

Gordian Attracts Capital Investment

Allied Capital Sees Strength in Firm's Market Position

by Stacy Notaras

Though its investment in an investment banking and financial advisory services firm stands out from its usual lineup of tangible product producing companies, Allied Capital Corp.'s \$8.3 million pledge of faith in the Gordian Group may prove to be one of its best investments yet thanks to the growing population of troubled U.S. companies.

Allied has made a \$2 billion business out of investing in private companies in niche industries, making it the largest business development company (BDC) in the United States. The July Gordian investment ranks as Allied's largest new private finance investment in the second quarter of 2002. Other investments in the same period included a pest control product manufacturer, a storage tank maintenance product provider, and a

cleaning product marketer.

Allied Managing Director John Shulman noted that the economic downturn's positive effect on the turnaround field has made such investments more attractive. "The current economic climate offers a wealth of opportunities for the company to lend its expertise and add value to businesses in complex situations," he explained.

Mr. Shulman emphasized that this arrangement is not Allied's first foray into consulting-type investments. "We really liked what we saw, the whole package of Gordian. I think it's going to be a great investment because their advisory business will continue to blossom," he said.

This anticipated growth is not likely to change, even if the economy starts an upswing. "One would assume that the trend line is good for a business that provides services like Gordian. Even if you believe that we're coming to the tail end of the difficult business cycle, turnaround advisory work goes well past that. Even when the cycles start to turn, there's still a tremendous amount of work advising distressed companies. That work is alive and well even in the best of times," Mr. Shulman said.

For Gordian's part, the investment seems well-suited to its own mission. "Allied Capital is very interested in working with Gordian Group to deploy capital in restructurings and special situations and that will enable us to broaden our product offerings and serve our clients even better," Gordian Managing Director Peter Kaufman said. He added that Allied's investment comes at a time in the economic cycle when capital is scarce and that this underscores the BDC's faith in Gordian's strategic market position.

Further, Mr. Kaufman explained that Allied is an ideal partner for Gordian because it allows the firm to maintain a "conflict-free" position when advising debtors with bondholder creditors. "What's different about this investment is that unlike the other firms in our business that are owned by someone, or have a significant investor, our new investor does not bring additional conflicts.

"We believe that boards of directors, particularly those who care about what happens to their shareholders in a financial restructuring, are entitled to conflict-free advice. We're the only firm

in the country that can give that, if a company has bondholders, because we're the only investment bank in this business with a national practice that neither sells and trades securities with bondholders nor solicits bondholders to do bondholder advisory side assignments," Mr. Kaufman said.

According to Mr. Kaufman, this sort of conflict is the "dirty little secret" that Gordian's competitors do not want to acknowledge. "Allied Capital is a big financial institution, but they bring nothing to the table that will taint us in our conflict-free position. Following this transaction with Allied, Gordian Group still won't be soliciting bondholder financial advisory assignments and still won't sell and trade securities with bondholders," he said.

Meanwhile, Mr. Kaufman also agreed that the timing of the investment is in tune with the general economic climate. "I think that it signals that they believe there's going to be an ongoing real need for services like ours for people who know how to solve complex and/or distressed financial situations," he said. "The thing about Gordian Group is that from time to time we get into mega cases - LTV, Chiquita, Ameriserve - but a lot of our practice is middle market. Allied also loves the middle market and that's another common focus we have."

But it's the people at Gordian that made the deal the most attractive. Mr. Shulman said that the personal relationship Allied has been able to forge with Gordian's management in the last year was key to his company's decision-making process. "That's crucial for us. We believe that management is absolutely fundamental to the success of any company. The best business model can often not succeed because of bad management. Management is the people. Part of our due diligence is to get to know the people in every way that we can."

Perhaps Gordian's management was easier to get to know due to the firm's impression of being a smaller organization, despite its laundry list of big-named clients. "We're in the middle market because while we have 17 professionals and can handle the

mega cases, sometimes the world likes to view us as small. The middle market also is one area that's not being served by the major investment banks. As you've seen all the consolidations of investment banks, everyone's gotten away from the middle market," stated Kaufman.

Allied's strategic investment in the Gordian Group came at a time when the BDC was facing some negative press surrounding its own public filings with the Securities and Exchange Commission and claims that it had overstated its portfolio valuation. In June, a hedge fund made specific accusations against Allied. The charges included the alleged use of improper accounting practices and the overvaluation of certain of its investments to cover up bad loans. Critics of the company also speculated that Allied was not generating enough cash flow from its operations to support the payment of dividends.

Allied responded to the accusations in an extensive and detailed refutation contained in a company statement issued by Chairman and Chief Executive Officer William Walton. The statement included several meticulous analyses regarding various specific investments and how and why their valuations were appropriate.

The statement further asserted that Allied's valuation policies are consistent with rules established by the Securities and Exchange Commission, the American Institute of Certified Public Accountants, and the Small Business Administration. Still, the debate negatively affected Allied's stock price for a time and spawned at least three class action lawsuits alleging that the company misled shareholders about its business and financial condition.

The announcement of the Gordian investment coincided with the stock price's return to the mid-\$20 range. Despite another dip in August, the price was back in the mid-\$20s at press time. □