Liquidity challenges in a down market

How newly public companies can survive a cash crunch

When financial markets slow, newly public companies may find themselves facing liquidity challenges. Due to inadequate cash flows, difficulty raising additional equity financing, and high interest rates on debt financing, these companies risk running out of cash before business prospects improve or fully develop.

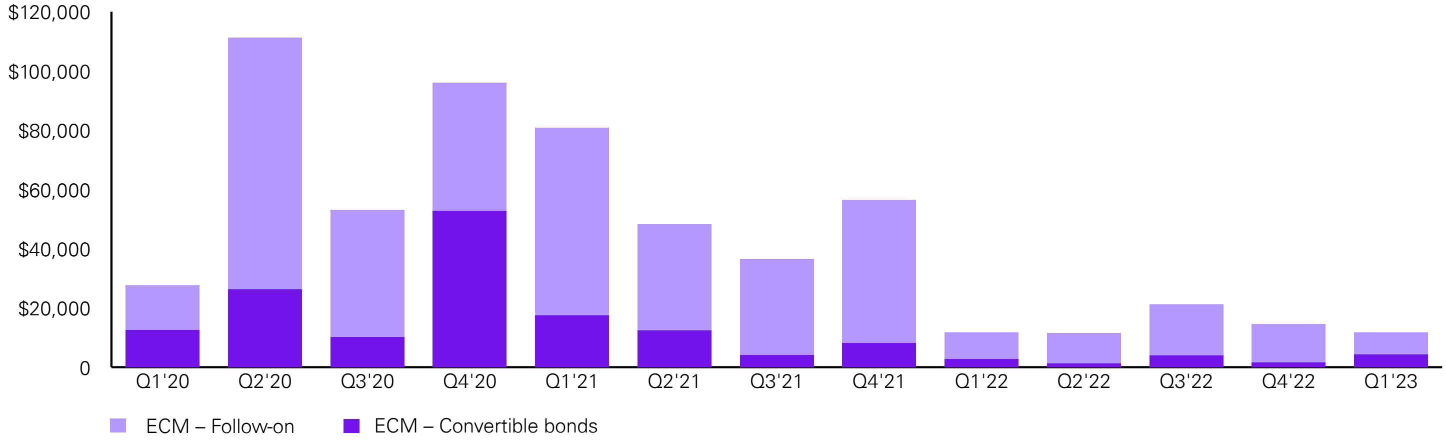
Our analysis of companies that went public in 2020 and 2021 indicates that almost one-third of them could be in such a situation today.[1] In this paper, we present our findings and examine different steps some emerging public companies have taken to address their liquidity issues. We then discuss the best courses of action available to companies in similar distress and how they can start on the road to recovery. To overcome the cash crunch and ride out the lean times, these companies need to be proactive while carefully considering what each possible solution entails.

Anatomy of a cash crunch

In early 2022, a combination of strong consumer demand, supply-chain disruptions, and Russia's war against Ukraine fueled the biggest spike in inflation in more than four decades. The Federal Reserve responded by repeatedly raising interest rates, leading to growing fears of recession and a sharp fall in stock prices. Shares in fast-growth emerging companies were hit particularly hard and the IPO market dried up. According to KPMG research, U.S. IPO issuances fell to just $7.7 billion in 2022,[2] which is 69 percent lower than in 2008, the year of the global financial crisis. Secondary equity offerings fell from $222 billion to $59 billion, and new issuances of corporate bonds also fell; borrowers raised just $499 billion in secondary debt in 2022, compared to $788 billion in 2021 (Exhibits 1 and 2).

Exhibit 1. Equity financing fell sharply in 2022

Secondary offerings, equity capital markets (ECM); transaction value $M

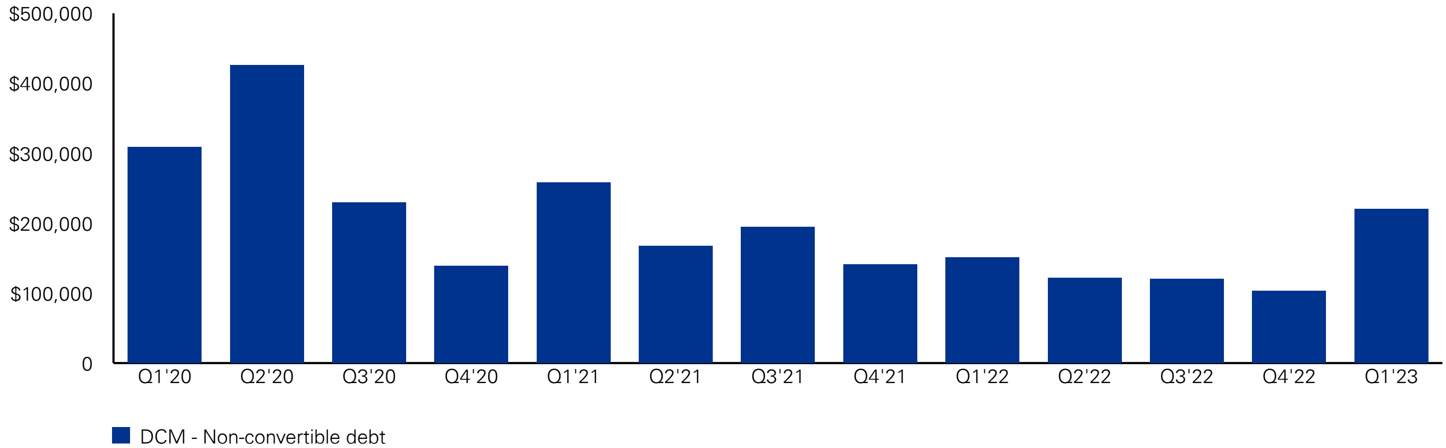


[1] This analysis focuses on companies that went public during the influx of IPO and SPAC activity in 2020 and 2021. Driven by COVID-19 recovery, these companies entered the market in record volumes, prior to macroeconomic stress in 2022 that cooled the market and yielded liquidity challenges for these newly public companies. This analysis explores those companies' financial conditions through Q1 2023, but does not include companies that went public in 2022 or 2023.

[2] KPMG, IPO insights Q4 2022

Exhibit 2. Debt financing fell sharply in 2022

Secondary offerings, debt capital markets (DCM); transaction value $M

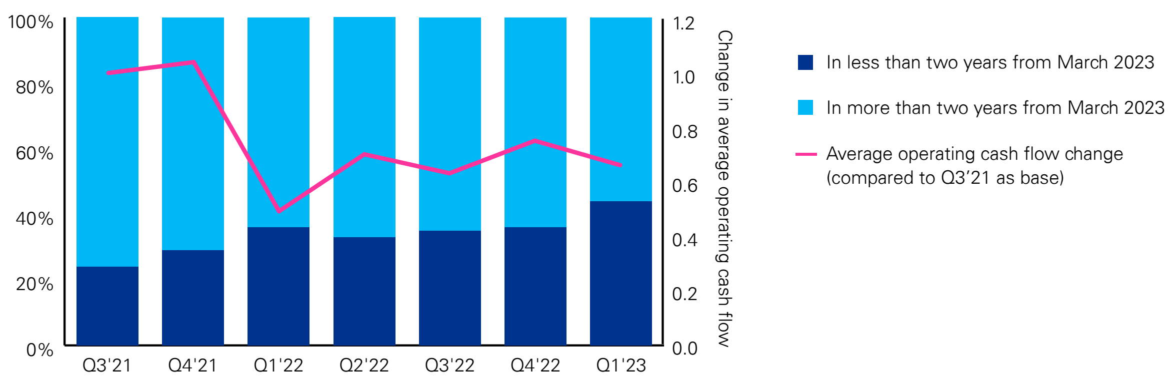


Although there are signs that a recession may be mild—or not materialize at all—the markets remain unsettled and access to public funding is limited. This may exacerbate liquidity problems at many newly public companies that are now struggling to maintain rapid sales growth and face significant net operating losses or negative cash flows from operations. Some of these companies need to continue investing heavily in research and development for future products and services, which may compound their cash woes.

KPMG reviewed FY 2022 and Q1'23 financials of U.S. companies that went public in 2020 and 2021, including 472 that carried out traditional IPOs and 200 companies that went public by being acquired by special-purpose acquisition companies (SPACs). We estimate that 174 IPOs and 77 SPACs could run out of cash within 24 months from March 31, 2023 (the end of Q1'23) without remedial action (Exhibit 3). Our analysis also indicated that over half of the companies—approximately 63 percent of IPOs and 78 percent of de-SPACs—are in the distress zone, signaling a risk of going bankrupt in the next two years from the end of Q1 2023.[3]

Exhibit 3. Changes in average operating cash flow show more companies at risk of a cash crunch

Percentage of companies that will experience a cash shortfall without remedial action based on current operating cash flows as of Q1'23



Generally, smaller companies have a higher risk of facing liquidity difficulties after going public. Approximately 56 percent of companies with annual revenue below $250 million, 68 percent of companies with market capitalization below $250 million, and 65 percent of companies with total assets below $250 million may run out of cash within 24 months from the end of Q1'23. These companies had recurring operating losses in 2022. We also found that approximately one-third of these companies are highly or moderately leveraged, making their ability to raise additional financing more difficult.

[3] Our study was based on 672 companies that went public in either 2020 or 2021, comprised of 70 percent IPO and 30 percent via de-SPAC transaction. They were from six industries—industrial manufacturing, consumer and retail, technology, financial services, healthcare, and energy. Market capitalization (as of March 2023) ranged from under $100 million to $78 billion, and annual revenues ranged from under $100 million to over $76 billion. We analyzed liquidity ratios (cash/total assets, cash/total liabilities, and average share price decline), as well as debt-to-equity ratios.

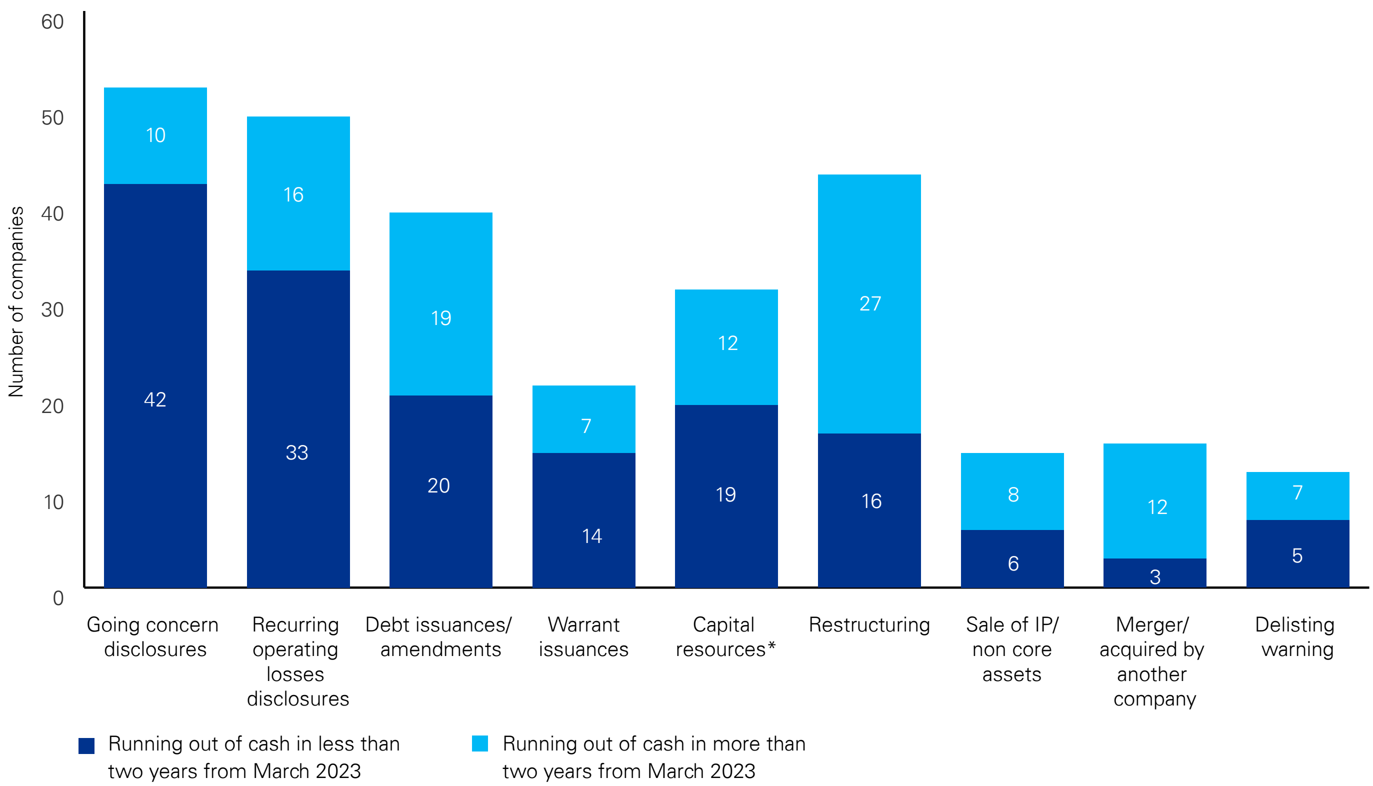
How companies are addressing the problem

To understand what companies are doing to get ahead of potential liquidity problems, KPMG analyzed financial statements of 102 of the 672 companies that went public in 2020 and 2021 that discussed liquidity concerns in their reporting. Of these, 51 percent cited going-concern issues, 48 percent mentioned recurring operating losses, and 30 percent told investors they may need to raise additional capital to continue to operate and execute strategic initiatives.

We found that these companies have undertaken several different initiatives (Exhibit 4 and 5) to improve their current financial situation. Some have issued additional debt, issued warrants, or restructured current debt. Others have pursued additional equity financing and announced, or executed, restructuring plans. Less popular actions to address financial concerns included the sale of intellectual property (IP) or non-core assets, and mergers with or acquisitions by other companies.

Exhibit 4. Strategic plans/actions and distress levels of 100 companies during Q1'22–Q1'23

Company actions



* Companies that disclosed in their financial statements that they may need to raise additional capital to continue to operate and execute strategic initiatives.

Exhibit 5. Examples of company actions to remedy liquidity issues

Companies that launched via IPO and SPAC merger

Company type	Liquidity issues	Actions	Details
Healthcare & life sciences **Pharmaceutical manufacturer**	• Low working capital and high expenses, leading to significant operating losses and accumulated deficits. • High dependence on external financing to run business and to fund research and development initiatives		• In 2021, entered a share exchange agreement with another U.S. commercial-stage pharmaceutical company to acquire issued and outstanding equity interests in that company in exchange for shares and cash payment • In 2021, the company issued shares of common stock. In a concurrent private placement, the company issued warrants to purchase these shares. The warrants had an exercise price at a premium to the direct offering price. The warrant exercise price was subsequently repriced to about half the direct offering price. In addition, the company issued a warrant to the placement agent to purchase shares of common stock • In 2022, entered an agreement to purchase senior secured promissory notes, with gross proceeds of over $1 million • In 2023, the CEO and CIO each loaned approximately $100,000 to the company due in October 2023 or upon event of default
Industrials **Machinery manufacturer**	• In 2022, unrestricted cash and cash equivalents decreased by over 75 percent vis-à-vis 2021, along with a rise in costs related to manufacturing and raw materials		• In 2022, the company engaged in an enterprise cost reduction program to reduce variable costs (related to supply chain and labor), and general and administrative costs. The company incurred over $1 million as additional expense under this initiative • In 2022, the company signed an amendment agreement related to its revolving credit facility to include a first-in, last-out sub-limit, and replace the LIBOR-based reference rate with an adjusted term, and secured an overnight financing rate • In 2022, the company acquired a specialty goods business to enhance its portfolio • In 2022, the company announced a share repurchase program
Healthcare & life sciences **Pharmaceutical manufacturer**	• Negative cash flow from operations, substantial losses, along with negative revenue outlook • Unfavorable clinical trials resulting in no product in the market or revenue from product sales		• In 2022, the company announced two reductions in workforce and recorded charges of over $6 million • In 2023, the company entered into a merger where the other party would be merged with a wholly-owned subsidiary of the company
Technology, media & telecom **Communications equipment manufacturer**	• Low cash, negative working capital, and substantial operating expenses		• In 2022, the company engaged in restructuring via reduction of 70 percent of its overhead and personnel, along with divestment of non-core businesses • At the same time, the company further entered into a note agreement with a related party for cash proceeds of about $100,000 at an interest rate of 3 percent

Legend: Debt refinancing/amendment   Direct offering   Warrant issuance   Acquisitions   Restructuring   Share repurchase

Companies that merged with a SPAC

Company type	Liquidity issues	Actions	Details
Healthcare & life sciences **Nursing care facilities operator**	• Negative cash flows from operating activities, rising wage costs amid insufficient labor supply, decrease in net operating revenue outlook • Difficulty in finding sufficient personnel, additional non-cash impairments for goodwill and intangible assets in 2022 • As of March 31, 2023, the Company had no available capacity under its revolving credit facility. Further, based on current liquidity and projected cash use, the Company anticipates violation of its minimum liquidity covenant within the next 12 months following the issuance of Q1’23 FS	● ●	• In 2022, the company entered a new senior secured term loan and revolving credit facility to refinance outstanding debt under its existing credit facility • In connection with the 2022 debt refinancing, the company issued preferred stock and warrants
Technology, media & telecom **Visual technologies provider**	• Significant loss in value in 2021: negative cash flows from operating activities; significant losses from operations in the past; and expected operating losses for at least the next 12 months • Internal conflict with management and resignation of former CEO in 2021	●	• In 2022, the company agreed to issue warrants to an investment company to acquire its shares subject to certain vesting conditions. This in turn more than doubled its share price in after-market trading • Also in 2022, the company proposed a merger with a technology company to strengthen its financial position via increased operational efficiencies along with expansion of customer and product portfolio

Legend: ● Debt refinancing/amendment ● Direct offering ● Warrant issuance ● Acquisitions ● Restructuring ● Share repurchase

The road to recovery

A company in distress and experiencing liquidity problems needs to take proactive steps to pinpoint its unique situation and craft a detailed plan to implement the appropriate solution.

Understand key challenges

1 How much time does the company have before it runs out of existing **liquidity?**

2 How does the company restructure its **operations** to become profitable?

3 How does the company build confidence in the **financial forecast**?

4 What are the company's **funding options** (equity, debt financing, go private)?

Assess your situation and options

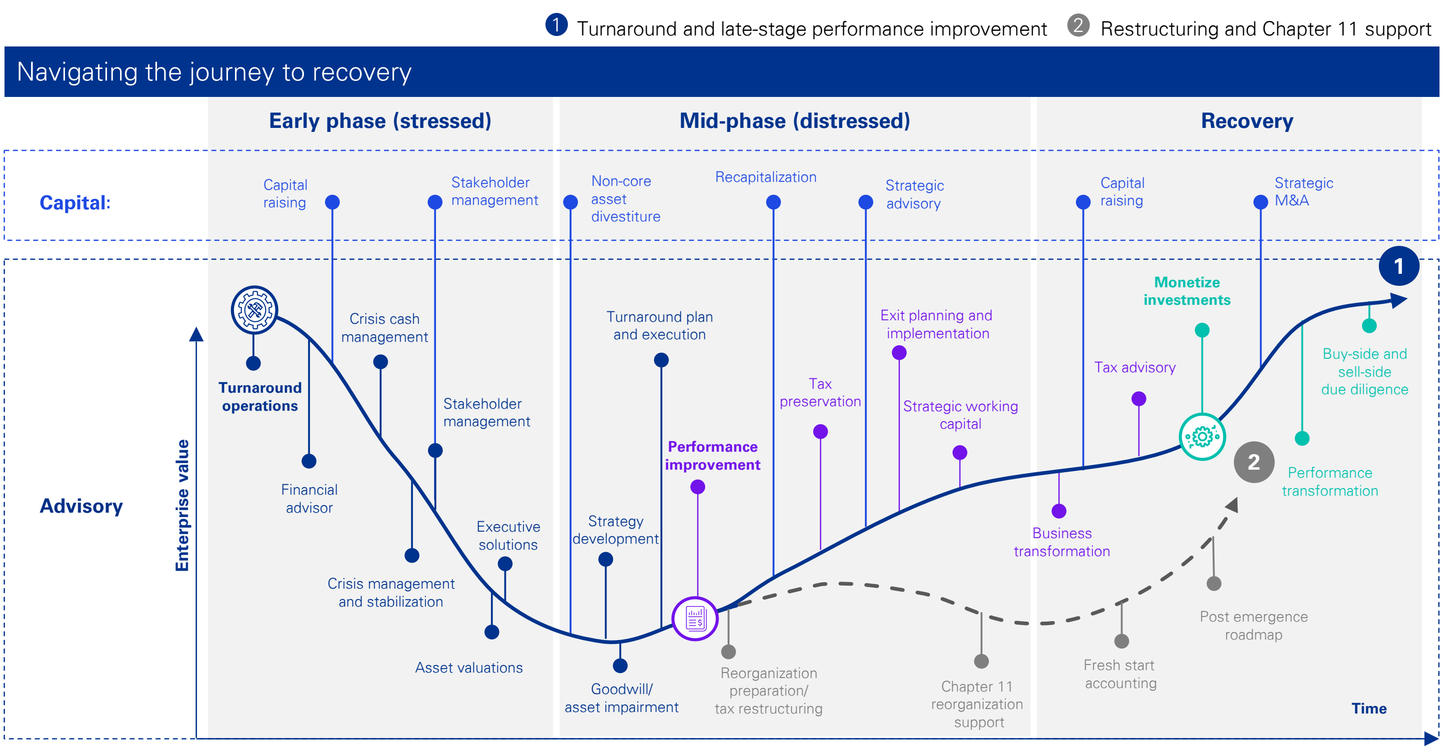
As a CEO or CFO, it may be important to ask if the company exhibits the attributes that most closely indicate a distressed or stressed company:

- Does the company have a **low valuation as compared to its peer** group?
- Does the company have a **depressed share price** relative to its intrinsic values?
- Has the company experienced a **change in its investor base**?
- Does the company have **poor equity analyst coverage** and **higher analyst forecast dispersion**?
- How does the **company's performance, capital allocation and valuation multiple** compare to its industry peers?
- Does the company have **low-performing assets** or **business segments**?
- Does the company have **excess/growing costs** and **reduced revenues** or **undeveloped revenues**?
- Has the company experienced a **deterioration of its cash flows**? Can the company pay its bills on time?
- Is the company struggling to find financing for its operations? Was there a **change in its credit rating**?
- Does the company have **unfavorable debt terms** or increasing debt obligations?
- Does the company have **budget shortfalls** and/or **lowered financial projections**?
- Does the company have marketable or unencumbered assets (e.g., real estate, intellectual property, etc.) that can be used to **raise additional capital?**
- Is there an **opportunity to improve liquidity** by better managing working capital?
- Does the company have a viable business model that is overly burdened by an **expensive capital structure**?

Define your roadmap

Based on the assessment of the company's current position, management should define the applicable roadmap—either working for a turnaround and performance improvement, or undertaking restructuring and bankruptcy support.

	Stabilize & protect value	Value recovery	Value realization
Turnaround	Rapid stabilization/ align stakeholders	Develop and stress test a deliverable recovery plan; Negotiation support	Work shoulder-to-shoulder to execute sustained turnaround
Liquidity	Cash conservation	Tactical working capital management	Implement best practices in cash management
Transformation	Rapid cost reduction and spend controls	Plan and deliver sustainable business improvement and re-org; Capital structure modifications	Rapid delivery of sustainable profit improvement/cost reduction
Planning and implementation	Baseline analysis; Strategic options assessment	Modeling and scenario analysis for informed decision making	Implement strategic initiatives and performance improvements



How KPMG can help

KPMG brings an end-to-end suite of services tailored to complex transactions. Our team of specialists bring experiences across the full stressed/distressed spectrum, from performance improvement to turnaround and restructuring services to deal transaction management to bankruptcy support.

Solutions and services for troubled companies

Capital advisory and corporate financing

Strategy, optimization, and restructuring

- Cash collateral analysis and arrangements
- Vendor negotiations: payment plans
- Lender negotiations: revisions, waivers, and forbearance
- Recommendations to enhance liquidity and working capital
- Assess capital structure and refinancing alternatives
- Market new debt or equity financing

Financial accounting, reporting, and valuation

- Develop and maintain 13-week cash flow forecast model
- Analyze compliance with debt covenants
- Debt modification and extinguishment accounting
- Lead private placement processes for refinancing, growth capital, acquisition financing, and dividend recapitalization

Tax support

- Maximize U.S. federal deductibility of interest expense
- Intercompany indebtedness restructuring (e.g., rate, capacity)
- Tax modeling support

Operational and financial restructuring

Strategy, optimization, and restructuring

- Supply chain improvement
- Facility expansion, closure, consolidation, and relocation
- Improve manufacturing process and plant floor plan
- Develop manufacturing and capital expenditure strategies
- Assist with operational planning and synergy execution
- Rapid EBITDA improvement programs
- Improving front-office function (customers, channels, etc.)
- Cost improvement/containment
- Commercial excellence (selling, segmentation, pricing, etc.)

Financial accounting, reporting, and valuation

- Re-segmentation and other reporting adjustments
- Improvement of internal reporting tools:
  - Budget/forecast framework and templates
  - Variance analysis for actuals versus budget/forecast
  - KPI tracking and business intelligence

Going private transaction

Strategy and optimization

- Going-private strategic option assessment
- Peer performance benchmarking analysis
- Development of 18-month rolling forecast model
- Synergy/optimization planning and tracking

Financial accounting, reporting, and valuation

- Buy-side/purchase accounting support
- Design of finance and accounting target operating model
- Ongoing value-creation program support
- SEC reporting assistance

Tax support

- Tax structuring optimization and compliance
- Transaction cost analysis
- Tax attribute planning and limitation modeling
- Deduction planning: bad debt, worthless stock, interest, etc.
- Intercompany debt restructuring and clean up
- Granite Trust transaction planning

Merger with another company

Strategy and optimization

- Buy-side financial due diligence, including target assessment and negotiation strategy
- Operational and commercial due diligence
- Synergy scenario analysis, planning, and tracking
- Refinancing and capital structure support
- Integration design and implementation, including finance and accounting, information technology, human resources, etc.

Financial reporting and accounting

- Buy-side/purchase accounting support, including valuation
- Detailed books and records pushdown assistance
- SEC reporting assistance, including IPO preparation

Tax support

- Tax structuring support and optimization
- Tax attribute limitation modeling
- Transaction cost analysis
- Compliance and reporting support

Sale of non-core assets, business and/or IP

Planning and buyer identification
- Strategic planning and analysis
- Market non-core businesses or assets for sale
- Analyze offers and transaction structuring
- Developing negotiation strategies
- Scenario modeling based on sale options

Financial accounting, reporting, and valuation
- Preparation of carve-out financial statements
- Presentation of discontinued operations or held for sale
- Fair value of non-core assets and IP valuation to support sale
- SEC reporting assistance

Tax support
- Sell-side tax due diligence
- Tax structuring support and optimization
- Transaction cost analysis
- Compliance and reporting support

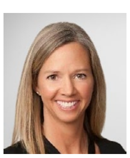
Bankruptcy advisory

Restructuring considerations:
- Chapter 11 advisory and §363 sale processes
- Out of court/restructuring advisory
- Liquidation and asset disposition
- Real estate negotiations

Financial accounting, reporting, and valuation
- Fresh start accounting, including valuation
- Debtor-in-possession accounting and reporting
- Court reporting (e.g., monthly operating reports)
- Detailed books and records pushdown assistance
- SEC reporting assistance
- Deal model with scenarios and value insights

Tax support
- Tax restructuring support and optimization
- Modeling support to assess tax cost and tax attribute reduction/limitation

Contact us



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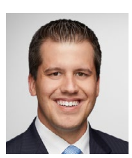

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