

Annual Factoring Survey

Report of Findings

Part I — General Industry Results

1) Industry results for 2003, are somewhat disheartening. In 2002, factoring volume rebounded at a 4.52% pace over 2001, the first year volume declined in the 27-year period since we began tracking this series. Total factoring volume in 2003 rose 0.34% over 2002 setting a new high of \$96.0 billion, an increase of nearly \$330 million.

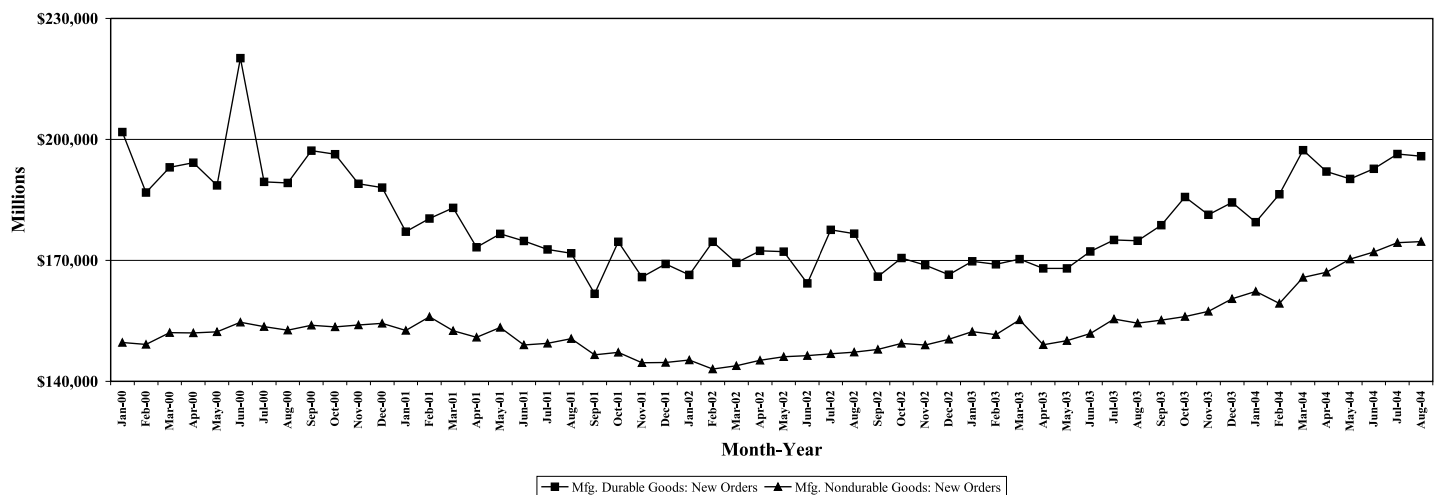
There are several reasons for 2003's sluggish performance. First, businesses have been hoarding cash to the tune of some \$600 billion, and using the cash to pay off outstanding debt rather than to incur more. Second, with interest rates remaining at all time lows, potential borrowers have been seeking out lower rates than offered by factors. Third, the economy remains weak due to slow job growth, lowered wages, and the effects of ever rising fuel costs on buyer demand. Finally, the industry has been hurt by the strong movement of textile, apparel, and furniture manufacturing out of the United States to the Far East and Mexico. The overall effects of these are shown in **Appendix Exhibit 1**. Although 2003's factoring volume set a record, the increase was the smallest ever recorded. Not including 2001's drop, the next smallest rise

occurred during the recession rebound of 1982 when total volume rose by \$518 million. See **Appendix Exhibit 2** where the changes are highlighted over the past 28 years.

According to *Barron's Magazine* (Aug. 20, 2004), the S&P 500 companies alone, not including Microsoft and commercial finance companies, have amassed nearly \$600 billion in cash and at the same time have paid down a substantial portion of their outstanding debt. Relative to the fast-moving 1990s, when cash amounted to just over 10% of total corporate assets, it now has risen to about 14% of that total. The article goes on to point out that long-term borrowing costs are currently approximately 38% below historical levels. Furthermore, our research shows that short-term rates being offered by commercial banks are at half those of the mid to late-1990s.

Economic weakness has prevailed throughout the U.S. over 2003 and well into 2004. New orders for durable goods as well as those for non-durables have risen sluggishly over this period. As shown in **Text Exhibit A**, seasonally adjusted monthly growth in

Text Exhibit A: Manufacturing Nondurable New Orders & Manufacturing Durable New Orders



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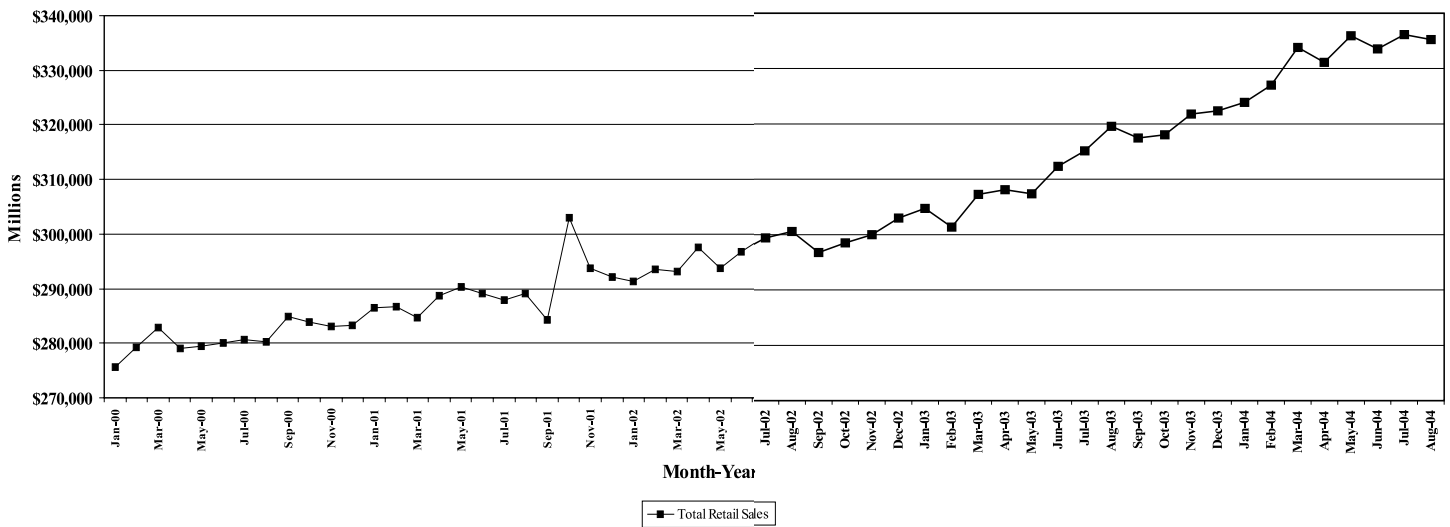
these measures has been steady, but have moved slowly since the 2002 recovery. Such orders drive factoring demand as producers seek funding to fill orders and to carry receivables generated. Similarly, increases in retail sales drive wholesale and retail firms to seek funding to carry their receivables and inventories. However, as **Text Exhibit B** also illustrates, retail sales have been sluggish in these industries over this period. Its growth was 3.54% in 2003 and 3.60% through the end of August 2004.

The weak rate of growth in employment as well as that of the Gross Domestic Product (GDP), have also played an important role in the almost non-existent movement of 2003's factoring

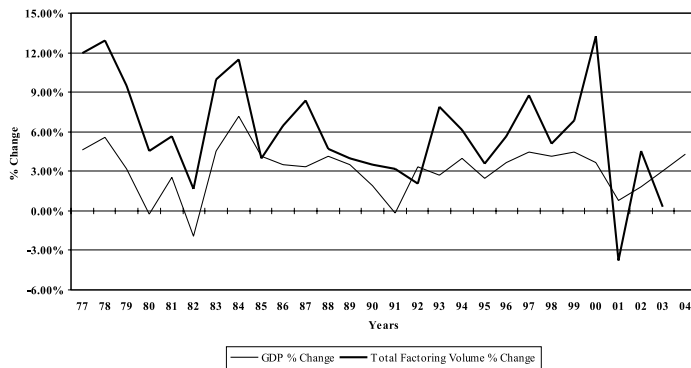
activity. As pointed out in 2002, both of these indicators appear to have had a strong relationship to factoring advances throughout the 28-year period of tracking industry activities. More specifically, **Text Exhibit C** shows that since 1994 changes in factoring activity have generally tracked that of the GDP. In 2003 they did not. Although the GDP has continued to grow, albeit at a slow 3.04% in 2003, factoring volume was virtually flat. So far in 2004, the GDP has not moved any faster than 2003 and is not likely to do so for the rest of 2004. Nevertheless, if maintained at this rate, the GDP could pull factoring up at a higher clip than 2003, perhaps as high as 2% growth in 2004.

In a similar, but more predictable manner, total employment also tracks factoring well, but with less variation than GDP, see **Text Exhibit D**. The change in factoring in 2001 followed the smaller percentage decline in employment that same year. However, 2002's rebound was not predicted by employment; indicators are not always perfect matches. The employment recovery remains weak both in volume and quality. As seen in the exhibit, total employ-

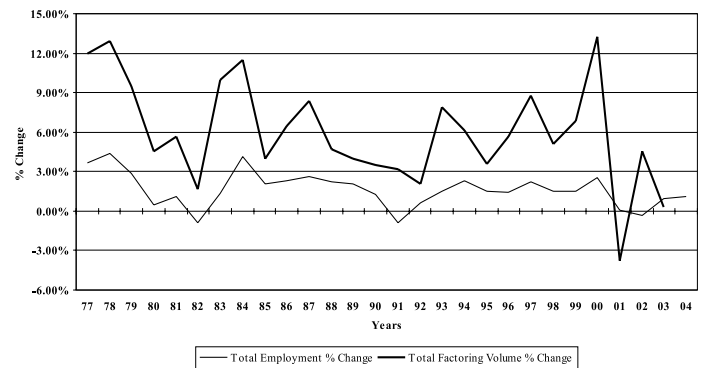
Text Exhibit B: Total Retail Sales



Text Exhibit C: Total Factoring Volume % Change vs. GDP % Change



Text Exhibit D: Total Factoring Volume % Change vs. Total Employment % Change



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ment in 2003 rose at an anemic 0.92%. The illustration there shows that it was not enough to sustain factoring growth. So far in 2004, it is rising at about the same speed, 1.12%, as in 2003. The implications of this, given 2003's growth correction in factoring advances, is again that factoring should move upward at around 2% in 2004.

Finally, and perhaps from a more long-term perspective, factoring volumes have been depressed in recent years by the increasingly strong movement of the textile, apparel, and furniture manufacturing industries away from the United States. Based on a *USA Today* report (April 1, 2004), between 1990 and projected year-end 2004, U.S. textile employment will have declined by 47% from 503,300 to 236,400. Forty-four percent of this decline has come from the five leading textile producing states of Alabama, Georgia, North Carolina, South Carolina, and Virginia. Just since 1997, 194 plants will have closed in these states. At the same time, between 1990 and 2003, the Far Eastern countries of China, India, Bangladesh, and Pakistan increased the value of their exports of apparel and clothing accessories to the United States from \$4.52 billion to \$16.5 billion. Added to that, Mexico increased its exports of these products to the United States over this period from \$700 million to \$7.2 billion. Moreover, many of these Mexican plants are themselves being closed and moved to the Far East. Since 18.7% of all factoring is done with manufacturers in these businesses and 41.9% is done with other firms in those industries (see **Text Exhibit G**), these outflows have had a strong impact on the volume of factors who specialize in these industries. Particularly hard hit are those factors in areas where firms in these industries have been decimated by imports. As shown in **Appendix Exhibit 4**, the Lower Northeast and the Eastern Southeast make up 56.2% of all factoring. In 2003 they grew at 1.80% and 0.4%, respectively. The largest percentage decline came in the Upper Northeast which lost 14.4% but comprises only 1.42% of total factoring volume.

In total, then, these elements have together played an important role in 2003's lackluster performance. They also provide a strong indication as to how the factoring industry will need to prepare and position itself in the future to maintain volume and continue to grow.

2) The factoring of instruments of sale is not entirely unrelated to that of asset-based lending collateralized by such transaction documents. **Appendix Exhibit 3a and 3b** illustrate their relationships. As can be seen in **Appendix Exhibit 3a**, asset-based lending outstandings move coincidentally with that of total factoring volumes. The prediction of a 4.0% increase in the former for 2004

provides a bellwether indicator that factoring volumes should improve as well in 2004. Asset-based lending advances tend to lead changes in those for factoring as indicated in **Appendix Exhibit 3b**. However, its movements are more pronounced than those for factoring. Accordingly, the strong rise in of 4.34% in 2003's asset-based velocity further supports the view that factoring in 2004 will rise, but by a lesser amount. (See the Annual Asset-Based Lending Survey — 2003 report.)

Many of the same forces that drive asset-based lending also drive factoring. However, the much greater size of asset-based lending activities makes them much more volatile than factoring. Its accentuated movements are of great assistance in visualizing both the expected future direction of factoring and the estimated degree of those movements. **Appendix Exhibit 3b** shows these over the past 7 years. The strong decline in asset-based lending advances starting in 1999 provided an indication of the flattening out of factoring that began in 2000. However, 2003's 4.34% upturn in those advances indicates that factoring for 2004 will turn upward approximately 2.0%.

Please Note: Appendix Exhibit 4, and several of the Text Exhibits have been revised from that reported in 2002's Annual Factoring Survey. These revisions have resulted from the increased number of responses, data, qualitative discussion, and other information. Accordingly, the exhibits for 2002 that contain such new data are indicated as being revised or contain an "R" next to such series. These changes have been made to reflect more accurately events that are taking place over time in the industry. Future factoring surveys will benefit from the revisions.

3) Turn now to our initial discussion in Section (1) of regional factoring developments. As indicated there, longer-term declines and/or weak growth in the Upper and Lower Northeast and in the Eastern Southeast have largely been the result of the outward movement of textile, apparel, footwear, and furniture manufacturers to East Asia and Mexico and the impact of export competition in the United States. **Appendix Exhibit 4** breaks down 2003's volume of factoring by region and compares changes in each since 2002. Overall, performance both in the economy and the volume of factoring across the nation, in Canada, and overseas has been uneven. Total factoring volume grew by only 0.34% throughout the world and 0.37% in the United States. However, it was much stronger in Canada, increasing by 12.48%, and much weaker elsewhere where it dropped by 3.24%.

As seen in **Appendix Exhibit 4**, the regions generally fall into three tiers in terms of volume. The top four areas — Lower Northeast, Far West, Eastern Southeast, and Other International (overseas) — each accounts for at least 8.4% of that volume. The second tier — Southwest, Canada, Eastern Midwest, Western Southeast, and Upper Northeast — each comprises at least 1.4% of total factoring volume. And, finally, the smallest group — Northwest, Western Midwest, Middle Atlantic, and Plain States — make up the

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remainder. The latter range from 0.8% to 0.3% factoring volume. Below is the detailed discussion of the volume of factoring activity that took place in each of these locales. They are presented in order of the volume, with the exception of the "Other International" delineation, because of the broad and general boundaries it covers.

Lower Northeast: No other region dominates factoring to the extent than does this one. It comprises 42.26% of all factoring in the world. However, as shown in **Appendix Exhibit 4**, volume there rose by only 1.80% over 2002. As already stated, this was partly because of the impact of textile and other soft goods manufactures. However, weaker than expected retail sales, especially higher priced items, also contributed to its sluggish performance. On the positive side, manufacturing activity in the region rose moderately, especially among firms producing plastic products, electrical equipment and food items. As seen in **Text Exhibit F**, manufacturing comprises 29.56% of factoring volume.

Far West: The second largest of the 10 regions, factoring in the Far West is quite different from its larger counterpart. Factoring volume there was half that of the Lower Northeast and growth nearly a fourth its rate. With a large concentration of defense contracting and manufacturing, technology and services, this region grew slowly because of cutbacks in orders, high inflation, especially in energy, and rising health insurance costs. However, the slight improvement in manufacturing in 2004 should lead to factoring gains.

Eastern Southeast: Effected heavily by the same weakened apparel, textile, footwear, and especially furniture industries, factoring growth there was only \$5 million, or 0.04%.

Southwest: In this region factoring activity fell modestly at 1.31%. This area is characterized by a variety of businesses there — oil and gas, farming and livestock, and a mixed variety of manufacturing. High production costs, primarily driven by fuel, shipping, and raw material prices, have depressed business in this region. While oil and gas has been strong, other industries have not. Thus, factoring demand fell.

Canada: Total factoring volume of Canada is about equal to that in the Southwest and the Eastern Midwest. However, the types of businesses that use this tool are different from both. Being a country that spans the United States, its activities are about as diversified as its overall U.S. counterpart. But Canada is much more a service-producing economy than is the United States. Services in Canada constitute 52.44% of GDP, manufacturing and

construction make up 22.68% while wholesale, retail, and distribution account for 16.49%. (The remainder is accounted for by minerals extraction, utilities, and agriculture and related activities.) This sectoral breakdown is different from factoring overall, as shown in **Text Exhibit F**. While growth in these sectors in 2003 ranged from only 1.12% for manufacturing and construction to 3.22% for services, factoring volume in Canada jumped 12.48% (see Appendix Exhibit 4.)

Eastern Midwest: Known primarily as the center of U.S. heavy manufacturing, as well as being an area also dominated by agriculture, livestock, and light manufacturing businesses, factoring there dropped at the fourth fastest rate, 10.79%, among all 13 regions covered.

Western Southeast: Often referred to as part of the Deep South, this region is characterized by traditional crop production, which remained steady in 2003. However, factoring there grew with the continuing movement of businesses to this area and their demand for financing. Thus, factoring volume rose by \$84 million, or 4.6%.

Upper Northeast: This area of the United States suffered the second largest factoring decline of any location examined. Hit by some of the same losses in the soft goods manufacturing industry as the Lower Northeast, in addition to declines in high technology and other areas of manufacturing there, factoring dropped by 14.40%, or \$230 million in 2003.

Northwest: The Northwest accounts for only 0.80% of worldwide factoring. The primary industries there include lumber, paper, aircraft manufacturing, and technology. All of these grew slowly in 2003, as did local retail sales. Thus, factored financing grew only 1.31%.

Western Midwest: Like its neighbor, the Eastern Midwest, this region was hit by many of the same adverse economic circumstances that caused the use of factoring there to decline substantially.

Middle Atlantic: A bright spot for factoring growth, the Middle Atlantic states, by far the smallest in physical size, is nevertheless located in the hub of the East Coast. It contains businesses of all sizes and types including vegetable, livestock, crop production, high technology, consulting, chemical manufacturing, electronics, and tool and industrial machinery manufacture, but the number of businesses located there is small. As discussed later in this report, there are only 186 client/customers that use factoring in this region (see **Appendix Exhibit 7**). However, the number of clients/customers using factoring grew 77.30% in 2003 (see the discussion in Section (6) later in this report) and factoring volume grew by 30.77%.

Plains States: Factoring in this region totaled only \$264 million, down 19.27% in 2003. The types of firms that do business in this area do not lend themselves well to this type of funding. With few

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towns, there is little wholesale or retail activity. While manufacturers have begun to locate there, most industry in this region is in agriculture, lumber, mining, and oil and gas. Throughout the whole region, only 93 firms used factoring in 2003.

Other International: This is a broad and encompassing locational classification covering all countries except the United States and Canada. At this time, data collection for the rest of the world remains largely undone. Results here are based on bellwether responses and statistical estimates.

4) **Appendix Exhibit 5** breaks down regional factoring by that done on a continuous basis versus that done on a single, or spot basis, and indicates that spot factoring represents a negligible part of the total. The difference between the two is that continuous factoring is carried out among clients/customers who regularly sell their instruments of sale to a single factor while spot factoring takes place when a business has a temporary need for financing for a one-time transaction with a single buyer of its goods and/or services.

Up until 2002, no data on spot and continuous factoring had ever been collected. Now that we have collected information for the last two years, we can at least get some glimpse as to their recent movements. As indicated in **Appendix Exhibit 5**, the total volume of spot factoring accounted for only 1.22% of total factoring. Amounting to only \$1.17 billion in 2003, this represents a decline of 62.5% from 2002's spot volume of over \$3.12 billion. Nearly all of the spot financing was carried out in the top 3 regions in the U.S. — the Lower Northeast, Far West, and Eastern Southeast. Together, they accounted for 87.11% of the total and on average in these three locations, spot factoring comprises only 1.37% of their factoring volume.

As discussed earlier in this report, S&P 500 firms have hoarded nearly \$600 billion in cash to date. This is thought to have been taking place since the 2001 recession by firms of all sizes. With this, businesses have a larger cushion of cash with which to service their very short-term cash needs without turning to such temporary sources as spot factoring.

Continuous Factoring amounted to \$92.54 billion in 2002. In 2003 it grew by 2.51% to almost \$95 billion. This indicates that continuous factoring in the United States accounts for 88.86% of the total factoring volume.

5) **Appendix Exhibit 6** is a new addition to this report. For the first time, we have examined factoring's average lending base by region. In much the same manner that outstandings appraise the funding foundation of asset-based lending, the average lending base measures that of the factoring industry. With the addition of this measure, factoring and asset-based lending activities can now be compared both in terms of volume of financing, i.e., average factoring lending base versus asset-based lending outstandings, and in terms of the velocity of lending by each, i.e., total factoring volume versus asset-based lending advances. Since this is the first year of its collection, all of the comparisons that were done in **Appendix Exhibits 3a and 3b** in Section (2) were based on that of asset-based lending advances.

Appendix Exhibit 6 presents the total volume, average lending base, and together, the factoring turnover rate they produce. For the United States, it ranks each factoring region by total volume. Canada and the Other International areas are shown at the bottom of the table.

Overall, factors turned over their funding base 8.73 times in 2003. The regions' turnover rates ranged from a low of 8.35 times in the Lower Northeast to a high of 10.56 times in the Eastern Midwest. While the rates shown in the exhibit may seem to be very close among these zones, on average in 2003 a difference of 0.1 times represents nearly \$1.0 billion in additional funding. In the U.S., the average turnover rate was 8.69 times.

Turnover rates allow us to assess the speed at which these sale instruments were being repaid. The data here indicates that collections averaged 41.8 days across the industry and 42 days in the United States. Collections were the fastest in the Eastern Midwest at 34.6 days, and the slowest in the Lower Northeast, 43.71 days. The Middle Atlantic region equaled the industry's time frame, 41.8 days.

6) **Appendix Exhibit 7** provides information on the number of clients/customers and their employees by region. The top five areas shown there increased their dominance in 2003 with nearly 80% of the companies that use factoring in this country and nearly 84% of the total employees of factored companies. The number of client/customers increased by 9.40% in the U.S. and 45.49% in Canada. The average factoring volume per client/customer fell 8.35% within the U.S. from \$6.47 million in 2002 to \$5.93 million in 2003. In Canada average client/customer volume dropped by 22.5% from \$3.11 million in 2002 to \$2.41 million in 2003. The average factoring volume per client/customer in the Other International areas rose from \$3.75 million in 2002 to \$9.25 million in 2003.

The Lower Northeast region continues to have the heaviest volume of factoring per client/customer, \$11.89 million. The average volume of factoring per client/customer was the smallest in the Eastern Midwest, \$1.72 million. The average U.S. client/customer had 161 employees in 2003, down 16% from 192 in 2002.

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Canada had a drop of 37% from 203 employees per company in 2002 to 128 employees in 2003. In contrast, overseas firms averaged only 61 employees in 2003, a 135% jump over 2002. While the Far West had the largest number of clients/customers, they averaged only 45 employees. The largest sized users were located in the Middle Atlantic states where the average firm had 272 employees.

Employee productivity, if measured in terms of the volume of factoring needed to sustain their activity, remained substantially higher in the Far West than in any other U.S. region. Factoring by companies there amounted to \$101,959 per employee in 2003, 1.6 times higher than that of the next largest section of the U.S. The Plains States maintained the second position at \$63,406 per employee. This is surprising, given the sparsity of businesses located in this region. Factoring volume in Canada amounted to only \$18,808 per employee in 2003. On average, the volume of factoring per employee of a client/customer was \$36,908 in the United States. The Other International areas had the highest level of employee productivity, \$152,159 per employee.

In closing this first portion of the report, it should be noted that in 2002 there were 3,982 people employed by the factoring industry. They produced an average of slightly over \$24 million in total factoring volume. In comparison, the 16,878 employees in the asset-based lending industry in 2003 on average produced \$140.3 million.

7) The last Appendix Exhibit is another new one. Explored only in our Asset-Based Lending survey (see Annual Marketing Survey for the Asset-Based Financial Services Industry) for 2000 as a special feature there, in 2003 we have introduced **Appendix Exhibit 8** as a permanent addition to this report.

The results indicate that there is strong competition within the industry. There are few large firms in the two highest volume categories and many small ones that fall into the lowest ones. (The sizes have been designed to match as closely as possible the relative activity in the asset-based lending industry.) The smaller firms make up an estimated 82.57% of the total factors in the industry.

The 18 largest firms accounted for 85.71% of total factoring volume in 2003, while the 90 smallest firms produced 14.29% of the \$96 billion in total factoring volume. As might be expected, the large factoring firms service large clients leaving the field open for the smaller firms to finance small and generally faster-growing clients. Overall, factoring continues to be a niche business.

Finally, before turning to Part II, compare the changes in factoring firm size categories with the only other study of this aspect that was conducted in 2000. Interestingly, neither the total number of factors, nor the proportions of the volumes accounted for by each segment has changed much. The volume provided in the top two tiers in 2003 declined somewhat from 2000's. Tier 1 fell from 84.11% of the total in that year to 79.30 in 2003. Tier 2 factoring activities declined slightly from 6.95% to 6.41% of the total. However, the portions accounted for by factors in the two smallest tiers increased over the last three years. Tier 4 lenders' portion of total factoring rose from 1.57% in 2000 to 2.63%. Tier 3 lenders jumped from 7.37% to 11.66%.

In total, Part I indicates that while the volume of factoring remained nearly constant in 2003, the degree of activity and competition within it has not. Part II provides a summary of the more specific individual attributes of factoring and of the manner in which they were carried out.

Part II — Results of the Specific Attributes Portion of the Questionnaire

8) Average collections slowed in 2003 to 54 days from 47 days, largely as a result of the sluggish economy and the higher cost of doing business. Moreover, the DSO (Days Sales Outstanding) approached 60 days. Once accounts reach that age, they become difficult and more costly to collect. The average age of purchased receivables remained steady at 5 days.

In 2002's report we discussed and compared the results of some outside studies of the probability of successfully collecting outstanding sale instruments to that of the factoring industry's actual performance. Most commonly the typical repayment terms offered by client/customers to their buyers focuses on a 30-day collection period. As indicated above, 2003 saw actual performance to be substantially longer than that. At creation, given such conditions, on average 96% of all generated credit is expected to eventually be paid off. By 30 days outstanding, the collection rate on those obligations that remain is 91%. At 60 days, it falls to 83% and by 90 days the probability of successful collection declines to 72%. Based on this model that underlies these studies, the probability of successful collection in 2003 is 84.5%. 2002's performance probability was higher at 86.4%.

At 90 days overdue, outstanding instruments are likely to require legal action to be collected. Because this time frame is so critical in this respect, we have evaluated the industry's performance at this collection juncture, see **Text Exhibit E**. As can be seen there, both in 2003 and 2002, accounts outstanding more than 90 days represent a very small portion of those purchased by the factoring industry. In 2002, they amounted to 3.78% of the total, or

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about \$3.62 billion. In 2003, they dipped to 3.18%, or \$3.05 billion, representing an improvement in collection productivity of \$570 million. As also shown in **Text Exhibit E**, eventual charge-backs to client/customers, i.e., under partial or full recourse relationships were extremely small and almost imperceptible in the graph. In 2003, they were only 5.16% of the accounts that remained outstanding at 90 days, or just \$157.58 million. In 2002, 5.92%, or \$214.17 million of the old accounts were deemed to be their clients'/customers' responsibility.

Although not shown in the exhibit, charge backs were broken down by their causes. About one quarter of them were due to known disputes between the factor's clients/customers and buyers of their goods and services. About 39% were the result of unknown disputes between these two parties. Thirty percent involved credit problems associated with the buyers themselves. The remainder, about 5%, were not specified. Typically these disputes arise between buyers and sellers because of price changes, agreed-upon specifications, quality, and delivery dates. They also can occur because of damage, missing items, or arrival locations. These are just a few of the reasons charge backs occur.

Finally, as indicated in **Text Exhibit E**, ultimate write-offs of outstanding accounts amounted to 0.32% of total purchases, or \$307.32 million, the same percentage as in 2002.

In 2003, factors were a little more patient with past dues than a year earlier. In 2003, they waited until these instruments were 76

days past due, or about 106 days since issue, before returning them to their clients. In 2002, they waited only 70 days past due before doing so.

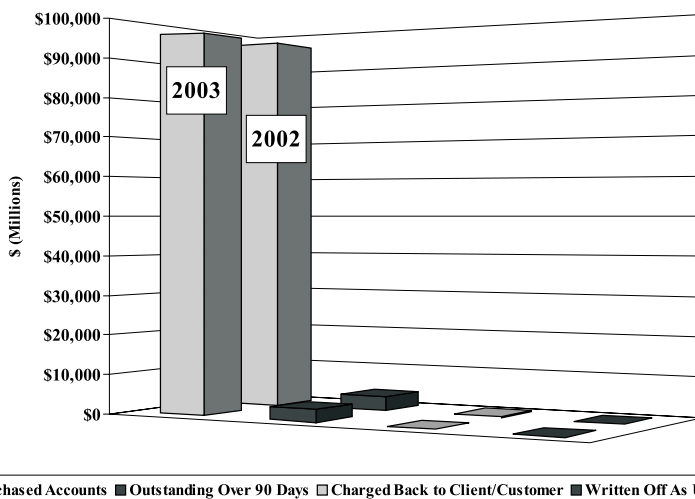
However, with respect to their own charge-offs, factors were much quicker to do so than in 2002. Write-offs were made at 121 days past due in 2003 versus 136 days in 2002. Given the probability of collection and the cost involved, factors may have decided that it was more economical, based on the financial conditions of the client and the client's customers, to do so earlier.

In any case, our data indicates that the industry does a far better job of collecting on these short term obligations than do sellers of their products or lenders collateralized by such accounts.

9) We also asked our respondents questions about the makeup of the instruments of sale they purchased in 2003. Nearly all were accounts receivable (A/R). In total, they amounted to 98.43%. Purchase orders made up only 0.01% of the total. However, we think that this proportion is lower than our data indicates. Federal, state, local government and other procurement guarantees comprised the rest, 1.56%. Nothing was reported as to volumes accomplished through letter's of credit, banker's acceptances, or other forms of credit instruments. Thus, we feel that the percentage accounted for by A/Rs is most likely to be somewhat overstated.

10) One reason for the above assumption is that reporting on the volume of domestic versus foreign factored transactions is large enough to indicate that far more non-A/Rs have been purchased than indicated by the respondents. In particular, domestic factoring made up 93.66% of the total. On the other hand, international trade financing, usually carried out through the use of LCs or banker's acceptances, represented 5.60%. With the latter volume being so large, it is most likely that A/Rs, in total, may comprise only about 82-85% of the total factoring volume.

Text Exhibit E: Disposition of Purchased Accounts



Next, turn to some of the most interesting and important aspects of the industries activities. These include the economic sectors and individual industries that utilize factoring [(Sections (11) and (12)], and the forms and conditions under which these sale instruments are carried out [Sections (13) through (17)]. As pointed out at the beginning of this report, several sets of data were revised from those utilized in 2002, because of better information.

11) **Text Exhibit F** presents the industry's activities in terms of the sectors of the economy in which its volume is generated. It is designed to provide an overall view of the manner and degree to which

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it serves the primary sectors of the economy. As can be seen, the largest sector is made up of wholesale and retail trade, transportation and distribution; all forms of manufacturing; and various types of services. The largest sector served by factors includes sales of textiles, apparel, footwear, furniture and other goods, trucking and warehousing, and other related types of businesses. In 2003, this segment comprised approximately 63.75% of the total factoring volume. This is slightly less than 2002 when it accounted for 65.27%. Manufacturing constituted 29.56% of the total in 2003, a small increase over 2002's revised estimate of 28.44%. The manufacturing sector includes both durable and nondurable goods. Such items range from heavy machinery production to goods sold over the counter. The service component of **Text Exhibit F** includes medical and dental practices, legal practices, various types of business and other consulting, temporary staffing and employment agencies and marketing and advertising. Together, they made up the remaining 6.69% of the industry's purchases of sales instruments in 2003.

12) **Text Exhibit G** below provides a graphic overview of the industries that are contained in each of the above-indicated sectors. In several sections earlier in this report, we discussed important developments that have affected these lines of businesses and, thus, their need for and use of factoring. **Text Exhibit G** indicates the degree to which each of these industries actually used this funding approach to fund their sales of goods and services in 2003. The exhibit is broken down into 2 additional lines of business and the remaining ones from 2003 were revised. These changes render 2002's results largely non-comparable to those discussed below.

Based on these changes, **Text Exhibit G** offers a new breakdown of the industry's client/customer businesses into 8 primary industries that sell their various instruments of sale to members of the industry. As has traditionally been the case, the wholesale-retail industry comprises the largest group accounting for nearly half of factoring business. Within this group, nearly 42% of all factoring is accounted for by apparel, footwear, and furniture .

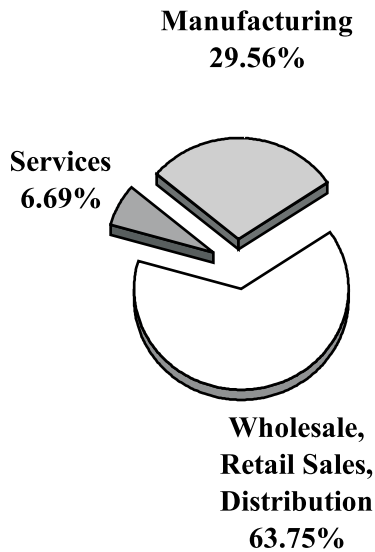
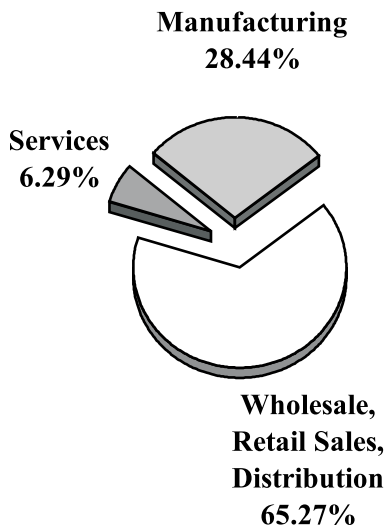
Manufacturers of textiles, apparel, footwear, and furniture account for 18.66% of total factoring volume in 2003. Adding factored sales of these products, 60.34% of the industry's total volume is generated there. Textile manufacturing represents almost the smallest portion of that for manufacturing sector. It accounts for only 3.3% of the total volume. Thus, again, developments involving competitors located beyond U.S. and Canadian borders will have a critical impact on the future of factoring here. They

must be quickly addressed and strategies developed to either take part in the growth overseas or the industry must refocus itself on opportunities in other industries for factoring.

Text Exhibit F: Factoring By Economic Sector

2002 (Revised)

2003



Within the manufacturing sector, we have identified other industries that utilize factoring services. These offer one avenue to the future expansion of factored financing. Other manufacturing, itself, accounted for 36.9% of factoring among all manufacturers in 2003. In total, non-traditional manufacturing generated \$10.5 billion in 2003. Some examples of the types of manufacturing businesses that utilized the product include shipbuilding, steel manufacturing, plastics and electrical component production, and high technology and computer equipment.

In another important area, the transportation and distribution industry comprised 17.8% or \$17.1 billion of all factoring volume in 2002. This is a relatively new and fast growing addition to the list of users of factoring services. Factoring offers a unique opportunity for companies in these businesses to add financing to the final phase of supply-chain manufacturing management.

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Finally, as shown in **Text Exhibit G**, business services represent the remaining 3.18% of the 2003's total factoring volume, or \$3.1 billion. These services include a wide range of businesses including employment services, temp agencies, medical and dental practices, printing services, telemarketing, computer systems and consulting. Although small and diversified at this time, future growth prospects are good and the strong movement to consolidation within many of these lines of business should offer another area for factoring to grow.

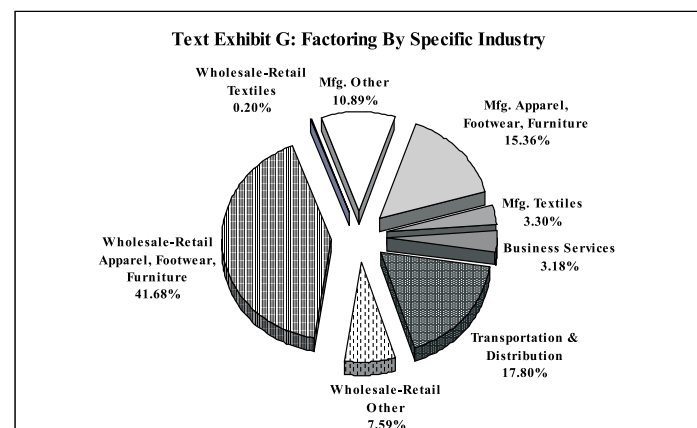
factoring volume and generated \$19.47 billion in 2003, a decline of \$852 million from 2002.

The last form of factoring is partial recourse or modified recourse factoring. In a partial recourse deal, the factor and its client/customer agree to share the risk of non-payment. The factor has recourse against the client/customer up to a pre-set limit. Beyond that amount, the factor assumes the remaining loss. Modified recourse segregates the client's customers in those that it will guarantee and those that it will not. **Text Exhibit H** indicates that this form of factoring is still small, but more than doubled from \$2.28 billion in 2002 to \$4.97 billion in 2003 and represents 5.18% or of all factoring activity.

14) **Text Exhibit I**, breaks down factoring into conventional and maturity funding. Conventional factoring provides advances against receivables as they are credited. This form of factoring represented 60.59% of the total industry activity, or \$58.19 billion in 2003, about the same percentage as in 2002.

In maturity factoring there is no advance to the client/customer. The client/customer gets its money after the receivable matures. This type of factoring is not as profitable since there is no interest earned on the transaction. The factor earns only a commission for the credit guarantee, collection, bookkeeping and other services provided. Maturity factoring totaled \$37.85 billion or 39.41% of total volume in 2003.

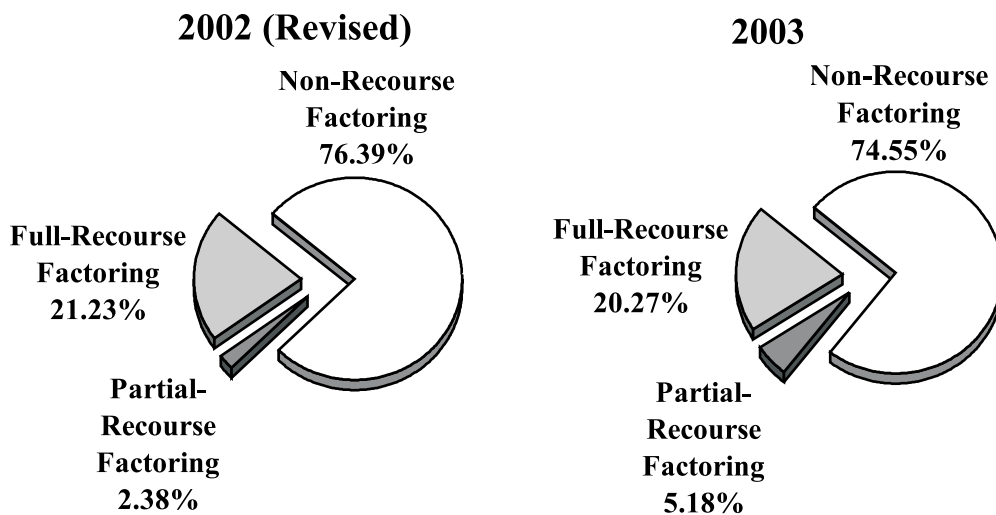
15) Most factoring is done on a notification bases. The client's customer is advised that its payable has been sold to the factor and payment should be made to the factor. In 2003, this type of factoring accounted for 82.14% of volume, little change from 2002. However, there are some clients who would rather not have its customers notified of the factoring arrangement. Thus payments are sent directly to the client who then pays the factor.



13) While most traditional factoring arrangements are on a non-recourse basis, there are exceptions. Under non-recourse financing, the factor assumes the risk of non-payment by the client's customer, after first approving the credit of the debtor. As indicated in **Text Exhibit H**, this form of factoring constituted 74.55% or \$71.6 billion in volume in 2003, down over \$1.5 billion from 2002.

Text Exhibit H: Types of Recourse Factoring

Recourse factoring allows the factor to charge back to the client unpaid receivables. The factor includes this provision in its funding agreement with a client/customer when the latter is selling to a large number of firms that are considered to be poor credit risks and the client/customer itself has a good credit rating. As seen in **Text Exhibit H**, recourse factoring accounted for 20.27% of



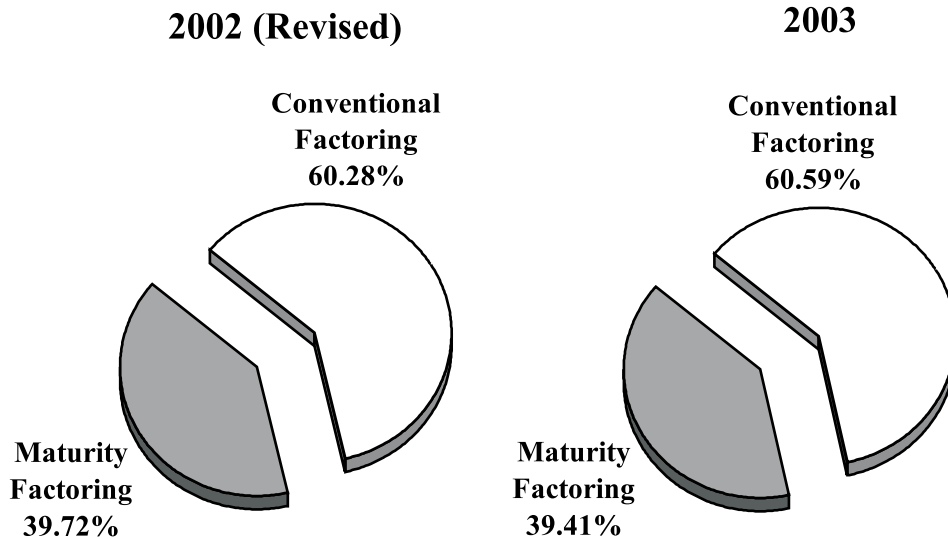
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16) Factoring arrangements may also be divided between traditional and non-traditional. Traditional factoring, also known as “old-line factoring”, is carried out both with recourse and with

notification. It is designed to facilitate continuous purchases of factored accounts over a long period of time. Non-traditional financing focuses upon short-term dealings between suppliers and buyers. As such, they are carried out on a spot basis and with recourse to the client/customer. Buyers may or may not be notified of this arrangement. Suppliers who fulfill their short term financing needs are usually weaker financially than those who use traditional factoring.

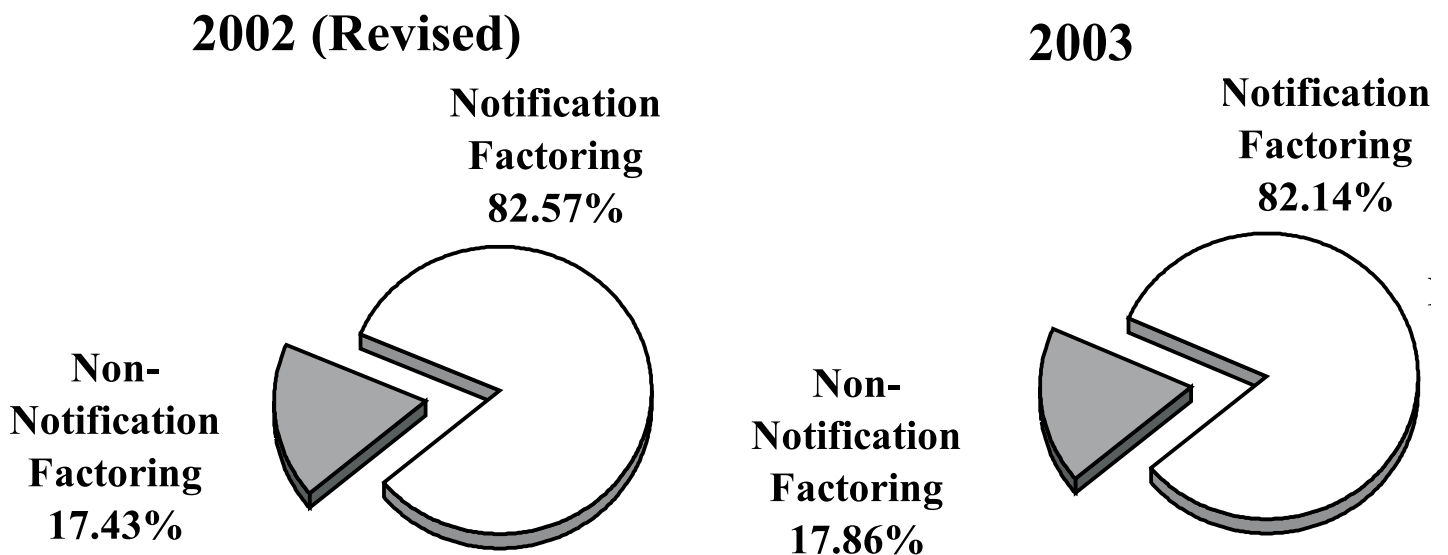
Text Exhibit K presents a comparison of the results of this aspect of factoring activity in 2003 and 2002. In 2003, traditional factoring amounted to \$91.78 billion or 95.57% of all factoring and non-traditional arrangements accounted for just over \$4 billion in 2003. The percentages were nearly identical to those in 2002.

Text Exhibit I: Conventional vs. Maturity Factoring



17) The last aspect of factoring examined for this report was that of re-factoring. Re-factors are generally small firms that provide advances to their client/customers, but lay off the credit risk with larger factors. Re-factoring largely resulted from the many consolidations in the factoring industry that established a niche for factors that could

Text Exhibit J: Non-Notification vs. Notification Factoring



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service small clients. Unfortunately, although many factors use re-factoring we have received no information on re-factoring volume.

Part III — Forecast for 2004

Our estimate of factoring growth for 2004 is that it will increase slowly, between 1.75% to 2.75%. In Sections (1) and (2), both economic and market conditions have been weakening throughout the first half of 2004. In **Text Exhibits A and B**, new orders for both durable and nondurable goods have been slowing since July. Retail sales have been oscillating up and down since March 2004 and have been flat since May. These results indicate that the manufacturing and retail sector demand for factoring will have achieved most of its growth by mid-2004. Demand thereafter is likely to be flat through the end of 2004.

In **Text Exhibit C**, the volume of total factoring has tended to move with, but gyrate to a much greater degree than the overall GDP. In 2003, Real GDP grew at 3.04%, after being revised downward from a preliminary 3.12%. First quarter GDP grew at an annualized rate of 4.42%. However, since that time its growth has fallen off. The second quarter rate was revised downward to 3.0% by the Bureau of Economic Analysis. Meanwhile, the economic consensus forecasts for the 3rd and 4th quarters have been dropped three times from 4.4% to 3.6% and 3.8%, respectively. The forecast is that real GDP will rise by, at most, only 3.5% in the third quarter and will finish out 2004 at a seasonally adjusted rate

of 3.4 - 3.5%. Much of the latter two quarters' increases will primarily be because of defense and election spending. 2005 may only bring real GDP growth in at a continued rate of 3.0 - 3.5%.

The demand for factoring is also related to that of employment. Cash is needed to cover the expenses of the production of goods and services. **Text Exhibit D** indicates that changes in the growth of factoring tend to move with those of employment. Monthly changes in employment have been erratic since November 2003, and this has been the case throughout September 2004. In September, employment dropped by over 200,000 and was flat the month before. This provides further evidence that the economy is not expanding. The estimate is that total U.S. employment will rise by only 1.12% for 2004. The general relationship between changes in this measure and that of factoring leads that growth in the latter will not exceed 2.75% in 2004.

Finally, the forecast is predicated upon the forecasted movements in asset-based outstandings and advances. In Section (2) in connection with **Appendix Exhibits 3a and 3b**, the same elements that affect asset-based lending also affect factoring volumes. Based upon the relationships discussed, factoring should be expected to move upward by about 2% 2004.

The total volume of factoring in 2004 should move upward between approximately \$97.7 billion and \$98.7 billion. It is even less sanguine about the 2005 economy. However, factoring volume should finally reach \$100 billion by that time.

Text Exhibit K: Non-Traditional vs. Traditional Factoring

2002 (Revised)

2003

