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Tightening the Proverbial Belt

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Corporate life often mirrors personal experiences. The COVID-19 pandemic shook the foundations of our lives, prompting a series of unexpected consequences across both our personal and professional domains. At the onset of the pandemic, most people did not anticipate such a significant disruption that would last well over a year. Some have gained the "freshman 15 pounds" during quarantine due to limited mobility, lack of exercise, and extended periods in front of computer screens on zoom calls in sweatpants all day. And there are those who took the opportunity to refocus, establish discipline in their routine, and get in the prime shape of their life. This analogy can be applied to the corporate world as well. Leaning up your organization will remain critically important in this uncertain future.

Given the slow economic recovery, rising corporate leverage, declining borrower credit quality, rising input costs, scarcity of labor, and hurt consumer confidence, financial experts expected to see a rise in credit defaults through the pandemic, yet defaults have fallen. To support businesses, lenders have modified loan terms and extended maturities to provide borrowers with liquidity and flexibility through the pandemic. Private debt funds have more capital under management to deploy than ever and LPs are pressing them to deploy capital even if at lower expected returns. Ratings agencies continued to allow higher leverage from corporate borrowers in an environment where there are no real punishments to disincentivize lenders.

And to further strengthen the credit wave, the U.S. Federal Government has issued trillions in credit to assist companies in the fight to sustain themselves through the pandemic. As of May 2021, the SBA alone has issued nearly $800 billion in Paycheck Protection Program (PPP) loans – $275+ billion in Q1/Q2 2021. The lifeline issued to many healthy and distressed middle market companies has served to stem the bleeding at least for now and tempered bankruptcies. For how long though? Are companies strategically investing the funding received in value-added, bottom line generating initiatives or simply using the funds to keep the lights on and delaying the inevitable?

Given this wave of available credit amid slow economic growth, one would expect a future rise in defaults and restructurings. The initial phases of COVID-19 challenged weaker companies and prompted an initial wave of bankruptcies that has largely subsided. There is a line of thinking that the recent wave of credit has delayed the next wave of bankruptcies. If economic recovery is slow, continued revenue stress, lower earnings, and working capital funding requirements will make existing and new debt much more difficult to service. Industries that may continue to experience significant shifts post-pandemic include commercial real estate and the business services that support them, brick-and-mortar retail, travel services, small or niche manufacturing, amongst others.

With these factors top of mind, it begs the question – when, if at all, will the levies break? Creditors have an intimate understanding of the business challenges brought on by the pandemic, but many remain skeptical about the speed of the rebound. Will buying patterns of

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consumers change? What traditional channels will continue to draw discretionary spending? What lifestyle needs, and the products/services that support them, remain post-pandemic?
Returning to pre-pandemic performance levels will be challenging. Now is the time for businesses to take a proactive approach regarding restructuring and managing their liquidity runways and investment strategies. And for those that have acted, closely monitoring variability against forecast as well as instituting contingency plans when triggers are met will be crucial. While the inclination for some owners and operators may be to continue to "wait and see," that approach runs the risk of situations becoming significantly more stressed as cash tightens. We are not out of the COVID woods yet, companies will continue to face operational headwinds. Act now by getting lean, investing in more efficient processes, and streamlining organizations. Shake off complacency, as many have personally done during the pandemic, and be proactive by looking inward and developing company-wide go-forward strategies.

Areas companies can immediately investigate and focus include:

• **Market assessments of their bread-and-butter segments** – determine what products are well positioned for corporate growth and provide continued value in our changing environment.

• **Pricing rigidity and/or flexibility** – margins are always key but focus on price sensitivity within one's customer base will allow companies to differentiate.

• **Inflation and rising input costs** – inflation concerns are real, so identifying efforts where pass through economics (to customers) or pegged contract pricing (with suppliers) are relevant.

• **Detailed profitability assessments by product families** – improved understanding of product profitability and key segments can help to drive capital investments and ROI.

• **New product investment strategies** – through continued innovation.

• **SG&A spending reductions** – understanding where parts of organizations can be smarter and leaner in spending habits.

• **Overhead reductions** – organization alignment and utilization are essential to driving success.

• **Plant consolidation opportunities** – focus on asset utilization and network optimization will help to drive cost management.

• **Process efficiency strategies** – becoming leaner and fit.

• **Supply chain optimization** – revisit supplier contracts and major cost elements (i.e., inventory, distribution, quality control) that can be pro-actively reduced and/or managed.

• **Revisit strategic acquisitions or carve-out divestitures** for core or non-core business units.

• **Short-term and long-term liquidity** – extend runways where possible for increased flexibility.

• **Balance sheet strength**

At G2 Capital Advisors, we are a group of sector-focused professionals who work as an extension of our clients executing on M&A growth strategies, capital raising activities and helping clients navigate challenging liquidity or performance environments. We bring industry expertise, a network of relationships, and relevant thought leadership to identify opportunities to help our clients achieve success. We pride ourselves in our ability to tighten the belt, pro-actively lean-out organizations, and position companies for continued growth.

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About G2 Capital Advisors:

G2 is an integrated multi-product, industry-focused investment bank and restructuring advisory firm focused on crafting bespoke operational and financial advisory solutions for our corporate and investor clients. We work with clients across a range of situational dynamics, from struggles with a challenging downtrend to development of and execution of a growth strategy. Our breadth of service capabilities is unparalleled in the middle market.

We encourage you to reach out to our team below for more information!

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