

ISSUER IN-DEPTH

15 December 2015

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RATINGS

Abengoa S.A.

CFR	Caa3
Outlook	Negative

Source: Moody's Investors Service

KEY METRICS:

Abengoa S.A.

	06/30/2015	12/31/2014	12/31/2013
Total Revenue (USD Billion)	8.7	9.5	9.6
EBITA (USD Billion)	1.3	1.4	0.7
Debt/EBITDA	12.2x	11.7x	13.5x

Source: Moody's Financial Metrics

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Abengoa S.A.

Reverse Factoring Has Debt-Like Features

- » **We believe that Abengoa's reverse factoring has debt-like features.** Spanish environment and energy group [Abengoa S.A. \(Caa3 negative\)](#) discloses a large-scale reverse factoring programme, which is reflected in both our rating and our credit metrics. There are several reasons why we think its reverse factoring has debt-like characteristics: a bank provides funds, which may enable buyers to extend payment times and sellers to be paid sooner; the bank's payment to the supplier transforms trade payables into liabilities owed to a bank; bank credit lines for reverse factoring are in most cases uncommitted.
- » **Reverse factoring can be used as a short-term financing tool for long-term needs.** Reverse factoring is effectively a short-term form of financing because banks can unwind the arrangement with little warning, similar to regular factoring of trade receivables. Similarly, these activities can become a permanent feature of a company's financing activities. We believe that if these sources of funding were to become unavailable to a company, this could affect a company's short-term liquidity, especially at a time of stress, exacerbating other problems. In this respect, we note that Abengoa recorded a significant contraction of working capital of approximately €400 million in Q3 2015, which was one of the reasons that forced the company into the pre-insolvency proceeding, which was announced on November 25, 2015. .
- » **We believe that Abengoa's case is not unique.** Lack of disclosure can make the extent of reverse factoring hard to measure, as accounting standards do not always require disclosure of this activity. Auditors sometimes accept that companies include reverse factoring as part of trade payables in their accounts, which means it is not reported separately and therefore cannot be separately identified in standard credit metrics. As such, we believe that this practice is likely more widespread than is reported, and possibly more so in countries or sectors where reported trade payables are longer-term in nature.

Reverse factoring at Abengoa has debt-like characteristics

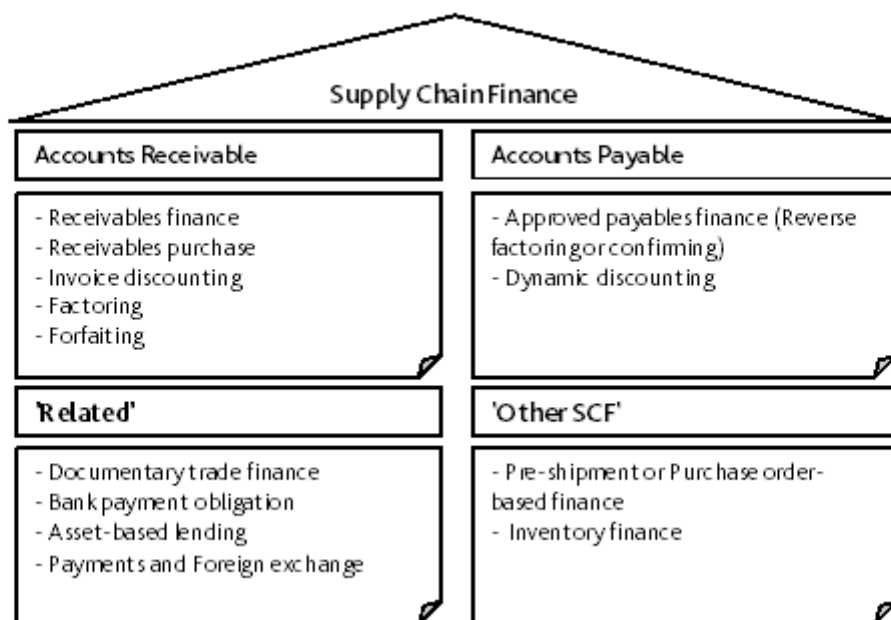
Reverse factoring is a type of supply-chain financing which we have included in our analysis. Analytically it has had the effect of increasing leverage since it is viewed as debt-like.

Companies usually include reverse factoring as part of trade payables in their accounts, as long as there are no material changes to the conditions of the trade debt (for example, to the due date, the amount or the interest rates). We understand that this is accepted by auditors and in line with existing accounting standards. Because reverse factoring is not classified as debt in the accounts, it is not reflected in our standard credit metrics. Companies are not always obliged to publicly disclose reverse factoring and, as a result, most don't. We believe that reverse factoring amounts to a short-term financing tool, which carries risks as well as benefits to the buyer.

Supply chain financing is an umbrella term for instruments used to finance working capital and is one of the many methods companies use to provide short-term liquidity, as shown in Exhibit 1, but also to improve working capital and leverage ratios. It is also an instrument to outsource a company's payables management to a bank. Reverse factoring, also known as "confirming", was first used by big aerospace and manufacturing companies who took advantage of their relatively strong creditworthiness to help provide working capital for smaller suppliers with weaker credit profiles.

Exhibit 1

Overview of Supply Chain Finance



Source: Euro Banking Association (2013)

The reverse factoring process is usually initiated by a buyer of goods or services and involves the supplier and a bank, or factor. A typical transaction involves the following steps:

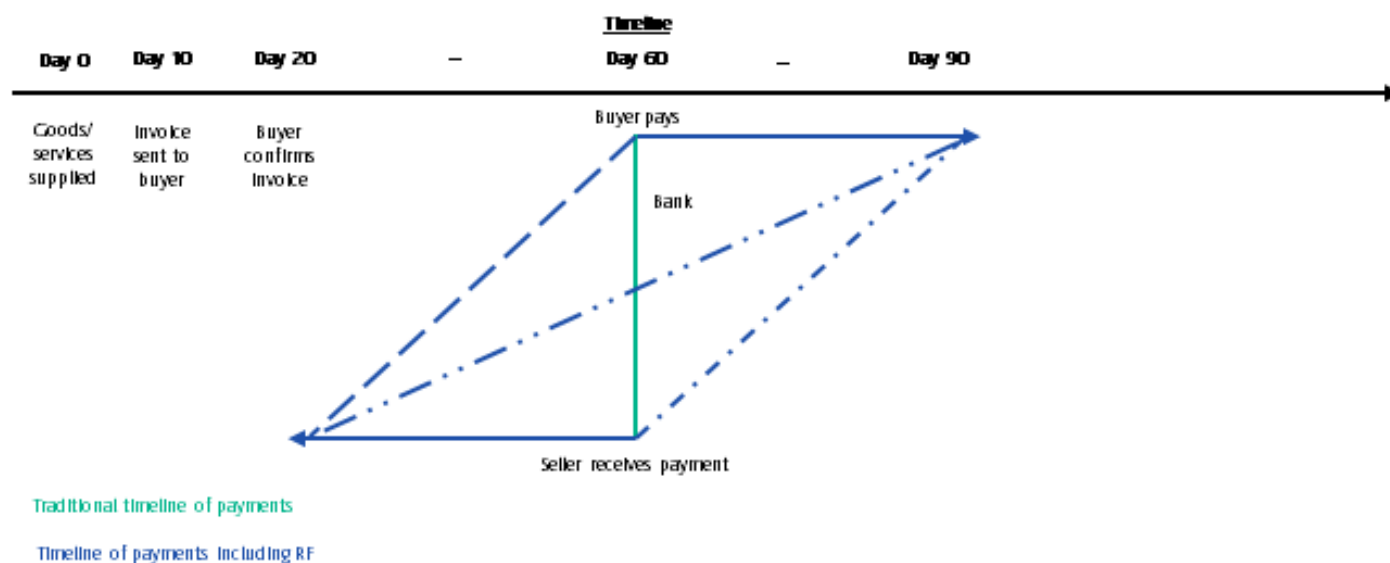
1. Supplier delivers goods or services to the buyer
2. Buyer approves (or "confirms") the invoice amount
3. Bank pays the supplier, after deducting a fee, which is implicitly or explicitly covering interest payments and handling fees. The payment may be materially sooner than the normal invoice payment date.

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4. Buyer pays the bank

The bank allows the buyer to take longer to pay than the standard payment terms and/or the seller to receive the money earlier. Payment terms vary from country to country, from 30 to 60 days in northern and western Europe to up to 180 days in southern Europe. The disconnect in the timing of cash flows between buyer and seller is a key feature of reverse factoring and improves working capital for both parties (see Exhibit 2).

Exhibit 2



Source: Moody's Investors Service

Abengoa's liabilities for reverse factoring bear some similarities to debt liabilities, such as:

- » The involvement of a bank, which provides the funds, enabling Abengoa to extend payment times, while, at the same time, suppliers can be paid sooner.
- » The bank's payment to the supplier in essence transforms trade payables into liabilities, which Abengoa owes to the bank. Once invoices are confirmed by Abengoa, the bank can pay the seller. After this has happened Abengoa owes money to the bank, not to the supplier.
- » Bank credit lines for reverse factoring are in most cases uncommitted, so they could be withdrawn at short notice. If that happens, the loss of this source of financing increases working capital requirements for Abengoa and the sellers and concurrently weakens liquidity for both.
- » It offers cost savings, which are usually shared between buyers and banks. The pricing terms in reverse factoring are better compared with traditional factoring arrangements, because banks take a usually higher credit quality of the buyer into consideration, when calculating the discount rate on the supplier's receivables. According to the Association of Chartered Certified Accountants, a global professional body, the potential cost saving usually ranges from 100 to 130 basis points over the base rate. The benefits from reverse factoring are shared between buyer and the bank. Without these interest cost benefits, buyers might have to accept less favourable terms and conditions for the goods or services.
- » Banks may require deposits from buyers, especially if they are speculative-grade companies. Depending on the credit quality of the buyer, these deposits may account for more than half of its trade payables linked to confirming/reverse factoring lines. Abengoa usually provides deposits in the form of cash and cash equivalents or short-term financial investments.
- » Reverse factoring may result in interest expenses for Abengoa. This can be direct or indirect, such as in the form of other financial expenses.

Reverse factoring can be a short-term financing tool to meet long-term needs

Reverse factoring is effectively a short-term form of working capital financing given the short-term nature of trade payables, and the risk that banks could unwind related credit lines with little warning.

Disclosure of reverse factoring in accounts may be voluntary. However, we expect companies to be transparent about their use of a financing tool which can deliver substantial liquidity benefits - or short-term liquidity shortfalls if the structure is unwound. If companies are using reverse factoring which is appropriately matched against financing needs, then disclosure helps to reinforce that message to investors. Conversely, weak or non-existent disclosure in our view, does not fully inform investors to the potential risks involved.

Resorting to reverse factoring may be an early sign of developing liquidity stress if it's not a tool that corporates normally use, or high risk appetite if it's used as a permanent part of the capital structure.

Lack of disclosure can make extent of reverse factoring hard to measure

The reason why companies include reverse factoring in trade payables is that it does not substantially change contractual terms and conditions between buyer and seller, and its cost is accounted for as "other financial expenses" or other cost, rather than interest payments. As a result, auditors accept that companies do not see a change in the nature of the liability and therefore do not move reverse factoring to financial liabilities on their balance sheets.

In this respect, we note that there is need for further improvement of the quality of disclosures in the financial statements of companies, which are doing reverse factoring. Our view is also supported by regulators, such as the European Securities and Markets Authorities (ESMA), which promoted such improvements in a public statement on October 27, 2015, specifically by encouraging issuers to present entity specific disclosures and focus on materiality.

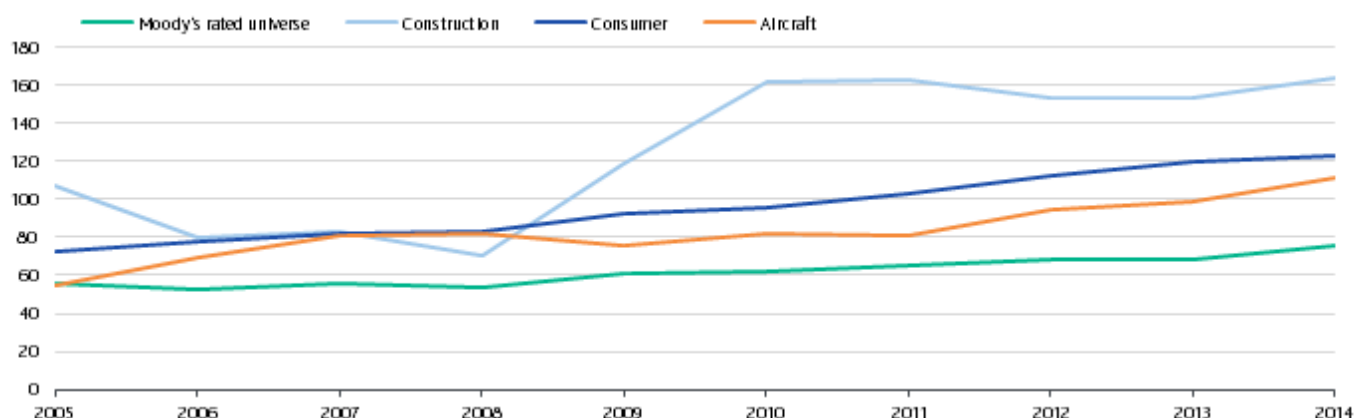
We think reverse factoring is most common in sectors where buyers' ratings are much higher than their suppliers, such as automotive, retail and industrials. In these cases, reverse factoring allows lower rated suppliers to benefit from the higher rating of their clients.

Reverse factoring is also common in construction, where ratings are usually lower, and companies are looking for additional sources of liquidity, without increasing reported financial debt.

The lack of disclosure makes it hard to estimate how widely reverse factoring is used. An important indicator is therefore the evolution of trade payable days, which measures trade payables outstanding in relation to cost of production.

From 2005 to 2014, there has been an extension of trade payable days by more than 35% to 76 days from 56 days across Moody's global rated universe, as shown in Exhibit 4 below. This suggests buyers of goods and services have taken measures to improve working capital, possibly including reverse factoring. The exhibit also shows the three sectors with the highest level of trade payable days: construction (164 in 2014), consumer (123) and aircraft (111). Trade payable days in these sectors have also grown significantly more than the rest of the rated universe.

Exhibit 3

Trade Payable days have got longer

Source: Moody's Investors Service

We think government initiatives to help suppliers get paid on time could help support future growth in reverse factoring. The European Union's Late Payments Directive requires buyers to pay their invoices within 60 days, unless they expressly agree otherwise and if it is not grossly unfair. So far, 27 of the 28 member states have implemented the directive into national law. Only Germany has not done this so far, because local standard practice for payments is shorter than the guideline set by the directive. The US government's voluntary SupplierPay initiative recommends large corporates pay small and medium-sized suppliers within 15 days. Payable days are therefore very dependent on geographical spread.

Given the longer-than-targeted trade payable periods in many sectors, many buyers will require additional working capital to meet these government initiatives. We expect reverse factoring could play an important role as an alternative to other financing sources, particularly in countries such as Spain or Italy, which have typically much longer payment times.

All three parties in reverse factoring, the buyer, bank and the supplier, have an incentive to participate. The buyers are able to delay final payment and enhance liquidity, as discussed above, while maintaining their relationship and payment terms to suppliers; conversely, for suppliers it can result in an earlier payment for goods or services; while the banks earn a margin as an intermediary.

Abengoa's accounts are transparent by disclosing significant reverse factoring

In our view, companies such as Abengoa that voluntarily disclose reverse factoring have a more open and transparent approach to reporting than those who use it without disclosure.

Exhibit 4 shows Abengoa's reported, non-adjusted leverage metrics for 2013 and 2014 on a consolidated level.

A considerable part of Abengoa's cash and cash equivalents relates to deposits for confirming debt (i.e. reverse factoring) and is therefore not available for the repayment of financial debt. We understand that this deposit, which amounts to slightly more than half of the accounts payable under Abengoa's confirming scheme, is required by banks in order to minimize their credit risks, especially once Abengoa's suppliers have factored their receivables with the banks. We note that Abengoa positively considers these deposits in their net leverage calculation. Given the very high amount of cash linked to Abengoa's confirming lines, we think the consolidated net leverage metric does not sufficiently illustrate the leverage situation of the company, and further analysis is necessary.

Exhibit 4

Reported financial leverage without considering confirming (reverse factoring)

	2013	2014
Group EBITDA	1,267	1,408
Consolidated Gross Debt	11,852	10,162
Current financial investments	926	1,049
Cash and Cash equivalents	2,952	1,811
o/w deposit and cash linked to confirming without recourse	1,337	1,226
as % of cash, cash equivalents and current financial investments	34%	43%
as % of confirming without recourse liabilities	56%	54%
Total net debt	7,974	7,303
Consolidated gross leverage	9.4	7.2
Consolidated net leverage	6.3	5.2

Figures in € million, based on Abengoa's definitions, excluding Moody's adjustments

Source: Abengoa annual report, Moody's calculations

Abengoa's balance sheet includes about €5 billion of trade payables, as shown in Exhibit 6. In the footnote of the annual report, Abengoa discloses that for 2014 €2.3 billion, or 44%, of these are "confirming without recourse", i.e., Abengoa has confirmed the liability to banks but not paid it. Abengoa states that the confirming strictly speaking does not change the conditions of the trade debt, for example due to the due date, or the amount of interest, if applicable, and from an accounting perspective, its origin does not change when a financial institution becomes the creditor. As a result, Abengoa continues to report its confirming within its trade payables. In our view, the sheer size of its program presents a degree of liquidity risk if these confirming lines were to become unavailable. Abengoa also engages in receivables non-recourse factoring, which we classify as debt. The company, indicates, however, that the confirming activities are excluded from debt calculations for covenant purposes, and hence if accounting standards changed and required these activities to be reported as financial debt, this would have no impact on its covenant ratios.

From a credit analysis perspective, however, we believe that Abengoa's trade payables have some debt-like features, especially:

- » an extraordinary long period of 219 days payable (223 days in 2013)
- » high related financial expenses of €85 million (€81 million in 2013) for the "outsourcing of payables"
- » a €1.2 billion deposit for confirming debt in 2014 (€1.3 billion 2013)

Exhibit 5

Analysis of Abengoa's trade payables

	2013	2014
Trade payables for goods and services	4,829	5,096
o/w confirming without recourse	2,377	2,250
as % of trade payables	49%	44%
Payables related to capex and others	-635	-1,425
Payables related to expenses	4,194	3,671
ex VAT (21%)	-728	-637
Payables related to expenses ex VAT	3,466	3,034
Raw materials and consumables used	4,470	4,083
Other operating expenses	1,201	977
Cost of goods sold and other operating expenses	5,671	5,060
Trade Payable Days	223	219

Source: Source: Abengoa annual report 2014, Moody's Investors Service

The reported net leverage calculation above positively considers cash deposits dedicated for reverse factoring liabilities. For analytical purposes, we have included reverse factoring in the leverage calculation, and we have given a credit of about €0.4 billion for an assumed standard level of 60 days of payables, which is based on the guidelines set by the EU Late Payments Directive. This is a conservative assumption, given that sector standard days payable may be higher. As a result of these considerations, net debt increases by about €1.9 billion. On a gross leverage basis, we have taken the offsetting effect of cash deposits dedicated for reverse factoring liabilities into consideration, because these funds can't be used for anything other than paying back these liabilities. The increase in gross debt is therefore only about €0.6 billion (see Exhibit 6).

Exhibit 6

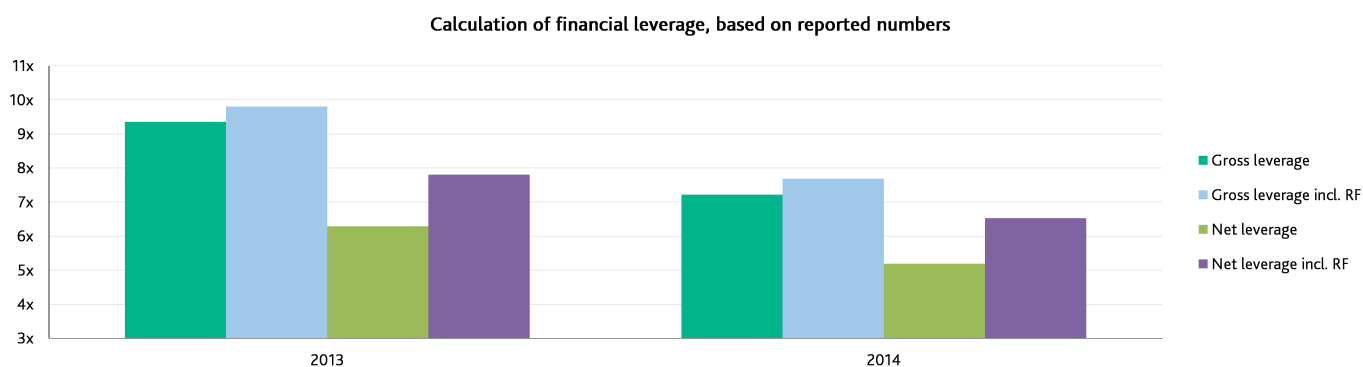
Calculation of financial leverage including reverse factoring

	2013	2014
Consolidated Gross Debt	11,852	10,162
Trade payables as reverse factoring	2,377	2,250
Ex standard level of 60 days of payables*	-459	-367
Cash deposits for reverse factoring	-1,337	-1,226
Consolidated Gross Debt including reverse factoring	12,433	10,819
Net debt	7,974	7,303
Trade payables as reverse factoring	2,377	2,250
Ex standard level of 60 days of payables*	-459	-367
Consolidated Net Debt including reverse factoring	9,892	9,185
Consolidated gross leverage incl. RF	9.8	7.7
Consolidated net leverage incl RF	7.8	6.5

* based on the guidelines set by the EU Late Payments Directive
Source: Abengoa Annual Report 2014, Moody's Investors Service

As a result, net leverage including reverse factoring is 1.3x-1.5x higher compared with the non-adjusted reported leverage. The incremental impact 0.4x-0.5x on gross leverage is smaller but still meaningful, considering the offsetting impact of the deposits (see Exhibit 7).

Exhibit 7

Impact of reverse factoring on Abengoa's gross and net leverage

Source: Moody's Investors Service

Appendix

Considering Moody's Adjustments, the calculations for Abengoa are as follows:

Exhibit 8

Financial leverage - considering Moody's Adjustments

	2013	2014
Group EBITDA	955	1,296
Reported Debt, including financial lease	11,975	10,283
Operating Lease adjustment	332	367
Securitization adjustment	583	556
Discontinued operations	0	3,953
Total Adjusted Debt	12,891	15,159
Short-term financial investments	742	908
Cash & Cash equivalents	2,952	1,811
Ex restricted cash and deposits	-1,337	-1,226
as % of cash, cash equivalents and current financial investments	36%	45%
as % of confirming without recourse liabilities	56%	54%
Total adjusted net debt	10,535	13,666
Consolidated gross leverage	13.5	11.7
Consolidated net leverage	11.0	10.5

Note: Securitization adjustment relates to non-recourse factoring

Source: Moody's Investors Service

Our adjustments include Operating Leases and Securitization (in Abengoa's case non-recourse factoring). Moreover, our 2014 debt adjustments include discontinued operations (essentially debt sitting at the level of Abengoa Yield). The reduction of Abengoa's stake in Abengoa Yield to 49.05% was announced on 14 July 2015.

Exhibit 9

Calculation of financial leverage including reverse factoring considering Moody's adjustments

	2013	2014
Total Adjusted Debt	12,891	15,159
Trade payables as reverse factoring	2,377	2,250
Ex standard level of 60 days of payables*	-459	-367
Cash deposits for reverse factoring	-1,337	-1,226
Consolidated Gross Debt including reverse factoring	13,472	15,816
Net debt	10,535	13,666
Trade payables as reverse factoring	2,377	2,250
Ex restricted cash	-1,337	-1,226
Ex standard level of 60 days of payables*	-459	-367
Consolidated Net Debt including reverse factoring	11,116	14,323
Consolidated gross leverage incl. RF	14.1	12.2
Consolidated net leverage incl RF	11.6	11.1

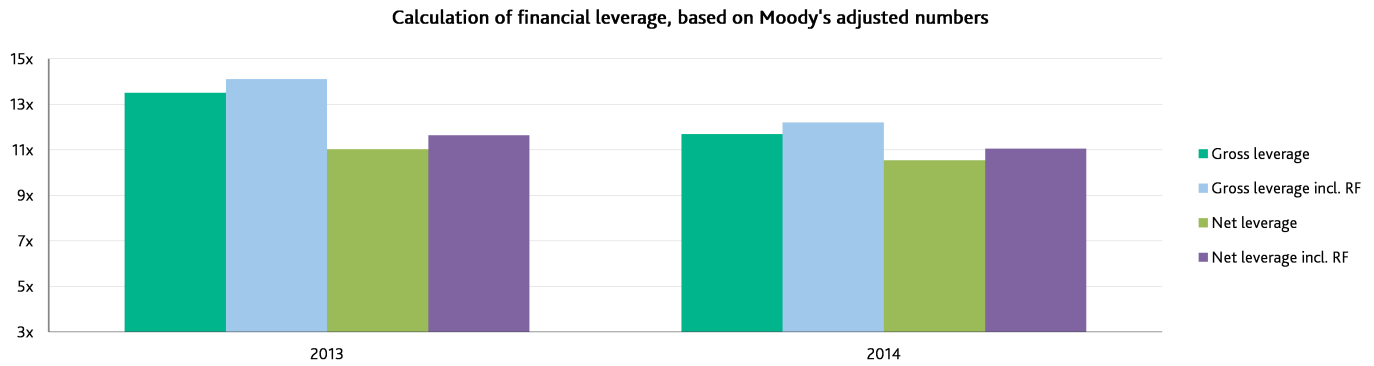
* based on the guidelines set by the EU Late Payments Directive

Source: Moody's Investors Service

Including RF our gross and net leverage metrics increase by approximately 0.5x-0.6x. As we deduct restricted cash from our net leverage calculation, the impact of RF is the same from a gross as well as from a net leverage perspective.

Exhibit 10

Impact of reverse factoring on Abengoa's gross and net leverage



Source: Moody's Investors Service

Moody's Related Research

[Credit Opinion on Abengoa \(Dec 2015\)](#)

[Cross-Sector Rating Methodology Financial Statement Adjustments in the Analysis of Non-Financial Corporates \(Jun 2015\)](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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