



Pathway Advisors LLC

Getting It Done

Management & Financial Insights for Business Professionals

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Dear Friend,

In the world of selling distressed, smaller and lower middlemarket companies, the importance of intangibles can't be overstated. In fact, in every one of the distressed company sales that Pathway has been involved with, intangibles have driven the deal. First, they motivated buyers to move quickly. Second, these buyers had particularly good reasons to pay -relatively speaking, top dollar. Today I'll be discussing three recent transactions that Pathway facilitated and the key intangibles that both sealed the deal and drove the selling prices up:

- *An established backyard product line*
- *A proprietary laser-based manufacturing technology*
- *10,000 residential trash collection stops*

As always, I invite your questions or comments.

Best regards,
Gerry

Intangibles Drive a Distressed Company Sale



Three Illustrative Transactions

An established backyard product line – and the new engineering plans needed to produce profitably in the US

The seller, Pathway's client, was the acknowledged quality leader in its backyard product niche. Nonetheless, for several years, they had been losing about \$2 million annually. There were two primary reasons for these losses. First, sales had been declining for years. Second, the costs of manufacturing in the US were just too high. Nonetheless, two bidders surfaced very quickly.

I also want to mention that a secondary, while still very meaningful, intangible asset also played a role here. Specifically, the seller had developed, but not begun to use, engineering plans that would dramatically reduce domestic manufacturing expenses. Needless to say, these plans would help jumpstart the buyer's efforts to gain profitability.

The winning bidder was a multi-line consumer product company with excess capacity in their North Carolina plant. They paid 100% of the cost of both finished and raw material inventory! A selling price for inventory you just don't see very often in these types of transactions - to say the least. They also agreed to keep the three family members that owned the company on the payroll for an extended period of time. And finally, the buyer also paid for the removal and clean-up costs associated with vacating the company's leased facilities. An expense that ran well over \$100,000.

Assessing this transaction, the product line was certainly the linchpin. At the same time, the importance of the finished engineering plans, an intangible as well, certainly made a difference.

A proprietary, laser-based manufacturing technology

The seller was a startup which had developed a package of proprietary laser-based manufacturing technologies. The problem was that the upfront planning process had been woefully off base about the time, effort and capital needed to reach breakeven. Thanks to the availability of PPP, EIDL and state-sponsored economic development funding, however, they had enough time to begin building volume. When Pathway was engaged, though, cash was perilously low.

It was no secret that the seller was struggling. The redeeming quality here was that the company's largest customer *needed* both the technology and the associated equipment to meet its customer's needs.

The forced liquidation value of the equipment was far, far less than what was owed to the lenders with outstanding balances due. The value of the technology, however, made it possible for the company to fully pay all but one of its five secured, personally guaranteed loans. In that case, much of that loan was paid down up front and the balance was resolved satisfactorily for all parties including the personal guarantors.

A trash collection company with 10,000 residential customers

The seller, Pathway's client, was a young company that had built a route system encompassing 10,000 residential stops. Despite this, the company had never really made any money. Furthermore, the seller simply did not have the capital needed to acquire the fleet of new, efficient trucks they needed to become profitable.

The buyer was a diversified operator active in several areas of the waste disposal industry. Outwardly, they wanted to increase both their sales volume and their controllable sources of supply. The seller really had nothing to offer except customers – but that was more than enough.

There's a great ending to the story! What we didn't know was that the buyer was actually positioning itself to be sold. As a result, the intangibles being acquired were more important to the buyer than was understood. Fortunately, the seller took back about 50% of the purchase price in stock that had been valued at about \$2 million at the time of the sale. The buyer's president had repeatedly said that the stock would rapidly increase in value, a claim I generally view with great cynicism. In this case, I was wrong – I'm happy to say! Within several years, the acquirer did sell and the stock Pathway's client took back had tripled in value!

A Final Note

To me, the sale of a company's valuable intangibles is virtually always what leads to the most positive outcome possible in a distressed company sale.

Understandably, though, when a company begins to falter significantly, ownership almost invariably focuses first on the most pressing issues - bank and creditor pressures, illiquidity, reducing personal and operating costs, assuring the continuity of deliveries, morale, etc. The selling of valuable intangibles is viewed more as an "if all else fails" step most of the time. While understandable, that's a mistake.

The consideration of selling intangibles, as well as the best way to do it, should be addressed right up front as well. That way, there is a far better chance to get the sale process in gear in the most advantageous way possible.

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Pathway Advisors LLC is a specialized business advisory firm focused on helping our clients effectively resolve their most significant profitability, cash flow, banking, operational, and organizational challenges. We pride ourselves on the ability to analyze issues quickly, develop plans to solve them efficiently, and leverage our deep relationships in the financial and business communities to do so. Pathway has helped over 450 companies throughout the eastern half of the US.