STEPS TO TAKE IN GETTING THROUGH A FINANCIAL CRISIS

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<u>Background to a Financial Crisis</u> - The current Covid-19 pandemic has laid bare what happens to viable businesses when, from out of the blue, sales dry up and customers can't pay their invoices due to their own cash flow issues or you have no choice but to close or scale back certain operations. If you find yourself in a crisis situation where, all of a sudden, you are now concerned about whether you will be able to maintain profitability and positive cash flow, draw a salary, pay your employees, landlord, bank and vendors, it becomes critical that you ***DO NOT PANIC***. So, take a deep breath and sit down to figure out how best to get through this pandemic, financial and economic crisis. It may take a while before business is back to normal, but, in the meantime, you need to survive and must be ***PROACTIVE*** in order to take the necessary steps to stay in business.

<u>Cash Flow Is King -</u> ***Companies are run based on generating positive cash flow***.

<u>Cash Receipts</u> – Making sure you have a positive cash flow means you need to put together a detailed cash flow forecast by week to show how much cash you can expect to bring in and what you absolutely need to pay to keep the business running. It is extremely important to recognize that revenue does not mean cash receipts. There is always a lag between generating revenue and generating enough cash to cover your expenses. You need to collect accounts receivable in order to generate cash. To the extent you have invoices outstanding that are due to be paid, follow up with your customers to make sure they will still be able to pay you and when. If they need to stretch out payments due to their own cash flow concerns, work with them. But you will also need to take the reality of your accounts receivable collection forecast into consideration in putting together your cash flow forecast. Be proactive. Make sure you send out invoices in a timely manner. <u>Communicate and work with your customers</u>. Is there is something you can do to help offset the loss of revenue and enhance collections? Most importantly, be realistic about your weekly forecasted cash receipts over the next 6-month period. Cash availability to pay the amounts due on a weekly basis includes the beginning cash balance plus the weekly cash collections less actual cash disbursements on a cumulative basis.

<u>Cash Disbursements</u> – Once you have determined the most likely scenario for forecasted weekly cash receipts, you will need to list cash disbursements ***<u>on a priority basis</u>***. The most important payments needing to be made should be listed first, including payroll and payroll taxes, priority vendor payments, then other overhead expenses, including lender payments and other fixed obligations. Once you have listed the required cash disbursements, subtract these payments from your cash availability for each week as forecasted. Assuming there is a negative cumulative cash balance after deducting the cash disbursements, you will need to adjust. For example, what can you cut or push out that is not critical? Do you still need the current level of employees on your payroll? Are there key vendors you can call to work out a payment schedule? Don't be afraid to call your vendors and tell them your situation. If additional help is needed, call your bank lender and ask for a deferral of interest or principal payments or a restructuring of your loan. Look into SBA loan programs being offered to help deal with the crisis. What about your landlord? ***Managing your cash flow is critical to survival and business viability.***

Cost of Sales, Gross Margin and Operating Expenses – One of the important items to take a close look at is your cost of sales, gross margin and operating expenses. If sales have fallen off, that is going to have a direct impact on the availability of funds to meet your operating expense needs. If you are not making enough margin to cover your own product cost, coupled with your overhead expenses and profit margin, then the product is not being priced correctly and / or expenses are too high. That means the more product you sell, the more money you are losing. To help offset this, is it possible to improve your gross margin by reducing direct labor costs or purchases? With reduced sales, can you operate in less space and sub-lease out the unused portion of your warehouse to generate income? What about your manufacturing overhead, such as utilities or freight? What operating expenses can be cut? With reduced sales, what other can cuts be made in these expense areas? If your pricing and gross margin are low to begin with, then lower sales means there will be an even greater need to find ways to reduce your cost of sales and operating expenses.

Breakeven Sales Calculation – This calculation shows the amount of sales needed to cover fixed operating expenses given the current gross margin percent. For example, if fixed expenses are $10,000 and the gross margin percent is 40%, then the amount of sales needed to cover the fixed operating expenses is $25,000. The formula is: *fixed expenses / (100 – the variable cost of sales percent).* If you are not at breakeven sales, then you are losing money in your business and corrections need to be made. Assuming a sales increase is unlikely at this time, then you will need to reduce cost of sales sch as material purchases, direct labor and variable overhead or reduce fixed operating expenses, such as selling, general and administrative expense items. When it comes to letting go of certain employees, make sure you check with your accountant or tax advisor to understand the unemployment benefit and tax considerations for your business and employees.

Purchasing / Excess Inventory – Building enough inventory to meet your sales forecast is critical to being able to meet your customer delivery needs. But, when sales are declining, having too much inventory can also lead to using up too much cash that you can't afford to use up right now and also means that you are taking too much of a risk that the inventory will not sell through and sit in the warehouse, becoming aged and worthless. Remember, ***inventory is illiquid cash***. Too much inventory will eat up your cash. So, don't be afraid to call your vendors and tell them that you need to reduce outstanding purchase orders right now until such time that your sales pick up. It is also important to time your inventory purchases and payment terms, so your cash is not upside down due to the lag in collecting accounts receivable after shipment to your customers.

Don't Be Upside Down on Trade Accounts –If you sell to a customer who either is not paying his invoices in a timely manner [i.e paying you in 60 – 75 days, while you pay your vendors in 30-45 days] or is returning product too frequently or taking up to much time to manage or is too costly to ship to due to his geographic location, then you should drop that customer, as you are likely losing money on him. Just as important, you should not put yourself in a position whereby you are upside down on your trade accounts. If your normal selling terms are net 30 days, then it is unacceptable to allow your customer to pay in 60-75 days or more. ***This is a killer to properly managing cash flow.*** Also look at how much inventory you really need to fulfill customer needs and make sure you ae getting the proper inventory turn. Whether it be 30 days or 45 days inventory on hand, or 3-4x inventory turn, manage your inventory levels based on actual sales needs and, given the lead time for deliveries, don't over-purchase or commit more than absolutely necessary.

Professional Resources Available – The most important thing to remember when faced with a financial crisis is ***DON'T PANIC.*** You are not alone in having to deal with these cash flow and crisis management issues. Remember, ***Cash is King.*** Take the time to sit down and put together a detailed cash flow forecast and make the hard decisions that will keep your business afloat until the economy improves. Also, in addition to mentors, there are several professional resources available to assist you. Don't be shy about reaching out for assistance. These resources include: the Small Business Administration District Offices, the Small Business Development Centers in your area, SCORE, the Senior Credit Officer at your bank, Turnaround Consultants, Professional Crisis Managers, Insolvency Attorneys and members of the Turnaround Management Association, a national organization of professionals dedicated to working with underperforming businesses.

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