BACK TO THE WELL?

CONSIDERATIONS FOR STRATEGY PIVOTS

By Steven Strom

Here is a headline no board wants to be featured in:

FTC HALTS MERGER: STOCK DROPS 40%.

But it happens.

Many companies pursue logical strategies to get to a better place. These strategies can range from seeking to maximize shareholder value through a sale of the company, divesting a money-losing operation to make an otherwise challenging refinancing easier, and even more *status quo*-oriented strategies such as raising capital to maintain market share or launching new products. These strategies, when successful, are often celebrated by Wall Street. But in some cases, the strategy fails, and the answer to what should come next isn't as simple as just going back to the same well.

Some examples of events that can derail the execution of a successful strategy include:

1. An M&A process where there is no bid for a company that clears the debt
2. FTC objection that blocks a sale transaction
3. A buyer "falls down" or loses their acquisition financing at closing
4. Failed capital raise
5. Loss of a significant client or contract that significantly impacts cash flows
6. Rapid disruption (often due to new technology)
7. A natural disaster or other unexpected event impacting operations in a meaningful way
8. Sudden and unexpected regulatory changes
9. Significant changes in market conditions
10. Other adverse impacts, such as losing a major lawsuit or legal appeal

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In these and other cases, failure of the corporate strategy can expose serious problems, such as poor performance, an impending going concern audit opinion, a challenging refinancing, or even a liquidity crisis. Suppose the company is underperforming or highly leveraged. In that case, the newly exposed problems can demand a radical strategy pivot, shifting the company into restructuring mode, a strategy involving negotiations with creditors (such as a liability management transaction), or even a bankruptcy filing.

An example of a radical pivot is Spirit Airlines, which in July 2022 announced a merger with JetBlue. In January 2024, a federal judge unexpectedly blocked the merger, resulting in plunging debt and stock prices at Spirit. The company then disclosed that it was actively considering strategic alternatives for addressing its debt maturities, and creditors began to organize. Spirit also made other strategic changes to address liquidity, including deferring aircraft deliveries and layoffs, and extending some debt maturities. Ultimately, the company filed a prearranged bankruptcy on November 18, 2024.

New facts can demand new strategies. When a strategy fails, the board must work with management and advisors to orchestrate a rapid pivot if they haven't already developed a contingency plan. A pivot to a restructuring strategy often involves:

1. Governance – Does the board have a suitable skill set to execute the pivot? At this point, companies should actively consider adding independent directors experienced in distressed situations who can help identify the right advisors and understand how these professional firms are typically compensated. In addition to helping build or rebuild the advisory team, they can also lend a fresh perspective to challenges and be positioned to conduct investigations if there is concern about releases in a restructuring.

2. Advisors – Does the company have the right advisors to execute a pivot? For example, a traditional investment banker may have run the initial sale process. When that process fails, a sale may still be possible in bankruptcy at a value less than the debt. That process, deal structure, and even likely buyers, however, may differ greatly from the original "regular way" M&A process. For situations where the investment bank has experience in both traditional M&A and distressed/bankruptcy M&A, the team may need to be expanded as part of the pivot to include restructuring professionals. Switching firms may be involved when the original bank lacks a qualified restructuring bench. Other advisors may also need to be added. If the pivot is to bankruptcy, the company will likely need to add restructuring counsel, a restructuring advisor (to develop a 13-week cash flow forecast and DIP-sizing and assist with preparing schedules and first-day analytics), advice on executive compensation, and a noticing agent.

3. Best practices – A failed strategy can increase the risk of litigation against the company, its directors, and its officers. This makes it especially important to use best practices for good governance and document corporate actions accordingly.

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4. Compensation/retention – What are people's incentives? Stock grants are a common compensation currency for many companies, but the pivot may make that currency unattractive. In particular, the senior leadership team may require a compensation adjustment to be retained to prevent disruption of the pivot.

5. Communications – Can we create a successful-sounding narrative after a failure? Companies may want to report optimistic news, but to minimize litigation risk, there needs to be careful consideration regarding external communications. It may also become necessary to bring other parties, such as lenders, customers, and other stakeholders, into the fold and under an NDA to help coordinate the pivot.

Sometimes, the pivot after a strategic failure may be going back to the well to try, try again. Other situations may require a radical pivot to prevent further value erosion and other problems. Agile boards will have the skill set to make these determinations, especially when they incorporate the market's reaction to the failure.

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