



Holding Your Future in Their Hands

Forging a working relationship with SAG may be the key to survival.

by Michael T. Newsome

One day, we awoke, and the world had changed. Not so long ago, the average American made a dollar and spent all of that, and more. A friendly banker chipped in the difference based on the belief that asset prices would climb forever. Bolstered by leverage-induced spending, the economy roared. Today, in the aftermath of the bubble's collapse, that same American spends but 90¢ (perhaps less) of each buck earned and pays down debt with the remainder.

It is hard to fathom that this shift away from leverage has a downside; but, the implications for businesses have been staggering on a global scale. We have seen an urgent col-

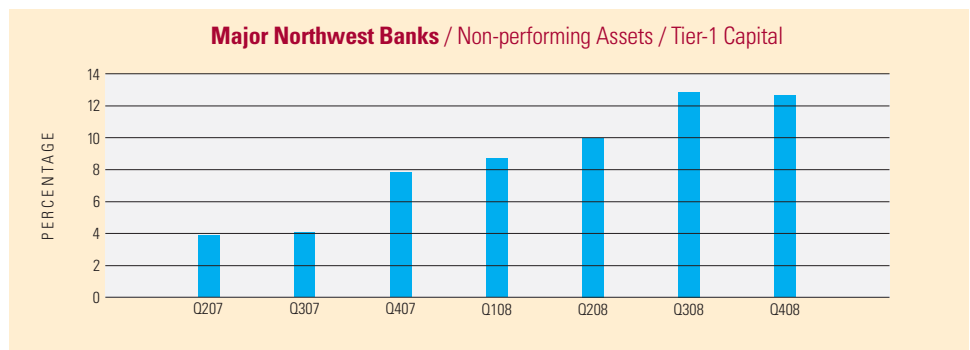
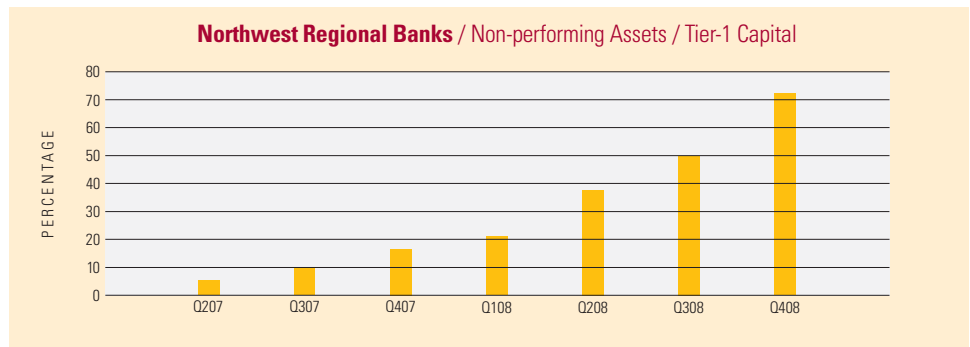
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lapse in the demand curve across the broadest swath of industries, particularly those fueled by consumer spending. Companies are bogging down against the head winds of slack demand and faltering liquidity. The impact is reverberating through banks and the broader financial system, which is soberly reflected in the growth of non-performing assets (see nearby charts). The time has passed when debt was cheap and the sky was blue.

Banks are gearing up to deal with the fallout. After a long hiatus, their workout units are in a growth mode and gathering clientele. A variety of labels are applied to these folks, but we refer to them as the Special Assets Group (SAG). Whatever the moniker, the mission is the same: avoid further losses and recover the bank's funds.

WELCOME TO SAG

Under today's circumstances, an introduction to SAG may not be a surprise. But, it is



disconcerting, nonetheless, as it confirms a loss of confidence on the bank's part and triggers anxiety over a critical supplier. Going into this new relationship, many clients are greeted with soothing reassurances as existing bankers bow out and the workout team steps in. Although some bankers may take issue with this, we have heard it often enough to know that the spiel is, at best, confusing and, sometimes, just misleading. For example, don't be surprised to hear the following:

"We will take responsibility for the relationship."

This means that all other relationships with the bank are severed and all future communication must be directed to SAG. Don't expect the relationships and rapport that you may have carefully cultivated inside the bank to transfer intact to SAG. You are unlikely to get much help (other than words of encouragement) from your old friends at the bank, even if they are senior officers. It's fair to say that interference with the dictates or objectives of

SAG has never advanced a banker's career.

"We will be available to help you address issues and needs quickly."

Not necessarily true, particularly with the bigger banks. SAG units tend to be bureaucracies that become even less agile and responsive when uncertainty ratchets up. This concern is made worse by the emerging avalanche of problems. In this vein, a nettlesome double standard often prevails. If SAG wants something, it is unlikely to brook much delay.

The flip side is that time is rarely a constraint when addressing a borrower's needs.

"Our mission is to rehabilitate rather than liquidate."

True, in part. Liquidations/bankruptcies are usually disasters for banks. This may be more true than ever, given the deflation in asset values we are witnessing and the dearth of capital available for restructuring. But rehabilitation is not the goal either. Implicit in moving the credit to SAG is a determination that the bank is, at the least, ambivalent

about retaining the relationship and would be happy to see the company take its business elsewhere. The priority is to avoid further deterioration by either quickly whittling down the credit exposure or exiting the relationship, which will be tough to do in today's world. Don't be lulled into thinking that the absence of an attractive alternative translates into an extended lease on life. Many veteran workout officers hold a firm conviction that the "first loss is the best loss" and, with little remorse, can roll over small firms that are barely treading water.

WORKING SUCCESSFULLY WITH SAG

At best, you should expect a cordial and candid working relationship with SAG. But, a pleasant demeanor or expressions of empathy should not be confused with support for management or the company. SAG is not your partner. SAG's agenda, and it is a reasonable one, is to reduce problem loan commitments as rapidly as possible and minimize losses. The bank's and borrower's objectives and interests are rarely perfectly aligned, and therein lies the source of friction.

With so many struggling, the priority is triage, the dirty work of segregating borrowers into the quick or the dead. Make no mistake; these are subjective judgments. There is little science and a lot of art to SAG decision-making. With this in mind, in order to garner support for a protracted workout, management must persuade SAG that it passes muster in three major areas, because it has:

- Provided evidence that all alternatives are being, or have been, considered for repayment of the loan. In today's environment, this means exploring the potential for a major rationalization or restructuring of the business that would restore profitability and/or liquidate unproductive assets to generate cash. It also presumes that all refinancing alternatives

will be investigated. While refinancing was the path of least resistance in a workout just 18 months ago, it is a very hard row to hoe these days.

- Presented a cogent argument that the plan being put forward is, in fact, the lender's best alternative for collection. It is not sufficient for the plan to simply be in the interest of shareholders. It must have legitimate prospects for improving the lender's position, while effectively mitigating further downside risk.

- And, proved that the borrower's team, however restructured and/or augmented, is better able to effect recovery than the bank alone.

The absence of even one of these basic considerations reduces the probability that a bank will accord the borrower anything more than a very short window of opportunity to get its act together. It is generally unspoken, but SAG bankers have a bias against owners/management teams that have never worked through a serious problem situation. There are a couple of ways to effectively combat the presumption of incompetence:

- **Get outside help.** Dealing with SAG is time consuming, just when the business demands maximum management focus. The guidance of a competent financial advisor and an experienced workout attorney both lightens management's load and instills greater confidence at the bank.

- **Get real; pursue change decisively.** Experienced bankers believe that deteriorating business performance is often a consequence of complacent management that is out of touch with the competitive environment, while marching on with a strategy that has lost relevance in the market. These businesses invariably exhibit some combination of denial that the problem exists, arrogance that difficulties can be overcome without assistance, or nostalgia for the "good old days"

when everything was fine. An ability to be realistic, candid, and proactive is an essential starting point in the process.

- **Finally, the road out of SAG depends on a realistic plan that can be achieved.** Demonstrate that every stone is being turned over to improve the business' circumstances. And, be sure the bankers understand the factors that may negatively impact results. In good times, reporting is required at regular intervals; in a crisis, it becomes continuous. Tell the truth, but manage expectations wisely—under promise, over deliver. In the absence of sufficient cash flow to meet both debt service and the reinvestment needed to sustain the firm over time, develop and be prepared to act on "Plan B." Here again, no alternative can be ignored, including a more radical restructuring, arranging outside capital, and/or a sale of the business.

Given the unprecedented nature of events over the past six months, it seems increasingly clear that it is going to be a long, hard pull out of this economic tailspin. As a result, the utmost care must be given to any restructuring arrangement made with the bank. Beware of partial or one-sided deals. New collateral and guarantees should be granted only in concert with a restructuring on terms that recognize the challenges and permit a reasonable chance of success over time. Resist SAG's inclination to keep the credit relationship on a short fuse (i.e., a series of rolling 30-day extensions). Hammer out a longer-term arrangement (at least a year) that provides certainty of adequate credit availability, subject to reasonable performance hurdles.

Maneuvering through SAG is challenging. Those that survive to prosper again will need to step up their game now. ♦



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