



TROUBLESHOOTING TO SAVE BUSINESS

How to spot the signs of trouble and get a company into turnaround before it's too late for a rescue.

By Michael Finland

It's a sobering thought that of the 10,000 to 14,000 Australian companies likely to become insolvent in 2009 in the midst of the global financial crisis, a significant number could have been saved if they had sought the right help early enough.

In many cases, the businesses that end up in receivership have not heeded early warning signs and sought the right assistance at the appropriate time. Companies must be willing to admit they need help.

In Australia there is a small but growing pool of specialist turnaround management expertise filling an in-demand niche.

Specialist turnaround advisers are the advisers companies are turning to so they

don't end up having to deal with insolvency practitioners.

The earlier we become engaged, the more options we have to restructure the business. Moreover, turnaround experts do not just work with businesses in trouble. Many clients seek their advice for general profit improvement.

In assisting a business in difficulties, a turnaround practitioner will use skills in a range of areas including insolvency, corporate finance, audit, management consulting, project management, negotiation and stakeholder management, HR and financial modelling, in addition to lateral thinking and the ability to stay calm under pressure.

What's involved

Three key elements of any turnaround rescue plan are financial restructuring, operational restructuring and stakeholder management.

The key is to critically assess the troubled entity's business plan and review profit and loss to determine the causes of underperformance such as rising production costs, loss of customers or increased competition.

Timing is crucial when a company is underperforming. Turnaround specialists create and implement rolling 100-day work plans detailing the key initiatives being targeted to improve business performance and ensure that the initiatives are implemented in a timely, efficient manner.

The work focuses around the objectives of:

- improving cashflow
- stabilising operations
- communicating with key stakeholders to re-build their support
- exploring all strategic options, and
- developing a comprehensive turnaround strategy.

The turnaround specialist will undertake strategic, financial and operational reviews to identify areas of underperformance and then work with management to implement strategies to improve the overall performance of the business.

It is not unusual for the turnaround expert to turn to their extensive network of financiers and private-equity firms to introduce the right combination of debt and/or equity to fund the troubled business.

Warning signs to look for

Although the ways companies can get into trouble are many, there are common themes.

These include when management has been too focused on growing revenue without considering the impact on margins and profit, businesses not having the right systems and controls in place to manage their working capital or businesses lacking the right management team depth of skill, and failing to review financial and operational performance regularly.

It is possible to turn around many of the dangerous situations companies can find themselves in.

The key signs that should start senior management's alarm bells ringing are:

- actual or likely bank covenant breaches
- working capital growth outstripping revenue growth
- profit warnings/missing forecasts/declining margins
- general industry downturn or industry consolidation
- loss of key management personnel or increase in staff turnover
- difficulty in obtaining general finance
- management 'buying' sales at the expense of margin
- creditor or debtor ageing issues
- competitor risk
- ATO and superannuation arrears
- loss of a major customer
- post-merger integration issues.

Stress test your business

Given tough and fast-changing economic times, it's essential to be undertaking detailed financial modelling and 'what if' scenario testing to gauge how various sudden changes in market conditions will affect your business – and more importantly, what initiatives management can deploy to combat these challenges.

All organisations should be placing a focus on stress testing their business whether they are in trouble or not.

These are the key questions we ask clients when they want to test the resilience of their business:

- What is the new break-even level for the business and how does it change from the previous level?
- What is the impact on revenue and earnings if you lose a major customer?
- If customers are demanding lower prices, what is your tipping point and are you prepared to lose customers in order to maintain earnings?
- What changes will you need to make to your cost base to match the new lower revenue base?
- How is cashflow affected if debtors take an extra 10 days, on average, to settle their accounts?
- Could there be a breach of banking covenants and if so, how will you respond to your financier's concerns?
- What changes will you require to your banking facilities and what would be your bank's attitude to an increase in lending, if required?
- Are staff cuts needed and how will you deal with this (four-day work week, pay reductions, retrenchments)?
- Do you have the cashflow to fund redundancies?
- What overheads will you reduce and what capex plans need to go on hold to preserve cash?
- What non-core assets could be sold to reduce debt/provide additional cashflow?
- Are sales or production levels too low to remain viable and is a merger/strategic partnership needed to maintain critical mass? Who would you approach?
- What plans do you have to meet ATO requests?

Cashflow is key

Any improvement in working capital – the amount of cash tied up in accounts receivable, inventory and accounts payable – is beneficial, especially in current deteriorated market conditions. Extra capital can be used to pay down debt, fund capital expenditure, satisfy seasonal cash requirements or further invest in growth initiatives such as research and development.

For specialist performance improvement and turnaround management firms, the aim is to provide strategies that rapidly improve profitability and cashflow. To do this, we need to know what drives their business, how to achieve above industry benchmarks and more importantly implement strategies that increase the financial performance and value of their business.

Success factors

In our experience, there are six essential elements that are required to achieve a successful turnaround:

1. Ability to prove business viability by demonstrating the various initiatives that will restore earnings and cashflow
2. Ability to manage all key stakeholders and keep them moving in right direction
3. Credible management, which might mean making certain replacements to bolster management effectiveness
4. Ability to maintain or enhance the reputation of the business
5. Ability to maintain supplier credit and terms
6. Ability to release internal working capital and secure external funding.

Rescued from disaster

This is a real-life case study of one of our clients whose business was able to be rescued from disaster.

The well-established manufacturing business with a blue-chip client base had grown by 93 per cent over three years to reach an annual revenue of \$46 million. Unfortunately, management had not implemented sufficient checks and balances and management skill to maintain control of this growth, culminating in a loss of \$4.4 million for FY 2008.

An analysis of the situation identified several critical issues for attention:

- poor working capital management
- no visibility on product and customer profitability
- lack of management depth
- business requires additional working capital



- 84 per cent staff turnover
- refinancing was not an option.

On the plus side, it was clear that the core business was still viable. Several important initiatives were implemented to turn the business around, including:

- a 100-day work plan incorporating 55 initiatives to stabilise the business
- a robust cashflow and earnings forecasting system
- a working capital management program to improve cashflow
- a capital raising process
- price increases ranging from six per cent to 18 per cent

In addition, a new CFO, HR manager and supply chain manager were recruited to bolster management, a staff retention strategy was developed, a round of redundancies implemented and the many stakeholders aggressively managed.

As a result, the crisis was averted. These actions resulted in:

- \$3 million in financial support
- conversion of \$2 million of debt to equity
- stakeholder relationships restored
- staff turnover down to 30 per cent
- FY09 H1 profit of \$0.3 million (versus \$4.4 million loss for the previous year)
- 10 per cent reduction in workforce.

Timing is all

Is it too late to turn things around? The above case study is not the only instance where a business has been brought back from the brink. The good news is that if a company in difficulty searches for the right sort of help early enough, it is possible to turn around many of the danger situations they can find themselves in. ▀



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