CERTAIN MOVES IN AN UNCERTAIN WORLD

Insights from the AlixPartners 18th Annual Turnaround and Transformation Survey

July 2023

Contents

As companies try to navigate choppy and unpredictable economic waters...

THE NUMBER ONE CHALLENGE THEY FACE IS THE COST AND AVAILABILITY OF CAPITAL.

The experts who work with troubled companies have told us that financing — which was fifth on the list of challenges for these companies last year — has risen to the top, as inflationary spikes, monetary tightening, and higher interest rates drive a crunch on capital that severely threatens recovery and growth efforts. Bankruptcies in the U.S. are at their highest level since the global financial crisis and events witnessed already this year in financial services have done little to steady swaying ships.

In our 18th Annual Turnaround and Transformation Survey, more than 700 executives continue to wrestle with another big problem — the persistent lack of clarity. Their immediate outlook for their markets presented split opinions. One in five said their region is already in a recession, 30% expect one imminently, while 20% say it will come within 12 months. A quarter believe they will avoid recession altogether.

HOW SHOULD BUSINESSES RESPOND?

Such unpredictability does, however, present opportunities to stabilize operational fundamentals.

What will transform today's organizations into tomorrow's frontrunners will be the ability to make agile decisions and take value-creating actions now in this volatile environment.

To further strengthen financial muscles, leaders should orient their businesses toward a set of characteristics best suited for continued ambiguity and undoubtedly tightening financial constraints:

FOCUS ON CASH

Viable, sustainable financing options will need to address all short-, mid-, and longer-term considerations. Bottoming out any new money need – to repay debt, close acquisitions, or fund operational requirements – should be underpinned by cash flow analysis of operations under various risk scenarios.

UNDERSTAND SCENARIOS AND THEIR RELATED RISKS

The complexity and criticality of financing have, in less turbulent years, perhaps been underestimated. Best-case scenarios must always be balanced with a worst-case one to help business leaders act fast if they need to manage the associated complications.

DRIVE PROACTIVITY AND AGILITY ON COST

Input costs must remain under the microscope as market dynamics for raw materials and other business-critical products and services continue to fluctuate. The darkness created by a less detailed understanding in this area is dangerous, so management teams must map their supply chain risks and underlying cost structures of their vendors and proactively track commodity rates – some will decrease at some point, and this must be acted upon quickly.

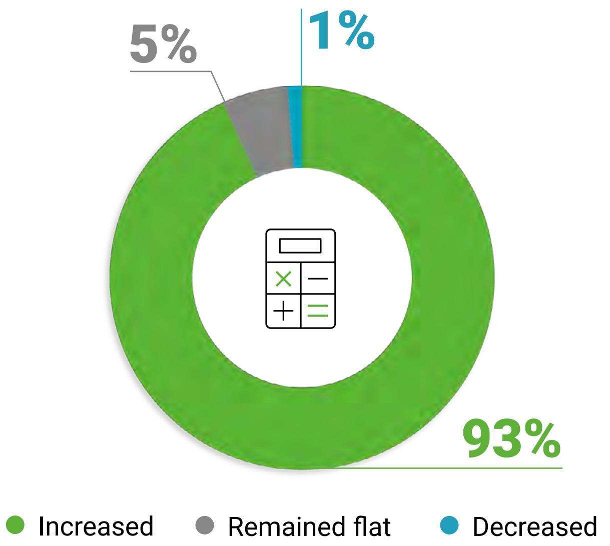
CHART A PATH FOR TRANSFORMATIVE CHANGE

Overcoming short-term challenges won't diminish the need to act on the numerous requirements for a successful long-term future, such as substantial investment in the climate transition or reimagining organizational structures in response to profound technological acceleration. Defensive strategies to protect margin and cash flow will, of course, be vital in mitigating the economic threats of inflation, interest rates, and funding availability. However, a vision of a long-term upward trajectory will remain just that, without taking steps towards that goal now.

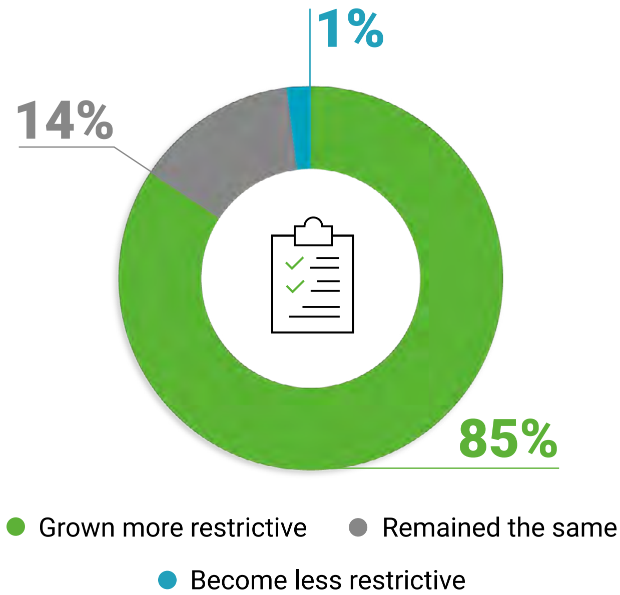
We hope that you find our report insightful and thought-provoking. In addition to our survey findings, on the following pages members of our global team have provided their personal market views and – critically – how business leaders can tackle the many challenges ahead of them.

HEADLINE FINDINGS FROM OUR 2023 SURVEY

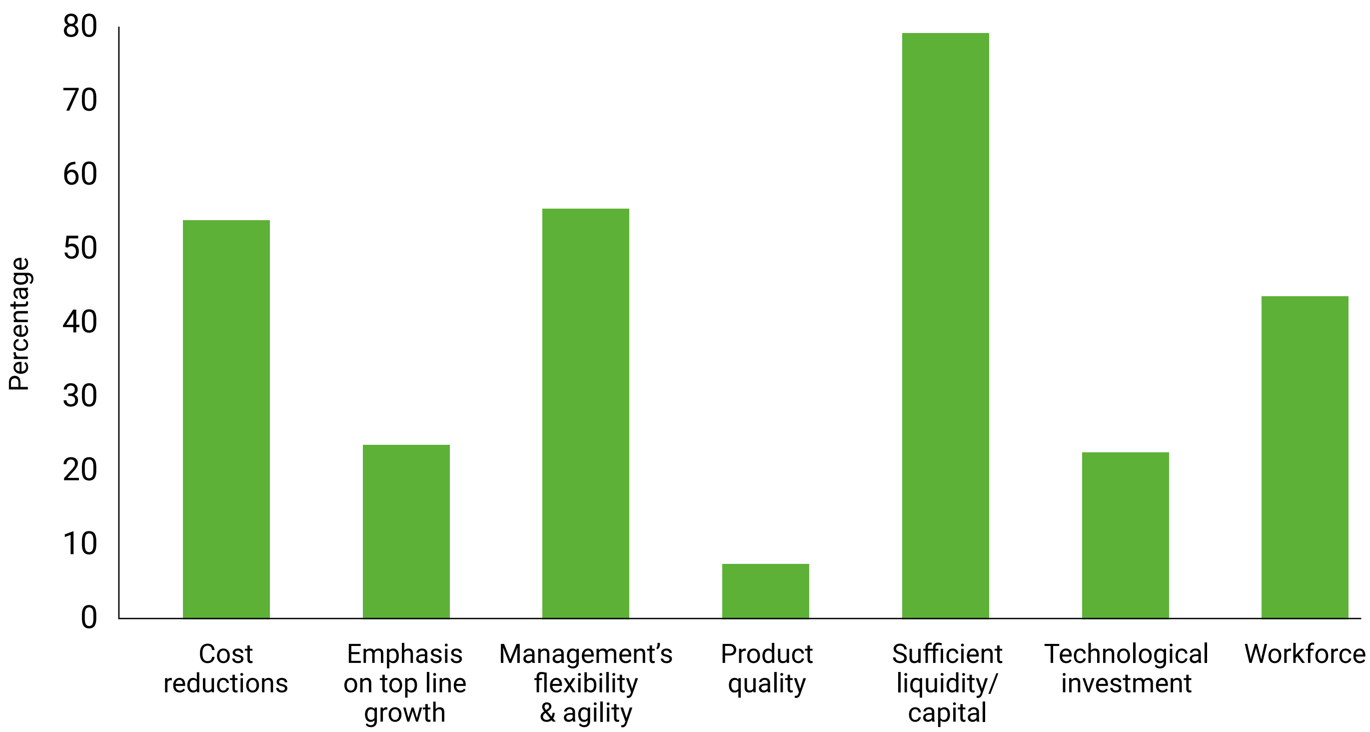
THE COST OF CAPITAL IN RELATION TO THE PREVIOUS YEAR HAS:



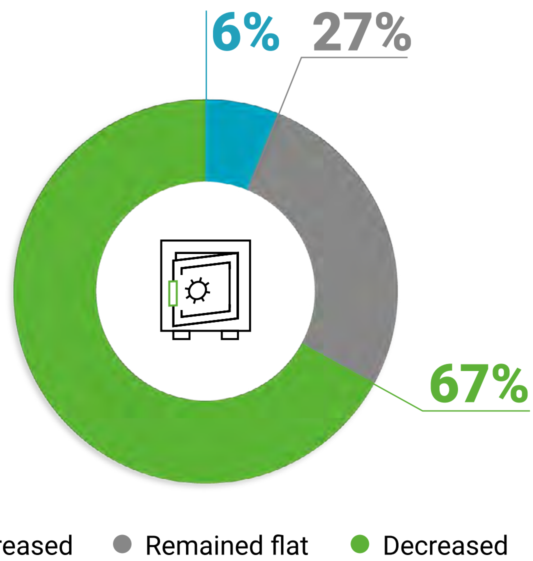
IN THE PAST 12 MONTHS, FINANCIAL/CREDIT TERMS HAVE:



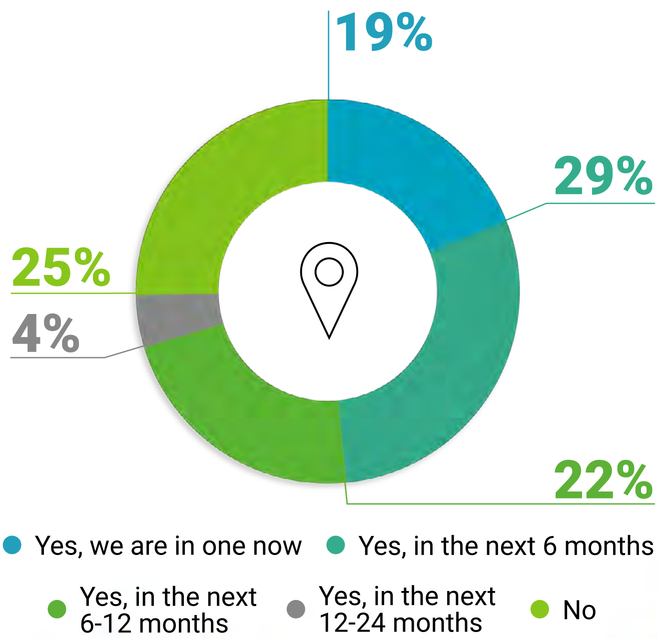
WHAT ARE THE MOST COMMON CHALLENGES CONFRONTING A COMPANY FACING A TURNAROUND OR TRANSITION?



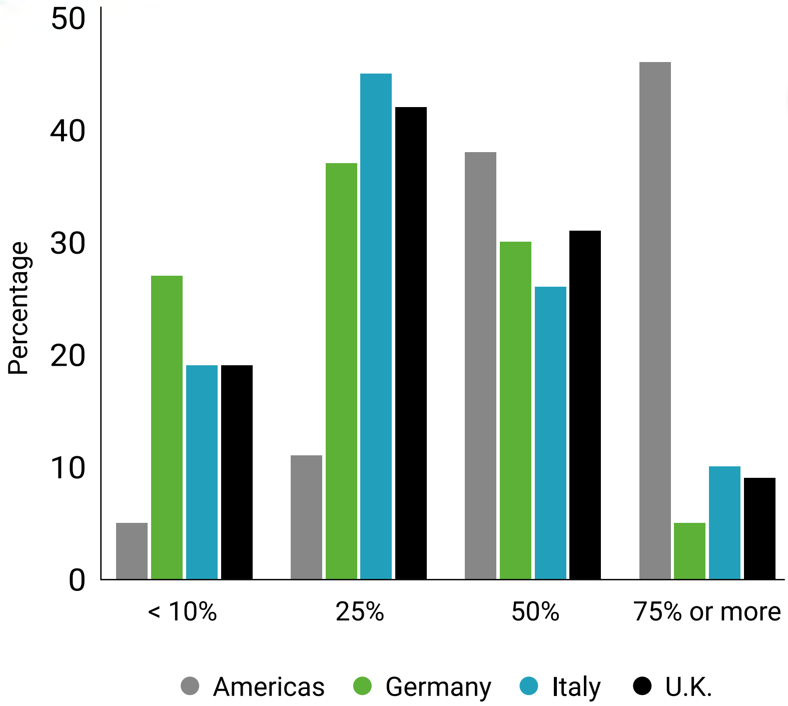
THE AVAILABILITY OF CAPITAL IN RELATION TO THE PREVIOUS YEAR HAS:



IN YOUR GEOGRAPHIC REGION OF THE WORLD, DO YOU ANTICIPATE A RECESSION?



WHAT DO YOU THINK ARE THE ODDS OF A U.S. RECESSION IN THE NEXT 12 MONTHS?



78%

Agree that recent banking failures will further limit capital availability

73%

Expect global supply chain disruption to remain steady or decrease in the next 12 months

90%

Believe that efforts by troubled companies to buy time through “amend and extend” debt agreements are temporary solutions that do not resolve fundamental business issues

WHAT A DIFFERENCE A YEAR MAKES...

Comparing our latest data set with 2022's survey reveals some significant swings from this 12-month period, as well as several steady states amidst the disruptive forces at play.

INDUSTRY DISTRESS SHIFTS FOCUS

Commercial Real Estate is the standout industry expected to face distress in 2023, ranked first by **34%** of our respondents, close to double that of Retail in second place (**18%**). Twelve months ago just **11%** anticipated distress on the horizon for this industry.

"In 2022, we still had the overhang of capital retailers accumulated to weather the storm during COVID, which helped sustain poorer performers. Now, in 2023 we are back to the continuing evolution in Retail around giving customers exactly what they want, further complicated and in some ways accelerated by cooling consumer demand."

HOLLY ETLIN
Partner & Managing Director, New York

"Although the Asian restructuring market has continued to be somewhat quiet (outside of China's property sector), we expect activity to accelerate into 2024 as rising interest rates put more stress on corporate balance sheets."

LIAN HOON LIM
Partner & Managing Director, Singapore

FINANCING SUPERSEDES SUPPLY CHAIN ISSUES

As one macroeconomic challenge recedes, another will rage. **In 2022, supply chains were the top factor driving distress.** This has been driven down to fifth position, replaced by the availability or cost of capital as the primary factor.

"Whilst the timing and depth of any economic downturn or recession are dependent on a large number of factors, the results of this year's survey, particularly in relation to the availability and cost of finance, clearly indicate warning lights. Companies need to take refinancing risk seriously and plan for debt maturities well in advance."

ANTHONY PLACE
Partner & Managing Director, London

GEOPOLITICAL AND CLIMATE CHANGE CHALLENGES PERSIST

Interest rates and the cost of capital are seen to be the biggest long-term economic challenge, as inflation falls from first to fourth place. Geopolitics and climate change, however, remain high on the long-term disruptive agenda for business leaders.

“Last year, Oil & Gas executives exhibited remarkable capital discipline and had the financial wherewithal to allocate capital for the benefit of investment and investors as the industry emerged from the pandemic. Now, their outlook is very different, as commodity prices have dropped precipitously due to rising interest rates, slowing demand growth, and potential recession fears. With cash flows much reduced, these companies will face tough choices regarding judicious and prudent capital allocation.”

JOHN CASTELLANO
Partner & Managing Director, Chicago

CAPITAL AVAILABILITY KEEPS CONTRACTING

The availability of capital has clearly crunched since our last survey. **Two-thirds told us it has decreased in relation to the previous year**, versus **44%** in 2022.

“Companies operating in a capital-constrained environment must aggressively transform their business to a more profitable model to survive. Agility and flexibility along with determination and decisiveness are some of the key characteristics required of senior leadership when transforming these businesses.”

RANDALL EISENBERG
Partner & Managing Director, New York

CREDIT TERMS TIGHTEN MORE

Credit terms have become more restrictive. Is “covenant light” now a term of the past? Already high on the watch-list in 2022, when **52%** of respondents said terms had tightened, **85%** of experts noted this trend in this year’s study.

“Now more than ever, businesses need more than just agile leadership and strong financial performance. To address the disruption in our markets, my clients are exploring every single aspect of their business models to survive. They realize it is now time to act.”

MAURO TRABATTI
Partner & Managing Director, Milan

MINIMAL MOVEMENT IN M&A

Expectations regarding M&A transactions related to distressed assets remain in line with 2022. Nearly two-thirds (**64%**) anticipate a slight increase in deals of this kind, aligned to the **63%** reported last year.

“In this environment, I see companies and PE finding fewer prospects worth the struggle to finance and close. Completing the ‘hairier’ transactions takes a three-pronged approach combining better diligence, more patience and creativity in financing, and a deal team that knows how to find value.”

PILAR TARRY
Global Co-Leader of M&A and Transaction Advisory, Chicago

GLOBAL PERSPECTIVE

PROTECT YOUR BUSINESS AMIDST GEOPOLITICAL SHIFTS

Joff Mitchell
Global Co-Head, Turnaround & Restructuring Services

This environment is as tough as it has ever been, and the key challenge is uncertainty.

If I think back 25 years, we felt the world would be at peace with a strong growing global economy. The concept of a free market global economy is now being questioned as countries seek to protect their supply chains from war and politically-led trade restrictions and sanctions. Prudent management teams – many of whom will be experiencing their first downturn – now need to build a global view of market activity, considering both the financial and geopolitical risks driven by international conflict and rising tensions between nations.

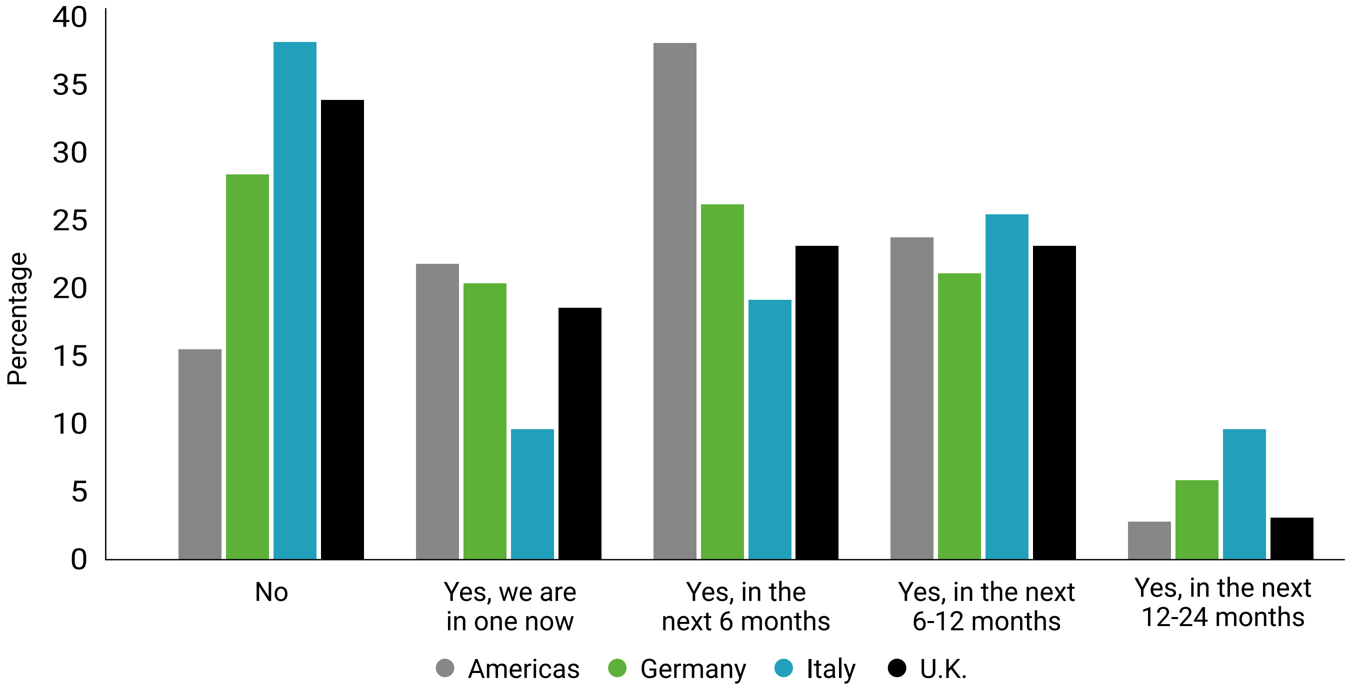
They must then overlay the continued high interest rate and constrained credit environment to try and chart a course forward – the biggest impact on restructuring activity this year will undoubtedly be the cost and availability of money. We are already in a very busy restructuring market now, and I would imagine that while interest rates may be close to peaking, we are still two or three years away from seeing any significant reduction.

Businesses must anticipate more global disruption and create agile responses, building appropriate scenario plans to mitigate the challenges and identify opportunities. It's unlikely anyone planned for a pandemic before it came, but today it is much more a case of "never say never".

70%

Believe their region is in a recession or expect it to happen within the next 12 months

IN YOUR GEOGRAPHIC REGION OF THE WORLD, DO YOU ANTICIPATE A RECESSION?



We cannot generalize on the impact of the shifting geopolitical landscape. For example, at a time when conflict sadly remains high on the disruptive agenda, there will be companies that will perform well as a result – in the defense industry for example.

There will be more universal issues to contend with, though. COVID ignited the latent vulnerabilities in global supply chains; now, more recent rising geopolitical tensions, primarily with China, require a sharp reassessment of the need for strategic and critical components – electrical and digital – to be secured via onshore manufacturing, improving business resilience from the potential impacts.

Finally, we shouldn't forget that many Western countries are facing the challenges of divisive internal political situations, driven by increasingly loud voices from the extreme right to the extreme left. It is very difficult to find or identify governments today that rule with consensus politics, which does little to deliver the long-term sense of stability that businesses need to thrive.

Management teams need to consider how this ever-shifting geopolitical environment may impact their organizations, whether it be their supply chains, input costs, or customers. This trend is unlikely to change in the near-term.

MACROECONOMIC PREDICTIONS FOR 2023

84%

Of American respondents think that the likelihood of a U.S. recession in the next 12 months is **50%** or more

59%

Overall think that the likelihood of a U.S. recession in the next 12 months is **50%** or more

35%

Of those interviewed believe that the U.S. is the country most likely to face distress in 2023

67%

Think the Ukraine/Russia conflict will have the biggest impact on the Oil & Gas (**67%**), Aerospace & Defense (**54%**) and Power & Utilities (**39%**) industries

70%

Agree that tension between the U.S. and China regarding how people and economies should be governed will directly lead to increased distressed situations

27%

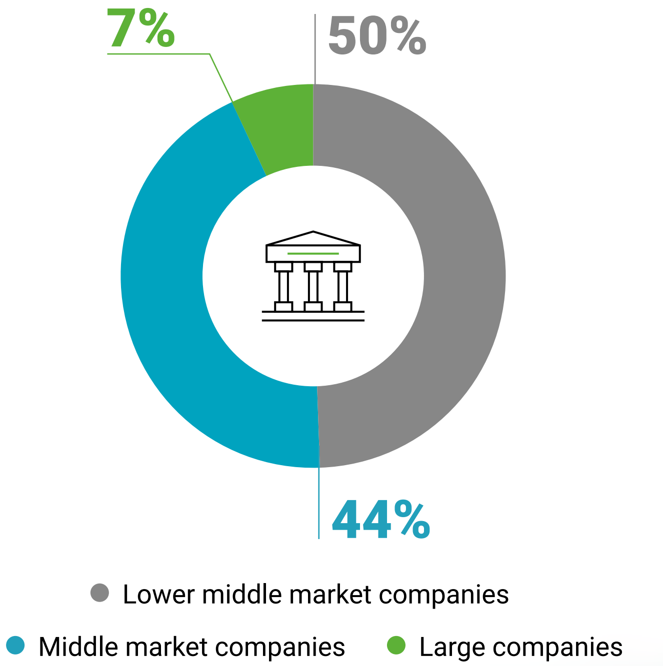
Think interest rate and cost of capital increases (**27%**) and geopolitical disruptions (**23%**) are the biggest factors challenging the long-term global economy

“Today’s agile leaders are stepping back to react to the macroeconomic challenges resulting from the one-two punch of higher inflation and the higher cost of capital. Across the Oil & Gas industry, in addition to the effects of these two issues, I see senior leaders continue to wrestle with operational and supply chain challenges, plus labor shortages. Adding to their complexity are the ripples created by geopolitical conflict in Ukraine, and the increasing pressure to align with ESG principles.”

FRANK POMETTI

Partner & Managing Director, New York

WHICH SIZE MARKET OF LEVERAGED BORROWERS WILL FACE THE GREATEST RISK OF DISRUPTION GIVEN THE COST AND AVAILABILITY OF CAPITAL IN THE COMING YEAR?



93%

Agree that workforce costs will continue to increase in the coming 12 months, which will lead to distressed situations

"In an environment of increasing labor costs, my clients often face a significant talent and capability gap in the adoption of their changing business model requirements. It's sometimes even hard to find people for 'simple' tasks, which provides a triple whammy to profitability as costs rise from simple wage increases, hiring new talent becomes over-proportionally more expensive, and business is potentially lost due to a talent deficit."

KARSTEN LAFRENZ
Partner & Managing Director, Zurich

GLOBAL PERSPECTIVE

PREPARE FOR A WORLD OF TIGHTER, MORE EXPENSIVE CREDIT

Jim Mesterharm
Global Co-Head, Turnaround & Restructuring Services

I expect that the wave of COVID-era extensions and loans that helped companies delay the inevitable will come to the fore over the next couple of years.

The distress that we see ahead won't be an onslaught like 2008 or during the worst of the pandemic, but more a steady drumbeat of increased insolvencies that government policymakers and treasury departments won't be able to solve in the way they have done historically. To combat runaway inflation, central bankers have had to tighten the money supply and raise interest rates. Given the extra leverage many companies are carrying based on years of "easy money" and the need to weather the pandemic, higher interest rates and tighter capital markets will undoubtedly drive an increase in restructurings.

While the increased cost of financing and reduced access to capital will affect many industries, a few appear particularly susceptible to increased distress over the coming years.

The Commercial Real Estate sector seems set for a huge correction, with building ownership shifting from developers and investors to lenders because of high leverage, increased costs, and the rapid emergence of hybrid work leading to an increase in commercial property vacancies. I see significant upheaval on the horizon here.

Meanwhile, Retail is – as always – an industry driven by the dollars in consumers' pockets. Continued inflation above recent historic norms will have major downstream impacts on disposable income, and rises in interest rates to combat inflation will also impact consumers who are once again carrying high levels of debt.

The viability and resolve of regional banks have also been severely tested, which will push greater power to the biggest institutions in the world, reducing competition and the availability of credit.

So how should businesses react to these rapidly evolving scenarios?

Leaders must get out ahead of situations and fully understand the dynamics at play. Credit metrics must improve, requiring more steps to be taken to extend their runway, improve liquidity, tighten working capital, and refine capital plans.

It's time to put on the bi-focal lenses. In addition to focusing on the immediate steps to extend their runway, leaders must adopt a bigger picture view to stay ahead of potential disruptions in their markets. The executives who can understand all the dynamics at play will build a collection of short-term actions that will lead to longer-term turnarounds and strengthened positions.

Companies in the past could avoid taking on these challenges because there was "easy money" available to support them. This won't be the case now. In many instances, sponsors will have to either walk away from investments or invest more money to buy the space to refinance, and management must work to reduce that check size by forcing better performance in their companies.

INDUSTRY PREDICTIONS FOR 2023

34%

Told us that Commercial Real Estate is most likely to face distress in 2023 globally, followed by Retail (**18%**) and Financial Services (**11%**)

23%

Automotive distress was significantly signaled by German (**23%**) and Italian (**20%**) respondents, failing to register as highly in other regions

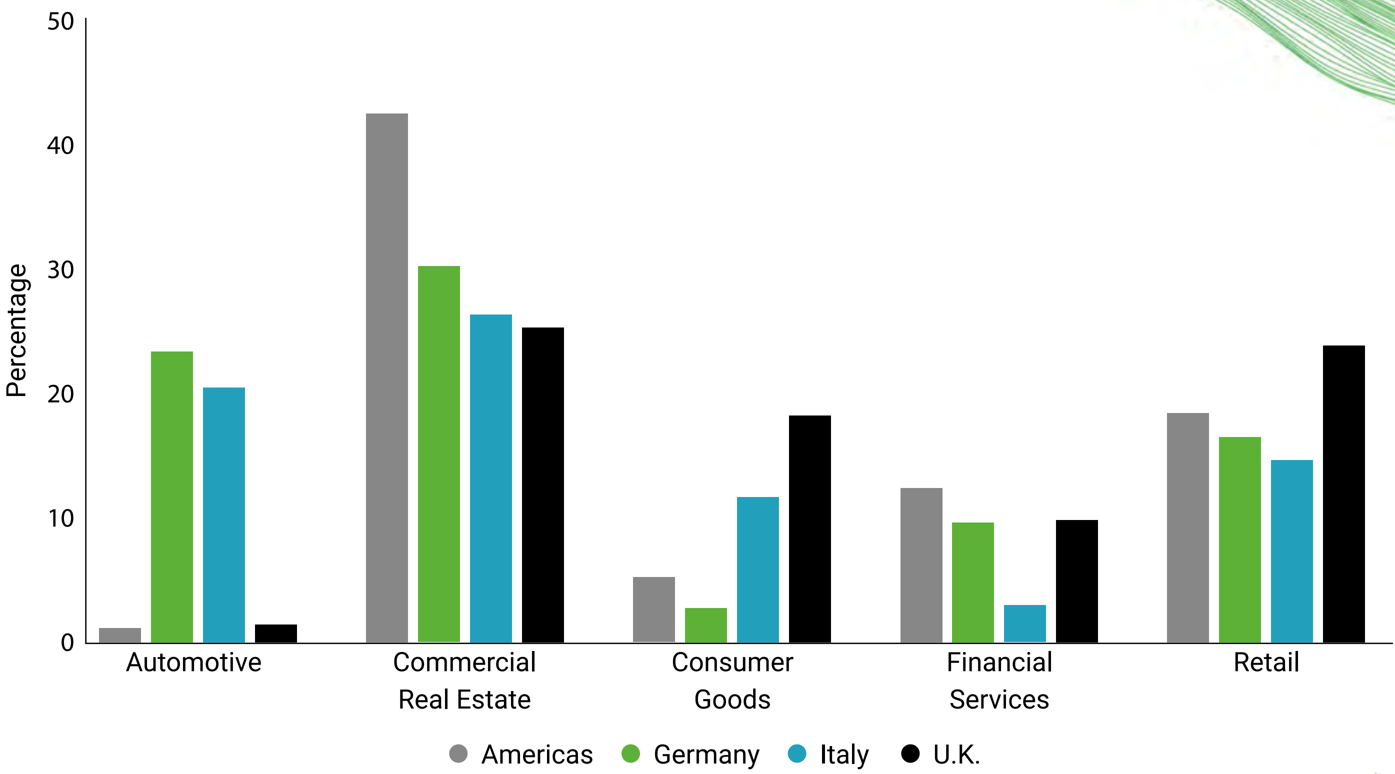
23%

Retail (**23%**) and Consumer Goods (**18%**) also registered highly among U.K. respondents, compared to the aggregated global data (**8%**)

> **"Rapidly rising interest rates are compounding structural dislocation and driving a reset of valuations across global real estate markets. Higher financing costs are in most instances not offset by rental growth, putting pressure on debt covenants while lenders are tightening underwriting standards. The result is a challenging refinancing market at a time when $500bn of real estate debt is maturing annually in the U.S. alone through 2027."**

ANDREA TROZZI
Partner & Managing Director, London

WHICH SECTOR GLOBALLY IS MOST LIKELY TO FACE DISTRESS IN 2023?



OVERALL TOP RANKING INDUSTRIES

1st Commercial Real Estate

2nd Retail

3rd Financial Services

4th Automotive

5th Consumer Goods

"While only at fourth position overall in this year's rankings, I see many automotive suppliers balancing on the edge of distress. They have to address challenges driven by high debt levels, the increasing cost of capital, often enormously increased factor cost, fluctuating demand and technological changes."

JENS HAAS
Partner & Managing Director, Munich

THE AVAILABILITY OR COST OF CAPITAL (36%), INFLATION (25%), AND CHANGES IN CONSUMER PREFERENCES (20%) ARE CONSIDERED THE TOP FACTORS DRIVING DISTRESS

36%
Cost of capital

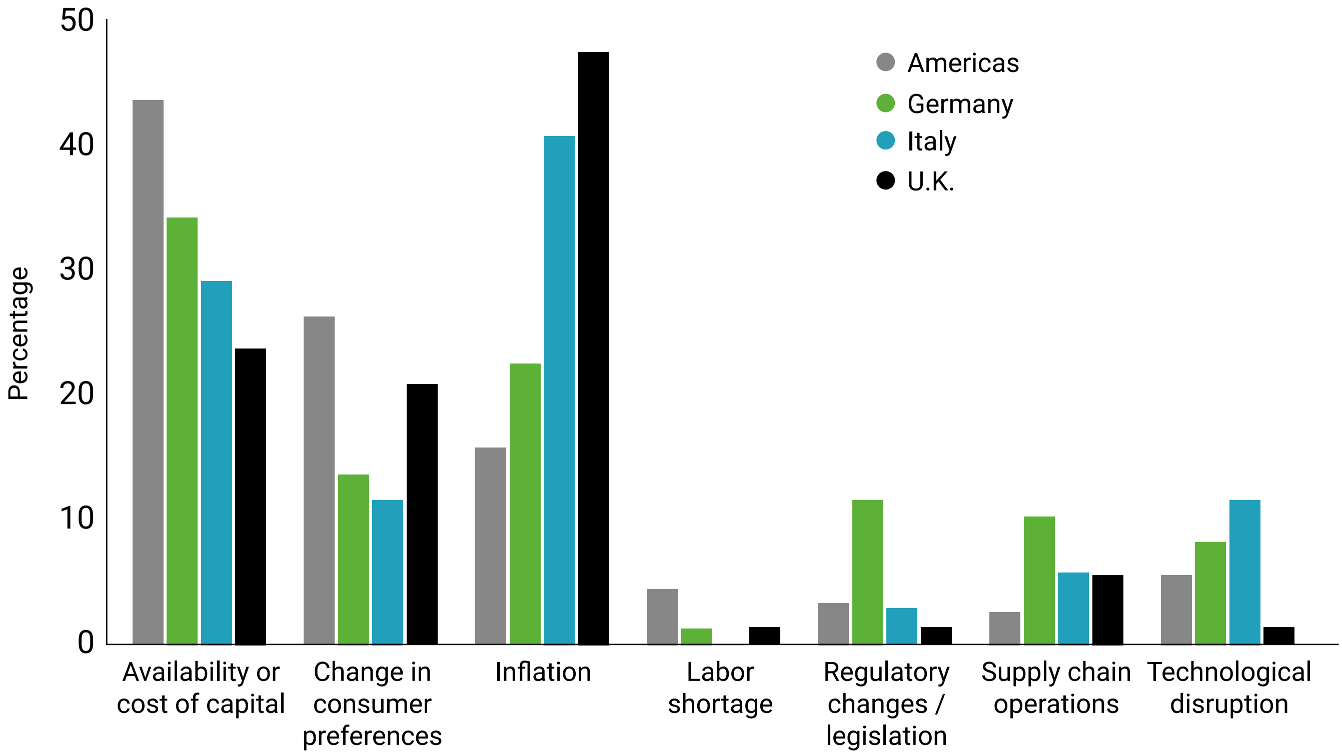
25%
Inflation

20%
Changes in consumer preferences

> **"Rather than bury their heads because of a limping business or waiting for financial relief, today's executives need to be rallying stakeholders to tackle disruption in their business operations and discover unique ways to address the big picture changes in consumer behaviors because of rising rates, mounting debt, and dipping confidence."**

CLARE KENNEDY
Partner & Managing Director, London

WHAT IS THE TOP FACTOR DRIVING DISTRESS?



GLOBAL PERSPECTIVE

REMAIN NIMBLE AND BE PREPARED TO CHANGE COURSE

Simon Appell
Co-Head, Turnaround & Restructuring Services, EMEA

We hear from our clients that there is much uncertainty in EMEA, and it remains unclear whether we are on the brink of a sustained downturn or whether we will see a level of resilience in the markets that avoids this scenario.

Central banks and economic units are wavering as interest rate strategies – and the likelihood of further rises – reach a delicate period of consideration. It is a very difficult market to call; there is liquidity that we've seen put to work, and while lenders will typically display support for "amend and extends" within a restructuring framework, they currently don't have a strong appetite for new money.

In the U.K. and Europe more widely, we haven't witnessed a huge uptick in insolvency filings this year to date, though there have been exceptions related to the fallout from Ukraine and associated Russian sanctions, plus some sectors such as Retail and Consumer Products. Our team in the U.S. has already seen an increase in restructurings, so activity in EMEA may be on the horizon, with the recent lull an issue of timing.

This time last year, those monitoring market dynamics closely took the view that things would get worse, so battening down the hatches was a clear and obvious option. Now, the situation has become that much more difficult to manage. The learnings of history are becoming less relevant, as markets, businesses, governments, and regulators break new ground as they seek to manage economic recovery.

As a result, it is extremely difficult for management teams, as they adopt the necessary dual track of trying to manage the risk of being overly prudent (and missing out on opportunities), and at the same time not being too aggressive (and endangering precious positive cash flow).

Ultimately, the key will be to establish a nimbleness that is clearly tied to an agreed strategic direction, with accurate, relevant, and timely reporting that will allow adjusting course as required.

93%

Said the cost of capital has increased in the past 12 months

85%

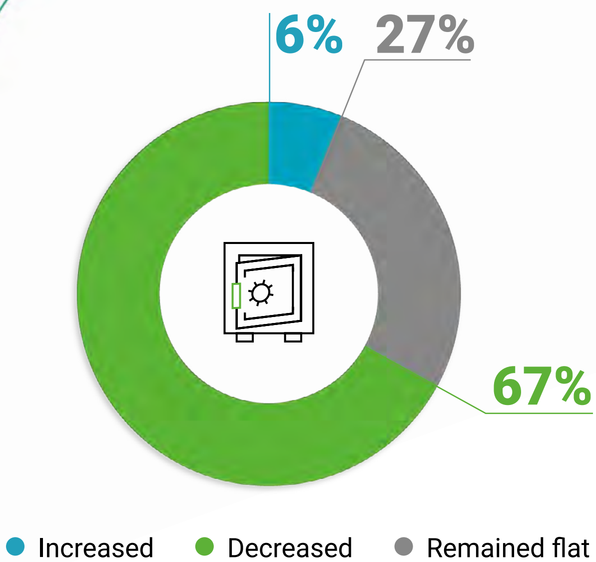
Believe financial / credit terms have become more restrictive

FINANCE MATTERS

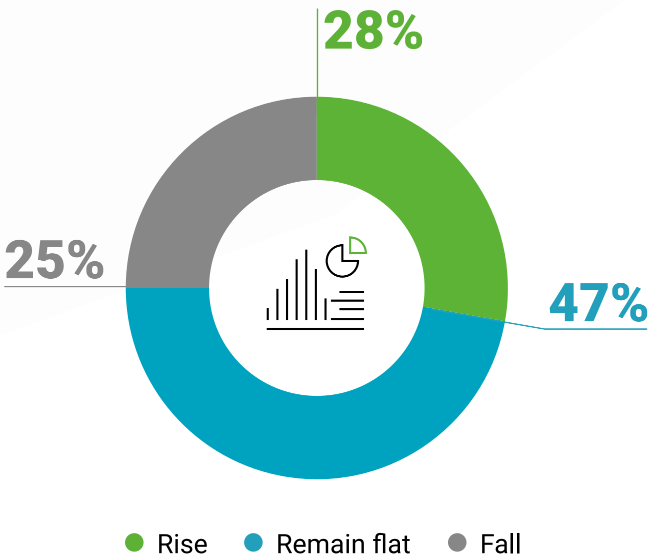
"Management's flexibility and agility is limited, as we have an entire management generation (since 2010) who have mainly lived 'crisis-free'. Immediate and bold cost reduction is required to get into the 'up-phase' of the turnaround – therefore, it's important to implement the right cuts and preserve the profitable core with attractive potential."

RAINER BIZENBERGER
Partner & Managing Director, Munich

THE AVAILABILITY OF CAPITAL IN RELATION TO THE PREVIOUS YEAR HAS:



WHAT DO YOU EXPECT THE INFLATION TREND TO BE IN 2023?



BALANCE SHORT-TERM SURVIVAL AND LONG-TERM GROWTH OPPORTUNITY

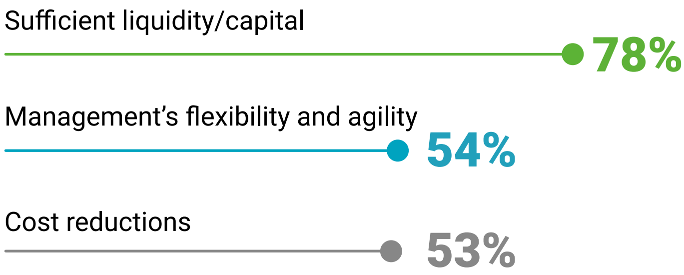
Eric Koza
Co-Head, Turnaround & Restructuring Services, Americas

If we are not in a recession in the U.S. now, then we are close. By its nature, this is always something defined after the fact and, irrespective of this specific timing, I expect restructuring activity to remain elevated for some time.

I also see this as something markedly different to what we have seen before. It is a longer-term cycle, not a rapid spike – inflation has driven rates up and increased rates have driven more disruption. There is no single trigger in one specific sector either; every industry, regardless of who is in the headline news, is experiencing the impact of this economic construct to some degree.

The businesses that are highly leveraged and subject to upcoming refinancing will be facing into significant financial headwinds. This is not a scenario to enter passively, and there are two key actions for leadership teams to take in balancing the immediate challenges with those further down the road.

WHAT ARE THE THREE MOST COMMON CHALLENGES CONFRONTING A COMPANY FACING A TURNAROUND OR TRANSITION?



1

Most importantly, if you are a company that is traditionally highly leveraged and you have an opportunity to tap into capital markets to improve your maturity and liquidity, take it. It's vitally important to use this to create a sure footing and an extended runway during these uncertain times.

2

Secondly, leadership teams must think about what comes next from a management standpoint. It is never too soon to think about how to improve your business, which may encompass rationalization, efficiency improvements, and a detailed evaluation of where the business could go depending on different views of what the next 18 months may hold. There are many different potential outcomes, and if management teams aren't thinking about that now, then it's already getting too late, as you'll need a series of quarters to build a robust view of the likely direction of travel.

55%

More than half (55%) believe the rapid advances in AI technology should be viewed by a distressed business as an opportunity

77%

Believe that the M&A transactions related to distressed assets will increase; 12% think that it will reach a new high

82%

See an increase in the number of distressed businesses as an opportunity for expanding their own business

Ultimately, success now will depend on planning and good judgement, scenario planning, and efficient execution. Critical short-term issues must be addressed now, and the long-term challenges that remain strategic priorities from a board, brand, and corporate standpoint may need to be pushed out a little just to ensure the survival of the business.

However, there still must be an active appreciation of this bigger picture – ESG for example. Having a clear set of deliverables related to the organization's longer-term goals and opportunities can be a differentiator in today's market. Without one eye fixed on these longer-term issues, which will drive reputation, regulation, and performance for years to come, a business will quickly fall into a position of competitive disadvantage.

GLOBAL PERSPECTIVE

ESG ACTION CANNOT BE A LONG-TERM CHALLENGE FOREVER

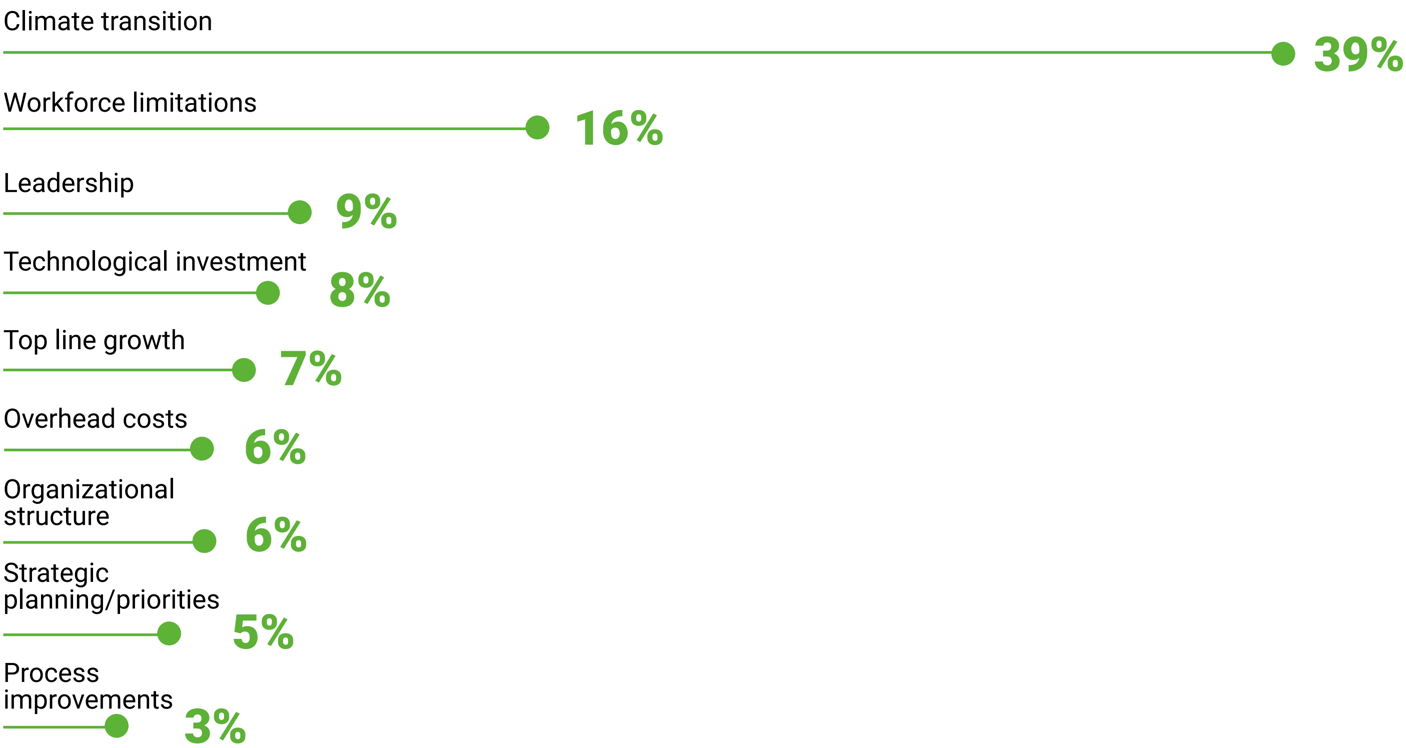
Axel Schulte
Co-Head, Turnaround & Restructuring Services, EMEA

I can understand why firms may not have ESG at the very top of their investment agenda, given the immediate issues of inflation, interest rates, and the reduced availability of capital. When money is scarce, resources need to be directed to the most pressing areas.

However, it would be shortsighted to pull too far back from this challenge, or you may quickly fall behind.

To deal with ESG in the right way, wholesale transformation must be undertaken – every part of your business needs to be touched – processes, product lines, supply chains – in every country of operation. The dial can only sustainably shift with significant internal investment to effect change across a business's environmental footprint, its transparency around global working conditions, and its reporting processes beyond purely financial metrics.

IF YOU OBSERVED LIMITED CAPITAL, WHICH ONE UNDERLYING OPERATIONAL ISSUE WILL NOT BE ADDRESSED IN THE COMING YEAR?



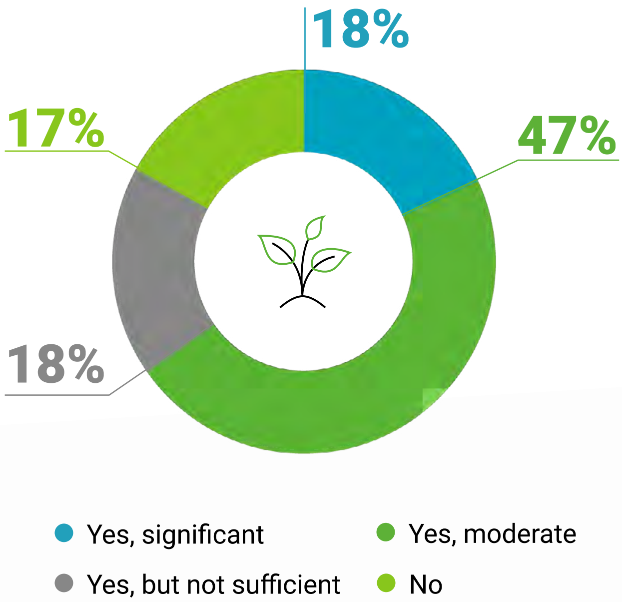
Every CapEx decision must carry an ESG consideration. The right move can create financial value through this lens and avoid risks later down the line. But this requires a generational mindset shift and acceptance of the fact that, at some point, banks simply will not provide money to companies which do not focus on ESG.

Many bigger firms continue to prosper with the financial strength to execute a strategic five- or ten-year ESG vision while contending with the immediate economic disruption. As you move further down, there will be high-performing mid-cap stars, guided by "next-gen" leaders who have grown up with the concept of ESG and with the DNA to drive change with products built for "good". This is not the majority though, and as margins are squeezed the level of investment that can be made now to realize the benefits later becomes severely restricted.

The first place to find a way forward for change is in the data – Scope 1-3 emissions; plant or product optimizations; workers' pay, conditions and working hours globally; and suppliers' associated KPIs. If you don't know how you are performing in these areas, how can you possibly identify the action to take, and the level of investment required?

It is true that ESG is a long-term challenge for every business – certainly on the "E". But we should not forget that a lack of attention to the "S" and the "G" could hurt you much faster as a business. A company's action – or inaction – on ESG is now not only a catalyst for improved financial performance, but also a defining factor in how long they will survive in their market.

ARE YOU SEEING CONTINUED INVESTMENT BY YOUR CLIENTS IN IMPROVING THEIR ESG CREDENTIALS AND PERFORMANCE?



METHODOLOGY

Research for the 18th Annual Turnaround and Transformation survey was conducted between May 2 and 25, 2023. Respondents comprised 700 lawyers, investment bankers, lenders, financial advisors, and other industry executives involved in corporate workouts representing more than 20 major industries globally, including the Americas, Europe, the Middle East and Africa, and Asia.

ABOUT US

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

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

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

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

AlixPartners