ProfitGuard | Dec 2018

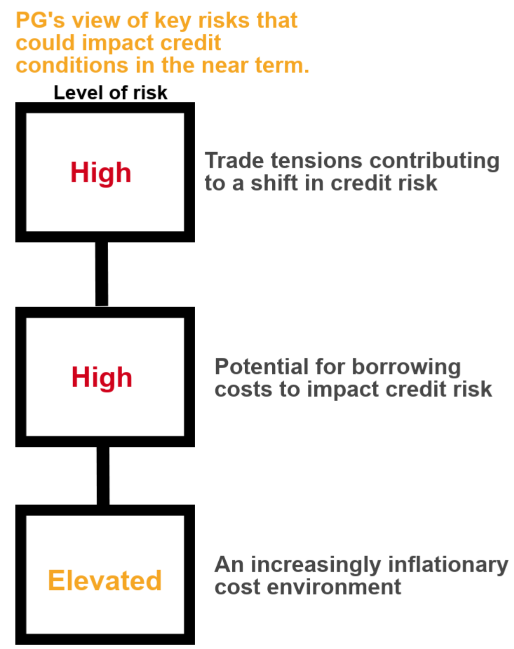
Credit Outlook: Metals Sector

Key Risks

- Trade Tension
- Borrowing Costs
- Inflation
- Current Cycle

Current Environment

Credit conditions in the metals sector remain stable in general. Economic conditions are mostly positive in North America with continued GDP growth and favorable, albeit slowing, end markets for most metal suppliers. However, there are a mix of factors that are more likely to pressure economic conditions versus help them. There are significant risks related to the ongoing trade tension between the U.S. and China, and to a lesser extent, other nations. In our view, the U.S. protectionist policies are creating some winners and some losers. We foresee the tensions getting worse before getting better.



The Federal Reserve is now well on its way to returning to a more normalized monetary policy as it continues to raise borrowing costs. One of the biggest risks to the current credit cycle is monetary miscalculations that could result in either a slowing economy or all out recession.

From a credit risk perspective, rising borrowing costs always ring alarm. This is especially the case for highly leveraged companies that have loaded up on cheap debt during the current expansion. These companies are a lot more vulnerable to external shocks should cash flow generation slow.

Along this same thread, we see the potential for refinancing risk increasing in the near term. Corporate debt levels remain at unprecedented levels and could become a point of contention as interest rates rise. Less creditworthy borrowers may find it difficult to refinance or raise new capital. We are already seeing this happen. Algoma Steel recently withdrew a $300 million exit term loan offering due to market conditions and lack of investor appetite.

In sum, we are seeing cracks on the surface as we endure the longest cycle on record. Any one of these risks mentioned, or another, could accelerate a market downturn or more significant level of corporate credit risk. Now is a good time to get prepared.

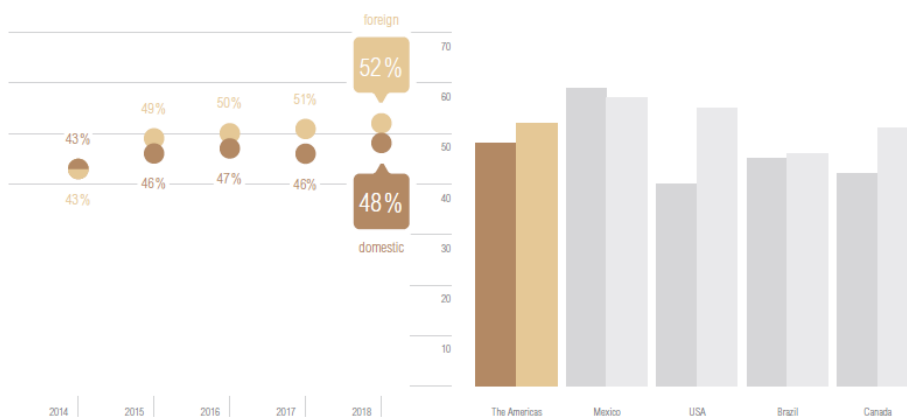
ProfitGuard
Know The Risk *Before* You Ship

Payment Trends

According to Atradius' June payment barometer, past due invoices increased in 2018 impacting 64.1% of their survey respondents in countries surveyed in the Americas.

While late payments from B2B customers were reported to occur less frequently, the average proportion of overdue invoices increased to 50% from 48.8%. All countries surveyed in the Americas – with the exception of the USA – reported increases. Respondents in Canada experienced the most significant increase of almost four percentage points. In contrast, the proportion of past due B2B receivables in the US declined from 52.0% last year to 47.6% in 2018.

Figure 1

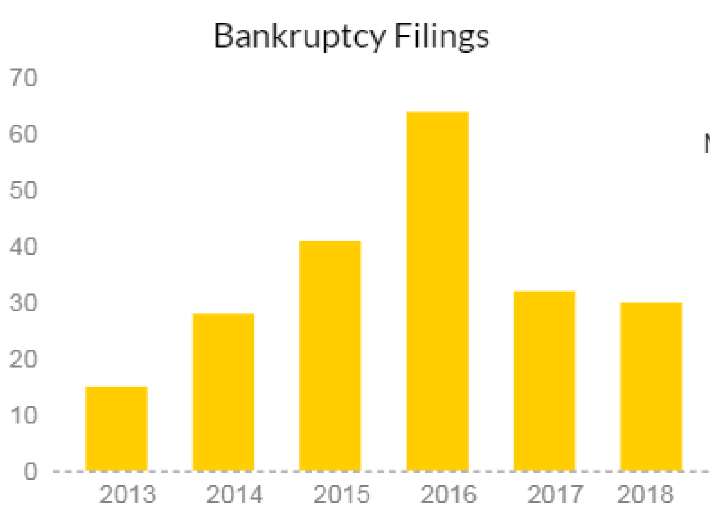


Sample: companies interviewed (active in domestic and foreign markets)
Source: Atradius Payment Practices Barometer – June 2018

Businesses were significantly impacted. 21.5% of respondents have had to correct cash flow, 20.3% to postpone payments to suppliers and 17.5% have lost revenue. The proportion of uncollectable B2B receivables decreased slightly and bankruptcy remains the main reason for write-offs.

Bankruptcy

With the industry restructuring mostly complete now 10 years after the great recession, we can see the level of insolvencies have also trended down for the past 24 months. This is no surprise as there is an inverse relationship between bankruptcy filings and broad-based economic expansion in a growth period. However, if you analyze the top 10 sectors where bankruptcies occurred, we still find metals or metal consuming industries in the top, which is a cause for concern. Construction, energy, machinery & equipment, metals, and automotive segments were all in the top. PG tracks only bankruptcies in the metals industry and saw a slight decrease year over year with 32 major bankruptcies in 2017 and 30 so far in 2018. Our expectation for 2019 is that the decline will begin to trend back up in the next 18 months.



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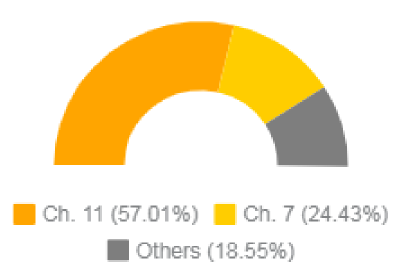
Major Bankruptcies and Insolvencies since 2013



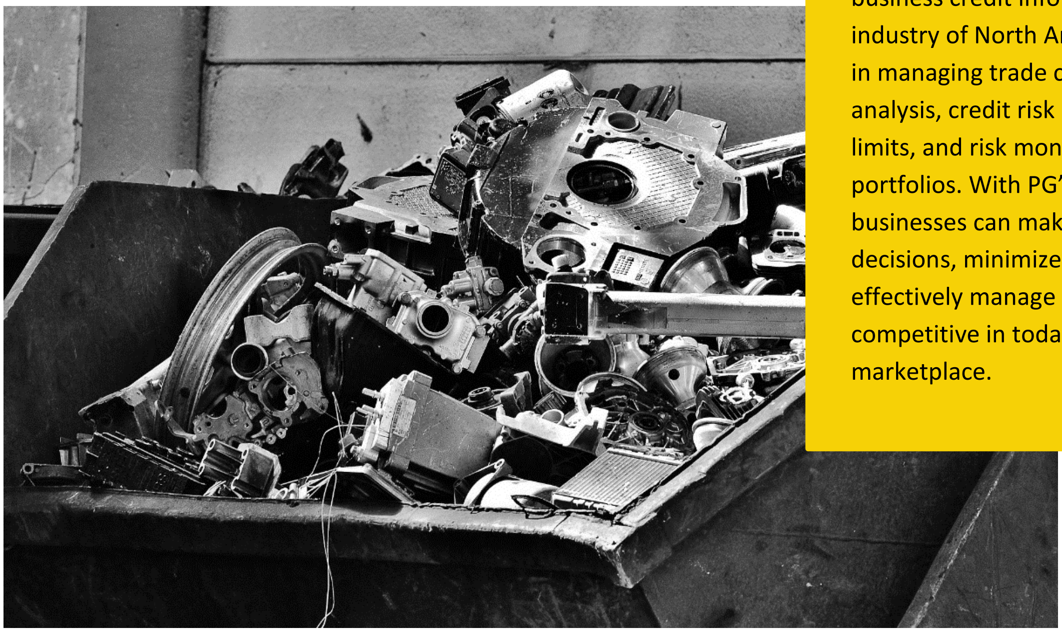
2013-2018 Total Filing Breakdown

What this means for Corporate Credit

For the balance of 2018 and into the new year our focus will be on gauging when the current credit cycle will turn causing economic expansion to slow. Being conscious of the canaries in the credit coal mine is going to be key in reigning in credit exposure on riskier customer accounts.

The top three areas we recommend focusing on are making sure credit staff have the tools and information needed to make informed credit decisions and monitor risk. Secondly, reviewing corporate risk appetite and tolerance to make necessary strategic adjustments for the next cycle and new year. Lastly, review corporate credit policies to uncover gaps or weakness and correct these items so you are better prepared for the future.

To find out how ProfitGuard can help your business, please contact us at **(866) 990-1099** or visit **eprofitguard.com**.



ProfitGuard is the leading provider of business credit information to the metals industry of North America. PG assists its clients in managing trade credit risk with valuable credit analysis, credit risk ratings, recommended credit limits, and risk monitoring of their customer portfolios. With PG's information service, businesses can make more informed credit decisions, minimize bad debt losses, and more effectively manage credit risk to remain competitive in today's rapidly changing marketplace.