THE WALL STREET JOURNAL.

Uncertainty is the Dominant Theme for 2017; Restructuring Professionals See Opportunity in Unknown Impact of Political Events

January 3, 2017

Uncertainty appears to be the name of the game for 2017, creating a sense of opportunity for distressed investors and restructuring professionals.

Last year's major political events—the election of Donald Trump as president and the U.K.'s vote to exit the European Union—have created a new world for businesses to confront. For some, it could be a boon if Mr. Trump carries out campaign-trail pledges to roll back various regulations and carry out major infrastructure projects. Other sectors don't know what to expect. For instance, a dismantling of the Affordable Care Act could send shock waves throughout the health-care industry.

"The imponderables here are as great as we've ever seen them," said Anders Maxwell, a managing director and partner in Peter J. Solomon Co.'s restructuring practice. "We've never been here before."

Heading into 2017, strong credit markets are expected to remain that way, even for non-investment-grade companies. S&P Global Ratings expects the speculative-grade corporate default rate to increase to 5.1% in September 2017 from 5% this past September.

Rising interest rates tend to spur more defaults, but restructuring professionals don't see any dramatic changes ahead. In mid-December, the Federal Reserve raised interest rates for the first time in 2016 and signaled it would make several more increases in 2017.

Rising rates should boost the dollar's value, according to Derek Pitts, the head of Peter J. Solomon's restructuring practice. "That to me has a much more fundamental effect operationally," he said.

A big driver of defaults has been oil and gas companies hit hard by the historic nosedive in commodities prices. As of Dec. 22, S&P said 157 corporations around the world had defaulted, compared with 113 in 2015. Of this year's 157 defaults, 64 were oil and gas companies, or nearly 41%.

S&P said these companies will continue to drive defaults and new bankruptcy filings, although at a slower pace. Many of them have already gone through chapter 11 restructurings—according to law firm Haynes and Boone, 114 North American oil and gas producers have filed for bankruptcy over the past two years. But the lack of a sustained and noticeable fuel price rally isn't going to save companies that haven't yet dealt with massive debt loads.

"The window of opportunity for distressed investors is certainly rapidly closing," Jeff Robinson, who oversees distressed investments by Bain Capital Credit, said of the energy industry. "It will be fewer and further commodities-related companies that file in the upcoming year."

Investors that focus on distressed situations will be looking for other places besides energy to put their money to work. And they have plenty of dry powder to play with. According to data provider Preqin, North America- and

Europe-focused investment fund managers had $52.9 billion in capital committed to distressed debt investments at the end of 2016.

Fund managers are looking for more cash. Preqin said that some of the biggest distressed investors—including Apollo Global Management, Centerbridge Capital Partners, Cerberus Capital Management and Oaktree Capital Management—are in the market seeking to raise billions of dollars in new capital for distressed-debt investments.

One place investors might turn to is the shipping industry, which continues to grapple with weakening demand and an oversupply of vessels. Last year saw the massive collapse of South Korea's Hanjin Shipping Co., the effects of which rippled throughout the world as billions of dollars' worth of cargo was temporarily stranded at sea.

"For the shipping industry, the distress just isn't going to end. Very few will be left unscathed," said Rick Chesley, the global co-chair of DLA Piper's restructuring practice.

And don't count retail out. Last year saw the chapter 11 filings—and liquidations—of Sports Authority Holdings Inc., Hancock Fabrics Inc. and Vestis Retail Group LLC's Sport Chalet. Even companies that found buyers saw large chunks of their chains close, like Aéropostale Inc. and Golfsmith International Holdings Inc. American Apparel Inc. filed its second bankruptcy case in November and is hoping a January auction will find a buyer for its approximately 100 stores, but it isn't guaranteed.

"The brick-and-mortar problem isn't going anywhere," Mr. Chesley said.

Restructuring professionals will be keeping a close eye on the health-care industry in light of a Republican White House and Congress. During his campaign, Mr. Trump vowed to repeal the Affordable Care Act of 2010, though after the election, he told The Wall Street Journal that he may keep certain parts of the legislation.

Bruce Mendelsohn, a partner in Perella Weinberg Partners' advisory practice, pointed out that although there haven't been many health-care defaults yet, his firm is keeping an eye on this sector in light of the uncertainty surrounding regulations.

"Next year, health-care may find its way into the restructuring arena, as energy did last year," Mr. Mendelsohn said of 2017.

Mr. Robinson, of Bain Capital Credit, said the assumption is that at least come components of the ACA will be peeled back. But other health-care companies had been in trouble before the election, struggling with competitive pressures as well as insurance reimbursement rates.

"So sure, the election is a driver of uncertainty and risk, which is a good thing for us in some sense, but it's not the only thing driving interest in the space," Mr. Robinson said.

Regardless of what happens with the ACA, Greg Hagood of investment bank SOLIC Capital said "the delivery model for health care is changing, and there are going to be some winners and a lot of losers." High on the list of losers are small community and rural hospitals, Mr. Hagood said, citing changing patient demographics and difficulty attracting talented physicians.

"You're going to continue to see these hospitals in these smaller markets go out of business," he said.

Other industries may be affected if there's a broad deregulation push by the Trump administration. The president-elect has targeted the 2010 Dodd-Frank financial law as well as environmental regulations affecting coal miners.

"Right now, every industry is holding out to see what happens—will they be the golden child in terms of more government spending happening there?" Mr. Chesley said.

Looking beyond the U.S., the U.K. is expected to experience an increase in business restructuring because of last summer's vote to leave the European Union. Negotiations over the terms of the Brexit are expected to take years to complete. However, Prime Minister Theresa May acknowledged in December that the U.K. will need a transition period to cope with regulatory and trading uncertainty following Brexit.

"Economic uncertainty often steers people away from doing business in a particular region or sector," said Holly Etlin, a managing director in AlixPartners' turnaround group. "That sort of uncertainty hangs over U.K.-based businesses."

So many unknowns aren't good for businesses generally, but restructuring professionals don't mind.

"When there's more change and uncertainty, there's a lot more that can go wrong," said Mr. Pitts.

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