ALTERNATIVE FINANCING

Kristy Melton
Business Finance Broker
Heritage Commercial Funding Corp.
kmelton@heritagecommercialfunding.com
www.heritagecommercialfunding.com
805-231-0562

DEBTOR IN POSSESSION (DIP) FINANCING FOR COMPANIES IN BANKRUPTCY

Businesses in financial distress find they have very limited options for funding when they need it the most. A company's abilities to obtain capital from their current lender will likely be cut off, and they may also fall into default on their loan covenants.

For many distressed companies, there is hope for new financing. Through the bankruptcy courts, they can file for Chapter 11 for bankruptcy protection. This will allow them to take advantage of DIP financing to help them reverse course, restructure, and return to profitability. Note that DIP financing is not applicable for Chapter 7 bankruptcy where businesses are liquidated and walk away.

Some lenders and financing sources actually see DIP financing as an attractive lending opportunity because of the special treatment that business bankruptcy loans receive under U.S. bankruptcy law. Under the law, DIP creditors are typically repaid before other creditors. In fact, many lenders will commit to a DIP Chapter 11 loan while they would not make a loan offer to the same business without the bankruptcy filing.

We represent a network of alternative funding sources for businesses, so we know what lenders will offer DIP financing.

A/R FACTORING USED IN DIP FINANCING

Companies can use A/R factoring as a financing tool in DIP financing, yet many small business owners do not realize this is a possibility. In fact, accounts receivable financing can be the fastest and most flexible way to obtain funding and recapitalization during the Chapter 11 bankruptcy process.

Factoring can be a win-win for both the borrowing company and the factoring firm. The company obtains needed financing that is not based on its own credit status. The total focus is on the quality of the business' debtors. Are they creditworthy? Even a company with a debtor concentration (selling to a single debtor) can be approved if that debtor is strong enough. The business needs to be selling to commercial customers (no retail sales).

The factoring firm "wins" by achieving priority status under the bankruptcy code. Many times, it was customer credit issues that pushed a company into bankruptcy. A protected A/R facility can stop that from happening again. If the factoring company will not approve a debtor with all of the data they have at their fingertips, then the small business should not be offering payment terms to that customer. They can still take COD but it's not worth the risk to basically become the bank for that client.

IN CONCLUSION

If your company is experiencing financial distress, it's important to consult an experienced bankruptcy attorney and a restructuring/turnaround specialist to determine all of your viable options. We can refer you to one we know if needed. A workout or other restructuring process outside of bankruptcy might be a better option for your individual situation. However, if you determine that bankruptcy is your best option, DIP financing may provide a strong opportunity to turn your company around.