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Selling Troubled Companies

Introduction

When selling a troubled company you are faced with two apparently conflicting objectives: getting rid of a headache as quickly as possible while at the same time maximizing the price you get for it. Making the achievement of these objectives even more difficult is that you most likely will be dealing with potential buyers who want to purchase the company for a price and terms that give them more than a fighting chance at successfully achieving a turnaround. Striking a mutually acceptable deal under this scenario is a complex and challenging process that takes the commitment of both buyer and seller. The following is the process I've successfully employed in selling troubled companies.

Process overview

The process includes four basic steps:

1. Understanding why the company is in trouble;
2. Determining what you would be selling and what realistically you can expect to obtain for the business;
3. Deciding who the company should be marketed to and how it should be marketed; and
4. Developing the negotiating and transaction structure strategy to be employed.

Why is the company in trouble?

The critical first step of understanding why the company is troubled is instrumental in determining how you will proceed throughout the remainder of the sale process. This analysis might lead you to conclude that the business is not salable and should be exited, with the process ending right there. As I mentioned earlier, time is of the essence in this type of transaction, and you can't afford to use it inefficiently or unproductively. Some common reasons for a company being in trouble include the following:

1. Poor management
2. Loss of key people
3. Lack of focus
4. Inappropriate or inadequate financial structure (could be over-leveraged or undercapitalized)
5. Product problems including quality, functional or technical obsolescence or lack of responsiveness to market needs
6. Operating problems or inefficiencies such as capacity under-utilization and unfavorable business economics due to raw material prices, labor rates and geographic locations of plants and warehouses and an unreasonable burden of a parent company's overhead
7. Customer problems including a loss of a key customer or customers or poor or deteriorating customer relationships
8. Market problems due to a declining market or market price level or a paradigm shift in the market
9. Litigation problems which could be environmental or patent related

What are you selling?
What you are selling goes beyond the stock of the company or the assets on the balance sheet. It's really the business attributes of the company that you're going to sell to obtain maximum value for the company. You need to highlight the strengths of the company and where possible turn the reasons for the company's problems into an opportunity for the potential buyer. Just a few examples:

- You might have a company with good products and a good customer base, but with inefficient manufacturing operations. This type of situation could be attractive to a potential buyer with an interest in the company's business having strong manufacturing capabilities looking to expand its product line and customer base.

- You might have a company with good products and gross margin4 that hasn't reached the size necessary to realize the economies of scale required to make it profitable. This company could be attractive to a potential buyer with an interest in the company's business who can absorb the company within its existing infrastructure.

- As a final example, and one which in many instances will be the case, you may have a company with the basic fundamentals to be successful whose major flaw is in its leadership and/or focus that could appeal to a potential buyer willing and able to remedy the problem.

What can you get for the company?
In most instances you will find it easier to maximize value for a company whose problem is related to its costs or expenses rather than its marketplace performance. Determining what you could possibly get for the business should be reflective of what you believe you have to sell, including the company's strengths as well as the buyer's opportunity to enhance value. Recognizing that the buyer is more likely, if at all, to share some of the expense-related improvements with the-seller, I try to create a pro forma income statement that as closely as possible mirrors the general economics of the business I'm selling. I then apply a range of multiples to the pro forma operating income to get a potential range of values. The range of the multiples used will depend upon the actual operating performance of the company compared to its pro forma level.

Simply said, a company whose actual performance is below the pro forma level will get a lower multiple than that which is above it. The potential purchase of the company as a going concern is then compared to the value that could be realized through its liquidation. If the potential purchase price is not significantly higher than the net liquidation value to reflect the time and risk of selling the company and receiving the anticipated proceeds, the decision will then be made to liquidate the company.

Who should the company be marketed to?
I learned a valuable lesson a while ago when selling an eight-year old Datsun 280Z sports car in mint condition that I once owned when living in Southern Connecticut. I placed an ad in two newspapers, one a highly prominent local paper which ran the ad daily for a week and the other in the New York Times which ran the ad once in its Sunday edition. I received sixteen responses to my ad in the local paper, but only one to my ad in the New York Times. On the surface this would appear disappointing because my one day ad in the New York Times cost more than my weekly ad in my local paper. However, the car was eventually sold to the single respondent from the New York Times. To get the best price for what you're trying to sell doesn't mean you need to get a lot of interest, but rather you need to get the right interest. Who are the right people to market a troubled company to? To me they should have the following attributes:

1. They should be familiar and experienced with turnaround situations.
2. They should have a high tolerance for risk.
3. They should have competence in the industry in which your company participates.
4. They should have the ability to move quickly.
5. They should have the proven ability to finance and close the transaction.

The potential buyers should be further qualified down to those who you believe would have the most interest in and be willing to pay the highest price for what you're trying to sell. Essentially, what buyers have the best opportunity for extracting the most value out of the transaction. Many times you will find that the most logical buyers aren't necessarily the right buyers.

How should the company be marketed?
The various approaches to marketing the company are revealed by the following questions:

1. Should the company be sold in a formal sealed bid auction or in a flexible auction?
2. Should the company be marketed publicly or privately?
3. How confining should be the confidentiality agreement and the information you are willing to provide potential buyers?
4. Should an offering document be prepared or should information be communicated in a more informal and unstructured manner?
5. Should the company be marketed internally or by a third party?

What path you choose will generally depend upon answers to these questions:

1. Who comprises the target universe of potential buyers and how broadly do you want to market the company?
2. How quickly do you need to move? (A lengthy sales process can jeopardize the company's market position and unfavorably impact its already precarious perceived value.)
3. How confidential do you want to keep the fact that the company's up for sale?
4. What's the story that needs to be told to attract interest in the company and maximize value received and can it best be expressed, or should it be expressed, in a written document?
5. Are there resources within the company with the time and expertise to market the company?

What should be the negotiating strategy and transaction structure?

Ask yourself what your key objectives are before beginning your negotiations:

1. Are you looking to obtain the maximum up front cash for the business?
2. Are you looking to obtain the highest value, which in most instances will require some seller financing?
3. Are you looking to obtain a meaningful premium over liquidation value?
4. Are you looking to get out from under certain liabilities such as debt, labor, plant or environmental?
5. Are you looking just to get out and get out quickly?
6. Are you looking to achieve a combination of the above?

I've found that the following factors are key to achieving the objectives that you establish for the transaction.

1. You must believe that the dog you are selling could be someone else's diamond and they might want to buy it as much as you want to sell it. There are few hard and fast rules for setting pricing for troubled companies, and attitude can be important. The optimum scenario is when the buyer believes he stole the company and the seller believes he got more for it than he ever anticipated.
2. You need to get more than one interested party bidding on the company. No matter how poor the property, competition will help drive the transaction and give you some leverage in the negotiations.
3. Given that timing is of the essence in these transactions, you need to be credible, responsive, creative and flexible in your negotiations with potential buyers. You may need to lead the potential buyers to where you want them to go as well as show them how to get there. In many instances you might end up structuring the deal for them. You almost need to think what you would do if you were buying the business, including what and how you would pay for it.

Conclusion

I've learned that to successfully sell a troubled company requires a well-defined sales process supported by a well thought out sales strategy.

Adherence to these disciplines should help achieve a timely disposition of the troubled company while significantly enhancing your chances of finding the right buyer who can see enough value in what you are selling to pay you the price that will enable you to attain maximum value.

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