Lernout Files for Bankruptcy Protection, Says Cash at South Korean Unit Is Missing

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Staff Reporters of The Wall Street Journal

Lernout & Hauspie Speech Products NV filed for bankruptcy-court protection, unable to withstand mounting financial irregularities and bank pressure to repay several hundred million dollars in loans.

The Belgian-American software maker's decision to file for a Chapter 11 reorganization in a federal court in Wilmington, Del., came after L&H executives discovered about $100 million apparently was missing from the company's South Korean unit, according to people familiar with the situation.

The company had been counting on the cash to pay its bills, these people said, and its disappearance made an already difficult financial situation untenable.

L&H said it plans to file for bankruptcy protection in Belgium Thursday. Its Dictaphone Corp. unit filed for bankruptcy protection in Delaware Wednesday.

The bankruptcy filing caps a tumultuous series of events at L&H, a maker of speech recognition and translation software that until recently had been a high-tech star. Started by two Belgian entrepreneurs 13 years ago, the company had emerged from nowhere to become a world leader in helping machines understand and use human speech.

But in recent weeks, the company has admitted "errors and irregularities" in its past financial statements. One of its co-founders, Pol Hauspie, has resigned as a director, and the company is the subject of investigations by the U.S. Securities and Exchange Commission and Belgian authorities. L&H stock, which hit a high of $72.50 in Nasdaq Stock Market trading in March, giving the company a market value of about $10 billion, had tumbled to below $7 when trading was halted this month.

The assets of Dictaphone, which L&H acquired earlier this year, now may become subject to a court fight, after Dictaphone's former controlling shareholder, Stonington Partners Inc. of New York, filed a lawsuit charging that it was defrauded by L&H in the deal. Stonington is seeking to have the acquisition rescinded.

L&H's banks had given the company until the end of the week to come up with a last-ditch restructuring plan that would include asset sales, without which they would demand immediate repayment of loans, people familiar with the matter said.
"We have tried, without success, to reach an acceptable accommodation with our bank lenders," said John Duerden, the company's chief executive officer. "After an intensive analysis &hellip; we concluded that a voluntary reorganization filing is both prudent and necessary to preserve and rebuild our valuable customer base and technology assets."

Until recent weeks, the South Korean subsidiary had reported about $100 million in cash on its books, according to people close to L&H. But in the past 10 days, Mr. Duerden and Daniel Hart, L&H's general counsel, discovered that the cash wasn't available to the company and is likely to be completely gone, according to Lanny Davis, an outside attorney for L&H.

Mr. Davis said the South Korean problem "might just be the tip of the iceberg, and certainly was a critical reason for the filing of the Chapter 11 action."

'Full Cooperative'

He added that Mr. Duerden and his team are "prepared to be fully cooperative with all authorities in Korea and elsewhere to find out what happened and help prosecute anyone responsible for violating the law."

The new reports of missing funds can only reinforce doubts about L&H's past claims of surging business in Korea. The company had negligible business in the Asian nation until September 1999. But in this year's first two quarters, it reported sales in Korea of $127 million, up from just $1.2 million in last year's first half.

Last week, L&H suspended Joo Chul Seo, CEO of L&H Korea, from his duties and removed him as a director of L&H Korea. He couldn't be reached to comment.

In August, an article in The Wall Street Journal raised questions about L&H's Korean business, noting that some Korean customers claimed by L&H either said they did no business with the software firm or said their purchases from L&H were smaller than L&H had claimed. At the time, L&H disputed the findings.

Complicating L&H's predicament is the lawsuit by Stonington Partners, the private equity firm that sold Dictaphone to L&H this year for stock -- then valued at $504 million -- plus $430 million in assumed debt. As part of the deal, Stonington agreed not to sell a portion of its L&H stock for two years and still holds the entire nine million shares it received.

'False Representations' Alleged

The suit, filed Monday in Delaware Chancery court, alleges that L&H used "blatantly false representations" to buy Dictaphone, a Connecticut company that sells call-center recording systems and dictation services to hospitals. The suit seeks to have the merger rescinded, along with unspecified damages. In addition, at Stonington's request, a Belgian court placed the shares of Dictaphone owned by L&H in escrow. Stonington's sole representative on L&H's board, Albert J. Fitzgibbons III, tendered his resignation as an L&H director on Monday, a Stonington lawyer said.

L&H officials believe their U.S. bankruptcy filing supersedes the escrow ruling obtained by Stonington on the Dictaphone shares, said people close to L&H. Thus, L&H believes it can keep control of
Dictaphone's assets for now, these people said.

Before L&H filed for bankruptcy protection, the company had held a series of tense meetings with its bankers over the past week. The banks declared L&H in default after the company failed to meet an interest payment on the loans from the banks due this week, according to people familiar with the situation.

The banking consortium, which is made up of Belgian banks KBC NV, Artesia Banking Corp. and Fortis NV and German banks Deutsche Bank AG and Dresdner Bank AG, extended a $450 million line of credit to L&H in early May to help it finance the Dictaphone purchase.

L&H has drawn down around $350 million of the $450 million credit line, according to the people familiar with the situation.

It faced a March 31 deadline to repay $200 million of that. At the end of September, L&H had $200 million in cash on hand, according to analysts. But $100 million of those funds was the money feared missing in South Korea, according to people familiar with the situation.

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10 Steps to Chapter 11

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