AlixPartners

JANUARY 2023

RECESSION READINESS

How to maintain liquidity and grow in a low-growth, high-inflation environment

As ongoing headwinds from high inflation, supply chain challenges and rising interest rates continue to bite, key issues for corporate boards will range from "*will we survive next year?*" to "*how will we meet our growth objectives and deliver shareholder value?*"

Recent trading performance, levels of financial gearing and liquidity will undoubtedly drive priorities. However, whether a board is sitting on a cash pile or feeling the pressure from balance sheet leverage taken on through the pandemic, a number of defensive and offensive strategies should be considered to achieve corporate priorities.

LIQUIDITY AND GROWTH

MAINTAIN LIQUIDITY	PROTECT MARGIN	GROWTH
Cash management	Supply chain surety	Competitor analysis
Capital raising	Pricing strategies	Strategic aquisitions
Portfolio review	Cost control	Integration and value creation
Divestments		
Restructuring		

Defensive strategies

Defensive strategies can range from best-practice housekeeping designed to protect margin and manage cash through to critical, life-saving measures to maintain liquidity and avoid distress.

1. MARGIN PROTECTION

In the current environment, with hyper-inflation, rising interest rates and volatility in supply and demand, never more so have margins been under such pressure. To combat this environment and protect margin, companies should adopt a continual "review > identify > take-action" process on a customer/SKU basis to ensure margins are sustained. For example, with increasing volatility in demand, a dynamic approach to pricing and sales must be taken, targeting pricing actions on underperformers (vs across-the-board price increases), enforcing commercial terms such as rebate clauses and surcharges. It is vital too to ensure that commercial and operations (manufacturing, supply-chain, and procurement) strategies are tightly linked to maximise revenue whilst minimising variable and fixed costs.

2. IMPROVE LIQUIDITY

Following the age-old mantra of "cash is king" is good house-keeping in any environment but in times of high inflation and increased volatility, maintaining and managing liquidity is critical. A group-wide understanding of where liquidity sits is key and regular assessments of contingency levels should help identify and navigate potential bumps in the road.

The single most important monitoring tool in times of uncertainty is a solid cash flow forecasting model. Typically prepared annually and monthly – and on a more detailed 13-week basis, this can be the life blood of a business in challenging times. It will assist management in making operating decisions, identifying potential liquidity pinch-points where additional capital may need to be raised or – in more extreme cases – where surplus assets or non-core businesses may need to be monetised to reduce cash outflows and increase liquidity. Clearly, the greater the visibility one has on liquidity requirements, the more control can be applied over the situation to maximise the best outcome. Planning is key.

Offensive strategies

For corporates with strong balance sheets and high growth ambitions, periods of volatility can present strategic growth opportunities. With a keen eye kept on competitors, an assessment of potential acquisition targets and a proactive approach to off-market discussions can yield positive outcomes. With a tougher trading outlook for the foreseeable future, shareholder (particularly private) attitudes to independence and openness to exploring a sale or merger can change materially, so now is the time to revisit previously unattainable assets. Similarly, with valuations likely to be depressed in the short term and debt markets more challenging, competition for deals is likely to be reduced. Now could be the time to strike. Indeed, from an assessment of the 2009 financial crisis, the table below highlights how a number of large corporates used M&A as a means of delivering above market returns during a volatile period.

FIGURE 1: SELECTED CORPORATE M&A ACTIVITY AND SHARE PRICE PERFORMANCE. 2008-2011

BUYER	SUBSECTOR	NO. OF DEALS	TOTAL DEAL VALUE (£M)	AV. DEAL VALUE (£M)	SHARE PRICE CHANGE	ABOVE INDEX PERFORMANCE
Eaton	Electrical Components	17	7,889	464	99%	75%
Ecolab Inc.	Specialty Chemicals	11	6,607	601	47%	23%
BASF SE	Diversified Chemicals	11	3,279	298	111%	81%
Caterpillar	Machinery & Heavy Trucks	10	5,963	596	57%	34%
Micron Technology	Semiconductors	10	3,668	367	47%	24%
Stanley Black & Decker, Inc.	Industrial Machinery	9	4,008	445	74%	51%
Texas Instruments	Semiconductors	7	4,842	692	43%	19%
Eastman Chemical Co.	Specialty Chemicals	7	3,143	449	149%	125%
Pentair	Industrial Machinery	4	3,418	855	43%	19%
WestRock	Paper Packaging	4	2,552	638	75%	51%
Raytheon Technologies	Aerospace and Defence	3	11,639	3,880	39%	15%
International Paper	Paper Packaging	2	2,872	1,436	53%	29%

Note 1: Share price change and above index performance in period October 2008 to December 20[12]

Conclusion

With headwinds continuing to blow and potential buying opportunities on the horizon, now is the time to take action, ensure any potential issues are planned for, performance improvement opportunities are identified and implemented, and strategic acquisition pipelines are refreshed. With a sustained period of disruption ahead, there is no time for inertia in 2023.

Our outlook

PRICING AND SALES

Julian Short
Partner & Managing Director
jshort@alixpartners.com

A dynamic approach to pricing, sales, and operations is key to mitigating inflationary cost impacts and protecting margins and volumes.

On pricing specifically, differentiated customer/SKU price increases are a more effective strategy than flat 'across-the-board' price increases protecting profitable customer volumes.

Linking sales and operational strategies will also enable operations to make and sales to sell the most profitable product mix to the most profitable customers.

COST REDUCTION

Sanjay Bailur
Partner & Managing Director
sbailur@alixpartners.com

A holistic, "no-stone-unturned" approach to cost reduction has proven to be a very effective way to generate fuel for growth.

Many companies have endured multiple rounds of cost reduction, sometimes at the cost of innovation, growth, or lost brand equity.

Rather than "lemon-squeezing", a holistic, zero-based approach to cost reduction with tight linkages to commercial decisions such as portfolio reshaping, customer and product profitability, and associated cost to serve has proven to be most effective in liberating funds for capex and growth.

SUPPLY CHAINS

Anna Del Mar
Partner & Managing Director
adelmar@alixpartners.com

In 2021 and 2022 many companies quiet simply lost predictability in their business operations. Whilst crystal balls remain in short supply, predicting and building supply chain and portfolio resilience will be critical to growth.

With disrupted supply chains, cost inflation and sustainability pressures, companies must continue to scrutinise the resilience and performance of their supply chains enabling them shift to different formulations, supply markets, and buying approaches.

'Should-Carbon' techniques will supplement 'Should-cost' sourcing and the de-commoditisation of traded supplies will require active supply market and supplier relationship management.

CASH MANAGEMENT

Stelios Fragkos
Partner & Managing Director
sfragkos@alixpartners.com

Companies under liquidity pressure must change operational gears to prioritise cash. Developing a cash culture is vital to navigate the current severe macro headwinds.

A cash culture is a departure from traditional accrual accounting and a sales driven approach. Cash is a key management measure. It repays debt, not operating income.

We are seeing an increased focus on cash management and tightening controls ahead of the storm.

To be effective, however, means being able to anticipate a liquidity crunch to achieve planned outcomes instead of being reactive. Start with developing a rolling, detailed cash forecasting model and managing communications with all stakeholders.

DEBT RESTRUCTURING

Lee Watson
Partner & Managing Director
lwatson@alixpartners.com

Don’t assume that there are any easy asks of lenders and that they’ll wave through amendments in the way they did during COVID. Credit has tightened and we’re seeing more assurance required to support decision making.

We’re seeing more circumspection and pushback from lenders on covenant amendment and facility extension requests, even those linked to prospective rather than actual breach, driven by audit going concern requirements.

To get the best result, pave the way with clear communication supported by good information, make sure that you’ve properly explored other financing options and don’t jam the decision with short timelines.

INTEGRATION

Stefan Ohl
Partner & Managing Director
sohl@alixpartners.com

The current market conditions and forecasts for 2023 require a thorough due diligence of target companies as well as the combined companies’ synergies / value creation potential – even more so than before and especially considering the low-growth and high inflation environment.

Meticulous pre-close integration planning is key to ensure an issue-free closing / Day 1 and initial integration to preserve value. Post-merger integration and related synergies / value realisation is key to achieve the actual strategic growth target. While this is not new in itself, it is more important than ever as deviation from plans can jeopardise liquidity. Further, proper integration is a strong anchor that holds even in a storm as strong as the current one.

M&A AND CAPITAL SOLUTIONS

Nick Wood
Partner & Managing Director
nwood@alixpartners.com

Despite ongoing levels of cautiousness, significant capital remains available to support good deals, whether that be a strategic acquisition or the sale of a business.

A strong investment thesis and a clearly articulated value creation plan will be key to deliver investor confidence and secure capital. From a lending perspective, with higher interest rates impacting pricing and traditional lenders taking a more cautious approach, the need to run competitive debt raising processes is absolutely critical. Preparation, clarity of message, and early lender education are key to success. For those with growth on the agenda, the current environment can bring buying opportunities. Increased volatility and uncertainty can influence shareholder perspectives, so being persistent with target engagement and creative on deal structuring to bridge value gaps can often lead to success, even with previously unattainable assets.

AlixPartners

ABOUT US

For more than 40 years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.