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SPECIAL REPORT

BUYING A BUSINESS OUT OF ADMINISTRATION

Jonathan Jay's DEALCLUB

Buying a Business out of Administration

THIS MONTH, you are going to learn:

- Why businesses go into administration
- What a ‘pre-pack’ administration is
- How to buy a business out of administration

The information we’re covering here has been finely tuned to suit where we are with the economy at the moment. A huge amount has changed over the last year or so and while the fundamentals remain the same, the way we need to work to get the best results has not. We’ve got to be up to date with everything, and this is the most up-to-date information you will find on these subjects.

Buying a Business out of Administration

We’re going to start by covering the three most commonly asked questions:

- Why does a business go into administration?
- What is the opportunity for the business buyer?
- How do you find out about businesses in administration?

Why does a business go into administration?

A business typically goes into administration because it is technically insolvent. Insolvency has several tests, one of which is:

Can the company pay its debts as they become due?

Now, every company owes money to someone, for things like supplies, services, rent, or whatever it might be, but the test is, can they meet those obligations when they become due? A business must be able to do that to be solvent, and the directors have a legal obligation to place that business into administration if it can’t. In that situation they’re actually doing the correct the correct thing. However, what many people don’t realise is that a business that goes into administration isn’t necessarily a bad business – businesses that are perfectly sound can also go into administration. This can happen because it is over-leveraged, it’s got too much debt, maybe there’s an unpaid HMRC bill that has been dragging around for years and HMRC suddenly issue a winding up petition. You can have a business that, if it didn't have all that debt, would actually be a nice business and that is the type of business we like.

What is the opportunity for the business buyer?

The opportunity is to buy a business that went into administration because of the debt, and to leave that debt behind. No one's going to buy a business loaded down with debt, so you have to be able to do that. You get a business that's free and clear of the debt so it can breathe again, and as a result you've now got a business that has a second chance. You can buy these businesses for pennies in the pounds via the administrator and get yourself a bargain.

How do you find out about businesses in administration?

Obviously to buy one, you need to be able to find out what's available. Statutory notices regarding businesses that go into administration are published in the *London Gazette*, which is available online (https://www.thegazette.co.uk/), and there's also a website called IP-BID.com – IP as in insolvency practitioner (https://www.ip-bid.com/).

However, by the time businesses get to a website like that the deal has often already been done, the assets have already been sold. Having said that, I have a private client who bought three that way during 2020, so it's not always the case.

Let's take a look at things from the other side of the deal now and consider things from the point of view of the administrator.

What are the priorities of the administrator?

The administrator has three key priorities:

- To receive their fee
- To find a buyer for the business
- To get the best return for the creditors

They want to receive their fee

They need to be paid for the job they do, and out of whatever money is leveraged, they get paid first. The preferred creditor is HMRC – that means out of all the people owed money by the business, HMRC is top of the list to be paid – but the administrator gets paid before them. It makes sense, if you think about it – why would the administrator do their job unless they were guaranteed payment?

They want to find a buyer for the business

This is their role – to find a buyer for the business.

They want to get the best return for the creditors

Creditors are the people who are owed money by the business, and the more money can be raised, the more creditors can get paid (although they'll be third in line at best, after the administrator and HMRC).

Having said that, and contrary to popular belief, getting the best deal for a business in administration is not always about selling to the highest bidder, it's often selling to the person who could move the fastest and with the most certainty. Someone could come along and offer a huge amount of money for a business but unless they've actually got the money or can very quickly raise it, then there's no deal. So it's not always about the highest bidder, it's about the person who can get the deal done.

How do I buy a business out of administration?

Not just anyone can buy a business out of administration. The administrator will look for some key credentials and experience.

You need to be a credible buyer

It helps if you have some track record in the sector. All the things we talked about earlier that you need when you're talking to the seller of a business – authority and confidence – you need ten times over when speaking to an administrator. These are tough guys, and they are mostly guys; they deal with lots of unsavoury characters in difficult situations so they're not sweet and delightful all the time. Having said that, I've got on my deal team two administrators that I think are great guys and they would bend over backwards to help you. But you need to be credible, and don't be a time waster. If you're a time waster you close the door on that administrator for good, and that would be a terrible shame.

You need to be able to prove cash funds

You need to be able to prove cash funds. Without a doubt, the buyer they are looking for is someone who's got the money in the bank and could move on it quickly. You might need to provide a letter from your accountant. I did one like this; the administrator decided they wanted to sell the property as well as the business, and we put our lawyer in funds so they could write to the administrator and say, 'I have the funds to back up the offer that Mr Jay has made.'

You need to be able to move very quickly

You haven't got days or weeks to think about this, you must be able to move very quickly. You'll need to make some fast decisions and that's always made easier if you've got a really good deal team. If you also understand the business that you are buying and have a track record in the sector that also help.

I think administrators are more cautious about this now because of the disaster with BHS being sold for a pound to Dominic Chappell, who made a mess of things and is now in prison for tax evasion.

Buying a Business via Pre-Pack Administration

A 'pre-pack' administration is where the buyer is lined up to buy the assets prior to the administration and buys the assets immediately after the company goes into administration.

It's a back-to-back situation – the business goes into administration and the buyer buys the assets immediately after. Now, in order to do that the buyer needs to be lined up in advance, which is why it's called a pre-pack – it's pre-packaged, we know exactly what's going to happen. When some businesses go into administration they can't find a buyer and eventually all the staff are let go and it's wound down; in other words, it's liquidated.

You can use the pre-pack approach when you find a business that's fundamentally sound, but made insolvent but its liabilities. You need what we call a 'tame' administrator, someone who's going to be on your side, to be appointed and you need to hold the seller's hand throughout the process.

The reason you need an administrator on your side is because if you just find one off Google, the chances are they already have their preferred buyers, their mates who buy businesses. You might take this business to the administrator and say, 'I've got this business, I think the owner needs to put it into administration, I'd like to buy the assets. Can we do that?' They'll say, 'Yes, of course.' They'll take the instruction and they'll know they've got their fee in the bag, and then they sell it to someone that they know, rather than to you. Now, that's their prerogative, but you don't want that to happen, which is why if you've got a tame administrator your life's going to be made an awful lot easier.

The benefit to the seller of the business is that they are immediately relieved of the stress – HMRC don't come knocking anymore, all the letters they were getting about unpaid bills stop. They also have a legal obligation to appoint an administrator if they can't meet their bills, as trading whilst insolvent is illegal and can have some serious consequences. You obviously are going to rescue their staff, customers and suppliers, so they can they can hold their head high and not be presiding over a disaster.

In most cases the main creditor is HMRC and quite frankly most people don't have any sympathy for HMRC. I know some people have a massive moral issue with the whole concept of administration and seeing the people responsible for them walking away from those debts, and I do get that. However, sometimes it's the only option and at the end of the day the staff, the customers and the suppliers win.

There are exceptions; everyone's got a story about a little supplier who lost their contract and didn't get paid and it was terrible. And of course the seller can tell people that they sold you the business, they can say it's not my problem, it's now Jonathan's business.

But if we look at the big picture from your perspective, as the business buyer, you didn't create that problem, the seller did. You're actually the knight in shining armour riding to the rescue.

I have private clients who are becoming very successful using just this one strategy. You'll remember I said earlier that you should find an acquisition strategy that works in your sector and then just repeat it again and again and again. Well, I've got people who are repeating the administration strategy now.

Sometimes when you buy a business out of administration it requires a little more hard work – possibly the owner's taken their eye off the ball in recent months. But you've got to balance that against paying very little for the business. Sometimes people ask if it's possible to pay the administrator over time; well, it helps if you've got a relationship with the administrator. If you don't have a relationship with the administrator then you are going to struggle with that one; if they know you then that becomes an awful lot easier.

Key points

A business typically **goes into administration** because it is **technically insolvent**.

The **opportunity** is to buy a business that went into administration because of the debt, and to **leave that debt behind**.

The administrator has three key priorities:

1. To receive their fee
2. To find a buyer for the business
3. To get the best return for the creditors

Not just anyone can buy a business out of administration:

- You need to be a credible buyer
- You need to be able to prove cash funds
- You need to be able to move very quickly

A 'pre-pack' administration is where the buyer is already lined up and buys the assets immediately after the company goes into administration.