Navigating a Distressed Transaction

How to Buy and Sell Companies During COVID-19 – Key Takeaways

AmherstPartners

On Wednesday, May 20th, Amherst held a webinar where Scott Eisenberg (Amherst Co-Founder), Ryan Blaine Bennett (Partner in Kirkland & Ellis's Restructuring Practice), Andrew John (Partner with Calvert Street Capital Partners), and Sheldon Stone (Amherst Partners' Restructuring Advisory Practice Leader) discussed the nuances of distressed transactions in the context of the COVID-19 pandemic. Below are the five key takeaways:

1 UNDERSTAND THE SOURCES OF DISTRESS

- When a business is in distress, they are out of money. The shortage of cash can be the result of a misaligned cost structure, deteriorating viability, poor management, high financial leverage, external factors, and more
- As a buyer, understanding the sources of distress is critical to a successful conclusion in a sale process, as it will lead to a thoughtful consideration of the best ways to extract value from the sale. As a seller, removing obscurity, highlighting prior positive performance, and discussing resolutions to the company's issues will increase bidder interest

2 VENUE WILL DICTATE THE PROFILE OF THE TRANSACTION PROCESS

- Venue can be in-court or out-of-court. An out-of-court sale process can be ideal for situations where the capital structure is relatively simple and there are few parties involved. Resolving issues out-of-court is often cheaper and can often be concluded expeditiously. However, if the situation involves many complex claims or stakeholders, resolving disputes out-of-court may not be ideal or feasible
- Despite potential adverse public exposure, buyers may prefer an in-court process because it will enable them to cherry pick assets free and clear of claims. Out-of-court transactions may increase certainty around closing but may increase risk post-closing

3 THE RIGHT BUYER MIGHT NOT BE THE HIGHEST BIDDER

- In a distressed transaction, because the business is often operating with negative cash flow, there is usually a party funding losses (e.g., a creditor or customer) during the sale process, which causes the timeline to be greatly abbreviated. Moreover, buyer "outs," indemnifications, and representations and warranties, if they exist at all, will be greatly constrained in scope and duration
- As a result, finding the buyer who is most comfortable operating in the context of a distressed sale, can move quickest, and can ultimately close is often more important than finding the buyer who will offer the highest purchase price

4 POST-MERGER INTEGRATION IS CRITICAL TO SUCCESS

- Effectively implementing an integration plan is particularly important in the case of distressed sale because the company is often melting down, causing disruption for its suppliers and customers, or facing public awareness that may scare away key stakeholders
- To successfully integrate these new assets, considerable effort must be expended prior to closing. Plans may include, for example, a roadmap for integrating financial systems, efforts to ensure the continued inflow of raw materials, and plans to stabilize the base of key employees

5 CHALLENGES WILL PERSIST, ADVISORS CAN HELP

- The pandemic has created a level of opacity into seller performance that is difficult to overcome. Given the uncertainty, the tightness in credit markets, and the inability to conduct critical due diligence, valuations are expected to face pressure
- Hiring advisors that can create transparency and effectively market your company through the turbulence created by the pandemic and unique process of a distressed transaction will help safeguard liquidation proceeds and mitigate negative outcomes

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