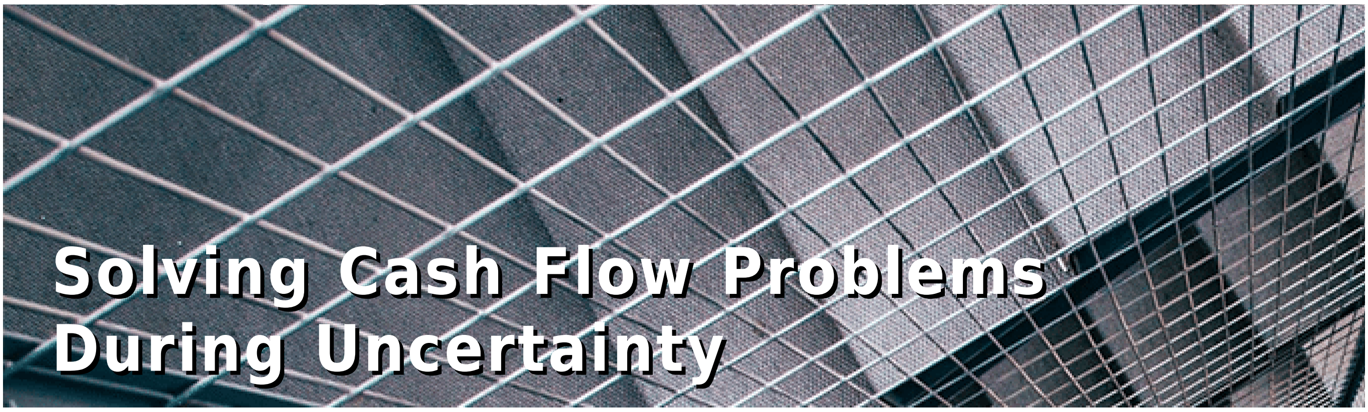

Solving Cash Flow Problems During Uncertainty

Is negative cash flow hampering your business during the COVID-19 outbreak? If so, Allan Nackan suggests a proactive approach—including the right diagnosis and a solid turnaround plan to help avoid formal insolvency proceedings and allow your business to get back on its feet.

Although winter is technically over, the current business climate facing Canadian businesses is 'frozen' with uncertainty. With the spread of COVID-19, businesses are facing various issues that are challenging their ability to prepare and operate in the normal course.

Since February, several industries have been subjected to unprecedented regulations from all levels of government, as well as various social, ethical and moral constraints self-imposed for the well-being of owners, employees, customers and the general public-at-large.

While many of these regulations and constraints are understood to be for the greater good, there will be lasting, adverse economic effects.

The COVID-19 outbreak is undoubtedly the single biggest factor causing uncertainty in local and global markets today. Compound the trouble caused by the virus with other macroeconomic factors—such as heightened competition, skilled worker shortages and minimum wage increases in various regions across the country—it's no surprise that many Canadian businesses are, or will be, running into debt and cash flow problems.

What is a Cash Flow Problem?

A company experiencing a cash flow problem is simply one whose actual or projected cash outflows exceed its cash inflows. In simple terms, the company doesn't have the money, or expect to have the money, to pay its bills.

Cash flow problems may be the result of systemic profitability issues or acute short-term challenges, for example, a delay in payment from a large customer.

Notably, businesses facing cash flow problems are not necessarily unprofitable. In fact, a profitable business may run out of cash because it is growing too fast and has a long cash conversion cycle.

Getting the Diagnosis Right

Like any business challenge, finding cash flow solutions starts with the correct diagnosis. Sometimes the cause of the difficulty can be obvious. For instance, one of our clients experienced cash flow challenges after losing its largest customer, which represented approximately 70 percent of sales.

Often, though, there are a confluence of factors which contribute. In another situation, delays associated with a plant move, higher commodity prices and the loss of business from a large customer all contributed to the company's troubles.

In the current climate, it's very important to perform a detailed financial analysis to understand the degree to which COVID-19 is affecting the bottom line—giving companies the opportunity to regain control on its financial future during this time of uncertainty.

Turnaround Plan

Once the root cause of each problem has been found, the company should put together a turnaround plan and tackle each problem one by one. There is a myriad of different options to be considered as part of a plan. For example, the federal government recently introduced an economic stimulus package to help Canadian businesses address short-term working capital issues.

Other short-term solutions could be to negotiate a 'bulge' in the company's lending facility, faster payment terms with customers, or longer payment terms with suppliers. It may even make sense to explore alternative financing options such as factoring.

Likewise, a financial model can be an invaluable tool in helping evaluate which options to pursue in dealing with cash flow problems. A proper financial model will include a forecasted income statement, balance sheet and cash flow statement. It will also forecast lending covenants and the borrowing base.

If longer-term profitability is an issue, various cost-cutting measures, such as closing unprofitable locations or divesting unprofitable lines of business, should be considered. Alternatively, it may be necessary to negotiate higher prices from customers or enter into longer-term payment plans with suppliers. However, if none of these measures work it may be time to file a formal insolvency proceeding.

Telling the Story

While no one enjoys talking about financial and debt problems—especially during these times—upfront dialogue with lenders, key customers and key suppliers can dramatically increase the chances of a successful turnaround—provided you convey a clear diagnosis of each problem and a sound action plan to address it.

A financial advisor can be a valuable partner in this regard. In addition to providing expertise and access to alternative financing options, a financial advisor can also examine the company's challenges and vet the turnaround plan—providing stakeholders with a heightened level of confidence.

An unbiased third party, in combination with a thorough financial model, can also help ensure stakeholders understand exactly what is being asked of them. For example, if a bulge is being requested, an advisor will make sure the lender knows the amount required, the time it will take to pay it back and what the borrowing base will look like throughout the forecast period.

A Proactive Approach

While it's true that debt and cash flow problems can lead to formal insolvency proceedings or restructuring, they don't have to. While we are all waiting for the dust to settle on COVID-19, it's imperative businesses begin the process of shifting back and focusing on the future. With early detection and the execution of a sound turnaround plan, it is possible to get back to positive cash flow.

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