

# Rehypothecation Risk in Supply Chain Finance: The Hidden Leverage Credit Professionals Can't Ignore

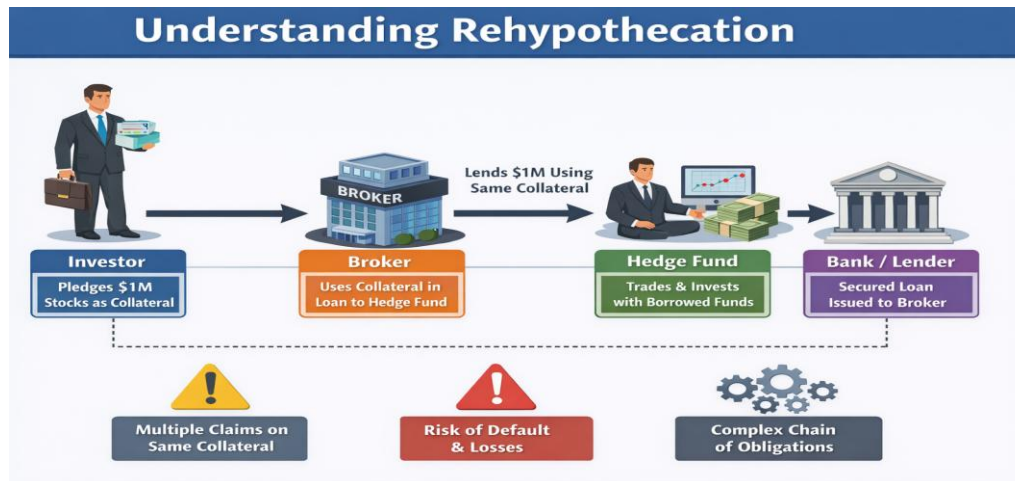


# WHAT IS REHYPOTHECATION?

*Hypothecation - When a borrower promises the right to an asset as a form of collateral in exchange for funds – i.e. a home is collateral for a mortgage*

*Rehypothecation/Repledging - When a lender uses an asset, supplied as collateral on a debt by a borrower, and applies its value to cover its own obligations. In order to do so, the lender may have access to a variety of assets promised as collateral including tangible assets and various securities.*

- *So in the hypothecation example the asset in question (the house) is pledged as collateral by the bank, along with other houses, for their own loans*
- *This cycle of leveraging another party's assets as collateral generates a type of derivative that can expand positive results or bankrupt companies quickly should the strategy fail.*
- *Very common with broker dealers and funds...until the 2008 Global Financial Crisis (MF Global, Lehman Brothers, etc.)*





## PROS

- + Lower borrowing costs for clients
- + Efficient use of capital in financial markets
- + Potential for higher profitability
- + Access to liquidity for brokers

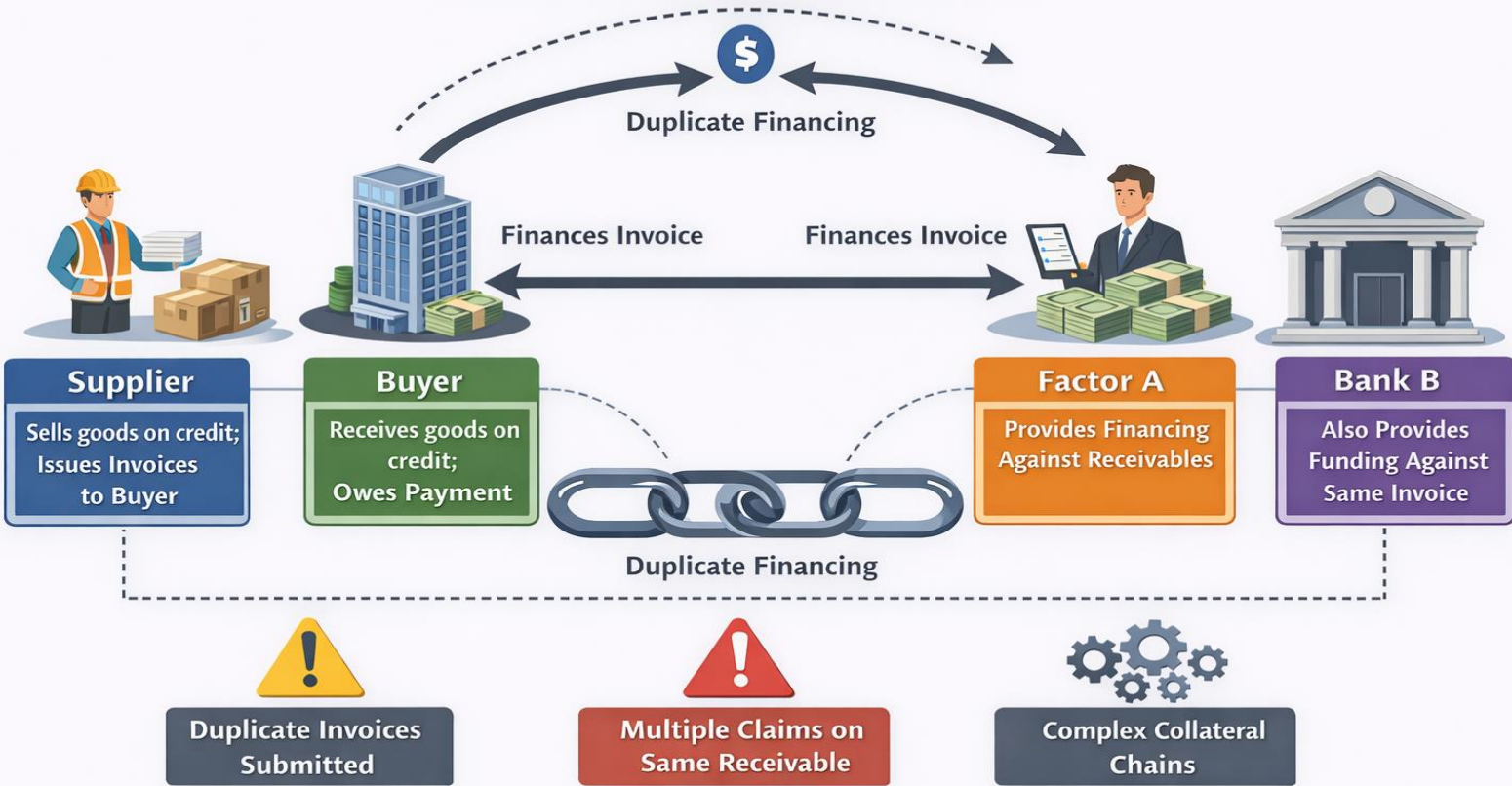
## CONS

- Lack of **transparency** for clients
- Increased risk of default
- Potential misuse of assets by brokers
- Complex creditor situations during bankruptcies



## Rehypothecation in Supply Chain Management

Duplicate Financing Risks





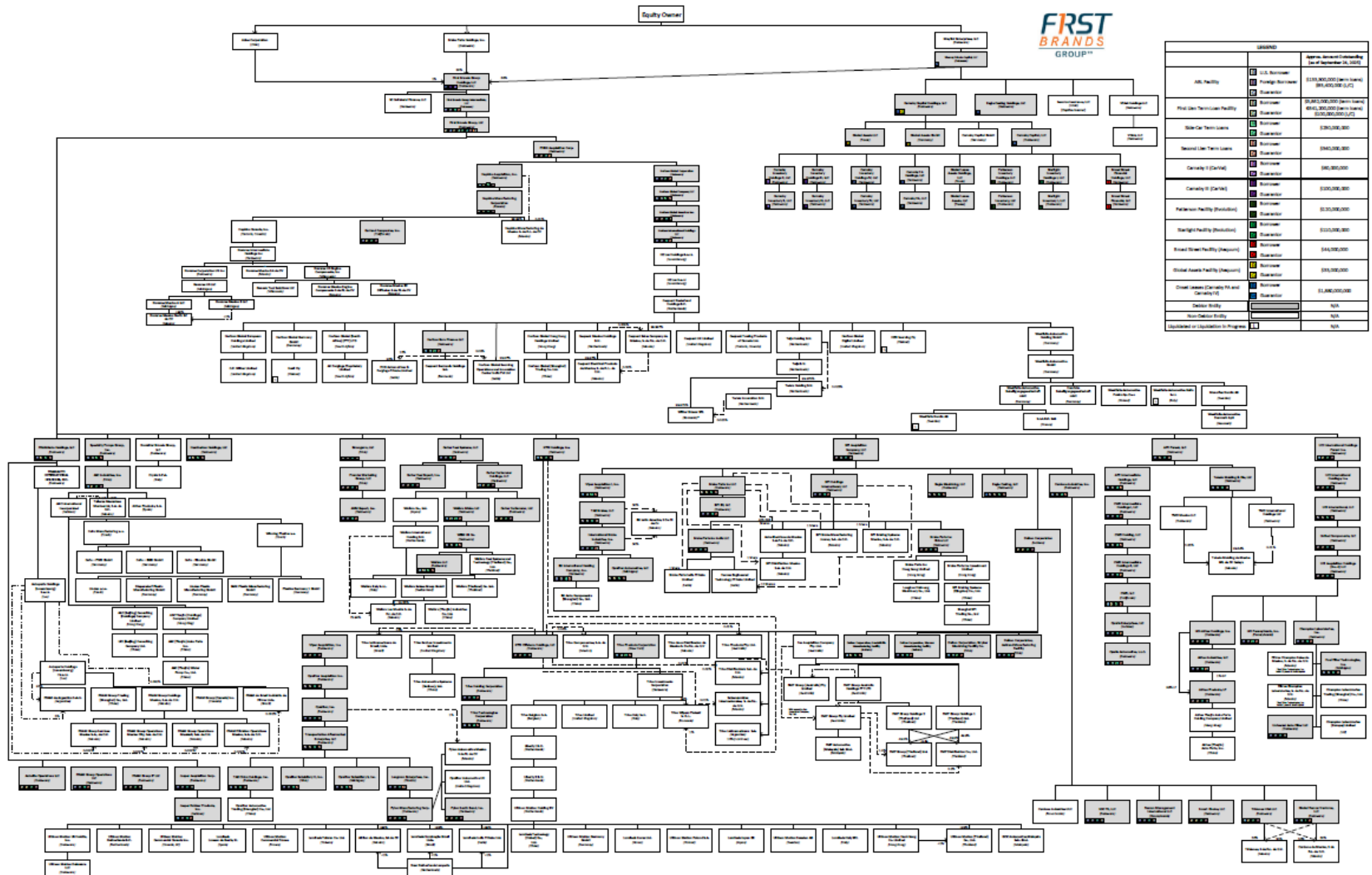
How First Brands Group collapsed | FT

- *September 2025 Bankruptcy Filing by First Brands Group LLC and 98 Affiliated Debtors*
- *Global Supplier of primarily aftermarket auto products, including wipers, filters, drums/rotors, brakes, lighting, and accessories*
- *Founded by Patrick James a reclusive entrepreneur originally from Malasia*
- *Company built up through an aggressive roll-up acquisition strategy*
  - *15 debt-financed acquisitions between 2011 and 2024 with the majority between 2020 – 2024*
- *Prior to its bankruptcy filing First Brands reported approximately \$6 billion in debt, consisting of \$5.5 billion in Sr. Secured debt and \$0.5 billion in Second Lien Debt*

Prepetition Indebtedness	Principal Amount Outstanding
<b>ABL Obligations</b>	
ABL Loans/Letters of Credit Obligations	\$226.9mm <sup>3</sup>
ABL Supply Chain Financing/Cash Management	\$369.4mm
<b>Total ABL Obligations</b>	<b>\$596.3mm</b>
<b>Term Loan Obligations<sup>4</sup></b>	
First Lien L/C Facility	\$100mm
First Lien Term Loans (USD)	\$3,886.9mm
First Lien Term Loans (EUR)	\$763mm <sup>5</sup>
Side Car Term Loans	\$250mm <sup>6</sup>
Second Lien Term Loans	\$540mm
<b>Total Term Loan Obligations</b>	<b>\$5,539.9mm</b>
<b>Off-Balance Sheet Obligations (SPV Debtors' Obligations)<sup>7</sup></b>	
Aequum Facilities	\$77.8mm
CarVal Facilities	\$159.0mm
Evolution Facilities	\$230mm
Onset Lease	\$1,880mm
<b>Total Off-Balance Sheet Obligations</b>	<b>\$2,346.8mm</b>
<b>Select Unsecured Obligations</b>	
Supply Chain Financing Obligations	\$812.4mm
<b>TOTAL DEBT OBLIGATIONS OF DEBTORS</b>	<b>\$9,295.4mm</b>



# FIRST BRANDS CORPORATE STRUCTURE

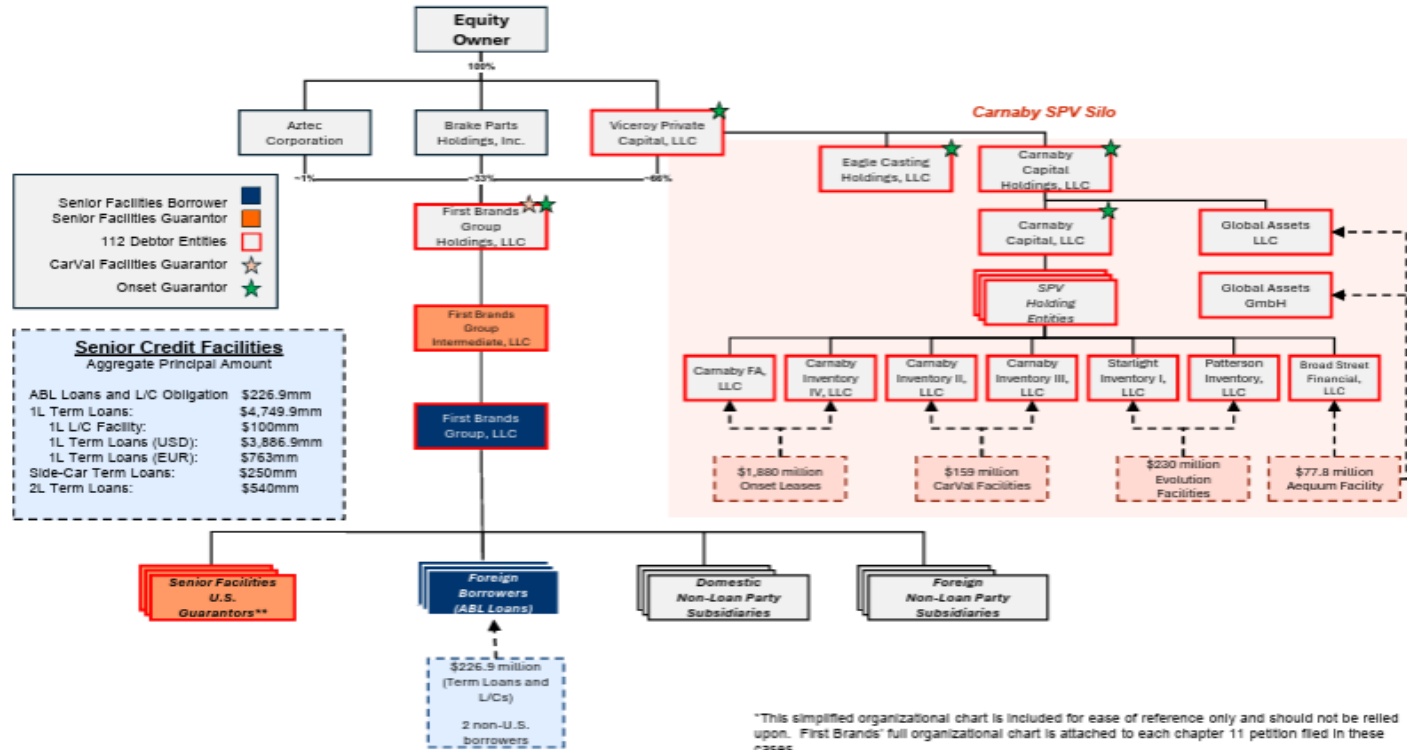




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## Simplified Organizational Structure\*



\*This simplified organizational chart is included for ease of reference only and should not be relied upon. First Brands' full organizational chart is attached to each chapter 11 petition filed in these cases.

\*\* One senior facilities guarantor, Eagle Casting, LLC, is also an Onset Guarantor



- *Early 2025 – First Brands attempts to address its upcoming debt maturities*
  - *Company rated B+/B1 by S&P and Moody’s at the time*
  - *Debt trading in the mid-to-high 90’s*
  - *Jefferies retained in July 2025 to lead refinancing efforts, including \$4.5 billion of 1<sup>st</sup> Lien loans coming due in March 2027*
  - *Red flags that were ignored for many years began to come to light and refinancing efforts failed*
  - *At the time of the Ch. 11 Filings - 1<sup>st</sup> Lien debt slipped to 30 cents on the dollar and 2<sup>nd</sup> lien debt fell to under 10 cents*
  - *By October 2025 CEO Patrick James resigned as CEO amid allegations of “accounting irregularities”*

First Brands Sues Founder Patrick James, Alleging Massive Fraud, Diversion of More Than \$700M of Company Funds to Affiliated Entities; Debtors Seek Asset Freeze, Citing Flight Risk, DOJ Probe



## First Brands Group, LLC

### Raistone Capital Seeks Emergency Appointment of Independent Examiner

- *Factoring service provider Raistone Capital alleges that up to \$2.3 billion tied to 3<sup>rd</sup> party factoring “irregularities” is unaccounted for and that roughly \$1.9 billion of factored receivables collected by the Company wasn’t turned over to the factors*

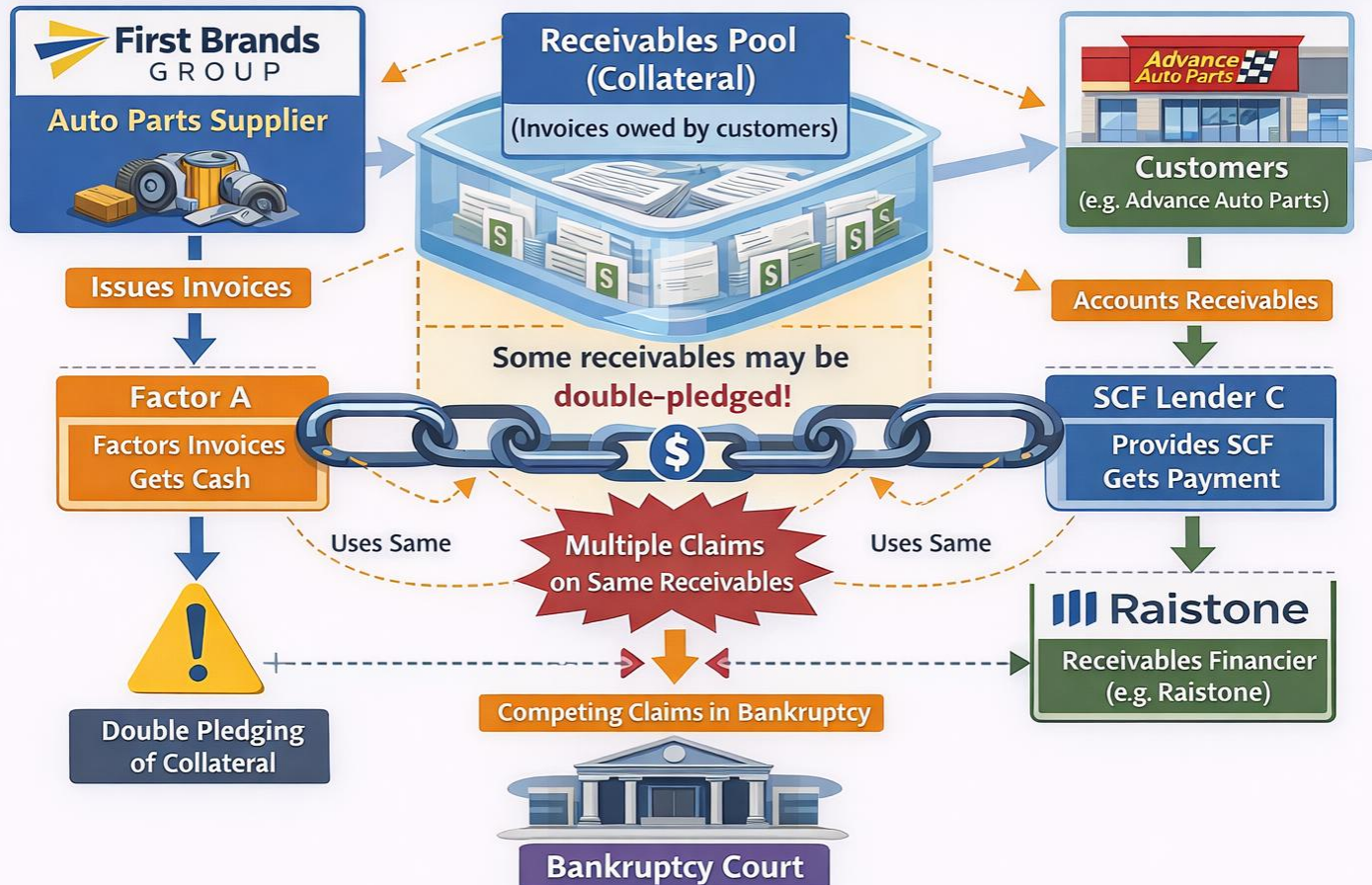
## First Brands Bankruptcy Damage Spreads to Jefferies, UBS

Banks disclose how much of the funds they manage are exposed to collapsed auto-parts supplier

- *Jefferies indicated that funds run by its asset management unit, Point Bonita Capital, are owed \$715mm from receivables ties to First Brands’ customers such as Walmart, AutoZone, NAPA, O’Reilly and Advance Auto Parts*
- *UBS said funds it operates have around \$500mm of exposure*
- *JV between Norinchukin Bank and Mistui & Co. and its U.S. subsidiary Katsumi Global faces \$1.75 billion in exposure backed by 210,000 purchased receivables*



## Rehypothecation in the First Brands Bankruptcy





## *Lenders and the First Brands Fraud Charges*

The feds indict the CEO, but the facts also aren't flattering to creditors.

*WSJ Article – January 29, 2026*

- *Mr. James submitted fake invoices and fraudulently inflated invoices to factors*
  - *One example...First Brands sold one customer invoice for \$8,976 in parts to a third party claiming it was worth double that amount...then sold the same invoice a few days later and claimed it was worth \$463,735*
- *Federal indictment says creditors hold \$2.7 billion of fake receivables*
- *Mr. James also established off-balance sheet vehicles to borrow more money and pledged the same inventory as collateral to multiple creditors*
- *When creditors requested customer invoices First Brand fabricated documents to show “aggregate amounts”*
  - *Why didn't creditors demand physical invoices documenting each transaction or a comprehensive audit of cash flows?*
  - *The promise of greater than 30% interest!*

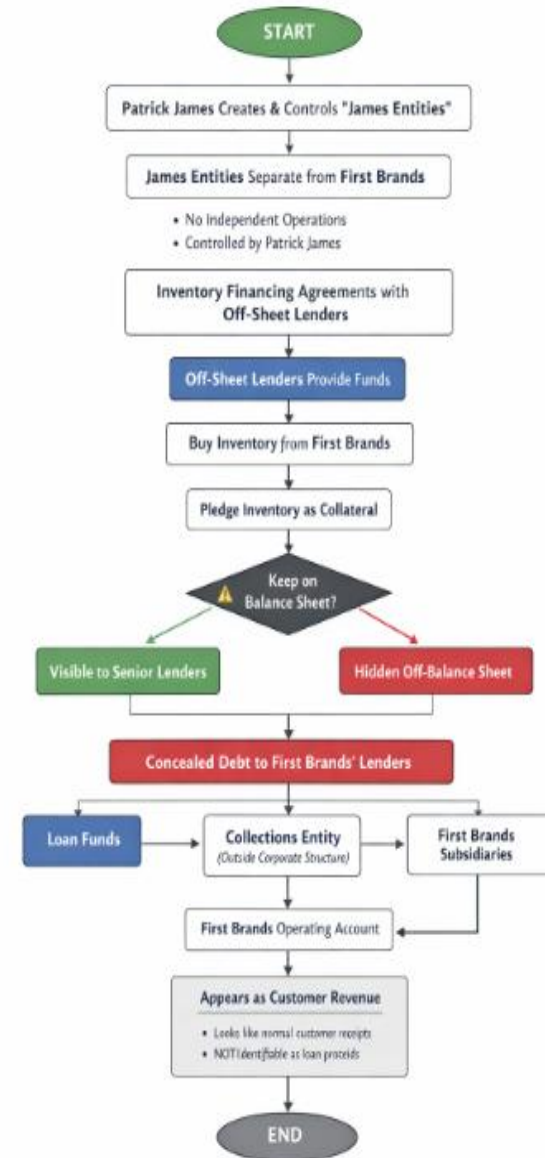


- *At the direction and with the approval of PATRICK JAMES and EDWARD JAMES, the defendants, First Brands obtained billions in invoice-based financing from factors through a series of fraudulent schemes...First Brands employees routinely submitted fake invoices, fraudulently inflated invoices, and double-pledged invoices for the purpose of selling and pledging them to factoring counterparties as if they represented valid, collectible receivables from customers. In some instances, invoices were generated for transactions that had never occurred, while in others the dollar amounts on invoices were altered to make them appear more valuable. Through the defendants' fraud schemes, First Brands sold its factoring partners billions of dollars of purported customer receivables that did not exist.*
- *First Brands submitted false and misleading invoice information and false and misleading information about First Brands' financial position to induce financiers to increase the funds advanced, a portion of which First Brands diverted to itself to cover cash needs. At First Brands, these self-payments were referred to as "round trips" or, euphemistically, as "corporate initiatives."*
- *Defrauded First Brands' lenders by disseminating materially false and misleading financial information about the company and secretly encumbering assets subject to the lenders' borrowing base and priority liens. At the direction and with the approval of PATRICK JAMES, First Brands employees made unsupportable financial statement adjustments to meet financial benchmarks set by PATRICK JAMES. To implement these directives, First Brands employees maintained internal "bridge" files that juxtaposed accurate corporate financials with the manipulated versions.*



# FIRST BRANDS EXAMPLE – US INDICTMENT

- *Unbeknownst to First Brands’ lenders, PATRICK JAMES and EDWARD JAMES also incurred massive off-balance-sheet debt through inventory-financing arrangements involving entities wholly owned and controlled by PATRICK JAMES (the “James Entities”). The James Entities were nominally separate from First Brands. In fact, they had no independent business operations. Through the James Entities, PATRICK JAMES entered financing arrangements with at least three inventory financiers (the “Off-Sheet Lenders”), whereby the lenders advanced funds to the James Entities to purchase inventory from First Brands. The James Entities, in turn, pledged that inventory purchased from First Brands back to the Off-Sheet Lenders as collateral for their loans. At the direction of PATRICK JAMES, the defendant, the inventory financing arrangements with the James Entities were maintained outside the First Brands corporate balance sheet and thereby concealed from First Brands’ senior lenders, who routinely requested and received First Brands’ financial statements.*
- *To further obscure the Off-Sheet Lenders as a source of funds to First Brands, PATRICK JAMES routed the loan proceeds from the Off-Sheet Lenders through a customer collections entity maintained outside the First Brands corporate structure, then disbursed the proceeds to First Brands subsidiaries before sweeping the funds into First Brands’ operating account. The defendants designed this flow of funds so that the funds appeared to be ordinary customer receipts from retail subsidiaries rather than loan proceeds from related-party financing arrangements with the James Entities.*
- *Finally, at the direction of PATRICK JAMES and EDWARD JAMES, First Brands made false and misleading representations to the Off-Sheet Lenders to fraudulently induce them to extend and expand financing. The James Entities pledged inventory that PATRICK JAMES and EDWARD JAMES, the defendants, purported to be unencumbered but in fact was already subject to liens by, or otherwise pledged to, First Brands’ senior lenders and remained on First Brands’ balance sheet.*





EXCLUSIVE CFO JOURNAL

## **BDO's First Brands Audit Painted Healthy Picture Months Before Collapse**

The audit of the auto-parts supplier didn't show the billions of dollars of off-balance-sheet debt and unpaid balances owed to financing providers

- *BDO – “During 2024 and 2023 the Company had factoring agreements with financial institutions without recourse.”*
- *First Brands recognized \$195mm of Accounts Receivable factoring related expenses, but didn't detail the amount of outstanding obligations stemming from factoring arrangements (1<sup>st</sup> Day Aff showed \$2.34 billion of off-balance sheet financing, plus \$812mm of unsecured supply chain financing)*
- *The \$2.34 billion of off-balance sheet receivable financing was backed by only \$347mm of accounts receivable.*
  - *Problem is that the factored invoices were collected by First Brands and then passed on to the financial institutions rather than being paid directly*
- *The size of the off-balance sheet obligations were material and as such should have been disclosed in the audit report*



- *Examiner appointment disclosed \$830mm in fraudulent transfers to Mr. James and his family between 2018 and 2025*
- *Examiner also focused on pre-petition receivables financing and off-balance sheet deals*
- *What went wrong with the Special Purpose Vehicles (SPV's)*
  - *SPV's by design are supposed to be insulated from bankruptcy – not the case with First Brands*
  - *Used to finance receivables so lenders can loan against the value of the assets rather than the creditworthiness of the Company – assets are supposed to be segregated and beyond the reach of other creditors*
  - *SPV's and its “independent” directors are supposed to only owe duties to the SPV and its creditors*
  - *SPV Debtors are not obligors under the Company's Prepetition Term Loan or ABL*
    - *“the facts underlying [the SPV] transactions raise serious concerns and questions about whether certain SPV Lenders have any collateral at all or if they do, what the status is of their liens relative to prepetition lenders.”*
    - *ABL and TL lenders may have perfected priority liens in the assets allegedly serving as collateral held by the SPV lenders*
    - *Inventory meant to serve as collateral to the SPV lenders was comingled with inventory of the First Brands debtors*
    - *Numerous SPV lenders brought adversary proceedings against First Brands*
- *The question now becomes which lenders have a first claim on the assets and what happens to the other lenders?*



- *On March 2, 2026, former CFO Stephen Graham admitted guilt to four counts, expressly including bank and wire fraud.*
- *This followed a guilty plea from former senior vice president of finance, Peter Brumbergs, who admitted to falsifying financial statements, inflating invoices and double-pledging collateral.*
- *Mr.'s Graham and Brumbergs will testify against Patrick and Ed James*



## *So Where are We in the Chapter 11 Process?*

- *DIP Financing now trading anywhere from 20 cents on the dollar to under 1 cent*
- *Emergency financing needed and provided by OEM's*
- *Exclusivity extended*
- *Assets being sold*
- *Raistone filed Chapter 7 in February*
- *Mediation ongoing for case resolution – Extended through March 27th*
- *The outlook for unsecured creditors is not good!*



## Lesson/Red Flag

- **Company Red Flags - Founder-owned businesses tend to be private (less disclosure), more aggressive, and overconfident. This creates an environment conducive to potential fraud.**
  - **Bernie Madoff and FTX were founder-led companies**
  - **Privately-held companies may not be willing to share audited financials**
  - **Non-public companies may be creative in their calculations of Adjusted EBITDA**
    - **General rule of thumb is if Adjusted EBITDA exceeds actual EBITDA by more than 20% this is a red flag**
  - **Aggressive, debt-financed growth – using leverage works well when things go according to plan but can exacerbate losses when things go sideways**

## Mitigant

- **Comprehensive background checks and reference checks – a google search would have shown that Patrick James had been sued numerous times over the years**
- **Analyze financial statements in-depth and ask probing questions – if they aren't willing to share or answer questions be careful**
- **What are the Company's borrowing costs?**
- **Separate organic growth vs. M&A growth.**



## Lesson/Red Flag

- **Off-balance sheet debt & Reverse Factoring**
  - **Factoring & SPVs place debt off-balance sheet but aren't they really the same thing as revolver/ABL borrowings?**
    - **Off-balance sheet doesn't mean off-risk**
  - **First Brands' debt was understated by approximately 40% by excluding off-balance sheet obligations**
  - **Rehypothecation risk is real and expanding given the growth in private credit**
    - **The more complex the structure the more difficult it is to track potential rehypothecation**
  - **Reverse Factoring/Supply Chain Finance – Stretches payables but at what cost?**
    - **First Brands was paying over 30% interest rates on its reverse factoring arrangements**

## Mitigant

- **Include off-balance sheet debt in your calculations – what happens to leverage and interest coverage?**
- **Does the interest rates a company is paying on its reverse factoring arrangement make sense given its supposed credit profile?**
- **Demand transparency on working capital programs – schedules of factored receivables, concentrations by counterparty, aging, etc.**
- **Random invoice sampling to check for overlapping liens**
- **UCC searches**



# THANK YOU!!

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