PROGRAM MATERIALS
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Analyzing Retail Bankruptcies

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Dr. Sharon Meit Abrahams is a legal talent development expert with over 25 years of experience in success coaching for attorneys and executing high impact programs for law firms. She has created and implemented firm wide initiatives that help attorneys maximize their productivity while maintaining engagement. When individuals produce, a firm increases its profitability. As a talent development leader, she has handled every aspect of an attorney's firm life from onboarding and integration, through mentoring and training to succession planning and exit interviews.

Dr. Abrahams has published three books with the American Bar Association and regularly publishes articles for Thomson Reuters and American Legal Media. Known for engaging and educational programs, Dr. Abrahams is a sought-after keynote speaker, program facilitator and law firm advisor.

SPEAKERS

Stephen B. Selbst
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Stephen Selbst is the co-chair of Herrick's Restructuring & Finance Litigation Group. He has more than 30 years of experience representing debtors, creditors, official committees, distressed investors and asset purchasers in bankruptcies and out-of-court restructurings.

Stephen advises clients from a wide range of industries, including financial services, telecommunications, government agencies and real estate. A skilled commercial litigator, Stephen also has significant experience in district and state courts, where he regularly represents clients in separate litigation arising out of bankruptcy. He also advises clients on structured finance and derivative transactions.

Steven B. Smith
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Steven B. Smith focuses his practice on complex corporate restructuring, liquidations and bankruptcy litigation, including in-court Chapter 11 and Chapter 15 cases and out-of-court workouts. He has extensive experience representing distressed debt investors, bondholders, official and ad-hoc creditor committees, administrative and collateral agents, indenture trustees, stalking horse and other asset purchasers, trade and tort claimants, and other significant parties-in-interest in a variety of jurisdictions across the United States.

He is a frequent lecturer on bankruptcy and restructuring topics and has published articles and book chapters on bankruptcy-related topics. He has been frequently quoted in newspaper articles on insolvency related topics and has appeared on CNBC.

HERRICK

ANALYZING RETAIL BANKRUPTCIES

STEPHEN B. SELBST &

STEVEN B. SMITH

OVERVIEW

- Market Update
  - Who’s Filing for Chapter 11
  - How the Covid Crisis is Impacting Bankruptcies
- Reorganizing and Liquidating Retail Debtors
- Analyzing Retail Bankruptcy Cases
  - Using Pleadings to Understand Case
  - Valuing Debtor Assets and Liabilities
- Bankruptcy Sale Process

RECENT RETAIL CHAPTER 11 FILERS

- **Big Box Leaseholders**
  - Neiman Marcus
  - JCPenney
  - Lord & Taylor
- **Other leaseholders**
  - Fast casual restaurant chains
  - Gyms (Golds, NYSC, etc.)
- **Individual Retailers**
  - Art Van Furniture
  - Ascena
  - Brooks Brothers
  - Fairway Markets
  - J Crew
  - John Varvatos
  - Lucky Stores
  - Modell's Sporting Goods
  - Pier 1 Imports
  - True Religion

COVID-19: DEBTORS & LANDLORDS GET CREATIVE

- Courts have recently authorized post-petition rent relief for retail debtors.
  - Courts issued orders temporarily relieving retailers from paying post-petition rent.
  - Used in Pier 1, True Religion, & Modell's bankruptcies; J Crew seeking similar relief.
- Relief is limited to debtors, not all tenants.
  - In Forever 21 case, court denied similar relief to purchaser of debtor's leases/stores.
- Use COVID to justify not closing on property sale?
  - 402-420 Metropolitan Ave: debtor is purchaser of property, filed bankruptcy instead of closing on $21.5m sale.
  - 138 QB Acquisition: debtor seeks to terminate purchase agreement and recover down payment.
  - Both debtors claimed COVID made obtaining financing impossible.

RETAIL CHALLENGED BEFORE COVID CRISIS

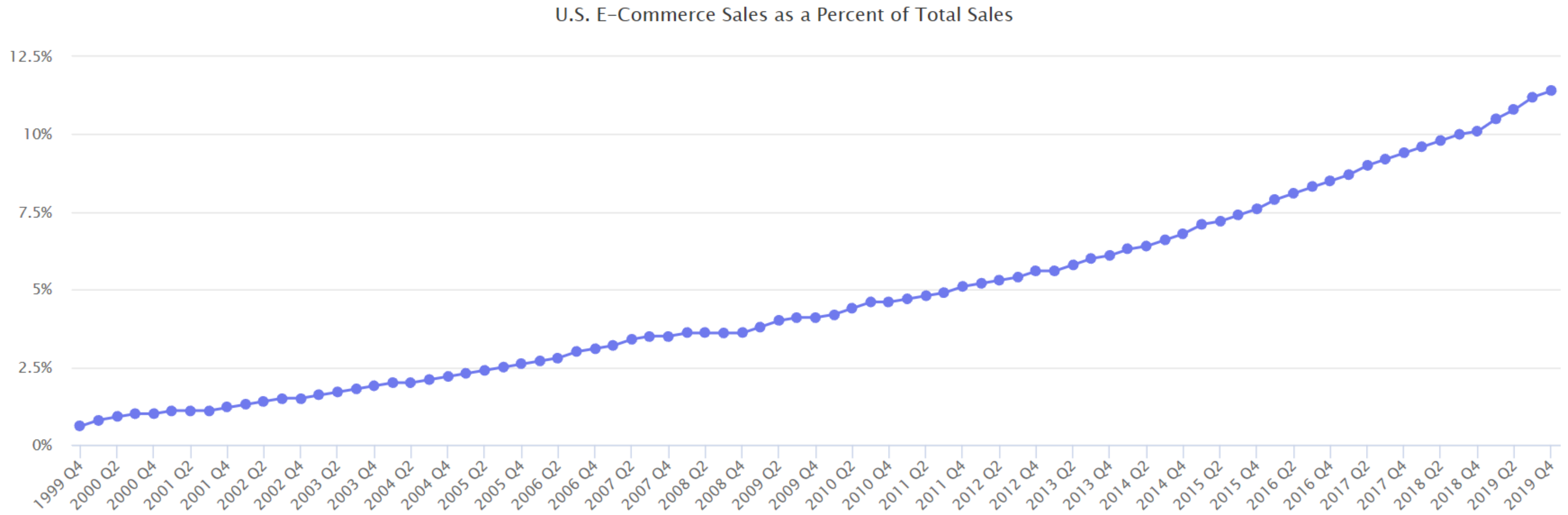
2017-2019 SAW GROWTH IN RETAIL BANKRUPTCIES

- Causes of distress include
  - Rise of e-commerce
  - Declining mall traffic levels
  - Changing consumer consumption patters
  - Overleveraged balance sheets
- Recent retail bankruptcies

2017	2018	2019
Eastern Outfitters	Brookstone	Barneys New York
The Limited	Gump’s	Forever 21
Radio Shack	Mattress Firm	Gymboree
Toys R Us	Rockport	Payless
Wet Seal	Sears	Z Gallerie

E-COMMERCE CHANGES RETAILING

STEADY GROWTH OVER PAST TWO DECADES

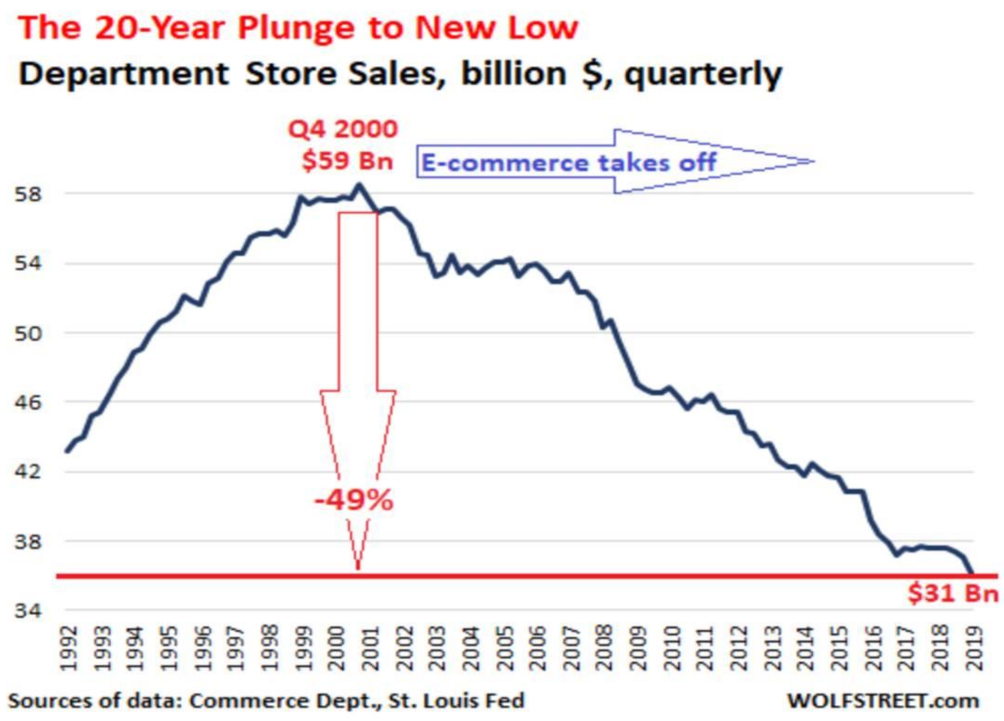


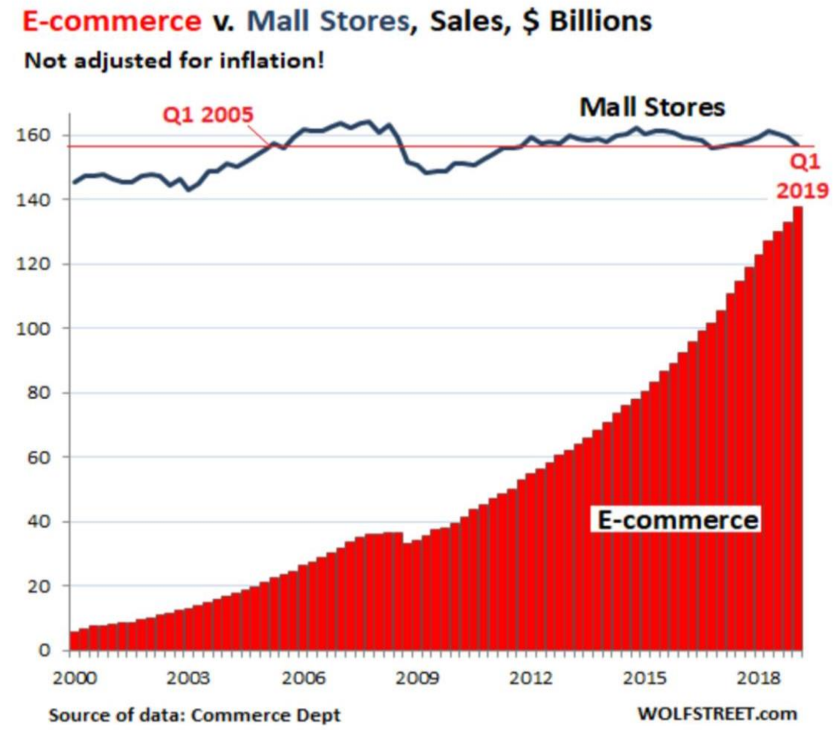
Source: US Commerce Department

DEPARTMENT STORES AND MALLS SUFFER

BRICKS AND MORTAR STORES LOSE MARKET SHARE AND SALES

Data Show Impact of E-Commerce





Source: WolfStreet.com

RETAIL STORES CLOSE UNDER PRESSURE

ANALYSTS PREDICT RECORD CLOSURES FOR 2020

- 11,000 stores closed in 2019. Top closers include:
  - Payless – 2,500
  - Gymboree – 650
  - Charlotte Russe – 520
  - Fred’s – 520
  - Shopko –371
- 5,800 stores closed in 2018
- 8,000 stores closed in 2017
- 2020 closings estimated at 20,000+

REORGANIZATION STRATEGIES

ELEMENTS OF A RESTRUCTURING PLAN

- Reorganize around core of most profitable stores
    - Use Section 363 to reject unfavorable leases
    - Attempt to monetize rejected leases
    - Consider sale of non-core assets
- Reduce leverage: Convert debt to equity
- Obtain DIP loan to ensure post-petition shipments of goods
- Build lender consensus prior to filing for Chapter 11
- J Crew and Neiman Marcus following this path in their cases

LANDLORD/TENANT ISSUES

BANKRUPTCY FILING BY TENANT

- Debtor is excused from paying all pre-petition obligations, including rent.
- Automatic stay bars all efforts to collect debt owed by tenant or obtain control or possession of estate assets.
- Landlord rights to terminate lease due to bankruptcy or violation of financial condition covenants are unenforceable.
- If Debtor fails to perform post-petition obligations, landlord must get relief from the automatic stay from the bankruptcy court before exercising remedies.
- Debtor must pay and perform all ***post-petition*** obligations.

ASSUMPTION OR REJECTION OF LEASES

BANKRUPTCY CODE ALLOWS TERMINATION OF UNFAVORABLE CONTRACTS

- A chapter 11 debtor may assume or reject executory contracts and unexpired leases with Bankruptcy Court approval.
  - Debtor may also assume and assign a lease, which may allow debtor to monetize its lease portfolio
- An executory contract is one where material performance is still due from both parties.
- Debtor has 120 days to decide whether to assume or reject leases, which can be extended for up to 90 additional days.
- Debtor can assign a lease ***even if*** it has anti-assignment clause or use limitation clause.

ASSIGNING, ASSUMING, OR REJECTING A LEASE

DEBTOR'S OPTIONS TO ADDRESS ITS LEASE OBLIGATIONS

- In an assumption, debtor must cure defaults and provide adequate assurance of future performance.
- In a lease assignment, assignee provides cure payment and adequate assurance of future performance.
- A debtor may reject (terminate) an unfavorable contract or lease; Bankruptcy Code §365(a).
  - Retail debtors rarely reject leases until after they have attempted to market them.
- Debtors can also sell "designation rights" to brokers, who then determine which leases to assume and/or reject.

RETAIL REORGANIZATIONS OFTEN FAIL

LIQUIDATIONS BECOMING COMMON

- 2019 continues the wave: Barneys, Shopko, Payless and Gymboree all liquidate
  - Pier 1 and Modell's liquidating; more will follow
- Bankruptcy Code makes it hard to reorganize retailers
  - Debtor has maximum
  - of 210 days to decide whether to assume/reject store leases
  - Suppliers with Section 503(b)(9) claims must be paid in cash
- DIP loans tied to 210 day lease period
- Hard to run an M&A process in 210 days
- Liquidations have become more efficient

WHY LENDERS FAVOR LIQUIDATIONS

FASTER AND LESS RISK THAN REORGANIZATIONS

- Lenders don’t want to make long-term DIP loans
- Avoids execution risk of reorganization or Chapter 22
- Faster process reduces administrative costs of bankruptcy
- Changes in inventory liquidation market improve returns to lenders
    - Sports Authority – 101% of inventory cost plus $1.8 additional guaranty
    - Coldwater Creek – 98% of inventory cost
    - Borders – 72% of inventory cost plus upside over sales threshold
    - The Bombay Company – 109.5% of inventory cost
    - Filene’s Basement – 90% of inventory cost

ANALYZING RETAIL BANKRUPTCY CASES

FIRST DAY PLEADINGS CONTAIN KEY INFORMATION

- First day affidavit is quickest way to get up to speed
- First day affidavit will contains:
  - History of the business
  - Capital structure, including current loan balances
  - Circumstances leading to chapter 11
  - Efforts to market the business prior to bankruptcy
  - Business plan in chapter 11
- Sale of assets in bankruptcy is common alternative
  - Business may be sold to a single buyer or multiple buyers
  - Very few retailers attempt stand-alone reorganizations
  - Details of sale process in bidding procedures order

TOOLS TO VALUE DEBTORS’ ASSETS

USE MARKET DATA TO AUGMENT FINANCIAL STATEMENTS

- Bottoms-up asset valuation
  - Value of inventory and store fixtures: recent cases provide comparables data
  - Value of real estate: Use comparables from recent bankruptcy sales
  - Intellectual property, including websites, customer lists, etc. may have value
- Compare assets to liabilities
  - Use bankruptcy court data for liabilities and consider lease rejection claims
    - Bankruptcy schedules will have payables and lease data
    - Landlord lease rejection claims can increase unsecured creditor pool
  - Analyze 503(b)(9) claims
  - Where is the fulcrum security?
    - Holders of fulcrum security have leverage in chapter 11

BANKRUPTCY SALE PROCESS

SECTION 363 SALES

- Section 363 Sale: Sale of assets outside a plan of reorganization
  - Primary way to sell business as a going concern
  - Public auction process, subject to higher and better offers
  - Typically takes 75-120 days to complete sale after petition date
  - Liquidations often follow failed sale efforts
- Overview
  - Bankruptcy Court approves auction procedures, called bid procedures
  - Bid procedures detail schedule, and terms and conditions of auction
  - M&A process run by investment bankers; lawyers run the legal process
  - Bids must be “hard” --no diligence or financing contingencies
  - Bidders must complete due diligence and obtain financing prior to bidding

BANKRUPTCY AUCTIONS

- Auction held if there are competing bids
  - Conducted by debtor outside court
  - Debtor/seller parties will have leeway to amend the auction rules to obtain the highest and best bid
  - Collusive bidding is prohibited
- Hearing to Approve Sale
  - Typically occurs 2-3 days after auction
  - Court has discretion over reopening the process
  - Losing bidders at auction may challenge fairness of process
  - Debtor is not bound until Court approves results

BANKRUPTCY SALE PROCESS

STALKING HORSES AND BID PROTECTION

- Debtor may have lined up potential buyer before bankruptcy, referred to as a "stalking horse"
  - Stalking horse usually gets bid protection of 2-4% of sale price if it is outbid
- Goal of section 363 sale is to determine whether debtor can obtain "higher and better" bid than stalking horse
  - Cash is king
  - Limited representations and warranties
  - Limited closing conditions
  - Seller and creditors want certainty sale will close
- Secured creditor(s) and creditors committee usually involved in evaluating the bids

AUCTIONS AND APPROVAL PROCESS

BANKRUPTCY COURT MUST CONFIRM AUCTION RESULTS

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CONCLUSIONS

COVID CRISIS

- Continuing change in retail and covid crisis will lead to more liquidations
  - Few retailers reorganize in bankruptcy
  - Most debtors' assets will be sold in inventory liquidations and lease auctions
- Valuing assets of retailers in bankruptcy requires analysis of undervalued assets, i.e., below market leases or IP, *and* of off-balance sheet liabilities, such as lease claims
- Covid crisis makes reorganizations more difficult
  - Consumers may have less income and may be wary of in-store shopping
- Use court filings to understand debtor's business and issues in case