



# Certified Turnaround Professionals: Week One

## Part 1: Management & Finance Case Study

### Purpose of Document

This document is a fictional case study developed for a TMA educational program. As they say in the movies: The events, characters and firms depicted in this case study are fictitious. Any similarity to actual persons, living or dead, or to actual firms, is purely coincidental.

Since this information is coming from the management of our fictional distressed client, not everything in this document may be the truth and there may be errors in any analysis in this packet. Welcome to your first day at the new client.

### Pre-Engagement Overview

It is Friday afternoon at 4:30pm and you suddenly get a cryptic message from Everett Kale of CityBank (“Senior Lender”) who asks you to call him urgently. When you return his call, he explains that the Senior Lender has some large concerns with one of their borrowers named Superior Home Trinkets, Co. (“Superior”). By the afternoon, you’ve had a call with Samantha Gordon, the CFO of Superior who explains that the Senior Lender has not authorized additional borrowing on Superior’s line of credit after Superior requested an over-advance from the Senior Lender (who was very surprised by the request). CFO is concerned about Superior’s ability to operate effectively without the over-advance. Superior has not yet submitted their 2019 reviewed financials to the Senior Lender, as they are in process with the accountant. The CFO explained that Senior Lender has requested, as a condition to entering into a forbearance agreement, that Superior must hire a turnaround professional to assist Superior through a turnaround. The bank has proposed that this turnaround professional act as CRO (Chief Restructuring Officer), but Superior prefers that the consultant be an advisor. After a couple of days and review of some preliminary information, your firm signs an engagement letter on March 23, 2020.

### Company Overview

Superior is a consumer products company that “makes trinkets for the finest homes in the United State and abroad” according to their marketing materials. In 2016, Superior was somehow spun out of Great Office & Organization Depot, Co. (“Good Co.”) to become a separate legal entity. Superior is owned by the same equity holders as Good Co. but is not a subsidiary of Good Co. The CEO, William Maduff, was named CEO of Superior when it was spun out from Good Co., where he previously had been a VP of Sales of Good Co.

Since then, Good Co. has continued to be very profitable, but Superior appears to have fallen on hard times. Superior’s challenges, according to the CFO, come primarily from failed large marketing bets in 2019 on the celebrity-endorsed Dwayne Jacobson “The Stone” Fine China Set and the Lebrune James Outdoor Grilling Tools. The CFO said that the company grew revenues in 2019 over 2018, but gross margins plummeted. The CFO blames “changing customer tastes”,



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saying that consumers didn't seem to equate The Stone's dainty image to the dinner table and Lebrune's mental toughness to steaks and chops.

During 2019, a few other key indicators showed (see attached Excel provided by CFO):

- Accounts receivables DSO (days sales outstanding) grew significantly
- Inventory turns got worse and inventory values grew
- Accounts Payables DPO (days payables outstanding) grew significantly
- Line of Credit grew and exceeded its Net Availability (based your back of the envelope analysis of A/R and Inventory using a blended advance rate)
- Fixed Charge coverage ratio dropped from 1.4 in 2018 to negative <0.4> in 2019

Superior's CFO has developed a plan that forecasts an increase in gross margin percentage back closer to 2018 values and calls for the Senior Lender to authorize additional \$4MM borrowing under the line of credit in 2020.

The Senior Lender has stated that they will not advance any more funds until you present them with a Report and Turnaround Plan within two weeks. The Senior Lender is typically a cash flow lender and so they do not seem to have the reporting tools of an asset-based lender.

Other important items included:

- Vendors have started calling daily asking for payment. The company has tried to negotiate payment plans and this worked for a while until Superior missed payments under the new payment plans. Vendors are now starting to request COD or prepayment on various goods and services; some are even threatening legal action, although no lawsuits have been served on the Company, yet.
- The physical inventory count is an internal process done annually by the Company.
- On June 30, 2019, Superior made a \$3MM payment to subordinated debt (held by the equity holders of the company) stating that "financials looked great in June 2019, so no reason not to reduce our debt". The Senior Lender did not notice this sub-debt payment in June 2019 and has asked Company management many questions about it since the over-advance request.
- During your first days at Superior, you started doing interviews with the key managers of the company. During one of your breaks, an office person comes up to you and tells you that they are very nervous because they have been asked, by the CEO of Superior, to shred certain files related to the Rachael Wray Bow and Arrow set that may have caused some injuries to buyers.
- A prior senior executive is claiming that they are a secured creditor with a blanket lien on all assets.
- The company does not use a payroll company to do its payroll.



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#### A Few Case Study Questions to Think About Before Education Session

##### Pre-Engagement

1. What materials should you review or what actions should be taken before accepting this engagement? What is the difference between being hired as a CRO vs. Financial Advisor? Are there any additional requirements you would have before accepting the engagement as CRO?

##### Finance and Accounting

2. What are the items on the actual financial results that concern you the most and why?
3. The company is asking the Senior Lender to lend another \$4MM in 2020. The Senior Lender says that this is a non-starter without other actions. What can you recommend to management and equity to get the Senior Lender to consider doing an over-advance?
4. What were the items that negatively impacted working capital in 2019? What do these changes mean and what red-flags do each indicate to you?

##### Management

5. What are the key questions you must answer to determine if Superior can be turned around?
6. What analysis tools will you need to develop in order to present to the Senior Lender?
7. What strategic actions would you proposed to take:
  - a. Immediately
  - b. During the next three months
  - c. During the next 12 months

##### Legal Principals

8. How would you evaluate the claims by the former executive that they are a secured creditor?
9. What do you think about the sub-debt repayment on 6/30/17? How would you advise your client about this?

##### Ethics

10. What should you do about the information your received from the records clerk?