

Trouble in 'Mayberry'

Disaster Averted, Despite Liquidation

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At first blush, the engagement had all the makings of a disaster:

- The European owners of a North Carolina textile mill were disenchanted. They had lost millions and saw no hope for recovery. They had to put up more and more security in the form of letters of credit to gain the forbearance of the secured lender.
- The secured lender was fed up with the company as well, after years of listening to its good intentions followed by lackluster performance and deteriorating credit quality. Now the collateral was falling out from under them. The unsecured creditors were owed millions. If the pattern of earlier textile meltdowns was repeated, they would be lucky to see pennies.
- The auto companies that were the mill's customers were blissfully unaware of how the impending meltdown would jeopardize their own continuity of operations —

even though they had precipitated the mill's troubles by re-sourcing long-term contracts.

- The employees, for the most part, were long-time textile workers. As mills in the area had been shuttered, they had moved from plant to plant. They felt that there was some security with this company, because its customers wanted product produced in the United States. The community, which was the real-life model for Mayberry, 1960s television's idyllic small town, had spent significant resources to induce the company to relocate to its jurisdiction. Bloggers and critics were having a field day pointing to the company as a poster child for corporate welfare.

There was no way this company could be saved. Yet at the end of the engagement, the owners, secured lenders, unsecured creditors, and local government entities all walked away with money in their pockets. On the

day the plant closed, the employees, who had all lost their jobs, lined up to thank the Certified Turnaround Professional who had made the wind-down a little less painful for all involved.

Defining Success

Often turnaround professionals are asked to quantify their success rate. It's a simple enough question on the surface, but in reality can be quite complex and difficult to answer. An outsider may believe that a turnaround's success hinges on the emergence of a revitalized business ready to face the competitive world with all the wisdom gained from the involvement of the CTP who orchestrated the process.

Unfortunately, such a scenario is not always feasible. For many reasons, some businesses will not — and often should not — emerge to fight another day. However, that does not mean that the knowledge and skills of the CTP or the money of the stakeholders are wasted on professional intervention with these companies.

The same knowledge and skills applied to rehabilitate a failing company can be applied to create value in a company destined for wind-down. Treating a troubled company as "just a liquidation" may be a costly mistake if it precludes professional efforts to create value. The case of the North Carolina textile mill exemplifies this concept.

As with many turnarounds, it was important to clarify for the diverse stakeholders their positions at the outset of the engagement. Typically a liquidation analysis under an assumed Chapter 7 process provides a useful benchmark, because it reflects the recovery available to the creditor community if no constituency does more than it is legally required to do to enhance the value of the company. A credible liquidation analysis should provide a baseline for expectations and also clarify for uninitiated creditors why cooperation and a balancing of interests will benefit the creditor community.



As is common in troubled manufacturing companies, the textile mill's inventory was largely obsolete. The production line ran hand to mouth. Accounts receivable reflected valid accounts due from credit-worthy customers that normally would be collectable. However, because the company was a Tier III supplier to the automotive industry, non-performance and quality charge-backs would decimate the value of collections in a liquidation.

The baseline liquidation analysis was bleak. Textile production equipment is not in short supply in the region and therefore has little value. Shuttered production facilities are not of much value in rural North Carolina either. The secured lender recovery would be complete only after the real estate was sold, and nothing would be available for any other constituency.

After drawing the baseline, it was important to determine which stakeholders were most at risk — who had the most to lose or gain if the company adopted a course of action other than a straightforward liquidation. After financial resources were cut off and the plant was shut down abruptly, it was easy to see who had the most to lose. Ironically, it was the big customer — the automobile manufacturer to which the company had become invisible as a Tier III supplier.

Finding Common Ground

How could it be that the industry that basically drove the textile mill out of business struck a blow to its own health by doing so?

Over the past few years, American auto companies had adopted a sourcing strategy intended to reduce costs by consolidating suppliers, particularly at the Tier II and III levels. The textile company shipped product to Tier I and II suppliers under directed supply agreements negotiated with the auto manufacturer. However, the Tier I supplier issued purchase orders and managed the day-to-day relationship. To negotiate a workable wind-down agreement, it was critical for the CTP to understand the entire inventory position and supply chain from the plant floor through the Tier I supplier and the original equipment manufacturer (OEM).

In doing so, it was determined that the timing of the wind-down was critical to the auto companies, which were pressed to avoid the cascading effect of line stoppages through the supply chain. The reactions of the automobile companies confirmed their status as most at risk. Their procurement managers and their lawyers threatened multimillion-dollar lawsuits, nonpayment of accounts receivable, and exclusion from future business opportunity.

As a result, a strategy was identified to create value for creditors where conventional wisdom said there was none. The textile company would supply quality product while allowing its customers to transition to a new supplier, thus avoiding the tremendous costs of production line downtime. In exchange, the customer's agreed to share a portion of the avoided costs with the textile mill's other stakeholders and not to take any of the punitive actions they had threatened. This wind-down agreement was executed with every customer wanting continuity of supply and a transition period.

Key elements of the wind-down agreement were developed based in large part on the threats of the auto companies. All outstanding accounts receivable would be paid prior to the first shipment. Indemnification from prior claims was required. Product quality was deemed to be accepted when product shipped, and the customer was given the option to put quality inspectors in the plant.

Each customer was required to purchase the raw materials required for its product and to pay a "tolling fee" for the textile mill to process the finished product. Payment terms were 10 days from invoice with no offsets. Customers and their consultants were allowed access to the plant to monitor

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the process. Essentially, the customers got everything they needed but on terms the textile company could live with comfortably.

With a significant opportunity to create value for creditors identified, the process turned to identifying other stakeholders who were critical to fulfilling the contracts and to providing incentives for their support. Key stakeholders whose buy-in was required included the secured lender, junior secured lender, unsecured creditors, the city and county governments, and the company's employees.

Secured Lender. The secured lender's cooperation was needed to provide additional financing to restart the plant. In exchange for assuming this additional risk, the secured lender could be paid in full from the proceeds of the accounts receivable collection without offset, as guaranteed under the wind-down agreements.

Junior Secured Lender. The junior secured lender was created when the secured lender drew against a standby letter of credit. The standby letter of credit was the form of guarantee provided by the owners to the secured lender and was secured by junior liens against all assets of the company and also guaranteed by the owners. These liens were a significant issue to the unsecured creditors who saw their opportunity for recovery threatened.

Clearly the best interests of creditors would be served by avoiding the expense of bankruptcy and litigation of the junior liens. To secure the cooperation of unsecured creditors, which included both critical vendors and the city, the junior lien holder was convinced to cede to the unsecured creditors the proceeds from the wind-down agreements and the sale of production machinery, while maintaining rights to the proceeds of the real estate.

Trade Creditors. As sole-source suppliers, the trade creditors were critical to the success of the plan. Most of the larger creditors had been through similar scenarios involving other textile meltdowns. They required an opportunity for recovery, but they had no taste for incurring added risk. The wind-down agreement's requiring material purchases to be made by the customers eliminated that concern by trade creditors.

City. The city government was under significant pressure to recapture some of the incentives it had granted to the company. City officials had nothing to lose politically by initiating a course of action that would put the company in bankruptcy. The recovery opportunity afforded by the wind-down agreement, however, together with the actions of the junior lien holder, secured the cooperation of the city government.

The engagement could not have succeeded without a comprehensive communication plan to keep stakeholders engaged throughout the process.

Employees. The company's employees had endured several rounds of downsizing. As a final blow, the plant was closed with no warning after financial resources were withdrawn. No money was available for severance or transitional assistance of any kind. However, these employees were crucial to fulfilling the wind-down agreements and generating the upside identified.

The employees needed a transition plan that would allow for their relocation, retraining, or retirement, and resources to fund it. They also needed a leader they trusted on the plant floor.

Employees were granted significantly enhanced earnings opportunities for working during the wind-down. A former quality manager who had an excellent working relationship with shop floor employees and the company was brought on board to lead plant floor activity and maintain an emphasis on quality under trying circumstances. Representatives from the local community college were enlisted to provide on-site counseling regarding educational options and career transition. Representatives from the state employment commission also were given on-site access to employees regarding employment transition options.

Cutting Losses

The results of what could have been "just a liquidation" speak for themselves. Two of the auto companies supplied under the wind-down agreements independently hosted appreciation luncheons for the mill's employees to recognize product quality and

timeliness of deliveries. The secured lender was paid in full about 45 days after the start of the wind-down plan. The unsecured creditors received about 50 percent of their claims, far exceeding expectations, and the city received a refund of 50 percent of the incentives it originally granted.

The employees benefited from substantially enhanced earnings, a transition period, and assistance in planning their next career moves. The owners were able to recoup from the sale of real estate a significant amount of the standby letter of credit they had guaranteed.

The engagement could not have succeeded without a comprehensive communication plan to keep stakeholders engaged throughout the process. The team of professionals that made this success possible included a debtor counsel who was a skilled negotiator with significant experience in non-judicial workouts. Also critical to success was the involvement of an unofficial creditors' committee represented by experienced counsel. While every effort may be made to communicate effectively with creditors and maintain credibility of the process, sometimes a creditor that is under stress needs to talk to one of its own.

Ultimately, the stakeholders judge whether the outcome was a good one. Even in cases in which a wind-down is inevitable, skilled CTPs look for leverage points and ways to balance the interests of all those who stand to lose, thus averting utter disaster for those involved. •

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