SOUTHEAST ASIA AND AUSTRALIA INSIGHTS

NAVIGATING UNCERTAINTY: AN ECONOMIC DOWNTURN PLAYBOOK

ALVAREZ & MARSAL

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If you can't fly then run,
if you can't run then walk,
if you can't walk then crawl,
but whatever you do you have
to keep moving forward.
Martin Luther King Jr.

Introduction

Global headwinds are a reality today. The infusion of liquidity during the pandemic followed by an unprecedented monetary tightening across the globe to tame inflation has resulted in several businesses going through a topsy-turvy situation. Many of these businesses are owned by private equity players. They are witnessing sudden pause in growth, liquidity crunch and erosion of profitability. If businesses are in the early stage of their lifecycle, they do not have the cushion of accumulated cash and are not profitable at the earnings before interest, taxes, depreciation and amortization (EBITDA) level. Such situations may quickly escalate to stress in the business leading to down rounds, absence of liquidity and bankruptcy.

Here, we attempt to answer the million-dollar question: What can private equity sponsors and management teams do to navigate through the crisis?

We believe there are 10 key "**Downturn Dictums**" that may help businesses navigate through such challenging waters.

The Downturn Dictums: 10 Commandments to Lead Companies Out of a Crisis

01 Cash is King, Queen and the Joker

In times of crisis, liquidity is everything; day-to-day business decisions need to prioritize cash availability over profitability. The company needs to prioritize cash optimization, focusing on decisions that generate positive cash flow and rapid returns within weeks. Working capital levers such as payables, receivables and inventory require significant attention. While private equity sponsors understand the importance of this shift, management teams often struggle to fully grasp and implement it.

For example, bulk buying to achieve a slightly lower purchase cost while accumulating months of slow-moving inventory is not a prudent decision. Similarly, both the supplier payment terms and unit price need to be evaluated to optimize cash flow. Net Present Value (NPV) positive, attractive ideas but with payback of more than three to four months should be deprioritized during a crisis/downturn. Sacrifice EBITDA at the altar of liquidity.

Challenges arise from factors like limited experience in managing cash-strapped operations, inadequate financial orientation of the Chief Executive Officer (CEO) and difficulties in effective analysis. To overcome these obstacles, we recommend establishing a top-priority cash office for our clients. This office will manage cash and carefully evaluate all expenses, taking sole responsibility for monitoring and improving weekly cash flow.

Illustration below represents **The Cash Management Pyramid:**

Cash Management

- Assess short-term cash flow forecasting capabilities (13-week liquidity)
- Identify improvements to cash cycle management and global cash positioning
- Implement stricter internal cash controls

Trade Payables Increase

- Optimize payment runs
- Stop/delay supplier payments
- Early payment discounts

Inventory Reduction

- Liquidate aged and slow-moving finished goods
- Sales and Operation Planning - Align inventory/production
- Reduce safety stock levels

Procurement

- Stop/delay delivery of materials
- Apply stricter purchasing controls
- Rationalize supplier base
- Extend supplier terms
- Assess compliance of invoice terms and payment history

Logistics

- Consignment stock/bonded warehouse review
- Refine make-to-order/make-to-stock

Emergency Triage

- Identify and implement survival actions
- Assess immediate liquidity against payments
- Pause normal operations
- Complete initial situation analysis

Transversal Collaboration Across BU Siloes is Critical in Managing Cash

- Define contract key terms
- Provide Chief Financial Officer visibility on cash outflow forecasts.
- Receive guidance on order timing to optimize cash flow
- Develop spend Delegation of Authority and Compliance

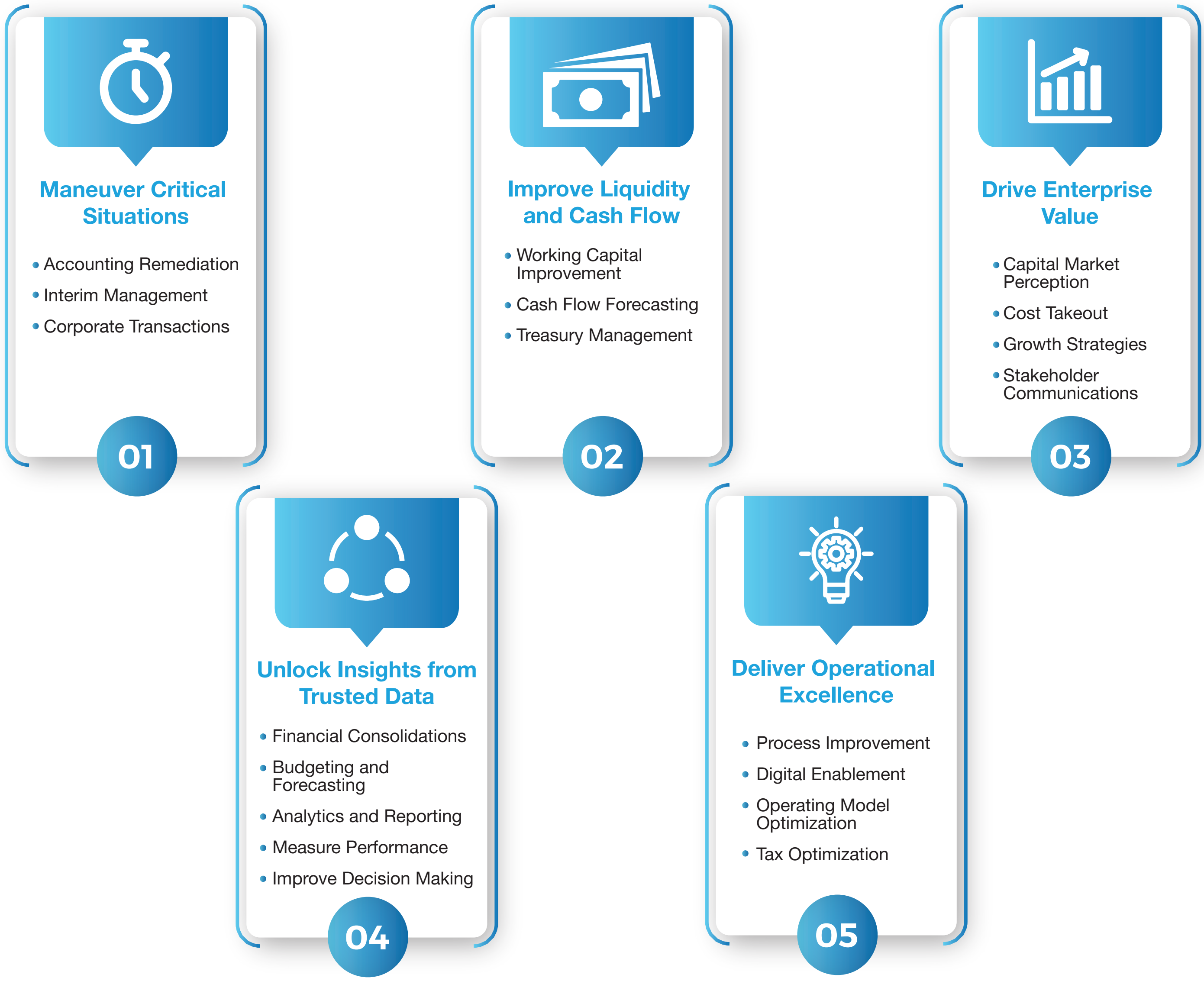
02 Do Not Let a Good Crisis Go to Waste, Be Unconstrained

Crisis is the best time for boldness and unconstrained actions, necessitating a comprehensive examination of the business and the willingness to pivot. Companies should seize this opportunity to engage in what we refer to as "rapid results design" in order to reset and emerge stronger after an economic downturn. This entails making tough decisions such as streamlining the business portfolio, redefining the customer proposition, shifting sales channel focus, optimizing physical locations (stores, offices, manufacturing facilities) and instilling a cost-conscious mindset among employees. While these decisions may be unpopular and challenging to execute during normal times, they can be sustained and beneficial once the downturn is over.

03 An “OK CEO” is okay, an “OK CFO” is not

Amid the turmoil, the Chief Financial Officer (CFO) plays a strong, central role in stablizing the business and positioning it to thrive when conditions improve. After all, the CFO is the leader who most directly contributes to the financial health and organizational resilience of the company. Ensuring a strong, steady leadership from the finance organization will be critical. If required, hire an interim CFO instead of maintaining status quo

Illustration below depicts how A&M interim CFOs are parachuted in to fix broken systems and processes for rapid results, especially during an economic downturn. .



04 Cost Management is the Art of the Possibility

"There is no dignity quite so impressive, and no one independence quite so important as living within your means." - Calvin Coolidge

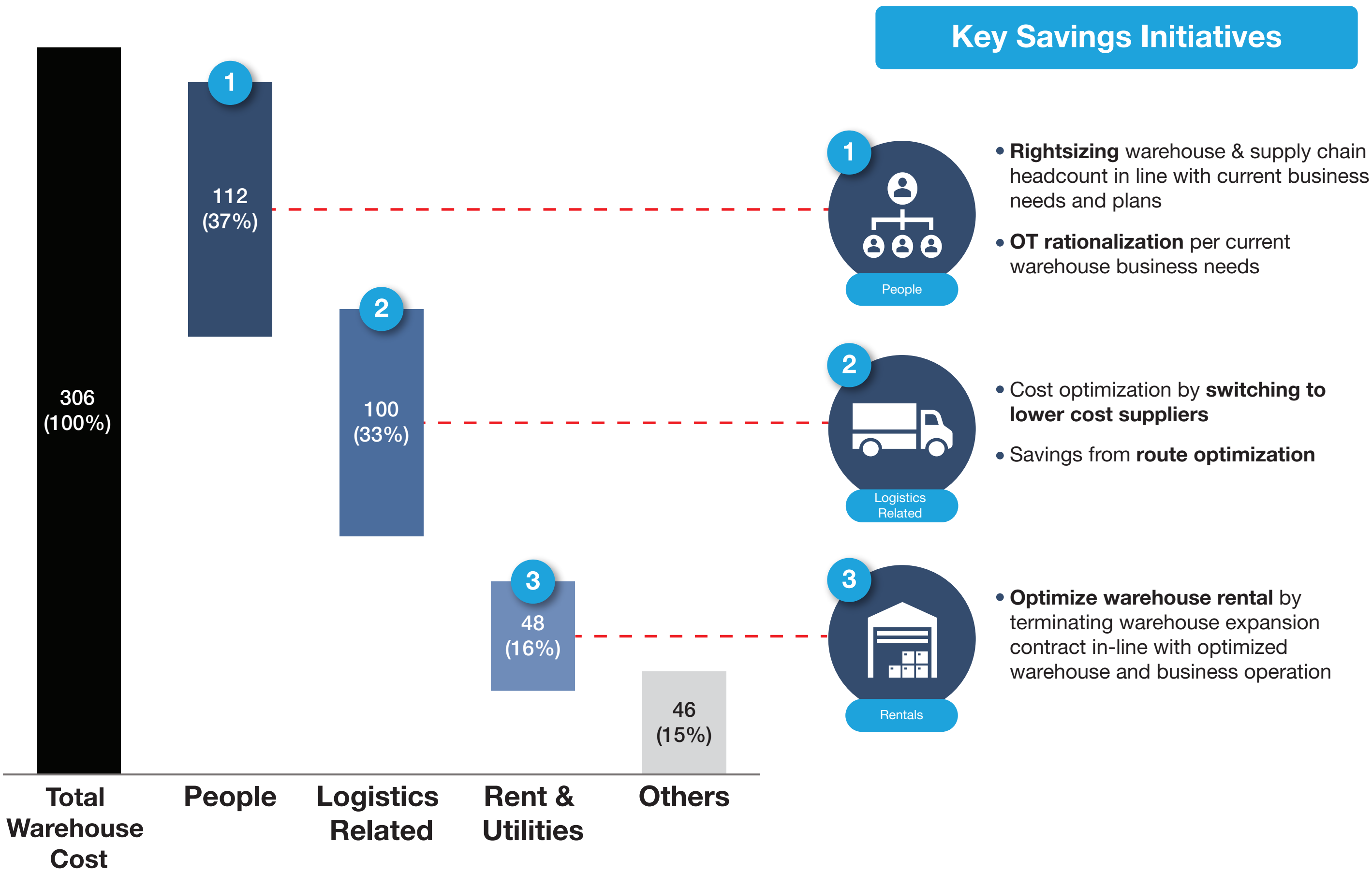
In order to achieve cost excellence, businesses need to adopt a new, out-of-the-box perspective that focuses on determining what is essential to be retained rather than solely on what could be reduced. This approach involves a strategic evaluation of every aspect of the business to identify the core elements and activities that are critical for its success and long-term sustainability.

Adopting a "what is essential to be retained" mindset fosters innovation and creativity in finding alternative solutions. Rather than simply cutting costs indiscriminately, businesses can explore new approaches, technologies and partnerships to streamline processes and optimize resource allocation. This perspective encourages thinking beyond traditional methods and encourages the exploration of unconventional ideas to achieve cost excellence while preserving critical capabilities. Of course every cost element should get defined from a 'zero-based budgeting' mindset and approach rather than inflationary increase over historical budget and/or trend.

Illustration below depicts a few real-life examples of what organizations focused on and how they achieved breakthrough success.

Variablization of Manpower (Distribution/Store)

1.8M USD (15 per cent) of saving has been incorporated through warehouse cost saving Initiatives



Headcount Rationalization – hard calls to rationalize under-productive business units

Headcount Reduction Plan with key milestones

Implementation Plan

Completed: 31 Aug

Completed: Mid Aug
- Analyze/Review Contract Clause and Details
- Define Redundancy Package

- Conduct Dept Townhalls (relevant dept)

Completed: 5 - 6 Sep
- Submit Redeployment Proposal to Labor Authority
- Align with Trade Union
- Prepare Mutual Agreement Document
- Briefing Session with HRBP, TR and HOD

Completed: 7 - 30 Sep
- 1 on 1 discussion with impacted personnel
- Formal agreement & handover with agreed cases
- Retail team on track to complete by 7 Oct

By mid-Nov
- End-Oct: formal agreement & handover for remaining cases (senior personnel)
- Mid-Nov: completion targeted for final batch from Property team (delayed due to ongoing store closure work)

Ongoing – end-Dec
- Retail team on track to complete by 7 Oct

Strategy Overview		
Strategy Overview Distinct approaches to manage Voluntary Resignation / Contract Non-renewal & Redundancy cases	**Voluntary Resignations**	• All Voluntary Resignation cases (except for in retention list) • Contract Non-renewal for ~10% Bottom Performers • Employment termination date as per resignation / contract expiry
	Redundancy	• Opportunity (34.8 Bn) assessed based on business needs and aligned with function lead /HR • Total Redundancy Package (3.4 Bn) • Alignment with Authority and Trade Union, followed by 1 on 1 Discussion for each case • Employment termination date as per case negotiation date • Phased implementation aligned with ongoing transformation / BAU business requirements

05 Lenders, Bankers and Financers Are Your Best Friends

"Don't make friends who are comfortable to be with. Make friends who will force you to lever yourself up." - Thomas J Watson

During an economic downturn, it is critical to maintain financially agility, protect funding and/or credit lines and have sufficient liquidity. Banking relationships are paramount. Banks are much more than just a checking account with money in it. Companies need creditors who will not suddenly stop and/or reduce credit lines, overdraft facilities, etc. Ensure proactive messaging and transparency with such partners, even timely communication of bad news. Be willing to listen to suggestions on cost control and frugality as they are delivered in the best interest of the business. Of course, do not hesitate to defer the implementation of a state-of-the-art automation system, which becomes a significant item on the balance sheet with an anticipated payback of more than five years.

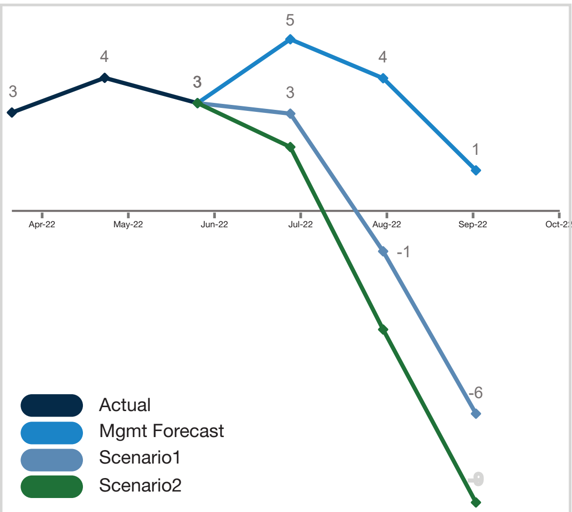
06 Planning is Dead, Long Live Planning

In challenging situations such as an economic downturn, long-term plans lose significance. Instead, the focus should be on short-term planning, including quarterly, monthly and weekly evaluations. Flexibility and adaptability are crucial, necessitating the creation of multiple scenarios and understanding the associated trade-offs. This includes modeling worst of the worst-case scenarios to prepare for any potential risks that could impact the business. To proactively manage the business, we recommend our clients establish a well-defined 26-52 week rolling financial forecast with prudent business assumptions. Additionally, implementing rolling 13-week cash flow forecasts will enhance proactive management and decision-making.

Illustration a) and b) below depict snapshots from actual management presentations from a mid-sized private equity-owned client. The scale and magnitude of volatility in Illustration a) is noteworthy.

Annual planning losing relevance due to volatility; monthly / quarterly planning is key

Free cash balance projections – divergent views over six months horizon between management forecasts and bottom-up projections



a)

Businesses require great agility to align to different scenarios that may play out

Trade offs involved between permanently decommissioning assets (store closure) vis-à-vis temporary pause; former beneficial in immediate term but compromises future potential

Dec'22 - Mar'23

	Cash impact (USD)	EBITDA/CM3 impact (USD)
Management forecast	X m	Y m
Scenario 1: Pause outlets (incorporated in base plan)	X m	Y m
Scenario 2: Close additional outlets	X m	Y m

b)

07 Build Resilience for the Worst

“If You're Going Through Hell, Keep Going” - Winston Churchill

In times of uncertainty, “survival” ought to be the most practiced strategy so that businesses live to see the light of market recovery. Hence, building resilience in planning and strategy to survive the worst of the worst-case scenario is critical and such strategy needs backup plans as well. Thoroughly examine all conceivable downside risks and challenges, including market downturns, supply chain disruptions, decreased consumer spending and regulatory changes, to identify vulnerabilities, develop contingency plans, and make informed decisions. If the call-to-action is to scale down operations, concede some market share to conserve cash. Private equity funds, board members and management teams should have the necessary courage and conviction to follow through and implement in order to ensure survival through difficult periods.

Illustration below depicts a snapshot of a worst of the worst-case scenario.

Currency: $USD M	Realistic	Conservative	Worst-Case
Gross Sales TTS + SD[1]	150 (50)	135 90 percent of Net Sales (45)	120 80 percent of Net Sales (40)
Net Sales	**100**	**90**	**80**
COGS (RM + PM + MOE[2]) Primary Logistic	(60) (10)	(60) (10)	(55) (10)
Gross Margin	**30**	**20** ~33 percent drop	**15** ~50 percent drop
Advertising & Promotion, Other Selling Expenses Corporate, General, and Administrative Overhead	(10) (10) (5)	(9) (10) (5)	(8) (10) (5)
Total (Sales, General and Administrative Expenses)	**25**	**24**	**23**
EBITDA	**5**	**(4)**	**(8)**
EBITDA percentage	(3.3 percentage)	(3.0 percentage)	(6.7 percentage)

If a business is resilient enough to survive ‘worst case’ scenario on Excel; it is more likely to survive in real life

08 Focus on Metrics that Matter

During an economic downturn, businesses must prioritize identifying and reorienting their management key performance indicators (KPIs) and dashboards towards balance sheet and cash preservation metrics to ensure business sustenance. Shifting the focus towards metrics such as liquidity ratios, working capital management and cash flow forecasts allow companies to comprehensively assess their financial health and make informed decisions to optimize cash flow and sustain operations. By closely monitoring indicators like cash conversion cycles, cash burn rates and inventory management, businesses can proactively manage resources, implement cost control measures and effectively navigate through challenging economic conditions. This strategic shift in focus not only demonstrates the company's commitment to financial stability but also instills confidence in stakeholders about its ability to weather an economic downturn and emerge stronger.

09 Maker vs. Checker

In order to have success with rapid execution, fail fast, learn and repeat; a robust maker-checker mechanism is imperative. This ensures the downside risks of rapid execution are adequately factored in and mitigated.

During an economic downturn, it becomes crucial for businesses to establish integrated review and reporting protocols to enhance compliance, governance and address any transparency issues that may arise. By implementing robust review and reporting mechanisms, companies can ensure adherence to regulatory requirements, maintain transparency and strengthen overall governance practices. Integrated review and reporting protocols involve comprehensive assessments of internal processes, financial statements and operational procedures to identify areas of non-compliance or potential transparency gaps. This includes regular audits, risk assessment and internal control evaluations to detect and rectify deviations from established standards.

10 Ideas Are Easy, Execution Is Everything

"A good plan, violently executed now is better than a perfect plan tomorrow."
- General George Patton

Procrastination is often the biggest enemy of progress. Several times, especially during a crisis or an economic downturn, management teams fail to act timely as they are in pursuit of a perfect plan. Delay in execution more often than not worsens the situation. It is important to cultivate the Execution DNA in management teams through processes, governance and, most importantly, an environment of trust and faith where people have the confidence to execute without a fear of failure.

Conclusion

Times are tough but as the saying goes, “when the going gets tough, the tough get going”. The current slowdown offers enough opportunities to fundamentally transform business models to not only survive but also thrive in future. All it takes is initiative, courage and unwavering commitment to follow the **Downturn Dictums.**

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