Bed Bath & Beyond – The Long Road to Bankruptcy

Introduction

Internationally, Bed Bath & Beyond is probably best known for its prominent role in the 2021 meme stock craze. Inside the US, however, the firm and its specialty homeware shops were a central part of popular culture. The company's April 23rd bankruptcy capped off a tumultuous couple of years, during which Bed Bath & Beyond tried to and ultimately failed at turning around its business. As the company neared bankruptcy, it scrambled to raise new financing in exotic ways, which we will draw attention to in this article in order to better understand the strategies currently deployed in distressed company financing. Given the recent tumult in the banking sector, such an understanding could prove helpful.

The Ascent and Initial Struggles

Somewhat ironically given its recent history, Bed Bath & Beyond itself was originally born out of a struggling retailer. Warren Eisenberg and Leonard Feinstein were both managers at the now-defunct discount retailer Arlan's when they noticed that the firm's struggles would not abate, given the increasing dominance of specialty retailers over generalist stores. Thus, in order to be on the winning side of the shift towards specialty retail, they started their own specialty retailer focused on bed and bath homeware, called *Bed 'n Bath*, in 1971. The company quickly found success, operating 17 stores by 1985, split across the New York City metro area and California. Recognizing that, following the trend of specialty stores, super stores were the 'next big thing', the founders opened their first super store in 1985 and changed the company's name to Bed Bath & Beyond, to show that they were now offering a broader selection of products. In further keeping up with the competition, the firm introduced a computerized inventory system in the early 1990s. Capping off a successful first 20 years in business, the company went public on the NASDAQ in 1992 with the ticker symbol BBBY.

After crossing the $1bn sales mark in 1999, both founders stepped back from the business and sold all of their stock. With their exit, the gradual decline of the firm set in. Despite already having been around in the 1990s, Amazon only became the online super store that it is today in the 2000s. Initially, Amazon's ascent did not harm Bed Bath & Beyond (BBBY) in any noticeable way, as revenues continued growing rapidly, leading to a compound annual revenue growth rate of 12.7% in the period 2001-13. This allowed the firm to grow inorganically, buying Buy Buy Baby from its founders, which were two of Leonard Feldstein's children, for $67m in 2007. In the period of 2013-18, however, the increasing competition from e-commerce seriously ate into revenues, which only grew at 1.2% per annum. Similarily, earnings grew at 14.5% per annum in the earlier period, before collapsing by -22% per year up to 2018.

In 2019, with an increasingly dire outlook and no vision for how to turn around the business, BBBY found itself under siege by three acitivist investment funds, who aimed at ousting the incumbent CEO, Steven Temares, and revamping the firm's board. Also, they critized the firm's apparent nepotism, given the acquisition of Buy Buy Baby and Chef Central from the founders' children. The activists succeeded, with the CEO being replaced by Target's former Chief Merchandising Officer, half of the board stepping down, and the board being shrunk from 12 to 10 members. However, instead of this bringing about the much needed turnaround for the firm, it only took it further down the path to misery. The new management ended the firm's decades old tactics of attracting customers through coupon mailers, which are coupons that are sent to people's homes, and other promotional discounts and tried to restrict the use of these coupons. Naturally, this drove some loyal customers, who had previously been drawn to the store by the coupons, away. Further, in an effort to boost margins, BBBY, under its new management, tried to develop private label brands. However, this also proved harmful to the business: in a world where consumer behaviour is driven by social media advertising, BBBY did not offer any of the brands that were hyped on social media, due to its private label strategy. Thus, customers who came to BBBY shops that wanted to acquire the social media brands were left disappointed. The advent of the pandemic made the situation for BBBY, which had a comparatively weak internet presence, even worse.

The Impact of Covid

BBBY stores were an American staple for decades – the brand gained infamy for its iconic large mailing coupons and abundant selections of quality cookware at a reasonable price. As consumers emerged from the pandemic, BBBY's management desperately tried and failed to reconcile critical mistakes which led the Firm to bankruptcy. As the Wall Street Journal Reports, BBBY experienced a fundamental shift early in the pandemic – as CEO Mark Tritton shifted the Firm's focus from its popular, branded products to a private-label strategy in search of higher product margins. Sourcing these goods became difficult due to supply chain reductions, and disgruntled consumers were no longer able to enjoy the Firm's famed selection of high-quality goods, as the chain faced shortages in its 200 most popular items during the holiday season, a critical miss for a brick and mortar retailer.

As the embattled Firm limped on, it began closing stores by the dozens in a move to preserve capital and continue as a going concern. One part of that strategy was closing an ever-growing number of stores. Also, the Firm's real estate holdings were heavily courted, with retailers, gyms, and other enterprises desperately in need of retail space, with vacancy rates near historic lows of 4.9% at the end of 2022. In addition to the reduction in physical stores, BBBY began selling off multiple subsidiaries in 2020, with 2.1 million square feet of retail space sold to Oak Street for $250m, custom gifts retailer personalizationmall.com sold to 800-flowers inc. for $250m, and holiday store Christmas Tree Shops ($233m) and imported foods retailer World Market LLC ($110m) being sold soon after in late 2020 & early 2021 respectively.

At this point, the Firm's distress became evident to markets, and its continued existence was in question. Eventually, BBBY drew the attention of the retail investor hordes driving the "meme-stock" craze. Bloomberg columnist Matt Levine retains two criteria to become a meme stock. Namely: 1. A troubled financial situation, and 2. Nostalgia value. BBBY, a household name, certainly satisfied both of these, and simply needed a catalyst to drive attention forward. Enter Ryan Cohen, the infamous founder of E-Commerce start-up Chewy. Cohen famously joined the board of Gamestop and oversaw it's exploding share price in 2021. In 2022, Cohen's investment firm took a large stake in Bed Bath, leading to BBBY's largest gain in share price in 30 years, with its public equity price rising as much as 86%.

More Recent Struggles

Despite Cohen's temporary involvement with the firm, the financial performance of BBBY in 2022 was marked by a 83% decrease in its share price and unusual volatility, with a 1-Year Beta of 2.33, which was much higher than both its historical number and its peers' median of 1.38. Its status as a "meme stock" contributed to this significantly, leading to investors making decisions that would appear to be irrational, such as buying millions of shares in a business that was on the verge of failing.

On the one hand, the company took advantage of this status. Because traders would continue to purchase BBBY's shares, the firm was able to sell a considerable amount of stock to retail investors and raise money. During the year of 2021, when the 'meme stock' phenomenon was probably at its peak, the firm was actually engaged in a stock repurchase plan. In 2022, however, it significantly changed its approach and tried to exploit bursts of bullish pressure. Setting the maximum aggregate offering amount at up to $150m, the company registered in a prospectus supplement, filed in August 2022, additional shares of its common stock as available for sale under its current at-the-market offering program. Notably, the company had already sold twelve million shares for approximately $75m in gross proceeds that same year. These numbers become particularly significant when considering that BBBY's market capitalization over the course of 2022 declined from $1.40bn to less than $300m, thus making the funds raised through the shares offering an extremely high percentage of its market capitalization, implying massive dilution for the existing shareholders.

On the other hand, being a meme stock was the reason behind a massive drop in BBBY share price in August 2022, from which it never recovered. When meme stock symbol investor Ryan Cohen sold his 12% stake in the company and the call options he held to record a gain of about $60m, the company's valuation suffered greatly, falling more than 40% in pre-market trading. According to securities filings, his investment vehicle RC Ventures bought the position at an average price of $15.34 earlier that year and was able to sell it for between $18.68 and $29.21. Given the nature of the trade and the connection to the controversial topic of meme stocks, some made accusations of a pump and dump scheme. Cohen was free to buy or sell his position and made no false statements about the company, but it is arguable that he had subtly manipulated the general perception of it. In fact, both a letter to the board and a social media post that followed the stake purchase could have reasonably led an investor to think that he planned to hold his position for the long term. Considering his following in the community of meme stock investors, who tend to replicate his trades, this aspect can't be ignored – as a matter of fact, the surge in BBBY share price came after the public announcement of Ryan Cohen's investment. He offered no reason for, nor did he comment on, his decision to sell his stake. Perhaps unsurprisingly, the parties involved in this transaction – Bed Bath & Beyond, Mr. Cohen, and JP Morgan [JPM: NYSE] for effectuating the sales – found themselves at the center of a lawsuit alleging that Mr. Cohen had engaged in market manipulation to raise the stock price and then sell his holdings in the business. It claimed that he failed to disclose in public filings his intentions to sell his stake and that he sent an ambiguous tweet that his devoted followers would interpret as a recommendation to increase their holdings. The lawsuit was filed by an attorney from Virginia, Pengcheng Si, who claims to have lost more than $100,000 from the supposedly orchestrated scheme and intends to turn his suit into a class-action complaint.

In September 2022, the situation took a tragic turn when the company's CFO, Gustavo Arnal, took his own life by jumping out of his luxury apartment in Manhattan. He had joined BBBY in 2020 and was named among the defendants in the lawsuit for having sold more than 50,000 shares of the company - worth $1.4m - right before Cohen's exit. The sale occurred in accordance with a prearranged trading plan, but just before he committed suicide he was reportedly overwhelmed with inquiries about the transaction, causing him particular stress according to friends and coworkers.

For what concerns the year 2023, it began with BBBY declaring that it was thinking about filing for bankruptcy. When it received a notice of default in January for breaching its loan covenants related to its credit line with JP Morgan, the situation was further aggravated. Consequently, JP Morgan demanded repayment of the entire principal on all loans made to BBBY. BBBY claimed that it did not have the required amount - greater than $1bn - and acknowledged that such a situation made it even more difficult for it to complete asset sales or acquisitions as well as to carry out business operations. BBBY could postpone bankruptcy in this instance only thanks to a last-minute and controversial agreement, signed in February 2023 with the hedge fund Hudson Bay, by which it attempted to raise $1bn through a more structurally complex share sale.

Innovative Financing

Since the arrival of Sue Gove as the company's new CEO in August 2022, BBBY made numerous attempts to turn its business around. The company looked at many options before finally turning to the innovative and controversial

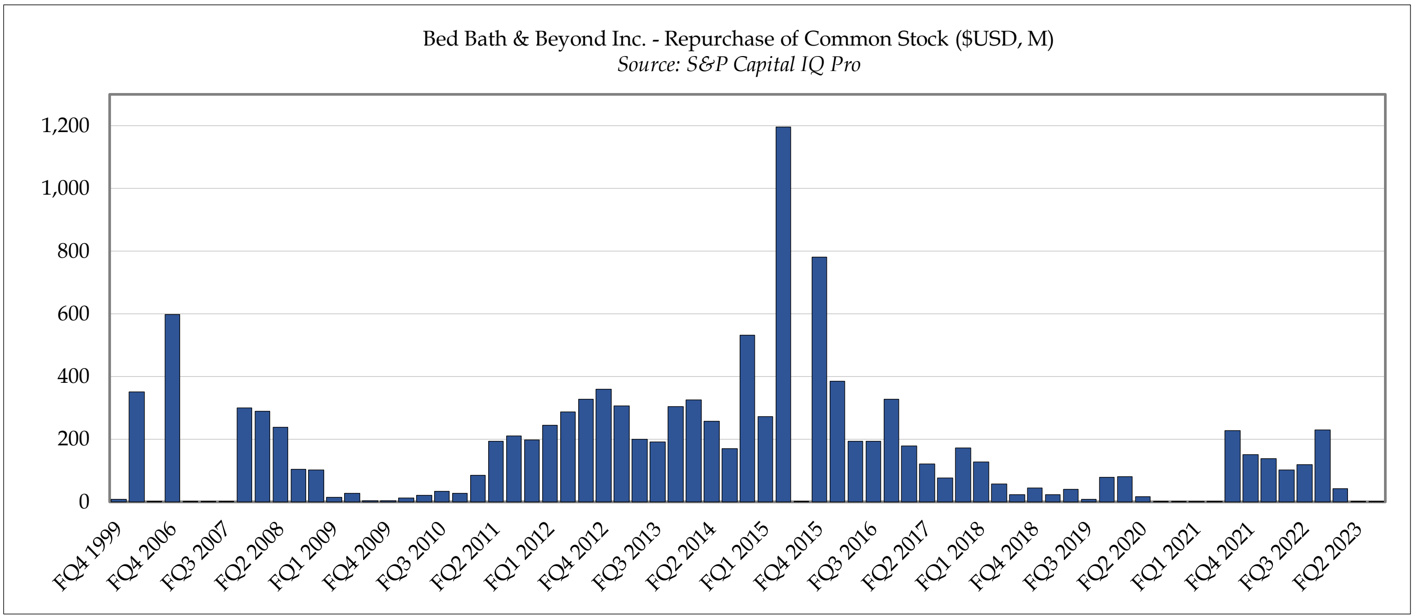
Hudson Bay deal. They first tried to survive by reducing their capital expenditure, closing stores and letting go of 20% of their staff members employed in stores and the supply chain. Furthermore, the business was able to secure $500m in new financing. This was enabled by a new $375m "first-in-last-out" facility led by Sixth Street Partners and an expansion of a $1.13bn asset-backed revolving credit facility with JP Morgan. On top of that, it intended to raise funds by selling additional shares to the market, allocating a portion of the proceeds to debt repayment.

Last October, in order to reduce its debt load and defer its maturities, BBBY advanced a Debt exchange offer. If creditors would have acceptedsuch an offer, they would have lost money but at least have been guaranteed a payment. The offer consisted in buying back senior unsecured notes due in 2024 with a 3.749% coupon – that were trading at 31 cents on the dollar – in exchange for secured notes due in 2027. More precisely, holders had the option to convert their note either at par for a lower 3.693% coupon or with new convertible debt at 8.821% interest but with a 59% cut on the principal. S&P Global Ratings downgraded BBBY's corporate credit rating for what appeared to be a "distressed offer" and only 18% of the shorter-term unsecured debt was converted, showing that this move was not well received.

The company then announced, at the start of this year, that it was looking for a buyer who could save it with a cash infusion. However, no offer was advanced and all the company's efforts to reduce the debt exposure were ultimately unsuccessful; with JP Morgan's notice of default, BBBY was facing an impending bankruptcy and liquidation. Relying on a creative financing arrangement, the company tried to obtain some short-term financing by leveraging the fact that investors were still betting on the company by buying its equity, as the had an equity market capitalization of between $300m and $400m at the beginning of February. By selling increasing numbers of additional shares of the company to the public, the goal was to generate enough revenue from the operation to lower the debt position and turn the business around. This would unavoidably dilute the stocks' value, but more gradually than in the event of bankruptcy; the challenge was to persuade investors to invest more money in a failing company. Ultimately, BBBY decided to sell shares through a hedge fund, Hudson Bay Capital, which provided a number of significant benefits, including the ability for the company to receive cash up front and a contribution to the operation's "confusing" nature for investors. From a technical perspective, BBBY was selling convertible preferred stock to Hudson Bay. Hudson Bay would then convert the preferred stock into common stock at a 20% discount to the current trading price, and then sell the new common stock to make a profit. In order for this to work, the hedge fund needed a margin on the price; so, if the stock price dropped below $1.25 from its starting point of $3, the ongoing deal would be terminated. The deal's structure involved a $225m initial sale followed by the issuance of warrants to Hudson Bay to purchase $800m worth of additional preferred stock. Bed Bath was in the position to demand that the counterparty exercise these warrants, as long as the aforementioned condition was satisfied.

The deal ended on March 30 due to BBBY shares consistently falling below the threshold. In accordance with the original stipulation, Hudson Bay was required to complete a final purchase of additional convertible preferred stock for the equivalent of ten million common shares – which on the 30th of March sold on the market for around 60 cents. BBBY raised $360m with this operation alone, counting the $225m obtained with the initial sale and an additional $135m out of the $800m it planned for, coming from the warrants exercised until the deal terminated. But in doing so, it reduced its stock price by 75% and increased the number of shares by more than threefold – notably, it raised funds for a value almost equal to the of its entire market capitalization. From the operation, Hudson Bay likely earned a total of $84m in profit. In an indeal world, the company would have used the proceeds from the share sales to renovate its stores and boost sales in order to survive and turn around the business. However, under the terms of the second amended credit agreement for its asset backed loan facility with JP Morgan, BBBY was required to direct the funds obtained by this operation to repay such loans. This crucial fact had been disclosed by the company in a Form 8-K of February 6, making it all the more astonishing that investors would have been willing to "invest" in a company that was, in fact, almost certainly doomed.

As of March 2023, BBBY stock was near worthless, trading at under $1 over-the-counter. However, the Firm's aggressive buyback program returned significant capital to long-term investors. The program was even sustained following the pandemic and in the quarters leading up to BBBY's bankruptcy. In fact, the Firm spent $11.8bn buying back its own shares since 2004. While some reports are critical of this corporate finance decision, arguing that the Firm would have been better served with other uses of capital such as debt paydown, others consider the sustained buybacks as an elegant way to manage a failing company. An equity holder since 2004 would have been paid back ~94% of their investment in cash buybacks. Regardless of one's view on management's decisions, shareholders are now faced with the likely reality of a liquidation scenario, although the corporate restructuring team still retains some hope of maintaing BBBY as a going concern.



Bankruptcy

Despite Bed Bath's aggressive efforts to access new capital, the Firm filed for bankruptcy on April 23, 2023. In December 2022, BBBY triggered defaults on multiple financing facilities, beginning its descent into a chapter 11 Filing. The Firm also announced a $240m, super-senior debtor-in-possession financing facility from Sixth Street, in order to finance compensation and capital needs during the liquidation process. Although restructuring advisor Lazard [LAZ: NYSE] spent months trying to find a potential buyer, the Firm continues to struggle in this regard, and a potential acquisition emerging out of the woodwork this late in the process is exceedingly unlikely.

Due to the sheer amount of share issuance preceding the bankruptcy filing, questions arise regarding regulatory investigations into the Firm's practice of new share issuance. On the one hand, management was likely aware of the firms' slim prospects of escaping bankruptcy and issued equity which would end up worthless in the majority of cases. On the other hand, the risks and use of additional equity investment were abundantly and clearly defined in the prospectus issued prior to the Hudson Bay deal, which stated that new funds would be used to pay down debt higher in the capital structure. Effectively, retail investors purchased 622 million shares of BBBY with full public knowledge of the firm's weak position – as well as knowledge of their standing in the capital structure (little to no recovery in a likely liquidation scenario). A similar issuance occurred during the Hertz [HTZ: NASDAQ]

Ch. 11 process, where "meme-stock" investors drove up the share price, and management attempted to capitalize on the price movement by issuing additional shares. However, although Hertz disclosed the erratic and irrational price movements of its shares, as well as its bankrupt status in regulatory filings, the SEC still halted the proposed issuance. Although BBBY issued shares well before its official chapter 11 filing, one might imagine that investors who had their equity investments directly funnelled to creditors (and later vaporized in the liquidation process) may be upset with BBBY's actions. This is a difficult battle to prove, given the extensive disclosures included in BBBY's prospectus, but we may expect some sort of legal action nonetheless. In the meantime, the BBBY odyssey is winding down, with long-term shareholder returns still bolstered due to consistent capital returned during buybacks over time, and some creditors receiving reasonable restitutions on their outstanding debts as a result of the liquidation process during a high-demand time period for retail space.

Conclusion

Whilst it is not yet clear which debtors will obtain how much recovery on their loans, we know that the current shareholders are to be wiped out. Through the massive volume of share buybacks that the firm conducted throughout the past two decades, however, long term investors will still only leave with a very modest loss, as over 90% of their shares were repurchased. Some might call this a peculiar example of where it paid to be a long-term investor. In any case, the innovative financing structures that the firm used in its desparate attempts to stay alive will prove a good learning case study for market participants, as this is surely not the last such a bankruptcy. Also, as the retail investors that blindly followed Bed Bath & Beyond's hype are highly likely to loose all of their investment, we are shown once again that there is no substitute for knowing and understanding what you are investing in.

TAGS: Bed Bath & Beyond, Restructuring, Bankruptcy, Sixth Street, JP Morgan, Ryan Cohen