

Working Without a (Working Capital) Net:

Cash Flow Constraints in the Energy Industry

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A special report by: THE RECEIVABLES EXCHANGE Working Capital Research Group

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Securing reliable working capital in sufficient quantities is the number one business challenge today for companies with revenues of \$2–200 million, edging out fears of escalating costs and maintaining margins, according to a landmark study conducted by The Receivables Exchange Working Capital Research Group. The Receivables Exchange studied 670 companies across 15 industries to understand their top business challenges and how working capital and cash flow issues are being viewed by decision-makers.

The study found an overwhelming majority of respondents feel they are performing a “high-wire act” when it comes to working capital management.

Viewed from a macro level, working capital constriction for this group of companies is a significant problem for the economy as a whole. Businesses of \$2–200 million in revenue account for roughly two-thirds of private sector workers and 45% of business revenues in the U.S., yet less than 5% of capital markets activity is devoted to funding them, leaving a substantial financing gap.¹ And that gap has only increased during the global financial crisis, which has further restricted access to capital – unsustainably for some businesses.

The Energy industry faces specific challenges when it comes to working capital, not the least of which is its heightened vulnerability to disruptive events. To provide insight into the key working capital challenges facing Energy companies, The Receivables Exchange Working Capital Research Group extracted industry-specific intelligence from the study data to aid Energy company leaders and financial decision-makers.

Nearly 70% of respondents wish they had a more significant “cash cushion” to fall back on in times of need.

A “Perpetual Challenge”

According to the study, working capital is the number one business challenge for companies in this revenue range, edging out escalating costs and margin maintenance for the top spot. And it’s not a new problem. Forty percent of companies in this revenue range state that procuring working capital has been a “perpetual challenge” over time.

Energy companies tend to concur with the overall importance of working capital, but put equal weight on cost control (Fig. 1). A report by the Deloitte Center for Energy Solutions explains that the financial crisis sent shockwaves up and down the Energy supply chain: “Upstream companies that had committed themselves to higher cost projects found themselves saddled with

What Is The Receivables Exchange?

The Receivables Exchange is a competitive online marketplace where small and midsize businesses sell their outstanding invoices for cash to institutional investors, like banks and hedge funds. Businesses that sell their invoices typically get 98-99 cents on the dollar, and get paid immediately instead of having to wait until their customer sends payment.

Companies that want to sell their receivables go through a one-time approval and verification process, after which they can get funds electronically deposited in their accounts in as little as 2 business days after issuing an invoice to a customer.

The competitive online auction process is an effective way to diversify funding sources and to drive down the cost of capital. Sellers can use the Exchange as much or as little as they need, without obligation.

Sellers in the Energy industry rave about the results they get from The Receivables Exchange. The owner of a Louisiana-based oil field services company said The Receivables Exchange helped him keep up with a sudden increase in demand for his company’s services. “Without The Receivables Exchange, I would not have been able to capitalize on this influx of new business,” he said.

Minimum qualifications apply, including trailing 12-month annual revenue of at least \$2 million, 2 years of operating history and being registered to do business in the U.S.

www.receivablesXchange.com/seller
or call 877-392-4952

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¹ Morgan Stanley BtoB Finance Report for Small and Medium Business, March 2010 via U.S. Census Bureau 2002 County Business Patterns and 2002 Economic Census

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Fig 1: Top Business Challenges for Energy

Escalating costs	60%
Working capital	59%
Margin maintenance	48%
Ability to forecast results	43%
Maintaining morale/productivity	40%*
Liquidity	26%
Managing growth	23%

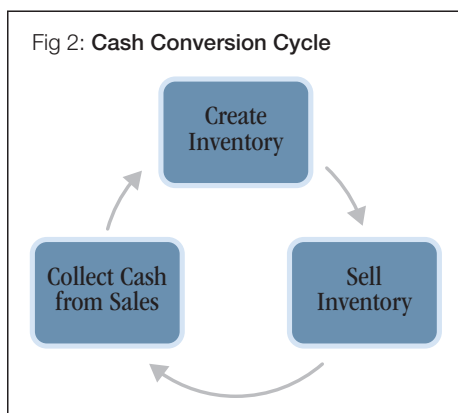
* Energy industry rated highest on this challenge

Source: The Receivables Exchange Working Capital Research Group, 2010

economic situation seems to be having on morale and productivity in Energy companies. Energy companies ranked “maintaining morale/productivity during the economic downturn” as a bigger challenge than any of the 15 industries surveyed. This may be driven by the same supplier power imbalance that drives the high incidence of extended payment terms, or another issue unique to Energy companies.

The Value of a Cash Cushion

Fig 2: Cash Conversion Cycle



policy against future events. In fact, half of all Energy companies surveyed – more than any other industry – said that if their company experiences some type of disruptive event, working capital will be a problem. Fifty-one percent cited disruptive events as a major trigger for seeking additional working capital. Because many of the Energy companies surveyed have a high rate of customers extending terms and are (on average) much smaller than their customers, they may be particularly vulnerable to disruption.

unsustainable production costs. As approvals for new projects ground to a halt, downstream companies also began experiencing the ill-effects of the global financial crisis.”²

Exacerbating these issues is a trend toward large companies demanding extended payment terms from their suppliers, and Energy is one of the industries most impacted by this trend. In fact, Energy companies were the second most likely of any of the 15 industries examined to have a high incidence of customers extending payment terms. Extending payment terms has a direct negative impact on a company’s cash conversion cycle and dramatically increases the need for additional working capital.

One striking feature of the study was the high impact the

“Energy companies were the second most likely of any of the 15 industries examined to have a high incidence of customers extending payment terms.”

According to that same Deloitte report, “The global financial crisis is now taking a toll on [Energy] companies of all sizes. Predictably, tighter credit markets are impelling smaller operators to defer expansion and capital projects, limit development and even sell off assets.”

Indeed, restricted access to capital can stand in the way of growth or force an adjustment to day-to-day operations. Perhaps that is why a full 69% of the companies surveyed ranked having a strategic “cash cushion” as very important to their business. Top uses for that cash cushion included coping with disruptive events, being in a position to take advantage of business opportunities, dealing with seasonality and slow-paying customers or customers extending terms.

For Energy businesses, that cash cushion is critically important as an insurance

“A sudden shift in the marketplace due to unforeseen events can be a boon to businesses,” said Bill Siegel, SVP and head of the Liquidity Desk at The Receivables Exchange, “but only if they have the working capital on hand to take advantage.”

² Deloitte Center for Energy Solutions, Oil & Gas Reality Check FY09/10: <http://goepartners.com/library/Dynamics-WhitePaper-Step2-OilGas-Reality-Check.pdf>

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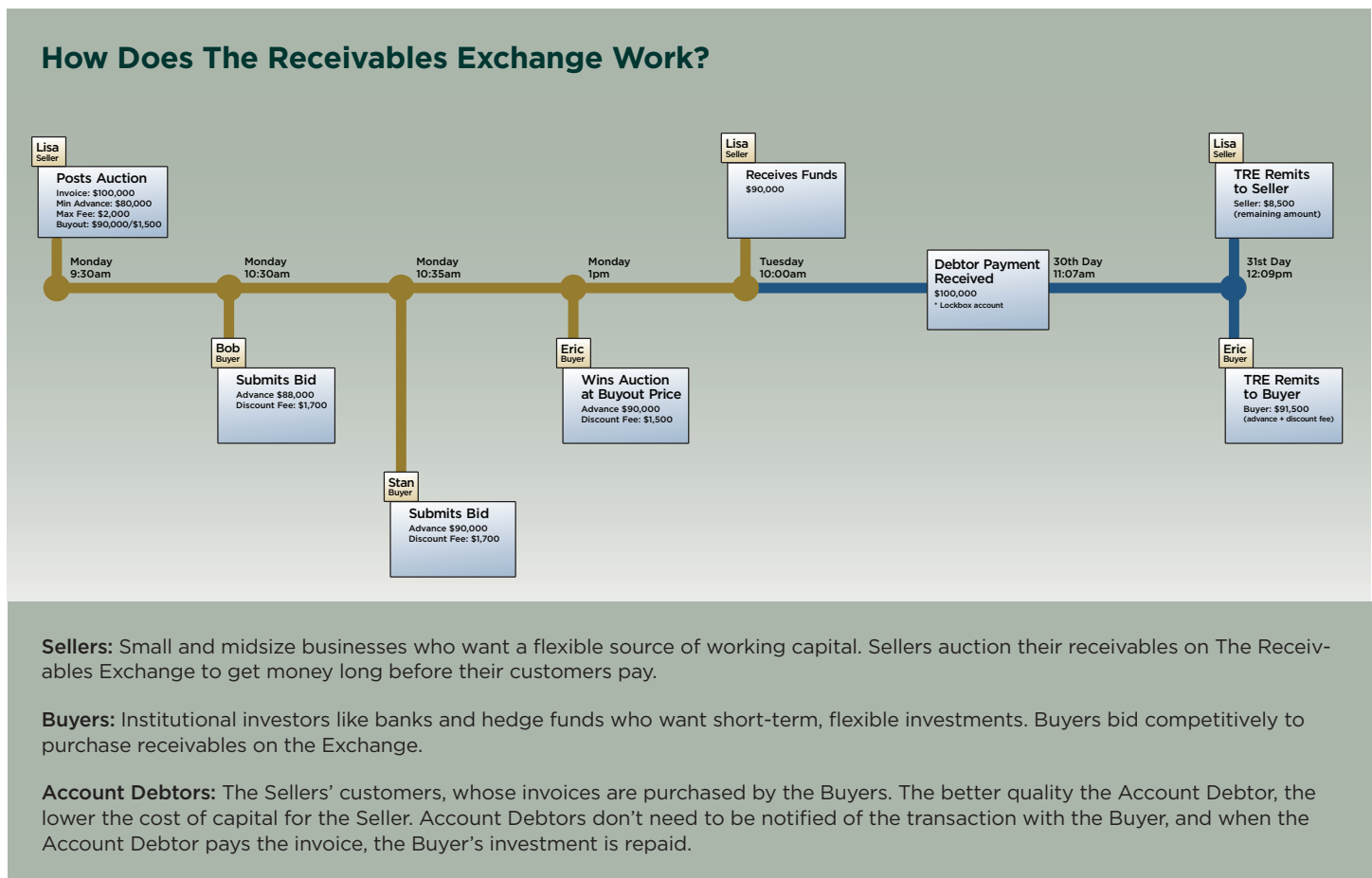
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Of course, disruption is not necessarily negative, provided a company is prepared. “A sudden shift in the marketplace due to unforeseen events can be a boon to businesses,” said Bill Siegel, SVP and head of the Liquidity Desk at The Receivables Exchange, “but only if they have the working capital on hand to take advantage.” New technology, regulatory changes and even competitors’ business issues can create opportunity. But companies must have resources on hand to seize that opportunity. This is easier said than done.

Working Capital is a Distraction

All of these working capital pressures add up to a major distraction for a large proportion of companies in this revenue range. One in four respondents said working capital challenges create excessive anxiety at their companies and 68% indicate they do not feel a sense of control when it comes to their company’s finances. Only 1 in 4 are happy with their company’s current strategic cash reserves. Even making payroll is a frequent concern for 15% of companies.

However, Energy fared somewhat better in these measures. While working capital creates anxiety at similar levels compared to other industries, there was more of a sense of control over financing options versus the other industries studied, which may stem from having proportionally higher levels of physical assets and thus broader access to traditional financing options.

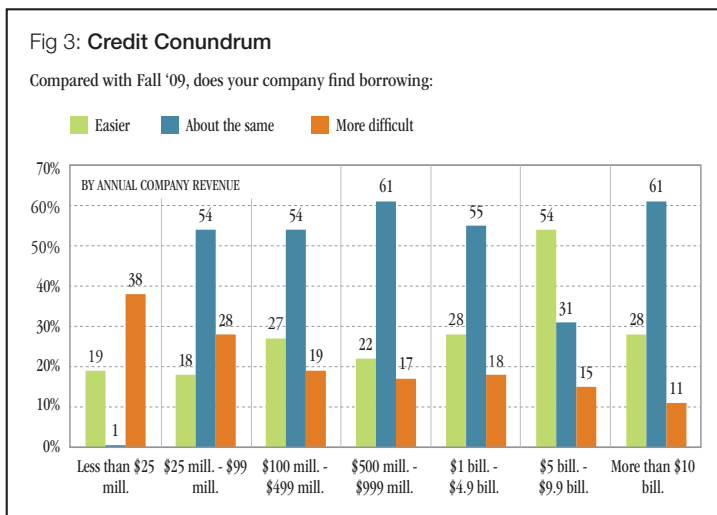


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Considering the level of angst over working capital issues, it is not surprising that 57% of respondents consider cash flow a key driver of their business success and 35% of respondents spend “a lot of time” researching and educating themselves about how to best manage working capital issues. What may come as a surprise is that 40% of respondents state they do not proactively manage cash flow “in good times” and that 26% “only deal with cash flow issues when they become a problem.” Energy companies were particularly troubled in this area: 25% of Energy company leaders say they do not have time to manage working capital issues in the best possible way.

“Twenty-five percent of Energy company leaders say they do not have time to manage working capital issues in the best possible way.”



Source: CFO Magazine, July/August 2010

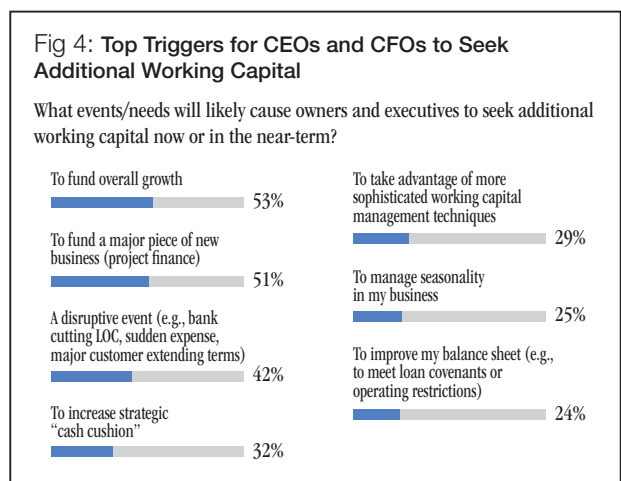
Seeking Financial Alternatives

This hand-wringing and efforts at self-education may be warranted. Until recently, most companies comfortably relied on traditional financing sources such as bank lines, asset-based lending or factoring to source working capital. But small and midsize companies are losing confidence in traditional financing as access to capital has become more restricted (Fig. 3). In fact, 1 in 3 companies studied believes small and midsize companies are increasingly blocked out of traditional financing sources that are now open only to very large companies. One in three also state that they themselves have been forced by the current economic situation to consider alternative forms of financing they had not previously considered. Energy was in line with these averages, turning to alternative forms of financing at surprisingly high rates considering its relatively

high asset base and historically strong relationship with traditional financing.

When asked specifically what events would be most likely to trigger their company to seek new financing, project finance (i.e., funding a major piece of new business) and disruptive events (examples cited included bank cutting line of credit, sudden expense and major customer extending terms) were at the top of the list (Fig. 4). However, funding overall growth was cited by a full 52% of companies, which would seem to indicate a deeper, more systemic issue with working capital access for companies in the \$2–200 million revenue range. This is in line with a recent survey by the Pepperdine Private Capital Markets Project, in which 71% of private companies said they believed they could grow their revenues, if only they had access to additional growth capital.³

The trend towards alternative financing may be driven by more than just availability of traditional financing. Diversification of funding sources has traditionally not been a major issue for companies in this size range, and yet about 40% of respondents indicate they are now concerned about “putting all their eggs in one basket” with a



Source: The Receivables Exchange Working Capital Research Group, 2010

³ Pepperdine Capital Markets Project, July 2010: <http://bschool.pepperdine.edu/newsroom/index.php/2010/07/private-business-owners-have-solid-growth-strategy/>

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single financing source, and a similar percentage stated that diversification of funding sources was of strategic importance to their companies.

However, despite tightened credit and the newfound desire for diversification, banks are still very much part of the picture. In fact, 70% of the companies surveyed had access to a bank line

“Banks are a key source of working capital for a large number of companies, but tightening in credit markets has led many companies to augment their lines with complimentary sources of liquidity.”

of credit. This number was highest in industries like Transportation and Logistics (81%), Manufacturing (78%) and Energy (76%) and lowest in Health Care and Education (both 61%). Banks were reported as fast, efficient and reputable sources of

working capital, and industries that had a high affinity for lines of credit cited strong ongoing personal relationships with their banks.

But even though 70% of companies surveyed had lines of credit, less than half of those companies indicated that their bank lines of credit were sufficient to cover their working capital needs, and 1 in 3 stated that they needed a financing option in addition to their line of credit. As Siegel puts it, “Banks are a key source of working capital for a large number of companies, but

Fig 5: What Energy Companies are Looking for in New Forms of Financing

Flexibility of terms	49%
Low cost	46%
Reputation	43%
Speed	32%
Ease of use/simplicity	31%
Simplicity	21%

Source: The Receivables Exchange Working Capital Research Group, 2010

tightening in credit markets has led many companies to augment their lines with complimentary sources of liquidity.” *Oil & Gas Financial Journal* agrees, citing low commodity prices that have taken a toll on certain exploration and production companies’ credit ratings, increasing their cost of capital and driving them to seek alternatives.⁴

Indeed, 38% of Energy companies studied were willing to try forms of financing they’d never used before. Alternatives include:

- Widespread use of credit card float (e.g., for T&E or other business expenses)
- Directly incenting earlier payment using techniques like invoice discounting
- Taking advantage of Supply Chain Finance opportunities offered by large customers
- Sale or auction of receivables to a third party

How Has The Receivables Exchange Helped Energy Companies?

The key to success in the Energy industry is adapting to change. The Receivables Exchange offers a flexible, affordable and fast way for Energy businesses to secure financing almost instantly, and on their terms. It is a financial solution perfectly suited to the varied working capital challenges Energy companies face.

One Louisiana-based oil field services company turned to The Receivables Exchange after the Deepwater Horizon accident greatly increased demand for its services. Without the speed and flexibility it found on The Receivables Exchange, the company would not have been able to handle this unexpected surge in orders. “The Receivables Exchange allowed us to turn a disruptive event into an opportunity to fuel growth,” the company’s owner said.

Another company, a fuel distributor in Arkansas, uses The Receivables Exchange to manage extended payment terms from its larger customers. By shortening days sales outstanding (DSO) from 70-90 days to as little as 24 hours, the company is able to retain customers, buy more fuel at a discount, and take on more business. The flexibility, speed and affordability of the Exchange helps the company boost cash flow at a time when more of its customers are taking longer to pay.

“When other financing sources weren’t providing the liquidity we needed, we turned to The Receivables Exchange to grow our business,” said the owner of a Texas-based drilling equipment supplier. The company’s line of credit proved too small and restrictive, so it approached the Exchange to finance the purchase of new equipment.

Whatever your company’s working capital challenge, The Receivables Exchange is the flexible, affordable and fast solution for you.

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⁴ Oil & Gas Financial Journal, March 2009: <http://www.ogfj.com/index/article-display/355775/articles/oil-gas-financial-journal/volume-6/issue-3/cover-story/industry-struggles-with-low-prices-lack-of-capital.html>

What They're Saying About **The Receivables Exchange**

"The Smartest Financing Opportunity You've Never Heard of" – *Bizmore*

"Turn unpaid invoices into cash – quickly." – *Crain's New York*

"The Receivables Exchange is an online workaround for slow-paying customers." – *Forbes*

"The Internet...has enabled the creation of a digital receivables auction in which borrowers set their terms and lenders compete to meet them." – *Crain's Chicago*

"The Receivables Exchange enables small- and medium-size companies to finance accounts receivable at...21st-century velocity." – *Institutional Investor*

"For sellers, The Receivables Exchange offers faster access to working capital, which is often critical for small businesses that have much of their cash tied up in receivables." – *American Banker*

"Suppliers Find Fast Relief in Auctions on The Receivables Exchange." – *Treasury & Risk*

"A winning online business-to-business idea." – *Institutional Investor*

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Each of these alternatives has pros and cons based on the unique business situation of an individual company. When Energy companies were asked what criteria they would use to select an alternate financing solution, flexibility of terms and cost of capital were at the top of the list (Fig. 5).

Looking to the Future

As the Energy industry slowly recovers from the global financial collapse, ensuring sufficient access to capital at a reasonable cost will remain a significant challenge. The prospect for these broader working capital issues resolving themselves is low. In the study, 60% of Energy companies anticipate their working capital needs will actually increase in 2011 versus 2010. As the Energy industry continues to recover from the economic crisis, they will need to manage risk more effectively.

While businesses will continue to feel the impact of the crisis, they will press forward with cautious optimism and a renewed focus on risk mitigation. This means optimizing working capital efficiencies, improving cash conversion and diversifying funding sources. Managing these risks is vital, not only to short-term profitability, but also to overall financial health and long-term sustainability for small and midsize suppliers in the Energy industry. Financing alternatives abound, including many exciting new options, and smart companies have more opportunities than ever to create competitive advantage using an optimal working capital structure. ■

About The Receivables Exchange

The Receivables Exchange is a flexible, fast and affordable solution that helps companies overcome working capital challenges and take control of cash flow. Named the most innovative e-commerce company in the world for 2010 by *The Wall Street Journal*, The Exchange lets businesses sell their B2B receivables online to institutional investors in a real-time auction, and competition among Buyers lowers their cost of capital.

The Receivables Exchange is a tailor-made solution for many of the working capital challenges Energy companies face. With the Exchange, businesses can shorten their days sales outstanding (DSO), helping them cope with extended payment terms from their customers. The Exchange lets businesses leverage the value of their receivables, where 60% of a company's annual working capital usually lies, so companies without many tangible assets can still get financing. The speed and flexibility of the Exchange can also help businesses stay nimble when disruptions occur. They can access capital in a matter of days, not weeks or months, and can use the Exchange when they want, selling as many or as few receivables as they choose.

Make an appointment today for a free cash flow consultation with an Exchange Associate and find out how The Receivables Exchange can help your business.

Learn more at www.receivablesXchange.com/seller or call 877-392-4952.