

# The Evolving Supply Chain Finance Market

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# Agenda

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# Our Speakers

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# I. Market Trends In Supply Chain Finance

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# Credit Market Downturn and Its Impact on Financing

## Widened Credit Spread

- Credit markets have improved considerably since the worst periods in early 2009. However, credit spreads remain elevated relative to 2007

## Lack of Financing

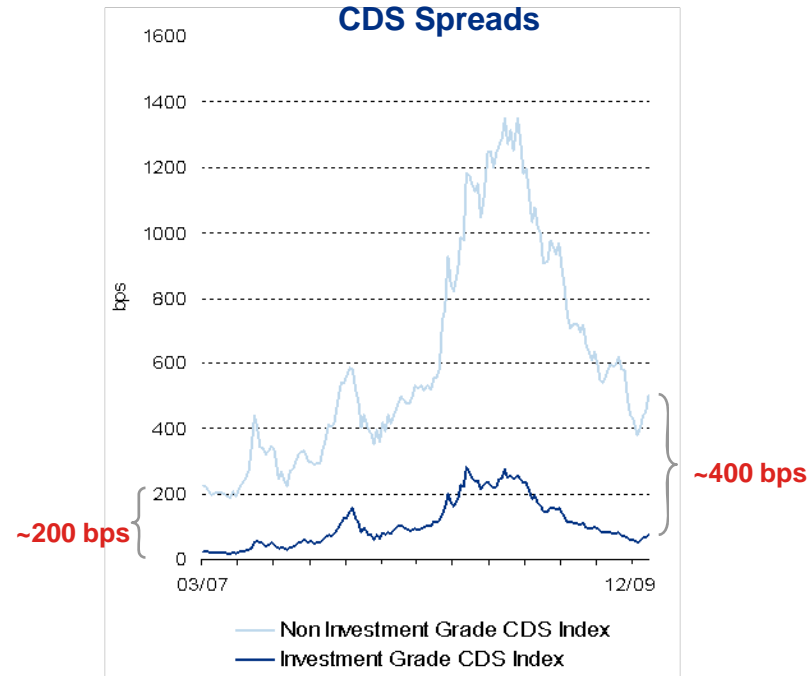
- Suppliers continue to find it difficult to gain and maintain access to working capital financing

## Standardization

- Large Corporations are focusing on improving their performance metrics and working capital management via standardized terms, standardized work flow and automated process.

## Supply Chain Pressure

- When corporations initiate DPO extensions, suppliers are left to fill in the finance gap to fund the supply chain
- In response, **Supplier Finance** programs are fast becoming an important Win-Win tool among buying organizations in generating cash flow, stabilizing supply chain and reducing supplier costs –
  - Citi estimates that 50% - 70% of S&P companies now use some form of Supplier Finance



Source: Bloomberg, iTraxx CDS indices

# An Improving Economy will put a Strain on Working Capital

The magnification of demand fluctuations down the supply chain results in increased trade credit provided by suppliers to their buyers putting a strain on their Working Capital.

## The Bullwhip Effect

- Demand variability increases significantly at each stage further down a supply chain from the final consumer
- Hence, small changes in consumer demand can result in considerable variations in orders placed downstream

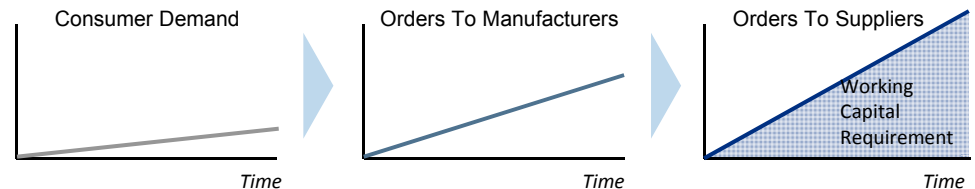
## Primary Cause

- Demand forecast inaccuracy due to lack of visibility of true customer demand down the supply chain

## Impact On Suppliers

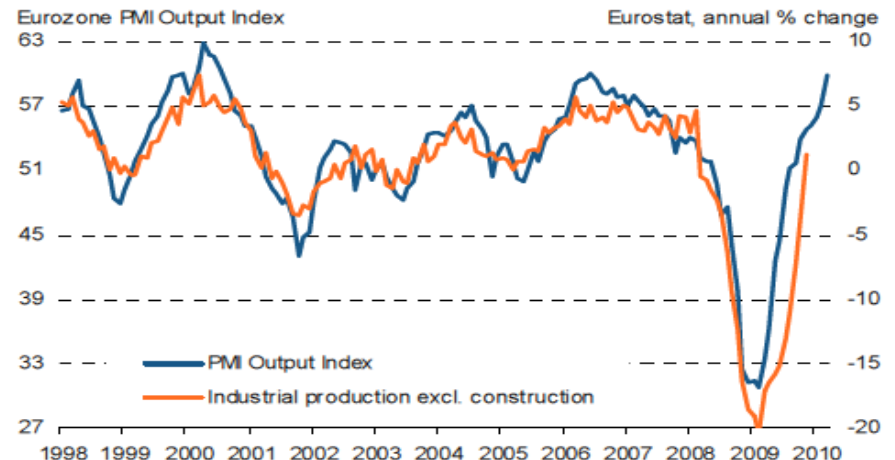
- Suppliers provide implicit 'trade credit' to manufacturers in the form of payment terms beyond delivery of goods
- This trade credit locks up supplier Working Capital
- Sudden increases in orders can greatly increase supplier working capital requirements and is one of the most common causes of insolvency
- With the economic cycle due for a growth stretch, suppliers are likely to feel the effects of the bullwhip effect over the next 12-24 months

## Effect On Supplier Working Capital



Increased consumer demand results in magnified orders to manufacturers, which is further magnified in orders to suppliers, putting a strain on Supplier Working Capital

## Economic Cycle Due For An Upturn



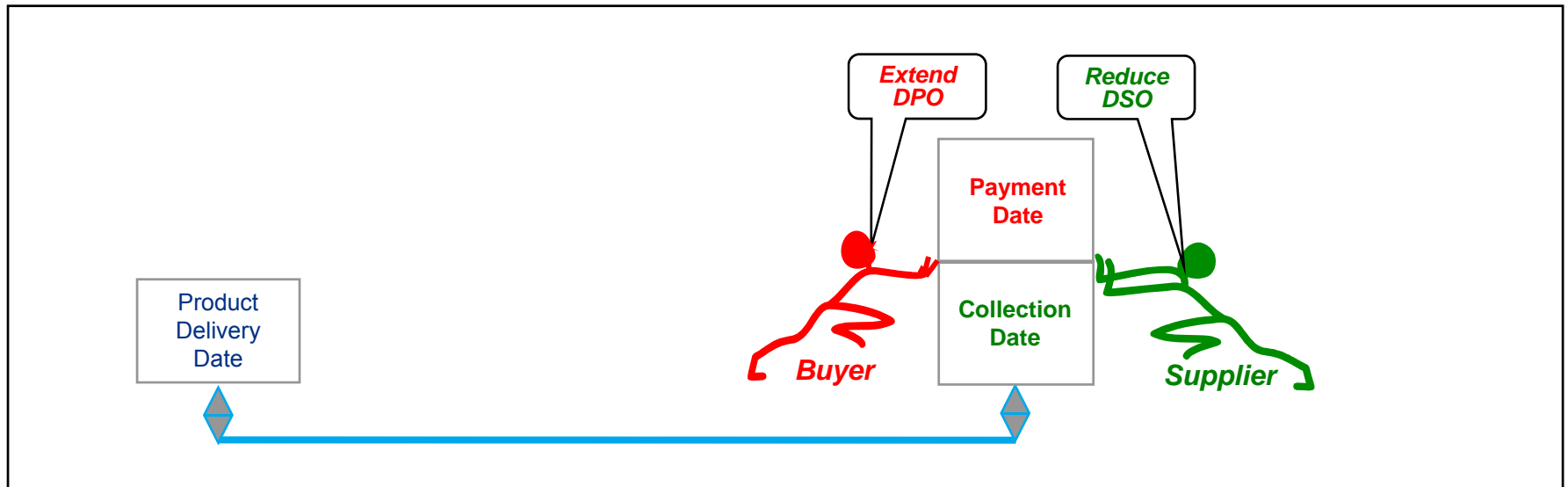
PMI – Purchasing Managers Index is a leading indicator of GDP growth

## II. What is Supplier Finance?

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# Working Capital as a Zero-Sum Game

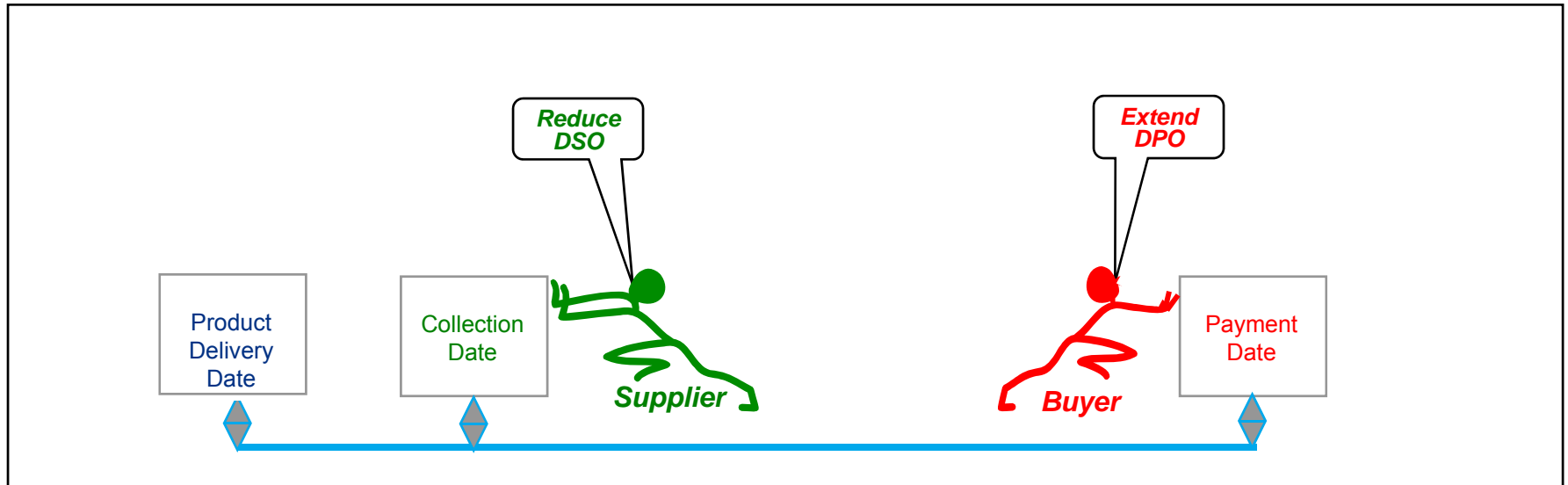
In a commercial terms negotiation, Buyers and Suppliers have conflicting objectives



- Extension of terms hurts suppliers
  - ▼ Reduces liquidity and margins without any incremental benefits
  - ▼ Acceleration of receivables is costly and limited by supplier's credit
- Initiatives to renegotiate commercial terms often damage relationships
- Friction in the relationship ultimately increases costs to both parties

# Working Capital as a “win-win”

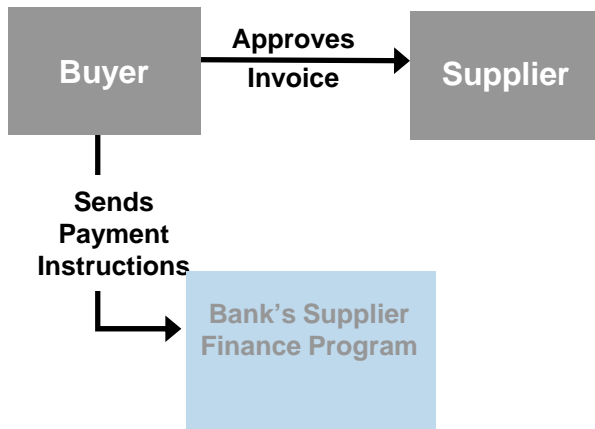
De-linking the payment date from the collection date through a supplier receivables purchase to create a win-win for both parties



- Enables Buyers to improve their commercial terms with Suppliers
- Enables Suppliers to accelerate collection of their receivables
  - ▲ Immediate non-recourse liquidity, eliminating credit and collection risk
  - ▲ Low-cost balance-sheet-friendly form of financing

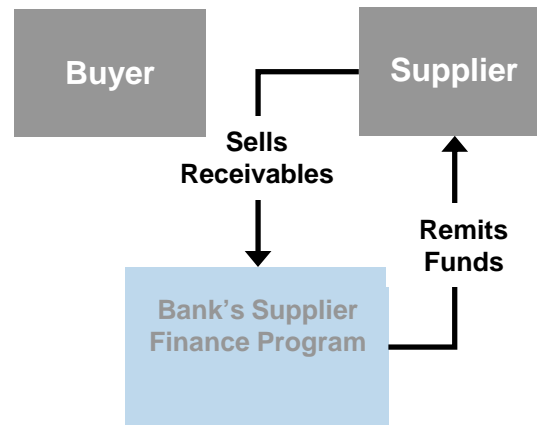
# A Supplier Finance High Level Process

## Day 3\*



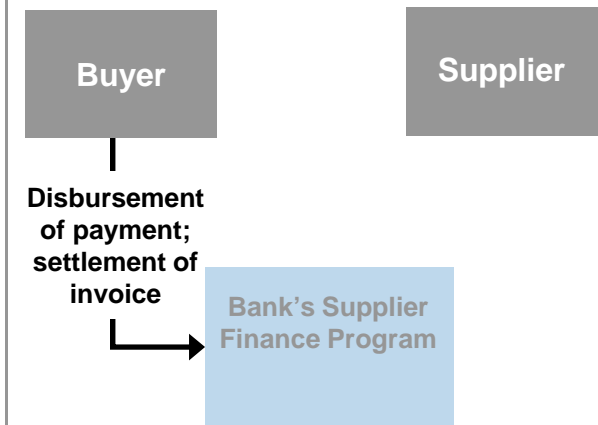
- Buyer approves supplier's invoice and electronically instructs Supplier Finance bank to pay supplier on a future date
- Supplier notified by the bank of a payment from Buyer scheduled for a future due date (e.g. day 60)

## Day 5\*



- Supplier may immediately and electronically discount the underlying receivables to cash, without recourse, at a very favorable funding cost
- Bank remits funds to supplier, typically same day instruction for next day settlement

## Day 60\*



- Buyer funds a disbursement account via normal AP processes at maturity
- Bank debits Buyer's disbursement account for the full amount of the payment due on the due date (e.g. day 60)

\* Actual timing will be determined based on AAFES's processes and objectives

### III. Benefits to Suppliers and Their Customers

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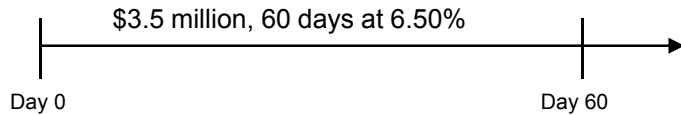
# Why Do Suppliers Sign up?

Supplier Finance builds Strategic Partnerships between Buyers and Suppliers

Key Driver	Key Considerations
Economics	<ul style="list-style-type: none"><li>• Lower cost than alternative financing</li><li>• Provides the most early cash</li><li>• Optional, used at their discretion</li><li>• Easy enrolment, no need to provide financial statements or install software</li></ul>
Working Capital Management	<ul style="list-style-type: none"><li>• Non-recourse true sale shortens DSOs</li><li>• Off-balance sheet financing</li><li>• Frees up credit lines to capture additional business with lenders</li><li>• Reduces Weighted Average Cost of Capital</li></ul>
Process Efficiency	<ul style="list-style-type: none"><li>• Increase payment efficiency with ACH deposits</li><li>• Offers visibility of approved payments and their timing</li><li>• Provides remittance information for each payment</li><li>• Allows better cash flow planning</li></ul>
Risk Management	<ul style="list-style-type: none"><li>• Reduces single-name concentration exposure</li><li>• Reduces Foreign Exchange risk</li><li>• Reduces Interest Rate risk</li><li>• Supports Buyer's initiative and protects against being put on another type of program with worse economics (such as Pcards, high APR Early Pay, etc.)</li></ul>

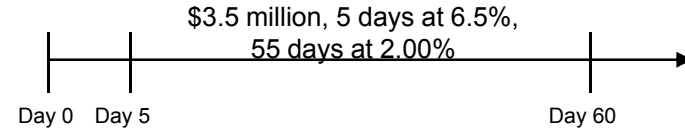
# Illustrative Example – Cost Savings to Suppliers

## Existing Financing Structure



- Existing cost of debt is **6.50%\***
- Cost to Supplier is \$37,917

## Supplier Finance Program



- Assume 3 days to approve payment
  - Receive payment on Day 5
- Supplier's effective cost of financing purchased receivables with the program is **2.00%**
- Total cost to Supplier is \$13,854

Total Savings  
**\$24,063 (63%)**

### Conclusions:

- Savings to Supplier = \$24,528 ( $\$37,917 - \$13,854$ )
- Supplier saves on financing costs by enrolling in a Supplier Finance Program

*\*NOTE: This analysis uses cost of debt to be conservative. Some companies use WACC as their benchmark, which is higher than cost of debt*

## IV. Selected Case Studies

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# Case Study 1

Manufacturer of tools and engineered security solutions worldwide. Products include consumer mechanics tools, mechanic and electronic security products & systems. The company's main customer base is in the US and Western Europe.

## Goals

- Corporate wide mandate improve working capital
- Align Payable terms with Receivable terms
- Create effective supplier communications for new terms
- Leverage Buyer's unused excess available credit and offer suppliers access to it via Supplier Finance
- Ensure supply chain stability and availability of financing to suppliers via a Supplier Finance solution
- Improve supplier's visibility to buyer's Payable approval process
- Streamline Buyer's invoice and payment approval process to enable early payment
- Automate payment process and eliminate paper checks
- Offer consistent Supplier Finance solution to suppliers across North America in both US Dollar and Canadian Dollar

## Accomplishments

- Buyer and the Bank worked closely in rolling out the program
- Successful implementation of new terms with a significant number of suppliers representing over USD 650 million in annual spend
- 1,000 suppliers signed up on the program, 98% of which are auto discounting and receiving electronic payments days from invoice submission
- "Unlocked" more than USD 65 million in liquidity
- Reduced administrative costs by 21%
- 9<sup>th</sup> Year in offering the program to its suppliers
- Maintained the availability of this program to its suppliers throughout the credit crisis

# Case Study 2: U.S. Treasury & Auto Industry

The Obama Administration mandated the U.S. Government to help stabilize the U.S. auto supply base during the height of the credit crisis. The bank partnered with the U.S. Treasury to structure a solution for the U.S. suppliers of the largest U.S. auto manufacturers.

## Goals

- Deliver a support package to the U.S. Treasury for the auto sector which was severely impacted by the economic downturn
- Allow suppliers to continue shipping parts to GM and Chrysler, with the guarantee of receiving payment
- Provide suppliers with access to liquidity, otherwise difficult to achievable via traditional banking products, and deliver financial support necessary to help them access loans to pay employees and continue operations
- Ease payment obligations for Auto OEMs by offering extended payment terms
- Improve relationships between Auto OEMs and Suppliers
- Full transparency for all stakeholders involved

## Accomplishments

- USD 5 billion Auto Supplier Support Program established by the bank and the U.S. Treasury in 28 days to benefit all parties – Auto Manufacturers and their Supplier base
- 1,000 suppliers fully processed and on-boarded onto the bank's technology platform within this timeframe
- Improved visibility / transparency to the U.S. Government as to the deployment of support packages
- Achieved normal payment terms and improved working capital for Auto OEMs
- Injected much needed liquidity into the supplier base and facilitated the return to normal trading conditions



# Case Study 3

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Major global retailer operating retail stores in various formats worldwide, including discount and grocery stores. The company's key markets are North America, Central and South America, Japan and the UK.

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## Goals

- Improve the stability of the supply of merchandise
- Provide an alternative source of attractive financing
  - Many suppliers historically sold receivables to factoring agents at a higher price;
  - However many of these agents were distressed and faced bankruptcy, therefore eliminating an important source of funding for Wal-Mart's suppliers
- Enable Buyer to extend payment terms with suppliers, without disrupting the supply chain
- Provide suppliers additional visibility into Buyer's payment status
- Create effective supplier communication on the benefits of the program

## Accomplishments

- The bank and Buyer worked extensively together to provide a solution to support Buyer's Payable processing requirements and technology needs
- Provision of a valuable financing program to suppliers
- Successful participation by suppliers and eagerness to join the program
  - Suppliers were very proactive and willing to make changes to their invoicing process and payment terms in order to qualify
- Ongoing partnership with several suppliers to resolve any challenges
- Expanded scope of the program across several regions
  - Other regions and markets

## V. How to Select a Supplier Finance Partner

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# How to Select a Supplier Finance Partner...

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- Track record and years of experience
- Industry recognition
- Supplier On-boarding strategy and support structure
- Technology platform: Owned or by Third party?
- Payment capability: integrated or outsourced?
- Assets outstanding or \$ amount of payments discounted per year
- Ample capital allocated or syndicated to support program capital needs

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