

# Challenge #2

## Managing Credit & Cash in a Tight Market

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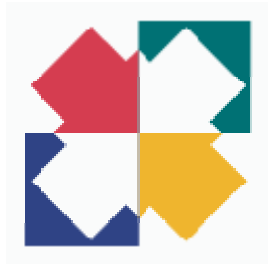
2009 Management Conference  
Incline Village, NV  
June 22

Ross Harris, CFO  
PowerTrack<sup>®</sup>, U.S. Bank

# About the speaker...

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Ross Harris, CFO  
PowerTrack<sup>®</sup>, U.S. Bank



*PowerTrack.*





Ross Harris, CFO  
PowerTrack<sup>®</sup>, U.S. Bank

# NOT A BUMBLE!

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This



Not this



# U.S. Bank Overview

- **6<sup>th</sup> Largest financial holding co. in the United States**
  - Strongest efficiency ratio in banking
  - Minimal sub-prime exposure
  - USD \$266 Billion in total assets and 55,000 employees
- **Leader in Business Payment Services**
  - Payables, Receivables, Freight, Utilities, Global Trade, Telecom, ACH, Check, Merchant, Commercial Card, Fuel Card, ATM, etc.
  - 5000+ Banking companies resell U.S. Bank payment systems
  - 250+ of Fortune 500 companies use U.S. Bank payment systems
  - PowerTrack is the automated payment network & fastest growing component

# Total Assets and Market Value

## Assets

U.S. Rank	Company	\$Billions
1	J.P. Morgan	\$2,175
2	Citigroup	1,945
3	Bank of America	1,818
4	WFC*/Wachovia	1,387
5	PNC/NCC*	291
<b>6</b>	<b>U.S. Bancorp</b>	<b>266</b>
7	SunTrust	189
8	BB&T	152
9	Regions	146
10	Fifth Third	120

## Market Value

U.S. Rank	Company	\$Billions
1	J.P. Morgan	\$93
2	Wells Fargo	68
3	Bank of America	41
<b>4</b>	<b>U.S. Bancorp</b>	<b>24</b>
5	Citigroup	19
6	BB&T	11
7	PNC	11
8	SunTrust	5
9	M&T	4
10	KeyCorp	4

Source: company reports & FactSet  
 Assets as of December 31, 2008  
 Market Value as of January 27, 2009  
 \*Proforma 3Q08



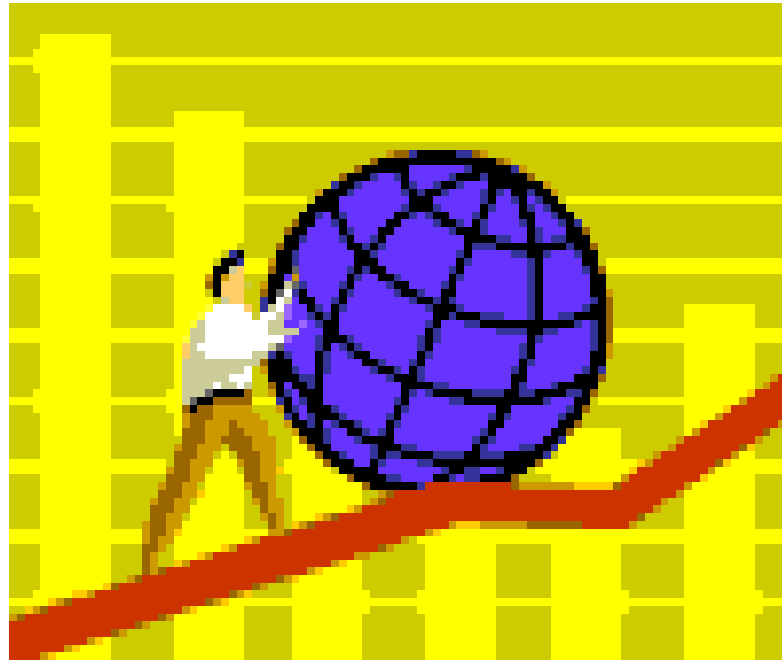
# Agenda

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- Current Economic Challenges
- Bank's view of a company's financials when considering credit
- Fiscal "Health" Metrics:
  - The Cash Conversion Cycle
- Operational & Financial Tools to maximize cash flow

# Current Economic Challenges

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# Economic Conditions

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- Global Banking Crisis
  - Subprime Mortgages
  - Devaluation of Loan Assets
  - Intra-Bank Lending
  - Credit Insurance
- Recent GDP growth now declining with dollar strengthening
- Weaker demand particularly in retail, manufacturing and automotive verticals
- Tight credit markets: restricted access, higher interest rates
- Started with bank-to-bank lending breaking down for the CREDIT FREEZE!



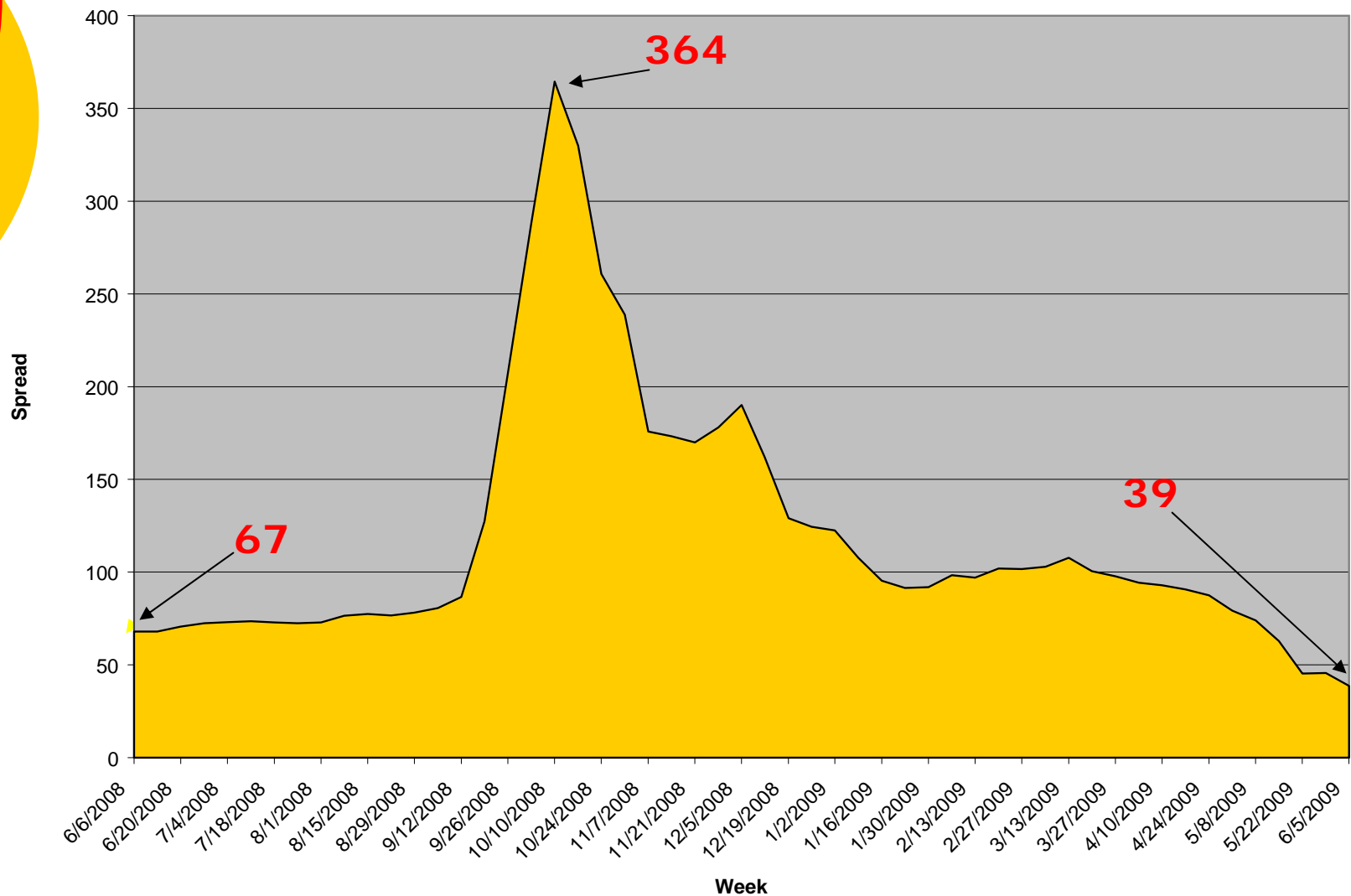
# Current Financial Market Conditions

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## ○ LIBOR-OIS Spread

- Spread between 3-month LIBOR rates and the overnight swap rate.
- It is a measure of bank-to-bank liquidity.
- Per Alan Greenspan, “Normal” is considered 25 or less.

# LIBOR-OIS Spread June 2008 - Present





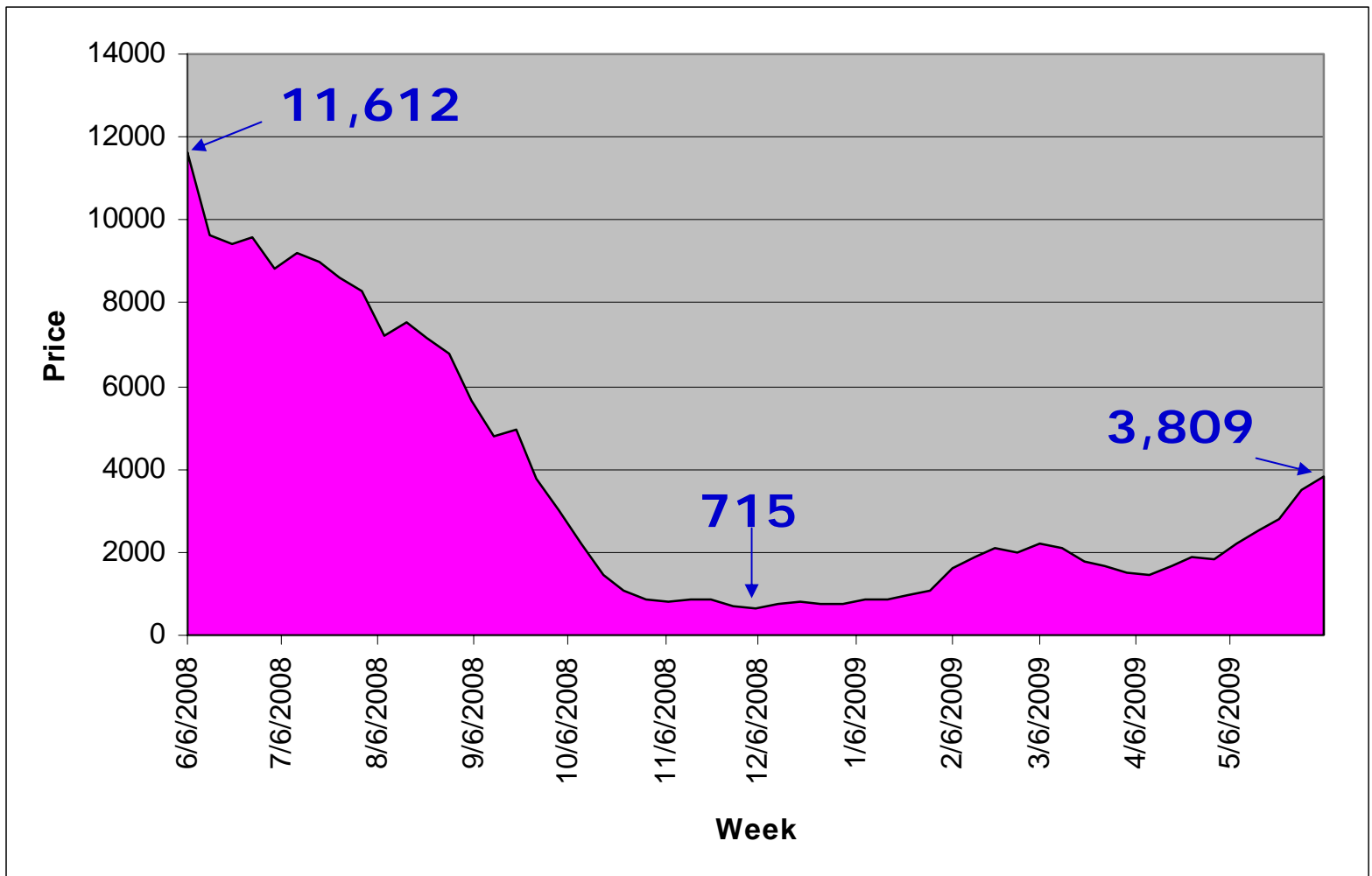
# Current Financial Market Conditions

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## ○ Baltic Dry Index

- An index in USD of the cost to ship, in 100,000 ton units, raw materials by means of cargo ship. Raw materials can include: iron ore, copper, rice, and other commodities.
- Top of the supply chain
- Purely a demand function since ships take 2 years to build.

# Baltic Dry Index June 2008 - Present





# Current Real Economic Conditions

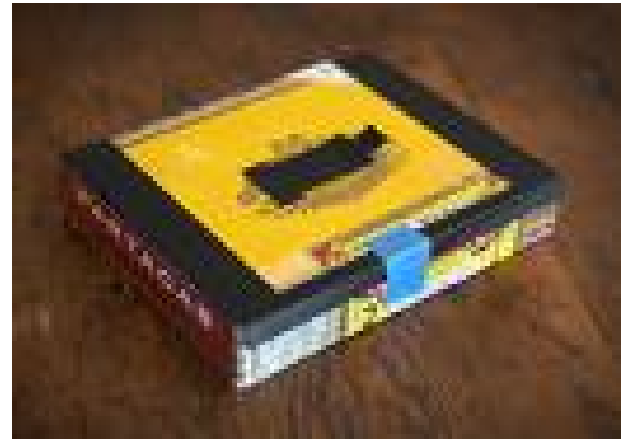
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- Wholesale Inventories
  - Draw down of 1.4% in May follows a draw down of 1.3% in April
  - 1.3 months of inventory on-hand
  - Based upon CURRENT sales volume
- Retail Inventories
  - Draw down of 1.1% in May follows a draw down of 1.0% in April
  - 1.4 months of inventory on hand
  - Based on CURRENT sales volume
- The Rubber Band!!!!!!

# Today's Economy

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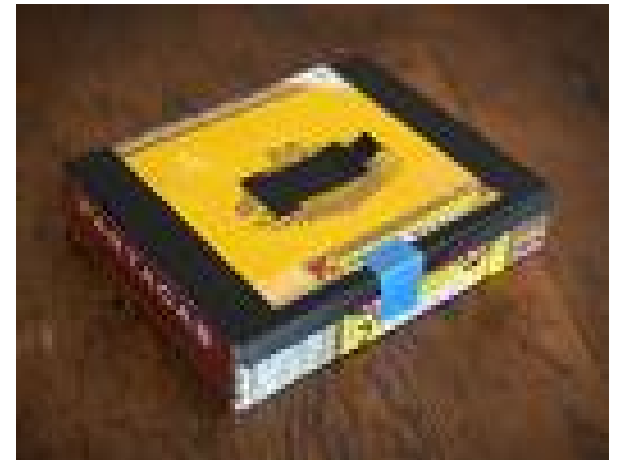
CASH  
IS  
KING



# What's up with the Cigar box?

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- On average, 75% of companies are profitable on the date that they file bankruptcy.
- They file bankruptcy because their "cigar box" is empty.
- THEY HAVE NO CASH



# A Bank's View

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# How Credit Decisions Are Made

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- Credit decisions are:
  - Qualitative and quantitative
  - Affected by how you are managing the bank relationship
  - Based on trends over time
  - Benchmarked by industry
  - Cash flow is king...



# Cash Flow Proxy - EBITDAR

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## ***EBITDAR***

- Earnings Before Interest, Taxes, Depreciation, Amortization, and Rents
- Rents include all operating leases
- A measure of Cash Flow
- Cash Flow from Operations can be manipulated
- Trends!!!

# What Could Impact Your Working Capital Line?

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## **Fixed Charge Ratio:**

- A measure of the sufficiency of a company's operating cash flow to cover fixed cash outflows which cannot be avoided.

# What Could Impact Your Working Capital Line?

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## **Fixed Charge Ratio:**

EBITDAR - Cash Taxes - Cash Dividends - Maint. CapEx

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Rental Expense + Cash Interest + Debt Principal Due

Healthy = 1.15+

Questionable = 1.00-1.15

Awful = Anything Under 1.00

# What Could Impact Your Working Capital Line?

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## *Cash Flow Leverage:*

Interest Bearing Debt

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EBITDAR

Healthy = 0.00-2.00

Questionable = 2.00-3.50

Awful = Anything Over 3.50



# Qualitative Aspects of Credit

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## **Other Qualitative aspects of credit:**

- Trends
- External Debt Ratings
- Internal Information on Default Risk
- The industry of the borrower
- Duration in business and in the industry
- Trends, Trends, Trends!

# Key Metrics

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# The Cash Conversion Cycle

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A metric that expresses the **length of time**, in days, that it takes for a company to convert **resource inputs** into **cash inflows**. The cash conversion cycle attempts to measure the amount of time each net input dollar is tied up in the production and sales process before it is converted into cash through sales to customers.

*- Investopedia.com*

# The Cash Conversion Cycle

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Is also known as...

- Cash to Cash cycle (C2C)
- Asset Conversion Cycle
- Net Operating Cycle
- Working Capital Cycle
- Cash Cycle





# The Cash Conversion Cycle

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Oh, yeah, don't ya know, it's a formula...

$$CCC = DIO + DSO - DPO$$

Where:

DIO represents days inventory  
outstanding

DSO represents days sales outstanding

DPO represents days payable outstanding

# The Cash Conversion Cycle

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Days Inventory Outstanding (DIO)

$$\text{DIO} = \frac{\text{Average Inventory}}{\text{Cost of Goods Sold}} \times 365$$



# The Cash Conversion Cycle

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Days Sales Outstanding

$$\text{DSO} = \frac{\text{Avg Accounts Receivable}}{\text{Sales}} \times 365$$



# The Cash Conversion Cycle

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Days Payables Outstanding

$$\text{DPO} = \frac{\text{Avg Accounts Payable}}{\text{Cost of Goods Sold}} \times 365$$



# The Cash Conversion Cycle

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Oh, yeah, don't ya know, it's a formula...

$$CCC = DIO + DSO - DPO$$

Where:

DIO represents days inventory  
outstanding

DSO represents days sales outstanding

DPO represents days payable outstanding



# How Do You Shorten CCC?

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- Get longer terms with suppliers
- Invoice faster
- Invoice more accurately
- Invoice more completely
- Shorten terms with customers / Get Paid Faster

# Operational & Financial Tools

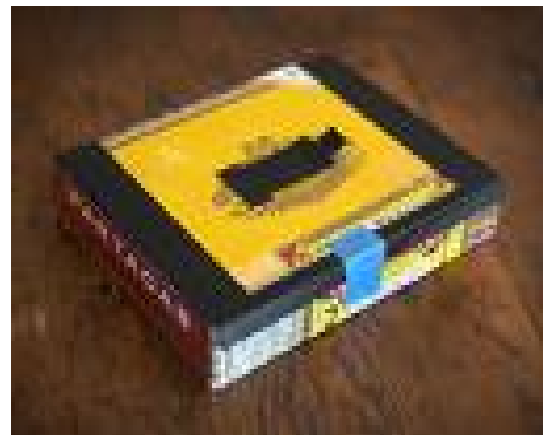
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# Remember the Empty Cigar Box?

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- 75% of companies are profitable on the date that they file bankruptcy
- Improve cash flow:
  - Automation of AR and AP for faster payment
  - Improve Accuracy of AR and AP
  - Finance your AR or AP and keep more cash in





# Automated Payment Network

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Integration of all services required to achieve economies of scale leveraged by buyers and sellers.

Automation	Network	Services
<ul style="list-style-type: none"><li>✓ Processing</li><li>✓ Audits</li><li>✓ Approval</li><li>✓ Payment</li><li>✓ Allocation</li><li>✓ System Interfaces</li></ul>	<ul style="list-style-type: none"><li>✓ Global payments</li><li>✓ Trading Partner connections</li><li>✓ Banks &amp; Settlement Network connections</li><li>✓ Economies of scale</li></ul>	<ul style="list-style-type: none"><li>✓ Seller Automation &amp; Integration</li><li>✓ Document Handling</li><li>✓ Document Audit</li><li>✓ Data Exchange</li><li>✓ Compliance checks</li></ul>

# A Metaphor: Dog Pack Attacks Gator In Florida

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- At times nature can be cruel, but there is a certain justice manifested within that cruelty..
- The alligator, one of the oldest and ultimate "apex predator", can still fall victim to a "multi prong" strategy, made possible due to the "survival of the pack mentality" bred into canines.
- In the photograph on the next slide, the Alpha dog has a muzzle hold on the gator preventing it from breathing, while another dog has a hold on the tail to keep it from thrashing. The third dog attacks the soft underbelly of the gator.
- **Not for the squeamish!**



Don't solve just one of the challenges!

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# Our First Puppy

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**AUTOMATION**



# Our First Puppy-AUTOMATION

## What Should I Seek?

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- Electronic submission of invoices
- Real-time visibility to status
- Electronic means to resolve exceptions
- Integration to existing systems
- Electronic payment with accurate and complete remittance detail
- Efficient means to correct root cause of errors



## Where Should You Spend Your Time?

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**The Gartner Group  
estimated that a 5%  
reduction in operating  
costs has the same impact  
as a  
30% increase in sales.**

# Our Second Puppy

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**ACCURACY**



# Our Second Puppy-ACCURACY

## Impact of Efficient Process

- Eliminate expense

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  - Automation of invoice processing – eliminate paper invoices
  - Reduction in number invoices
  - Reduced and/or better utilization of FTEs
  - Decreased dispute handling costs & collections
- Accurately account for spend
  - More timely expense posting & better visibility
- Financial control and regulatory compliance
- Improve working capital
  - Increased ability to manage cash flow
  - Improve working capital metrics
- Accurate supply chain intelligence
  - Stop disputing what occurred, focus strategically / relationship
  - Growth opportunities



# Payment Process Benchmarks

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- Paper Invoices : 79%
- Paper checks: 66%
- Electronic invoices: 21%
- Electronic payment: 34%
- Secondary bills: 10-15%
- Audit Exceptions: 8-9%
- Bad cost center/ incorrect accounting code: 5-10%
- Late Fees: 5%
- Inaccurate accruals: 5-10%
- Duplicate payments: 1-3%
- Accrual at time of payment: 64%

# Our Third Puppy

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**FINANCING**



# Our Third Puppy-FINANCING

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## ○ **Traditional Receivables Financing**

- Only a portion of the A/R is financed
- ON balance sheet, source of capital increasing leverage ratios
- For service companies, it usually one of the only assets to use as collateral. Once pledged, there is little else
- Does not adjust readily to recovery of business activity



# Our Third Puppy-FINANCING

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## ○ **Factoring**

- Reserves prevent the full amount of cash from being received
- Customers are left with the perception of financial instability
- Recourse prevents any risk shifting on slow payers.
- Volume deficiency dramatically increases cost of capital.
- Ancillary fees such as buyer late fees, EFT fees, etc. drive the effective cost way beyond the discount fee..

# True Cost of Freight Factoring

2.0% Discount Fee	2.00%
+ 15-20% reserve	+ 0.50%
+ Delayed Funding	+ 0.50%
+ Delayed Reserve Release	+ 0.25%
+ Buyer Late Fees	+ 0.50%
+ EFT/Delivery Fees	+ 0.25%
+ Volume Deficiency Fees	+ 0.25%
+ Personal Guarantees	Priceless
Total	<b>4% or More!</b>

Not to mention the late fees and Full Recourse if the Buyer does not pay!

# Our Third Puppy-FINANCING

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- **Trade Finance with an Automated Payment Network**
  - Full value of invoice received within 48 hours.
  - Discount Fees substantially lower than factoring with additional savings from automation and accuracy.
  - OFF balance sheet source of financing.
  - Your buyer's credit is used for relationship not yours
  - Adjusts to increases in business conditions by providing financing on all invoices regardless of volume/size. There is no "credit limit" on the seller.

**CASH FLOW IS**  
  
**KING**

COMPLIMENTS OF LEASING NEWS, INC.



# Name the Dogs

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- Automation
  - Automation of the Financial Supply Chain with an Automated Payment Network (APN) saves administrative costs and promotes...
- Accuracy
  - Automated Payment Network captures all billing opportunities
- Financing
  - An APN with a financing component...cheaper than factoring and off balance sheet flexibility not offered by traditional financing!



**Questions?**

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