BUSINESS CONDITIONS SLUMP IN 1H2020, CRITICAL OUTLOOK FOR 2H2020

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KEY RESULTS:

- ☑ Business activity crashed in 1H2020, as reported by 77% of respondents
- ☑ Local sales and export sales decline for 75% and 69% of respondents, respectively
- ☑ Production costs moderating: 46% report higher COP, down from 53% in 2H2019
- ☑ CAPEX slowing down: 10% increase CAPEX, down from 26% in 2H2019
- ☑ Soft outlook for local and export sales in 2H2020 as most respondents adjust projections lower
- ☑ Most respondents to reduce production volume and increase costs in 2H2020
- ☑ CAPEX expected to trend lower: 19% to increase and 36% to cut down in 2H2020
- ☑ 82% and 81% report lower revenues and profits in 1H2020, respectively
- ☑ 34% believe their business is sustainable for more than 12 months
- ☑ 71.6% need between 4 months to 2 years for business recovery to pre-COVID-19 levels
- ☑ Lean manufacturing top strategy for business recovery
- ☑ Delays in delivery from suppliers, higher logistic and shipping costs main supply chain disruptions
- ☑ China and ASEAN top sources of new suppliers
- ☑ 66% need to reduce labour costs; most to adopt headcount freeze
- ☑ Until Dec 2020, 42% of respondents to reduce headcount up to 30%
- ☑ 64% yet to move their businesses online
- ☑ Tax deduction/capital allowance for COVID-19-related expenses, and wage subsidy until September 2020 and reduction in work week top PENJANA initiatives found to be useful and likely to be taken up by respondents

Indicators	FMM – MIER Business Conditions Index Values							
	Current (Compared to 6 months ago)				Looking Forward (Next 6 months)			
	2H2018	1H2019	2H2019	1H2020	1H2019	2H2019	1H2020	2H2020
Business conditions	107	78	**90**	**31**	101	101	**88**	**76**
Local sales	93	77	**84**	**34**	94	101	**86**	**71**
Export sales	107	73	**91**	**41**	105	101	**87**	**69**
Production volume	111	82	**96**	**35**	110	105	**93**	**78**
Capacity utilisation	107	82	**97**	**38**	109	105	**95**	**78**
Capital investment	114	103	**109**	**61**	120	108	**105**	**83**
Number of employees	110	96	**102**	**82**	105	105	**104**	**93**
Cost of production	155	153	**144**	**130**	148	134	**142**	**133**

The first half of 2020 has been most challenging for Malaysian manufacturers as the impact of the economic disruptions resulting from the MCO, CMCO and, most recently, the RMCO during this period weighed heavily on their businesses. Reflecting this are the results of the latest FMM-MIER Business Conditions Survey which showed significant drop across-the-board in all indicators from local and export sales to production, capital, investment and employment. The outlook for this sector is equally critical going forward as it continues to grapple with the uncertainties and high risk of economic vulnerability at home and globally arising from the COVID-19 pandemic.

RECORD FALL IN BUSINESS ACTIVITY SINCE 2012

Business activity slowed down considerably in 1H2020, as shown by the index for current general business activity which, at 31, is the lowest level as never seen before since the inception of this survey in 2012. About 77% of the respondents had to reduce their business activities in 1H2020, up from 38% last quarter and 45% in 1H2019.

Weak Local and Export Sales

Sales performed dismally in recent months, both locally and abroad. The current index for local sales dipped to an all-time low of 34 in 1H2020, with 75% of the respondents reporting lower sales, far exceeding the 41% and 44% in 2H2019 and 1H2019, respectively. Only 9% sold more, compared to 25% previously. The latest index for current export sales fell 50 points from 2H2019 to 41, another record-low. 69% reported selling less in 1H2020, while 10% enjoyed better sales and 21% managed to maintain their sales during this period.

Lower Production Volume and Capacity Utilisation

Weak sales had dampened production and capacity utilisation. Reflecting this are the current indices for production and capacity utilisation which plummeted to their all-time low of 35 and 38, respectively, losing 61 and 59 points from 2H2019, respectively. Three-quarters of the respondents cut back on their production in 1H2020, while 71% operated on lower capacities, up from 36% and 33% in 2H2019, respectively.

Cost of Production and Capital Investment Moderating

Not only has the index for current production cost declined for the third consecutive period since 2H2018, it has tumbled to an all-time low of 130, an implication that production costs had shifted lower in 1H2020. 46% had to put up with higher costs in 1H2020, down from 53% in 2H2019 and 62% in 1H2019. There was no change in costs for 38% of the respondents during this period, but 16% experienced lower costs.

Another all-time low was recorded by the index for current capital investment (CAPEX) which, at 61, had lost 48 points from 2H2019, suggesting that CAPEX had slowed down in 1H2020. Only 10% of the respondents increased their CAPEX recently, while 49% reduced theirs, compared to 26% and 17% in 2H2019, respectively.

Employment Opportunities Lacklustre

Recruitment in the manufacturing sector was put on hold in 1H2020, as denoted by the current employment index which fell to 82, the lowest on record so far. Only 6% of the respondents increased their headcount recently, down from the previous survey's 21%. Another 69% had retained their current staff, while 24% retrenched theirs in 1H2020.

CRITICAL OUTLOOK FOR THE NEXT SIX MONTHS

With the COVID-19 pandemic far from over in many economies worldwide, Malaysian manufacturers are taking a pessimistic stance in their projections on the prospects of their businesses for the rest of 2020. All forward-looking indicators in the latest survey fell to their lowest levels since the commencement of this survey in 2012, with most respondents replying negatively, especially on export and domestic sales.

The latest index for expected business activity fell to its all-time low of 76, an indication that business activity will be scaled down in the coming months. Most (48%) respondents attested to this, up from the previous period's 34%, while 24% are expecting their businesses to pick up soon.

Projections on local and export sales in the next six months are both lacklustre. This is shown by the latest indices for expected local sales and export sales which descended to their lowest levels on record, to 71 and 69, respectively. 49% of the respondents who sell locally and 50% of those who export are bracing for a dip in their sales in the months ahead.

The expected indexes for production volume and capacity utilisation also plunged to their lowest levels in the latest survey. At a reading of 78 each, it postulates a slowdown in production and capacity utilisation in the next six months. 46% of the respondents will likely cut down on their production soon, while 24% are looking into expanding theirs, compared to 33% and 26%, respectively, in the prior survey. Those considering operating at lower capacities rose to 46% from 30% previously, while 24% will increase their capacities soon, little change from the previous survey's 25%.

The expected index for cost of production also sank from the prior survey to 133 currently, an implication that production costs are moderating for the rest of 2020. 45% of the respondents foresee a spike in their production costs in the coming months, down from 51% previously, while those anticipating a reduction in theirs have risen to 12% in the latest survey.

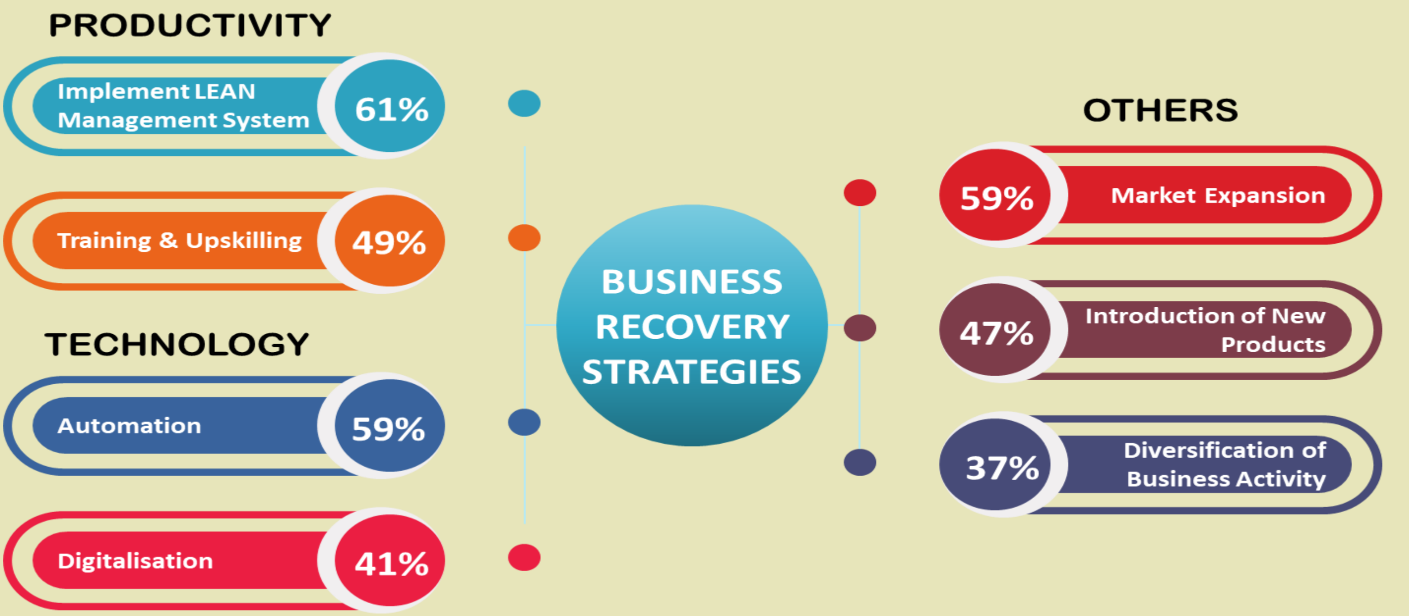
CAPEX and hiring in the manufacturing sector are expected to slow down further in the coming months. Declining for the third consecutive survey since 2H2018, the indices for expected capital investment and expected employment dropped to 83 and 93 in the current survey, respectively. 19% of the respondents are planning to increase their CAPEX soon, while another 36% are contemplating lowering theirs, compared to 24% and 19% in the preceding survey, respectively. 16% will likely recruit more employees soon, while 23% have retrenchment plans, compared to 17% and 13%, respectively, previously.

FINANCIAL IMPACT OF COVID-19 AND MCO ON BUSINESS

In the past six months, both the revenue and profitability of most respondents were affected negatively. 82% suffered a decrease in revenues, while almost 81% reported lower profits in 1H2020. Only 8% and 7% enjoyed higher revenues and profits, respectively.

Among those who reported lower revenues, most (27%) estimated their decrease at 21-30%, while

Strategies For Business Recovery In The Next 6 Months



19% and 17% assessed theirs at 41-50% and 11-20%, respectively, and 10% experienced a decline of up to 10%. Most (18%) of those who confirmed lower profits appraised their loss at 21-30%, while close to 18% valued theirs at 11-20% and 15% noted a loss of 41-50%. Another 13% claimed a decrease in profitability of 1-10% in 1H2020.

BUSINESS SUSTAINABILITY AND RECOVERY POST-MCO

In terms of sustainability, majority (34%) of the respondents believed their companies will be able to sustain their businesses for more than twelve months, followed by 18% and 9% who estimated theirs at 4 to 6 months and 10 to 12 months, respectively. About 25% were not affected at all.

To recover their businesses to pre-COVID-19 levels, most (24%) respondents said they will need a period of 1 to 2 years, while 18% and 16% estimated a timeframe of 4 to 6 months and 10 to 12 months, respectively. 15% will likely require 7 to 9 months for this.

It is encouraging to note that 11% of the respondents had their businesses recovered to pre-COVID-19 levels, and 8% even reported that their businesses are faring better now than pre-COVID-19 levels.

IMPACT OF SUPPLY CHAIN DISRUPTIONS ON BUSINESS

Of the supply chain disruptions encountered in 1H2020, delays in delivery from suppliers and higher logistic and shipping costs were reported by most respondents, followed by higher raw material prices, shortage of raw materials and shorter credit periods.

In sourcing for new suppliers, the top two destinations preferred by most respondents are China and ASEAN, with 35% and 22% of the respondents listing them, respectively. Europe and Malaysia garnered 9% responses each. Only 2-5% indicated that their new suppliers will likely be from Thailand, Taiwan, India, Indonesia, Korea, Japan, Vietnam and the US.

IMPACT ON EMPLOYMENT

Reduction in manpower costs was necessary for 66% of the respondents in 1H2020. The most popular cost reduction measures adopted by most of them were, namely, headcount freeze, removal of non-contractual allowances and benefits, and elimination of part-time manpower/outsourcing, with 43%, 21%, and 19% responses, respectively. Between 16-17% implemented reductions in their workdays/week, hours/day or mandatory annual leave on their employees.

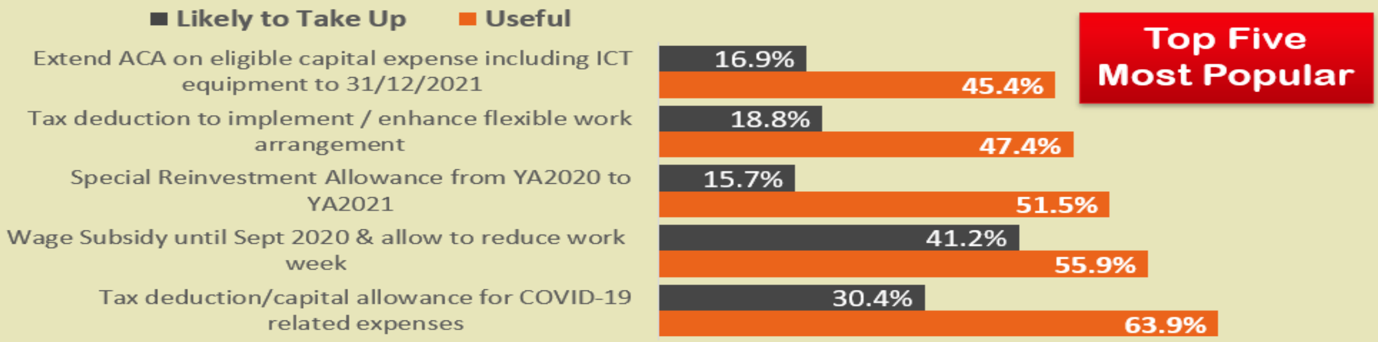
Among those who will likely implement pay cuts soon, most are planning on a quantum of 5-20% salary reduction for their top management and management staff, while employees at the executive and non-executive levels are likely subject to cuts of up to 10%.

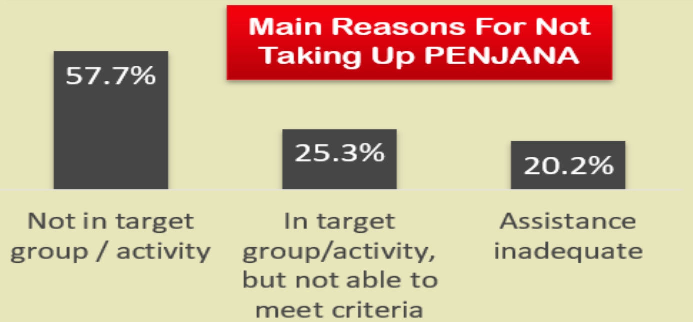
For those respondents whose last resort is retrenchment, most (42%) will only implement it on 10-20% of their staff from 2021, while 25% will carry out this exercise between now and December 2020 on up to 30% of their employees. As of July 2020, 17% have already reduced their headcount by 10-30%.

STRATEGIES/ACTION FOR BUSINESS RECOVERY IN THE NEXT 6 MONTHS

As part of their strategy for business recovery, most respondents will implement lean manufacturing (61% responses), as well as training and upskilling (49%) to increase their productivity in the next six months. In terms of technology, 59% will adopt automation, while 41% will go digital soon. Other strategies such as market expansion, introduction of new products and diversification of business activity were also cited by 59%, 47% and 37% of the respondents, respectively.

SHORT-TERM ECONOMIC RECOVERY PLAN (PENJANA)





Other Specific Incentives for PENJANA

- ➔ Reduction/waiver in corporate tax rate
- ➔ Provision of higher energy discounts for industries

DIGITALISATION OF BUSINESS

When asked if they have moved their businesses from offline to online, 64% have yet to do it, while 24% have already done so before the MCO and 12% went online during the MCO.

Between those who are already online, 71% noted an increase in their business, with most (47%) estimating their increase at 1-10%, while 17% each enjoyed an increase of 21-30% and 11-20%, respectively. 16% experienced a drop in their businesses after having gone online, with most of them evaluating their decline at 1-30%.

SHORT-TERM ECONOMIC RECOVERY PLAN (PENJANA)

On 5 June 2020, the Short-term Economic Recovery Plan or PENJANA was announced by the Government to relieve the cashflow of businesses by offering remissions of penalties for late tax payments.

Of the many initiatives included in this Plan, the top five most popular that 45-64% of the respondents find useful and will likely take up are: tax deduction/capital allowance for COVID-19 related expenses; wage subsidy until September 2020 and reduction in work week; Special Reinvestment Allowance from YA2020 to YA2021; tax deduction to implement/enhance flexible work arrangement; and extension of Accelerated Capital Allowance on eligible capital expense including ICT equipment until 31 December 2021.

For those not taking up the PENJANA initiatives, the main reason was because 58% of them are not in the target group/activity, while 25% do not meet the criteria although they are in the target group/activity, and 20% cited inadequate assistance.

There was some feedback on this Plan from respondents who commented that there is no assistance provided to the mid-tier, large and multi-national companies; guidelines for some initiatives are absent or unclear; procedures should be simplified and red tape reduced in the application process; and processing and disbursement of funds is slow.

When asked if other specific incentives should be introduced in PENJANA, most respondents suggested a reduction/waiver in the corporate tax rate and provision of higher energy discounts for industries. Other proposals included a reduction in business costs, additional tax incentives, further extension of the wage subsidy, exemption of the SST, waiver/reduction in all utility charges, and a reduction/exemption in the personal tax rate.

The FMM-MIER Business Conditions Index (FMM-MIER BCI) is a collaborative effort between FMM and the Malaysian Institute of Economic Research (MIER). Business condition is the general state of an economy affecting business viability. The FMM-MIER BCI uses the current level of business activity as a proxy for current business conditions, compared to six months ago.

Index values range from 0 to 200 points. A value above the growth-neutral threshold level of 100 points indicates an improvement or positive outlook, while that below the threshold indicates a worsening or negative outlook.

The FMM – MIER Business Conditions Survey 1H2020 received 549 responses, of which 67.2% were SMEs (based on full-time employees), with 176 & 112 responses from Klang Valley & Perak respectively. The top three industries for responses were: Chemicals & Chemical Products (15% of respondents); Food, Beverage & Tobacco (15%); and Electrical & Electronics (10%).

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