

CASH FLOW CONTROL: A NEW LIQUIDITY SOLUTION

Growth-minded small and midsize businesses are embracing an innovative financial solution that lets them increase liquidity and manage cash flow by monetizing receivables

INTRODUCTION

Maintaining the reliable cash flow needed to invest in growth while keeping up with day-to-day financial obligations is a perennial problem for small and midsize businesses (SMBs), even in a strong economy. More than half of small business owners surveyed by Rasmussen Reports for Discover Small Business Watch reported having temporary cash flow problems in June 2010, for example.¹ “Maintaining consistent cash flow is our number one challenge and our top priority after sales,” says Dan Copfer, president of Visual Evidence/E-Discovery LLC, a Cleveland-based technology solutions provider for the legal industry. “We have two people dedicated to working on it every day.”

When it comes to accessing capital, small businesses historically have had limited options—primarily bank lines of credit and commercial factors—and that was before lending all but shut down. During the recent recession, many saw even those sources dry up. One potential source of financing needed for both day-to-day operations and growth is the 60% of current assets² the average small business has tied up in outstanding receivables. What businesses have lacked is an efficient, economical way to access that resource. The Receivables Exchange, the world’s first electronic marketplace for receivables finance, was created specifically to fill that gap, and it is tapping a significant reservoir of pent-up demand for additional diversification among a broad array of institutional investors.

“Maintaining consistent cash flow is our number one challenge and our top priority after sales.”

UNDERSTANDING THE EXCHANGE CONCEPT

Justin Brownhill and Nicolas Perkin, CEO and president, respectively, and co-founders of The Receivables Exchange, started from a simple premise in creating the concept behind the company: The velocity of business—the

¹ “Discover Small Business Watch,” Rasmussen Reports, June 2010.

² Current Assets = Cash + Bank + Debtors + Bills Receivable + Short-Term Investment + Inventory + Prepaid Expenses.

speed at which business is conducted in today’s highly connected world—is much faster than the speed at which most small and midsize companies are able to gain access to capital. “Traditional business finance mechanisms are cash flow-focused solutions and have minimum cash flow requirements that most SMBs can’t meet,” Perkin says. “We realized that an asset-based solution would make more sense, and the question became which asset would make the most sense.”

The partners began analyzing the typical SMB balance sheet looking for assets that could be easily standardized for trading, and they quickly zeroed in on receivables. They concluded that the most liquid non-cash asset on the SMB balance sheet was receivables outstanding—a highly under-utilized asset, collectively valued at about

\$17 trillion annually in the U.S.³ They found the existing receivables market to be highly fragmented and therefore inefficient. “There was no information share, such as factor-to-factor or bank-to-bank. And for many small businesses, the constraints and cost of capital were more than their business could handle. Furthermore, there was no easy way for SMBs to benefit from responsible use of those solutions over time,” Perkin says. It became immediately clear that a centralized, transparent market for SMB receivables would solve these issues. The assets could be traded using an auction model, with SMBs retaining control over which receivables they offered for sale, when, and at what price. The Receivables Exchange would allow SMBs to monetize their accounts receivable with a high degree of flexibility and control and to reinvest that capital into their day-to-day operations more efficiently.

“The Receivables Exchange provides us with the access to cash we need to pursue larger projects and to generate more sales.”

3 The Federal Reserve Board, Flow of Funds Accounts of the United States , Table L.223 “Trade Credit”, 1Q2009

CASE STUDY

Nabbr, Inc.: Funding Aggressive Growth

INDUSTRY:

Media

CHALLENGE:

In the fast-paced world of online digital media, aggressive growth is not just desirable, it's a requirement. Nabbr, a top 20 provider of video ads on the web, uses its capital and cash flow as competitive weapons to deliver ever-larger shares of the Gen Y audience marketers are eager to reach. But with its largest source of working capital tied up in outstanding invoices, Nabbr's liquidity was constrained. With just three years of operating history under its belt, and facing a difficult credit environment, Nabbr considered factoring as a short-term solution, but rejected it because of its rigidity and the amount of control the company would have to cede.

SOLUTION:

Less than three months after joining The Receivables Exchange in May of 2009, Nabbr significantly improved its cash flow position, allowing it to take a more aggressive approach to growth. By developing a reliable trading history and leveraging the receivables of its higher-credit-quality Fortune 500 customers, Nabbr has been able to lower its cost of capital, improve its working capital position and accelerate cash flow. "The ease and speed with which we were able to obtain capital was impressive," says Matt Minoff, Nabbr's CEO. "The Receivables Exchange provides us with the access to cash we need to pursue larger projects and to generate more sales."

A NEW FINANCIAL SOLUTION FOR SMALL BUSINESSES

Using receivables in commercial finance transactions is not a new idea; they are widely used as a collateral component in business lines of credit, asset-based lending solutions and factoring deals. What's different about the model behind The Receivables Exchange is the way in which the transactions are structured. As Perkin puts it, The Receivables Exchange “synchronizes 21st century business with 21st century access to capital” by putting control in the Seller’s hands—a radical deviation from existing models in several respects:

- No personal guarantee is required of the Seller.
- No all-asset liens are placed, only a lien on the particular receivable being sold.
- The Seller’s customers are not notified; Sellers maintain complete confidentiality.
- Pricing is market-based and incorporates transparency of information (Seller’s financial information and transaction history, information on the Seller’s customer, and payment history, etc.) which over time significantly lowers the cost of funds.
- No minimum requirements are imposed in terms of maintaining a balance of outstanding invoices.
- Access to a vast group of potential Buyers brings down cost of capital and diversifies funding sources across industries.
- The transaction represents a true sale of the receivable. The receivable is not collateral, and the advanced funds are not a loan.
- There are no monthly fees or obligation to sell receivables. The Exchange’s transaction-based model means the Seller pays fees only upon successful completion of a transaction.

Who’s Who on The Receivables Exchange

Account Debtor: The business or organization responsible for paying an invoice. The account debtor is the Seller’s customer, who owes the receivable being auctioned on the Exchange.

Buyers: Accredited institutional investors who engage in competitive bidding to purchase receivables on the Exchange. Buyers are typically commercial banks, hedge funds, asset-based lenders, and factors.

Sellers: Businesses—usually small and midsize companies—that post receivables for sale on the Exchange.

Sellers and Buyers must be approved by the Exchange to trade. Account debtors are not notified that their receivables are for sale.

CASE STUDY

Ramard, Inc.: Reducing the Cost of Capital

INDUSTRY:

Manufacturing

CHALLENGE:

As a fast-growing company marketing nutritional supplements for animals, Ramard relies on cash flow to get its products into distribution. But that cash flow is squeezed on one side by on-demand payment terms from its manufacturers and on the other by the extended payment terms its customers require.

SOLUTION:

As demand for Ramard's products grew, it could no longer rely on self-funding, business credit cards and a line of credit from a local bank to keep pace. Owners David Menard, DVM, and Jeff Ramey rejected factoring as an alternative source of financing because of the control they would have to give up and the level of risk it entailed. Since completing their first auction successfully in December of 2009, the partners have driven down their cost of capital by building a successful transaction history, and gained the flexibility they need to manage cash flow on their own terms. They've reduced their distribution backlog from 21 days to as little as seven days, and are looking at potential growth as high as 25% over the coming year.

HOW IT WORKS FOR SMALL AND MIDSIZE BUSINESS SELLERS

The auction process used by The Receivables Exchange is simple, efficient and transparent, allowing SMBs to access working capital in as little as one day by auctioning their receivables to a global network of institutional Buyers. Sellers must meet minimum eligibility requirements (two years of operational history, registered to do business in the U.S., at least \$2 million in annual revenue), complete an online application and pay a one-time registration fee. The Receivables Exchange performs due diligence on each Seller applicant (lien and bankruptcy searches, verification of submitted fiscal-year-end and year-to-date financials, tax returns, bank statements, etc.). Approved Sellers can log in to their established profile indicating auction posting preferences and set auction terms and bidding parameters (auction length, minimum advance amount, maximum discount fee), making the entire receivables trading experience easy for small and midsize companies.

Sellers can then create account debtor profiles for validation and post one or more receivables for auction. The Seller's privacy is always respected; their customers are not notified about the auction, even when the receivable is sold. Sellers control the terms and timing of each auction by setting minimum advance and maximum fee amounts and the duration of the auction. They can also set a Buyout Price—similar to the “buy it now” price on an eBay auction. Sellers can track the bidding on their receivables in real time, 24/7, and the auction remains open for the

How The Receivables Exchange Works for Buyers

Buyers on The Receivables Exchange are a diverse mix of institutional investors, including hedge funds, commercial banks, asset-based lenders, and family offices, many of whom are looking for additional diversification for their investment portfolios. Buyers undergo a similar application, validation and membership process, can post profiles indicating their preferences and proactively browse and search for auctions of interest to them. They are also notified when an auction matching their investment preferences goes up. Buyers engage in real-time competitive bidding for Sellers' receivables on a 24/7 basis, with submitted bids based on maximum advance, minimum fee and notional amount of face value.

(continued on page 8)

amount of time they have stipulated or until their Buyout Price is met. Once the auction closes, the proceeds are wired into their business account the next business day. Then, once the Seller's receivable is paid by the account debtor, The Receivables Exchange remits the amount due to the Buyer, with any remaining amount remitted back to the Seller. Sellers benefit from the control, flexibility, competitive bidding, speed, and ease of use the auction model provides, and as they build a transaction history over time, their cost of funds tends to decline. On average, Sellers decrease their cost of capital as much as 30% after six months of trading on the Exchange.

How The Receivables Exchange Works for Buyers

The SMB universe represents between 60% and 70% of gross domestic product and the employment base in the U.S. but just 1.5% of the capital markets, making it a significantly under-represented asset class. The auction model gives investors access to this market in a transparent manner never before available. It provides a risk-adjusted return that is attractive to investors and allows pools of capital to increase diversification in a new way.

CASE STUDY

Healthworks, Inc.: Navigating a Crisis, Returning to Growth

INDUSTRY:

Staffing

CHALLENGE:

Founded in 1997, Healthworks, a provider of staffing, education, and consulting services to the cardiovascular healthcare industry, logged more than a decade of steady growth, expanding both its scope of services and its geographic market reach. Then, recession-driven cutbacks in spending by healthcare providers hit the company hard. With payroll averaging 80–85% of its ongoing cash requirements, managing cash flow to meet payroll needs was one of its biggest challenges. Despite being approved for SBA loans five separate times, no bank would write the company a loan. Not only was growth temporarily sidelined, president and CEO Sandra Wolfe-Korejwo worried the company's continued existence might be in jeopardy.

SOLUTION:

Wolfe-Korejwo knew her business model was solid and that demand for her company's services would continue to grow in the long term, but finding a cash flow solution for her biggest operating expense, payroll, was imperative. After attending one of The Receivables Exchange's webinars in June of 2009, Healthworks' management liked the idea of being able to take control of their cash flow and signed up to trade. The auctions were instantly successful. The company initially used the proceeds to help make it through a difficult economic period and now is relying on The Receivables Exchange for the cash flow liquidity and flexibility it needs to transition back into growth mode. As Healthworks has built a history of successful auctions, its cost of funds has dropped from about 2.75 cents per dollar to about 1.5 cents. "When things were at their worst, we could bill on a Monday for our prior week's work, use the auction to collect on those sales by Tuesday, and that was our money to make payroll for the following week," Wolfe-Korejwo recounts. "Now we're back on the upward slope and are cash-positive again."

A FLEXIBLE SOURCE OF CASH FLOW: CAPITAL WHEN AND HOW YOU NEED IT

Mason-Grey Corporation has been focused on growth since Joe Reini launched the venture from the ashes of a predecessor company in 2001. Reini recognized that unmet demand for Mason-Grey's highly specialized engineering services to improve industrial process plant efficiencies would provide a reliable engine for consistent growth. Early on, the company easily funded that growth through internal cash flow, and Reini carefully managed Mason-Grey's growth rate to avoid the need for outside financing. "Achieving consistent growth was never a major issue for us," Reini says. "It was making sure we managed the growth correctly that was a key focus."

Typical of the engineering services field, salaries represent a high proportion of Mason-Grey's total costs. Because salaries are a recurrent cost, Reini had to carefully balance invoice remittance from new growth initiatives with salary obligations in order to avoid overreaching. By late 2008, it became clear that the company had reached a point where Reini needed to explore bank financing if he wanted to be able to fund greater growth. As is commonly the case with service companies lacking much in the way of tangible assets to collateralize a loan, despite the undeniable sales growth the new capital would generate, the bank was only willing to extend a line of credit for a small percentage of the company's outstanding accounts receivable—and at disproportionately restrictive terms.

AUCTIONING RECEIVABLES PROVIDES SOLUTION FOR CONTINUED GROWTH

Reini discovered The Receivables Exchange in the spring of 2009. Intrigued by the notion of being able to post his outstanding invoices—singly or in multiples—for auction on his own terms, and using the influx of capital to act on growth opportunities he would otherwise have to pass up, he decided to give it a try. When the receivables in his first auction sold on his terms, and the funds were wired into the company's bank account within 24 hours,

Reini was hooked. After just a few auctions, Mason-Grey was able to build a consistent transaction history on the Exchange, improving its appeal to Buyers and reducing its cost of capital, a trend that continues.

“Now we can accelerate our growth when we want, on our terms,” Reini says, citing the flexibility Mason-Grey enjoys as a result of the increased liquidity and access to affordable short-term working capital the Exchange provides. “If I want to add staff, I can add them, make them billable, and immediately turn those new hires into cash. We have some very significant growth opportunities ahead of us, and without The Receivables Exchange, we would not be able to capitalize on them.”

“Now we can accelerate our growth when we want, on our terms.”

AUCTIONS CAN BLUNT LONG PAYABLES CYCLES

For Visual Evidence/E-Discovery, the issue is the length of time it can take to collect on accounts receivable from slow-paying customers. “Our industry is unique,” Copfer explains. “We work for attorneys in order to stay protected under the attorney-client privilege rule, and we bill by the month. But law firms often have a limit on what they can pay a vendor each month, and bills sometimes have to be sent to a client or an insurance company, so they may go through several layers of approval. It can take 60 to 90 days or longer to get paid in some cases.”

“I pick and choose my invoices and don’t have to tie up all my receivables,” he says. “We set the auction rates ourselves, our auctions average two to three days, and the money is wired directly into our account.”

The recession exacerbated the slow-pay problem, and at the same time bank credit virtually disappeared in Cleveland, Copfer says. He spoke with several factoring agents, but they wanted him to tie all the company’s receivables to the credit lines they offered, and he did not want to do that. An Internet search took him to The Receivables Exchange website, and he found it offered just the solution he needed to get through a tough financial stretch

and keep his business thriving. “I pick and choose my invoices and don’t have to tie up all my receivables,” he says. “We set the auction rates ourselves, our auctions average two to three days, and the money is wired directly into our account.”

REIGNITING GROWTH WITH FLEXIBLE, AFFORDABLE ACCESS TO CAPITAL

Copfer had been using auctions to generate cash for payroll and taxes as needed during the recession, but now he’s using the flexibility and almost instant access to funding The Receivables Exchange provides to reignite growth at his company. Sales were up about 70% through the first half of 2010, with a number of new large projects pending.

“One deal we are working on would represent the single largest client in our history. The effort requires us to add staff and resources upfront, and the only reason we are able to pursue this growth opportunity is because of the liquidity and affordable access to working capital the Exchange provides us,” he says. “The Receivables Exchange makes it easy for small businesses like us to get access to funds. I’ve been recommending it to other small businesses here in Cleveland.”

THE RECEIVABLES EXCHANGE - BY THE NUMBERS ⁴

AUCTION STATS
Average auction size: > \$50,000
Average # of invoices per auction: 6
Discount fee: 0.5%–4%
Shortest auction: 4 seconds
Average auction duration: < 1 day
Completion rate: > 99%

⁴ As of June 2010

SELLER FACTS

Number of Sellers: >1100

Percent repeat Sellers: >74%

Average revenue: >\$15 million

Accounts receivable inventory: >\$15 billion

Buyer liquidity: >\$30 billion

Industries: 45

States: 49

CREDIT SUMMARY OF ACCOUNT DEBTORS

Investment grade⁵: >94%

S&P 500: >30%

Publicly traded: >50%

⁵ Percentage of account debtors with publicly rated debt.

CONCLUSION

Small and midsize businesses are the backbone of the U.S. economy. They face a wide array of challenges, often dictated by current market and economic conditions. One challenge they face in both good times and bad, however, is securing timely, reliable access to working capital in the most flexible, efficient and cost-effective manner possible. Until recently, their options in that regard were severely limited. But as more than 1,000 SMBs have discovered—and more are finding out every day—monetizing their most valuable balance sheet asset through auctions on The Receivables Exchange can provide them with access to the funding they need, when they need it and on terms they themselves dictate. That funding can be used to smooth over balance sheets, buy new equipment, hire new employees—whatever SMBs need to fund growth. The Receivables Exchange has created a new capital marketplace for SMBs nationwide.

*For more information about **The Receivables Exchange** and to get started monetizing your own accounts receivable, go to www.receivablesXchange.com today.*

Creating the Optimal Auction: 5 Tips for Setting the Right Parameters

1. Trade often to build up a consistent transaction history and drive down your cost of funds.
2. Post receivables soon after invoicing to greatly reduce your days of sales outstanding (DSO).
3. Provide transparency with thorough supporting documentation (Seller financials, purchase orders, historical ledger showing payment history between Seller and account debtor, etc.)
4. Sell the receivables of your best customers; Buyers are interested in the creditworthiness of your account debtors.
5. Choose public and large companies over private and small ones. Trading activity on The Receivables Exchange has indicated a very high correlation between the size of the account debtor and the level of interest in the auction.