WHEN IT REALLY MATTERS.

A 2019 Review

AlixPartners

FOREWORD

In this day and age, when constant change is simply the norm, the need for strong leadership has never been greater. CEOs who stick it out and succeed beyond the regular four-year cycle are likely to represent the bravest and boldest in the business.

If strength at the top were taken as read, and we represent a tailor-made partner to support our clients, why are the challenges we all face still so difficult to overcome?

I would say that now – more than any other time – executives are acknowledging how hard it is to effect real business change, beyond the initial development of a strategy in the boardroom.

The cultures of organisations and associated structures built over many years are institutionally resistant to significant change. However, if you don't tackle underperformance head-on, others may come calling demanding that you do.

This year, Private Equity continues to grow, aided by a plentiful supply of cheap debt, continuing to drive up asset prices. The emergence of investor activism seen previously in the USA has also firmly jumped across the pond and landed in the UK, challenging businesses to think about what's really holding them together (see page 44). We have also seen an unmatched uptick from public to privates.

In 2019 we've seen that restructuring has particularly taken grip in consumer-facing markets, further impacting suppliers and retailers. For example, in the restaurant and casual dining sector seismic shifts in consumer habits present some fundamental questions about how to treat a new and growing channel, online delivery (see page 28).

Of course, these disruptions and innovations can be an opportunity as well as a threat – the familiar double-edged sword in business. E-commerce and big data are two more prime examples in retail, where harnessing data-driven insights and putting them to their very best use – driving business decisions – could mean the difference between survival and failure in years to come (see page 18).

The automotive industry, too, is struggling to gain control of the incredible technological advances that will shape the future for generations to come. Yet, after seeing a resurgent manufacturing base for the industry here in the UK in recent times, political uncertainty suggests that this will come under increasing pressure, as business models are re-evaluated and the race to tap into the right tech for the long term gathers pace (see page 42).

I've seen operating models also come under the microscope in the world of telecommunications this year, where new entries to the market in terms of fibre and 5G represent huge capex burdens and create additional challenges in building any kind of equity growth story. With increasing levels of debt, it's harder to justify large balance sheets, which is why we're seeing operators divesting tower assets to capitalise on market valuations (see page 38).

More broadly in business, though, there's a growing trend for the role of the corporation to be benchmarked against much more than just revenue KPIs. We see "big tech" under pressure regarding privacy and personal data; just one example of how the world feels that a better balance needs to be struck by what are perceived to be large "homeless" corporates, plying their duty for a purpose greater than just shareholder value. In fact, the relentless pursuit of a corporate culture that exudes trust and transparency can only set businesses on the road to positive outcomes (see page 32).

2020 will no doubt deliver further disruption, putting strength of leadership to the test once again, and the value of experience in those critical "when it really matters" moments will be key to success or, indeed, survival.

Eric Benedict
Managing Director, AlixPartners, London

"I would say that now – more than any other time – executives are acknowledging how hard it is to effect real business change, beyond the initial development of a strategy in the boardroom."

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THE DANGEROUS MISSPEAK OF DIGITAL TRANSFORMATION

When I was a child, we looked after a kitten on what was supposed to be a temporary basis. Not wanting to cause confusion for the next owner, we didn't give her a name other than 'Kitten.' Somehow, she stayed, and once she was obviously not a kitten, she needed a new name. My dad, a straightforward man, called her, "Kitty." Problem solved.

In a similar way, I believe what we call Digital Transformation is misnamed, misleading and very often missing the mark. Names matter, and we need to find a new way to describe what we are attempting, in order to guide our efforts and investments more effectively. Unfortunately, my dad is not around to solve this one, so I will try.

Let me begin by positioning the subject of technology using a spatial analogy. When I started my career in the early nineties, IT was at the back of the organisation. It was a necessary but expensive function that was seen as administrative rather than strategic. In the late nineties, it moved to be under the organisation providing the foundations of process and information flows through ERP. Soon afterwards it moved dramatically forwards, first through CRM and then online business. At this stage, technology enveloped the organisation, finally becoming crucial to its success. This situation persisted until around 2010, but then the biggest shift of all started to happen: technology began to move into the organisation helping to define what a business actually is.

We have chosen to call this latter phase 'digital transformation', which is enormously confusing. All computing has been digital since around 1950, so this name carries no intrinsic meaning. Like the proverbial elephant described by multiple blindfolded people, what you say about digital transformation often depends on which part you are touching.

Digital includes major advances in technology such as AI and blockchain; easy and inexpensive access to vast computing power through cloud; the mass adoption of mobile and online technology by consumers; the rise of 'born digital' companies with new business models that are disrupting whole markets; and a new 'agile' culture that is collaborative, dynamic and cool. But these are the conditions that created digital transformation and some of its attributes, not the phenomenon itself.

WE NEED TO SEE THE WHOLE ELEPHANT

To do this, we must return to the idea that technology is moving into the business. Until recently, technology and 'the business' were considered somehow separate, the former enabling the latter. Technologists were always keen to know what 'the business' wanted to do. The existence of a border between business and technology undermines agility, prevents a fluent translation of strategic need into a holistic response, and frustrates efforts to use data natively for insight. The perpetuation of the business-technology dichotomy also preserves old business thinking and old technology thinking, that are both rapidly losing their relevance in the modern marketplace.

What is needed, and what is beginning to happen, is a deep fusion between business and technology, where the two distinct entities combine to form a new whole. When this happens, the resulting organisation has radically new properties and capabilities. So much so, that I argue these are a new kind of organisation.

Having been so critical of the term 'digital transformation', I recognise some responsibility to find a better name for the outcome of what I am describing. After considerable thought, and some entertaining dead ends, I have returned to a simple fusion of business and technology to mirror the concept itself: BizTech. This is also an extrapolation of the widely used 'FinTech', which is somewhat analogous. Even if this term is eventually superseded, it is a good working title.

> *"I believe what we call digital transformation is misnamed, misleading and very often missing the mark. Names matter, and we need to find a new way to describe what we are attempting."*

WHAT IS BIZTECH?

BizTech has a superior set of characteristics that mark it out competitively:

- Strategy, product and change execution are enacted through adaptive, agile models in rapid, collaborative cycles
- The capabilities of the organisation are encoded and extended in software and data, forming a codex of its knowledge and wisdom
- The organisation has plug-and-play interfaces at its borders to interact with customers and consume services from other organisations
- Data is a strategic asset of the company that is mined continuously for insight
- The organisation can be configured and reconfigured quickly and easily using an automation-first approach
- Technologists are diffused through the organisation rather than siloed in one place, but there is still cross-company planning and technical cohesion
- Digital assets are protected with security and risk considerations engineered into every design
- Culture is fast, dynamic, smart and empowering

The goal of traditional and born-digital companies alike is to acquire and maintain these capabilities. Everything else is a means to that end. As such, BizTech provides a meta-narrative that helps us describe and organise everything else we are currently talking about in the world of digital.

My hope is that a better-defined objective will help reduce the high number of disembodied and ill-conceived digital transformation efforts we see in the market today.

Assessing whether a company has acquired BizTech characteristics is a much more structured task than asking whether a company has digitally transformed. This is largely because it answers the lingering question we have today: "Transformed into what?" A

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Image ©: Getty Images

FORK IN THE ROAD?

With health and wellness trends on the rise in the UK's food and beverage manufacturing sector, how are companies, private equity and venture capital reacting to the ongoing disruption from consumers demanding healthier products?

As attitudes towards health, wellness and sustainability continue to cause disruption within food and beverage markets, large companies are being forced to adapt their approach to innovation.

Western markets are under pressure with low growth and input cost volatility, while many heritage products are losing their relevance to consumers. Innovative products are satisfying the desire for healthier, more sustainable eating and this is reflected in strong growth performance for these segments.

Consumer demand in the food and beverage industry is changing. As demonstrated by the free-from movement, it is becoming healthier, more transparent and sustainable in its production and packaging.

This shift is also represented in the way new products are undergoing development. With consumers looking for a different experience, companies are responding by widening their product offering. These dynamics are taking place against the backdrop of lower consumer confidence and fluctuating input costs. Adding to this pressure is increasing own-label competition from traditional grocers and discounters.

INNOVATE OR DECLINE

Companies are responding by adapting existing product portfolios to meet key health and wellness trends, pushing new product development or acquiring existing brands to improve top-line growth.

However, agile start-ups are well placed to deliver successful new product development within the UK's F&B sector. Large companies are far less nimble than smaller competitors, so it is difficult for large companies to adapt at pace. With the need to get new products to market quickly to exploit these new growth sectors, large companies have been increasingly looking to acquisitions as a means of fast-tracking innovation.

As an alternative to investing in new product development, acquisitions offer the opportunity for large companies to acquire an emerging leader in a growth segment or channel rather than build from scratch.

PAYING THE PRICE FOR INNOVATION

The market is seeing more and more acquisitions of smaller founder-owned businesses by larger companies as they seek to buy their way into the health, wellness and sustainability sub-sectors.

This method of acquisition as a shortcut for innovation is increasing as these emerging sub-sectors continue to show strong growth in an industry that is under pressure to regularly announce improving revenue and profitability figures.

Companies are seemingly willing to pay over the odds for acquisitions in the scramble to exploit these new opportunities. Recent deals, such as Unilever's purchase of graze and Lotus Bakeries' acquisition of Kiddylicious, have taken place for significant multiples.

Companies have been willing to pay a median of 14.8x EBITDA for UK health and wellness F&B businesses – 43.8% higher than what would be expected for a typical UK F&B acquisition.[1]

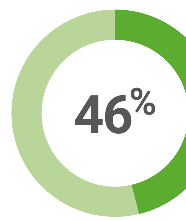
RECENT EXAMPLES OF COMPANY ACQUISITIONS OF UK HEALTH AND WELLNESS F&B BUSINESSES

- Unilever – graze (February 2019)
- Science in Sport – PhD Nutrition (November 2018)
- Finsbury Foods – Ultrapharm (September 2018)
- Lotus Bakeries – Kiddylicious (July 2018)
- Unilever – Pukka Herbs (September 2017)

BUYING HABITS ARE CHANGING

Source: Information Resources Inc. (IRI)

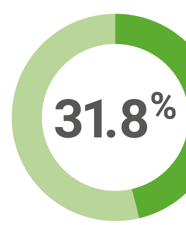
THE SEARCH FOR GROWTH



Unilever stated in May 2018 that its most sustainable brands grew faster than the rest of its business by 46%

Source: Unilever press release

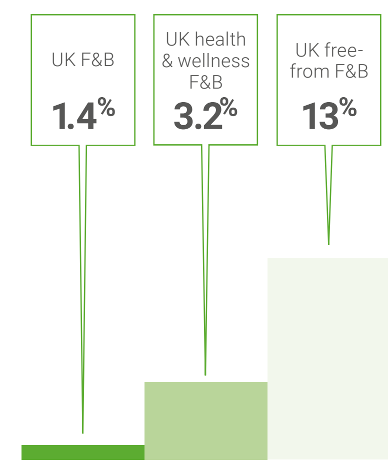
FOOD INNOVATIONS



of all food innovations in the UK in 2015 were related to health and physical fitness

Source: XTC World Innovation

SIGNIFICANT OUT-PERFORMANCE OF FREE-FROM CATEGORIES



Source: Euromonitor. Data based on 2013 to 2018 CAGR, in value terms

1. Based on a median of relevant transactions since January 2015. Source: AlixPartners research, Mergermarket

While on the surface this may seem a panicked approach to the pursuit of growth, there are understandable motivations behind these eye-watering deals:

- Companies need to adapt their existing portfolios to meet long-term shifts in consumer tastes towards health, wellness and sustainability
- These acquisitions are typically strategic investments with less need to generate swift returns in the short run
- Companies can gain significant revenue synergies by expanding the acquired businesses into existing channels or internationally. In addition, cost synergies can be achieved by realigning operations or through increased bargaining power with retailers

Companies' willingness to pay high prices for quick access to innovation is influenced by the realities of a fast-changing market. Consumer preferences continue to evolve over time and getting to market quickly is important to avoid missing the boat.

Higher multiples mean more pressure to succeed and making the right choice of company to purchase is paramount. Poor investment decisions are inevitable, however, as consumer preferences shift and trends become outdated. The priority is getting the valuation right, integrating carefully and ensuring a robust strategy.

> *Bringing an innovation unit in-house aims to ensure a continuous pipeline of innovation, while embedding an innovation culture into the company's DNA."*

SELF-SUSTAINABILITY

As large companies begin to accept that traditional models of innovation are no longer working, F&B multinational companies are developing their own innovation units such as SnackFutures, which is part of Mondelēz, the global snacking company and owner of the Cadbury brand. Launched in October 2018, SnackFutures is focused on three key areas:

- Invention of new brands and businesses in key strategic areas
- Reinvention of small-scale Mondelēz brands with large-scale potential
- Venturing with start-up entrepreneurs to seed new businesses

Bringing an innovation unit in-house aims to ensure a continuous pipeline of innovation, while embedding an innovation culture into the company's DNA.

HEALTHY COMPETITION?

So, what does this increased M&A activity mean for private individual sellers of businesses and private equity? For private equity funds, it has meant being priced out of the market for the fastest-growing brands, such as graze. For private individuals, families and founders, who are the owners of most UK F&B businesses and also sell the most UK F&B businesses, this means seriously considering a sale to a larger company. As the figures opposite show, private equity funds saw a significant drop in the number of food and beverage deals completed, from 13 in 2017 to 5 in 2018. In addition, private equity has also had a far smaller presence in acquisitions of individually-owned businesses – the main owners of food and beverage businesses – falling from 27% in 2017 to 12% in 2018.

Private equity is clearly nervous of the market's shift towards high multiples and increasing investment in the UK from multinationals, as well as overall market concerns due to the uncertainty over Brexit. This has led to a tendency to be more selective when choosing companies. Naturally being more financially disciplined than companies, private equity is typically reluctant to pay over the odds for acquisitions due to their financial requirements, which stipulate an internal rate of return of at least 20% within three to five years. Any high-entry multiple will also require a high multiple on exit, which is not a surety.

PRIVATE EQUITY STRATEGIES IN UK F&B

There are three primary strategies for private equity:

1. Build relationships with companies who wish to remain independent

This approach will increasingly require extensive searching, building relationships with owners and management teams, particularly when owners have a strong conviction to remain independent. This will come with deeper and more complex planning, as private equity tends to require defined entry and exit plans before taking the plunge.

This approach allows smaller funds to get involved and can feature deals that would be too small to appear on larger companies' radar. In addition, this can be very attractive for entrepreneur-led companies who do not wish to be swallowed up by a large corporate but simply wish to retain their own culture and values while gaining financial support for the next step of the journey.

In November last year, Inverleith, a Scottish private equity fund that typically acquires businesses with revenues of £5-£30 million, acquired a controlling stake in Montezuma, a founder-owned UK luxury chocolate brand that had seen success with a range of vegan, free-from and ethical products. Helen and Simon Pattinson, the founders, were keen to find a suitable investment partner who shared their values and

CASE STUDY: ITALIAN DESSERT SECTOR
ALIXPARTNERS' COST SAVINGS AND INTEGRATION CAPABILITY

AlixPartners recently advised a major Italian dessert company. The business was struggling following a combination of a difficult macroeconomic climate, increased competition and a foreign exchange impact due to the Brexit referendum result. AlixPartners was mandated to advise the company on identifying and implementing several profitability initiatives, and also on the integration of a recently acquired company.

AlixPartners identified and implemented a series of initiatives resulting in a €4.9 million improvement in EBITDA and identified permanent improvements to the financial control function.

FIGURE 1: NUMBER OF UK F&B ACQUISITIONS BY TYPES OF ACQUIRER

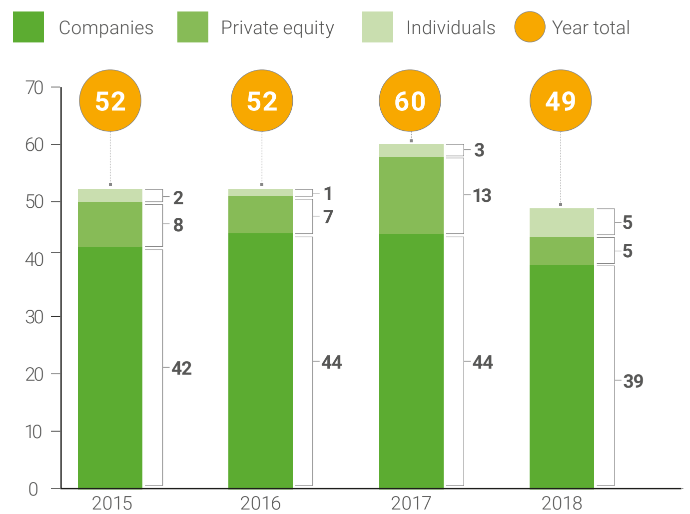
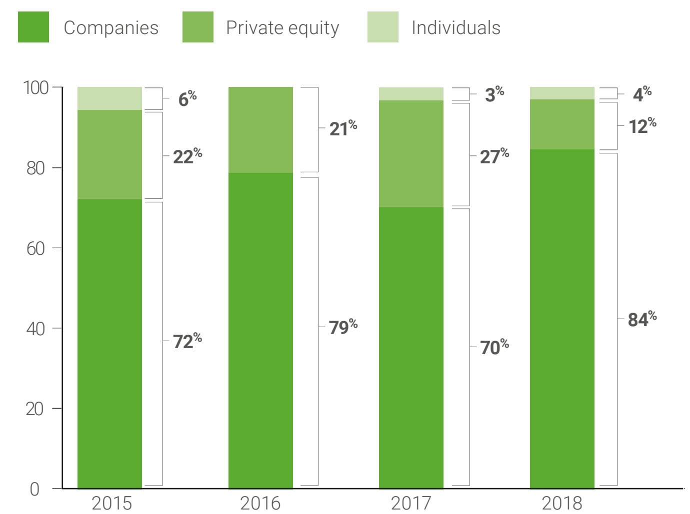


FIGURE 2: ACQUIRERS OF F&B BUSINESSES OWNED BY INDIVIDUALS



Note: Private equity acquisitions exclude bolt-on deals by existing private equity owned companies. Source: AlixPartners research, Mergermarket could take the business to the next stage of growth. Following the deal, the Pattinsons stepped away from management roles and took ambassadorial roles and director positions in the business.

2. Acquire existing unloved brands and pivot their offerings to match new trends
This strategy can take the form of acquiring an existing brand in an unhealthy segment that could be developed into a healthier offering. This would typically require development capital expenditure, as well as a management team with a clear, executable vision for turning the brand around. An example is KKR's acquisition of Unilever's spreads division in July 2018 in a mega £6 billion deal, with potential plans to improve profitability and pivot the Flora brand into healthier and natural segments.

3. Buy and build a business
This strategy is typically pursued by larger private equity funds that have the capacity to acquire a number of businesses over a period of time. CapVest, who established Valeo Foods in 2010, have undertaken a complex strategy of acquiring eight businesses and increased the EBITDA to well in excess of €100 million from approximately €20 million in 2010. This approach requires extremely careful orchestration, both in convincing owners to sell to them and also the ability to successfully integrate a wide range of organisations.

> *In 2019, we expect lender support for the sector to continue. Banks and credit funds are likely to be interested in resilient and emerging growth companies…"*

CASE STUDY: GLOBAL BAKERY PRODUCTS SECTOR ALIXPARTNERS' CARVE-OUT

AlixPartners recently advised a large private equity fund in a highly contested carve-out of a North American bakery products business from a major global bakery product firm.

AlixPartners advised the private equity fund on complex carve-out aspects, including separation plans, supporting negotiations on the Transitional Service Agreement. AlixPartners also undertook operational due diligence with a view to identifying and quantifying significant risks and opportunities. In addition, AlixPartners was engaged to implement a Project Management Office. The transaction was completed ahead of schedule under an accelerated timetable.

DEBT MARKET VIEWPOINT

Unlike other sectors, where credit funds account for approximately 50% of term-lending, the UK food and beverage lending activity is dominated by banks.

Midmarket debt activity remained broadly stable in 2018, with notable UK bank deals including NIBC and Lloyds supporting Exponent's acquisition of Meadow Foods and the amend to extend ComplEAT Food Group's banking facilities by HSBC and SMBC, owned by Equistone.

In 2019, we expect lender support for the sector to continue. Banks and credit funds are likely to be interested in resilient and emerging growth companies, particularly where there is an opportunity to provide expansion funding for buy and build deals.

NOTHING VENTURED

Venture capital, whose traditional focus has been the technology sectors, has also woken up to the possibilities of the free-from F&B sector in a big way. Major venture capital firms such as Balderton and relative newcomers such as PowerPlant Ventures, New Crop Capital and Stray Dog Capital have focused on pumping money into innovative plant-based meat start-ups such as Beyond Meat in a bid to find a winner in this emerging growth market. The size of the prize is potentially huge as illustrated by Beyond Meat's $1.5 billion IPO and Burger King's partnership with Impossible Foods, another plant-based substitute business, to produce the meat-free Whopper burger.

A CLEAR-MINDED APPROACH

The mega-trends of health, wellness and sustainability are disrupting the F&B industry. Combined with a difficult macroeconomic backdrop, established companies are being forced to adjust their strategies to survive. With squeezed margins and higher price points on acquisitions increasing the pressure to succeed, companies must pursue robust planning on target identification, valuation and integration. This aggressive buying of innovation requires a clear-minded operational, organisational and strategic approach, but can offer inroads into growth markets for players who are adequately prepared.

Private equity must also shift its acquisition strategy, moving off-market and connecting with owners who wish to retain independence while gaining investment. The need for careful targeting and screening here is paramount and private equity needs to be very smart in selecting the correct winners, turning around an unloved brand or following a sophisticated buy-and-build strategy, which comes with its own execution risks.

The proliferation of food tech start-ups will also see greater activity from venture capital, or company-backed venture capital funds who are willing to take greater risks in order to unearth future hidden gems.

Realising the opportunities of F&B's growing health, wellness and sustainability sectors will require a mix of boldness, care and planning. If traditional players and new market entrants want to thrive in this rapidly evolving environment, they must update their approaches and think differently to win in the F&B market over the long-term.

A TASTE OF SUCCESS – THE CASE OF INNOCENT SMOOTHIES

Coca-Cola's investment in Innocent in 2008 was an early sign of a big player moving into the health and wellness beverage sector. Coca-Cola supported Innocent to follow its sustainable business approach and made further investments, culminating in a controlling stake after acquisition. Annual revenue was approximately £105 million in 2008, which had grown to almost £370 million by 2017.

> *British brands translate well across the globe due to significant innovations, use of quirky branding, high degrees of product trust and the vast reach of the English language."*

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CEO SUCCESS REQUIRES A SPLIT PERSONALITY

After more than 20 years in the retail industry, 2019 has been the first time I've ever heard CEOs tell me they're not sure what to do next.

They are faced with reconciling an almost impossible dichotomy – the challenges of cost-cutting and store optimisation, alongside developing new, exciting and relevant customer propositions, delivered largely through digital channels.

Effectively managing a business on these two very different fronts presents a serious headache. And that's even before you factor in responding to competitor innovation and meeting the needs of increasingly demanding consumers. The bar for customer experience and convenience continues to rise as tech giants such as Amazon and Uber relentlessly lead from the front.

How do you guide your people through a tough, hard-nosed rationalisation process, while trying to inspire creativity and growth through digital?

The two very different tasks require very different approaches, in terms of style and staff capabilities. As a result, CEOs are faced with the prospect of developing a "split personality" in order to lead equally and effectively on both fronts.

GO BIG OR GO HOME

The greatest danger to this kind of fragmented leadership is that, as priorities separate, so do budgets and staff resources, with legacy parts of the business undergoing brutal reconstruction, while the digital arm aims to break new ground.

Without a single, unifying strategy, the two sides can quickly become detached from each other, diluting brand identity. Two separate silos back to back, arms folded, looking in opposite directions, not talking to each other. Customers will instantly see this disconnect through a disjointed customer experience, eroding their brand confidence and loyalty.

Too many traditional retailers are responding too slowly to this changing market landscape, moving forward only in small and carefully considered steps. Time is of the essence – and by the time any action of this kind is taken, a window of opportunity will be missed, and further ground ceded.

Today, the message for retail CEOs is clear – go big or go home. Take bold steps bravely. The next question, of course, is how?

> *"There are many data-based approaches and tools to help determine optimum store estate and cost structure. However, leadership judgement is key to setting the right parameters to guide the analysis."*

CUT DEEP, BUT MIND THE MUSCLE

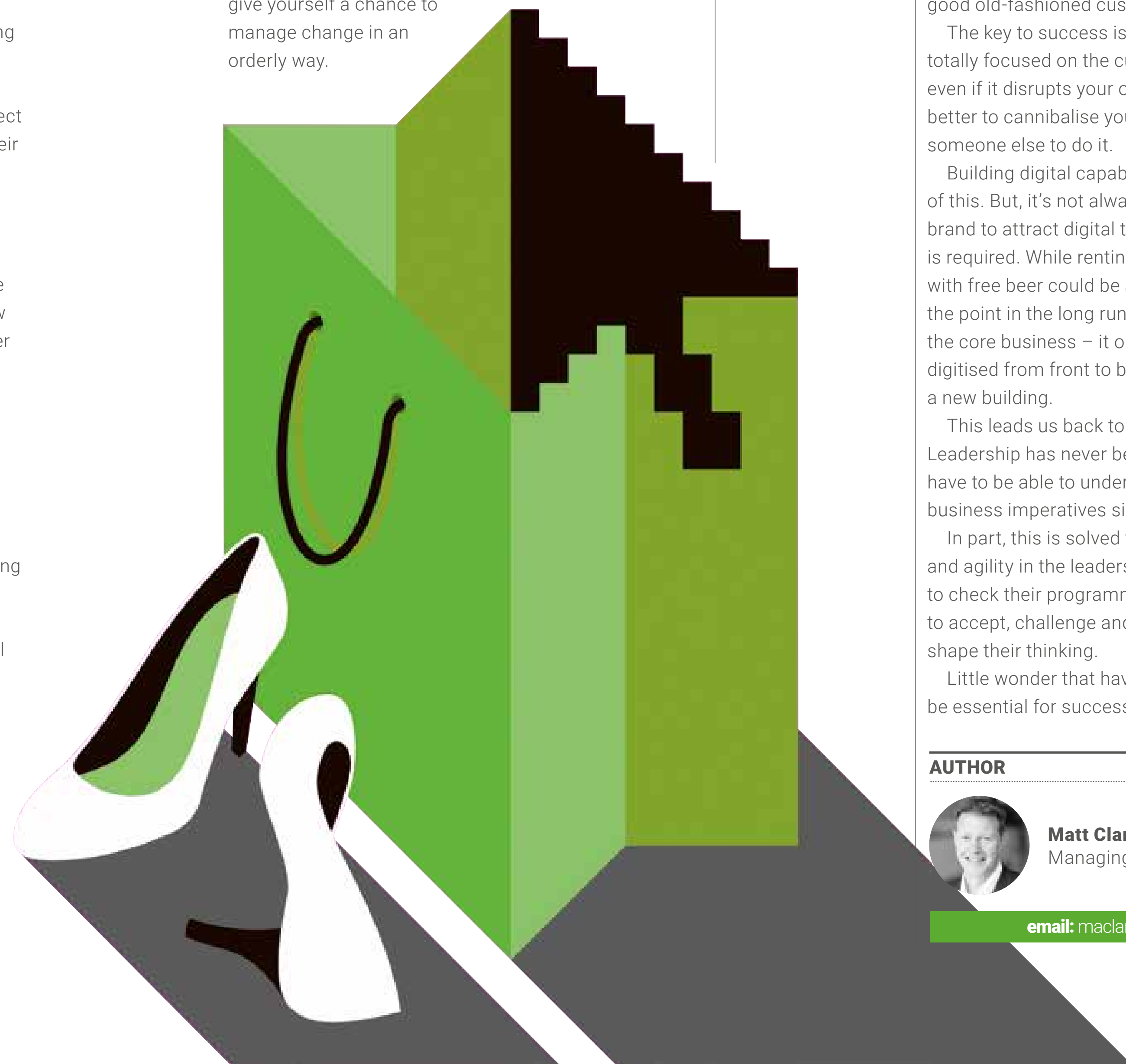
If you are one of the many retailers dealing with declining profitability in the store estate, and sub-scale digital channels that are too reliant on expensive external partners for growth – you are not alone.

Deciding where to cut cost, and how deep, is never easy, but a common mistake is to try to salami-slice budgets or store numbers when a total rethink of the cost base and store portfolio needs is required.

Fortunately, there are many data-based approaches and tools to help determine optimum store estate and cost structure. However, leadership judgement is key to setting the right parameters to guide the analysis.

For example, how will the role of the store change in the future? Could it become an "experience store" – essentially a marketing channel – or is it an omnichannel experience designed to recruit customers to the digital channel? Brands including Burberry, Nike, Apple, and Samsung have all created such formats, and demonstrate what innovation can do to transform the customer experience.

The single biggest challenge is actually underestimating how deep to cut. It is essential to give yourself sufficient time and money to build new propositions and digital capability. Simply chipping away at the cost base to keep your head just above water is not a sustainable plan. Forecast the customer trends from store to online and think about what cost base you'll need in three or five years' time. The trends are unlikely to reverse, and you'll give yourself a chance to manage change in an orderly way.



INNOVATE AND EMBRACE THE DIGITAL NATIVES

In most retail sectors, value for money and convenience are commodities. You simply have to offer amazing value and enable customers to access products and services in any way they want, largely for free. That is today's reality. The remaining differentiator is the quality of your proposition and experience. Offering customers something relevant and unique, and giving them an amazing experience still counts for a lot (in certain sectors).

Disruptors like Airbnb, Rent the Runway and Warby Parker are examples of businesses that have embraced innovation – a combination of new business models and giving something back to the community. Creating unique experiences is a powerful draw – from Selfridges' amazing Accessories Hall, to the fishing lakes in Bass Pro shops – but don't forget the value of good old-fashioned customer service – the human kind.

The key to success is to be authentic, relevant and totally focused on the customer, embracing new ideas, even if it disrupts your old business model. It's always better to cannibalise your own sales than wait for someone else to do it.

Building digital capability is, of course, a major part of this. But, it's not always easy for a traditional, legacy brand to attract digital talent. A differentiated approach is required. While renting a funky office in Shoreditch with free beer could be a first step, this may be missing the point in the long run. Digital cannot be separate to the core business – it only works if your business is digitised from front to back, requiring a new attitude, not a new building.

This leads us back to the CEOs' "split personality." Leadership has never been easy, but these days retailers have to be able to understand and support multiple business imperatives simultaneously.

In part, this is solved through increased diversity and agility in the leadership team. But CEOs also need to check their programming constantly and be ready to accept, challenge and question the paradigms that shape their thinking.

Little wonder that having multiple personalities could be essential for success. A

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Image ©: Alamys

RESILIENCE IN RETAIL

How a fresh look at data could hold the key to redefining and re-engineering retail businesses

It's a tough world for retail businesses today. Rising business rates and labour costs, the increasing power of the consumer to dictate price and demand, and digital savvy competitors are all causing major headaches for traditional retailers across Europe.

Middle-market high street retailers and department stores – particularly those without a clear value proposition or those susceptible to online pure-play due to a legacy of underperforming stores in secondary locations – are starting to face tough competition.

In the UK, the high street is going through apocalyptic changes. Historical retail powerhouses such as Homebase, New Look and Mothercare have been forced into restructuring deals and HMV has fallen into administration, while other household high street brands, from Toys R Us to Maplin, have simply disappeared. ›

However, while e-commerce hits traditional stores hard, many already possess the tools to start the fightback – often without realising it. While they may not have the nimble online-only infrastructure of newer competitors, they are able to harness an enviably rich set of data. This data can provide invaluable insight into a number of areas such as customer behaviour, staff and store footprint efficiency and the effectiveness of distribution channels – and could provide the starting point to reclaim the retail landscape.

In an increasingly digital retail market, the use of smart, data-driven insight to inform business decisions could mean the difference between survival and failure. The good news is that most retail businesses are already sitting on a gold mine of data gleaned from transactional behaviour, customer loyalty schemes and operational analytics. They just need to learn how to use it to their advantage.

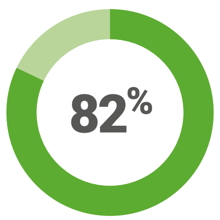
BROKER BETTER BRANDED GOODS DEALS

Managing product lines with a large proportion of branded goods has historically been a challenge for high street retailers. And with today's online competitors such as Amazon offering reduced prices and near immediate delivery on branded products, this challenge has grown.

Suppliers of branded goods have long had the upper hand in commercial negotiations, thanks to the emotional power of their brands and customer expectations that retailers will sell these named goods at competitive prices. Shoppers are also becoming more savvy, with 82% of smartphone users[1] consulting their phones before committing to an in-store purchase. This leaves traditional retailers stuck between a rock and a hard place when it comes to pricing.

> *In an increasingly digital retail market, the use of smart data-driven insight to inform business decisions could mean the difference between survival and failure."*

MOBILE SHOPPERS



of smartphone users[1] consult their phones before committing to an in-store purchase

This is not a new challenge. Buying and merchandising teams have always sought to improve gross margins through category management and private label expansion. The difference today is that retail brands may actually have an ace up their sleeves. The huge amount of customer insight they possess – often gained through transactional data and loyalty card schemes – can be used as an asset in negotiations with branded suppliers.

Think of all the customer insight that brand suppliers would love to get their hands on – from what time of year, week or day their brand sells best, to what effect store location has on the item's attractiveness to buyers, and even which competitors are beating those brands on price. All of this data-driven insight is an invaluable tool when negotiating and could save buyers within retail businesses significant costs.

QUASHING MYTHS AROUND STOCK ORDERING

In an ideal world, retailers would stock everything their customers might want. While this is, of course, not feasible in a bricks and mortar retail environment, online shop fronts can give the impression of doing so. So, how do retail stores compete, and cater for choice in a sustainable way?

A retailer's job requires the ability to predict what customers want, when they want it, and to negotiate a price that will attract customers while returning the maximum profit for the business. Historically, buyers within the retail organisation might have made some ranging decisions based on gut-feel judgments and what has worked for them in the past. For example, the idea that stocking particular low-profit items causes associated purchasing of higher profit items.

In this case, a store may stock a large range of low-margin items, based on the idea that when people come in specifically to buy them, they will also purchase a higher-margin item. The logic may be sound in some cases but, with today's data-driven tools able to read the transaction data from millions of purchases, we can finally make these decisions based on hard evidence. In many instances, we've found it is usually not the case.

Many retail stores also may not fully understand the true profitability of their stock, failing to consider the costs associated with storing lower profit items, or whether items have a short shelf-life – both in terms of perishability (e.g. food, pharmaceuticals) and time-sensitive desirability (e.g. fashion, new electronics).

Understanding exactly how stock is performing – and how elements in a range perform together – is all achievable with smart statistical analysis of transactional data, which retail businesses already possess. In this way, data transforms hit-and-miss guesswork of stock purchasing into an incredibly powerful, intelligent tool.

SMART USE OF BIG DATA COULD HELP RETAIL BUSINESSES

- Negotiate better deals with branded goods suppliers
- Make smarter decisions for stock assortment and storage
- Create a full picture of staff efficiency and organisation structure
- Transform a store or network's physical footprint for maximum impact
- Tackle the growing complex issues about online stores and distribution
- Harness the benefits of retail's offline experience to build a strong digital presence

In the UK, the high street is going through apocalyptic changes. Historical retail powerhouses have been forced into restructing deals or administration.

UNLOCKING RETAIL'S PEOPLE POWER

Often one of the first outward signals that a business is in financial trouble is a cut in staff numbers. In the UK, the Centre for Retail Research reported that nearly 150,000 retail jobs were lost in 2018, and predicted many more to come. While Europe isn't yet experiencing loss on the same scale, alarm bells are starting to ring as the massive German upmarket department store, Kaufhof cut 2,600 jobs this year as part of a merger with Karstadt, with a further 4,000 to 5,000 staff jobs threatened.

While reducing headcount is one way for companies to quickly cut costs, without adequate long-term planning it can often result in additional strain being placed on remaining staff and failure to tackle crucial inefficiencies. It's about knowing the right solution for the business.

A different approach to headcount reduction is a 'return on invested labour' (ROIL) approach, when a company assesses its in-store staffing levels using detailed customer transactional data to provide insights into optimal resourcing levels. These insights can be fine-tuned all the way down to department level, and for different parts of the day. This approach doesn't look simply at reducing staffing, but precisely pinpoints sub-optimal labour resourcing, and where significant sales are being lost, enabling smarter resourcing decisions to be made.

RETAIL REDUCTION

150,000

UK retail jobs lost in 2018

(Source: Centre for Retail Research)

ROIL can ensure labour is correctly 'invested' in areas and times of the day where there are customers to serve. This approach provides greater visibility of where a retailer can put on more staff and cut back in areas or times of day where footfall does not justify the investment.

This is also true when applied to corporate management, using tools to effectively map out how a large retail business is structured and rapidly identify inefficiencies, which can be tackled swiftly and smoothly.

1.Bazaarvoice, ROBO Economy Study, 2018

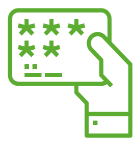
TRANSFORMING THE RETAIL FOOTPRINT

Today's successful multi-channel retailers require agile organisation coupled with a lean footprint. However, most retailers find it difficult to even begin evaluating their network, which often involves the integration of operational, financial and strategic factors, as well as an understanding of country-specific legal constraints.

The main challenge for retailers is getting full value from their store portfolio. Stores will not go away completely – they just have to work in concert with the wider offering. The aim is to make stores more of a destination for customers and a means to fulfil orders that come in from other channels. For businesses, the challenge is to decide which stores to keep and what their role is.

Insights from network-wide transactional data can help redefine a retailer's footprint – from the number of stores needed to maximise purchasing power, to their location and even the most effective store layout.

LOYALTY DATA



16m

Tesco has more than 16 million loyalty card members

> *Omni-channel retail has raised the bar in operational complexity."*

Stores will not go away completely – they just have to work in concert with the wider offering.

RETHINKING DISTRIBUTION CHALLENGES

According to a recent Nielsen report, e-commerce is growing four times faster than traditional sales channels, prompting a transformation for legacy retail businesses as they attempt to broaden their customer base to digital platforms. However, it is not simply the online presence of a brand that matters – it is the full shopping experience, from product selection to the all-important distribution.

Omni-channel retail has raised the bar in operational complexity. Many non-digitally native retail businesses are struggling with the need for on-time, cost-effective order fulfilment as part of their ecommerce platforms.

A key factor that retailers must consider is cost transparency. For example, what each delivery costs per item, what is variable and what is fixed; the relevant KPIs in understanding cost drivers; and automation and scale. Most retailers do not have the resources to both manage this effectively and have agreements with outsource providers.

Through e-commerce, retailers are also seeing a dramatic increase in micro-orders in particular – often pushing for same or next-day delivery – and an influx of returns, necessitating a higher volume of reverse logistics.

Reverse logistics are also a major consideration, particularly for apparel retailers where, as a rule, customers order several sizes or colours and send back what they don't want. The logistics set-up has to reflect this fact and be organised to allow customers to make returns seamlessly. Any system must also be scaleable, so as volumes go up, logistics costs go down as a percentage of sales.

Analytics can be used to run multiple scenarios to provide the best bespoke distribution solution for any retail business. This could result in a complete overhaul of a retail network's distribution footprint, including:

- Using logistics hubs with smaller 'infill' urban warehouses
- Leveraging shared logistics synergies
- Pooling last-mile concepts
- Improving in-store picking processes

GDPR COULD BE RETAIL'S BEST FRIEND

In a post-GDPR world, many digital-only businesses may be hitting their first stumbling block as their marketing channels go from being 'opt-out' to 'opt-in'. While the jury is still out on the long-term effect the regulation has had on digital businesses, many may find that they have fewer opportunities to reach new customers.

But this change to the use of customer data is opening a window of opportunity to traditional retailers, who suddenly have an advantage over their online competitors. They don't rely only on digital marketing, but have a physical high street presence that can be used to attract new business.

Many retail businesses are waking up to the wider value of experiential shopping, through the use of in-store promotions, unique experiences and perks. Something as simple as free wi-fi or coffee, in-store experiences, or loyalty programmes, can attract customers' attention, bring them into stores and build brand advocacy.

According to the Nielsen Global Retail Loyalty Sentiment Report, nearly two-thirds of respondents in Europe say they belong to one or more loyalty programmes, with 67% stating that they shop more frequently and spend more at retailers with loyalty programmes.

Luxury French make-up brand Sephora has long reaped the benefits of this, launching its tiered rewards programme – Beauty Insider – in 2007. It now boasts more than 17 million loyal members, who contribute around 80% of Sephora's annual sales. As well as earning redeemable rewards, members can also claim free beauty classes, makeovers and consultations, offering shoppers a huge incentive to visit stores in person.

Programmes like these not only work as a means of increasing footfall, they also enable the capture of GDPR-compliant data that can then be fed back into digital marketing campaigns.

Supermarket chain Tesco, for example, which was one of the front-runners of the reward card programme, has been running its Clubcard scheme since 1995. The company now reports having over 16 million members, which is an enormous set of demographic and transactional data that it can use to its advantage. Four years after an accounting scandal hit the company, it announced a 28% jump in profits, despite an 'uncertain' market.

CLEVER DIGITAL MARKETERS CAN USE THE DATA GATHERED TO FORM INSIGHTS AND DRIVE TARGETED DIGITAL ADVERTISING, RESULTING IN:

- Increased return on advertising and promotional spend
- Uplift of revenue on digital platforms
- Improved allocation of marketing spend across channels and promotion spend across sites
- Improved online and in-store traffic
- Enhanced user experience and personalisation
- Developed pricing strategies suited for omni-channel requirements

ONLINE APPETITE

x4

E-commerce is growing nearly four times faster than traditional sales channels

MOVING FORWARD

As the retail landscape continues to change, businesses must increasingly use the power of the information that they already own to stay ahead. From a deeper understanding of customers' shopping needs, to reorganisation of the business structure, unlocking transaction and operational data offers invaluable insight to help retailers stay relevant in a rapidly evolving environment.

While the landscape is undoubtedly tough, there are many opportunities for retail businesses to harness the power of the data they already have to make significant improvements and savings – to not only survive, but to flourish. A

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ENGAGING WITH ACTIVIST INVESTORS

To meet the challenge of activists, boards must mirror their approach

2018 was the year that activist investors came of age in the UK and Europe. Having evolved from being seen as a disproportionately vocal irritation, they are now ubiquitous and, no matter what you may think about them, they are also experiencing significant success.

And why shouldn't they be? Activists mainly focus on portfolio organisations operating multiple business with limited strategic or value-generating reasons to be held together. They campaign by removing emotion from the equation, instead leveraging data and insights. Notable successes include some of Europe's largest and most recognised public companies including Unilever, GKN, thyssenkrupp, ABB and Whitbread.

ACTIVIST DEAL NUMBERS SWELL

European activist activity has evolved and become much more sophisticated, while massively ratcheting up overall activist deal numbers. More than 400 companies outside the US were subjected to activist demands last year, with record numbers in the US, Canada, Japan, Australia and the UK.

Notable successes have increased activists' assets under management by 1,400% since 2003, much higher than other alternative investment classes.

With divestment being the number one demand, and undoubtedly the single largest value driver for successful activists, there is a ready market for non-core assets. This comes in the shape of private equity firms who, after several years of relative inactivity, are sitting on a large amount of dry powder in Europe and need to put that money to work.

It's clear that the crucible is going to get hotter for undervalued and sometimes underperforming public companies. The big question is whether boards have learned lessons, and if they are prepared to meet the activist challenge.

HOW SHOULD BOARDS MOVE FORWARD?

Dealing with the activist threat is proving to be a conundrum. On one hand, the required approach is simple – because the activists' endgame is similarly straightforward – and yet, on the other, boards struggle to address it.

At its core, the aim of activists is very clear – to effect change and grow value. Invariably the proposed mechanics that underpin calls for change are nothing that haven't been previously discussed around the boardroom table, usually on several occasions. Every activist intervention we have seen has focussed on one or more of 'five Cs': cost savings, cashflow, corporate governance, capital structure and core vs non-core.

Every one of these should be at the heart of the boardroom agenda, and yet every time these are the cracks that the activist seeks to exploit. ›

CORPORATES VULNERABLE TO ACTIVISTS CAN STRENGTHEN THEIR HAND BY FOCUSING ON THE '5 Cs'

Most corporate boards have plans that address these areas, but the perceived pace and urgency might not satisfy activist investors.

COST SAVINGS

Improve EBITDA and create sustainable value through:

- Reducing the overhead burden to the necessary basics
- Greater operational efficiency
- Extracting greater value from the supply chain

CASHFLOW

Optimise net cash generation

- Liberate cash through efficient use of working capital
- More robust capex processes to maximise returns
- Redeploy capital to focus on higher ROE activities

CORPORATE GOVERNANCE

Strengthen management and boards

- Support and appropriately incentivise management teams

CAPITAL STRUCTURE

Raise debt to distribute cash to shareholders

- Debt capacity could be much higher under private ownership
- Higher debt leverage improves returns on equity

CORE VS. NON-CORE

Sharpen focus by disposing of non-core assets

- Sum of the parts is greater than the whole
- Potential to reduce business complexity
- Reduce exposure to unfavourable sector multiples

Image ©: Getty Images

ADOPT AN ACTIVIST MINDSET

So, while the activist community is, thanks to an increasingly available array of outside-in digital sources, extremely well-informed, it isn't coming up with insights that are invisible or unavailable to a target's management team. What activists are doing, however, is taking all the information available to them and harnessing it in a detached and dispassionate fashion. It is this lack of emotion that frequently gives activists the upper hand, and where we see boards struggling, both prior to direct intervention and once embroiled in it. Despite how it may feel to the company, an activist knocking on the door or climbing up the share register is not personal. It's not about discrediting careers, tarnishing previous successes, or disassembling corporate cultures.

> *Allowing emotion to cloud a board's thinking is time consuming and a major distraction from the issues that need to be addressed"*

Equally, activists are unencumbered by baggage associated with the company's past, no matter how glorious. Instead, activists bring a laser-like focus on the future in the pursuit of business improvement and enhanced financial performance.

When in the sights of an activist, allowing emotion to cloud a board's thinking is time consuming and a major distraction from the issues that need to be addressed. Instead of channelling energy into fighting the perceived enemy, pull them closer and invest the effort in carefully examining their agenda, even though it will likely involve a process of uncomfortable self-analysis.

For many boards, the first step in adopting an activist mindset has to be consciously removing emotion from their deliberations. Only then will those who find themselves the objects of activist interest be able to ask the difficult questions of themselves and their colleagues in order to take the steps needed to ward off unwanted advances, and own change that deep down many have known to be required all along. A

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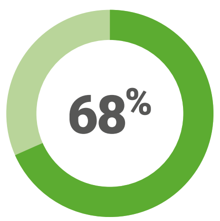
THE TIME FOR HONEST REFLECTION

As European executives' concern over activism rises, more than half admit they lack a clear strategy to deal with approaches.

With the continued prominence and success of activist investors across Europe, AlixPartners surveyed over 500 public company board-level executives from the UK, France, Germany and Italy, and found that while the majority of companies are concerned, only one third feel that they have the expertise to deal with an activist approach.

QUESTION 1:
Does the rise of investor activism concern you?

"Activists often desire transactional, specific replies, and instead we deliver slick and general group communications. There is a disconnect."[1]

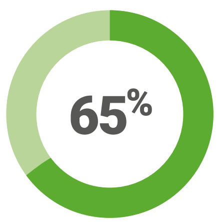


of companies report concerns about the rise of investor activism

KEY SECTORS:
Oil & Gas, Automotive, and Financial Services

QUESTION 2:
How has the importance of managing activism changed in the last 12 months?

"We are trying to catch up – but it feels like we are behind the curve."

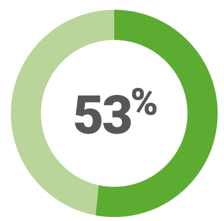


of companies say the importance of managing investor activism has increased in the last 12 months

KEY SECTORS:
Telco, Pharmaceuticals, Retail, and Consumer Products

QUESTION 3:
Do you have a clear strategy for dealing with Investor Activism?

"We just don't have a real strategy at the moment."

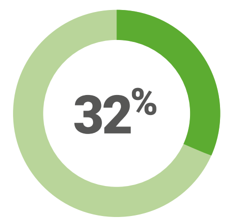


of companies report a lack of a clear strategy for dealing with investor activism

KEY SECTORS:
Retail, Energy, and Financial Services

QUESTION 4:
What is your in-house level of expertise for dealing with investor activism and other forms of activism?

"Part of the problem is the impact of actually having a strategy. When you formalise it, you immediately need to start baking things into plans that have cost and margin implications"

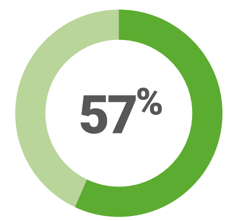


of companies report low levels of expertise at dealing with investor activism

KEY SECTORS:
Construction, Financial Services

QUESTION 5:
Do you expect to need expert third-party support to manage activism over the next 12 to 24 months?

"Trust is a factor. For a long time, this has been managed behind closed doors."



of companies expect to need third-party help to manage investor activism in the next 12 to 24 months

KEY SECTORS:
Oil & Gas, Automotive, and Financial Services

1. All quotes taken from anonymous PLC leader interviews undertaken during Dec 2018 by Explain the Market on behalf of AlixPartners Engaging with Activist Investors

Image ©: Getty Images

WHY ONLINE DELIVERY SHOULD BE YOUR FIRST CONCERN

The rapid growth in delivery app usage in the UK has left many restaurants wondering how to work within this space and navigate the type of disruption that has decimated incumbent players in other industries.

Over the last ten years, changes in social trends and economics have led to a shift in the way we consume food. Longer working hours, people remaining single for longer, the economic crisis, and the growth in technology platforms has resulted in people choosing to 'dine-in' rather than dining out.

This has contributed towards over-capacity in restaurant units and a subsequent decline in the number of bricks-and-mortar stores over the last 24 months. At the same time, the delivery market has seen rapid growth, and is forecast to grow at an even faster rate over the next five years.

This change in consumer behaviour and the rise of technology platforms has caused new market structures to emerge. These pose both challenges and opportunities for operators.

AN EVER-CHANGING DINING LANDSCAPE

Just 15 years ago, the UK restaurant sector was comprised principally of bricks and mortar, with consumers eating on premises, or ordering and collecting takeaways directly from restaurants. Delivery services were provided by delivery-only players, such as Domino's, or on a smaller scale by restaurants' own drivers.

The emergence of online platforms, such as Uber and Airbnb, saw the gig economy gather momentum. Technology has enabled new business models, platforms and sales channels, with platforms placing themselves between the service provider and the consumer.

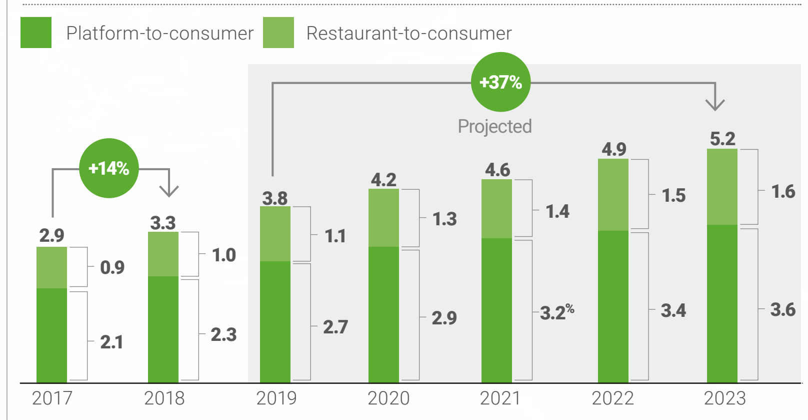
In addition to taking control of the consumer, the transparency and range of offerings provided by social media and platforms has made it harder for operators to offer online delivery as an afterthought, as customer reviews and ratings quickly push consumers to the best delivery operators.

As more digitally native Millennials and Gen Zs become economically active, these means of selecting and transacting with restaurants, pubs and other food establishments will continue to accelerate.

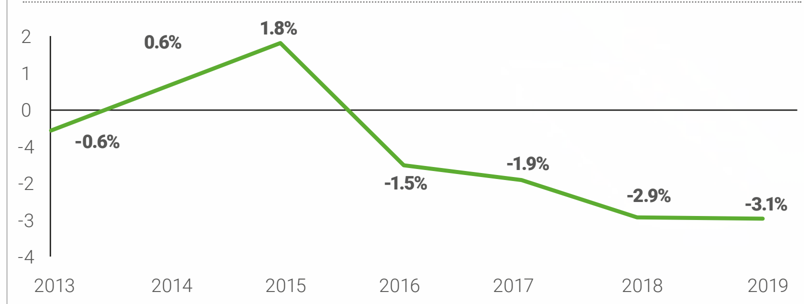
A continued rise in technology and smartphone usage, and the evolving consumer behaviour that this perpetuates, means that online delivery is not simply a trend, but is firmly here to stay. This poses significant challenges for restaurants, who need to consciously decide how they want to play in the online delivery space:

• Customer segmentation is becoming increasingly complex – there are 'groups within groups' and each group expects their needs to be fulfilled
• Consumers now expect – and demand – personalisation, from menu choices to delivery preferences
• Some customers use online delivery exclusively, creating an essential sales channel that would be lost if online delivery is ignored
• Convenience and value-for-money remain critical for consumers – delivery must be on time and high quality
• Online marketplaces feature multiple sellers and increased competition – reviews are critical to consumers' decision-making process, and not being online will likely result in sales cannibalisation ›

UK DELIVERY MARKET 2017 TO 2023 (£BN)



UK RESTAURANT GROWTH (% YEAR ON YEAR)



Source: Statista, last update: 2019-06. Direct restaurant-to-consumer includes orders directly delivered by restaurants, which will include orders sourced via platforms (e.g. Just Eat) or websites (e.g. Dominos). MCA Restaurants Report 2019

WHY ONLINE DELIVERY MATTERS

Following the rapid growth in online delivery and consolidation in the sector, three powerful players have emerged. All have strong brand recognition and consumers are exceptionally loyal to their platform of choice. These brands may well exert a stronger influence on customers' ordering choices than brand alone:

1. Just Eat – launched in the UK in 2001, this is the longest running provider and currently owns the largest share of the market. It offers a digital aggregate space to restaurants that are not digitally connected.
2. Deliveroo – launched in the UK in 2013, it focuses on affordability, growth in less dense areas and international expansion.
3. Uber Eats – a latecomer to the UK in 2015, but a fast riser. It leverages its driver network and mapping software.

While online delivery offers opportunities to restaurants as a new sales channel, it also raises new business challenges for established bricks and mortar operators:

- Lowers the barriers to entry via virtual brands and extended offerings, and increases competition from restaurants that consumers may not frequent if dining in-store
- Delivery can impact in-store operations and the diner experience, if not set up and resourced with careful planning
- Loss of direct relationships with customers
- Margin impact from third-party partner costs which include fees and commissions (which could be up to 30% of the sales value)

XXXXXXXXX

- Should we do it?
- What needs to be in place to do it?
- Do the financials stack up
- How do we do it?

TAKEAWAYS

55%
UK consumers use online delivery once a month

8.4m
active online delivery users in 2018

> *Bringing an innovation unit in-house aims to ensure a continuous pipeline of innovation, while embedding an innovation culture into the company's DNA."*

ASSESSING HOW TO PLAY

Two reactions from operators are common in the face of these threats and opportunities – 'doing nothing' to address delivery and 'jumping in' without planning. Both, however, can be disastrous to sales, operations and reputation.

If you're ignoring delivery as a channel and doing nothing about it, perhaps believing it to be a passing trend or something for future consideration, think again. Online delivery is happening now. By ignoring it you could be overlooking a potential high-growth sales channel for your business and enabling competitors to get ahead and steal your market share.

Conversely, jumping into a delivery offer without carefully evaluating the financial and operational impacts on your business could result in even greater damage. Without rigorous preparation, your brand could be irreparably damaged through long delivery wait times, poor quality food, disruption to in-store operations, and destruction of the dine-in customer experience.

Carefully assessing how, and if, delivery fits with your brand promise, food concept and customer expectations is the first critical step in determining how delivery might fit with your business. At this early stage, it may be clear that online delivery is not a viable channel, leaving the business to focus on its current growth strategy, without the constant distraction of the 'delivery' question.

If a clear fit exists between the business and delivery model, detailed operational and financial planning needs to be undertaken, which will ultimately form the basis for the underlying execution plan.

Planning should be performed in a structured way, and should include restaurant operational and staffing changes, IT integration requirements, a marketing plan, a robust business case, delivery partner evaluation and selection, a store rollout plan, and development of Key Performance Indicators to monitor execution of this sales channel.

Failing to plan in this brave new world is akin to 'planning to fail', and our experience shows that those who do not plan are losing out on potentially lucrative new ways of reaching and serving customers.

Looking to the future, forecasts show that delivery growth will accelerate faster, and will evolve in significant ways as it develops. Delivery is expected to become an even greater part of the value chain, with consolidators growing and enabling restaurants to go 'direct to customer' via white label delivery offerings.

We also see further consolidation in the online delivery sector, with new offerings and models emerging out of the current providers. All of which strengthens the message that, right now, online delivery should be your first concern.

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FOOD DELIVERY

84%
of the top 50 branded UK restaurants offer delivery

1.1bn
forecast for food delivery sales platform-to-consumer in 2019

TALKING HEADS: The M&A perspective

Graeme Smith,

Craig Rachel

"Companies' approach to online delivery is front-of-mind for private equity, those that already own businesses in the space, or those weighing up a new investment. Existing investors will be conscious that their portfolio companies are optimising a potentially valuable revenue stream, while ensuring that the ROI on any infrastructure required to facilitate online delivery stacks up. They will also have one eye on exit, and will want to ensure that management's strategy and approach to online delivery is 'future proof', and drives EBITDA gains.

"Those considering an investment in the space will focus on the business plan to ensure that online delivery is appropriately factored in, assumptions are deliverable, and any changes to strategy do not have a detrimental impact on the brand. Those companies seeking investment that are able to demonstrate a credible, earnings accretive and future-proof online delivery strategy should prove attractive to potential investors."

INVESTIGATING THE INCIDENT PERIMETER

No organisation is immune from the risk of financial misconduct, but what can be done to maintain and restore trust when an incident occurs?

Financial misconduct by employees – whether fraud, theft, bribery or other means of dishonesty – can have a significant effect on a company's bottom line and reputation. Unfortunately, no organisation is immune from these threats.

While the risks posed by employee misconduct are as severe as ever, financial wrongdoing is often detected earlier than it used to be. Developments in compliance and corporate governance have driven a largely pro-whistleblower agenda, and the vast majority of investigations have their origins in tips and suspicions being passed on, rather than as a result of any internal control or audit.

Although financial misconduct is more likely to be uncovered at an early stage than in the past, many organisations are no better at dealing with the fallout. Sometimes, it is tempting for management teams to identify the perpetrator quickly, usher them out of the door with minimal fuss, and then celebrate the avoidance of any scandal, disruption or reputational damage.

However, this natural instinct to avoid opening a can of worms can allow distrust to fester within an organisation.

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INVESTIGATING THE PERIMETER OF AN INCIDENT

By the time AlixPartners is enlisted to investigate a case of suspected financial misconduct, most companies will already have an idea of who was directly responsible, what they did, and how much money was involved. Identifying and dealing with the perpetrator is essential, but this alone won't restore trust among the management team.

To restore this trust, it is important to investigate the perimeter of any case. This involves finding out who was involved, and perhaps most importantly, who wasn't involved. Searching questions need to be asked: Who did their job properly? Who did their job badly? Who else knew about the misconduct? Who was in a position to stop it? Where and how could processes be improved? It is this probing around the perimeter of an incident that serves to clear individuals of wrongdoing and restore trust at leadership level.

In addition to jeopardising trust within a leadership team, serious financial misconduct can also sow distrust of management among staff. Restoring and maintaining this trust relies on clear, consistent and proportionate responses to misconduct.

Staff can often be quick to see fault in senior management – meaning that leadership teams need to be quick, consistent, thoughtful and fair. Rather than seeming overly litigious or blindly following policies, it is important that management is seen to be making significant efforts to investigate, understand the facts, and make informed and appropriate decisions.

ZERO-TOLERANCE DOESN'T ALWAYS WORK IN PRACTICE

Distrust often stems from a perceived lack of fairness in the approach of management to financial misconduct. Some companies will hide behind zero tolerance policies that look good on paper, but don't always work in practice. There is little in common between the actions of someone on the shop floor stealing £100 in petty cash, and a head of procurement implicated in procurement fraud, for example. A zero-tolerance approach that sees both individuals dealt with in the same way – allowed to resign for example – is not reflective of how the criminal justice system works and will only serve to breed cynicism.

Just as damaging is a lack of consistency. Sacking a shop floor worker found guilty of theft, but allowing the individual accused of procurement fraud to resign from their position, for example, could propagate an organisational culture that is susceptible to fraud, bribery and other forms of organisational misconduct.

DEVELOPING TRANSPARENCY

While perimeter investigations to establish all the facts will develop a fair and consistent response to a case of financial misconduct, there also needs to be a well-managed disciplinary structure, alongside efforts to identify and close any loopholes that may enable fraud to take place. A mere slap on the wrist is unlikely discourage fraudulent misconduct.

Appropriate, consistent and thoughtful decision-making will only mean so much if staff aren't aware of, or can't see, the process. Clear and transparent investigations are needed to restore trust among the leadership team, while transparent policies for dealing with financial misconduct will help to ensure that cynicism, or a culture of wrongdoing, doesn't develop within an organisation.

Leadership comes in many forms, and to develop and maintain trust in the wake of financial misconduct, bold and proactive steps must be taken to develop a fraud-resistant culture. At an executive level, giving in to the temptation to keep wrongdoing quiet at the time of investigation will likely prove counterproductive in avoiding the recurrence of similar scenarios later down the line.

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FOUR STEPS TO AN EFFECTIVE RESTRUCTURING

In an environment characterised by severe business conditions, leveraged companies need to confront balance sheet issues and take a hard look at their long-term viability.

Image ©: Ikon Images

Some enterprises will face painful decisions, such as undergoing a financial and operational restructuring, or even insolvency. And they cannot let pride get in the way of making changes, or they will be heading for a fall! Whatever the particular situation, early contingency planning for multiple possible scenarios is crucial. That way, no matter what happens, they will be prepared.

Today, many companies face 'once in a lifetime' market pressures. In most industries, companies have been blindsided by changes in the way customers choose and buy products and services. For highly leveraged companies, these conditions can lead to a financial crisis that triggers the need for restructuring.

Boards and management teams should prepare for multiple possible outcomes from a crisis, and many companies — not only highly leveraged ones — may have to fix their balance sheets in order to resume their long-term viability. 'Kick-the-can-down-the-road' scenarios aimed at extending liquidity and providing short-term relief from running out of cash, might not be enough.

Companies should take a more sustainable approach. To do this, they need to align their long-term liabilities with their current cash flows and other economic realities. This requires thoughtful planning in anticipation of several different possible scenarios.

Following a four-step process can help companies get back on their feet and resume the fight from the strongest possible position.

> *"Many companies hire a chief restructuring officer to head the team and oversee all aspects of the restructuring."*

STEP 1:
ASSEMBLE YOUR TEAM

Whatever the catalyst that has triggered a crisis, you need to act fast. But your management team and board should be devoting their time and energy to keeping the business running, including managing relations with employees, customers, vendors, shareholders and lenders.

That's why you need to assemble a team of experts familiar with restructurings, who can guide ›

CASH FLOW FORECASTING TIPS:

- Conduct a sensitivity analysis that generates a base scenario along with best- and worst-case scenarios. This will show how much breathing room you have
- Identify one-time collections and assess the likelihood of their being paid. In your worst-case scenario, exclude these or assume that if they come in, it will be far in the future
- Forecast employee turnover, lease rejection costs, exiting loss-making businesses, and vendors' requests for cash on delivery. Include anything that might limit your credit lines and reduce your credit terms
- When assessing your company's short-term liquidity, understand and model all timing anomalies, such as seasonality of sales
- In your forecast, account for capital plans, legal and advisor fees, bank fees, and default interest payments
- Determine if your company pays its bills and obligations through a revolving line of credit based on a borrowing base, rather than on actual cash in the bank. Understand your credit agreements and lender relationships so that you don't commit a misstep that jeopardises cash availability
- Be aware that any form of insolvency process, be it actual or threatened, can affect your collections. Customers might look for alternative suppliers, drag their feet in paying, or take more credits than usual

you through your options. Your team should include financial advisors experienced in restructurings, legal experts, bankers, and public relations specialists to handle internal and external communications. A good restructuring team should develop several different scenarios that could play out for your company.

Team members should define the financial options for enabling your business to continue as a going concern, along with potential operational solutions for fixing what can be improved with your business and returning it to health. Examples include selling off non-core or unprofitable divisions or assets, exiting unprofitable leases, or rightsizing the company's operating expenses.

The team should also start conversations and manage negotiations with lenders, customers, suppliers, unions and key stakeholders. Many companies hire a chief restructuring officer to head the team and oversee all aspects of the restructuring.

CASE STUDY: AGROKOR - HELPING AVERT NATIONAL DISASTER IN GAME-CHANGING CASE

The situation:
Collapse could mean disaster

In 2017, food and retail conglomerate Agrokor, Croatia's largest business group, neared collapse. With more than €6bn in debt, Agrokor was unable to meet its obligations to suppliers and creditors. As the largest employer in the Balkans, Agrokor was so enmeshed in Croatia's economy that its demise would have impacted virtually every citizen and business in the country.

The approach:
Too big to fail, too complex to fix

Agrokor was involved in every phase of food manufacturing and distribution, retailing and wholesaling, but struggled to maintain a healthy financial position. The Croatian government refused to bail the company out, and insolvency laws provided only for liquidation of financially distressed companies with no path for restructuring. As the payment date for sizeable debt approached, a new law was passed to enable the restructuring of systemically important businesses. Agrokor then entered extraordinary administration under the provisions of the new law.

The outcome:
Restructuring plan and lessons learned

Our multidisciplinary team assessed the viability of the company's many operating units, tackled cashflow, and developed a long-term plan to sustain the company and equitably settle claims when it really mattered. AlixPartners stabilised the business, implementing best-practice cash management processes, developing business plans and improving EBITDA. We restructured the company's finances through asset sales, debt cancellations, payment deferrals and debt-for-equity swaps.

A national crisis has been averted – the viable parts of Agrokor now operate under Fortenova Group and new owner-managers are in charge, with robust governance structures in place.

This case demonstrates that liquidation and breakup aren't the only recourse when a company is in distress, and that a swift, efficient and equitable restructuring procedure can generate far more value for creditors. 'Lex Agrokor', the first law of its kind, has set a global precedent for statutes on restructuring systemically important companies. .

STEP 2:
GET A CLEAR PICTURE OF YOUR CASH FLOW

Cash is king when a company is in crisis. Do you know how much cash you have? Your restructuring team should develop a detailed cash flow forecast so you can get a clear line of sight into your company's liquidity.

The forecast should be based on a direct-method model that shows receipts and disbursements and that sheds light on your company's liquidity. This will determine which key performance indicators and tracking tools to use to monitor, measure and even reward performance.

The cash flow forecast also reveals potential funding shortfalls that need addressing in an insolvency process or other scenario. A detailed and accurate forecast helps everyone on your management team to stay focused on cash.

STEP 3:
MAP OUT YOUR OPTIONS

Once your restructuring team is in place and has a solid understanding of your cash flow and liquidity, it's time to take a close look at how to get out of the crisis.

Distressed companies typically pursue an out-of-court restructuring first. For instance, they could raise new equity or debt, sell or merge the company, or restructure it with existing stakeholders. These are all viable options. Indeed, out-of-court restructurings are less disruptive to the business; constituents can often reach agreement faster than in an in-court process, and costs are lower.

But out-of-court restructurings require full consent from all constituents – such as lenders, bondholders, and shareholders – with regard to how to adjust the company's liabilities. If time is running out, or all constituents can't agree on next steps, an in-court restructuring may be your company's only hope for survival.

Craft a plan to put each option into action. Make sure these include how you would communicate important decisions and changes in your organisation to both internal and external parties.

As you build a plan for an insolvency scenario, include a work plan for first-day motions. For example, determine how you'd meet payroll, use whatever cash you have on hand, maintain bank accounts, and manage other resources to keep your company operating.

> *As you build a plan for an insolvency scenario, include a work plan for first-day motions."*

STEP 4:
EXECUTE YOUR PLANS

Once you've determined possible crisis resolution scenarios, start implementing the plans you've developed. If you are attempting an out-of-court restructuring first, you'll have to execute your communications plan to give interested parties necessary information.

Also, start negotiating with your lenders and other creditors about the amounts your company owes. For instance, try to renegotiate operating leases and negotiate with unions or employees. If you can't get consensus on desired changes from those constituents, you may have to commence an insolvency process. But at least you'll be prepared, thanks to the planning you've already done.

Emerging from an insolvency process is not the endgame, but your company should come out of the process with a cleaner balance sheet, less debt, and less-burdensome pensions, employee contracts, and other obligations. A

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TOWERS DEALS TO HIT NEW HEIGHTS

The scene is set for a potential $20 billion in European asset deals.

Telecom tower owners and prospective investors are gearing up for a frantic period of deal-making in a European market full of opportunity. As activity heats up, AlixPartners has identified that a potential $20 billion in asset deals could be on the table in the next 12 to 24 months. But how do investors and divestors alike get the most value from these deals?

In stagnating markets, where growth is limited and sometimes non-existent, Mobile Network Operators (MNOs) are finding their cashflow under growing pressure. This is exacerbated by telcos being pushed to increase the speed and reach of fibre deployments, and find vast sums for new spectrum investment. With revenue increasingly de-coupled from costs, telcos need to think differently.

Most European operators have already realised significant capex savings and operational efficiencies from sharing network infrastructure. The time may now be right to look at not just sharing, but offloading.

Until now, many MNOs have been jealously guarding their tower assets, with the goal of better coverage and speed differentiation. But the tables are turning. 5G deployment looks set to be rather different to previous iterations of mobile technology, as operators seek to differentiate and monetise through focused B2B use cases, rather than mass consumer deployment. This changing focus supports a rethink of the traditional logic of tower ownership.

Reducing expectations for 5G-related tower deployment in some markets supports the offloading of tower assets for cash. It also challenges core business cases and key value creation levers for investors. Many investors are potentially keen to take advantage of telcos' willingness to sell. Assets offer a strong guaranteed return that the markets like, and whole business models (TowerCos) have been built up to take advantage of this. And financial investors – Private Equity and Infrastructure funds – are interested, too. But investors should be careful – if changing 5G ambitions means MNOs are willing to divest, then the business case they are assuming might not be there.

AlixPartners' analysis suggests that in the next 12 to 24 months we could see deal activity involving assets worth more than $10 billion in Western Europe, including those of European powerhouses Vodafone, Deutsche Telekom, and Orange; and a further $10 billion in Eastern Europe, including Russia. These huge numbers are supported by the fact that tower assets can still command more than $100,000 per tower.

MNOs, TowerCos, and investors need to deliver on the value promise that towers present. But it's far from easy, and each group must overcome a variety of strategic, competitive, technical, and financial considerations to develop their towers' business case and navigate the operational challenges to deliver on that promise:

- MNOs must maximise asset value realisation, while retaining sufficient operational control and not diminishing any strategic market advantage.
- TowerCos must be careful to acquire assets at a value and under market conditions that allow successful execution of value creation levers.
- Financial investors face the same challenge as TowerCos, with the added complexity of multiple investment models available to them to assess.

WHAT'S THE MO FOR MNOS?

Several key factors are driving the decision for MNOs to suddenly start selling off the family silver. Primarily, it's the need to free up cash, supporting the requirement for additional investments that are de-coupled from growth curves, and resolve debt issues on the balance sheet.

On this new playing field, retaining passive infrastructure and a cash-poor position is unlikely to keep MNOs ahead of their competition.

MNOs need to understand which assets to carve out, at what price, to who, and under what model, without limiting their options in further network sharing or 5G deployment, factoring in local market constructs.

A number of different business models have emerged, with different levels of external investment and operational control. At one end of the scale, some operators have set up a wholly-owned subsidiary – such as DTAG's Deutsche Funkturm and TIM's INWIT – potentially as a precursor to further activity, to manage, control and drive value from the assets. This model can still provide a vehicle for external investment and cash injection.

At the other end is full tower sale to an independent third party that manages assets and leases back space to operators. This model is commonplace in the US, where American Tower controls more than 40,000 sites and in China, where China Tower operates a mammoth 1.9 million sites. Here, cash realisation for MNOs is at its highest, but the risk of ceding operational control and flexibility is obviously much higher.

VIEW FROM THE TOWERS – THE FUTURE

Financial pressures make further consolidation in the European MNO market highly likely, potentially even bringing in versions of the much-discussed Netco/Servco model. Any sharing, and indeed asset sales, should consider what could be on the horizon, and ensure that options are not overly limiting for choices of business model or partner in the future. ›

GLOBAL SITES

40,000
American Tower controls more than 40,000 US sites

1.9m
China Tower operates 1.9 million sites in China

BOOSTING TOWERCO VALUATIONS

With markets significantly undervaluing assets within a telco, there is the opportunity to realise tower valuations within TowerCos of more than three times that of the same asset under MNO ownership. The reasons for this include:

- A simpler business model
- More stable revenue flows than that of an operator
- The ability to monetise the asset better – charging subsequent site tenants the same price as the first, something which operators cannot do
- Improved management focus

> Network sharing is a strong tactical move for MNOs and can offer significant benefits – but it can be a double-edged sword. While the benefits of easing cashflow concerns and driving operational efficiencies are clear, MNOs can find it challenging to grow if they and their sharing partners have different market ambitions or fiscal outlooks. If a partner does not share growth ambitions, an MNO's deployment plans could be hampered, and/or divestment options reduced. Low levels of sharing present an opportunity to drive further efficiencies and revenue streams. But, as levels of sharing increases, asset valuations can fall, given the increased difficulty for investors to create further value.

An MNO's deployment ambition and technology choices as part of a 5G strategy will also significantly impact tower divestment selections.

For MNOs, a successful transaction requires the negotiation of complex steps, from business case to value realisation. The key strategic issues operators must navigate, which inform asset, price, and business model decisions, are:

- What to sell – should MNOs include all towers and rooftop sites or carve out regions/ locations that still offer differentiation potential?
- What model to adopt – how do MNOs balance cash opportunity with retaining sufficient operational control and flexibility to drive independent deployment strategies and realise savings from other possible levers, including sharing?

And, of course, once divestments are in place, operators will still face the challenge of managing the transaction and establishing workable operating/governance models with the new asset owners.

LOFTY AMBITIONS – HOW CAN TOWERCOS TAP INTO HIGH EXPECTATIONS?

Independent TowerCos are actively looking to grow their presence and volume of assets in European markets. Once acquisitions are complete, they seek to bring them on board and drive operational efficiencies as standalone assets and as part of their wider regional portfolio.

The market has witnessed a significant number of TowerCo transactions in recent years, the focus of which has been to capture consolidation and optimisation synergies. Cellnex in Europe and American Tower in the US, for example, realise the simplicity of an operating structure, and maximise value through the deployment of automation technology.

Italy, France, and the Netherlands have been hotspots for consolidation, and eyes are now turning to major markets, such as the UK and Germany, for further acquisition opportunities.

While the key levers may appear simple, TowerCos face a similar set of challenges around a potential investment as those divesting: what to buy, at what price, and with what value creation assumed to be possible.

Key for TowerCos is not just the commercial due diligence of an asset (what value can be realised over time) but also the technical due diligence – asset age and condition, how much spare capacity exists, and if and how they could be upgraded.

> *"Italy, France and the Netherlands have been hotspots for consolidation, and eyes are now turning to major markets such as the UK and Germany."*

REALISING TOWER VALUE

TowerCos have a seemingly straightforward business model – akin to any infrastructure management fund – with the challenge to deliver value via four key levers. Overall, these levers can increase value anywhere between 2x and 2.5x, depending on the current maturity of the asset, and each lever will contribute to this increase to a different degree:

1. Consolidating a portfolio by delivering the same revenues from a reduced set of towers with a lower cost base.
2. Increasing tenancy through the addition of equipment from other operators or next-generation equipment, plus gaining more revenue from the same cost base.
3. Driving operational efficiencies through automation, better support systems and processes, and a more productive workforce.
4. Increasing revenues by opening up towers to other industries, including media broadcasters or Internet of Things (IoT) networks.

The technological transformation of towers doesn't come cheap. Reaching a position where automation and cutting-edge inventory management squeezes every last drop of optimisation from an asset requires a long-term investment strategy, committed to the delivery of regular steady revenues, as opposed to a simple buy-and-hold position.

New challenges are impacting previous assumptions about value creation. Reduced 5G deployment plans, increased network sharing from operators, 'all-you-can-eat' pricing models are also reducing revenue opportunities, and EEC code regulations are reducing the cost base to be optimised.

With all this in mind, it would be wise to focus business cases for acquisition on opportunity, where network sharing is more nascent, for example. In regions of high tenancy and more mature market consolidation, the chance for revenue growth may have passed already.

Of course, once a business case is in place, TowerCos will still face the challenge of managing a transaction and delivering the value they see – a big ask in markets where they might not have an existing presence, workforce, or systems in place.

TOWER ASSETS

$100k

Tower assets can still command $100,000 per tower

$300k +

Recent global deals have seen tower valuations exceed $300,000 per tower

FINANCIAL INVESTORS – AN OPPORTUNITY TO ACHIEVE TOWERING PROFITS

Financial investors are more willing to invest in increasingly different tower business models. Telco towers promise a steady revenue stream from long-term reliable contracts, and there have been deals across the world in recent years where tower valuations have exceeded $300,000 per tower.

Previously, Private Equity houses were only interested in investing in tower assets managed by independent TowerCos like Cellnex – which is investing in TowerCos itself – but the burgeoning market has created interest in other areas of tower investment such as wholly-owned operator subsidiaries like Altice's SFR Towers.

The strategic assessments, opportunities, and challenges for financial investors mirror those of TowerCos, with an additional layer of complexity presented by the distance they may experience in being able to directly manage the pursuit of assets' value levers.

Beyond that concrete understanding of the assets and their value potential, it's also the ambition for potential investment partners that must be examined. Alignment is essential, as buying for upside potential and a speedy exit will clearly clash with those investors after regular cashflow for the long-term.

Here, picking the right dance partners could avoid any slips and trips later down the line, as different partners could take opposing approaches in matters, such as investing more money to transform, aggressiveness in cost take-out, and when to exit and at what price. A

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NEW MOBILITY, OLD CHALLENGES

Investment and development in new technologies is driving a wave of transformation across the automotive industry. What can traditional players do to avoid falling by the wayside?

At a macro level, things are already looking tight in automotive. Sales are predicted to slow, with the European market forecast to create 200,000 fewer units in 2019 than 2018, and growth is expected to soften to 1.3% between 2019 and 2026. On top of this, the rapid move away from diesel engines is expected to lead to a market of only 10% of new car registrations by 2030.

Ongoing drops in vehicle sales and the exit of a number of manufacturing sites – Honda's Swindon plant and Ford's Bridgend plant among them – will see production activity in the UK fall further. This will affect the wider OEM, Tier 1 and Tier 2 supply chains, who risk sitting on capacity at levels that will no longer be needed.

This overall industry slowdown comes at a time when the need to invest in new technologies has never been greater.

With $275bn expected to be invested over the next five years in electric (EV) and autonomous vehicles (AV) – $225bn in EV alone – industry players are re-evaluating their portfolios and strategic partnerships while they seek scale and speed. Many anticipate large-scale restructuring to free up capital in order to be fit for the future.

Of course, there is no guarantee that these investments will even be fit for the long term. With limited standardisation across new technologies, and a changing landscape of battery- propulsion technologies, competing platforms continue to emerge, leading to the very real risk of investments not paying back.

> *"The overall industry slowdown comes at a time when the need to invest in new technologies has never been greater."*

BIG BETS – BUT WHICH IS THE RIGHT TECH TO BACK?

Standardisation around L4/5 autonomous technology stacks, and new developments in battery-cathode technologies, are just some of the ever-evolving technologies driving the new wave of automotive investment and R&D across the value chain.

Manufacturers are faced with decisions to invest, design and build capacity for technologies that may be uncompetitive by the time they reach mass adoption. Inevitably, this means that significant investments may not pay back as manufacturers and suppliers look to reinvest for a different direction of travel.

Even beyond subsets of accepted technologies like EVs, which are required to meet short-term emissions targets, OEMs are beginning to look at more fundamental powertrain transformations. Fuel cells represent both a potential alternative to electric vehicles and an increasing field of research for OEMs as they seek to bridge the gaps to long-term emission targets.

With an ever-changing landscape, new technologies are being developed to meet the requirements of external forces to the automotive industry along the whole supply chain, without the industry truly able to assess which one will win out.

DEALERSHIPS IN DANGER

These macro-trends impacting the industry affect the dealership market in particular. Dropping volumes of car sales are a cause for concern, but the knock-on effect of new technologies in electrification and autonomous vehicles can have a secondary impact on profitability. Differences in engineering and design mean EVs are likely to realise £1,000 less revenue over the warranty period by virtue of having fewer parts requiring regular service and replacement over that time.

In addition, advances in driver assistance (ADAS) technologies will impact the collision aftermarket, both through the prevention of collisions and through increasing the reliance on the OEM aftermarket for the high-value ADAS components in windscreens, bumpers, mirrors and doors. This significant hit to both the top and bottom lines is one that many dealers will not be able to recover from without some form of intervention.

CLIMATE CHANGE CHALLENGES

Emission targets remain challenging across the industry and the rapidity of the move away from diesel has compounded the problem, with fleet emissions slightly increasing in 2019. Wholesale changes will need to be made to meet 2025 standards and, beyond this, tighter emission targets will require further transformative behaviour.

Some OEMs are facing a potential scenario where they are unable to meet their fleet emission targets for 2025 without significantly forcing fleet mixes into lower emission vehicles, and increasing electrification and hybridisation of their new production vehicles.

There are also legislative challenges for OEMs. Incentives on low-emission vehicles are still the primary factor in boosting demand, alongside government intervention through indirect disincentives (diesel vehicle usage restrictions).

A WAVE OF RESTRUCTURING ON THE HORIZON

While there has already been limited restructuring activity across the industry, we anticipate that further activity is coming. OEMs and suppliers will need to take a proactive approach in realigning portfolios and industrial footprints to remain on the front foot. Delays in addressing the macro automotive trends until it's too late will only result in restructuring scenarios from positions of weakness.

Ratios and trends demonstrate that now is the time to look hard at your business, while you still have the finances to take a proactive view, ready for the future.

Keeping your head well above water in this way, as others around you sink, will likely place your business in a position to really ride the coming wave of opportunity.

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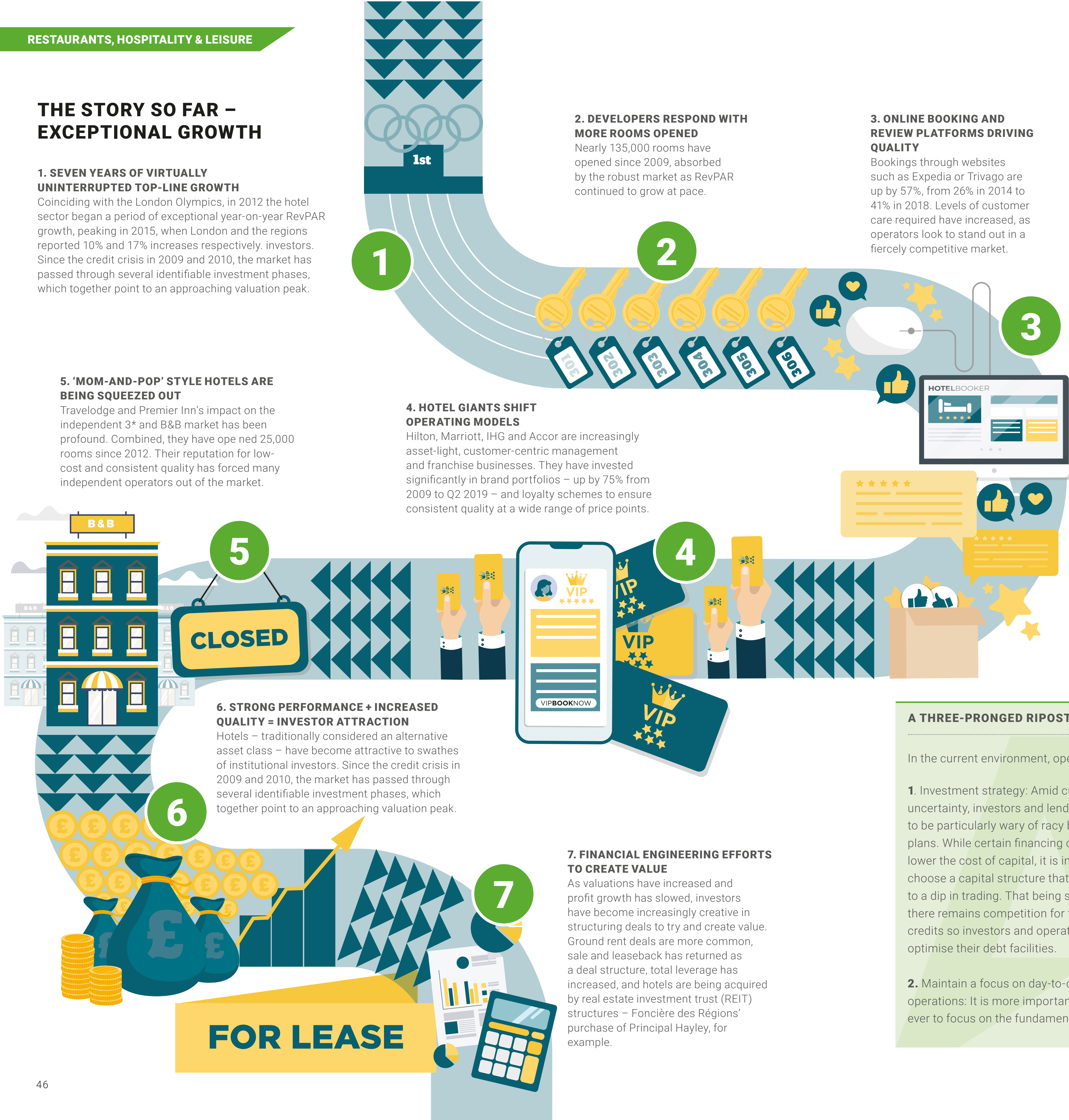
HOTEL DISTRESS ON THE HORIZON?

A perfect storm is forming in the UK hotel sector, but how should those at risk best respond to the challenge?

It's an uncertain time for the UK hotel market. After seven years of solid growth, revenue per available room (RevPAR) growth is decelerating and costs are mounting. Delivering growth, upon which many previous investment and lending decisions have been based, appears increasingly challenging.

With macroeconomic uncertainty intensifying, even London faces a more sluggish growth outlook. The signs point to the UK hotel market reaching a cyclical valuation high, with an increasing amount of restructuring appearing inevitable. But how have we reached this point, and what should investors, lenders and operators do next?

THE STORY SO FAR – EXCEPTIONAL GROWTH



1. SEVEN YEARS OF VIRTUALLY UNINTERRUPTED TOP-LINE GROWTH
Coinciding with the London Olympics, in 2012 the hotel sector began a period of exceptional year-on-year RevPAR growth, peaking in 2015, when London and the regions reported 10% and 17% increases respectively. investors. Since the credit crisis in 2009 and 2010, the market has passed through several identifiable investment phases, which together point to an approaching valuation peak.

2. DEVELOPERS RESPOND WITH MORE ROOMS OPENED
Nearly 135,000 rooms have opened since 2009, absorbed by the robust market as RevPAR continued to grow at pace.

3. ONLINE BOOKING AND REVIEW PLATFORMS DRIVING QUALITY
Bookings through websites such as Expedia or Trivago are up by 57%, from 26% in 2014 to 41% in 2018. Levels of customer care required have increased, as operators look to stand out in a fiercely competitive market.

4. HOTEL GIANTS SHIFT OPERATING MODELS
Hilton, Marriott, IHG and Accor are increasingly asset-light, customer-centric management and franchise businesses. They have invested significantly in brand portfolios – up by 75% from 2009 to Q2 2019 – and loyalty schemes to ensure consistent quality at a wide range of price points.

5. 'MOM-AND-POP' STYLE HOTELS ARE BEING SQUEEZED OUT
Travelodge and Premier Inn's impact on the independent 3* and B&B market has been profound. Combined, they have ope ned 25,000 rooms since 2012. Their reputation for low-cost and consistent quality has forced many independent operators out of the market.

6. STRONG PERFORMANCE + INCREASED QUALITY = INVESTOR ATTRACTION
Hotels – traditionally considered an alternative asset class – have become attractive to swathes of institutional investors. Since the credit crisis in 2009 and 2010, the market has passed through several identifiable investment phases, which together point to an approaching valuation peak.

7. FINANCIAL ENGINEERING EFFORTS TO CREATE VALUE
As valuations have increased and profit growth has slowed, investors have become increasingly creative in structuring deals to try and create value. Ground rent deals are more common, sale and leaseback has returned as a deal structure, total leverage has increased, and hotels are being acquired by real estate investment trust (REIT) structures – Foncière des Régions' purchase of Principal Hayley, for example.

HOW BEST TO WEATHER A PERFECT STORM?

Investors need to find ways to reduce their cost of capital to make valuations work. But these developments reduce financial flexibility and the ability for hotels to weather any material downturn in performance.

Hoteliers also face the prospect of increasing overheads, particularly in the regions, where skinnier EBITDA margins leave the sector more susceptible to a performance downturn. But where are these cost pressures coming from?

ONLINE TRAVEL AGENTS: Operators often pay up to 30% for bookings through these platforms – hard to swallow for those without the critical mass to justify an alternative central marketing expense to attract direct traffic.

PAYROLL: The introduction of the National Living Wage in April 2016 squeezed profits, and further increases will do likewise. Brexit will impact the sector, too, as falls in sterling value could see a heavily-relied-upon pool of overseas workers leaving – posing payroll increase and staff availability issues

BUSINESS RATES: Changes introduced in 2018 have had a significant impact on hoteliers, particularly in London and southern regions.

UTILITIES: Well-publicised rises in utilities overheads, caused by increased consumption, are adding to the cost pressures piling up on hotel operators.

FOOD AND BEVERAGE: Currency fluctuations, increases in global commodity prices and rising production costs have seen year-on-year food price inflation continue through 2019..

A THREE-PRONGED RIPOSTE

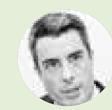
In the current environment, operators, investors and lenders should keep three things in mind

1. Investment strategy: Amid current uncertainty, investors and lenders need to be particularly wary of racy business plans. While certain financing options can lower the cost of capital, it is important to choose a capital structure that is resilient to a dip in trading. That being said, there remains competition for the best credits so investors and operators should optimise their debt facilities.

2. Maintain a focus on day-to-day operations: It is more important than ever to focus on the fundamentals of hotel operations. Maintaining close tabs on what the competition is doing, reacting to changing customer needs and closely managing staff efficiency and departmental profitability is essential. At this time, it is imperative to maintain capital expenditure levels and capital liquidity in preparation for a rainy day.

3. Preserve value: If things start to go wrong, valuations have the potential to move very quickly. It is essential that investors and lenders have planned and understand exit options, and can if necessary, act quickly and decisively to maintain value.

AUTHORS



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2020 TRENDSPOTTING

As 2019 draws to a close, AlixPartners' industry experts provide their outlooks for the twelve months ahead, assessing the opportunities and threats presented by a global business landscape in the throes of continued political uncertainty and unprecedented technological acceleration.

CONSUMER PRODUCTS

Sanjay Bailur
Managing Director, London

The Consumer Products industry is facing intense disruption. Global power brands are struggling to maintain relevance as private label brands and trendy, niche challengers – often powered by direct-to-consumer sales channels – continue to perform strongly.

At the same time, I see significant consumer-led disruption. Health and wellness trends, combined with consumer demand for sustainability – ranging from the growth of veganism and the reduction in the use of palm oil and packaging, to action on global warming – means that many brands will need to adapt their offering. Alongside this, weak consumer sentiment is benefiting the discount segment, while the convenience market also continues to perform strongly.

Supply market uncertainty as a result of ongoing Brexit negotiations is adding further complexity. As a consequence, I expect to see consumer products brands facing input price and trade uncertainty, alongside the potential for increased competition and wage inflation caused by labour shortages.

In response, corporate strategies are shifting. I anticipate significant portfolio reshaping and consolidation, and – following disappointing emerging market growth – a renewed focus on core home markets. Digital technologies will continue to transform the industry with improved customer insight and personalisation, commodity price management, and manufacturing and distribution efficiency.

This disruption certainly poses a threat, but there is also huge opportunity. The winners will be those that create relevant brands and private label products that meet changing consumer requirements, while embracing new strategies and technologies to remain cost-competitive, innovative and exciting.

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RETAIL

Matt Clark
Managing Director, London

Retail is facing an existential question. Its traditional distribution role is being disrupted by technology platforms like Amazon and Google, and customers feel they can get better value and convenience from discounters or online.

While there is still growth in parts of the market such as luxury, discount and specialised retail, the mid-market is severely challenged. I see a 'muddle in the middle' where the over-supplied and undifferentiated middle market will continue to be squeezed and the weak will die. Costs are only going up, high street footfall is only going down and technology platforms are only getting better. Only those with relevant value propositions, a lean cost base, manageable debt and operational excellence will survive.

In addition to the fundamentals, I believe every retailer must become a tech company at heart, building significant internal capability and the ability to partner intelligently with platforms. It is essential to master digital channel economics and leverage customer and product expertise to deliver growth. This huge task requires intelligent investment, new talent and, most importantly, substantial cultural and leadership change.

Finally, the power of authenticity cannot be underestimated. Retailers with a clear sense of purpose and a strong track record of ethical sourcing and sustainable policies will continue to be more attractive to customers. Those that merely pay lip service to sustainability will be found out and business will suffer.

My advice is to take bold steps bravely. The retail graveyard is littered with those that acted too late or did too little. Go big or go home.

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TECHNOLOGY, MEDIA & TELECOMMUNICATIONS

Eric Benedict
Managing Director, London

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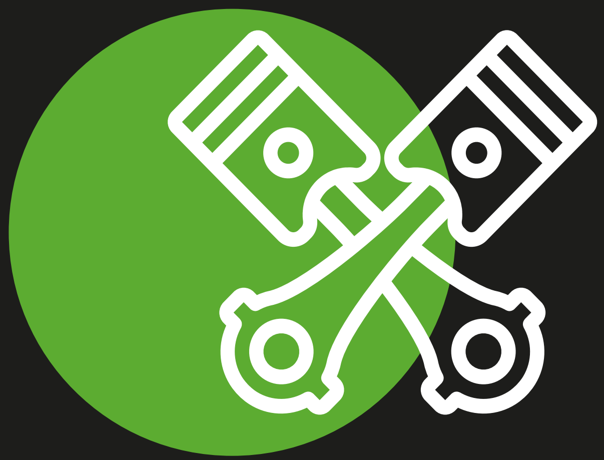

AUTOMOTIVE & INDUSTRIAL

Andrew Bergbaum
Managing Director, London

I wouldn't assume that things are going to get better for the automotive industry next year. Yes, we've seen record sales and production in recent years, fuelled by a cleverly designed payment system, and a resurgence of UK-built vehicles – but times have changed.

In 2020, I expect consumer confidence to dip further, and motorists to become much less inclined to take up PCP financing. Dealerships will see the volume of new car sales fall, as more second-hand cars enter the market, putting further pressure on distribution networks.

The potential rise of clean-air rhetoric, as mayoral elections are contested in May, could spook vehicle buyers and further shift buying behaviour. Broader political uncertainty will also affect supply chains and impact the viability of component production plants in the UK. While there will be some winners here, who will run with the opportunity for 'on-shore' production, others may find that their businesses become much less attractive.

Whatever the driver for the re-evaluation of automotive businesses, it's simply what industry players should be doing now anyway. Those who make bold decisions sooner rather than later, while they still have cash in the system to fund new strategies, will be the winners.

Dealers, manufacturers and suppliers should take a proactive approach in realigning their portfolios and industrial footprints to remain on the front foot. In this saturated market, the risks are that much higher, so it's time to do everything they can to streamline, improve and restructure. Those who don't are likely to regret it.

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RESTAURANTS, HOSPITALITY & LEISURE

Graeme Smith
Managing Director, London

Over the last decade, changes in the way we consume food have come with major implications for the restaurant sector, which I believe present both challenges and opportunity.

One of the biggest shifts has come thanks to the rise of technology platforms like Deliveroo and Uber Eats, which have resulted in many more people choosing to dine in. Many restaurants are wondering how to play in this space, as it has contributed to the recent decline in the number of bricks and mortar locations.

Alongside this, we've seen the rise of the conscientious consumer and a growing health and wellness trend that means many of us are now looking for restaurants with clear positions on issues ranging from supply chain sustainability to animal welfare, while at the same time offering menus with more plant-based options and allergen information.

Complicating efforts to respond to these changes, restaurants are having to deal with rising costs, particularly in relation to staff and property. This is contributing to a focus on de-skilling and automation, and a situation where quick and limited service restaurants are outperforming casual dining.

With cost pressures mounting, the natural inclination for many will be to explore cost-cutting measures. However, with consumer behaviour changing rapidly, now is the wrong time to halt investment. In order to thrive in this new environment, I believe that restaurants will need to establish a laser-focused investment strategy and think more carefully than ever about why and where capital is being allocated in order to drive optimal returns.

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PRIVATE EQUITY & INVESTORS

Mark Veldon
Managing Director, London

It has been a mixed year for Private Equity (PE), with financial and political uncertainty impacting deal flow, along with a lack of quality assets coming to market. Valuations continue to be at very high levels, increasing the need for more innovative strategies to creating value. But I've seen PE sponsors continuing to raise significant funds, with dry powder (marketable securities) at all-time highs.

With PE outperforming many other asset classes, the need to deploy capital remains strong, leading to an increased focus on 'mega-deals' such as carve-outs from corporates (e.g. Nestle, Bosch and Hitachi), and an increasing interest in 'public to privates' (e.g. Osram and Stada).

Given the current climate, I would expect PE firms to continue developing innovative ways to deploy capital and, with the increase in activist or LP activity, competition in this environment is set to continue.

Economic trends will have a major impact on the sector in the coming years. We're seeing signs of a global downturn and are asking how bad it will be and how long it will last. It will be critical to proactively manage portco performance and, in particular, cashflow, and expect an increased focus on infrastructure and special situations / credit.

Moving into 2020, I suggest that PEs should prepare for the worst. They should gain a thorough understanding of the performance drivers across their portfolio, how they may be impacted by a downturn and actions that can be put in place to maintain profitability and, more importantly, generate cash. Integrated digital and operational solutions will be key to accelerating and unlocking more value.

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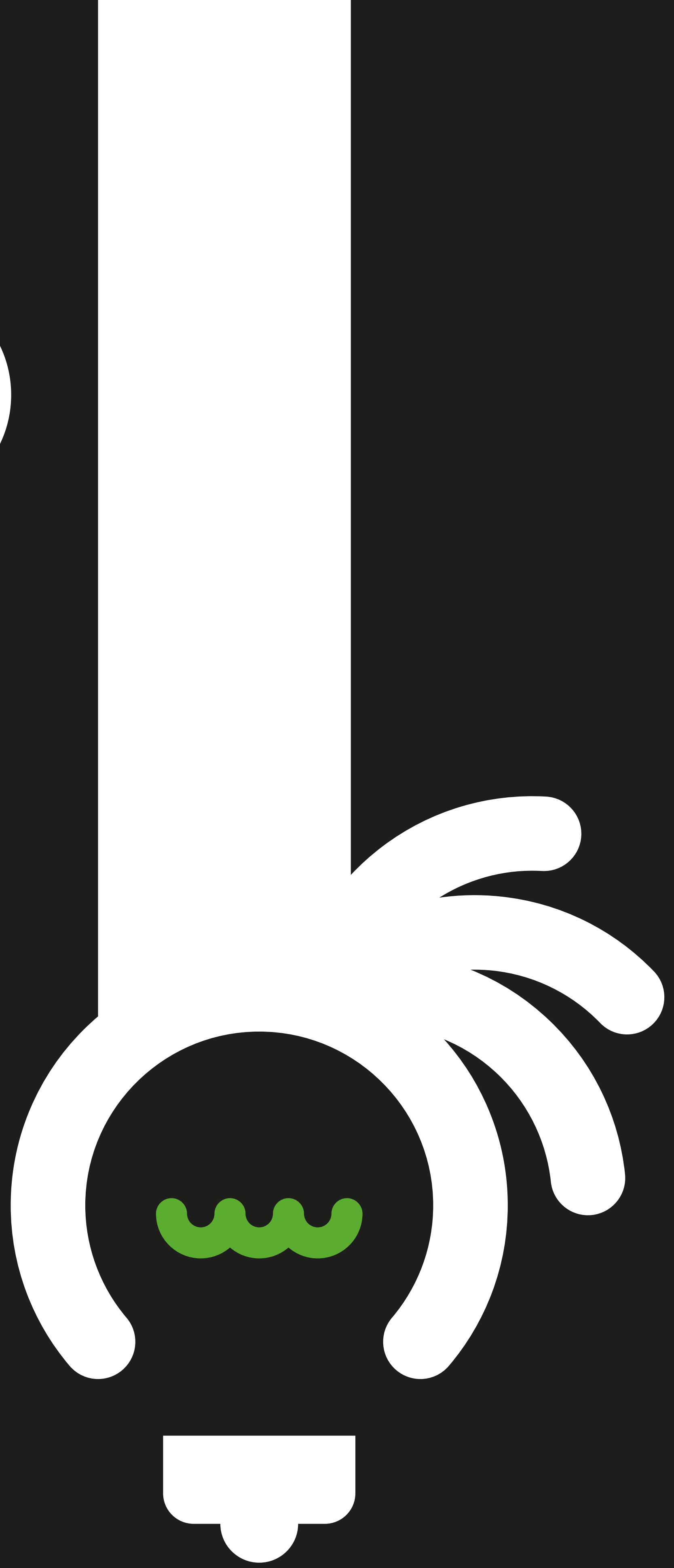

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ABOUT US
For nearly 40 years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it. We work in small, highly-qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.