RESTRUCTURING

A&M Distress Alert (ADA)

JANUARY 2024

Distress levels rise to highest since the pandemic as inflation and policy tightening get real for European corporates in 2023

Companies in Europe and the Middle East felt the pinch from waning consumer demand and higher operating costs on their financial performance last year, exacerbating levels of corporate distress across the region.

The percentage of corporates in distress – a combination of weak balance sheet and underperformance – has increased to 9.8% last year, from 8.6% recorded in 2022, reaching the highest level since the start of the pandemic in 2020, according to a preview of the 2023 edition of Alvarez & Marsal (A&M)'s Distress Alert (ADA).

The ADA assesses the robustness of balance sheets and earnings of thousands of companies across 33 countries in the EMEA region, identifying companies that are, or may soon be, in financial distress (read more on the Methodology on page 4.)

	FY20	FY21	FY22	LTM23
Companies with weak balance sheet	32.4%	30.7%	30.7%	31.3%
Companies with weak performance	18.8%	12.8%	12.3%	14.8%
Distressed companies that need a turnaround	13%	8.9%	8.6%	9.8%

Our 2023 analysis shows that businesses' weakening performance played a larger role than before in pushing levels of financial distress higher. As the impact of inflation finally set in, last year's earnings have been squeezed by elevated operating costs, including higher labour and energy costs, as well as decelerating consumer demand.

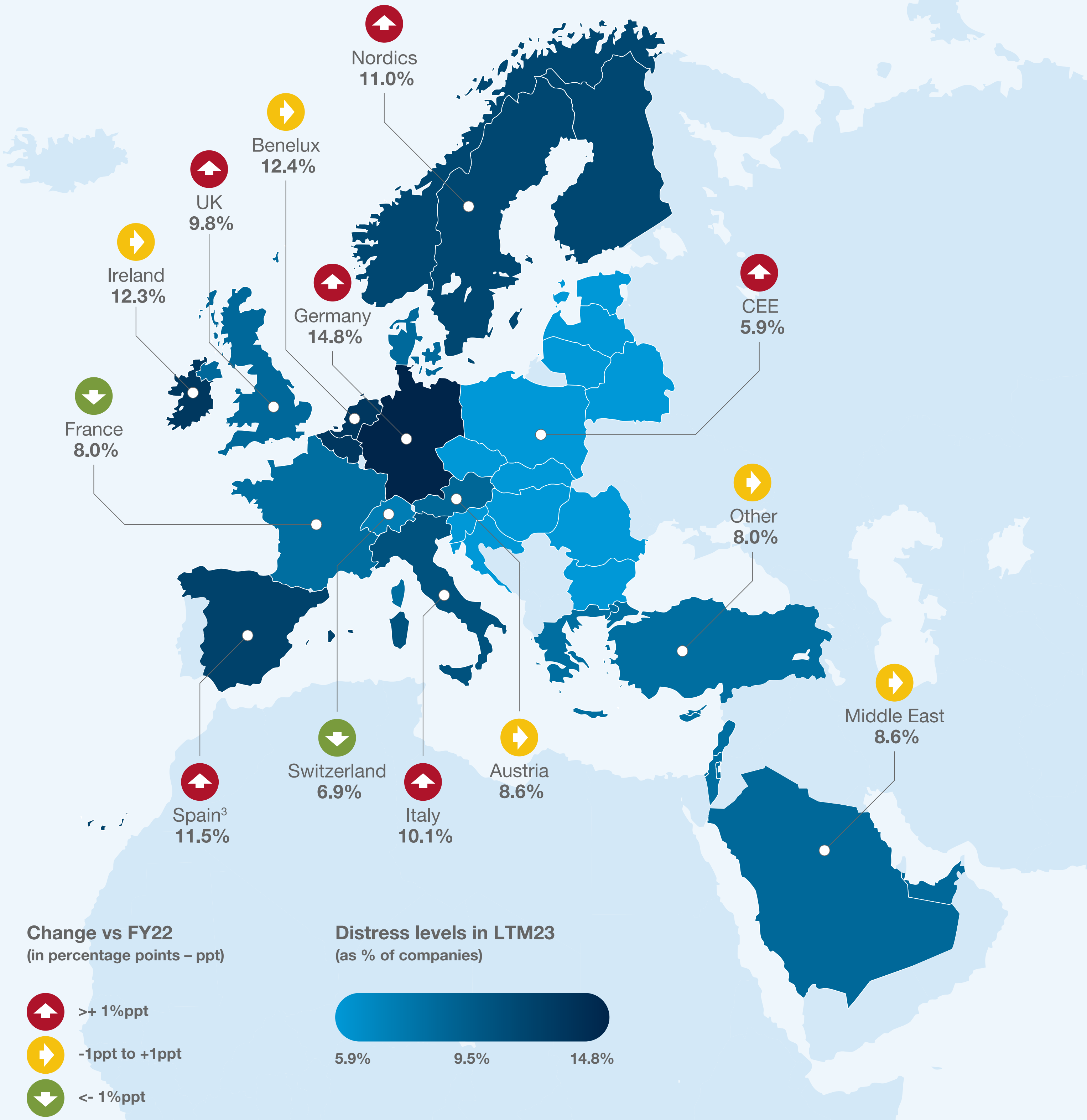
This has added strain on corporates already contending with rising debt costs and upcoming maturities in a higher interest rate environment, with fragile balance sheets remaining a driving factor of distress last year.

The percentage of businesses lacking balance sheet robustness continue to increase steadily, rising to 31.3% last year, the highest since 2020. Meanwhile, the proportion of companies lacking performance jumped to 14.8% from 12.3% in 2022, also reaching the highest level since 2020.

Indeed, A&M estimates that European companies face a $500 billion refinancing bill in the first half of 2024, a challenge that could tip many over the edge in the current audit season, with auditors likely to challenge the going concern assumptions in light of tighter financing conditions.

At a closer look: country and sector trends

Among the 33 countries under the scope of this ADA edition, the highest proportion of distress was seen among German companies, at approximately 15%[1]. This represents a sizeable jump from 9% seen in 2022. Of those, Consumer (Fashion), Consumer (Others)[2] and Construction sectors had the highest percentage of distress, of 33.3%, 31.6% and 25% of total businesses, respectively.

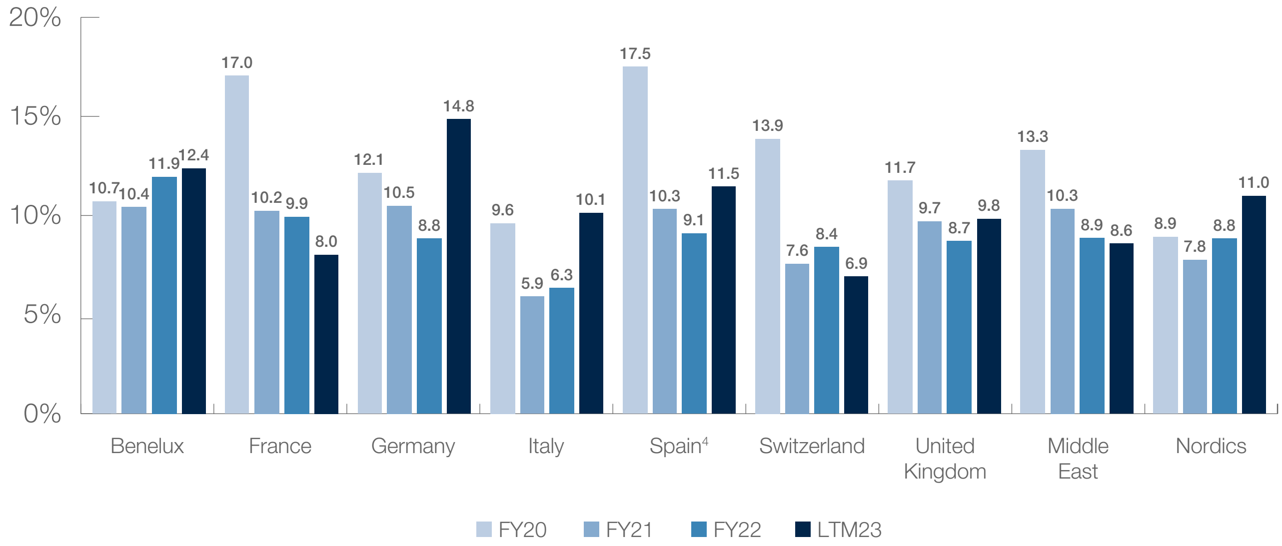


[1] Based on the financial results of companies reporting financial results through November 2023.

[2] Consumer (Others) comprises Consumer Electronics, Household Products, Specialized Consumer Services, Drug Retail, Home Improvement Retail, Computer and Electronics Retail, among others.

[3] Due to the insufficient number of Spanish companies reporting their financial results by November 2023, the figures are not statistically relevant.

Distress levels (as % of companies)



"HIGHER OPERATING COSTS AND WANING DEMAND ARE ADDING STRAIN ON COMPANIES ALREADY CONTENDING WITH RISING DEBT COSTS"

These figures reflect a tough business environment for German companies in 2023, resulting in a sizeable uptick in restructuring activity in the German market, which is not only driven by the stricter early warning system that applies to German entities. High costs for energy and labour have taken a toll on some businesses in several of the country's key industries, such as manufacturing and construction. The capital-intensive real estate sector, in addition, has struggled with higher interest rates, which has made access to financing difficult and put both prices and new construction activity under pressure.

Meanwhile, consumer-facing businesses such as apparel retailers have struggled as consumers in Germany cut discretionary spending in response to inflation and growing economic uncertainty.

After Germany, Benelux (12.4%) and Italy (10.1%) showed the highest levels of corporate distress within our analysis.

In the Benelux region, the worst-performing sectors were Information Technology (IT) and Consumer (Fashion). Companies in these high fixed-cost industries are struggling to maintain revenue growth and control costs in an inflationary environment. Trailing performance has also depleted their cash reserves, resulting in weaker balance sheets.

Italian corporates under pressure

In Italy, the proportion of companies in distress is at the highest since the peak of the pandemic, jumping to 10.1% from 6.3% in 2022. Italian corporates have faced pressure both in terms of economic performance and liquidity positions, as a result of macroeconomic challenges. Furthermore, consumer sentiment in the country has been weaker than the average in the eurozone.

The U.K. too has seen more companies struggling in 2023, with the distress level at 9.8% versus 8.7% a year earlier. British businesses have been made fragile by a combination of factors, including higher borrowing costs and unsustainable debt service costs, elevated energy prices and lower spending as U.K. consumers battle higher mortgage bills.

[4] Due to the insufficient number of Spanish companies reporting their financial results by November 2023, the figures are not statistically relevant.

Among sectors, Media & Entertainment companies faced the highest level of distress in 2023, at 16.3%, compared to 13.3% a year before. The growing vulnerability of Media & Entertainment corporates reflects long-term industry trends of declining advertising revenues and the decentralization of content creation, as well as reduced demand as consumers cut back on discretionary spending.

The financial health of Consumer (Fashion) businesses has also worsened last year, with 16.1% of firms in this space now in distress, versus 13.5% in 2022, according to our analysis. The liquidity position of many companies in this sector is deteriorating fast given persistently elevated operating costs and pressure on consumer spending.

Fashion businesses' operating costs continue to be impacted by raised energy prices, volatility in shipping costs and ongoing rises in minimum wages, whilst in some markets, high inventory levels have driven incremental promotional activity that has compressed margins.

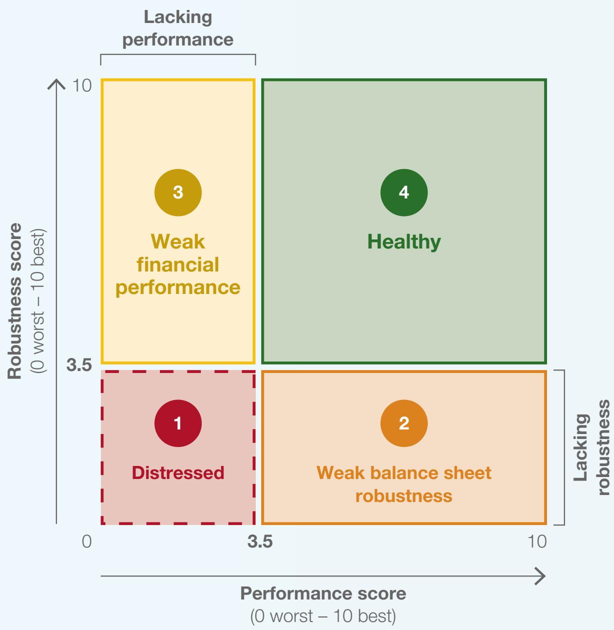
Meanwhile, consumers have been exposed to increased living costs and inflation above long-term levels, with low consumer confidence indices across Europe illustrating the pressure on consumer spending in discretionary categories such as fashion.

Finally, distress among Energy & Utilities firms has increased markedly, jumping from 8.4% in 2022 to 13.7% of total companies in the sector, mainly caused by inflation, higher cost of capital and supply chain disruptions.

Methodology

The A&M Distress Alert assesses performance and balance sheet robustness of European businesses, aiming to identify those that are in financial distress or may soon be heading in that direction.

Our proprietary tool analyses 18 Key Performance Indicators (KPIs) of both listed and private companies with over €20 million of annual revenues across 33 countries in Europe and the Middle East. The study is based on data from over 26,000 companies for the full years between 2020 and 2022, and from approximately 4,700 companies that have reported financial results through November 2023.



Distressed (Cluster 1): companies have (significant) deficits in terms of both their financial and earnings situation. These therefore have insufficient liquidity and/or inadequate and unsustainable capital structures and, at the same time, weak/insufficient profitability. Some of these companies are therefore likely to be in "financial distress".

Weak balance sheet robustness (Cluster 2): companies with a robust earnings/profit performance but insufficient liquidity and/or inadequate and unsustainable capital structures. These companies are in a potential need of a financial restructuring.

Weak financial performance (Cluster 3): companies have a fundamentally solid balance sheet but show weaknesses in their earnings or profitability. These companies are in a potential need of performance improvement measures.

Healthy (Cluster 4): includes companies that have a solid balance sheet and robust earnings.

How Can A&M Help?

A&M has the most comprehensive suite of services to help companies and their stakeholders through challenging times. Our Financial & Operational Restructuring specialists bring decades of experience of working on the world's largest and most complex transactions and gaining consensus amongst multifaceted stakeholder groups to deliver outstanding outcomes against difficult backdrops.

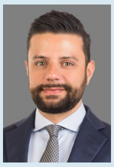
These core restructuring services are all supported by a comprehensive suite of complementary skills to address every single aspect of the most complex transactions from within one team, including deep strategic, operational and financial expertise, valuations and tax advice together with cutting-edge contingency planning support to ensure we can get a transaction done in any circumstances.

A&M. Leadership. Action. Results

Leading companies, financial institutions and public entities turn to Alvarez & Marsal (A&M) to solve their operational, financial and regulatory challenges and provide turnaround management solutions that work. Companies around the globe are facing unprecedented operational and financial challenges due to ever more complex global markets and the rapid disruption across industries.

A&M is uniquely positioned to help your business confront challenges and provide you with solutions that bring long-term value. As your trusted partner, we will provide clarity and deliver results from beginning to end – driving critical change that will optimise performance, maximise value and mitigate risks. Our team brings significant industry experience covering a variety of different sectors including consumer products, retail, energy, financial services, healthcare, industrials, life sciences, media, natural resources, pharmaceuticals and technology.

CONTACTS



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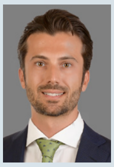

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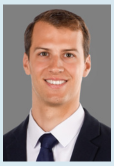

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Companies, investors and government entities around the world turn to Alvarez & Marsal (A&M) for leadership, action and results. Privately held since its founding in 1983, A&M is a leading global professional services firm that provides advisory, business performance improvement and turnaround management services. When conventional approaches are not enough to create transformation and drive change, clients seek our deep expertise and ability to deliver practical solutions to their unique problems.

With over 9,000 people across six continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, leverage A&M's restructuring heritage to help companies act decisively, catapult growth and accelerate results. We are experienced operators, world-class consultants, former regulators and industry authorities with a shared commitment to telling clients what's really needed for turning change into a strategic business asset, managing risk and unlocking value at every stage of growth.

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