Why Banks Pulled the Pin on Dick Smith

> “How did you go bankrupt?"
> "Two ways. Gradually, then suddenly.”
>
> Ernest Hemmingway - *The Sun Also Rises*

It's true. When it happens, it happens quickly. Even we, however, are shocked at the rapidity of electronics retailer Dick Smith's demise. The company reported a profit of $38m for the year to 28 June 15 and forecast something similar for the following year. Its directors even declared a dividend of 5 cents per share - almost $11m in total - and paid it to shareholders on the 30th of September last year. Three months later it files for receivership?

As Matt presciently pointed out in Dick Smith is the Greatest Private Equity Heist of All Time, the company's working capital deficit on listing left it in a precarious position. Despite the supposed profits, free cash flow last financial year was negative $35m. That would undoubtedly be making banks and suppliers nervous. We've been hearing rumours for the past few months about the latter refusing to supply inventory unless they get paid upfront. No inventory equals no sales and no sales equals no profit.

If I had to hazard a guess as to why the banks pulled the pin so quickly, however, it's probably because there is no better time to do so. There's no doubt they would have hoped that the Christmas sales went well and that Dick Smith could profitably trade its way out of trouble. But, absent that scenario, the banks would want to preserve their position in any restructuring or liquidation.

Think about what a retailer's balance sheet looks like just after the Boxing Day sales. Christmas gift cards have been sold but mostly not yet redeemed (I didn't notice it myself but Twitterati are suggesting the company pushed its gift cards hard through Coles in December, offering up 10% bonuses on the cards in order to ship them out the door). Inventory has been sold but not yet paid for. So cash is at its high point.

It seems counter-intuitive that a retailer could file for receivership at the high cash point of the year. But, if you are the bank and you have the ability to force the situation, there is no better time. Stop the clock today and the cash will end up in the banks' coffers. Wait another few weeks and a large chunk of it will be paid out to unsecured suppliers instead.

Christmas trading must have been woeful. But banks jockeying for position is likely a better explanation for the timing of Dick Smith's demise.

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