OWNERSHIP CONCERNS

IN THE

SALE OF A DISTRESSED BUSINESS

In the sale of a distressed business, a rescue plan for the owners and the sale of the business needs to be carefully choreographed and implemented, as illustrated by the following case.

After suffering eighteen months of operating losses in their manufacturing business, the owners had lost hope. Out of capital, on credit hold with their suppliers and bank, and emotionally spent, they were prepared to close their doors. Bankruptcy was not a viable option, since they were too far gone financially to take advantage of a reorganization under Chapter 11, or a liquidation under Chapter 7, as it would have triggered liquidations of their personal holdings, including their homes.

Their business was grinding to a halt. The owners had no exit plan. They had no strategy for capturing the fair value of the company's good will, equipment, accounts receivable, work in process and inventory. In a fire sale they would not even have realized sufficient cash to pay off the bank. To make matters worse, their business was their sole source of income and health benefits. They were also dependent upon the business paying them rent. That's how they made mortgage payments on the facility they owned and leased to the company. Also, the bank held a blanket lien on all the owners' assets – their business, their facility and their homes. At age 50, the owners would have to start over – an unattractive prospect, at best.

This situation was bleak, but not hopeless. There were positive steps to take. First, they had to keep the doors open and the company operating while information could be assembled and a longer term plan developed. Working with them, the first few days, our objective was to gain immediate control over all aspects of the business operation, its daily cash flow and to squeeze all the cash out of the business and into the bank.

By the end of the first week, certain things were evident. The business was not savable without a significant cash infusion. Management was worn out and wanted out as soon as possible. The doors could be kept open for six to eight months, at most. Further, a plan was required to meet both owner and business objectives. The owners needed to pay off the bank, the only secured creditor, and leave their individual credit intact. Income and benefits needed to be continued for several more months so they could pay off most of their creditors, recover some of their investment in the business and the facility, and preserve the ownership of their homes.

A plan for the orderly sale of the business and liquidation of its assets was undertaken. The following actions were required to implement this plan and to achieve the objectives of the owners.

- First, the primary focus was on stockpiling cash and keeping the doors open. We filled the pipeline of orders at a level the company could sustain and emphasized customer and sales representative retention. During this period, the owners continued to draw their salaries and benefits, as well as having an opportunity to plan for their futures.

- Second, the land and building were listed for sale with a competent local commercial real estate broker. We were seeking an owner/user buyer because we had determined that a competitor would be the most likely buyer because it could fold the company's customer list, catalog, molds and designs, and sales representative organization into its on-going operation. Thus, it appeared likely that the facility would be vacant following a sale or cessation of business.

- Third, a list of prospective buyers likely to act immediately (i.e., competitors) was developed and contacted. Once confidentiality was assured, these companies were furnished the company's catalog and promotional package. Negotiations followed.

- Fourth, all saleable equipment and furniture, together with their estimated value, including liquidation value, was listed. Potential buyers for this equipment were identified and a strategy to sell this equipment was prepared.

This example illustrates the importance of bringing in an experienced investment banking and crisis management team as early as possible who can develop, coordinate and manage the business and owners' crisis plan. Although it was too late to turn a sow's ear into a silk purse, the business returned far more to the owners than they had hoped or expected.

THE AUTHOR – *Gordon Gregory, JD, MBA is Chairman and Managing Director of Mosaic Capital LLC and Mosaic Capital Securities LLC (member NASD) – an investment banking firm specializing in sale and divestiture transactions, debt and equity financing, and valuations for rapidly growing and distressed middle-market companies. He can be reached at 15165 Ventura Blvd., Suite 425, Sherman Oaks, CA. 91403. Phone 818-728-7555. E-mail* ggregory@mosaiccapital.com.