Trade Working Capital Viewpoints

Monetizing Government Receivables

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Treasury and Trade Solutions

Foreword

"For corporates of all sizes and industries, monetizing their government receivables can be one of their most efficient paths to securing well priced liquidity for their organization."

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Executive *Summary*

In a challenging borrowing environment, corporate treasurers may find it difficult to secure economically priced liquidity. For corporates across a range of sizes and sectors who have government receivables, monetizing those government receivables represents an efficiently priced, diversified funding source that can be supportive of broader working capital goals.

Government contracting represents a significant opportunity: Public procurement accounts for 13% of GDP in OECD countries.[1]

Government receivables represent an efficient source of liquidity: The investment grade creditworthiness of many sovereigns makes monetizing government receivables a viable path to low-cost liquidity.

Borrowing *In the Current Environment*

Today, borrowers face higher borrowing costs as a result of increased interest rates aimed to curb inflation and overall tighter lending conditions. However, now that inflation appears to be on a cooling trajectory, central banks may begin to shift to less restrictive policy.[2] While rate cuts from the U.S. Federal Reserve and further cuts by the European Central Bank are expected in H2 2024, it remains unclear by how much as central bankers remain cautious. New York Fed President John Williams voiced "I definitely don't feel urgency to cut interest rates" at Semafor's World Economy Summit on April 18th, while indicating that he expects rates will need to be lower at some point, and that point would be dictated by the economy.[3]

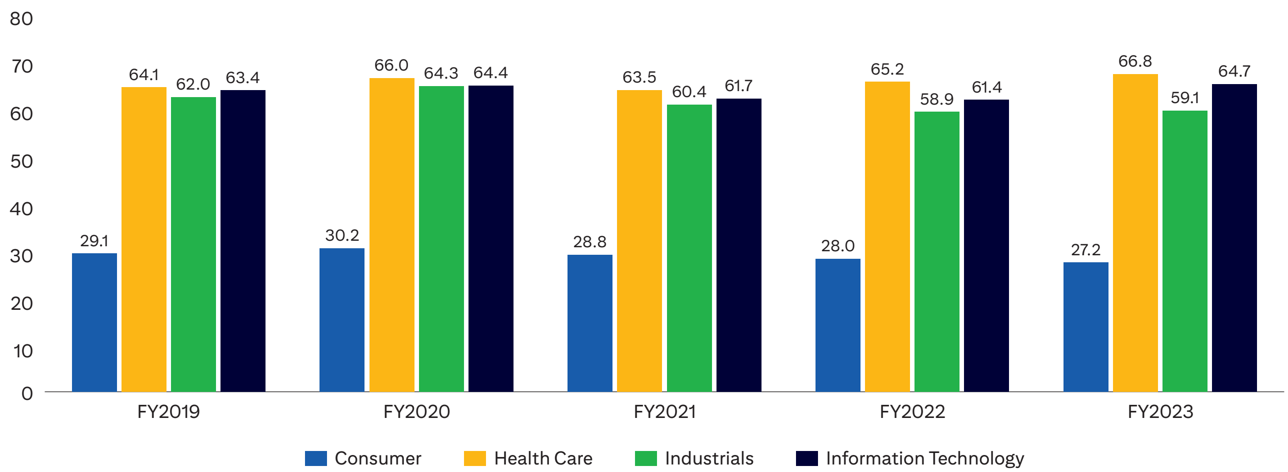
After surging during 2020, Days Sales Outstanding (DSO) has retreated to near pre-pandemic levels but remains under pressure (see Figure 1). Notably, the healthcare industry and the technology industry both saw an increase in DSO from 2022 to 2023 as higher borrowing costs have made many customers seek longer payment terms. Cash conversion cycle (Figure 2), or the time it takes a company to disburse and collect cash, lengthened from FY2022 to FY2023 for healthcare, industrials, and technology corporates. This may likely be the result of increasing, or stagnant, DSO – combined with the added inventory challenges many corporates continue to face. The current environment has given treasurers reasons to be thoughtful about how they attain liquidity, putting all solutions on the table. Corporates with government receivables have an opportunity to monetize those receivables in exchange for an efficient source of liquidity that may simultaneously improve DSO.

[1] OECD, Public Procurement Performance: A framework for measuring efficiency, compliance and strategic goals, 2023

[2] Citi Velocity, Global Economic Outlook & Strategy - Global Resilience Amid Mounting Risks, 2024, Citi Research

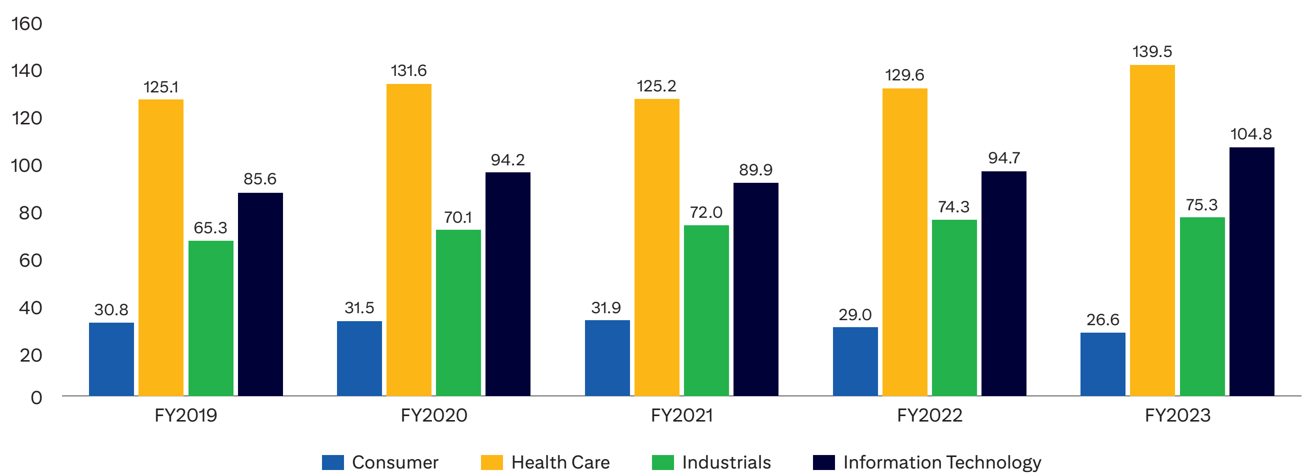
[3] Reuters, Fed policymakers agree: there's no urgency to cut rates, 2024

Figure 1. Days Sales Outstanding for Select Industries, S&P Global 1200 Index



Note: Figure is for illustrative purposes only and subject to change.
Source: S&P Capital IQ, Citi Treasury and Trade Solutions

Figure 2. Cash Conversion Cycle for Select Industries, S&P Global 1200 Index



Note: Figure is for illustrative purposes only and Subject to Change.
Source: S&P Capital IQ, Citi Treasury and Trade Solutions

Why Corporates are *Monetizing Government Receivables*

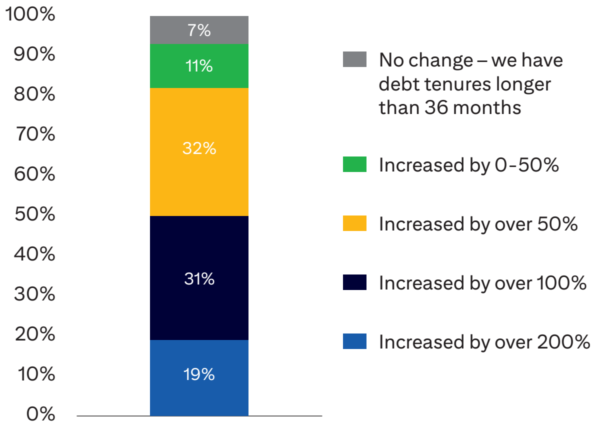
Corporates of all sizes have many reasons for seeking financing; in a rapidly shifting technological landscape corporates are making the investments in artificial intelligence and manufacturing capability that will fuel the returns of tomorrow. Elevated funding costs have been a catalyst for corporates to reevaluate their funding structures as many seek ways to limit growing interest expense and minimize borrowing costs. In a recent survey of large corporates nearly 50% of respondents saw their interest expense increase by at least 100% compared to the year prior (see Figure 3). And, for small-medium sized enterprise corporates with limited access to capital, monetizing government receivables can be an efficient path to liquidity.

The cost-effective rate corporates are able to access through monetizing their government receivables makes seeking financing against these flows particularly attractive, and often times will not significantly impact the corporate's bank lending limits. By virtue of many governments' strong creditworthiness, lenders may have higher risk appetite for financing these flows compared to other types of receivables. For this reason, lenders' risk assessment process may be faster than in other flows.

Drivers of Lower Funding Margins

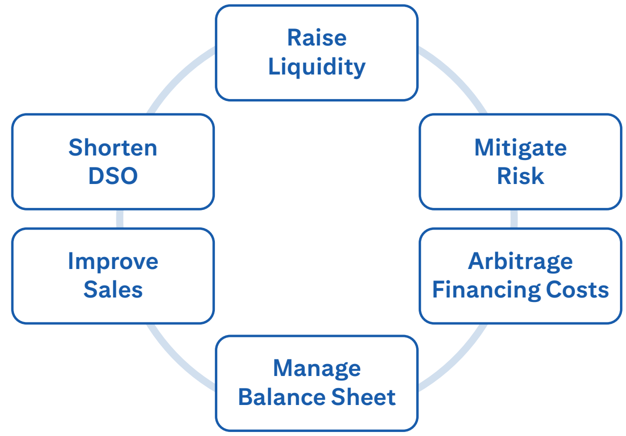
- Lender's may have less of a need to hold regulatory capital when financing government flows, which may lead to potentially lower pricing.
- Government entities may have a history of paying on time and in some cases early.

Figure 3. How much has your total debt linked interest expense changed in the last 6-12 months?



Note: Figure is for illustrative purposes only and Subject to Change.
Source: Citi GPS, East & Partners Large Corporate Survey 2023, Citi Treasury and Trade Solutions

Figure 4. Objectives of Receivables Finance



Note: Figure is for illustrative purposes only and Subject to Change.
Source: Citi Treasury and Trade Solutions

It's estimated that public procurement, or when the public sector procures from the private sector, accounts for 13% of GDP in OECD countries.[4] For corporates in a wide range of sectors, including but not limited to aerospace & defense, agriculture and healthcare, government contracting opportunities can represent meaningful revenue opportunities. One inherent risk of government contracting is the potential disruption in payments related to budgetary or funding hiatuses. In selling receivables to a lender, corporates are able to transfer that risk, securing an important risk mitigant that is especially valuable for corporates dependent on governmental flows.

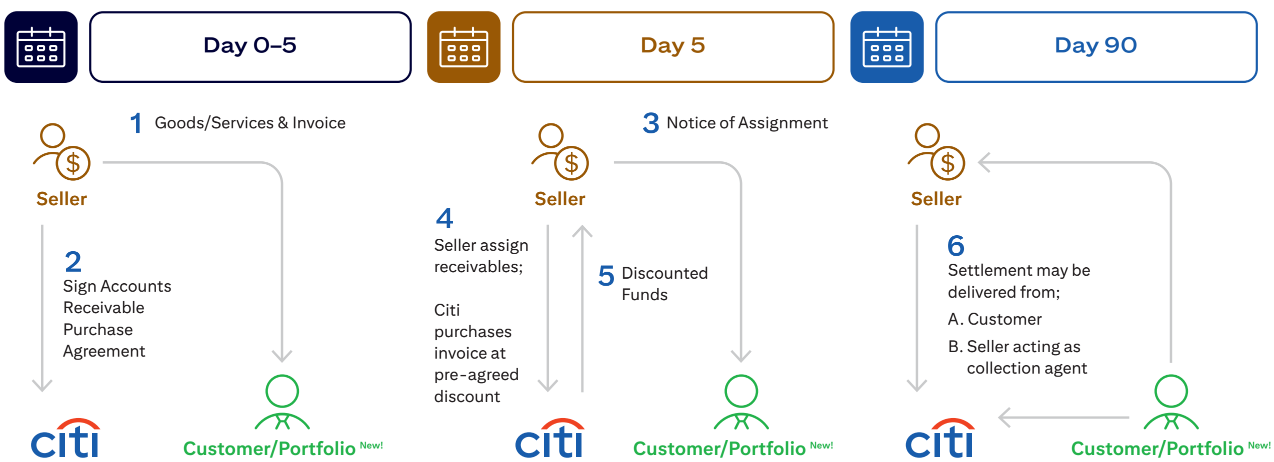
[4] OECD, Public Procurement Performance: A framework for measuring efficiency, compliance and strategic goals, 2023

How Corporates Can *Monetize Government Receivables*

With uncertainty surrounding borrowing costs and to what extent central bankers will reduce policy rates, accessing liquidity at the most efficient rates possible remains a chief concern for borrowers. Accounts receivable structures are a popular tool that corporates can use to access and manage their liquidity and may be used in conjunction with a commercial paper program as a way to manage their liquidity position.

While each structure can vary significantly from client-to-client, Figure 5 represents how a government receivable program may work. After a corporate invoices for a good or service to a government buyer, it would then enter into a receivable purchase agreement with a lender who then purchases the receivable from the seller in exchange for funds at a predetermined discount. At settlement, sellers may act as collection agent in repayment to the lender.

Figure 5. Account Receivables Finance Flow



Note: Terms and conditions apply.

Corporates commonly seek to monetize proceeds from contracting awards. In some jurisdictions VAT receivables, or tax credits, such as those for R&D incentives, may also be underwritten. In the US, corporates' ability to transfer clean energy tax credits has resulted in a new opportunity for corporates to monetize receivables at a time when many are managing a transition to more sustainable operations.

For one federal contractor completing work across several agencies, including the Federal Aviation Administration and Department of Veterans Affairs, government receivables represent a significant portion of their accounts receivable. They sought additional channels to security liquidity, other than its revolving credit facility (RCF), to support capex given the organization's heavy focus on R&D.

Given the high-quality nature of the corporate's government receivables, a structured accounts receivable finance program was the right solution to help the corporate access liquidity at an extremely efficient rate.

Partnering closely with the client, Citi provided a structured solution that monetized receivables from multiple federal agencies, supporting the client's strategic aspirations. Additionally, Citi helped formulate a cost-efficient onboarding solution aimed to incorporate the client's unique billing cycle with limited administrative requirements.

Converting Tax Receivables into an Efficient Funding Source

For many corporates, both in the mobility industry and outside the mobility industry, research and development accounts for a significant portion of their capital expenditure. For governments, incentivizing research and development can be a significant contributor of economic activity, yielding among other things, quality jobs within their country.

For a major, global OEM, France's R&D tax incentive programs yields a refund in excess of EUR 100mm annually. To eliminate these medium-term receivables from pooling on their balance sheet, the OEM chooses to partner with a financial services intermediary and discount these receivables in the market.

Since the obligor is a sovereign government, which can often be very well rated, Citi was able to structure an accounts receivable financing arrangement that provided the OEM with a cost efficient, diversified source of liquidity. The transaction was a win for the client as the they were able to tap an efficient source of liquidity that they could then reinvest back into their business.

Considerations When Monetizing Government Receivables

As is the case with other forms of accounts receivable financing, monetizing government receivables are structured solutions tailored to each corporate's particular needs and circumstances. Financing government receivables can be more nuanced than other forms of receivables and not all lenders may be willing to provide financing against these flows.

Monetizing government receivables may be subject to additional rules and regulations, and greater offset risks, not applicable to other corporate receivables.[5] For example, receivables due from the United States government and its agencies are likely governed by the Federal Assignment of Claims Act. Similar rules exist within the European Union but vary by each member. Additionally, lenders may take into consideration the underlying product being exchanged that is creating flow when electing to underwrite receivables financing. A large relationship bank, such as Citi, with experience working with over 40 U.S. federal agencies can help corporates assess how to potentially monetize receivables and help improve their overall working capital strategy.

Staying the Course on *Working Capital*

Through any point in the economic cycle maintaining access to liquidity and careful working capital management are essential components to facilitating investment in emerging technologies such as AI or advancing a sustainability agenda. Monetizing government receivables can be one of a corporate's most efficient sources of liquidity.

- **Putting valuable assets to work:** Due to the strong credit rating of many sovereigns, government receivables may be some of the most valuable assets on a corporate's balance sheet, providing a cost-efficient path to liquidity.
- **Resilient and growing businesses require stable access to liquidity:** Maintaining multiple channels to liquidity is conducive to the flexibility needed to navigate varied economic conditions and fund strategic initiatives.

Citi's global Working Capital Advisory team can help firms interested in incorporating government receivables financing into their funding mix assess their options and determine a strategy that is supportive of their overarching working capital goals.

[5] Citigroup is not acting in an any advisory role in relation to Legal, Tax, or Accounting issues relating to this structure or otherwise. All companies should obtain their own Legal, Tax, or Accounting advice in relation to your evaluation.

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