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**HEADLINE:** Focal's many hang-ups; Troubled telco running out of options to rescue biz

**BYLINE:** JULIE JOHANSSON

**BODY:**

Chicago's Focal Communications Corp. is running low on time-and strategic options-as it faces a deadline to boost financial performance or risk violating covenants on its \$370-million debt.

The Chicago phone company, once hailed as a rising star and challenger to the Baby Bells, provides voice and data services to large corporations and Internet service providers. Like many within the devastated telecommunications sector, Focal has top-notch assets but is struggling to reach profitability.

Focal increasingly appears headed for bankruptcy protection-an option company officials dismiss, for now-as management's efforts to find an acquirer or merger partner drag in a buyers' market glutted with distressed telecom firms. Investor concerns about such a reorganization are reflected in Focal's stock, which is down 99% for the year and was trading at 35 cents at midday Friday-a fraction of its \$36.05 52-week high set last Oct. 18.

Focal contributed to the bankruptcy rumbles last week by revealing it had hired Miller Buckfire Lewis & Co., a leading restructuring group whose principals had until this summer led the workout practice at New York investment bank Dresdner Kleinwort Wasserstein.

The New York advisory firm will help Focal determine its "strategic options, redo our business plan and position us for the future," a Focal spokesman says. "This is not an announcement of bankruptcy; it's quite the contrary."

But Miller Buckfire counts several high-profile companies in the midst of bankruptcy reorganization among its current roster of clients, including Kmart Corp., Polaroid Corp. and Sunbeam Corp.

It also advises Level 3 Communications Inc., a Colorado-based fiber optic network operator that is backed by investor Warren Buffett. Observers view Level 3 and Dallas-based Allegiance Telecom Inc. as the likeliest acquirers of Focal (Crain's, Aug. 19). Neither company would comment on whether it is in talks with Focal.

But while such deep-pocketed acquirers are in no hurry to seal a deal, time is not on Focal's side.

Barring a sale or miracle, Focal is likely to violate its current loan covenants for the fourth quarter, risking a technical default on the debt. A company spokesman says that restructuring those loan terms is a top priority for Miller Buckfire.

The syndicate of banks that underwrote Focal's loans requires it to generate revenues of \$90 million, have 770,000 access lines in service and report a positive cash flow of \$4 million in earnings before interest, taxes, depreciation and amortization (EBITDA) for the fourth quarter.

For the second quarter, Focal had revenues of \$94.4 million, meeting the first hurdle. But it had installed only 718,997 phone lines, and its EBITDA was a negative \$6.2 million.

While Focal's revenues are growing at a healthy clip, up 15% over the year-earlier quarter, expenses are increasing at a faster pace. The company's total operating expenses were \$134.6 million during the second quarter, up 25% from its year-earlier tally. Unless Focal reverses that spending trend, it won't show the positive cash flow the bankers require by this quarter.

"The problem that Focal has is not uncommon to this part of the telecom industry," says Terrence Barnich, president of **New Paradigm Resources Group Inc.**, a Chicago-based research and consulting firm. "They haven't been able to manage their SG&A (selling, general and administrative) costs; it's costing too much to add customers."

The phone company laid off 300 workers last week, including 85 at its Chicago headquarters, a move it says will save about \$25 million annually.

While the company cut employees across the board, its sales organization took the heaviest hit. To Mr. Barnich, that suggests Focal is preparing to reorganize, since it was, until recently, beefing up its salesforce to meet the revenue targets in its loan provisions.

"If there's any threat of violating their debt covenant, they would want to tackle that upfront," he says.

The Focal spokesman says any such speculation is premature. "We have a whole range of options and we're just at the beginning of the process of exploring them."

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