

BUYING DISTRESSED COMPANIES

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What is a Distressed Company?

- Financial position of the target company
- Insolvency Tests - S123 Insolvency Act 1986

The cash flow test:

- inability to pay debts as they fall due

The balance sheet test:

- value of assets less than liabilities taking into account its contingent liabilities and prospective liabilities

What is a Distressed Company?

Deeming tests:

- unsatisfied judgements
- unsatisfied formal demands

Should the Company Continue to Trade?

- Personal liability of directors
- Who are directors
 - appointed directors
 - de facto directors - a person who assumes to act as a director, is held out as a director by the company and claims and purports to be a director, although never appointed as such
 - shadow directors - a person in accordance with whose directions or instructions the directors of the company are accustomed to act.

Should the Company Continue to Trade?

- Nature of fiduciary duties of directors
 - owed to Company shareholders
 - owed to creditors on an insolvency

Should the Company Continue to Trade?

- Potential liability of directors
 - wrongful trading
 - the company has gone into insolvent liquidation
 - that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation
 - at the time was a director

Should the Company Continue to Trade?

- Potential liability of directors
 - misfeasance
 - breach of duty
 - defences available for wrongful trading
 - reasonable prospect of avoiding insolvency
 - took every step with a view to minimising potential loss to creditors
 - regard to general knowledge, skill and experience - objectively and subjectively

Potential Steps the Target Company should be Encouraged to take

- Daily financial review
- Regular board meetings
- Prepare timetable for further investment or action to restructure or liquidate
- Prepare statement of affairs
- Take insolvency advice

Steps for the Acquirer to Consider

- Bridging finance
 - debt or equity
 - if debt
 - convertible
 - warrants
 - security to be taken?
 - is it capable of being granted?
 - could it be set aside?
 - consents needed

Steps for the Acquirer to Consider

- Bridging finance
 - basis of money advanced
 - management accounts

Maintenance of Value in the Company

- Key commercial contracts
 - assignment
 - insolvency clauses
 - change of control issues
 - previous non performance

Maintenance of Value in the Company

- retention of title
- leasehold property interests

Due Diligence

- Time of the essence
- Ascertaining the nature of liabilities
- Identify the assets
 - are tax losses available?
 - can customer lists be utilised?

Due Diligence

- Discover reasons for the failure
- Business plan going forward
- Future management of the business
- Discussions with existing management

Insolvency Procedures

- Liquidation
 - compulsory
 - creditors voluntary liquidation
 - members voluntary

Administrative Receivership

- Nature of administrative receiver
- Who can appoint

Administration

- Nature of administration
- Reasons that the Court would consider:
 - Court has to be satisfied that the making of the order would be likely to achieve one or more of the following purposes:
 - the survival of a business as a going concern

Administration

- the approval of a voluntary arrangement, a scheme of arrangement or compromise under section 425 Companies Act
- a more advantageous realisation of the assets than would be effected as a winding-up
- factors that will be considered
- the degree of support administration proposals have

Administration

- will a sale as a going concern achieve a better price?
- can the administration be funded?
- speed of sale
- likelihood of additional losses during administration period
- profitable contracts that might be retained

Nature of Sale Process

- Advertisement
- Sales packages
- sale process
 - private contract
 - auction
 - tender
 - pre liquidation agreements

Nature of Sale Process

- Nature of sale agreement
 - hive down
 - taxation considerations
 - assets/share sales
 - one sided nature
- Valuations
 - best price obligation

Nature of Sale Process

- Timing
 - usually of the essence

Purchaser Issues

- Warranties and Indemnities
 - effect on price
- Title to assets
- Data protection issues

Purchaser Issues

- Employees
- TUPE liability
 - indemnity from liquidator
 - price reduction
- Pension Issues
 - buy the pension scheme

Purchaser Issues

- establish new scheme
- other pension issues
- Intellectual Property
- Parties to the agreement

Post Acquisition

- Manager incentives
- Management changes
- Financial Disciplines
- Reorganisation of business