

Lessons from the Enviva Bankruptcy: Understanding Key Risk Factors

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Enviva, LLC, the world's largest producer of industrial wood pellets for biomass, filed for Chapter 11 bankruptcy in March 2024, citing excessive debt and liquidity challenges.

- Entered bankruptcy with over \$2.6 billion in debt, creating significant financial strain.
- Stock price collapsed from \$6 billion in 2022 to near zero before its 2024 delisting.
- Underwent a court-supervised restructuring while continuing production, emerging in December 2024 with debt converted to equity.

1. Rigid Fixed-Price Contracts Squeezed Profit Margins

- Enviva locked customers into long-term, fixed-price contracts, preventing price adjustments as costs rose.
- Raw material costs surged, but the company could not increase customer pricing, squeezing profit margins.

2. Soaring Costs Outpaced Revenue Growth

- Wood fiber, labor and logistics costs surged, driving up operating expenses.
- Higher costs exceeded revenue, leading to persistent cash flow deficits.

3. Aggressive Expansion Led to Costly Overcapacity

- Rapid expansion was driven by overly optimistic demand forecasts, leading to costly facility investments.
- When demand failed to materialize, Enviva was left with excess production capacity and high fixed costs.

4. Excessive Debt and Cash Flow Shortages Created Liquidity Crisis

- Took on excessive debt to fund expansion, pushing the debt-to-equity ratio to unsustainable levels.
- Consistently negative free cash flow left Enviva unable to meet debt obligations.

Key Takeaways

1. **Fixed pricing can be risky:** Companies locked into long-term, fixed-price customer contracts may struggle to absorb rising costs, leading to margin pressure.
2. **Growth must align with demand:** Rapid expansion without confirmed demand can result in costly overcapacity and underutilized assets.
3. **Debt management is critical:** When debt grows faster than revenue, a company may be relying on borrowing to sustain operations rather than generating true profitability.
4. **Liquidity issues appear before insolvency:** Consistently negative free cash flow and repeated debt refinancing often signal financial distress before insolvency.
5. **Watch for multiple warning signs:** Companies showing multiple warning signs – shrinking margins, rising debt and missed revenue forecasts – are at high risk of financial distress.