# SFSA CASTEEL REPORTER

**Steel Founders' Society of America**

**a monthly publication serving SFSA steel casting industry Members**

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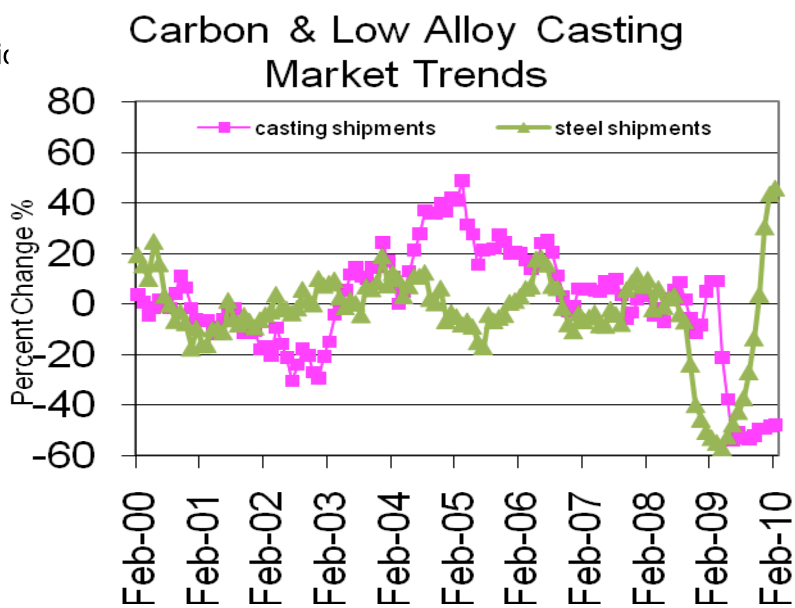
# ***May — 2010***

## Casteel Commentary

The Casteel Commentary expresses a basic optimism about our near term future business conditions. We have not created the capital equipment capacity to meet the global demand for materials and energy. When the financial system stabilizes and allows large capital investments, steel casting producers should be busy and profitable. I expect this to happen at least by 2011 if not sooner.




## Spring Management Meeting

The Spring Management Meeting was well attended. Handout materials for members can be downloaded from http://www.sfsa.org/meetings/spring10.php. The presentations included a discussion of credit management by Steve Gan and an article is attached to this newsletter. Of particular interest should be statistics on financial ratios and performance on steel casting producers in the US.

## Upcoming Meetings

-Specifications Committee – St. Louis, MO – 5.18.10

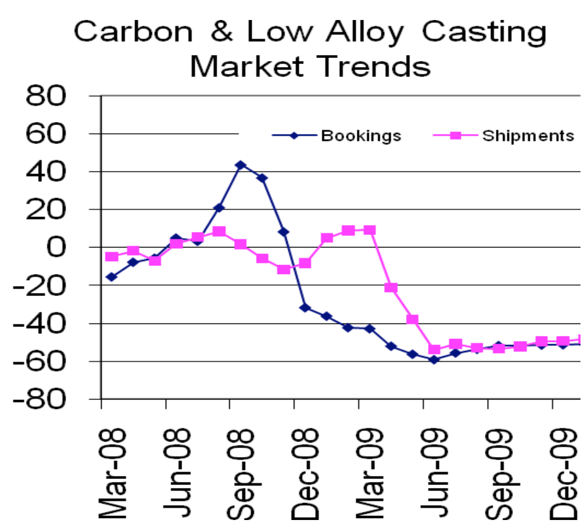
-Safety + HR – Rexnord-FALK, Milwaukee, WI – 8.18/19.10

-North Central/Heavy Section Product Group
- MEelecmetal (V-process), Duluth, MN – 6.22.10

-Carbon and Low Alloy Research Review meeting
- Schiller Park, IL - 7.14/15.10

-Specifications Committee – San Antonio, TX – 11.16.10

-National T&O Conference – Chicago, IL – 12.8/11.10



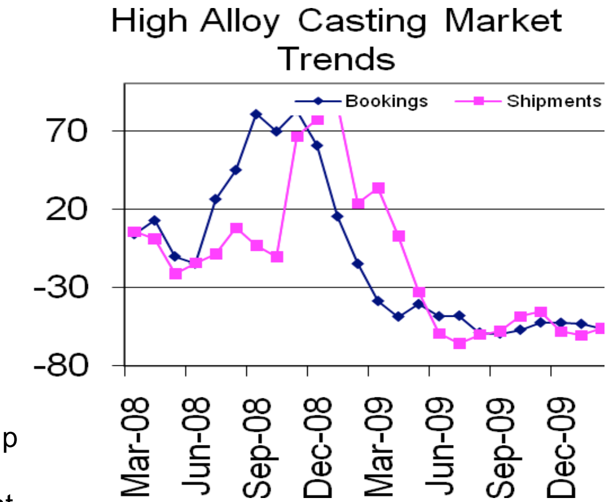

## Future Leaders

The Future Leaders met in conjunction with Cast Expo. Attendees enjoyed the opportunity to see the show equipment and discuss current foundry practices to brainstorm novel approaches with their peers. If you are interested in participating, please contact David Poweleit.

## Investment Casting Product Group

The first meeting of the SFSA investment casting product group was held at Mercury Marine. The meeting included significant research from past SFSA programs on the process. The future direction of the group was Any member involved in investment casting is welcome to join this group.

## Market News

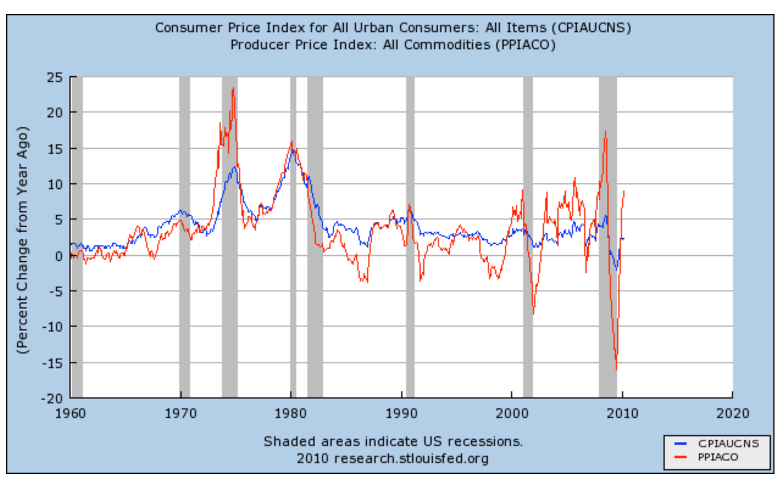



Most market news and commentary indicates a strengthening recovery led by manufacturing. Employment news and consumer sentiment-spending all show improving economic conditions. Steel makers are up sharply. Steel casting production is highly correlated with steel production with an r-squared of over 0.70 for the past three decades on an annual basis. The graph inserted shows the monthly percent change numbers for steel shipments and steel casting shipments. The steel shipments numbers come from AISI and the casting shipments are from the SFSA trend cards. While the month to month trends do not have a good match, it is possible that the steel production numbers lead the steel casting production numbers by 6 to 12 months. This graph suggests that the recovery in steel products may be seen by mid-year in steel casting shipments.

The SFSA trend graphs show dismal market condition through February of 2010. Bookings are off more than 50% from a year ago in both steel and stainless markets. Shipments are off less but not by much. Backlogs have increased modestly from the extremely low levels of a year ago.

As seen above steel product shipments have improved markedly. After falling from producing over 9 million tons a month in mid 2008 to about 4 million tons a month in mid 2009, the production of steel long products is back to over 6 million tons. Steel mills are operating in the range of about 70% of capacity. The Census numbers for iron and steel casting orders and production have shown a similar trend. Shipments and orders of iron and steel castings fell from levels of $1,900 million in late 2008 to $1,100 million per month in mid 2009 before rebounding to $1,300 million per month in early 2010.

Our steel casting production peak was later occurring in early 2009 and our low was likely late summer to early fall 2009. Anecdotal reports suggest that markets have improved for most suppliers of steel castings. Production levels appear to be above 50% of peak production but the market is still uncertain and volatile. Strong orders will be followed but slack periods.




Commodity prices continue to point to the probability of strong demand for capital equipment. High inventories and continued instability in the financial markets have tempered the ordinary improvements in demand that should be evident.

It is likely that we will continue to see a slight improvement in a period of continued business volatility. When the recovery or some other triggering factor moves the economy to more typical conditions, demand for steel casting should be robust. We are likely to be operating at high levels of capacity utilization by the middle of 2011.

**Casteel Commentary**

I remain optimistic about the future of our industry. Making a component by casting it is the most efficient process and allows the highest performance and most elegant design. Much of our research is developing the manufacturing, design and inspection technologies we need to exploit the potential of our products. Steel castings can experience a breakout with new and challenging products undreamt of today.

I am also optimistic because steel casting will be in strong demand as we invest in capital equipment needed for the expanding global economy. The inserted graph shows the year to year change in the producer price index PPI in red and the consumer price index CPI in blue.

In the inflationary late 1970s, the PPI outpaced the CPI and steel foundries were able to raise prices and operate profitably. Much of the capital investment that we have today in infrastructure and manufacturing capacity was made in the 1960s and 70s. From 1980 onward, PPI was often negative, we were reducing our prices while CPI was modestly positive. Our excess investment in infrastructure and capacity was being liquidated by inadequate price realization.

Eventually, the growth in global economies and the liquidation of capacity led to a shortfall in supply. After the recession starting in 2001, the obsolete capacity overhang from the 70s was liquidated and with global demand increasing commodity prices rose sharply. This led to steel foundries operating at near capacity. Price rose to reflect this new imbalance between supply and demand.

The mismanagement of the financial system provided money to fuel the sharp price rises in commodities. This financial mismanagement was compounded by the shift from a capital infrastructure with excess capacity to one that was limited in supply. The breakdown of the financial system dumped the economy into a hole that saw a sharp decrease in demand for all commodities. This is a temporary downturn and has the perverse effect of liquidating additional capacity that will be needed to meet future requirements.

So, as soon as the credit system stabilizes so that large capital projects can be released, Steel casting demand will push us back to operating at capacity, likely to happen by the middle of 2011 if not sooner. The ability to invest in new or expanded capacity will be limited by the 30 years of mostly excess capacity, the memory of this economic downturn, and the lack of willing lenders or capital. We have not needed the large capital investments in infrastructure and capital since the 1970s and public policy is a disincentive to make these critical investments.

Existing plants will be able to reap the strong returns because of the lack of capacity and should be able to recapitalize and modernize their plants.

*Raymond Monroe*

## DON'T LET THIS ECONOMIC BLACK HOLE MELTDOWN YOUR ACCOUNTS RECEIVABLES

*In these unprecedented economic times, Commercial Credit Insurance can be an indispensable tool for minimizing the impact to your company due to a customer bankruptcy.*

By Steven Gan

It seemed that by even mid-2008, our economy was still going strong and there was a feeling of continued prosperity ahead of us. Then all of a sudden we were totally shocked by the ultimate collapse of Bear Stearns (and its sale to JP Morgan at pennies on the dollar) and subsequently other major investment houses. Since then we have witnessed the collapse of the US auto industry and have been grappling with an economy that has produced thousands and thousands of business bankruptcies.

The number of business bankruptcy filings nationwide in 2008 totaled 43,546, which was almost double that of the 23,889 business bankruptcy filings reported in 2007. Furthermore, according to the American Bankruptcy Institute, the total number of business bankruptcies (either Chapters 11 or 7) for 2009 came to 60,837. Where this economic black hole will lead us to is anybody's guess but with so many well-known and "built to last" companies declaring bankruptcy, we can longer assume that even our "blue chip" customers are immune from falling prey to financial collapse.

I'm not trying to be all "gloom & doom" in this article but at this point you should not only be seriously thinking about the financial stability of your customers but you should also be taking as many credit risk management precautions as possible to protect your company in these very uncertain economic times.

Besides the tools, equipment and machines that many SFSA members consider to be their prized assets, your accounts receivables are also one of your very valuable assets. However, it is an asset that unfortunately most company owners and managers may not really understand.

In its simplest terms, an accounts receivable represents the monies that your customer owes you. However, more completely it represents all of the labor and material resources that you have utilized in order to create, market, manufacture, ship and sell your products and services, ***all on the promise that you will be paid***.

And what happens if your accounts receivable never gets paid? Can your company weather this loss? The problem may not lie with your customer, who you know very well and have done business with for many years, but with your customer's customer about whom you know very little. In normal times this happens occasionally but in this economy, especially in view of all the bankruptcies related to certain industries such as auto, housing, manufacturing, and construction, it will most likely happen much more often and could seriously impact your cash flow, bringing your own company to a complete halt. We may think that we know our customer but often ***we don't know our customer's customer, and herein lies the risk***.

With the above in mind, **Accounts Receivables Insurance** (also known as Credit Insurance), is a before sales credit risk management product that insures your commercial accounts receivables against your customer's failure to pay or bankruptcy. In other words, even if your customer defaults on payment or goes bankrupt, the credit insurance company will step in and insure that you receive your payment.

In Europe over 80% of all commercial transactions are covered under credit insurance. In the US, although credit insurance is not very well known, it is a multi-billion dollar industry. The credit insurance industry is comprised of about 10 major insurance companies that include: Atradius, Euler ACI, Coface-USA, FCIA, QBE-USA, Ex-Im Bank, AIG, Lloyds, Chubb Group, and Zurich. Some of the credit insurance companies will cover both domestic and overseas receivables, while others will concentrate only on insuring overseas receivables. Some provide a variety of credit risk services such as credit reports, factoring, and debt collection, while others provide only credit insurance coverage. Regardless, depending upon the insured's industry, history of losses, and creditworthiness of its customers, credit insurance policies are very flexible and can be tailored to fit the insured's needs.

At the most basic level, credit insurance is designed to protect a company from unexpected large losses due to the insolvency or payment default on the part of the insured's customers. The above-mentioned underwriters who specialize in this unique coverage, will in most cases, conduct credit evaluations on the accounts that a company wishes to insure and approve them for specific coverage limits. The coverage limits are determined based upon requests by the insured and the results of the credit investigation. Given this active credit investigation on the part of the insurer, credit insurance should be approached as a tool you can use to grant credit to companies in the event of a possible loss for which you are looking to shelter.

The first step to understanding if a credit insurance program is a good fit for your company is to identify the potential risk within your customer base and accounts receivable portfolio. If there are significant customers overseas to whom you are selling on credit then this would be considered a risk. Or, if there is a significant pool of customers within your customer base that occupy a large percentage of your total sales, whereby even one default would have an impact on cash flow, then this also would be considered a risk situation.

Credit insurance policies can be tailored for specific credit risks, so coverage details vary. Some policies may cover an entire accounts receivable portfolio while others may cover only the top 10 customers. Some policies may contain both deductibles and co-insurance — it all depends upon the needs of the policyholder and the risks within the portfolio.

As I had mentioned above, the main events that are covered under a credit insurance policy are Payment Default and Bankruptcy of a customer. Payment Default is defined as the customer having the will and volition to pay but not the ability to pay. Disputes against the products or services sold are not immediately covered by the credit insurer. If they cannot be resolved amicably, then they will need to be settled in court with a judgment in favor of the policyholder before being reimbursed by the credit insurance carrier. Conversely, any time that a bankruptcy is declared, whether it is Chapters 11 or 7, the claim will be immediately recognized by the credit insurance carrier and payment will be forthcoming shortly.

Although credit insurance is a safety net that protects a company's receivables, not every customer can be covered under a policy. Prior to entering into a policy, credit insurers will perform an underwriting process in which the credit worthiness of all the major accounts are reviewed. During this process, any negative information—such as lawsuits, history of non-payments, or other issues against the customer—may come to light, which could affect the possibility of coverage. Depending upon the degree of the negative information, some policyholders may be covered only up to a certain limit or not at all.

<u>How much does credit insurance cost?</u>

Generally speaking, the premium is based upon a potential insured's estimated annual sales. For example, if sales were about $10 million then the premium rate would range between 0.15 – 0.25% and the premium would be about $15,000 - $25,000 per premium period (usually one year).

There are several factors that influence a premium rate such as:

- Industry of the Insured
- Pool of Customers Being Covered
- Creditworthiness of Customers
- Customer Location (domestic or international)
- Deductible Amount (this is always an annual aggregate amount)
- Previous Loss History
- Financial Condition of the Insured
- Internal Credit Management Control of the Insured

<u>How much is paid out?</u>

Depending upon the amount of the deductible and the co-insurance that an insured has with their policy, credit Insurance generally pays out between 80 – 90% of the loss. Payments will be reduced by the return or salvage of any equipment and inventory. Subsequently, the credit insurance carrier takes over the receivable as the creditor and either performs collection activities against the debtor or stands in line as one of the unsecured creditors. In addition, depending upon other secured interests that the creditor may have against the debtor, all these secured interests will need to be perfected prior to any payouts.

<u>Enhancement of Borrowing Power</u>

Although the main goal of Credit Insurance is Accounts Receivable loss protection, it is often used as a way of ***<u>Enhancing Borrowing Power</u>***. If the insured is using its receivables as collateral for a line of credit (working capital loan), credit insurance can provide additional comfort and protection to the lender so that they may be able to enhance the borrowing arrangements. They do this by increasing the percentage they will advance against insured accounts, and/or roping more accounts into the borrowing base – such as large concentrations, slow payers, export customers, etc. This allows the insured to maximize the amount of working capital available from the same pool of receivables. If the insured is in a high growth mode and finds himself in need of more working capital, credit insurance is a great way to resolve this problem.

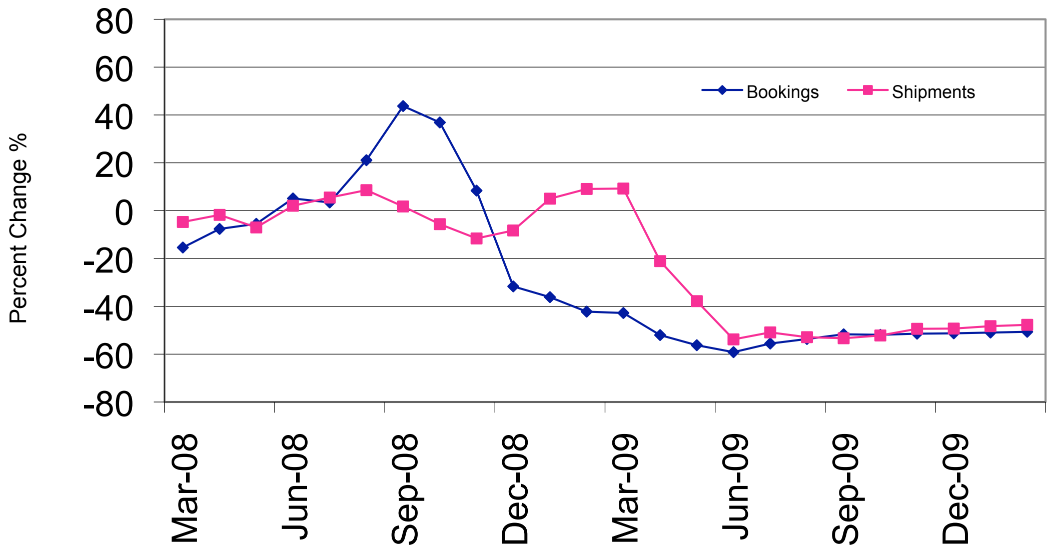
I hope the above has given you a solid idea of how you can continue to offer your customers credit terms while at the same time create a safety net that will not only insure your accounts receivables from getting hammered in this economic abyss but to actually support your company's continued success during these very turbulent times.

**Steven Gan** is the founder and president of Stellar Risk Management Services, Inc., in Northbrook, IL providing credit risk management products and services that increase cash flow and minimize the risk of doing business on credit. Prior to this, Steven Gan operated his own accounts receivable management company in Tokyo for 15 years. Steven Gan is a native of Chicago, Illinois and graduated from the University of Illinois with a BS in Electrical Engineering and graduated from the Thunderbird – Garvin Graduate School with a Master's of International Management. Mr. Gan is also a Certified Public Accountant and a Certified Credit Executive. He can be contacted at s.gan@stellarrisk.com or 847-714-0121.

**STEEL FOUNDERS' SOCIETY OF AMERICA**
**BUSINESS REPORT**

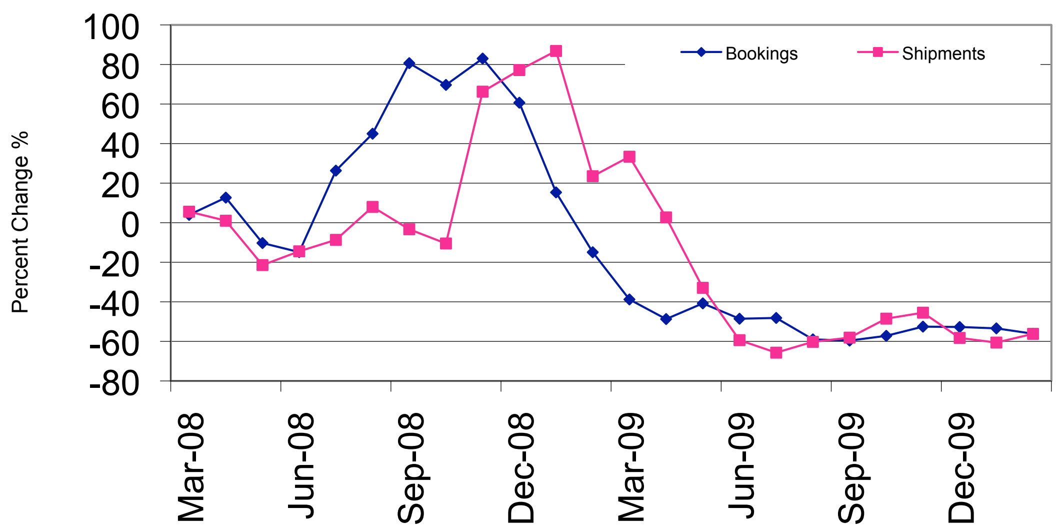
| **SFSA Trend Cards** (%-12 mos. Ago) | 12 Mo Avg | 3 Mo Avg | Feb | Jan |
|---|---|---|---|---|
| **Carbon & Low Alloy** | | | | |
| Shipments | -47.0 | -47.7 | -48.0 | -48.7 |
| Bookings | -53.0 | -50.7 | -50.3 | -50.6 |
| Backlog (wks) | 5.6 | 8.3 | 6.0 | 9.0 |
| **High Alloy** | | | | |
| Shipments | -48.7 | -56.2 | -39.3 | -49.3 |
| Bookings | -52.1 | -56.1 | -54.7 | -56.4 |
| Backlog (wks) | 4.0 | 5.3 | 6.0 | 6.0 |
| **Department of Commerce Census Data** | | | | |
| **Iron & Steel Foundries (million $)** | | | | |
| Shipments | 1,217.6 | 1,291.7 | 1,280 | 1,258 |
| New Orders | 1,200.5 | 1,338.0 | 1,317 | 1,273 |
| Inventories | 2,286.8 | 2,148.3 | 2,182 | 2,133 |
| **Nondefense Capital Goods (billion $)** | | | | |
| Shipments | 57.0 | 58.0 | 57.2 | 57.4 |
| New Orders | 53.7 | 57.2 | 60.6 | 56.7 |
| Inventories | 136.1 | 132.1 | 132.5 | 132.0 |
| **Nondefense Capital Goods less Aircraft (billion $)** | | | | |
| Shipments | 53.0 | 54.2 | 54.1 | 53.9 |
| New Orders | 51.8 | 53.9 | 53.8 | 52.9 |
| Inventories | 99.4 | 96.0 | 96.1 | 96.0 |
| Inventory/Orders | | 1.78 | 1.78 | 1.81 |
| Inventory/Shipments | | 1.77 | 1.78 | 1.78 |
| Orders/Shipments | | 0.99 | 1.00 | 0.98 |
| **American Iron and Steel Institute** | | | | |
| Raw Steel Shipments (million net tons) | 5.4 | 6.3 | 6.3 | 6.6 |

## Carbon & Low Alloy Casting Market Trends

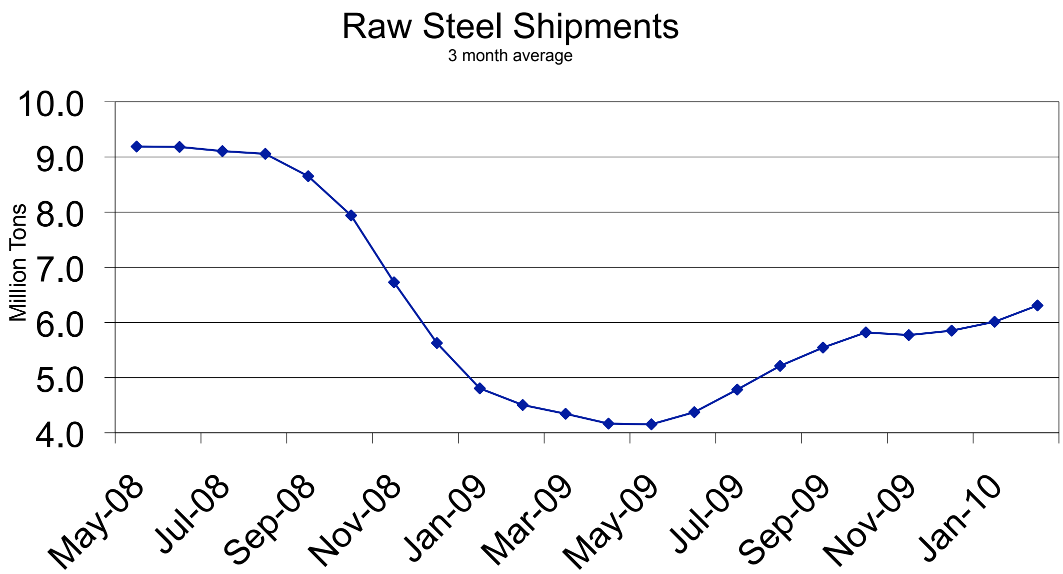



SFSA Postcards

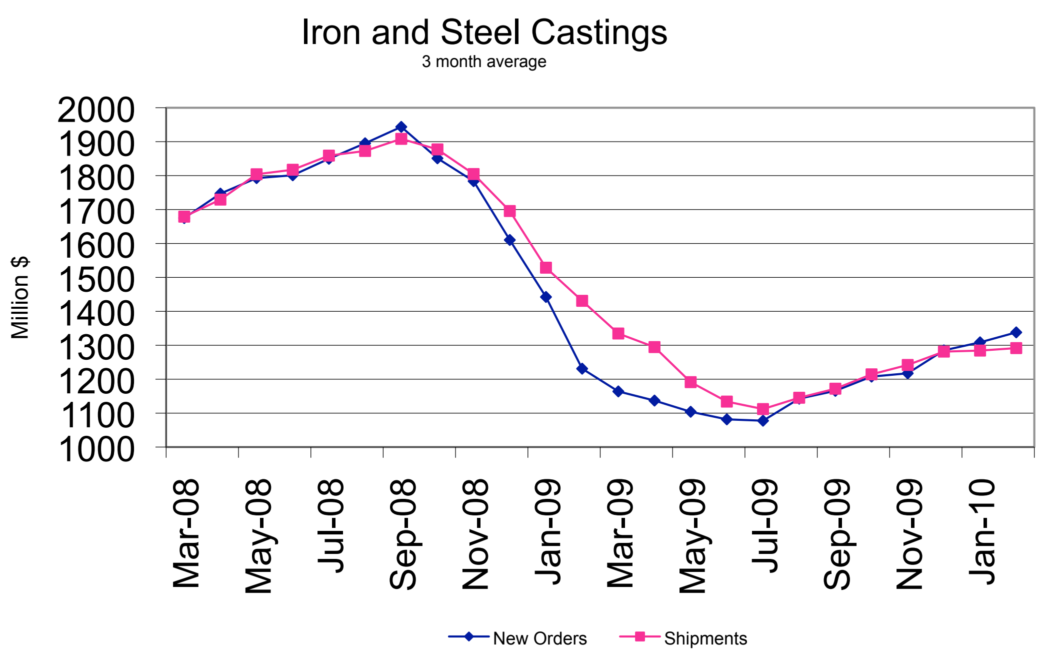
## High Alloy Casting Market Trends




SFSA Postcards




AISI Data

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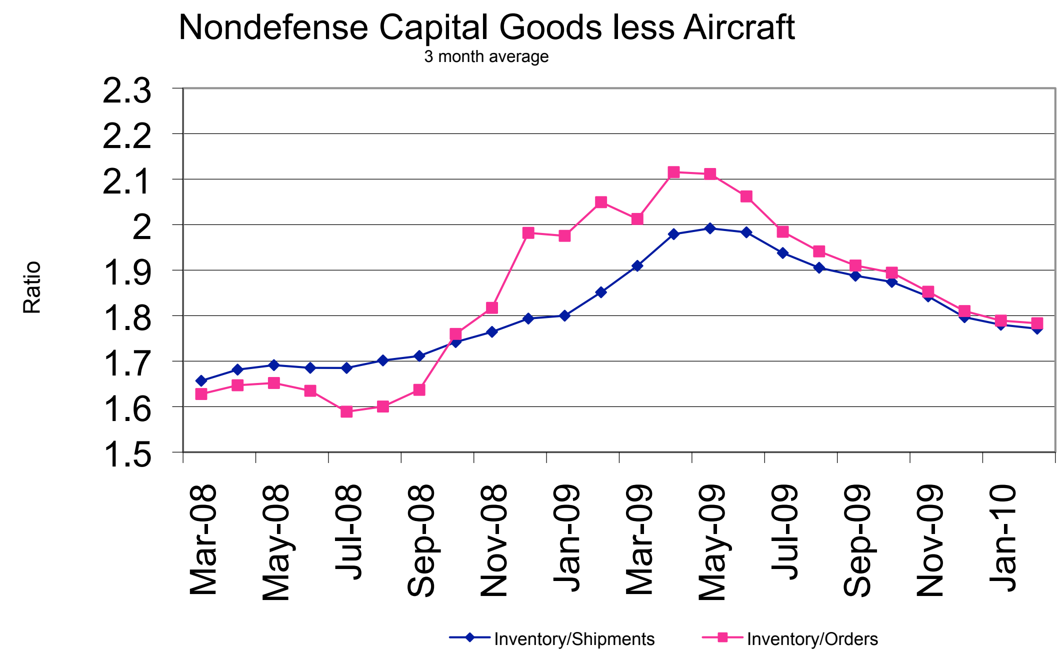
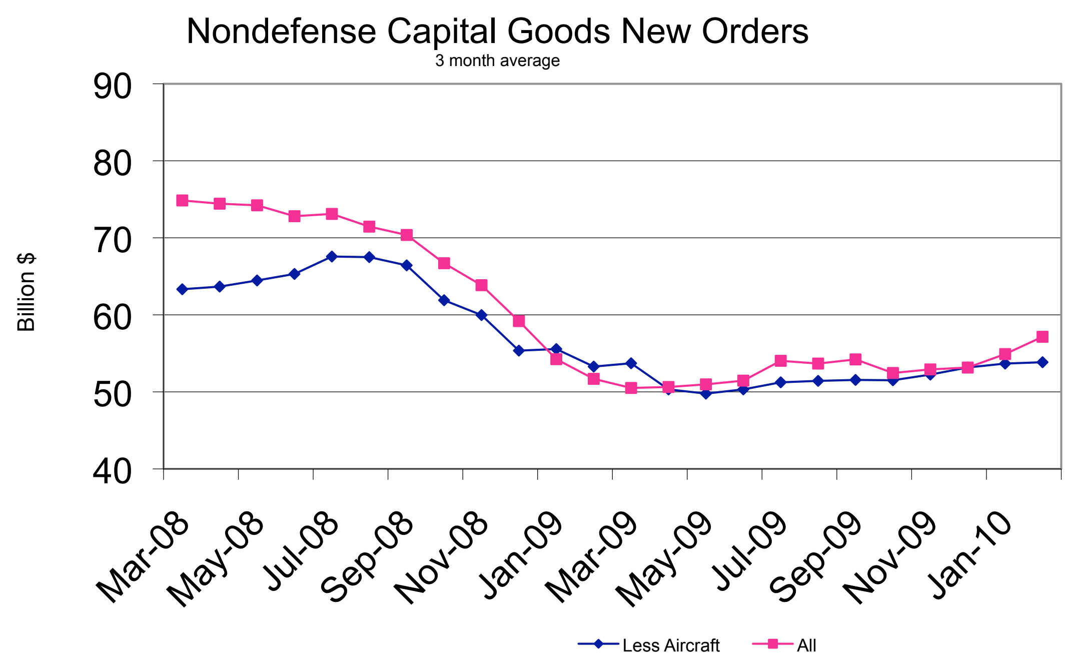



Department of Commerce

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