RESTRUCTURING

Why Jack Welch Was Right: The Enduring Power of Fix, Sell, Close to Maximise Portfolio Value

In 1981, shortly after Jack Welch became CEO of General Electric (GE), he issued a now-famous directive: Each of the company's business units had to be number one or two in their markets; if not, they'd have to fix, sell or close it.

This strategy led to extensive divisional restructuring and M&A activity at GE in the subsequent years. Managers at the firm were compelled to constantly assess their business units, making tough decisions to align with Welch's directive. The approach proved highly successful in its early years, with GE's revenues rising from around $27 billion in 1981 to nearly $55 billion by 1990 amid a dramatic change in its product and revenue mix[1].

The Fix, Sell, Close approach was thus popularised as a turnaround method, one that remains as relevant today as it was then. Yet, in our opinion, it is still underutilised.

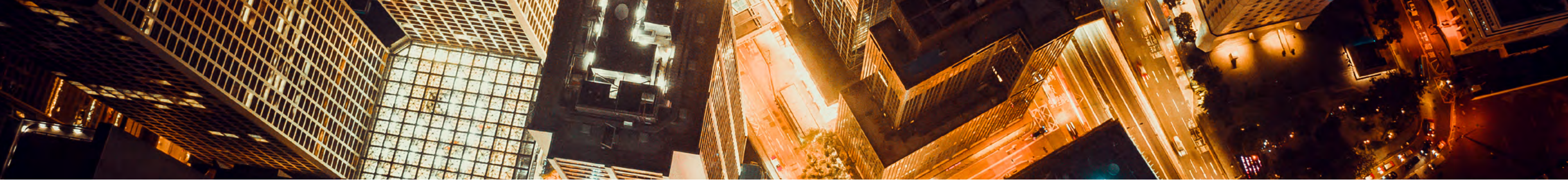
This option analysis – which can typically be completed within four to six weeks – empowers management and stakeholders to quickly and objectively evaluate relative performance, identify available options and choose the best course of action for underperforming assets. By doing so, it unlocks greater value across a wider group or portfolio.

In this two-part series, we discuss why an objective Fix, Sell, Close assessment is a powerful strategy for businesses and investors looking to use their capital more effectively, and outline the benefits and potential scenarios for each option.

This first article focuses on the A&M approach to Fix, Sell, Close solutions, with a detailed examination of the "sell" route.

"The Fix, Sell, Close approach empowers businesses to swiftly evaluate underperforming assets, unlock greater value, and deploy capital more effectively."

1 https://www.annualreports.co.uk/HostedData/AnnualReportArchive/g/NYSE_GE_1999.pdf



Fix, Sell, Close today

In the current climate of growing geopolitical and economic turbulence, we have observed a surge in companies and financial stakeholders proactively seeking a Fix, Sell, Close assessment to optimise their capital allocation and regain focus on core, value-generative activities. This trend is driven by several forces:

Increased cost of capital: rising interest rates[2] in recent years have pushed up the cost of capital for companies, intensifying their focus on profitability and internally generated cash flow. In this environment, businesses and their financial stakeholders can no longer afford to absorb any underperformance and wish to focus resources on value-accretive activities.

Rising distress: heavily indebted companies are struggling to repay their debt in a higher-for-longer rates environment, with global leveraged loan defaults climbing to 7.2% in the 12 months to October, according to Moody's, the highest since the end of 2020[3]. Amid growing stress and distress, firms and stakeholders are eager to understand the options available to them, whether it's right sizing the business or its operations, or undergoing a full-blown restructuring.

New ownership requirements: private credit funds are increasingly accustomed to taking the keys of companies they financed, as higher interest payments and a worsening economic climate take a toll on borrowers[4]. This change in control is typically followed by a strategic review, with the new owners demanding a business plan that outlines a clear roadmap to value creation, and the exit of cash-consuming activities.

Exit incentives: managers at private credit and private equity funds may feel incentivised to close or sell poor-performing businesses to accelerate payment of carried interest on their investments. The realisation of such incentive fees may have been delayed due to a slowdown in exits, so many general partners may view a "sell or close" solution as a faster and more straightforward form to secure liquidity, rather than waiting for a full turnaround of the business to materialise.

Pressure on performance: corporate performance and balance sheets have been materially impacted by persistent inflation, a softer demand environment (in certain industries), higher interest rates and continuous supply chain and geopolitical challenges. Some companies have also experienced uneven performance across different business divisions and regions due to the macroeconomic challenges. This is compelling boards and shareholders to reassess their strategic and financial positions.

Rising shareholder activism: continuing low valuations in Europe, particularly in the U.K., alongside international trade challenges that are likely to create corporate winners and losers, are attracting the attention of activist investors from across the globe[5]. Activists challenge corporates to use their capital more effectively, often driving calls for portfolio reviews that result in divestments and operational restructurings.

Market opportunities: In the current environment, shaped by the challenges mentioned above, opportunities arise from "sell or close" decisions in complementary businesses. Seizing these opportunities requires a robust balance sheet and financial profile. As such, "grasping the nettle" of underperformance via a Fix, Sell, Close process places businesses in a stronger position to capitalise on market opportunities.

2 https://www.bankofengland.co.uk/boeapps/database/Bank-Rate.asp
3 https://www.ft.com/content/e6ba508c-4612-4b4a-9a6b-ecde6fc91c12
4 https://www.bloomberg.com/news/articles/2023-08-10/private-lenders-take-control-of-more-companies-as-rates-surge
5 https://www.alvarezandmarsal.com/insights/am-activist-alert

What do I do with my asset?

Solution	Options	Initiatives
Fix	■ Performance improvement ■ Liquidity/working capital management ■ Business portfolio review	■ Cost-out and cost variabilisation ■ Workforce planning ■ Supply chain optimisation ■ Commercial excellence ■ TOM design and implementation ■ Digital optimisation, strategy and transformation ■ Project management and execution focus
Sell	■ Solvent sale ■ Solvent sale to a special situations buyer ■ Insolvent sale to strategic or special situations buyer	■ M&A and carve-out planning and execution ■ M&A and carve-out due diligence ■ Capital raising ■ Accelerated M&A and fundraising ■ Contingency planning for an insolvency sale
Close	■ Solvent wind-down ■ Insolvent wind-down	■ Wind-down plan preparation ■ Asset sale preparation ■ Management of liabilities and risks ■ Contingency planning for an insolvency

In each of the options noted above, it is important to assess the impacts on:

i) Group financial performance, cash flow and associated timing

ii) Cost of implementation

iii) Reputational and regulatory impacts

iii) Group strategy and customer delivery.

By performing an assessment of different options, leverage is given to discussions that may be associated with alternative options, with the close decision providing an important understanding of the “backstop” financial position.

Part 1: The "sell" route

In the context of a Fix, Sell, Close assessment, a "sell" decision is deemed necessary when:

- It is economically more beneficial than a close or a fix.
- It is more efficient in terms of management time, meaning the problem goes away faster and the leadership team has more time to focus on the profitable, cash-generative or strategic parts of the business.
- From a corporate reputation perspective, selling may be preferable to a prolonged fix or closure, which often involves difficult actions such as layoffs and plant closures.
- The division or business in question no longer fits with the overall direction or strategy of the broader group. This lack of "portfolio fit" means the business would be better served under new ownership.

A sale may refer to the overall company, a specific division, product line or geography region, and can occur in several forms:

Solvent "good book" sale: this involves selling a performing but non-strategic asset to a strategic buyer or financial investor focused on growth or profit. From the seller perspective, the disposal aims to release capital and redeploy it to generate better return on investment (ROI), while freeing up management time to focus on growing the core business/es. To maximise value, these deals are carried out as standard M&A processes over a period of six to nine months.

Solvent sale to a special situations buyer: this type of sale is often directed toward special situations buyers, who are dedicated private equity-style funds familiar with acquiring assets facing financial and operational issues. These transactions are typically run as standard M&A processes with specific input from special situations advisers to provide access to this specialist buyer community. Additionally, mainstream private equity investors focused on inorganic growth in portfolio companies are increasingly considering these assets to utilise fund dry powder. The advantage of this approach is speed, while the downside is the often-lower value achieved (yet with certainty of funding that supports wider liquidity planning).

Insolvent sale: consists in selling an asset to a strategic buyer or a special situations investor and is usually handled by an insolvency practitioner (IP) or a special situations M&A advisor working alongside an IP. Such sales tend to yield minimal value, but can be executed quickly, helping the seller avoid further liabilities or restructuring costs in an insolvency context.

In all circumstances, it is helpful to sell the business (where it is underperforming) with an understanding of the "backstop" net cash flow/value position that would be achievable on a solvent wind down. Often this provides the minimum acceptable valuation of the entity. It may be that if a business is cash flow negative, the best approach is to sell the business with a dowry, where this represents a lower or equal cost to closing the business (or provides the requisite financial certainty).

If a business cannot be fixed or sold, for a lack of buyer appetite or because of difficult market conditions, the next option is closure – either solvently or insolvently. Critical to the Fix, Sell, Close workstream is to progress all options in parallel, so that if a sale fails, the close process has been progressed and can be executed rapidly without further value loss. In the next article, we will look into when a closure is recommended and its key features.

"Sell" case study: FGP Group sale to Rcapital

Situation

A U.K.-headquartered precision engineering company specialising in the aerospace and defence sectors faced a critical financial challenge. The loss of a key contract triggered the withdrawal of its working capital banking facilities, leaving the business with an urgent funding requirement and a cash runway of just two weeks.

A&M approach

With a highly compressed timeline to secure a solution, the company engaged A&M to execute an accelerated M&A process. In a two-week period, A&M conducted a targeted marketing process and facilitated multiple solvent offers for the business. Rcapital, a special situations investor with a significant portfolio in the aerospace industry, was subsequently identified as the preferred bidder. As the transaction required approval under the National Security and Investments Act (2021), A&M worked with the company and bidder to structure a tailored debt funding solution, supporting cash flow during the NSIA approval process and through to the completion of the solvent equity transaction.

Outcome

The process successfully delivered a solvent sale of the business, ensuring the transfer of all employees to the combined group. This outcome avoided the severe consequences of an insolvent sale, which would have terminated key contractual relationships and reduced value. A cost-out "fix" solution to right size the business was deemed unfeasible due to time constraints and the risk it posed to the delivery of critical contracts. Instead, the consolidation with an industry operator, supported by funding from a specialist capital provider, allowed the combined group to realise significant operational and financial synergies.

The A&M approach to Fix, Sell, Close analysis

A&M's Financial & Operational Restructuring practice offers a dedicated and focused Fix, Sell, Close service, delivered by a team of professionals with deep expertise in operational restructuring, corporate finance and insolvency situations. Our approach combines operational and financial acumen with a sharp focus on liquidity, while using specialist insights from A&M's multidisciplinary capabilities including performance improvement, transaction advisory, debt advisory, digital, tax and more.

This holistic, cross-functional strategy makes us uniquely positioned to provide clients – both corporates and investors – with a full option analysis and a clear, actionable implementation plan including, where required, interim management and stakeholder management capabilities.

Our hands-on spirit and deep-rooted heritage in restructuring and turnaround mean we understand the urgency our clients face and the critical importance of effective stakeholder management for a successful outcome.

Oftentimes, clients will have an intractable problem that is diverting too much management time from value-additive activities. Allocating a project team – whether internal or advisory – is an essential way to allow management to focus on the go-forward business while ensuring solutions for underperformance are at hand and being executed, and neutralising cash outflows or liquidity drags.

A&M's Fix, Sell, Close offering includes a comprehensive range of services through the following practices:

- Operational turnaround, solvent wind-down: Financial & Operational Restructuring team
- Solvent sale: Corporate Finance team
- Special Situations sale: Special Situations M&A team
- Insolvent close: Insolvency team.

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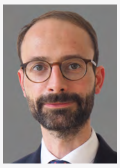

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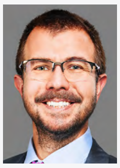

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ABOUT ALVAREZ & MARSAL

Founded in 1983, Alvarez & Marsal is a leading global professional services firm. Renowned for its leadership, action and results, Alvarez & Marsal provides advisory, business performance improvement and turnaround management services, delivering practical solutions to address clients' unique challenges. With a world-wide network of experienced operators, world-class consultants, former regulators and industry authorities, Alvarez & Marsal helps corporates, boards, private equity firms, law firms and government agencies drive transformation, mitigate risk and unlock value at every stage of growth.

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