

Wells Fargo Capital Finance

Solve inventory financing dilemmas with purchase order finance

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When a company lands a large sales opportunity only to find that it doesn't have sufficient borrowing capability from its lender or open terms from its suppliers, a purchase order finance program may be the answer the company is looking for.

Managing cash flow against sales growth, costs, and overhead can be a challenge for every business. Oftentimes, a company's desire for fast growth clashes with its financial resources, and forces it to find an alternative, complementary form of capital to meet its short-term requirements while evaluating a long-term solution.

There are many alternative and complementary funding options available to companies, including:

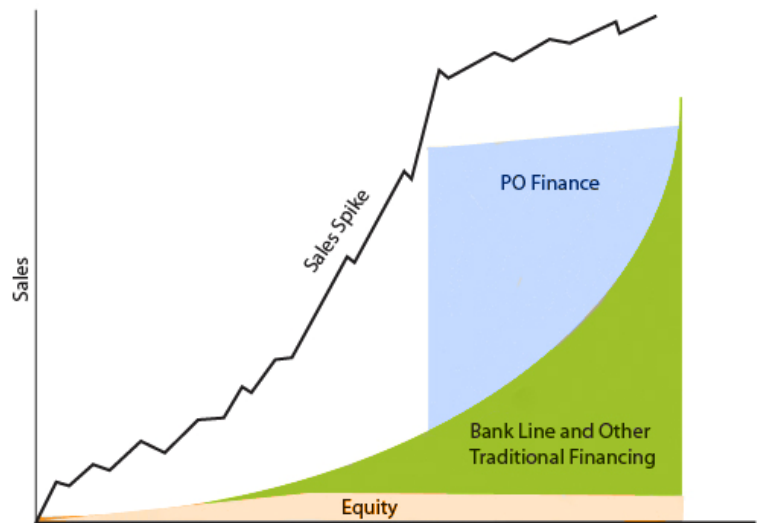
- Equity could be the best long-term solution for the company, but most sales opportunities have very tight time constraints. Finding an equity investor or acquirer can take a significant amount of time, which likely rules this out as a short-term option. In addition, principals of a business are often uncomfortable bringing in long-term equity partners to solve a short-term problem.
- Mezzanine debt is similar to an equity infusion, and may give the mezzanine lender the ability to convert to an ownership or equity position if the loan is not fully paid back in time. Therefore, the ability to control the brand and possibly the licenses may be appealing to an outside investor if a company fails. Because mezzanine debt is most often used for company expansion, a company must be established in the industry and produce a solid expansion plan for the business. With these stiff requirements, finding mezzanine debt may be difficult and time consuming.
- Tranche B or "second lien" debt lenders can generally adapt their facility to the needs of the borrower, but this option may not be appropriate for a short-term sales opportunity. The lender compares the value of the assets and enterprise value against the senior lender's position. If the Tranche B lender believes the increase in sales is a sustainable situation, it may be interested. Tranche B lenders may agree to second priority lien provisions but attempt to position themselves as *pari passu* in right of payment with the senior lender. Also, Tranche B loans may be structured such that the Tranche B lender has leverage to negotiate an equity position in the company.
- Transaction finance has various forms, with purchase order finance being the most applicable, for a sudden, large sales opportunity. Unlike other types of financing that emphasize formulas and assets, purchase order financing focuses on specific transactions, which support known programs and sales. The funds provided are used to fund the cost of manufacturing inventory, the related logistics costs, including duty, freight, warehousing, and the delivery of the goods to the company's customers. The transactions supported are carved out of the borrowing base of the senior lender and are treated on a stand-alone basis.

Purchase order financing will not satisfy every situation where a company needs short-term financing. But, if a company wants to complete a large sales opportunity that is out of its reach financially, purchase order financing may be its best – or only – option.

Typical purchase order financing scenarios

Traditional financing is often the answer for moderate levels of sales growth for a stable company. However, certain sales situations may put a lender in the position of not being able to provide a customer with the necessary short-term funding. Consider these scenarios:

- An asset-based lender has a customer that distributes industrial tools. The distributor suddenly lands a large order from a national construction company, and requests an immediate over-advance to purchase the inventory. The lender is uncomfortable extending the company's credit line; however, in this situation, a purchase order finance relationship can fill the gap by providing up to 100% of the cost of inventory.
- A factor is working with a mid-sized importer of apparel faced with a large order for back-to-school clothes. Seasonal sales spikes are common in consumer products and can very quickly create large capital infusion needs for a relatively short funding-to-reimbursement cycle. While a factor purchases a company's accounts receivable at a discount for cash, a purchase order finance company can finance inventory in-transit.
- A turnaround consultant is getting a client back on its feet when the client lands a large sales order. The business would like to take advantage of the sales opportunity, but the turnaround manager is focused on debt management and negotiating with creditors to help the company eliminate debt and bring its past due accounts back up to date. A purchase order finance company may be the only option.

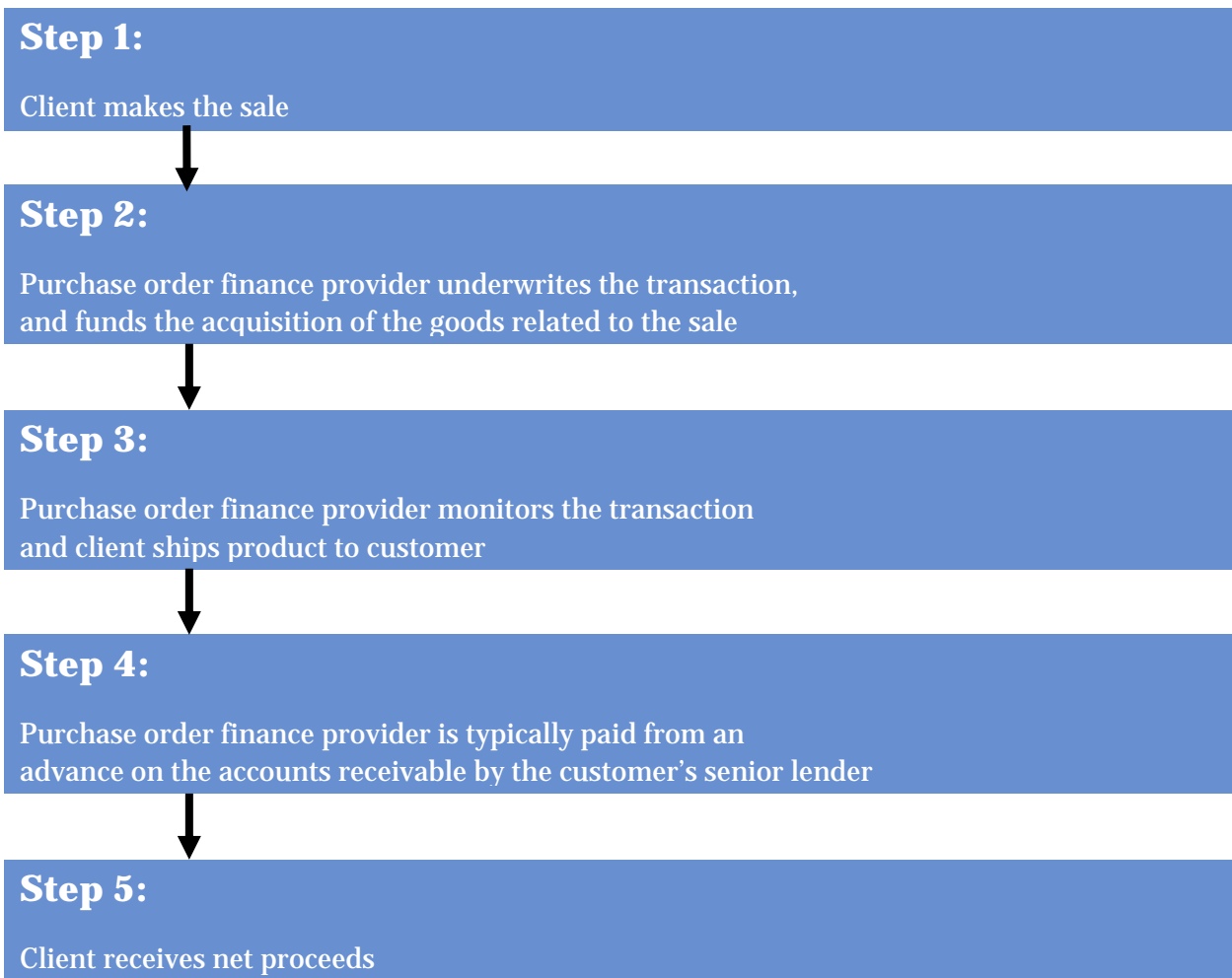


Requirements of purchase order financing

If the business would like to work with a purchase order finance provider to help meet its short-term funding needs, its senior lender needs to agree on the purchase order finance provider's requirements, including:

1. All assets created by transactions funded by the purchase order finance provider belong to the purchase order finance provider until the purchase order finance provider is paid for the assets. The senior lender must be willing to allow the transaction assets created to be junior to their lien priority until the transactions are completed. This is typically completed when the senior lender pays the purchase order finance company for the assets.
2. The transactions available must be sufficient to warrant support by the purchase order finance provider.

Typical purchase order finance provider process



Benefits of working with a company that specializes in purchase order financing

In addition to providing financing, a company specializing in purchase order finance brings the ability to assist in analyzing, structuring, executing, and minimizing international trade risk. Its expertise in international trade credit enhancements, such as letters of credit, payments, or acceptances in exchange for documents (documents against presentation and documents against acceptance) generally creates a more disciplined and profitable transaction for everyone.

Because an integral part of the financing will be to establish contractual arrangements, as appropriate, with vendors, shippers, freight and duty companies, and warehouses, the purchase order finance company's involvement may aid the client in properly structuring its transactions, facilitate product delivery, and mitigate potential risks to all involved parties.

The final result: the client may take advantage of growth opportunities leading to potential substantial increases in sales and related profits and create additional accounts receivable for banks, asset-based lenders, and factors to advance against increasing their loan outstandings and related income. Using a purchase order finance solution may enable a client to take advantage of a sales opportunity that might otherwise be missed.

Wells Fargo Capital Finance

Wells Fargo Capital Finance helps businesses expand their borrowing capacity by leveraging the value of their assets. We offer traditional asset-based financing, specialized senior secured financing, accounts receivable financing, purchase order financing, and supply chain financing to companies in a wide range of industries. In addition, specialty groups within Wells Fargo Capital Finance develop financing tailored to retailers, software and technology companies, commercial finance companies, staffing companies, government contractors, and timeshare developers.

The Purchase Order Finance Group at Wells Fargo Capital Finance has been providing customized financing solutions to companies nationwide for nearly 20 years. Our facilities work in tandem with a company's existing financing and can include programs from \$500,000 to \$50 million or more, advance rates up to 100% of the cost of pre-sold inventory, letters of credit and other short-term funding for goods purchased domestically or internationally. For more information, visit wellsfargo.com/purchaseorderfinance or call 847-282-6600.

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