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Bankruptcy Update

Expert Analysis

Changes in Teen Spending Affect Once-Popular Brands

By Edward E. Neiger

This article focuses on the continuous stream of teen apparel bankruptcies. The industry continues to decline as the shift in teen spending habits from fashion to technology becomes more pronounced. In addition, fast fashion companies built on expedited production processes aimed to get new trends to the market quickly and cheaply draw sales over companies built on brand name logo appeal. This article discusses developments in the bankruptcy proceedings of once-popular mall brands Pacific Sunwear of California, Aeropostale and Quiksilver as they try to survive in a changing landscape.

Pacific Sunwear

On April 7, 2016, teen clothing retailer Pacific Sunwear of California Inc. and affiliated debtors filed petitions for relief under chapter 11 of the Bankruptcy Code in the U.S. Bankruptcy Court of the District of Delaware. The company cited the shift in business to online retailers as well as several unsuccessful business decisions over the past decade as the precipitating causes of its bankruptcy filing.

The debtors were formed in 1982 and grew rapidly in the 1990s as their Southern California skateboarding-influenced products grew in popularity among teens. At the time of the filing, the company had more than 9,000 employees and operated 593 stores located primarily in shopping malls. During the course of the bankruptcy proceedings, the debtors hope to significantly reduce their $140 million occupancy costs through negotiations with landlords or rejection of unfavorable leases under section 365 of the Bankruptcy Code.

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The debtors entered bankruptcy armed with a restructuring support agreement negotiated with affiliates of Golden Gate Capital, which provides for the conversion of $88 million in term loan debt into equity in the reorganized company. The proposed restructuring also provides for payment in full to select key suppliers that provide credit terms to the debtors during the pendency of the chapter 11 proceedings and following emergence from bankruptcy, while other unsecured creditors are slated to receive minimal distributions.

The debtors also secured a $100 million DIP financing commitment to fund operations under chapter 11 as well as a $20 million exit financing commitment. The debtor-in-possession financing package was approved on an interim basis and grants the debtors access to $62.5 million to be used to pay down their prepetition asset-based loan balance and provide approximately $7 million in additional liquidity to fund company operations.

A hearing on approval of the disclosure statement in connection with the debtors' plan of reorganization was originally scheduled for May 16 and adjourned as the debtors negotiate with significant stakeholders, including the official committee of unsecured creditors. The Office of the United States Trustee also voiced concerns regarding the fast pace of the proposed reorganization as well as the limited information initially provided with respect to a liquidation analysis, a requirement to consider whether a plan is confirmable.

Significantly, the plan may undergo significant changes as it provides for a bid and auction process for the equity stake in the reorganized company. In that regard, Golden Gate Capital will set the floor with its proposal acting as a

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stalking horse bid. A minimum alternative offer will have to pay off the balance of the company's DIP loan and $88 million term loan and provide an additional $500,000 benefit to the estate.

Pacific Sunwear of California (Bankr. D. Del. Case No. 16-10882)

Aeropostale Holdings

On May 4, 2016, teen apparel company Aeropostale Holdings, Inc. and affiliated debtors filed petitions for relief under chapter 11 of the Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of New York. The bankruptcy filing was widely expected as the company recently reported net losses of $136.9 million for the 2015 fiscal year as well as an 18 percent reduction in net sales compared to the previous year.

The company has more than 800 stores in the United States and Canada. It also operates stores in Latin America, Asia, Europe and the Middle East. The debtors report that they intend to immediately close 154 underperforming stores.

The debtors secured a $160 million DIP financing package comprised of a $75 million term loan and an $85 million revolving line of credit to be provided by Crystal Financial LLC. The DIP facility was approved on an interim basis over the objection of secured creditor Aero Investors LLC which urged a prompt liquidation. As a result, the debtors may access up to $100 million of the DIP facility on an interim basis, with approximately $73 million going to pay down principal on an asset-based prepetition credit facility.

A week following the bankruptcy filing, the debtors reported that they have resolved a dispute with one of their primary suppliers, MGF Sourcing US, LLC. In a move that may have precipitated the bankruptcy filing, MGF shifted the debtors to cash in advance terms at a time when the debtors alleged to have $100 million in availability under a revolving credit facility.

The debtors argued this action was unauthorized and sought to compel performance while MGF countered that the terms of the sourcing agreement between the parties specifically provided for such relief. Following several days of negotiations, the debtors and MGF reported they reached a settlement agreement pursuant to which MGF would supply goods on outstanding orders pursuant to a specific delivery schedule and the debtors would pay for such goods within 14 days of delivery of the goods. The settlement further provides for a delay discount of $4.72 million, termination of the sourcing agreement and certain mutual releases.

Aeropostale Holdings (Bankr. S.D.N.Y. Case No. 16-11285)

Surf Apparel Company

On Sept. 9, 2015, surf apparel company Quiksilver Inc. and affiliated debtors filed petitions for relief under chapter 11 of the Bankruptcy Code in the U.S. Bankruptcy Court for the District of Delaware. The company commenced an operational turnaround in 2013 but continued to experience liquidity constraints and operating losses which ultimately led to the need for bankruptcy relief.

The debtors entered bankruptcy after reaching a plan support agreement with major lender Oaktree Capital Management LP, which, together with Bank of America, would also offer a $175 million DIP financing package to fund working capital needs through the bankruptcy proceeding.

The plan support agreement called for a plan of reorganization whereby U.S. secured notes (over 70 percent of which were held by Oaktree) would be converted into equity, approximately $225 million in guarantees of Quiksilver's European notes would be reinstated and $7.5 million would be made available for distributions to holders of unsecured claims against the debtors.

Both the DIP financing and the reorganization plan were met with vehement opposition by the official committee of unsecured creditors who brought forward an alternative financing proposal by Brigade Capital Management LLC which was ultimately rejected in favor of the Oaktree DIP package as it was not tied to any ultimate resolution of the case.

As a hotly contested confirmation hearing and enterprise value fight appeared imminent, the court referred the parties to mediation before Judge Robert Drain of the Southern District of New York Bankruptcy Court. Plan mediation proved successful, as the parties were able to agree on the terms of an amended plan of reorganization and moved forward to confirmation in January 2016. The most crucial change to come out of the mediation was an increase from $7.5 million to $14 million in cash for distributions to unsecured creditors.

Nevertheless, not all stakeholders were pleased with the outcome and plan confirmation, as a group of former employees seeking $7.3 million in severance pay appealed the confirmation order. In late April, the debtors announced that they reached a resolution in principle of the employees' claims and the appeal. Under the settlement, the former employees will be eligible for approximately $132,000 in administrative and priority claims as well as an additional general unsecured claim.

In re Quiksilver (Bankr. D. Del. Case No. 15-11880)

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