



Serta Simmons Deep Dive and Chapter 11 Filing, and Rob Citrone



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Welcome to the fourth Restructuring newsletter,

Thank you for being a subscriber.

Today, we will learn more about:

- 1, Serta Simmons Deal Overview
- 2, Serta Simmons Chapter 11 News Update
- 3, Rob Citrone - Capital Allocators Summary

Serta Simmons - One of the most famous restructuring deals of recent years

In 2020, Serta Simmons needed to restructure. Due to the pandemic and the massive debt load it incurred from a private equity takeover, the company was facing steep maturity walls it was in no position to pay [1]. Rather than file for bankruptcy protections which would further destroy value and reduce recoveries, Serta decided to undergo an out-of-court restructuring whose outcome is being litigated to this day. To understand Serta's restructuring, one must first understand the twin strategies—non-pro-rata uptiers and dropdowns—proposed in its execution. Thus, before delving into the intricacies of what happened/is happening with Serta Simmons, the upcoming slides will explain the proposed restructuring solutions central to the case.

Uptiers

Uptier transactions allow a majority (50% + 1) of secured creditors to prime non-majority secured creditors by giving themselves “super-priority” liens on a loan’s underlying collateral. This differs from another trend in restructuring, IP transfers, by reordering claims on a loan’s underlying collateral rather than stripping it from certain creditors and transferring it to others (although minority creditors would argue they effectively do the same thing). These transactions are contingent on two key factors:

1. Whether credit docs allow for a simple majority to amend lien subordination provisions
2. Whether the debtor is allowed to execute non-pro rata debt-for-debt exchanges

Majority creditors give themselves super-priority liens by amending credit docs to create new tranches of debt above any existing term loans. These creditors then exchange their old debt, at a discount, for new debt within the super-priority tranche (while also contributing new money to the debtor). The debt exchange acts as an out-of-court DIP rollup, while the new money functions as out-of-court DIP financing. This then raises the question, how is this allowed? Doesn’t the priming of minority secured creditors violate pro-rata sharing provisions within credit docs (provisions stating that any term loan pay down must be done equally amongst all term loan holders)? This is where the two necessary factors for an uptier transaction come into play.

For non-pro rata subordination, the devil is in the details. If credit docs allow for a simple majority to amend subordination provisions, or rather, if they don’t require unanimous consent to amend said provisions, then the creation of super-priority tranches can be done easily. The tricky part is how to justify the debt-for-debt exchanges, as these are only done with a select group of creditors. The key to these exchanges is found within the language surrounding a debtor’s allowed open market purchases (of their own debt). If credit docs allow debtors to conduct cashless transactions (e.g., debt-for-debt exchanges) as a part of their open market purchases, then majority creditors can bypass pro-rata sharing provisions as these purchases, by definition, are done with some creditors and not others [2].

Dropdowns

IP transfers, or dropdowns, were first utilized in J.Crew’s 2020 bankruptcy. Essentially, they involve a restricted group (restricted by secured loans tied to a specific piece of collateral) transferring out a collateralized asset (in this case intellectual property) to an unrestricted subsidiary. This unrestricted sub is then free to issue new loans using the newly transferred IP as collateral [3]. What allows debtors to do these transfers are “baskets” laid out in credit docs. These baskets describe the maximum dollar amount for exceptions to loan covenant restrictions. For the purpose of IP transfers, the exception of note is the dollar amount of value that can be held within a specific unrestricted sub. IP transfers are only possible if the unrestricted sub’s credit docs have the basket capacity to transfer the value of a brand’s IP.

These transfers are conducted in coordination with a specific group of creditors (who have liens on the pre-transfer IP). Once a transfer is complete, the debtor will raise new debt and/or facilitate a debt-for-debt exchange (at a discount, of course) with some of the restricted group's secured creditors [4]. This then raises the question, why would any creditor acquiesce to this strategy? Well, by reducing the number of creditors with liens on the IP, any new creditor would effectively increase the recovery value available to them in the case of a Chapter 11. This strategy is also appealing to debtors, as they may be able to reduce their overall debt burden while simultaneously securing a fresh source of liquidity.

Serta Simmons' 2020 bankruptcy was one of the more contentious restructurings in recent memory, primarily due to the uptier transaction executed by majority secured creditors. The bedding company had \$1.95B of 1L term loans and \$450M of 2L term loans it needed to restructure. A group of majority creditors (which included Eaton Vance Corp. and Invesco Ltd.) proposed an uptier transaction on their bundle of loans. They offered to exchange their existing loans for discounted debt within a new super-priority tranche (taking 74 cents on the dollar for their 1L loans and 39 cents on the dollar for their 2L loans). These creditors also stated they would inject \$200M of fresh liquidity into the company (in the form of new super-priority term loans) [5].

Minority creditors (which included Apollo and Angelo Gordon) proposed an IP transfer in conjunction with new money term loans, though the specifics of their proposal are not too important as we will soon see. Ultimately, majority creditors won the bid and the minority group sued to block their uptier transaction. However, Justice Andrea Masley of New York's Supreme Court rejected the group's lawsuit, stating there was no "irreparable harm" to justify an injunction [6]. This allowed the restructuring to complete soon after the Justice's ruling. Apollo and another group of primed creditors went on to sue Serta in early 2022 to retroactively invalidate the uptier, arguing the language surrounding open market purchases did not expressly allow the transaction and that regardless, it breached an implied covenant of good faith and fair dealing [7].

Sources: [\[1\]](#), [\[2\]](#), [\[3\]](#), [\[4\]](#), [\[5\]](#), [\[6\]](#), [\[7\]](#).

Serta Update - January 2023

On January 23, 2023, Serta Simmons filed for Chapter 11 bankruptcy. Currently, the company's capital structure—at least the structure relevant to its restructuring—is as follows [1]:

\$200mm ABL	\$ -
FLFO Tranche	195
FLSO Tranche	832
ABL + PTL Facility	\$1,027
 Non-PTL Term Loan	 \$862
Total Debt	\$1,889

The FLFO (“first lien, first out”) and FLSO (“first lien, second out”) tranches are the super-priority tranches (referred to in the First Day Declaration as the PTL Facility) created to prime non-participating lenders in Serta’s 2020 uptier. The remaining debt, the ~\$900M Non-PTL Term Loan, contains the minority group currently suing to reverse this uptier.

Serta is looking to reduce its \$1.9 billion in debt to \$300 million and has entered into an RSA (Restructuring Support Agreement) to do so. Their plan proposes the following:

- (a) FLFOs can exchange their claims for a pro rata share of \$195M in New Term Loans.
- (b) FLSOs can exchange their claims for a pro rata share of
 - (i) 100% of the debtor’s post-reorg equity (less equity distributed to Non-PTL Claims, as determined below)
 - (ii) \$105M in New Term Loans functioning as takeback (i.e., replacement) debt
- (c) Non-PTL Term Loans can receive their pro rata share of
 - (i) 4% of post-reorg equity, if they vote to confirm the plan
 - (ii) 1% of post-reorg equity, if they vote to reject the plan

Serta currently has the support of 81% in FLFO aggregate principal amount, 77% in FLSO aggregate principal amount, and a majority of existing equity holders. They have also secured DIP financing in the form of a new \$125M ABL Credit Facility, which combined with \$170M of cash on hand will support Serta through its restructuring process [2].

To effectuate its plan, and finally quash dissenting creditors, Serta is asking the court to issue a declaratory judgement validating its 2020 uptier. In doing so, the court would force Non-PTL creditors to the negotiating table, where they would likely consent to Serta’s plan to maintain a modicum of

recoveries. The consequences of this case will be monumental, as it could usher in an age of increasingly egregious uptiers or forbid them altogether.

Sources: [\[1\]](#), [\[2\]](#).

Rob Citrone - Fidelity -> Tiger Management -> Discovery Capital Management

Seeking to elucidate the thought process behind the world's best investors, the Capital Allocators podcast provides listeners with changes in market trends alongside in-depth perspectives regarding the investment decision making process. For this particular episode, Rob Citrone (founder and head of Discovery Capital Management) tells us his experiences as an emerging markets investor throughout the years, having spent time under the likes of Julian Robertson at Tiger Management. Furthermore, Citrone describes the lessons that he's learned as head of his very own fund.

As someone who became fascinated with the intricacies of the capital markets from a young age, Citrone graduated from college and found work at First Boston. Initially, a credit analyst, Citrone found himself at the forefront of the Latin American Debt crisis in the early 1980s, getting the chance to dive into the nitty grittiness of emerging markets. Intrigued by this area of finance, Citrone then progressed onwards to **Fidelity Instruments** where he headed the emerging market fixed income and currency practice. It was here that Citrone bore witness to the financial crisis of 1987 (now commonly referred to as Black Monday), experiencing in firsthand the pandemonium that unfolded.

After the harsh learning curve at Fidelity Investments, Citrone was headhunted by **Tiger Management** (a now legendary hedge fund whose former members have gone on achieve success on their own). Following a stringent application process complete with psychological examinations, Citrone began worked as an analyst focused on the credit markets of emerging economies. Having worked closely hand in hand with Julian Robertson during Tiger Global's investment in the Argentinian markets, Citrone looks back at his time with Tiger Management with great fondness; commending the tight-knit camaraderie and the individual brilliance of each individual at the firm.

Leaving the fund shortly before it was shut down, Citrone decided to start his own fund; having missed managing actual money and being able to "call the shots." Utilizing both top-bottom and bottom-up strategies, Citrone emphasizes the use of macro-analysis in the idea-generation process, helping to provide the supplemental background for bottom-up investment ideas. In Citrone's eyes, the equity markets are far more inefficient than the currency markets, enabling an investor attuned to changes in the underlying macro conditions to realize significant returns in the equity markets.

Having started the fund back in 1999, Citrone has learned much during his time so far at **Discovery Capital Management**. Through his focus on covering a variety of asset classes across the globe, Citrone's investing acumen has improved substantially in addition to developing a rolodex of significant individuals in crucial markets. Much like his former boss Julian, Citrone makes use of what he refers to as his "toolbox", an extensive rolodex of major players in certain markets. Reflecting upon his career path, Citrone attributes the successes that he has had to his strong work ethic and desire to win.

As someone who has spent time at institutions such as Fidelity and Tiger Management, Rob Citrone is a veteran of the financial markets. Initially starting his career as a credit analyst, he now runs one of the world's most successful macro-funds at Discovery Capital Management. Having witnessed and overcome the likes of "Black Monday" in 1987, Citrone has developed a keen set of skills and a comprehensive rolodex that has enabled him to keep his finger on the pulse of the global capital markets.

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