

ABLs & Turnaround Professionals: Working Together to Create Liquidity and Provide Value

Asset-based lenders and turnaround professionals work together to create liquidity and value for companies "in transition". Both are important factors in the corporate renewal process, and so an understanding of what turnaround professionals expect should prove useful to success in asset-based lending.

By Howard Brod Brownstein, Contributing Editor

Articles abound covering how to select a turnaround manager, and the factors that asset-based lenders should consider when recommending names of turnaround consultants to a borrower.¹ And every ABL portfolio or credit officer keeps close at hand her "short list" of turnaround advisors that have demonstrated a strong track record for rapid situational assessment, identification of strategic alternatives, versatility in both non-bankruptcy and bankruptcy advisory and managerial roles, and — most of all — the ability to make change happen quickly.

But what do turnaround managers look for in an asset-based lender? While the turnaround professional is usually stuck temporarily with the lender with whom his client is probably in default or workout, there is frequently an effort to refinance as part of the turnaround plan. Refinancing is, as often as not, a move "down the lending food chain" from higher credit/lower cost to lower credit/higher cost, and this frequently means a move from a cash flow lender to an asset-based lender, or from a regulated, i.e., bank asset-based lender, to a non-regulated asset-based lender.

Therefore, turnaround professionals exert a strong influence over the placement of asset-based loans, and it is no wonder that the asset-based lending community is so visible at local and national meetings of the Turnaround Management Association. And prior to the refinancing, turnaround professionals have to deal with the existing lender — frequently an asset-based lender — on a day-to-day basis. Therefore, turnaround professionals definitely have opinions about how asset-based lenders can be supportive of the turnaround process.

The lender to the turnaround professional's client today is the replacement lender for a different client tomorrow. So how an asset-based lender handles its loans that are in turnaround mode, can affect whether that lender will see lending opportunities from turnaround professionals. At the top of the turnaround professional's list are those asset-based lenders that respond in moderation to the borrower's problems, are least likely to suffer from "lender fatigue", are consistent in the lending terms they apply, and provide leadership to their lender group participants.

Here are some observations shared by turnaround managers about asset-based lenders: The Good, The Bad, and the Unwilling to Advance Funds!

During the Turnaround Process

As noted, lenders regularly recommend several (e.g., 3 to 5) turnaround professionals to their borrowers. It is helpful if the lender advises the firms recommended as to who else is being interviewed, so that the firms can provide the prospective client with information to help it differ-

entiate among the firms and make an appropriate selection decision. Assuming that the professionals that are recommended are reputable firms and members of the Turnaround Management Association, they will not disparage each other in order to gain an assignment (see the TMA Code of Ethics Ethical Standard 3.5).

A lender should make it clear what it wants the borrower to get from engaging the turnaround professional, especially where the engagement is a condition of a forbearance agreement or other continued financial support by the lender. Is the lender requiring the borrower to engage a crisis manager or interim CEO or CFO, or just a turnaround advisor? What Scope of Work should be included in the engagement agreement? Will the turnaround professional be required by the lender, and permitted by the borrower-client, to interface directly — and perhaps privately — with the lender?

The lender should understand that the turnaround professional must remain independent (see TMA Code of Ethics Ethical Standard 2.2). While the turnaround professional is no doubt appreciative of her relationship with the lender, perhaps based upon referrals on other engagements, and also for the lender's confidence in including her on the list of firms recommended to this borrower, the professional's duty is to her client, not the lender. This duty includes, among other things, obligations of confidentiality that are provided for in the TMA Code of Ethics (E.S. 2.5) and also possibly in the engagement agreement. Indeed, the lender that seeks to improperly influence the turnaround professional in the performance of her duties, or carry on clandestine communications not authorized by the client, does so at its peril, risking lender liability and/or equitable subordination, as well as putting the professional in a position where she might have to resign, causing discontinuity in the turnaround process.

This does not mean that the turnaround professional should not seek to learn, on behalf of the client, everything she can about what the lender is thinking and what results the lender expects. The appearance and reality of candor by the turnaround professional in communicating directly and perhaps privately with the lender (with authorization by the client) can be helpful in winning the lender's support. And managing expectations of all parties is important to the turnaround process. But maintaining independence and objectivity, candor and truthfulness are key to successful turnaround management, and lenders should see such attributes as positive traits in a turnaround professional, even though it means accepting "bad news" or even some "pushback" by the borrower and its advisors in support of a plan that they feel is reasonable.

Note that the lender is free to engage its own turnaround advisor, especially when there are multiple lenders that may not all be regulated, may not all have the loan in workout, may not all have taken a write-off or reserve. Their views need to be harmonized so that the lender group can be effective, and an advisor can be critical to this process. An advisor engaged by the lender owes the same duties to her client that she would to a borrower.

Avoid “moving the goalposts”. There is an understandable need on the part of the lender to improve its position, whether through better loan documentation or lien position, tighter credit standards on future availability or extensions of credit, or requirements for reducing the outstanding loan. There should be a clear signal from the lender whether or not it wants to exit the credit. And there should be allowance for the lender to factor new information continually into its view of the borrower and continuing to provide financial support.

At the same time it is important to remember that the borrower’s business is like a community well, out of which all stakeholders must draw water. It is vital that no one mistake the well for another kind of receptacle. So daily “fire drills” and other shifting requirements by the lender that cause the borrower’s management and turnaround advisors to be consumed with responding to the lender instead of managing the business, are not beneficial to getting the lender repaid. Sometimes such actions are taken by the lender to “get the borrower’s attention”, however if the turnaround professional is reputable and one that has been recommended by or is acceptable to the lender, then the lender should seek to send simple, clear and unmistakable signals to the borrower: “Here is what the lender is willing to do, here are the terms. Absent a material change in circumstances, these terms will not change.” Then the turnaround professional can devote his time to managing or advising the client so as to meet lender’s requirements that are clearly understood and not a moving target.

Harvey Gross, executive director of the New York Institute of Credit, says that the lender should be consistent during a turnaround concerning points of loan structure, such as collateral eligibility requirements, cross-aging and concentration limitations, collateral sub-limits such as for inventory, etc. Once these are set at the outset of a forbearance or interim loan arrangement — even if there are changes from the pre-default structure — the lender should try not to keep tinkering with the terms.

Lenders will be glad to hear that turnaround professionals find the “discipline of debt” provided by the lender to be a useful tool in fomenting needed changes in the client’s business. Thomas D. Hays, III, CTP, a Principal in the author’s firm recommends that, once the forbearance or other interim arrangement has been reached and the turnaround professional engaged, the lender should continue to require the discipline inherent in the lending terms. That is, set reasonable terms, but don’t let up. Turnaround management is a process, not an event.

Refinancing

A quick “no” is always preferable to indecision or a slow “no”. The business development representatives of asset-based lenders sometimes seem to say “yes” to everything, just to get the deal flow. It is the turnaround professional’s responsibility to understand in advance the marketing “footprint” of leading asset-based lenders, so as not to waste the prospective lender’s or the borrower’s time by presenting loans that don’t “fit”. But it helps when the prospective lender declines the lending opportunity as soon as it is determined that the lender isn’t interested. Anu Singh, a Director at Huron Consulting Group, says he has more confidence in lenders that say “no” expeditiously, when they finally do say “yes” on a subsequent deal.

Similarly, a predictable and rapid process toward closing is invaluable in a turnaround situation. The current lender is dyspeptic and cranky, and wants to be replaced. If the replacement lender has gotten comfort-

able with the credit, then dragging the process out is usually detrimental to all parties. Delay in the name of unreasonably protracted due diligence can earn an asset-based lender the wrong sort of reputation.

Has anyone seen a binding loan commitment lately? Every lending proposal seems to begin with the words, “This is not a binding legal commitment...”. Sound underwriting notwithstanding, it is helpful to the refinancing process when the proposed lending terms do not “slide” unless there is clear basis for the change. Turnaround professionals can help by presenting a true picture of the prospective borrower, warts and all; lenders can help by making a realistic proposal on which they intend to close if at all possible.

Mr. Singh of Huron Consulting says he favors those asset-based lenders that send both a business development person as well as an underwriter to the initial meeting with the client, since he feels that those lenders are more likely to close on the terms originally proposed. In addition, he points out, the turnaround manager has to manage, in the interim, the expectations of the existing lender who’s being replaced, and it makes that process more difficult if the existing bank has been given one set of replacement financing terms, which then keep getting revised.

Pricing and structure are like Boyle’s Law of Gases: if you squeeze a balloon, the other end just juts out further. So getting concessions on structure can cause a rise in pricing, and vice versa. Turnaround professionals should submit a proposed term sheet with realistic pricing and structure terms to prospective lenders along with the request for financing, and these terms should be such that the borrower, given reasonable assumptions, can comfortably meet. Prospective lenders should respond candidly whether they can come close to meeting these terms, and avoid a ping-pong game of negotiation.

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ENDNOTE:

1 See, eg., “The Care and Feeding of Turnaround Managers”, *ABF Journal*, December, 2002, by the author.