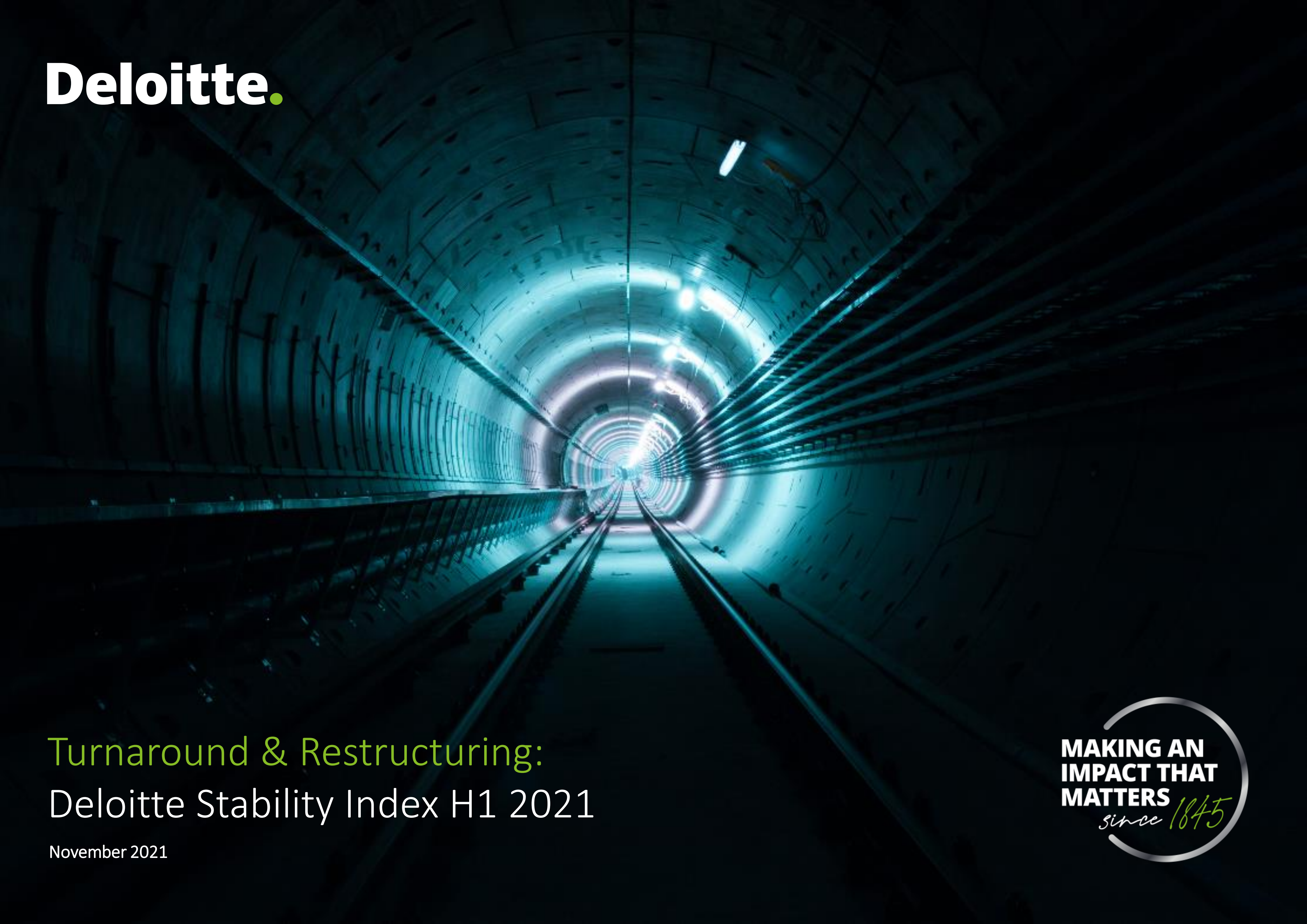


Deloitte.

Turnaround & Restructuring:
Deloitte Stability Index H1 2021

November 2021

MAKING AN IMPACT THAT MATTERS since 1845

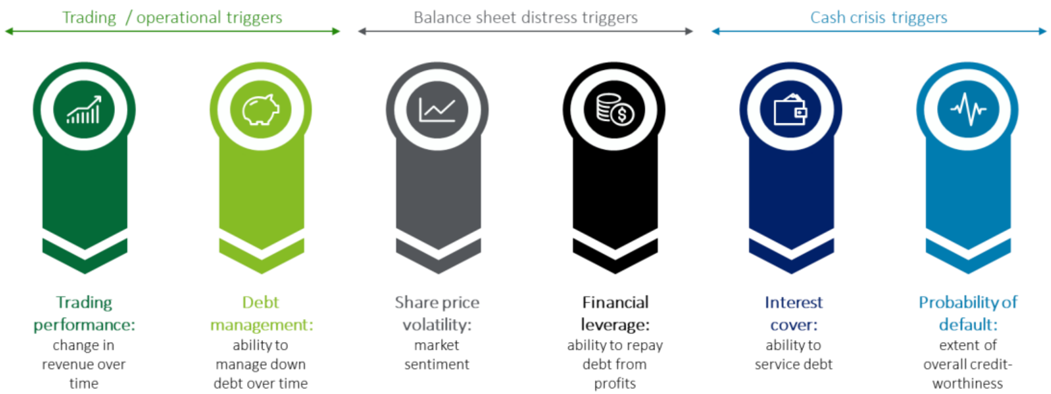
Contents

01 Deloitte Stability Index

Deloitte Stability Index

The Deloitte Stability Index ("**DSI**") measures the extent to which a company is financially stable based on a granular model that converts leading indicators into a composite score.

The Deloitte Stability Index tracks six leading indicators



We take a four-step approach to arrive at a DSI score

Ratio analysis 1	The six ratios opposite are calculated for each listed company in the dataset for the defined time periods.
Scoring 2	Each ratio is assigned a score based on boundaries that have been set.
Aggregation 3	The six ratios are aggregated to form an overall score out of 100, where 100 is the lowest level of stability.
Categorisation 4	We assign each company a sector classification based on Deloitte's industry taxonomy, and banking relationships are derived from AFS.

Key themes for H1 2021:

Credit taps were open at the height of the crisis

Total debt increased by c.R250bn in the first wave of Covid-19 as lenders rushed to the aid of their clients, preventing a credit crunch – this drove down the DSI in 2020.

Covid-19 has had a polarising impact on the JSE

The gap between the top and bottom 20 performers widened during Covid-19, creating "winners" and "losers" along sector lines.

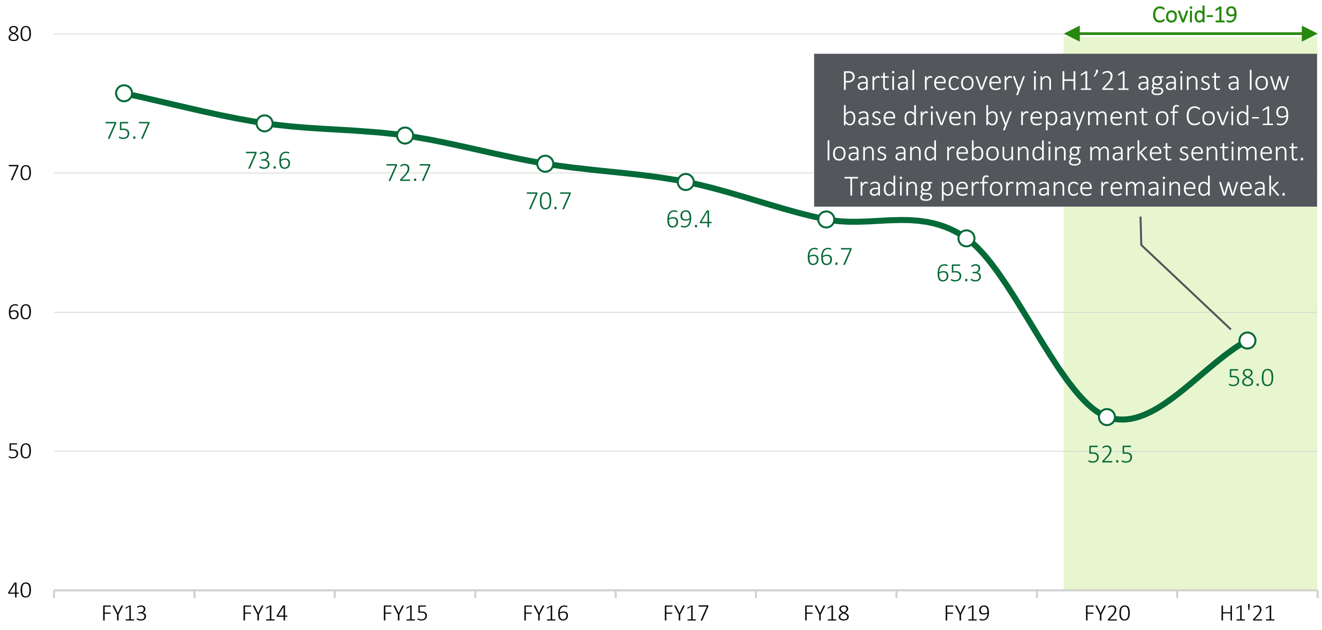
The "winners" repaid Covid-19 loans in H1 2021

The improvement in the overall DSI score in H1 2021 was driven by companies who took the opportunity to repay Covid-19 loans.

But trading remains muted

The metrics that track trading remained low in H1 2021. For many, liquidity runway is rapidly disappearing: difficult decisions must be made.

Figure 1.1: Deloitte Stability Index Score (score is stated out of 100)

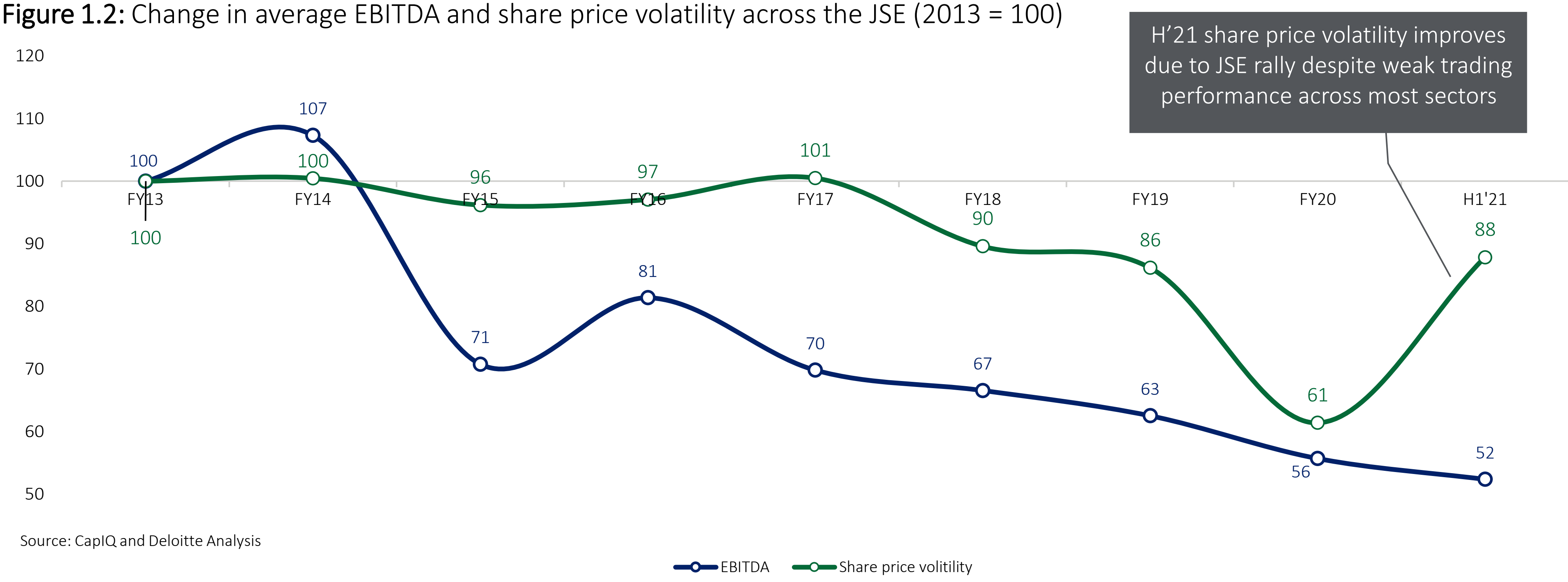


Key assumptions and limitations

- DSI data is based on publicly available information for listed JSE companies as reported on Capital IQ. We have not sought to audit, verify or reconcile this data to original annual financial statements.
- Detailed DSI information is available on request.

The headline-grabbing rally in JSE stocks has been fuelled by global factors such as a booming commodities market and optimism around a global recovery – this is reflected in the H1’21 uptick in the DSI. But this rally seems to belie local fundamentals where fragile business and consumer confidence has kept trading performance weak in 2021.

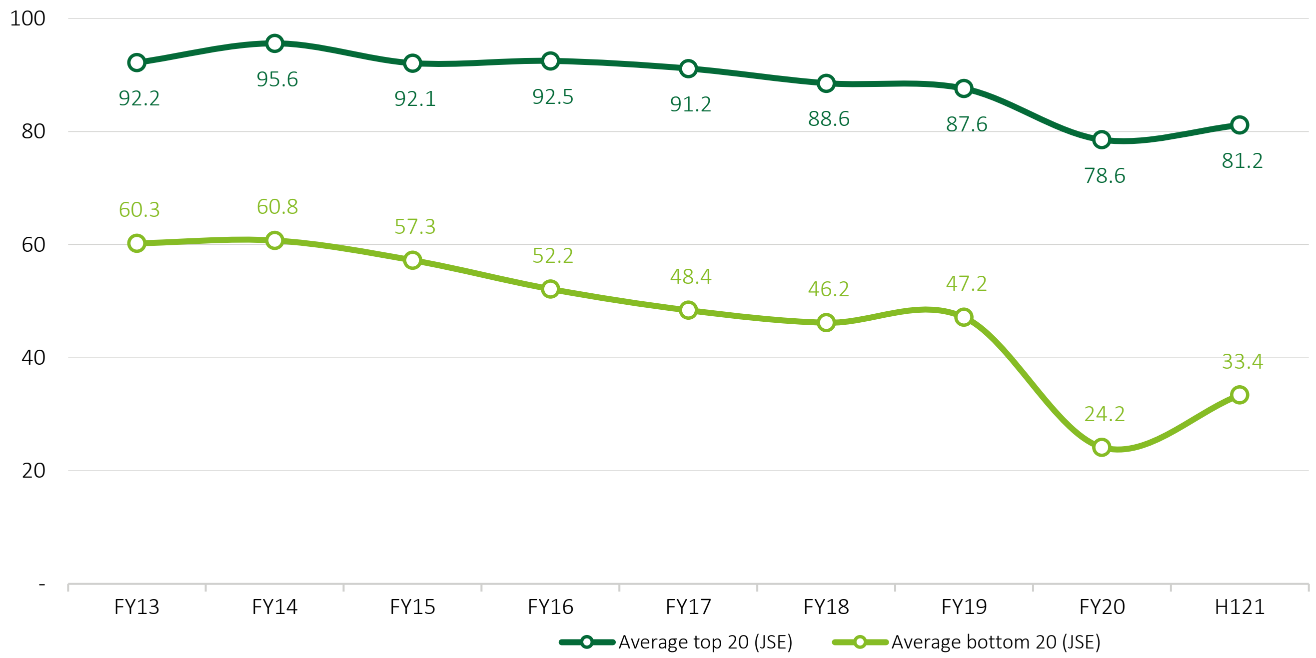
Figure 1.2: Change in average EBITDA and share price volatility across the JSE (2013 = 100)



Source: CapIQ and Deloitte Analysis

The gap between the best and worst performers widened during the Covid-19 pandemic for the JSE: mining, metals and chemical companies benefited from the commodity price boom, keeping the average top 20 score trending near 100, whereas the Covid-vulnerable real estate and hospitality sectors drove the bottom 20 score ever lower.

Figure 1.3: Deloitte Stability Index score (score is stated out of 100)



High performing sectors

- Banking and capital markets
- Insurance
- Investment management
- Life sciences
- Telecoms, media and entertainment

Low performing sectors

- Automotive
- Healthcare
- Industrial products and construction
- Real estate
- Transportation, hospitality and services

South Africa's ailing healthcare sector, and the real estate and hospitality sectors are particularly vulnerable to Covid-19 lockdowns. The workout of lender exposures to these Covid-vulnerable sectors hinges on an accelerated vaccine rollout programme and, for hospitality, continued lobbying of key tourist markets such as the UK to ensure SA remains off red lists ahead of the critical December period.

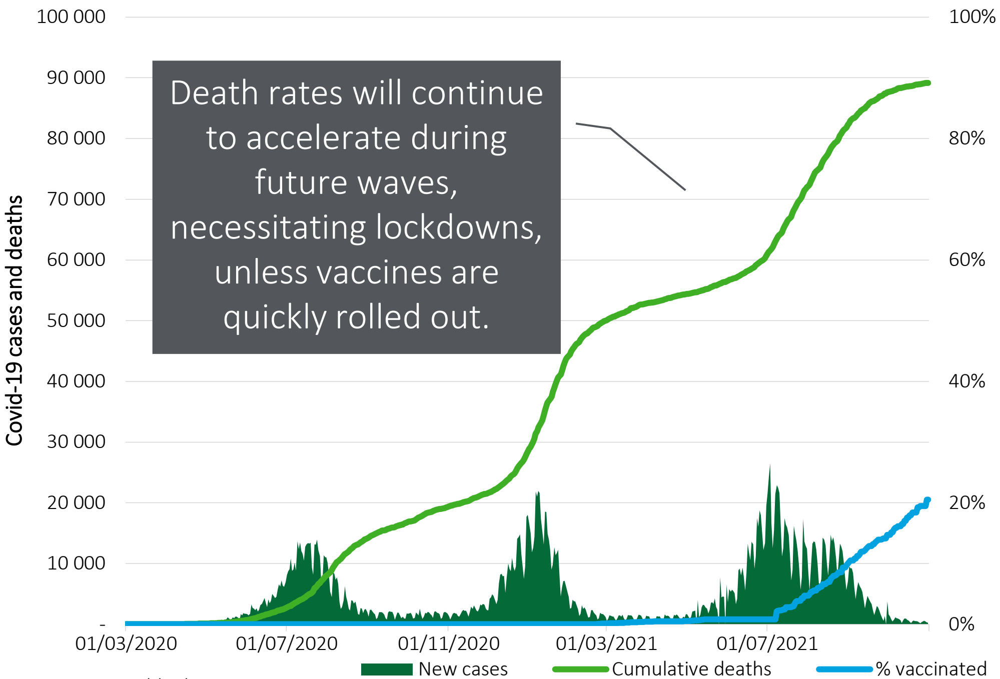
Sector	No. of constituents in H1'21	Deloitte Stability Index score by sector									Covid-resilient sector?	Sector outlook
		FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	H1'21		
Automotive	4	84.7	76.3	75.0	73.7	68.3	74.5	70.0	39.0	50.5	No	Neutral
Banking and capital markets	3	59.5	67.5	79.5	64.7	65.3	73.7	77.7	68.3	67.3	Yes	Neutral
Consumer products	26	79.6	82.0	79.0	78.2	75.8	72.4	70.9	59.6	61.0	No	Strong
Healthcare	4	88.5	88.0	86.3	72.3	61.3	68.0	66.8	38.5	39.3	No	Weak
Industrial products and construction	19	76.6	72.7	67.1	67.7	66.0	69.9	60.8	42.4	55.1	No	Weak
Insurance	9	95.2	89.1	86.7	79.8	87.2	84.3	85.4	63.8	67.0	No	Weak
Investment management	19	67.6	76.6	74.8	71.0	68.4	61.0	71.3	62.3	69.4	Yes	Neutral
Life Sciences	3	75.0	59.0	77.3	71.3	73.0	55.0	63.0	63.3	68.3	Yes	Weak
Mining and metals	28	71.2	70.0	59.7	66.5	67.2	65.0	65.3	58.4	64.0	Yes	Strong
Oil, gas and chemicals	12	75.5	71.8	75.5	71.8	66.6	65.7	59.8	47.8	55.6	No	Weak
Real estate	38	68.9	59.9	65.3	61.0	63.2	57.8	56.1	44.8	46.3	No	Weak
Retail, wholesale and distribution	17	75.7	80.7	74.6	68.5	74.7	71.9	72.2	52.2	60.4	No	Strong
Technology	20	78.2	72.3	82.1	76.2	71.1	62.9	61.0	52.8	61.5	No	Strong
Telecoms, media and entertainment	11	75.1	73.8	76.1	78.1	75.9	73.3	73.4	70.1	68.2	Yes	Strong
Transportation, hospitality and services	20	74.9	73.4	71.2	73.3	64.1	64.2	60.0	41.7	49.7	No	Weak

02 Market update

The rise of black swan events

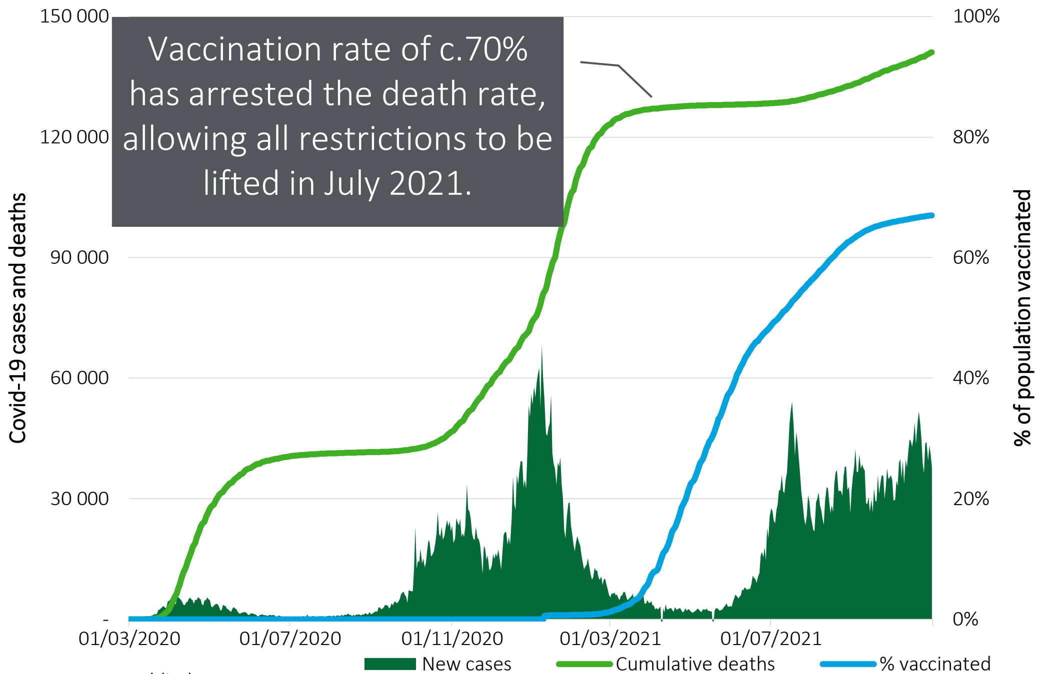
Precedent from advanced economies shows that a successful vaccine rollout is key to eliminating draconian lockdown measures. However, SA’s rollout has been slow despite being open to all adults.

Figure 2.1: Covid-19 data for South Africa



Source: ourworldindata.org

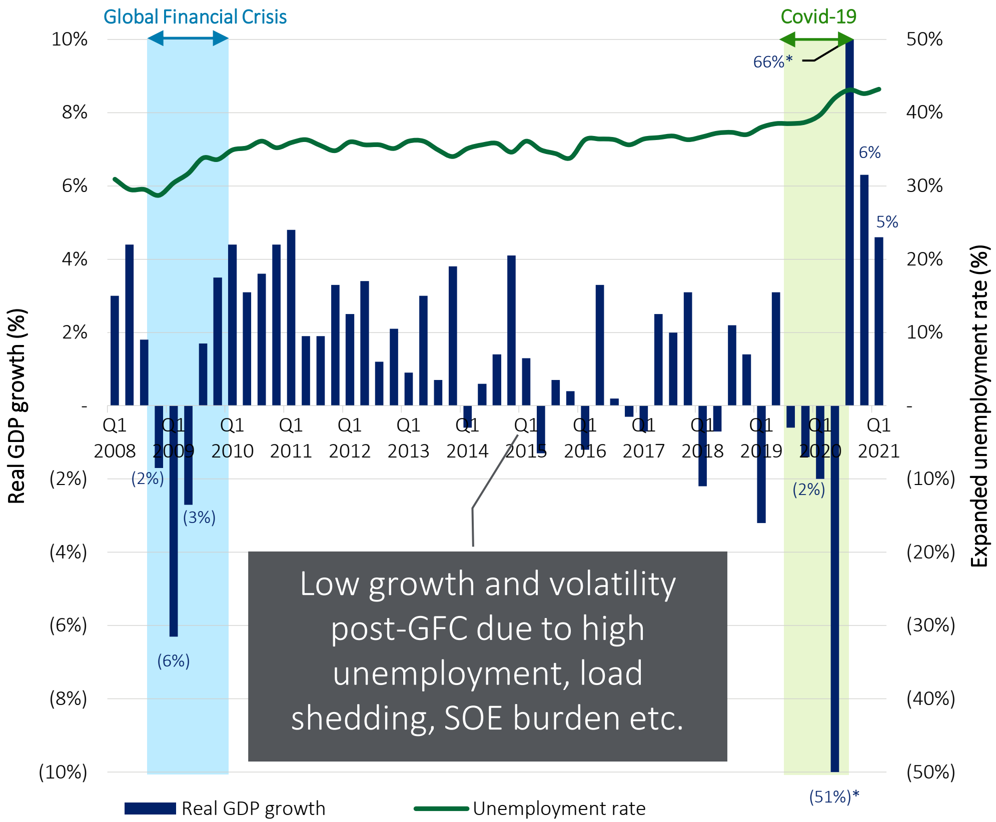
Figure 2.2: Covid-19 data for the UK



Source: ourworldindata.org

South African companies were just coming to grips with the impact of the Covid-19 pandemic when the July 2021 riots hit. The events of the past year have shown that black swan events will continue to increase in frequency. How management teams respond will become a critical determinant of survival.

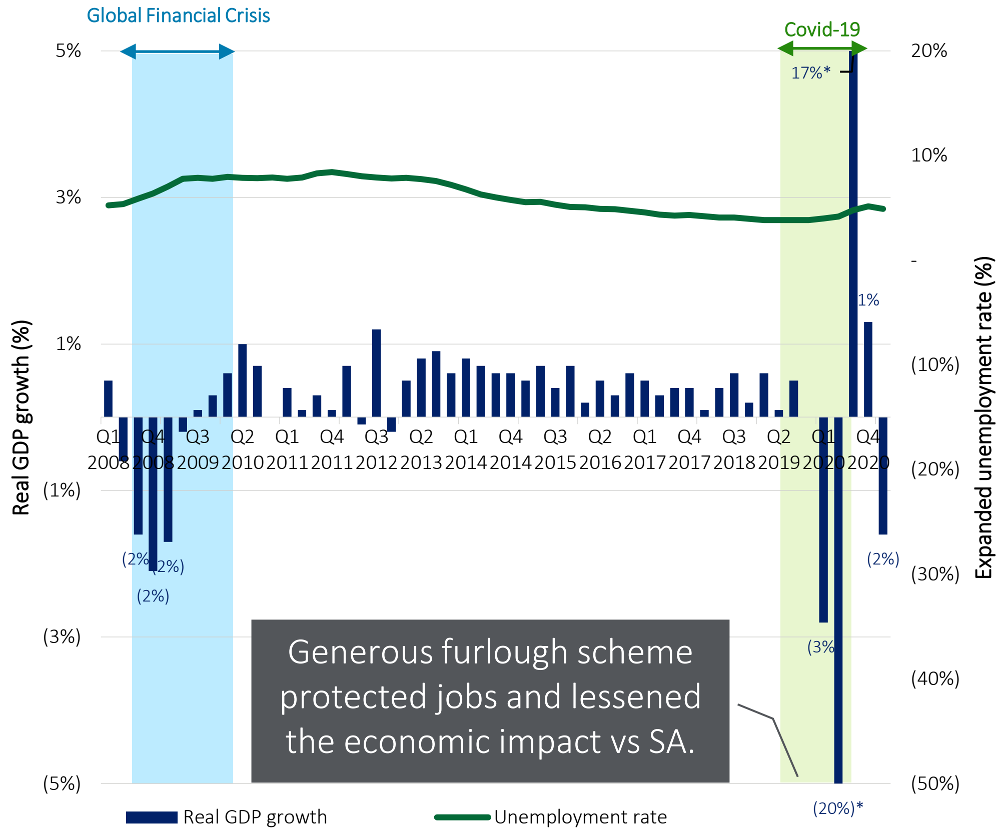
Figure 2.3: SA unemployment v GDP growth



Source: Stats SA

* Axis capped at 10% / (10%) for readability)

Figure 2.4: UK unemployment v GDP growth



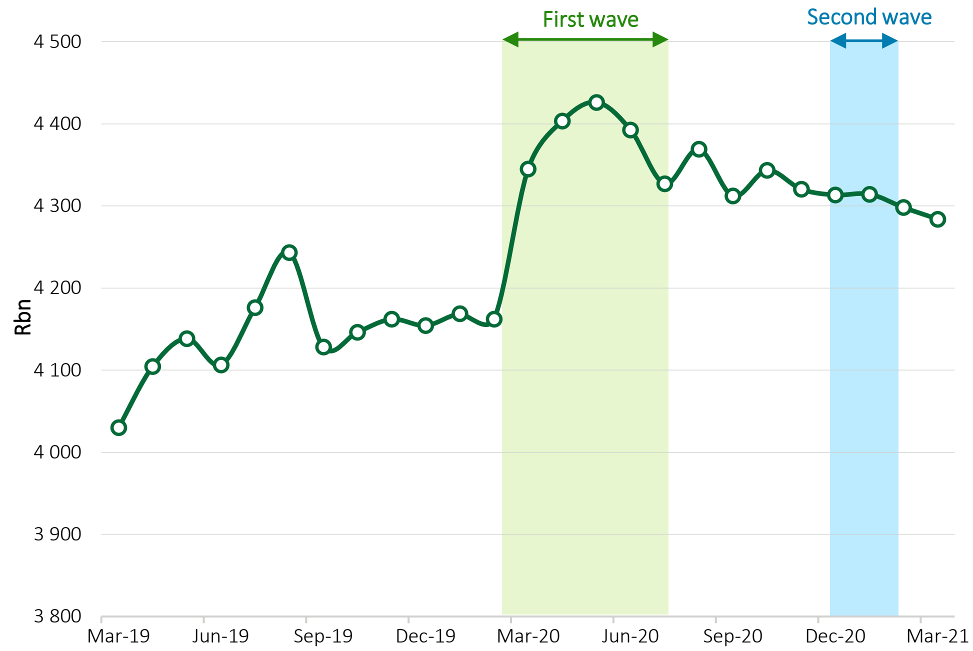
Source: ONS

* Axis capped at 5% / (5%) for readability)

The end of the road?

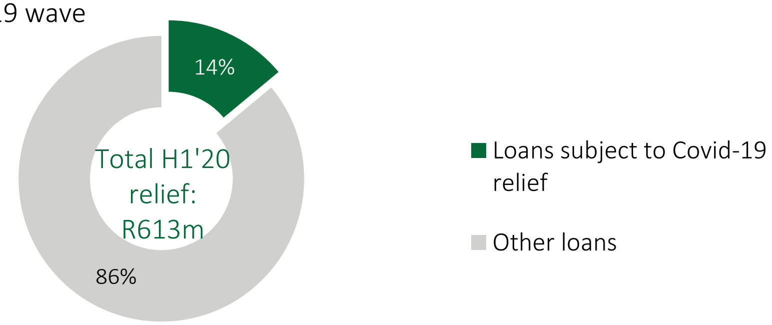
The banking sector has taken up the mantle of supporting South Africa's economy through the pandemic so far. But as commercial enterprises, banks' capacity to fulfil a sovereign role is limited.

Figure 2.5: Total credit extended to the private sector in SA



Source: SARB

Figure 2.6: Covid-19 relief provided by the 'Big Four' SA banks during the first Covid-19 wave



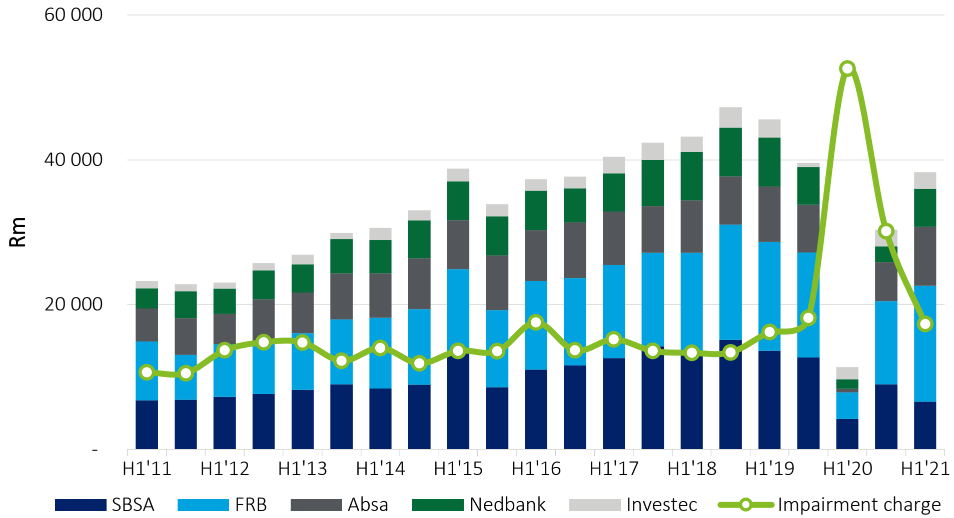
Source: interim and annual financial statements

"67% of respondents to the 2021 Deloitte Restructuring Survey believe financial institutions handled the fallout from the Covid-19 pandemic well, compared to 8% for government".

As we continue to see volatility in banks' profits and shareholder returns, we expect to see less support towards distressed clients, particularly where there is no clear turnaround plan.

It may be the end of the road for restructuring options such as 'amend & extend', especially given the more stringent capital requirements for distressed positions – tough decisions will need to be made by all stakeholders.

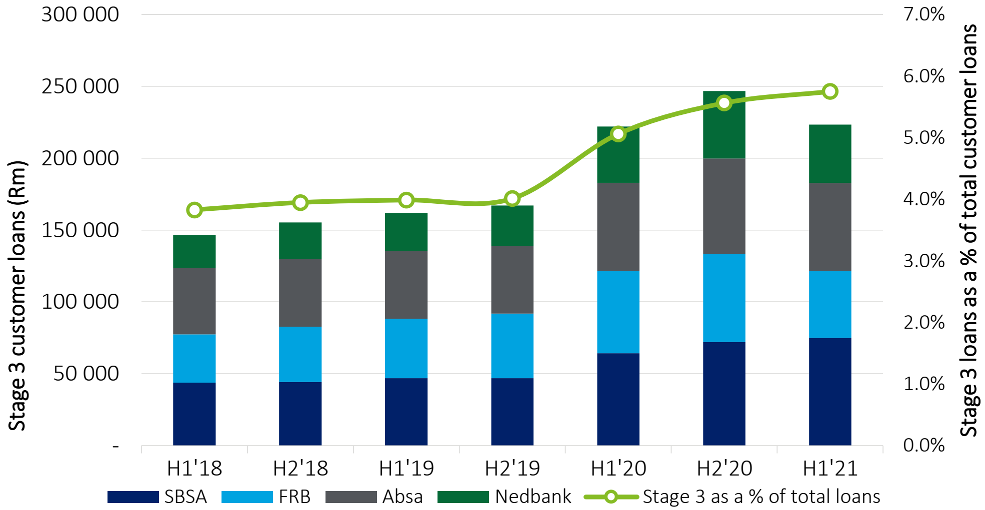
Figure 2.7: Headline earnings and impairments by major SA bank[1]



Source: Capital IQ, annual financial statements

[1]At the time of writing, Investec had not reported H1'21 data, therefore H2'20 data shown in the graph

Figure 2.8: Stage 3 customer loans



Source: interim and annual financial statements

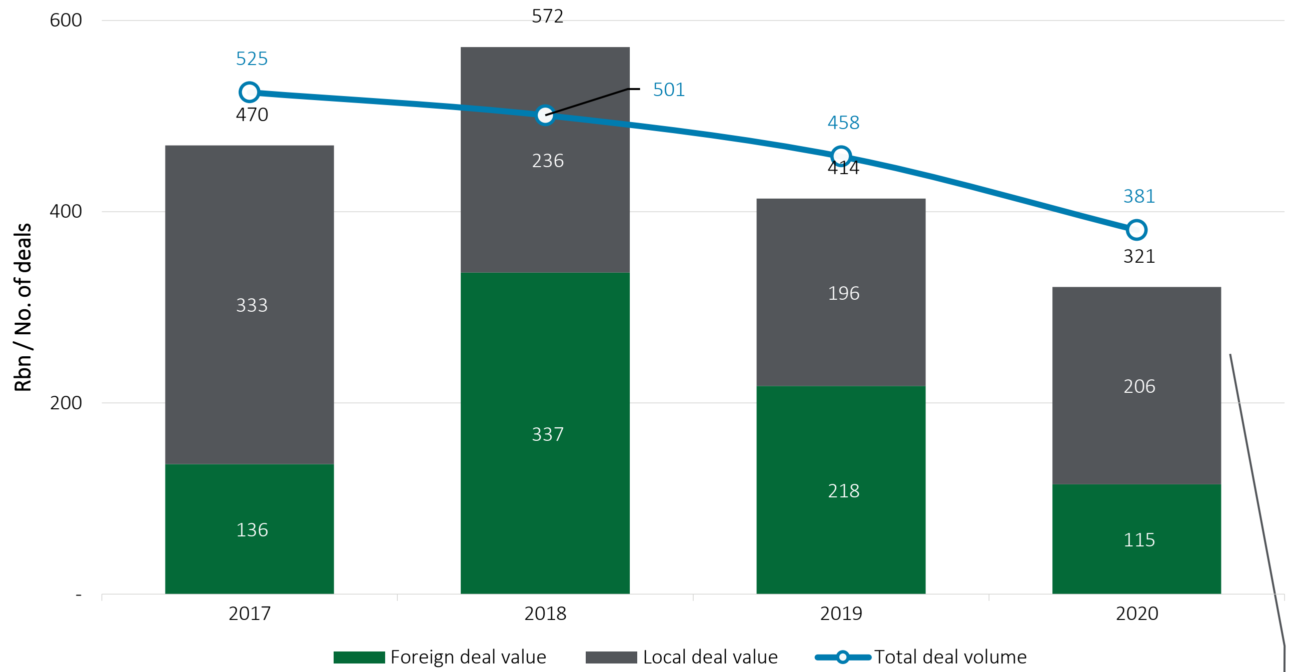
Without further lender support, many 'zombie' companies that are unable to articulate a coherent turnaround strategy will face insolvency, either via business rescue or directly into liquidation.

"However, business rescue is only a means to an end, not the end itself."

Recent case law places increasing pressure on BRPs to deliver a plan in shorter timeframes and stakeholder impatience with the business rescue framework is increasing.

With these factors at play, we believe that accelerated M&A will become the standard exit route out of business rescue.

Figure 2.9: Listed M&A activity in SA



Source: Dealmakers South Africa

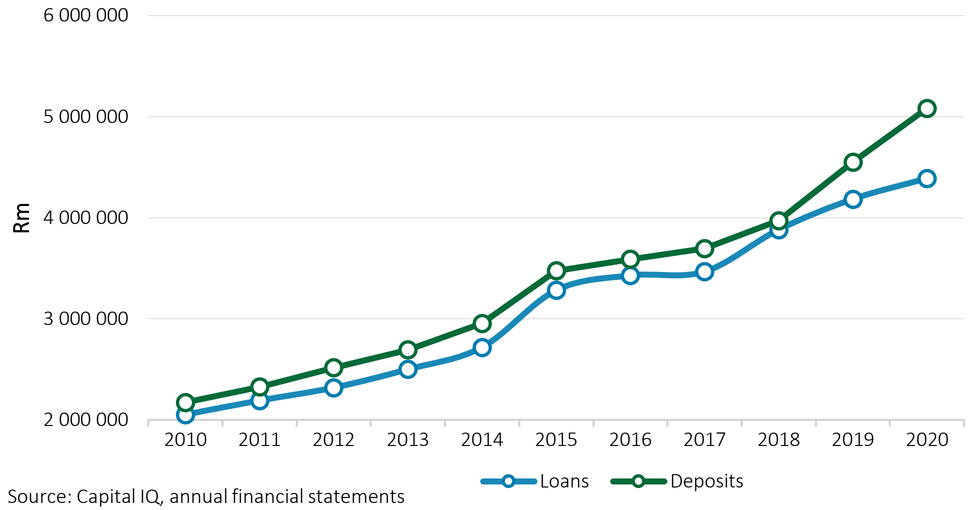
Fall in deal activity driven by deals where one party was non-SA due to logistical difficulty of conducting DDs remotely and reluctance of SA companies to invest abroad following recent high profile failures.

Local deals slightly up due to uptick in distressed M&A activity.

A new beginning

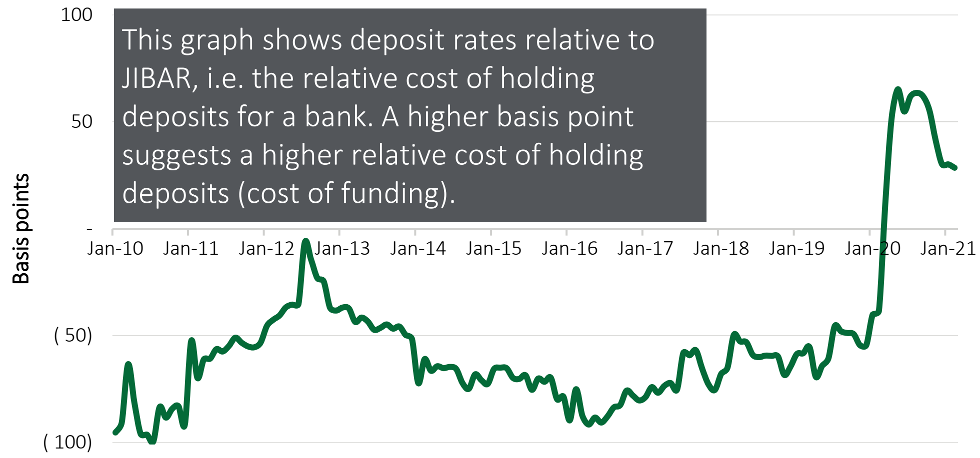
Banks have capital to deploy and the cost of not putting it to work is increasing. Companies with a clearly articulated investment case supported by robust forecasts should be able to secure funding on favourable terms.

Figure 2.10: Total deposits vs loans for the big four SA banks



Source: Capital IQ, annual financial statements

Figure 2.11: Weighted average cost of funding for SA banks



Source: SARB

03 Appendix: Our growing team

Our growing team

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Key highlights:

- Almost 50 years of collective restructuring experience
- Over 25 years of European experience
- Almost 20 years of banking and private equity experience
- Full team membership of SARIPA / TMA
- Whole team enrolled in SARIPA insolvency law course
- Five chartered accountants
- Global insolvency / cross border expertise

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