RACHEL FOWLER ADVISORY

INSOLVENCY I RECOVERY I GROWTH

Rebalancing the Balance Sheet Post-Covid

The speed that Covid impacted NI businesses in 2020 was extraordinary. Almost overnight, whole trenches of the economy ground to a halt as more and more restrictions were introduced. Meanwhile, business owners were forced to address issues and risks that had never remotely been on their radar.

Cash Lifelines

Second only to ensuring that there was a safe operating environment for staff, was **cash** – where was it coming from, and how was it going to be allocated? To its credit, the Government played an unexpected, and unprecedentedly generous role at an individual business level. Mind you, the alternative of not providing liquidity would have been much, much worse for society.

The most visible and instant liquidity initiative was the Furlough Scheme. This delivered a cashflow lifeline to businesses and in doing so created a degree of certainty to huge swathes of the workforce. CBILS and BBLS provided businesses with easy access to loans on very favourable terms, followed by more industry & entity specific support schemes (e.g. to hospitality & leisure industries), VAT deferral and easing of time-to-pay process, and more localised initiatives such as business rates relief. All of these were very welcome initiatives to business in buying time while the public health issues worked out.

Free Dinner?

Not quite. The legacy of this period will be reflected in the annual accounts of businesses now and in years to come. New debt needs to be repaid from cashflow, and losses need to be recovered from future profits. A big question remains unanswered – how will your stakeholders, e.g. bank, suppliers, shareholders view your financial statements for 2020 and 2021 – positively, negatively, or just confused? This is critical as the annual accounts are relied upon (among other stakeholders): by suppliers to set credit terms; by customers where you are tendering for a contract; and, the bank in evaluating borrowing – both new, and old.

How will your business stand up to financial scrutiny?

Due to all that has occurred in 2020 and 2021, the financial strength of a business will be compromised by oddities in both Profit & Loss, and Balance Sheet. Margin analysis on the P&L will be problematic as turnover will include a disproportionate "Other Income" line reflecting government support, on top which are raw material anomalies in the period, including price fluctuations, that will need to be clarified before we even start to explain the sales, cost of sales and overhead lines.

The Balance Sheet will also have issues to contend with. Current Liabilities may show a build-up in creditors (e.g. rent, accrued VAT, PAYE, NIC) as cash was rationed but will also be balanced by missing items such as accrued/pre-paid business rates, or perhaps surplus unutilised cash balances sourced from CBILS/BBLS. Credit terms may have changed on both supplies, and your sales, all of which will need consideration when assessing ongoing working capital needs. Then we have the problem of evaluating long term liabilities arising from taking on CBILS/BBLS loans. This will play havoc with gearing ratios, a traditional control covenant used by banks as an intervention trigger.

Need for a Clear Financial Strategy

Undoubtedly some latitude will be given by stakeholders in the short term, however the same level of understanding can't be assumed for subsequent years. Hence, there needs to be a clear financial plan in place to start to deliver change in 2021/2.

This creates a great opportunity to reflect on the real funding requirements of the business:

- What is the working capital cycle, and then the optimum way to fund this?
- Is it appropriate to sit to expiry with a long term CBILS/BBLS debt, or should the strategy be to pay this down quicker, or aim to replace with working capital funding?
- Why continue to pay interest on long term debt that was taken on to plug short term losses once the business is back to profitability?
- The old principle that long term debt should be used to fund long term assets hasn't changed, so does the current funding structure reflect this?

The Covid crisis dented the confidence of business to make investment decisions on even medium term capital projects. Until the business is on a stable financial footing this will be a handbrake to growth.

Move to Action

Early and robust planning is key. Get Advice, Create a Plan, and Share this with your key stakeholders. Map out where you are going – demonstrate that you are forging your destiny, not a passenger on a drifting ship.

Help is at Hand

Having a trusted adviser beside you to challenge, validate, and originate ideas, and manage stakeholder relationships has never been more appropriate. At RFA we truly believe that we can help guide you through this phase (including exploring availability of grant assistance) to help you achieve the optimum solution for your business.

We would be delighted to speak with you.

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