RENAISSANCE

FEBRUARY 2002

A NEWSLETTER PUBLISHED BY MORRIS•ANDERSON & ASSOCIATES, LTD. (M•A&A) FOR THE MIDDLE-MARKET TURNAROUND MANAGEMENT INDUSTRY

"SIX CRITICAL STEPS IN THE TURNAROUND PROCESS — AN OWNER'S VIEWPOINT"

By Dick Pulver, Former Chairman, Pulver Systems, Inc.

STEP 1 – RECOGNIZE THE PROBLEM – A MAJOR CRISIS

The undeniable temptation of the owner seems to be conveniently blaming one major event for all the problems of the company. Perhaps it's just another low point in the regular cycle. Perhaps it's just one bad management decision on extending credit or investing heavily in a new product that failed. Perhaps it's just a couple of new orders that cost more money than anticipated. Your advisors (lawyers, accountants, etc.) have got to help you accept the fact that your business is in fact in a Life Threatening Major Crisis. Rarely is a crisis caused by one stand-alone event. Accordingly, the sooner you accept and acknowledge that you are in a crisis, the sooner you can take appropriate steps to deal with it.

STEP 2 – RECOGNIZE THE NEED FOR OUTSIDE HELP

If you are in a true crisis or near one, it's critical to seek help from outsiders who have "been there and done that." You are likely faced with dwindling cash, increasing lender and supplier pressures, little time to act, and decreasing options still available. Most owners have never even heard of "turnaround consulting" let alone witnessed a turnaround specialist in action. Therefore, the concept of "real economic value" that a turnaround consultant can provide, seems vague and abstract at best. The cost of the turnaround consultant is a huge shock to the owner and entrepreneur. Having one or more fulltime consultants on the expense ledger charging several hundred dollars an hour for several months is very expensive. Although, frankly speaking, what does it matter? You need to take your best shot at survival with a specialist, or accept the longer odds of trying to do it alone and increase the real possibility of losing your company, your investment, your career, your status, etc.

> ***"Your advisors have got to help you accept the fact that your business is in fact in a Life Threatening Major Crisis."***

STEP 3 – SELECTING THE "RIGHT FIRM"

Almost all entrepreneurs operating a business in crisis are scared of failure. This fear often paralyzes the decision making process of the company. However, the open-minded owner looking for an option to escape the crisis and save the company must act quickly and forcefully. Most often the best way to do this is to bring in an objective and experienced turnaround consulting firm. Many owners make the FATAL mistake of believing they can fix the company themselves (usually with the same management team). It's FATAL because if they had the skills, experience and credibility with all the stakeholders necessary to fix the company, why haven't they done it so far?

This brings me to how to select a turnaround firm and consultant. Chemistry, personality and style of your day-to-day lead consultant are most important in my mind. In essence, you have to believe that you can really trust your lead consultant and that other stakeholders will as well. Although the lead consultant must "fit in" with you and your company's culture, it is also critical that the lead consultant is a hands-on, goal driven professional as you must create a sense of urgency among the employees regardless of your current culture. We were fortunate to find the right person and right firm. Unfortunately, my company had a less than satisfactory false start with a report-writing, accounting type consulting firm.

STEP 4 – ANNOUNCING THE DECISION

Our lead consultant emphasized the immediate necessity of communicating with our various

Continued on page 2

groups of stakeholders. Although this direct style of communicating the crisis was a little scary at first, it worked very well. I was told that owners are always worried about directly telling stakeholders about the seriousness of the problem, but I was assured that the vendors and the employees especially, were well aware that the company was in serious trouble.

The first day the "real" turnaround consultants started with us, I was asked to convene three meetings. First, we met with the senior management team, second with all managers and supervisors, and finally with all employees. The agenda was essentially the same at all three meetings. I explained that fundamentally I felt we had a good company, but that events of recent years had put the company into serious financial difficulty. Therefore, I had decided to hire professional help who had a strong track record in turnarounds, and that I had full confidence that our consultants would identify what we needed to attack and lead us through the difficult issues of change. Then, the lead consultant explained that over the next few weeks the company would be refocused on generating more cash, reducing costs and establishing good management controls on decisions, processes and results. The primary purpose of the employee meetings was to open the lines of communication, to start to create a sense of urgency with the employees and to help empower the turnaround consultant.

We initially contacted all vendors by letter announcing the selection of the turnaround consultant, using a positive spin. We immediately had our purchasing manager personally call all major vendors to discuss the announcement and to offer a face-to-face meeting with the consultant and management. And yes, I completely turned over the check-book to the consultant so that all emotion and politics were removed from the expenditure process.

The lender went to the consultant directly and frequently. At first, I was somewhat uncomfortable with this, especially since the lender had recommended the consultant. However, as time wore on and I trusted the consultant more and more, my concerns went away. The consultant helped the lender by significantly improving the timeliness and accuracy of both financial and operational information. Obviously, this communication process went a long way toward improving our relationship with the lender and easing the pressure on the company and me.

We did not directly communicate the consultant's engagement to our customers, as we sold fairly expensive capital equipment. However, we did arm our sales force and senior managers on how best to handle the inevitable customer questions and concerns. In general, we followed the recommended approach – be factual, don't downplay the seriousness of the problems, but focus on the viability of the business and our commitment to making the necessary changes to fix it.

> ***"Many owners make the FATAL decision that they can fix the company themselves (usually with the same management team)."***

STEP 5 – GETTING TO WORK

The turnaround consultant must be granted and be able to assume full authority to implement changes. That doesn't mean that the consultant has no accountability to the owner. An experienced consultant will build a relationship with the owner by checking in daily and by explaining the rationale for any major decision prior to its announcement and implementation. The owner must be willing to allow the consultant a fairly free rein to get the job done and thus, be willing to let go of sacred cows and even long-term employees if necessary. A good consultant will understand and appreciate the natural emotion involved in such difficult issues and be helpful, but firm in working them through.

It is critical that ownership and senior management give unwavering public support to the consultant. Any disagreements should be handled in private meetings. Additionally, this is a time when it's "critically important to under-promise and over-deliver", so that credibility starts to be restored in the owner and managers.

Our consultants maintained high visibility throughout the engagement. They walked the plant floor and office daily talking with employees, getting input and sharing stories illustrating progress. They set up and managed cross-functional work teams to address specific issues. We set up regular update meetings with employees. They had meetings with vendors or were accessible by phone. I made it a point to introduce all visitors to the consultants, even customers. Finally, they frequently sent updates to the lender, who obviously had high confidence in their skills.

STEP 6 – CONCLUDING THE PROJECT

Although no owner wants to hear this, a good consultant will tell the owner upfront that sometimes businesses are not viable and that they are so financially troubled that a quick sale or liquidation is the only realistic option. A good owner needs assurance that the consultant will help the owner and the company through whatever the outcome, as well as protect the owner's integrity during any wind-down process. Luckily, my business was viable.

Assuming milestones are generally met and the company's financial results and prospects are now stable and positive, it's time to return the company to regular management. However, it's critical that both the owner and the turnaround consultant believe that a capable management team is in now place. If this was not the initial situation, your turnaround manager should have helped cull out and rebuild the team, as happened in our case.

EPILOGUE

The turnaround of my company was indeed dramatic. In 6 months under the leadership of our turnaround consultant, we went from <u>losses of nearly $2 million</u> annually on $20 million of sales, a $2 million loan with a $750 thousand over-advance, a lender who wanted out immediately and a host of operating maladies <u>to a company making nearly $1 million annually</u>, a new $2.5 million loan with nearly $500 thousand of availability, and a much smoother operation.

On a personal note, I no longer had to worry quite as much about the business and the real possibility of having my personal guarantee called, and potentially losing our home. Approximately a year later, my business was successfully sold for a very nice value. Although the turnaround consultant was onsite for seven months and cost the company a pretty penny, it was the best investment decision I have ever made. ■

Dick Pulver has owned or managed a dozen privately held businesses. He was the second-generation son who returned to the primary family business in the mid-1990's to succeed his older brother. This article reflects his experience at Pulver Systems, Inc. a 50-year-old custom equipment manufacturer for the large volume bakery industry.

TALES FROM THE TRENCHES — "A RESTAURANT CHAIN WENT LOOKING FOR FAST SERVICE"

By Daniel F. Dooley and Jacques Hopkins, M•A&A

With the spurt in the number of distressed companies, it follows that many turnaround and merger and acquisition professionals are spending more time trying to sell underperforming and troubled companies. Because today's market clearly favors buyers, the real challenge of course, given the typical seller viability and liquidity issues, is to maximize value. Morris·Anderson faced such a daunting task recently, and in a 60-day period honed its Quick Sale skills and achieved a very satisfactory result to boot.

BACKGROUND

On September 18, 2001, M·A&A was asked to market a $20 million theme restaurant chain that included 3 big restaurants in 3 different states. One restaurant was still in startup mode, one was in early turnaround mode and one was very profitable. The company had gone through almost $40 million of capital in its 3-1/2 year life and had yet to generate any profits in the aggregate. Furthermore, the recession and the events of September 11th had hurt sales volume and cash flow significantly.

The request to sell the chain followed on the heels of an M·A&A viability and situational analysis which showed the chain to be insolvent and running out of cash within 60 days. Not surprisingly, management was receiving loan payoff and other demands from its senior lender.

What follows are the steps taken by Morris·Anderson and the time frames in which the steps were completed.

STEP 1 – DETERMINE THE LIKELY BUYERS

Prospective buyer names came from multiple sources: the officers and directors, companies or individuals known to M·A&A as buyers of distressed companies, and industry listings of chain restaurant owners that were stratified by size and geography. Simultaneously, M·A&A put together a two-page "blind summary" describing the company in general terms and providing basic financial information. At the end of day 2, M·A&A had e-mailed or faxed over 300 blind summaries with a simple Confidentiality Agreement attached. Over the next three weeks, M·A&A received back ten executed confidentiality agreements.

Certain officers and directors were determined to be potential buyers themselves. M·A&A segregated the sale process as between insiders and outsiders. This was done by assigning a separate M·A&A point person for the outsiders versus the insiders. This helped preserve the integrity of the "arms-length" sale process.

STEP 2 – ASSEMBLE AND DISTRIBUTE A DATA BOOK

M·A&A assembled and reproduced the Data Book within 2 days. The book utilized the narrative and the financial projections already available that M·A&A had reviewed, modified and confirmed as part of the initial analysis. Additionally, typical due diligence material was included such as asset lists, tax returns, etc. When books were distributed, a "drop dead" bid date was communicated.

STEP 3 – PROACTIVELY CONTACT PROSPECTIVE BUYERS

A prospective buyer was defined as anyone who had signed the Confidentiality Agreement and received the Data Book, or who M·A&A nevertheless believed to be a highly likely bidder. Face-to-face meetings were arranged. It is a very busy world and M·A&A has found that you need to "help" prospective buyers invest the time necessary to evaluate the purchase of the seller, especially in the Quick Sale mode that M·A&A had established.

The objective of the close personal attention, in addition to expediting and fostering the process, was to find and encourage a "stalking horse" bidder who was willing to bid at an amount in excess of the chain's orderly liquidation value.

STEP 4 – NEGOTIATE A TERM SHEET

A "stalking horse" bid from an officer was received within 2 weeks at a value of $8.3 million, which was enough to pay the senior secured lender in full, pay one-third of the junior secured lender and cover employee payroll and most benefit liabilities.

In addition to the traditional terms of sale found in a term sheet, M·A&A and counsel, with the agreement of the Board, had considered the appropriate means of selling the business. It was decided that among the options, a §363 bankruptcy sale made the most sense. A deal was negotiated with the "stalking horse" bidder which was subject to a §363 auction procedure. With the stalking horse bidder, the auction procedure was set up with a very short, under 30 days, time line as cash and hence viability continued to be near-term concerns.

The approved auction process required that each bidder submit bids in conformity with an agreed format. This process minimized apples versus oranges bids that would have been difficult to compare as to value.

STEP 5 – EXECUTE THE SALE PLAN

An Asset Purchase Agreement was negotiated, as well as a §363 bankruptcy sale bid procedure and a small DIP loan facility with the stalking horse bidder. The company filed for Chapter 11 protection on October 4. At the October 5 first day hearing, less than 3 weeks after September 18, the day the marketing and sale engagement started, the judge agreed to an auction date of October 30 due to the emergency nature of the case (the company would have been out of cash but for a M·A&A negotiated short-term DIP loan intended to "bridge" the company to a Quick Sale).

Over the next 3 weeks, in addition to facilitating work on pre-closing tasks with the stalking horse bidder, M·A&A focused primarily on three additional buyer groups in hopes of getting a higher and better offer. All of these buyer groups entered into the ultimate dynamics of the auction. At the actual auction, the company's major unsecured creditor who has a unique dining promotion and restaurant financing business, put in a whopping $3 million overbid and raised the bar to $11.4 million. This prompted the stalking horse to raise his bid by nearly $2 million. Ultimately, the company accepted the unsecured creditor's bid and closed the sale on November 19th, just 61 days after the M·A&A sale process started. The results:

1. Senior secured creditor paid in full
2. Junior secured creditor paid in full
3. Employee claims and most benefit claims paid in full
4. Customer claims paid in full
5. Administratively solvent estate
6. Likely double digit dividend to unsecured creditors

The orderly liquidation value of this restaurant chain's hard assets was estimated to be under $1 million. The stand-alone going concern value of the one very profitable restaurant was estimated to be $4 or $5 million. This compared to the actual value of the final asset sale at $11.4 million, which represented almost a 40% improvement to the stalking horse bid.

STEP 6 – MAINTAIN DETAILED RECORDS

Detailed records of all prospects contacted, responses to those contacts, additional information requested and provided, meetings, etc. were maintained. Those records were made available to all parties having sale approval rights and fiduciary responsibilities in allowing a

Continued on page 4

TALES FROM THE TRENCHES
Continued from page 3

sale to go through. Additionally, a summary of that information was provided periodically to those parties as well as the Court throughout the process. M·A&A's experience is that a properly documented marketing and sale process is critical toward ensuring that any possible objections to a proposed sale, especially in a court supervised §363 bankruptcy sale, can be handled with strong evidence of a thorough marketing process combined with an arms-length sale process having the clear objective of achieving the "highest and best offer." ■

It is Morris·Anderson's view that many more distressed companies can be sold at much higher values if a hands-on turnaround consultant or other professional using a Quick Sale Process were engaged. M·A&A is fortunate to have been able to refine its Quick Sale Process, which means one stop shopping (i.e., workout services and quick sales) for our clients and referral sources.

Daniel F. Dooley is a M·A&A Principal and Jacques Hopkins is a M·A&A Manager, both based in Chicago.

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News Desk . . .

- **Baker Smith**, M·A&A President, announced that **Bob Starzyk** has been elevated to Principal in the firm's Dallas office. Baker comments that "We are excited about Bob joining M·A&A as a shareholder and I have high hopes that Bob will lead M·A&A into establishing a major presence in Texas."
- **Alan Glazer**, M·A&A Principal, announced that **David Weinstein** has joined the firm as a Regional Director based in New York City. Alan indicates that "David is a great addition to our team. His many years in lending, most recently with Congress Financial, will add a new perspective to M·A&A's financial advisory services. Additionally, David and **Andrew Barnett**, M·A&A Principal, have opened a M·A&A satellite office in **Wilton, Connecticut** in January, 2002".
- **Baker Smith**, M·A&A President, announced that **Robert Swett** has joined the firm in **Tampa** and has opened a satellite office there for M·A&A. Baker states that "The firm has had numerous assignments in Florida in the last year, so it's very timely that Robert has joined M·A&A to establish a greater local presence in this key market."
- **Dan Dooley**, M·A&A Principal, announced that **Richard Case** has joined the firm's Chicago office as **Healthcare Consulting Manager**. Dan commented that "Rich has a healthcare background that really broadens our industry expertise."
- **Tom Walker**, M·A&A Regional Director in Wisconsin, was quoted in the Corporate Report Wisconsin article entitled *"Battling Bankruptcy"* appearing in the September, 2001 edition. **Dan Dooley**, M·A&A Principal in Chicago, was quoted in the Family Business magazine in an article titled *"Bouncing Back from Bankruptcy"* appearing in the Autumn, 2001 edition. **David Weinstein**, M·A&A Regional Director in Connecticut/New York City, was quoted in CFO Magazine in an article titled *"Why Restructuring is Getting So Tough"* appearing in the August, 2001 edition.
- **Baker Smith**, M·A&A President in Atlanta, served as panel moderator at the November, 2001 TMA panel on "Desperate Measures: Funding a Turnaround in a Credit Crunch."
- **Bob Morris**, M·A&A Managing Director in Chicago, served on an August, 2001 AIRA (Association of Insolvency and Restructuring Advisors) panel on "Financing of Distressed Businesses."

Some Recent Morris•Anderson Engagements

- Railroad Equipment Manufacturer (East) – Debtor Representation – Chapter 11 Planning, Cash Management, §363 Bankruptcy Sale Process Management.
- Theme Restaurant Chain (Midwest) – Debtor Representation – Business Assessment, Financial Projection Review, Marketing and Sale of Company in §363 Sale, Wind-Down of Debtor's Estate (Bankruptcy Causes of Action).
- Public Utility Equipment and Parts Distribution (Southeast) – Lender Representation – Business Assessment, Liquidation Planning and Implementation.
- Fastener Distribution (East) – Debtor Representation – Business Assessment, Financial Projection Development, Cash Management, Interim Management (CEO), Turnaround Planning and Implementation.
- Information Technology Services (Midwest) – Lender Representation – Business Assessment, Assignment for Benefit of Creditors (ABC), Liquidation.
- Agricultural Products Processor (East) – Lender Representation – Strategic and Business Assessment, Financial Projection Review and Financial Restructuring Analysis.
- Catalog Mass Marketer (Midwest) – Debtor Representation – Business Assessment, Business Plan Development, Information Systems Turnaround and Financial Reporting Improvement.
- Textile Manufacturer (Southeast) – Debtor Representation – Business Assessment, Financial Projection Review, Chapter 11 Planning, Reorganization Planning and Implementation.
- Medical Products Retailer (East) – Debtor Representation – Business Assessment, Business Plan Development and Refinancing.

MORRIS • ANDERSON
& ASSOCIATES, Ltd.
1111 E. Touhy Avenue, Suite 286
Des Plaines, IL 60018