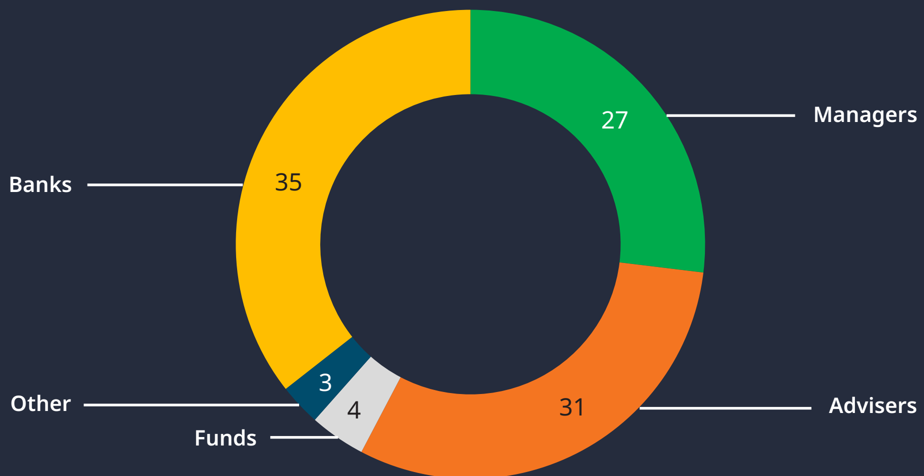
OliverWyman

THE CRISIS AFTER THE CRISIS

Dr. Lutz Jaede

CORPORATES NEED TO ADAPT TO A CHALLENGING WORLD

Exhibit 1: Structure of study participants
In % of total participants



Source: Oliver Wyman Restructuring Survey 2022

80%

of surveyed experts think that late effects from the COVID-19 crisis will drive companies into large-scale distress in 2022

INTRODUCTION

Dear Reader,

Even after more than two years, the COVID-19 pandemic still impacts the global economy. While most sectors have recovered from the steep drop in demand experienced in 2020, many companies still struggle with the late effects of the crisis, such as shortage of supplies, rising commodity cost, or an increase in freight rates.

And the war going on in the Ukraine has not only caused a humanitarian catastrophe, but also poses further pressure on supply chains, energy costs, and availability of important commodities.

So, what is the state of European companies caught between these two crises? What are the challenges remaining from the COVID-19 crisis, and which new ones will arise? And which sectors are most exposed to these challenges?

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 analyses and Points-of-View. We hope you find it an interesting read.

Sincerely yours,

Dr. Lutz Jaede
Head of Turnaround & Restructuring Europe

CONTENTS

THIS IS NOT A TRANSIENT STORM

Management Summary

COMPANIES ACROSS EUROPE HAVE WEATHERED THE COVID-19 CRISIS WELL

The steep drop of global economies in 2020 was mitigated by effective state aid measures and capital available from banks or capital markets which helped to secure liquidity in the crisis. As a result, the companies across Europe emerged strongly from the crisis in 2021. Revenues in Q2 2021 were already 6% above the same period pre-crisis, and EBITDA margins improved by more than 300 basis points. At the same time, companies were able to increase their cash levels well above the increase of debt, hence reducing their net financial debt and leverage significantly.

A closer look at individual industry sectors, however, paints a more nuanced picture. Some sectors, such as tourism or aviation, still operate at lower revenues and EBITDA margin compared to pre-crisis levels. Others, like the metal and mining industry, have grown and improved their EBITDA significantly.

THE LATE EFFECTS OF COVID-19 ARE AMPLIFIED BY THE IMPACT OF THE WAR IN UKRAINE

As a result of the crisis, costs for important commodities and container transport rates have exploded. This development is further amplified by the impact of the Russian invasion in Ukraine on global supply chains. Shortages of supplies add to these challenges as they hinder the completion of products and keep capital locked in higher inventory levels.

The re-financing of state aid, access to capital, and rising interest rates are perceived as much less of a challenge. This indicates that financial markets are still intact.

SOME INDUSTRY SECTORS FACE HIGH RISK — BUT CAPITAL IS AVAILABLE IF THE STRATEGY IS SOUND

The pressure expected on 2023 profit levels differs across industry sectors. Companies that operate with global supply chains, depend on commodities, and consume a lot of energy have little negotiation power over customers, and suppliers will face high challenges.
This is the case for many automotive suppliers and for manufacturing, engineering, and construction companies.

At the same time, these industries are undergoing disruptive changes such as electrification of power trains, digitization, and the need for environmental, social, governance (ESG) compliance. The disruptive shifts can create a “perfect storm” for some companies that will need to be weathered in the next years.

However, managers who can adapt their businesses to cope with changing markets and rising operational challenges will still be able find capital providers willing to satisfy their financing needs.

MIXED IMPACT OF COVID-19 ACROSS SECTORS

Companies in Europe on the whole have weathered the COVID-19 crisis remarkably well. Some sectors, however, still suffer from the demand shocks related to the pandemic.

STATE AID AND CAPITAL MARKETS HAVE CUSHIONED THE IMMEDIATE CRISIS IMPACT

Economies across Europe have been hit hard by the COVID-19 pandemic in 2020. After years of economic growth, the gross domestic product (GDP) declined between 3% and 11% in the world's largest economies. (See Exhibit 2.) The year 2021, however, already saw markets emerging strongly from the crisis, thanks to effective mitigation measures by states.

Exhibit 2: GDP Development 2017-2021
Real annual growth in %

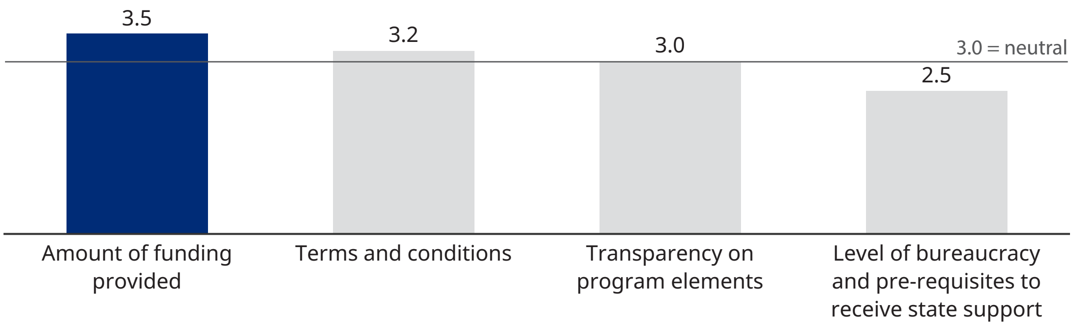
	2017	2018	2019	2020	2021
Germany	2.7	1.1	1.1	-4.6	3.1
France	2.4	1.8	1.8	-8.0	6.3
Italy	1.7	0.9	0.3	-8.9	5.8
Spain	3.0	2.3	2.1	-10.8	5.7
UK	1.7	1.3	1.4	-9.8	6.8
US	2.3	2.9	2.3	-3.4	6.0

< -3%   < 0- -3%   > 0-1%   >1-1.5%   >1.5%

Source: European Commission, Eurostat, IMF as of Feb 2022, Oliver Wyman analysis

Corporates have received this support very well. (See Exhibit 3.) Our survey participants expressed their satisfaction with the amount of funding provided and the terms and conditions. Only the level of bureaucracy could have been reduced.

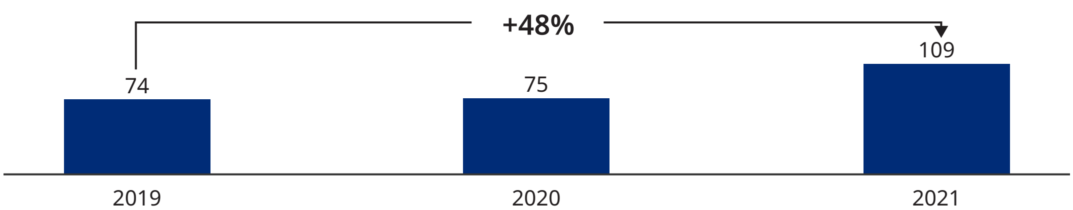
Exhibit 3: How satisfied are you with the effectiveness of state aid measures for covering the impact of the COVID-19 crisis?
Rating from 1 "not satisfied" to 5 "fully satisfied"



Source: Oliver Wyman Restructuring Survey 2022

In addition, banks and capital markets were open to support companies in need with liquidity. As an example, the amount of high yield bonds rose by almost 50% during the crisis, indicating that even companies with lower credit ratings were able to get financing. (See Exhibit 4.)

Exhibit 4: Issuance of high yield bonds 2019-2021
In € BN, Europe[1]



1. Countries: Austria, Belgium, Bulgaria, Croatia, Republic of Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden

Source: Dealogic, Oliver Wyman analysis

MANY CORPORATES ACROSS EUROPE HAVE EVEN IMPROVED THEIR FINANCIAL PERFORMANCE

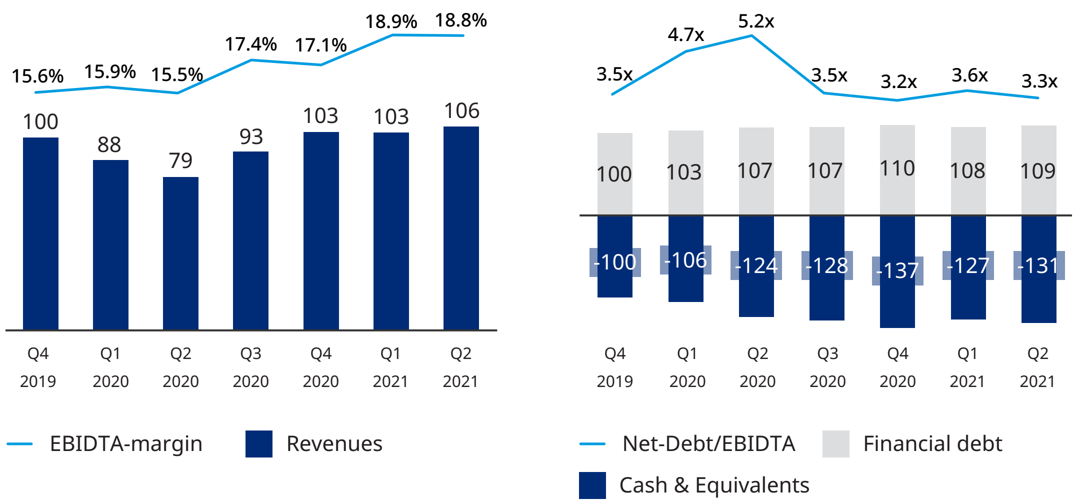
The crisis has left its mark on companies' financials in 2020 — but most companies recovered remarkably fast and often even exceeded pre-crisis performance levels. (See Exhibit 5.) Revenues dropped by 21% between Q4 2019 and Q2 2020 but rose above 2019 levels from Q4 2020 onwards, the average EBITDA margin hardly declined at the beginning of the crisis and increased significantly as companies recovered in 2020 and 2021.

At the same time, companies increased their amount of debt slightly but also grew their cash reserves by more than 30%! That helped to limit the leverage increase despite lower absolute EBITDA returns during the crisis.

Exhibit 5: Financial performance of corporates during the COVID-19 crisis

Revenues and EBITDA-margin
Aggregated and normalized revenues, Q4 2019=100

Leverage
Aggregated and normalized financial debt and cash, Q4 2019=100



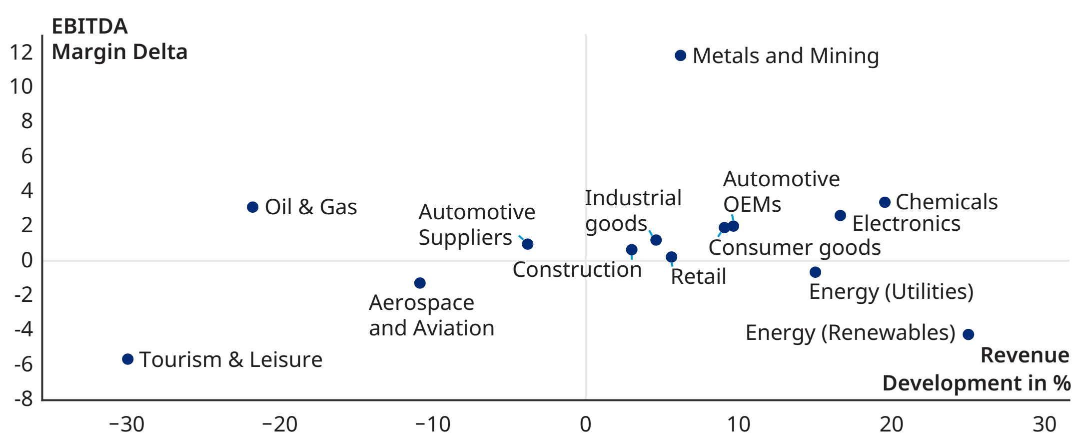
Based on a sample of 2907 listed European non-financial companies, aggregated on industry level

Source: S&P Global Market Intelligence, Oliver Wyman analysis

SECTORS DEPENDING ON MOBILITY STILL SUFFER

Looking in more detail at single industry sectors tells a more differentiated story. (See Exhibit 6.) While some industry sectors have been able to grow their revenues and EBITDA margins in 2021 versus 2019, sectors such as tourism and aviation still suffer from lower demand.

Exhibit 6: Revenues and profits of European industries
1st half of 2021 compared to 1st half of 2019



Delta in pp, YOY growth in %; Calculation based on aggregated revenue and EBITDA data from industry sample
Based on a sample of 2907 listed European non-financial companies, aggregated on industry level.

Source: S&P Global Market Intelligence, Oliver Wyman analysis

LATE EFFECTS OF COVID-19 AMPLIFIED BY THE WAR IN UKRAINE

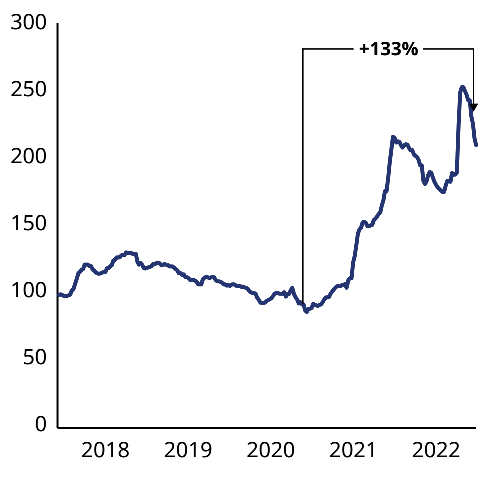
Rising commodity cost and supply chain problems remain as challenges caused by COVID-19 and are further intensified due to the war in Ukraine.

SUDDEN COST INCREASES COULD OFTEN NOT BE MITIGATED

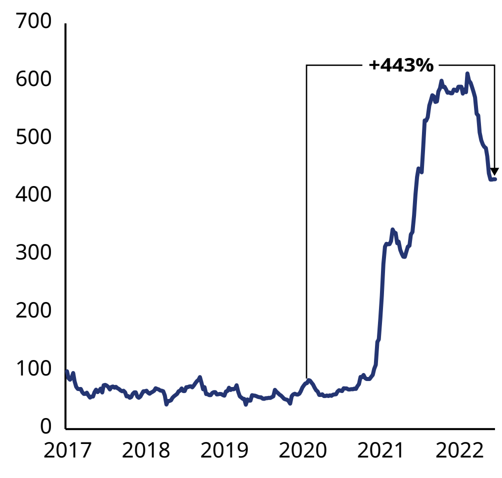
As a result of lockdowns and supply shortages, but also due to investment money available at very low cost, the prices for important commodities sky-rocketed during 2021 and further increased after the Russian invasion in Ukraine. Likewise, the cost for container shipments exploded — fueled partly by capacity adjustments which had taken place in the shipping sector before the COVID-19 crisis even started. (See Exhibit 7.) Many companies are not able to pass on these cost increases to their customers since price escalation clauses are not common practice in their industries or the delivery contracts which are in place are not designed to cope with such sudden cost increases.

Exhibit 7: Cost increases due to the COVID-19 crisis

Steel
Steel Price Index Europe SHGSI, March 2017=100



Oversea Container Rates
FBX China to NE Container Index, March 2017=100



Source: Refinitiv Datastream, Oliver Wyman analysis

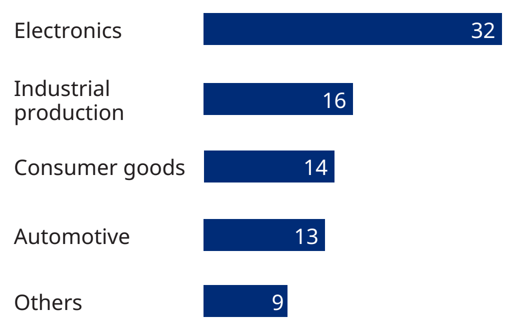
SUPPLY CHAIN PROBLEMS CAUSED INVENTORY INCREASE

Waiting times for vessels to be unloaded in European ports increased from less than 20 days at the beginning of 2021 to almost 50 days during the rest of the year due to lockdowns or absence of workers. As a result, goods could not be finished due to missing parts, and inventory levels of European companies grew by double-digit rates. The electronics industry — dependent on the supply of semiconductors from China — was hit the hardest, with a 32% growth of inventories between Q4 2019 and Q2 2021. (See Exhibit 8.)

Exhibit 8: Impact of supply chain problems

Terminal Congestion Index (dwell time)
In days vessel spends at port
(e.g. for offloading)

Increase of inventories[1]
Q4 2019 to Q2 2021 in %

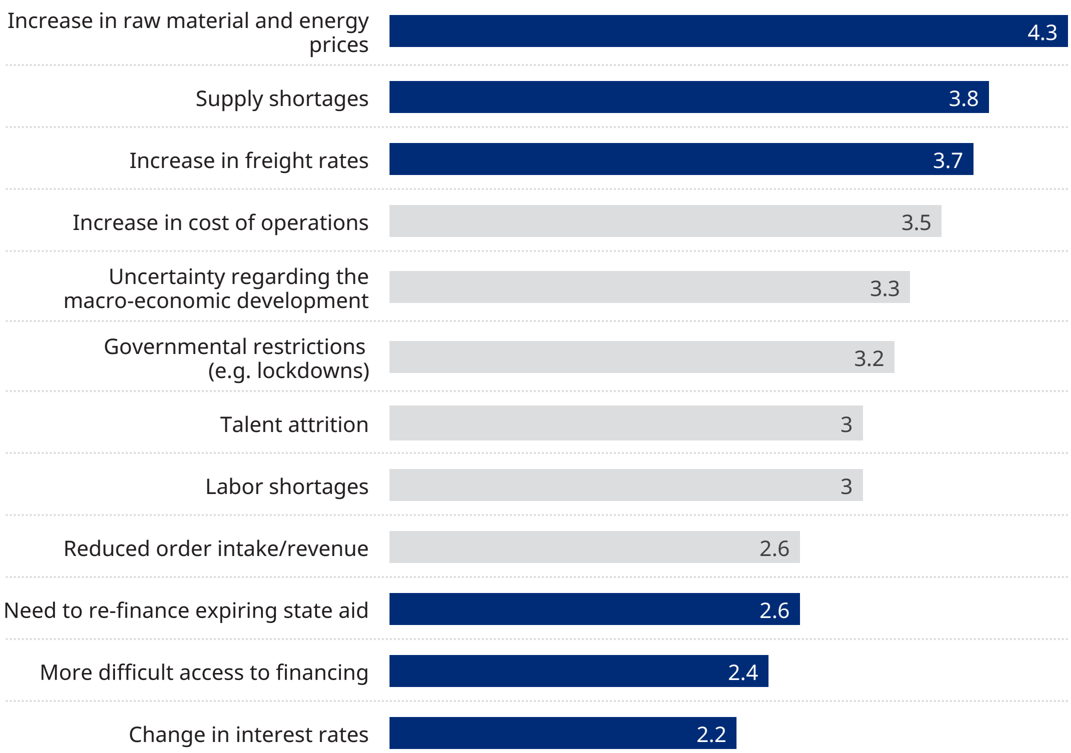


1. Based on a 3409 listed European non-financial company sample with balanced panel data, aggregated on industry level
Source: Sea Intelligence, S&P Global Market Intelligence, Oliver Wyman analysis

FINANCING WAS NOT A BIG PROBLEM

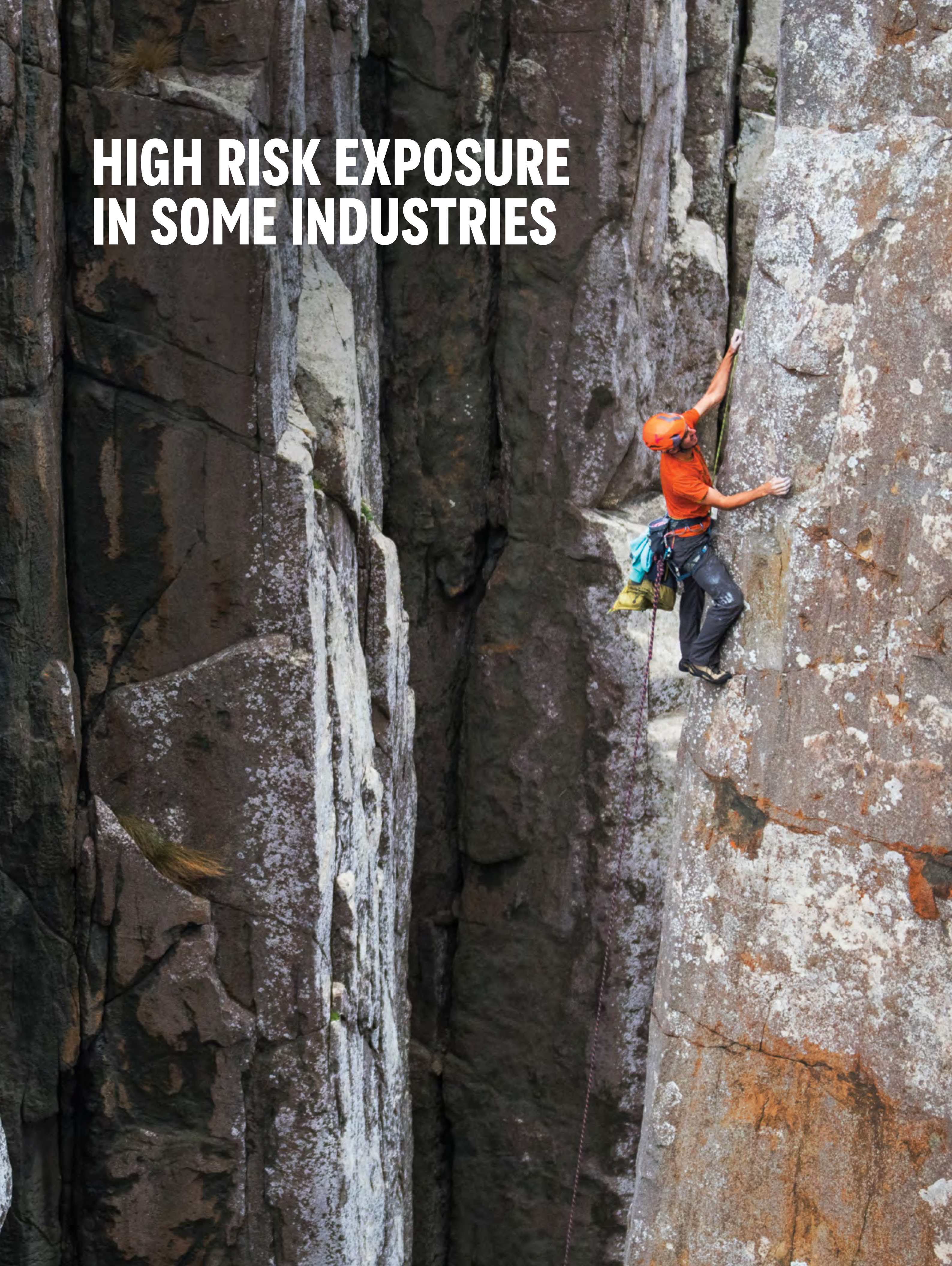
Consequently, the experts surveyed for our report state that price increases, supply shortages, and increase of freight rates are the biggest challenges remaining from the COVID-19 crisis. But financial markets seem to be intact as the need to re-finance state aid, access to financing, and rising interest rates are perceived much less of a challenge. (See Exhibit 9.)

Exhibit 9: Which challenges do businesses experience as a late effect of COVID-19?
Rating from 1 "no challenge" to 5 "very high challenge"



Source: Oliver Wyman Restructuring Survey 2022

HIGH RISK EXPOSURE IN SOME INDUSTRIES



The challenges due to the late effects of COVID-19 and the potential impact of the war in Ukraine differ across industry sectors. Some industries face very difficult times ahead.

DIFFERENT LEVELS OF PRESSURE ON EBITDA 2023

Looking ahead, the challenges for companies to improve their EBITDA will differ. (See Exhibit 10.) On the one hand, all companies will be impacted by the late effects of COVID-19 and the war in Ukraine, such as rising costs, declining GDP growth, and longer-lasting supply-chain problems. On the other hand, some companies are more exposed to these risks than others due to their dependency on commodities and energy, purchasing power, and exposure to macro-economic cycles.

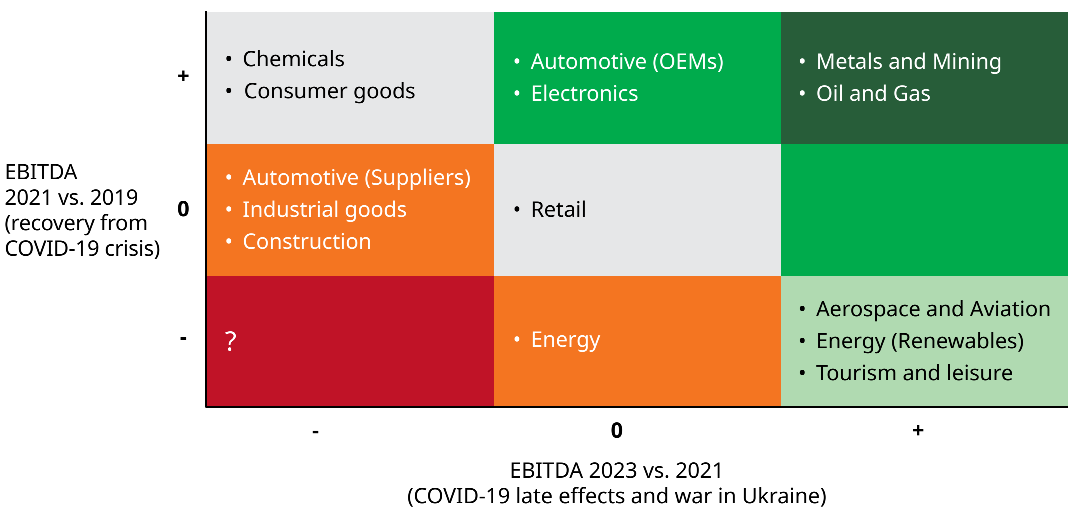
Exhibit 10:

Source: Oliver Wyman analysis

TRADITIONAL INDUSTRIES WITH HIGHEST RISK EXPOSURE

We have created a "risk heatmap" for industry sectors in Europe (see Exhibit 11) based on their current level of recovery from the COVID-19 crisis (vertical axis) and the level of pressure we believe they will face due to late effects of COVID-19 and the impact of the war in Ukraine (horizontal axis). We conclude that some of Europe's most traditional sectors are more impacted than others. Automotive suppliers are highly exposed to rising commodity and energy costs while having low counteracting power over customers and commodity suppliers. Industrial production, engineering, and construction companies face additional challenges because they consume a lot of commodities and depend on functioning supply chains.
At rising prices, the contribution margins of orders already in their backlog will fall. Utilities will likely suffer from a lack of inexpensive supply of gas and oil — but utilities at least may be able to mitigate this by changing their product mix towards renewable energy sources.

Exhibit 11: Impact of COVID-19 and the war in Ukraine on European industries
Indicative



Source: Oliver Wyman analysis

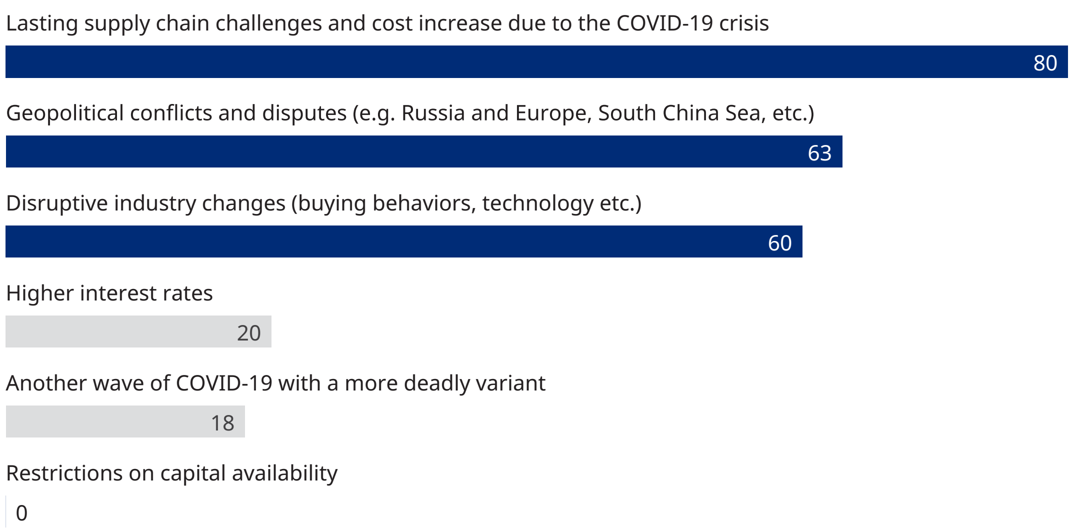
DO NOT FORGET THAT INDUSTRIES KEEP CHANGING!

Given the above, it is not surprising that 80% of our study participants have rated late effects from the COVID-19 crisis as one of the most likely factors to drive companies to large-scale distress in 2022 (see Exhibit 12), followed by 63% mentioning geopolitical conflicts as a crisis cause. But of course, markets keep changing and disruptive developments in customer buying behaviors and technologies pose further challenges, confirmed by 60% of the surveyed experts.

On the other hand, we received not a single response that was concerned about capital availability! It seems that companies who can present a compelling plan how to address the strategic and operational challenges will likely also be able to find financiers to support them.

This sets the agenda for corporates in 2022: Develop a strategy how to address market changes and adapt the operations to cope with rising cost and supply chain challenges. That will help to get financial support and win even in difficult times!

Exhibit 12: What are the three most likely factors driving companies into large scale distress in 2022?
# of participants that checked the option (up to three selections possible)



Source: Oliver Wyman Restructuring Survey 2022

CONCLUSIONS

CRISIS IS THE NEW NORMAL

The COVID-19 crisis is not over yet. Some industries are still recovering from the COVID-19 demand shock, and companies across all sectors are exposed to higher commodity prices, supply chain problems, and high freight cost. These late effects will remain as they are further amplified by the impact of the Russian invasion in Ukraine on the global economy.

DISRUPTION IS STILL HAPPENING

The attention of managers was very much on sustaining the COVID-19 crisis over the past years. But fundamental changes are still going on in many industries and could drive companies in distress if not properly addressed. Examples include the electrification of the automotive powertrain, digitization of industrial manufacturing and engineering, and the shift towards renewable forms of energy.

A "PERFECT STORM" IS GATHERING IN SOME SECTORS

Some industries are particularly exposed to the late effects of COVID-19 and the impact of the war in Ukraine. At the same time, they are undergoing fundamental changes that are forcing companies to re-think their business designs and operating models.

CAPITAL WILL COME TO THOSE WHO ADAPT

Companies who have a compelling plan how to adapt their businesses to cope with rising costs, supply chain challenges, and changing markets will be able to satisfy their financing needs. Capital is available from banks and investment funds. But capital is no longer for free — and therefore must be used wisely.

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.

CONTACTS

Dr. Lutz Jaede
Partner, Head of Turnaround & Restructuring Europe, Munich
+49 89 93949 440
Lutz.Jaede@oliverwyman.com

Timothy Hoyland
Partner, Head of Turnaround & Restructuring Americas, Dallas
+1 214 7581807
Tim.Hoyland@oliverwyman.com

Pietro Castronovo
Partner, Head of Turnaround & Restructuring IMEA, Dubai
+971 522 605 160
Pietro.Castronovo@oliverwyman.com

Virgile Bertola
Partner, Paris
+33 6 38522632
Virgile.Bertola@oliverwyman.com

Michele d'Angelo
Partner, Milan
+39 342 8796808
Michele.Dangelo@oliverwyman.com

Thierry Duvette
Partner, Paris
+33 6 49814900
Thierry.Duvette@oliverwyman.com

Emily Harte
Partner, Chicago
+1 312 5091276
Emily.Harte@oliverwyman.com

Thomas Kautzsch
Partner, Munich
+49 89 93949 460
Thomas.Kautzsch@oliverwyman.com

Dr. Joachim Krotz
Partner, Munich
+49 89 93949 462
Joachim.Krotz@oliverwyman.com

Maximilian Majic
Partner, Munich
+49 1525 4551479
Maximilian.Majic@oliverwyman.com

Chris McMillan
Partner, Head of Private Capital Europe, London
+44 20 78527764
Chris.McMillan@oliverwyman.com

Dr. Markus Mentz
Partner, Munich
+49 89 93949 548
Markus.Mentz@oliverwyman.com

Bernd Oehring
Partner, Munich
+49 89 93949 543
Bernd.Oehring@oliverwyman.com

Henning Tielker
Partner, Dusseldorf
+49 89 93949 776
Henning.Tielker@oliverwyman.com

Vicente Vazquez Bouza
Partner, Madrid
+34 91 432 8456
Vicente.VazquezBouza@oliverwyman.com

Steven Walsh
Partner, Dallas
+1 214 6754178
Steven.Walsh@oliverwyman.com

Oliver Wuensch
Partner, Zurich
+41 44 5533249
Oliver.Wuensch@oliverwyman.com

Jared Yerian
Partner, Chicago
+1 773 294 2609
Jared.Yerian@oliverwyman.com

Contributors

Remigius Erhardt
Engagement Manager, Munich

Linus Leopold
Engagement Manager, Berlin

Jannik Elmer
Consultant, Munich

Adam Romanowicz
Research Analyst, Warsaw

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

For more information, please contact the marketing department by phone at one of the following locations:

Americas	EMEA	Asia Pacific
+1 212 541 8100	+44 20 7333 8333	+65 6510 9700

AUTHOR

Dr. Lutz Jaede

Partner, Head of Turnaround & Restructuring Europe
Lutz.Jaede@oliverwyman.com