# Tupperware Brands: the bonds have (potentially a lot) further to fall

FEBRUARY 25, 2020 / PUPPYEH / EDIT

I posted a tweet thread a week or so ago on Tupperware Brands (TUP) – you can see the thread here, but the thesis was essentially that the short-dated Jun'21 TUP bonds ($600mm outstanding), then at 99.5c, didn't anywhere discount the possibility of a needed restructuring of the company, given the leverage picture; the deterioration in the business in China and Brazil; the structure of the debt burden; and imminent covenant breach.

TUP's preliminary earnings released today were a bit of a disaster – the stock fell 50% – and the bonds are now down 10pts or so to around 90c. I was short a bit of stock and a lot of bonds, so while this is a good outcome, I am still a little perplexed why the bonds are hanging in so well. Here's the capital structure as it stands today, and then what it will look like at year-end FY20E (note, this is using gross leverage, not net, since although TUP has >$100mm cash on balance sheet this is all tied up overseas and basically impossible to repatriate so gross leverage is the appropriate way to look at the business):



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| | FY19E outstanding | Price | Mkt outstanding | Leverage thru (x) | FY20E | Price | Mkt outstanding | Leverage thru (x) |
|---|---|---|---|---|---|---|---|---|
| Revolver | 265 | 100% | 265 | 1.0x | 207 | 100% | 207 | 1.0x |
| Secured bonds (Jun'21) | 600 | 100% | 600 | 3.4x | 600 | 100% | 600 | 4.1x |
| Other debt | 5 | 100% | 5 | 3.4x | 5 | 100% | 5 | 4.1x |
| **Total debt** | **870** | | **870** | **3.4x** | **812** | | **812** | **4.1x** |
| **LTM EBITDA** | **255** | | | | **198** | | | |
| | | | | EV thru (x) | | | | EV thru (x) |
| Market cap (ref $3.1) | 50 | 3.1 | 155 | 0.6x | 50 | 3.1 | 155 | 0.8x |
| **Total EV** | | | **1025** | **4.0x** | | | **967** | **4.9x** |
| LTM EBIT | 200 | | | | 147 | | | |
| Interest expense | 45 | | | | 50 | | | |
| **Interest coverage (x)** | **4.5x** | | | | **2.9x** | | | |

A few things worth mentioning off the bat:

- I treat the secured bonds – the issue maturing Jun'21 – as a par bond, even though the price today is 90c. This is because the issue is so short-dated, it doesn't really make sense to consider a discounted market-implied debt value for such a near-term obligation;
- I include interest coverage – even though this is not in any company covenants – as I think its important to think about buffer for the existing capital structure for a business like this (and it is something the revolver lenders will consider when thinking about what total sustainable leverage is for the enterprise).

There are of course a couple of interesting observations. Firstly, the market cap now – just $155mm – is a small fraction of the total EV (<20%), befitting a highly distressed capital structure. Despite this, however, the bonds remain at a high dollar price (90c) – quite unusual, since normally when equity value trades down to option value on the entire capital structure (as is the case here) the bond price will trade at a more distressed level – that is, closer to perceived recovery value. So the bond market apparently thinks either there is limited refi risk or that recovery value on the bonds is close enough to 90c…hmm.

The main reason for the discrepancy in this case is that optically leverage is not that high: just 3.5x on LTM, and 'only' around 4x on NTM. Of course, these are very short-dated bonds as well, meaning most businesses could refinance (even at a higher cost) with this amount of leverage as most all the debt should be covered by business value, assuming EBITDA is even close to stable.

Therein, of course, lies the rub – how stable is EBITDA? Remember that TUP is not like normal businesses: it is a multi-level marketer (MLM), reliant on ~3mm external salespeople to push its products to their 'downlines.' These businesses are by their nature highly momentum-driven, since a prosperous seller draws in more and more people to start selling (driving sales momentum for the first and second movers) – until of course the market for the given product is saturated, at which point there is a massive unwind as the late joiners find it impossible to make money, start dumping product/leaving the system, which puts pressure on the brand/margins and hurts the reputation of anyone else selling in the system, and the entire cycle goes into reverse.

Since the company just reported double digit negative organic growth for 2019 (on top of declines in 2018); is guiding to another double-digit negative performance in 2020; and has already penetrated the entire developed and most of the emerging world, it is hard to see how EBITDA stops going down, let alone stabilizes. This is why businesses

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October 2022 (7)

like this – Nuskin (NUS) for example – shouldn't be run with much, if any leverage (a lesson TUP failed to learn).

Refinancing the $600mm bond due next June, then, isn't just a question of paying up for a penal interest rate and finding the money. With the equity trading at a fraction of a turn, the $600mm of new capital will have to underwrite almost 4x of pro-forma leverage on an EBITDA number still very much in decline AND be willing to own all the equity if something goes wrong (since the equity today trades at just 3.8x EV/EBITDA). And of course you'll still be behind $200mm+ in revolver; have most all the cash on balance sheet trapped in foreign jurisdictions; and with a huge exposure to China (maybe 15% of profits in the business today) just as its going through the coronavirus scare. And what is the exit for those bonds anyway, once they are issued? You have to underwrite this businsess for at least 3+ years if you buy it today…extremely difficult to do with accuracy.

There is probably a price for this refi – that is why the bonds are still at 90c, after all – but what is that price – 10%? 12%? TUP will be a solid junk issuer with sustainability issues and no real issuance history in the market (they last sold these bonds in 2011) – but if we assume even say 11% cost of debt on the newly refinanced bonds, then on FY21E numbers the cap structure is just as ugly and interest coverage is unsustainably low:

| | FY19E outstanding | Price | Mkt outstanding | Leverage thru (x) | FY20E | Price | Mkt outstanding | Leverage thru (x) | FY21E | Price | Mkt outstanding | Leverage thru (x) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Revolver | 265 | 100% | 265 | 1.0x | 207 | 100% | 207 | 1.0x | 194 | 100% | 194 | 1.1x |
| Secured bonds (Jun'21) | 600 | 100% | 600 | 3.4x | 600 | 100% | 600 | 4.1x | 600 | 100% | 600 | 4.0x |
| Other debt | 5 | 100% | 5 | 3.4x | 5 | 100% | 5 | 4.1x | 5 | 100% | 5 | 4.0x |
| **Total debt** | **870** | | **870** | **3.4x** | **812** | | **812** | **4.1x** | **799** | | **799** | **4.0x** |
| **LTM EBITDA** | **255** | | | | **198** | | | | **172** | | | |
| | | | | EV thru (x) | | | | EV thru (x) | | | | EV thru (x) |
| Market cap (ref $3.1) | 50 | 3.1 | 155 | 0.6x | 50 | 3.1 | 155 | 0.8x | 50 | 3.1 | 155 | 0.9x |
| **Total EV** | | | **1025** | **4.0x** | | | **967** | **4.9x** | | | **954** | **5.6x** |
| LTM EBIT | 200 | | | | 147 | | | | 122 | | | |
| Interest expense | 45 | | | | 50 | | | | 88 | <—-Assuming 11% refi on the $600mm | | |
| **Interest coverage (x)** | **4.5x** | | | | **2.9x** | | | | **1.4x** | | | |

There is no way senior lenders will put up with the reinstatement of 4x of leverage and interest coverage so weak, when EBITDA is falling 15% year over year. That is to say – I think these bonds have a very good chance at being equitized in the next 12months…

**What's the new equity worth?**

This is really a bit of a guessing game since so much depends on where EBITDA stabilizes. Still, if we assume simply that the revolver gets reinstated (around $250mm today, maybe a bit more or less); then some amount of DIP (maybe $75-100mm) to account for liquidity needs, further cash-out restructuring of the cost base; working capital; and fees through B/K; and then the rest of the debt gets equitized (leaving pro-forma gross leverage of 1.7x, so still a bit high for comfort), then bondholder recovery looks something like this:

| Recovery scenario | Low | Mid | High | Notes |
|---|---|---|---|---|
| EV | 515 | 686 | 858 | 3x, 4x, 5x EV/EBITDA on FY21E EBITDA |
| Less DIP/Revolver at 300mm | 300 | 300 | 300 | add 75-100mm for res'ting costs, W/C needs |
| Pro-forma equity value | 215 | 386 | 558 | |
| Implied bond recovery in equity | 36% | 64% | 93% | |
| Add carry before filing | 4% | 4% | 4% | assume files in 9mos |
| **Total bondholder recovery** | **40%** | **68%** | **97%** | |
| **Pro-forma leverage (x)** | **1.7x** | **1.7x** | **1.7x** | vs 3.4x today and >4x on FY20E |

September 2022 (7)
August 2022 (10)
July 2022 (8)
June 2022 (8)
May 2022 (10)
April 2022 (7)
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December 2020 (7)
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So maybe bondholders get back close to par, but a slightly more penal assessment could see quite low recovery value (40-70c). Of course, since (probably) all their recovery will be in equity, I am willing to bet the bonds trade much towards the lower end of the spectrum than the high, if it comes to that (especially given the governance issues; nature of the business as an MLM; and thus clear zero risk in liquidation). Not pretty at all.

Putting precise probabilities on unknowable outcomes is always fraught with risk. But if its reasonable that in an equitization the bonds have 30-50pts of downside whilst only 10pts of upside if they get refinanced, it seems to imply around a 25% chance of default. This seems plain wrong given where the equity trades (around 2x NTM cash flow) – and so this is one of those situations where I think the bonds are just completely out of whack, rather than the stock.

That all said – I am not brave enough to dive into the stock as a long here, even against the bonds, so am just maintaining (and potentially adding) to my bond short. However if the stock takes another large leg lower and the bonds hold up (perhaps after the 4Q call), it may well be worth looking at. Next catalysts would be a downgrade to full junk at all agencies; then the likely tricky 4Q earnings call and (what I think will be) an abysmal 1Q earnings report in May.

**Disclosure: short TUP Jun'21 senior bonds**

Uncategorized

TUP

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## 10 thoughts on "Tupperware Brands: the bonds have (potentially a lot) further to fall"

*Arbi*

FEBRUARY 26, 2020 AT 12:27 AM

I like the idea. How do you short bonds technically? Can you do it via Interactive Brokers? Do you have to pay a borrow fee like with stocks? Thanks!

Like

REPLY EDIT

***puppyeh***

FEBRUARY 26, 2020 AT 9:31 AM

thanks for the interest. i use Interactive brokers and shorted the bonds just like w/ stocks. yes there is a borrow fee involved.

Like

REPLY EDIT

***Clemens***

MARCH 8, 2020 AT 2:14 PM

Is there a way to check the borrow fees of bonds in advance? The SLB tool only provides it for stocks

Thx for the article

Like

EDIT

***puppyeh***

MARCH 8, 2020 AT 9:20 PM

hi there – i also had this issue, i couldn't figure it out. i think i am paying around a 9% borrow cost at the moment – so think of it as ~0.8pts per month in principal terms. since i expect this to rerate to the low 70s in a matter of months, this still makes the trade well worth it even with the highish borrow cost.

Like

EDIT

Pingback: 361 Degrees: June'21 dollar bonds yield 13-14% but should be money good | Raper Capital EDIT

***Kovs95***

FEBRUARY 27, 2020 AT 12:43 AM

Thanks for sharing. I am learning a lot from you. Can you elaborate more on why you bet the bonds will trade lower since the recovery is all equity?

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REPLY EDIT

***puppyeh***

FEBRUARY 29, 2020 AT 1:29 PM

hi there. i think i explained it fully in the article. people who are buying the bonds expect a fixed return (given the nature of the instrument); when it gets turned into equity (through restructuring), as probably happens here, the return profile becomes much more uncertain (since its equity, no fixed returns, etc). this necessarily leads to forced selling from many of the original fixed income investors who don't want to take that kind of bet.

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REPLY EDIT

Pingback: 361 Degrees: June '21 Dollar Bonds Yield 13-14% But Should Be Money Good – Darwin Wealth Creation EDIT

***Francis Lee***

JULY 1, 2020 AT 7:39 PM

Any updated thoughts here with bonds having rallied back to 60c from 30c trough

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REPLY EDIT

***puppyeh***

JULY 1, 2020 AT 8:52 PM

hi Francis – actually yes. something funny is going on. the business itself has only done worse, but the co is acting like they have a plan to refinance these bonds. they tendered for $175mm of the $600mm, paying around $100mm total; they relied on fully drawing the revolver (and waiving covenants, in return for very little extra security) to fund this repurchase. then they gave a bunch of equity awards to some new hires (strongly suggesting they think they won't file for Chpt11).

i actually bought some bonds for a punt at 45c after the first tender was announced, but sold them recently at 61c. I don't see how these bonds can actually be refinanced; more likely seems some kind of distressed exchange (turning the $425mm left into a longer maturity, second-lien piece of paper, with some kind of large coupon, probably PIK). with leverage now probably close to 6x on a real basis, there is a reasonable chance these bonds are largely impaired in a court-led restructuring – hence the likely acceptance of a distressed exchange, like this.

the one thing i can't figure out is why the banks a) waived covenants for so little extra security; and then b) let the company spend $100mm cash to repurchase notes below them. speaks also i suppose to everyone's desire to keep this out of court as fundamental value is quite low given the ongoing deterioration in the business.

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