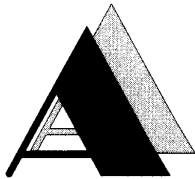


THE NEW REALITIES OF WORKING WITH TROUBLED COMPANIES

by Daniel M. Morris



As the 80s wound down, it became increasingly apparent just how much damage had been done by bad leveraged buyouts. Many so-called players who could talk the LBO talk, couldn't walk the LBO walk.

The 1990s came in on a very different and sobering note. Today, companies unable to meet the terms of their LBO loan agreements are being forced to pay the piper. Yet the tail end of the 80s and the early 90s mark a prosperous time for savvy turnaround investors, consultants and restructuring specialists. Their activity is booming as American businesses and their bankers attempt to unravel the overfinanced and underperforming tangle created in the earlier years.

The primary focus of such activity, for consultants in particular, has been triage: stabilizing clients' businesses and arresting internal bleeding. In support of the short-term concerns of senior secured lenders in workout situations, and clients in response to those lenders, many turnaround consultants have focused almost entirely on short-term issues to the exclusion of all else.

Over the next several years, we see a major and welcome change in the concerns and activities of both senior secured lenders and turnaround consultants. In our view, this change will best serve the short and long-term interests of the borrower, the lenders and the other stakeholders who depend on the borrower as a revenue or product source.

A strategic marketing focus

After the bleeding has been stopped and appropriate stabilizing action has been taken, surviving business borrowers are usually exhausted and their companies lack the resources and creative juices to plot new courses which will return them to real health.

Where do surviving businesses go after stabilization? The response to that question will be the driving force behind the future roles of management, secured lenders and turnaround consultants alike. The principal focus of each should be strategic in nature, market-driven and should have a much greater impact on any subsequent restructuring discussions.

In the past, the concerns of some asset based lenders have been substantially limited to an evaluation of these three essential elements:

- Collateral: the liquidation value of the debtor's assets.
- The character of management: the commitment, integrity and skills of the business's leaders.
- Cash flow projections: responsible estimates of future receipts and disbursements based on history, adjusted for current knowledge.



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Going forward, however, lenders will, in addition, insist on being part of the borrower's process in examining and planning the future of the debtor's business, its markets and their potential. Through careful analysis and due diligence, the lender should establish that any such plan is reliable and responsible. Restructuring decisions based only on historical information adjusted for today's data stand a good chance of being bad decisions. Decisions utilizing such information, coupled with a responsible strategic plan for the future, offer the best opportunity to avoid a second or third calamity.

Recognizing competitive dynamics

The level of growth for the economy by industry segment is a significant factor for the lender to consider. Without new directions to capture market share, troubled companies in flat industries will be forced to fight continuing sales and margin erosion with little hope of success. Spent management teams, with limited resources and ideas have little hope for success. Effective campaigning for market share must address niches, products, pricing and distribution.

The new realities...

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These concerns are simply the fundamentals of good marketing. Lenders and consultants alike will need to analyze the competitive environment and understand in specific terms the market or niche opportunities for a company's products and services. Among other things, a basic marketing plan also addresses issues including:

- Profit center and product line rationalization
- Advertising and promotion
- Strategic alliances.

Ideally, consideration of a longer-term strategic view should start during underwriting. Nevertheless, for a secured lender involved in a restructuring, a detailed evaluation of the long-term strategic direction and opportunities of the borrower are fundamental to enhancing opportunities for success.

No longer is it enough to assume that borrowers can replicate past growth, or even that there is industry potential for growth. Traditional thinking must bend to the dictates of the marketplace.

Inherent in the concept of restructuring is the idea that a stabilized company can return to normalcy and historical performance patterns. It is clear, however, from the experience of the late 1980s and early 1990s that historical performance patterns were not relevant then and less relevant now.

Remember the words of George Santayana: "Those who cannot remember the past are condemned to repeat it."
