SUPPLY CHAIN FINANCE FUNDAMENTALS FOR AUTOMOTIVE:

What it Is, What it’s Not and How it Works

PR PrimeRevenue

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When it comes to the automotive industry, looks can be deceiving. A cursory glance at overall performance shows an industry that's experiencing record-breaking growth. According to a recent report released by PwC, profit margins for OEMs and suppliers are at a 10-year high and worldwide sales reached 88 million autos in 2016.

But a closer look at the financial health of the industry tells a different story. While the annual rate of return (total shareholder return) for the S&P 500 and Dow Jones Industrial Average has been 14.8 percent and 10.1 percent for the last five years, the average return for auto makers has been a mere 5.5 percent. Return on invested capital hasn't fared much better – just 4 percent for the top 10 OEMs and only marginally higher for the top 100 suppliers.

The financial challenges of the automotive industry continue to overshadow strong sales – most notably:

- **Rapid pace and cost of innovation: Not since the industrial revolution has the automotive industry seen such rapid and broad-reaching innovation.** Electric vehicles, connectivity, embedded digital services, autonomous driving, updates to core systems (e.g. powertrains)…the list goes on. However, the cost burden of these advancements on OEMs and suppliers is heavy. The combined capital spending of the top 10 OEMs (including R&D and M&A) has increased by 34 percent over the last decade and the cost to produce automobiles today is as much as 20 percent greater than the previous generation.

- **Skilled labor shortage: In addition to the hard costs of innovation, many automotive companies are encountering another cost burden: lack of skilled labor.** According to the Manufacturers' Outlook Survey published by the National Association of Manufacturers, 64.4 percent of respondents cited attracting and retaining a quality workforce as one of their top business challenges. To overcome this challenge, many automotive OEMs and suppliers like BMW, Michelin North America and Mann + Hummel are spending billions of dollars on technical training and scholarship programs to develop a domestic workforce that can meet consumer demand.

- **Increasing cost of capital: An already low inflation-adjusted cost of capital combined with the trend of low returns means the cost of capital for most companies in the automotive industry is expected to rise.** Traditional financing alternatives like commercial-based loans will become more expensive – perhaps prohibitively given the pressure on automotive OEMs and suppliers to improve fiscal health.

The dual pressures of rising production costs and innovation have put automotive companies in a tough position. Consumers are demanding more and more innovation from OEMs and that has long-tail implications for suppliers, which – like OEMs – must adapt to these pressures with speed, agility and resiliency.

Historically, companies have turned to commercial-based lending. But adding the extra debt required to tackle the scope of these challenges – often in excess of $1 billion – isn't a viable solution for many of today's automotive OEMs and suppliers.

The objective of supply chain finance is to unlock working capital trapped in the supply chain–in a manner that benefits all parties involved.

Enter supply chain finance. The largest automotive companies have been using it for years to improve cash flow without negatively impacting balance sheets.

But what exactly is supply chain finance? What is it not? And how does it work?

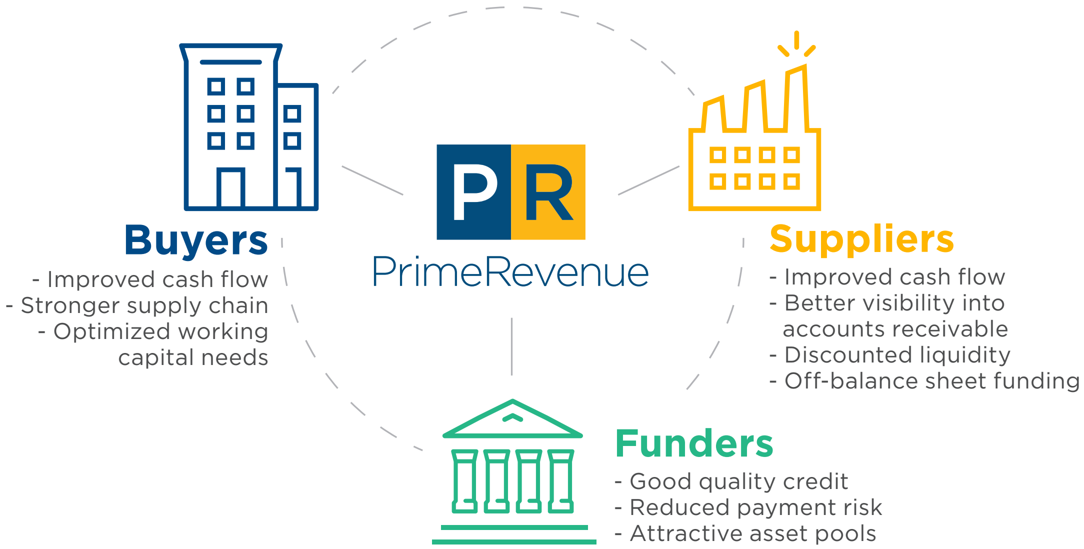
PrimeRevenue Supply Chain Finance In Action

A German OEM manufacturer wanted to expand its global market share in the automotive filtration business through a mix of acquisitions, production optimization, production line consolidations and long-term strategic relationships.

PrimeRevenue's unique multi-funding solution delivered a program satisfying new suppliers with unmatched rates, thus expanding the company's strategic supplier base beyond the largest. Over the past 4 years, the program has grown by 70 percent on an annual basis and improved days payable outstanding by more than 25 days. The OEM manufacturer has onboarded just under 100 suppliers in 16 countries so far, with cash flow gains of more than $110m.

Over the past year, the supply chain finance program has enabled them to hire 100 new employees, open 3 new offices, acquire 2 new production facilities as well as expand their product portfolio in heating, ventilation, air conditioning (HVAC) and HEPA filters.

Understanding the Supply Chain Finance Ecosystem



To operate effectively, supply chain finance requires an ecosystem that improves the velocity of working capital across a supply chain. Participants in the ecosystem are as follows:

Buyers: Typically large organizations that rely on a multitude of supplier-provided goods and services to deliver products for their customers. Buyers often operate on a global basis.

Suppliers: Companies that supply goods and services to buyers in the supply chain ecosystem. Some suppliers are large enough to also operate as buyers thereby having their own suppliers, complex supply chains and the same need to optimize cash flow.

Funders: Bank and non-bank sources of investment capital that advance funds to cover the cost of approved supplier invoices.

Platform Providers: Technology solution providers that facilitate the supply chain finance ecosystem and program management. Today, leading platforms are cloud-enabled, meaning they do not require installation and operation of specialty software systems.

Supply Chain Finance Defined

Supply chain finance — also known as supplier finance or reverse factoring — is a set of solutions that optimizes cash flow by allowing buyers to extend supplier payment terms. Increasing the time it takes to pay a supplier improves several financial metrics (e.g. days payable outstanding or DPO), and most importantly, frees cash that would otherwise be trapped inside the supply chain. A buyer can use increased cash flow to invest in operational, competitive and innovation initiatives that will drive additional growth. They can also return cash to shareholders in the form of dividends or stock repurchases.

Simultaneously, supply chain finance offers suppliers a way to mitigate the effect of payment term extensions and to accelerate their own cash flow. Suppliers who participate in a program have the option to get paid early – typically as soon as an invoice has been approved by a buyer. The supplier can accelerate payment on some, all or none of their receivables, depending on their financial position and funding requirements. For those receivables that are paid early, the supplier will pay a small finance charge or discount.

All of this occurs without negatively impacting the balance sheets of either company. Accounting treatment for supply chain finance, when done properly, does not count as additional debt for a buyer or supplier.

Furthermore, since the buyer is the obligated party, financing is offered to the supplier at rates that are typically more favorable because they are based on the buyer's credit history and rating. For many suppliers, this access to a lower cost of funding is exceptionally important.

Supply chain finance thus creates a win-win situation for both buyers and their suppliers. The buyer optimizes working capital because it has more time to pay suppliers. Meanwhile, suppliers can generate additional operating cash flow by getting paid early without affecting their balance sheets.

When it comes to optimizing cash flow, supply chain finance is a rare win-win scenario for both buyers and suppliers in the automotive industry. It's a way to unlock working capital for both parties without having a negative impact on either entity's balance sheet.

What Supply Chain Finance is Not

The world of trade finance is complex and varied. There are numerous ways to increase business capital on hand and, in many cases, the differences are slightly nuanced. Given this landscape, it's not just important to understand what supply chain finance is; it's also important to understand what it is not.

It is not a loan. Supply chain finance is an extension of the buyer's accounts payable and is not considered financial debt. For the supplier, it represents a non-recourse, true sale of receivables. There is no lending on either side of the buyer/supplier equation, which means there is no impact to balance sheets.

It is not dynamic discounting or an early payment program. It is not dynamic discounting or an early payment program. Early payment programs, such as dynamic discounting, are buyer-initiated programs where buyers offer suppliers earlier payments in return for discounts on their invoices. Unlike supply chain finance, buyers are seeking to lower their cost of goods, not to improve their cash flow. Dynamic discounting and early payment programs often turn out to be expensive for both suppliers (who are getting paid less than agreed upon) and buyers who tie up their own cash to fund the programs.

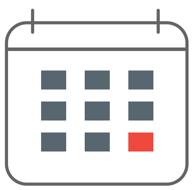
It is not a loan. It is not factoring. Factoring enables a supplier to sell its invoices to a factoring agent (in most cases, a financial institution) in return for earlier, but partial, payment. Suppliers initiate the arrangement without the buyer's involvement. Thus factoring is typically much more expensive than buyer-initiated supply chain finance. Also, suppliers trade "all or nothing" meaning they have no choice to participate from month-to-month to the degree that their cash flow needs dictate. Finally, most factoring program are recourse loans, meaning if a supplier has received payment against invoices that the buyer subsequently does not pay, the lender has recourse to claw back the funds.

SUPPLY CHAIN FINANCE:
How it Works

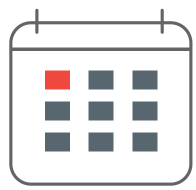
Supply chain finance employs two primary tactics. The first is the extension of supplier payment terms. In this tactic, the buyer extends payment terms with all of its suppliers – for example, from 60 to 120 days. This dramatic slowdown of cash outflow gives the buyer access to more working capital.

The second tactic in supply chain finance is a counterbalance to the first. The buyer gives selected suppliers the option to get paid early by selling their invoices to financial institutions (or funders). This offsets the negative impact of longer payment terms on suppliers, while still enabling the buyer to meet its cash flow optimization objectives.

Two primary methods:



Buyer extends payment terms with all suppliers



Suppliers get paid early by selling their invoices

Invoice selling (or trading) is facilitated through a buyer-side implementation of a supply chain finance platform and program. In this program, buyers identify and invite target suppliers to participate in the program (usually based on the size of spend and/or the strategic value of the supplier). Once a supplier accepts the invitation, they are onboarded into the program and its procurement/sourcing teams are trained on how to use the processes and tools that will facilitate invoice trading. They are also matched to a funding partner or financial institution.

It's important to note the critical role of a strong onboarding program and the availability of multiple funding sources in this process. The onboarding process should be efficient, simple and immediately beneficial to the supplier. Furthermore, access to multiple financial institutions ensures the supply chain finance program is always well funded and suppliers are partnered with a source that understands the geographical, regional and/or industry nuances of their business.

PrimeRevenue Supply Chain Finance In Action

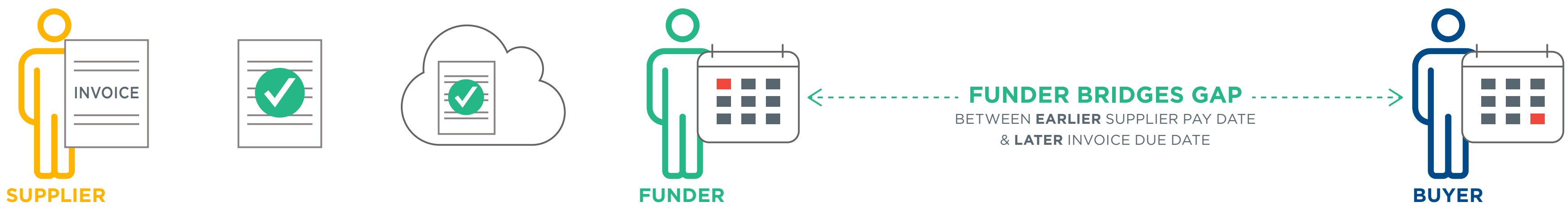
To solidify its position as one of the world's top manufacturers of tires, this company outlined an ambitious 5-year growth strategy. Goals included delivering $1B+ in additional cash flow and achieving a minimum of 15 percent return on capital employed.

Meeting these aggressive financial necessitated a wide-ranging change in current business practices, including the implementation of a supply chain finance program powered by PrimeRevenue. Within months of implementation, PrimeRevenue's supply chain finance program helped the company unlock more than $100 million in cash flow.

Improved access to working capital has helped the company tackle other challenges – like workforce development. To overcome a skilled labor shortage, the company's North American division has made large-scale investments in local technical training programs and educational partnerships.

THE SUPPLY CHAIN FINANCE PROCESS

Following onboarding, it boils down to these five simple steps:



1

The supplier submits an invoice to the buyer following normal protocol;

2

The buyer approves the invoice, then uploads it into the supply chain finance platform;.

3

The supplier logs into a supply chain finance platform portal with the option to sell or trade their invoice for early payment with their assigned funding partner;

4

If the supplier selects an invoice for trading, the funder receives and processes that request and provides early payment to the supplier. The full sum of the invoice – less a small financing fee or discount – is transferred electronically to the supplier's bank account;

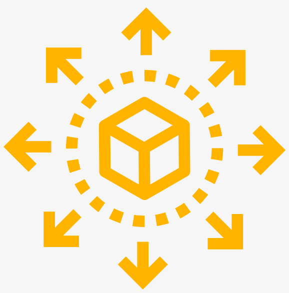
5

Once the invoice has matured, the buyer is instructed to pay either the funder (if the supplier has sold the invoice) or the supplier (if they have not sold the invoice).

THE BENEFITS OF SUPPLY CHAIN FINANCE

Supply chain finance is one of the few financial health improvement tactics that works for organizations on both sides of the supply chain. Buying organizations can extend their payment terms, and suppliers can get paid earlier. It's a true win-win solution for both trading partners.

A meaningful increase in working capital can be transformative for companies in the automotive industry, many of which operate with thin margins. Whereas



conventional finance tactics may yield $15M in added cash flow, supply chain finance yields an average of $200M or more for large, multinational buyers. Furthermore, suppliers also realize substantial gains in cash flow as they now have the option to get paid early on each invoice they submit to the buyer.

This translates into much-needed agility for companies across the automotive supply chain. This working capital can be used by both buyers and suppliers to fund new product development or rebranding/repositioning initiatives as well as strategic acquisitions. Money that has traditionally been tied up in accounts payable/receivable can now be used to generate income and strategic advantage in the marketplace.

Supply chain finance also strengthens supplier health and relationships. Not only does it minimize or negate the impact of extended payment terms, suppliers can receive near-immediate payment for invoices at an interest rate often many times lower than other financing approaches. This increase in cash flow can protect suppliers which are often more vulnerable to marketplace dynamics.

Forward-thinking automotive companies – from OEMs to parts suppliers and everywhere in between – are using supply chain finance to overcome the challenges of today's business climate. By unlocking cash trapped inside of their supply chains, these companies are rising above the competition and positioning themselves for long-term growth and stability.

PrimeRevenue Supply Chain Finance In Action

Belgium-based ALRO Group provides surface treatment of plastic and metal automotive parts and has grown from a small local coating company to worldwide leader with several locations in Western and Central Europe. Its finishes can be found on Audi, Mercedes, BMW, Range Rover and other luxury automotive brands.

When the company's endurance and tenacity was put to the test by the global financial crisis, it approached one of its largest automotive manufacturing customers to discuss its cash flow requirements. The automotive manufacturer invited ALRO to participate in its supply chain finance program led by PrimeRevenue.

The ability to receive near-immediate payment for invoices, rather than wait 75 days or more, was an ideal solution to ALRO's cash flow challenges. Since joining the PrimeRevenue platform, the company has traded over $181 million with an average of $80,000 per invoice. On average, ALRO gets paid 100 days early. Additionally, the company can track invoices online and remedy any issues or discrepancies before they have an impact on cash flow.

PrimeRevenue

Cash flow **matters.**

About PrimeRevenue PrimeRevenue is the leader in working capital financial technology solutions, managing and optimizing cash flow for more than 20,000 customers in over 70 countries. PrimeRevenue processes more than $180 billion worth of payment transactions through its platform – helping companies unlock billions of dollars in working capital. PrimeRevenue uses an extensive database and sophisticated analytics, coupled with proven supplier onboarding processes to drive customized programs across complex global supply chains. www.primerevenue.com

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