.

Group Assets

The estimated outcome statement has been prepared on a consolidated basis, on the assumption that the Bank has sufficient security by way of the debentures with DCB, which acts as supporting security behind the unlimited guarantee which exists between DCB and BCD.

We have assumed that a going concern scenario includes a sale of the business via an Administration. The forced sale scenario assumes a closure of the business and a piecemeal disposal/realisation of the Group's assets.

Land and Buildings – We have relied upon the valuation completed by professional valuers for each scenario and have applied a 3% charge of realisation costs, in a forced sale scenario.

Motor Vehicles – An estimated to realise value of 80% on a going concern basis has been assumed and 50% realisable value in a forced sale scenario, for illustrative purposes only. We understand that all the vehicles are subject to hire purchase agreements.

We note that an amount of £87k is due on Hire Purchase. We have applied this against Plant & Machinery and Motor Vehicles accordingly.

Office Equipment & Computers – We have estimated realisable values of 20% on a going concern basis and 15% in a forced sale scenario, for illustrative purposes only.

Plant & Machinery – We have estimated realisable values of 30% on a going concern basis and 20% in a forced sale scenario.

Trade debtors - A balance of £173k is due to the Company. An estimated to realise value of 30% has been applied on a going concern basis and 10% in a cessation. We estimate that trade debtors will realise 30% of book value in a going concern assuming continuity of operations in a sale, subject to the agreement of SFA and Corporate debtors to this. In a Forced Sale scenario, we have significantly discounted the realisable value to 10%, given that the majority of invoices are raised in respect of future periods. On a closure of the business, we would expect debtors to challenge the validity of such debts.

Stocks – These are made up of metals and other miscellaneous materials used as part of the on site tutelage. We have been informed that stock is kept to a minimum. We have estimated a realisable value of 15% on a going concern basis and 10% in a forced sale scenario.

	Book Value £'000	Going Concern £'000	Forced Sale £'000
Assets Subject to Fixed Charge			
Land and Buildings	715	740	675
Less: Realisation Costs 3%		-	(20)
		740	655
Less: Due to Bank - Loans and O/D		(484)	(484)
Surplus c/d		256	171
Motor Vehicles (80%/50%)	85	68	43
Less: Due to Hire Purchase	(87)	(87)	(87)
Deficit	(2)	(19)	(44)
Assets Not Specifically Pledged			
Office Equipment (20%/15%)	44	9	7
Plant & Machinery (30%/20%)	45	14	9
Stock (15%/10%)	6	1	1
Debtors (30%/10%)	173	52	17
		76	34
Surplus b/d		256	171
Costs (Est)		(50)	(35)
Available to Preferential Creditors		282	170
Preferential Creditors (Est)		-	(25)
Available to Unsecured Creditors		**282**	**145**

- Based on the Consolidated Balance Sheet as at 31 May 2013, the Bank appear to be fully secured on their lending in both scenarios primarily due to the valuations in respect of the property.
- Although a revaluation of the property was conducted in 2011, we believe a formal valuation of the Company's assets should be undertaken. This will identify the true value of the assets on the bases we have outlined, which in turn will provide additional assurance to the Bank.

Options and Recommendations to the Bank – Retain Connection

We recommend that the Bank provides continued support to the Group, conditional on the terms outlined below.

Option		Benefit		Risk		Risk Assessment	Recommended Option
Unconditional Support – Continue to provide the two term loans on existing terms and the increased level of overdraft required by the Group		• Continuity of trading		• The servicing of the debt on existing terms may constrain Group cash flow going forward. • The overdraft over the forecast period may not be repaid unless a formal repayment plan is implemented.		**HIGH**	
Conditional support – the Bank should consider providing continued support, subject to the following conditions being considered: • Consolidate the existing term loans and additional overdraft requirement to a new term loan (c.£520k). • The repayment terms of the new term loan to be extended and priced accordingly (20 year term). • An overdraft facility of £92k is required until September 2013, reducing to the existing facility of £50k until September 2014 and the current account is to remain in credit beyond then. • A desktop valuation of the property to be undertaken by professional valuers to support current values on an existing use basis and a vacant possession basis (with a sale within 6 months). • A security review is considered by the Bank to support our assumption that the Bank can rely upon its debenture, cross guarantee and legal charges to have the appropriate fixed and floating charges over all the assets of the Group. The Bank should consider obtaining security in EDC. • Key KPI's are reported to the Bank with monthly management information, namely progress reports on NVQ2 and NVQ3 targets for annual intakes. • Progress reports on Apprentice applicants for job vacancy interviews. • Ongoing reporting on attrition rates of placed apprentices. • Comparatives of other income streams between actual and budgeted figures.		• Continuity of trading and a manageable servicing of debt		• Failure is still possible but unlikely in the short to medium term.		**LOW/MEDIUM (given the existing property valuations)**	✔ **Our Recommendation**

Options and Recommendations to The Bank – Exit Connection

In order to exit the connection, the Bank should consider a refinance of its lending as opposed to an insolvency process, which is not recommended.

Option		Benefit		Likelihood		Risk Assessment	Recommended Option
• Insolvency Exit of the Company	⇨	We currently see no reason why the Company should enter an insolvency process.	⇨	• Unlikely at this stage given no external creditor pressure and 2014 income being largely secured.	⇨	**HIGH RISK Strategy that would impact on realisations in the event a buyer for the business could not be found**	
Manage-away	⇨	Less reputational risk and continuity of operations	⇨		⇨	**MEDIUM**	✔ **But only in the event of the Bank wishing an exit**
• Private Investor				• Possible under a sale and leaseback of the property			
• Re-Bank				• Unlikely			
• VC/ PE/Private				• Unlikely given low rates of return, and difficulties given the charitable status of BCD			
• ABL/Invoice Finance				• Unlikely – we note that at any point in time the debtors ledger contains a significant amount of invoices billed in advance of services, particularly in relation to the SFA. • In the event of an insolvency, the SFA contract allows set off under clause 13.6 and termination charges under clause 22.1.2. • Given these circumstances it is unlikely that an invoice funder would be able to advance any monies against the ledger.			

Options & Recommendations to the Group

The key driver to the success of the Group is the level of NVQ Apprenticeship intake each year. Every effort should continue to be made to grow the sponsor and applicants pool. The inhouse sales and marketing function should ensure the Group continues to focus on this.

Issue		Benefit		Risk		Achievability
Consider sourcing of apprentices directly from Corporate Sponsors and commencing courses throughout the year		• Reduction in seasonality of business by commencing apprenticeship courses throughout the year		• Disproportionate increase in overheads associated with the provision of additional courses, for example increased wages and salaries costs		**MEDIUM**
Increase marketing activities and actively seek out new business		• Provision of additional number of apprenticeships, covering the range of qualifications currently provided , thus improving turnover and cash generation		• Increased marketing costs		**HIGH**
Seek to enter into partnerships with competitors		• Lower costs as a result of elimination or reduction of duplicate costs • Access to extended marketplace and additional resources		• Disagreements with partners putting a strain on relations and in turn the business		**LOW**
Consider expanding the Company, operating in a new geographical location		• Provides the Company with access to a new geographical marketplace		• Overtrading and expanding too quickly without having access to sufficient resources		**LOW**
Consider sale and leaseback of owned premises		• Repayment of the Bank's exposure • Reduced debt servicing costs impacting favourably on cash flow				**MEDIUM/LOW**

Letter of Engagement

Appendix 1

Management's Forecasts

Appendix 2