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Turnaround Succeeds by Focusing on the Big Picture

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When companies begin to fail, most executives realize that they must do something to ensure survival. The "something," however, is generally outside the core competency of the business. With a financial crisis looming, there is little time to make choices.

Ironically, what many companies need at this point is a willingness to step back and look at the big picture. By revisualizing the business, managers, trade creditors, lenders, and other stakeholders can gain a better understanding of a company's underlying strengths and design strategies to compensate for its weaknesses.

Revisualization centers around two questions:

1. What are the company's current annual revenues?
2. During the growth phase, was the company profitable at that same revenue level?

These questions provide the starting point for renewal. By looking for opportunity in the new revenue level, revisualization makes it possible to begin again.

Peregrine Systems, Inc.

The case of Peregrine Systems, Inc., a San Diego–based provider of consolidated asset and service management solutions, shows how troubled companies can start over. Over 20 years, Peregrine's revenues had grown to $500 million and then plummeted to $150 million.

Looking at Peregrine in September 2003, few if any lenders would have believed they would be paid in full:

- Never before had a public software technology company of this size emerged from bankruptcy as a public company.
- The CEO, CFO, and other top financial executives had recently resigned amid controversy involving the company's unraveling.

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- Cash would run out in early July 2002—just one month after consultants were engaged.
- The Securities and Exchange Commission (SEC) was investigating the handling of reciprocal transactions.
- The company had twice changed its outside auditors, from Arthur Andersen to KPMG to PricewaterhouseCoopers.
- Financial institutions, bondholders, shareholders, unsecured creditors, middle management, the SEC, and potential future sources of capital mistrusted all accounting information.
- Peregrine was burdened with high personnel costs, noncore businesses, and excess physical facilities.

Five Steps to Revisualization

On the way up, Peregrine Systems, Inc. was profitable at $150 million. The challenge in July 2002 was to make the company profitable at $150 million again. Once a profitable $150 million business was visualized and compared to the existing infrastructure, it became possible to determine appropriate uses of cash, sell nonessential units, adjust staffing, and envision a future at the new revenue level.

Over approximately 10 months, the revisualization effort was divided into five major areas:

1. Stabilize the company.
2. Reestablish confidence in Peregrine's financial data.
3. Meet interim cash needs.
4. Measure the financial results of turnaround.
5. Prepare for successful emergence from Chapter 11.

Stabilize the Company

The consulting team created a 13-week cash flow forecast that showed that the business would run out of cash in 30 days if it continued to operate at its current rate. This defined the time parameters. From there, negotiations began with vendors to stop the noncritical 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. An unsecured creditors' committee was established to represent them.

In addition, the company negotiated a forbearance agreement with three factor banks that were on the verge of putting Peregrine into involuntary bankruptcy. It negotiated a facility funding agreement with Peregrine's European operations. Consultants assisted new management in completing a sale of one of its entities to generate $49 million of interim financing that bought the company approximately six months to turn around.

Reestablish Confidence in Peregrine's Financial Data

Restoring credibility was essential for negotiations. Peregrine needed to approach banks with a believable road map for its future. Turnaround consultants and new management created an interim operational and financial model to assist management, the board, and the banks in understanding the financial direction of the company. Using 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 other services.

Meet Interim Cash Needs

Key moves were made to meet cash requirements. The company was able to spin off a number of noncore 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. Staffing was reduced from 3,400 to 650. Investment bankers assisted the company in contacting 49 potential investors/buyers. Six proposals were received for the purchase of Remedy Corporation, a valuable subsidiary. Remedy was sold for $355 million, which provided the cash needed for the turnaround.

Measure the Turnaround

Operational breakeven was achieved by December 2002. Peregrine exceeded its revenue target in the six-month period ending March 31, 2003, by 116 percent and its earnings target by 140 percent. New management developed a bottom-up budget system, which became the template for establishing cost centers and simplifying the chart of accounts. The new budget system enabled management to measure the effect of its actions on the financial condition of the company.

A cash and key-business-driver reporting system was produced, which was updated weekly and reported progress toward goals. The workout consultants chaired weekly meetings with the factor banks, creditors' committee professionals, and, eventually, the equity committee professionals.

The company's financial staff focused on the restatement of the past three years' financials, while its consultants reconfigured 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.

Prepare to Exit Chapter 11

Peregrine prepared 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. Before the start of each quarter, Peregrine prepared a proposed-use-of-cash forecast to secure court and creditor approval for anticipated disbursements for operations and restructuring.

The consulting team assisted in preparing material for meetings with the SEC, which led to the creation of an equity committee to represent shareholder interests. These meetings were critical in reaching a consensual plan of reorganization in July 2003.

The 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. It was key in determining the final allocation of shares for the reorganized company.

Also instrumental in the successful emergence from Chapter 11 were the spirited and productive negotiations between professionals of the unsecured creditors' committee and the equity committee. The existence of an equity committee is rare and underscores the value re-created through the revisualization process.

A Return to Viability

Peregrine has come out of bankruptcy successfully, a first in the history of public software companies:

- Peregrine is now a profitable company with revenue in excess of $170 million.
- Creditors were paid in full, 100 cents on the dollar. Existing equity holders retain a 37 percent interest in the company.
- Noncore assets in excess of $425 million were divested to generate cash.
- Peregrine payroll was dramatically trimmed from 3,400 to 650. The company saved 2,250 jobs through the sale of certain entities.
- Peregrine reached a settlement with the SEC with no monetary penalties, which allowed new management to focus on the operation of the business.
- Enterprise value increased by more than $250 million. Earnings before interest, taxes, depreciation and amortization (EBITDA) numbers went up, a good metric because it eliminates the effects of financing and accounting decisions and represents profitability.

Peregrine shows that companies can be saved if management is open to the revisualization process. By understanding current revenues and the company's revenue and earnings history, management can take quick and decisive action. In addition, specific information about revenue and past profitability at the current revenue level can inspire all parties to cooperate. Peregrine used this information to create a viable business while dealing equitably with the various stakeholders—all in just 10 months.

Flat or declining revenues do not have to result in business failure. It's always worth examining whether troubled companies are candidates for revisualization. For companies in transition, it is crucial to take a step back and ask the important questions. That is the essence of the revisualization process.

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