



HOW DID THEY DO IT?

# Neiman Marcus and the myTheresa Spin-off

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# Situation Overview

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The chapter 11 reorganization of Neiman Marcus Group LTD LLC (“Neiman Marcus” or the “Company”) has brought renewed focus on the 2018 spin-off of the Company’s myTheresa business, a major e-commerce platform then valued at approximately \$280MM, to the Company’s owners.

- Prior to its 2020 bankruptcy, Neiman Marcus was a leading omni-channel luxury fashion retailer, which historically focused its business on brick-and-mortar retail shops.
- In October 2013, Ares and the Canadian Pension Plan Investment Board (collectively the “Sponsors”) purchased Neiman Marcus from Warburg Pincus and TPG for approximately \$6B, funded primarily through debt.
- In October 2014, the Company acquired mytheresa.com (“myTheresa”) for \$181.7MM to expand its e-commerce platform and international presence.
- From 2015-2018, the Company experienced financial stress as its EBITDA fell by over 30%. Given the Company’s heavy debt load, its leverage ratio crept higher during this period.
- In stages from 2014-2017, the Company designated the myTheresa entities as unrestricted subsidiaries under its existing debt documents.
- With financial performance deteriorating, in September 2018, the Company disclosed that it distributed substantially all of the holdings of the myTheresa entities to its ultimate parent, Neiman Marcus Group Inc. (“Parent”), utilizing a provision in its credit documents that allowed the Company to make a dividend of the equity of any unrestricted subsidiaries, such as the myTheresa entities.
  - The Parent was not a guarantor or otherwise restricted under Neiman Marcus’s credit facilities. As a result, all of the value of the myTheresa business was preserved for the Sponsors.


***How was a company able to distribute a business line of at least \$280MM to its sponsors during a period of uncertain financial stability without triggering any covenant breaches under its multiple credit facilities?***



## Key Takeaways

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To spin off the myTheresa business, the Company took advantage of the loose requirements to designate an unrestricted subsidiary and generous basket flexibility under the Company's credit facilities. The spinoff raises a number of considerations for lenders to prevent similar leakage to a sponsor.


- Each of the Company's existing debt instruments contained negative covenants placing parameters around unrestricted subsidiary designation, limiting investment capacity, and limiting dividends.
- Despite these protections, the Sponsors were able to divert approximately \$280MM in value to themselves, removing a material e-commerce platform and related assets from the restricted party group and eliminating a potentially significant source of value for the Company's creditors.
- For sponsors, these contractual provisions can prove essential to preserving maximum flexibility for liability management transactions down the line, and may free up attractive newly-unencumbered assets that can serve as collateral in new rescue financings or other special situations investments.
- Conversely, carefully restricting negative covenant flexibility can help existing lenders preserve collateral security and avoid potentially significant leakage of valuable assets.
- The transaction reminds lenders of the pitfalls associated with fairly common baskets in a credit agreement's negative covenants.
- Inherent in any such type of transaction is the  [potential risk of a fraudulent transfer claim](#).

# The Spin-Off Transaction



The Spin-off was accomplished through a two step process.

STEP 1	STEP 2
The myTheresa entities were designated as “unrestricted subsidiaries”, meaning the covenant limitations of the Credit Facilities would not apply to them.	The Company utilized an express exception to the limitation on restricted payments to distribute the capital stock of the myTheresa entities to the Parent.

- There were two factors in play that made the spin-off transaction work in only two steps.
  - The Company already had certain flexibility with the myTheresa entities upon their acquisition. The myTheresa entities were not guarantors under any of the credit facilities – meaning the lenders did not have a lien on the myTheresa assets (even if the lenders could ultimately benefit from the value of the business in a downside scenario through their pledge of equity at levels above the myTheresa business). This fact allowed the Company to avoid having to structure a transaction that would release liens,  [as in PetSmart](#).
    - However, the myTheresa entities were “restricted subsidiaries” that were subject to the affirmative and negative covenants of the credit facilities.
  - Parent was not a guarantor under any of the Company’s credit facilities, nor was Parent subject to any of the covenants or other restrictions of the credit facilities. Thus, if the Company could transfer the myTheresa entities to the Parent, the value generated from the business would flow up directly to the Sponsors, and not to the lenders.



# How Did the Company Accomplish Step 1?

The Company utilized basket capacity to designate the myTheresa entities as unrestricted subsidiaries.

- Each credit facility permitted the Company to designate any restricted subsidiary as an unrestricted subsidiary subject to no event of default and sufficient investment capacity, while (i) the ABL facility also required a minimum of \$225MM in excess availability, and (ii) the term facility required a Fixed Charge Coverage Ratio of at least 1.0x on a pro forma basis.
- In 2014, the Company designated the myTheresa entities as unrestricted subsidiaries under the ABL facility and the term facility.
  - In 2014, the Company valued myTheresa entities at approximately \$253MM.
  - The Company had at least \$502MM of investment capacity through the use of its builder investment basket, general investment basket, and foreign subsidiary investment basket.
- In 2017, the Company designated the myTheresa entities as unrestricted subsidiaries under its note indentures.
  - At the time, the Company valued the myTheresa entities at approximately \$280MM.
  - The Company had at least \$578MM of investment capacity through the use of its builder basket and general investment basket.

***As a result, in 2017, the Company had successfully designated the myTheresa entities as unrestricted subsidiaries under all of its debt facilities, and Step 1 of the spin-off was accomplished.***



## How Did the Company Accomplish Step 2?

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In September 2018, the Company spun-out the myTheresa entities to the Parent by distributing the capital stock of the myTheresa entities up the corporate ladder.

- Even though the credit facilities restricted the Company's ability to make dividends and distributions, each of the Credit Facilities contained an exception that allowed the Company and its restricted subsidiaries to make a distribution of the capital stock of any unrestricted subsidiary:

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*The Company was allowed to make a “distribution, as a dividend or otherwise, of shares of Capital Stock of, or Indebtedness owed to the Borrower or any Restricted Subsidiary by, one or more Unrestricted Subsidiaries (other than Unrestricted Subsidiaries the primary assets of which are cash or Cash Equivalents).”*



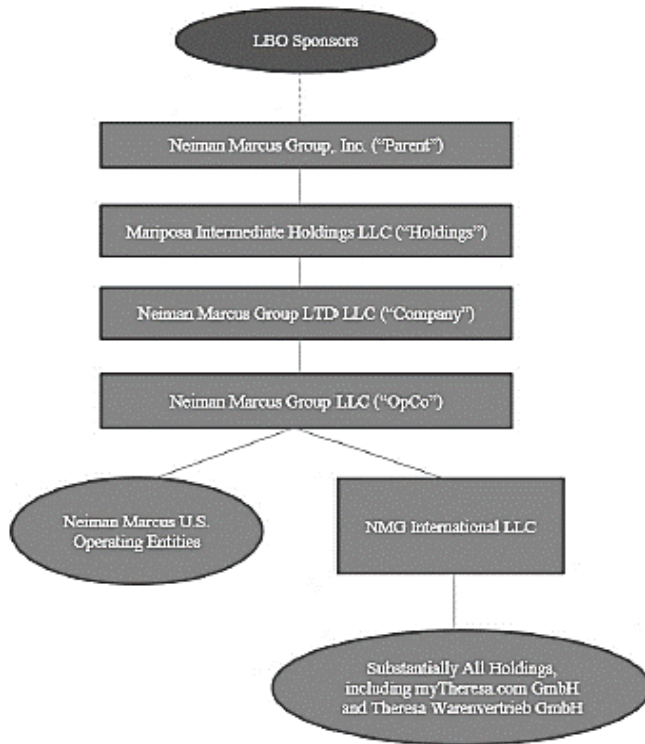
- As of September 2018, as soon as the myTheresa entities had been designated as unrestricted subsidiaries under each Credit Facility, the distribution of the capital stock of the myTheresa entities was permitted under each Credit Facility.
- Because the spin-off was effectuated as a dividend rather than a sale:
  - No fair market value consideration was required to be received.
  - No mandatory prepayment resulted from the transaction.

***As a result of the spin-off, the Parent owned 100% of the capital stock of the myTheresa entities, and Step 2 of the spin-off was accomplished.***

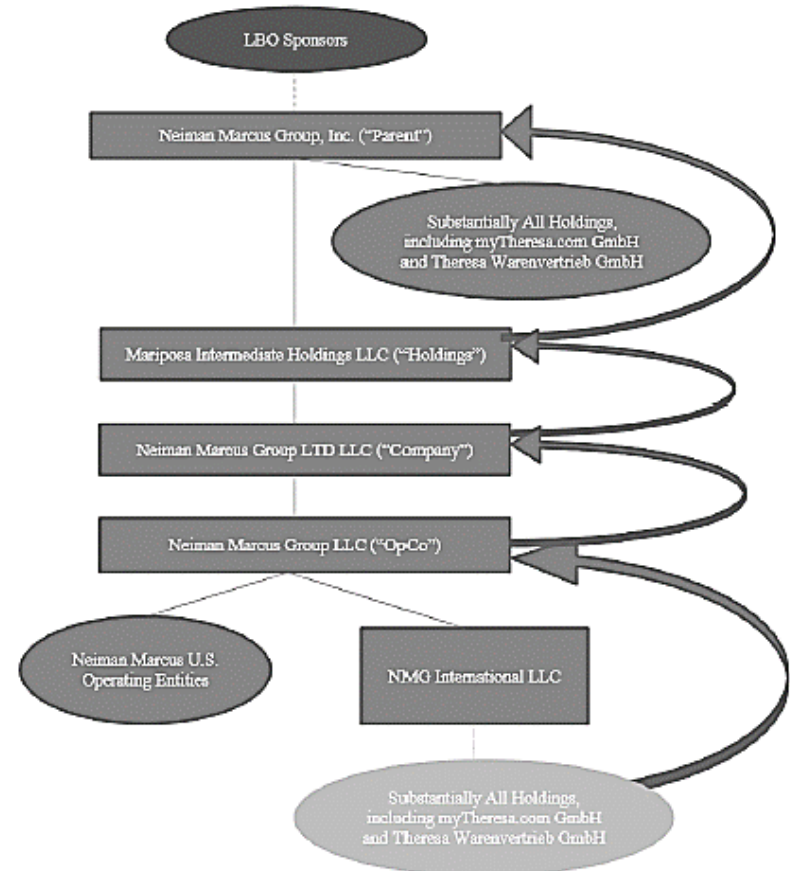
# Neiman Marcus Corporate Structure



## Prior Corporate Structure



## Post Spin-off Structure



# Considerations for Lenders




## IMPACT ON LENDERS: *IF A BORROWER DISTRIBUTES ASSETS THAT DO NOT CONSTITUTE LENDER COLLATERAL, WHY SHOULD LENDERS CARE?*

- Although an unrestricted subsidiary is not bound by the covenants of a credit facility and the assets of the unrestricted subsidiary do not constitute collateral, any distributions on account of an unrestricted subsidiary's capital stock would flow up to the loan party group, thus providing secured creditors indirect credit support.
- The risk of a Neiman Marcus transaction is that any residual value can be leaked outside of the loan party group, even to a sponsor or other insider, to the detriment of the secured creditors.
- In other situations, a borrower could utilize basket capacity to move collateral to an unrestricted subsidiary, and then use the Neiman Marcus loophole to distribute those assets to a sponsor.

*The unrestricted subsidiary dividend basket used by Neiman Marcus remains fairly common in the syndicated market. The ability to “free up” assets through a spin-off transaction provides both a source of concern to existing lenders, as well as opportunities for new sources of debt capital to pair with sponsors to provide additional liquidity in liability management transactions.*

## To protect against a Neiman Marcus transaction, lenders should consider:

- Eliminating any specific baskets for distributing the equity of an unrestricted subsidiary. If such negotiation fails, seek to:
  - have the basket contained in the asset sale covenant and make the sale subject to receipt of fair market value; and
  - have any such sale trigger a mandatory prepayment.
- Limiting transfer of material or other “crown jewel” assets to non-loan party subsidiaries.
- Requiring leverage tests for designation/creation of unrestricted subsidiaries.
  - Interest coverage ratio tests are generally borrower favorable and provide greater flexibility in times of distress to comply with the test.

 [What can I do? Drafting Tips to Address Liability Management Transactions](#)

 [What is it? Frequently Discussed Liability Management Transactions](#)