A&M INSIGHTS

COVID 19 – Pivot to Recovery

How should liquidity be managed as companies seek to emerge from COVID-19?

The transition from lockdown will result in a new set of significant liquidity risks. How should management teams address these risks as recovery plans are developed?

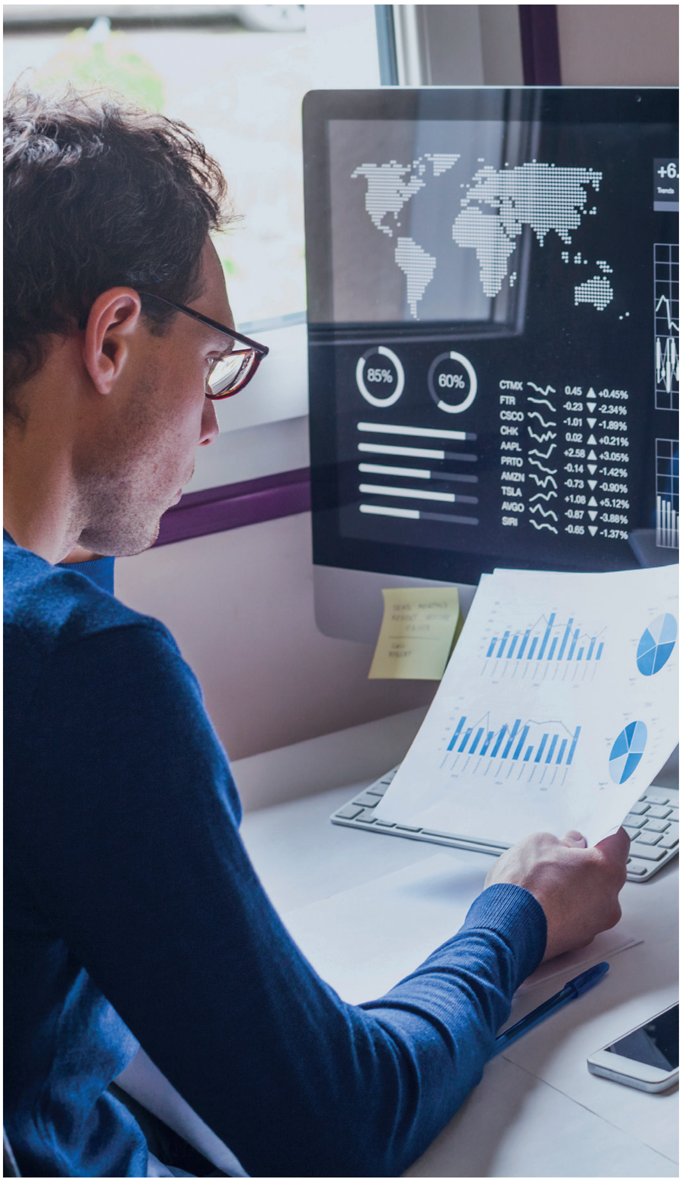
As businesses Pivot to Recovery™, a new set of liquidity risks will come into play as operations re-start. As part of their recovery planning, management teams must keep their foot on the pedal in maintaining cash visibility and control.

Aside from the well-being of employees, many businesses were forced to Pivot to Cash™ to ensure survival through the COVID-19 crisis, rightly maintaining management and visibility of liquidity as the highest business priorities.

As lockdown measures are relaxed across geographies, attention will shift to recovery. It is essential that boards and management teams maintain visibility of liquidity as they develop recovery plans.

Risks remain significant and may increase as new liquidity challenges present themselves during lockdown transition. These must be managed closely to ensure that a lack of liquidity doesn't hinder the path to recovery.

In this document, we describe the current liquidity environment, the key risks that it presents and finally A&M's 5-step approach to liquidity management that we recommend to management teams as they develop transition plans.



A Highly Abnormal Liquidity Environment is Driving Post-Lockdown Risk

Though precise risks will differ significantly by geography and industry, the current environment has driven highly abnormal liquidity profiles, characterised by:

- Government support in the forms of employee support schemes, loan funding and tax payment deferrals
- Trading performance up to 100% below budgetary and business plan levels in certain periods and significant interruption to supply
- Highly irregular working capital profiles:
  - Stretched payables
  - Reduced trading prepayments and impaired rebate provisions
  - Increased days sales outstanding
  - Obsolete or excess inventory
- Deferred investment plans.

What risk factors are driving liquidity risk on lockdown exit?

Exiting lockdown and materially re-starting operations will present concurrent liquidity challenges

The "new normal" is not known

Re-start demand levels are highly uncertain, and the core customer may have changed. The shape of recovery is not known and will be subject to factors out of management's control (e.g. distancing legislation). Flexibility is required in the event of any further lockdowns. The business mix may change, impacting cash as well as margin where differing terms of business exist (e.g. lead times, payment terms and minimum order quantities).

Large working capital shifts are likely

Suppliers that have been stretched may need short-term paydown to ensure supply, investment in re-start inventories are likely and opportunities to realise faster and larger customer collections may transpire. Further, working capital may be adversely impacted by permanent changes, particularly where some suppliers have moved to cash on delivery.

Government support schemes will lapse

Cash outflows will increase for employees returning from furlough or where employee support funding is reduced or ceases. Deferred tax payments will become due and repayment of government loans will need to be planned for.

One-off costs could drive significant cash outflows

Furloughed employees whose roles become redundant plus any other one-off costs associated with wider transformation plans will drive short term and lumpy cash outflows.

Short term investments may be required

Such investments may arise to allow safe return to work on premises/efficient medium-term home working. This will need to be considered alongside the re-instatement of investments that are fundamental to the medium term success of the business.

Funding conditions are weak

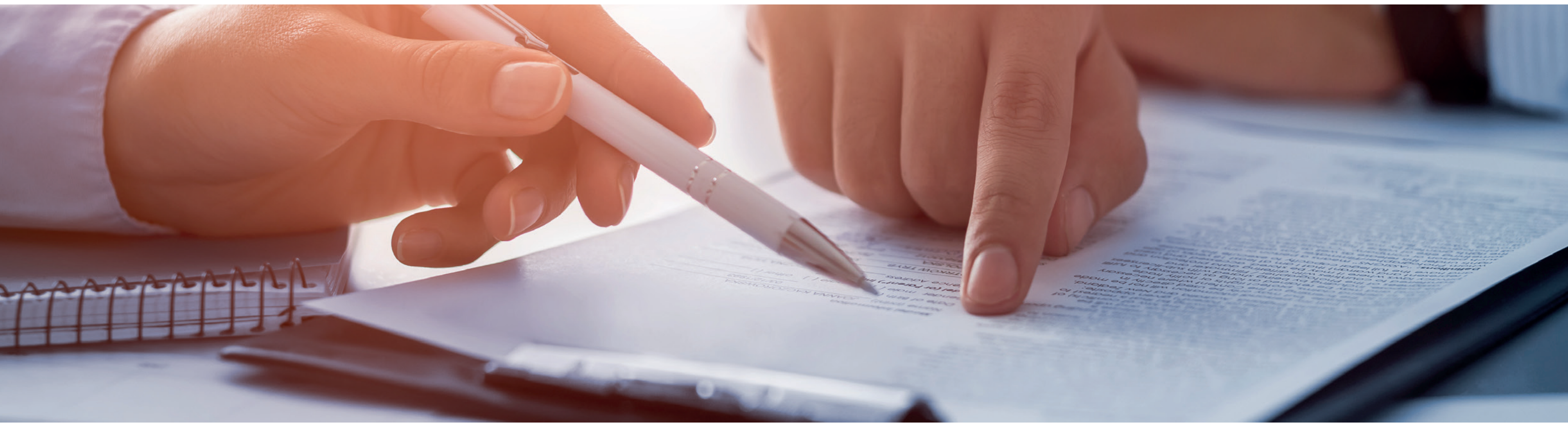
Businesses cannot rely on liquidity risks being covered by accessing third party capital – self-funding operations should be a starting assumption.

These 6 challenges drive the possibility of significant short-term cash outflows. Together with highly uncertain trading conditions, a material and unprecedented liquidity risk arises that management teams must meet head on in their transition plans.

A&M Recommends a 5-step Action Plan to Address Transition Liquidity Risks

We recommend 5 key actions that management teams should take to manage transition risk:

1 Maintain close visibility of cash flows	Maintain a 13-26 week cash flow forecast and compare actual results on a timely basis. Integrate sales and operations planning into cash forecasting to ensure coordinated and up-to-date demand, purchasing and working capital assumptions.
2 Perform a 360 review of liquidity	Perform a holistic review of all liquidity risks and elements, including a deep dive into: actual results, balance sheet accounts that provision for cash movements (e.g. legal provisions, rebate provisions, bad debt review and inventory analysis) and key customer and supplier risk reviews. Incorporate conclusions into the 13-26 week cash flow forecast.
3 Plan re-start liquidity scenarios	The “new normal” is not known. Scenario planning is required to understand a reasonable range of liquidity outcomes taking into account demand planning, updated cost structure and working capital assumptions based on a ramp up of supply chain, production and inventory levels. Crucially, sustainable operational plans must be developed to address alternative scenarios with appropriate flexibility maintained to ensure deliverability.
4 Ensure that key decisions still reference liquidity	Ensure the wider business understands ongoing liquidity risk and the parameters to new business are understood (for instance, are working capital investments affordable?).
5 Work in partnership with key customers and suppliers	Prioritise customers and suppliers that will drive cash and profitability post-crisis as well as providing ongoing flexibility. Place appropriate focus on customers and suppliers that firstly, will partner and plan around demand, inventory and cash risk; and secondly, are most agile to changing demand landscape (e.g. suppliers that can most quickly respond to changing customer demand).



How can A&M help?

A&M has worked with some of the largest European and global organisations to stabilise financial performance, transform operations, catapult growth and accelerate results through decisive action. When traditional improvement activities are not enough, A&M's restructuring and turnaround heritage brings fact-based, action-oriented leadership to transformation and delivers rapid results.

Our professionals have both operations and advisory experience together with a proven track record in leading businesses through tough, complex situations, often characterised by tight liquidity environments. They have deep expertise in cash forecasting and management, working closely with company management teams and boards of directors as they address their liquidity constraints. To learn more about our expertise and to understand the full scope of our work please get in touch with one of our key contacts.

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ABOUT ALVAREZ & MARSAL

Companies, investors and government entities around the world turn to Alvarez & Marsal (A&M) when conventional approaches are not enough to make change and achieve results. Privately held since its founding in 1983, A&M is a leading global professional services firm that provides advisory, business performance improvement and turnaround management services.

With over 4500 people across four 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, help organizations transform operations, catapult growth and accelerate results through decisive action. Comprised of experienced operators, world-class consultants, former regulators and industry authorities, A&M leverages its restructuring heritage to turn change into a strategic business asset, manage risk and unlock value at every stage of growth.

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