SRG Partners
CFO + Transaction Advisory
COMMERCIALISING OPPORTUNITY

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CONSERVING CASH DURING A TIME OF CRISIS

Most people and businesses are already impacted by Covid-19.

With lives at risk, we hope that conditions improve as quickly as possible.

In the interim, we should brace ourselves for turbulence and have a prepared mindset for the scenarios that may play out personally and for the businesses we either own or operate within.

Looking at what is happening globally and what many companies are already facing, Covid-19 will:

- **Cause a drop in business activity**. Some companies have seen their growth rates drop sharply over at least the last month. Companies that were on track at meeting or exceeding their budgeted performance are now looking at shrinking markets and potentially seeing all their recent hardwork disappear, as the effects of Covid-19 and Government action ripple wider. Struggling business may find it difficult to survive, whereas businesses built on strong foundations will be best placed to weather the storm.
- **Supply chain disruptions**. The unprecedented lockdown across the globe, is directly impacting global supply chains. Many companies may need to find alternative suppliers.

It will take considerable time, perhaps several quarters, before we can be confident that Covid-19 has been contained. It will take even longer for the global economy to recover. Some of you may experience ongoing soft demand; some of you may face supply challenges.

The following aspects need to be critically assessed together, by all businesses:

1. Monitoring Cash
2. Managing Working Capital and Maximising Net Cashflow
3. Scenario Modelling
4. Cost control

1. Monitoring Cash

Cash is king – more than ever it is important to understand your short-term cashflow.

We recommend all business maintain an accurate and flexible 12-week cashflow. This should be updated either on a daily or at a minimum on a weekly basis.

The 12-week cashflow should include:

- Cash receipts: expected receipt of debtor payments, stimulus packages, funding inflows, other cash inflows
- Cash payments: payroll, creditor payments, tax obligations (where deferral is not possible), financing (principal and interest), other cash outflows
- The resultant net cash flow and closing cash balance

The 12-week cashflow helps you quickly understand your cash reserves and how long they will last under different scenarios (e.g. delay in debtor receipts, reduced sales)

The assumptions should be granular enough so that everyone is clear on what is required particularly with respect to paying creditors, chasing debtors and the impact of sales and cost reductions. (e.g. material customer receipts may need to be modelled separately if customers commence paying on different terms).

This analysis will give you time to determine at which point you will require additional funding from your financiers, enabling you to have those discussions in advance of the funding requirement. You need to ensure you can meet your payroll obligations and make payments to your suppliers as agreed with them.

All businesses should already be liaising with their banks (or brokers) on what finance options are available and the support that their financiers are able to provide. Various banks have commenced providing principal and interest repayment holidays, covenant breach waivers, increase in facility limits or provision of temporary overdraft facilities, to support their customers.

Given the significant economic downturn expected and various uncertainties, a 12-week cash forecast is critical for every business.

2. Managing Working Capital and Maximising Net Cashflow

Working capital is a critical component of your cash flow and given cash constraints, it is imperative to minimise your investment in working capital.

The entire executive team and senior management team should understand the impact of their decisions on the investment in working capital and cash burn. (e.g. the sales team need to consider the impact of allowing an extension in debtor terms). The finance team should be responsible for training the relevant personnel in these areas.

Management of working capital should not just be the responsibility of the finance team, particularly during times of crisis. The management of working capital needs to be spread across the entire senior management team. This will ensure that the whole business will consider the impact of decisions on cash flow and will assist the finance team and business in managing its working capital.

Managing working capital may comprise:

- **Creditor Payment Monitoring** – confirm that you are paying suppliers on the due date and not before. Enforce these rules and manage expectations internally and externally. System set-ups should be reviewed to avoid earlier than required payments.
- **Supplier collaboration** – quickly liaise with large and critical suppliers to seek relief such as payment term extensions. Suppliers may be open to extensions however, they will require certainty and you delivering on your promises, so if you promise to pay on a certain date, this should be upheld. The supplier is most likely in the same position as you, trying to manage their own cashflow.
- **Manage high value and risky receivables** - constant communication with your customers is recommended to understand their ability to make payment in line with existing or agreed terms. Payment plans may need to be put in place and monitored.

- **Inventory** – should be closely managed. Businesses should ensure critical materials do not run-out, however businesses will also need to consider the amount of cash tied up in their inventory and link this to the expected short term sales volumes.
- **Capital expenditure** – should be committed to and spent with caution, taking into consideration the cash impact (i.e. whether it will be financed) and future operating cashflows. Capex should be deferred where possible.
- **Identify surplus assets** - that can be sold to generate cash (e.g. aged inventory, under-utilised machinery etc.).

Executive management need to support the finance team (in particular Accounts Payable and Accounts Receivable) to ensure constant communication with customers and suppliers. Although, the focus may be on delaying creditor payments and pursuing debtors, each business needs to ensure strong relationships are maintained with these key stakeholders, to ensure longevity and support during the economic recovery.

The level of cash tied up in working capital needs to be reviewed and minimised, at the same time as managing delicate relationships with customers and suppliers.

3. Scenario Modelling

Scenario modelling is utilising an integrated three-way financial model to plan various business scenarios.

The three-way financial model should consist of an **integrated** profit and loss, balance sheet and cashflow, and be based on the critical business drivers (assumptions). The model should be updated regularly (at least quarterly), not just during budget setting time.

The forecast model can be in the form of a software program, or more simply, built within excel.

Scenario modelling is critical during this downturn as the impact of Covid-19 is uncertain, and an infinite number of scenarios could be played out. Scenario modelling will enable a business to consider what actions are needed based on a reduction in sales or productivity, ahead of the actual event occurring.

An example could be considering a 25%, 50% and 75% reduction in sales volumes across a product range. The scenario modelling would highlight the profit reduction and cash burn under each scenario, and provide the senior management team a view on the level of cost reductions and other actions that need to be implemented. This will enable the business to survive through this economic downturn and put it in the best position to come out the other side a stronger business.

These days we have a significant amount of data available to us to enable an accurate review of the current state and assist in our forecasting process. It is imperative that businesses use this data to their advantage.

Scenario modelling should be based on changes to your key business drivers to highlight the impact of various scenarios and enable corrective actions to be considered and implemented in a timely fashion.

4. Cost Control

Cost management is currently a critical topic and the forefront of most businesses.

Cost management should be considered by looking at:

- Labour overhead (fixed and variable)
- Non-labour overhead (fixed and variable)

Variable costs will typically flex with the change in production or sales. Fixed overhead will be incurred regardless of your sales activity, and hence will have a bigger impact to your bottom line as sales reduce.

Cost control should include:

- Review of all expenditure and categorise its criticality and ability to defer or cancel (e.g R&D, product development, marketing)
- Reduce, defer or eliminate non-essential expenditure (e.g. subscriptions)
- Discussion with suppliers in relation to pricing discounts
- Discussion with customers to reduce the level of rebates payable
- Discussion with landlords to obtain rent relief
- Implement immediate controls on the use of the casual workforce, discretionary overtime, temporary labour and subcontractors
- Redeploy or refocus under-utilised staff - Redeploy staff to areas of the business that are exceeding or near capacity as a result of activity changes around COVID-19. Refocus other staff to remain motivated and deliver improvements (e.g. process improvements) that have been otherwise deferred due to time constraints
- Review the current organisational structure – this is an opportunity to streamline roles, update position descriptions and improve operational efficiency (can production be maintained with lower level of personnel).

Businesses need to consider the financial impact of redundancies, standing down staff or retaining staff at a reduced wage or hours (4 day weeks). It is a good opportunity for businesses to request staff to utilise their annual and long service leave accrued, however note that this doesn't alleviate the cash outflow.

Current Government incentives such as the Job Keeper payment incentive should be utilised to retain staff within the business.

Cost control can be initiated as required based on the scenario modelling adopted, and flexed as the impacts of the downturn come into effect within the business. However, we recommend that businesses have a complete list of cost saving initiatives that can be implemented quickly.

Reduce defer or eliminate costs – but be careful to not permanently destroy culture, capability or capacity.

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Summary

- Have the right tools in place, to help you understand your short term cashflow (12-week cashflow) and undertake accurate meaningful scenario modelling (Integrated 3-way financial model)
- Be data led and act quickly (don't allow perfection to stand in the way of speed to act), understand your options and the impact of your decisions
- Understand the true cash position of your business and manage the impact on cashflow
- Work with your suppliers and maintain strong relationships – if you don't ask you won't get receive
- Work with high risk customers – manage your risk, but remember that these customers may take their business elsewhere
- Manage critical inventory – avoid excess stock and stock-outs
- Reduce costs – reduce, defer or eliminate costs, and form a view on whether actions may impact longer term capability and capacity

Lastly stay healthy, keep your business healthy, and if you need any assistance to discuss what has been presented, work through plans or need general advice please do not hesitate contact one of the SRG team members.

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