S&P Global Ratings

European Corporate Support Schemes: Extending And Amending

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Key Takeaways

- The resurgence of COVID-19 in Europe over the winter has led governments to further extend and amend most of their emergency support measures, some as far as to the end of December 2021, to minimize structural damage to economies.
- Credit support alone will not be sufficient to protect credit quality in sectors most disrupted by the pandemic, as our liquidity scores for rated companies illustrate.
- Official support is therefore shifting from the provision of liquidity toward restoring balance-sheet strength for companies that are able to generate growth and employment over the longer term.
- Together with further extensions to regulatory forbearance, it is likely that the expected rebound in corporate bankruptcy filings, especially among unrated small businesses, may be delayed until 2022 when emergency state aid is wound down. They may also be spread over a few years.
- The extended emergency raises risks that companies that are no longer viable continue to put off restructuring, leading to inefficient capital allocation and distorted competition with healthy companies.

As the vaccine rollout in Europe gathers pace, and amid cautious optimism that economic growth will rebound strongly in the second half of 2021, authorities are turning their attention to when and how to scale back emergency fiscal measures while minimizing any cliff effects. For corporates, this means authorities are shifting their approach from ensuring adequate liquidity is available toward restoring balance-sheet strength of companies that will be viable over the longer term, so that they can create growth and jobs. This is no mean task given the severe hit to earnings, increase in debt, and the rapid transformation in many companies' business models, notably in sectors most disrupted by limitations on social contact.

This evolutionary approach is clear to see in the EU. As a result of the resurgence of the virus over the winter, the EU Commission in March 2021 extended and amended the Temporary State Aid Framework from June 30, 2021, until Dec. 31, 2021--with the potential to extend it further should circumstances require.

Key amendments included doubling the ceiling for permitted aid that could be granted to companies, and new provisions to enable member states to cover any shortfall in revenues compared to fixed costs up to a limit of €10 million for those companies that suffered a material loss of business due to the pandemic. But, importantly, with an eye to the future recovery, the Commission also introduced the ability for member states to reconstitute “repayable instruments” issued under the Temporary Framework into more direct types of grant, tax relief, or other financial aid as may be necessary. Generally, the ceiling will be limited to €1.8 million per company--therefore largely benefiting SMEs--and conversions will be permitted until Dec. 31, 2022. This is in addition to the initial recapitalization provisions contained in the Temporary Framework that permit debt and capital support for strategic businesses subject to certain restrictions.

For the U.K., no longer bound by EU state aid rules after Jan. 1 2021, the approach is somewhat different: the emphasis is less on restructuring debt into equity-type instruments, while continuing to provide temporary solvency support in the form of furlough schemes, tax relief, and business rate concessions.

While beneficial from a credit perspective in the short term, companies with higher levels of debt are likely to be under more financial pressure once emergency support is retracted. The upside is that those U.K. businesses that remain viable will be better positioned to compete as compared to some weak businesses in the EU that might survive post COVID but only by virtue of debt forgiveness provided under the EU framework.

Table 1

Support Schemes Across Europe

	France (€ bil.)		Germany (€ bil.)		Italy (€ bil.)		Spain (€ bil)		U.K. (£ bil)	
Support scheme breakdown	Size	Uptake	Size	Uptake	Size	Uptake	Size	Uptake	Size	Uptake
Guaranteed loans	300	136	500*	49.8	600	175.2	175	123.6	330	75.1
Direct grants	-	21.9	unlimited	32.9	-	33.5	7	tba	-	20
Subordinated LT loans or equity	20	tba	100	8.5	44	tba	14	tba	-	-
Corporate moratoria	-	-	-	-	-	130	-	-	-	-
Total uptake	158		91		339		124		95	
No. of corporates ('000s)	668 (loans) 2,000 (grants)		132 (KfW loans) 2,000 (grants)		1,870		647		1,630	
Loans as % 2019 NFC debt (%)	6.1		2.8		14.3		13.6		5.7	
Government guarantee (%)	70-90		80-90		70-90		60-80		80-100	
Program end date	Dec. 31, 2021		Dec. 31, 2021		Jun. 30, 2021		Dec. 31, 2021		Dec. 31, 2021	
Latest data	Apr. 8, 2021		Apr. 22, 2021		Apr. 7, 2021		Mar. 31, 2021		Mar. 21, 2021	

NFC--Nonfinancial corporate, tba--to be announced. *Includes €400 billion general credit guarantee program; €100 billion KFW loan guarantee program. Source: France Strategie, BMWi, BMF, KfW, Association of German Guarantee Banks, Bank of Italy, ICO, HM Treasury S&P Global Ratings.

Despite operating under the umbrella of the EU Temporary Framework, there are notable differences between the various EU countries in terms of design, size, and utilization of various national support programs (see table 1). While the direction of travel is clearly moving beyond liquidity support toward the provision of grants and other types of equity, these measures are largely targeted toward small and midsize enterprises (SMEs) that typically have fewer funding options. These are outlined in detail in the deeper dives on specific countries below.

S&P Global Ratings believes there remains high, albeit moderating, uncertainty about the evolution of the coronavirus pandemic and its economic effects. Vaccine production is ramping up and rollouts are gathering pace around the world. Widespread immunization, which will help pave the way for a return to more normal levels of social and economic activity, looks to be achievable by most developed economies by the end of the third quarter. However, some emerging markets may only be able to achieve widespread immunization by year-end or later. We use these assumptions about vaccine timing in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

How The Pandemic Affected Liquidity Assessments

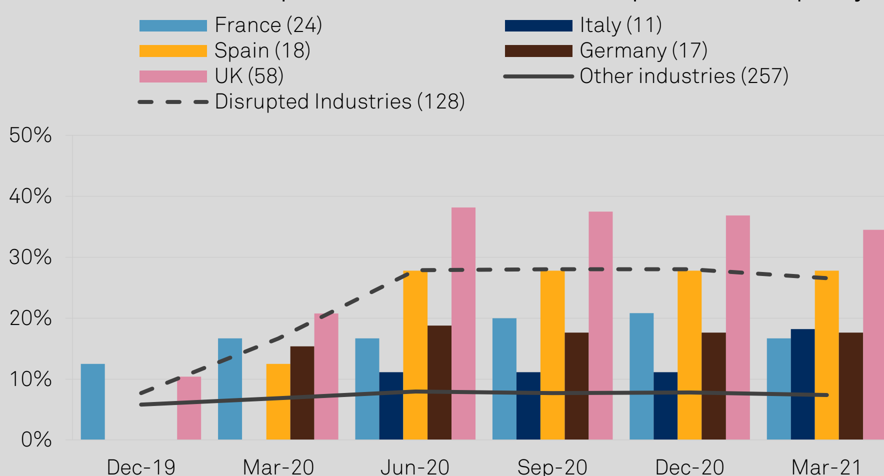
The severity of the liquidity squeeze on speculative-grade rated corporates differed by sector and country.

The liquidity scores that we assign to speculative-grade companies ('BB+' and below) in Europe provide an insight into the credit sensitivity and importance of liquidity to nonfinancial corporates. Our liquidity assessment is based on a forward-looking view of whether sources of funds (including committed bank lines) exceed the necessary uses of funds over the next two years. The scores—which under our criteria we assess in five categories from strongest to weakest—therefore provide clear insight into the severity of the pandemic's impact on funds from operations and provision of credit. When we assess liquidity to be less than adequate (LTA) or weak—our two weakest of our five liquidity scores—our assessment feeds into a more negative assessment of corporate creditworthiness and, usually, a lower rating.

Chart 1

Speculative-Grade (SG) Issuers In COVID-Disrupted Sectors* Still Face Liquidity Squeeze

(% SG-rated issuers in disrupted sectors with less-than-adequate or weak liquidity by country)



Source: S&P Global Ratings. *Disrupted sectors cover aerospace and defense, autos, oil and gas, media and entertainment, retail, and transportation. Number in brackets is the number of SG ratings. Dataset comprises public SG ratings in France, Germany, Italy, Spain, U.K.

Our liquidity scores on corporates in the five largest European countries shows that the liquidity position of companies in sectors most disrupted by the pandemic (including the oil and gas sector) deteriorated sharply in the first half of 2020. The proportion of speculative-grade rated companies with LTA or weak liquidity scores rose to about one-third of the total (see chart 1). In contrast, we saw no material change in our liquidity assessment of companies in sectors not disrupted by the pandemic: the proportion of LTA and weak liquidity scores has remained quite steady at 6%-8%.

At the same time, we have observed striking differences between companies in the most disrupted sectors by country. U.K. companies were hit hardest, with the percentage with LTA /weak liquidity scores almost quadrupling to 40% in the first half of 2020, and to date we have only seen a modest improvement. Media and entertainment, retail, and restaurants have suffered relatively higher in the U.K. than in the other EU countries. Spain also stands out, with almost 30% of speculative-grade companies operating in these disrupted sectors now having poor liquidity scores compared to 0% at the end of 2019. The position of companies in Germany, France, and Italy appears more stable.

This provides support to our view that the provision of credit support is not sufficient on its own to protect the credit quality of companies in sectors most disrupted by the pandemic. This aligns with the IMF's broader liquidity assessment[1] of the position of European corporates that "public support so far is estimated to have filled 60% of European firms' liquidity needs because of the COVID-19 shock". Moreover, the more pressing problem is how to address the equity shortfall that has caused the share of insolvent firms to rise by 6% during the pandemic by the IMF's estimations, predominantly affecting small and micro businesses rather than for larger companies.

1. *IMF: Staying Afloat: New Measures to Support European Businesses, March 2, 2021*

U.K.

Renewed Lockdowns, Extended Support

The resurgence in the virus in December and January triggered a third national lockdown starting on Jan. 5, 2021, and led the government to extend its various emergency programs to provide further necessary support to businesses and households.

The original flagship liquidity support that the government first rolled out between March and May 2020 comprised three corporate guarantee loan schemes targeting businesses of various sizes affected by the pandemic. Extended three times until the end of March 2021, the three schemes paid over £75 billion to more than 1.6 million businesses with the Bounce Back Loan Scheme (BBLS; loans up to £50,000 or 25% of turnover) comprising almost 94% of the number of loans supported and 62% of the total by value. In large part, the attractions of the BBLS scheme for borrowers were the rapid accessibility given minimal level of credit checks, up to 10-year maturity, no interest payment for first 12 months, and provision for repayment holidays and interest-only periods. Participating banks benefitted from a 100% government guarantee of principal plus interest.

Following the latest winter lockdown, the government consolidated and relaunched the loan guarantee program as of April 6, 2021. The new "Recovery Loan Scheme" operates on a more commercial basis, is open to all businesses, and can be used for any legitimate business purpose, including for investment and growth. It will run through to the end of December 2021. Loans benefit from an 80% government guarantee and can vary in size from £25,000 to £10 million, so, unsurprisingly, banks' credit assessment is expected to factor in future business prospects more than was necessary under the BBLS where 100% guarantees were provided.

Furlough And Other Reliefs Beneficial For Solvency

Yet, with so much attention being given to the debt program created to underpin companies' liquidity positions during the early days of the pandemic, it is easy to overlook the role other measures played in supporting solvency. In 2020, the government provided as much as £97.6 billion through the furlough short-time work scheme, business rates relief, and grants, of which the furlough scheme at £53.8 billion was the largest component (see table 2). These measures directly improved cash flow for business without any additional accumulation of debt liabilities. Moreover, these measures have been extended and amended into fiscal year 2021-2022 at a budgeted cost of £38.9 billion.

Table 2

Main U.K. Government Business Support Schemes Announced In The 2021 Budget

		Cost FY 2020-21* (£ bil)	Cost FY 2021-22 (£ bil)	Liquidity	Solvency
Recovery Loan Scheme	As of April 6, 2021, this will replace previous loan schemes and provide lenders with a guarantee of 80% on eligible loans between £25,000 and £10 million. The scheme will be open until Dec. 31, 2021.	£75 contingent liability	Contingent liability	++	--
VAT	The £34 billion deferred tax can now be paid in up to 11 equal payments from March 2021, rather than one larger payment due by March 31, 2021.	n/a	n/a	+	o
	The reduced VAT rate for hospitality, accommodation, and attractions has been extended: it is 5% to Sept. 30, 2021, and then 12.5% to March 31, 2022.	4.1	4.7	+	+
Labor	**Coronavirus Job Retention Scheme (CJRS)** is extended until the end of September 2021, tapering between July and September.	53.8	9.6	++	++
Business rates	**Business rates relief:** three months 100% holiday, nine months 66% relief with cap for eligible retail, hospitality and leisure properties.	10.0	6.8	++	++
Grants	**Self-Employment Income Support Scheme (SEISS)** grants will be worth 80% of three months' average trading profits, and capped at £7,500 in total for each of the February-April and May- September periods.	19.7	12.8	++	++
	Restart grants will be provided in England of up to £6,000 per premises for non-essential retail businesses and up to £18,000 per premises for hospitality, accommodation, leisure, personal care, and gym businesses.	20.0	5.0	++	++

Source: HM Treasury, S&P Global *Cost of comparable program in FY 2020-21
Liquidity and solvency descriptors: ++ = strongly supportive; o = no impact; -- = highly unsupportive-

It is also notable that the U.K. has not legislated for loan moratoria or loan payment deferral arrangements for corporates, unlike some other jurisdictions in Europe where that has been an important part of the support provided. Moratoria may not increase the level of outstanding debt, but rather just delay the timing of servicing the debt. As noted by the European Systemic Risk Board, take-up has been quite high in countries such as France where the level of debt is relatively high in the nonfinancial corporate sector. Nevertheless, U.K. banks have been open to providing payment holidays for commercial mortgages, and companies operating in hard-hit industries such as physical retail have been quite aggressive in delaying rental payments and even renegotiating lease terms. Added to this are the quite material deferral of £34 billion in VAT payments due to be paid in instalments over the course of the current financial year.

Funding Support Has Risen To The Scale Of The Challenge

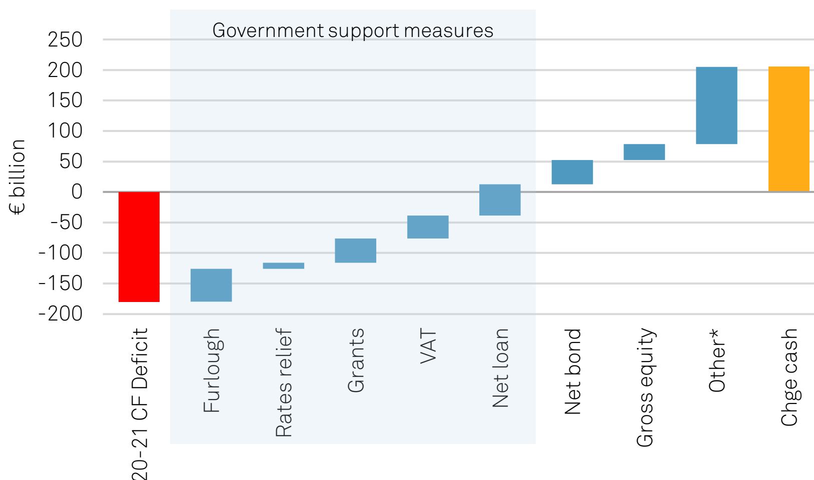
What does the scale of this support mean for the solvency of U.K. companies?

One way to measure the impact is to consider how sources and uses of funds have changed over the course of the past year. To the extent that the liquidity raised offsets the shortfall in cash flow, then this would be mirrored by an increase or decrease in the cash position. Of course, corporates maintain positive cash balances for working capital and to provide day-to-day liquidity. Before the pandemic struck in March 2020, U.K. corporates held cash and cash-equivalent balances of about £750 billion and had access to £260 billion in undrawn credit facilities from their banks.

The economic shock of the pandemic has played havoc with the free operating cash flow of many companies, particularly in the most social contact-intensive sectors. At the most recent Bank of England (BOE) Financial Policy Committee meeting on March 11, the committee reconfirmed its estimate of the total cash flow deficit suffered by U.K. corporates in 2021-2021 (before taking account of emergency support measures) at around £180 billion. Interestingly, this is unchanged from its initial analysis published in May 2020--even though the initial analysis assumed the recovery would gradually build through Q3 2020 and Q4 2020 as social restrictions were eased and did not factor in the further national lockdown that the U.K. experienced during Q1 2021. As the FPC minutes highlighted, “the cash flow impact of the additional public health measures since December had been largely mitigated by the extension of fiscal support measures and stronger economic performance in Q4 2020, which had supported U.K. corporate cash flows”.

Chart 2

Public Support Measures On Their Own Broadly Offset U.K. Corporates' Cash Flow Deficit In 2020-2021



Source: Bank of England, ONS, S&P Global Ratings. *Other includes positive free cash flow from non-cash-flow deficit companies, sale of assets, investments etc.

The waterfall in chart 2 highlights the relative contribution of the various support measures listed in table 2 that have been deployed to help companies bridge to recovery. Of the identified instruments providing financial support in fiscal year 2020-2021, debt and equity issuance contributed 45%, deferred payments (such as VAT) 15%, while relief payments (furlough, rates, and grants) provided around 40%.

While illustrative, the key point to note is the overall breadth and scale of the response by the government, markets, and corporates themselves to the pandemic emergency. Corporate cash balances--capturing operating performance, government support, and fund-raising activities--rose by as much as £205 billion, (or 27%) to £955 billion between the end of March 2020 and the end of December, the same order of magnitude as the cash-flow deficit estimated by the BOE.

While striking, there are some important caveats to acknowledge. First, the cash-flow deficit estimated by the BOE includes only companies that were burning cash, so the overall cash-flow deficit position of all corporates would be much smaller and likely positive, although as an offset to that their dataset only captured a small proportion of midsize and smaller companies that generate as much as 25% of total corporate turnover. Second, the support measures and fundraising activities detailed here covered all corporates and not just those with cash-flow deficits. Third, the cash balance position shown here is for December 2020 because March 2021 is not yet available from the ONS. Given the renewed lockdown in January 2021, it would not be unreasonable to expect some rundown in the level of cash balances. However, as the take-up of new guaranteed loans in Q1 2021 was only £7 billion (equivalent to a 10% increase) it appears that the liquidity stress has largely been alleviated.

The bottom line here is that the scale of the response has translated into a very significant increase in the liquidity position of U.K. corporates even after factoring in certain assumptions over cash-flow deficits. At the same time, it is not clear in our view that--as highlighted by the still weak liquidity scores for rated companies in the more disrupted sectors (see above "How COVID Affected The Liquidity Position Of European Speculative-Grade Companies")--the support has been spread evenly. And as cash-flow deficits are expected to remain higher than average in 2021-2022, further support will be needed, particularly for the most disrupted sectors and smaller companies that may not have access to capital markets. This is where we expect to see the next round of defaults and insolvencies materializing, most likely from the second half of 2021.

The precise timing remains difficult to pin down because corporates continue to benefit from regulatory forbearance as temporary insolvency and corporate governance measures have provided breathing space for struggling companies during the pandemic. Creditor protections, such as the ability to serve winding-up petitions, and wrongful trading rules have been suspended again until the end of June 2021, while companies already subject to insolvency proceedings or subject to a winding-up petition can enter a moratorium governed by more relaxed rules until Sept. 30, 2021.

France

State Support Is Evolving To Help French Corporates Recover

The French government acted decisively throughout the pandemic to support the domestic corporate sector. The massive response helped to keep many businesses, even smaller ones, afloat. Support measures are now being extended in time and complemented with schemes closer to pure grants (*fonds de solidarité*) or equity injections (*prêts participatifs avec soutien de l'état* or *PPSE*) to provide a recovery boost once the French economy shifts into positive growth momentum, expected around mid-year 2021.

First and foremost, France enacted a comprehensive furlough scheme in March 2020 and extended it to June 2021 last year. It guarantees all employees at least 84% of their wages--and almost 100% when businesses are forced to close because of lockdown or for sanitary measures (e.g. for restaurants or leisure businesses). The main benefit is obviously for those individuals at risk of losing their jobs. But the program also helps corporations navigate the down times until their activity picks up again (such as in commercial aviation) or simply resumes (such as restaurants). The French furlough scheme will be phased out over summer 2021.

In addition to its wide-ranging furlough scheme, the French government also offers the option to all businesses that face mandatory closure because of lockdown or sanitary measures to rollover the payment of their tax obligations and social levies.

Long-term partial activity plans (APLD) were also introduced in June last year and can be negotiated with unions to cover a two-year period, extending into 2022. An APLD allows an employer facing economic hardship to reduce employees' working time while maintaining their

salaries and receiving compensation from the French government. At end-January 2021, 7,000 APLDs had been signed in France, covering 550,000 employees.

The French €100 billion stimulus plan (*plan de relance*) announced in September last year also includes measures that will continue to support the corporate sector in 2021: wide-ranging cuts in production taxes (saving French corporations an estimated at €10 billion per year), labor shortages and retraining programs, and subsidies for moving to cleaner energy are all part of the French stimulus plan and will contribute to the French corporate sector's competitiveness. Specific aid plans were also approved for a few industries viewed as strategic for France, such as aviation and autos, as well as some smaller directly hit sectors, such as nightclubs and gyms. These will continue to be deployed throughout 2021.

As of now, none of the support measures implemented by the French government include anything from the EU's €750 billion Next Generation funding for France; estimates are that these should contribute about €40 billion to the domestic economy, once available.

The most sizable show of support to all corporations, including smaller ones, came with the €300 billion state-guaranteed loan program (PGE; see table 3) managed by the government's equity investee and wholly owned banking subsidiary, BPI France, since March 2020. Availability of the French PGE scheme is currently being extended to the end of fiscal 2021.

Table 3

French Corporates And The PGE--Main Features

Maximum program size	€300 billion
Denomination	*Prêts Garantis par l'Etat* (PGE)
Duration	March 31, 2020, to June 30, 2021, now extended to Dec. 31, 2021
Legal foundation	Act of Parliament voted on March 23, 2020, and related decrees
Beneficiaries	Any corporation or profession legally incorporated in France, including self-employed
Out of scope	REITs, banks, any corporation involved in bankruptcy proceedings
Distribution channel	General banking network operating in France
Underwriting standards	Underwriting is done by the company's core bank using its usual underwriting criteria, including use of Banque de France scoring and review of core financial ratios
Targets of the program	* SMEs + PME/TPE (less than 250 employees or less than €50 million in sales) * ETIs (intermediate size companies with less than 5,000 employees or sales comprised between €50 million and €1.5 billion sales) * Groups (more than 5,000 employees or more than €1.5 billion sales)
State guarantee	* SMEs: 90% of principal * ETIs : 80% of principal * Groups : 70% of principal
Guarantee provider	BPI France Financement SA
Type of guarantee	Irrevocable and unconditional guarantee provided by the French government to the lending bank(s) up to the maximum guaranteed amount
Maximum principal guaranteed	25% of annual sales (2019 basis)--one quarter of revenues
Redemption schedule	* 2020 and 2021: no redemption (possibility to extend grace period until mid-2022 on a case-by-case basis) * Thereafter: loan to be amortized over one-to-five years
Guarantee fee	2020: 25 bps Thereafter: 50 bps to 200 bps per year depending on company size and amortization schedule

bps--Basis points.

Under the PGE program, all small businesses are eligible to receive a loan representing about one-quarter of their usual sales. The lending banks benefit from an irrevocable and unconditional guarantee ultimately provided by the French state, usually of up to 90% of the loan principal, with no principal redemption due before end of 2021. Based on public data provided by the French Ministry of Economy, about 46% of the program had been used by early April 2021, with the total outstanding reaching €136 billion and the number of corporate borrowers exceeding 668,000. Loans to very small businesses (with annual turnover below €2 million or less than 10 employees), averaging a low €90,000, represent 43% of the money lent under the PGE scheme. Small and midsize enterprises (with annual turnover below €50 million or less than 250 employees) represent an additional 34% so that overall, about 77% of the PGE scheme is lent to a category--small or very small companies--whose credit quality we believe is difficult to track.

With the impact from the pandemic extending in time, the French government has developed new support schemes to help the corporate sector.

First, the government decided late last year that any company granted a PGE could apply for an extension of its no-redemption period for a full year, basically postponing start of redemption from end of June 2021 to mid-2022. As of April 2021, two-thirds of PGE program borrowers have already indicated their repayment intentions and opted for the longest possible loan term (2026 maturity).

Second, a solidarity fund (*fonds de solidarité*) was established in September last year from which small companies affected by forced closure decisions (such as restaurants, cafés, gyms, clubs, some retailers. And later extended to include most ski resort businesses) can tap on a rolling monthly basis. Amounts drawn vary between €10,000-€200,000 per business. The purpose is to compensate for the volume of sales lost because of forced closure. This is basically a grant scheme.

By early April 2021, the French solidarity fund had benefitted 2 million French SMEs, and had a total outflow of €21.9 billion (almost 33% of it to hotels and restaurants, and 13% to the retail sector).

In addition to the PGE, the French government has also negotiated with the EU a €20 billion subordinated loans and notes scheme (*prêts participatifs avec soutien de l'état* or PPSE) to be able to support selected companies, although additional loans that can be viewed as closer to equity.

The PPSE program is much more limited in size than the PGE and targets the funding of specific investment needs (see table 4). The subordinated nature of the aid provided and the higher costs of the PPSE versus the PGE may also represent extra complexities for smaller corporations. Deployment of the PPSE scheme is expected to take place over 2021, with mutualizing features for the lending banks to be announced soon.

Table 4

French Corporates And The PPSE--Main Features

Maximum program size	€20 billion (€14 billion through banking loans + €6 billion through dedicated funds)
Denomination	*Prêts Participatifs avec Soutien de l'état* (PPSE)
Duration	April 2021 to June 30, 2022
Distribution channel	General banking network operating in France
Underwriting standards	Underwriting is done by the company's core bank using its usual underwriting criteria, including use of Banque de France scoring and review of core financial ratios
Targets of the program	* SMEs + PME/TPE (less than 250 employees or less than €50 million in sales) * ETIs (intermediate size companies with less than 5,000 employees or sales comprised between €50 million and €1.5 billion sales)
Duration and requirement	Eight-year maximum maturity with no redemption for the first four years Funding a specific investment plan or capital expenditure program
State guarantee	30% but on a mutualized basis
Maximum size	5% to 12.5% of annual sales (2019 basis) – versus one-quarter of revenues for the PGE
Redemption schedule	* 2021 to 2025: no redemption * Thereafter: loan to be amortized over a one-to-four-year period
Costs	Coupon: 4.0%-5.5% Guarantee fee: 100 bps to 200 bps per year depending on company size and amortization schedule

bps--Basis points.

The PPSE program is aimed at SMEs and intermediary-sized groups reporting less than €1.5 billion annual sales or with less than 5,000 employees. As for the PGE, distribution will be carried out through the French banking system with underwriting decisions made by the primary lending banks themselves.

Aid plans approved for strategic domestic industries, such as aviation and autos, also include ad hoc funds to inject equity into suppliers that are facing difficulties but are viewed as a critical component of value chains. Amounts at stake are limited, however, and should not run beyond several €100 million, with Air France (€3 billion equity injection under way) and SNCF (€4.1 billion new equity injected last year already) being notable exceptions.

COVID-19's effect on French corporates will continue to be felt for years in terms of the growth outlook, financial policy, and credit metrics. In 2020, and thanks to the massive government response, the number of bankruptcy filings fell dramatically in France: at end-December 2020, the cumulative annual number of filings was 36% lower than in 2019, according to the *CAE Banque de France*. This did not include a few rated French groups that restructured their capital structure in the past year, causing a default but not a corporate filing, such as Europcar, Vallourec, and Technicolor.

However, given the severity of the economic shock from COVID-19 we expect a rebound in corporate bankruptcy filings from the end of 2021 and into 2022, especially among unrated small businesses, as state aid systems gradually end. Ripple effects in terms of filings are also likely to be felt over a few years. The impact should be most visible for those sectors dominated by small independent businesses, such as restaurants and non-food retail, and for which consumer habits may have durably changed, such as business travel and hotels. Given their small size, these are not commonly part of our rated universe. But the impact could still be felt by domestic banks, if less so by bondholders.

Germany

Grants And Equity Support Are Stemming Bankruptcies

Following the second lockdown in December 2020, the German government shifted its support program decisively away from loans toward grants. One major reason for this is that, in general, while larger corporates that received loans from state-owned development bank KFW managed to cope with the crisis far better than initially anticipated, smaller businesses and the self-employed faced more severe problems and were more severely hit by the lockdowns. Overall, German corporates that we rate therefore only in exceptional cases tapped these loans or equity support. The two most prominent cases include Lufthansa and TUI, which both benefited from state equity and KFW loans.

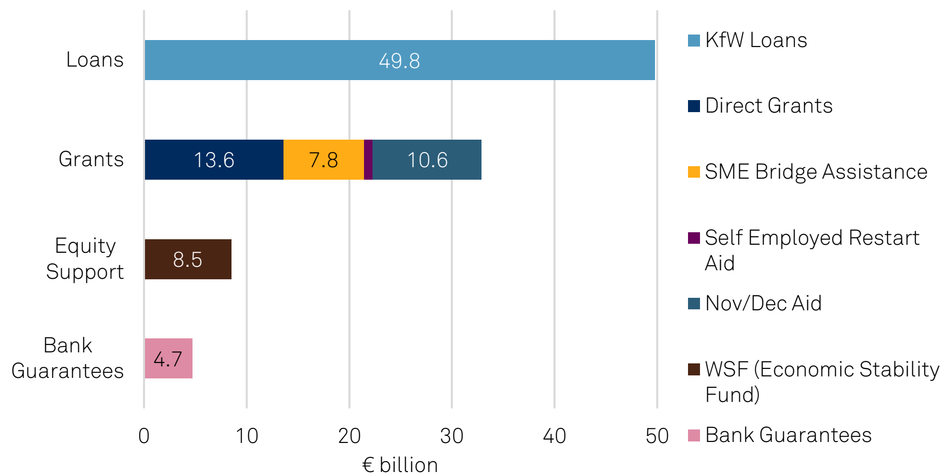
Most support measures are provided under the €600 billion package from the Wirtschaftsstabilitätsfond (WSF). Within this, there are three components: €400 billion guarantees available to corporates to support capital market funding (currently largely unused); a €100 billion guaranteed loan program operated through KFW; and €100 million available to provide equity support to corporates.

The new support program, “Überbrückungshilfe” or SME Bridge Assistance (see chart 3), targets smaller companies and the self-employed, which have been posting meaningful declines in revenues compared to past years. This program has not been restricted in size but is managed on a rolling basis over time. In March 2021 the government launched the third version of this program, also supporting smaller corporates with equity injections beyond grants to restore their balance sheets. Furthermore. given the uncertainty caused by the resurgence in the virus, all programs have been prolonged to the end of the year. The number of companies requesting grant support varied meaningfully but averaged about 2 million on a monthly basis. A recent report confirmed that services, restaurants, and retail together account for about 60% of company requests, while industrial companies only accounted for 6%. As a company is able to request the help on a monthly basis or bundle several months together in their request to the government, the precise number of companies benefiting from the grants so far is not available.

Since our last publication in November ("European Corporate Support Schemes: A Long Unwinding Road," published Nov. 25, 2020), the loan volume provided through state bank KFW has grown only modestly from €45.4 billion to €49.8 billion, while the volume of grants has more than doubled to €32.9 billion. In addition, the amount of equity support increased from €6.7 billion to €8.5 billion, reflecting the trend toward grants and equity rather than loans. This will help corporates in Germany support the recovery because the overall increase in debt could be limited by these effective state support measures.

Chart 3

Overview Of Support Measures For Corporates In Germany:



Source: BMWi, BMF, KfW, Association of German Guarantee Banks, S&P Global Ratings. Data as of April 20, 2021.

While these government measures are proving very effective in suppressing bankruptcies well below historical levels, the further suspension of COVID-19-related bankruptcy proceedings until the end of April 2021 has also played a part. Despite a pick-up in bankruptcies in November and December by 5% and 18%, respectively, year on year, the trend has declined again since January 2021. In January 2021, bankruptcies declined by 31% year on year. However, some early indicators of insolvency registrations show an increase in recent months, and we expect this increase to pick up further during the second half of 2021.

Many corporates continue to use the furlough schemes. However, their use has declined markedly in recent months: about 500,000 employees were still in short-time work as of February 2021, compared with about 7.5 million at the peak of the COVID-19 crisis. Nevertheless, the number of unemployed has increased over the same period, by about 500,000 to 2.75 million currently.

Italy

New Government Ramps Up Support For Corporates Facing Extended Restrictions Into 2021

Forging an economic recovery from the pandemic is the primary focus of Prime Minister Mario Draghi's government. It will also craft a strategic plan to invest the country's €200 billion share of the EU Next Generation Fund, including reforms of Italy's economy, fiscal framework, and judiciary. The new government will also closely monitor the health of the corporate sector, largely made up of small and midsize enterprises, hit hard by the pandemic.

In March 2021, the government approved a new support package for households and corporates that included about €11 billion of grants to small businesses. This largely compensates the tourism sector for lost turnover as a result of new restrictions to movement adopted in the fourth quarter of 2020 and the first quarter of 2021. With this package, Italy confirmed its framework of support to SMEs and small businesses through grants, which it introduced in mid-2020 in parallel with liquidity support. As of mid-April, total grants stood at €33.5 billion. The government is currently in the process of approving an additional support package with a budget of around €40 billion, which would include additional grants to SMEs affected by the pandemic.

The Italian government is also considering freezing until end-2021 the progressive dismantling of state liquidity support. This would further temporarily protect nonfinancial corporates' creditworthiness and bank asset quality until year-end when hopefully the economic recovery will have spread broadly to all business sectors. The corporate debt moratoria framework introduced in the second quarter of 2020 (with currently €130 billion outstanding) expires in June 2021. In addition, early next year, companies are scheduled to start making capital repayments on their

state-guaranteed loans (€175 billion as at April 2021). Absent an extension of the liquidity support, several companies that have not yet recovered from the pandemic may not have sufficient cash flow to support debt service.

We believe this six-month extension of the liquidity framework will further postpone the expected surge in corporate defaults due to the pandemic to 2022, and may prevent some defaults if, in the meantime, companies can recover from the crisis. Still, we see a risk that the extended support could keep afloat some companies whose capital structure has become unsustainable, leading to inefficient capital allocation and a distortion of competition with healthy companies.

A New Fund To Inject Hybrid Capital To Midsize To Large Corporates Should Ramp Up Shortly

The Patrimonio Rilancio, a new fund managed by Cassa Depositi e Prestiti (CDP) aimed at supporting corporate capital by injecting hybrid equity or subordinated notes, is likely to become operational in the next few weeks. With an initial budget of €44 billion, the fund would operate under the Temporary Framework set by the European Commission. It is open to companies with a turnover of more than €50 million with financial difficulties related only to the pandemic. If widely utilized, we believe the fund could play a key role in strengthening midsize Italian corporates' balance sheets—a secular weakness that has deteriorated further during the pandemic. So far, however, most Italian midsize companies have been reluctant to fund their balance sheets with sources other than bank loans.

Corporate Liquidity Widely Benefited From Government Support

On top of the direct fiscal support, the Italian government has provided indirect stimulus to corporates by underwriting new credit to firms and households. Only about 0.2% of the GDP value of these measures represents so-called "below the line" transactions that require upfront financing. The remainder, both guarantees or other liquidity measures, are contingent liabilities totaling a maximum envelope of about €600 billion, or 33% of GDP. These measures include:

- Guarantees from the Fondo Centrale di Garanzia for up to €5 million of SMEs' financial liabilities (based on the EU definition). The total size of the guarantee facility is €100 billion.
- Additional state guarantees covering up to 30% of the value of SME loans subject to moratoria (€70 billion) and 70%-90% of the value of loans for all businesses (€200 billion).
- Up to €200 billion of loan guarantees from SACE, the Italian export credit finance agency. These guarantees cover a maximum of 90% of the loan's principal. Borrowers must pay a fee for the guarantee ranging from 25-50 bps for the first year, increasing to 100-200 bps for the fourth to sixth year.
- The government's €0.5 billion guarantee to back a state development bank fund managed and guaranteed by CDP. The purpose is to guarantee the liabilities of larger companies, defined as those with annual turnover exceeding €50 million.
- A moratorium agreement, under which liquidity-constrained SMEs can postpone principal payments on debt.

As of April 7, 2021, total corporate loans that benefit from moratoria stood at €130 billion, or 10% of total Italian corporate debt (see chart 4). About 80% of this relates to loans and credit lines granted to SMEs. From August 2020 to March 2021 the total stock of loans under moratoria had been rather stable at around €190 billion following a rapid increase in May to June 2020, but then it dropped significantly in April 2021 to €130 billion. The Bank of Italy highlights that the lower data in April most likely reflect that a material portion of corporate loans subject to moratoria have expired. If the lower data is confirmed in the next survey in May, it would indicate better liquidity conditions of Italian SMEs, ahead of an improving Italian economy.

Chart 4

Italian Corporate Loan Moratoria 2020-2021

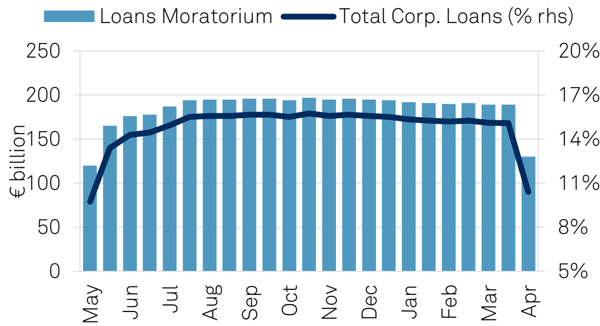
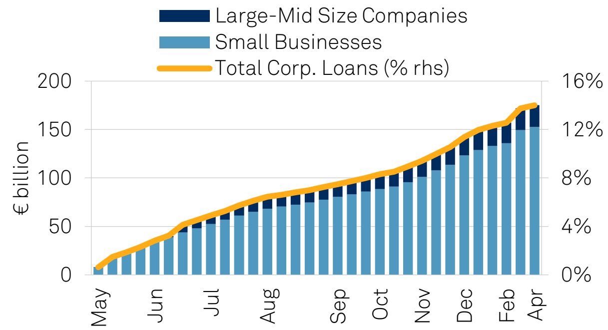


Chart 5

New State-Guaranteed Corporate Loans In Italy 2020-2021



Source: Bank of Italy, S&P Global Ratings.

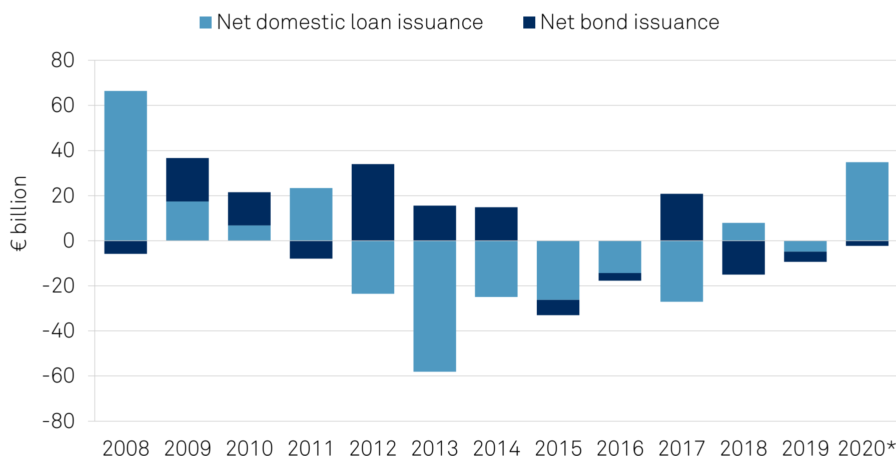
As of April 7, 2021, new loans with a state guarantee (either through the Fondo Centrale di Garanzia or SACE) reached €175.2 billion, or 14% of total Italian corporate debt (see chart 5). Unlike the loans under moratoria, new loans with state guarantees increased steadily since the pandemic started in the spring of 2020. SMEs, typically not rated, have been the main beneficiaries of the support programs, obtaining as much as 87% on new loans under the state guaranteed scheme.

State Support Pushed Up Corporate Debt

As consequence of the state guarantee scheme for new loans, Italian corporate loans increased by about a net €35 billion during the first nine months of 2020 (see chart 6), according to Bank of Italy. This represents the highest annual absolute increase since 2011. Corporate loans further grew during 4Q 2020. Based on our calculations, total loans in 2020 should have increased by about €90 billion when we exclude the effect of NPLs securitized during the year, or 8.5% of total loans. The increase in corporate debt is largely concentrated at SMEs. At the same time, in 2020 SMEs rolled over both short-term and medium- to long-term loans with state-guarantees, which resulted in about a €40 billion drop in short-term loans.

Chart 6

Italian Corporate Debt Funding Sources (2008- 2020)



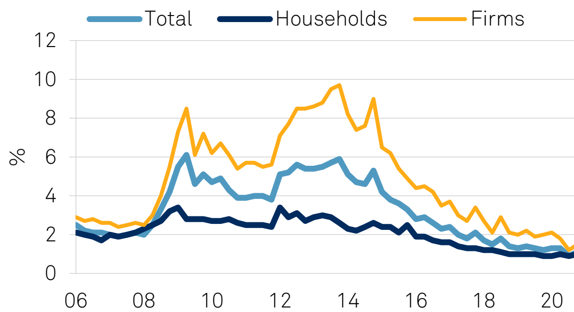
Source: ECB, Bank of Italy, S&P Global Ratings. *-- 2020 issuance to end Q3 2020.

Corporate Defaults Remain Contained So Far

The pandemic and related restrictions are unprecedented in modern times and the full magnitude of the potential effects on corporate creditworthiness is still to be determined, depending on whether the government measures are successful in materially alleviating corporate defaults. State support to corporates (both moratoria and state guaranteed loans) succeeded in providing liquidity at the peak of the pandemic, and this explains the absence of a significant rise in corporate NPLs in 2020 (see charts 7 and 8).

Chart 7

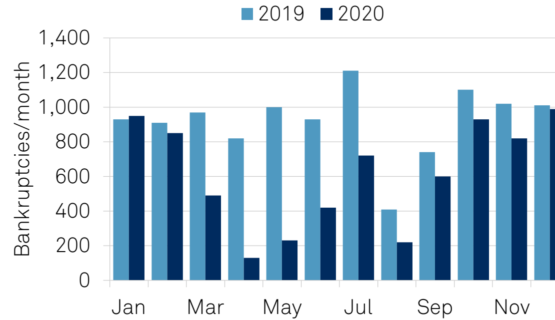
Quarterly Inflow Of Gross Nonperforming Exposure



Source: Bank of Italy Economic Bulletin, S&P Global Ratings.

Chart 8

Number of Bankruptcies Per Month in 2019-2020



Source: Bank of Italy, Infocamere, S&P Global Ratings.

Supporting the above picture, according to Bank of Italy, the total number of corporate bankruptcies in 2020 stood at around 7,000, about one-third less than in 2019. For 2021-2022, however, the central bank estimates that the number of bankruptcies may reach 17,500, well above the average annual level of about 11,000, due to both the severity of the economic crisis during the pandemic and the postponement of some insolvencies from 2020. The bank nevertheless notes significant uncertainty surrounding this estimate given the peculiarity of the crisis and the exceptional support the state provided.

In our view, to assess the final impact of the pandemic-induced recession on corporate creditworthiness, particularly SMEs, we need also to consider some longer-term structural damage to sectors more directly affected by the restrictions--such as transport, travel, hotels, and restaurants--and the effect on those already undergoing disruption to their business models, such as retail.

Spain

Support Priority Has Shifted To Keeping Companies Afloat

Similarly to other EU countries, Spain has made extensive use of government guarantee schemes during the pandemic. As of end-March 2021, €94 billion in approved guarantees had been utilized, resulting in total guaranteed lending of €124 billion, or about 20% of the stock of the Spanish banking sector's corporate lending over the past year. Spain's greater use of guarantees than other countries is probably because the banks could use the guarantee schemes to back their existing credit exposures. Indeed, the actual increase in the stock of Spanish banks' loans to nonfinancial companies only grew by €40 billion in 2020, just one-third of the total amount of guaranteed lending.

As permitted under the EU's Temporary Framework that now runs through to the end of December 2021, the Spanish government in February modified three existing support schemes. In designing its new package, the Spanish government has shifted its priority from helping companies cope with liquidity shortages, to ensuring that they remain afloat, particularly those whose activities continue to be disrupted by social-distancing measures. It assessed a new approach was necessary, not least because a viable corporate sector with the capacity to invest is key to the economic recovery.

The new €11 billion support package focuses on SMEs and regions where businesses have suffered the most from the pandemic. The three amended schemes are as follows:

- The bulk of the support--€7 billion--will take the form of direct grants to companies or entrepreneurs operating in sectors that the pandemic has hit particularly hard and that have experienced a fall in revenues of over 30% during 2020. The aid will cover a 20%-40% share of the lost revenues. SMEs will likely be the main beneficiaries, as the support cannot exceed €200,000 per beneficiary. Geographically, the Balearic and Canary Islands will receive a larger share of the grants, as these are the two Spanish regions most affected by the pandemic due to the importance of tourism to their local economies.
- A €1 billion recapitalization fund will be run by the government-owned funding institution Cofides. This will provide temporary assistance to SMEs, most likely in the form of equity or

quasi-equity, although debt is also a possibility. This is separate from the existing €10 billion recapitalization fund created by SEPI.

- €3 billion will be allocated by the government to enable companies to partially write down existing loans guaranteed by the Instituto de Credito Oficial (ICO) should this become necessary. Before reaching this point, however, borrowers should extend the maturity of their ICO-guaranteed loans for an additional three years, up to a maximum of eight years, and request another 12-month extension of the grace period. Additionally, banks and borrowers could negotiate the conversion of all or part of their guaranteed loans into quasi-equity participating loans, while maintaining the guarantee on the same terms. Only if these two alternatives are insufficient will debt write-offs be contemplated.

In addition, certain insolvency regulations remain suspended until Dec. 31, 2021, to ensure that companies that were viable pre-COVID have legal protection to facilitate their recovery and allow them to maintain employment.

This report does not constitute a rating action.

Related Research

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- Credit Conditions Europe Q2 2021: New Horizons, Old Risks, March 30, 2021
- Spain's €11 Billion Aid Package For The Private Sector Signals A Shift From Liquidity To Solvency Support, March 18, 2021
- French Corporates Face An Uneven Climb-Out From COVID-19, Jan 27, 2021
- European Corporate Support Schemes: A Long Unwinding Road, Nov. 25, 2020

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