

THE TRUTH ABOUT TURNAROUND PROFESSIONALS

By **Howard Brod Brownstein, CTP**,
principal, *NachmanHaysBrownstein, Inc.*

As a result of the dramatic changes that have reshaped our country's economy and the technological landscape, more companies are struggling with shrinking profits and greater losses. Many businesses fail to meet these challenges head-on, leaving many of them doomed to bankruptcy.

For faltering companies, an experienced turnaround consultant who complements the services and support of other professionals can make the difference between recovery and bankruptcy by devising short- and long-term solutions for financial problems.

The turnaround professional is a specialist who focuses on the rapid analysis and treatment of business problems and, whenever possible, the restoration of profitability. In many cases, turnaround professionals act as advisers to a management team that remains in place, typically reporting to the board of directors and working with a designated corporate officer contact, usually the CEO, COO, or CFO. In some situations the turnaround professional acts as an interim manager, such as chief restructuring officer. The profession began in the 1970s and currently ranges from sole practitioners to entire departments within larger accounting firms.

Although the popular image of a turnaround manager is that of a soloist, in actuality the turnaround professional's first task is to assemble a team composed of members of top management as well as the turnaround firm. The turnaround professional may have to confront individuals resistant to change.

The next task, a situation analysis directed at confirming the company's viability, is achieved by answering questions such as, What are the company's successful core businesses? Which core businesses are profitable? What organizational and financial resources are necessary to sustain such viability and prof-

itability? Are those resources available, either within or from outside the company?

The answers to these questions result in a strategic question: Can the problem be fixed or is an exit strategy needed? Most experienced turnaround professionals prefer to formulate a turnaround strategy that will enable the company to survive independently, rather than be sold, reorganized, or liquidated. But turnaround professionals must remain objective in spite of management pressure, and if an exit strategy is what is really needed, the turnaround professional should advise so.

Evaluating Future Prospects

A key tool that turnaround professionals use 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 typically updated every four weeks. A "base case" projection is initially constructed that shows the trajectory that the company is currently tracking. The rolling cash flow projection becomes a roadmap by which course corrections are made continuously as information unfolds. If the situation worsens, it can be recognized early.

The turnaround professional also plays a key role in dealing effectively with the constituencies whose support is critical to the company's survival: lenders, suppliers, customers, employees, shareholders, regulators, and tax authorities. Although the company's relationships with some or all of these groups may be strained, frequently the turnaround professional can persuade everyone that the company has a reasonable chance to reclaim its standing as a good borrower, customer, employer, supplier, and taxpayer. The mere fact that the turnaround professional is an outsider with no axe to grind often reassures constituencies and gains their support.

Once the business appears to be stabilizing and the key stakeholder groups support the process, the turnaround professional can attend to restructuring

the business. The following questions must be asked:

- How did we get into this situation?
- How can we prevent it from happening again?
- What changes must we make in order to restore profitability and sustainability?
- What resources do we need to implement these changes?

Satisfactory answers to these questions indicate that a turnaround is possible. Perhaps there has been an equity infusion to bolster the capital structure. The company may have been streamlined and refocused on profitable activities. If refinancing will be necessary, a fresh start with a new lender may help.

When There's No Way but Out

Some cases require the turnaround team to implement an exit strategy. Most turnaround professionals always formulate an exit strategy as a contingency plan. Exit strategies may include a sale or merger of all or part of the business, technology transfer, bankruptcy reorganization, or a structured liquidation. Although some turnaround professionals are qualified to act as financial advisers when selling the company, in many cases a better strategy is to engage an investment banker experienced at marketing distressed companies.

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

Bankruptcy is time-consuming and expensive, and the statistics on successful reorganizations of middle-market companies are not promising. With adequate planning by an experienced turnaround professional and bankruptcy counsel, bankruptcy can be an effective sword rather than just a temporary shield. Whenever a company's survival is in jeopardy, a turnaround professional should be called on to assess whether bankruptcy may be an appropriate tool and what contingency plan-

ning should be done, such as the engagement and briefing of bankruptcy counsel.

The Long Road Back

Many businesspeople wrongly suppose that turnaround professionals' only approach is to cut costs and reduce the workforce. While a zero-based budgeting analysis of a business may result in eliminating unprofitable or unnecessary activities, in fact it is often necessary to increase the number of employees in order to effect a turnaround (e.g., to strengthen the sales effort).

All CPAs and financial executives should track of the following danger signs, keeping in mind that lenders are on the constant lookout for the same signals:

- Delayed or restated financial statements
- Operating losses
- The need for covenant waivers
- "Stretched" accounts payable
- Slippage in accounts receivable average DSO
- Increases in accounts receivable "dilution": credits, returns and adjustments
- The need to revise plans and projections, especially if this occurs more than once
- "Hockey stick" forecasts (usually by the sales department), in which past sales grew slowly or were flat but the forecast shoots up boldly with huge growth rates, just as soon as "something" (e.g., an investment) happens.
- Erosion of order backlog or contract balance
- Excessive management turnover
- Glitches in computer system installations or conversions.

Timing Is Everything

The chances of a successful turnaround go up dramatically when the professional is brought in before the lenders, creditors, or investors force management's hand. If the company is already running out of cash, the tools at the turnaround professional's disposal are far more limited. Anyone who can raise a red flag before the company really starts to go under is doing everyone a favor. If the company is in denial, how-

ever, a whole new set of challenges must be addressed. □

Howard Brod Brownstein, CTP, is a principal of *NachmanHaysBrownstein, Inc.*, headquartered near Philadelphia and with offices in New York.

Editor's note: For additional information, contact the Turnaround Management Association (www.turnaround.org), which awards the certified turnaround professional (CTP) certification. For a sample issue of the publication *Turnarounds & Workouts*, contact the Beard Group (www.beardgroup.com).

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