

VIEWPOINT

How A Turnaround Professional Weighs The Economic Evidence

By Peter L. Tourtellot



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Economists are not quite ready to say the United States is headed into a recession, or is already in one. They invoke time-tested and time-honored criteria for what constitutes a recession. We professional turnaround managers, on the other hand, feel confident in saying that trouble is here now. We listen to our client companies, we see the mounting difficulties they face, we pay attention to evidence that may not be on the radar of scholarly prognosticators.

Many of the signs are now making front-page news daily. Consumers are adding to their mountain of credit card debt every hour to cover the basic necessities of food and gas. Retailers' sales are below their projections, and once-thriving companies like The Sharper Image are filing bankruptcy. Consumer confidence is at its lowest point in five years. Inflation has set in.

One of the most dramatic, and telling, pieces of evidence is that eight million Americans now have homes that are worth less than the amount of their mortgages. According to Mark Zandi, chief economist of Moody's Economy, the last time so many homes were valued at less than the amount they were mortgaged at was during the Great Depression.

In January single-family home sales fell to the lowest rate since February 1995. Housing starts are approaching lows set in 1991. Slow housing sales and housing starts have implications beyond the obvious. According to the National Association of Home Builders, every dollar spent on the purchase of a new house is worth another seven to eight dollars to the overall economy. This should come as no news to any first-time homeowner, or anyone who has ever moved up to a larger house. Along with the mortgage comes the need for furniture and lawn fertilizer, curtains and kitchen utensils, pest control services and potted plants.

In more ways than can be easily measured, home is where the heart of the economic downturn is. When houses are not worth the amount of their mortgages, when people can't sell their homes after months and months of having them on the market, there's a psychological effect. Consumers start to think of themselves as not being able to afford things, as being poor. And when people don't feel well off, they tend not to spend.

A slump in the housing industry is a blow to dozens of kinds of companies, from marble contractors to mattress manufacturers. For starters, here are some industries that are already feeling the pain:

- Lumber, plywood, millwork and wood panel wholesalers
- Roofing, siding and sheet metal contractors
- Plumbing and heating equipment suppliers
- Ready-mix concrete manufacturers
- Heating and air-conditioning equipment suppliers
- Paint and coating manufacturers
- Roofing, siding and insulation material wholesalers
- Brick, stone and related construction material suppliers
- Carpet and rug mills
- Legal services
- Building equipment and machinery installation contractors
- Non-metallic mineral product manufacturers
- Other construction material wholesalers
- Cutlery and hand tool manufacturers

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- Urethane and other foam product manufacturers
- Tile, terrazzo and mosaic contractors
- Communications equipment manufacturers
- Wrecking and demolition contractors
- Sawmill and woodworking machinery manufacturers
- Plumbing, heating and air-conditioning contractors
- Electrical contractors
- Drywall, plastering, acoustical and insulation contractors
- Painting and wall covering contractors
- Masonry and stone contractors
- Household furniture manufacturers
- Home improvement chains like Home Depot and Lowe's
- Hardwood companies
- Textile companies
- Hardware suppliers
- Paint and coating manufacturers
- Trucking companies
- Retail furniture outlets.

For companies in the furniture industry, the drop in single-family home sales represents a double whammy, as most have also been fighting a losing battle with overseas competition.

Many companies in these housing-related industries are likely to need restructuring help in the near future. Unless their balance sheets are in A-1 condition, many may find it difficult to get loans. The credit crunch has moved downstream and is now increasingly affecting smaller businesses.

As the liquidity bubble has burst, the bankruptcy rate has been climbing. Of particular significance is the recent spate of bankruptcies filed by businesses owned by private equity funds. Some prominent examples include Fortunoff Fine Jewelry, Silverware LLC, Wickes Furniture, Hoboken Wood Flooring, Allied Van Lines, Jiffy Lube, Performance Transportation Systems, the Buffets restaurant chain, and Silver State Helicopters among others. The private equity fund managers appear to be saying that companies who recently looked promising are now likely lost causes or the only way to restructure is through the Chapter 11 process. However, what is clear is many PE shops aren't willing to throw good money after bad.

What also seems pretty clear to those professionals who work daily with distressed companies is that we're seeing a situation that is going to get worse, without a glimmer of a recovery. The unraveling of the subprime mortgage meltdown, the cascading consequences for every industry that touches residential real estate, the tightening of credit all the way down the line, the continuing lay-offs in many industries and consumers' fears all add up – not to a forecast of trouble but a photograph of trouble. The bad times are here, and the going will be rough for the foreseeable future.

(Opinions expressed are those of the author, not of Dow Jones Newsletters.)

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