TURNAROUND & RESTRUCTURING FOR BUSINESS STABILITY AND PERFORMANCE IMPROVEMENT

TURNAROUND & RESTRUCTURING | FINANCIAL ADVISORY SERVICES

CAPSTONE PARTNERS

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Addressing Business Stability and Performance Improvement

Turnaround & Restructuring

INTRODUCTION

Financial distress and operating disruptions are often shared experiences by business owners across all industries; Capstone's Financial Advisory Services (FAS) group can offer stakeholders a range of turnaround and restructuring advisory services designed to stabilize a troubled company's position and to help it preserve value and return to sustained growth. When a business becomes distressed, rapid changes require quick and decisive action. In such instances, it is vital to have a knowledgeable and experienced team to help assess the root causes of the distress and implement immediate solutions. This paper will equip stakeholders with information needed to help discern what services are available and when to engage a Turnaround & Restructuring professional.

Capstone Partners has developed a full suite of corporate finance solutions, including merger and acquisition (M&A) advisory, debt advisory, financial advisory, and equity capital financing to help privately owned businesses and private equity firms through each stage of the company's lifecycle, ranging from growth to an ultimate exit transaction.

To learn more about Capstone's wide range of advisory services or Turnaround & Restructuring capabilities, please contact Capstone Managing Partner Brian Davies or Managing Director and Head of Financial Advisory Services Jim Calandra.

Key Turnaround & Restructuring Services

Turnaround Advisory
Analyzes areas for performance improvement through methods including customer surveys, market assessment, cost structure, trade terms, and manufacturing processes.

Crisis Management
Executes immediate needs of the company including negotiating payment terms and extensions, minimizing legal consequences, and maintaining credibility with stakeholders.

Restructuring Advisory
Sets in motion strategies for successful recovery including a detailed cash flow analysis, negotiating terms with secured lenders for funding, treasury management, and portfolio evaluation.

Debtor & Creditor Advisor Services
Optimizes debtor and creditor recoveries including assessing for short- and long-term liquidity needs, debt restructuring, tax optimization, and capital structure improvements.

Court-Appointed Receiver
Acts as a neutral third-party between a company and its creditors including assessing existing debt, analyzing company viability, ensuring regulatory compliance, and negotiating with lenders.

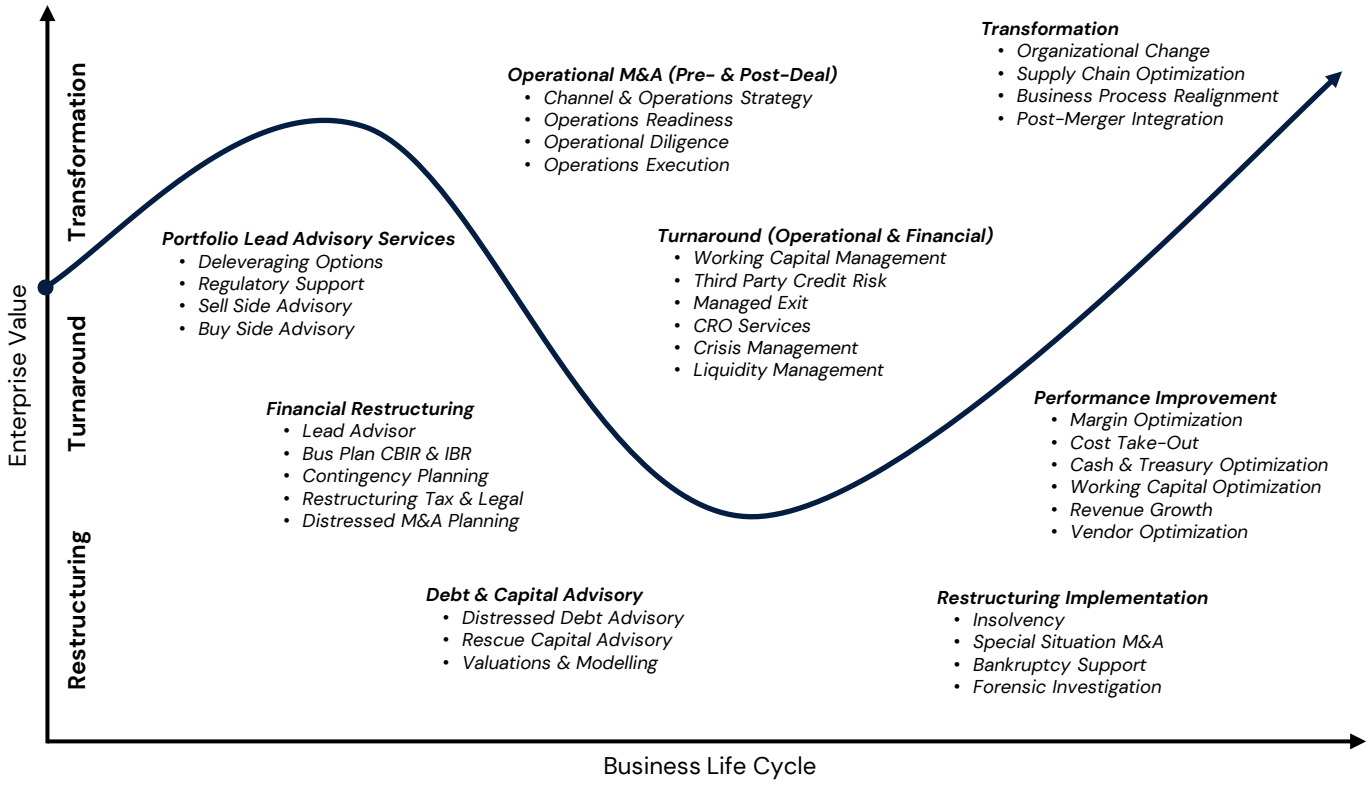
Chief Restructuring Officer Advisory
Advises on strategic options including capital restructuring, developing and presenting business plans, creating settlements with creditors, and analyzing options for a potential sale.

TURNAROUND & RESTRUCTURING IN THE BUSINESS LIFE CYCLE

Operational and financial challenges are often a common phase of the ebb and flow of a company's performance over time, influenced by factors such as rapid growth, acquisitions, or sudden changes in market conditions. No company is entirely immune to these cyclical challenges and corporate playbooks with successful turnaround stories include many of today's most innovative and profitable companies. Apple (Nasdaq:AAPL) is often cited as the leader of comeback kids in recent corporate history. Twenty years after its founding and successful growth into an American icon, the company was reportedly 90 days away from layoffs and bankruptcy due to new competition from Microsoft (Nasdaq:MSFT) and a change in leadership with the departure of CEO Steve Jobs. Returning as interim CEO in 1997, Jobs spearheaded a wide-ranging process to address the issues Apple faced and streamlined product lines, optimized supply-chains, outsourced manufacturing, and partnered with competitor Microsoft—ultimately setting the company back on a growth path to reemerge as the world technology leader it is today.

While a business owners' experience and optimism are integral to entrepreneurial success and can often provide them with the confidence that they need to confront challenges and prevail, they can also delay responding to signs of company distress. Acknowledging that a decline can be a natural and temporal phase of a business life cycle and knowing when to seek outside consulting services is an important first step. This will help businesses overcome short-term challenges and reposition themselves to navigate complex situations and create opportunities to build enterprise value. Financial advisory services professionals utilize a proven methodology that emphasizes a close and quick examination of the organization's financial functions, operational performance, and business plans to provide an objective assessment of the causes of any under performance and develop improvement initiatives tailored to each unique situation.

Turnaround & Restructuring for Business Transformation



Source: Deloitte and Capstone Partners

KEY MARKET FACTORS THAT BUSINESS OWNERS SHOULD MONITOR

Turnaround and restructuring needs typically arise in adverse economic conditions and monitoring changes to this business environment can provide early warning signs to help owners prepare for or mitigate distressed situations. In addition to owners routinely asking themselves the considerations outlined to the right, they should be aware of common distress indicators in the market.

Debt ratios and drawdowns on revolving credit facilities can be a telling sign of balance sheet strength and long-term viability. During the pandemic, companies took on significant levels of debt to address short-term liquidity needs to keep operations running or, in some cases, to capitalize on new growth opportunities in the changing environment. Nonfinancial corporate debt spiked from $10.3 trillion to $12.6 trillion from Q4 2019 to Q2 2022, according to the Board of Governors of the U.S. Federal Reserve System.[1] This marked the sharpest increase in the dataset's 72-year history. Additionally, the government infused more than $1 trillion into programs and tax credits for small businesses under the American Rescue Plan.[2] This artificially kept many zombie companies (those generating enough cash to repay interest on debt but with no long-term ability to pay off debt or grow) afloat and delayed restructuring demands.

The necessity of formal corporate restructuring processes is expected to increase in the near future as recession risks rise and markets have become increasingly volatile, creating operational disruptions including supply chain issues, labor market shortages, inflation and geopolitical tensions. While restructuring levels can remain low during times of easy access to capital, the continuum of rising interest rates will put pressure on companies with increased leverage ratios as they face price increases.

While caution should be taken, economic downturns can also present opportunities for businesses to consolidate competition and vertically integrate under favorable M&A conditions. Companies with strong balance sheets, that have put themselves in a favorable strategic and financial position may want to evaluate the marketplace for potential acquisition targets.

Market Considerations To Ask Yourself as a Businesss Owner

The State of Competition for Market Share – Are you gaining or losing market share? If you are losing market share, who is taking it and why?

The Pricing Environment for Goods and Services – Are prices under pressure or is there pricing flexibility that can be exercised? What are competitors doing about prices?

The Current and Anticipated Future Cost for Key Goods and Services – Have costs been rising? Will they continue to rise? Are there ways to reduce the impact of rising costs?

The Impact of Rising Labor and Healthcare Costs – Are pay and benefits competitive? Are staffing levels reasonable in light of the economic outlook? Are there strategic ways to manage labor and healthcare costs?

Dependence on Borrowed Money – Does the business depend on borrowed money to operate? If so, how sensitive are cash flows to rising interest rates? Are there ways to reduce dependence on borrowed money? Are there ways to reduce the impact of rising interest rates?

Recession Planning – Is the business sensitive to economic recession (i.e., highly dependent on consumer spending)? What are the potential down-side scenarios that could result from a sustained recession? Are there plans in place to be proactive in the face of a sustained recession?

Source: Capstone Partners

WAYS TO IDENTIFY A COMPANY IN DISTRESS

Most companies typically wait too long to engage Turnaround & Restructuring professionals, taking the first steps only after a lender or key supplier has left them with no alternative. The probability of a successful turnaround is much higher at the early stages, so engaging as soon as distress signs are evident increases a company's chances of succeeding and reduces the cost of the turnaround—not only in financial terms, but also in the management distraction that accompanies a turnaround initiative.

Restructuring advisors can effectively assess and put performance improvement initiatives in place for companies encountering a broad spectrum of business challenges; from early-stage decline to late-stage distress and everything in between. Below are the three primary stages of a company in distress, along with key warning signs that may suggest it is time to engage a Turnaround & Restructuring professional.

Stage 1:
Early Warnings

- Sustained declining or negative cash flow
- Overdrafts
- High interest payments
- Increase age in outstanding accounts payable or receivable
- Obsolete inventory
- Long cash conversion cycle
- Violation of debt covenants
- Revolver drawdowns
- Decline in working capital
- Poor capital budgeting
- Reduced capital investment programs
- Going-concern opinion
- Declining industry fundamentals
- Increase in employee turnover
- High debt-to-equity ratio
- Poor accounting systems and low financial reporting quality
- Non-GAAP compliant financial reports
- Manufacturing quality issues due to rushed work

Stage 2:
Delays, Declines, & Defaults

- Sustained decline in revenue
- Declining EBITDA margins
- Late payments to creditors
- Out-of-formula loans
- Unresolved near-term debt maturities
- Large contingent liabilities
- Expedited or missed shipments
- Loss of key customers
- Regulatory inquiries
- Management turnover

Stage 3:
Liquidity or Insolvency Crisis

- Taxes are not being paid
- Payroll is in danger of being missed
- Vendors cut off credit
- Employee benefits have not been paid
- Current liabilities exceed current assets
- Reduction in force (RIF)
- Payments on deliver of product (POD)
- Full vendor payment triage
- Restructuring professionals brought in

Source: Capstone Partners

FAQS: TURNAROUND & RESTRUCTURING SERVICES

Jim Calandra
Managing Director,
Head of Financial Advisory Services

What is the process for hiring an advisor? Before hiring a restructuring advisor business owners must first recognize that their business is declining. Business decline is often characterized by declining sales, profits, and/or cash flows. Other signals include rising indebtedness, stretched accounts payable, and difficulties meeting general financial obligations. Frequently, a company's lender will be the first to suggest that business owners seek the assistance of a restructuring professional and will often provide a list of professionals known to the lender. Hiring a restructuring advisor typically involves meeting/interviewing several candidates, selecting the preferred candidate, defining the scope of work for the engagement, negotiating the commercial terms of the engagement, and documenting the agreement. It is common for lenders to present specific requirements for the scope of work of the restructuring advisor and to request certain written deliverables, especially if the lender is being asked to make concessions to the company.

Are there specific services that are always included versus tailored services? The initial engagement of a restructuring advisor typically involves a scope of work that includes a general assessment of the business, detailed analysis of financial trends, and the review/preparation of a weekly cash flow projection. For companies with asset-based loans, the initial scope of work usually includes a detailed review of the most recent borrowing base certificates. Beyond the initial scope of work, restructuring advisors are typically engaged to evaluate potential financial and operational performance improvement initiatives to return the company to financial health. Restructuring advisors are often engaged to develop strategic alternatives available to companies, which might include refinancing and other capital markets alternatives.

What are the key metrics you will evaluate to help form a Turnaround & Restructuring plan? Detailed historical financial trends, which typically include revenue, gross profits, operating expenses, EBITDA, free cash flows, and the company's debt service coverage ratio. The financial trend analysis typically leads to discussions about changes in the company's operating environment, such as:

- New competition
- Changes in customers
- Changes in pricing of goods or services
- Changes in costs of revenue
- Changes in operating costs

What is the typical fee structure for restructuring advisors? The fee structure will depend on the relevant scope of work. Restructuring professionals typically work on an hourly basis like other advisors. In certain circumstances, restructuring professionals will work on a fixed or capped fee basis. Those circumstances include:

- The initial scope of work, which entails a business assessment, financial analytics, and the review of a cash flow projection.
- When there are narrow and well-defined scopes of work.

Restructuring advisors typically require a deposit or retainer in connection with their engagement. They will also invoice on a weekly basis and require prompt payment of all invoices. These requirements are driven by the commercial realities of working for companies that are in financial distress.

What is the most common mistake companies make when in distress? The most common mistake is believing that increasing sales will solve their problems. It is the inherent optimism and problem-solving characteristics of entrepreneurs that often fuel the belief that working harder will fix

FAQS: TURNAROUND & RESTRUCTURING SERVICES (CONTINUED)

things, and it often does. This experience often causes companies to wait too long to engage a restructuring advisor. When a company waits too long, the overall impact is invariably harsher than it needed to be. For example, a company that waits until its lender insists on the engagement of a restructuring advisor, will often find that it has compounded its operational and financial challenges by introducing the need to refinance its loans with that lender.

At what point is it most beneficial to bring in an interim management professional such as a Chief Restructuring Officer (CRO)? When we're talking to business owners and managers, we prefer to minimize the role of CROs in turnaround and restructuring engagements because they are typically mandated by outside constituents, such as a lender. Instead, we focus on working with business owners and management teams to implement turnaround plans.

The introduction of an experienced restructuring professional is often recognized as a positive step by lenders and other key constituents because the professional brings with them a level of objectivity and specialized knowledge. In cases where a lender, or other third-party, has requested the engagement of a restructuring advisor, it will be important for that advisor to hold the trust of the business owner while building rapport and credibility with the lender to enable a successful turnaround or restructuring. Companies benefit most when they engage an advisor and empower their management to collaborate in developing and implementing performance improvement initiatives. Third parties, such as lenders, will often be more flexible in making accommodations when they feel that their borrowers are doing everything that they're able to do to address their concerns. Because of this, hiring a restructuring advisor is typically one of the measures that lenders view favorably. Companies can therefore benefit not only from the specialized skills and experience that the restructuring professional brings with developing and implementing performance improvement initiatives within the business, but they can also benefit from the increased flexibility that a credible restructuring advisor can create with lenders and other creditors by presenting an objective turnaround plan.

What about employee reactions when bringing in outside managers? Will everyone find out that we need a Turnaround & Restructuring Advisor? Employee reactions vary greatly from situation to situation. Experienced restructuring professionals understand that employees will have questions and concerns, and they work with business owners and managers to provide appropriate assurances. Employees are often aware that a company is in distress and can be assured by the engagement of restructuring professionals. Engagement of a restructuring professional is typically kept confidential. To the extent that a company is already in financial distress and has been able to keep commitments to its customers and key suppliers, there is no need to communicate the engagement of restructuring professionals.

What other players (internal at the company or external) are important in a turnaround, rescue, or contingency plan? The internal team usually consists of the business owner, lead financial manager, lead operations manager, lead sales manager, and others involved in the executive management of the business. The external team will typically consist of the restructuring advisors and restructuring attorneys.

What strategic decisions should I be thinking through in the current environment to protect the health of my company? As I think about this question, it seems to me that business owners and managers ought to be focused on evaluating their strategy, which may or may not lead to decision making. So, my responses focus on the considerations that they should be making right now. Important market factors driving strategic analysis:

- High rate of inflation
- Rising costs for goods and services
- Rising labor and health care costs
- Rising interest rates
- Potential economic recession

Have additional questions?
Contact us to learn more from one of our Financial Advisory Services professionals.

CLIENT CASE STUDY

The Problem

Beach Mold and Tool, Inc. was a mid-south based, 43-year-old family-owned and operated, $160 million automotive supplier. The company was having significant financial difficulties due to an unsuccessful launch of an original equipment manufacturer (OEM) program. The company's lender had a block on their operating line, increasing by a set amount every week. This action, paired with $6 million in ineligibles and $10-$12 million in account payables above a normal level, constrained their availability and was causing problems with their trades. When the advisory team arrived, the company was insolvent.

The Solution

The team identified the root causes of the company's liquidity problem and evaluated the situation through a combination of working with customers, inventory management, and implementing tighter controls on cash management. This strategy provided additional "runway" for the company. This allowed management, and our team, the highly needed time to create a go-forward strategic task-driven operational plan. This plan included divesting an underperforming plant which had been a drain on management time, capital expenditures, and cash.

The Result

The company's availability improved due to reducing the ineligibles from $6 million to $1 million and their past due payables from $10-$12 million to $5 million. The Capstone team negotiated to remove the block on availability and return part of the amount in reserve to working capital. In June 2019, the company completed a transaction under which its assets were acquired by a Michigan-based global manufacturer of interior and technology solutions for the Automotive industry. As exclusive advisor on the transaction, our team ran a robust process to find a buyer with the vision and resources to take over the company's revitalized operations and preserve existing relationships with its customers and employees. The transaction saved 400 jobs at Beach and was recognized by the Turnaround Management Association as the Mid-size Company Transaction of the Year in 2020.

BEACH
MOLD & TOOL, INC.

Headquarters: Indiana
Industry: Automotive Supplier
Year Advised: 2019
Service: Turnaround & Restructuring

CAPSTONE SERVICES

- **Supported the restructuring of cash management practices**
- **Developed refinancing strategy with lenders**
- **Number of vendors on cash on delivery (COD) or cash in cash in advance (CIA) reduced by 70%**
- **Facilitated sale of company assets**

FIRM TRACK RECORD

Capstone has represented companies in a range of industries to meet their Financial Advisory Services needs. While many of these remain highly confidential, below is a sample showcasing the of breadth of services and sectors that our professionals have advised.

MODULAR CONSTRUCTION MANUFACTURING RESTRUCTURING ADVISORY SERVICES	**MOBILE PAYMENT COMPANY** RESTRUCTURING ADVISORY AND FORENSIC EXAMINATION SERVICES	**FRAC SAND MINING COMPANY** RESTRUCTURING ADVISORY SERVICES	**WATER TECHNOLOGY AND SERVICES** RESTRUCTURING ADVISORY SERVICES
MULTI-STATE CASUAL SEAFOOD RESTAURANT CHAIN RESTRUCTURING ADVISORY SERVICES	PROVISION HEALTHCARE RESTRUCTURING ADVISORY AND INSOLVENCY SERVICES	**SEGA BIO FUELS** RESTRUCTURING ADVISORY AND INSOLVENCY SERVICES	**DARI FARMS** RESTRUCTURING ADVISORY AND INSOLVENCY SERVICE

Optimizing Outcomes with Deep Sector Knowledge

Our Financial Advisory Services Group is uniquely strengthened by Capstone's 12 industry-specific Investment Banking Groups, who provide intricate knowledge of sector-specific trends and nuances.

- Aerospace, Defense, Government & Security
- Consumer
- FinTech & Services
- Industrial Technology
- Building Products & Construction Services
- Education & Training
- Healthcare
- Technology, Media, & Telecom
- Business Services
- Energy, Power, & Infrastructure
- Industrials
- Transportation & Logistics

KEY CONTACTS

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Brian is the Managing Partner of Capstone Partners' Financial Advisory Services (FAS) group. He has more than 25 years of professional experience working extensively in the fields of post-merger integration, business reorganization and interim management services. He has provided financial advisory services to lenders, debtors, creditors' committees, trustees and equity holders in bankruptcy matters and out-of-court restructurings. Brian has provided assistance to under-performing businesses, potential acquirers of distressed assets/entities, and advised financially distressed companies to develop cost containment and asset rationalization plans.

Brian has served as an Operating Partner in a leading global private equity firm focused on management buyouts and recapitalizations of middle market companies as well as growth equity investments. His primary objective was managing all distressed/challenged operations of any portfolio company experiencing performance issues, liquidity concerns, covenant breaches, availability diminution, management voids and synergy attainment.

Jim Calandra
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Jim is a Managing Director and Head of Capstone Partners' Financial Advisory Services (FAS) group. Jim has more than 25 years of experience in turnaround management consulting, interim management, fraud and forensic accounting, mergers and acquisitions, and recapitalizations.

Prior to joining Capstone Partners, Jim was managing member and co-founder of Birch Hill Partners a management consulting firm focused on turnaround management and business performance improvement. Over the course of his career, Jim has advised more than 50 companies through significant strategic transitions involving both public and private middle market companies with varying situations. Jim is an experienced turnaround management professional and has successfully managed more than 30 turnaround engagements and is known for his straightforward approach and clear-thinking strategic advice. Jim has served as a board member for numerous companies, including the board of Boston Generating, LLC through its landmark § 363 bankruptcy restructuring case in the Southern District of New York in 2011.

ENDNOTES

1. Board of Governors of the Federal Reserve System, "Financial Accounts of the United States - Z.1," https://www.federalreserve.gov/releases/z1/, accessed October 24, 2022; and Federal Reserve Bank of St. Louis, "Nonfinancial Corporate Business; Debt Securities and Loans; Liability, Level," https://fred.stlouisfed.org/series/BCNSDODNS#0, accessed October 24, 2022.
2. U.S. Department of the Treasury, "FACT SHEET: The Impact of the American Rescue Plan after One Year," https://home.treasury.gov/news/press-releases/jy0645, accessed October 24, 2022.

CAPSTONE PARTNERS

Common Goals. Uncommon Results.

Capstone Partners, a subsidiary of Huntington Bancshares Incorporated (NASDAQ:HBAN), has been a trusted advisor to leading middle market companies for over 20 years, offering a fully integrated range of expert investment banking and financial advisory services uniquely tailored to help owners, investors, and creditors through each stage of the company's lifecycle.

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SUPERIOR CLIENT RESULTS

TOP RANKED PERFORMANCE

ESTABLISHED BRAND REPUTATION

A DIFFERENT KIND OF FIRM. BUILT FOR THE MIDDLE MARKET.

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- Buy-side Advisory
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- Mergers & Joint Ventures

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- Equity Advisory
- Debt Advisory
- Infrastructure Finance

Financial Advisory

- Transaction Advisory
- Interim Management
- Performance Improvement
- Valuation Advisory
- Litigation Support

Special Situations & Restructuring

- Special Situations
- Turnaround
- Restructuring
- Bankruptcy
- Insolvency

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Market Presence

With a long-established U.S. footprint, together with an international partner platform, we provide clients with broad expertise and access to key market relationships on a global basis. Our presence is backed by ~200 professionals in the U.S. with 450+ professionals across 41 countries.

109
M&A transactions completed in H1 2022

$18B
aggregate transaction value

26%
of our deals are cross-border

7th
globally ranked for deals under $500m

59%
of deal volume in Technology, Business Services, Industrials, Financial Services, and Food & Beverage

77
deals involving private equity firms

62%
completed with a European partner

United States

~200 professionals
12 offices

Boston · Chicago · Dallas · Denver · Detroit · Los Angeles · Orange County · Philadelphia · Richmond · San Diego · Tampa

International

450+ professionals
60+ offices in 43 countries

Asia: China · India · Japan · Thailand
Africa: Congo · Egypt · Ghana · Ivory Coast · Mauritius · Morocco · Nigeria · Senegal · South Africa
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