Distressed M&A: Maximizing Value in Challenging Times

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How do you avoid the bargain bin when selling your business? Unloading a distressed company is by no means ideal, but it's not the end of the world. Glenn Bowman examines distressed M&A—providing four ways to sell smartly during a downturn.

Many business owners share a dream of selling their company at the highest price when value in the marketplace has peaked. But what happens if the decision is taken out of your hands?

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Perhaps your performance has declined to a point where the bank is forcing you to sell your business or its assets. Perhaps a shareholder dispute has triggered a shotgun agreement or forced sale. Or maybe a cyber breach or internal fraud has impacted the business to such an extent that it can no longer continue operating as it has in the past.

These are tough scenarios at any time, but more so amid economic volatility. If you're facing a forced sale during a possible recession, you're likely concerned about extracting the full value for your business. Fortunately, a distressed sale doesn't need to be a low value sale. Here are four ways to sell smartly during a downturn.

Be proactive and transparent

If your business is floundering, it can be tempting to ignore the warning signs in the hope that the challenges will blow over. The problem? The longer a company is in distress, the more likely it becomes that you will lose the support of clients, suppliers and your employees.

The exit of your CFO or accounting staff, for instance, could signal that your company is struggling—making it more likely for your bankers to call their loans. Similarly, high staff turnover could spook your suppliers, inducing them to cut credit lines. To complicate matters, selling a business without key staff almost always reduces its value.

To prevent this downward spiral, it’s important to take swift and immediate action to calm your stakeholders by being honest and transparent.

Buy time

Once you’ve informed your stakeholders of the challenges you face, your next step is to show them how you plan to protect their interests. By committing to a formal recovery or sales process, you can provide your lenders with a level of assurance that they will ultimately be repaid. This could give you the breathing room you need to either turn the business around or extract value through a sale.

Lenders who know they have an exit off ramp tend to be more patient, giving you time to get your management and shareholders on board for a potential sale, and to ideally line up qualified buyers.

Prove your worth

Businesses that are forced into a sale often fall into a trap that prevents them from realizing full value for their company. After all, if you have no choice but to sell, you lose negotiating leverage, making it possible for buyers to reduce their offering price.

With a little knowledge and planning, however, you can overcome this “distressed discount”. The key is to demonstrate to buyers what your business is really worth.

One way is by pointing to your historical earnings. Often, a business that has lost money in the past year or two gets judged on its most recent performance. To counter this recency bias, you need to show buyers that your company’s underlying earning power remains solid, despite recent missteps. Buyers who understand this may be more willing to pay a premium for the company’s future earning potential and recovery to historical levels previously attained.

Before making this case, you’ll want to reposition your earnings to exclude non-business expenses, non-recurring costs and one-time losses. By stripping out these charges, you can present your potential buyers with a more sustainable income statement.

A second way to extract value for your business is by choosing the right buyers. Rather than selling to an industry outsider, for instance, a sale to a competitor may allow you to realize a higher price because your buyer won’t have to cover your current overhead costs. Instead, a competitor that has an overhead structure already in place may even be able to realize cost savings while adding incremental value to their business.

Get creative

When it comes to selling a business, value—like beauty—is in the eye of the beholder. That’s why, during a distressed sale, it’s your job to make your business ‘beautiful’ in the eyes of your potential buyers.
If you’re selling to a competitor, for instance, you may want to explain how they can scale up by adding your product line to their existing distribution network, allowing them to increase their sales without incurring additional back-end costs. Or perhaps the value to them is in gaining access to your customers or sales channels, allowing them to access markets they’re currently struggling to break into.
If you’re selling to a customer, you’ll want to show the critical role your product or service plays in the overall supply chain. In these cases, customers may be willing to pay a premium for your business, not to realize commercial value, but to gain the benefits delivered by vertical integration.
Rather than having buyers apply traditional valuation metrics to your company—metrics that might show your company has no real value—aim to showcase the hidden value of your business as well. In many cases, your equipment, expertise or intellectual property might be worth more on a standalone basis than they are as part of the larger company. By selling these assets for their replacement value, you can often realize an unexpected capital return.
While selling a company that is stressed is by no means optimal, it doesn’t need to be a major financial blow. Taking a proactive approach, buying time, proving your worth to the marketplace, and leveraging the hidden value in your company can all help you extract value during hard times.

Selling your business?

Glenn Bowman sets the stage and offers some preliminary insight for entrepreneurs looking to maximize value to sell their business. Read article

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