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New Breed of Chapter 22 Takes Shape as Wet Seal Bankruptcy Begins

Teen angst within the industry sunk the business, but new realities at retail are emerging from this latest filing.

By Kari Hamanaka
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This is becoming predictable.

Wet Seal's Chapter 11 bankruptcy filing Thursday morning — largely expected after the company began liquidating stores last month — sends the company back to court as it winds down the business and now looks to market its intellectual property to potential suitors.

A look from Wet Seal's holiday 2016 campaign

It's the IP that continues to be the key asset for retailers going under as companies are forced to restructure or wind down. That's been the case so far this year with Gildan Activewear Inc. acquiring American Apparel's IP plus some equipment for $103 million and Boohoo.com PLC's bid for the Nasty Gal brand and customer data for $20 million.

Wet Seal now joins American Apparel in Chapter 22 — in what's becoming an all out shakeout at retail in 2017. Other filings in more recent years include Aéropostale Inc., Pacific Sunwear of California Inc., Quiksilver Inc., Deb Stores Holdings LLC, Delia's and Body Central Corp. Last month, The Limited filed for Chapter 11 following the closure of its stores. That's in addition to companies such as Macy's Inc., Sears Holdings Corp., BCBG Max Azria LLC and Fossil Group Inc. rationalizing their store fleets and employee head counts.

"[Retailers are] by now getting all their Christmas data in. There were disappointing sales. A lot of [Chapter] 11s were premised on increased sales post-[Chapter] 11 happening," said Michael Malter of Silicon Valley law firm Binder & Malter LLP, which specializes in bankruptcies.

That the industry is beginning to see Chapter 11s being filed in relative rapid-fire succession is indicative of a new trend emerging.

"I wouldn't call these a real Chapter 22. This is damage control," said Rob Harris, a partner at Binder & Malter. "This is clean up after the failure of an 11, using another 11 for liquidation and salvaging whatever IP or salable assets remain."

Wet Seal's filing follows the company's 2015 Chapter 11 bankruptcy and subsequent sale to Versa Capital Management. While the company squeezed out efficiencies in operations following the first restructure — which allowed it to shed more than 300 store leases — and aimed to play up the brand's Southern California heritage, it wasn't enough to improve its performance.

The business "incurred operational losses stemming from, among other things, onerous lease obligations, underperforming retail locations and increased competition in the teen fashion retail industry on a broad scale. Moreover, the continued growth of online competitors and decline in mall shoppers has consistently challenged the [company's] ability to right-size their balance sheet and operate on a sustained, profitable basis resulting in a precipitous drop in EBITDA through 2016," Judd Tirnauer, Wet Seal executive vice president and chief financial officer, said in a court filing Thursday.

Wet Seal's total sales last year were $144.5 million, according to Tirnauer's declaration. The company is now in the midst of shuttering its roughly 142 doors, located across 37 states, with closing sales estimated to end Feb. 28.

"You have this heavy online presence and then you have these retailers who are dealing with ridiculous rents in centers, and some of them going solely into online is very understandable," Malter said.

The success of the off-price channel, plus online hasn't helped. Add to that fast-fashion and it's rough out there, said Howard Davidowitz, chairman of New York retail consultant and investment banking firm Davidowitz & Associates Inc.

"Young people have different priorities today," Davidowitz said. "Their biggest priority is their iPad and their sneakers as opposed to sweaters and jeans. Millennials don't like going to malls. They don't even like driving cars."

Wet Seal has Hilco Streambank handling the marketing of its IP with a bidding and auction, if need be, to be done in the "early months of these Chapter 11 cases," Tirnauer said in his filing.

There's something to be had in the brand, but its value remains to be seen. This is where licensing and brand management companies could come into play, said Lloyd Greif, president and chief executive officer of Los Angeles investment banking firm Greif & Co.

"Wet Seal is not what it used to be. It's not like there's a lot of luster around that brand," Greif said. "There could be a brand licensing or brand management company that might desire to pick the bones…. It will be a virtual company. Wet Seal will be a brand that'll be licensed into whatever category one of these companies can jimmy up….This is what they do. That's why American Apparel almost went to Authentic Brands [a leading brand development company]. They do lurk in the wings waiting for opportunities to make a killing. One man's garbage is another man's gold. So there's an opportunity there with very little risk to see what reward can be had from milking the brand for all it's worth."