How to preserve capital and promote growth in uncertain times

Webcast Summary
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External factors continue to put pressure on business operations and liquidity. Driving long-term value hinges on balancing cost reduction and capital conservation while also recognizing opportunities to stay competitive and agile. Business leaders must continue to optimize preservation, performance, and growth.

The recent KPMG webcast discussed the following strategies to assess existing liquidity levers and important considerations for cash flow planning in the current economic scenario.

- Alleviate cost pressures and preserve capital
- Build a strong cash flow foundation
- Create value through divestitures of non-core assets
- Access capital in turbulent times

Alleviate cost pressures and preserve capital

Improving cash flows while staying attuned to emerging economic trends is critical to growing sustainably. This can be achieved by reviewing current budgets, forecasts, and building various "what-if" scenarios periodically, thereby identifying opportunities and risks, and enabling effective decision-making.

Most organizations are taking proactive steps to alleviate pressures arising from the challenging financial environment. There are three key areas of focus: commercial, operating expenses (OpEx), and investments.

Commercially, companies are evaluating pricing and rebate structures to optimize their gross margins. They need to be selective about discounts and promotional strategies, utilizing targeted and time-bound tactics to drive sales without negatively impacting their overall revenue.

As for OpEx, every aspect of the organization's spending, such as marketing and logistics, needs to be scrutinized, while making practical investments that create tangible value and build strong cash positions. The aim is to cut costs that do not directly contribute to winning customers or better serving the market.

Lastly, high-performing organizations are adopting a different mindset toward investments. Instead of basing decisions on previous years, they are questioning what they need to do now to compete, win, and achieve financial targets in the near term. They are also emphasizing value-creating initiatives and a focus on investing for growth.

Strategies to maximize cash flow

The Federal Reserve's decision to pause interest hikes is expected to stabilize markets and allow for more steady financial modeling. Nonetheless, companies need to be proactive in restructuring capital and planning for potential cash flow disruptions. Keeping an open dialogue with investors and lending institutions can help address cash flow constraints through collaborative financial solutions, such as debt restructuring. There are many levers they can pull to maximize their cash flow, including:

- **Utilizing working capital facilities:** Companies with short-term liquidity needs, such as lags between purchasing supplies and shipping to customers, can benefit from working capital facilities to decrease upfront cash requirements.
- **Factoring receivables:** Businesses with longer payment terms can sell their receivables to receive steady income until full collection, providing more immediate cash flow.
- **Converting cash flow loans to asset-based loans:** To address capital needs for new equipment, lines, or buildings, companies can opt for asset-backed loans, which have seen increased popularity over the past year. These loans use assets as collateral, offering more liquidity and flexibility.

- **Utilizing private credit markets:** As traditional bank lending has tightened, private credit has grown significantly. Companies can now consider borrowing from non-bank lenders, which may offer more flexibility and faster execution.
- **Addressing potential covenant breaches with lenders:** Companies with covenant pressure can also approach their lenders to renegotiate loan terms, implement cost-saving measures, or explore alternative financing options. Lenders may agree to short-term suspension of covenants or renegotiation if the company presents a clear plan and timeline.

Lastly, both traditional and non-traditional capital markets offer options to raise capital. However, these options can be expensive and dilutive to shareholder value. Businesses need to prepare, develop scenarios for different market situations, and remain nimble when accessing these markets. This preparedness can enable them to adapt and seize opportunities as they arise while overcoming challenges associated with last-minute funding attempts.

Build a strong cash flow foundation

A strong cash flow foundation is critical for successful conversations with lenders. We suggest creating a 13-week rolling cash flow plan to improve visibility for proactive discussions with lenders. Once a solid cash flow foundation is established, it is essential to build a structured program around it. This includes:

- Navigating payables carefully, stretching them as far as possible and taking advantage of discounts and rebates when available.
- With softening demand, companies may see inventory piling up. Avoid getting stuck with depreciating inventory by using commercial leverage to create demand and move through excess inventory without accumulating loss reserves.
- Stress testing capital expenses to determine if spending is necessary, and distinguish between nice-to-haves and need-to-haves.
- Staying updated with constantly changing tax policies to identify any new efficiencies that may become available.

Focusing on these areas can collectively boost cash reserves and business efficiency. As executives and boards shift attention to cash optimization, navigating it effectively is key to business success.

Create value through divestures of non-core assets

Companies may have the ability to access untapped liquidity by considering selling assets that are not central to the company's core operations. This approach has gained popularity in recent times, with businesses adopting a more private-equity-like mindset when evaluating their holdings.

Monetizing non-strategic assets offers several short- and long-term benefits, such as driving immediate capital infusion, focusing on core operations, boosting investor sentiment, attracting new sources of capital, and driving incremental growth. In the long run, the freed-up cash can also be reinvested into more profitable internal growth projects or acquisitions.

Management must evaluate deals after acquisitions to ensure value creation is being achieved. Two potential paths are:

Standalone: Ensuring acquisitions are achieving desired results, necessitating adjustments where needed.

Integration: Focusing on accelerating top and bottom-line synergies, considering complexity and potential value.

Create a value creation roadmap

Considering value creation when divesting underperforming assets can result in better outcomes for the company, such as:

Attract PE buyers: PE buyers are often seeking assets with a value creation story and potential add-on acquisitions.

Increase sale multiples: Having a robust sell-side plan with a proposed value creation strategy allows selling organizations to control the narrative and lead to a higher multiple.

It is crucial to pre-package a value creation plan and understand both internal and external value drivers before announcing an asset's divestiture. This strategic approach can significantly improve the deal's overall success and result in better value realization for the selling company.

Secure stakeholder buy-in for divestiture plans

Businesses need to secure buy-in from various stakeholders, including the board, C-suite, investors, and employees to maintain stakeholder trust and ensure a smooth transition. To gain buy-in:

- Clearly define the metrics, values, and rationale for the divestiture plan, and communicate this to investors and stakeholders to highlight the strategic benefits.
- Conduct frequent, in-depth conversations with the C-suite and board to ensure their full alignment and address any questions or concerns they may have.
- Keep your employees informed and maintaining focus on the core business mission. Effective communication helps prevent distractions or dissatisfaction that may impact business performance negatively.

Access capital in turbulent times

The current financial climate is choppy, making it even more difficult for businesses to accurately forecast their cash flow needs. Navigating today's high-rate environment requires organizations to look beyond traditional models of operation to address immediate liquidity needs:

Private capital: Non-traditional lenders may provide more lenient terms and hybrid products, enabling growth and flexibility.

Equity markets: Although down rounds have increased, founders may be more open to reasonable valuations.

Position for future capital markets: Investing in strategy, top and bottom-line growth, and internal structures may lead to successful access to the public markets.

It is also essential for businesses to ensure optimal banking partnerships. This means regularly assessing market terms for lending, engaging proactively with lenders to stay informed about changing rates and opportunities, and obtaining competing, flexible covenants from banks.

Closing comments

Capital preservation strategies necessitate establishing a strong cash flow foundation, strategically divesting non-core assets, and accessing capital beyond traditional means to thrive in the current economic climate. Organizations must respond by planning and proactively managing their businesses, capital structures, talent, and operations to help mitigate further disruption.

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