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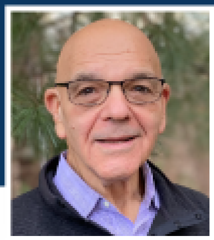

GETTING IT DONE

Actionable Financial and Management Insights for Business Owners

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Dear Friends:

One thing is for sure – the sale of a troubled company's assets sometimes offers the opportunity for a win, win, win, win. Specifically, I'm speaking to the interests of the buyer, the seller, the secured party, or parties, and hopefully unsecured creditors as well. The key is to preserve some measure of the seller's intangible going concern value through what I refer to as a "Strategic Asset Sale." Realism, proactivity, and a comprehensive approach to managing the disparate needs and prerogatives of the four constituencies I listed above are the keys to maximizing the net value generated. This issue examines these central factors in detail and how they can come together to make a real difference in the effort towards "Getting It Done" for all parties concerned.

I hope you find these thoughts of value and I invite your questions if I can provide further help.

With my very best,
Gerry

A STRATEGIC ASSET SALE: *It Can Be a Win, Win, Win, Win*

Overview

As a company slips into distress, every party involved wants to emerge as unscathed as possible. Ownership wants to protect their future prospects; potential buyers want a new opportunity that helps them grow and prosper; secured parties want to come out whole, or as close as possible; and unsecured creditors want to protect their interests to the extent the situation realistically allows. In virtually all instances, the key to a successful transaction lies, first and foremost, in the hands of a seller's ownership and senior management. Accordingly, it makes the sense to look at maximizing a strategic asset sales' value from their perspective and a good way to look at this is by focusing on two keys:

1. **Acting realistically and proactively**
2. **Executing comprehensively**

- Assembling the right team
- Understanding the company's intangible "value drivers"
- Developing a focused sales strategy
- Managing various creditor classes based on their specific needs
- Moving with due speed

It is also important to note that these keys don't play out in a linear fashion. Rather, they interact with one another throughout a process that results in a closed deal.

#1 Acting realistically and proactively

I'll start with a story. Many years ago, an insolvent Pathway client knew that they'd have to merge in some fashion with one of their four major regional competitors. Otherwise, they wouldn't survive very long in any form or fashion. Against our advice, the client insisted on waiting until the end of their upcoming peak season to pursue a transaction. That was simply because the client felt that rumors about his financial issues would kill the company's quarter that traditionally generated 50% of annual sales. So, what happened? When the season was over, his four largest competitors had consolidated into two companies and my client ended up in bankruptcy both corporately and personally. The opportunity to preserve even a modicum of going concern value had totally evaporated. This is a cautionary tale I often tell.

#2 Executing comprehensively

Getting a successful strategic asset sale accomplished requires five components:

Assembling the right team

One way or another the "right team" needs to have:

- industry-specific knowledge
- deep distressed company experience
- financial expertise
- appropriate legal training
- transactional know-how

Most typically, some of these skillsets are available internally but invariably, outside professionals must be engaged as well. Otherwise, the opportunity to maximize going concern value is flat-out unlikely. It should also be noted that less than five individuals will often be needed to cover these bases. For example, Pathway has decades of distressed company experience, financial expertise in some, but generally not all financial areas, and transactional know-how developed over the course of managing numerous strategic asset sales.

Understanding the "value drivers" that can maximize sale proceeds

From a "big picture" standpoint, the right team's first step is to fully understand the "value drivers" that a potential buyer will covet. It might be a complementary customer base; a leading-edge technology; synergistic product lines; key personnel; or new market territories. Regardless, these "value drivers" must be strategically aligned with the buyer's business in some form or fashion. In other words, the seller's historic EBITDA has little, if any, meaning to a buyer's valuation of the transaction.

Developing a focused sales strategy

The core of a sound sales strategy, quite obviously, is the identification of legitimate potential buyers. Often, for smaller companies in particular, this can be done with relative ease because the search is often regional. When the search covers the entire US or is even broader in nature, an experienced investment banker, more often than not, will be essential.

Managing various creditor classes based on their specific needs

The strategy for managing various creditor classes must be based on their specific needs, interests, and points of leverage. For example, a secured line of credit lender needs to be confident that their collateral value won't be dissipated during the sales process. On the other end of the spectrum, unsecured creditors need to understand what the parameters of their recovery will be even if the answer is nothing. That's because these creditors may, at least, have the chance to keep the buyer as a customer.

All this having been said, when the right team and the right sales strategies are in place, creditor management is actually quite straightforward. They need to understand the process, understand what's in it for them, and have full confidence that what they're being told the truth. It's also important to note that a strategic asset sale, particularly outside of a bankruptcy proceeding, will almost always maximize a creditors recovery because the sale will be accomplished at a lower cost. Furthermore, sale proceeds are generally available more quickly, again particularly outside of a bankruptcy because the in-court process is usually more drawn out.

Moving with due speed

This has everything to do with preserving the sellers' "value drivers." Generally, they will be dissipated over time. Customers will often seek out suppliers they can count on; key vendors will invariably change their selling terms – or stop selling to a distressed company altogether. Further, good employees will increasingly seek out new jobs as time goes on. In that regard, though, the payment of "retention bonuses" has become an increasingly common method for keeping these employees on board.

CONCLUDING COMMENT

I'll conclude with another story. It's an exceptional example but it drives home the point I want to make. A Pathway client was insolvent and had sufficient tangible asset value to repay their bank - but virtually no more. Our client, though, had developed a strong brand name in the women's apparel market. The $2.8 million premium the buyer paid for the brand provided the junior secured creditor with a 70% payment towards their $4 million exposure. Best of all though, both of the owners were given 5-year contracts with a modest base salary but substantial incentives. Over the course of the contracts, the brands' sales grew from about $12 million annually to over $100 million. As a result, each of the two owners' incentive payments were over $3 million - far more than they had ever earned before. So, this sale was, in fact, a win, win, win, win, win The sellers increased their earnings substantially, the buyers obtained a highly profitable brand name, the senior creditor was paid in full, the junior secured recovered 70% of their receivable and the factories in China retained a meaningful customer. Clearly, in this case, the brand name "value driver" made the difference. And while this was an exceptionally positive result, this case demonstrates the potential power of a strategic asset sale.

MANAGEMENT TIP OF THE MONTH

"A company can seize extra-ordinary opportunities only if it's very good at the ordinary operations."

– Marcel Telles, Billionaire Brazilian Industrialist

Every company has its strengths and weaknesses. Some are very good at sales but come up short on meeting delivery schedules – or some may be very good in terms of quality control but come up very short in terms of financial control. The fact is that precision day-in, day out operations across the board are an essential foundation for meeting, or possibly exceeding long-term goals.

Coming In The Next Issue

Driving a Lasting Turnaround: The Three Essentials