

***Is it over?** In the wake of one of the most brutal economic and financial downturns in which businesses of every size and sector faced historic liquidity challenges, those still standing are wondering if it is finally safe to exhale. The concern is certainly justifiable.*

To gain further insight into the aftermath of the economic downturn, Alvarez & Marsal (A&M) reviewed the published business data of 1,900 publicly traded companies and determined which firms would not fare well in the future without significant change.

Please refer to the end of this document for more information on the utilized metrics and stipulations of the study.

*This issue of **Cash is King** takes a look at how key indicators moved during the second half of 2009 – whether the numbers tell the full story – and explores the strategies and tactics companies can deploy to prepare for whatever challenges lie ahead.*

ISSUE TWO:

Managing Through Uncertainty

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While the strength of the recovery is still yet to be determined, companies that survived have emerged stronger and leaner. A recent review conducted by Alvarez & Marsal showed that in most cases, the financial indicators for more than 1,900 publicly traded companies were reversing course during the second half of 2009. Compared to the first half of the year, revenues rose by 10 percent, gross margins were up 12 percent and cash flow from operations was up 38 percent. (See graph B).

In addition, companies clearly embraced the “cash is king” mantra, with strong working capital improvement. With tighter management of receivables, payables and inventory, working capital cycles went from 57 days of sales in 2008 to 53 days in 2009. While a reduction of four days may at first seem insignificant, it represents \$107 billion of cash flow that has been unlocked from balance sheets, free to be put to work for investment, debt repayment or stock re-purchase, to name just a few strategic initiatives.

Yet, as the number of companies with negative cash reserves remained stable, more companies are again generating cash (87 percent versus 82 percent). Overall 12 percent of the companies reviewed improved (moving to a better quadrant) while only 8 percent deteriorated. (See Graph A).

One area is somewhat of a surprise: selling, general and administrative (SG&A) costs have risen to 22 percent versus 20 percent in 2008, and one in four companies is still highly dependent on the credit markets.

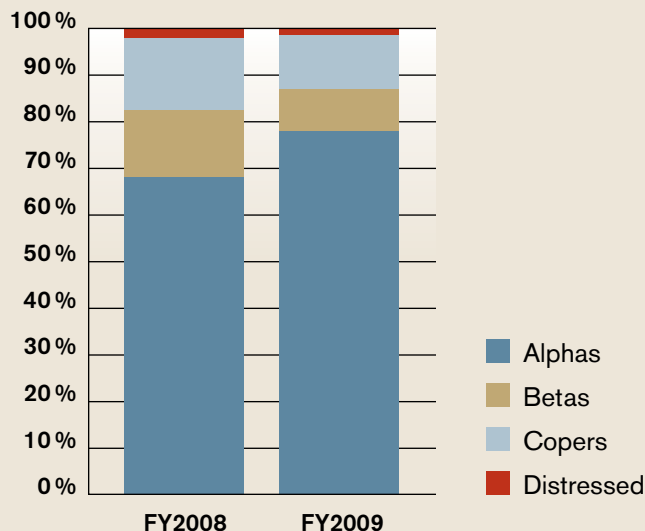
Not all industries fared the same

During the course of 2009, while all industries have been able to reconstruct their war chest primarily by controlling cost and deferring investment, several are not generating the operating cash flow they used to: Capital Goods, Energy Producers, Raw and Semi-Finish Material, and Semiconductors and Equipment are generating 25 percent to 50 percent less cash than in 2008. (See graph C).

Others, such as Automobiles and Components have experienced a significant comeback, with the market sector, once badly hemorrhaging cash, generating \$2.18 million a day by the end of 2009. Similarly, Healthcare Equipment and Services and Retailing have improved their cash generation by more than 10 percent.

Company Shifts

(A)



BEYOND THE NUMBERS

While the numbers may portray many bright spots, not everyone is convinced that the economic winds are finally at our backs. At a recent conference sponsored by A&M and NYU Stern School of Business, thought leaders from finance and industry expressed reservations. Despite the tremendous amount of money flowing into the markets, many questioned whether this money is being used by issuers to “extend and pretend,” propping up balance sheets or pushing out maturities, and whether business fundamentals have really improved. Another ominous sign is the trillion dollars of debt coming due in the next five years. [Download the PE Conference brochure.](#)

IS CASH REALLY KING?

Of the 32 companies that found themselves in the D segment (no war chest and not generating cash), a third are in serious trouble (in the process of being delisted, in bankruptcy proceedings or being acquired) and half received some form of emergency cash infusion through sales of assets, or new debt.

WHAT CAN BE DONE?

Against this backdrop, the question becomes: where do we go from here, particularly when it comes to saving cash? Which is the best offense and defense?

Cash is King [Issue One](#) looked at how cash can be extracted from the Balance Sheet through better management of Working Capital, this issue will focus on SG&A.

While most executives keep a close eye on overhead in an income statement sense (e.g., as a percentage of revenue or as a total dollar line item on the financial reports), many forget that overhead line item represents real cash flowing out the door every day. Finding ways to reduce overhead not only helps the income statement, but can also be a significant ongoing source of cash savings.

Following are a number of areas on which companies should focus:

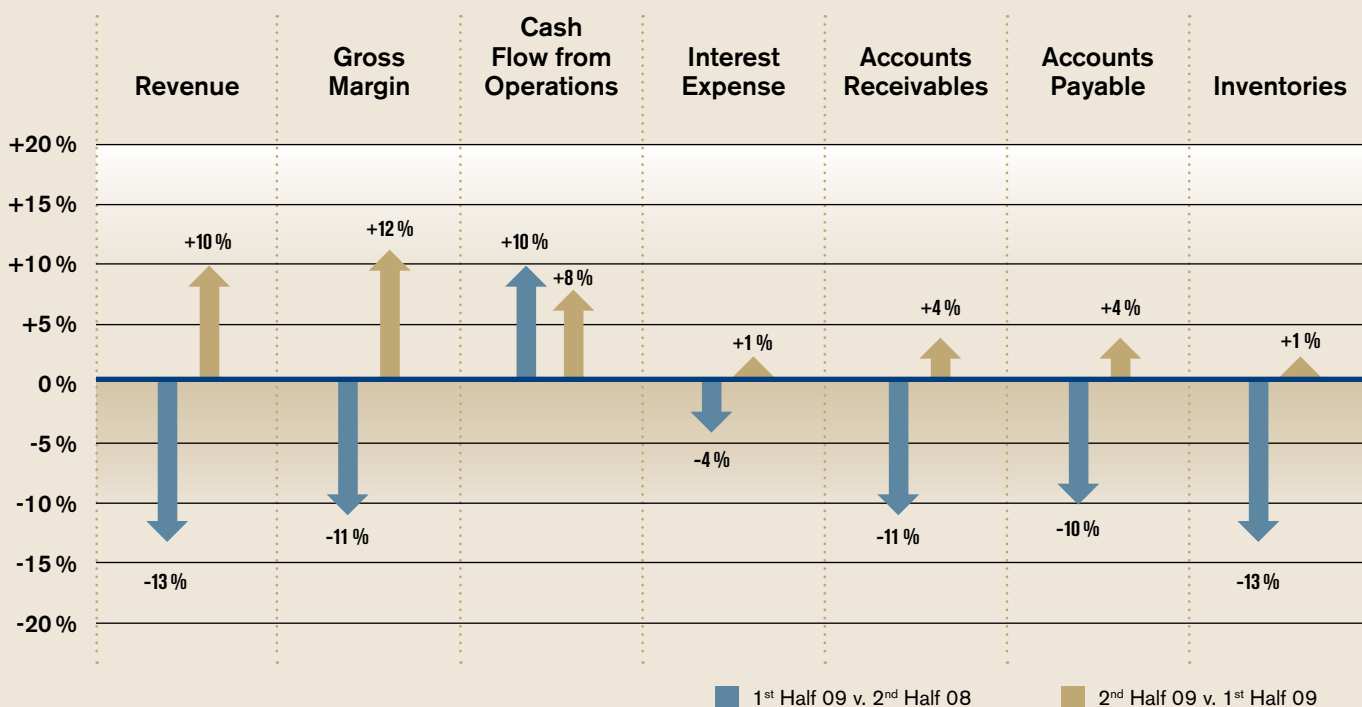
Reduce Indirect Spending

One straightforward way to reduce overhead is to examine indirect spending, which can broadly include most non-inventory purchases, but is typically considered to be related to expenses such as office supplies, telecommunications, utilities and outside services, among others. To reduce indirect spending by 10-15 percent, companies can either pay less for what they buy, or buy less of what they pay for.

Achieving the former includes renegotiating contracts, rationalizing the supplier base to achieve greater volume discounts and / or eliminating unnecessary product

Business Indicator Shifts

(B)



variations. For example, one A&M client saved more than \$1 million annually when it reduced its need for 20 different sizes of plastic shrink wrap to three. In addition, many companies install compliance and reporting mechanisms to ensure that employees take advantage of the savings opportunities and vendors abide by new prices and terms.

Buying less of what a company pays for is often achieved by adjusting service level agreements (SLAs), realigning purchasing authority and spending thresholds, and allocating costs internally based on usage or consumption to motivate more frugal behaviors.

Review Infrastructure, Especially IT

Infrastructure investments, especially in technology, can be a significant source of overhead savings, resulting in greater productivity, improved quality and / or enhanced communications. But over time infrastructure spending tends to gain its own inertia and unnecessary costs creep in.

The first step is a technology asset inventory. There are often surprising discoveries, for instance, when software licenses exceed the number of users or when maintenance is still being paid on retired hardware. In a broader sense, technology investments may no longer be aligned with the company's strategic priorities.

Potential adjustments (and sources of cash) can include consolidating or eliminating redundant or underutilized assets; relocating from high cost to lower cost facilities; discontinuing capital expenditures that no longer match corporate priorities; and creating a technology governance structure to more closely scrutinize future investments.

Optimize Processes

Process optimization goes by many names – redesign, reengineering and transformation – and is often focused on reducing costs in overhead areas such as accounting or human resources. This type of change tends to be more disruptive to the organization than reducing indirect spending or reviewing infrastructure because it typically impacts people and the way they work on a daily basis. However, the ongoing overhead savings can be significant.

At one end of the spectrum, outsourcing an entire business process to a more efficient third-party can save money when the activity is not strategic or when a company has attempted and failed to make improvements. At the other end, keeping all activities in-house can lead to improvements when common process tools are applied, including elimination of non-value added activities, standardization and automation. Whether processes are fully outsourced or optimized internally, most companies establish key performance metrics and regular reviews to be sure that the savings are achieved and maintained.

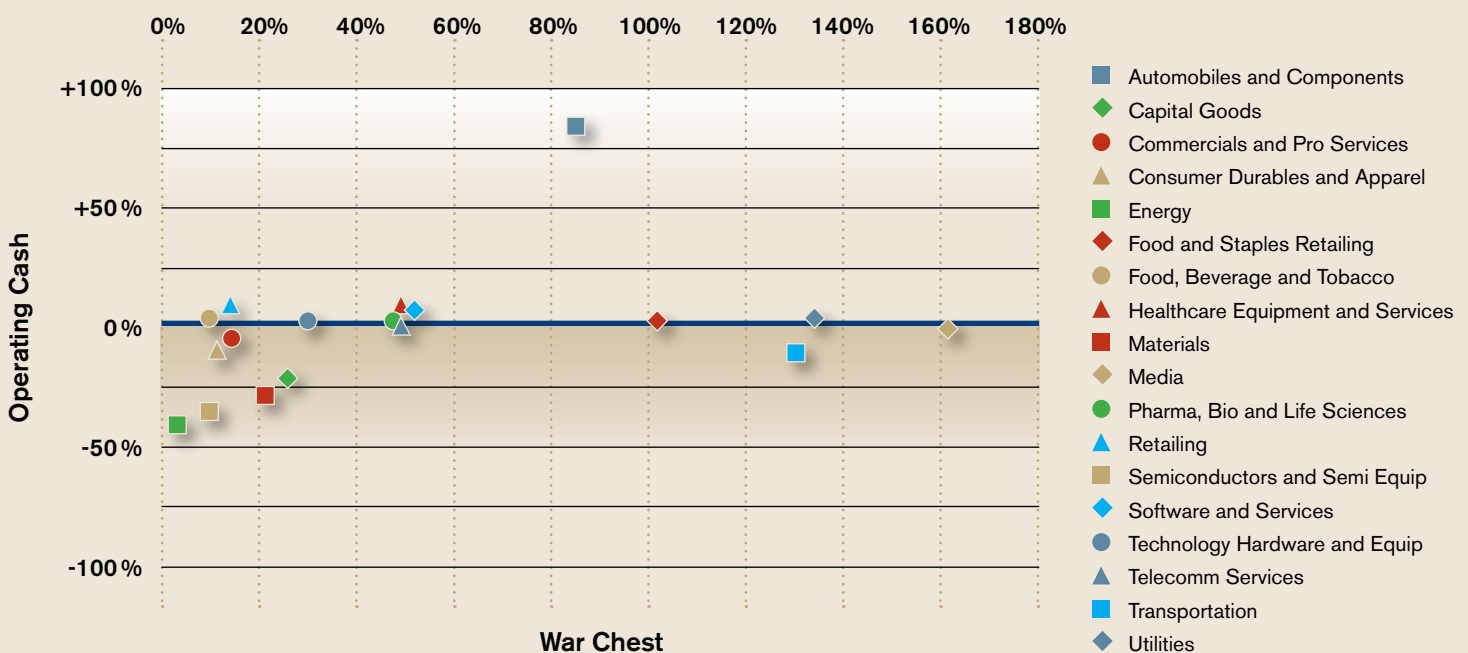
Examine The Organization

Salaries and wages are frequently the largest portion of overhead costs. Reducing headcount is almost always painful, but is frequently a necessary step to conserve limited cash resources. Rather than just performing emergency reductions when a crisis is imminent, some companies evaluate their organizations and make adjustments on a regular basis.

Market Sector Comparison

Operating Cash and Daily War Chest – Percentage Change

(C)



Especially during and after some of the activities in the above sections, it is a good idea to examine the organization critically. Are there more management layers than necessary? Is the average span of control too narrow (i.e., too few employees reporting to each supervisor)? Is the current organizational structure – functional, geographic, matrix – no longer suited to the company’s direction?

Besides the evaluation of headcount numbers, other organizational savings levers include performance management systems, training programs to improve efficiency and pay-for-performance incentives. Up-front investment may be required and must be weighed against the expected savings.

Where You Should Start

Objective, data-based analysis is almost always the best way to identify and reduce unnecessary overhead, but there are some quick ways to identify potential areas of opportunity. Look for:

- Three or more purchase contracts for the same commodity or multiple sources of contact with key suppliers – you may not be taking advantage of your purchasing power.
- Cost areas that have historically or even automatically ratcheted upward when revenue grows, but always remain fixed when revenue falls – cash is often unnecessarily flowing out the door.

- Multiple IT platforms performing the same business function. Are multiple systems really needed? Each one requires ongoing development, maintenance and support – e.g., cash outflow – on an ongoing basis.
- Decentralized support functions – centralizing or outsourcing can be a big project, but may generate big returns and cash savings over time.
- Back office operations that were never integrated after a merger or acquisition – similar to decentralized support functions, there may be savings in standardizing and folding operations together.

Note:

Based on 2009 fiscal fourth quarter results (publically reported in SEC filings), A&M evaluated each company according to two metrics:

- Ability to generate cash (proxy for their “ability to cover their costs”)
- Balance sheet strength (proxy for “ability to meet commitments or obligations”)

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