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Restructuring trends 2019: A global view

Introduction: Gathering headwinds

An expectation of an increasingly busy restructuring landscape is building as geopolitical tensions exacerbate the pressures within a global economy edging towards the end of the post-financial crisis economic cycle. This has become especially visible in recent weeks with the inversion of US and European yield curves in mid-August. Sectors ranging from retail to automotive also face disruptive shifts in technology, regulation and customer expectations.

As we explore in this second edition of our Restructuring trends: A global view, behind the global story are a series of local nuances. These stretch from the threat to labour-intensive industries emanating from depopulation in Central and Eastern Europe, to the impact of higher sales taxes in Japan, and how the overhaul of digital taxation by the US and EU might affect an Irish economy already under threat from Brexit.

The coalescing local and global trends are revealing hidden weaknesses in companies buoyed by cheap credit and prolonged GDP growth over the past decade. Their ability to turn their businesses around is impeded by the exceptionally unpredictable nature of the policy developments affecting international trade as an era of globalisation gives way to renewed economic nationalism.

There is a huge amount of ‘dry powder’ ready to be invested. In turn, regulatory developments ranging from India’s Insolvency and Bankruptcy Code to the EU Directive on Restructuring and Insolvency aim to accelerate restructuring and eliminate some of the impediments. Yet, more than ever, restructuring needs to be proactive, coordinated and transparent to be effective in this volatile and uncertain market. This greatly improves the chances of preventing collapse, stabilising the business and maximising asset values. Making this possible demands a clear understanding of both the big global picture and the nuanced local trends. Bringing together input from our restructuring specialists in markets worldwide, this report is designed to strengthen our clients’ understanding of these issues.

If there are any issues or opportunities highlighted in this report that you would like to discuss further, please feel free to get in touch with me or our global Partners (there is a list of contacts in each individual territory section).

Ed Macnamara
Partner

[Image of world map with PwC territory sites and areas covered in the report]
Key themes

Geopolitical uncertainty

From US-China trade tensions and the impact of Brexit to international sanctions and disruption to international oil shipments, the global economy is subject to volatile political developments.

Many organisational structures, supply chains and operational models were built for an age of open global trade. Now, the resurgence of economic nationalism, sanctions and tighter border controls are transforming this landscape. Once stable trade agreements are now being torn up. Protectionist tariff hikes in one market can trigger retaliation elsewhere. Physical, political and economic barriers to trade now make reaching markets more difficult and uncertain by the day.

The next 12 months will see a number of planned or highly anticipated elections which is likely to ensure geopolitical uncertainty continues to drive markets.

Highly leveraged structures under the spotlight

Highly leveraged financing structures from the last few years are beginning to underperform in some countries, particularly in sectors that have been subject to significant levels of disruption. Although equity cushions have remained higher than in 2007 for new issuance, corporate performance has been more volatile given the multiple effects of geopolitics, technology and changing consumer demands.

The increased prevalence of cov-lite documentation in North American and European markets is, however, limiting lenders’ leverage to engage borrowers in restructuring discussions early, potentially limiting options for resolution.

Agriculture

Bellwether industries with high levels of global interdependence such as agriculture are showing signs of a slowdown. The US-China tensions are having a significant impact on exports. For example, in 2018 soya bean exports were 75% down on 2017. Extreme global weather, including droughts and flooding, has in turn affected yields.

Automotive

The industry is showing clear signs of entering into a restructuring cycle, mainly triggered by the overall slowdown in consumer demand and exports in some of the major manufacturing territories. In the EU, in particular, the compliance pressure from new emission tests has caused production bottlenecks, especially for companies with high levels of diesel vehicle output. Pressure in the supply chain is being felt across developed markets, including France, Germany, Spain, Italy, Canada and Japan.
Banking and the wider financial services sector in many regions have been under pressure to reduce their non-performing loan (NPL) exposures. Depending on the regulator, the approach includes encouraging and facilitating NPL sales (e.g. Turkey and India) and providing government guarantees for senior securities and general securitisation (e.g. Italy). This has put a heavy regulatory compliance burden on these institutions, as well as making it harder for distressed companies to find new funding from lenders.

Retail

Transformation is gathering pace across almost all mature and developing economies. The shift from physical ‘bricks and mortar’ stores to a more globally-integrated digital shopping platform is forcing traditional retailers to change, resulting in many restructurings and insolvencies. The wave of retail failures is also beginning to put pressure on shopping centres and the related commercial real estate sector.

Stress in the retail sector is also a direct result of the slowdown in the global economy, overshadowed by uncertainties in trade and the political environment. As disposable income is squeezed and consumer confidence dips, we’re seeing cutbacks in non-discretionary spending in areas such as leisure and entertainment.

Harmonisation of restructuring laws

The EU Directive on Restructuring and Insolvency came into force in June 2019. The updated EU regime creates a new toolkit for harmonisation across jurisdictions. Having lagged the UK in terms of the attractiveness of the legal environment for restructuring, markets such as Germany and France will increasingly see restructuring enacted domestically while the Netherlands may compete with the UK as a restructuring destination.

Similarly, the restructuring regime in Turkey is being updated with the introduction of new mechanisms including standstill and cramdown options, which are expected to speed up restructuring processes and attract fresh investment.

Meanwhile, the Indian restructuring and insolvency law is slowly maturing, leading to increased investment opportunities, while the Middle Eastern jurisdictions of Saudi Arabia and the UAE have also seen major changes to local bankruptcy laws.

Interest rate expectations reversed

Low interest rates have helped to mask some of the stresses in developed economies. Over the past ten years, capital has also gradually moved from the US to more ‘adventurous’ high risk/high reward jurisdictions in the search for yield.

In late 2018, investors anticipated tighter monetary policy and increasing yields would allow more capital to be allocated to ‘safe’ economies. However, the outlook is very different now, with central banks around the world cutting interest rates in the light of trade concerns and other headwinds.

Europe is slowing as Germany stutters and the UK braces itself for Brexit. The expectation overall is that monetary and fiscal stimuli will continue.

As such, investors are likely to see more of the same rather than the anticipated shift. Those solely focused on ‘safe jurisdictions’ will continue to struggle to find yield and will be forced to accept ever more borrower-friendly terms (low rates, cov-lite, etc). Others will be forced back to jurisdictions they wouldn’t previously have wanted to invest in.
Key themes

Construction

Capital-intensive sectors like construction and infrastructure are heavily hit by limited access to credit lines and uncertainty among investors. The construction sector also faces a margin squeeze, where the contractors bear the cost increase in raw material and labour, as well as unfavourable risk allocation for delays and issues. Notwithstanding these pressures there is anticipated to be a positive outlook for infrastructure over the coming years.

Shipping and offshore

An oversupply of vessels is putting pressure on returns and forcing some companies to explore restructuring options. A similar trend is evident in the dry bulk market. Overall demand for dry bulk cargo is expected to remain stable, but rates are likely to be volatile.

The containership market continues efforts to reinvent itself, as the new alliances formed amongst the liner operators in early 2017 struggle to deliver the full range of anticipated benefits and synergies. There are mixed signals as some liners aim to increase their mega containership fleet, whilst others aim to find better utilisation patterns for their existing vessels.

Troubled shipping companies have managed to negotiate concessions from their lenders, primarily involving covenant relaxations and, when needed, repayment deferrals to relieve any liquidity pressure points. Should the volatility in the market persist and cash buffers run out, there may be companies in need of a more wholesale restructuring.

The offshore industry outlook remains challenging. Whilst modern drilling rigs are securing contracts, these are often short-term. Older vessels are facing significant challenges in securing employment. The offshore support vessel market remains difficult on account of significant oversupply. However, we have seen some winners due to geographical focus and innovations focusing on growing markets like wind.

Higher capital demands and squeeze on lending

Banks across Europe have started to prepare for new capital regulations (the so-called ‘Basel IV’). Changes include new risk-weighted asset (RWA) floors. The move to ‘Basel IV’ also seeks to usher in more harmonised approaches in risk-based capital requirement assessment across banks and underlying risk management and market discipline.

The effect of such changes is expected to result in a sharp increase in the RWA of banks, particularly those who relied on an advanced internal ratings-based (IRB) approach for their RWA calculation. The capital requirements of European banks could increase dramatically, which may prompt banks to pursue an aggressive reduction of their more capital-intensive portfolios, or try to reprice loans at considerably higher margins.

Higher capital demands are likely to have a knock-on impact on borrowing costs, especially for companies that do not have a credit rating. Furthermore, as banks may decide to reduce portfolios by selling to third parties, companies may find negotiations with lenders more complex.
Global utilisation and rates for driller and OSV operators remains low

Key observations
- Since Q2-17 the market saw the utilisation of the mid water drillers being consistently higher than that of the deep water drillers
- It is evident that demand of the deep water drillers has failed to pick up and most energy majors active in the offshore space, focus production in the mid water fields
- A short term increase in demand of deep water drillers in Q2 and Q3-18 related to short term contracts for the well drilling of existing fields

Source: Clarkson's Offshore Intelligence Network

Global utilisation and rates of AHTS and PSV vessels remain challenging

Key observations
- The AHTS and PSV markets have been impacted by the volatility in the market
- Day rates have been consistently under the 100 index point since the beginning of 2016, and despite signs of recovery in rates, utilisation remains at considerably low levels
- Both the AHTS and the PSV markets are undermined by oversupply

Source: Clarkson's Offshore Intelligence Network
# Themes by countries and regions

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Australia remains attractive to foreign investors due to its stable political and legal environment, and proximity to Asia. However, US-China trade tensions have impacted Australia’s trade-dependent economy.

Flat credit growth stemming from the fallout of the high profile the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, together with an increased scrutiny of lending practices, tightening of lending regulations and subdued business conditions.

Substantial amount of ‘dry powder’ available in the market from private equity-backed residential lending platforms and other second and third tier lenders such as superannuation funds and hedge funds.

New law that provides ‘safe harbour’ to directors of stressed or distressed companies, and the amendment of insolvency legislation to void ‘ipso facto’ clauses, both promote restructuring opportunities and enhance value retention for stakeholders.

Retail sector faces headwinds for the foreseeable future. Construction, property development and related services are also adversely affected by oversupply in the residential apartment market, leading to a downturn in property prices and dip in consumer sentiment.

Subdued confidence

Australia’s economy continues to show signs of being in a ‘holding-pattern’. The re-election of the conservative coalition government in April is expected to result in a more stable political environment than in recent years. Recent tax cuts – together with a flurry of large infrastructure projects and favourable terms of trade – are expected to provide a slight boost to the economy. However, other indicators, including subdued consumer confidence, point to a difficult period ahead.

Falls in house prices and mortgage origination continued in 2019 despite the all-time low base interest rate. Australian households are spending less, and saving less, driven by low growth in wages. Stalling consumer spending reflects lower general confidence, which can also be observed in the business lending market.

The economy is continuing to feel the impact of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, the full ramifications of which are yet to be determined. The high profile nature of the misconduct probe, increased public and political scrutiny of lending practices, progressive tightening of lending regulations, and subdued business conditions have contributed to flat credit growth.

Impact of trade tensions

Australia continues to be an attractive destination for foreign investment. The draws include the country’s consumer base, proximity to Asia and a relatively stable political and legal environment. An infrastructure boom – focused in particular on Melbourne and Sydney – has helped to maintain healthy employment growth. Despite growth, there remains excess capacity in the labour market.

Like much of the global economy, Australia is feeling the effects of US-China trade tensions. While the US Government was not successful in introducing value-added tax on imported goods, the trade tariffs being implemented could be seen as playing the same role as increased indirect taxation at the border. As a trade-reliant nation – and with the US as one of its largest trading partners – this will undoubtedly have significant impacts on Australia.

The US is also leading the way on corporate tax cuts, and providing avenues of greater competition for investment flows.
Residential property prices

Consumer confidence

Private final consumption vs. Savings vs. Average annual real wages

Source: Australian Bureau of Statistics

Source: Organization for Economic Co-operation and Development, Federal Reserve Economic Data

Source: Australian Bureau of Statistics, Fitch Solutions
Sectors under pressure

Unsurprisingly, the growing shift to online marketplaces continues to put pressure on physical stores. Together with consumer sentiment and the evolving delivery model, retail and related sectors will continue to face considerable challenges for the foreseeable future.

Construction, property development and related services have been adversely affected by oversupply in the residential apartment market, house price falls and consumer sentiment. This has been partially offset by significant infrastructure investment in Australia’s main capital cities.

Dry powder looking for targets

Australia continues to sit on a substantial amount of liquid reserves from alternative sources of capital. Holders include private equity-backed residential lending platforms and other second and third tier lenders such as superannuation funds and hedge funds. These sources are traditionally more open to different risk profiles and non-standard lending structures (e.g. mezzanine lending) and continue to be favoured in certain markets, especially the inbound residential buyer market.

Regulatory shift

In 2017, Australia adopted new laws that provide a ‘safe harbour’ for directors regarding their personal liability in relation to stressed and distressed corporates. This is as long as they are working with an appropriately qualified professional and meet other prescribed requirements.

Moreover, during 2018 insolvency laws were amended to void ‘ipso facto’ clauses on new contracts entered into from 1 July 2018 in the context of a formal insolvency. Ipso facto clauses provide contract counterparties with the ability to terminate contracts upon the contractor entering into insolvency.

The combination of these amendments is designed to promote restructuring opportunities and enhance value retention for stakeholders, both pre- and post-corporate insolvency.

As these amendments are relatively new, it’s too soon to assess uptake and success, but they are expected to feature as important tools in future financial reorganisation of troubled corporations.

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18, 20, 82.7, 1, 8, 11

18. See page 76 for more details. (Source: The World Bank)
Belgium

Brexit and impact on trade with the UK a key concern
Increase in restructurings due to technological disruption
Highly leveraged historical credits that are now underperforming

“Investment and consumer confidence in Belgium are being affected by the uncertain trading environment.”

Uncertainty erodes confidence

While the main economic indices remain stable, confidence has been affected by uncertainties over political developments and international trade. Particular concerns centre on the difficulties surrounding the formation of new federal and regional governments, and the potential impact of a looming no-deal Brexit given Belgium’s close trading ties with the UK. Furthermore, a slowdown in some of Belgium’s key trading partners (e.g., Germany) is further eroding confidence.

Consumer confidence

Source: Organization for Economic Co-operation and Development, Federal Reserve Economic Data

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Pressure on finances drives increase in restructuring

A combination of these short-term headwinds and longer term challenges in areas such as financing arrangements and changing consumer behaviour have led to a significant increase in the number of companies entering into major restructuring.

A significant part of this centres on sectors facing escalating disruption including retail, construction, transport and logistics. We’re also seeing strains on the highly leveraged financing structures that have been put onto companies in recent years. Many of these companies are not meeting targets, and often need refinancing.

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See page 76 for more details. (Source: The World Bank)
The economy has been slow to recover, with much needed structural reforms (e.g. tax and social security) still in progress. Banks are reluctant to lend as the government gradually reduces its credit line subsidies, with the liquidity gap being filled by the bond market. Despite a slow economic recovery and suppressed levels of investment, there is an upbeat mood in the business world.

**Credit squeeze**

The gradual withdrawal of government-backed credit subsidies has reduced access to funding for many companies. Many banks are in turn moving away from direct lending in favour of advising companies on how to tap into alternative capital markets.

Recent research by CVM (the Brazilian Securities authority) shows a credit reduction that equates to 8% of GDP between 2015 and 2018. Sectors feeling the impact include infrastructure development, which had previously been able to rely on state-backed funding from sources such as the BNDES (the Brazilian National Development Bank).

The extent to which the capital markets are moving in to fill the void left by the banks is reflected in the fact that the funding raised through corporate bonds (debentures) was equal to that through BNDES lines in 2016. Debenture CAGR was 17% between 2014 and 2018, with the agribusiness sector seeing the biggest rise in these kind of securitisations.

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**Government credit line subsidies (BNDES) versus corporate bonds**

Source: The Brazilian Development Bank, Securities and Exchange Commission
Waiting for reform

The slow pace of tax, social security and other structural reforms is holding back investment in fixed assets for now (only around 5% of GDP at present), though this is likely to be reversed once planned liberalisation gets underway in earnest.

On the consumer side, household debt remains high, having been exacerbated by the crisis. Attempts to bring debt levels down are underway, though this could hold back any pick-up in consumer sentiment. Unemployment also remains high, with little immediate sign of a reduction.

The government is looking into the possibility of a partial release of FGTS (the severance indemnity fund) as a way to boost consumption in the short-term. However, there is the risk that these funds end up being used by families to reduce debts, as was seen the last time the government tried this move.

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**Real GDP growth vs. Unemployment as % of Labour Force vs. Fixed capital formation change**

![Graph showing real GDP growth, unemployment, and fixed capital formation over time.]

Source: Brazilian Institute of Geography and Statistics, Rich Solutions
Sectors under pressure

Among sectors facing the most difficulty are heavy construction and infrastructure, retail, agribusiness and real estate.

In addition to the scaling back of government funding, infrastructure development has been affected by the fallout from a series of corruption scandals, which has forced many companies into the judicial recovery process (the equivalent of Chapter 11).

Real estate and construction are suffering from high levels of land and property inventories, which have slowed the launch of new projects.

However, sentiment among new entrants in infrastructure and construction has been buoyed by expected privatisation and new investment plans. Low interest rates are also encouraging capital markets and private investors to provide funding to these sectors.

Sugar and ethanol businesses have been affected by falling sugar prices, reductions in once high government subsidies and competition from subsidised counterparts in other countries. More positive signs include authorisation for the issuance of infrastructure bonds by sugar and ethanol mills.

Agribusinesses have been facing both funding issues and difficulties accessing insurance. However, funding from alternative sources could continue to rise, with investors attracted by higher returns than those linked to the low base rate.

The companies feeling the squeeze also include smaller businesses that are below the usual threshold for capital market funding. The government is looking at ways to open up access to such capital market funding through the issuance of ‘mini-bonds’, mirroring an approach pioneered in Europe.

Positive about the future

Despite the slow recovery and low levels of investment, business confidence is high – in a recent survey, over 75% of executives expressed confidence in macroeconomic trends, were positive about GDP growth prospects and reduced unemployment.

Changes in judicial administration

The superior court recently recognised the legitimacy of the use of the ‘taxa referencial’ (reference rate), which is a Brazilian index that has been historically lower than the base rate, to adjust the debt of companies undergoing judicial recovery if agreed among the parties in the creditors general meeting.

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1-4 See page 76 for more details. (Source: The World Bank)
Subdued economic growth in 2018, reflecting low consumer spending, with knock-on impacts on construction and capital investment. The slowdown is forecast to continue in 2019.

Uncertainty about global trade is affecting investment.

**Downward trend**

The Canadian economy grew by only 1.8% in 2018, compared to 3.0% in 2017. This reflects a slowing of growth in consumer spending, which in turn affects investment in machinery and equipment, as well as construction.

The projections for 2019 are similarly muted (1.6% growth in GDP). On the positive side, growing employment and rising wages can help to sustain consumer spending - this saw an improvement in the first quarter of the year but is expected to settle back to 2018 levels. Concerns about a housing ‘bubble’ have also eased.

However, export growth and business investment have remained subdued in the face of global trade uncertainty and protectionism. Canada's growth potential is highly dependent on foreign economic developments. Although tariffs on Canadian goods exported to the US were lifted in May 2019, the escalating trade conflicts between the US and various countries (notably China) continue to put pressure on the Canadian economy. The impact of the US-China tensions will depend on their duration, any potential trade diversion (e.g. China shipping more to Canada), and the broader influence on market sentiment. Overall, the softness in exports and investment is expected to continue through the rest of 2019.

We are also awaiting the impact of the ‘new NAFTA’ - the US-Mexico-Canada Agreement (USMCA). A tentative deal was reached in late 2018, which from the Canadian perspective was better than having ‘no deal’, but was not as favourable as NAFTA. However, this trade agreement still needs to be ratified by Canada and the US, with the course of events likely to be affected by both upcoming Canadian elections and political divisions within the US.

**Sectors under pressure**

Lenders are continuing to monitor exposures in the retail sector, which has been significantly disrupted by innovation and competition (largely

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**Retail insolvency expected to increase as competition from new business models mounts**

Increasing number of restructuring cases where liquidity from a wider range of sources is providing solutions in the process.

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Canada is experiencing the same mix of short-term uncertainty and longer term disruption facing other markets, though given the country’s proximity to the US, the impact of US-China trade tensions is likely to be mixed.

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**Real GDP growth rate**

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<tr>
<td>2021</td>
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</tr>
</tbody>
</table>

Source: PwC Analysis, International Monetary Fund
from American retailers). It is expected that Canadian bankruptcy filings will continue in the retail sector, driven to some extent by American filings i.e., where the head office based in the US.

The oil and gas sector in western Canada is drawing increasing attention, as local commodity prices continue to lag behind the rest of the world. This is due to the impact of underinvestment in transportation capacity, a slow drawdown of inventories, waning investor confidence, and increased production of cheaper oil by foreign producers. We anticipate further oil and gas filings over the next 1-2 years, especially in the gas sector.

The real estate market in some regions (notably Alberta) continues to be affected by significant vacancies, which resulted after the downturn in the oil sector of the mid-2010s. Options for stakeholders are not helped by limited growth in the region. Similar pressure is being seen in the construction industry in some regions.

With the economy slowing, we anticipate further pressure in several sectors, including automotive, particularly as auto manufacturing moves further south and diminishes the comparative advantage of Canadian manufacturers. We also foresee challenges in other manufacturing sectors.

Limited growth in consumer spending could also be the lag impact of tighter mortgage rules and increased interest rates. From a restructuring perspective, this trend could have a negative impact on the retail, leisure and real estate sectors.

Additionally, as the cannabis sector continues to mature following legalisation in 2018, we anticipate restructuring and M&A opportunities will become apparent.

We’ve observed a small increase in formal corporate restructuring proceedings over the year, though most of these have been isolated cases not linked to systemic issues in a particular sector. The availability of liquidity from a variety of lenders, distressed funds and other alternative lenders has facilitated considerable refinancing of companies encountering challenges.

### Household spending real growth and Unemployment, % of labour force

![Graph showing household spending real growth and unemployment percentage.]

**Sources:** National Statistics, PwC Solutions

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1. See page 76 for more details. (Source: The World Bank)

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Restructuring Trends – A global view | 17
Cayman and British Virgin Islands

Low interest rate environment pushes private investors ‘reach for yield’, which causes increased exposure to risks of mismatch in liquidity, especially when investor confidence is low.

Cov-lite agreements and loose documentation suggest limited protections for the lenders, and could lead to delays in restructuring.

Fund managers tend to seek return for outside capital through a formal liquidation process.

Increasing use of common law jurisdictions to seek recovery in relation to international asset portfolios; new legislation requires stricter assessment of economic substance and centre of main interest of the entities.

Illiquid mismatch

In the decade since the financial crisis, the sustained low interest rate environment has encouraged fund managers to ‘reach for yield’ and take on additional risk, often through increased exposure to illiquid assets.

Such exposure, when coupled with the promise of daily or weekly redemptions, creates a liquidity mismatch which can become a self-fulfilling prophecy if investor confidence is shaken.

The sustained low-interest rate environment continues to put pressure on fund managers.

Average lending rate

<table>
<thead>
<tr>
<th>Year</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>2.0</td>
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<tr>
<td>2015</td>
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<td>2021</td>
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Source: International Monetary Fund, Rich Solutions

Period

Average real lending rate
The consequences can be seen within the hedge fund (e.g. GAM and H20) and private equity (e.g. Abraaj) spheres, with a multi-jurisdictional liquidation (including Cayman) ongoing. Any significant dislocations in the leveraged loan sector – an increasingly important funding source for many private equity-backed acquisitions, with diminishing covenant and documentation protections for lenders – will likely lead to an uptick in offshore fund restructurings, including in Cayman and the British Virgin Islands.

We’re also seeing an increase in the number of active managers looking to return outside capital and convert to family office structures due to the continued rise of passive investing and the pressure of trying to maintain above-benchmark returns in the low-interest rate environment. Recent examples include Eton Park, Highfields and Paulson & Co, where, absent a liquidity crisis, a voluntary, solvent wind down of the fund outside of a formal liquidation process is the mechanism of choice for fund managers to return outside capital. We expect this trend to continue in the near to medium term.

Impact of Indian and Latin American bankruptcies

A recent surge in high-value Indian and Latin American bankruptcies (the former driven by a new Indian insolvency regime and regulatory pressure on banks to deal with NPLs) has raised the question of interaction with offshore funding structures. Where overseas lending structures are facing increased dilution or subordination by onshore processes, there is increasing focus on the use of common law jurisdictions to seek recovery, in particular in relation to international asset portfolios.

Recent regulatory developments

Both Cayman and the British Virgin Islands have recently introduced legislation requiring in-scope entities to demonstrate economic substance in the jurisdiction. Looking ahead, there is some potential linkage between the new substance requirements and the centre of main interests (COMI) criterion used to determine the location of cross-border insolvency proceedings.

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Real GDP growth rate

![Real GDP growth chart](chart.png)

Source: Economics and Statistics Office, Fitch Solutions

Restructuring Trends – A global view | 19
Central and Eastern Europe

Labour-intensive business models at risk, as a result of low productivity and depopulation in the region

Limited NPL activity, with a focus on single corporate tickets and with increasing secondary market

Low interest rate environment with flattening yield curve

"Central and Eastern Europe (CEE) economies have traditionally relied on labour-intensive industries. However, as depopulation and labour shortages mount, the resulting wage pressures call into question many business models in the region.

Growth strong

The CEE region has experienced another strong year, with growth rates significantly higher than in Western Europe. Interest rates continue to fall and liquidity conditions remained loose, which has helped businesses to offset some of the labour market pressures.

Real GDP growth

Sources: Eurostat, Czech Statistical Office, Fitch Solutions
Challenging outlook for retail and construction

As especially labour-intensive, retail and construction are feeling considerable strain. In retail, the impact of labour shortages and resulting wage pressures has been exacerbated by competition brought by discounters from Western Europe.

The construction industry faces comparable labour supply pressures. And we expect similar issues for the automotive supply industry across the region, with owners’ increased readiness to sell sending an early signal.

NPL deal activity

Commercial and retail real estate, consumer, SME and corporate portfolios drove NPL deals to a market peak in 2015 and 2016. Falling NPL ratios and international investors’ shift in focus from CEE to bigger markets like Italy and Spain have reduced investor interest in the region. On the other hand, servicing platforms, established track record and an improving regulatory environment have led to the emergence of single corporate tickets. The size of single tickets has also spurred an increase in liquidity in the secondary market, led by US funds, along with local private equity firms.

Yield curve flattening

Falling NPL ratios have helped banks in the region to increase profitability, with the banking sector returning profits in all markets. However, a flattening yield curve and decreasing interest rate spreads are putting pressure on banks to increase credit activity, especially within the consumer segment. However, central banks continue to enforce stricter regulations, mostly on retail lending, in order to prevent excessive risk-taking.

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Interest rate

Source: Czech National Bank, National Bank of Hungary, National Bank of Poland, National Bank of Romania, European Central Bank
Sectors feeling the squeeze

Traditional retail continues to suffer from mounting online competition, while the introduction of new minimum wage requirements is making manufacturing less competitive. As a result, some global operations have switched or plan to shift to alternative markets such as Vietnam, which has led to an increase in optimised exit situations. Ratings warnings on bonds in the manufacturing sector in the past 12 months have been running at approximately ten per week.

The frequency of ratings warnings in the financial sector is even higher, principally due to lenders themselves feeling the squeeze from the increase in non-performing credits. Whilst the pressure has built, the State is expected to intervene to prevent a failure. Indications of this came when the Chinese government recently stepped in to support a provincial commercial lender by inviting one of the ‘Big Four’ state-owned banks to manage the troubled company to “curb systemic financial risk” and stabilise operations. This is a significant move and the first time we’ve seen such intervention in almost 20 years.

Although it appears likely that depositors will be protected for the most part, financial creditors can expect a haircut on their position in due course. Therefore, whilst the State is stepping in to prevent contagion, they have made it clear that they will not underwrite lenders’ losses.

Slow pace of reform

There have been no changes of note to the restructuring and insolvency regime since the measures introduced in early 2017 to strengthen regulation and increase creditor protection. The Companies (Corporate Rescue) Bill has made little progress, but remains on the agenda.

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**Czech Republic**

<table>
<thead>
<tr>
<th>Measure</th>
<th>Value</th>
</tr>
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<tbody>
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**Hungary**

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1 See page 76 for more details. (Source: The World Bank)
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<th>Ease of doing business ranking¹</th>
<th>Resolving Insolvency DTF²</th>
<th>Resolving Insolvency rank³</th>
<th>Recovery rate (cent on the dollar)⁴</th>
<th>Time (years)⁵</th>
<th>Cost (% of estate)⁶</th>
<th>Strength of Insolvency framework Index (0-16)⁷</th>
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<td>18.0</td>
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China and Hong Kong

Global trade tensions and domestic economy slowdown affecting market sentiment

The political unrest in Hong Kong puts extra pressure on Hong Kong’s economy, the real impact of which is not yet fully assessed at this stage. This will certainly hit the retail, tourism and real estate sectors hard, and more importantly investors’ confidence in Hong Kong’s role as the financial hub in Asia.

Increased labour costs are encouraging some global manufacturers to switch to neighbouring countries, and adding pressure in the manufacturing sector

Squeezed lenders are under pressure to reduce NPL levels

Defaults are increasing, but this has not led to refinancing or bankruptcy, due to lack of restructuring tools, and the intervention of the government.

Another issue that has become more apparent in recent months is the extent to which mainland companies have exercised their ability to offer their cash and equivalent assets as collateral without making full disclosure to investors. This has led to a number of situations in which bond defaults were not anticipated as the publicly-filed information showed ample cash balances to meet coupon payments and capital redemptions.

Tight liquidity and default

Liquidity has become increasingly tight in the last 12 months in China and Hong Kong. The number of mainland bond defaults is also increasing, though the lack of restructuring tools and the forbearance and/or intervention of State and Provincial stakeholders combine to mean that defaults do not necessarily lead to refinancing or bankruptcy.

Issue of mainland companies collateralising their cash and cash equivalent assets without full disclosure, which causes unexpected bond defaults

China and Hong Kong are seeing an increase in defaults, but restructuring options remain limited.

PwC estimate of NPLs in China’s financial sector (stock, US$ bn)

<table>
<thead>
<tr>
<th>Period</th>
<th>Bank NPLs</th>
<th>Bank ‘Special Mention’ loans</th>
<th>AMC distressed debt</th>
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<tr>
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<td>88</td>
<td>213</td>
<td>98</td>
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<tr>
<td>Dec 14</td>
<td>98</td>
<td>126</td>
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<td>Dec 15</td>
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<td>313</td>
<td>190</td>
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<td>Dec 16</td>
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<td></td>
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Source: PwC Analysis
Real GDP growth

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<th>Period</th>
<th>% Change Y-o-Y</th>
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<td>2010</td>
<td>10.6</td>
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<td>2011</td>
<td>9.5</td>
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<td>2012</td>
<td>7.8</td>
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<td>7.3</td>
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<td>2018</td>
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<tr>
<td>2019</td>
<td>6.3</td>
</tr>
<tr>
<td>2020</td>
<td>6.2</td>
</tr>
<tr>
<td>2021-25</td>
<td>5.9</td>
</tr>
</tbody>
</table>

Source: PwC Analysis, International Monetary Fund

Whole economy annual real wages

Source: National Bureau of Statistics China, Fitch Solutions
Sectors feeling the squeeze

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T: +852 2289 1826
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<table>
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<tr>
<th></th>
<th>China</th>
<th>Hong Kong</th>
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<td>36.9</td>
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<td><strong>Cost (% of estate)</strong></td>
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<tr>
<td><strong>Strength of Insolvency framework Index (0-16)</strong></td>
<td>11.5</td>
<td>6</td>
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</tbody>
</table>

*See page 76 for more details. (Source: The World Bank)*
**East Africa**

**Liquidity squeeze for government suppliers due to expenditure tied up in debt servicing for infrastructure projects**

Reduced debt capacity of regional governments has led to a slowdown in larger debt financed infrastructure.

**Liquidity pressures**

Liquidity continues to be a challenge for East African businesses as government expenditure is tied up in servicing and repayments of debt financing for infrastructure projects undertaken in past years. Suppliers to the Kenyan national and county governments are facing delays in receiving payments for services rendered – this is having a knock-on impact on liquidity and causing working capital challenges. The difficulties have been acknowledged in a Kenyan government directive requiring ministries, departments and agencies to settle outstanding payments without audit queries by 30 June 2019.

**Infrastructure investment slows**

Investment in large debt-financed infrastructure projects has slowed down across the East African region, largely due to the reduced debt-carrying capacity of regional governments. Growing concerns about debt servicing, the viability of some infrastructure projects and repayment of existing obligations and the resulting need for fiscal consolidation are likely to drive slower, more measured approach to infrastructure spending. This is demonstrated by the challenges the Kenyan government is facing in securing funding for the second phase of the Standard Gauge Railway, a major Chinese-funded project under China’s Belt and Road Initiative.

**Despite constrained credit and the challenges to the real estate sector, the growth outlook for the region is positive at over 5%**

While growth remains strong overall, fresh constraints on credit are revealing underlying weaknesses in many businesses.

**Weaknesses come to the surface**

An interest rate cap on commercial lending introduced by the Kenyan government in 2016 to improve access to affordable credit has had the opposite effect of constraining liquidity as lenders tighten their procedures and adopt risk-based pricing models. Companies are finding it more difficult to access credit and this is causing some distress, especially among SMEs.

Warren Buffet once commented that when the tide is low, you discover who has been swimming naked. The tightening of credit availability in East Africa would appear to bear out this dictum, with a number of companies that have operated with poor corporate governance practices and structures now exhibiting a high degree of distress and increased failure rates. There have been a number of high profile administrations of such companies, including corporations listed on the Nairobi Securities Exchange.

The credit squeeze is putting considerable pressure on construction, real estate and retail companies. Construction faces the additional impact of oversupply. Retail is in turn feeling the impact from foreign competition and the fallout from overly rapid expansion.

**Positive sentiment**

Despite this, the outlook for business in Kenya and the wider East Africa region continues to be positive. Most economies are set to grow by more than 5%. Infrastructure spending continues (albeit at a slower pace), driving economic activity across the region. In turn, government reforms are making it easier to do business.

In Kenya, the government has identified the ‘Big 4’ drivers of development as manufacturing, food security, affordable housing and affordable healthcare. Regulation and targeted government investment aim to spur private funding and market activity in these areas.
Rescue-based insolvency

Insolvency activity is increasing as lenders (and to some extent debtors) embrace new rescue-based insolvency and restructuring regulations in Kenya, Uganda, Rwanda and Zambia. We’re also seeing an increase in out of court financial restructuring cases. These mainly relate to a number of large distressed private corporations that have multiple fragmented facilities with various lenders in non-syndicated situations. Our experience suggests that the success of such restructuring initiatives depends on the level of coordination. This is more effectively achieved when external financial and legal advisors are retained to assist in building consensus on the restructuring solution, as well as in the implementation.

In Kenya, the Official Receiver has formed a Technical Working Group on the Insolvency Act 2015 and invited suggestions for amendments to the legislation based on the experiences of practitioners. For instance, a recent amendment proposed to the local legislation is a pre-insolvency moratorium for companies seeking a restructure – a measure similar to recent amendments to the UK insolvency regime.

In the long-term, however, we expect legislative changes to continue to promote consensual approaches to insolvency and restructuring in tackling the high level of NPLs across the region.

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Kenya – Real GDP growth

Source: United Nations, Fitch Solutions
France

Growth rate in line with Eurozone average
Attractiveness of doing business in France improving

Key concern is around Brexit with food, fishing, automotive and aerospace industries most at risk
EU Directive on Restructuring and Insolvency adopted in June 2019

"The economy is performing well, but immediate risks such as Brexit and longer term transformation in sectors such as retail and automotive are putting many companies under pressure."

Strong now, but uncertainty ahead

With the economy performing well and the attractiveness of doing business increasing, we’re seeing strong job creation and falling unemployment.

Foreign investment is rising on the back of pro-business policies, including more efficient and predictable labour laws. Key beneficiaries include research and development and digital technologies.

The impact of the ‘Gilets Jaunes’ demonstrations (primarily an anti-tax movement) has been offset by the injection of €10.3 billion of tax breaks and other pro-demand measures at the beginning of 2019.

Among the main geopolitical risks, a no-deal Brexit would hurt the French economy. Food, fishing, automotive and aerospace could be the most severely affected – for example, each year, France sells €33 billion of food to and buys €21 billion of food from the UK.

Real GDP growth rate

<table>
<thead>
<tr>
<th>Year</th>
<th>% change Y-o-Y</th>
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<tbody>
<tr>
<td>2007</td>
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<td>2020</td>
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<tr>
<td>2021-25</td>
<td>1.8</td>
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</table>

Source: PwC Analysis, International Monetary Fund
Impact of disruption

The strengthening economy means that insolvency rates remain low. However, there are disruption and stresses coming up on the horizon.

While shipping and oil and gas are coming to an end of the recent wave of restructuring, retail is feeling the full impact of online-led business models. Many companies are stressed as a result.

Automotive (16% of the French manufacturing base) is probably at the beginning of a restructuring cycle, particularly among the supply chain. Key developments include the move away from diesel and the introduction of increasingly stringent emissions regulations. The total number of cars assembled in France is also expected to fall from 1.9 million in 2017 to 1.7 million in 2020. Potential plant closures as a result of consolidation or falls in demand could worsen the outlook and its impact.

Easing barriers to restructuring

The EU Directive on Restructuring and Insolvency is due to be passed into law through the 'Action Plan for Business Growth and Transformation' within the next two years. Developments that will bring French insolvency regulations in line with international standards include:

- a new preventive restructuring framework grounded in the principle of formation of classes of creditors called on to vote on the restructuring plan
- a cross-class cramdown mechanism
- a simplification of the legal framework of security on property, to make it more secure and predictable in restructuring contexts

By facilitating the efficient adoption of restructuring plans, with full consideration of the rights and interests of the various creditors, the French legal framework may become one of the most attractive in Europe.

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**Business lending rate and Unemployment as a % of Labour Force**

![Graph showing business lending rate and unemployment as a percentage of the labor force.](image)

**Sources:** Banque de France, National Institute of Statistics and Economic Studies, Fitch Solutions

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1 See page 76 for more details. (Source: The World Bank)
Germany

Confidence in the economy at a five-year low

Key automotive export industry suffering from soft global demand, trade tensions and increased regulation

Historically, Germany had been trailing behind in preventative restructuring procedures. New EU framework is expected to make German regime more efficient and attractive for restructuring

No longer immune

Not so long ago, Germany appeared immune from the difficulties building up in other major economies. Now, however, trade tensions and subdued demand are causing serious anxiety among manufacturers. After nine consecutive years of growth, optimism among business leaders sank to its lowest level in five years at the end of the second quarter of 2019; some experts even see Germany drifting towards a recession.

Concern among manufacturers

The US-China trade tensions and prospect of Brexit are particularly troubling for an economy dominated by export-led manufacturing. In addition, new emissions testing under the Worldwide Light Vehicle Harmonised Test Procedure (WLTP) led to a significant fall in German automotive output in late 2018. While the upheaval created by the WLTP is easing, recent weaknesses in global car demand indicate that a swift recovery of production is unlikely – with the biggest structural sector challenges yet to come.

Resilient consumer market

By contrast, domestic demand remains strong. Wages and employment are expected to continue to increase in the near-term at least. The outlook for the construction sector, in trade, and in other services sectors also look fairly positive overall.

Business confidence index

![Graph showing business confidence index from June 2014 to June 2019]

Source: Organisation for Economic Co-operation and Development
Weakness in certain early-cycle industries

Over the last few months, restructuring activity accelerated and a further uptick is likely as we come towards the end of 2019. Sectors such as automotive, retail and consumer goods continue to show signs of weakness, with early-cycle indicators such as mechanical engineering starting to follow closely behind.

In addition to the troubled economic outlook, the impact of longer term disruption is taking hold. Companies are being urged to transform their business models in order to keep pace with changing consumer demands and sustain competitiveness globally. And as we look beyond the next 12 to 18 months, we’re mindful that we’re heading towards the end of the current economic cycle and the outlook could see significant change.

Harmonised restructuring provisions

Germany has lagged behind other countries in its preventive restructuring procedures. The deficiencies have spurred some companies to perform restructurings in the UK to make use of options not available under German law. While Brexit might put an end to this, the competitive environment has already adapted with measures such as the Dutch ‘Scheme of Arrangement’ ready to take up these cases.

With the approval of the EU Directive on Restructuring and Insolvency, a new toolkit providing more flexibility for pre-insolvency restructuring procedures will now also be added to German legislation. While details of implementation, and differentiation from existing local insolvency legislation are still to be specified, this alternative restructuring regime can be expected to prove particularly useful with increasingly complex capital structures and partnerships between more diverse stakeholder groups coming into restructuring.

Real GDP growth, Unemployment as a % of Labour Force, Whole economy average annual wages

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP Growth % y-o-y</th>
<th>Unemployment %</th>
<th>Average Wages</th>
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<tr>
<td>2020</td>
<td>1.1</td>
<td>2.6</td>
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</tr>
</tbody>
</table>

Sources: Bundesbank, Federal Statistics Office Germany, Eurostat, Fitch Solutions

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Restructuring Trends - A global view | 33
Greece

Economy is back on track, with GDP growth expected to rise to 1.8% 2020

Aim to reduce the NPL portfolios by more than €60 billion by 2021, with securitisation and carve-outs expected to be a catalyst for Greek banks

Positive outlook

GDP growth reached 1.9% in 2018, boosted by exports and higher private consumption. PwC’s latest projection is for growth of 1.7% in 2019, rising to 1.8% in 2020 as private investment picks up. The unemployment rate is projected to decline to 18.5% by 2019.

Portfolio funds and individual investors are increasingly interested in the Greek NPL market, especially real estate and hospitality assets. We’re also seeing growing interest in commercial real estate, residential properties, retail and export sector assets.

A combination of the successful completion of the economic adjustment programme in August 2018, the political stability following elections, the upgrades of the credit rating of Greek sovereign debt and the country’s gradual return to international financial markets have bolstered confidence in the economy, restored the sustainability of public finances and created a favourable global investment climate.

Real GDP growth

Source: PwC Analysis, International Monetary Fund

1 PwC Global Economic Outlook – August 2019
2 PwC Global Economy Watch July 2019
Drivers for NPL deals

Greek banks are under pressure to accelerate the reduction of the bad debts left by the country’s eight-year recession. Securitisations and carves-outs are at the forefront of moves to achieve the ambitious targets agreed under the Single Supervisory Mechanism (SSM) for the reduction of their NPL portfolios by more than €60 billion by 2021. Landmark deals such as Grivalia’s merger with Eurobank, along with a number of initiatives now reaching their closing stages, highlight the growing pace and efficiency of resolutions, which is helping to accelerate the unwinding of NPL exposures.

Opportunities within the NPL market have increased the appetite of portfolio funds and individual investors. Transactions include a number executed through the rehabilitation process. Real estate and hospitality assets are the main targets for investors, given the significant growth of tourism in Greece over the last couple of years. There is also growing interest in commercial real estate (especially for offices and logistics/warehouses mainly in Athens and in Thessaloniki), residential properties, retail and export sector assets.

Non-Performing Loans ratio

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<thead>
<tr>
<th>Year</th>
<th>%</th>
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</thead>
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<tr>
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<tr>
<td>2003</td>
<td>0.2</td>
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<tr>
<td>2004</td>
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<tr>
<td>2005</td>
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<td>1.0</td>
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<tr>
<td>2019</td>
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</tbody>
</table>

Source: Bank of Greece

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3-4 See page 76 for more details. (Source: The World Bank)
India

7.4% GDP growth last year, but facing weakening consumption this year

Sectors under pressure and experiencing significant levels of default include retail, construction, infrastructure, steel and power

The introduction of the Insolvency and Bankruptcy Code three years ago ushered in time-limited processes for insolvency resolution

The introduction of the ‘Prudential Framework for Resolution of Stressed Assets’ provides additional measures for banks to deal with their distressed assets, with the help of an intercreditor agreement among the lender banks

India is one of the world’s fastest growing economies. However, with elections over, the immediate challenge is arresting economic slowdown and providing timely resolution for NPLs.

Private final consumption

Source: Central Statistics Organisation, Fitch Solutions
Qualified optimism

With domestic consumption making up more than 60% of India’s GDP, weakening demand is set to curb growth and put pressure on investment. Nonetheless, the Confederation of Indian Industry (CII) remains positive about the county’s economic outlook as long as investment and policy create the right environment.

Surge in M&A activity

The Insolvency and Bankruptcy Code (IBC), which has paved the way for faster resolution and sale of distressed assets, is contributing to a surge in acquisitions (at a five-year high) and private equity activity. The availability of distressed assets across a number of core sectors has spurred the interest of global and domestic investors, and created fierce competition among investors looking to pick up these assets.

In an effort to establish their footprint in the distressed market, private equity and sovereign wealth funds are tying up with asset reconstruction companies (ARCs) and setting up distressed funds.

Corporate failures highlight challenges

While India is still the standout growth story in the global economy, challenges are mounting. Many of these are highlighted by the failures of RCom (difficulties included high levels of debt and failure to keep pace with advances in technology), Jet Airways (difficulties included overly ambitious expansion) and Infrastructure Leasing & Finance Limited (difficulties included high levels of debt and cost escalation).

Sectors under pressure

The non-bank finance sector is facing a severe liquidity crunch in the face of mutual funds reluctance to refinance loan portfolios. This is having a knock-on impact on consumer and real estate lending.

Steel is facing the pincer of slowing demand and low-cost competition, principally from China.

Power is facing a combination of oversupply and rising fuel costs. Many suppliers’ tariffs are currently loss-making.

The long lags between investment and return within road and infrastructure development are being exacerbated by delays in land acquisition and environmental clearance. The performance of and investment in the sector is also being held back by regulatory price caps for airport and road projects.

Real GDP growth

![Real GDP growth chart](chart.png)

Source: PwC analysis
Reshaping resolution

As loopholes and unintended consequences of the IBC are progressively ironed out, the Code is emerging as a robust insolvency process. If there is no resolution within the time limits, the assets of the borrowers may be sold to repay creditors. Benefits include making debtors more wary of default. The IBC also has a built-in process that ensures integrity and transparency in the selection of resolution professionals to manage companies.

Key catalysts for the reshaping of resolution under the IBC include:

Pre-insolvency: Fear of losing control is forcing promoters to look for investors, which makes it a huge investment opportunity.

Pre-admission: Payments to avert insolvency mean that more than four thousand pre-admission cases have been settled.

Post admission: Many cases have been resolved or are heading towards liquidation. More than two thousand corporate debtors had been admitted into the corporate insolvency resolution process by the end of June 2019.

The gross NPL ratio of the banking system had registered a continuous rise from 4.3% in March 2015 to 11.5% in March 2018. This trend has now been reversed during 2018-2019 with the ratio having declined to 9.3% in March 2019.

Progress on 12 significant cases

1. Bhushan Steel
   Successfully completed

2. Electrosteel Steels Ltd.
   Successfully completed

3. Monnet Ispat and Energy
   Successfully completed

4. Alok Industries
   Ongoing

5. Amtek Auto
   Ordered for Liquidation

6. ABG Shipyards
   Under liquidation

7. Bhushan Power & Steel
   – Steel and Power
   Ongoing

8. Essar Steel
   Resolution Plan of Arcelor Mittal for Essar Steel has been approved by the appellate authority. However, the judgement has been stayed by Hon’ble Supreme Court

9. Jyoti Structures
   Resolution Plan approved. In the process of takeover

10. Jaypee Infratech
    Ongoing

11. Lanco Infratech
    Ordered for liquidation

12. Era Infra Engineering
    Ongoing
Recently, the regulator issued key amendments to streamline the insolvency and liquidation process. Proposed measures include priority to secured financial creditors and tighter timelines of 330 days to complete the entire process. There is also increased pressure on the committee of creditors to arrive at a fair and equitable resolution plan.

However, there are certain weaknesses in the IBC that require further consideration. The need for separate entity proceedings doesn’t reflect the interdependencies within the group and their mutual value. The lack of clarity on legislation relating to group insolvencies contributed to the collapse of RCom, Jet Airways and Infrastructure Leasing & Finance Limited. In turn, defaulting promoters can, and often do, use every legal artifice to drag out the resolution procedure. Resolution mechanisms also often overrun despite the time-limit.

**Tackling bank NPLs**

The IBC is having a significant impact on the resolution of bank NPLs. The central bank (RBI) has also just introduced the ‘Prudential Framework for Resolution of Stressed Assets’. This provides banks with time-limited measures for restructuring NPLs, with the help of an inter-creditor agreement among the lender banks.

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**Net FDI inflows**

![Graph showing Net FDI inflows from 2009 to 2017 with % change Y-o-Y values from 2009: (19.7), 2010: (40), 2011: 86.4, 2012: (10.2), 2013: 8.8, 2014: 44.9, 2015: 15.3, 2016: (1.1), 2017: (15.0). Source: Reserve Bank of India, Fitch Solutions.]

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1–7 See page 76 for more details. (Source: The World Bank)
Ireland

Could be severely affected by both Brexit and US-China trade tensions

Close to full employment capacity raises concerns about skill shortages and wage pressures

Possible US and EU reform of how technology companies are taxed could put pressure on Irish tax arrangements

Recent case highlights the effectiveness of examinership filing for Irish parent or an Irish Scheme of arrangement

Ongoing review of the restructuring and insolvency law in Ireland ahead of Brexit

“Economy continues to recover, boosted by exports, higher private consumption and post-election stability.”

Real GDP growth, Unemployment as a % of Labour Force, Whole economy average annual wages growth

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Overheating
The rapid rebound of the Irish economy following the financial crisis is coming under strain. Signs that the economy may be in danger of overheating includes employment reaching towards full capacity, resulting skills shortages and rising labour costs. High housing prices and a housing shortage in the cities at the centre of the economy are exacerbating the pressure on wages and making it harder to attract talent.

Vulnerabilities
While the outcome of Brexit is still unclear, concerns are mounting over the possibility of the UK exiting without a formal deal. Forecasts suggest the strains of a no-deal Brexit on the Irish economy could include no or low growth in 2020, up to 85,000 job losses and a budget deficit of between 0.5% and 1.5%. This could be exacerbated by rising US tariffs, with the International Monetary Fund putting Ireland top of the list of countries that could be worst hit.

Debt concerns
Ireland’s government debt is still more than 100% of Gross National Income. If the US and EU press ahead with changes in the way digital companies are taxed, this could worsen Irish government finances given the amount of tech and digital companies that are resident in the country.

Limited restructuring activity
The domestic restructuring market is relatively quiet at the moment with few restructurings of note. Most sectors are performing well, though talent shortages could create challenges.

Restructuring law review
The statutory body, the Company Law Reform group, is currently carrying out a number of work programmes that might impact restructuring and insolvency legislation:

- Review of Irish Company law provisions in relation to a winding up
- Proposals in relation to the harmonisation or convergence of national Company insolvency laws
- Examine as to whether it’s necessary or desirable to adopt, in Irish Company law, the UNCITRAL Model Law on Cross-Border Insolvency

All of these reviews are timely given the October deadline for Brexit, which could result in the EU Insolvency Regulation no longer applying in the UK, depending on the final terms of the UK’s withdrawal from the EU.

Examinership filing
There have been a number of international restructures that have had impacts on Irish entities, primarily in tax inversion structures where the parent company is an Irish entity. In some circumstances, this had led to an Irish filing, but generally these have been handled through Chapter 11 filings in the US. These cases have primarily impacted the insurance, aircraft leasing and energy sectors.

In some instances, Irish Court protection may be availed of through an examinership filing for the Irish parent or an Irish scheme of arrangement can be used. A recent example of the latter was Ballantyne Re plc, an Irish headquarterd reinsurer that restructured $1.6 billion of bond exposures through an Irish scheme with Chapter 15 recognition in US, where the bonds were listed.

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1 See page 76 for more details. (Source: The World Bank)
Italy

After some tentative growth, the economy is flatlining again

Real estate, construction and automotive industries are especially challenged

Economy stalling

With growth having ground to a halt once again, Italy has still yet to fully shake-off the impact of the financial crisis, while now feeling the strains of the gathering Eurozone slowdown.

Construction is suffering the most, with a number of leading companies recently filing for bankruptcy. Automotive is also showing some early indications of a slowdown that could worsen if we see a further contraction in exports. Real estate is still stagnant apart from the Milan area, which is experiencing growth in prices and new investments.

Non-performing resolution

Following the introduction of strict regulatory rules, Italian banks are fully engaged in managing and rightsizing their NPLs. Levels of bad debts have also been reduced following the introduction of GACS (a State guarantee scheme for senior securities issued as part of NPL securitisation operations).

Real GDP growth

Italian banks are focused on reducing NPLs on their balance sheets, with a 15% CAGR reduction in ‘Unlikely to Pay’ loans (UtPs) from 2015 to 2018

UtPs are expected to remain a key asset class in the deleveraging plans, at least in the next three years. In fact, statistics illustrate how the overall NPL volume in the Italian banking sector has declined to a gross amount of €180 billion, of which €79bn (44%) is classified as UtP. As of December 2018, the net book value of UtPs is around 1.5 times greater than bad debts.

The restructuring market is seeing strong activity as banks move to tackle NPL levels.
The successful management of UtP files (aimed at bringing the portfolio back into performing status) requires strong specific expertise and competencies. Therefore, new specialised players are entering the Italian UtP market (primarily challenger banks). The entrants can either work in place of or collaborate with traditional banks by offering an effective combination of financing capability, restructing skills, flexible IT systems, tailor-made collection strategies and scale economies.

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Gross NPL and bad loans trend

Source: PwC analysis data of Statellino Statistica di Banche di Italia and ABI Monthly Outlook

1 See page 78 for more details. (Source: The World Bank)
Japan

Under the stagnant economic situation, whilst companies are seeking to reinvigorate profit through overseas acquisition, their success rate has been low due to problems with post-merger integration (PMI).

A spate of corporate scandals implies that corporate governance and crisis management are key issues.

Easing monetary policy and flexibility in financial institution lending have contributed to a decline in domestic bankruptcies.

Japanese companies are aggressively expanding overseas amid the stagnant domestic market.

Overseas Japanese M&A completed deals

Real GDP growth

Source: PwC analysis. International Monetary Fund
Sales tax rise
The stagnation in growth seen since the mid-1990s looks set to continue. The long-term challenges of a decline in the working age population have been exacerbated by a number of immediate concerns. These include fears about a slowdown in personal consumption following the upcoming increase in sales taxes.

Looking overseas for growth
With the domestic economy sluggish, an increasing number of companies are looking to cross-border acquisitions to sustain growth. However, the results are often disappointing. According to the PwC M&A Survey, published in June 2019, 36% of the Japanese respondents that have conducted deals in recent years report business performance remained below the business plan developed at the time of the acquisition. Only 12% of the companies acquired recorded performance that exceeded the original business plan.

Common problems include the difficulties of establishing a PMI process for generating appropriate synergies and in introducing a governance structure at overseas subsidiaries. Among the underlying challenges are an insufficient PMI promotion structure, process deficiencies and the absence of a PMI leader.

Although the number of companies engaged in cross-border M&As has been growing, failure to meet the business plan means that the need for turnarounds and operational restructurings of the acquired overseas subsidiaries is becoming increasingly pressing.

Bankruptcies decline
Despite the difficulties within the economy, the number of domestic bankruptcies is falling. The main reasons are the Bank of Japan’s monetary easing policy and flexibility in the attitude of lenders. The Financial Services Agency wants financial institutions to respond flexibly to companies’ requests for a rescheduling of loan repayments.

Inadequate corporate governance
By contrast, an increasing number of companies are facing crises emanating from accounting fraud, recall issues or regulatory non-compliance. For example, the number of listed companies in Japan that announced fraud accounting is increasing year-by-year. They tend to lack sufficient corporate governance and crisis management is now an important management issue. When faced with such a crisis, it’s critical to secure corporate value by promptly resolving the issues and minimising losses.

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1 See page 78 for more details. (Source: The World Bank)
The region’s two largest economies (Saudi Arabia and the United Arab Emirates) are now experiencing deflation.

Business leaders are less optimistic about the short-term economic outlook.

Bahrain, Saudi Arabia and the United Arab Emirates have amended legislation in the last 12 months to provide their jurisdictions with stronger restructuring frameworks.

“With deflationary risks rising, the economic outlook in the Middle East remains challenging.”

Deflationary cycle

Saudi Arabia and the United Arab Emirates (UAE) both dipped into deflation in 2019. A prolonged recovery in the oil price and reduced expectations of US Dollar interest rate hikes (Saudi Arabia and the UAE both peg their currencies to the Dollar) could potentially provide respite, although the impact of deflation on corporate profitability and growth remains a real concern.

Saudi Arabia and United Arab Emirates inflation

Source: International Monetary Fund
Downturn in construction

Construction remains a significant part of regional economies and its slowdown continues to weigh on performance. Largely as a result of considerable oversupply, the rental market was the predominant driver of deflation, showing the largest decline (5.6% overall in April), and represents the largest component of the regional Consumer Price Index (28%).

Looking ahead, business leaders in the Middle East are less optimistic about the short-term economic outlook than their counterparts elsewhere in the world as shown in the last PwC CEO survey.

Evolving restructuring market

The Middle East restructuring market continues to evolve as governments and lawmakers seek to improve the legislative framework. In the last 12 months, we’ve seen new or amended bankruptcy laws implemented in Saudi Arabia, Bahrain and the Dubai International Financial Centre amongst others.

Key features of each of the new laws include procedures designed to help companies to restructure in order to survive, as opposed to a primary focus on bankruptcy as the only course of action for an insolvent company. Whilst take-up of procedures in some regions has been slow, in Saudi Arabia there has been a number of companies seeking to apply the new regulations.

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The Netherlands

The Dutch open economy is still growing, but slowing down as a result of geopolitical issues impacting exports and decreasing consumer confidence.

Inflow of restructuring cases remains relatively high despite current position in the economic conjuncture.

Economy turns

For the sixth consecutive year economic growth is expected in 2019. Although this is a positive event, the expected GDP growth of 1.6% is 0.9ppt down on the previous year (2018 GDP: 2.5%). With growth of 1.5% expected for 2020, the outlook for 2020 is even more sober and indicates declining growth. The main driver for this downward trend is uncertainty in the geopolitical arena: American trade policy, uncertainty concerning Brexit and political developments in EU countries such as Italy.

Other signals that the economy is at a turning point are: (i) the decline in bankruptcies has bottomed-out and shows first signs of increase again; (ii) consumer confidence has plummeted after years of growth; (iii) banks indicate that the watch list of Dutch cases increases; and (iv) the current inverted yield curve.

All taken together, we think that, despite the positive growth, the next crisis is just around the corner.

In particular, retail, healthcare and shipbuilding remain distressed sectors.

Upcoming legislative changes obtain momentum – the Dutch restructuring environment will change significantly, with the Dutch Scheme expected in the first half of 2020.

"The Dutch economy is still growing but the first signs of the next crisis are becoming visible."
Sectors under pressure

Retail
Retail continues to struggle, as illustrated by the insolvency of Intertoys, the largest toy retailer in the Netherlands, and the continuing struggles at Hudson Bay. Decreasing footfall on the high streets continues to pose challenges for traditional retailers, which have failed to find solutions for the changes in consumer behaviour. This is particularly troublesome as international pure online players such as Amazon, Zalando and Alibaba continue to penetrate the market. In addition, retailers continuing to moving away from stores in the city centre to XL stores on the outskirts, further reducing footfall on the high streets. The earlier mentioned decreasing consumer confidence is another indication that this sector will continue to be subject of further restructurings in the year to come.

Healthcare
Overall, the Dutch healthcare industry is facing ongoing challenges: labor shortages, high administrative burden and increasing costs of healthcare. The costs of healthcare are rising due to the emergence of more expensive treatments and an ageing population. The government and insurance companies are seeking to manage these costs, which causes additional pressure on tariffs.

The healthcare industry struggles to adjust to this challenging environment resulting in significant restructuring activity. The recent bankruptcy of the Dutch hospitals “Sintervaat ziekenhuis” and “Ijsselmeerziekenhuis” illustrate the difficulties within this industry.

Shipbuilding
Although 2019 was a good year in terms of revenues, margins have been under severe pressure as only limited orders came to the market and were therefore aggressively priced. Also, some of the larger shipbuilding companies still struggle with orders that were acquired in 2015-2015 at onerous terms. There remains significant over-capacity at shipyards throughout this international market. Combined with (i) lower cash buffers; (ii) difficulty to obtain financing from traditional lending institutions; and (iii) macro-economic developments as described above which will impact the timing of new orders, it is clear that Shipbuilding faces difficult years ahead. Shipbuilding companies will likely try to take capacity out of the market (e.g. through closure or mothballing of yards).
Dutch Scheme is almost there

The dynamics in Dutch restructurings are expected to change significantly with the introduction of the ‘Dutch Scheme’, also called the ‘WHOA’.

Key themes under the WHOA are value preservation, deal certainty and a fair distribution of reorganisation value i.e. in line with the economic entitlement of each stakeholder. It is a hybrid of the UK Scheme of Arrangement and US Chapter 11, enriched by various interesting features.

Currently, effectively two options exist in the Netherlands to restructure a company; a consensual deal where all stakeholders agree or an insolvency. This often leads to specific stakeholders banking on the nuisance value they have (e.g. a minority creditor in a bank syndicate). Under the WHOA this is no longer possible as it possible to give effect to a restructuring plan (or controlled wind-down plan) if one class of creditors votes in favour. Amongst other effects, it allows for debt-for-equity swaps to bind secured creditors and to terminate onerous contracts (such as lease contracts).

At the same time, to give effect to a restructuring, supporting rules are included to stimulate debtor in possession DIP financing, request general or specific creditor protection through a moratorium and, if certain conditions are met, provide creditors with a cash-out option at the value of their return in a liquidation scenario if they don’t wish to participate in the restructuring. The legislator has also included provisions which are similar to the ‘sufficient connection’ used for the UK Scheme and a provision to ensure international recognition. As such, the Dutch restructuring environment will also become more internationally attractive. The bill is currently in parliament and is expected to become effective either at the start of Q1 2020 or at the end of Q2 2020, hopefully sufficiently tested before the next crisis kicks in. The Dutch Scheme gives effect to the EU Directive on Restructuring and Insolvency Framework.

Aside from the WHOA, the legislator recently initiated a track to introduce a bill to improve the protection of employees when a business is sold out of insolvency. Up to a number of years ago TUPE rules did not apply, meaning that a purchaser could decide who it would take on and on which terms.

This was also the case when it concerned a pre-packaged sale via insolvency. Recent case law already made the latter impossible, but the draft bill goes even further and implies that all re-launches following an insolvency, in principle, all staff should transfer at the same employment terms. Staff can only be left behind if there is a need from an economical, or business rationale from the perspective of the purchaser (and not the insolvent seller). On top of that, selection of staff left behind should be based on objective criteria. It is currently uncertain how the draft bill will be amended and what the impact of the new law will be on (prices paid for) re-launches through an insolvency. Therefore, it is unclear if employees will actually be better off. We expect that it will take at least until 2021 before this becomes law.

All in all, it will be an interesting year for Dutch restructuring as the government continues to modernise the outdated insolvency and restructuring regime.

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1st See page 76 for more details. (Source: The World Bank)
New Zealand

Construction sector suffering from squeezed margins, a tight labour market and unfavourable allocation of risk for the contractors

Increase in lender or company-led restructuring situations, and recent entry of non-bank lenders and distressed funds into the market

Limited options to exit highly leveraged distressed dairy assets as it is becoming more difficult for overseas investors to purchase the land

The Reserve Bank’s aim to increase banks’ requirements could raise funding costs for households and certain sectors, SME and agriculture business in particular

Growth slowing
Factors such as global growth uncertainties, resource constraints and changes to banking capital adequacy requirements are all impacting negatively on the economy. Interest rates are already at an all-time low (1.0% Official Cash Rate following a 50bps reduction in August 2019), with prospects of a further decline to stimulate GDP growth.

Increased capital demands squeeze lending
The Reserve Bank of New Zealand (RBNZ) has proposed changes to the minimum amount of capital that banks are required to hold (an increase from 8.5% to 16% for large banks and 15% for smaller banks). This could result in a big leap in costs for homeowners with mortgages and price increases for certain sectors of business lending. These changes could dramatically change the way (and amount of) credit flows into the economy. Agriculture and SME lending may be the most impacted.

Restructurings are increasing, non-bank lenders and distressed funds entering the market.

Real GDP growth and central bank policy rate

Source: Reserve Bank of New Zealand, Fitch Solutions
Sectors under pressure

Construction
The construction sector has seen two high-profile failures and heightened pressure on subcontractors and suppliers. A competitive market has driven low pricing and unfavourable risk allocation for contractors. This combined with rising costs emanating from a stretched labour market has resulted in very tight margins on projects.

Dairy
The dairy sector continues to be over-leveraged. The RBNZ estimates that the sector debt-to-income ratio sits at c.3.36x (making it the second most vulnerable in New Zealand after commercial property), and that 35% of dairy debt is with highly indebted farms. We are observing a sustained upward trend in NPLs. Given the global outlook, there is a risk that this trend accelerates due to heavy reliance on commodity prices. There are limited options for exit on larger exposures, with Overseas Investment Office rules making it difficult for investors from outside New Zealand to purchase farms.

Non-performing Dairy loans

![Graph showing non-performing Dairy loans from 2008 to 2018]

Source: RBNZ BBS

Limited restructuring activity
We continue to see a decline in statutory appointments and an increase in both lender and company-driven restructuring.

More recently, we’ve also started to see the emergence of non-bank lenders and distressed funds within the market. It’s difficult to predict how this will play out in the distressed asset cycle or exit.

Long-awaited legislation to establish the new insolvency practitioners’ regime has been passed. Associated changes include a formal accreditation process for insolvency practitioners.

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1-7 See page 76 for more details. (Source: The World Bank)
Nordic markets

Global pressures weighing on prospects for growth
The region continues to show strong deal flow

Proactive approach is likely to be a key factor in separating the winners from the losers in offshore energy restructuring

“Nordic economies are currently faring well, but headwinds are increasing, opening up opportunities for restructuring ahead.

Challenging outlook
Forecasts for GDP growth for the next two years are between 1-2% for both Denmark, Finland and Norway. However, trade is expected to slow in 2019 due to uncertainties in the global economy from the US-China trade conflict and Brexit. Finland may be especially vulnerable given the economy’s heightened reliance on international trade.

Domestically, these pressures could be exacerbated by increased interest rates, high debt levels in Norway and a less business-friendly environment following elections in Denmark.

Real GDP growth

Source: Statistics Denmark, Eurostat, Statistics Norway, Statistics Sweden, Fitch Solutions
Norway – Central bank policy rate (%)

M&A deals

Source: S&P Capital IQ
Strong deal flow
The region continues to see strong deal flow, with less focus on restructuring. In common with counterparts in other parts of the world, traditional retail is feeling the strain of online competition. Companies are being forced to adapt and innovate.

The property market in Norway is still buoyant, but the interest rate increases over the last year, coupled with high debt-levels and some observed weaknesses in the stock market point to challenges ahead.

In Sweden, there are questions about how the country’s developing high-yield bond market will play out in a downturn, as investment is highly weighted towards real estate. Construction companies are also showing signs of stress as growth in industrial investment slows in Denmark and Finland.

Healthy credit supply
With the recent tightening of regulation in the financial market in Denmark, pressure on bank lending is increasing. However, other sources of funding including international funds and local pension funds have made up for any shortfalls in bank lending, so there is plenty of liquidity in the market.

Restructuring opportunities offshore
Drilling activities in the region improved slightly, but oil majors show a clear preference for newer and more specialised rigs, with shorter contract terms and subdued rates. The scrapping of older rigs continues. Norway and Denmark have seen an uptick in the offshore support market, but oversupply and low rates mean it is still challenging.

This backdrop has provided a number of restructuring opportunities. The key lesson from recent activity is that, assuming there will be no radical market turnaround, proactive behaviour is likely to be a key factor in separating the winners from the losers.

Within the energy market, Fred Olsen Energy entered bankruptcy recently and may serve as a good example of the fate awaiting those with poorly positioned older rigs.

There is still opportunity for those seeking to innovate and invest in their vessels. Several owners have managed to capitalise on new business opportunities in the North Sea offshore wind turbine installation sector. However, the level of activity of that industry is not sufficient to absorb all excess tonnage.

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1-6 See page 76 for more details. (Source: The World Bank)
<table>
<thead>
<tr>
<th>Country</th>
<th>Ease of doing business ranking</th>
<th>Resolving Insolvency DTF</th>
<th>Resolving Insolvency rank</th>
<th>Recovery rate (cent on the dollar)</th>
<th>Time (years)</th>
<th>Cost (% of estate)</th>
<th>Strength of Insolvency framework Index (0-16)</th>
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<td>88.3</td>
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</tbody>
</table>

1-3 See page 76 for more details. (Source: The World Bank)
Russia

Russian economy will remain stretched and domestically-focused in the medium-term, with significant growth potential being held back by US and EU sanctions.

Volatile oil prices and Ruble depreciation have weighed on consumer demand and confidence in the recent years, driving further growth in corporate NPLs and the increase in the role of the State in the economy.

Major State-owned banks remain key players in the corporate restructuring market working out distressed assets which they acquired via debt to equity swaps or as part of the pledge repossessions.

Whilst there have been a few cases in the market, the overall readiness of the corporates to initiate restructuring processes themselves and start dialogue with the banks remain at a relatively low level.

Changes to the insolvency regulations to protect debtors, increase transparency and efficiency of insolvency procedures are being considered.

“GDP had an uptick in 2018 but is slowing down in 2019 with rather cautious outlook and significant restructurings ahead.

Growth stalls

Positive global growth dynamics, higher oil prices, large infrastructure projects and the hosting of the FIFA World Cup helped growth to reach 2.3% in 2018, up from 1.6% in 2017. The outlook for 2019 is more cautious, with growth slowing down to 0.5% year-on-year in the first quarter 2019 (the lowest quarterly growth rate since 2016), though it could rise higher if disruption in international oil shipments lead to a sustained increase in oil prices.

Oil price susceptibility

With Russia being the second largest crude oil exporter and 60% of export revenue coming from oil and gas, price volatility creates considerable challenges. Oil prices fell by 25% between the end of April and early August 2019 after bouncing back by 40% at the start of the year. Oil production capacity has also been affected by the reduction in investment in recent years.

Russian real GDP growth vs crude oil prices

Source: IMF, eia.gov, Fitch Solutions Macro Research (FSMR)
Impact of sanctions

International sanctions continue to weigh on the Russian economy. Among the businesses affected are major corporations such as Gazprom, Rosneft, Rusal and the VTB Group.

Access to the international capital markets is restricted, which limits corporations’ ability to refinance debt and attract new funding. Inbound investments are at historically low levels. In this environment, large corporations are reducing investment programmes, with a knock-on impact on construction and support services.

The difficulties are tempered by informal government guarantees and financial support for State-owned and quasi-private businesses on the sanctions list.

Rouble depreciation

Volatile oil prices, rising geopolitical tensions and turbulence in other emerging markets resulted in the Rouble’s depreciation in 2018. This had a major impact on import-oriented segments, consumer demand, Eurobond issuers and borrowers with foreign currency exposure.

Weakened banking sector

The Russian banking sector is dominated by State-owned banks (more than 65% of total assets) and remains weak, with relatively low capital adequacy ratios (12.1% as of May 2019) and rising NPLs (officially 10.3%). The real NPL ratio could be close to 25% as banks tend not to report the real picture because of loopholes in the reporting requirements and concerns over capital levels.

Oil and gas, servicing companies, construction, real estate, retail, airlines, mining, shipping and financial services have significant default and NPLs. They are therefore at a high risk of financial stress and possible insolvency proceedings.

Changes to insolvency regulations

The government is considering changes to the insolvency law through the introduction of new debt restructuring optionality and a mechanism to protect debtors experiencing temporary difficulties, stimulate business turnaround activity and increase efficiency of the insolvency procedures and creditors recoveries.

Sectors under pressure

The following sectors of the Russian economy have generally higher defaults and NPL statistics and bear higher risk of financial distress and possible insolvencies:

Independent oilfield services and refinery companies

The extension of OPEC oil supply limits to March 2020 have led to a cut in investment by large vertically-integrated oil companies. Further pressure is coming from high competition and informal State control of the selected oil refinery products prices on the local market.

Construction and real estate

Falling investment in the sector, generally low profitability and introduction of the new stricter regulations on the financing of residential property construction have led to a significant increase in costs and may force some SME developers to restructure or exit the market.
Non-food retail
Overall consumer demand and buying power have dropped as a result of rising household debt and redistribution of the wealth from households to the State through recent changes in pension age and the increase in VAT from 16% to 20% in 2019.

Airlines
Russian airlines are seeking government support following losses driven by the spike in jet fuel prices in the fourth quarter of 2018 and limited scope to increase prices without driving down customer demand.

Coal mining
Mining companies are impacted by three-year low coal prices in the global markets, increased competition following a drop in China’s coal demand and additional supply from the US, as well as the moves to green energy sources in the EU.

Financial services
Smaller banks are struggling to compete on margins with large State-owned banking groups. Micro-financing and payday loans companies are experiencing increased default rates. Insurers are also facing high loss ratios.

Automotive manufacturers and dealers
Despite healthy growth in 2018, turbulence in the economy is expected to reduce consumer demand and raise prices. A combination of lower sales, increased competition and reduced availability of State support is likely to force some mid-size manufacturers to restructure or exit the market, which will have further impacts on suppliers and dealers.

Regional government-owned businesses
Regional governments have accumulated major portfolios of business assets in utilities, transportation, energy, construction and other sectors which are often struggling from poor corporate governance, lack of management accountability and controls, inefficient working capital management and overall financial losses. The businesses are usually socially important for the region and require public subsidies to stay afloat.

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1-2 See page 76 for more details. (Source: The World Bank)
Singapore

Growth held back by international trade tensions

As a small and highly open economy, Singapore has inevitably been affected by the continued trade tensions between the US and China.

Offshore sector sees no sign of recovery back to the pre-downturn levels as overcapacity continues under the shadow of uncertainty in global trade

Restructuring solutions show signs of seeking higher write-downs from investors, and going beyond the usual Consent Solicitation Exercise. This poses an increased challenge to retail investors.

Business confidence wanes

The impact of trade tensions has stifled prospects of growth and increased downside risks for the Singapore economy. Businesses are concerned that a slowdown, and even a possible recession, are on their way.

Domestically, the growth momentum in key sectors such as construction and services has also dipped. Businesses and consumers are treading cautiously.

In June 2019, the Monetary Authority of Singapore (MAS) reduced the growth forecast for the year, and further revisions may be likely if the anticipated pick-up in the second half of the year does not materialise.

Offshore sector doubts

Whilst crude oil prices may have recovered from the historical lows of 2015/2016, the offshore sector has continued to face challenges, with no industry-wide recovery in sight.

Overcapacity in the sector remains. Given the intense competition and the uncertainty about the direction of global oil prices, as well as concerns about the global economy, it is unlikely that demand and charter rates will return to the pre-downturn levels in the foreseeable future.

A number of offshore companies continue to face liquidity pressure, which increases the need to undertake a restructuring to achieve the required deleveraging and rightsizing of balance sheets.

Real GDP growth

Source: Statistics Singapore secured data from: Fitch Solutions
Retail investors at risk

In the last decade, many companies, especially those in the offshore sector, have relied on capital raising from retail investors through the issuance of instruments such as perpetual securities and preference shares.

In most of the past restructurings for such companies, the issuers and their financial advisors have undertaken a Consent Solicitation Exercise (CSE) for the indebtedness under these retail instruments. The CSE typically involves the amendment of terms of the underlying instruments and/or waivers of the existing breaches or defaults. Critically, these do not involve any significant changes or resolution to the outstanding claims which do not achieve the objective of deleveraging for these companies.

The treatment of retail investors has been brought into sharp focus by the restructuring of Hyflux Ltd. Instead of merely undertaking a CSE, the prospective ‘white knight’ looking to inject funds to stave off liquidation sought to down grade the calls on the company’s finances from these retail investors. This triggered some of these retail investors to take on an activist stance, resisting attempts by the incoming white knight to compromise their claims. It is likely that this will set a precedent and pose challenges in future restructuring exercises involving instruments subscribed by retail investors.

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1-2 See page 76 for more details. (Source: The World Bank)
South Africa

The economy continues to face significant challenges, with GDP per capita lower than 2010. The government has provided large State-owned companies with significant levels of debt guarantees, which has strained government finances.

2019 has been particularly challenging for the construction industry, with a number of high profile failures due to overcapacity, reduced demand, fixed contracts and the weak Rand.

"As the economy stalls, future confidence and growth hinges on the successful turnaround of the largest State-owned enterprises."

Consumer confidence remains negative in the face of high unemployment levels and inflation.

Spending rises fail to boost growth

After a decade in the economic doldrums, typified by alleged ‘state capture’ and political uncertainty, rising public spending has not been able to boost growth in the economy. GDP per capita is lower than 2010, inflation remains relatively high and the ratio of debt-to-GDP has more than doubled since 2008.

Unsurprisingly, consumer confidence has remained stubbornly negative, reflecting the prevailing high unemployment and inflation rates. Amidst a series of corporate failures and scandals, not only has confidence suffered, but many consumers, private pensions and investments have been caught up in the impact of a myriad of investigations around accounting irregularities, most notably Steinhoff, the contagion of which was felt internationally too.

All told, 2019 has been a tougher year than even 2018, albeit increased political stability is laying the foundations for a (slow) recovery in 2020.

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All told, 2019 has been a tougher year than even 2018, albeit increased political stability is laying the foundations for a (slow) recovery in 2020.
Troubled State-owned enterprises

Ratings agencies see the biggest risk to the economy as the challenges faced by State-owned enterprises (SOEs), which are pivotal to the performance of the economy as a whole. They include companies such as South African Airways, Transnet and most importantly Eskom, which provides 95% of South Africa’s electricity. Key industries such as mining, already under pressure from the weak Rand and volatile commodity prices, have had to contend with regular blackouts that harm productivity and, worse still, yearly above-inflation rises in power costs.

The government has propped up SOEs by providing debt guarantees – if these are included, debt-to-GDP could increase from 56% in 2018 to over 70%, putting the government finances under even more severe strain.

Business models under threat

The past few years have seen increased scrutiny in the retail and property sectors, with a number of businesses showing signs of ongoing and significant distress, most notably Edcon.

Against the backdrop of economic stagnation, shifts in consumer behaviour have forced many companies to adapt or restructure. Worse still, their landlords (property funds and REITs) have had to pass on double-digit inflation and the high cost of debt to these already beleaguered retailers. The property sector, particularly in office rental and industrial sectors, continues to suffer from both increased vacancy levels (of up to 13% in office rentals) and lower rentals.

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Construction woes

In the years since the construction boom fuelled by the 2010 FIFA World Cup, the construction industry has been buffeted by a ‘perfect storm’ of factors.

Demand has slumped in the wake of reduced government spending on infrastructure and weak private sector investment. At the same time, the weak Rand has pushed up input costs, while the use of fixed rate contracts have increased the risk of underperformance. Projects have run over-budget, putting pressure on already thin margins and creating significant liquidity pressures. This has led to high profile distressed cases such as Group Five, Aveng and Basil Read. That said, the reduction in overcapacity may allow a faster recovery of this sector once demand comes back.

Ease of doing business ranking
82

Resolving Insolvency DTF
54.49

Resolving Insolvency rank
66

Recovery rate (cent on the dollar)
34.5

Time (years)
2

Cost (% of estate)
18

Strength of Insolvency framework Index (0-16)
11.5

¹–² See page 76 for more details. (Source: The World Bank)
Ongoing international trade tensions are affecting the South Korean economy

Lower growth of 2.3% expected in 2019 and interest rates reduced in July

South Korean restructurings are becoming increasingly private-led and less government/bank-led

The restructuring market is moving to an approach in which public and private sectors share the risk and return.
Growing uncertainty

South Korea is not only affected by US-China trade tensions, but also the tightening of Japan’s export regulations. As a result, growth is expected to hover around the 2.3% level in 2019. Fiscal and budgetary policies and additional interest rate reductions are expected to follow.

Sectors under pressure

The semiconductor and display industries, which lead the domestic economy, are threatened by the economic dip.

Samsung Electronics is expected to face an immediate decline in sales and profit, and the profitability of the companies in Samsung’s value chain may also deteriorate. Unlike the automotive industry, however, profitability of semiconductor and display related companies remains solid, preventing any major problems for the time being.

With the acquisition of Daewoo Shipbuilding & Marine Engineering from Hyundai Heavy Industries, South Korea’s shipbuilding industry will be consolidated from a Big 3 to Big 2, and SME shipbuilders are expected to accelerate restructuring. The restructuring of SME shipbuilders will be driven by the consolidation of overlapping businesses.

Shift in restructuring

Restructuring in South Korea is moving toward a private sector-led approach that utilises a structural adjustment fund in government- and bank-led restructuring. However, instead of a private fund (PEF) or investment bank (IB), there are moves towards a restructuring system in which the government and the private sector share risk and return (in the form of joint contribution from government and private investors).

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1-3 See page 76 for more details. (Source: The World Bank)
Spain

Spain facing a slump in exports and recent slowdown in production levels

Automotive sector faces heavy compliance burden, which is causing bottlenecks in production

Accounting laws set to tighten provisioning of NPLs, limiting the access to new funding

Retail sector going through transformation to a more global, online/offline integrated platform

Tourism sector sees pricing competition from other neighbouring countries, and also suffering from the uncertainty over Brexit

Growth prospects remain strong for now, but a series of challenges are lining up, which could spur further restructuring ahead.

Real GDP growth

![Graph showing Real GDP growth from 2007 to 2021.](source: PwC Analysis, International Monetary Fund)

NPL deals (EUR m)

![Graph showing NPL deals from 2015 to 2019.](source: Debtwire)
Pressures build

Corporates are positive about the outlook over the next five years. PwC estimates real economic growth at 2.3% for 2019 and 2% for 2020. However, political uncertainty, trade tensions, protectionism and tighter regulation are putting short-term pressure on business in Spain.

Tensions in international markets have slowed production and exports. Output within the automotive sector has also been affected by new regulations, creating extra work for staff to comply and leading to bottlenecks in production plants.

After the upward trend of recent years, tourism is facing a tough summer season. This derives from the aggressive prices set by Mediterranean and North Africa competitors. Together with a smaller number of British visitors caused by Brexit, this is forcing companies to offer discounts in order to stay competitive.

With the rise in e-commerce affecting traditional retailers and challenges in the commodities and shipping industries, Spain is also facing similar sector specific challenges as seen globally.

Tighter provisioning squeezes new funding

New accounting rules have tightened bad debt provisioning policies, forcing banks to recognise NPLs earlier. This is limiting access to new funding and making it difficult for companies to refinance from a position of stress. The government is also considering a tax increase on banks and investment funds.

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Ease of doing business ranking¹

30

Resolving Insolvency DTF²

79.1

Resolving Insolvency rank²

19

Recovery rate (cent on the dollar)³

77.3

Time (years)³

1.5

Cost (% of estate)⁷

11

Strength of Insolvency framework Index (0-16)⁷

12

¹-⁷ See page 76 for more details. (Source: The World Bank)
Turkey

Leverage levels in Turkish corporates have been increasing over time, driven largely by foreign investment.

Investors are reluctant to sign debt restructuring deals due to high foreign exchange and interest rate volatility – current deals are generally ‘amend and extends’

New legislation aims to make Turkey more attractive from a restructuring perspective and now includes key processes such as a standstill mechanism and a cramdown rule.

“Economic conditions continue to be exceptionally challenging. The rise in financial distress needs to be carefully managed and resolved.”

Tough times

Businesses and financial institutions face considerable challenges in managing their foreign currency exposures and liquidity positions.

Since the early 2000’s, external capital and financing have been important catalysts for economic growth in Turkey. Therefore, Turkish corporates’ leverage has increased over time, particularly in foreign currency – which has resulted in financial distress. At the same time, in order to sustain economic growth, banks need to find ways to step up lending in the face of the sharp decrease in credit demand since the second half of 2018.

Growing debt stock

As an emerging market, Turkish financial markets are materially affected both by domestic economic conditions and global macroeconomic developments. Since 2012, the foreign debt stock of both public and private sectors substantially increased whereby on average 71% of the foreign debt is undertaken by the private sector.

Public and Private Sectors Foreign Debt Development (billion USD)

Source: Central Bank of Turkey
NPL rise

Turkey’s NPL ratio increased by 29% in 2019 due to conversion of loans in Stage 2 to Stage 3. Despite this, the current NPL level of 4.2% is still low, essentially as a result of regular NPL sales, indicating relatively good asset quality of remaining loans.

Loans under the watchlist ratio increased to 11.7% in the first quarter of 2019, up from 5.7% in 2017, largely due to the impact of IFRS 9 adoption.

As a result of high interest rates and foreign exchange volatility (26% depreciation in the Turkish Lira against the US Dollar in the 12 months), lenders are reluctant to sign the debt restructuring deals that would provide a stable platform for distressed borrowers to dispose assets for deleveraging with maximum equity value. Debt restructurings have been based on a contractual and consensual basis only between the lenders and the borrowers without any regulatory intervention and mostly aimed to amend the existing loan agreements and extend the maturities of such loans.

FX Rates and Benchmark Bond

Source: Bloomberg

NPL Growth

Source: References: Banking Regulation and Supervision Agency, The Banks Association of Turkey
Restructuring reform

Among the government-led steps being taken to encourage orderly restructuring, the Banking Regulation and Supervision Authority (BRSA) published legislation for financial restructurings. The Turkish Banking Association has prepared a General Framework Agreement under this legislation that would be signed by all interested parties (local and international lenders having exposures in Turkish corporates).

Market participants believe that several legal amendments have been needed to pave the way for debt restructurings. Key aspects of the resulting legislation include:

- **Commercial Debts**: Only borrowers with a total debt amount of over TL 100 million are accepted in the new restructuring scheme. Financial institutions are not eligible to be a borrower under the new restructuring regulation.
- **Standstill Mechanism**: Lenders will not be able to take any legal action for repayment of loans if the borrowers restructuring application is approved by the lender group.
- **Cramdown Rule**: If restructuring of a borrower is approved by lenders accounting for at least two-thirds of the borrowers’ outstanding debts, the rest of the lenders who have signed the Framework Agreement would be forced to restructure the debts of the borrower.
- **Independent Business Review**: Independent parties must assess the borrower’s financial situation and projections to give opinion on the viability of the restructuring plan.
- **New Loans**: Borrowers can be extended new loans only with approval of its lenders constituting 90% of the loans being restructured.
- **Waiver/Write-off**: Waiver from or haircut of borrower’s loans is allowed with 100% approval of the lenders.
- **Debt for equity**: The lenders are allowed to take over the shares of a borrower in exchange for its debts.
- **Period**: Restructuring transaction must be closed in a maximum of 150 days.
- **Foreign Creditors**: Foreign financial institutions are able to involve in the process upon request and without any further approval of other lenders.

The new law also introduces a new type of measure for debt restructurings, which transfers the loans to special purpose vehicles or investment funds. Some distressed energy and real estate loans are planned to be restructured under this measure.

While the market participants expect the restructuring processes to speed up with the introduction of the new law, there are still question marks. What will be the legal consequences on the lenders who do not participate in the restructuring deals even if they signed the framework agreement? Is the embezzlement risk of executives of Turkish lenders writing off receivables and other similar transactions lifted with the new law?

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1-2 See page 76 for more details. (Source: The World Bank)
Economy is still performing well despite macroeconomic challenges. Historically low interest rates and 2017 tax cuts continue to have a positive impact.

**Positive outlook for now**

July 2019 marked the 122nd month of the current economic expansionary cycle in the US, the longest since the Great Depression, and yet the slowest pace of growth during that time.

There is no shortage of potential catalysts for a potential reversal including US-China trade tensions, instability in the Middle East, commodity price volatility – the list goes on. Yet these disruptive global forces have not yet had broad impacts on the US economy. Instead, the US economy continues to respond to historically low interest rates and the 2017 tax cuts with steady quarterly growth, low unemployment and a stable inflation rate.

**Real GDP growth**

![Real GDP growth graph]

Source: PwC Analysis, International Monetary Fund

"Growth remains strong. Yet, as the current cycle ages, market participants are naturally looking for signs that we may be approaching the next recession."
Cov-lite ramifications

In addition to searching for potential causes, it’s important to consider what may be different about the next recession compared to previous cycles. Notably, leveraged credit markets have experienced significant growth over the past ten years, driven in large part by the emergence of non-bank direct lending firms. The magnitude of capital chasing deals in this sector has created a borrower-friendly environment, which has led to fewer financial covenants and lender protections. In fact, the notional amount of covenant light (cov-lite) loans outstanding increased tenfold from 2007 to 2018. In contrast to the public bond market, loans in this market are less standardised and aren’t subject to the same level of broader market scrutiny. As a result, there’s more subjectivity and less transparency into financial adjustments and add backs that borrowers are permitted to make in their financial reporting to lenders.

Cov Lite as a percent of total leveraged loans

Unemployment rate


Source: S&P LCD

*as of October 2018
What implications do these changes have on restructurings in the next credit cycle? We expect that fewer maintenance covenants in the loan market will combine with reduced transparency into the financial condition of borrowers to result in companies restructuring later in the stages of distress. When restructurings are delayed, companies typically have fewer strategic options and less financial flexibility in delivering a successful turnaround plan, which usually results in lower recoveries for investors and other stakeholders.

Sectors at risk

When the economy does slow, we expect sectors that are already navigating challenges from technological disruption, competition and commodity price volatility will experience the most restructuring activity. Retail, healthcare, automotive suppliers and oil and gas are the sectors at the top of our watchlist.

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1-2 See page 76 for more details. (Source: The World Bank)
West Africa (Ghana)

Ghana’s economy is performing well with 7.6% GDP expected in 2019

Ongoing bank reforms are causing challenges, with companies and savers facing difficulties accessing funds following the closure of a number of lending institutions

Prospects for growth are encouraging. However, bank reforms aimed at strengthening long-term resilience in the sector have caused short-term problems for savers.

Sustaining strong growth

Ghana is the second-fastest growing African economy, trailing only Ethiopia, with significant contributions from oil, gold and cocoa. In 2018, Ghana’s economy continued to expand rapidly, albeit at a slower pace than 2017.

In the medium-term (2019-2022), GDP is projected to grow on average at 7.0%, buoyed by both oil and government-led boosts to agriculture and manufacturing. Inflation is expected to remain in the target range of 6-10% in 2019, while the fiscal deficit is expected to be marginally higher at 4.2% of GDP.

FS clean-up

Unchecked growth in banks, savings and loans and micro-finance institutions has contributed to overcapacity and underperformance. Instability in the sector had also been fuelled by a combination of funding pressures, poor governance, bad debts and difficulties meeting regulatory capital requirements.

In 2017, the Bank of Ghana embarked on a major programme of stabilisation and reform. This has included revoking the licences of nine commercial banks and 386 microfinance/micro-credit institutions.

While these measures aim to strengthen resilience in the long-term, the short-term impact has been the difficulties faced by companies and private savers in gaining access to funds held in institutions that have been forced to close. Difficulties in gaining access to bank funds have also prevented some fund managers from meeting payment obligations. Further impacts include job losses among financial services staff.

Real GDP growth

Source: World Bank national accounts data, and OECD National Accounts data files
Despite the challenges facing the financial sector, companies are positive about their prospects over the next five years. They believe that the economy will be more resilient and the policy reforms being undertaken by the government in other areas can make doing business in Ghana easier. The Bank of Ghana has put in place the following measures to boost economic performance and resilience:

- Comprehensive review of licensing and supervisory policies and directives
- Reviewing the minimum capital requirements for microfinance companies and encouraging possible consolidation through voluntary mergers and acquisitions
- Introducing proportional corporate governance, fit and proper, and risk management directives
- Strict supervision of licensed institutions and enforcement of relevant regulatory requirements
- Increase in resources available for effective supervision of licensed microfinance companies

Moreover, businesses believe that the stability of the Ghana Cedi will also go a long way to make the cost of production lower since Ghana currently relies heavily on imports.

Changes in restructuring and insolvency

The government introduced an updated Companies Act in May 2019. Key measures include a new Registrar of Companies, which will be responsible for the appointment of inspectors and will assume the functions of the Official Liquidator under the Bodies Corporate (Official Liquidations) Act 1963.

The Corporate Insolvency Bill 2019 is also in the pipeline. Key aims include:

- Efficient closure and transfer of assets of businesses which are no longer viable
- Proper winding up of businesses where the members decide to cease
- A strengthened framework for the regulation of insolvency practitioners to facilitate access to timely, efficient and impartial insolvency proceedings. This will reduce the burden of insolvency through potentially higher and equitable distribution of assets of failed companies to creditors and provide the framework for effective creditor participation in insolvency proceedings either directly or through the creditor’s committees

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1-2 See page 76 for more details. (Source: The World Bank)
## World Bank indices

1. **Ease of doing business** — ranks economies from 1 to 190, with first place having the most business-friendly regulations. A high ranking (a low numerical rank) means that the regulatory environment is conducive to business operation.

2 & 3. **Resolving insolvency DTF & Resolving insolvency rank** — the data for the resolving insolvency indicators are derived from questionnaire responses by local insolvency practitioners and verified through a study of laws and regulations as well as public information on insolvency systems. The ranking of economies on the ease of resolving insolvency is determined by sorting their distance to frontier scores for resolving insolvency.

4. **Recovery rate (cent on the dollar)** — is recorded as cents on the dollar recovered by secured creditors through judicial reorganization, liquidation or debt enforcement (foreclosure or receivership) proceedings. The calculation takes into account the outcome: whether the business emerges from the proceedings as a going concern or the assets are sold piecemeal.

5. **Time (years)** — is the number of years from the filing for insolvency in court until the resolution of distressed assets.

6. **Cost (% of estate)** — the cost of the proceedings, recorded as a percentage of the value of the debtor's estate, is calculated on the basis of questionnaire responses and includes court fees and government levies, fees of insolvency administrators, auctioneers, assessors and lawyers, and all other fees and costs.

7. **Strength of insolvency framework Index (0-16)** — the index ranges from 0 to 16, with higher values indicating insolvency legislation that is better designed for rehabilitating viable firms and liquidating nonviable ones.

Source: The World Bank