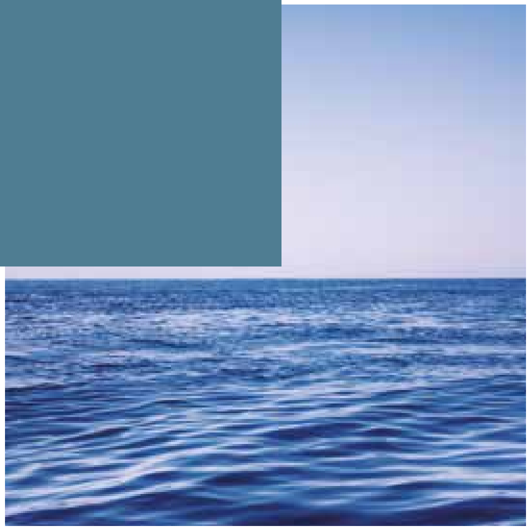
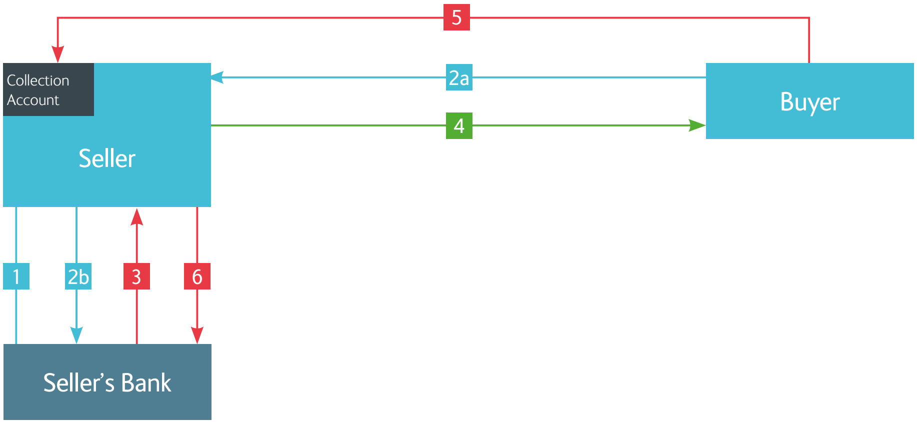
Simmons & Simmons

Structured Trade & Commodities Finance



Pre-shipment Finance



Mechanics

1 Seller enters financing arrangement with the Bank. This may involve security over the underlying works/ receivables/finished goods related to the financing.

2a The Buyer sends a Purchase Order (PO) to the Seller.

2b The Seller forwards the PO to the Bank in evidence to drawdown working capital funds in order to manufacture or prepare the goods for shipment.

3 Funds are provided to the Seller.

4 Finished goods are sent to the Buyer by the Seller in accordance with the PO.

5 The Buyer pays the Seller on receipt of goods or in accordance with the Seller's invoice and into a controlled account or Collection Account that is subject to a charge in favour of the Seller's Bank.

6 Seller repays the Bank in accordance with the terms of the financing arrangement but usually tracking the payment patterns of the Buyer's POs or cash cycle.

Pre-shipment Finance

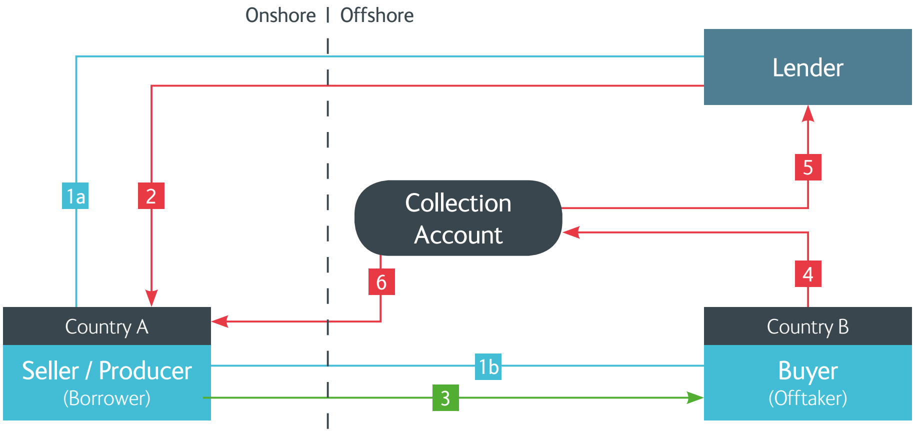
What is it?

1. A loan provided to a Supplier for sourcing, manufacturing or conversion of goods to finished goods, which are then shipped to a Buyer.
2. Also known as Purchase Order Financing, Packing Finance or Contract Monetization.

Core features

1. Financing can be provided against POs, demand forecasts, or underlying commercial contracts.
2. Can cover a series of POs or be conducted on a transactional basis.
3. The financier may provide post-shipment finance in conjunction to this PO financing arrangement, often called a Multi-Trade Facility.
4. Sources of repayment from the Buyer may include the proceeds of Letter of Credit or Bank Payment Obligations.
5. The Seller's Bank will usually lend a certain percentage of the PO, and disburse it in stages only as the PO is being fulfilled.
6. The facility's maturity date is usually agreed between the Seller and the Seller's Bank, and is linked to the date of the Buyer's payment in order to provide self-liquidating risk mitigation.
7. The Seller's Bank is subject to non-payment of the Buyer and non-performance of the Seller, this can be mitigated by:
   - having inspection rights over the Seller during the period of manufacture or conversion; or
   - assessing the commercial history and supply chain performance between Seller and Buyer.

Pre-export Financing



Mechanics

1a Lender and Seller enter into a Pre-Export Finance agreement (PXF Agreement) whereby a facility is made available for the purposes of the purchase of raw material, production and the export of goods and structured together with a specific purchase agreements in place with the Offtaker.

1b Buyer, or Offtaker, enter into longer term commodity purchase Contract of Sale with the Producer, usually matched to the tenor and repayment profile set out in the PXF Agreement.

2 An advance is made by the Lender to Seller of, for example, upto 90% of the Offtake Contract, as an utilisation of the PFX Agreement.

3 Seller then exports and ships goods to Offtaker.

4 Buyer pays for goods into a specified Collection Account, that is segregated from the general cash accounts of the Seller, and secured in favour of the Lender.

5 The Lender is then repaid scheduled repayments and interest from monies in the Collection Account or a specified debt service repayment account in accordance with the PXF Agreement.

6 Any excess cash after Lender has been repaid can then be swept or released back to the Producer in accordance with a prescribed account waterfall procedure set out in the PXF Agreement.

Pre-export Financing

What is it?

Advance funding to an exporter or producer to enable the production or supply of goods to be exported. The Lender makes a direct loan to the Seller in order for them to purchase materials and refine products that are not yet ready for export. In turn the producer is able to give the Offtaker potential buyer credit terms. The Lender gets paid from Buyer on delivery of goods from the producer under an Offtake Contract.

Core features

1. The Exporter will often be situated in less developed and politically higher risk countries.
2. The Lender will often be located offshore in a financially mature country but will have experience in doing business in the less developed location.
3. The Lender will often have a long standing relationship with the Buyer (Offtaker) and will understand his business model as ultimately the Lender receives payment from the Offtaker in the form of the Seller's receivable.
4. Most important Security granted to the Lender are assignments of the Offtake Contract and control over the Collection Account. Therefore, the structure is often seen as having a limited security structure. Because of the jurisdiction of the Producer it is unlikely any collateral granted by the Seller will be a form of acceptable collateral for a typical direct loan.
5. LMA has now produced a LMA PFX agreement for international Pre-export transactions.

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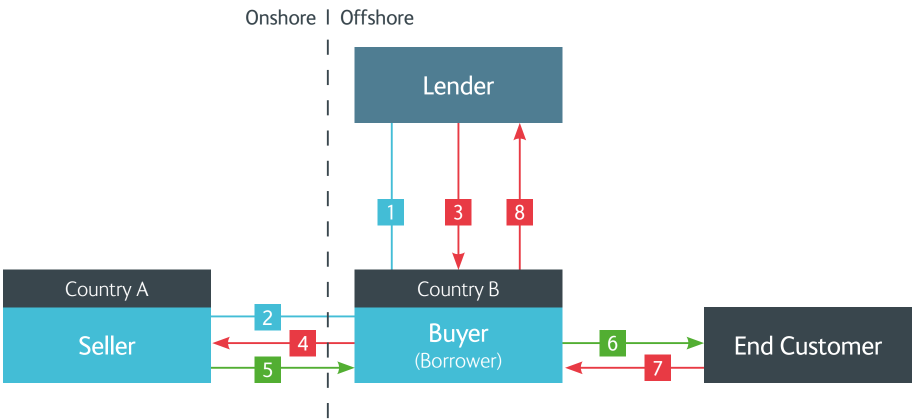
Prepayment Financing



Mechanics

1. Lender and Borrower enter into a finance prepayment arrangement subject to satisfactory conditions precedent and legal documentation.
2. Buyer and Seller enters into Contract of Sale, a specific term of which includes that the Buyer will make a prepayment of consideration in advance of receipt or shipment of goods
3. Lender advances funds to the Buyer.
4. Buyer advances prepayment to the Seller.
5. Seller can use monies to produce, mine or process goods in order to perform under Contract of Sale. Seller then ships goods to Buyer.
6. Buyer sells goods onto End Customer.
7. End Customer pays Buyer for goods.
8. Buyer repays the Lender in accordance with terms of the prepayment facility which is often linked to the delivery schedule of the goods set out in the Contract of Sale.

Prepayment Financing

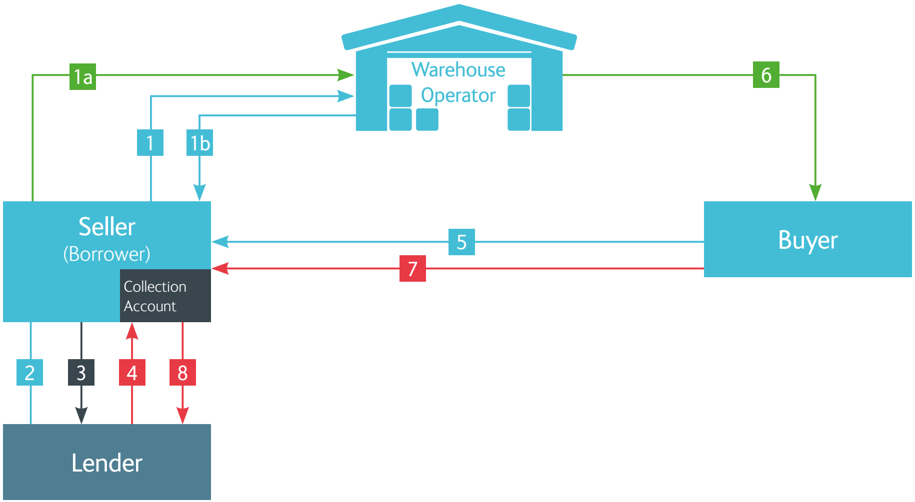
What is it?

Credit facility under which the Lender provides an advance to Buyer for prepayment to Seller under the Contract of Sale. The advance can address the Seller's funding issues and by offering the Seller advance payment before delivery of goods enables Buyer to secure a favourable long term contract price. Seller delivers goods to Buyer which in turn sells to End Customer. Repayment is realised from the sale to End Customer. This structure is also known as Indirect Pre-Export Financing.

Core features

1. Seller and Buyer in these structures are often located in different jurisdictions.
2. The loan is often made on a limited recourse basis against the Buyer. Therefore the payment risk of the Offtaker is passed onto the performance risk of the Seller. To mitigate performance risk taken by the Lender, they will often insist on performance guarantees of the Seller or some kind of ECA standby L/C or guarantees.
3. There is no direct relationship between the Lender and Seller and the transaction can be structured as self-liquidating. The Lenders, in providing this type of facility, often maintain long-standing relationships with the Buyer – although as a trader often thinly capitalised – and so understanding the supply chain cycle is of critical importance.
4. Given Lender and Borrower are both offshore, the structure tends to provide some resilience against country default.
5. Will include a limited Security package, but control by the Lender over the Export or Offshore contract and Collection Account is very important.

Warehouse and Inventory Financing



Mechanics

- **1** Borrower and warehouse provider enter into an agreement.
- **1a** Goods are sent to the warehouse.
- **1b** Warehouse issues a warehouse receipt for storage of goods.
- **2** Lender and Borrower enter into financing agreement.
- **3** Borrower provides security to Lender in form of a Charge over receivables; a Security Interest over the Warehouse Receipts; and Pledge of goods.
- **4** Lender releases financing to Borrower.
- **5** Buyer sends PO to Seller under existing or new Contract of Sale.
- **6** Seller sends goods to the Buyer from the warehouse.
- **7** Buyer pays the Seller for the goods. The payment is placed into the Seller's bank account (usually subject to a Charge) held with the Lender.
- **8** Seller repays Lender in accordance with the financing agreement but usually linked to monies due and received from the Buyer ensuring Self Liquidating characteristic of the financing arrangement.

Warehouse and Inventory Financing

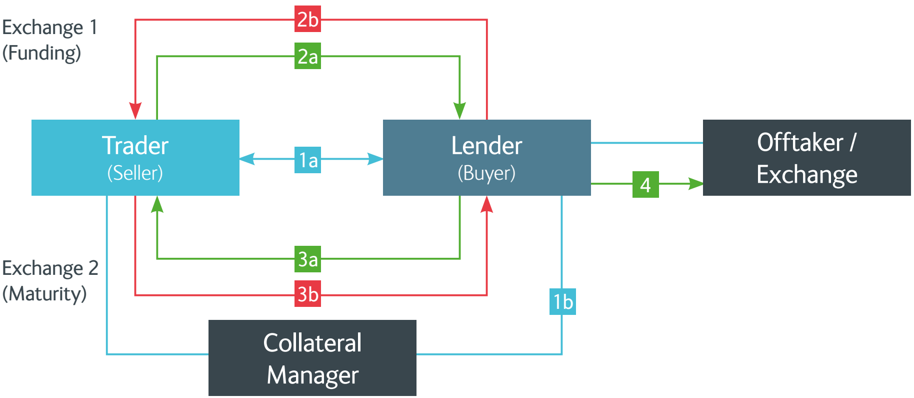
What is it?

1. Financing given to a Borrower in exchange for security over inventory or goods.
2. Also known as Warehouse Finance, Inventory Sale and Repurchase.

Core Features

1. Usually a short-term uncommitted facility with annual review.
2. Usually constrained by the time frame that inventory awaits sale.
3. It is possible for the Borrower to store the goods on-site, and not use a warehouse operator. In such a case, the Borrower will give the Lender a pledge of the goods, or an assignment of rights relevant to the inventory location, in place of warehouse receipts.
4. Ancillary agreements with warehouse operator and third party collateral management or inspection agents may be used often known as a Collateral Management Agreement.
5. Goods that are in transit may also be included within this arrangement. Security over goods in transit may be given in form of bills of lading consigned to the Lender.
6. A major risk to the Lender is the resale value of the inventory/goods. The loan is usually only a percentage of the inventory's value. The Lender must be confident of its ability to re-possess and dispose of the inventory in the event of Borrower default. Typically confined to qualifying marketable commodities which value is easy to ascertain. Where the finished goods or work-in-progress has potential lack of marketability, Lenders may require a buyer to be identified as a condition to drawdown.
7. Title to the goods will usually be held by the Lender for the duration of the loan. Title is released when the loan is repaid, or the inventory is purchased.
8. To perfect any security given, the goods must be identifiable, and the Lender must be able to exert control over the goods.
9. It is a risk that a Borrower may double-pledge their goods. Lenders should check that they can control good title over the goods.
10. Destruction of goods will lead to a Borrower being unable to repay. Lenders should ensure that appropriate insurance is taken to cover loss and damage to the goods.

Repurchase (Repo)



Mechanics

1a Seller, usually a trader, enters into a master purchase and sale agreement (MPSA) with a Buyer, usually a Lender or financial institution.

1b The Buyer, Seller and a Collateral Manager can sign upto a Collateral Management Agreement. The Collateral Manager, usually a warehouse operator or surveillance company, is employed to control the asset in its storage facility, monitor levels of the commodity and report directly to the Buyer.

2a A Repo is a two part exchange between the parties. In the first exchange, Seller delivers the assets to the Buyer, together with the commitment to buy back the assets at a specified date in the future.

2b Simultaneously, the Buyer will advance cash to the Seller at an amount equal to the market value of the assets.

3a The second exchange occurs at maturity, when the Buyer returns the asset to the Seller.

3b Simultaneously, the Seller repays the original cash amount to the Buyer plus an agreed sum of interest – known as the Repo Rate.

4 In the event of a default by the Seller (to repurchase the goods), the Buyer, as owner of the goods can sell them to a pre-arranged conditional offtaker (in less liquid goods) under a conditional offtake agreement or sell the goods on a commodity exchange to recover the original position.

Repurchase (Repo)

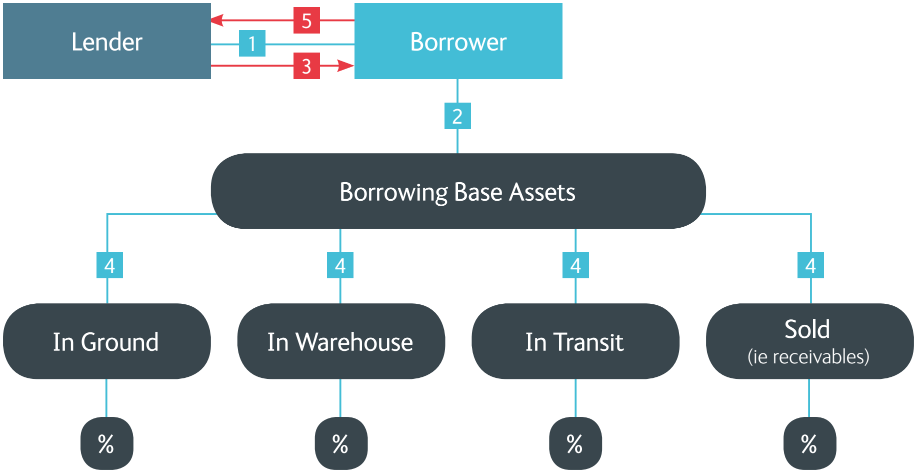
What is it?

A Repurchase or Repo is a form of inventory finance pursuant to which a creditor purchases, on a True Sale basis and as owner, goods from a debtor and sells the goods back to the debtor following the expiry of a specified period. The Repo is effectively a cash transaction with a forward contract. The difference between the full price and spot price is effectively the interest and the settlement date of the forward contract is effectively the maturity date.

Core features

1. The Repo transaction can be perceived as a collateralised loan. However, the legal relationship is as a sale and repurchase and not a debtor creditor relationship as per a loan. Given that the Repo is entered into on the basis of full True Sale and title transfer the Buyer must complete all the correct due diligence to ensure the Seller has good title and can legally transfer title to the Buyer.
2. To mitigate exposure from changes in market price movement, the commodity is usually marked-to-market. Therefore, this allows the Buyer to call for additional cash or top-up of additional asset should the price fall.
3. Given that the Buyer is obligated to return the assets at maturity there must also be a right of set-off in the event of an insolvency of the Seller prior to the maturity date. Furthermore, the Lender will want the resale to be on a "as is, wherever basis" to avoid additional disputes on the goods on return.
4. There is the risk of re-characterisation by the courts that the sale and purchase of goods is characterised as loan secured on the goods. If that is the case, then the Lender will be deemed not to own the goods and the goods will form part of the Seller's estate on an insolvency. It is more than likely that there would be no valid security in that case and the Lender merely has an unsecured claim against the debtor.
5. In order to avoid any re-characterisation these must be carefully drafted documents.
6. The key to a Repo is that the Lender has ownership in absolute terms and not just a security interest over the goods. The benefit of this is that, on an insolvency of the Seller for example, the Lender can sell the goods without any competing claims over the goods.
7. As an owner of the goods, the Lender must act as an owner and have the requisite skills to deal in that particular goods or commodity. Issues that might need to be considered by the Lender include risks associated with insurance responsibility, relationship with the storage provider or damage or loss of goods.

Borrowing Base Lending



Mechanics

1. Borrowing Base facility agreement signed between Lender and Borrower whereby utilisations can be made provided the Borrower demonstrates an adequate cover of collateral relative to the amounts borrowed – this is known as the Borrowing Base.
2. Security interests, or otherwise known as collateral, is granted under Security Agreement(s) by the Borrower and other security provider(s) in favour of the Lender over the assets in the Borrowing Base. Borrower and the other security provider perfects the securities created under the Security Agreements(s) in accordance with local law requirement.
3. Lender provides funding to Borrower based on a percentage of the available collateral pooled within the Borrowing Base.
4. The Lender can adjust the credit limit in line with the Borrowing Base from time to time.
5. Repayments made by Borrower to Lender as scheduled under terms of Loan Agreement or in the event of any price fall or collateral value deterioration.

Borrowing Base Lending

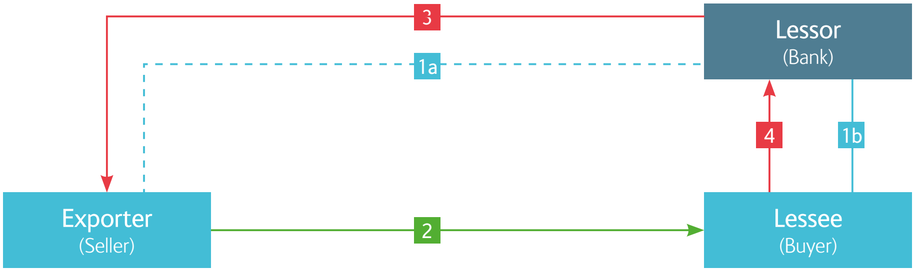
What is it?

Credit facilities secured by way of collateral furnished by the Borrower or third parties for a flexible source of funding. The amount of available facility is adjusted according to the underlying value of the collateral, i.e. the Borrower may increase the credit limit in line with its financing requirements from time to time by varying the amount of the collateral furnished.

Core features

1. Borrowing Base Report will be issued periodically during the term of the facility to determine the value of the Borrowing Base and thus the credit limit.
2. The key difference between a Borrowing Base Lending and a traditional working capital asset based facility is that Lender of a Borrowing Base Lending has discretion (subject to agreed parameters) to revise commodity pricing assumptions in valuing the collateral and setting the credit limit.
3. The collateral pool to be taken will vary depending on the asset base and the jurisdiction in which they are situated. These often can be (a) security over bank accounts, (b) assignment of key contracts, (c) stock or inventory and (d) security over physical reserves in the ground.
4. In taking security over the Borrowing Base, the Lender should take note the legal and regulatory requirement (e.g. licensing) in the jurisdiction where the Borrowing Base assets are located, and the effective creation and enforcement of securities in these jurisdictions.
5. Depending on the quality of the collateral, the Lender will discount, by a percentage of the asset being furnished or reported in the Borrowing Base Report. For example, cash in a charged account may be allocated a percentage of 100% due to the ease with which that collateral can be realised. Security over receivables may be allocated slightly less if in an easily reasonable jurisdiction against a debt in that jurisdiction (or whether or not insurance is attached to a particular receivable). However, security over production inventory, or even more so raw asset in ground (i.e. reserves) will be allocated at a far lower percentage given the difficulty to liquidate the security asset.

Lease Financing



Mechanics

- 1a Exporter and Lessor usually a bank or financial institution enter into sales agreement for the purchase of equipment or machinery.
- 1b Lessor enters into a leasing agreement with the Lessee.
- 2 Delivery of equipment is usually made directly to the Lessee.
- 3 Bank pays Exporter amounts in the invoice.
- 4 Lessee makes repayment and interest payments to the Lessor.

Lease Financing

What is it?

A medium term financing structure used primarily for assets such as machinery, equipment and vehicles. The lease is a contract where the Lessor provides an asset for usage to the Lessee for a specified period of time in return for specified payments. The Lessee has the legal right to use the asset for the period without owning or title to the asset which remains with the Lessor.

Core features

Leases fall into two categories:

1. Operating lease – often termed as a rental and where the Lessee uses the asset but risk of ownership and all corresponding related rights (e.g. insurance and maintenance) is borne by the Lessor and remains on the Lessor's book. The duration of the lease is usually much shorter than the expected life of the asset.
2. Finance lease – where practical risks of ownership are borne by the Lessee. From the lease payments the Lessor is expecting to recover the capital cost of the equipment together with interest for the period of the lease. From a tax perspective the equipment remains on the books of the Lessee.
3. Detailed knowledge of the legal and tax implications is crucial in leasing. For example, should, and who is responsible for any sales tax. Legal ownership may depend on a particular's jurisdiction interpretation of whether an operating or financing lease considering factors such as length of lease, in relation to the life of the asset or transfer of ownership. Legal ownership is important in relation to allocation of commercial and political risk. For example, who is responsible for any damage or third party claims.
4. Often Export Credit Agencies (ECAs) offer insurance policies to facilitate this form of trade finance (see ECA Finance).