



[Print this article](#) | [Return to Article](#) | [Return to CFO.com](#)

Looking for the Light

Guiding a company through a turnaround is no easy feat, but CFOs who can do it are in high demand.

[Kate O'Sullivan](#), CFO Magazine

February 1, 2011

It's a situation most finance chiefs hope never to be in: sales plunging, cash dwindling, debt-covenant violations looming.

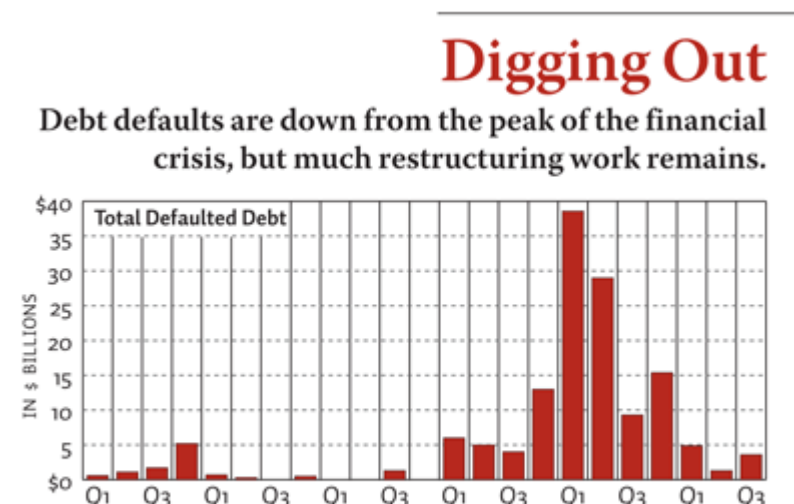
Those classic signs of a business in serious trouble are often clear to the CFO long before anyone else at the company understands just how bad things are. As first responders, CFOs play a critical role in determining the fates of distressed businesses — and their own fates often hinge on the outcome.

Guiding a business through a restructuring and turnaround is dramatically different from the usual routine of overseeing the financial operations of a company in steady growth mode. It's stressful and demanding, often requiring 15-hour days and long, tense meetings with bankers. Some CFOs, however, not only thrive on the opportunity but actually seek it out again and again, transforming themselves into turnaround masters. They develop a highly prized skill set, one that any CFO would do well to become acquainted with, if not specialize in.

Harold Earley is one such CFO. In December 2008, Earley, a veteran of two previous turnarounds, became finance chief at Foamex (now FXI), a maker of polyurethane foam for the furniture and auto markets. He took the job knowing that the company would likely need to perform some sort of balance-sheet restructuring. A public company at the time, Foamex was laboring under a heavy debt load and was already struggling to meet its banking covenants, having emerged from a 2007 bankruptcy still saddled with debt.

But even with that accurate read on the company's vital signs, Earley didn't know at first just how dire the prognosis was. "I could tell the company was going to be in default by the end of the year," he says. "What I didn't anticipate was how quickly it would occur. In short order I had to sit down with the CEO and say, 'I don't think we're going to make our interest payment this month.'" Within 60 days of starting the job, he helped Foamex file for bankruptcy again.

Today, despite signs that the economy is improving, the legacy of the financial crisis and recession lingers. Many CFOs find themselves working at troubled businesses, often with no prior experience in developing strategies to pull their companies back from the brink. Corporate defaults may be down significantly (the leveraged loan default rate in third-quarter 2010 was just 4%, down from 10% in Q3 2009), but many companies, particularly smaller ones, continue to struggle. Indeed, in the latest Duke University/*CFO Magazine* Global Business Outlook Survey, 20% of respondents reported that credit conditions were worse than they were in fall 2009. We spoke to restructuring experts and experienced CFOs like Earley, and asked them to share the key steps that finance chiefs should take when they detect unmistakable signals of distress.



Nail Down the Cash

Turnaround advisers and seasoned CFOs agree that getting a handle on cash flow is the top priority for finance chiefs when they start to realize that their companies are in trouble. Earley agrees: the first thing he did upon arriving at Foamex was to focus on cash by analyzing the business's daily cash needs.

"Understanding the cash flows is probably the most critical initial step a CFO can take," says former CFO Ken Sanginario, now a partner at NorthStar Management Partners, a turnaround advisory firm. "It gives them visibility as to how much liquidity they have or don't have. It starts to give them a framework

of how bad the problem is and how much time they have to fix it."

Tracking the company's cash does more than simply provide a reality check, Sanginario says; it can also help the CFO identify fast fixes to improve the situation. Collecting receivables more aggressively is one relatively easy way to boost working capital, for example. Carrying less inventory can also help the business build cash. "The more time the business has, the more options the management team can consider," he says. "A lot of times constructing a cash-flow forecast is an eye-opening exercise," alerting the CFO to just how bad the company's problems are. Sanginario says a majority of the distressed companies he has worked with do not have an adequate understanding of their cash flows.

A cash-flow forecast is not only valuable for the CFO in running the business but also critical for lenders, who will regularly check in on the company's liquidity status once the management team raises the red flag and informs them of the potential for problems. "You have to have a very accurate forecast, because there are going to be a lot of folks looking over your shoulder trying to figure out if you're going to make it," says Terry Moriarty, former finance chief at United Site Services, a sanitation-services company that completed a successful restructuring in November 2009.

Tom Spielberger, CFO of Celestial Seasonings and a veteran of a recent restructuring at Pliant Corp., a flexible-packaging company that successfully emerged from bankruptcy in December 2009, agrees. "If you say that cash will be X and it ends up being \$6 million less than that, you will spend a lot of time explaining what happened," he says. The credibility of the CFO, as always, rests on his or her ability to get the numbers right.

Jonathan Cleveland, a managing director in the financial restructuring group at investment bank Houlihan Lokey, urges CFOs of highly leveraged companies to analyze short-term cash needs (which he defines as between 9 and 13 weeks), midterm cash needs (about six months), and long-term (one to three years) cash requirements. For the short-term forecast in particular, "you need to be extremely precise," he says. "It can't be delusional and aspirational. Really look at the business and come up with a set of projections that are right, plus or minus 5%."

In testing their numbers, CFOs need to develop a variety of worst-case scenarios and consider what impact they will have on cash, Cleveland says. "What are the implications if the first signs of trouble start filtering out to the marketplace?" he asks. "It often creates a mini-run on the bank. Is your company prepared to withstand that?" Finance executives who fail to consider such possibilities and end up missing their projections quickly damage their credibility with their bankers and risk being replaced.

Contacting key suppliers is a second important task for the finance chief. While a first instinct might be to hide the company's troubles, talking to vendors and ensuring their cooperation is critical, and it's better for them to hear the news from the CFO than through the supply-chain grapevine. "People are afraid to let vendors know that they're in a restructuring process, but everybody knows already," says Sanginario. "It's the elephant in the room."

Sanginario adds that many companies wait too long to work out payment terms with their suppliers, and by the time they do, "the supply chain is closing down on them." Suppliers may begin shipping materials late and the company's plants can quickly become backlogged as a result. In a situation where working-capital management is of utmost importance, such a scenario quickly puts the company under serious pressure.

Calming the Waters

When Earley began the restructuring process at Foamex, he contacted the company's suppliers right away. "There are only a handful of vendors that supply our chemicals, so making sure we could get credit from them was very, very important," he says. CFOs should expect to spend a lot of time communicating with vendors, he adds. "Suppliers were calling me on a very regular basis for updates," he recalls.

"Suppliers get very nervous," says Spielberger. "You need to walk them through the restructuring process. A lot of them don't really understand it." In Pliant's case, the company filed for bankruptcy and Spielberger was able to secure debtor-in-possession financing, which meant that, under the terms of the restructuring, suppliers would be paid before any other creditors. The news, understandably, had a calming effect. "We did not lose any suppliers throughout the entire process," he says.

Sanginario also stresses the importance of ongoing, rather than one-time, communication with vendors. "A common mistake CFOs make is thinking that just because they've made payment deals, usually going on a C.O.D. plan and freezing old balances, the supply chain is okay," he says. "A lot of times it's not. Suppliers might accept the payment plan, but it doesn't mean they're happy."

In retaliation, they may move a company to the bottom of their list, stretching out delivery lead times, or delivering products of lesser quality or higher price. Sanginario urges CFOs to regularly check in with front-line workers on these issues and take action — like seeking out other suppliers or carrying more inventory — to defend against them.

Earley also spoke with those on the other end of the supply chain — customers — to make sure they knew that their business would not be interrupted by Foamex's troubles. In the process, he learned that one of the company's largest customers was going through a restructuring of its own. He developed a good relationship with his fellow CFO and the two spoke often throughout the restructuring.

As a supplier to the auto industry, Foamex had plenty of company in its distress. "Two of our top five customers went through restructuring right after we emerged from bankruptcy," says Earley. "The whole supply chain was getting restructured." By speaking regularly with top executives at Foamex's customers, Earley not only created a strong rapport with them but also gained a sense of how those companies were faring and whether any of their key accounts might disappear. Foamex was ultimately able to retain all of its major customers.

CFOs should also communicate frequently with employees to help them understand the restructuring process and to make sure the business remains on track for a turnaround. Not only does the finance chief need to enlist the help of front-line workers in reducing costs, collecting receivables, managing inventory, and conserving cash, but he or she must also ensure that employees understand that a restructuring or even a bankruptcy filing does not necessarily mean that they will be out of a job.

While emphasizing the hard work that needs to be done, "you need to make sure you don't send panic throughout the organization," says Moriarty. He adds that "competitors can be ruthless in that scenario," by, for example, alerting customers to their rival's cash crunch. Word can filter back to employees, who may assume the worst and begin looking for work elsewhere unless they get some reassurance that things are under control.

There may also be some hard personnel decisions to make, says Sanginario. "Very often, when a company is in distress, there's just a 'lackadaisicalness' throughout the company that's very tough to change," he says. "I've been at companies where every delivery they ship out is late, and it doesn't even seem to bother anybody." In that case, he says, the CFO may have to examine the corporate culture and replace problem staffers.

Still, "the CFO has to be careful not to cut things that can be critical to the company," Sanginario adds. In an effort to clean house and jump-start a turnaround, finance executives, who often have years of cost-cutting experience, can go too far. Sanginario cites the example of one distressed client where the management team made deep cuts in their safety and environmental compliance group and later received a significant fine for an environmental violation. Finance chiefs need to strike a balance between reducing costs and ensuring the business has the resources to eventually return to its full strength.

Be an Honest Broker

As much as a restructuring will put a finance chief squarely on the front lines, CFOs should also recognize the valuable role they play as intermediaries, representing the company to stakeholders on all sides of the business: lenders, equity holders, vendors, and customers, in addition to employees and board members.

Understanding the interests of these various parties, and taking them into consideration in drafting restructuring and turnaround plans, is perhaps the most challenging and most valuable part of the finance executive's job, says Moriarty. "It's important for the CFO to really know everything that he can about the parties involved," he says.

This reconnaissance can often help the finance chief find solutions to the company's woes, he adds. "What buttons might the CFO be able to push with each of the various stakeholders?" he asks. "Say you're running short on cash. Do the equity holders have the ability to provide more funding? Do they want to? Are the debt holders able to provide more flexibility relative to payment terms?"

Finance executives can increase the odds of winning such flexibility by communicating clearly and frequently to all parties and demonstrating a command of all of the facts of the company's situation. "It's an art form that the CFO has to learn. It's pretty amazing how much more cooperation you get from lenders when they have confidence that you're making things transparent and not trying to do things to circumvent their interests," says Sanginario.

"You need to be able to explain the situation to lenders in a thorough, comprehensive, honest way," agrees

Houlihan Lokey's Cleveland. "Acknowledge any management missteps, show the desire to fix the problem, and describe any strategies that have been put in place to do so."

Telling lenders that the company has closed underperforming locations and reduced head count helps demonstrate that the management team grasps the gravity of the situation and is already working to improve things. That's far better than living in a state of denial, a reaction that turnaround experts say is a common problem among executives at troubled firms. "It goes a lot easier if you can point people to something positive that you're doing, rather than just throwing up your hands," says Moriarty.

If all of this sounds exhausting, it is. While experts and finance chiefs alike acknowledge that restructuring a company and leading it through a turnaround is grueling, it is also an incredibly valuable experience, and one that truly can take a CFO to the next level. "It's a tremendous career opportunity, because so few people have that trial-by-fire experience," says Cleveland. "From a personal standpoint, a CFO should look at it as the hardest 12-to-18 months of his or her professional career, but know that it will pay long-term rewards."

Kate O'Sullivan is a deputy editor at CFO.

© CFO Publishing Corporation 2009. All rights reserved.