PrimeRevenue

4 Ways Supply Chain Finance Helps Private Equity Owned Companies Overcome Buyout Challenges

Introduction

As the volume of private-equity-backed buyouts surges, so does the pressure for newly purchased companies to become high performers post-buyout. To understand these pressures is to understand the current (and complex) challenges facing private equity groups.

According to Dechert LLP's Global Private Equity Outlook 2019, there were 5,100 buyouts in 2018 – a 10-year high. Moving into 2019, global fund managers are ready to deploy a record USD$2.1 trillion in private capital according to institutional investment data provider Prequin. But while the private equity (PE) market appears to be robust, there are also headwinds. Trade frictions, slowing global economic growth (especially in China), high purchase price multiples and volatile equity markets are just a few.

However, there are two headwinds of noteworthiness – the first being rising interest rates. In the U.S., the Federal Reserve Bank raised rates four times in 2018 and has raised rates a total of 9 times since December 2015. The second challenge facing PE groups is that competition for deals is unusually high, which means firms are paying more and finding it increasingly difficult to keep loan-to-value ratios in check.

For a newly acquired company, the mandate is clear. PE groups need a faster path to positive returns — and companies need to be able to respond.

Newly acquired companies have always been under pressure to improve financial performance – but the pressure is mounting in the current post-buyout environment. Companies are facing twin imperatives: (1) to generate more cash, quicker without taking on additional debt, and (2) to respond effectively to the innovation, transformation and changing consumer preferences happening across their industry. Furthermore, these objectives need to be largely self-funded as private equity groups are reticent to invest additional equity.

Lessons Learned

In February 2019, 3G Capital, renowned for having an aggressive focus on savings and being a standard bearer for zero-based budgeting, began to make headlines for the wrong reasons. It's cost-saving strategies have come at the expense of innovation and product development for some of its portfolio companies. While competitors have been freshening up product lines, one of its companies had to write down the value of its assets by $15.4 billion

The lesson? Following acquisition, companies must focus on innovation-led growth and find ways to fund that growth without taking on additional debt. In today's business climate, it's paramount to survival.

1 Paying down debt.

In recent years, low interest rates have motivated many companies to use debt as an inexpensive way to fund acquisitions, expansion and stock buybacks (which are at record levels—$1 trillion for U.S companies in 2018, alone). But, by mid-2018, nonfinancial U.S. companies rated by Moody's were sitting on nearly $6 trillion of debt.

Today, there are concerns that economic expansion is slowing and a market contraction—or even recession—is on the horizon. Coupled with higher interest rates, pressure is high for companies to deleverage— even more so for newly acquired companies. PE groups are demanding positive returns quickly and debt reduction is a critical part of that journey.

It's no longer a question of "should we deleverage?" but "how can we deleverage quickly and most effectively?" Unlike other debt reduction approaches like workforce cuts or leaning operational infrastructure, supply chain finance enables companies to pay down debt quickly and substantially. By improving cash flow, companies can deleverage at a rate that has a material and favorable impact on debt-to-EBITDA ratios.

Historically, when a supplier can get paid is linked to when the buyer chooses to pay them. Supply chain finance breaks that link, freeing both the buyer and supplier to pay or get paid when they choose.

The buyer can optimize cash flow by holding on to cash longer through extended payment terms, and suppliers can improve their cash position by selling their invoices to a funder and receiving early payment. Both parties are individually strengthened, thus, a stronger trading partnership is created.

SUPPLY CHAIN FINANCE IN ACTION: GLOBAL BEVERAGE COMPANY

Facing $6.4B in leveraged buyout debt, a global caffeinated beverage manufacturer turned to PrimeRevenue to help more quickly pay off its debt. Within the first quarter of launching a supply chain finance program, the company generated USD$750 million in cash flow gain, which was used to pay back 15 percent of its debt and increased the company's trailing-twelve-months debt/EBITDA ratio by approximately 20 percent. The company has substantially reduced its cash conversion cycle, and S&P has upgraded its credit rating multiple times since the program launched. Having recently acquired an American soft drink company, the beverage giant now has an estimated USD$11 billion in annual revenues.

2 Accelerate strategic initiatives.

Given the transformations happening across most industries, the need to invest in innovation, R&D, acquisitions, infrastructure upgrades and workforce development has never been greater. This is especially true in industries like food, beverage, retail and automotive, where changing consumer preferences and technological advancements are redefining virtually every aspect of the business.

This business climate is introducing new dynamics to the relationship between acquired companies and the PE groups that own them. Traditionally, PE groups have turned their primary focus to optimizing the acquired company's financials within a relatively short exit timeframe. Today, these groups are focusing (and investing) more on strategic and innovative growth as a way to maximize exit profitability.

Leadership within acquired companies is feeling the impact of this shift in focus. There is pressure to accelerate strategic initiatives that will enable the business to be agile, grow, transform and outperform the competition – and ultimately generate higher returns in a timely exit. But the price tags for executing these initiatives in a timeframe that's aligned with the PE group's exit strategy are a challenge.

At a time when taking on new debt is unadvisable, companies need funding options that don't negatively impact the balance sheet. This explains why more companies are turning to supply chain finance. By accelerating cash flow, companies can unlock working capital previously trapped within their supply chains and invest this capital in strategic initiatives.

WOODSTREAM™

SUPPLY CHAIN FINANCE IN ACTION: WOODSTREAM

Woodstream, a leading manufacturer and marketer of branded pest and animal control products, wanted to increase enterprise value, despite a mostly seasonal cash flow cycle. With goals to develop industry-leading innovation and expand via acquisition, Woodstream needed to reduce debt and strengthen its cash position. The company implemented a mutually beneficial, PrimeRevenue-led supply chain finance program that unlocked nearly $12 million in cash flow gain within the first 3 months. As a result, Woodstream paid down debt and self-funded new market acquisition in less than two years – all while supporting suppliers through unprecedented economic volatility.

3 Meet value creation targets despite current economic conditions.

From the moment of acquisition, value creation is priority number one in accordance with the PE group's strategy. This covers everything from organic versus inorganic growth to operating plan targets for EBITDA, working capital, capital investment and others. While these targets and strategies may differ, they all have one commonality: they require financial agility. Whether it's deleveraging, expanding through acquisition or investing in fixed assets, companies typically need access to material sums of cash to achieve these targets.

Furthermore, companies must meet or exceed these targets regardless of market conditions. The economic climate can vary greatly between acquisition and exit, but the PE group's objectives are firm. This is one more reason why companies use supply chain finance. Regardless of business climate, it provides companies a financing alternative that reduces interest expense, generates cash and improves debt-to-EBITDA ratios.

SUPPLY CHAIN FINANCE IN ACTION: ELECTRICAL COMPONENTS INTERNATIONAL (ECI)

Electrical Components International (ECI) is a major supplier to the world's leading home appliance and specialty industrial manufacturers. In late 2008, at the height of a global recession, late customer payments began to threaten the health of the business. Supply chain finance proved to be a lifeline for ECI, which accelerated USD$25 million in cash flow and helped the company more accurately forecast revenue performance and obstacles. Then CFO Mitch Leonard remarked: "In a time of financial catastrophe for many companies, supply chain finance provided us the cash flow we needed to weather recessionary times."

4 Diversify funding mix.

Economic growth and expansion have defined much of the last decade, but the party may be over. While it's yet to be seen if fears of a full-blown recession are valid, an economic slowdown of some degree is underway. Companies (and their investors) are reevaluating their financial positions and ability to weather whatever turbulence may be ahead.

Corporate treasurers and CFOs know that ability is directly tied to the funding options available to them. Commercial lending, dynamic discounting and early payment programs are all levers used to increase cash and optimize cash flow. Supply chain finance is one more to add to the mix with the added benefit of offering a lower cost of funds than a revolving line of credit and a more material impact to cash flow than dynamic discounting or traditional early payment programs.

SUPPLY CHAIN FINANCE IN ACTION: FREIGHT AND LOGISTICS PROVIDER

Backed by a global PE firm, this sub-investment grade freight and logistics provider is a supplier to several major brands in the automotive space. With an IPO exit on the horizon, the PE firm wanted to diversify the company's funding mix so it could better optimize working capital and extract as much cash out of the business pre-exit. PrimeRevenue's supply chain finance program helped the company accomplish these objectives while also providing the scalability and flexibility needed to change the funding structure as the company's risk profile changed.

Carving a Faster Path to Positive Returns with Supply Chain Finance

Newly acquired companies face several challenges unique to the private equity landscape. It's not just about growth – it's about value creation and expediency. By materially improving cash flow, supply chain finance can unlock large sums of working capital that can be used to pay down debt, accelerate strategic initiatives and meet other operational and value targets. This all paves a smoother and faster path to positive returns that exceed investor expectations.

About PrimeRevenue As a pioneer in global B2B payments, the PrimeRevenue SurePay Platform connects the entire supply chain by improving working capital and automating digital payments. Thousands of companies around the world leverage one streamlined platform to increase payment visibility, enhance control, and improve cash flow. PrimeRevenue is headquartered in Atlanta, with offices in London, Prague, Hong Kong, and Melbourne. For more information, visit **www.primerevenue.com.**

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