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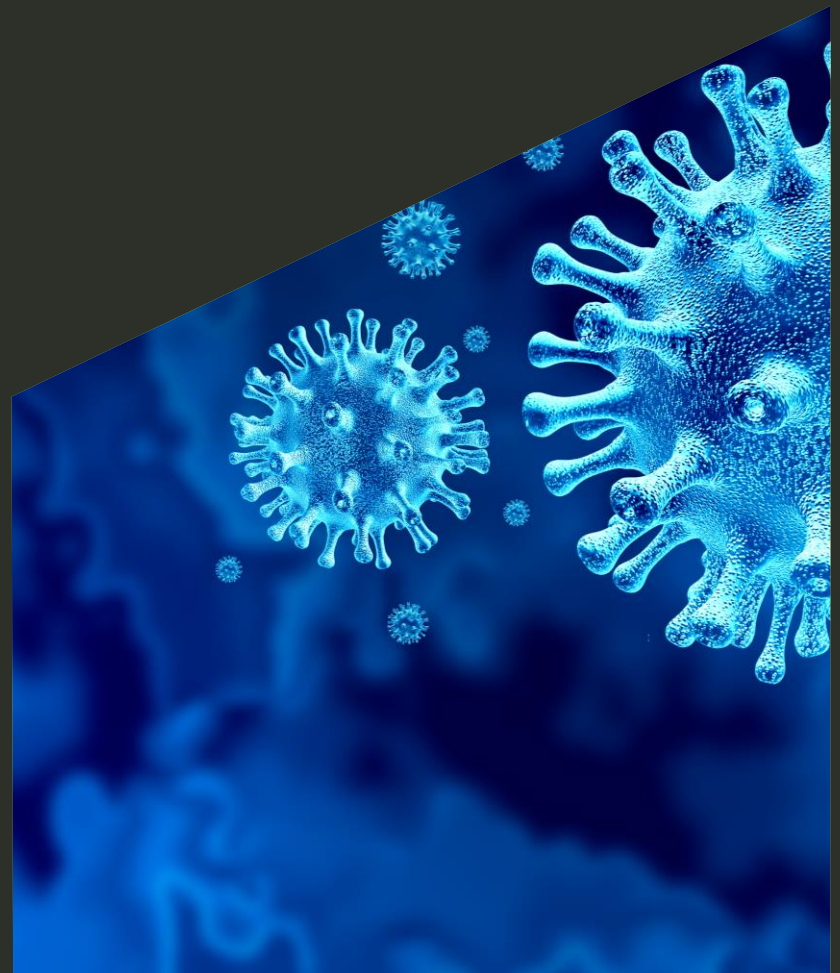
PROACTIVE STEPS COMPANIES SHOULD TAKE TO PRESERVE VALUE AND EVALUATE OPPORTUNITIES

Wednesday, September 9, 2020



SPEAKERS

FELICIA PERLMAN

Global Co-Head of Restructuring & Insolvency
McDermott Will & Emery

Felicia Perlman focuses her practice on complex business reorganizations, debt restructurings and insolvency matters. She is the global co-head of the Firm's Restructuring and Insolvency Practice Group. Felicia advises debtors, creditors, lenders, investors, sellers, purchasers and other parties-in-interest in all stages of restructuring transactions, from Chapter 11 reorganizations to out-of-court negotiations, workouts and acquisitions. She frequently presents on bankruptcy topics and is featured in several notable publications.

BRAD GIORDANO

Partner
McDermott Will & Emery

Brad Giordano represents debtors, equity sponsors, lender groups, creditors, and strategic investors in all aspects of in-court and out-of-court restructurings. Brad advises senior managers and boards of directors on operating in Chapter 11, fiduciary duty considerations and strategic restructuring alternatives.

SPEAKERS

RENU SHAH

Vice President & Assistant General Counsel
JPMorgan Chase

Renu Shah is an in-house attorney at JPMorgan Chase. She advises the bank on all types of commercial bankruptcy and workout matters, including out-of-court transactions, chapter 11 reorganizations, and state law insolvency proceedings.

PILAR TARRY

Managing Director
AlixPartners

Pilar Tarry helps large and middle-market companies devise and implement complex restructuring solutions both in and out of court. She brings more than 15 years of expertise to bear in helping clients with negotiation of capital market solutions, contingency planning, case management, management of liquidity, and the design of crisis communication and vendor management programs. She also leads stakeholder management programs and implements restructuring transactions–primarily section 363 sales and recapitalization transactions.

AGENDA

- Steps to Take
- Interacting with Lenders
- Opportunities for Stable Businesses
- Industry Impact

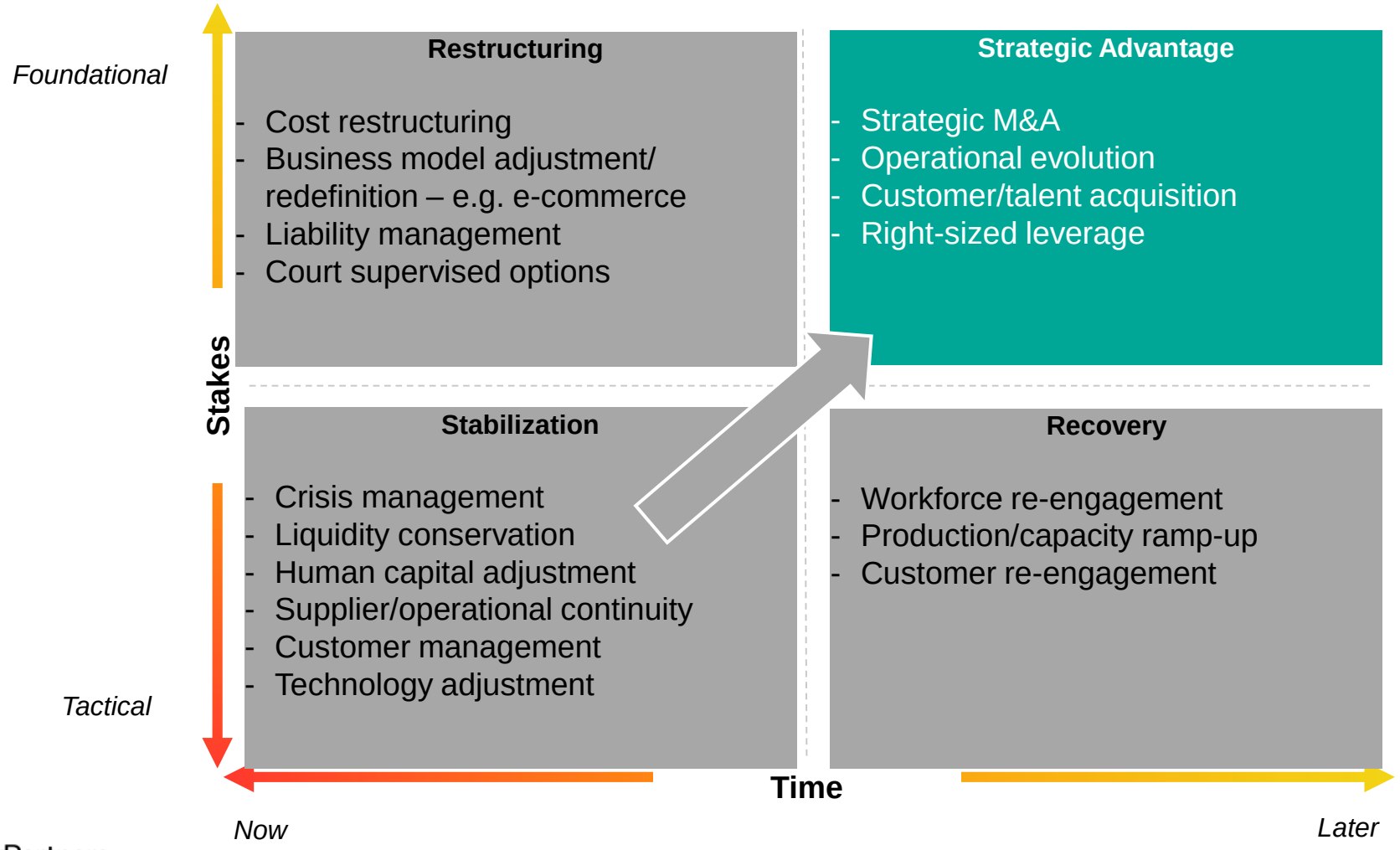
STEPS TO TAKE

Operational and financial steps to take in the short- and mid-term to address the prolonged nature of the economic downturn

STEPS TO TAKE

- In the early stages of the downturn, many companies took proactive steps to:
  - Increase liquidity;
  - Extend the runway of their debt repayment; and
  - Minimize the short-term impact of COVID-19.
- However, the continuing effects of COVID-19 may make taking additional measures necessary or desirable.
  - These measures may be operational, financial, or both.

STEPS TO TAKE – DISRUPTION MANAGEMENT FRAMEWORK



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STEPS TO TAKE – ADDRESSING DISRUPTION

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STEPS TO TAKE – MID-TERM PLANNING

Liquidity Conservation and Management

- Explore **relief options** from governmental agencies and best spending practices.
- **Reliable forecasting** – more than just a 13 week – assessing headroom required to absorb likely volatility and inefficiency.
- **Reduce fixed overhead costs** to align with reduced activity levels.
- Take **immediate actions** on cash and cost reduction **to demonstrate ability to self help**.

Lender Negotiations and Management

- Demonstrate **rigorous forecasting of cash needs** and cash is king culture.
- Prepare a **revised business plan** based on current conditions, including analyses of alternative scenarios for business recovery.
- Analyze **current lender agreements and capital market conditions** to develop a practical array of options for discussion.
- Understand your target **capital structure** and options for discussions with lenders.
- Using formal **restructuring processes** as necessary to secure required accommodation from lenders and creditors.

Opportunistic M&A

- Strategic **assessment of core / non-core areas** of the business that could be divested or benefit from targeted acquisitions.
- Rapid **evaluation of potential targets**, focus on value triggers (signs of distress), applying an outside-in opportunity assessment framework.
- Detailed **pre-DD opportunity analysis** (rapid cost-out scenarios, bottom-up integration simulation.
- Cash-based assessment of **integration/divestiture scenarios.**

STEPS TO TAKE – OPERATIONAL

- Businesses should evaluate their performance from an operational perspective.
  - Evaluate the supply chain and other key components of operations, such as vendors, contract parties, and customers.
    - Consider whether these parties need support to ultimately protect the business.
    - Maintain connections with customers, as their habits, needs, and preferences change.
    - Gauge the impact of workforce disruption on the continued operation of the business.
  - Assess the duration of contracts, renewal rights, termination rights and requirements, and force majeure provisions and consider whether contracts should be extended or canceled.
    - Consider the specific provisions of the contract and the ability to replace the contract.
  - Consider whether operational changes are needed to adjust to the long duration of the slowdown or a fundamental change in the business going forward.

STEPS TO TAKE NOW – FINANCIAL

- Businesses should closely monitor their financial situation.
  - Find sources of additional liquidity, if necessary to address the prolonged downturn or a need to adapt the business.
  - Assess Paycheck Protection Program loans or other government funds that must be repaid or may be subject to recoupment.
  - Take steps to properly account for government funds.
  - Evaluate covenant terms to confirm whether government funds may be used in covenant calculations.
  - Note any impending maturities and the business' ability to satisfy those obligations.
  - Consider the implications of missed targets on the ability to achieve longer term projections and revise business plans accordingly.
  - Assess the implications of the delay of capital expenditures and the ability to obtain subsequent financing.

STEPS TO TAKE – CARES ACT FUNDING

- The borrower faces losses that jeopardize continued operations of the business

- Credit is not reasonably available at the time of the transaction

- Created or organized in the US; or
- Under the laws of the United States
- Has significant operations and majority of employees in the US

- The intended obligation by the borrower is prudently incurred

The loan is
- (1) sufficiently secured or
- (2) made at a rate that reflects the risk of the loan and that is above market rate pre-crisis

- March 24, 2020 levels to be maintained until Sep 30, 2020
- Will not reduce its employment levels by more than 10%

- The duration of the loan is as short as practicable, and less than five years

- No dividends or capital distributions until 12m after loan repaid

- Except to the extent required under a contractual obligation in effect as of March 27, 2020 – no stock buybacks until 12m after loan repaid

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STEPS TO TAKE NOW – GOVERNMENT RESPONSES

State support measures	Canada	USA	France	Germany	United Kingdom
Fiscal envelope to COVID-19 (amounts in USD)[2]	$204Bn (12% of GDP), including $127Bn in direct support, $62Bn in liquidity support through tax deferrals, $14Bn in health and safety	$1,141Bn (6% of GDP), including $293Bn in one-time tax rebates, $268Bn in expanded unemployment benefits, $175Bn for hospitals	$124Bn (5% of GDP)	$175Bn at federal level (4.9% of GDP) + $159Bn at Lander level	$65Bn ($20Bn for NHS, $36Bn for businesses, $10Bn for social safety net)
State loans of credit guarantee for business (amounts in USD) [2]		$510Bn of loans & guarantees $670Bn of forgivable SBA loans & guarantees $62Bn of SBA grants & loans (6% of GDP)	$354Bn (14% of GDP) of Guarantee funds to secure loans	$851Bn[1] (24% of GDP), including $112Bn fund to invest in strategic companies + $71Bn at Lander level	$406Bn UK Coronavirus loans and guarantees package and guaranteed loans (CBILS,CLBILS)
Total effort (amounts in USD) [2] *(in % of GDP)*	**$204Bn** *(12% of GDP)*	**$2,383Bn** *(11% of GDP)*	**$478Bn** *(19% of GDP)*	**$1,027Bn** *(29% of GDP)*	**$471Bn** *(17% of GDP)*

French-German initiative discussing EUR 500 Bn fund for the recovery of the European economy (including Strategic sovereignty in the healthcare sector, Fund for economic recovery in the EU, Green Deal and digitization)

(1) Through newly created economic sConverted to USD from local currency using June 30, 2020 rate
(2) tabilization fund (WSF) and public development bank KfW
Source: IMF, Canadian Department of Finance, US Department of the Treasury

STEPS TO TAKE NOW – GOVERNMENT RESPONSES ILLUSTRATIVE EXAMPLES

State support measures	Canada	USA	France	Germany	United Kingdom
# of jobs in A&D	90,000 direct jobs (215,000 direct and indirect)	881,000 direct jobs (2.55 million direct and indirect)	200,000 direct jobs (300,000 direct and indirect)	>100,000 direct jobs	>128,000 direct jobs
A&D in % of GDP	0.9%	1.8%	2.7%	1.2%	2.3%
State incentives to Airlines (amounts in USD)(2)	No bailout of airlines $331M of waived ground lease fees for Canadian airports	$25Bn for air carriers(1), $4Bn for cargo air carriers, $3Bn for contractors	$8Bn to Air France	$10Bn to Lufthansa	NA
State incentives to A&D	NA	NA	$9Bn	NA	NA
Public measures to support innovation	Industry Associations calling for government support with 6 key recommendations	NA	$1.7Bn on R&D for green aircraft $337m on digitization of small A&D players	Industry group BDLI calling for government support to A&D industry	Industry groups ADS Group, Airlines UK and the AOA (Airport Association) calling for government support, incl. extension of Job Retention Scheme and relief from business tax rates
Anticipated public orders		$3.1Bn orders to Boeing for Harpoon missiles	$936M for Defense material		
Dedicated funds to protect supply base		NA	$1Bn investment fund to protect key French suppliers		

(1) Support to be negotiated by each airline with the US Department of the Treasury and includes grants, low-interest loans, and equity
(2) Converted to USD from local currency using June 30, 2020 rate
Source: AIA, AIAC, IMF

STEPS TO TAKE – GOVERNMENT AID CHECKLIST

Management has a number of factors to consider before agreeing to receive government aid program funds.

- ✓ Understand the liquidity needs of the business.
- ✓ Model the financial impact of the government aid on the company's business plan.
- ✓ Evaluate the restrictions associated with any aid program.
- ✓ Identify potential conflicts with the go-forward plan.
- ✓ Examine existing credit agreements and corresponding covenant compliance.
- ✓ Review material contracts to understand the financial obligations of those contracts.
- ✓ Identify available collateral that could be used to secure the advance.
- ✓ Perform an assessment of the impact of the new government aid on the company's existing capital structure.
- ✓ If equity is issued as part of participation, evaluate the impact on the company's existing equity.

INTERACTING WITH LENDERS

How to approach lenders to ensure productive discussions

INTERACTING WITH LENDERS

- It may be necessary to approach lenders, either because of an impending covenant default or to seek other relief.
  - Potential covenant defaults may arise from, among other things, declines in financial ratios, worsening business performance, or a drop in the value of the business.
  - Relief for such defaults may come in the form of a forbearance, waiver, or amendment.
- When approaching lenders:
  - Be prepared, organized, and ready to share financial and operational information;
  - Present a plan for the business that demonstrates the outcome of the relief to the lenders and its impact on the borrower’s ability to repay lenders; and
  - Ask for what the business needs, as it will be more difficult to approach lenders again in the future.

INTERACTING WITH LENDERS (CONT'D)

- Lenders will want to confirm:
  - The stability of the business;
  - The feasibility of the business plan; and
  - That the lender is properly protected.
- To facilitate productive discussions:
  - Remember that lenders are likely dealing with distress across their portfolios and are receiving similar requests from numerous borrowers;
  - Be reasonable in requests and in negotiations; and
  - Be ready to provide diligence materials to lenders.

OPPORTUNITIES FOR STABLE BUSINESSES

How stable businesses can take advantage of opportunities existing in the market

OPPORTUNITIES FOR STABLE BUSINESSES

- A stable business can take advantage of existing market conditions to strengthen its position for the future.
- Pursue horizontal or vertical acquisitions to strengthen the business or shape industries while potential targets are experiencing distress.
- Think outside the box regarding the potential for strategic transactions and consider opportunities to expand or diversify.
- Acquisitions undertaken through bankruptcy present certain advantages:
  - Free and clear of liens and interests;
  - Ability to assume certain favorable agreements and reject unfavorable contracts;
  - Ability to credit bid;
  - Ability to reduce footprint through lease rejection;
  - Protection of automatic stay; and
  - Certain procedural advantages.

OPPORTUNITIES FOR STABLE BUSINESSES (CONT'D)

- The downturn also provides businesses the opportunity to reimagine their operations and position themselves for success in a post-COVID-19 environment.
- Businesses should consider how their industry may change going forward.
  - Consider what adjustments the business can make to prepare for and take advantage of those changes.
- Healthy businesses have an opportunity to use stability and liquidity to make changes and set themselves up for significant returns following the downturn.

OPPORTUNITIES FOR STABLE BUSINESSES – ILLUSTRATIVE EXAMPLES

- Some companies have already undertaken significant moves during this downturn to reshape their businesses and position themselves for success going forward.
  - Intelsat, while in bankruptcy, obtained approval to purchase the commercial division of Gogo, capitalizing on its existing infrastructure.
  - Simon Property Group, the largest mall owner in the U.S., engaged in discussions with Amazon to convert some of its anchor department stores into Amazon distribution hubs.
  - Simon Property Group purchased, or is exploring purchasing, retailers such as Brooks Brothers and Ascena Retail Group, to acquire inventory and IP at attractive values and prevent closures of stores that it needs at its malls.

INDUSTRY IMPACT

Industries will be affected differently in both the short- and long-term, which should shape businesses' decisions during the downturn

INDUSTRY IMPACT

- COVID-19 has impacted every business, although the effects in both the short- and long-term have differed by industry and region.
- When making decisions during the downturn, businesses should keep in mind both the likely short- and long-term outlooks for their industry.
- Those businesses that are able to successfully predict and account for the long-term changes in their industry will be best positioned for success following the downturn.

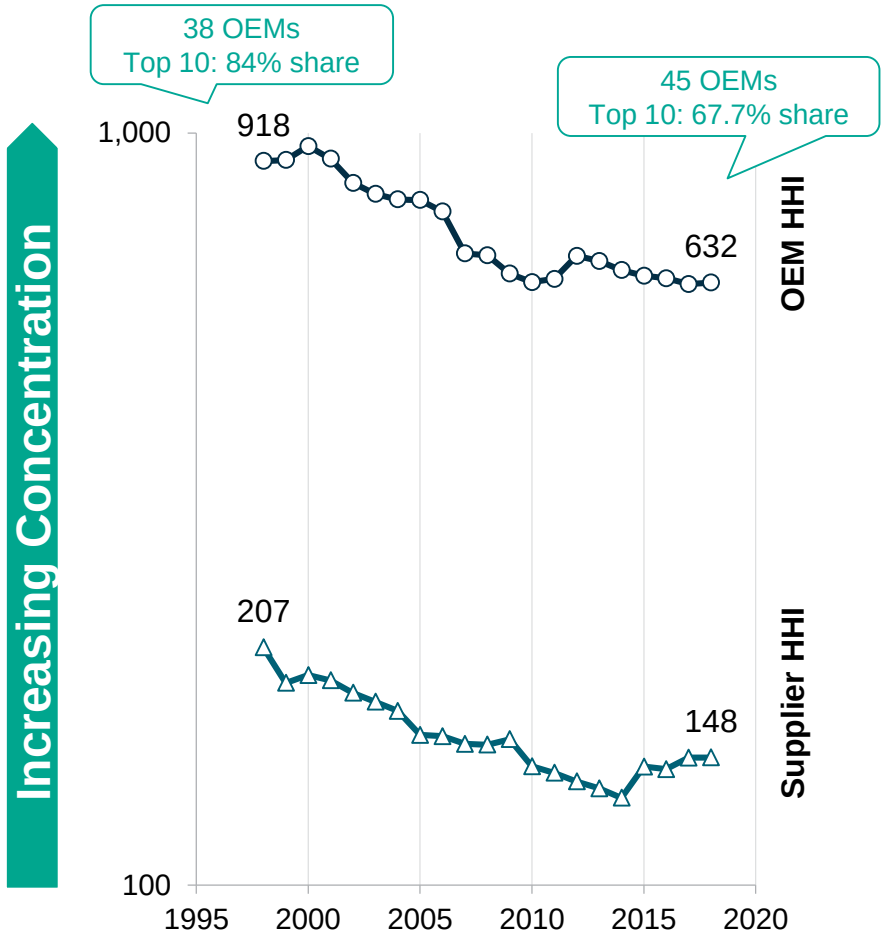
INDUSTRY IMPACT – SELECT INDUSTRIES

Industry	Short-Term Effects	Long-Term Effects
Auto	•Significant decline in vehicle sales •Supply chain disruption •Decrease in R&D spending	•Investment-grade issuers will tap financial markets to improve liquidity •Significant amount of restructuring as dealers are unable to pivot quickly •Suppliers may succumb to liquidity issues, exacerbating supply chain disruption
Healthcare	•Declines in profitable elective procedures as a result of restrictions and patient hesitancy •Increased expenses associated with COVID-19 •Influx of government funding	•Postponed procedures will occur eventually •Greater proportion of the population without insurance •Repayment of government loans and accounting for government grants funds
Retail	•Difficulties with forced closures, health and safety concerns, supply chain issues, and availability of labor •Changing consumer habits	•Businesses will consolidate •Consumers will emerge from the downturn with new spending habits •Shift to online platforms
Food and Beverage	•Significantly reduced consumption, particularly for higher margin out-of-home consumption •Supply chain disruption	•Out-of-home consumption will normalize, but not cover short-term lost sales •Businesses will reconsider their inventory strategies, supply chains, and delivery

INDUSTRY IMPACT – SELECT INDUSTRIES (CONT'D)

Industry	Short-Term Effects	Long-Term Effects
Airlines	•Travel restrictions and decline in demand •Influx of government funding •Deferral of aircraft deliveries and selling/mortgaging aircraft and other assets	•Formation of strategic partnerships to replace vendor relationships •Low-yield travel will return faster than high-yield travel •Increased debt burdens incurred during downturn
Energy, Oil and Gas, and Power	•Significant decline in demand •Decline in investment activity •Payment defaults by customers	•Recovery of both prices and demand •Permanent customer loss as some businesses are no longer viable
Fitness and Wellness	•Forced shutdowns and capacity limits •Changing consumer preferences •Increased demand for at-home equipment	•Consumer preference to utilize digital content and at-home work outs will remain •Gyms and in-person services are unlikely to return to pre-downturn levels
Real Estate	•Loss of tenants •Rent concessions and abatements •Delays in obtaining permits and completing construction	•Potential for amended building codes, which would impact costs and function of spaces •Consumer shift to online and virtual interaction will limit demand for real estate

INDUSTRY IMPACT – GLOBAL OEM AND SUPPLIERS



Higher concentration than supplier markets, with many new entrants and OEM partnership models

- Continued globalization is fragmenting the OEM market driving competition, mainly from China.
- Traditional OEMs prefer partnerships to share significant cost for both their core business (*e.g.*, Renault/Nissan/Mitsubishi, Daimler/ BMW) as well as innovation (*e.g.*, GM/Toyota investing in Lyft/Uber).

OEMs face new entrants and significant cost, driving them into partnerships / alliances

Suppliers saw a slight uptick over the past 5 years – COVID-19 will likely accelerate this for the healthy ones with filled M&A chests

- Uptick in industry concentration starting in 2014 and continued through 2018 and flattened again in 2019, yet still very fragmented overall.
- Increase in concentration partially driven by inorganic growth aspirations that may continue to drive market consolidation.

We expect increase in inorganic growth in the aftermath of Covid-19

Notes:
- U.S. Department of Justice classification: <1,000 = Competitive; 1,000-1,800 = Moderate concentration; >1,800 = Concentrated; 10,000 = Monopoly
- HHI Calculated using sum of squares of market share methodology i.e. Σ (RevenueCompany/RevenueTotalYear)2
- Visteon's revenue $18.5B down to $3.0B

INDUSTRY IMPACT – HEALTHCARE

- The healthcare industry will be impacted in the short- and long-term, which will decrease liquidity and increase the potential for restructurings.

Liquidity

- Loss of efficiency, as hospitals remain at the ready to address COVID-19 cases
- Surge in payroll expenses and ancillary costs associated with COVID-19
- Negative effects on billing and collections
- Lower reimbursement payments from Medicare, as more patients shift to Medicare and government-sponsored options
- Decrease in higher-margin elective procedures

- Ongoing liquidity pressures
- Highly volatile cash flow
- Increased cost of regulatory compliance
- Anti-fraud investigations
- CARES Act recoupment actions
- Proposed regulation on service providers that would make billing prices more transparent

Potential for Restructuring

QUESTIONS?

Reminder: Please use the Zoom Q&A feature to submit your questions. Questions answered during the call will not be attributed to the participant who submitted the question.

THANK YOU FOR ATTENDING.

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The un-bankruptcy: An alternative for smaller companies navigating financial distress

May 2020

The implementation of shelter-in-place orders, social distancing, and the closing of non-essential businesses has sent the economy teetering across the United States and, indeed, around the world. Heavily consumer-facing businesses – such as restaurants, hotels, and non-essential retailers – have had to furlough or lay off large numbers of employees and, in many cases, 'go dark' with their brick-and-mortar locations. Many smaller companies now find themselves with limited financial resources and have indicated that they may need to seek bankruptcy protection.

Although President Trump has signed the CARES Act, it remains unclear how quickly companies will be able to apply for loans, when they will receive the cash, and whether the program will be large enough to meet unprecedented demand. Companies need a strategy to bridge the gap until help arrives.

In addition to considering a bankruptcy filing, many smaller companies could be better served by taking an alternative approach. We call this the 'un-bankruptcy', which entails putting the company into survival mode outside the structure of court protection.

Why not Chapter 11?

The Chapter 11 process has proven over time to be successful at helping manage through some of the most significant business and economic challenges the United States has encountered. The process of reorganizing companies in bankruptcy often works well for larger businesses – especially those with complex debt structures – because it offers many tools that form the basis of a fair and equitable treatment of like parties to support successful reorganizations.

Given this, it is understandable that Chapter 11 would be seen by many as a clear route to take for distressed companies during this period. However, there are reasons the process may not be the right step forward for smaller businesses at the current time, including:

- The process can consume significant amounts of liquidity needed to keep the business operable.
- With its many requirements (including monthly reports to the court and hearings) a bankruptcy filing can distract the management team when business operations require 100% focus.
- Receipts may have dropped well below the fixed costs a company is required to pay post-filing date.

For these reasons, during a time of crisis, a Chapter 11 that is filed without adequate planning or liquidity may quickly convert to a Chapter 7 – a liquidation of the business. Our experience is that smaller Chapter 11 reorganizations are significantly more difficult to complete successfully because of time and cost.

The un-bankruptcy framework

What type of framework would be needed for businesses to survive without resorting to Chapter 11? Such a process would need to use many of the concepts of a Chapter 11, without the legal protections or requirements and without the same expense – an un-bankruptcy.

Here is how it would work:

- **Advise creditors that the company is temporarily unable to pay:** Similar to a traditional Chapter 11 process, companies would separate their creditors into classes. For most smaller companies, there are likely only two: secured and unsecured.

  Unsecured creditors would be advised in writing that the company is temporarily unable to make scheduled payments, and it would be opening communication with stakeholders. Secured creditors would need to be dealt with individually.
- **Manage for survival liquidity:** The cessation of all payments to unsecured creditors could allow a company to prioritize critical payments that are essential to support temporary suspension of the business. However, in most cases, the company will still need to aggressively manage itself in order to maintain liquidity, updating cash forecasts weekly, pulling as much cash into the business as possible, and limiting all disbursements to absolute essentials.
- **Maintain open communications with stakeholders and seek to work collaboratively on solutions.** The company should immediately begin communication with creditors, including their anticipation of when payments of deferred amounts can begin, as well as the status of its application for loans under the CARES Act. It is important to provide regular updates on company performance.

For an un-bankruptcy to work effectively, communication, transparency, and flexibility will be critical, as will be a collective effort to keep businesses up and down the supply chain involved. In part, this is to avoid the domino effect caused by withholding payments.

Advantages of an un-bankruptcy include:

1. avoiding confusion and, potentially, legal proceedings;
2. increasing survivability;
3. providing time for relief dollars to reach the business and for thinking about the recovery phase; and
4. creating goodwill with creditors.

This process isn’t guaranteed to work, and it doesn’t eliminate the risk of creditors potentially disrupting operations. But, especially for smaller companies, it offers an alternative to a bankruptcy filing, for which they may lack the financial resources and necessary time to survive. For these companies, the un-bankruptcy may offer the best option to surviving the current crisis.

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About AlixPartners

AlixPartners is a results-driven global consulting firm that specializes in helping businesses successfully address their most complex and critical challenges. Our clients include companies, corporate boards, law firms, investment banks, private equity firms, and others. Founded in 1981, AlixPartners is headquartered in New York, and has offices in more than 20 cities around the world. For more information, visit www.alixpartners.com.

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Disruption Insights

Seven years of change in seven months:

COVID-19 through the lens of disruption

When it really matters.

Simon Freakley
Chief Executive Officer

When we introduced the AlixPartners Disruption Insights report at the World Economic Forum in January of this year, little did we know that COVID-19 was about to turn all of our worlds upside down. Now there really is no doubt that disruption is the central challenge facing business and the global economy today.

Like all crises, COVID-19 too will pass, but disruption is here to stay. And as we discuss in this update, businesses and their leaders will be defined by their ability to master the waves of disruption that are becoming ever steeper and more frequent.

How a business fares in the face of disruption is partly down to the external environment—which is beyond management's control—and the speed of response and quality of their leadership—which are absolutely within it.

This is a time when quality leadership will shine through. There will be winners and losers, but one thing is for sure: the decisions you make now really matter.

As you navigate the seas of disruption, I hope that this report provides helpful direction.

All best,

Simon Freakley

The COVID-19 crisis has demonstrated clearly the central economic reality of our times: disruption is the new economic driver.

In recent years, cycles of disruption, which displace existing businesses, markets, and value networks in favor of newer models and relationships, are occurring more frequently and with greater impact. They have emerged as both the main force in the economy and the central strategic challenge for business leaders.

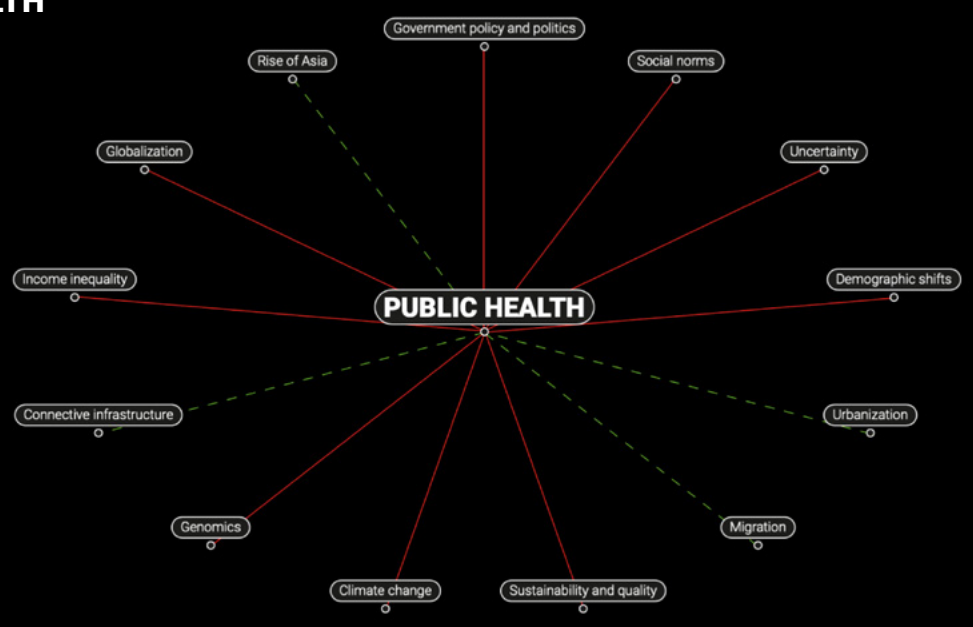
Leveraging our 40 years of helping companies confront disruption, AlixPartners embarked last year on a study of disruption, its impact on business, and how corporations were responding.

However, few could have predicted the massive disruption that COVID-19 would cause. This crisis demonstrates how a single disruptive event can have a reverberating and amplifying effect across geographies, industries, and supply chains.

And in fact, its impact could not have been as dramatic without the legacy of previous waves of disruption. Trends such as the rise of Asia, globalization, urbanization, and an aging global population have all amplified the spread of the virus and its impact, both from a health and an economic perspective.

DISRUPTION IN PUBLIC HEALTH

Many disparate yet interrelated forces are at the heart of disruptive change. This chart shows the relationship between public health and other disruptive forces, which are magnifying and accelerating each other.



High influence

Medium influence

Thankfully, disruptive technological advances, particularly in connectivity, proved significant mitigants to the economic impact of the COVID-19 crisis. For those able to work remotely, the tools and infrastructure to do so are in place and have proven reliable. Consumers have embraced digital commerce, even in areas, like grocery, that have lagged. And, as historical data have become less reliable signals for forecasting and pricing, artificial intelligence and machine learning are increasingly being deployed to find the needle in the haystack for recalibration.

What does COVID-19 mean?

It is still early to begin making long-term predictions. Indeed, while we would like to think we're at the beginning of the end of the current crisis, it's more likely that we are only at the end of the beginning. And we must remain cautious against the cognitive bias to weigh recent data more heavily than historical ones. That said, we can suggest a few educated hypotheses on likely outcomes.

1. DEGLOBALIZATION ACCELERATES

In recent years, trends toward more national and regional patterns of trade have emerged. Trade as a proportion of global economic output has fallen. The share of global profits commanded by multinational corporations has shrunk, while foreign direct investment went from 3.5% of global GDP in 2007 to 1.3% in 2018.

Trade tensions are partly to blame. But so are factors such as the growing importance of the Chinese domestic market, which is absorbing more goods and services as opposed to exporting them. Many multinationals have discovered the difficulty in penetrating foreign markets, particularly in the face of established local competition, and have scaled back their ambitions. More broadly, the more global supply chains are, the more things can and will go wrong. More regionalized or nationalized supply chains carry less risk in a globally connected world. As a result of all of these factors, manufacturers are relying more on regional networks of suppliers, and intra-regional trade has been rising at the expense of transcontinental flows for roughly the past decade.

> "The pandemic has prompted an anachronism, a revival of the walled city in an age when prosperity depends on global trade and movement of people."
>
> — Henry Kissinger, former U.S. secretary of state [1]

COVID-19 is unlikely to reverse any of these trends, and in fact, will likely accelerate them. In the short to medium term, barriers to international travel and trade will continue until a vaccine is developed and widely available. Longer term, a global recession, with higher unemployment and wage pressures, will almost surely fuel popular sentiment for higher tariffs and reshoring of supply chains critical to national security. As discussed below, corporations will further shorten and strengthen their supply chains in the face of demonstrated fragility in the current crisis.

In another era, a global pandemic might have brought countries together in a united response to a common threat. But as can be seen in the mounting rhetorical blame game between the U.S. and China, such an outcome seems unlikely today.

2. RESILIENCE TAKES PRECEDENCE OVER EFFICIENCY

In the immediate and foreseeable future, risk tolerances are likely to be low. Business planning will be biased toward resilience over efficiency, given the numerous vulnerabilities and uncertainties this crisis has exposed.

A chain is only as strong as its weakest link, and supply chains are no exception. Manufacturers in Europe and the United States first experienced this crisis through disruptions in the supply of critical parts. For example, an automobile has 30,000 parts, but it takes only one missing component to shut down production. As COVID-19 spread beyond China, chains began fracturing around the world.

The U.S. meatpacking industry illustrates the fragility of some networks. In April, spiking infection rates caused the closure of seven processing plants. As a result, The New York Times reported that one-fifth of Wendy's restaurants in the country ran out of hamburgers, and grocers Kroger and Costco limited the amount of beef, poultry, and pork that shoppers could purchase.

Going forward, operations will need to conduct a careful risk assessment of their supply chain, viewing it holistically—end to end—and building resilience at the right points in that chain. For some, this may mean redundancy for critical suppliers, more localized sources, or working with existing suppliers to add to their capabilities. For others, this may entail increased investments in in-house production—or some combination of the above. With many suppliers facing financial distress, some companies may find it prudent to extend credit or advance payment to critical components of their supply chain.

In some cases, as in pharmaceuticals, companies may feel political pressure to onshore capabilities due to national security concerns.

This trend toward greater resilience also implies potentially slower growth, lower margins, and higher prices for consumers.

3. TECHNOLOGICAL DISRUPTION SHIFTS INTO OVERDRIVE

They say that necessity is the mother of invention. In this crisis, necessity has given birth to acceptance and implementation. Consumers have further embraced digital commerce, streaming entertainment, and online gaming. Employees have discovered both the efficiencies and challenges in working remotely. Companies have accelerated their digital transformations by orders of magnitude.

This experience has shown us that, for the most part, the impediments to adoption have been less technological (or even operational) and more behavioral. And as countries emerge from lockdown, some of these patterns, like online sales and remote work, are moderating, but we do not expect a reversion to pre-crisis levels. The benefits in terms of productivity and convenience are too significant.

This means that consumers' self-centric expectations for accessing products and services where, when, and how they want, will only increase. For retail, this will mean more channel shifting and more brick-and-mortar closures, particularly in the United States and United Kingdom where there is still excess capacity.

Categories, like grocery, that had been resistant to online penetration have gained significant momentum. Last year, analysts at UBS estimated that brick-and-mortar retail would fall from 90% of total US market share to 75% by 2025. Due to the pandemic, those levels were reached in April—five years earlier than expected. And while those levels are moderating somewhat, we expect digital commerce to remain significantly above pre-crisis levels.

"Even before the pandemic, we saw a customer who was moving faster to digital experiences, in particular, than we were even moving… So, we need to gear toward a customer who is going to expect convenience and speed at rates never before seen."

— Corie Barry, CEO, Best Buy[2]

For all businesses, but particularly those in the "knowledge economy," will increased normalization of working from home habits, combined with enhanced tools and access, generate similarly self-centric demands from the workforce going forward? What are the right models to maximize both productivity and a shared culture? And do companies have the right cybersecurity measures in place to protect against new vulnerabilities?

With more people working from home, the crisis has proven a tipping point for cloud migration, as lingering concerns have fallen away as its benefits and, indeed, necessity has been made so apparent. An April 2020 executive survey by technology firm Flexera found that 30% of large enterprises expect to increase their cloud investments post-COVID, all while cutting IT spending overall.

The potential for machine collaboration is only beginning to be tapped. New AI tools like virtual assistants that can not only schedule meetings but also conduct research or attend meetings on one's behalf promise vast improvements in productivity. The biggest obstacle to further adoption of AI and machine learning continues to be trust. Explainable AI will help demystify some of its black box decision making and should reduce lingering skepticism.

4. CONSUMERS WILL SEGMENT BY INCOME AND HEALTH PRIORITIES

Much remains unclear about the future, but some directional shifts in consumer behavior, which we believe will take hold for the next 18 to 24 months, are emerging. Positioning to address these likely shifts in behavior now, while maintaining flexibility to amp the response to each shift up or down as the fog further lifts, offers companies the opportunity to thrive.

Two central criteria will likely predominate in consumer behavior in the coming period. The first is the financial impact the crisis has had on family income. Those consumers who have been most impacted will focus on making their money stretch further. A recent AlixPartners survey indicates that 86% of stimulus checks in the United States were devoted to non-discretionary essentials such as groceries, rent, utilities, and debt repayments.

A longer-term recession will further bifurcate consumers along income lines and lead to dramatic shifts in what and where consumer spending occurs, likely benefiting discount retailers and low-cost brands.

Second, heightened sensitivity to health and hygiene in the wake of COVID-19 will bring with it several shifts in consumer expectations related to the physical environments in which they consume products, services, and experiences.

"I … think that as we come through this, and whatever continuum of economic environment you might expect, I do think there is going to be strain. And I think value will play an important role for consumers going forward."

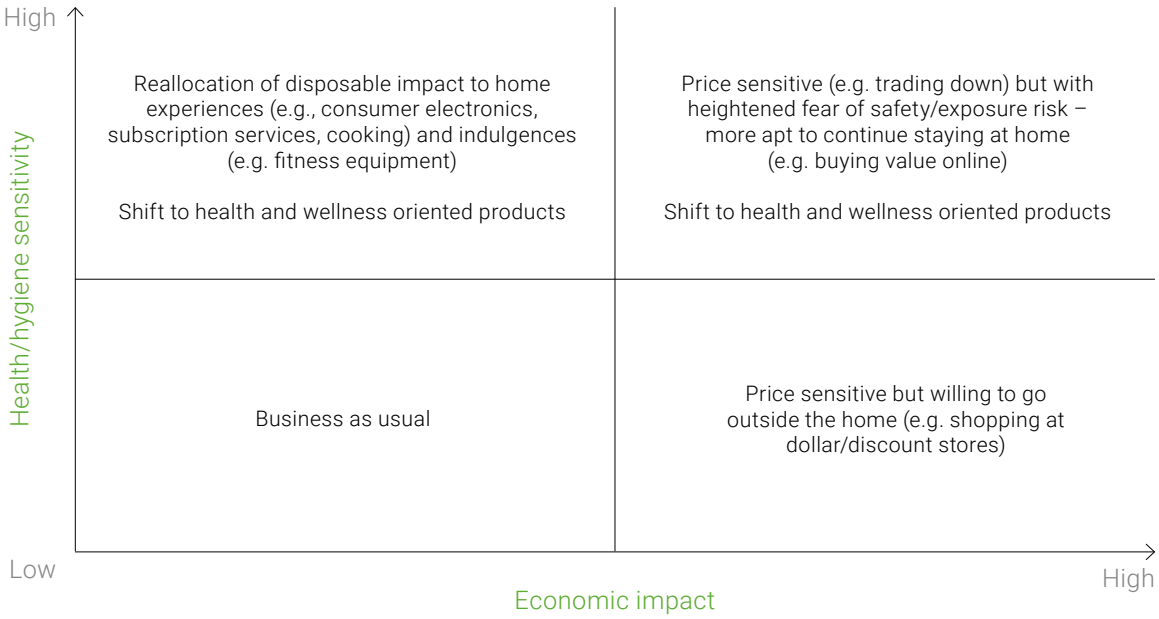
— Mark Clouse, CEO, Campbell Soup [3]

Health and wellness trends will accelerate as consumers strive to strengthen their well-being in the face of obvious vulnerabilities. Expectations that corporations act to protect people and the environment at large will be paired with these individual concerns.

We expect nutrition will take a more prominent role in addition to exercise, sleep, and mindfulness in the overall wellness approach taken by consumers. Early signs of this trend emerged in March as sales of immunity products (like vitamins, supplements, and probiotics) increased 199% and the number of consumers buying such products jumped 125%. A reluctance to enter public spaces will take hold for a material subset of consumers, leading to long-term shifts in product and service delivery models.

These shifts in consumer behavior have broad ranging implications: new consumer segments to target; sustainable adjustments to cost structures; a need to fundamentally reevaluate top-line management and product portfolio strategy; and a recognition that digital capability development has become a higher priority.

HOW CONSUMERS ARE NOW SEGMENTED



5. TRUST BECOMES AN EVEN MORE VALUABLE COMMODITY

Uncertainty has rooted more deeply into the collective psyche under COVID-19 in the absence of consistent and reliable information. Medical factors and risks remain vague. The government response in many countries has been equally unclear at times, leaving people uncertain about anything beyond a week or two in the future. Social distancing practices are under strain after months of enforced isolation.

And while the platforms have taken steps to limit it, social media and its algorithms contribute to this uncertainty by facilitating the spread of rumors and false information and by feeding heightened tribalism. Confusion, fear, and a lack of common understanding are likely to exacerbate existing divisions. Continued uncertainty will lead individuals deeper into their own, self-defined bubbles. In this environment, companies must engage with consumers, and even their own employees, on their shared values. One tangible way of doing so is to demonstrate care for customer and employee safety as retail begins to reopen. Those companies that have installed the necessary equipment, trained their employees effectively, and demonstrate good hygiene will build trust, particularly with those customers who feel most vulnerable.

"With significant economic uncertainty, consumers are turning to big brands they trust. Ultimately, the question is what this will do for consumer behavior. It's not about whether or not drinkers will continue to consume, because they will. But it's about how, where, or what they will consume?"

– Gavin Hattersley, CEO, Molson Coors Brewing [4]

Responding to health and wellness concerns in product development and marketing can help ease consumer confusion over what products are healthy for them and build trust. Similarly, as environmental and sustainability considerations inform more consumers, companies must make decisions about sourcing, packaging, and transparency and communicate those clearly to their customers.

This year, food group Danone was the first French company to adopt a new legal status, enterprise à mission, requiring it to not only generate profits for its shareholders but to do so in a way that benefits the health of its customers and the planet.

Social justice protests are another challenge in building trust and engagement with both customers and employees. Corporations have expressed their support for the protestors and promised millions of dollars for aligned causes. IBM, Amazon, and Microsoft have all committed to stop allowing police to use their facial recognition technologies due to concerns over misidentifying people of color. However, many activists have demanded more, including greater racial diversity in senior management positions. Only four of America's largest 500 companies have a Black chief executive.

There are no simple answers, but those companies that engage honestly and authentically will have a head start.

What should you be doing?

We face many unknowns about the future and a potential return to normalcy. Will we have a vaccine and in what time frame? Can medicine develop effective treatments? What will be the lasting impacts on consumer behaviors? What is the future of travel? Of entertainment? Of city life? Of work?

Faced with this uncertain and fluid environment, what should you be doing? First, to determine where you need to go, you must establish where you are. AlixPartners has developed a framework for understanding the expectations of critical stakeholders during each phase of this crisis and reopening.

STAKEHOLDER MANAGEMENT IN A COVID-19 AFFECTED WORLD

	EMPLOYEES	INVESTORS	SUPPLY CHAIN	CUSTOMERS	SOCIETY
STAGE 1	**SAFE AND CARING:** The company is seen as concerned about health and well being and is taking care of its people.	**VIABLE:** The company will not default; it has taken steps to maximize liquidity and has alternatives to call upon if needed.	**FUNCTIONAL:** The Supply Chain is working. Products and services are available (almost) regardless of cost, using extraordinary measures (air shipments, repositioning inventory, etc.) if required.	**SAFE AND AVAILABLE:** Customers feel safe availing themselves of a good or service. They do not feel at risk in a physical environment, and they feel that their data and financial information is secure when transacting in a remote environment.	**RESPONSIBLE:** The company is viewed as doing the right thing without regard for financial consequences. They put health, safety, and social responsibility above other considerations.
STAGE 2	**PROACTIVE AND CREATIVE:** The company is leading and influencing direction, not just reacting to outside factors.	**STABLE:** The cash crisis has passed. The company has sufficient cash flow, can meet its obligations, and if stressed by unforeseen challenges, can react quickly with options. The company is positioned to take market share.	**RELIABLE:** Goods and services are available when and where customers want or need them on a consistent basis and without extraordinary or heroic measures. Customers and suppliers do not need to be concerned and their trust is reflected in sales.	**RELEVANT AND NEEDED:** Now that the "newness" of the situation has worn off, the product or service is a part of the normal course of customers' daily habits. If it was part of their lives pre-COVID, it still is. If COVID caused a customer to trial the good or service, it has now moved into their normal.	**COMMITTED:** The company is viewed as serving employees, customers, and other stakeholders in a balanced and thoughtful way. It considers the complex and often conflicting obligations it has and demonstrably seeks to strike the best balance possible.
STAGE 3	**EXCITING AND GROWING:** The company is positioned to grow and prosper. Its people feel secure in their roles, and personal prospects are bright.	**OPTIMIZED AND FLEXIBLE:** The company has driven its cost of capital down to appropriate levels while having a plan for best, most likely, and worst-case scenarios. It has explained this to all appropriate parties and inspired confidence. It has articulated a growth plan that is logical and supported.	**ADAPTABLE AND REDUNDANT:** There is a viable plan for key things that could go wrong, such as the unexpected shutdown of a location or a key supplier. While this flexibility has a price, the supply chain is lowest appropriate cost, adjusting for risk.	**VALUABLE AND ALIGNED:** The confidence crisis has passed, and customers have choices. But they do not exercise them because they view the product or service, and the company providing it, as part of a valued relationship.	**LEADING:** The company is seen as a positive change agent. It is recognized as a voice of reason and wisdom in guiding positive change in its industry, wider commerce, and the world at large.

Establish where you are in the continuum between immediate crisis management to a stabilized and reset normal. Then examine how well your company is performing against the expectations of your critical stakeholders. By doing so, you can begin developing a specific plan of action to address any shortcomings and put your enterprise back on a path to renewed resilience and growth.

"Businesses have taken a lot of criticism in the past few years. The trust and the relationship between business and its communities has been challenged. But I think this is a very timely opportunity to be able to demonstrate that business is key to…assuring that everyone across the world is able to have full and healthy lives."

– Gavin Patterson, President and CEO, Salesforce International [5]

After making this assessment, three focus areas provide a foundation for action:

1. ESTABLISH ADAPTIVE CULTURE, LEADERSHIP, AND TOOLS

This crisis has demonstrated the singular importance of execution and adaptability in the face of rapid change. Those companies that responded to this crisis by quickly establishing health and safety protocols to protect their workers and customers, that shifted suppliers when established chains broke down, and that successfully found new routes to market and engagement with customers are best positioned to emerge from this crisis.

An AlixPartners survey in April found that 25% of US consumers who tried new brands during this period intend to stick with them after the crisis is over. This suggests that those companies that were able to deliver operational performance and service levels throughout this crisis are well positioned to improve share. Those companies who were not able to maintain in-stock positions may face longer term challenges.

Adaptive execution requires adaptive leadership. In times of crisis, how leaders respond makes a world of difference. Our experience with crises and their outcomes suggests that the most effective leaders during tough times are adaptive: they address urgent needs while also repositioning their organization for greater resilience in the future. With an adaptive leader at the helm, employees and teams can respond flexibly to the fast-changing, unpredictable, and unfamiliar impacts the crisis has inflicted—emerging stronger than ever.

As we move out of crisis management and into recovery, given the many uncertainties that are likely to remain for some time, adaptability will remain key. Maintaining financial flexibility and liquidity, particularly for those businesses and industries facing sustained droughts in demand, is essential. Accelerating digital transformation programs and embedding AI and machine learning tools in planning processes will also facilitate greater adaptability. Maintaining those organizational structures and decentralized decision-making authorities that were effective during crisis mode may also prove valuable during this extended period of uncertainty.

2. PROACTIVELY PREPARE FOR AN ALTERED FUTURE

A wait-and-see attitude in the face of such pervasive disruption is a recipe for disaster. Workplaces will change. Companies will be more decentralized and virtual. Step out in front.

Digital commerce will continue to become a larger share of most markets. Supply chains will be shorter. Capital allocations will change. P&Ls and balance sheets will be different. Begin planning now and communicate to your employees, suppliers, customers, and investors. Proactive movement, authenticity, and a bias towards communication will pay dividends now and in the future.

The COVID-19 crisis has dramatically accelerated disruptive trends that were coming at a fast but manageable pace. Virtualization, automation, digitization, real estate strategy and design, and cybersecurity, among others, have all jumped forward. The crisis may have decelerated some trends, as well, like the sharing economy and fully autonomous vehicles.

If you cannot transform now, you never will. This is the time to accelerate needed transformations that might otherwise not be achievable for cultural or other reasons. This may entail breaking down silos between businesses or refocusing business priorities or sales channels. It may mean increasing digital investments. Systematic scenario planning can illustrate both vulnerabilities and opportunities.

"You can't afford to be complacent. [Customers'] demands are going to change dramatically and people's new demands will be built on what they're experiencing today. My aim is to invest more heavily on the back of this crisis, to think long-term for all of our stakeholders to see [if] we can create new opportunities out of what has been a really, really difficult situation."

– Phil Jansen, CEO, BT Group [6]

Strategic and opportunistic M&A targets will present themselves in this environment. Begin studying the competitive landscape, both vertically and horizontally, so that your business is prepared to take advantage of opportunities as they emerge or catalyze opportunities that might not emerge on their own.

Suddenly, the world has jumped forward 5 to 10 years–in terms of technology, consumer behaviors, and work arrangements. It's better to be in front of this than chasing it. How your company acts and reacts to this will define its culture and near-term success.

3. LIVE YOUR VALUES

In an uncertain and balkanized world, communicating clearly and embodying your core values is the way to authentically engage with customers and employees. This can be around issues such as social justice or sustainability, or around the brand promise of your products or services.

As we begin to emerge from the COVID-19 crisis, how you prepare for and treat employees and customers will have profound implications for your brand going forward. All businesses are, of course, anxious to return to a stable normalcy, even if it's profoundly altered. However, a rush to prematurely ramp up operations before either external conditions or internal processes are prepared would be a mistake.

Companies will, of course, be guided first and foremost by health and political authorities. But even as these conditions are met, caution is necessary. Becoming a locus for a second wave of infections, either with workers or customers, would have a devastating long-term impact on brand and reputation, beyond the immediate health and safety effects. As second waves of infection hit, additional safety measures and even re-closures may become necessary.

"I believe that investing in culture right now and making sure that your team members feel safe during these times is a corporate responsibility, and I also believe it's a great investment... So that's been my focus, is to really make sure that we're doing this as a family and to think about the future, because you can quickly disrupt a culture that takes years and years to build."

– Matthew Maddox, CEO, Wynn Resorts [7]

In general, business has received high marks through the crisis. In a March survey, Edelman found that in 8 of 10 countries, respondents found their employers better prepared for the virus than their government and trusted in their employer to respond effectively and responsibly to the virus.

With this trust comes an expectation to act. Seventy-eight percent of Edelman's respondents expect businesses to act to protect employees and the local community.

This reality puts a premium on honest and frequent communication, dealing with hard truths, and ensuring that core values are on display. Some of the ways of doing this are obvious—like deploying personal protective equipment, training employees, and maintaining high hygienic standards. Other steps may be less straightforward. Grocery retailers could, for example, work with suppliers to ensure that food items are delivered to stores pre-wrapped, rather than loose. The benefits could be significant in terms of safety and consumer reassurance, and the costs could be shared between the customers, through higher prices, and slightly lower margins for both supplier and retailer.

Many business leaders have shown true authenticity and purpose during the COVID-19 crisis. The president and CEO of Marriott International, Arne Sorenson, did this in March with a direct and emotional video to employees about the crisis's impact on the business and necessary steps that company was taking in response. Tesco Chief Executive Dave Lewis has been a frequent and clear communicator about what the steps the grocery chain has taken to keep customers safe as they return to stores.

As we begin to move into a new phase of this crisis, businesses must remain focused and not lose sight of core principles in a rush to restart.

Take the right action

Disruption can be merciless, but at the same time, opportunities abound. Industry after industry is being altered fundamentally by the current crisis. Consolidation will be necessary in some of the hardest hit sectors, like airlines, leisure, and hospitality. Shifts in power in industries like retail, restaurants, and media will accelerate.

If there is one thing that we have learned from 40 years of helping organizations manage disruption, it is that scanning your environment, understanding your financial situation, and acting quickly and decisively to optimize your situation, whether from a position of strength or weakness, is essential. There will be winners and losers, and complacency or inertia will prove fatal. Clear and consistent communications with employees, customers, and investors continues to be needed, as is financial flexibility.

Define your own future. Be bold. Now is the time to lean in.

Notes

1. Henry Kissinger, "The Pandemic Will Forever Alter the World Order," The Wall Street Journal, April 3, 2020.

2. Talks at GS, May 28, 2020, www.goldmansachs.com/insights/talks-at-gs/corie-barry.html.

3. Campbells Soup Company, Q3 2020 Earnings Q&A Conference Call, June 3, 2020.

4. Molson Coors Brewing Co., Q1 2020 Earnings Call, April 30, 2020.

5. "Leading Through Change" Webcast, Salesforce, April 27, 2020, https://www.salesforce.com/blog/2020/04/bt-group-ceo-stands-by-customers-employees.html.

6. "Leading Through Change" Webcast, Salesforce, April 27, 2020, https://www.salesforce.com/blog/2020/04/bt-group-ceo-stands-by-customers-employees.html.

7. Wynn Resorts, Q1 2020 Earnings Call, May 6, 2020.

To learn more about our Disruption Insights, visit
https://www.alixpartners.com/disruption-insights/

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About us

For nearly forty 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.

Tackling situations when time is of the essence is part of our DNA, so we take an action-oriented approach at all times. 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.

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HOW COVID-19 HAS CHANGED CONSUMER PRIORITIES

Five actions companies should take to respond

The fog is beginning to lift on the shape of the world's recovery from COVID-19. Of course, a tremendous deal of uncertainty remains. With hopes for a V-shaped recovery fading, will the path forward look more like a U, W, or something else entirely? Will a vaccine be required to approach a return to normal? Which of any number of scenarios will take hold? The answers to these and many other questions remain unknown. At the same time, the directional shifts in consumer behavior, which we believe will take hold for the next 18 to 24 months, are starting to be defined.

Positioning to address these likely shifts in behavior now, while maintaining flexibility to amp the response to each shift up or down as the fog further lifts, offers consumer products companies the opportunity to thrive.

The most impactful changes to consumer behavior can be segmented into four areas: health, hygiene, home, and habits. Heightened sensitivity to safety will bring with it several shifts in consumer expectations related to the physical environments in which they consume products, services, and experiences. Health and wellness trends will accelerate as consumers strive to strengthen their well-being in the face of obvious vulnerabilities. Expectations that corporations act to protect people and the environment at large will be paired with these individual concerns.

A reluctance to enter public spaces will take hold for a material subset of consumers, leading to long term shifts in product and service delivery models.

The financial implications of the crisis, including the potential for a longer-term recession, will act to further bifurcate consumers along income lines and lead to dramatic shifts in what and where consumer spending occurs.

These shifts in consumer behavior have broad ranging implications: new consumer segments to target; sustainable adjustments to the cost structure; a need to fundamentally reevaluate top-line management and product portfolio strategy; and a recognition that digital capability development has become a higher priority.

CONSUMER PRIORITIES
have fundamentally shifted: the four Hs

The most impactful changes to consumer behavior can be segmented into four areas: health, hygiene, home, and habits.

HEALTH

HYGIENE

HOME

HABITS

1 HEALTH

The health and wellness megatrend will accelerate, and the on-going shift from curative medicine to a focus on wellness and prevention will gain even more traction. Nutrition will take a more prominent role in addition to exercise, sleep, and mindfulness in the overall wellness approach taken by consumers. The focus will shift to improving well-being to enhance protection against illness and disease. Early signs of this trend emerged in March as sales of immunity products (like vitamins, supplements, and probiotics) increased 199% and the number of consumers buying such products jumped 125%.[1]

Moreover, consumers, who already connect sustainability expectations and health and wellness, will place heightened importance on trust and expect that brands demonstrate accountability for the health and wellness of participants across the value chain, as well as environmental impacts.

1. IRI CPG Demand Index, April 27, 2020.

2 HYGIENE

Consumers will continue to be reluctant to be within crowded and unfamiliar places for some time. When they do, many will carry and expect companies to use and provide personal protective equipment and follow strict hygiene practices. Based on a recent AlixPartners survey, 30% of consumers expect to dine out less post COVID. And it is no surprise that about 70% of consumers indicate that sanitation practices will influence take-out and delivery restaurant selection. For some, a concern about virus exposure risk will be particularly heightened, bordering on the type of aversion previously exhibited only by only those members of the population who suffer from immune disorders. Traditional complements to travel such as planes, trains, and hotels will continue to experience soft volumes as consumers opt to stay local and near the home.

3 HOME

More than ever, the home will become the hub for work, school, exercise, entertainment, and dining. In fact, 35% of consumers expect to prepare more meals from home post COVID according to a recent AlixPartners survey. These nesting tendencies will also result in consumers seeking to improve the quality of at-home living and devoting a larger portion of their discretionary spending on renovation, landscaping, cooking, exercise equipment, and hobbies. Appetites for at-home bandwidth will also grow as consumers adopt collaborative tools like Zoom and Microsoft Teams, engage more with companies and content online, and expand their use of online ordering and home delivery. At-home living will likely continue to depress demand for health and beauty products, but we would expect certain DIY categories for nail and hair to remain strong.

4 HABITS

The economic hardships of COVID has not been even across the economy. The impacts have been different along geographic, income, and educational lines. According to a recent NBC/Wall Street Journal poll, job losses were 3 times greater for the poor working class than the upper class.[2] Similar differences are evident across geographies, due to industry concentration. For these impacted segments, discretionary spending has been disrupted tremendously, and stimulus checks have not adequately backfilled losses. A recent AlixPartners survey indicates that 86% of stimulus proceeds are devoted to non-discretionary essentials such as groceries, rent, utilities, and debt repayments. With this type of economic impact and the prospect of an economic recession on the horizon, consumers will be focused on stretching their dollars further. Private label offerings will gain in their share of categories and price sensitive consumers will migrate to value grocers and dollar retailers. When consumers spend, they will prefer to do so locally to support their communities and seek trusted, iconic brands as source of comfort, at the expense of start-up brands for the immediate future. A recent AlixPartners survey identified that 38% of consumers now favor local restaurants versus chains. Moreover, luxury and indulgent consumption will not cease but continue in those consumer segments not impacted by the economic hardship of COVID and any follow-on recession.

2. NBC/Wall Street Journal poll, April 13-15, 2020.

The impact to consumer behavior across these four areas—health, hygiene, home, and habits—will have significant implications for companies. Specifically, we believe there are five key implications that companies should be proactively addressing as we emerge from COVID-19 over the next 18 to 24 months.

Changed consumer priorities demand new business responses

TARGET NEW SEGMENTS

ADJUST COSTS

RETHINK MANAGEMENT

EVALUATE PORTFOLIO

DIGITAL ADOPTION

Five key implications

1 IDENTIFYING AND TARGETING CONSUMER SEGMENTS

As a result of COVID-19, we believe companies should think about identifying and targeting consumer segments along two dimensions: economic impact vs. health and hygiene sensitivity. This could also result in potential growth from new emerging segments.

For example, given consumer concerns associated with health clubs, some of our clients are seeing a significant surge in sales as consumers shift discretionary spending towards in home fitness equipment. With many consumers evaluating these purchases against an average annual gym membership of $600, consumers are justifying larger investments (up to $2,000) than they otherwise would have made. As such, the willingness to pay in traditional and mainstay categories has shifted, resulting in new market and segment definitions.

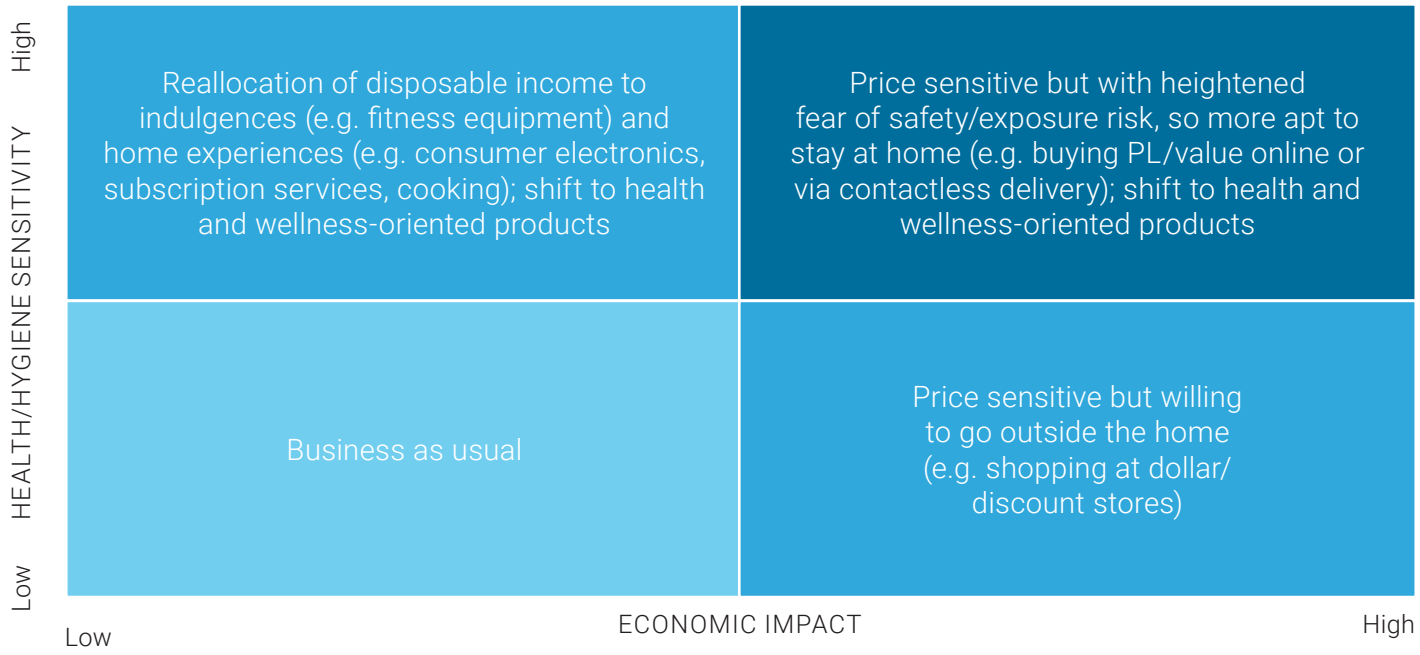
2 SUSTAINABLY ADJUSTING THE COST BASE

Companies need to proactively accelerate their approach to sustainably adjust the cost base to thrive in this new environment. This adjustment could take many different forms including scrutinizing sales and marketing spend (like rethinking event-driven consumption and marketing given cancellations or potential fan-less venues), assessing labor optimization opportunities (including potential for automation), transforming general and administrative expenses, accelerating procurement efforts (including demand management), and cutting discretionary spending.

Many of our clients are aggressively pursuing cost transformation programs, including:

- A multinational consumer products company with a diverse product offering that continues to assess, plan, and execute end-to-end continuous improvement programs throughout its global business.
- A household products company that, given how productive the shift to work from home has proven, does not need as many regional offices, allowing them to move forward with rationalization plans.

Consumer segmentation changes dependent on economic impact and sensitivity to health and hygiene matters



3 RETHINKING TOP-LINE MANAGEMENT

Companies should not only focus on the cost side, but also reevaluate top-line priorities, given the impact to consumer behavior and the likelihood for channel shifts, preferences for value, and new emerging consumer segments. We believe this reevaluation needs to be holistic in nature, covering go-to-market strategy, product assortment, customer and product prioritization, strategic pricing, gross-to-net management, marketing effectiveness, and demand planning. Recently, a packaged food client has seen a sharp drop in foodservice demand, and as a result, is shifting some production to retail customers while also driving network consolidation.

4 EVALUATING PORTFOLIO STRATEGY

An overarching implication for companies is how they should view their portfolio from a strategic standpoint, looking at potential mergers, acquisitions, and divestitures. In the current environment, sellers have pulled back activities, while buyers are focused on shoring up their balance sheets. As we emerge from this crisis, however, we expect the market to begin to thaw. Brand strength will matter more than ever, and strong brands are best positioned to benefit from market consolidation. Companies with weak balance sheets or brands are unlikely to survive on their own. Indeed, large retailers are stronger companies and financial sponsors should focus on acquisitions that create scale, access adjacencies, or are opportunistic in nature.

On the flip side, companies should focus on divestitures for divisions that do not fit their strategy moving forward. Some of our clients have been exercising strong pricing discipline and patience when pursuing potential acquisitions in the current environment. We would expect many of these discussions to reactivate as we emerge from this crisis, with better line of sight on target companies' financial performance.

5 ACCELERATING DIGITAL TRANSFORMATION

Many of the impacts to consumer behavior including social distancing are driving faster adoption of digital tools and channels. We've already seen a dramatic increase in online grocery, with 48% of US consumers increasing online grocery shopping during COVID-19.[3]

This material change requires companies to accelerate their digital transformation. Key considerations include investing in improving supply chain infrastructure, increasing capabilities, revisiting online assortment, and focusing on engagement and conversion. Several of our clients are actively building out digital capabilities given this structural shift that will continue well into the future.

3. AlixPartners COVID-19 Demand Surge Consumer Survey, March 27-31, 2020

PREPARING FOR THE NEXT PHASE

As we emerge from this crisis, it will be imperative for companies to shift from the day-to-day of crisis management to preparing for the eventual recovery. There will be several significant impacts to consumer behavior, some of which we expect to last 18 to 24 months. However, many of these changes will be more structural in nature and long-lasting—effectively accelerating trends which were already in place before the current crisis. As a result, it is critical for companies to address the five key implications that we have discussed in detail in order to thrive moving forward.

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AlixPartners consumer survey data was taken from two polls of US consumers on March 27-31 and on April 20-24.

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ABOUT US

For nearly forty 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.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. 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.

PRESS RELEASE

DUE TO THE COVID-19 CRISIS, THE AUTO INDUSTRY FACES A VOLUME DROP OF UP TO 36 MILLION UNITS OVER THE NEXT THREE YEARS AND A NEW-DEBT BURDEN NOW TOTALLING $72 BILLION, SAYS ALIXPARTNERS

JUNE 4, 2020

All this comes on top of the demands of an industry preparing itself for a historic transformation away from traditional vehicles; companies must 'rapidly reduce' their breakeven points and be 'microscopically selective' with capital allocation

DETROIT and LONDON (June 4, 2020) – Coming in the midst of both already-softening automotive markets globally and a once-in-a-lifetime transformation away from traditional vehicles and systems, the effects of the Covid-19 crisis are presenting the entire auto industry with severe revenue and cost challenges, along with some very tough capital-allocation choices. In particular, due to lockdowns, slow restarts and lingering blows to consumer confidence and employment, the industry faces a cumulative volume drop of up to 36 million vehicles this year through 2022 (compared with sales in 2019), as well as a burden of $72 billion in new debt added since early March of this year. That's according to new research from AlixPartners, the global consulting firm, entitled *The AlixPartners Global Automotive Outlook: Mastering Uncertainty*.

The AlixPartners analysis also forecasts automaker sales globally to be 70.5 million vehicles this year, with sales in the United States being 13.6 million units.

Meanwhile, on the supplier side of the industry, the analysis shows that in 2019, before this crisis, suppliers representing only 6 percent of that sector's revenues were financially "strong," according to a proprietary AlixPartners formula and database that includes such measures as debt-to-equity ratios, working capital and return on capital employed (ROCE), while companies representing 50 percent of revenues were either "stressed" (those representing 43 percent of revenues) or "distressed" (those representing 7 percent).

"With this sharp drop creating gaping holes in their profit-and-loss statements and ballooning balance sheets, players in this industry should rapidly reduce their true breakeven points," said **Mark Wakefield**, global co-leader of the Automotive and Industrial Practice at AlixPartners and a managing director at the firm. "To be prudent given the uncertainty of the pandemic, companies should get their breakeven points to Great-Recession levels—to be in line with global industry sales of only about 65 million units, or at most about 14 million units on the U.S. side."

Meanwhile, other parts of the AlixPartners research find further evidence that suppliers and automakers alike indeed entered this crisis in worse financial shape than during the Great Recession. For instance, according to the research, ROCE—an important measure of profit and capital efficiency—had declined 47 percent on average for automakers globally last year versus 2015 and 36 percent for suppliers. In addition, it also finds that from 2015 through the first quarter of this year, debt loads for suppliers increased 33 percent while for automakers total debt was up 36 percent in the same period. And all that was before, notes the study, Covid-19 added the incremental $72.1 billion in new debt—$19.7 billion in new term-debt and $52.4 billion in drawn-down revolving credit—to the books of automakers and 50 suppliers globally, beginning in early March through May 22nd.

"The impact of the Covid-19 crisis globally is as if a market the size of all of Europe had vanished for the year," said **Stefano Aversa**, chairman of Europe, the Middle East and Africa (EMEA) at AlixPartners and a decades-long auto-industry expert. "Clearly, automakers, suppliers, mobility players and all others connected to this industry need to be microscopically selective with their capital-allocation decisions—closely and unsentimentally examining each and every program and spend for its cash and profitability implications. To weather the storm, companies need to be courageous, yet forward-looking in their decisions, all the while taking full advantage of any favorable governmental policies available to them."

The AlixPartners global sales forecast for this year includes what the firm calls a "mixed-speed recovery," with China (where lockdowns and restarts took place first) recovering the fastest, to 23 million units; followed by the U.S., at 13.6 million; and Europe (parts of which were regarded to be hit the hardest by Covid-19), at just 14.1 million. Overall, AlixPartners doesn't see global sales returning to their recent-peak levels (2017 levels) until after 2025.

Among the other findings in the AlixPartners research:

- Prior to the Covid-19 crisis, industry investments in autonomous vehicles were scheduled to be $79 billion cumulatively from 2020 through 2025, but the crisis—on top of other setbacks—means that that spending rate will likely be pared back substantially.

- Around 40 percent ($13 billion) of disclosed automotive-related mergers-and-acquisitions activity last year was in what AlixPartners calls the “CASE” (connected, autonomous, shared-mobility, electric/electrified) domain, while CASE-related partnerships increased 32 percent (to 560), up from 423 in 2018.

- A “moment of truth” is arriving for the European auto industry and European regulators, in that AlixPartners finds a 21 percent gap exists between current European Union automotive targets for carbon-dioxide emissions and the industry’s anticipated performance through year-end 2020—issues that might well require a political solution, or else companies will face fines of 10-14 billion euros in 2021 if nothing changes.

ABOUT ALIXPARTNERS

AlixPartners is a results-driven global consulting firm that specializes in helping businesses successfully address their most complex and critical challenges. Our clients include companies, corporate boards, law firms, investment banks, private equity firms, and others. Founded in 1981, AlixPartners is headquartered in New York, and has offices in more than 20 cities around the world. For more information, visit www.alixpartners.com.

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Board Financial Oversight Responsibilities During Pandemic-Driven Distress

April 23, 2020

Michael W. Peregrine | Felicia Gerber Perlman

SUMMARY

Seventh in a series of updates on how the pandemic is informing basic elements of governance.

The extraordinary pandemic-based financial challenges impacting hospitals, health systems and other providers as a result of the Coronavirus (COVID-19) should prompt boards to re-evaluate focus on their duty to monitor the organization's financial condition. Existing case law provides useful direction on the scope of these duties, particularly during periods of financial distress. There is value to enhancing the engagement of the board's finance (or similar) committee on solvency matters during this period of crisis.

Of course, the corporation's business and day to day operational performance are managed under the oversight of the board of directors. More specifically, the board is expected to focus on the integrity and clarity of the company's financial reporting and other disclosures about corporate performance. The board is also expected to have meaningful involvement in the company's capital allocation process and strategy, and in reviewing, understanding and overseeing annual operating plans and budgets.

These responsibilities expand as the corporation experiences material financial distress and approaches potential insolvency. Old concepts of "the zone of insolvency" have been rejected by many courts. However, case law does recognize a shift in the identity of to whom the board's duties run.

Generally speaking, the fiduciary duties of directors of solvent companies run to the shareholders (in the case of for profit companies) and to the corporate mission (in the case of not-for-profit corporations). Should the company become insolvent, however, those duties may be extended to the creditors of the company, as well due to their equitable interests in the company at that point in time. As a result, creditors may be able to pursue derivative claims based on allegations of breach of fiduciary duties owed to the totality of the company's claimants (including its creditors).

This doesn't mean, however, that when a company enters insolvency its directors must pursue certain creditor-focused extraordinary actions. Directors are able to act consistent with informed business judgment to pursue

corporate strategies that reflect the best interests of all of the residual claimants. In other words, fiduciary duties are owed to the enterprise itself rather than any particular stakeholder.

Of course, the impact of the pandemic has had a disastrous financial impact on hospitals, health systems, physician groups and other providers, arising primarily from the suspension of normal operations due to restrictions on scheduled or non-emergent procedures. In many instances, the steep declines these providers are experiencing in volume and revenue raise questions as to whether they are either approaching insolvency or have actually become insolvent.

Courts have defined "insolvency" under both a balance sheet test and a cash flow test. Under the balance sheet test, a company is insolvent if the sum of its debts exceed the aggregate value of its assets. A company is insolvent under the cash flow test if it is unable to pay its debts as they become due.

Fiduciary issues may arise even in circumstances where the actual or potential insolvency is expected to be only temporary. Creditors may pursue breach of duty claims as long as the insolvency existed at the time of the alleged breach and the plaintiff was a creditor of the company at that time.

In this time of crisis, the board, its finance committee and its financial officers should be alert to the warning signs of insolvency. They should also be particularly attentive to the proper exercise of their fiduciary obligations (including the avoidance of material board-level conflicts of interest) to the extent they could be perceived as damaging to the interests of creditors. It is important to remember that it is difficult to determine when a company may become insolvent, and any cause of action will be brought with the benefit of hindsight.

Case law suggests that a creditor will have a difficult time obtaining judgment on a derivative claim for breach of fiduciary duty during a time when the company was insolvent. But, these claims often follow a notoriously slow pace through the courts. Directors and financial officers should thus be mindful of the old saying that "you may avoid the result, but you will not avoid the ride." For this and other reasons, proper planning by the finance committee can be critical.

Click here to access the first article in this series, Corporate Authority for Extraordinary Delivery of Care Decisions.

Click here to access the second article in the series, The Executive Committee in Times of Crisis.

Click here to access the third article in the series, Virtual Board Meetings in Times of Crisis.

Click here to access the fourth article in the series, *Emergency State Action Affecting Board Processes and Corporate Filings*.

Click here to access the fifth article in the series, Assuring Appropriate Information Flow to the Risk and Compliance Committees.

Click here to access the sixth article in the series, Revisiting Executive and Board Succession Planning in Response to the Pandemic.

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