

# Strategies for success in an Economic Slowdown

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12 June 2008

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## Today's agenda...

- ✓ Global credit crisis and its impact
- ✓ European private equity outlook
- ✓ 8 point defensive action plan
- ✓ When the economy grows again
- ✓ Questions and answers

## The credit bubble.....

- Strong GDP growth and low default track record
- Rapid lending growth by banks by increasing leverage
- Increased loan competition reduced covenants
- Willingness to refinance at low levels of loan amortisation
- Loan origination incentives decoupled from increased risk profiles
- Increased complexity, synthetic CDO, SIVs

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## The bubble bursts....

- US sub prime defaults amplified by crash in CDO ratings (July 2007)
- Basis Alpha Yield (August 2007) early sub-prime casualty
- Northern Rock crisis (September 2007)
- "...anticipate defaults to near 4-5 per cent, against the current rate of less than 2 per cent" (October 2007)
- Bear Stearns crisis (March 2008)
- "If the recession is deeper and longer than expected and lending...the default rate could ...possibly reach 8.5 per cent" (May 2008)
- "Germany's jobless figure rises" (May 2008)
- "Baltic states on course for hard landing" (May 2008)
- Oil prices hit US\$137 / barrel (June 2008)

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## The consequences....

- Many banks forced to recapitalise
- Reduced credit availability, falling real estate values, more equity participation, and tightening other terms
- Companies with leveraged balance sheets struggle to refinance when repayments are due...
- ...forcing companies to tackle core liquidity, operational and balance sheet issues
- Declining consumer confidence and spending
- Tangible impact on wider economy expected over the next 6-9 months

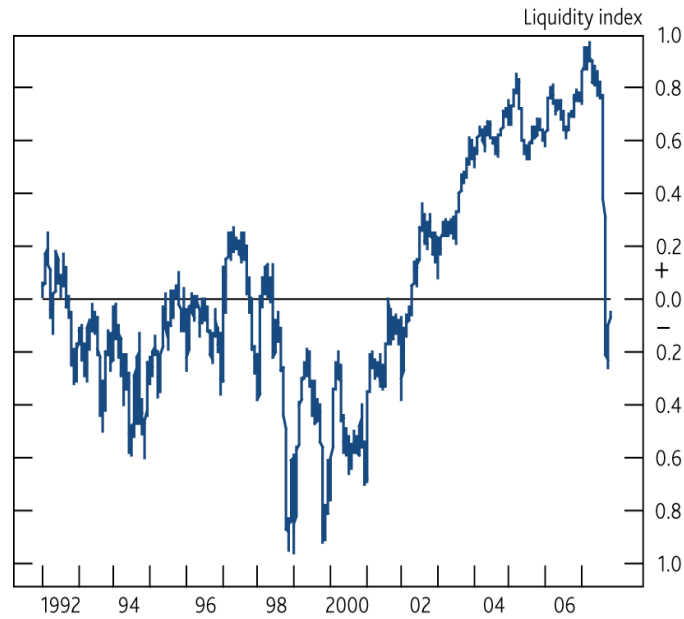
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## Private Equity – 2008 outlook

- Recent Debtwire / Grant Thornton study
- 110 European lending bankers, CLO providers, hedge funds and private equity executives consulted on their views on the market
- 78% of respondents expect European M&A dealflow to be adversely affected by the credit crunch, especially mega LBO buyouts, less so for mid and small cap deals
- Significant expectation of defaulting LBO credits over the next two to three years
- Views on the winners and losers across industry sectors

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# Liquidity levels:

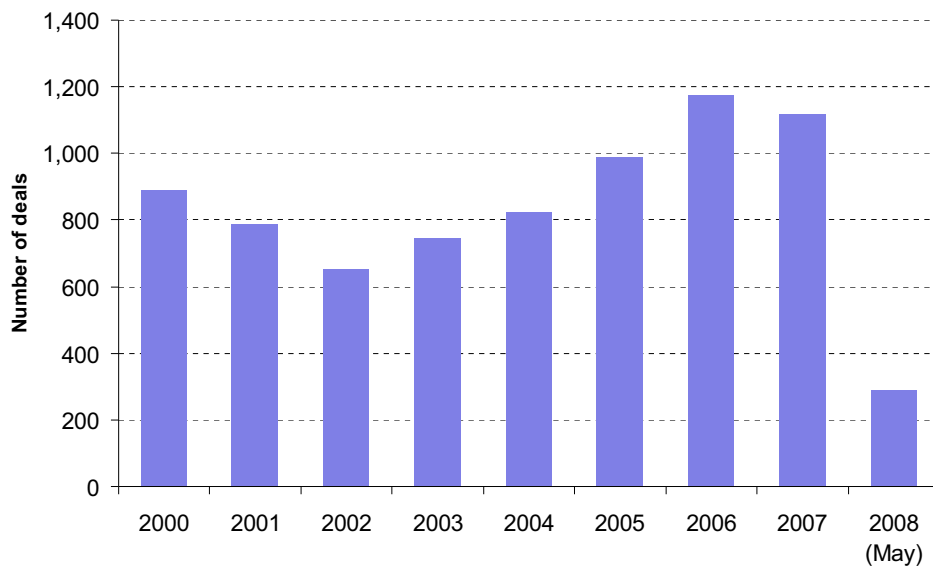


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Sources: Bank of England, Bloomberg, Chicago Board Options Exchange, Debt Management Office, London Stock Exchange, Merrill Lynch, Thomson Datastream and Bank calculations.

# LBO trends

## LBO trends in Europe 2000–2008 (May) - volume

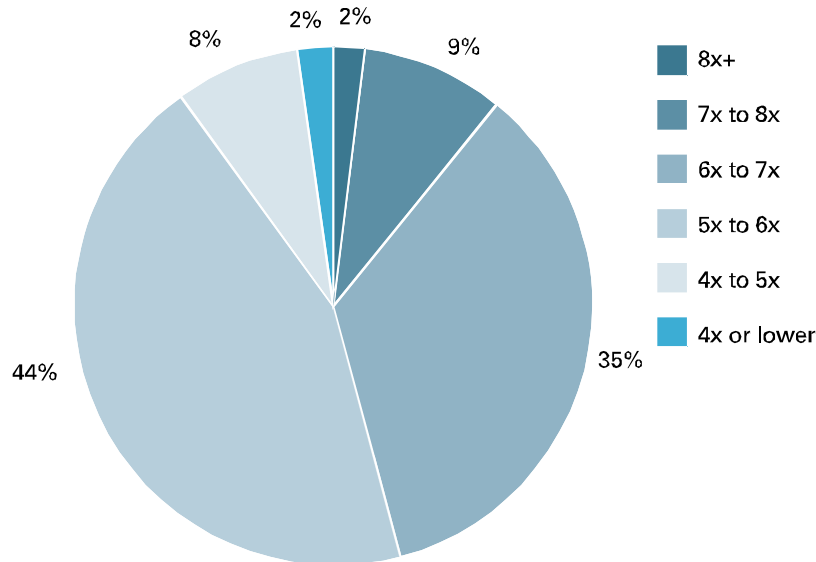


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Source: Thompson OneBanker

## Future leverage:

"79% expect total leverage to sit between 5x-7x EBITDA in 2008."

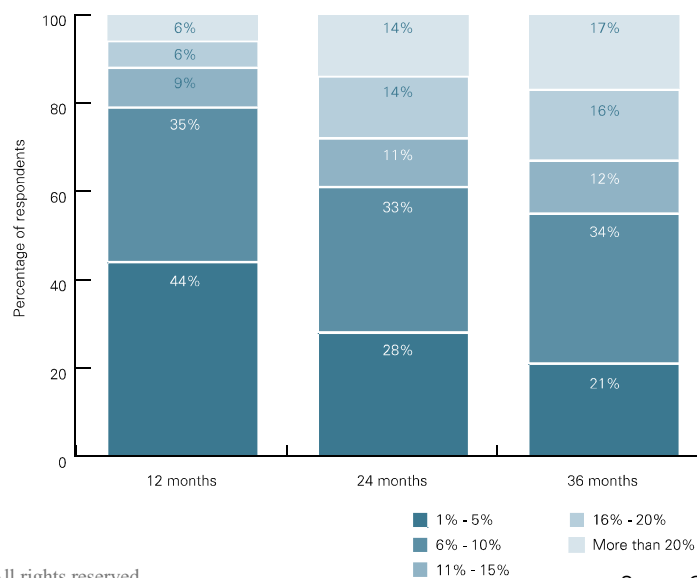


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Source: Grant Thornton/Debtwire Report Nov 07

## Future covenant breaches:

While default rates remain at historic lows, "17% of respondents expect a breach of 20% or more in 3 years' time."

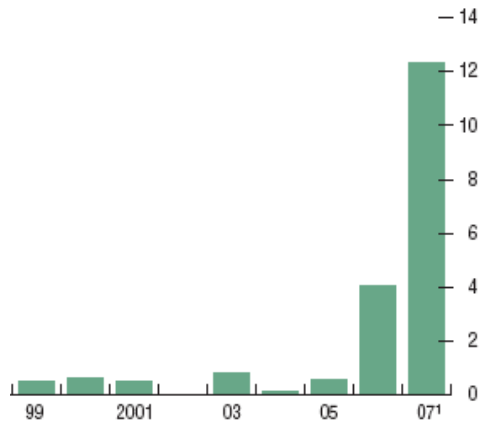


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Source: Grant Thornton/Debtwire Report Nov 07

# Debt structuring:

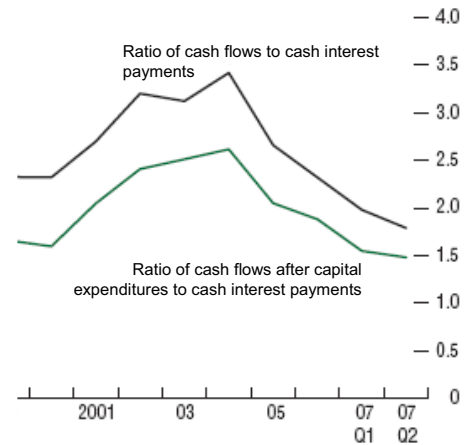
Cov-lite loans as a % of total



Source: Standard & Poor's Leveraged Commentary & Data.  
<sup>1</sup> First half of 2007

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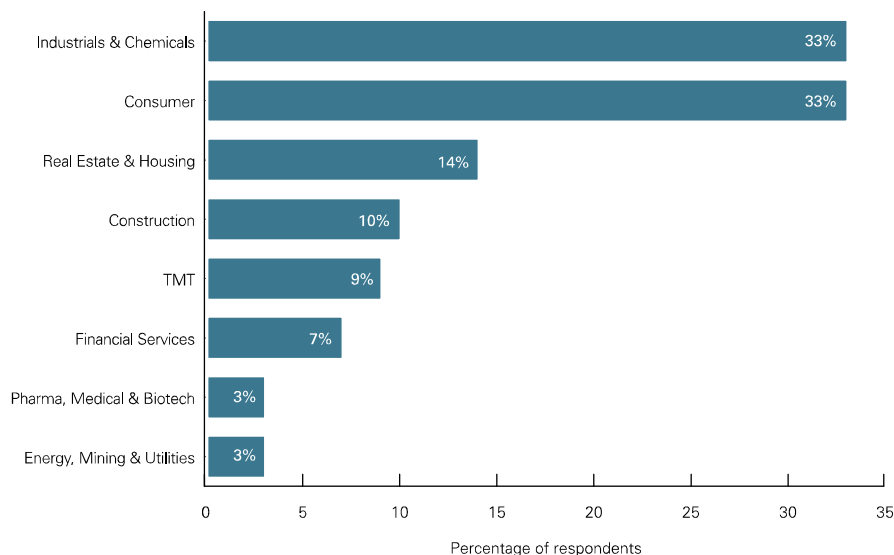
LBO Interest Coverage Stats



Source: Standard & Poor's Leveraged Commentary & Data.

# Sector focus - challenges:

Sectors likely to experience the most difficulty:



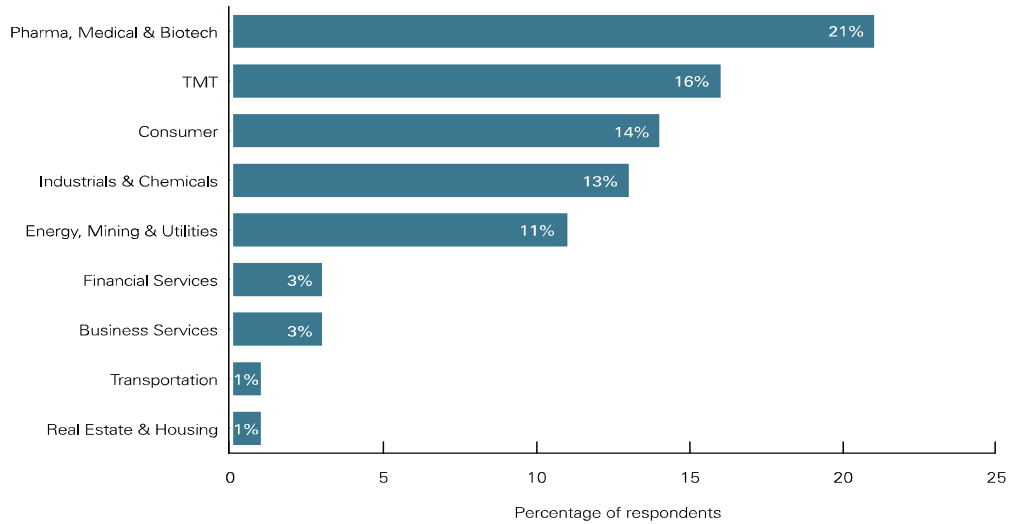
Please note that some respondents gave more than one answer

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Source: Grant Thornton/Debtwire Report

# Sector focus - opportunity:

## Sectors likely to experience the most opportunity:



Please note that some respondents gave more than one answer

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Source: Grant Thornton/Debtwire Report

# Summary of future trends in Europe.....

## What's in:

- Deeper due diligence
- Conservative lending
- Lower leverage
- Tighter covenants
- Higher cost of funding
- Operational performance

## What's out:

- High leverage
- Recaps / Refinancings
- Public-to-privates
- Easy exits
- Creative structuring
- Cov-lite deals

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## Spanish economy

- March 2008 - Spanish doubtful debts at 1.13% and rising
- real estate and construction industries in shock - domestic and overseas demand
- 800,000 new houses, more than France, Germany, UK together
- Spanish unemployment at 10%
- flat Eurozone growth expectations at 2%
- previous short-term 120% funding against property with rising values now restricted to 80% against falling values
- retail and leisure industries driven by disposable income

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## Specific issues for Spain

- relatively high leverage of debt by Spanish companies
- stigma of failure and impact of director liabilities
- new insolvency laws in Spain but largely untested
- limited experience over the past years of dealing with crisis files - applies to banks, judges, advisers, management...
- suspicion of counterparties - abandoned deposits, construction funding withdrawn
- emotional resistance to loss of value causing poor communication
- stakeholder relationships stressed

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## 8 point defensive action plan

- Focus on preserving liquidity
- Identify opportunities to degear
- Getting closer to lenders / financiers
- Being rigorous on cost control
- Review financial information systems
- Right size the business
- Revisit strategy
- Reassess investment plans

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## Preserving liquidity

- prioritising cashflow vs profitability
- working capital management
- short term cash flow forecasting
- treasury management & cash pooling to reduce pressure on credit lines

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## Degearing opportunities

- review the balance sheet for hidden treasure
- sell non-core businesses and assets to generate cash
- care to avoid covenant breaches
- will disposals breach net asset covenants or force high write downs?

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## Managing lender / financier relationships

- collaborative vs adversarial
- sharing financial information
- using financial advisors
- early notice of decisions and requests
- refinancing options

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## Approaches to cost control

- be relentless
- converting costs from fixed to variable
- prioritise using Value Added Analysis
- renegotiate contracts / leases
- procurement advisory support
- avoid false economy mistakes

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## Reviewing financial information systems

- no information = no control
- dashboard of key data and KPIs
- profit and cash drivers
- improve frequency of reporting
- timing vs quality – using flash data

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## Right sizing the business

- projected capacity utilisation
- labour costs – cut quickly and deeply
- retain key strategic skills and capabilities
- customers & products profitability analysis
- communicate well with key stakeholders
- remotivate and lock in talent with incentives

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## Revisiting strategy

- addressing underperformance
- industry and competitive analysis
- external threat analysis
- prices and delivered cost
- understanding the business model

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## Reassessing investment plans

- adopt cautious view of value and timing of returns
- invest in high quality diligence
- defer unless business critical
- prioritise with effective ROI and cash payback analysis
- renegotiate terms where possible

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## When the economy grows again

- how deep have companies cut resources?
- can management reverse "siege" mentality
- "going for growth" requires adequate working capital
- businesses "overtrading" may fail
- so...maintain internal cost, margin and financial discipline

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# Questions and Answers?

Thank you for your attention and participation

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