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Strategic Confusion Put RadioShack at Mercy of Lenders
Bankruptcy Filing Comes as Electronics Retailer Was Forbidden to Close as Many Stores as It Wanted

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In a commercial last year, Hulk Hogan and a mob of other nostalgic characters stormed into a RadioShack and ripped it apart, to the refrain, “The ’80s called; they want their store back.”

Now it’s the creditors who are clawing at RadioShack Corp.’s shelves.

The struggling electronics chain filed for bankruptcy on Thursday afternoon, after a long spiral that landed it in retail limbo. As part of the reorganization process, hedge fund Standard General LP and wireless carrier Sprint Corp. will take over about half of RadioShack’s roughly 4,000 U.S. stores, and the rest will be shut.

The plan aims to head off the sort of liquidation that claimed Circuit City and Borders, where the inventory was sold to pay off their lenders. But even before the filing, the company was furiously shutting down stores around the country and preparing to close more, according to employees interviewed over the past week.

Joe Magnacca, RadioShack’s seventh CEO in nine years, inherited a company buffeted by some of the toughest forces in retail. The business of selling electronics was being pillaged by the Web, and a giant bet on cellphones fell apart when Apple Inc. ’s pricey iPhones started pulling the margin out of sales that had once been lucrative for RadioShack. Revenue was falling, and cash was drying up.

The more immediate cause of the downfall, however, was a series of missed financial targets and strategic confusion that handed power to bare-knuckled lenders. RadioShack also spent millions of its increasingly scarce dollars advertising an ambitious store overhaul, many elements of which the chain never had the money to roll out.

In late 2013, the company agreed to a $250 million loan from Salus Capital Partners, an investment firm owned by Harbinger Group Inc. The loan came with few strings, but there was a catch: Salus had to sign off if RadioShack wanted to close more than 200 stores a year, giving it a veto over one of the company’s only ways to raise cash.

When finances deteriorated faster than expected, RadioShack tried to save itself by closing a quarter of its stores early last year. Salus objected, lacking confidence that the proposed business plan would succeed and unwilling to let the company sell off inventory—the collateral for its loan—people familiar with the matter said. The inability to close stores extinguished hopes for the turnaround plan.

The events are a cautionary tale for executives who find themselves turning to nontraditional lenders when their businesses falter. RadioShack spent the past year struggling with creditors when it was under pressure to fix its operations. Piecemeal efforts to push new products like portable speakers and toy helicopters, and a well-received move to reposition the chain as a place to repair broken cellphone screens weren’t enough to turn things around.

The last straw was a humbling holiday season in which many of the company’s stores sat largely empty of people. One sign of the chain’s marginalization: Many stores had just half a dozen iPhones to sell, employees said. A worker in San Jose, Calif., said his store was allotted only three to sell “for a good two months.”

“We’re not getting a lot of foot traffic,” said Bruce Clark, a store worker in Langhorne, Pa. Mr. Clark said his location was slated to shut down any day and workers were spending much of their shifts packing Apple gear and Beats headphones for shipment to other stores.

RadioShack set up shop in Boston 94 years ago and flourished as interest in electronic gadgetry took off in the ’70s and ’80s. But eventually its cables and plugs were easily found on the Web and elsewhere. House brands like Tandy faded as other manufacturers took over electronics. And consumers stopped needing batteries for their portable music players.

The company began to rely heavily on sales of cellphones and accessories, a business that grew to around half its revenue in recent years. But after the iPhone came out in 2007, the profitability of the business weakened. Carriers cut back payments to resellers like RadioShack to offset the cost of subsidizing expensive iPhones that sold themselves.

By 2013, the company was approaching a crisis and looking for a new CEO. That February, it hired Walgreen Co. executive Mr. Magnacca. The 50-year-old Canadian had never run a public company. Still, board members were impressed with his work at Walgreen's Duane Reade, a New York-area pharmacy chain that took off after his team brightened the stores' interiors and filled them with new merchandise.

The new chief executive planned to use similar tactics at RadioShack: test a new store design, bring in newer gadgets and support the effort with more aggressive marketing. RadioShack directors told Mr. Magnacca they wanted profitability restored for the full year in 2015, a person familiar with the company said.

"The expectation was that this was probably a two- to three-year process to get it all rationalized,'' the person said. "He thought that was reasonable."

Mr. Magnacca got to work, striking deals like an exclusivity agreement with Beats Electronics LLC Chief Executive Luke Wood to sell its new Dr. Dre Pill speakers and realigning sales commissions to take the emphasis off phones.

By June, he had put together a showcase for his new store design in a brightly lit store on Manhattan's Upper West Side, which was visited by the company's full board.

"Everybody was pleased,'' the person familiar with the company said, adding the layout reminded him of an Apple store. "It was creative. It was interactive. It was cool.''

Nevertheless, results got worse instead of better. Frequently shifting marching orders and commission structures left workers confused. Jahiera Torres, a store manager in Morrisville, Pa., said thin staffing and a flurry of emails from management, each mandating a new strategy on short notice, started to take its toll on morale.

"I just wish they gave us more notice," Ms. Torres said. "There's no consistency."

Sales that summer fell 8% from a year earlier, excluding newly opened or closed stores, and the company needed to line up more cash.

By October 2013, RadioShack secured $835 million in loan commitments. They included a $585 million line of credit led by GE Capital and the $250 million term loan led by Salus.

RadioShack is facing a dwindling market share and the possibility of bankruptcy. But the story of the company over the last 50 years shows how Americans fell in love with personal electronics. (originally published 9/16/14)
The Salus loan beat a competing offer in part because the money came with hardly any lender protections known as covenants, people familiar with the loan said. But Salus negotiated for one point that would bedevil the retailer—the veto over store closings.

Salus takes a hard line if debtors get into trouble, according to people who have worked with the firm. As an asset-based lender, Salus lends money against collateral like inventories or accounts receivable that would cover it even if a business closes. Three apparel retailers—Dots LLC, Love Culture Inc. and Delia's Inc.—liquidated in recent years after borrowing from Salus and failing to turn around their businesses.

Salus's loan to RadioShack is the largest the firm has made. It was secured by all of RadioShack's assets, but on some of it held the equivalent of a second mortgage—meaning if Salus had to make sure there would be enough assets left over after higher-ranking creditors were paid. That made it risky to allow RadioShack to close stores and sell inventory to raise cash for itself.

Salus's strategy has been successful. Through Sept. 30, none of the loans in its portfolio has ever failed to pay principal, interest or fees, according to a regulatory filing. There is a risk it could lose money on RadioShack, however.

"We're very focused on the collateral value there," said Omar Asali, president of Harbinger, Salus's parent company, on a conference call with investors in November.

The relationship between Salus and RadioShack was tense from the start. Days before the loan was due to close, Salus threatened to back out, citing weaker than expected operating results at RadioShack, the people familiar with the loan said. It ultimately sold $100 million of the debt to Cerberus Capital Management LP, a distressed-debt investor that is also known for taking a tough stance with troubled borrowers. The $250 million Salus loan closed in December 2013.

RadioShack knew by the end of 2013 that it would need to close stores, but hoped it could keep the number in the low hundreds, said Troy Risch, the company’s executive vice president of store operations and real estate at the time. The number grew after it became clear that Christmas sales were lousy.

And while the company made a big splash with the ad featuring Cliff Clavin and Alf during the Super Bowl, only about 100 of its flashy new stores had been rolled out.

“It was a great commercial, but there just wasn’t anything to carry the business at that time,” said Mr. Risch, who left RadioShack in April for another job in the industry.

In early February, the company was looking at closing several hundred stores, but the number was constantly growing, Mr. Risch said. On March 4, RadioShack announced it wanted to shut as many as 1,100. Salus and Cerberus balked.

“That was a tactical error that I can’t even explain,” a person close to RadioShack’s restructuring efforts said of the decision to announce the closings without first getting the lenders on board.

The lenders said they would agree to the store closures if RadioShack would pay off more than $50 million of the loan, but RadioShack viewed the demand as too costly, according to a person familiar with the matter.

Unable to raise cash by closing stores and selling off their inventory, Mr. Magnacca couldn’t revamp the stores as promised.

“Simply put, we exceeded our organization’s capabilities by trying to do too much too quickly,” Mr. Magnacca said on a conference call that March.

The company tried to make do by refreshing its remaining locations with new store signs, fresh paint and tweaks that moved less profitable merchandise like cellphones from central display tables to the walls. But a growing cash problem made it hard to keep them stocked.

By fall, some of the retailer’s advisers began preparing for a bankruptcy filing, a person familiar with the matter said. A rescue package from New York hedge fund Standard General bought the company some time. But by November, the company was down to about $15,000 per store in cash, and the weak holiday results proved too much to bear.

Now, as clerks follow orders to ship big-ticket smartphones to nearby stores that would remain open and slash prices on remaining inventory, many of the tech enthusiasts who fueled RadioShack’s ascent decades ago say there isn’t much the chain could do to win them back.

Evan Koblentz, president of the Mid-Atlantic Retro Computing Hobbyists, said most tinkerers in his group now shop online for parts.

“People used to go to RadioShack to hang out. It’s almost a place to avoid now,” he said. “Those of us who are hobbyists have been lamenting RadioShack’s fall for 20 years.”