

# Assets For Sale

FOR SALE signs in the residential housing market have been a common sight to see for the past year, and highly leveraged lending, poorly documented loans and overly optimistic buyers, sellers and lenders are to blame. The housing crisis, along with rising fuel and food costs, have consumer confidence at a 16 year low and that condition will likely not change for at least another five months as the national election brings terms like “recession” and “economic downturn” into our daily lives. Organizations facing the prospect of posting their own FOR SALE signs are either reactively or proactively dealing with the current economic realities in the business community.

## REACTIVE APPROACH

Until early 2007, most businesses, including those with questionable credit, had access to liquidity through loan agreements with covenant-lite documentation. Despite being highly leveraged, all parties freely entered into these transactions with hopes that they would be able to refinance or enter into a replacement transaction in the future. History tells us that defaults for highly leveraged loans tend to rise two to four years after a new issuance, which means we are currently at the front end of the default cycle stemming from the highly leveraged lending practices in 2004-2006. The 27 U.S. corporate defaults registered to date in 2008 already surpassed the total of 17 in 2007, and according to Standard & Poor’s credit rating agency more than 107 more defaults are projected this year.

Since these loans are so highly leveraged, there is little to no equity left in the company, eliminating the possibility of an equity infusion as part of the solution. This is putting an enormous amount of pressure on lenders who are not able to sell these loans in the secondary market. If loans are in default, businesses will often be pressured into selling individual assets, multiple assets or the entire company. Under the worst scenario, companies have no choice but to file bankruptcy for the primary purpose of liquidating the assets and paying off secured lenders.

## PROACTIVE APPROACH

Healthy companies that study the marketplace and understand the leverage-default cycles will also realize that it will take time to restore consumer confidence and subsequent consumer spending. These companies can evaluate their own conditions to determine how best to generate cash and reduce leverage in advance of a lender-driven directive. In this process, a company may decide selling assets is an appropriate proactive step. The challenge is determining which assets are not critical to the core business and make the most sense to sell.

In the past, a business defined its core business as that which was the basis for its existence like superior technology, processing/production capability, a unique marketing niche, strong supply and distribution chains, price advantage or all or any of the above. A core business also can be that which continually provides above-average returns by focusing solely on that business. In today’s more complex economy companies must consider whether a business line will be viable into the future when defining its core business.

It is important to understand that with today’s rapidly changing technology, core businesses will morph with the marketplace. Enlightened management will not only analyze assets based on return on investment or operating margins, but also the longer term position in a changing market. Keeping future cash needs and longevity of a business in mind, companies must not only consider non-core assets, but also core assets producing below average returns, such as a facility that is not profitable or will require a large capital investment. GE’s decision to sell its appliance unit and Weyerhaeuser’s decision to sell its homebuilding business are examples of companies that eliminated assets as a means to long-term success.

It is anticipated that there will be a wave of merger and acquisition transactions stemming from companies forced into bankruptcy or forced to pare back to those core businesses that will carry them through the future. Conversely, healthy organizations will find opportunities to purchase assets at prices that will provide attractive long term returns.

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