THE WEIL EUROPEAN DISTRESS INDEX

APRIL 2024

Weil European Distress Index Movements

Feb 2024	QoQ trend	YoY trend
+3.7	▲ +3.4 Nov 23	▲ +2.8 Feb 23

Macro view

- The latest Weil European Distress Index (WEDI) indicates a mild increase in corporate distress compared with the previous quarter and rising on last year's levels. Amid ongoing challenges facing European listed businesses, corporate debt refinancing remains a key concern.
- A more polarised performance across industry groups is emerging, particularly for corporates reliant on large capital financing and highly leveraged businesses, particularly vulnerable to variable rate loans or due for refinancing in 2024/25.
- This is especially impactful for smaller businesses, often with lower credit ratings, which are more sensitive to rate hikes.
- Current macroeconomic indicators also present a more nuanced picture than previous forecasts. For the Euro Area, the revised projections from the IMF in January 2024 anticipate GDP growth of 0.9% in 2023, followed by an uptick to 1.7% in 2024. Inflation has decreased to a level of 2.6%, offering a reprieve from previous highs, which is consistent with a broader trend of easing inflationary pressures across Europe.
- In the UK, GDP has seen a contraction of 0.3% in Q4 2023 – confirming the economy entered a mild recession at the end of last year - while inflation has moderated to 4.0% (Jan 2024). The unemployment rate held at 3.9% (Jan 2024), remaining remarkably robust, while a steady interest rate of 5.25% persists. Indicators such as the Manufacturing PMI at 47.5 suggest sectoral contraction, whereas the Services PMI at 53.8 points to modest growth.
- This mixed picture highlights ongoing uncertainty. The economic backdrop in Europe continues to be marked by complexity. The cooling of tighter monetary policy has provided more confidence in some parts of the market, although the aftereffects of past hikes still linger.
- Lower asset values, particularly in real estate, risk businesses facing a funding gap as less favourable loan-to-value ratios (LTVs) limit refinancing potential. Some of this exposure could be felt in the banking sector as debt profiles mature in the future.
- Higher interest rates make new capital investments more expensive too, potentially slowing down expansion plans and technological upgrades, particularly in capital-intensive industries.
- Germany remained the most distressed market covered in the WEDI. The IMF expect the German economy expand by 0.5% in 2024, a marked improvement on 2023 (-0.3%) but remaining the worst performer of all advanced economies. This is followed by the UK (+0.6%), Italy (+0.7%), France (+1.0%) and Spain (1.5%), with the Euro Area overall expected to rise by 0.9% this year and 1.7% in 2025.

Sector view

- In the latest data, the European Real Estate market remains the most distressed and worsened on the previous quarter. Weaker investment metrics was the principal driver of distress, reflecting a challenging outlook for highly leveraged companies facing elevated costs of capital. Squeezed liquidity has emerged as the second highest driver of distress as refinancing is a key concern and funding gaps widen for some businesses.
- Elsewhere, healthcare companies remained the second most distressed sector, although the intensity of distress has moderated over the last quarter.
- The industrials sector has experienced a rise in levels of distress in comparison to the previous quarter. This sector encompasses a wide range of businesses that are typically capital-intensive and sensitive to economic cycles. What's more, supply chain disruptions in the Red Sea has led to increased costs and delays. This is evidenced by Tesla and Volvo suspending some production in Europe due to a component shortage, a direct impact of the disruption.

How do we define ‘distress’?

The Weil European Distress Index (WEDI) provides a measure of the level of corporate distress by aggregating company fundamentals and financial market indicators across key European countries.

Corporate distress can be defined as uncertainty about the fundamental value of financial assets, volatility and increase in perceived risk. It also refers to the disruption of the normal functioning of company financial performance, including their ability to fulfil their debt requirements.

The definition is purposely broad as corporate distress can manifest in different ways, and no two stress events are identical for each company.

Although stress events differ in composition, there are several common characteristics of corporate distress ranging from pressure on liquidity, reduced profitability, rising insolvency risk, falling valuations and reduced return on investment. These company indicators are also set against a backdrop of market conditions that can also indicate levels of distress (e.g. business confidence, rising volatility and rising levels of perceived market risk).

Methodology

The WEDI is a univariate time series that distils information embedded in more than 16 indicators into a summary measure of corporate distress. It can then be decomposed into five markets (Total Europe*, UK, Germany, Spain-Italy, and France), size of company (based on market cap) and 10 industry groups:

- Retail and Consumer Goods
- Travel, Leisure and Hospitality
- Industrials
- Healthcare
- Technology, Media and Telecoms
- Financial Services
- Oil and Gas
- Infrastructure, Utilities and Power
- Commodities and Natural Resources
- Real Estate

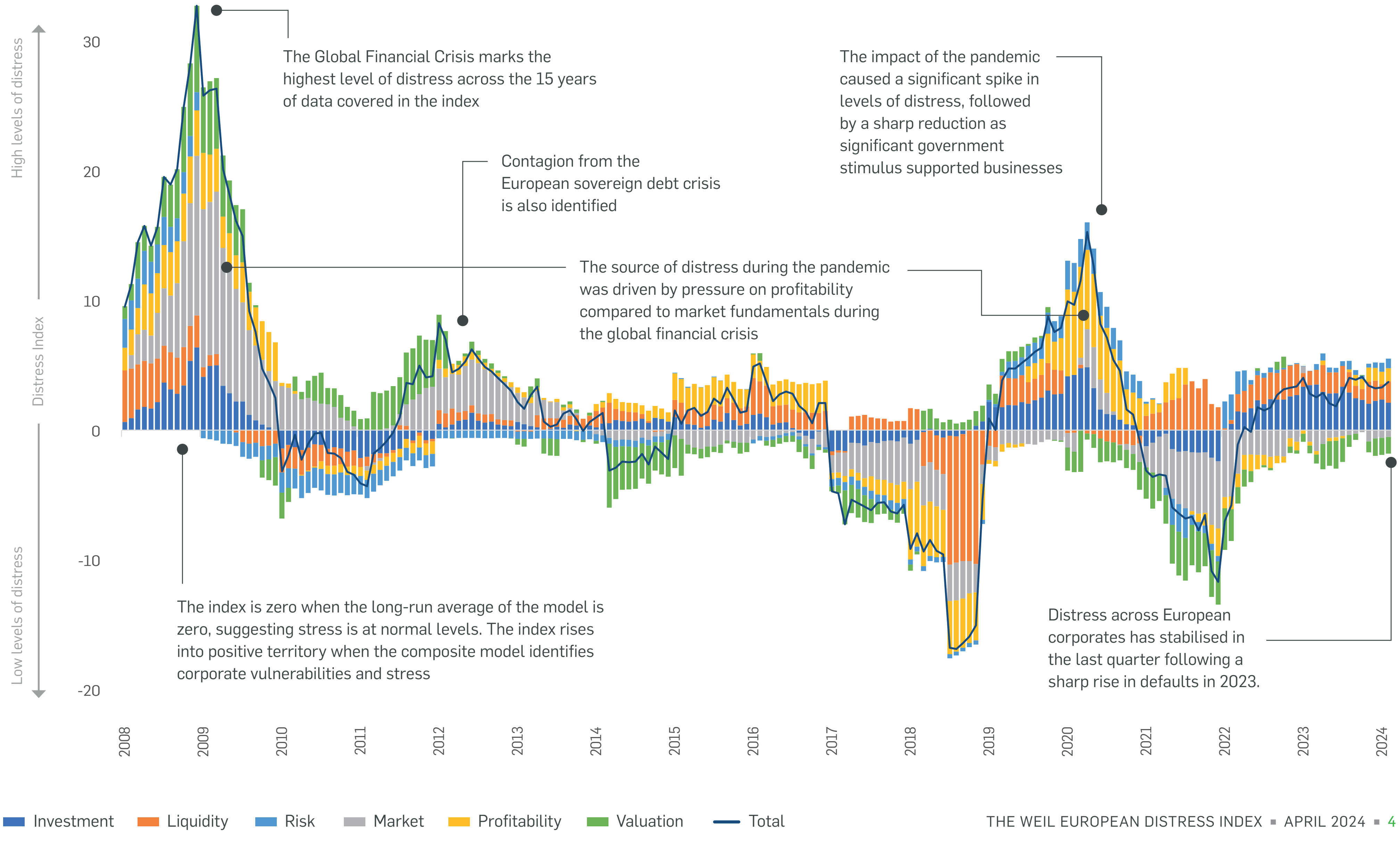
The WEDI is constructed using data from over 3,750 listed European companies and a range of financial market indicators. 16 indicators have been used to construct the WEDI which reflect one or more symptoms of corporate distress based on comprehensive academic and desk-based research.

The WEDI uses a Dynamic Factor Model – a statistical approach that captures the variability across the 16 indicators in a single composite index using key company fundamentals going back to 2005 and incorporates over five million data points.

METRIC	DEFINITION
Liquidity	Contains measures of liquidity such as the current ratio, quick ratio and operating cashflow metrics which are used to determine a company’s ability to pay off current debt obligations without needing to raise external capital.
Profitability	Contains measures such as return on equity, net profit margins and return on assets to assess the business’s ability to generate earnings relative to its revenue, operating costs, balance sheet and shareholders’ equity over time.
Risk	Contains measures such as debt to equity ratio and interest cover to assess a company’s capital structure and current risk levels, often in terms of debt levels and risk of default or bankruptcy.
Valuation	Contains measures such as price to earnings, price to book value and enterprise value to EBITDA multiples, used to assess the relative valuation of a company over time.
Investment	Contains measures such as dividend per share and dividend yield used to assess the potential attractiveness of a business as an investment opportunity.
Financial markets	Contains measures such as index market capitalisation, market volatility, risk, credit default swaps and business confidence which are used to track levels of distress across broader financial markets in key European markets.

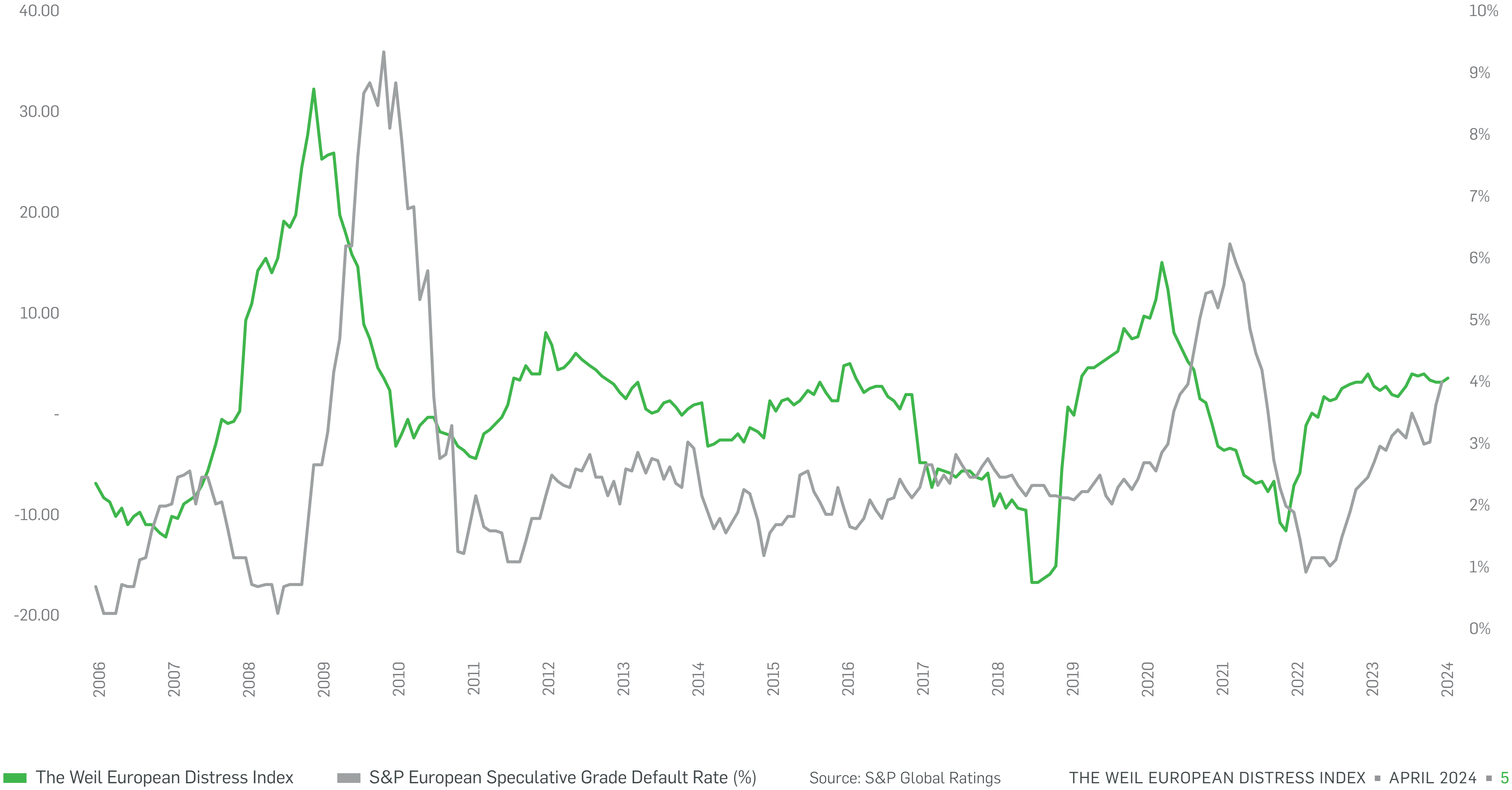
* Total Europe includes UK, France, Germany, Spain, Italy, The Netherlands, Republic of Ireland, Belgium, Norway and Portugal

The European Distress Index



The Weil European Distress Index vs Default Rates

- In the two most major recent crises, the Global Financial Crisis and Covid pandemic, we have observed that the WEDI peaks in advance of the S&P European Speculative Grade Default Rate.
- The WEDI tracks the deterioration in financial markets conditions and company performance which occurs in advance of a default wave to provide an early warning indicator.



Source: S&P Global Ratings

THE WEIL EUROPEAN DISTRESS INDEX
APRIL 2024

SIZE ANALYSIS

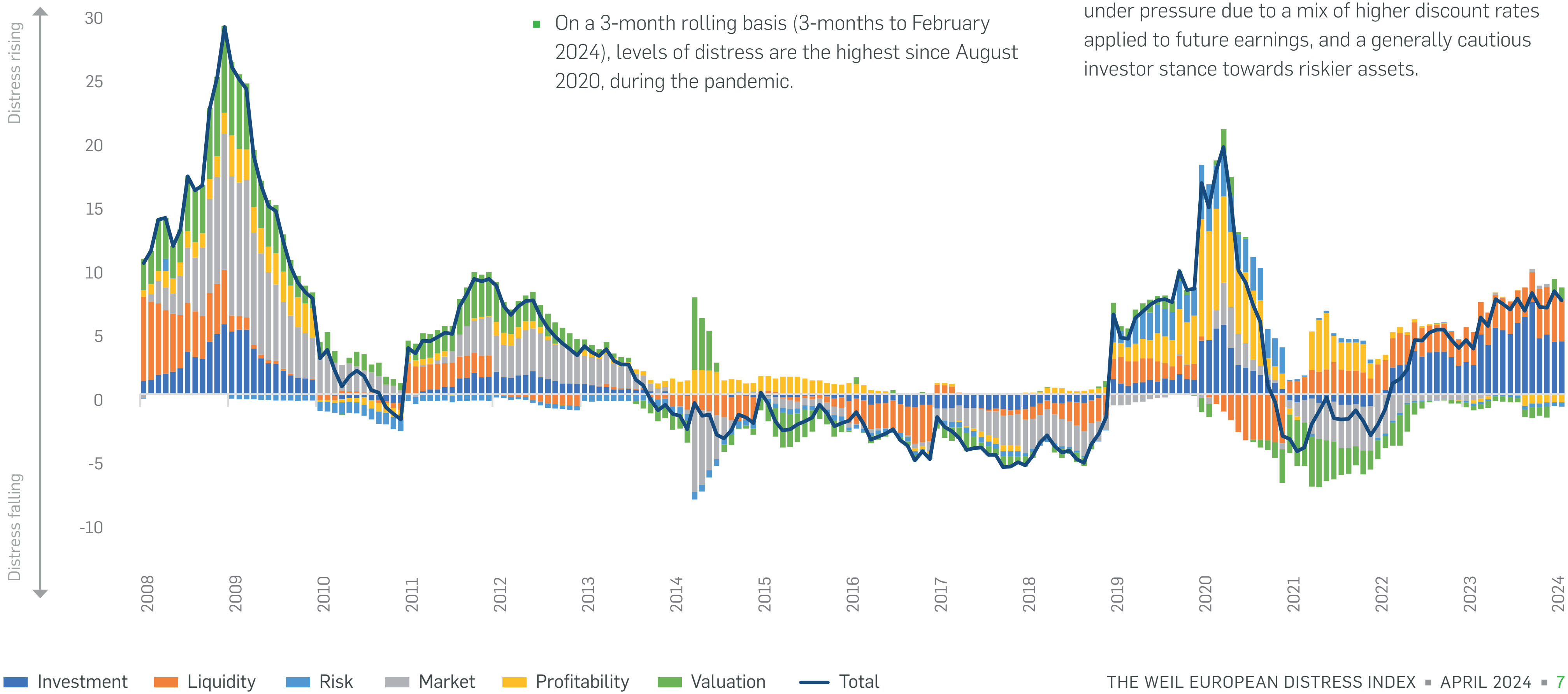
INDUSTRY ANALYSIS

COUNTRY ANALYSIS

Small Corporates

(market cap <€5bn)

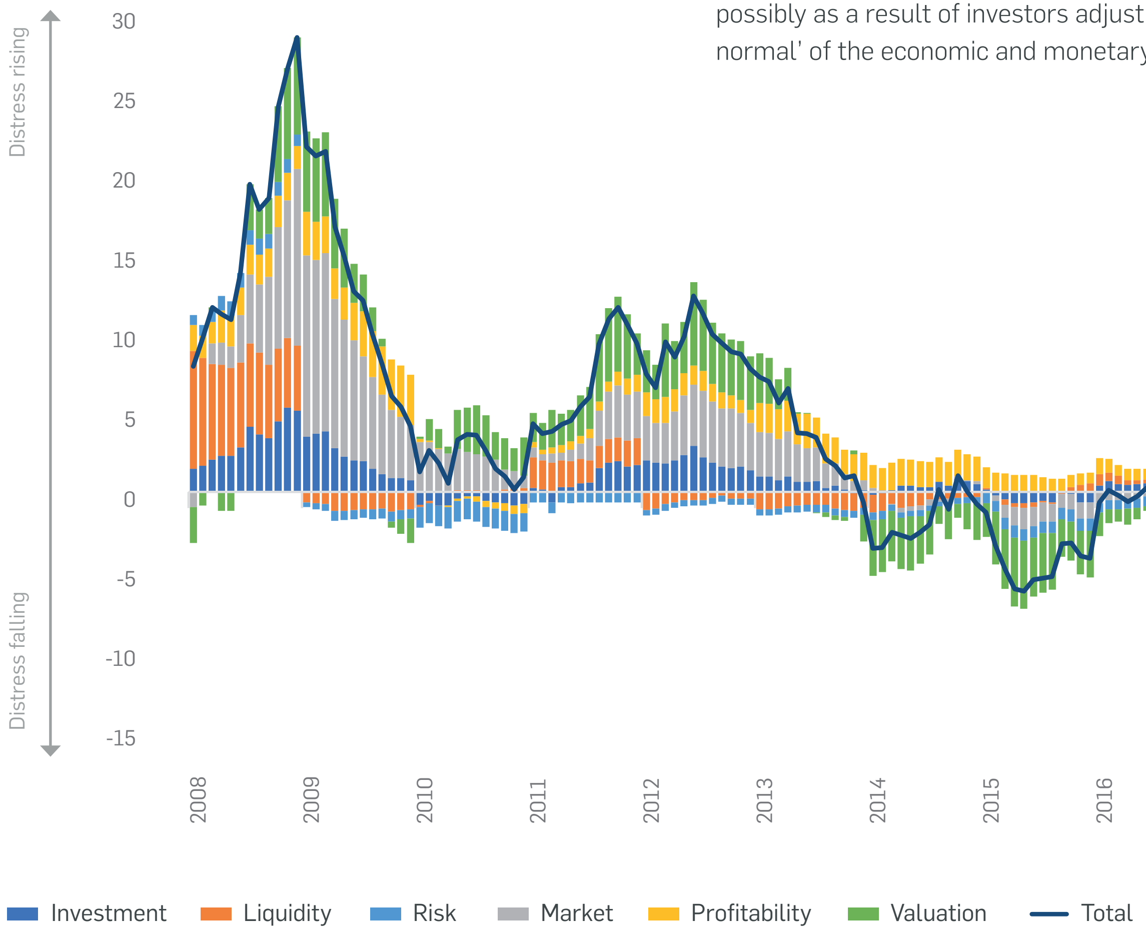
- In the landscape of European corporates, small companies [those with a market capitalisation under €5bn] continue to experience the highest levels of distress.
- This trend persists with the latest data reporting a slight increase in the levels of distress observed in the most recent quarter, according to the WEDI.
- Investment challenges and liquidity constraints remain the primary drivers of distress, reflecting a consistent theme that has been prevalent in previous quarters.
- On a 3-month rolling basis (3-months to February 2024), levels of distress are the highest since August 2020, during the pandemic.
- Smaller firms face ongoing pressures from a tightened borrowing environment as a result of sustained high interest rates, which disproportionately impacts their financing and operational flexibility compared to their larger counterparts.
- Liquidity remains squeezed for small corporates which could be the consequence of a slower turnover of inventory and receivables, thereby impacting cash flows.
- Elsewhere, valuations for small corporates may be under pressure due to a mix of higher discount rates applied to future earnings, and a generally cautious investor stance towards riskier assets.



Medium Corporates

(market cap €5bn – €25bn)

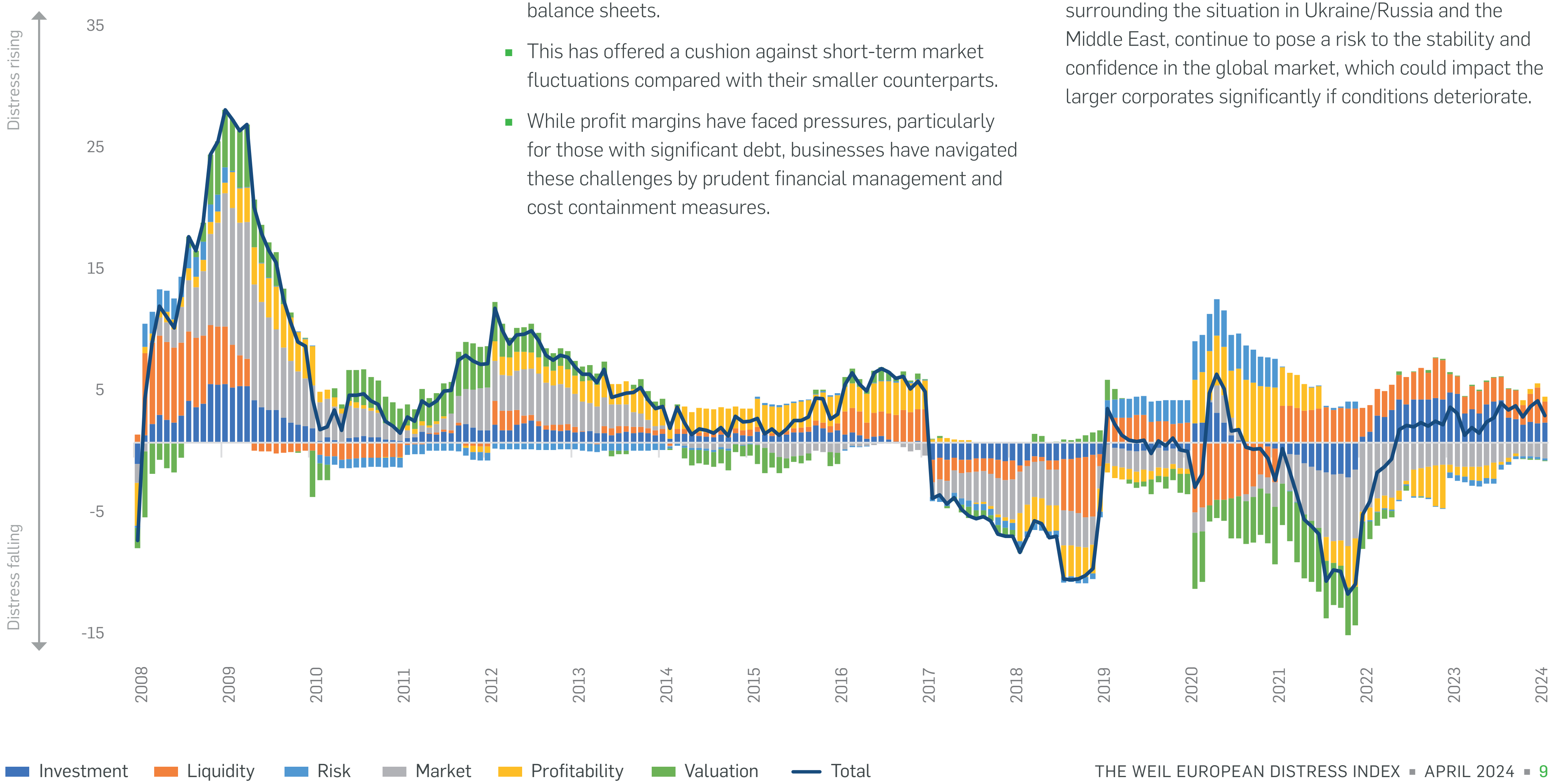
- In the medium-sized corporate sector, those with market capitalisations ranging from €5bn to €25bn, there has been a moderation in distress levels from the previous quarter according to the latest data.
- The trend throughout 2023 pointed to a stabilisation in distress, suggesting these firms are navigating the economic headwinds with a degree of resilience.
- In some instances, there may have been a market reassessment that led to more stable valuations, possibly as a result of investors adjusting to the 'new normal' of the economic and monetary landscape.
- In the context of a changing economic environment, medium-sized European corporates appear to be demonstrating adaptability from the extremes of market volatility compared with smaller firms.
- The next quarters will be crucial in determining whether this trend is sustainable as these firms continue to adjust to the global economic climate.



Large Corporates

(market cap >€25bn)

- In the latest quarter to February 2024, large European corporates (those with market capitalisations exceeding €25bn), have shown distress levels plateauing at current levels, but remaining above the long-run average.
- Tightened liquidity has remained a challenge, but large corporates have shown robustness potentially due to better access to diverse financing options and stronger balance sheets.
- This has offered a cushion against short-term market fluctuations compared with their smaller counterparts.
- While profit margins have faced pressures, particularly for those with significant debt, businesses have navigated these challenges by prudent financial management and cost containment measures.
- There are signs that business confidence has seen a boost in several key markets, perhaps in anticipation the monetary policy tightening cycle coming to an end, providing greater certainty for future corporate planning and investment.
- Despite these positive indicators, the persistent geo-political tensions, especially the uncertainties surrounding the situation in Ukraine/Russia and the Middle East, continue to pose a risk to the stability and confidence in the global market, which could impact the larger corporates significantly if conditions deteriorate.



Distress Index February 2024

Least distressed — Most distressed

Real Estate

Distress ranking	Index value	YoY trend
1	+7.5	↓ +8.4 Feb 23

Investment | Liquidity | Market | Profitability | Risk | Valuation

Healthcare

Distress ranking	Index value	YoY trend
2	+5.2	↓ +5.9 Feb 23

Investment | Liquidity | Market | Profitability | Risk | Valuation

Industrials

Distress ranking	Index value	YoY trend
3	+3.6	↑ +1.4 Feb 23

Investment | Liquidity | Market | Profitability | Risk | Valuation

Retail and Consumer Goods

Distress ranking	Index value	YoY trend
4	+2.3	↓ +2.8 Feb 23

Investment | Liquidity | Market | Profitability | Risk | Valuation

Travel, Leisure and Hospitality

Distress ranking	Index value	YoY trend
5	+1.3	↑ +0.4 Feb 23

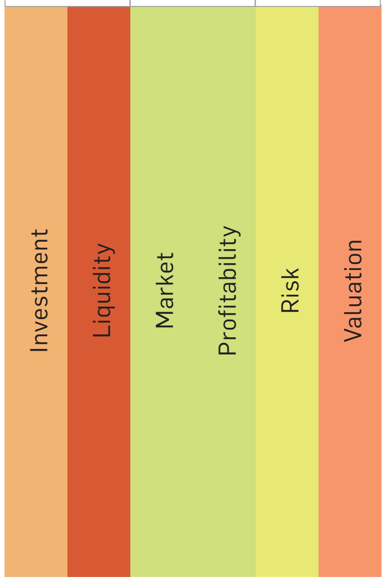
Investment | Liquidity | Market | Profitability | Risk | Valuation

INDUSTRY ANALYSIS

Least distressed — Most distressed

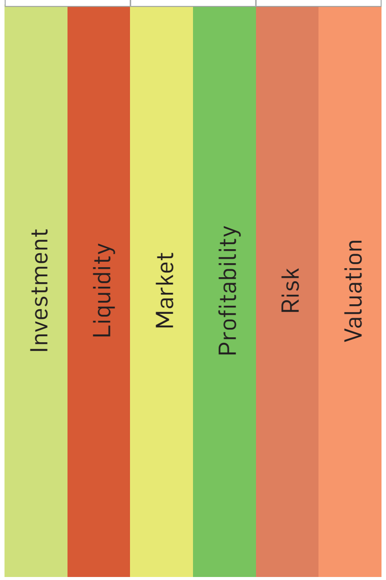
Oil and Gas

Distress ranking	Index value	YoY trend
6	-1.6	↓ -0.7 Feb 23



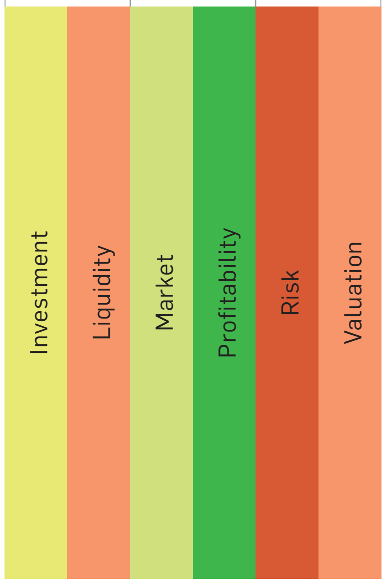
Commodities and Natural Resources

Distress ranking	Index value	YoY trend
7	-2.7	↑ -5.5 Feb 23



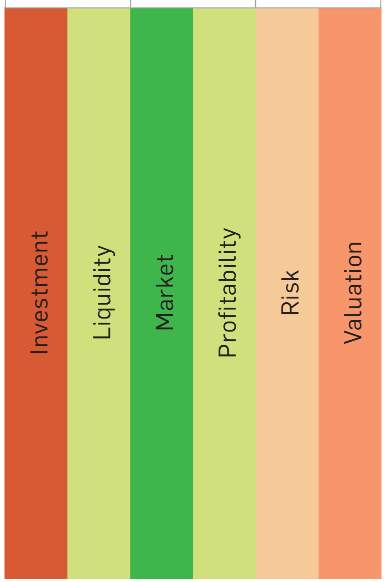
Financial Services

Distress ranking	Index value	YoY trend
8	-2.9	↓ -0.9 Feb 23



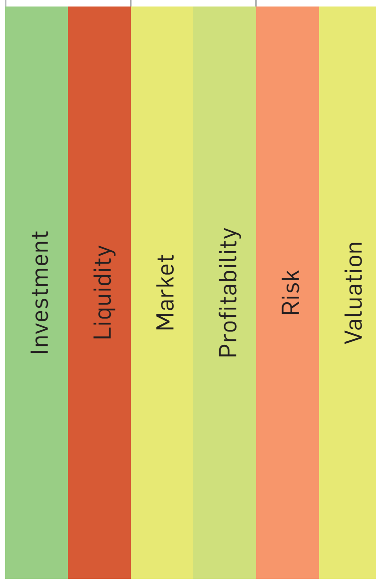
Technology, Media and Telecoms

Distress ranking	Index value	YoY trend
9	-3.7	↓ -2.2 Feb 23



Infrastructure

Distress ranking	Index value	YoY trend
10	-5.1	↓ -1.8 Feb 23

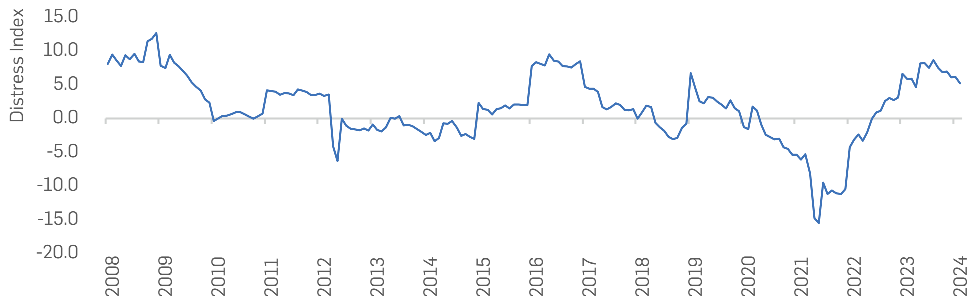


Real Estate

Persistently high interest rates, alongside declining valuations, continue to exert significant pressure on the European real estate market, securing its position as the most distressed sector. Real estate firms, particularly those with high leverage ratios, face mounting challenges in servicing or refinancing debt, exacerbated by elevated construction and operational costs.

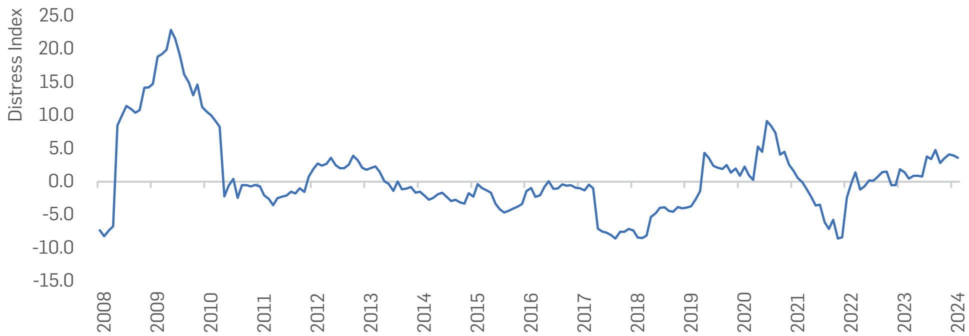
Healthcare

The most recent data indicates a continued easing in distress levels within Healthcare, yet profitability and risk factors continue to drive sectoral concerns. The slightly improved liquidity situation does not overshadow the operational challenges, with profitability strains being a significant pressure point. Meanwhile, the sector's ability to navigate leverage loan impacts will be critical in mitigating ongoing financial pressures.



Industrials

Industrials witnessed an uptick in distress compared with the previous quarter, primarily attributed to weakening investment metrics and more challenging valuations. Economic uncertainties, combined with elevated interest rates, continue to inhibit the appetite for new large-scale, capital-intensive initiatives among firms.

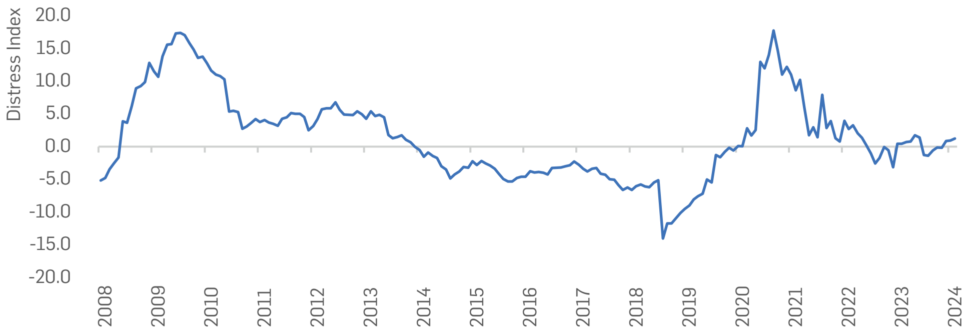


Retail and Consumer Goods

Consumer spending is facing headwinds as households adjust to the new norm of higher remortgaging rates, and the squeeze from rising rents impacting discretionary spending. This scenario maintains pressure on the sector, with businesses striving to balance operational costs against consumer price sensitivity.

Travel, Leisure and Hospitality

The Travel, Leisure & Hospitality sector, despite making strides in recovery from pandemic peaks, has encountered increased distress in recent months, marking the highest levels since June 2023. The uptick in distress is primarily attributed to tightening liquidity and cautious investment in the sector.

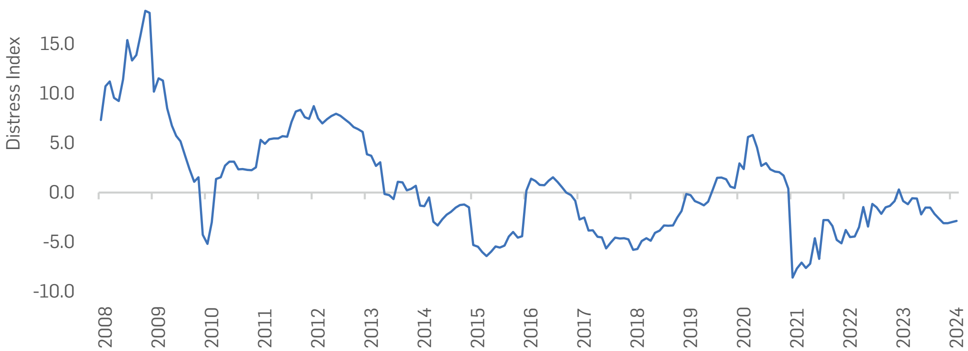


Oil and Gas

The Oil and Gas sector has maintained distress levels below the historical average, continuing the trend set post-pandemic. Oil prices rose to a four-month high, breaching $85 per barrel for the first time since November 2023, which will support firms operating in the sector.

Financial Services

Distress in the Financial Services sector experienced a notable decline. The sector is showing resilience in the face of market volatility, with firms demonstrating robust risk management strategies to combat margin pressures and manage debt servicing costs more effectively.

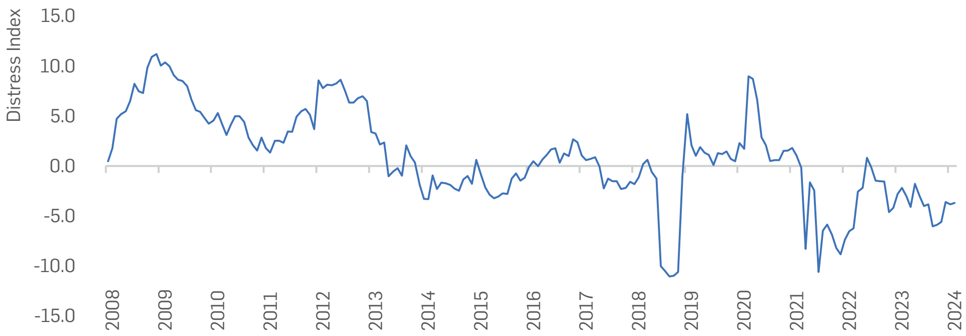


Commodities and Natural Resources

The Commodities and Natural Resources sector, while still registering below long-term average distress levels, has shown a marked improvement compared to the previous quarter. A combination of strategic investment decisions and sustained profitability has contributed to lower levels of distress. Despite these positive indicators, there remains a cautious sentiment within the sector, partly due to concerns over a potential global economic downturn, which may be dampening confidence and investment enthusiasm moving forward.

Technology, Media and Telecoms

The Technology, Media, and Telecommunications (TMT) sector has shown an increase in distress levels this quarter but maintains a position below long-term historical averages. This resilience can be attributed to robust market fundamentals and enhanced liquidity.



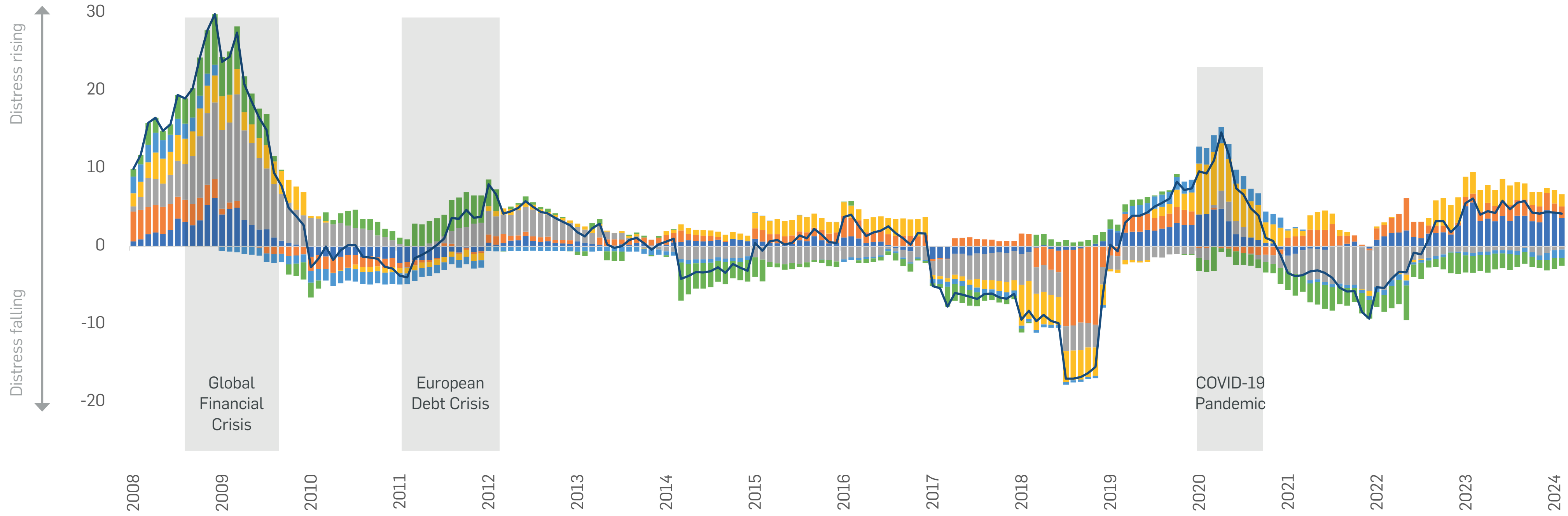
Infrastructure, Utilities and Power

The Infrastructure, Utilities, and Power sectors have maintained a level of distress below the long-term average, as shown in the most recent data. Despite the broader economic headwinds, these sectors continue to benefit from sustained market support and stable profit margins. The steady investment and positive market sentiment towards these essential services indicate a continued confidence in their resilience.

Feb 2024	QoQ trend	YoY trend
+4.2	+4.2 Nov 23	+6.1 Feb 23

United Kingdom Distress Index

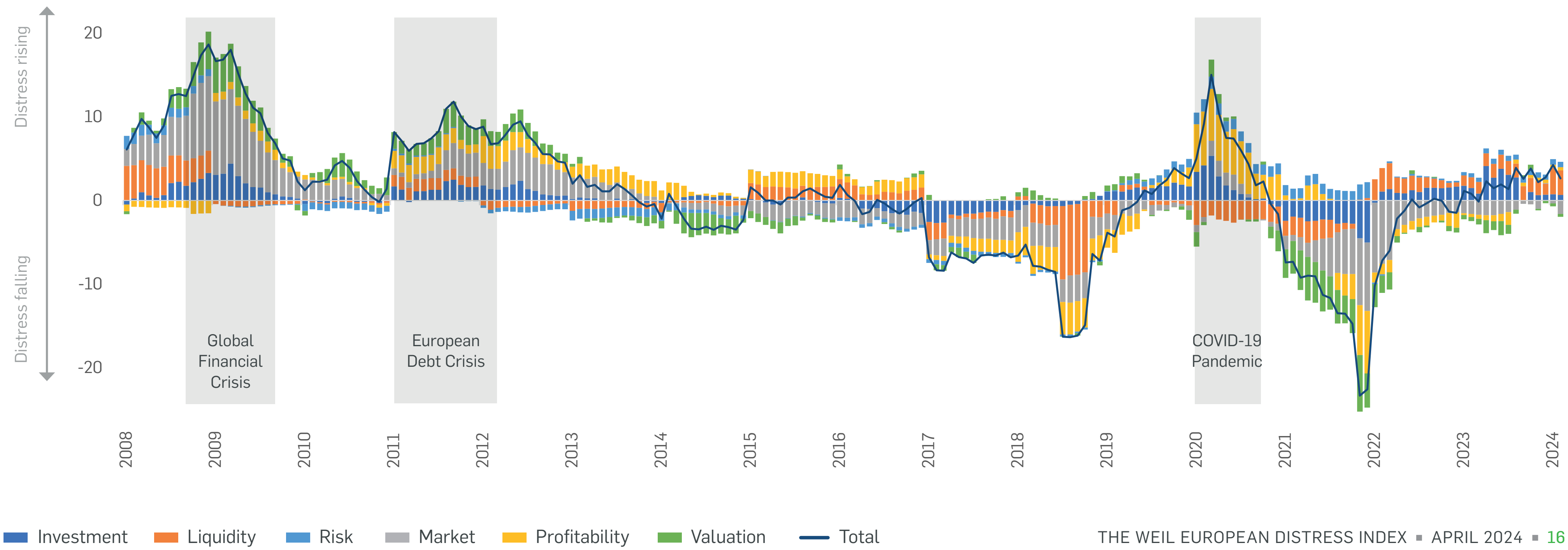
- In the UK, corporate distress remains consistent with levels shown in the previous quarter, although it continues to sit below the levels observed last year. Investment reticence, constrained liquidity, and subdued profitability persist as the primary contributors to distress.
- The prevailing high-interest-rate environment is still filtering through, with many firms grappling to accommodate the increasing debt service costs amidst more rigorous refinancing conditions and weakened demand.
- Although the UK entered recession in the final quarter of 2023, signalling underlying weakness in demand, many commentators expect this to be short-lived. Positive news has emerged from falling inflation, a resilient labour market and consumer confidence which is considerably higher than this time last year. The housing market is also proving to be more robust than many had expected with data suggesting the number of agreed sales jumped in the first two months of the year, 23% up year-on-year.



Feb 2024	QoQ trend	YoY trend
+2.6	+2.2 Nov 23	0.8 Feb 23

France Distress Index

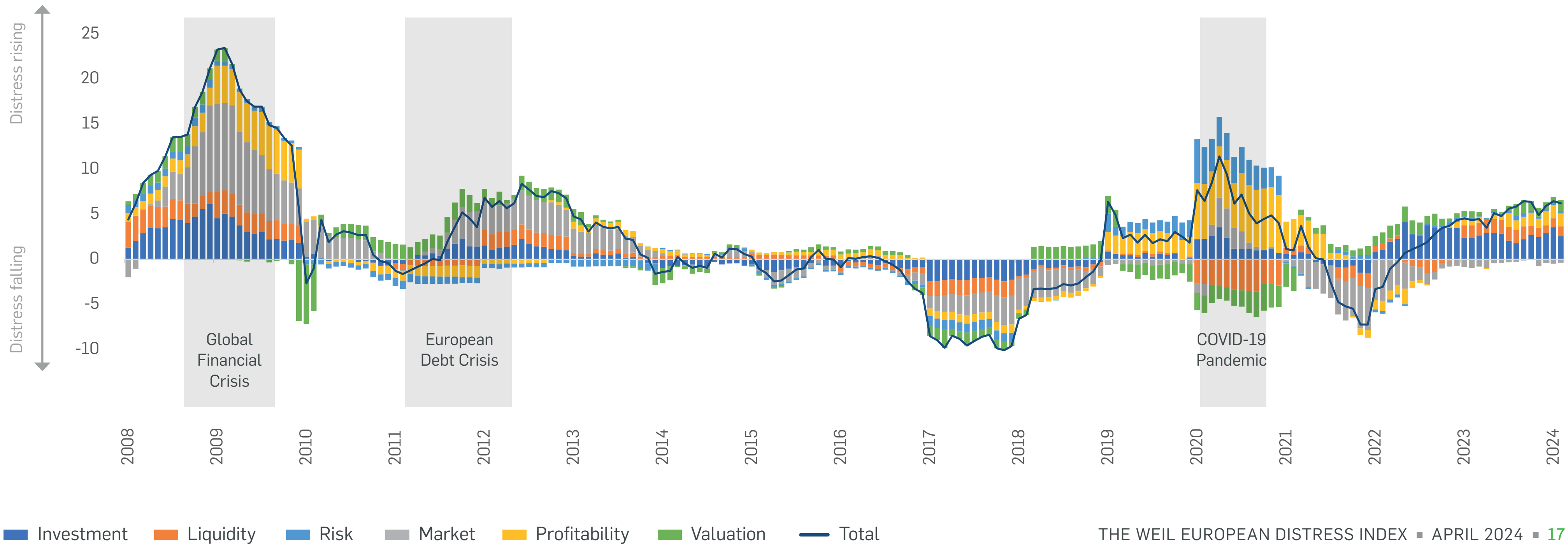
- Distress levels in France remained above the long run average for the 11th consecutive month, remaining the third most distressed country covered by the WEDI.
- The sources of distress were driven by pressure on liquidity, weaker investment metrics, and a faltering appetite for risk.
- GDP has flat-lined, showing no growth in the third and fourth quarter (QoQ), while consumer confidence fell in February following fourth consecutive increases, albeit remaining significantly higher than this time last year.
- Retail sales remained in negative territory, showing no growth in the value of sales for any month in 2023, and down 2.4% in December.
- Despite the challenging backdrop, business confidence has improved in recent months, reaching a 7-month high in February 2024. The HCOB France Composite PMI was revised slightly upwards to 48.1 in February 2024, the slowest rate of decline in business activity in the current nine-month period of contraction. Both the services sector and manufacturing activity posted much smaller contractions.
- Unemployment has also remained steady at 7.5% in Q4 2023, and wage growth at 3.8% continues to moderate from last year's levels. Inflation has continued its downward trajectory, now at its lowest level since September 2021.



Feb 2024	QoQ trend	YoY trend
+6.2	+4.9 Nov 23	+4.3 Feb 23

Germany Distress Index

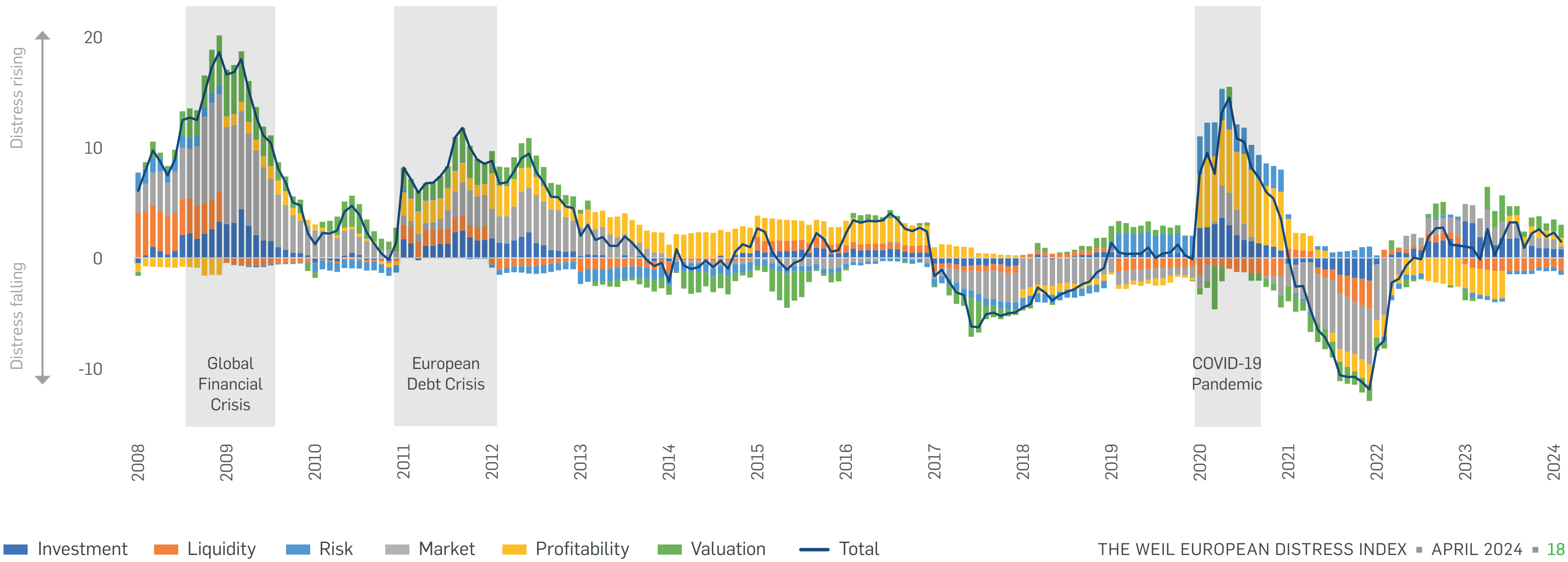
- German corporates continued to experience the highest levels of distress across the countries measured.
- Investment hesitancy, alongside ongoing liquidity and profitability challenges, continue to impact firms amid a macroeconomic environment burdened by weaker economic growth.
- Indeed, Germany's economic ministry reported that a tangible economic recovery remains out of sight given persistently weak domestic demand, high financing costs and continued subdued sentiment among private households and companies.
- German government's own forecasts predict GDP growth of just 0.2% in 2024, revised down from 1.3%, worse than the IMF. In part, Germany's reliance on exports has made it vulnerable to weaker global trade patterns, while ongoing structural labour market issues limiting the supply of labour remain challenging.
- Germany's central bank, the Bundesbank, said "stress factors" would remain and that economic output could "decline again slightly in the first quarter of 2024", sliding the economy into recession. A recent survey (March 2024) by Bloomberg reported that Germany is already in recession and its economy is hardly expected to grow at all in 2024.
- Construction, in particular, remains under pressure from the combination of higher interest rates, skilled labour shortages and higher levels of bureaucracy than European neighbours. From January to October 2023, the number of corporate insolvencies rose by 24.1% to 14,751 in Germany (Reuters Jan 2024).
- However, inflation rates are now falling (3.2%), unemployment (5.9%) remains low and energy costs have come down, meaning the economy is expected to recover this year.



Feb 2024	QoQ trend	YoY trend
+1.5	+2.6 Nov 23	+0.9 Feb 23

Spain and Italy Distress Index

- Corporates headquartered in Spain and Italy continue to experience levels of distress above the long run average but remained the lowest of all countries measured in the WEDI.
- Distress fell on the previous quarter and resides at the lowest level since September 2023. Concerns across weaker investment, softer valuations and squeezed profitability drove distress.
- Nevertheless, the economic outlook for Spain and Italy appears more positive than the UK and Germany. GDP is expected to rise by 1.5% in Spain, and 0.7% in Italy in 2024, according to the IMF. Across advanced economies, Spain is expected to see the second fastest rate of growth, only surpassed by the US (2.1%).
- Consumption and investment are set to sustain economic growth in Spain, supported by further real income gains for households and high levels of household savings.
- Investment is set to recover, driven by government and RRF-funded infrastructure projects
- Distress fell in the previous quarter and resides at the lowest level since September 2023



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