# TAKING CHARGE: HOW HEALTHCARE COMPANIES CAN USE PRESTRUCTURING TO NAVIGATE ECONOMIC TURBULENCE

In a previous article, we discussed the need for healthcare companies to adjust cost structures and operating models in response to the profound changes brought by the Covid-19 pandemic.

In 2023, a difficult economic climate and industry-specific challenges are making it imperative for businesses to engage – once again – in prestructuring, an approach that involves taking proactive measures to identify and address issues that could lead to financial difficulty.

In this article, we will discuss the current macroeconomic conditions threatening companies' growth prospects and balance sheets, as well as explore the strategic actions available to them in this environment.

## Turbulences Ahead for Healthcare Businesses

Recession fears, labour shortages, supply chain issues and rising operating costs are just some of the multiple headwinds that healthcare & life sciences businesses are having to contend with in 2023.

The current economic climate is punctuated by low growth and high inflation, while the war in Ukraine has heightened geopolitical tensions and uncertainty on top of inflicting widespread economic damage.

Inflation remains high in the UK, with CPI rising to 10.1% in the 12 months to March 2023[1], well above the 2% target set by the Bank of England. Euro area annual inflation was 6.9% in March, down from 8.5% in the previous month as energy pressures eased.

Euro area core inflation, however, which excludes volatile energy and food items, rose to a record of 5.7% in March[2]. Business and consumer confidence indexes have been slumping across the region as a result.

In addition, central banks continue to raise interest rates to fight inflation, making capital to fund businesses' growth more expensive. Recent turmoil in the banking sector is also raising the prospect of a credit crunch that could weaken economic activity even further.

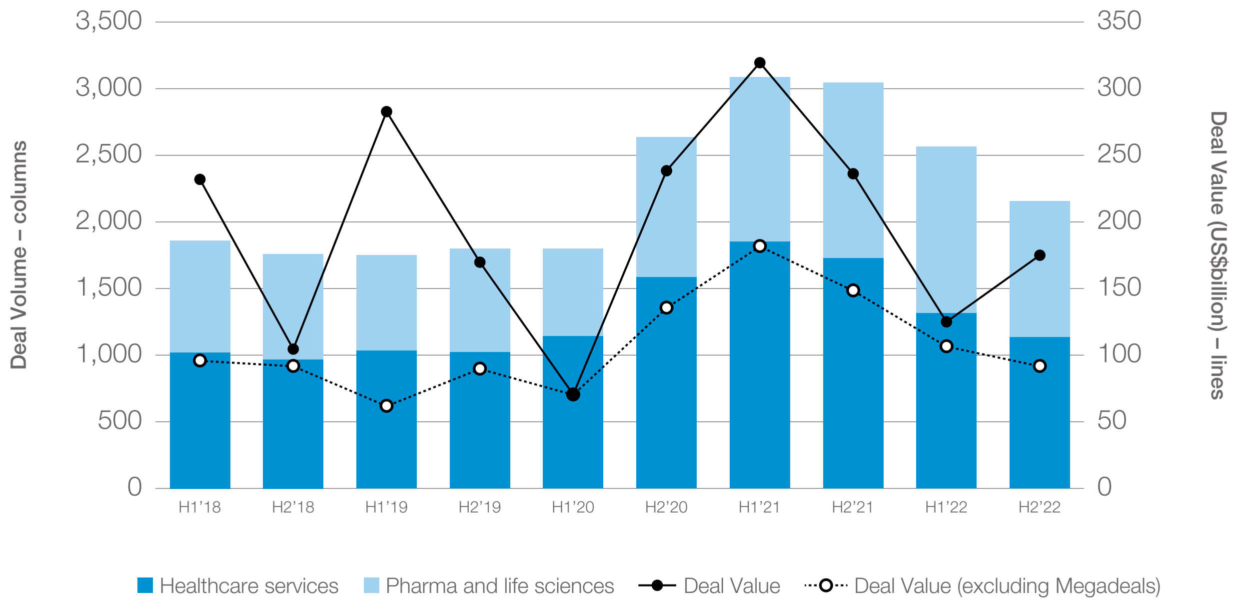
Meanwhile M&A transactions, which fuelled much of the sector's expansion and boosted value creation in recent years, have slowed down since 2022.

The healthcare & life science sector was no exception to that trend. Total deal value last year dropped 46% from a peak of US$554 billion in 2021 to US$229 billion[3], while total deal volumes fell 23%, from 6,104 to 4,703 in total. The significant decline in deal value may reflect businesses deflated valuations currently seen in the market compared to the pandemic years, when healthcare and pharma-focused assets attracted strong demand (and premiums) from investors.

With companies reluctant to accept the reality of lower prices in a dramatically altered environment, many transactions are dying on the vine.

Finally, healthcare & life sciences players are having to deal with other major sectoral trends including rising healthcare costs, greater drug pricing scrutiny, cybersecurity threats and the need to keep up with rapid technology advances and digitalisation.

1 Consumer price inflation, UK - Office for National Statistics
2 https://ec.europa.eu/eurostat/documents/2995521/16324747/2-31032023-AP-EN.pdf/e1ba8561-cfa9-6734-3be3-e0ca47d635b6
3 https://www.pwc.com/gx/en/services/deals/trends/health-industries.html



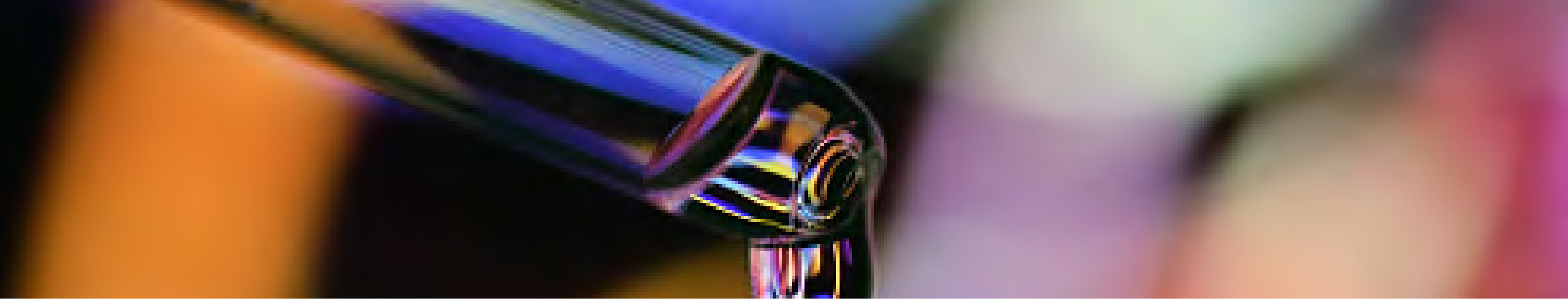

Sources: Refinitiv, Dealogic and PwC analysis

## The case for prestructuring

Prestructuring can be broadly defined as financial and operational measures taken by a company before it faces financial pressures. To head off the turbulences ahead, companies must be able to anticipate early signs of financial distress and implement action changes to rapidly address internal underlying issues. A&M's prestructuring approach aims to provide the framework for that.

Companies that engage in prestructuring can either prevent financial distress from occurring at all, or be better prepared to navigate a potential restructuring if it happens, significantly minimising the impact on the business and its stakeholders.

This proactive approach can not only help business to steady the ship as economic tides turn but also provide healthy companies an opportunity to stand out in the market by accelerating high-return growth investments.



We recommend looking into the following five strategic areas within a prestructuring programme:

## 1 Focusing on cost bases with Zero-Based Budgeting

As economic conditions worsen, companies should put a sharp focus on the cost bases of their businesses. Zero-Based Budgeting (ZBB) is a management framework that involves an extensive review of every expense item in a business' budget from scratch and justifying it. Unlike traditional budgeting, where the previous year's budget is used as a baseline, ZBB requires managers to justify all expenses based on their current needs.

ZBB typically involves five steps:

- Identifying all the activities that your business needs to execute to achieve its objectives.
- Prioritising those activities based on their impact on the business.
- Determining the cost associated with each of those activities.
- Allocating resources in accordance with the cost of each activity.
- Reviewing and approving budgets for every activity and associated cost.

ZBB can be useful in the current scenario as it helps organisations to scrutinize budgets and eliminate inefficiencies. It prioritises the most critical needs and a more efficient allocation of resources, resulting in reduced costs, cash savings and enhanced profitability.

## 2 Improving working capital and cash controls

Companies need to re-examine working capital and cash controls to ensure they hold enough money to meet its liabilities, especially in the current scenario where capital has become expensive following years of ultra-low interest rates. This effort requires initiatives such as:

- Development and maintenance of a robust cash flow forecast.
- Regularly monitoring of receivables and payables to ensure that payments are collected on time and invoices are paid promptly.
- Establishing payment policies that include payment terms and credit limits for customers, payment schedules for vendors, and payment authorisation processes.
- Setting up efficient inventory management systems to ensure that businesses have enough inventory to meet customer demand while minimising the risk of excess inventory. Examples include using just-in-time inventory management and monitoring inventory levels regularly.

## 3 Focusing the operating model on the core

Companies may need to reconsider their strategic plans to respond to current challenges and best position themselves once conditions improve. This begins by identifying the high-value areas of the business and growth initiatives that are likely to produce attractive returns. Businesses must then focus on “doubling-down” on these core strategies, by dedicating greater resources and adjusting the organisational structure to support them.

Simultaneously, leaders must assess what are the low-value areas that are not aligned with the business’ strategy and ambitions. In many cases, this exercise will lead to investments being dialled back or the direct sale of assets that no longer serve its long-term vision.

Several healthcare & life sciences companies are already undergoing strategic shifts given secular megatrends in the sector. Novartis, for example, divested its generics drugs unit Sandoz in 2022 to focus on innovative medicines in five core therapeutic areas. The pharmaceutical company said the spin-off would allow it to maximise value creation by prioritising capital and resource allocation as well as increased management focus on each business’ needs.

This rethinking of business priorities is only likely to accelerate as more companies pursue alternative routes to growth in a tougher economic climate.

## 4 Managing debt in a new era of higher rates

With borrowing costs soaring, managing corporate debt proactively and efficiently has become a matter of survival for many businesses. Ultimately, this means ensuring the business earns enough cash to service their debts – a difficult task in a period when lower growth and other cost pressures are increasingly weighing on profitability.

In the US, the sustainability of some healthcare companies’ debt has come under the spotlight recently. A fifth of the country’s distressed bonds[4] were issued by companies operating in this sector, according to an Ice Data Services index, highlighting the financial pressures they are facing from broader and industry-specific headwinds.

In response to that, businesses should act pre-emptively. They must review covenant headroom under loan documentation to determine whether there is sufficient headroom or if there may be any breaches in the forecast period.

Early engagement with lenders should be a priority. Communicating any anticipated challenges to creditors sooner helps to maintain a healthy relationship and allows early conversations that will reduce uncertainty if a breach occurs. It is prudent to carry out this exercise well in advance of any potential breaches (between nine to 12 months prior). Given the current volatility in markets, providing visibility and transparency is likely to be well received by lenders.

4 https://www.ft.com/content/b0679b82-baf2-495f-8684-8ac8d3d80a0f

In addition, anticipating conversations around refinancing plans helps to de-risk upcoming maturities. This is even more crucial in scenarios where the macro environment is more difficult and/or when business performance is weaker than anticipated. A prudent approach is to start refinancing planning at least 18 months ahead of a maturity.

Undertaking a general review of debt products and suitability will also help to ensure that the business has the optimal capital structure or if other funding structures may be more appropriate going forward (e.g. cash flow- vs. asset-based loans; bank facilities vs. credit funds, public vs. private debt markets).

## 5 Tracking business performance to identify risks in advance

In the midst of growing economic uncertainty, businesses can benefit from implementing robust tracking and monitoring measures to keep oversight of business performance and how specific improvement measures are being implemented. This approach can highlight red flags and pre-empt issues before they materialise.

Some of the recommended actions to enhance performance improvement monitoring include:

- Establishing specific, measurable, achievable, relevant, and time-bound (SMART) goals that are aligned with the business' strategy, communicating them regularly to all employees and reviewing to ensure they are being met to build transparency, accountability and trust.
- Developing sets of key performance indicators (KPIs) that can be tracked and measured over time and use software such as PowerBI and Microsoft Excel to create dashboards and visualisation tools which can provide real-time insights into performance.
- Using the KPIs in management meetings and holding managers accountable for the performance.
- Incubating a culture of continuous improvement through regular feedback sessions, employee recognition programmes and incentives for innovation and creativity. This enables staff to identify areas for improvement and devise quick solutions to problems.

## Case study

In a relevant case, A&M assisted with groupwide turnaround, interim Treasury and CFO support for a leading pan-European IVF clinic network operator which controls 30 centres across six countries, generating over €100 million in revenues.

After merging with a competitor, the company experienced challenges in integrating and turning around underperforming areas of the business, resulting in lower operational performance and profitability, particularly in Germany, Austria, and the Nordic countries. The effects of their underperformance were exacerbated by the outbreak of COVID-19 and the consequent lockdowns enforced by respective governments, requiring the financial support of investors and creditors.

At the outset, A&M supported management in identifying target groups and service offerings as well as reaching out to prospective clients. We supported the CFO, CEO and Treasury team in reviewing and improving the group cash flow forecasting process as well as conducting variance analysis.

Our work also extended to identifying ways to improve the company's working capital with a particular focus on account receivables management, as well as supporting the CEO and operations team in designing and developing a cross-country staffing operating model. A&M monitored the company's net financial position and reported findings to stakeholders at weekly steering committee meetings.

As a result of our assistance, we were able to increase investor and creditor financial visibility, while supporting the reinstatement of key financial control initiatives by management. We developed and implemented a new group cash flow forecasting model and successfully transitioned to staff to incorporate it as a business-as-usual process.

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A&M has worked with some of the largest European and global organisations to stabilise financial performance, transform operations and accelerate results. A&M's Health and Life Sciences team brings decades of experience creating value and driving results for healthcare businesses.

To learn more, reach out to our key contacts **Ray Berglund** and **Diana Wong**.

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With over 7,500 people across five continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, leverage A&M's restructuring heritage to help companies act decisively, catapult growth and accelerate results. We are experienced operators, world-class consultants, former regulators and industry authorities with a shared commitment to telling clients what's really needed for turning change into a strategic business asset, managing risk and unlocking value at every stage of growth.

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