'There's going to be a reckoning': A look at restructuring in 2021

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(Reuters) - For months, companies that were already burdened by heavy debt loads have flocked to Chapter 11 as the impact of the COVID-19 pandemic tipped them over the edge. But restructuring experts say we're nowhere near the end of COVID-related bankruptcies and that an uptick in filings may occur in mid-2021 as companies across several industries are forced to address creditors they've fended off since March and debt they've taken on to survive the economic downturn.

"I think that right now we are, to a large extent, in the eye of the hurricane," Marshall Huebner, co-head of Davis Polk & Wardwell's restructuring group, said.

"The sheer volume of new debt on hundreds of balance sheets will ultimately and unquestionably result in weaker players and industries needing to restructure in the next few years," Huebner added. "So the other wall of the hurricane is coming. It's only a question of when."

The transportation, healthcare, and real estate sectors are likely to see an increase in restructurings, experts say. Moreover, the wave of energy, retail and restaurant Chapter 11 cases that have clogged up bankruptcy courts this year as a result of the pandemic isn't going to retreat anytime soon. With a variety of legal, financial and societal factors in play, 2021 will be a year of critical decision-making for distressed businesses in these industries.

TRANSPORTATION: The increasing popularity of virtual meetings, while a saving grace to many businesses during the pandemic, is wreaking havoc on the transportation sector. Companies have realized that they can be just as productive without spending money on business travel for employees and will likely want to retain those savings even when a vaccine is widely available and travel becomes less of a potential health risk than it has been for the past 10 months.

"One of the first things that we all learned during the pandemic is that video services work for many purposes. I think that many companies are and will be taking a very hard look at travel costs and expenses," Huebner said.

U.S. airlines have been largely shielded from the effects of the pandemic thanks to a $25 billion government bailout in April. They may be in line for another $17 billion to keep them afloat in 2021. Those outside the U.S. haven't been as lucky, with three major Latin American airlines filing for Chapter 11 protection since May.

But even if U.S.-based airlines are able to keep their cash stockpile healthy for now, the damage to travel — especially for business purposes — has been done. And without ongoing financial support from the government, airlines may be forced to face the music, experts say.

"Profits are only going to come from increased travel and that's not going to happen. (The airlines) know this," said Hugh Ray, head of McKool Smith's national restructuring practice.

HEALTHCARE: Though some regional healthcare systems have already started seeking bankruptcy protection in 2020 — see New Hampshire's LRGHealthcare's filing in October — experts believe the industry could see more restructuring and Chapter 11 cases in the coming year, especially for practices that have been forced to put lucrative, non-urgent surgeries on hold as a result of the pandemic.

Structural costs in the form of employee benefits and pensions, plus increased efforts by the federal government to rein in healthcare costs and pursue False Claims Act litigation to control overbilling will contribute to the stress the industry is under. However, virtual appointments will help keep lower costs for these companies.

ENERGY, RETAIL, HOSPITALITY: 2020 has been the year of retail bankruptcies, from historic department stores to regional discount shops. Casual restaurants have taken a hit too as indoor dining has been drastically reduced through government regulations. Energy companies, meanwhile, have been a steady source of Chapter 11 filings for the past several years.

None of that is going to change in 2021, experts say. Retailers, especially, will take advantage of cash they bring in from year-end sales to fund their restructuring process, head of Duff & Phelps' New York corporate finance practice Josh Benn said. Retailers and restaurants that have managed to keep vendors and landlords at bay in 2020 won't be able to do so forever, he added.

"At some point there's going to be a reckoning," Benn said.

The energy industry, meanwhile, is in the midst of a sea change as pressure grows on legislators to curb fossil fuel emissions. Traditional oil, gas and coal companies are seeing their access to financing diminish, Ray said.

REAL ESTATE: The downturn of nearly all of these industries is bad news for real estate. In November, two mall operators became the first high-profile landlords to take the plunge: Pennsylvania Real Estate Investment Trust and CBL & Associates Properties. While PREIT managed a quick reorganization, CBL is still muddling through. They're only the beginning, experts say.

But mall operators won't be the only type of landlord impacted in 2021. Providers of commercial office space are in for trouble as companies increasingly permit workers to perform their duties remotely. Office space is already well on its way to becoming an unnecessary cost that businesses are eager to cut.

"When COVID's over, people say they're going to move back (into offices)," Ray said. "But they're not."

References

AMERICAN AIRLINES GROUP INC; CBL AND ASSOCIATES PROPERTIES INC; MCKOOL SMITH A PROFESSIONAL CORP; PENNSYLVANIA REAL ESTATE INVESTMENT TRUST

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