FEBRUARY 2019

ALIXPARTNERS 14TH ANNUAL TURNAROUND & RESTRUCTURING EXPERTS SURVEY:

Disruption is the new normal

Turnaround professionals have a well-established reputation for being intently focused on the timing of the next recession—and for good reason. In the past, restructuring activity has been closely tied to the credit cycle. Today, that's far less true. The cycle still matters, but activity is increasingly driven by a steady drumbeat of disruption, even when overall macroeconomic factors are strong. New technology, rapid-fire shifts in consumer behavior, changing regulation, potential trade barriers, and tectonic changes like Brexit all threaten companies and entire sectors.

What's more, professionals increasingly need to demonstrate industry-specific expertise to understand new business models, threats from new entrants, and other factors to successfully steer their clients through turnaround programs. In other words, disruption is the new normal in many sectors, and both business leaders and advisors need to understand the implications of that change:

- A higher baseline of distress, even in good times.
- An emphasis on industry specialization.
- An increased need for innovative, tailored solutions.

Those are the clear messages from our annual online survey (conducted this past December) of more than 300 lawyers, investment bankers, lenders, financial advisors, and other restructuring industry experts. This year we updated our methodology to drill deeper into root causes. We also expanded our geographic focus. In addition to focusing on the Americas, we reached out to respondents in Europe, the Middle East, Africa, and Asia-Pacific. As always, however, our goal was to take the temperature of the turnaround industry, explore big-picture themes, and identify the sectors that are most likely to see increased activity in the coming year.

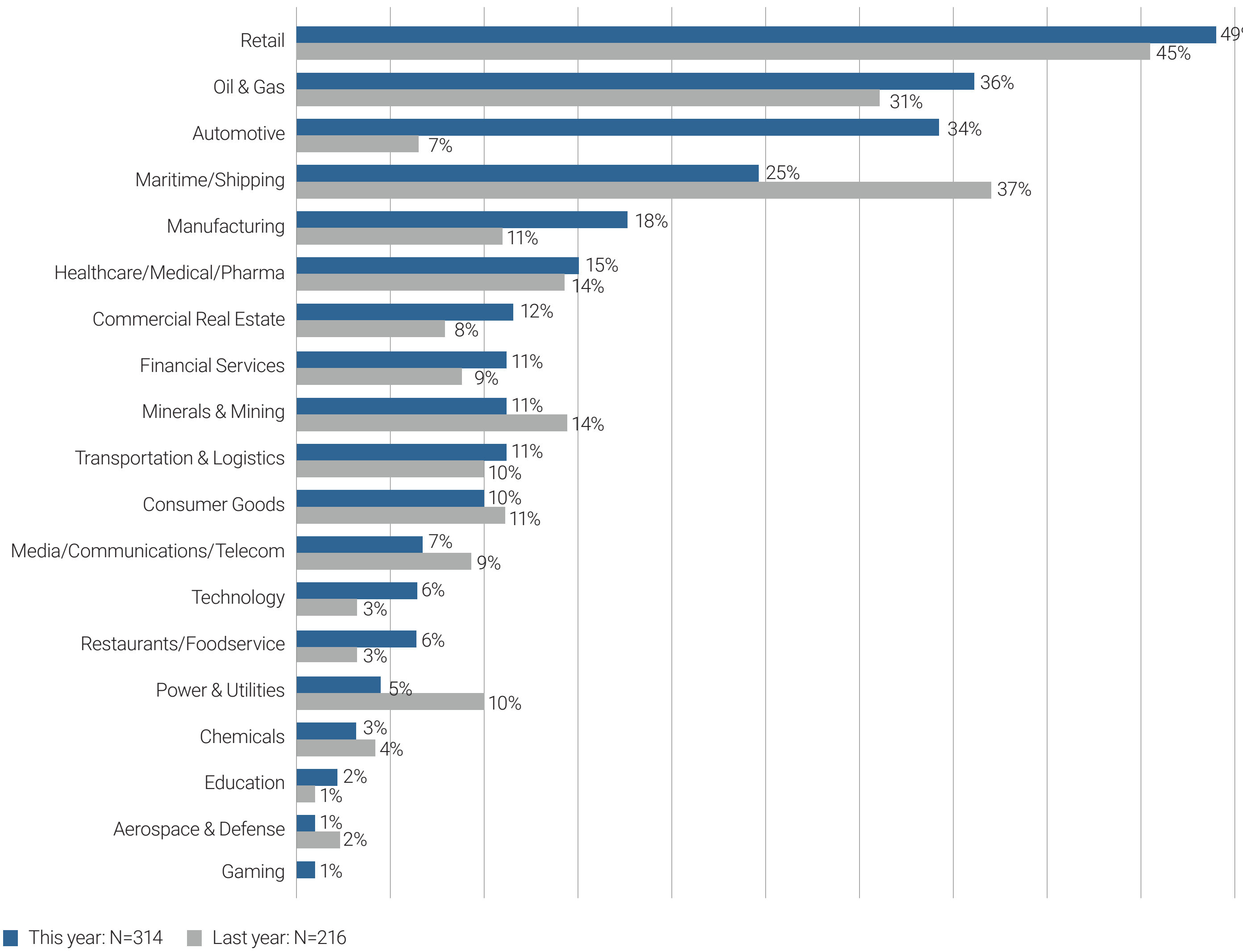
KEY FINDINGS

The industries that respondents say are most likely to face distress worldwide include retail (cited by 49% of global respondents), oil and gas (36%), and automotive (34%). It's no coincidence that all of these sectors are undergoing seismic change, with their trials and tribulations playing out almost daily in the financial press. (In the Americas, healthcare was also named as a threatened industry—ranking second for the second year in a row—due in large part to regulatory uncertainty in the US.) Retail and automotive are both facing a "Bermuda triangle" of threats: unfavorable economic conditions, disruptive forces, and changing consumer preferences. Those factors are creating a perfect storm for management teams to address—and some may not navigate it successfully.

Interestingly, experts are less bearish than one might think at this point in the cycle. A majority believe that their region will not slip into a recession. When asked about key risks, most see an economic slowdown in China, tariffs and trade disputes, and disruptive elements (along with a Eurozone debt crisis and Brexit among respondents in Europe) as the most likely to create challenges for companies in 2019.

FIGURE 1: SECTORS MOST LIKELY TO FACE DISTRESS

Respondents were asked to select up to three industries – total of responses will exceed 100%



RETAIL: NO APOCALYPSE, BUT PLENTY OF ACTIVITY

In last year's survey, respondents predicted a "retail apocalypse": a wave of filings among established companies with large physical store networks, spurred by online shopping.

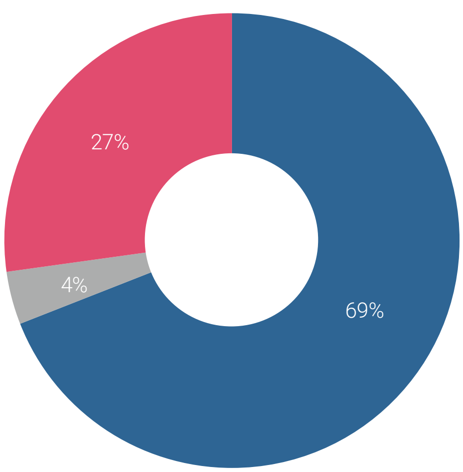
That apocalypse didn't quite materialize in 2018. There was plenty of activity, but the industry saw fewer headline-grabbing crash filings compared to 2017 (with the notable exception of Sears). Still, respondents named retail as the sector most likely to be challenged in 2019. It was cited by 49% of respondents worldwide, and 69% in the Americas. (One potential reason for the disparity is that retailers in some emerging markets haven't yet seen penetration levels of e-commerce that are sufficient to displace brick-and-mortar retailers.)

Compounding the challenge for retail is that it faces multiple threats right now. When asked about the specific factors that will lead to increased restructuring activity, respondents were essentially split among three: changing consumer preferences, unfavorable economic conditions, and disruptive forces. For leadership teams in retail, a storm of converging factors is brewing, creating an existential threat for many companies.

Among disruptive forces, Amazon is now moving aggressively into the grocery and pharmacy sectors, and Walmart is offering new last-mile solutions. Other competitors, including discount grocers that have strong house brands, are expanding, threatening incumbent players. And new cold-storage logistics chains are being built out. Grocery is notoriously capital-intensive and has razor-thin margins, and some players are over-leveraged, suggesting that the sector will likely see continued distress.

FIGURE 2: RETAIL PREDICTIONS FOR 2019

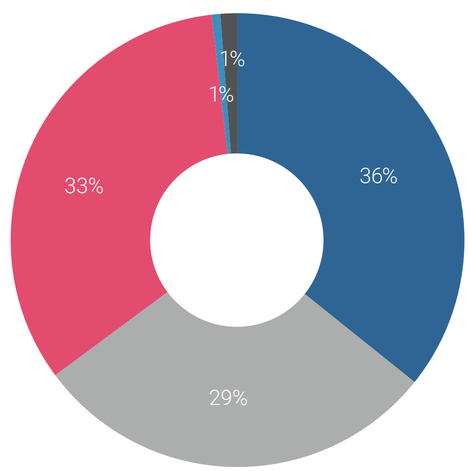
Q: I expect the global prevalence of retail restructurings to ____ in 2019.



N=239

Increase   Decrease   Stay the same

(To those who answered "increase")
Q: Why?



N=165

Disruptive forces   Economic conditions   Customer preferences
Regulatory impacts   Other

OIL AND GAS: CAN THE SECTOR WEATHER ANOTHER STORM IN 2019?

Oil and gas is another sector likely to face continued distress.

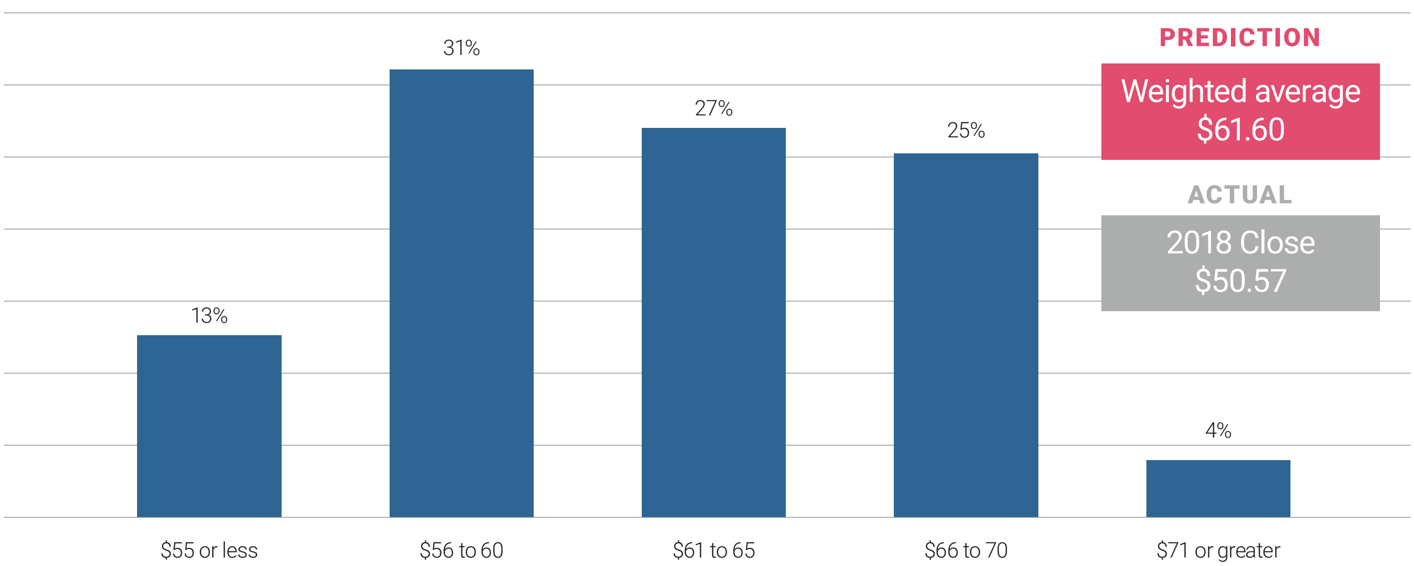
If there's a silver lining, it's that compared to retail, the biggest challenge facing oil and gas companies is clear: oil prices have dropped, challenging the economics for producers and ancillary service providers.

In last year's survey (conducted in late 2017, when Brent Crude prices were about $62/barrel), we asked respondents for their prediction about the direction prices might move. Only 13% predicted that Brent Crude would price below $55/barrel at the end of 2018, yet those pessimists turned out to be correct. In December 2018, a drop to nearly $50/barrel triggered alarm bells, and compelled experts to name oil and gas as a likely candidate for distress.

The industry already saw a wave of restructuring activity in 2015 and 2016, and those companies should be better positioned to weather the storm. But there's a real question as to whether those companies can thrive in an environment with sustained oil prices near $50/barrel—with many of the factors leading to low prices, such as cheap shale gas in the US, still in place.

FIGURE 3: LOOKING BACK – PREDICTIONS FROM LAST YEAR'S SURVEY

Q: As of mid-November 2017, the price of Brent crude oil was approximately $62 a barrel. What do you think the price will be at the end of 2018?



N=174

AUTOMOTIVE: A SEISMIC SHIFT IN TECHNOLOGY

The automotive industry also faces challenges, according to the experts we surveyed.

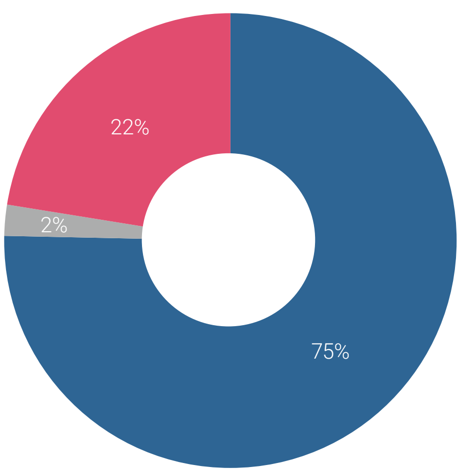
Worldwide, 75% of respondents see an increase in restructuring activity in 2019, and another 22% see levels remaining steady. As with retail, respondents were divided when asked to identify the biggest factor leading to this increase: new consumer preferences, disruptive forces and the overall economy were all flagged as likely instigators.

In terms of consumer preferences, the forecast is decidedly negative. In many developed markets, younger people are simply less interested in owning a car. (In fact, many are less interested in going out entirely, due to better in-home entertainment options, streaming services, and social media.) New ride-sharing entrants make car ownership less necessary, exacerbating the headwinds facing auto companies.

Regarding disruptive forces, the industry is seeing a seismic shift from internal combustion engines to electric powertrains. That will lead to under-utilization of factories among vehicle manufacturers. Suppliers are seeing the same forces, as connected cars require more specialized semiconductors, threatening the business model of established players that are tooled to produce more commoditized components. As if that's not enough, autonomous vehicles are looming, with deep-pocketed new entrants such as Google and Uber investing heavily. Incumbent automotive companies need to figure out how to wring profits from their existing operations, while also timing the transition to newer technologies—a tough balancing act.

FIGURE 4: AUTOMOTIVE PREDICTIONS FOR 2019

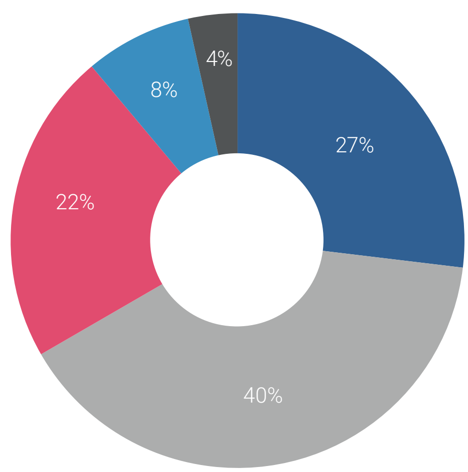
Q: I expect the global prevalence of automotive restructurings to ____ in 2019.



N=227

Increase Decrease Stay the same

(To those who answered "increase")
Q: Why?



N=171

Disruptive forces Economic conditions Customer preferences
Regulatory impacts Other

HEALTHCARE: CHALLENGES LOOM IN THE AMERICAS

The healthcare industry remains top of mind among respondents in the Americas, where it was cited as the second most-challenged industry for the second year in a row.

The biggest factor facing healthcare companies is continued regulatory uncertainty, particularly in the US.

As in other industries, technology and consumer preferences are upending established healthcare business models. Consider that CVS and Walmart now offer walk-in medical care for minor health needs, which threatens providers. Mobile and connected-care applications are connecting patients and physicians in new ways, and giving people greater control over their own care. And new payment models are emerging, as payors, providers, and device manufacturers all wrestle with the transition from fee-for-service to value-based care. All of these factors are overshadowed by ongoing changes in federal and state regulations. This leaves companies aiming at a moving target with little stability in sight.

RECESSIONS MATTER LESS THAN THEY USED TO

58%

of respondents did not think their region would go into a recession in 2019.

Finally, we looked at the overall sentiment among turnaround experts and found that they were surprisingly optimistic with respect to the broader economy. There are rumblings of an end to the current expansion, marked by increased volatility in equities markets and rising interest rates. Yet among respondents, a majority (58%) did not think their region would go into a recession in 2019.

Among key risk factors, respondents cited an economic slowdown in China, tariffs and trade disputes, and disruptive elements (along with a Eurozone debt crisis and Brexit among respondents in Europe). Most believe the next recession—when it does come—will arrive slowly, and be handled through aggressive interventions by policymakers.

Perhaps most important, those respondents also didn't seem to think that the presence—or absence—of a recession in 2019 would dramatically affect their stance regarding activity levels. Some 82% of respondents said that their outlook for the turnaround industry was closely tied to their outlook for the overall economy, yet nearly half said that their survey answers would not change even if they knew for certain that the current expansion would continue through 2019. In other words, the cycle still matters, but it's not as critical for driving turnaround activity, as continued disruption means a higher baseline of distress even when the economy is flush.

That shift to a market based on disruption within industries, rather than one closely tied to the credit cycle, has a clear implication for turnaround professionals: sector-specific expertise is becoming more important. In this year's survey, 87% of respondents agreed that the traditional capabilities required to successfully serve clients will remain important but may not be sufficient on their own—nearly two-thirds said that industry specialization will play an increasingly prominent role in the restructuring space.

Why? Because recent drivers of corporate distress have not been isolated to company financial statements. Instead, they are more multi-faceted and complex, driving the need for business model changes and other shifts within organizations. To succeed in this environment, professionals need to be current on the core issues facing specific industries. They need to speak the language, understand the sector's changing dynamics, be credible when talking to management teams and boards, and bring an expanded toolbox to support meaningful transformation.

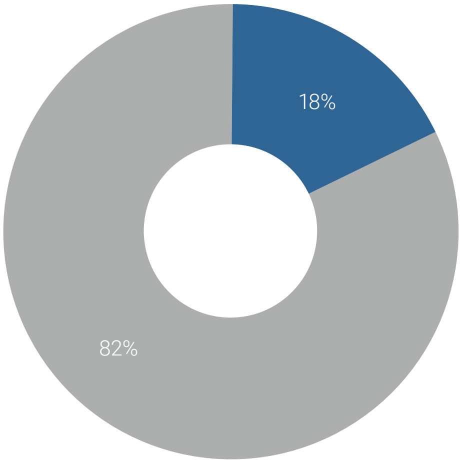
STAYING BUSY REGARDLESS OF WHAT COMES

In sum, our survey shows that turnaround professionals are likely to stay busy regardless of what happens with the credit cycle.

In 2019 and beyond, some industries will always be under duress due to technological shifts, changing customer behavior, and other disruptions. Macroeconomic factors will continue to affect activity levels, but increasingly, they are just one part of the equation.

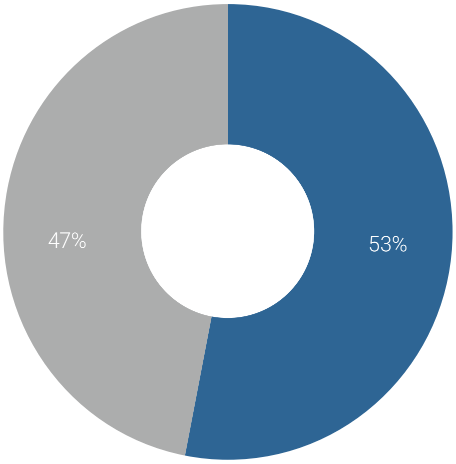
FIGURE 5: THE INFLUENCE OF ECONOMIC CYCLES

"Your 2019 outlook for the restructuring industry is closely linked to your outlook for the broader economy."



N=272

"If you knew with certainty that the current expansionary cycle would continue through 2019, your answers to this survey would remain the same."



N=262

■ Disagree with this statement ■ Agree with this statement

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ABOUT US

For nearly 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.