BUYER RISK ASSESSMENT: CREDIT, OPERATIONAL & LEGAL RISK

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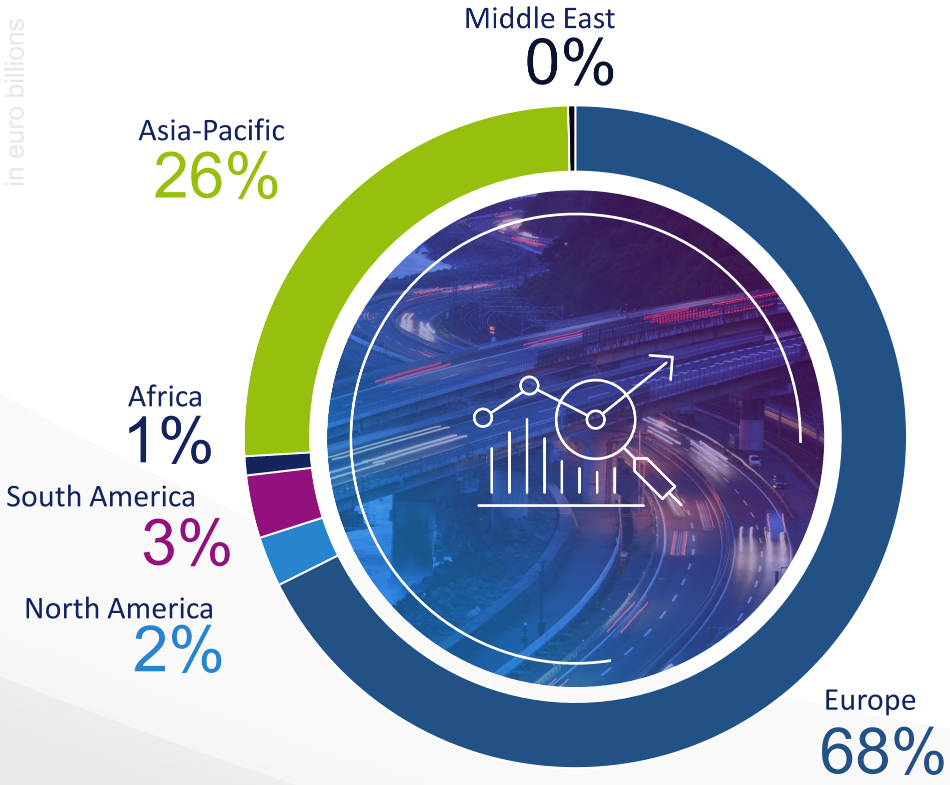
General Introduction to Buyer Risk

FCI 2020 GLOBAL FACTORING STATISTICS AND MARKET SHARE BY REGION



	2019	2020	Group rate % Change
Europe	1,976.2	1,844.7	-6.7%
North America	86,7	66,6	-23.2%
South America	132,0	83,6	-36,7%
Africa	24,6	25,2	+2,8%
Asia- Pacific	687,6	697,1	+1,4%
Middle East	9,9	9,5	-4,2%
Total	2,917.11	2,726.73	-6.5%

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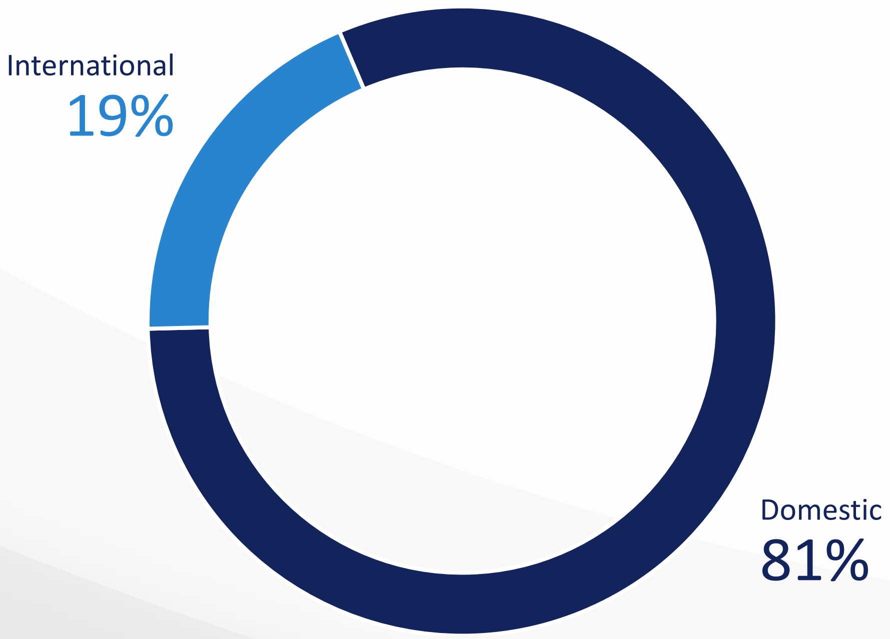
PRODUCTS & COMPOSITION

FCI PRODUCTS 2020

Factoring Turnover 2020



FCI COMPOSITION 2020

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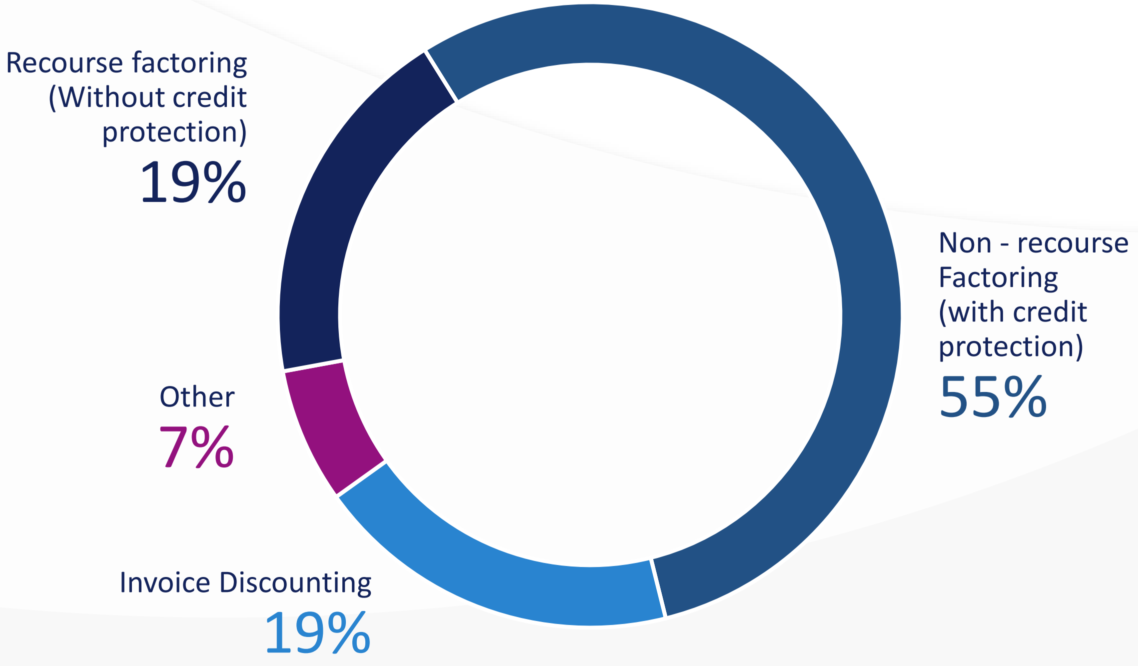

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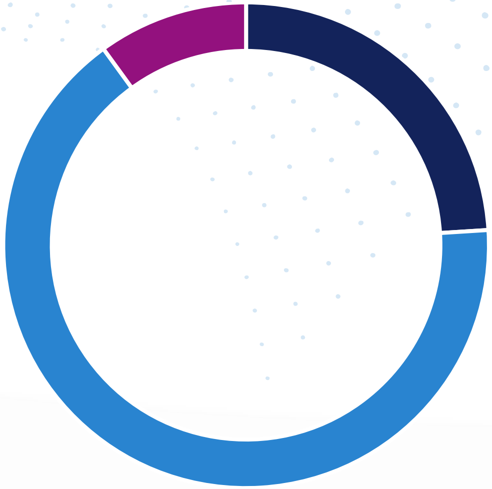
CLIENT & DEBTOR OUTLOOK 2021

CLIENT RISK OUTLOOK

Negative 24%

Neutral 66%

Positive 10%

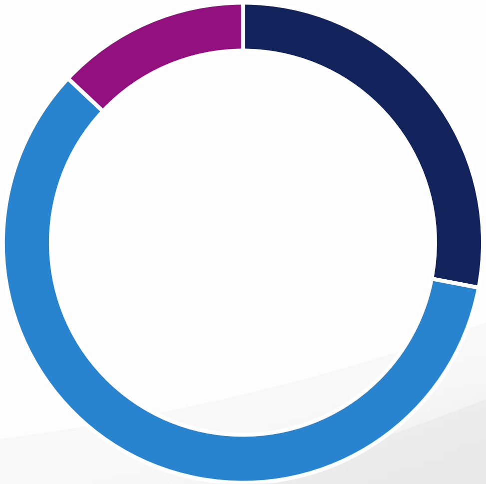


DEBTOR RISK OUTLOOK

Negative 28%

Neutral 59%

Positive 13%



Importance and Differentiation of Buyer Risk in Factoring

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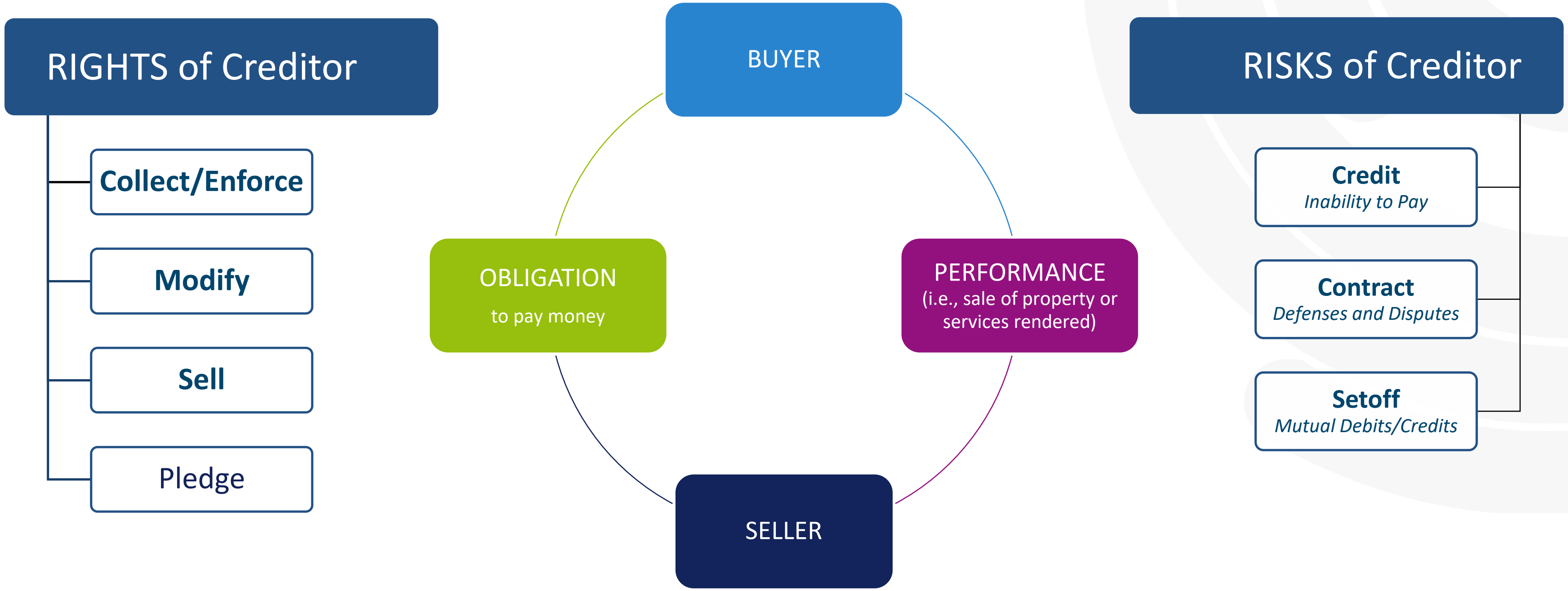
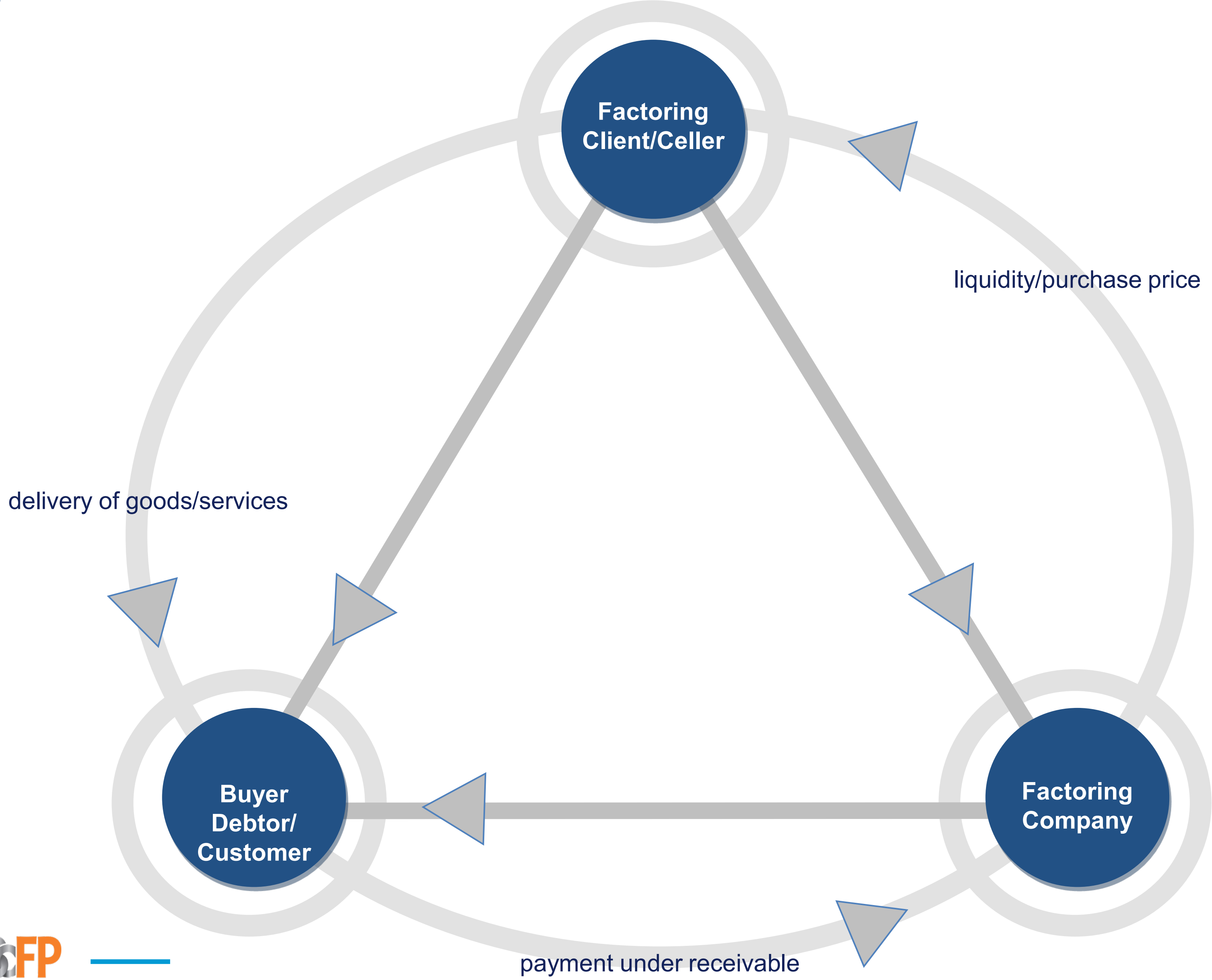
WHAT IS A RECEIVABLE & WHAT ARE THE OWNER'S RIGHTS?



Definition: A receivable is an intangible asset on the balance sheet of the supplier, created when the seller agrees to ship on open account terms, typically for a period up to 180 days

Factoring: Three Corner Model



Importance of Buyers Risk Analysis

- There are 2 main drivers that determine the level and amount of financing to the seller/client:
  - *Quality of buyers*
  - *Spread of buyers*

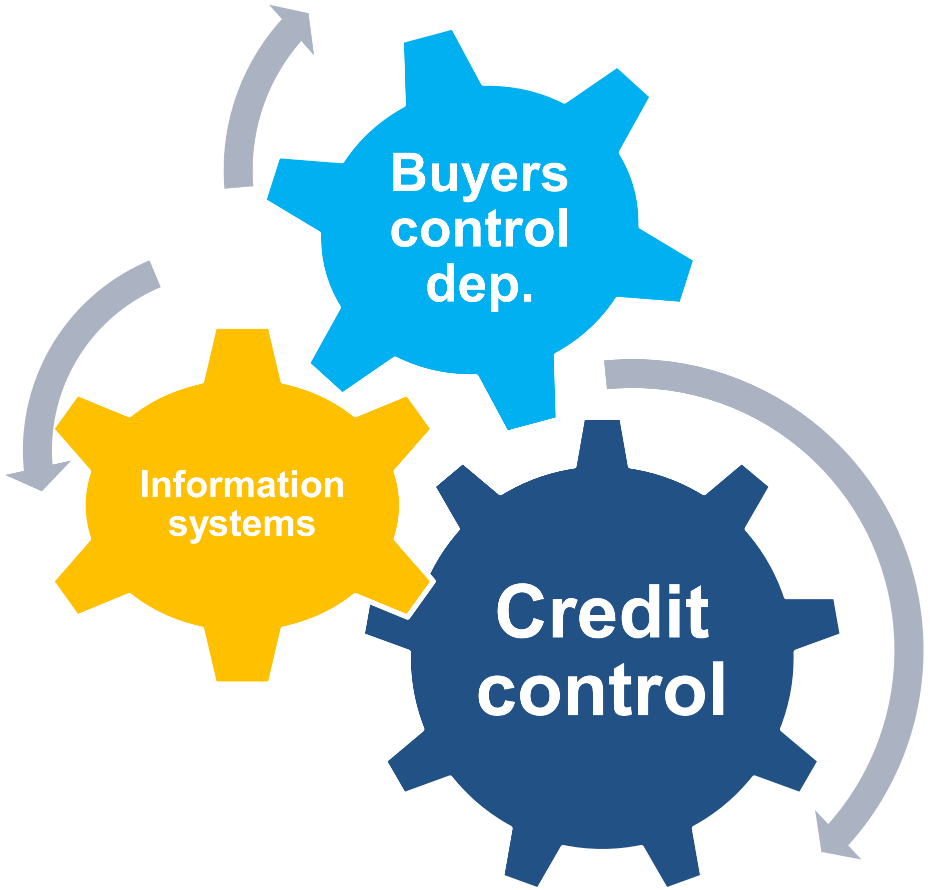
Quality of buyers

- Assess whether a buyer will be able to pay the full amount of the A/R as they become due under the terms of sale – liquidity risk

Spread of buyers

- A good spread of assigned buyers is always a positive element in factoring
- **Concentration rates** are important rather than the number of buyers
  - Creates dependencies

Buyer Risk Control Mechanism



Buyer Risk Assessment

"A Factor must rely both on accounting and non-accounting information."

➢ Accounting Information

Audited Financial Statements

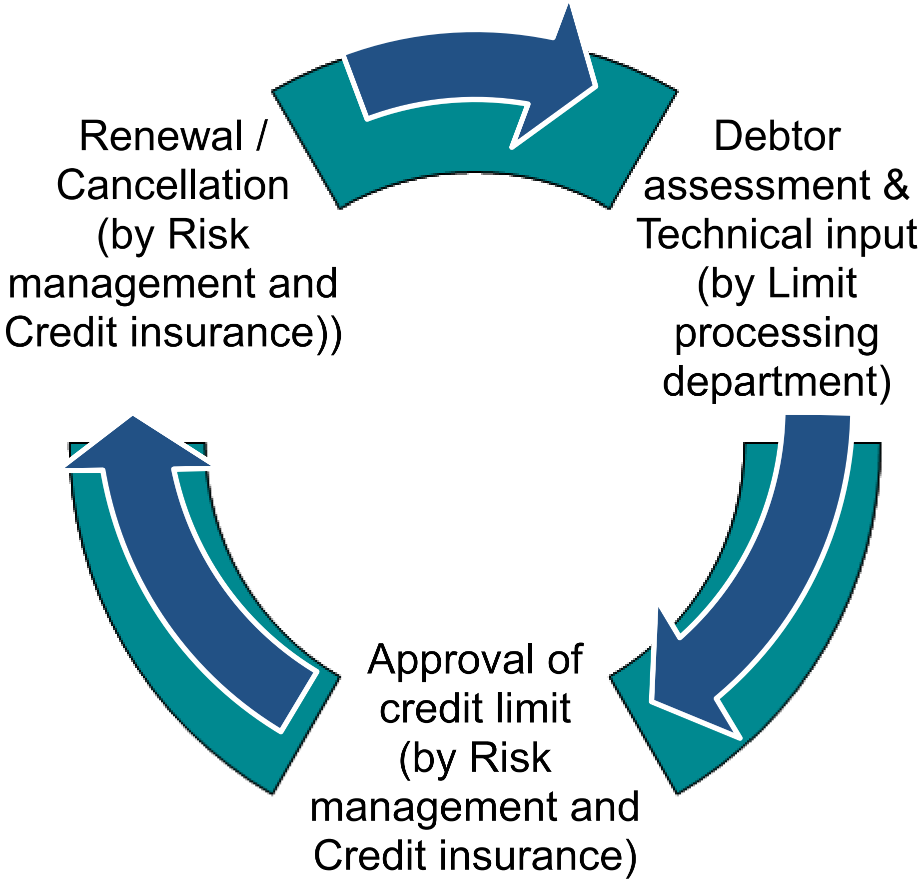
- **Balance Sheet**
- **P&L Accounts**

- **Profitability/Margins**
- **Performance/ROA-ROE**
- **Debt/Equity**
- **Liquidity/Cash Flow/EBITDA**
- **Trade Cycle**
- **Working Capital**

Along with the Audited Financial Statements:

- ➢ Interim reports are an additional very valuable tool
- ➢ Peer analysis – compare with average industry performance

Credit Limit Cycle



Debtor Underwriting Procedures:

- Self Underwriting (direct model)
- Credit Insurance (indirect model)
- Banks/Put Options (indirect model)

Credit protection methods

Factor

in-house underwriting

Credit Insurance

- Factor's credit insurance policy
- Client's credit insurance policy

Bank Coverage

FCI Two-Factor System (cross-border)

Put Options

Direct debtor (buyer) Risk Coverage

- Assessment of clients' debtors before signing a factoring contract
- Regular assessment of debtors after signing a factoring contract

Assessment based on different information sources

- Credit information agencies
- Bank information / Reports
- Identification numbers
- Balance sheet / monthly Profit & Loss statement
- Rating / Grading
- Press / Online publications
- Receivables ledger of factoring client
- Internal information sources

Credit limit decision

- Credit limit with expiry date or
- Credit limit until further notice or
- Rejection of credit limit

Banking Facility

Banking Information

- ❑ Secured/Unsecured
- ❑ Expiration/Renew Date
- ❑ Covenants:
  - ▪ Financial Ratios
  - ▪ Dividends/Payout
  - ▪ Acquisitions
- ❑ Type of Financial Institution

INDİRECT DEBTOR (BUYER) RİSK COVERAGE

Via credit insurance

- 1-contract model (debtor coverage by CI contract of the Factor)
- 2-contract model (debtor coverage by CI contract of the Client)
  - Factor accepts own credit insurance contract of his client
  - All rights of the credit insurance (CI) are assigned to the Factor (CI has to agree)
  - Obligations of the CI contract can be fulfilled either by client or Factor
  - Factor normally covers the self retention (of 10-20%) in order to provide true sale
  - Currency risks to be considered

Via Banks through the FCI 2-Factor network

- Risk assessment by Import Factor
- 100% Risk protection
- Payment under approval 90 days after due date (according to GRIF)

Via Put Options

IMPORTANT ELEMENTS OF CREDIT INSURANCE

Self retention: percentage withhold from CI per bad debt case, usually 10-20%
Franchise: individual fixed amount per bad debt withhold from CI
First loss: fixed amount up to which the CI is not obliged to pay indemnification

Payment period for indemnification:

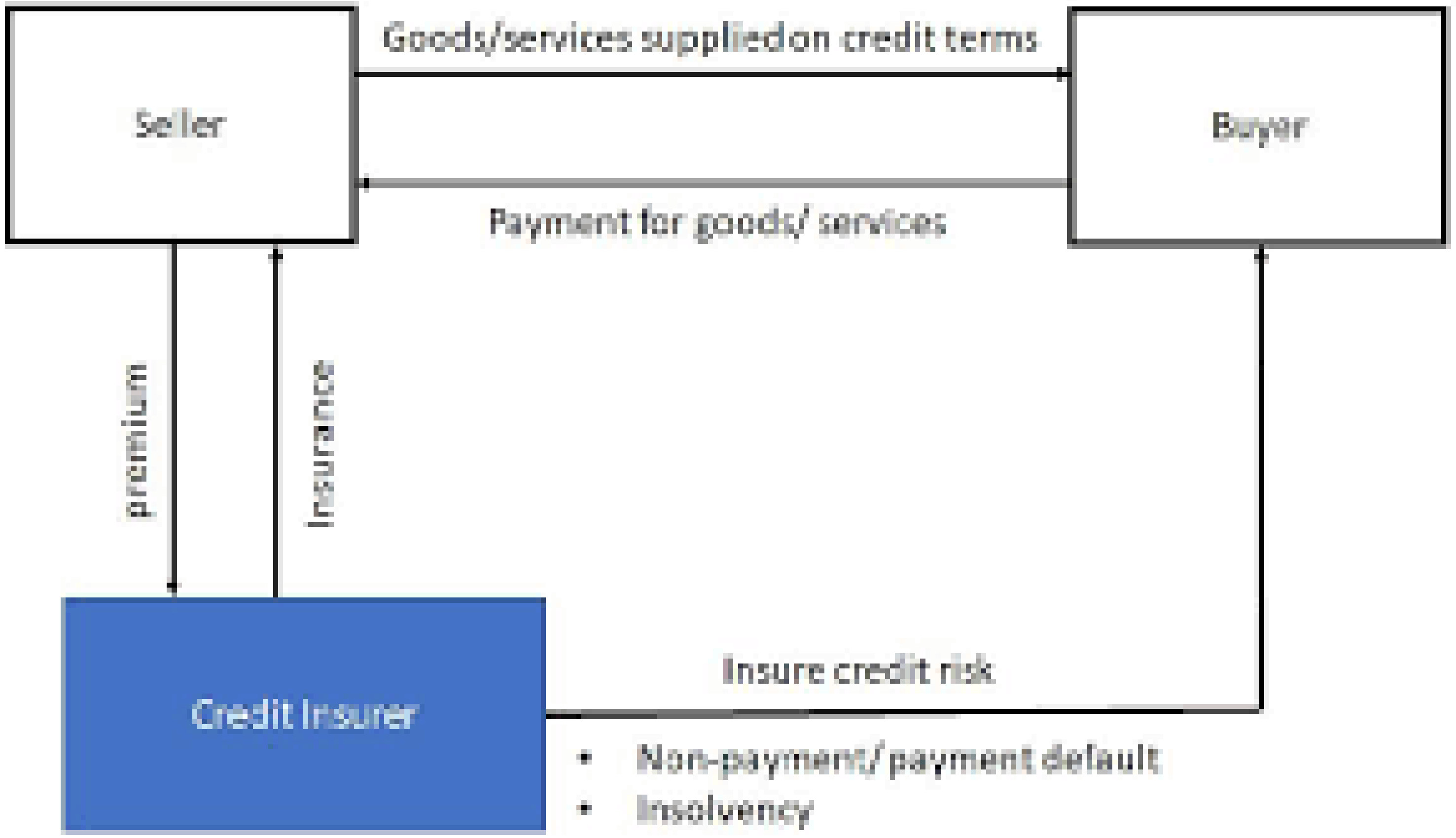
a) when insolvency proceedings have been opened

b) protracted default: earlier indemnification, usually 180 days after due date

Maximum Indemnity Limit: Overall maximum exposure by the CI (per policy period), generally a multiple of paid insurance premium

Covenants: information of CI (within defined period) about overdues
bad financial information
bad debts
payment of insurance premium

Typical Trade Credit Insurance Scheme



Cancelation of Credit Limit

Cancellation of credit limit, if for example…

- Negative payment behaviour
- Increasing overdues
- Request for installments
- Deterioration of grading
- Bad financial information
- Negative development in certain industries

- CI covers debtor risks, but if bad debt ratios exceed 70-80% of paid premium, you can expect:

- Increase of insurance premium, if claims exceed defined ratios
- Downgrade of debtors and cancellation of credit limits
- Tightening of insurance terms (i.e. higher first loss, franchise, etc.)

Specific Buyer/Debtor Cases

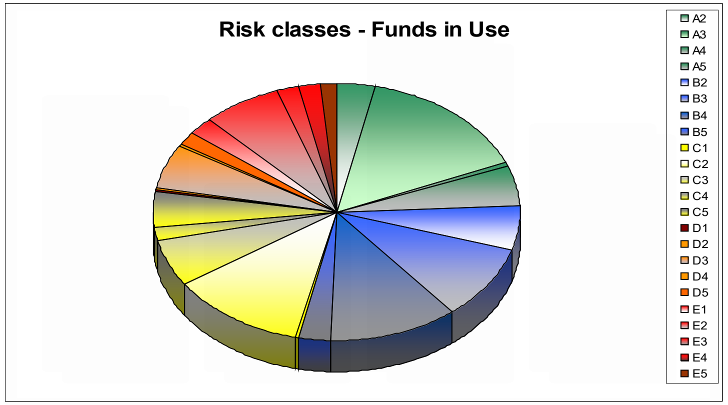
- Buyer is also a client:
  - Increased risk profile
  - High solvency requirements
- Reverse Factoring
  - 100% debtor concentration
  - High solvency requirements
  - Accumulation of credit limit amounts
- Undisclosed Factoring / NNF
  - No direct contact to debtor
  - Risk of fraud
  - High solvency requirements

STRUCTURAL/PROCEDURAL BUYER RISK ANALYSIS

Buyer analysis

- ❑ Regular analysis of industry sector concentrations
- ❑ Regular analysis of share of top buyers in proportion to total portfolio
- ❑ Rating of debtor groups
- ❑ Analysis of country risk

Example of buyer risk portfolio



Typical industry risks

- ❑ Industries in which partial payments are usual
- ❑ With high potential of disputes
- ❑ With payment of installments over a longer period
- ❑ With strong changes in resource prices/ market conditions
- ❑ In which rights of return are usual
- ❑ In which debtor is liable for unpaid social insurance contribution in case of supplier's insolvency

Handling Debtors Insolvency

Liquidator:

- Appeal against buyer's payments to the Factor
- Repayment demand against Factor

Measures of Factor:

- Extensive incorporation of Retention of title-rights into terms and conditions of suppliers' contracts
- Protection of supplier's rights to separate or segregate receivables out of buyer's insolvency assets and transfer them to the Factor:

Before buyer's insolvency

- Retention of title
- Extended retention of title
- Prolonged retention of title

During insolvency process

- Participation on supplier's pool
- Segregation of claimed goods out of buyer's insolvency assets to Factor or
- Payment of claimed goods' actual value to Factor

Example of Debtor Risk in the Consumer Electronics Sector

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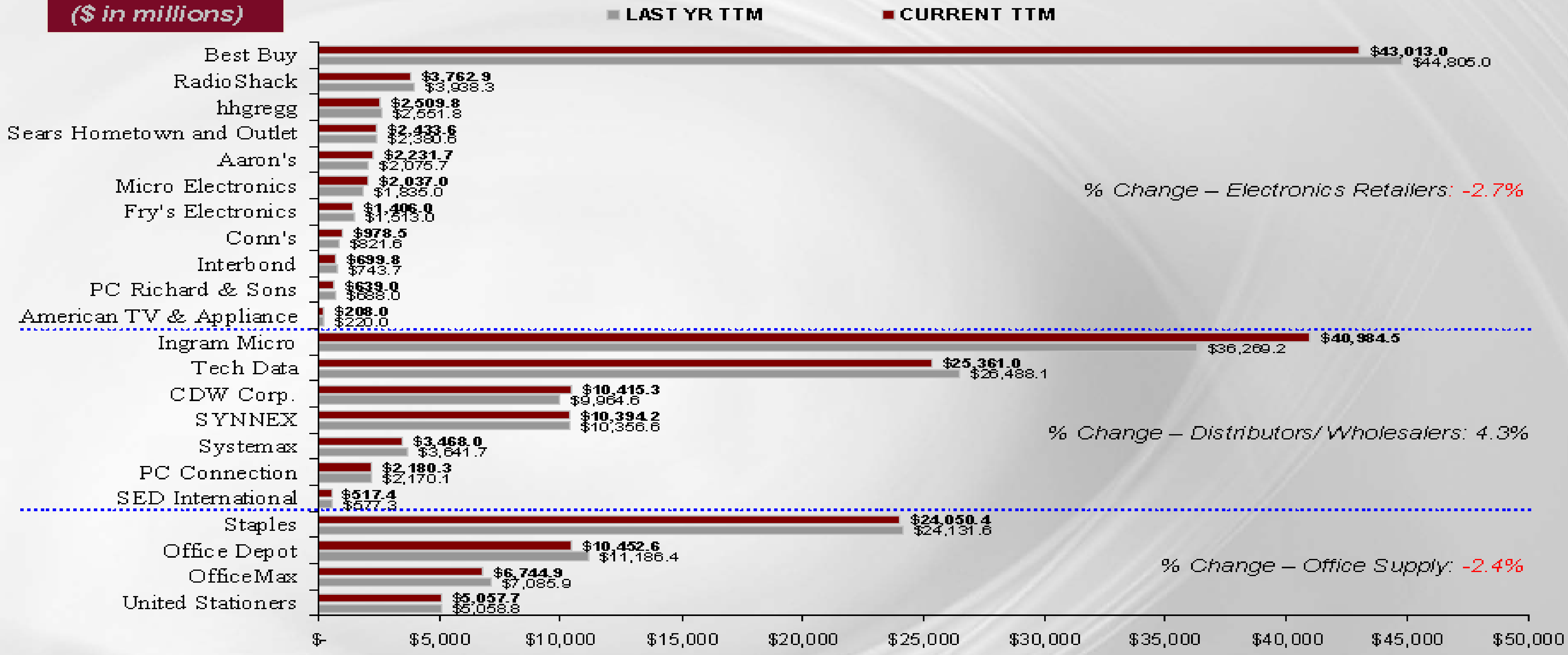
Trailing 12 Months Sales

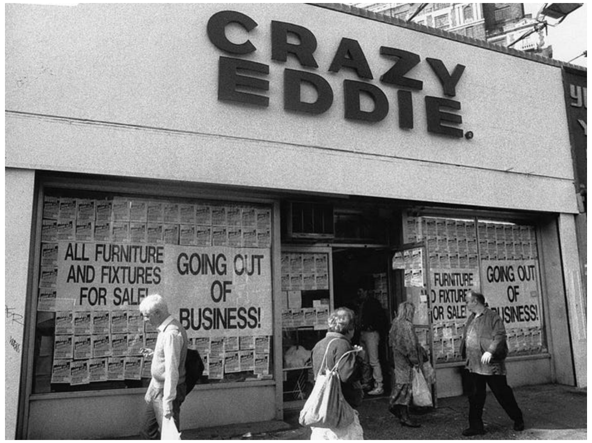
Consumer Electronics & Office Supply

($ in millions)



Highest Year-Over-Year $ Increase:	Ingram Micro	$4,715.2
Largest Year-Over-Year $ Decrease:	Best Buy	($1,792.0)
Highest Year-Over-Year % Increase:	Conn's	19.1%
Largest Year-Over-Year % Decrease:	SED International	-10.4%

Consumer Electronic Industry in Hard Times



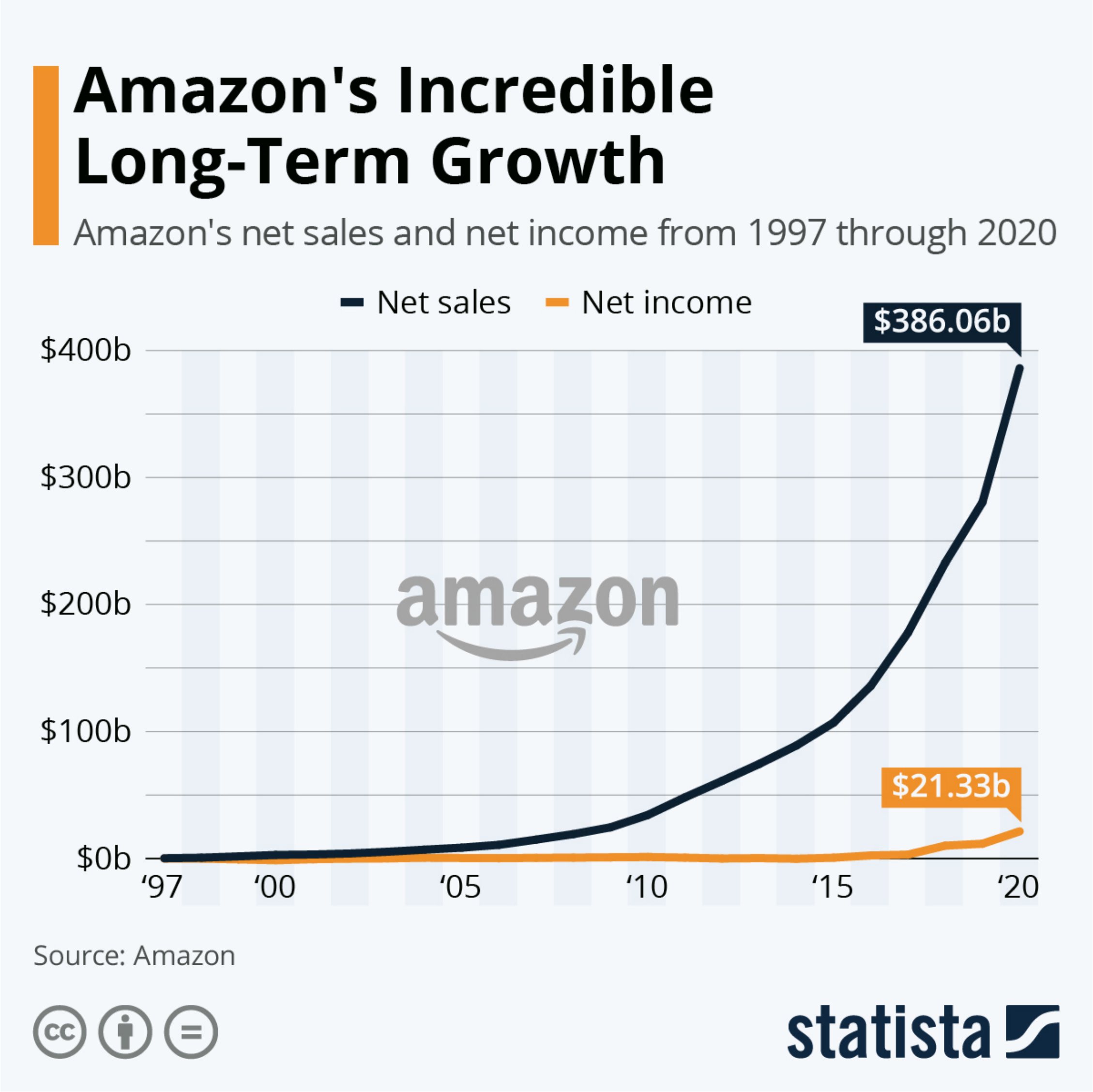
Evolution of E-Commerce

The US online e-commerce retail sector has exploded in growth since the financial crisis.

The number of people making purchases via the Internet will reach 2.14 billion in 2021, according to statistics released by Statista. The same number was 1.66 billion 5 years ago.

China's online shopping market is enormous, and it has become the largest e-commerce market in the world.

The United States is second, with an expected 19 percent share of all online retail sales, followed in third place by the United Kingdom, with 4.8 percent.



Summary Overview of Debtor Management

Monitoring Buyer Risks

- Monitor buyer relationships for one or more sellers & collection of A/R
- Agree on the payment methods with buyer(s)
- Bank payment, cheques*, etc.
- A/R periodic balance reconciliation
- Invoice verification (large amounts)
- Overdue invoices control and dunning actions
- Reminder letters, telephone calls, visits, legal actions

Buyers control dep.

Monitoring Portfolio Risk

Information system reports

- Overdue invoices reports over x days
- Buyers Concentration reports
- Limit excesses
- Credit period extension
- Negative payment behavior
- Non-notification relationships reports (Invoice discounting)
- Exposure per sector
- Reports for dishonored checks and bills of exchange

- Facility for inputting and analyzing financial data
- Integration with operational processes
- Macro data grouping
- Executive level summaries and reports

Information systems

Customer Debtor Credit Control

Macro level

To monitor the debtors and provide reports to the risk committee:

- Perform field audits (also audits by third party should be considered)
- Monitor data bases (i.e. credit agencies)
- Reports in media (market news, internet, social media)
- Regulatory changes affecting client's business
- Macro economic & political changes

Micro level

- to constantly monitor the quality of the A/R
- to detect fraud at early stages
- to react immediately

CRISIS: OPPORTUNITY

The opportunities are ripe for Factoring:

- As economies begin to rebound, the need for liquidity and risk mitigation will increase
- We are already seeing a surge in demand for new business opportunities

However, to avoid potential fraud, we must:

- Focus on sustainable risk profiles
- Stick to our core products
- Secure the risks on behalf of our clients
- Implement strong operational controls
- Invest in sound technology

BACK TO
BASICS

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