

WHITEHALL GROUP

focus

PROVIDING SERVICES TO COMPANIES IN TRANSITION

Joe Bione



Guiding Companies Through Today's Economic CHAOS Our Perspective

In today's uncertain and distressed economic climate, businesses are being faced with a number of issues. Every business, regardless of size or what goods or services they provide, has been forced to cut their volumes. This trickle-down loss then dominoes to the workforce and eventually causes production problems at each supplier down the supply chain. There are very few companies that are not in financial distress. If they continue to conduct business as usual, then it is only a matter of time when they will join the ranks of failing businesses. Companies are running short of cash and are in jeopardy of going out of business. Every business needs to evaluate their structures

and environment. The financial community is reacting to the business shift by eliminating or limiting credit. This will immobilize many organizations that in the past have not felt the need to think about their viability. Internally, businesses are being bombarded with issues associated with capacity, headcount, cash flow. They do not have the ability to identify where they are at risk and what they can do about mitigating that risk.

At a recent Original Equipment Suppliers Association (OESA) event, leaders in the turnaround industry presented their thoughts and recommendations regarding how to leverage best practices in uncertain times. Whitehall Group was part of the agenda, and although our presentation was directed primarily to the business people and manufacturers in attendance, it had relevance for lenders, accountants, attorneys - those who are in a position to advise and assess financial viability. It is important to understand best practices which can contribute to assisting companies during these difficult times.

How We Can Help

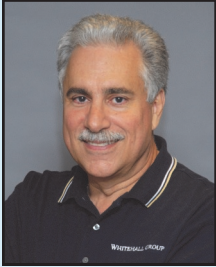
Many business leaders and manufacturers need to be asking "*What should I be doing during these troubled times?*" As explained in the Whitehall OESA presentation, there are six critical factors that must be addressed by every organization in order to realize success during these economic times, including:

- Get your financials in order ~ daily cash management, 13 week cash flows
- Manage the business with data ~ daily metrics, goals and objectives-measurement
- Answer the question, "Did I make money yesterday?" ~ daily profitability
- Establish a War Room environment ~ accountability, sense of urgency
- Don't forget the soft side ~ communications, team approach
- Get the right support ~ augment your team with experts

To learn more about how organizations can better understand the necessary tools to survive in today's fierce environment, contact us. We will be able to share the details behind each of the critical factors listed above, and provide recommendations to help any business manage through these troubled times.

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Gregory A. Bryen

Today's Chaos and Tomorrow's Viability Our Perspective

Today's economic conditions have an effect upon all enterprises and individuals attempting to cope and survive until a better day comes along. Each morning newspaper or evening news broadcast brings forth more "information" related to financial distress encompassing all levels of business and personal circumstances. Economic stimulus packages, financial sector bailouts and auto industry requests for assistance seem to multiply daily.

In reality, the economy as a whole is experiencing the travails of failing the age old dictum of "Cash is King". We are all participants, victims or perpetrators of the current liquidity crisis, whether individuals, business enterprises, borrowers, lenders or government agencies. As such, the following conditions exist:

- As lenders withdraw from lending, cash flow and the overall velocity and elasticity of the money supply is adversely impacted
- When conventional lending is reduced, the next sources of borrowing or capital, Bonds and Stock Issues come into play
- Due to reduced monetary supply and fiscal uncertainty, the Bond market is negatively affected
- With depressed earnings and weakened balance sheets added to reduced monetary supply and investor risk aversion, the opportunity for stock issuance at historic prices is not possible, and yields are inadequate
- The negative cycle persists

This crisis has given rise to a chaotic situation wherein financial paralysis has become the response to an economy that has capacity that appears to be 30% or more greater than the currently sustainable demand levels related to goods and services. Excess capacity needs to be, and will be, removed from all sectors of our economy in response to the current situation. Certain capacity removals will be temporary, while others will be permanent. Capacity elimination may result in business closures, business combinations dictated by market requirements, and lender demands resulting from a failure to perform on loan covenant or payment requirements.

These loan defaults are further reducing lenders abilities to finance their remaining customers. They also have limitations brought about by practical and impractical banking and bank accounting practices originally intended to protect depositors and consumers.

- The lenders protective instincts are brought into play by the banks desire to continue in business (never forget that "he who holds the gold makes the rules")
- Covenant failures are not being waived, but rather made more stringent
- Collateral bases are becoming more distressed as customers default or delay payments. Their inventory loses value when their customers vanish leaving behind excess, over-age or unusable inventories
- Both of these fundamental collateral bases end up having a degraded value within their borrowing base
- Further exacerbating the situation are loans related to long-term asset-supported transactions. The decline in value of real property and equipment is accelerated by this excess capacity. The market for used equipment and the ability to sell or refinance real property with replacement lenders has disappeared with declining appraisals and loan to value requirements

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Today's Chaos and Tomorrow's Viability (continued)

This chaos and distress is brought to the forefront when an enterprise is presented with a situation of no access to the cash needed to continue day to day operations in a manner consistent with past practices.

- Profits have become losses as a result of a reduction in volume and the variable contribution fall off. Such a decline wipes out prior net profits. These losses need to be financed
- Customers are adding 15 to 30 days to the collection cycle, and asking for better prices, thus mitigating or reducing the borrowing capacity of receivable assets
- Customers have stretched Suppliers to in excess of 60 days, and are approaching 90 days
- Since the Suppliers now have reduced borrowing capacity, they now want Cash on Delivery or more to continue material flow, and another source of financing disappears
- Payrolls may have been cut to the perceived minimum manning of needed functions, suppliers are getting late on deliveries and quality is placing business in jeopardy with their customers
- Current businesses may be at risk due to delivery and quality issues. They may become a candidate for elimination rather than a source for new business as customers consolidates their supply base

How We Can Help

Given the above state of affairs, how can the business community respond to the current situation? It is mandatory that every enterprise understand the factors that constitute viability and recognize that in many cases companies are in a state of distress and denial.

To survive in the future, every business needs to evaluate its ability to maintain a continuous stream of cash flow in response to the current situation. Whether done internally, or with the experienced professionals at Whitehall, the following three tests of viability must be considered and addressed immediately:

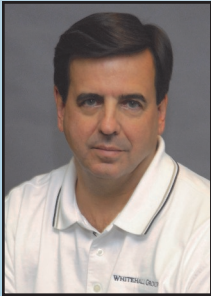
- **Core Business**, defined as goods/services while maintaining a reasonable rate of return
 - Maintain competitive pricing
 - Reduce capacity in all facets, whether on the shop floor or front office, to match demand.
 - Customers will not grant price increases to fund excess capacity.
 - Prudently accept conquest business as competitors fail or withdraw from a market
- **Adequate Financing**, defined as having cash flow sufficient to fund the operations on a continuous basis without interruptions resulting from the lack of current cash or capital:
 - Evaluate current book of business and costs to sustain
 - Understand the impact of customer and vendor term demands
 - Reduce costs by understanding and managing the drivers of costs
 - Create and monitor rolling future period cash flows and budgets
 - Communicate with lenders, customers and suppliers as required
 - Consider where new capital may come from or business combinations with current competitors
- **Competent Management**, defined as a team capable of managing through the current chaos and distress
 - Evaluate the capabilities of the current team
 - Keep the multi-talented and flexible personnel
 - Discharge those not needed to support capacity or incapable of change
 - Augment internal capabilities with appropriate external skills where appropriate

Businesses have a greater chance of success if they immediately start to evaluate their weaknesses and opportunities.

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William Wiechec



Mitigating Supply Base Risk Our Perspective / How We Can Help

At a recent OESA conference, it was noted that 2/3 publicly held NAFTA suppliers are financially “unhealthy” or “at risk”, based on their Z-score which is a standard measure of bankruptcy risk.

In today’s economic climate, businesses can no longer take for granted the viability or continued supply of product or services from their supply base. The failure of just one supplier could have a dramatic impact on their business. *So what actions need to be taken to mitigate the risk of having a supplier disrupt your supply chain?*

Initially, each business needs to bring together their internal stakeholders who regularly interface with the supply base. Utilizing the combination of internal data and conventional wisdom, a list of “at risk” suppliers can be identified. Typical internal indicators which would suggest a concern includes:

- ◆ known quality problems (spills, rejected parts, parts-per-million measure)
- ◆ delivery issues (expedited freight, late shipments, behind schedule)
- ◆ request for price increases
- ◆ request for change in payment terms

From a financial perspective, review of a publicly held supplier’s Z-score or obtaining financial statements can provide insight regarding financial viability.

Secondly, an in-depth review or assessment of the “at risk” suppliers’ business systems is required to more accurately understand your vulnerability. Unfortunately, most internal information is focused on cost, quality, and delivery; in other words, product driven data. However, in today’s business climate it is far more valuable to understand your suppliers’ process or systems capability on an enterprise-wide basis. By necessity, this would include an objective analysis based on the principles of lean enterprise criteria, which examines operational, financial, and management business processes. Just as product performance is the outcome of sound manufacturing processes, business performance (or viability) is the outcome of a strong core business, with capable management and business processes, and adequate financing. *Supplier viability must be assessed on the basis of their processes and systems, not their product.*

The challenge for many businesses is the internal experience and skill sets required to conduct an on-site assessment of their suppliers’ operational, financial, and management systems. In some instances, the ability to evaluate a supplier(s) in an objective, unbiased, and standardized manner may also be an issue. *Where the internal expertise is not available or cannot be deployed, outside help should be pursued.*

Thirdly, the combination of internal product performance data, external financial related data, and operational, financial, and management assessment results provides a business with sufficient information for developing an overall supply base strategy. Many options exist to mitigate risk:

- ◆ rationalize the number of suppliers
- ◆ move selected tools and products
- ◆ provide support
- ◆ encourage/demand 3rd party intervention as means to continue/grow the business relationship

Finally, the most critical action is to develop and implement a risk mitigation strategy while there is still time to react. The Whitehall Group has the experience and skill sets to provide the support to you or your customers.

SPONSORED EVENTS



“The Road Ahead: Best Practices For Managing Uncertainty with Customers and Suppliers”



MACPA Feb. 25th
“Managing Your Company’s Credit Through A Troubled Economy”



EMU Ethos Week
“Ethics in Supply Chain Management”
March 9-13

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