



The voice of steel distribution

Will next year be better?

The question always comes up as we near December. Various institutions are churning out economic outlook reports for 2015 and 'gloomy' sums up the forecasts for the global economy. Indeed even our Prime Minister has recently commented that 'the lights are flashing red again on the dashboard of the global economy'. Clearly there are concerns regarding the slowdown in India and China and more marked slowdowns in Brazil, Turkey and South Africa but it would have been naive to expect these very high levels of growth to be maintained. Putting aside the ongoing geopolitical uncertainties surrounding Russia and Ukraine and threat of Ebola the question is what has the global economy done to prepare for this inevitable slowdown? The answer is very little.

As a result we are faced with a more serious issue closer to home in the shape of the Eurozone. Whilst weak growth on its own is not necessarily catastrophic for the UK, slow growth could force markets to re-evaluate the debt sustainability of countries such as Italy where national debt will be 114% of GDP this year. If investors feel that that public finances are out of control all bets on the sustainability of the Eurozone could be off. Let's be clear Italy would be a different ball game to Greece!

If there are some positive points they are that Eurozone growth was better in the third quarter than expected and countries should be enjoying a boon

from low oil prices which set to remain with us for the short term. Whilst this will not be such good news for oil producing countries it will offer some much needed assistance to the oil-importers in Europe.

Looking closer to home the UK economy has started to slow with British manufacturing growing at the slowest rate for 17 months in September as demand weakened due to the strength of sterling and weak demand in Europe. Whilst the UK economy looks set to outpace other advanced economies this year it is expected to slow to 0.5% in the last quarter of 2014 compared to 0.7% for the third quarter. At present best estimates for the UK economy in 2015 show growth levels of 2.5% down from 3% for 2014 with the services sector expected to continue to drive the UK economy. Whilst manufacturing output has grown during 2014 the outlook is less bright due to the aforementioned slowdown in the Eurozone.

The cooling down of the economies in India, China and Turkey has provided the European steel market with further tests. The resultant overcapacity from these regions has driven prices down across Europe, in a market that is already experiencing problems with demand. This problem is not product specific and presents significant threats to European producers as demand remains weak across all sectors within the industry.

These conditions are not alien to UK

Steel Stockholding and as such stockholders have adapted trading strategies brought on by the first recession in 2008 to meet these challenges. Whilst the underlying supply of off the shelf products may be under pressure most stockholders now provide added value services and this is where additional revenue and margin is being achieved. This is not by luck but by recognising what a volatile, highly competitive market requires. Is this example one of the reasons why the UK can outperform its neighbours during difficult times? I'd like to think so.

There is no doubt 2015 will present challenges as we cannot expect to remain isolated from the problems being experienced by other economies. That said, we have shown previously in 2003 (when Germany was in recession) and Eurozone growth was 0.7, the UK was able to expand by 4.3%. Whilst it would be wonderful to see this level of growth again a realistic view of growth for 2015 would be around 2.5%, with a realistic possibility of inflation remaining below 2% and wage growth finally out-performing inflation at 3%. How many of our neighbours would settle for that now?



EULER HERMES

Our knowledge serving your success

As we are all closing our books for 2014, it is time to take stock on what has happened for businesses around the world, especially when it comes to past dues, non-payments and insolvencies. We have good news: worldwide, insolvencies decreased by -12% this year and past dues have also decreased for the first time since 2011 by almost -30%. However, we also have concerns. The false start for the global economy caused company turnovers to remain flat in too many countries. If you add to that political hotspots where short-term financing is constrained and sluggish structural reforms in several advanced and emerging economies, we unfortunately continue to see bankruptcies around the world standing 12% above their pre-crisis levels. Turbulence is still on and companies cannot afford to be taken off guard. (Source: Euler Hermes Economic Outlook – no 1211 - 1212)

What does it mean for 2015? Well, the second half of this year offers a mixed picture as payment terms continue to increase by 1 day every year since 2010, reaching 73 days by yearend, and non-payments went up by +23%, mainly because of China and Russia. We therefore expect insolvencies to continue to decrease in 2015 but only by -3%

this time as growth, trade and financing will only be picking up moderately, and potential headwinds on demand, liquidity and politics are still looming ahead. When you break down these results by industry, you understand why the devil is in the detail: stories differ quite a lot across sectors or countries. The continued severity of bankruptcies in the commodities sector because of low oil prices causing margins to fall very rapidly, the restored confidence in the UK offering solace to the retail industry after years of painful restructuring, and the protracted domestic crisis in Italy are good examples of how details matter. (Source: Euler Hermes Economic Outlook)

The UK will remain the fastest growing Western European economy in 2015. Growth is expected to slow to +2.5% after 3% in 2014. In 2014, Euler Hermes expects the total number of insolvencies to fall to 24,100 cases (-5%). The positive dynamics in recent years is not surprising given Britain's rapid economic recovery. However, in 2015 EH expects the improvement to slow down to -1% for several reasons. The country is likely to be affected by external factors, such as the economic woes of France and Germany, two of its major trading partners. (Source: Euler Hermes Economic Outlook)

A global view is always required when reviewing the steel sector. Global steel consumption is now expected to grow only 2% this year, significantly below the association's

previous forecast of 3%. (Source: World Steel Association). The slowdown in China's demand, reflecting the structural transformation of the economy, has contributed significantly to the lower global growth projection. Europe is expected to see a rise in steel use of 3-4% this year to 146m metric tonnes, however, that figure is expected to fall to 2.9% next year as both Germany and France falter. In terms of the global steel prices, they have remained weak and overcapacity will remain the largest concern within the sector. European demand remains at more than 25% below its pre-recession peak. In China we expect GDP growth to decelerate to +7.4% in 2014 and +7.3% in 2015. Government efforts to rebalance growth away from investment toward consumption are underway. Exports will likely act as a cushion with an increase of USD300bn in 2014-15 benefitting from rising global demand. The cooling economy in China has seen a shift with its steel producers selling excess stock on the international markets. Nowhere has this been more evident than in construction related steel, and Chinese reinforcing bars is now reported to account for 35% of the UK market.

Cheaper iron ore prices have helped the industry to claw back some profitability, and the steel making commodity recently fell to \$68, its weakest level

since June 2009. A supply glut stoked by big, low-cost miners that boosted output at a time when the Chinese economy was slowing has seen iron ore prices fall by more than 45% this year. Weak iron ore prices will be hurting those at the higher end of the iron ore cost curve in China. Iron ore prices are expected to remain weak in 2015. For European steel producers, however, energy costs remain a huge burden. European producers will want a policy that does not impose heavy carbon emission penalties on companies that compete against less regulated Asian rivals. Regulators are reported to be recommending a 40% cut in carbon dioxide emissions. Steel producers say that will drive up costs for heavy industry and make European steel less competitive.

Euler Hermes UK has been in regular dialogue with a number of NASS members regarding their current purchasing strategy. Following our discussions with members, there is clear consensus that there has been a shift in the supply base with imports taking a larger share. These discussions have enabled us to re-align cover as appropriate in line with purchasing patterns whilst taking into account peak trading requirements were temporary limits are considered.

For some time now European steelmakers have been contending with rising imports, and we have seen increased market competition in nearly all products, with end user markets such as Construction, Automotive and renewable energy generating increased demand. NASS members have also very pro-active in keeping us updated on these changes and also helping us understand their forward purchasing. We have found this very useful and would encourage this to be maintained.

GRAYDON open in business

"Not out of the woods just yet"

The general feedback from NASS Members and our other steel clients is that trading currently, and so far for 2014, has been pretty good, and certainly no worse than in 2013. There remain good opportunities across a number of sectors, particularly Automotive and Energy, confidence is growing and, although not spectacular, it is increasing nonetheless. From my Credit Insurance colleagues, there remains a good appetite for providing cover across the board as well.

There are problem areas of course, none more so than construction (commercial that is) and that will be the case for some time to come. Most good news from this sector is regionalised (London and the South East) and not a reflection of the UK as a whole. Forget what you read about construction statistics in the press - this includes house building and, as we all know, not a lot of Steel goes into domestic house building. For commercial construction to turn the corner, it will take a major policy change by Government and, as I have mentioned before, the vast majority of commercial construction comes from Government Initiatives.

Banks are still a major problem. They are not lending to pre-recession levels and are continually falling short on Government recommendations, with still no end in sight to this scenario. Alternative lenders appear very much to the fore when it comes to growing their lending book but this comes at a cost - a high cost at that, however, if you can't go down the traditional route of getting support from your bank and you haven't recently won the "Euromillions" jackpot, then who else do you turn to?

Insolvencies are down, and unless something goes spectacularly wrong in the 4th Quarter, will remain significantly down overall com-

pared to 2013. Who says so? The Insolvency Industry, that's who, and this is confirmed in the close discussions I have had with major firms, such as The P&A Partnership.

There have been a few notable failures this year including Redi-Rack and Coupe Foundry but the most notable failure would be The McArthur Group Ltd., a business dating back 170 years but who had sustained large losses over a period of several latterly. The Administrators sold the business almost immediately (doesn't that always happen) to a firm of venture capitalists (VCs) under the usual banners of "Preserving jobs" and "Securing the future of an established business", and never mind the creditors who had supported and stood by the business for many, many years and who lost money through no fault of their own. Preserved jobs and secured a future? The reformed business failed again within 5 months!

I do have a particular issue with regard to VCs, and have done for some time. Don't get me wrong, there are some very good ones but also some very bad. I recently wrote an article for a publication headlined, "VCs, can you trust them?" Only recently, a giant of a business, Phones4u, was placed into Administration, threatening over 5,000 jobs - it was VC owned, as was another recent failure, Unipart. The latter had only had a majority stake purchased in it in 2011. Other notable failures in recent years, which have been VC backed, include famous names such as Comet and MFI, names which have now completely disappeared from the high street. The point I'm making here is how much times have changed. Generally, a VC strategy was to Invest, turn around a business in 3-5 years and sell on. These days, we see some of these investments last less than two years or, in the case of McArthur Group, less than six months. With VCs generally investing in big concerns, the failures are mostly headline grabbers and involve multi-million pound operations. There will be others, so be aware about who actually owns that big customer of yours!

You don't need me to tell you how tough it is

out there, not only in securing affordable finance for growth or sustaining current sales levels, but also keeping costs under control. Energy prices are high, as are raw material costs for the producers.

It never ceases to amaze me how resilient a bunch the operators are in the Steel Sector. Bashed by a recession the likes we have never seen before and, in a lot of cases, having had to adjust their business models to fit the times, they remain steadfast in seeing out the storm and fighting tooth and nail to keep their businesses going. The famous quote (and a song for some of you more mature readers) "when the going gets tough, the tough get going" sums up the Steel Sector perfectly. I didn't notice an empty room at the very excellent NASS Dinner this year, did you?

Sustained growth opportunities will return, of that I have no doubt whatsoever, but remain vigilant:-

- New practices, adopted during and since the recession, must remain a habit. For the credit professional - keep that good dialogue with customers, prospects and your own sales team going. Remind them (sales) that a good sale is one that paysand on time!
- Get regular and on-going management accounts from your customer to ensure you have the fullest and most up to date information on them. Know how they are doing NOW! Don't just rely on historical data.
- The customer is king! Yes, that still applies - sales are the life-blood for any business, but knowledge about your customer, or prospect, is the king of kings.



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