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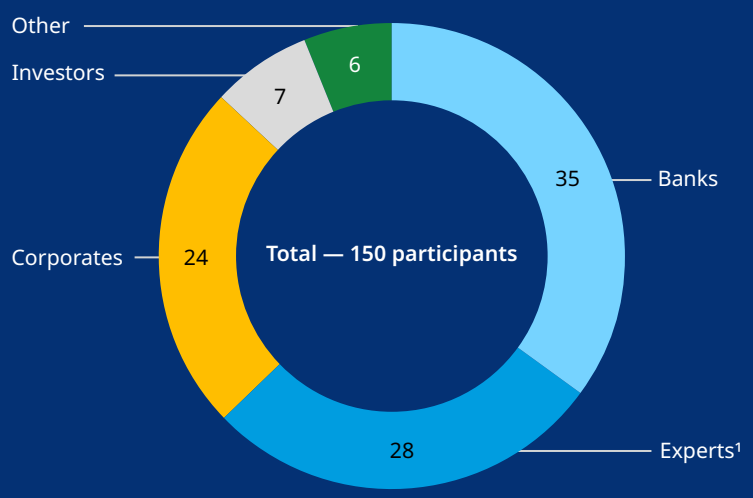
IS THE COVID-19 RESTRUCTURING WAVE STILL TO COME?

Dr. Lutz Jaede

HOW HAS THE GLOBAL PANDEMIC IMPACTED THE EUROPEAN RESTRUCTURING ECOSYSTEM?

Exhibit 1: Participants of our Restructuring Survey 2021
In percentage of total participants



1. Lawyers, CROs, management consultants, other advisers
Source: Oliver Wyman Restructuring Survey 2021

83% of surveyed experts expect more companies in crisis in the future

INTRODUCTION

Dear Reader,

COVID-19 has impacted economies throughout the world, creating demand shocks in industries yet also leading to new ways of working and accelerating technology trends. Government aid programs aimed at affected companies, together with other sources of capital, have managed to help troubled businesses in many instances but have also left many companies highly vulnerable — particularly as their debt burden comes due.

So, how has the restructuring ecosystem changed in the wake of COVID-19? What should be on the agenda of corporates as they emerge from the crisis? And what role can governments play in facilitating economic recovery?

These are the questions we address in this year's *Restructuring Report*. It is based on an expert survey of approximately 150 participants across Europe, complemented by analyses and articles that reflect Oliver Wyman's viewpoint. We hope you find it an interesting read.

Sincerely yours,

Lutz Jaede
Head of Restructuring

ECONOMIC SHOCKS CUSHIONED BY FRESH CAPITAL

Management summary

THE IMPACT OF COVID-19 VARIES ACROSS SECTORS

As a result of the COVID-19 pandemic, the gross domestic product (GDP) of the EU-27 is expected to decline by 7.6 percent in 2020. Depending on the length and scope of the local lockdowns, the impact varies greatly, ranging from a drop of minus five percent for Germany to a decrease of between -10 percent and -11 percent for France, Spain, and Italy.

The travel and leisure sectors experienced a near collapse, with revenue declines of more than 30 percent and a steep fall in profitability. Other sectors, such as automotive, were hit hard but managed to recover during the year. And the retail and electronic sectors remained relatively stable.

Forced to stay at home during the pandemic, restructuring experts who were surveyed have adopted new ways of working. Some of these new modes of functioning are likely to be with us for a while as negative effects, such as reduced opportunities for networking and developing new relationships, are counterbalanced by positive benefits, such as shorter, more productive meetings.

AMPLE FINANCING AVAILABLE

Despite a precipitous drop in revenue and profits, the cash position of big European companies increased by 37 percent during the pandemic, thanks to an increase of debt provided by banks and investment funds. While this mitigated the impact of the crisis, it also presents new challenges, given the looming debt load that will need to be repaid and refinanced in the coming years.

As a result, the number of restructuring cases so far has only increased at smaller companies, which may not have ready access to fresh capital and were not able to borrow. The real restructuring wave for bigger companies may be yet to come.

SOUND BUSINESS DESIGN NEEDED TO MEET CHALLENGES AHEAD

More than 80 percent of the surveyed experts expect to see more companies in crisis mode going forward. This represents a record figure since we first began measuring it in the *Restructuring Report* in 2012.

Uncertainty over the shape and pace of recovery in many sectors is the main challenge facing companies in emerging from the crisis. To adapt to market developments and secure the trust of capital providers will require a sound and flexible business design.

Governments should provide a framework to facilitate economic growth and ease restructurings. Direct support to individual companies, however, is not favored by the surveyed experts, as it may delay needed restructurings and hinder free-market forces.

DIVERSE ECONOMIC IMPACT OF COVID-19

The COVID-19 pandemic shocked the European economy and interrupted a long period of economic growth in most countries and sectors. The impact on different countries and sectors, however, has varied, and the subsequent “new normal” has created benefits that may remain even after the crisis has passed.

GDP DECLINE EVERYWHERE — BUT WITH BIG DIFFERENCES ACROSS COUNTRIES

Due to the shutdowns put in place across Europe, GDP declined sharply in all the countries analyzed in this report. (See Exhibit 2.) After six years of growth, real GDP in the EU-27 is projected to be 7.6 percent lower in 2020 than in the previous year. However, there are wide variances between the different member states: While France, Italy, and Spain faced a decline of 10–11 percent, Germany shrank by just five percent. While these differences are attributable in part to the varying length and scope of shutdowns in each nation, they also reveal individual countries' resilience to shock.

Exhibit 2: Gross domestic product development in Europe

Real annual growth in percentage

	2014	2015	2016	2017	2018	2019	2020E
EU-27	**1.6**	**2.3**	**2.0**	**2.8**	**2.1**	**1.6**	**-7.6**
Germany	2.2	1.7	2.2	2.5	1.5	0.6	-5.0[1]
France	1.0	1.1	1.1	2.3	1.8	1.5	-9.8
Italy	0.0	0.8	1.3	1.7	0.9	0.3	-10.6
Spain	1.4	3.8	3.0	3.0	2.4	2.0	-11.0[1]
Greece	0.7	-0.4	-0.2	1.5	1.6	1.9	-9.5
UK	2.6	2.4	1.9	1.9	1.3	1.4	-9.8

<-3% <0– -3% >0–1% >1–1.5% >1.5%

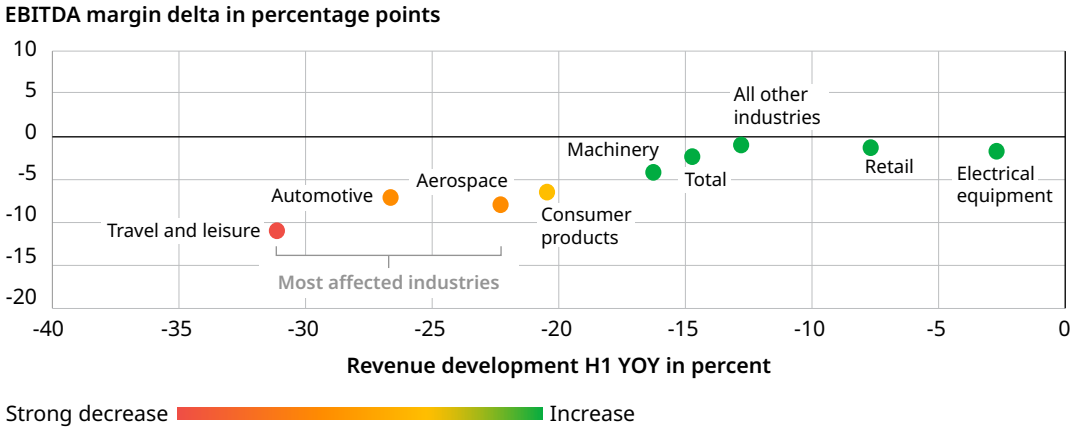
1. Actual

Source: Eurostat, IMF as of October 2019, Oliver Wyman analysis

TRAVEL AND LEISURE SECTORS COLLAPSED

COVID-19 had a diverse impact on the various industries and sectors in Europe. (See Exhibit 3.) While retail and electrical equipment sectors faced only a moderate decline in revenues and EBITDA margins in the first half of 2020, revenues in the travel and leisure industries fell more than 30 percent, while EBITDA margin fell by about 11 percentage points. Other sectors such as automotive were hit hard in the first half of 2020 but recovered in the second half.

Exhibit 3: Development of EBITDA margin and revenue first half 2019 to first half 2020

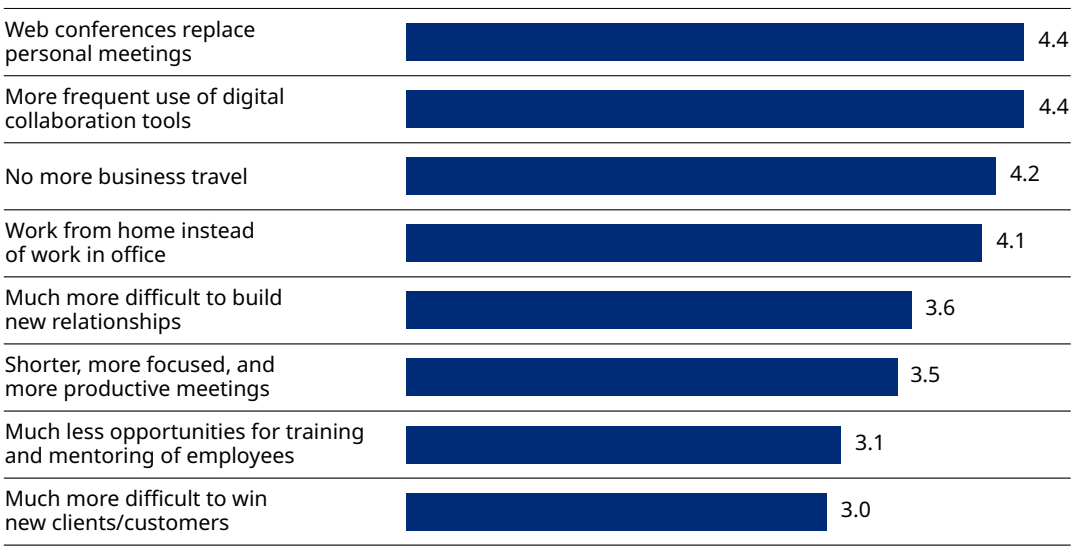


Note: Based on a sample of 2,681 listed European non-financial corporations
Source: Oliver Wyman analysis, data provided by S&P Global Market Intelligence

THE "NEW NORMAL"

The pandemic has changed the way in which companies operate and work. Survey participants mentioned the frequent use of web conferences and digital tools for collaboration and that work from home has replaced business travel. (See Exhibit 4.) The negative effects of the changes, such as the difficulty in building new relationships and winning new customers, were only rated as having a medium impact. On the other hand, positive side effects were noted, including shorter, more focused, and more productive meetings.

Exhibit 4: How much did COVID-19 change your way of working?
Rating from 1 "does not apply" to 5 "does strongly apply"



Source: Oliver Wyman Restructuring Survey 2021

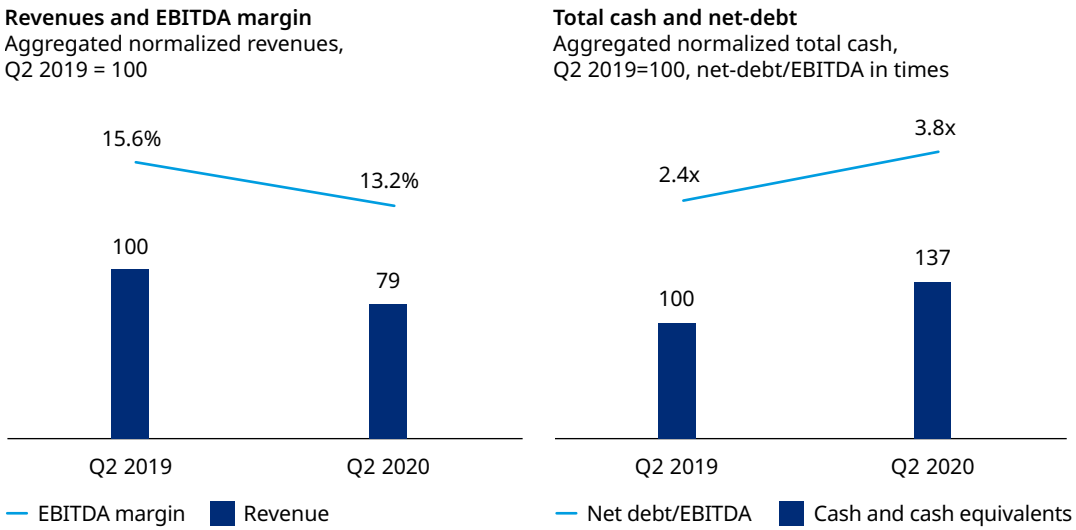
THIS IS NOT A FINANCIAL CRISIS

Despite the severe impact on revenues and profits, the number of restructuring cases remained remarkably low in 2020. This may be due to the ample amount of capital available to cover liquidity shortfalls.

INCREASE OF CASH DESPITE DECLINING PROFITS

On average, revenues of European companies outside of the financial services sector declined by 20 percent in second quarter of 2020 compared with the previous year, and they lost 2.4 percentage points of EBITDA margin. (See Exhibit 5.) At the same time, the companies were able to increase their liquid funds by 37 percent. But debt increased in that period as well. As a result, leverage (as measured in net debt divided by EBITDA) increased to 3.8 times from 2.4 times — which indicates a high debt load and a need to bring profits back to their pre-crisis levels to sustain financial viability.

Exhibit 5: Financial performance of European companies

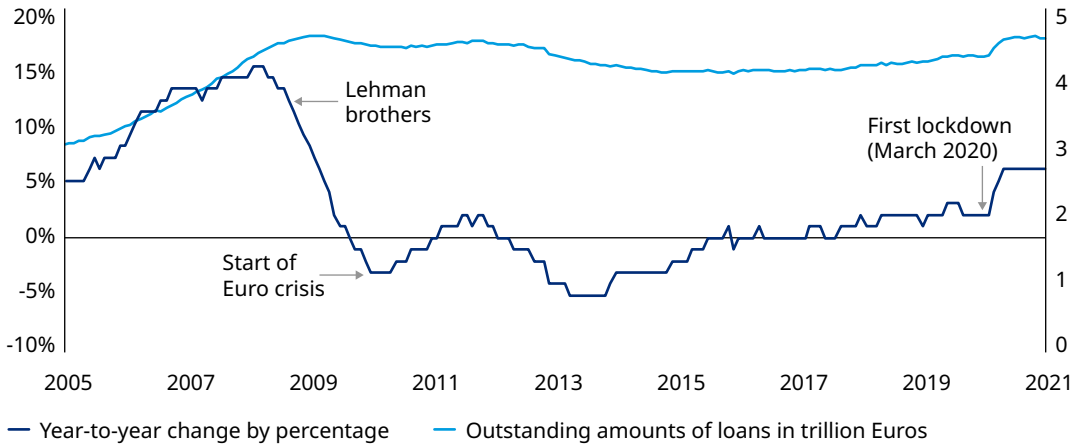


Note: Based on a sample of 2,681 listed European non-financial corporations
Source: Oliver Wyman analysis, data provided by S&P Global Market Intelligence

SHARP INCREASE IN DEBT FINANCING

In contrast to the economic crisis following the collapse of the subprime mortgage sector in the US in 2008, the COVID-19 crisis is not a financial crisis. This can be seen by analyzing the amount of outstanding loans to non-financial corporations in the Euro area. (See Exhibit 6.) While the total amount of loans declined after the insolvency of Lehman brothers and the subsequent Euro crisis, debt financing increased sharply during the first lockdown in March 2020. Part of this was due to state-backed loans to stressed corporates, but another big portion came from private debt funds and institutional investors buying high yield debt and other credit instruments.

Exhibit 6: Outstanding loans to non-financial corporations in Euro area[1]



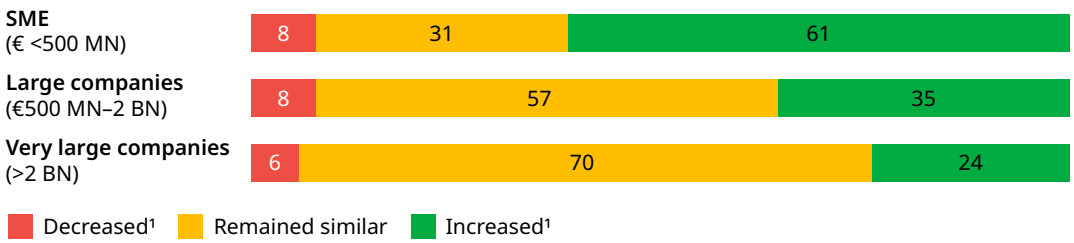
1. Amounts of outstanding loans at the end of period of MFIs excluding ESCB to non-financial corporations in Euro area
Source: ECB, Oliver Wyman analysis

INCREASE OF RESTRUCTURING ACTIVITIES ONLY AT SMALLER COMPANIES

The ready availability of fresh capital to cover liquidity shortfalls served to limit the number of new restructuring cases in the loan portfolios of European banks. The situation differed across segments, however. (See Exhibit 7.) For large companies, 65–76 percent of surveyed banks indicated that the number of restructuring cases in their portfolio remained the same or even decreased. For smaller companies, though, the picture is different: Banks have seen a jump in restructuring. Smaller companies find it more difficult to access capital and may also be more vulnerable to sudden shocks.

Exhibit 7: How did the number of new restructuring cases develop in 2020 versus prior years?

Single choice per category, answers in percentage of surveyed participants (banks)



1. Change of more than 10 percent
Source: Oliver Wyman Restructuring Survey 2021

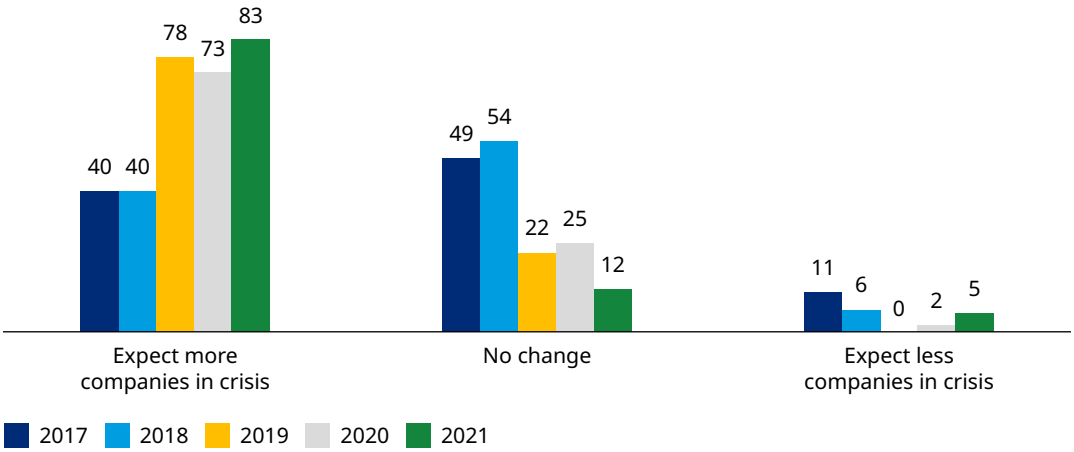
THE REAL CHALLENGES STILL LIE AHEAD

Injection of capital into stressed companies may have mitigated the symptoms of the crisis, but what about the ability of the companies to recover and repay their debt?

MORE COMPANIES IN CRISIS EXPECTED

The restructuring experts surveyed remain concerned about the future. The main reason for this concern is the large amount of debt accumulated at companies — many of who were already facing strategic and operational challenges before the crisis. Therefore, 83 percent of the survey participants expect to see more companies in crisis over the next year. (See Exhibit 8.)

Exhibit 8: Percentage of expectations concerning development of crisis events



Source: Oliver Wyman Restructuring Survey 2021

UNCERTAINTY REMAINS

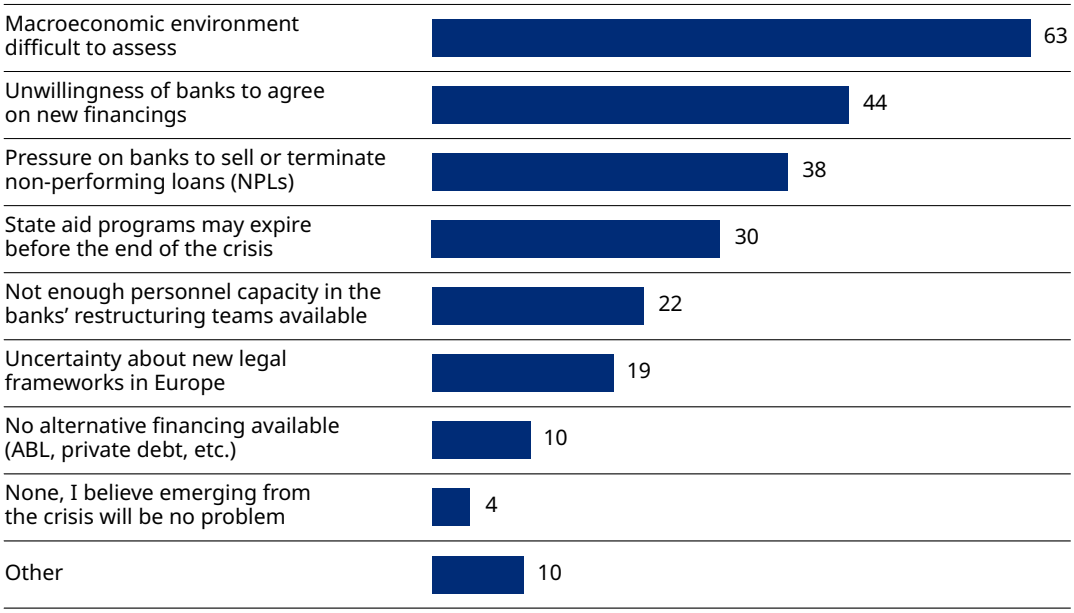
Asked about the main challenges in emerging from the crisis, most of the experts mentioned the difficulty of projecting economic growth and patterns of recovery, making it hard to ramp up capacity and put capital to work. Some 44 percent of survey participants are concerned about the willingness of banks to agree to new financings. (See Exhibit 9.) That may create room for alternative providers of capital, such as debt funds or special situation investors, to take a bigger role. Creditors, however, will require debtors to present a sound and robust business design and operational plan to overcome the crisis.

GOVERNMENTS NEED TO PROVIDE FRAMEWORKS

The amount and speed of state aid in 2020 helped to cushion the negative impact of the COVID-19 crisis. Going forward, the restructuring experts see the role of governments evolving. (See Exhibit 10.) Instead of providing direct financial support to individual companies, governments should create ways to facilitate out-of-court restructurings and foster economic growth through innovation and demand. State aid programs are still deemed to be important — but they should be commonly available and not hinder market forces or delay necessary business transformation.

Exhibit 9: What are the biggest challenges you anticipate for corporates in emerging from the crisis in 2021?

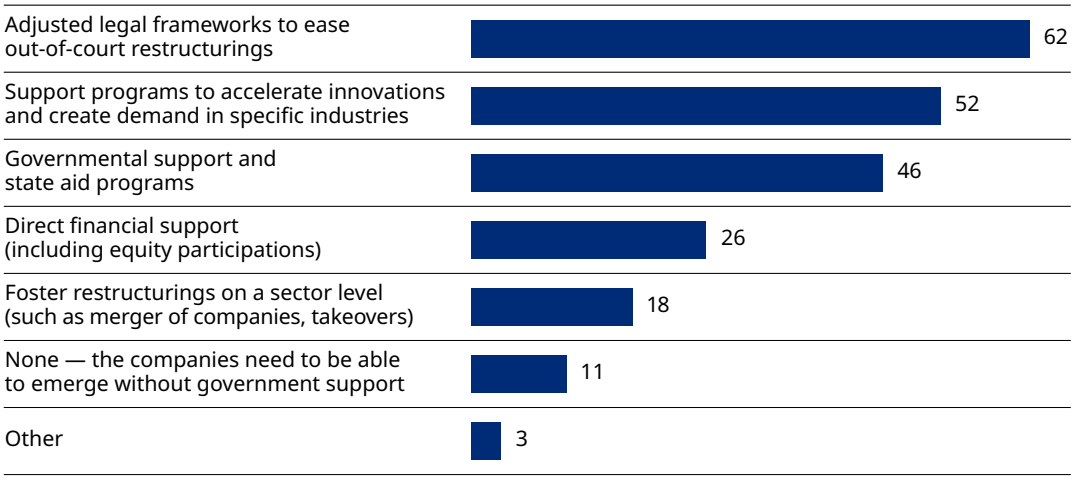
Multiple choice (up to three selections possible), percentage of surveyed participants



Source: Oliver Wyman Restructuring Survey 2021

Exhibit 10: Which types of support from governments are needed to support companies in emerging from the COVID-19 crisis?

Multiple choice, answers in percentage of surveyed participants



Source: Oliver Wyman Restructuring Survey 2021

FINAL THOUGHTS

Capital injections have secured most companies' liquidity

Banks and other capital providers were able and willing to support companies in distress during the crisis. This mitigated the worst effects of the downturn but also created new challenges, as companies will need to refinance their debt in the coming years.

The "wave" of restructuring cases may yet arrive at larger companies

Banks have seen an increase of restructuring cases only at smaller companies to date. Larger companies have remained relatively stable thanks to better access to capital and greater resilience. But challenges may only have shifted: More companies may run into distress as they struggle to pay back debt going forward.

Strategic flexibility and operational excellence are paramount

Uncertain economic developments and higher levels of debt require companies to rethink their business design and maximize profitability to remain viable. This will also be the prerequisite to sustain lenders' trust and attract new financing as the state-aid programs expire and current financing comes due.

Governments should provide frameworks

Restructuring experts say governments must provide frameworks that foster economic growth and make restructurings easier. Apart from that, market forces should be allowed to play out. If need be, state aid programs should be made available to all companies, rather than favoring individual ones.

RESTRUCTURING WITH OLIVER WYMAN

Backed by years of experience, Oliver Wyman acts as a trusted adviser to banks, investment funds, and distressed corporates as they take on the challenges of strategic, operational, and financial restructuring.

We support commercial banks by providing solutions for their book of non-performing loans (NPLs), leveraging our deep understanding on the financial services industry and world-leading expertise in finance and risk. At the same time, we work with the world's biggest investment funds and advise them on investments in distressed debt and equity.

When working with distressed corporates, we place a priority on developing sustainable restructuring concepts that address the market and the competitive environment, as well as specific factors for achieving operational excellence. Oliver Wyman acts as a coordinator for restructuring processes, an objective expert, and a neutral third party who provides quantitatively supported advice to address the interests of management, shareholders, lenders, and other stakeholders.

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