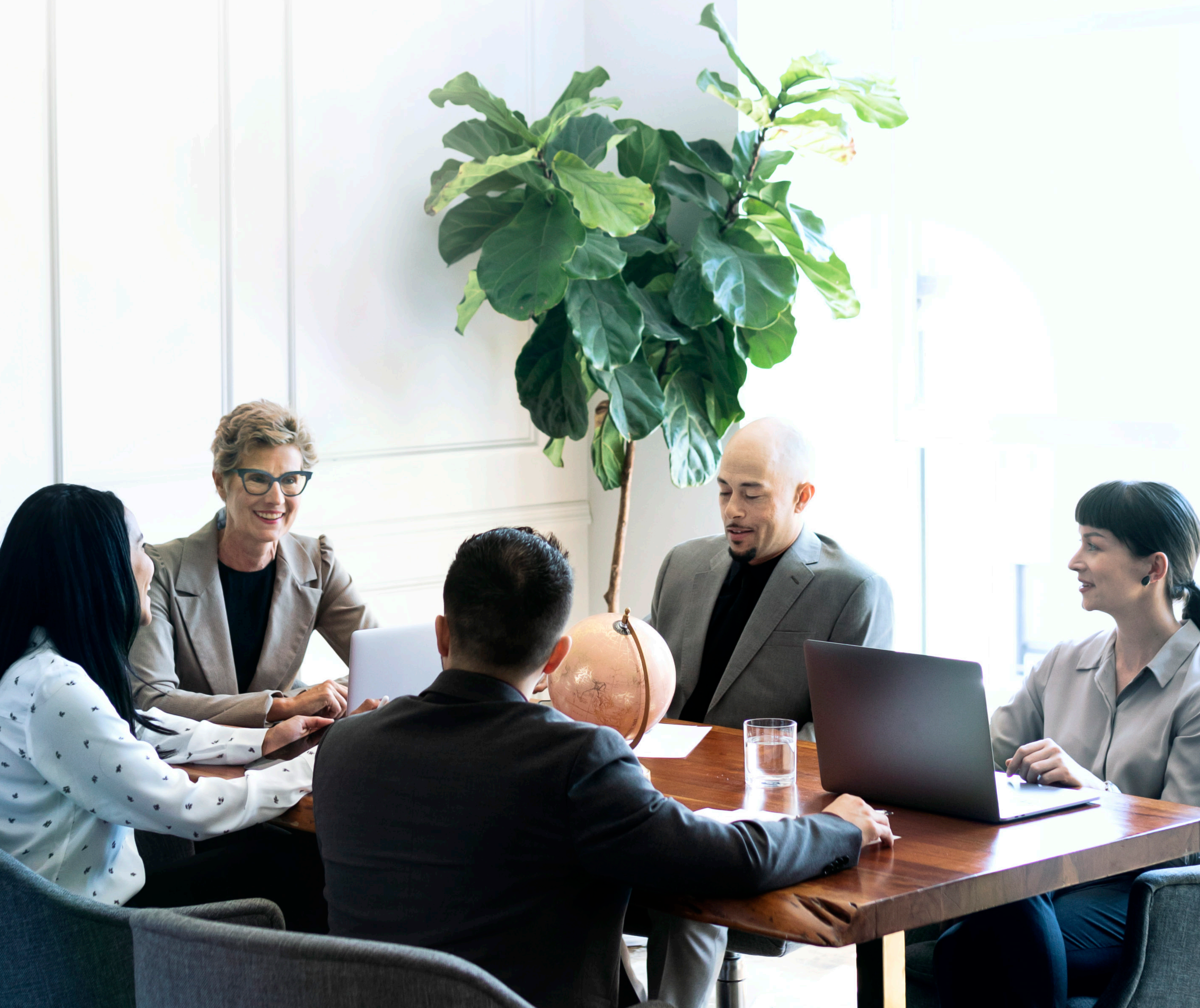
BSR
BUSINESS SALE REPORT

HOW TO FIND & BUY DISTRESSED BUSINESSES AND ASSETS



INTRO

The effects of the COVID-19 pandemic are lingering on in corporate Britain. Many businesses have been severely impacted and it has become a challenge for them to survive, let alone generate organic growth. Along with restricted opportunities for growth, the other main impact of the pandemic on industry has been a huge increase in business distress.

DISTRESS LEVELS RISING

There's no letting up. The number of corporate insolvencies in the first quarter of 2022 was more than double the number in the first quarter of 2021.

There are currently over half a million UK businesses experiencing a significant amount of distress.

County Court Judgements have also skyrocketed - up 157% to 22,552 in the quarter compared with a year ago - a worrying sign of future insolvency levels.

However for business owners who are looking to grow as the pandemic begins to recede, this also presents an opportunity.

With organic growth difficult, distressed takeovers are the ideal way for businesses to grow through acquisitions.

Unfortunately, there will always be a few companies that have no viable trading future as going concerns.

The assets left behind, like equipment, machinery and property, are left for the licensed insolvency practitioner (IP) or liquidator to sell on to try and make some money back for creditors who are owed money.

Assets are often sold at a bargain, and are often split up individually or into groups. Proceeds from asset sales are then distributed equally to creditors and the case is closed.

In this guide, we'll talk you through the different types of distress that can affect a business, detail the process of finding and buying a distressed company, explain how distressed acquisitions can be the perfect way for businesses to grow, and give you invaluable tips for buying business assets.

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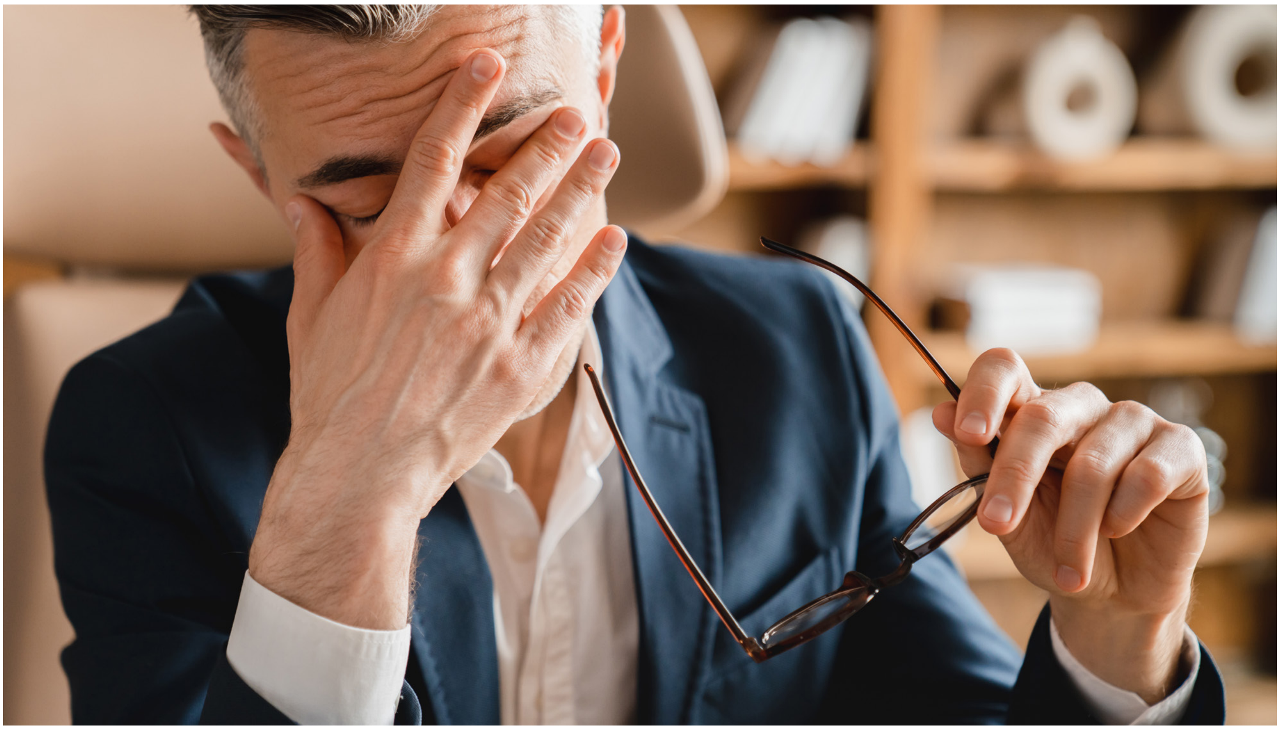
30 YEARS IN BUSINESS

100+ UK PARTNERS

£1B+ TOTAL DEAL FLOW

362 MONTHLY REPORTS

EARLY SIGNS OF DISTRESS



What are the signs that a business is in severe to critical distress? Here are some common warning signs to look out for. If the business doesn't implement recovery measures, a formal insolvency process is likely to follow.

01 Regular cash flow problems. Struggling to meet rent or payroll at month end. The business is simply spending more than it earns. Negative working capital ratio.

02 Interest payments are high. Lenders are taking a view that this is a higher risk company, and therefore charging more. Personal guarantees may be asked for by lenders.

03 Creditors are often hounding the company to pay up. Rise in debtor or creditor days. The company is defaulting on bills. County Court Judgements may have been issued against the company.

04 Profits are falling. Falling margins indicate that the company isn't raising its prices to compensate for rising costs.

05 Morale is low. Owners and managers are not happy as they are stressed and this gets passed down the line. People are leaving.

FINANCIAL DISTRESS

DISTRESS STATS

CORONAVIRUS BUSINESS INTERRUPTION LOAN
£26.4B

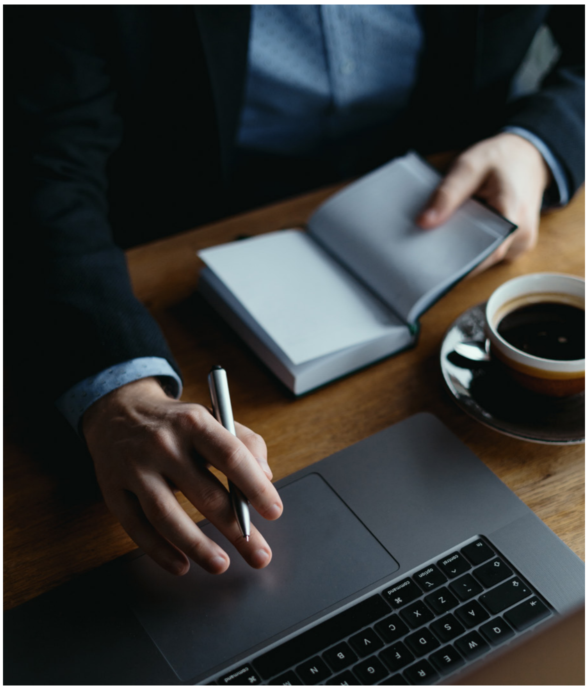
BOUNCE BACK BUSINESS LOAN
£47.3B

BUSINESSES IN DISTRESS
581K

RISE IN CCJS Q1 2021 VS Q1 2022
+157%

Early in the COVID-19 crisis, the government launched a range of support measures for businesses, including low interest loans, grants, furloughing, as well as the winding-up relief outlined above. These support offerings were heavily subscribed to, with the Bounce Back Loan scheme by far the most extensive in its reach with over 1.5 million businesses obtaining a low interest facility to help tide them over.

Aside from looking at court judgements, distress levels can be estimated by looking at key financial ratios and indicators, such as working capital (current assets less current liabilities); and where there are significant drops in retained profits and net worth.



By identifying companies in distress before an insolvency event or court judgement occurs is often a smart way to target acquisitions. These are companies who have mounting debts, diminished revenues and cashflows, and will often be amenable to an active investment or acquisition approach.

It can be time-consuming to delve into individual company accounts to try to shortlist distressed companies within a sector, and for that reason not many business buyers pursue this strategy.   At the Business Sale Report, we have developed a facility that allows users to search company records for off-market businesses that meet their acquisition criteria.

FORMAL INSOLVENCY PROCESSES

WINDING-UP PETITION

This is often the first step in the insolvency process that could ultimately lead to a company being wound up, i.e. placed in liquidation.

If a company owes a creditor more than £750 and cannot settle that debt (usually following a number of demands), then the creditor is able to apply to the courts for the company to be wound up. If the creditor's application to have the company liquidated is successful, then a winding-up order is issued.

That means the company's assets will be sold off and debts collected, with the funds used to pay all creditors.

Temporary legislation brought in to help companies through the pandemic crisis had raised the winding-up petition threshold to £10,000. This expired on 1st April 2022.

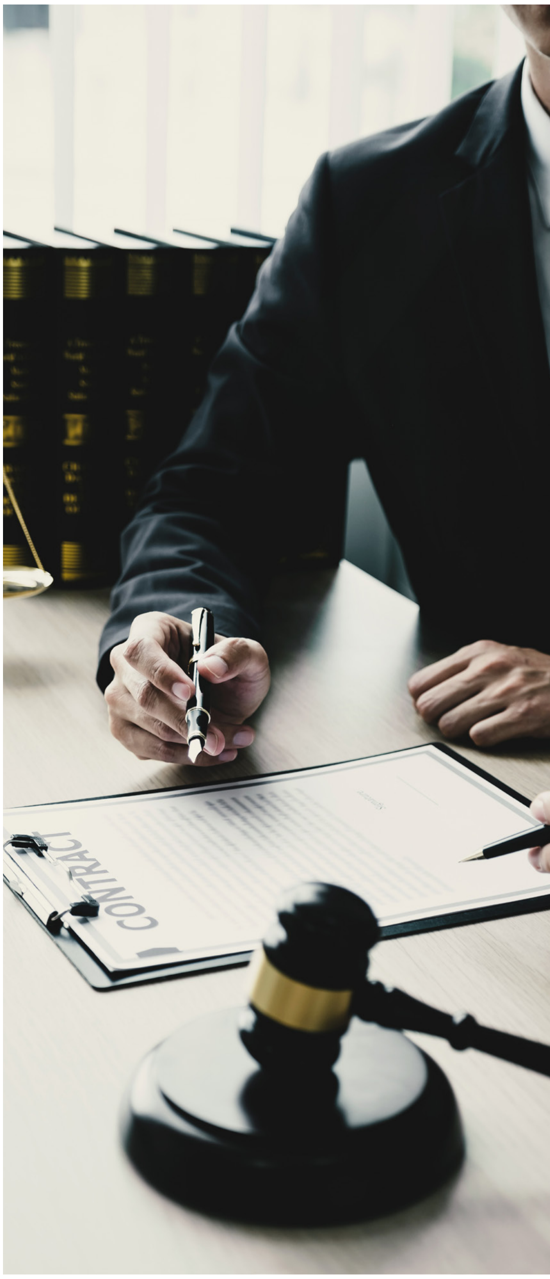
At the same time, restrictions that prevented commercial landlords from issuing winding-up petitions against limited companies for unpaid rent during the pandemic also ended.

Expiry of this temporary relief legislation is very likely to result in a surge of new winding-up petitions being issued over the rest of the year.

To find companies that have had winding-up petitions presented, or have just had insolvency practitioners place them into administration or liquidation, visit https://www.business-sale.com/distressed-businesses

FORMAL INSOLVENCY PROCESSES

ADMINISTRATION



During an administration, a company that is insolvent has its management transferred to administrators. Administration grants the company protection from creditors and the threat of being wound up through a moratorium on legal action.

In order for the company to enter administration, the process must satisfy one of the following statutory purposes: to rescue the company; to achieve a preferable result for creditors than could be achieved by winding up the company; or to realise property or other assets to distribute to creditors.

During the process, administrators take control of the company's management and seek to resolve the company's situation. This can be achieved either by the company undergoing a restructuring or being sold out of administration.

LIQUIDATION

If an administration isn't a viable option for the company or its creditors, then a liquidation may be pursued. In a liquidation, the company ceases trading and will be struck off the companies register. Its assets are sold off in order to repay its creditors, with any remaining funds distributed among shareholders.

There are three different ways through which a company can enter liquidation.

Firstly, creditors' voluntary liquidation, in which a company director proposes liquidation and shareholders then vote to approve it.

Secondly, compulsory liquidation, in which a company is insolvent and a third party, usually a creditor, has successfully applied to the courts for it to be wound up.

Thirdly, members' voluntary liquidation, in which the company is solvent but wishes to cease trading, e.g. if the owner is retiring and doesn't wish to sell the business.

THE KEY DIFFERENCES

Administration is a formal process that is designed to give breathing space to a business in the hope that it can continue to trade with the aid of a rescue package or a realisation of some of the assets.
A liquidation is an orderly process of winding up a company that will never trade again.

BUYING A DISTRESSED BUSINESS

Buying a distressed business isn't as easy as just picking the first struggling company you come across. Despite the possibility of an attractive price tag, buying a business in any kind of distress is a risky investment and one that will require proper research and a clear plan.

BUILD A PROFILE

Firstly, you'll need to have a profile in mind of the type of business you want to acquire. What type of business or sector do you want to buy into? What location? What kind of size business do you want to acquire?

MOVE FAST

Secondly, you need to be prepared to move quickly. Having the profile of the business you want to acquire in mind before you've identified a specific target will be crucial to this, as will ensuring that you have the finances in place to do the deal.

Any insolvency practitioner or administrator will need to see proof that you have the capital to go ahead with the deal and, as they are under pressure in their role to ensure a quick resolution to the company's issues, they will not hesitate to find other interested parties if you don't have all the funds and documentation in place.

With time being of the essence, your due diligence when you have selected a company you wish to buy will need to be swift as well as rigorous. You won't always get the complete picture in a short space of time, so you'll need to ask the right questions.

Look into the reasons why the company fell into distress in the first place. This will be key to assessing whether you can turn the company around. If the problems that lead the company into trouble are persistent and beyond your capacity to solve then moving to acquire the business would probably not be wise.

Conducting a physical inspection of any of the business' property or assets will be vital to ensuring that you know exactly what you are taking on board. Does it tally with the sales memorandum?

Throughout these processes, having trustworthy advice will be crucial. For that reason, make sure that, when considering making a distressed acquisition, you retain a lawyer or another experienced M&A advisor to assist you in everything from selecting an acquisition target, to due diligence, to negotiations with the administrators or insolvency practitioners.

The COVID-19 pandemic saw numerous high profile UK retailers fall into administration, allowing savvy buyers to acquire their well-known brands and add them to their increasingly vital e-commerce offerings.

One of the most notable UK brands to fall into administration was fashion brand Jaeger, formerly part of the Edinburgh Woollen Mill Group, which called in administrators in November 2020, along with fellow EWM Group brand Peacocks.

In January 2021, Jaeger's brand was acquired from administrators by Marks & Spencer. The acquisition, which did not include Jaeger's estate of 63 physical stores, was M&S's first fashion acquisition in over 16 years and represented an effort to diversify its online offerings.

WHY BUY A DISTRESSED BUSINESS?

With each level of seller distress comes equal measures of buyer opportunity and risk. Distressed businesses can offer huge value to a smart buyer, but keep in mind that if you make a critical mistake along the way, a distressed acquisition could cost you more than you bargained for. Let's look at the three main plus points:

ATTRACTIVE PRICE

While there is of course a considerable degree of risk associated with buying a distressed business or its assets, there's no denying that distressed acquisitions offer one very attractive feature: a below-market price.

A low price doesn't necessarily mean good value, so conducting proper due diligence will be vital to unlocking real value in a distressed acquisition.

An attractive price tag won't count for much if you rush into an acquisition of a business that you can't turn around or of assets with very little actual value.

But, with proper due diligence and advice from a lawyer or turnaround practitioner, a distressed acquisition does provide the opportunity to acquire a potentially successful business or valuable assets at a bargain price.

DEBTS REMOVED

Another obvious advantage of buying a business out of administration or liquidation is that its debts will have been wiped during the administration process and the business will no longer have significant creditors.

While this alone may not be enough to resolve the issues that lead the business to its distressed state, it still removes what would have proven a significant problem for a struggling business and enables your ownership to start with a clean slate.

When it comes to acquiring distressed assets, this may come with the advantage of any liabilities having been removed. However, it will be crucial to perform due diligence on any assets to ensure there are no skeletons or hidden liabilities that could impact you, such as intellectual property disputes, product liability claims, adverse litigation judgements or, in the case of property, contaminated land clean-up costs.

Following a two-year contraction in the UK commercial vehicle sector, Warrington Mercedes dealership Roanza Ltd and subsidiary Premier Vehicle Rentals' 2019 losses were exacerbated during the COVID-19 lockdown and the companies were placed into administration. Within days, administrators from Grant Thornton oversaw the sale of parts of the business to new company eStar Truck and Van Limited.

Mercedes industry veteran Sid Sadique moved quickly to acquire Roanza's valuable Mercedes-Benz Truck and Van franchises along with five of its eight North West locations and establish his new eStar business. Sadique commented:

"We looked at the franchise proposition from a strategic point of view and realised that given the different service points and offerings we already have, the opportunities to 'cross-sell' made for a compelling business case."

WHY BUY A DISTRESSED BUSINESS?

POTENTIAL FOR A QUICK DEAL

If you lay the groundwork well in advance by developing a clear profile of the kind of company you'd like to acquire and get your financing and documentation in place ahead of time, this gives you the power to move quickly once you find the right acquisition target. Many standard business acquisitions can take many months, with much higher associated costs. A long deal timeline takes a lot of patience, with time and energy moved away from your core business for much of the process.

The next step is to commence negotiations with administrators or insolvency practitioners. This needs to be conducted swiftly. The IPs will be working on a time-critical basis and are highly motivated to complete a sale in order to resolve the company's future.

At BSR, we often send 'Fast Sales' updates to members, where assets are being sold in a hurry, offering a valuable opportunity to acquire distressed assets.

REAP THE REWARDS LATER

A big part of the attraction of a distressed acquisition is taking a struggling business on (at a reduced price) and turning it around into a successful enterprise. Not only do you get the reward of running a flourishing business, but also the satisfaction of having acquired it for a bargain and the pride in having put in the hard yards to turn it around.

In the current climate, where COVID-19 and supply issues - with inflation and world recession on the horizon - have pushed thousands of previously profitable companies into distress, the opportunity to make valuable distressed acquisitions at low prices has probably never been more present and may never be again.

The British public sector has begun to prioritise procurement from British businesses rather than looking far afield to grant contracts to overseas suppliers. Wherever possible, the public sector will be looking to buy British, shortening supply lines. We should also see a 'buy local' move from the private sector. Making a distressed acquisition now could pay significant dividends within a very short timeframe indeed.

TIPS FOR BUYING DISTRESSED ASSETS

ONLY DEAL WITH THOSE THAT CONTROL THE ASSETS

Make sure that you are buying assets through an insolvency practitioner appointed by the company, or with a firm they have appointed to work with i.e. surveyor or auction house. Do not deal with a company director unless you can be sure the company is not technically insolvent. Moving assets or selling property at a lower price before an IP is appointed can be seen as wrongful trading and a breach of the Insolvency Act 1986, referred to as 'Transaction at under value'. That would trigger a formal investigation and assets would be taken back by the Insolvency Practitioner.

DO YOUR RESEARCH

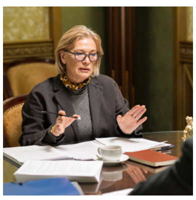
There may be more than one Insolvency Practitioner dealing with the company's assets, so it's worthwhile doing some research on what's offered by each. Check that the Insolvency Practitioner is licensed and properly qualified by a relevant association or body. Understand fully what is up for sale, and have your first tranche of questions to the seller carefully pre-prepared to save everybody time.

CHECK FOR ASSOCIATED CONTRACTS

If you are looking at buying assets that include service contracts (i.e. with machinery or other technical equipment), be aware that these probably end in the event of insolvency. Before buying any assets, check that suppliers will agree to an ongoing contract and all parties are happy to continue. Some lenders or third parties may have security over certain assets which you'll need permission to release.

HAVE FINANCE READY

A quick sale is typically preferred because of time constraints, so buyers should ensure they have funds accessible. There could be various other buyers interested so having funding in place puts you in a good position. Buying a whole business as opposed to just a few assets will involve greater due diligence and responsibility on both sides. Insolvency practitioners will not want to be wasting time on 'tyre-kickers', so make sure that you appear serious in every respect. Having proof of funds is a very good start.



PREP YOUR ADVISERS

If you don't have an in-house legal and accounting team that you can draw on, then make sure you have primed your lawyers in advance, so any deal is not jeopardised by unnecessary waiting. The same with your accountants if you think their advice is going to be needed. In most cases, whether you are buying assets or the company as a whole, getting both legal and financial/tax advice is highly recommended.

CONCLUSION

By their very nature, distressed acquisitions carry considerable risk and can easily go wrong. Often, the old adage that:

"If it seems too good to be true, it probably is" applies.

However, with access to the right tools, preparation, having solid advice and conducting due diligence, acquiring a distressed company or its assets can prove an incredibly valuable investment.

Once stabilised, the path ahead is not so different to investing in any other kind of business that has a demonstrable demand for its product or service going forward, for at least long enough to maximise the return on investment prior to or at the point of intended exit.

For over 30 years, Business Sale Report has enabled thousands of committed business buyers to find their perfect acquisitions, with over £1 billion in completed transactions.

Whether you are looking to buy a profitable or distressed business, searching for an on or off-market opportunity, we have the databases, tools and resources to make it very easy to quickly narrow down your search and make contact with the target's owners.

Get in touch with us today on 020 8875 0200, email us at info@business-sale.com or visit our website at www.business-sale.com.

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