

Survival or extinction?

The giant motor manufacturing companies have long dominated the automotive supply chain. Despite this, historically from an ABL perspective, as long as the continuity of supply was maintained, thus avoiding crippling line stop charges, then insolvency of a supplier was soluble as the existing debt would be paid with minimal deductions. In some cases reverse ransoms have been extracted by administrators in respect of future JIT (just-in-time) supplies.

In November, European new car sales plummeted by an average of 26%, but in Britain sales are down 36%. We have seen severe downturns before, most recently in the early 1990s, but this time the credit crisis has exacerbated the problems facing the weaker motor manufacturers.

So in addition to the normal complexities associated with lendings to automotive suppliers, we have the additional risk of the potential insolvency of one or more of the major manufacturers. The scale of the problem is daunting. One modern UK manufacturer, which recently announced an extended New Year shut down, operates with a state of the art, fully automated Kanban purchasing and stock management system capable of placing 600 JIT orders with 300 suppliers on a daily basis. This vividly illustrates the potential scale and spread of this crisis amongst the supplier network.

So how should an ABL providing support to a troubled automotive supplier react? We recommend the following:

Identify all manufacturing clients with any dependency upon a motor manufacturer. Make sure that you hold the latest management information and understand how well the management team is responding to the crisis now rapidly unfolding. MCR can help a beleaguered

management team understand the scale of the problems they face and the best response to the crisis.

It is important to understand quickly the extent of the damage already caused by the precipitate fall in new car sales, whether as creditor pressure or cash shortfall. Swift and well thought through cost reductions are essential. It may be necessary to enter into complex negotiations with key creditors and debtors, including the automotive manufacturers.

Given the highly integrated supply chains, automotive debt can inevitably be complex, involving detailed contracts. It is important that the relevant contractual provisions are well understood. Provided compliance is maintained, the debt should be relatively free from erosion. MCR is expert at assessing potential problems that may have been overlooked in the original assessment. It is worth re-checking such issues now.

Where an ABL is providing inventory finance to a large automotive supplier, it is reasonable to assume that the stock management systems and reporting will be relatively sophisticated in order to match the manufacturer's requirements. That said, as demand falls, it is crucial that suppliers are not left holding disproportionately high levels of buffer stocks.

On any inventory, plant and machinery and property exposures, valuations should be up to date and a current and thorough book debt, and inventory audit should be undertaken. Depending on the client status, it may be appropriate to undertake a full security review of all the lending documentation and key contracts with major debtors. Make sure key motor manufacturer exposures are monitored closely and keep abreast of restrictions announced by any major trade credit insurers.

In the short term the management team at the automotive supplier should develop an action plan detailing their immediate proposals for the lender to consider. However, right now we are in uncharted territory, so MCR recommends a separate and detailed overview of the various insolvency scenarios. This would consider the outcome if the supplier failed simply as a result of the manufacturer's reduction in output, as a consequence of the recent fall in consumer demand for new cars, and the Armageddon scenario arising from the insolvency of a major manufacturer.

As ever the message as we watch this latest crisis unfold, is be prepared and make sure your clients are too. We may yet see extreme crisis arising from a collapse in the automotive sector. So far the downturn is severe but not without precedent. It is vital that you understand how many of your clients are exposed to the sector and that specific problem cases are assessed in more depth. This is a challenging and difficult process at the best of times. At present, many of the options normally available to a lender dealing with the potential insolvency of an automotive supplier may be severely constrained, but a proactive approach may still mitigate a very difficult situation. If you have problem clients, please call us as we have the experience and contacts to add value.



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