

Optimizing Financial Supply Chain Management in Today's Tight Credit Market

Citi Trade University and *Women's Wear Daily*

November 2008

Agenda

1. Introduction: Industry Overview
2. Financial and Credit Environment
3. Working Capital Management
4. Solutions for Supply Chain Management

Introduction: Industry Overview

Arnold Karr
Women's Wear Daily

A Tense Market

- Retail sales tracking downward since spring
- Emphasis on inventory control and cost reduction
 - Men's outpacing women's
- Discounters, off-pricers weathering storm best
- Department stores under severe pressure
 - Luxury holding up, for now



Sourcing Concerns

- Deflationary pattern at risk
- China's jeopardized monopoly
 - Free trade under attack
 - No WTG for WTO

Dramatic Impact on Sales

Soft Sales

	2008 (\$mm)	2007 (\$mm)	Change (%)
Women's	99.5	103.7	(4.1)
Men's	57.2	56.2	1.6
Total	156.7	159.9	(2.0)

Source: The NPD Group. Adult apparel sales for 12 months ended July 2008 vs. prior year.

Searching for Sales, High and Low

	2008 (\$mm)	2007 (\$mm)	Change (%)
Specialty Stores	51.3	52.2	(1.8)
Department Stores	26.9	28.4	(5.2)
Mass Merchants	25.7	25.9	(0.6)
National Chains	22.5	23.0	(2.1)
Off-price Retailers	13.0	12.4	4.2
Direct Mail/E-tail Pureplays	8.4	9.4	(10.3)
Other	6.7	6.1	10.0
Factory Outlets	2.2	2.2	0

All categories except "other" and "factory outlets" were up in the prior year, with national chains ahead 8.8%.

Source: The NPD Group. Adult apparel sales for 12 months ended July 2008 vs. prior year.

Changing Channels – Market Share

	2008 (%)	2006 (%)	Change (%)
Specialty Stores	32.7	32.0	0.7
Department Stores	17.2	18.4	(1.2)
Mass Merchants	16.4	16.2	0.2
National Chains	14.4	13.7	0.6
Off-price Retailers	8.3	8.1	0.2
Direct Mail/E-tail Pureplays	5.4	5.5	(0.1)
Other	4.3	4.5	(0.2)
Factory Outlets	1.4	1.7	(0.3)

Even in a down market, mass merchants, national chains and off-pricers picked up market share at the expense of department stores, as did teen and adult-focused specialty stores.

Source: The NPD Group. Adult apparel sales for 12 months ended July 2008 vs. prior year. Discrepancy in national chain change attributable to rounding.

Looking Forward

Not-Such-Great Expectations

- The National Retail Federation forecast that holiday sales in all categories would rise 2.2% this year, to \$470.4 billion
 - Would be lowest since 2002, when sales were up 1.3%
 - 10-year average = 4.4%
-
- Archstone Consulting projects a 5% drop in the sales of gift cards for holiday, to \$25 billion.
 - Only 24% expect to increase spending
 - Restaurants/fast food strongest category
 - Teen and post-college consumers strongest demographic
 - No price-promotion advantage for buyer

Pockets of Power

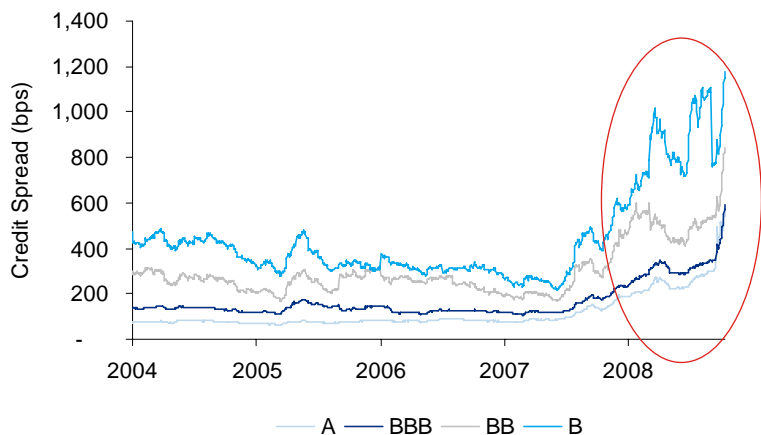
- Online spending projected to grow but at single-digit pace
- Strong brands continue to globalize sourcing and sales
- Luxury and “aspirational” buyers: Persistent but at risk

Financial and Credit Environment

John Ahearn, Phyllis Kai-Kee, Olivia Xu
Citi

Credit Market – Dramatic Increase in Spreads

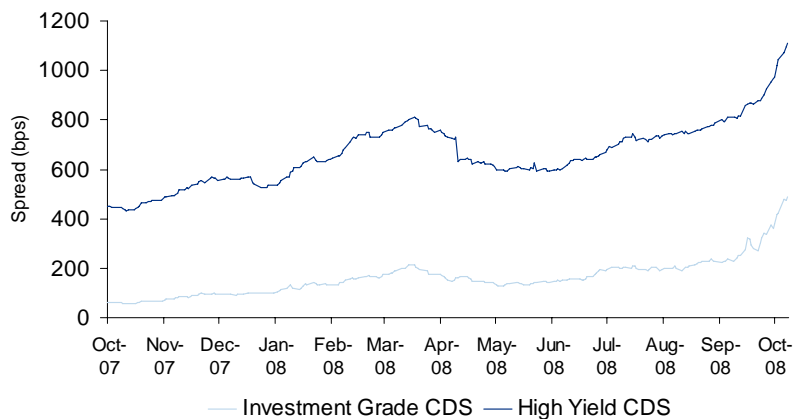
Credit Spreads, High Yield (YTD)



Source: Citi Yield Book

- A stable period in the US credit markets ended with a bang in mid-2007.
 - The volatility has been most pronounced in HY, where spreads increased almost 900bps from July 07 to August 08. HY spreads narrowed to 757bps in September 08, but they are still at historically high levels.
 - The index of A-rated companies traded higher than BBB- in late September, reflecting investor concerns about financial institutions, which are predominantly A-rated.

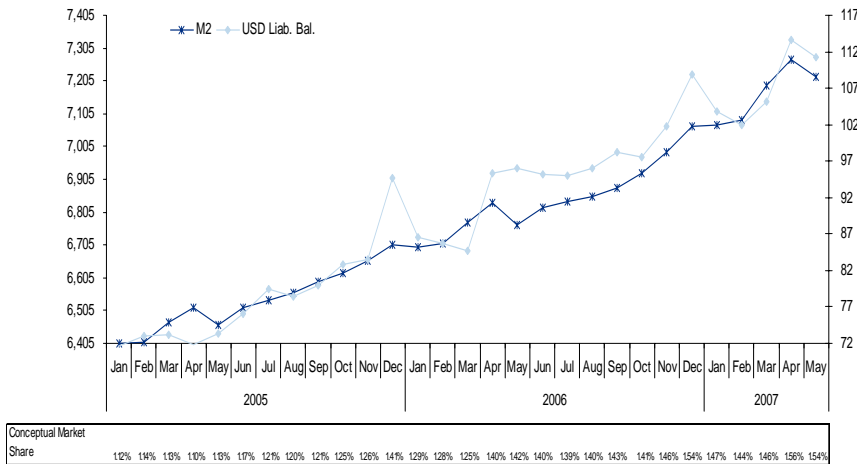
Credit Default Swap Spread Movement (YTD)



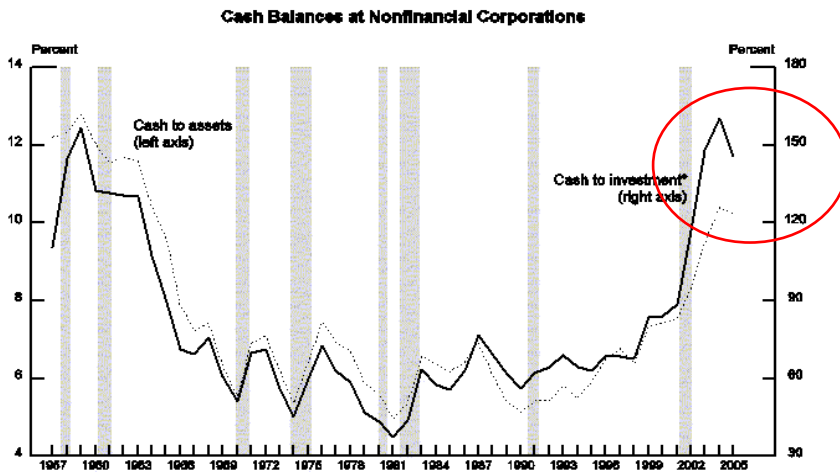
Source: Citi Investment Modeling & Data Analytics

- CDS spreads have increased dramatically over the past year, up 713% for investment grade and 157% for high yield CDS.
- The upward spike continued in the first week of October, with investment grade CDS up 111bps (30%) and high yield up 35bps (14%).
- To provide perspective, investment grade CDS (489bps) is now trading above 2007 high yield levels (446bps)

We Have Been Riding A Liquidity Wave Since 1999 but Market Conditions have Changed



- Credit crunch has reduced access to and dependency on external funding so there is a need for improved working capital efficiency / internal funding vs external debt
- The credit crunch is a global event, impacting your suppliers' access to working capital
 - Increases in your vendors' financing costs typically flow through to your COGS
- To bullet-proof your supply chain, you must identify all sources of working capital and use a variety of tools and resources to efficiently manage working capital across your end-to-end supply chain



Rating Agencies Focused on Liquidity *Particularly for Retailers*

- “One of the major risks underlying our negative view is retailers' ability to manage working capital and maintain liquidity as the consumer-spending downturn continues to pressure earnings and cash flow.” – *Moody's Outlook for Retail, April 2008*

Working Capital Management

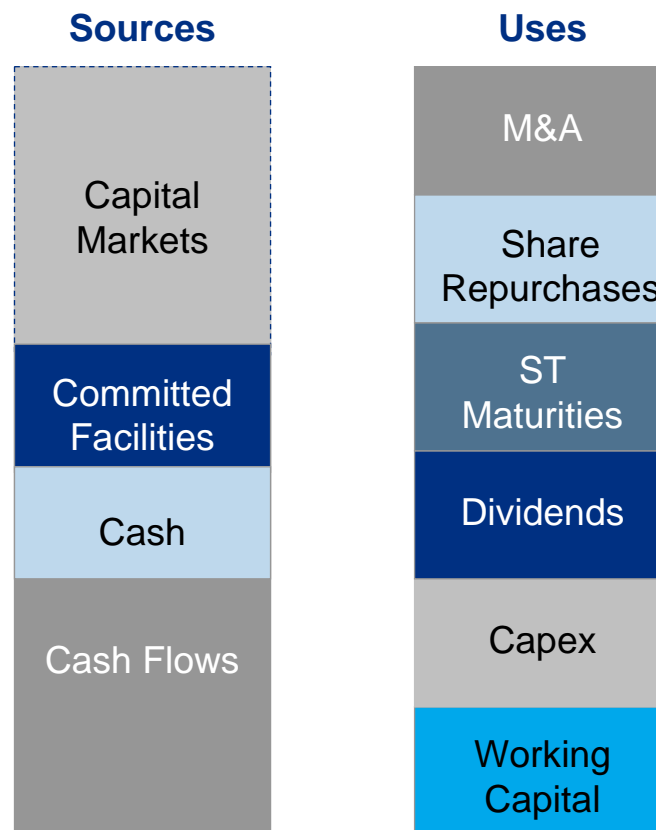
Working Capital – A Liquidity Lever

As the premium to access incremental liquidity from external sources continues to increase, the relative value of unleashing capital from inside the business grows.

Why “Buy” what you can “Make Yourself”?

Internally Generated Liquidity Provides Opportunities

“...a comprehensive cash management survey...revealed less than 10% of corporate CFOs, Treasurers and Controllers believe their current cash flow and cash management processes to be very efficient.”
– *Corporate Survey*



Working Capital is one of the largest core users of capital - though many companies have made significant improvements in working capital management, there remains tremendous upside to leveraging the latest tools & resources to take it to the next level.

Maximizing Working Capital

With liquidity tight and traditional loans expensive for both Suppliers and Buyers, a need to manage Working Capital more efficiently has emerged

How to Maximize Working Capital:

- | | | |
|------------------------------|-------------|---|
| Economic Assets | GOOD | • The only economic asset in the Supply Chain is Cash |
| Uneconomic Assets | BAD | • Inventory; Accounts Receivable |
| Non-Interest Liabilities | GOOD | • Accounts Payable – free but needs to be balanced with Supplier relationship and Cost of Goods Sold (COGS) |
| Interest Bearing Liabilities | UGLY | • Debt |

- Optimal Working Capital management achieves the lowest number in the equation:

$$\text{Net Cash Cycle} = \text{Days Sales Outstanding} + \text{Days Inventory Outstanding} - \text{Days Payables Outstanding}$$

- A negative Net Cash Cycle is optimal

Working Capital Analytics

A Working Capital analysis of Company A, a large retailer, against industry peers

- Company A's DSO of 35 days still has room for improvement. This is offset by DPO of 33 days, which is 16 days behind the industry leader (Peer 2).

Peer Group Sample	WACC	DSO	DIO	DPO	Net Cash Cycle	Company A to Group	WACC to Sales	COD to Sales
Company A	0.00%	35	81	33	83		0.000%	0.000%
Peer 1	10.75%	38	83	33	88	(5)	1.821%	0.520%
Peer 2	0.00%	-	76	49	27	56	0.000%	0.000%
Peer 3	0.00%	13	68	28	53	30	0.000%	0.000%
Peer 4	7.81%	32	72	31	73	10	1.297%	0.522%
Delta to Leader (days)		35	13	(16)	56			
Average		24	76	35	65			
Delta to Average		11	5	(2)	18			

- Company A's DPO is 2 days behind industry average and Net Cash Cycle is 56 days worse than industry leader

Working Capital Analytics – Adjusted

A Working Capital analysis of Company A, a large retailer, against its industry peers after achieving target DPO and DSO

A 30 day extension in DPO...

...and a 15 day reduction in DSO

Peer Group Sample	WACC	DSO	DIO	DPO	Net Cash Cycle	Company A to Group	WACC to Sales	COD to Sales
Company A Adjusted	0.00%	20	81	63	38		0.000%	0.000%
Peer 1	10.75%	38	83	33	88	(50)	1.821%	0.520%
Peer 2	0.00%	-	76	49	27	11	0.000%	0.000%
Peer 3	0.00%	13	68	28	53	(15)	0.000%	0.000%
Peer 4	7.81%	32	72	31	73	(35)	1.297%	0.522%
Delta to Leader (days)		20	13	-	11			
Average		21	76	41	52			
Delta to Average		(1)	5	22	(14)			

...results in a competitive Net Cash Cycle of 38 days (from 83 days)

Working Capital Analytics - Opportunity

Company A can significantly improve its Cash Flow by obtaining more favorable terms

(000's)	DSO Cash Flow (Sales/360 Days) * DSO		WACC Cost 0.00%	DPO Cash Flow (COGS/360) * DPO		WACC Cost 0.00%	Cash Flow	Net Capital Cost
<i>Current</i>	DSO @ 35 days			DPO @ 33 days				
<i>Potential</i>	DSO Target Turn @ 20 days			DPO Target Turn @ 63 days				
Company A ONE DAY FLOW	\$	12,715	\$ -	\$	6,699	\$ -	\$ 12,715	\$ -
CURRENT Company A FLOW	\$	445,025	\$ -	\$	221,067	\$ -	\$ 766,577	\$ -
POTENTIAL Company A FLOW	\$	254,300	\$ -	\$	422,037	\$ -	\$ 374,882	\$ -
POTENTIAL VS. CURR.	\$	(190,725)	\$ -	\$	200,970	\$ -	\$ (391,695)	\$ -

- Reducing DSO by 15 days releases \$191 million in cash flow

- Extending DPO by 30 days increases cash flow by \$201 million

Reducing Net Cash Cycle by 45 days provides \$392 million in cash Company A can redeploy.

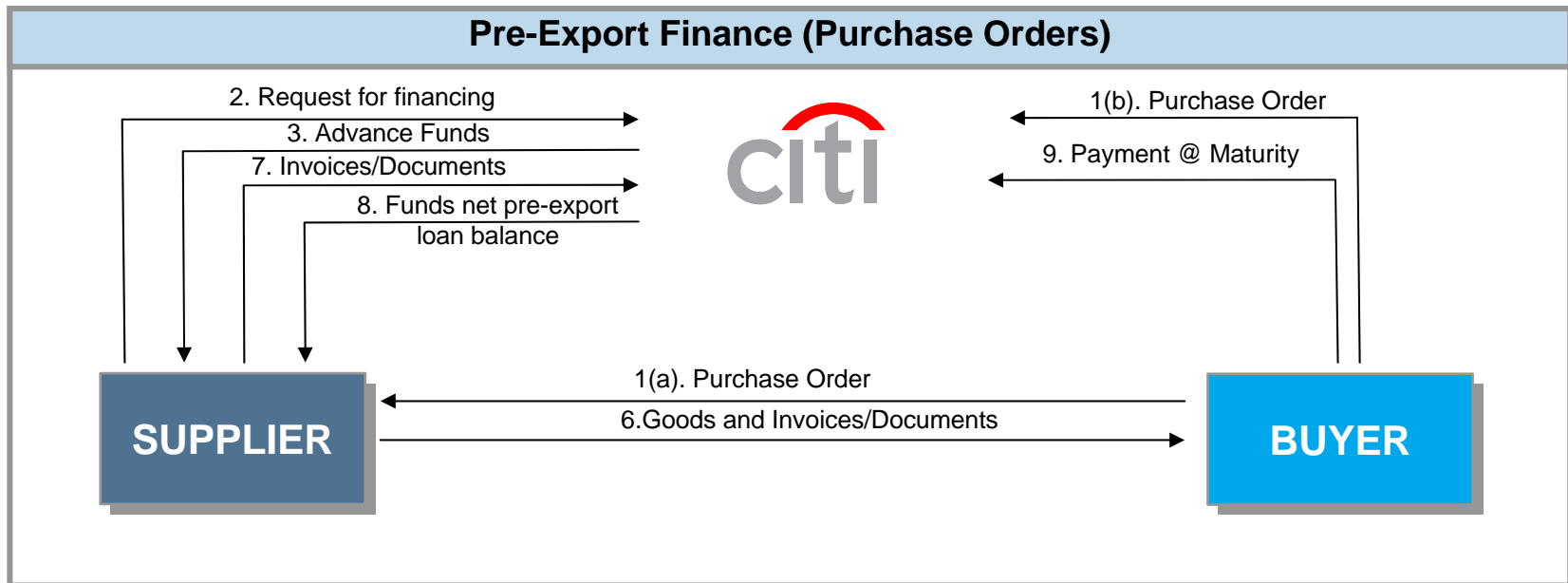
Solutions for Supply Chain Management

Supply Chain Financial Solutions

Biggest Win for Trading Partners Focuses on Non-Economic Asset Finance and True Sales, Non-Debt Balance Sheet Treatment

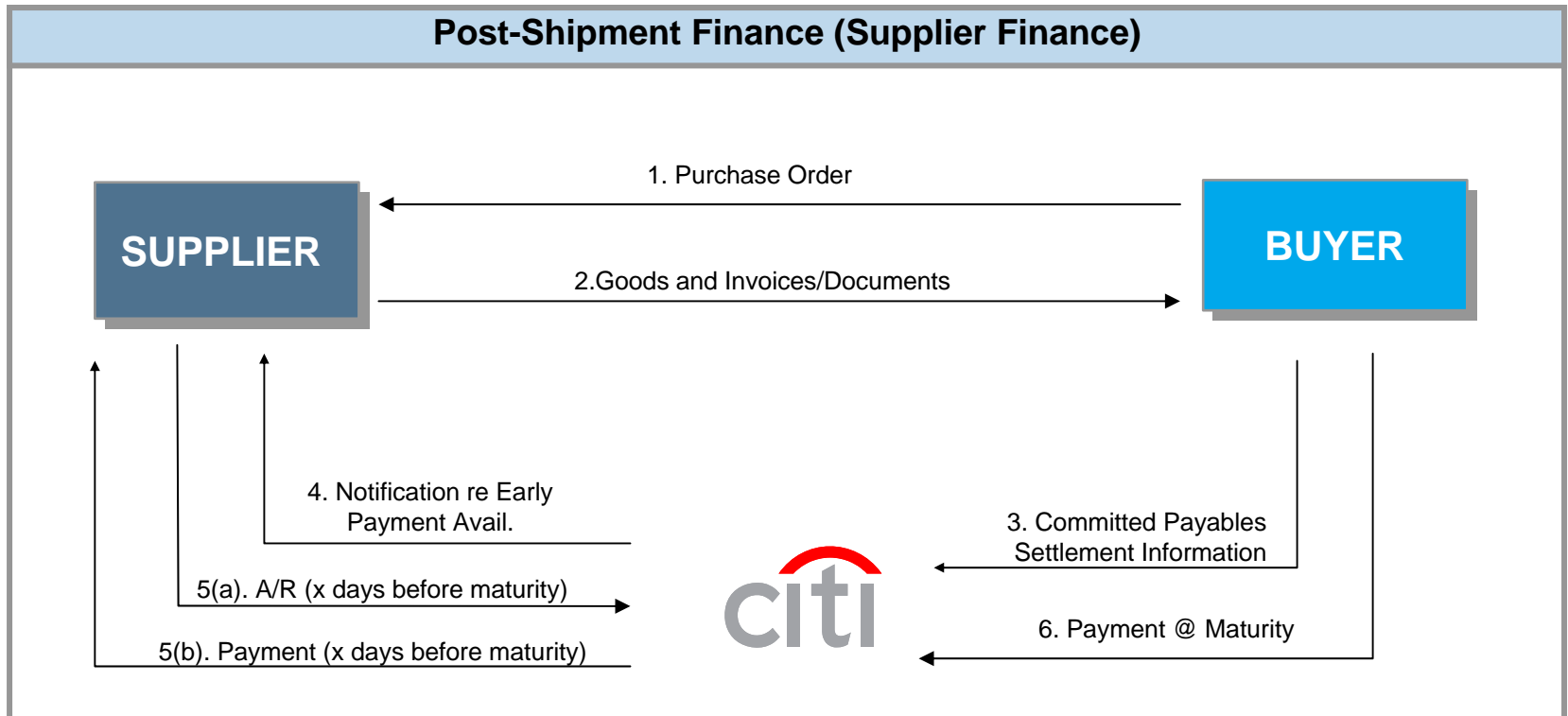
- Obtaining liquidity has become more difficult and more expensive
 - USD financing scarce in some Asian markets
- Post-Shipment Solutions are the most attractive alternative means of providing liquidity to suppliers in today's market
- Pre-Export Financing may be available in certain markets to strong, qualified suppliers

Pre-Export Finance



- Supplier gains non-core bank liquidity to fund inventory (scarcity of capital & credit play)
- Buyer lowers carrying costs in its procurement supply chain (non-core bank)
- **CAVEAT:** The current market environment necessitates Buyers to work with their bankers to provide additional transactional support
 - Identification of strategic suppliers
 - Transparency re projected spend, PO performance on per-supplier basis
 - Visibility into PO issuance/fulfillment/cancellation process, metrics
 - Notification of change in supplier relationships
 - Negative impact of missed spend projections

Post-Shipment Finance



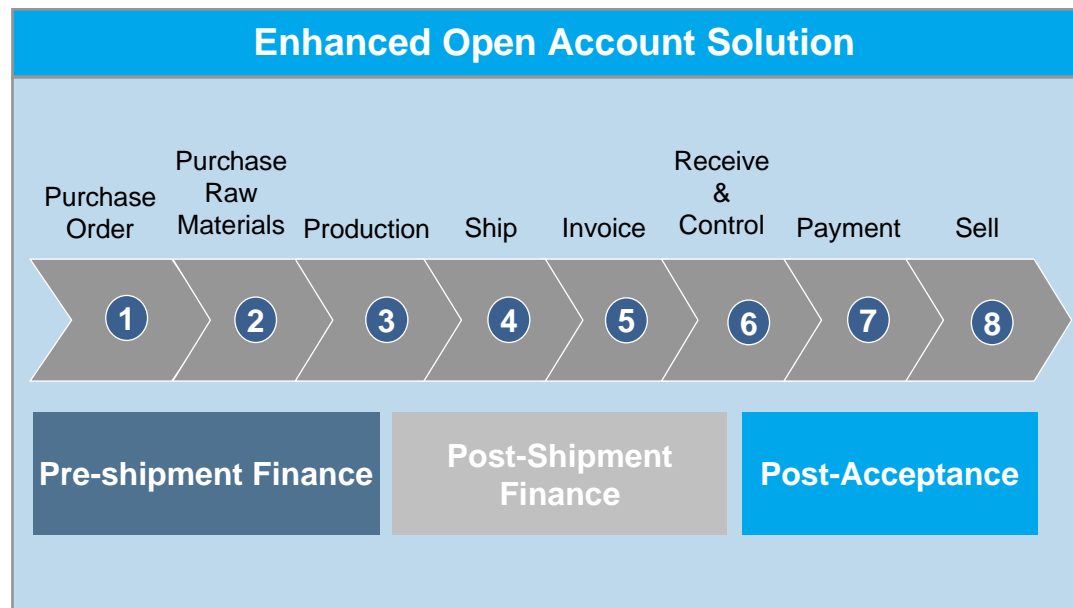
BENEFITS:

- Buyer uses its better cost of capital to lower carrying costs in procurement supply chain leads to lower COGS with benefit of retaining its own cash (better DPO)
- Suppliers convert uneconomic A/R asset to economic asset (cash), at a rate less than own cost of capital (i.e., rate driven largely by Buyer's credit risk rating)

Case Study - Enhanced Open Account Solution

- **Retailer Needs:**

- Branded apparel retailer (\$5Bn in Sales) seeking to migrate vendors from Import LC's to open account payment terms to achieve cost reduction
 - Presentation and reconciliation of Purchase Orders (PO's)
 - Effective technology platform providing "visibility" into the supply chain
- Vendors desire access to pre-and post-shipment financing to mitigate working capital impact of conversion from LC's to open account combined with current difficult market conditions



- **Solution:**

- Retailer designates bank as paying agent and provides bank with POs and approved payment files
- Suppliers present paper documents to bank for examination, processing and digitization; retailer receives electronic data and images of documents
- Bank conducts a supplier adoption program in key Asian markets to offer early payments to suppliers at a borrowing rate based on the retailer's credit rating and market conditions

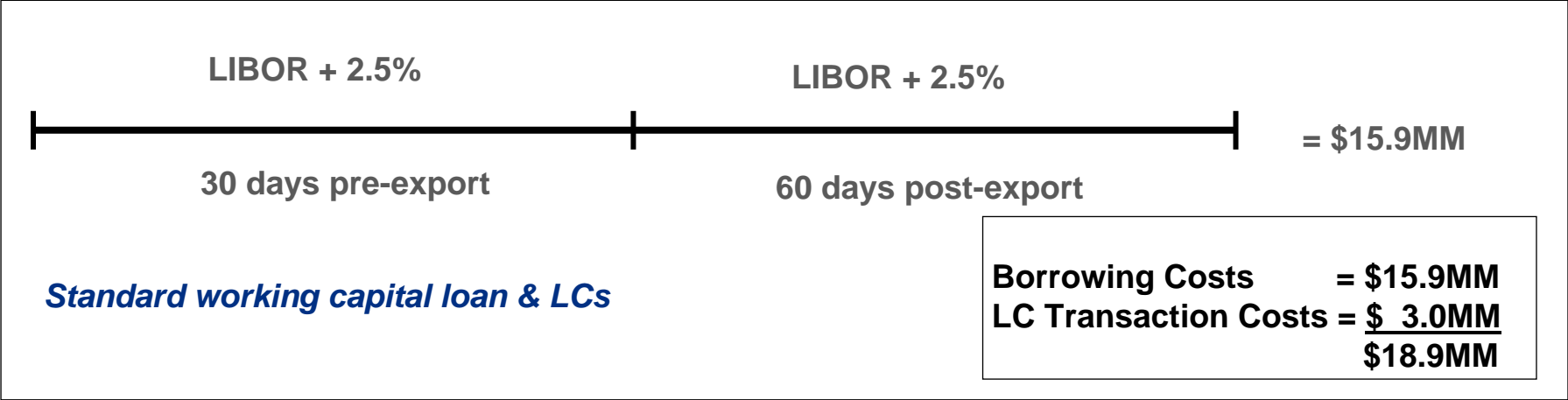
- **Benefits:**

- An estimated **\$23.7 million total supply chain savings**
- Greater financing opportunities to retailer's vendors at attractive interest rates, thus negating impact on retailer's COGS; extended payment terms without any supply chain disruption

Case Study - Benefits of Enhanced Open Account

Borrowing Cost Benefits (Supplier Side)

Assume: \$2.4Bn COGS, 50% impacted. LIBOR = 2.80% Buyer CP Rate = 5% p.a.



Borrowing Cost Savings: \$4.0MM or 25.2%



Case Study - Benefits of Enhanced Open Account

Working Capital Maximization (Buyer Side)

Assume: Net Cash Cycle Reduction = 45 days

- Includes payment terms extended to 60 days

\$392MM in cash freed up

CP Rate = 5% p.a.

Value of Net Cash Cycle Reduction = \$19.7MM

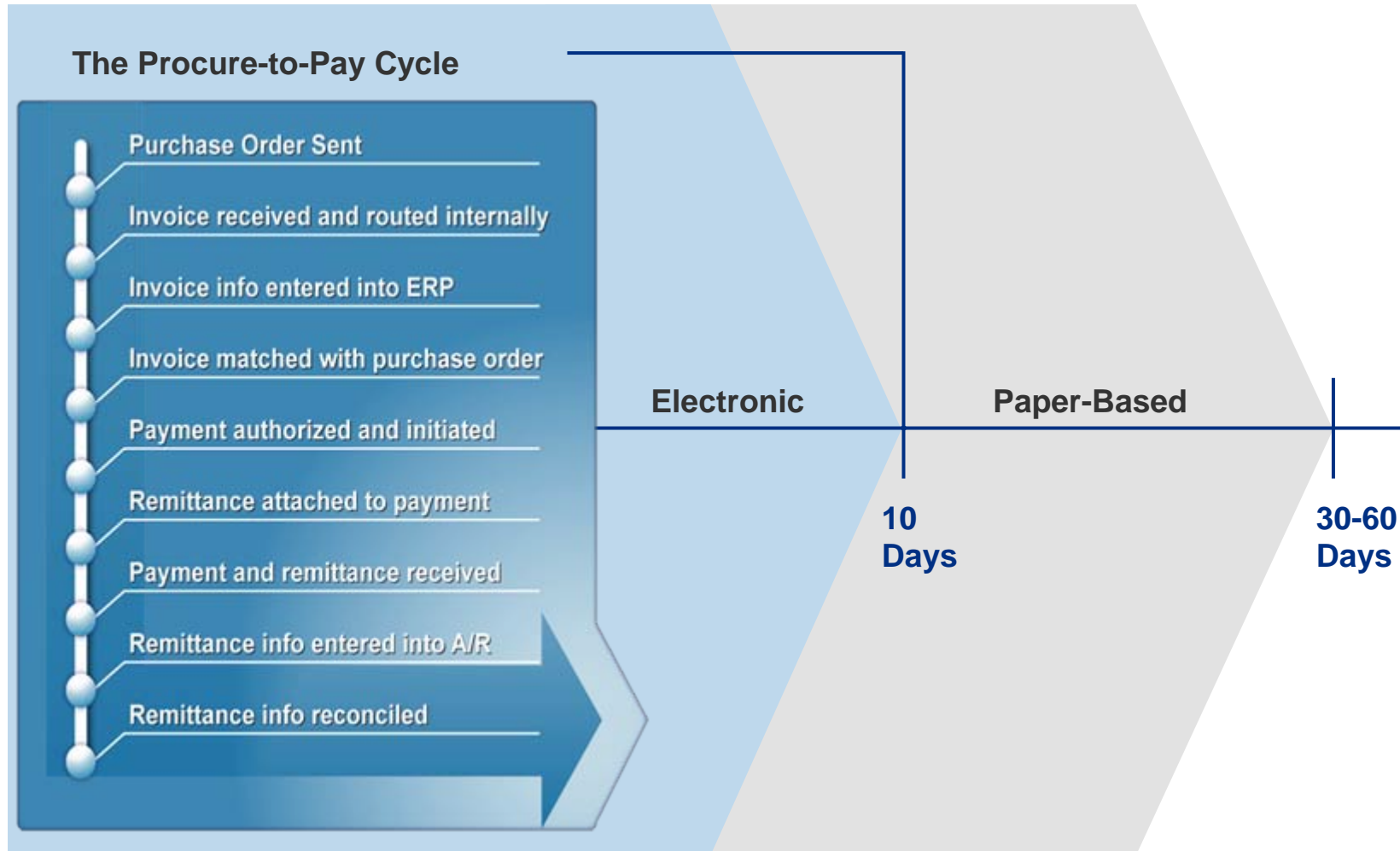
Potential Total Supply Chain Impact

<i>Borrowing Cost Savings:</i>	<i>\$ 4.0MM</i>
<i>Value of Net Cash Cycle Reduction:</i>	<i><u>\$19.7MM</u></i>
<i>Total Supply Chain Savings:</i>	<i>\$23.7MM</i>

Automating the Full Procure-to-Pay Cycle

Achieving full end-to-end Supply Chain Management through Procure-to-Pay, a combined Treasury and Trade Solution.

The collective set of accounts payable processes that begins with the issuance of a Purchase Order and ends with payment to the supplier:



Wrap-Up

- Managing working capital across your end-to-end supply chain is critical to immunizing your supply chain against financial market shocks
- Access to liquidity is a key concern for your suppliers in today's economic environment
- Leveraging the financial strengths of the major player in the supply chain benefits all involved through both cost and process efficiencies
- Working with intermediaries who understand the financial supply chain and the physical supply chain can help buyers and suppliers meet their goals and help fill the gaps

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Citi works with its clients in greenhouse gas intensive industries to evaluate emerging risks from climate change and, where appropriate, to mitigate those risks.

efficiency, renewable energy & mitigation

