



Cost and liquidity improvement opportunities

Discussion with FKG members

April 2020

Presentation to



With you today



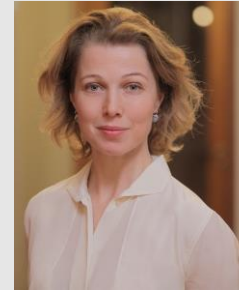
Gustaf Sahlén

- ▶ Gustaf is focused on automotive / auto supplier as well as broader industrial equipment industry
- ▶ Actively working with auto suppliers on cost reduction projects
- ▶ Strategy and operations with specific focus on profitability improvement projects



Michael Diné

- ▶ Michael is responsible for EY Reshaping Results in the Nordics, covering Turnaround & Restructuring services, Working capital and Distressed Supplier Advisory
- ▶ He has successfully led several turnarounds with operational focus as well as large scale working capital and cost reduction initiatives and he supports large Automotive OEM's with supplier crisis situations



Paula Hogéus

- ▶ Paula is the Global Labor & Employment Law Leader at EY and leads a team of 300 lawyers in approx. 60 countries
- ▶ Advices on Swedish labor & employment law since 15+ years
- ▶ Experience in workforce transformation and workforce risk management; cross boarder project lead



Anna Byström

- ▶ Anna is Head of Digital Law at EY
- ▶ Before joining EY in 2019, she was the General Counsel of Telenor Sweden.
- ▶ Advices on commercial law, digital law (incl privacy/security), corporate law, regulatory issues and corporate governance, compliance and legal tech.

Agenda

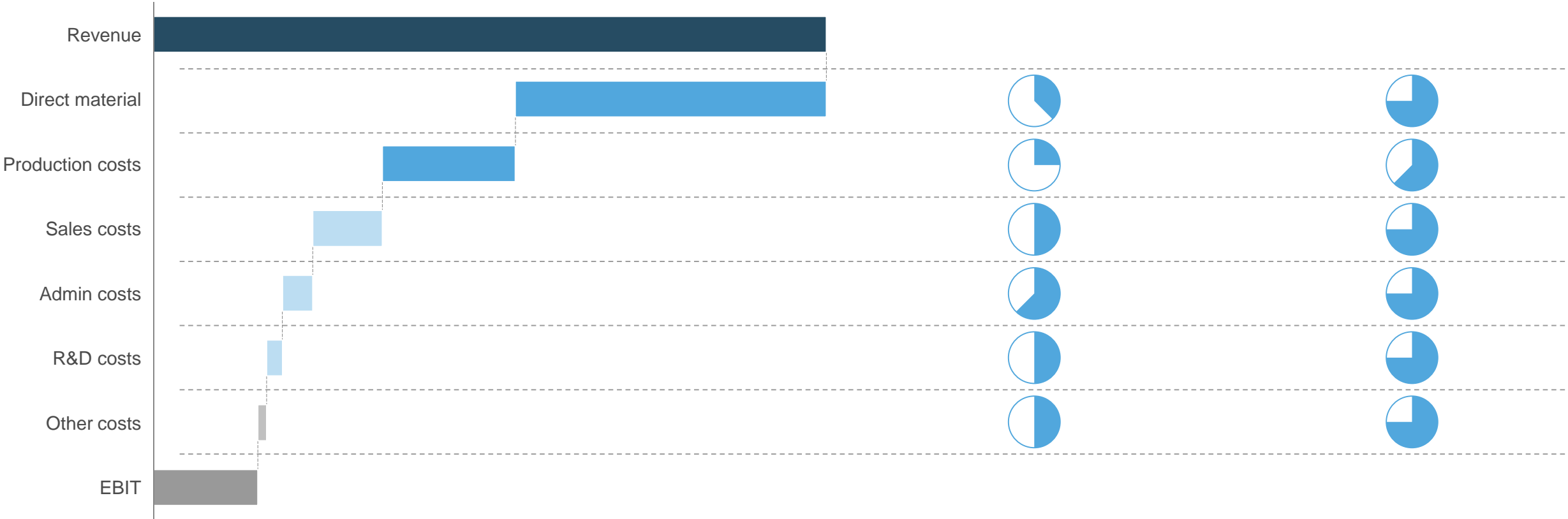
- ▶ **Short and medium term cost reduction opportunities**
- ▶ Short term liquidity improvement opportunities
- ▶ Specific Covid-19 levers in Europe
- ▶ Q&A

COGS standing for lions share of costs while SG&A typically easier to impact

Typical P/L for automotive supplier

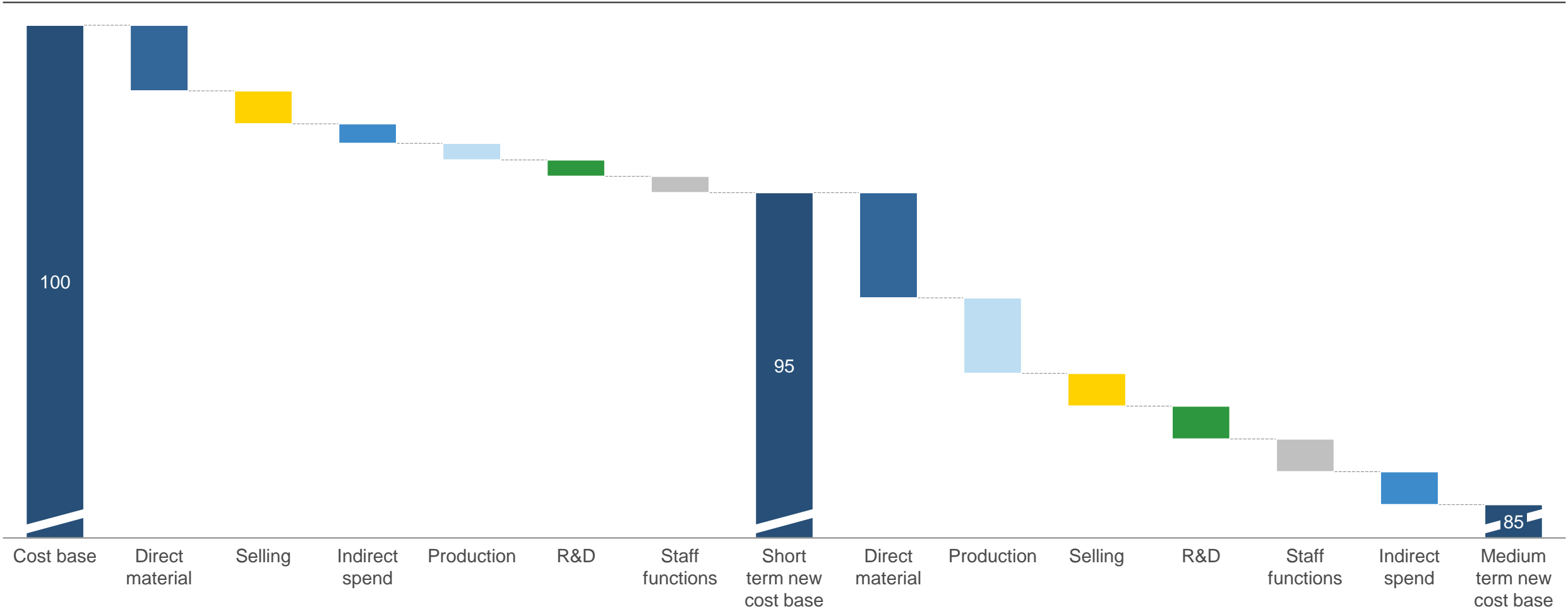
Ability to impact short term

Ability to impact medium term



Without significantly impacting output the medium term cost reduction potential is typically ~15%

Short term and medium term cost reduction potential (%)



Cost of Goods Sold (COGS) hold significant cost reduction potentials – especially in the medium term

NON EXHAUSTIVE

Short term levers

- 1 Raw material commercial renegotiation
- 2 Component commercial renegotiation
- 3 Capacity planning - shift reduction / overtime reduction

Industrial equipment company reduced key **raw material cost with 13%** by applying fact based negotiations combined with pooling of contracts

Medium term levers

- 1 Value analysis / value engineering / should costing
- 2 Raw material / component commercial renegotiation
- 3 Footprint optimization / industry 4.0

Defense company **reduced COGS with 18%** on key complete vehicle through should costing / tear down / value engineering

Sales, General and Admin (SG&A) with significant short term potential

NON EXHAUSTIVE

Short term levers

- 1 Reduction of customers to approach proactively
- 2 Adjustment of service levels of HR, IT, Finance
- 3 R&D output prioritization combined with consultant reduction
- 4 Indirect spend reduction

Tier 1 supplier reduced **sales and marketing cost by 15%** through establishment of internal sales function

Medium term levers

- 1 Establishment of internal sales function
- 2 Centralization / outsourcing of staff functions
- 3 Digital functions e.g. RPA, AI / ML
- 4 Labor arbitrage cross functions

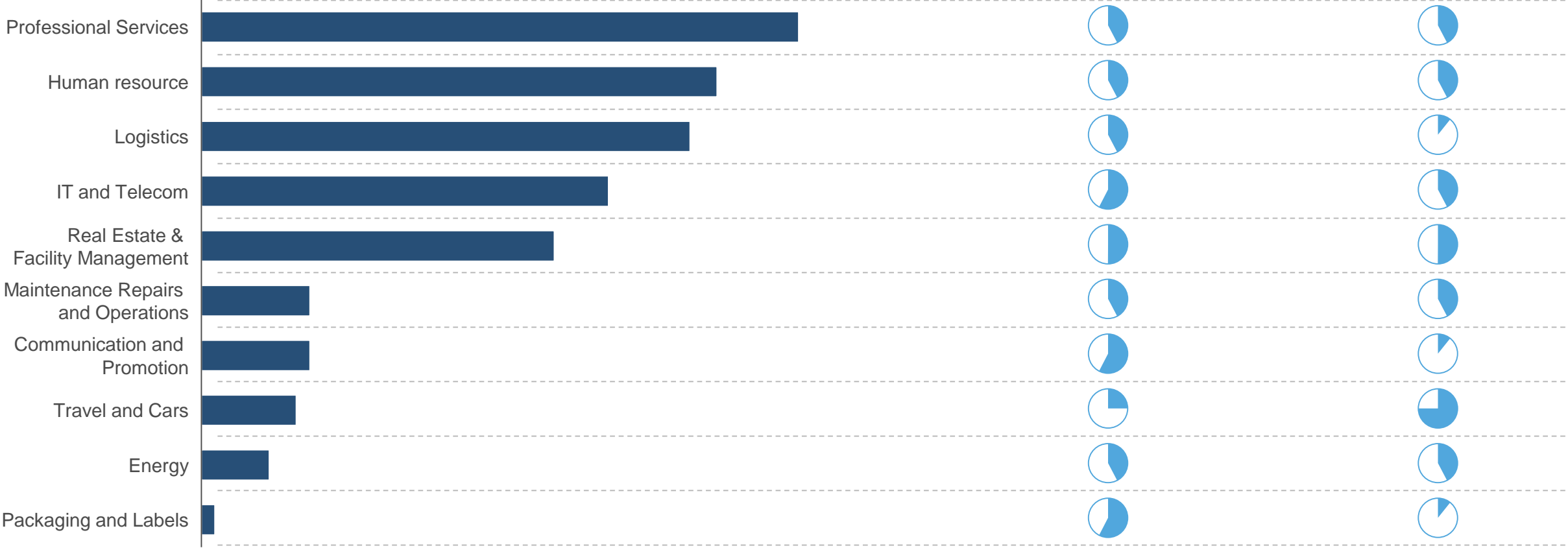
Auto OEM reduced **R&D cost with 30%** through implementation of lean inspired methodology

...and differs by relative lever focus

Typical indirect spend by per category (relative)

Commercial

Demand mgmt.



Key messages

1

Clearly differentiate between costs that can be impacted short and medium term

2

COGS holds the largest cost reduction potential

3

SG&A with most significant short term reduction potential

4

Indirect spend often overlooked and holds significant – non personnel related – cost reduction potential

5

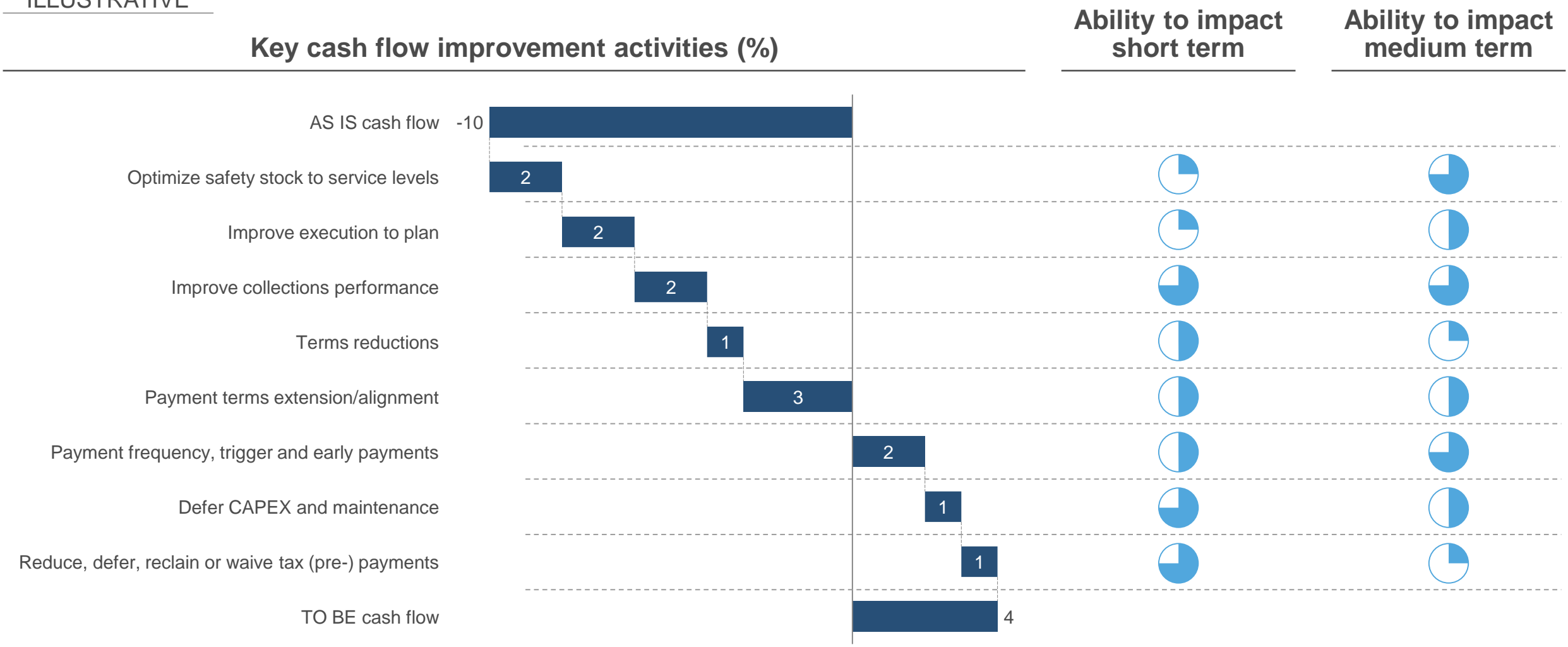
Demand management a key lever for short term indirect spend reduction

Agenda

- ▶ Short and medium term cost reduction opportunities
- ▶ **Short term liquidity improvement opportunities**
- ▶ Specific Covid-19 levers in Europe
- ▶ Q&A

On average we see around 10-15 ppt cash flow improvements from working capital across medium cost control automotive manufacturing companies

ILLUSTRATIVE



Accounts payable deep dive

Key levers

- 1 Supplier categorization, consolidation and negotiation
- 2 Supplier payment terms strategy by commodity and region
- 3 Alignment of supplier terms (CAPEX and OPEX)
- 4 Goods receipt and invoice timing
- 5 Optimize invoice trigger, payment processing and runs
- 6 Utilize payment timeliness and rebate management
- 7 Leasing and financing terms negotiation
- 8 Resourcing strategies improvements

Examples

A Forging & Castings company found 20% of invoices being paid, on average 3 days early, representing an opportunity to **reduce working capital requirements by SEK 500k** by ensuring that payments were made on the agreed due date rather than early

Utilizing the most favorable invoice trigger for payments can lead to significant cash flow benefits, for one iron casting company, **16 days change for just one supplier released over SEK 400k**

Inventory deep dive

Key levers

- 1 Standardize order lead times and volumes
- 2 Set service level targets
- 3 Optimize safety stock calculations
- 4 Replenishment quantities examination
- 5 Improve MTO/MTS strategies
- 6 Investigate demand forecasting and stock coverage
- 7 Explore replenishment logic and lead times / cycle times
- 8 Follow seasonal inventory requirements and procedures
- 9 Supply volatility / quality
- 10 Overhaul slow moving and obsolete procedures

Examples

An industrial manufacturer stopped early deliveries and returned to their stated terms, leading to **significant reductions in tied up capital**, expensive rush transports, and constant preplanning and firefighting

In times of distress, coordination of funding across suppliers, producers, and end customers can **keep production stable, avoiding otherwise necessary shut-downs**

Accounts receivable deep dive

Key levers

- 1 Contractual terms negotiation
- 2 Optimized invoice processing frequency, timeliness and quality
- 3 Categorization and prioritization of customers
- 4 Collection procedures and strategy improvements
- 5 Dispute resolution management and escalation utilization
- 6 Credit renegotiation
- 7 Payment method optimization
- 8 Negotiation of prepayment policies
- 9 Financing solutions improvements
- 10 Cash application

Examples

To avoid bankruptcy of a supplier delivering machined parts, an Automotive OEM agreed to **decrease payment terms from around 100 days to, in average, 7-10 days** during a defined period of time

In a constrained situation, it is not uncommon that a customer temporarily **agrees to pre-pay for deliveries**

Other cash flow action deep dive

Key levers

- 1 Establishment of reliable cash forecasting
- 2 Customer support utilization
- 3 Identification of cash conservation measures
- 4 Capitalizing on government incentive packages
- 5 Evaluation of bridge financing options
- 6 Consider employee related cash-out items
- 7 Execute cost freezing activities
- 8 Reduce, defer, reclaim or waive tax (pre-) payments
- 9 Defer or cancel non-urgent CAPEX and maintenance
- 10 Consider (non-recourse) factoring

Examples

A large automotive OEM purchased the steel and aluminum inventory from a distressed supplier and sequentially delivered it back JIT for production, resulting in a **strengthened cash flow for the supplier**

VAT and tax analytics process can lead to quick optimization of payments and reclaim overpaid VAT/taxes resulting in a **cashflow effect between 5%-20%**

Key messages

1

Understand your liquidity situation, create a detailed, rolling, short term cash flow forecast for 13 weeks

2

Know your main cash burners and put an immediate stop to what is not necessary for the coming weeks/ months

3

Invoice as fast and accurate as possible – and do not pay earlier than necessary

4

Working capital and cash improvements are your cheapest source of financing

5

Be transparent with main customers and suppliers for mutual support – when the crisis is over and we must return to normal

Agenda

- ▶ Short and medium term cost reduction opportunities
- ▶ Short term liquidity improvement opportunities
- ▶ **Specific Covid-19 levers in Europe**
- ▶ Q&A

Furloughs have been established across Europe – in different shapes and forms

Most countries in Europe with furloughs



Example countries



Sweden has established a relatively generous compensation in case of furlough

Sweden

Level	Reduction of working time	Salary reduction	Employer	The government	Reduced cost for employers
1	20 %	4 %	1 %	15 %	-19 %
2	40 %	6 %	4 %	30 %	-36 %
3	60 %	7,5 %	7,5 %	45 %	-53 %

Key levers

- ▶ A new system on short-time work will enter into force on 7 April 2020; however with retroactive effect as of 16 March 2020.
- ▶ The proposal means that the employer's salary costs may be reduced with 53% while the employee receives 92.5% of his or her salary. The cost is shared between the government, the employer and the employees.
- ▶ The state aid is capped at monthly salaries of SEK 44 000.
- ▶ The steps that need to be followed will depend on whether there is a CBA in force or not.
- ▶ Support is provided after approval by the Swedish Agency for Economic and Regional Growth (Sw. Tillväxtverket).
- ▶ In order for employers who are bound by a central collective bargaining agreement ("CBA") on short-time work, they also have to enter into a local CBA in which the detailed conditions for the application of time work have been established.
- ▶ Employers who are not bound by a central CBA on short-time work can apply for support provided that there is a written agreement between the employer and each of the employees affected by short-time work. Additionally, at least 70 percent of the employees at the operating unit are required to participate in the short-term work during the period covered by the support.

Covid 19 – Contractual obligations/relationships and Corporate Governance

Contractual obligations and force majeure

Will the Covid-19 situation constitute force majeure under key agreements?

- ▶ Possibility that a party can be excused for non-performance etc. if unforeseeable events outside the party's control are at hand.
- ▶ Possibility to request adjustment of the contract by reference to the "general clause" in Section 36 of the Swedish Contracts Act
- ▶ Circumstances to be assessed case-by-case;
 - 1) wording of force majeure clause
 - 2) concrete underlying cause of a disruption,
 - 3) whether there is an actual disruption, and
 - 4) invoking party's possibilities to mitigate the effects.

Rental agreements/customer and supplier relationships

Can payment of rent on commercial premises be reduced or avoided?

- ▶ Tenant's obligation to pay rent may be affected by reference to the situation falling within force majeure clause.
- ▶ Mitigation of rent by reference to Section 36 of the Swedish Contracts Act/might be reduced by reference to the Swedish Land Code or general principles of contract law.
- ▶ Government is proposing State support to assist and speed up rent renegotiation for some sectors.

What can we do if customer faces liquidity problems?

- ▶ Review whether delivery can be stopped, whether access to any goods delivered can be curtailed or goods repossessed.
- ▶ Require advance payment, or security in respect of further deliveries.

What can we do if supplier faces liquidity problems?

- ▶ Secure necessary comfort, such as agreeing that payment will be made only on full delivery of the goods, and/or to look for alternative suppliers.

Corporate Governance

Business continuity and crisis plans

- ▶ Importance of having adequate strategic management processes for identifying potential threats, advance planning and the safeguarding of critical business functions.

Meetings and AGM

- ▶ Possible to carry out an AGM with shareholders and proxyholders present and others participating by video link or through another hybrid technology.

Dividends and incentives

- ▶ Prudent to take a step back and gauge market, public and stakeholder reaction to distribution of dividends.
- ▶ Consideration will need to be given to cashflow management, banking arrangements and refinancing as well as available assistance/incentives.

Disclosure

- ▶ Companies listed on regulated market should ensure adequate disclosure without delay of information which should be made known to the public.

Key messages

1

Initiate a plan for furlough; analyze option for state aid. For Sweden: start preparing application to “Tillväxtverket”

2

In case redundancies may be needed; prepare now with notification to “Arbetsförmedlingen”; i.e. “varsel”

3

Assess the opportunity to defer certain tax payments

4

Review business critical agreements and arrangements to understand implications of virus break out

5

It is not too late to set up a business continuity and crisis plan to secure management of crisis

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