The Halftime Report: A High-Scoring First Half — Or Was It?

If we had to describe the state of restructuring activity during the first half of 2023 in one word, it would be ***"Whew."*** We all knew this year would be a stark improvement for restructurings compared to the dud that was 2022, but few expected the strong and steady flow of monthly Chapter 11 filings that occurred in 1H23. As some economists and other pundits now revisit their recession calls given recent data indicating slowing inflation and a mostly resilient U.S. economy, restructuring activity has proven to be equally resilient so far this year, even in the absence of economic contraction or shock events. Who needs a recession, anyway?

A Year's Worth of Restructuring Activity in Just Six Months — If the Year Was 2022

The two primary measures of restructuring activity — large (>$50 million) Chapter 11 filings and rated corporate debt defaults, which overlap to some varying degree— both trended favorably in 1H23 (**Figure 1**), essentially doubling from their respective prior-year comparable totals while nearly matching totals for the entirety of 2022. As we have said previously, this very favorable comparison speaks both to the strength of 1H23 and the modesty of 2022 with respect to restructurings.

There were exactly 100 large Chapter 11 filings in 1H23 compared to 46 filings in 1H22, 103 filings in all of 2022 and 118 in all of 2021. Large filings this year consistently have stayed close to a monthly average of 16, about 50% above the long-term average of 10.5 monthly filings since 2010. Filing totals in 1H23 included 47 filings with liabilities greater than $250 million and 18 filings greater than $1 billion, compared to 24 and 8, respectively, in 1H22, and 44 and 16, respectively, in all of 2022. The healthcare sector accounted for 20% of large filings in 1H23, more than double the next closest industry sector, and healthcare's 20 filings in the first half already have topped the sector's 15 filings in all of 2022.

So, in just six months this year, the filing totals for all of 2022 were nearly replicated. Besides this standout comparison, first-half 2023 was the strongest first-half for large Chapter 11 filings in the post-Financial Crisis period aside from 2020, and was appreciably better than any six-month period other than the pandemic year since we began tracking this data in 2016 (**Figure 2**). Even the comparison to 2020 is respectable, with

100 filings in 1H23 falling short of the 115 filings in 1H20 by just 13%. But it doesn't nearly feel the way mid-2020 did for restructuring activity, does it? There's a reason for that.

Similarly, S&P reported 84 global corporate debt defaults among rated issuers in 1H23 compared to 38 rated defaults in 1H22, 83 rated defaults in all of 2022 and 72 in all of 2021. Again, these favorable comparisons in 2023 are encouraging but also reflect depressed default activity in 2020-2021. Nearly two-thirds of global corporate debt defaults in 1H23 were U.S.-based issuers, which is consistent with the long-term average and a sharp increase over 2021-2022.

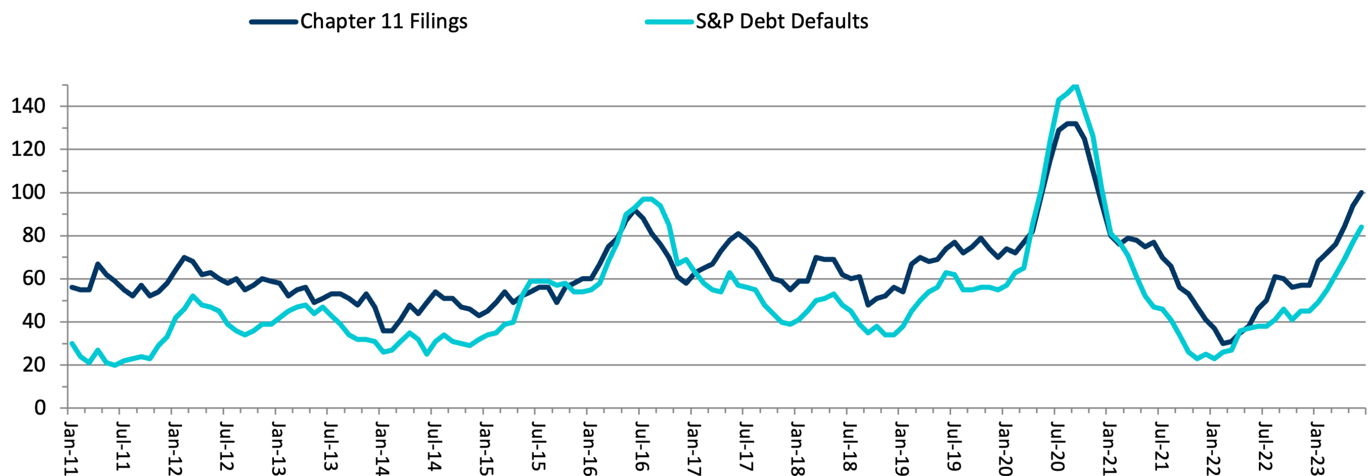
However, unlike large Chapter 11 filings in 1H23 that approached 1H20 totals, the 84 rated debt defaults in 1H23 fell far short of the 124 debt defaults in 1H20, or one-third below comparable pandemic-year default totals. Domestically, there were 54 S&P rated debt defaults in 1H23 compared to 82 in 1H20, or 35% fewer. This is an important distinction: Companies with rated debt tend to be considerably larger than the average Chapter 11 filer, and the former were falling like dominoes in 2020 but not nearly as much in 2023.

The surge of Chapter 11 filings by middle-market companies relative to rated corporate debt defaults in 2023 vs. 2020 partially explains why the U.S. speculative-grade debt default rate remains modest, at 3.2%, at a time when our profession seems busier than such a subdued default rate would imply. The speculative-grade default rate is by definition a lagging indicator, as it is computed based on LTM default totals, which currently encompass a modest 2H22 and a robust 1H23. It shakes out to a current default rate that is below the 4.2% long-term average, which seems inconsistent with current restructuring activity levels. The tilt of elevated instances of corporate failure towards unrated middle-market companies in 2023 explains much of this disconnect.

Moreover, the percentage of U.S. leveraged debt issuance that was rated upon issuance has declined steadily in recent years (that's a story unto itself), with credit estimates — which are not considered rated debt and are not nearly as comprehensive as a full credit rating — often sufficing for institutional investors and private credit, meaning that such debt is omitted from the rated spec-grade pool and the calculation of a default rate. Hence, it could be argued that the corporate default rate as computed by the rating agencies is less representative than it used to be of the totality of corporate issuance and failure, and may be underestimating such events relative to the large corporate landscape. The corporate spec-grade debt default rate will be ticking up in the months ahead as 2022 continues to fall out of the calculation, but rating agencies' forecasts still project a modest 4.5%-5.0% default rate range by year's end or early 2024, which is slightly above average. Does it seem merely "average" these days for restructuring activity?

Even among Chapter 11 filers, average filing size (liabilities at filing) was $400 million in 1H23 compared to $850 million in 1H20. So, while the number of large Chapter 11 filings in

Figure 1 - Chapter 11 Filings and S&P Debt Defaults (6-Month Rolling Totals)



Source: The Deal and FTI Consulting Analysis

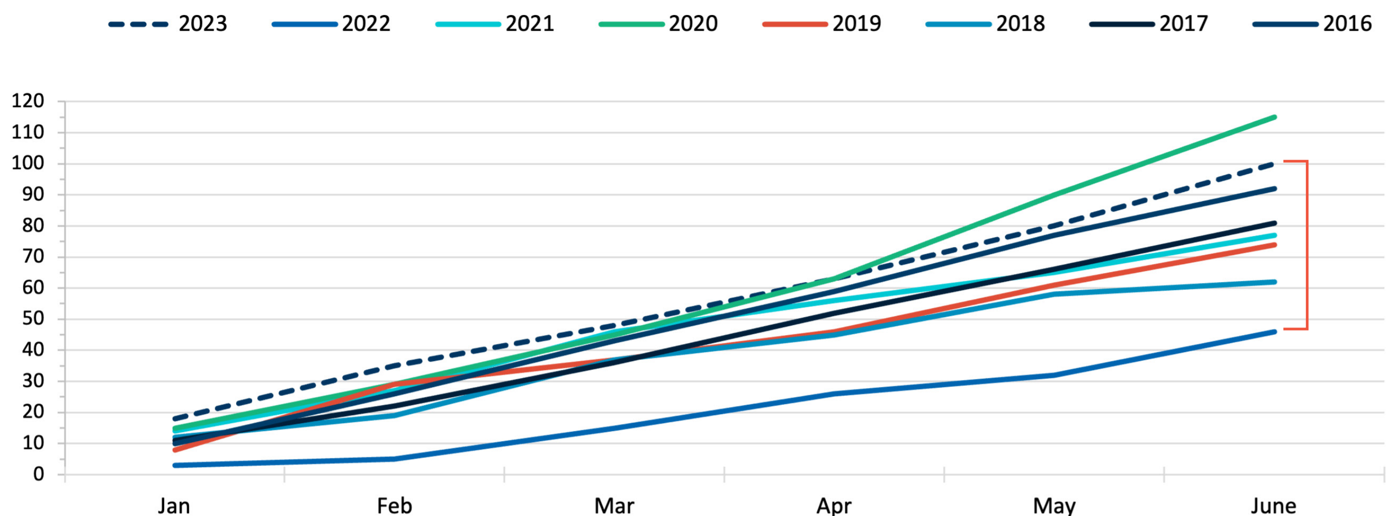
1H23 was roughly comparable to 1H20, the average size of a filer was considerably smaller — by more than one-half. Whatever economic and financial market afflictions are hitting Corporate America currently, it is predominantly a middle-market phenomenon with respect to weakening operating and leverage metrics and capital markets access. In stark contrast, the economic ravages of the COVID-19 pandemic were indiscriminate and did not spare large multinational companies in those early months.

So, perhaps it is time to stop making restructuring comparisons to 2020 and, instead, recognize that unique period as a generational anomaly that won't be replicated any time soon and which shouldn't be considered the high bar against which subsequent years' filing and default activity are compared. But before we move on from 2020 comparisons, there is one other measure by which to gauge restructuring activity — and by this metric, 1H23 wasn't quite the stellar period that the filing numbers suggest, especially compared to 2020. Financial advisor (FA) mandates as compiled by Debtwire have been a reliable directional indicator of restructuring activity, both in-court and out-of-court, for nearly a decade. Total new FA mandates compiled by Debtwire rebounded nicely in 1H23 vs. 1H22, as one might have expected, after slumping badly in 2021 and 2022 following a blowout year in 2020. But the rebound in new FA mandates pales in comparison to 1H20 (**Figure 3**); there were some 323 new FA mandates in 1H23 compared to 197 in 1H22, and a whopping 643 new FA mandates in 1H20 when companies and creditor groups intensively sought advisory guidance, given the unprecedented nature of the COVID-19 crisis and its spillover effect into corporate actions and creditor reactions. The FA hiring frenzy in 2020 was truly an outlier, with some 1,100 new FA mandates involving 422 companies per Debtwire, and shouldn't be considered a yardstick for such activity going forward.

New FA mandate comparisons in 1H23 vs. 1H22 and 1H20 were considerably less impressive than comparable changes in Chapter 11 filings during those same periods. How can that be? Again, smaller companies and less-complex cases that filed or otherwise restructured were the likely culprits. To that point, if we annualize 1H23 new FA mandates, the projected total falls squarely in line with annual FA mandate totals from 2016 to 2019 (**Figure 4**), despite the fact that the number of Chapter 11 filings in 2023 will easily surpass any annual total during those four years. In this respect, restructuring activity in 2023 does resemble an "average year" despite the notable increase in filings, while its proximity to the subpar years of 2021-2022 makes it seem stronger.

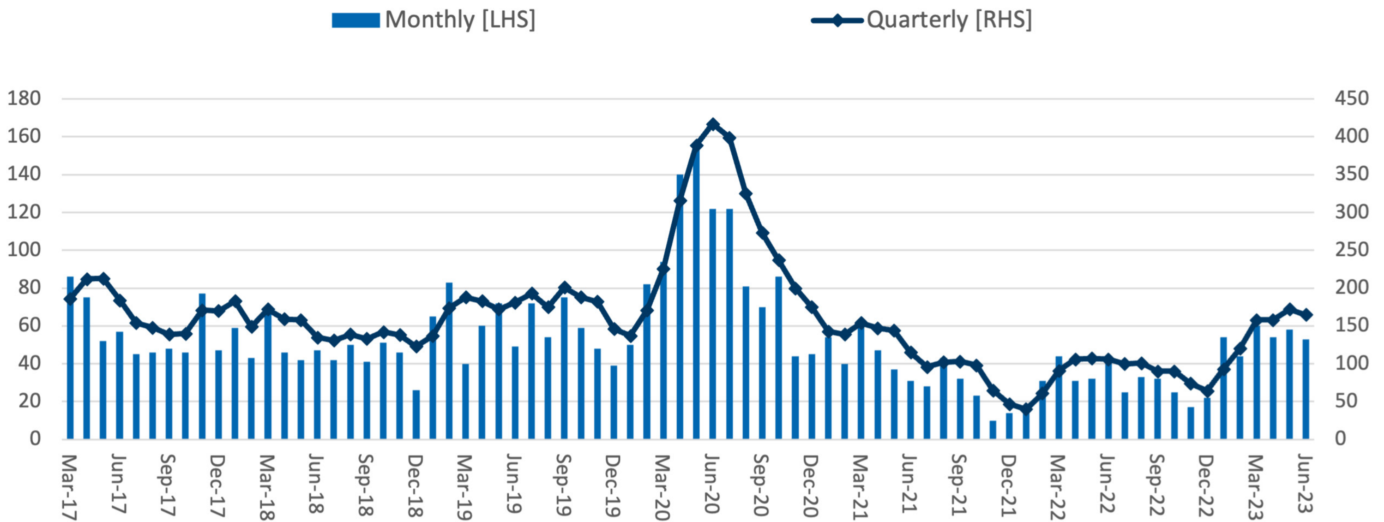
It's a strange moment for the domestic economy and overall corporate performance. Few experts have strong convictions about where we are headed. So what is the current state of restructuring activity? It's healthy, but likely not as robust as some pundits or headlines would suggest. At a minimum, it's strong enough, and likely to stay that way or strengthen further over the balance of the year. What's wrong with that?

Figure 2 - YTD Cumulative Chapter 11 Filings (Liabilities af Filing > $50 million)



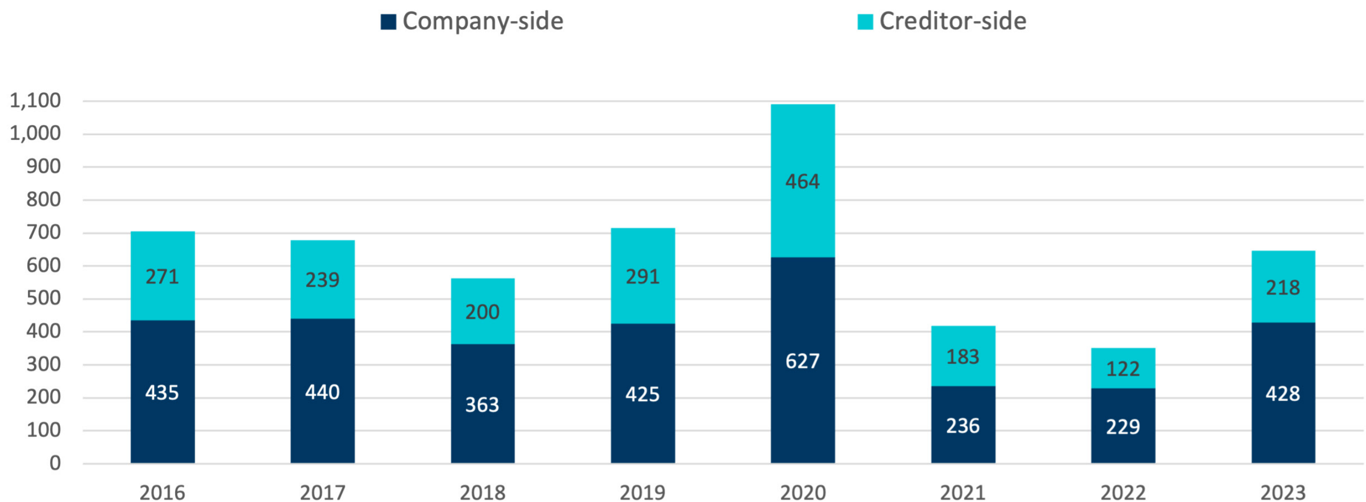
Source: The Deal at FTI Consulting Analysis

Figure 3 - Financial Advisor Mandates



Source: Debtwire and FTI Consulting Analysis

Figure 4 - Annual Financial Advisor Mandates
Note: 2023 totals are annualized from 1H23 totals



Source: Debtwire and FTI Consulting Analysis

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