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Crisis Looming? Consider a Turnaround Expert

Turnaround professional Howard Brod Brownstein explains what experts in his profession do, when they're most effective and some of the actions they typically take when a company is in dire straits.

When businesses get into unfamiliar waters, when outside forces threaten a company's profitability and even its existence, it's time to call the turnaround manager.

That call often comes from top financial executives. It's the financial executive who is usually the first to see problems ahead. He or she is responsible for charting the financial path, for budgeting the company's life-blood -- cash. All too often, the financial executive's nonfinancial colleagues are in denial, and it's the financial executive who must deliver the unwelcome message, "We need help."

Here is a brief description of what turnaround professionals do, when to call them and what they can do for your company.

The turnaround profession is several decades old, and consists of firms ranging from sole practitioners to whole departments of Big Five accounting firms. Some of the best turnaround firms are recognized in *Turnarounds & Workouts*, a publication of [The Beard Group](#), which publishes the "Top Twelve Turnaround Firms" annually.

Among the most prominent turnaround professionals are the 200-plus certified turnaround professionals (CTPs), who have demonstrated their career commitment to the turnaround profession. They have five or more years proven experience in turnaround management consulting, have undergone rigorous background and reference checks, and have passed a comprehensive exam covering management, finance, accounting and law.

CTPs are required to maintain their skills through a demanding continuing education requirement. And perhaps most importantly, they subscribe to a code of ethics that requires them to exercise independence, candor and confidentiality in all their client engagements.

True turnaround managers are not general-purpose management consultants, and financial executives should be careful of consulting firms that "dabble" in turnaround management. The turnaround professional is a specialist -- akin to a surgeon -- who focuses on the rapid analysis and treatment of business problems and, if possible, the early restoration of profitability.

In many cases, turnaround professionals act as advisors to a management team that remains in place. In these instances, the turnaround professional typically reports to the board of directors, with his or her daily contact being the CEO, COO or CFO. However, turnaround managers can also be hands-on interim officers of the client, sometimes referred to as "crisis managers." The role of the turnaround expert and the scope of his or her services, as well as how fees and expenses are handled, should be governed by a written engagement agreement that is reviewed by the client's counsel.

Turnaround managers are sometimes incorrectly depicted as solo John Wayne types. In actuality, the turnaround professional's first task is to assemble a turnaround team utilizing elements of the client's top management, as well as his or her own firm. But the image of the U.S. marshal of the Wild West is somewhat accurate, since the turnaround expert may have to weed out managers who are resistant to change.

The turnaround professional's next task is "situation analysis." He or she must confirm the company's viability by answering a series of questions: What core business(es) does the company have? Which are or could be profitable? What organizational and financial resources are necessary to sustain such viability and profitability? Are those resources available, either within or from outside the company?

The answers to these threshold questions result in a strategic decision: Either the problem can likely be fixed, or an exit must be found. Most experienced turnaround professionals prefer to formulate a turnaround strategy that will enable the company to survive and continue independently, not be forced to seek refuge in a sale, reorganization or liquidation. But turnaround professionals are not advocates; they will not recommend whatever plan management favors. Rather, they must be objective, and if an exit strategy is what is really needed, a turnaround professional will so advise the client.

A key tool used by turnaround professionals during the early stages of an engagement is a rolling cash flow projection. This is a bottoms-up forecast of cash sources formulated on a weekly basis, depicting the next 13 weeks of operations, and is typically updated every four weeks. A "base case" projection is initially constructed, showing the company's current trajectory.

All too often, this reveals that the business is on a "Thelma & Louise" course -- headed for an abyss and accelerating all the way; that is, running out of cash. The turnaround expert then builds various scenarios that take into account emergency actions that could effectively move the "wall" farther away by generating and conserving cash. The purpose of these actions is to buy precious time in order to determine and then effect the longer-term changes needed to restore profitability. The rolling cash flow projection becomes a "road map" by which course corrections are made continuously as information comes in. If the situation worsens, that can be recognized as early as possible.

A central role played by the turnaround expert is dealing effectively with the constituencies whose support is critical to the company's survival: lenders, suppliers, customers, employees, shareholders and even government regulators and tax authorities. While the company's relationships with some or all of these groups may have become strained, the turnaround professional can frequently persuade everyone that with the turnaround firm's help and their cooperation, the company has a reasonable chance to be once again the good borrower, customer, employer, supplier and taxpayer it once was.

The turnaround firm may be well-acquainted with these other constituencies and/or their counsel, and so these otherwise frustrated stakeholders will likely view the turnaround professional's arrival on the scene as a welcome move.

Once the business appears to be stabilizing and the key stakeholder groups are starting to support the process, attention can be given to business restructuring. How did we get into this fix? How can we prevent a recurrence? What changes do we have to make in order to restore profitability and sustainability, and what resources do we need to implement these changes?

If the above questions can be answered satisfactorily, then a turnaround should be achievable and the business may return to more normal operations. In many cases, refinancing will be necessary, such as where there has been "lender fatigue" and a fresh start with a new lender would benefit the company. Perhaps there has been an

equity infusion to bolster the capital structure. The company may have been streamlined and refocused on profitable activities. In fact, it may look like a once-shaggy poodle that has been to the dog groomer, but it will have survived.

Alternatively, an exit strategy may be required, and most turnaround professionals formulate one in every case as a contingency plan. Exit strategies might include a sale or merger of all or part of the business, technology transfer, bankruptcy reorganization or even a structured liquidation. While some turnaround professionals are qualified to act as financial advisor in selling the company -- e.g., a sale to a strategic buyer when the time frame is limited -- in many cases it is preferable to engage an investment banker who is experienced at marketing distressed companies.

If a sale is unlikely, a structured liquidation plan could permit maximum realization on the company's assets by completing work-in-process in an orderly way, shutting down and selling off facilities sequentially according to a plan and maintaining the sale value of intellectual property, brand names, customer lists, etc.

Bankruptcy is a time-consuming and expensive process, and the statistics for successful reorganization of middle-market companies aren't promising. In the hands of an experienced turnaround expert and bankruptcy counsel, and with adequate planning, bankruptcy can be an effective sword rather than just a temporary shield. In any case where a company's survival is in jeopardy, analysis should be performed by a turnaround professional to determine whether bankruptcy might be an appropriate tool. Contingency planning, such as engagement and briefing of bankruptcy counsel, also should be done.

Back in the 1970s, when turnaround professionals first came onto the scene, they were sometimes called "workout" firms, named after the workout departments of banks that handled troubled borrowers and required them to "get help -- or else." While lenders are still a referral source, turnaround managers are increasingly introduced to their clients through equity and venture firms, attorneys and key suppliers. The failed roll-ups and leveraged buyouts of the 1990s have become typical candidates for restructuring, recapitalization and reorganization.

Some clients understandably but wrongly suppose that, since the turnaround firm may be introduced by a lender or investor, its allegiance lies other than with the client. This is where the code of ethics to which CTPs subscribe can provide reassurance, since it requires professionals to exercise independent judgment and avoid conflicts of interest. Many managers also presume that turnaround professionals' only approach is to cut costs, and especially to reduce headcount, à la "Chainsaw Al" Dunlap. While a "zero-based budgeting" analysis of a business can result in elimination of unprofitable or unnecessary activities, it is actually often necessary to increase headcount to effect a turnaround, such as when the sales effort needs strengthening.

How do you know when to call a turnaround professional? What are the danger signs? Here is a partial list to which financial executives should be alert. Remember -- these are the same signals that your lenders are watching for!

- Delayed or restated financial statements
- Operating losses
- Need for covenant waivers
- "Stretched" accounts payable
- Slippage in accounts receivable average DSO
- Increases in accounts receivable "dilution" -- credits, returns and adjustments

- Need to revise plans and projections, especially if this occurs more than once
- "Hockey stick" forecasts by sales department
- Erosion of order backlog/contract balances
- Excessive management turnover
- Glitches in computer system installations/conversions

Finally, where do you find a good turnaround professional, and how do you select the right one? A good place to start is the [Association of Certified Turnaround Professionals](#). Speak to a few firms and ask them for references. Ask for recommendations from your law firm. And - as surprising as this might seem -- keep your lender advised and don't be shy about asking it for recommendations. Your lender will likely be more supportive if it sees you being proactive.

All too often, senior managers are in denial -- unwilling to acknowledge problems, or even if they do, unwilling to ask for or accept outside help. Like the serious medical conditions with which business problems are often compared, a key to recovery is to get help early. The turnaround professional's chances for a successful turnaround go up dramatically if he is called in before the lenders, creditors or investors require management to do so. When turnaround experts are called in only when the company is running out of cash, the tools at their disposal are far more limited.

The financial executive's disciplined and objective viewpoint can be critical to the turnaround process right from the outset. Financial executives must have the courage to speak out, identify danger and ask for outside help, even if they risk being viewed as the only person on the ship who is able to see the rocks ahead.

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