Issue 4

April 2012

NASS

The voice of steel distribution

The underlying theme running through previous issues of this Bulletin was, at least from a macro-economic perspective, uncertainty - specifically, uncertainty as to whether the UK economy was going to embark upon a period of steady, albeit slow, recovery from the doldrums of 2008/09 or lapse into a double-dip recession. At the time of writing, the latter appears to have been averted, although taking the last six months together there has once again been no growth at all.

Whilst data reported by sources such as the Office of National Statistics (ONS), Markit, etc. do seem to ebb and flow from month to month, it has been possible to pick out a couple of clear macro trends in recent times, one positive, one negative. On the positive side, the Bank of England's long-anticipated fall in inflation has begun and appears to be on a firm, albeit gentle, downward path - this should help to mitigate the steady erosion in real wages seen since 2009 and help in improving consumer sentiment. On the other hand, that sentiment will not be helped by the unremitting rise in unemployment. Official figures show 2.7m people unemployed, a 17 year high, although that number does not include large numbers who are underemployed e.g. those in part-time work who wish to work full-time. Whilst the private sector has created net new jobs, albeit often low-paid, these have in many months been insufficient to offset job losses in the public sector. Who knows what the net effect of these divergent trends will be!

In any event, the broadly flat economy (only half of the 2008/09 GDP loss has yet been recovered) remains vulnerable to external shocks e.g. likely European recession and/or further Sovereign debt problems in the Eurozone & to internal problems engendered by a general lack of confidence.

With regard to confidence, there has been some evidence recently to suggest that business sentiment is improving somewhat. Many steel-using industries, construction generally excepted, are performing well (e.g. auto, energy, yellow goods). It is ironic, therefore, that there have been some indications of late that credit insurers are becoming a little more cautious, especially perhaps in regard to some quite high profile buyers in a variety of trade sectors. Whether this is a sign of things to come remains to be seen, but it is certainly the case that the increasing volume & value of late payments & claims currently in evidence will not help matters. Add into the mix a ballooning of corporate refinancing deals becoming due in 2013 & a recent government study pointing to a funding shortfall over the next five years of up to £191bn resulting from 'continuing bank deleveraging', and there is certainly the potential for credit insurance market conditions to worsen over the medium term.

As ever, Graydon UK offer readers sound advice on credit management-related issues and some illuminating data on current insolvency trends, whilst for this issue, we welcome Atradius as our insurer contributor, who inter alia, offer some interesting comments on some of the key steel-using industries.

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Atradius and the Steel Sector

Ongoing dialogue - help us to help you

The economic problems of 2008/09 re-focused all businesses on the basics - cost, cash flow and stock inventory levels - and the same is entirely true of the steel industry. This focus has continued as commodity prices rose at the beginning of 2010 and 2011, followed by price deflation as the year progressed, mainly on the back of weakening demand. In order to regain margins, mills have announced price rises from March 2012, meaning re-stocking for service centres highlighted by an increase in credit limit traffic.

Growth in the UK economy since the end of 2009 has been weak as the woes of various world economic problems have impacted UK growth, with GDP for 2011 recently revised down from 0.8% to 0.7%. Overall, the economy has alternated between growth and contraction in successive quarters since mid 2010. This trend seems set to continue - growth declined in Q4 2011, so we are likely to see some low growth for Q1 2012, with no technical return to recession. It is predicted that the economy will continue to zigzag between growth and contraction this year, resulting in predicted GDP of less than 1% for the year.

Despite the gloom, some sectors are performing better than others. If we take the three main sectors serviced by steel service centres, namely automotive, manufacturing and construction, we could view these as green, amber and red in terms of risk analysis. Having said that, there are some blips on the horizon even for automotive. Despite recent news on the expansion of some of the car manufacturers there are concerns over the viability of the GM facility at Ellesmere Port, which will impact suppliers. And whilst engineering can be considered a fairly stable ship, in contrast, the problems within construction are well-documented, with little prospect of recovery until at least 2014. The magnitude of this problem is reflected in our own Atradius data - in 2011, construction contributed 7% to our overall risk portfolio yet was responsible for 21% of the claims paid. Another area of ongoing concern is steel fabrication where a number of insolvencies have recently been announced and others continue to show clear signs of distress.

Having said all of this, it isn't entirely doom and gloom. Demand for steel in the UK in 2011 was 5% higher than in 2010, though still 27% below 2007. In some respects, demand tracked pricing, greatest in the first quarter but dropping off in April, compounded by the proximity of Easter and Royal Wedding Holidays and component shortages at UK-based Japanese car plants following the tsunami. Despite the summer shutdown, demand fell only slightly in Q3 with Q4 showing a similar deterioration. Deliveries from UK mills were down 1.9% whilst imports rose by 9.9%.

In view of this statistic, recent reports that 70% of galvanised steel and circa 45% of structural sections are imported are unsurprising. Admittedly the tough business environment seems set to continue through 2012, with a number of companies looking towards growth through export. But this also means that there is still business to be won by UK service centres.

So, what does this mean to Atradius in underwriting your business?

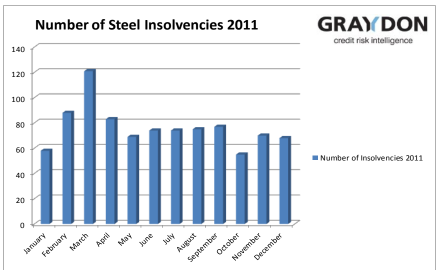
As a sector, metal represented the sixth largest exposure in our risk underwriting portfolio in 2011 , representing a significant part of our risk portfolio, and despite the challenging environment, we remain very much open for business. Whilst the sector has improved in general, some subsectors continue to struggle. In view of this, we continue to stress the importance of providing us with up-to-date management information - open, ongoing dialogue is critical in accurate risk assessment in today's challenging environment.

We would like to thank NASS members for taking this on board in our regular meetings with them. With this in mind, we've also made it easier to keep in touch – our team of specialised underwriters are regularly available for meetings in our offices in Birmingham, Manchester, London and Cardiff, in addition to ad hoc site visits. Keep in touch - and continue to challenge us if you disagree with our assessments.

GRAYDON
credit risk intelligence

All in all, 2011 was not the "blood-bath" a number of analysts were forecasting at this time last year. Will 2012 be a similar year? Too early to tell but we see no reason to believe it will be worse at this stage. 2012 does look likely to be another difficult year for all concerned and, whilst the forecasted price rises will help, competition will remain extremely tough.

Assessing insolvencies in traditional "metal bashing" sectors, such as Engineering, Fabrication etc. in 2011, we saw a sharp increase in the first quarter culminating in a peak rise in March which was more than double that for January. Thereafter the numbers fell to an average of around 72 per month for the remainder of the year, see graph below. The Construction sector looks likely to remain very difficult and depressed and credit insurers reluctant, understandably, to provide across the board cover. Matters are not helped by the Government's austerity measures and their impact on Government spending on large and even medium scale projects.



It should also be pointed out that the vast majority of winding up petitions came from actions taken by HMRC and this trend will no doubt continue; we see no let up - the Government needs money!

One of the biggest obstacles for companies in general this year will again be access to finance. Banks failed miserably last year, with the Government seemingly toothless to implement actions against banks for failing lend to SMEs. This, to a certain extent, has paved the way for alternative lenders to both enter and increase their presence in the marketplace but as an expensive alternative. This is a worrying trend putting increased pressure on all concerned to either grow or just survive.

You could argue that it has never been a tougher time to be a credit manager but it is also the case that the credit manager has never had a better opportunity to both implement and dictate procedures and terms to both customers and potential customers. Opening new accounts with competitors remains a difficult procedure, with companies reluctant to take on someone else's bad payer or potential bad debt. Much better to keep an existing supplier happy.

It is essential that the stringent procedures put in place over the last couple of years remain in place. Complacency must be avoided even if / when these troubled times abate. If anything, strengthen these procedures. The relevant points below are a must:

- Continue to get the most up to date accounting information from customers, be it management of draft accounts, and diarise to get these at the earliest opportunity. Back this up with forecast figures as well.
- Ask about their client base, and evaluate those risks too.
- Work with your sales team, not against them.
- Don't be a customer's bank - be strict on payment terms. A good sale is one that pays on time.
- Be particularly aware if your customer is not credit insured.
- Assess companies' lenders (via charges registered) as expensive alternatives to the main line banks are on the increase.
- Interrogate your credit information supplier - you pay good money for this information and you need to feel confident that they are doing all they can to help you avoid bad debts.

The same message from 2011 should still be applied to 2012, " Credit, where credit is due".

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