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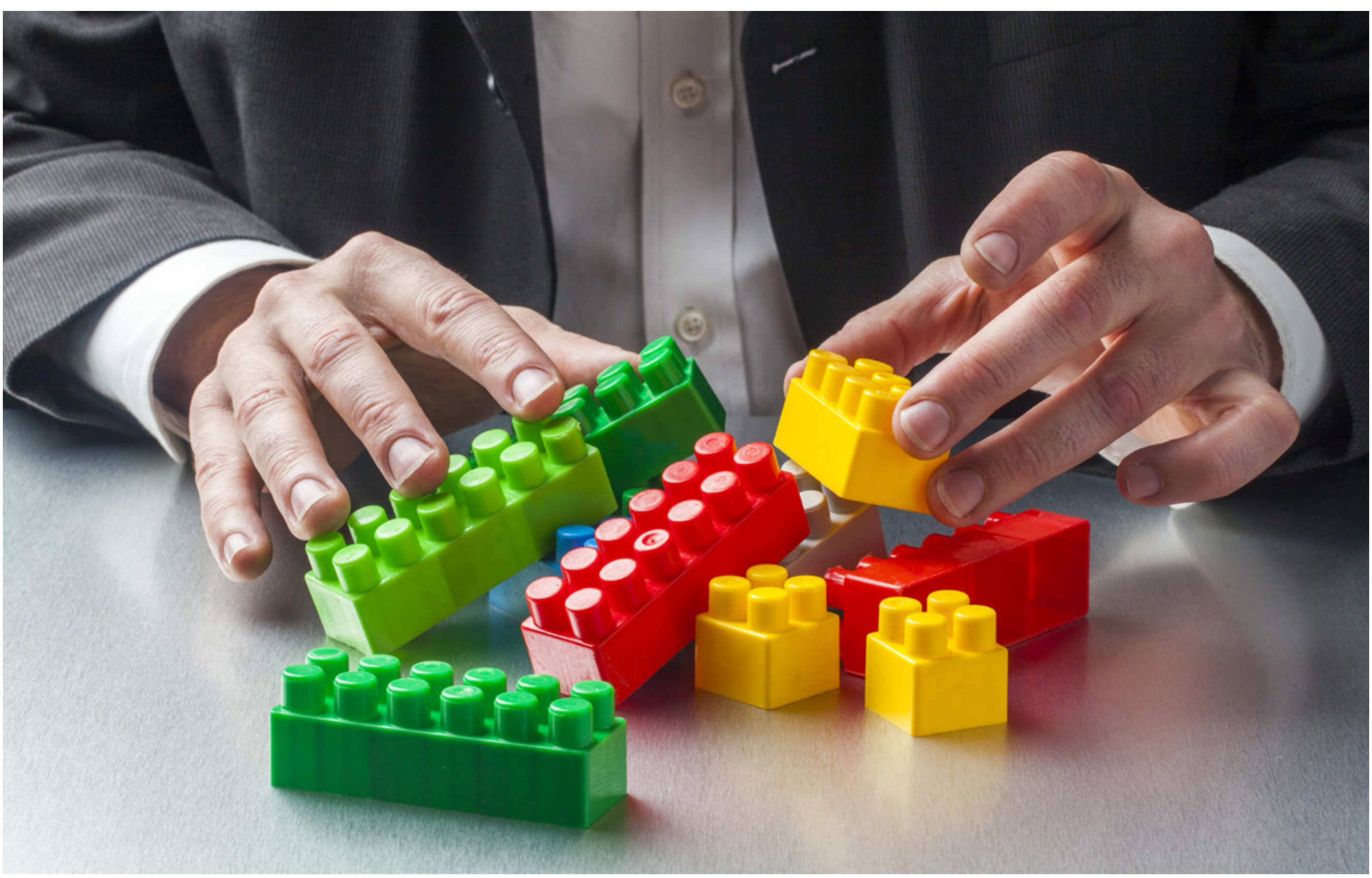
Published by Financier Worldwide Ltd

INDEPTH FEATURE Reprint May 2021

BANKRUPTCY & RESTRUCTURING

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



UNITED STATES

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Respondents

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Business Advisory Practice Leader
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John DiDonato has more than 30 years of experience guiding organisations through restructuring, operational transformation, capital raising, buy-side advisory and merger integration. His expertise encompasses a wide range of industries, including automotive, metals and mining, manufacturing, aerospace, specialty engineering and construction, transportation and logistics, retail and technology.

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Agatha Serda has over 17 years of experience helping clients navigate defining events in the life of an organisation. Her roles focus on providing financial, strategic and operational advisory capabilities in various situations, including lender advisory, balance sheet restructurings, operational turnarounds, Chapter 11 bankruptcy, receiverships, unsecured creditors committee, liquidating trustees, litigation advisory and business valuation services.

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Q. How would you describe the impact of COVID-19 on corporate bankruptcies and insolvencies in the US over the last 12-18 months? Are you seeing more or fewer business failures in general?

A. Leading into the first quarter of 2020, the US economy was robust and many borrowers had a strong balance sheet. As the pandemic began, most companies quickly reduced costs to conserve cash and there was significant activity to amend credit agreements to allow borrowers more flexibility in relation to financial covenants suspension and replacement. In fact, we found most lenders, both traditional and non-traditional, were willing to underwrite debt modifications, waivers and amendments to help companies avoid financial distress and defaults. This led to fewer credit agreement defaults and restructurings. However, while many companies have been able to navigate the challenging financial impacts of the COVID-19 pandemic, including decreased revenue and profitability, there were some that saw a near overnight evaporation in their demand, especially consumer-facing industries such as restaurants and retail, travel and entertainment, education and healthcare. While nearly every sector was impacted, certain industries, such as restaurants and retail, were less successful in gaining support from their stakeholders and were forced into an in-court restructuring.

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

A. As the US economy slowly emerges from COVID-19 pandemic shutdowns, consumer demand and confidence is gradually returning. While last year saw many restaurant, retail, travel and entertainment restructurings, the next 12 to 18 months is likely to see restructurings from other sectors, such as commercial real estate and higher education. With the increase in web conferencing and other communication technologies, the shift in the way work gets done will likely become a permanent one and many organisations will continue to seek ways to reduce their corporate footprint through lease renegotiation or exit of unrequired space. According to a recent Cushman & Wakefield study, an estimated

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215 million square feet of office vacancy has already been created globally due to the pandemic and office vacancy rates are not forecast to return to their pre-COVID-19 peak levels until 2025. Higher education institutions, many of which were already facing challenges pre-COVID-19, were forced to quickly rethink how they delivered services to students and transition to a remote environment. Only time will tell if the introduction of virtual learning technologies will challenge the traditional in-person learning model and premium paid by students to live on or near campus. Coupled with rising student debt, which has now reached nearly $2 trillion, many students have begun to re-evaluate attending college in person versus virtually, given the total cost of an education in the US today. As a result, schools will need to look inward and will be challenged to compete for students who may not even need to reside on campus. Lastly, it remains to be seen what the ultimate financial impact will be for many companies and industries whose supply chains have been disrupted due to global shutdowns from COVID-19 restrictions.

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

A. We have seen companies with very suppressed top and bottom lines successfully identify and raise private and public financing. According to PitchBook, the amount of 'dry powder' available from US private equity (PE) groups is estimated to be more than $725bn. On a worldwide basis, PE dry powder is estimated to be nearly $1.3 trillion. A lot of the saturation comes from the US Federal Reserve keeping interest rates low, along with the continued action by Congress through the Coronavirus Aid, Relief and Economic Security (CARES) Act that layers additional liquidity into the economy – the current tally is around $5 trillion. The US is not alone, of course, as governments and central banks worldwide have enacted trillions of dollars in stimulus measures to try to counteract the disruption caused by the pandemic and provide relief. In many cases, access to this capital has acted as a bridge loan, with a substantial amount being forgiven, which has allowed most companies to get to the other side. It remains to be seen how long

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this relaxed monetary policy and continued stimulus will last, but the recent uptick in US treasuries may be a warning to markets that the end of stimulus may be near.

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. On 27 March 2021, president Biden signed legislation into law that extended, for another year, the increased debt threshold for entities to avail themselves of the small business subchapter V provisions of Chapter 11. This may not impact large enterprises, as most restructuring activity in the courts involves smaller businesses. Keeping the debt threshold at $7.5m of aggregate secured and unsecured debt allows a greater number of entities to address their financial and operational challenges through the protection of Chapter 11. Additionally, the Government Accountability Office, an independent, nonpartisan agency that works for Congress, has been asked by Congress to provide information on the incidence and magnitude of bonuses paid by companies

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in Chapter 11 bankruptcy in fiscal year 2020. As part of their work, they plan to describe the Code's provisions that allow debtors to pay bonuses to executives, identify selected debtor companies that requested or granted bonuses to their executives in financial year 2020, and analyse the benefits and costs of potential revisions to the bankruptcy code limiting such bonus payments.

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. The appetite for distressed businesses is large. Given the proliferation of new funds and a growing comfort level of managing and operating distressed businesses, many of those transactions are seeing aggressive valuations and are benefitting from competitive processes when in the past that may not have been the case. Additionally, we would expect these funds to stay competitive, whether for refinancing or M&A. Those needing capital or the target companies will be the beneficiaries. Such a phenomena is playing out in the marketplace today with regulated lenders and their aggressive approach to providing capital.

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

A. Many of the credit agreement amendments that were executed in 2020 will be expiring or maturing in 2021 or 2022 and this will lead to one of two things. First, the borrowers' revenue and earnings before interest, taxes, depreciation and amortisation (EBITDA) will rebound to pre-COVID-19 levels. This would allow the borrowers to support the current debt level without any covenant and principal and interest accommodations, enabling them to identify affordable replacement financing. Second, the borrower did not rebound and will have to find replacement financing at a higher yield from one of the distressed funds or the borrower will not be able to identify replacement financing and strategic alternatives will have to be explored.❑

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