KordaMentha – TMA Australia 2023 Turnaround Survey

August 2023

Introduction

The annual KordaMentha – TMA Survey provides insights from the last 12 months and a perspective on the business and turnaround outlook beyond 2023.

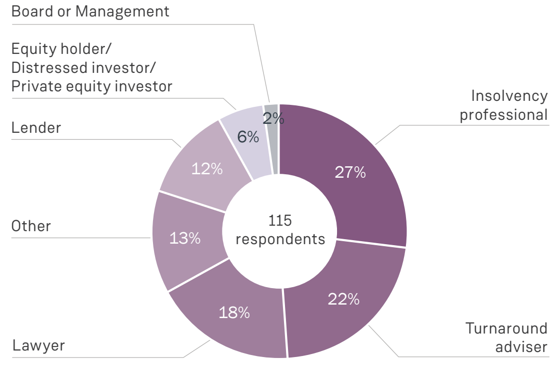
KordaMentha, in conjunction with the Turnaround Management Association of Australia ('TMA'), surveyed Australian insolvency, turnaround and other professionals for their insights on the current state and outlook for the next 12 months.

The results of the survey have now been tallied and summarised into the following topics:

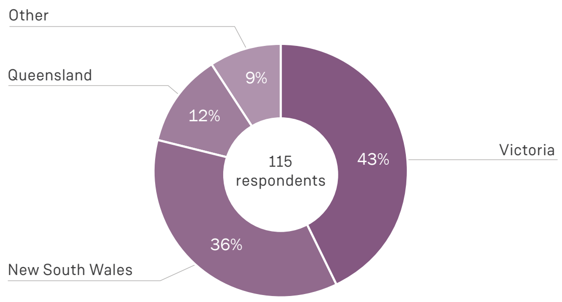
- Market outlook
- Australia's insolvency environment
- Current turnaround environment
- Drivers and management of distress
- Expected response from businesses
- Access to financing and ESG
- M&A activity
- Law reform.

Profile of respondents

By profession – Percentage, count (n=115)



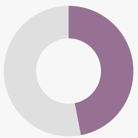
By state – Percentage, count (n=115)



Key insights

This year, respondent sentiment is resoundingly more bearish than previous surveys. Respondents overwhelmingly anticipate a recession as the impact of inflation and rising interest rates flow through the economy. Compounding these forces for business is a tightening of traditional debt and equity markets.

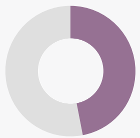
Recession



70%

Anticipate a recession in the next 12 months, including 19% who anticipate a recession in the next 6 months.

Inflation



47%

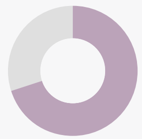
Anticipate inflation to remain around current levels over the next 12 months, with a third of respondents believing it will continue to rise.

Distressed sectors

57%

Point to construction, commercial real estate and consumer discretionary as the industries facing the most distress.

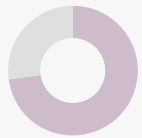
Financing



70%

Believe it has become harder to obtain new debt, whether from new or existing lenders.

M&A activity

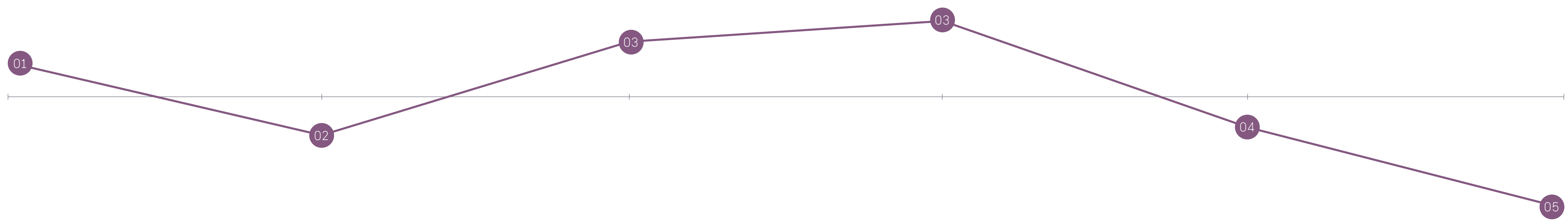


73%

Believe the market for opportunistic and distressed M&A transactions will increase in the next 12 months.

A timeline of survey responses

2023's survey has the firmest expectation for a near-term recession and the most bearish outlook. Access to debt and equity funding has largely dried up, construction businesses are entering administration, consumers are slowing spending, real estate valuations are declining, and costs and wages continue to rise. Companies have returned focus to cost reduction, after a period of emphasising growth in the low-rate, liquid market of 2021-2022.



2019

01 Pre-pandemic

- Minor concerns of a looming recession.
- Moderately easy access to funding, particularly from non-traditional lenders.
- Exceptionally strong equity finance market.
- Retail, construction and manufacturing sectors appeared distressed.

2020

02 COVID-shock Mar to May

- Companies entered crisis mode; tightening spend and focusing on survival.
- Uncertainty of forthcoming Government support.
- Daily COVID case numbers on the rise.

2020-2021

03 Buoyant market – Jun 20 to Dec 21

- Vast Government subsidies (particularly JobKeeper) helped to keep businesses afloat.
- Introduction of a Director moratorium for insolvent trading.
- Businesses focused on growth at all costs; RBA set cash rate of 0.1% and access to capital from all types of lenders was readily available.
- Hospitality, tourism and retail sectors appeared distressed.

2022

04 Declining conditions

- Uncertainty and volatility in markets.
- Broad anticipation of rise in distress and insolvencies.
- Reasonable conditions to obtain finance, however RBA began to rapidly increase the cash rate.
- Concerns over rising input costs.

2023

05 Recession concerns

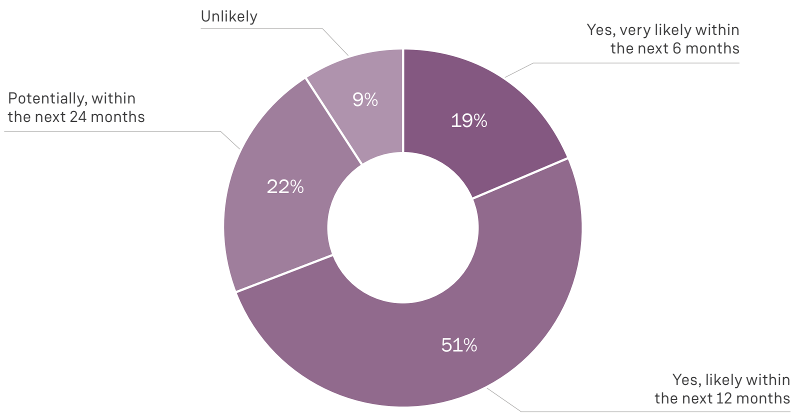
- Strong expectation of an Australian recession.
- Belief that inflation and interest rates will remain high for the next 12 months.
- Tightened lending and reduced consumer spending.
- Difficult conditions to obtain debt/equity finance.

Market outlook: Economic environment

51% of respondents anticipate that a recession is likely in Australia in the next 12 months, and 19% anticipate one is very likely in the next 6 months. This is a significant shift from September 2022 when only 27% of respondents anticipated a recession. Between surveys inflation has remained above 7% and the cash rate increased by 1.75% to 4.1% in July 2023.

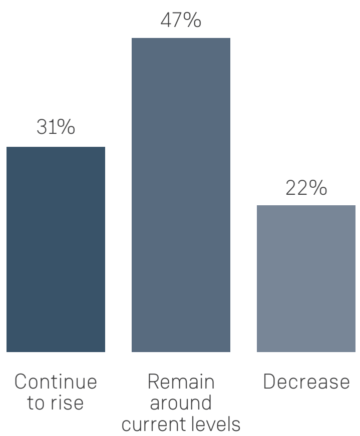
Recession

Do you anticipate a recession in Australia?

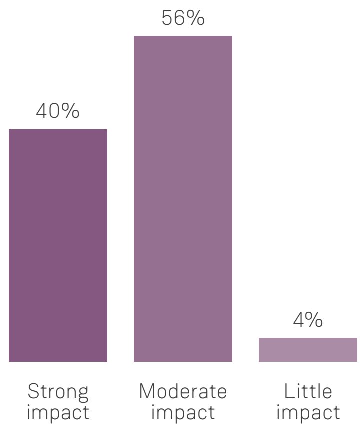


Inflation

What do you expect the inflation trend to be in the next 12 months?



What impact will the inflation trend have on business in Australia?



The majority of respondents anticipate a recession in the next 12 months; last year, only 27% of respondents anticipated a recession in the same time horizon.

High inflation, interest rates, cost bases and reduced consumer spend are key identified drivers for this perspective.

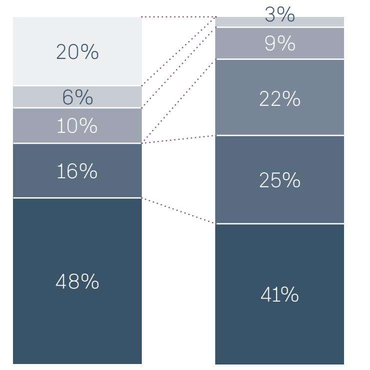
78% of respondents expect inflation to remain around current levels or continue to rise over the next 12 months. Only 22% expect a decrease, indicating that high input costs will remain a key driver of financial pressure.

Respondents believe that these continued levels of high inflation are going to have a meaningful impact on business in Australia.

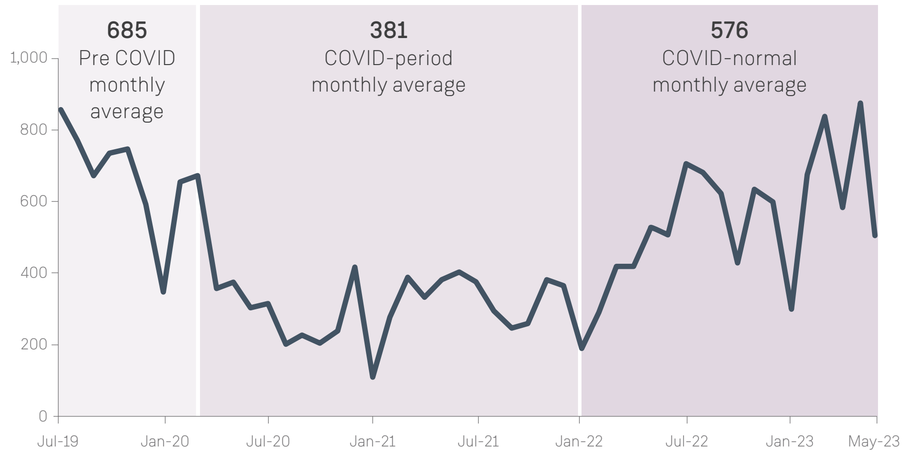
Australia's insolvency environment

Consistent with last year's survey, respondents believe the most influential trigger for formal insolvency appointments in the next 12 months will be ATO enforcements. Average monthly first-time company appointments of external administrators have steadily increased since the peak of the pandemic.

What will be the most influential trigger for formal insolvency appointments in the next 12 months?



Number of first-time company appointments of external administrators



"The ATO have been proactively reducing their arrears for some time now and we expect this trend to continue and the ATO to be more proactive in the market. Directors need to continue to be cognisant of their obligations across the board in a dynamic operational environment and seek early and appropriate support in times of financial stress."

Sebastian Hams
Partner
Restructuring

In last year's survey, unexpected continuations of lockdowns and subsequent government support were highlighted as key factors why the number of external administrations remained low.

Looking ahead, respondents believe that formal insolvency appointments will be driven by ATO enforcements, secured creditor enforcement and company appointments.

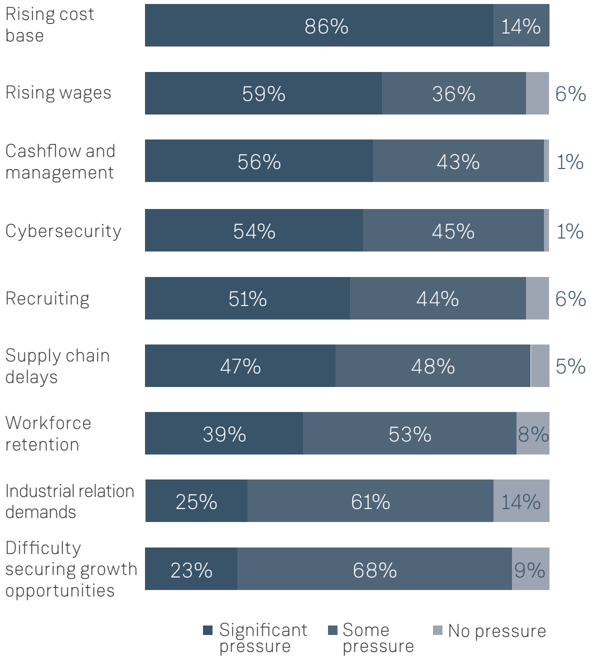
Source: ASIC insolvency statistics.

Current turnaround environment: Drivers and management of distress

Rising costs and wage increases are the primary cause of financial pressure on businesses. These pressures are leading to distress in sectors that are unable to pass through these costs to consumers either for contractual reasons (construction) or due to weak demand (consumer discretionary and commercial real estate).

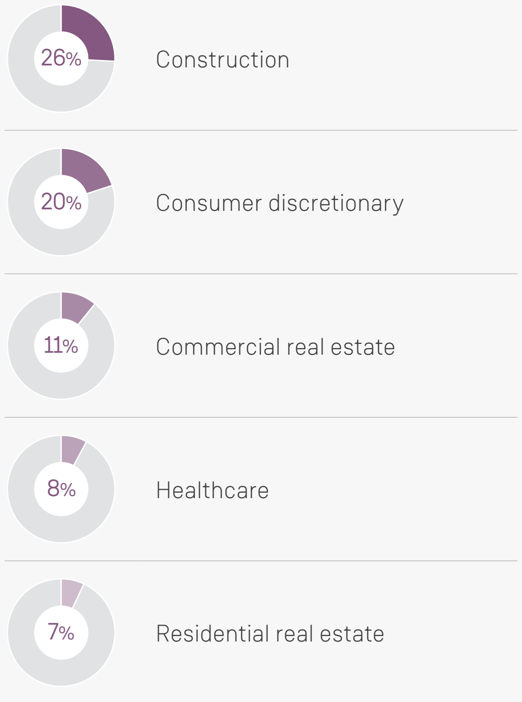
Key pressures causing distress

How would you describe the pressure businesses are facing from each of the following?



Five most distressed sectors

Which of the following sectors are currently facing the most distress?



> "Price escalations have been rife across the property value chain, from building material costs to skilled labour costs. Many projects are facing immense risks as fixed-price contracts were entered before these dramatic cost increases. Prudentially managing cashflow and workforce is now more important than ever."

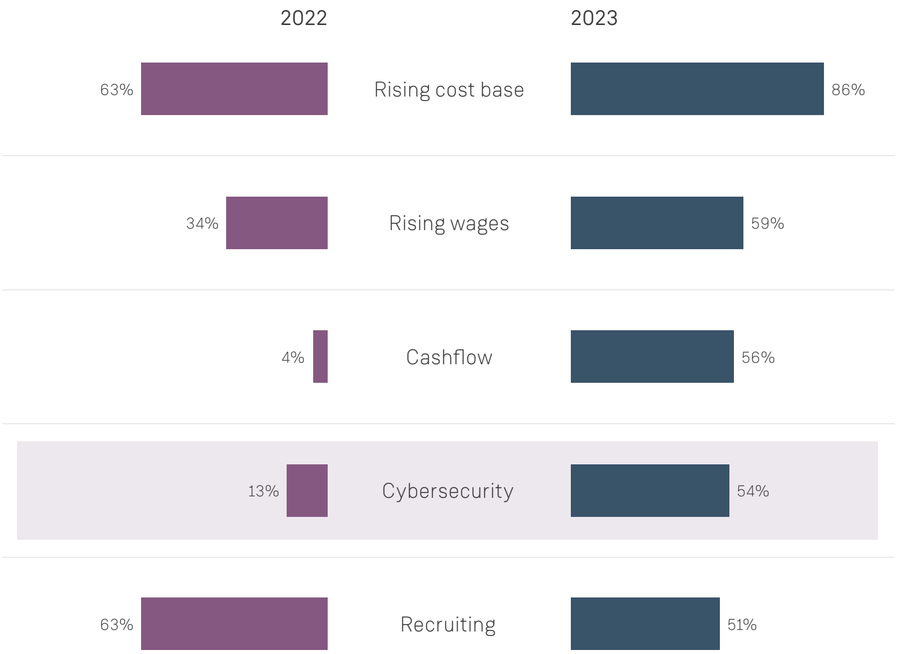
Zachary Pearson
Executive Director
Real Estate

Current turnaround environment: Drivers and management of distress

Whilst financial factors are causing the most pressure on business, the growth of cybersecurity as a factor continues. Cybersecurity risk has continued to dominate boardrooms following another year of public breaches.

Factors causing business pressure

Top five factors causing significant pressure to business, ’22 – ‘23



> The increase in cybersecurity threats to business is likely to continue and increase in scale in the years to come. As the threat landscape evolves with increasing automation, and new technologies, businesses will need to adapt their cybersecurity strategies accordingly.
>
> Cybersecurity risk is now a board-level issue. Boards of directors need to be aware of the risks and take steps to mitigate them.
>
> In response to the growing threat of cyberattacks it is imperative that businesses:
>
> - Implement a strong cybersecurity culture. This includes raising awareness of cybersecurity risks among employees and ensure they are trained how to protect themselves and the organisation
> - Implement a comprehensive cybersecurity program. This includes having a risk assessment, implementing security controls and monitoring for threats
> - Be prepared to respond to a cyberattack. This includes having a plan in place, exercise the plan, counter the attack and recover from it.

Rahul Lobo
Partner
Cybersecurity

Expected response from businesses

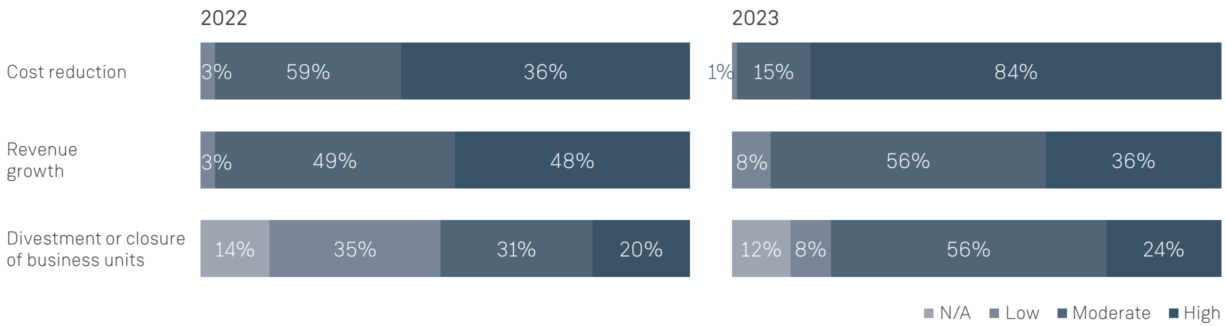
There has been a clear change in sentiment as organisations shift from a focus of revenue growth in a low interest rate environment to tight cost control. As balance sheets weaken and business unit performance is scrutinised, divestment or closures of underperforming business units are increasingly being explored.

"The immense amount of stimulus in the economy throughout the Covid period allowed business to access cheap capital and focus on growth at all costs. With cost pressures mounting on the back of rapid rises in inflation and interest rates, businesses are being forced to preserve and deploy relatively sparse capital with a focus on survival. This may take the form of streamlining operating models and reducing duplication, through to strategically refocusing and reprioritising individual functional areas of the business."

Suzanne Wauchope
Partner
Performance Improvement

Key short-term initiatives and focus areas

What is the importance of each of the following initiatives for businesses over the next 12 months?



Responses in the 2023 survey suggest businesses must consider both revenue and cost initiatives to navigate through the current economic challenges.

- In our 2022 survey, 59% of respondents viewed cost reduction initiatives as high importance, compared to 84% this year.
- Revenue growth initiatives were viewed as slightly lesser importance to last year, with 36% of responses considering it of high importance compared to 48% in 2022.
- Initiatives relating to the divestment or closure of business units have increased in relative importance, with 80% of respondents believing this to be of moderate to high importance, up from 51% in 2022.

Access to financing and ESG

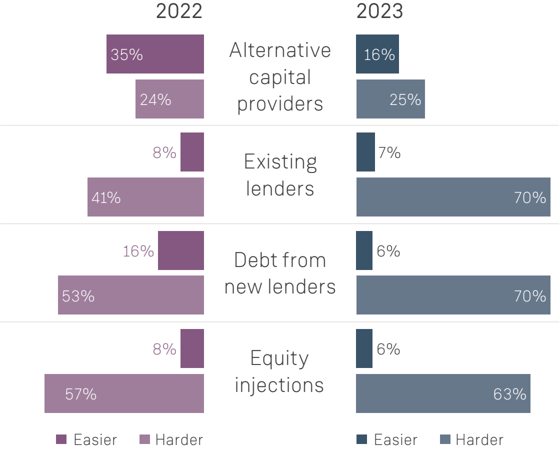
Access to capital via both traditional debt and equity has become harder, while alternative capital providers appear to be an available option for some. Despite the macro forces at play, Environmental, Social and Governance considerations are becoming even more important for lenders.

> "Economic uncertainly, changing regulatory environments and evolving investor expectations have all contributed to the rise of alternative capital providers, providing diverse funding options outside the scope of traditional financiers, particularly in stressed and distressed situations.
>
> ESG is now forming a much larger part of the due diligence process in financing transactions, with alternative lenders recognising the need to evaluate borrowers from a financial and ESG perspective, driven by regulatory and risk management pressures, along with stakeholder and investor demands."

Kate Conneely
Partner
Restructuring

Access to finance

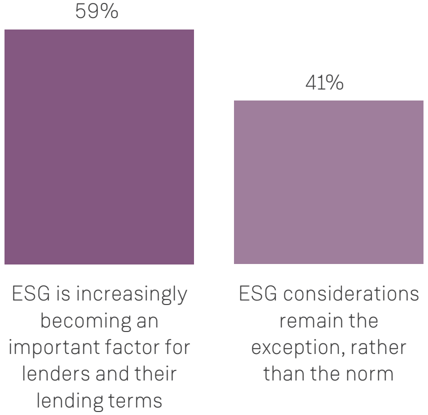
How have organisations' ability to secure the following external debt or equity finance changed over the last 12 months?



Respondents believe that organisations' access to all forms of debt or equity financing has become more challenging in the last 12 months. As expected, with the distress in the market, financing from alternative capital providers (special situation funds, hedge funds, PE funds) are viewed as the most accessible avenue for funding.

ESG

How have ESG considerations impacted companies seeking refinancing or recapitalisation over the last 12 months?



The majority of respondents believe that ESG factors are increasingly becoming important for lenders and their lending terms.

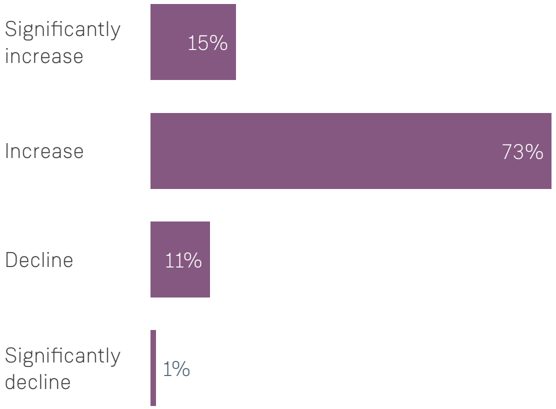
In an environment of decreased liquidity and increased distress, businesses that can demonstrate strong ESG practices may be able to gain more traction with financiers.

M&A activity

Respondents resoundingly believe opportunistic M&A activity relating to distressed assets will increase over the next 12 months, driven by a desire to make bolt-on acquisitions and an urgency to sell.

M&A activity

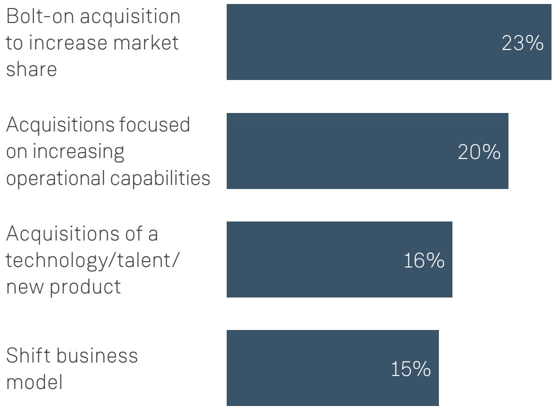
How will M&A transactions related to distressed assets trend over the next 12 months?



88% of respondents believe M&A activity transactions relating to distressed assets will slightly or significantly increase over the next 12 months, compared to 73% in the 2022 survey.

Drivers of M&A activity

What will be the key drivers of M&A activity in the next 12 months?



Respondents believe that M&A activity in this distressed environment will mostly focus on expanding services offerings, capabilities, technologies, talent or products to increase market share.

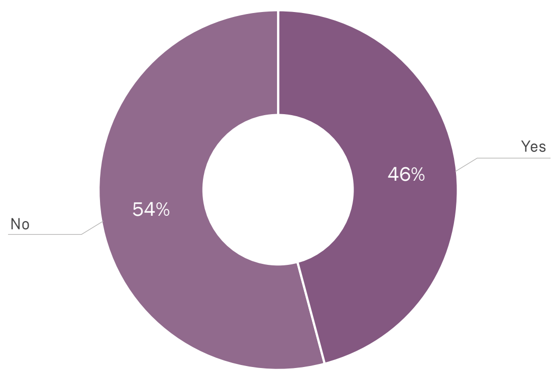
"We will see more underperforming assets with the potential for turnaround upside. Those willing to transact should scrutinise the post deal delivery plan. Any acquisition based on turnaround potential carries significantly greater risk, and will require strong execution capability to extract the value promised in the deal."

Sophie Gibbons
Partner
Performance Improvement

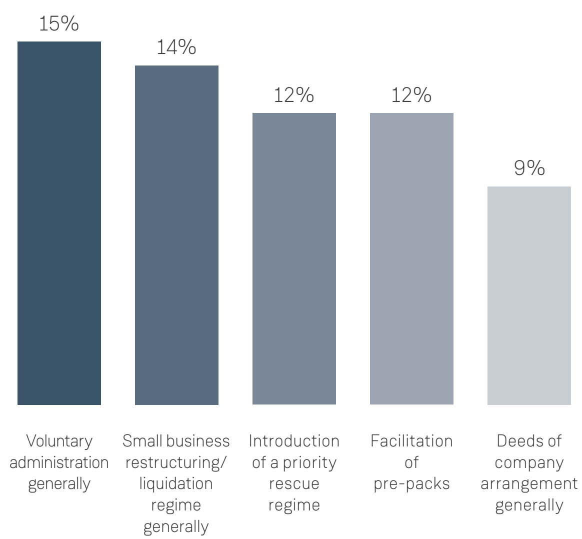
Law reform

Almost half of the respondents believe that there is a significant need to reform aspects of restructuring or insolvency law in Australia; these areas include voluntary administration generally and small business restructuring/liquidation generally.

Do you think there is significant need to reform any aspects of restructuring or insolvency law in Australia?



Areas most in need of law reform



"Piecemeal reform of Australia's insolvency laws over the past decade has resulted in an increasingly complex and costly framework that is confusing for participants and creates uncertainty in key areas. Recommendations from the recent Parliamentary Inquiry clearly recognise the need for more holistic change to develop an accessible, modern regime that supports better outcomes for all stakeholders."

Lara Wiggins
Executive Director
Restructuring

"Australia requires a UK-style restructuring plan for genuine mid-market and larger businesses"

"Safe harbour provides a lawful mechanism, but Directors still lack the aptitude and confidence to apply"

"Insolvent trading needs a rethink. The UK model of 'wrongful trading' strikes me as a better model. Our laws are too puritanical"

"Regulation of the 'pre-insolvency' space is needed to exclude all individuals unless they are qualified accountants or practicing lawyers"

Our team

For specific questions or feedback in relation to the survey, please contact one of our team members below.

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