Anatomy of a Turnaround —
Managing Expectations & Achieving Results

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There are numerous times during the course of a restructuring and financing that the situation can turn for the worse. Providing assurances and guidance to all parties involved will assist in a successful outcome even in the worst circumstances. Advising clients, lenders, customers and vendors is equally important in gaining common ground and resolution for a successful restructuring and financing.

The prospect of a Chapter 11 bankruptcy scenario, under any circumstance is a stressful and tumultuous time for a business, its employees, customers, vendors and lenders. Managing the expectations of all parties is a delicate and complex task because all parties involved have different interests and objectives with a lot to gain, but usually with substantially more to lose. There is rarely anything sweeter than a successful, prosperous and profitable ending to a bankruptcy, be it through a §363 sale or reorganization.

In one of our cases, Executive Sounding Board Associates (ESBA) took a client from the verge of liquidation through a successful restructuring with its current lender and connected it with an infusion of equity from a new strategic partner. In less than 18 months, ESBA completed a refinancing with a new asset-based lender providing an increased borrowing capacity, a lower cost of capital and a new lender that was prepared to assist the company in achieving and executing its growth strategy. This restructuring succeeded due to exceptional business performance and coordination among all parties, resulting in exceeded expectations.

In 2008, in the midst of the economic crisis, the client (a Mid-Atlantic manufacturer and distributor of household furnishings) launched a retail store division funded by a private equity firm. It opened during the peak of the financial crisis and could not gain the foundation it needed to succeed. As a result, the retail store division filed bankruptcy and liquidated. Unfortunately, much of its debt was intermingled with the manufacturing parent. The manufacturing parent was profitable and sustained itself individually, but the predecessor liabilities of the defunct retail division were draining the remaining entity.

The client’s financial model and business plan were sustainable despite the overall market conditions and offered an excellent potential for success. But taking control of the situation and ensuring future longevity required continuous lender support. Despite its uneasiness and unwillingness to support the company, the lender released enough control to not force the company into liquidation.

The client faced pressures from vendors, customers and employees. The vendors wanted assurances that they would be paid not only for their past support, but also during the reorganization, which required cash in advance for goods. The company had a heavily concentrated customer base and rumors swirled in the marketplace about the company’s deteriorating financial condition. If it lost any of its major customers the effects would be detri-
ment to a reorganization and would surely result in liquidation. In addition, the strains of the bankruptcy affected the company’s employees: morale deteriorated and they became less productive as they feared for their jobs and their own financial futures.

Where to Go From Here?
A focused yet diplomatic approach is required for success. While each party was motivated by its own interest and agenda, their mutual goals could only be achieved through a coordinated restructuring plan that ensured the company’s future as a going concern. The alternative — liquidating a company in the midst of the winter and the “inventory build season” — would have been disastrous, resulting in significant shortfalls for the bank, insignificant recoveries for creditors, job loss for the employees, and loss of all equity and investment for the company’s stakeholders. How do you bring unrealistic expectations into consensus?

In many instances, analyzing everyone’s interests and points of view often results in a better opportunity for ultimate success. Part of a restructuring is understanding everyone’s position and what they need to accomplish to be successful, and working to gain a consensus. A liquidation will rarely, if ever, produce effective and acceptable results for the majority of the constituencies and this situation was no different. All parties want a company with a sustainable and viable future; no one wants to be unemployed, liquidate assets or lose a customer. It is a painful, expensive and arduous process.

For this restructuring to be a success, we had to gain a consensus from all parties, communicate effectively to keep all constituencies informed, manage the expectations of all stakeholders, know where their pressure points were, and where their recoveries had to be.

We understood that during a forbearance, the lender is compelled to charge default fees and interest rates and impose additional reporting requirements to protect its collateral. These additional pressures will hinder the process and potentially jeopardize the recovery.

By providing the lender with a detailed rolling cash-flow forecast, weekly budget to actual variance reports and weekly status calls, the company reached an accord with its lender to continue funding the operations during the bankruptcy as it pursued its sale and reorganization strategy.

When suppliers hear the word “bankruptcy” they automatically fear that they will never get paid. By convincing vendors to continue shipping by guaranteeing prepayments, the company stabilized its product sourcing and supply channel. In turn, that enabled the company’s management team to meet with its customers to outline its plan to exit Chapter 11 bankruptcy in an expedited timeframe with an improved capital structure and better cash flow. Customers that previously decreased order size started to increase the size and frequency of orders.

The process had begun with communication agreements and compromises with the lender, vendors and customers that created the breathing room the company needed to stabilize, explore and execute its alternative paths of action.

The best alternative was to attempt a sale of the company to either a private equity group or competitor. Due to the unprecedented conditions of the economy and poor timing, there was some modest interest from competitors; but the majority of the previously readily available funding sources had dried up and due diligence processes had become exceptionally protracted. The company still had legacy issues pertaining to the retail store division.

To streamline the company and restructure its balance sheet, the company filed for Chapter 11 bankruptcy early in 2010. After an orderly transition and negotiation process, its lender provided the necessary DIP financing including, with much trepidation, the needed overadvance facility that enabled the company to exit bankruptcy in two months through a §363 sale to a strategic investing group.

In addition to the constituencies outlined above, the company and its professionals had to assure the court that it met all the disclosure and party in interest tests as well as arms-length terms and condi-

The newly recapitalized entity was positioned to increase sales significantly with a positive image as it prepared for its industry trade show. And, it was able to turn a profit in its first year of emergence from bankruptcy.
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Our firm continued to assist the company, working to secure financing in an effort to reduce our client’s cost of capital. Because of the long-standing relationship ESBA had with the company and integral knowledge we had of the business, we were able to streamline the marketing process. Focusing on the company’s restructuring, recapitalization, recent performance, growth and its strong management capabilities resulted in multiple interested lenders.

The company recounted its efforts and circumstances in a time when others had been liquidated; it turned around and became profitable as the economy was stagnant. Lenders saw the resilience in this business and potential growth in its future.

We were able to negotiate improved terms but more importantly, the company’s ongoing and open communications; conservative approach to managing expectations and updating constituencies and stakeholders; delivering on its promises; and management’s ability to successfully execute on its growth trajectories and plans all provided the foundation for the company’s performance to track accordingly.

The company chose the lender it felt would be the most strategic partner. While due diligence was progressing, the company and ESBA worked to phase out the existing lender, ensuring that there were no major bumps during the transition and that availability remained sufficient.

Sudden Thoughts and Second Thoughts…

The refinancing was successfully completed and the company ultimately reduced its cost of capital by a significant sum. Over the course of a few years, many compromises, and much patience, a trait in this day and age very few possess but a virtue that is critical to long-term success, the company went from the verge of closing its doors and all constituencies suffering immeasurable losses — money, jobs, loan haircuts, supplier write offs — to a growing, viable and prosperous business where all stakeholders and constituencies returned more than 100% on the dollar.

Managing and understanding the needs and expectations of all parties involved is pivotal to a positive outcome. There are numerous times during the course of a restructuring and financing that the situation can turn for the worse. Providing assurances and guidance to all parties involved will assist in a successful outcome even in the worst circumstances. Advising clients, lenders, customers and vendors is equally important in gaining common ground and resolution for a successful restructuring and financing.

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