

Global Transaction Services

Cash Management Trade Services and Finance Securities and Fund Services

Optimizing the Supply Chain For Trade in Latam

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Rogério Haddad

Agenda

- **Performance Measurements**
- **Risk Management: The Credit Engine for Trade and Channel Finance**
- **Integrated Trade and Channel Finance Solutions**
- **Identifying Opportunities (example)**

Performance Measurements



“Measure Twice, Cut Once”

“*Measure twice, cut once*”
is an old and popular saying
in the carpentry
and building trades.



**This same phrase also applies to Modern
performance measurement techniques
that are now driving factors in corporate behavior**

It's Not The Finance Agent Perspective that Matters.
It's the Client's...

Customers are looking for **Solutions,**

**Satisfy the Customer,
Create a Marketing Edge and
Build an Enduring Relationship**

**To successfully structure finance solutions, there is
a need to understand the customer's needs and**

Performance Measurement Concerns

Measurement Concerns are Real Concerns

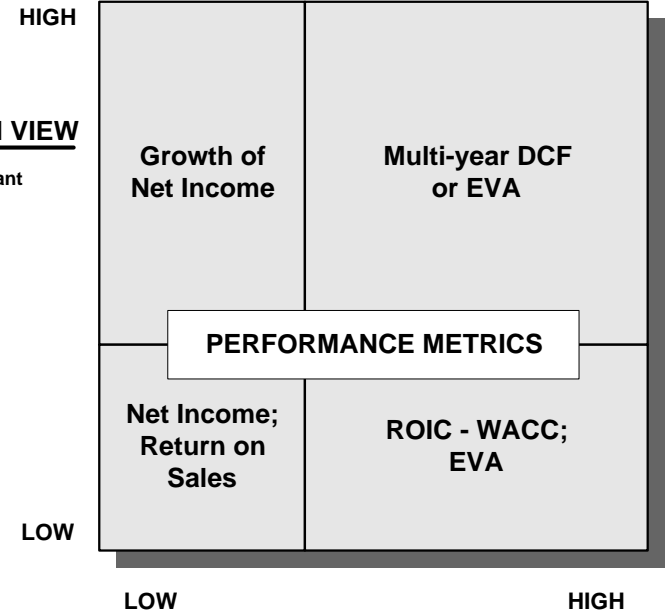
Performance Measurement ...

Decision making is influenced by the **Performance Measurement** that is selected.

Understand the measurement and you understand the motivation.

NEED FOR LONG-TERM VIEW

- High Probability of Significant Industry Change
 - Technology
 - Regulation
 - Competition
- Long Life of Investments
- Complexity of Business Portfolio



CAPITAL INTENSITY
(Need for Balance Sheet Focus)

- Working Capital
- Property, Plant and Equipment

Adapted from: Copeland, Koller and Murrin, Valuation: Measuring and Managing the Value of Companies, 1994.

Channel Finance solutions strives to understand

- Management Motivation
- Corporate Measurement
- Market Measurement and Valuation

In order to help their customer's performance by

- Turning soft-assets into Cash
- Reducing overall capital requirement
- Providing Balance Sheet enhancing solutions
- Reducing administrative expenses
- Increasing sales
- Outsourcing services that detract from the company's main activity
- Improving Risk Management

How Companies are Measured

Individual measures are usually suited to specific companies and industries

Over time, however, there has been a gradual shift from emphasis on **SIZE** to:

Profits

And, more recently:

Value Creation



Measurement techniques

- **Corporate Measurement considers**
 - Growth
 - Profitability
 - Efficiency
 - Asset Intensity
 - Debt Capacity
 - Cost of Capital, etc.

- **There are numerous techniques and formulas**
 - ROI, ROE, ROA, DCF, CFROI, EVA , etc.

Not everyone has the same goal

Managerial Role

CEO	X	X		
Corporate Staff	X	X		X
Business Unit Manager		X	X	
Functional Manager			X	X
All Other Workers				X

Returns to Shareholder

Economic Profit

▪ EBIT
▪ Capital Utilization

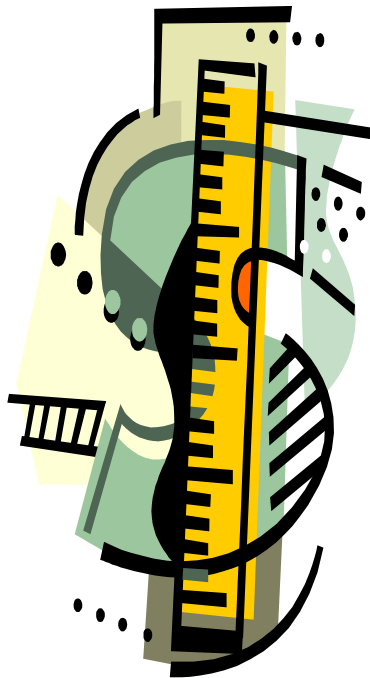
Individual Operating Value Levers

Performance Metric

Adapted from: Copeland, Koller and Murrin, Valuation: Measuring and Managing the Value of Companies, 1994.

Measurement Methods

Three, frequently employed methods of corporate measurement:



- **EVA** – *Earnings Value Added*
- **CFROI** – *Cash Flow Return on Investment*
- **DCF** – *Discounted Cash Flow*

When are they used?

While the three are interrelated, and often substitute for one another...

- **EVA** is most often used to judge *management performance for compensation purposes*
- **CFROI** is mainly used as a *tool for equity analysis*, and
- **DCF** is primarily used to judge *new projects or investments*.

EVA: *The Economic Profit Equation...*

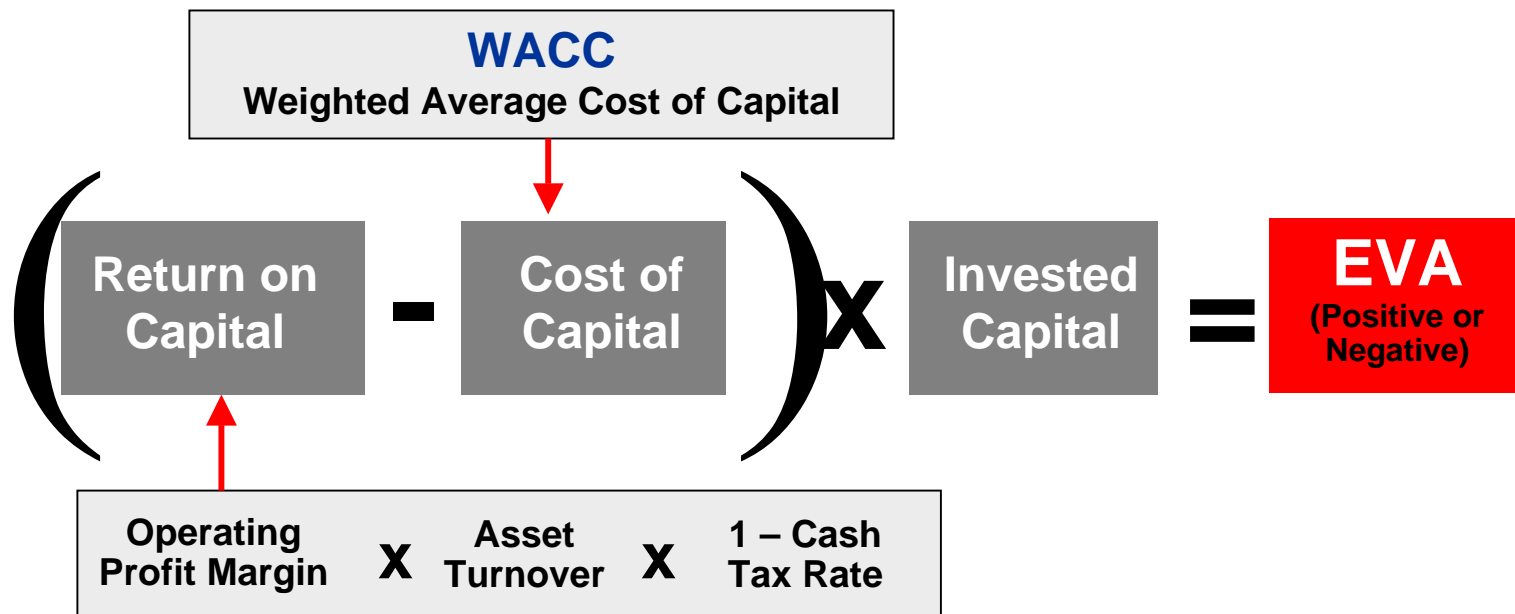
Many companies are now being judged and judge their individual business units and their managers on the basis of *“Earnings Value Added”* (*“EVA”*).

EVA

EVA cont.

EVA: *The Economic Profit Equation...*

There are two manners in which companies calculate EVA. In reality they are the same, and yield the same result. We will focus on one:



EVA cont.

EVA: *The Economic Profit Equation...*

Therefore, to increase its value, a company must do one or more of the following:

- Increase the level of profits it earns on existing capital;
- Maintain profits while reducing required capital;
- Increase the return on new capital investment;
- Increase its growth rate, but only to the extent that the return on new capital exceeds WACC; and/or
- Reduce WACC.

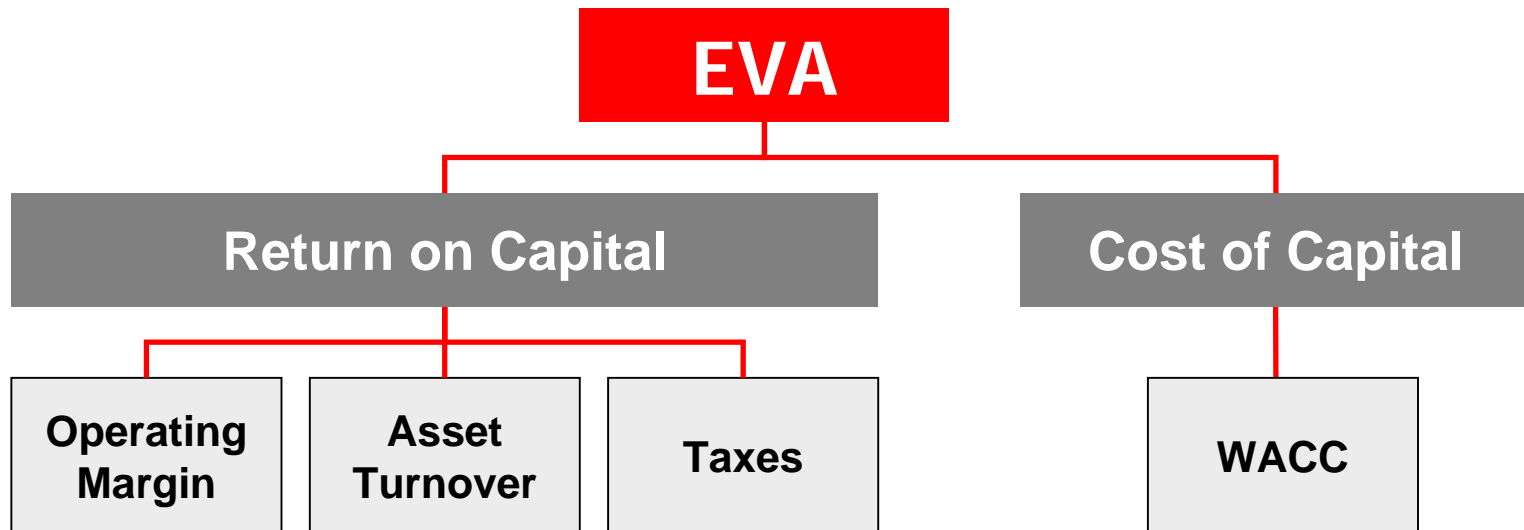
The message to corporate management is that they must focus on capital as well as cost.

EVA cont.

EVA: *The Economic Profit Equation...*

An October 1998 Citibank study attempted to demonstrate how finance products can be utilized to positively influence **EVA** value drivers.

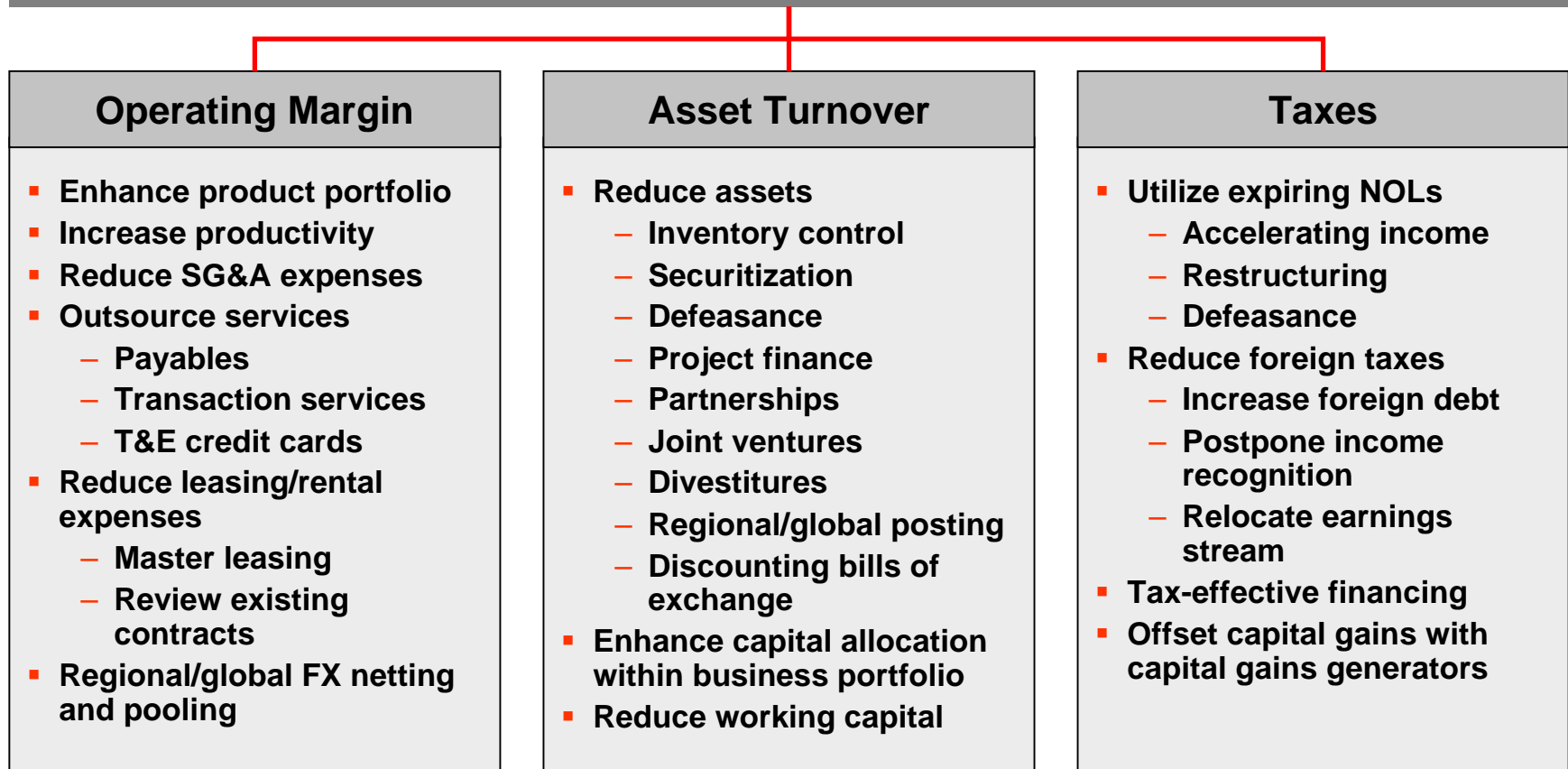
The study reported the following:



EVA cont.

The October 1998 Citibank study

Return on Capital



EVA cont.

The October 1998 Citibank study

Cost of Capital

WACC – Weighted Average Cost of Capital

- Optimize capital structure
- Equity derivatives
- Asset-backed bonds
- Efficient use of global capital markets
- Broad investor base—ADRs
- Investor-driven issues
- Derivatives
- Minimize non-earning assets
- Reduce Beta (volatility)
- Return profits to shareholders advantageously (e.g., share buybacks)

Take Note:

The issues and products studied here almost always have the same effects on **DCF** and **CFROI**.

DCF...Discounted Cash Flow

Discounted Cash Flow (DCF) is the classic capital budgeting & project evaluation tool.

DCF compares cash investment in a project with cash to be generated over the life of the project.

The objective is to find projects in which the *Internal Rate of Return* of the investment exceeds a *hurdle rate*, often Cost of Capital. The amount of value added by the project is its Net Present Value.

DCF-1

CFROI...Cash Flow Return on Investment

CFROI is the Internal Rate of Return that equates the Present Value of gross cash investment with gross cash flow over the average life of the firm's existing assets.



CFROI is often calculated by equity analysts to identify mispriced stocks. It involves significant prediction.

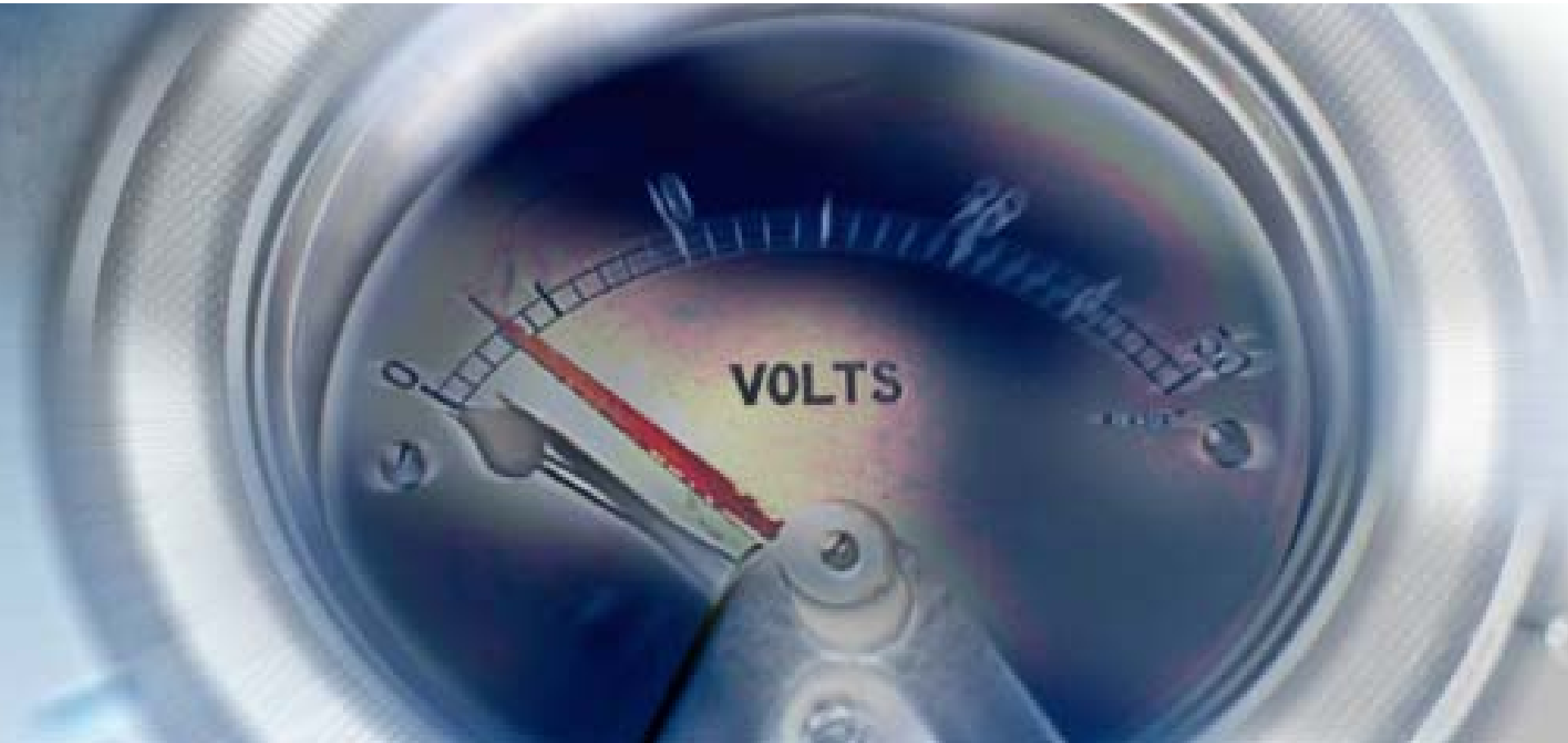
What comes from existing investments?

What comes from future investments and what will it cost?

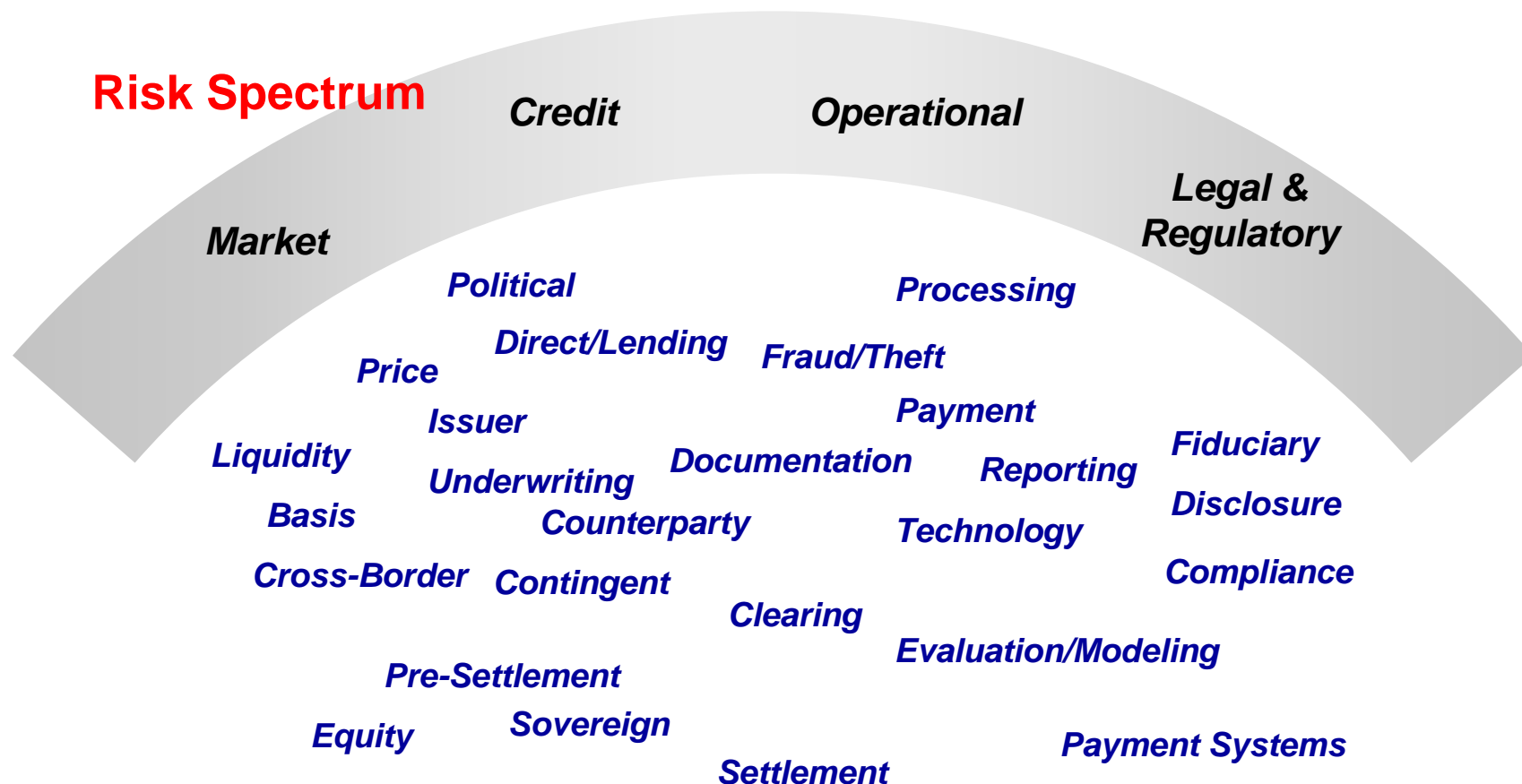
$$\text{PRICE} = \frac{\text{Free Cash Flow on Existing Investment}}{(1 + \text{Cost of Capital})} + \frac{\text{Free Cash Flow on Future Investment}}{(1 + \text{Cost of Capital})}$$

CFROI-1

Risk Management: The Credit Engine for Channel Finance



It's not just credit risk ...



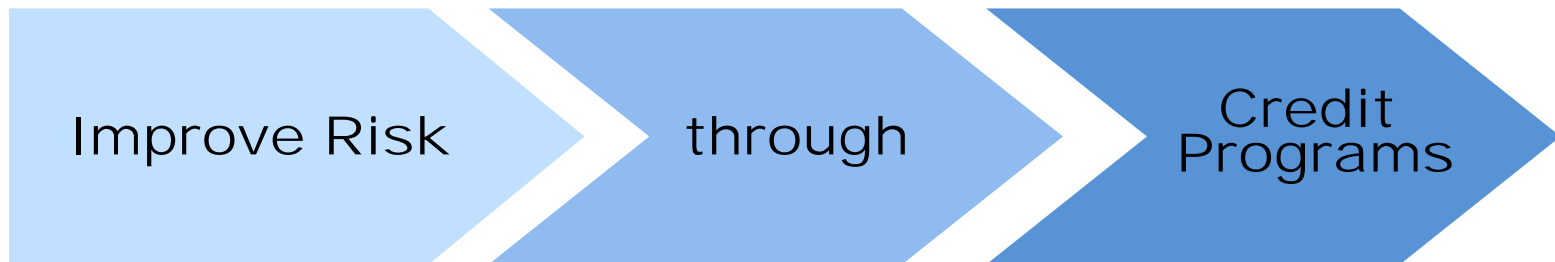
The Risk Spectrum contains additional risks; those listed are just a sampling

Risks in the Channel...for supply chain finance programs (Finance agent perspective)

Risk	Supplier	Sponsor	Distributor
Commercial performance	X	X	
Credit	X	X	X
Compliance	X	X	X
Documentation (perfection)	X	X	X
Documentation (custody)		X	
Portfolio		X	
Information reliability	X	X	X
Bad management and misconduct		X	
Adequacy of loss coverage		X	
Program continuity		X	
Collecting agency		X	
Operational	X	X	X
Fraud	X	X	X
Currency risk	X		X

Risk Management

The Credit Engine for Trade & Channel Finance: Taking & Managing Risk



- Balance sheet
- Commercial
- Currency
- Sovereign
- F&G

- Assessing portfolio quality
- Portfolio monitoring
- Support from our sponsor

- Full, partial & limited recourse programs

Structuring the Finance Solution

Risk Management	Funding	Balance Sheet Optimization	Legal	Services
<ul style="list-style-type: none"> ■ Commercial Risk ■ X – Border Risk ■ Fx Risk ■ Operational Risk ■ Dilution ■ F&G Risk 	<ul style="list-style-type: none"> ■ Liquidity ■ Currency ■ Extended credit terms ■ More efficient funding structure 	<ul style="list-style-type: none"> ■ Improve Financial Ratios ■ Reduce need for other sources of funding ■ Match funding to commercial cycle end-to-end ■ Achieve Performance Measurement goals 	<ul style="list-style-type: none"> ■ Legal enforceability ■ Types of instruments ■ Master Agreements 	<ul style="list-style-type: none"> ■ Collections and servicing ■ Information flow / Data track record ■ Settlement Services

Integrated Trade and Channel Finance Solutions



What is It?

Trade Finance

- **Trade Loans:** Provide liquidity to International Flows of goods and services:
 - Import Finance
 - Export Finance
 - Bill Discount
 - It's a Bilateral "Lending relationship"
- **Structured Trade Finance:** Commodity Finance and ECA/MLA Finance, Risk Participation
- **Channel Finance ...**

What is It?

Channel Finance is about:

Structuring **commercial** and **financially *integrated solutions***

&

Managing **risk** and **serving** relationships that are defined by the commercial and financial *flows* across the **Supplier** and **Distribution *local & international*** chains.

There are four key characteristics

*Sponsor
Based*



Mostly the business starts with a Corporate client as “Anchor Customer”

*Soft Asset
Based*



Underlying assets financed are receivables/payables/ inventories (flow of goods & services)

Ongoing



Participate actively on the supply chain flow

Short Term



Throughout the Chain (linked to the Operating Cycle)

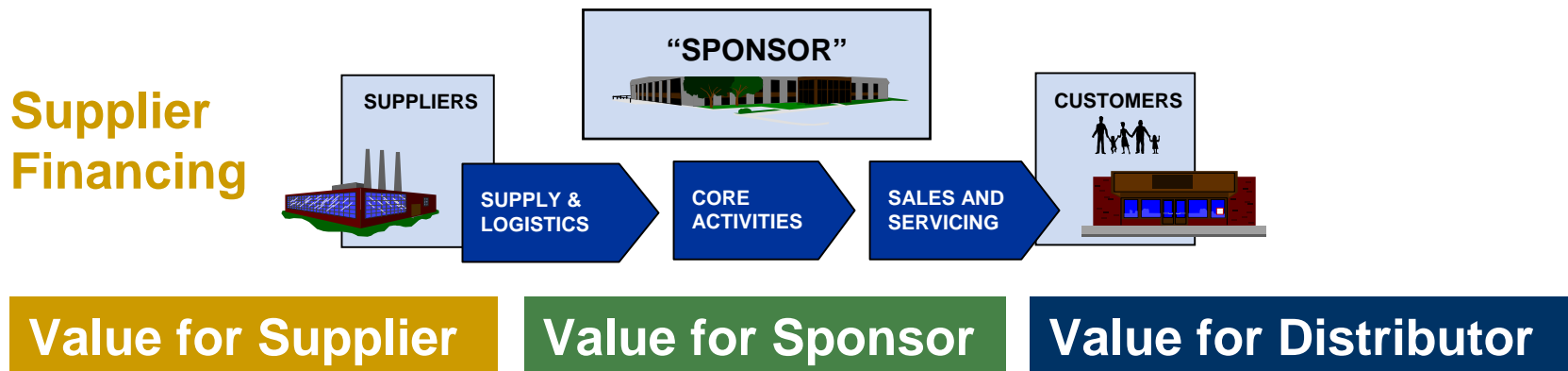
The Channel finance is about creating...

“Value”

Value is created by **bundling financing**
and **services** into a unique tailor made solution

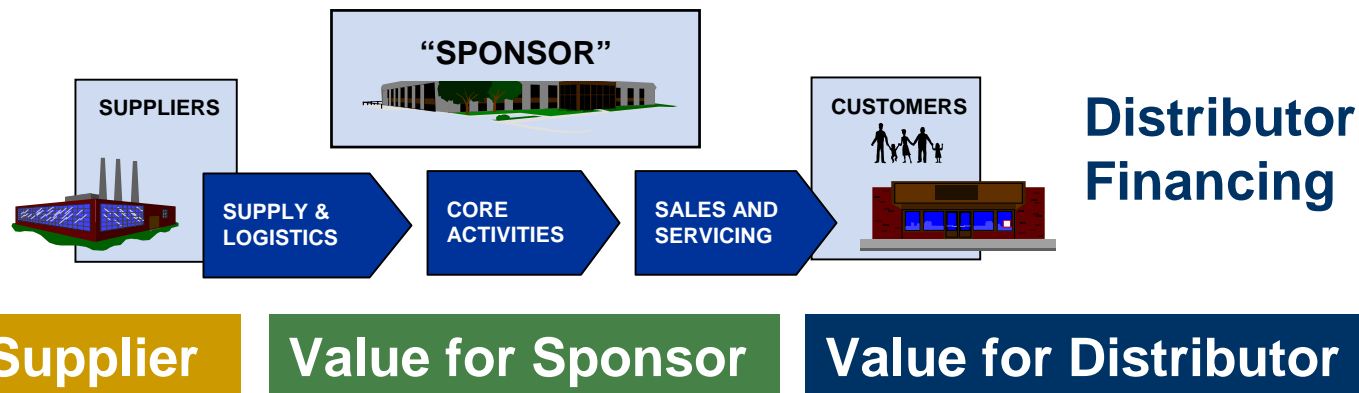
And by **managing risk** in a smart way

It's all about creating value...



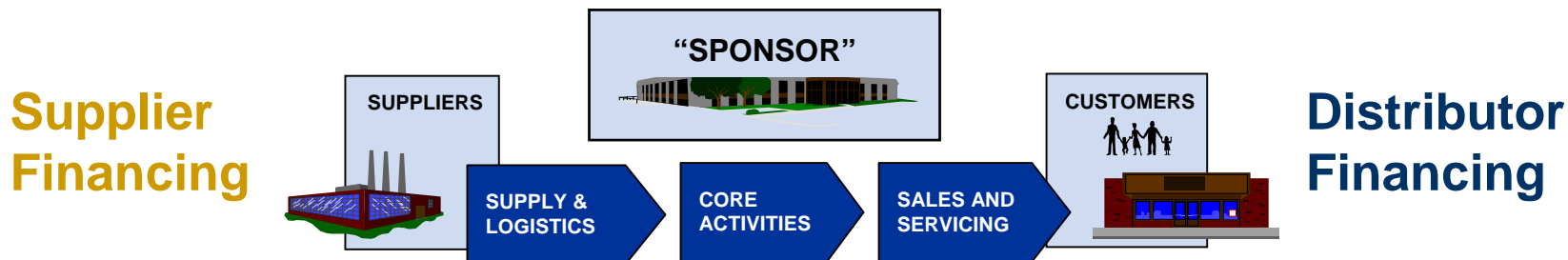
- **New Source of Financing**
- **Expanded working capital capacity**
- **Optimize liquidity and cash flow management**
- **Can offer better financing terms**
- **Access to more competitive interest rates**
- **New bank relationship**

It's all about creating value...



- Better sales financing terms and conditions
- Incremental credit line
- Access to more competitive interest rates
- Expanded working capital capacity
- New bank relationship

It's all about creating value...



Value for Supplier

Value for Sponsor

Value for Distributor

- **Risk Mgmt:**
 - Commercial, currency, political, sovereign and other risks
- **Capital Mgmt:**
 - Reduce WC needs and Capital charges, improving corporate performance (EVA, ROIC, etc.)
- **Profitability:**
 - Increased sales and margins by offering more competitive financing terms and conditions
- **Funding:**
 - Improved liquidity and cash flow management
 - Past due mgmt. (carrying cost linked with managing receivables and cash shortfalls)
- **Services:**
 - Outsourcing of collection management
 - Outsourcing of payment process
- **Process:**
 - Improvement of overall collection and payment process
- **Expenses:**
 - Reduction of administrative expense and workload

Identifying Opportunities



Benefits

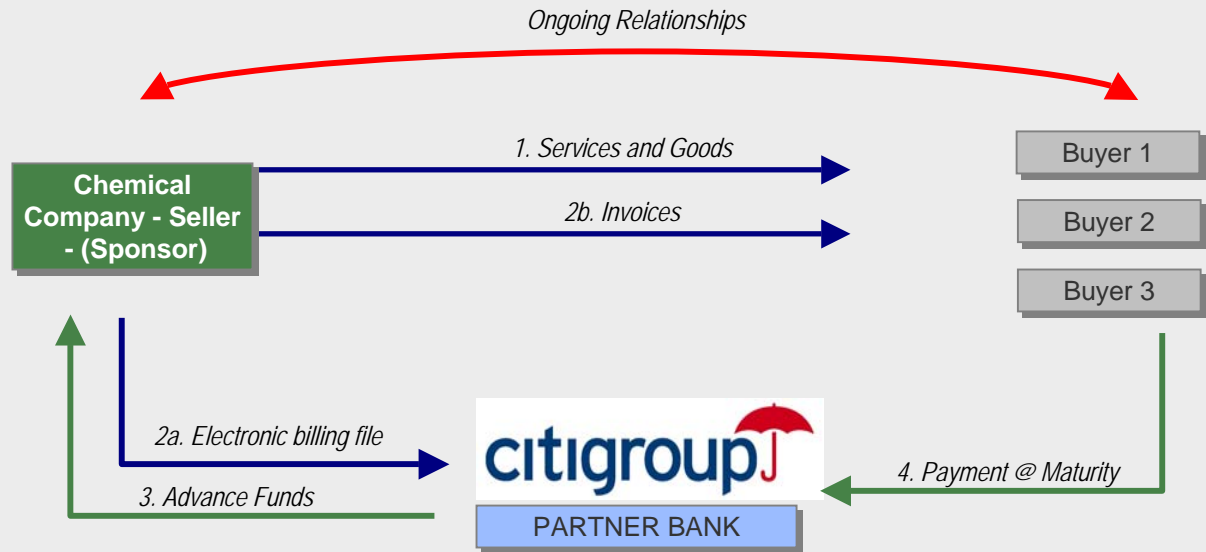
■ Benefits to Client/Seller

- Liquidity matched to the day-by-day; improved cash conversion cycle
- Flexible funding structure
- Risk Mitigation: partial recourse portfolio guarantee
- Reduction of DSO's; managerial goals achievement
- Collections services

■ Indirect Benefits to /Buyer

- Seller liquidity ensures uninterrupted supply flow
- Trade record provides history within Citibank; opportunity for future relationship

I – Receivables Cycle: Partial Recourse Sponsored Receivables Finance



Target Company Profile

- Target Industries: Chemical, Oil, Pulp & Paper, Packaging, Consumer Goods, Metals, etc (soft assets, short-term receivables)
- Common Customer Characteristics
 - Major Manufacturer
 - In need of liquidity or wants to improve Financial Ratios
 - Large Number of Buyers
 - Wants to mitigate the risk of buyers

Questions to Think About

- What are your performance measurement goals? (mainly those related to receivables management – DSO, EVA, etc)
- What is your annual volume of domestic sales for merchandise or materials?
- How many customers do you have?
- Where are they located?
- What are your terms of sales?
- Which are your historical financial figures regarding A/R portfolio?
- How timely are your customers with their payments?
- What are your credit collections policies?
- How large is your credit collections staff?
- Is there seasonality in your sales?

Pricing

- Banks / Sponsor: pre-established interest over amount financed
- Sponsor / Buyers: Bank's interest rate + financial revenue (applicable or not)

Decision Makers

- Commercial Unit heads
- Chief Financial Officer
- Financial Director
- Treasurer
- Credit & Collection Manager

Benefits

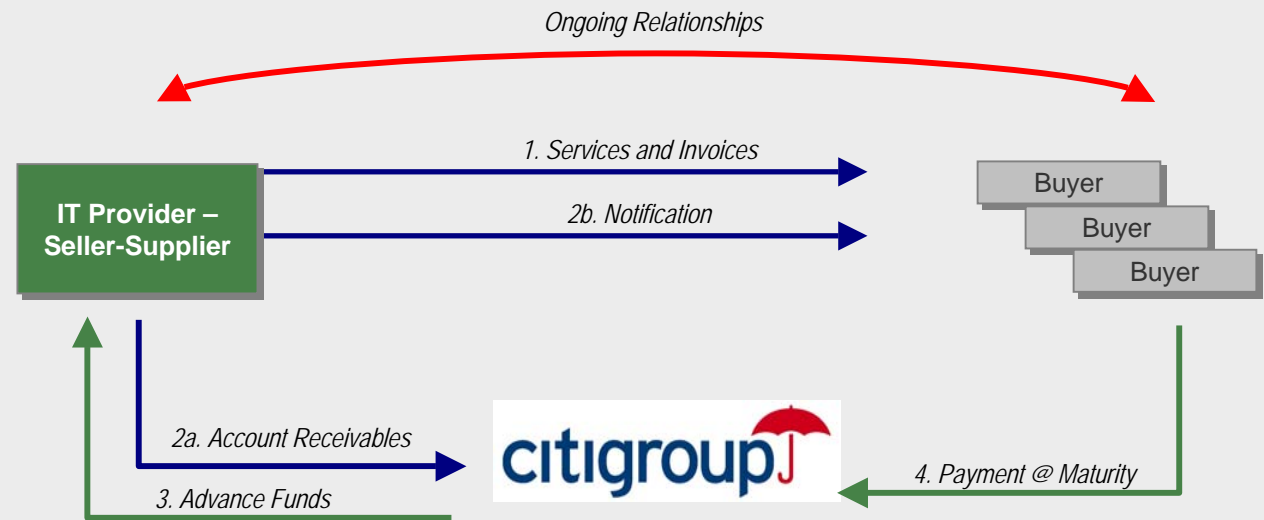
■ Benefits to Supplier

- Liquidity matched to the seasonality of the business and the currency of the underlying receivable
- Risk Mitigation: Ability to sell more or on open account
- Improved cash conversion cycle; Reduction of DSO's
- Collections services

■ Indirect Benefits to Buyer

- Seamless process allows to buy more on open account
- Supplier liquidity ensures uninterrupted supply flow
- Trade record provides history within Citibank; opportunity for future relationship

II – Partial Recourse → Limited Recourse Sponsored Receivables Finance



Target Company Profile

- Target Industries: → C & H → TMC → Industrials → PECM
- Common Buyer Characteristics
 - Major Manufacturer or Distributor
 - In need of liquidity or wants to improve Financial Ratios
 - Large Number of Buyers
 - Wants to mitigate the risk of buyers

Questions to Think About

- What is your annual volume of exports and domestic sales for merchandise or materials?
- How many customers do you have?
- Where are they located?
- What are your terms of sales?
- How timely are your customers with their payments?
- What are your credit collections policies?
- How large is your credit collections staff?
- Is there seasonality in your sales?
- How many suppliers do you have and where are they located?
- What terms do you receive from your suppliers?
- What are your performance measurement goals? (mainly those related to receivables management – DSO, EVA, etc)

Pricing

- Supplier: Interest over amount financed
- Fees for risk mitigation, collections, other services

Decision Makers

- Commercial Director
- Assistant Treasurer
- Chief Financial Officer

Benefits

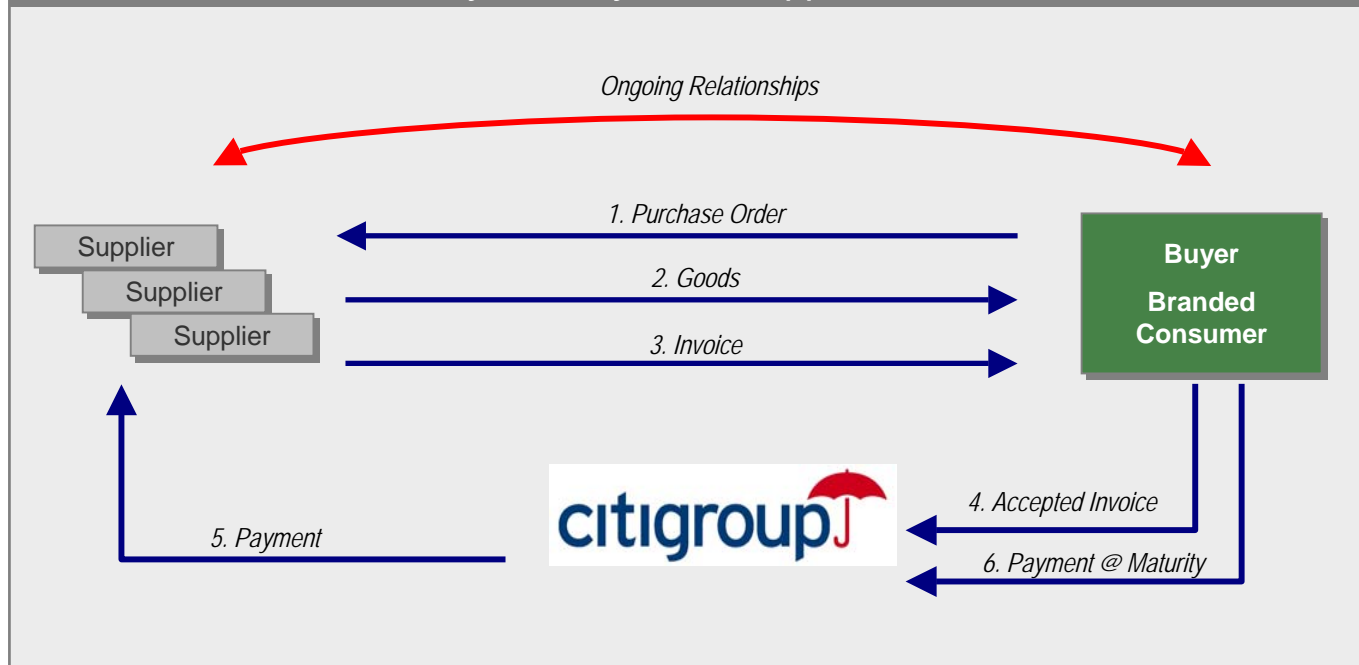
■ Benefits to Buyer

- Supplier liquidity ensures uninterrupted supply flow
- Consolidation of payment process
- Ability to negotiate improved terms

■ Benefits to Supplier

- Liquidity matched to the seasonality of the business and the currency of the underlying receivable
- Risk Mitigation: Ability to sell more
- Improved cash conversion cycle; Reduction of DSO's
- Collection services

III - Payables Cycle → Supplier Finance



Target Company Profile

- Target Industries: → C & H → TMC → Industrials → PECM
- Common Buyer Characteristics
 - Major JENA Manufacturer & Retailer
 - Large Number of Suppliers
 - Improved financing rates
 - Supplying critical goods for the Buyer

Questions to Think About

- What is your annual volume of imports and domestic purchases for merchandise or materials?
- In what countries are your suppliers or vendors primarily located?
- What are the terms of your payments? Are they at sight or term payments (30, 60, 90, or 180 days)?
- What type of payment option are you currently using to pay your suppliers: 1) Letters of Credit, 2) Documentary Collections, and 3) Open Accounts?
- Do your suppliers have a need for alternative financing sources and what would be the main drivers for that?
- What is the typical credit rating of your domestic suppliers and / or borrowing rates for your international suppliers?
- Do you currently work with a bank to provide financing to your vendors?
- How large is your payables staff? Is there seasonality in your purchases?
- Do you have any selection criteria for your suppliers (years in business, etc.)?

Pricing

- Buyer: Fees for payables settlement services
- Supplier: Interest over amount financed; Fees for risk mitigation, collections, other services

Decision Makers

- Purchasing Manager
- Assistant Treasurer
- Chief Financial Officer

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