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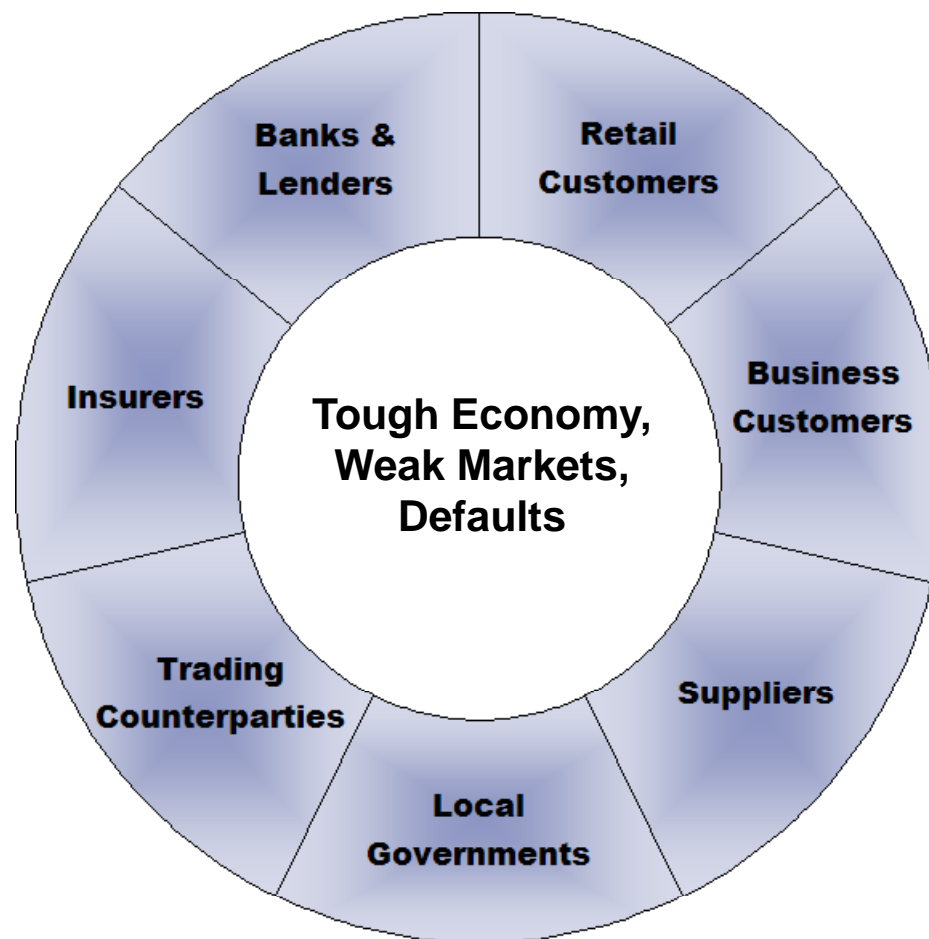
ORIGINAL
ESSENTIAL
UNBIASED
INFORMATION



Credit Risk Coming And Going

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Enterprise Risk: Counterparties



Focus on Supply Chain

- Mission critical supplier Exposure keeps Expanding
 - Fewer vertically integrated enterprises
 - Heightened globalization complicates & increases risk
 - Outsourcing of “non-core competencies”
- Supplier Evaluation issues include
 - Quality, Price, Efficiency, Logistics,
 - Collaboration, Degree of integration
 - Management, Innovation, R&D capabilities
 - Financial strength; Staying power
 - Common or Custom product / Single or Alternative Sources

Strength in Bad Times

- Financial strength matters most in a bad economy; on both sides of your business.
- Your enterprise gains strength with strong suppliers and with strong customers; even though it may suffer less leverage over costs and pricing.
- Weak counterparties pose serious risk of disruption, reputation and losses; even though pricing/cost may appear highly attractive.

Counterparty Evaluation

- Performance is most general issue
 - Quality, reputation
 - Dependability, efficiency
 - Strength to overcome adversity
- Financial strength is a component issue
 - Near term: flow of goods/cash
 - Longer term: staying power
 - Weaker counterparties increase risk of lost cash flow, lost production, lost service. Require defensive precautions.
- Centralize financial evaluations for efficiency and to maximum expertise.

Suppliers vs. Customers Procurement vs. Collections

- Presumption that normal relationship with suppliers differs from relationship with customers
- Colors our view of appropriate depth of financial evaluation

Suppliers vs. Customers

Procurement vs. Collections

- Customer relationship presumed fleeting
 - Seek to maximize customer base
 - Performance means timely payment; cash flow
- Defensive measures include
 - Payment terms (receivables)
 - Credit lines
 - Holding shipments
 - Cash in advance or Collateral
 - Third party A/R financing or credit card sales
 - Price to cover “acceptable” level of non-payment

Suppliers vs. Customers

Procurement vs. Collections

- Suppliers relationship presumed lasting
 - Optimize number in supplier base
 - Physical performance; flow of good or services
- Defensive measures include
 - Alternative vendors
 - Inventory buffers
 - Payment practice (payables)
 - Contingency planning
 - Business interruption insurance

Suppliers vs. Customers

Procurement vs. Collections

- Presumption reflects depth/complexity of relationship
 - Time span
 - Commodity or custom work
 - Critical to core operation
 - Concentrations, either volume or financial
 - Some suppliers are as fleeting as retail customers
 - Some customers are wholly integrated into your business
 - Risk exposure reflects relationship
 - Both operational and financial exposure
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Suppliers vs. Customers Continuum on both sides

- Commodity products, exposure usually short term
 - Many customers / vendors? Credit analysis less material
 - Concentration on either side? Financial staying power important, analysis warranted, contingency planning
 - Lightly customized products, exposure medium term
 - Exposure includes inventory as well as receivables
 - Credit analysis warranted for larger vendors & customers, contingency planning
 - Materially customized products, exposure longer term
 - Exposure includes capital investment (machinery, etc) as well as inventory and receivables
 - Contingency planning should be mandatory
 - Credit analysis and monitoring also required
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Credit Department Analysis

- Credit analysts evaluate counterparty finances
 - Upon opening relationship and continuing monitoring
 - Customer industry expertise expected
 - Supplier industries may be far more diverse
 - Globalization; foreign counterparties more difficult
- Efficient evaluation is critical to be able to monitor all important counterparties and large exposures.
 - Information sources and analytical tools are available to cover diversity of industries in a consistent & disciplined fashion
 - Minimize time required to evaluate consistent public companies; free analyst time for privately owned or companies in transition.

Future Electronics Overview

- World-class leader and innovator in the distribution and marketing of semiconductors and passive, interconnect and electro-mechanical components.
- Key distributor in Supply Chain to manufacturers
- Global presence Americas, Europe and Asia
 - 169 locations in 42 countries
 - Headquarters: Montreal, Canada
- 5,000 employees supplying 50,000 customers

Supply Chain Influences

- Supply components to manufacturers of common electronic products
- Electronic components often have long lead times
- Buyers place high importance on Future's stability and dependability.
- Shortages cut into customer's revenue when technology manufacturers allocate available supply.
- Shortages are dangerous: A missing part can stop a customer's assembly line.

Reverse Role of Credit Department Focus on the Vendor

- Credit Department constantly assesses credit quality of customers and monitors over time
- Evaluation uses standardized credit tools
 - Credit assessment / internal financial score
 - Collections experience, also scored
 - Dispute resolution
- Same assessments now used to qualify vendors for “mission critical” big ticket items and services

Reverse Role of Credit Department Critical Vendor Analysis

- Mission Critical
 - Any purchase made by Future that is deemed to be critical to the company's sustainable operation
 - Example – New warehouse technology, new ERP system,
 - The box story
- In these situations Credit is asked to assess the credit quality of a potential vendor
- Factors into the overall selection process

Reverse Role of Credit Department Distribution Agreements

- Future is a “franchised distributor” for many major technology manufacturers
 - Motorola, ST Micro, Tyco, MicroChip, Phillips, etc..
 - Over 300 franchise agreements in place
- Credit provides Future’s Marketing organization quarterly analyses of the fiscal health of all public companies that we represent
- High quality, reliable manufacturers are critical to insuring Future’s position in our customers’ supply chain.

Credit Department Role Reaches Beyond Collections

- Credit has become a more visible department in most organizations
- Credit expertise is no longer considered a “back office operation”
 - Visits to customers & vendors is now common
 - Title change to Director or Vice President
 - Reporting to Chief Financial Officer

Credit Department Role Reaches Beyond Collections - Benefits

- Cash is King !
- Credit staff have best skill set in most companies to assess vendors' financial strength; help assure supply chain continuity
- CFO has total fiscal responsibility and comes to trust the judgment of the Credit staff
- Risk management goes beyond Credit organization
- It makes sense !

Total Petrochemical USA

- Total SA is the fifth largest integrated petroleum company in the world
 - Operations in 130 countries; 96,000 employees
 - Upstream, downstream and specialty chemicals
- Total Petrochemicals USA produces polypropylene, polyethylene, styrenics, base chemicals & fuels.
 - Operations in Texas & Louisiana
- Middle of supply chain
 - Supplies more than 3,000 industrial customers
 - Sources from more than 3,000 suppliers

Practical Credit: Credit Policy

- Credit Policy sets overall guidelines
- Create a Credit policy that addresses, at a minimum
 - For customers: A/R is exposure
 - Credit limit approval authorities
 - Payment term approval authorities
 - Customer review period guidelines
 - For suppliers: Performance is exposure
 - Contract limit approval authorities
 - Contract review period guidelines
 - Financial strength quality scale
 - Watch list criteria, when extra precautions are needed

Practical Credit: Credit Procedures

- Credit Department Procedures
 - Define the step-by-step financial evaluation
 - Serve as a credit reference company-wide
 - Establish a forum for best practice discussion
 - Provide discipline to both collection and procurement monitoring processes

Practical Credit: Objective Evaluation

- Develop a consistent counterparty evaluation process
 - Objective standards mitigate differences in analyst experience and education.
- Objective credit scoring mechanism should evaluate:
 - Financial performance
 - Payment performance
 - Agency ratings
- Add subjective evaluation once objective evaluation complete
- Next step: recommendations appropriate to collections or procurement

Practical Credit: Contracts

- Contract should provide an escape/modification clause in case the counterparty's financial stability deteriorates
 - “If in the Seller's sole judgment Buyer's financial status is unsatisfactory...”
 - Offset amounts
 - Require financial security
 - Change payment terms
 - Cease shipments
 - Reduce credit limits
 - Similar provision for Suppliers, though protective actions differ
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Practical Credit: UCC-1 Filings

- UCC (Uniform Commercial Code) filings:
 - Elevate your position from unsecured to secured
 - Grant the right of inventory or equipment repossession
 - Generally protect from preference suits

Practical Credit: Payment Spiral

- Declining customer performance indicators
 - Discount to net payments
 - Net to sporadic late payments
 - Sporadic late payments to recurring late payments
 - Recurring late payments to insolvency
- Declining supplier performance indicators
 - Timeliness – dependability – quality decay
 - Unusual discount terms offered
 - Undue pressure to speed payments

Takeaway: Continuum on both sides

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