Association of Insolvency & Restructuring Advisors

Newsletter Index

President's Letter

Editor's Letter

Executive Director's Letter

Blind Application of Valuation Mulitples Can Blur the Result
Jeffrey M. Risius & Cory J. Thompson

Spotting the best - Keeping the Best: How to Staff a Winning Turnaround Team
Miles Stover, CIRA

Liquidations: Finding Value, Creating Success
John Kokoska & Robert Starzyk

Make it New
Anthony Sasso, CIRA

Tax Cases
Alan Barton, CIRA

Bankruptcy Cases
Baxter Dunaway

Club 10

New CIRA

New AIRA Members

Also in the News

Back to August/September 2005 Newsletter main page

AIRA Journal

August/ September 2005

Liquidations:
Finding Value, Creating Success

By: John Kokoska
Robert Starzyk

Saying “liquidations” and “successes” in the same breath may sound like an oxymoron, but the two can coexist. How? In truth, it’s really quite simple: the liquidation manager must recognize opportunities to align the various stakeholders to maximize recovery and minimize expenses—within an acceptable timeframe. It’s important to remember that everybody is a potential buyer of certain asset categories—there’s an old adage that “life is leverage” and we add that “time will take that leverage away.” As much as we all like to think we are geniuses, the simple facts are that one develops a sound strategy, gets the right people in place and sticks with the plan. At times one pampers and at other times draws a line in the sand. One tolerates no excuses and one rewards successes.

Liquidations need to be conducted in an orderly manner to maximize the return on sales, but as quickly as possible to minimize expenses. Sometimes, to maximize realization, expenses exceed proceeds for a few initial weeks, making lenders very uncomfortable. Because proceeds from sales that are burned up in operating expenses can devalue the process, lenders and other creditors need constant communication on the progress. While risk in liquidations cannot be entirely avoided, it can be mitigated by utilizing precise timetables, milestones, headcounts and other quantifiable goals that are tied to the cash budget so that they can be measured, tracked and controlled.

There are two basic tools the liquidation manager employs throughout the process: the liquidation analysis and the cash budget. These schedules, which need frequent updates as values change, are typically done in balance sheet format. The liquidation analysis examines what each category of assets should bring, less liquidation expenses. It also notes what is owed to creditors in order of priority. The cash budget serves as a roadmap, a scorecard, for the entire process. It should tie out to the liquidation analysis and show, week by week, how the liquidation is proceeding.

It certainly helps if the company has a good core of sales and financial people to carry out the liquidation. This reduces the need to add more expensive consulting resources and saves costs. It also allows the consulting team to switch gears and develop a strategic plan for recovery of each asset category. One cornerstone is a retention incentive plan that covers all employees who are necessary for maximizing value in the liquidation process. Notice we said all employees—not just top management and the sales force—down to the loading docks. These stakeholders understand their product, why customers need it, and have relationships with potential buyers and creditors. One caution is that top management’s “frame of mind” is critical. When they are at odds with the fundamental concept of liquidation, they must be taken out of the process.

The accounts receivable collection plan utilizes the employees, such as customer service reps and salespeople, who mind the relationships with the customers. They are critical to collecting the largest accounts, which are typically the single largest value category. A systematic call program allows them to make compromises on offsets and charge-backs and settle these disputes quickly. Those accounts determined to be “hardcore no-pays” are promptly turned over to an agency.

Next, it's critical to develop a strategic plan for selling inventory to key customers, and institute sales incentive plans for customers and employees. Of course, one needs to know the composition of the inventory, including seasonal factors. Do not let customers cherry-pick the inventory—they must take the good with the bad. Note: During one of our recent engagements, we were able to sell off the vast majority of bad inventory in one transaction at a "blended" price of 15 cents on the dollar. If the customer had been allowed to cherry-pick, realization would have been far less. To qualify for this low price, the buyer had to reimburse the company for labor costs and use its own freight carriers.

To sell inventory, there must be a strong incentive plan for the customers. To achieve maximum value for the estate and avoid criticism from the Creditors' Committee, one needs to demonstrate that many products can command a sales price good enough to offset the remaining low-value inventory. Accomplishing this is quite simple: appeal to the customers' greed by knowing what they bought over the last year, what they paid for it and then striking a deal. Give the sales force enough leeway to get the deals done and then get out of their way. We find that giving a decent discount allows one to get the customers to buy some of the harder-to-move goods and gets them to pay in a relatively short (1- to 2-week) time frame. Of course, they also need to pay their pre-liquidation accounts receivable balance.

Freight can't be overlooked. In some cases, the companies may be distributors. When they file chapter 11, the carriers become unsecured creditors. There will be a number of instances in which the carriers will not ship even if freight is prepaid. So what does one do then? Simple: find alternative carriers that will take cash upfront or have the customer pay shipping costs.

By asking the right questions and being resourceful, the liquidation manager may uncover or create unique strips of value among overlooked or indistinct assets. In a recent manufacturing case involving various niche products, we partitioned the assets by product line, and found buyers for asset packages that included the machinery, dies, engineering drawings, contracts and customer lists. This resulted in a far higher value than selling the individual assets would have.

Intellectual assets can be particularly difficult to identify and market; however, they can have great potential value to competitors. These assets may include trade names, patents, licenses, franchises, contract rights and rights to territories. Many intellectual assets have expiration dates, so time is of the essence in finding buyers. Often a foreign buyer will pay a premium for an asset package or for U.S.-based rights as an entrée to U.S. markets.

Value can also be found in other non-recorded assets, such as claims, pollution credits and other rights. In one case, for example, the company had rights to pump millions of gallons of water a day from land that was vacant and appeared to have little value. We found a buyer for those rights.

Ultimate success really depends on the liquidation manager's leadership, and the incentive plan for the sales force, key executives and the entire workforce. While a portion of the business may be sold as a going concern, most people will lose their jobs. The goal is to keep a core team that will stay focused instead of looking for new work. Because well-treated employees will stay, good retention plans reward good results with good incentive pay. The other key in dealing with personnel is being honest with them. Tell them the time frame and what's expected.

Every liquidation has a window of opportunity where one can realize maximum value for the assets before the customer base finds new sources of supply. We have found that one can capitalize on the window simply by having a well-developed and focused plan, coupled with a highly incentivised work force, and finding hidden value.

Bios of **John Kokoska** and **Robert Starzyk** are available at:
http://www.morris-anderson.com/company

:Top:

AIRA Journal is published six times a year by the Association of Insolvency and Restructuring Advisors, 221 Stewart Avenue, Suite 207, Medford, OR 97501. Copyright 2005 by the Association of Insolvency and Restructuring Advisors. All rights reserved. No part of this newsletter may be reproduced in any form, by xerography or otherwise, or incorporated into any information retrieval systems, without written permission of the copyright owner.