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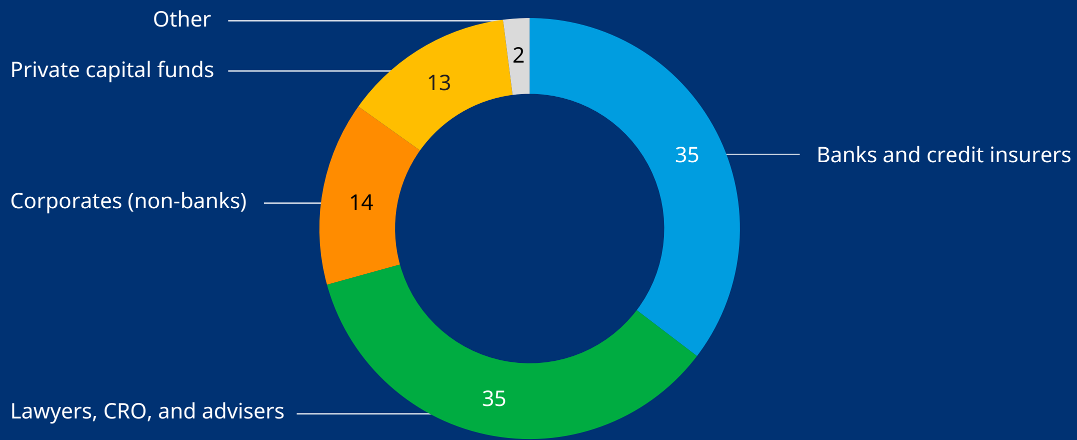
TIME TO TRANSFORM

A strategic approach to restructuring in difficult times

Dr. Lutz Jaede

STRUCTURE OF STUDY PARTICIPANTS

In percent of total participants



Source: Oliver Wyman Restructuring Survey 2023

69%

of surveyed lenders said they have increased their requirements when granting loans to companies in distress

INTRODUCTION

Dear Reader,

The COVID-19 pandemic and the war in Ukraine have significantly impacted European economies. Volatile demand, rising costs, supply chain problems, and disruptive market changes have created big challenges for corporations — and their outlook remains pessimistic as geopolitical risks increase and financial institutions become more cautious in providing capital.

What are the key challenges companies have faced, and how did they fare in the last years? Is financing still available for companies under stress? And what are their key concerns going forward?

These are the questions we address in this year's *Restructuring Report*. It is based on a survey of experts across Europe, complemented by Oliver Wyman analysis. We hope you find it an interesting read.

Sincerely yours,

Dr. Lutz Jaede
Head of Turnaround & Restructuring Europe

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CONTENTS

Management summary **5**

A rough journey **7**

Remarkable resilience **11**

Financing requires a convincing plan **16**

Challenging times ahead for some sectors **20**

Conclusions **24**

Restructuring with Oliver Wyman **25**

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Management Summary

CHALLENGING TIMES DEMAND CONVINCING STRATEGIES

COMMODITY COST AND SUPPLY CHAINS RETURN TO NORMAL — BUT THE IMPACT OF CRISIS MIGHT BE RETARDED

The last two years have been marked by major challenges for companies in Europe. First, the pandemic and related lockdowns have led to significant sales losses and supply chain issues. Already in 2021, and again exacerbated by the war in Ukraine in early 2022, there was a significant increase in the cost of key raw materials as well as freight capacity and energy. Prices have gradually returned to pre-crisis levels, but the impact on the liquidity of companies in sectors with long order cycles has yet to materialize. And interest rates are on the rise, which will be an additional challenge for highly indebted companies.

FINANCIAL PERFORMANCE OF CORPORATES REMAINS STRONG, BUT DEBT LOADS HAVE INCREASED

On average, companies in Europe were able to increase revenues and maintain strong earnings before interest, taxes, depreciation and amortization (EBITDA) margins over the past few years. The number of insolvencies in Europe, meanwhile, has fallen by around 20% since the beginning of 2020. This was due to the availability of debt capital to close liquidity gaps, partly supported by government guarantees for loans to companies in crisis. As a result, loans to companies in the eurozone rose by 16% from the beginning of 2020 to the end of 2022. However, the increased debt of companies could turn out to be a burden in the future if profitability does not improve at the same rate.

FINANCING BECOMES MORE DIFFICULT AND REQUIRES A COMPELLING PLAN

69% of the lenders we surveyed said their requirements have increased when they consider providing capital to companies with poor financials. However, they said they still grant loans when management teams provide a compelling strategy and financial plan that addresses the challenges in the specific market and competitive environment.

DISRUPTION IS BACK ON THE AGENDA

The situation is further exacerbated by market changes, some of which are disruptive, and which have been temporarily out of focus during the pandemic. The study participants cited changing customer needs and technologies (30% of respondents) and geopolitical risks (26%) as potential causes of crises in the coming years. Some of the industries currently under the greatest strain are particularly exposed to these challenges — for individual companies, this could mean a “perfect storm” is gathering.

However, the study also shows that many banks and other financiers are still willing to provide capital to companies in difficult times, so long as the borrower can demonstrate a resilient plan to overcome the crisis. So, companies can still navigate stormy times successfully if they have a transformation strategy to adapt their portfolios and business model to disruptive market changes and to make their supply chains more resilient against geopolitical risks.

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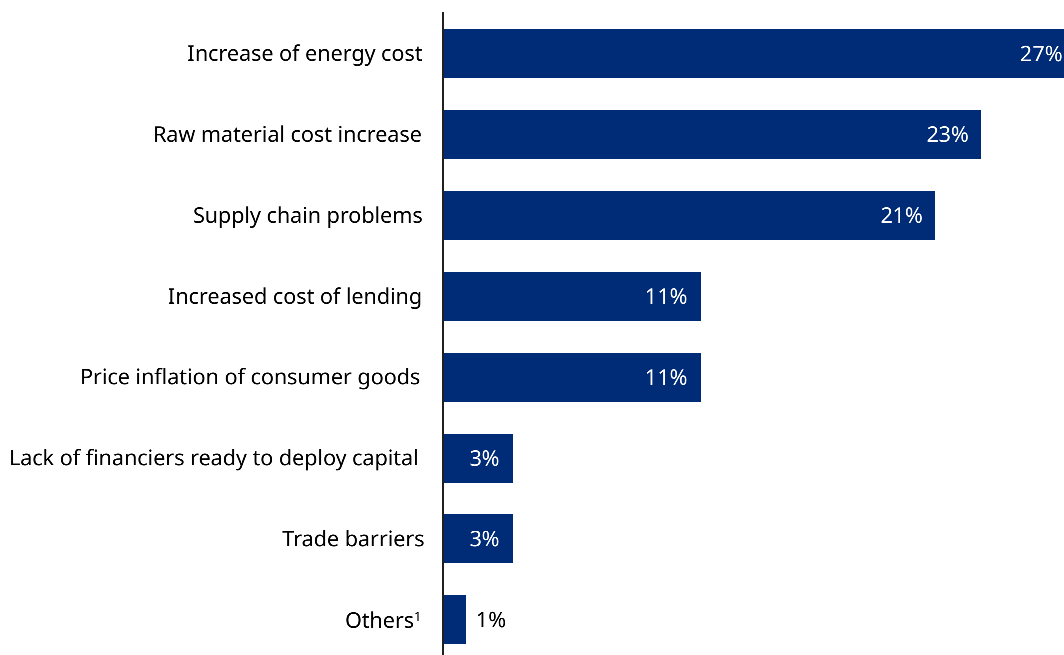
A ROUGH JOURNEY

The pandemic and the war in Ukraine have affected companies in Europe in multiple ways. Our survey participants mentioned rising energy and raw materials costs and supply chain problems as the most severe risks they are facing. (See Exhibit 1). Only 3% of the participants perceived the availability of capital as a problem.

Exhibit 1: What are the "top three" challenges related to COVID-19 and the war?
Responses in percent of participants



1. Increasing personnel costs, mobility restriction
Source: Oliver Wyman Restructuring Survey 2023

As commodity cost and supply chains gradually return to their pre-crisis levels, however, rising capital costs are becoming a burden for highly indebted corporations.

SPIKING COMMODITY COSTS

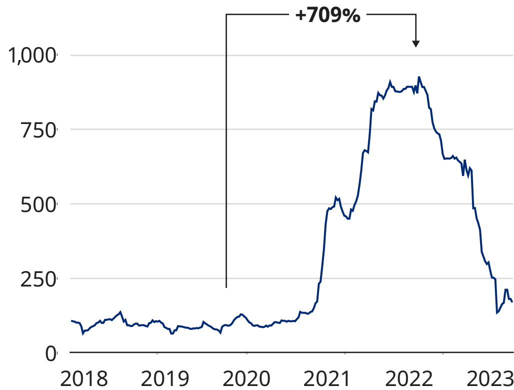
As a result of lockdowns and other supply chain disruptions that were exacerbated by the Russian invasion of Ukraine, the cost of important commodities increased sharply beginning in 2021. (See Exhibit 2). The prices for steel and aluminium more than doubled, while the cost of container transportation rose by more than 800%. Unprecedented volatility in energy prices made it costly for companies to operate in the absence of long-term supply agreements or framework contracts with their energy suppliers.

Exhibit 2: Development of raw material price

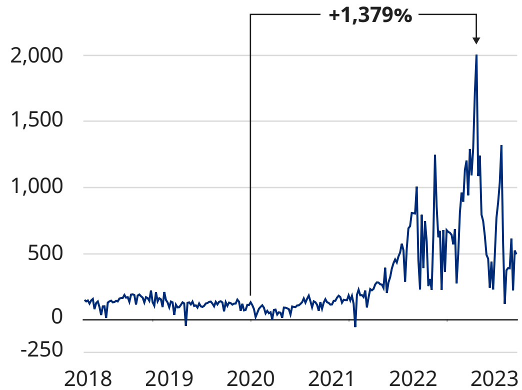
Steel prices Europe
Steel price index

Aluminium prices
LME-aluminium 99.7% cash, indexed

Oversea container rates
FBX CHN EA to N EUR container index



Energy prices
EEX — Phelix Base Hr.01–24, indexed



Source: Refinitiv Datastream, International Energy Agency, Oliver Wyman analysis

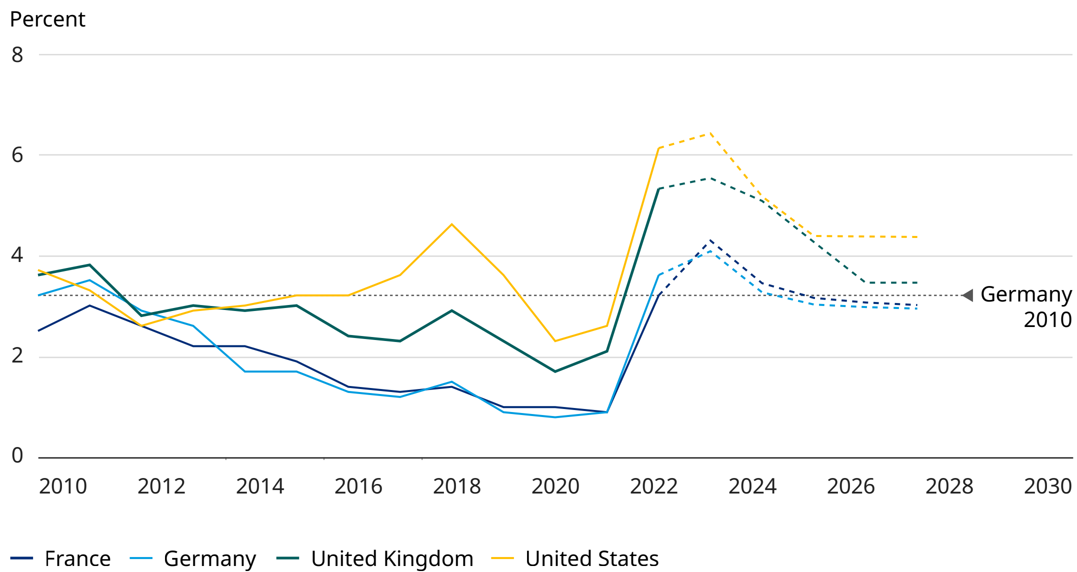
Since the beginning of 2023, most of the commodity prices have been gradually returning to pre-crisis levels. But companies operating with long order cycles have yet to experience the true liquidity impact of the cost increases. Companies that couldn't agree on pass-through clauses for material cost increases are experiencing much lower margins on orders delivered now because the cost of sourced materials was higher than expected at the time of the order.

INTEREST RATES ARE ON THE RISE

Interest rates are another matter. Rates have increased in most major economies recently and are expected to rise even further in the future as central banks fight inflation. (See Exhibit 3). Even though interest rates are forecast to rise only to historically normal levels, the increase puts additional pressure on highly indebted companies and could lead to slumps in industries that depend on capital investments, such as machinery, engineering, and construction.

Exhibit 3: Interest rate development

Corporate borrowing rate (period average)



Source: Oxford Economics, Oliver Wyman analysis

REMARKABLE RESILIENCE

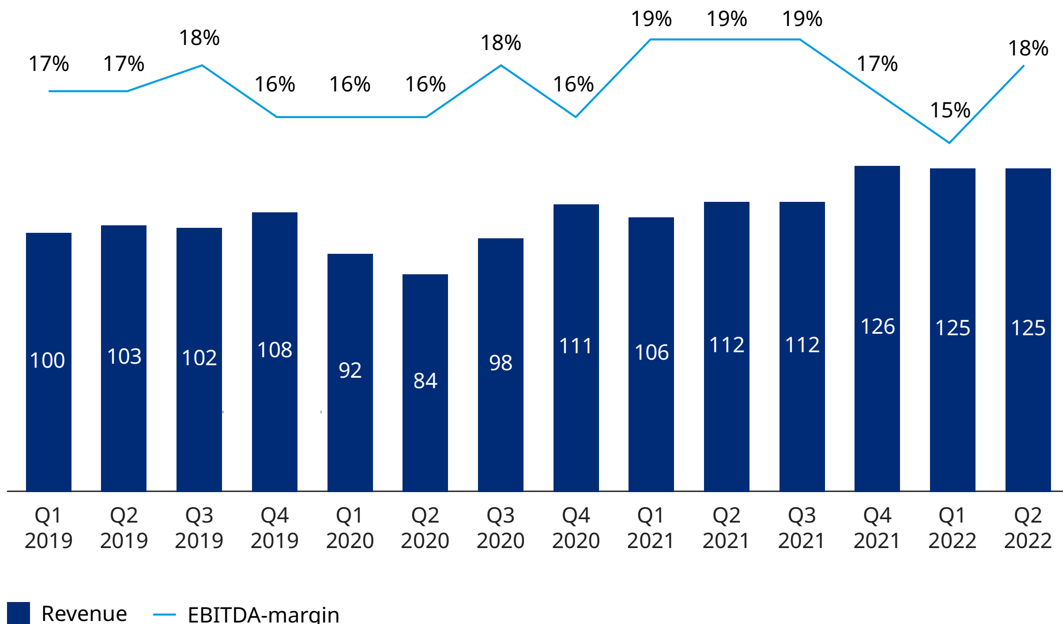
How did companies in Europe cope with the challenges of the last three years? They fared remarkably well and benefited from the availability of capital. Some sectors, however, are still performing below pre-crisis levels, and companies' increased indebtedness could become a burden in the years to come.

IMPROVING PERFORMANCE THROUGH THE CRISIS

We benchmarked approximately 3,400 publicly listed companies in Europe (excluding financial institutions) to analyze their financial performance over the last four years. Comparing their revenue and EBITDA development per quarter shows that European companies on average were able to increase revenues and profitability through the crisis. (See Exhibit 4). Revenues recovered strongly after a sharp drop in 2020 due to the lockdowns, climbing in 2022 to 25% above 2019 levels — partly driven by price increases as a reaction to rising material cost.

EBITDA margins declined by 200 basis points in 2020 and improved strongly in 2021, before taking another dip in 2022 because of commodity inflation. The strong improvement in the second quarter of 2022 shows that many companies were able to pass through the impact of cost increases or benefited from a decline of cost.

Exhibit 4: Revenues and EBITDA margin of European companies[1]
Revenue Q1 2019 = 100



1. Based on sample of 3409 listed companies in Europe (without financial institutions)
Source: S&P Global Market Intelligence, Oliver Wyman analysis

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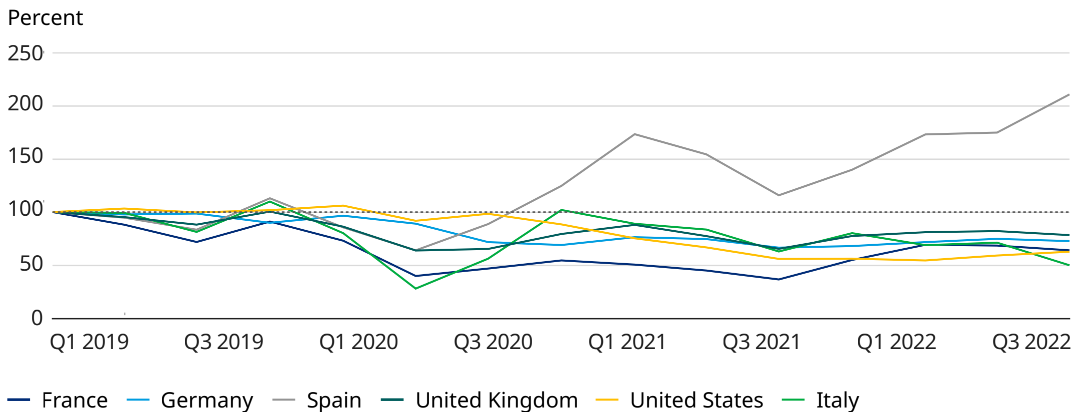
CAPITAL AVAILABILITY PREVENTED INSOLVENCIES

The number of insolvencies declined in most of the economies we analyzed. (See Exhibit 5). The only exception was Spain, which depends strongly on the tourism and leisure sector and suffered from extended travel restrictions in 2022.

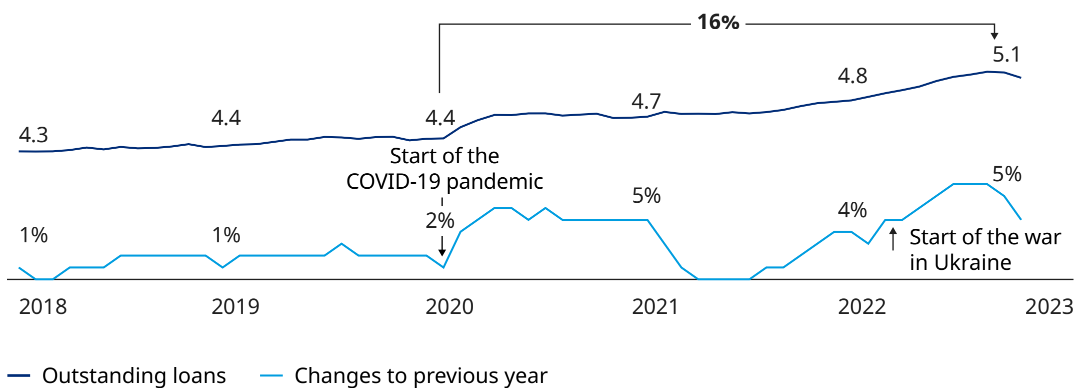
Exhibit 5: Quarterly indices for declarations of bankruptcies of businesses
Non seasonally adjusted, Q1 2019 = 100, EU and sample of selected countries



Source: Eurostat, United States Courts, Oliver Wyman analysis

The strong recovery was mainly the result of government assistance and lenders' willingness to support borrowers during the crisis. In all, the total amount of debt provided to nonfinancial corporations in Europe has increased by 16% since the beginning of the COVID-19 pandemic. (See Exhibit 6). Most of the loans were provided in two waves: one during the lockdowns in 2020 and another to mitigate the liquidity impact of commodity cost increases in 2022.

Exhibit 6: Monthly outstanding amounts of loans to non-financial corporations in Euro area[1]
In Euro trillion and percent



1. Amounts of outstanding loans at the end of period to non-financial corporations in Euro area
Source: Eurostat, United States Courts, Oliver Wyman analysis

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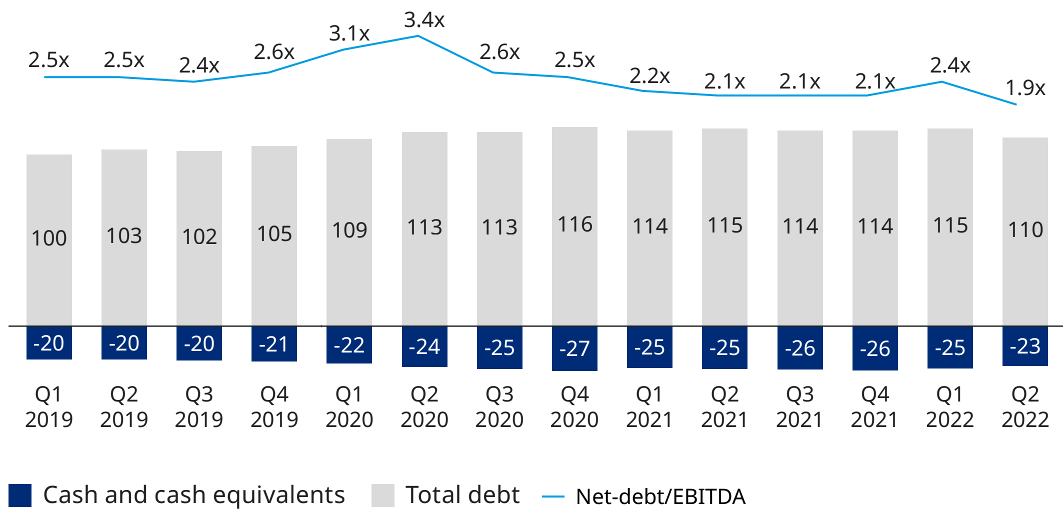
Despite the borrowing, the leverage of the benchmarked corporations declined during the same period. (See Exhibit 7). This was due to the increase of revenues and EBITDA margins since 2019, as well as the ability of the surveyed companies to maintain and even increase their cash reserves. Nonetheless, the higher level of debt could become a burden if companies fail to maintain growth and profits going forward.

Exhibit 7: Total debt, cash and net-debt of European companies[1]
Total debt Q1 2019 = 100, cash and cash equivalenced scaled with same factor



1. Based on sample of 3409 listed companies in Europe (without financial institutions) with balanced panel data
Source: S&P Global Market Intelligence, Oliver Wyman analysis

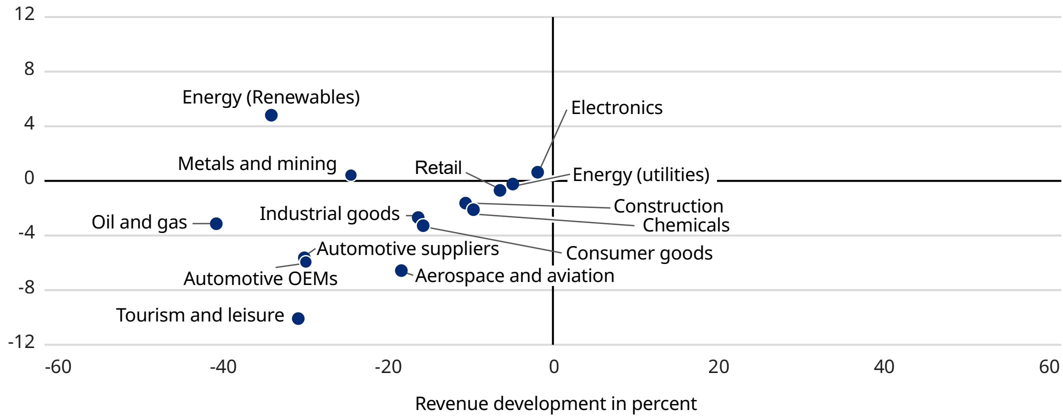
SHARP DIFFERENCES ACROSS SECTORS

The development of revenues and EBITDA margins tells a different story for each industry. (See Exhibit 8). Tourism and leisure, for example, faced a steep drop in revenues and margins during the pandemic but recovered strongly and returned almost back to pre-crisis levels in 2022. Sectors like metals and mining and oil and gas took advantage of rising prices of their products, while utilities and renewables companies increased their revenues but faced declining margins due to increased materials costs. It is also interesting to note that automotive OEMs increased their margins over the last few years while their suppliers' profitability softened. This is because carmakers have much better bargaining power vis-a-vis their commodity suppliers and find it easier to pass through price increases to their customers.

Exhibit 8: European industries

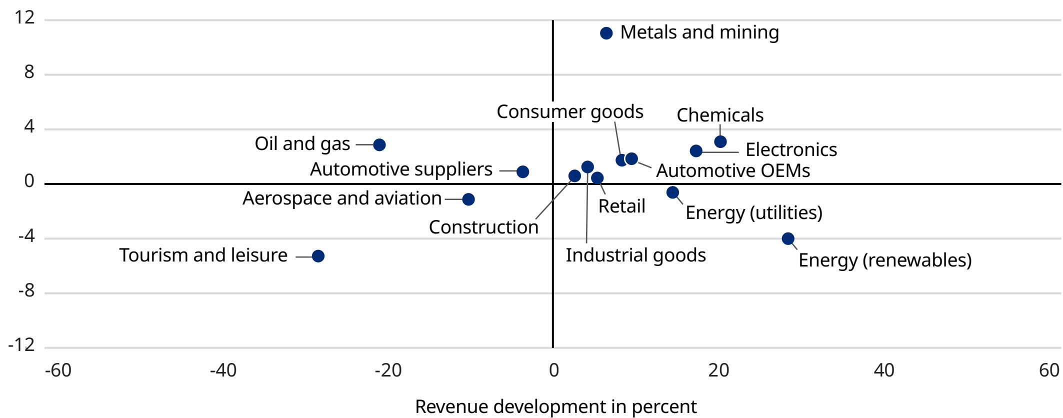
First half of 2020 compared to first half of 2019

EBITDA margin delta in pp (aggregate across industry)



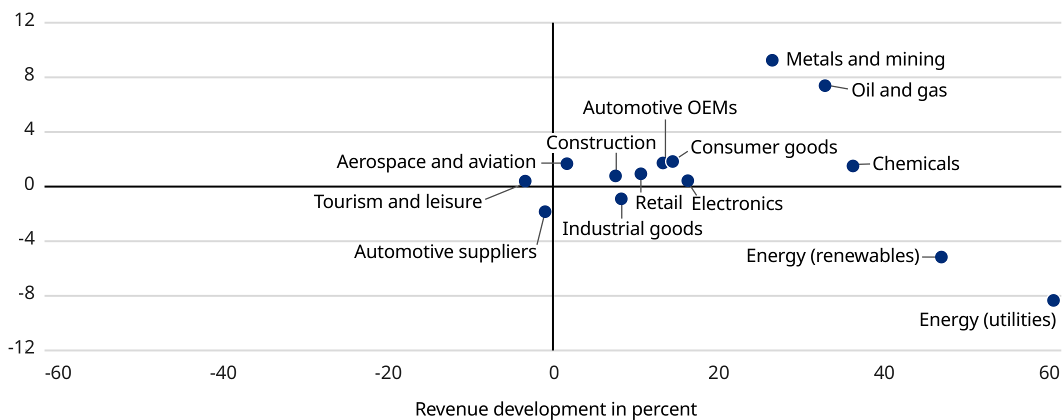
First half of 2021 compared to first half of 2019

EBITDA margin delta in pp (aggregate across industry)



First half of 2022 compared to first half of 2019

EBITDA margin delta in pp (aggregate across industry)



Note: Delta in pp, YOY growth in percent; Calculation based on aggregated revenue and EBITDA data from industry sampleBased on a 2907 listed European non-financial company sample with balanced panel data, aggregated on industry level
Source: S&P Global Market Intelligence, Oliver Wyman analysis

FINANCING REQUIRES A CONVINCING PLAN

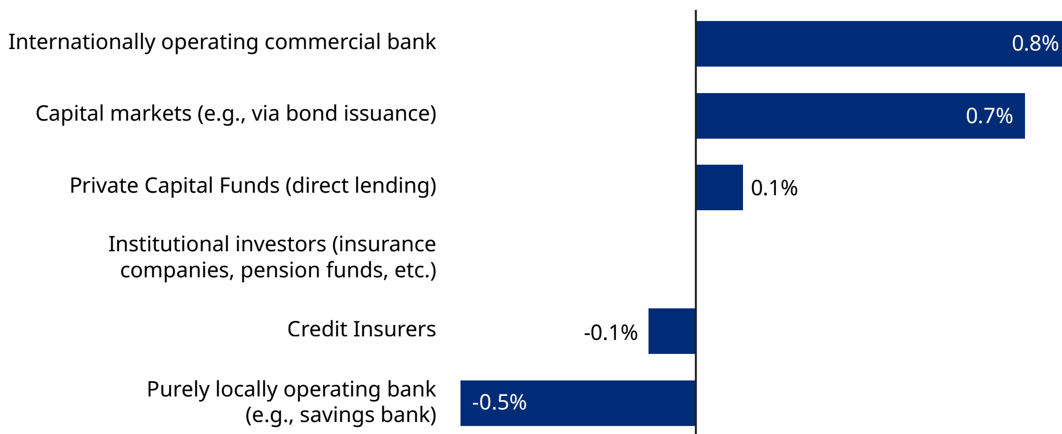
Banks and other capital providers are becoming more cautious. But capital is still available for borrowers that can lay out a robust plan for how to succeed in difficult times.

LARGE BANKS AND CAPITAL MARKETS GAIN IMPORTANCE

When asked to rank their preference of different categories of capital providers, survey respondents indicated a shift toward internationally operating commercial banks and capital markets. (See Exhibit 9). Smaller and locally operating banks such as savings banks ranked lower. This may be due to the ability of large banks and bondholders to cope with challenging times because they are better positioned to mitigate risk across larger lending portfolios.

Private capital funds — which should also be able to deal with distressed assets by means of an active investment approach — increased only slightly in the rankings. This indicates that they are still challenged by higher financing cost and return expectations when competing with banks.

Exhibit 9: Change in importance of different types of lenders for corporates
Rating from -2 “significantly lost importance” to +2 “significantly gained importance”

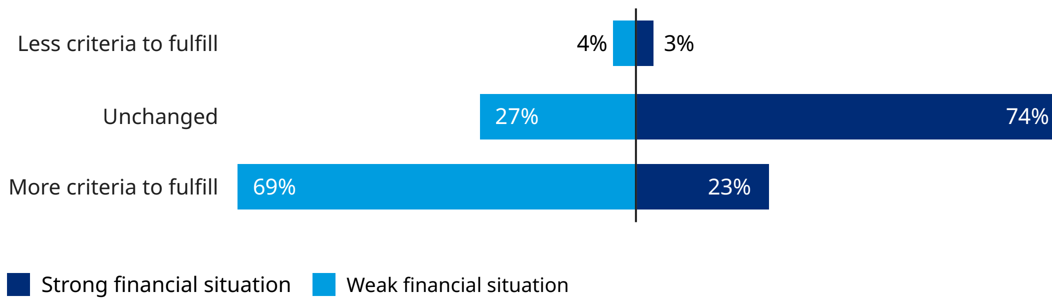


Source: Oliver Wyman Restructuring Survey 2023

CHALLENGES ARISE AND STRATEGY COUNTS

Across all types of lenders, we observe a significant increase in requirements in the lending process. (See Exhibit 10). A large majority (69%) of surveyed lenders said they have increased their demands when considering providing capital to companies with weak financials. And 23% of lenders said they do so even if the performance of the debtor is strong. This reflects an uncertainty about future developments and clearly shows that financing will become more difficult in the future.

Exhibit 10: Change of requirements for providing capital
Responses in percent of participants (banks and private capital funds only)



Source: Oliver Wyman Restructuring Survey 2023

But this is not a financial crisis! Despite special situations in the banking sector these days, we believe capital is still available, and most banks remain willing to provide funds to companies even in a difficult situation.

So, what are the — increased — requirements lenders are imposing on borrowers? Our study participants said most of all they expect a compelling strategy and financial plan that addresses the challenges in the specific market and the company's competitive environment. (See Exhibit 11). The actual financial performance is important too, of course, but poor figures can be compensated by a robust restructuring plan if management shows the capability to execute it.

Exhibit 11: Importance of information needed to decide on a loan or investment
Rating from one "unimportant" to five "very important" (banks and private capital funds only)

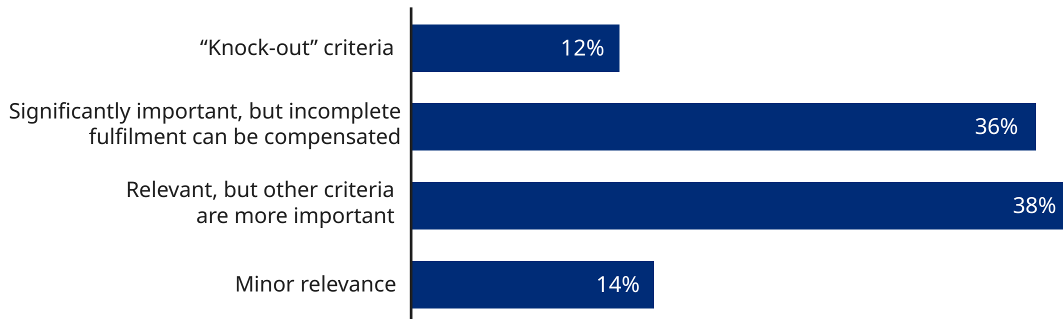
Source: Oliver Wyman Restructuring Survey 2023

ESG IS IMPORTANT BUT NOT (YET) A GAME CHANGE

Somewhat surprisingly, the importance of complying with environment, social, and corporate governance (ESG) criteria was rated significantly below the other requirements in lending decisions. Most of the surveyed lenders (72%) deemed ESG criteria relevant but said other criteria are more important and can compensate for a poor ESG rating. But 12% already see ESG criteria as a "must have" and said they would not provide financing if the criteria were not fulfilled. This indicates that all companies need to work on their ESG compliance.

Exhibit 12: How important is fulfilling your ESG compliance requirements compared to other financing/investment criteria

Number of participants that checked the option (single choice)



Source: Oliver Wyman Restructuring Survey 2023

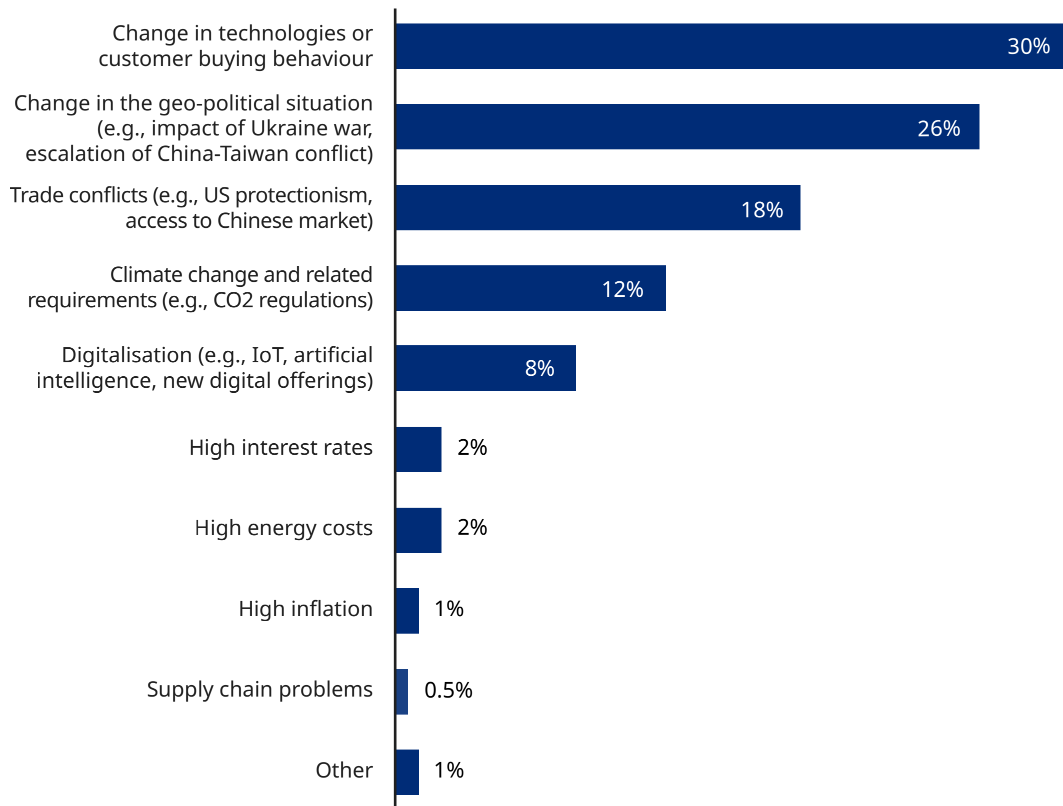
CHALLENGING TIMES AHEAD FOR SOME SECTORS

Disruptions are taking place up across many dimensions, creating special challenges for some industries. Expectations for state support remain high and reach beyond pure financial support.

NEW CHALLENGES CALL FOR A STRATEGIC RESPONSE!

Most companies mentioned cost increases and supply chain problems as major challenges in the past few years. But looking ahead, our study participants said other factors could drive a company into distress. (See Exhibit 13). Disruptive changes in technologies and customer buying behavior, which have been around for years but possibly were concealed by the recent crises, top the list. Geopolitical risk and trade conflicts are also near the top, while concerns over climate change and digitization fell a bit. The main challenges of the past few years are seen less as a problem going forward — possibly because uncertainty around these is much lower than for the other factors.

Exhibit 13: What are the "top three" drivers for 2023 that could have a disruptive impact on your business or the companies you work with?
Number of participants that checked the option (up to three selections possible)

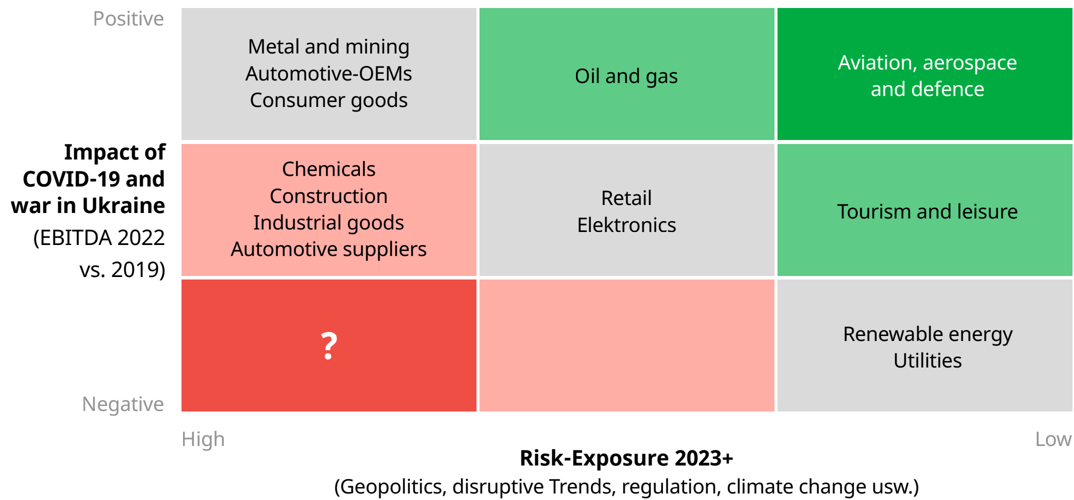


Source: Oliver Wyman Restructuring Survey 2023

A "PERFECT STORM" MIGHT BE GATHERING IN SOME SECTORS

The impacts of these future challenges will be felt differently across industries, just as industries have fared differently over the past few years. Combining these two perspectives leads us to a "risk heatmap" that indicates the level of challenge for each sector. (See Exhibit 14.) We believe the renewable energy sector and utilities will recover strongly due to the increasing demand for green energy and political support. Sectors that have not fully recovered from the crises of the past and that are exposed to disruptive trends and geopolitical risk face the strongest headwinds.

Exhibit 14: "Heat map" of challenges per sector — Indicative

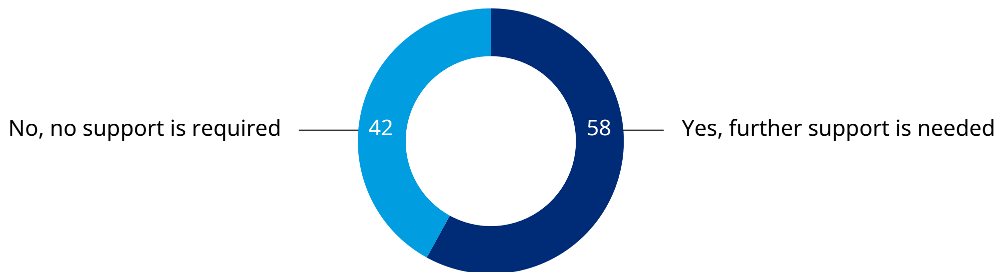


Source: Oliver Wyman analysis

SHOULD THE STATE PROVIDE FURTHER SUPPORT?

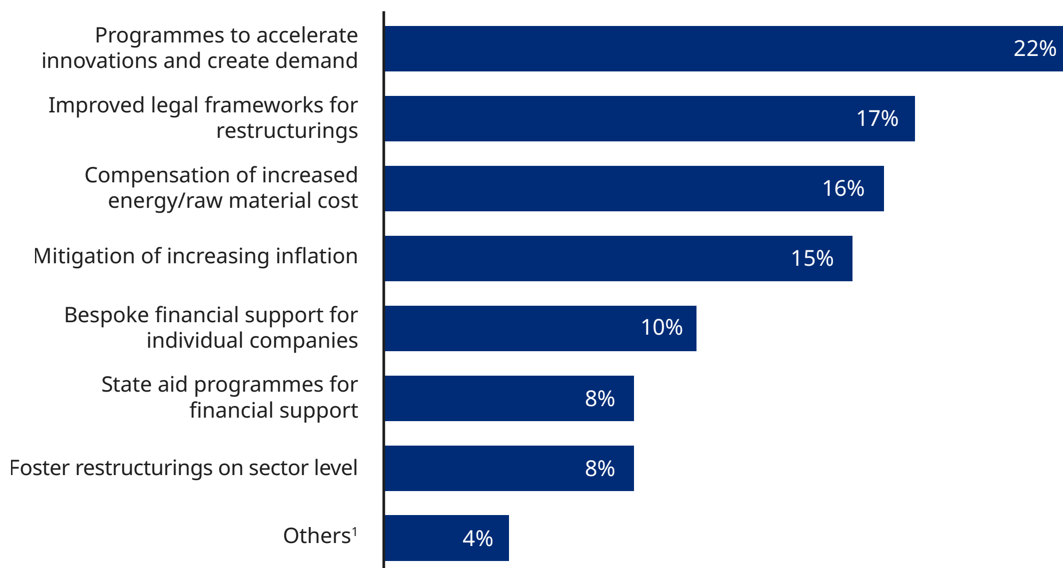
Almost 60% of the study participants said the state and central banks should support European businesses in mitigating the challenges. (See Exhibit 15). The nature of the support, however, should be more than just providing capital. (See Exhibit 16). Our respondents expect the state to accelerate innovations and create demand, put in place legal frameworks that facilitate restructuring processes, and support them in dealing with increased commodity costs and inflation. Only about 10% said financial support like that provided over the past few years is necessary going forward.

Exhibit 15: Should governments and central banks provide support to mitigate the future challenges?
Responses in percent of participants



Source: Oliver Wyman Restructuring Survey 2023

Exhibit 16: "Top three" measures requested from government or central banks to overcome current challenges
Responses in percent of participants who suggested that further support is needed



1. Incl. ESG-support, less bureaucracy, restricted power of labour unions, bringing women in the jobs, limit power of unions
Source: Oliver Wyman Restructuring Survey 2023

We should also note that 42% of the experts said the state should not provide further support but rather should let the market decide the structural changes associated with disruptive developments. One might argue that driving innovation, creating demand, avoiding restructurings, and enabling supply chains and operations to deal with increased cost is the core task of any management team.

We tend to agree and we remain available to support executives in developing plans that will persuade their lenders and sponsors and hence ensure sustained financial support during challenging times.

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CONCLUSIONS

Supply chain problems subside but sometimes have a delayed impact
Costs for commodities have gradually returned to pre-crisis levels but impact on liquidity in sectors with long order cycles will materialize now.

European companies proved resilience, but debt loads have increased
Financial performance of European companies has improved on average, but high debt loads create risk, especially in sectors still suffering from the impact of past crises.

Financing becomes more difficult
Financiers are becoming more cautious when they consider providing capital to distressed companies and require convincing plans for how to restructure and improve.

Future challenges require a strategic response
Disruptive trends and geopolitical risks are key challenges going forward. Management teams need to develop their own response and should not rely only on state support.

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RESTRUCTURING WITH OLIVER WYMAN

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

We support commercial banks by providing solutions for their book of nonperforming loans, leveraging our deep understanding of 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 companies, we leverage our deep industry knowledge and breadth of capabilities for performance improvement to develop 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 that provides quantitatively supported advice to address the interests of management, shareholders, lenders, and other stakeholders.

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