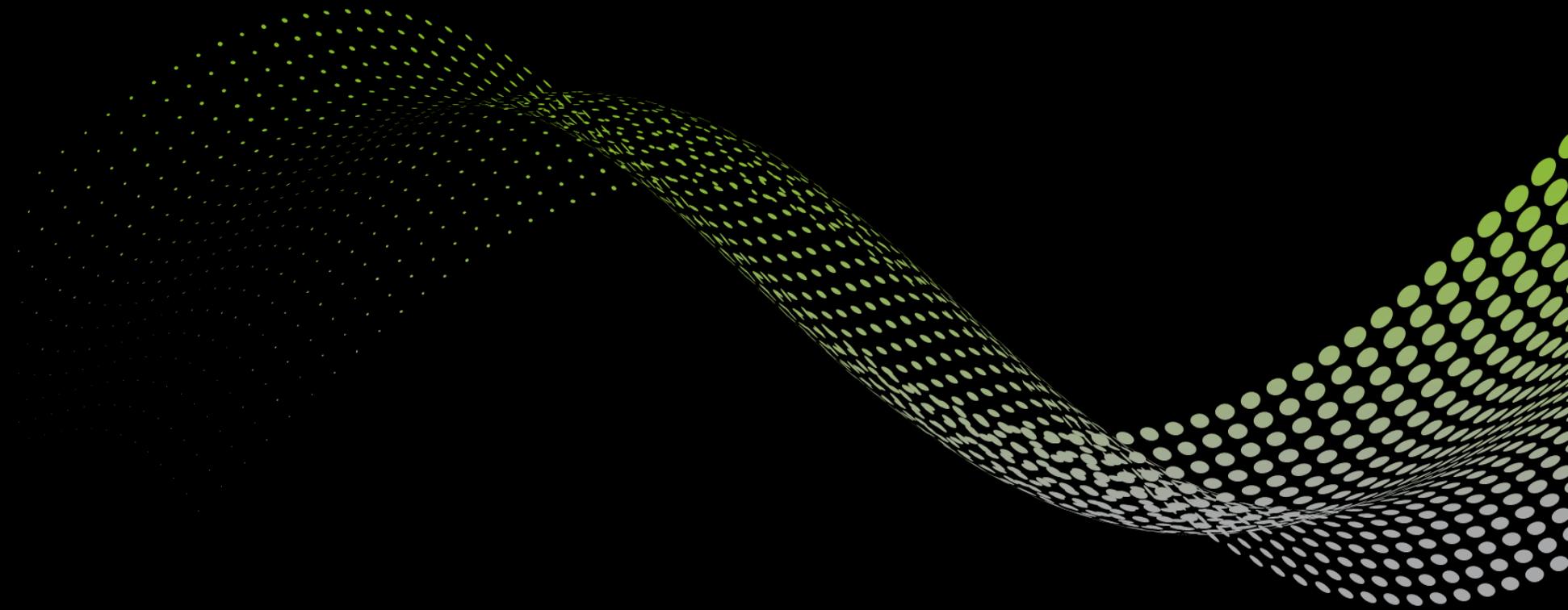




## Distressed M&A The Fine Art of the Bespoke Deal

Session I: Essentials, Approach and Due Diligence



Presentation and structure

# Speakers

## Session I

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**Frank Tschentscher, LL.M.**  
Business Recovery and Insolvency  
Lawyer | Partner

Phone: +49 40 3785 3821  
E-mail: [ftschentscher@deloitte.de](mailto:ftschentscher@deloitte.de)



**Moritz Baron Schenck**  
M&A Advisory Services  
Managing Director  
Corporate Finance Advisory

Phone: +49 69 756 956 328  
Email: [mschenck@deloitte.de](mailto:mschenck@deloitte.de)



**Marcus C. Spangenberger, M.B.L.-HSG**  
Business Recovery and Insolvency  
Lawyer | Senior Associate

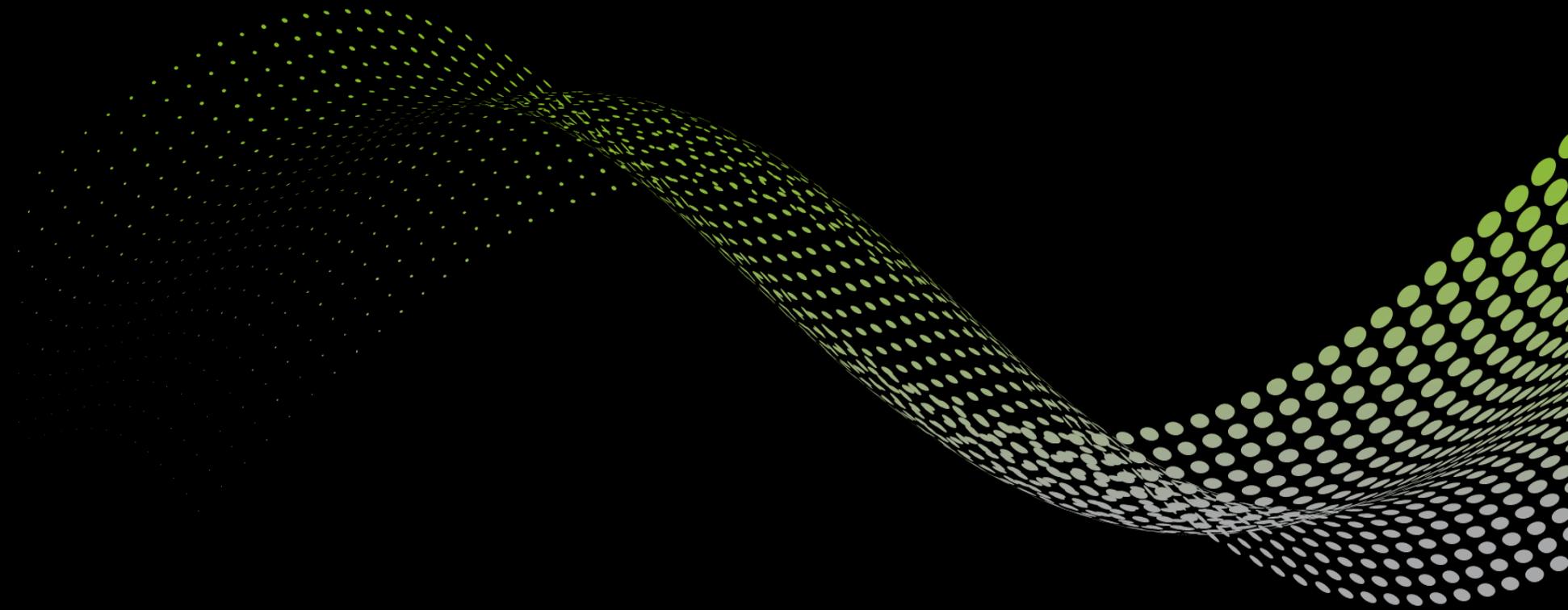
Phone: +49 40 3785 3821  
E-mail: [mspangenberger@deloitte.de](mailto:mspangenberger@deloitte.de)

# Structure

## Session I

- I. Presuppositions
- II. Transaction structures
- III. Corporate crisis
- IV. Stakeholder
- V. Sales process
- VI. Tactical considerations



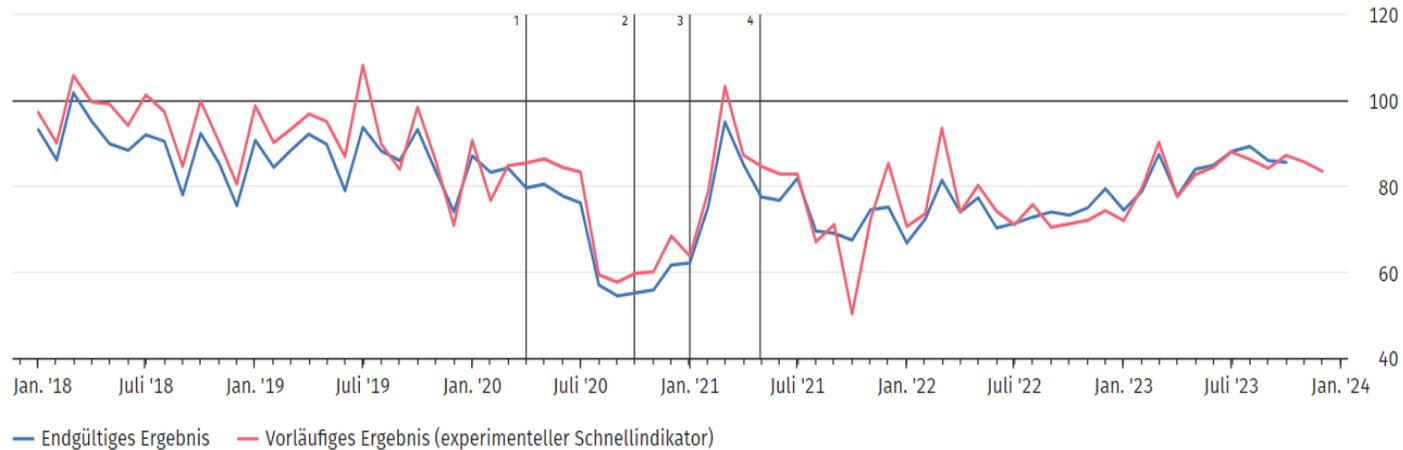


Presuppositions

# Initial situation

## Beantragte Regelinsolvenzen

Index 2015 = 100



Insolvenzantragspflicht ausgesetzt: 1 für Corona-Betroffene. 2 bei Überschuldung. 3 bei ausstehenden Hilfszahlungen. 4 Wiedereinsetzung Insolvenzantragspflicht.  
Quellen: Statistisches Bundesamt, neu.insolvenzbeachtmachungen.de

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Distressed M&A refers to corporate transactions at the time of a "crisis". The crisis stage can be both

- pre-insolvency as well as
- be in insolvency.

However, since pre-insolvency distressed M&A transactions are associated with significantly higher uncertainties for potential acquirers than insolvency transactions, distressed M&A transactions are implemented particularly frequently in the context of opened insolvency proceedings.

A sharp rise in corporate insolvencies is currently being recorded again after a significant slowdown in previous years, meaning that the number of distressed M&A deals is also increasing both qualitatively and quantitatively.

In the following, the focus of the analysis will lie on an asset deal transactions structure **with or after** the opening of insolvency proceedings as the most common variant with the greatest possible structuring options.

# Initial situation



If the seller of a company, the target company to be sold or even both are in an economic crisis or already in a cash-flow crisis or insolvency proceedings at the same time, the legal framework conditions relevant to a corporate transaction change. Transactions in such situations are

- associated with particular legal and factual risks and
- are usually carried out under considerable time pressure.

In theory, the term distressed M&A is still not uniformly and precisely defined. The term distressed M&A is used for transactions in which the sale

- of an entire company via shares (**share deal**) by means of an **insolvency plan** pursuant to Sections 217 et seq. InsO or
- the assets of the company (**asset deal**)

will be carried out.

# Delimitation

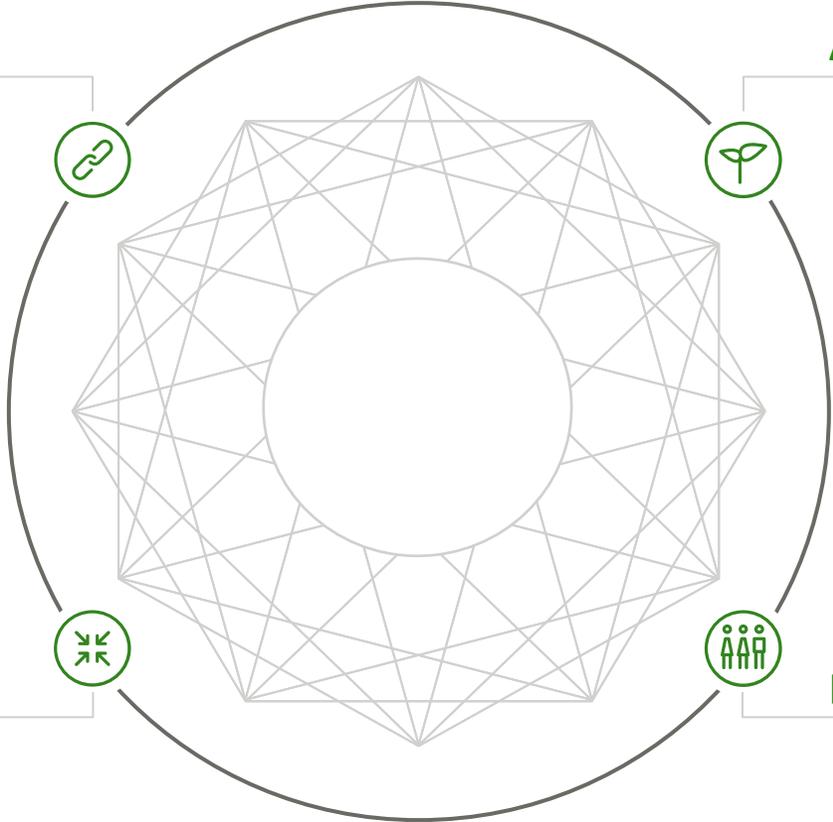
The most important differences between distressed M&A and conventional M&A lie in the

**Transaction structure**

**Available time**

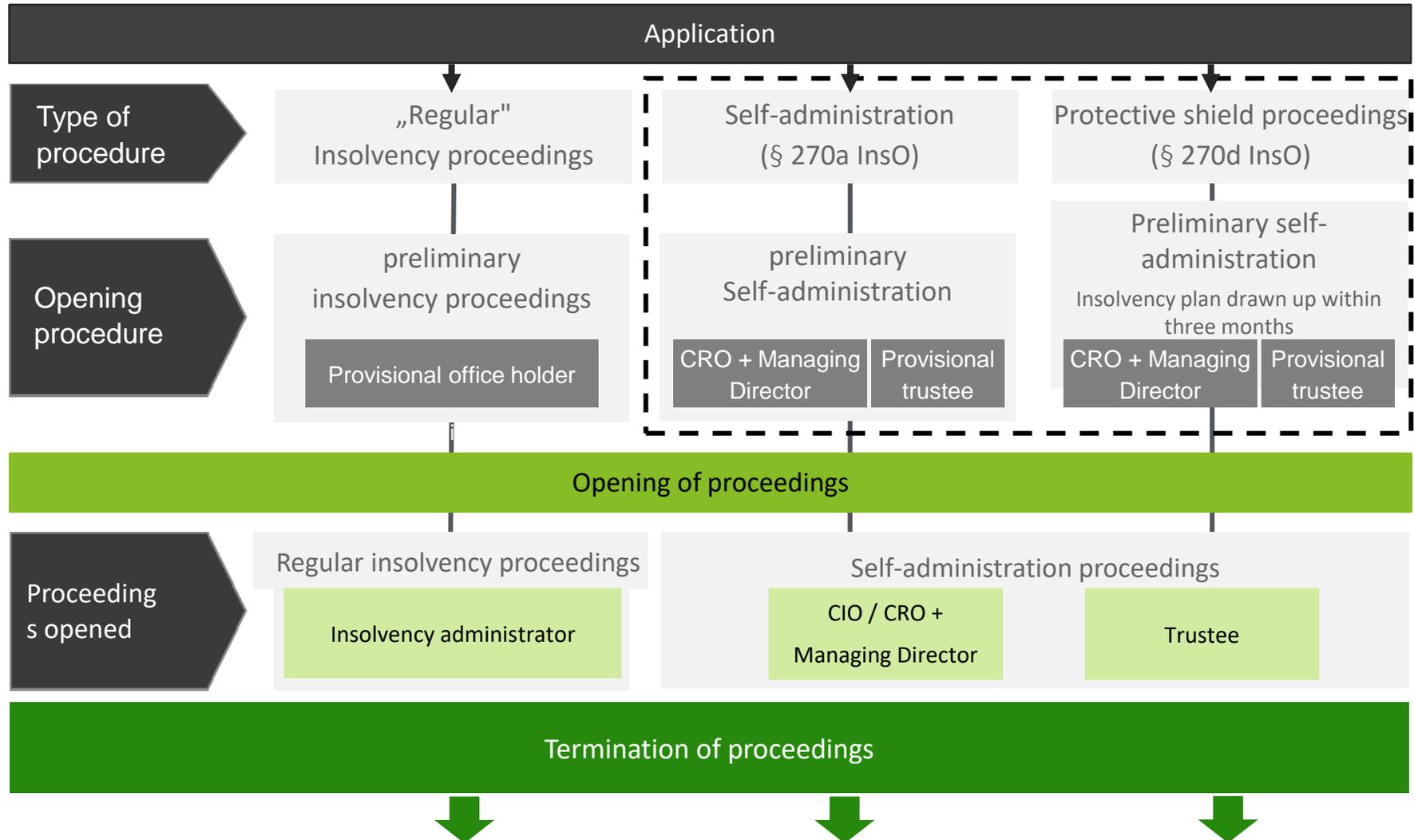
**Rating of assets**

**Involved parties**



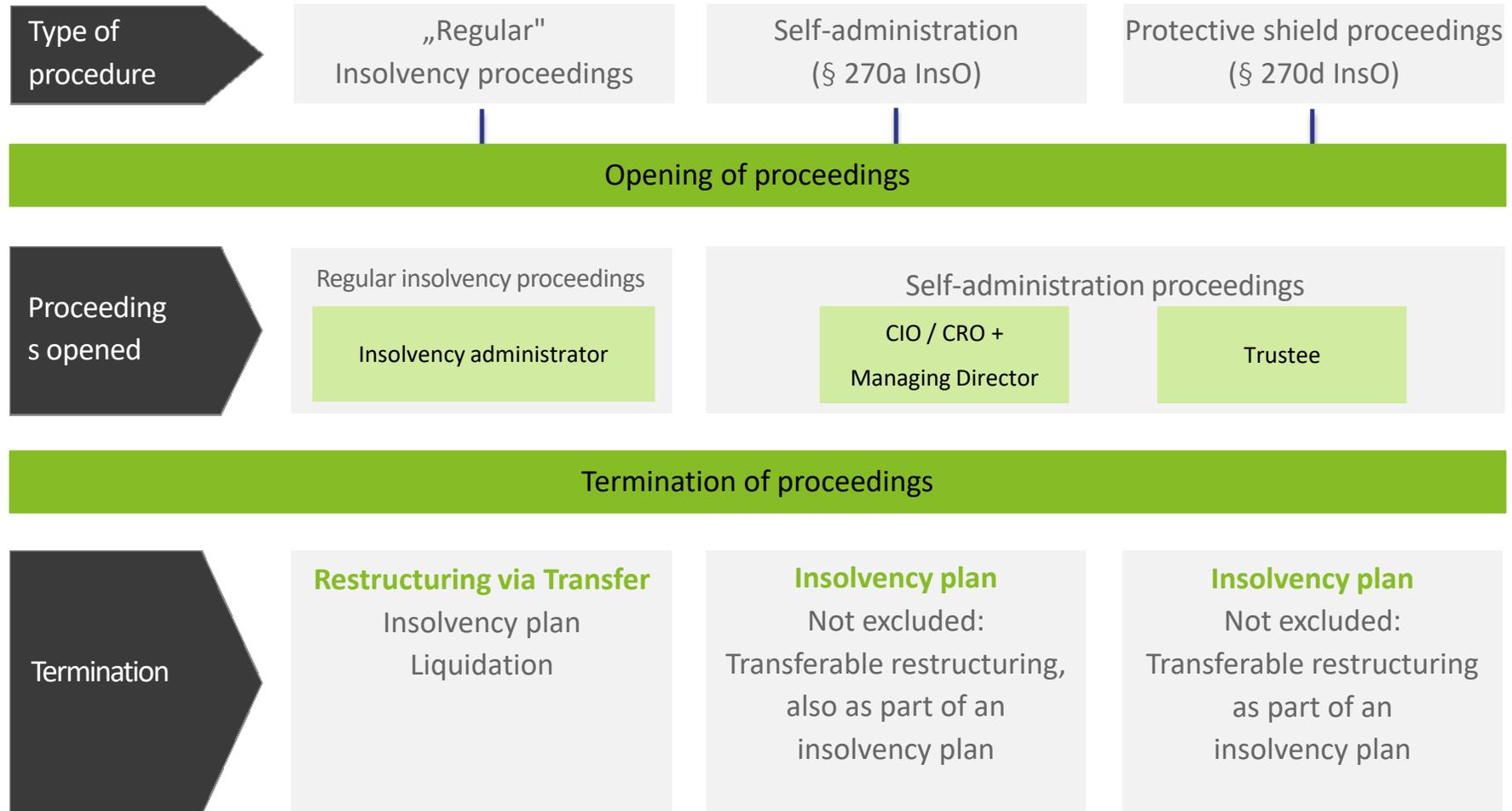
# "IN COURT RESTRUCTURING"

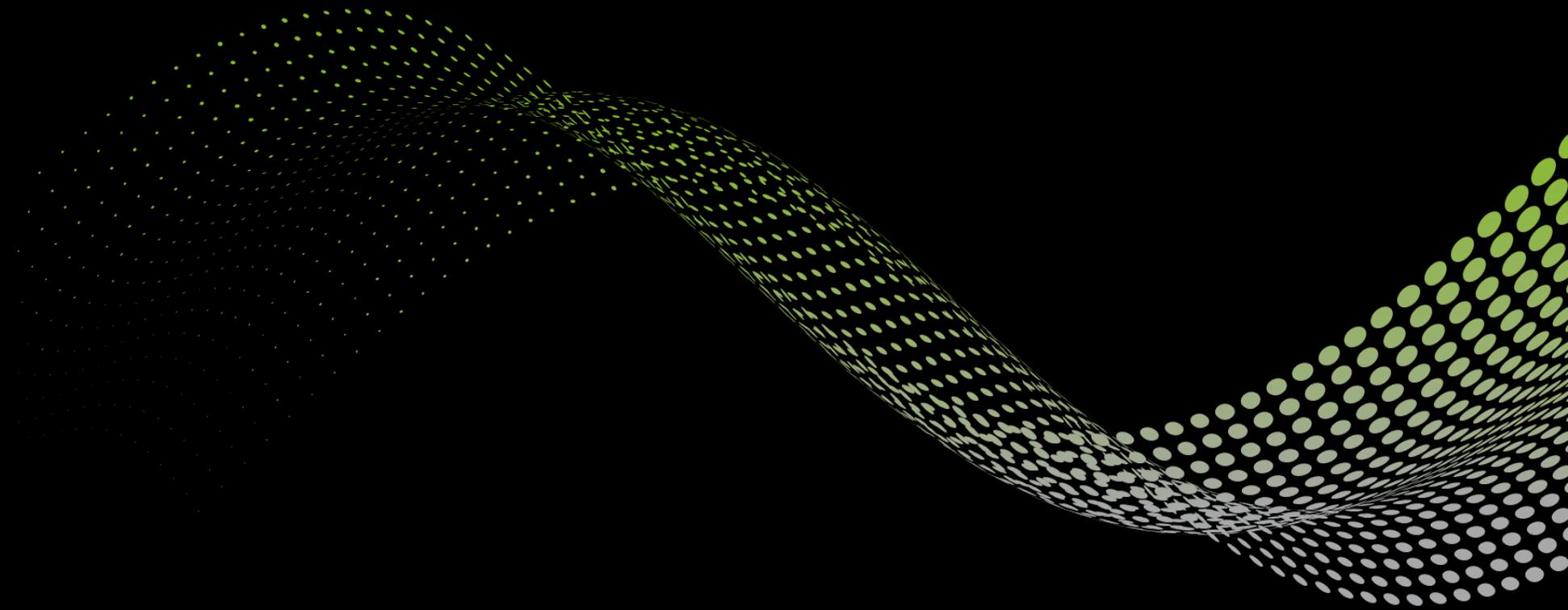
Types of proceedings and persons involved (1/2)



# "IN COURT RESTRUCTURING"

Types of proceedings and persons involved (2/2)





Transaction structures

# Transaction structures



## SHARE DEAL

**Transfer of ownership:** In a share deal, ownership of the legal entity is transferred by means of a legal purchase in accordance with Section 453 BGB.

**Partial takeover of shares:** The term can also refer to the partial acquisition of shares in a company.

**Preservation of the legal entity:** Characterized by the preservation of the legal entity including the right to bear a name and associated rights such as licenses, patents or permits.

**Continuation of existing contracts:** Existing contracts and business relationships are generally continued, as are liabilities and liability regulations.

**Change in shareholder structure:** Only the shareholder structure of the company concerned changes.

**Less uncertainty among business partners:** Leads to less uncertainty among business partners.

**No cherry-picking:** It is generally not possible to select only profitable parts of the business (cherry-picking).



## ASSET DEAL

**Acquisition of assets:** An asset deal involves the acquisition of all or only the assets required for operations.

**Separation of assets and liabilities:** The principle of separation of assets and liabilities is characteristic, whereby liabilities and obligations are not transferred.

**Balance sheet is "divided":** Figuratively speaking, the insolvent company's balance sheet is split down the middle, which often enables a new start without legacy burdens.

**Transfer of employment relationships:** Employment relationships are transferred to the acquirer in the event of a transfer of business pursuant to Section 613a BGB.

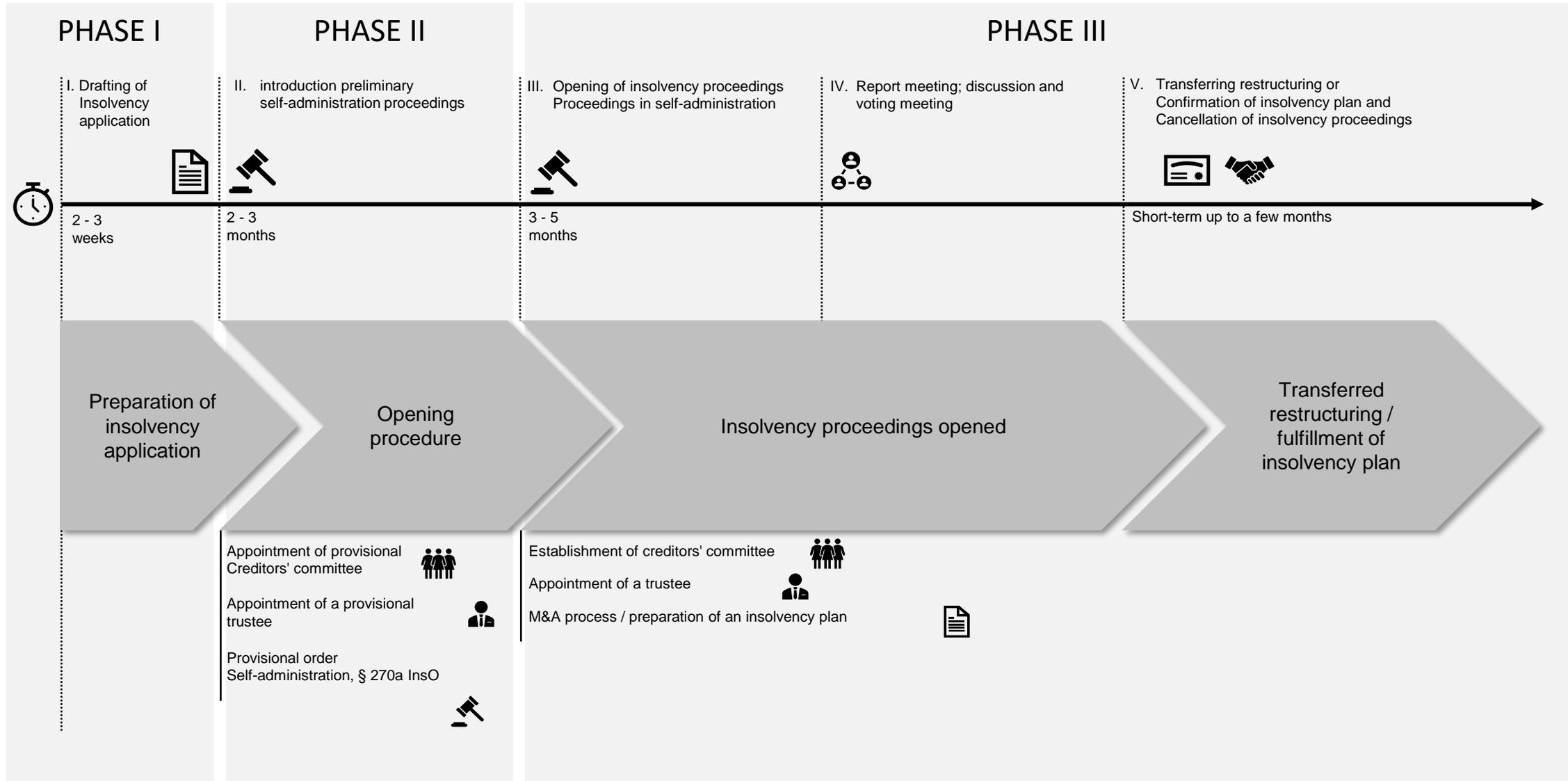
**No utilization of loss carryforwards:** The acquirer cannot utilize loss carryforwards.

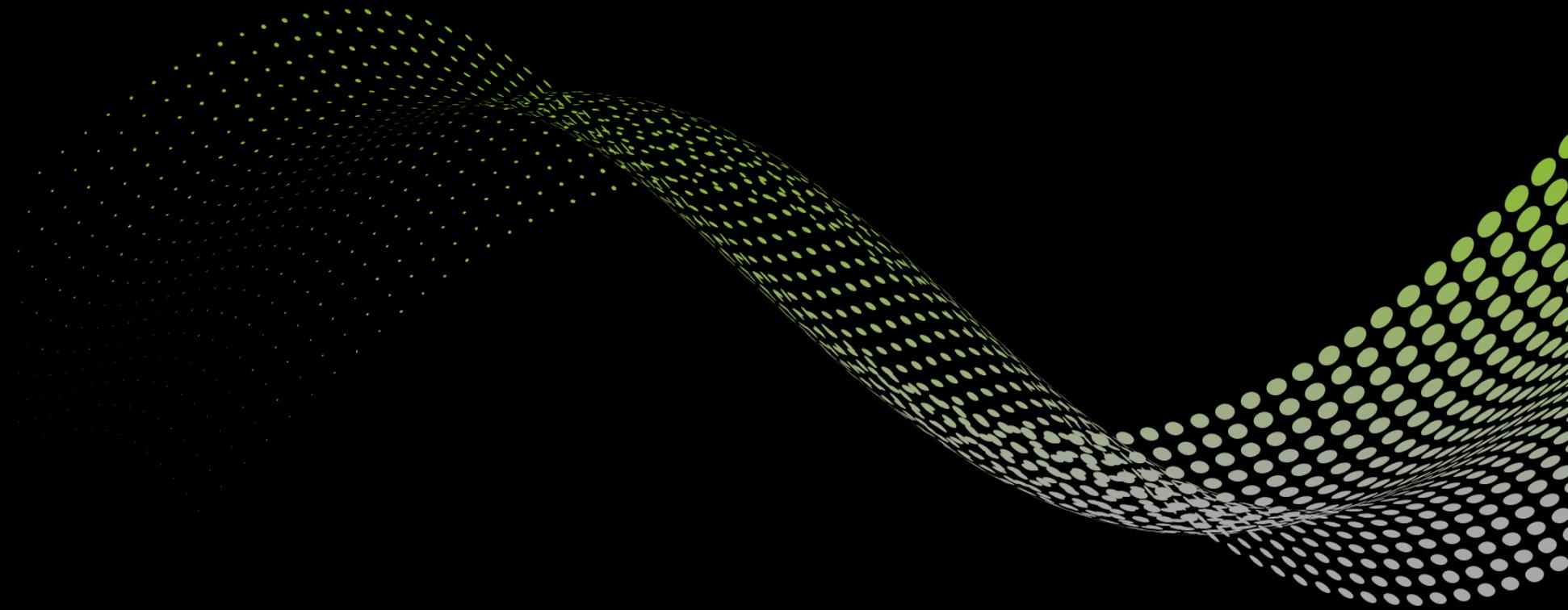
**Fast implementation:** The asset deal is characterized by much faster implementation than the share deal.

**Cherry-picking:** A selection of profitable parts of the business (cherry-picking) is possible and desirable.

**Exclusion of liability in insolvency transactions:** In the context of an insolvency transaction, the acquirer's liability for the debtor's liabilities is excluded.

# Timeline

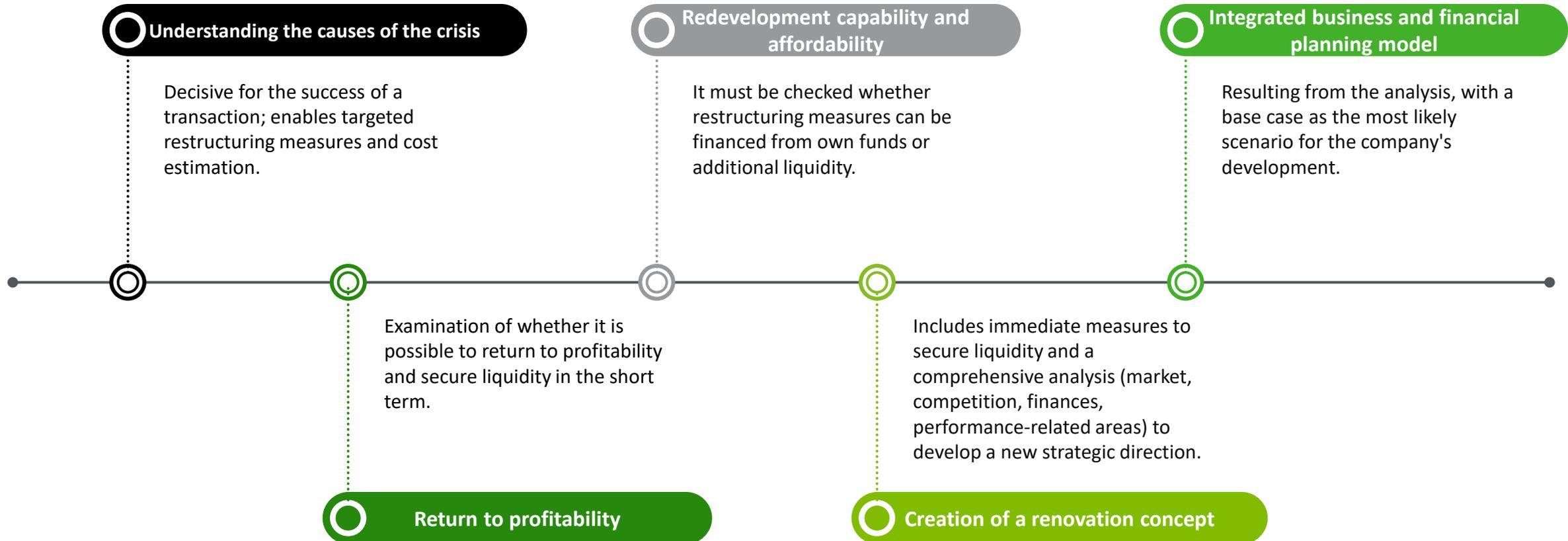




Corporate crisis

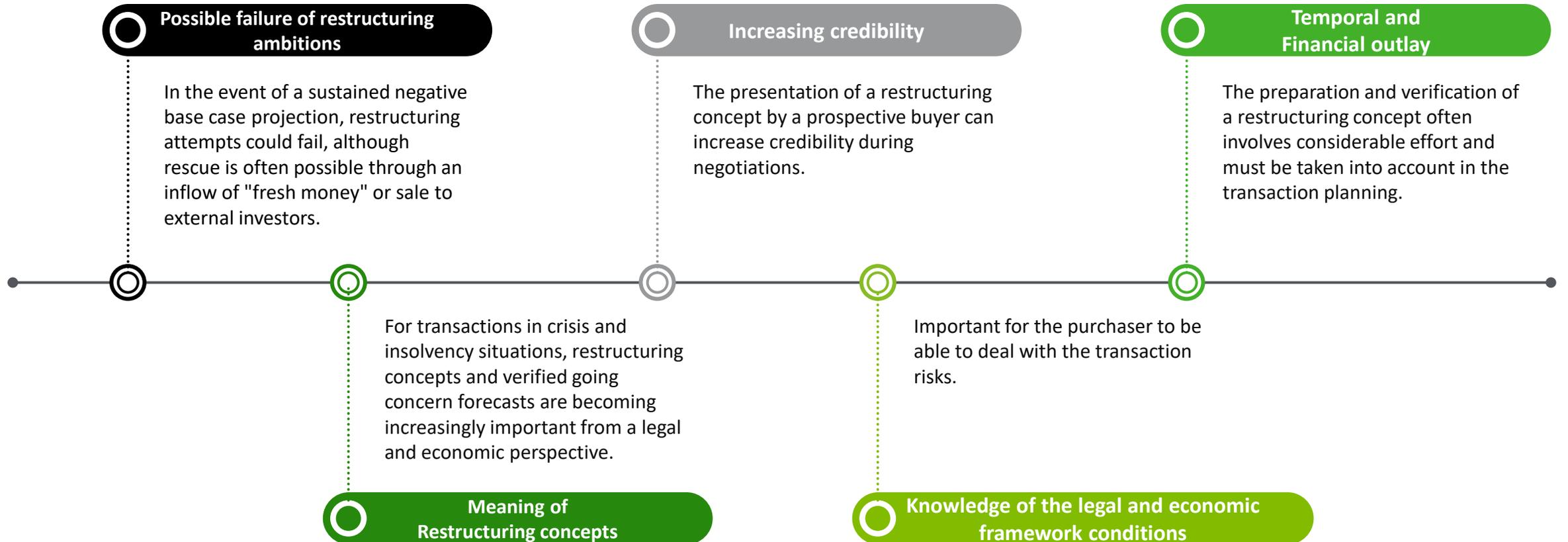
# Understanding a state of crisis as a process

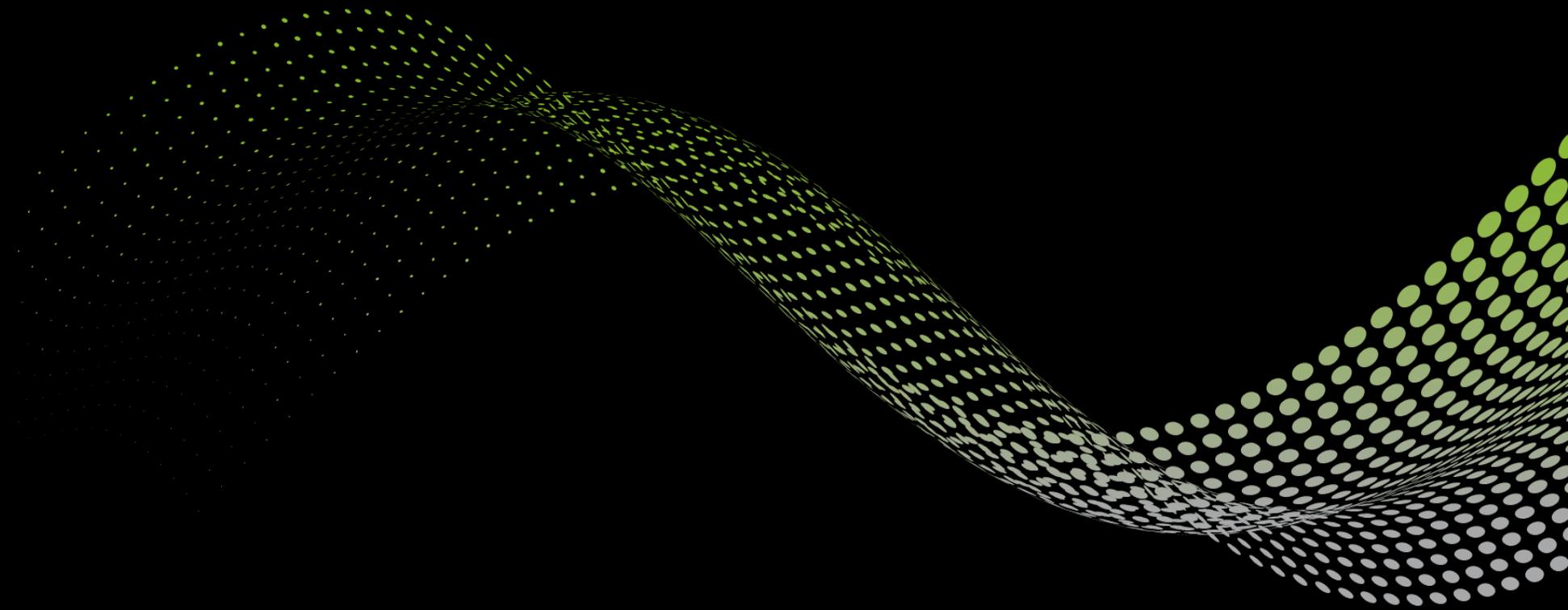
Companies go through crises due to internal and external undesirable developments



# Understanding a state of crisis as a process

Companies go through crises due to internal and external undesirable developments





Stakeholder

# Stakeholders in the process

- Financial creditors, such as credit institutions, credit insurers, bondholders, joint representative of the bondholders
- Creditors entitled to separate satisfaction and segregation, unsecured creditors
- Employees, employment agency,
- Suppliers, major customers
- Works council, trade unions
- customers, particularly in sectors with closely interwoven value chains, such as the automotive supply industry
- Company bodies, such as management and shareholders,
- "Self-administrator", trustee, insolvency administrator, Chief Restructuring Officer (CRO)
- Consultants and lawyers
- Management, key personnel, etc.



# Potential buyers

Buyers of a company in crisis can be both strategic investors and financial investors. Occasionally - but more often in the case of smaller companies - private individuals, such as the company's management, may also be considered as investors. In individual cases, the existing shareholders also re-acquire "their" company during insolvency.



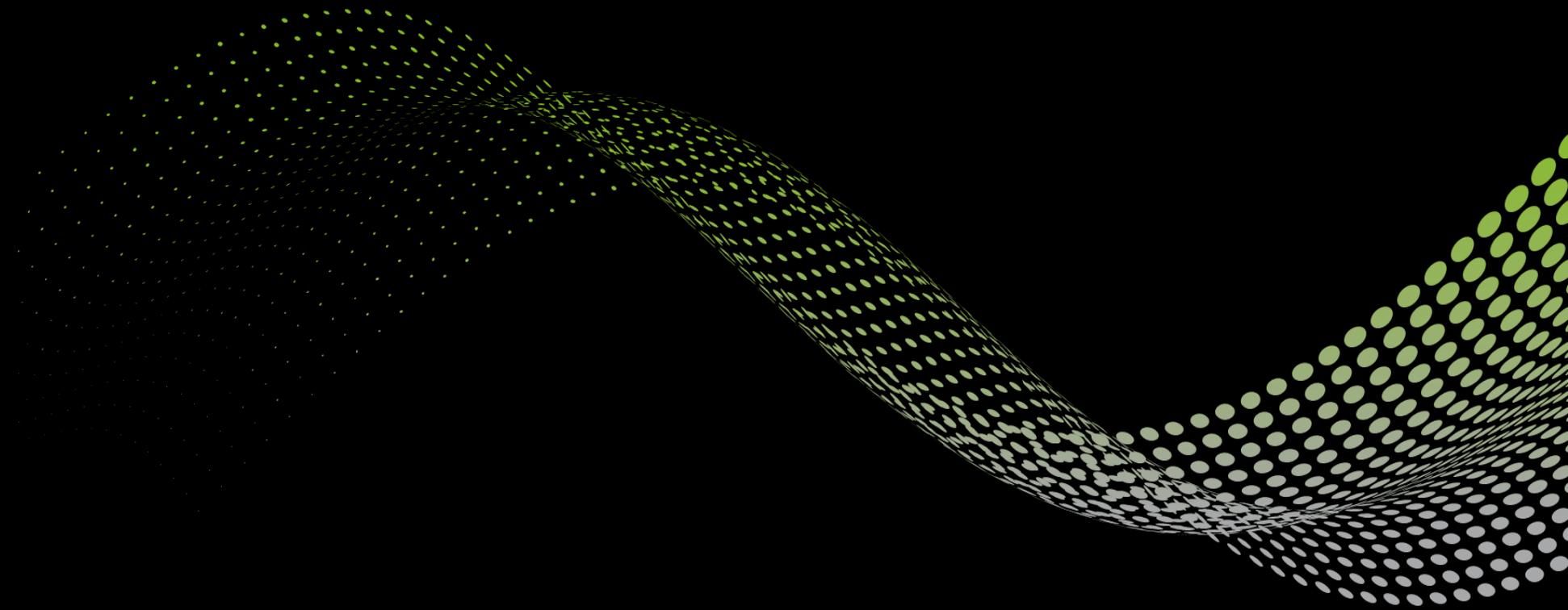
## Strategic investors

- Mostly from the market environment of the target company.
- Can be direct competitors, companies with complementary products/services/technologies or companies in different sales markets.
- An increasing number of foreign companies, particularly from China, showing interest in acquiring German companies. Focus on profitable technology companies (critical review by the Federal Ministry of Economics to prevent the outflow of critical technologies).



## Financial investors

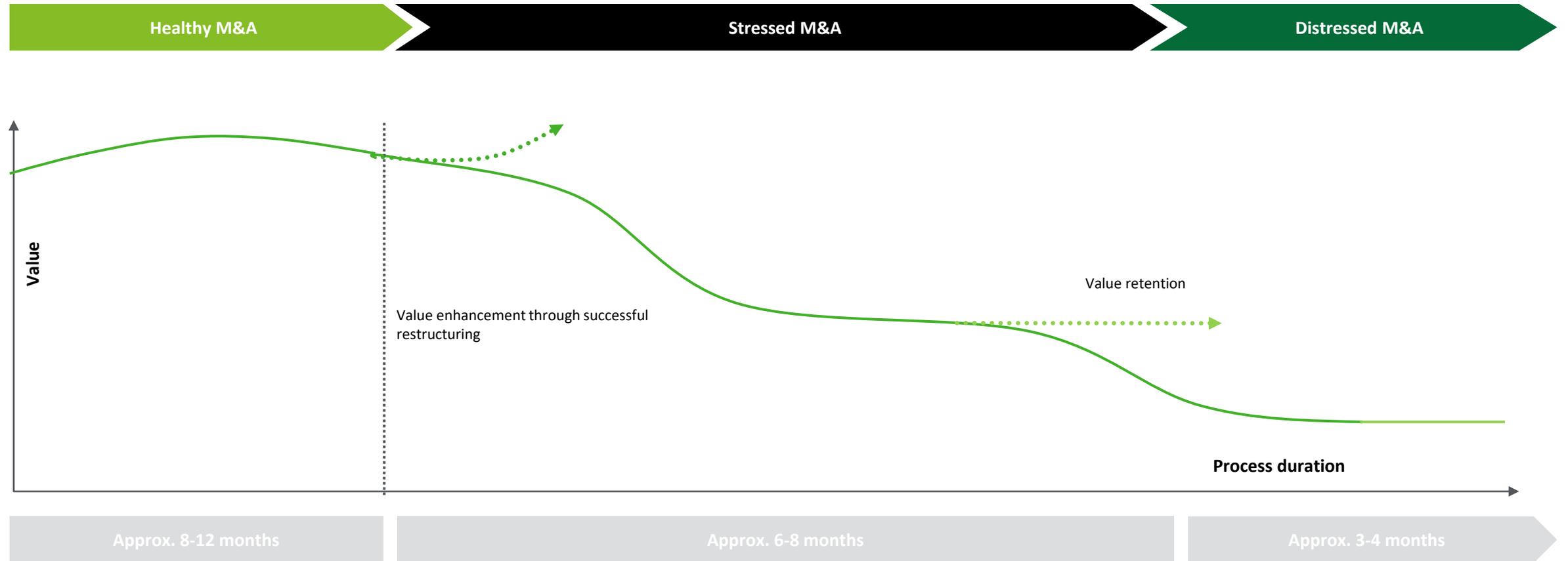
- Objective: High total return from income and sales proceeds.
- Multi-layered spectrum: Industrial holding companies, family offices, evergreen funds, specialized in restructuring cases or the acquisition of companies in crisis.
- Generally no synergy potential, which leads to lower valuations.
- In the case of existing investments in the market environment of the target company (buy-and-build strategy), similar position to a strategic investor.



Sales process

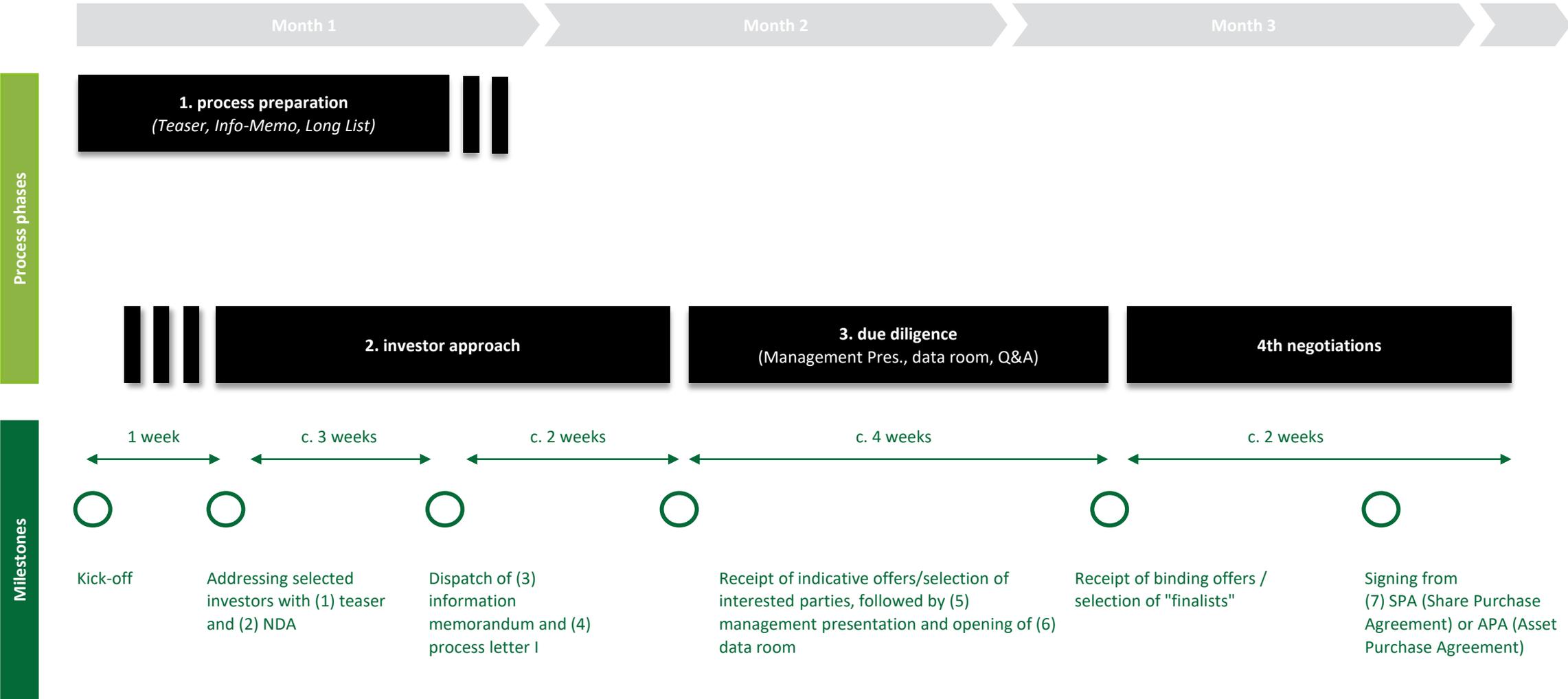
# How long does a distressed M&A process take? | What are the special features?

A key difference between distressed M&A processes is the timeline, which is why they are often referred to as "accelerated M&A"

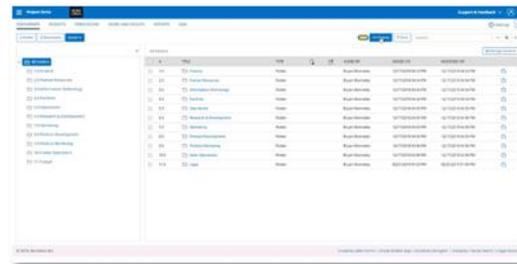


# How is a distressed M&A process structured?

Sales processes from insolvency are extremely compressed and usually take no longer than 3-4 months

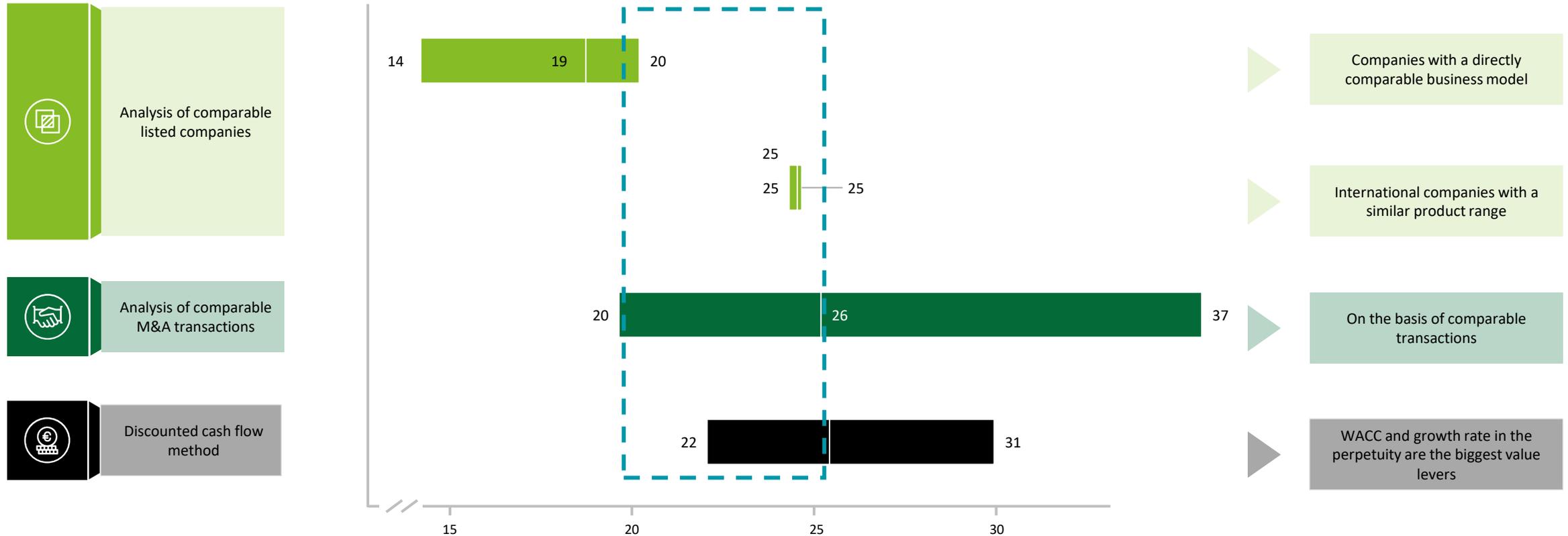


# How is a distressed M&A process structured? | Relevant documents



# How are distressed targets valued?

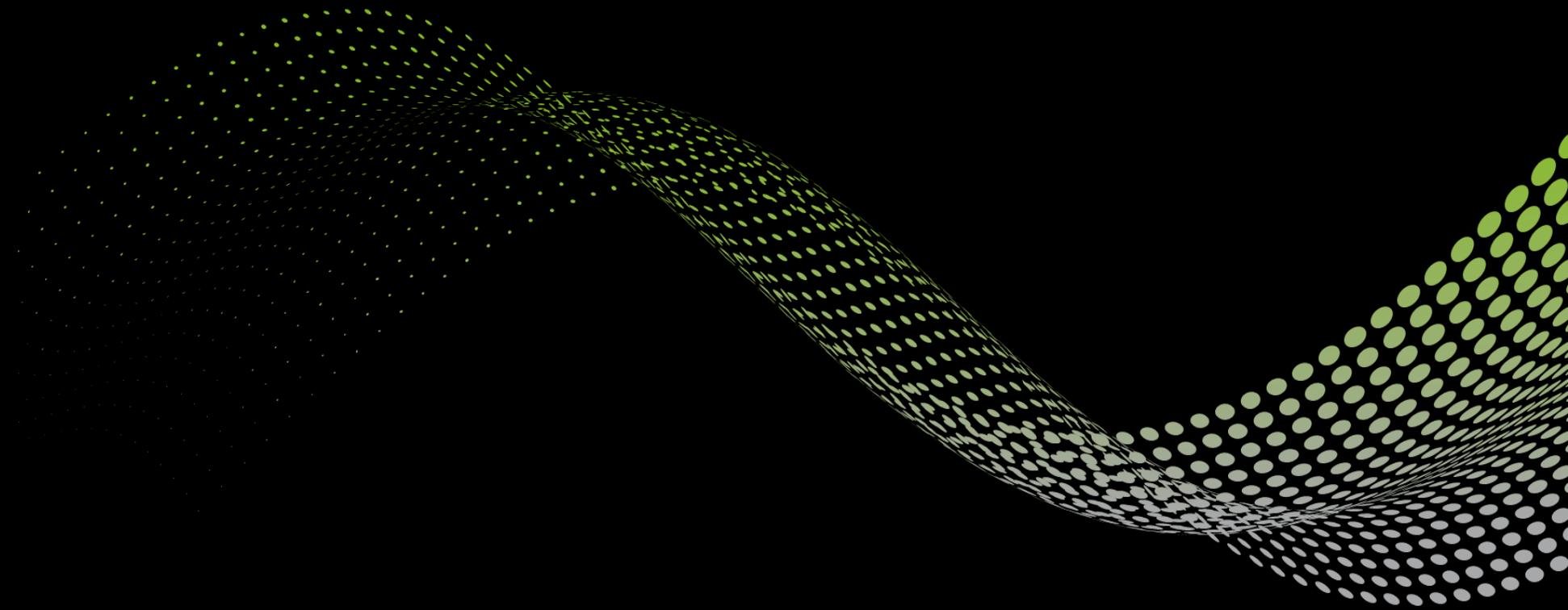
In addition to the usual multiples and DCF, the net asset value is also very important in insolvency cases



- The basic prerequisite for this valuation approach is reliable historical profitability and current trading that confirms the planned EBITDA/EBIT.
- Valuation discounts are common, as the guarantee catalog in the purchase agreement is very limited due to the insolvency and an insurance solution is not available. Possible risks must therefore be covered by a purchase price discount.
- Up to 100% of the DCF value lies in the so-called "perpetual annuity" and thus in the "future fantasy" due to the restructuring situation.
- As a rule, future planned restructuring costs are also deducted and the necessary build-up of working capital is also acquired as part of an asset deal, as no bank financing is available due to the restructuring situation.

# What are the success factors of distressed M&A projects?

 <b>Ensuring liquidity</b>	Securing liquidity, if necessary through agreements with customers, suppliers and lenders, in order to gain time for the sales process.
 <b>Structured process</b>	The sale of a company in a crisis situation is usually very time-critical, as a potential loss of trust among customers, suppliers and employees during the crisis can have an impact on the value of the company. It is therefore crucial to implement the sales process in a structured manner and without frictional losses.
 <b>Support from the management</b>	M&A transactions in times of crisis require a high level of human resources in the short term.
 <b>Communication</b>	In M&A transactions during a crisis, a large number of different interests clash between the parties involved (lenders, other creditors, potential investors, employees, existing shareholders, etc.), which must be constantly "played".
 <b>Industry expertise</b>	In M&A transactions during a crisis, the existing industry expertise is a key success factor in order to ensure the rapid identification of potential strategic investors and specialized financial investors and to discuss possible restructuring approaches "at eye level".
 <b>International network</b>	The chances of successfully completing a transaction on the best possible terms are often substantially increased by a geographically diversified search for investors, particularly with regard to strategic investors
 <b>Insolvency law</b>	For transactions in the context of insolvency proceedings, in-depth knowledge of the special framework conditions of insolvency proceedings is required, e.g. with regard to the special requirements for contracts, in particular with regard to warranties and guarantees, or with regard to the possibilities of optimizing business plans due to possible restructuring instruments of the Insolvency Code. The specific time frame must also be taken into account.



Tactical considerations

# Strategy for buying out of insolvency

- **Legal certainty:** Greater for acquisitions out of insolvency proceedings compared to transactions in crisis.
- **Market approach by insolvency administrator/self-administration/M&A advisor:** Once insolvency proceedings have been opened, the insolvency administrator or self-administration attempts to address the market on a broad basis. Early entry into the process ensures competitive advantages.
- **Pre-packaged deals:** Possibility to close quickly immediately after the opening of insolvency proceedings by preparing and pre-negotiating the transaction.
- **Coordination in preliminary insolvency proceedings:** Requires successful coordination with the provisional insolvency administrator and creditors' committee.
- **Attractive offer for rapid liquidation:** Purchasers should persuade the provisional insolvency administrator and creditors' committee to refrain from approaching interested parties further.
- **Cherry picking:** In the best case scenario, the valuable assets and profitable business operations can be removed from the insolvent company by means of an asset deal, thus ensuring its continuation.



Q&A





**Thank you very  
much**  
for your attention

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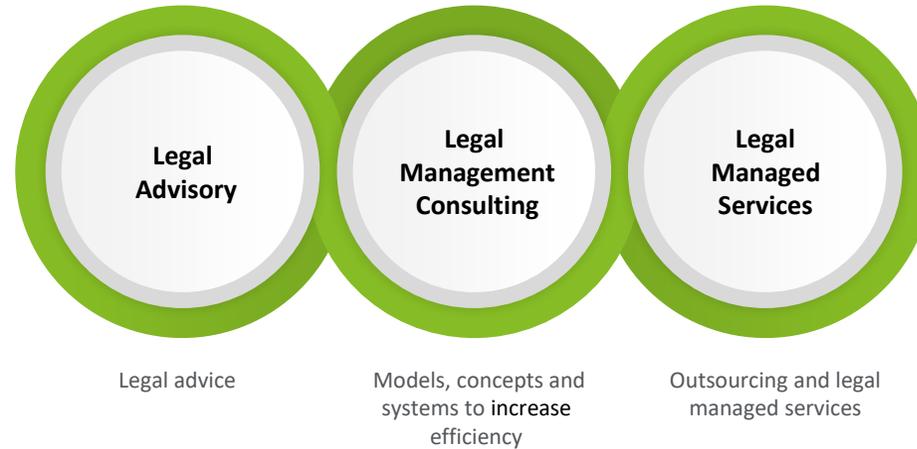
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