# THE WEIL EUROPEAN DISTRESS INDEX

DECEMBER 2022

## Macro view

- Corporate distress across key European markets has intensified over the latest quarter and has worsened considerably over the last 12 months since the inaugural Weil European Distress Index report. Against an increasingly challenging macroeconomic and geo-political environment, corporate distress reached its highest level for two years (September 2020).
- The latest period showed distress accelerating across the main index driven by large corporates. Seven of the ten industry groups covered showed levels of distress worsening in the last 12 months.
- The backdrop of slowing global growth, spiralling inflation, tightening fiscal and monetary policy, China's on-going covid restrictions and the Russia-Ukraine conflict is weighing heavily on corporate distress.
- In the latest quarter, distress was pushed higher by deteriorating investment metrics, growing pressure on liquidity and weaker valuations.
- Although major European financial markets have shown recent resilience, support from market fundamentals has deteriorated considerably over the last 12 months, now the lowest in over two years.
- Against these harsher economic headwinds, many investors are shying away from riskier assets.
- UK corporates remained the most distressed across the European markets covered. Levels of distress rose on the previous quarter and are considerably worse than at the same time last year, now at their highest levels since July 2020.
- The Bank of England has warned that the UK economy is already contracting and will continue to shrink for eight consecutive quarters to 2024.

### Weil European Distress Index Movements

| November 2022 | November 2021 | QoQ trend | YoY trend |
|---|---|---|---|
| 4.2 | -10.9 | 2.7<br>August 2022 | |

- Germany was the next most distressed market, driven by greater pressures on investment, liquidity and weaker valuation metrics. The European Central Bank (ECB) has also raised interest rates sharply, up 75 basis points to 1.5%, now the highest since 2009.

## Sector view

- The largest driver of distress in the latest data (November 2022) came from businesses operating within 'Retail and Consumer Goods', driven by a squeeze on liquidity, weakening investment metrics and renewed pressure on profitability.
- During the latest quarter, distress in this sub-sector rose to the highest levels since mid-2011.
- The next most distressed market was 'Real Estate' which in the latest quarter has reported distress rising to levels not seen since 2012.

## 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, France, Germany, 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

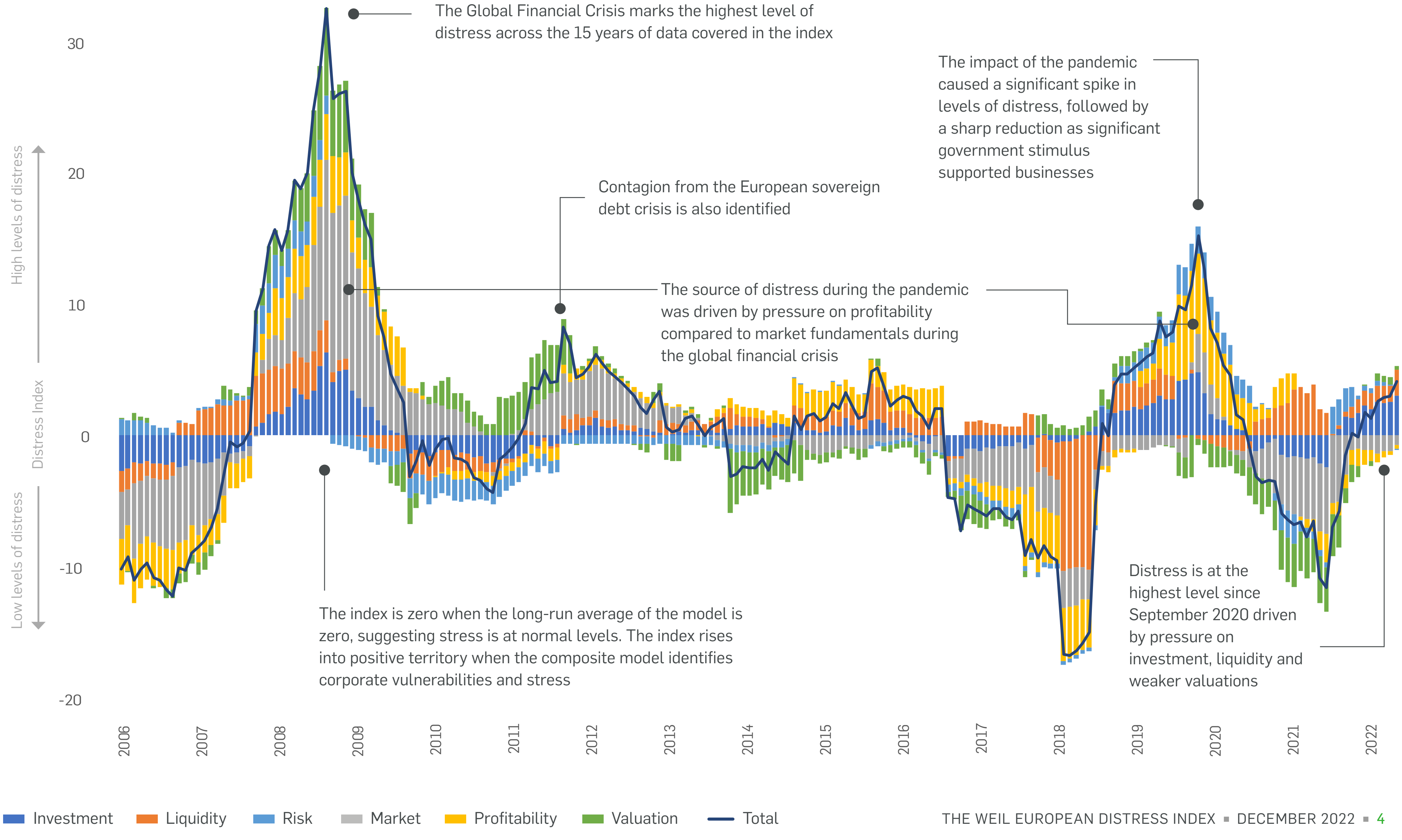
The WEDI is constructed using data from over 3,750 listed European companies and a range of financial market indicators. 16 indicators have been used to construct the WEDI which reflect one or more symptoms of corporate distress based on comprehensive academic and desk-based research.

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. |

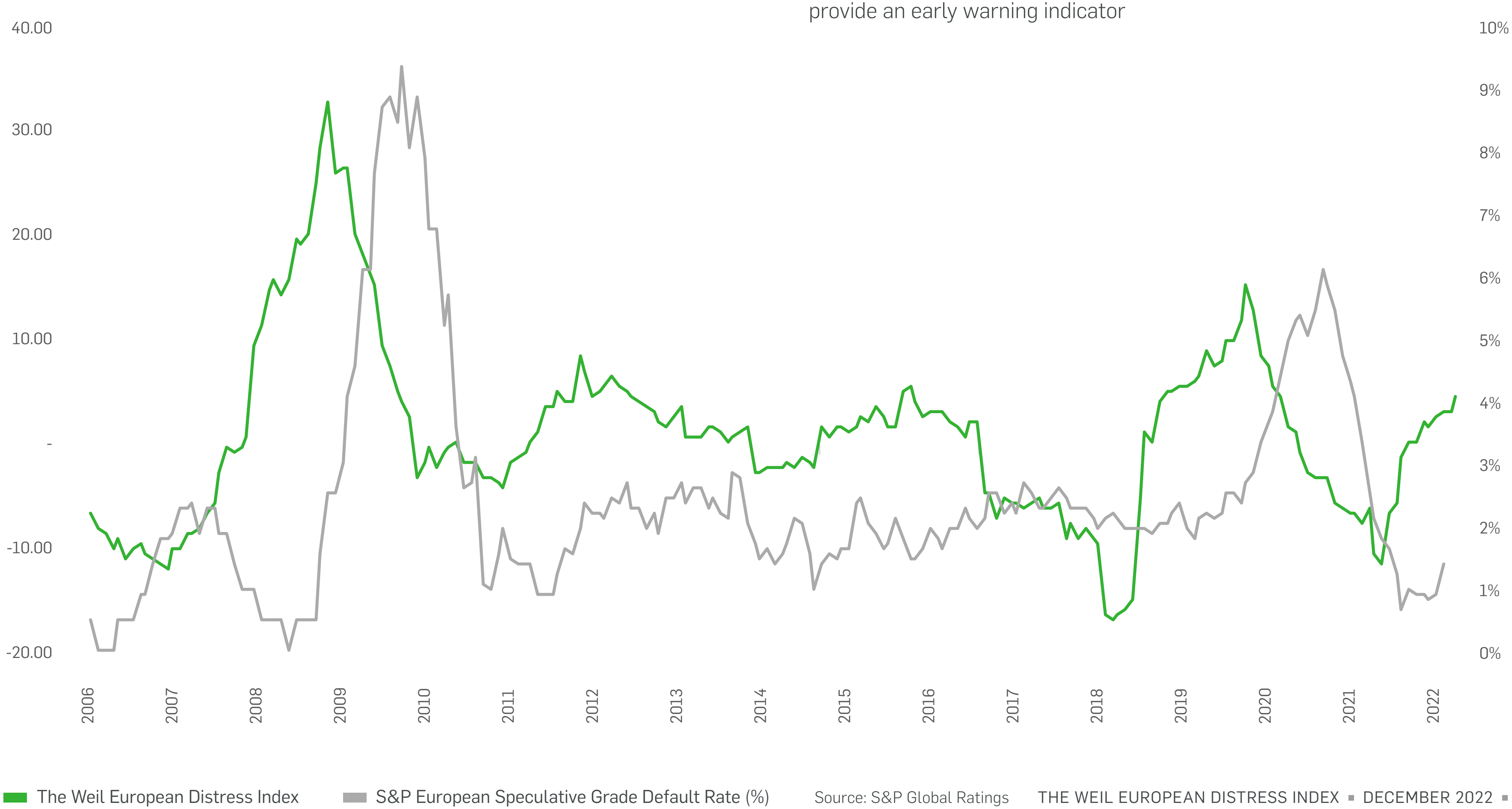
* Total Europe include UK, France, Germany, Spain, Italy, The Netherlands, Republic of Ireland, Belgium, Norway and Portugal

# 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
## DECEMBER 2022

SIZE ANALYSIS

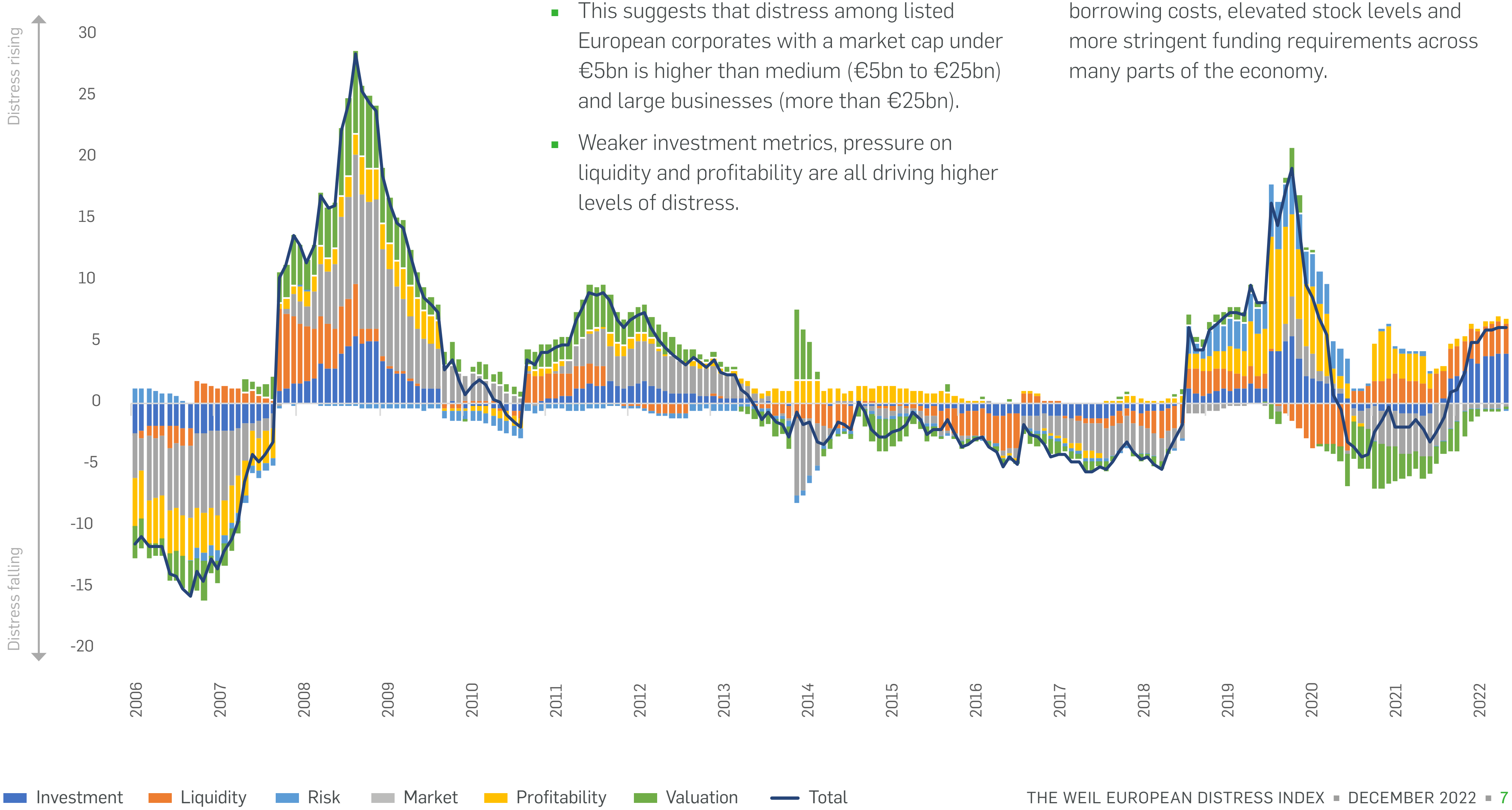
INDUSTRY ANALYSIS

COUNTRY ANALYSIS

# Small Corporates

## (market cap <€5bn)

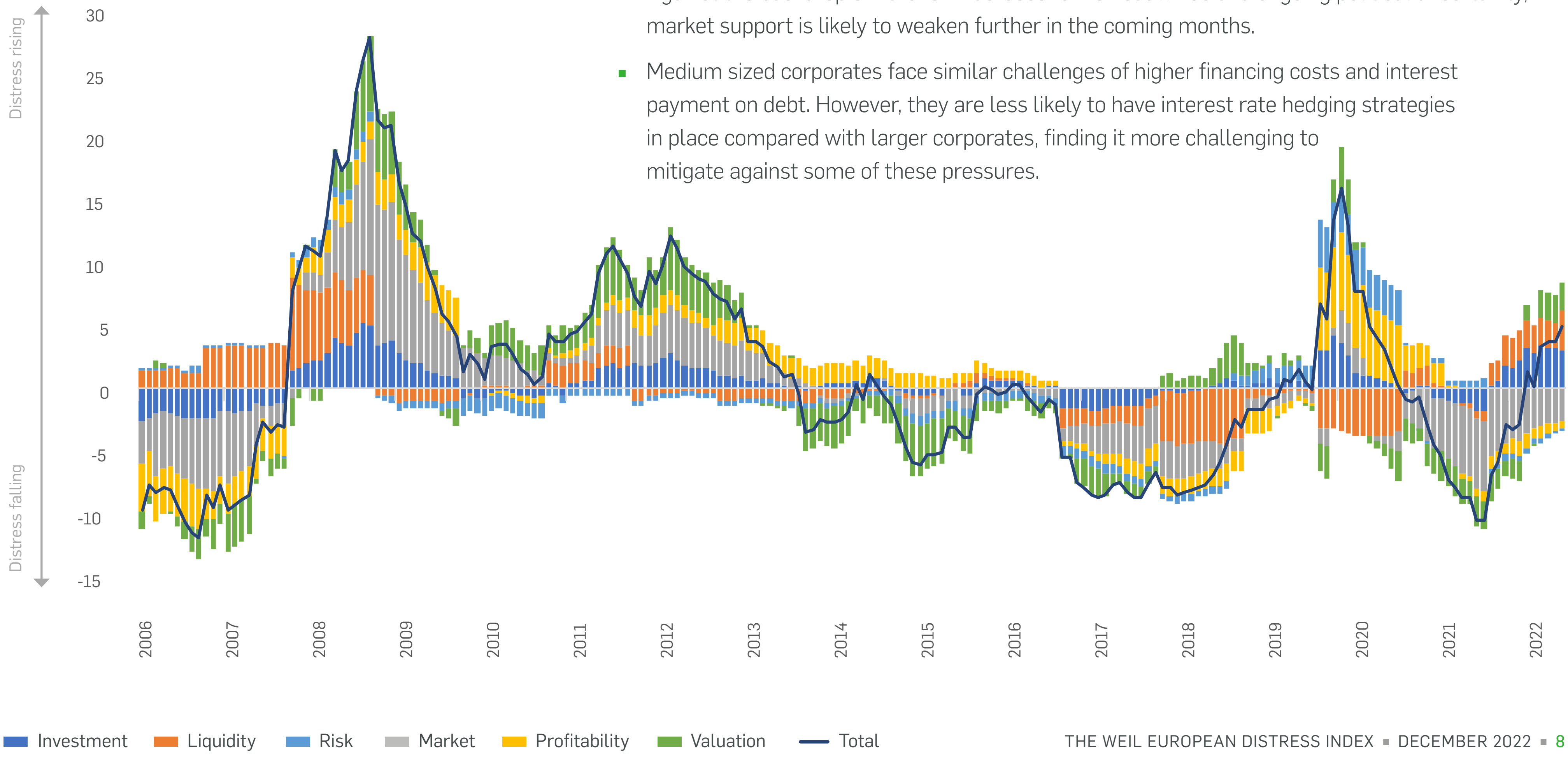
- Distress across small European corporates has risen sharply in the latest quarter, remaining in positive territory for nine consecutive months, and residing at its highest level since August 2020.
- This suggests that distress among listed European corporates with a market cap under €5bn is higher than medium (€5bn to €25bn) and large businesses (more than €25bn).
- Weaker investment metrics, pressure on liquidity and profitability are all driving higher levels of distress.
- Meanwhile, support from market fundamentals has also waned considerably in recent months, and more so for medium and large corporates.
- Tighter liquidity has driven levels of distress as softening demand meets with rising borrowing costs, elevated stock levels and more stringent funding requirements across many parts of the economy.



# Medium Corporates

## (market cap €5bn – €25bn)

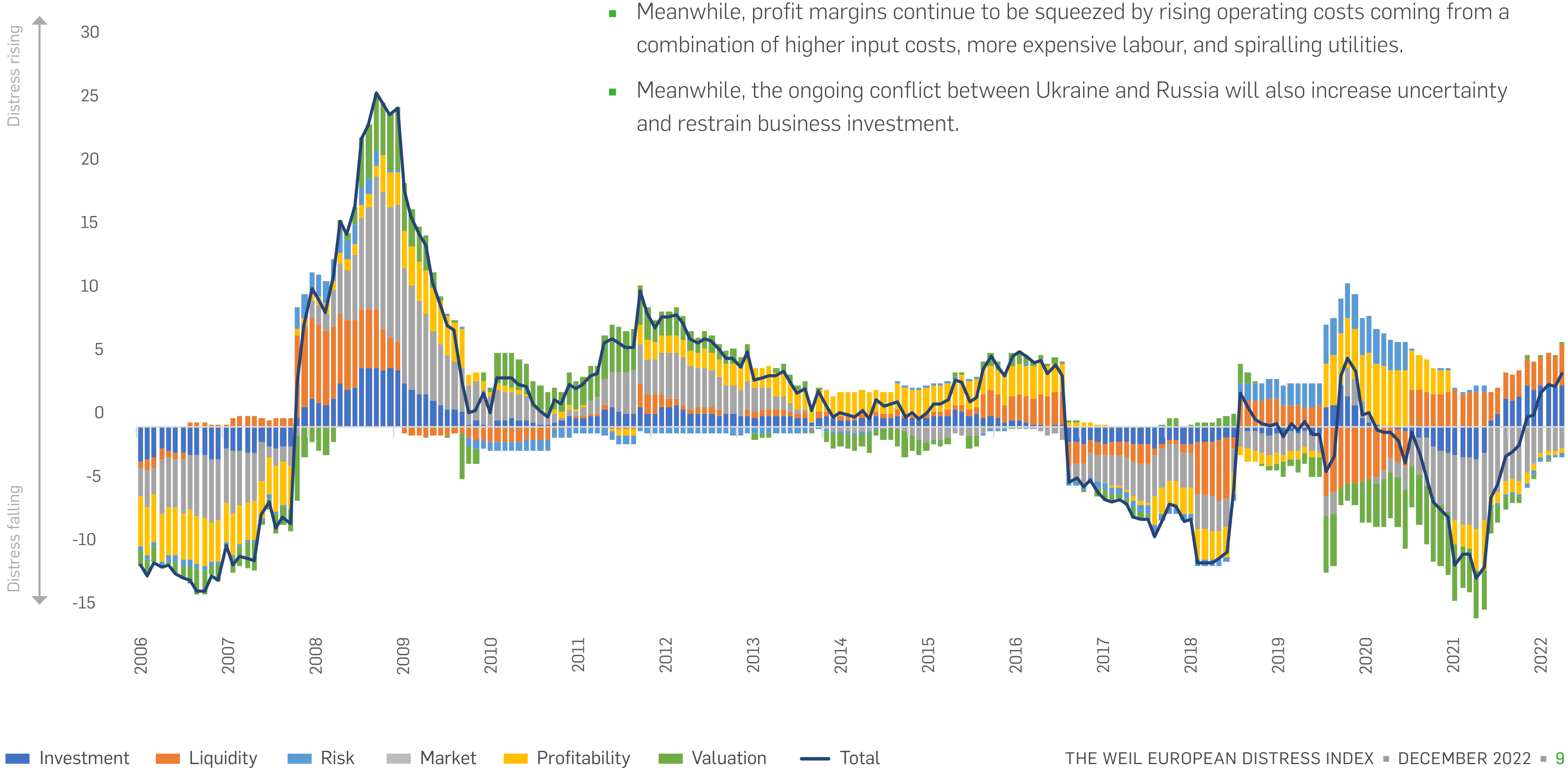
- Medium sized corporates have seen levels of distress rise to the highest level since July 2020 in the latest quarter.
- Overall distress has been driven by weaker investment metrics, poorer liquidity and faltering valuation measures.
- In particular, the pressure on liquidity has deteriorated markedly over the last 12 months. Distress coming from liquidity is now at the highest level since 2008 – during the financial crisis.
- Against the backdrop of harsher macroeconomic headwinds and ongoing political uncertainty, market support is likely to weaken further in the coming months.
- Medium sized corporates face similar challenges of higher financing costs and interest payment on debt. However, they are less likely to have interest rate hedging strategies in place compared with larger corporates, finding it more challenging to mitigate against some of these pressures.



# Large Corporates

## (market cap >€25bn)

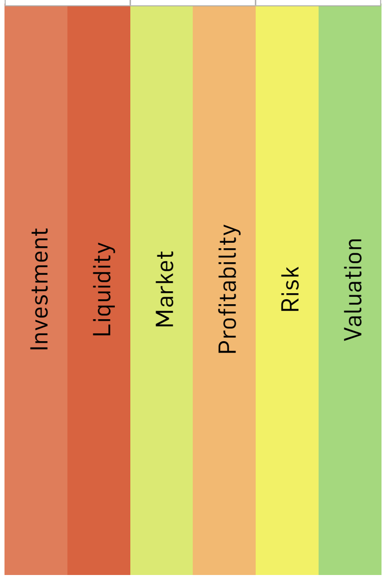
- Distress across large corporates has risen to its highest level since December 2016, surpassing the immediate impact of the pandemic.
- Distress has now been detected for the last six consecutive months, driven primarily by weaker fundamentals across investment metrics, liquidity and valuation.
- A combination of pressures include rising borrowing costs, euro/sterling weakness against the dollar, and ongoing supply chain issues continue to create challenging conditions.
- Meanwhile, profit margins continue to be squeezed by rising operating costs coming from a combination of higher input costs, more expensive labour, and spiralling utilities.
- Meanwhile, the ongoing conflict between Ukraine and Russia will also increase uncertainty and restrain business investment.



# Distress Index December 2022

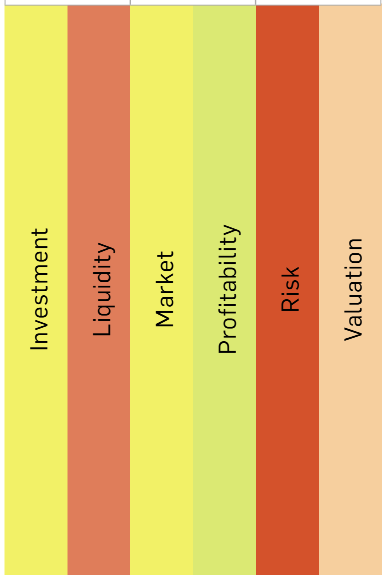
## Retail and consumer goods

| Distress ranking | Index value | YoY trend |
|---|---|---|
| 1 | +5.3 | ↑ -7.0 Nov 2021 |



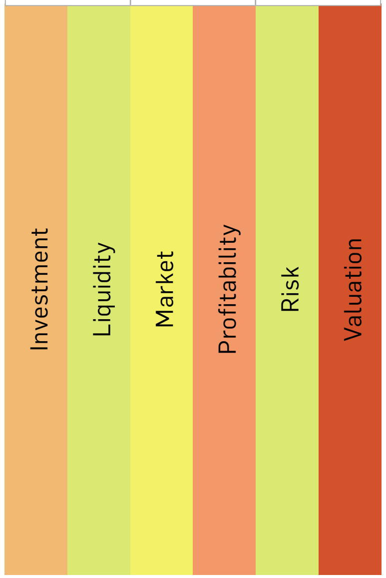

## Real Estate

| Distress ranking | Index value | YoY trend |
|---|---|---|
| 2 | +4.8 | ↑ -6.2 Nov 2021 |



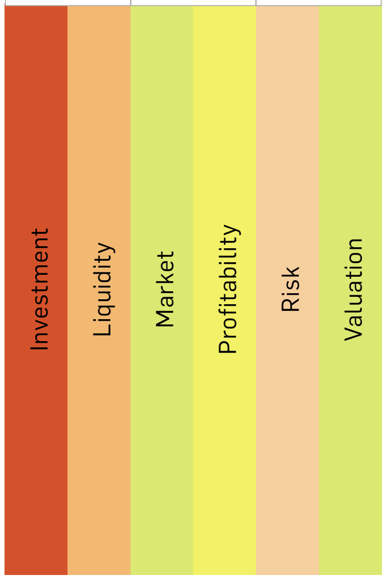

## Industrials

| Distress ranking | Index value | YoY trend |
|---|---|---|
| 3 | +2.6 | ↑ -8.6 Nov 2021 |



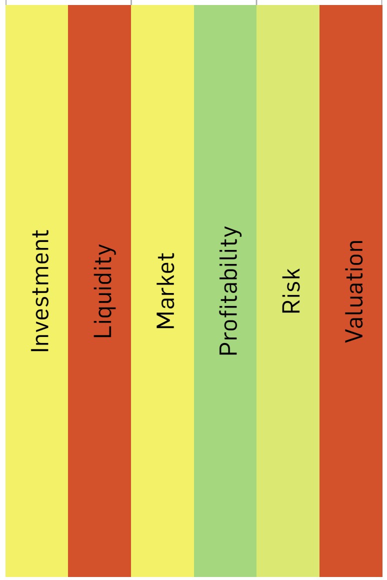

## Healthcare

| Distress ranking | Index value | YoY trend |
|---|---|---|
| 4 | +1.1 | ↑ -11.2 Nov 2021 |




## Oil & Gas

| Distress ranking | Index value | YoY trend |
|---|---|---|
| 5 | +1.0 | ↓ 3.6 Nov 2021 |



Least distressed | Most distressed

## Travel, leisure and hospitality

| Distress ranking | Index value | YoY trend |
|---|---|---|
| 6 | +0.4 | 1.3 Nov 2021 |

Investment | Liquidity | Market | Profitability | Risk | Valuation

## Financial Services

| Distress ranking | Index value | YoY trend |
|---|---|---|
| 7 | -0.6 | -3.4 Nov 2021 |

Investment | Liquidity | Market | Profitability | Risk | Valuation

## Commodities / Natural Resources

| Distress ranking | Index value | YoY trend |
|---|---|---|
| 8 | -1.1 | -5.3 Nov 2021 |

Investment | Liquidity | Market | Profitability | Risk | Valuation

## Technology, media and telecoms

| Distress ranking | Index value | YoY trend |
|---|---|---|
| 9 | -1.1 | -8.2 Nov 2021 |

Investment | Liquidity | Market | Profitability | Risk | Valuation

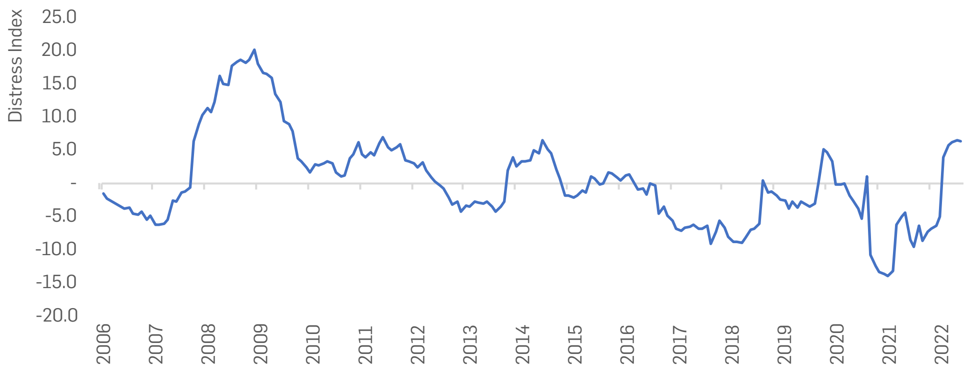
## Infrastructure

| Distress ranking | Index value | YoY trend |
|---|---|---|
| 10 | -2.9 | -1.8 Nov 2021 |

Investment | Liquidity | Market | Profitability | Risk | Valuation

## Retail and Consumer Goods

Retail and consumer goods companies are the most distressed across all sectors as decade highs in inflation and rising interest rates squeeze household incomes. Meanwhile, retailers continue to face an increase in borrowing, operating and input costs which, against a backdrop of weaker demand, has put pressure on liquidity and profitability.

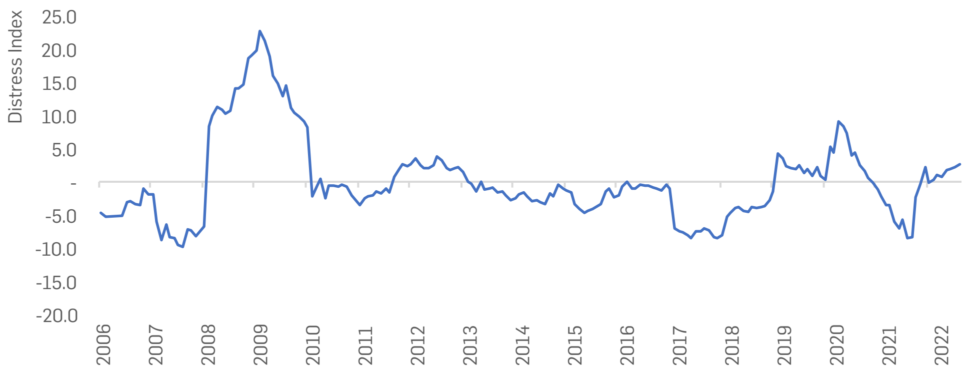



## Real Estate

Real Estate companies across Europe have seen levels of distress rise significantly on last year and on the previous quarter. Distress has been pushed higher by increased risk metrics, weaker valuations and lower levels of liquidity, amid an outlook of rising interest rates and lower expectations of capital appreciation.


## Industrials

Distress remained in positive territory for industrials, rising for four consecutive months in the latest data, driven by a deterioration in valuation metrics, weaker profitability and poorer investment metrics. Firms continue to face rising input and operating costs against a backdrop of slowing global demand.

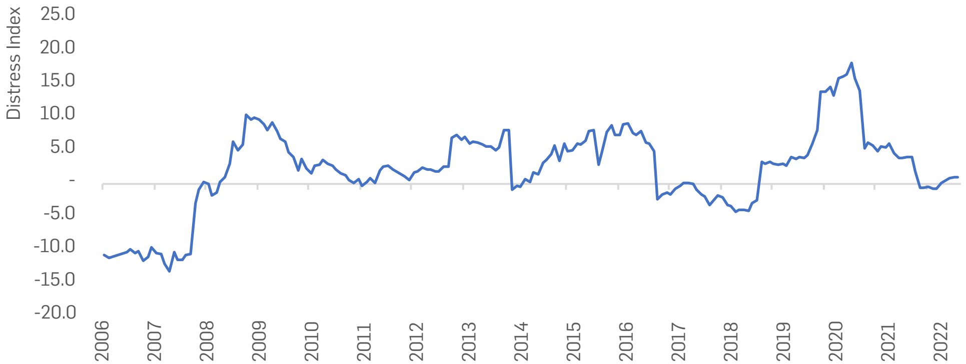



## Healthcare

European healthcare corporates have seen distress levels remain in positive territory over the last quarter, caused by a deterioration across investment, while liquidity and risk metrics have also come under pressure as the pandemic comes to a period of containment and greater certainty.

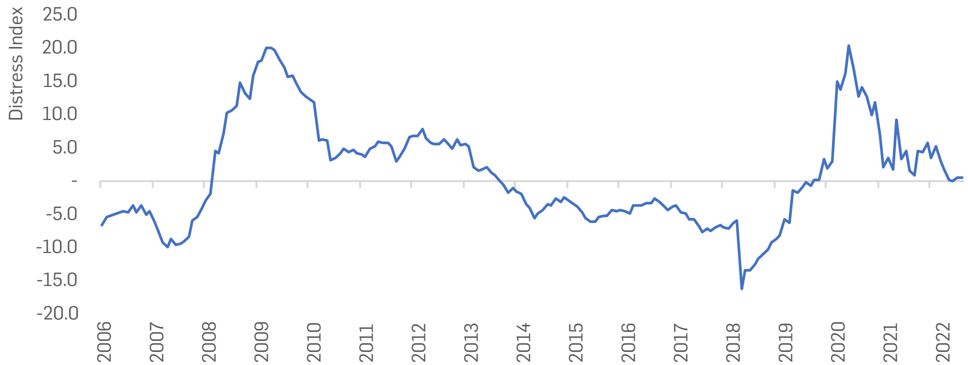
## Oil and Gas

Oil and gas companies have seen levels of distress rise above the long-run average in the latest quarter. A combination of weaker oil prices amid slowing global growth and worries of the hit to industrials and consumer demand are of particular concern.




## Travel, Leisure and Hospitality

Travel, Leisure & Hospitality saw levels of distress driven to record levels during the pandemic but have eased considerably in recent months as economies reopen and demand gains traction. However, distress remains above the long run average and rising operating costs and slowing global demand suggest that distress could rise again in the near-term.

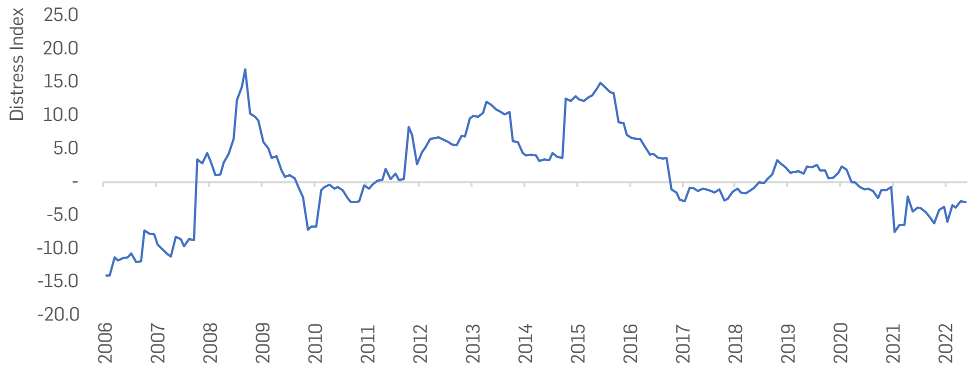



## Financial Services

Distress across European financial services firms continued on an upward trajectory, but remains below the long run average. However, financial services firms remain among some of the least distressed corporates, supported by solid market metrics and profitability.

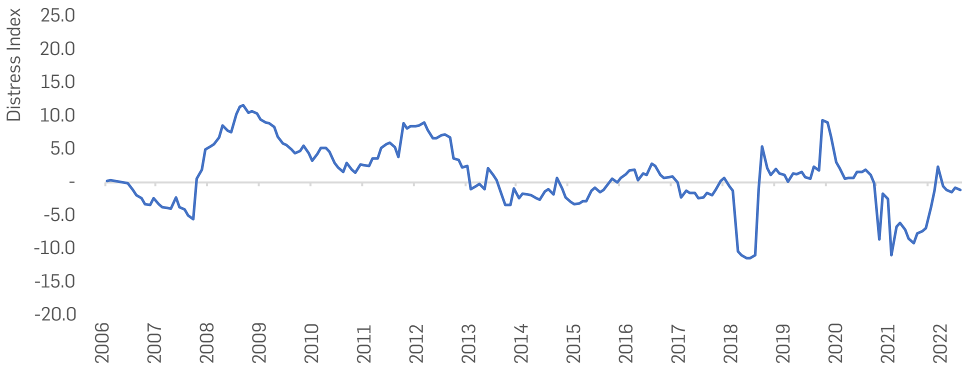

## Commodities and Natural Resources

Corporate distress across commodities and natural resources remained in negative territory in the last quarter, although is on an upward trajectory. The industry continues to benefit from ongoing pent-up demand for natural resources which has helped deliver a period of improved profitability.



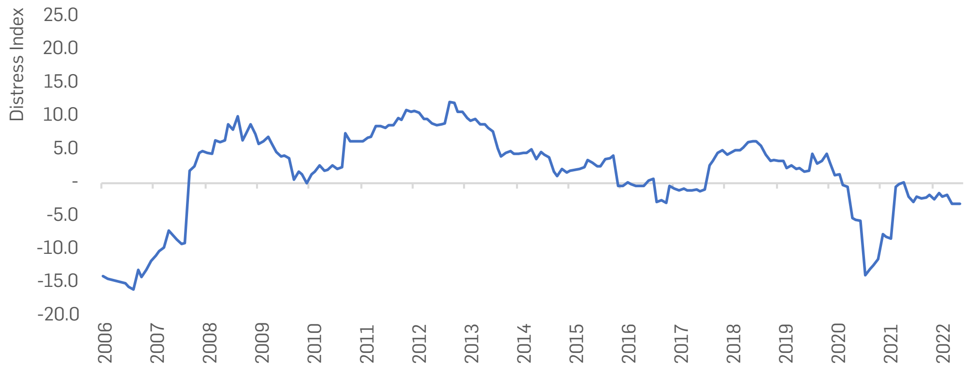
## Technology, Media and Telecoms

Levels of distress across TMT rose briefly into positive territory before retreating below the long-run average, unchanged in the last quarter's data. Technology companies have seen supportive factors brought about by the impact of the pandemic weaken, albeit distress remains in negative territory.




## Infrastructure, Utilities and Power

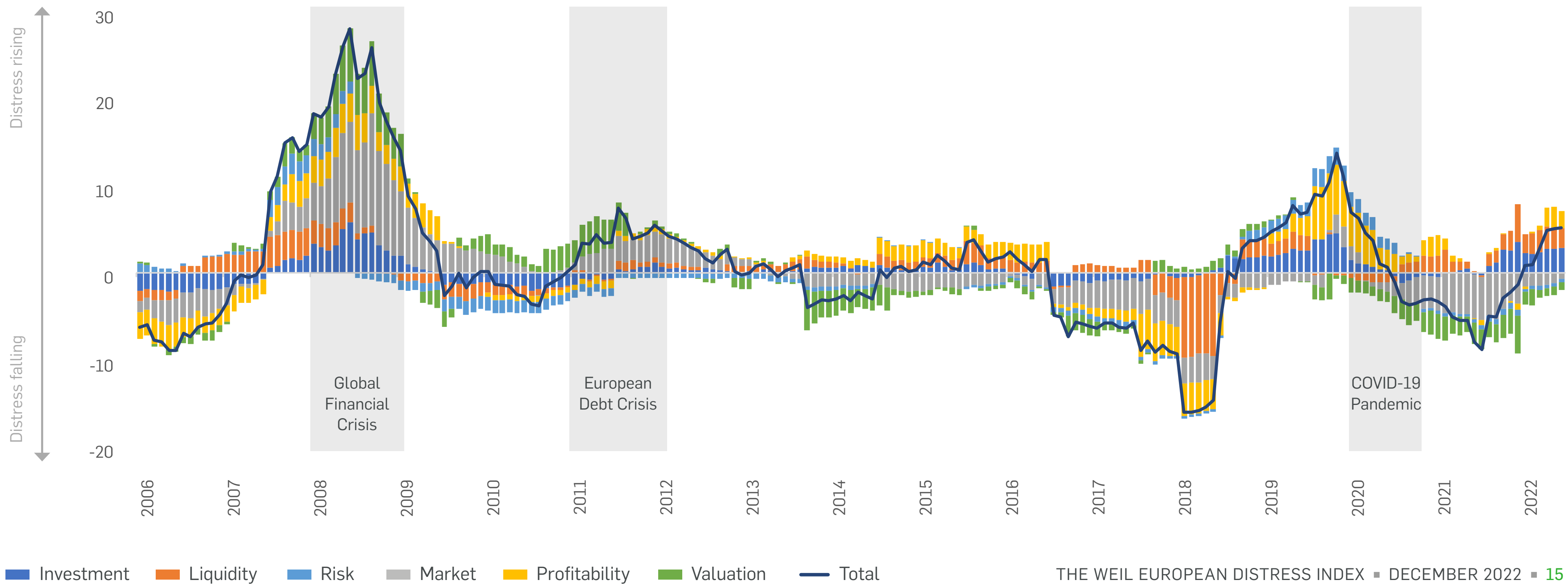
Infrastructure, Utilities and Power corporates have seen levels of distress fall on last quarter's levels as higher energy and utility prices are passed on to consumer and businesses. Strong support from profitability, low levels of perceived risk and solid market fundamentals have helped.



| Nov 2022 | Nov 2021 | QoQ trend | YoY trend |
|---|---|---|---|
| 5.5 | -8.4 | ⬆ 2.9 Aug 2022 | ⬆ |

# United Kingdom Distress Index

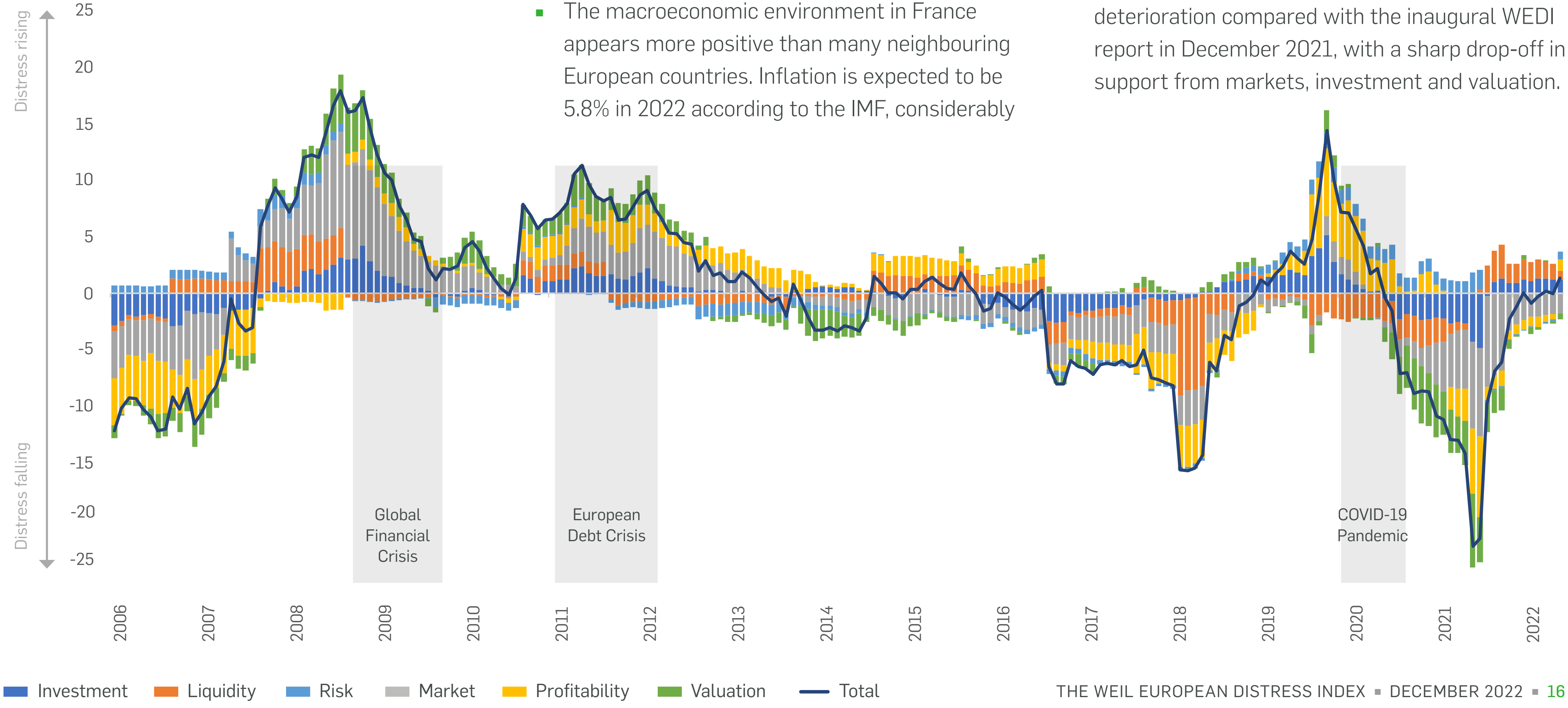
- Distress across UK-based corporates has risen sharply on last year's levels and has risen on the previous quarter. Distress in the UK is at more than a 2-year high (since July 2020), with the main drivers continuing to stem from weaker investment metrics, tighter liquidity and ongoing pressure on profitability.
- During the last quarter, the macroeconomic environment has deteriorated further with a combination of rising inflation, higher interest rates and weakening demand amplifying challenges for many businesses.
- Inflation rose to a 40-year high of 11.1% in October, prompting the Bank of England to increase interest rates to their highest level since November 2008. While housing affordability will be put to the test for many households (2 million households are set to remortgage at markedly higher rates over the next 12 months), business financing costs and revolving debt facilities will also be stress tested.
- Meanwhile, a choppy political environment led to the appointment of Rishi Sunak, Prime Minister, which was soon followed by an Autumn Statement outlining a range of fiscal tightening measures. Although financial markets showed broad support with sterling regaining much of Autumn's lost ground against the dollar, pressures facing UK households intensified with many facing future tax rises.



# France Distress Index

| Nov 2022 | Nov 2021 | QoQ trend | YoY trend |
|---|---|---|---|
| 1.4 | -23.3 | -0.3 Aug 2022 | |

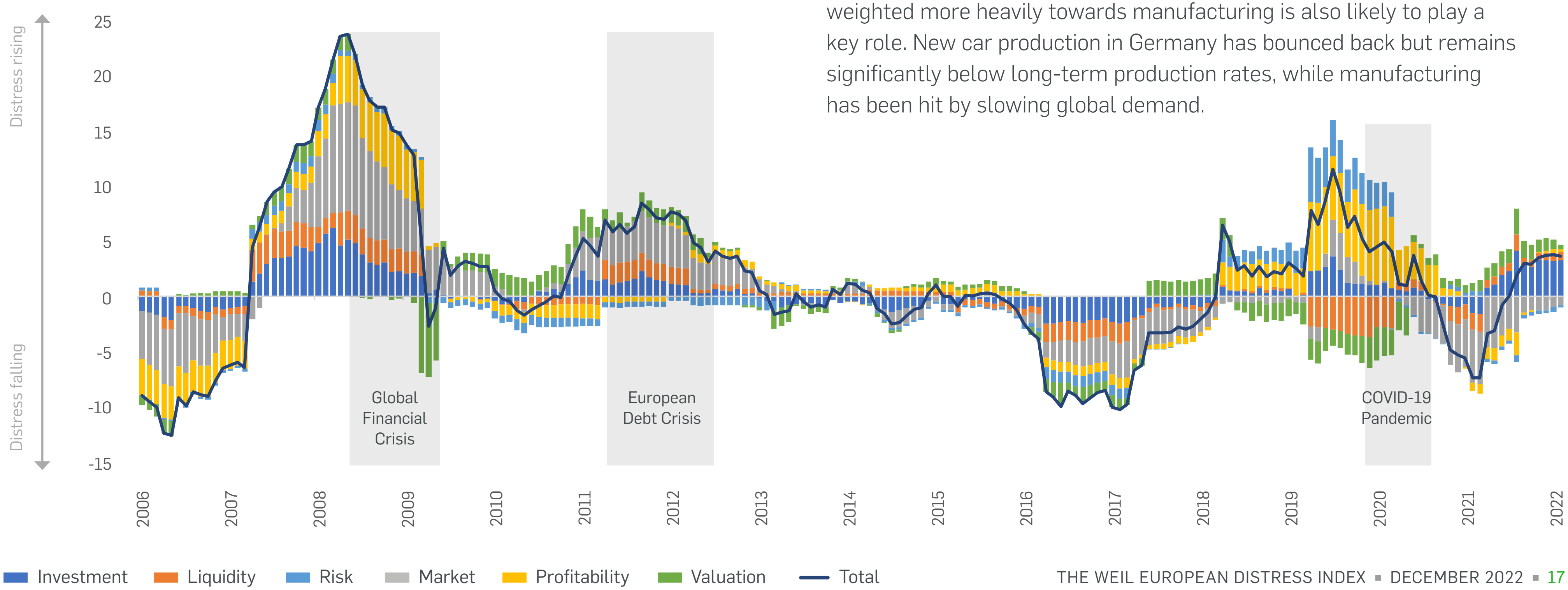
- Levels of distress across corporates in France rose into positive territory for the first time since October 2020 as pressure built up across liquidity, weaker profitability and weakening investment metrics.
- However, France remained the least distressed country across the territories included in the index, buoyed by stronger valuations and support from markets.
- The macroeconomic environment in France appears more positive than many neighbouring European countries. Inflation is expected to be 5.8% in 2022 according to the IMF, considerably lower than Germany (8.5%), UK (9.1%), Spain (8.8%) and Italy (8.7%).
- Prospects for economic growth next year appear more bullish too, with the economy projected to grow 0.7% in 2023, higher than Germany (-0.3%), UK (+0.3%), Spain (+1.2%) and Italy (-0.2%).
- Nevertheless, there has been a sharp deterioration compared with the inaugural WEDI report in December 2021, with a sharp drop-off in support from markets, investment and valuation.



| Nov 2022 | Nov 2021 | QoQ trend | YoY trend |
|---|---|---|---|
| 3.6 | -7.2 | ↑ 3.5 Aug 2022 | ↑ |

# Germany Distress Index

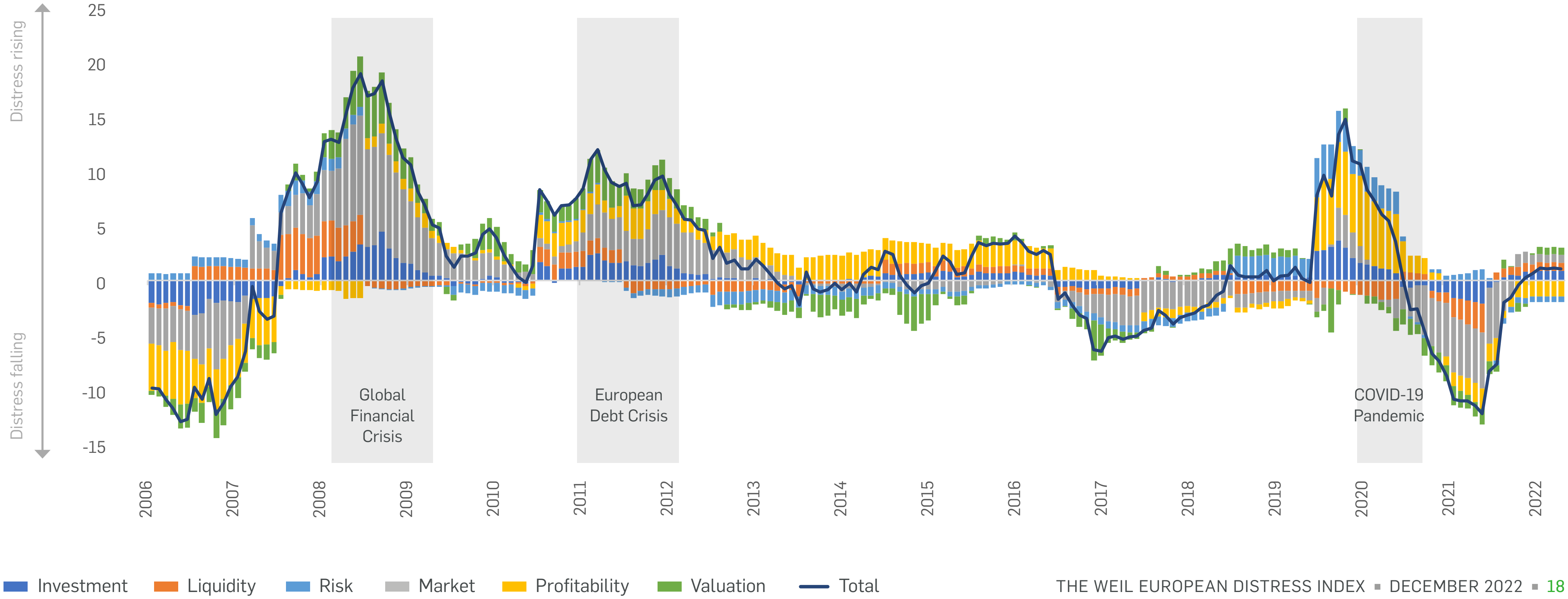
- Corporates in Germany were the second most distressed group across the countries measured, with overall distress rising sharply on last year. Conditions have also intensified compared with the previous quarter, although a recent improvement in financial markets has provided some support.
- Over the last 12 months, there has been a significant deterioration in investment metrics as a riskier outlook and faltering demand takes the shine off investment opportunities.
- Support from market metrics and liquidity have also seen a sharp reversal since the inaugural release of the WEDI last year, reflecting a much more challenging macroeconomic and geopolitical environment.
- Distress in the latest quarter reached the highest level in two years, driven specifically by weaker investment metrics, squeezed liquidity and weaker valuations.
- Inflation also remains a key concern, rising to 10.4% in October. This level set a new peak since the reunification, amid euro weakness, the energy crisis, and lingering supply chain issues.
- Ongoing supply chain issues across the auto sector and an economy weighted more heavily towards manufacturing is also likely to play a key role. New car production in Germany has bounced back but remains significantly below long-term production rates, while manufacturing has been hit by slowing global demand.



| Nov 2022 | Nov 2021 | QoQ trend | YoY trend |
|---|---|---|---|
| 1.1 | -11.2 | ↔ 1.1 Aug 2022 | ↑ |

# Spain and Italy Distress Index

- Corporates headquartered in Spain and Italy have seen levels of distress rise sharply on last year and worsening over the last two quarters, driven by much weaker market fundamentals, pressure on liquidity and weaker investment metrics.
- Corporate distress moved into positive territory in June 2022 and has remained there for the sixth consecutive month. The latest quarter revealed a broader base of distress drivers compared with other European markets, but pushed higher by a deterioration across investment, liquidity, valuation and market metrics.
- However, distress remains markedly below levels seen in the UK and Germany which could be explained by economic growth forecasts for Spain (+4.3%) and Italy (3.2%) outpacing the Euro Area (+3.1) in 2022 according to the IMF. This compares with weaker prospects for Germany which is expected to grow by just +1.5%.
- Additionally, exposure to the Russia/Ukraine conflict is also more contained compared with Germany.



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