CIT factoring clients have few alternatives

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By Elinor Comlay and Caroline Humer - Analysis

NEW YORK (Reuters) - When finance company CIT Group Inc (CIT.N: Quote, Profile, Research, Stock Buzz) first warned in July that it could go bankrupt, its retail clients tried to head out the door -- but many found that they didn't have anywhere else to go.

Thanks to market dominance and tight contracts, CIT has managed to keep much of its $42 billion "factoring" business intact, even though the notion that a finance company is on the brink usually causes customers to flee, legal experts say.

CIT provides factoring loans to small companies, mostly in retail, by buying their accounts receivables and then working within a disparate web of manufacturers, wholesalers and importers to collect payment.

"I still believe that is a very profitable part of CIT's business. There is really no other alternative to turn to," said Jim Carr, head of bankruptcy and restructuring at Kelley Drye & Warren in New York.

Companies that lose access to these types of factoring loans -- which run from a few million dollars up to $20 million or more -- would face cash flow problems immediately, and that would mean more bankruptcies in retail, Carr said.

CIT spokesman Curt Ritter said the company's factoring volume for the first six months of the year was $16.5 billion, vs $20.7 billion a year ago. He added that CIT continues to sign new factoring business and is committed to its clients.

CIT said it has 2,000 factoring clients that service 300,000 retailers and wholesalers. The business is estimated to be at least five times the size of its closest competitor Wells Fargo & Co (WFC.N: Quote, Profile, Research, Stock Buzz), followed by others like GMAC and Rosenthal & Rosenthal.

BREAD AND BUTTER

Experts say factoring has been CIT's bread and butter business, but the economic downturn and credit squeeze made it more expensive and hurt many retail customers in the sector.

Despite these problems, CIT worked out a plan to shore up its finances by raising $3 billion from bondholders. That may have slowed some attempts at departures, but bankruptcy still remains a distinct possibility.

CIT's factoring business has so far been protected by not only a lack of competition and financing availability, but the year-long contracts with few out clauses that mark the industry, factoring experts said.

"The CIT agreements typically have fairly stringent termination provisions from a perspective of a customer," said Mark Jacobs, partner at Pryor Cashman in New York. The agreements can typically only be terminated on their anniversary, and even then CIT needs 60 days notice, he said.

There are exceptions of course. Last month, CIT and a New Jersey apparel maker, Scherr Inc, settled a case in which Scherr had argued that CIT's financial instability had caused it to break its factoring agreement.

And at least one competitor said it has seen an uptick in business since CIT's troubles emerged.

"Our new business activity has picked up significantly and CIT is a part of the reason," said Michael Stanley, managing director at factoring and finance company Rosenthal & Rosenthal in New York. The broader decline in lending due to the credit crisis has also given customers fewer alternatives, he said.

WATER-TIGHT CONTRACTS

Factoring agreements are even tougher to get out of than their larger cousins -- asset backed loans or ABLs, which usually have a provision to kick out a lender who has filed for bankruptcy, according to one expert.

"The lender and factorer are always reluctant to include in their contracts provisions that have obligations on themselves or that will give the borrower an opportunity to force the lender out," said Jeffrey L. Dunetz, head of the ABL finance group in the Americas for law firm Mayer Brown in New York.

So if CIT does file for bankruptcy, it is unclear what its customers will walk away with, experts say.

"That's the biggest concern for the community at large: what happens to my money? Am I going to see it, or does it go to CIT creditors that I have no relationship with?," said Jeffrey Knopman, principal, Profit Solutions Group Inc, a chargeback recovery company.