COVID-19: Financial Stress Testing & Forecasting

The outbreak of COVID-19 and the impact on the wider economy is placing unprecedented pressures on businesses.

Liquidity and funding is likely to be eroded quite significantly during the disruption period. Securing a firm grip of the cash burn profile now is essential to the implementation of effective counter-measures as part of a robust Financial Resilience strategy.

KPMG can assist you in assessing the horizon over which your existing financial reserves and debt facility headroom extend. This is critical in determining the commercial and operational levers you deploy in your response to COVID-19.

The challenges you are facing are not unique to South Africa. We are connected to a global working group that are assisting clients in developed and developing markets to:

- understand the short and medium term implications of COVID-19; and
- develop strategies to maximise cash resources and mitigate ever changing risks on a daily basis.

We are able to leverage off these global learnings, localise them for the South African context and implement them for South African businesses to respond immediately to mitigate the threats businesses are currently facing.

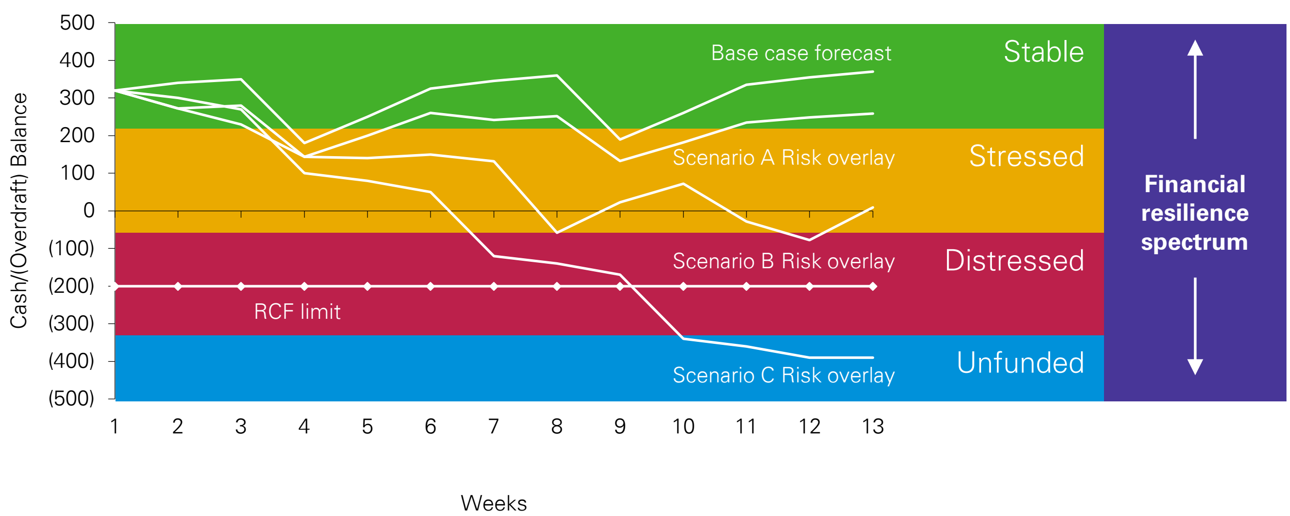
Step 01 Apply scenario-based 'risk overlays' to base line cash forecasts

— Have you factored in ongoing disruption and uncertainty into your financial forecasts and has this been modelled across cashflow, profit and loss and balance sheet?

— What are the new sales orders (demand-side) scenarios you have looked at and what assumptions are you making?

— How have you assessed existing sales orders or contracts and your ability both to fulfil them operationally and get paid? What assumptions are you making?

— To what degree have you reviewed your contracts or Service Level Agreements for potential issues such as penalties for delays in supply?



Step 02 Model Mitigation Options (cash preservation & generation initiatives)

Having identified the extent of the problem, the next stage is to understand what tasks can be undertaken on a 'self-help' basis in order to maximise liquidity.

Taking **proactive steps** now may help avoid more drastic action further down the line.

1 Implementing Business as Usual liquidity 'good practice'

These are measures that firms can take 'with no regrets' that can improve liquidity. Examples include:

- Accessing COVID-19 support, for example:
  - Pay-As-You-Earn (PAYE) relief for tax compliant business with turnover of less than R50 million
  - Possible temporary reduction in Unemployment Insurance Fund (UIF) and Skills Development Levy Fund (SDL) contributions
  - Additional Employment Tax Incentive (ETI) for employers with private sector employees earning below R6,500 per month
  - Acceleration of the payment of ETI reimbursements to employers from twice a year to monthly
- Maximising existing payment terms with suppliers
- Ensuring payments are received within agreed limits
- Reviewing policies and identifying 'quick win' savings.

2 Moderate impact 'tactical actions'

These measures are likely to be more extensive and may result in a short-term loss of goodwill:

- Engaging with landlords on rent reductions or holidays
- Deferring capital expenditure on growth projects
- Renegotiating payment terms with suppliers
- Removing or deferring unnecessary costs e.g. contractors working on non-core activities, marketing
- Review of material agreements (including supply and procurement agreements) to consider the application and legal impact of force majeure clauses
- Review of material agreements to highlight the provisions dealing with trigger events, acts of default or minimum volume requirements and consider risk mitigation steps required
- Review funding agreements with banks and other financiers to highlight the provisions dealing with trigger events and acts of default. Consider loan covenants, consequences of default and penalty clauses
- Consider intra-group funding and the application of intra-group subordination agreements and letters of support
- Consider any special dispensation that may be applied by the company's funding banks in response to COVID-19 (payment holidays, debt relief, extension of credit lines)

3 Making 'last resort' changes

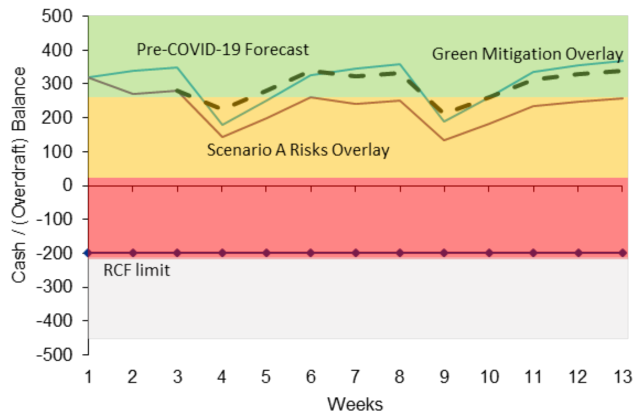
These are aggressive cash preservation options that may be suitable in certain circumstances:

- Deferring non-salary/wage outflow via agreement or temporarily withholding payment
- Reducing overheads by closing/reducing operations
- Considering voluntary reduced worktime or salary/wage reduction options for employees

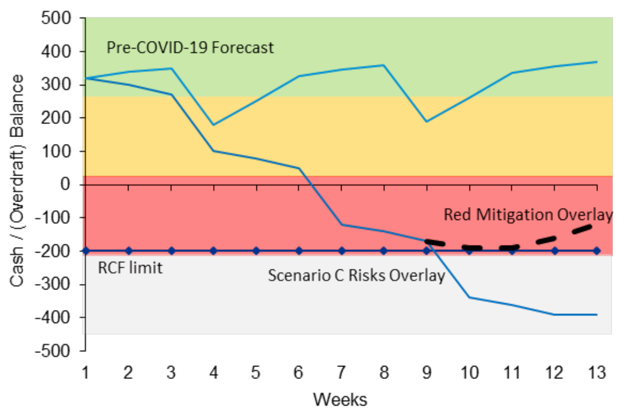
A special depensation has been announced by the Companies Intellectual Property Commission (CIPC) in respect of the application of section 22 of the Companies Act in the context of the COVID-19 pandemic which deals with the following provisions of the Companies Act:

- The reckless trading provisions as set out in the Companies Act
- The categorisation of a "financially distressed" company

In some cases proactive changes made early on may avert significant stress…



…whilst 'last resort' interventions may be required in more acute situations



Step 03 Overlay any 'Special Measures' COVID-19 Strategy and review daily

It is important to assess where and how the additional proposed measures announced by Government may assist in the continuing viability of businesses, these may include, *inter alia*:

- National Treasury and SARS relief initiatives;
- National Disaster Benefit Fund;
- Temporary Employee Relief Scheme;
- Department of Small Business Development funding for to distressed SMEs;
- Industrial Development Corporation funding commitment for vulnerable firms and companies critical to fight the virus and its economic impact;
- Department of Tourism;
- Solidarity Response Fund.

With support from landlords and the various proposed measures announced by Government, it may be possible to place viable businesses into '**hibernation**'. Modelling the cash funding through the implementation of such a strategy will be crucial to avoid an unplanned insolvency event.

The COVID-19 situation is changing rapidly and it remains important for businesses to review key assumptions daily.

Key contacts

Nick Matthews
Partner and Head of Deal Advisory
T: +27 83 452 8351
E: nick.matthews@kpmg.co.za

Roula Hadjipaschalis
Partner, Corporate Tax
T: +27 83 389 6510
E: roula.hadjipaschalis@kpmg.co.za

Mike Louw
Associate Director, Deal Advisory
T: +27 60 715 2417
E: mike.louw@kpmg.co.za

Anton de Bruyn
Partner, Legal Services
T: +27 82 719 0317
E: anton.debruyn@kpmg.co.za

Angie da Silva
Senior Manager, Deal Advisory
T: +27 71 680 6018
E: angie.dasilva@kmpg.co.za

kpmg.co.za

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2020 KPMG Services Proprietary Limited, a South African company and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in the United Kingdom. The KPMG name and logo are registered trademarks or trademarks of KPMG International.