MERCER CAPITAL
BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

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Issue No. 1, 2021

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2021 Tax Update

As valuation professionals, we aim to be an equal partner in the tax planning process with estate attorneys and advisors for businesses and high-net-worth individuals. Our goal is to actively participate in the estate planning process.

Recently, we had the opportunity to attend (virtually) the **Estate Planning Council of Greater Miami's 9th Annual Estate Planning Symposium** for a day of networking and presentations. **Stephen Akers**, Senior Fiduciary Counsel at Bessemer Trust, highlighted several legislative developments in the tax arena, with the most notable proposals including:

- Acceleration or alteration of the estate-tax exemption
- Ending basis step-up at death on capital gains exceeding $100,000
- Raising corporate tax rate from 21% to 28%
- Tax capital gains as ordinary income for taxpayers with income over $1 million
- Raise top income tax bracket from 37% to 39.6%
- Limit itemized deductions to no more than 28% of deductions
- Restore Pease limitation for incomes over $400,000
- Phase out 199A deduction for QBI above $400,000
- Eliminate like-kind exchanges

More recently, Senator Elizabeth Warren has introduced legislation to create a **tax on household wealth** above certain threshold levels. This would necessitate annual (or some periodic) top-to-bottom appraisal of families and individuals' assets to levy such a tax.

While we do not wish to opine on the pros and cons of the listed tax policies, practitioners cannot simply wait and see what will happen. However, we also realize that if you work to create wealth plans for everything that may happen, you may unnecessarily overwork (and worry) your clients. We gathered thoughts on these proposals and talked to a smattering of estate and wealth planning professionals to get their thoughts on the most impactful pieces of tax legislation.

J. Mark King, CFP is the President & CCO at C&J Wealth Advisors, a wealth management firm based in Tennessee. King was rather bullish on taxes rising under current political leadership.

"My belief regarding taxes is that anything which changed under the Trump tax proposal is fair game to the current party in control," said King. "Some of this rests on how robust the economic recovery is once the U.S. and the rest of the world open back."

King saw the most likely changes including a lowering in the estate tax exemption, an increase in the federal corporate tax rate, and an increase in the top personal income tax bracket.

Patrick Baumann, CFA, CTP, is the Chief Investment Officer and Partner at FourThought Private Wealth, an independent RIA based in Florida. Baumann predicts an increase in the corporate tax rate, an increase in the top personal income tax bracket, and a form of a wealth tax as the most likely tax proposals that could come to fruition.

"I do anticipate an inflection point with our fiscal policies as our economy continues to recover," said Baumann. "Congress will have to shift its agenda from stimulating the economy to focusing on initiatives supporting our aggressive stimulus programs and infrastructure investment."

Baumann saw the basis step-up at death as safe, a sentiment shared by **Garrett Watson**, Senior Policy Analyst at the Tax Foundation. In a **late 2020 Barron's piece** covering President Biden's tax policy, Watson indicated one aspect of Biden's plan would be dead on arrival in Congress: an elimination of the step-up in cost basis at death, citing administrative hurdles as well as political friction. This reasoning led Watson to see an increase in tax rates on capital gains over

$1 million from 20% to 39.6% and a new 12.4% payroll tax on earnings over $400,000 holding less opportunity to pass.

Watson cites two most likely changes – an increase in the corporate tax rate to 28% and an increase in the top personal income tax bracket. These changes would unwind portions of the TCJA (Tax Cuts and Jobs Act of 2017), making implementation easier to pull off. A reduction in the estate tax exemption would also fall into this category.

Baumann echoed Watson's sentiment in our discussion. "The December 2017 Tax Cuts and Jobs Act contains provisions, including sunset, that will revert to the regulations in effect before the 2017 Act." He agreed that this will make anything currently not set in stone easier to roll back.

One thing was clear, however. The belief is that taxes are going up. The *New York Times* ran a piece titled ***It May Be Time to Start Worrying About the Estate Tax***, citing similar factors as mentioned. Professionals should be positioning their clients for larger tax bills.

Baumann also opined "…it is not a question as to if our taxes will increase, but rather when." King indicated any tax change in the headlines as "in play."

"I don't think many HNW [high-net-worth] families and their advisors have adequately planned for what's likely coming later this year or next," said **Brooks Hamner, CFA, ASA,** Vice President, and a senior member of Mercer Capital's Investment Management Industry team.

"Biden's most recent proposal calls for a 50% reduction in the Unified Tax Credit (the exemption on gift and estate taxes), elimination of the cost basis step-up upon death, and increases to the capital gains and personal income tax rate for high earners. Financial advisors should be imploring their HNW clients to do some significant estate planning to take advantage of the current high level of exemptions and low tax environment before it is too late. We've seen some of this but not nearly enough." It's clear many are taking a wait-and-see approach.

So how can tax and estate professionals be proactive? **Travis Harms, CFA, CPA/ABV,** Senior Vice President, leads Mercer Capital's Family Business Advisory Services Group and regularly works with family businesses regarding tax and estate issues. In the next article, Travis has provided a to-do list of important estate tax tasks to undertake for family business owners and tax professionals.

Mercer Capital has written extensively on estate tax planning and other tax topics. We have included some of our most popular articles below.

- **Estate Tax Planning May Be the Next Surprise for RIA Community | Mercer Capital**
- **A 2021 Estate Planning Reader | Mercer Capital**
- **Estate Planning Opportunities in the Current Environment | Mercer Capital**

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Family Business Director's Planning for Estate Taxes To-Do List

Excerpted from Mercer Capital's *Family Business Director Blog*

Family business leaders cannot afford to ignore estate taxes. While it is true that the legal burden of the estate tax falls to individual shareholders rather than the family business itself, many family shareholders have not accumulated sufficient liquidity to pay estate taxes without some action on the part of the company. The required actions may range from a shareholder loan to a special dividend to sale of the business. **As we've noted numerous times** in the past few months, there are good reasons to focus on estate planning right now.

- The fair market value of many family business ownership interests is depressed because of the negative impact of the pandemic.
- Applicable federal rates are quite low, which increases the effectiveness of many of the more sophisticated estate planning techniques.
- Political uncertainty is high, and the Biden campaign has indicated that estate tax reform would be a priority if elected.

In this article, we provide a to-do list of important tasks for family business directors seeking to help prevent, or at least minimize, unhappy surprises resulting from the estate tax.

Review the Current Shareholder List/ Ownership Structure for the Family Business

In family businesses, the lines between family membership, influence, employment, economic benefit from the business, and actual ownership can be blurry. Based on the current shareholder list, are there any shareholders that – were the unexpected to happen – would be facing a significant estate tax liability? Are there potential ownership transfers that would not only alleviate estate tax exposure, but also accomplish broader business continuity, **shareholder engagement**, and family harmony objectives?

Obtain a Current Opinion of the Fair Market Value of the Business at the Relevant Levels of Value

A current valuation opinion is essential to quantifying existing exposures as well as facilitating the desired intra-family ownership transfers. If you don't have a satisfactory, ongoing relationship with a business appraiser, the first step is to retain a qualified independent business valuation profes-

sional (we have plenty to choose from **here**). You should select an appraiser that has experience valuing family businesses for this purpose, has a good reputation, understands the dynamics of your industry, and has appropriate credentials from a reputable professional organization, such as the **American Institute of Certified Public Accountants (AICPA)** or the **American Society of Appraisers (ASA)**.

The valuation report should demonstrate a thorough understanding of your business and its position within your industry. It should contain a clear description of the valuation methods relied upon (and why), valuation assumptions made (with appropriate support), and market data used for support. You should be able to recognize your family business as the one being valued, and when finished reading the report, you should know both what the valuation conclusion is and why it is reasonable.

The appraisal should clearly identify the appropriate **level of value**. If one of your family shareholders owns a controlling interest in the business, the fair market value per share of that controlling interest will exceed the fair market value per share of otherwise identical shares that comprise a non-controlling, or minority, interest. Having identified the appropriate level of value, the appraisal should clearly set forth the valuation discounts or premiums used to derive the final conclusion of value and the base to which those adjustments were applied.

For example, many common valuation methods yield conclusions of value at the marketable minority level of value. In other words, the concluded value is a proxy for what the shares of the family business would trade for if the company were public. Some refer to this as the "as-if-freely-traded" level of value.

- If the subject interest is a minority ownership interest in your privately held family business, however, an adjustment is required to reflect the lack of marketability inherent in the shares. All else equal, investors desire ready liquidity, and when faced with a potentially lengthy holding period of unknown duration, investors impose a discount on what would otherwise be the value of the interest on account of the incremental risks associated with holding a nonmarketable interest. In such a case, the appraiser should apply a marketability discount to the base marketable minority indication of value.
- On the other hand, if the subject interest represents a controlling interest in the family business, a valuation premium may be appropriate. The "as-if-freely-traded" value assumes that the owner of the interest cannot unilaterally make strategic or financial decisions on behalf of the family business. If the subject interest does have the ability to do so, a hypothetical investor may perceive incremental value in the interest. Such premiums are not automatic, however, and a discussion of the facts and circumstances that can contribute to such premiums is beyond the scope of this post.

We occasionally hear family shareholders express the sentiment that, since gift and estate taxes are based on fair market value, the lower the valuation the better. This belief is short-sighted and potentially costly. For one, gift and estate tax returns do get audited, and the "savings" from an artificially low business valuation can evaporate quickly in the form of incremental professional fees, interest, penalties, and sleepless nights when the valuation is exposed as unsupportable.

Perhaps even more importantly, an artificially low business valuation introduces unhealthy distortion into ownership transition, shareholder realignment, shareholder liquidity, distribution, capital structure, and capital budgeting decisions. The distorting influence of an artificially low valuation can have negative consequences for your family business long after any tax "savings" become a distant memory. While the valuation of family businesses is always a range concept, the estimate of fair market value should reasonably reflect the financial performance and condition of the family business, market conditions, and the outlook for the future.

Identify Current Estate Tax Exposures and Develop a Funding Plan for Meeting Those Obligations When They Arise

With the appraisal in hand, you can begin to quantify current estate tax exposures and, perhaps more importantly,

begin to forecast where such exposures might arise in the future if expected business growth is achieved. Are shareholders prepared to fund their estate tax liability out of liquid assets, or will shareholders be looking to the family business to redeem shares or make special distributions to fund estate tax obligations? If so, does the family business have the financial capacity to support such activities? The most advantageous time to secure financing commitments from lenders is before you need the money. What is the risk that an estate tax liability could force the sale of the business as a whole? If so, what preliminary steps can directors take to help ensure that the business is, in fact, ready for sale and that such a sale could occur on terms that are favorable to the family?

Identify Tax and Non-Tax Goals of the Estate Planning Process

As suggested throughout this article, while prudent tax planning is important, it can be foolish to let the desire to minimize tax payments completely overwhelm the other long-term strategic objectives of the family business. If there was no estate tax, what evolution in share ownership would be most desirable for your family and business? The overall goal of estate planning should be to accomplish those transfers in the most tax-efficient manner possible, not to subordinate the broader business goals to saving tax dollars in the present.

The professionals in our family business advisory services practice have decades of experience helping family businesses execute estate planning programs by providing independent valuation opinions. Give one of our professionals a call to help you get started on knocking out your to-do list today.

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Restricted Stock Discounts: The Expected Holding Period Premium Is the Cause

Excerpted from Chris Mercer's Blog

What does a restricted stock discount measure? This discount measures the difference between two prices. We define the restricted stock discount (RSD) in Exhibit 8.1 of ***Business Valuation: An Integrated Theory Third Edition***. I don't think anyone will disagree with the definition.

$$RSD = 1 \quad \frac{\textit{Purchase Price per Share for Restricted Shares}}{\textit{Market Price per Share for Issuer's Unrestricted Shares}}$$

$$RSD = 1 \quad \frac{\$15.00}{\$20.00} = 25\%$$

Exhibit 8.1 Definition and Calculation of Restricted Stock Discount

The purchase price per share for the restricted shares is the price at which the restricted shares were issued. The market price for the issuer's unrestricted shares is observed for the same day.

In this example, a closed-end fund made an investment in restricted shares of PubliCo at $15.00 per share. The freely traded price on the day of the transaction was reported at $20.00 per share. As we see in the exhibit above, this transaction would have been recorded as showing a restricted stock discount (RSD) of 25.0%.

This 25.0% discount measures the difference between two prices, and nothing more. The primary inferences we can draw based on the available information are that:

- The restricted stock transaction occurred at a price of $15.00 per share
- PubliCo's unrestricted shares traded at $20.00 per share at the time of the transaction
- The restricted stock transaction price was $5.00 per share lower than the freely traded price
- The restricted stock transaction price was 25.0% lower than the price of PubliCo's otherwise identical but freely tradable shares on that date
- Publico's unrestricted shares closed at a price $5.00 per share higher than the transaction price in its restricted shares on that date
- PubliCo's unrestricted shares closed at a 33.3% premium to the restricted stock transaction on that date

The bottom line is that any restricted stock discount measures the difference between two prices. There is no economic evidence in any one or any average of discounts that provides direct economic evidence of **why** any transaction was priced as it was.

Given the hypothetical transaction in Exhibit 8.1 above, what information was available to public market participants and to investors in restricted shares? Exhibit 8.2 provides a summary.

Available Information for Investors on Dates of Restricted Stock Transactions	
Shares of Freely Tradable Stock	**Restricted Shares**
Historical operating performance	Same
Historical stock performance	Same
Available analysts' expectations/outlook	Same
Available public disclosure	Same
Expectations for future performance imbedded in current stock price	Same
Inferences regarding public required returns based on current stock price	Same
Knowledge that freely traded shares can be sold at any time for their then current market prices (no enforced holding period, so no holding period premium return)	Same

Exhibit 8.2 Restricted vs. Freely Traded Shares

Except for the restrictions on trading imposed by SEC Rule 144, restricted shares of publicly traded companies are identical to their freely-traded counterparts. Exhibit 8.2 focuses on the similarities between the shares from the viewpoint of market participants and valuation analysts. What is clear about the restricted shares is that, on transaction dates, investors had access to all information available to public investors in each company's publicly traded shares.

To understand why restricted shares were usually traded at discounts (and often steep discounts, to their freely traded counterparts) we have to understand how restricted shares differ. The answer lies in the information available to the managers of issuing public companies and to investors purchasing their restricted shares, as summarized in Exhibit 8.3.

Like all transactions, restricted share issuances were the product of negotiation between two or more parties with adverse interests. The issuer of restricted shares is motivated to receive the higher issuance price possible (i.e., to negotiate the smallest possible discount). Buyers of restricted shares,

Available Information for Investors on Dates of Restricted Stock Transactions	
What Else is Known by Both Parties? Issuers of Restricted Shares	**What Else is Known by Both Parties? Purchasers of Restricted Shares**
The funds from restricted transactions are needed to finance their companies and is not available from a cheaper source (if it were not so, they would find the cheaper alternative financings)	Knowledge that restricted shares are restricted from transfer for two or three years (or more, effectively, for large blocks) and that any discount to public prices represent that result of a holding period premium return for the extra risk of illiquidity
As when selling anything, performance matters. More attractive investments should trade at lower restricted stock discounts that poorer performing companies	When buying, better performing companies are more attractive to a wider spectrum of buyers, and price may have to be bid up (restricted stock discounts lowered) to obtain them

Exhibit 8.3 Restricted vs. Freely Traded Shares

on the other hand, were motivated to achieve the lowest possible issuance price (i.e., the highest possible discount). As the text in Exhibit 8.3 indicates, the observed discounts reflect the relative negotiating leverage of the parties.

We engage in a bit of simple logic here. There is little doubt that in the early restricted stock studies, significant discounts to publicly traded prices of issuers were observed. The difference in prices is referred to as the restricted stock discount (RSD). So, the restricted stock price can be described as in Exhibit 8.8.

$$V_{rs} = V_{ft} - RSD$$

Exhibit 8.8
The Restricted Stock Discount

The question to be answered is this: what causes restricted stock discounts? The answer flows from the analysis above. The expected cash flows and expected growth for restricted shares of the same public company on the same day of issuance are the same. The only thing that could be different is the perception of risk over the required expected holding period of illiquidity for the restricted shares.

We employ the Gordon Model in Exhibit 3.10 to illustrate.

$$V_{rsd}\searrow = \frac{\mathbf{CF_1\ (same)}}{\mathbf{r}\nearrow \mathbf{-\ g\ (same)}}$$

Exhibit 3.10
The Gordon Model | Public Restricted Share Price

We see that if V_{rsd} is less than the freely traded price, the only explanation is that the discount rate must be higher for the restricted shares than for the freely-traded shares. This is fairly obvious from this brief analysis.

We call the difference in discount rates between the freely traded pricing (which would be r) and the restricted share pricing the expected holding period premium to the discount rate, or HPP. In ***Business Valuation: An Integrated Theory Third Edition***, we illustrate this symbolically as in Exhibit 3.11. The book is available on Amazon.com.

$$V_{rsd} = \frac{CF_1 \text{ (same)}}{(r + HPP) - g \text{ (same)}}$$

Exhibit 3.11
The Gordon Model | Symbolic Representation of Restricted Shares

We discussed the Silber Study, which was published in 1991, in the **previous post in this series**. That study showed many years ago that more attractive companies (i.e., those with less risk) issued restricted shares at lower discounts than less attractive companies (with more risk). As a profession, we should have clued into this fact some three decades ago.

In the meantime, order your copy of ***Business Valuation: An Integrated Theory Third Edition***.

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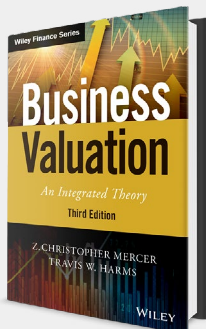

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The revised and updated third edition of *Business Valuation: An Integrated Theory* explores the core concepts of the integrated theory of business valuation and adapts the theory to reflect how the market for private business actually works.

In this third edition of their book, the authors, two experts on the topic of business valuation, help readers translate valuation theory into everyday valuation practice. This important updated book:

- Includes an extended review of the core concepts of the integrated theory of business valuation and applies the theory on a total capital basis
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The third edition is the only book available regarding an integrated theory of business valuation, offering an essential, unprecedented resource for business professionals.

The Moral of the Story

Premiums for Control & Valuing Control Shares

How do you appraise controlling interest voting in a large profitable corporation? For example, consider a company with 10% voting shares and 90% non-voting shares. The two classes of shares are identical in all respects apart from voting rights. Many studies of publicly traded, voting versus non-voting shares like the hypothetical company described above reveal that minority voting shares are priced at a small premium to the non-voting shares: typically a 2% to 5% premium. However, what if you had the opportunity to buy all the voting shares? This would allow you to select the Board of Directors, make yourself Chairman of the Board, travel First Class extensively on company business, and take a fair market salary of $1.5 million a year.

Again, consider that the hypothetical company described above has 200,000 common shares outstanding. If all the non-voting shares (180,000 shares) were sold at once and the shares were worth $1,000 each, would this mean that the voting shares (20,000 shares) be worth 4% more than the non-voting shares? A 4% voting premium corresponds to a $40 premium for each voting share. The incremental dollar amount required for total control of the corporation is $800,000.

First, let's test that "answer" with common sense: you could receive benefits of over $2 million a year, for $800,000 – let me buy it. I will mortgage my house. The answer does not make sense. So how much could it be? Of course, it depends on the facts and circumstances of a particular corporation but there are a few transactions over the years that suggest that, if there are no restrictions in the voting power of the voting shares, then a percentage of fair market enterprise value (debt + equity) is appropriate. Many of these transactions suggest the appropriate percentage to be 2% to 5%.

If the shares that represent voting control are 1,000 out of 50,000 total shares and the enterprise is worth $50 million, the "low" cost solution to transferring control could be in the form of an exchange of voting for non-voting shares plus payment of the fair market premium for control to the original voting shareholder. So, if the premium for control was hypothetically 3% of the enterprise value in this example, then the premium for control would be $1.5 million ($50 million x 3%). The transferor of voting control would receive either cash or a note for that amount and 1,000 non-voting shares.

In this example, if interest-bearing debt was $10 million, the equity value would be $40 million. The pro rata equity value at the control level would be $40 million divided by 50,000 shares or $800 a share but the 1,000 control shares would be worth $2,300 per share. If the pro rata minority closely held share required a 30% combined minority and marketability discount, the fair market value per share would be $560 a share. The value of the voting shares would be 4.1 times the value of the minority non-voting shares – not the 3% to 5% difference shown in the publicly traded voting and non-voting minority share example.

At the end of the day, make sure you carefully analyze the facts and circumstances of the subject valuation to avoid a major error when dealing with shares that represent control of large, profitable corporations or partnerships. It all depends, of course, on the facts and circumstances of a particular case.

The Moral of the Story

Do not assume the premium for a minority voting share necessarily has anything to do with the premium paid in a change of control transaction.

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Neiman Marcus: A Restructuring Case Study

The Neiman Marcus Chapter 11 bankruptcy filing raises multiple valuation questions:

- *Fraudulent conveyance (asset stripping) and solvency related to pre-filing asset distributions*
- *Liquidation vs going concern value*
- *Value of the company once it emerges from Chapter 11*
- *Allocation of enterprise value to secured and unsecured creditors*
- *Fresh start accounting*

Neiman Marcus Group, Inc. ("Neiman Marcus" or "Company") is a Dallas, Texas-based holding company that operates four retail brands: Neiman Marcus, Bergdorf Goodman, Last Call (clearance centers), and Horchow (home furnishings). Unlike other department store chains, such as JCPenney and Macys that cater to the mass market, Neiman Marcus's target market is the top 2% of U.S. earners.

Among the notable developments over the last 15 years were two private equity transactions that burdened the Company with a significant debt load and one well-timed acquisition. The debt and acquisition figured prominently in the May 7, 2020 bankruptcy filing in which the company sought to reorganize under Chapter 11 with the backing of most creditors.

Iconic Luxury Retailer to Indebted Morass

History

The iconic Neiman Marcus department store was established in 1907 in Dallas. Over the ensuing decades, the Company prospered as oil wealth in Texas fueled demand for luxury goods. Neiman Marcus merged with Broadway-Hale Stores (later rechristened Carter Hawley Hale Stores, Inc.) in the late 1960s. Additional stores were opened outside of Texas in Atlanta, South Florida, and other wealthy enclaves around the U.S. except for New York where Bergdorf Goodman (acquired in the 1970s) operated two stores.

In 1987, Neiman Marcus along with Bergdorf Goodman was partially spun out as a public company with the remaining shares spun in 1999.

In 2005, the Company was acquired via a $5 billion LBO that was engineered by Texas Pacific Group and Warburg Pincus. Once the economy rebounded sufficiently from the Great Financial Crisis, the PE-owners reportedly sought to exit via an IPO in 2013. However, the IPO never occurred. Instead, the Company was acquired for $6 billion by Ares Management and the Canada Pension Plan Investment Board ("CPPIB").

In 2014 Neiman Marcus acquired MyTheresa, a German luxury e-commerce retailer with annual revenues of $130 million, for $182 million of cash consideration. During 2018, the entity that held the shares of MyTheresa (MyT Holding Co.) was transferred via a series of dividends to the Neiman Marcus holding company directly controlled by Ares and CPPIB and thereby placed the interest out of the reach of Company creditors.

Neiman Marcus filed an S-1 in 2015 in anticipation of becoming a public company again; however, the registration statement was withdrawn due to weak investor demand.

Although Neiman Marcus' common shares had not been publicly traded since 2005, the Company filed with the SEC because its debt was registered. During June 2019, the Company deregistered upon an exchange of new notes and preferred equity for the registered notes. S&P described the restructuring as a selective default because debt investors received less than promised with the original securities.

Review of Financials

Figure 1 below presents a recent summary of the company's financial performance and position one year prior to the bankruptcy filing. Of note is the extremely high debt burden that equated to 12.4x earnings before interest taxes, depreciation, and amortization ("EBITDA") for the last twelve months ("LTM") ended April 27, 2019. Although definitions vary by industry, federal banking regulators consider a company to be "highly levered" if debt exceeds EBITDA by 6x.

Moody's downgraded the Company's corporate credit rating to B3 from B2 in October 2013 with the acquisition by Ares and CPPIB. Moody's also established an initial rating of Caa2 for unsecured notes issued to partially finance the acquisition. By the time the notes were deregistered, Moody's had reduced the corporate rating to Caa3 and the notes to Ca.

Moody's defines Caa as obligations that "are judged to be of poor standing and are subject to very high credit risk," and Ca as obligations that are "highly speculative and are likely in, or very near, default, with some prospect of recovery in principal and interest." Neiman Marcus has struggled with a

Figure 1 : Historical Financials

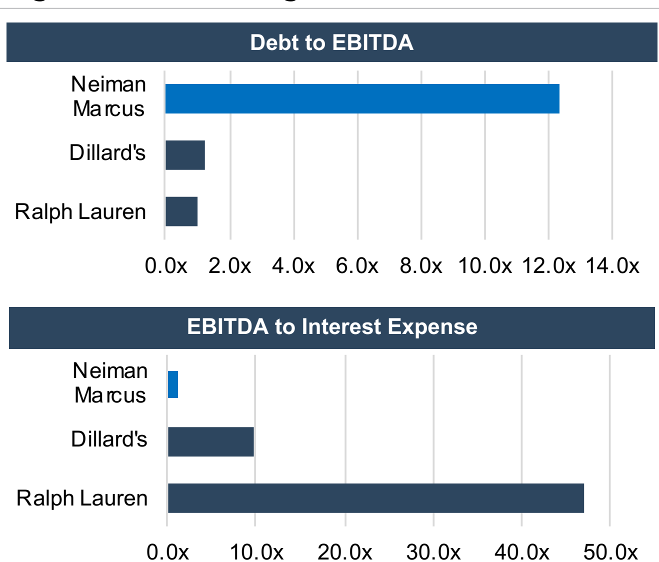
	Fiscal Years Ended				LTM	9 Months Ended	
	8/1/15	7/30/16	7/29/17	7/28/18	4/27/19	4/28/18	4/27/19
Income Statement Items ($M)							
Revenue	**$5,095**	**$4,949**	**$4,706**	**$4,900**	**$4,688**	**$3,768**	**$3,556**
Pretax Income	28	(547)	(749)	(211)	(242)	(89)	(120)
Interest	290	286	296	307	322	230	245
Amortization	137	111	104	98	95	73	70
Depreciation	210	251	250	239	225	181	167
Impairment	0	466	511	0	0	0	0
EBITDA	**$665**	**$567**	**$412**	**$433**	**$400**	**$395**	**$362**
Capex	270	301	205	175	197	110	132
EBITDA - Capex	**$395**	**$266**	**$207**	**$258**	**$203**	**$285**	**$230**
EBITDA Margin	13.1%	11.5%	8.8%	8.8%	8.5%	10.5%	10.2%
EBITDA-Capex	7.8%	5.4%	4.4%	5.3%	4.3%	7.6%	6.5%
Balance Sheet Items ($M)							
Cash	73	64	49	39	39	39	39
Other Current Assets	126	147	185	158	335	164	335
Inventory	1,155	1,125	1,154	1,116	1,065	1,180	1,065
Fixed Assets (net)	1,478	1,588	1,587	1,570	1,534	1,567	1,534
Favorable Leases	1,040	986	931	879	841	892	841
Other Assets	17	17	16	45	41	45	41
Intangible Assets	4,831	4,330	3,782	3,739	3,504	3,762	3,504
Total Assets	**$8,720**	**$8,257**	**$7,704**	**$7,546**	**$7,359**	**$7,649**	**$7,359**
Current Liabilities	837	811	774	831	722	797	722
Other Liabilities	1,884	1,890	1,758	1,304	1,320	1,356	1,320
Debt	**4,585**	**4,613**	**4,705**	**4,652**	**4,940**	**4,667**	**4,940**
Equity	$1,414	$943	$467	$759	$377	$829	$377
Financial Ratios ($M)							
Tangible Equity	(4,457)	(4,373)	(4,246)	(3,859)	(3,968)	(3,825)	(3,968)
Debt / EBITDA	6.9x	8.1x	11.4x	10.7x	12.4x	8.9x	10.2x
EBITDA / Int Exp	2.3x	2.0x	1.4x	1.4x	1.2x	1.7x	1.5x

Source: Neiman Marcus Group LTD LLC 10-K and 10-Qs (NM deregistered 6/21/19)

high debt load since the first LBO in 2005, which has been magnified by the disruptive impact that online retailing has had on department stores. EBITDA declined from $665 million in FY2015 to $400 million in the LTM period ended April 27, 2019; the EBITDA margin declined by over a third from 13.1% to 8.5%, over the same time. By April 2019, debt equated to 12.4x LTM EBITDA and covered interest expense by 1.2x.

By way of reference, the debt/EBITDA and EBITDA/interest ratios for Ralph Lauren (NYSE: RL) for the fiscal year ended March 30, 2019, were 1.0x and 47.1x, while the respective ratios for Dillard's (NYSE: DDS) were 1.2x and 9.9x for the fiscal year ended February 2, 2019.

Figure 2 : Debt Coverage

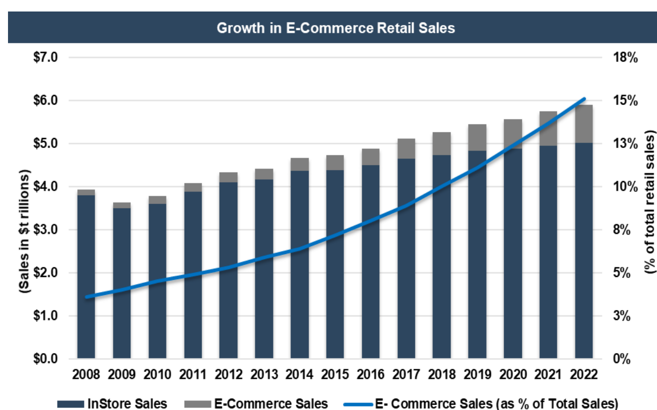


Source: S&P Global Market Intelligence

At the time of bankruptcy, Neiman Marcus generated about one-third of its sales (about $1.5 billion) online. MyTheresa generated approximately $500 million of this up from $238 million in 1Q17 when certain subsidiaries that held MyTheresa were designated "unrestricted subsidiaries" by the Company. While MyTheresa's sales increased, the legacy department store business declined as the Company struggled to connect with younger affluent customers who favored online start-up boutiques and had little inclination to shop in a department store.

As shown in Figure 3, ecommerce sales as a portion of total retail sales have doubled over the last five years to about 12% in 2019. The move to work from home ("WFH") and social distancing practices born of COVID-19 in early 2020 have accelerated the trend such that the pre-COVID-19 projection of e-commerce sales rising to 15% by 2020 will likely prove to be significantly conservative.

Figure 3 : Rising E-Commerce Retail Sales



Source: S&P Global Market Intelligence

Bankruptcy Filing

Neiman Marcus filed on May 7, 2020 for chapter 11 bankruptcy protection. The COVID-19 induced shutdown of the economy was the final nail in the coffin, which forced major furloughs and the closing of its stores in accordance with various local shelter-in-place regulations. Other recent retail bankruptcies include Lord & Taylor, Men's Warehouse, Ann Taylor, Brooks Brothers, Lucky Brands, J. Crew with many more expected to file.

The initial plan called for creditors to convert $4 billion of $5 billion of debt into equity. The plan does not provide for mass store closures or asset sales, although the Last Call clearance stores will close.

As noted, the bankruptcy filing follows a restructuring in June 2019 that entailed:

- An exchange of all but $137 million of $960 million of 8.0% cash pay and $656 million of 8.75%/9.50% PIK Toggle unsecured notes for $1.2 billion of (i) 8.0% and 8.75% third lien Company notes and (ii) $250 million of Series A preferred equity in MyT Holding Co., a US-based entity that holds the German corporate entity that operates MyTheresa;

- The issuance of $550 million of new second-lien 6% cash pay/8.0% PIK notes due 2024 with a limited senior secured claim of $200 million from MyT Holding Co. and other MyT affiliates;
- A partial paydown of the first-lien term loan facility at par with the proceeds of the second lien notes; and
- An exchange for the remaining $2.2 billion first-lien credit facility with a new facility and an extension of the maturity to October 2023.

The restructuring did not (apparently) materially impact the Company's $900 million asset-based credit facility of which $455 million was drawn as of April 2019; or the first lien $125 million debentures due in 2028.

As shown in Figure 4, market participants assigned little value to the $1.2 billion of third lien notes that were trading for around 8% of par when the bankruptcy filing occurred and 6% of par in late August 2020.

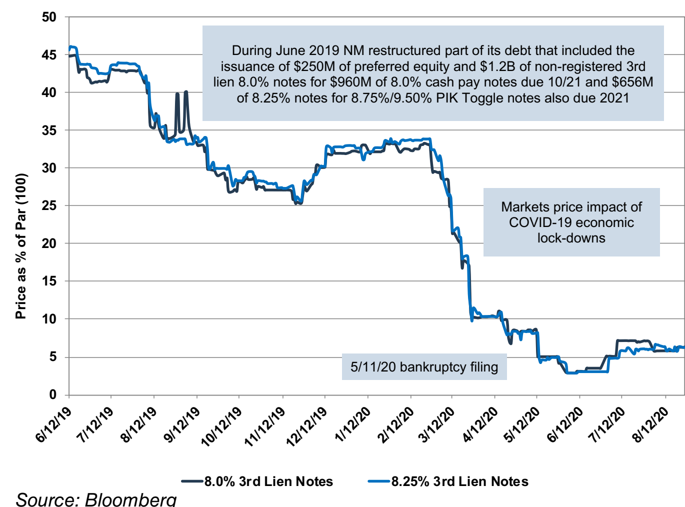
The binding Restructuring Support Agreement ("RSA"), dated May 7, 2020, included commitments from holders of 99% of the Company's term loans, 100% of the second line notes, 70% of the third line notes, and 78% of the residual unsecured debentures to equitize their debt. Also, certain creditors agreed to backstop $675 million in debtor-in-possession ("DIP") financing and to provide $750 million of exit financing which would be used to refinance the DIP facility and provide incremental liquidity.

DIP financing is often critical to maintain operations during the bankruptcy process when the company has little cash on hand. DIP financing is typically secured by the assets of the company and can rank above the payment rights of existing secured lenders. DIPs often take the form of an asset-based loan, where the amount a company borrows is based on the liquidation value of the inventory, assuring that if the company is unable to restructure, the loan can be repaid from the liquidation of the retailer's assets.

Bankruptcy Path: Chapter 7 vs. Chapter 11

Federal law governs the bankruptcy process. Broadly, a company will either reorganize under Chapter 11 or liquidate under Chapter 7.

Figure 4 : Market Value of $1.2 Billion of 3rd Lien Notes



Source: Bloomberg

A ***Chapter 7*** filing typically is made when a business has an exceedingly large debt combined with underlying operations that have deteriorated such that a reorganized business has little value. Under Chapter 7, the company stops all operations. A U.S. bankruptcy court will appoint a trustee to oversee the liquidation of assets with the proceeds used to pay creditors after legal and administrative costs are covered. Unresolved debts are then "discharged," and the corporate entity is dissolved.

Under ***Chapter 11***, the business continues to operate, often with the same management and board who will exert some control over the process as "debtor in possession" operators. Once a Chapter 11 filing occurs, the debtor must obtain approval from the bankruptcy court for most decisions related to asset sales, financings, and the like.

Most public companies and substantive private ones such as Neiman Marcus file under Chapter 11. If successful, the company emerges with a manageable debt load and new owners. If unsuccessful, then creditors will move to have the petition dismissed or convert to Chapter 7 to liquidate.

Most Chapter 11 filings are voluntary, but sometimes creditors can force an involuntary filing. Normally, a debtor has four months after filing to propose a reorganization plan. Once the exclusivity period ends creditors can propose a competing plan.

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Usually, the debtor continues to operate the business; however, sometimes the bankruptcy court will appoint a trustee to oversee the business if the court finds cause to do so related to fraud, perceived mismanagement and other forms of malfeasance.

The U.S. Trustee, the bankruptcy arm of the Justice Department, will appoint one or more committees to represent the interests of the creditors and stockholders in working with the company to develop a plan of reorganization. The trustee usually appoints the following:

- The "official committee of unsecured creditors"
- Other creditors committee representing a distinct class of creditors such as secured creditors or subordinated bond holders; and
- Stockholders committee.

Once an agreement is reached it must be confirmed by the court in accordance with the Bankruptcy Code before it can be implemented. Even if creditors (and sometimes stockholders) vote to reject the plan, the court can disregard the vote and confirm the plan if it believes the parties are treated fairly.

Neiman Marcus pursued a "***prepackaged***" or "***prepack***" Chapter 11 in which the company obtained support of over two-thirds of its creditors to reorganize before filing. Under the plan, the Company would eliminate about $4 billion of $5.5 billion of debt. The creditors also committed a $675 million DIP facility that will be replaced with a $750 million facility once the plan is confirmed by the court.

The Role of Valuation in Bankruptcy

Valuation issues are interwound in bankruptcy proceedings, especially in Chapter 11 filings when a company seeks to reorganize. Creditors and the debtor will hire legal and financial advisors to develop a reorganization plan that maximizes value and produces a reorganized company that has a reasonable likelihood of producing sufficient cash flows to cover its obligations.

There are typically three valuation considerations for companies restructuring through Chapter 11 Bankruptcy.

- Companies must prove that a Chapter 11 Restructuring is in the "best interest" of its stakeholders;
- A cash flow test must prove that post-reorganization the debtor will be able to fund obligations; and,
- "Fresh Start Accounting" must be adopted in which the balance sheet is restated to fair value.

Sometimes as is the case with Neiman Marcus there is a fourth valuation-related issue that deals with certain transactions that may render a company insolvent.

Fraudulent Conveyance

A side story to Neiman Marcus relates to the 2018 transaction in which the shares of MyTheresa were transferred in 2018 to bankruptcy-remote affiliates of PE owners Ares and CPPIB. Under U.S. bankruptcy law, transferring assets from an insolvent company is a fraudulent transaction.

During 2017, Neiman Marcus publicly declared the subsidiaries that held the shares were "unrestricted subsidiaries." Once the distribution occurred in September 2018, creditors litigated the transaction. All but one (Marble Ridge) settled in 2019 as part of the previously described debt restructuring.

Since the bankruptcy filing occurred, the unsecured creditors commissioned a valuation expert to review the transaction to determine whether Neiman Marcus was solvent as of the declaration date, immediately prior to the distribution and after the distribution. As shown in Figure 5, the creditors' expert derived a negative equity value on all dates. If the court accepted the position, then presumably Ares and CPPIB would be liable for fraudulent conveyance.

At the time the distribution occurred, Neiman Marcus put forth an enterprise valuation of $7 billion and relied upon the opinion of two national law firms that it was within its rights to execute the transaction. Since filing, the PE owners have commissioned one or more valuation experts whose opinion has not been disclosed.

On July 31, 2020, the committee of unsecured creditors and the Company reached a settlement related to the fraudulent conveyance claims arising from the MyTheresa transaction.

Figure 5

	3/14/17 Declaration	9/14/18 Pre-Dividend	9/14/18 Post-Dividend
Neiman Marcus (x-MyTheresa.com)			
Guideline Company Method (50%)	$2,440	$3,035	$3,035
Discounted Cash Flow Method (50%)	3,142	3,106	3,106
Concluded Value for NM (x-MyTheresa.com)	2,791	3,071	3,071
MyTheresa.com			
Guideline Company Method (50%)	$657	$803	
Discounted Cash Flow Method (50%)	683	834	
Concluded Value for MyTheresa.com	670	819	0
Neiman Marcus Enterprise Value	**$3,461**	**$3,889**	**$3,071**
Less: Debt	(4,707)	(4,713)	(4,713)
Add: Cash	48	39	35
Neiman Marcus Equity Value	**($1,198)**	**($785)**	**($1,608)**

Source: the Michel-Shaked Group expert valuation report, dated July 15, 2020

Ares and CPPIB agreed to contribute 140 million MyTheresa Series B preferred shares, which represent 56% of the B class shares, to a trust for the benefit of the unsecured creditors. The Company also agreed to contribute $10 million cash to the trust. A range of value for the series B shares of $0 to $275 million was assigned in a revised disclosure statement filed with the bankruptcy court.

Marble Ridge, which served on the committee, did not view the settlement as sufficient as was the case in 2019 when it did not participate in the note exchange as part of the 2018 litigation settlement.

During August, it became known that Marble Ridge founder Dan Kamensky pressured investment bank Jeffrey's not to make a bid for the shares that were to be placed in a trust because it planned to bid, too (reportedly 20 cents per share compared to 30 cents or higher by Jeffrey's). The anti-competitive action was alleged to have cost creditors upwards of $50 million. Marble Ridge subsequently resigned from the creditors committee and announced plans to close the fund. Kamensky was arrested on September 7th and charged with securities fraud, extortion, wire fraud, extortion, and obstruction of justice, according to the U.S. Attorney's Office for the Southern District of New York.

Best Interest Test

A best interest test must show that the reorganization value is higher than the liquidation value of the company, to ensure that the creditors in Chapter 11 receive at least as much under the restructuring plan as they would in a Chapter 7 liquidation.

In the case of Neiman Marcus, the liquidation vs. reorganization valuation analysis was a formality because most unsecured creditors and the Company agreed to a pre-packaged plan subject to resolution of such items as the MyTheresa shares. Nonetheless, we summarize both for illustration purposes.

Figure 6

Liquidation Analysis

A rough calculation of Neiman Marcus' liquidation value is included below, based on balance sheet data from April 2019 as these are the most current figures available.

Figure 7 : Liquidation Value

		Range of Liquidation Value			
	Book Value		Low End		High End
Cash	$129	100%	$129	100%	$129
ABL Segregated Cash	50	100%	50	100%	50
Accounts Receivable	45	82%	37	100%	45
Merchandise Inventory	900	94%	846	104%	936
Prepaids & Other Deposits	50	25%	13	50%	25
Intellectual Property	125	50%	63	100%	125
Net Fixed Assets	NA	NA	381	NA	476
Other Assets	88	0%	0	5%	4
Avoidance Actions	NA	NA	0	NA	275
Assets to be Liquidated	**$1,387**		**$1,518**		**$2,065**
Accrued Payroll & Benefits	$16	100%	$16	100%	$16
Other Current Liabilities	20	100%	20	100%	20
Other Priority & Admin Claims	39	120%	47	100%	39
Chapter 7 Trustee Fees	Variable	100%	25	100%	28
Wind Down Expenses	121	115%	139	100%	121
Admin Claims & Liq Costs	**$196**		**$247**		**$224**
Proceeds after Wind Down			**$1,271**		**$1,841**
Pre-Petition ABL Facility	$765	100%	$765	100%	$765
Pre-Petition FILO Facility	102	100%	102	100%	102
DIP Term Loan	531	76%	404	100%	531
Amended Term Loan	2,255	0%	0	7%	167
2013 Term Loan Stub	13	0%	0	7%	1
7.125% First Lien Debentures	129	0%	0	0%	0
14.0% PIK 2nd Lien Notes	606	0%	0	0%	0
3rd Lien Notes (8.0% / 8.75%	1,285	0%	0	0%	0
Estimated Secured Claims	**$5,686**		**$1,271**		**$1,566**
Estimated Secured Recovery %			***22%***		***28%***
Proceeds for General Unsecured Creditors			$0		$276
General Unsecured Creditors' Claims			5,288		4,848
Estimated Unsecured Recovery %			***0%***		***6%***

Source: Disclosure Statement for the Debtors' First Amended Joint Plan of Reorganization Pursuant to Chapter 11 of the Bankruptcy Code, dated 8/4/20 and Mercer Capital

Substantial value in a liquidation analysis depends upon what an investor would be willing to pay for the rights to the Neiman Marcus name as well as its customer lists and proprietary IP code. The recovery ratio applied to Neiman Marcus' inventory is higher than expected recovery ratios across the broader apparel industry since much of Neiman's inventory is designer goods. Nonetheless, the analysis implies creditors would face a significant haircut in a Chapter 7 liquidation scenario.

Reorganization (Going Concern) Analysis

The reorganization value represents the value of the company once it has emerged as a going concern from Chapter 11 bankruptcy. Typically, the analysis will develop a range of value based upon (i) Discounted Cash Flow ("DCF") Method; (ii) Guideline Public Company Method; and (iii) Guideline Transaction Method.

Both guideline methods develop public company and M&A "comps" to derive representative multiples to apply to the subject company's earnings and cash flow. Market participants tend to focus on enterprise value (market value of equity and debt net of cash) in relation to EBITDA. Secondary multiples include enterprise value in relation to EBIT, EBIT less ongoing Capex, and revenues.

As it relates to Neiman Marcus, we note that Lazard Freres & Co. ("Lazard") as financial advisor focused on adjusted EBITDA for the LTM period ended February 1, 2020 and the projected 12 months ended February 1, 2022. In doing so, Lazard looked past 2020 and 2021 as excessively abnormal years due to the COVID-19 induced recession. Our observation is that this treatment (for now) is largely consistent with how many market participants are treating various earning power measures in industries that were severely impacted by the downturn.

A DCF analysis for Neiman Marcus that assumes the Company emerges from bankruptcy in the fall of 2020 will incorporate the impact of the adverse economy as reflected in presumably subpar operating performance in the first year or two of the projections. More generally, the DCF method involves three key inputs: the forecast of expected future cash flows, terminal value, and discount rate.

1. **Forecast of Expected Future Cash Flows**: Valuation practitioners typically develop cash flow forecasts for specific periods of time, ranging anywhere from three to ten years, or as many periods as necessary until a stable cash flow stream can be realized. Key elements

of the forecast include projected revenue growth, gross margins, operating costs, and working capital and capital expenditure requirements. Data from other publicly traded companies within similar lines of business can serve as good reference points for the evaluation of each element in the forecast.

2. **Terminal Value:** The terminal value represents all cash flow values outside of the discrete forecast period. This value is calculated through capitalizing cash-flow at the end of the forecast period, based on expectations of long-term cash flow growth rate and discount rate. Alternatively, a terminal value can be determined through the application of projected or current market multiples.

3. **Discount Rate:** The discount rate is essential in estimating the present value of forecasted cash flows. A proper discount rate is developed from assumptions about costs of equity and debt capital, and capital structure of the new entity. For costs of equity capital, a build-up method is used with long-term risk-free rate, equity premia, and other industry/company-specific factors as inputs. Cost of debt capital and new capital structure can be based on benchmark rates or comparable corporations. The discount rate should reflect the financial risks that come with the projected cash flows of the restructured entity.

The sum of the present values of all forecasted cash flows indicates the enterprise value of the emerging company for a set of forecast assumptions. Reorganization value is the total sum of expected business enterprise value and proceeds from the sale or disposal of assets during the reorganization.

Figure 8 : Hypothetical DCF Value

		Projected Post-Reorganized Neiman Marcus				
Post-Reorganization Projections		**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Projected Revenue		$3,407	$3,982	$4,148	$4,271	$4,435
Growth Rate			*16.9%*	*4.2%*	*3.0%*	*3.8%*
Projected EBITDA		**66**	**342**	**429**	**467**	**505**
EBITDA Margin		*1.9%*	*8.6%*	*10.3%*	*10.9%*	*11.4%*
- Depreciation		(289)	(290)	(294)	(300)	(300)
Earnings bef Interest & Taxes (EBIT)		(223)	52	135	167	205
- Estimated Taxes	25.7%	57	(13)	(35)	(43)	(53)
Net Op Profit After Tax (NOPAT)		(166)	39	100	124	152
+ Depreciation		289	290	294	300	300
- Capital Expenditures		(96)	(98)	(99)	(95)	(95)
- Cash Adj to EBITDA		(140)	(20)	(20)	(20)	(20)
- Pension Contribution & Other LT Liabilities		(45)	(44)	(49)	(54)	(57)
+/- Incremental Working Capital		153	(60)	30	9	6
Free Cash Flow to Firm		**(5)**	**107**	**256**	**264**	**286**
Valuation Date	*9/30/20*	*3/31/21*	*3/31/22*	*3/31/23*	*3/31/24*	*3/31/25*
Discounting Periods		0.5	1.5	2.5	3.5	4.5
WACC Discount Rate	13.0%	0.9407	0.8325	0.7367	0.6520	0.5770
PV of Free Cash Flows		($4)	$89	$189	$172	$165

Present Value of Discrete Cash Flows		$611	
+ Present Value of Terminal Value		1,700	*Calculated below*
Enterprise Value Post-Reorganization		**2,311**	
+ Cash		129	*Series B MyT preferred shares contributed to a trust for unsecured creditors valued at $0-$275M; $200M 7.5% MyT PIK notes for second lien notes and 50% common equity in MyT for 3rd lien notes are not considered directly in the recovery*
+ MyTheresa Series B Preferred Shares		138	
Existing Debt (with Initial DIP)	5,686		
Less: Creditor Agreement Debt		(1,398)	
Converted Debt-to-Equity	**4,288**	**$1,179**	*27.5% Recovery rate on a combined basis*

Source: Neiman Marcus forecast (per 8/4/20 Disclosure Statement, Exhibit C) and Mercer Capital

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Cash Flow Test

The second valuation hurdle Neiman Marcus will have to jump is a cash flow test. The cash flow test determines the feasibility of the reorganization plan and the solvency of future operations. Since a discounted cash flow analysis is typically used to determine reorganization value, the projected cash flows from this analysis are compared to future interest and principal payments due.

Additionally, the cash flow test details the impact of cash flows on the balance sheet of the restructured entity, entailing modeling changes in the asset base and in the debt obligations of and equity interests in the company. Therefore, the DCF valuation and cash flow tests go together because the amount of debt that is converted to equity creates cash flow capacity to service the remaining debt. If the cash flow model suggests solvent operations for the foreseeable future, the reorganization plan is typically considered viable.

Fresh-Start Accounting

When emerging from bankruptcy in the case of going concern, fresh-start accounting could be required to allot a portion of the reorganization value to specific intangible assets. The fair value measurement of these assets requires the use of multi-period excess earnings method or other techniques of purchase price allocations.

Conclusion

Neiman Marcus plans to eliminate about $4 billion of over $5 billion of debt and $200 million of annual interest expense in a reorganization plan that was approved by U.S. bankruptcy judge David Jones in early September. The plan will transfer the bulk of ownership to the first lien creditors, including PIMCO, Davidson Kempner Capital Management and Sixth Street Partners. PIMCO will be the largest shareholder with three of seven board seats.

Other creditors will receive, in effect, a few pennies to upwards of one-third of what they were owed depending in part on the value of MyTheresa Class B preferred shares that were contributed to a trust for the benefit of unsecured creditors. Also, the Company's term loan lenders, second lien and third lien note holders waived their right to assert deficiency claims and thereby eliminated upwards of $3.3 billion of additional claims in the general unsecured claims pool (now limited to $340 to $435 million).

Lazard estimated the value of the reorganized Company upon exit from bankruptcy to approximate $2.0 billion to $2.5 billion on an enterprise basis with the equity valued at $800 million to $1.3 billion.

Creditors and the Company negotiated a plan that has presumably maximized (or nearly so) value to each creditor class based upon the priority of their claims. We are not privy to the analysis each class produced and how their views of the analyses, relative negotiating strength and the like drove the settlement.

Ultimately, the performance of the reorganized Neiman Marcus will determine the eventual amount recovered by creditors to the extent shares are not sold immediately. Some creditors would be expected to sell the shares immediately, while others who have flexibility to hold equity interests and have a favorable view of the reorganized company's prospects may wait to potentially realize a greater recovery.

In Figure 9 (on the next page) we have constructed a waterfall analysis which we compare with the actual settlement. We assume a range of enterprise values based upon multiples of projected FY22 EBITDA, or $342 million, and compare the residual equity after each claimant class is settled to provide perspective on the creditors' recovery.

This waterfall implies that class 5 through 7 debt, which for our purposes here is more or less pari passu, should receive the bulk if not all of the equity given $2.4 billion of debt owed to the three classes. Because ~10% of the equity was allocated to subordinated creditors, the senior lenders may have been willing to cede some ownership in order to reach a settlement more quickly.

Per the settlement, ~90% of the equity was allocated to the 2019 senior secured term loan (~$2.3 billion; 87.5%), 2013 residual senior secured loan ($13 million) and first lien debentures ($129 million; 2.8%).

Recovery for the 2019 senior secured creditors was estimated in the Disclosure Statement to approximate 33% compared to about 19% for the first lien debentures.

Figure 9 : Hypothetical Waterfall vs Proposed Settlement

		Range of Assumed Value for Waterfall					Class	Projected Recovery
FY22E EBITDA (+/- "Ongoing")		$342	$342	$342	$342	$342		
Multiple		4.5x	5.0x	5.5x	7.0x	7.5x		
Enterprise Value		**$1,539**	**$1,710**	**$1,881**	**$2,394**	**$2,565**		
Add: Cash		129	129	129	129	129		
MyTeresa Class B Preferred		138	138	138	138	138		*$0-275M value, allocated to unsecured creditors*
Non-Operating Assets		0	0	0	0	0		
Less: Other Secured & Priority Claims		TBD	TBD	TBD	TBD	TBD	1, 2	*100%; cash payment*
Asset Backed Debt Facility		(749)	(749)	(749)	(749)	(749)	3	*100%; cash payment*
FILO Secured Claims		(100)	(100)	(100)	(100)	(100)	4	*100%; cash payment*
DIP Term Loan (Initial Draw)		(531)	(531)	(531)	(531)	(531)	4	*100%; cash payment*
Equity Value to be Allocated		**$426**	**$597**	**$768**	**$1,281**	**$1,452**		
2019 Sr Secured Term Loan	$2,255	426	597	768	1,281	1,452	*5*	*33%; 87.5% of Newco equity*
% of Par		*19%*	*26%*	*34%*	*57%*	*64%*		
2nd Derivative Residual Equity		$0	$0	$0	$0	$0		
2013 Sr Secured Term Loan	$13	0	0	0	0	0	*6*	*12.8%; 0.2% of Newco equity*
% of Par		*0%*	*0%*	*0%*	*0%*	*0%*		
3rd Derivative Residual Equity		$0	$0	$0	$0	$0		
First Lien Debentures	$129	0	0	0	0	0	*7*	*18.8%; 2.8% of Newco equity*
% of Par		*0%*	*0%*	*0%*	*0%*	*0%*		
4th Derivative Residual Equity		$0	$0	$0	$0	$0		
Second Lien Notes	$606	0	0	0	0	0	*8*	*1.4%; 1% of Newco equity, 7yr warrant for 25% equity; and $200M of MyT 7.5% PIK notes (2L MyT*
% of Par		*0%*	*0%*	*0%*	*0%*	*0%*		
5th Derivative Residual Equity		$0	$0	$0	$0	$0		
Third Lien Notes	$1,228	0	0	0	0	0	*9*	*5.6%; 8.5% of Newco equity and 49.9% of MyT common (3L MyT Distribution)*
% of Par		*0%*	*0%*	*0%*	*0%*	*0%*		
6th Derivative Residual Equity		$0	$0	$0	$0	$0		
Unsecured Notes	$137	0	0	0	0	0	*10*	*2%-34; Liquidation of trust w $10M cash from NM and MYT Series B preferred shares worth estimated $0-$275M; claims < $50k to be paid in full in cash*
% of Par		*0%*	*0%*	*0%*	*0%*	*0%*		
7th Derivative Residual Equity		$0	$0	$0	$0	$0		
General Unsecured Claims	$387	0	0	0	0	0	*11*	
% of Par		*0%*	*0%*	*0%*	*0%*	*0%*		
Residual Value to NM Equity Holders		$0	$0	$0	$0	$0		

** Claims reflect contractual amounts, accrued interest where applicable and other projected amounts*

Source: Mercer Capital; Disclosure Statement for 1st Amended Reorg Plan (8/3/20) and Order Confirming Reorg Plan (9/4/20)

Interests in MyTheresa also impacted projected recoveries for the junior and unsecured creditors, a by product of the litigation to settle the fraudulent conveyance claims related to the 2018 transaction.

The second lien noteholders ($606 million) would obtain (i) 1.0% equity interest; (ii) seven-year warrants to purchase up to 25% of the reorganized equity at an agreed upon strike price; (iii) participation rights in the exit loan and associated fees; and (iv) an economic interest in MyTheresa in the form of $200 million of 7.5% PIK notes.

The disclosure statement indicates the recovery equates to less than 2% of what is owed to the second lien note holders, which appears to exclude whatever value is attributable to the PIK notes because 1% of the Newco equity would equate to $800 thousand to $1.3 million of value based upon a range of equity value of $800 million to $1.3 billion.[1]

The third lien noteholders ($1.3 billion) would obtain (i) 8.5% equity interest; (ii) participation rights in the exit loan and associated fees; and (iii) a 50% economic and 49.9% voting interest in the common equity of MyTheresa.

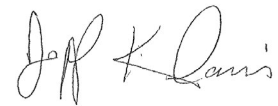
The disclosure statement indicates the recovery to be 5.6% of the claim, which also appears to exclude the value of the MyTheresa common shares if the equity interest is equal to $68 million to $110 million based upon an aggregate equity value of $800 million to $1.3 billion.

The issuance of $200 million of PIK notes and transfer of 50% of the common equity interest in MyTheresa to the second and third lien noteholders appears to be a result of the 2019 debt restructuring and settlement of the 2018 litigation surrounding the 2018 transfer of MyTheresa to the parent company and out of the reach of creditors.

The final wrinkle in the disputed MyTheresa saga involved an agreement reached in late July 2020 in which Ares and CPPIB agreed to allocate 140 million (56%) MyTheresa Series B preferred shares to a trust established for unsecured creditors. Neiman Marcus as debtor also agreed to contribute $10 million cash to the trust.

At the time the settlement was announced in late July, the value attributed to the preferred shares was $162 million; however, the August 3 Disclosure Statement assigned a range of value of $0 to $275 million. Marble Ridge reportedly had planned to bid 20 cents per share to provide certain unsecured creditors (e.g. unpaid vendors) immediate liquidity before the fracas with Jeffrey's occurred.

Neiman Marcus emerged from Chapter 11 by September 30, 2020 in a streamlined process via the prepackaged negotiations that will leave the Company with significantly less debt in its capital structure. As outlined in this article, valuation is an important factor in the bankruptcy process.



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[1] The issuance of $200 million of PIK notes and transfer of 50% of the common equity interest in MyTheresa to the second and third lien noteholders appears to be a result of the 2019 debt restructuring and settlement of the 2018 litigation surrounding the 2018 transfer of MyTheresa to the parent company and out of the reach of creditors.

[2] The projected 1.4% recovery rate for the second lien notes apparently excludes the MyTheresa PIK notes, while the projected 5.6% recovery rate for the third lien notes likewise appears to exclude the 50% common equity interest in MyTheresa.

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