STRATEGIC CHANNEL FINANCING SOLUTIONS FOR OEMs

CASE STUDY: DISTRIBUTION FINANCING

Original Equipment Manufacturer (OEM) is an expression commonly used in some industries such as Automotive and Technology to refer to large companies that manufacture end products, like cars and computers.

OEMs typically source components and materials from multiple Suppliers, manufacture products in industrial plants and sell them via Distributors. Therefore, the management of working capital is critical for OEMs and their Buyers (Distributors) particularly when it comes to its financing. Amongst various alternatives, OEMs can finance working capital via Accounts Receivable (AR), i.e. reducing days of sales collection from Buyers and Distributors, or via Accounts Payable (AP), i.e. obtaining longer payment terms from Suppliers.

In this report, we explore two strategic solutions that OEMs can use for financing working capital, whilst at the same time grow sales.

Distribution Financing

How it works. Distribution Financing (DF) is a strategic AR based financing program established by an OEM in consideration of a selected portfolio of Buyers. The OEM extends the payment terms offered to these Buyers in order to promote sales and at the same time, sells the AR to the Funder on a "true sale" basis. The Funder pays the OEM earlier (or on the original invoice due date) and collects from the Buyers at the extended due date. The OEM and Funder sign a Receivables Purchase Agreement and the Buyers typically sign a Promise to Pay Agreement with the Funder.

Role of the OEM. DF programs are usually sponsored by the OEM, which can absorb the cost of the program or pass it onto to the Buyers, either fully or partially. The OEM might also provide certain level of recourse to the Funder of approximately 5% – 10%, with the remaining credit risk being with the Funder purchasing the AR. Some Funders use credit insurance coverage.

Benefits. DF is an innovative yet straightforward solution that OEMs can use to generate the following benefits:

- The OEM boosts sales by improving the payment terms offered to Buyers, reduces credit risk and enhances working capital by decreasing Days of Sales Outstanding (DSOs).

- Buyers enhance cash flow and working capital metrics (increase Days of Payables Outstanding or DPOs) as the extension of terms is considered as trade payables. Furthermore, Buyers do not need to place collateral.

Case Study

	Program: Distribution Financing.
	Originator: Global IT OEM.
	Buyers: 50 IT Distributors in 16 countries in Europe.
	Size: EUR 2 billion in aggregate credit limits.
	Billing documents financed: Invoices and credit notes in 6 currencies.
	Program objective: Extension of payment terms offered to Distributors from 30 to 60 days, with the IT OEM collecting on day 14 from the Funder.
	Impact in OEM´s working capital: The true sale of receivables allowed the IT OEM to reduce DSOs to 37 days, the lowest level amongst peer companies (average DSO 50 days).
	Improved profitability for OEM: Positive impact in operating margin of the IT OEM driven by increase in sales of 8.3% and savings obtained due to the cancelation of early payment cash discounts.
GSCF GLOBAL SUPPLY CHAIN FINANCE	**Advanced program processing:** Done by leading servicer GSCF, ensuring full automation and tailored reporting for all stakeholders in real time, as well as tight credit risk monitoring over Distributors.

Growth Financing

For the cases in which the OEM does not wish to engage in selling a portfolio of AR but instead prefers to support working capital related to trades with a selected list of Buyers, Growth Financing is the most applicable type of solution.

How it works. Growth Financing (GF) is an AP based financing program driven by an OEM that selects key Buyers in need of payment terms extension and presents them to a Funder. The Funder is mandated to handle the individual Buyers` AP towards the OEM and as a result pays the OEM on behalf of the Buyer on the invoice due date. Under that mandate, the Funder extends the payment terms to the Buyer, collecting from the Buyer at a later date agreed. Alternatively, the OEM can modify the terms with the Buyer by introducing an early payment cash discount and extending the net payment terms offered so as to enable an AP treatment by the Buyer. The Buyer mandates the Funder via an AP Services Agreement and the OEM typically signs a non-legally binding letter acknowledging the program.

Role of the OEM. OEMs sponsor GF programs, though more indirectly than in DF. The cost of the program can be borne either by the Buyer or by the OEM. In the latter case, the OEM establishes an early payment cash discount that covers the program cost. The OEM does not provide any credit cover nor does it legally engage with the Funder.

Benefits. GF is another strategic tool that OEMs can use to generate the following benefits:

- The OEM promotes sales to Buyers by supporting a payment term extension without inflating DSOs. The OEM does not have to sell its AR and yet it is able to improve cash flow forecasting**.**
- Buyers enhance liquidity and could account for the financing as AP, thus improving working capital metrics (increase DPOs).

Conclusion

In general terms, OEMs need to balance out offering favorable payment terms to Distributors, which drives sales and enhances the OEMs´ general competitiveness amongst peers, with the OEMs´ own balance sheet situation. DF and GF solutions are two strategic ways to achieve this dual objective.

Alternative Distribution Financing Ltd. (ADF), part of the GSCF Group headed by Global Supply Chain Finance Ltd. (GSCF) the world's leading servicer in the working capital financing space, has profound experience in structuring and managing DF and GF programs involving global OEMs and their Distributors worldwide.

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