Pandemic-Triggered Surge in Bankruptcies Amid Rising Debt and Volatility Across Sectors in the US in 2020

aranca

July 2021

Executive Summary

01

Onset of the COVID-19 pandemic in 2020 was a huge shock to the global economy.

- It is not just a humanitarian crisis but also the harbinger of an economic crisis.
- Global trade spiraled and even a developed country such as the US struggled as large companies collapsed.
- Bankruptcy filings by large companies in sectors such as energy and consumer discretionary increased 62% and 162%, respectively, in 2020 compared with those in the previous year.

02

US, the largest contributor to global economic output, was severely impacted.

- Subdued economic activity in the first two quarters heavily impacted revenue generation as the demand for goods and services fell.
- Aggregate sectoral revenue was down 9% to $40.7 trillion, while profitability fell around 46% to $1.9 trillion compared with that in the previous year.
- US markets registered record declines and stunning rebounds as 7 of 11 S&P sectoral indices ended the year in positive.

03

Despite sustained defaults, companies continued to issue debt, resulting in a bond binge in the market.

- This triggered a frenzy in bond markets with companies taking additional debt to stay afloat.
- Severely impacted sectors such as energy and consumer discretionary continued issuing investment grade and junk bonds.
- Corporate non-financial bond issuances spiked to ~$2.3 trillion in 2020.

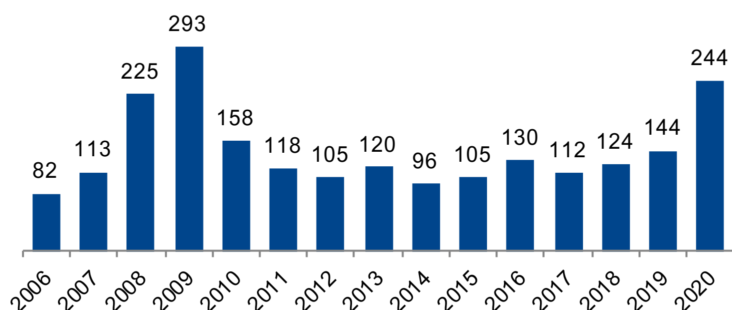
04

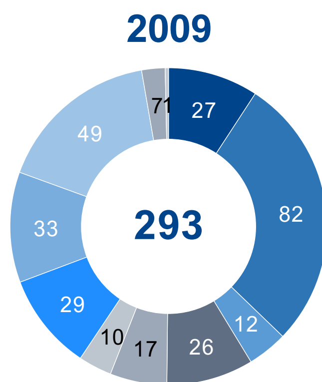
While the economic scenario can be likened to the global financial crisis of 2009…

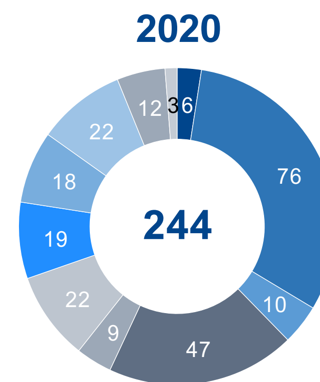
- Recovery from the crisis back in 2008–09 had been quick. However, it is too early to predict how the economy will perform in the next few years.

Between 2006 and 2020, around 2,200 companies listed on major US stock exchanges went bankrupt; highest filings recorded in 2009 and 2020 at 15% and 11%, respectively

Bankruptcy filings by large companies (those with at least $0.5 billion in liabilities) surged 120% YoY. Of the companies with assets more than $1 billion, 45 filed for bankruptcy compared with 38 in 2009 and 18 in 2019.

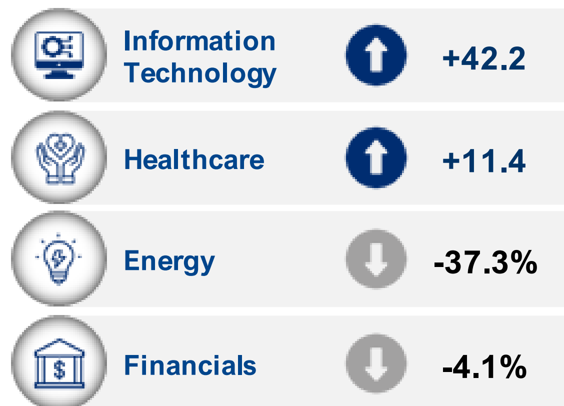




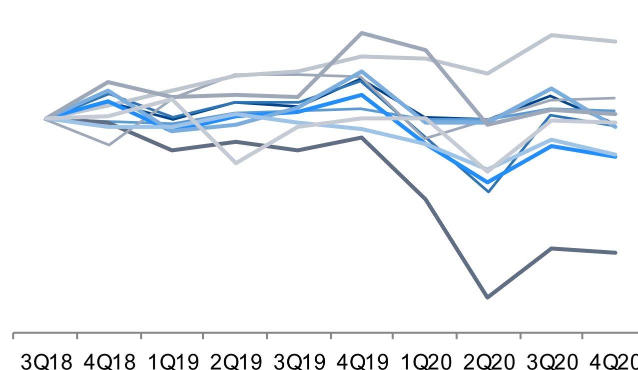


- Communications
- Consumer Discretionary
- Consumer Staples
- Energy
- Financials
- Healthcare
- Industrials
- Materials
- Real Estate
- Technology
- Utilities

Price performance of key S&P 500 sectoral indices in 2020



Revenue in energy, financials, real estate and consumer discretionary sectors was the most impacted in 2020.



	FY20	FY19	% Change
Communication Services	2,746	2,844	-3.4%
Consumer Discretionary	5,729	6,439	-11.0%
Consumer Staples	4,355	4,364	-0.2%
Energy	3,312	4,861	-31.9%
Financials	6,394	6,983	-8.4%
Health Care	3,540	3,358	5.4%
Industrials	6,016	6,846	-12.1%
Information Technology	3,204	3,255	-1.6%
Materials	2,749	2,993	-8.2%
Real Estate	920	964	-4.6%
Utilities	1,692	1,726	-2.0%

Source: *Bloomberg, Capital IQ, S&P and Aranca Analysis*

Energy sector severely impacted by COVID-19 and declining oil prices in 2020; despite bankruptcy count crossing 08-09 level, debt issuance at an all-time high

Bankruptcy Tracker

47
Bankruptcies in 2020 vs.
38
Bankruptcies in 2008–09

Top 5 Bankruptcies

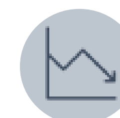
Company	Filing on	Business type	Liability
Chesapeake Energy	28-06-2020	Oil & Gas Exploration	$11.8B
McDermott International	21-01-2020	Engineering & Construction	$9.9B
Valaris PLC	19-08-2020	Oil & Gas Services & Equip	$7.9B
California Resources	15-07-2020	Oil & Gas Exploration	$6.4B
Whiting Petroleum Corp	01-04-2020	Oil & Gas Exploration	$3.6B

The energy sector has been grappling with declining oil prices since 2019. Further drop in prices to negative levels in 2020 only worsened the situation.

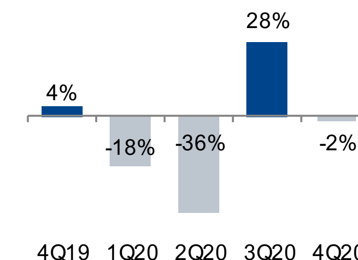
Many companies used substantial debt to fund acquisitions, expecting an uptick in demand that would help generate revenue and reduce their debt liabilities.

With restrictions imposed on movement, demand for oil dropped and many industry pioneers were forced to take protection under Chapter 11.

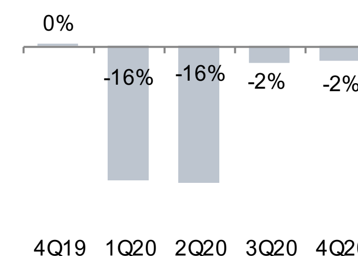
S&P 500's energy sector lost more than 40% of its value in 2020 despite the dramatic rebound in the overall stock market in the second half of the year.



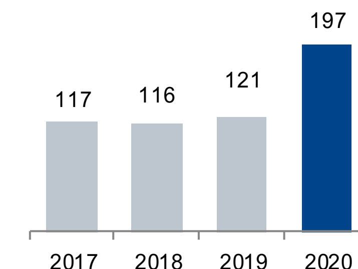
Revenue Growth (QoQ)



Profit Margin (%)



Debt Issued ($B)



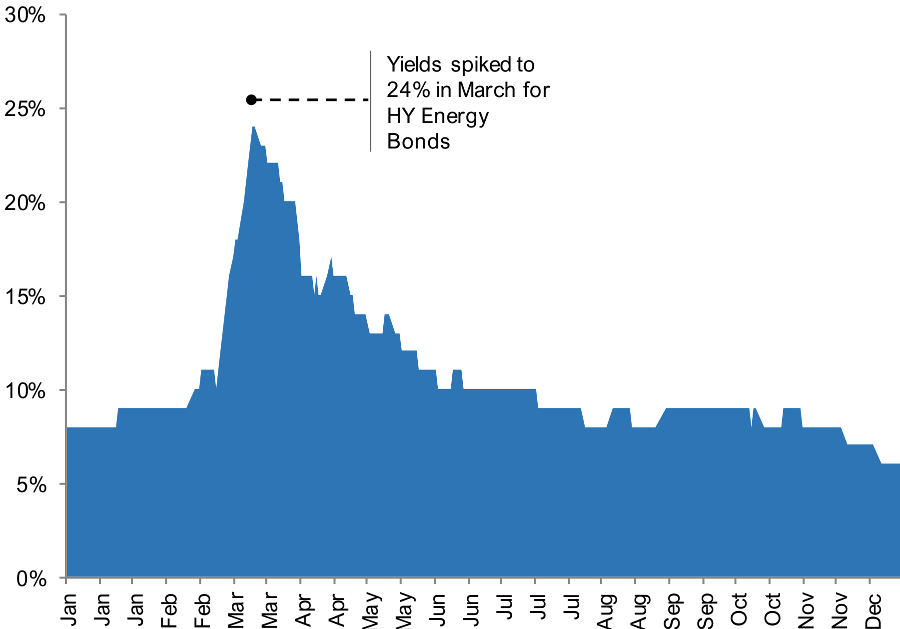
Source: *Bloomberg, Capital IQ, S&P and Aranca Analysis*

Decline affected prices of bonds issued; energy bonds worth around $37 billion traded at distressed levels in December 2020, significantly down from $144 billion in March

Yields of high-yield energy bonds dropped to 6% from 24% in March 2020.

- As oil went into a downward spiral, the prices of investment-grade and junk bonds issued by energy companies in the US plummeted.
- Companies with junk-rated bonds have been defaulting on interest payments at record levels.

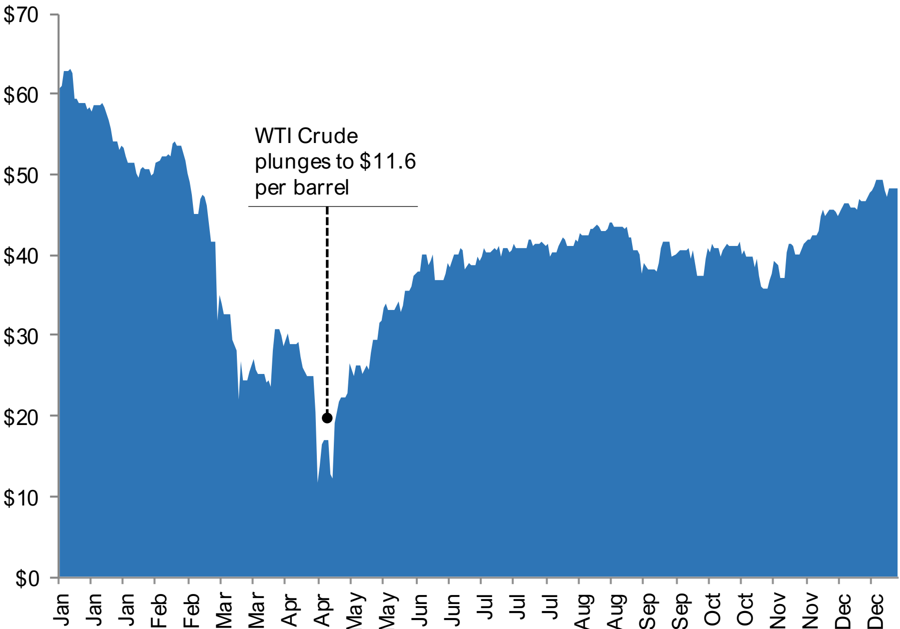
Barclays Bloomberg HY Index



Demand shock seen in crude oil in 2020 due to COVID-19.

- Oil prices have since recovered to around $40 per barrel from the fall in April.
- Uncertainty surrounding economic recovery and debt maturities scheduled in 2021 and 2022 cast a doubt on the debt servicing capabilities of companies.

WTI Crude $ per barrel



Source: *Bloomberg, Capital IQ, S&P and Aranca Analysis*

Loan defaults, payment deferrals lead to high provisioning in financial sector; however, banks resilient enough to absorb considerable credit losses

Bankruptcy Tracker

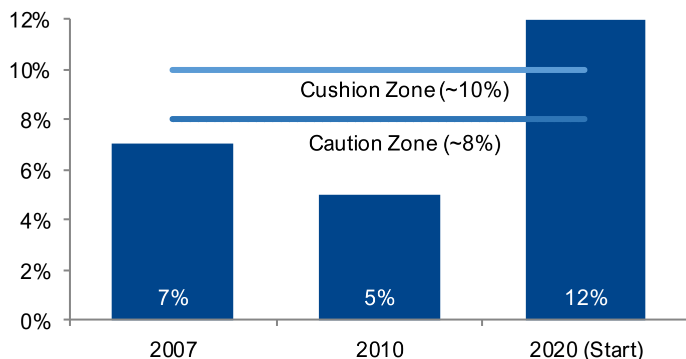
Top 5 Bankruptcies

Company	Filing on	Business type	Liability
Cred Inc	07-11-2020	Crypto Financial Platform	$142.6M
Florida First City Banks	15-01-2020	Regional Banks	$131.0M
Emergent Capital Inc	15-10-2020	Consumer Finance	$123.6M
IMH Financial Corp	23-07-2020	Thrifts & Mortgage Finance	$63.8M
Chineseinvestors.com	18-06-2020	Financial Exchanges & Data	$7.6M

The financial sector has been moderately affected by consumers' ability to pay back debt, forcing banks to set aside more to cover for souring loans, thus denting their net interest income. At the same time, decrease in consumer spending negatively impacted a large part of the revenue streams of banks: credit card fees and service charges.

US banks entered the crisis with liquidity and capital reserves well above the regulatory requirements.

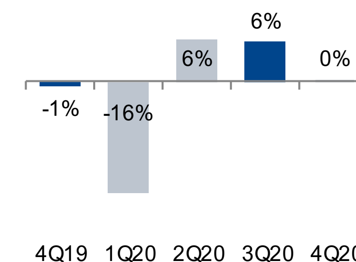
CET1 ratio of US banks with more than $50B in assets



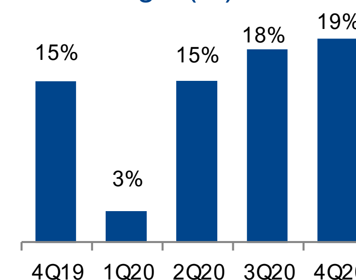
The pandemic has created a few other positives for the financial sector, some of which are mentioned below.

- Increase in refinancing volumes due to historically low mortgage rates has led to a rise in capital market and mortgage fees.
- Rapid deployment of digital services in unprecedented times has helped banks increase digital transaction volumes and, consequently, revenue.

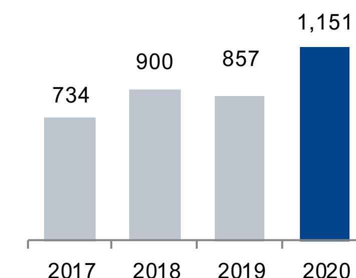
Revenue Growth (QoQ)



Profit Margin (%)



Debt Issued ($B)



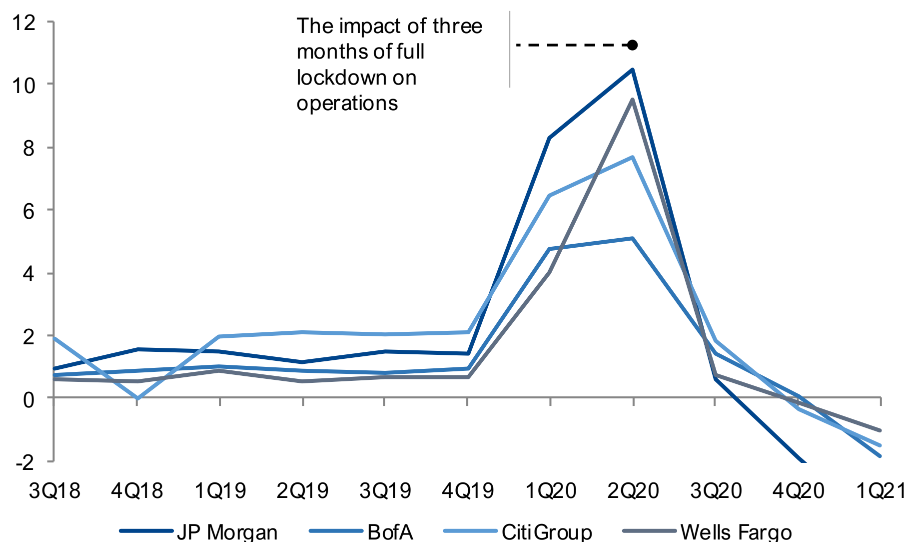
Source: *Bloomberg, Capital IQ, S&P and Aranca Analysis*

Revenue in financial sector affected by low FED rates and tepid loan growth in 2020, along with a spike in provisioning in 1HY20; profit margins recover in 3Q20

In the US, provisioning by top banks spiked in 2020; reversal in provisions was recorded in 4Q20 and 1Q21.

- On the provisioning front, the top 100 banks in the US made $115 billion in loan loss provisions up to 9M20.
- Relief measures and stimulus provided by the US government helped banks reduce the provisions made and release reserves.
- Increased consumer spending helped the top four lenders reduce loan loss provisions by $12.7 billion in 1Q21.

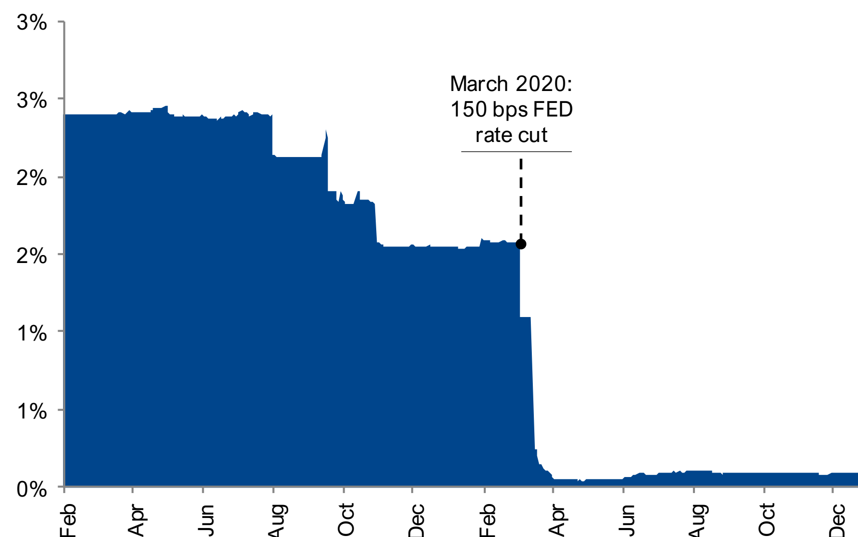
Provisioning by Top 4 banks (US $ Billion)



FED rates were slashed to almost 0% amid the pandemic to boost the economy.

- With FED rates at multi-decade lows, the revenue of banks is affected.
- Consumers are deleveraging and commercial borrowers are turning to capital markets.
- Banks are likely to report moderate profitability in 2021 but slightly better earnings than those in 2020.

US Fed rate: FEDL01 Index Jan 2019–Dec2020



Source: *Bloomberg, Capital IQ, S&P and Aranca Analysis*

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COVID-19 worsened the condition of debt-laden companies that were already facing liquidity and inventory issues; debt issuance rose by 186% in 2020

Bankruptcy Tracker

76 Bankruptcies in 2020 vs. **147** Bankruptcies in 2008–09

Top 5 Bankruptcies

Company	Filing on	Business type	Liability
Ascena Retail Group	23-07-2020	Apparel Retail	$12.5B
J.C. Penney Co Inc	15-05-2020	Departmental Stores	$8.0B
Neiman Marcus Group	07-05-2020	Departmental Stores	$5.1B
Tailored Brands Inc	18-05-2020	Apparel-Wholesale & Retail	$2.8B
CEC Entertainment	24-06-2020	Restaurants	$2.0B

- Consumer spending, a major source of economic activity, collapsed as the first wave of the pandemic swept across countries in early 2020. As lockdowns were implemented across the world, expenditure on non-essential goods/services decreased considerably with consumers staying away from retail chains.
- The problem was exacerbated by supply chain issues and increasing demand for online retail.
- The sudden and deep drop in consumer spending resulted mainly from cutbacks to in-person services, especially travel, entertainment, dining, and clothing retail.

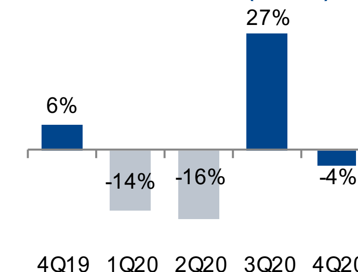
Notable bankruptcies in severely impacted industries in the consumer discretionary sector

Home Improvement Retail

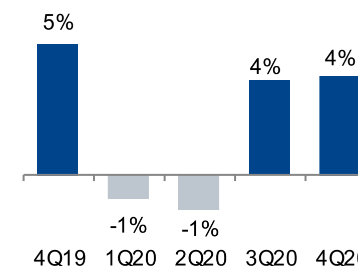
Restaurants

Apparel Retail

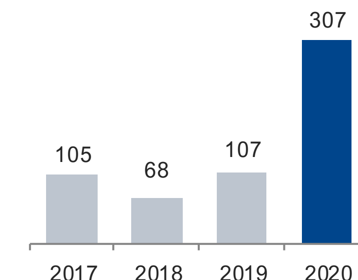
Revenue Growth (QoQ)



Profit Margin (%)



Debt Issued ($B)



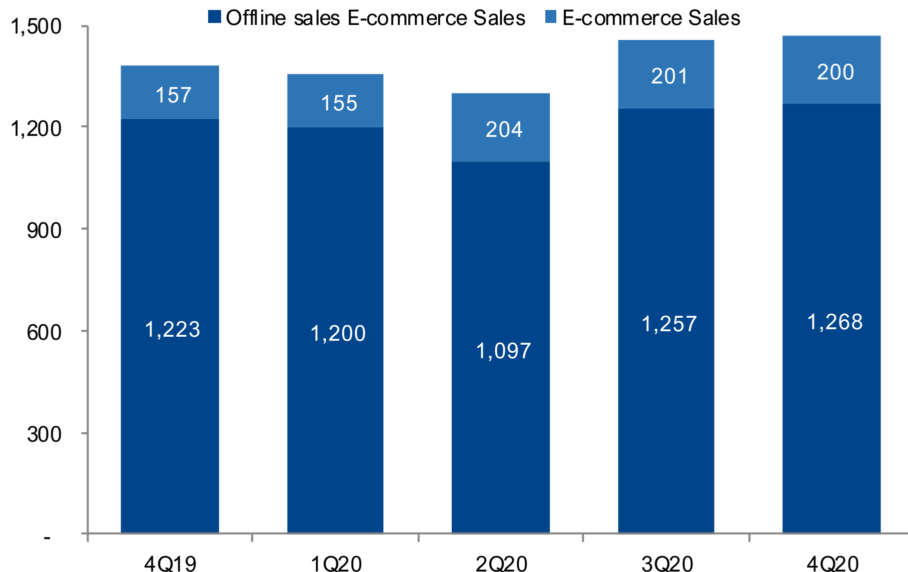
Source: *Bloomberg, Capital IQ, S&P and Aranca Analysis*

In 2020, consumers shift to online retailers and D2C brands; despite the high defaults, S&P consumer discretionary sector index surges 85% from its low in March

Seasonally adjusted e-commerce orders at $205 billion in 2Q20 indicated an uptick in online demand.

- Worldwide online sales accounted for 19% of the total retail revenue in 2020, up from 16% in the previous year, according to estimates from UN Conference on Trade and Development (UNCTAD).
- Consumers are turning to digital and omni-channel services. The adoption of e-commerce by previously uninitiated users has increased and the trend is likely to continue even after the pandemic subsides.

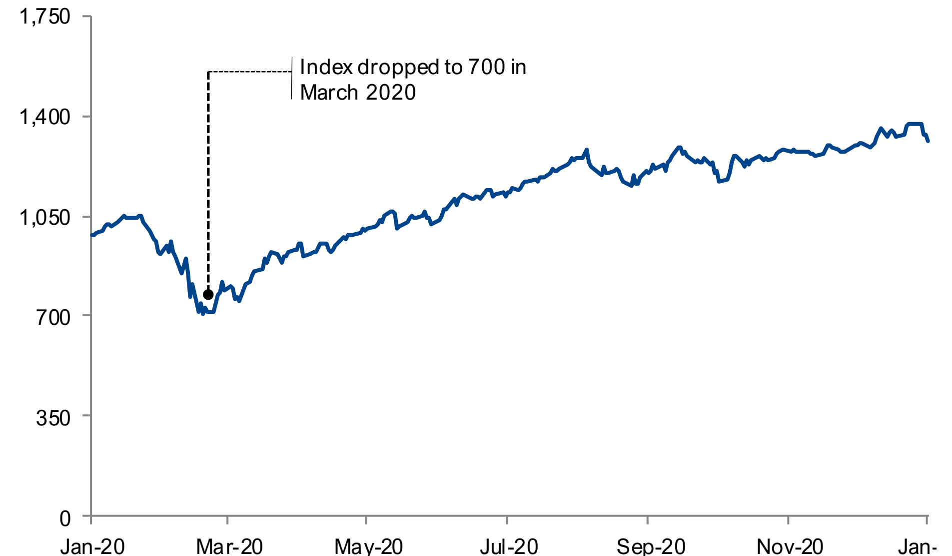
Online vs. Offline Sales ($ Billions)



Easing of lockdown procedures and government stimulus aided in the rebound of the consumer discretionary sector.

- The S&P consumer discretionary sector index stood at 1,307 in January 2021, up from its lowest level of 700 in March 2020.
- The $1.9 trillion fiscal stimulus helped in increasing the disposable income and savings of consumers.
- Following effective rollout of the vaccine program, consumer demand is likely to reach pre-pandemic levels. Post-vaccination, consumer confidence is expected to increase, as would pent-up demand, and accumulated savings.

S&P 500 Consumer Discretionary Index



Source: *Bloomberg, Capital IQ, S&P, US Census Bureau and Aranca Analysis*

Residential Real Estate recovers after recording lowest sales since the housing crisis in 2007; lag in Commercial Real Estate due to restricted cash flow and high debt

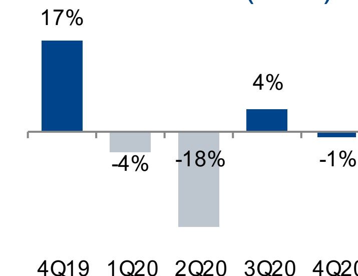
Bankruptcy Tracker

22
Bankruptcies in 2020 vs.
76
Bankruptcies in 2008–09

Top 5 Bankruptcies

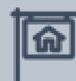
Company	Filing on	Business type	Liability
CBL & Associates Prop.	01-11-2020	Retail REIT's	$2.5B
Penn Real Estate Invest	01-11-2020	Retail REIT's	$2.0B
RGN-Group Holdings	17-08-2020	Holding Company	$950M
Renpath Holdings Inc	12-02-2020	Online Real Estate Services	$715M
Parkway Inc	06-07-2020	Real Estate Development	$450M

Revenue Growth (QoQ)



Residential Real Estate

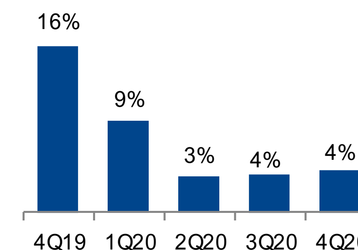
- Demand in the US housing market continued despite the pandemic.
- Purchase of new homes in suburbs (aided by the shift to remote work, lower tax, and continued low interest rates) magnified the housing boom.
- Despite strong demand, residential construction activity remained weak during 2020. This was partly due to rising cost of materials amid pandemic-related restrictions.
- Demand for housing is robust, but supply is limited. The monthly supply of all homes in the US fell to 3.8 months in December 2020 compared with 5.3 months a year ago.



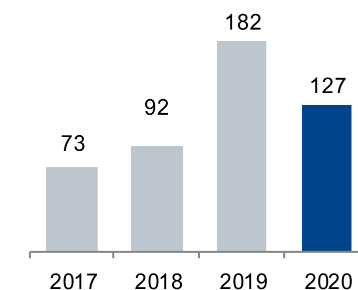
Commercial Real Estate

- Commercial real estate and associated industries provide a different picture.
- The CRE industry experienced a lag during the recession compared with other industries where recovery has already started, indicating that the worst may still not be over for the industry.
- Commercial real estate deal volumes in the US fell 32% compared with that in 2019.
- While demand was the highest in the apartment market, performance of the industrial sector overtook the office sector, as the pandemic compelled investors to focus on warehouses needed for online retailing.

Profit Margin (%)



Debt Issued ($B)

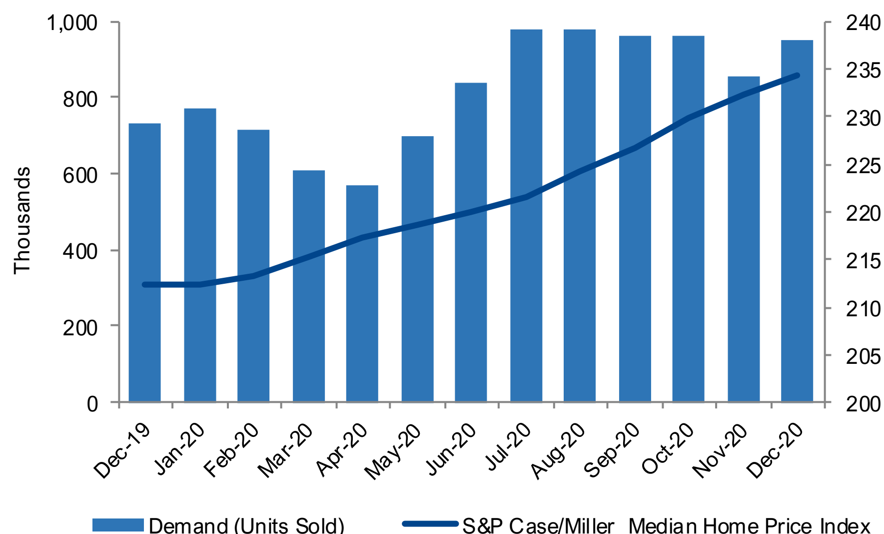


Source: *Bloomberg, Capital IQ, S&P, NAR, US Census Bureau, CBRE and Aranca Analysis*

Low mortgage rates boost residential home purchases; remote working policies and shift in consumer preferences may permanently affect demand for commercial spaces

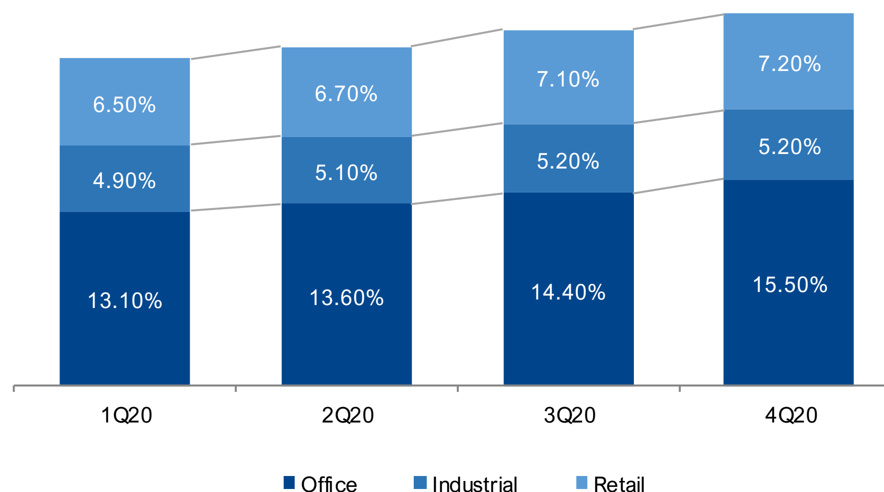
New residential home sales increased 15%; home price index was up 10% in Dec-2020 compared to the previous year.

- Sale of new homes rose to 0.95 million units in December 2020, as per the US Census Bureau. Sales are likely to continue increasing, with mortgage rates hovering around 3%.
- The S&P CoreLogic Case-Shiller national home price index posted a 10.4% annual gain in December, up from 9.5% in November — the fastest growth rate since 2013. The index is now 25% above the peak reached pre-Great Recession.



Commercial real estate vacancy rates increased during the year; retail sector consistently underperformed in 2020.

- The US office sector is expected to face more challenges in 2021 than 2020, as forecasted by Moody's Analytics. Vacancy rates could rise to 19.4% in 2021, surpassing the previous high of 17.6% in 2010.
- The industrial and apartment sectors recorded price gains in December 2020, with the RCA CPPI index rising 8.8% and 8.3%.
- The retail sector consistently underperformed other property types in 2020. The RCA CPPI retail index was the only one to post a negative annual return in December, down 4.3%.



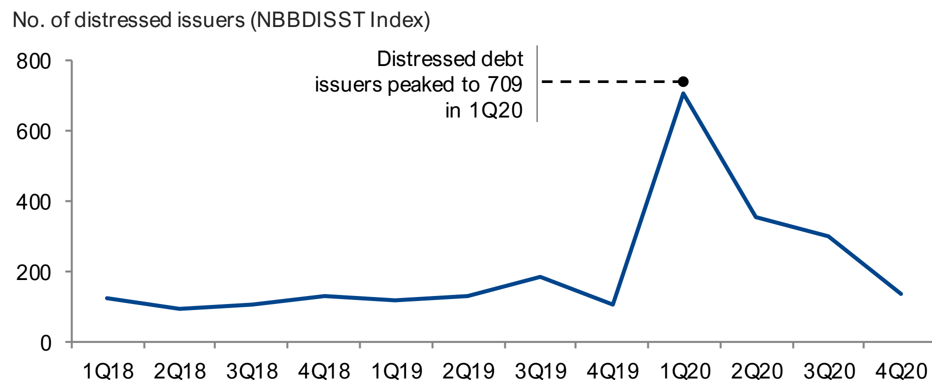
***Source:** Bloomberg, Capital IQ, S&P, Cushman & Wakefield, NAR and Aranca Analysis*

Amid rising bankruptcies, spike in corporate non-financial bond issuances in 2020; to provide stimulus, US government bought corporate bonds, including junk grade

Despite increasing number of distressed issuers and default rates….

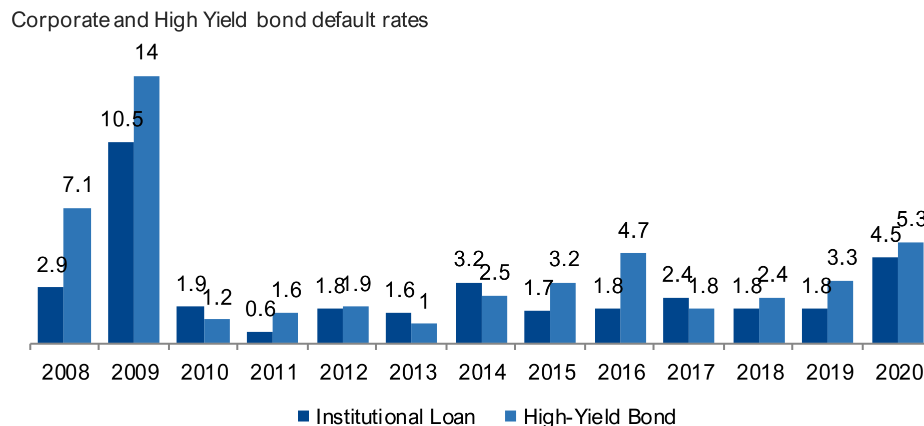
Led by the energy sector, a sudden spike was seen in distressed debt issuers in the US in 1Q20.

No. of distressed issuers (NBBDISST Index)



Default rates for corporate and high-yield bonds increased to 4.5% and 5.3% versus 1.8% and 3.3% in 2020 and 2019, respectively.

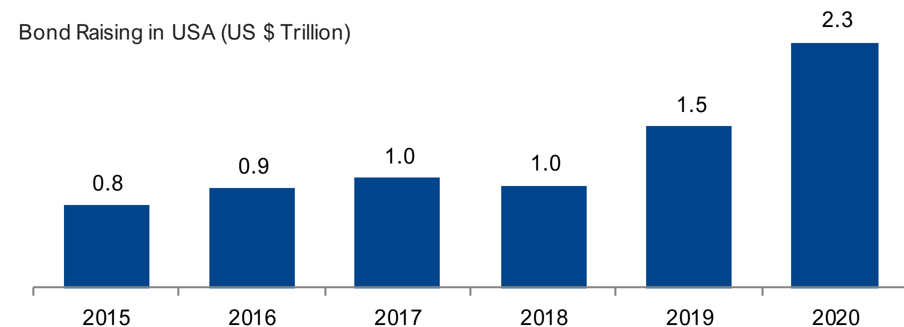
Corporate and High Yield bond default rates



….corporates continued to raise significant amount of debt with the percentage of total non-financial corporate debt-to-GDP peaking to its highest ever level at 108% in 2020.

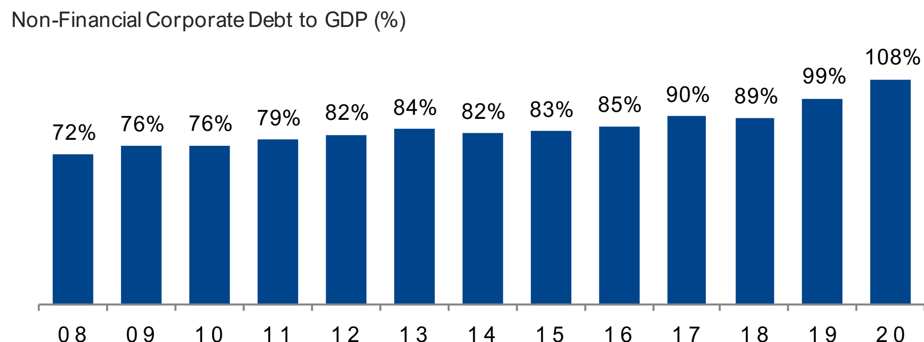
US corporates raised $2.3 trillion of debt in 2020, a 53% increase from that in 2019.

Bond Raising in USA (US $ Trillion)



Debt-to-GDP ratio surpassed 100% for the first time.

Non-Financial Corporate Debt to GDP (%)



Source: *Bloomberg, Capital IQ, S&P, Fitch Ratings and Aranca Analysis*

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