
Selling Your Company: Options for Distressed Foodservice Distributors

By Bill Beattie

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Some failed to properly assess their risk while others felt they could just "hold on" and things would work themselves out. Unfortunately, holding on to a declining business too long can result in the liquidation of the assets under a fire sale situation. When this occurs, owners can lose practically all of the value they created in their business, sometimes over generations.

But there are warning signs and alternatives to a fire sale.

The Warning Signs

What are signs of distress we most often see?

- The distributor has recently lost a significant portion of their revenue due to changing customer buying patterns, fierce pricing competition, or customer credit issues; or from unanticipated bad debt write offs from several significant customers in amounts for which there were insufficient reserves. Customer issues can also include reliance on a small number of large customers (concentration of risk) that are negatively impacted by a combination of customer and/or economic changes – thereby placing an inordinate level of exposure on the distributor.

- The business is experiencing a severe cash flow crunch. Symptoms typically include delaying payments to vendors, lost cash discounts, being placed on COD or pre-pay. This often means they can't keep a sufficient stock of inventory in the warehouse, resulting in out of stocks of key items or shorting key customers. In tandem, banks or other lenders start paying very close attention to the distributor's financial condition. There is increasing discussion about loan covenants, terms of default, penalties, and so on.

- DSRs, or other key employees, are getting very nervous about their personal job security and are considering, or have already started, to leave the company, perhaps taking customer relationships with them.

A general malaise sinks in. The owners sense broader (and deeper) problems. Many find that business is down, the economy is down, and don't know where to turn. They see that a desirable exit strategy could be 3-5 years away – or longer. Many begin to lose their willingness to continue with the day-to-day grind.

These scenarios provide very clear signals that immediate action is necessary. Should they arise, the owners need to closely examine their assumptions about the business and make plans accordingly.

Typical Actions Taken by Distressed Businesses

This section is short, because, generally, owners of distressed business end up taking one of only a few alternatives:

- Continue the daily fight and hang on as long as possible – with the hope that the operating and selling environment will improve in the future.
- Sell at close to liquidation values, thereby losing the historic value built up over time.
- Wait too long and be forced by the creditors to close the business.

Possible Options for Distressed Companies to Consider

In addition to the traditional routes taken, there are several other options that can be evaluated with your advisor and accountant. Not all scenarios are available to all companies, and some of these might actually increase owners' personal exposure – so each must be evaluated carefully with respect to your specific situation:

- Look for ways to recapitalize the business with a new, outside source of capital. Finding outside investors can be difficult given our industry and its margins. In certain instances, when the equity in the real estate owned by the company is significant and the lender is agreeable, an owner may be able to tap into that source.
- Restructure the current debt arrangement. For those with asset based lenders, it may be possible to renegotiate a higher draw on A/R and inventory, thereby freeing up cash. If the situation has not deteriorated too far, lenders may sometimes restructure long term debt or lines of credit (or both) to free up working capital. This can require a combination of additional collateral and personal guarantees.
- Structure a company sale that includes an earn out provision. This approach allows the seller to be paid after the transaction closes based on the new company's profits or other measurements. The amount is based on defined terms and would be earned during a specified period after the closing of the sale.
- Work with an experienced advisor who can help guide the company through the next 12-18 months with specific strategies and tactics. First, the owner works closely with the advisor to determine whether the financial position of the company can be solidified, and then they develop a realistic plan to re-build the value of the business. This plan will include a targeted list of actions to take every quarter, with benchmarks and performance measures to ensure the business is back on track to success.

These difficult and unprecedented times can challenge the confidence of even the most successful business owner. You may just need an outside perspective to help you see the alternatives that are available. It's worth your time to learn about your choices.

