The bankruptcy question

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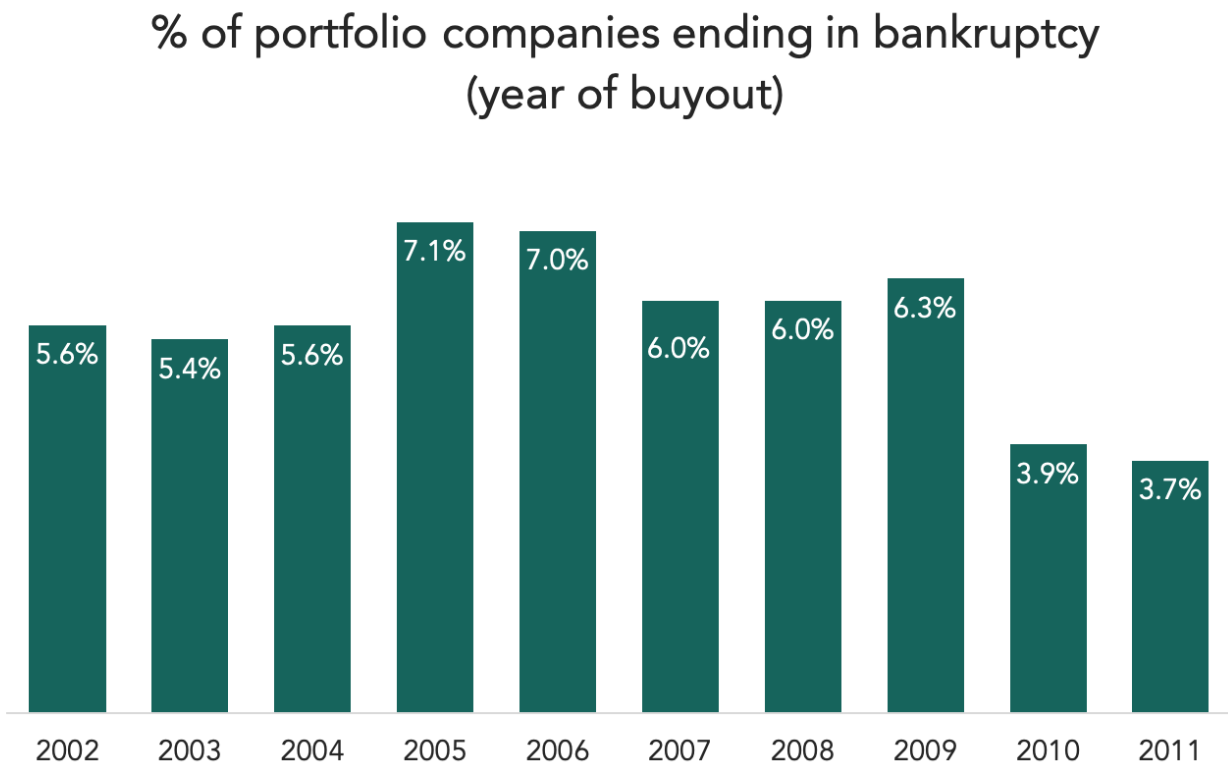

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A looming question over the next several months is how many PE-backed companies will be forced into bankruptcy. The odds suggest an increase in PE-backed bankruptcies as cash flows begin to dry up in the short term. According to PitchBook's Quantitative Perspectives, GFC-era data offers some clues on what to expect.

For US buyouts between 2005 and 2009, the median debt load for eventual bankruptcies was 64.9%. Less-levered companies fared better—those that successfully exited had debt components of 57.1%. The good news, according to PitchBook's numbers, is that debt components have been around the 50% mark for the past few years. The rolling four-quarter median dipped to 48.9% in 2016 and currently stands around 46.4%. As a multiple, the median debt level was around 6x of EBITDA for companies purchased between 2017 and Q1 2020. Paul Volcker (RIP) would be happy to see that. Diminishing cash flows have the potential to inflate that multiple drastically, however. If EBITDA is cut by 25%, the same debt component becomes 8x. If EBITDA is cut in half the leverage ratio pops to 12.1x, and if EBITDA is cut by 75% it balloons to 24.1x. Debt can become significantly harder to manage even in the short term, and an uptick in equity infusions is inevitable. Another backstop is the private debt market, where dry powder has more than tripled since 2007 ($57.2B compared to $176.3B as of Q2 2019). The overall PE dry powder figure was $740 billion as of mid-2019.

The industry's growth in size cuts both ways, though. There's more dry powder to deploy, but there are also more portfolio companies to keep afloat. The US company inventory has more than doubled since 2007, from 4,381 sponsored companies to 8,785 in 2020. A sizable chunk of them are in risky sectors like consumer (20.7%) and energy (6.8%). Within consumer, over two-thirds of them (68.7%) are in retail, travel or entertainment. Based on those percentages, sponsors are tending to well over a thousand at-risk companies at the moment. As a loose juxtaposition, note that companies purchased between 2005 and 2009 ended in bankruptcy at a rate of at least 6%, depending on the year of the buyout.