

## Acquiring Insolvent Businesses

### Introduction

Our recent experience indicates a growing trend in favour of purchasers acquiring businesses through formal insolvencies to negate the need for costly and time consuming due diligence together with the elimination of any uncertainty as to what is being acquired.

In our view, the essential element for a successful acquisition in such circumstances is the co-operation of the existing management team. In virtually every case this determines the approach and process.

To show what is possible, a number of possible situations are detailed below.

It should be emphasized that these only apply to companies who are demonstrably insolvent, although the liabilities may, of course, be owed to associated creditors or a sympathetic stakeholder.

### 1. Acquire share capital and formal arrangement with creditors

This would involve a Company Voluntary Arrangement (“CVA”) conditional upon a sale of some or all of the company’s shares which in turn is conditional on the CVA being approved.

In a typical scenario we would envisage

- a small number of key creditors
- causes if insolvency capable of being addressed
- industry sensitive to insolvency (especially a contract based business)
- co-operative shareholders and creditors

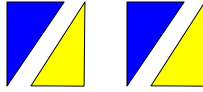
The purchaser must offer or guarantee sufficient to assure creditors that their return is either significantly greater or substantially quicker than could be expected in a Liquidation. Any sale of shares is likely to be viewed negatively by creditors while an increase in share capital in return for an injection of funds into the company positively.

### 2 Acquisition of business and assets from a company subject to formal insolvency

In a typical scenario we would assume

- loss making operations
- deficient management
- aggrieved creditors

A formal insolvency, generally Administration or Administrative Receivership, would determine contracts, crystallize liabilities and allow for restructuring of staffing, pensions and leases. It allows the purchaser to acquire those parts of the company’s business that are required without necessarily having to take on those he does not.



The Administrator/Receiver will, however, need to ensure that the best possible deal is struck and will not want to be left with uneconomic or unprofitable assets. An element of horse trading is inevitable and the purchaser should also be mindful of transfer of undertaking issues regarding contracts for staff that he does not intend to employ.

### **3 Pre-packaged sale of business and assets following insolvency process**

A typical scenario will involve a business sensitive to insolvency and co-operative shareholders, directors and other key stakeholders.

This process involves the virtually simultaneous appointment of (generally) an Administrator or Administrative Receiver and sale of the company's business by the office holder. The speed of the transaction provides continuity to customers and suppliers but the purchaser will need to pay a premium price to justify the office holder not advertising the business on the open market. There is also a limited opportunity to restructure the business.

### **4 Purchase of business and assets after trading in insolvency**

In a typical scenario, the business has been marketed by the duly appointed insolvency practitioner, again generally an Administrator or Administrative Receiver.

The factors for a purchaser to consider before bidding are the potential deterioration of the business, the price (depending on whether he is the sole bidder or whether there are competing bids) and the opportunity to restructure the business.

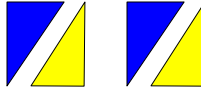
In both scenarios 3 and 4 the insolvency practitioner will need to obtain an independent professional asset valuation and, in the case of a pre-packaged sale, demonstrate a clear premium. The purchaser will need to provide funding on demand and reach agreement with the company's suppliers, customers and other stakeholders, usually in a very limited timescale.

### **5 Acquire share capital and compromise major creditors**

This scenario envisages the company already being in Administration, trading on and being marketed.

Supportive management and key customers and suppliers are necessary and these will need to be receptive to an offer from a third party to allow an exit from Administration by way of a CVA.

There will need to be a compelling reason to acquire the shares (for example, tax losses), the causes of insolvency should be capable of being remedied and co-operative stakeholders.



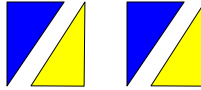
## **Conclusion**

For purchasers, an early indication of the target provides the best opportunity to influence the process and an assessment of key issues at an early stage is crucial to formulating strategy.

The co-operation of and confidence in management must determine the final approach and speed is likely to be critical.

Purchasers will need to quickly weigh up the balance of price and risk and, unless they introduce the insolvency practitioner to the situation themselves, should not be surprised to find themselves getting drawing into a bidding war.

Stephen Goderski



*Geoffrey Martin & Co was formed in 1983 by Geoffrey Martin, who was until then a partner with Arthur Andersen. It now operates from offices in Leeds and London which collectively employ 5 partners and 30 staff.*

*We are business recovery professionals (the new term for what used to be called insolvency practitioners). We have no audit or corporate finance arms or associations and are solely dedicated to assisting companies, partnerships or individuals with financial or cash flow difficulties.*

*We would welcome the opportunity of working alongside you to provide bespoke solutions to the needs of your clients. These would not necessarily be formal insolvency procedures.*

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