BUILDING FINANCIAL FORTITUDE

Quantuma

Survive or thrive

A guide to building financial fortitude in times of crisis

May 2021

Contents

Introduction: Building financial fortitude in a crisis?

2020 was a year like none other and with the world facing a rise in cases of Coronavirus (COVID-19), 2021 is shaping up to be another, if not more challenging year. Businesses face an extraordinary trading environment with the impact of COVID-19 and further lockdowns, coupled with other headwinds such as Brexit and the prospect of further tax reforms. The need for resilience and financial fortitude has never been greater.

So, what action can businesses across the UK take now to ensure survival in the challenging days that lie ahead?

Carl Jackson
Chief Executive Officer, Quantuma

A guide to help you take practical action

We've pulled together a series of practical and helpful articles into one handy guide to provide you with a no-nonsense approach to building resilience during times of difficulty. Packed with useful tips and expert insight, from our years of experience in helping businesses in difficulty, this is a combination of short, informative articles written to help both advisers and businesses alike navigate what is likely to be a difficult trading environment for some time to come.

Get advice early

Professional firms like ours want companies to survive and grow. Your business doesn't have to be in serious difficulty to justify having that conversation: it's always worth seeking advice, even if it's just to clarify a point or to bounce ideas off somebody. Please get in touch with someone in our team if you would like to discuss any issues you are having.

Building financial fortitude programme: get more content like this

Aimed at helping advisers and business alike, we've created a new programme called building financial fortitude that will give you access to a series of articles, guides and insight, providing practical and purposeful information.

You can find more content and useful information here: www.quantuma.com/fortitude

About Quantuma

We are a leading advisory firm serving the needs of mid-market companies and their stakeholders. We deliver the full suite of advisory services to support businesses through financial and operational challenges, growth as well as change. Our advice has a commercial, realistic and real-world focus, providing value to all stakeholders.

We have deep experience and specialist expertise in corporate finance, forensic accounting and investigations, restructuring and insolvency. We work alongside banks, major law practices, private equity houses, hedge funds, asset based lenders, brokers, accountants and regulators.

2020: the year that changed the game for Britain's businesses

Back at the start of 2020, none of us could have known that we were about to be plunged into a once-in-a-generation event that would radically change the way we live and work. In this final article, Graham Randall, a managing director in our Restructuring & Insolvency team, looks back at an unprecedented year which saw thousands of businesses closing their doors for good, some fighting for their survival, and others benefiting from the perfect storm of conditions created by the virus.

Nine months on from the start of the pandemic, the future is still uncertain. We've emerged from a second national lockdown period only to find ourselves back in the tiering system and thrown into another lockdown. The announcement of a 95%-effective vaccine – and the start of a nationwide rollout - has introduced a ray of hope as we begin this new year. However, as a result of tighter restrictions and a new COVID-19 variant in force, businesses continue to face financial challenges and an urgent imperative to secure their survival – not just through the crisis, but beyond.

The upside to Brexit

The end of the Brexit transition period has now been and gone, with businesses wondering what challenges they could face on the other side. But there will also be some real opportunities: owners and managers should seize this chance to review and adapt their structure and financial controls to ensure that their businesses are Brexit-ready.

Landlords and tenants still locked in stalemate

Since March 2020, when the government introduced its business rents moratorium – extended to 31 March 2021 - some landlords have refused to engage with beleaguered tenants; others have been actively aggressive. And many tenants have been unwilling – or simply unable – to give ground. While this well-intentioned government policy was the right thing to do at the time, commercial landlords are now facing a £4.5 billion rent shortfall by year-end.

With tenants still unable to pay, we've now reached a stalemate – and dialogue will only work if both sides come to the negotiating table, willing to engage and compromise.

Repurposing unneeded office space

With the transition to home-working set to become permanent for some corporates, overall demand for office space is only likely to fall. So, property owners may now be questioning whether their current balance between commercial and residential property still makes sense. Fuelled by the UK-wide housing shortage, recent legislative changes have made it easier to switch commercial property between classes of use – an option that could provide more flexibility in the ever-changing landscape of our towns and cities.

A double dose of disruption for businesses

Louise Durkan
Managing Director, Financial Advisory

When the first lockdown kicked in, M&A deal volumes fell through the floor as transactions were scrapped or put on hold for the foreseeable future. Then in July, when the lockdown began to be relaxed, deal activity started to pick up again. While there's no shortage of money in the marketplace, quality opportunities are few and far between. Deals are taking longer, primarily because good businesses are hard to find in the current environment – and by that, we mean businesses that are good in spite of the pandemic; not those that are good because of it.

Government lifelines can't last forever

Meanwhile, there's still a big question mark over what happens once the government starts to withdraw its financial lifelines. As things stand, we know that the furlough scheme is due to be wound up at the end of April. And we know that the landlord-tenant relationship will come under even greater strain at the end of March if the moratorium on commercial rents grinds to a halt as planned, or further into 2021 if it's extended once again. At the same time, directors and managers are now having to face up to the reality that loans, deferred VAT and other tax bills will need to be repaid in the not-too-distant future.

Brexit: another spanner in the works

Of course, the pandemic is not the only significant force disrupting our economy right now: we still have the start of a new phase having left the EU to reckon with – and the fear of the unknown that comes with it. But this degree of disruption will also be a real source of opportunity. Businesses that have fared poorly in 2020 might well be considering/have considered trying either to sell the entire company or parts of it. Valuations have inevitably deteriorated given that few are trading under normal circumstances or revenues at the present time. In addition, the difficulty of valuing businesses in this kind of climate means that canny buyers are taking their time to make decisions and scrutinise the future sustainability of potential acquisition targets.

Repercussions for cross-border transactions

As the dust begins to settle after Brexit, opportunities may emerge here too. For instance, UK-based businesses might opt to buy up European suppliers in order to keep their existing trade channels open. But whether that target company is based in Europe or the UK, completing transactions during these challenging times is more difficult and brings a new level of risk – what does the buyer do with their acquisition and how do they make it operational quickly?

Restructuring: from disintegration to reintegration

This highly disruptive environment creates some significant opportunities for restructuring. And this is where the concept of 'corporate memory' comes into play. Corporate memory – sometimes known as organisational or institutional memory – is all about the vital data, information and knowledge that's amassed by a business over its lifetime.

Take the example of a company that's acquiring a division of another business. While the buyer is essentially acquiring the assets that sit on the balance sheet of that division, the 'softer' elements of the business need to be more gently disentangled to ensure that corporate memory can be kept intact and successfully transferred across divisions. How can that division be either co-located or integrated into the buyer's existing business? How can joint services and intellectual property rights be carved out between them? And how can businesses hold on to in-house knowledge relating areas like software, design and testing?

Businesses that fail to give these issues the attention they deserve run the risk not only of losing or diluting that corporate memory, but also of ending up with a less-than-seamless integration. When we work with clients who are acquiring a division of a business, we always advise them to conduct rigorous due diligence on the target, before the transaction takes place. As the transaction completes, restructuring teams are essential to ensure that the corporate memory which sits around every asset, service, product, person and market is also extracted. Post-transaction, that same team need to ensure that it is successfully planted into the acquiring business.

Moving forward

As we all continue to experience a once-in-a-generation scenario which with it brings challenges and economic uncertainty, it is important for businesses to find light in the darkness and seek out new opportunities. Although not abundant or immediately obvious due to the tough economic conditions we find ourselves in, businesses should consider options which they may not have contemplated in the past. Whether this be utilising government funding, restructuring or seeking opportunities in this new era following Brexit, it is imperative that businesses adapt to the current climate in order to survive. When weighing up options, businesses should take a prudent approach and be aware of the current and future challenges they face so as to agree upon the best course of action for success.

Valuing businesses in challenging times

Jonathan Thornton
Managing Director Transaction Services

Richard Hill
Assistant Manager Corporate Finance

Due to the economic impact of COVID-19, valuing private companies has become more challenging. With ongoing uncertainty testing the application of traditional approaches, two of our experts explore what it takes to value a private company in today's environment.

In the past, various methods of valuing private companies have become established as standard. However, the current environment is very far from normal, and the COVID-19 pandemic is effectively challenging the application of traditional valuation methods.

Valuation methods in the current climate

One of the most commonly used valuation methods is discounted cashflow (DCF), which is based on discounting the future expected cashflows of a business.

The biggest challenge for many businesses in the current environment is establishing what future cashflows are likely to be. This is especially true with, for example, businesses in the hospitality sector. Not knowing what future lockdowns or other restrictions may be placed on the business makes it very hard to forecast.

This uncertainty regarding the future also leads to an additional return required by the market in order to justify the additional risk (the 'market risk premium'). The additional risk premium increases the discount rate and therefore creates downwards pressure on valuations.

An alternative to a DCF is to value a company based on the multiples of profits at which transactions involving comparable companies have taken place. This method is also more challenging, given the relative paucity of transactions in recent months and the number of accelerated mergers and acquisitions (M&A) processes where transactions may have taken place in distressed or fire sale situations.

Whether valuing a business based on its future cashflows or profit multiples, understanding the underlying sustainable profitability of a business is more important than ever. In the course of our work, we're increasingly hearing the term 'EBITDAC' - earnings before interest, tax, depreciation, amortisation and the impact of COVID-19.

The latter is very subjective, could be positive or negative and requires an assessment of to what extent things will return to 'normal' post COVID-19. For example, demand for office space or business travel may return to some extent post COVID-19 but almost certainly not to their pre COVID-19 levels.

What does this mean for owners looking to sell?

So, what does the difficulty of establishing valuations mean for business owners who are looking to sell at this point in time? Typically in an economic crisis, we see an increase in the gap between the price that sellers of businesses think that they can achieve and the price that buyers are actually willing to pay. That gap has widened as a result of this current crisis, but it may be possible to bridge that gap. For example, the use of earnouts and deferred consideration allow buyers to reduce the risk they are taking on, and the seller to participate in any upside. We expect these to be used even more frequently in the future.

For strong companies that can demonstrate financial fortitude, we are seeing resilient valuations and significant interest from potential acquirers. Investors are still seeking returns on their uninvested funds and require investment opportunities to generate returns for shareholders.

Some industries are seeing enhanced deal activity of course – Technology, Media and Telecommunications especially, as well as anything that takes business online and away from bricks and mortar.
Notably, buyers are putting enhanced premiums on those businesses with recurring or repeating revenues in business-to-business spaces and being highly cautious on consumer and discretionary spend businesses or ones which rely on big one off sales, as these are harder to get customers to sign off on in the current uncertain financial world.

Is now the right time to sell?

Despite the challenges involved, businesses may have very sound reasons to sell now. One of those reasons is the government's potential change to Capital Gains Tax (CGT). The scrapping of the Autumn Budget may have put that change on hold for now, but it could still be on the cards. With that in mind, selling a business now could make sense for business owners who want to avoid the risk of taking a bigger hit from CGT further down the line.

In addition, there is now an appetite among investors to do deals. Back when the pandemic first began, many private equity (PE) investors were firmly focused on looking after their existing portfolio companies, to make sure they would survive the crisis and provide help where needed. However, with portfolios generally settled, things have moved on and deals are now happening. The PE firms have plenty of dry powder ready to invest, and there will be some attractively priced opportunities out there – particularly among distressed companies – for players with the power to move quickly.

Get in touch with us to find out more and have a look at the webinar we held earlier this year for further information on how you should approach business valuations during uncertain times.

How to produce the right financial and management information

Graham Randall

Managing Director
Restructuring and Insolvency

Keep your management information up to date

Now, more than ever, businesses need to actively monitor their financial resilience by producing and reviewing management information. Across the spectrum of businesses, management information is crucial when it comes to monitoring performance, assessing and minimising risk, making investment decisions and providing external oversight.

A business that's backed up by solid financial management processes is well positioned to make better-informed decisions and producing accurate as well as up-to-date management accounts significantly speeds up the production of annual accounts. It also gives funders, shareholders and other stakeholders critical confidence that you're in control by: providing insight into the current financial health of your business; tracking key performance indicators such as sales trends; carrying out customer analysis; as well as looking at costings, margins and overheads.

Relying on regularly checking your bank balance is not enough. Develop simple profit and loss accounts as well as balance sheets and, if in doubt, ask for help from your accountant or a professional adviser. We frequently see directors and business owners who look at their pipeline, consider what the potential orders might be, check their bank account balance and assume that they are therefore in control. But this is a very risky approach, because it fails to take account of extra costs, loan repayments, unpaid debt including HMRC arrears, and delayed rent or mortgage payments.

Back to the basics on cashflow

Cashflow is the lifeblood of any business, and optimising working capital can help determine whether a business is likely to be successful or not. With the future still uncertain, it's time for businesses of all sizes to go back to basics. And that means assessing whether they are profitable on a day-to-day basis and making sure they have enough working capital to meet ongoing financial commitments as well as support any investment and expansion plans.

Whatever kind of business you run, you need to assess your cash requirements, particularly as your working capital requirements may well have increased as a result of the unpredictable economic conditions. And it's vitally important that your cashflow forecast covers both the short and medium term. Your cashflow forecast should also be sensitised to what you've learnt from the current market and backed by a solid understanding of the level at which sales or costs make cash tight.

In these extremely challenging times, where there is so much uncertainty around, the cashflow forecast will be the most important tool you have to ensure your business remains as resilient as possible.

Operating without a cashflow forecast is a bit like driving with a blindfold on: it leaves businesses – and directors - in a challenging and potentially dangerous position.

Make sure the underlying assumptions that support your forecast are honest and realistic, and if you can't draw on the skillset or experience in the business to produce this critical tool, ask your accountant, or relevant professional adviser, to recommend somebody with the right expertise to help.

Carrying out this essential task doesn't just force you to identify all the income and cost opportunities you face; it will also give you a clear picture of what cash your business will have access to at any given time during the period covered by the forecast.

It's also vital that you monitor and change your forecast on a monthly – or, ideally, a weekly – basis, because no forecast ever turns out to be 100% accurate. So, update the numbers to reflect the actual current position of your business and factor in any change in circumstances too. You'll then have a good idea of if and when the business is going to run out of cash, giving you essential time to take corrective action such as raising additional finance, cutting costs, seeking support from your landlord or HMRC, or negotiating delayed payments to suppliers.

Be realistic, not just optimistic

None of us can see what is around the corner. But while forecasting can be difficult, it pays to be as realistic as possible. Don't be over-optimistic but instead, err on the side of caution. For example, don't include revenues for contracts that you haven't yet won; assume customers will take longer to pay you because they are suffering just like you are. And don't take deferral payments for granted unless you've already reached an agreement with your creditors – either individually or collectively – that allows you to do so.

Seven simple steps that businesses need to consider taking

Paul Slevin

Director
Financial Advisory

Last year we all had to adapt to a once-in-a-generation scenario that none of us has ever experienced before. For now, all we can do is try our best to adapt to our new circumstances – and that applies not just to the way we live our daily lives, but the way we do business too.

Changes to insolvency legislation should boost businesses in the long term

Back in April, the government changed the Corporate Governance and Insolvency Bill to give company directors some degree of protection during this difficult time. But while the bill gives directors some leeway to make decisions that are in the best interests of their business long term, it offers no protection against deliberate wrongful trading. So, if you're unsure about the legality of the decisions you're making, seek professional advice. Also, remember that claiming ignorance of the rules does not constitute a legitimate defence. Therefore, before you decide, get all the facts, do the right research, and make sure you fully understand the challenge involved. Above all, document every decision you make.

Seven simple steps for survival

We've outlined seven simple steps that you can take now to prepare for the eventual end of the pandemic and sidestep the worst of a recession wherever possible:

1. **Keep your management information up to date:**

   Produce monthly reports on turnover, costs, cash etc, rather than relying on bank balance management alone. Create simple profit and loss statements as well as balance sheets and get professional help if you need it. Directors and business owners often look at their order book, think about what the potential orders might be, check their bank account and assume that this means they are in control. This is a risky approach right now, partly because it doesn't take account of liabilities like extra costs, loan repayments, unpaid debt, and delayed lease or mortgage payments.

2. **Produce short and long-term cashflow forecasts:**

   Make sure you have robust and honest cashflow forecasts that extend well beyond the end of the year to see you safely past the end of the transition period. Make sure you check your forecasts to ensure you know at what level of sales or costs cash would become tight: don't risk running out of cash without even knowing it was happening. Above all, remember that forecasts can change, so they need to be updated monthly – and ideally weekly.

3 Review your supply chain's resilience:

Does your supply chain still work to the same levels and costings as it did pre-crisis? Don't assume that sourcing your supplies from the UK means that Brexit won't affect your business: after all, your UK-based supplier might get their raw materials or labour from outside the EU. Any disruption to your supply chain could encourage your customers to go elsewhere, reducing volumes and jeopardising your ability to meet orders. Don't forget that other businesses are also feeling the pinch of the additional costs now involved in doing business, due to factors such as lower volumes and the need to comply with social distancing measures. In addition, any company could be hit by higher material costs as the price of goods increases. And finally, there's a chance, as we've briefly seen already, that Brexit could see the introduction of tariffs - and delays.

4 Think about your markets after Brexit:

- Are you still be able to trade into the same markets?
- Has COVID-19 changed the nature of your market? Is the same level of demand still there?
- Has COVID-19 adversely affected any of your customers?
- Will imports and exports be subject to further delay, increasing costs in the process?
- How is your workforce affected?

5 Build positive relationships with your landlord, your lender, HMRC and other major creditors:

Most lenders and creditors are keen to support struggling businesses, particularly if you've developed an open, honest relationship with them and worked with them to solve the problem. The end of landlord forbearance could represent a tipping point for legal actions against commercial tenants who have failed to engage with their landlords in a reasonable way. So, if your business is struggling, act now.

6 Keep your forecasts realistic:

In times of uncertainty, aggressive budgets come with even greater risks attached. So, keep your forecasts realistic, test your budget, then look at the worst-case scenario so you know what warning signs to look out for and what you might do if that scenario becomes a reality.

7 Get professional advice:

Professional firms actively want companies to survive and grow. Your business doesn't have to be in serious difficulty to justify having that conversation: it's always worth seeking advice, even if it's just to clarify a point or to bounce ideas off somebody.

Forecasting in a pandemic

Mark Roach
Director
Restructuring and Insolvency

Back at the start of 2020, I never thought that I'd ever have to write an article with a title like this. And I certainly would never have imagined what a different environment we'd all be living in a year on. How quickly things can change.

When we talk to businesses, we always stress the importance of forecasting and promptly identifying potential problems in order to maximise the options they have for addressing them. So, with no clear idea of how the pandemic might evolve – or how long it might last – are businesses essentially relying on guesswork?

Forecasting goes way beyond 'guesswork'

Of course, there's a big difference between a guess and a forecast. A forecast is an educated, reasoned assumption based on factual evidence or supporting information. And the more information you can gather in the forecasting process, the more accurate your forecast will be.

In other words, forecasting isn't about correctly predicting the future; it's about being prepared for what might happen if you've predicted it incorrectly.

Traditional approaches to planning and budgeting often result in a set of numbers that are more target-orientated, with final plans being locked in place for the whole year. They can be 'top down' – driven by revenue - or 'bottom up' - driven by cost-cutting. In normal times, these figures typically reflect current trading, plus a percentage change. They can also reflect 'management's will': what they want to achieve, rather than what's actually realistic.

But what often happens is that businesses put forecasts together and then promptly file them in the bottom drawer - never to be seen again. Other businesses don't have a forecast at all.

In reality, a forecast is only one possible outcome based on a number of variables. And what we have learnt this year is that circumstances can and do change - sometimes very quickly.

A short-term planning cycle makes sense in uncertain times

So where do you start your forecast in times as uncertain as these? While it's important to remember that past performance is not always a good predictor of future performance, looking at historical management information can help you to focus in on several important factors, such as:

- What are the main drivers of your business?
- Who are the key customers you rely on?
- What are your best products or services?
- How does your business cycle look, from purchasing, manufacturing/provision right through to sale and receipt of working capital?
- Which of your costs are variable and which are fixed? (The longer the forecast period, the more variable, and less fixed, items become.)

Once you've identified the key variables that define success – or failure – for your business, start your forecast with a limited, short-term, planning cycle:

- Start from the next month, perhaps even reviewing daily if required
- Next, look ahead to the end of the next 13 weeks
- Then look at each quarter to the end of the year
- Think about the impact of seasonality and peaks and troughs on your business, depending on your sector.

Stay flexible in your forecasting

The further ahead you're forecasting, the lower the level of detail you'll be able to include thanks to current market volatility, conditions in six or 12 months' time are much harder to predict than conditions next month.

Once you have an initial forecast, look at adding in different sensitivities and 'what-if' scenarios. This type of simulation will help to give you a clearer idea of the impact of a range of potential outcomes on your business.

Above all, don't stop reforecasting your forecasts. As time passes, update your forecasts to actuals, make adjustments for known events, expand on future months as they draw nearer, and then add more forecast periods onto the end - creating a constantly rolling forecast.

(And whatever you do, don't leave your forecasts in the bottom drawer until next year!)

Building financial fortitude:
A new programme of support

A forward-looking programme designed to help businesses and professional advisers find their way through these trying times.

Offering a fresh perspective, we have curated and developed a wealth of resources to support you during this pandemic and beyond.

In partnership with James Ashton, a leading financial journalist, we will be releasing:

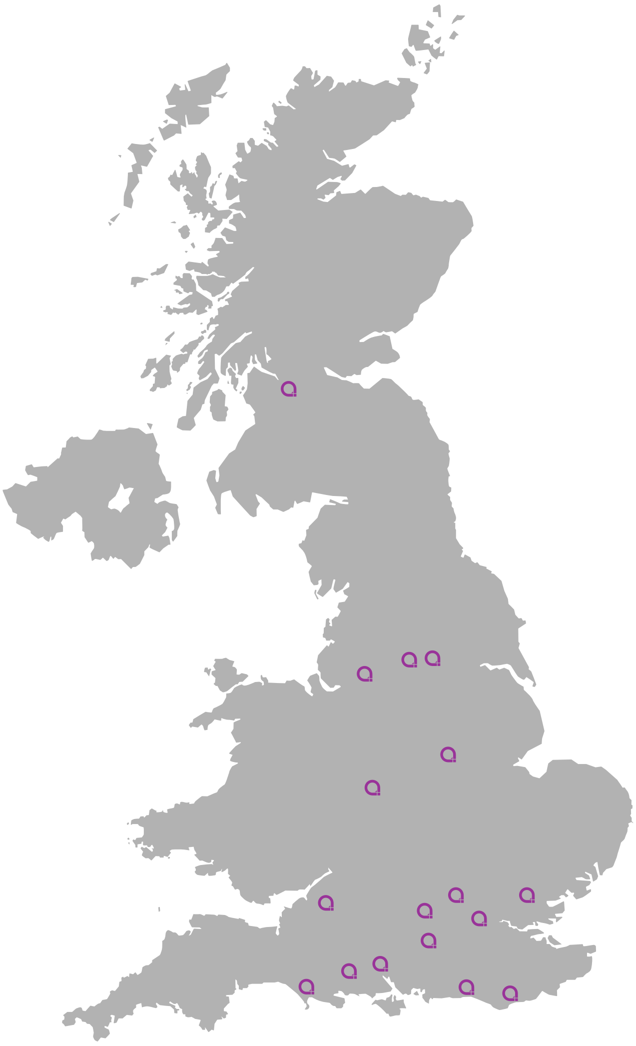
- Informational videos profiling key experts
- Articles covering key issues for businesses
- Timely insight on pertinent issues in our series of informal blogposts
- Handy guides and templates to make internal evaluation processes easier

James Ashton
Financial Journalist

Find out more today by visiting: **www.quantuma.com/fortitude**

BUILDING
FINANCIAL FORTITUDE

Get in touch



London
High Holborn House, 52-54 High Holborn, London, WC1V 6RL
+44 20 3856 6720

Leeds
Workspace Hub, Northgate, 118 North Street, Leeds, LS2 7PN
+44 800 955 3595

Glasgow
Turnberry House, Turnberry House, 175 West George Street, Glasgow, G2 2LB
+44 141 285 0910

Manchester
No.1 Spinningfields, Quay Street, Manchester, Greater Manchester, M3 3JE
+44 161 6949144

Guildford
1 Farnham Road, Guildford, Surrey, GU2 4RG
+44 1483 549549

Birmingham
Spaces, Lewis Building, 35 Bull Street, Birmingham, B4 6EQ
+44 800 955 3595

Southampton
Office D, Beresford House, Town Quay, Southampton, Hampshire, SO14 2AQ
+44 23 8033 6464

Nottingham
14 Derby Road, Stapleford, Nottingham, NG9 7AA
+44 800 955 3595

Watford
1st Floor, 21 Station Road, Watford, Herts, WD17 1AP
+44 1923 954170

Bristol
3rd Floor, Vintry Building, Wine Street, Bristol, BS1 2BD
+44 117 428 7400

Maidenhead
15 Forlease Road, Maidenhead, Berkshire, SL6 1RX
+44 1628 478100

Brighton
3rd Floor, 37 Frederick Place, Brighton, Sussex, BN1 4EA
+44 1273 322400

Weymouth
Basepoint Business Centre, Jubilee Close, Weymouth, Dorset, DT4 7BS
+44 1305 858284

Ringwood
71 Christchurch Road, Ringwood, BH24 1DH
+44 1202 970430

Bradford
Trust House, 5 New Augustus Street, Bradford, BD1 5LL
+44 800 955 3595

Eastbourne
The Old Printworks, 1 Commercial Road, Eastbourne, East Sussex, BN21 3XQ
+44 1323 409618

Chelmsford
75 Springfield Road, Chelmsford, Essex, CM2 6JB
+44 1245 201 233

Cayman Islands
Genesis Building, Genesis Avenue, Georgetown, Grand Cayman, Cayman Islands
+1 (345) 326 1790

Cyprus
32 Stasikratous Street, 4th Floor, Nicosia, 1065
+ 357 22 668 021

Mauritius
4th Floor Eagle House, 15 A5 Wall Street, Cybercity, Ebene, Republic of Mauritius, 72201
+230 464 6900

Quantuma

Restructuring & Insolvency | Financial Advisory | Forensic Accounting & Investigations

Cross-Border Asset Recovery | Pensions Advisory | Corporate Finance | Creditor Services

www.quantuma.com