



Cameron Partners Insight Series

Surviving and Thriving in a Recession

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Key Messages

- A tectonic shift has occurred in the economic environment
- We have now entered a recession and the recovery will take time
- It is possible to survive and thrive in a recession
- Businesses will fail, survive and/or thrive depending on their exposure to the recession and how they respond to the changed environment
- There is a real opportunity to 'leap frog' competitors in a recession

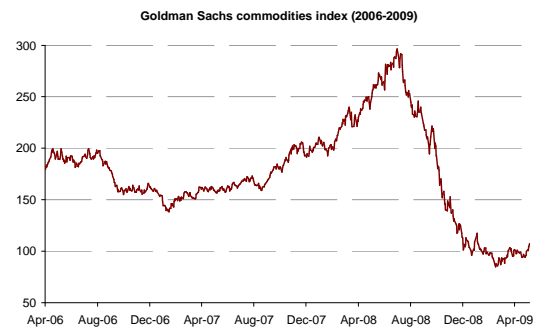
1. A tectonic shift has occurred in the economic environment

The global financial crisis is conforming to the anatomy of past crises but it involves unprecedented levels of leverage and 'contagion'

- It was preceded by several leverage-driven bubbles (residential housing, mortgages, corporate earnings). This was the '**mania**'.
- The crisis began in the US but shifted rapidly to other regions/markets – the '**panic**'.
- The speed and extent of change – the '**crash**' – has been dramatic:
 - Several commodity markets fell 71% from their peak.
 - Baltic Dry Index fell 95% from peak to trough.
 - World sharemarket indices fell dramatically. Peak to trough, the:

- S&P500 fell 57%;
- ASX200 54%;
- NZX50 43%.

- Volatility rose dramatically (718%).



Source: Bloomberg



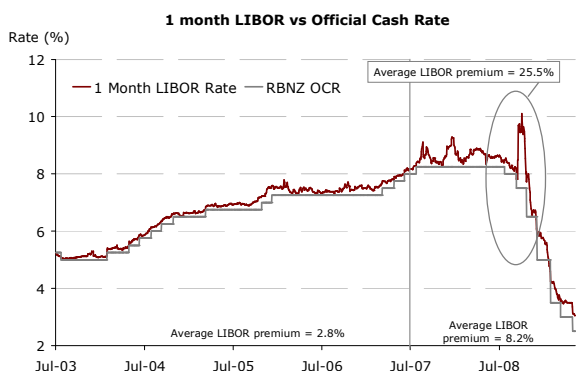
Source: Bloomberg

... and it continues to profoundly constrict global credit availability and cost

- This will continue for the next several quarters:
 - Credit terms and conditions continue to tighten.
 - Inter-bank lending iced up, thawed, but it is still at historically high premia.
 - Credit rating agencies are tightening and more rigorously apply ratings criteria.
 - Banks will continue to monitor and actively reduce exposure to companies and their shareholders.
 - 'Acceptable' levels of leverage for any given level of cash flow/asset base has reduced significantly.

It will impact on all asset prices and yields

- Risk premiums are being radically revised.
- Assumptions about the capital appreciation component of total return are being revised.
- Required cash yields will rise.
- Asset prices are adjusting to reflect 'fundamentals' – but the economics which drive these fundamentals are still uncertain.



Source: Bloomberg

2. We are now well into the recession phase that follows a financial crisis ...

Recession is the inevitable outcome of the adjustments that follow:

- Consumer and business deleveraging.
- Realignment of asset prices and returns.
- Moderation of global imbalances.

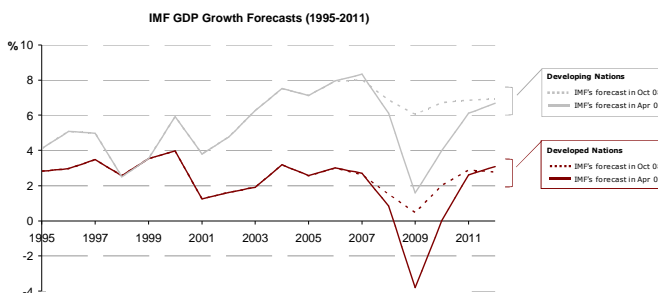
- Impacts on wealth of property and sharemarket declines.

The length and depth of recession following crises have varied significantly

- Catastrophic recessions occur only when there is a prolonged 'blockage' in the provision of capital to business and a long delay in restoring confidence among consumers, companies, investors and lenders.
- The differences have been determined by how governments have responded – the quality of the financial sector 'clean up' and stimulus packages.

But we know that recovery will take time

- On average, countries take two years to emerge from recessions that follow financial crises.
- On average, GDP and company earnings 'turning points' lag sharemarket turning points by 5-6 months and 10-12 months respectively – but there has been significant variation in the length of these lags.
- The IMF has substantially revised its view of the depth of the recession – after only six months.



So we should expect to be living with recession for a while

It is profoundly impacting the business environment creating:

- Fundamental uncertainties and 'downside' risks in the period ahead.
- Unprecedented opportunities that could drive competitive advantage for years ahead.

3. There are three steps to surviving and thriving in a recession

The first step is to understand your exposures in a recession

- The sensitivity of your industry to the recession:

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- Are past business cycles a good guide?
- Will wealth effects play a bigger role in this recession?
- Will consumers make bigger behaviour changes if they expect the recession to be relatively long?
- How will competitors behave (especially if industry capacity and costs are fixed)?
- The strategic position of your company in your industry:
 - What is your market position?
 - How does your business model position you (eg relative fixed costs, strengths and capability of your channel partners, etc)?
 - How good are your capabilities relative to competitors?
- The financial position of your business:
 - Does your current capital structure support your business model?
 - Do you have 'financial flexibility' to weather further downturns/shocks and take advantage of opportunities?

The second step is to identify your choices for responding to the new environment

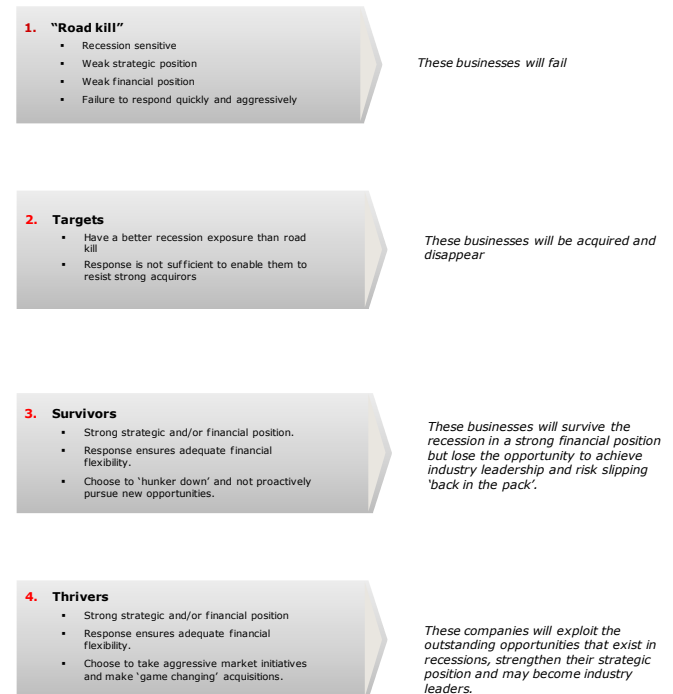
- Adjust your business strategies and refocus:
 - Search for markets and customers that are under or unserved.
 - Protect and grow customer loyalty.
 - Adjust and refocus your business model.
 - Develop and acquire new capabilities.
- Increase revenues and margins
 - Redirect spending to selling and advertising.
 - Develop proactive pricing strategies and tactics.
- Aggressively manage costs and cashflow:
 - Simplify and streamline the organisation.
 - Manage G&A costs.
- Target new acquisitions, partnerships and alliances
 - Look for combinations that are 'game changing'.
 - Search for 'bargain' acquisitions.
- Raise capital
 - Seek capital to create financial flexibility.
 - Do not wait until you 'need' it.

The third step is to determine your priorities for action and implement them

- Priorities will depend on a combination of your industry sensitivity, your strategic position and your financial position.
- Companies with strong strategic and financial positions can move rapidly to strengthen their lead through spending to increase sales and by making game changing acquisitions.
- Companies in recession sensitive industries and with weak financial positions have little choice but to aggressively manage costs and cashflows.
- Companies with strong strategic and financial positions can spend to increase revenues, margins and market position.
- Adjusting and refocusing business strategies is a priority for all companies in a recession.

4. Businesses will fail, survive and/or thrive depending on their exposure to the recession and how they respond to the changed environment

Businesses will place themselves in one four categories over the next 12 months or so



5. Businesses will fail, survive and/or thrive ...

but the opportunity to 'leap frog' competitors is real

- Economic downturns create more opportunities for companies to move from the middle of the pack into leadership positions that any other time in business. Bain & Company analysis of 2,500 companies suggests:
 - 24% more firms moved from the back of the pack to the front in the 2001 downturn compared with the subsequent period of economic calm.
 - 20% of "leadership companies" fell to the bottom quartile.
 - Winners in recessions tend to brake quickly heading into a downturn, focus on what the company does best, reinforce the core business and spend to gain share through marketing, R&D and acquisitions.

- McKinsey & Co noted that:
 - During recessions successful industry 'challengers' pursued more, larger game changing acquisitions than their less successful former peers, and were prepared to spend a higher proportion of their cash reserves.
 - Leaders that remained successful during recessions pursued more deals, and spent considerably more on selling and marketing

(indeed they increased this category of spending) than their former peers. They also doubled their spending on R&D relative to peers.

- Recession provides the opportunity to make bargain acquisitions to build up the core – even when it means taking risks.
 - McKinsey & Co:
 - M&A in a downturn likely to increase value relative to M&A in boom times.
 - In a recession, 60% of companies simply "freeze" – make no business portfolio moves.
 - Of the potential growth strategies in a downturn – divest, acquire, invest to gain share – an aggressive acquisition strategy creates the most value for shareholders.

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