August 2019

ProfitGuard
Know The Risk *Before* You Ship

Credit Risk Newsletter

Credit Risk Insight, News, and Best Practices for the Metals & Manufacturing Industry

In this edition...

Recent Events Impacting Credit Risk

The month of August saw some acquisitions in the scrap metal segment and JSW Steel USA put its backward integration and new EAF plant on hold due to current market conditions. Meanwhile, the oil and gas industry continues to reel from volatile energy prices plaguing the segment.

First off, private investment firm Mill Rock Capital Management LP and Dallas, TX based metal recycler Venture Metals, LLC acquired Versatile Processing Group, Inc. (VPG) on August 5, 2019 for an undisclosed sum. VPG is based in Indianapolis, IN and specializes in recycling nonferrous materials. The combined company will operate six processing facilities and will reportedly have annual revenues in excess of $700 million.

Venture Metals's management will lead the combined company along with executive teams from both organizations and members of Mill Rock. Mill Rock is based in New York and is an affiliate of Stellex Capital Management LP.

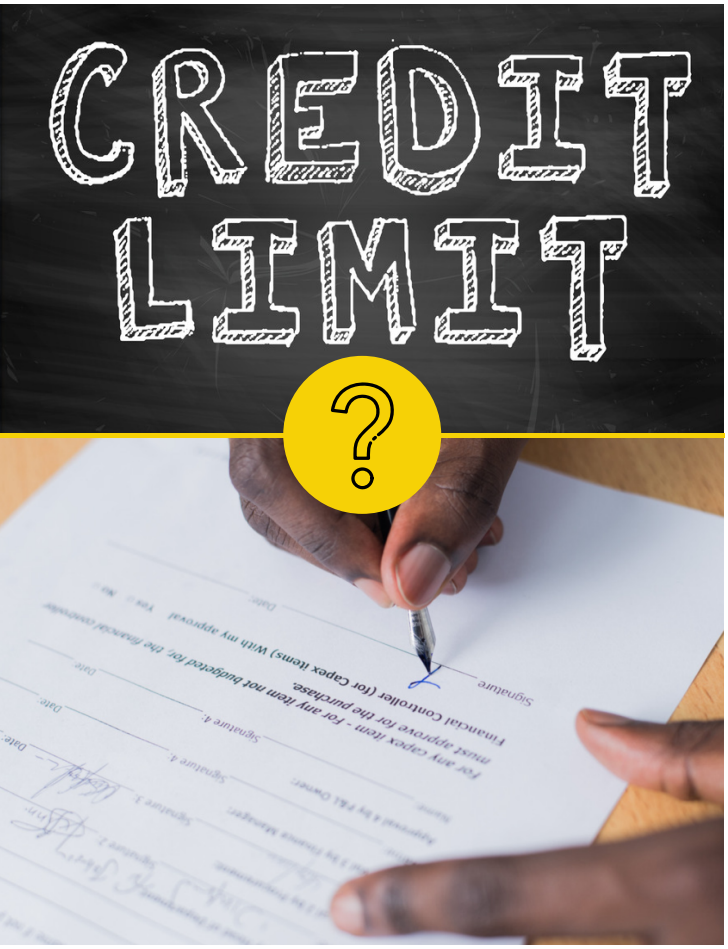
Industrial Services of America, Inc. (ISA) assets also changed hands in August. ISA announced on August 19, 2019 that it entered a definitive agreement to sell substantially all its assets to River Metals Recycling LLC, a subsidiary of The David J. Joseph Company. ISA is a ferrous and non-ferrous metal recycler and the purchase price is $23.3 million. The sale comes after an extended process in which a special committee of ISA's board of directors explored strategic alternatives for the company. Sale of the company was unanimously approved by the company's board of directors but remains subject to certain conditions, including the approval of ISA's shareholders. The sale is expected to close in the fourth quarter of 2019 or the first quarter of

2020 and ProfitGuard views the sale as a positive risk development for ISA.

Shifting to the steel industry, JSW Steel USA recently put plans on hold to construct a new electric arc furnace at its plate mill in Baytown, TX. The furnace was part of the company's previously announced $500 million investment plan to produce its own slabs at its Baytown, TX mill. JSW cited current market conditions and the prevailing policy environment as reasons for its decision. The company's Baytown mill remains dependent on imported slabs to produce its products. However, the company continues to work on ramping up its Mingo Junction electric arc furnace and caster with the intention of it providing slabs to its Baytown, TX mill.

After a relatively quiet 2018, S&P has reported an elevated level of defaults within the oil and gas sector this year. Many troubled companies that survived the industry's numerous bankruptcies between 2015-2017 are now facing challenges from volatile energy prices, liquidity issues, and high leverage once again. S&P reported that ten rated oil and gas companies have been downgraded to 'Default' or 'Selective Default' so far in 2019. Speculative grade, also known as "junk" rated, companies are exhibiting signs of distress and becoming increasingly susceptible to bankruptcy or other forms of restructuring. Short of a significant reversal in commodity prices, the oil and gas sector could be in for another round of defaults. Thus, it is imperative to keep a close eye on any customers that have significant exposure to the oil and gas industry.

Establishing an Appropriate Credit Limit



Setting credit limits for your customers is a practice that every credit manager should use to reduce risk and maximize profit. Without prudent limits, your company may become overexposed without even knowing it. This becomes a major threat to your company's operations when troubles arise with slow paying customers or customers who file bankruptcy.

To begin the process, it is helpful to establish a preliminary credit limit based on the amount of business you expect to do with the customer. This involves taking a dollar volume of credit sales over a period and dividing by the number of expected orders to give you a preliminary credit limit.

Once you've established a preliminary credit limit, you must then evaluate the company's financial strength to see if the limit is appropriate or if it should be adjusted. This can be done by reviewing the customer's financial and banking information, in addition to its payment history and other available

credit data. The limit should be custom tailored to each customer, the competitive situation, and the current operating environment.

Once you have established a limit for the customer you must continuously monitor the customer to see if you should maintain, expand, or constrain the limit. Regularly obtaining financial and banking information can help you monitor the health of the company. Improvements in liquidity and financial results may warrant an increase in credit or a decrease if the results become worse. It is also important to keep an eye on the customer's payment behavior. If their payments start to slow down, this should trigger a credit review.

It may also be useful to set up a credit granting matrix based on the size of the credit limit for each customer. For example, if a credit manager or controller wishes to set a credit limit at $10 million, it may be wise to require the approval of an upper level executive such as a finance director or CFO. On the other hand, if the credit limit is lower such as $50,000 it might not warrant the approval of upper level management.

As you can see, setting a credit limit can be very subjective and there are many factors that make each case completely unique. Following the above-mentioned steps can help minimize risk and ensure that your exposure levels remain manageable.

Trucking Industry in a Recession?

The trucking industry is a vital part of the U.S. economy, moving 71% of all the freight in America and accounting for $796.7 billion in revenue in 2018 according to the American Trucking Association. Freight revenue is expected to increase to $1.6 trillion over the next decade. This sector also employs nearly 6% of all American full-time jobs. Naturally, any major disruption in the trucking industry can negatively impact businesses and consumers alike.

We note the transportation industry is highly cyclical, with big ups and downs. After last year's significant growth, the industry is now in a recession. Major trucking companies have filed for bankruptcy or closed its doors in 2019 including, Falcon Transport, New England Motor Freight, and LME to name a few.

The Cass Freight Index, which measures freight volumes and expenditures of all transportation types and how they relate to the overall economy, points to signs of an economic

contraction as shipments continue to decline. Demand is now weak across many modes of transportation, both domestically and internationally. Cass also stated, "tariffs have throttled export volumes in many areas of the U.S. economy, most notably agriculture exports and other select raw materials."

FTR Transportation Intelligence also reported a deteriorating environment in its Trucking Conditions Index (TCI). The Trucking Conditions Index tracks the changes representing five major conditions in the U.S. truck market: freight volumes, freight rates, fleet capacity, fuel price, and financing. A positive score represents good, optimistic conditions. Conversely, a negative score represents bad, pessimistic conditions. The TCI fell deeper into the negative in May, the third month in a row for a negative reading. FTR's VP of Trucking stated, "most of the weakness is in the industrial sector, so trucking activity related to consumer demand should be relatively stronger than the rest of the industry."

As shipments decline and pessimism grows, this has shifted the trucking industry from capacity crunch to overcapacity. North American Class 8 orders continue to slide and fell below 10,000 units for the first time since 2010. Despite most order boards being opened for 2020 build slots, carriers appear in no rush to grab production capacity. Given the industry turbulence, we believe operational headwinds are increasing for truck manufacturers and their supply chain.