Runway Disappears Quickly for Companies as Recession Looms

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Fall is here, and restructuring professionals are seeing more distress.

By Stephanie Gleason

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It was July 28 when telecommunications company Avaya Holdings Corp. (AVYA) cut its third-quarter guidance in half. Adjusted Ebitda wouldn't be between $140 million

and $150 million — it would be between $50 million and $55 million.

A little more than a week later, on Aug. 9, adjusted Ebitda came in at $54 million.

That fact pattern caught everyone's attention, Ryan Dahl of Ropes & Gray LLP said.

Dahl specializes in representing creditors, and the companies he was talking to this summer were telling his clients, "We don't need to talk to you, everything's fine." And then suddenly, he started getting calls from companies in crisis — 10 days before they were going to run out of money, he said.

It's turned into a significant number of active situations, he said — companies working on deals hoping to stay out of bankruptcy.

"The impact of inflation and growth of inflation isn't something any of us have seen in our professional lifetimes," he added. "Smart, sophisticated management teams are being asked to forecast in an environment they've never seen before."

Leah McNeill of Alston & Bird LLP is seeing it too. Usually when companies reach out, they've got a year to figure out their troubles, she said. Lately, she's had three or four calls from companies that only have three months of runway.

For Drew McManigle of Macco Restructuring Group LLC, it was Labor Day weekend that the calls started rolling in. He'd gone on vacation and wound up working the whole time.

Since then, his firm has been getting one to two calls a week, he said.

Companies in trouble had been "waiting to reach out because they thought things might change," McNeill said, adding that so many had been able to get through Covid much better than they'd expected because of government grants. "I don't think anyone was expecting it all to come to a head so quickly," McNeill said. Instead, many companies that thought they were going to be all right "looked up one day and thought, 'Oh, just kidding.'"

Things certainly weren't going well in the first part of 2022. There were signs that economic trouble was coming. But, perhaps foolishly, companies that had been propped up through the pandemic thought they'd weather rising inflation and interest rate hikes — at least for a few more years. The maturity wall coming in 2025 was the story that was floating around.

Now, with the third quarter wrapped up, it's clear that the bottom won't hold, maybe not even through the end of the year.

Fitch Ratings Inc. reported that the total dollars of its market loans of concern — the term it uses to track at-risk U.S. institutional leveraged loans — were up 39% in September compared with the end of the first quarter. September saw was the largest one-month increase since the onset of the pandemic.

The ratings firm said it expects the default rate for 2022 to finish at 1.5%. But 2023 could end with a default rate as high as 3%, and it could go to 4% by the end of 2024.

David Miller of Alvarez & Marsal LLC said he first noticed things were changing when earlier this year he began getting internal referrals from other A&M practice groups. Relatively healthy companies were struggling to manage "the most volatile workforce management environment we've ever seen," he said.

It's been more than seven months since the Federal Reserve started raising interest rates, Miller noted. Now, supply chain issues, extreme staffing problems and inflation are layering on and forcing practically every company to fight liquidity fires. Very few people have dealt with these issues in combination before, he added.

"It's just amazing," Miller said, "I've never seen anything like it."

Law firms and restructuring firms are staffing up, McManigle said, and waiting for 2023.

"Lenders are beginning to look at their credits; companies are beginning to realize the interest rate increase isn't their friend. Companies that have survived and been zombie companies for years and years because of the zero interest rates — the day of the walking dead is here," McManigle said.

Companies are dealing with a host of issues, including supply chain troubles, record inflation, weakening consumer spending, rising interest rates and trouble with staffing.

Supply chain issues affect different sectors in different ways, Dahl explained. For the home furnishings business, for example, supply chain issues mean that hard quarantines in China are affecting manufacturing and freight costs are sky-high. For automotive manufacturers, it means lack of access to semiconductors. In food production, supply chain issues mean the high price of food is going to work its way through the system.

For Miller, the labor market — even more than inflation — is the biggest challenge for many companies. Some private equity firms have staffing companies practically on retainer, he said, to keep their portfolio companies functioning.

Broadly, the idea that many companies across sectors pushed out maturities recently won't matter next year, McManigle said. Many companies lost business this year, and 2023 isn't looking better for sales. Supply chain issues now appear endemic. There isn't an industry that looks like it's doing just fine, he said.

Companies that have structured their basic business models to remain nimble might survive, he said.

"Those that can't are going to go out of business."

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COMPANIES MENTIONED

Alston & Bird LLP | Alvarez & Marsal LLC | Avaya Holdings Corp. | Ropes & Gray LLP

Fitch Ratings Inc. | Macco Restructuring Group LLC

PEOPLE MENTIONED

Leah Fiorenza McNeill | David W. Miller | Drew McManigle | Ryan Preston Dahl