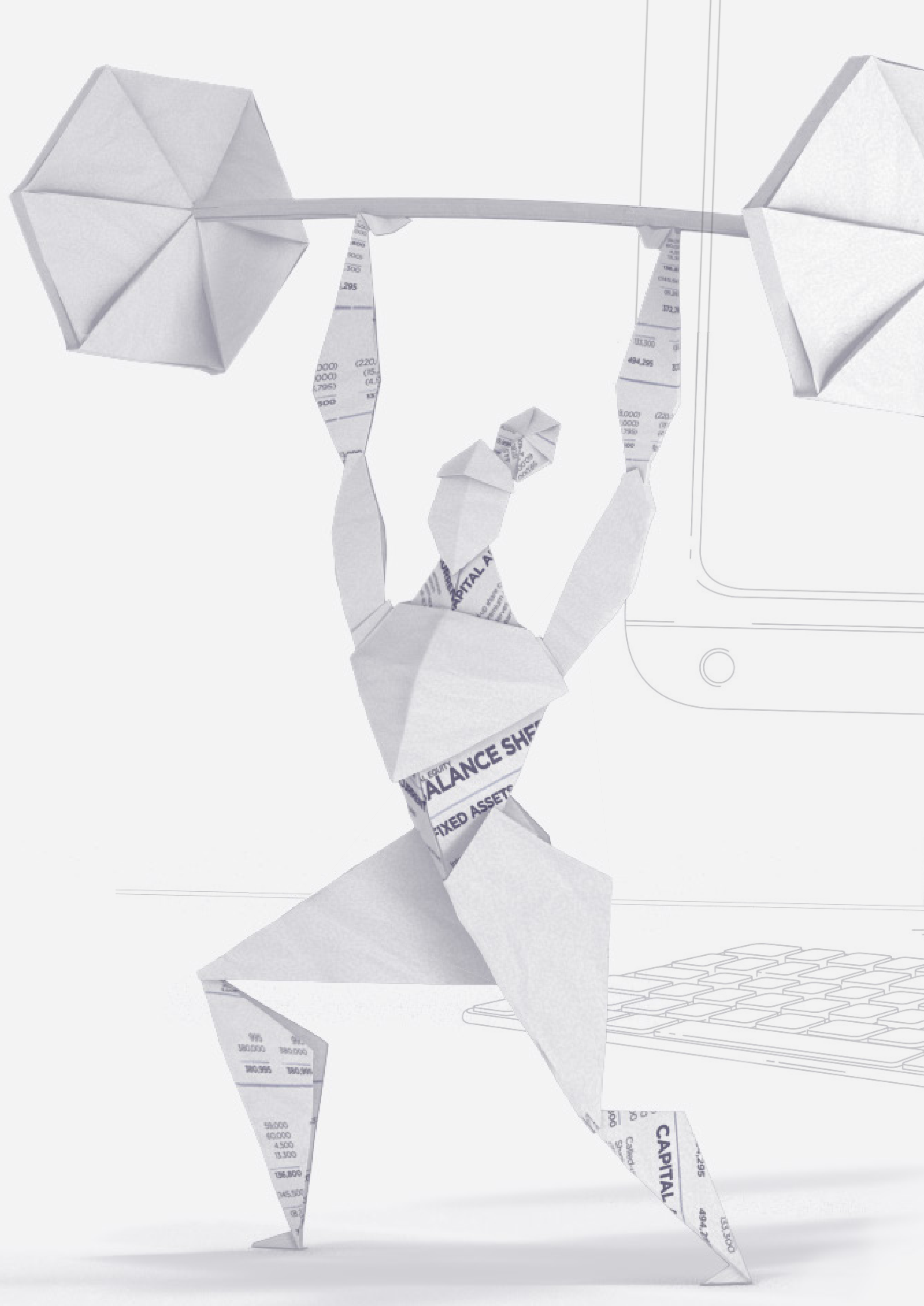
HOW TO IMPROVE BALANCE SHEET STRENGTH: DIVERSIFICATION

Essential points to consider if your company is looking at ways to improve balance sheet strength, whether strategically, opportunistically, or to help repair the damage done by the pandemic.



ADDLESHAW GODDARD

60 SECOND BASICS

WHAT IS IT

Diversification is the process where a business moves into new markets or products in an attempt to generate new sources of revenue and increase cash on the balance sheet. It can be achieved organically or through acquisition.

WHY DO IT

To generate new revenue by developing and selling new products or services or entering into new markets or territories.
This is often achieved organically but the acquisition route can be more rapid especially when entering new territories.

To improve the risk profile of the business. Increasing the range of products and routes to market can provide an effective hedge against the underperformance of existing products or markets.

To enhance shareholder value. Putting investor funding to work in new and profitable ways can create scope for increasing the value of the company. Seizing opportunities to develop and grow the business in ways that are not possible with the existing business.

WHY AVOID IT

Can be expensive. Diversification, whether organic or by acquisition, will require investment. The time frames for the return on investment can vary wildly and are not guaranteed.

Potential distraction for management. The management team may already have its hands full with business as usual activities and exploring new markets or territories can be very time-consuming.

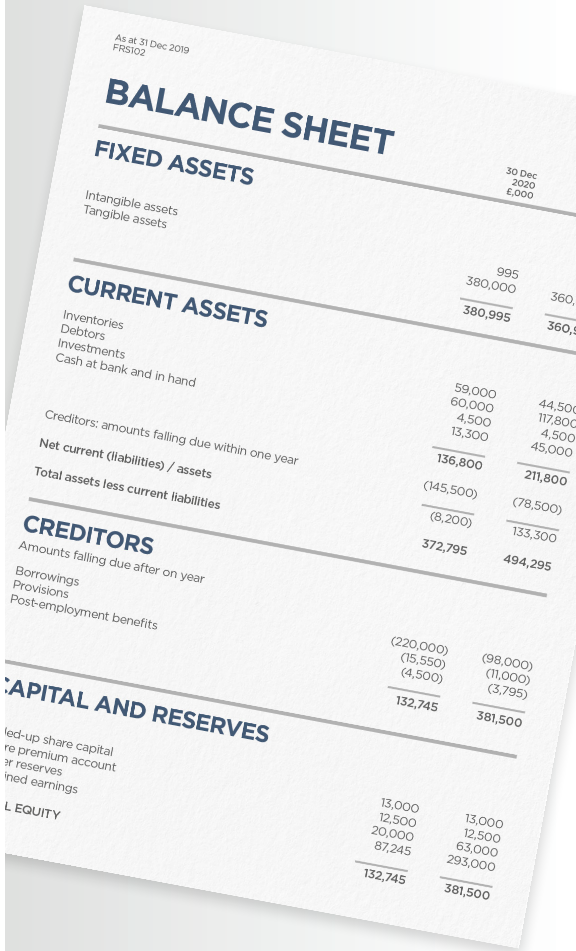
Lack of strategic assets. It is likely that the business will not have the full spectrum of assets required to explore the new opportunity and it will have to acquire or develop them.

Insufficient expertise. Depending on the nature of the diversification, the business may lack relevant expertise. This will need to be bought in or developed internally (which can take longer).

High barriers to entry. If the diversification is into a regulated sector or one that requires significant capital expenditure then the barriers to entry can be significant. Often this leads businesses to favour acquisition.

Risk of failure. The greater the factors mentioned above, the greater the risk of failure.

Potential destruction of shareholder value. The return on investment is not guaranteed.



WORKOUT ESSENTIALS

IF THE ORGANIC ROUTE ISN'T AN OPTION CONSIDER THE ACQUISITION OF AN EXISTING BUSINESS.

When organic diversification is considered too difficult or too slow the acquisition route is usually favoured. Finding the right acquisition target at the right price can be challenging and requires detailed strategic planning.

VARIOUS STRUCTURES, EG ACQUISITION OF A COMPANY OR A BUSINESS.

The acquisition of a business is often favoured by purchasers as it means leaving a greater proportion of the liabilities behind (and for this reason sellers will normally prefer to sell the company not just the business). Purchasers will want to protect against downside risk and liabilities with an appropriate suite of warranties and indemnities and potentially W&I insurance.

PRICE PROTECTION

Deferred payment and earn-out structures should be considered to help bridge the pricing gap.

WALKAWAY RIGHTS

In the current environment there will be increased focus on material adverse change and other walkaway rights.

CONSIDER SHARING THE RISK BY ENTERING INTO A JOINT VENTURE TO EXPLORE NEW MARKETS.

Where there is a need to share the risk of diversification teaming up with a joint venture party who has greater expertise or financial fire power can help mitigate the risk. The dynamics, governance and termination provisions of the joint venture relationship will need careful structuring and management.

ARE THERE CROSS-BORDER COMPLICATIONS?

Entering new territories will carry additional risk because of unfamiliar regulatory regimes and other potential issues such as foreign exchange controls and local employment rules.

WHAT ARE THE CAPITAL REQUIREMENTS?

Do we need to raise new funding? Any diversification will require capital to some extent and, depending on the state of the company's balance sheet, it may need to look to external sources to achieve this.

SHOULD ANOTHER PART OF THE BUSINESS BE SOLD OR CLOSED DOWN?

Consideration should be given as to whether closing or selling an existing part of the business is sensible to generate capital for the new line of business and to liberate valuable resources and management time.

ARE WE ENTERING INTO AN UNFAMILIAR REGULATORY ENVIRONMENT?

This can either be due to entering a new jurisdiction or a regulated sector.

TAX IMPLICATIONS.

The tax implications of any new line of business or structure can have a significant impact on the routes chosen and should be considered at an early stage.

GET IN TOUCH

We are helping businesses with a wide range of strategies to improve the strength of their balance sheets. For an informal view on what we're seeing strategically and at the coalface, or to help accelerate your business strategy, please get in touch:

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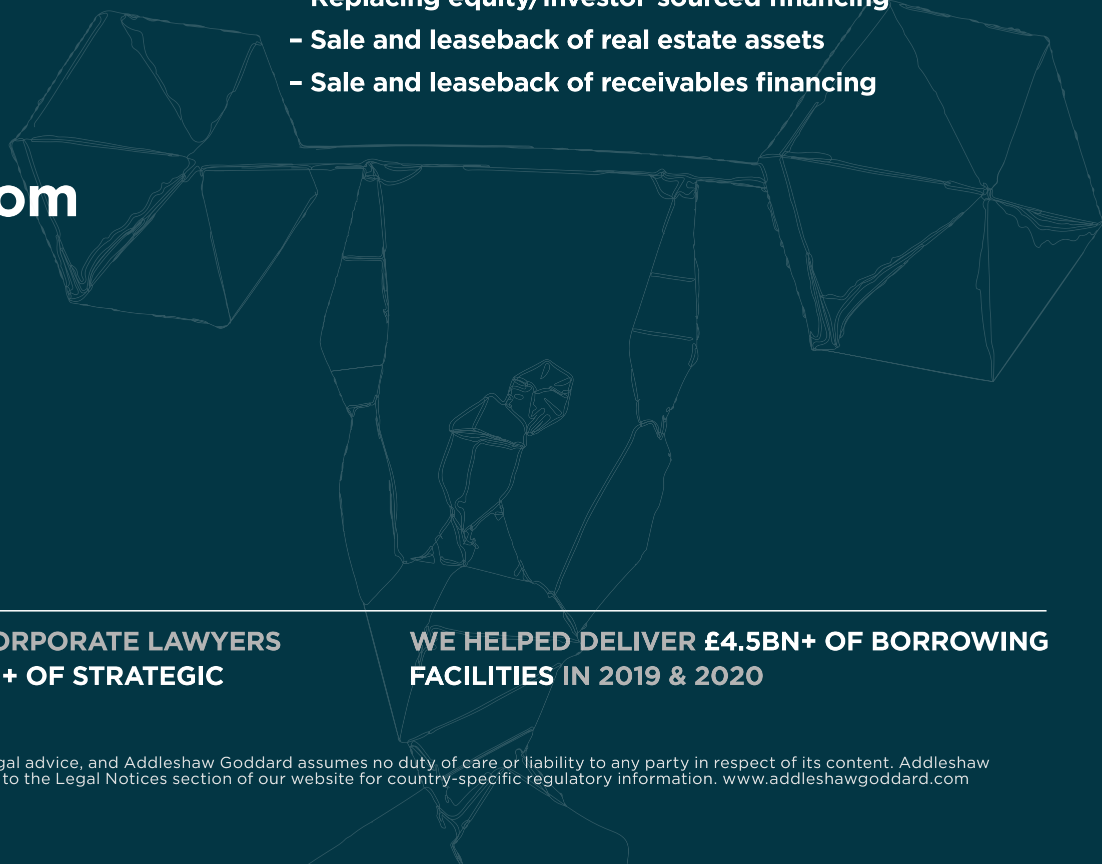
BALANCE SHEET STRATEGIES WE ARE SEEING:

- Additional borrowings
- Amendments to share rights
- Bringing intangible assets onto the balance sheet
- Buybacks, redemptions and reductions of capital
- Capital raisings
- Corporate simplification
- Debt for equity swaps
- Diversification
- Divestment
- Replacing equity/investor-sourced financing
- Sale and leaseback of real estate assets
- Sale and leaseback of receivables financing



WHY ADDLESHAW GODDARD?

WE ACTED FOR **43 FTSE 100 COMPANIES** IN THE LAST 2 YEARS

OUR TIER-1 RANKED CORPORATE LAWYERS HELPED DELIVER **£8BN+ OF STRATEGIC DEALS** LAST YEAR

WE HELPED DELIVER **£4.5BN+ OF BORROWING FACILITIES** IN 2019 & 2020