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Retailers Fear Impact of a CIT Bankruptcy *Many Could Face Disruption in Flow Of Merchandise*

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The potential bankruptcy of lending firm [CIT Group](#) threatens to disrupt the flow of merchandise between retailers and their vendors just as they are gearing up for the crucial holiday season.

Three prominent retail trade groups sent letters to financial regulators this week warning that the failure of CIT would rip a hole in the industry supply chain. Dunkin' Donuts said the ability of its franchisors to open new stores or expand operations could be affected. And New York bankruptcy lawyer Jerry Reisman said he received more than two dozen calls from panicked stores and apparel manufacturers, some of which said they may not have the money to pay their employees today.

"They are unbelievably concerned right now," Reisman said. "What we may have here is a total disruption in small business."

CIT plays an important behind-the-scenes role in the retail industry. When stores place orders for merchandise, they typically have two to three months to pay for the goods. Suppliers hand those IOUs over to lenders such as CIT -- a process known as factoring -- which in turn provide suppliers with cash upfront to make their merchandise. If that system were to be disrupted, industry experts said, the result could be barren store shelves and a ruined Christmas.

CIT had asked the federal government for help in avoiding bankruptcy, but officials this week refused to step in. The Treasury Department lent \$2.3 billion in to the company in December. Some officials now expect that investment to be lost.

Yesterday, the company turned to its bondholders in a last-ditch effort to save itself. CIT gave investors 24 hours to raise an additional \$2 billion, though some analysts said even that would not be enough to avoid insolvency. The company's shares fell 75 percent to close at 41 cents.

The ultimatum left bondholders with a dilemma, forcing them to choose between putting even more money into a failing company or a bankruptcy filing in which they would suffer heavy losses. Some of the bondholders floated the possibility of swapping bonds that are due soon for long-term debt to give the company some extra time.

Analysts doubted whether these maneuvers would work. And several credit rating agencies downgraded the firm to junk status in expectation of a bankruptcy.

"We believe the figure is in the range of \$4 to \$6 billion, making outside capital sources shy away from such a heavy recapitalization," according to a research note released yesterday by CreditSights. "We believe the prudent course for bondholders is to brace for bankruptcy."

The fundamental problem with CIT is that its business model is broken, government officials said, and a fresh round of federal aid would do little to keep the company from failing. In making this determination, the officials were taking a chance that the financial system would be strong enough to absorb the collapse of a large financial firm.

CIT primarily provides financing for small and medium-size businesses; large consumer products companies typically access credit directly from banks. It also is a key source of financing for retail franchises, such as Dunkin' Donuts.

According to its annual report filed in March, CIT accounted for about \$42 billion in factoring volume last year. The American Apparel and Footwear Association, a trade group, said about 60 percent of its members have done business with the firm.

"They're basically the bank for the way we do business," AAFA chief executive Kevin M. Burke said. "At any point there where the money stops, then the movement of that product stops as well."

CIT caters to apparel and furniture manufacturers, which typically require long lead times to produce goods and have high manufacturing costs. Stores are currently placing orders for merchandise that will appear in stores in the fall and winter -- the most important selling season of the year. Suppliers are worried that a lack of financing could keep them from buying materials to produce their goods, much less ship them to retailers. Retailers say that any disruption in receiving merchandise could derail hopes of recovering from their sales slump.

"The ripple effects of this kind of event are not really appreciated in the halls of power," said Matt Polsky, managing director of retail investment firm Net Worth Solutions.

Retail trade groups expressed disappointment yesterday in the government's decision not to extend a lifeline to CIT and have been lobbying the administration to reconsider. The Retail Industry Leaders Association, which represents both stores and their suppliers, urged Treasury Secretary Timothy F. Geithner in a letter to investigate "every available option."

"Any additional tightening of the credit markets will only exacerbate the constraints on our members' ability to provide the products that consumers seek and most importantly, to maintain millions of retail jobs across the nation," the letter said.

But speaking on his cellphone between meetings on Capitol Hill, the group's senior vice president of government affairs, John Emling, acknowledged the prospects of a reversal seemed dim.

"It doesn't sound good," he said. "But at the same time, what other options do we have?"