

## Acquiring Distress Companies

*As we all have been aware, current economic pressure and changes causes' significant impact to many companies, which resulted in release off their businesses or assets at prices below intrinsic value. I interpret this as a business opportunity to do M&A. How to minimize the risk of acquiring such distressed companies?*

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A company is considered in distress when it has financial difficulty or when it can not fulfil its financial obligations to its creditors. The chance of financial distress increases when a company has relatively high fixed costs, non-performing assets, or revenue that is sensitive to economic downturns. However, most companies were caught in financial distress because of over investment which leads to high debt and related costs.

A distress company deemed as potentially having growth opportunity – industry wise and the business itself – is still interesting in the buyer view, so long that the opportunity exceed the risks. However, buyer need to assess whether the company can be 'turned-around' or not prior to acquisition. There are several points that need to be address that plays a role in minimizing the risk and maximizing the return simultaneously.

First, there should be an appropriate acquisition structure. Buyer will be exposed to more liability risk if they acquire the business in the form of stocks or partnership interest rather than assets. Buyer prefers to buy assets and seller prefers to sell

stock. While an asset acquisition is preferable from a buyer's perspective, all risk may not be eliminated, although it is likely lower compared to stock acquisition.

Second, there should be a thorough due diligence. It is better to uncover the risk as early as possible before purchasing any liability, rather than uncover it post-acquisition, with little or no possible opportunity to re-course.

Distressed acquisitions often must be completed in a tight time frame for various reasons such as to preserve the company's business value before lenders taking any action that might harm buyer's opportunity and effort or seller's business. Concurrently, buyer should also really assess risks to the expected return, to bear force forward closing with imperfect information.

Valuation is among one of several powerful risk management tools, if a buyer is uncertain of whether it has been able to adequately address risk through acquisition structure and due diligence – buyer needs to include an appropriate risk discount into the purchase price to account for that uncertainty.

Customer and supplier relationship also play a role in distress acquisition. The risk on customer due to target or supplier's distress needs to be assessed; buyer may also consider re-source options to other supplier. While great effort is spent by buyer attempting to maintain relationship with key customers to preserve the value of an acquired business, an equal amount of attention should also be paid to key suppliers and vendors.

A distress company may have difficulty retaining key employees. Problem with employee's retention appear for various reasons such as compensation freeze or cuts, elimination, lack of bonuses and requirements for larger employee contributions toward employee benefit plans. Therefore, buyer must have a strategy to keep key employees remain in the acquired company.

After acquisition, buyer must coordinate with stakeholders to reduce any possible risks that have been explained in the previous points and focus on achieving business stability. Then, buyer can start executing their strategies and turn around the business.

### KEY POINTS

- The right acquisition structure could reduce risk in acquiring a distress company.
  - Thorough due diligence is required to uncover hidden risks or liabilities, opportunities and risks within a tight time frame.
  - Valuation, key employees, customers and suppliers relationship are crucial consideration in the acquisition strategy.
  - Post-acquisition, maintain good coordination with stakeholders to ensure stability and turn around the business.



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