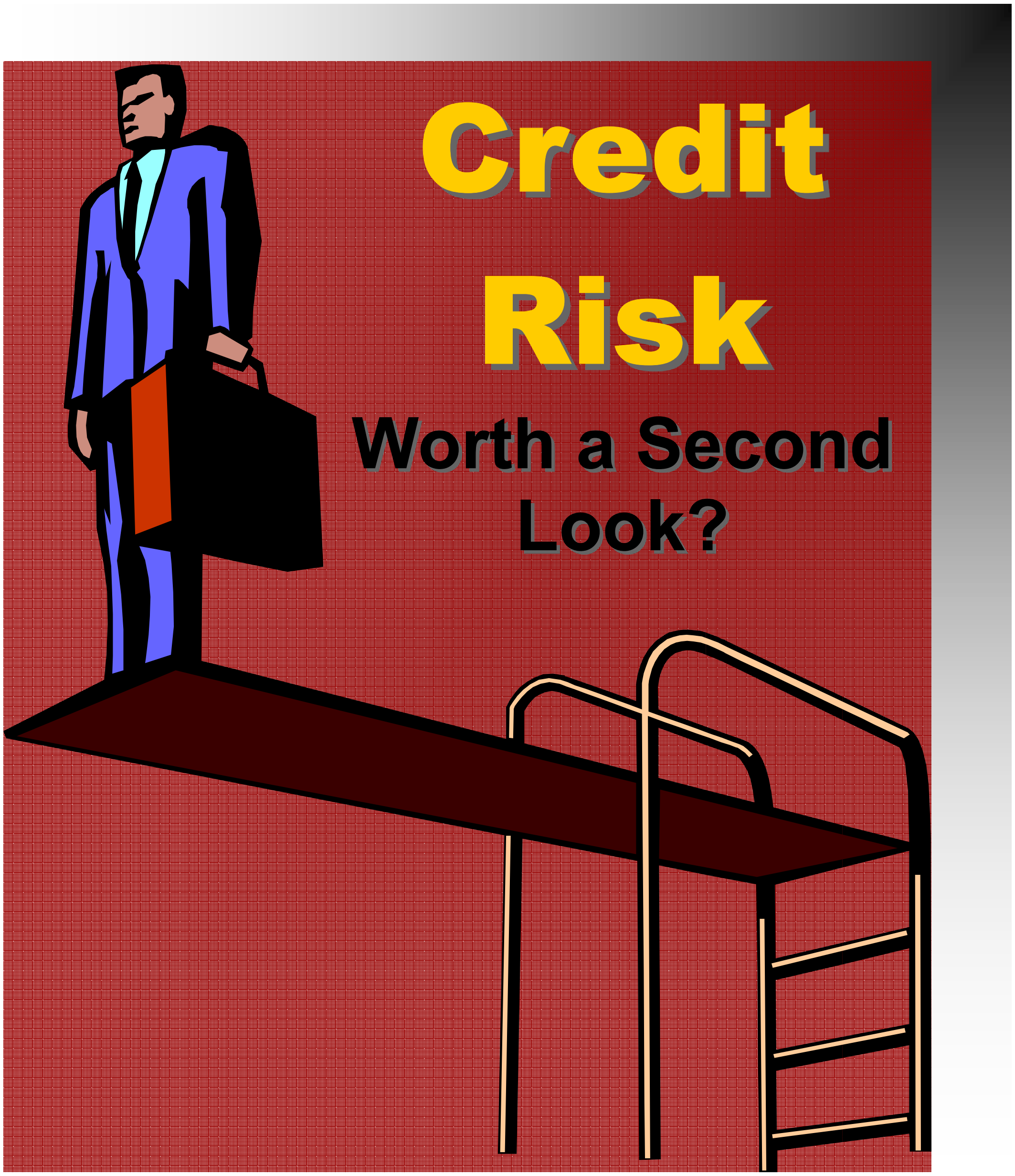

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Absolutely. This question seemingly resurfaces every time the business cycle turns or changes. Simply put, credit risk is not something that just comes and goes. It is an element of doing business that is always present and managing it shouldn't be reactionary. The best approach is to manage credit proactively and be ahead of the game. Sure the level of credit risk changes but it's always there and requires a certain level of attention. To illustrate what is going on in the market right now, I will touch on three key areas. The current state of the US economy, where I feel credit risk is most concentrated in today's metal market, and what can be done to stay abreast of cutting edge credit management.

Current State of the US Economy

The US economy and the global economy as a whole are two very dynamic machines and as a result they are often difficult to pinpoint. However, there are several leading indicators that we can discuss that will provide a fairly decent picture of what is going on currently. Among these signs are the value of the US dollar, the US budget deficit, China and its growing appetite for goods and services, and a couple leading economic gauges.

The Bush administration is now projecting that the 2005 budget deficit will reach a record $427 billion, including an $80 billion supplemental request for operations in Afghanistan and Iraq. The growing deficits in both the budget and the current account (which relates to the trade deficit) pose an increasing long-term threat to the value of the dollar and the stability of the macro economy.

According to a recent article published in the February 1st, 2005 issue of the Economist, "A new report by the Congressional Budget Office indicates that the budget deficit will total $368 billion in 2005 and $855 billion over the next ten years, even before the cost of operations in Iraq and Afghanistan are accounted for. Though the Bush administration says it is still committed to cutting the deficit in half by 2009, it has made no serious moves in this direction, and the parlous state of the national savings rate may undercut the economic growth needed to fill the gap."

Many experts concede that the dollar will indeed continue to fall for 2005 and may help in the overall global economic recovery. However, with the dollar weaker these days, the price of scrap is costing more due to strong global demand. As many people in the industry well know, scrap is not the only commodity that businesses are experiencing rising costs. All metal product prices have increased as most raw material inputs are escalating. The prices of oil, energy, and natural gas are all on the rise. Several countries such as South Korea, Canada, and Mexico are top markets for U.S. scrap metal exports but China stands at the front of the line and has been procuring scrap metal for construction projects and goods production at a growing rate. A recent article in The Wall Street Journal stated that China is the "the world's largest steel consumer, because of increased purchases of washing machines, refrigerators and cars, as well as the building of facilities for the 2008 Summer Olympics in Beijing."

In summary, there are several economic metrics pointing to an overall improving economy. However, there are still a few factors that are not improving as fast, such as the unemployment rate, trade deficit, and the dollar as mentioned.

Credit Risk Continues to be a Threat

There are still several sectors of the metals industry that have troubled financial bills of health. One area that credit risk is concentrating itself in is the automotive supplier base. Many firms have been hard hit by rising raw material costs, energy costs, and health care costs to name a few. Some firms have been able to pass along these costs with surcharges and other creative methods. However, many companies are not able to and a few have resorted to bankruptcy such as Intermet Corp., Citation Corp., and Tower Automotive among others. Some firms are currently restructuring through debt or equity issues in attempts to improve their leverage and liquidity.

Right now the biggest concern for this sector is weakening demand, escalating raw material costs, health care costs, continued pricing pressure and the loss of accelerated payment programs to suppliers. Companies will now have to look to other sources of financing in the absence of these payment accommodations. This may prove to be very difficult for some suppliers considering their already strained liquidity and leverage positions. According to a recent release from Standard & Poor's "Most suppliers are seeking alternative financing arrangements to replace the fast-pay programs, but at least a portion of the increased working capital assets are expected to be financed with existing liquidity sources. More stringent covenant compliance requirements combined with weaker operating performance and cash flow generation could result in a liquidity crunch in the sector. Several companies have already amended their secured credit facilities or put in place additional financing to support liquidity during 2005." Unfortunately, there are still many that need to take these steps and it's undetermined at this point if the markets will provide necessary support.

In order for companies to weather this current squeeze, they are going to be required to aggressively lower operating costs, healthcare costs, and energy costs in an effort to remain competitive and solvent. If you are selling or operating in this particular sector, I would strongly recommend that you are on top of your credit exposures and are managing them closely.

To address the rest of the industry, I would say that there is still a certain level of credit risk present in the foundry business. You need to pay special attention to foundries that are automotive related. However, the heavy truck segment is performing strongly at the moment. Nonetheless, we continue to see very slow payment experiences from this buyer segment, which has created a cycle of slow pay for the whole sector and has strained cash flow for many firms.

China still remains a major threat to credit risk. China's appetite for imported scrap has continued to increase as their economy grows. The major risk here is the lack of knowledge about who you're selling, the poor credit quality in China's debt and financial system, currency valuation, and the risk of Chinese companies dumping on US soil.

China continues to add to its overall metals production capacity. If supply ever starts to outstrip demand in China, this would cause a shift to the global metals industry and change the overall credit fundamentals to negative.

China is also becoming much more advanced and is beginning to move into industries the United States was once the leader, such as state of the art electronics, automobiles, specialty metals, and so on. This is becoming a great threat to our markets here in the US as Chinese companies are not profit-centered, nor are they cost-sensitive. Many Chinese firms are selling goods for less than a US firm can procure the raw materials. This Chinese pricing system is going to continue to bankrupt US companies until they are able to compete on a level playing field.

Actively Managing Your Credit Risk in Today's Volatile Market

To manage your credit risk effectively, it helps to know the financial health of your customers as well as whom they are selling to. This is for the simple fact that a hit from further downstream could significantly impact your customers' bottom line which could be severe enough to take out as a result.

There are several ways you can go about researching and learning more about your customers. One of the first and most important pieces of information to attempt to secure would be a financial statement. This is relatively easy if you're dealing with publicly traded companies, less so with private entities. This information will only help you, of course, if you have someone in-house who can analyze such financial data. Also, keep in mind that you run the risk of offending your customers (who probably never had to provide such information in the past). Still, given the tenuous market situation, you can hardly be blamed for asking.

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Scouring the Internet for credit related information on customers of concern is another great option. Undoubtedly, the Web has made such information more accessible to anyone with a computer and the time to search. The drawback is that it's difficult for many companies to dedicate the effort needed to gather what they want and/or to evaluate what they find. There are several services that offer news or company related search functions that can provide very relevant data that can be used in your credit decisions. An example would be Lexis Nexis or Thompson Gale. Both services can be quite costly however.

Another tool is paying a credit-reporting agency for information and reports on your customers. As a caveat, this information is often limited and, again, needs to be reviewed and analyzed by a knowledgeable person. As a result, these reports provide little or no value to many scrap suppliers and, hence, haven't been used effectively in the past. To address some of the shortcomings of the above information sources, my company developed ProfitGuard an exclusive agency specializing only in the metals industry. We created the service to deal with the growing level of credit risk and lack of credit expertise in the metals industry. In essence, ProfitGuard provides an outsourced credit department to metals companies with or without a credit department in place, as well as a supplemental form of credit support to those firms with the most sophisticated credit procedures.

Aside from actively managing credit information, it is important to minimize your credit exposure. One way to achieve this is to start asking your riskier customers to put up letters of credit or pay cash in advance for their scrap purchases. While this would be great for you, guaranteeing payment for your product, it would be less-than-great for your customers because such terms would tie up their working capital. Unless you offer something unique in the marketplace or are willing to offer a discount to secure such terms, you'll most likely lose the customer to a competitor. None the less it's still an option.

Another tool to keep in mind is credit insurance, which protects your firm if a customer defaults. The credit insurance markets have recently opened up again and some carriers are underwriting business in the metals industry. The fact is that credit insurance is a "proactive" tool and it needs to be pursued in good times when coverage can be approved. It is not an umbrella to be sought after the storm has hit. You can't expect a credit-insurance underwriter to accept a small premium for the large risk to be hedged in the current environment. Still, though you can't use credit insurance to protect against current known risks, you may want to seek coverage on today's good risks since they could become tomorrow's bankruptcies.

Whichever tools or strategies you choose to implement, the important point is to recognize credit risk is still present. I would highly recommend you increase your vigilance in managing your credit risk before your company is hurt by the failure of a major customer. Just because you have not been hurt in the past, it doesn't guarantee your future. Remember, a sale isn't a sale until the cash is collected. With that said, you need to manage this resource effectively or risk the long-term survival of your company.

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