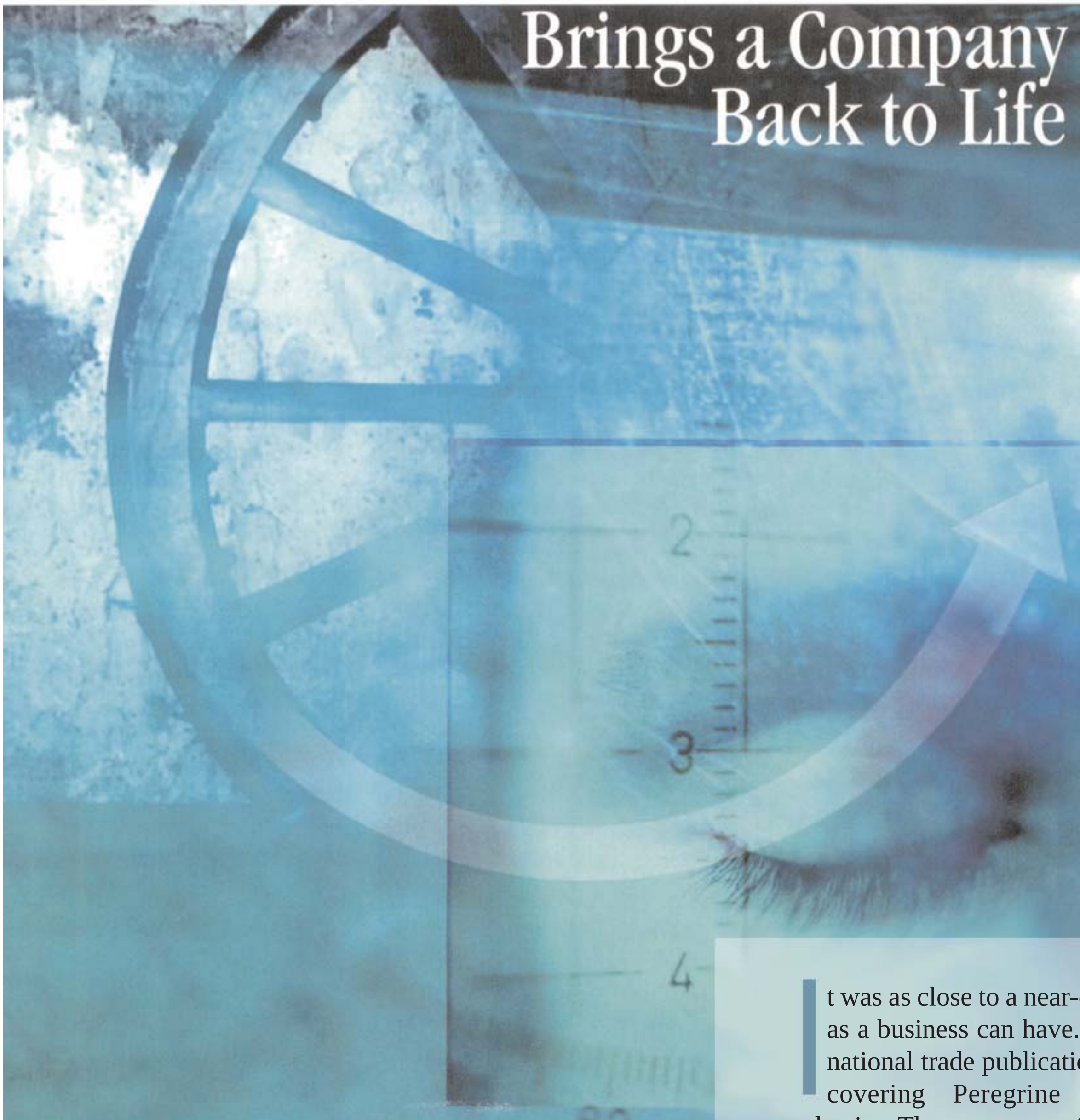
RE-VISUALIZATION Brings a Company Back to Life



In an extended case study, the president of a turnaround firm reconstructs the rescue of a failing software company and its eventual return to health.

By Harvey Kibel

It was as close to a near-death experience as a business can have. Local press and national trade publications were already covering Peregrine System Inc.'s demise. The company, a San Diego-based provider of consolidated asset and service management software solutions, found itself in quite a bind.

When Kibel Green Inc's (KGI) on-site manager, Bruce Conklin, surveyed the landscape in 2002, he, too, wondered whether trying to rescue the company would simply be like "rearranging chairs on the Titanic." And although this story has a happy, profitable ending, it does for only one reason: the company agreed to be "re-visualized."

Re-visualization's Key Questions

While it may sound oddly New Ageish for a business concept, "re-visualization" describes the process too well to dismiss it. Re-visualization centers around two questions:

- What is the company's current status?
- During the growth phase, was the company profitable at that same revenue level?

Over a 20-year growth spurt, Peregrine had grown to $500 million in revenues, and it took only a few years for it to plummet back down to $150 million. But, a company must look to its history for answers. On the way up, Peregrine was profitable at $150 million — which leads to the first step of revisualization: making the company profitable at $150 million on the way down. So, once we knew Peregrine's current annual revenues and knew the company was profitable at that level a number of years ago, we had established a starting point. The goal here is to create a picture of the organization once the business completes the "comprehensive mapping projects."

Facing the Grim Facts

Admittedly, it wasn't always easy to see much beyond organizing an orderly liquidation. Every turn presented a more daunting obstacle. However, Gary Greenfield, the CEO, and Conklin recognized they faced a formidable task:

- Poor odds, considering that never before had a public software technology company of this size emerged from bankruptcy as a public company.
- Recent resignations of the CEO, CFO and other top financial executives, amid controversy involving the company's unraveling.
- Revenues declining from a peak of over $500 million to approximately $150 million.
- Cash depletion by early July 2002, even though KGI had just been engaged a month before.
- An SEC investigation regarding the handling of reciprocal transactions.
- Three changes in outside auditors, from Arthur Andersen to KPMG to PricewaterhouseCoopers.
- Complete mistrust of all accounting information on the part of: financial institutions, bondholders, shareholders, unsecured creditors, middle management, the Securities and Exchange Commission and potential future sources of capital. This credibility was an essential ingredient for negotiations with all interested parties.
- A high personnel base, emphasis on non-core businesses and excess physical facilities.

Clearly, the odds were against a successful ending, which reinforced the need to go through the re-visualization process. It forced a new start by looking at opportunities with a new point of view.

Five Steps to Revisualization

Once the new, profitable $150 million business was re-visualized and compared with the existing infrastructure, the task was a lot easier. The challenge then became how to transition from the old structure to the new.

How was all this accomplished over an approximately 10-month period? The effort can be divided into five major areas:

1. Stabilize the company;
2. Re-establish confidence in Peregrine's financial data;
3. Meet interim cash needs;
4. Measure the turnaround;
5. Pave the way for successful emergence from Chapter 11.

Stabilize the Company. While Greenfield and his management team focused on the core business, its customers, partners and employees, KGI's focus turned to Peregrine's cash position. KGI created a 13-week cashflow forecast that quickly determined that the business would run out of cash in 30 days if it continued operate at its current rate. This helped define the time parameters.

From there, negotiations were begun with all vendors to stop the non-critical cash outflow until a plan could be put together. Vendors needed assurance that they would receive equal treatment and that their positions would not deteriorate.

Other efforts to bring the company to stability included negotiation of a forbearance agreement with three "factor" banks that were on the verge of putting Peregrine into involuntary bankruptcy. Also, a facility funding agreement was negotiated with the directors of the European operations. Finally, KGI assisted new management in completing a sale of one of its entities, coupled with $49 million of interim financing that bought the company time, until mid-September, to turn around.

Re-establish confidence in Peregrine's financial data. Peregrine had lost its credibility. The company needed to approach banks with a reliable, believable road map for its future. KGI created an interim operational and financial model to assist new management, the board and the banks in understanding the company's financial direction. Utilizing this vehicle, the "burn rate" was brought under control, and vendor programs were developed to preserve cash by paying critical vendors for current services and establishing moratoriums for non-critical services.

Meet interim cash needs. Key moves were made to meet cash requirements. The company was able to spin off a number of non-core assets that generated a much-needed $41.5 million. Approximately 70 percent of a software company's costs are people, with another 10 percent in real estate. Staff was slashed from 3,400 to 650. Investment bankers assisted the company in contacting 49 potential investors/buyers. Six proposals were received, but only for the purchase of Remedy Corp., a valuable subsidiary. Remedy was sold for $335 million in the fall of 2002, which provided the cash needed for the eventual turnaround.

Measure the turnaround. Operational break-even was achieved by December 2002, and Peregrine exceeded the revenue target in the six-month period ending March 31, 2003 by 116 percent, while exceeding the earnings target by 140 percent. A "bottoms up" budget system was developed with

Re-visualization Brings Real Results

1. Peregrine has come out of bankruptcy successfully, a first in the history of public software systems companies.
2. Peregrine is now a profitable company with current revenue in excess of $170 million.
3. The creditors were paid in full, 100 cents on the dollar. Existing equity holders retain a 37 percent interest in the company.
4. Non-core assets in excess of $425 million were divested to generate important cash to operate the business.
5. Peregrine payroll was dramatically trimmed from 3,400 to 650, while 2,250 jobs also were saved through the sale of certain entities.
6. A settlement was reached with the SEC with no monetary penalties, which allowed new management to focus on the operations of the business.
7. The credibility of the financial and operating systems was restored.
8. Enterprise value was increased by more than $250 million.
9. Peregrine now has a solid foundation for future growth.

new management, which became the template for establishing cost centers and simplifying the chart of accounts. It enabled management to measure the dramatic impact of its actions on the company's financial condition.

KGI created a cash- and key business-driver reporting system, which was updated weekly and reported progress toward goals. KGI chaired weekly meetings with the factor banks, creditors' committee professionals and, eventually, the equity committee professionals. Over time, this gave the outside world the knowledge and trust that the turnaround was succeeding.

While the company's financial staff focused on a restatement of the past three years' financials, KGI was able to reconfigure the information so it could be compared with the new budget system. This became an important step in confirming the plan, since the company had to demonstrate its ability to operate at the reduced expense level contemplated in the plan.

Pave the way for successful emergence from Chapter 11. KGI then assisted in preparing a four-year operating plan and projections for the filing of a plan and disclosure statement in January 2003, within the 120-day exclusive period. This alone is a rare occurrence. KGI prepared a proposed use of cash forecast prior to the start of each fiscal quarter to secure court and creditor approval for anticipated disbursements for both operations and restructuring.

KGI was involved in preparing material for meetings with the SEC, which led to the creation of an equity committee to represent shareholder interests. All of these meetings were critical in reaching a consensual plan of reorganization in July 2003. This plan of reorganization and the quarterly budget system became the basis for determining Peregrine's enterprise value. Investment banking experts used it for the debtor, creditors and equity committees, and it was critical in determining the final allocation of shares for the reorganized company.

KGI was also involved in the various spirited and productive negotiations and mediations between professionals of the unsecured creditors' committee and the equity committee. The existence of an equity committee in its own right was rare, and only underscored the tremendous value that had been re-created through the "re-visualization" process.

What was really hard work on the part of everyone involved at Peregrine may have looked like a minor miracle to outside observers. As Conklin observes, “Most companies can be saved if management is open to the re-visualization process, quick and decisive action is taken and there is cooperation between the parties who have a vested interest.” In this case, the goal, to create a safe and viable business while dealing equitably with the various stakeholders, was successfully met.

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