recycling today

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ProfitGuard surveys credit risks in light of COVID-19 impacts

Victor Sandy, executive with scrap-focused credit advisory firm, says monitoring creditworthiness should be systematically managed.

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 Posted by Brian Taylor

Financial Ferrous Nonferrous Plastics

The first half of March 2021 has witnessed the downfall of a Europe-based financing firm tied to a significant player in the global metals industry and a bankruptcy filing by a plastic scrap consumer with growing capacity in the United States.

The receivership status of Greensill Capital and Greensill Bank in Europe has raised questions about the financial footing of the United Kingdom-based GFG Alliance. That conglomerate has three portfolio companies that produce steel and aluminum, with one of the three—Liberty Steel—operating a ferrous scrap-consuming electric arc furnace (EAF) steel mill in Illinois.

Victor Sandy, president-global commercial credit of Bingham Farms, Michigan-based ProfitGuard LLC, says there is not yet "much clarity" on if or how GFG Alliance's connection to Greensill will affect its U.S. steelmaking operations.

In the plastic recycling sector, Los Angeles-based CarbonLite Holdings LLC, which reprocesses scrap polyethylene terephthalate (PET) bottles into new bottle material, announced in early March it had filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code.

In its limited statements about potential financing difficulties, GFG Alliance has pointed to "disruption caused by" the COVID-19 pandemic and restrictions. Likewise, CarbonLite Recycling CEO Leon Farahnik has cited pressures directly related to the pandemic, including temporary production slowdowns caused by employee illness and the low price of virgin plastic relative to recycled PET (rPET), as reasons for its financial setback.

With COVID-19 having caused a full calendar year of volume and pricing volatility, *Recycling Today* has asked Sandy about the current credit landscape and how recyclers can take measures to prevent being a materials supplier left in the lurch by a bankruptcy filing.

Recycling Today (RT): *When mills, foundries or other consuming facilities have "breaking news" financial concerns, what steps can scrap suppliers take quickly? What can or should they have been doing to look out for or stay ahead of such news?*

Victor Sandy (VS): To stay ahead of a potentially significant credit risk event, scrap suppliers should always have current credit files on all their accounts. Too often we see clients who are not monitoring an account closely enough because they have a good/long relationship or have always been paid on time (classic complacency).

The credit risk of each account should influence how often the credit file is updated and then reassessed –lower risk accounts can go longer between updates (every six to 12 months) while higher risk customers should be updated more frequently (every one to three months). An example of a current credit file would include financials, bank/liquidity data, trade references and customer contact information.

Then, when the significant credit risk event happens, we would recommend reviewing your credit file (get updates if needed) and speak with the customer to get additional information on the event, which can then help ensure the right decision is made once all the information is reviewed. By proactively monitoring your customers, you'll be able to uncover significant risk items well in advance.

If a developing risk is found that raises the company's default probability, scrap suppliers can take the following steps. You can start working down your current exposure to the company by placing them on credit hold until your previous invoices are paid. This helps keep your exposure levels to a minimum. If you're on the sidelines and not currently selling to the company, stay put until further clarity is provided or the company's risk profile improves. Additionally, credit insurance is a proactive financial risk management tool designed to protect your accounts receivable. Having a policy in place will mitigate any unexpected risk.

RT: *What is the role of credit insurance in the financing market and why did it prove to be a crucial link in the Greensill situation?*

VS: Trade credit insurance is often used as a borrowing enhancement to provide protection against insolvency or past due default in the insured receivables portfolio, which is then pledged as security to a lender. This protection gives lenders some added flexibility to expand on advance rates, provide better cost of funds, address concentration issues in the portfolio and include more accounts in the borrowing base that may normally be excluded if they are slower paying. The end goal is to maximize the availability of working capital from that insured group of receivables and provide the client with more money at less risk to the lender.

Note [in the Greensill case] there may have been other financial instruments used that were referred to as credit insurance, but are not the typical trade credit insurance used to protect pledged receivables. Some articles on this story mentioned credit insurance on notes, which could be a different form of coverage on a different aspect of the financing transaction. In this reply, we're talking to actual trade credit insurance on the underlying accounts receivable being used as security for a line of credit. We can't really speak to any other financial tools that were employed around the deals that may have helped support the arrangements.

RT: *GFG reportedly pre-sold receivables as a financing mechanism. Can this be an effective financing technique, or does it raise red flags when investors or risk analysts conduct due diligence assessments?*

VS: Supply chain financing can be an effective financing alternative and has grown in popularity since the 2008 financial crisis, when some companies had trouble financing their working capital needs through more traditional forms of financing (e.g., revolver, term debt, etc.). The key is to fully understand the arrangement your customer has so you can assess the credit risk. Supply chain financing has the potential to provide much needed working capital for both seller and buyer.

However, supply chain financing is typically more expensive, which can begin to weaken the company's financial position over time, because the company receives less money for the goods produced. This has less of an impact when market fundamentals are solid, and industry pricing is strong. Also, the lender could pull the financing at its discretion, which could have a material impact on liquidity. All these factors should be considered when reviewing the credit risk of a company using supply chain financing.