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Case Studies in Credit Insurance

September 29, 2023

Enhance Borrowing Case

Company: Consumer products manufacturer

Situation: Medium sized company experiencing good growth opportunities, especially from international markets. Foreign receivables were being internally funded, which was beginning to limit their opportunities.

Operating Facts:

Annual Sales:	$200 million (50% from export sales)
Average Accounts Receivable:	$30 million
Gross Margin:	20%
Account Turns Per Year:	7

Credit Management handled by Corporate Controller

Objective: Credit risk was not the most important issue - the company was interested in leveraging assets within a borrowing arrangement, freeing up capital so they could maximize on all selling opportunities, both domestic and international.

Average Receivables	$30 million
"Eligible" Receivables (Borrowing Base)	$15 million
Advance Rate	80% (domestic sales only)
Available Working Capital	$12 million
Internal Funding Required	$18 million

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Solution: Implement a domestic and export credit insurance program that eliminated all buyer credit risk for the lender.

Results: Credit insurance transformed pledged accounts receivable into "riskless" assets for the lender, allowing an increase in advance rates, inclusion of foreign receivables in the borrowing base, and elimination of concentration limits. In total, the program was projected to make available up approximately $12 million in additional working capital for the company.

Enhance Borrowing Case

Additional Working Capital / Profit

Average Receivables	$30 million
"Eligible" Receivables (Borrowing Base)	$15 million
Prior Advance Rate	80% (domestic sales only)
Prior Available Working Capital	$12 million
Internal Funding Requirement	$18 million (capped out)
New Eligible Receivables	$30 million
New Domestic Advance Rate	90%
New Export Advance Rate	70%
New Available Working Capital	$24 million
New Internal Funding Requirement	$6 million*
Total Cost of Credit Insurance Program	$500,000
Incremental Sales Necessary to Break Even	$2,500,000 (1.25%)

* Receivables can triple before the company again reaches its internal funding cap

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Improve Your Financing!

If you have a few large customers or do a lot of exporting, **<u>you are viewed by banks as a bad credit risk</u>**! Having credit insurance improves your own creditworthiness.

Reduce concentration risk	Increase the pool of “eligible” receivables, often including foreign receivables	Increase advance rates	Reduce interest rates	Strengthen client relationships - you can offer better financing terms backed by the knowledge you can obtain funding

Some banks will **<u>purchase</u>** insured receivables, enabling programs where you can offer customers financing that will actually be carried by your bank.

If you are securitizing your receivables, credit insurance can be used to overcome concentration limits and to make foreign receivables “eligible.”

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Financing Insured Receivables

When financing insured receivables, it is important to remember these key points:

The policy will specify retention in the form of coinsurance, deductibles or both for each transaction to be insured. The bank will take this retention into account when calculating the borrowing base of eligible receivables.

- For example, if the Insured has coinsurance of 15% on a covered receivable in the amount of $100,000, our maximum claim for this buyer is $85,000 (85% of $100,000). The bank will count 85% of the invoice value as eligible in this case in order to assure themselves of a full recovery of the principal amount if a valid claim against the policy arises.
- The bank will subtract the full amount of any deductible from the borrowing base.

Although they may be used as loan collateral, it is not feasible to sell receivables covered by a policy with a deductible.

Lenders are often concerned about the additional conditions that accompany discretionary limits.

It is common for Atradius to write policies with no deductibles and no discretionary limits.

This tends to comfort lenders and facilitate financing.