

THE MERIDIAN GROUP

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**TURNAROUND
STRATEGIES**



THE MERIDIAN GROUP

Most turnaround/workout situations are not recognized by management until the company is having serious cash flow problems. The associates of The Meridian Group can call upon their extensive experience in workout situations to aid management in determining what actions need to be taken. This assistance can be critical in keeping the troubled company's focus on serving its customers, while resolving its internal problems.

For a consulting firm, a turnaround situation demands immediate attention to problems arising from the client's customers, creditors, employees or competitors. From experience, The Meridian Group recognizes the level of demands and understands the effort required to help a company through the crisis. Our depth of management enables us to address many problem areas simultaneously.

We specialize in directing management through all the stages involved in a workout environment. This presentation has been designed by The Meridian Group for the express purpose of assisting our clients in quickly developing a basic understanding of the turnaround process and their role in it.

The last section of this presentation demonstrates The Meridian Financial Model. Knowing that timing is critical to any successful turnaround, this model enables a company in a troubled situation to rapidly assess its current situation, develop short term cash flow strategies and formulate a longer term strategic plan.



***RECOGNIZING
THE TURNAROUND
SITUATION***



THE TURNAROUND SITUATION

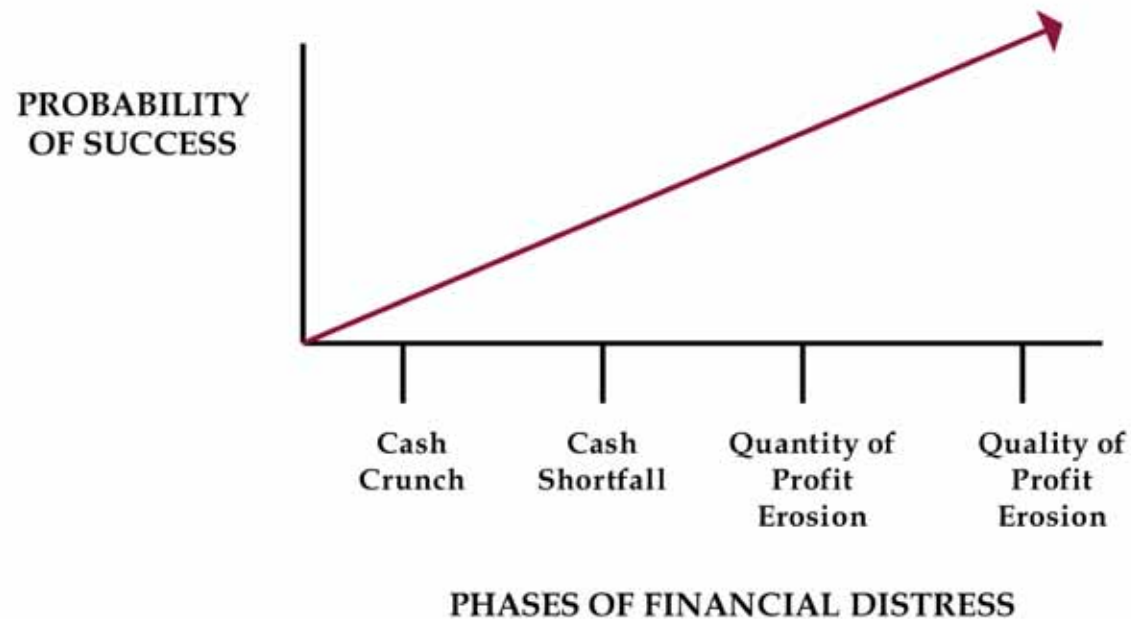
PHASES OF FINANCIAL DISTRESS

<u>PHASE</u>	<u>CHARACTERISTICS</u>	<u>TIMING BEFORE CREDIT/CASH DISAPPEARS</u>
Quality Of Profit Erosion	<ul style="list-style-type: none">◆ Operating profit margins are declining◆ Competition is increasing◆ Net cash flow is steady or beginning to decline	9 To 18 Months
Quantity Of Profit Erosion	<ul style="list-style-type: none">◆ Company is beginning to show an operating loss◆ Gross profit margins are shrinking◆ Net cash flow is tightening	6 To 12 Months
Cash Shortfall	<ul style="list-style-type: none">◆ Cash is extremely tight◆ Vendors are displeased with lateness of payments◆ Bankers are concerned about financial situation	3 To 9 Months
Cash Crunch	<ul style="list-style-type: none">◆ Overdrawn on bank account◆ Line of credit is exhausted◆ Vendors have company on COD basis◆ Payrolls will soon go unpaid	NOW



THE TURNAROUND SITUATION

EARLY RECOGNITION INCREASES THE PROBABILITY OF SUCCESS



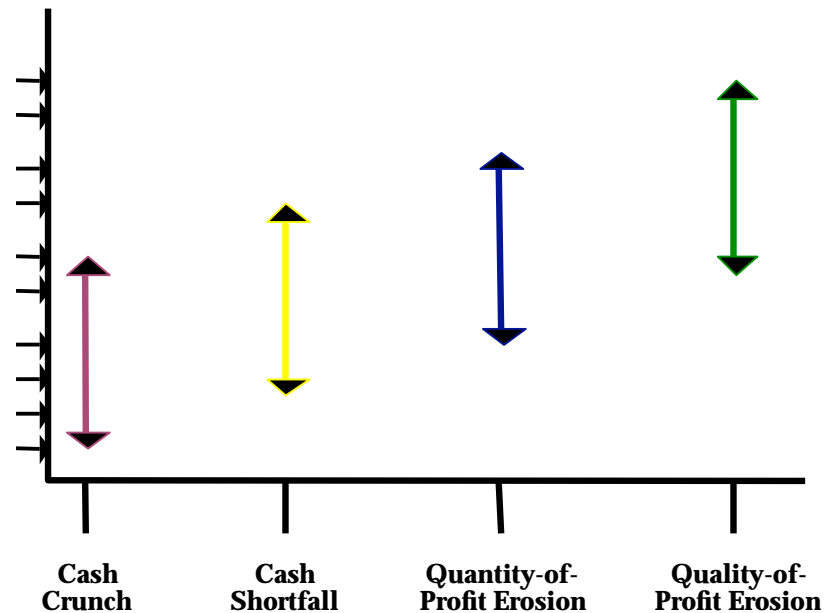


THE TURNAROUND SITUATION

EACH PHASE OF A TURNAROUND DICTATES DIFFERENT ACTIONS

POTENTIAL ACTION:

- Increase Capacity Utilization
- Eliminate Unprofitable Operations
- Raise Prices
- Decrease Variable and Fixed Expenses
- Reduce Purchases
- Renegotiate Credit Lines and Debt Service
- Renegotiate Labor Contracts
- Factor Accounts Receivable
- "Fire Sale" Inventory
- Liquidate Excess Fixed Assets



PHASES OF FINANCIAL DISTRESS



THE TURNAROUND SITUATION

SYMPTOMS OF A TROUBLED COMPANY

- Inability to pay debt service, taxes, contract obligations or accounts payable
- Inability to pay salaries, commissions, fringe benefits or pensions
- Inability to pay for capital improvements
- Excessive debt/equity ratio
- Flat or declining sales
- Eroding gross margin or operating margin
- Increasing labor or material costs as a percent of sales
- Increasing variable or fixed burden expenses as a percent of sales
- Increasing SG&A expenses as a percent of sales
- Inconsistent valuation of inventory
- Decreasing capacity utilization
- Declining unit sales or product line profitability
- Decreasing customer profitability



THE TURNAROUND SITUATION

A TURNAROUND SHOULD BE PURSUED WHEN:

THE VALUE OF THE TURNAROUND IS MORE THAN

THE VALUE OF LIQUIDATION

OR

*THE VALUE OF THE BUSINESS ON A DISTRESSED SALE
BASIS*



THE TURNAROUND SITUATION

WHY TURNAROUNDS FAIL

- The Plan is initiated and implemented in the same manner and by the same management that led the Company to its current situation
- Creditors are unwilling to support the Plan because of a lack of confidence in management and/or the Plan
- Company has had poor communications with creditors
- The Plan is undertaken too late
- Distractions are high forcing attention away from more crucial issues
- Critical timing posts are not met
- Unilateral cuts are made which prove ineffective and alienate employees
- Remedial action steps are taken which are inappropriate to the problem



***OVERVIEW
OF THE
TURNAROUND
PROCESS***



THE TURNAROUND PROCESS

STAGE 1: INITIATE DAMAGE CONTROL PROCEDURES

STAGE 2: EVALUATE CURRENT CONDITIONS AND CAUSES

STAGE 3: STAY ALIVE THROUGH SHORT TERM LIFE SUPPORTS

STAGE 4: COMMUNICATE PROBLEMS TO ALL CREDITOR GROUPS

STAGE 5: DEVELOP LONG TERM SOLUTION

STAGE 6: DEVELOP REORGANIZATION PLAN

STAGE 7: IMPLEMENT PLAN OF REORGANIZATION



THE TURNAROUND PROCESS

STAGE 1

INITIATE DAMAGE CONTROL PROCEDURES

CONTROLLING CASH FLOW IS THE SINGLE MOST IMPORTANT ELEMENT IN ACHIEVING A SUCCESSFUL TURNAROUND

- Initiate changes to provide immediate access to daily cash flow information
- Consolidate spending authorization to a few key people
- Halt any disbursements of cash not scrutinized by the key people
- Establish controls on accounts receivable collection and credit authorization
- Approve all vendor payments
- Start analyzing what means are available to bring additional cash into the business (i.e., more aggressive collection policy, sale of certain assets)
- Begin developing a twelve week rolling cash flow statement to guide the company through its initial workout stages



THE TURNAROUND PROCESS

STAGE 2

EVALUATE CURRENT CONDITIONS AND CAUSES



THE TURNAROUND PROCESS

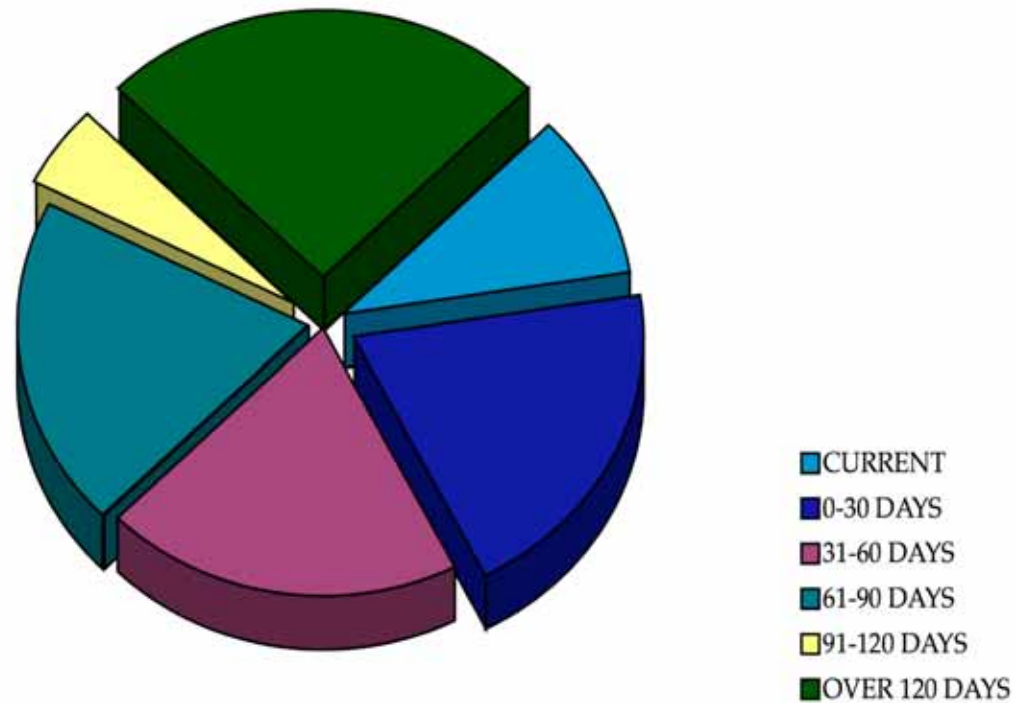
GATHERING INFORMATION

- Five years of annual financial statements including the last six months by month and current year-to-date
- Monthly agings of accounts receivable
- Monthly agings of accounts payable
- Current list of inventory
- Detailed schedule of fixed assets and estimated utilization
- Copies of all loan/security agreements with secured creditors
- Detailed schedules of notes payable and other long term debt
- Detailed schedules of current costs and expenses
- Copies of three years of tax returns
- Sales analysis by customer and product for past two years and year-to-date
- Checking account information
- Appraisals of fixed assets, if available



THE TURNAROUND PROCESS

DETERMINE CONDITION OF ACCOUNTS PAYABLE





THE TURNAROUND PROCESS

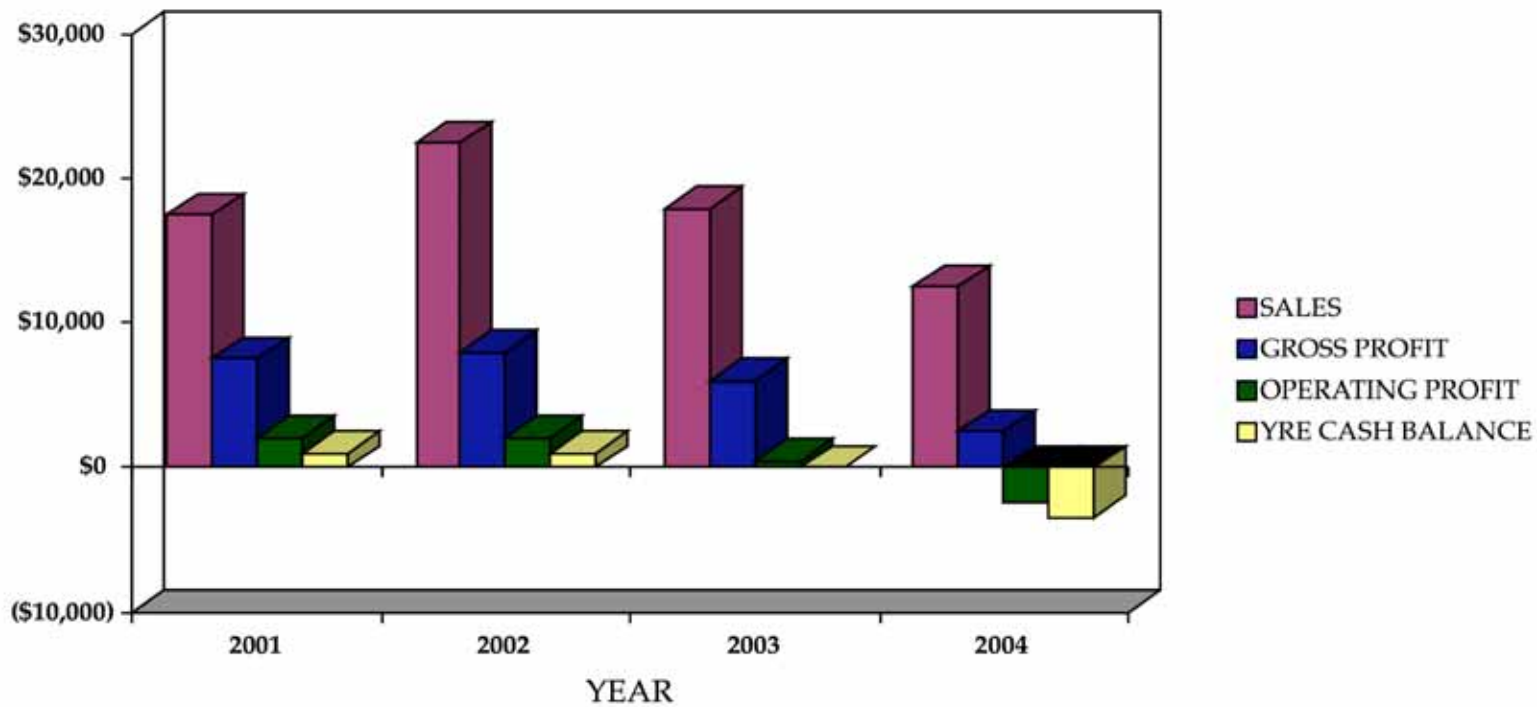
ANALYZE THE HISTORICAL BALANCE SHEETS AND STATEMENTS OF OPERATION

- Test, validate and verify key balance sheet account values
- Compare financial ratios to the industry
- Check for unusual changes in accounting methodology
- Verify accuracy, usefulness and timeliness of financial statements
- Test inventory control system, quantities and valuation techniques
- Analyze aging trends for accounts receivable and accounts payable
- Review effect of macroeconomic conditions on Company's business situation
- Analyze cash management and control techniques
- Determine which expense items are growing faster than sales
- Perform trend and ratio analysis of balance sheet, statement of operations and cash flow
- Review backlog versus prior periods
- Determine if Company is “playing its Float” with the bank
- Review internal controls



THE TURNAROUND PROCESS

ANALYZE HISTORICAL FINANCIAL INFORMATION





THE TURNAROUND PROCESS

ASSESS THE CAUSES OF THE UNDERLYING PROBLEMS CREATING THE CURRENT FINANCIAL SITUATION

- Review operating methodologies and efficiencies
- Determine if labor costs are excessive
- Analyze inventory controls and systems
- Check credit controls on customer accounts
- Assess environmental and insurance risks
- Analyze sales by product by month by year
- Determine competitors' impact on Company sales
- Detail executive compensation and perquisites
- Analyze pricing strategies
- Review quality control procedures
- Determine if payroll and other taxes are current



THE TURNAROUND PROCESS

STAGE 3

STAY ALIVE THROUGH SHORT-TERM LIFE SUPPORTS



THE TURNAROUND PROCESS

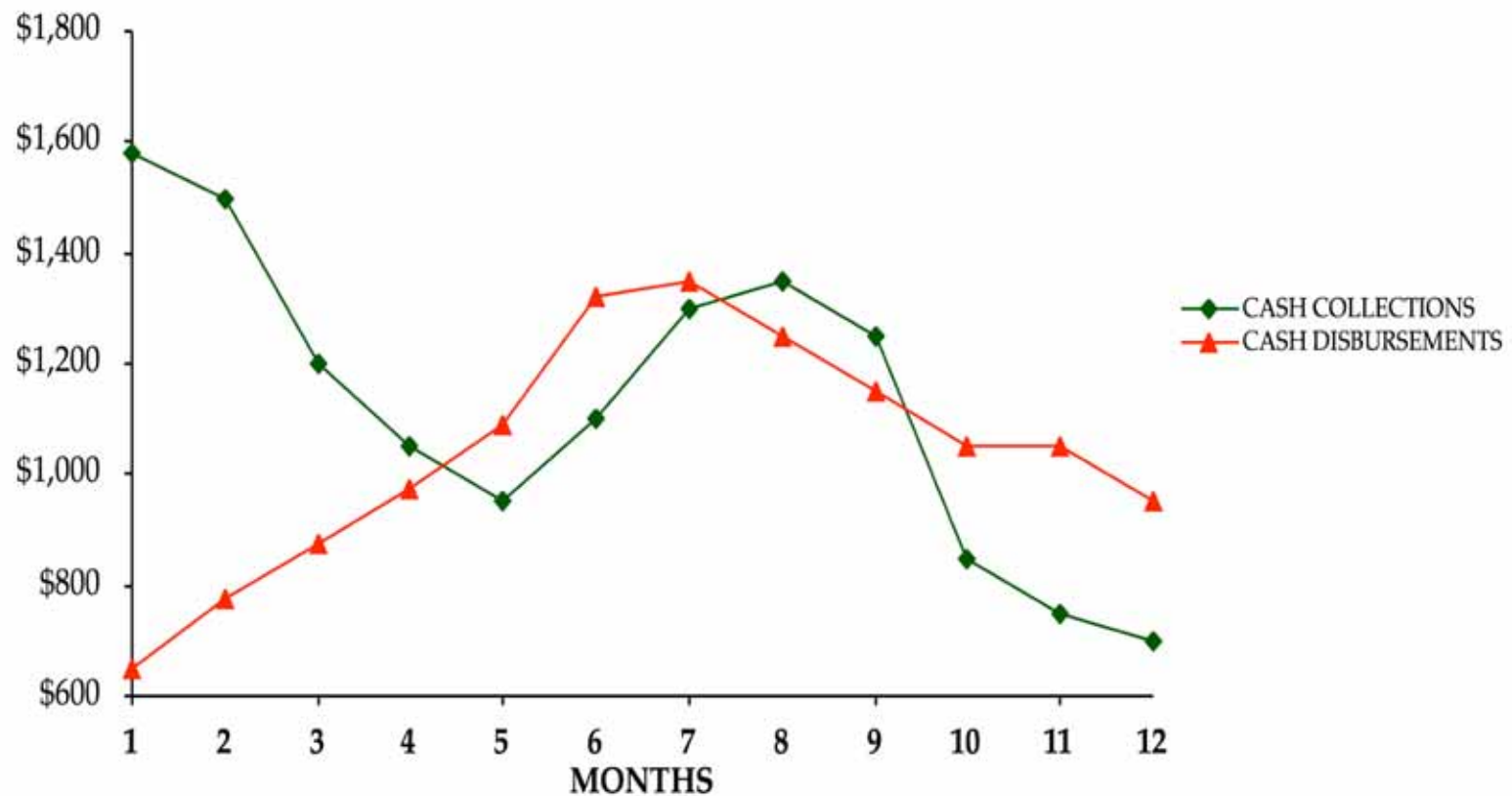
DEVELOP A TWELVE MONTH ROLLING FORECAST THAT OPTIMIZES CASH FLOW

- Develop basic assumptions concerning sales, production, purchasing, payroll and their effect of working capital requirements
- Estimate receipt of cash
- Categorize creditors into classes
- Prioritize payments to vendors and other creditors
- Determine payment schedule based on cash receipts
- Develop cash flow based on a “worse case” scenario
- Develop sensitivity analyses to prepare Company to respond quickly if assumptions change
- Refine and incorporate twelve week rolling forecast



THE TURNAROUND PROCESS

PROJECT CASH FLOWS FOR THE FIRST TWELVE MONTHS





THE TURNAROUND PROCESS

STAGE 4

**COMMUNICATE TO CREDITORS, CUSTOMERS AND
OTHER CONCERNED PARTIES THE CURRENT
FINANCIAL CONDITION AND FUTURE PLANS OF THE
COMPANY**



THE TURNAROUND PROCESS

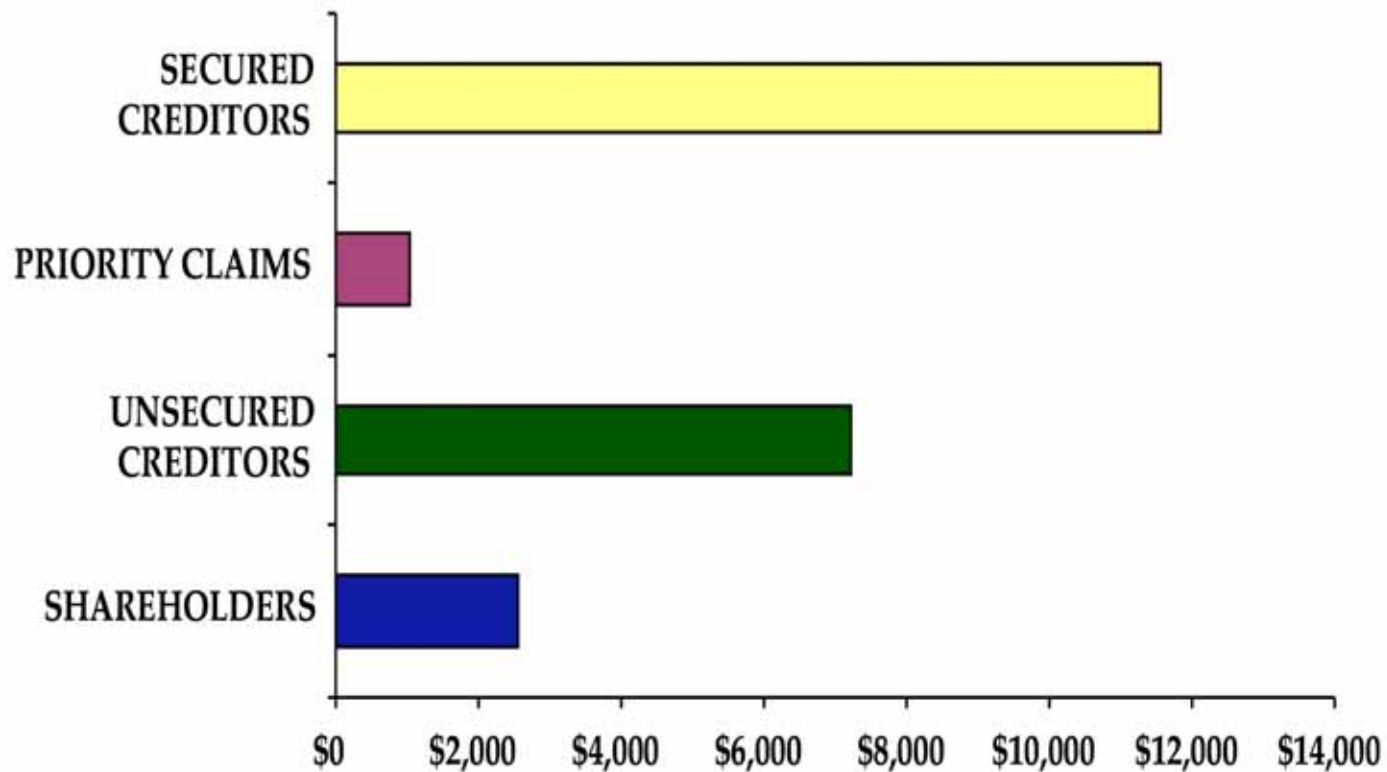
INITIATE NEGOTIATIONS WITH VARIOUS CREDITOR GROUPS

- Explain current financial difficulties
- Show evidence of steps being taken to turn situation around
- Emphasize the “Holding” of creditor’s position (not getting worse)
- Lay out next steps of developing reorganization plan
- Request moratorium period
- Stress need for creditor support
- Present twelve month forecast
- Assure creditors that no preferences will be given
- Request creditors committee be elected, if necessary
- Request no legal action be taken during moratorium
- Agree to buy from existing suppliers on a good-funds basis, COD basis
- Explain various creditors’ positions if forced liquidation occurred



THE TURNAROUND PROCESS

SEPARATE CREDITORS INTO VARIOUS CLASSES





THE TURNAROUND PROCESS

STAGE 5

DEVELOP A LONG-TERM STRATEGIC PLAN

- Continue to analyze underlying problems and steps necessary for correction
- Refine assumptions concerning sales, production, purchasing, payroll and their effect on working capital requirements
- Conduct in-depth competitive analysis and define Company's market position and strengths and weaknesses
- Determine level of capital expenditures necessary for Company to achieve plan goals
- Analyze product/product line profitability for possible savings/elimination



THE TURNAROUND PROCESS

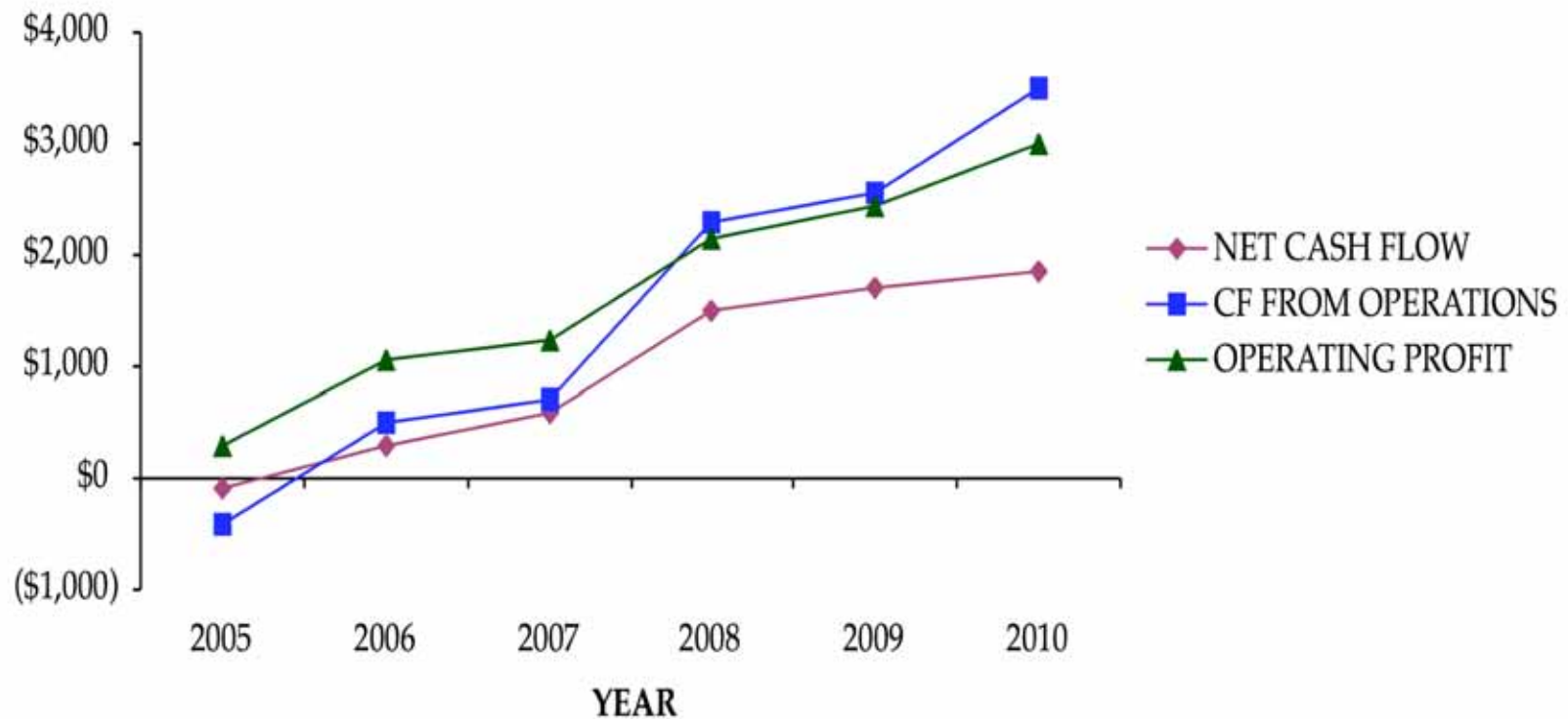
BASE THE STRATEGIC PLAN ON THE CASH FLOW AVAILABLE TO THE BUSINESS

- Develop comprehensive list of steps taken to date and to be taken in the near future
- Finalize what steps need to be taken to achieve a long term positive cash flow
- Develop pro-forma balance sheets and income statements for next three years
- Clearly define treatment of various creditor classes in plan
- Determine types of guarantees available to creditors if performance targets are not met
- Prepare risk/sensitivity analysis
- Review expense reductions on a line-by-line basis
- Compare strategic plan against the option of liquidation and/or sale of certain assets of the Company



THE TURNAROUND PROCESS

PREPARE FORECASTED FINANCIAL STATEMENTS





THE TURNAROUND PROCESS

STAGE 6

DEVELOP REORGANIZATION PLAN

THE PRIMARY COMPONENTS OF A PLAN ARE:

- Classification of claims and interests
- Treatment of classes of claims or interests under the Plan
- Means of execution of the Plan and description of funding of Plan obligations and working capital requirements
- Discussion of role of Creditors Committee
- Security available to guarantee performance
- Financial reports and related matters
- Executive compensation and related provisions
- Default and set-off provisions
- Effective date of the Plan
- General provisions



THE TURNAROUND PROCESS

PREPARE A DISCLOSURE STATEMENT TO ACCOMPANY THE REORGANIZATION PLAN

THE STATEMENT SHOULD EMPHASIZE:

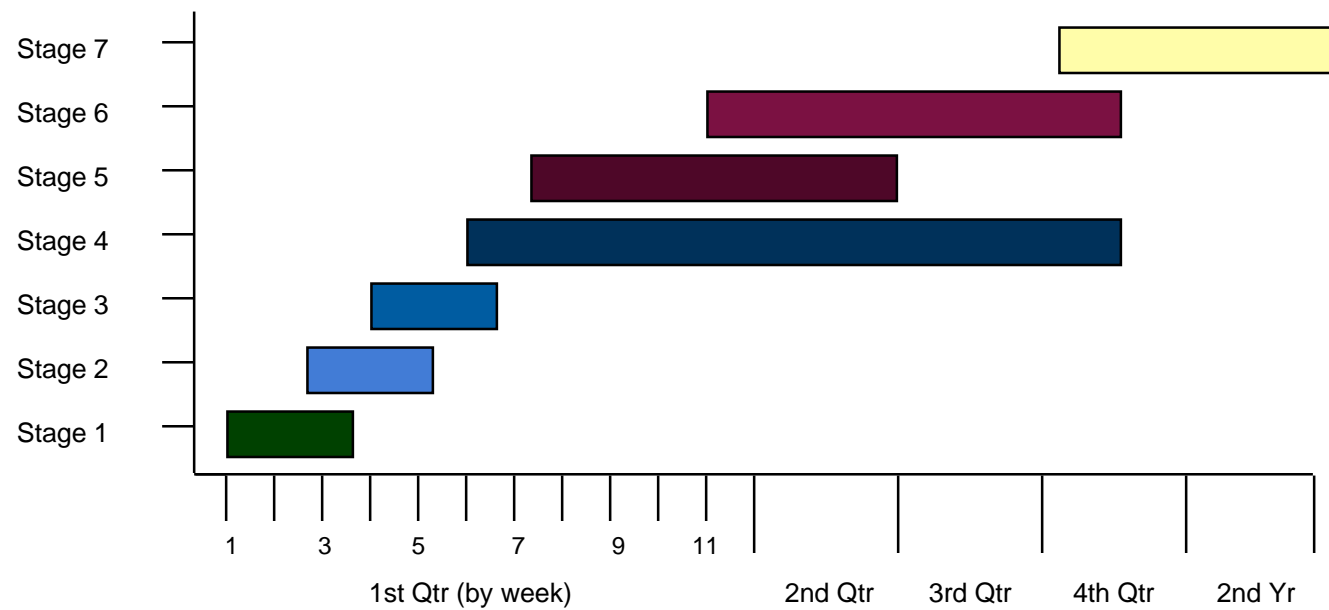
- The history of the Company including events leading up to the current problems
- The results of operation with particular stress given to the last three to six months
- The current status of negotiations with Creditors
- A summary of the Plan of Reorganization including a summary of the payment provisions of the Plan
- A feasibility study and risk factor analysis
- An analysis of a liquidation alternative
- A description of the management of the Debtor
- A statement from the Creditors Committee



THE TURNAROUND PROCESS

STAGE 7

IMPLEMENT PLAN OF REORGANIZATION





***OVERVIEW
OF THE
MERIDIAN
FINANCIAL MODEL***



THE MERIDIAN FINANCIAL MODEL

THE MERIDIAN FINANCIAL MODEL PROVIDES A PATHWAY TO:

- **RAPIDLY COMPREHEND A COMPANY'S FINANCIAL AND OPERATIONAL DIFFICULTIES**
- **DETERMINE THE NECESSARY CHANGES DEMANDED TO SATISFY THE NEEDS OF THE SHAREHOLDERS AND THE CREDITORS**



THE MERIDIAN FINANCIAL MODEL

SUMMARIZE HISTORICAL FINANCIAL STATEMENTS



THE MERIDIAN FINANCIAL MODEL

DEVELOP FINANCIAL PROJECTIONS



THE MERIDIAN FINANCIAL MODEL

CALCULATE FINANCIAL RATIOS



THE MERIDIAN FINANCIAL MODEL

ANALYZE ACCOUNTS RECEIVABLE



THE MERIDIAN FINANCIAL MODEL

ANALYZE ACCOUNTS PAYABLE

**PRIORITIZE ACCOUNTS PAYABLE ON A “NEED TO PAY”
BASIS**



THE MERIDIAN FINANCIAL MODEL

**DEVELOP A TWELVE MONTH CASH FLOW
FORECAST BY ANALYZING
CASH COLLECTIONS
AND
CASH DISBURSEMENTS**



THE MERIDIAN FINANCIAL MODEL

DEVELOP A TWELVE WEEK PLAN TO MANAGE CASH DISBURSEMENTS