Restructuring Study 2015

Business in Switzerland: under pressure

Deal Advisory

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Contents

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Summary

This KPMG restructuring study shows that the current strength of the Swiss franc in particular has meant a significant worsening of the economic situation for many Swiss companies. Accordingly, 45% of companies surveyed categorize their present state of business as negative. One of the main reasons for this is the intensive price pressure domestically and internationally. Although some companies may have intended to transfer this price pressure to their business partners, this option is very limited and at best delivers only time in which to make the necessary structural adjustments.

These changes in the market environment have also been reflected in negative assessments of Switzerland as a business location. Accordingly, 64% of those surveyed estimated the country's competitive potential to have declined since the previous year. The strong Swiss franc has proved a particular difficulty for Swiss companies, with 16% of those surveyed seeing it as a threat to their very existence.

In terms of politics, companies are most worried by the possible abrogation of Switzerland's bilateral agreements with the EU: nearly two thirds of all those surveyed believe this would have negative or even potentially fatal consequences for their organization. There is also some corporate uncertainty about the Swiss Corporate Tax Reform III, currently under parliamentary review: 73% view the potential consequences as neutral.

Overall, in spite of these uncertainties, companies are continuing to look to the future and are pursuing a proactive course aimed at innovation and expansion, rather than focusing only on cost-cutting. However, about 40% of those respondents that assessed the market environment as negative are currently carrying out or planning restructuring measures.

Ultimately, the healthy business operations and generally conservative financing practised by many Swiss companies in past years have ensured that they now have sufficient reserves on hand. Accordingly, many companies are not yet seeing any acute capital or liquidity problems, despite the unfavorable economic environment.

Preface

Recent years have seen some dramatic changes in the regulatory and political framework in which Swiss companies operate. The highest profile of these include the approval of the federal popular initiative against mass immigration in February 2014, the Swiss National Bank's decision in January 2015 to remove the minimum exchange rate against the euro and to introduce negative interest rates, and the uncertainty surrounding the Swiss Corporate Tax Reform III.

Developments in the national economy, such as Swiss companies' increasing integration into global markets and the technological changes resulting from digitalization, are further important factors. In this context, and also due to significant changes in the behavior of corporate and individual customers, many companies have been forced to reevaluate their business model.

At the same time, the very viability of some Swiss economic activities, even those with a traditional background and strong local roots, is being seriously called into question.
The situation is particular acute in certain key industries, such as manufacturing for export, retail, tourism, construction and the energy sector.

KPMG has carried out a study based on a survey of about 80 Swiss companies, in order to investigate the impact of these developments on Switzerland as a business location. In this document, we are pleased to present a summary of our findings from this first KPMG restructuring study.

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Findings

This study surveyed a total of 81 companies belonging to the following sectors:

46% Industry and manufacturing

24% Services

18% Consumer goods and retail

12% Construction and energy

Of the participating companies, 63% employ fewer than 250 personnel; the remaining 37% are larger companies.

believe that Switzerland is less competitive as a business location than in the previous year

Most popular measures

Strategic

Growth and sales programs **65%**
Innovations programs **58%**
Adjustments to the product portfolio **56%**

Operative

Optimization of procurement **83%**
Optimization of IT **52%**
Personnel-related measures **45%**

Financial

Optimization of net working capital **72%**, including by means of adjusted or more intensively exploited payment terms **32%** or short-term liquidity planning **42%**

The top macro-economic cause of competitive deterioration is the removal of the minimum exchange rate against the euro

71%

negative consequences

of which

16%

see it as "potentially fatal"

Companies are suffering most from a decrease in profitability

58%

due to lower sales figures

47%

35% currently implement restructuring measures,

19% or plan to (primarily in the consumer goods, retail, construction and energy sectors)

Of surveyed companies in all industries, about

45%

view their current business outlook as negative.

have noted price pressure within Switzerland,

69% beyond Switzerland

Among consumer goods and retail companies, this figure rises to

83%,

but among construction and energy companies only

51%

Swiss economy struggling with the consequences of the Swiss franc shock

The removal of the minimum exchange rate against the euro on 15 January 2015 adversely affected Swiss economic growth in the first quarter of 2015. According to the State Secretariat for Economic Affairs (SECO), after a weaker first quarter real GDP rose slightly in the second quarter, and stagnated in the third quarter of 2015. Assuming that the economic situation especially in the eurozone is due to recover, SECO expects Swiss GDP growth of 0.9% for 2015 and 1.5% in 2016. Due to the sluggish economy, SECO has predicted that unemployment levels will rise next year from an average of 3.3% to 3.6%.

KPMG's assessment

The economy has until now been bolstered, *inter alia,* by household consumption, but in view of the forecasted rise in unemployment, the uncertainty regarding future immigration levels and the effects related to 'shopping tourism', we expect the economic stimulus of consumer spending by private households to decline in the future. Retail businesses located near the country's borders will continue to suffer most from the strength of the Swiss franc.

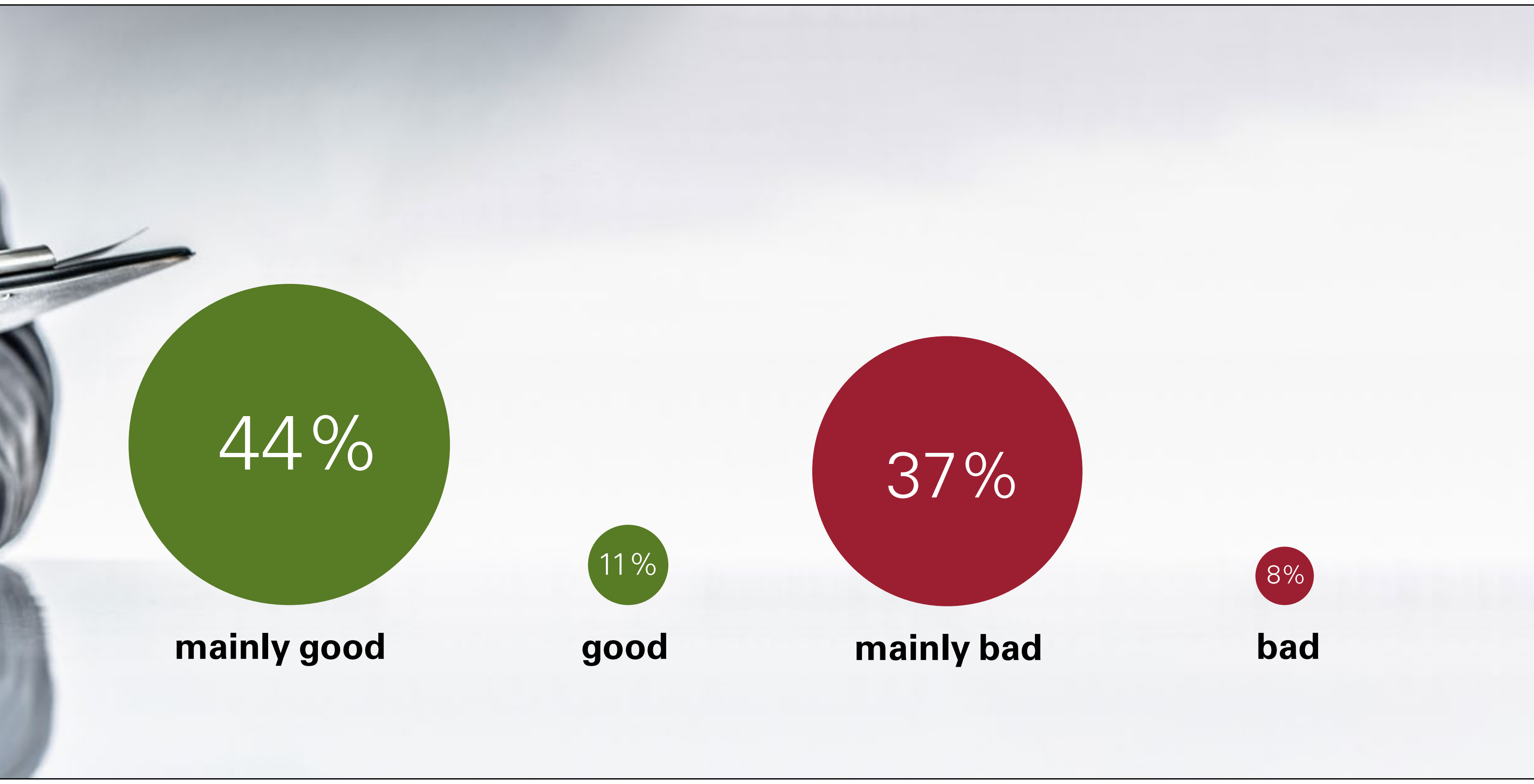
How do you view your company's current economic situation?

Nearly half of companies are doing badly

The challenges resulting from the appreciation of the Swiss franc between 2008 and 2011 were once again dramatically accentuated for Swiss businesses in January 2015. In the wake of the currency shock, overall economic performance slowed in the first quarter of 2015 and the situation remains somewhat fraught. Correspondingly, about 45% of participants in our survey described their current circumstances as "bad" or "mainly bad". However, 55% of surveyed companies described their current business outlook as "mainly good" or "good", in spite of the challenging environment.

KPMG's assessment

The abrupt revaluation of the Swiss franc had immediate consequences in several sectors: electronics retailers, for example, were faced with cheaper deals from competitors in border regions just a day after the SNB's announcement. In other sectors, the process of adjustment happened much more slowly, and in some cases is not yet concluded. We expect that the full consequences will not be apparent before mid-2016, 18 months after the event. Further repercussions are bound to surface even later. This will affect in particular integrated suppliers of specialized components, which regularly supply their consumers under framework agreements. Replacement of these partners takes longer due to reconciliation and quality requirements and notice periods. There is a risk that these types of orders may be irrevocably lost.



Industry trends hold few surprises

At the moment, the service sector appears to be least affected by the current challenges: 73% of companies surveyed described their economic outlook as "mainly good".

Fallout from the Swiss franc shock is being felt most strongly in industrial and manufacturing companies active in the export market. More than a third (38%) of the industrial and manufacturing companies surveyed described their situation as "bad" or "mainly bad", but only 21% as "good". A key factor appears to be the significant price pressure from domestic and international customers. For example, according to SECO, exports of machinery and electronics proved negative in the third quarter of 2015, the sixth successive negative quarterly result - a negative trend that has been significantly exacerbated since the first quarter of 2015. The watchmaking industry has had a similarly unsatisfactory year to date. For this sector, the effect of the strong franc coincided with the anti-corruption campaign in China and the slowing economy in Asia as a whole, resulting in the largest minus in the export of Swiss watches since 2009.

The situation is similarly bleak in the construction and energy sectors. It is worth noting that the energy industry has been faced with new challenges due to the gradual deregulation of the market, since 2008 for major customers and since 2014 for smaller and private customers. Business in the construction sector was particularly hard hit in tourist regions by the second home initiative (according to SECO, investment in construction dropped by 0.9% in the

How do you view your company's current economic situation (by sector)?

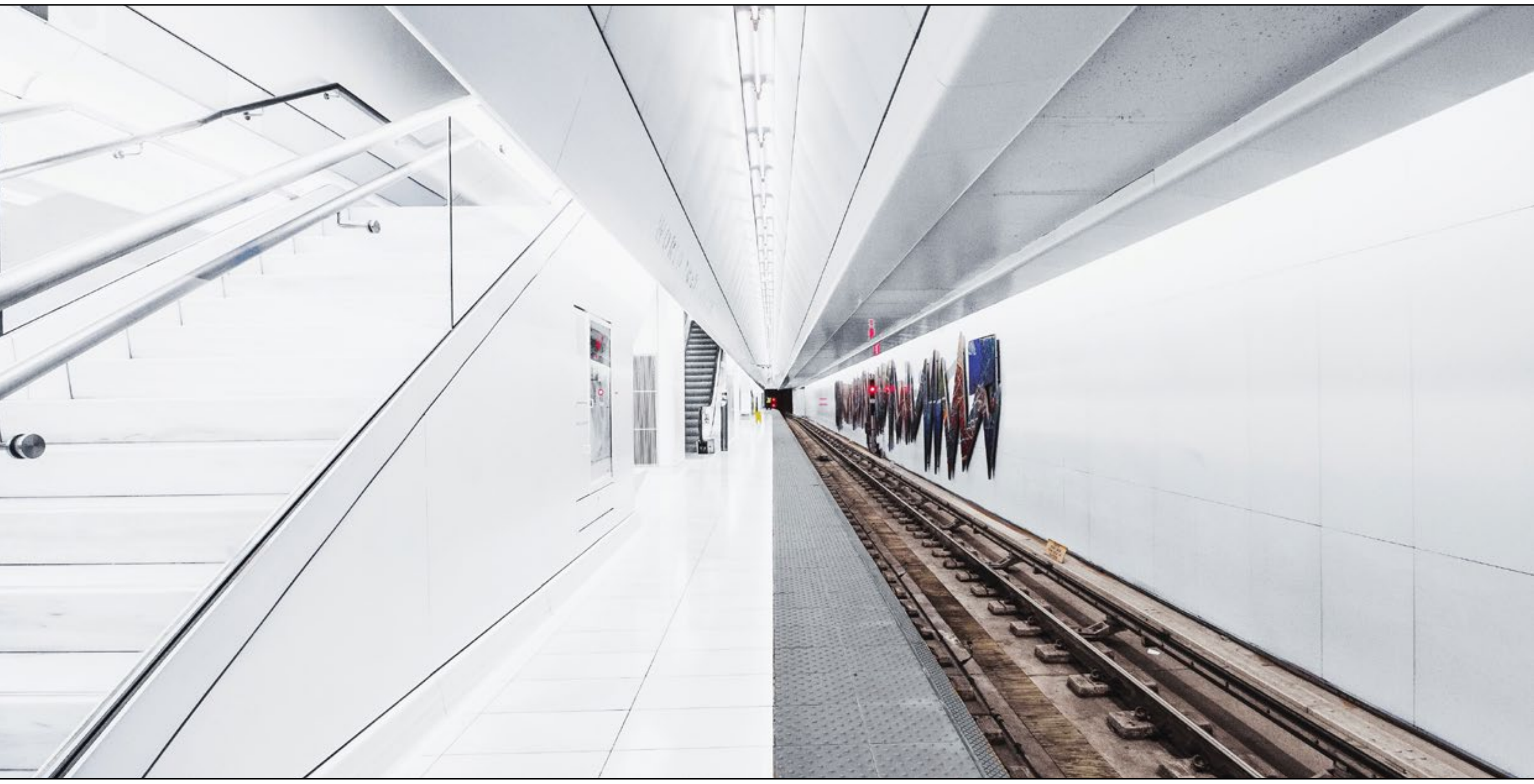
third quarter of 2015). Half (51 %) of companies surveyed in these two sectors described their current situation as "mainly bad" or "bad".

However, the consumer goods and retail sectors are most seriously affected by the current economic environment: 83 % of these companies described their current business outlook as "mainly bad" or "bad". It has been estimated that the negative effect of 'shopping tourism' in 2015 will total about CHF 9 billion[1].

KPMG's assessment

Although both the continuing rate of immigration and past price reductions are stimulating consumption, the impact of certain key factors on the economy as a whole is as yet unknown. On the one hand, retailers are being faced with challenges such as 'shopping tourism', digitalization and changes in consumer behavior. On the other hand, customer consumption is being encouraged by discounts and house ownership by low interest rates. Future developments in the unemployment level, actual earnings and future rates of immigration may have noticeable consequences for the consumption that until now has bolstered the economy.

[1] (Source: Stoffel Zurich, shopping center market report 2016)



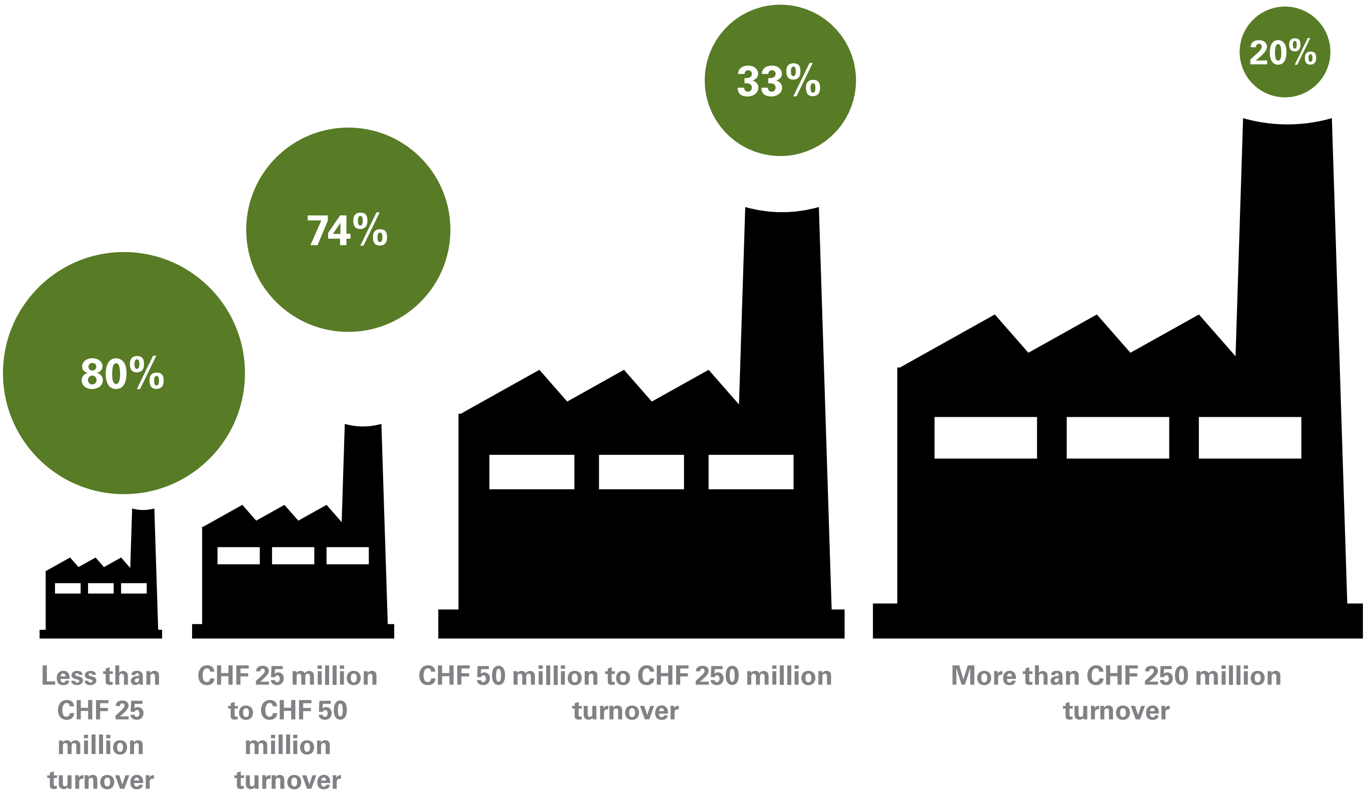
Larger companies suffering more

The results of our survey show a negative correlation between a company's size and its current economic situation. Thus, companies with turnover below CHF 25 million have, on average, proved significantly more positive about their circumstances than businesses with annual turnover in excess of CHF 50 million. Three quarters of respondents with turnover below CHF 50 million assessed their present state of business as "good" or "mainly good". In contrast, only 33% of medium-sized companies with a turnover of between CHF 50 million and CHF 250 million reported a "good" or "mainly good" situation, a self-assessment echoed by only 20% of larger companies with a turnover of more than CHF 250 million.

KPMG's assessment

In our view, this correlation can be attributed, among other factors, to the fact that larger companies tend to have a higher degree of internationalization and can not react to changes as swiftly as smaller businesses.

Proportion of companies in a "good" or "mainly good" economic situation



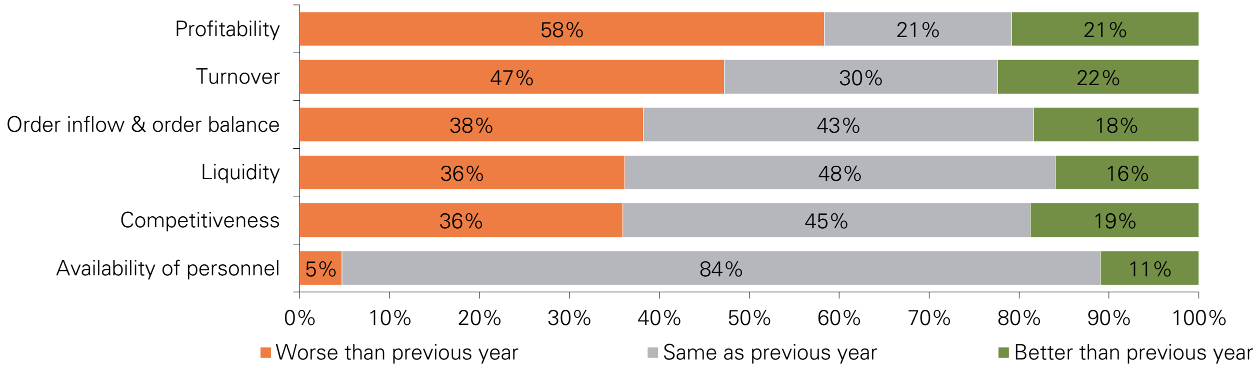
Turnover and profit largely in decline

Of the surveyed companies, 58% found that their profitability had declined in comparison with the previous year; 47% reported a decline in turnover and 38% fewer orders received. A drop in incoming orders is an advance indicator of a potential slump in sales. Price pressure, on the other hand, leads to narrower gross margins, which, when the company's cost structure is insufficiently flexible, results in lower profits.

In terms of liquidity, more than a third of companies said they were worse off than in the previous year ("the same" for about 45%, "better" for 16%), which can be explained not least by the loss in value suffered by customer credit balances in foreign currencies. Similarly, more than a third of companies surveyed reported a decline in their overall competitiveness from the previous year: 45% saw no difference and 19% even improved in this respect from 2014.

Only 5% of respondents reported deterioration in the availability of personnel. This may have been influenced by the rise in unemployment and the continuing positive immigration figures.

How have the following parameters changed for your company compared with the previous year?



KPMG's assessment

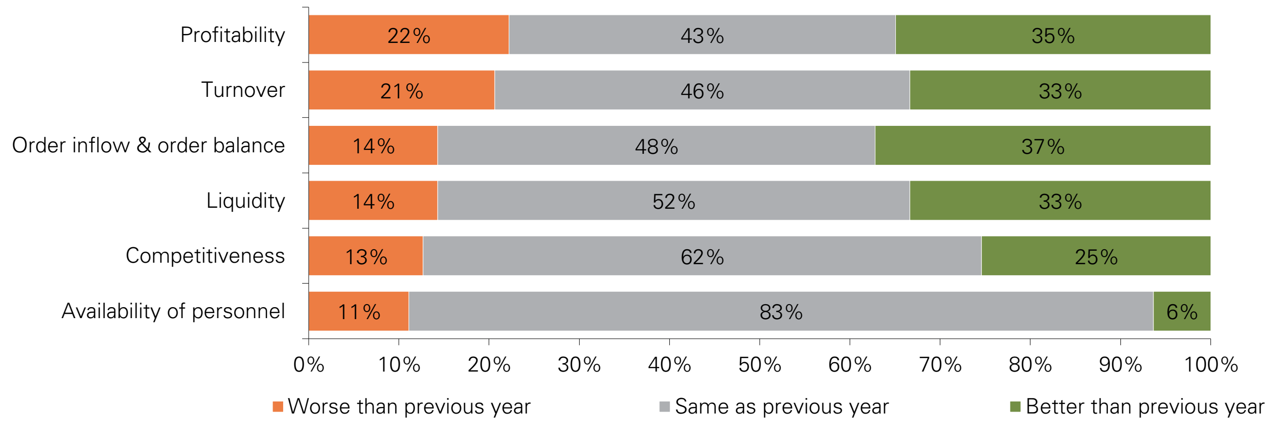
Supply of qualified skilled personnel may become a risk factor
The results of our survey show that the companies questioned are not currently experiencing any acute shortage of skilled personnel. This situation is expected to remain the same next year; however, this can be said only of the specific industries included here. Other sectors, such as healthcare, can be assumed to be experiencing quite different trends.

We assume that the demand for skilled personnel has been met in recent years by the increasing immigration. Currently and next year, availability of personnel should continue to pose no significant problem to Swiss companies, owing to slender economic growth and the downsizing and relocation that is increasingly being planned across all sectors.

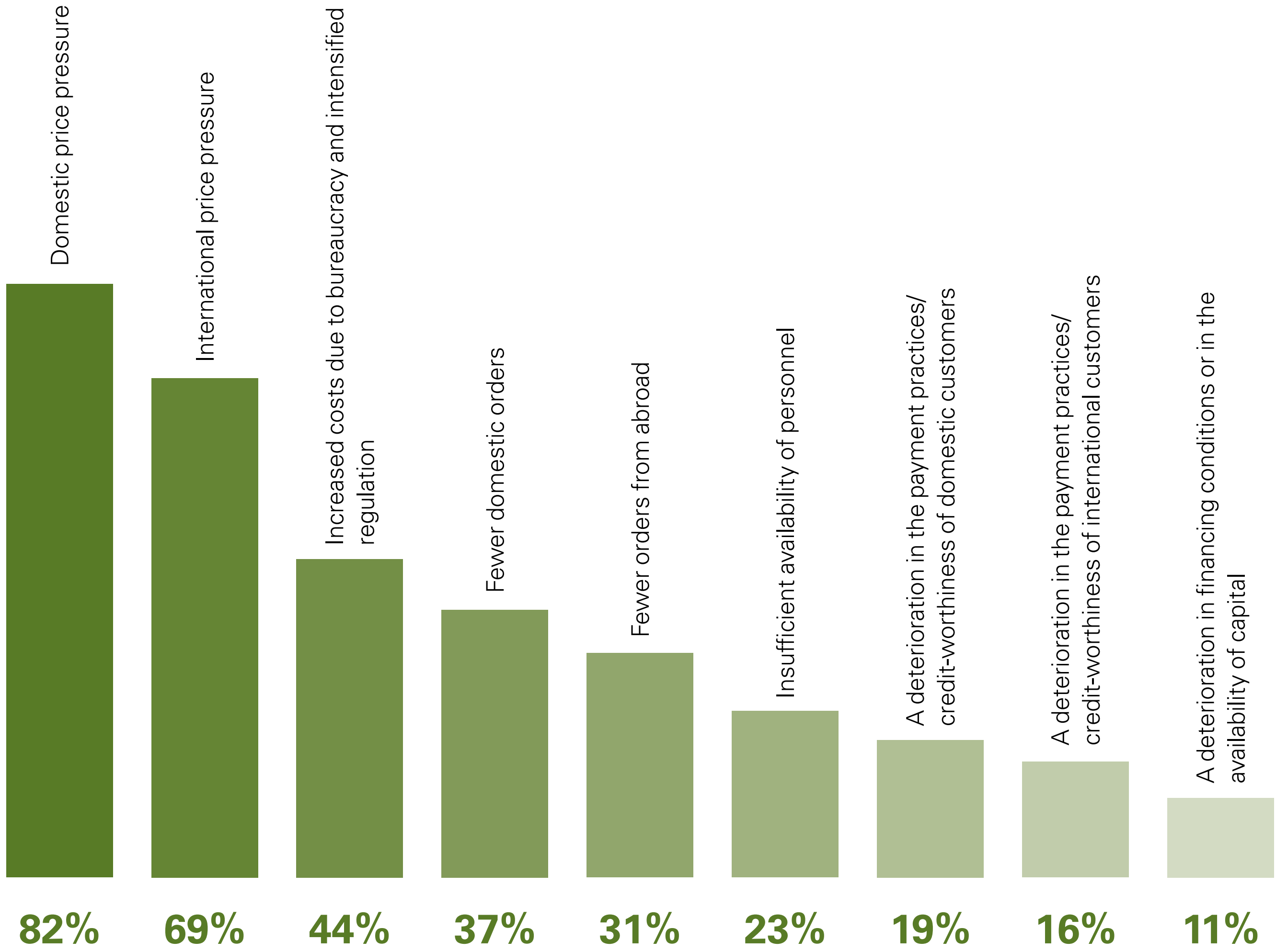
Depending on the design for the implementation of the mass immigration initiative, and how this affects the current bilateral agreements with the EU, we nevertheless consider that a shortage of skilled personnel may potentially be a medium-term risk and a limiting factor in the long-term growth of the Swiss economy.

A majority of respondents expects the business outlook for the coming year to remain the same or improve on the current situation. In particular, respondents foresee positive developments in terms of profitability (35%) and orders (37%). Overall, the percentage of respondents that predict an improvement is much larger than the number that continues to expect a change for the worse. The sole exception relates to the issue of personnel availability, where a majority of those surveyed expects the situation to remain unchanged.

How do you expect the following parameters to change for your company in the next year?



Is your company currently experiencing one or more of the following factors?



Where companies' assessments are currently negative, this is primarily due to price pressures, as mentioned by 82% (domestic price pressure) and 69% (international price pressure) of those surveyed. This in turn can be traced back to factors including the SNB's announcement of 15 January 2015: the stronger franc has had a clearly adverse effect on Swiss companies' cross-border competitiveness. Conversely, price benefits on imports largely have to be handed on to the customer (vehicles, clothing, furniture, etc.). For example, since the start of the year foreign companies have been taking advantage of the currency environment to gain market share with attractive prices.

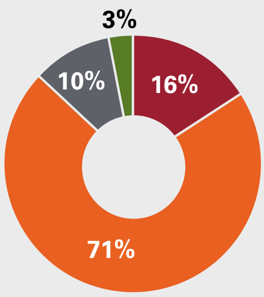
In connection with price pressure, 37% of those surveyed reported a drop in domestic orders and a 31% drop in orders from abroad. Alongside the repercussions of the SNB's decision, the most significant challenge is in the form of a reported increase in bureaucracy and regulation (44%). However, this phenomenon is not felt to the same degree by all sectors: our survey found that energy suppliers are the most affected by bureaucracy and intensified regulation.

Mood of pessimism in Switzerland's business sector

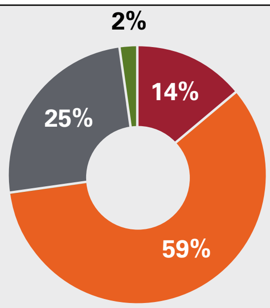
The survey illustrates just what effect the removal of the minimum exchange rate against the euro has had on Swiss companies: 71% of businesses questioned see the consequences of the current strength of the franc as negative and 16% as potentially fatal. This is particularly true in the case of companies (including in the tourism sector) where the business model means income is generated abroad, but (personnel) costs are incurred in Switzerland. Where there is a lack of differentiation, poor competitive capacity inevitably impacts profit margins. Participants in the survey view any potential renegotiation of the bilateral agreements with the EU as a comparably serious potential threat: 59% fear that such a move will have negative consequences for their company, while 14% believe it may be potentially fatal.

This issue, as with the above findings on personnel availability, again highlights the significance of the mass immigration initiative on corporate competitiveness. Although the initiative as passed in the recent referendum is regarded as negative for companies by 56% of those surveyed, only 2% see it as a long-term threat to their company's overall viability.

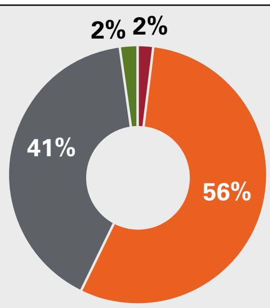
How do you assess the impact of the following economic or political developments on your company and its competitiveness?



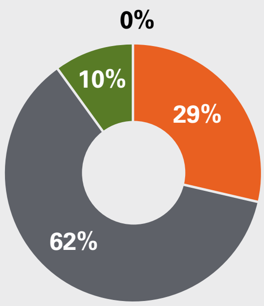
Removal of euro minimum exchange rate



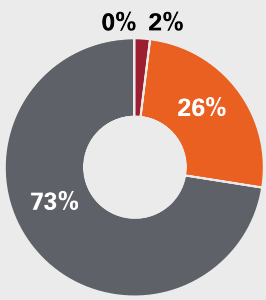
A potential abrogation of bilateral agreements with the EU



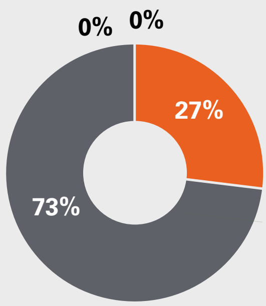
Popular initiative against mass immigration (restriction on overseas workers)



Popular initiative against excessive remuneration (Minder Initiative)



Uncertainty due to the Swiss Corporate Tax Reform III

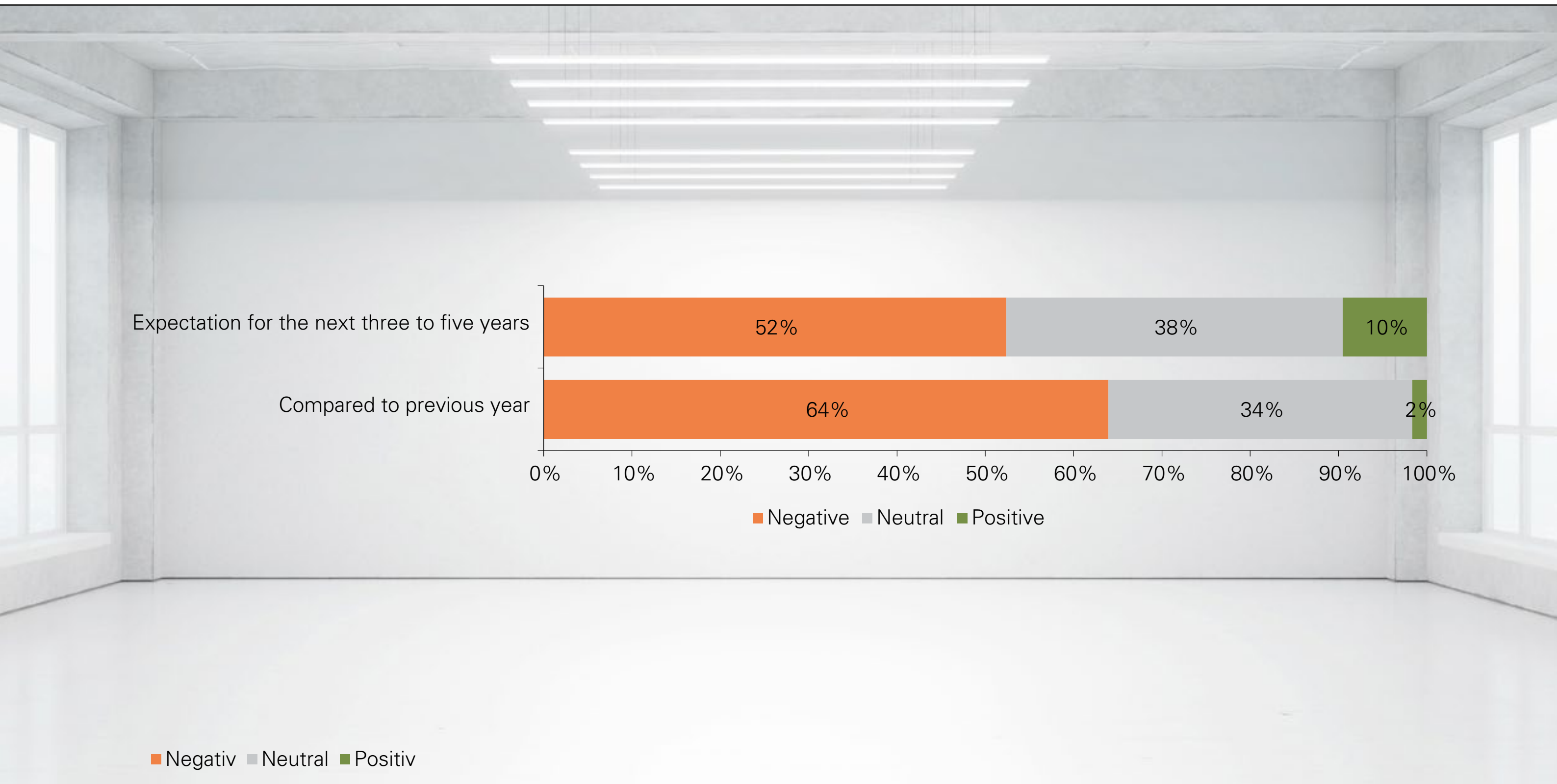


Base erosion and profit shifting (BEPS) OECD measures catalog59

Potentially fatal   Negative   Neutral   Positive

In summary, respondents predict that due to various economic and political phenomena, their companies will become less competitive in Switzerland in the short and medium-term. As the EU is Switzerland's main trading partner, the exchange rate of the franc against the euro is likely to have been a key factor in this assessment. A decline in Switzerland's attractiveness as a business location was perceived, primarily by survey participants from the consumer goods and retail sectors (75%), and from industry and manufacturing (71%).

What changes have you seen in Switzerland's competitiveness as a business location?

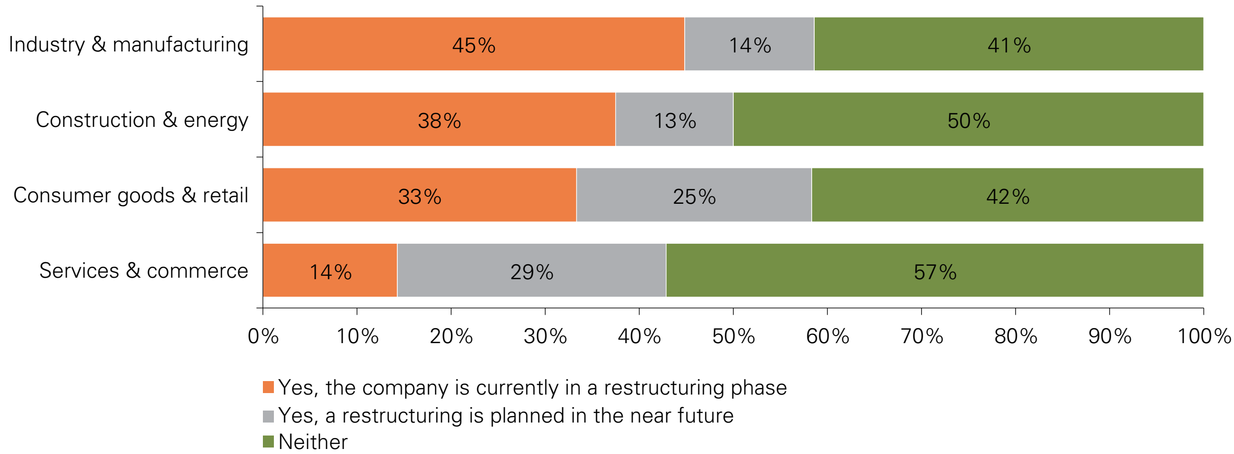


Proactive countermeasures or wait and see?

Switzerland's uncertain economic climate is reflected in companies' restructuring activities. About 35% of companies surveyed said that they are currently engaged in concrete restructuring measures. A further 19% are planning to carry out such measures in the near future.

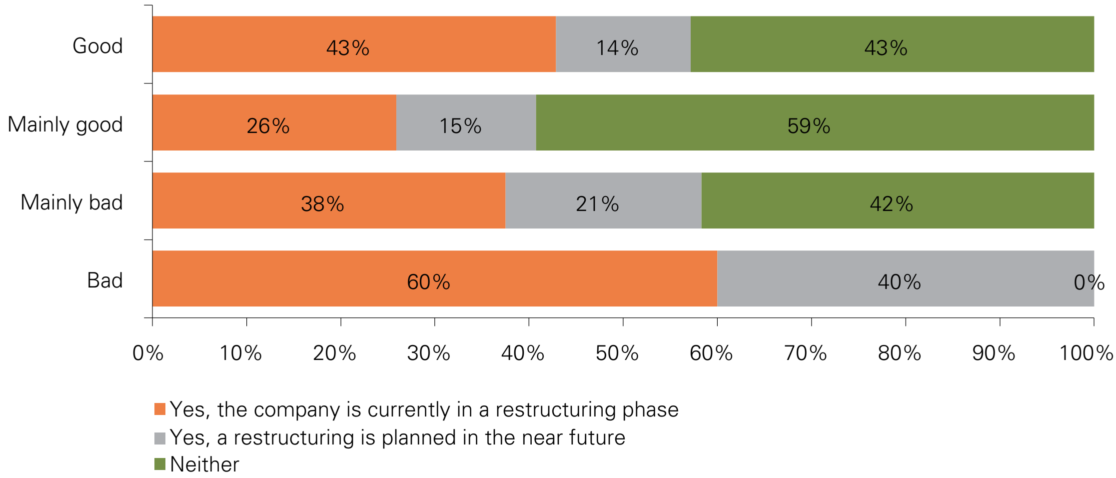
Restructuring activities are particularly high in the industrial and manufacturing sector: 59% of those companies reported engaging in or planning a restructuring phase. The construction and energy sectors (51%) and retail industry (58%) reported a similar level of restructuring activity, while there is lower engagement in the service sector (43%).

Is your company currently undergoing a restructuring phase, or are you planning to carry out restructuring measures in the near future (by sector)?



Those companies that described their current business situation as "bad" are currently engaged in (60%) or are planning (40%) a restructuring phase. Of those companies that described their current business situation as "mainly bad", 42% are not implementing or planning any restructuring measures.

Is your company currently undergoing a restructuring phase, or are you planning to carry out restructuring measures in the near future (by business location)?



KPMG's assessment

Use the momentum of restructuring situations to fully exploit potential

As the survey shows, 42% of companies that described their current business situation as "mainly bad" are not implementing or planning restructuring programs. We suspect that these companies assume that the deterioration will be only temporary and believe it to be a dangerous strategy.

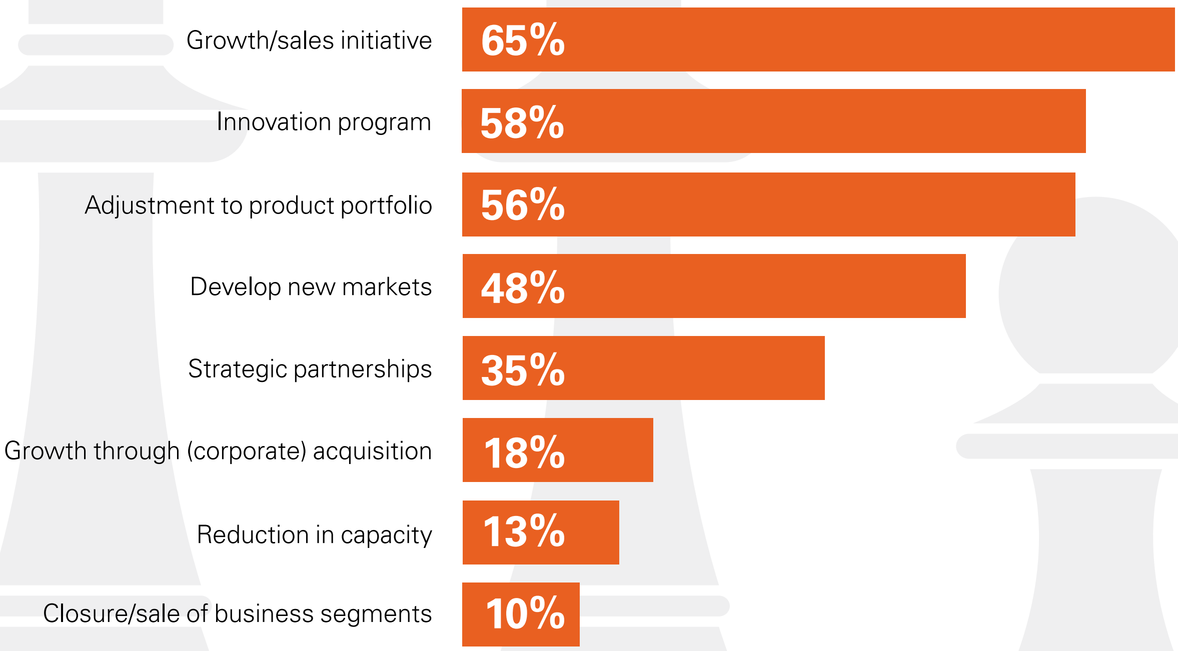
In our view, a period of crisis is a good time to implement company measures that may have been deferred or which may be unpopular. Experience has shown that in such phases, personnel are more willing to accept change and have a better understanding of the situation than in times when the outlook is better. Therefore, we believe that many companies can potentially increase their long-term competitiveness by carrying out concerted restructuring projects. In addition, we do not consider the current economic downturn to be merely a short-term phenomenon.

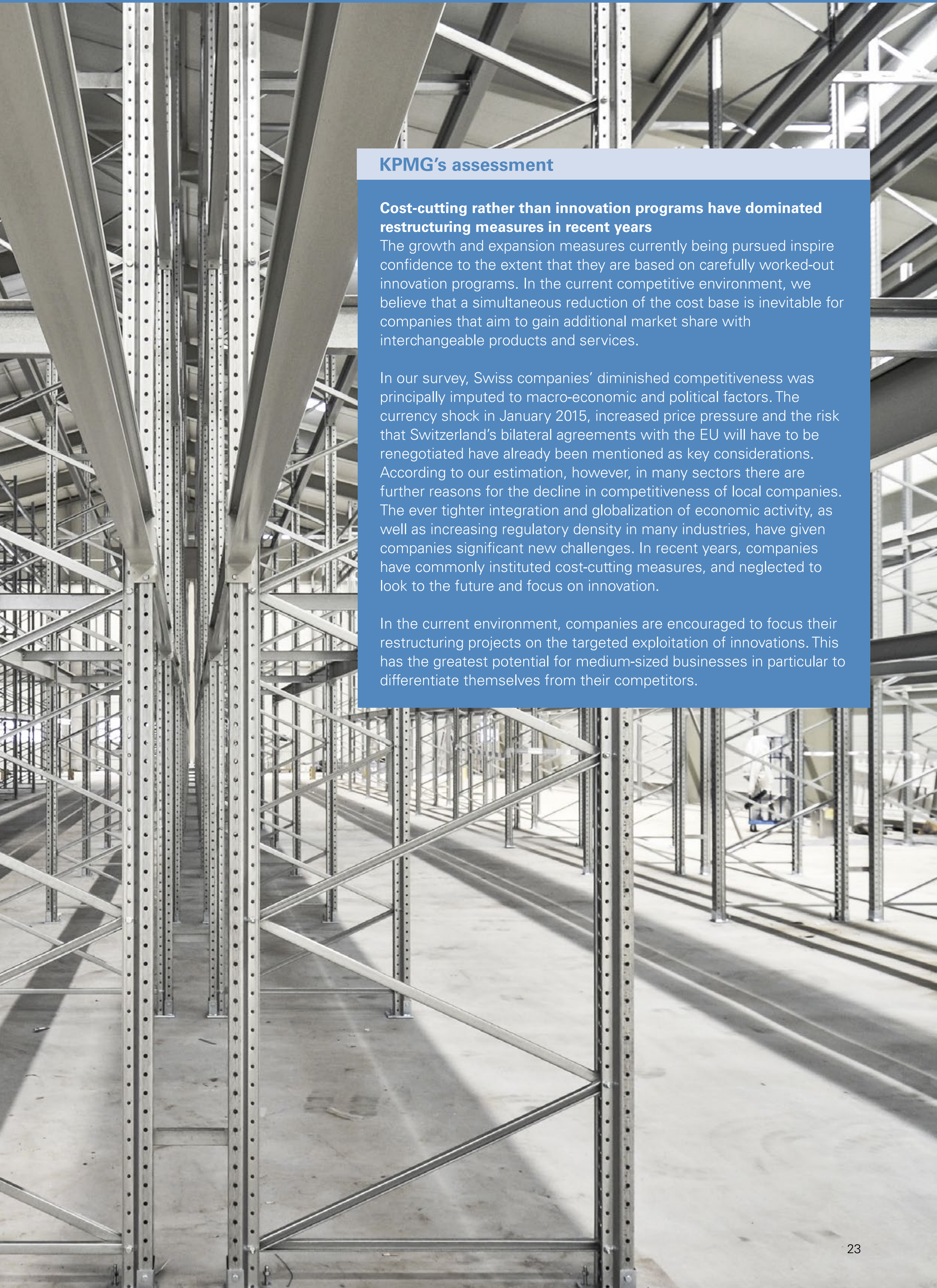
Growth and innovation instead of cost-cutting and reduction in capacity

As our survey findings illustrate, companies in Switzerland are not merely passively accepting their current situation, but are taking strategic, operative and financial measures to improve their economic circumstances.

Although participants mentioned measures such as closures and selling off business segments (10%) and a reduction in capacity (13%), most restructuring measures are not aimed at cost-cutting. Respondents are not focusing their measures primarily on cutbacks, but rather are countering decreased turnover with strategic measures in the areas of innovation, growth and sales. Adjustments to product portfolios are also being undertaken, particularly in the industrial, manufacturing, consumer goods and retail sectors.

What strategic measures are you currently implementing or planning to implement?





KPMG's assessment

Cost-cutting rather than innovation programs have dominated restructuring measures in recent years
The growth and expansion measures currently being pursued inspire confidence to the extent that they are based on carefully worked-out innovation programs. In the current competitive environment, we believe that a simultaneous reduction of the cost base is inevitable for companies that aim to gain additional market share with interchangeable products and services.

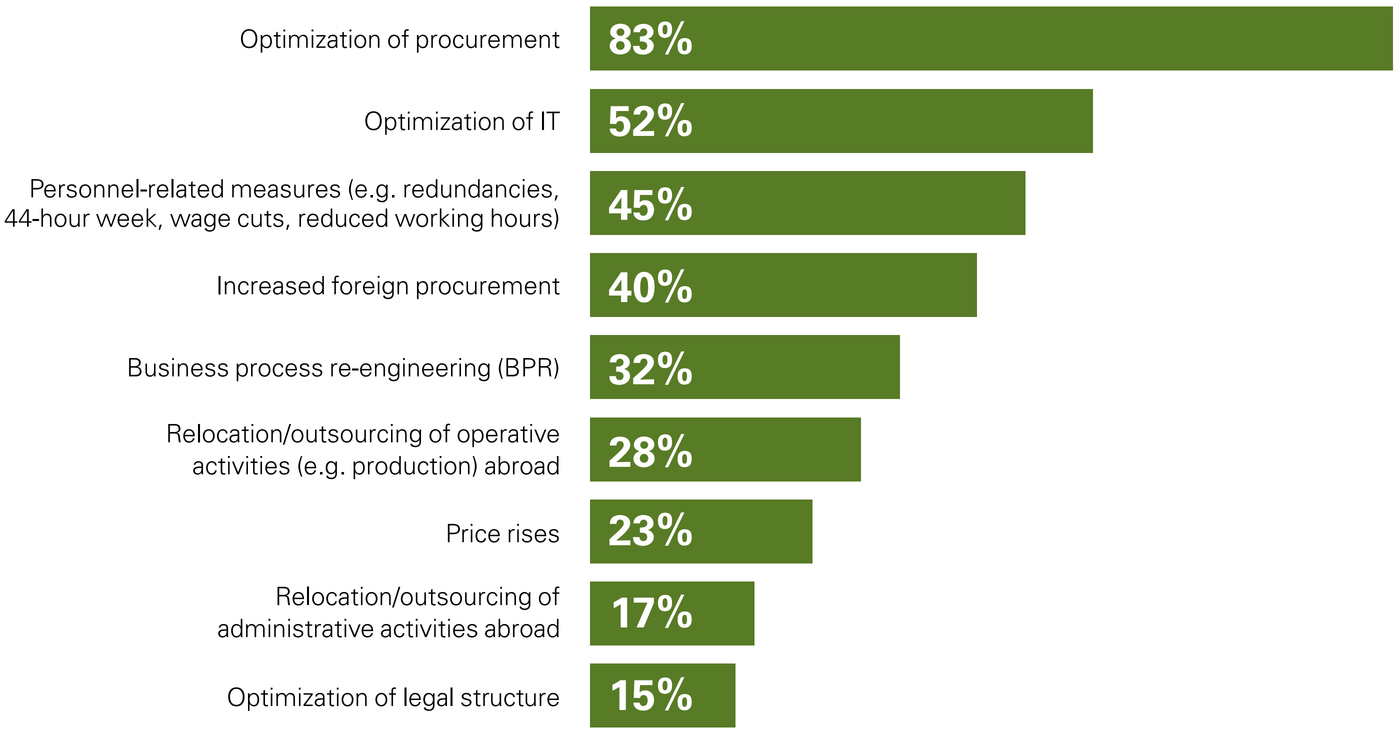
In our survey, Swiss companies' diminished competitiveness was principally imputed to macro-economic and political factors. The currency shock in January 2015, increased price pressure and the risk that Switzerland's bilateral agreements with the EU will have to be renegotiated have already been mentioned as key considerations. According to our estimation, however, in many sectors there are further reasons for the decline in competitiveness of local companies. The ever tighter integration and globalization of economic activity, as well as increasing regulatory density in many industries, have given companies significant new challenges. In recent years, companies have commonly instituted cost-cutting measures, and neglected to look to the future and focus on innovation.

In the current environment, companies are encouraged to focus their restructuring projects on the targeted exploitation of innovations. This has the greatest potential for medium-sized businesses in particular to differentiate themselves from their competitors.

In terms of operative measures, respondents across all sectors are making procurement optimization a clear priority. Thus, companies are increasingly striving to renegotiate their agreements with suppliers and to define new payment terms.

A small number of respondents also mentioned far-reaching measures, such as moving operative or administrative activities to locations outside Switzerland.

What operative measures are you currently implementing or planning to implement?



KPMG's assessment

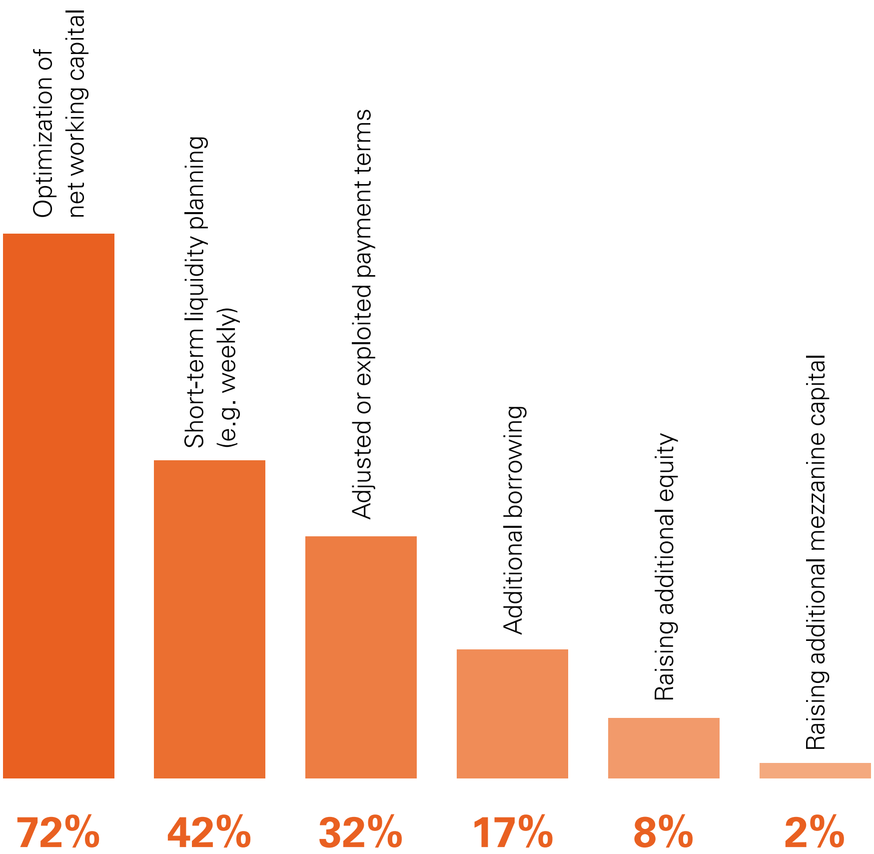
The adjustment of procurement conditions in reaction to increased price pressure is the most widely used measure, but is it sustainable in the long term?
Our survey results clearly show that Swiss companies are exposed to intense price pressures from domestic and international sources. Accordingly, procurement optimization was the most frequently mentioned operative measure. This is understandable, as measures outside the company are less painful, with potential savings to be made on imported products in particular. However, we take the view that procurement optimization alone can not deliver enough to constitute sustainable restructuring and is appropriate as a short-term measure only.

Little demand for additional capital

In terms of measures relating to liquidity, 72% of those questioned said they were planning or already carrying out an optimization of their net working capital, typically by a reduction in warehouse and inventory stock. Specifically, 32% of respondents wanted to more intensively exploit payment terms or to adjust these terms where necessary, while 42% mentioned a stronger focus on short-term liquidity planning.

Respondents did not yet see any pressing need for action regarding financing: only 17% are currently initiating any additional borrowing. Measures mentioned included raising additional equity (8%) or hybrid capital (2%).

What measures to secure liquidity are you currently implementing or planning to implement?



KPMG's assessment

In our view, this survey supports the belief that although in the current situation Switzerland, as a business location, is presented with significant challenges, the bulk of Swiss companies still possess sufficient liquidity and capital, and are not yet facing an existential crisis from a financial perspective.

Companies can use the current low interest rate environment in order to optimize their financing conditions and secure them for the long term, if an imminent interest rate rise is feared. A company's capital position can be made more crisis-resistant through a committed credit agreement or a fixed-rate financing plan.

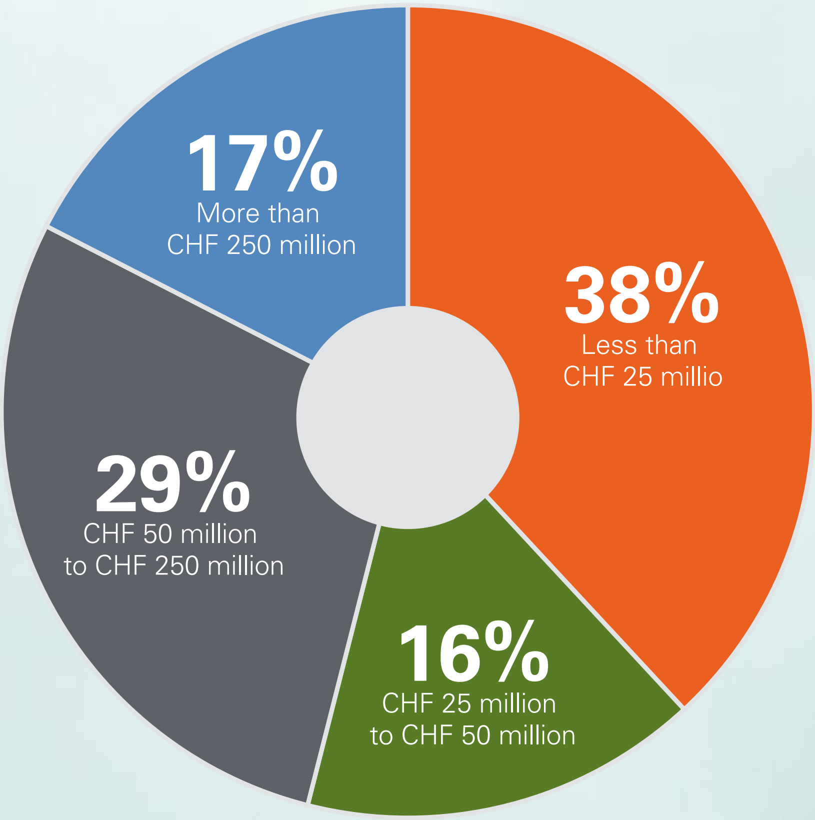
Methodology

A total of 81 companies representing various sectors took part in this survey. In order to be able to draw useful conclusions, we divided them into the following categories:

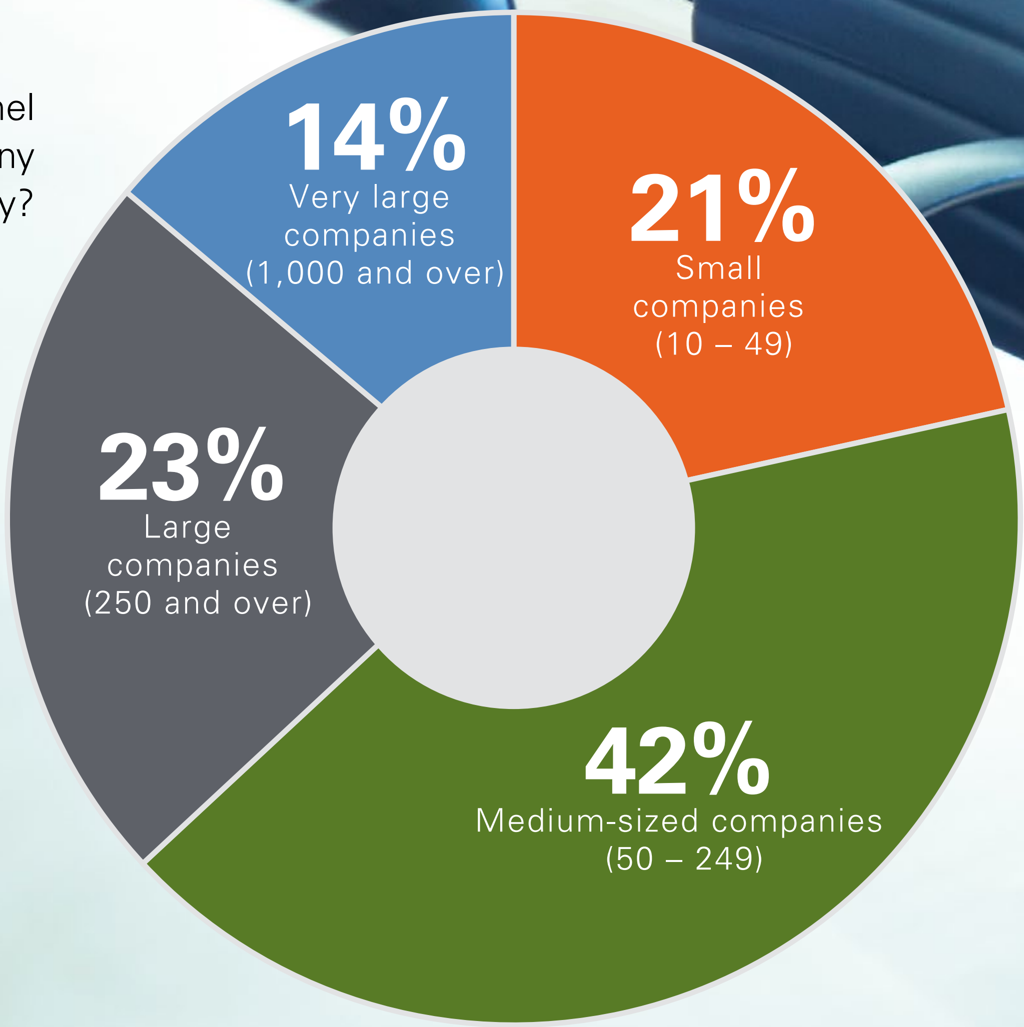
46%	24%	18%	12%
Industry and manufacturing	**Services**	**Consumer goods and retail**	**Construction and energy**
Manufacturing	IT	Producers of consumer goods	Construction industry
Industry	Media	Retail	Energy suppliers
Chemicals	Wholesale		Suppliers to the energy industry
Pharmaceutical	Service provid-ers		

63% of participating businesses were small and medium enterprises (SMEs) with up to 249 full-time equivalents (FTEs), while the remaining 37% were large companies with 250 or more FTEs. Grouped by annual turnover, 28% of our participating companies had turnover of less than CHF 25 million, 16% had turnover of between CHF 25 million and CHF 50 million, 29% had turnover of between CHF 50 million and CHF 250 million, and the remaining 17% had revenues of more than CHF 250 million.

How much turnover did your company generate, in CHF, in the last full financial year?



How many personnel does your company employ?



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