KPMG

COVID-19
Financial outlook

How will Denmark's business sectors cope?

Updated May 28 2020

Who will survive?

The scale of the disruption caused by the COVID-19 virus has been unprecedented. Every company – across every business sector – has experienced some impact from the crisis. Some are weathering the storm; others are struggling to stay afloat.

In this report, we take a close look at the underlying fundamentals of Denmark's business sectors. We examine a range of factors – consumer confidence, debt-to-equity ratios, cash burn rates and financial risks – to predict which business sectors are the most resilient and which will suffer the highest rate of potential bankruptcies and layoffs over the coming year.

Our analysis suggests pockets of significant weakness in certain sectors. But also significant opportunity. Indeed, there is still time for those 'on the bubble' to avoid bankruptcy. And there are innovative deals to be made.

We hope this report helps business leaders understand their position and assess the potential options.

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Key findings

1

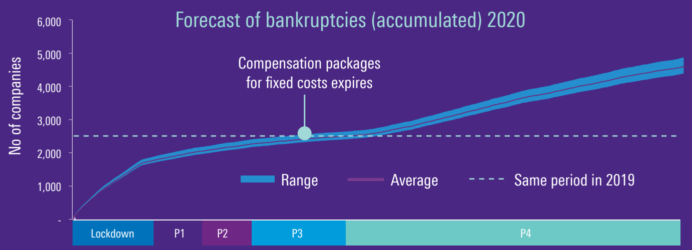
NUMBER OF BANKRUPTCIES AND LAYOFFS SET TO SKYROCKET

The government compensation packages have slowed the pace of bankruptcies following the lockdown of Denmark.

However, when the compensation packages expire on 8 July, we expect bankruptcies to spike and almost double from around 2,500 in 2019 to more than 4,500 this year.

Our analysis suggests that more than 70,000 jobs may be lost following the wave of bankruptcies.

Additional jobs might be at risk as companies pursue cost-cutting measures to avoid bankruptcies.



2

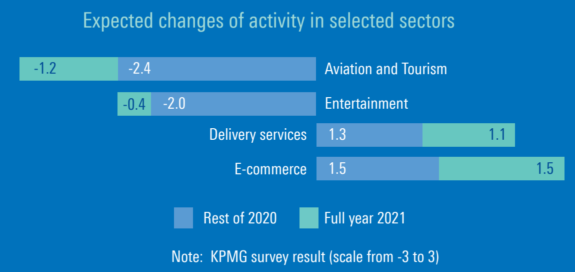
RETURN TO GROWTH WILL BE SLOW

There is a high risk of financial distress in certain sectors due to poor safeguards.

Our research shows that the short-term financial impact will be widespread and some sectors may not return to growth until 2021.

At the same time, other sectors have enjoyed in¬creased business activity as an immediate con-se¬quence of the pandemic.

Ability to respond to shifts of supply chains and changes in customer behaviour will be essential for succeeding post COVID-19.



3

MEGATRENDS WILL CHANGE THE DANISH BUSINESS LANDSCAPE

Emerging trends, challenges and opportunities:

- Shift to localisation
- Emergence of socially conscious customers
- Accelerated digitalisation
- Reduced trade and export
- Distressed M&A.

Many sectors are impacted but a few stands out, in particular:

- Travel & Leisure
- Consumer markets
- Transportation and logistics
- Manufacturing.

Our key advice on suggested actions to succeed the new normal evolves around:

- Embrace the accelerated pace of business evolution
- Enabling capabilities to rethink the business model and the operating model.

01

Sector analysis

market reaction

Stocks tumble in the wake of COVID-19

The COVID-19 pandemic has created significant volatility on the Danish stock market. Financials, Travel and leisure, retail, real estate, industrials and trans¬portation stocks were hit particularly hard. In contrast, technology and healthcare are driving a positive trend on the overall stock index.

News coverage

Despite the help packages provided by the government, a number of retailers and restaurants have already filed for bankruptcy while the airline industry is on its knees.

"Industry organisation: The Corona Crisis will cause bankruptcies despite compensation packages"

Berlingske – 20 March 2020

"Michelin restaurants in the Kedeau-group filled for bankruptcy"

Finans – 31 March 2020

"Danish clothing company PWT will close stores and prepares mass firing"

Børsen – 25 May 2020

Nationwide bookseller Arnold Busck goes bankrupt – closing all stores"

Børsen – 27 April 2020

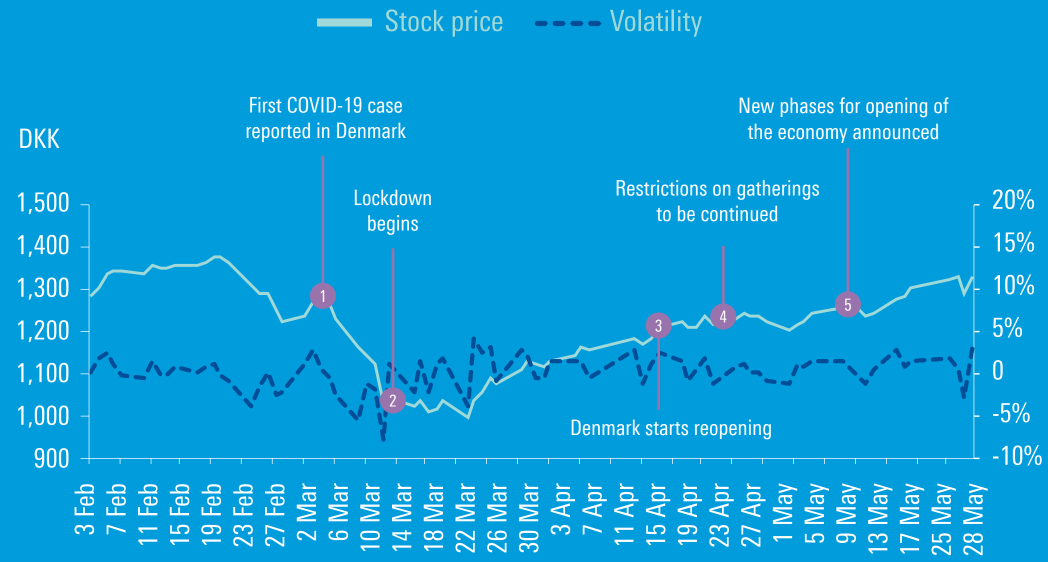
"SAS prepares a mass firing: will cut up to 5000 jobs"

Børsen – 28 April 2020

"We see that companies are working with an orderbook from pre-crisis, but look to a substantial gap in 3-4 months.",
Thomas Bustrup, COO at DI

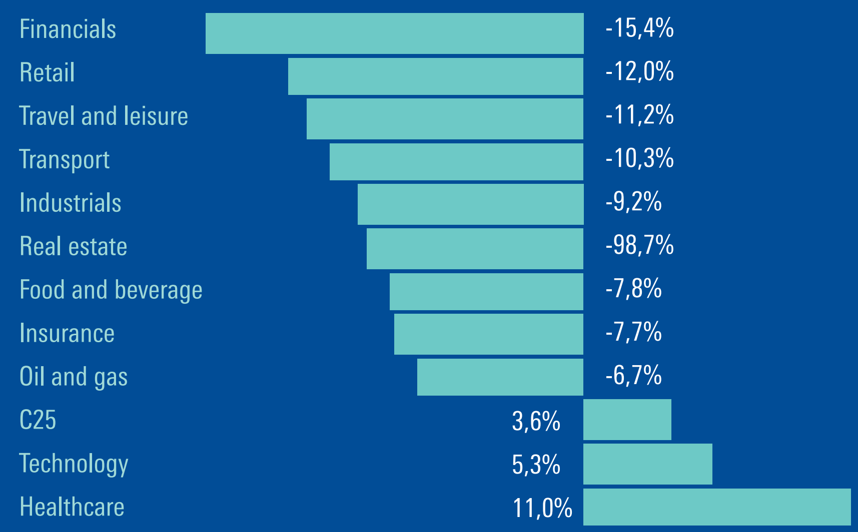
Børsen – 17 May 2020

DANISH C25 INDEX: PRICE AND VOLATILITY



Source: Nasdaq

CHANGE IN VALUE OF SELECTED SECTORS (1 FEBRUARY TO 28 MAY 2020)



Source: Nasdaq

Short-term and mid-term impact varies by industry

While some sectors suffered a collapse in business activity of more than 50 percent, others enjoyed an increase of around 25 percent. Most can expect a rebound in activity by 2021, but some will see continued slow growth.

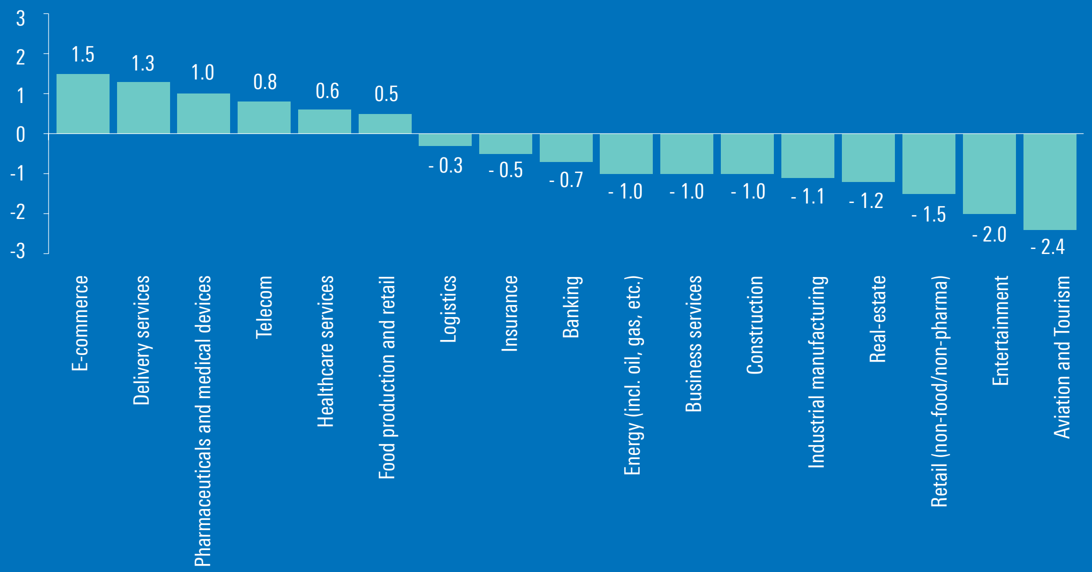
Our view

The immediate impact of the lockdown and ensuing economic shock has had negative consequences for the majority of market sectors. Tourism and entertainment were hit hard in the immediate aftermath. In addition, ongoing changes to consumer behaviour are having a long-term negative impact on a range of sectors including retail, construction and real estate.

At the same time, other sectors have enjoyed a spike in business activity as a result of the pandemic, particularly 'remote services' such as e-commerce and delivery services. The ongoing uncertainty surrounding the health situation suggests these sectors will continue to be impacted by the crisis for a long time.

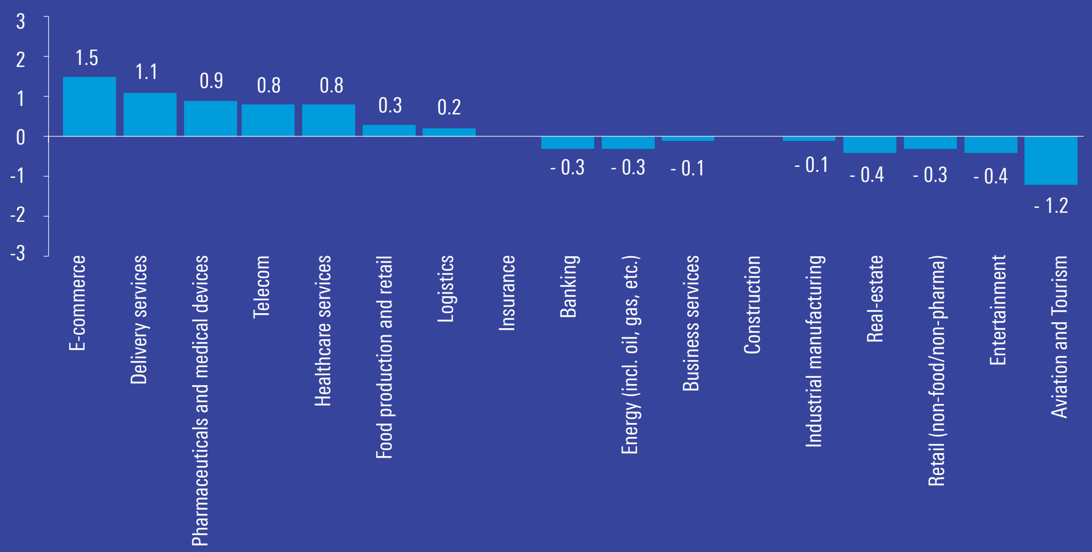
While most conventional industries such as industrials and logistics can expect a return to growth in 2021 as global markets slowly reopen, some sectors – aviation and tourism in particular – are expected to continue to see slow growth for a period of time.

EXPECTED ACTIVITY OVER THE NEXT SIX MONTHS (VERSUS SAME PERIOD 2019)



Source: KPMG survey

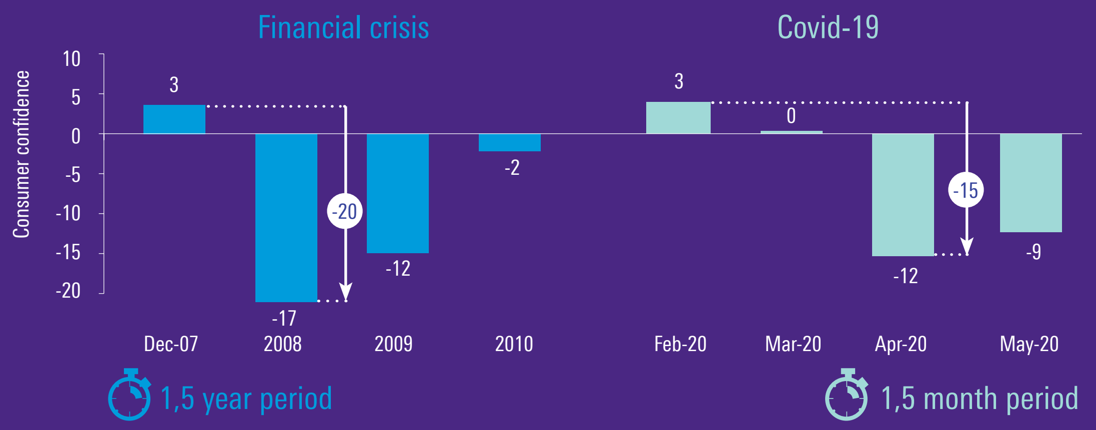
EXPECTED ACTIVITY FOR 2021 (VERSUS 2019)



Source: KPMG survey

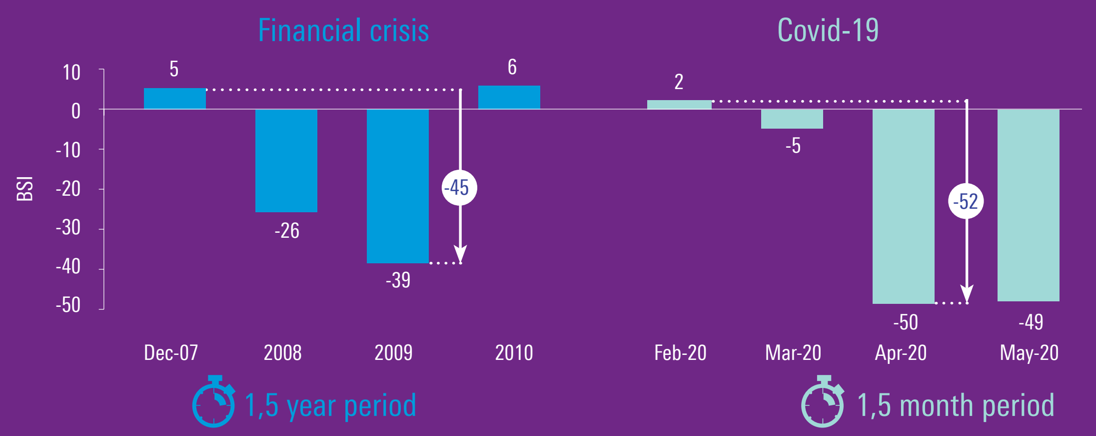
3 Increase > 50%
2 Increase 25% to 50%
1 Increase 5% to 25%
0 Stable +/- 5%
-1 Decrease 5%-25%
-2 Decrease 25%-50%
-3 Decrease >50%

CHANGES IN CONSUMER CONFIDENCE DURING THE GLOBAL FINANCIAL CRISIS AND COVID-19



Note: (a) Financial crisis: The consumer confidence for the years 2008-2010 is presented as the lowest point recorded in each year
Source: Danmarks Statistik, KPMG analysis

CHANGES IN BUSINESS SENTIMENT INDICATOR (BSI) DURING THE GLOBAL FINANCIAL CRISIS AND COVID-19



Note: (a) Financial crisis: The BSI for the years 2008-2010 is presented as the lowest point recorded in each year
(b) We have applied a base value of 0 instead of 100 as applied by Denmark's statistic.
Source: Danmarks Statistik, KPMG analysis

Danish consumer and business sentiment suffer historic drop

Business confidence fell 52 points from February to April 2020, plummeting to levels significantly lower than those experienced during the 2008/2009 Global Financial Crisis. Consumer confidence saw its highest bimonthly decline in recorded history.

Our view

In comparison to the Global Financial Crisis, both business and consumer confidence has fallen extraordinarily quickly. The 45-point decline in business confidence experienced during the GFC happened over a year and a half; the recent drops occurred over just two months.

While consumer confidence seems fairly buoyant in comparison to business sentiment, this may simply reflect popular optimism as the country began rolling back the more stringent lockdown measures in April. Businesses, on the other hand, recognise that growth will continue to be bumpy for some time; not surprisingly, the decline in business sentiment was largely driven by the services and retail sectors.

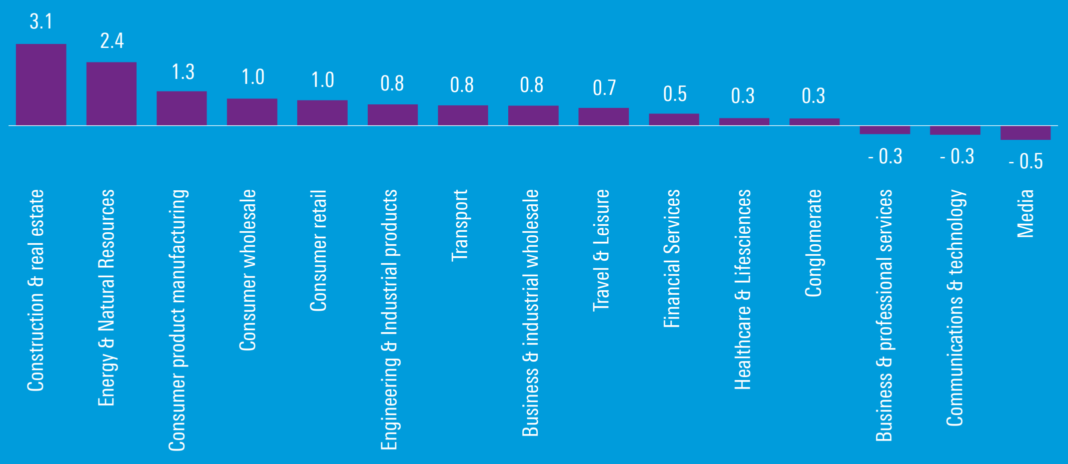
We expect both consumer and business confidence to start to rebuild during the summer as lockdown measures are further reduced and businesses start to fully reopen.

02

Sector analysis

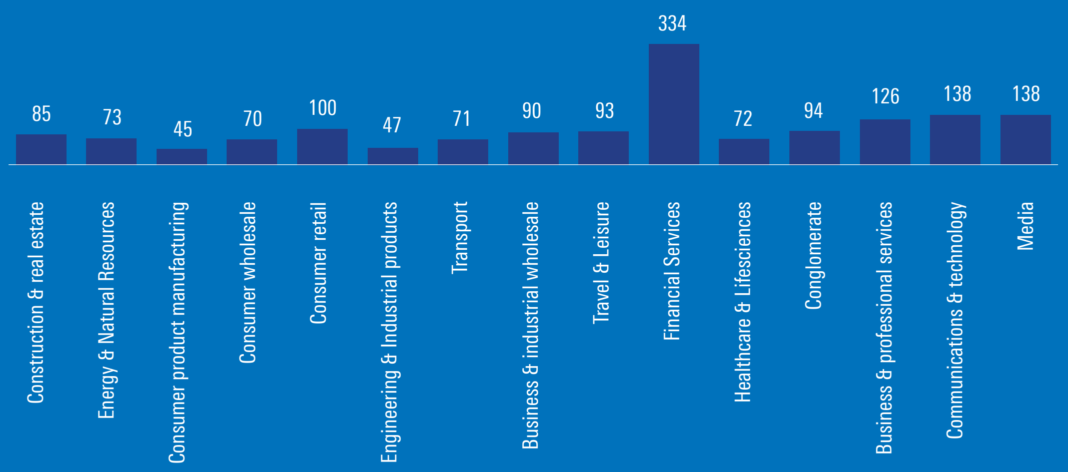
financial safeguards prior to the crisis

DEBT-TO-EQUITY AVERAGE BY SECTOR



Source: KPMG analysis

AVERAGE NUMBER OF DAYS OF ‘CASH BUFFER’ FOR FIXED COSTS BY SECTOR



Source: KPMG analysis

Highest-risk sectors lack financial safeguards in Denmark

Businesses with high debt-to-equity ratios and short cash runways will be at particular risk in a low or no-revenue environment. Those with a lower debt-to-equity ratio, on the other hand, may have opportunities to secure additional external funding to shore up cash reserves.

Our view

The combination of high gearing and low cash reserves is creating signif¬icant stress for many sectors in Denmark, particularly those that suffered from low or no-revenues as a result of the lockdown. As cash reserves dry up, many will find it difficult to secure new liquidity. Consumer-facing sectors seem at greatest risk.

However, it is not only companies with high debt-to-equity ratios and short cash runways that seem high risk. Both the travel and leisure sector and the transportation sector enjoy average burn rates overall, but due to ongoing uncertainty around travel restrictions, we view these sectors as high risk.

The high levels of gearing in the construction and real estate sectors, on the other hand, largely reflect the high leveraging common in these business models and do not pose a particularly high risk.

Significant financial exposure to distress constitute a high risk going into a crisis

Based on EBIT margins and compound annual growth rate (CAGR), at least 10 percent of companies across all sectors may be at high risk of potential financial distress. Judged by the more sophisticated Z-score approach, the percentage of companies at risk looks much higher.

Our view

By our calculations, these numbers suggest that more than 40,000 Danish companies may currently be facing a high risk of potential financial distress.

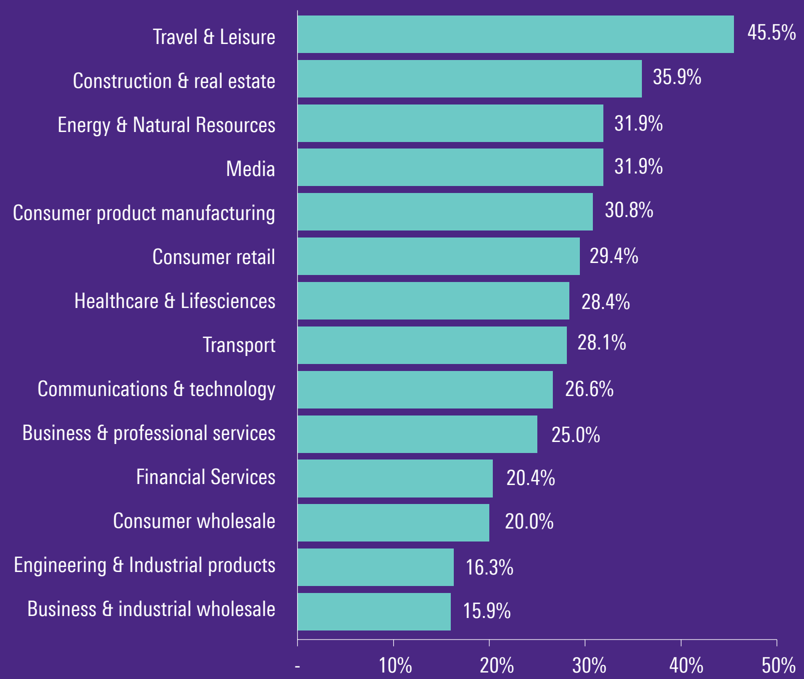
Once again, the travel and leisure sector seems particularly high risk. Based on Z-scores, nearly half of the companies operating in this sector before the crisis may soon find themselves in financial distress.

Viewed against the sector's high debt-to-equity ratios and high cash burn rates, travel and leisure seems particularly high risk.

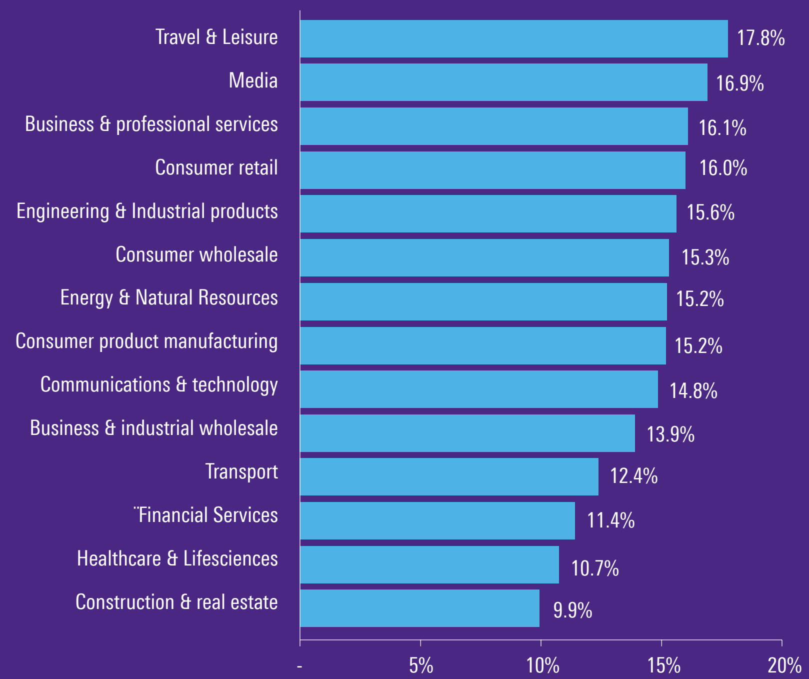
However, as with many aspects of this crisis, traditional measures do not always tell the full story. The fortunes of many consumer-facing organisations will largely depend on how they respond to shifts in supply chains and changes in consumer behaviour. The media sector, which the data suggests may be at high risk, may also prove more resilient due to low debt-to-equity levels and increased demand.

ESTIMATED RISK OF FINANCIAL DISTRESS BY SECTOR

% of companies at high risk based on Z-score



% of companies at high risk based on low growth/margin



Source: KPMG analysis
Note: The Altman Z-score is developed by NYU Stern PhD professor Edward Altman as indicator of risk of financial distress. Please refer to appendix for more details on our approach using the Altman Z-score including analysis of historical bankruptcies

Sector analysis

03 current impact and beyond

Estimated number of bankruptcies to almost double compared to last year

While bankruptcies in the first four months of the year have been slowed by the government's compensation packages, we expect to see a significant rise in the number of bankruptcies going forward.

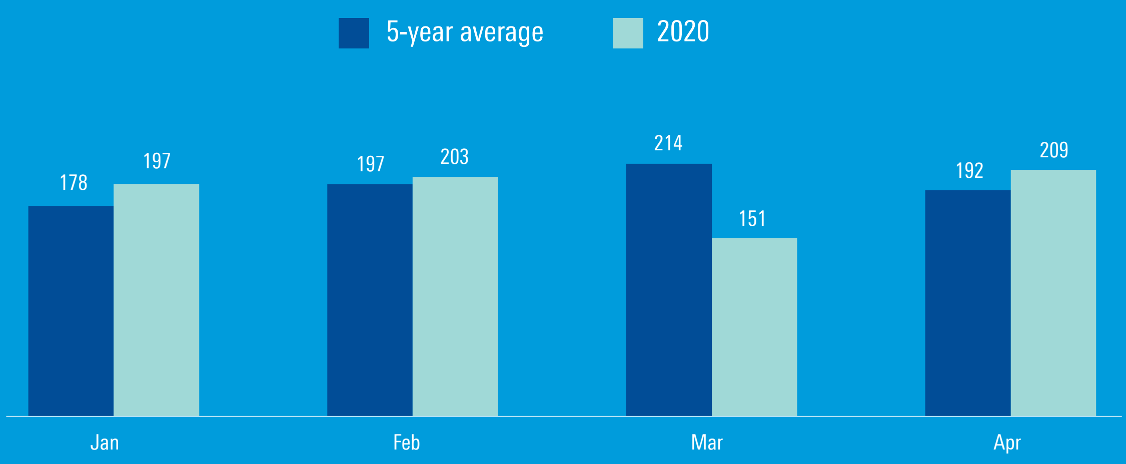
Our view

Data from the first four months of the year suggest a rise in the number of bankruptcies compared to the past five years with a sharp increase through April. Our view indicates that this is just the tip of the iceberg.

As our data have demonstrated, there are a significant number of companies currently at high risk of financial distress. Government compensation packages and emergency stimulus measures have indeed slowed the increase of bankruptcies, but we expect the number to skyrocket when then the current compensation packages end on 8 July.

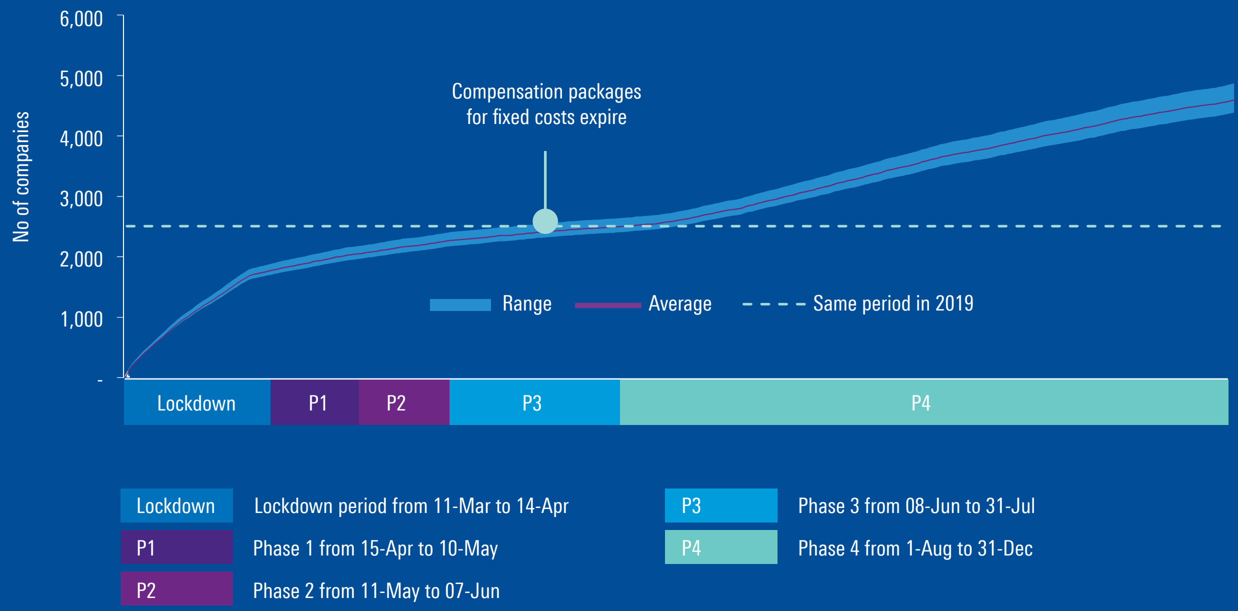
Our forecasts suggest that the Danish market will see the number of bankruptcies double this year, from around 2,500 in 2019 to more than 4,500 in 2020.

NUMBER OF BANKRUPTCIES JANUARY TO APRIL 2020 COMPARED TO 5-YEAR AVERAGE



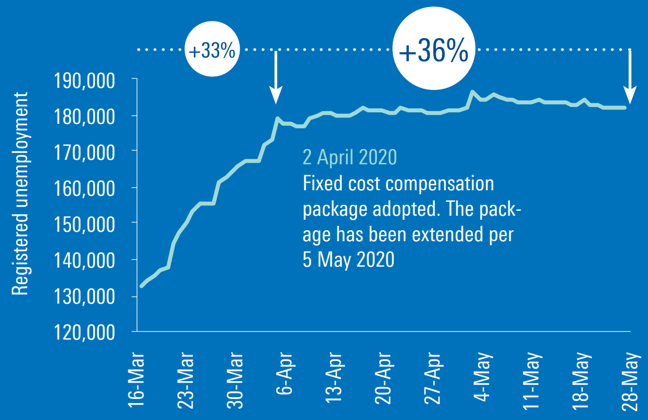
Source: Danmarks statistik, KPMG analysis

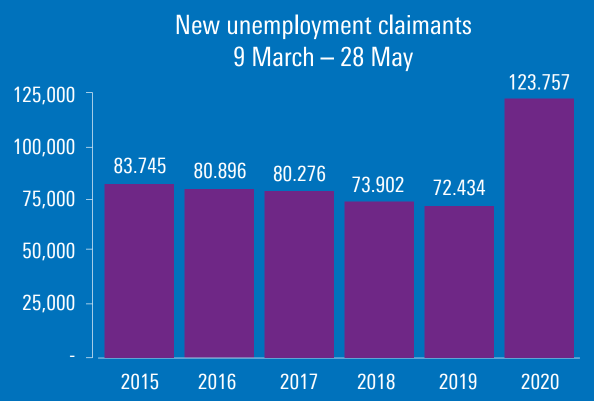
FORECAST OF BANKRUPTCIES (ACCUMULATED) 2020



Source: KPMG analysis

REGISTERED DAILY UNEMPLOYMENT (11 MARCH 2020 – 28 MAY 2020)



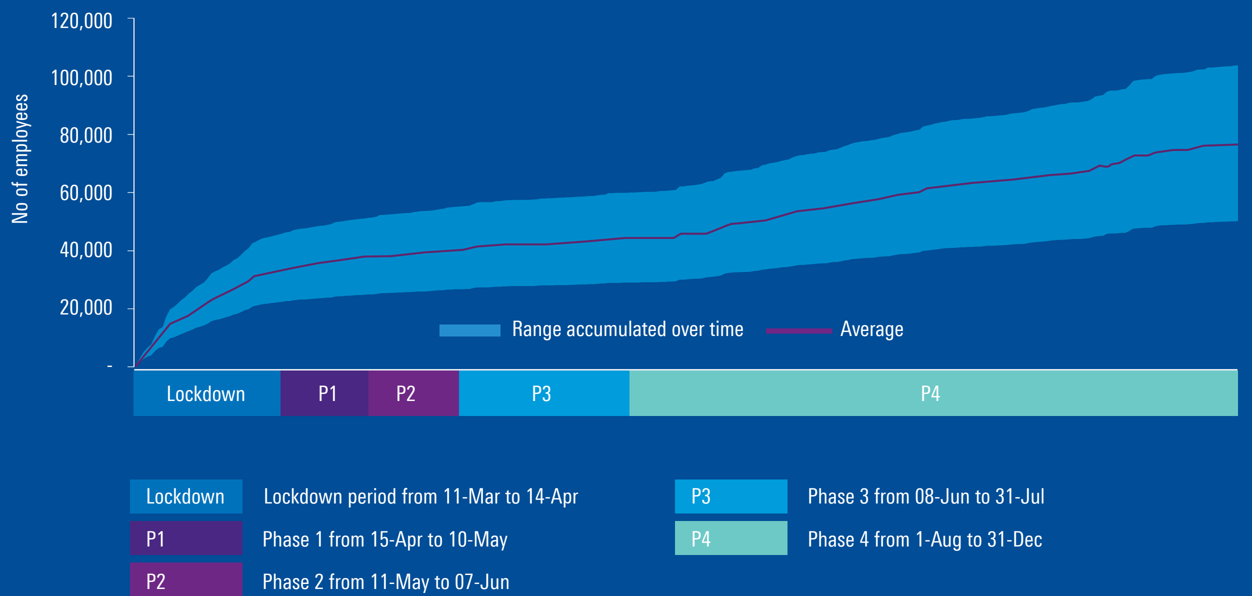


Note: (a)Registered unemployment: number of unemployed registered on Jobnet

Source: Danmarks Statistik, Jobindsats.dk, KPMG analysis

Source: Jobindsats.dk

FORECASTED NUMBER OF EMPLOYEES IMPACTED BY BANKRUPTCIES



Source: KPMG analysis

Unemployment levels to rise due to expected bankruptcies

Unemployment jumped 34 percent during the lockdown period. Government compensation packages have helped slow the rise since 2 April. But our forecast for the rise in unemployment suggests more than 70,000 jobs may be at risk.

Our view

While the unemployment rate skyrocketed in the first two weeks of the lockdown, it seems government compensation packages announced on 2 April 2020 may have softened some of the damage; unemployment climbed just 3 percent in the month following the announcement.

However, our view suggests that the unemployment rate is set to rise further over the coming year as compensation packages start to wind down and businesses start to file for bankruptcy.

Indeed, based on the bankruptcy forecasts presented earlier, we predict that around 70,000 people may be impacted over the coming months (broadly in line with predictions from De Økonomiske Råd). However, as highly impacted companies fight to avoid bankruptcies, even more jobs could be at risk due to cost cutting measures being implemented.

Financial distress will impact all sectors to varying degrees

Travel and leisure will see the most financial distress and is expected to shed the most employees. But financial distress in many other people-intensive sectors will also add to the unem¬ployment numbers.

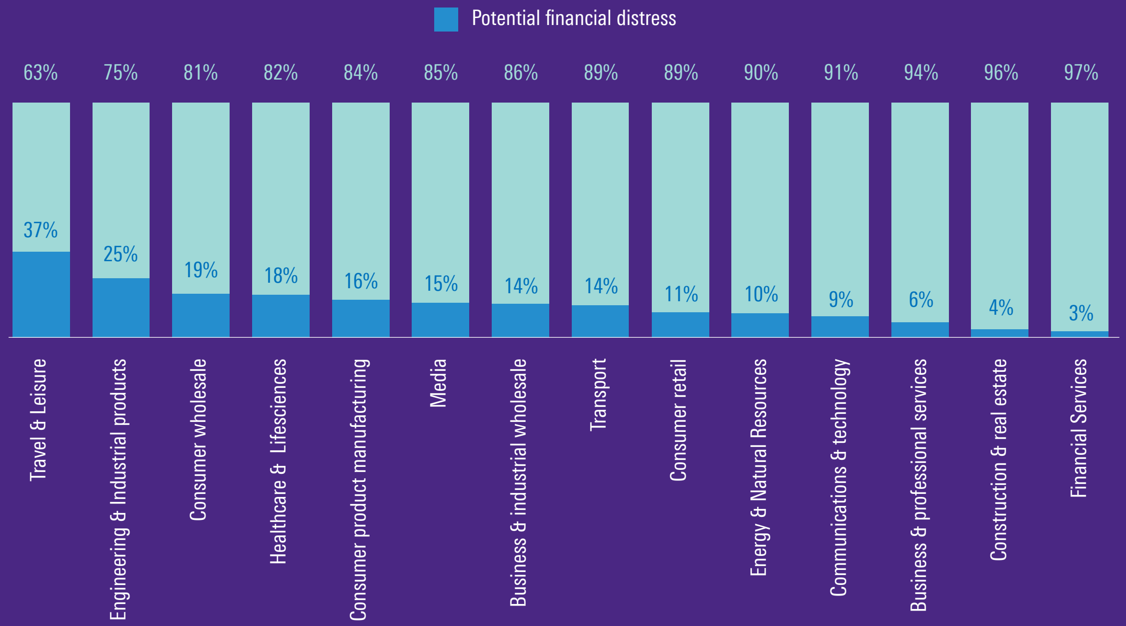
Our view

A combination of weak financial safeguards, high levels of revenue disruption and uncertain growth expectations put the travel and leisure sector under heavy stress. Our forecast suggests that around 37 percent of travel and leisure companies currently facing financial distress could file for bankruptcy, potentially impacting more than 39,000 jobs.

Other business sectors will also have a disproportionate influence on employment numbers. Just 6 percent of companies in the business and professional services sector are likely to go experience financial distress. Yet, due to their highly people-intensive business models, this could impact more than 28,000 jobs. Similar scenarios will, likely, be seen in the consumer retail and construction sectors.

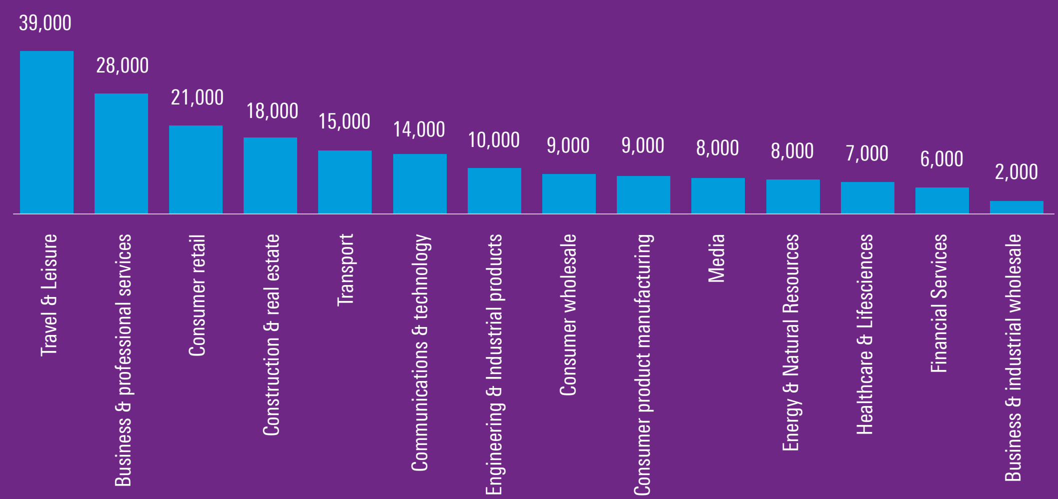
At the other end of the spectrum, while a significant percentage of consumer product manufacturers seem at high risk of bankruptcy due to changing consumer behaviour and the difficult export climate, heavy use of automation means that fewer jobs may be at risk.

PERCENTAGE OF COMPANIES FORECASTED TO BE IN FINANCIAL DISTRESS BY SECTOR



Source: KPMG analysis

FORECASTED NUMBER OF EMPLOYEES IMPACTED BY SECTOR



Source: KPMG analysis

How COVID-19 will change the world

The COVID-19 crisis has highlighted five key megatrends that will impact the Danish market. Here is our advice.

SHIFT TO LOCALISATION

- Shift towards local suppliers to reduce supply chain risk and costs
- Increased demand for personalised services and experiences.

SECTORS IMPACTED

- Transport and logistics
- Consumer retail
- Consumer manufacturing.

SUGGESTED ACTIONS

- Reconfigure global and regional supply chain flows
- Aggressively evaluate near-shore options to shorten supply chains
- Understand the post COVID-19 consumer and cater to new demands.

EMERGENCE OF SOCIALLY CONSCIOUS CONSUMERS

- Increased awareness of environmental and social impact
- Reluctance to travel internationally.

SECTORS IMPACTED

- Travel & Leisure
- Consumer retail.

SUGGESTED ACTIONS

- Take an empathetic view of your customers and their immediate needs
- Minimise reputational damage.

ACCELERATED DIGITALISATION

- Booming E-commerce
- Increased AI & IA in supply chain.

SECTORS IMPACTED

- Consumer retail
- Transport & logistics
- Manufacturing.

SUGGESTED ACTIONS

- Develop new digital communication platforms to engage your customers directly
- Embrace the digital possi¬bilities and align existing capabilities.

REDUCED TRADE AND EXPORT

- Governmental financial aid to domestic countries (skewing competiveness)
- Headwind for sub-suppliers to international value chains.

SECTORS IMPACTED

- Transportation & logistics
- Manufacturing.

SUGGESTED ACTIONS

- Assess broader industry or adjacent sector partnerships
- Bring products and technologies to new markets.

INCREASED DISTRESSED M&A ACTIVITY

- Expected wave of distressed asset acquisitions
- Securing portfolio companies.

SECTORS IMPACTED

- Private equity.

SUGGESTED ACTIONS

- Scan investment targets in potential financial distress
- Rapid diagnostic and holistic working capital and cash management improvement programs.

04

appendices

Appendix 1

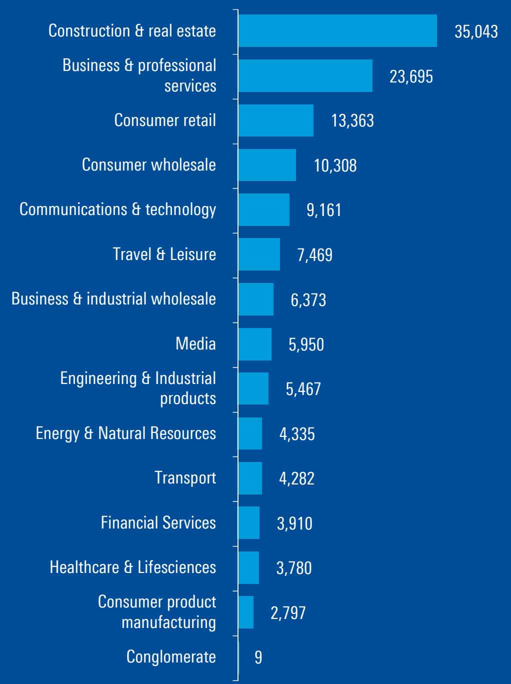
Basis of preparation

We have analysed a large population of companies in Denmark and prepared a bankruptcy forecast model based on this sample.

#135,942

Total number of companies included in our sample who have published annual reports in the period 2018-2020.

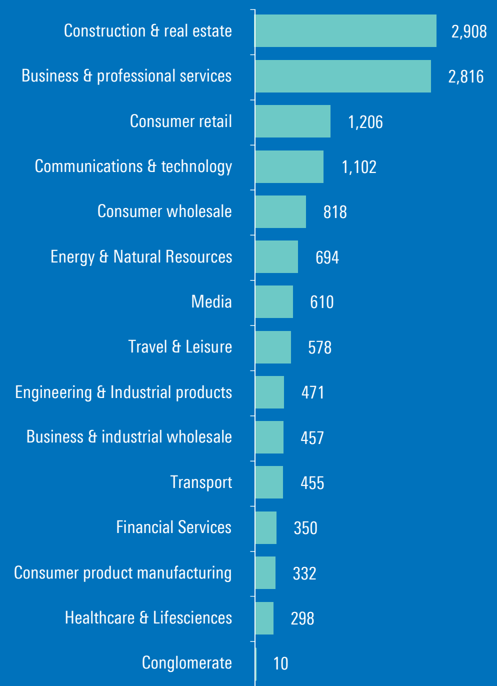
- All reports have been categorised to 15 different sectors



#13,105

Total number of companies reporting revenue and EBIT of more than one year.

- These are the companies we have used when analysing KPIs such as revenue CAGR and EBIT Margin



Assumptions

Our forecast model is based on the following assumptions:

1. Forecast period runs from March to December 2020 (this period was chosen as the Danish probate court was impacted by the national lockdown and has only been able to process a limited number of bankruptcy cases in this period)
2. Gross margin is fixed on latest announced annual report from the company
3. Companies are not scaling their fixed costs over the analysed period
4. Companies are allowed to finance cash scarcity by bank debt to a maximum of 50% of equity
5. Daily fixed costs are calculated as fixed costs/364 days and are paid daily
6. Daily gross profit is calculated as gross profit x revenue assumption in period/364 days and it is assumed that it reflects daily cash impact
7. Our revenue assumptions are prepared on sub-industry (94 sub-industries) basis and are based on revenue from the following sources:
    1. Statistics of Denmark survey on the Danish industry impact on COVID-19
    2. Survey based on 28 KPMG offices' expectations of COVID-19's impact on revenue across sectors
    3. Spending report from Danske Bank
    4. "Genåbning af fase 2: Økonomiske prioriteringer", Danish Ministry of Finance, 28 April.
8. If the company is expected to have a revenue reduction within the ranges of the fixed cost compensation package, we assume the company will be entitled to receive the full compensation applicable.

Appendix 2

There is a clear correlation between growth, margins, Z-score and distress

We use Altman Z-score, EBIT Margin and revenue CAGR to identify companies in financial distress. We have tested our metrics on all companies which have gone bankrupt since 2014.

Altman Z-score:

The Altman Z-score indicates if a company is in financial distress. A Z-score below 1.1 is in a high critical stage.

Our test of the Altman Z-score is based on 10,098 companies that were declared bankrupt since 2014.
Our conclusion states that the Altman score is highly relevant to use for prediction of bankruptcies.

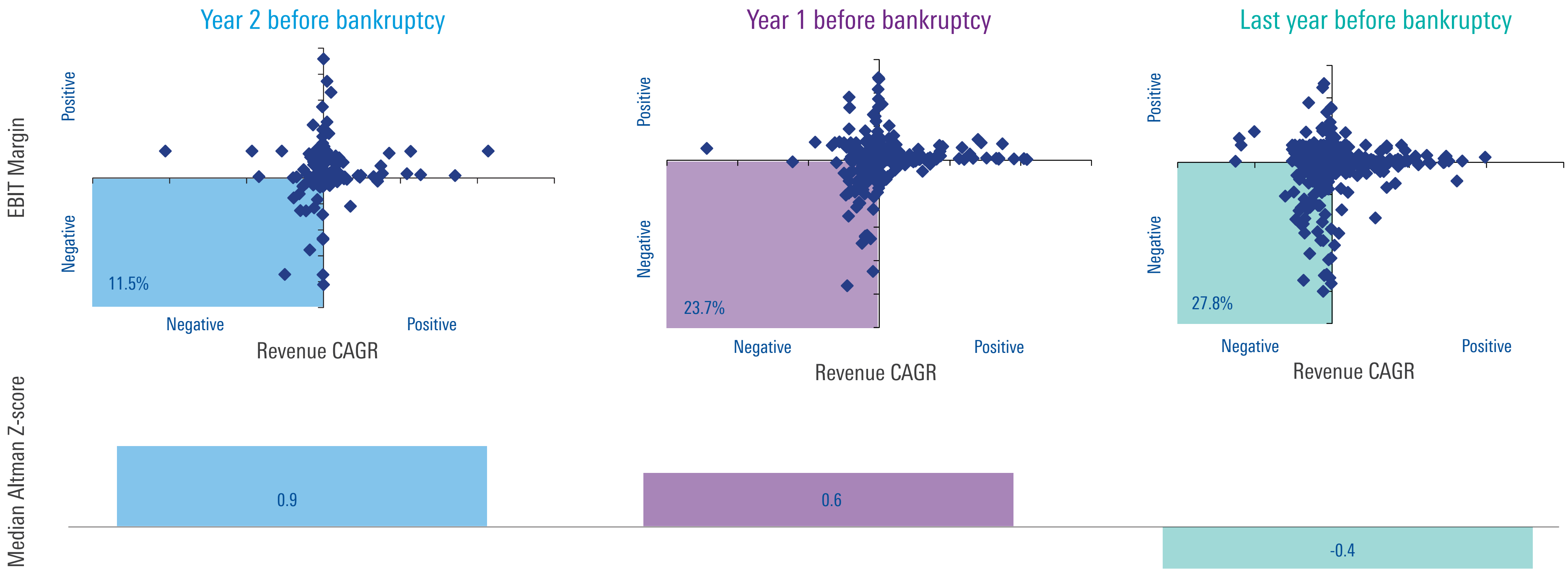
CAGR and EBIT Margin:

Revenue CAGR indicates that the company is able to grow its business. A revenue CAGR less than 2% indicates that a company is not able to grow more that inflation and will therefore be challenged.

EBIT margin indicates if the company is able to convert its revenue to positive cashflow. If the company has a negative margin, it is burning cash and will, over time, go bankrupt.

Our test sample indicates that an increasing number of companies show negative growth and EBIT margin before they go bankrupt.

INDICATORS FOR FINANCIAL DISTRESS – ANALYSIS OF 10K HISTORICAL BANKRUPTCIES BETWEEN 2014 AND 2019



Source: CVR, KPMG analysis

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