



Toward Recovery

Value adding strategies to assist private companies

KPMG ENTERPRISE

How Private Companies Can Help Themselves through Focused Cash Management

Smaller Companies Feel the Squeeze

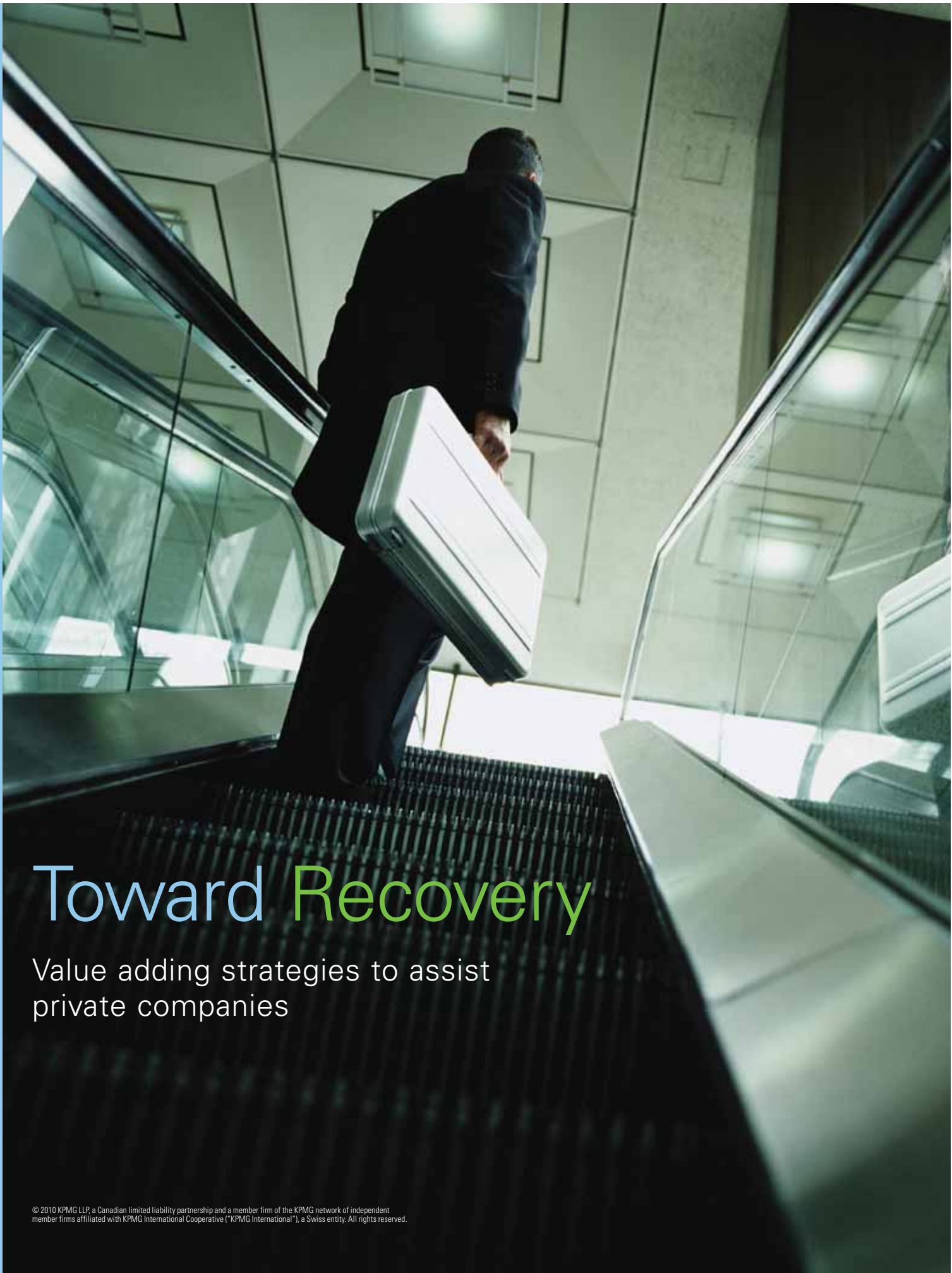
Cash in Stressed and Distressed Situations

Leading CEOs Discuss Value, Innovation, Opportunity, and Customer Loyalty

Pillars to Strength

Cash Flows: Improving the Supply Chain's Cash and Working Capital to Gain a Competitive Advantage





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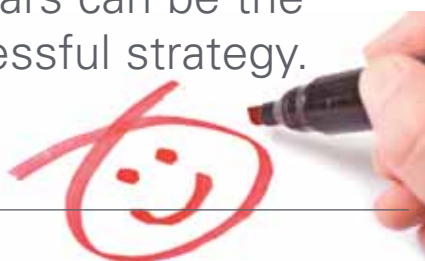
Value adding strategies to assist
private companies

Pillars to Strength



As the market recovers, the competitive environment will likely become more intense. As Canadian private companies retrench their focus towards business as usual, they should consider and assess how they align with the six strategic pillars that underpin a successful business. These six strategic pillars can be the foundations to a successful strategy.

By Pierre Ste. Marie, KPMG Entreprise (Montréal)



1 Managing the cost base. When business survival is a priority, cost control is an overriding imperative. Often, valuable long-term initiatives or secondary support activities may have to be sacrificed in order to better control costs. As the business gets back on course, the challenge can become rather more subtle. There is no doubt about the need for cost control as the economy moves forward, but its position with other business needs will become more balanced. The competitive environment is likely to become more intense. The trick will be to sustain a competitive cost base that does not compromise high standards of service, the development of a high-value brand, and expansion into new products and markets to meet customer aspirations.

2 Enhancing the business model. The business model should be re-evaluated and attuned to the new realities of the marketplace. In many cases, this may mean greater simplicity and a focus on core products and services.

3 Ensuring robust capital and liquidity. Enhancing the balance sheet to ensure it supports the requirements of the business in the most flexible and cost-effective way may likely require more active management—not less. Private companies should maintain open communication and build solid relationships with their bank.

4 Retaining and recruiting talent. Hiring and keeping the right people is still perhaps the most single important contributor to building a sustainable and successful business. But, this is simple to say and much more difficult to do, especially as the environment changes. During the worst of the crisis, few companies dared to maintain their normal recruitment levels and many had to let people go. As the recovery gathers pace, the situation could reverse quite rapidly. Demographic changes mean there are fewer young people available for recruitment than 20 or 30 years ago, and they may be motivated by different priorities and looking

for more fulfilling employment. In the case of more mature, more experienced employees—the core of any successful business—increased competition will lead to more people being hired away. The battle for top talent will be more intense. In all cases, recruiting and retaining the best people will depend on building the best brand and reputation.

5 Rebuilding reputation, trust, and enhancing the brand.

All successful businesses depend on developing relationships of trust with customers and other stakeholders, and building brands that embody trust. The implications extend across all business operations we have seen—from business models to talent management. Brand management is not just about public relations and advertising; it is about managing the whole of the business in ways that articulate, embed, and communicate the desired brand values. The most successful Canadian private companies will likely be those that get this right.

6 Developing new products and markets. Economic and demographic change will continue to open up new opportunities around the globe. Foreign markets are where to be if a Canadian company is to achieve maximum growth in today's global economy. More than ever, there is a need to identify and exploit opportunities abroad and perhaps shift market strategy. An owner of or an executive working with a private company should design a global expansion strategy that is in synch with their business goals and objectives. With the right products, organizational commitment, and input from professionals at home and abroad, expanding beyond Canada's borders can help propel a business to a new level of success and prosperity.

EXECUTIVE ROUNDTABLE:

Leading CEOs Discuss Value, Innovation, Opportunity, and Customer Loyalty

Food in Canada annually convenes executives from different sectors of the Canadian food and beverage industry to discuss how their companies are surviving and thriving despite current economic conditions.



Willy Kruh, Partner, KPMG LLP, and Steve Smith, Partner, KPMG Enterprise, moderated the discussion, which was published in the September 2009 edition of the magazine. The following excerpt shares best practices while addressing value, innovation, opportunity, and customer loyalty, despite economic conditions. With 70 years of experience, Food in Canada is recognized as the voice of the food and beverage processing industry in Canada.

Steve E. Diakowsky, President & CEO, The Allan Candy Company Limited

Allan S. Kliger, Founder and President, Victory's Kitchen Ltd.

Brent J.M. Cator, President, Cardinal Meat Specialists Ltd.

Paul Higgins Jr., Co-CEO, Mother Parkers Tea & Coffee Inc.

Gideon Pollack, Director, Claridge Inc.

Henry Demone, President and CEO, High Liner Foods Inc.

Steve Smith: What best practices can you point to that have helped you to continue to be successful during these times?

- **Allan Kliger:** We've been, if you will, compulsive about exploiting any opportunity that's been out there. Historically, we started out as a food service manufacturing company. We went from being essentially a kettle-cook large batch processor, to getting into portion pouching or portion dipping cups or even shelf-stable bottles, all of which leverage our core strength, which is making large quantities of great quality. So now that that's established, in these challenging times what do you do? We can't jump at all the opportunities we would have years ago. We've got to sit back and say, "Okay. The infrastructure is there, how are we going to make money at this project? And can we really bring value to the customer? Can we bring value to the company long term?" Because, if we can't do that, we're not doing ourselves any service and we're

certainly not doing the industry any service either if we're compromising our financial strength. We're also finding that in these times the industry seems to be working a lot closer together. We do a tremendous amount of manufacturing for other manufacturers, very low key, behind the scenes, and off the radar.

Steve Smith: How have your companies managed growth during these times, and what's happened to new product development? Has there been any noticeable change there?

- **Gideon Pollack:** Absolutely. First of all, one of our best practices really is always keeping the new product development pipeline full 24 months ahead of time. I think what we're seeing is the need to adjust the product that we put in the market to a changing consumer. We're seeing across-the-board demand for value products, so we need to adapt and put products on the market that a changing value consumer is going to purchase.

■ **Henry Demone:** Well, we've continued to develop new products. Where we see a change in the market is, in particular, in national restaurant chains focused on the family and casual dining segments. And I would say more so in the US than in Canada. These businesses are really under pressure—there's a lot of time and money invested in bringing a successful new product into their system anyway. And, in this environment, we find that really tough. On the other hand, I think that with the shift in consumer demand, it has made the retailers and the club stores open a little bit more.

■ **Paul Higgins:** From a new customer opportunity, we're actually getting people calling us to talk about being their supplier. It is the first time it's ever happened. And we're not talking about small guys; we're talking about some big players in the industry. So I find that curious, but I think every business is looking at what they can do to improve themselves. The other aspect of our business is that—like everyone—the value equation is “in” right now. If you can find a way of, for example, taking green tea, which is considered to be a premium product, and moving it into the economy segment, you've satisfied peoples' interest.

■ **Brett Cator:** We're seeing some significant increases in new business opportunities. I would say there are a lot of companies looking for value, not necessarily cheap quality. We're in the burger business, we're not high-end steak. And Cardinal can deliver real value in a segment that people turn to when they're looking for comfort food, when they're looking to trade down, but still want to feel pride in what they're buying. New customers are interested in our approach in the burger category and in our fully cooked meat business. We're approaching that with a certain amount of cautious optimism too, because, the reality is, there's a lot of pressure for these buyers to go out and find better value.

■ **Steve Diakowsky:** The confectionery category is almost exclusively driven by innovation, and a very significant percentage of revenues come from new products. While we have not seen a decrease in the number of customers that are requesting new products, we are focusing more and more of our innovation efforts on distribution, activation, and in-store execution types of programs. We participate in an impulse category, so most of our innovation has been based on what I call the three key occasions in the consumer's confectionery purchase decision, which are the point of awareness, the point of buying, and the point of consumption. So as opposed to innovating around our core products, from a formulation perspective, I'm more willing to innovate around format and display mechanism to meet one of those three key decision points.

Willy Kruh: What about customer loyalty? Do you believe there's a paradigm shift from a consumer standpoint between brand and private label, and is it permanent? Is there loyalty in this price-sensitive environment?

■ **Henry Demone:** There is definitely a paradigm shift. Right now, what we see is a search for value. I think what happens when retailers put more emphasis on private label is that it puts more pressure on secondary brands than it does on the leading national brand. And I think the search for value, the emphasis by retailers on private labels, is going to be with us for some time.

■ **Gideon Pollack:** I think there's no question that private label has been growing at a higher clip in the last year or two as a result of the economic collapse. But I don't think people are going to abandon brands at all. President's Choice drew a lot of people in because it was priced right, but the consumer really fell in love with the products because of their quality. From our perspective, our

businesses tend to be private label or what we call “control brand,” and two of our six businesses are exclusively branded. We don't have a problem growing those brands because they are completely focused on being value-add in the categories they're in; for instance, our allergen-free business, which has been a pretty hot category for us. But when we get asked by retailers to do private label in allergen-free, our brands still outgrow those private label products that we provide those retailers, which I'm sure has something to do with our level of support for our branded products at trade level.

■ **Allan Kliger:** I think customers are still being loyal, but are now quite demanding. What we're finding, being primarily focused on the private label side, is that we have to appreciate who our customer is and why we're getting the business we do. In the private label game, it takes a long time to get a contract, and then a lot of resources go into getting the product out into the market. It also means that once your customer has chosen you as the private label partner—and you assume that the reason you've been selected is that you're offering something different, better service, better quality, more value-added, or tremendous quality control—there's got to be a tremendous paradigm shift for you to lose that business. So with us, for instance, while there may have been cost pressures, we've still been able to keep business because of those relationships.



How Private Companies Can *Help Themselves through* Focused Cash Management

Cash remains on or near the top of the agenda for most private companies. Market conditions and pressures from suppliers and customers continue to put a strain on cash.



By **Bina Mehta**, National Director, Cash & Working Capital Management, Advisory Services, KPMG Enterprise (Toronto)

When cash from external sources is not as readily available as it was in the past, or where there remains increased levels of scrutiny from lenders, it will be those businesses that can release cash from their working capital and other areas of the business that will be best positioned to respond to market changes, take advantage of market recovery, and preserve and create value for stakeholders.

Things you can do now

Understand cash is at the heart of strategic discussions

Cash is perceived as a finance issue, but should be front of mind for all strategic implementations, including sales, purchasing, logistics, HR, and marketing. It is often perceived as just stretching creditors and monitoring debtors; instead, it is about gaining greater visibility and control over cash flows and understanding in minute detail how it flows around your entire business, where it gets stuck and why, and then doing something about it.

Improve visibility of funding requirements

Clear reporting formats, accountability for input and output, and a rigorous process of preparation form the foundations of good cash flow forecasts. Improving the accuracy and quality of forecasts will require budget holders to communicate the required information with documented assumptions. It also means reviewing and challenging these assumptions on a regular basis to help ensure they are still relevant, as well as monitoring actual performance against forecast to understand where improvements can be made.

Identify short-term cash flow initiatives

In many private companies there are likely to be other unrecognized opportunities to release cash. They often involve business processes and practices that needlessly inflate working capital requirements (e.g. excess inventories, poor negotiation of terms). To generate cash quickly, extend creditor terms out as far as possible while carefully monitoring your debtor position, review stock levels, and limit discretionary

spending. In any event, it is also critical to watch what is happening to your competitors, customers, and suppliers and anticipate how that may affect you going forward.

Assess capital expenditure

Past expenditure programs that assumed continued market growth may need to be re-evaluated in light of changing economic conditions and heightened associated risks. It is particularly valuable to consider what capital expenditure decisions can be reversed with minimal effect.

Stick with it

Cash flow management isn't a short-term fix, though there will undoubtedly be quick wins. Cash management should be a discipline that drives the growing value of the business. Private companies that are good at this strive to develop a "cash culture" across the business; they achieve a clear alignment of goals and drive these down to the individual level.

Smaller Companies *Feel the Squeeze*

In June 2009, a total of 350 finance executives in Europe were surveyed by CFO Research Services for KPMG International's second annual cash survey: Cash is back in fashion, but is it here to stay? Survey results found that companies have pushed cash generation up the agenda in response to the changing demands of analysts, lenders, and ratings agencies. As was predicted in last year's survey, many stakeholders have placed increased pressure on companies to strengthen cash generation.

By **Peter Miller**, Partner, KPMG Enterprise (Winnipeg)

The research also showed clearly that smaller companies are feeling the brunt of the financial and economic crisis. It's also plain that smaller companies trail behind larger ones in their working capital efforts.

Consider payables. Smaller companies usually buy less and therefore have less purchasing power, so they often feel greater pressure to pay than their large counterparts. "Vendors are quick to cut us off if we slow payments," says a finance executive who works for a company in the automotive sector with USD\$250 million–\$500 million in annual revenues.

It's a similar picture in receivables. Here, 50 percent of small companies say they expect customers' stretching payment terms to be a top pressure on working capital. Smaller companies often have less bargaining power than their larger counterparts in collections efforts.

And it's worth noting that in forecasting, the smallest companies in the respondent pool appear to be doing worse than the largest companies; 49 percent of respondents who work for the smallest companies reported missing forecasted cash flow in the past year, compared with 40 percent of respondents from the largest companies.

And smaller companies are less likely to run a working capital management improvement program than larger ones: only 48 percent of smaller companies say they have run such a program, versus two-thirds of medium and large companies. Accordingly, just 30 percent of respondents who work for smaller companies are linking employee remuneration to cash performance, versus 55 percent from the largest companies.

It's little wonder, then, that smaller companies are less optimistic about future cash savings from working capital than their larger peers; while 53 percent of the largest companies foresee an improvement in their working capital in the coming 12 months, the figure is just 37 percent among the smallest companies.

Why the stark contrasts? The most likely explanations are all tied to the scale and scope of smaller companies. Small companies are less likely to prevail in negotiations and disputes with suppliers and customers that are large. Another reason may be that fewer small companies have sophisticated IT platforms in place, leaving finance staff with fewer tools with which to work. A third possibility is that some smaller companies, with fewer staff in the finance function, don't have the resources to dedicate to managing working capital.

Whichever factors are at play, it's likely that smaller companies will continue to feel the pressure for some time to come, even as a possible recovery in business conditions appears on the horizon.

Given restricted access to financing, it's possible that small companies will face fresh financing challenges as the economy recovers. It is therefore critical that they adopt some of the tactics used by larger companies to manage their working capital.

37%

OF THE SMALLEST COMPANIES FORESEE AN IMPROVEMENT IN THEIR WORKING CAPITAL IN THE COMING 12 MONTHS, COMPARED TO 53 PERCENT OF LARGE COMPANIES.

30%

OF RESPONDENTS WHO WORK FOR SMALLER COMPANIES ARE LINKING EMPLOYEE REMUNERATION TO CASH PERFORMANCE, VERSUS 55 PERCENT FROM THE LARGEST COMPANIES.

Cash Flows:

Improving the Supply Chain's Cash and Working Capital to Gain a Competitive Advantage



By Jérôme Thirion, KPMG Entreprise (Montréal)

Cash is King, Again. But, This Time, the Rules of King Cash Are Different.

Companies across industries and geographies have seen the effects of an extremely tight lending environment. Private company owners are facing expiring debt agreements and significantly increased interest expense for new debt. Slowing consumer consumption is leaving inventory on store shelves, in warehouses, and on balance sheets.

Simply put, the cash that allows businesses to flow has been drying up. In this environment, leaders worldwide have new opportunities to enable their companies to compete over the long term. While recovery may be around the corner, leaders in every industry can encourage its return with a careful examination of their balance sheets and income statements, along with tough adjustments to their business models.

Rethink the Business Model

Every company has a distinct business model that requires differing levels of cash, working capital, debt, and other assets to generate revenue. Some use

customers' advances to fund operations, others rely on bank debt, and still others rely on subsidies. Yet, even within a category of business model, performance varies. Questions to ask include:

- How can we leverage others' assets in our company to our customers' advantage?
- How can we work with our suppliers to integrate them into our business model and make it easier and less expensive for them to support us rather than our competitors?
- How can we better construct our contracts to help improve cash flow and deliver on customer expectations

Rules of King Cash

Although each company's situation is different, all companies can benefit from understanding the rules for the new King Cash:

1. Get back to basics

Understanding the parameters in the company's material requirements planning (MRP) system is critical. Do open purchase orders exceed demand?

Do materials exceed requirements? Do routings reflect reality? How aged is the inventory? Who has ownership of total inventory? Is there healthy tension between the competing priorities for inventory and cash?

2. Get the data

(from the source, without filters)

Create reports that monetize critical cash-control decision points in key processes—purchase order, receiving, order management, quality, production, and distribution—and challenge reports that filter the data (possibly masking policy or process problems) before they present information.

3. Educate finance on the language of operations

Monetize inventory reports. Monetize variance to compliance with inventory policies. Monetize variance to purchasing policies. By providing finance with an understanding and report of how cash is consumed in the operational processes, leaders can create a new understanding of cash within the executive ranks.

4. Educate operations on the language of finance

A seasoned operations executive can assess order fill-rate performance by walking down a factory aisle. But mapping operational performance metrics to top level financial metrics—including returns on sales, net assets, invested capital, and capital employed—is critical to linking operational policies and decisions with the consumption of cash. If finance takes the time to educate operations on its top-level metrics and how they can influence them, both positively and negatively, the company can make smarter and more strategic decisions.

5. Benchmark your performance to your policies, your industry, and outside your industry

Although a private company's performance may be exceeding its peer group, is its performance truly exceptional or is it simply the best of the underperformers? If you were able to run your business at the parameters that are within your current policies and procedures, how much working capital would your business require? Less than is tied up today? Can you name the company with the best-in-class days-payables-outstanding in your industry? Do you know how that company achieves that performance? Have you looked to other industries that have innovated in the order-to-cash process and considered if their practices are applicable to your business?

6. Establish a hierarchy of metrics that result in freeing up cash

Influencing top level cash and working capital resultant metrics, such as days of sales outstanding, inventory outstanding, payables outstanding, and working capital, requires executives to identify lower-level metrics that directly influence those measures. Depending on the company's business model, causal metrics can be identified that enable leadership to quickly drill down to the underlying process areas, assess performance, and initiate corrective action.



7. Establish a “cash council” of cross-functional senior executives

Improving working capital performance in one area may require revising process, policy, procedures, or metrics within another area. A cash council of senior executives provides a powerful forum where process, policy, procedure, and metric issues can be discussed and resolved quickly, helping to ensure a healthy tension between requiring enough cash and working capital to support customer demands, but not so much as to create inefficiencies in the business model.

8. Aim high and re-evaluate the business model

Often, the goals of incremental improvement result in incremental thinking. Sometimes the better decision is to aim for a goal so large that leadership is compelled to consider new ideas. For example, a 30 percent reduction in working capital requirements may not be attainable by efficiency improvements alone. Leaders may need to re-evaluate and update the business model in areas such as customer contract type and terms, vendor management of inventory, outsourcing of business processes, supply chain restructuring, and new partnerships or joint ventures, to enable significant changes in the consumption of cash and working capital.

9. Invest in systems to automate cash and working capital performance reporting

Often, the causal and resultant metrics used to assess cash and working capital performance are pulled from several fields and combined into new reports. But unless leaders work with IT to institutionalize these new metrics into the Key Performance Indicator's (KPI's) regular reporting package, momentum on improvements will likely be lost. “What gets measured gets done” still applies.

10. Review cash policies on a periodic basis going forward

As credit market conditions and other business circumstances evolve and internal performance capabilities change, organizations need to periodically review and update key policies driving cash and working capital consumption. These policies include material purchasing planning parameters, bill of material routing and planning guidelines, ABC inventory policies, supplier payment terms, customer payment terms, and invoicing cycles. Many private companies are implementing cash conservation plans, but they should also address policies that can free cash and bring flexibility to the balance sheet as change occurs.

What's Your Private Company's Working Capital IQ?

Implementing cash and working capital improvements is an ongoing process requiring action on several fronts, with input and cooperation from several areas of the company. Although starting the process can seem daunting, one way to begin is to review the list of 10 key rules handed down by the new Cash King (adjacent) and assess where your company is relative to each of them. Rate your company on a scale of 1 to 3 on each of the items, scoring one point when the rule is not being addressed, two points if the rule is under consideration, and three points if the rule has been implemented. Add your company's score and see where it falls under the categories below:

10-15 points: Your private company has not focused on cash and working capital and can significantly reduce working capital levels.

16-22 points: Your private company has addressed the common areas for cash and working capital improvement, but to achieve significant improvement going forward, a focused program is required.

23-30 points: Congratulations! Your private company has mastered cash and working capital management and should use the excess cash to pay down debt, fund new R&D, acquire poor performers, and harvest the cash—or return the cash to shareholders.

Working capital performance can become a competitive advantage. Private company owners who approach the issue with a constant focus and a steady hand—and treat it as a collaborative effort throughout the organization—will likely be able to achieve long-term sustainable results that can outlast today's spending freezes.

Cash in *Stressed and Distressed* Situations

Get the most out of cash and working capital.



Cash management is critical for stressed and distressed private companies that have limited choices and need to preserve cash to buy time to restructure and/or refinance.

Are you facing any of the following issues?

- In breach of or about to breach banking facilities and/or covenants
 - Struggling to meet short-term funding requirements and making unexpected requests for additional funding
 - Withdrawal of supplier credit lines and/or trade insurance
 - Being forced to micro-manage cash/defer payments
 - Receiving more requests from customers to extend credit terms when cash is already tight
 - Forecasting covenant breaches that may require short-term liquidity management to avert.
- KPMG Enterprise can help establish the need for cash in a business and help management:**
- Enhance visibility of funding requirements through the development and implementation of robust cash flow forecasts
 - Identify and implement short-term cash generation/preservation initiatives
 - Introduce tighter controls over cash-related procedures
 - Introduce cash-related Key Performance Indicators (KPIs)
 - Advise on stakeholder management
 - Buy time to enact a long-term restructuring plan that typically involves the following activities:
 - Stabilize or enhance cash position/headroom
 - Manage around a short-term or seasonal peak cash requirement, or a covenant issue.

Our Cash Management process

Through robust cash management and effective cash generation/preservation initiatives, significant benefits can be delivered to your business.



About KPMG Enterprise

KPMG Enterprise™ is a network of professionals devoted exclusively to serving private companies in Canada. Our business advisers care passionately about the success of their private company clients.

As the primary point of contact, they take time to understand your business and help deliver value that is unique to your private company, bringing forward the best people and the right resources to serve your specific needs. Our service delivery goal is to provide relevant, timely advice and ideas in a way that is manageable and affordable, which can ultimately help any private company save time and money.



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