Turnarounds & Workouts

JANUARY 2023

VOLUME 37, NUMBER 1

News for People Tracking Distressed Businesses

www.TurnaroundsWorkouts.com

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More Liability Management Deals Seen

By Christopher Patalinghug

Restructuring experts expect companies to continue to engage in liability management transactions, according to a *Turnarounds & Workouts* survey. These experts also looked back on notable court decisions issued in the past year that may influence future restructuring transactions.

"One of the most significant trends from 2022 that will continue and increase in importance is the use by companies of liability management techniques to avoid full-scale traditional restructurings," according to Damian Schaible, partner and Restructuring co-head at Davis Polk & Wardwell LLP. He notes myriad "bootstrap" Amend and Extend transactions were undertaken in 2022, where existing creditors agreed to extend the maturities of otherwise unrefinanceable debt in exchange for economic and documentation concessions.

"And we will see many more in 2023," Schaible says. "But we will also see

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Retailer Turmoil '23

By Christopher Patalinghug

Party City recently filed for bankruptcy and Bed Bath & Beyond has signaled that it is planning to file for Chapter 11 in the coming weeks. These two instances appear to signal broader issues for retailers across the country in 2023, as retailers face rising costs, labor struggles, and inflationary pressure.

"The Party City filing, as well as the anticipated Bed Bath & Beyond bankruptcy, are signs that the wave of brick-and-mortar retailer bankruptcies the market had been bracing for in 2020 and 2021 may now be coming," according to Christopher Carty, partner in the Restructuring & Finance Litigation Department at Herrick, Feinstein LLP. Carty says COVID-related economic relief and low interest rates have staved off retail bankruptcies until this point. "We can expect more retailers to suffer short-term struggles with the impacts of inflation and higher interest rates, exacerbating their underlying issues that will make bankruptcy necessary."

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These reflect "continued — but not unexpected — stress and disruption" in the retail sector, says Jarret Hitchings, counsel with Bryan Cave Leighton Paisner in Charlotte.

Duane Loft, partner at Pallas Partners, LLP, points out, "Declining valuations, shifting consumer behavior, and tightening credit have combined to hit the retail sector particularly hard. These latest Chapter 11 filings are a harbinger. It may be that the worst is still to come." Loft, who leads his firm's New York office, notes retailers saddled with expensive debt following LBO transactions tend to be the most vulnerable.

"Many of these struggling retailers have already retained restructuring counsel and financial advisors, portending an uptick in activity for the [restructuring] industry," Loft adds.

Party City

Party City Holdco Inc. and its domestic subsidiaries filed voluntary Chapter 11 petitions for relief in the U.S. Bankruptcy Court for the Southern District of Texas after reaching an agreement with an ad hoc group of noteholders. The company's subsidiaries outside of the U.S., its Party City franchise stores, and its Anagram business, which is a global market leader in foil balloons, were not part of the Chapter 11 proceedings and will continue as core components of the Party City enterprise.

The ad hoc noteholders group is extending up to $150 million in debtor-in-possession financing to provide ample liquidity to support continued business operations. Ankura Trust company, LLC, serves as administrative agent and collateral agent under the DIP Facility. As of Jan. 17, 2023, the ad hoc group held more than 70% of Party City's $750 million first-lien fixed-rate notes and $161.7 million first-lien floating-rate notes.

Based in New Jersey, Party City is the largest vertically integrated manufacturer, retailer of party goods and Halloween specialty retail chain in North America. At the time of filing, the company continues to operate more than 800 Party City stores and online at www.partycity.com. Party City reported $2.8 billion in total assets against $3 billion in total liabilities as of Sept. 30, 2022.

The restructuring is expected to be completed in the second quarter of 2023.

Bed, Bath & Beyond

Bed Bath & Beyond Inc. recently reported a wider net loss of $1.11 billion on $4.16 billion of net sales for the nine months ended Nov. 26, 2022, including a net loss of $393 million on about $1.26 billion of net sales for the most recent quarter. For the same nine-month period ended Nov. 27, 2021, the company posted a net loss of $400 million on $5.81 billion of net sales, including a then third quarter net loss of $276 million on $1.88 billion of net sales.

As of Nov. 26, 2022, the company had $4.40 billion in total assets, $5.20 billion in total liabilities, and a total shareholders' deficit of $798.64 million.

Bed Bath & Beyond has reportedly hired turnaround firm AlixPartners, LLP, restructuring lawyers at Kirkland & Ellis, LLC, and investment bankers at Lazard Ltd. The company also has announced plans to shutter 150 outlets.

Citing recurring losses and negative cash flow from operations, Bed Bath & Beyond early this month acknowledged there is substantial doubt about its ability to continue as a going concern even as the company continues to pursue actions and steps to improve its cash position and mitigate any potential liquidity shortfall. This includes obtaining bankruptcy relief, the company said.

Other Retailer Bankruptcies

Other retailers that have sought bankruptcy protection this year include Performance Powersports, FORMA Brands, and Serta Simmons.

Performance Powersports Group Investor LLC and three affiliates,

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including Performance Powersports Group Holdings, Inc., filed for Chapter 11 in Delaware to pursue a sale of their assets. A unit of equity sponsor, Kinderhook, is opening an auction slated for March 9. Performance Powersports is a producer of entry-level powersports equipment sold through "Big Box" retailers, including dirt bikes, go-karts, ATVs, and golf carts. It disclosed up to $500 million in both assets and liabilities in its petition.

In advance of the 2021 holidays, Performance ordered products from Huansong, one of its then primary vendors, who was to deliver all-terrain and utility vehicles prior to the fourth quarter of 2021. Those vehicles were not, however, delivered until the beginning of January 2022. As a result, Performance could not capitalize on the 2021 holiday season and suffered losses from their inability to sell its vehicles when demand was high. Its financial distress was further compounded by delays and costs in shipping caused by supply chain disruption felt across the country, increased costs associated with freight, shipping, demurrage and warehousing of inventory deliveries, and a "post-pandemic" reduction in demand from customers. Huansong also has commenced litigation against the company for purportedly outstanding amounts and has threatened to file an involuntary bankruptcy petition against at least one of the Debtor entities.

Portage Point Partners, LLP, Performance's restructuring advisor and investment banker, continues to seek other offers for the assets. Performance will accept bids until March 7.

FORMA Brands, a skincare and cosmetics company, through its direct parent company, FB Debt Financing Guarantor, LLC, has entered into a definitive asset purchase agreement with an entity controlled by the agent under FORMA Brands' existing secured debt, Jefferies Finance LLC, under which substantially all of FORMA Brands' assets will be acquired. The investor group includes funds managed by Cerberus Capital Management, L.P. and FB Intermediate Holdings, LLC, which are also secured lenders.

FORMA Brands initiated voluntary Chapter 11 proceedings in Delaware to facilitate the sale process. The company has received a commitment for $33 million in debtor-in-possession financing from the Investor Group. The company said its assets and liabilities range from $500 million to $1 billion.

Mattress maker Serta Simmons Bedding, LLC, placed its U.S. operations under Chapter 11 protection after striking a restructuring support agreement with 81% of its first lien, first out priority term loan lenders and 77% of its first lien, second out priority term loan lenders, as well as a majority of the company's existing equity holders. The restructuring, commenced in the Southern District of Texas, is expected to reduce the company's funded debt from $1.9 billion to $300 million, and enable the company to continue making critical investments in its business and brands. Serta Simmons filed with the court a prepackaged Chapter 11 plan together with the bankruptcy petitions. The company has received a commitment for a $125 million exit ABL Credit Facility available upon emergence from Chapter 11. The company has also obtained a debtor-in-possession financing in the form of a $125 million ABL Credit Facility that, along with $170 million of cash on hand and cash generated from ongoing operations, will be used to support the business during the court-supervised process.

Inter-Lender Dispute

Industry experts are keeping a close eye on Serta Simmons' case from a liability management perspective. Randall L. Klein, Principal at Goldberg Kohn and Co-Chair of the firm's Bankruptcy & Creditors' Rights Group, relates, "Serta's bankruptcy case, dependent upon resolution of lender-on-lender litigation, is part of a trend following the Delaware Court

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in the *TPC Group* case that swiftly decided an inter-lender dispute and proceeded to confirm a plan."

In June 2020, Serta Simmons closed a recapitalization transaction with certain of its existing secured lenders that allowed it to receive an infusion of $200 million in new money through a new, super-priority credit facility, to weather the economic downturn. Certain of the company's existing lenders that were not party to the 2020 transaction have sued the company and the participating lenders, alleging breaches of their loan agreements and the implied covenant of good faith and fair dealing, among other causes of action, and seeking to unwind the transaction entirely. Under threat from the 2020 transaction litigation, and with significant maturities looming in 2023, the company redoubled its efforts to find a strategic partner, including engagement with plaintiffs in the state court action to attempt to negotiate the terms of a settlement. While settlement discussions were ultimately unsuccessful, the company and the participating lenders reached a deal with respect to the terms of a recapitalization transaction, culminating in the RSA and prepackaged plan.

Contemporaneous with the bankruptcy filing, Serta Simmons has commenced an adversary proceeding seeking a declaratory judgment that the 2020 transaction was valid under the terms of the term loan agreements with the suing plaintiffs. "The company's ability to restructure its balance sheet and emerge from chapter 11 is inextricably tied to the resolution of the disputes raised in the 2020 Transaction Litigation," according to John Linker, Serta Simmons' Chief Financial Officer.

Klein notes, "The federal District Court sitting in New York may have a very different view about whether a Bankruptcy Court in Texas can take away litigation that was first filed in New York. As Judge Easterbrook (Seventh Circuit Judge) famously quipped when a Bankruptcy Court enjoined litigants from appearing before him (sitting by designation as a District Court judge), 'I practically fell out of my chair, and I have a sturdy chair.' Certainly, claims against Serta are stayed, but other defendants are involved in the state court litigation."

"Serta and its supportive lenders who are the subject of New York litigation likely will hear claims of 'forum shopping,' but shopping for forums is exactly what a debtor's counsel is hired to do," Klein adds.

New Wave?

"We are seeing the resumption of the wave that began in 2020 and paused briefly in 2021 and early 2022," Rick Hyman, partner at Crowell & Moring, tells *Turnarounds & Workouts*. He notes 2020 saw more than 50 retail bankruptcies and this year's filings may approach that total. "Retailers are facing global economic challenges that are testing their ability to source product efficiently. Their costs of capital, when available, are increasing dramatically in today's interest rate environment. Their customers are challenged by inflation and burgeoning household debt. Although very expensive, bankruptcy for these retailers can be a pretty cost-effective way to remake their capital structure and reduce their footprint," Hyman says.

Howard Ehrenberg, partner at Greenspoon Marder, says it is hard to extrapolate to the entire retail industry from Party City and Bed Bath & Beyond as some of the causes of their troubles are unique. He explains Bed Bath & Beyond made a series of poor decisions over a decade regarding its inventory mix, online platform and footprint. Party City was hit very hard by the pandemic, supply chain disruption and a worldwide helium shortage. "However, these businesses are similar to all retail in that they mostly sell consumer discretionary items and will be negatively impacted by the likely slowdown in consumer spending."

"It is my opinion that we are entering a new wave which is being

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caused by a confluence of factors, including inflation, interest rates, real estate valuation dropping, consumer spending dropping and overall consumer sentiment," according to Ehrenberg, who believes consumer staples are less vulnerable than consumer discretionary retailers. "Thus, food and apparel will be less impacted, although you will see consumers reducing the quality of their spending to lower cost foods and apparel. The more discretionary retailers will see more vulnerability such as hobbies, furniture, higher price point restaurants, mid and higher end department stores, appliances and electronics."

Angela Allen of Jenner & Block expects the hardest hit sectors to include home goods, apparel and department stores, as post-COVID spending trends reflect decreases across comfort, home and athleisure, and increased spending on grocery and tourism instead. "Simply put, consumers may be more inclined to pay increased prices for eggs and groceries but skip the trip to Bed Bath & Beyond. Compounding matters, a number of retailers are facing labor shortages and wage inflation, an oversaturated supply chain having stockpiled too much inventory, tightening liquidity and increased capital costs," Allen says.

"So while 2020 brought a massive upswing in sewing related hobbies, Joann Fabrics is now reportedly facing distress and closing stores," Allen continues. "Longer term consumer trends reflect increasing environmental, social and ethical concerns among younger generations as more millennials and Generation Z opt for tourism over consumerism. Retailers should be prioritizing ESG and leveraging technology to attract these consumers and stay relevant."

BCLP's Hitchings offers a different take. "This doesn't yet seem to be a 'new' wave, nor the tail of the pre-pandemic wave of retail filing," Hitchings states. "Rather these filings reflect ripples in specific sectors responding to particular challenges faced by the respective debtors."

Hitchings explains that unlike the previous wave of retail cases, the recent retailer bankruptcies aren't necessarily being driven by a need to correct outdated or over-extended brick-and-mortar footprints. Instead, many of these cases are the result of failed strategies adopted during the pandemic. "As the pandemic subsides — ,or at least becomes endemic — a return to 'normal' may no longer align with company business models implemented during and in response to the pandemic. For others, bankruptcy was probably likely years ago but the companies were able to stay afloat due to pandemic-support including lender forbearance and government money. As that support wanes, it becomes harder to keep the ship from sinking."

"The next wave of retail bankruptcies will likely be focused in sectors that have fundamentally and forever changed during the pandemic," Hitchings continues. "This is particularly the case where the change is driven by advances in technology as opposed to merely consumer habit or convenience.

"Movie theatres are the principal example. But I doubt people will stop going to restaurants simply because they can get relatively high quality ready-made meals at home. Groceries stores are similar — outside pick-up and deliver became ubiquitous during the pandemic, but until technology can fundamentally change the shopping experience for the better, people are still likely to head to the store.

"Direct-to-consumer businesses may be particularly vulnerable, especially if they lack liquidity. As consumer spending becomes more discerning and the cost of materials and shipping continues to increase, can smaller brands survive? The trending increase in subchapter V small business filings suggests not."

For Herrick Feinstein's Carty, the advantage of starting early — its first day filings suggest Serta started negotiations with key constituencies in September 2022 — will likely give Serta the advantage of a softer landing

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in bankruptcy. "Bankruptcies do not always go as planned, but you would much rather be a debtor entering Chapter 11 with a pre-packed plan supported by key constituencies with financing already secured than the alternative," according to Carty. "Since the economic realities leading to filings like Serta and Party City took shape in 2022, I would expect that other retailers have been engaged in discussions with creditors as they consider all alternatives."

Mega-Merger, Anyone?

In 2005, Kmart Corp. completed an $11 billion deal to merge with Sears, Roebuck and Co. to form Sears Holdings Corporation, then the nation's third largest retailer, with about $55 billion in annual revenues and a national footprint of nearly 3,500 retail stores in the United States. Kmart exited Chapter 11 bankruptcy in 2003, wiping out $6 billion in liabilities.

The combined company filed for bankruptcy in 2018, weighed down by $11.33 billion in total liabilities.

"The prospects of another mega-merger seem dim," Crowell & Moring's Hyman says when asked if deals similar to the Kmart-Sears merger are likely. "The goal of many struggling retailers today would seem to be: exit burdensome leases, reduce costs of capital and wait out a coming recession. The notion that success requires a larger footprint and the assumption of greater risk as retail continues to move on-line might be a hard sell to lenders and other interested parties."

Greenspoon Marder's Ehrenberg believes there will be opportunities for mergers "although many of them already took place during the great recession."

Ripple Effect

"There is always a ripple effect," says Ehrenberg on the retail bankruptcies' impact to other sectors. "People will lose jobs which will have an overall negative impact. This becomes a cyclical problem as lost jobs become lost spending which results in more cutbacks at retailers and manufacturers. Empty real estate creates its own ripple effect as loans go into default, foreclosures rise, valuations drop which makes refinancing more difficult."

Jenner & Block's Allen suggests vendors and landlords in particular should be closely monitoring the distress of any retail counterparties and working to protect against bankruptcy risks. "The last 'retail apocalypse' included some administratively insolvent bankruptcy cases, so even the otherwise priority claims, like 503(b)(9) and claims for post-petition rent, were at risk of nonpayment," Allen explains. "Be alert to the warning signs of distress — look for bad press, slow or partial payments, payments being made by third parties, and other warning signs. Carefully consider your contract terms, do not hesitate to exercise contractual and UCC rights pre-bankruptcy, and take steps to minimize any exposure including stricter payment terms, guarantees and security interests."

"Retail distress is also likely to negatively impact real estate more broadly, as brick and mortar retail, office and residential sectors continue to face post-pandemic volatility, a slow return to office and much higher interest rates," Allen adds.

Crowell & Moring's Hyman believes the flood of retail bankruptcies that we have, and will continue to see, does not mean doom for the retail industry. "Indeed, they will likely lead, in time, to a stronger retail market, although with different ownership. Post-bankruptcy, those retailers with a reason for being may thrive with reasonable leverage and without the burden of out-of-market leases. Fewer stores may force many retailers to advance their on-line presence and increase profitability."

Dan Dooley, CEO and Principal of Chicago-based business management consulting firm, MorrisAnderson, notes Party City was hurt by the COVID-19 pandemic, supply chain issues, inflation and reduction in consumer discretionary spending. Dooley believes consumers resisting necessary higher prices (needed due to inflation) is a temporary stage. "Margins but likely not volume will [fuel] recovery in 2024. There is a reason for [Party City] to exist."

Dooley points out Bed Bath & Beyond is affected by the same issues affecting Party City. However, he notes the home furnishings sector has a trendy fashion aspect to it. Bed Bath & Beyond "may not be in the fashion vogue post its inevitable [bankruptcy] filing," Dooley continues. "I'm not convinced [Bed Bath & Beyond] has clear reason to exist." ¤