EARLY ACTION IS CRUCIAL TO MAXIMIZING RETAIL BRAND VALUE IN BANKRUPTCY

BY RICHELLE KALNIT, SENIOR VICE PRESIDENT &
BEN KAPLAN, ASSOCIATE, HILCO STREAMBANK

The 2005 amendments to the U.S. Bankruptcy Code foreclosed the ability of retailers to defer store lease assumption or rejection decisions until the end of a bankruptcy case. Following the 2005 amendments, retailers followed a predictable path leading up to bankruptcy, typified by waiting as long as possible to file and only doing so (i) going into the fourth quarter, when inventory recovery values are highest due to holiday season sales volumes, or (ii) coming out of the fourth quarter, when asset-based loan availability is often constrained.

While the lead-up to the holiday season creates liquidity, it also presents challenges to effectuate a restructuring or going concern sale, as potential buyers and new investors wait to confirm proof of the restructuring concept. Moreover, when retailers run out of availability under their asset-based loans, they typically do not have the flexibility, *i.e.*, time and money, to preserve their brands in a restructuring or sale.

Under these circumstances, restructuring timelines are often imposed by the retailer's secured lenders with an eye to managing borrowing capacity, consistent with the deadlines imposed by Section 365(d)(4) of the Bankruptcy Code, to ensure they can liquidate their collateral, if necessary, before a debtor's leases are rejected. Yet these timelines are often inconsistent with and disruptive to the maintenance and preservation of brand value, resulting in brand erosion.

While many bankrupt retailers, including RadioShack, Circuit City, and Sports Authority, were able to monetize their brands through the sale of their intellectual property as a stand-alone asset, the brand value of each of those companies undoubtedly would have been enhanced had it been coupled with other assets before the liquidation of those assets. This is often the breaking point between liquidation and a successful restructuring or going concern sale, because the brand is the asset class with the greatest potential high-low swing in terms of value. The brand values in a restructuring or going-concern sale can differ markedly from the brand value as a stand-alone, static asset.

A Proactive Approach

Recently, however, a number of retailers have successfully mapped a new route to navigate the unique terrain of the bankruptcy landscape by focusing on their brands, and as a result, they have preserved meaningful enterprise value. The paradigm shift is coming from the top, specifically from management teams and boards of directors. Likely due to witnessing the onslaught of retail liquidations, these retailers are taking a more proactive approach to avoid the fate experienced by many of their competitors since the enactment of the Bankruptcy Code amendments. Namely, they are evaluating their alternatives and bringing their constituents to the table while they still have availability under their asset-based loans and, in doing so, are preserving their brand value.

It remains to be seen whether and under what circumstances proactivity is enough to maximize brand value. Yet, as the examples that follow indicate, bankruptcy can be used as a tool to preserve brand value.

rue21. A specialty fashion retailer of apparel and accessories, rue21 operated approximately 1,180 retail locations and an e-commence platform as of its bankruptcy filing in May 2017. In the fall of 2016, faced with decreasing sales, increasing costs, a shift away from traditional brick-and-mortar retail to online shopping, and e-commerce fulfillment issues, it retained an investment banker to shop the company and/or solicit refinancing proposals, as well as explore potential new liquidity. The company subsequently retained counsel and a financial advisor in February 2017, after which it determined that a formal restructuring process was needed.

By starting the process when it still had meaningful liquidity under its asset-based loan, the company had the flexibility to negotiate with its prepetition term loan lenders, asset-based lenders, and unsecured noteholders, and obtain and evaluate financing proposals. This allowed the company to file for bankruptcy with a business plan in

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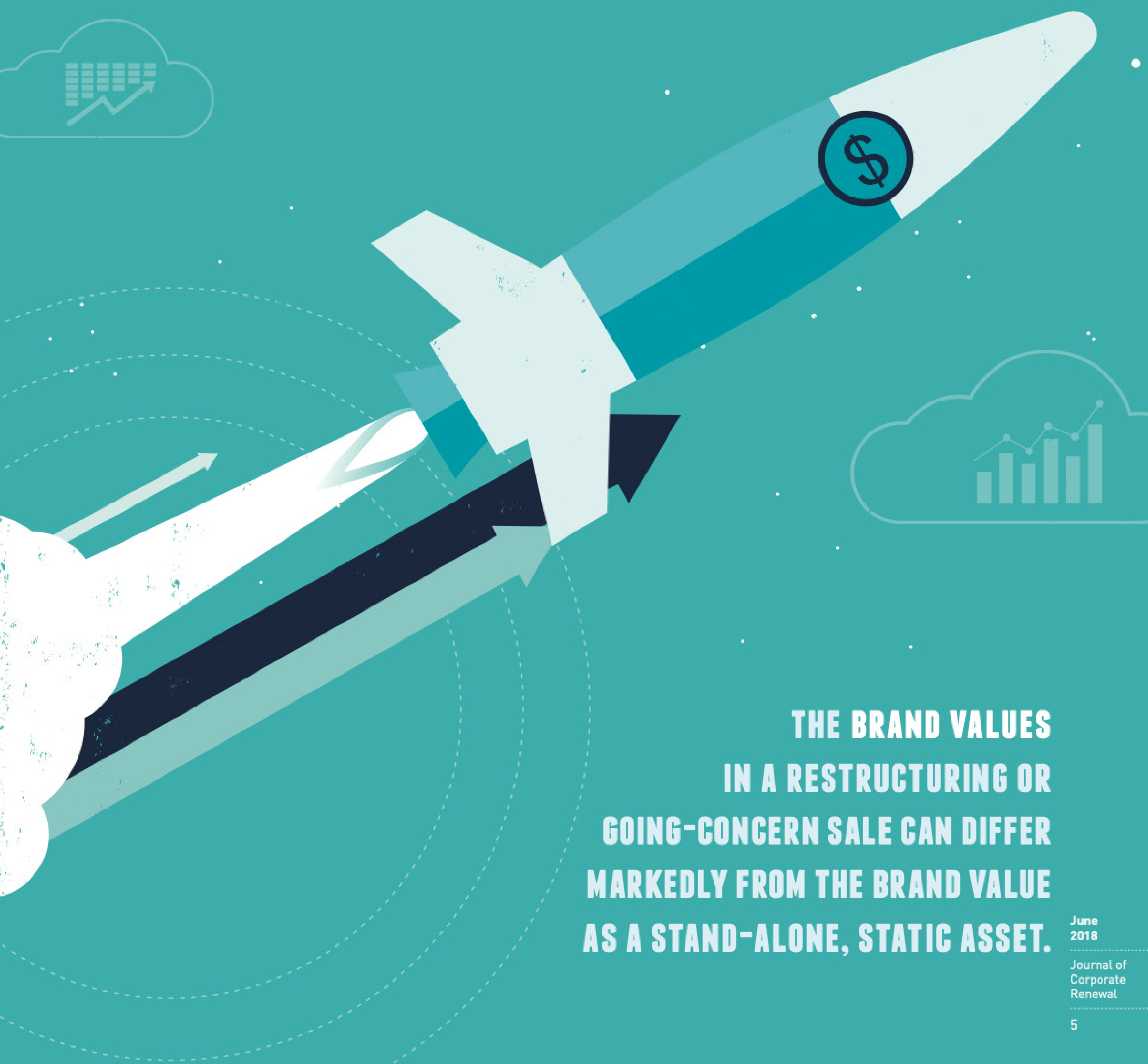

THE BRAND VALUES IN A RESTRUCTURING OR GOING-CONCERN SALE CAN DIFFER MARKEDLY FROM THE BRAND VALUE AS A STAND-ALONE, STATIC ASSET.

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hand and financing to support it. Within about two months of filing bankruptcy, the company filed a plan, which effectuated the deals reached with its constituents and resulted in the closure of approximately 400 unprofitable lease locations.

Payless. Payless is an iconic footwear retailer that operated nearly 4,300 stores in more than 30 countries as of its bankruptcy filing in April 2017. In the years prior to its bankruptcy, purchasing errors caused by antiquated systems, port strikes, foreign exchange declines, increased popularity of online channels, and funded debt load contributed to the deteriorating financial and operational condition of the company.

Recognizing these challenges, the company opened a dialogue with its term loan lenders and other constituents. While the parties determined that a court process would be necessary, as it often is to shed leases, the dialogue resulted in the development of terms of a prenegotiated plan that included converting more than $350 million of funded debt to equity and provided a commitment for a working capital facility to fund ongoing operations and operational improvements.

Payless provided a detailed presentation of its business plan, centered on preserving the brand, to the Bankruptcy Court at its first day hearing, The company had at least 97 percent brand awareness among women and moms in the U.S., and more than 36 percent of U.S. households are members of the Payless database. The plan also identified brand licensing partnerships (Disney, Marvel), design partnerships (Steve Madden, Skechers, and Fila), and proprietary brands that would shape the foundation of the brand's go-forward financial viability.

The successful negotiations leading up to the filing and implementation through bankruptcy preserved these valuable assets and maximized the value of the Payless brand. Indeed, Payless's presentation to the court—placing the brand at the forefront of the company's mission—could serve as a blueprint for other retailers looking to preserve their brands in the face of balance sheet and operational challenges.

Gymboree. Gymboree historically operated approximately 1,300 retail stores under the Gymboree, Janie & Jack, and Crazy 8 banners, all of which focused on children's apparel. In early 2017, the company retained a banker and financial advisor, and immediately commenced negotiations with its term lenders and other constituents regarding the company's challenges.

In June 2017, the company filed for bankruptcy with a prenegotiated plan and term sheets for exit loans in hand, which provided for a reduction of approximately $1.1 billion in secured debt, to approximately $300 million; an infusion of up to $115 million in new money; and a rationalization of the company's store footprint that contemplated a reduction of approximately 380 retail locations.

By hiring consultants and commencing discussions with lenders months before its eventual filing, Gymboree was able to formulate a plan that preserved its brand and provided for sufficient funding to implement operational initiatives.

The Walking Company. The Walking Company (TWC) designs, manufactures, and sells footwear with a focus on comfort. TWC's private label brand, Abeo, generated annual sales of more than $112 million in 2017, representing approximately 55 percent of the company's total sales.

TWC encountered substantial obstacles by the end of 2016, when the manufacturer of the popular Ugg brand of boots and shoes terminated its relationship with the retailer, leaving a product and revenue void that TWC was unable to quickly fill. The company attempted to obtain rent relief from its landlords prior to filing for bankruptcy, but the lease savings proved too trivial to offset soft sales in mall stores during the 2017 holiday season and the loss of Ugg sales.

In March 2018, TWC filed for bankruptcy with a prenegotiated plan, which included securing $10 million of equity from its largest shareholders and $50 million in exit financing. With lease negotiations pending at nearly all retail locations as of the petition date and a plan confirmation hearing set for June 2018, it remains to be seen whether landlords will agree to rent relief sufficient to effectuate the company's plan or if equity will provide additional funding if lease negotiations are not as fruitful as the company hopes.

These cases demonstrate that a retailer's bankruptcy need not result in the liquidation of the retail brand, despite the 2005 amendments to the Bankruptcy Code, when management and the board are willing to make difficult restructuring decisions before all liquidity is exhausted and to effectuate a plan while the retailer maintains flexibility to realign its retail store footprint. However, when retailers follow the more traditional blueprint—filing without a go-forward plan in place, hoping to identify one during the bankruptcy—the result may be a significant devaluation of the retail brand.

Brand Erosion

Recently, the market witnessed the dismantling of two great retail brands: Bon-Ton and Toys R Us. The lack of prenegotiated restructuring plans and dwindling liquidity, coupled with mounting administrative expenses, created insurmountable hurdles that prevented these retailers from effectuating a restructuring transaction that may have maximized brand value.

Bon-Ton. Bon-Ton, a hometown department store retailer, operated seven retail banners through approximately 256 department store locations that included such well-known nameplates as Carson's, Elder-Beerman, and Younkers, among others. The company faced headwinds in 2017, which impacted its ability to competitively position its business for the 2017 holiday season. Leading up to that time, the company retained a financial advisor in July 2017, followed by a banker in August 2017. Like many of the earlier examples, Bon-Ton took action before it ran out of availability and, in fact, obtained additional liquidity under its asset-based loan before the 2017 holiday season, giving the company time to test certain operational initiatives.

While the company engaged in discussions with its noteholders regarding the possible conversion of debt to equity, the noteholders' consent was predicated on the company identifying a third-party strategic sponsor to invest new capital alongside the group and assume majority ownership of the entity at emergence. This proved to be too tall an order to accomplish in the bankruptcy, preventing the company from preserving its storied brands as a going concern. Following the failure to consummate a going concern sale, the brand is now uncoupled from the other assets. However, there is certainly value in the intellectual property, and it will be interesting to see how Bon-Ton's new owners maximize the remaining value.

Toys R Us. Toys R Us (TRU) operated approximately 1,600 brick-and-mortar store locations and 250 additional franchised locations under the TRU and Babies R Us banners. In July 2017, the company retained counsel and a financial advisor, complementing its earlier retention of an investment banker. The three were tasked with evaluating capital structure options. By August 2017, the company commenced discussions with certain of its lenders regarding liquidity. However, those discussions were derailed by media reports that the company was considering a Chapter 11 filing.

Within a week a domino effect ensued, with nearly 40 percent of the company's vendors refusing to ship on trade terms and factors withdrawing support. Soon after, virtually all of the company's vendors refused to ship without cash on delivery, which would have required $1 billion of additional liquidity. TRU and its advisors had little control over when to file bankruptcy once the media ran a story forecasting the company's imminent filing, leaving no time prior to the bankruptcy for the company to continue conversations with its constituents.

While TRU declared that it was "here to stay," the reality was the opposite. Although the DIP loan did not contemplate restrictive sale milestones, which, as noted earlier, were a contributing factor in the demise of many other retailers, the company tripped covenants in its DIP loan following disappointing holiday sales. Projected to run out of cash in May 2018, the company was forced to liquidate its inventory. In the process, the brand, including its vast customer database, suffered.

While TRU may re-emerge in the future in a different form, as other retailers have before (*e.g.*, CircuitCity.com), the brand undoubtedly would have fared better had the company had sufficient time and liquidity to implement initiatives designed to preserve it.

Much to Gain—or Lose

When all of a retailer's major asset classes are considered—inventory, leases, and intellectual property—it appears clear that the intellectual property, comprised of the brand (including trademarks and digital assets), customer data, and other intangible assets, has the greatest high/low fluctuation potential. It has the most to gain from management and boards proactively addressing financial and operational challenges before availability under an asset-based loan runs out and, conversely, the most to lose in a meltdown liquidation.

Going into a restructuring, inventory values are well understood, and actual recoveries rarely deviate significantly from appraised values. The differences among the fair market value (FMV), orderly liquidation value (OLV), and

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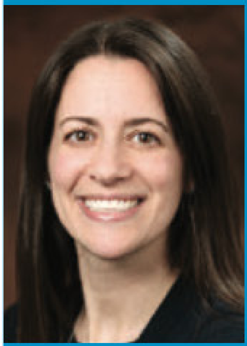
forced liquidation value (FLV) of a retailer's intellectual property are significant. In general, FLV recovery values for intangible assets are less than half of OLV and less than 10 percent of FMV. For a struggling retailer, evaluating alternatives before availability runs out under an asset-based loan may be the first step in preserving brand value.

In many of the cases discussed, brand valuations were commissioned prior to and during the restructurings that illustrated these differences. History suggests that cases like Toys R Us and Bon-Ton will follow the examples of cases that preceded them, such as RadioShack, Circuit City, and Sports Authority, where brand recoveries ultimately reflected FLVs. Notably, however, in cases in which management took a proactive approach to commencing a bankruptcy case, with liquidity and a meaningful time frame to effectuate a realignment of real estate and operations, brand recoveries were achieved that equaled or exceeded projected OLVs.



Richelle Kalnit is a senior vice president of Hilco Streambank, which specializes in the monetization and valuation of intangible assets, including trademarks, patents, and domain names. She has more than 12 years of experience in the corporate restructuring and distressed investing industries, including more than a decade practicing bankruptcy and restructuring law. Kalnit has managed the sale, reorganization, and liquidation of several prominent retailers and consumer products companies, and she manages intellectual property disposition engagements for an extensive array of clients.

Ben Kaplan is an associate of Hilco Streambank, which specializes in the monetization and valuation of intangible assets. He has been with the firm for three years, focusing on the brand intellectual property (IP) disposition services business. Kaplan is part of the team that led the processes to sell the brand IP assets of The Sports Authority, A&P, Brinkmann, Marbles the Brain Store, and, most recently, digital publisher LittleThings.