

Working Capital Improvement through Supplier Finance

... It's Not Just for Large Corporates

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Together we'll go far



Topics

- Trends in supply chain finance
- Evolution
 - Procure 2 Pay: E-Invoicing
 - Dynamic discounting
 - Buyer-centric approved payables finance
- Strategies & solutions for middle market to extend DPO
- Case Studies
- Keys to success

Cash conversion cycle

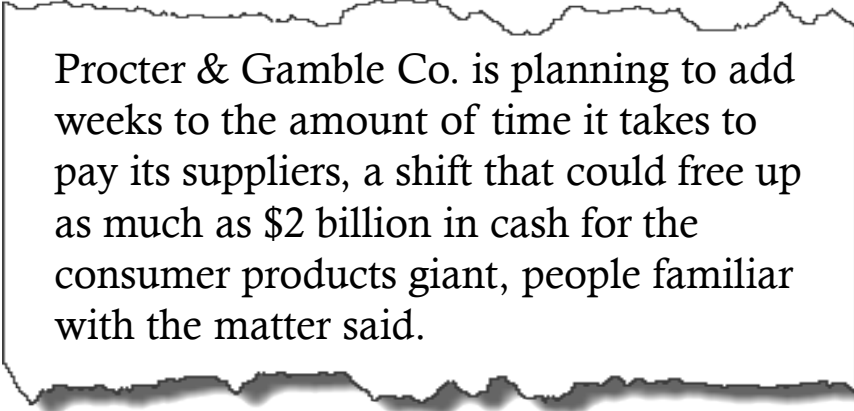


Pressure to optimize working capital

THE WALL STREET JOURNAL

TUESDAY, APRIL 16, 2013

P&G, Big Companies Pinch Supplier on Payments



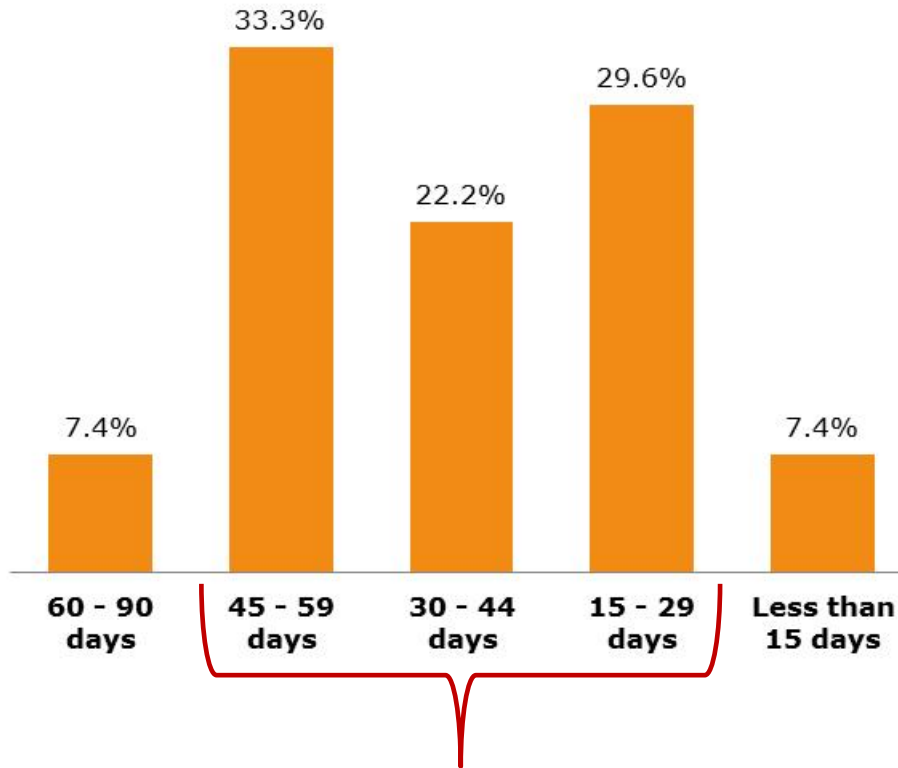
Procter & Gamble Co. is planning to add weeks to the amount of time it takes to pay its suppliers, a shift that could free up as much as \$2 billion in cash for the consumer products giant, people familiar with the matter said.

- In recent years, many corporations with international supply chains have been lowering their COGS by eliminating Letters of Credit (moving to open account) and improving their working capital by extending their payment terms (improved DPO).
- This trend is driving middle market companies to look for similar ways to optimize working capital to remain competitive and realize the same benefits in working capital with their own supply chain.

Average trade terms with suppliers

2014

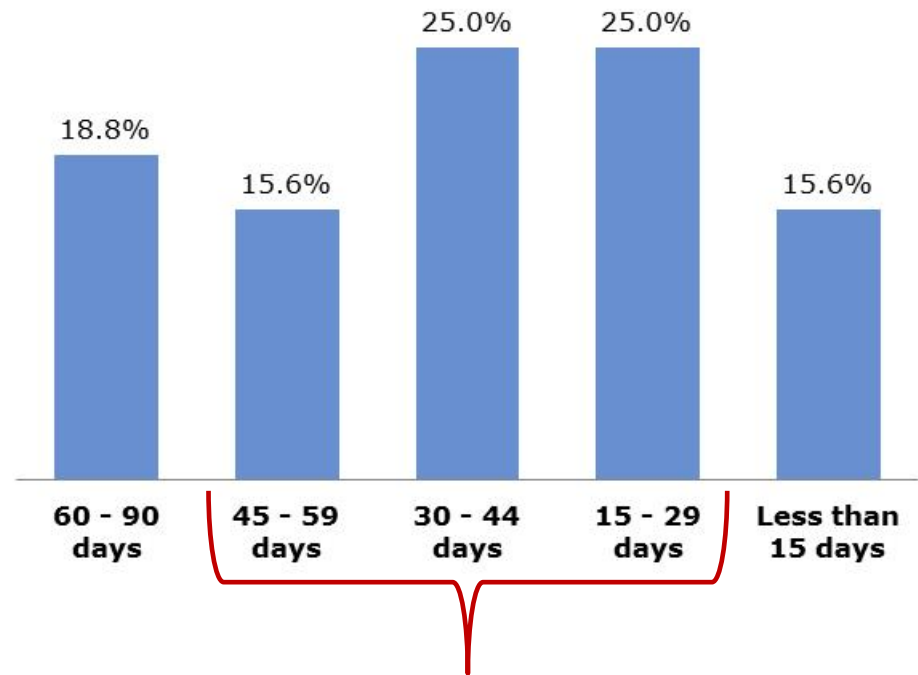
(27 respondents)



85% at 15-60 days

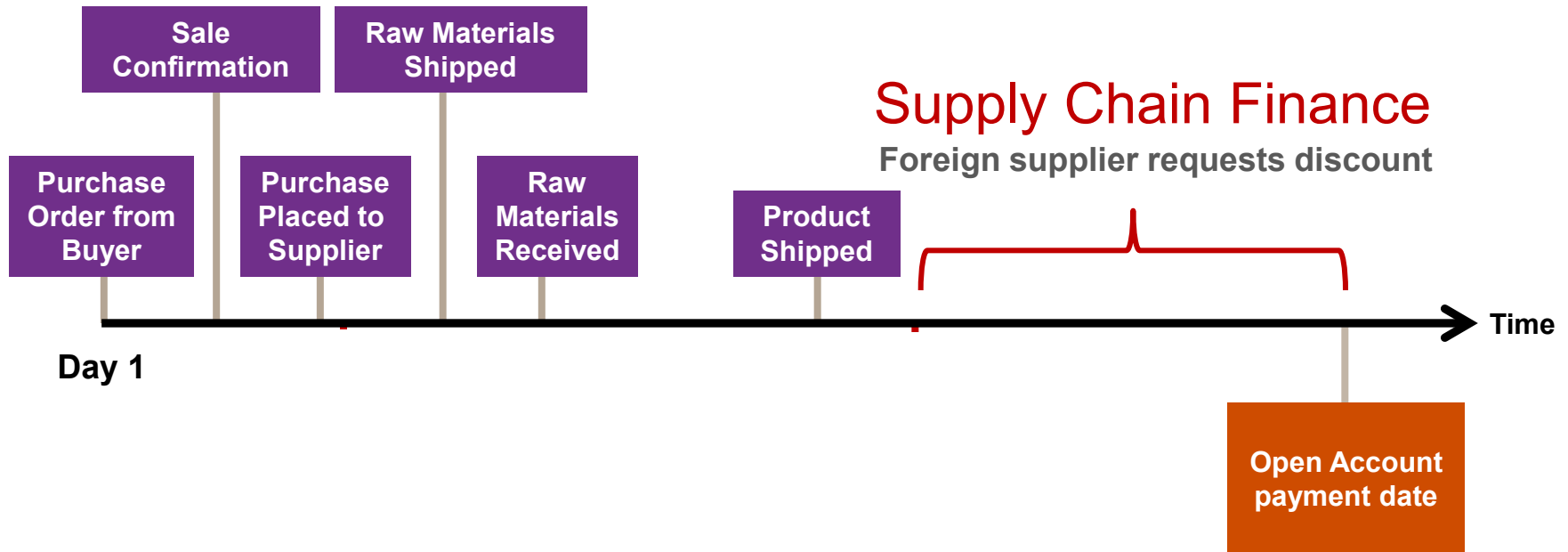
2013

(32 respondents)



66% at 15-60 days

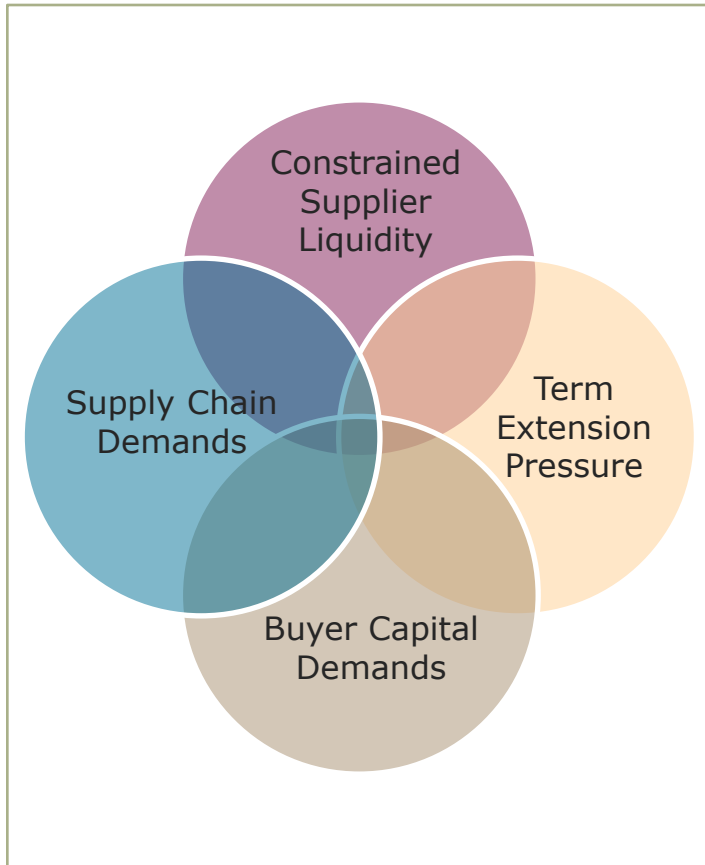
The shift from L/C's to Open Account has created funding gaps



Current environment

Working capital management is a principal focus for firms across all industries and for both buyers and suppliers.

Why Supply Chain Finance?



Issues driving need for Supply Chain Finance

- Buyers, in an effort to preserve capital, are pushing out payment terms.

Potential Supply Chain Finance benefits for buyers

- Increase DPO
- Reduce COGS

Potential Supply Chain Finance benefits for suppliers

- Attractive liquidity management tool through the early payment option
- Positive working capital benefits

KPI / Working Capital metrics

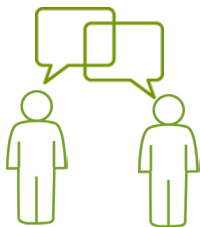
Which areas have KPI or Working Capital improvement metrics?



Procurement



Supply Chain



Sales



■ **2014** (11)
■ **2013** (16)
(# respondents)

Supply Chain Finance & Electronic Invoicing

Market progression



Multiple flavors of Supply Chain Finance

	Types	Delivery
Buyer-centric	Letter of Credit	Commercial letter of credit has been a standard supply chain finance tool for years
	Purchasing Card	Evolving A/P solutions
	Payables	<ol style="list-style-type: none"> 1. E-Invoicing 2. Buyer financed (Dynamic Discounting) 3. Approved Payable Finance
	Receivables	A/R Purchase – supplier sells invoice; however, the discount rate is based on strength of buyer
Supplier-centric	Supplier-driven receivables	Examples include: factoring and invoice discounting
	Inventory Financing	Example: Vendor Managed Inventory

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E-Invoicing with dynamic discounting

What is it?

- E-Invoicing
 - Presentation, matching and approval of individual e-Invoices and Purchase Orders
- Dynamic Discounting
 - Varying levels of discounts off invoice amounts offered to buyer for early payment

Benefits

- Supplier
 - Early payment option without incurring bank debt
- Buyer
 - Lower product pricing and Cost of Goods Sold
 - Better return on cash than most alternatives

E-Invoicing market adoption

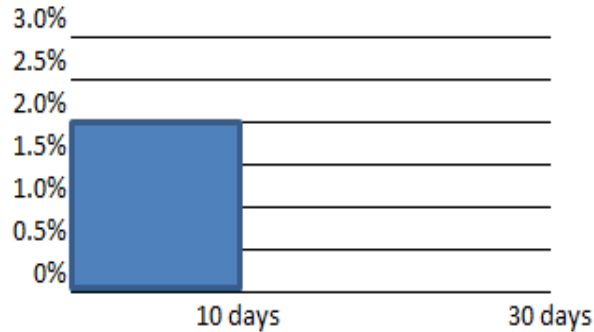
Trends driving adoption

- Increased automation across enterprises
- Improving onboarding tools and ease of use
- Government e-Invoicing mandates (starting in public sector and moving to industry-specific and general mandates)
- Successful case studies

Solution value proposition: e-Invoice Efficiency

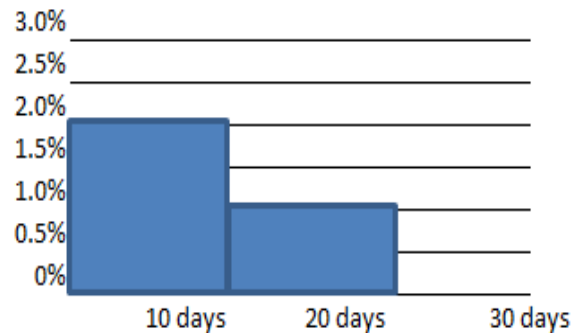
- Accounts Payable processing efficiency
- Faster approvals
- Reduced processing costs
- Increased visibility for buyers and sellers

Dynamic discounting evolution



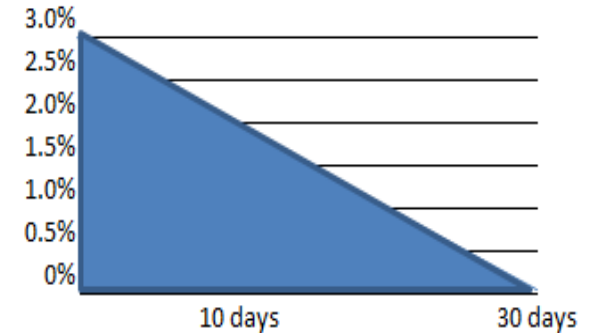
Static discounting

Single offer, fixed discount such as typical 2%, 10 net 30



Staggered discounting

Multiple fixed discount levels, such as 2%, 10 or 1%, 20 net 30



Dynamic discounting

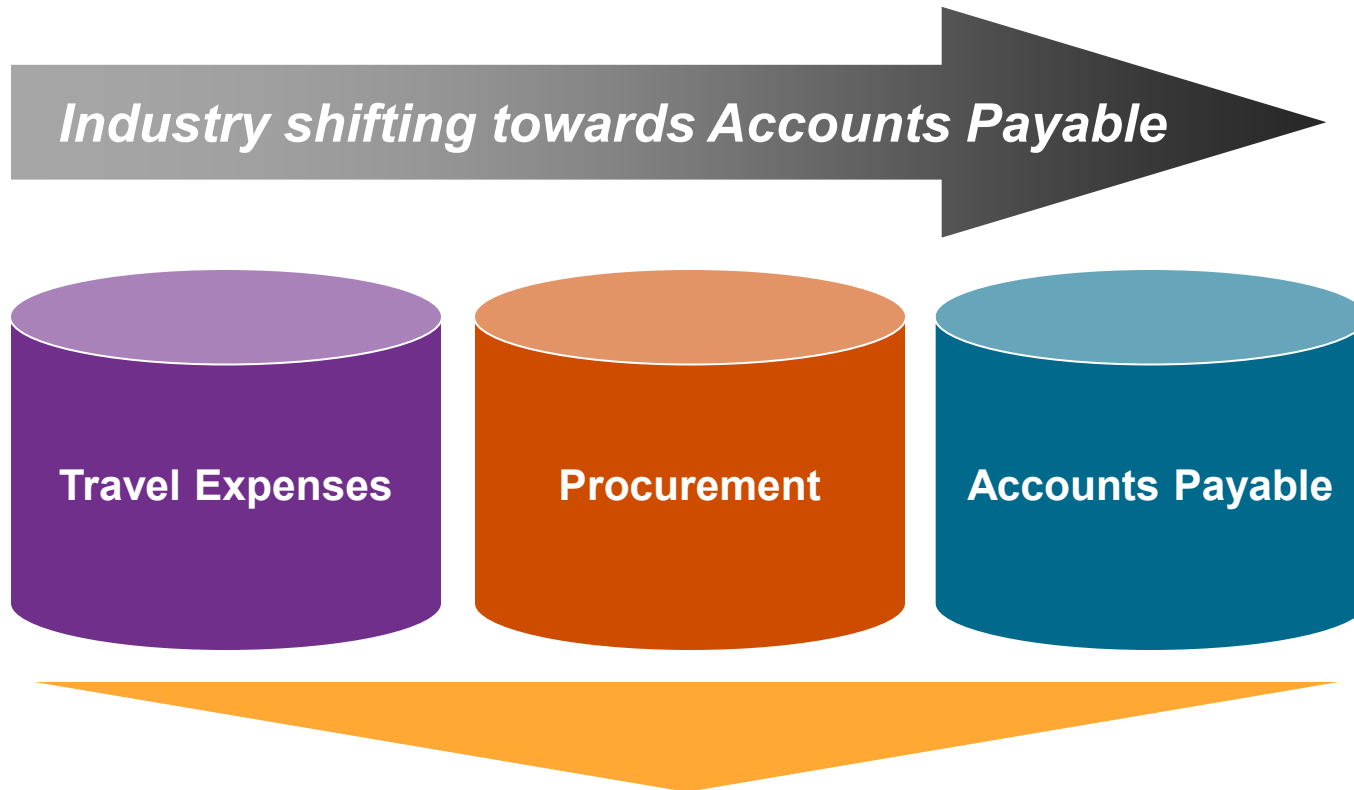
Sliding scale from 0 to X days based on linear or other discount schedules, customizable by supplier

Dynamic Discounting challenges

Constraints

- Some buyers do not have excess cash
- Negative impact on buyer working capital
- Lack of technical resources to roll out a program
- Onboarding
 - Partial adoption
 - Legal agreements
- Variability in:
 - Invoice formats across buyers, countries, and industries
 - Regulations: E-Signatures, in-country archiving requirements
 - Tax requirements (VAT)
 - Tax Id #'s
 - Variable Rates by country
- An expensive option for the seller

Purchasing Card has been trending toward A/P spend



Objectives include increased efficiencies, reduced costs, and an improved bottom line

A/P Card solutions

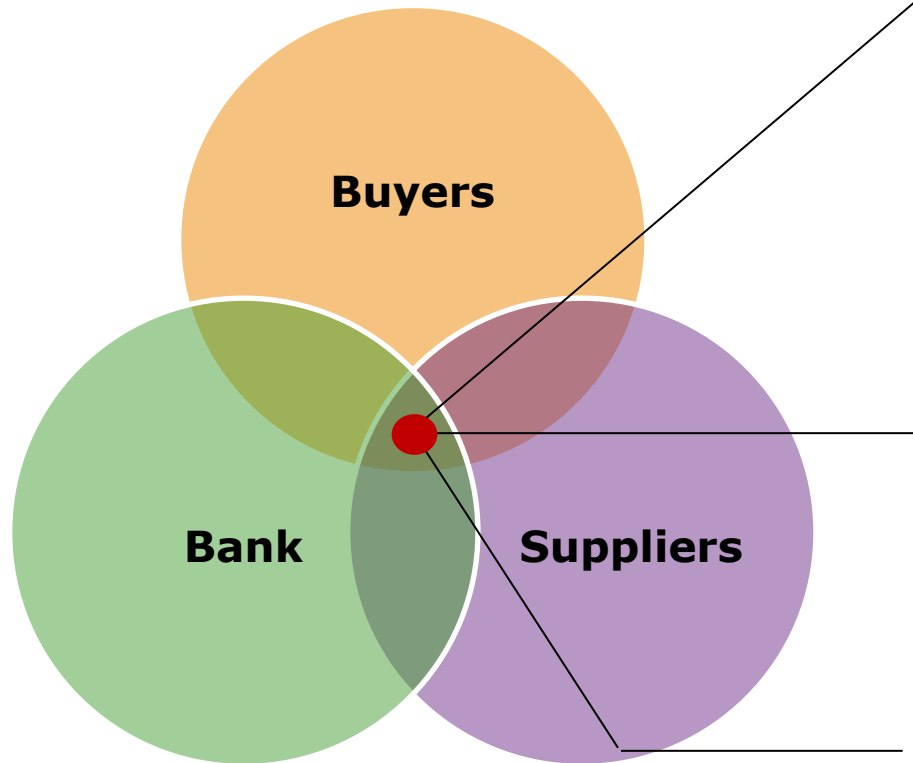
Trends driving adoption

- Card no longer required in the transaction
- Straight through processing
- Bank assisted on-boarding
- Rebates
- Working capital benefits

Constraints

- Interchange fees can be high
- Strategic suppliers may not be willing to accept the payment form
- Supplier onboarding

Supply Chain Finance: factors driving adoption



Buyers

- Reduces Cost of Goods Sold (COGS)
- Increases Days Payable Outstanding (DPO)
- Offers cash flow certainty
- Strengthens supply chain and reduces supply chain financing costs
- Improves supplier relationships
- Buyer tends to maintain trade payables status; programs generally not classified as debt
- May provide working capital advantage over competition

Suppliers

- Attractive liquidity management tool
- Positive working capital benefits
- Full payment transparency
- Ability to receive information and payment in a format that best suits their needs
- Improve structure of balance sheet

Bank

- Generates strong new income streams
- Promotes credit line utilization
- Introduces potential new supplier relationships

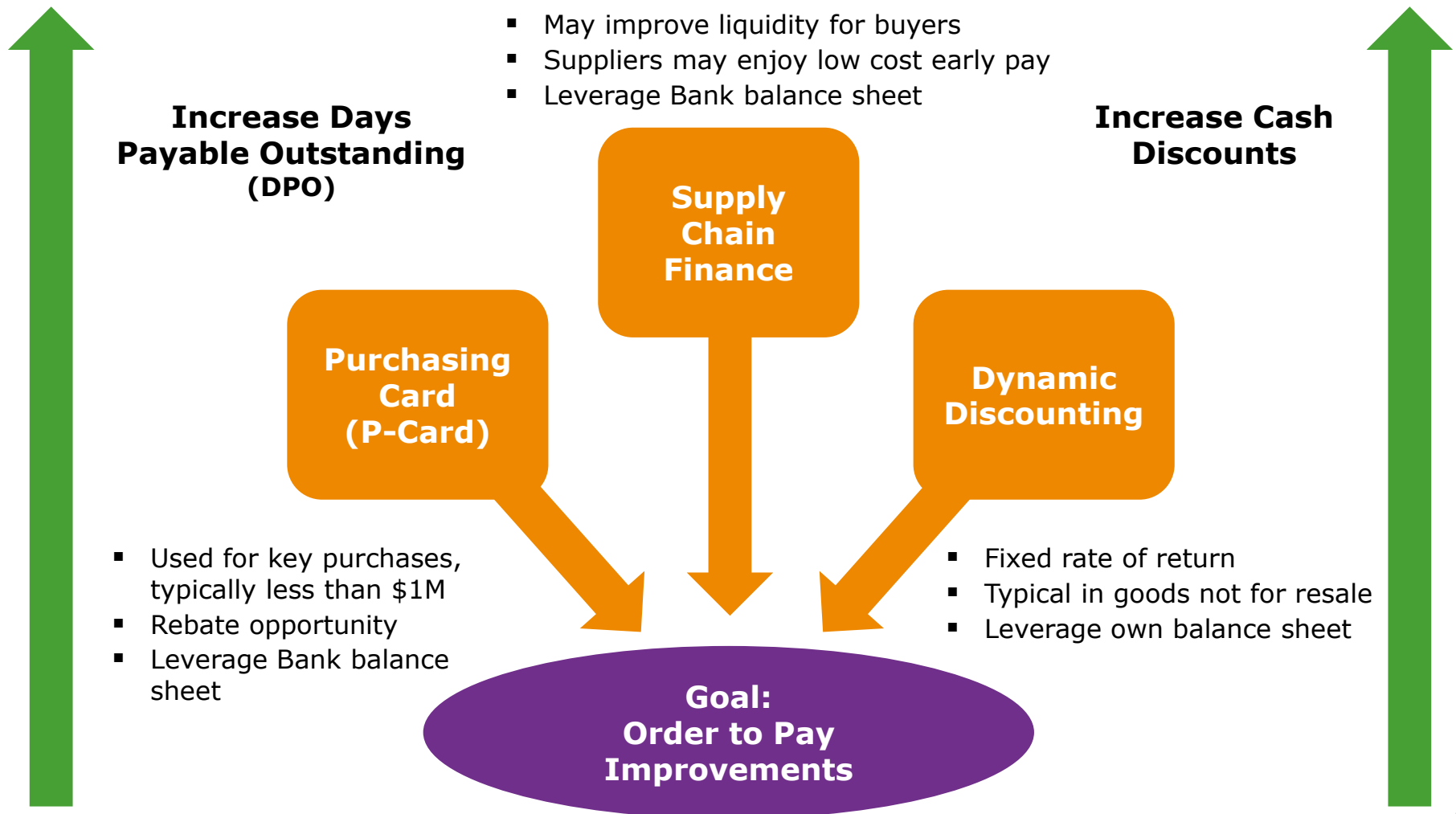
Supply Chain Finance: constraints

Constraints

- Know Your Customer certification
- Variability in regional requirements
 - Enforceability of supplier agreements
 - Banking license, regulatory consent or other approvals
 - Does the bank have to comply with any regional export control laws
- Accounting treatment
- Onboarding
- Providers have had difficulties creating a 'Win-Win-Win' outside of investment grade companies

Order to Pay: improvement begins with a solid strategy

Strategy: Working Capital enhancement through optimizing your Accounts Payable



What about payables solutions
for the middle market?

Approved Payable Finance with non-investment grade companies

Challenges

- May not be the strongest link in the supply chain
- Programs can be expensive to implement
- Access to liquidity
- Technical resource availability

Opportunities

- Purchasing cards
- Some providers are coming to market with alternatives for this sector (< \$2B in sales; non-investment grade)
- 'Integration-lite'
 - Trade drafts
 - Paying agent
- Works best with strong credit rate arbitrage opportunities
 - Weaker SME suppliers in the supply chain
 - Suppliers in high interest rate markets (China, India, etc.)

Let's look at some case studies

Things look OK, right?

Plumbing, Inc.

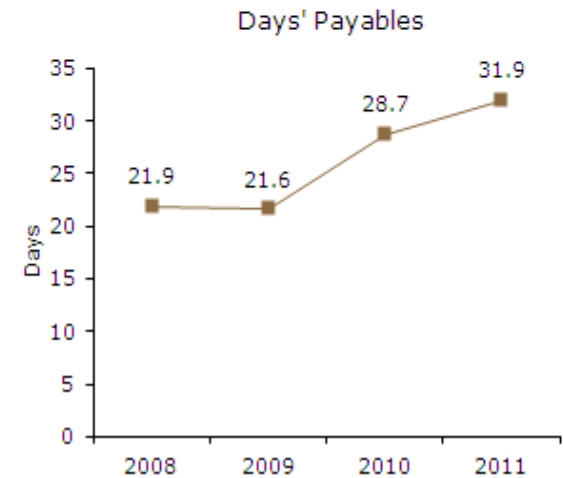
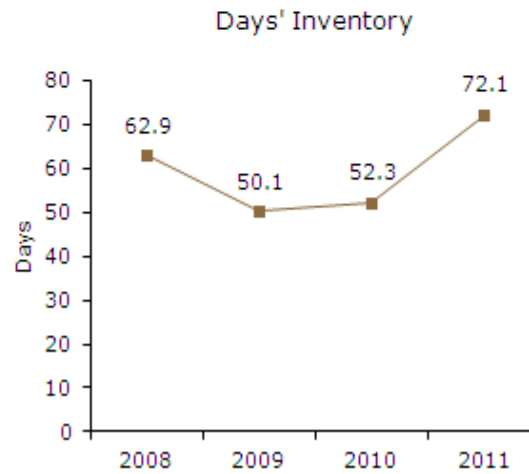
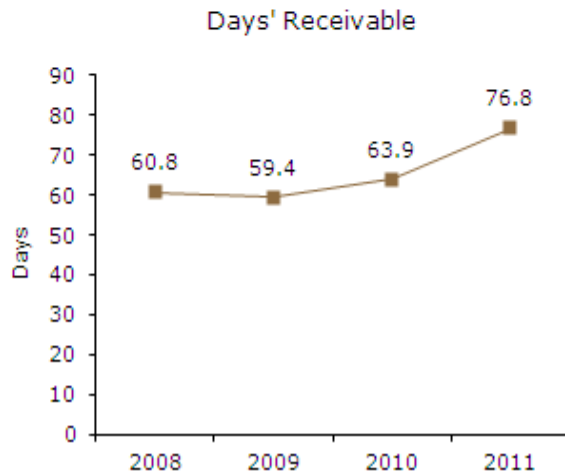
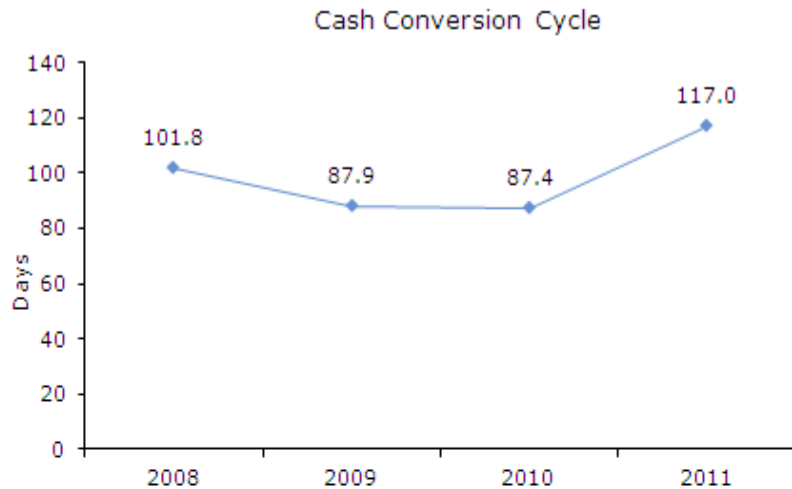
Sales (\$000)

\$ 150,248

Trend Observations

- Cash Conversion Cycle 15.2 days
- Days' Receivables 16.0 days
- Days' Inventory 9.2 days
- Days' Payables 10.0 days

Increase (Decrease)



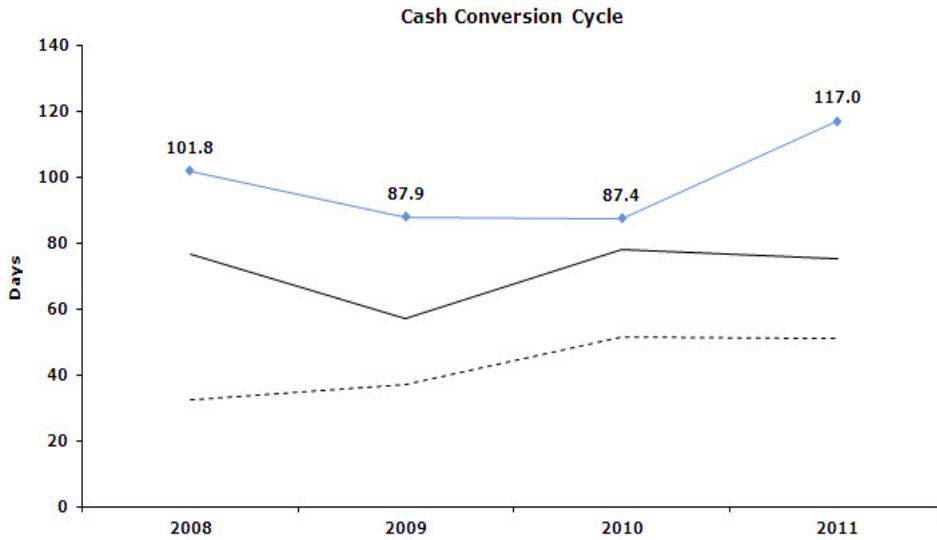
Or do they ... ?

Plumbing, Inc.

NAIC: 423840

Sales Range: \$100 - \$250

of RMA companies: 26



Trend Observations

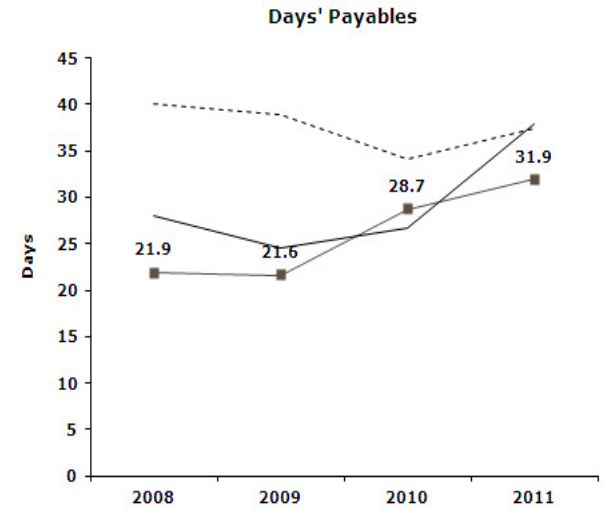
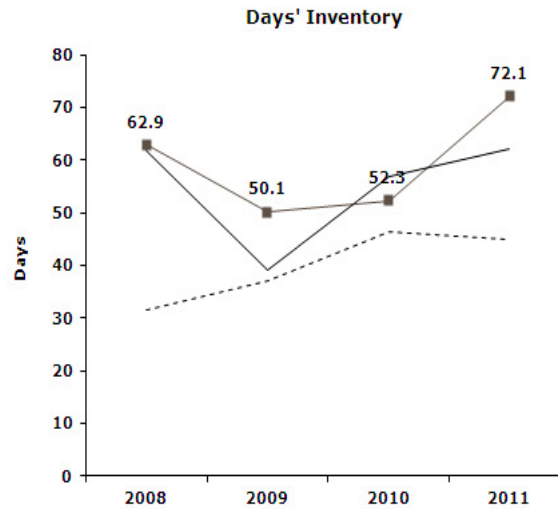
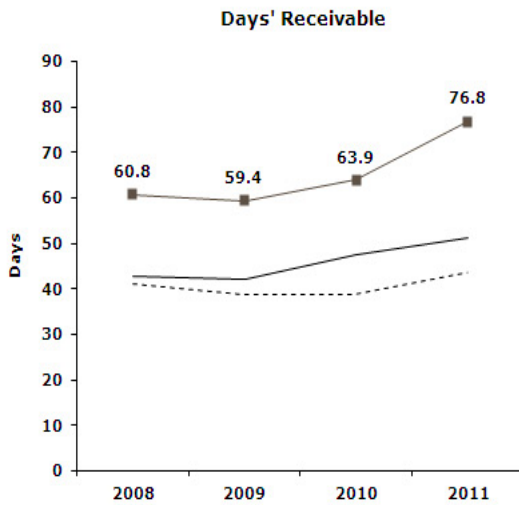
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- Days' Inventory
- Days' Payables

Increase (Decrease)

- 15.2 days
- 16.0 days
- 9.2 days
- 10.0 days

2011 RMA Median

- 75.3
- 51.0
- 62.2
- 37.9



RMA Quartiles

Median — Top - - - -

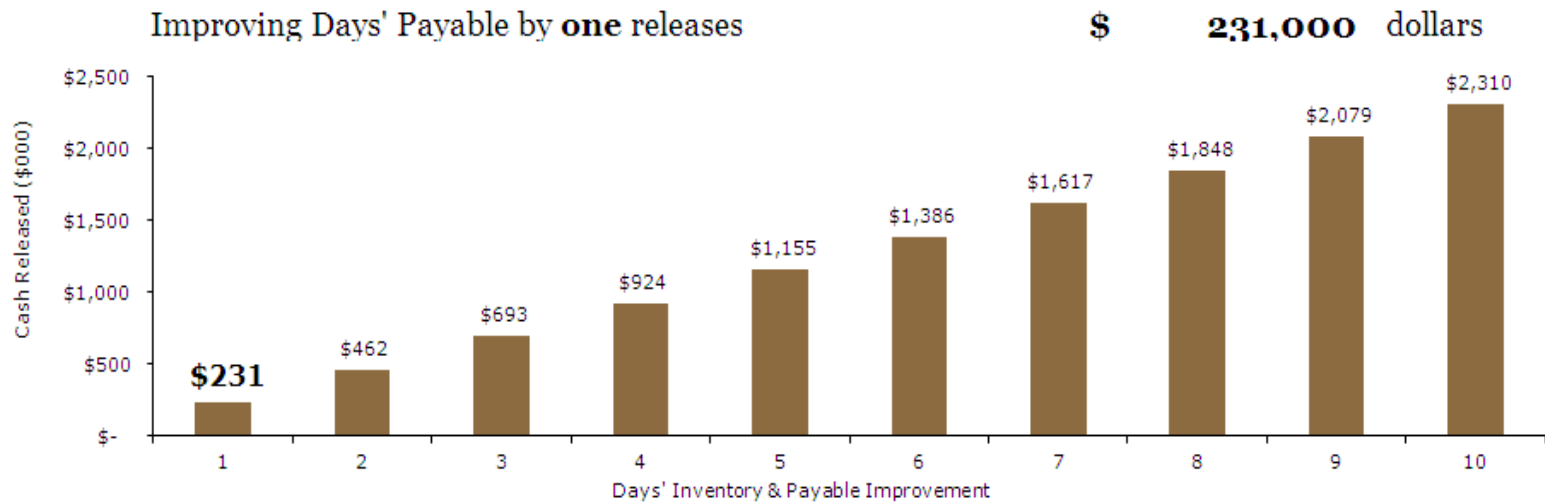
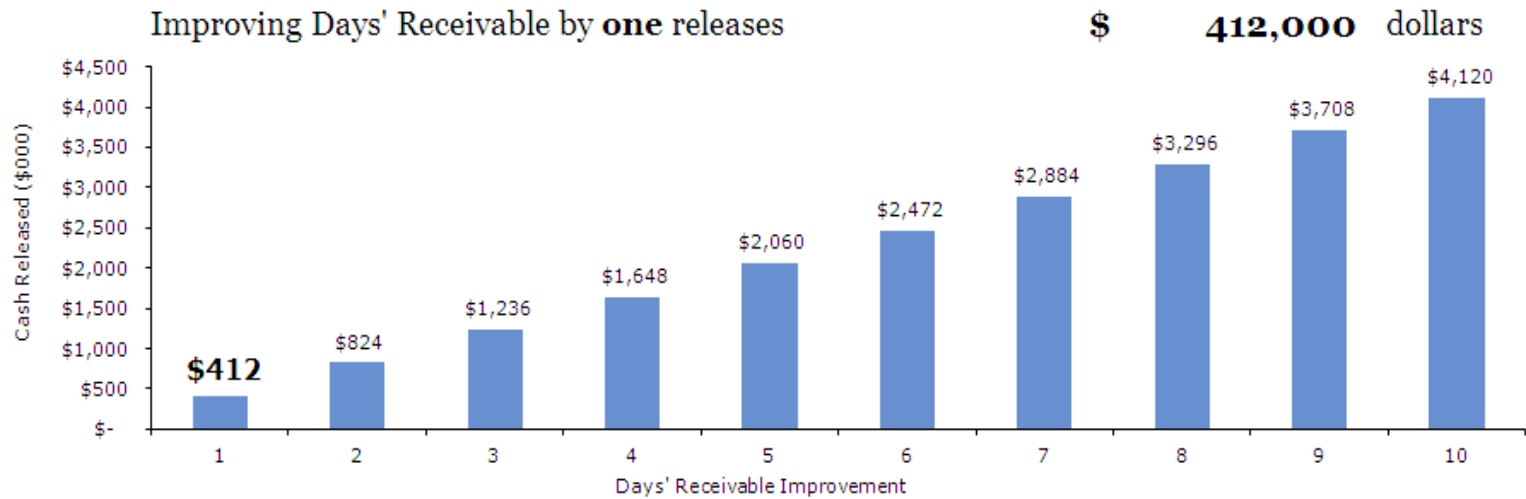
Note: RMA trend lines extended over missing years' data

Big numbers

\$412,000

\$231,000

That can be even bigger



Company X case study

Background

- Company X is based in the U.S. and has approximately \$100 million in sales
- Manufactures, markets and designs food and beverage products

Scenario

- Company X has a trading partner in China that supplies a majority of the finished product that they design and sell
- Their original terms for payment with this supplier was 30 days FOB with payment made via wire (open account)
- Annual spend with the supplier is approx. \$42mm
- The CFO was interested in ways to improve his Working Capital
- Revolver pricing is L+ 225 bps; SCF spread 50 bps; all-in supplier discount rate 3%

Working Capital Enhancement for Company	
PMI Est. Program Spend	\$42,000,000
Vendor Participation Rate	100%
Spend @ Participation Rate	\$42,000,000
Current DPO	30 days
DPO increase from 30 to:	90 days
DPO improvement (net increase)	60 Days
Working Capital Enhancement	\$7,000,000

Working Capital analysis (supplier)

- Rate on revolver: **Libor + 225 bps**
- SCF Spread: **50 bps**
- Supplier discount rate: **~ 3%**

Working Capital Enhancement Supplier	
	<u>Annually</u>
Purchase Amount	\$42,000,000
Current payment tenor (days)	30
Desired payment tenor (days)	90
Current Interbank Interest Rate - China	6.00%
Assumed Supplier borrowing rate	10.00%
Cost of Borrowing locally (30 days)	\$350,000
Assumed Discount Rate to Supplier from Company X through SCF	3.00%
Borrowing Rate Delta	7.00%
Comparison of financing costs using extended payment terms of 90 days	
Cost of borrowing locally in China for 90 days @ 10%	\$1,050,000
Cost of financing for 90 days using SCF rate of 3%	\$315,000
SCF Borrowing Savings to Supplier	\$735,000

→ **30 Days (Existing financing cost = \$350,000)**

→ **90 Days (New financing cost= \$315,000)**

Company X wins:

60 days in working capital benefit (~\$7 million)

Supplier wins:

- Reduces financing cost by \$35,000
- Creates capacity on existing facility
- Obtain 100% financing versus 80% - 90% when compared to factoring

Keys to success

- Run the analysis
 - Vendor analysis
 - Working capital analysis
- How much credit (or cash) do you have available to support your supply chain?
- Review comparable term standards in your industry
- Include key stakeholders in evaluating the value proposition
- Choose the right partner
 - What assistance will they provide in on-boarding?
 - Do they have a successful track record?
 - Does their solution set and infrastructure match up well with your needs?
- Determine the right rollout plan for your company

Questions