

*Research Report*  
**A Receivable Advantage**

issue no.

14

A study on the use of trade receivables securitisation in sub-investment grade company financing arrangements, by Europe's top 40 banks

## Key Findings

- Research amongst Europe's top 40 banks clearly reveals that TR securitisation has been one of the great survivors of the financial markets crisis.
- TR securitisation is seen by these top banks as an essential tool in structuring, or restructuring, a corporate finance programme, with 64% of respondents rating the technique as 'very important'.
- The main attractions of TR securitisation are reduced cost of funds and diversification of funding sources, by separating the pool of invoice debt from the issuer's own corporate credit rating.
- TR securitisation is viewed as an especially attractive tool for sub-investment grade companies in what remains a tight market for relationship credit.
- While TR securitisation volumes dropped during 2008 - 2009, they are once more growing strongly.
- TR securitisation is also seen as a key financial restructuring tool, particularly for LBOs seeking to bring down their cost of funds and commence the deleveraging process.
- TR securitisations are predicted to grow at a steady pace throughout the decade, with increased demand coming from more highly leveraged companies.

## Introduction

Trade Receivables (TR) securitisation appears to be one of the great survivors of the financial markets meltdown of 2007 - 2009. This has been especially true for financiers of sub-investment grade (SIG) companies, looking to find the optimal set of funding structures for their clients in a time when TR securitisation separates outstanding debt from the creditor company. It means that the debt can be rated on the basis of the collection of debtors, rather than predicated on the creditor company's rating which, in the case of an SIG company, will be low.

Demica has conducted a series of research projects, dating back to 2007, which have tracked the interest in, and take-up of, TR securitisation by European corporates. However, the further progress of the TR market will not maintain its momentum unless financiers themselves are actively promoting such programmes. Therefore, in order to understand the views of the European banking community on the position and growth of TR securitisation, Demica commissioned a research project amongst the European Top 40 banks, with fieldwork taking place across January to April 2011.

In terms of general trends in TR securitisation, respondents noted that subprime assets, mezzanine (convertible) structures and exotic instruments have died in the market and are unlikely to return, especially with the fiercer regulatory atmosphere that has resulted from the financial crisis. On the other hand quality assets, in the form of TR, leases, auto loans and prime residential mortgages have been seen to be robust and are experiencing something of a revival post-crisis.

Top European banks are seeing increased demand for accounts receivables securitisation as other sources of distribution and risk-offloading have disappeared. Invoice-based finance in general, and invoice securitisation in particular, are rated as very important by banking respondents – 64% rated it

as 'very important'. From the banks' commercial point of view, TR securitisation is important either to enhance client relationships, or establish bridgehead with new clients with a product that has a low risk-weighted asset consumption under Basel II/III. One bank noted invoice securitisation as "a vital component in corporate finance"; and other said "it offers more diverse sources now that other traditional avenues have dried up"; another called it "a valuable and vital tool – more real in comparison to exotic products and much more secure."

The following section of this report summarises the views of respondent banks on the importance of TR securitisation to sub-investment grade companies.

## Key benefits of TR securitisation for sub-investment grade companies

According to our survey participants, the ultimate two benefits for SIG companies of utilising TR securitisation are cheaper funding rates and diversification of funding sources. Access to capital markets for lower-rated companies, as well as the ability to customise the securitisation programme in order to suit the company's individual needs, are equally recognised as the second level benefits.

With the underlying portfolio rather than the balance sheet of the originator being the key risk factor in such securitisations, financing is based on the debtor risk profile rather than the creditor's rating, enabling a lower financing cost. Moreover, SIG companies can also gain wider access to funding sources. As one respondent pointed out, if companies only finance their working capital needs through bank facilities, they will be far too reliant on their core banks. By obtaining the same level of funding through different providers, companies can often continue to enjoy the credit lines they have with their core banks at the same time as

accessing more diverse funding sources. Respondents also noted the meritocratic nature of TR securitisations in rewarding business growth, in that the greater the volume of receivables generated, the greater the level of funding they can generate.

From the banks' perspective, respondents share the convergent view that TR securitisation presents banks with a safer, more secured way of allocating capital while allowing them to continue to provide funding through revolving bank facilities. While seller risk still has to be taken into account, if their portfolios have large exposure to corporates of good creditworthiness, banks will be much more willing to provide financing on this secured basis.

An interesting illustration is provided by the client portfolio of a couple of survey participants where up to 65% of their clients are SIG or indeed unrated companies. As one respondent highlighted, the more sub-investment grade a company is, the more collateral it will have to provide. Another respondent also suggested that through TR securitisation, it is possible to structure a deal which would allow a single B rated company to get funding at A rated pricing.

Most respondents noted that not all SIG companies have an appetite for the level of transparency that a TR securitisation programme demands. Some SIG firms still opt for high-yield bonds, despite the higher costs, whereas the others appreciate the discipline that comes with securitisation transactions, as well as the by-product of improved cash and working capital management.

Respondents were split on whether they tended to offer TR securitisation only to existing SIG clients, or specifically to new clients. A quarter of survey participants noted that their banks do not have an explicit stringent risk policy which requires them only to work with existing SIG clients. One respondent stated that while 75% of their SIG TR securitisation clients are existing customers of the

bank, the remaining 25% are new customers. Several respondents noted their strategy to use securitisation as a bridgehead for relationships with new clients, then gradually extending this relationship to other business areas.

## Challenges

As with all funding tools, there are also challenges associated with TR securitisation. Over 80% of the respondents see the complexity and the time required to implement securitisation programmes as the biggest challenges. The next two most cited hindrances are higher fixed costs and operational disruption in the set-up phase.

Lead time for securitisation can be lengthy as the structuring process is highly involved and requires a great deal of up-front work. As one respondent noted, it is often very difficult for banks to anticipate from the onset the investment required in terms of time and costs in ironing out implementation issues. Another banking respondent supports this view by saying that any securitisation is a complex project involving various parties across different departments including IT, accounting and legal.

One of the most important prerequisites for TR securitisation is superior IT capabilities, since it is of paramount importance that companies execute strict management in monitoring their trade receivables. One banker shared his experience of having seen clients opting for TR securitisation programmes because it also acted as a driver for better working capital visibility and management. Superior IT capabilities need not, of course, be internal. They can be provided either by hiring experts internally to create a home-grown facility, or outsourced to a specialist provider with a proven track record in TR securitisation processes.

Several respondents pointed out that this up-front investment in time, effort and cost recede in

importance, especially for sub-investment grade companies, when compared to the benefit of access to finance that TR securitisation enables. Especially after the financial markets crisis, companies of all sizes have been looking for ways to diversify their funding sources. Respondents to this survey are of the opinion that TR securitisation is an absolutely essential tool for SIG companies, and that available technology can massively reduce the ongoing administrative burden of running such a programme.

Indeed, one banker also noted that well-known investment grade corporates in the US have securitisation facilities as back-up facilities, which can be used readily in case they see the need. Throughout the financial turmoil, commercial paper has remained one of the least affected funding sources; companies therefore find it reassuring to have securitisation as an alternative funding channel.

## Funding rates

Almost 80% of the respondents agreed that TR securitisation offers SIG or unrated companies better funding rates than relationship lending. As bank funding for companies is limited, TR securitisation can provide SIG companies which have significant liquidity facilities with an alternative source of funding while reducing their reliance on relationship lending and thus easing the pressure on the lending bank.

It is, however, not easy to quantify the level of saving as it varies on a case by case basis and is contingent on various factors including the companies (eg, portfolio) circumstances (eg, perception of risk on a company) as well as the complexity of the deals. Thus, it is almost impossible to generalise the potential savings. As an indication though, several of the respondents said that TR securitisation can be 25% cheaper than relationship lending in some cases. One of the banking professionals also outlined that if syndicated loans are charged at 125 basis points, then customers of securitisation

could potentially get 75 - 90 basis points. For the really established bank customers, the range might even go down to 50 basis points.

While there is general consent among the respondents that TR securitisation provides SIG or unrated companies with cheaper financing than relationship lending, in order to support the borrowing requirements companies have, several respondents have stressed the absolute necessity of having a robust system (eg, IT capabilities, reporting etc) in place for the effective monitoring of receivables. If companies have different accounting systems across their clients' portfolio, they will not be in a position to put their reporting together without a unified system. Prompt collection of their receivables will also play a critical role. As these respondents pointed out, TR securitisation is an advanced funding tool and it can only be utilised effectively as long as companies can leverage their resources and work in a well organised fashion.

## Future of TR Securitisation in the SIG Sector

While all survey participants expect some degree of growth in TR securitisations, over 75% of them anticipate that growth to be 'steady'. Respondents noted that leading banks have now fully comprehended that TR securitisation is a very secure lending product. Given that capital is scarce, they are constantly looking for efficient lending mechanisms, so TR securitisation will remain an effective way for banks to allocate their capital. To give a gauge of growth rates, one respondent reported an increase of 10 to 15% in TR securitisation in the past two or three years.

At least 25% of the bankers have seen 'many more' SIG companies embarking on TR securitisations over the 18 months and even more deals are being evaluated at the moment. They are confident that the demand will continue moving forward. One said that the market was

quite buoyant before 2007, went quiet in 2008 - 2009, but activities are coming back with debt restructurings or refinancing by companies who had to accept less advantageous rates during the financial markets crisis.

One respondent stressed that the crisis has helped demonstrate the benefits of TR securitisations. Many companies are now much more aware of the advantage of accessing liquidity outside the straightforward vanilla bank market. Before the crisis, SIG companies had access to cheap liquidity, so there was no inducement for them to participate in heavily structured programmes. As cheap liquidity no longer exists in light of the tight credit environment, companies are considering obtaining capital from structured types of facilities.

Another survey participant felt that TR securitisation is highly correlated to GDP. When companies are anticipating a slowdown or a subdued economic environment, there is less incentive to invest. If the economy gathers pace, the demand for working capital rises and there should be an increase in securitisation activities. This banker also reported an increase in utilisation at their bank. A year ago, the utilisation of securitisation transaction was around 60 – 70%, now it is closer to 85% or 95%.

Similar to SIG companies, 90% of the respondents believe that TR securitisation would make a good funding tool for unrated companies. One banker highlighted that in the US, virtually every company is rated because the revolving credit facilities require ratings to operate the pricing companies receive, which is not the case in Europe. In Europe, many companies would be investment grade but are actually unrated because they do not issue public bonds. It is not a tradition for European companies to be rated unless they are going to the public market. It is therefore widely known that in Europe corporate ratings are rare relative to the US because bank lending has dominated and public debt issues have been relatively few. This means that there is a sizable universe of unrated

European companies - including mid-caps such as the German Mittelstand - that can usefully capture the advantages of funding secured against their debtors - those advantages being funding diversification and favourable pricing.

## Trade Receivables Securitisation for Highly Leveraged Companies

While all respondents agreed that TR securitisation can also be an option for highly leveraged companies in securing funding, some also pointed out that the SIG rating band in which a company would be eligible is extremely tight. One respondent note that “a high single B to low double B rated company will be the rating band within which the bank can work.” In contrast, others noted their banks much wider view, highlighting the fact that since TR securitisation is concerned with the risk of the receivables base and less the risk of the company itself, then regardless of the company’s leverage position, they can still make use of TR securitisation. There are, however, several considerations that need to be examined closely in determining whether TR securitisation is a viable option for highly leveraged companies, including analysis of both current and historic accounts receivables activity, debtor profiles, sales and collections activity, and also the manner in which that activity is recorded and reported.

One leading banker raised the point that in order to predict growth of deals among highly leveraged firms, it will be essential to look at bank market capacity, which he believes is going to increase significantly in the next two or three years, although perhaps not to the level seen prior to the crisis. Moreover, many highly leveraged companies which were established during the glut of leveraged buyouts, tended by definition to be rated as sub-investment grade, and are all confronted with very significant maturities over the next couple of years. To help them recapitalise, a combination of

high-yields bonds and new bank financing, including TR securitisation, will be put in place. This opinion is echoed by another respondent who has mostly witnessed highly leveraged companies making use of TR securitisation as part of the restructuring and rebalancing of their whole capital structure, and eventual path towards deleveraging.

Respondents noted that in a typical leveraged funding package, it is difficult to pinpoint the proportion of the trade receivables funding component as it depends on various factors including the circumstances of the companies and the pool of assets – eg, business with high volumes of fairly high turnovers with reasonably liquid assets will differ largely from business which has significant loans and fixed assets. But the figure given by the majority of the respondents tends to lie between 20% - 30%. One respondent described the typical scenario where two or three banks provide the senior debt for the acquisition in a leveraged funding package, and within this package, one-third of the funding volume might be a TR securitisation. The overall pricing of the debt will be reduced as a result of the assets serving as security.

## Frequent Asset Performance Reporting

In order to mitigate and manage risk in a SIG trade receivables securitisation, all respondents noted that frequent asset performance reporting is absolutely essential. Since TR securitisation programmes relies on superior management of the asset pool, an effective monitoring system is an absolute prerequisite. In the event of a bankruptcy of the client, banks will need the capability to trace down each individual invoice in order to find out the debtors of the invoices, which is of paramount importance. Several bankers emphasised their view that item level reporting is critically important, not only to prevent problem transactions being hidden in aggregate reporting, but also to

monitor, manage and automate integration with the bank's invoice acceptance business rules.

## Conclusion

This research amongst Europe's top 40 banks clearly reveals that TR securitisation has been one of the great survivors of the financial markets crisis, and while volumes inevitably dropped during 2008 - 2009, they are now once more growing strongly.

TR securitisation is seen by these top banks as an essential tool in structuring, or restructuring, a corporate finance programme. This is especially the case for sub-investment grade companies in what remains a tight market for relationship credit. TR securitisation enables wider access to finance, either through an existing relationship bank, or through a new banking partner. It is seen as a key restructuring tool, particularly for LBOs seeking to bring down their cost of funds by separating their pool of invoice debt from their own corporate credit rating.

Growth is envisaged for TR securitisation throughout the decade, albeit at a steady pace, and the technique plays a particular role in the deleveraging process for high-debt companies.

## Methodology

Research was conducted amongst Europe's top 40 banks by assets (compiled using the Forbes Global 2000 list) during January and April 2011. Qualified respondents were interviewed about the position and growth of trade receivables securitisation, with particular view on sub-investment grade companies. Respondents were asked to give their opinions on the market in terms of recent growth; projected growth; key benefits; challenges; funding rates and utilisation rates among corporates.

[www.demica.com](http://www.demica.com)

Demica is a market leading provider of specialised working capital solutions, providing consulting, advisory and technology services to a diverse range of multi-national clients. Demica works with the world's leading banks, private equity sponsors and global corporations to implement innovative solutions to their securitisation and supply chain finance requirements.

Demica is based in London.

For further information visit [www.demica.com](http://www.demica.com)



Demica Limited,  
Crowne House,  
56-58 Southwark Street,  
London SE1 1UN, UK

T: +44 (0) 20 7450 2500  
F: +44 (0) 20 7407 5825  
E: [info@demica.com](mailto:info@demica.com)  
[www.demica.com](http://www.demica.com)



Certificate No. IS 567347