RBC Global Asset Management

Rise in European restructurings

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“Along with the short-term volatility, the economic picture in Europe remains challenging.”

With an ever-changing macro backdrop, we look at the outlook for stress and defaults in the European mid-market corporate space and what this means for investors.

Key points:

- **Global volatility has compounded challenges for European corporates.**
- **We increasingly see companies that need an overhaul of strategy and operational restructuring.**
- **We have seen increased opportunities with business process outsourcers, auto parts, and energy & shipping companies.**

Markets have been unnerved by the inconsistency of the President Trump’s tariff policy. Initially, the US delivered a complex array of tariffs that were higher and more broad reaching than anticipated, triggering investor concerns that pushed equities much weaker and bonds higher. Following significant turmoil, the President reversed course, putting most of the tariffs on hold for now. Clearly, uncertainty abounds.

Markets have been unnerved by the volatility, and the underlying economic sentiment has turned negative. Recently, the University of Michigan’s index of consumer sentiment experienced a sharp 27% year-over-year[1] decline, reflecting heightened public anxiety over potential economic repercussions. In Europe, policymakers are increasing defence and infrastructure spending as a countermeasure to tariffs.

Along with the short-term volatility, the economic picture in Europe remains challenging. The unwinding of leverage, which will need to take place over the next few years, will create opportunities for Special Situations investors, even without a significant recession. In our judgement, Europe will continue to be the epicentre for stress and distress in corporate finance. This is especially true in the European mid-market where companies have limited access to capital markets, are less diversified by product type and are more vulnerable to economic downturns.

[1] Source: The Regents of the University of Michigan, data.sca.isr.umich.edu.

Consumer sentiment and industrial growth are starting to drop, and higher interest rates are working their way through to companies which face significantly higher interest rates when their debt matures. Considering that developed economies are not yet in recession we have seen a pickup in the amount of distressed exchanges in Europe which has risen in 2025 and currently accounts for 71% of defaults through Q1 2025.

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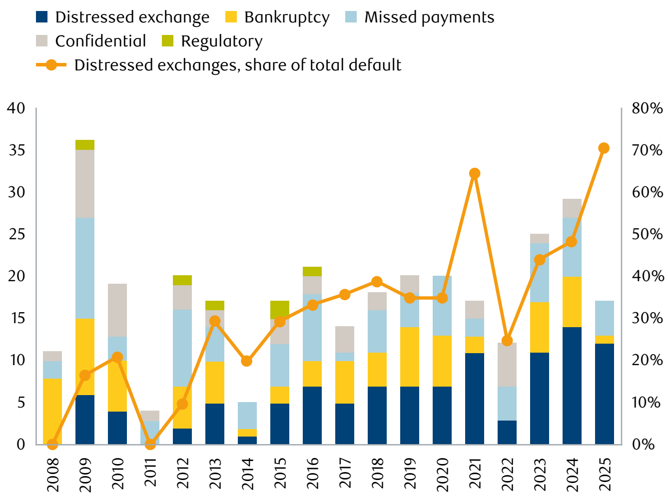
Furthermore, the European Banking Authority released data on the 24th March 2025 showing German banks' non-performing loans (NPLs) were up over 22% year-over-year from the end of 2023 to December 2024. As we explain to our investors, European banks make up approximately 70% of lending to corporates with a market size of 6.2tr EURs[2] to non-financial corporations. Clearly with a market that size it does not require much distress to provide a ripe opportunity set for us as distressed/special situation investors.

Chart 1: Distressed exchanges contribute to 71% of year-to-date default reasons

Year-to-date default reasoning



Source: S&P Global Ratings Credit Research & Insights. Data as of February 28, 2025. Data has been updated to reflect confidential issuers.

Commensurate with this view and the data, we have seen our distressed book within our portfolio grow to its largest allocation on record during the recent past. It stood at 44% as at the end of February 2025. Companies hit liquidity crisis' and need solutions to survive.

There are basically three options available to companies and their equity owners:

- Firstly, the equity sponsor can inject new equity to support the company.
- Secondly, the company could complete a restructuring which entails many options such as an equity injection in addition to lenders receiving a haircut on their debt.
- Finally, the equity sponsor could relinquish control of the business handing the keys of the business to the lenders.

Within our portfolio we have seen all three scenarios play out over the past couple of years.

Crucially, RBC GAM aims to have a seat at the table when it comes to negotiations with other lenders and the company. Typically, we target smaller capital structures where we can hold a significant amount of the debt, allowing us to influence terms beneficially for both our investors and the long-term sustainability of the company.

To give a sense of the scale of the restructurings within the strategy, we have six companies which have either completed their restructuring or should complete their restructurings in 2025. As a part of these restructurings, we have put new money into the companies and seen our debt elevated. It is also worth highlighting that the economic headwinds and perfect storm of issues for corporates has touched almost every sector as illustrated by the sectors in which we are participating in restructurings which includes the consumer goods, retail, energy, auto parts and construction sectors.

Recent Portfolio Activity

Entering the year, there were four sectors that we thought were worth watching; business process outsourcers (BPOs), auto parts, utilities and energy & shipping. To date we have been active in all sectors, with the exception of utilities.

Within the BPO space we have remained extremely active investing across 3 issuers who operate in the sector. Valuations in the sector have dropped amid artificial intelligence (AI) disruption. We feel is overblown and that the AI transition will be gradual over several years. Company earnings within the sector continue to hold up well. At these trading levels the business value creation is very low and we take comfort in the fact that recently there have been opportunistic transactions which are supportive of the level at which we have invested.

[2] Source: Bloomberg.

The auto parts sector has remained ripe for opportunity as the German economy continues to flirt with recession and large original equipment manufacturers (OEMs) signalled production cuts and plant closures in the latter end of 2024. This has fed through directly to the mid-market auto part suppliers who will see lower demand for their products. We are currently on the Ad-hoc Group (AHG) of a market leading sealing systems company operating primarily out of Germany. The negotiations with the private equity owner are ongoing and we optimistic about the deal that will be finalised over the coming months.

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Additionally, we added exposure to a private German company who produce kinematics within the car such as panoramic sunroof systems, electric blinds, boot storage solutions amongst other products. Through our banking network we had the opportunity to purchase bank debt at a significant discount in which we were creating the business at extremely low leverage and with significant upside. To our knowledge we are the only secondary creditor in this business with refinancing of the debt expected to take place later this year.

Within the energy sector we have recently invested in the bank debt of a Norwegian accommodation vessel provider. We have joined the AHG and negotiations with the company on its debt restructurings have begun.

Finally, our strategy is primarily focused on mid-market European corporates. As a result, our portfolios are relatively insulated from the direct effects of the US tariffs, as only a select few companies within it have partial revenue exposure to the US market.

Even before this most recent volatility, we were increasingly seeing companies that need an overhaul of strategy and operational restructuring. We are prepared to roll up our sleeves for these opportunities. Our view is that the ideal investment for a special situations investment team is a business with a sound underlying strategy that needs financial restructuring. These cases involve having the wrong capital structure, for example, in an otherwise good underlying business.

Moreover, the massive dislocations that are happening globally creates volatility that is generally good for us and for the strategies. There was a significant amount of activity already happening in the European mid-market, but the current turmoil is going to strengthen the opportunity set massively. We are now seeing refinancing pulled, IPOs and acquisitions pulled and spreads widening. It is undoubtedly the case that we are going to see more stressed/distressed and more rescue financing opportunities.

In essence, while the capital markets face challenges, our strategies are uniquely positioned to thrive. The unfolding landscape is opening doors to investment opportunities that we are well-equipped to capitalize on.

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