What has changed in 2024

EY-Parthenon quarterly analysis of UK profit warnings

Q1 2024

EY Parthenon

Building a better working world

Contents

Q1 2024 highlights

18.7%	11	25%	29%	61%
UK-listed companies warn in the last 12 months	Financial Services companies warnings in Q1 2024	FTSE Industrial Support Services companies warn in the last 12 months	of warnings cite contract delays and cancellations	'first' time warners in Q1 2024
The percentage of companies issuing warnings rises again to a new post-pandemic high.	Industry warnings hit their highest total since the pandemic.	The sector continues to feel the impact of cuts and delays in business spending and recruitment.	Uncertainty continues to affect contract renewals and business-to-business spending.	Percentage of companies warning for the first time in over 12 months hits highest level since Q1 2022.

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What's changed in 2024?

The new year has brought more growth, but also familiar and new challenges. Our profit warning data reflects the evolving challenge of forecasting and building earnings momentum in what is still a tentative and uneven economic recovery.

UK-listed companies issued 70 profit warnings in Q1 2024, five fewer than the same quarter of 2023. But, despite this fall, the proportion of companies warning in the last 12 months grew again to 18.7%, 0.7% higher than the peak of the Global Financial Crisis and 1.2% higher than a year ago.

Why are we seeing this mismatch? Whilst the number of UK-listed companies has fallen by 6% in the last 12 months – and 10% in the last two years – the number of companies issuing profit warnings hasn't fallen. In fact, for 61% of companies warning in Q1 2024, this was their first warning in over 12 months.

Macro-economic pressures haven't entirely relented, growth is still weak, and the full impact of interest rate increases is yet to come. New warnings are still being triggered by high inventories, spending delays and by economic pressures catching up with larger companies and sectors, like luxury goods, that typically show higher resilience to economic shocks. Secondly, prolonged economic stress also exposes internal weaknesses. In Q1 2024, a third of warnings cited internal failures, such as troubled contracts and accounting issues. Finally, the first quarter of 2024 saw increasing regulatory challenges, which contributed to financial services profit warnings hitting a post-pandemic high.

And this is still a divergent picture with an exceptionally high number of companies still issuing multiple profit warnings. At the end of Q1 2024, 39 companies had issued three or more warnings in the last 12 months, of which almost a fifth have already delisted due to insolvency or acquisition – often well below their pre-warning cycle share price.

These figures underline how integral swift action is to value preservation. Recovery is coming, but companies cannot afford to rely on economic resurgence, ignore the warning signs, and hesitate to address fundamental challenges. One of the first warning signs in many sectors is a loss of credit insurance (or other contingent credit) and we'll explore how companies can preserve access to this vital liquidity source. We'll also discuss how activity is increasing across the restructuring spectrum – and why and where we expect this to rise further.

This is still an uncertain time with the run into an unprecedented roll call of global elections and geopolitical risks still high on the agenda. As much as this looks like an economically easier year, companies still need to be scenario planning and thinking about how their business needs to adapt to near-term and long-term changes in their markets.

Pressure is still catching up with larger companies …

Economic outlook

Swings and roundabouts

After two years of minimal growth, 2024 is shaping up to be the year when the UK economy finally leaves economic stagnation behind. But growth will remain relatively sluggish this year, and there are risks ahead and obstacles to overcome before recovery is assured.

Positive factors for UK growth continued to build in the first quarter of 2024, with falling inflation and the prospect of lower interest rates contributing towards renewed momentum. But set against this increased positivity is growing geopolitical risk, the ongoing impact of interest rate increases, and the carryover effect of a recession at the end of 2023.

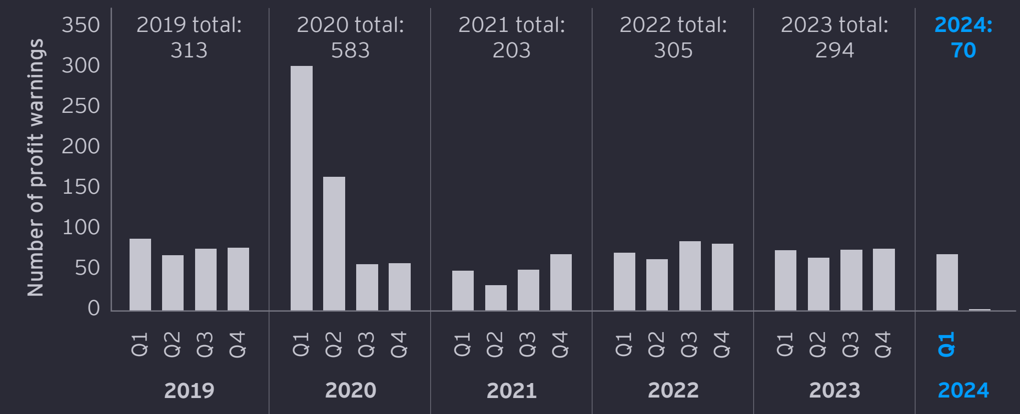
The net effect of these headwinds is that the EY ITEM Club has downgraded its growth expectations for 2024 to 0.7%, from 0.9% three months ago, but slightly raised its 2025 forecast to 2% from 1.8% previously, as the fruits of lower inflation and tax cuts feed through. Growth in 2026 is expected to continue at around 2%, although a potential change of government and economic policy following the upcoming UK general election – as well as the swathe of elections elsewhere across the globe – increases the uncertainty of forecasts beyond the next year.

There are other risks to this more positive outlook. This forecast relies on inflation falling below 2% and interest rate cuts starting this summer. This prediction is driven largely by a substantial forecast drop in energy prices, which could be disrupted if the conflict in the Middle East widens, or other factors cause prices to surge again. Employment data has also been mixed, muddying the waters. A different path for interest rates would have broad implications for household incomes, residential housing transactions and house prices.

As we can also see across our profit warning data, demand is still lumpy, and growth is unevenly spread. This is a recovery, but one where several scenarios could still play out and companies need to be prepared for short-to-medium term volatility and a variety of outcomes.

UK profit warnings remain above average

Number of profit warnings by quarter



Our profit warning console contains more current and historic data: ey.com/warnings

Sector overview

Old problems, new challenges

The macroeconomic pressures that have plagued earnings since the pandemic are easing, but not relenting, whilst new stresses continue to emerge in 2024.

- The FTSE sectors with the highest number of warnings in Q1 2024 were: Industrial Support Services (9), Retailers (7), Personal Goods (5), Pharmaceuticals and Biotechnology (5), and Household Goods and Home Construction (5).
- The FTSE sectors[1] with the highest percentage of companies' warning in the last 12 months were: Personal Goods (67%), Leisure Goods (58%) and Chemicals (53%).
- The primary triggers for profit warnings in Q1 2024 were delayed or cancelled contracts (29%), weaker consumer confidence (17%), increasing costs (17%) and the impact of higher interest rates (13%).

Profit warnings citing headline macroeconomic pressures continue to fall in 2024. Cost-related warnings rose slightly in the first quarter, but levels have more than halved since their peak. Supply chain-related warnings are also back to average levels, with Red Sea disruption yet to cause a significant earnings impact. Although we haven't seen the full impact of interest rates on debt-costs, the housing market shock also appears to have eased as mortgage rates fall.

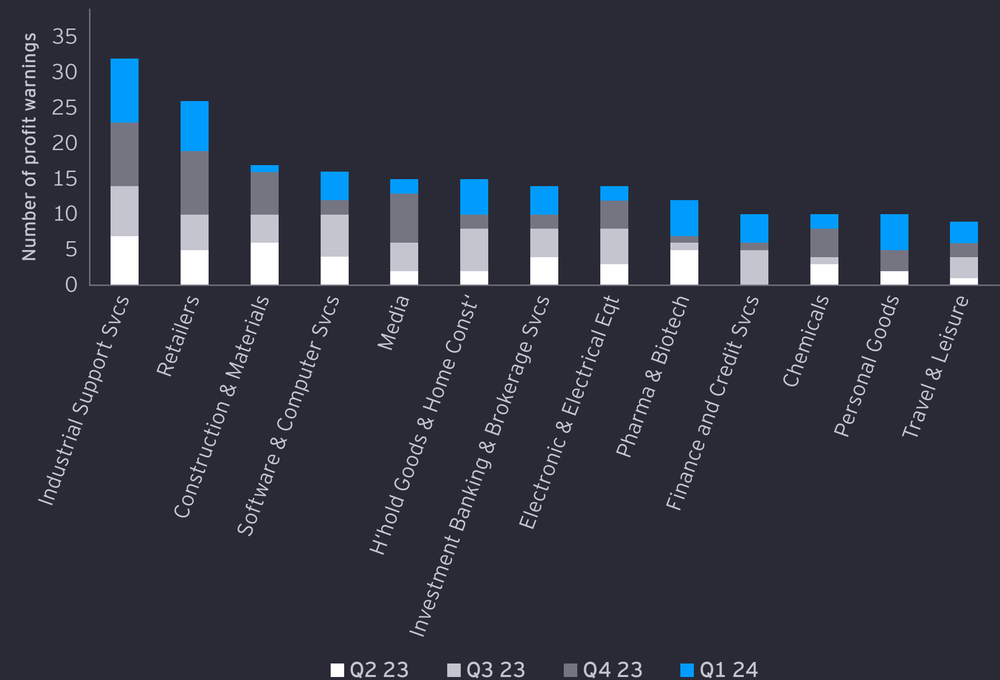
So why and where are there more companies warning? Falling costs have clearly helped industrial sectors, where warnings have halved since the last quarter. But cost levels haven't returned to normal, and it takes time for confidence to build. Warning levels are still high in sectors that rely on the ability and confidence of business and consumers to spend. Inventory levels are also still high and will take time to dissipate. Historically national elections have also led to a spending hiatus, adding further risk to this mix.

We can see this in the more than four-fold year-on-year rise in warnings from FTSE Industrial Support Services, a sector highly exposed to business-to-business spending. Inventory hangovers and slow demand have also contributed to FTSE Technology Hardware and Equipment companies equalling their 2023 level of warnings in one quarter in Q1 2024. On the consumer side, warnings are spreading to previously resilient luxury and premium areas, with more than half of FTSE Personal Goods companies warning in Q1 2024.

1 FTSE sectors with more than five constituents

New factors are also triggering warnings in new areas. A rise in companies citing regulatory actions is the primary reason for warnings from Financial Services sectors hitting their highest post pandemic level. We're seeing more companies from across all sectors hit by accounting and operational issues. This continues to be a cycle that has sector-themes, but which isn't necessarily sector driven.

Profit warnings by FTSE Sector



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The hard impact of losing 'soft' credit

Company balance sheets don't always tell the whole story. This is particularly true in sectors like construction, oil & gas, and retail, where contingent credit – including trade credit insurance, bonding lines, and payment processing advances – often act as the invisible glue that holds a business together.

One of the key reasons why 'soft credit' is underestimated is that it isn't visible on the balance sheet, which is why it often goes unnoticed in benign credit conditions. But these aren't benign conditions. For businesses grappling with a more difficult climate, downgraded access to contingent credit can be a significant blow – not least because other forms of credit may also be tightening.

The institutions that extend contingent credit are also varied and dance to a different tune to balance sheet creditors. Risk appetite is finer and their opportunity to act and withdraw or seek collateral often drives a different and more responsive behaviour pattern. Major credit insurance providers are already reacting to a significant rise in business insolvencies and are adjusting cover on companies and sectors they think are most at risk.

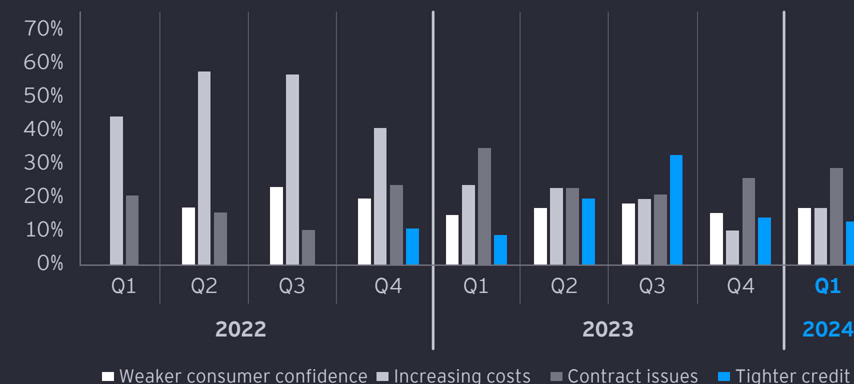
Increased risk translates into tightening availability, especially in retail and construction where insolvency levels are highest. There's also a high chance of a negative feedback loop because 'soft credit' is such a vital part of the sector ecosystem, as we've seen in several recent retail and construction restructurings and administrations.

How does this hit in practice? A payment processing company may defer cash settlements to build a reserve; a contingent credit provider may require collateral or decline to rollover arrangements; and suppliers who lose trade credit insurance may seek earlier payment or even payment upfront. This cuts liquidity and the impact can snowball if cuts in coverage trigger a confidence domino effect through other suppliers or customers, core lending relationships, and auditor risk concerns.

With all this in mind, it's vital that proactive boards act now to protect their position:

1. **Quantify risk and set up reporting mechanisms:** Forewarned is forearmed. It's vital that boards have visibility over their soft credit usage and key relationships, and that robust reporting mechanisms are in place to flag movements early to ensure effective action and decision making.
2. **Build resilience:** Given the heightened risk of losing cover, boards should be taking proactive steps to underpin their position to support stability and build financial resilience.
3. **Prepare to act quickly:** Companies who act quickly and consistently, with strategic and uniform approach across all providers, are more likely to limit contagion and get better outcomes, as tightening or loss of cover from one provider can quickly snowball into a wider issue with other providers and loss of confidence amongst other stakeholders.

Contract issues and spending delays remain the top reason for warning



Market reaction

Rates in focus

Market sentiment improved over the quarter, but spring has brought more uncertainty and focus on the outlook for interest rates. UK rates should still start to fall in 2024, but the timetable is still in flux.

The median share price fall on the day of profit warning fell to 14.7% in Q1 2024, from 18.8% in Q4 2023. The average fall also dropped to 16.7% from 20.2% in Q4 2023. By both measures, share price reaction is at its lowest level since Q2 2023 as investors start to look forward to earnings improving as the economy grows. But it's not a straightforward recovery, as our profit warning data highlights, and this share price picture is more uncertain and nuanced than the headline numbers suggest.

Interest rate cuts should come by mid-2024, but the timing and number are in flux due to mixed inflation, employment and wage data points. At the start of the year, markets were pricing in 1.25% worth of interest rate cuts in the UK in 2024, starting in this summer with the Federal Reserve and the ECB (European Central Bank) on a similar trajectory. At the time of writing, markets have lowered their expectations to 0.75% of UK rate cuts, starting in June, with two further 0.25% reductions by the end of 2024. But this is unlikely to be the end of the story. Meanwhile, in the US, expectations for cuts have been moved even further out by higher-than-expected inflation and strong payroll data, with a rise even possible this year.

This still uncertain picture is reflected in an index breakdown of share price movements on the day of warning. As the chart below highlights, there is still a wide gap between the share price reaction to profit warnings from FTSE 100 and AIM listed companies – a gap we normally see when investors are more risk averse. With almost 19% of the market warning in the last 12 months – and the number of listed companies falling by 10% in the last two years – investors will be focused on companies that can show resilience.

Our profit warning console contains more current and historic data:
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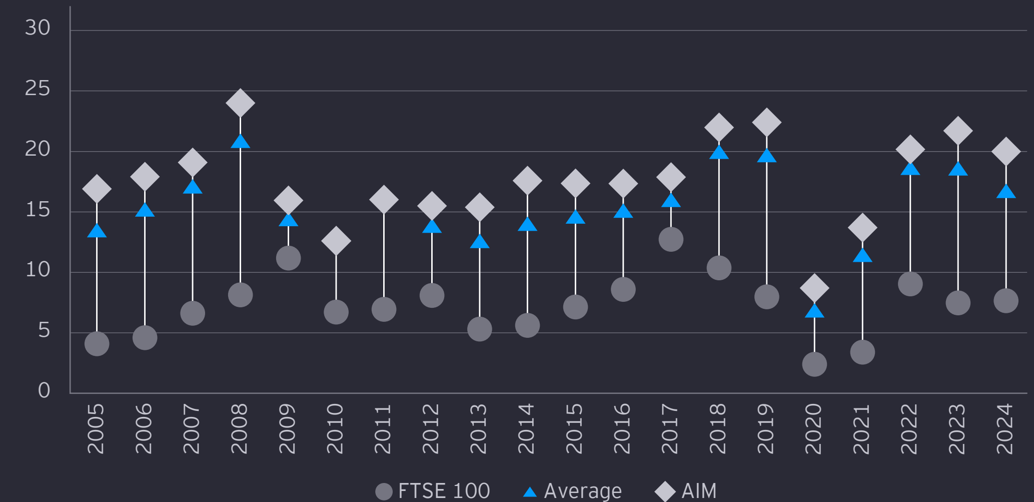
Average share price fall drops, but investor nerves still evident

% average first-day share price fall



Restructuring outlook

Insolvency levels continue to rise, but are these figures underplaying the level of stress amongst UK companies?

The official insolvency data is still dominated by Creditors Voluntary Liquidations (CVLs), triggered by the delayed impact of the pandemic and escalating costs that hit smaller companies first and hardest. But, as noted last quarter, profit warnings and insolvency are spreading into the mid-market and beyond. Administrations, although well below earlier peaks, have been rising year-on-year since the end of 2021. In Q4 2023, almost a third of profit warnings came from companies with turnover over £1bn. This fell back to around a quarter of warnings in Q1 2024, but this is still double the 12% figure we recorded in Q1 2023.

Beyond the official data, we see activity increasing across the restructuring spectrum. From an increase in the number of administrations and restructuring plans in progress, to more balance sheet restructurings, asset sales and a rising focus on working capital as companies look to reshape their business in response to their changing market. But anecdotally, we are also seeing more situations late in the cycle, when companies are more stressed and where there is less time for action, increasing the need for accelerated solutions, and offering less chance of value preservation.

This delay is partly due to there being fewer opportunities for intervention. In the last decade, but especially during and since the pandemic, there has been increasing prevalence of covenant-lite or covenant-free debt, more use of 'amend-and-extend' debt processes where maturities are pushed back, and a rise in payment-in-kind' practice (PIKs), where borrowers with low liquidity issue new debt to meet interest payments.

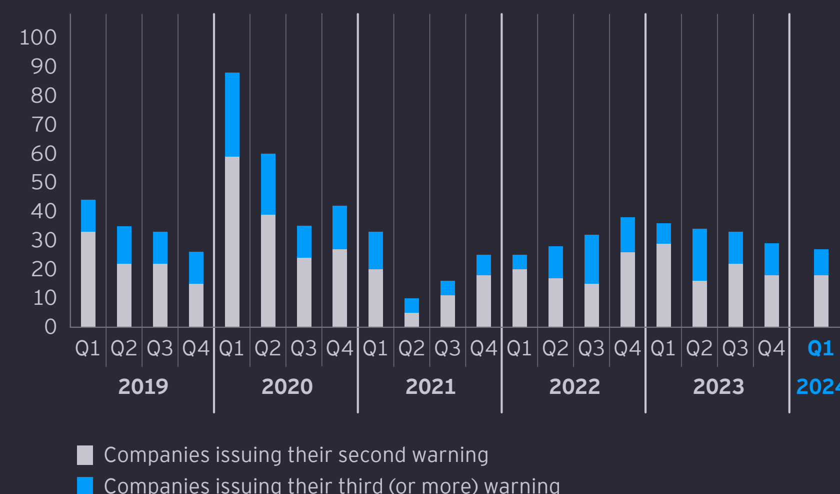
These measures undoubtedly helped to smooth the temporary impact of the pandemic and the shock of the rising interest rate cycle for otherwise financially and operationally robust companies. Used well, they can provide time for companies to reshape their business and balance sheet. But there is a flipside to this trend when companies don't use the time to reshape their business and restructure their balance sheet.

The Bank of England recently expressed concern about the prevalence of amend and extend agreements, which it estimates has pushed out the maturity wall for about 75% of leveraged loans that were due to be refinanced in 2024. It's worried that firms may come under financial pressure due to the higher yields and tighter financial controls that come with the agreements and that these agreements may just push refinancing risks down the road.

Our profit warning data underlines the risk of delaying action. The number of companies issuing at least three warnings in a 12-month period stayed at 39 companies in Q1 2024 but stays high compared with 31 companies in 2022 and 23 in 2021. Of these 39 companies, 20% have already delisted – or are doing so.

In the last year, 18% of companies warning have done so for the third time in 12 months

Companies issuing their second or third warning in a rolling 12-month period



FTSE Industrial Support Services

FTSE Industrial Support Services companies issued nine profit warnings in Q1 2024 and 18 warnings in the last six month, more than the whole of 2022. This is a diverse sector, but companies share a high dependence on business spending and contract execution that leaves them exposed to uncertainty, rising costs, and failures in internal controls.

This sector's exposure to business spending makes it a yardstick of activity and confidence in the economy and this cycle is no exception. Weak growth and uncertainty have been strong themes in profit warnings since mid-2023 and spending delays and cancellations have featured in half of the sector's warnings in the last six months. Recruitment companies, which are often early confidence barometers of falling confidence issued seven (39%) of those warnings, with business service providers and industrial suppliers making up the remaining warnings.

Historically, weak demand has also catalysed and exposed contract issues and investors will be on high alert for issues within the sector. The long complex nature of outsourcing contracts heightens the risk of snags and delay, whilst also increasing vulnerability to changing circumstances, such as cost inflation – especially labour costs. Meanwhile, customers are still pushing for greater value, with increasing competitive pressures.

Companies have undoubtedly learnt lessons from prior failures. But weaker demand and higher costs leave less margin for error and boards need to guard against the temptation to lower prices during dips in activity to sustain volumes. Some of the biggest profit warnings and distressed situations in the sector have been triggered by a limited number of rogue contracts that were misjudged at their inception and mishandled in execution. Risk management needs to happen across the contract lifestyle, with constant monitoring and vigilance so companies can mitigate against failure and spot risks early.

The combination of cost and pricing pressures with extended cycles means that companies across the sector should be thinking about how they build resilience to ride out volatility and protect margins. Companies also need to watch how they evaluate and manage their working capital profile across contract portfolios and tender pipeline. Cash flows can also be especially vulnerable to 'performance by results' contracts.

The flipside of this exposure to weak demand and confidence is that the sector should receive a boost from an uptick in activity and confidence later in 2025. But there could be some tough times ahead. In addition to pressure on business spending, local authorities are under spending pressure, whilst general elections have historically caused a hiatus in government spending.

FTSE Financial Services

Financial Services companies issued 11 profit warnings in Q1 2024, the highest total since the pandemic and, prior to that, the global financial crisis. The challenges facing the sector 2024 aren't systemic, but there are running themes that are creating pockets of stress.

The 11 profit warnings issued by financial services companies in Q1 2024, is the highest quarterly total since the 17 and 24 issued in Q1 and Q2 2020, at the start of the pandemic, and 14 in Q4 2008. The sector and the global economy are in better shape in 2024. UK financial services across banking, credit, insurance, and asset management is generally in good health. But we have seen localised pockets of stress, predominantly because of recent rapid changes in macro-economic conditions but also in part due to more assertive regulation.

Higher interest rates are not intrinsically problematic for the financial services sector. Many retail banks have profited from a wider spread between their deposit and lending books. But the rapid rise in inflation and the associated rise in interest rates are starting to take effect. Corporate and consumer debt stress levels are well below historic peaks, but they are rising, and the full impact of rate rises hasn't played through yet to lending books created during an extended period of low rates and low risks.

US and European commercial Real Estate portfolios are starting to see stress. The rapid increase in interest rates has also exposed funding imbalances in lenders reliant on wholesale markets. The Bank of England recently expressed its concern that these imbalances could force private lenders – who've become an integral part of the corporate lending market – to reduce lending, leaving a huge corporate funding gap.

The inflationary environment has also created challenges in insurance. EY estimates that motor insurers paid £1.11 in claims and operating costs for every £1 they received in premiums in 2022, rising to an estimated £1.14 in 2023. This made 2022 and 2023 two of the worst years on record for the sector – with a similar picture in home insurance. Cost cuts and increased premiums have alleviated some pressure. But costs continue to rise and there's a question mark over how much stretched consumers can absorb.

Regulatory action was a contributing factor in the increase in financial services profit warnings in Q1 2024. But there are longer roots to this trend. The FCA is entering the final year of its 2022–25 strategy in which it set out (amongst other aims) to reduce and prevent serious harms. We have seen this manifest with assertive supervision and intervention in areas such as motor finance and wealth and asset management.

Looking ahead into 2024, the tide is still going out and it will leave some companies exposed. Interest rates should start to fall this summer, but they won't fall back to pre-pandemic rates and almost every company and consumer will refinance at a higher rate. Default and insolvency rates are still rising, understanding portfolio risk will be key. Funding and operating costs will remain relatively high. Companies across the sector need to think about how they will adapt their business models to this changed environment and communicate this change and a clear purpose to customers, investors and supervisors.

Other sectors to watch

FTSE Retailers issued seven profit warnings in Q1 2024, two more than the same quarter of last year. The strain on disposable incomes is easing, but slowly, and earnings pressures aren't relenting, with 41% of the sector warning in the last 12 months. The outlook for real pay is looking increasingly positive, but EY ITEM Club's forecast shows consumer spending rising just 0.7% in 2024, compared with their 0.9% winter forecast. The weakness is due to the revival in consumer spending coming off a relatively weak base, the ongoing pass through of mortgage increases, and a still elevated cost of living.

FTSE Personal Goods companies issued five profit warnings in Q1 2024, the highest number since the pandemic. In the last 12 months, two-thirds of the sector has issued a profit warning, compared with a third at the end of 2023, making this the sector with the highest percentage of companies warning and the fastest increase in the last three months. The increase reflects the spread of earnings pressure into the luxury goods sector and ongoing pressure on semi-durable goods – like clothing, footwear and jewellery, where spending is still 10% below pre-COVID-19 levels in real terms.

FTSE Travel & Leisure profit warning levels are the lowest in Consumer Discretionary sectors and amongst the lowest across the whole index. Just 17% of companies have warned in the last 12 months, as consumers continue to prioritise experience spending. Nonetheless, parts of the sector are coming under increasing pressure. Gaming regulation is increasing. The night-time economy is showing strain due to the higher cost of living for younger consumers, changing habits, and increasing costs due to the increase in the national living wage. A sustained increase in the oil price could also make the travel sector an area to watch.

FTSE Technology Hardware and Equipment companies issued four profit warnings in Q1 2024, equal to the total number of warnings issued in 2023. The sector issued the same number of warnings in Q1 2024 as it did in the whole of 2023. All four warnings reported a slowdown in demand due to high industry inventories or customers delaying orders or payments. Companies stockpiled inventory just as consumer demand turned down – especially in the automotive sector – and the pandemic's semiconductor shortage has become a glut. The long-term outlook is strong, but this is a cyclical sector and demand could remain in balance through 2024.

UK overview

[Please click the buttons to find out more]

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