



THE PHOENIX FORECAST:
Bankruptcies and Restructurings 2002

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March, 2002

Public Company Chapter 11 Bankruptcies:

Recent Levels and Implications for 2002

In 2001, the national recession that officially began in April 2001 and the September 11 events exacerbated conditions for those companies already beset by a range of risks that include any of the following: high leverage, domestic and foreign competition, excess capacity, major technology investments, challenges integrating mergers and acquisitions, managing the accumulation of years of growth, and “creative” financing and complex investing. This led to bankruptcy filings by 257 public companies with \$256 billion in assets in 2001. This is the highest number of filings recorded between 1980 and 2001 and more than twice as many as the annual filings in the last recession (125 filings in 1991 and 91 filings in 1992).

PricewaterhouseCoopers (PwC) estimates that bankruptcy filings in 2002 will reach 200, 22 percent below the 2001 level but well above the 1986 to 2000 average of 113 public company filings.

In this briefing, PwC reviews historical rates of bankruptcy filings, anticipates the scope of filings in 2002, and compares recent public company bankruptcy filings in the U.S. to filings during the last national recession. It identifies industries under stress (including telecommunications, auto, metals–industrial, computer hardware, chemicals and retail industries) and discusses the current status and future outlook of these industries.

Public and Private Business Bankruptcy Filings: 2001 and 2002

PricewaterhouseCoopers forecasts 200 public companies will file for Chapter 11 protection in 2002. PricewaterhouseCoopers estimates that another 10,800 private companies will file for Chapter 11 protection in 2002. In total, 11,000 companies, private and public, will file for Chapter 11 protection in 2002.

In 2001, 257 public companies with \$256 billion in assets filed for bankruptcy, and a total of 10,185 public and private companies filed for Chapter 11 bankruptcy.

Exhibit 1 on the next page presents the number of Chapter 11 bankruptcies, public and private combined, for the period 1988 through 2002.

Public Company Bankruptcy Filings

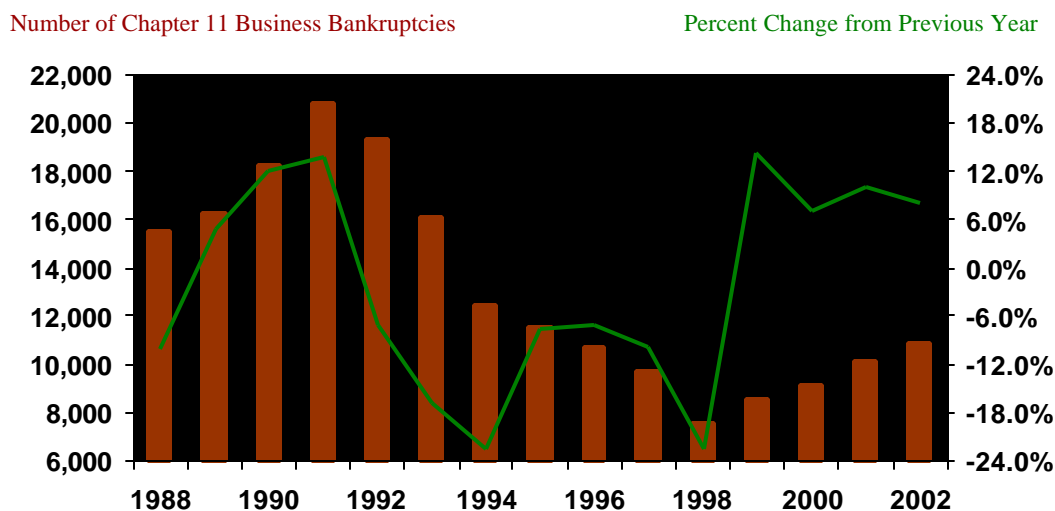
The 257 public company bankruptcy filings in 2001 represent a 46 percent increase in filings over the 176 filings in 2000.¹ This percentage increase is the highest recorded between 1980 and 2001 and more than twice as many as the annual filings in the last recession (125 filings in 1991 and 91 filings in 1992).

PwC estimates that public company bankruptcy filings in 2002 will likely reach 200, below the 2001 level but well above the 1986 to 2000 average of 113 bankruptcy filings. Many of the defaults and bankruptcies associated with companies that issued high-yield debt in the late 1990s have already occurred. However, the four-fold increase in corporate debt in the last decade², along with the surge in new issues most of which were rated speculative-grade in the 1997 to 1999 period³, make over-leveraged companies that have not yet declared bankruptcy vulnerable in the modest economic rebound expected in 2002.

Private Company Bankruptcy Filings

Private companies, which also face increased pressures in the current economy, are expected to record an increased number of bankruptcy filings in 2002. PwC estimates that approximately 10,800 private companies will file for Chapter 11 protection in 2002. This represents the highest number of private bankruptcy filings since 1995 and an 8.8 percent increase over approximately 9,930 estimated private bankruptcy filings in 2001.

Exhibit 1- Chapter 11 Business Bankruptcies



¹ Bankruptcy filings by publicly traded companies are compiled by bankruptcydata.com. Of the 257, two are Chapter 7 filings, according to bankruptcydata.com.

² Based on Standard & Poor's data.

³ Based on Moody's Investor Service.

Overall, from 1988 to 2001 Chapter 11 bankruptcy filings mirrored the condition of the U.S. economy. The recession from July 1990 to March 1991, compounded by various external factors, such as the Persian Gulf War, resulted in a surge in filings from 1988 to 1993. The longest post-war economic expansion slowed the number of business bankruptcies each year from 1994 to 1998, reaching an all time low below 8,000 in 1998. Bankruptcy filing rates began to slowly increase in 1999 as U.S. economic growth slowed.

Expected Emergence from Bankruptcy

PwC estimates that 100 of the 257 publicly traded companies that filed for Chapter 11 protection in 2001 will emerge successfully within 18 months of filing. Success in such situations is defined in two ways: first as a company's adoption of a restructuring plan with the court's approval, and second as a company's emergence from Chapter 11 proceedings after the successful implementation of its approved plan. PwC's estimates are based on empirical evidence from the period 1986 to 1999: during each year of this period, between 22.1 and 70.3 percent of the companies that filed for bankruptcy emerged successfully in the following year.

Of the 11,000 public and private businesses that will file for bankruptcy protection in 2002, PwC estimates that 3,600 will emerge successfully.

Restructuring: 1992 versus 2002

Two factors suggest that the current period of restructuring will be less difficult compared to the 1990 to 1992 period: (a) macroeconomic conditions supportive of business growth and (b) a more fundamentally sound financial system. However, there are risks that the current process of restructuring may be prolonged because banks and other credit institutions' lending practices have become more restrictive, especially towards what may be viewed as financing or refinancing over-leveraged companies.

Macroeconomic Conditions: 1992 versus 2002

In contrast to early nineties (1990 to 1992), during the current economic cycle companies are expected to benefit from lower interest rates and lower inflation. In particular, prior to the brief 1991 recession (which lasted from the third quarter of 1990 through the first quarter of 1991), the U.S. economy suffered from much higher unemployment, inflation, and interest rates. Exhibit 2 presents an overview of several key economic metrics from 1987 to 2003.

Based on the Macroeconomic Advisers February 2002 forecast, the U.S. economy will exit the current recession with historically low levels of inflation and interest rates, as well as an unemployment level relatively low compared to other recessionary periods.

Exhibit 2- Macroeconomic Indicators

	Real GDP Percent Change	Inflation	Unemployment Percent	Pre-Tax Corporate Profits Percent Change	Federal Funds Rate Percent
1987	3.4%	3.7%	6.2%	29.2%	6.7%
1988	4.2%	4.1%	5.5%	21.4%	7.6%
1989	3.5%	4.8%	5.3%	-1.4%	9.2%
1990	1.8%	5.4%	5.6%	6.6%	8.1%
1991	-0.5%	4.2%	6.8%	3.6%	5.7%
1992	3.1%	3.0%	7.5%	8.5%	3.5%
1993	2.7%	3.0%	6.9%	13.0%	3.0%
1994	4.0%	2.6%	6.1%	12.3%	4.2%
1995	2.7%	2.8%	5.6%	16.6%	5.8%
1996	3.6%	2.9%	5.4%	8.7%	5.3%
1997	4.4%	2.3%	4.9%	9.1%	5.5%
1998	4.3%	1.5%	4.5%	-9.0%	5.4%
1999	4.1%	2.2%	4.2%	7.7%	5.0%
2000	4.1%	3.4%	4.0%	8.9%	6.2%
2001	1.1%	2.9%	4.8%	-15.0%	3.9%
2002	1.7%	1.2%	5.7%	4.1%	2.3%
2003	3.8%	2.3%	5.4%	5.8%	4.4%

Source: Forecasts for 2002 through 2003 are from Macroeconomic Advisers, LLC; Bureau of Economic Analysis, Bureau of Labor Statistics, PricewaterhouseCoopers LLP.

In fact, the lower prevailing short-term interest rates, following 11 consecutive reductions in the Federal Reserve federal funds target rate, are expected to stimulate consumer and business spending and accommodate a faster recovery of the overall economy. The absence of significant inflationary pressure has allowed the Federal Reserve to repeatedly lower interest rates without fear of accelerating price inflation.

Finally, the significant declines in pre-tax corporate profits experienced during 2001 are estimated to reverse in mid-2002. However, as will be explained in more detail in the next section, specific industries such as the metals industry, which witnessed significant erosion in profit margins in 2001, are expected to face a more uncertain recovery.

Financial System: 1992 versus 2002

As previously introduced, the second factor suggesting that the current period of restructuring will be less difficult than the 1990 to 1992 period is the fundamentally sound state of the banking system. As the U.S. economy recovered from the 1991 recession, the U.S. banking system was also in the process of recovering from financial problems following the savings and loan crisis. In contrast, the current future profitability outlook of the banking industry remains positive. A recent Standard & Poor's industry survey indicated that "...this is particularly the case with respect to credit loss reserves and business mix, which banks have shifted to ensure revenue streams are less cyclical than those of the traditional banking activities."⁴

⁴ "Banking", Industry Surveys, Standard & Poor's, November 8, 2001.

Potential Problems that Could Prolong the Recovery Process

Bankruptcy experts warn that certain potential issues could prolong the recovery process. For example, despite forecasts for an economic recovery, certain debtors and especially those who have filed for Chapter 11 are expected by some to face a more prolonged recovery process. Some experts indicate that certain bankruptcy courts are either reaching or near capacity. This is specifically seen as the case for the specific court of choice for firms filing for Chapter 11 protection, the Delaware court. Additionally, banks and other creditors may be less willing to extend credit to bankrupt companies in volatile sectors, in an overall climate of cautious lending practices.⁵

Conclusions

Following are the highlights of PwC's research on recent bankruptcy filings and implications for 2002 levels.

- Even with the anticipated modest U.S. economic rebound in 2002 and a turnaround in corporate profits by the middle of 2002, PwC expects public company bankruptcy filings this year to decline only to 200 from the record level of 257 filings in 2001. However, 200 filings will still represent historically high levels.
- Private company filings for Chapter 11 protection will increase to 10,800 filings, the highest since 1995. Unlike the record-setting levels of public company bankruptcy filings during the current downturn, the estimated number of 2002 private filings remains at least 31 percent lower than private filings between 1989 and 1993.
- About 3,600 of the 11,000 private and public companies filing for bankruptcy in 2002 will secure court approval of their restructuring plans and implement these plans successfully.
- Two factors may make for a less difficult period of restructuring today compared to the 1990 to 1992 period: (a) macroeconomic conditions supportive of business growth and (b) a more fundamentally sound banking financial system. However, there are risks that the current process of restructuring may be prolonged because banks and other credit institutions' lending practices have become more restrictive, especially towards what may be viewed as financing or refinancing over-leveraged companies.
- PwC has identified industries in which there is and will be a high concentration of bankruptcy filings: telecommunications, auto, steel, computer hardware industries, chemical, and retail industries.

⁵ "Beyond the Brink", Euromoney Institutional Investor, December 2001, Page 34.

About the Author

Carter Pate, author of the report and head of PricewaterhouseCoopers' Financial Advisory Services practice in U.S., oversees more than 1600 professionals in five product groups. Mr. Pate is a renowned restructuring expert with over 20 years' experience in business consulting/management, including serving as CEO and Chairman of several public firms. He is the author of *The Phoenix Effect: Nine Revitalizing Strategies No Business Can Do Without* (Wiley, 2002) and is a contributing author of *Workouts and Turnarounds II* (1999). Mr. Pate is the founding member and former director of the Turnaround Management Association and founding partner of Pate, Winters & Stone, the national consulting firm.

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