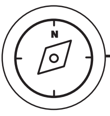

THE DASH FOR CASH

The enforced closure of business operations during lockdown has seen liquidity dry up, leaving countless companies needing external financing. Vicky Meek looks at how businesses should manage that most valuable of all commodities – cash

As COVID-19 spread and lockdown measures closed entire sectors, many companies all over the world faced a fight for survival because cash, the lifeblood of any business, evaporated overnight. With the relaxation of lockdown measures in the UK since May, what was feared has become abundantly clear – many sectors and businesses will remain under intense stress.

By 23 June, more than a million UK businesses had accessed the government's emergency financing schemes, securing £29.5bn from the Bounce Back Loan Scheme (BBLS), £11.1bn from the Coronavirus Business Interruption Loan Scheme (CBILS) and £2.3bn from the Coronavirus Large Business Interruption Loan Scheme (CLBILS).

Clearly, some segments felt an overnight negative, most obviously non-essential retail, travel, leisure and hospitality, while others have continued relatively normally.

Ben Slatter, partner at special situation investor Rutland Partners, explains. "In our portfolio of seven businesses, each has been affected differently," he says. "At one end of the spectrum, you have companies that have experienced minimum disruption; at the other, large parts of businesses have had to be mothballed and staff furloughed."

BEYOND OBVIOUS

Over the longer term, it seems highly likely that the effect of COVID-19 will ripple out even further. "Whole ecosystems will be affected," says Lisa Ashe, EMEIA operational restructuring partner at EY. "Obviously, there are certain sectors suffering right now, but this will reverberate through the supply chain. If no one's flying, airlines won't order new planes."

Indeed, hopes in the early days of the crisis that the economy could quickly rebound appear optimistic now. Dire warnings by the Bank of England in May of a 14% shrinkage of the UK economy and a doubling of unemployment rates suggested there was much more pain to come – and for a wide range of companies. In early August, the Bank reduced its estimate for 2020 to a still-record 9.5%.

By July, there was a proliferation in job cut announcements – 12,000 at British Airways, 3,000 at Rolls-Royce in the UK, 4,500 at easyJet, 1,700 at Airbus in the UK, 1,300 at John Lewis, 950 at Marks & Spencer, 900 at Clarks and 600 at TM Lewin to name a few. In July the OECD estimated that UK unemployment could reach 15% of the working population if there was a second spike of infections, and further lockdown measures taken.

"The biggest effect will be on businesses that rely on transactional activity, where there is discretional spend or where there are high fixed costs, such as property agents, lawyers, architects or consultancies," says Mark Lucas, a corporate finance partner at Quantuma in Southampton. "Legal businesses, for example, often have high working capital and payroll costs and expensive property. We've seen a lot of law firms in difficulty. Any business that services predominantly SMEs will have a tougher time, as these will be looking very hard at their costs. Those targeting medium-sized and large companies will tend to have a more robust platform."

KING CASH

Vast numbers of companies will have looked to raise capital since March. But the most immediate issue will have been cash conservation, and that is likely to be an ongoing theme.

"The first step should be to manage liquidity to ensure businesses have enough cash to see them to the end of the crisis," says Ashe. "You need clear visibility of what the cash needs will be and a real grip on cash management."

While the end of the crisis is unclear, for now it means staying on top of accounts receivable and inventory levels, accessing government schemes where appropriate, deferring tax and

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keeping a close eye on how much to pay creditors and when. "Companies also need to look through their balance sheets line by line to determine if there are pockets of value they can release – there may be aged inventory, for example, that could be sold to generate cash," adds Ashe.

Michelle Shean, partner, restructuring and insolvency, at Fieldfisher, agrees. "Right now, every business has to be on top of its cash situation," she says. "They need to accelerate their receivables payments and chase up past due accounts while considering asking for payments upfront. They should also be looking to negotiate with their creditors, maybe ask for more frequent, but lower, invoices or payments to help manage cash flow."

Shean also suggests companies look to standardise monthly costs where possible, so they know more precisely what needs to be paid. However, she warns that selling non-essential assets may be viewed as a fire sale and full value may not be attained.

A solid contingency plan covering all parts of the organisation, from operations and finance through to sales, legal and HR teams, plus a section that deals with suppliers, must be drawn up.

"In most instances, we're advising companies to put together a crisis management plan," says Bristol-based Louise Durkan, a restructuring partner at Quantuma. "All businesses need this right now and they don't tend to have one in their back pockets.

"There needs to be a plan of who's doing what, with regular communications between the board and the rest of the company as well as broader stakeholders. You also need a plan B."

While current cash is vital, companies also need to be more future-facing in

TWEAKING

Key performance indicators (KPIs) are beloved of private equity firms to understand what is going on in portfolio companies. They are even more important in times of difficulty. But which KPIs should be used? In the current environment, it may not be the ones that companies are familiar with.

"If you're relying on pre-COVID-19 KPIs as a measure, that could be challenging," says Quantuma's Louise Durkan. "You really have to look at your new plan and work out which KPIs make sense in today's situation."

Operating cash flow
"This is the key one to understand now," says Fieldfisher's Michelle Shean. "When are payments due and when are you receiving payments? Finance departments need to be really up to scratch."

Debt ageing
"This is an important KPI now," says Quantuma's Mark Lucas. "When you do your 13-week cash-flow forecast, you need to get into the weeds and work out when customers will pay. Ageing debts will cause issues with invoice discounting lines when debts fall out of funding terms, which have been 90 days."

Book-to-bill ratio
"Where businesses have been busy, this is important because it offers visibility on future demand and not simply finishing off an order book," says Lucas. "This will be key to managing future capacity."

Net profit
Durkan says: "There will be a period where if you look at net profit, it's not going to give you an accurate view of the business. Companies are going to have to be able to turn the lights back on, get employees back, and there will be a time lag in many companies between generating revenue and that converting through to profit."

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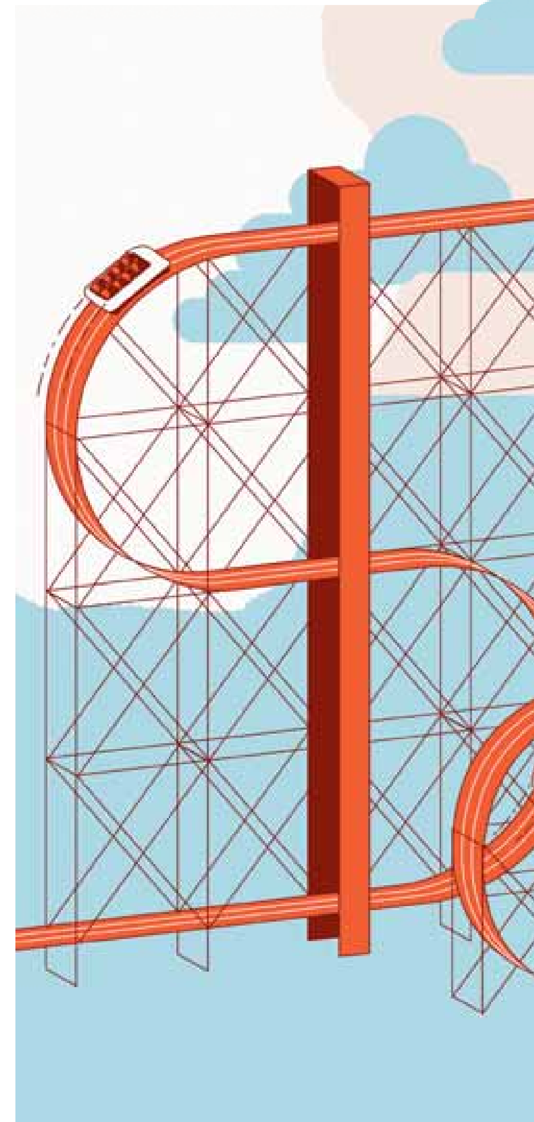

their reporting. Slatter explains: "You need a forward view of cash flow – a 13-week forecast – based on known payments and receipts to identify the scale of any problem and find the lowest point of headroom in that period."

He says every business Rutland backs implements this, whether it is underperforming or not. "It takes time to refine these to provide an accurate view of cash requirements by comparing what happened with what was predicted," he adds.

Forward planning has been particularly important as companies looked to restart operations following lockdown and the end of the furlough scheme. For many, this may be the most critical point as costs, such as payroll, are likely to rise and government support eases off, while cash may not come in immediately.

"Scenario planning is vital," insists Ashe. "And it needs to take account of different assumptions around recovery. What actions can you take in each situation and how can you ensure the business survives? Do you need to cut travel budgets? Do you need to make redundancies? The planning needs to include specific actions that will conserve cash."

The best advice is to consider what will happen over the coming year, even though uncertainty looks set to prevail for some time yet. As restrictions have lifted, businesses need to have considered how to reflate their balance sheets. Workers will have come off furlough, but sales volumes and revenues may well not be at previous levels, while fixed costs will be unchanged. "At the same time, their debt burden may be higher than before if they have deferred tax or rent payments," adds Ashe.

It's likely at this point many businesses will look for finance. The good news is

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that there's a wide range of financing options available – from traditional bank financing and invoice discounting through to specialist and niche finance providers, private debt and private equity.

Slatter explains: "There will be a lot of under-capitalised businesses that will have seen their working capital fall as their business has shrunk, and so need liquidity to go back into working capital to get them on an even keel with suppliers and creditors."

Those businesses that can demonstrate a tight grip on cash flow has been maintained, along with planning for a range of scenarios, are likely to receive a warmer reception from lenders or investors. Durkan says: "As we move into the next phase, companies need to think about financial fortitude – they need to set and define future goals. That means all companies, even those currently doing well, because those with financial fortitude can react quickly and effectively to changes, wherever they may come from." ●

NEW INSOLVENCY REGIME

The Corporate Insolvency and Governance Act came into force in the UK at the end of June. Already in progress through Parliament prior to the spread of COVID-19, the Act creates a more supportive framework for businesses experiencing stress and includes temporary measures, such as a suspension of the provisions around winding up, statutory demands and wrongful trading.

Airline Virgin Atlantic became the first company to test the new restructuring process when it filed for bankruptcy protection at the beginning of August.

"The suspension of wrongful trading provisions will be a significant help for those struggling to pay all creditors as a result of COVID-19," says Benjamin Wiles, managing director, global restructuring advisory, at Duff & Phelps. "Companies have worked to conserve cash, and in doing so they will have pushed back a number of liabilities, such as HMRC and rental payments. This, combined with the suspension of statutory demands and winding up petitions, helps the process of formalising the forbearance of creditors."

Yet it's the more permanent changes that Wiles believes are the most significant. The new rules allow for a moratorium that affords businesses protection from creditors' actions before implementing a restructure, such as a company voluntary arrangement (CVA). It also prevents suppliers seeking a termination of contract in situations where they believe a company to be insolvent. Embedded in the new law as a check and balance is the requirement to appoint a monitor. The monitor must be an insolvency practitioner, able to assess the company's suitability for a moratorium.

"Previously, businesses could seek a moratorium only if they were ultimately entering an administration process," explains Wiles. "That may not offer suppliers or other trade creditors the best return. The new regime will give companies more time to assess the options available to them, such as the disposal of assets or refinancing, and that gives creditors greater protection.

"The supply termination rules are a really useful introduction. Businesses depend on the smooth supply of goods and services to continue trading. The new regime will offer reassurance to suppliers that their customers will continue to pay through a moratorium period."

The new regulations may be particularly helpful given the large number of businesses that may experience stress but were profitable before COVID-19. "The use of CVAs is especially beneficial under these circumstances," explains Wiles. "CVAs previously had a bad name because they were not always used appropriately. The situation today is that many companies that would otherwise be viable just need time to work through the options available to them. We'll see fewer administrations than would otherwise be the case."

Benjamin Wiles, global restructuring advisory MD, Duff & Phelps