SUPPLY CHAIN FINANCE

Receivables Finance Programs Can Free Up Needed Liquidity

Europe's UniCredit knows how to optimize the supply chain's working capital benefits even further.

Working capital optimization is a key priority for corporate treasurers and is an important benefit of just about all transaction banking products and services. Along with technological evolution, it's fair to say optimization has been the most relevant strategic transformation driver of the corporate commercial banking space in the last 10 years. Traditional transaction products today are fully commoditized because treasurers' needs are simple, focused and driven by cash flows. Meanwhile, the desire for real-time views, simplicity and security are the key drivers behind technological innovation in the space.

The problem is that the benefits are uneven across the transaction banking spectrum. Looking at the universe of large and complex multinationals, particularly in the US, there is a relatively advanced penetration of payables programs where the convergence of corporate demands and bank innovation has brought significant advantages in terms of securing key supply-chain and working capital benefits—at least for the largest and best-rated manufacturing companies. On the other hand, there has been less progress on receivables.

"There appears to be a much less advanced and coherent market for receivables, which are typically complicated by several credit risks," says Fabio Della Malva, managing director in corporate investment banking at UniCredit. "This is exacerbated if we go international—incurring additional country risks and factoring in complications from multiple jurisdictions."

AN ARRAY OF RECEIVABLES FINANCE SOLUTIONS BRING WORKING CAPITAL BENEFITS

Yet receivables finance solutions bring a range of benefits for corporates, chiefly freeing up vital liquidity—usually at less expense than doing so internally by wrestling with complex corporate structures. But the type of solution a corporate chooses depends on its specific needs. This could include forfaiting, which enables exporters to secure financing immediately by selling receivables contracts from a single debtor, including on a one-off basis, or factoring, which makes it easier to sell large numbers of invoices or large and diverse portfolios on a revolving basis.

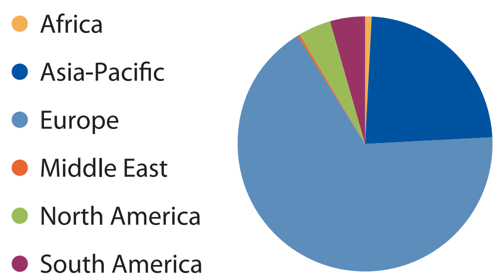
As the comfort level for participating in buyer programs—primarily because companies can either profit or keep their balance sheets healthy—companies are taking advantage of the benefits of factoring. According to Factor Chain International, global factoring is about $3 trillion annually and growing, so suppliers are already financing. This means faster repayment and reduced days sales outstanding (DSO) by discounting invoices prior to maturity as well as improved cash-flow forecasting; it also means lower financing costs, which translates into access to higher levels of working capital financing.

Structured portfolio solutions—where a bank provides individual tailor-made financing programs in combination with credit insurance coverage—can be useful for clients with mul-

GLOBAL FACTORING VOLUMES BY REGION

(in millions of Euros)

Continent	2015	2016	Change	2016 share
Africa	18,721	20,393	8.93%	0.86%
Asia-Pacific	596,633	555,550	–6.89%	23.38%
Europe	1,557,052	1,592,974	2.31%	67.05%
Middle East	8,028	7,583	–5.54%	0.32%
North America	100,530	95,072	–5.43%	4.00%
South America	86,826	104,396	20.24%	4.39%
Grand Total	**2,367,790**	**2,375,967**	**0.35%**	



Source: Factor Chain International, Annual Review 2017 tiple or single debtor portfolios that don't fit into traditional models. Structured options include securitization programs or setting up a special purpose vehicle (SPV), funded by a bank credit facility or asset-backed commercial paper, to buy receivables on a revolving basis.

Of course, improving liquidity isn't the only objective that can be realized through receivables finance. Corporates should also consider using the techniques above to help forward their balance sheet optimization and risk management goals.

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> —Fabio Della Malva

BALANCE SHEET OPTIMIZATION

Selling receivables enables corporates to drive down working capital metrics such as their Days Sales Outstanding (DSO), thereby accelerating their Cash Conversion Cycles (CCC). This also improves the overall asset quality on the balance sheet by replacing idle assets with liquidity that can then be reinvested. Additionally, optimizing working capital can enhance various profitability measures and key performance indicators such as Return On Capital Employed (ROCE) or Net Debt, thus adding to shareholder value.

RISK MANAGEMENT

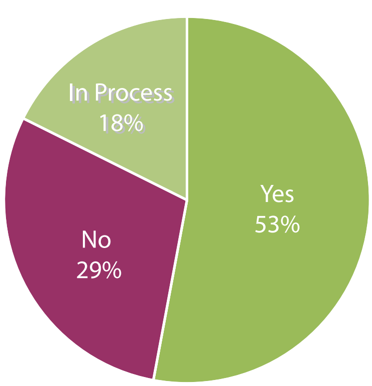
Receivables contracts on a corporate's balance sheet represent exposure to the risk of non-payment, and these risks increase proportionally as exposure to counterparties, regions or industries increases. Stability and growth are dependent on mitigating this risk, and consequently many companies cap the number of sales to one client, industry or geography in order to limit this exposure. But while this is a sensible precaution, it can restrict revenue if sales demand exceeds internal exposure limits. By removing the risk from the balance sheet altogether, receivables finance solutions transfer the associated risk to a third party and can free internal limits to enable the sales department to maximize revenue.

CASH MANAGEMENT AND TRADE FINANCE INTEGRATION

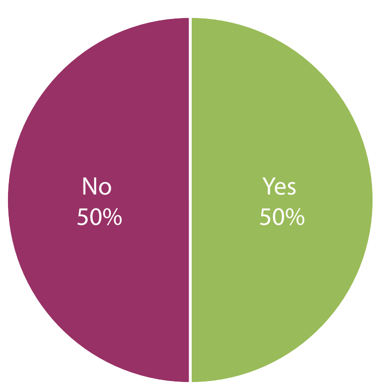
Platforms that integrate trade and cash management solutions can bring further value to receivables programs. Virtual accounts, for example, are an innovative structure that allows banks to create "dummy" accounts, linked to a physical current account, in large numbers without incurring the accounting and regulatory workload

SUPPLY CHAIN FINANCE PROGRAMS GAINING GROUND …

Do you have a Supply Chain Finance Program?



Do you have an AR Factoring Program?



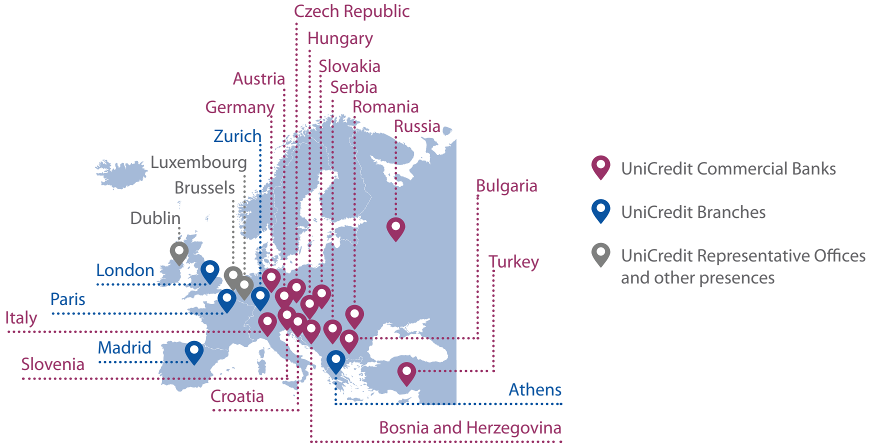
… BUT STILL ROOM TO GROW

NeuGroup Peer Research shows many member companies have supply chain finance initiatives. Those with an AR program have very specific use cases:

- "AR factoring is generally discouraged but we have small program in certain countries to offset customer risk."
- "We have an AR securitization facility, but this is considered borrowing (rather than a true sale) and is on balance sheet. We use it only as another source of liquidity."
- "AR program is focused on a handful of customers with the primary objective of mitigating credit risk."

Source: NeuGroup Peer Research, 2017 H2 (tMega, T30 LC, T30, Tech20, ATLG)

UNICREDIT CIB—HOME MARKET ADVANTAGE WITH GLOBAL EXPERTISE



Source: UniCredit, 2018

tied to ordinary bank accounts. This allows treasury departments to cut the number of physical accounts they need to open to identify their key buyers, eliminate issues around missing remitter information and manually intensive tracking and investigation processes, and streamline and automate the reconciliation process for accounts receivables—leading to improved working capital metrics such as DSO. Virtual accounts are a particularly attractive option for corporates with decentralized collections across wide geographies.

UNICREDIT'S UNIQUE POSITION IN THE MARKET

UniCredit—one of the few pan-European commercial banks with a unique network across Western, Central and Eastern European—has steadily been building its reputation in the receivable finance space. The bank offers a variety of products that can overcome the complexities that cross-border payments in Europe—and their many jurisdictional and regulatory layers—can present. Lately, the bank has seen its expertise leveraged by US treasurers, who have been focusing on domestic and international receivables rather than seeking to squeeze the last few drops of savings from supply chains' long-tail leftovers.

RECEIVABLES FINANCE IN PRACTICE WITH A US MANUFACTURER

For instance, UniCredit's Americas team worked with a US manufacturer to unlock a variety of otherwise hidden benefits by developing a better path to maximizing the receivables financing value chain. Mr. Della Malva explains that the project began with "a relatively quick win" when the bank suggested the company concentrate on its larger domestic clients, which "placated board expectations" and showed fast execution from concept to facility signing—with startup in just over a month.

Massimo Ortino, UniCredit's head of global transaction banking, Americas, outlines the two main objectives of the project: first, to reach a minimum sizable amount or benefit while avoiding targets that were too ambitious; and second, to put in place an efficient and scalable infrastructure from legal, accounting and operational points of view. This last element is of particular importance in securing efficiency, automation and security throughout the process; for the bank, the ability to provide a ready-to-use and simple platform for this purpose was a key factor in its success.

Once this platform was established, the second step was to optimize and upscale the existing facility as much as possible by adding debtors and jurisdictions. At this

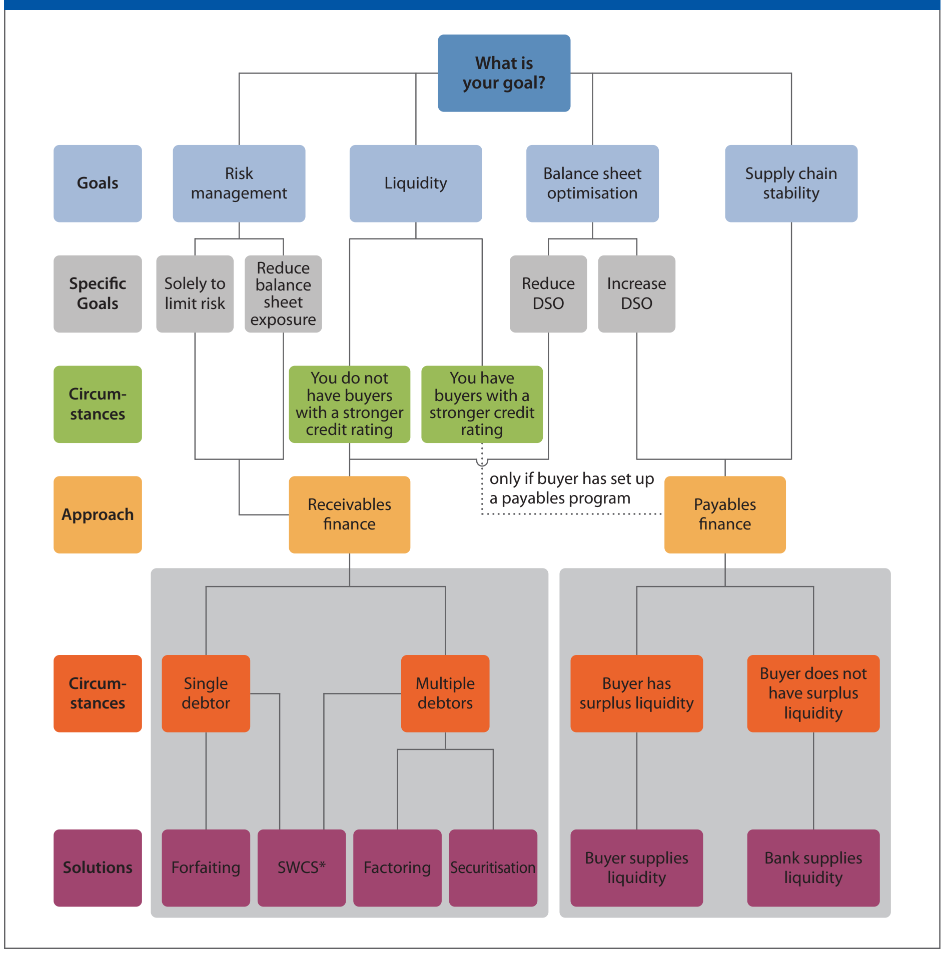
Platforms that integrate trade and cash management solutions can bring further value to receivables programs.

point, depending on the nature of the client portfolio and goals, there are different alternatives to move forward. If the company's main driver is, for example, risk mitigation weighed against further balance sheet optimization, a combination with an insurance program would make sense. In the case of an international company fragmented across several domestic or regional markets, replicating the main programs in other jurisdictions or hubs—evaluating all possible local alternative structures—could be the best choice. Should the client portfolio be relatively concentrated, scaling up a syndicated facility, combining other banks or insurance players, could also be an appropriate solution.

In this particular case, the company's priority was to enhance the balance-sheet benefits by dealing with a very granular portfolio. UniCredit, using its global Structured Accounts Receivable Financing Program, which offers automation and simplicity, was able to structure a flexible and tailored solution using an insurance "wrap" and a dedicated vehicle to provide an off-balance-sheet strategy for the entire portfolio. Further, the client was able to retain its customer relationship and servicing role, all the while obtaining the large-scale collection and reconciliation benefits on top of liquidity and balance-sheet improvements.

As global multinational corporations continue to streamline working capital management to make every dollar work harder and more efficiently, the effort should also include mastering and extracting value from the supply chain. In the end, benefits will continue to grow for all sides of global trade transactions.

CHOOSING THE RIGHT SOLUTION FOR YOUR BUSINESS



*Structured Working Capital Solutions

Source: UniCredit, 2018

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