AlixPartners

OCTOBER 2024

HIGH RATES AND MATURITY WALLS:

Debt refinancing challenges in the DACH region

The DACH region is navigating a complex financial landscape marked by elevated debt levels, rising interest rates, and looming maturity walls. In the wake of the pandemic, companies across the region have faced growing pressures as they approach a wave of upcoming debt maturities and tightening refinancing conditions. Many firms took on additional debt to weather the economic turbulence, which has further complicated the corporate landscape. While the immediate effects of the pandemic have begun to recede, these elevated debt levels have created a ripple effect, leading to new challenges in refinancing.

At the same time, market trends are shifting. Traditional sources of debt, such as leveraged loans and high-yield bonds, are evolving as companies adapt to changing market dynamics. In response, there is an increasing focus on private debt and direct lending, with many borrowers and sponsors turning to these alternatives due to the limited availability of conventional funding options.

The region also faces a broader economic backdrop that exacerbates these challenges. Rising interest rates, persistent inflation, and economic stagnation have put additional strain on companies' operational budgets and investment capabilities. As firms grapple with increased operating costs and shrinking profit margins, the risk of insolvencies has grown. In response to these mounting challenges, companies are exploring strategic measures and operational improvements to strengthen their financial stability.

INCREASED DEBT LEVELS

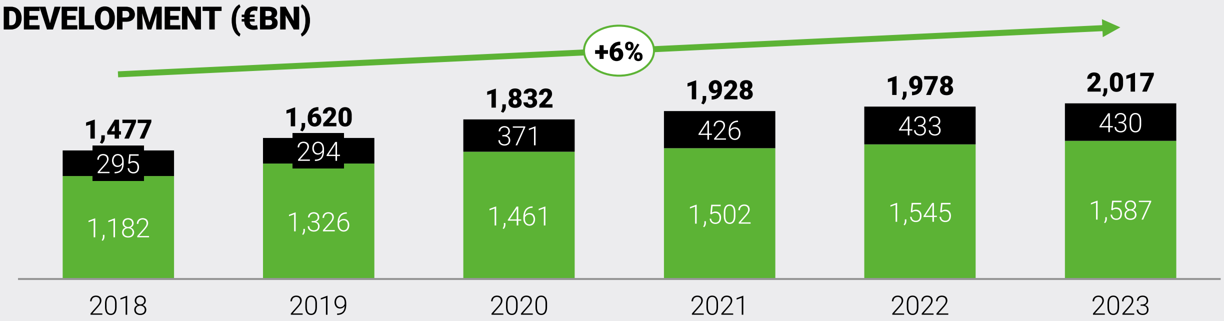
During the pandemic, companies across various sectors, particularly those hardest hit by lockdowns and supply chain disruptions, significantly increased their borrowing to bolster their balance sheets. This led to a sharp rise in debt levels, as many firms tapped into cash reserves and borrowed heavily to navigate the economic uncertainty.

By 2022, as the immediate effects of the pandemic began to recede, companies started to rebuild their cash reserves and recover revenue streams. However, net debt levels remain elevated compared to pre-COVID. Additionally, the surge in LBO activity in the region contributed to higher debt levels, as many companies became overleveraged during the acquisition process.

Despite concerted efforts to stabilize leverage through refinancing and strategic debt management, companies in the DACH region are still grappling with several challenges. Rising interest rates, ongoing economic volatility, refinancing risks, and pressures specific to certain sectors continue to pose significant hurdles.

The sustained high leverage is exerting downward pressure on profitability, primarily through increased interest expenses and operational constraints. This financial strain has led to a deterioration in creditworthiness, raising the risk of defaults and creating additional obstacles in refinancing efforts. As companies navigate this complex landscape, the legacy of pandemic-era borrowing continues to weigh heavily on their financial health and long-term stability.

FIGURE 1: DEBT DEVELOPMENT (€BN)



AS EBITDA MULTIPLE	2018	2019	2020	2021	2022	2023
Net leverage (net debt/EBITDA multiple)	**2.9x**	**3.2x**	**4.1x**	**4.3x**	**3.9x**	**3.5x**
Total leverage (total debt/EBITDA multiple)	**3.6x**	**4.0x**	**5.1x**	**5.5x**	**5.0x**	**4.4x**

Net Debt   Cash & Cash Equiv.

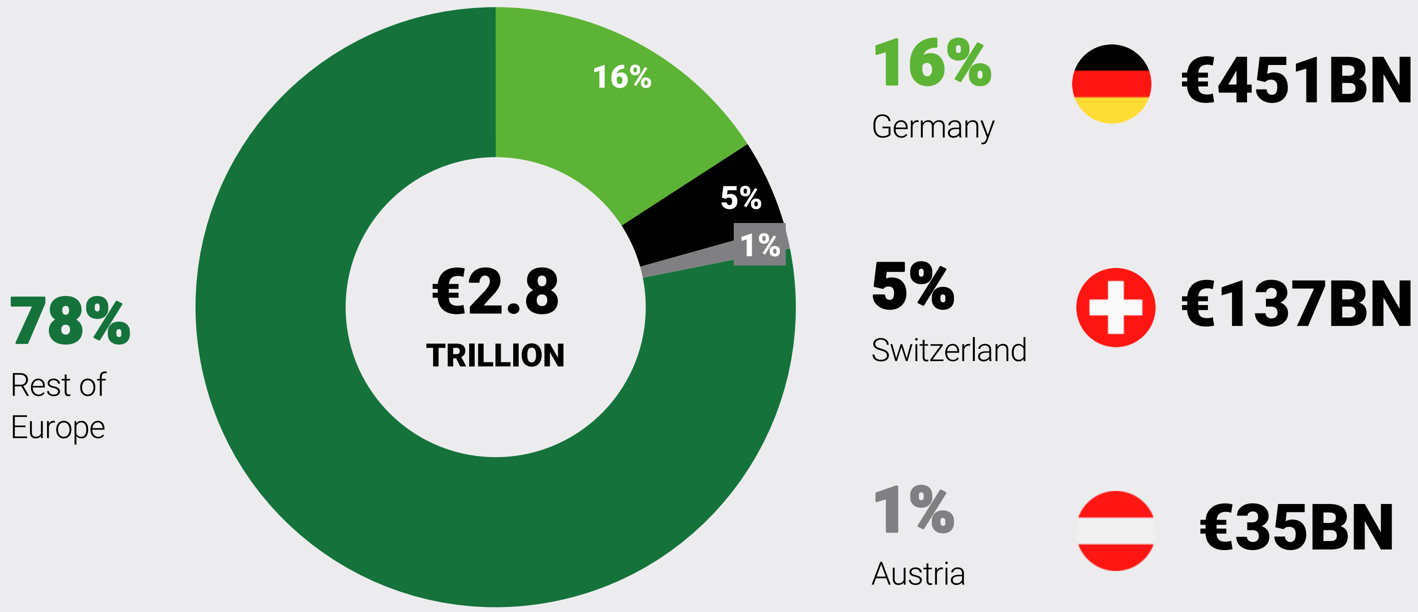
Source: Capital IQ, Bloomberg
Note: Based on a sample (n=990) of listed companies in DACH region, excluding Financial Services and Real Estate

MATURITIES

Rising debt levels have significantly increased the volume of debt maturing over the next five years, leading to the formation of steeper maturity walls. This impending wave of maturities presents a significant challenge, particularly in the DACH region, where the landscape for refinancing is expected to favor higher-quality issuers. These issuers, who typically do not face significant refinancing difficulties, are likely to secure financing more easily, putting considerable pressure on lower-rated issuers struggling to access capital.

The costs associated with refinancing debt maturing in the upcoming quarters are also climbing sharply. This rise in costs is placing additional strain on companies' liquidity and solvency, particularly those for whom traditional bank financing is no longer a viable option. Highly leveraged LBOs are expected to encounter even steeper costs when attempting to roll over their existing debt, further exacerbating the financial strain.

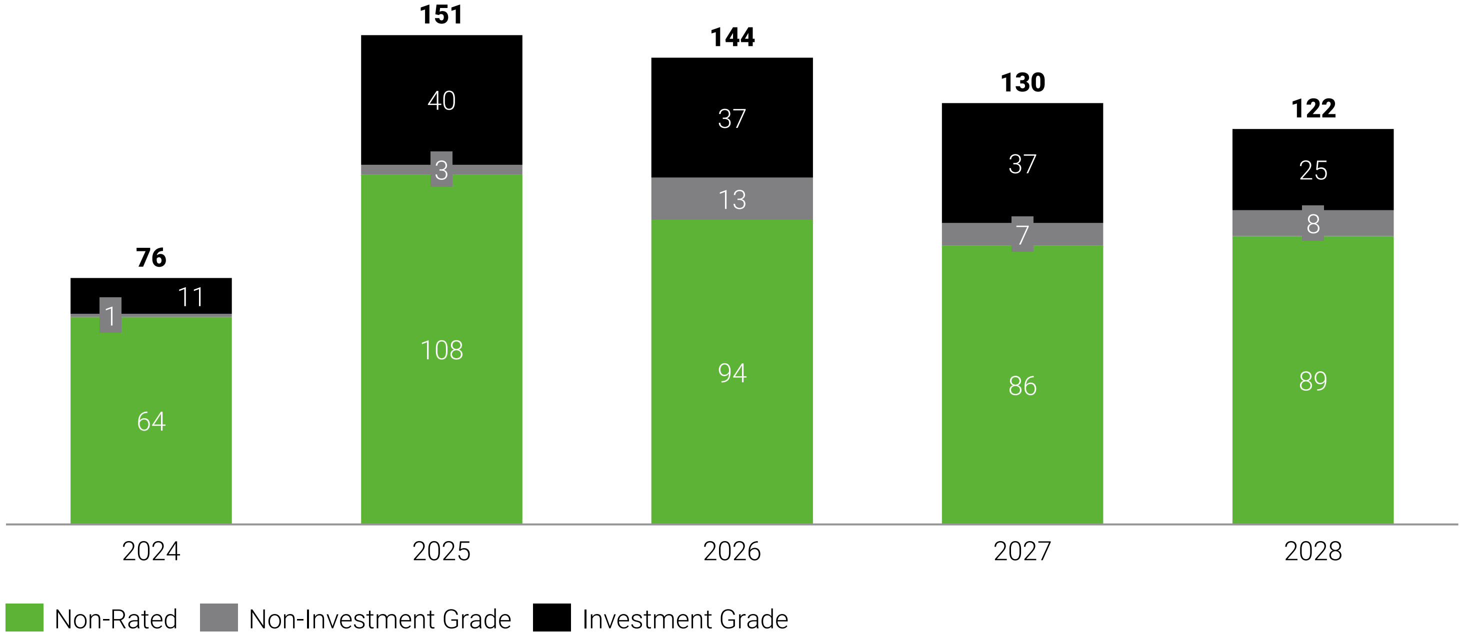
FIGURE 2: TOTAL CORPORATE DEBT MATURING BETWEEN 2024 AND 2028 IN EUROPE (IN €BN)



Source: Capital IQ, FactSet, Refinitiv, Bloomberg
Note: Excluding Financial Services and Real Estate

The necessity to refinance at higher interest rates could have a profound impact on corporate balance sheets, especially for companies with significant leverage. This financial pressure may hinder their ability to invest in growth initiatives and maintain operational budgets, potentially slowing down innovation and overall business expansion in the region. The approaching maturity walls thus pose a critical test for the financial resilience of companies across the DACH region.

FIGURE 3: DACH CORPORATE DEBT MATURITIES BY ISSUER CREDIT RATING (€BN)



Source: Capital IQ, FactSet, Refinitiv, Bloomberg
Note: Excluding Financial Services and Real Estate

DEBT MARKET TRENDS

LEVERAGED LOANS

In H1 2024, leveraged loan issuance experienced a significant surge following three consecutive weak quarters. This resurgence was largely driven by a wave of loan refinancing and repricing activities, indicating a shift in market dynamics after a period of subdued activity.

While LBO transactions have lagged, the expanding M&A pipeline and the uptick in refinancing efforts suggest that the loan markets are beginning to stabilize after facing recent challenges. The increase in refinancing activity highlights a growing confidence among borrowers and investors, as companies seek to optimize their debt structures in anticipation of a more stable economic environment.

HIGH YIELD BONDS

Over the past two years, high yield bond issuance has seen a marked decline, with German companies hitting particularly low levels of issuance due to rising interest rates. The challenging interest rate environment has made refinancing the primary driver behind the limited issuance of these bonds, as companies focus on managing existing debt rather than taking on new obligations.

However, the first half of 2024 has shown encouraging signs of market stability after two difficult years. This renewed stability has been bolstered by recovering corporate earnings and a surprisingly muted reaction to central bank actions, which had previously contributed to market volatility.

PRIVATE DEBT

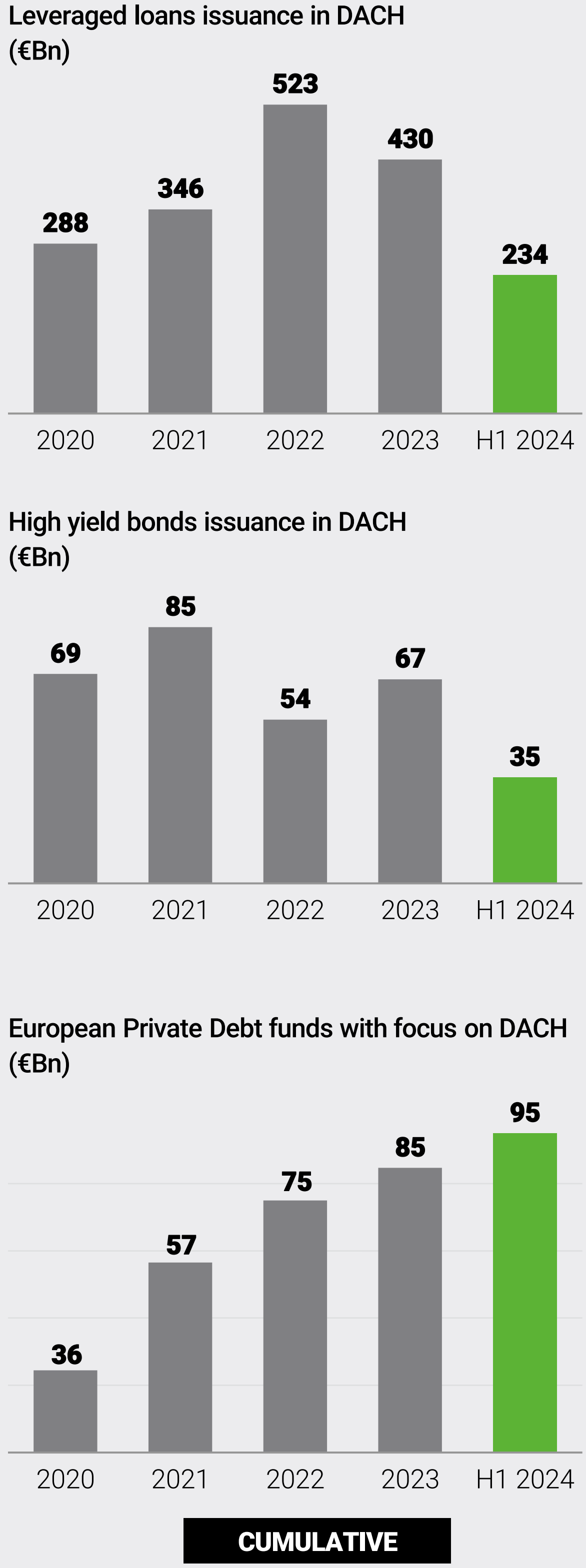
Due to the limited availability of conventional funding options under favorable terms over the past two years, many borrowers and sponsors have shifted their focus from traditional leveraged finance markets to alternative financing solutions, such as direct lending.

As syndicated loan markets faced increasing challenges, direct lenders offered enhanced flexibility and faster access to capital, particularly for larger transactions. This has led to a notable rise in fundraising within the direct lending space, as evidenced by the significant growth of European direct lending funds, particularly in the DACH region.

Despite the growing demand for private debt, the overall volume of financing sourced from this market remains smaller compared to traditional bank lending. However, several large banks have recognized the potential in private credit, making commitments to enter the market through in-house funds or partnerships with debt funds.

Private debt has evolved from a niche solution into a critical component of corporate financing, with direct lending becoming a dominant and increasingly indispensable source of funding in the DACH region.

FIGURE 4: DEBT ISSUANCE



Source: Refinitiv, S&P Global, Pitchbook LCD, Capital IQ
Note: Excluding Financial Services and Real Estate sector. Private Debt funds figure was calculated following a cumulative method

UNCERTAINTY AHEAD

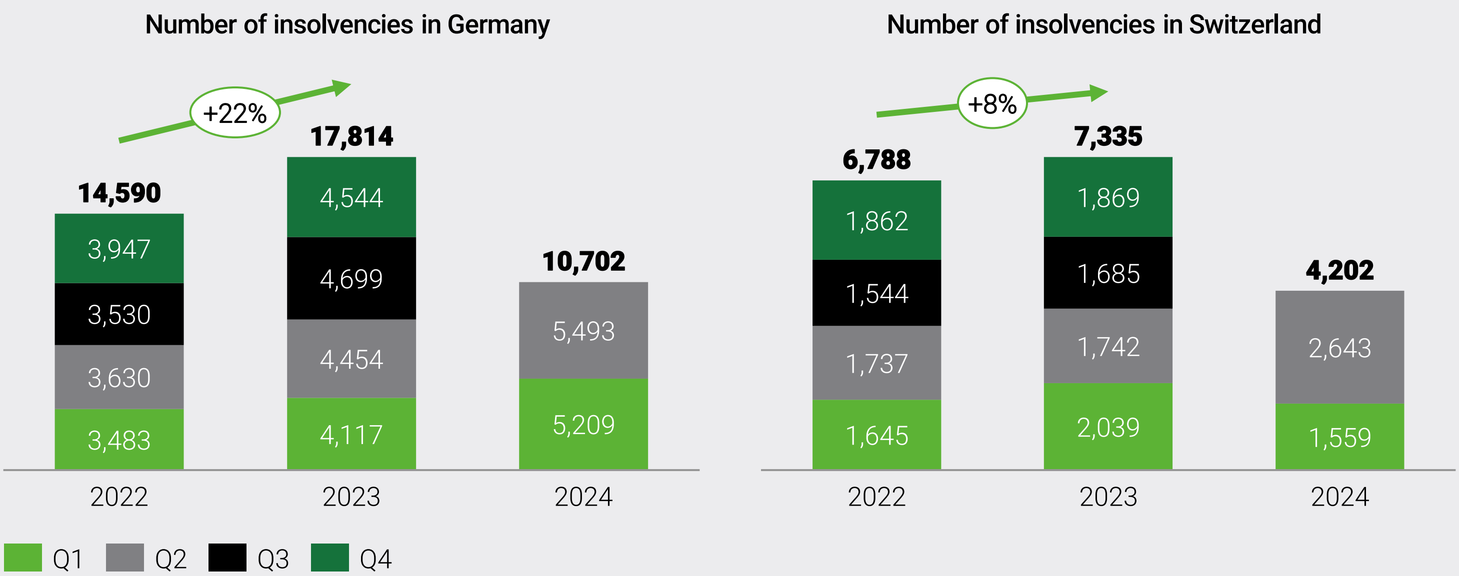
The rising inability of companies to service elevated interest expenses or refinance maturing debt has emerged as one of the leading causes of corporate defaults. In Germany, this issue has become particularly pronounced, with the number of insolvencies increasing by 22% in 2023—a trend that is continued into the second half of 2024.

The surge in financially distressed companies in Germany has been exacerbated by a combination of economic stagnation, persistently high interest rates, increasing wage demands, elevated energy costs, and a constrained government budget. These factors have created a challenging environment for businesses, leading to a growing wave of insolvencies.

Switzerland is also facing significant financial distress, with the number of insolvencies reaching record highs, primarily driven by over-indebtedness. The combination of high interest rates and economic challenges has placed immense pressure on companies, particularly those with high levels of debt. In addition to high interest rates and economic challenges, the strong Swiss franc has placed further strain on Swiss companies which rely on exports facing significant declines in orders from key markets.

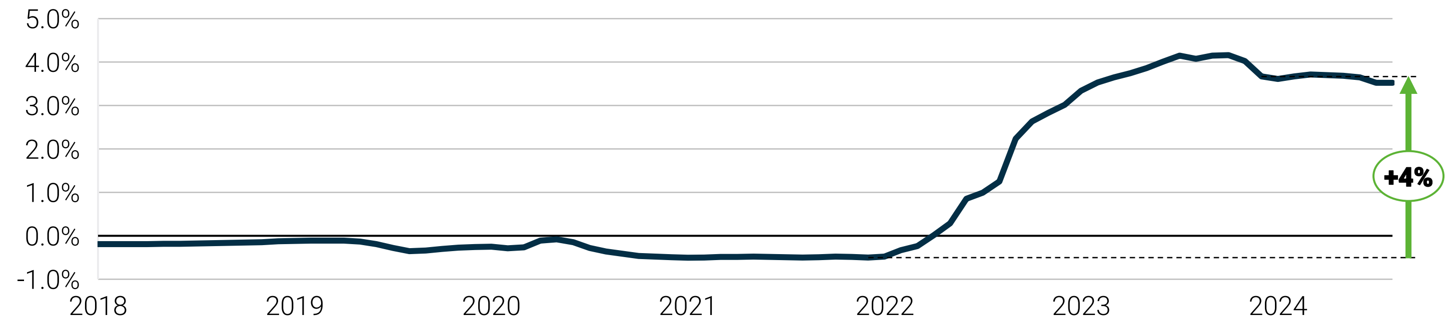
Additionally, higher inflation rates are further straining corporate finances by driving up operating costs and reducing consumer spending, which in turn affects profitability. As these pressure continue to mount, the risk of insolvency remains a significant concern for businesses across both Germany and Switzerland.

FIGURE 5: INSOLVENCIES DEVELOPMENT IN GERMANY AND SWITZERLAND



Source: Bloomberg, S&P Global, Creditreform, Destatis, Financial Times

FIGURE 6: EURIBOR 3-MONTH DEVELOPMENT (JAN 18 – SEP 24)



Source: European Central Bank, Bloomberg, as of August 2024

IMPROVEMENT LEVERS BEFORE (RE) FINANCING

Considering rising financing costs and the need to refinance debt, companies must prioritize improving EBITDA while ensuring transparency over their liquidity positions. Strengthening financial performance and demonstrating sound management of resources are key to enhancing creditworthiness and securing favorable (re)financing terms. To convince banks and investors, companies must show a proactive approach by improving operational efficiency, optimizing working capital, and demonstrating implementation prowess. Furthermore, providing clear and transparent financial reporting, coupled with detailed liquidity forecasts, will instill confidence in the company's ability to meet debt obligations. Based on our experience, the following strategic levers and management capabilities to implement it are essential in this context:

LOWER CAPITAL EMPLOYED: Optimize the balance sheet by selling non-core assets and limiting capital-intensive investments	**USE CAPEX WISELY:** Establish capex allocation governance to ensure effective investment	**OPTIMIZE WORKING CAPITAL:** Tighten cash conversion cycles, improve inventory turnover, and optimize receivables & payables	**IMPROVE OPERATIONAL EFFICIENCY:** Streamline processes, eliminate inefficiencies, and adopt a cost-saving strategy	**OPTIMIZE COST:** Leverage strategic sourcing and supplier management to reduce procurement costs effectively

ALIXPARTNERS' ROLE IN FINANCIAL RESTRUCTURING AND HOW WE SUPPORT OUR CLIENTS

CRITICAL WORK STREAMS

INVESTMENT BANKS/ FINANCIAL ADVISORS

Focus:
Capital structure options, negotiations, debt and capital markets

Illustrative Responsibilities:
- Capital structure
- Liability Management
- Manage M&A/Divestiture
- Valuation
- Investors/sources of capital
- Debt Capacity Analysis

Shared with AlixPartners:
- Financial Modeling
- Covenants
- Strategic options
- Board Presentations
- Creditor Communication

AlixPartners DACH

Focus: Day-to-day management support, on-site coordinator of various restructuring workstreams, liquidity/treasury

Illustrative Responsibilities:
- Business Plan Development/Review
- Liquidity Management
- Creditor Diligence Management
- Contingency Planning
- Operational Improvement

Shared with Legal Advisors:
- Board Advice
- Strategic options
- Reporting/ Compliance
- Contingency Planning
- Stakeholder Management

LEGAL ADVISORS

Focus:
Negotiations and legal implementation

Illustrative Responsibilities:
- Stakeholder Negotiations
- Drafting Legal Documentation
- Advising Company's Board of Directors and Management
- Contingency Planning/Preparation

Closely coordinate with financial and legal advisors

AlixPartners

FOR MORE INFORMATION CONTACT:

Dr. Rainer Bizenberger
Partner & Managing Director
rbizenberger@alixpartners.com

Alban Baiker
Partner
abaiker@alixpartners.com

Tim Theurer
ttheurer@alixpartners.com

Abdelaziz EL Otmani, CFA, FRM
aelotmani@alixpartners.com

ABOUT US

For more than 40 years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.