Asset-backed securitization and accounts receivable factoring overview
SFTMA Symposium
6 May 2016
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Agenda

► Sources of funding compared to AR sales and ABS
► Benefits and challenges of the programs
► How AR factoring works
► How ABS works
► An ABS project pricing and timeline example
► Appendix
  ► Information requirements
► Questions?
## Typical sources of working capital

<table>
<thead>
<tr>
<th>Type of loan</th>
<th>Cost</th>
<th>Notice required</th>
<th>Min./Max. maturity</th>
<th>Comment</th>
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</thead>
<tbody>
<tr>
<td>Bilateral unsecured credit lines</td>
<td>Typically to be below 4%</td>
<td>Same day</td>
<td>1 day/2 weeks</td>
<td>Unsecured lines subject to immediate repayment</td>
</tr>
<tr>
<td>Revolver London Interbank Offered Rate (LIBOR)</td>
<td>LIBOR plus spread</td>
<td>3 days</td>
<td>30 days/1 year</td>
<td>Part of syndicate with term loan</td>
</tr>
<tr>
<td>Revolver swing line borrowing</td>
<td>Over 4%</td>
<td>Same day</td>
<td>1 day/1 year</td>
<td>Part of same revolver above</td>
</tr>
</tbody>
</table>
## Accounts receivable (AR) factoring and asset-backed securitization (ABS)

<table>
<thead>
<tr>
<th>Receivable financing programs</th>
<th>Borrowing base</th>
<th>Funds availability and maturity</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>AR sales/factoring</td>
<td>Customer by customer</td>
<td>2–3 days in advance; matures at customer terms</td>
<td>Need available AR</td>
</tr>
<tr>
<td>AR securitization</td>
<td>Consolidated by originating entities</td>
<td>Tracked regularly for borrowing or repayment; contract can be 1–3 years</td>
<td>Need available AR</td>
</tr>
</tbody>
</table>
Benefits

- Potential to achieve lower cost of funds while monetizing receivables more quickly with very short notice.
- The AR holder may benefit from the higher credit rating of the AR payor.
- Can preserve revolving debt capacity.
- Can be an alternative to letters of credit.
- Non-recourse funding is compatible with all other types of debt.
- Many jurisdictions may not require customer consent to sell or securitize assets.
- Multiple financial institutions can bid and thus reduce costs.
- Banks are typically willing to commit larger amounts than in revolvers.
  - The self-liquidating asset is very attractive.
Benefits

► Client could standardize agreements to ease renewal and bidding.
► Securitization could enable the company to benefit from having a receivable portfolio of various credit ratings.
► Potential to insure “excess” concentration receivables in the ABS programs to get greater liquidity.
► Programs can be structured with an “accordion” feature to allow for business seasonality.
Considerations and challenges

- Business changes require new actions to provide sustainability of funding model and capacity.
  - Changes in credit concentration and credit profiles result in challenging funding conditions and potentially greater reserve requirements.
  - Expansion or restructuring of business into challenging jurisdictions such as China and Brazil can lead to delay or loss of funding.
  - Change in tax laws can lead to business moving elsewhere and may require new amendments to the master agreement to accept the new entities or jurisdictions.

- Consistency and availability of AR actuals and forecast
  - Understanding of late customer payments
  - Tracking of credits, rebills and other AR adjustments

- Manpower to gather data for onboarding new customers and complying with audits

- Communication of changes to the business and systems

- Collection of funds still managed by the borrower
Considerations and challenges

- Ongoing cost consideration of expert legal services
  - Can cost as much as several hundred thousand dollars to set up
  - Ongoing amendments, audits, renewals must be budgeted
- Ability to get consent letters in some jurisdictions
- Large customer concentrations that may be limited in the program
- Customer resistance to changing payment location
  - Some programs simply change the ownership of the collection account rather than redirecting to a different account
  - Can require a “block” agreement on the collection account, which would add a cost and time component to implementation
- Programs may have ratings requirements
- ABS takes a “reserve” in order to achieve an investment-grade rating
How AR factoring works
Cash flows for AR factoring programs

1. Goods are sold
2. AR created
3. Client sends file of AR invoices to be sold to bank
4. Bank pays invoices net of interest fee to client bank account
5. Customer pays cash for AR to site’s bank account (may be blocked account)
6. Collections from customer for sold invoices are sent to bank
Key considerations

► Consider centralized programs for reporting and accounting consistency.
► Customer history is usually needed to show collection patterns and revenue volumes. Could be two years of history requested.
► Pre-contract audit of customer receivables is usually required when adding new banks. Allow for this time to start up a new factoring program.
► Banks may set limits on certain customers. Be sure to have multiple banks available for factoring each customer.
► Accounting for A/R factoring arrangements can be complex and individual arrangement terms such as recourse and other forms of continuing involvement could impact the accounting treatment.
► Verify that UCC filings are clearly understood by bank.
► Negotiate administrative requirements that can be realistically supported by your team.
► Bank should not require hard-copy original invoices, for example.
How ABS works
ABS overview

ABS enables companies to potentially secure lower-cost working capital financing through the securitization of short-term receivables.

Receivables are pooled based on credit quality. Typically, the pools are over-collateralized to provide credit enhancement. Concentration limits are typically required for portfolio diversification.

ABS programs require a separate, bankruptcy-remote organization structure and third-party evaluation of the credit quality of pooled receivables.
Transaction structure

Letter of credit issuance:

► The facility can be structured to permit the issuance of letters of credit (L/Cs):
  ► L/Cs to be issued in US dollars.
  ► The borrowing base available for cash borrowings will be reduced to the extent of outstanding L/Cs.
  ► L/Cs accrue fees at the drawn (all-in) rate.
  ► If an L/C is drawn and not repaid by the Company, a cash advance will be automatically be made to repay the L/C.
  ► Any L/Cs outstanding after the expiration of the program will be cash-collateralized through receivable collections.
Pricing and funding cost

Pricing in prior years:
- Pricing of a facility is dependent on several factors, including the following:
  - Facility tenor and size
  - Borrower rating
  - Transaction rating
  - General market conditions
- Transactions are typically structured to an implied ‘AA’ and sample pricing at that level is below.

<table>
<thead>
<tr>
<th></th>
<th>Investment grade borrower</th>
<th>Non-investment grade borrower</th>
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<tbody>
<tr>
<td>One year</td>
<td>60–65 bps</td>
<td>65–70 bps</td>
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<tr>
<td>Two years</td>
<td>70–75 bps</td>
<td>75–80 bps</td>
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<tr>
<td>Three years</td>
<td>80–85 bps</td>
<td>85–95 bps</td>
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</table>

- The unused fee is typically half the drawn fee.
- Up-front fees vary between 5 bps and 7.5 bps for each year of tenor.
- Agent or structuring fees may be assessed depending on the circumstance.
AR securitization example

- Company (originators)
  - Purchase price
  - Sale or contribution of trade receivables

- Special-purpose vehicle (seller)
  - Overcollateralization
    - Liquidity facility: 102% of program size
  - Cash proceeds

- Conduit purchaser(s)
  - Cash proceeds
  - ABCP

- Investors

Company

Banks

Asset-backed securitization and accounts receivable factoring
Borrowing base calculation to reach investment rating

- Gross receivables pool balance
- Unapplied credits and collections
- Ineligible receivables
- Contra receivables
- Eligible pool balance
- Excess concentrations
- Net pool balance
- Required reserves
- Available capital
- Undrawn capital
- Drawn capital
Details on funding reserve items

- Excluded obligors
  - Obligors or jurisdictions not in program
  - Affiliate receivables
- Ineligible debtors
  - Payment terms outside of standard
  - Debtor part of another program
- Credit notes
- Excess concentration of debtor and/or jurisdiction
- Delinquent and defaulted items
- FX “haircut”/reserve
- Loss reserves
Sample customer cash flows – two examples

Customer A

SPV account blocked

Customer A collection account

Corporate cash consolidation account

Customer B

SPV account blocked

Customer B collection account–blocked

AR offset on corporate books

Automated pooling or same-day wire

Automated pooling or same-day wire

AR offset on corporate books
Key questions to ask before securitization
Factors to consider

Information treasury needs:

1. What is the monetary amount of the estimated quarterly sales from this customer?
2. Does the customer have a credit rating? What is the credit history of the portfolio?
3. In what currency are revenues billed?
4. Do you have a history with the customer in other parts of the company, or are they new?
5. Do you have or plan to have an L/C or parent guarantee for subsidiaries of the customer?
6. Do you have a Master Service Agreement (MSA) or Purchase order (PO) with the customer that can be reviewed?
7. Will the structure require credit insurance and at what cost?
8. Does your accounting firm have an opinion on these programs?
Example of project pricing and timeline
**Transaction structure**

### Sample concentration limits

<table>
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<th>Short-term rating (or long-term equivalent)</th>
<th>Concentration percentage</th>
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<tr>
<td>A-1/P-1 (or equivalent)</td>
<td>15%</td>
</tr>
<tr>
<td>A-2/P-2 (or equivalent)</td>
<td>10%</td>
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<tr>
<td>A-3/P-3 (or equivalent)</td>
<td>5%</td>
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<tr>
<td>None of the above (or unrated)</td>
<td>3%</td>
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</tbody>
</table>

Special concentration limits can be implemented for specified obligors.

**Administration requirements:**

- A pre-negotiated monthly report format detailing receivable levels, borrowing capacity and performance
- An annual agreed-upon audit report that tests the various reporting functions and policies (this usually requires a third-party auditor and a live bank review)
- Annual unaudited special-purpose vehicle financial statements
Execution timeline – before bank selection

► Weeks 1 through 10
  ► Select legal representation and commit internal and external resources
    ► Will need external counsel and 3rd party consulting with experience in this area
    ► Begin setting up “bankruptcy remote” special purpose vehicle (SPV)
    ► Consult with accounting to get an understanding of the journal entries
  ► Identify financial institutions with “skin in the game” in the securitization space
    ► Will want to open bidding to any banks in your loan syndication
  ► Prepare and present “road show” materials regarding borrowing objectives and timing
    ► Solicit proposals
  ► Meet with bidding financial institutions and discuss their proposed terms
    ► Follow up on modifications to proposals
  ► Select financial institution(s) to move forward
    ► May need multiple institutions to reach funding goals and business objectives
Execution timeline – after bank selection

Weeks 11 through 14
- Gather and analyze receivable sample (two-year history)
- Perform due diligence
- Present securitization to bank corporate credit
- First draft of legal documents and opinions

Weeks 14 through 17
- Receive bank credit authorization
- Negotiate final version of legal documents
- Receive due diligence report

Weeks 18 and 19
- Counsel confirms all conditions precedent have been met
- Receive funding request from company
- Closing and funding
Appendices
Information requirements
Information requirements

Quantitative information

- At least two years of the following information:
  - Receivables rollforward (including sales, collections, write-offs, recoveries and dilutions)
  - Gross receivables aging (debit-only) in 30-day buckets up to 120 days past due
  - Top 10 obligor concentrations
  - Foreign receivables
  - Government receivables
  - Intercompany receivables
  - Receivables subject to offset where customer is also a vendor
  - Receivables with terms greater than 60 days
  - Other receivable categories particular to the Company’s business (e.g., unbilled receivables, bill-and-hold receivables, non-trade receivables)
Information requirements
Data template

At least two years of rollforward and aging data (debit-only) is needed

Schedule A – general ledger receivables rollforward
24 months of historical rollforward data is requested; 36 months is preferable (1)(2)(3):

<table>
<thead>
<tr>
<th>(1) Beginning balance per G/L</th>
<th>(2) Gross sales</th>
<th>Cash collections</th>
<th>Non-cash credits</th>
<th>Contractual credits (3) [Other]</th>
<th>Charge-offs</th>
<th>Debit memos</th>
<th>Recoveries from prior charge-offs</th>
<th>Other</th>
<th>Ending balance per G/L</th>
<th>Ending balance per aging</th>
<th>Difference from G/L to the aging</th>
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</table>

(1) If possible, exclude any intercompany receivables from the rollforward.
(2) Cash collections is actual amount collected (do not include cash discounts or other non-cash reductions).
(3) Non-cash credits are non-cash reductions to the receivable balance (i.e. dilution) other than for bad debt purposes. Example categories include credit memos for returns, billing adjustments, cash discounts, volume rebates, early pay rebates, etc. If possible, show "contractual dilutions" (e.g., volume and early pay rebates) in a separate column from other credit categories (this will help lower reserves and increase the securitization's advance rate).
### Schedule B – receivables aging schedule

Enter most recent month end: **8/31/15**

24 months of historical gross aging data (debit-only) is requested; 36 months is preferable

Report credits separately in the "unapplied cash and credits" column

Add columns as needed to show additional extended aging buckets if possible (for example, 121-150 DPD)

<table>
<thead>
<tr>
<th>Month</th>
<th>End total</th>
<th>Current debit only</th>
<th>1-30 days past due debit only</th>
<th>31-60 days past due debit only</th>
<th>61-90 days past due debit only</th>
<th>91-120 days past due debit only</th>
<th>121+ days past due debit only</th>
<th>Unapplied cash and credits</th>
<th>Unbilled receivables</th>
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<tbody>
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<td>Sep-14</td>
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</table>

(1) Remove intercompany receivables from the aging if possible.
### Schedule C – receivables characteristics

Complete the categories that are applicable. Do not double count receivables (if an AR exists in one category do not count it in another category)

24 months of receivables data is requested; 36 months of data is preferable (1)(2)(3).

<table>
<thead>
<tr>
<th>Month</th>
<th>Total</th>
<th>Intercompany receivables (if not already excluded from aging and rollforward)</th>
<th>US federal government receivables</th>
<th>Canadian receivables (USD equivalent per spot rate)</th>
<th>Foreign obligor receivables (other than Canadian); specify currency</th>
<th>Advance payments</th>
<th>Receivables offset by accounts payable (“Contras”) (1)</th>
<th>Cross-aged receivables (2)</th>
<th>Receivables with modified payment terms (3)</th>
<th>Bankrupt obligor receivables</th>
<th>Unearned receivables (e.g. billed not shipped)</th>
<th>Non product billings (e.g. late fees)</th>
<th>Notes receivable (if also included in aging)</th>
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<td>Mar-15</td>
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(1) Any customer which is also a supplier or to whom you owe money (the lesser of the A/R or A/P balance should be reported as a Contra amount).
(2) For each obligor, if amount of receivables greater than 60 days past due is greater than 50% of the total obligor’s balance, then the less than 60 days past due amounts should be counted in the “Cross-aged” column.

### Schedule D – concentrations and contra accounts

#### Ten Largest Obligors based on A/R

12 months of data is suggested to optimize concentration levels and maximize the advance rate (1)

<table>
<thead>
<tr>
<th>Number of Obligors (most recent reporting period)</th>
<th>Name</th>
<th>A/R balance</th>
<th>Current</th>
<th>1-30 days past due</th>
<th>31-60 days past due</th>
<th>61-90 days past due</th>
<th>91-120 days past due</th>
<th>121+ days past invoice</th>
<th>A/P balance (1)</th>
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<td>Aug-15</td>
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(1) Include accrued payables/unvouched payables.
### Schedule E – payment terms

*Breakdown of sales terms by outstanding receivables (use applicable columns)*

3 months of data is sufficient if there are no material changes in terms during the past year

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Questions?
Contact

Sandra J. Tullis
Senior Manager
San Francisco
+1 415 984 7153
sandra.tullis@ey.com

Background
- Sandra is a senior manager in EY's Global Treasury Services practice. She has worked with a wide range of US and international companies based in the Bay Area, including manufacturing, software and health care companies.
- Sandra and the Global Treasury Advisory team are responsible for providing a broad range of services to the firm’s clients, including assistance with global cash management, payment networks and pooling, debt and investment management, insurance risk management, receivables financing, and currency risk management.

Engagement experience
- Sandra leverages 20 years of industry experience and has been a Certified Treasury Professional since 1999. She is a respected speaker at national and regional conferences for multiple treasury associations. Most recently, she led the treasury due diligence process for a technology acquisition worth US$800m+.

Prior work experience
- Most recently, Sandra was the Treasury Director at Flextronics International, where she was primarily responsible for global cash management, corporate finance and foreign exchange. She successfully led the implementation of a global banking request for production with multicurrency pools in Asia, Europe, the Middle East and Africa, and North America. She also implemented a hedging strategy for optionality, placing zero-cost collars for currencies impacted by declining oil prices.
- Sandra has led highly successful treasury workstation implementations with multiple systems, including cash positioning, payment centralization and debt management. In addition, she completed a multicurrency intercompany netting project that included 124 locations netting 60k invoices and more than US$600m of intercompany trade per month. Sandra is also a subject-matter resource for accounts receivable factoring and has managed over US$1b in factoring and asset-backed securitization programs.
- During her time at Trimble Navigation and CRC Health, Sandra renewed and managed insurance portfolios totaling over US$500m in coverage. This included property, business interruption, general and professional liability, product liability, environmental and directors and officers liability insurance. Additionally, she has led initiatives for post-acquisition integrations of treasury systems, insurance coverage and SSC processes.
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