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## Unlocking Value in Highly Aged, Written-off Receivables

Almost all executives and advisors dealing with a financially distressed company or bankruptcy estate are well aware that the company's fresh accounts receivables (A/R) can be a source of quick liquidity. For many turnaround professionals, asset-based lending or factoring firms can be excellent sources for converting these receivables into much needed cash.

However, executives and advisors often neglect a meaningful source of additional cash – the highly aged or previously written-off receivables. Most asset-based lending and factoring firms will not give much, if any, credit for receivables outstanding for more than 90 days. Convincing these firms to monetize older, written-off receivables that are no longer on the aging report is a long shot at best. But the receivables and write-offs from two, three, and even four years ago still represent a significant amount of unrecovered cash and should be considered in any strategy that attempts to maximize near-term liquidity.

### Case Study #1 – Section 363 Acquisition by Major LBO Fund

#### The Situation

A leading private equity fund acquired a company that had been through significant prior distress and had just emerged from bankruptcy. During the distress, the company wrote off \$2 million of uncollectible receivables.

#### The Challenge

- The write-offs averaged 782 days old and some were actually over 4 years old.
- These receivables came from a division that was no longer in operation.
- Only paper invoices copies existed; there was no access to accounting systems.
- No proofs of delivery or any other documentation was available.

#### The Results

Despite the obstacles a specialty collections agency hired for the project recovered over \$500,000 from the old write-offs, providing important working capital to the company.

## **How to Identify the Opportunity**

The first step in identifying the opportunity to turn highly aged receivables and historical write-offs into cash is to gather an aging schedule that lists the outstanding receivables. While this provides a good starting point, any such schedule is likely to show only part of the picture. Executives often indicate that “the company’s A/R is very clean and DSO (days sales outstanding) is better than the industry average.” However, further digging often reveals an interesting insight – the A/R looks clean because the company has routinely written off accounts to maintain an artificially low DSO.

As a result, one must be prepared to dig around into old reports and records to find these receivables. If they were easy to find and collect, then they wouldn’t be overlooked so often. Experience shows that about 75 percent of stable companies have significant write-offs that are still collectible. In distressed situations, this percentage rises to over 90 percent.

## **Options for Capturing the Opportunity**

After identifying that a potential opportunity exists, the next key decision point is how best to capture it. Three basic options are discussed in this article: (A) Collect internally, (B) Outsource on a contingency basis, or (C) Sell for cash.

### **A. Collect Internally**

This option should be used when resources are available internally, particularly employees that are adept at taking a proactive, problem-solving approach. Even with this skill set in place, it still might make sense to work the written-off receivables internally for only 30 days. This strategy ensures that the easier, “quick hit” collections are made without an over-commitment of resources.

Far too often, executives and turnaround professionals make the mistake of assuming that the company’s existing credit and collections personnel are well-suited for such activity. It is quite tempting because these employees “know the accounts” and are “familiar with the situations.” However, this line of thinking can often be erroneous because chances are these employees had limited success with these collections before and are unlikely to find alternative paths to success now.

### **B. Outsource on a Contingency Basis**

If resources to collect internally are limited or non-existent, then turnaround professionals should consider outsourcing the collection effort on a contingency basis. Many firms have existing relationships with collection agencies that perform well on accounts less than a year old. However, many of these agencies struggle with commercial accounts one to four years old and often won’t even apply the required effort towards them.

Aged receivables and historical write-offs often have limited documentation and are rife with disputes. It takes a specialized agency to have success with these types of accounts, particularly the prior write-offs. A call center type of agency with hourly employees working from a dialer and script typically will not have the time or wherewithal to sort through complex issues often found in these more distressed situations.

Conversely, an agency with highly experienced collectors that are empowered to utilize a thoughtful and creative approach – a consultative approach – will show dramatically higher rates of success. This type of experienced, consultative approach can often yield recovery rates on highly aged receivables of 15 to 40 percent, depending on the particular situation. Given the complex nature of this work, turnaround professionals should expect a specialty agency to charge between 20 to 45 percent of recoveries on these highly-aged accounts and write-offs. With portfolios even as small as \$5 or \$10 million, there is a significant opportunity to bring back meaningful amounts of cash.

Additionally, advisors representing companies in the midst of a bankruptcy are best served by selecting an agency or a buyer (per the next section) that has prior experience being approved for similar roles in bankruptcy proceedings.

### **Case Study #2 – Commercial Bank Takes Over Assets From Liquidated Borrower**

#### **The Situation**

A leading commercial bank had taken over all the assets of a liquidated customer that was in default on its loan from the bank. The bank had already liquidated PP&E and collected lock-box receivables, but was still “under water” and wanted to recover cash from a portfolio of written-off receivables.

#### **The Challenge**

- The borrower had ceased as an operating business roughly two years prior, further complicating the collections activity.
- Many of those owing the receivables were also owed trade credits and wanted to return unsold product in accordance with past practice.

#### **The Results**

- The bank first sent the accounts to a “traditional” collections agency about a year after the liquidation. The agency opened up the boxes, identified the age of the files, and then sent them back to the bank.
- The bank then sent the accounts to a collections agency that specializes in highly aged accounts. This specialty agency worked through a myriad of issues, ultimately generating meaningful cash from the old write-offs and helping the bank further recover its loan.

**C. Sell for cash**

If simplicity and the need for immediate cash are the key considerations, then an outright sale of the highly aged receivables and written-off accounts may make sense. However, unlike the consumer credit card debt market where buyers are abundant, firms willing to pay cash for written-off commercial receivables are fewer in number. A key reason for the difference is that credit card portfolios have common characteristics, whereas commercial receivables tend to have unique attributes from one company to the next. For instance, credit applications can differ dramatically, as do ordering forms, invoices, and proofs of delivery. A buyer for commercial receivables must be able to quickly assess the available documentation, which is often quite limited, and make a meaningful proposal in short order.

Such purchases typically include a short timeframe for recourse by the buyer on accounts deemed invalid, shifting into a non-recourse situation thereafter. Depending on pricing and documentation, the sale can sometimes even be done on a modified as-is, where-is basis, with limited representations by the seller.

**Summary of Options to Capture the Opportunity**

	<b>Use this option when:</b>
Collect Internally	Internal resources are available, particularly people who are adept at being proactive and taking a problem-solving approach to complex issues.
Outsource	Internal resources are limited and/or unequipped to generate success with aged accounts and write-offs.
Sell for Cash	Time, simplicity and the need for immediate cash are key considerations.

**Conclusion – Hidden Liquidity**

Bankruptcy trustees and restructuring advisors may be able to turn highly aged receivables and write-offs into much needed cash that otherwise would be left on the table. Nearly every bankruptcy estate and distressed company sits on these types of portfolios, and turnaround professionals should consider attempting to monetize these intangible assets.

**Bio**

David Linn is a Vice President at Oak Point Partners ([www.oakpointpartners.com](http://www.oakpointpartners.com)). Oak Point Partners pays cash to purchase intangible assets such as highly-aged commercial receivables (1 to 4 years old), default judgments from preference claims, and bankruptcy trade claims held by bankruptcy estates.



David received a BA with highest distinction from Northwestern University and an MBA from the Harvard Business School. He can be reached at 212-245-3033 or [david@oakpointpartners.com](mailto:david@oakpointpartners.com).