

## **Securing the Automotive Supply Chain**

*Auto suppliers can act now to unlock the value of their receivables and free up the cash they so desperately need to survive*

**By Drew Hofler**

Recent weeks have seen a flurry of activity around the auto industry rescue, with Treasury Secretary Geithner holding the first meeting of the Auto Industry Task Force, Chrysler and GM presenting their formal restructuring plans and bailout proposals to the task force, and the government recently moving to back up to \$5 billion in receivables for auto suppliers.

Through all of this activity, there are lots of good ideas, the merits of which the government continues to weigh. And while the government's approval of the supplier proposal submitted by industry groups Motor & Equipment Manufacturer's Association (MEMA) and Original Equipment Supplier Association (OESA) helps, auto suppliers still face an uncertain future.

According to Chrysler's bailout plan, 22 percent of the company's spend -- some \$8.5 billion -- is with financially troubled suppliers, a number which is up from 10 percent only last August. In its letter to Treasury Secretary Geithner, MEMA states: "Recent industry surveys indicate that approximately one-third of all suppliers are currently in severe financial distress and another one-third will be in distress by the close of the first quarter of 2009." Respondents to a measure conducted by the OESA support this claim:

- 59 percent stated they either are currently in violation or will be in violation of their loan covenants by the end of 2009
- 62 percent of suppliers consider themselves to be in danger of severe financial distress by the end of 2009 (31 percent imminent or by the end of Q2)
- And 92 percent believe that it is at least likely that one or more of their direct suppliers (Tier 2 & Tier 3) will declare bankruptcy within the next 6 months

The positive news is that the auto makers, after slowing down production significantly over the past few months, are planning to ramp up production again in March and April. But the restarting of full-scale production does present a unique challenge to the auto supply chain. Because of the production slowdown, and subsequently lower sales and cash flow in the previous months, suppliers will be faced with a severe cash flow crunch as they await payment on their new orders for 45 days or more. Not enough cash coming in the front door to fund production would be problem enough, but according to the Chrysler report, 43 percent of Tier 1 suppliers have also received requests from their sub-tiers for payment terms compression.

The combination of delayed cash flow from their buyers and accelerated payment to their sub-tier suppliers puts auto suppliers in the untenable position of having to find liquidity amidst a cash flow drought without the ability to utilize one of their greatest assets -- their receivables. According to one Tier 1 supplier who responded to the MEMA survey, "We are all very concerned that our receivables are at risk. There is nothing we can do in the current market to protect our receivables, at any cost."

### **Act now to access liquidity in receivables**

But there is. Right now, suppliers can act to access the cash flow potential in their non-auto and auto receivables since the government has taken the first step toward backing them.

While taking advantage of what bank products they may still have available, suppliers now have some very good options outside of the traditional credit markets, which are more part of the problem than the solution right now. Some of these options include working with buyers to accelerate payments in a mutually beneficial manner, and utilizing bank-neutral supply chain financing or receivables auction providers to connect with sources of liquidity in the capital markets looking for good short-term asset classes like receivables in which to invest now that the government has moved to back them.

### **Consider non-bank options to monetize receivables... without adding debt**

Government backing will enable suppliers to once again use their receivables as collateral for working capital loans from traditional banking sources. However, traditional banks are not the only source of working capital and likely may not be the best. Bank funding of receivables is still debt on a supplier's balance sheet and will continue to expose suppliers to the risks and restrictive covenants of traditional bank debt.

However, non-bank providers such as Orbian and The Receivables Exchange give suppliers access to large pools of alternative sources of capital via models that allow the supplier to engage in a true sale of their receivables, thus lowering their Days Sales Outstanding (DSO) and accessing accelerated cash flow without adding a single penny of debt to their books. And the competitive nature of the receivables sale to a variety of capital providers bidding for these assets drives the price down through market forces, ensuring suppliers the lowest possible cost of cash.

### **Be ready for when the government acts**

Any provider of funds for receivables, be it a bank, a third-party trade finance provider or a receivables auction, will require some number of days for due

diligence and system access. For many of these options, suppliers can lay the groundwork without committing to a binding obligation and can test the waters with a portion of their receivables.

As the saying goes, when the going gets tough, the tough get going. Auto suppliers have been down before. And they've emerged successfully. By tapping into innovative tools that allow them to convert their receivables to cash, they will again.

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