The failing firm test—part 1: imminent failure

1. The first criterion of the failing firm test is whether, in the absence of a restructuring or a sale, 'the firm was unable to meet its financial obligations in the near future'.[1]

2. This appendix presents a summary of the evidence we reviewed.

Trends in operating profit, costs, sales and forecasts

3. The former directors of GVI submitted that:

> The initial months of the business [after the MBO in 2003] went well. Cash flow was not a problem because we inherited a considerable volume of finished but untested goods with the acquisition, little material had to be purchased in order to ship these and convert to cash. As time went on we became overstretched as we took orders for many high cost instruments which had to be paid for before we received cash ... Poor cash flow put pressure on our relationships with suppliers which in turn resulted in delays in supply of stock, delayed deliveries and unhappy customers.

4. The GVI group's statutory results confirm this initially positive, but subsequently declining, trend, as shown in Table 1.

TABLE 1 **GVI group statutory results**

	£'000
Year	*Profit/loss before tax*
2003/04	214
2004/05	531
2005/06	–623
1.3.06 to 20.7.06 (5 months)	–622

Source: GVI statutory accounts 2003/04 to 2005/06.

5. The former GVI directors submitted that: 'in the last 6 months, loans from shareholders increased from £495,000 to £1,166,000 to fund these losses'.

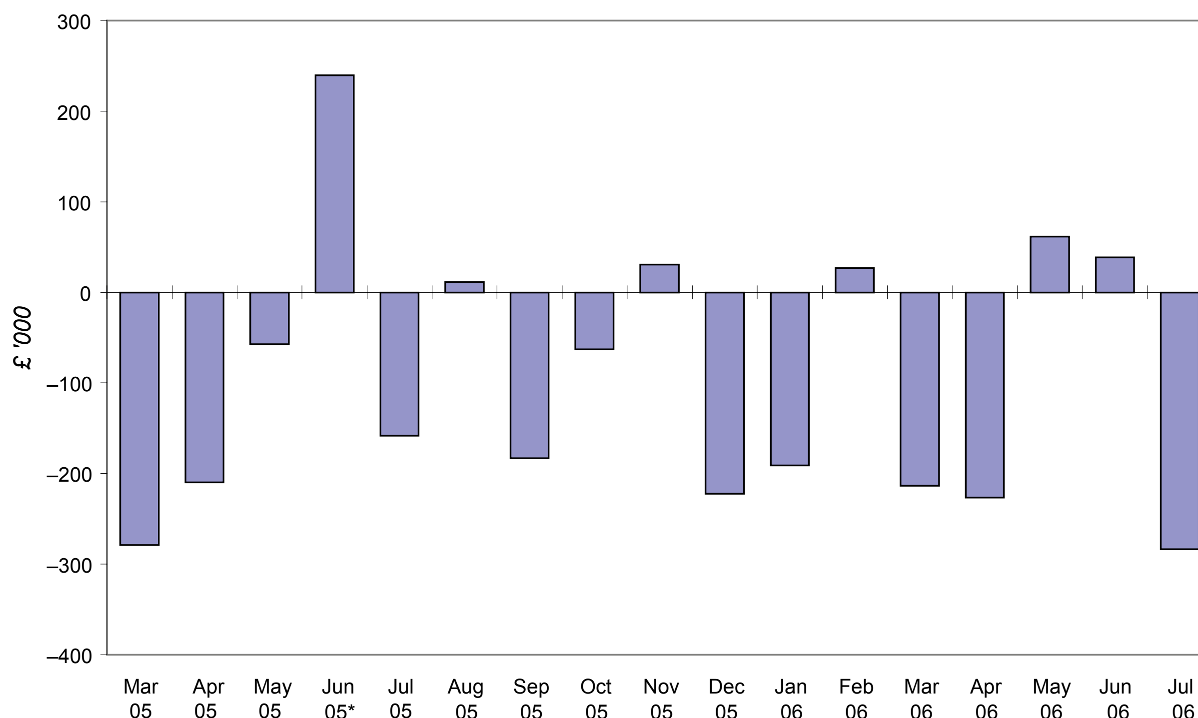
Operating profit

6. Thermo has provided financial data, prepared by GVI prior to the acquisition, which shows that in the 17 months prior to the transaction (1 March 2005 to 20 July 2006), the company achieved monthly operating losses in most periods, with small levels of profitability in the final month of each quarter [✂]. These results are illustrated in Figure 1.

[1] *CC2*, paragraphs 3.61 to 3.63.

FIGURE 1

GVI operating profit: 1 March 2005 to 20 July 2006



Source: Thermo.
*The profit of £240,000 in June 2006 is a result of an exceptional gain of £411,000, arising from the discounted settlement of a debt with Waters and consequent cancellation of a liability. There was actually an operational loss in this month as in most others.

7. The cumulative operating loss for this 17-month period (for the UK business alone, not for the group) was £1.68 million.

8. From this evidence, it appears that GVI was persistently loss-making over a sustained period prior to the transaction. Though detailed cash-flow information has not been provided, the lack of many non-cash items from these results (depreciation was only approximately £10,000 a month) means that GVI was clearly losing cash from its operations. This poor performance could not be sustained indefinitely.

Costs

9. However, despite these repeated losses, there appears to have been no attempt to reduce the cost base of the business. In particular, wages and contractor costs, which together represented between £260,000 and £300,000 a month (ie approximately 70 per cent of the total monthly overheads), did not change significantly over the period. Also, over this period, GVI was paying approximately £30,000 a month in interest costs to its directors and its bank. Though GVI did secure a 'holiday' in the capital repayments due to its bank, it continued to pay the interest due to both its directors and its bank throughout this loss-making period, apparently prioritizing both these payments over the debts due to its creditors.

Sales

10. GVI's total worldwide product sales have been constantly around £[✂] over the last three years, though more recently there has been a decline in its Gas IRMS product

sales and a significant increase in its Noble Gas MS product sales, as demonstrated in Table 2.

TABLE 2 **Product sales**

	Year to 28.2.04		*Year to 28.2.05*		*Year to 28.2.06*	
	Units	*Value £'000*	*Units*	*Value £'000*	*Units*	*Value £'000*
IsoPrime						
Noble Gas MS						
IsoProbe T MC-ICP				✂		
Total						

Source: Thermo.

Forecasts

11. In the year to February 2007, GVI was forecasting instrument sales of £[✂] and service revenues of £[✂], achieving an operating profit of £[✂]. However, this forecast was significantly end-loaded, with the last eight months of the year forecast to generate profit of £[✂], reversing a forecast loss of £[✂] from the first four months. This forecast included a total debt interest cost for the year of £[✂]. It did not incorporate any restructuring as total employee/contractor costs were forecast to remain consistently at around £[✂] a month.

Thermo's assessment of GVI pre-acquisition

12. Thermo's preliminary financial due diligence made the following observations:

- GVI's recent performance 'shows a pattern of deteriorating margins and operating profit 2004–2006. The 2007 forecast appears to be way too aggressive and is likely to be very unrealistic ([✂] per cent sales increase and [✂] point increase in operating margin vs 2006)'.

- 'There are many apparent signs of cash flow problems: negative cash balances, loans from directors to fund operating losses, etc.'

- 'There is £[✂] of inventory in the UK for which it is unclear whether there are any E&O reserves.'

- 'There have been no receivables write offs over [✂]; however the UK aging as of May 15, 2006 indicates potential problems (>90 days may represent up to [✂]% of total receivables).'

13. Despite these many problems, Thermo was still willing to pay £11.6 million for the business (or at least £[✂] excluding the escrow amount). The summary base case Thermo valuation model assumed that GVI [✂] in 2007, the first full year, but would [✂], with sales increasing at [✂] per cent a year. In addition, the model assumes sales synergies of £[✂] a year and cost synergies of £[✂] a year, both from [✂]. By 2011, the fifth year, the model assumes annual free cash flow of £[✂] a year. Assuming a weighted average cost of capital of [✂] per cent, the model derives a

present value of future cash flows of £[✄], easily justifying a price for the business of £11.6 million.

14. Thermo has subsequently recognized that:

> Thermo's valuation model relied on a number of assumptions that in retrospect turned out to be wrong. As a consequence, GVI was substantially overvalued ... Thermo expected GVI's performance to remain stable after FY05/06 onwards. In fact, in the period between March 2006 and the date of acquisition (20 July 2006), GVI's financial performance suffered a rapid deterioration … In particular:
>
> - Thermo forecast a gross margin for 2007 of [✄] per cent based on the fact that GVI's gross margin in FY05/06 was [✄] per cent. However, in the period between March 2006 and the date of acquisition GVI only achieved a gross margin of [✄] per cent.
> - Thermo forecast EBITA losses of £[✄] for 2007 (ie it was assumed that GVI would achieve a similar result as in FY 05/06). However:
> - According to statutory accounts, in the period from March 2006 to the date of the transaction alone GVI realised an EBITA loss of £[✄], [though] actual losses might in fact have been substantially higher;
> - GVI incurred further EBITA losses of £[✄] and £[✄] in Q3 and Q4 of calendar year 2006, leading to an overall loss from March to December 2006 of around £[✄].

(The losses post-transaction could be in part due to problems related to the transaction or the subsequent integration of the businesses.)

Thermo's restatement of GVI's performance post-acquisition

15. Thermo has restated GVI's financial data for mis-stated asset and liability valuations and inappropriate revenue recognition to argue that GVI was loss-making (before tax) from 2003/04 onwards, rather than just from 2005/06. Thermo's restated estimates of GVI's profit before tax (for the UK business alone) are shown in Table 3.

TABLE 3 **Thermo restatement of GVI results**

£'000

Year	*Statutory profit/loss before tax*	*Restated profit/loss before tax*	*Difference between statutory and restated profit/loss before tax*
2003/04			
2004/05			
2005/06		[✄]	
1.3.06 to 20.7.06			
Cumulative			

Source: Thermo.

16. The adjustments relate to the items shown in Table 4, which Thermo believed were incorrectly recognized.

TABLE 4 **Difference between statutory and restated P&L**

	£'000
Stock issues	[✂]
Bad debts	
Unrecognized depreciation	
Incorrect revenue recognition	
Unprovided liabilities—software licence	
Unprovided liabilities—sales commission	
Unprovided liabilities—delivery penalties	
Unprovided liabilities—customer repayment	
Cumulative adjustments	

Source: Thermo.

17. These adjustments are discussed individually below.

Balance sheet position at time of completion

18. Thermo's proposed adjustments to GVI's profit before tax presented above also imply a restatement of GVI's annual balance sheets (again for the UK business alone). These restatements are shown in Table 5.

TABLE 5 **Thermo restatement of GVI balance sheets**

£'000

Date	*Statutory net assets*	*Cumulative difference between statutory and restated P&L*	*Restated net assets*
28 Feb 2004		[✂]	
28 Feb 2005			
28 Feb 2006			
20 July 2006			

Source: Thermo.

19. The changes reflected in GVI's company accounts would all flow through to the group accounts on consolidation. Thermo has not analysed the various GVI subsidiaries (USA, Canada, France and Germany) to propose changes to these accounts.

Stock

20. The stock balance at completion was £[✂]. Thermo has suggested that this should be adjusted down by £[✂] to £[✂], due to significant slow-moving and obsolete stock. In a post-transaction onsite review of GVI, Thermo's Operations Director noted: 'Obsolete inventory is a concern and we need to resolve this through the wind down completion of our offer for the business … A major portion of this obsolete inventory comes from old product that was acquired by GVI as part of the deal when they bought the business from Micro-Mass.'

21. [✂]

22. [✂]

23. In December 2005, Glenrose Instruments, a company potentially interested in acquiring GVI, commented in its post-due diligence internal proposal that the stock of GVI should be written down by £[✄].

24. Though we are unable to form an independent expert view on this asset valuation, the comments above provide persuasive evidence that stock was significantly over-valued.

Debtors

25. The debtors balance at completion was £[✄]. Thermo suggested that this should be adjusted down by £[✄] to £[✄].

26. GVI's UK trade debtors at 18 July 2006 totalled £[✄] (not including amounts due to GVI's international subsidiaries), of which [✄] per cent was more than three months old. (It is unclear from GVI's aged debtors report whether 'current debtors' are the current period's debtors or all debtors which are not overdue. If the former, and if the credit terms typically offered to customers are three months, then [✄] per cent of debtors appear to be overdue; if the latter, then [✄] per cent of GVI's debtors appear to be overdue.) The total debtors balance had reduced from £[✄] at 28 February 2006, showing some success at gathering outstanding debts, but at that point only [✄] per cent was more than three months old. The cash-flow benefit of this reduced debtors balance was limited due to GVI using invoice discounting facilities wherever possible (ie GVI borrowed cash from an invoice discounter, secured on some of its outstanding debtors, such that when the debt was repaid, the repayment would be passed immediately to the invoice discounter to settle the loan).

27. Including GVI's intercompany debtors, and its intercompany sales, GVI UK had debts owing to it of £[✄] at completion, representing [✄] debtor days. However, this position was a significant improvement from the summer of 2005, when it had debts owing of up to £[✄], representing up to [✄] debtor days. It would appear that GVI was previously content to keep cash within its foreign subsidiaries but, in 2006, it sought to gather this cash into the UK business to finance its UK operations. At 28 February 2006, GVI's intercompany debts were £[✄] but, by 19 July 2006, they had reduced to £[✄]. In part, GVI's reduction in its debtor days over the period would also have been due to its falling sales. (The reference balance sheet as at 28 February 2006 suggests that gross trade receivables were £[✄], though the detailed analysis suggests that they were £[✄]—this difference has not been explained.)

Creditors, deferred income and provisions

28. The creditors balance at completion was £[✄]. Thermo suggested that this should be adjusted upwards by £[✄] to £[✄]. Thermo's suggested restatements are shown in Table 6.

TABLE 6 **Thermo restatement of GVI creditors**

	Balance sheet item affected	*Difference between stat and restated P&L £'000*
Incorrect revenue recognition	Deferred income	[✂]
Unprovided liabilities—software licence	Creditors	
Unprovided liabilities—sales commission	Creditors	
Unprovided liabilities—delivery penalties	Provisions	
Unprovided liabilities—customer repayment	Provisions	
Cumulative adjustments		

Source: Thermo.

29. GVI's trade creditors at 18 July 2006 totalled £[✂]. (GVI did not make purchases from its international subsidiaries so the UK figures are the same as the GVI group figures.) Of this creditor's balance, [✂] per cent (£[✂]) was more than [✂] days old (though again it is unclear from the aged creditors report if this balance is more than [✂] days old or more than [✂] days overdue). GVI's creditor days have fluctuated around [✂] from the start of 2005, reaching a peak of [✂] days in November 2005, but reducing back to around [✂] days throughout the first six months of 2006, possibly as a result of suppliers beginning to tighten their trading conditions.

30. The former GVI directors noted in their detailed warranties to Thermo that 'some suppliers [had] overdue balances … The total amount outstanding to these suppliers is £353,124.11' (warranty 4.9a).

31. In the acquisition proposal prepared by Glenrose Instruments in December 2005, after a three-month period of due diligence, it is estimated that to bring payables down to 60 days would cost £[✂].

Post-completion adjustment to consideration

32. Due to potential competitive conflicts, GVI did not allow Thermo to undertake significant financial due diligence. Rather, Thermo required extensive warranties from the GVI directors and £[✂] of the consideration (approximately [✂] per cent) to be placed in an escrow account. The reference balance sheet, on which the initial proceeds of funds were based, was the audited, statutory balance sheet of 28 February 2006. The final completion balance sheet as at 20 July 2006 was to be prepared by the acquirers and agreed with the vendors. Any change in the value of the business between these two balance sheets was to be accounted for out of the escrow account.

33. The former GVI directors warranted, among other things, that:

- GVI had 'paid its creditors in accordance with their respective credit terms' (warranty 3.6).

- 'Business … has been carried on in the ordinary and normal course so as to maintain the same as a going concern' (warranty 4.1a).

- In the period from 28 February 2006 to the date of completion, 'there has been no material adverse change in the turnover or the financial or trading position or prospects of [GVI]' (warranty 4.1b).

- GVI 'has not manufactured, sold or supplied products or services which are or were in any material respect faulty or defective' (warranty 4.11).

- 'In the sellers' reasonable opinion none of the stock is obsolete, slow moving, unusable, or inappropriate or of limited value in relation to the current business of [GVI]' (warranty 6.4a).

- 'As far as the Sellers are aware, the stock of [GVI] is in good condition and is capable of being sold by [GVI] in the ordinary and normal course of its business in accordance with its current price list without rebate or allowance to a buyer' (warranty 6.4b).

34. On 22 November 2006, Thermo met with the former GVI directors to agree the completion accounts and negotiate the release of the escrow fund. As a result, the £[✄] placed in escrow has been fully repaid to Thermo. In return, Thermo has released the former GVI directors from all their warranties concerning GVI's pre-transaction trading and the appropriate valuation of GVI's assets at completion (including the warranties listed above). The only warranties which now remain in force relate to legalities, such as the directors' appropriate ownership of assets. Thermo has not sought any further recompense from any of GVI's former directors.

Financing: cash injections

35. GVI was funded with £[✄] of shareholders' equity, all from private shareholders including most of the senior management team, and approximately £[✄] of debt. Due to cash constraints, the shareholders performed a rights issue in January 2005, increasing the equity from £[✄] to £[✄], and again later in 2005 to increase the equity further to £[✄]. At completion, the debt was as shown in Table 7.

TABLE 7 **GVI's debt funding**

	Amount of loan £'000	*Interest rate %*
Bank of Scotland loan		
Overdraft		
Directors' loans (Myatt, Schofield and Daniel)	✄	
Invoice discounting		
Total debt		

Source: Thermo.

36. The high level of interest on the directors' loans in part reflects the higher investor risk associated with an unsecured loan.

37. The terms of the acquisition were agreed on a debt-free basis so the settlement of all GVI's debts (approximately £[✄]) was taken out of the £11.6 million consideration. The shareholders received £[✄] (£11.6 million – £[✄] – £[✄]) upon completion, representing a 4.4x return on the value of their equity investment.

38. The Bank of Scotland provided a slightly different breakdown of GVI's outstanding debt at 20 July 2006 (shown in Table 8), including the GVI bank guarantees on which it was exposed (these were issued to customers in return for GVI receiving a large deposit with its orders):

TABLE 8 **GVI's debt funding**

	Thermo submission £'000	*Bank of Scotland submission £'000*
Bank of Scotland loan		
Overdraft	[✂]	
Total debt owed to Bank of Scotland		
Bank guarantees		

Source: Bank of Scotland.

39. The Bank of Scotland loan facility had five covenants. As at 20 July 2006, GVI was in breach of at least two covenants:

- its gearing was [✂], while the bank required [✂] and
- its interest cover was [✂] (ie the company was loss making pre-interest and tax), while the bank required [✂].

GVI was meeting the other three covenants on its balance sheet records but might not have done on Thermo's suggested restatement.

40. On acquisition, Thermo made a cash injection of £[✂]. This was necessary in order to satisfy debts with suppliers and restore trading agreements, settle debts with employees and agents, and to finance working capital. In the first five months post-acquisition (21 July 2006 to 31 December 2006), Thermo has cumulatively invested approximately £[✂] of cash into the business. On a cash-flow basis, £[✂] of this amount represented an operating loss, £[✂] was spent repaying suppliers, £[✂] was the release of deferred revenue for customers who had paid deposits but now took receipt of goods and £[✂] was spent on new stock so as to enable production to begin.

41. It is impossible to determine exactly how much of the post-transaction cash injection which Thermo has put into GVI is due to GVI's pre-transaction condition and how much is due to the costs for Thermo to achieve its own restructuring objectives with the business, and the costs associated with achieving the OFT's interim undertakings. However, the significant extent of Thermo's cash injection into GVI provides strong evidence which confirms Thermo's account of the state of the company prior to Thermo's acquisition, with unpaid suppliers, disgruntled customers and insufficient stock to produce goods, despite a large apparent stock balance.

Banking arrangements

42. The total consideration of the management buyout of GVI from its previous owners, Waters Corporation, was £[✂], with the management team contributing £[✂] and the balance of £[✂] being funded by deferred consideration, repayable to Waters over [✂] years. Working capital was provided through an invoice discounting facility provided by Davenhams. In May 2005, GVI was refinanced by Bank of Scotland. Bank of Scotland provided term loans totalling £[✂] to repay the outstanding debt to Waters, which wrote off £[✂] of its debt in return for early settlement. In addition, Bank of Scotland provided overdraft and Bank of Scotland cash-flow (BOSCF) facilities to replace those previously provided by Davenhams.

43. [✂]

44. GVI was referred within Bank of Scotland to its credit risk department in September 2005, following its results for the six months to August 2005 which showed a loss of £[✂].

45. By March 2006, the relationship between BOSCF and Paul Schofield had deteriorated to such an extent that GVI ceased its relationship with BOSCF and returned to Davenhams for its invoice discounting, though continuing its relationship with Bank of Scotland in all other respects. By this time, Bank of Scotland had developed serious concerns over GVI and its ability to recover its debt.

46. In March 2006, GVI's trading performance was well behind budget and GVI's directors had accepted that they had failed to meet various promises made to its bank, which GVI and Bank of Scotland had agreed would trigger an Independent Business Review (IBR) by an accountancy firm of Bank of Scotland's choice. From Bank of Scotland's perspective, there were some positive factors concerning GVI's performance, which provided some support for a view that an immediate IBR may be premature, such as an injection of £[✂] from the GVI directors' own money and an offer to buy GVI for £[✂] from Glenrose. Bank of Scotland was also aware that Thermo was a potential purchaser of GVI. By this point, however, GVI had performed significantly behind the forecast which it had provided to Bank of Scotland and, as a result, had been referred by Bank of Scotland into its High Risk department. In the eight-month period to 31 October 2005, GVI had made a trading loss of £[✂] on turnover of £[✂], compared with a budgeted loss of £[✂] on sales of £[✂].

47. Bank of Scotland did attempt to monitor the performance of GVI closely, and received much information, though often it was late and incomplete. By April 2006, Bank of Scotland did not have any forecast balance sheets against which it could check GVI's financial position, such as its forecast gearing, cash flow, or stock and asset cover. Nonetheless, it appeared to Bank of Scotland that GVI's PBIT was in breach of the loan requirements set by the bank [✂], with forecast profits of only £[✂] and interest costs in the year to date of £[✂]. Whilst GVI remained confident in its projections for the business generally, Bank of Scotland had reached the point where it was considering whether to obtain an independent appraisal of the financial viability of GVI.

48. In seeking to juggle GVI's cash flow and ensure the payment of creditors, Paul Schofield sent many emails to GVI's relationship and risk management directors at the Bank of Scotland. As an example, at the end of May 2006, he sent an email explaining that, due to payments from GVI's Japanese agents being slow, GVI was unable to make its 6 June 2006 loan repayment.

49. [✂]:

> Key in respect of cash flow [at GVI] has been non-delivery of trading performance which has led to issues servicing the bank debt. Whilst the order book always seems to be healthy, GV seems to have consistently under delivered on the timing of turning orders into profit and ultimately cash. In my opinion, that is the fundamental problem and is what needs to be addressed. If this cannot be changed in the short term the bank would ideally look for this to be met by a cash injection, not by placing more funds on and extending the term of the bank loan.

50. [✂]

51. [✂]

52. From March 2006 onwards, GVI's bank was ready to instruct investigating accountants to review GVI's commercial viability. The evidence above suggests that the bank primarily held back due to the prospect of an imminent sale of the company and the repayment of all its debt. If the sale to Thermo had not gone through, [✂], the bank would in all likelihood have sent in its investigating accountants immediately.

Forecast of future sales: order log

53. At completion, GVI's order book was £[✂]. However, Thermo has submitted that none of the [✂] ordered systems, which represent this entire order book, could be completed due to insufficient supplies. Post-acquisition, Thermo has sought to re-negotiate dispatch and installation terms with all of GVI's outstanding customers. Thermo argued that, with no possibility of turning its order book into revenues, GVI's only means to generate cash was to keep achieving new sales and taking cash on order, even though these orders were themselves not going to be fulfilled.

54. Due to the cost of manufacturing expensive IRMS products, it is usual practice for suppliers to charge a large proportion of the total price (around 50 per cent) as a deposit on order. Due to GVI's cash constraints, particularly in the period prior to sale, Thermo has submitted evidence that [✂]. Emails regarding a sale to [✂] record the explanation: [✂] (from Paul Wheeler). Similarly, Tony Williams (MD) responded to Stephen Guilfoyle (Sales Director) on 14 July 2006 regarding a customer [✂] who was pressing for a delivery date earlier than could be achieved: [✂].

55. Thermo has also submitted evidence which indicated that, at least on some occasions, GVI sought sales at loss-making prices in order to generate cash. A re-structuring review undertaken by GVI's Technical Manager in the summer of 2006 reports that a total margin calculation should be undertaken for every new sale, such that 'if a potential order is not profitable then that order should not be accepted, with unanimous support of the entire management team'.

56. [✂]

57. [✂] GVI did not own dedicated demonstration units for its TIMS or MCP-ICP-MS products. Rather, the MC-ICP-MS unit which was intended as a demo was shipped to a customer (Urenco) early in 2006. GVI failed to complete the build of a new demo unit due to the shortage of relevant supplies.

Supplier relationships

58. Thermo presented evidence that, at 20 July 2006, [✂] of GVI's top 20 suppliers were 'on hold'. In particular, of the [✂] suppliers considered critical for further production, [✂] were 'on hold'. Thermo argued that GVI's inability to pay suppliers had caused all necessary supplies to cease, except on a cash basis. Several suppliers had begun court proceedings to recover their debt, and Thermo has supplied copies of many emails from GVI's suppliers showing the pressure which they were exerting on GVI.

59. The lack of necessary supplies had caused manufacturing to effectively cease, which was recognized by Thermo's Operations Director on a post-acquisition site visit. In the six weeks post-acquisition, GVI achieved [✂] sales, as it sought to settle terms with suppliers, free up new supplies and begin manufacturing again.

60. GVI's creditor days were over [✄] at the end of every quarter from 28 February 2005 until July 2006. Thermo considered that the norm for IRMS suppliers was approximately [✄] days. GVI's creditor days reached a peak in November 2005 but relationships were strained for over a year prior to the sale to Thermo. The creditor days did not increase in 2006 due to GVI's suppliers becoming increasingly firm in their repayment demands, requiring the settlement of GVI's old debts in order to continue supplies.

61. [✄]

Employees and agents

62. At the date of completion there was an outstanding dispute with five of GVI's key sales staff. There were two issues: first, a delay in the payment of their annual bonus (due one month after the year end, ie on 31 March 2006); and second, the amount of the bonus. The sales personnel argued that their bonus contracts stipulated that the bonus was dependent on achieving a threshold of orders, whereas the directors stated that it depended on actual sales (ie product delivery). The difference in these amounts was small but significant relative to the individuals' salaries, eg for [✄] the difference was approximately £[✄].

63. The sales staff wrote an initial letter to Tony Williams on 20 March 2006 and, having received no response, wrote a follow-up letter on 16 May 2006. Tony Williams replied on 18 May 2006, explaining that the bonuses were not paid at the end of March 'due to the fairly well known fact that at the end of March the company simply did not have the cash in the bank to pay'. The lower bonus amount, based on sales rather than orders, was eventually paid in April and May 2006. However, the sales staff initiated a formal grievance procedure for the remaining balance, which GVI did not pay. After the acquisition, Thermo recognized the claim of the sales staff and settled all the outstanding bonus payments.

Management

64. [✄]

65. [✄]

66. [✄] Between June and November 2005, when GVI was beginning to make losses and pressure was beginning to be felt from suppliers, all three directors had new cars, replacing their existing cars which were two years old, at a total cost of £86,475.

67. [✄]

68. The former GVI directors also recognized this problem: 'In the financial year 05/06 our chronic cashflow problem became worse as large amounts of finance were required to fund research and development (Noble Gas in particular).'

69. [✄]

70. [✄]

71. [✄]

72. In a post-transaction onsite review of GVI, Thermo's Operations Director noted that, 'On average, employees are positive with our acquiring the business. Many have been very frustrated with the financial situation (part shortages hindering production) and tension with senior management.'

Former GVI directors' assessment

73. The former GVI directors submitted that GVI's main problem was that it was under-capitalized for a small business, with long lead times between orders and sales. The problem, they argued, was one of cash flow, rather than product or operational failure.

74. The former directors submitted that:

> Had Thermo not acquired the business, GVI would have been in an extremely difficult position. We would have implemented a redundancy plan … [and] would have continued to seek new investment to ease the chronic cash flow problems which were the root of our difficulties, however we were not optimistic about finding such investment. Had another buyer not come along it is likely the company would have gone into liquidation.

75. On another occasion, Tony Williams repeated that, in the absence of Thermo acquiring the business, GVI would have implemented its redundancy plan, saving approximately £400,000 a year, but, on this occasion, he suggested the business would have carried on. However, the former directors had not calculated the cost of implementing such a restructuring programme, or considered how it would fund it or how it would re-establish its trading relationships with suppliers in the meantime. Tony Williams recognized that if the costs of the programme were prohibitive, the company would not have been able to carry it out.

Observations from competitors and customers

76. Due to the small nature of the IRMS community, many competitors and customers were aware that GVI was struggling and cash-constrained.

77. [✂] of [✂] commented that, in his opinion, GVI was poorly managed and run. He believed that GVI had tended to focus on developing new instruments when its core products were not working. He was aware that GVI was shipping poor product and spending far too long with engineers on-site rectifying problems that should have been sorted out at the R&D stage, only because they were trying to take cash on delivery earlier. He also 'knew … that they weren't paying suppliers'.

78. [✂] of [✂] also commented that he knew the situation at GVI very well and believed, from the knowledge he had, that it would not have survived much longer.

79. [✂] approached GVI in January 2006 and had a number of discussions with a view to buying the business. In February 2006, [✂] instructed its accountants to perform a commercial viability review of GVI, which caused [✂] to withdraw its interest. The review highlighted a number of concerns:

- [✂]
- net assets 'appear to be significantly overstated given the issues over the quantum and valuation of stocks and recoverability of debtors';

- a lack of readily available management information and no key performance indicator (KPI) reporting;
- a lack of control over stock;
- little comfort from the business's audited accounts, given the excess reporting of stock;
- potential for a couple of disputes with the Inland Revenue;
- 'a lack of due attention to the commercial reality of the company's situation';
- the increase in staff numbers since the MBO suggests that 'the business is being run from a technical rather than commercial perspective'; and
- the number of instruments in production and various stages of repair 'seems completely out of line with annual demand'.