European Corporate Outlook: In The Firing Line

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Tech Disruption: Case Study (1/2)

In January 2018, Amazon.com Inc., Berkshire Hathaway Inc., and JPMorgan Chase announced that they were planning to join forces to reduce healthcare costs for their employees by forming a non-profit entity. Though details on the plan were sparse, the US healthcare industry registered a loss of market cap of about $69 billion on same day, highlighting investor jitters around the sustainability of margins given healthcare business models that provide limited pricing transparency.

Selected Insurance and Pharmacy Companies’s Market Cap Loss on Announcement

S&P Global Ratings thinks the healthcare industry is ripe for disruption given its increasing costs, growing consumerism, and greater regulatory scrutiny. The industry is also opaque with respect to pricing and how much players are compensated along the supply chain, so entrance by an e-commerce giant like Amazon could be a game changer.

Amazon has brought price transparency and convenience to many retail segments, shifting consumer expectations and behaviors with its e-commerce model. Legacy retailers are in various stages of adapting to the new landscape and not all have been successful.

Several Negative Rating Actions in EMEA in 2017-2018 Driven By Disruption In A Context Of Economic Recovery

2017-2018 Ratings Actions in Europe by Sector (#)

Our Analysts Assess Disruption Among The Top Risks At Par With The Macro Risk

Q: In one or two words, what is the biggest risk factor facing your industry?

S&P Global Ratings analysts have been asked to describe in one or two words of freeform text, the biggest risk factor facing their industry. The figure above gathers those responses into the themes that could be categorized from the responses. Chart shows percentage of responses for each category.

Italian Corporate Investments Is Benefiting From Industry 4.0 Tax Benefits. Will It Endure?

Corporate fixed Investments change yoy and contribution to GDP (2008 - 1H2018)

Source: Istat

S&P Global Ratings
Global Competitiveness: Italy Ranks 31°, But 22° On Innovation Capability

Source: World Economic Forum

S&P Global Ratings
## Top European Risks

<table>
<thead>
<tr>
<th>Risk level</th>
<th>Very low</th>
<th>Moderate</th>
<th>Elevated</th>
<th>High</th>
<th>Very high</th>
<th>Risk trend</th>
<th>Improving</th>
<th>Unchanged</th>
<th>Worsening</th>
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<td><strong>Global Trade</strong></td>
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<td>Downside risk is growing of a material escalation in trade tensions if the U.S. administration opens a new front against Europe, and the German auto industry in particular, provoking a tit-for-tat response. The concern is that global supply chains would start to unwind, given no obvious path to resolve the underlying issues anytime soon.</td>
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<td><strong>Disruptive Brexit</strong></td>
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<td>The likelihood of a disruptive Brexit in March 2019 is increasing as there is no obvious landing zone for the outline political agreement on the future relationship required as part of the legal withdrawal treaty. The unwillingness of both the U.K. and EU to publicly coordinate their &quot;no deal&quot; safeguarding measures risks exacerbating the inevitable disruption that would arise.</td>
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<td><strong>Asset Price Volatility</strong></td>
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<td>While European financial markets are showing sensitivity to idiosyncratic risk and monetary conditions are starting to tighten gradually, the main threats to markets continue to be external, relating to growing trade tensions and the potential for contagion to spread among emerging markets.</td>
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<td><strong>Weakening European Political Cohesion</strong></td>
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<td>Mainstream political parties continue to be challenged from all sides, with Sweden the latest to veer to the right. With their sights set firmly on the European parliamentary elections next May, a sizable vote for nationalist parties could put the brakes on any remaining momentum toward an ever-closer union. This would also make it harder for the European Commission to guide social and economic policies to improve solidarity. Immigration remains one highly divisive issue that may yet undermine the free movement of labor within Schengen.</td>
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Global Trade Risk: In The EU, Germany and Italy Are The Largest Contributors To US Trade Deficit

Main country elements of US visible trade deficit (US$ Billion, 12 months to February, 2018)

EU visible trade balance with US by country (US$ Billion)

Source: U.S. Census Bureau, Thomson Reuters Datastream, S&P Global Ratings.
European Business Confidence Indicators Retraced From Peak, Though Still Pointing To Expansion

Global Manufacturing PMI trend (Jan 2016 – Jul 18)

Source: Markit, Thomson Reuters Datastream

Italy Industrial production and business confidence indicators (monthly data, Index 2015 = 100)

Source: S&P Global Ratings
Italian Corporate Profitability Further Recovered In 2017, But Gap Persists With Europe

Italian Companies and Rated European Companies: EBITDA margin 2006-2017e

Source: S&P Global Market Intelligence, S&P Global Ratings calculations
Italian Corporate Financial Leverage Further Improved In 2017, And Is Aligned With European Average

Italian Companies and Rated European Companies: Debt/EBITDA 2006-2017e

Source: S&P Global Market Intelligence, S&P Global Ratings calculations
Corporate Bond Yield Curve Moderately Shifted Upward Since 2017 Bottom

ENI SpA

YTM 9/10/2018  YTM 9/10/2017

Enel SpA

YTM 9/10/2018  YTM 9/10/2017

Leonardo SpA

YTM 9/10/2018  YTM 9/10/2017

Telecom Italia SpA

YTM 9/10/2018  YTM 9/10/2017

Source: Bloomberg
Thank you!

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