



# Current Factors Affecting Supplier Risk

Supplier Financial Impact Assessment

# Executive Summary

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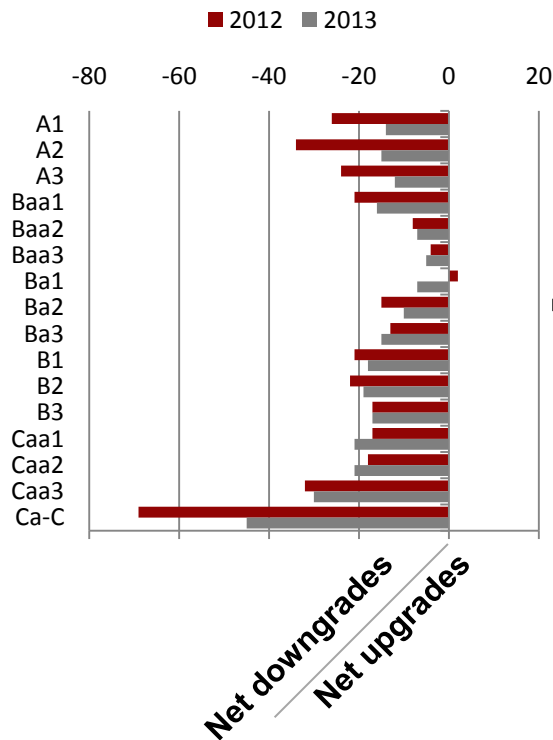
The protracted European recession and tightening credit in China is straining the finances of many suppliers unable manage debt burdens.

- ***Supplier Leverage*** – Companies have increased their debt burden over the past three years—as the debt comes due, not all suppliers will be able to refinance
- ***European Lending Constraints*** – Additional financial institution requirements are restricting lending resulting in over 20% of companies reporting difficulty in securing bank loans
- ***China Banking Issues***– The People’s Bank of China is attempting to reign in the country’s non-state run banks which primarily provide loans to the private sector
- ***Credit Downgrades*** – Moody’s credit rating had a net downgrade of 350 European companies in 2012 and 300 expected for 2013 resulting in higher borrowing costs and fewer options for financing
- ***Volume Decline*** – As global trade slows planning for financial stress contingencies is critical

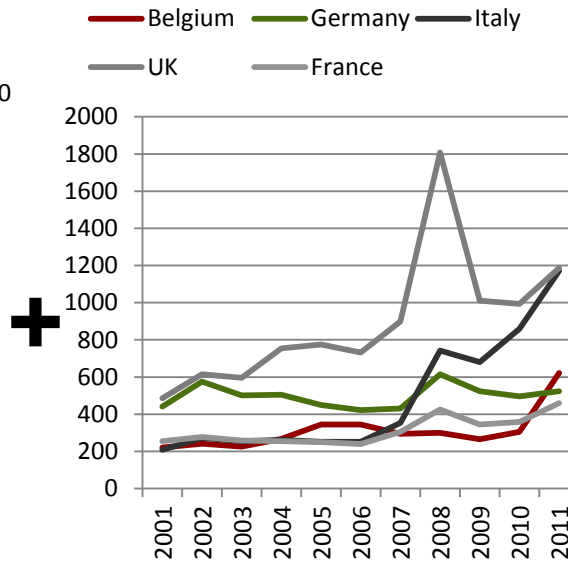
# European Growing Risk Scenario

Company downgrades and new financial institution regulations restrict capital.

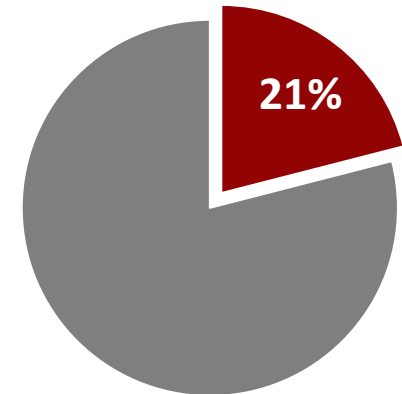
## Moody's net up/down grades for European companies



## Financial institutions Debt to Equity leverage



## Companies reporting difficulty getting bank loans



Source: Moody's, Eurostat, Cost & Capital Analysis

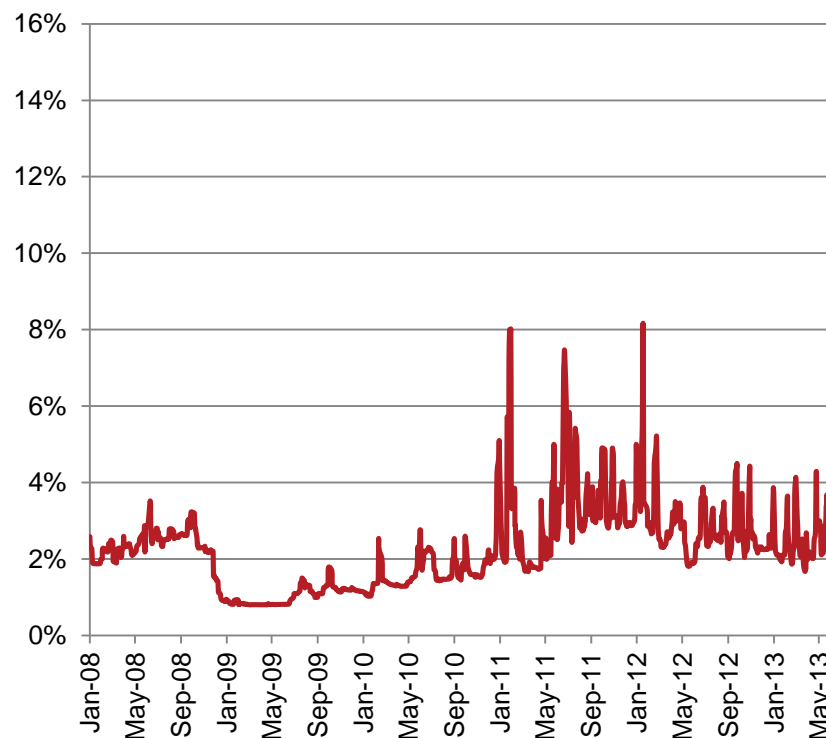
# China Banking Developments

Recent shocks to the Chinese banking system may be indicative of wider systemic economic issues.

## Summary

- During June 2013, the overnight Shanghai Interbank Offered Rate briefly spiked to 13.4% after the People's Bank of China indicated the banking system needed more discipline
- Bad loans at branches of mid-sized banks in Shanghai have increased to 5%, which is higher than the official national average of 1%
- Big Four banks have a default rate of 2% because they mainly loan to healthier state-owned enterprises
- Tightening of lending by “shadow” banks will primarily impact non-state owned enterprises

## Overnight SHIBOR 2008-2013



# Proactive Supplier Monitoring

Buyers need visibility into suppliers' financial health for internal risk management and to comply with customer requirements.

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- ***Supply Continuity*** – Ensuring supply for critical components requires part data management combined with supplier financial assessments
- ***Private Suppliers*** – Private suppliers need to be engaged to collect required financial data to determine the state of financial health and risk
- ***Public Suppliers*** – Assessing public supplier financial distress requires a methodical approach to collecting, summarizing and publishing assessments
- ***Customer Requirements*** – A formal report is often required to present the state of financial stress in the supply chain to customers as well as the board of directors

# Supplier Detailed Scorecards

Proactive supplier monitoring goes beyond traditional risk reports such as D&B to identify key levers to discuss with suppliers to understand the full cash scenario.

Detailed cash metrics provide at-a-glance assessments of the supplier

## Cash Metrics

LT Debt / Equity	(1.61)
Current Portion of LT Debt / Eo	0%
Current Ratio	3.38
Quick Ratio	2.25
LT Debt / Trailing EBITDA	4.03
Projected Change in Cash / Revenue fo	-22.1%
LT Debt Due in One Year	0.0%
Cash Requirement for 2009 / Cash on Hand	610.5%
Percent of Cash Requirement as Credit	128.8%
Cash and Cash Equivalents (\$M US)	158

*Sample Scorecard*

Supplier mix of business can be customized to address specific industry exposure

## Volume Metrics

Percent of Non-Distressed Customers	0.0%
Projected Q1 2009 Volume vs. Q4 2008	70.8%
Total 2009 Volume vs. 2008 Volume	63.5%

Operating Metrics highlight supplier cost & capital efficiency ratings

## Operating Metrics

COGS / Sales	94.7%
SG&A / Sales	7.3%
R&D / Sales	0.0%
CAPEX / Sales	3.5%
Operating Margin	-2.0%
DSO	60.9
DPO	65.6
DSO / DPO	0.9
Days of Inventory	42.9
Fixed Asset Turnover	10.4

# Industry Supplier Summary - Transportation

Financial risk modeling highlights suppliers at the greatest risk of stress.

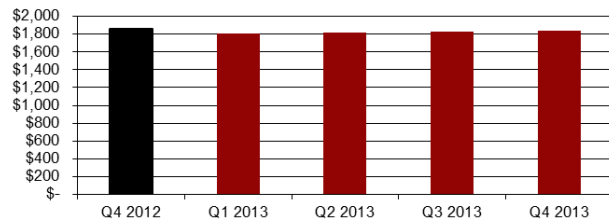
Company	LT Debt / LT Debt + Equity	Current Assets / Current Liabilities	Next 12 months Cash Required / Available Cash	Next 12 Months Cash Required / Cash + Available Credit	Z-Score	Overall Risk
YRC	38%	130%			0.31	Critical
NOL Group	64%	117%	98%	46%	0.39	Critical
→ CEVA	241%	111%	36%	29%	0.32	Probable
CH. Robinson	14%	136%	157%	71%	4.47	Moderate
→ DHL	34%	112%	209%	114%	1.30	Moderate
UPS	73%	186%	236%	208%	1.92	Moderate
China Shipping	38%	204%	35%	35%	0.64	Moderate
China Merchants	16%	127%	37%	37%	0.40	Moderate
→ TNT Express	8%	123%	37%	15%	0.75	Low
Sinotrans Ship	0%	2604%	5%	5%	1.26	Low
Werner Enterpr	11%	181%			2.24	Low
Pacer Internati	0%	146%			24.76	Low
Hub Group	4%	166%			1.93	Low
Ryder	72%	82%			0.64	Low
Con-way	47%	163%			1.37	Low
J.B. Hunt	56%	110%			0.76	Low
Landstar Globa	23%	172%			4.66	Remote
FedEx	13%	190%			1.98	Remote
Expeditors Inte	0%	280%			2.25	Remote
→ UTIW	20%	147%			3.19	Remote
→ Panalpina	0%	149%			2.36	Remote
→ Kuehne & Nag	1%	126%			2.54	Remote

→ Company with significant (i.e. > 25% of sales) exposure to Europe

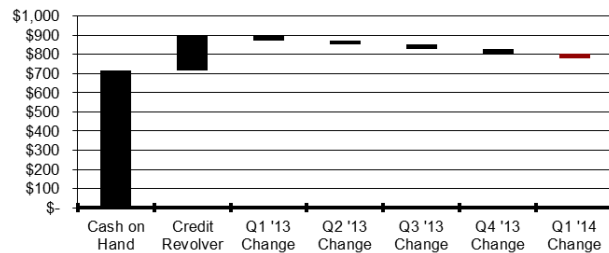
# Company Detail Report – CEVA

## Diagnostics

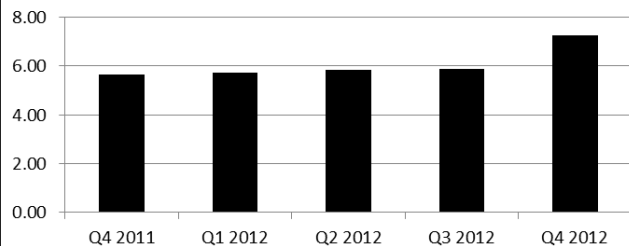
**Quarterly Revenue and Projection**



**Cash Position**



**Fixed Asset Turnover**



Latest financial data update: May 2013

### Cash Metrics

Debt / Equity	(1.71)
Current Portion of Debt / Equity	-7.7%
Current Assets / Current Liabilities	1.11
Debt / Trailing EBITDA	9.64
Projected Change in Cash / Revenue for 2013	-1.3%
Debt Due in One Year	4.3%
Cash Requirement for 2013 / Cash on Hand	19.4%
Cash Requirement for 2013 / Available Credit	52.8%
Cash Requirement for 2013 / (Cash + Credit)	14.2%
Cash and Cash Equivalents (\$M US)	\$487.0

### Operating Metrics

COGS / Sales	71.2%
SG&A / Sales	28.5%
R&D / Sales	0.0%
CAPEX / Sales	1.1%
Operating Margin	-24.0%
DSO	53.33
DPO	94.14
DSO / DPO	0.57
Days of Inventory	1.03
Cash Conversion Cycle	(39.78)
Fixed Asset Turnover	7.27
Working Capital Turnover	10.33

**Note:**

"LT Debt" = Long-Term Debt

"COGS" = Cost of Goods Sold

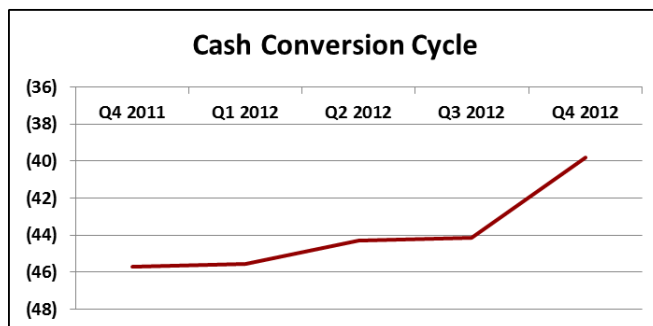
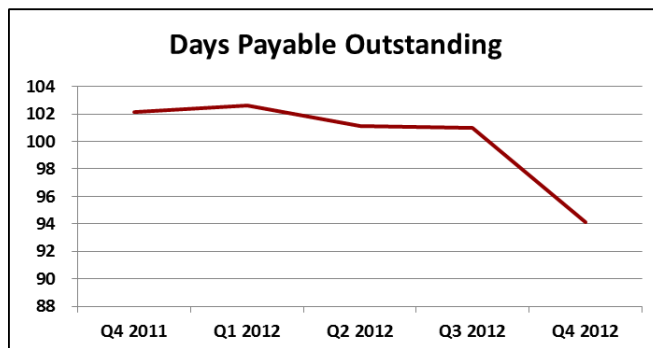
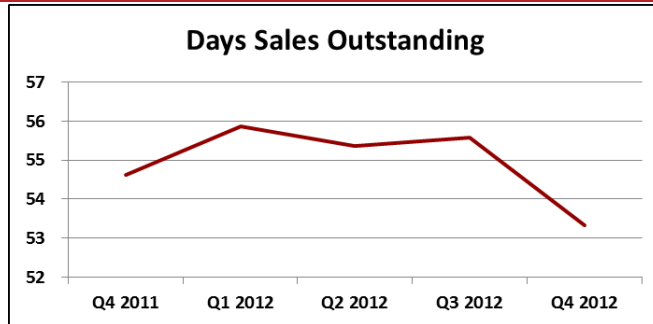
"SG&A" = Sales, General, & Admin Costs

"CAPEX" = Capital Expenditures

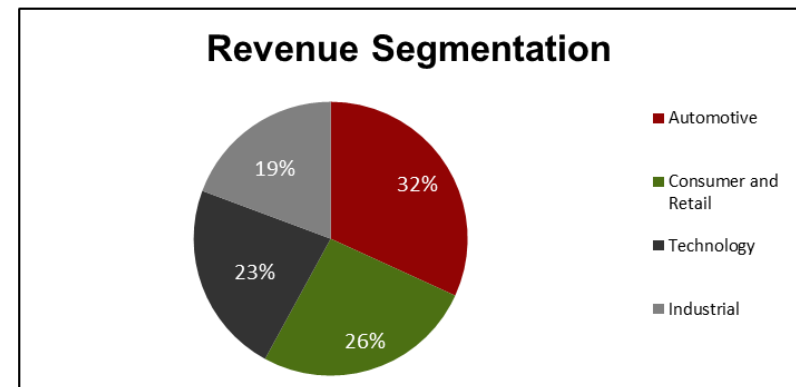
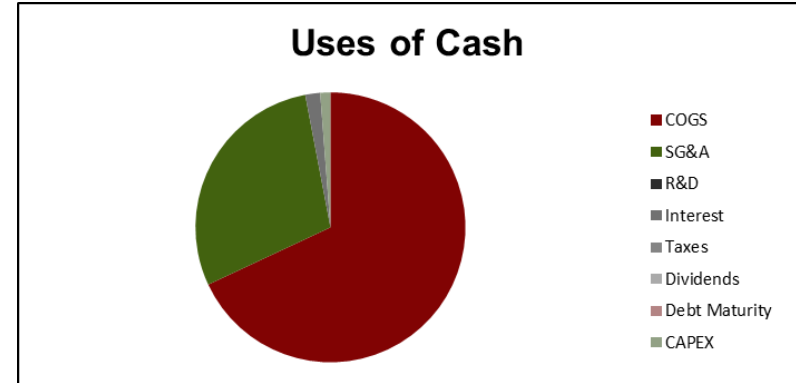


# Company Detail Report – CEVA

## Working Capital Performance



Latest financial data update: May 2013



# Company Detail Report – CEVA

## Summary

- In May 2013, CEVA underwent a recapitalization program and has reduced its consolidated net debt by approx. €1.3 billion, reduced its cash interest expense by over €130 million and has received cumulative new capital commitments of over €230 million for investment in its business plan
- € 119 million of debt is due February 2014, € 689 million in 2018, and € 577 million in 2020
- About 40% of CEVA's business is Europe and it's recovery and future state is uncertain

## Constraints Analysis

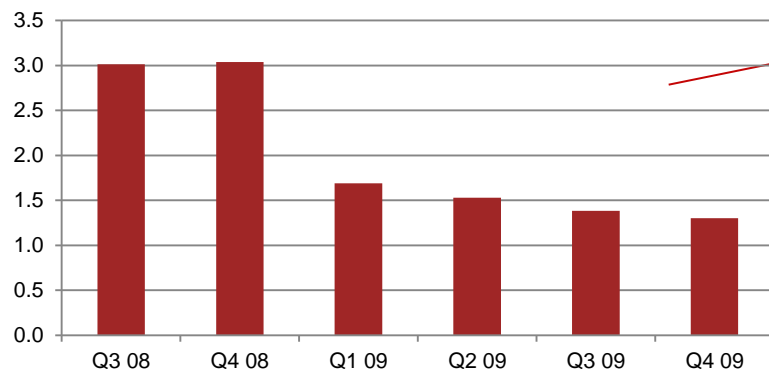
<b>Z Score</b>	<b>1.57</b>
Working Capital / Total Assets	0.05
Retained Earnings / Total Assets	1.00
EBIT / Total Assets	(0.12)
Market Value of Equity / Total Liabilities	-
Revenue / Total Assets	0.52

<b>2013 Projected C&amp;CE Score</b>	<b>2.73</b>
Cash Flow / Revenue	-0.1%
Cash Flow / Capital Employed	-1.3%
Cash Flow / Debt	-0.2%
Cash Flow / Current Liabilities	-0.4%
Cash Flow / Equity	1.3%
Cash / Capital Employed	100.0%
Cash / Debt	35.1%
Cash / Current Liabilities	31.0%
Cash / Equity	-59.9%

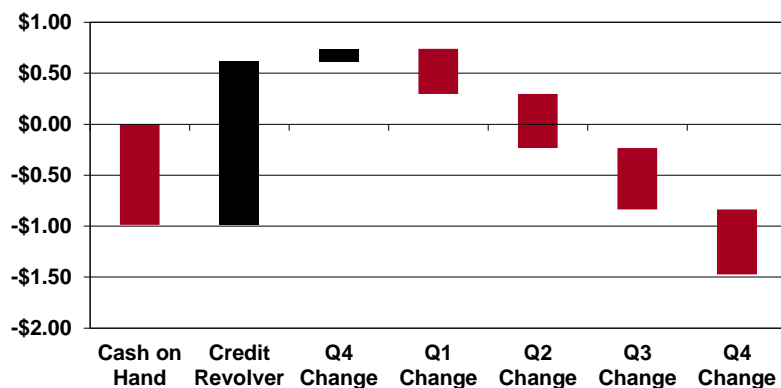
# Supplier Detailed Scorecards

Reduced European volumes and tight credit require cash burn rate analysis for leveraged suppliers with significant volume reductions.

## Revenue Modeling



## Cash Position



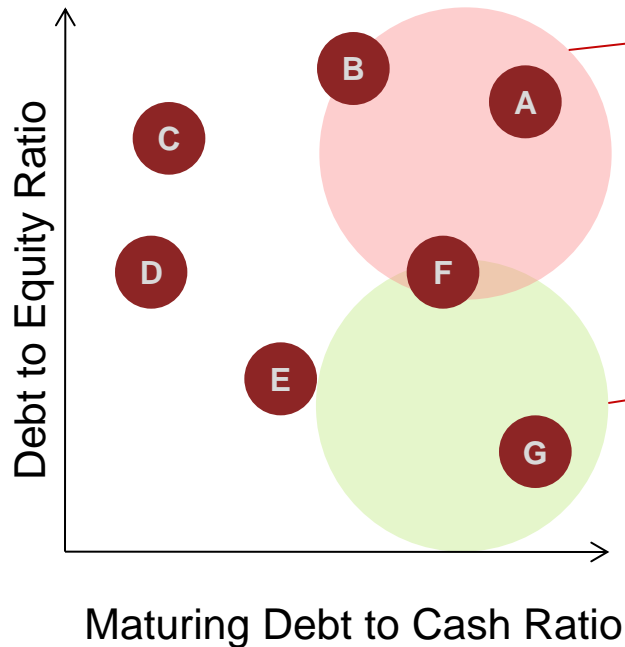
## Prioritized Approach

- For suppliers exposed to troubled markets, specific characteristics such as individual customer exposure and new business award can model cash flows and EBIT for future quarters
- Based on debt maturities, fixed costs and reduced volumes, supplier cash flows are modeled to determine when a supplier is at risk of insolvency

# Supplier Detailed Scorecards

Financial stress can be prioritized for each category to identify consolidation opportunities and pre-emptive exit strategies.

## Category Review



## Prioritized Approach

- Suppliers that fall into the high Debt to Equity (D/E) Ratio and do not have cash on hand based on profit projection models face insolvency and should be exited quickly
- Suppliers with low Debt to Equity (D/E) Ratios but with maturing debt face coverage issues and need to be engaged to determine their ability to raise cash to cover debt

# Supplier Summary Reports

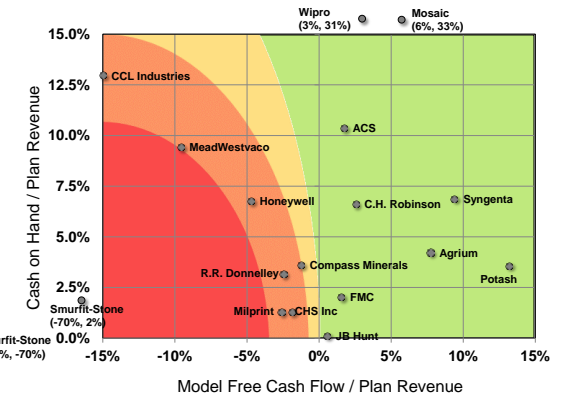
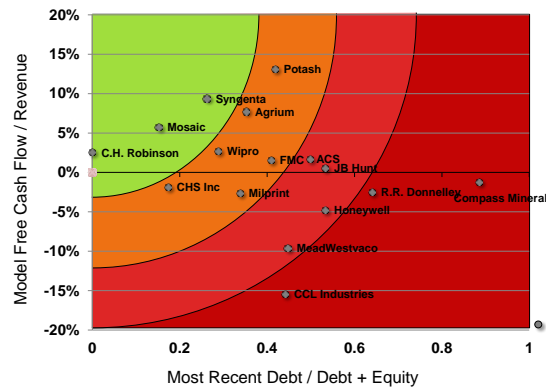
The entire supply base is presented to show the relative ranking of each supplier's health which allows for prioritization of risk mitigation.

## Quick Glance Summary

## Cash Flow vs. Leverage

## Cash on Hand vs. Cash Requirement

	LT Debt / LT Debt + Equity	LT Debt Due In One Year	Current Assets / Current Liabilities	Cash Required / Available Cash	Cash Required / Available Credit	Z-Score	Overall Risk
Smurfit-Stone	169.7%	50%	19%	3474%	1389%	-4.21	Bankrupt
CCL Industries	44.1%	4%	147%	119%	178%	1.13	Moderate
MeadWestvaco	44.7%	4%	178%	100%	73%	0.62	Moderate
Moore Wallace (RRD)	64.0%	18%	132%	78%	15%	0.38	Moderate
CHS Inc	25.3%	35%	152%	144%	29%	1.81	Remote
JB Hunt	53.3%	9%	114%	0%	0%	2.19	Remote
Honeywell	53.3%	16%	117%	70%	38%	1.52	Remote
Milprint (Bemis)	33.8%	3%	233%	200%	20%	2.35	Remote
Compass Minerals	88.5%	1%	181%	0%	0%	2.58	Remote
Conrad Fafard (SYT)	34.4%	0%	180%	0%	0%	N/A	Improbable
ACS	49.9%	2%	201%	0%	0%	1.57	Improbable
Potash	41.8%	3%	87%	0%	0%	3.46	Improbable
Agrium	35.2%	0%	182%	0%	0%	1.50	Improbable
FMC	40.9%	0%	189%	0%	0%	2.30	Improbable
C.H. Robinson	0.0%	0%	202%	0%	0%	10.85	Improbable
Mosaic	15.1%	2%	425%	0%	0%	3.81	Improbable
Wipro	27.4%	1%	146%	0%	0%	N/A	Improbable



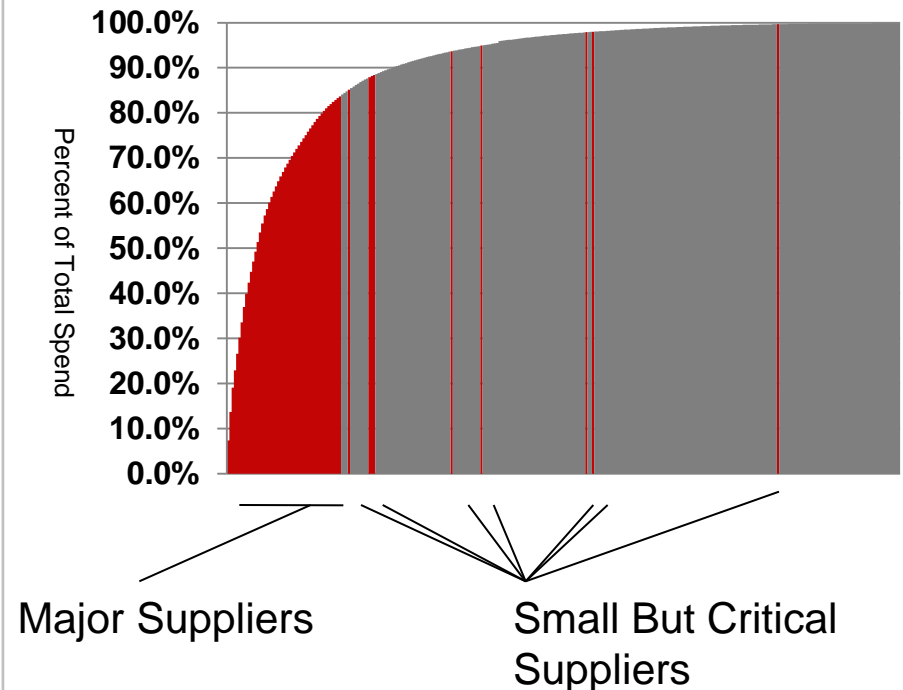
# Supplier Prioritization

Risk assessment can be prioritized for large as well as small but critical suppliers.

## Prioritized Approach

- Resources should be focused on major suppliers as well as suppliers that provide supply-critical components
- Working with manufacturing and engineering highlights critical components
- Working with supply chain highlights limited sources for critical components
- Efforts should be narrowed to the most critical suppliers

## Supplier Focus by Spend



# Private Supplier Analysis

In addition to public supplier data, Cost & Capital Partners works with our clients to collect and categorize private supplier data.

## Supplier Survey

Financial Data	Amount (USD)	Comments
Interest payments on debt		
Q1 2009		
Q2 2009		
Q3 2009		
Q4 2009		
2010		
2011		
Debt Payments (amortization + principal re-payment/expiring debt + maturing bonds)		
Q1 2009		
Q2 2009		
Q3 2009		
Q4 2009		
2010		
2011		
Debt Covenants (agreements between a company and its creditors that the company should operate within certain limits)		
Current covenants (list agreed covenants with creditors for each loan)		
Performance against covenants (list performance against agreed covenants)		
Consequences if covenants are breached for each loan		
Balance Sheet Items (please state date/year)		
Cash and cash equivalents		
Accounts receivables		
Inventories		
Plant Assets		

## Survey Methodology

- Private suppliers need to be engaged to share key financials to provide visibility into exposure
- Based on the data, Cost & Capital works with the teams to create negotiation agendas with the suppliers
- Additional key information such as sources of capital, new program launches and debt maturities paint a full picture of the supplier's health and key milestones to achieve during the year

# Supplier Stress Impact

Quantifying supplier stress needs to be combined with the business impact.

## Supplier Strategy

- Some categories will not have a significant impact on the business if a supplier goes bankrupt, such as telecom, office supplies and MRO
- Other categories where key product items are sole sourced, use patented processes or have binding contracts, a specific risk mitigation strategy is required

## Criticality Matrix

Likelihood of Disruption	Highly Probably					
	Probably					
	Moderate					
	Remote					
	Improbable					
		Negligible	Marginal	Serious	Critical	Catastrophic
Severity of Impact						



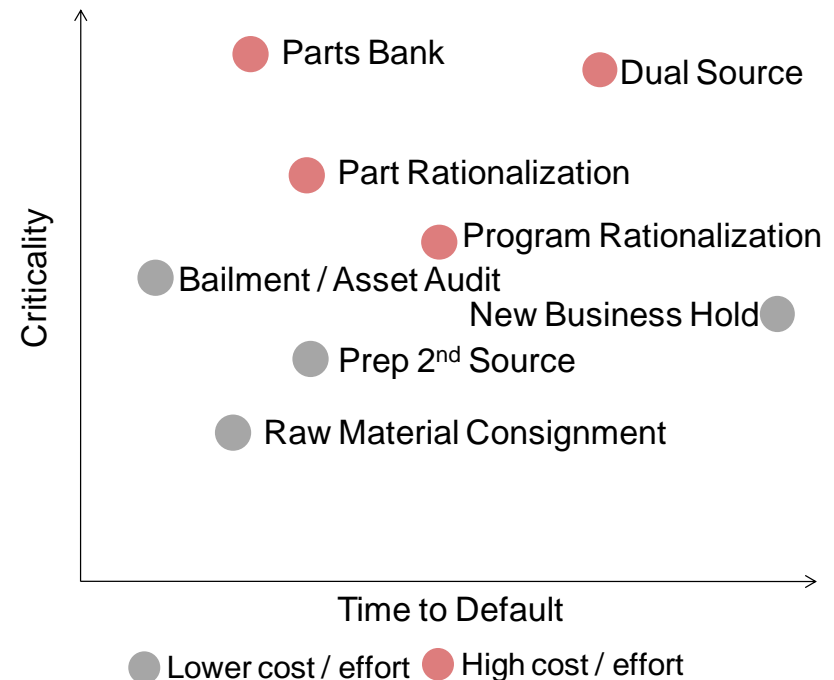
# Supplier Risk Management

Cost & Capital works with our clients to mitigate supplier financial risk through deployment of countermeasures meant to secure supply and manage price

## Situation Appropriate Response

- For each troubled supplier, the best countermeasure is dependent upon part criticality, anticipated time to default and the effort and cost to implement
- The supplier stress analysis combined with a business case highlights the best strategies to apply
- Short term approaches such as price increases and term improvement apply at all phases but are the least desired approach

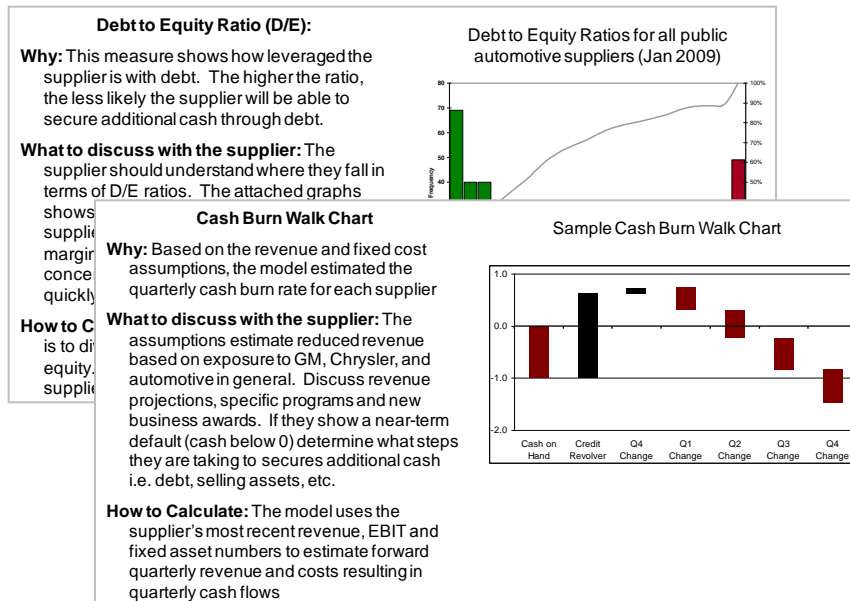
## Countermeasure Applicability



# Risk Identification and Management Training

As management of supplier financial risk increases, building up competency within the supply chain organization is critical for long term stability.

## Supplier Stress Training



## Prioritized Approach

- Supplier financial stress is often within the realm of the finance department
- Reduced volumes and tight credit requires a supply chain organization to identify risk, deploy strategies, and remediate bankruptcy events
- Supplier Stress Training builds this competence within the organization to understand supplier situations and provides visibility beyond reactive financial stress scoring services

# Cost & Capital Partners Introduction


- **Cost & Capital Partners focuses on the two most critical levers for shareholder value today - *Cost Efficiency* and *Capital Efficiency***
  - Cash should be treated as the valuable resource it is
  - Spend management preserves cash
  - Capital efficiency frees cash trapped in traditional operations
- **We deliver results – not just recommendations, each and every time**
  - We stand behind our recommendations and prefer to be involved in implementation
  - We conduct negotiations on behalf of our clients
  - We are passionate about our work and the results
  - We work with our clients to implement the changes required to improve the business

## Previous project work



# Sourcing Toolbox

Cost & Capital deploys the following tools to engage direct and indirect suppliers.

	Internal Analytics	Plan Development	Supplier Engagement
<i>Tactical</i>  <i>Strategic</i>	Benchmarking	Leverage Development	“Should-Cost” Buildup
	Cost Analysis	Strategic Supplier Program	Contracting
	Risk Assessment	Target Setting	Fact-Based Negotiations
	Metrics and Reporting	Supplier Footprint	Supply Base Management
	Market Analysis	Value Engineering	Risk Management
	Value Stream Mapping	Supply Vision	Value Chain Optimization

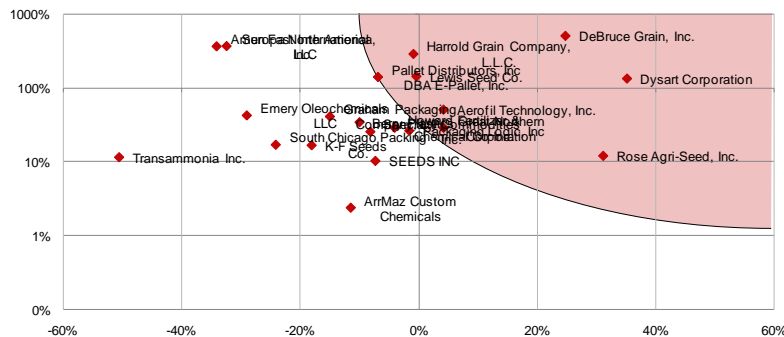
# Category Experience

Raw Material	Process	Component	Indirect	Capital
Resin	Stampings	Paint	Maintenance	Greenfield
Steel	Injection Molding	Tires	Temp Labor	Conveyor
Zinc	Welding	Automotive	T & E	Tilt-up Buildings
Copper	Assembly	Batteries	Telecom	Docks
Aluminum	Painting	Electronics	Engineering	Tools
Chemicals	Blow Molding	Wiring	Data Services	Forklifts
Cement	Smelting	Wheels	Distribution	Furniture & Fixtures
PGM	Laser Welding	Labels	Logistics	HVAC
Lead	Blanking	LCD Displays	Advertising	Tilt-Tray Sorters
Glass	Die Casting	Lighting	Energy	Pallets
Textiles	Cut & Sew	Compressors	Waste Management	Site Selection
Leather	Extrusions	Pumps	Prof. Services	
Corrugated	Hydro Forming	Valves	Packaging	
Natural Gas	Roll Forming	Motors	Landscaping	
Diesel	Dyeing	Switches	Mechanical	
Palm Oil	Sequencing	Antennas	IT Development	

# Reference Case

## Risk Management

### Packaging – Chemicals



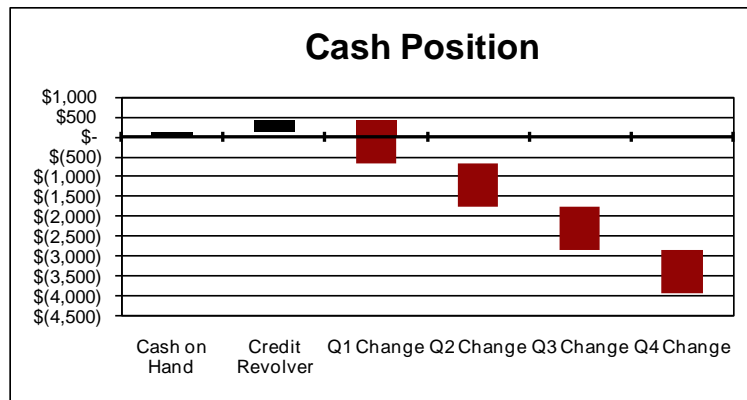
### Engagement Overview

- Cost & Capital was asked to review risk factors for packaging suppliers for a maker of lawn and garden care products
- The team analyzed and audited packaging suppliers to determine the level of risk in the supply chain due to financial strain, capacity and cost reduction initiatives
- Suppliers were segmented into low, medium, high and critical risk suppliers
- Detailed agendas were created to engage the suppliers and develop risk mitigation plans

# Reference Case

## Risk Management

### Supplier Risk Management – Industrial Equipment



### Engagement Overview

- Maintaining plant continuity during a credit crunch, a major automotive OEM tasked the team with identifying troubled suppliers beyond D&B ratings for private suppliers
- Suppliers were audited and key cash burn rate details were summarized to identify the more critical suppliers to monitor
- Each supplier was assessed for access to credit, cash as well as upcoming debt maturities
- The resulting analysis helped the client to consolidate the supply base and manage reduced volumes

# Cost & Capital

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