Plan now to win the recession

Don’t just survive, thrive

Scott Davis
Ryan Maupin

February 2019

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Today’s presenters

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Mr. Davis is a Partner who focuses on dynamic organizations in transition. He co-leads the firm’s healthcare mergers and acquisition practice and distressed healthcare practice. Mr. Davis joined Grant Thornton in 2007 after serving as a Partner for both PricewaterhouseCoopers and KPMG, and as a Senior Managing Director for Mesirow Financial Consulting. Mr. Davis is a Certified Public Accountant (CPA) and a Certified Insolvency and Restructuring Advisor (CIRA).

Mr. Davis has more than 30 years of advisory and interim management experience assisting both growing and underperforming organizations in the areas of due diligence, strategic change, restructuring, performance improvement, business planning, cash flow forecasting, litigation and forensics. His experience includes developing and implementing strategic business plans, establishing budgeting and forecasting tools, improving cash management and liquidity, negotiating refinancing and plans of reorganization, identifying and implementing revenue enhancements and cost reductions, identifying and disposing non-core business segments, identifying and pursuing alternative sources of recovery, and negotiating acquisitions and dispositions, turnaround, workout and restructuring.

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Mr. Maupin is a Principal in Grant Thornton's Transaction Services practice. Specifically within the Corporate Finance team, he specializes in advising domestic and international companies, secured and unsecured creditors, and private equity funds, in workout situations both in-court and out-of-court. Mr. Maupin is primarily focused on advising clients in sale processes, complex financial restructurings, liquidations as well as serving in various interim management roles. Mr. Maupin rejoined Grant Thornton in 2013 after serving as Director for KPMG's restructuring practice. Mr. Maupin holds his B.S. from Millikin University.

Mr. Maupin has over 15 years of restructuring experience within a variety of industries. Most recently, he advised the administrative agent in the chapter 11 bankruptcy of Ignite Restaurant Group (Joe’s Crab Shack and Brick House Tavern + Tap). Prior to that he served as interim CEO to an oil field value, pipe and fittings distribution company as well as its subsidiary, an oil well casing services business, during their respective chapter 11 cases. Mr. Maupin and his team were successful in selling all company assets through a §363 sale process.

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Today's economic environment

U.S. Summary

- Financial Markets have rebounded strongly since Q4 2018 even in the face of downward trends in growth rates for advanced economies and the global economy
- U.S. economy continues to stay strong as global economic uncertainty rises
- Record level in terms of unemployment rates in the U.S. Lowest in 50 years
- Inflation is slightly above the Fed's 2% target
- Wages moving up in fits and starts
- Real GDP growth in the U.S. for 2018 came in at around 3%; 2019 guidance comes in around the same as 2018 (just shy of 3%)
- Consumer spending is expected to slow and housing is expected to continue to soften
- Fed seems to be taking a more flexible approach to raising rates amid growing concerns over global growth and as trade issues remain highly elevated
- By the time an economic slowdown shows up in the data, it may be too late to do anything to stop it from morphing into a recession

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Today's economic environment

Global Issues

- Q4 2018 saw a global equities collapse along with break-even inflation expectations in the bond market – each of these contributed negatively to the world economy
- Emerging markets are a much larger share of global output than in prior years and leverage has increased dramatically – could soon be due for restructuring
- Japan's economy contracted in 2018 after eight consecutive quarters of growth
- China's economic slowdown continues to be an area of concern
- Italy has a large public debt problem right now and markets are questioning whether they will be able to pay it back
- U.S. budget deficit rose to nearly $900 billion, largely related to 2017 tax cuts funded with borrowed money
- National debt hit $21.9 trillion
- Since the 2008 financial crisis, global sovereign debt has doubled
    - U.S. government debt to GDP has grown from 74% in 2008 to 105% in 2017
    - U.K. 50% to 88%
    - Italy 102% to 132%
    - Spain 39% to 98%

Today's economic environment

Other Issues for Consideration

- Leveraged loan market ($788 billion issued globally since 2017 and almost at the same clip in 2018)
- Approximately 80% of the 2018 vintage was issued as "covenant-lite"
- CLO market has increased 130% since 2008
- 50% of the BBB bond market exceeds the size of all higher rated bonds (everything else above BBB)

Industries to Watch

- Energy (oil and gas, power/utilities, coal)
- Retail
- Restaurants
- Automotive
- Healthcare
- Cable Media
- Non-cable Media

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Assessing your current situation

Companies are likely to find themselves in one of following four categories – determining early warning signs is key

Category	Distressed	Stressed	At Risk	Healthy
Key indicators	• Liquidity is currently tight • Credit insurance cover has been withdrawn • Sudden management changes • Refinancing is overdue /stalled • No other obvious sources of financing • In breach of or about to breach banking facilities and covenants • Making unexpected requests for additional funding	• Industry is significantly impacted by an economic downturn (house building, retail, leisure, automotive etc.) • Growing cash flow and operating performance concerns • Concerns over the ability to meet banking covenants • Refinancing is due in the next six months • Equity unwilling or unable to shore up balance sheet with capital injection • Concerns over solvency of customers and suppliers	• Currently profitable but deterioration of performance has started or is expected • Competitive position weak but previously masked by robust economic environment • Long term financing in place but have some concerns over ability to meet covenants if performance deteriorates • Refinancing due in next 6-18 months • Leveraged deals done in last few years	• Profitable currently and in foreseeable future • Strong and stable competitive position • Cycle defensive industry • No cash flow or working capital concerns • Substantial cash resources therefore able act as predator in rapid acquisitions • Long term financing in place • No concerns over breaching of covenants in the future
	Stabilize and survive	Maintain or retain control of future	Preparing to respond to a recession	Maximize competitive advantage

Checklist item #1

- **Cash is King** — Cash is the lifeblood of any business and matters more than earnings. In a slowing economy, understanding and managing cash flow is of paramount importance. Banks are no longer as happy to step in and fill funding gaps as in previous years, but the following are some steps you can take to help your business maintain its liquidity in these troubling times:
  - Undertake a critical analysis of your business operations and how it impacts your liquidity
  - Build a war chest of cash, even at the expense of drawing down on interest bearing credit facilities
  - Forecast near-term cash receipts and cash disbursements based on realistic financial projections
  - Analyze variances and learn from them
  - Negotiated aggressive credit terms with suppliers and customers
  - Strategically manage inventory; potentially selling inventory to generate cash; minimize new purchases if possible

Checklist item #2

- **Get Closer to Your Bank** — Today, companies still have access to credit markets, however banks post-financial crisis banks are a lot more cautious and concerned about credit quality. Banks are still lending money; they just need greater persuasion to do it. In the end, you are trying to ensure that your company has the financing available to operate the business effectively and that may mean you have to go back to your lender for assistance. Often times, getting your bank to work with you depends on how you ask. Here are some things to consider:
  - Treat your banks as a partner in the business by keeping them informed
  - Be proactive in your relationship with your lender
  - Have a well thought out plan in hand if you do need help – discuss best approach with your advisors
  - Avoid breaching covenants in your agreements as this could trigger technical defaults or result in being put on the bank's "watch list"
  - Stay current on your debt if at all possible
  - Remember that banks make money by lending money – the majority want you to prosper so they can continue to lend you money. If you discuss issues with your bank early enough, they may be more open minded in working through problems with you

Checklist item #3

- **Cost Optimization: Be Relentless on Cost Control** — Maintaining your current or historic levels of profitability in an environment characterized by decreasing demand and volatile commodity prices will be difficult without a cut to costs and spending. Here are some ideas to keep in mind when looking to keep your operating costs under control:
  - Have a strategy – cost cutting initiatives shouldn't be undertaken as the risk of compromising revenue generating capabilities or diminishing value
  - Review fixed and variable costs very carefully and determine what costs you actually need to run the business
  - Look for ways to improve performance
  - Reduce spending and institute polices that encourage and reward cost savings and conservation
  - Validate assumptions you've made about your business, your competitors and the industry in which you compete
  - Don't automatically cut marketing expenses. Remember that despite a recessionary environment, there is a lot of business out there – it just becomes a matter of trying harder to secure market share

Checklist item #4

- **Evaluate Customers and Suppliers** — Challenges in credit markets on the heels of a general economic downturn could put increased pressure on the purchasing power and credit-worthiness of customers while at the same time resulting in a tightening of credit terms and product availability from suppliers. Don’t assume your customers or suppliers are financially healthy. The tips below should help you avoid being taken by surprise:
    - Re-evaluate credit terms with current customers and negotiate the shortest reasonable terms
    - Carefully review the credit-worthiness of each new customer before extending credit
    - Continuously monitor accounts and address any problems quickly
    - Understand how closely your business is linked to the average consumer and your customers’ tighter access to credit could affect your business
    - Bargain for the longest and most favorable credit terms with suppliers
    - Critically evaluate your supplier base to determine if your current arrangement is still the most favorable for your business
    - It’s important to do what is right for the business. Failing to collect receivables and address unreasonable credit terms may result in a cash flow shortfall that could affect all areas of your business

Checklist item #5

- **Get Smarter on Tax** — Tax, in its various forms, is usually one of the biggest costs for a business. With a potential recessionary environment, you need to look carefully at how you can reduce tax costs and improve cash flows. The following are some simpler ways you can successfully navigate through these trying times:
    - Don’t make any tax payments earlier than you need
    - Determine if you qualify for quarterly tax installments instead of monthly payments
    - Review the balance due date for any remaining taxes for the year
    - Investigate ways to reduce your payroll costs
    - Don’t fall behind with your tax payments and other compliance obligations

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Checklist item #6

- **Reconsider Capital Investment Plans** — Investing in new assets in a downturn can bleed you of cash when you need it most. Carefully consider your capital investment plans and take into account these suggestions:
    - Consider delaying or deferring investments that are not mission critical
    - Negotiate for the most favorable terms when acquiring mission-critical assets
    - Weigh benefits against financing costs and understand any changes in working capital that may result in a particular investment
    - Incorporate realistic assumptions into capital budgeting metrics
    - Be mindful of how the economic challenges in the lending climate are affecting your customers
    - Don’t just stop investing in capital during difficult times. If an investment is vital to keeping your business operating properly, don’t suspend or postpone the investment decision just because financing is more expensive and complicated

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Checklist item #7

- **Keep an Eye Out for Bargains** — If lending markets contract in a downturn, some companies will have to anticipate having liquidity problems. The feeling of uncertainty will drive many shareholders to seek an exit or partnership with strategic investors, thus creating opportunities at depressed prices. Well-capitalized companies looking to expand might find it worthwhile to look into acquiring targets in this way rather than invest internally. Why?:
  - The best buys are made in a down market
  - Less competition for attractive acquisition targets can potentially lead to reduced pricing multiples on acquisitions
  - Good acquisitions are an important part of a well-thought out growth strategy
  - Seek out a professional advisor who can increase exposure to such opportunities while ensuring transactions are priced and executed in an effective cost-efficient manner

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Checklist item #8

- **Protect your Personal Wealth** — When business conditions get tight, it's important for owners to avoid being too reliant on the business. You need to have a clear view of how you separate your personal wealth from the finances of your business. In the future, banks will likely be asking for additional security and private business owners should know all the implications the current economic climate may have on their personal wealth. You may wish to think about the following:
    - Consider taking recently made "healthy profits" out of the company, while being mindful to keep the company solvent
    - Talk to a professional advisor to review the company's strategic options
    - Don't put money back into the business unless there is a solid business reason to do so
    - Consider all your options when lending personal funds to the company as you may not be able to recover all your funds. Above all, avoid throwing good money after bad

Checklist item #9

- **Worst Case Scenario** — You've taken a hard look at the business and your future is uncertain. You've produced short-term cash flow forecasts and your current outlook is negative, and you foresee a serious liquidity crisis looming in the near term. A payment is due on bank debt, liquidity waning and a default is imminent. Don't panic. Consider taking in to account the suggestions below:
  - Carefully consider strategic alternatives such as restructuring the business through a formal insolvency process or selling all or part of the business
  - Look at your business without its existing debt and determine its debt capacity based on your most current financial projections
  - Understand your bargaining position and your views on value
  - Consider your fiduciary responsibility – if you are operating in the "Zone of Insolvency," your responsibility is to creditors, not to shareholders
  - Do not, under any circumstances, wait until you're almost out of cash. Hire professionals who can help you assess your options and develop a game plan. If possible, defer conversations with banks and creditors until such a time. Don't assume the problem will go away over time.

Checklist item #10

- **Back to Basics** — Most of the suggestions mentioned herein center on good business practices – the fundamentals of which are often ignored when the focus is on revenue growth. Pay ongoing attention to instilling rigor and discipline throughout your business. The economic landscape is changing daily – it is crucial to monitor the situation closely and seek professional advise when necessary.

Questions?

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