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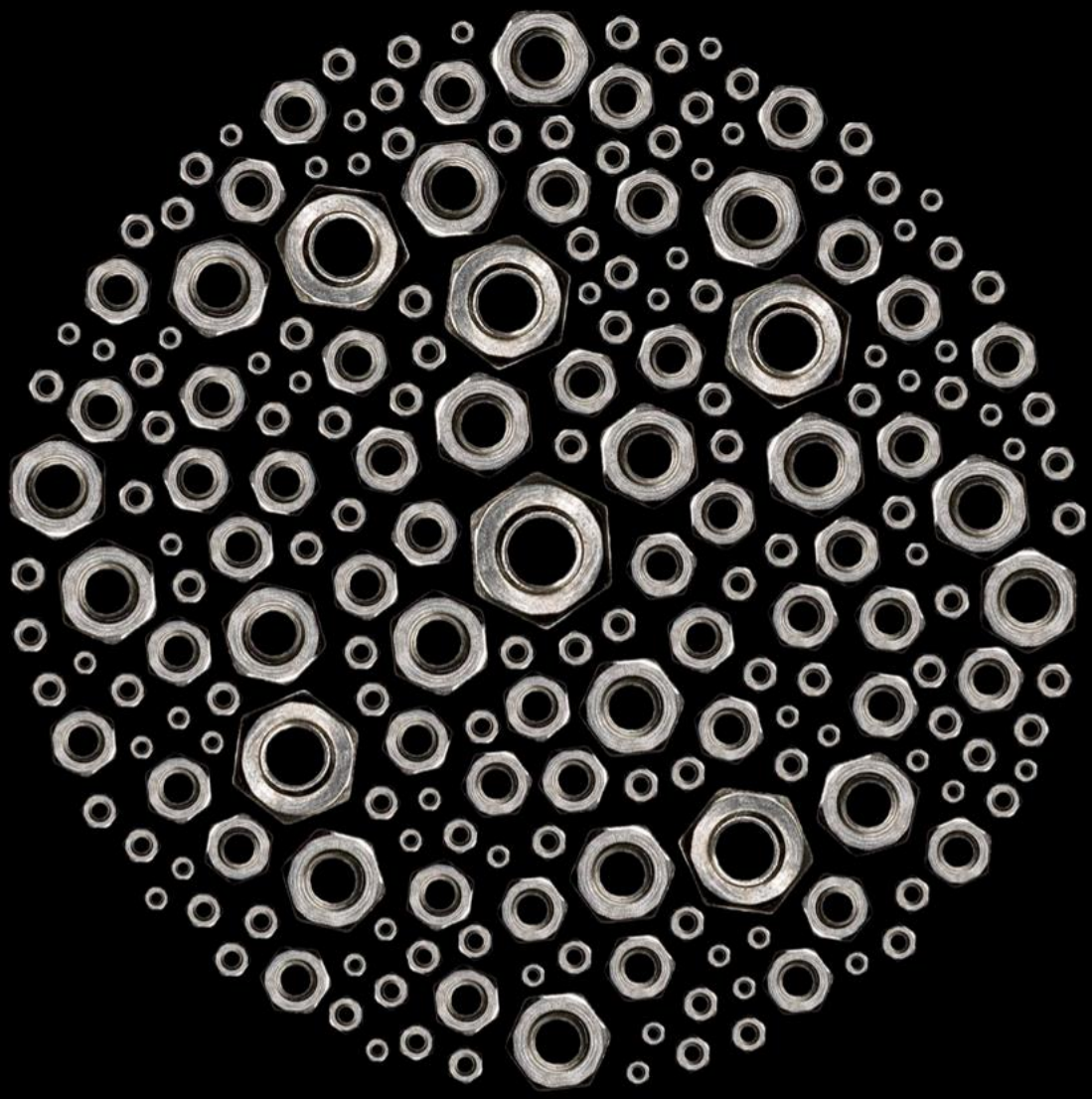

COVID-19 support withdrawal symptoms

The approaching decision trigger points for UK business

Preface

In the face of the COVID-19 pandemic, governments across the globe initially focussed on emergency health measures and 'whatever-it-takes' financial support to economies, business and employment.

As the first wave of infections began to be controlled, and the public health outlook stabilised somewhat, this focus moved towards an interim balance that sought to allow economies to open whilst capping transmission rates. This then provided the fiscal space to begin the assessment of the economic impact and the steps required to address it.

The financial hangover and the withdrawal or wind-down of stimulus schemes has also been tackled in very different ways across developed economies. And so, as a different normality resumes, economic recovery is likely to differ from one country to another.

The UK, was approaching the first of several key milestones at the end of October with the withdrawal of the Coronavirus Job Retention Scheme (CJRS) scheme. The Chancellor's announcement on 24th September, set out plans aiming to help businesses and employees, including a new Job Support Scheme to replace CJRS.

For priority sectors worst hit by the COVID-19 pandemic, such as hospitality, aviation, automotive and oil and gas, this still leaves significant uncertainty and requirement for action to address the medium term issues and changes to business strategy and operations.

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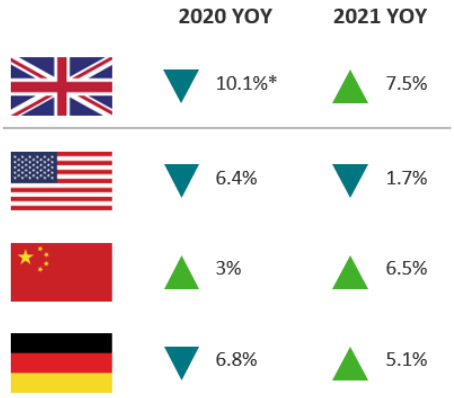
Government stimulus programs have been numerous and substantial in most major western economies, but focus is now moving to recovery and the wind-down of these schemes

Governments now focused on recovery

As the COVID-19 pandemic first hit developed markets, governments naturally put their attention into ensuring health systems had the capacity and capability to deal with the response. The lockdowns that accompanied this drove a 'whatever-it-takes' approach to developing schemes and financing to support economies and business; and to mitigate the risk of significant unemployment.

With the control of infection and death rates, and as confidence grew that public health systems were no longer being overwhelmed; governments have sought to reopen their economies to reduce the economic impact.

COVID-19 Economic Impact, GDP



Source: Deloitte COVID-19 Economics Monitor, Sep 2020

*Notes: * UK peak-to-trough reduction in GDP estimated at 23%*

At the same time, a review began into the levels and targeting of support schemes, and the opportunity to assess the degree of the financial hangover.

Across the globe, the withdrawal or wind-down of stimulus schemes has been dealt with differently. For some economies, stimulus has been targeted directly at the population via cash handouts or grants. For many western economies, they have channelled employment support and other measures via businesses to encourage the retention of staff and avoid demand shocks. As these schemes are wound-down or withdrawn, this may present a very real risk of financial and operational decision triggers for business as a different normality resumes.

Priority sectors – those most impacted by the pandemic response - have emerged largely as expected for aviation, hospitality, high-street retail, automotive and oil and gas. Whilst job losses have been increasing, the true extent of the level of distress in business may only be apparent once these support mechanisms have been withdrawn or ended.

UK adjusting course

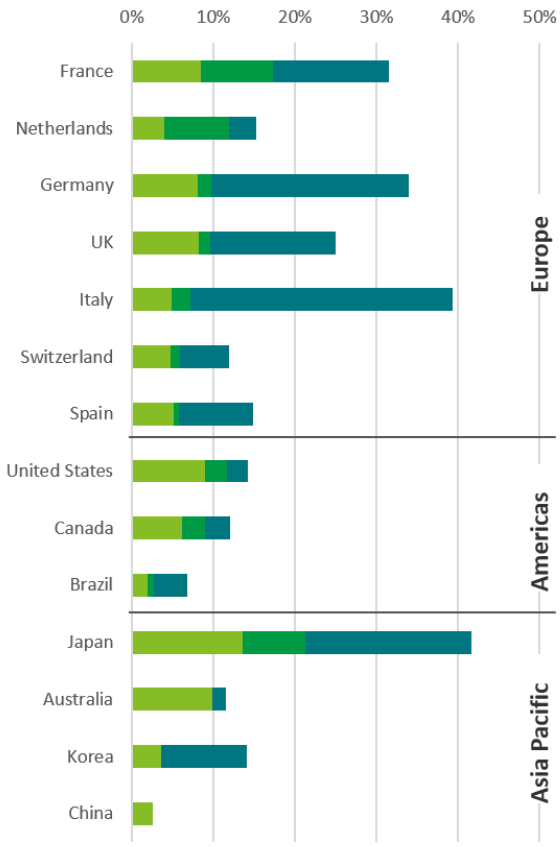
The UK has, like many of its European counterparts, sought to provide coverage whilst the lockdown was in place, and incentives to re-open the economy through the summer. Unlike Germany and France, the UK's principal employment support scheme, the Coronavirus job retention scheme (CJRS), was designed to taper down to an October end.

As the rate of infections has begun to rise, and non-pharmaceutical interventions (NPIs) re-tightened, it has become clear that this trigger point – one of several for the UK – needed to be addressed. On Thursday, 24th September, the Chancellor announced a new scheme, bringing the UK closer in some ways to those seen in Germany, France and other major European economies with availability extended to Apr 2021.

However, these have only tapered the trigger points somewhat and we may expect that as the next six months progresses, the artificial liquidity that many businesses have enjoyed, will run out. For some, this may result in an increasing level of business distress.

Discretionary 2020 fiscal measures adopted in response to coronavirus by 26 Sep 2020*

% of 2019 GDP

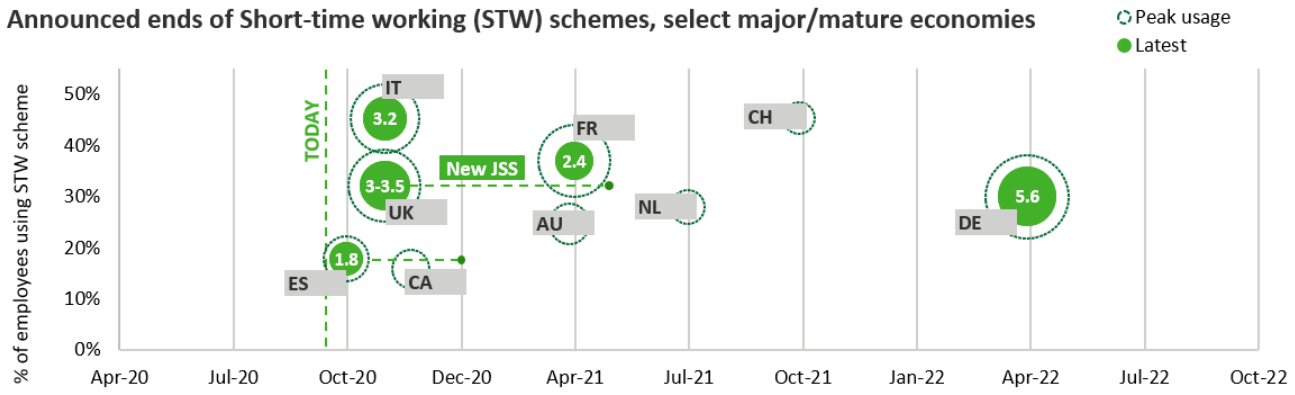


Source: IMF, Bruegel, OBR (UK), PBO (Canada), Japan Times (Japan), Leaders League (Switzerland), Deloitte Analysis

Notes: State-level initiatives have not been fully reflected in the analysis

Immediate fiscal impulse
Deferral
Other liquidity /guarantee

Business has in many instances been shielded from the full fall-out of COVID-19 by government stimulus programmes. Over the next 6 months the withdrawal and reduction of many major components will apply real pressure to businesses' liquidity



Source: IBR, various public sources, Deloitte analysis

Notes: Deadline for some countries are specified as part of the scheme, other deadlines, e.g. France and Germany, are based on the maximum duration of support available (12 months and 24 months respectively), assuming that typical businesses worst affected subscribed to schemes from the start of their lock-down periods. The US, with its highly flexible employment law, has provided most stimulus via direct payments to households, resulting in a much higher and sudden increase in unemployment rates

When's the conclusion of employment support?

A comparison of the UK to other developed markets and their short-time working schemes (prior to the September announcement of its Job Support Scheme) revealed the relative longevity of schemes in other countries, and the persistent reliance on it for many sectors.

The Job Support Scheme (JSS), which extends employment support measures for a further 6 months, is however much reduced from the existing CJRS scheme (even in its tapered state). Estimates of monthly costs for the JSS are approximately £0.5-1.0bn per month compared to £4-10bn for the CJRS.

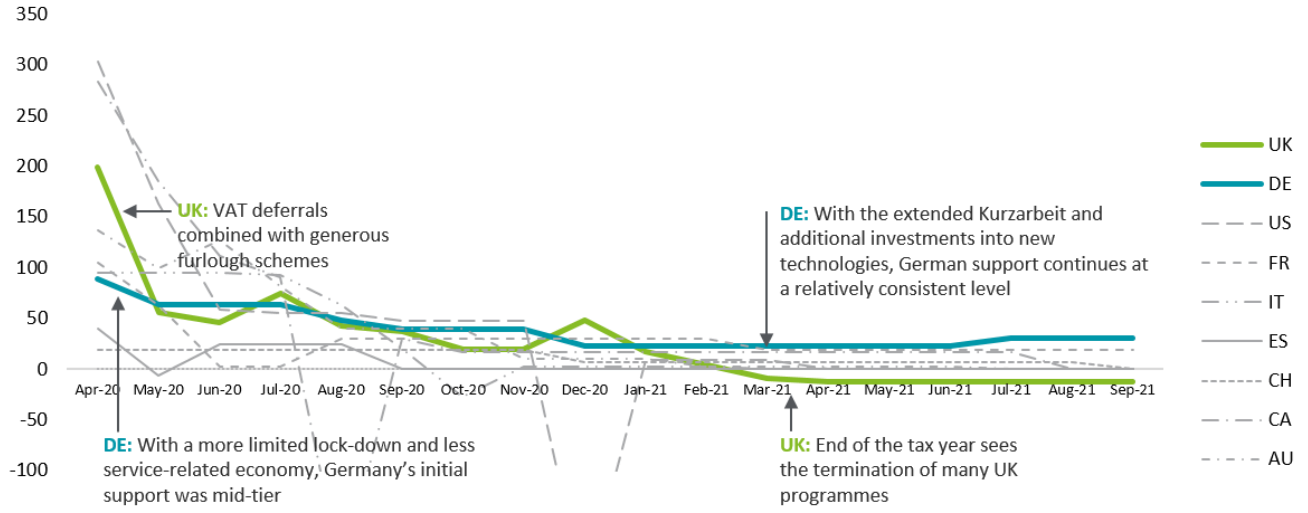
This leaves a reduced, but still apparent trigger point for the UK at the end of October, as well as ones from January into February and at the end of the tax year in April.

The tapering of wider business support measures

Illustratively comparing the wide array of business support schemes that countries have put in place demonstrates the differing sharpness in the decline of that support. For example, comparing the UK (after the changes announced on 24th September) to Germany shows a materially higher level of support during the UK's more serious first wave, but that levels of support diverge in the opposite direction from November, aside from the CJRS bonus payments in January 2021.

These variations may in turn lead to trigger points for changes in business' approach to be less marked in some countries. Additionally, some governments are making specific investments in industries of the future and other hoped-to-be-beneficial schemes (Electric vehicles and renewables, AI, energy efficiency etc.)

Business support: Illustrative monthly % of GDP supporting liquidity, basis points

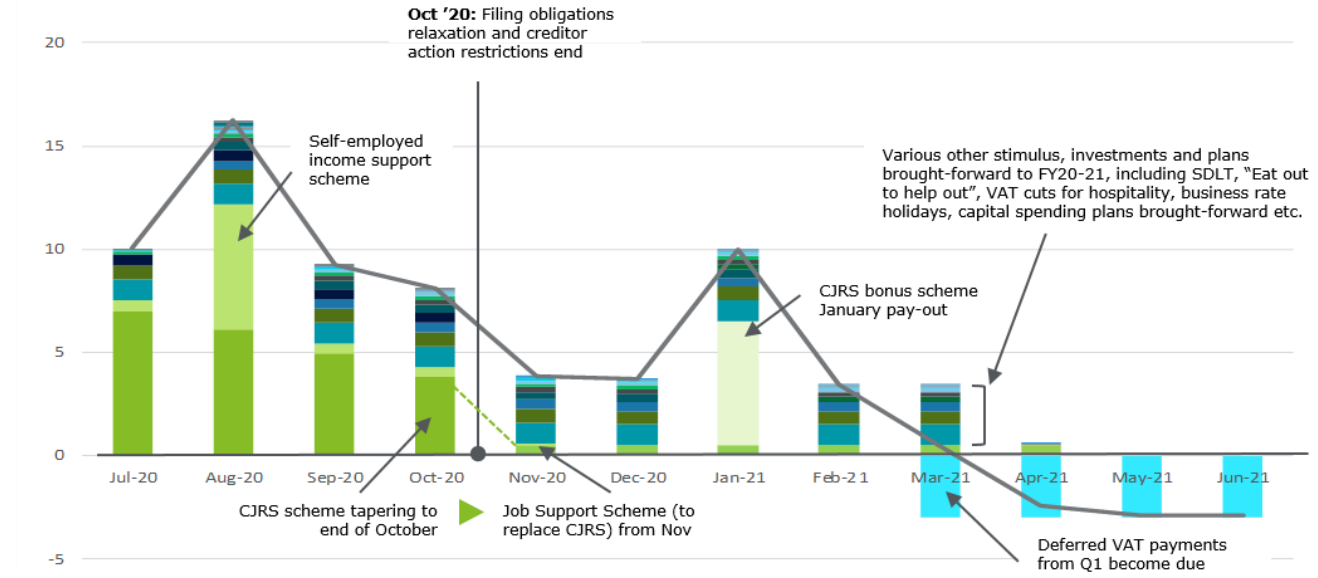


Source: IBR, Various public sources, Illustrative Deloitte analysis

Notes: Most major government schemes providing support to business (rather than healthcare spend in response to COVID) have been considered. Where schemes have limited data on costs, then assumptions have been made on the phasing of costs ahead of withdrawal deadlines. Deferred taxes appear as a peak in the month payments would have initially been due, and an equivalent trough in the period(s) to which payments are delayed.

As fiscal impulses and short-time working schemes are wound down and deferrals of taxes and payments come due, a material uptick in business distress rates may be expected

Illustrative cash flow impact of various COVID stimuli measures to business, £bn



Source: OBR estimates (Aug 20), Bruegel, Deloitte analysis

Notes: OBR phasings for tax receipts and expenditure have been used for CJRS and self-employed scheme and VAT deferrals. Other stimuli have been illustratively shared across periods in which they apply. Timings are subject to review and may be delayed or extended by HM Government. VAT tax deferrals are now payable over 11 payments – it is unclear if these are monthly or quarterly

Fiscal impulse and deferral trigger points

In the UK, trigger points are predominantly driven by three of the largest schemes.

1. Evolution of CJRS to JSS

The wind-down of the CJRS (and self-employed income support) scheme at the end of October 2020 and its 6-month replacement by the Job Support Scheme, provides a significant reduction in the degree of government support. Monthly costs to the Treasury are expected to reduce from £4-10bn for CJRS to less than £1bn for JSS, as the government reduces support from its initial peak of 80% to a maximum of 22% for many workers.

While less directly linked to a business liquidity trigger point, the JSS also brings an incentive for companies to reduce staff numbers compared to the CJRS. Employer costs per hour of output increase as the staff member's level of activity decreases incentivising companies to have fewer, but busier staff.

2. The one-off CJRS bonus

Companies may have to adapt until the receipt of this bonus in January, but then - seeing little room for optimism, particularly given the imminent arrival of the tax year end – take action.

3. Tax-year end and deferred VAT payments

From the end of March 2021, multiple smaller schemes come to an end, whilst simultaneously the VAT deferred from the start of the pandemic comes due.

The Chancellor has announced that deferred VAT can now be paid over 11 payments, much reducing the pain, but this still represents a significant additional outflow of cash for businesses. On the various tax deferrals, there have also been broader claims to defer tax outside of just the VAT one. HMRC granted these at the start but have been wanting to see more evidence that businesses have accessed all sources of funding before granting more deferrals. With the cancellation of the Autumn budget there is also limited visibility of future tax changes that may come to pay down the deficit despite press speculation of what they might be.

Loan guarantee schemes

A less sudden, but important pressure relates to loan schemes, including Bounce Back Loans, CBILS and CLBILS which were closed to new applications (since May 2020), and the CCFF which closes to new drawings in March 2021. Bounce-back loans were limited to approximately three months revenue, with no repayments or interest for 12 months.

As financing sourced under these (typically less restricted or onerous) schemes is consumed additional issues may surface: illustratively for a company with fixed costs amounting to 33% of revenue, funds will cover costs for 9 months. The demand for repayments may trigger additional pressures on small businesses from Q2 2021.

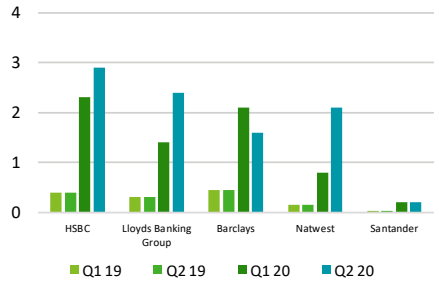
For the UK, government schemes have led to approximately £55bn of BBLS/CBILS/CLBILS lending, with some estimates that 40-50% may not be repaid in relation to the Bounce-Back Loan Scheme - the largest of the three schemes aimed at SMEs.

Whilst the government is set to foot the bill for those businesses unable to repay, UK banks, in step with their US counterparts, have also made provisions for bad debt in H1, with levels 5-6 times higher than a year before, a total of approximately £16bn.

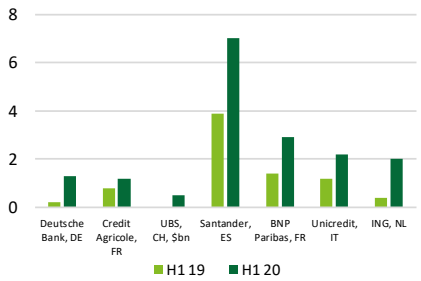
For priority sectors, heavily tapered support schemes and due payments will lead to the business realities manifesting in greater liquidity issues and distress. This will likely lead to increased asset disposals, M&A and debt restructuring as well as P&L, headcount and real estate right-sizing

Banking provisions: *During the H1 interim reporting season, banks in UK and US have announced 5-6x COVID-driven increases in impairment provisions.*

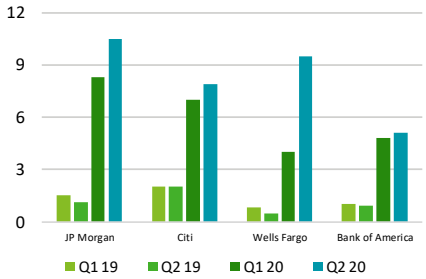
Big 5 UK banks H1 quarterly provisions announced, £bn



European banks H1 quarterly provisions announced, €bn



Big 4 US banks H1 quarterly provisions announced, $bn



As the pandemic emerged, and lockdown measures were put in place, many sectors were impacted more than others. Some, such as aerospace, set out structural changes to demand and sought to take rapid steps to reconfigure themselves to these changes. Others, including many in the hospitality, leisure and non-food, high-street retail sectors have taken up CJRS and other schemes to put-off difficult decisions as long as they can. However, the tapering of these support schemes means businesses will need to act soon.

Automotive

- Automotive dealers are under significant cash flow pressure due to the sharp decline in sales; dealer capacity is too high and **consolidation of dealerships is expected**
- OEMs are hard hit and need to shift to **"resilient supply chains"** (i.e. regional focus on flexibility rather than global supply chain cost optimisation); expect a rise in domestic and near-shore supplier networks
- **OEM and supplier concentration expected to shift to the East** with the US and EMEA on sell-side

Aviation

- Airlines are expected to **reduce the size of their fleets** as a result of demand sharply declining; reduction in capital expenditure on new aircraft and renegotiation of leases
- Many national carriers have access to cash reserves or will be nationalised; **discount airlines and mid-size / regional carriers are hardest hit**
- Privatised airport operations and **ground handling services are facing radical capacity reductions** and financial restructuring or potential wind down

Hospitality

- Halted consumer demand has **forced closure of many hospitality venues** (live sports and large-scale venues hardest hit)
- **Business model changes have been accelerated** in particular for big restaurant chains to address profitability in a social distancing era
- **Digital channels and home delivery** are expected to grow fast
- Many hotel chains are facing liquidity issues due to very low occupancy rates and **further consolidation is expected**

Oil and Gas

- At US$40 per barrel most upstream operators cannot make a profit; national oil companies (including SOEs) have cash reserves but **services /maintenance companies are being hit hard**
- **Downstream companies and related chemical companies** are facing liquidity issues and undertaking financial restructure
- **Workforce instability is a significant issue** as the ability to work remotely is limited on many sites and travel restrictions have greatly impacted the FIFO workforce

Retail and Wholesale (non-food)

- Physical locations will face a prolonged reduction in footfall, posing **viability issues for companies that can not move to digital channels**
- There has been a significant **acceleration in consumer online sales** with companies rushing to move their offering to digital channels to maintain demand
- More than ever before, customers will **expect a seamless omni channel experience** with new shopping and delivery options that affect margins

Focus areas for businesses

Scenario planning will help businesses consider the duration and length of the dip, as well as the potential for emerging in a "new normal". This then leads to some general and specific requirements to help safeguard the business, and allow it to thrive once the shock abates.

Key areas companies might consider include:

- Employees, leadership, trust and co-ordination;
- Liquidity, cash and working capital;
- Supply chain and costs;
- Planning for the "new normal";
- Operational flexibility and risk management;
- Restructuring and reshaping the business;
- Taxation.

Liquidity and cash

As a result of COVID-19, companies have been facing severe cash flow and liquidity issues that have been partially offset by government support. It is imperative to get visibility of cash flow and the options to improve working capital.

Supply chain continuity

Many companies have made efforts to improve resilience in supply chains, but as business stress rates may increase, the ability to predict issues amongst suppliers and customers, and have the internal flexibility to deal with those issues becomes more and more important.

A strategic response to the "new normal"

As part of preparing for the "new normal", and in order to offer a compelling vision of the future and demonstrate returns on investment to the stakeholders, businesses may need to change the shape of the business and set it up for growth longer term. This requirement for strategic transformation planning may be particularly acute in sectors under severe pressure from the COVID-19 crisis.

Operational flexibility

Companies are needing to balance the imperative to cut their cloth to mid-term demand with uncertainty around the form and size of demand longer term.

Restructuring and reshaping the business

Companies in distress may need to look at restructuring options to allow fundamental change in their operations and financial position.

Companies are also looking to M&A both defensively and offensively to navigate the pandemic's impact. Defensively these might include disposals to release capital, risk-sharing options with others in the value chain or acquisitions to shore up the supply chain. Offensively, these may include measured disposals of non-core units to re-focus, or opportunistic – but strategically considered - acquisitions to push the business forward.

Taxation

HMRC are in the process of reviewing CJRS claims for errors or potential fraud. Companies should think about rechecking calculations to see if they need to make any corrections.

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- Value creation practitioners: **350+**
- VCS Engagements: **550+**

2 Americas

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3 Asia/Pacific

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