

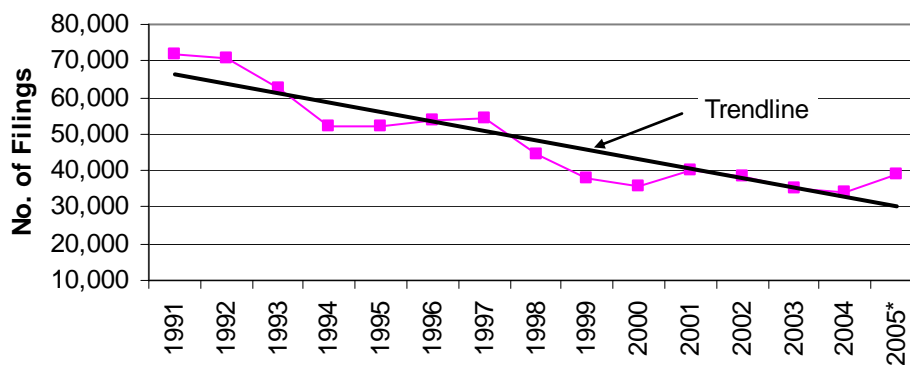
## Corporate Restructuring Trends: The Day of Reckoning, Hedge Funds, and How to Prevail

### A Q&A session with Ron Norelli, CTP Chairman, Founder and CEO of The Norelli Group

1. Corporate bankruptcies have gone down for many years. What factors continue to drive this trend?

*Continuing economic growth plays, of course, a big role. Other, technical factors include (a) continued trends of large banks to package and sell troubled loans into distressed debt markets rather than "workout" the problems; in fact, large US banks have severely downsized their own Workout groups; (b) more creativity and emphasis to use various "alternatives to bankruptcy" strategies; (c) very high costs (professional fees) and delays in getting through bankruptcy processes; and (d) for middle-market debtors, the low probability that the company can successfully emerge from a bankruptcy process.*

### Bankruptcy Filings of U.S. Businesses in the Past 15 Years



Source: American Bankruptcy Institute

2. Is it fair to say the majority of vulnerable companies are merely postponing the day of reckoning?

*Generally speaking, yes. Human nature doesn't change regardless of specific events or regulations. Denial, Distractions and Delay [dubbed the 3D's in earlier writings of Ron Norelli] will continue to be the most serious barrier to a company maximizing its potential for a favorable outcome during a restructuring period, or even just surviving. A rhetorical question that I often use in presentations to audiences of restructuring professionals is, "How many of you are aware of a troubled situation, when in looking back on how the process ultimately unfolded and concluded, the people involved say, 'We acted too fast.'?" Invariably, the question results in laughter, heads shaking "no", and no hands go up. [See Ron Norelli's article "Procrastination and consequences" in *Financier Worldwide's "2006 Global Restructuring & Insolvency Review"*.]*

---

\* The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 generally tilted the playing field in favor of creditors. Enacted on October 17, 2005, the law led to an unusual high number of bankruptcy filings in the fourth quarter of 2005. As a consequence, business bankruptcy filings were at a record low level in the first quarter of 2006, just 40% of the average quarterly filings of the previous 10 years.

3. Could you highlight any new regulations, or important changes to existing regulations, that will have an impact on the way insolvency is conducted in the future?

*Certainly the recent changes in the US bankruptcy code are having a significant impact here; not generally favorable to the debtor.*

4. Is it becoming more difficult to generate consensus among creditors in bankruptcy and restructuring cases?

*The potential for inter-creditor squabbles that turn destructive is always a risk. What might be different this time are factors such as (a) introduction of new players who not only may not have much experience in navigating complex workout situations, but also think differently from one another and have divergent expectations and objectives regarding investment outcomes; and (b) the fact that some large banks have substantially downsized their own "Special Assets" groups in recent years, again leaving them with neither adequate capacity nor the knowledge or experience base in these kinds of battles.*

5. Do you anticipate that the huge levels of liquidity in the market, provided by powerful sources such as hedge funds, are more likely to assist future restructurings by providing the necessary capital to fund them, or will it be the root cause of disputes that delay and erode efforts to effect corporate rejuvenation? Are both scenarios plausible?

*Both scenarios are likely. I am particularly concerned about the possibility that those handling hedge fund involvement in a workout process involving a portfolio operating company may not be well-trained or experienced in these kinds of matters, potentially leading to a more difficult and/or protracted restructuring process. And, time is never an ally of constituents involved in a restructuring process. Hedge funds also do not necessarily want the outcome to be getting paid. They'd rather own the company.*

6. In restructuring cases, how important is a communication plan to govern the release of information to employees, the media, potential lenders or possible buyers of a troubled company?

*Good communication is critical to the success of any restructuring efforts. A few reasons are (a) to head off rumors which almost always lead to negative (and usually untrue) conclusions; (b) to keep negative momentum from building up to a point where it's more difficult to reverse; (c) to foster trust and creativity in finding win-win solutions: good communication always rallies employees (and other constituents as well, such as suppliers), can create ideas for help that otherwise might not surface, and can build trust and morale (the opposite is true for poor or nonexistent communication); (d) to satisfy a longing for the truth on the part of many who have been feeling that the truth has been lacking.*

7. What are the key points of a good communication plan?

*Two simple rules should govern everything: (1) always tell the truth; (2) don't promise something (or give the impression you're promising something) that you can't deliver. And, one often must consider the importance of timing, and be able to sense when it's the right time (or not the right time) to deal with a particular matter in a way that can mobilize the right people to do or support the right thing.*

8. What do you predict will be the causes of the next corporate restructuring wave? Do the signs tell us how far away we might be from a cyclical downturn?

*The causes will include all those that have been there historically: Declining competitiveness of a company, poor asset productivity, false measures of success, poor strategic decisions, bad execution and operating fundamentals, sea changes in an industry that go unrecognized by management for too long (globalization is certainly one), emergence of new competitors who are breaking the rules, poor acquisition assimilation or acquisitions done for the wrong reasons, lack of focus (global mediocrity across the company's business model, management suffering from the 3D's, fraud or unethical practices), and lastly, factors that really are out of management's control. Add to these the hedge fund emergence, and the large quantity of other private equity money chasing too few really worthy deals, pushing up prices on good companies and leading to not-so-good deals that perhaps shouldn't be done at all.*

9. What do middle-market companies have to do to prevail in an increasingly competitive and global business environment?

*There are a handful of ground rules middle-market companies should follow to heed the causes of failure which I listed above:*

*a. Focus on market niche*

*Careful market segmentation and intimate knowledge of one's customers is essential to achieve and maintain corporate growth. Excellence in a select few market segments trumps mediocrity in many areas.*

*b. Invest in profitable growth*

*Continued investment in product development is necessary to stay competitive. Although it seems obvious, a successful growth strategy not only results in increases in the top line, but also similar or greater percentage increases in the bottom line. Top line growth at the expense of the bottom line is not a sustainable strategy as it eventually leads to the destruction of shareholder value.*

*c. Respect the financial function*

*Declining gross margins, asset productivity and unsatisfactory return on investment are just a few quantitative warning signals which should be monitored and taken seriously. Inaccurate or a complete lack of important financial data render sound strategic decision making impossible.*

*d. Rethink established rules*

*According to the Association for Certified Turnaround Professionals, management failure (including unanticipated changes in the competitive landscape) is the main cause for a business's demise. This goes back to my earlier comment regarding "Denial, Distractions, and Delay." Underestimating certain competitors, holding on to cherished yet outdated beliefs, are common internal issues that can be avoided with an organizational design and culture that balance "old vs. new" conflicts.*

*e. Use the Board as an intangible asset*

*To be effective, a Board must perform beyond compliance with the administrative and procedural demands of good governance. The Board must rise to the level of a true "intangible asset" in the same way as other intellectual property assets of the business. The majority of the Board should be made up of outside directors, former CEOs with hands-on experience in sales, finance and operations, and battle-tested in previous directorships. And, just as important, the "outside" Directors should also be "independent" Directors, having no previous ties with either one another or any individual family member in a family business environment. The Board must set demanding expectations and understands that performance means results, not good intentions. Outside Directors can be effective mentors not only for the owners of a family business, but also for non-family executives and managers. They must*

*quickly assert themselves when they sense management is becoming enamored with alternative strategic directions fraught with danger.*

The interview was conducted in August of 2006.