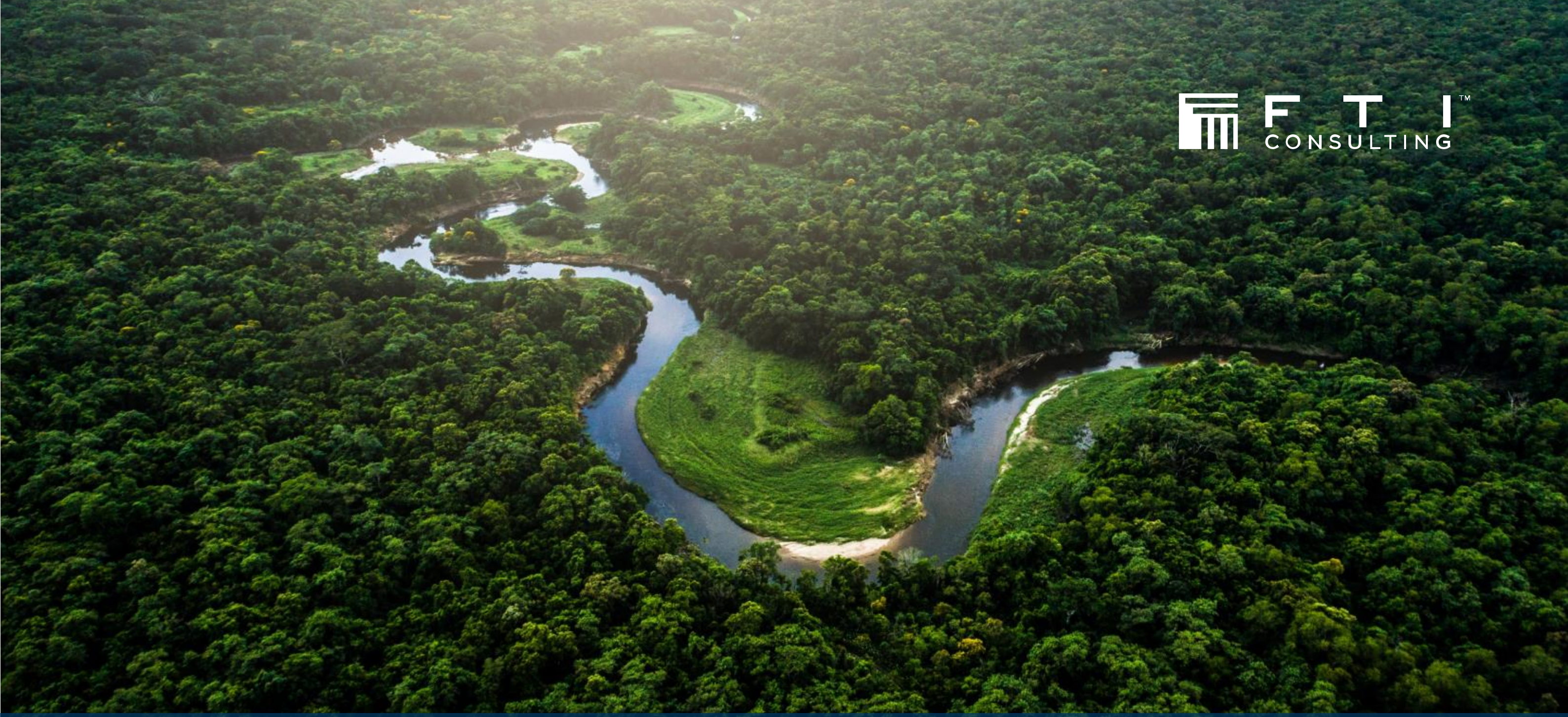

Diamonds in the rough: Selling distressed businesses

Transacting a business that is experiencing some form of distress requires an approach different to that normally adopted in a business sale.

Time is often of the essence and an objective approach to key matters such as valuation is needed. Keeping a careful eye on trading, and continuing to run the business, is critical to preserving going concern value. In this article, Mike McCreadie and Drew Forbes look at some of the key points for selling a business in financial distress.

Can you survive and is there anything saleable?

Before fully committing to the sale process, it's advisable to take time for inward reflection – after all, any distressed seller will at some stage need to ask the tough questions of themselves, including whether their business is saleable, or whether it should simply cease trading. To do so, sellers should assess whether their business is distressed due to a select number of discrete factors that can be dealt with through a sale process, or are there more fundamental, systemic problems with the business which are not capable of being resolved?

It is, however, important to keep an open mind in this process - factors such as onerous leases, supply contracts or licence agreements for example, which many vendors would consider roadblocks to a sale, could all be dealt with expeditiously through an external administration.

Spending some time thinking about what is salvageable and saleable will also assist in marketing the business, forming a view on value and identifying buyers. Sellers should consider what the real market value of their assets might be and where the intrinsic value in the business lies – i.e. in longstanding customer relationships, product patents or reputation. Conversely, if for example the real value of the business is tied up in the name, reputation and expertise of the individual vendors, achieving a sale could be difficult.

Find the synergies and identifying potential buyers

While the business on a standalone basis may be unprofitable and therefore unattractive to suitors, marketing it as a "bolt on" is a tried and true way of successfully extracting value.

For example, you own a business that is a wholesaler to a large national retailer and has a long-standing relationship with that customer. However, for a range of reasons, your business is not viable on a standalone basis. Who might be interested? Logical buyers would include competitors in your sector who do not have an existing relationship with that major national retailer but would value having one or suppliers in an adjacent sector who may already have a relationship with that customer and wish to broaden their relationship.

Such parties will likely have existing infrastructure and people that allows them to remove costs and realise value in the business that other parties looking to operate the business independently may not be able to achieve.

When identifying potential buyers, start with the basics – who are your competitors, who operate in a complimentary space and who is on the acquisition path? Focus on well established, successful players who will likely have the financial capacity to support a transaction and the expertise to run the business post acquisition. Exploring options with private equity adept at dealing with underperforming businesses and assisting with turnaround is also an alternative.

Get your house in order

One of the easiest ways to weaken interest is to present a business which isn't ready for sale. While the level of distress may dictate how long you have to prepare the business for sale, some of the key things you can address are:

- Ensure your financial accounts are up to date and that all statutory lodgments have been completed – not only will this be of interest to potential buyers, but it will also allow the vendor to make an informed decision as to what price is achievable and what is the best way forward post sale. Pay particular attention to the issues that are likely to be of importance to buyers – for example, most buyers will want to see a current position with respect to employee entitlements, the results of a recent stock take and a reconciled debtors ledger;
- Deal with assets and liabilities that are not core to the transaction – related party debts should be repaid or forgiven and if aged stock is an issue consider liquidating it, given any purchaser is unlikely to attribute significant value to it. Also, consider whether there are segments or divisions of your business that are successful in their own right that may benefit from being sold off separately and "freed" from association with the distressed business;
- Bring management/key staff "into the tent" – at some stage, interested parties are likely to want to spend time with key staff. Engaging with key staff and in some instances incentivising them on the back of a successful transaction can produce a more seamless and effective due diligence and overall transaction process;
- Pull critical documents together – think about what you would like to see in evaluating a business like yours and collate those documents, so they are at hand when needed – financial information, details on key assets and liabilities and any material contracts is a good starting point;
- Action any cost saving measures at the earliest opportunity. Often businesses even in distress have not actioned the necessary cost saving measures that are critical to survival, as they work towards a turnaround. Starting these measures not only preserves cash thereby buying time, but it also gives potential acquirers insights into turnaround plans for the business;
- Identify the stakeholders that count. Inevitably, the majority of sale transactions are complicated by either leases or licence agreements that need to be assigned or other contracts which include "change in control" provisions. Your advisors will need details of these parties so that they can engage these stakeholders early in the process, to ensure there are no unforeseen problems when completing a transaction; and
- If your business is suffering from debt-stress, engage with your lenders proactively. Having seasoned advisors by your side who are adept at managing the financiers will allow you to focus on actioning your turnaround.

Face reality when it comes to price and process

While the above will assist in a sale process, it is important to face up to the fact that it may not be possible to achieve a price that delivers a healthy return to the vendor, or even in some cases, payment in full to all creditors.

Easier said than done but removing the emotion from the process is key. Having an objective valuation in mind that takes into consideration the market value of the assets, the existence of any goodwill and the other alternatives available to business will be key.

Treading a fine line: protecting yourself

In considering whether the business can continue in the immediate term to allow the possibility of a sale to be explored, directors need to be cognisant of their obligations, particularly when it comes to the trading whilst insolvent provisions of the Corporations Act 2001 (Act). This is particularly important if the strategy is to affect a sale of the business assets and to deal with the remaining corporate shell via an external administration.

Recent amendments to the Act, commonly referred to the "Safe Harbour" amendments, can provide directors with protection from insolvent trading claims, provided the action they are taking is ***reasonably likely*** to result in a ***better outcome*** than immediate liquidation.

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