



## Working Capital Financing

### Structured Trade Finance Accounts Receivable Financing

Working capital financing using structured trade finance products to monetize accounts receivable is a good way to convert illiquid assets into cash. This particular form of accounts receivable financing allows a growing business to raise cash by pooling accounts receivable. Known as structured trade finance, this technique is used to generate cash for (i) rapidly growing companies; (ii) companies that have seasonal sales; and (iii) companies involved in mergers and acquisitions. This article maintains a general focus on working capital financing through structured trade finance in the typical trade accounts receivable context.

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#### Why working capital financing?

*Growing businesses* often find that accounts receivable pile up faster than the cash needed to fund working capital. Structured trade finance is a way of financing working capital using accounts receivable. Similar accounts receivable are pooled together. Interests in the pool of accounts receivable are then sold to investors. The proceeds from the sale of those interests can then be used to fund working capital.

You *benefit* from this type of working capital financing (structured trade finance accounts receivable financing) by being able to:

- convert illiquid assets (accounts receivable) into cash;
- raise cash based on pools of similar accounts receivable;
- improve your company's balance sheet;
- enhance your company's creditworthiness; and
- raise money at rates more favorable than direct borrowing (commercial loans).

#### Working Capital Financing – Structured Trade Finance defined

##### What is Structured Trade Finance?

Structured trade finance is a way of raising cash by selling interests in a pool of similar assets. A form of accounts receivable financing, structured trade finance involves the collection of similar accounts receivable into pools. Individually, the accounts receivable would not be able to support an accounts receivable loan. However, pooled, similar accounts receivable can support significant fund raising efforts.

Interests in the pool of accounts receivable are then sold to investors. Typically, institutional investors purchase the interests. The underlying support for the interests, the pool of accounts receivable, is diversified, providing investors with a degree of insulation from risk. Structured trade finance transactions also have other built-in safeguards that decrease the risk of default. Because risks are minimized, investors are usually satisfied with a reduced interest rate.

If a structured trade finance transaction is done correctly, investors do not have recourse to the originator. Investors only receive payment from the cash flow generated by the pool of accounts receivable.

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## A General Look at a Structured Trade Finance Transaction

### Working Capital Financing using Structured Trade Finance

1. Create a subsidiary or affiliate that is a special purpose entity (SPE).
2. Transfer your company's accounts receivable to the SPE.
3. The SPE issues securities (notes or trust certificates) that are backed by the accounts receivable.
4. The SPE uses the proceeds from the issuance of securities to purchase the accounts receivable from your company.
5. You can now use the cash generated by the sale of the accounts receivable to the SPE to fund working capital.

### Critical Objective of Structured Trade Finance

Structured trade finance is a type of working capital financing that is dependent on the ability to insulate the cash flow generated by the accounts receivable from any financial difficulties. The cash flow is insulated from both the financial difficulties of the originator of the accounts receivable (your company) and those of the SPE.

Structured trade finance law accomplishes this critical objective by focusing on three areas:

- Using corporate legal safeguards to “bankruptcy proof” the special purpose entity (SPE);
- Preventing the SPE from being included in the bankruptcy of the company that originated the accounts receivable under the legal doctrine of substantive consolidation;
- Eliminating the originating company's legal interest in the accounts receivable by structuring the transfer of the accounts receivable as a “true sale” rather than an assignment for security.

### Structured Trade Finance and Credit Rating Agencies

Unlike other forms of working capital financing, structured trade finance involves the sale of securities to institutional investors through the capital markets. These institutional investors rely on credit rating agencies (Moody's; Standard & Poors) to comment on the risk profile of the securities. The credit rating agencies do so by analyzing the transaction and providing a credit rating. The more favorable the credit rating, the lower the costs of borrowing (the interest rate).

While credit rating agencies review all aspects of a transaction, particular focus is paid to the:

- credit quality of the accounts receivable;
- default history of the accounts receivable; and
- extent to which the cash flow from the accounts receivable has been insulated from financial difficulties of the originator.

## Working Capital Financing – Structured Trade Finance Benefits

### Convert Accounts Receivable into Cash

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The primary objective of working capital financing is to monetize assets – convert illiquid assets into cash. Structured trade finance accounts receivable financing accomplishes this objective by pooling similar accounts receivable and selling interests in the pool of accounts receivable to investors.

### **Raise Cash Based on Pools of Similar Accounts Receivable**

As a form of working capital financing, structured trade finance accounts receivable financing is attractive because it allows a company to generate cash by pooling similar accounts receivable.

For example, what if your company sold US\$3,000 flat-screen televisions on 60-day terms. It would be hard for you to raise cash based on a single account receivable. However, if you pooled the accounts receivable from 10,000 sales of US\$3,000 flat-screen televisions, all on 60-day terms, you might then be able to raise US\$30,000,000.

### **Improve Your Company's Balance Sheet**

It may be possible keep liabilities related to the special purpose entity's sale of securities off of your company's balance sheet. The transfer of accounts receivable from your company to the special purpose entity (SPE) should be structured as a sale of the accounts receivable and *not* an assignment. If the transfer is recognized as a true sale, it may be possible to remove liabilities associated with the issuance of SPE securities off of your company's balance sheet.

### **Enhance Your Company's Credit Worthiness**

If structured correctly, a structured trade finance transaction can remove assets and associated liabilities from your company's balance sheet. Ideally, when the accounts receivable are transferred to the SPE, the transfer is structured as a lawful true sale. By removing assets and liabilities from your company's balance sheet, you may find it easier to satisfy debt covenants or meet credit rating agency capital adequacy requirements.

### **Raise Cash at Rates More Favorable than Direct Borrowing**

A properly structured trade finance working capital financing transaction can earn a high investment grade credit rating. Even if your company has a non-investment grade credit rating, this form of working capital financing allows your company to borrow at a low interest rate from institutional investors. Because the pooled accounts receivable are carefully insulated from risk of default, you are able to raise cash at rates that are more favorable than the rates offered by traditional commercial lenders and factoring companies.

### **Is Structured Trade Finance Accounts Receivable Financing Right for You?**

To learn whether structured trade finance accounts receivable financing is right for your company, visit [www.shajlaw.com](http://www.shajlaw.com) and click on "Learn More."

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