Seizing the initiative: Act now to recover

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Executive summary

Even bigger tests to come

The COVID-19 pandemic has brought the importance of cash and working capital sharply into focus.

2020 has upended even the most well-prepared business plans and the uncertainty is set to continue. While the upheaval has revealed longer term transformational opportunities, your business first needs to weather the difficult months ahead.

Heather Swanston
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Government support, which has provided a lifeline for many businesses, cannot be extended indefinitely. Businesses need to prepare for the impact of a scaling back of measures. The coming months will also see an end to debtor protections, rent freezes and tax deferrals, heightening the pressure on already strained cash positions.

Difficult months ahead: Cash calls and end of exemptions

As business leaders, you face tough decisions ahead as you strive to meet obligations to employees, suppliers and shareholders, while fulfilling legal, financial and regulatory duties.

Some of the challenges are immediately obvious such as revenue declines or pressing cash calls. Others may be harder to foresee, but are potentially the most critical – disruption to your supply chain or increased working capital needs, for example. It's important to keep track of multiple issues at once; sometimes warning signs in one part of your organisation could be a symptom of underlying issues elsewhere.

Businesses can't afford to wait for such threats to materialise or for the recovery to take its course before you respond – with an expiry date on Government support measures, the time to fix the roof is before the (worst of the) storm, not during it. The businesses out in front are taking proactive and decisive action now.They're not only developing a clear understanding of the challenges in their path and how to steer through them, but also how to keep pace with changing customer expectations and capitalise on the opportunities ahead.

Drawing on the experience and insights of our business restructuring team, this report looks at the early warning signs of problems ahead and how to take proactive action in response. The key objective is to act early enough to maximise your options and remain in control. This can mean minimising the impact of financial difficulties if matters become more challenging, proactively managing your stakeholders if encountering a financial restructuring and in all cases understanding the tools available to you to execute your turnaround plan and preserve value .

If you have any queries about the issues raised in this report or how they might affect your business, please feel free to get in touch.

Challenging times, but there is a way forward

During the Global Financial Crisis (GFC) many businesses found that cash quickly dried up. But this time there is more of a cash and working capital cushion. Our survey of 19,500 companies globally showed that working capital days improved by 0.6 days in 2019, freeing up €81 billion from balance sheets and boosting liquidity. In other words, many astute businesses have bought themselves breathing space. While there has been an improvement in performance over the last year, we believe the total global cash opportunity that companies could release, through better working capital management and eliminating excess, is €1.5 trillion. This would give companies additional breathing space and ability to weather further shocks.

Moreover, there is more capital out there, waiting to be deployed, than in the depths of the GFC. The unusual nature of the COVID-19 pandemic and its economic impact mean that many stakeholders are prepared to be flexible and supportive, as well as providers of new capital. Further, at an operating cash level, landlords have generally been accommodating to tenants facing falls in revenue, while new legislation provides options that can help avoid insolvency and improve the chances of business rescue.

Chances of stabilisation and turnaround have also been improved by the opportunities to drive deals-led recovery through recapitalisation, carve-out and divestment of non-core operations. With record amounts of dry powder to put to work, the acquisition appetite within private equity is especially strong.

At the same time, the pandemic looks set to accelerate longer term shifts in the economy. This ranges from the move to digital retail to strengthening sustainability. Corporate restructuring is set to play a key role in boosting strategic agility and future-proofing business models by helping to simplify structures, clear away non-core operations and free up funds for investment.

Successful businesses will use these openings to secure competitive advantage, evaluating the way forward and taking proactive action. Time and again, our business restructuring team sees how an early appreciation of new risks and the willingness and ability to act fast are the differentiators that can enable businesses to steer through turbulence and emerge stronger.

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The power of proactivity

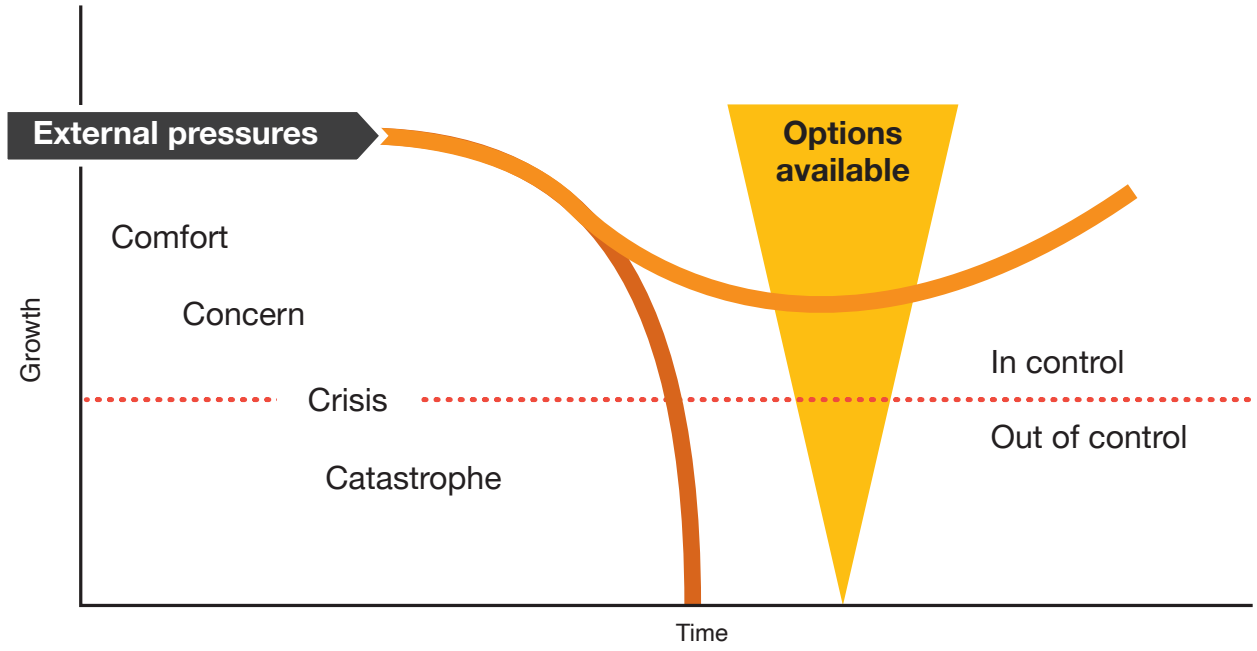
The key attribute needed to survive and thrive in tough times is proactivity – thinking ahead, acting now. Proactivity buys time. The more time you have, the more options you have. Once a business enters crisis mode, leaders do tend to act energetically and proactively by instinct. They seek to manage and mitigate threats such as lost revenues, a credit downgrade, covenant breaches or the risk of exceeding credit facilities.

However, it is of course far better when leaders recognise the early warning signs of a looming crisis and act before it gets out of hand – as the saying goes, a stitch in time saves nine. In our experience, this requires three key attributes: the ability to identify the potential dangers ahead, the insight to recognise how such risks might be connected and compound one another, and an adept approach to managing multiple work streams and complexity.

A common mistake we see business leaders make when their organisation comes under financial pressure for the first time, is fixating on problems in one area of the business at the expense of others. As a result, they can easily lose sight of the interconnected challenges and find themselves short of options to deal with the secondary issues that arise.

Although issues in one area may seem to be the most pressing, it may turn out to be less immediately obvious challenges in another which are the biggest threat to survival. Think of this like slaying a hydra where every head (issue) you remove causes two more. The graph below shows the challenge of tackling these interconnected risks; as they stack, the options available to you reduce. Quickly, control of your business can be lost. A proactive approach to the options available to you is your best route to recovery.

Understanding the recovery curve



Restructuring in action: Getting ahead of the curve

An events company had seen revenues dry up as lockdown and travel restrictions forced it to cancel events. With little or no money coming in, the business was at imminent risk of breaching debt obligations, which could in turn have led to insolvency. Without proactive moves to shore up the balance sheet, the business also faced knock-on risks, including calls for the repayment of deposits on postponed events.

To boost liquidity, we prepared cash flow forecasts and advised on cost reduction and the fast tracking of insurance claims. Separately, our independent business review team worked with the company and its creditors to help secure covenant waivers and debt roll-over. With lenders on board, the company could then explore further financing options including equity funding. With the company's immediate future now secure, it can engage with customers and plan future events once restrictions are eased.

This restructuring underlines the importance of moving quickly to stave off liquidity threats that could not only put a business at risk of debt breaches, but also undermine confidence across the wider stakeholder group. It also shows the interconnections between stakeholders – if you can secure lender support, you're in a better position to seek further finance and retain key customers.

Knowing your financial indicators

The most obvious signs that a business is entering the danger zone tend to be financial. Profit erosion, liquidity pressure or the loss of a key customer or supplier are hard to miss. Likewise the risk of breaching one or more financial covenants, or debt slowly increasing over time to unsustainable or 'un-refinanceable' levels.. Pensions or other long tail liabilities may become unaffordable, loan repayments or maturing debt might be unmanageable.

One of the issues we often see is an inability to forecast cash flows precisely. This is especially dangerous when the business is thrown off course by unusual situations (such as recent events) and becomes more reliant on the day-to-day accuracy of their forecasting than in the past. When there are significant shocks and disruption to core income and costs, new processes are needed to forecast cash flow day-to-day.

Identifying these warning signs early can allow time to get lenders organised, informed and hopefully on side, and set in train the financial solution you require.

Experience underlines the importance of also maintaining active communications with other key stakeholders, including employees, suppliers and customers. Failing to manage these stakeholders could easily derail your business recovery.

Key considerations – financial restructuring

1. How is the current recession and impact of COVID-19 affecting your business, its financial performance, liquidity and your capital needs?
2. Who are your key stakeholders, how are they likely to be impacted, what is their response and how are you managing them?
3. What options are you actively considering and implementing to mitigate these impacts?
4. How much worse might the situation become and how proactively are you considering and planning for these scenarios?

Knowing your true cash position

Liquidity is everything. Operations need to be funded, bills have to be met and any emergency government loans eventually repaid. This means a laser-like focus on liquidity, including the optimisation of working capital and identification of locked-in cash, while exploring all possible internal and external sources of finance.

The starting point is knowing what your weekly, or even daily, cash flow looks like. Accurately mapping payments and receipts gives clarity and comfort as you assess the durability of your cash position and the options available to your business. Generating a 13-week cash flow forecast that captures the best available information from your business would provide further insights on how much room for manoeuvre you have and which course of action is most viable.

Restructuring or selling a business can take months, so knowing when you could run out of cash is vital in deciding the best way to support recovery. Your management team can then work out how to shore up short-term cash flow so you can keep operating. That could involve stretching some payment terms, negotiating with customers to convert receivables earlier, efficiently managing inventory to release capital faster, or renegotiating interest or amortisation payments with lenders.

Cash flow evaluation at a functional level can help release vital funds. Cash may be available, but locked in the wrong part of the business. Top line measures of cash flow can often prove misleading in businesses spanning multiple jurisdictions because currency controls, tax implications or different lending facilities can make it hard to transfer funds between different parts of the business to manage liquidity pressures. Many mid-size businesses which have mainly operated through periods of growth have rarely, if ever, needed to think about transferring cash between different parts of the business before. Learning how to identify and release tied-up cash will therefore be a key survival skill in the coming months.

Getting cash flow reporting right is equally critical. This is partly a question of accuracy, which you can assess by looking at how forecasts compare to actual results. But it is also a question of timeliness. If it takes months to close accounts, cash flow is harder to map. If cash flow reporting is slow because of manual processes or the need to pass information around many people, this can be a subtle sign of danger.

The foundation for timely and accurate reporting is ensuring that evaluations are capturing and maintaining visibility of key data points. Having this data in front of you provides a strong basis for strategic conversations. Our work with clients highlights the value of effective tools and dashboards to ensure they have the right data at their fingertips, at the right time.

Useful tools we use include cash flow forecasting, cash flow review, and working capital benchmarking.

Key considerations – cash optimisation

1	Is working capital management a priority across functions?
2	Do you know where cash is tied up in the organisation?
3	Who is responsible and accountable in each function for working capital management?
4	How confident are you about the accuracy and consistency of cash flow reporting across the business?
5	Do you have a complete and accurate view of short-term cash flow across the entire business?

Knowing your operational indicators

With revenues depleted but fixed costs still to be met, your business may need significant operational adjustment and repair in the short-term, and more fundamental restructuring ahead. Common forms of disruption include restrictions on customer numbers because of social distancing or a switch to remote working and digital customer engagement that leaves large amounts of office space empty.

Erosion of margins is the most visible sign of trouble, whether driven by shrinking revenues, rising commodity prices, price volume mix issues or other commercial changes. Resulting considerations include how to reduce fixed costs and eliminate waste in the short-term, while exploring ways to streamline your business, adjust supply chains and harness technology to boost efficiency.

With office needs unlikely to come back to pre-pandemic levels in many companies, it's important to check whether your real estate footprint is still fit for purpose. Our work with businesses looks at the options for adjusting the real estate portfolio and renegotiating leases, while exploring alternatives such as flexible tenancies or moving from physical to digital customer engagement.

Less obvious and often overlooked operational indicators include excess spend on the administration of financial, tax or regulatory issues. This often stems from multiple entities and overly complex operating structures built up through many years of acquisition and new market entry. It's therefore important to look at ways to rationalise and simplify operating structures.

The upheaval over the past year has also highlighted the risks to supply chains as suppliers were forced to shut factories or movement of goods was restricted. While offering cash flow efficiency in normal times, just-in-time processes can be especially vulnerable to these kinds of sudden shocks. This has underlined the need for contingency planning to manage unforeseen interruptions.

Business process outsourcing was also disrupted as offices went into lockdown, especially where personnel in offshore third-party suppliers were unable to work remotely from home. It's important to map supply chains and be clear about the risks and how to mitigate them. A lack of such understanding is one of the danger signs we often see.

Key considerations – operations

1. Are you taking a strategic approach to cutting costs?
2. Do you know how much value the activities your workforce undertakes contribute to the business?
3. Have you fully considered where and how activities being performed in your organisation and whether automation or outsourcing would be more cost-efficient?
4. Can any services within your business be cut?
5. Do you manage third-party spend as well, and as strategically, as other areas of spend?
6. Could you benefit from working more effectively with your supply chain?

Getting out of danger

Every situation is unique and every firm has a different set of challenges, but there are common tools and techniques that we can use to help a business get out of danger and move forward.

Some come from the insolvency toolbox. For example, sometimes a business that is unable to service its liabilities can be sold to a new party in a way that enables it to carry on operating, serving customers, retaining employees and supporting suppliers.

In other cases, we can secure collective agreement with multiple creditors for a financial compromise to reduce the firm's liabilities. This often involves solving problems which a business is unlikely to have encountered in the course of day-to-day operations during good times. For example, bringing creditors on side normally requires unanimous consent amongst multiple parties, but such agreement is not always forthcoming. Using our strong connections and collaborative approach, we are often able to achieve consensus and improve the firm's financial position.

Further support includes accelerated merger and acquisition. Operations may no longer be core to your business, either through lack of scale or a refocus on other areas targeted for growth. Normally a divestment is a structured process involving the preparation of a great deal of data, management presentations, and multiple bidders. It can take between six and twelve months, which is often more time than is available when a business is in distress. We can help solvent businesses or operations within them to find buyers much more quickly, thanks to the strength of our relationships with turnaround investors and our knowledge of their areas of focus, available funds, and how quickly they can move.

However, we often find that the main benefit we bring is simply our hands-on-experience. No matter where a business is on the recovery curve, we have likely seen a similar situation before, can quickly understand the danger signs, and are able to prioritise.

Key considerations – operations

1	Are you the target of shareholder activism?
2	Has COVID-19 rendered previously core functions as surplus to requirements?
3	Is your business model changing as a result of COVID-19?

Restructuring in action: Accelerating stabilisation and turnaround

A plastics manufacturer was facing a haemorrhage of cash from its loss-making automotive division. The cash drain was putting the rest of the business at risk of breaching loan agreements and possible insolvency ahead. The risks were compounded by difficulties in forecasting cash flows from the troubled division. Rising liabilities also meant that the group was in danger of failing to meet its pension obligations.

We worked with the group to identify, assess and explore options for stabilisation, capital and debt raising and turnaround. Support included reviewing the cash flow forecasting needed to facilitate possible debt refinancing which played a key role in securing agreement with creditors on the restructuring of debts.

In parallel, we used our networks to identify potential buyers for an accelerated M&A process for the loss-making division, which eventually led to a sale to a trade buyer. The threat of insolvency for the remaining group was averted. Jobs in the divested division were protected. The proceeds from the sale went to shore up the pension scheme and contribute towards rightsizing its debt. Freed from the escalating losses, the group has been able to refocus resources on its profitable operations and clear the path to revenue growth.

For many businesses, the next few months will be the rockiest in living memory. But if you understand the danger signs and are proactive, there is no reason why you should not be able to take the action required to survive and prosper for many years to come.

For more insights, see our content online on protecting cash, focusing on value, and our overview of the areas to consider. Please feel free to get in touch to discuss how we can support your business recovery.

Actions to take

Every second counts. So don't waste time with the wrong strategy.

It may feel straightforward to spot the obvious points of stress in your business. But beware the hidden complexity. Resolving issues in a way that will best help you either regain or maintain control means avoiding two pitfalls.

The first is to not focus exclusively on the immediate issue at the expense of the other core areas of your business. Check that what you are seeing is not an indicator of problems elsewhere – or that additional challenges won't be created through addressing the issue at hand at the expense of others. As we've shown throughout – the complex and intertwined nature of businesses means problems rarely occur in a vacuum. And they shouldn't be tackled in isolation.

The second trap is the emotional response, which can sometimes be the hardest to address. Business leaders know the importance of being proactive. To make the decisive, and sometimes tough, decisions – quickly and with resolve. This is what buys your business time. Time to take back control or to successfully pivot to take advantage of future opportunities. Whatever the situation, business leaders need the clarity to recognise the challenges in their organisation and the courage to act.

Early action helps you maximise the options available to you.

We've seen time and time again how business leaders who understood the true position of their business on the recovery curve and were able to respond swiftly were able to steer their path back to a position of control. There is no single route to success. What that path may look like will be unique to each organisation. Which is why getting early advice can help you spot both the options and the obstacles that the immediate issue may have obscured.

Our market leading and multidisciplinary teams can help you to rapidly understand the areas of tension within your business as well as map out the options open to you. This isn't only for when issues spiral out of control. A proactive and strategic mindset can find opportunities to better align with future markets and navigate uncertainty. We can bring the right tools, teams, technology and expertise to support you on that journey.

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