

Many Bankruptcies Leading to Liquidation

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Fashion and retail are in a down cycle — and bankruptcy might not protect them anymore.

In days when bankruptcy meant reorganization, firms had plenty of breathing room to get their affairs in order and then, hopefully, come out of Chapter 11. No longer. Changes in the bankruptcy code have complicated the quest for retail reincarnation — and the evaporation of financing in the past nine months has made it even harder.

“Once a retailer is in bankruptcy, the ball game is over,” said Lawrence Gottlieb, a bankruptcy attorney at Cooley Godward & Kronish, who has represented many unsecured creditors committees.

Since the rewriting of the bankruptcy law in 2005, debtors are in a race against time, Gottlieb noted. They now have a 120-day period when they have the exclusive right to file a plan of reorganization, with the possibility of a 180-day extension. In addition, debtors have an initial 120-day period to assume or reject leases, with the possibility of a 90-day extension.

Previously, there were unlimited extensions to both time periods, as well as more lenders ready to work with the debtors.

So retailers now have to make business decisions as soon as they file, and often don't get the chance to operate through the crucial Christmas selling period to determine if they've made the right decisions. In addition, because banks want to get repaid on their loans, they're closely watching the clock and keeping tabs on the feasibility of a sale.

If one isn't likely, they've usually pushed for a liquidation, Gottlieb said. Just ask Steve & Barry's, Mervyn's and Gottschalks.

“The bankruptcy amendments may have convinced [some] banks it is better to have everything out of the way in 210 days, because that's when retailers lose their leases,” he said. “Banks have liens on the inventory, and the stores are needed to conduct going-out-of-business sales. The only way for banks not to butt up against the time frame is to have the liquidation sale 120 days before you get to the 210th day. So you really have just 60 to 90 days to get the liquidation moving.”

With banks more risk-adverse than ever, there's no shortage of failed attempts at retail

reincarnation. Steve & Barry's exited Chapter 11 with a buyer, Bay Harbour Management, in place, but quickly reentered for a second tour under the proverbial "Chapter 22," only to perish later. Creditors negotiated with potential buyers in the Gottschalks bankruptcy, but the parties ran out of time to negotiate the deal. Goody's Family Clothing Inc. folded after a second tour of bankruptcy, and Mervyns and jewelers Friedman's, Crescent and Whitehall are gone.

Among vendors, the brands under Hartmarx Corp. could be split up should the stalking horse bid of London-based private equity turnaround firm Emerisque be topped by better offers at auction.

Just last week, Eddie Bauer Holdings Inc. said it hoped to maintain most of its operations after the retailer entered Chapter 11 with Rainier Holdings, an affiliate of CCMP Capital Advisors, as the stalking horse bidder at \$202 million for at least 250 stores. Also last week, Filene's Basement cleared a hurdle in its fight for survival when it was bought out of bankruptcy by a subsidiary of Syms Corp. and financial investor Vornado Realty Trust for \$65 million.

In previous bankruptcy cycles, many debtors, including Warnaco Group Inc. and Maidenform Brands Inc., exited Chapter 11 by restructuring operations. Others, such as Barneys New York, found new owners.

But there's no such clarity in the latest cycle, partly because many strategic buyers are thinking twice before buying, and some financial players, such as private equity firms, are cautious in where they're biting — if they're biting at all.

Lack of debtor-in-possession financing has been a persistent problem for bankrupt companies. Private equity firm Sun Capital Partners Inc., which specializes in restructuring and turnaround situations, has attempted to fill that void with firms still deemed viable.

"We provide the DIP financing when the companies file for Chapter 11," said David Blechman, a principal at Sun Capital. "Our old equity gets wiped out, but we buy the business back [as the exit strategy] and own the new equity in the reorganized firm."

The financing helps good companies with balance sheet problems that would otherwise liquidate because of DIP shortfalls, he noted. In essence, Sun Capital is providing life support for the still-solid firms in its portfolio that operate in difficult industries.

There is no shortage of companies to buy in bankruptcy, but Blechman said the problem is "finding businesses that [you know] for sure will make it through the downturn. No one knows how long this will continue. What is a good company? That may depend on the market. In this environment, the bar is higher to make sure the companies have a place in the market, where consumers are buying essential things and have a need to shop

there.”

Without the fiscal burden of multiple storefronts in most cases, vendors are more likely than retailers to find second lives. Production can be moved to contractors domestically or overseas or, through licensing, eliminated entirely. Brands not facing financial distress also may go the licensed route through sales to brand management companies.

All that doesn't mean brands are an easier sell. Banking sources said Hartmarx, which filed for Chapter 11 in January, sought to sell the firm as a going concern but received just three bids from different private equity firms: Emerisque, New York-based Mistral Equity Partners and Yucaipa Cos. in Los Angeles. The Emerisque bid, favored by unsecured trade creditors, was the only one for the entire firm. In contrast, the Stateside offers contemplated selling off assets to help pay down the bid price. Those U.S. firms, and at least one other, are now believed by bankers to be waiting to make bids at auction on selected assets, with a few eyeing the same brands. All the bidding took place even as Hartmarx' major creditor, Wells Fargo, stepped up the pressure for a liquidation — stoking a major political outcry in the process.

“You need to look at what role the brand plays for consumers,” said Gabe Fried, founder of intellectual property consulting firm Streambank. “How competitive is the category that the brand operates in and are there natural extensions into other lines? Does the brand require a specialist in rehabilitation?”

For companies taking a long-term view, Fried said the current low value of assets presents a good buying opportunity that doesn't come along often.

Bankrupt firms aren't the only ones looking to shed assets. Jack Hendler, president of merger and acquisitions firm Net Worth Solutions Inc., said some companies are seeking strategic partners that can help them navigate through the tough retail environment.

“Many companies come to us to find strategic partners. There's been some significant [account] concentration at Kohl's, Wal-Mart and Target. The banks are petrified firms have that kind of concentration. All they need is one order canceled and their balance sheet is turned upside down,” Hendler said.

He said many companies are doing poorly because they lost 15 to 20 percent of their volume on the sales floor. And liquidators are looking around because there is inventory available.

“A year and a half ago, 70 percent of buyers were financial players or private equity. Today I have one deal going to private equity, although some are now starting to look around again,” he said. “Too many strategic firms, even if they can make acquisitions, don't want to use existing lines of credit in case they need it for their current business. A few are even wondering even if they'll still be in the fashion industry over the next couple of years.”

“Fashion changes every five years,” Hendler said. “Few live through those changes. Polo Ralph Lauren, Donna Karan, Calvin Klein — those are the exceptions to the rule.”