

## Middle-Market Report

# Fixing the Troubled LBO

Although leveraged buyouts generally are regarded as a successful segment of the m&a marketplace, a disquieting note has been sounded by an expert in turnaround management. Daniel Morris, head of Morris Anderson & Associates, a turnaround consulting firm based in Glenview, Ill., projects that 70 percent to 80 percent of middle market LBOs don't achieve anticipated financial results. And between 30 percent and 50 percent of the companies that miss the mark financially, Morris stated, get into "financial distress" that requires refinancing, or undergo a drastic operational restructuring.

### Clash with perceptions

Morris admitted that he lacked exact statistics to confirm his estimate, but asserted he was basing the projection on his own experience. He said his firm has been involved in nearly 40 turnarounds and workouts, about half of them LBO rescues. Most have been the Midwest, Southeast, and East and "we believe they are representative of U.S. industry in general," he commented.

The key flaw that Morris Anderson has found is that the troubled firm began with an unrealistic business plan that was drafted to impress financiers but was not attainable. As a result, Morris stated, the company was unable to generate enough sales and cash flow to keep on schedule with debt service.

"We judge how well they conformed to their business plans," Morris noted. "Eighty percent of the companies that we have seen had not achieved their plans. There was enough of a variance from the plan to turn the plan off."

Frequently, he stated, his concern

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**A turnaround specialist estimates that 30 percent to 50 percent of middle-market leveraged buyouts get into financial hot water.**

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finds a "20-percent deviation" from plan in sales and generally a shortfall of "more than that on positive cash flow." Most plans are sales-driven plans," Morris pointed out. "They count on increasing sales products, new developments, and revitalized marketing. But if the sales don't materialize, the company is in big trouble."

While banks measure actual performance against the plan and often offer extra help if "there's a blip," Morris said, the company's deterioration may continue if the management refuses to "admit it made a mistake" and doesn't revise the original plan. An overly ambitious sales projection, Morris added, leaves the company with "far too little room for operating leverage." "There has to be growth in sales and on a significant basis," he asserted.

In larger LBOs, the company frequently can raise cash to offset a sales shortfall by selling assets. But the more focused and leaner middle market seldom has excess assets that can be put on the block, Morris noted.

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