



Toys R Us Bankruptcy Prospects Depend On Big Holiday Sales

By **Alex Wolf**

Law360, New York (September 20, 2017, 10:54 PM EDT) -- While the future for Toys R Us Inc. looks uncertain now, the company's performance over the crucial holiday season will go a long way toward determining its long-term prospects, with experts pointing to the timing of and rationale for the company's bankruptcy filings this week.

The problems that have plagued brick-and-mortar retailers over recent years caught up to Toys R Us in a big way this week as the global seller of toys and baby products was **thrust into restructuring proceedings** in both the U.S. and Canada to deal with a crush of funded debt obligations and continually declining sales.

Although it may have been impossible for Toys R Us, with nearly 1,600 stores worldwide, to hide its balance sheet problems, the company said in court filings that its trip to the courthouse was sped up by the actions of its major vendors, who were unwilling to fulfill orders for fear they might not receive full payment. That fear was stoked by recent leaks to the press that the retailer was in the midst of putting together a restructuring plan.

Now, with a Chapter 11 case filed and a \$3.1 billion post-petition loan facility secured, Toys R Us has positioned itself to make immediate payments to toy manufacturers and keep its inventory at preferred levels just before the year's final sales quarter, when 40 percent of its annual revenue is made. By taking the leap into bankruptcy when it did, Toys R Us seems to be setting itself up to use this holiday shopping season as a litmus test for the company's long-term presence, experts say.

"You definitely need to look at Toys R Us' sales in this season, and that will be the base for what we see as Toys R Us in the future," said bankruptcy attorney Jeffrey R. Gleit of Sullivan & Worcester LLP. "Everyone is going to go through the numbers, put together projections based on this year and what they think the projections will look like in the future."

What that future holds, according to a declaration by Toys R Us CEO Dave Brandon, is fierce and ongoing competition from online sellers like Amazon.com Inc. and big-box retailers

like Wal-Mart Stores Inc. and Target Corp., which have the advantage of getting customers in the door with products other than just toys.

The consumer habit challenges that Toys R Us faces have dragged down other big names across the retail industry this year, including Payless ShoeSource Inc., Gymboree Corp. and BCBG Max Azria Group Inc. — all of which were forced to close stores and slim down their physical footprints in bankruptcy.

In court filings, Brandon acknowledged that the company intends to use its bankruptcy to close underperforming stores and renegotiate lease terms. That the retailer hasn't produced a list of locations it intends to shutter could be a sign that it was unexpectedly rushed into filing for bankruptcy, but it also allows the company to further analyze sales patterns this holiday season, experts told Law360.

"Obviously, they want to be able to sell as much as possible through the holidays," said Bilzin Sumberg Baena Price & Axelrod LLP partner Jay Sakalo. "They may have made the strategic decision as well to just keep the stores open, sell whatever they can, and then make the decisions afterwards."

The New Jersey-based children's toy chain and owner of Babies R Us filed for Chapter 11 protection with more than \$5 billion in funded debt, stemming in large part from money its owners borrowed in 2005 to fund a \$6.6 billion leveraged buyout of the company and take it private.

The commencement of the bankruptcy cases is meant to address near-term liquidity issues and longer-term capital needs, and "accomplish a comprehensive reorganization" to improve operations worldwide, the company said in court papers.

Additionally, because Toys R Us generates so much of its annual revenue in the final quarter of the year, it was imperative for the merchant to quickly find a way to pay manufacturers like Hasbro Inc. and Mattel Inc. to reopen supply channels and "ensure a successful holiday season," Brandon said.

While the sales period just before Christmas is important for most retailers, especially peddlers of kids' toys, bringing in holiday cash for a bankrupt company like Toys R Us is crucial, said Ted Gavin of corporate restructuring firm Gavin Solmonese LLC.

"Traditionally, retailers will sort of build a war chest and file after the holiday season, but there are ample reasons to file beforehand," he said. "It makes it ultimately a stronger company to reorganize and it gives more leverage in dealing with creditors by taking some of the transactional risk of the reorganization itself off the table."

Gavin also noted that the company's key constituents will likely view its holiday sales as a signal of what the future has in store.

Attorney Bill Norton of Bradley Arant Boult Cummings LLP said that this holiday period may also be used to judge what Toys R Us can do operationally to separate itself from others to give it a competitive edge, like ramping up its in-store experience.

"They need to hit this holiday season in a strong way," he said. "That will show to the court and the creditors, and give confidence to their lenders, that they're on the right path to reorganize, which will be invaluable going down the road."

Toys R Us is represented by Edward O. Sassower, Joshua A. Sussberg, James H.M. Sprayregen, Anup Sathy, Chad J. Husnick, Robert A. Britton and Emily E. Geier of Kirkland & Ellis LLP and by Michael A. Condyles, Peter J. Barrett and Jeremy S. Williams of Kutak Rock LLP.

The case is In re: Toys R Us Inc. et al., case number 3:17-bk-34665, in the U.S. Bankruptcy Court for the Eastern District of Virginia.