Operational Restructuring and Turnaround

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Tenzor Ltd.

- In operation since 2009. UK 2009-2016, Canada 2016-present
- Focuses on corporate restructurings, operational due diligence, and working capital management
- We work end-to-end: from problem to solution
- Projects included UK, Europe, US and emerging markets - Ukraine, India, Russia, Turkey, Argentina, Hungary, etc.
- Prior experience in both banking and well-run blue chip company- great mix for turnarounds
- Managed COVID-19 related working capital transition for major corporations worldwide

Why Turnaround?

- Insolvency may be an efficient solution if there are substantial assets in the business (based on actual liquidation value), and they can be easily secured.
- Otherwise, one needs to keep the company going concern as the best way to recover - and this is not only the lender's decision.
- To do so, one needs to answer why the company exists and how it is linked to its environment.
- Bank lender makes a one-off decision to lend-supply chain partners making their decisions (including granting credit) every time they trade

Five "C's" of Turnaround

- **Control**
  - Creditors seek to control assets and decision making
- **Capability**
  - The team (existent, new, or interim) need to be capable of the task
- **Credibility**
  - Turnaround plan and the team need to have credibility with all stakeholders
- **Clarity**
  - What is the company's core business, how it fits with the industry structure, and does the business model match it
- **Co-operation**
  - The lending group is not the only stakeholders. Ongoing support from suppliers, customers, distributors, and others are vital for survival

Steps for Distressed Turnaround

- Diagnostic – “post-deal” due diligence
- Fixing the team
  - Loyalty
  - Competence
  - Communication
- Re-defining the business- absolute key in the current environment
- Process optimization

Fixing the Team

- Building loyalties
- Motivation - not just money
- Understanding informal networks
- Identifying kickbacks, leaks, and frauds
- Approaches to bringing new people
- Making the culture shift
- COVID-19 challenge- how to do the above without regular face-to-face communication?

Industry structure and Supply Chain

- Global industry structures changed massively
- A platform company "Produces nowhere but sells everywhere... know where the clients are and what they want and where the producers are. Platform companies then simply organize the ordering by the clients and the delivery by the producers (and the placing of their logo on the product just before delivery).“- GaveKal
- Integrated and collaborative supply chains.
- Contract manufacturing, outsourcing, muli-tier distribution
- The rise of protectionism and COVID-19 have a profound effect on Supply Chain Strategies

Supply Chain- Distribution of Risk and Reward

- Understanding the supply chain is core to determining the future of the company.
- How are wealth and risk distributed?
- What is outsourced to whom? Who does financing- is the company a bank? Should it be?
- Is the issue overall health of the chain, distribution of rewards, and risks at a particular layer, or just company specific issues?
- Who can “shortcut” the chain, and what would be the consequences?
- Who is going to lose the most if the company disappears, and what can they contribute to rescue?

Working Capital- Good Starting Point

- Most of the problems of companies manifest themselves in working capital (A/R, Inventories, A/P)
- Aged debtor list and its analyses vs. sales:
  - Are receivables real?
  - Is aging real ?
  - Why payments are late – disputes vs. credit?
  - Are sales real?
  - What happened before the sale?
- A sale is converting inventory to A/R, showing a profit. Did it:
  - Push the problem next level?
  - Channel overstocking?
  - Produce uncollectable A/R
  - Is there actual end-user demand?

Working Capital Analyses – cont.

- Analyzing late payments allows to uncover issues with quality, logistics, systems, etc. –credit management is the best source of information about the company issues
- A/P
  - Short terms – why terms are not offered? What can be done to regain them?
  - Long terms –are these sustainable?
  - Overdues- would these be tolerated?
  - Key question – are suppliers still supplying, or are they already or about to stop?
  - May be significant cash outflow post-acquisition/funding.

Working Capital Analyses-cont

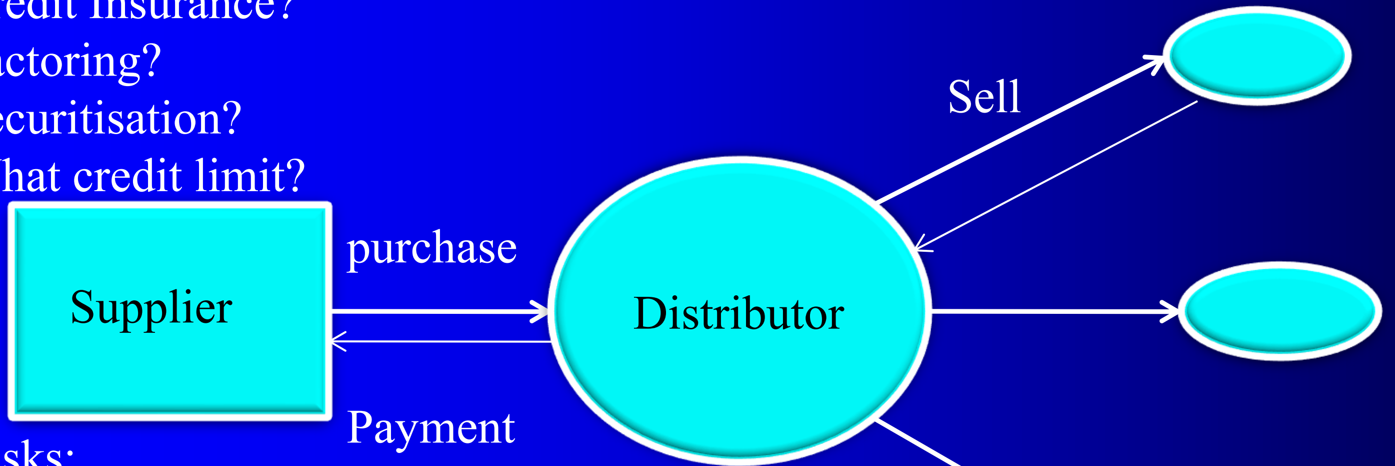
- Inventory
  - A clear distinction between finished goods, components, and work in progress
  - Obsolescence
  - Components for wrong models? They may be perfectly good but utterly useless
  - Is there a process for managing inventories?
- Overreliance on ratios - these are just averages
  - "Good" DSO may be a mixture of prepayments and massive overdue
  - "Good" DIO may be a large pile of useless stuff and a massive shortage of needed inventories
  - "Good" DPO may be a mixture of pre-paid suppliers and the ones who already stop supply and are looking for legal action

CAPEX/ Development Costs

- EBITDA focus creates a strong incentive to underinvest
- A company can run on close to zero CAPEX and even maintenance for a while – but this would mean massive cost in the future
- Cutting R&D improves short term profitability but negatively affects future cash flows.
- Cutting people improves profitability, but in many businesses this is the main asset.
- Particularly relevant for industry buyers- often overestimating own ability to develop/support
- Changing business model costs money
- Death by a thousand cuts vs. exit strategy

Redesigning the Model - Distribution example

Credit Insurance?
Factoring?
Securitisation?
What credit limit?



Risks:
Distributor credit risk
This risk may be highly concentrated
Customer credit risk (if the distributor has little capital)
Product liability (in any case)

Provides:
Marketing/Sales
Logistics
Service
Working Capital
Finance?
Risk mitigation???

Diversified risk?
Low concentrations?
Single vs. multi tier?
How do you finance receivables in EM?

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Distribution example

Credit Insurance -
easier to obtain?
Invoice discounting?
Factoring?

Provides:
Marketing/Sales
Logistics
Service
Collections?
Performance risk
mitigation?

Low working
capital needs!

Diversified risk?
Low concentrations?
Single vs. multi tier?

Rise of ABL

- Cash flow lending was the primary trend in the past. Today, for some businesses, EBITDA is much more volatile- reducing multiples and making cash flow lending unavailable in many areas.
- Lending against assets is becoming more used, especially where the value can be determined. And more data can transfer better valuation techniques.
- Illiquid and long term assets are challenging to lend against – the shorter term is easier but requires proper analyses.
- "New Financial Engineering"- how to reduce the risk in transactions
- Unlike cash flow lending, ABL often requires an understanding of operations

Supply Chain and Turnaround Financing

- The supplier (even a highly distressed one) is a lender, providing the next step in the chain (distributor, manufacturer, end-user, etc.) with credit through payment terms (sometimes they are the only or primary source of credit).
- A buyer of the goods can effectively provide money to the seller through reduced payment terms without taking a risk (providing that the supplier fulfilled the contract).
- This may give a workable alternative to DIP (Debtor in Possession) financing, allowing in some cases to provide funds to a distressed company without being affected by possible bankruptcy procedures

Key Early lessons from COVID-19

- Supply chains are key- understand the drivers
- Business models change quicker than ever before– should be part of most turnarounds
- Finance providers do not understand the risk and/or can not adjust regulatory models- diversify, educate and be creative
- Ample liquidity still available- buy time, but keep an eye on the end game

Thank You and Good Luck!

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