Retail faces uncertainty as CIT enters bankruptcy

Contributed by Egypt News
Monday, 02 November 2009

The bankruptcy of a key lender that helps retailers stock their shelves is adding to the industry's worries ahead of the critical holiday shopping season.

CIT Group Inc . filed for Chapter 11 bankruptcy protection Sunday in New York after months of struggling to avoid collapse. The company provides badly needed credit to thousands of small and mid-sized businesses, and is a critical part of the flow of capital in the retail sector .

CIT stressed that its lending operations will continue to operate as it proceeds through bankruptcy with the hope of shedding $10 billion in debt. Chairman and CEO Jeffrey M. Peek said the company's prepackaged reorganization plan "will allow CIT to continue to provide funding to our small business and middle market customers , two sectors that remain vitally important to the U.S. economy."

But retail groups and analysts warn that the case will likely add to the instability in the retail sector. CIT is an important source of capital, working with 2,000 vendors that supply merchandise to more than 300,000 stores. About 60 percent of the apparel industry depends on CIT for financing.

In the last few weeks, the nation's stores have begun filling their floors with holiday merchandise, but they still need a reliable source of lending to prevent shipping disruptions and to restock after the holidays. Even one day that vendors are cut off from much-needed financing could create a bottleneck, resulting in shipments of merchandise left on docks or in vendors' warehouses.

CIT expects to emerge from bankruptcy by the end of the year, but a dragged-out case or any glitches could further disrupt the already tight credit markets for retailers, said Joe Alouf, a partner with Eaglepoint Advisors, a crisis management company that is partly owned by Kurt Salmon Associates.

"CIT is the 600-pound gorilla in the industry," Alouf said.

Craig Sherman, vice president of government affairs at the National Retail Federation , thinks the industry "dodged a bullet on the holiday season" for the most part, because most merchandise is in stores' distribution centers . However, he said CIT's woes could throw a wrench in ordering for the important 2010 spring season. NRF officials say that as stores prepare for a rebound in consumer spending next year, access to credit is very important.

Harold Reichwald, co-chair of law firm Manatt, Phelps & Phillips' banking group, said that CIT's case will likely force the company's customers to look elsewhere for financing.

"If I was a small businessman, I would say to myself, 'I have to find alternatives,'" Reichwald said. "In this marketplace, there isn't a lot of alternatives."

CIT's Chapter 11 filing is one of the biggest in U.S. corporate history, following Lehman Brothers , Washington Mutual , WorldCom and General Motors . The bankruptcy filing shows $71 billion in finance and leasing assets against total debt of $64.9 billion. The move wipes out current holders of its common and preferred stock, meaning the U.S. government will likely lose the $2.3 billion in taxpayer funds it sunk into CIT last year to prop up the company.

The government could have lost billions more, however, had it not declined to hand over more aid to the company earlier this year. Treasury Department spokesman Andrew Williams said Sunday that the government will be closely monitoring the bankruptcy proceedings, but acknowledged that "recovery to preferred and common equityholders will be minimal."

CIT had been trying to fend off disaster for several months and narrowly avoided collapse in July. It had struggled to find funding as sources it previously relied on, such as short-term debt, evaporated during the credit crisis. The company pulled back sharply on lending to businesses as it tried to preserve cash. According to its most recent quarterly earnings report , the company originated just $4.4 billion worth of new business during the first six months of 2009, compared with $11.3 billion in the first half of 2008.

The company received $4.5 billion in credit from its own lenders and bondholders last week, reportedly made a deal with Goldman Sachs to lower debt payments and negotiated a $1 billion line of credit from billionaire investor and bondholder Carl Icahn . But the company failed to persuade bondholders to support a debt-exchange offer, a step that would have trimmed at least $5.7 billion from its debt burden and given CIT more time to pay off what it owes.

Ever since CIT's troubles flared up last summer, the retail industry has carefully monitored the lender, with many vendors scrambling to find alternative financing at rivals like Rosenthal & Rosenthal. But finding a replacement hasn't been easy because competitors can only take on so many more clients. Moreover, while large publicly traded companies with sales of more than $2 billion have found the credit market loosening up in recent months, small and medium-based companies have largely found themselves shut out, Alouf said.

The big question is how long CIT will remain under court protection. A prepackaged bankruptcy, which has the support of major bondholders, speeds up the process of restructuring CIT's debt and could help it exit court protection in a matter of months. A swift exit by the holidays could alleviate some retailers' worries.

EGYPT NEWS