



How to Stress Test Your Business in Times of Crisis

This is the only time it is worth the trouble....

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Session Presenter

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Take the Risks that You Understand and Avoid Those that You Don't

Gaining Share in Large Disruptions Is All About Risk

Factors Predicting Share Loss

- Cash flow issues are a factor
- Blindly taking care of their largest customers ignoring many others
- Being fearful for the future and getting under the turtle shell
- When the market recovers, they run out of working capital

Factors Predicting Share Gain

- Leveraging a strong balance sheet
- Aligning limited resources to the most attractive customers that will most likely survive
- Being a resigned, but optimistic leader to their customers helping them as they create the new normal
- Willing to make investment bets

Stress testing significantly reduces risk

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This Was the NAED Group Opinion as of March 30th

Every distributor will plan for this scenario and take the actions necessary to ensure their survival. They don't have to like it; they just have to do it.

Exclusive Baird Research Confirms Steep March Revenue Decline

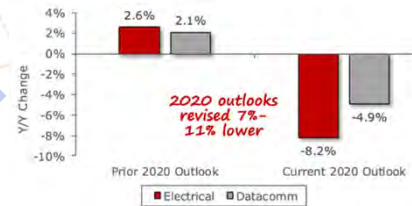
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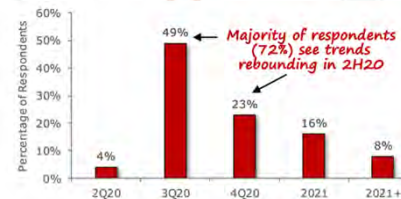
A special COVID-19 research project for *iED* magazine confirms a steep decline in revenue for electrical distributors beginning the first week of March. But, a majority of electrical distributors expect to see a rebound in the second or third quarter of this year.

RJ Baird launched the special research project on March 27th and followed it up with questions for distributors during the week of March 30. A total of 127 people responded to the survey, which represent companies that report a combined \$25 billion in yearly revenue.

How bad will it get?



How long will it last?



This Is What the Banks Did After the Great Recession in 2009 and 2010 Stress Testing Uncovers Your Actual Limits, Not Opinions

This is testing, not predicting or forecasting

Stress testing is a means to measure the resilience* of a business when subjected to unexpected shocks:

1. What are the outside ranges of potential revenue declines?
2. How long will the test conditions continue and how will they return to 'normal' operating limits, i.e. is it a V or a U or an L?
3. How comprehensive is the designed cost reduction program and how effectively is it executed?

Distributors that go broke are almost always surprised

Stress testing eliminates any surprise and provides time, if corrective action is needed

** Time before running out of cash or blowing a lender covenant*

1	UNL
2	Beginning Cash
3	Unadjusted Ending Cash
4	Cash Adjustment
5	Adjusted Ending Cash
6	
7	Margin Adjustment
8	Current Proforma Margin %
9	Margin Adjustment in Basis Poi
10	Adjusted Margin Dollars
11	Total Margin Adjustment
12	
13	Sales & Marketing Expenses
14	Personnel Cost Adjustment
15	Other Adjustment
16	Total Sales & Marketing Expe
17	
18	Delivery Expenses (expense)
19	Personnel Cost Adjustment
20	Other Adjustment
21	Total Delivery Expenses Adjur
22	
23	Warehouse Expenses (expense)
24	Personnel Cost Adjustment
25	Other Adjustment
26	Total Warehouse Expenses Ad
27	
28	Occupancy Expenses
29	Adjustments
30	Total Occupancy Expenses Ad
31	
32	Information Technology Expe
33	Personnel Cost Adjustment
34	Other Adjustment
35	Total Information Technology
36	
37	General & Administrative Exps
38	Personnel Cost Adjustment
39	Other Adjustment
40	Bad Debts
41	Total General & Administrativ

There Are Many Difficult Meetings Along The Way

By Step Five You Have the Confidence to Take Action

1. Download* the free Excel cash flow modelling spreadsheet, along with instructions on how to use it at: <https://www.ircg.com/services/stress-testing>
2. Get finance to load your historical data into the template and give them freedom to add whatever extra specifics that they want
3. Develop a series of three scenarios; optimistic, realistic, and pessimistic expressed as percentage sales declines from the same period in 2019 (next slide)
4. Plug the values into the template to determine when you run out of cash or blow a bank covenant
5. Test multiple combinations of cost reductions to optimize survivability while positioning the firm's strength for the recovery

* No personal information is required to access these files

No One Knows if the Economic Recovery Is Shaped Like a V or a U or an L How Deep and for How Long Defines the Stress Level

The McKinsey Covid-19 scenarios, are displayed on the right where A4 is best case (V) and B3 is worst case (L) as of April 15th

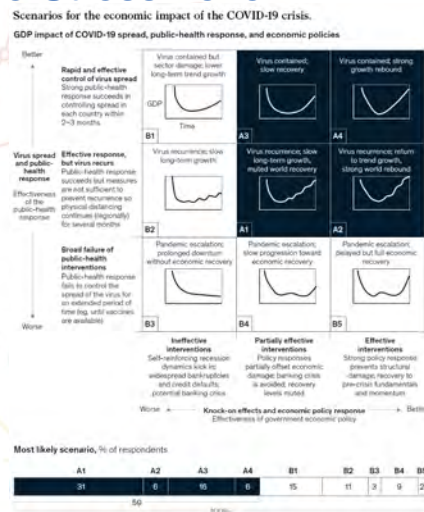
Since no one really knows, we might consider that most things occur in the middle of a bell curve, which is their A1 scenario

- If you decide it is A1, then test for revenue declines from 2019 from the table below and measure your survival time at various scenarios
- You are testing, **NOT** predicting

Example only

Revenue Declines	Q2 20	Q3 20	Q4 20	Q1 21
O - Optimistic	-20%	-15%	-10%	-5%
R - Realistic	-40%	-30%	-20%	-10%
P - Pessimistic	-60%	-50%	-30%	-15%

The ranges you choose should be defined by your geography, where you are in the phases, and the markets you serve, e.g. Infrastructure vs. O&G



<https://cdn.ksrinc.com/mckinseysurvey/article68.pdf>

Taking a 'Wait and See' View Increases Your Risks Going Forward

Using the Tool

A stress test tool replaces planning as the core control process because you can't predict the market and can only focus on executing the fundamentals well while being innovative

	A	B	C	D	E	F	G	H	I	J	K	L	M
1	ONLY ENTER VALUES IN SHADED CELLS												
2	Beginning Cash	\$13.0	\$16.0	\$36.7	\$54.2	\$74.0	\$97.2	\$99.5	\$79.2	\$48.6	\$17.4	(\$1.5)	(\$16.1)
3	Unadjusted Ending Cash	\$16.0	\$36.7	\$54.2	\$74.0	\$97.2	\$99.5	\$79.2	\$48.6	\$17.4	(\$1.5)	(\$16.1)	\$0.0
4	Cash Adjustment	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
5	Adjusted Ending Cash	\$16.0	\$36.7	\$54.2	\$74.0	\$97.2	\$99.5	\$79.2	\$48.6	\$17.4	(\$1.5)	(\$16.1)	\$0.0

If this was your pessimistic forecast, you would likely conclude that you passed

If you don't like your survival time in a scenario you design a cost reduction program that achieves your minimum acceptable standard

Using an analytical tool supports evaluation of multiple cost reduction alternatives

- Stress tests let you measure the impact of providing extra customer terms or supplier dating terms on survivability
- Keep it current to incorporate changing events so you don't ever have to wonder

Cost Reduction Lever One: Payroll Reductions (~65% of the Gap)

Your group must define which kind of expense dollars can more easily be eliminated, even for a short time, over others

- Differentiate between revenue producing expenses and pure overhead expenses
 - Except for field sales: If customers aren't buying, there will be opportunities to upgrade your sales team, so turnover should make you stronger*
- You must be able to ship before you can invoice, so protecting warehouse operatives becomes critical, especially as illness will make absenteeism a major issue through the summer
- Pay close attention to the changing federal and state support programs available so your customers look to your team as their experts
- Consider furloughs in addition to split work teams to provide continuity when one team must self-quarantine (It is only a question of when)

Cost Reduction Levers Two and Three

Non-Payroll Cost Reduction (~25% of the cost gap)

Tell each department head that the salary reduction plan is based on the assumption that 25% of non-payroll expenses can be eliminated or deferred into 2021

Ask them what can be cut, and if they can't hit 25%, let the CFO know ASAP

Margin Improvement (~10% of the cost gap)

Look at vendor consolidation to optimize buy prices, push private label, reduce commission rates on non-stock items, when close to recovery negotiate a 2021 annual order with monthly releases and a large cancellation fee, put limits on panic discounting by reps (Don't forget to ask suppliers for extra discounts for fast payment)

Put together a strong working group of branch managers, and sales reps, along with finance, purchasing, and operations staff, then challenge them to build a plan and tell them a RIF will make up the difference

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Hunkering Down and Waiting for it to Pass Is Potentially a Risky Choice

What We Are Advising Our Clients Now

1. Recognize that the affects of this pandemic will be with us for a long time and things will never go back to the way they were in January
 - The real question is not when it will be over, rather it is how do you continue and win?
 - The pandemic is accelerated the changing role of the field sales rep, so how will you drive this?
2. Do a stress test to remove your uncertainty
3. If cost reduction is needed, do it deep and fast
 - Speed is a weapon
 - There will be opportunities to upgrade staff
 - Optimize your strength for the pandemic recovery point while protecting your core team
4. Develop your strategy and scenarios to exploit market disruptions as there will be many (these are planned to support aggressive and quick reactions to opportunities)
 - In any major disruption, initiating has much more value than just reacting
 - We already have two clients that are primarily focused and working on share growth in the recovery (one is an NAED member)



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