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AlixPartners 2018 annual restructuring experts survey: a bit of the old mixed with a bit of the new

The year 2017 was one of change in many respects: a new US administration, tax reform, a record-making stock market, and increased geopolitical uncertainties dominated the news cycles. Headlines seemed to defy norms and expectations at nearly every turn, yet in the world of restructuring, it could be argued that things actually went exactly accordingly to plan: as our expert survey respondents correctly predicted last year, the retail and oil & gas sectors went on to dominate the 2017 distressed landscape.

The past year could be characterized as, among other things, the year of the so-called retail apocalypse because more large retail bankruptcies were filed in 2017 than during the peak of the Great Recession.

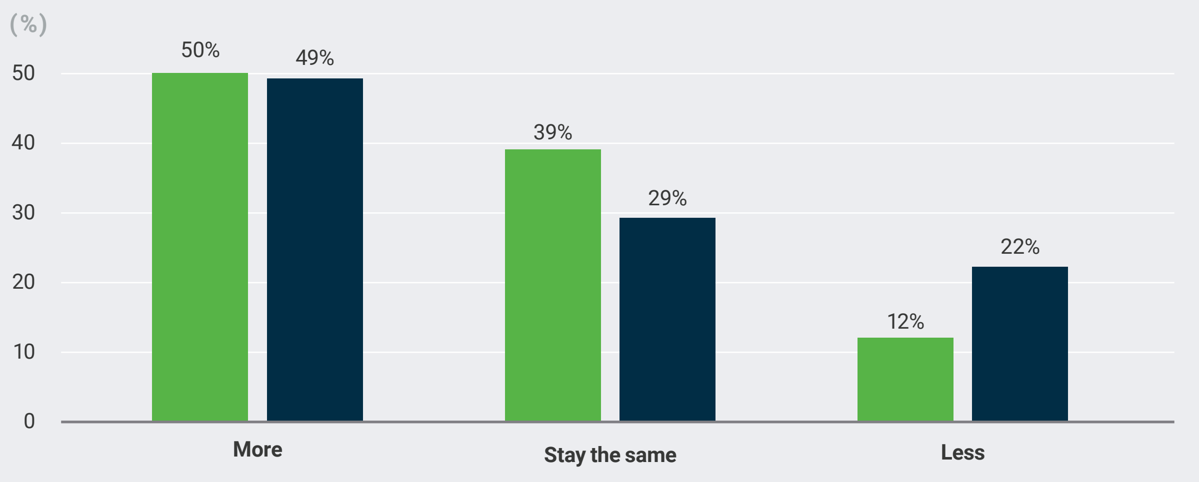
Meanwhile, we also experienced what could be called energy 2.0 because additional restructuring activity in the power industry and related sectors augmented the high number of oil & gas restructurings in the past two years.

What will 2018 bring? To find out, we fielded our annual online survey to 216 restructuring lawyers, investment bankers, and other industry experts just before the end of the year.

OVERALL, HERE'S WHAT THEY HAD TO SAY:

- Even with the US economy churning at nearly full strength—with manageable inflation, favorable employment rates, stock prices at all-time highs, and tax reform on the way—50% of respondents said they expect to see restructuring activity in the United States increase in 2018; and another 39% expect restructuring to remain roughly the same as in 2017 (figure 1).
- Their outlook for restructuring globally is somewhat comparable to last year's: 35% expect more activity in 2018 compared with last year, and 29% see levels remaining the same.

FIGURE 1: MOST EXPERTS SAY RESTRUCTURING ACTIVITY WILL EITHER STAY THE SAME OR INCREASE IN 2018



■ 2017 survey, N = 216 ■ 2016 survey, N = 205
Source: AlixPartners 2018 annual North American restructuring experts survey

So, what, exactly, is going on? Do those estimates reflect experts' wishful thinking for more deal flow? Or could it be that they're seeing certain fundamental weaknesses in the economy and certain disruptions in businesses today that others may be underestimating?

Let's take a deeper dive to find out.

COULD THERE BE EVEN MORE DISTRESS FOR RETAIL?

A large majority of respondents (84%) again cited retail as one of the industries most likely to face distress in the year ahead (figure 2). That makes sense given the disruption pervading the retail sector. New technologies and evolving consumer preferences have already dramatically affected retail, leading—at least in part—to that record number of bankruptcies last year.

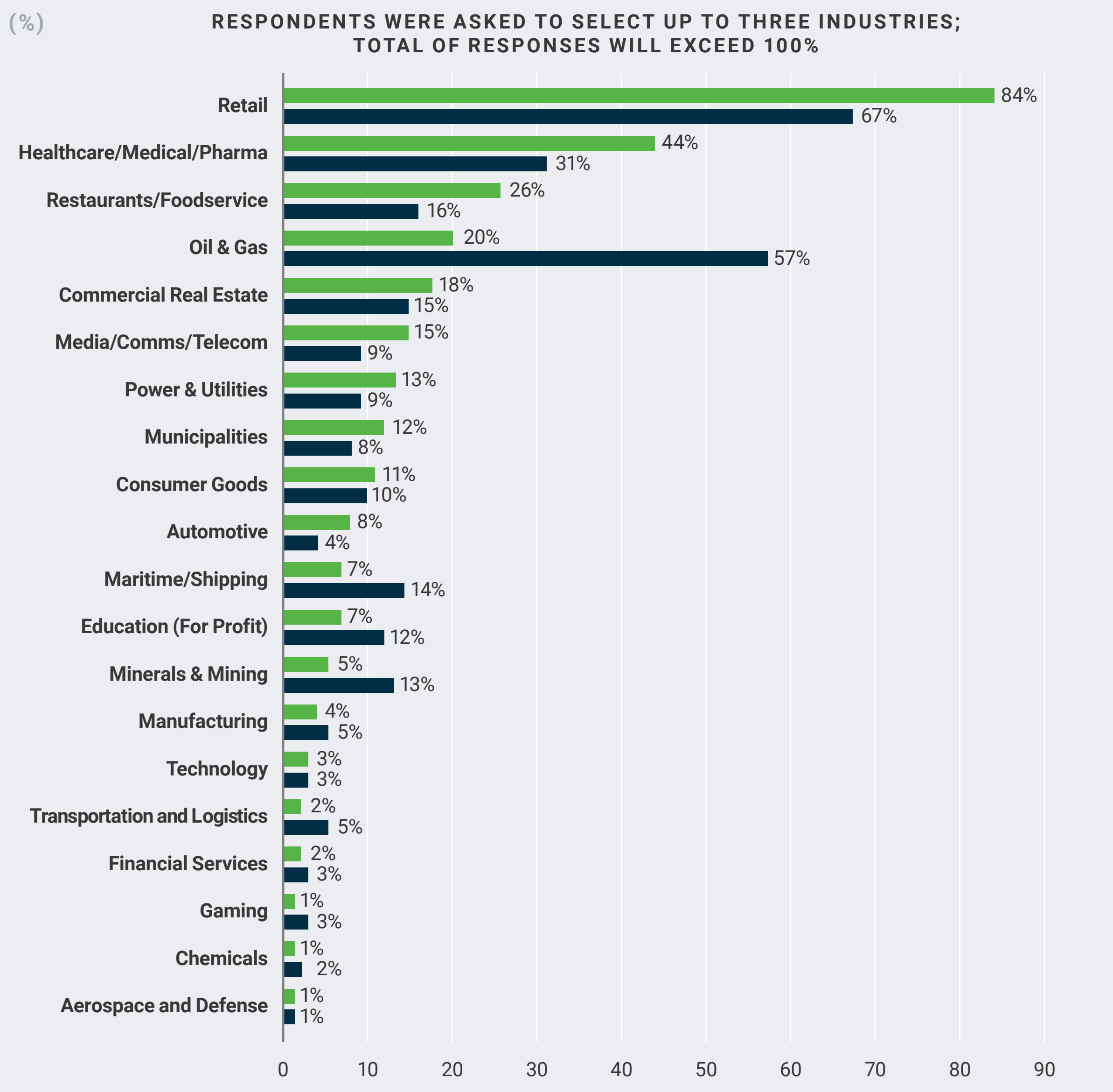
Indeed, 53% of respondents said the shift to e-commerce was the primary reason for the record number of retail filings in 2017 (figure 3). But e-commerce is not the only threat: 36% also cited high debt loads as an equally significant pain point, and 11% said excessive debt was the primary driving factor in retail bankruptcies.

All told, restructuring experts are anticipating a challenging 2018 for retailers. Can retailers with less-debt-laden balance sheets weather the storm, or will they still suffer the same fate as their more-highly-levered peers?

Given the challenges ahead for retailers, it's also worth pointing out that commercial real estate has moved onto our survey respondents' radar screens. About 18% flagged the commercial real estate industry as likely to face distress in 2018, which makes it the fifth-most-vulnerable US sector in our survey.

Naturally, store closures—and the underlying slowdown in foot traffic—are causing problems for shopping malls and forcing landlords to get creative as they work to fill newly vacated spaces. If stores don't react quickly enough, brick and mortar's struggles could be ominous signs for commercial real estate in the coming years.

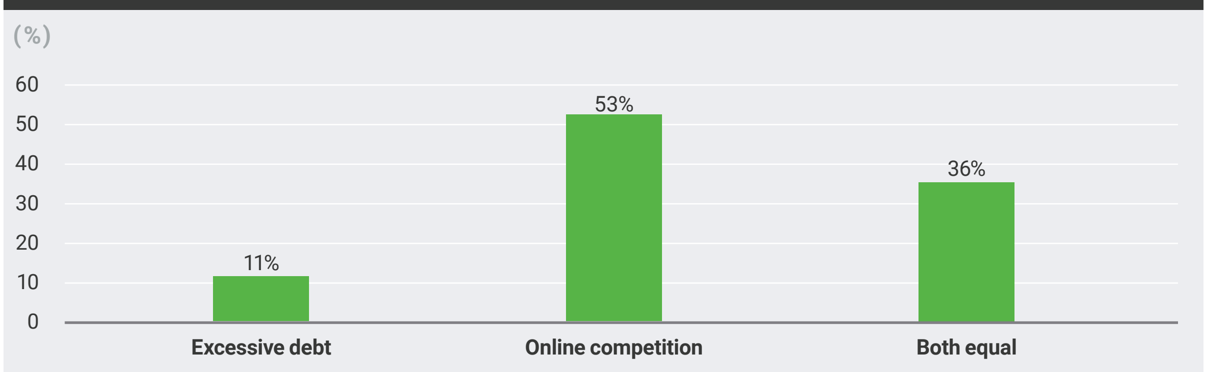
FIGURE 2: SECTORS MOST LIKELY TO FACE DISTRESS



■ 2017 survey, N = 216 ■ 2016 survey, N = 207

Source: AlixPartners 2018 annual North American restructuring experts survey

FIGURE 3: FACTORS MOST DIRECTLY RESPONSIBLE FOR THE RECORD NUMBER OF 2017 RETAIL BANKRUPTCIES



N = 215

Source: AlixPartners 2018 annual North American restructuring experts survey

IS HEALTHCARE GETTING SICKER?

The second-most-likely trouble spot is occupied by healthcare, medical, and pharmaceutical companies, according to our survey: 44% of restructuring experts flagged that sector as being likely to face distress in 2018.

Today, providers and payers still operate in an extremely dynamic marketplace in which aging populations and the prevalence of chronic disease are increasing the level of demand for care. At the same time, the shift from a fee-for-service model to value-based care is leading to heavier pricing pressures for medical device manufacturers, pharmaceutical firms, and healthcare providers such as hospital networks and private-sector payers such as insurers.

Those issues, in addition to the prospect of healthcare-related legislation, were top of mind among respondents: 57% said they believe that eliminating or significantly changing the US Affordable Care Act could lead to an increase in US restructurings in 2018.

ARE RESTAURANTS SUDDENLY BACK IN THE CROSSHAIRS?

Another interesting development was the experts' selection of restaurants and foodservice companies as the third-most-threatened industry in the United States. The industry has not been ranked in the top three since our 2012 survey, but it does face a number of immediate challenges. Diners' increasing preferences for healthy and convenient offerings, coupled with a significant increase in supply, have created fierce competition over only modestly increasing share.

All the while, stagnating middle-class incomes have exacerbated the downward pressure on pricing, whereas labor costs have been increasing because of the strong labor market and pockets of state and local minimum-wage increases. Operating margins are getting squeezed from that formidable combination of declining traffic, labor cost pressures, and lack of pricing power. Will the experts' concerns about restaurants and foodservice manifest in the form of more filings this year?

Stay tuned.

WILL 'ENERGY 2.0' ROLL ON?

When asked about the direction of future oil prices (for Brent crude), more than 70% of respondents predicted that at the end of 2018, prices would be no higher than $65 per barrel. (Brent crude was approximately $62 per barrel at the time of the survey.) And if their predictions actualize, certain segments of the industry are not likely to see their fortunes improve in 2018.

Restructuring experts pointed to offshore drilling (cited by 38%) and oil field services (cited by 34%) as the oil & gas subsectors that will see the most restructuring activity in 2018. That aligns with their views on Brent crude because stagnating oil prices could mean continued strife for offshore drillers that have not made significant strides in cost structure rationalization. And for marginal players in this sector, any further bumps in the road could be potentially catastrophic.

Further, because those stagnating oil prices are unlikely to spur meaningful increases in production levels, oilfield services companies are could feel the pressure as well. Absent a production boom, oilfield services companies—many of which granted significant price concessions to their clients in 2015 and 2016—appear unlikely to win back pricing power in the near term. The inability to expand margins through top-line growth has led some oilfield services companies to pursue M&A opportunities as a way of reducing their cost bases, which could increase leverage and render them even more vulnerable to any drops in oil prices.

Elsewhere in the power industry, potential issues loom—albeit for different reasons. When asked about challenges that independent power producers (IPPs) will face in 2018, 64% of restructuring experts said tepid overall growth in consumer demand was the greatest challenge. Many IPPs are already struggling with low wholesale energy prices that in many cases do not provide sufficient margins for fixed-cost recoveries.

Further, IPPs hoping for a windfall from government subsidies may have to go back to their drawing boards in 2018 following the Federal Energy Regulatory Commission's unanimous decision to reject the Department of Energy's proposed Grid Resiliency Pricing Rule. The Energy Department's proposal, among other things, would have provided cost recoveries for coal and nuclear plants in exchange for the baseline power and resiliency that they provide for the US power grid. But with those subsidies now in question, IPPs may find themselves having to restructure. In fact, more than 80% of restructuring experts anticipate that the frequency of power bankruptcies (excluding oil & gas) will either increase (39%) or stay the same (45%) in the upcoming year compared with 2017. All in all, 2018 has the potential to be a very compelling year in power.

PERHAPS A PICK-UP IN MUNICIPAL RESTRUCTURINGS, LED BY VENEZUELA?

On the sovereign front, Venezuela was viewed as the likely number one hot spot for restructuring activity in 2018, with 85% of restructuring experts flagging that country as a likely home for significant restructuring activity this year. Venezuela recently announced that it intends to restructure up to $150 billion in sovereign debt, with some $9 billion due in 2018 alone.

In the United States, restructuring experts flagged Illinois (71%) as most likely to be in the news—based on financial distress in 2018—frequently citing the City of Chicago and the Chicago Public Schools system as potential focal points. They also identified Connecticut as an area of interest among municipalities (37%), calling out the City of Hartford specifically.

ANOTHER BUSY YEAR ON THE HORIZON

The year 2018 has the potential to be another intense year for restructuring professionals. Activity in certain sectors—especially retail and energy—may feel familiar. However, developments in healthcare, restaurants/foodservice, and other parts of the power industry could add a unique flavor to the year ahead.

And with nearly 90% of respondents anticipating that 2018 will be at least as robust as last year, restructuring experts should plan to have their hands full. **A**

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