

Distressed Business Deals Likely to Surge

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“When a thing is done, it's done. Don't look back. Look forward to your next objective.” -*George C. Marshall*

This extraordinary economic downturn is new territory for all of us. Despite government's steps to increase access to small business capital, as a business broker I am seeing a consistent rise in SOS calls from owners of financially distressed businesses. Most of these owners have already cut costs to the bone and restructured their debt, and are reaching the limit of their personal resources. Some have tried selling a portion of their assets or shares to generate liquidity.

If this recession drags on, more business owners will be faced with one of these tough decisions:

1. *Merging with another business*
2. *Selling the whole business, while still a going concern*
3. Liquidating the business
4. Filing bankruptcy and formulating a plan of reorganization

This article explores two of these options for distressed business owners: the Merger strategy to survive by pooling resources, and the Sale strategy to maximize proceeds and move on. By the way, I sincerely hope that by the time this article appears, this topic can be relegated to the dust heap!

Merger Strategy

For some distressed businesses, merging with a competitor, supplier, customer or other industry player is an excellent survival strategy. Combining operations can provide immediate cost savings and efficiency gains. Cost savings are often found in rent, labor, transportation, purchasing power, inventory carrying costs, insurance, marketing, administration and capital expenditures. Redundant assets can be liquidated to generate cash or pay off debts to strengthen the combined balance sheet. Top line sales can be increased quickly through cross selling of products and services, increased overall capabilities, reduced price competition and a strengthened market position. Gross profits can be improved through vertical integration, elimination of redundancies and better capacity utilization. Ideally the merger will also produce a stronger management team and talent pool, making life better for the partners.

I can say from first-hand experience that mergers have numerous challenges and potential pitfalls. Compatibility of processes, technology, product lines, markets, people and culture all require careful consideration early on. You will have to agree on relative business valuations, negotiate transaction structure and new shareholder agreements, work out post-merger management responsibilities, control and compensation, develop a successful integration plan and have a meeting of the minds on eventual exit strategy. Requisites to making a merger work are strong, mutual owner motivation, compatibility and flexibility.

When merging with a direct competitor is the best alternative, the first problem is often getting past hard feelings and an inherent lack of trust. Engage professional and experienced accounting and legal advisors, an impartial business appraiser, and a transaction intermediary to facilitate the process, resolve disputes and make the deal happen within a short timeframe.

Distressed Sale Strategy

With the viability of your business at risk, it may be time to relinquish ownership and control while the business is still a going concern. The market for distressed businesses is far more limited than that for profitable and financially stable businesses. Time is of the essence in getting to market, finding willing and capable buyers, negotiating a deal and closing the transaction.

Prospective buyers of distressed businesses are usually 'strategic' buyers (industry players with synergies) or private equity groups with complementary platform companies in their portfolios. If your business can prosper long term on a stand-alone basis, individual investors with deep pockets and long-term investment horizons can also be a good bet. In either case, there must be a need for the business, and someone has to be able to buy it for less than it would cost them to start a new company or buy a profitable one.

In my experience, in distressed sale situations, most prospective buyers wait around or vacillate until they believe they will lose their chance to buy. Finding and bringing all likely buyers to the table at the same time, fully informed, and asking them to submit their best offers based on their unique plans and circumstances usually produces the best result for the seller, and a successful acquisition for the ultimate buyer.

All buyers will proceed with caution, mindful of their own financial positions and the inherent risks of purchasing a distressed business. For example, relationships with suppliers may be impaired. When the purchase price isn't sufficient to pay the selling company's creditors in full, the creditors become parties to the transaction and structuring the deal becomes more complex. Buyers will need lots of information, quickly, and time to consult with their legal and financial advisors, partners and financing sources.

Both of these strategies take time to implement -- expect at least 120 days. If a wave of distressed deals does roll in, being in front of the wave will be important. There are a limited number of buyers for troubled companies, and most can handle just one transaction and business integration at a time. Their capital resources are also finite and many may not be capable of buying if this recession persists.

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