

Building Value In Companies To Prepare Them For Sale: Investing In Distressed Opportunities

By John M. Collard



Investing in under-performers and rebuilding value can present lucrative opportunities. In this instance, valuing a company is the easy part. Using its potential to create value, on the other hand, is a far more formidable task. Before investing in under-performers, there are certain steps that should be taken:

- Ascertain if a company is turnable;
- Know how to fix the problems;
- Avoid spending money on past-sins;
- Obtain at the right price;
- Manage the turnaround; and
- Sell at increased value.

Other considerations and measures investors can take to increase the likelihood of success when investing in under-performing companies are:

- **Seek enterprises at a financial precipice:** Look for those with critical capital shortages, yet future potential, but avoid the pitfall of insolvent beyond repair. Acquire companies that can provide quality products at competitive prices.
- **Take advantage of distressed-level asset pricing:** The infusion of capital put in the hands of a leader with a sound strategy and return-on-equity goal in mind can be a powerful motivator.

The key to achieving returns is to build a business that future buyers would want to invest in. Build an enterprise with the sole purpose of selling it at maximum value — concentrate on exit strategies from the start. Build ‘going concern value’ to yield peak results. Key features buyers typically look for include:

- Consistent performance;
- High probability of future cash flows;
- A marketing-oriented management team;
- Track record demonstrating ability to sell and compete, develop, produce and distribute products, thrive and grow;
- Realistic return potential from their fair entry valuation.

Take Control

There must be evidence of success before the entity can be sold. Never leave this to chance. Always take active control of the entity.

Determine viability by truly understanding the two or three things wrong within the company causing a breakdown in value. Don’t be fooled by symptoms.

Ensure you have solutions to fix the real problems that no one else has utilized, as this will gain a competitive edge. Assess whether you can bring new non-cash resources or applications to influence the revitalization. Simply put, the answer is never, “just add cash”, and always requires new leadership and board guidance to implement changes.

Substantial value is derived from bringing in outside directors and advisors with senior operating leadership background experience on their side. They can determine whether one strategy or another can positively affect the renewal, and why others didn’t work in the past.

Process of Recovery

There is a process to guide an entity through corporate renewal. It involves utilizing a transferable set of skills to revitalize the company and restore it to a sale-worthy state. Only once this has been achieved, you should then be able to sell the entity and realize returns.

Bring Leadership

Focus on value creation and guide the company to a new plateau. Your advantage is that of objective focus, untarnished by the situation at hand. You bring a perspective that does not reside within the company because the players lack experience with their new situation. You are the teacher, the stakeholders are the pupils and together you rebuild in a new direction. You effectively manage change control.

Install a board with independent directors, with transition experience in value-building situations. These leaders will demonstrate expertise in the following:

- Managing crisis, transition, and rebuilding processes;
- Shaping business strategy and financial structure;
- Developing management talent, building caliber teams, utilizing and growing existing resources;
- Growing sales and market share;
- Maximizing return on capital;
- Linking management performance to ultimate goals;
- Developing incentive-based compensation programs.

In order to achieve these ultimate goals, leadership must get directly involved in making conscientious decisions, such as elevating sales at an increased valuation. They must also be held accountable for work performance and timely results. Most importantly, they must get things moving, understanding that stagnating performance and results must be improved. On the revenue/sales side, look at where and how revenue is generated and maintain the momentum while ensuring that production and throughput are consistently met with products or services shipped out the door on target.

Set Strategy

While situations differ, one essential strategy is to drive revenue, as growth cannot occur without more sales. The strategy must address the problems plaguing the company and provide a roadmap to revitalization. If all you can do is think of strategies tried before — don't invest.

An effective strategy is key to implementing change. You must establish a new vision. Instill this direction into concrete goals and objectives and create a guide for everyone to follow. Rebuilding momentum is critical to success.

Build Quality Management Team

The value of a company increases sharply with a strong, permanent, credible team who can demonstrate its ability to produce consistent sales, profit and cash flow results. Establish continuity in the organization to allow everyone to manage their workload appropriately while maintaining orderly change, and ethical company morale and career development opportunities.

Capitalize on available under-utilized human capital, as chances are they are dedicated to the company and its success. Guide them to their next level, and they will take the company up the ladder.

Acquire New Business/Sales

There are only two ways to increase sales:

- 1) Sell new products to existing customers.
- 2) Sell existing products to new customers.

Unfortunately, most under-performers have forgotten the basics of marketing and promotion. Clearly promote what your products and services can do for your customer to satisfy their needs while differentiating why your product stands apart from the competition. Adapt to changing conditions and improve your competitive position and deliver only what they are willing to pay for.



John M. Collard, Chairman, Strategic Management Partners, Inc., an Annapolis, Maryland, USA-based turnaround management firm specializing in asset and investment recovery, outside director advisor governance, investing in and rebuilding underperforming distressed troubled companies. John is a Certified Turnaround Professional (CTP), Certified International Turnaround Manager (CITM), Past Chairman of the Turnaround Management Association, Past Chairman of Association of Interim Executives, Senior Fellow of the Turnaround Management Society. John is enshrined in the Turnaround Management, Restructuring, Distressed Investing Industry Hall of Fame, is a co-Founder of TMA, honored with Interim Management Lifetime Achievement Award from the Association of Interim Executives, honored as Most Admired CEO in Maryland by Daily Record, and honored with SmartCEO Distinguished Leadership Award. He can be reached at 410-263-9100, www.StrategicMgtPartners.com

Establish Sound Capital Structure

Establish a sound strategy with a viable marketplace to create well-grounded reasons for investors to invest and buyers to buy. Notably efficient delivery and production vehicles coupled with a cohesive management team will entice the investment community, as securing new capital becomes much easier when investors see high probability of return and a viable exit strategy.

Ensuring cash infusions will not be diverted into past commitments is as equally important. Establish relationships with creditors so they will work with the new management team — keep them informed and participating.

Implement Processes

Use systems and processes to drive the business and control the day-to-day environment, which allows management to run critical elements of the company. Focus on the important things — controlling cash and costs, increasing sales and enhancing value creation. Manage these.

Nurture Resources

Leverage all resources — people, facilities, advisors, etc. — to complete the turn. Often a key resource is an outside advisor, they have been there before. Set up an incentive structure paying only when employees accomplish the goals set forth in your long-term strategy. A robust incentive structure shares the risk -- if successful, all will gain. If not, you're not subsidizing poor performance. Your incentive for investing is return when the sale occurs. Their incentive should be based on performance that will take the company beyond its sale. After all, they are a key asset your buyer is looking for.

Exit

Know when to 'cash-out'. The greatest ROI comes when the rebuild is complete, and the company is ready for the next tranche of investment to grow funds. At this point, there are many new investors who will want to participate. Remember:

Earnings and cash capacity +
 achieved **X** multiple on investment +
 demonstrated **I**mprovements +
 functioning management **T**eam in place = time to sell.

A small X^R growth in revenues can yield many X^N returns on invested equity. *Buy, invest, manage, renew* with one thing in mind — maximizing value for resale, and in turn, drive one result: Value Creation and X^N multiple returns.

Strategic Management Partners, Inc.

Turnaround Management Specialists



For more information please contact:
 +1 410 263 9100