CORPORATE TURNAROUNDS AND VALUE CREATION

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CEO, Harwinton Capital LLC
Outline

1. My experiences with turnaround situations and shareholder value creation:
   • Chrysler
   • IBM
   • Apple
   • Tyco International

2. Summary – The key elements for a successful turnaround
Kellogg Turnaround Management Conference

What Produces Restructuring Situations?

The Symptoms:

- Wrong Strategy?
- Wrong Business Model?
- Poor Execution?
What Produces Restructuring Situations?

The Disease:

- Poor Governance?
- Inadequate Management?
- Major Shift in Industry Conditions?
Chrysler Corporation

- Great Strategy:
  - Invented the Minivan
  - Bought Jeep early in the SUV revolution

- Business Model Too Slow and Costly:
  - Major changes to the product development process
  - Major reductions in administrative costs (aka bureaucracy)

- Operations Seriously Deficient in Passenger Cars:
  - Huge progress by Ford and the Japanese
IBM Corporation

- **Broken Strategy:**
  - Premium prices way too long
  - Decentralization to a fault

- **Business Model Too Slow and Costly:**
  - Bureaucracy precluded competing in short cycle businesses
  - SG&A + R&D $7 Billion (25%) too high

- **Operations Seriously Antiquated in Many Areas:**
  - Go-to-market, procurement, finance, product development, even IT!
Apple, Inc.

- No Strategy:
  - Key R&D resources being squandered on Newton
  - No plan to conquest Microsoft customers

- Business Model:
  - Serious distribution issues
  - Losing dominance in education to Dell

- Operations Reasonably Decent, But:
  - Too much manufacturing in North America rather than Asia
Tyco International, Ltd.

- Single-Legged Strategy:
  ~ Acquisition Machine

- Business Model Had Excessive Balance Sheet Leverage:
  ~ Anything going wrong could result in a financial crisis
  ~ Accounting approaches very aggressive

- Operations Essentially Not a Priority:
  ~ Hundreds of acquisitions with no “back office” or manufacturing consolidation
## What Are the Similarities/Dissimilarities?

### The Symptoms

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Business Model</th>
<th>Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chrysler</td>
<td>Overall Good</td>
<td>Too Slow &amp; Costly</td>
</tr>
<tr>
<td>IBM</td>
<td>Severely Flawed</td>
<td>Too Slow &amp; Costly</td>
</tr>
<tr>
<td>Apple</td>
<td>Essentially None</td>
<td>Distribution Problems</td>
</tr>
<tr>
<td>Tyco</td>
<td>Good but Risky</td>
<td>Too Costly</td>
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</tbody>
</table>

Similarities: 2 of 4  3 of 4  2 of 4
### What Are the Similarities/Dissimilarities?

#### The Disease

<table>
<thead>
<tr>
<th>Governance</th>
<th>Management</th>
<th>Industry Conditions</th>
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</thead>
<tbody>
<tr>
<td><strong>Chrysler</strong></td>
<td>Independent, Strong Board</td>
<td>Lack of Good Teamwork</td>
</tr>
<tr>
<td><strong>IBM</strong></td>
<td>Strong Board, Decisive</td>
<td>Rigidity to Past</td>
</tr>
<tr>
<td><strong>Apple</strong></td>
<td>Silicon Valley Vets, but…</td>
<td>Lack of “Mac Passion”</td>
</tr>
<tr>
<td><strong>Tyco</strong></td>
<td>Hampered; in Awe of CEO</td>
<td>Acquisition Machine</td>
</tr>
</tbody>
</table>

**Similarities:**
- 2 of 4
- 3.5 of 4
- 2.5 of 4
Chrysler Turnaround Results

• Initial Results:
  ~ Spectacular. Share price from low of $9 in 1990 to $45 in 1993 when turnaround “completed”
  ~ Chrysler purchased by Daimler-Benz in 1998 for $35 billion

• Longer Term Results:
  ~ Major restructuring II in 2002 to 2004 period
  ~ Major restructuring III commenced in 2006

• Conclusions:
  ~ Fundamental competitive weakness versus the Asian producers never adequately addressed
IBM Turnaround Results

• Initial Results:
  ~ Spectacular. Share price from low of $10 in 1993 to $124 currently

• Longer Term Results:
  ~ Company has continuously transformed itself, growing its services and software businesses, and shrinking its hardware businesses
  ~ It has not let "success" preclude it from taking periodic retrenchment actions where needed

• Conclusions:
  ~ Growth in the services industry is slowing… Could indicate additional restructuring to come
Apple Turnaround Results

• Initial Results:
  ~ Spectacular. Share price from low of $4 in 1997 to $20 in 2000, and now at $168
  ~ Principal initiatives were award-winning designs and substantially improved Mac operating system

• Longer Term Results:
  ~ Apple has invested in two huge initiatives, both highly successful:
    – Its own B&M distribution – key to expanding Mac platform sales
    – The music business, a transforming event for the music industry

• Conclusions:
  ~ Continual innovation--the latest being the iPhone
Tyco Turnaround Results

• Initial Results:
  ~ Spectacular. Share price from low of $9 in 2002 to $47 currently
  ~ Multiple crises successfully addressed:
    – Board and management credibility
    – Accounting and liquidity crises
    – Legal and regulatory crises

• Longer Term Results:
  ~ Acquisition machine turned off; focus shifted to organic growth and operational excellence
  ~ Decision made that best way to maximize shareholder value is to break up the company

• Conclusions:
  ~ Separation of $40 billion Tyco into three pieces should allow each new company to better focus
Key Turnaround Elements (in my experience)

1. Senior management passion and determination
2. Sell, sell, sell, explain, explain, explain it to the troops
3. Set the example. “Tone setters” are important
4. Benchmark everything
5. Take a highly structured approach
6. Measure and report status frequently
Role of Board of Directors (Governance) in Situations Requiring Turnaround

- IBM:
  ~ After three years of precipitous deterioration, the board took drastic action; new CEO and CFO appointed from outside the industry

- Chrysler:
  ~ One can conclude board wanted new CEO, but wanted an “orderly transition”

- Apple:
  ~ After two straight underperforming CEOs, board approached Steve Jobs to return, which he agreed to do subject to major changes in board composition

- Tyco:
  ~ Severe regulatory and legal situation forced the prior board to go outside for new CEO, and dictated major change in board composition
Wrap-Up

• The World is Changing Rapidly
  1. Shifting Demographics
  2. Emergence of China with others not far behind
  3. Global Warming
  4. Transformation of American Business

• Steady-State is No Longer the Norm (if it ever really was)

• Turnarounds are Crucial Where Needed, But….  
  1. Cannot be considered to be “one time” events
  2. Must be followed by continuous improvement approaches, and high levels of strategic adaptability
  3. Global competition is here to stay even if the lobbyists, politicians, etc., try to stop it. Capital will flow to where it gets the best returns.
Economic Center of Gravity of the World
### Sovereign Wealth Funds

**US Investment Activities:**

Citigroup / Merrill Lynch / Morgan Stanley / Others

- $21.5 Billion Invested in US in 2007 [A]
- $22.6 Billion Invested in US in 2008 [A]

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<tr>
<td>Oil Exporting Countries</td>
<td>35</td>
<td>192</td>
<td>484</td>
</tr>
<tr>
<td>Eastern Asia</td>
<td>133</td>
<td>198</td>
<td>446</td>
</tr>
<tr>
<td>Rest of World</td>
<td>114</td>
<td>119</td>
<td>389</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>282</strong></td>
<td><strong>509</strong></td>
<td><strong>1,319</strong></td>
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Global Warming...AKA Global Crowding

- Billions
- 10^12
- World Population
- Year
- 2060, 2000, 2040
- Billions
- 12
- 10
- 8
- 6
- 4
- 2
- 0
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