THE WEIL EUROPEAN DISTRESS INDEX

JULY 2024

EXECUTIVE SUMMARY

Weil European Distress Index Movements

May 2024	QoQ trend	YoY trend
+2.3	↓ +3.2 Feb 24	↑ +2.1 May 23

Macro view

- The latest Weil European Distress Index (WEDI) indicated a mild fall in corporate distress compared with the previous quarter, but levels remained ahead of last year.
- Across the UK and France, levels of distress fell on the previous quarter, but rose in Germany and marginally in Spain/Italy.
- While ongoing geo-political and economic uncertainties persist across Europe, the outlook has improved compared with last year. Economic growth across the Euro Area rose by 0.3% in the first quarter of 2024, beating expectations and marking the end to a mild recession.
- GDP is expected to rise 0.8% in the Euro Area in 2024, a slight improvement from the previous forecast made by the European Commission (EC).
- Importantly, inflation continues to moderate, easing pressure on household incomes. In the Euro Area, inflation is expected to fall from 5.4% in 2023 to 2.5% in 2024 and 2.1% in 2025 (EC).
- Meanwhile, the Producer Price Index showed that inflation facing industrial producers remained deflationary for the 12th consecutive month in the Euro Area (April 2024), with prices falling 5.7%, following a decline of 7.8% in the previous month. A 14.7% decrease was seen in energy cost and prices for intermediate goods also moved lower (-3.9%).
- Although inflation has eased considerably in recent months, expectations of an imminent interest rate cut have been pared back. Financial markets now expect a more gradual pace of policy rate cuts than at the beginning of the year in the EU, with expectations suggesting short-term nominal interest rates will decrease from 4% to 3.2% by the end of the year and to 2.6% by the end of 2025.
- In the UK, the Bank of England has suggested that the economy continues to move in the right direction, hinting at rate cuts. A poll of economists conducted by Reuters suggested all but two out of 65 expected a rate cut in August, with the majority expecting a further cut before the end of the year.
- Higher interest rates increase the cost of new capital investments, potentially hindering expansion plans, technological upgrades, especially in capital-intensive industries, and debt-financed growth.
- Post-election certainty in the UK and France may restore some confidence for firms who held back investment pending a definitive outcome. However, major elections throughout developed economies in the second half of the year could cause further uncertainty.
- Germany remained the most distressed market covered in the WEDI, with levels rising on the previous quarter. The IMF expects the German economy to expand by 0.2% in 2024, falling from 0.5% forecast in the previous quarter.
- Germany remains the weakest performing economy across all advanced economies. This is followed by the UK (+0.5%), Italy (+0.7%), France (+0.7%) and Spain (1.9%), with the Euro Area overall expected to rise by 0.8% this year and 1.5% in 2025.

Sector view

- Key industries such as Real Estate, Healthcare and Retail/Consumer remain above long-term distress levels.
- In the latest data, the Real Estate market remained the most distressed sector, although levels eased on the previous quarter. Property value declines have moderated following a two-year recalibration process to higher interest rates, providing a more positive outlook compared with last year.
- Weaker investment metrics and squeezed liquidity were the principal drivers of distress, reflecting a challenging outlook for highly leveraged companies facing elevated costs of capital.
- Healthcare companies remained the second most distressed sector, although the intensity of distress has eased for three consecutive quarters. An easing of operating costs from lower energy bills and weaker wage growth, as well as more stability in the real estate market, are all likely to have supported an easing in distress.
- Retail and Consumer experienced levels of distress rising on the previous quarter, reflecting ongoing weakness in consumer spending and supply chain disruptions caused by tensions in the Middle East.

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

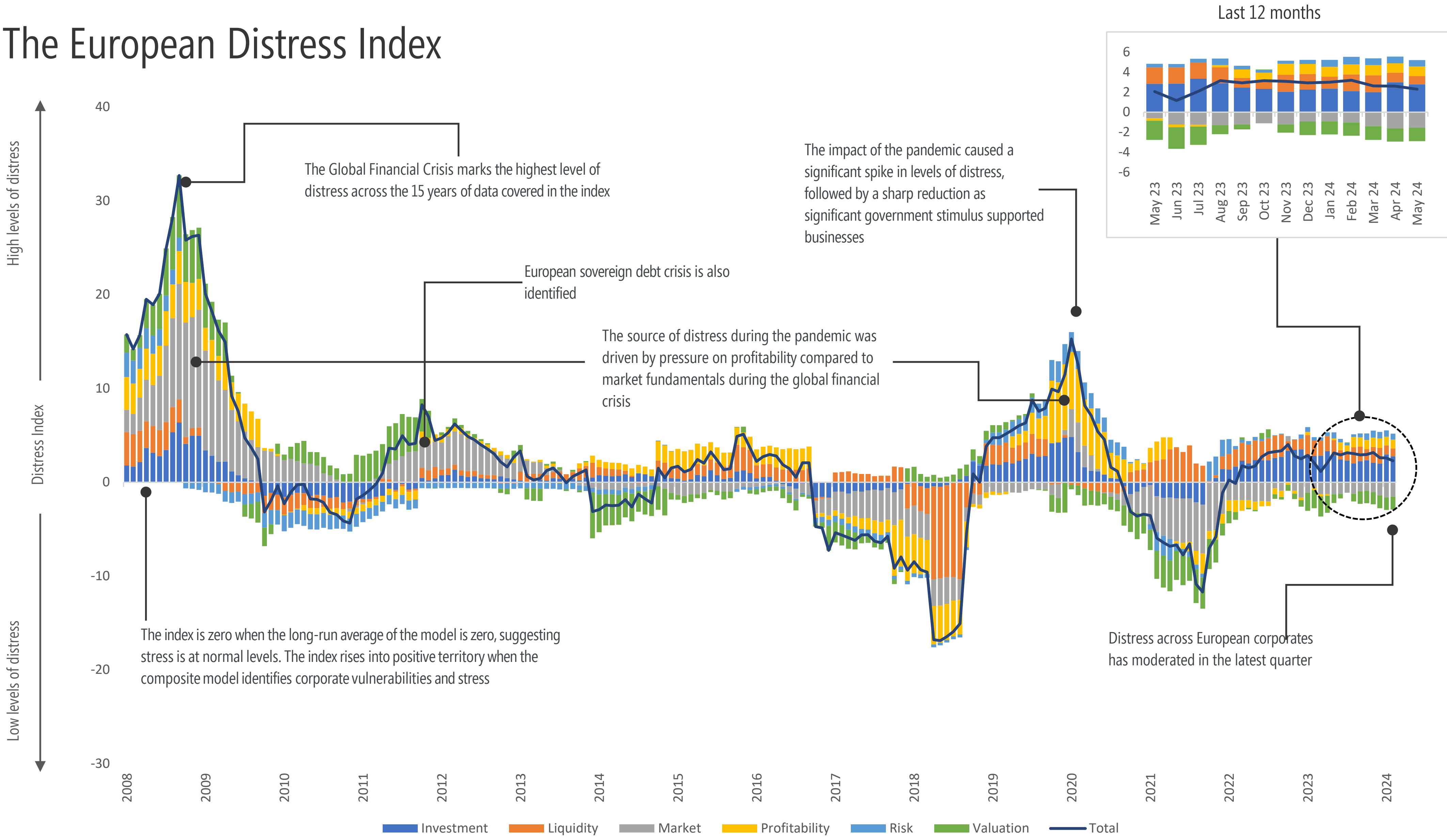
The WEDI is constructed using data from over 3,750 listed European companies and a range of financial market indicators. 16 indicators have been used to construct the WEDI which reflect one or more symptoms of corporate distress based on comprehensive academic and desk-based research.

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.

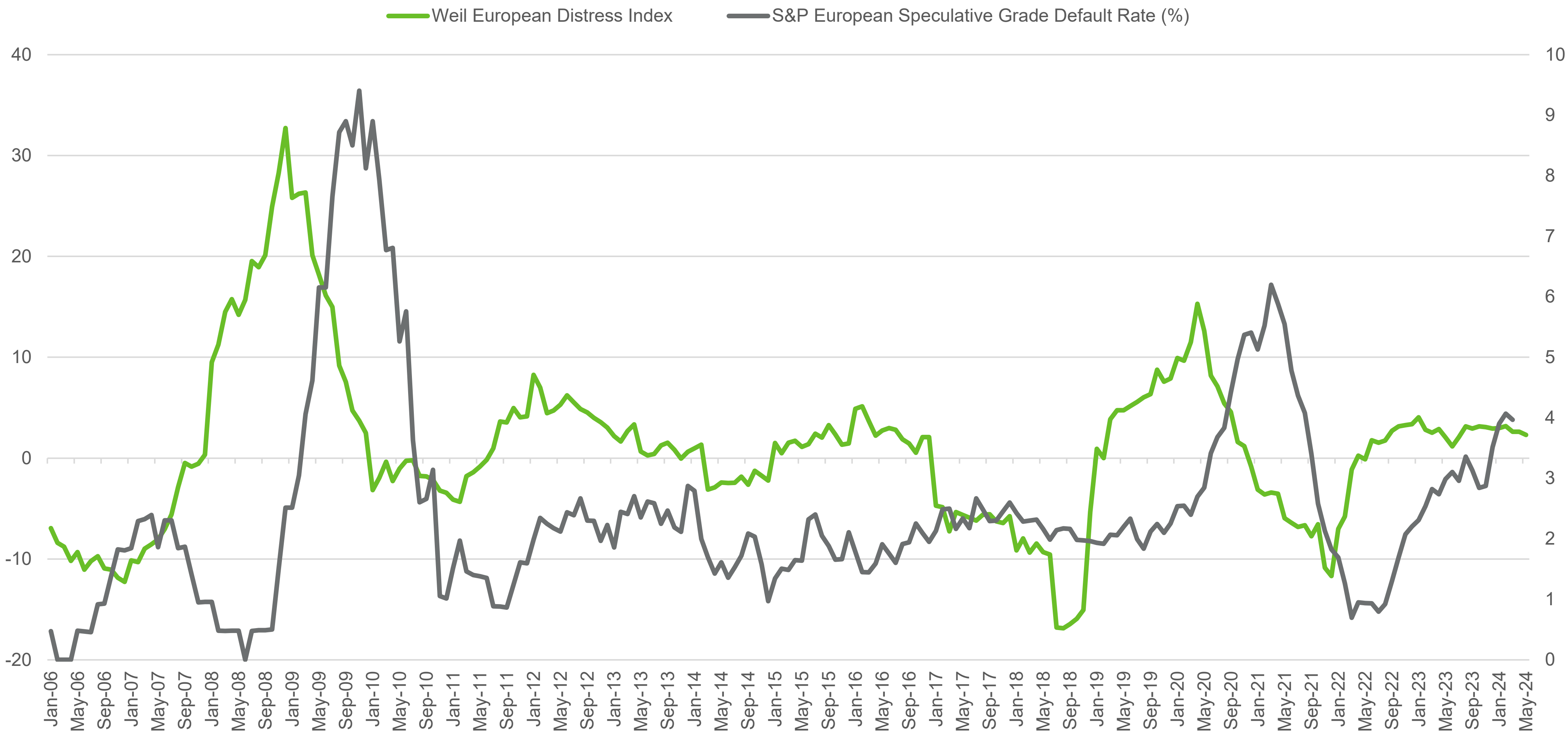
*Total Europe includes UK, France, Germany, Spain, Italy, The Netherlands, Republic of Ireland, Belgium, Norway and Portugal

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.



THE WEIL EUROPEAN DISTRESS INDEX

JULY 2024

SIZE ANALYSIS

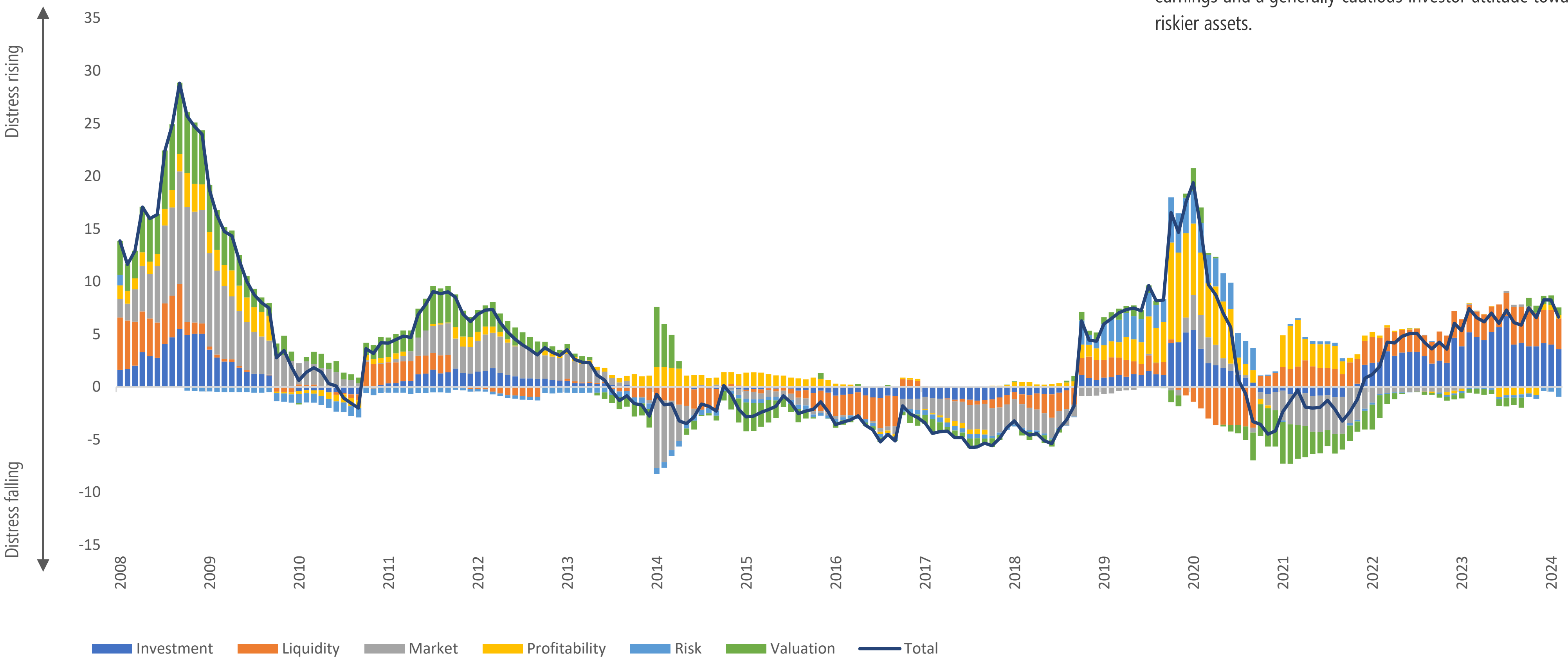
INDUSTRY ANALYSIS

COUNTRY ANALYSIS

Small Corporates

(market cap <€5bn)

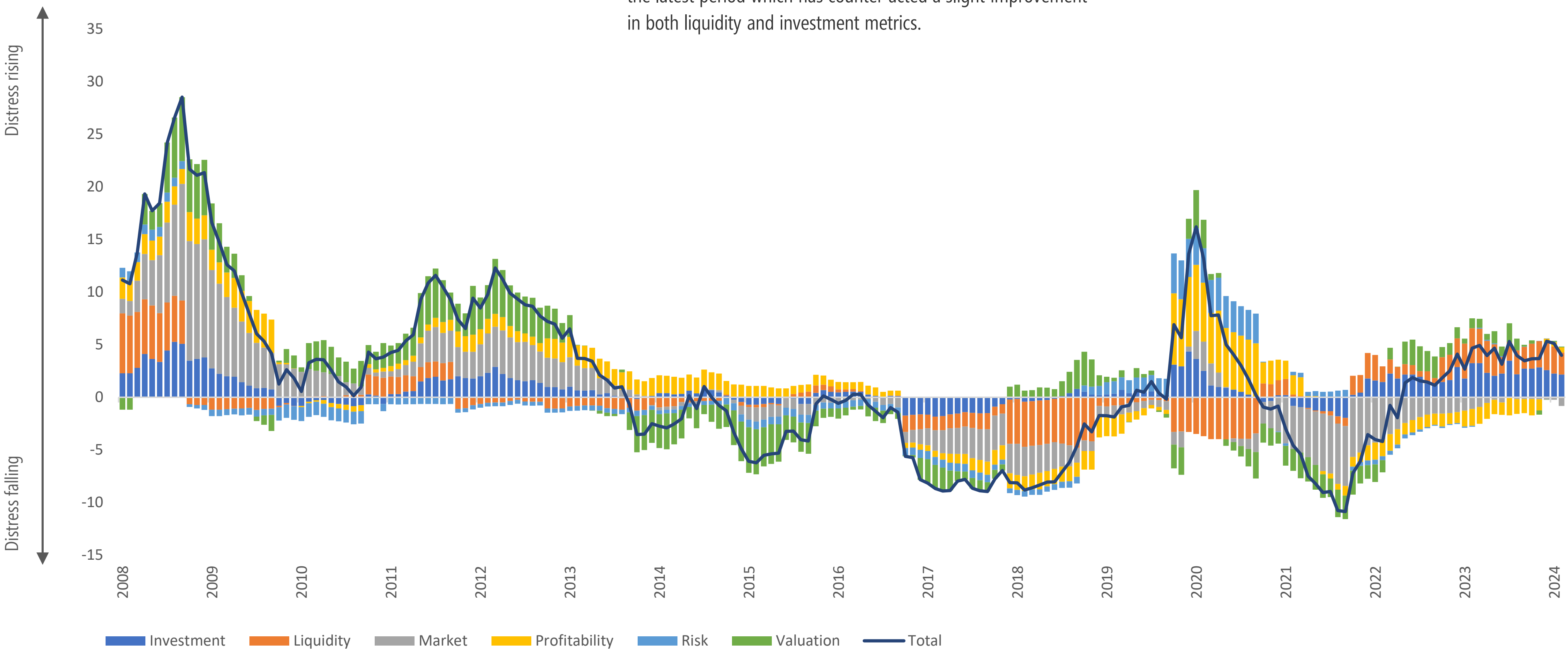
- In the landscape of European corporates, small companies [those with a market capitalisation under €5bn] continue to experience the highest levels of distress.
- While the most recent data does point towards an easing in the overall level, the general trend over the last 12-18 months continues upwards.
- Investment challenges and liquidity constraints remain the primary drivers of distress, reflecting a consistent theme that has been prevalent in previous quarters.
- Smaller firms continue to experience the most significant pressure from a constrained borrowing environment due to persistently high interest rates, which affects their financing and operational flexibility.
- Among tough economic headwinds, liquidity remains tight for small businesses, as demand remains soft and a slower velocity of sales ties up cashflow.
- Additionally, valuations for small businesses may be under pressure owing to higher discount rates applied to future earnings and a generally cautious investor attitude towards riskier assets.



Medium Corporates

(market cap €5bn – €25bn)

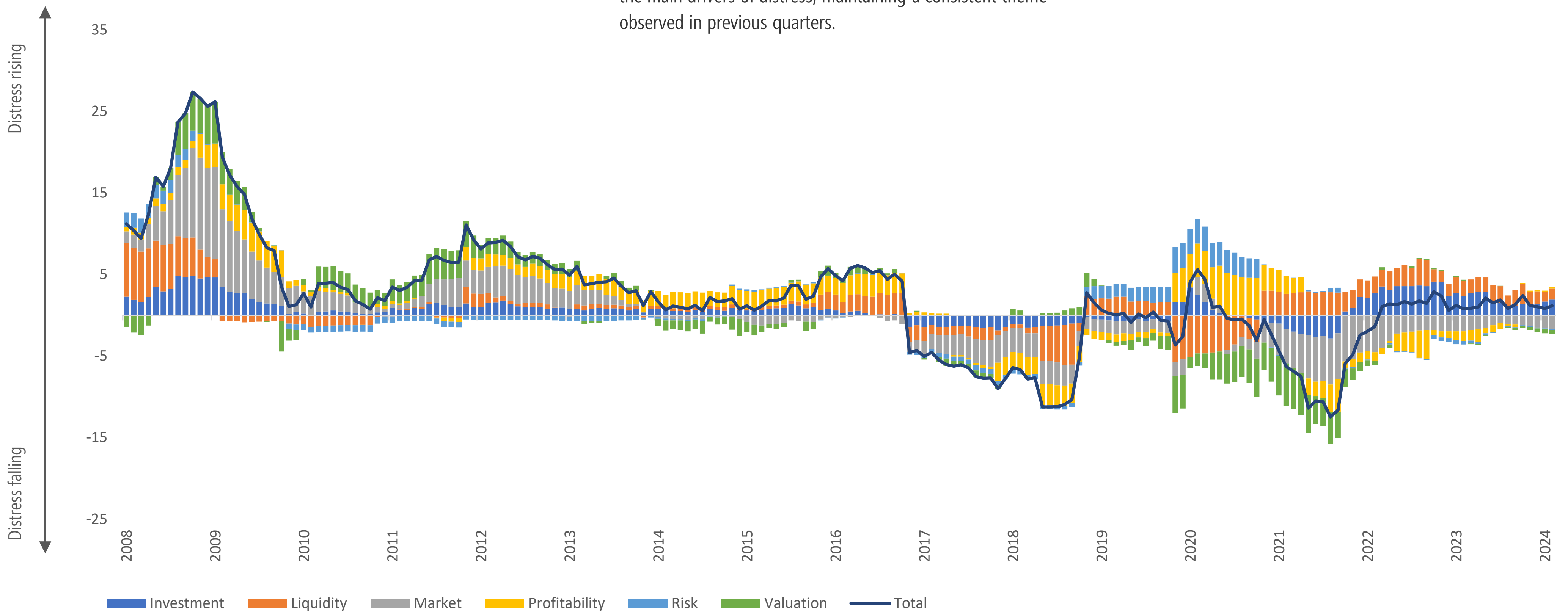
- In the medium-sized corporate sector, those with market capitalisations ranging from €5bn to €25bn, levels of distress remain broadly similar to those experienced over the last 12 months.
- Corporate distress has remained near current levels, driven by pressures on investment and poor levels of liquidity. However, the latest period is the lowest in three months and continues to move within a similar range throughout the last 18 months.
- More concernedly, support from profitability has waned over the latest period which has counter acted a slight improvement in both liquidity and investment metrics.
- Meanwhile, support from financial markets appears to have strengthened in the latest quarter.
- Overall, distress remains above long-run averages and higher than larger corporates who generally have better access to capital at more attractive rates.



Large Corporates

(market cap >€25bn)

- In the landscape of European corporates, large companies [those with a market capitalisation over €25bn] continue to experience the lowest levels of distress.
- Distress has remained broadly stable over the last 24 months for large corporates who have managed to navigate the challenges of the higher interest rate environment, rising geo-political uncertainty and disrupted supply chains with more flexibility than smaller firms.
- Investment challenges and liquidity constraints continue to be the main drivers of distress, maintaining a consistent theme observed in previous quarters.
- Business confidence has shown improvement in several key markets, reflecting a more certain economic outlook.
- Inflation has returned to near-target across many European countries, while a mild recession in the Euro Area and the UK was short-lived.
- However, ongoing volatility in the geo-political environment remains a concern across key markets and continues to disrupt supply chains.



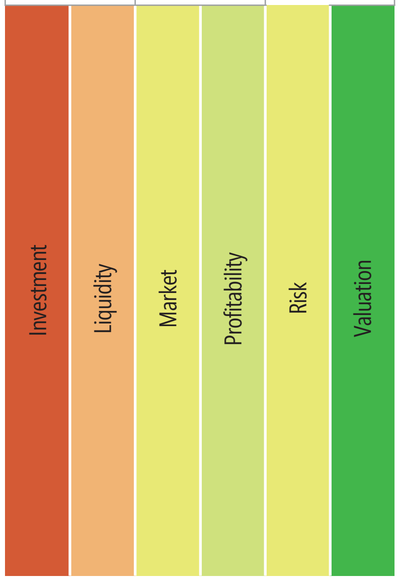
Distress Index May 2024

Least distressed

Most distressed

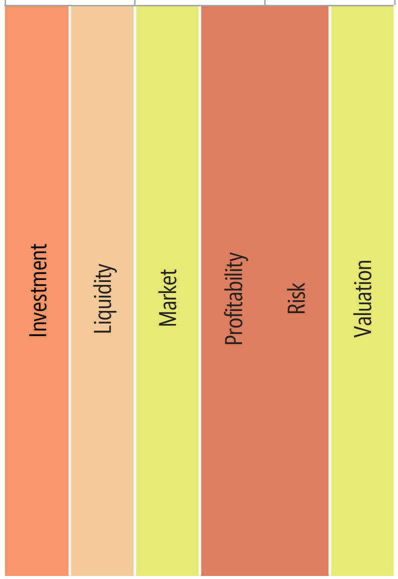
Real Estate

Distress ranking	Index value	YoY trend
1	+7.4	↑ +5.0 May 23



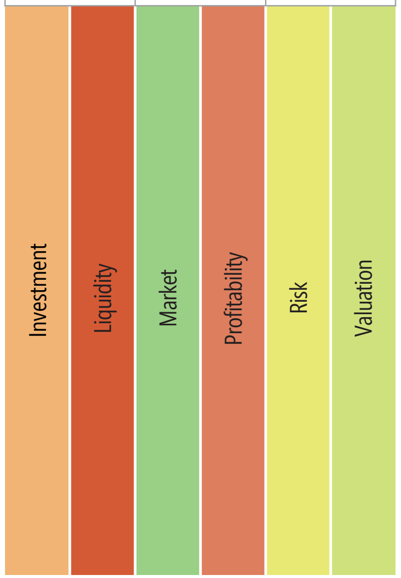
Healthcare

Distress ranking	Index value	YoY trend
2	+5.3	↓ +8.2 May 23



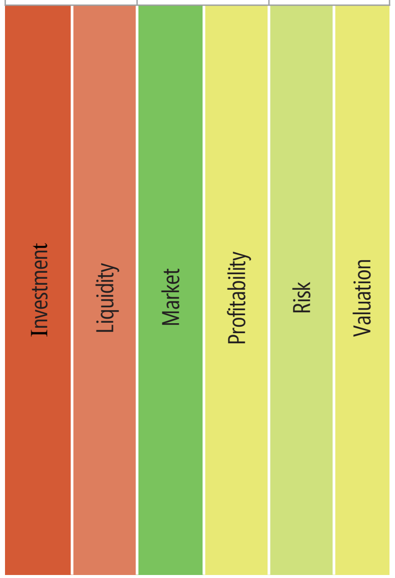
Retail and Consumer Goods

Distress ranking	Index value	YoY trend
3	+3.8	↑ +1.9 May 23



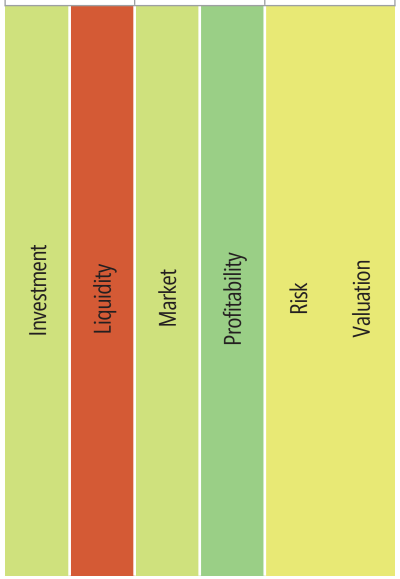
Industrials

Distress ranking	Index value	YoY trend
4	+2.2	↑ +0.9 May 23



Travel, Leisure and Hospitality

Distress ranking	Index value	YoY trend
5	-1.6	↓ +1.7 May 23



Distress Index May 2024

Least distressed

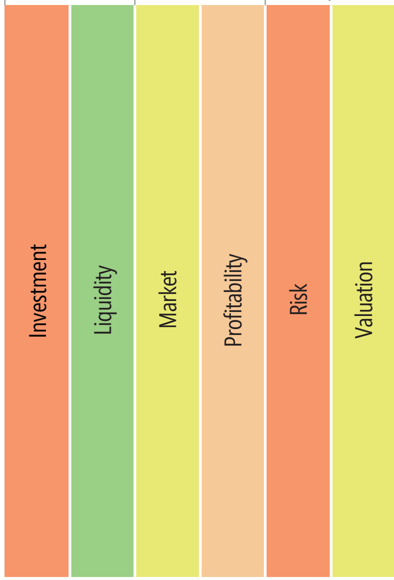
Most distressed

Oil and Gas

Distress ranking	Index value	YoY trend
6	-2.0	↑ -2.7 May 23

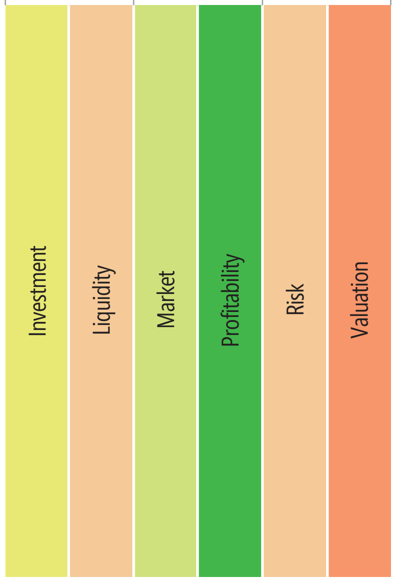
Infrastructure

Distress ranking	Index value	YoY trend
7	-3.0	↑ -4.5 May 23



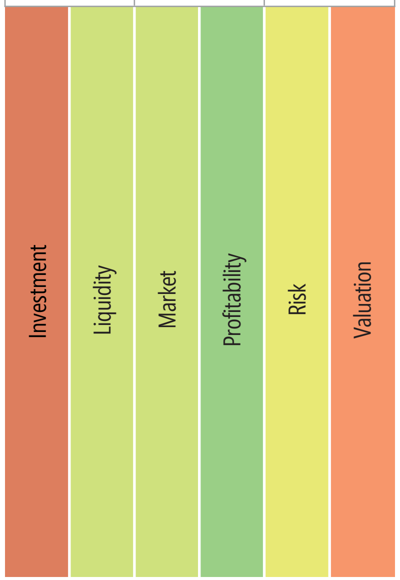
Financial Services

Distress ranking	Index value	YoY trend
8	-6.1	↓ -0.6 May 23



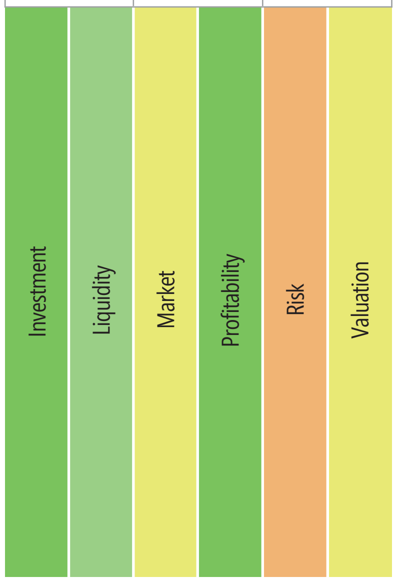
Technology, Media and Telecoms

Distress ranking	Index value	YoY trend
9	-6.2	↓ -1.8 May 23



Commodities and Natural Resources

Distress ranking	Index value	YoY trend
10	-8.4	↓ -1.4 May 23

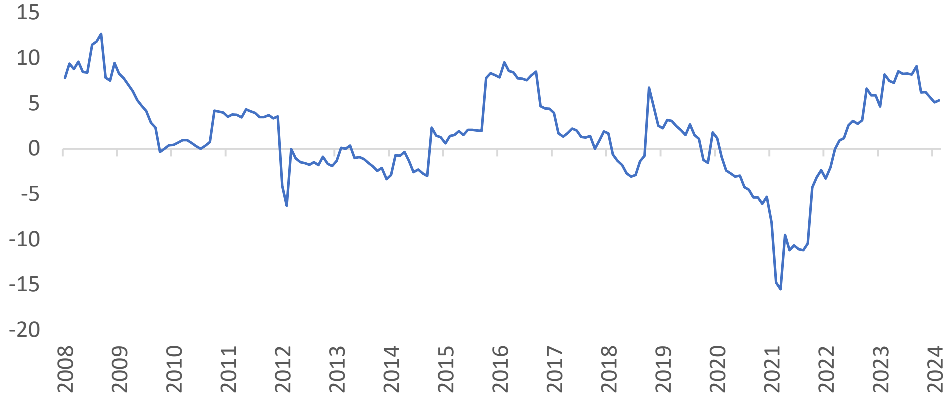


Real Estate

Real Estate remains the most distressed sector, however, levels have showed signs of easing. Property value declines have flattened following a two-year recalibration process to higher interest rates, providing a more positive outlook compared with last year. Nevertheless, the outlook remains challenging especially for those with high leverage ratios who are increasingly challenged by refinancing debt.

Healthcare

The latest data shows a continued easing of distress in the Healthcare sector, but it remains the second most distressed across the sectors covered. Profitability and risk factors weighed on concerns, although there are ongoing improvements in liquidity. Operational challenges persist, with weaker investment sentiment also undermining the sector's performance.



Retail and Consumer Goods

Retail and Consumer Goods is the third most distressed industry across those measured in the WEDI, seeing levels of distress rise to their highest since Covid (April 2020). The impact of higher interest rates continue to feed through to households in the form of elevated mortgage repayments and steeper rents, choking spending power. Meanwhile, ongoing supply chain disruptions in the Red Sea have also pushed up the cost of freight and containers while delaying delivery of products into Europe.

Industrials

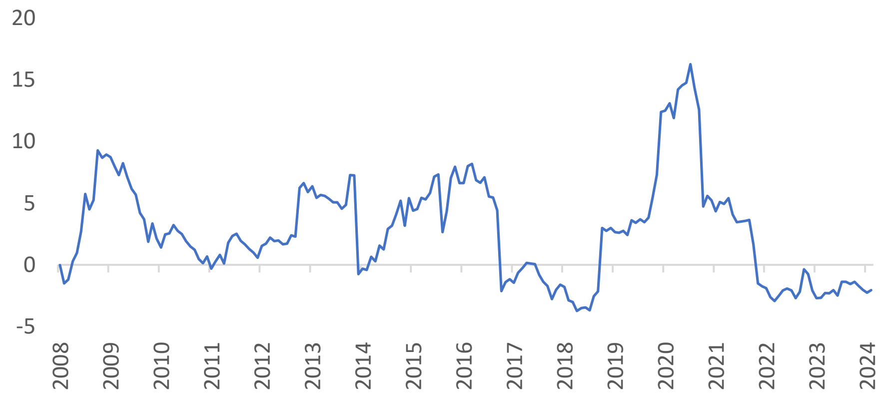
The Industrial sector experienced an easing in distress compared to the previous quarter, although it remained higher than the previous year. While conditions remain challenging, decreased volatility alongside the prospect of interest rates cuts is likely to be improving confidence for new projects among firms.

Travel, Leisure and Hospitality

Travel, Leisure & Hospitality sector has experienced a further easing in the levels of distress in the latest period, remaining below the long-term average. While pressure remains on liquidity, support from firmer investment metrics, profitability and financial markets have pushed distress to levels lower than during the pandemic.

Oil and Gas

The Oil and Gas sector has kept distress levels below the historical average, continuing the post-pandemic trend. While the outlook for both global and European economies remain fragile, sentiment continues to improve following sharp falls in inflation, a recovery in spending power and better prospects for growth.



Infrastructure, Utilities and Power

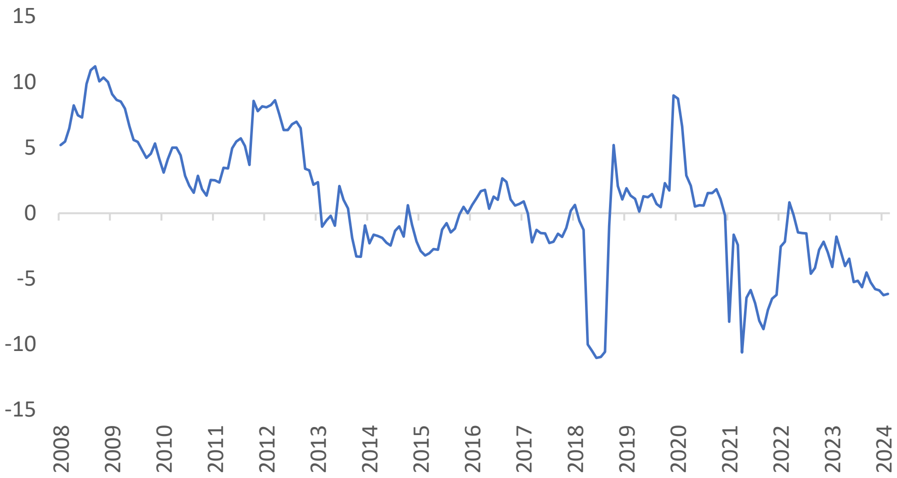
The Infrastructure, Utilities, and Power sectors have maintained distress levels below the long-term average, but rising on the previous quarter. The steady investment and positive market sentiment towards these essential services reflect continued confidence in their resilience.

Financial Services

Distress in the Financial Services sector has significantly declined. The sector reflects resilience in the face of rising interest rates, benefitting from improved margins and more stable and strengthened balance sheets following the financial crisis of 2008.

Technology, Media and Telecoms

The Technology, Media, and Telecommunications (TMT) sector has seen levels of distress fall this quarter and it remains below long-term historical averages. This resilience is due to strong market fundamentals and improved liquidity.



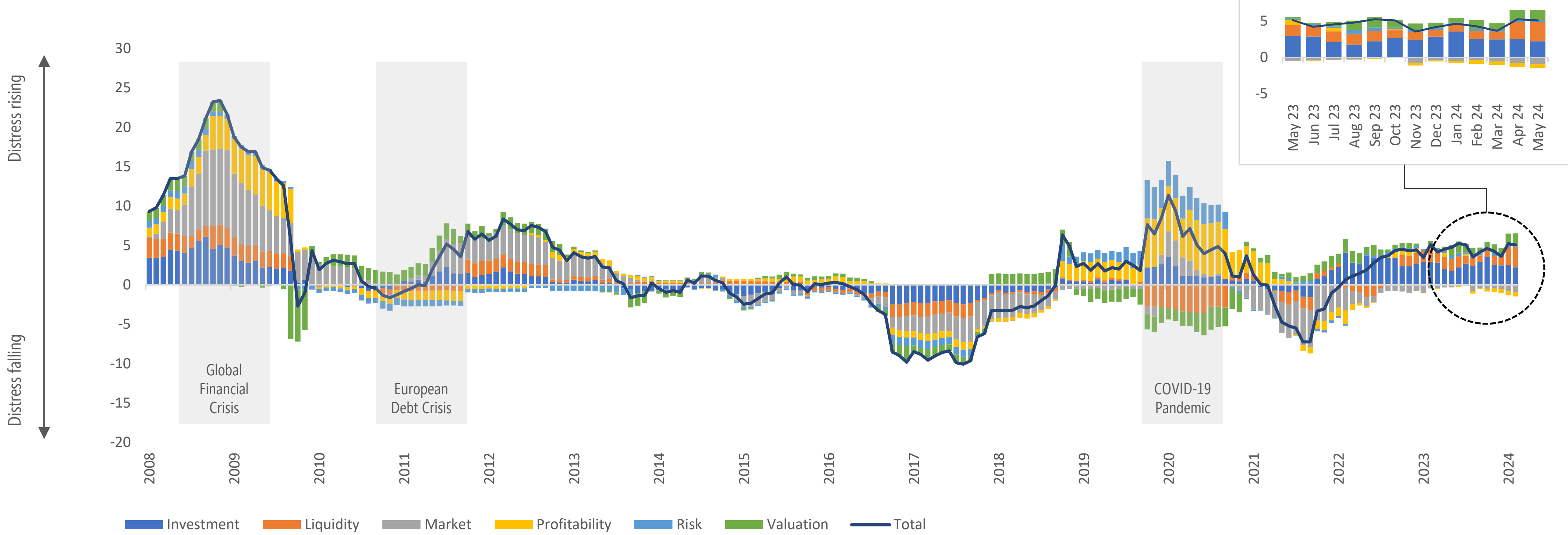
Commodities and Natural Resources

Strategic investment decisions and sustained profitability have contributed to reduced distress. While caution remains, sentiment within the sector has improved reflecting a more positive global economic outlook and improving business confidence.

Distress Ranking	May 2024	QoQ Trend	YoY Trend
1	+5.1	+4.3 Feb 24	+5.1 May 23

Germany Distress Index

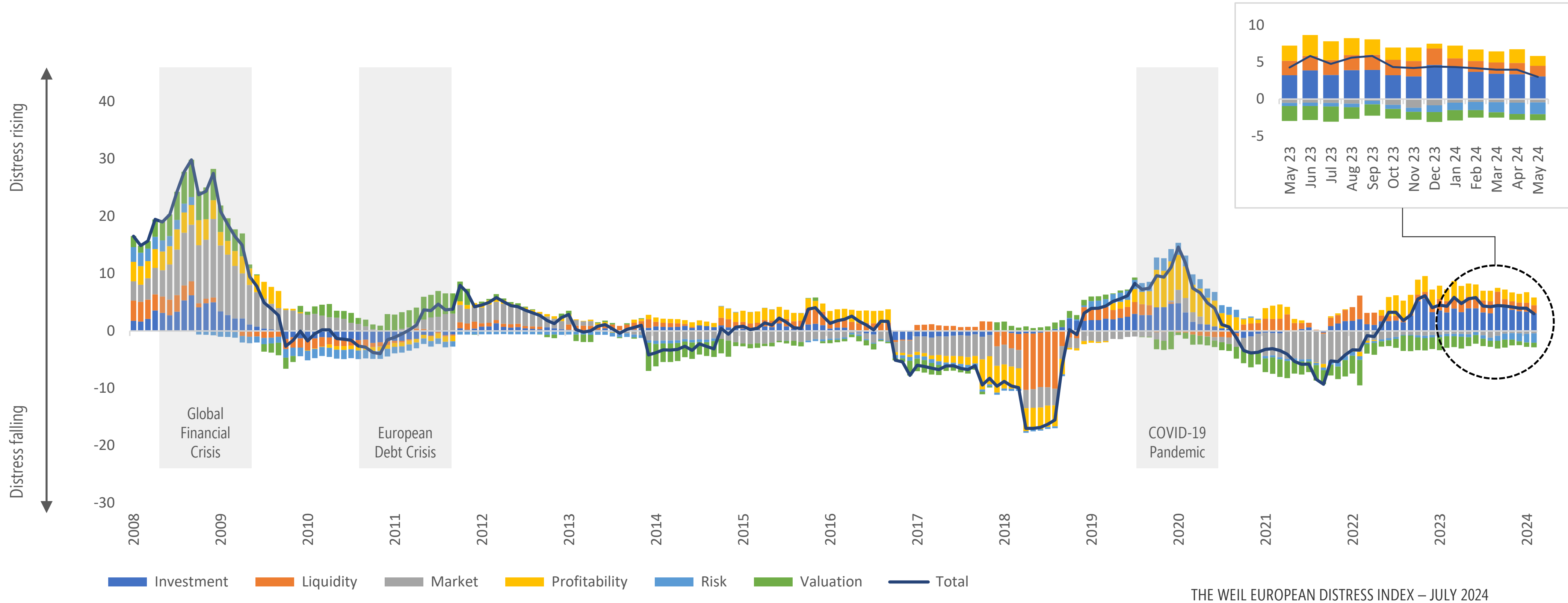
- German corporates continued to experience the highest levels of distress across the countries measured. While levels of distress rose on the previous quarter, they remained static on the previous year and stable over the last 18 months.
- Ongoing investment hesitancy, alongside tighter liquidity and profitability challenges, reflect wider macroeconomic challenges faced by the economy.
- In its latest update, the European Commission portrays Germany as having a stagnant economy throughout 2024, with investment remaining well below pre-pandemic levels. Exports are forecast to remain sluggish in 2024 and slowly recover in 2025.
- This tough outlook is supported by the latest forecasts from the IMF (April) who suggest growth of just 0.2% in 2024, the weakest of all advanced economies and notably lower than the overall Euro Area (+0.8%).
- The German export industry has cooled down considerably which is a major contributor to the current economic weakness. Energy intensive industries such as manufacturing, a core component of the German economy, have suffered from high energy costs, lacklustre global orders and higher interest rates.
- In a recent address to the German Chambers of Industry and Commerce, Chancellor Olaf Scholz said "The German economy has faced unprecedented challenges over the past two years or so since Russia's invasion of Ukraine".
- However, the economy is expected to show signs of recovery later in the year, with inflation expected to fall and nominal wages forecast to rise. The European Commission has suggested 1.0% growth in 2025.



Distress Ranking	May 2024	QoQ Trend	YoY Trend
2	+3.0	+4.2 Feb 24	+4.3 May 23

United Kingdom Distress Index

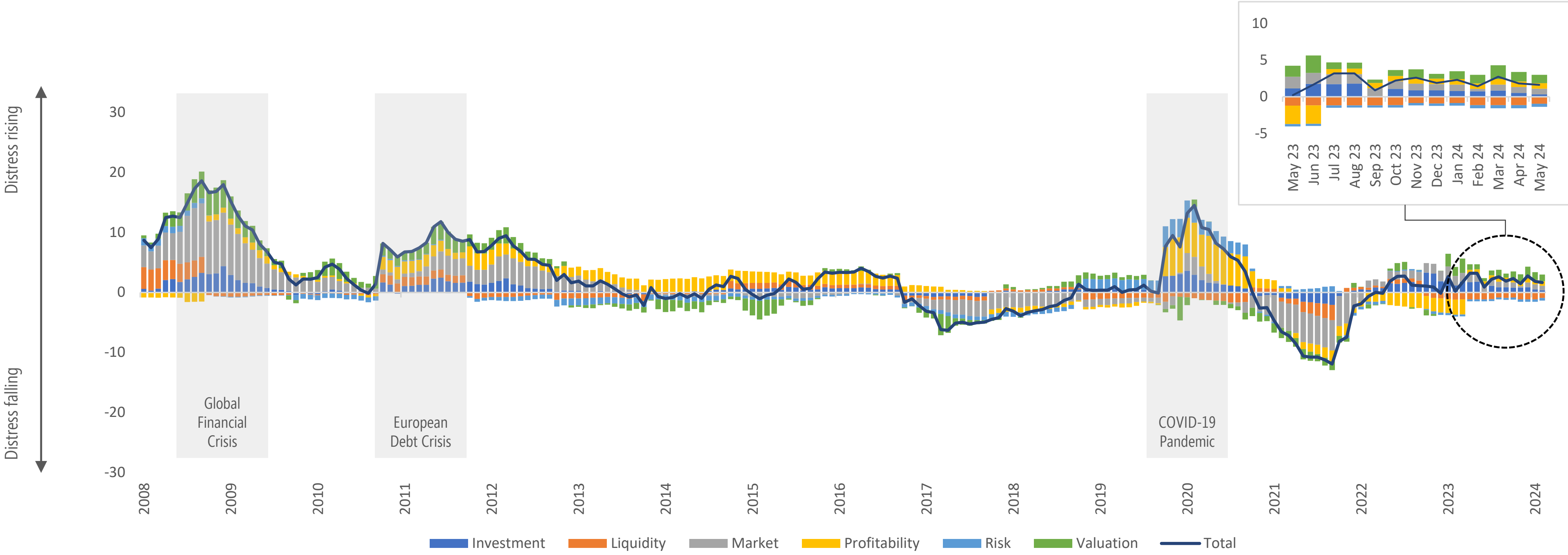
- In the UK, corporate distress fell on the previous quarter and has continued to moderate over the last 12-16 months. Nevertheless, distress remains above the long-run average and is the second most distressed market covered in the WEDI. Pressure from weaker investment metrics, pressure on profitability and tighter liquidity remaining the key drivers.
- The latest data showed GDP growth stalling in April, held back by falls in the production and construction industries, but services reported the fourth consecutive month of growth.
- A more positive outlook for the economy has emerged over the last 12-18 months, supported by falling levels of inflation and a tentative recovery in output. Both consumer and business confidence have showed signs of improvement, while forecasts suggest an easing in interest rates starting in August.
- However, past rises in interest rates will continue to filter through to many firms struggling with increasing debt service costs and tighter refinancing conditions.
- Meanwhile, post-election certainty will provide businesses with the clarity needed to support business decisions. The stalling in GDP may prove to be short-lived and factors such as a shift in the timing of Easter and unseasonably poor weather conditions can impact a shorter-term view of economic performance.
- In particular, retail sales have been weak in recent months with the ONS reporting that retailers suggested output was dented because of the wetter weather, with rainfall well above the long-term average.



Distress Ranking	May 2024	QoQ Trend	YoY Trend
3	+1.6	+1.5 Feb 24	+0.2 May 23

Spain and Italy Distress Index

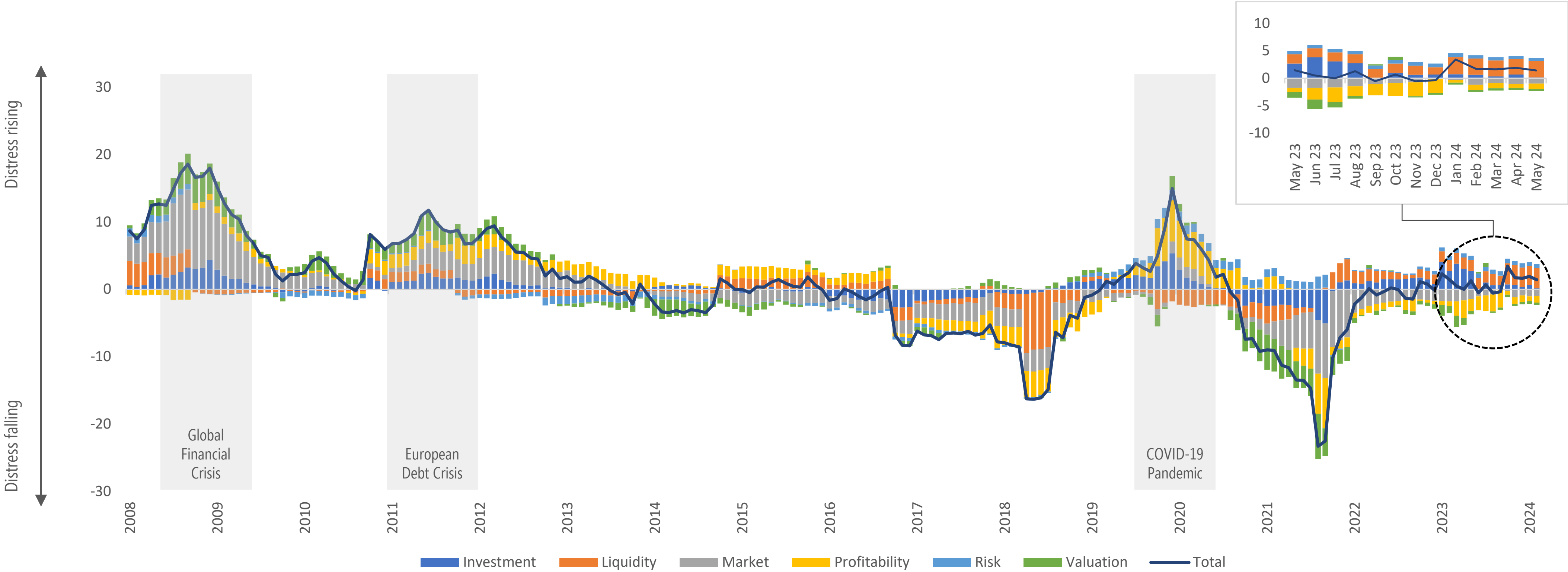
- Corporates headquartered in Spain and Italy continue to experience levels of distress above the long run average but remained the lowest of all countries measured in the WEDI.
- Distress rose marginally on the previous quarter, leaving it the third most distressed market.
- In Spain, GDP rose by 0.7% on quarter in the first quarter of 2024, aligning with a revised figure from the preceding quarter and surpassing market expectations of a 0.4% rise. Household final consumption recorded a modest increase of 0.3%.
- The Spanish economy saw both exports (+2.4%) and imports (+1.1%) register growth. On the supply side, there were positive growth rates across all major sectors, notably manufacturing, construction, primary activities and services.
- In Italy, GDP expanded by 0.3% in the three months to March of 2024, accelerating from the 0.1% growth rate in the final quarter of 2023.
- It underscored some traction in the Italian economy as the market continues to benefit from the gradual normalisation of energy prices and to higher interest rates by the ECB.
- Indeed, forecast for growth in Spain (+1.9%) and Italy (0.7%) surpass those of the UK (0.5%) and Germany (0.2%) in the latest IMF (April) economic outlook.



Distress Ranking	May 2024	QoQ Trend	YoY Trend
4	+1.4	+1.7 Feb 24	+1.5 May 23

France Distress Index

- Distress levels in France remained above the long run average but eased on the previous quarter and are fractionally lower than last year's levels.
- The sources of distress were driven by pressure on liquidity, a faltering appetite for risk and to a lesser extent, weaker investment metrics.
- France remained the least distressed market of those covered in by the WEDI, but there are signs of an uplift compared with the final half of 2023.
- GDP has showed signs of improvement with the latest data suggesting growth of 0.2% in the first quarter of 2024, the strongest since Q2 2023.
- The slight upturn was supported by the further increase in government spending (0.6% vs 0.4% in Q4), and the positive contribution from net trade, as exports rose 1.2% (vs 1%) and imports grew at a slower 0.4% (vs -1.7%).
- Other data reported a more mixed picture. The S&P Global France Manufacturing PMI increased to 46.4 in May 2024 from 45.3 in April. This marked the 16th consecutive month of contraction in France's factory activity, although the shallowest decline since February.
- Looking ahead, confidence on the 12-month outlook on business growth was at its strongest since February 2022.



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