THE WEIL EUROPEAN DISTRESS INDEX

DECEMBER 2023

Macro view

- Corporate distress across European corporates continued its gradual ascent during the latest rolling quarter but November fell against the previous reported level in August. Nevertheless, distress remained broadly consistent in the latest three months and higher than the previous three-month period according to the latest Weil European Distress Index (WEDI).
- The macroeconomic backdrop remained challenging throughout Europe. While the tightening of monetary policy may be nearing its end, European economies continue to feel the impact of rising interest rates.
- The cost of borrowing and refinancing corporate debt has risen significantly over the last 12 months, creating a challenging environment particularly for highly leveraged capital-intensive sectors, such as Real Estate.
- The latest IMF forecasts (Oct 2023) portray a slowing picture for global economic growth which is expected to dip from 3.5 percent in 2022 to 3.0 percent in 2023 and 2.9 percent in 2024.
- The outlook for growth is even more downbeat for advanced economies with growth falling from 2.6 percent in 2022 to 1.5% in 2023 and 1.4 percent in 2024 as rising interest rates continue to bite. Euro Area growth is expected to be just 0.7 percent in 2023 before rising to 1.2 percent in 2024.
- On the upside, inflation has moderated significantly over the last few months, residing at 2.9 percent for the Euro Area in December, but rising on the previous month and signalling potential volatility. While in the UK, inflation fell to 4.6 percent in October, down from 6.7 percent in the previous month and marking the lowest level since October 2021.
- However, the geo-political environment remains turbulent with the ongoing conflict in Russia and Ukraine amplified by tensions in the Middle East which have escalated significantly. Meanwhile, global trade has been hit by rising tensions in the Red Sea as trade routes continue to be impacted by Houthi attacks on commercial shipping.

Weil European Distress Index Movements

Nov 2023	QoQ trend	YoY trend
+4.5	↓ +5.0 Aug 23	↑ +3.3 Nov 22

- In 2024, countries making up over 50% of global GDP will undergo decisive elections. Votes will take place against a backdrop of a precarious geo-political environment and softer economic growth.
- Risk mitigation and contingency planning have become a critical part of business strategy against elevated levels of distress across European corporates. The sources of distress remain consistent with previous periods with businesses facing weaker investment metrics, pressure on liquidity and squeezed profitability.
- Germany remained the most distressed market covered in the WEDI. The IMF expect the German economy to contract by 0.5% in 2023, the worst of all advanced economies. This is followed by the UK (+0.5%), Italy (+0.7%), France (+1.0%) and Spain (2.5%).

Sector view

- Real Estate remained the most distressed sector. Poorer investment metrics reflect an increasingly challenging outlook for highly leveraged companies facing elevated costs of capital. The sector continues to face falling valuations, higher energy and construction costs which are all bearing down on profitability.
- Elsewhere, corporate distress in Healthcare companies remained the second most distressed sector followed by Retail and Consumer companies.
- The consumer sector remains challenging as household affordability comes under increasing pressure from rising mortgage rates and private rents. Indeed, in the UK, the latest data showed private rental costs rising by 6.0%, the fastest rise since the 1990s.

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

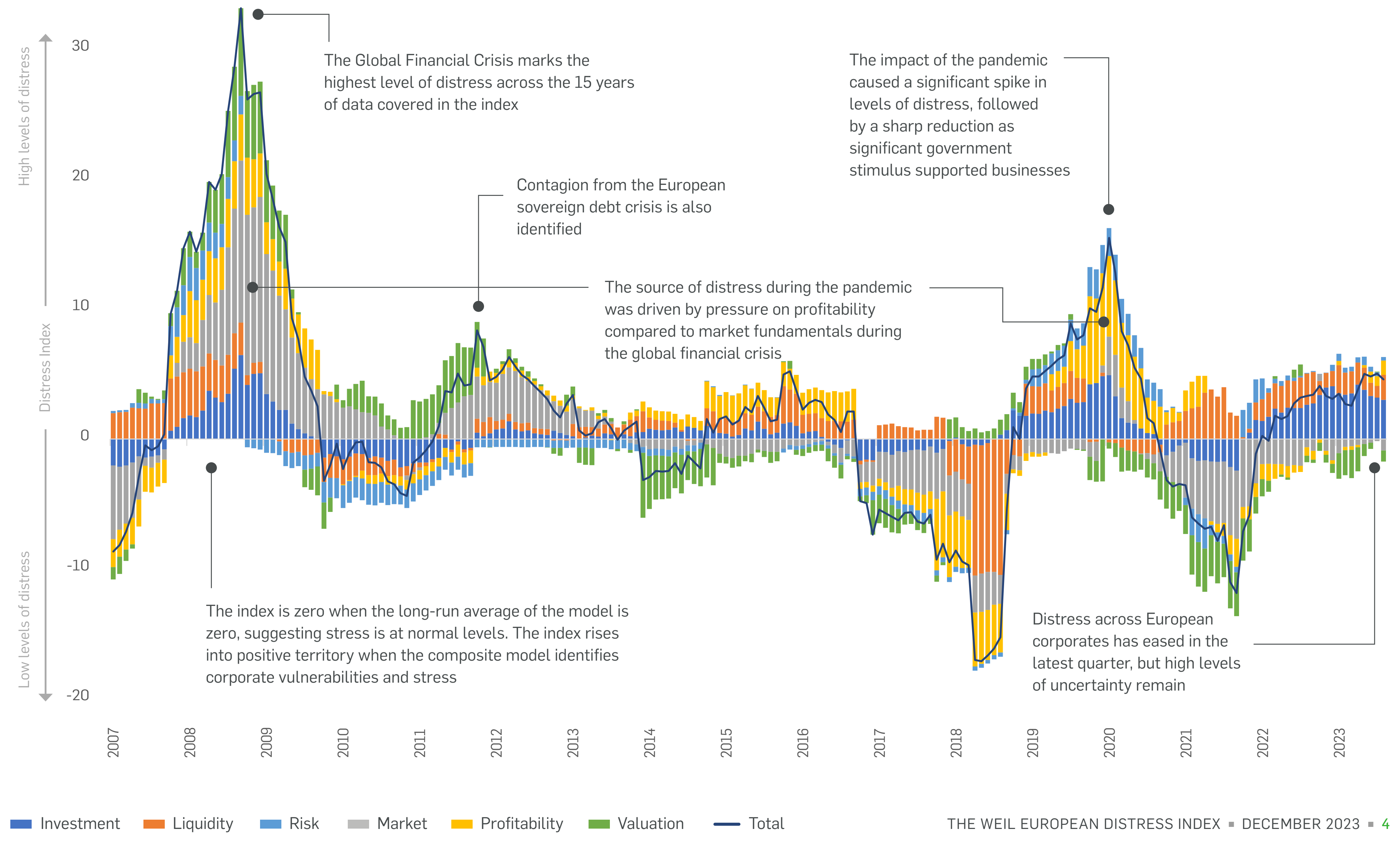
The WEDI is constructed using data from over 3,750 listed European companies and a range of financial market indicators. 16 indicators have been used to construct the WEDI which reflect one or more symptoms of corporate distress based on comprehensive academic and desk-based research.

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.

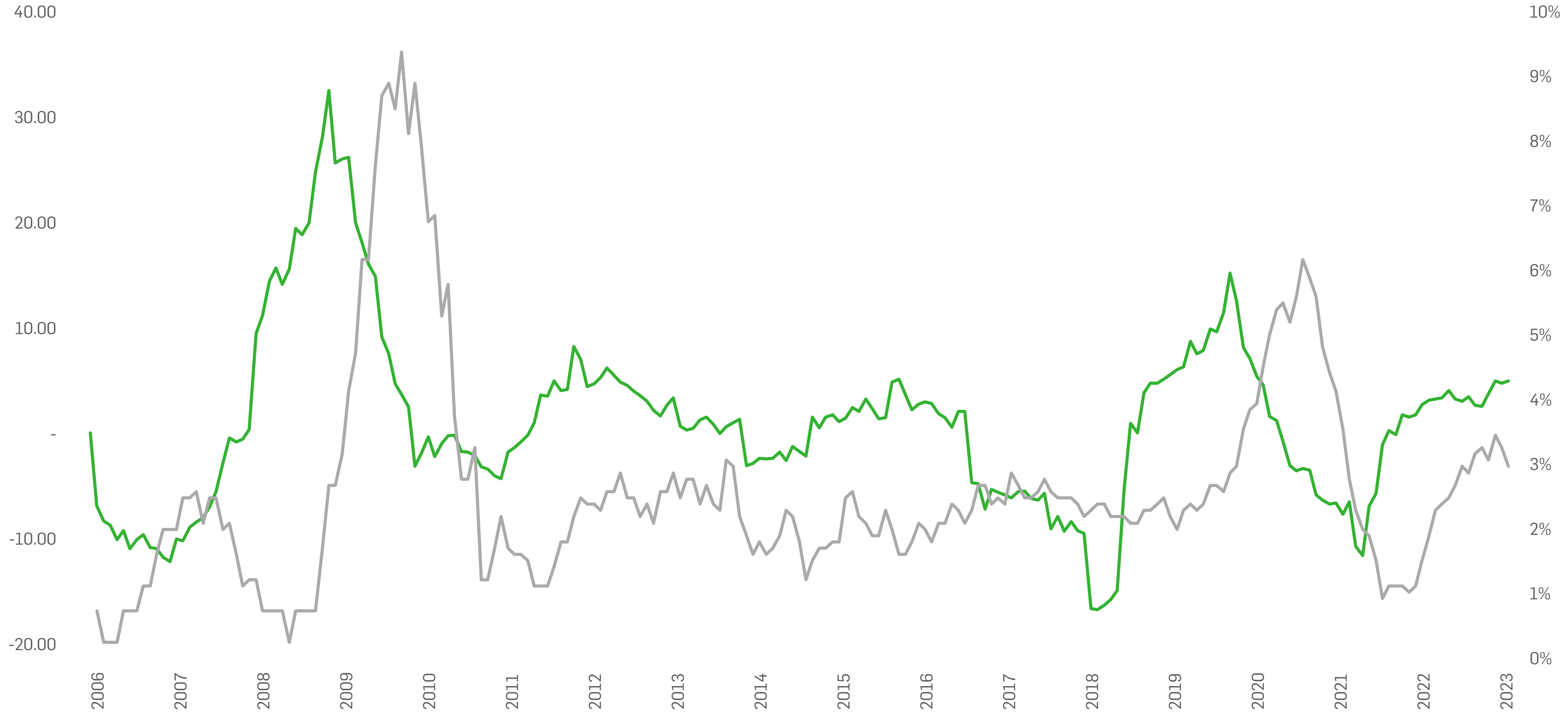
* Total Europe includes UK, France, Germany, Spain, Italy, The Netherlands, Republic of Ireland, Belgium, Norway and Portugal

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
DECEMBER 2023

SIZE ANALYSIS

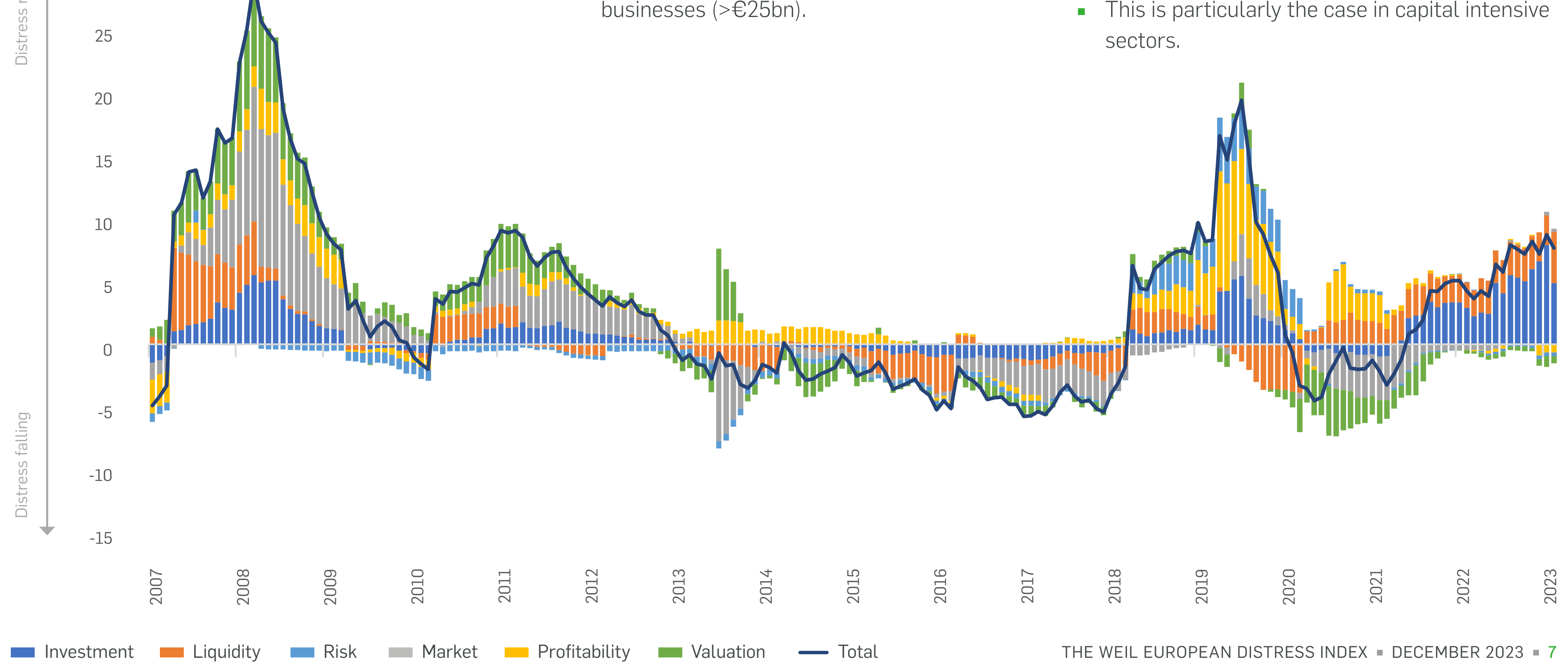
INDUSTRY ANALYSIS

COUNTRY ANALYSIS

Small Corporates

(market cap <€5bn)

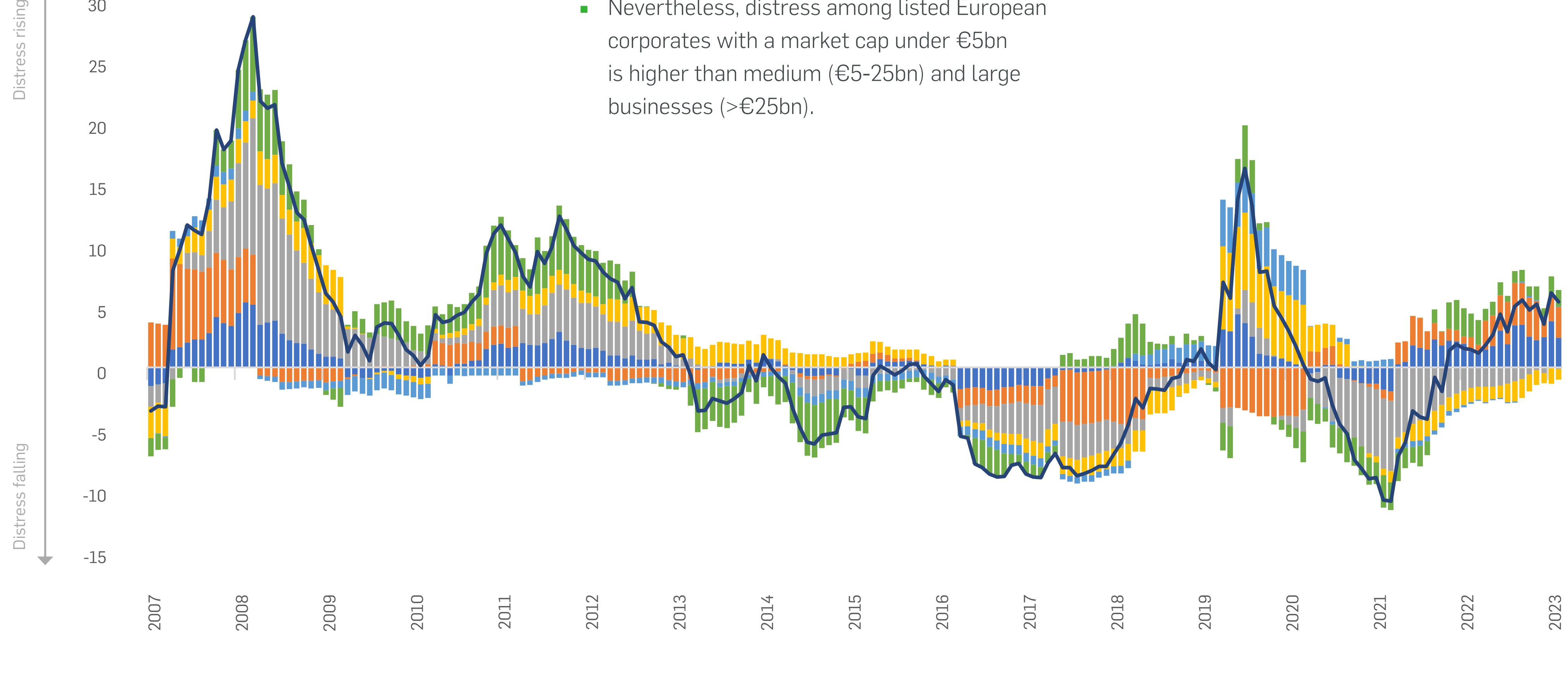
- Corporate distress remains highest across small European listed companies, although levels have remained stable over the last quarter.
- The drivers of distress remain unchanged from previous months, driven primarily by weaker investment metrics and squeezed liquidity.
- Nevertheless, distress among listed European corporates with a market cap under €5bn is higher than medium (€5-25bn) and large businesses (>€25bn).
- Interest rates across the UK and EU remain at elevated levels, impacting the cost of servicing debt and raising capital, both of which are likely to disproportionately impact smaller firms who often face tighter lending criteria – particularly for refinancing debt.
- What's more, smaller firms may often operate with weaker balance sheets which will make refinancing debt at the most competitive rates more challenging.
- This is particularly the case in capital intensive sectors.



Medium Corporates

(market cap €5bn – €25bn)

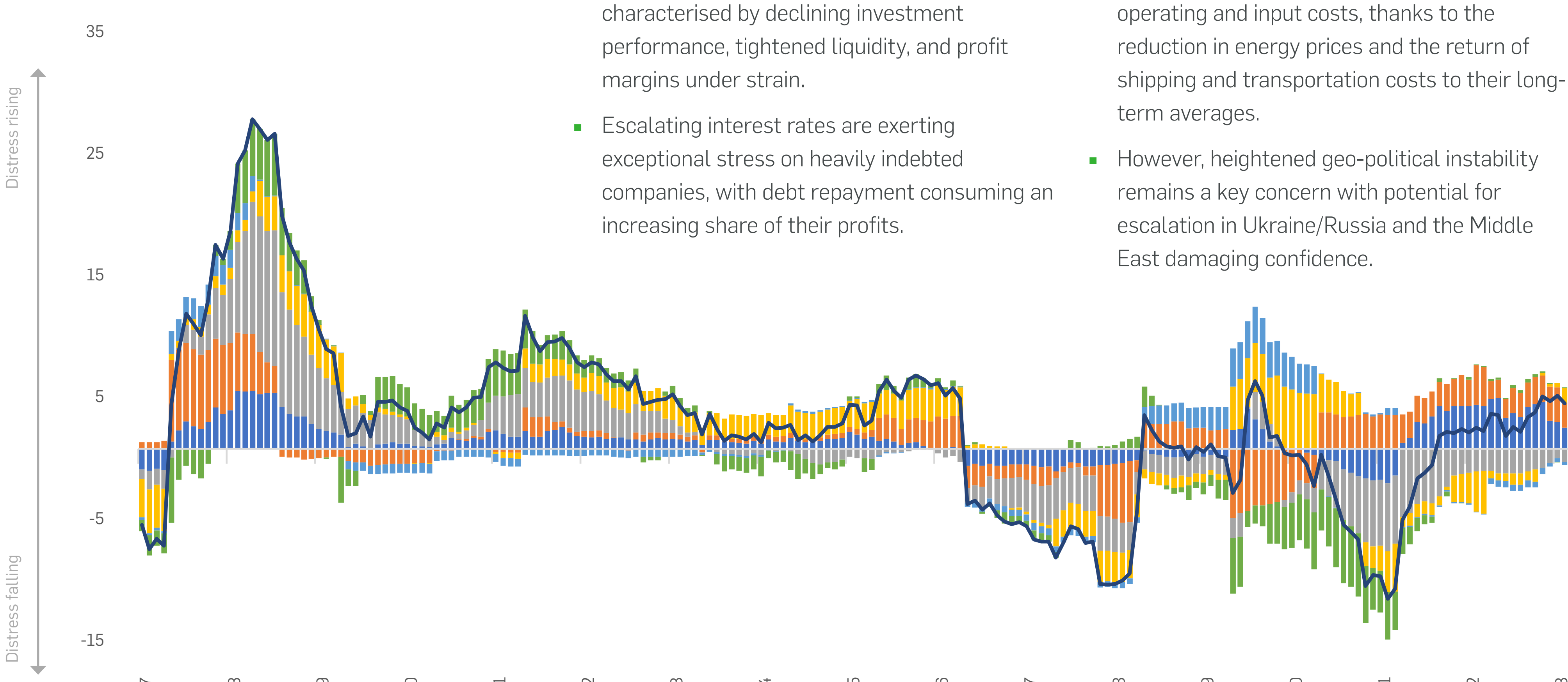
- Medium sized corporates have seen levels of distress rise marginally on the previous quarter but remaining relatively stable over the course of 2023.
- Primary drivers of distress across this cohort continued to be driven by poorer investment metrics, weaker valuations and squeezed liquidity.
- Nevertheless, distress among listed European corporates with a market cap under €5bn is higher than medium (€5-25bn) and large businesses (>€25bn).
- Mid-sized corporate entities are encountering challenges akin to those of their smaller counterparts, grappling with high financing costs and diminished investor sentiment.
- This strain may heighten the risk of defaults, prompting a number of businesses to cut back on investments and workforce.



Large Corporates

(market cap >€25bn)

- Distress across large corporates remained steady in the three months to November 2023, although it eased marginally on the previous months.
- The primary factors perpetuating distress remain consistent with the previous period, characterised by declining investment performance, tightened liquidity, and profit margins under strain.
- Escalating interest rates are exerting exceptional stress on heavily indebted companies, with debt repayment consuming an increasing share of their profits.
- Nevertheless, business confidence appears to have improved across many countries, with the monetary policy tightening cycle seeming to be nearing an end, providing more certainty about the future.
- There is also further support from easing operating and input costs, thanks to the reduction in energy prices and the return of shipping and transportation costs to their long-term averages.
- However, heightened geo-political instability remains a key concern with potential for escalation in Ukraine/Russia and the Middle East damaging confidence.



Distress Index November 2023

Least distressed — Most distressed

Sector	Distress ranking	Index value	YoY trend
Real Estate	1	+6.9	+3.0 Nov 22
Healthcare	2	+6.4	+2.7 Nov 22
Retail and Consumer Goods	3	+2.8	+0.3 Nov 22
Industrials	4	+2.4	-0.5 Nov 22
Financial Services	5	+1.0	-1.4 Nov 22

INDUSTRY ANALYSIS

Least distressed — Most distressed

Travel, Leisure and Hospitality

Distress ranking	Index value	YoY trend
6	-0.2	-0.6 Nov 22

Investment · Liquidity · Market · Profitability · Risk · Valuation

Commodities and Natural Resources

Distress ranking	Index value	YoY trend
7	-0.5	-9.2 Nov 22

Investment · Liquidity · Market · Profitability · Risk · Valuation

Oil and Gas

Distress ranking	Index value	YoY trend
8	-0.8	-2.7 Nov 22

Investment · Liquidity · Market · Profitability · Risk · Valuation

Infrastructure

Distress ranking	Index value	YoY trend
9	-2.5	-3.3 Nov 22

Investment · Liquidity · Market · Profitability · Risk · Valuation

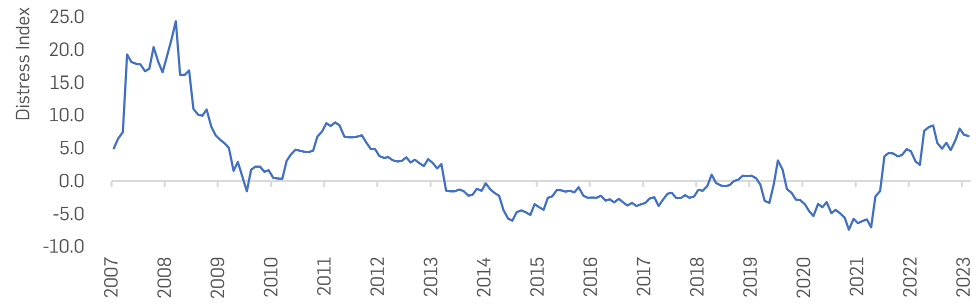
Technology, Media and Telecoms

Distress ranking	Index value	YoY trend
10	-4.5	-4.6 Nov 22

Investment · Liquidity · Market · Profitability · Risk · Valuation

Real Estate

Stubbornly high interest rates, falling valuations, elevated energy and construction costs, and increasingly expensive financing are all bearing down on the European Real Estate market, keeping it the most distressed sector according to the WEDI. Distress remained at elevated levels as poorer investment metrics reflect an increasingly challenging outlook for highly leveraged companies who may struggle to repay or refinance their debt in the coming months.

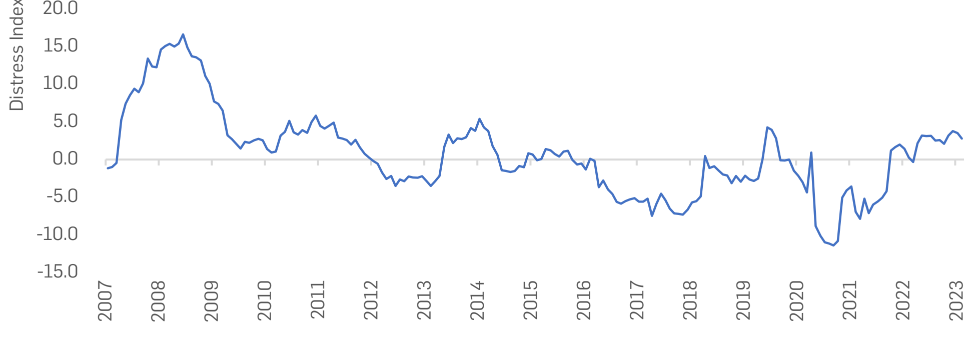


Healthcare

Last quarter distress for European healthcare companies remained at elevated levels but did moderate slightly as they continue to contend with the impact of higher interest rates and steeper debt servicing costs. Liquidity issues, and poor investment performance are particularly problematic for those highly leveraged businesses, many of who have been hit by leveraged-loans. Increasing operational expenses and softer asset prices, linked frequently to property values, are squeezing margins.

Retail and Consumer Goods

Distress levels are high within the Retail and Consumer Goods sector, trailing just behind Healthcare and Real Estate. Consumer spending is expected to remain under pressure as households remortgage at considerably higher rates, while rising rents bear down on discretionary spending power. While inflation continues on a steep downward trajectory, living costs remain elevated in key European areas, particularly in the UK and Germany.

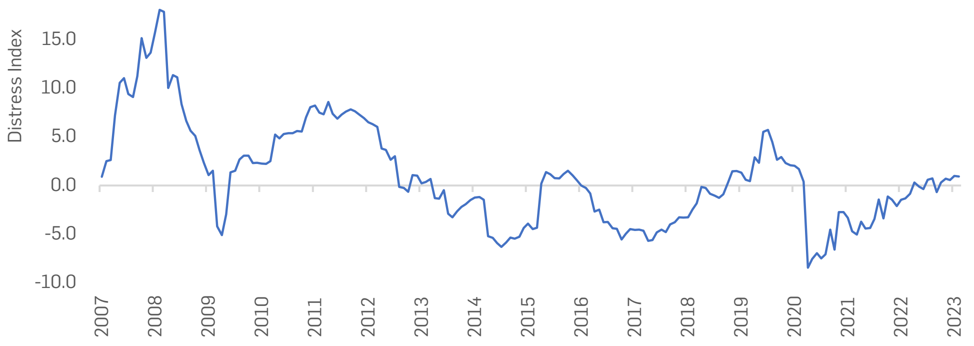


Industrials

The Industrial sector's distress has risen above long run levels, escalated by weaker investment metrics and faltering valuations. Ongoing uncertainty and higher interest rates are likely to be dissuading some firms and Governments to commit to large capital-intensive projects.

Financial Services

Distress levels in Financial Services remained higher than the long-term average driven by weaker market sentiment and a more cautious outlook for risk. This could reflect a higher risk outlook for company default rates as the impact of steeper debt servicing, margin pressure and weaker demand feeds through to sentiment.



Travel, Leisure and Hospitality

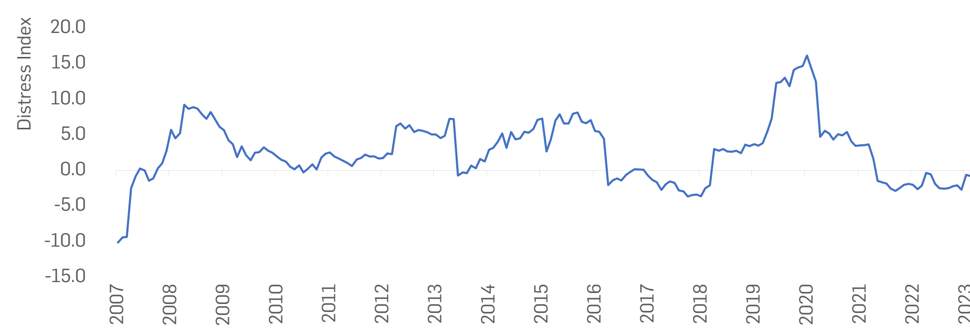
The Travel, Leisure and Hospitality sector has experienced a robust recovery from its peak pandemic distress, with a surge in demand for both business and leisure travel. However, levels of distress have risen in the three months to November, driven by weaker investment metrics and worsening liquidity.

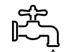
Commodities and Natural Resources

Distress levels within the Commodities and Natural Resources sector remain below the long run average but have increased markedly since the start of the year. Market support and robust profitability have been underpinning factors but worries of a global slowdown is likely undermining confidence.

Oil and Gas

Distress levels for oil and gas firms, continue to bounce below the historical average and have done since the pandemic. However, oil prices have moderated considerably over the last month down from over $90 per barrel at the end of September to just over $70 per barrel in December which could dent profits in the coming quarters.



Infrastructure, Utilities and Power 

The Infrastructure, Utilities and Power sectors have seen distress remain below the long run average in the latest data. Market backing and solid profit margins continue to bolster entities within this industry.

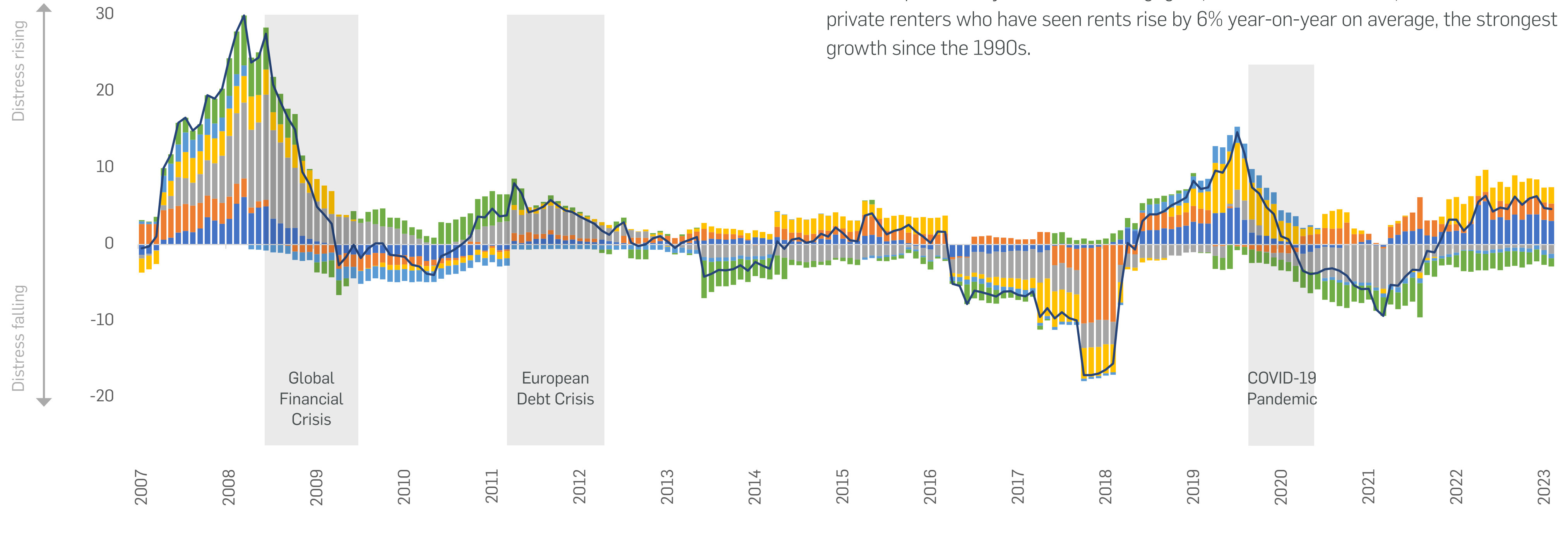
Technology, Media and Telecoms

Distress in the Technology, Media, and Telecommunications (TMT) sector has lessened in the recent quarter, staying beneath historical norms. The absence of distress reflects solid market fundamentals and higher levels of liquidity. Intense interest in AI-technologies is also likely to be lifting the sector.

Nov 2023	QoQ trend	YoY trend
+4.6	+6.0 Aug 23	+1.8 Nov 22

United Kingdom Distress Index

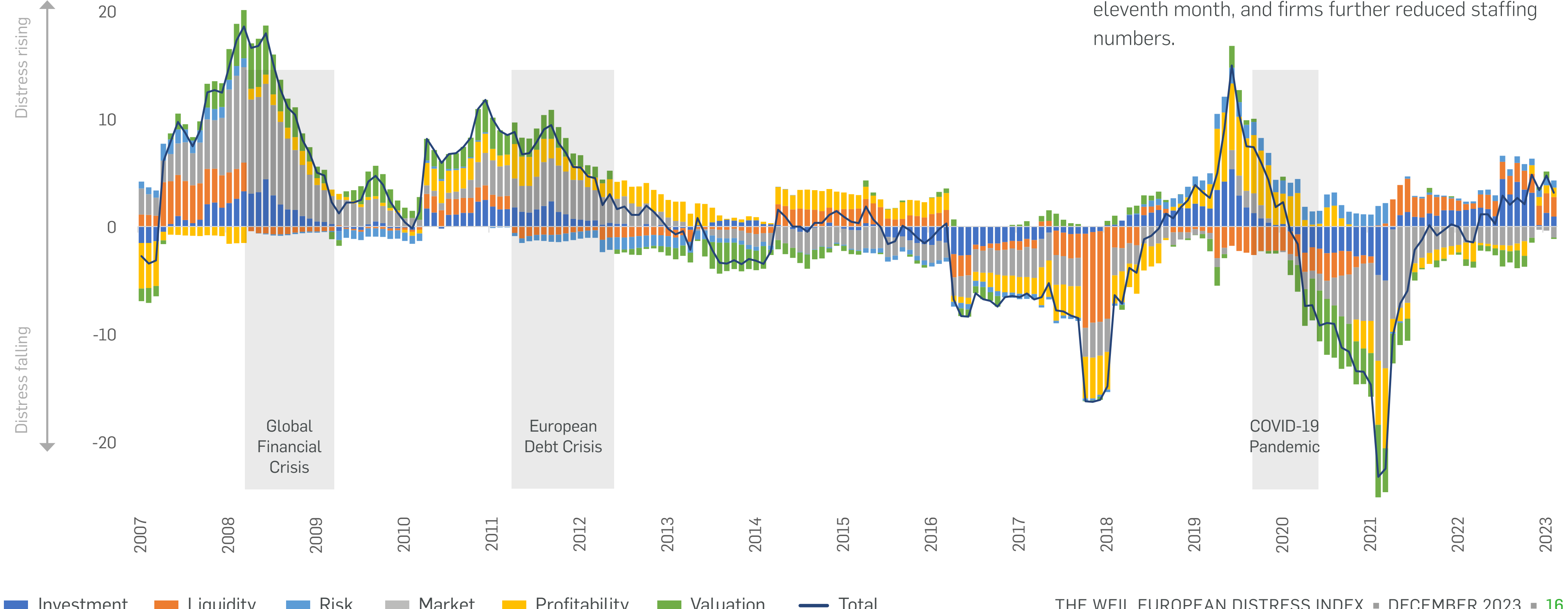
- Corporate distress in the UK remained at elevated levels albeit softening marginally on the previous quarter. It remains significantly higher than levels experienced last year.
- The sources of distress remained consistent with previous months, with weaker investment metrics, squeezed liquidity and lower levels of profitability driving higher levels of distress.
- The ongoing impact of higher interest rates feeding through to corporate borrowing continues to playout across the economy, with many businesses struggling to adjust to higher debt servicing costs while facing burdensome refinancing, against a backdrop of softer demand.
- Despite more optimistic data from the S&P Global/CIPS UK Manufacturing PMI which showed the fastest expansion since May, GDP fell in the three months to November according to the ONS.
- The longer-term view remains one of an economy that has shown little growth over the last year.
- Meanwhile, separate data showed company insolvencies rising 21% in November (YoY), higher than levels seen during the pandemic. With respect to households, the latest labour market data showed wage growth easing sharply and mortgage distress rising in further signs that interest rates are beginning to bite.
- Even with the intensity of the cost-of-living crisis easing, challenges facing households remain – particularly those with mortgages (7.4 million households) and over 5 million private renters who have seen rents rise by 6% year-on-year on average, the strongest growth since the 1990s.



Nov 2023	QoQ trend	YoY trend
+3.1	+4.8 Aug 23	-1.3 Nov 22

France Distress Index

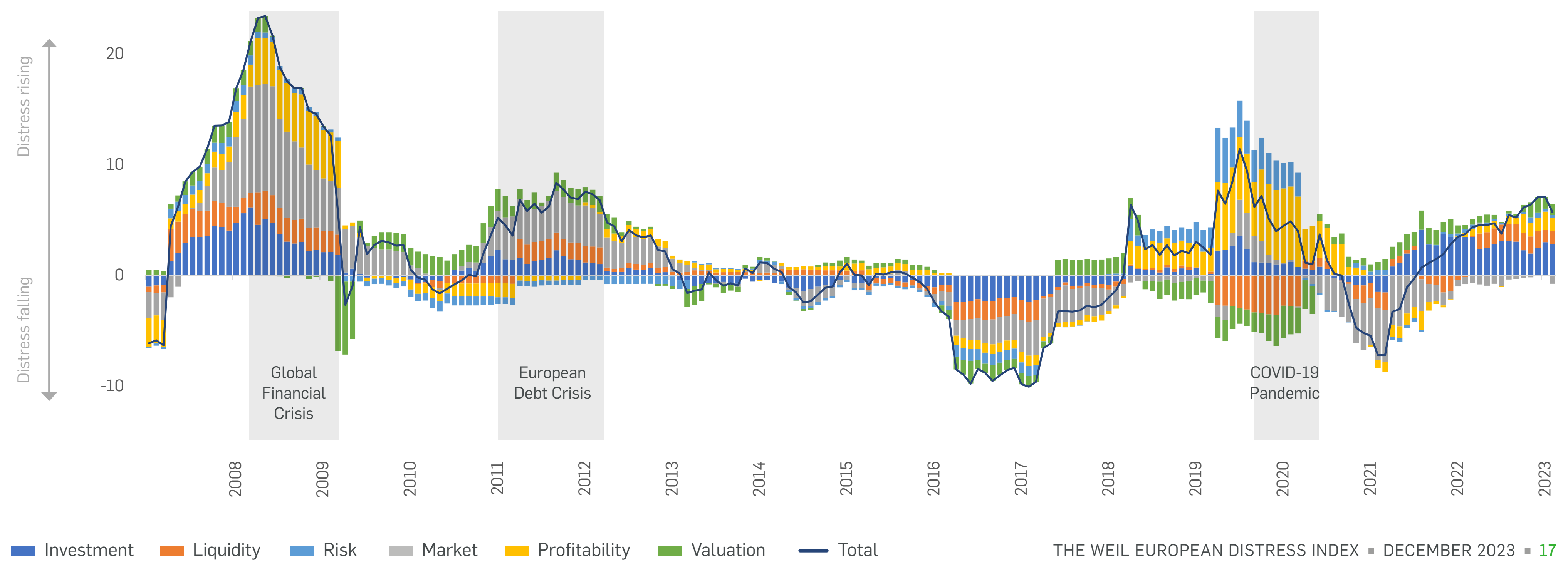
- Distress levels in France remained above the long run average for the 11th consecutive month, now the third most distressed country covered by the WEDI.
- The sources of distress were the same as those experienced in the UK, driven by weaker investment metrics, and pressure on liquidity and profitability.
- GDP fell sharply in France in the third quarter, down 0.1% compared with a 0.6% rise in the previous quarter. Healthier household consumption growth (+0.7%) over the quarter was counteracted by a strong negative contribution from foreign trade.
- Although nominal wage increases have supported households to regain spending power, early indications of a softening labour market are emerging. Meanwhile, consumer confidence continues to be subdued and inflation (+3.5%) remains above target levels.
- In other data, the S&P Global France Manufacturing PMI fell against the previous month, and below expectations. It was the eleventh consecutive month of contraction and marked the steepest since May 2020, as output continued to drop at an accelerated pace. Similarly, outstanding orders declined for the eleventh month, and firms further reduced staffing numbers.



Nov 2023	QoQ trend	YoY trend
+5.7	+6.4 Aug 23	+3.7 Nov 22

Germany Distress Index

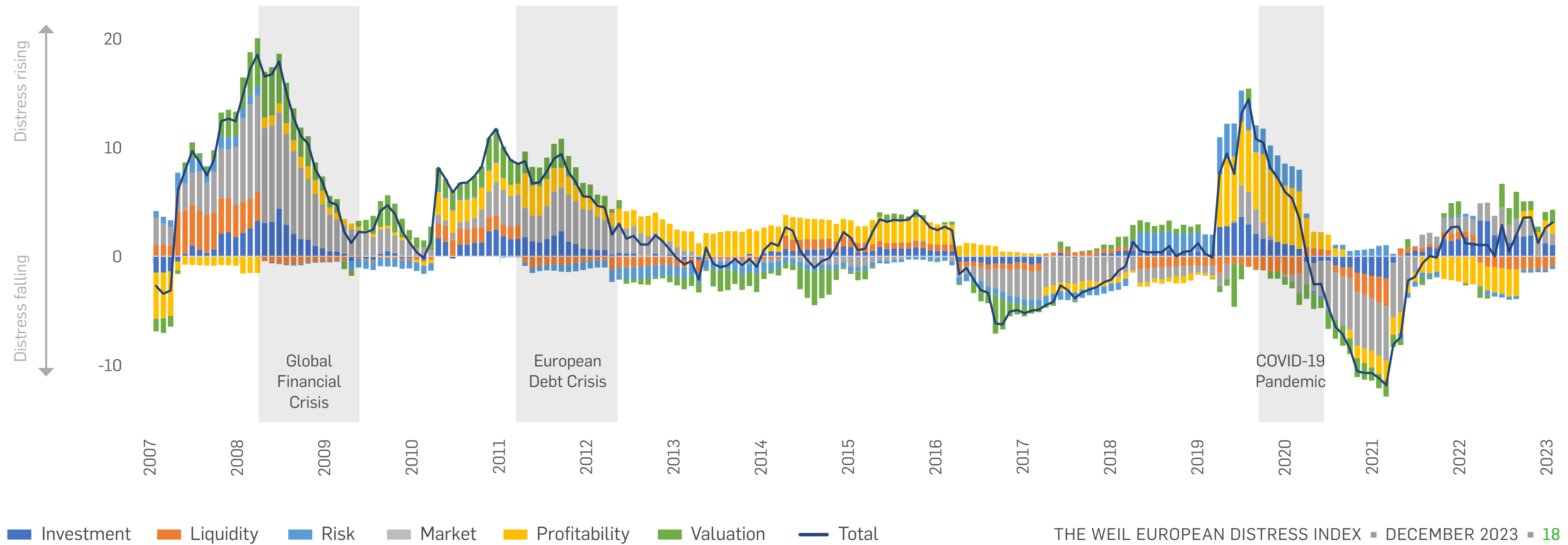
- The WEDI continues to report German corporates experiencing the highest levels of distress across the countries measured.
- Distress was pushed higher by poorer investment metrics, pressure on liquidity and faltering profitability which has been unchanged since the start of the year.
- Germany's government expects the economy to shrink by 0.4% this year due to high inflation, high energy prices and weak international trade. The government's own forecasts suggest the economy is then expected to grow just 1.3% next year and 1.5% in 2025 – reflecting weakness in the industrials sector.
- This is also reflected by the European Commission who cut its forecast for the German economy to a 0.4% contraction this year, compared with the 0.2% growth projected previously.
- Although the HCOB Germany Manufacturing PMI edged up in December 2023, the reading continued to point to a sharp contraction in the manufacturing sector.
- The GfK Consumer Climate Indicator remains very weak, characterised by uncertainty and concern, with no signs of a sustainable recovery.



Nov 2023	QoQ trend	YoY trend
+3.1	+3.6 Aug 23	+1.2 Nov 22

Spain and Italy Distress Index

- Corporates headquartered in Spain and Italy continue to experience levels of distress above the long run average, albeit less intense than other countries. Nevertheless, November marked the 16th consecutive month the distress has remained in positive territory.
- The distress backdrop continued to be marked by concerns across weaker investment, softer valuations and squeezed profitability.
- Nevertheless, the economic outlook for Spain and Italy appears more positive than the UK and Germany. GDP is expected to rise by 2.5% in Spain, and 0.7% in Italy in 2023, according to the IMF. Albeit forecasts for 2024 are more pessimistic.
- Indeed, the HCOB Spain Manufacturing PMI dropped in November remaining contractionary for the eighth consecutive month against a backdrop of ongoing political and economic uncertainties. Output and new orders fell further, with the former declining at its steepest pace in 2023.
- There are similar conditions in Italy with both output and new orders declining further, with the former decreasing at the fastest pace in three months. Worryingly, businesses signalled excess capacity since workers were laid off at the quickest rate since July 2020.
- This could suggest rising levels of distress heading into 2024.



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