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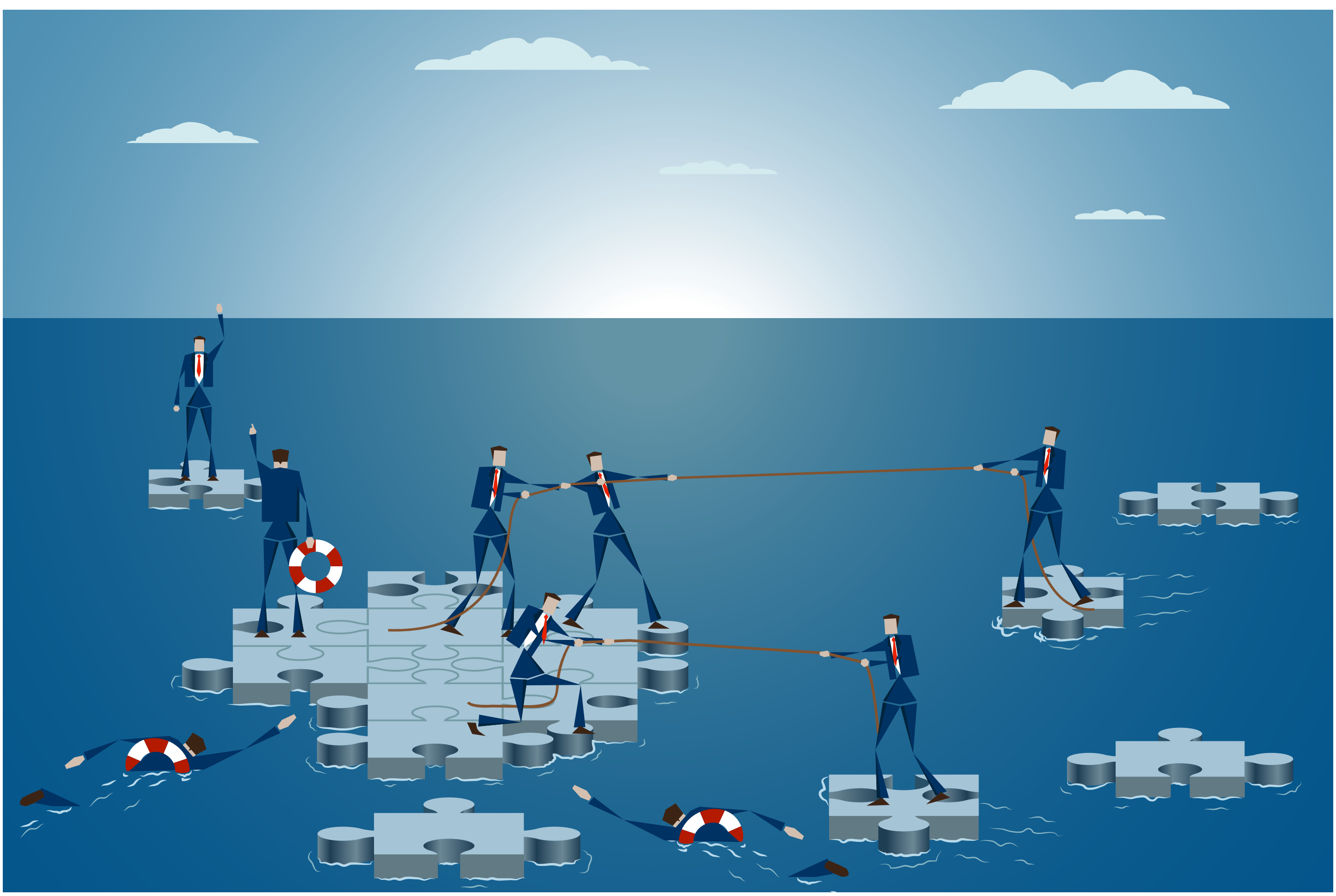
BANKRUPTCY & RESTRUCTURING

Financier Worldwide canvasses the opinions of leading professionals around the world on the latest trends in bankruptcy & restructuring.



UNITED STATES

Teneo

Respondents

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David Sawyer has over 30 years of experience in global financial markets as both a principal investor and as a trusted adviser to corporate boards and chief executives. Prior to joining Teneo, he was the head of special situations at Golub Capital, a $40bn asset manager. He was the co-head of turnaround and restructuring at Ankura Consulting before joining Golub, where he was instrumental in building the T&R team to over 90 professionals. His career has also included over seven years as global head of workouts at Barclays. He spent several years at Silver Point Capital and Credit Suisse before joining Barclays.

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Jay Goffman leads client development and execution for Teneo's North American Financial Advisory business, while also working across the broader business globally. Prior to joining Teneo, he was vice chairman of global advisory at Rothschild & Co. Before Rothschild, he spent 36 years as a lawyer focused on restructuring, debt advisory and distressed M&A. For the last 24 years of his legal career, he practised at Skadden Arps, where he was the long-time global head of the corporate restructuring department. He developed and pioneered the use of prepackaged restructurings in the early part of his career.

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Q. How would you describe corporate bankruptcies and insolvencies in the US over the last 12-18 months? Are you seeing more or fewer business failures in general?

A. Chapter 11 petitions have increased in the US by more than twofold, with 81 filings, through the first week of March 2023 versus the same period last year. While large, publicly traded companies continue to enjoy access to equity and debt capital markets for now, the majority of 2023's bankruptcies have been filed by smaller, middle-market companies that cannot roll over bank debt or have otherwise been cut off from any additional sponsor capital.

Q. In your experience, which sectors seem to be demonstrating structural weaknesses leading to more restructuring efforts?

A. By industry, real estate and retail and consumer discretionary companies account for the majority of filings in 2023. This a pivot from years past, in which energy companies accounted for the majority of restructurings. Companies that have demonstrated an ability to pass through underlying inflation in the form of higher prices, namely consumer staples outfits and utilities, have, for the most part, been able to make the case for earnings stabilisation to lenders at the refinancing negotiations stage. Other industrial entities, such as those that produce more discretionary products, like home furnishings, or those that lack leverage against concentrated customer groups, such as auto and aero suppliers, are suffering margin and cash flow erosion that prevents feasible refinancings. Crypto-exposed financial institutions are continuing to experience upheaval. Three Arrows, FTX and Silicon Valley Bank Financial Group are prime examples of the turmoil. This is generating debate over the safety of deposits – crypto or otherwise – at both bank and non-bank institutions. Figuring out new strategies for maximising recoveries is also critical. New problems require new solutions.

Q. To what extent are troubled companies able to refinance and renegotiate existing debt structures in the current market?

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A. A near quadrupling of Fed rates and corresponding borrowing benchmarks, such as Libor and two-year treasuries, has substantially increased interest payments for borrowers saddled with variable-rate debt obligations. These rate hikes have, of course, been initiated in response to high single-digit producer and consumer inflation rates, which have pressured issuers' input costs, labour expenses and sales volumes. Those issuers that have seen 2-3 percent all-in rates convert to 10-11 percent rates and have no path to revenue or earnings growth in the next two to three years have not been able to refinance without agreeing to substantial covenant tightening or conveying additional collateral or guarantees. Many issuers are instead opting to restructure to free up cash to reinvest in research and development (R&D), marketing and so on, rather than simply direct such cash flows to double-digit interest obligations.

Q. Have there been any recent legislative or regulatory developments, including high-profile cases, in the US that will have a significant effect on bankruptcy and restructuring?

A. Various class actions against distributors of prescription drugs, such as Endo and opioids, and other allegedly harmful consumer products, including 3M earplugs and J&J talcum powder, led to creative uses of the US bankruptcy code to isolate liabilities. A recent decision by the Third Circuit Court of Appeals threatens those strategies. The Third Circuit Court of Appeals ruling in *LTL Management*, which negated the J&J debtor subsidiary's filing for lack of 'financial distress', raises significant issues related to valuation and litigation, as well as the division of assets and assignment of liabilities across complex corporate structures. The decision soon after by the official committee of unsecured creditors for the tort claimants in Aearo Technologies' Chapter 11 proceedings to file a motion to dismiss 3M's subsidiary's bankruptcy petition demonstrates how quickly the restructuring community and the companies it advises will need to adapt to the landmark ruling. While the Supreme Court may, in the future, consider whether the Third Circuit was correct, until then company advisers will need to adjust strategy to account for the ruling, by demonstrating 'financial distress' in these filings. This will require professionals to assess solvency requirements and value-contingent liabilities – efforts that will underpin any future attempted use of the LTL 'Texas Two-Step' strategy. The incentives offered to green energy technology companies under the Inflation Reduction Act may be a short term net positive for US investment and employment but could potentially result in overcapacity across overleveraged assets in unproven industries. The capital outflows from the EU may in fact result in associated restructurings across both sides of the Atlantic. The No Surprises Act, which took effect in 2022 and is intended to address surprise out-of-network healthcare billing, is negatively impacting revenue accrual and cash flow timing for many different healthcare providers, such as those reliant on timely Medicare reimbursement.

Q. What trends are you seeing in the market's appetite to purchase troubled assets? How would you describe recent distressed M&A activity?

A. Private equity firms are finding it more challenging to exit investments

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through either initial public offerings (IPOs) as the market has cooled, or sales to publicly traded, strategic acquirers, whose shareholders have imposed more conservative capital allocation policies. This is particularly true for energy and commodities companies and is forcing sponsors to effect secondary sales among themselves, at slimmer and slimmer equity cushions. By the time such operating entities have reached Chapter 11, the buyer pool may have dried up. More and more often, this results in Chapter 11 plans or 363 sales in which stalking horses take the form of first-lien lender credit bids. Such prepetition lenders, rather than distressed buyers, then wind up with ownership of troubled assets.

Q. What trends are you seeing in cross-border or multijurisdictional insolvencies? What additional challenges do such engagements present?

A. The use of the US Chapter 15 bankruptcy rules to recognise and resolve international insolvencies continues to grow, particularly for large multinational firms domiciled in countries without well-developed corporate bankruptcy frameworks. The coronavirus (COVID-19) pandemic and other idiosyncratic events, resulted in restructurings of issuers domiciled in Latin America, for example. But many of these issuers' dollar-denominated bondholders reside in the US, necessitating a Chapter 15 filing. Simultaneously, many non-US companies have been utilising Chapter 11 to resolve their difficulties when the restructuring laws in their home countries do not provide workable solutions. Globally, there is an emerging pivot toward more US-esque insolvency laws, as evidenced by overhauls to the restructuring laws in Singapore, India and other countries.

Q. Looking ahead, what developments do you expect to see in restructuring and bankruptcy processes in the coming months?

A. The increase in interest rates and shrinking pool of distressed buyers may illuminate for both issuers and lenders the inevitability of a restructuring. The earlier this happens, the better a case can be made for prepackaged and prenegotiated plans. Additionally, given the prevalence of 'covenant-lite' credit agreements and indentures entered into over the last decade, there remains a broad capacity for companies and lenders to stave off Chapter 11 filings with out-of-court solutions, be they coercive exchanges, asset transfers or non-pro-rata or priming transactions. The looming worldwide recession, inflation, increasing interest rates and the changes wrought by the pandemic, the Russian invasion of Ukraine and other geopolitical considerations all suggest that the pace of global restructuring should quicken over the coming months. ❑

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TENEO is the global CEO advisory firm. The firm partners with its clients globally to do great things for a better future. Drawing upon its global team and expansive network of senior advisers, Teneo provides advisory services across its five business segments on a standalone or fully integrated basis to help clients solve complex business challenges. The firm's clients include a significant number of the Fortune 100 and FTSE 100, as well as other corporations, financial institutions and organisations. The firm has more than 1600 employees located in more than 40 offices around the world.

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