McTevia Comments to AnnArbor.com on the Fate of Borders Group Inc.

Borders faces critical April 1 loan deadline as it hires for Ann Arbor-based digital division

By Nathan Bomey, AnnArbor.com

A New York hedge fund manager may control the fate of Borders Group Inc., even as the distressed Ann Arbor-based book store chain advertises to hire several people for its digital division.

Borders faces a critical April 1 deadline to repay a $42.5 million loan owed to Pershing Square Capital Management, a hedge fund managed by investor William Ackman, who's already renegotiated the loan three times.

Ackman could opt to extend the loan again, giving Borders more runway to pursue a profitable business model. But if he decides to force repayment, Borders may be forced to fork over cash vital to its daily operations.

Borders had $32.8 million in cash as of Oct. 31, down from $38.4 million at the same point in 2008.

Turnaround experts familiar with major corporate restructurings told AnnArbor.com that they're concerned Borders won't avoid bankruptcy much longer.

A spokeswoman for Ackman said he was not available for comment.

"Borders has poor operating revenue and not a lot of cash," wrote Lou Kasman of Ann Arbor-based consultancy Marketing/Management Associates LLC, in an analysis conducted on behalf of AnnArbor.com. "I don't see strong cash flow, so meeting debt is questionable. Whether the lenders will change payment requirements is the question."

Borders' financial trajectory has led to reports that the firm is laying off inventory managers, weeks after the company cut its corporate head count by 10 percent.

Borders spokeswoman Mary Davis declined to make executives available for comment.

"Borders is always looking for opportunities to improve performance and profitability," she said in an e-mailed statement. "Any recent changes are a continuation of our efforts."

With speculation swirling about Borders' future, the firm has quietly posted job openings for six software engineers and programmers on the Web site of economic development group Ann Arbor SPARK.

The firm is also seeking a new leader for its digital operation.

"As far as the job postings, as a matter of doing business we are actively working to fill positions as we need to as other organizations do," Davis said in an e-mail. "No news there."

By most accounts, Borders narrowly dodged liquidation during the height of the financial crisis in late 2008 and early 2009. The firm aggressively cut costs and streamlined its operations to escape bankruptcy in the short term - but Borders' long-term viability is still in question, said Jim McTevia, managing partner of Bingham Farms-based turnaround consultancy McTevia & Associates.

"Borders is a classic example of a company that is struggling for survival," McTevia said. "I would say that if somebody doesn't buy Borders and merge them into an operation that Borders will probably fail and liquidate."

That decision may fall to Ackman, Borders' largest individual shareholder.
Ackman told CNBC in February that he envisions a "low probability" of Borders filing for bankruptcy.

Still, Borders, which employs 646 workers at its headquarters on Phoenix Drive, faces numerous challenges, including:

-A massive real estate footprint. Borders, which had 513 super stores in the U.S. as of Oct. 31, faces annual lease costs of $562 million. Those leases could be renegotiated or shed under bankruptcy protection.

-Revenue crisis. Declining sales show no signs of reversing, which reflects general industry trends. Consumers are flocking to the Internet to buy books, and book industry experts said competitor Barnes & Noble is beating Borders on the in-store experience. Borders said in January that its holiday sales slipped 13.7 percent for the 11-week period ended Jan. 16. The firm is expected to report its full fourth-quarter results within the next two weeks.

"Barnes & Noble is on the same downturn in sales and profits, but Barnes & Noble is much more diverse and has a stronger balance sheet," Kasman said.

-Leadership turmoil. Ron Marshall, who took over for ex-Borders CEO George Jones in early 2009, resigned in January 2010. New CEO Michael J. Edwards, the company's executive vice president and chief merchandising officer, has not publicly identified any major turnaround initiatives.

"The question that needs to be addressed by Borders' management and Board of Directors: When are you going to face reality rather than thinking things will change by osmosis?" Kasman said.

Nonetheless, investors seem to be gaining confidence in Borders shares. The stock, which had briefly slipped below $1 a share in recent weeks, was trading back above $2 late last week.

Still, Borders' long-term financial health is uncertain.

"We plan to operate our business and execute our strategic initiatives principally with funds generated from operations, financing through the credit agreement, credit provided by our vendors and other sources of new financing as deemed necessary and available," Borders said in an SEC filing Dec. 4.

"However, there can be no assurance that we will achieve our internal sales projections or that we will be able to maintain our current vendor payable support or borrowing capacity, and any failure to do so could result in our having insufficient funds for our operations."

McTevia said the general industry trends are the greatest concern, as Amazon.com surges and consumers begin to embrace e-book readers like Amazon's Kindle, Barnes & Noble's Nook and Apple's iPad.

"You're seeing the beginning of a decline in the industry that sells book to the consumer in the store," McTevia said. "I think eventually you're going to see Barnes & Noble struggle."

McTevia said he would advise Borders to hire a consultancy that specializes turnaround strategies. He speculated that it's possible Borders is already quietly working with a turnaround team.

Borders should "hire a sophisticated turnaround company to get in there and try one last time to reorganize the company outside of court and get the creditors together and get the bondholders together and try to work something together as opposed to letting the company failing."

But Kasman said creditors will want to see a defined strategy for reversing Borders' declining revenue. He suggested Borders try selling video games to capitalize on the success of firms like GameStop and generate foot traffic.

"Here is a test for Borders management and its Board of Directors - why haven't you moved on new innovative revenue streams?" Kasman said. "If I was going to lend them money now, that's one of the big questions I'd ask. To me, that is the major problem for Borders' business to grow again and make money; seems like they see themselves as only a book seller."