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More red flags up at Borders

Analysts: Chapter 11 an option; company needs a strategy, too

Daniel Duggan

Withholding payments to suppliers, senior executives resigning and difficulty getting loans are among the red flags being raised by Ann Arbor-based Borders Group Inc.

The recent moves have financial analysts urging caution of a near-term bankruptcy, and Wall Street is worrying about a company that leases office space to Borders.

And even with Chapter 11 as an option, there are questions of whether that will solve the problems.

"Right now they're mired in problems with their balance-sheet woes; and they're in a transforming industry, but they don't have the capital to alter their business enough to compete," said Mike Souers, an industry analyst covering Borders for S&P Equity Research.

Souers downgraded Borders last week, setting a price target of 50 cents on the stock -- which traded at a 12-month high of \$1.60 and an all-time high of \$37 in 1998. The stock closed Friday at \$.

He said that restructuring debt is a priority for the company and that a Chapter 11 bankruptcy filing may resolve some of the issues. By restructuring its debt to a lower level, and terminating leases where stores are unprofitable, the company will have more money to devote to competing online and at the remaining stores.

But it needs a strategy as well.

"If they could emerge from a Chapter 11 filing, they still don't have the kind of e-book strategy in place to really compete," Souers said. "Close to 10 percent of book sales are online now, and if it keeps growing at the current pace, we're looking at 25, maybe 30 percent of all sales in the next five years."

Borders Corporate Affairs Manager Mary Davis said the company is taking steps to improve liquidity and restructure the organization. The company does not comment on outside opinions about Borders, she said.

"We are in discussions with potential lenders for replacement financing and are meeting with certain vendors to discuss financing arrangements," she said in an e-mail. "We are seeking to restructure our finances and are not in a liquidity crisis."

Investors also showed optimism Friday morning after a story in The Wall Street Journal indicated Borders is meeting with investment advisers to restructure debt, and not meeting with bankruptcy attorneys.

Mass resignations

Also crippling Borders is lack of executive firepower as the company started 2011 with five resignations.

Thomas Carney, executive vice president, secretary and general counsel, resigned on Jan. 2, and D. Scott Laverty, senior vice president and chief information officer, resigned the following day.

Additionally, the firm's vice president of real estate, Tony Grant; the senior vice president of marketing, Bill Dandy; and the senior vice president of business development, Larry Norton, were eliminated as part of a restructuring, Davis said.

With Carney and Laverty's resignations, the remaining three executives on the "management" portion of the company's website have been appointed in the past year.

The CEO, Bennett Lebow, was named in June as part of taking the largest ownership stake in the company, making the previous CEO, Mike Edwards, president and CEO of Borders Group subsidiary Borders Inc.

Edwards, however, only had been CEO since Ron Marshall left the post in January 2010.

Another high-level resignation came in August when CFO Mark Bierley resigned. He was replaced by Scott Henry.

The company's chief accounting officer, Glen Tomaszewski, was named interim CFO in August then later moved to his current position.

Also in flux has been the board of directors, with five members resigning in summer 2009.

Suppliers

Borders' relationship with the companies that supply books has generated a lot of attention since the company announced on Dec. 30 that it is delaying payments to some suppliers as it seeks to restructure payments.

That news prompted New York-based Rowman and Littlefield to stop making shipments to Borders stores.

"When a customer of that size calls you up and says you aren't getting a check, that's a piece of information you have to act on," the company's CEO, Jed Lyons, told The Wall Street Journal.

Borders also said there can be no assurance that its larger refinancing efforts will be successful and that it could violate its existing credit agreements and experience a liquidity shortfall in the first quarter this year.

Last week, rumors began to circulate that some suppliers will continue to ship books and will accept interest-bearing debt instead of a payment. The move prompted a statement by competitor Barnes & Noble Inc.

"We think the playing field should be even," according to the statement. "We expect publishers to offer the same terms to all other booksellers, including Barnes & Noble and independent booksellers.

"We fully expect publishers will require Borders to pay their bills on the same basis upon which all other booksellers pay theirs. Any changes in publisher terms should be made available to all."

Borders has been seeking a financing agreement to consolidate its debt but has not been able to secure new debt, according to multiple reports last week.

Ann Arbor impact

Borders started as the Borders Book Shop, which Tom and Louis Borders opened in 1971 on State Street near the University of Michigan campus.

After being purchased by Kmart, built into a national company and spun off in a 1995 IPO, the company has grown to 19,500 employees. The original store closed and Borders took over a former Jacobson's department store only a block away, at 612 E. Liberty St.

Ann Arbor Mayor John Hieftje said the city has always embraced Borders and is hopeful for its future. In the event of a Chapter 11 filing, he said, the headquarters would likely remain in Ann Arbor, though with fewer people.

While the loss of employees would hurt, Hieftje also worries about the retail space

"If the company were to fold altogether, the biggest blow to the city would be the big hole in the downtown," Hieftje said. "While it would be disappointing, the downtown market has been hot and I wouldn't be surprised to see that retail space snapped up."

The Borders headquarters building at 100 Phoenix Drive, south of I-94 near Briarwood Mall, is owned by the Farmington Hills-based real estate investment trust Agree Realty Trust (NYSE: ADC).

Last week, Agree's share price dropped after Janney Capital Markets analyst Andrew DiZio downgraded the company's stock based on the 16 leases it has with Borders.

With the stock trading at \$26.07 per share on Monday, DiZio downgraded the stock from "buy" to "neutral" based on the impact that speculation of a bankruptcy is having.

However, DiZio said that the impact on Agree will be minimal if Borders goes into bankruptcy. He concluded that if Agree lost all of the revenue from Borders leases, the company would still have a fair value of \$24 per share.

With Agree stock closing at \$23.30 on Friday, it actually could increase after a bankruptcy.

"This company has always traded at a discount to its peers, and without Borders in the portfolio, that discount would go away," he said.

With a Borders financing agreement instead of a bankruptcy, DiZio set a \$27 price target.

Writing on the wall?

Are the recent moves by Borders following the signs of a company about to file bankruptcy?

"Yes," said Jim McTevia, managing partner of Bingham Farms-based business consulting firm McTevia & Associates LLC.

Having seen countless companies head into bankruptcy court, McTevia said Borders is doing what most do: preserving cash, delaying payments to vendors and struggling to find financing.

"Marshalling cash, conserving cash, that's what companies that go into Chapter 11 need in order to have enough cash to stay alive while they're in bankruptcy," McTevia said. "Enough so they don't become Chapter 7 and liquidate."

He added that Borders might be having a hard time finding financing because it is such a risk right now.

The Detroit 3 automakers are perfect examples of how hard it can be to find financing when business starts to get dire, McTevia said.

As things started to tighten, Ford Motor Co. picked up enough debt to stave off a bankruptcy, while the former General Motors Corp. and the former Chrysler LLC were too late and couldn't get enough money.

"Now, GM and Chrysler were able to knock on the door of the U.S. taxpayer and get it from us," he said. "I don't think Borders will have that option."

But, said Ann Arbor's Hieftje, comparing Borders to the domestic automakers shows that there could be light at the end of the tunnel.

"In the event that Borders enters bankruptcy, they'll emerge," he said. "If you look at GM and Chrysler, they're doing well now and making money."

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