Neiman Marcus Offers Lessons for Retail RESTRUCTURING in the COVID-19 Era

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As the COVID-19 pandemic continues to wreak havoc on the economy, corporate restructuring has provided a strategic alternative for many retailers. Coming as it did amid an already fragile retail environment, the pandemic pushed more than three dozen retailers into Chapter 11 bankruptcy in 2020, representing an 11-year high.[1] While the COVID-19 crisis has forced some retailers into asset sales and liquidations, others thrust into distress during the pandemic have been able to resolve balance sheet and operational issues and emerge as going concerns, leaner and ready to navigate today's new marketplace.

The successful outcome of the recent Neiman Marcus case, and in particular the company's ability to shed billions of dollars of debt and raise $750 million of new liquidity while maintaining a significant brick-and-mortar presence at a time when many retailers could not, offers an example and case study of corporate restructuring as a solution for the retail sector. A closer look at the key elements that contributed to Neiman Marcus's emergence as a healthy and lean enterprise reveals practices and lessons learned that can serve as tools for other companies and professionals who are navigating the current treacherous retail environment.

Consensus Building

The success of the Neiman Marcus case is in large part attributable to the willingness of nearly all of the stakeholders, including prepetition lenders, major brands, smaller merchants, and consignment vendors, to make concessions and come to agreements that enabled the business to continue as a going concern.

The linchpin of the restructuring was achieved during the prepetition period, when the company had to convince its funded-debt creditors that a consensual and expeditious restructuring was the only way to maximize value and avoid a liquidation. After approximately six weeks of negotiations, the company reached a restructuring support agreement with the supermajorities of its funded-debt creditor groups, including holders of its first-, second-,

and third-lien term loan debt and debenture debt, and its equity holders.

These debtholders had complex and interrelated collateral packages and could have pursued various legal remedies in a traditional bankruptcy case in a fight to maximize their slice of the pie. Critically, the company was able to convince these parties that their litigation arguments would have ultimately destroyed value and thus reduced their recoveries, which led to execution of the restructuring support agreement just before the Chapter 11 filing.

With lender and sponsor consensus locked in before the filing, the company was able to chart its course to emergence from bankruptcy just as the Chapter 11 cases were beginning. A July settlement supported by the official committee of unsecured creditors sealed the deal and made Neiman's September emergence a *fait accompli.*

Accelerated Timeline

Because of the prepetition creditor and sponsor consensus, Neiman Marcus was able to complete its restructuring over an accelerated five-month timeline, from May to September 2020. This quick timeline was pivotal to the success of the case, a theme seen time and again when it comes to retail restructurings. A retailer needs to have a quick path to emergence to avoid liquidation, due to both business and legal considerations.

First, to minimize business damage, retailers need to be able to send a strong message to their vendors, employees, and customers that they have a vision to put their capital structure issues in the rearview mirror.

Second, retailers tend to rely on financing from asset based lenders (ABLs), which have security interests on the inventory. Unless the retailer can refinance the ABL loans during the case, it needs to obtain court authority to use the cash collateral of those lenders

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and prevent them from foreclosing on their inventory collateral. For their part, these ABL lenders are typically unwilling to consent to retailers using cash collateral and warding off inventory liquidation for an extended period of time. This is due to tension between the Bankruptcy Code provision allowing only 120 days for a debtor to assume or reject leases (with the potential for a 90-day extension) and ABL lenders' demand for time on the back end if the reorganization fails to step into stores and liquidate their inventory while the debtor retains possession of the store leases.

The need for speed in retail reorganizations gives all parties—debtors, lenders, and equity holders—incentive to reach a prepetition deal that can be implemented quickly. Neiman Marcus was able to execute its transaction successfully because it enlisted experts at the onset of COVID-19 and related store closures. This, in turn, allowed Neiman to begin negotiations with its creditor groups with enough runway to reach a global deal.

Strategic Lease Negotiations

Unlike many other brick-and-mortar retailers that have restructured during the pandemic, some of which were forced to shutter all of their locations, Neiman Marcus emerged from Chapter 11 with minimal store closures, just modestly slimming its store footprint to enhance efficiencies and fit its business plan.

One key aspect of the business that enabled Neiman Marcus to maintain its brick-and-mortar presence was that all of its stores were four-wall EBITDA positive prior to the onset of COVID-19, so the company and its lenders saw value in keeping its store footprint largely intact. Of course, Neiman, its advisors, and its lenders performed substantial analysis during the bankruptcy case to determine whether certain stores fit the go-forward business model and used the threat of lease rejection to obtain concessions where available.

Best Practices

As one of the rare retailers that successfully emerged from the Chapter 11 process as a going concern during the COVID-19 pandemic, the Neiman Marcus case can provide a model and road map for other distressed retail businesses. The following are best practices that can provide guidance for other retail restructurings during the COVID era and beyond:

- Enlist support from experts to help once a problem is identified. When capital structure issues arise or appear possible, a retailer should find ways to leverage and bring in experts to help identify solutions, whether they are restructuring lawyers, real estate professionals, financial advisors, or claims and noticing agents. Neiman Marcus enlisted the help of restructuring professionals once the COVID-19 pandemic struck, which provided time to foster creditor and equity holder consensus on a restructuring support agreement and paved the way for the success that followed.

- Time is of the essence. Moving quickly and strategically through Chapter 11 can serve the interests of all parties while minimizing downtime and costs associated with the process.

- Preparation is key. It is important that case-specific and other relevant information is organized and easily accessible to those who need it throughout the process.

- Striving for transparency and open disclosure is important. In negotiations and in dealing with all stakeholders, sharing information will build the foundation for productive communication throughout the case and result in stronger outcomes.

As the retail industry navigates the challenges brought on by the COVID-19 pandemic and the ongoing shifts in consumer behavior, retail debtors and their professionals can benefit by heeding the lessons from those retailers that have survived retail distress with a strategic and expeditious approach and by following best practices from these precedential restructurings. J

[1] cnbc.com/2020/12/26/the-10-biggest-retail-bankruptcies-of-2020.html

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