THE WEIL EUROPEAN DISTRESS INDEX

JUNE 2022

Macro view

- Corporate distress across key European markets rose to their highest level since August 2020, according to the Weil European Distress Index (WEDI).
- Latest data shows that corporate distress has been pushed higher by ongoing pressure around risk metrics, while weaker investment and a sharp deterioration of market fundamentals have contributed to the rise.
- Support from valuation has also waned recently to its lowest level in over two years.
- Distress across German corporates was the highest compared with other European markets. Levels haven't been higher since July 2020 – in the midst of the global pandemic.
- The UK was the next most distressed market, reaching the highest level since September 2020, driven by pressures around liquidity, investment and profitability.
- European markets have continued to face heightened geopolitical risks, the ongoing impact of disrupted supply chains, rising operating costs, labour shortages and a weaker economic outlook.
- In many markets, this has manifested in investors shying away from riskier assets.
- Many European economies are experiencing 30-year highs in inflation, with tightening monetary policy.
- The Bank of England raised interest rates for the fifth consecutive time in June, reaching the highest level since the global financial crisis.

Weil European Distress Index Movements

May 2022	May 2021	QoQ trend	YoY trend
4.7	-6.0	⬆	⬆

- Meanwhile, the European Central Bank (ECB) has confirmed it will end its net asset purchases in the third quarter of 2022, opening up the possibility of a rate hike, which some policymakers hinted could come as early as July 2022.
- With increased uncertainty caused by the Russia-Ukraine conflict, the outlook for corporate distress has become more volatile across most industry groups.

Sector view

- The largest driver of distress in the latest data (May 2022) came from businesses operating within the 'Retail and Consumer Goods' sector, driven by poorer investment and valuation metrics and a squeeze on liquidity.
- The cost-of-living crisis across Europe has put intense pressure on living standards as rising prices for energy, food and transport erode discretionary spending power.
- Levels of distress across the 'Travel, Leisure & Hospitality' sector have fallen markedly since the pandemic but remain above the long run historical average.

How do we define ‘distress’?

The 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, France, and Spain-Italy), size of company (based on market cap) and 10 industry groups:

- Retail and consumer goods
- Financial services
- Travel, leisure and hospitality
- Oil and gas
- Industrials
- Infrastructure, utilities and power
- Healthcare
- Commodities and natural resources
- Technology, media and telecoms
- Real Estate

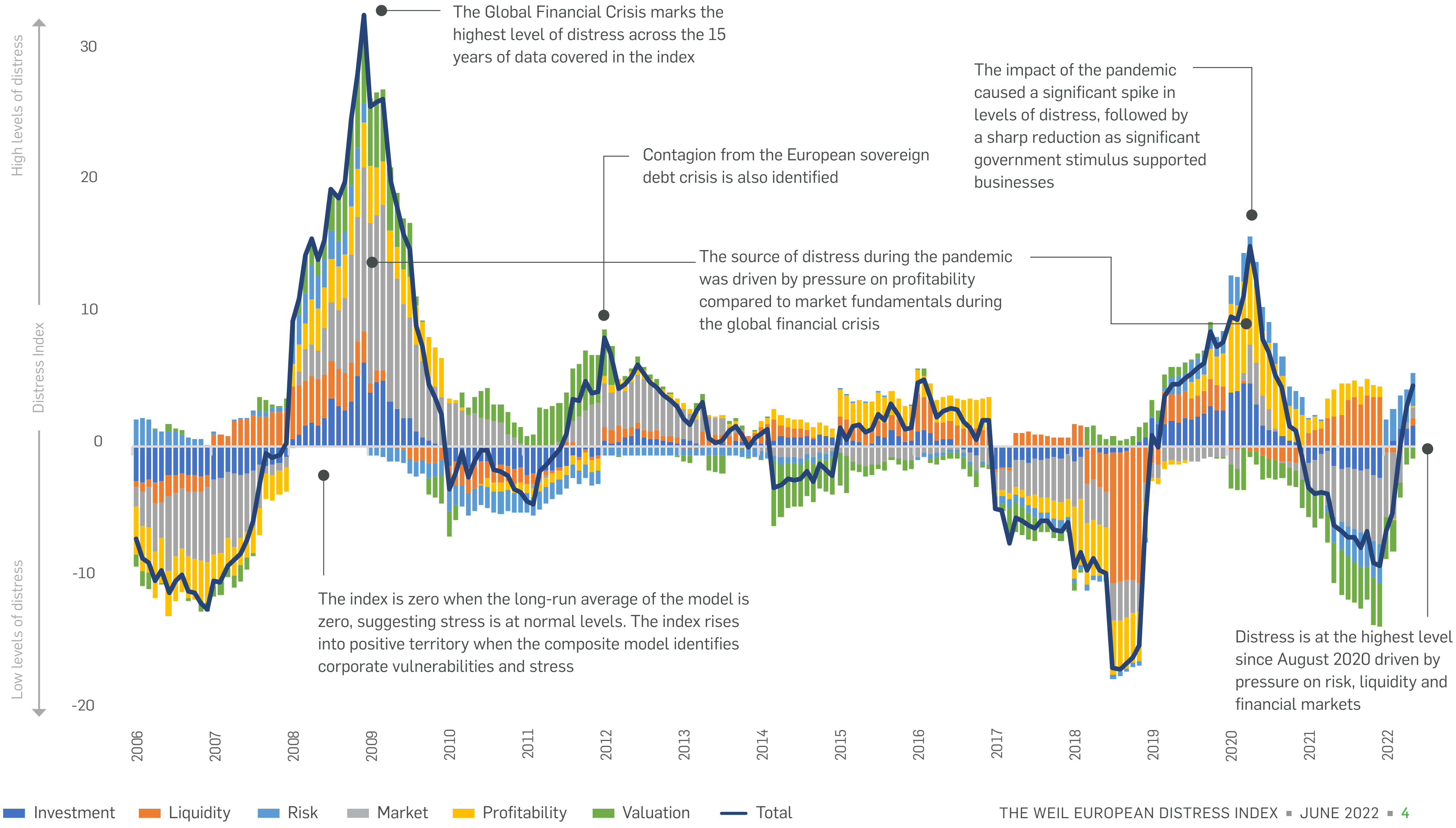
The WEDI is constructed using data from over 3,750 listed European companies and a range of financial market indicators. 16 indicators have been used to construct the WEDI which reflect one or more symptoms of corporate distress based on comprehensive academic and desk-based research.

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.

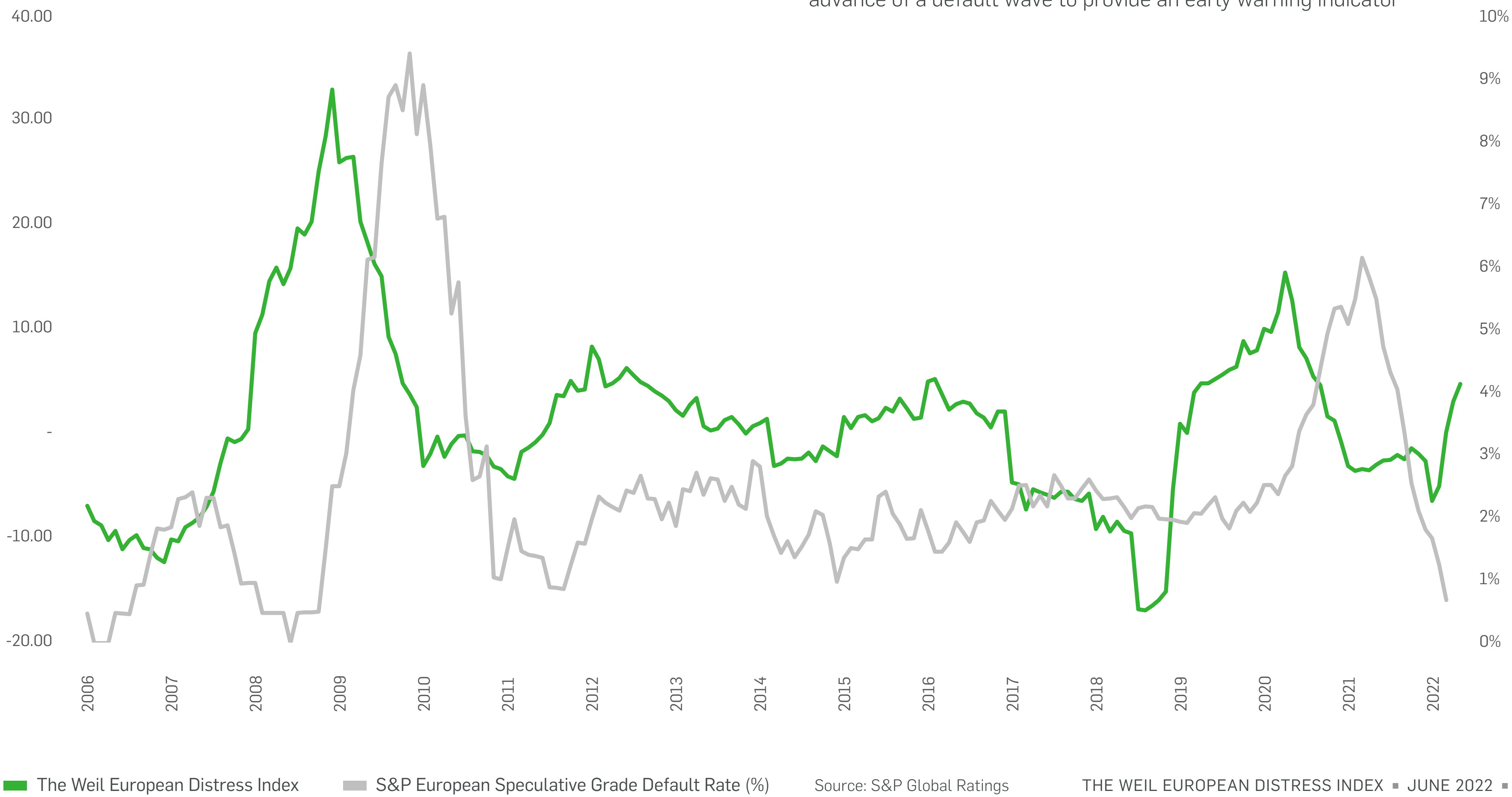
* Total Europe include UK, Germany, France, Spain, Italy, The Netherlands, Republic of Ireland, Belgium, Norway and Portugal

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 Weil European Distress Index peaks in advance of the S&P European Speculative Grade Default Rate
- The Weil European Distress Index 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
JUNE 2022

SIZE ANALYSIS

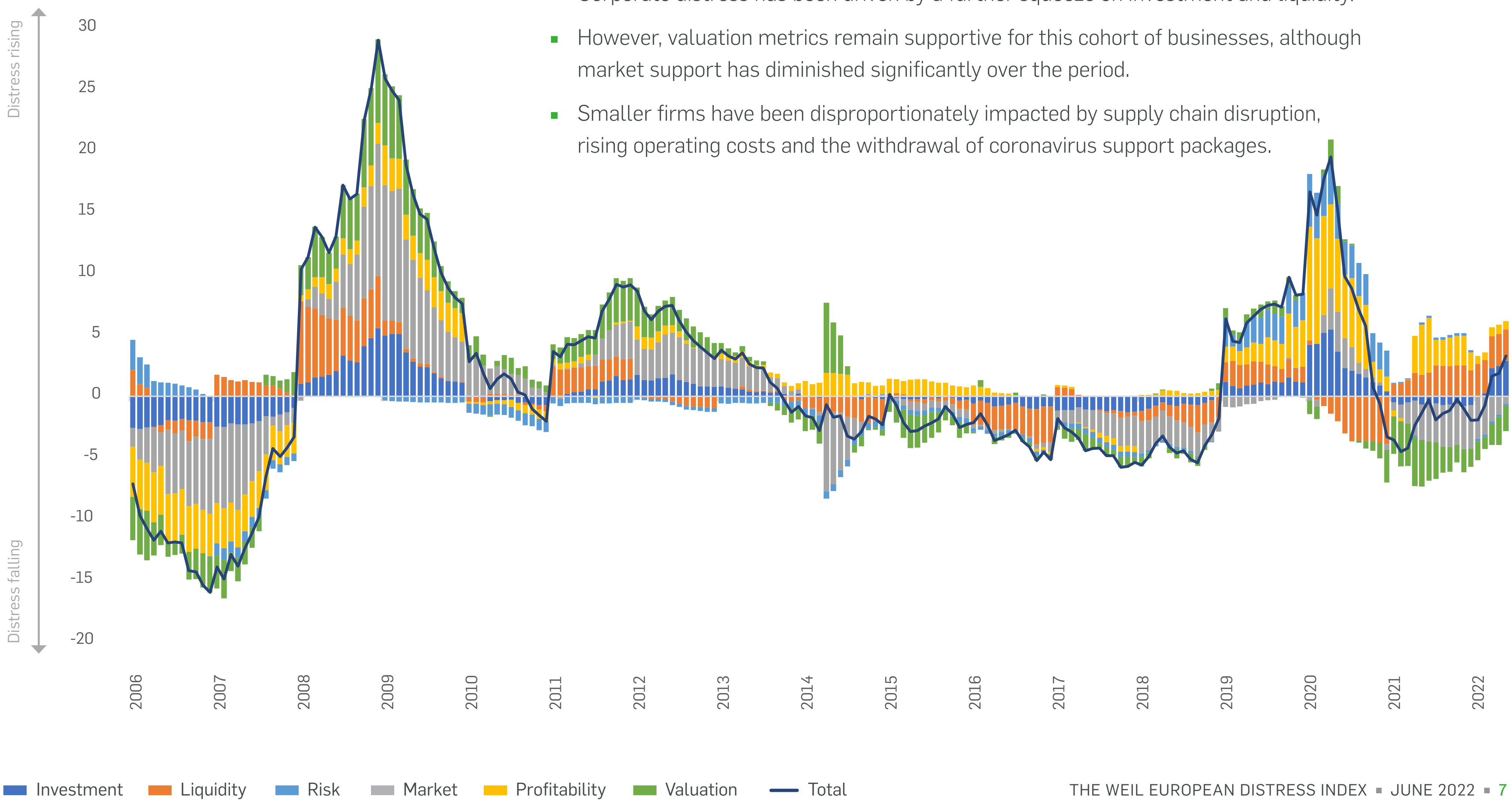
INDUSTRY ANALYSIS

COUNTRY ANALYSIS

Small Corporates

(market cap <€5bn)

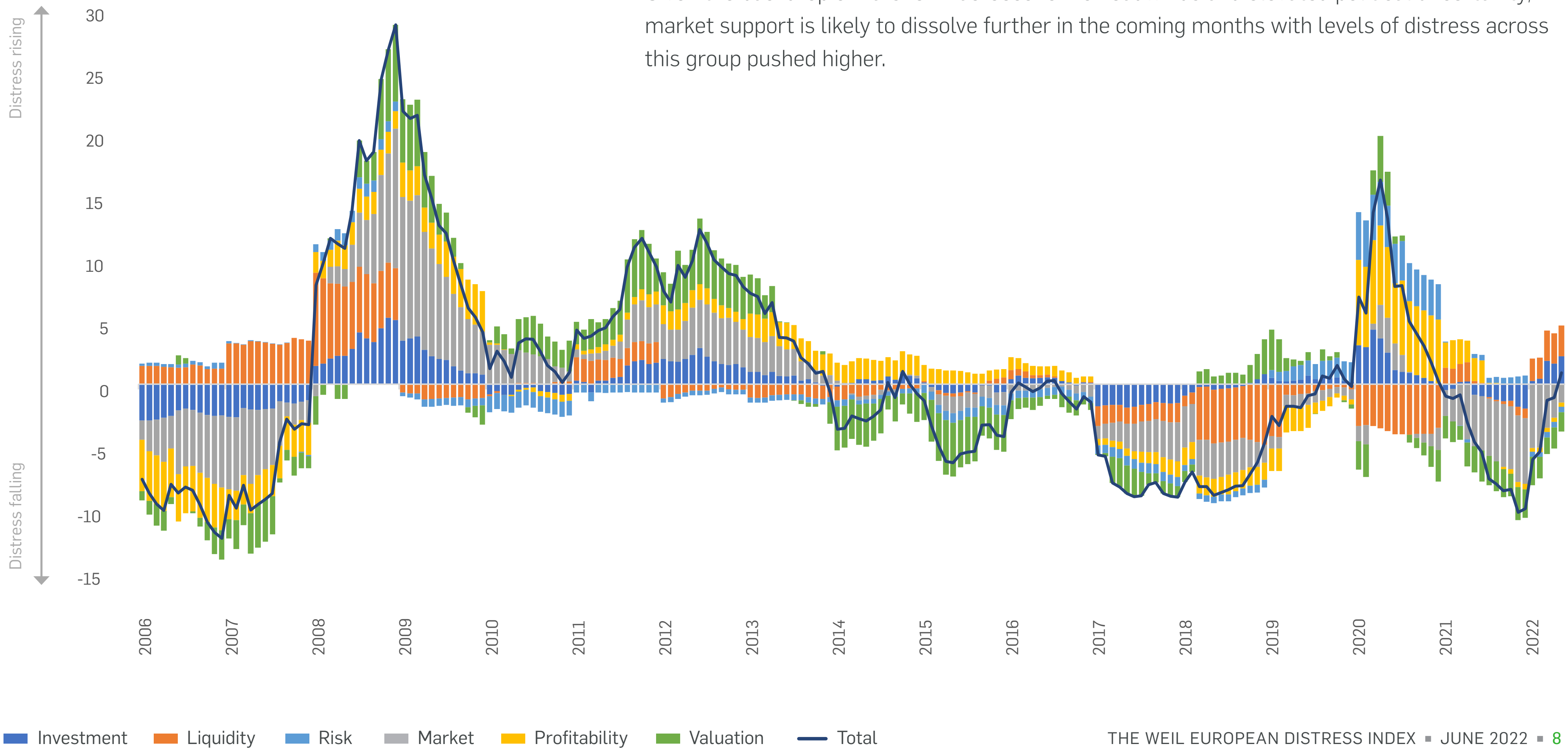
- Small European corporates saw levels of distress remain in positive territory for three consecutive months, reaching the highest level since September 2020.
- This suggests that levels of corporate distress among listed European corporates with a market cap under €5bn are higher than the long run average.
- Corporate distress has been driven by a further squeeze on investment and liquidity.
- However, valuation metrics remain supportive for this cohort of businesses, although market support has diminished significantly over the period.
- Smaller firms have been disproportionately impacted by supply chain disruption, rising operating costs and the withdrawal of coronavirus support packages.



Medium Corporates

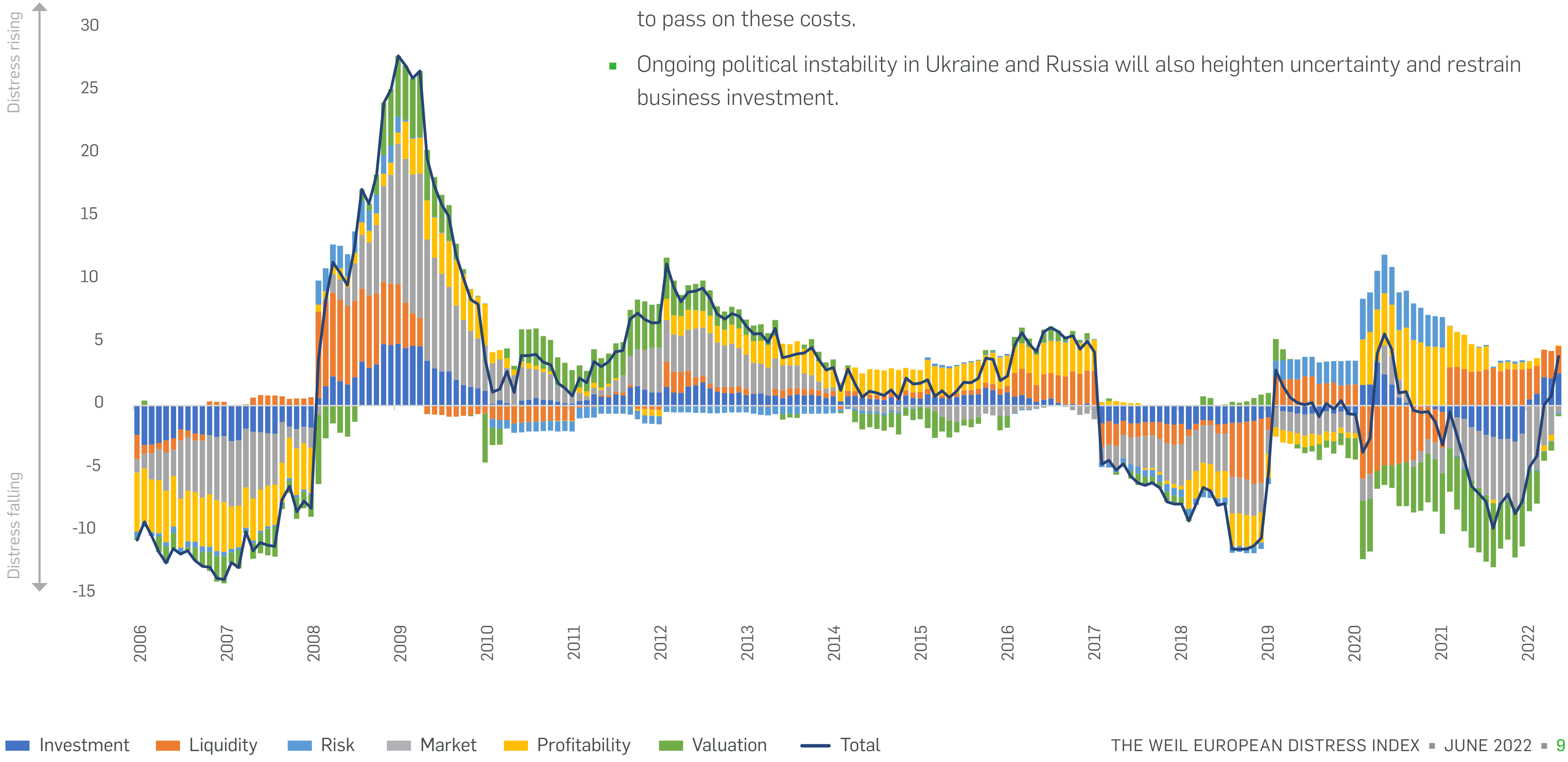
(market cap €5 – €25bn)

- Medium sized corporates have seen levels of distress rise sharply in the latest quarter, entering positive distressed territory for the first time since December 2020.
- Distress has been driven higher by constraints around liquidity and softer confidence across investment metrics.
- Meanwhile, there has also been less support offered by valuation and market fundamentals over the latest quarter.
- Given the backdrop of harsher macroeconomic headwinds and elevated political uncertainty, market support is likely to dissolve further in the coming months with levels of distress across this group pushed higher.



Large Corporates
(market cap >€25bn)

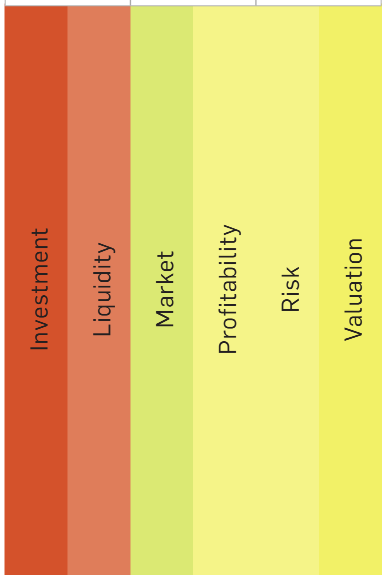
- Large corporates are experiencing the highest distress levels across all groups of companies. Distress levels have been higher than the long-term average for three consecutive months, reaching their highest level since June 2020, following the impact of the pandemic.
- However, distress has been pushed higher during the latest period with ongoing pressures around liquidity and weaker investment metrics.
- Rising operating costs from labour, logistics and utilities against a backdrop of rising cost of goods is squeezing margins. Against a weaker economic outlook, businesses will find it difficult to pass on these costs.
- Ongoing political instability in Ukraine and Russia will also heighten uncertainty and restrain business investment.



Distress Index June 2022

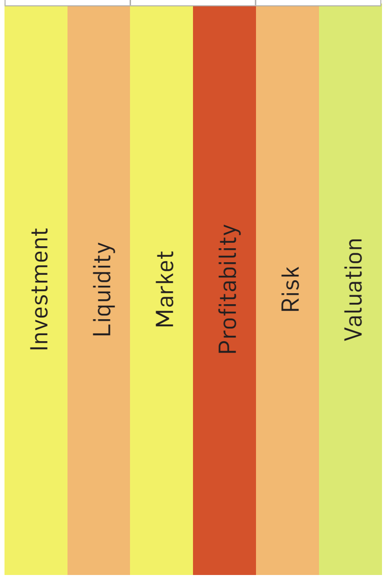
Retail and consumer goods

Distress ranking	Index value	YoY trend
1	+3.0	↑



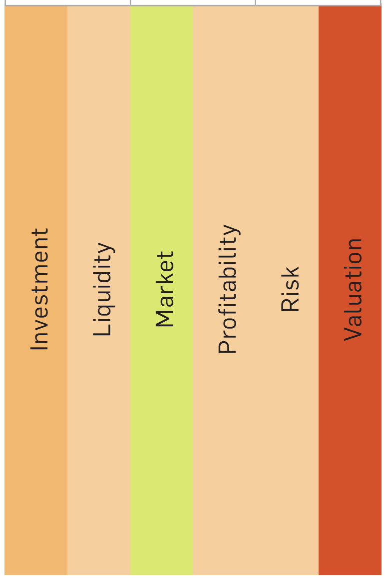
Travel, leisure and hospitality

Distress ranking	Index value	YoY trend
2	+2.1	↓



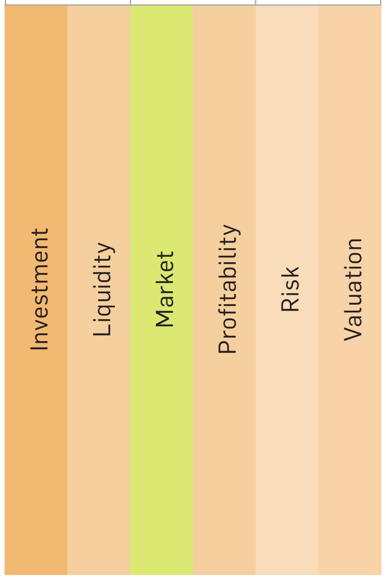
Industrials

Distress ranking	Index value	YoY trend
3	+1.6	↑



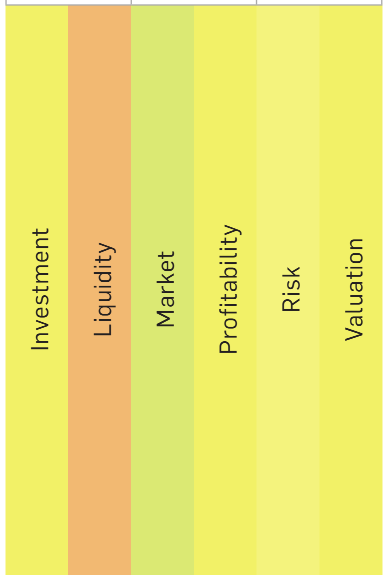
Real Estate

Distress ranking	Index value	YoY trend
4	+0.9	↑



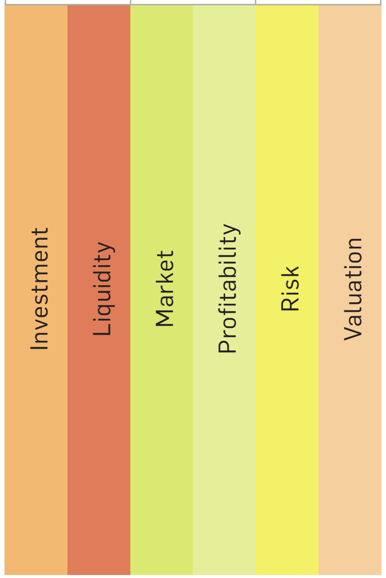
Healthcare

Distress ranking	Index value	YoY trend
5	-1.9	↑



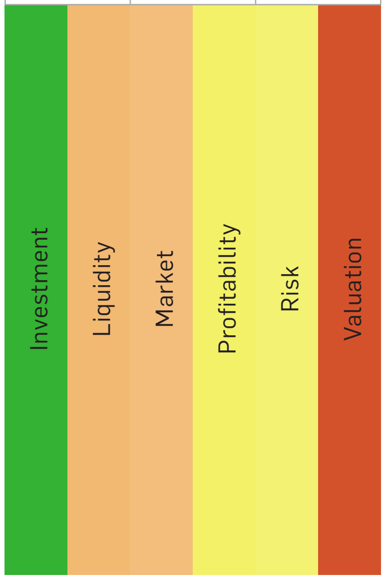
Infrastructure

Distress ranking	Index value	YoY trend
6	-2.0	↑



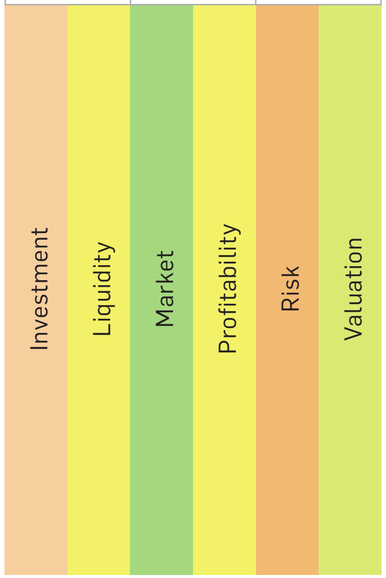
Commodities / Natural Resources

Distress ranking	Index value	YoY trend
7	-2.2	↑



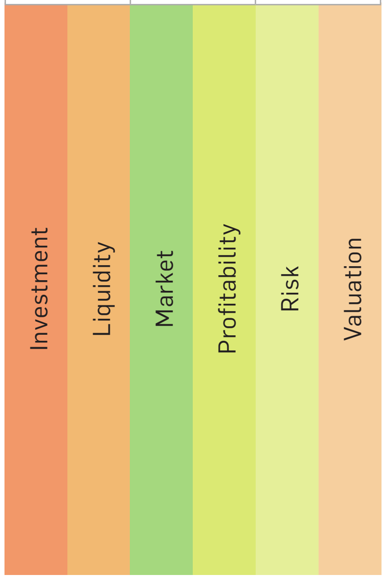
Technology, media and telecoms

Distress ranking	Index value	YoY trend
8	-2.7	↓



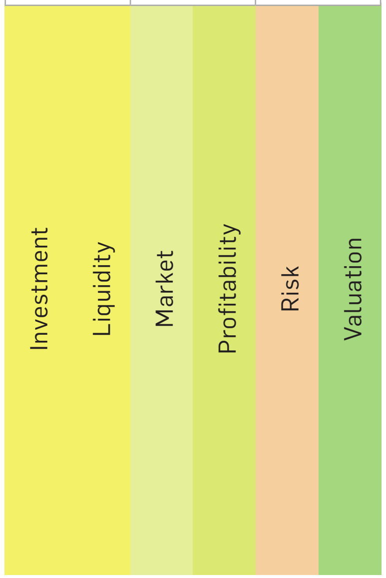
Oil & Gas

Distress ranking	Index value	YoY trend
9	-3.4	↓



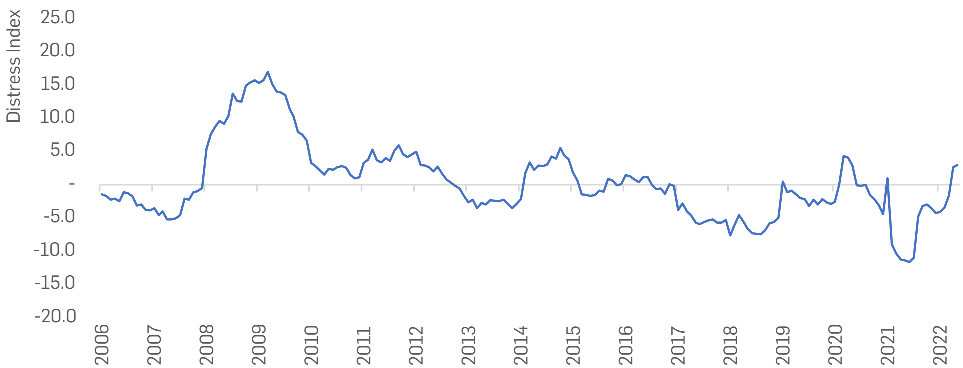
Financial Services

Distress ranking	Index value	YoY trend
10	-4.1	↑



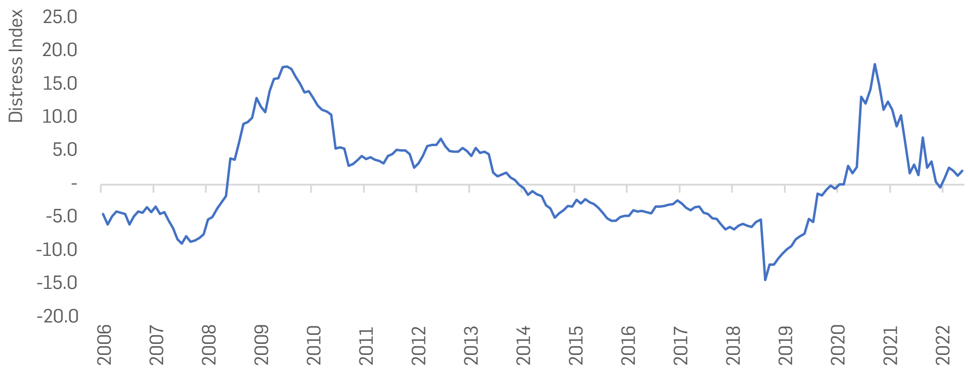
Retail and Consumer Goods

Retail and consumer goods companies are the most distressed across all sectors as 40-year highs in inflation squeeze household discretionary incomes. Meanwhile, businesses continue to face rising costs, supply chain disruption and labour shortages.



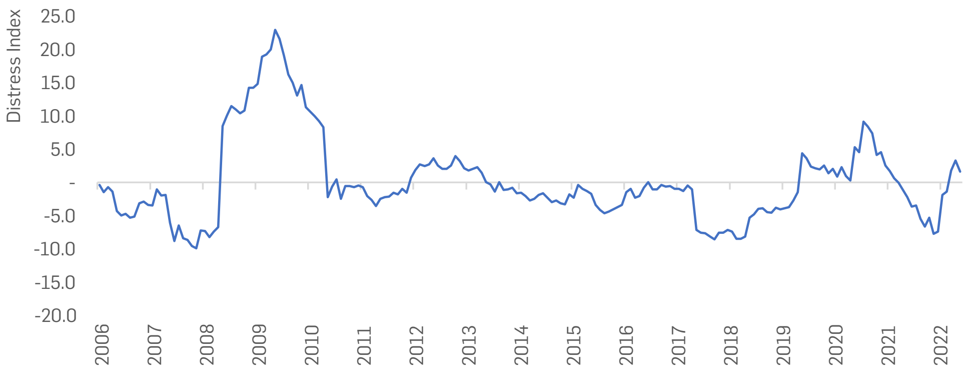
Travel, Leisure and Hospitality

Travel, Leisure & Hospitality has seen levels of distress ease considerably since the reopening of economies and the ramping up of international travel. However, it remains above the long-run average as profitability remains under intense pressure against the backdrop of rising costs and weaker demand.



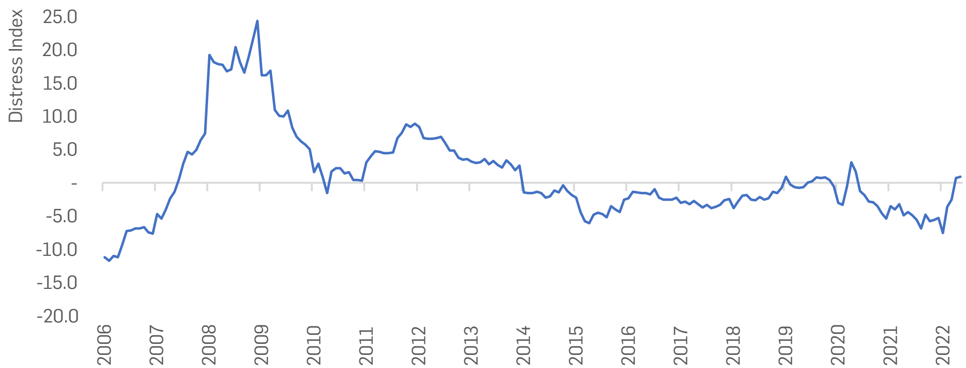
Industrials

Distress across industrials picked up in the latest data, driven by a squeeze on investment, profitability and pressure on valuations. Firms will also continue to battle inflationary pressures which will be more challenging to pass on through the supply chain against a weaker economic environment.



Real Estate

Real Estate companies across Europe have seen distress rise above the long-run average in the latest quarter, pushed higher by weakening investment metrics, a squeeze on profitability and lower valuations. There are ongoing challenges from the impact of the pandemic and a weaker economic outlook.

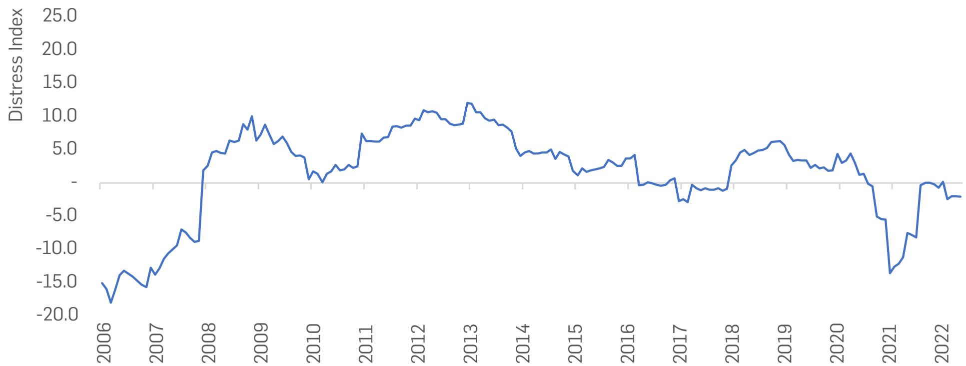


Healthcare

European healthcare corporates have seen levels of distress rise sharply as the positive impact from the pandemic continues to wane. While remaining below the long-run average, distress has been pushed higher by pressure on liquidity and weaker investment factors.

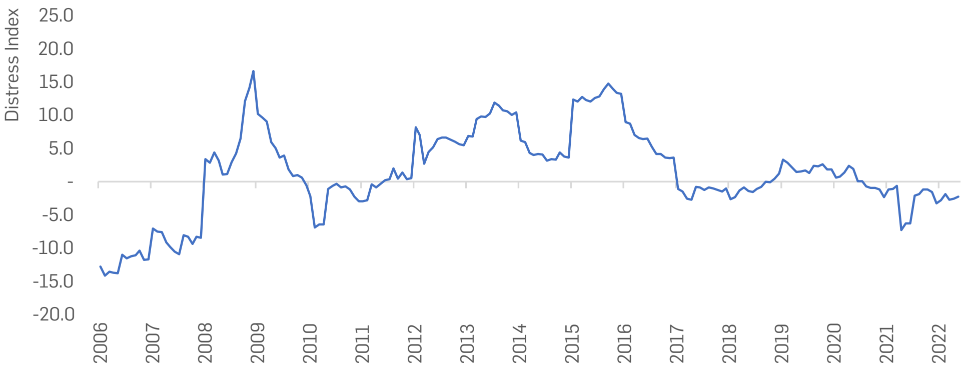
Infrastructure, Utilities and Power

Infrastructure, Utilities and Power corporates have seen levels of distress fall on last quarter's levels as higher energy and utility prices are passed on to consumer and businesses. In particular, lower levels of distress have been supported by improved valuation metrics, market fundamentals and profitability.



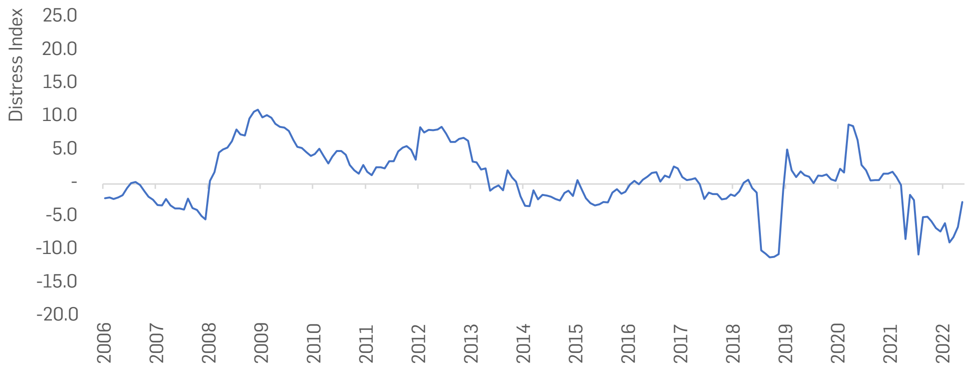
Commodities and Natural Resources

Corporate distress across commodities and natural resources remain in negative territory as ongoing pent-up demand for natural resources boosted investment metrics, while levels of risk in this sector remained low. To an extent, lower valuation metrics countered positive momentum.



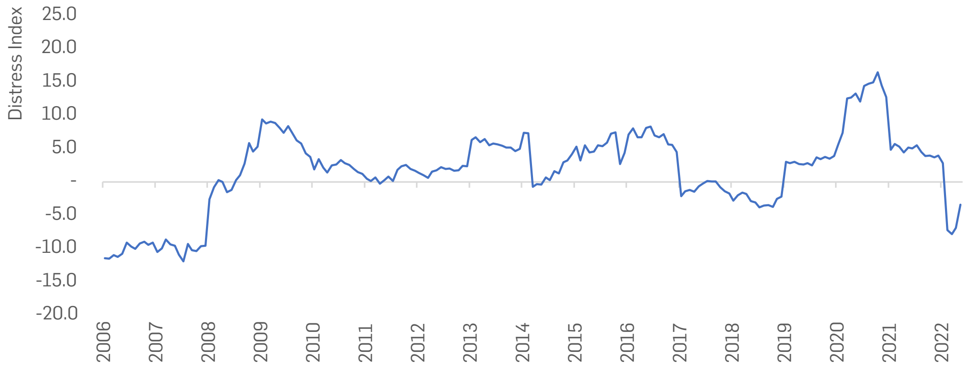
Technology, Media and Telecoms

While levels of distress have increased over the last quarter, they remain well below the long-run average for TMT corporates across Europe. The main drivers of distress were across higher perceived risk, weaker investment metrics and waning market support.



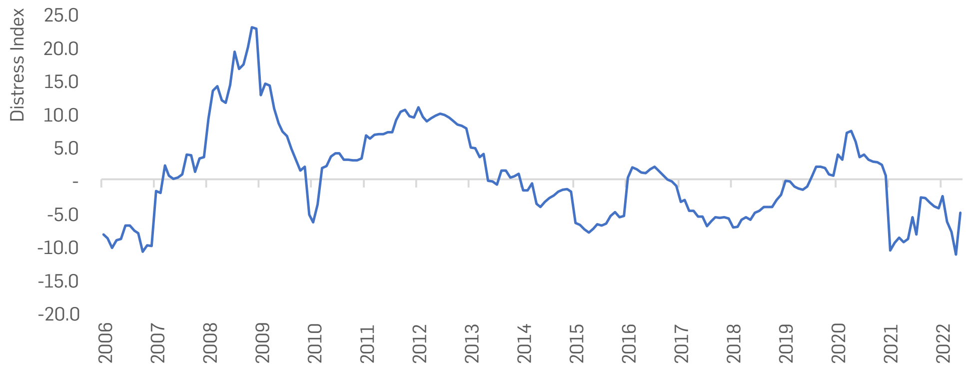
Oil and Gas

Oil and gas companies have seen levels of distress rebound over the quarter but remain well below the long-run average. Higher oil prices have supported market fundamentals, profitability and lower levels of risk across the sector.



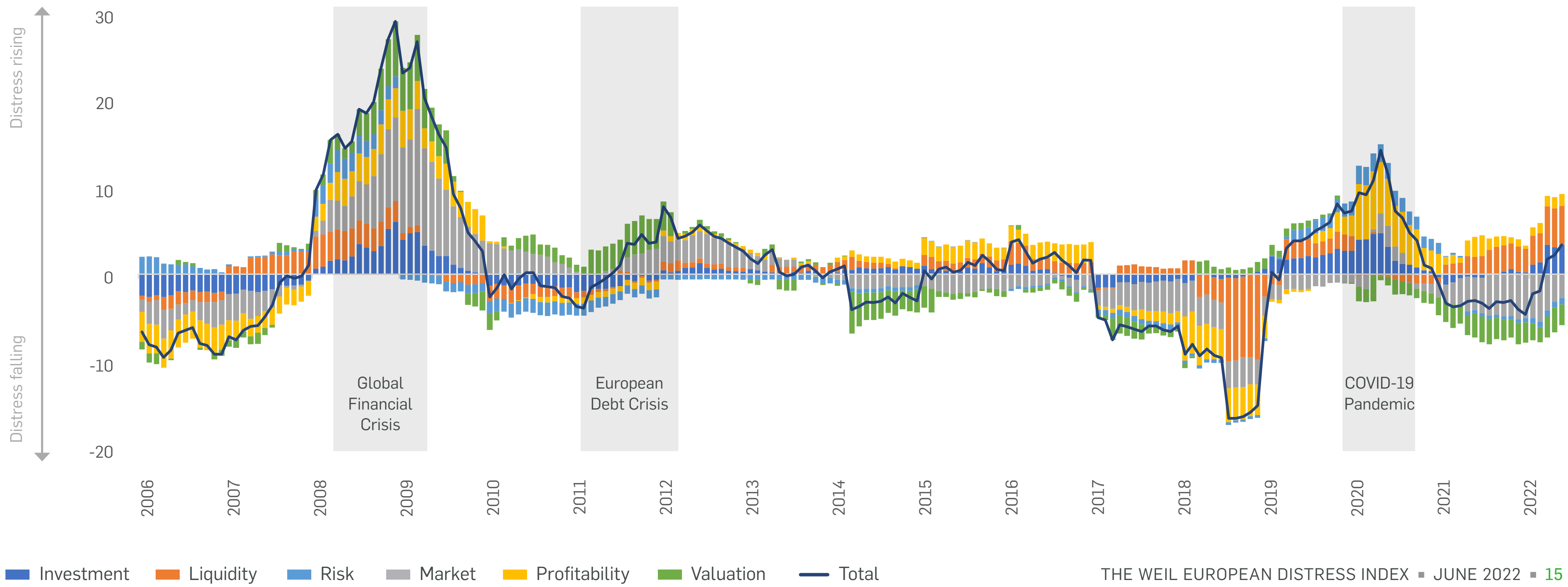
Financial Services

Distress across European financial services firms fell in the last quarter but have ticked up again in the latest period. There has been broader support from improved valuation metrics, profitability and stronger market fundamentals which has seen levels of distress below the long-run average.



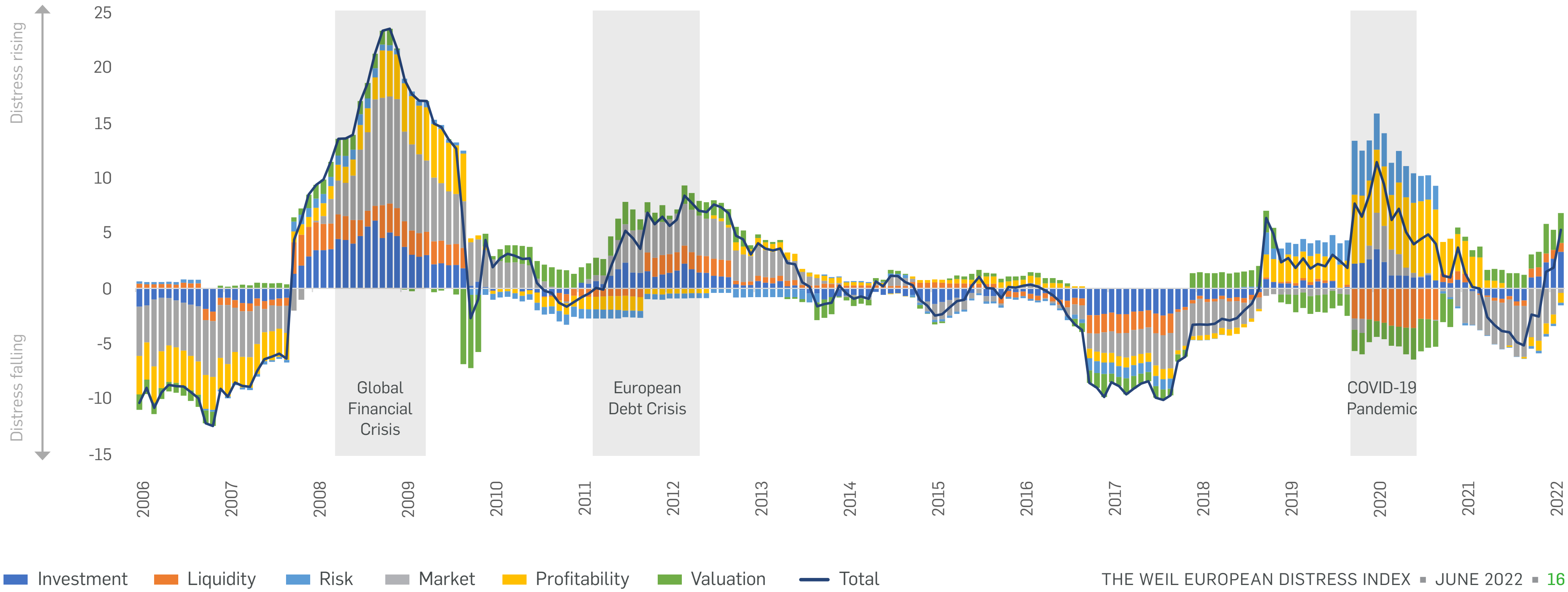
United Kingdom Distress Index

- Distress across UK-based corporates rose on the previous quarter to its highest level since September 2020.
- The main drivers of distress continue to come from ongoing pressure on liquidity, weaker investment metrics and challenges around profitability.
- Over the latest quarter, support from financial markets has waned considerably, although valuation metrics remained relatively robust.
- The economic outlook has become significantly more challenging in the last quarter. Inflation hit 9.0% in May, a 40-year high, while prospects for economic growth have been downgraded. The Bank of England raised interest rates to 1.25% in June, the fifth consecutive hike as they carefully balance tightening monetary policy with economic growth.
- Levels of household discretionary incomes are under significant pressure, particularly challenging for the UK, given consumer spending accounts for two-thirds of GDP.
- Meanwhile, many businesses continue to face ongoing disruption of supply chains and escalating operating costs. Pressure on profitability is expected to continue to drive higher levels of distress across the UK.



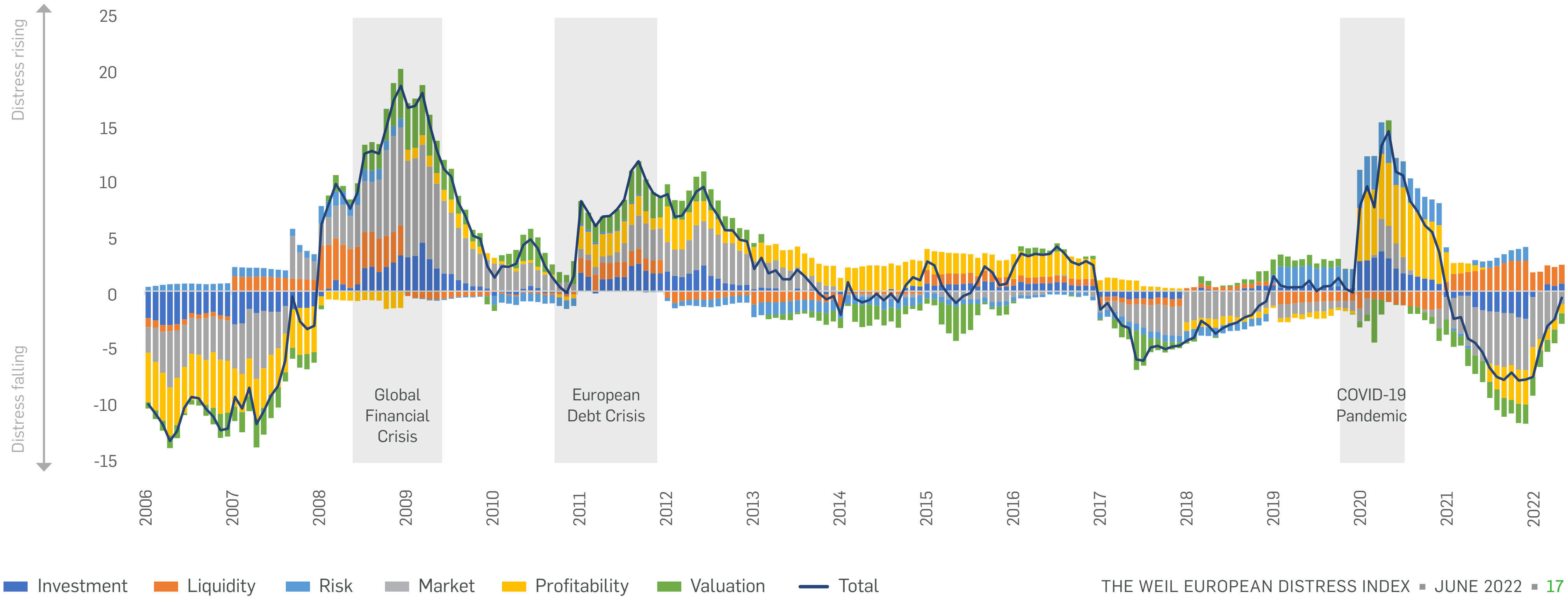
Germany Distress Index

- The Weil Distress Index for German corporates rose into positive territory in the latest quarter, reaching its highest level since July 2020. It is the most distressed market across all European countries measured in the index.
- A sharp rise in corporate distress was driven by a deterioration across investment metrics, weaker valuation and an ongoing squeeze on profitability.
- There has also been a sharp drop in the support offered from market fundamentals. The reliance on the auto industry which continues to undergo ongoing supply chain issues and structural change is also likely to present country-specific challenges.
- The Russia-Ukraine conflict has heightened both political and economic uncertainties. Higher energy costs are a key contributing factor for Germany, particularly problematic given their dependency on Russian supply.
- Inflation has risen to near 50-year highs in recent months in Germany, reaching 8.7% in May, pushed higher by supply chain bottlenecks and cost increases from upstream stages of production.
- With further inflationary pressure in the pipeline, the outlook for the consumer sector appears particularly challenging.



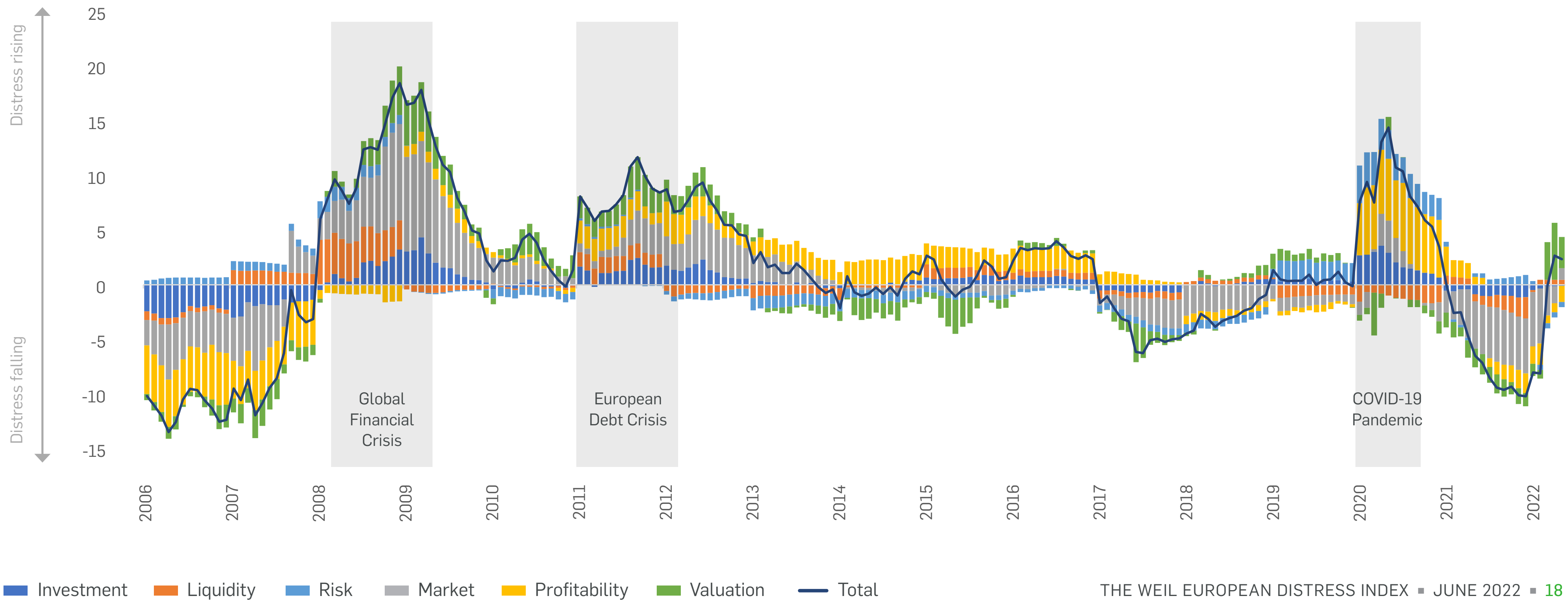
France Distress Index

- Levels of distress across corporates in France rose sharply in May, but remains below the long-run average. This is the only European country across our coverage where this is the case.
- Nevertheless, there has been a sharp deterioration in recent months, driven by ongoing constraints around liquidity, while significantly less support has been provided by financial market metrics.
- The level of distress across France remains in negative territory and below their long run average.
- Inflation across France remains one of the lowest within Europe, reaching 5.2% in May.
- Corporate distress is expected to rise in coming months as a weaker economic backdrop, tighter monetary policy and elevated geo-political risks dampen the appetite for risk and hold back investment.



Spain and Italy Distress Index

- Corporate distress across Spain and Italy rose markedly in the latest period to its highest level since December 2020.
- Corporate distress remains above long-run averages driven higher by weakening valuation metrics and pressure on liquidity. In addition, market sentiment has also become more challenging.
- Both Spain and Italy have suffered supply chain disruption and rising energy costs which has pushed up the cost of living. Inflation in Italy (+6.9%) and Spain (+8.5%) have risen to uncomfortable levels, while the labour market in both countries is significantly weaker than other European nations.
- In addition, support across profitability metrics are likely to wane in coming months due to rising operating costs, raising the prospect of corporate distress.



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