Private Equity Drives 80% Jump in Defaulted Debt

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By Georgia Hall

(Bloomberg) --

Private equity-owned companies drove an increase in defaults and continue to turn to distressed debt exchanges after credit conditions deteriorated in the wake of US tariff announcements, according to Moody's Ratings.

In the three months through June, 21 companies defaulted on more than $27 billion of debt, the ratings company said in a Tuesday report. That's up from the 15 companies that defaulted on about $15 billion of debt in the prior quarter.

Many private equity firms were caught out by interest rate hikes in 2022 after snapping up lower-rated businesses during the easy money era using floating-rate debt. Those firms are typically more highly leveraged than their public equivalents making them more vulnerable to distress. PE-owned companies accounted for three out of five bankruptcies filed during the second quarter: Ascend Performance Materials Operations LLC, At Home Group Inc. and CareerBuilder LLC.

Some lower-rated issuers, which were already facing heightened credit risk, were compelled to restructure or renegotiate their debt, mostly through distressed exchanges, a trend that's expected to continue in the third quarter. About three in four of the exchanges involved PE portfolio firms.

For privately-owned companies, weak liquidity is one of the major risks, according to the report.

"If the market becomes volatile they won't be able to access liquidity they need," Julia Chursin, vice president and senior analyst at Moody's, said of these companies. "They will unlikely be able to refinance their debt."

The loan market bore the brunt of the distress, as many businesses backed by PE firms have capital structures only made up of loans. The default rate for loans was 6.6% at the end of June, compared to 4.2% for high-yield bonds, according to Moody's.

"The problem with loan-only debt structures is that these loans have a floating rate," Chursin said. "If there is a widening of the spread they have to do an out-of-court restructuring."

Junk-rated telecommunications provider Radiate HoldCo LLC, owned by Stonepeak Partners and TPG Inc., marked the quarter's largest default, affecting $3.8 billion of loans and $1.9 billion of notes.

The company launched a distressed exchange to address its outstanding debt maturing between 2025 and 2028.

Companies typically propose distressed exchanges — a kind of restructuring agreement — to improve liquidity, reduce liabilities, manage upcoming debt maturities and ultimately avoid bankruptcy. These exchanges made up the majority of defaults at 13 companies tied to $20 billion of loans and bonds. Several companies, including Community Health Systems and All Day Acquisition LLC, had tapped out-of-restructurings before.

“Distressed exchanges are idiosyncratic, they are harder to predict and do not work most of the time,” Chursin said. “There is a 50/50 chance of filing for bankruptcy. We call it, ‘kicking the default can down the road.’”

Moody’s predicts that durables sector, which includes appliances and automobiles, will make up the majority of the defaults in the next year, in part due to tariff pressure. But regardless of the sector, low-rated businesses “remain highly susceptible to tariff-related risks,” according to the report.

(Corrects quote to refer to floating rate in eighth paragraph.)

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