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Serving the Trade Credit and Supply Chain Risk Markets, CreditRiskMonitor is helping Public Corporations and B2Bs Analyze Financial Risk

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CEOCFO: ***Mr. Flum, what is CreditRiskMonitor?***
Mr. Flum: CreditRiskMonitor is both a public corporation and a B2B financial risk analysis and news platform that serves the trade credit and supply chain risk markets. We recently launched a sister service, SupplyChainMonitor™, which has been specifically designed for supply chain risk use cases and features significantly expanded functionality relative to CreditRiskMonitor.

Most people are aware of some of the more typical supply chain use cases such as sourcing alternative or redundant suppliers, comparing providers in competitive bidding processes, and onboarding assessments. Some additional problems that SupplyChainMonitor™ can assist with include the ongoing monitoring of and real-time alerting on current vendors to avoid disruptions; quickly understanding and reporting on exposure to geographic, industrial, and/or risk level factors; and investigating geopolitical country-level risks in the development of sourcing strategies like nearshoring; to list a few.

"We're already starting to see risk mounting in the B2B market, foretelling a spike in bankruptcies… To use a war analogy, you don't learn to shoot your rifle while the enemy is advancing on your position. You learn to shoot in basic training, so those skills are well-worn muscle memory by the time you need to use them. Don't wait for bankruptcies to impact your business before establishing policies and protocols. Now is the time to prepare so you aren't scrambling in the 11th hour." Mike Flum

In contrast, I'm not as confident that people understand the trade credit use cases. Trade credit refers to the extension of accounts receivable credit to a customer making a purchase. If I am selling 100 widgets to Company X for $10 per widget, I am providing credit to Company X for that $1,000 purchase, and that credit comes with terms, such as Net 30, meaning that 30 days after receipt of those widgets, Company X would need to pay that $1,000 invoice. Helping subscribers understand the repayment risk associated with that short-term extension of credit is the focus of the CreditRiskMonitor service. In a nutshell, we help users judge the financial risk and credit worthiness of their business counterparties as well as the potential for delinquent payments on those credits so they can more effectively manage their cash conversion cycles.

Our subscribers include over 35% of the Fortune 1000, plus thousands of other businesses worldwide and we have been in business since 1998. Over those 22-plus years, the service has evolved from only covering a few hundred U.S. public companies to about 30 million businesses worldwide.

We are covering about 57,000 public companies internationally, plus more than 325,000 European private companies with our 96%-accurate, daily-updating FRISK® score, which predicts the probability of corporate bankruptcy within the subsequent 12 months. For context, in 2021 that group represented $91.4 trillion in corporate revenue compared to an estimated global GDP of $89.4 trillion. We have private company scores on an additional 4.5 million businesses, including our proprietary, 75%-accurate PAYCE® score on more than 100,000 U.S. and Canadian private businesses.

CEOCFO: ***Do most businesses do routine credit checks on their customers; is it standard practice?***
Mr. Flum: Yes and no. For most sophisticated businesses, credit checks have certainly been more standard operating procedures, but there is a big distinction between conducting an initial review and ongoing monitoring of customers. Most public businesses have a process for approving credit requests and quarterly reviews of outstanding AR to assess the allowances reserved for bad debts as required for regulatory compliance. Most of those businesses have a team dedicated to processing credit applications and a collection function, whether in-house or outsourced.

That said, since the Great Recession, the world has been in an exceedingly easy credit regime supported by the central bank policies of very-low-to-zero interest rates and quantitative easing. These policies have made it exceedingly difficult for low-quality, non-profitable, businesses to go bankrupt since they've had consistent access to cheap, plentiful credit and can roll that financing over at each maturity. A fact reflected by the spectacular growth in the number of "zombie" companies, those that cannot effectively cover their interest expenses with their earnings, over this period.

We're already starting to see risk mounting in the B2B market, foretelling a spike in bankruptcies. If you are a business without formal credit checks and ongoing monitoring processes, there is no time to waste in establishing them before the carnage starts. To use a war analogy, you don't learn to shoot your rifle while the enemy is advancing on your position. You learn to shoot in basic training, so those skills are well-worn muscle memory by the time you need to use them. Don't wait for bankruptcies to impact your business before establishing policies and protocols. Now is the time to prepare so you aren't scrambling in the 11th hour.

CEOCFO: ***What is the key to staying on top of a changing situation at any company as far as credit worthiness?***
Mr. Flum: For us, it comes back to the analytics themselves. They need to be accurate and they need to be timely to support the initial assessment and ongoing monitoring of counterparty creditworthiness. Our daily-updating FRISK® score correctly identifies 96%-plus of public company bankruptcies as high risk at least three months before they file. The FRISK® score is a machine learning AI model that takes in information from four different signals to achieve its eye-popping accuracy.

The first input is a Merton model, which uses daily stock market information including the volatility and market cap for a particular company to calculate its probability of bankruptcy. We also include a financial ratio-based signal similar to the Altman Z"-Score, a publicly-available bankruptcy model developed by Dr. Edward Altman, Professor Emeritus, New York University's Stern School of Business. We use many of the same ratios in the Z"-Score, but also include ratios derived from the statement of cash flows thus tying in all three financial statements. The weights applied to each ratio have also been optimized in a non-linear manner to better capture the risk impacts of changes in those ratios. Third, we factor in the lowest agency rating from Moody's, Fitch, and DBRS Morningstar, when they are available.

Finally, we have our proprietary, crowdsourced sentiment analytic, which is calculated daily, based on the aggregate research patterns of our subscribers. As I said earlier, we've been in business for more than 20 years, have exclusively delivered our service via the internet, and have thousands of subscribers including over 35% of the Fortune 1000. As a result, we have an enormous dataset of usage information from some of the most sophisticated agents in trade credit analysis. If a significant group of users displays similar click patterns over a specific period when assessing the credit risk of a particular counterparty, that creates a sentiment signal which is independently predictive of bankruptcy.

We're capturing the sentiment of the very people in charge of the extension of trade credit. So it makes sense that, when the sentiment indicates increased concern for a particular counterparty, a likely result could be the reduction in the extension of trade credit to that counterparty. The loss of that trade credit will create a hole in that firm's working capital, escalating its risk of bankruptcy. For context, trade credit is an enormous component of most companies' working capital, with some estimates having the overall market in the U.S. alone at over three times the size of bank loans.

On top of that, trade credit is typically interest-free or even potentially offered at a discount. Many businesses offer things like 2-10 Net 30 terms, meaning that a customer can get a 2% discount on the invoiced amount if it pays within 10 days instead of taking the full 30 days. In comparison, other sources of working capital like bank loans, bonds, notes, or private capital from a PE or other non-bank financial institution are always going to come with the interest rate, making such financing significantly more expensive than trade credit.

If enough suppliers cut back on the issuance of trade credit, either on the amount by asking for more dollars up front, or by shortening the duration, it could significantly impair the liquidity and working capital of a particular business. Additionally, all of these credit managers are outside of SEC Fair Disclosure meaning that they are allowed to have non-public conversations with their competitors and customers without triggering the need to make a public filing.

For instance, I am going to be providing credit to your business and it's the middle of a quarter. If I was an investor and you told me how revenue was going within that quarter, you would be required to make an 8-K statement to avoid insider trading by providing me with material, non-public information. For credit managers, they have an apparent waiver from the SEC for Regulation Fair Disclosure, meaning the CFO can answer that question about intra-quarterly revenue without having to make an 8-K filing. Without such an apparent waiver, credit managers would need to be significantly tighter in underwriting trade credit and risk locking up global commerce, hence the SEC exemption. To hammer this point home and give a picture of the scale of this market, the WTO estimates that 80-90% of international commerce relies on trade financing.

Analytics that lack similar attention to accuracy and timeliness, like those that only use payment or financial statement information, will always leave risk on the table due to ineffectiveness or latency.

CEOCFO: ***What about supply-chain, potential recession, all the macro events, where and how can they come into play?***
Mr. Flum: It is reflected in all the pieces of information, but I think there are a few that I would call out specifically. Certainly, the market component is a clear indicator. The investor class is a very sophisticated group and essentially, they are making risk decisions daily in how they trade and what stocks they buy and sell. Investors factor in a lot of information in these decisions including ESG, resiliency, and macro data.

Additionally, agency ratings will pick up such information. For a recent example from early April, when the OFAC Russian sanctions went out, a lot of Russian businesses were de-rated. This action marks a very quick reaction from the ratings agencies as compared to normal operations. For most rated businesses, you are going to get one to two ratings a year, depending on how frequently you are issuing securities.

We can also pick up these factors from the news. We process thousands of stories a day from hundreds of sources, which we assess for materiality and subject company matching, and then push those that pass our quality assurance requirements to subscribers. Our news categories include many of these topics including supply chain risks, public filings, score or rating changes, etc.

Finally, SupplyChainMonitor™ features additional information on 10 more general risk categories including macroeconomic, geopolitical, tax policy, legal, labor, security, and many more from the Economist Intelligence Unit (EIU). We are constantly looking for more data to enrich our offerings on all types of business risk, but we are always best-in-breed when it comes to financial risk specifically.

CEOCFO: ***What went into creating the SupplyChainMonitor?***
Mr. Flum: CreditRiskMonitor has been going to the Institute for Supply Management's (ISM) World conferences for nearly a decade and over that time, we've seen our revenue related to procurement and supply-chain subscriptions grow to about 25%, indicating a clear need for financial risk and other risk data in supply-chain use cases. In 2019, we decided to pursue a new service that was more specifically designed for those use cases.

What started with a lot of conversations with existing supply chain and procurement clients about how they are using our data, and what other insights, information, and features would be useful to them, spawned a three-year development effort. This platform, anchored by our best-in-class analytics, features a much richer, interactive, and graphical user experience.

We focused a lot of attention on making our reports and the general user experience much more customizable. Each user can update or create report formats and data views based on his or her preferences to optimize the use of such information in existing workflows. That entire notion came from conversations with clients and was polished using agile, iterative feedback during our beta process, which included ~50 existing clients and ran for about a year.

SupplyChainMonitor™ officially launched at ISMWorld2022 toward the end of May, so it is new in the market, but we are well-positioned as a financial risk expert with reasonable pricing. The Company has always strived to make sure that the value provided to our customers exceeds the price they pay. We've also dramatically expanded our coverage over the past 20 years from approximately 300 companies to about 30 million. Our coverage will likely never be as broad as Dun & Bradstreet's, but it will be full of deep, actionable insights you can trust on the counterparties that matter most to dollars-at-risk: public and large private companies.

CEOCFO: ***How do you reach out to potential customers or are people coming to you?***
Mr. Flum: The CreditRiskMonitor brand is much more recognizable now than when we started, so we definitely have been getting a lot more inbound requests for information and demos than in the past. As far as prospecting goes, we create a lot of content to drive the upstream sales funnel. We put out more than 100 thought leadership pieces a year, including post-mortem Bankruptcy Case Studies. A lot of marketing goes out via email campaigns and social media, as well as some targeted paid advertising. However, the vast majority of our sales come from our revenue teams, which are heavily involved in cold-calling to develop and move leads down the pipeline.

CEOCFO: ***Is there one offering where people can choose different pieces, are there a number of separate solutions?***
Mr. Flum: On the CreditRiskMonitor service, we offer a Worldwide subscription and a North American subscription. Our North American subscription covers businesses in Canada, the U.S., Mexico, and the Caribbean. Within the SupplyChainMonitor™ service, we only have a Worldwide subscription because supply chains tend to have international exposure within their Tier 1 and Tier 2 suppliers.

It's also important to remember that our fundamental services are all-you-can-eat. You can consume as much as you want, so any and every business in our database that you have a relationship with can be part of your portfolio for ongoing monitoring.

There are a few add-ons including a European private company data enhancement that gives you access to about nine million businesses in 10 Euro-zone countries that file financial statements with the country registries. Of those, we can FRISK® score about 325,000 and Z"-Score about 1.2 million, so it is a big coverage enhancement.

For private companies not already covered in our database, several confidential financial statement offerings can be leveraged to fill the gaps and are charged on a transactional basis. Using buyer power as a customer or supplier power as a vendor, you can compel your private counterparties to provide financial statements as part of the contract requirements. We will confidentially process those financial statements and return a private company FRISK® score, Z"-Score, and financial spreads, where available. Clients can take part in this program by doing the data entry themselves, by inviting their counterparties to do the data entry on our Confidential Financial Statements Portal, or by sending the statements to us for data entry.

We also offer a platform-agnostic, REST API that can be leveraged to integrate and automate our data into any other workflow tool that our clients use. Building out more pre-built connectors to workflow systems that are popular with our subscribers is a point of emphasis for future development.

CEOCFO: ***CreditRiskMonitor is a public company; is the investment community paying attention?***
Mr. Flum: We are not a heavily traded unit, but we are listed on OTC Bulletin Board. The volumes are not huge, but it is a small business with $17 million in recurring revenue for 2021. In general, our enterprise value is $12.6 million, so we're trading at 70% of recurring revenue. Information requests from small-cap investors in the value space are starting to come in more frequently. The biggest thing driving valuations with SaaS businesses has been their revenue growth rates. We have started to show high-single-digit to low-double-digit revenue growth, which has been helping to drive up investor interest. We also are unique in comparison to many other subscription businesses in that we've accomplished all of this while maintaining a focus on profitability.

Our founder, Jerry Flum, comes from the investment space having operated a hedge fund for over 50 years. We have not operated our business under the strategy of growing revenue without regard for profitability or free cash flow generation. We do not want to be in a position where the business is overly leveraged, so we have no debt on the books. We have cash equal to 60 or 70 percent of sales, so it is a very stable business with strong recurring subscription revenue. As the market changes to reflect renewed interest in profitability coupled with investors retreating from risk into safe and quality assets, there should be a lot more interest in our business.

CEOCFO: ***What if anything might people miss about CreditRiskMonitor that they should understand?***
Mr. Flum: As far as the business is concerned, we've scaled to a point where we are pretty stable. From a customer perspective, we hear all the time that our customer service is best-in-breed. Every customer has a dedicated account manager that they can reach out to at any time. We typically respond in hours and generally will have a resolution within one business day. That is pretty unprecedented in terms of our competitors. On top of that, we have the best-in-class analytics available for public and private businesses. When it comes down to it, we offer exceedingly high value for a reasonable price.

Finally, we collect over $2.5 trillion in trade AR credit transaction data per year as part of our Trade Contributor Program. This data is provided every month to us by subscribers and non-subscribers. It is comprised of a list of customers, the value of the transactions with those customers, and how past due those customers are in paying those invoices: current or some amount of days beyond terms. We aggregate these provider experiences at the customer level to summarize how well that business is paying its Tier 1 vendors. This payment data is also at the heart of our PAYCE® score, which leverages deep neural network AI to predict private company bankruptcies in the U.S. and Canada.

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