A&M INSIGHTS

Pivot to Recovery™

A business planning approach to manage the transition to a post-COVID environment

Background

COVID-19 has had a significant impact on business globally and has forced many companies to adopt crisis management techniques in order to survive in the short-to medium-term. Whilst the outlook is still uncertain for many businesses, restrictions are continuing to ease, and focus will now turn to reassessing business plans and reducing risk to capital structures.

What has become clear to us is that most pre-COVID-19 business plans and budgets are now obsolete and company Boards of directors and management teams are reassessing their corporate strategy, corporate structures and capital structure accordingly.

As a natural part of this reassessment, business plans will need to be updated to reflect new realities and strategies to drive effective management decisions. New plans will be the anchor point for companies discussing future requirements with customers, suppliers, finance providers and governments.

Pivot to Recovery™ is a term that A&M has adopted with our clients to describe the step change and associated processes required to manage and exit the crisis COVID-19 has created.

In this insights piece we set out the staged approach that the senior leadership team and Boards of companies should take to prepare a business plan to meet the challenges posed by the transition to a post-COVID-19 environment and address the needs of financial stakeholders. Activity is likely to fall into two workstreams:

1. Preparing the business plan; and
2. Addressing capital structure requirements and working with financial stakeholders.

Pivot to Recovery™ – Business plan preparation

1. Assess where you are today. Consider the impact that COVID-19 has had on trading and supply chains, the effects that COVID-19 has also had on the balance sheet (whether balances have unwound, or not) and what impact the timing and cessation of government support packages will have across the business.
2. Know your risks and operational responses now. The current environment is highly uncertain. A credible range of risk scenarios should be identified (including the risk of a second lockdown period). Crucially, commercial and operational responses to such risks must be thought through as part of the plan.
3. Ask the tough questions. What operations/services and products will generate cash and profits and be in demand as business picks up?
4. Articulate management's Pivot to Recovery™ vision. What updates to strategy, business model and operating model need to be executed to address the new reality?
5. Demonstrate the Pivot to Recovery™ vision in a compelling base plan. Ensure a base plan is fully integrated from core post-COVID-19 trading and operating assumptions through to a clearly articulated funding requirement, if necessary.

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Pivot to Recovery™ – Capital structure requirements

Once business plans are prepared, leadership teams will need to address their capital structure requirements. Financing risks are currently high, characterised by:

a) Liquidity risks on exit from lockdown (as described in our insight piece 'Covid-19 – Pivot to Recovery')

b) Potential covenant breaches in Q3 2020 onwards as the impacts on trading of the COVID-19 lockdown period are better understood and need to be reported and;

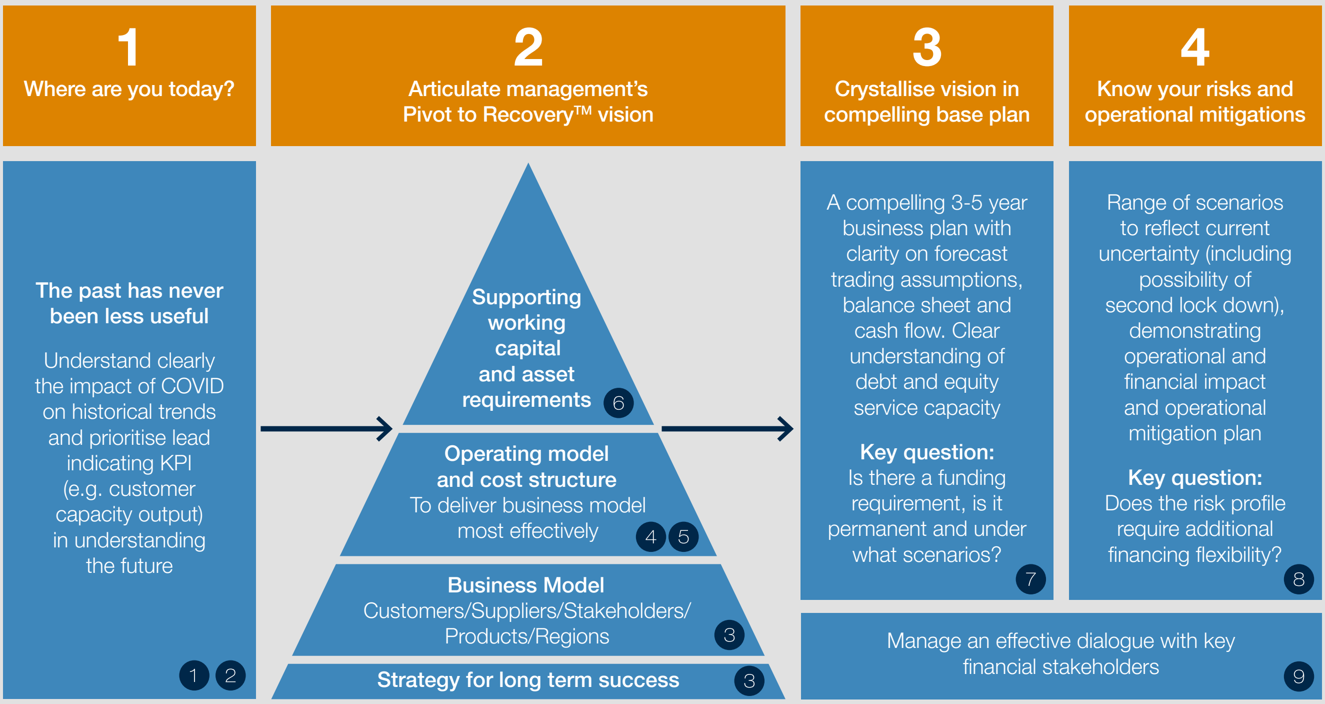
c) Significant medium-term uncertainty driven by the fundamental business shifts resulting from the current crisis.

The business plan will need to clearly outline the funding requirements and where the business sits versus its existing finance commitments, highlighting clearly any breaches of debt facilities.

Armed with updated post-COVID-19 business plans (that have been approved by the Board of directors, and given a mandate by the Board to engage with financial stakeholders), we recommend that senior executives engage early with financial stakeholders as they seek to enable stable and flexible financing platforms upon which to execute their plans. In the following section we set out a step plan approach that leadership teams can take in preparing their business plans

Pivot to Recovery™ - A model to address business plan preparation and financial stakeholder engagement

In order to transition successfully to the post-COVID recovery period, we recommend the preparation of an updated business plan as the basis for an effective discussion with financial stakeholders.



Detail for each work step 1-9 considered below

How should business plans communicate an effective Pivot to Recovery™ vision? (continued)

As management teams prepare updated business plans they will need to balance the continued need for COVID-19 reactive measures with a future proof strategy and an operating plan that underpins a new business plan. We set out below the key considerations as business plans are prepared.

Each of the following points refer to associated number in the above diagram.

Assess where you are today

1 The past has never been less useful

a) Ask whether historical trends will be useful in predicting the future for the business. COVID-19, a first in a lifetime event for most businesses, has the power to permanently change demand and the customer and supplier landscape. Knowing and responding to the impact of such changes is core to the business plan.

b) Have a view on the trading recovery and its shape – consider carefully the timing of the recovery and articulate the COVID-19 impact; the acceleration of pre-existing trends and non-COVID-19 related trends.

c) Clearly integrate the impact of government support measures (cessation of old measures and/or introduction of new measures).

d) Prioritise lead indicating KPIs and drivers of your business plan assumptions – enabling an early understanding of whether the base case is the case to manage against.

2 As you exit COVID-19 lockdown, know the impact of the unwind

a) Opening balance sheet – understand the cash impacts on the balance sheet during the lockdown period. This may mean adjusting assumed repayment terms to reflect changed customer and supplier behaviour, formally agreed or not, and the cash impact of any provisions.

b) Claims from counterparties – consider whether there are any claims arising from contractual disputes that need to be provisioned and when they would be payable.

c) Claim insurance – take account of any insurance claims you may benefit from and the timeline for resolution.

d) Investment requirement – ensure that any investment needs related specifically to the COVID-19 response are included in your plan, prioritising the health and well-being of employees (e.g. safe working spaces and practices).

e) One plan – ensure consistency between short term assumptions and planning (often best achieved through rolling 13 week cash flow forecasts) and the business plan.

What is Management's Pivot to Recovery™ Plan?

3 Reassess strategy and be clear on the business model that will deliver it

a) Which customers and suppliers will form the basis of the future business model? Prioritise those customers and suppliers that are willing to partner, offering flexibility as the lockdown period is exited and partnership in management of future risks.

b) Explain the markets and products that will drive growth, and how they have been impacted by the pandemic.

c) "Has the crisis expedited the shift to a digital model?" Be prepared to answer this common question, clearly articulating the revised timeline, investment and operational requirements.

4 Be clear on any changes in operating model

a) Consider if updates to the business model require a change in operating model to drive customer responsiveness and appropriate risk mitigation:

i) Are there now businesses in the group considered non-core?

ii) Are there now jurisdictions that are considered non-core?

iii) Is the manufacturing footprint appropriate for future business requirements?

iv) Is the supply chain balanced and flexible for future business requirements and what lessons about stability of supply chain during the COVID-19 crisis need to be actioned?

v) Do longer term changes need to be made between physical and online fulfilment?

vi) Are support service functions right sized and fit to serve the business?

vii) Do management structures facilitate manager empowerment and agile decision making?

b) Consider the investment requirements coming out of any changed operating model assumptions.

Prioritise customers and suppliers that are willing to partner, offering flexibility and partnership

5 Clarity on cost structure and its flexibility

a) Express clearly the cost structure that is in place, and its current optimisation for the business plan period.

b) Generate enhanced management credibility through articulation of successfully executed cost self-help measures.

c) Clearly set out any cost reduction plans and opportunities.

d) Demonstrate flexibility/constraints for additional cost reduction as a response to identified risks.

6 Understand your working capital and asset requirements

a) Know clearly the level of working capital requirement that arises as levels of business increase post-COVID-19.

b) Assess and be able to defend the minimum operating cash requirement at subsidiary and at group level – this is a common question from stakeholders when asks are being made.

c) Consider whether working capital assumptions have been impacted by any changes in the business model post COVID-19. e.g. are there any permanent changes in arrangements with suppliers/customers or has there been a change in business mix?

d) Calibrate working capital optimisation with any operating model changes in response to COVID-19. i.e. does the business now need higher minimum stock levels for critical parts?

e) Demonstrate the trade-off between CapEx that has been put on hold not being invested vs future growth.

7 Crystallise your vision in a compelling and flexible base plan

a) Your Pivot to Recovery™ plan should be communicated in a fully integrated and flexible trading (P&L) forecast, balance sheet and cash flow model. You should be able to quickly understand the impact on cash and funding of changes in core assumptions as the plan is developed through iteration.

b) The plan should clearly demonstrate its ability to service debt and equity.

c) Crucially, the plan should demonstrate whether there is a funding requirement, when it is first needed and the permanence of that requirement. Is it one-off COVID-19 related, seasonal, intra month or a permanent requirement?

8 Assess your key risks and link to operational assumptions

Despite many geographies taking measures to 'reopen', there remains significant caution. The anticipated return to the post-COVID-19 world is uncertain and may be delayed if news flow and customer/consumer confidence is unsupportive. Scientific communities do not have consensus on the risks of a second wave, or the best approach to address one.

As such, the current level of uncertainty is significant and the need for credible scenarios is critical. The impact of risks on financial statements should be expressed by comparison of key conclusions against the plan (e.g. debt/equity service and the demonstrated funding requirement).

a) Within such scenarios, common scenarios requested by shareholders and lenders include:

   i) A second lockdown scenario; and

   ii) Alternative shape of recovery (size and timing)

   iii) Addressing specific key counterparties risks (requires an understanding of how financially robust key stakeholders are)

b) It is important to be able to demonstrate the commercial and operational contingency plans that exist in response to the above risks to give confidence they can be adequately managed.

Being armed with a robust updated business plan will give the best opportunity for constructive dialogue with debt and equity investors; whether that is to stabilise the business and/or remedy breaches of existing arrangements, or seek new financing to fund growth. We consider below a template for how management teams should engage with financial stakeholders as they emerge from the COVID-19 lockdown.

9 Engaging with financial stakeholders

Financial stakeholders will expect, in the majority of cases, pre-COVID-19 business plans to be obsolete. These stakeholders will also be expecting a company's Board and management teams to be reassessing the company's capital structure, liquidity needs and reporting requirements based on an updated business plan that has taken into account the points that we have discussed so far.

Such assessments will each pose different financing challenges, and different approaches will be necessary. In each of the latter three cases, early and effective engagement with existing stakeholders, both debt and equity, will be required.

There is an expectation that such assessments may result in a range of outcomes:

Less stressed → Distressed

Financing structure remains fit-for-purpose	Requirement to fund base plan investments (but sufficient day-to-day liquidity)	Insufficient liquidity to support increase in trading (i.e. working capital)	Anticipated contractual default of facilities (e.g. forecast covenant breach, minimum liquidity breach etc.)	Anticipated payment default under existing facilities (e.g. inability to refinance debts as they fall due or pay interest)

For all but the first scenario, leadership teams will need to engage with their financial stakeholders.

On the following page we highlight the four key considerations as the basis for addressing financial stakeholders.

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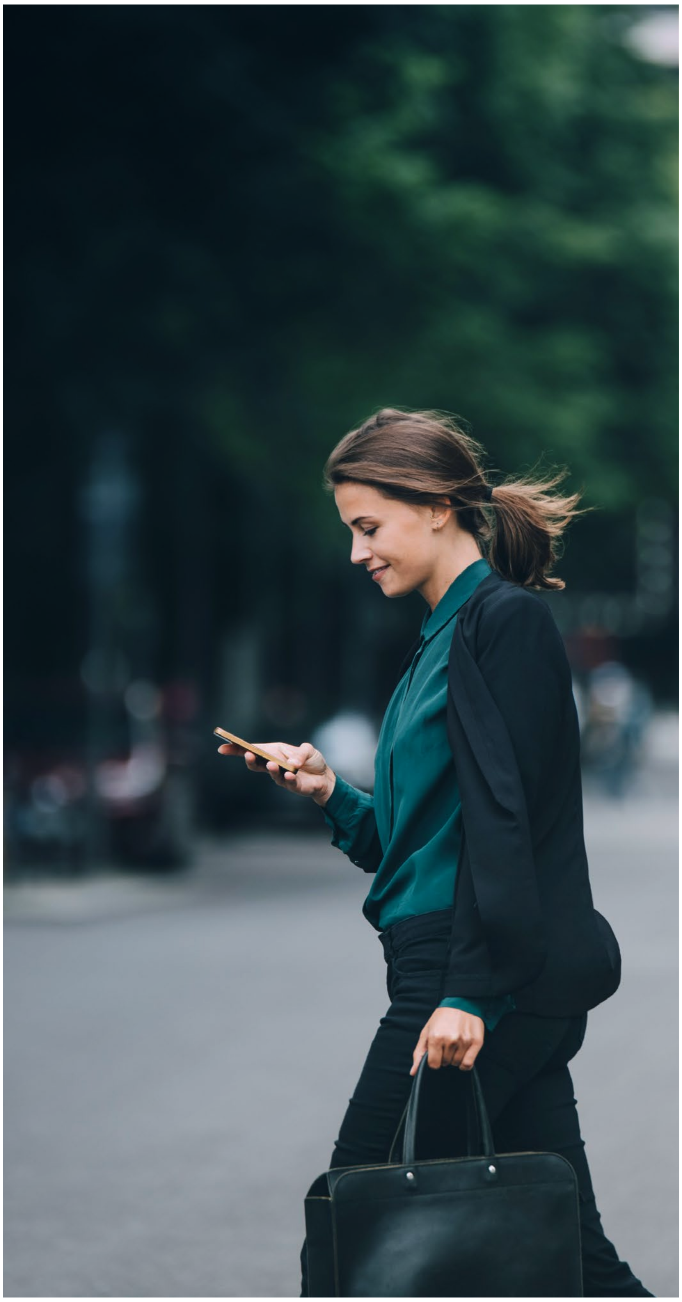

Those that are armed with a revised fit-for-purpose business plan will be best positioned for long-term resilience and growth

1. **Engage early with all relevant financial stakeholders –** The crisis will create significant capacity issues for financial stakeholders and competition for new capital/credit committee approvals. Begin discussions early. Communicate the current status of trading and business plan status. Having a third party like A&M assist in the preparation or review of the plan will often be seen as an objective and sensible move by the company's leadership. Establish and agree a robust timetable for engagement. Don't forget rating agencies and other external stakeholders and the need to maintain clear internal communications.
2. **Establish initial support levels across your financial stakeholder group –** Understand early who is willing and able to provide assistance. Know the starting positions of all financial stakeholders and what level of interdependence there is between them. Take financial and legal advice. Consider how any financing requirement will be shared and remain open minded, flexible and creative during the process: the solution may be offered by existing equity alone, some combination of current financial stakeholders or may be presented during the process by new debt and equity investors.
3. **Be clear on what you are asking for –** Whether it is a covenant reset or new money requirement – know the ask and its permanence. Always include headroom to cover future risk under a range of credible scenarios. Ask well and ask once!
4. **Maintain trust in the management team –** Through the transparent explanation of COVID-19 impacts on the business, where specific and known, and communicate the steps and rigour of process taken in order to build the plan.

In summary, as management teams Pivot to Recovery™, those that are armed with a fit-for-purpose business plan and use it to engage early and effectively with financial stakeholders will be best positioned for long-term resilience and growth.

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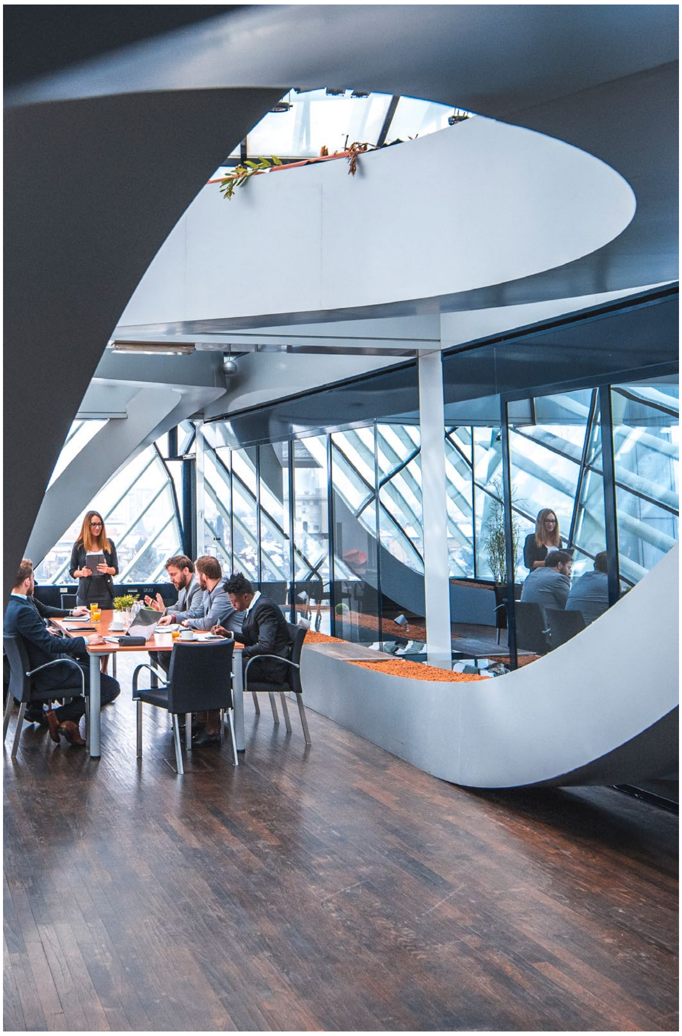

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