The Coronavirus's $20 Trillion Hit to Global Corporations

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The corporate losses have caused a domino effect as companies try to survive the global shutdown. The size of the hit is unprecedented (we estimate about $20 trillion). Some of the hit will be taken on incomes, some on the balance sheets of households, corporations, central banks, and governments. Who takes the losses and how will determine how easily economies can emerge from this shock. We are studying the scale of the holes across economies and entities and how those holes are being managed. We expect huge differences between companies and economies in their ability to manage this hit, and we expect those differences will drive variation in economic conditions and markets going forward.

On March 19th, we shared our perspective on the massive losses facing US corporations, the levers they are likely to pull to cut back, and the knock-on effects for markets and economies. We have now extended our analysis to other major economies, and today we share our perspective on how the global losses stack up.

The lost revenue and the downstream profit losses and spending cuts are set to be enormous in every economy we've looked at, totaling more than $20 trillion globally. This reflects our best understanding based on our read of the coronavirus's impact economy by economy, and in some cases sector by sector, triangulated with what is implied by markets, though of course how policy makers manage will drive variation in the size of the contraction and the speed of the recovery. This revenue hit will wipe out over $5.5 trillion in corporate profits and $2.9 trillion in cash on corporate balance sheets. It will probably trigger around $6 trillion in cuts to corporates' spending on labor and capex and $1 trillion in cuts to financial spending. Even with these cuts, a large number of companies will still face significant capital needs (totaling $1.5 trillion). While there is much imprecision in these numbers, we think market participants and policy makers should be thinking about what follows as a rough base case. A bad case could easily lead to about double this, as even more promising cases like China and Korea are still proving devastating. We will continue to monitor and update our numbers.

How Global Non-Financial Companies Fill the Revenue Hole

	Global Total	Global Listed	Global Unlisted	USA Total	EUR Total	JPN Total	CHN Total	Rest of World Total
Est Revenue Fall (USD, Bln)	**-$21,100**	**-$8,600**	**-$12,500**	**-$4,800**	**-$4,400**	**-$1,600**	**-$4,000**	**-$6,300**
Est Revenue Fall (%GDP)	**-27%**	**-11%**	**-16%**	**-22%**	**-34%**	**-31%**	**-28%**	**-27%**
Immediate Cuts w/ Less Output	$15,900	$6,500	$9,400	$3,500	$3,400	$1,300	$3,000	$4,700
Labor Costs	$3,200	$1,300	$1,900	$800	$700	$200	$500	$1,000
Intermediate Goods	$12,700	$5,100	$7,600	$2,700	$2,700	$1,000	$2,500	$3,800
Cuts w/ Weaker Cyclical Conditions	$3,400	$2,000	$1,400	$1,100	$600	$200	$500	$1,000
CapEx	$2,400	$1,000	$1,400	$600	$500	$200	$400	$700
Buybacks/ M&A/ Dividends	$1,000	$1,000	$0	$400	$100	$100	$100	$300
Company Financial Offsets	$4,300	$1,700	$2,600	$1,000	$900	$300	$800	$1,300
Lower Cash Inflows	$1,400	$600	$800	$300	$300	$100	$300	$400
Spend Down Cash	$2,900	$1,100	$1,800	$700	$600	$200	$500	$900
Remaining Capital Need*	-$1,550	-$500	-$1,050	-$600	-$100	-$50	-$300	-$500
2019 Profits (UDS, Bln)**	**$12,500**	**$6,600**	**$5,900**	**$4,100**	**$2,300**	**$1,000**	**$1,400**	**$3,700**
Est 2020 Profits (USD, Bln)	**$6,700**	**$4,600**	**$2,200**	**$2,700**	**$1,100**	**$600**	**$300**	**$2,000**
Profit Decline (USD, Bln)	**-$5,800**	**-$2,100**	**-$3,700**	**-$1,400**	**-$1,200**	**-$400**	**-$1,100**	**-$1,700**

Extremely large revenue losses across economies

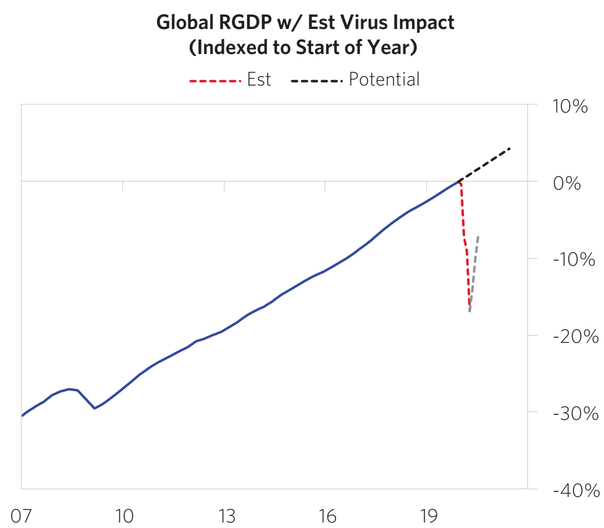
Profit growth weaker outside the US, but fewer companies are likely to require new funding

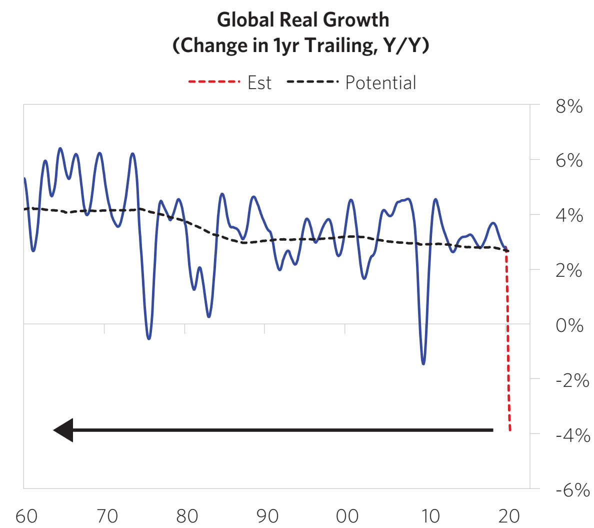
**Sum of negatives by company. Note capital need is now calculated after accounting for expected spending cuts.*
***Here profits are EBITDA profits.*

Next, we take a closer look at these numbers, focusing first on the aggregate impact globally, and then taking a closer look at some of the differences across economies.

We Expect a Big Hit to End Demand Across the World…

The severity and speed of the decline in global economic output currently underway is unlike anything we've seen in recent history. Below, we show what we are expecting globally. Based on our bottom-up assessment of how spending is likely to transpire (described in more detail below), we expect a nearly 20% fall in global output over the span of just a couple months, with growth rates for the year likely averaging around -4% or worse. The big question is the shape and the speed of the recovery. In the charts below, we show our rough estimate for the level of global activity, indexed to the start of this year, relative to our baseline if the economy continued to grow at potential. The estimated short-term decline is shown in red, and our base case for the first few months of recovery is shown in gray.





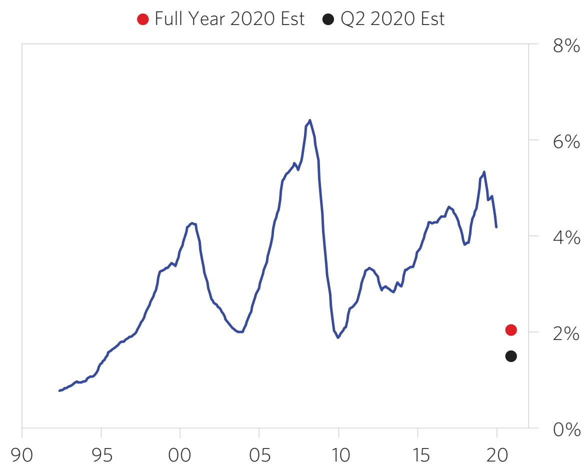
…That Will Lead to a Huge Hit to Profits…

The fall in revenues will result in large hits to profits. Corporates will scramble to cut costs as best they can, as the spike in recent jobless numbers shows, but won't be willing or able to cut costs as fast as falling revenues. The total wipeout in profits this year across listed and unlisted companies globally is likely to be on the order of $5-6 trillion. The second quarter will likely prove to be the worst, with global publicly listed non-financial corporates making on net close to zero profits in Q2. Note that fiscal and monetary action are likely to cushion this decline to some extent.

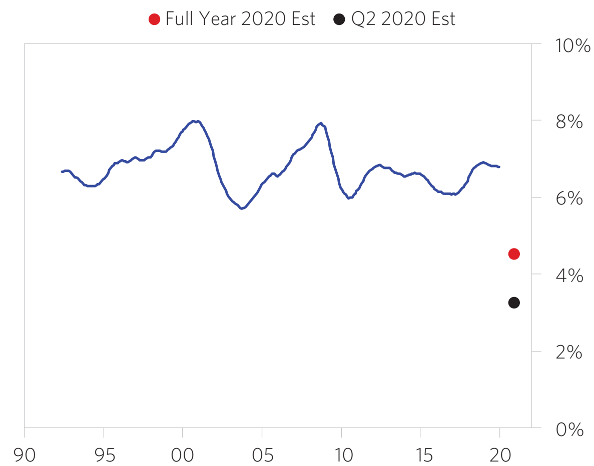
…And to Big Downstream Cuts in Corporate Spending…

Companies typically spend in line with their revenues and profits, so lower revenues and profits will flow through to spending cuts. We have already seen numerous announcements of companies firing workers, halting buybacks and dividends, and delaying plans for expansion. While the second quarter is likely to be the worst period for corporate spending this year as companies face the most acute income drop, we think businesses are likely to remain extremely conservative for the remainder of the year. As a result, there is a good chance that in 2020 we will see the lowest levels of capex and financial spending in more than 20 years. The knock-on implications for profits and equity prices will be significant. We expect this to be particularly acute in the US, where financial engineering was providing an outsized boost to earnings per share.

Global Non-Fin Buybacks & M&A (% Trend Sales, Listed Corps)



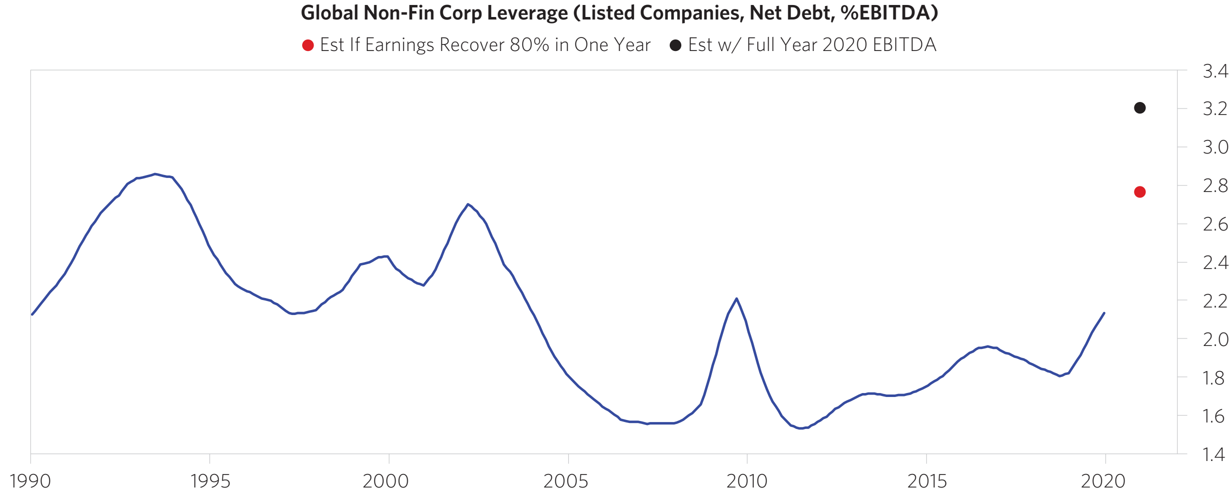
Global Non-Fin Capex Spending (% Trend Sales, Listed Corps)



…Leaving Companies Far More Indebted on the Other Side of This

Left with much lower profits and a shortfall of cash, companies are likely to come out on the other side of the coronavirus more indebted. By the end of the year, companies will likely look as leveraged as they've been since the '90s. Many companies will need time to rebuild their balance sheets, and it's still an open question as to how long it will take earnings to get back to levels seen before the coronavirus. Even those that are relatively less encumbered are likely to remain more cautious about their level of capital expenditures, business expansion, and financial spending than they have been in years past. The more that businesses focus on deleveraging and cutting spending, the harder it will be for economic growth rates and corporate profitability to return to what they were before.

Global Non-Fin Corp Leverage (Listed Companies, Net Debt, %EBITDA)



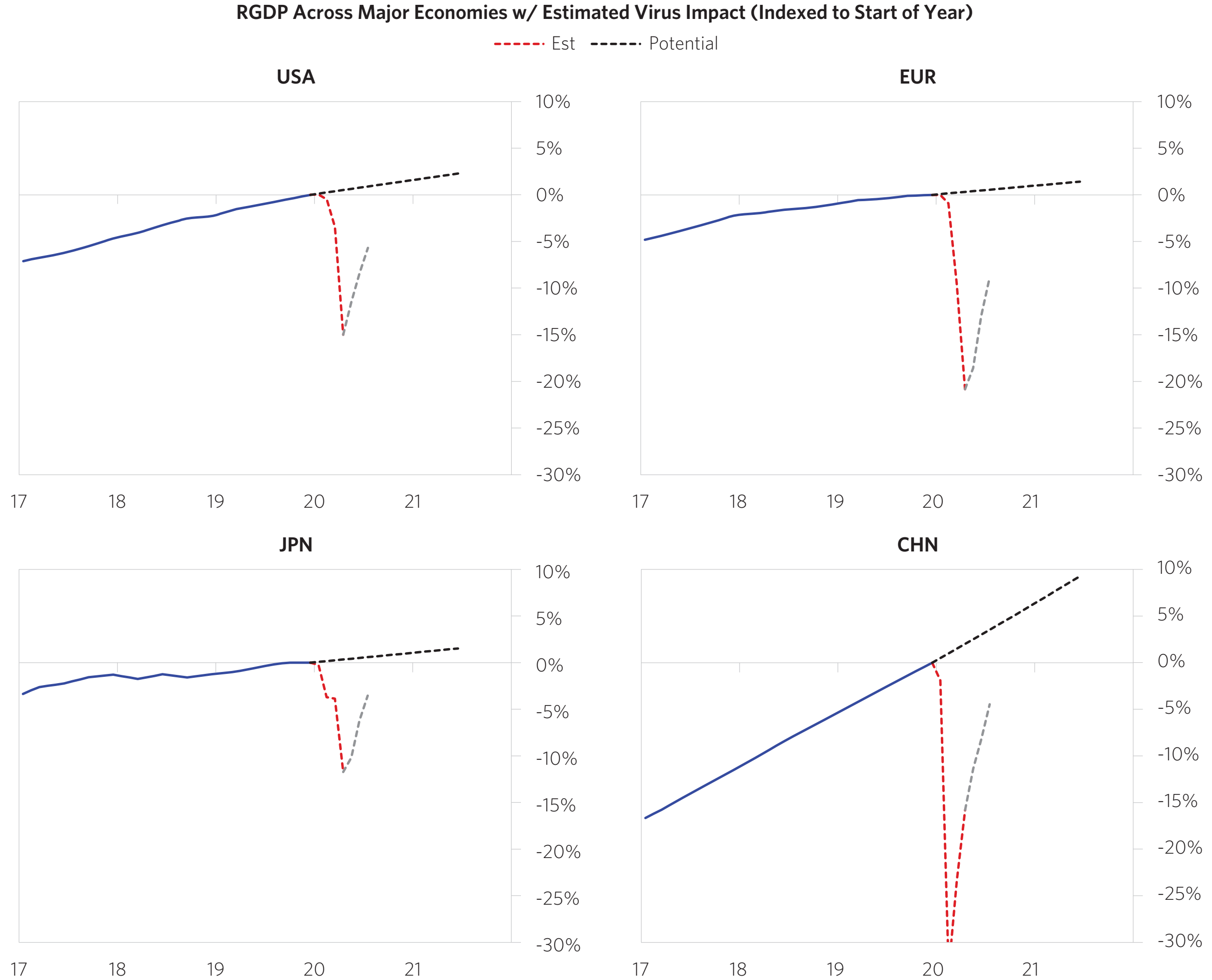
Taking a Closer Look at the Shape of the Hits Across Economies

The rest of today's research takes a closer look at the dynamics discussed above for some of the major economies (US, Europe, Japan, and China). As we discussed above, the big deal is that the lost revenue, downstream profit losses, and spending cuts are enormous in every economy we've looked at, but there will be important differences in the size of the holes and who ultimately bears the losses. These differences come from the underlying structure of different economies, the nature of their corporations, and how policy makers respond, which will be key drivers of divergent market outcomes.

The Growth Hits Are All Large with Variation Based on the Policy Response

The charts below show declines in economic output we'd roughly expect across the major economies, in the same format shown earlier for the global economy. The virus will create big drags everywhere, both through domestic disruptions and slowing trade. However, the size and shape of these disruptions will depend at least in part on how policy makers move to contain the virus: aggressive shutdowns and effective containment (as it seems we are seeing in China) will likely create bigger immediate drags followed by a somewhat faster recovery; more muted responses will likely lead to rolling disruptions and slower recovery. The economic policy response will also be key. If governments don't step in to plug the hole, then the slowing will cascade through incomes, confidence, asset prices, and spending in a self-reinforcing way. US policy makers appear to be on track to avoid this, while others (like in Europe) are running a much higher risk.

RGDP Across Major Economies w/ Estimated Virus Impact (Indexed to Start of Year)



Differences in Sector Exposure and Underlying Cost Structures Should Leave US Profits Better Off

Looking more closely at the listed-company universe (which makes up a little under half of global revenues), most major equity markets are set to experience earnings declines of around 50% for the full year. And we expect the peak impact will be substantially worse, with the level of profits falling to zero or negative across all major economies in the second quarter. Beyond that, there remain noteworthy differences in the degree of profits declines across economies. These are primarily driven by 1) the degree to which revenues decline, 2) the level of existing margins, and 3) companies' ability and willingness to cut costs. The US stands to benefit on all these fronts, as we describe below.

Breakdown of Corporate Profits (Listed Non-Financial Corps)

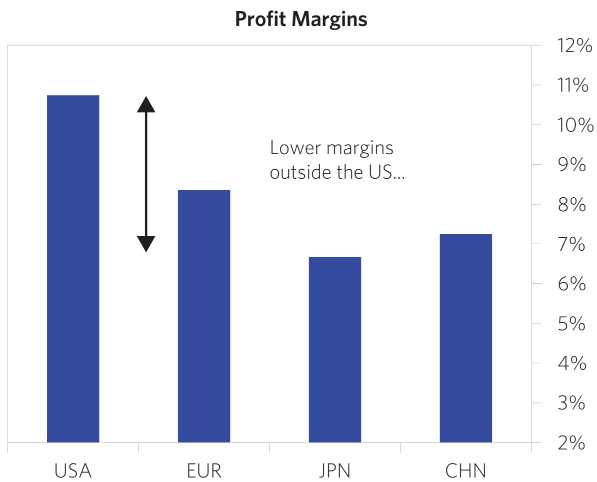
	Global	USA	EUR	JPN	CHN
% Change Revenue (Y/Y)	-20%	-17%	-24%	-17%	-25%
% Change EBITDA (Y/Y)	-31%	-25%	-34%	-31%	-55%
% Change Operating Income (Y/Y)	**-55%**	**-42%**	**-70%**	**-55%**	**-96%**
2019 Operating Income (USD, Bln)	**3,778**	**1,457**	**459**	**411**	**324**
2020 Lost Profits Est (USD, Bln)	**-2,087**	**-608**	**-320**	**-225**	**-312**

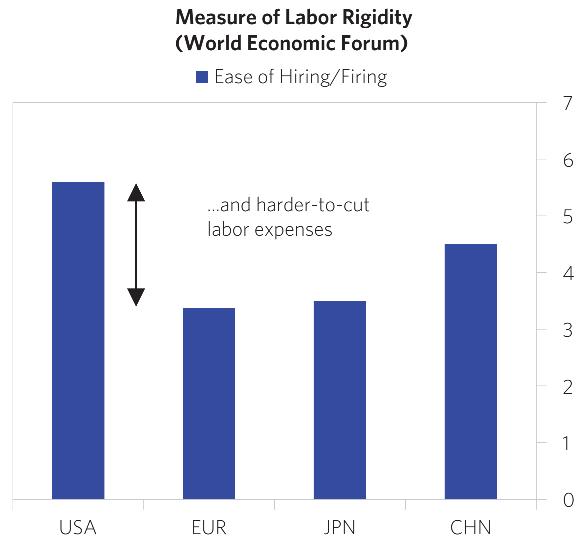
While the hit to revenues everywhere will be massive, it will be marginally less so for US public companies. We constructed estimates of corporate revenues and GDP bottom-up, using timely information on the hits to different kinds of spending, as well as triangulating with what the markets are telling us and common sense. The hardest-hit companies will clearly be those in travel and leisure (directly impacted by the quarantines), consumer durables (mainly autos, which are already seeing significant declines in demand and potential supply chain disruptions), providers of traditional investment goods (hit by the massive fall in capex that's likely to occur), and resources. US revenues are noticeably less exposed to these sectors than other economies, and more exposed to less-impacted sectors (tech and other cyclical consumption—mainly services).

Global Composition of Sales by Sector (Listed Non-Financial Companies)

	Est Global Revenue % Decline (Full Year 2020 vs 2019)	Sector Sales (% Total Non-Financial)			
		USA	EUR	JPN	CHN
Hardest Hit	**-25%**	**35%**	**60%**	**55%**	**73%**
Travel and Leisure	-37%	3%	2%	1%	2%
Consumer Durables	-24%	5%	18%	17%	9%
Traditional Investment (Structures and Equipment)	-23%	15%	23%	29%	34%
Resources	-30%	12%	16%	8%	28%
Middling	**-9%**	**40%**	**19%**	**27%**	**16%**
Tech Investment	-12%	14%	5%	14%	9%
Other Cyclical Consumption	-6%	25%	14%	13%	7%
Potential Winners	**0%**	**25%**	**21%**	**18%**	**12%**
Consumer Staples	0%	14%	18%	13%	8%
Pharmaceuticals	-2%	3%	2%	2%	2%
Healthcare	-2%	7%	2%	2%	2%

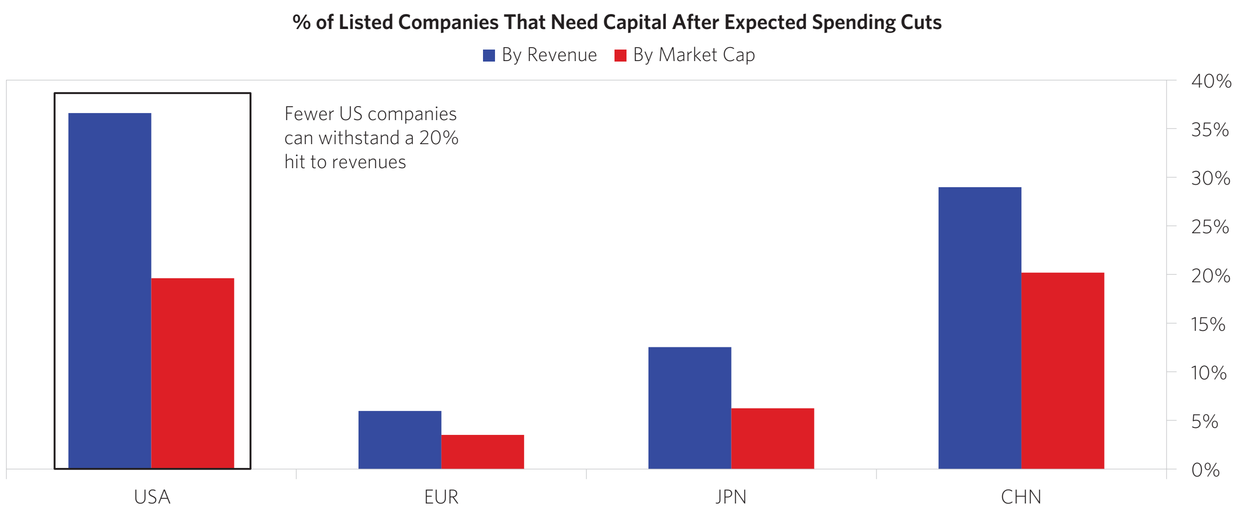
In aggregate, US companies also have lower fixed costs, which will blunt the impact on US profits relative to other economies. Forces behind the global secular rise in profit margins have been especially strong in the US, and US companies generally have higher profit margins than other economies. In addition, US companies have more flexible cost structures because of more business-friendly labor laws. As shown below on the right, it is substantially easier to cut labor expenses and fire workers in the US. Of course, firing workers just shifts the losses to the household sector.



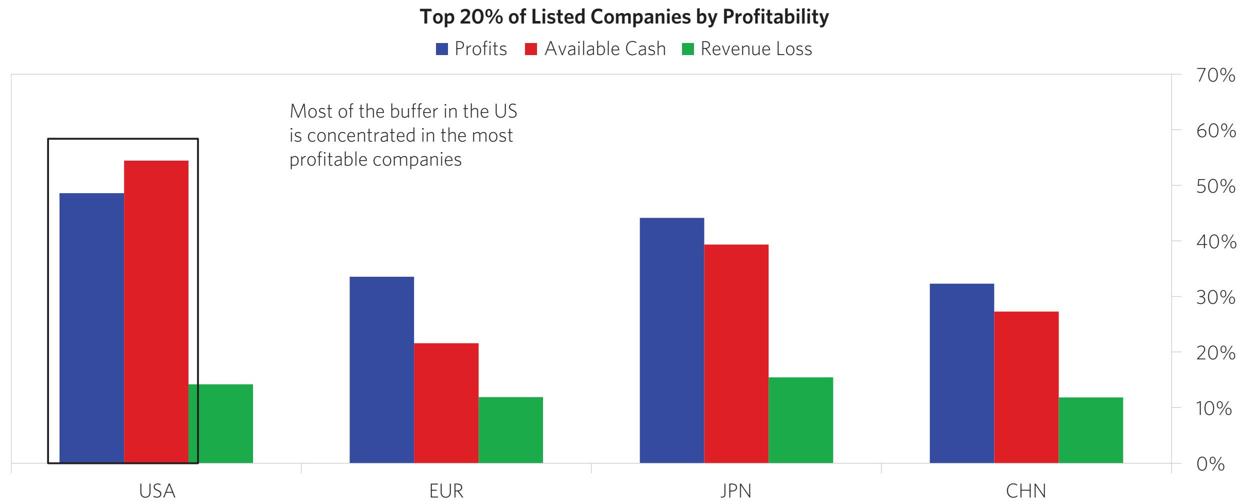


While Aggregate Profitability in the US Is Likely to Hold Up Better, There Is a Bigger Tail of Companies That Will Face Cash Squeezes

While the hit to US profits will be smaller <u>in aggregate</u>, the US has many more public companies that are going to be in trouble. We calculate that roughly 35% of US companies by sales (and 20% by market cap) are not able to withstand a 20% hit to revenues lasting 12 months without raising new capital or making spending cuts that are more dramatic than our base case (e.g., fully suspending dividends).



The main reason is that in the US, the buffers that companies have in order to withstand a revenue shock—i.e., their profit margins and their cash on balance sheet—are much more concentrated among a small handful of companies (e.g., the tech giants), whereas it's more equally distributed in other economies. In the US, while the top 20% of companies by profitability will account for about 15% of this year's lost revenues, they account for around half of all profits and available cash among US companies.



Stepping back, how the global losses get handled is a big question that will stay with us long after the virus is gone. The losses globally are enormous. How those losses are handled and ultimately distributed will have huge impacts both for the global outlook and the differences across economies for years to come.