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Gray Security: Building a South African Services Firm

Dick Aubin, cofounder and chairman of Gray Security, looked out across the harbor of Cape Town, South Africa. Several miles behind him, and 3,600 feet above him, tourists were looking over the same beach from the top of Table Mountain, but Aubin preferred to look from where he could hear and smell the ocean. Cape Town, he felt, was one of the world's loveliest cities and well worth experiencing from within. Taking a deep breath of the ocean air, Aubin turned and began walking back to Gray's head office on the waterfront. It was January 4, 1999, a pleasant summer day, and he would be meeting with his key management team over the next few days to outline Gray's strategy for the coming years. Aubin wondered what he should communicate as his top priorities at this meeting.

Aubin felt he had good reason to be proud of Gray's growth to date, as well as to be optimistic about the company's future. From a modest beginning financed through personal capital, Gray had grown at a consistent rate of 30% per annum to become the largest company offering complete security services to South African firms. A business strategy that produced healthy cash flows had enabled this growth to take place without need for outside funding. Indeed, Gray's owners had been able to capture much of the firm's value through a leveraged refinancing that the firm's cash flows had comfortably been able to support.

Gray had also developed an operations strategy that Aubin felt gave it an edge over its competitors. Few South African companies could offer the scope of services Gray brought to its clients, and Gray was often able to create value for its clients beyond the normal benefits of outsourcing. Moreover, Gray's approach to human resources management had resulted in relatively low employee turnover and overall labor relations well above the industry, or the South African, norm. Aubin had continuously emphasized the need to hire and to retain the best people at all levels of the company, and he believed Gray had been largely successful in doing so.

Despite Gray's strong market position, however, Aubin knew there were some difficult challenges ahead. For one, South Africa was changing. The end of apartheid and the rise to power of the black majority African National Congress (ANC) Party was changing the face of South Africa. Gray had never relied heavily on government contracts, but the current changes went far beyond normal political shifts. Programs and pressure for redistribution of South Africa's wealth in favor of previously disadvantaged groups would continue to change the way business was conducted across many fronts.

Professor Walter Kummerle and Charles M. Williams Fellow Chad Ellis (MBA '98) prepared this case. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

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South Africa's economic outlook had changed, too. The local currency, the rand (\$1 = R5.860 in January 1999), had depreciated significantly in recent years (see Exhibit 1 for exchange rate history) and was widely expected to continue to weaken against most foreign currencies. Successful expansion into other African nations and then into Western Europe had established Gray's international presence. With a weak currency and prospects for a lengthy recession at home, Aubin felt it was in Gray's best interests to accelerate its overseas growth.

Changes in the security industry itself also argued for building Gray into an international firm. The industry was globalizing as multinational companies tried to reduce the number of suppliers they relied on, whether for goods or services. Oil firms and other multinational players had been a key source of contracts for Gray, and early expansion into other African countries had been in part driven by the benefits of offering services across Africa. Now that trend was extending to global contracts. Moreover, where a pan-African approach had been a source of competitive advantage until now, in the future a global service might become a competitive necessity, without which even Gray's core South African business could come under threat. Transforming Gray into an international firm was not merely a way to reduce its shareholders' dependence on South African earnings; it might prove necessary for the firm's long-term survival.

But if becoming a global player was a strategic goal, the best path to take was by no means clear. Gray had expanded primarily through organic growth, supported by modest strategic acquisitions. This had enabled the company to maintain a corporate culture and vision that Aubin felt had served it well. Could Gray continue to base the core of its expansion on opening new offices in other countries, or would the company have to turn to more ambitious acquisitions?

Aubin knew there was another possibility to consider. Gray was not the only security firm considering acquisitions as part of a global consolidation. As the clear leader among African firms, Gray would make an attractive target for acquisition by one of the world's other major players. Was it better, in this case, to be the hunted rather than the hunter?

South Africa—A Story of Turbulent Political and Economic Development

Historical Background

South Africa, a country about twice the size of France, occupied the Southern tip of Africa. (See Exhibit 2 for a map.) The indigenous people were gradually driven north by Dutch farmers who arrived after a trading post was established at the Cape in 1652.¹ The descendants of the Dutch came to be known as Afrikaners or Boers. They imported slave labor from a variety of countries including Mozambique and Madagascar.² British settlers who started arriving in the 19th century settled mostly along the coastline. In a series of conflicts between Afrikaners and British, the British eventually prevailed. A strong level of resentment over this loss persisted within the Afrikaner community well into the 20th century.³ South Africa started to exist as a state in 1910 with the establishment of the Union of South Africa.

¹ *The Statesman's Year-book*. 2004. 140th edition. New York: St. Martin's Press, p. 1457.

² Byrnes, Rita M. 1996. *South Africa: A Country Study*. Washington, DC: Federal Division, Library of Congress. p. 13.

³ Casewriter interview with Gray management.

Rise and Fall of Apartheid

While there was ongoing tension between Afrikaners and the British, both sides were eager to keep joint control over a steady supply of cheap African labor. Many of the African workers were employed in diamond and gold mines. Exports of these two resources formed the basis of South Africa's wealth at the time and extracting these resources was labor-intensive. A number of laws restricted the mobility of African workers. Also, in 1913 a law was enacted that reserved 93% of South Africa's land for white ownership.⁴ African workers lived in so-called 'townships' under dismal conditions. By law, colored mining workers could hold only unskilled or semiskilled jobs.

Resistance to discrimination led to the formation of the predecessor-organization of the African National Congress (ANC) in 1912.⁵ But this did little to stop the further cementing of segregation. In 1948 the ruling party officially introduced the system of Apartheid—"in theory the separate, but equal, development of all racial groups, in practice leading to white, particularly Afrikaner, supremacy . . ."⁶ In 1964, Nelson Mandela, an important ANC leader, was jailed. Over the years it became increasingly clear to white South Africans that the system of Apartheid was not sustainable, especially with South Africa being increasingly isolated by the international community. However, inertia kept the system going. Surprisingly, other countries imposed tough economic sanctions only after South Africa declared a state of emergency in 1986 to control increasing civil unrest.⁷ White South Africans finally got serious about change. In February 1990 Nelson Mandela was released from prison and in 1992, a white-only referendum effectively ended Apartheid. In the first general election, Nelson Mandela was elected president in March 1994. He was succeeded by Thabo Mbeki in the 1999 elections.

South Africa in 1999

Between 1994 and 1999, relations between Afrikaners and previously disadvantaged groups were characterized by a surprisingly constructive attitude. Both sides seemed eager to build a new South Africa. On the bright side, the country had a good infrastructure, especially by the standards of other African countries. For example, 41.5% of all roads were paved versus 18.8% in Nigeria and 9.3% in Brazil. However, by 1999 South Africa was still a country of huge contrasts. Whites were educated and were typically affluent, while most blacks were poor. Adult literacy stood at only 16%.⁸ (See Exhibit 3 for economic statistics.) Segregation now occurred by wealth rather than strictly by color. The Johannesburg suburb of Sandton, for example, was affluent and host to many new corporate headquarters buildings. Downtown Johannesburg, by contrast, had lost many of its corporate tenants. Squatters had taken over. Car jackings at traffic stops were common and whites sought to avoid the area.

Even though efforts were underway to improve general education and access to jobs, it would likely take at least one or two generations for previously disadvantaged groups to reach standards of living comparable to those of white South Africans.⁹ The uncertainty around South Africa's future

⁴ Byrnes, Rita M. op. cit. p. 45.

⁵ Byrnes, Rita M. op. cit. p. 45.

⁶ *The Europa World Year Book*. 2003. 44th edition. London: Europa Publications Limited. p. 3762.

⁷ *The Statesman's Year-book*. 2004. 140th edition. New York: St. Martin's Press. p. 1458.

⁸ Compared to Nigeria's literacy rate at 43%.

⁹ Casewriter interview with Gray management.

was reflected in the development of its currency, the rand, which had declined from 2.27R/\$ in 1988 to 3.48R/\$ in early 1994 and to 5.86R/\$ in late 1998. (See Exhibit 4 for recent exchange rate history and Exhibits 5 and 6 for capital flow and reserve information.)

The Roots of Gray Security

Aubin was born in 1946 to a Canadian father and South African mother. He grew up in Port Elizabeth, and in 1971 he graduated, with honors, from the University of Cape Town. He joined the engineering firm Hubert Davies and Co. in Johannesburg, where he rose to the level of director and had control of five subsidiary companies (see Exhibit 7 for management résumés).

In 1979, Aubin left Hubert Davies and moved to Cape Town as managing director of Consani Engineering, a heavy-engineering company that was part of a large conglomerate headed by South Africa's largest insurance company. Sabotage had begun to be a concern at Consani, and Aubin decided it would be best to hire a professional security firm to help safeguard the plant's production. He recalled:

We looked for a quality security company, but we couldn't find one. Security was more of a luxury issue in the late '70s and early '80s, as there was not much crime in South Africa. While several large firms, particularly in mining and oil, had security, it was usually handled in-house. I hired Andy Gray through a headhunter to put together a team of 20 people over six months. From that point on, the idea of starting a professional security firm was always on our minds.

Aubin approached his superiors about forming a security company within the group, but there was little interest and no financial support. Deciding that the idea was worth pursuing, Aubin, together with Gray, Chris Convery, and Steve Woods, formed a new venture. In late 1980, financed with R25,000 in equity from an overdraft loan, Gray Security Service (Pty.) Ltd. was formed. Aubin recalled:

The problem, initially, was credibility. We had an innovative idea for winning the confidence of new clients; we would assume full liability for losses up to an amount covered by a professional indemnity insurance policy we would take out. That reduced the risk a client might feel they were taking with a new firm, but we still needed that initial contract to let us show what we could do.

The initial contract came in 1982 from oil giant Mobil, which awarded Gray an annual contract of just under R1 million to take over seven of its facilities in South Africa including an oil refinery. Aubin explained that Mobil might not have realized how important its contract was for securing Gray's future:

The Mobil contract was obviously very important to us. Here was a major multinational, working at a strategic asset for South Africa, hiring us to handle their security needs. They may have trusted us based on the names of our board of directors, which had a lot of overlap with our former parent company, Abercom Group. Those names appeared on our proposal letter,¹⁰ and Mobil may have just assumed that Abercom was backing us financially.

Several other contracts followed Mobil's, and Aubin soon felt that his business instincts had been borne out. Three years later he left Consani to devote himself full time to the new company.

¹⁰ As required by South African law.

Early Growth

Gray spread rapidly through the Western Cape region. Aubin believed this growth was possible due to two key factors: a business model with healthy cash flows and minimal capital requirements, and a hiring policy that attracted entrepreneurs. He explained:

The key is finding the right guy. We would look for someone with some experience in the security industry and who had proven himself as a businessman. We didn't want yes-men, or people who needed a lot of direction. That guy then had to go out and win some contracts before we would even begin operations. He would then be paid a base salary plus 10% of the pretax profits of his business. If he was very successful, and in several cases this happened, he could be getting paid more than I was.

Because we only start spending money once we've already got some business, we have usually been able to achieve positive cash flow within the first year. Our billing system helps with this. We don't pay our staff until the 30th of the month, but our clients pay in advance; on average we receive payment on the seventh of each month for that month's service. This means that we have negative working capital in a business that requires very little in the way of long-term capital.

Of course, not all of our clients like paying in advance, but we have usually been able to negotiate it into our contracts. We point out that we incur an up-front cost during our security audit, i.e., when we examine their facilities and determine with them what their needs are. When that fails, sometimes we can solve the problem with a bit of creativity. In one of our few government contracts, we were told that payment in advance was impossible. During the negotiations we agreed to accept payment at the end of the month, but in return they gave us a one-month deposit!

By 1985, Gray had expanded into three major areas: Cape Town, Durban, and Johannesburg. The company had reached sales of R2.63 million, with plans to expand further in South Africa and elsewhere, all without taking on any additional capital.

Managing Expansion

As Gray expanded, it became clear that the firm needed to develop and implement systems and values throughout the company in order to prevent decentralization from leading to a loss of control (see Exhibit 8 for an organizational chart). "All our local units are highly autonomous," explained Aubin, "but that is a challenge in and of itself. You have to make sure that they perform well, in terms of cash flow and profitability, and also in terms of protecting and promoting Gray's reputation. We need to be able to tell them what to do, while letting them decide how best to do it." Gray's management concentrated on a number of core policies that could be instilled throughout the group: human resources, integrity, type of service, and financial performance.

Human Resources Management—A Core Process in a Service Company

Staff turnover in the South African security industry was notoriously high, with some industry firms reaching annual levels of 200%. "Most security firms in South Africa are run like paramilitary organizations," explained David Plane, who joined Gray in 1989 from one of its competitors and was appointed CEO in 1995. "I opened a small security firm in Cape Town for Coin Security (one of

Gray's competitors) but didn't like the way they treated people." Most industry players saw security guards as plentiful, relatively unskilled, prone to quitting but easily replaced. Antagonistic labor relations therefore characterized much of the industry, with strikes, violence, and pay fraud being common.

Gray took a contrary approach to human resources. "From the start we wanted to hire, train, and retain the best people throughout the company," explained Jenny Ibbotson, director of human resources. "Although we know we will probably never quite reach that point, our philosophy has always been that we should be able to develop any security guard to become a local area manager." Whenever possible, Gray emphasized promotion from within, and several local managers had risen to a point where Gray sponsored them to open a new regional office.

The structure of promotions also appealed more to entry-level employees looking for longer-term employment. A new Gray guard earned between R1,200 and R1,500 per month. While this compared favorably with other security firms, it was below the level earned by a starting worker in the manufacturing sector and was not enough to live on. By the end of the first year, however, a Gray employee typically earned more than his counterpart in manufacturing did. "It's not unusual for a good employee to receive two or three promotions in his first year," commented Plane. "At that point he's better off with us than with most other employers, and he can see a real future with Gray."

A Gray security guard received more training than did those at any other South African security company. Gray's basic training started at 15 working days, as opposed to an average of five working days for a competitor's. In addition, Gray did between five and 10 working days of on-the-job training and additional class work during the first year of service of an employee. (See Exhibit 9 for a list of areas in which Gray guards received training.) Training continued throughout an employee's career, including management courses at local business schools as well as industry-specific courses at Gray's own training centers.

Gray also strove to avoid the paramilitary feel of most of its competitors, believing this suited not only its corporate clients' desire for a professional, nonthreatening force but also its employees. Although some uniforms were somewhat military in appearance (see Exhibit 10 for pictures of typical Gray Security uniforms), most guards wore uniforms more like suits than military garb.

The result of these efforts was that Gray's annual staff turnover was just 38%, which Ibbotson believed to be the lowest of any major security firm. Gray also felt that it was able to hire and retain a higher caliber of workers.

Integrity—A Key Requirement in the Security Industry

Closely linked to Gray's determination to develop a high-quality workforce was its commitment to integrity on the job. Corruption or theft at one site could affect Gray's reputation throughout the organization. Gray therefore had a very strict policy on employee misconduct. As Plane explained, maintaining integrity in the organization was more complicated than it might seem:

The temptation of corruption is only part of the challenge. Guards are being paid a small fraction of the value of what they protect, so the temptation is always there. It is fairly common in the industry to find that dishonest employees of the client firm will recruit guards to help them steal. Guards can also come under threat from employees if they won't cooperate and may be naturally reluctant to turn people in if they catch them. So the psychology is a complex problem.

We try to deal with this in several ways. First, our hiring process screens out anyone with a criminal record. Then, our training includes ethics and measures to detect criminal behavior. Finally, when we design a security system for a client, we make it difficult for any individual guard to have too much control over a given area.

Nothing is foolproof, however, and one of our challenges is often that our clients do not have as strict disciplinary policies as we do. In one case, some of our guards and our client's employees were caught stealing. The client was having some labor difficulties and did not want to press charges against their employees and asked us not to press charges either. We told them we would walk off the site before we would compromise our discipline. We aren't selling uniforms, we're selling honesty, and both our clients and our employees have to know we won't make exceptions.

Plane estimated that roughly 5% of the South African security workforce was fired each year for involvement in crime at the work site.

Segmentation of Security Services

Private security in South Africa consisted of a wide range of segments. Home-security companies offered a private equivalent to the local police force, with home monitors and armed response teams. Other firms concentrated on transporting valuables in armored vehicles. Gray avoided these areas, which were characterized by high levels of violence, and concentrated exclusively on providing integrated security services to commercial sites. Plane explained:

Our sites vary a great deal in size, ranging from just one guard on duty at a time to over a hundred total staff. In general we aim for contracts involving over 20 of our guards, because those are the ones where we can offer the most added value. We emphasize full service, including handling technology aspects and finding ways to improve security beyond simply supplying a number of guards.

Gray believed that its strategic emphasis on full-service corporate contracts had positioned it as the leading firm for the most attractive contracts. As major companies outsourced activities like security, they were able to pay Gray quite attractive rates and still reduce costs. The vice president of security for a large South African insurance company explained the decision to retain Gray for its head office:

They certainly aren't cheap. In fact, they may be the most expensive in the industry. But we have almost 8,000 people working here [at this site], and we need both to keep track of that flow and to prevent other security problems like theft. There are at most one or two other firms that could credibly meet our needs, and the costs of having the job done poorly don't stay hidden for long. I get calls every week from people wanting this contract, but when I ask them what their biggest contract is, they have never covered anything nearly this big.

Louis Rademerer, the project manager, explained some of the advantages Gray offered:

There are 65 guards working on the site, and the [lobby] receptionists are also Gray. Our guards have the training it takes to fit in with an environment like this and to understand all of its security needs. We're also able to design and implement a security system that meets the client's needs better than most of our competitors. Security engineers are good in theory, but they haven't worked behind a desk, so if a client goes to an alarm or monitoring company they

often design and implement a system that doesn't fit. We know what works and can integrate human guards and electronic security.

Aubin believed that Gray's commitment to high-quality service, and its strategic emphasis on contracts few other companies could compete for, had been key to the firm's rapid growth. Despite charging premium rates, Gray's annual client retention was 95%, and expansion was often supported by new business from clients who were Gray customers in other regions. Gray's customers clearly felt they were getting good value.

Financial Performance—Nothing to Worry About?

Gray monitored several key metrics to ensure that its various operating companies were meeting the necessary performance objectives (see Exhibits 11 and 12 for Gray financial information). This enabled the company to detect any slippage in performance by a particular region or manager and to address the issue early without micromanaging a local operation. Plane explained the measurements he examined most carefully:

First, there's growth in turnover. This is closely linked to growth in employees; although we sell services, not people, manpower is by far our greatest cost. Gross margin tells us how efficiently those people are being managed. We know margins will vary from region to region, but tracking a given region over time helps us keep track of performance. Staff turnover, which is running at about 38% per year, helps us track how satisfied our employees are. Sometimes we can take action to reduce staff turnover throughout the organization, which can save a lot of money. One problem has been a lot of employees wanting to quit just before Christmas and then hope to be rehired afterwards. We've recently implemented a policy not to rehire guards who quit before Christmas. Finally, cash collections are very important to our business model. We collect 70% of revenues for a given month's service by the seventh of the month.

Gray's careful strategic focus had enabled the firm to grow rapidly through the 1980s and 1990s. The company had not only done so without recourse to additional equity capital, it had built up a cash reserve of R8.8 million.

Brait Capital Partners—A Local Private Equity Player

Brait Capital Partners was one of a relatively small number of private equity firms in South Africa. Brait was currently investing its second private equity fund (Fund II). This fund had investor commitments of \$150 million, 80% of which were from U.S. investors.

Eduardo Garcia, a partner in the Johannesburg office, had joined the firm in April 1997. He explained the firm's origin and strategy:

Private equity has been, and remains, a neglected asset class in South Africa. Contrary to what you see in much of the developed world, in South Africa there isn't a lot of money chasing deals. On the other hand, the deal flow itself is much less developed, so you have to be more creative about finding opportunities. I think what we're best at is sitting down face-to-face with people and negotiating deals. Currently we're involved in fairly traditional venture capital investing, but we are planning on raising a larger fund which will seek to capture the hidden value in a lot of South Africa's conglomerates.

In April 1997, Gray hired Brait to help it identify a value-adding “black empowerment partner.” Black empowerment partners (BEPs) were shareholder groups, often affiliated with trade unions, created as part of the effort to redistribute wealth in postapartheid South Africa. Such partners typically acquired stakes in white-owned companies at a discount to market value, and in some cases received board representation as well. Having a BEP shareholder was not a statutory requirement but was considered an advantage when doing business with the government or with companies with a significant dependence on government contracts.

Although Aubin believed that bringing in a BEP was important for Gray, there was no urgency behind the search. Aubin explained:

We have almost no government business and aren't that eager to get more, as the government isn't the most reliable when it comes to paying on schedule. So, while we wanted a black empowerment partner as a significant shareholder, we felt we could be fairly selective. We didn't want to give away a board seat unnecessarily, and we didn't want anyone who would have to borrow money in order to buy our equity. That left us with about seven groups to look at.

The search for an appropriate BEP also served to develop a relationship between a leading South African operating company and one of its few true VCs. Gray wanted to develop a relationship with Brait with a view toward potential fund-raising abroad, while Brait was naturally interested in developing ties with a fast-growing firm with strong cash flows.

Financial Restructuring—Reshuffling the Deck

While working with Gray to identify BEP candidates, Garcia became interested in negotiating a buyout of the firm. He recalled the factors he felt formed a basis for such a deal:

Gray was a simple, well-run business with fairly predictable cash flows and good prospects. Working capital was negative, and the business wasn't asset intensive. This suggested to us that the firm could support a good deal of leverage. Furthermore, Gray's record of very low levels of labor unrest reassured us that unpleasant surprises on that front were unlikely.

Aubin originally resisted the idea of a buyout. “The same factors that made Gray attractive from a buyout perspective meant that they didn't really need capital, and the owners were very jealous of the business,” Garcia recalled. “I knew we would have to devise a deal structure that appealed to them if we were going to make this work.”

Garcia looked carefully at other factors that might influence the deal. Experience with other South African entrepreneurs had taught him that a refinancing could prove attractive even when founders wanted to retain control of a business and there was little or no need for additional capital. Some shareholders inevitably wanted to achieve liquidity on at least part of their investment, and Garcia knew that some of Gray's original shareholders were now less involved with the business and might want to cash out.

Garcia also knew that Aubin wanted to increase Gray's international presence, which was complicated somewhat by South Africa's exchange controls. A local Gray entity in a foreign country would be able to access international capital markets in a way that Gray itself could not under its current structure, most obviously through a local listing in that country, but also simply by borrowing from local institutions that might not wish to lend money to a South African firm. Aubin

had also expressed an interest in motivating Gray's managers with equity, either through grants or options, and Garcia knew a refinancing might facilitate such an incentive system.

Garcia approached Aubin with an innovative deal structure that he felt would meet the needs of Gray's various shareholders. (See Exhibit 13 for a diagram of the refinancing structure.) A new company (Newco) would purchase Gray's business operations for R140 million,¹¹ of which R71 million would be cash with the remainder on loan account. Brait would provide R55 million to Newco, of which R24 million would be an equity investment in Newco, on shareholders' loan account, and the rest would be a conventional loan. Another 16 million of surplus cash would be put toward the purchase price of Gray.

The ownership of Newco would be structured in a way that would allow certain of Gray's existing shareholders to retain exposure to further upside and would also enable executives to acquire equity. There would also be an allocation of equity to employees for a nominal consideration. Fund II acquired an effective equity stake of 24.5% of Newco; employees received 15%, with the balance of 60.5% going to certain existing shareholders and the management team.

A significant component of Brait's Fund II was based offshore. Thus, if Gray wanted to expand overseas through acquisitions, it would be possible to raise capital from the offshore component of Fund II and through access to Fund II's offshore investor base. The transaction structure also proved to be tax effective due to a mismatch on the deductibility of interest paid on the loans by Gray and the taxation on the interest received by the providers of the loans.

Aubin and Gray's other shareholders agreed to the restructuring, which was carried out on August 30, 1997. As anticipated, Gray's vigorous cash flows enabled it to service its debt obligations, and the company maintained its level of annual growth. Aubin felt, however, that the restructuring was only the first step necessary toward positioning Gray for the long-term future.

Looking to the Future

Despite his success to date, Aubin felt more needed to be done:

I am concerned about globalization. International companies are trying to cut back on their number of suppliers, especially in noncore activities like security, so there is an increasing trend toward regional or global contracts. South African Breweries recently asked us if we could provide security for their brewery in Poland. The poor company [that had been providing security previously] didn't know what hit them. I don't want to find Gray in the reverse situation.

If we manage it right, globalization can really work for us, because our reputation will help us compete for these big contracts and make us an attractive partner for other firms. In the aviation industry, for example, we have a reputation for being very reliable. Gray guards 97% of all foreign airlines flying into South Africa. That's a strong position to be in.

Gray had expanded outside South Africa with the acquisition of Imperial Security Services in the United Kingdom in September 1998, as well as organic ventures elsewhere in Europe. More recently, Gray had sent one of its senior managers to the United States to develop business there. "The guy who went to the United States prepared for nine months to go there," Aubin explained. Gray hoped

¹¹ Details, such as the final purchase price and consequent shareholdings, would be finalized after negotiation between the parties.

through organic expansion or strategic acquisition to be able to transform itself from a regional power to a global competitor.

One step Aubin was considering was an initial public offering (IPO) of Gray Security shares on the South African stock exchange (see Exhibit 14 for stock exchange data). There were several strategic advantages to doing so, he explained:

An IPO would probably be a good idea even without the need to grow globally. It would provide our employee shareholders with liquidity and would also be an ideal opportunity to bring in a good black empowerment partner. But globalization is what makes it particularly attractive. Public companies are more transparent, which enhances their credibility with certain clients. For example, their credibility would be enhanced with the central bank, which would improve Gray's prospects of getting central bank approval to acquire offshore entities.¹² As a public company we would also be in a position to acquire another public company abroad, through a share exchange, and might then be able to raise capital abroad.

Gray had retained the investment banker Merrill Lynch to examine the prospects of a local IPO. A Merrill Lynch analyst had prepared earnings estimates for Gray over the next few years and a table of comparable companies that investors might use to value Gray during an IPO (see Exhibits 15 through 17).

Aubin knew, however, that an IPO in and of itself would do only so much to position Gray as a global firm. It was not clear how strong a currency rand-denominated equity would be in acquiring firms with hard-currency earnings. Moreover, there were larger firms already beginning to acquire smaller players.

Aubin smiled as he completed the walk back to his office and closed the door behind him. Gray's journey over the past years had not been easy, but he and his team had succeeded through a clear strategic vision and hard work. The problems to come were of a somewhat different nature. The direction and financing of growth was going to be a bigger challenge than ever.

¹² In January 1999, the South African Central Bank maintained strict exchange controls. This meant that Gray had to seek approval for any investment abroad or any transfer of funds to offshore destinations. While a very small number of South African firms, including conglomerate Anglo American Corporation, were considering listing their shares on stock exchanges abroad, gaining approval for a similar move would have been very difficult for a small firm like Gray.

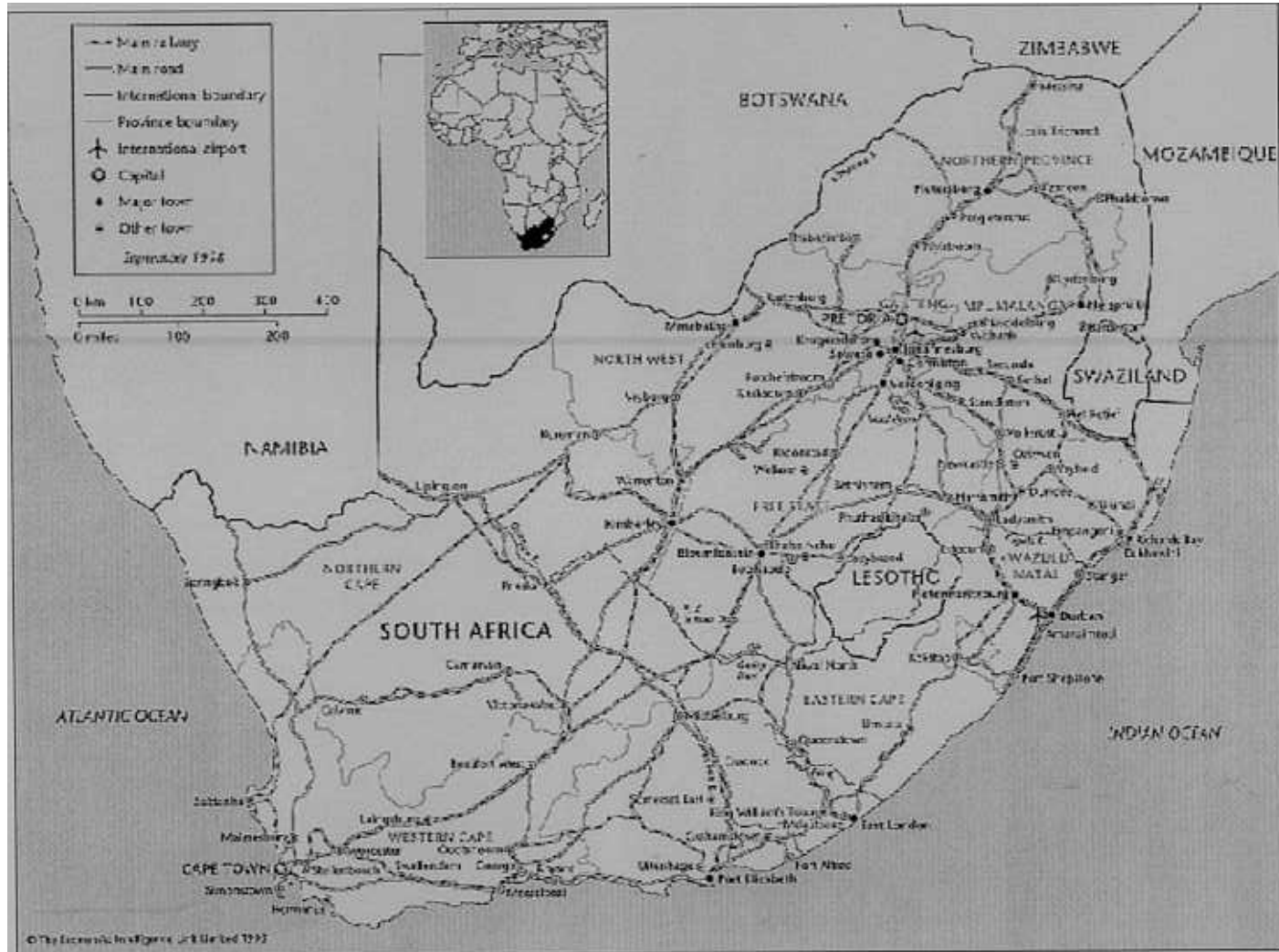
Exhibit 1 Interest and Exchange Rate Data

	1994				1995				1996				1997				1998			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
South African Rand : U.S. dollar (end of quarter)	3.4795	3.6515	3.5645	3.5435	3.5905	3.6365	3.6495	3.6475	3.9805	4.3345	4.5300	4.6825	4.4225	4.5305	4.6615	4.8675	5.0345	5.8665	5.8725	5.8600
South African prime lending rate (repo)	15.25	15.25	15.58	16.25	17.08	17.50	18.50	18.50	18.50	20.17	19.50	19.92	20.25	20.25	20.25	19.25	18.92	19.58	25.00	23.67
South African Treasury bill rate	10.15	10.64	10.78	12.15	12.87	13.50	13.95	13.80	14.03	15.32	15.39	15.40	15.94	15.64	14.86	14.59	13.89	13.99	20.12	18.14
U.S. Treasury bill note	3.52	4.18	4.64	5.64	5.73	5.50	5.26	5.16	4.96	5.11	5.15	4.87	5.14	4.92	4.97	5.16	5.03	4.99	4.74	4.42

Source: Compiled from IMF, *International Financial Statistics* data.

Note: At the time of the case, 20-year U.S. Government Bonds had a yield of 5.4%. A US dollar bond issued by the South African Government maturing in 2017 yielded 11.7%.

Exhibit 2 Map of South Africa



Source: EIU Country Profile of South Africa 1998-99. London: Economist Intelligence Unit. 1998. Preface.

Exhibit 3 Economic Statistics

South African Economic Data	1994	1995	1996	1997	1998 ^a
GDP at market prices (R bn)	431.1	484.6	542.7	594.9	637.7 ^b
Real GDP growth (%)	2.7	3.4	3.2	1.7	0.1 ^b
Consumer price inflation (year-end %)	9.0	8.6	7.4	8.5	6.5
Current account (\$ bn)	(0.32)	(2.76)	(1.71)	(1.93)	(2.36)
Total external debt (\$ bn)	18.7	22.3	23.6	24.3	25.7
Debt-service ratio, paid (%)	8.9	8.7	10.6	10.7	10.5
Exchange rate (Avg. R:\$)	3.549	3.627	4.271	4.603	5.530

Source: Compiled from Economist Intelligence Unit data

^aActual.

^bEIU estimates.

Comparative Economic Indicators

(1997 unless otherwise indicated)	South Africa	Zimbabwe	Nigeria	Brazil	United Kingdom	United States
Gross domestic product (\$ bn)	129.3	8.5	37.5 ^a	806.4	1,288.2	8,110.9
GDP per capita (\$)	3,340	733	356	5,048	21,848	30,263
Consumer price inflation (%)	8.5	18.9	8.5	6.4	2.8	2.4
Merchandise exports fob (\$ bn)	30.4	2.3	15.6	53.0	279.3	680.3
Merchandise imports fob (\$ bn)	28.4	2.4	8.2	61.4	299.8	877.3
Foreign direct investment (% GDP 1996)	0.1	0.1	4.3	1.3	2.8	1.0
Net aid flows (% GDP 1996)	0.3	5.2	0.6	0.1	(b)	(b)
Electrical power						
Per capita (Kwh 1996)	3,719	765	85	1,660	5,198	11,796
Production CAGR (% 1980-1996)	3.9	6.0	5.6	4.6	1.3	3.0
Paved roads (% total 1996)	41.5	47.4	18.8	9.3	100.0	60.8
Adult illiteracy (%)	16.0	15.0 ^c	43.0	16.7		
Life expectancy (years 1996)	65	56	53	67	77	77
Population (m)	41.5	11.2	111.7	159.0	58.1	267.1
Population growth (% 1990-1996)	1.7	2.4	2.9	1.4	0.3	1.0
Telephone mainlines						
Per 1,000 people	107	17		107	540	644
In largest city (per 1,000 people)	415				--	
Burglary (per 1,000 homes)	1.5 ^d				23.1	44.6
Homicide (per 100,000 people)	59.2				1.4 ^d	7.4

Source: Data compiled from "1999 World Development Indicators" and "1998 Atlas," World Bank; Economist Intelligence Unit; African Development Bank; U.S. National Center for Health Statistics, Vital Statistics; U.S. Bureau of Justice; Criminal Statistics, England and Wales 1997; the U.K. Home Office.

^aAt the 1997 average autonomous exchange rate (R83.5:\$1).

^bNet aid donor.

^c1995.

^dEngland and Wales only.

^eStatistics given come from the South African police. However, the vast majority of the population of South Africa live in squatter camps and tenement housing developments, and the probability that every break-in will be reported is extremely low. In addition, the deterioration of the level of service of the SAPS is so marked that unless there is an insurance claim possibility, it is also unlikely that the more affluent population will report every break-in.

Exhibit 4 Recent Exchange Rate History

1995	"On March 10, the financial rand was abolished." ^a
February 1996	"On February 16 [the] rand suffered its most turbulent day since the 1994 general election following unfounded rumors that the president, Nelson Mandela, was ill and that exchange controls were about to be eased further.
February–March 1996	"A sequence of other political and economic rumors, combined with concrete events such as the resignation of the finance minister, [. . .] buffeted the currency in the months that followed. From steady levels of around R3.65:\$1 seen during most of 1995, the rand fell to R4:\$1 in March 1996."
Late 1996	"Brief rallies were followed by fresh plunges; by mid-December 1996 the currency was trading at slightly over R4.7:\$1 and lost nearly 30% of its value against the dollar in 1996." "The currency declined only slightly between November 1996 and March 1997 but experienced renewed volatility owing to contagion effects from the Southeast Asian markets crisis, to trade at close to R4.90:\$1 in December 1997."
July 1998	"The value of the rand plummeted to its lowest level of R6.75:\$1 on July 6 1998 when the financial markets reacted negatively to the appointment of Tito Mboweni as the governor-designate of [. . .] the central bank."
September 1998	"[The rand] recovered to R6.05:\$1 at the end of September. A 6-percentage-point rise in the prime lending rate to 24% in June and July helped to stabilize the rand [. . .]."

Source: Quoted text, including footnote, from *EIU Country Profile South Africa 1998–99*. London: Economist Intelligence Unit, 1998. pp. 40–41.

^a"[The financial rand was] a second-tier currency, available only to foreigners, which traded at a discount to the commercial rand and was used for all conventional balance-of-payments transactions, thereby insulating the country's foreign reserves from politically inspired capital flight."

Exhibit 5 Recent Capital Flow History

1984–1993	Substantial short-term capital outflows—country net capital exporter. Reasons include international sanctions and related disinvestment, as well as the unilateral declaration by the central bank [. . .] “of a debt standstill in 1985 in response to a perceived external debt crisis.”
1994–1995	Dramatic turnaround in flows after the 1994 election of Mandela. Net capital inflow of \$1.8 billion in 1994 and \$1.9 billion in 1995.
1996	“[Net capital inflows slow sharply] as much of this short-term investment left the country with the plunge of the rand.”
1997	Capital inflows rise to record levels as the SARB lifts exchange rate controls for nonresidents in July, thus enabling the future repatriation of profits and capital.
1998	Capital inflows affected by the emerging-market crisis and the rand crisis in June.

Source: Quoted text from *EIU Country Profile South Africa 1998–99*. London: Economist Intelligence Unit, 1998. p. 39.

Exhibit 6 Foreign Reserve Information

(\$ millions; end-period)	1994	1995	1996	1997	1998
SDRs	1	5	1	7	132
Foreign exchange	1,684	2,815	940	4,790	4,171
Total reserves excluding gold	1,685	2,820	942	4,799	4,357
Gold ^a	1,212	1,229	1,261	1,048	1,034
Total reserves including gold	2,897	4,049	2,203	5,847	5,391

Source: Compiled from Economist Intelligence Unit data and IMF, *International Financial Statistics* data

^aValued at 75% of the fourth-quarter London gold price.

Exhibit 7 Management Resumes**Chairman—Richard Aubin (52)**

Aubin attained a B Bus Sc degree with Honors at the University of Cape Town. He joined the engineering industry and was employed by Hubert Davies and Co. where he was appointed the Director and Executive Chairman of five subsidiary companies. In 1980 he joined Abercom Group and became a director of Abercom Group and the Deputy Chairman and Managing Director of Constant Engineering. During 1984 he left Abercom Group to join Gray as the Chairman. Aubin is one of the founding shareholders of Gray.

Deputy Chairman—Chris Convery (53)

Convery initially obtained a B.Sc (Maths) degree at the University of the Witwatersrand. He spent a few years in the insurance industry before moving to Deloitte Haskins & Sells, and qualified as a Chartered Accountant in 1976. He served as a manager after qualifying and was involved with liquidation and judicial management work for two years. He spent a period in International Commodity Trading (Raphaely's) before joining Consani Engineering as the Financial Director.

Convery is one of the founding shareholders of Gray and joined Gray on a full-time basis in 1983, with responsibility for its finance and administration. At different times he has acted in a wide spectrum of responsibilities. He was seconded to Imperial Security Services for four years in London (1991-1994).

Chief Executive Officer—David Plane (49)

Plane completed a Business Management Diploma and attended the Program for Management Development and Advancement Management Program at the University of Cape Town Graduate School of Business. While employed in the marketing and contracting field, Plane became a director of three companies in the Protea Holdings/Malbak group. As a citizen force soldier he attained the rank of Lieutenant-Colonel and commanded the Cape Town Highlanders Regiment from 1970 to 1983. Plane became involved in the contract security industry 12 years ago and has been with Gray for nine years.

Executive Director—Paul Bell (52)

Bell completed his BA (Maths/Economics) and BAI (Engineering) at Trinity College Dublin in 1971. The majority of Paul's working career has been spent in heavy engineering and construction, initially with the Dorbyl Group and subsequently with Genrec Holdings and Murray & Roberts. He served on the boards of Murray & Roberts Engineering Holdings and Genrec Holdings, and was Chairman of Elgin Engineering, Alloywheels International, Consani Engineering and Gentec.

Bell joined Gray in June 1998 and became involved with setting up project management systems for the electronics division of the company. He is currently an executive director of the company with responsibility for the United Kingdom and European operations.

Executive Director—Alex De Witt (43)

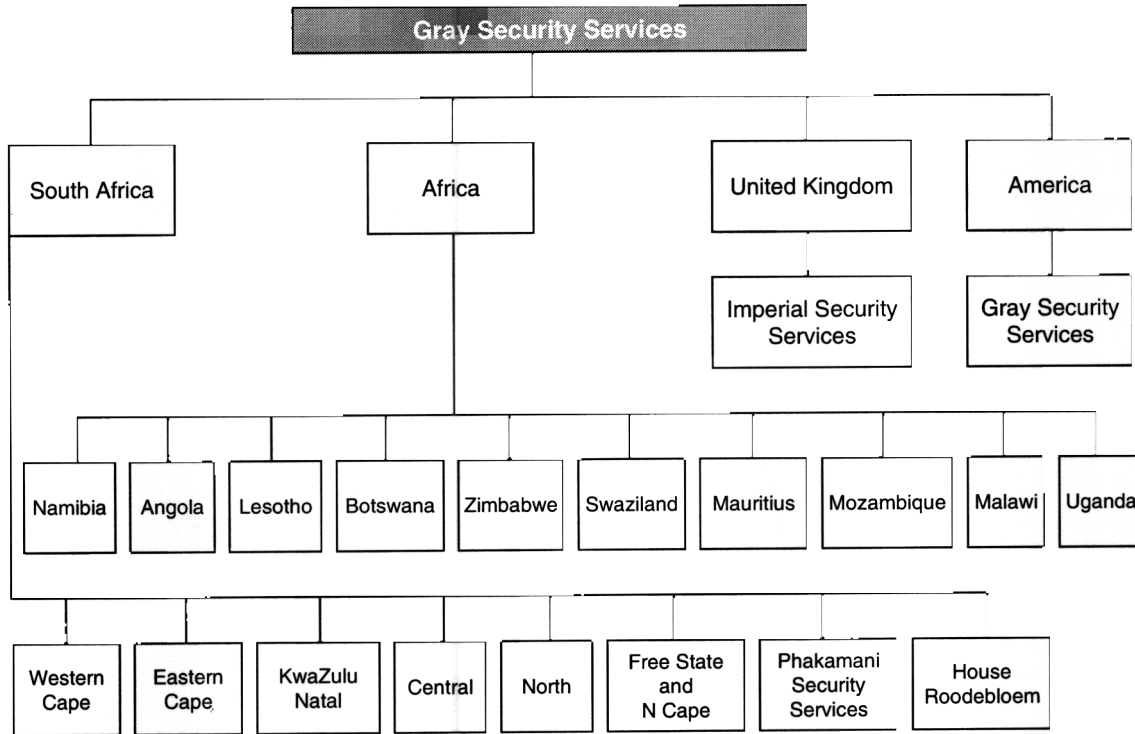
De Witt has completed several management courses. He joined the South African Defense Force in 1978, leaving in 1991 with the rank of Lieutenant-Colonel. De Witt joined Gray in 1991, initially as regional manager and subsequently as the Managing Director of Gray Security Services (North) (Proprietary) Limited. He was a serving member of the Guarding Advisory Committee of the Security Officers' Board. He is currently an executive director of Gray, responsible for operations in Africa outside of South Africa's borders.

Executive Director—Fanie De Witt (42)

De Witt was the Commanding Officer of the Citizen Force Tank Regiment, Prince Alfred's Guard from 1987 to 1993 and holds the rank of Lieutenant-Colonel. De Witt joined Distillers Corporation in Port Elizabeth in June 1984 and was subsequently promoted to National Product Manager at Distillers Corporation head office. He has completed several management courses including the Programme for Management Development at the University of Stellenbosch. He joined Gray in November 1991 and established Gray in the Eastern Cape. De Witt became an executive director of Gray, with responsibility for the three coastal companies in the group. He currently is the Executive Director responsible for new business development in the Americas.

Source: Gray Security

Exhibit 8 Organizational Chart



Source: Gray Security.

Note: Headcount—16,000 guards worldwide (including 1,000 at Imperial Security).

Exhibit 9 Training at Gray Security

The foundation for a successful career with Gray Security Services rests on a balance between integrating new recruits within a team, whilst encouraging individual initiative.

Gray has more training centres than any other security company in Africa. Furthermore, great emphasis is placed on ensuring that the training Gray personnel receive remains relevant to Clients' needs.

All recruits undergo a basic training programme covering practical aspects of security. Prior to the commencement of duties, candidates are familiarised with the specific requirements of the site to which they will be assigned. Formal induction training is mandatory for all Security Officers arriving on site for the first time. On-the-job training is conducted by Supervisors and Managers.

On site, Gray recruits display the confident, courteous but firm manner required to command respect and co-operation.



Basic Training Curriculum

- Access control
- Loss control
- Communications
- Emergency procedures
- Legal powers of arrest and search
- First-aid
- Safety
- Fires
- Records
- Reports
- Alarm systems
- Self-defence
- Criminal tactics
- Equipment identification
- Public relations
- Junior leadership

Industry Specific Training

- Hotel & Leisure
- Gaming
- Retail
- Mining
- Petro-chemical
- Aviation

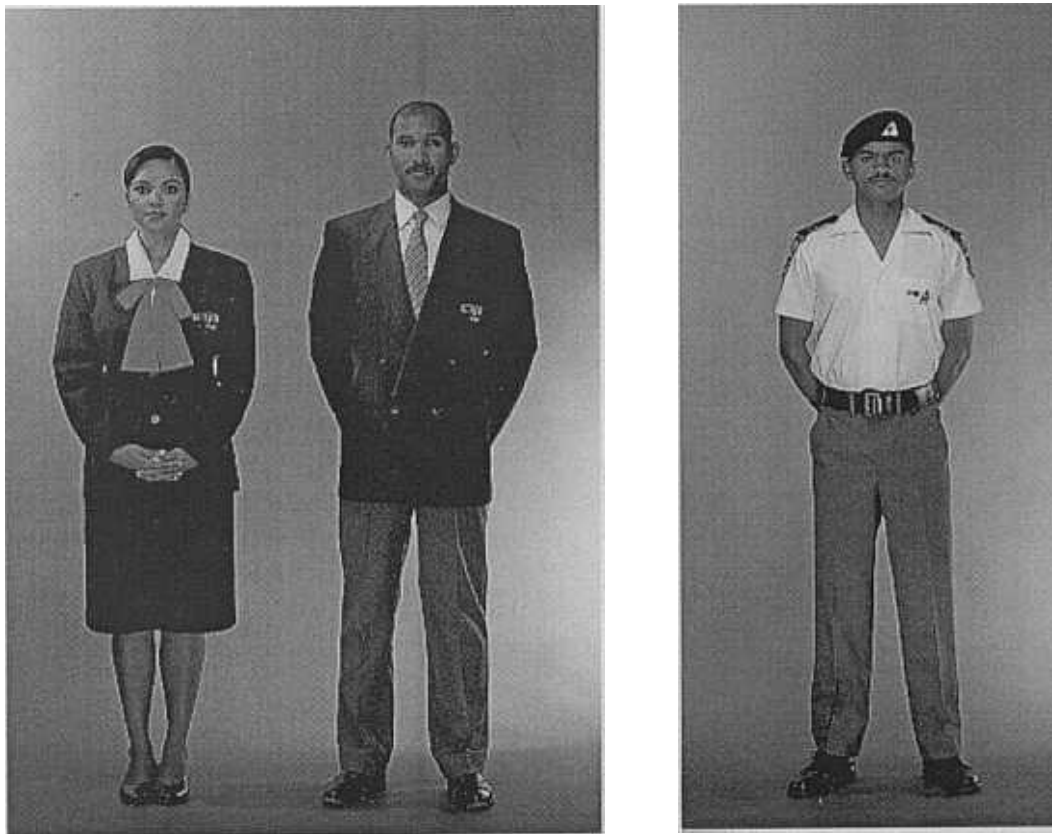
Qualified instructors ensure that the highest standards of training are being maintained

Source: Gray Security.

Exhibit 10 Gray Security Uniforms

Gray Security Services' uniforms are designed in accordance with varying environments. Clients are consulted on their individual preferences. This varies from corporate apparel to utility uniforms.

Gray is synonymous with smart, identifiable uniforms which portray a professional, rather than a militaristic, appearance.



Gray Security Services personnel in corporate uniform (left) and the utility uniform (right).

Source: Gray Security.

Exhibit 11 Profit History and Forecast (R'000)

	Profit Forecast for Year Ending 31 August 1999	Year Ended 31 August 1998	Years Ended Last Day of February			
			1997	1996	1995	1994
Turnover	517,063	425,917	304,434	215,353	163,490	128,860
Operating income before interest	46,289	32,927	16,655	6,747	6,636	4,312
Interest paid	15,771	25,509	1,778	1,807	1,292	719
Shareholders' loans ^a	12,671	23,202	--	--	--	--
Other	3,100	2,307	1,778	1,807	1,292	719
Net income before taxation	30,518	7,418	14,877	4,940	5,344	3,593
Taxation	(10,681)	(1,994)	(5,888)	(1,706)	(3,231)	(1,085)
Attributable earnings	19,837	5,424	8,989	3,234	2,113	2,508

Source: Gray Security.

^aThe Gray group achieved significant growth in turnover and operating income before interest paid over the last three years. Despite this fact, the Gray group reported a substantially lower attributable earnings for the year ended 31 August 1998. This was solely due to the financial restructuring which took place during August 1997 which resulted in an interest charge of R23,202 million on shareholders' loans for the year ended 31 August 1998 and results in an interest charge of R12,671 million on shareholders' loans for the year ending 31 August 1999. In terms of this restructuring, structured loan agreements were entered into on 1 September 1997 between Gray and certain of its shareholders, to the value of R124 million. In order to present comparable results, the attributable earnings for the year ended 31 August 1998 and the year ending 31 August 1999 have been adjusted to represent the earnings that would have been generated by the group (i.e., absent higher interest charges) had the restructuring not taken place.

Exhibit 12 Balance Sheet (R'000)

31 August 1998^a	
Capital Employed	
Share capital	54,104
Distributable reserves	<u>4,993</u>
Shareholders' equity	59,097
Long-term liabilities and loans	<u>111,722</u>
	<u>170,819</u>
Employment of Capital	
Property, plant and equipment	25,069
Goodwill ^b	159,066
Deferred taxation	4,345
Trademark	34,289
Net current liabilities	(51,950)
Current assets	<u>31,886</u>
Inventories	312
Accounts receivable	22,752
Funds on call	7,200
Bank balances and cash	<u>1,622</u>
Current liabilities	83,836
Accounts payable	73,077
Taxation	5,902
Bank overdraft	<u>4,857</u>
	<u>170,819</u>

Source: Gray Security.

^aDue to massive restructuring, prior year balance sheets were not comparable.

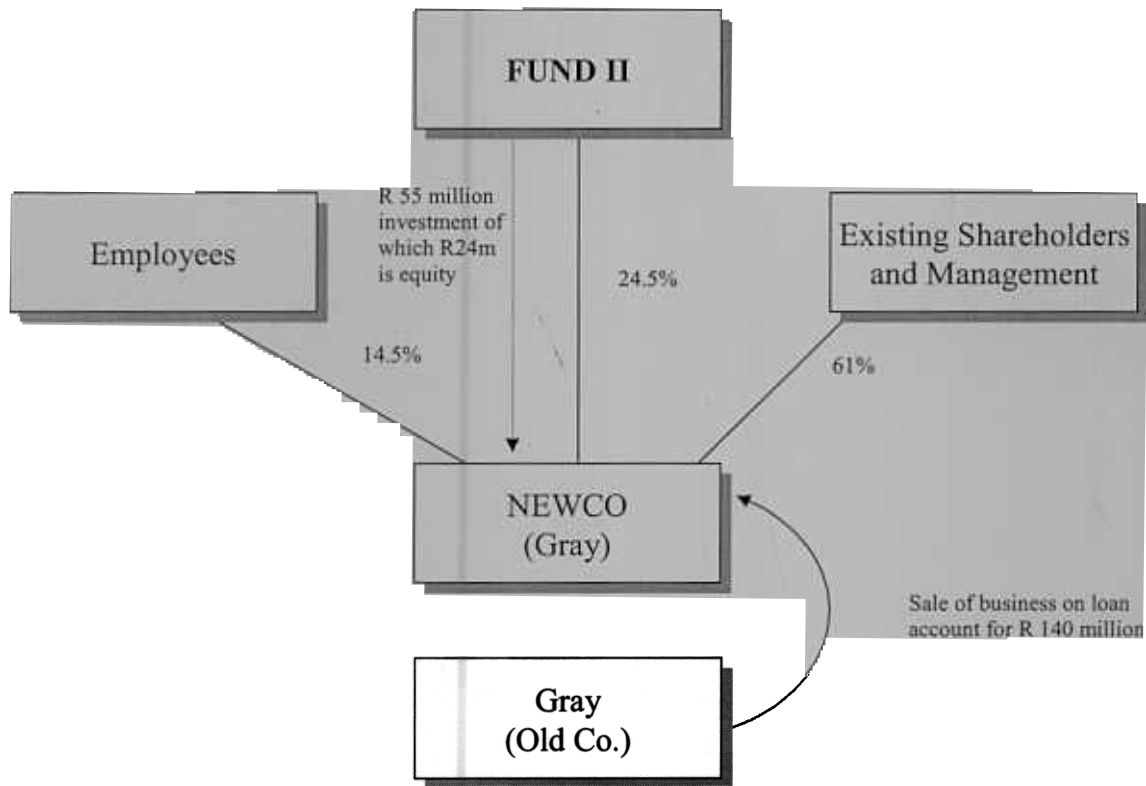
^bIt was anticipated that goodwill would be depreciated over 30 years. This depreciation would have *no* tax effects.

Exhibit 12 (continued) Cash Flow Statement for the Year Ended 31 August 1998 (R'000)

	Group 1998
Cash Flows from Operating Activities	
Cash generated from operations	84,796
Interest received	2,067
Dividends received	--
Interest paid	(25,226)
Taxation paid	(83)
Cash Flows Expended on Investment Activities	(214,893)
Additions to property, plant and equipment	(20,369)
Acquisition of goodwill	(104,968)
Acquisition of trademarks	(34,289)
Proceeds on disposal of property, plant and equipment	1,714
Acquisition of subsidiaries	(58,103)
Increase in loans to subsidiary companies	--
Interest in joint ventures	1,122
Increase in loans from joint venture companies	--
Cash Flows from Financing Activities	157,304
Proceeds on issue of share capital and share premium	54,104
Increase in long-term liabilities	660
Increase in long-term portion of shareholders' loans	102,540
Cash and Cash Equivalents at End of Year	<u>3,965</u>
Total Cash and Cash Equivalents Comprise:	
Funds on call	7,200
Bank balances and cash	1,622
Bank overdrafts	<u>(4,857)</u>
Total Cash and Cash Equivalents	<u>3,965</u>

Source: Gray Security.

Exhibit 13 Structure of the Gray Group after the Brait Investment



Source: Gray Security

Note: The interest rate on the loan was 22%, the South African banking prime lending rate (the lowest interest rate charged to AAA corporate clients).

Exhibit 14 Data on the Johannesburg Stock Exchange

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Number of companies listed	781	740	683	647	639	638	626	642	668
Total Market Capitalization (US\$ million), year-end	167,311	190,074	164,631	220,869	252,450	258,620	266,235	245,072	178,525
JSE All Share Index	2,719.74	3,440.30	3,258.80	4,893.00	5,866.90	6,228.40	6,657.53	6,202.31	5,433.22
Total Market P/E Multiple	9.35	12.64	12.61	18.28	18.90	16.60	15.00	16.90	n/a

Source: Data compiled from "Guide to World Equity Markets," Salomon Smith Barney, 1998; "World Stock Exchange Factbook," 1994/1995, 1998; Johannesburg Stock Exchange, www.jse.co.za.

Exhibit 15 Analysis of Main Competitors

Gray has three significant competitors. They are Fidelity Guards, Coin Security and Springbok Patrols.

Fidelity Guards is a private equity investment of Corvest which is controlled by Rand Merchant Bank. It offers a range of security services from cash-in-transit protection through to contract guarding. They enjoy a solid reputation and are Gray's most serious competitor. Fidelity is diversified, offering security services such as cash-in-transit protection, armed response and contract security. Consequently, it is not considered by Gray to be a significant threat.

Coin Security is organized and run as a para-military organization. Many of its staff are housed in barrack-type accommodations which has allowed labor dissatisfaction to foment. In December 1994 there was a violent incident of labor unrest at one of Coin's hostels. Coin has a high profile in the cash-in-transit market but is not able to effectively compete in high-quality service provision in the contract security market, as it is said to be losing focus. Coin appears to be losing market share in the contract security market.

Springbok Patrols are at the bottom end of the market. It has a poor reputation, particularly for its alleged abusive labor practices. It is able to offer guards at a low cost but with limited service. Gray does not consider Springbok to be a serious competitor at its end of the market. A substantial portion of Springbok Patrols has recently been sold to DLJ's South Africa fund.

There are no security companies listed on the Johannesburg Stock Exchange that are directly comparable to Gray. The sentry security/armed division of Klipton focuses primarily on the provision of domestic security.

Source: Brait Capital Partners.

Exhibit 16a Valuation Comparisons: Local Firms

Company	Share Price (R)	Equity Beta	FY1998 EPS	FY1999 EPS	Historic P/E	Forward P/E	Market Cap ZARm	Long-Term Debt ZARm	D/(D+E)	Security Earnings	Guarding Earnings
Super Group	1,170	1.14	5.23	71	22.4x	16.5x	3,471	367.9	9.6%	15%	1%
Servest	250	0.73	9.6	15	26.0x	16.7x	280	6.9	2.4	40	15
Bidvest	4,640	0.99	185.6	270	25.0x	17.2x	13,019	35.0	0.3	1	1
Klipton	630	0.70	55.3	66	11.4x	9.5x	228	21.2	8.5	95	5
Paramed	325	NA	19.2	24	16.9x	13.5x	167	7.4	4.2	90	10
Average					20.3x	14.7x			5.0		
Gray Security										100%	100%

Source: Compiled from I-Net consensus estimates, Merrill Lynch estimates.

Note: Since there were no listed companies that were directly comparable to Gray, the companies above were used by Merrill Lynch. As a matter of reference, Super Group was a transportation company, Servest was a diversified services company, Bidvest was a conglomerate, and both Klipton and Paramed's operations were mainly in the personal security industry.

type

	Market Cap (12/31/98)	LT Debt £m 12/31/98	D/(D+E) 12/31/98	Equity Beta	Year End	Pretax £m	Tax %	EPS p	P/E	Net Div p	Yield	EPS Growth	EV/ Sales	EV/ EBITDA
AEA* (AETAF)	561	33.0	0.7%	1.06	31/03/98	29.0	31	23.5	28.6	9.6	1.40%	19.90%	2.0	19
B-4-3-7 Reduce /q/					31/03/99E	33.7	32	26.9	25.0	10.75	1.6	14.5	1.7	13.5
					31/03/00E	38.2	32	31.1	21.6	12.0	1.8	15.6	1.6	11.4
	673p				31/03/01E	42.7	32	34.0	19.8	13.2	2.0	9.3	1.4	10.6
Aggreko* (ARGKF)	480	97.8	16.9%	0.71	31/03/97	33.4	39	7.9	23.3	3.5	1.9	3.8	3.4	7.8
					31/12/97	33.2	35	8.2	22.4	3.8	2.1	3.8	3.4	7.8
					31/12/98E	37.0	37	8.9	20.7	4.0	2.2	8.5	3.3	7.1
C-1-2-7 Buy /q/	184p				31/12/99E	40.0	37	9.6	19.2	4.4	2.4	7.9	3.0	6.5
Alkins, W.S.* (WATKF)	454	3.0	0.7%	0.92	31/03/98	30.5	39	20.2	24.4	8.1	1.6	16.8	0.9	11.2
					31/03/99E	34.0	39	22.7	21.7	9.2	1.9	12.4	0.8	11.1
					31/03/00E	36.2	38	24.5	20.1	10.0	2.0	7.9	0.7	0.8
B-3-2-7 Neutral /q/	493p				31/03/01E	39.0	37	26.6	18.5	11.0	2.2	8.6	0.6	8.5
Bunzl 240* (BULNF)	1,078	117.3	9.8%	0.82	31/12/97	123.7	35	17.6	13.6	6.8	2.8	7.3	0.7	8.1
					31/12/98E	130.0	35	18.5	13.0	7.3	3.0	5.1	0.6	7.3
	240p				31/12/99E	136.0	35	19.1	12.6	7.8	3.3	3.2	0.6	6.8
Capita* (CTAGF)	969	0.2	0.0%	0.95	31/12/97	18.3	32	6.5	80.3	2.1	0.4	35.4	5.5	45.0
					31/12/98E	26.5	32	8.8	59.3	2.8	0.5	35.4	3.8	30.6
					31/12/99E	33.8	32	11.2	46.6	3.3	0.6	27.3	3.0	23.0
B-2-1-7 Accumulate /q/	522p				31/12/00	38.9	32	12.9	40.5	3.9	0.7	15.2	2.5	19.8
Davis Service* (DVSVF)	500	49.2	9.0%	0.91	31/12/97	44.3	32	21.9	16.5	11.3	3.11	15.5	1.4	4.5
					31/12/98E	53.0	32	26.0	13.9	12.5	3.5	18.6	1.4	4.2
					31/12/99E	56.0	32	27.5	13.1	13.7	3.8	5.8	1.4	3.9
B-1-2-7 Buy /q/	361p				31/12/00E	60.0	32	29.5	12.2	14.7	4.1	7.3	1.3	3.6
Hays* (HAYPF)	4,948	217.7	4.2%	1.01	30/06/98	201.2	28	17.0	343.1	5.35	0.9	28.9	3.3	19.9
					30/06/99E	233.5	29	19.5	29.6	6.15	1.1	15.0	2.8	17.3
					30/06/00E	262.0	29	21.6	26.8	7.08	1.2	10.8	2.4	15.4
A-3-2-7 Neutral /q/	578p				30/06/01E	294.5	30	24.0	24.1	8.13	1.4	11.1	2.1	13.9
Millie* (MTIGF)	195	5.2	2.6%	0.69	31/03/97	8.2	34	4.0	36.8	1.0	0.7	24.8	0.9	17.2
					31/03/98	11.1	32	5.1	28.8	1.25	0.9	27.5	0.8	12.4
					31/03/99E	14.0	32	6.3	23.3	1.5	1.0	23.5	0.7	9.6
B-2-2-7 Accumulate /q/	147p				31/03/00E	16.5	32	7.4	19.9	1.8	1.2	17.5	0.6	8.0
Rentokil* (RTOIF)	13,499	342.1	2.5%	1.00	31/12/97	417.0	29	10.3	45.8	3.06	0.6	20.7	4.8	23.3
					31/12/98E	496.0	30	12.2	38.9	3.64	0.8	17.9	4.6	20.0
					31/12/99E	586.0	30	14.2	33.3	4.37	0.9	16.7	4.2	17.4
B-2-2-7 Accumulate /q/	473p				31/12/00E	661.0	31	15.9	29.8	5.24	1.1	11.8	3.8	15.6
Sercor* (SRCPF)	735	49.0	6.3%	1.01	31/12/97	22.0	343	23.9	50.9	6.4	0.5	27.1	1.6	30.6
					31/12/98	26.5	31	28.8	42.3	7.4	0.6	20.5	1.3	26.9
					31/12/99E	30.5	32	33.9	35.9	8.5	0.7	17.7	1.1	20.2
B-3-2-7 Neutral /q/	1,217p				31/12/00	34.0	32	39.1	31.1	9.7	0.8	15.3	1.0	17.4
Williams* (WIHGF)	2,282	824.4	26.5%	0.73	31/12/96	243.0	34	23.5	13.4	13.4	4.8	11.0	1.4	8.0
					31/12/97	285.1	34	22.4	14.1	15.8	5.0	-4.7	1.5	8.6
					31/12/98E	306.0	34	23.2	13.6	16.5	5.2	3.6	1.4	7.3
B-3-2-7 Neutral /q/	316p				31/12/99E	306.0	34	24.5	12.9	17.2	5.4	5.6	1.4	7.3
Market Average (FT Non-financials)			7.6%		31/12/97				22.0		2.20%	6.00%		
Estimates based on ML Analysts Forecasts					31/12/98E				22.0		2.4	0.0		
					31/12/99E				20.7		2.6	6.0		
					31/12/00E				19.2		2.8	8.0		

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Exhibit 17 Gray Earnings Forecast

	FY1998A	FY1999E	%Δ	FY2000E	%Δ	FY2001E	%Δ
Turnover	425	530	25	661	25	819	24
South Africa	350	412	18	494	20	593	20
Africa	23	53	130	69	30	90	30
United Kingdom/Other	52	65	25	98	50	137	40
Operating income before interest	33	47	42	60	28	76	26
South Africa	26	37	42	46	23	56	21
Africa	7	7	6	9	30	12	30
United Kingdom	0	2	NA	5	112	8	68
Interest paid/received	-26	-16	-37	1	NA	5	460
Net income before taxation	7	31	314	61	99	81	32
Taxation	2	11	428	18	74	24	32
Attributable earnings	5	20	272	43	112	56	32

Source: Compiled from Merrill Lynch, Worldscope, Bloomberg data.