

Outlook

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Economic Consequences Lead to Failures in Export Markets

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The recession has had an impact on Canadian companies and it has destroyed many long established pillars of the North American economy. These stories took place in our backyard and the business press covered them extensively. By now, we all know the gory details. If we were hit heavily by the recession, what about developing countries?

As Rex Murphy would say, "poorer countries have been caught in the confluence of adverse circumstances outside of their control". In developing countries, the turnaround in the world economy, led by the USA which is a major market for the products of many developing countries, caused banks to lose liquidity and thus tighten credit, currencies to devalue and commodity prices to drop. Over the last year, credit insurers have seen unprecedented numbers of claims in export markets due to these factors.

The best way to illustrate the impact of the combination of these circumstances is to use the following example:

- on September 1, 2008 a Canadian trader receives an order for US\$ 100 K of lentils from a Mexican buyer with whom it has dealt before;
- the lentils are to be delivered at Mc Allen, Texas by November 1, 2008;
- the payment terms are 60 days from arrival at Mc Allen, i.e. February 1, 2009.

Now, what can go wrong in period from the time the order was accepted to the time the payment was due?

- Because of liquidity problems with the buyer's bank in Mexico, due to credit and foreign exchange problems, the bank reduces the buyer's line of credit, which reduces the buyer's cash flow.
- The buyer to whom the lentils have been onward sold is also experiencing cash flow problems for the same reason and delays the payment.

- When the order was placed on September 1, 2008, the exchange rate was 10.3 pesos to the US\$. When the payment was due on February 1, 2009, the Mexican peso had devalued to 14.36 pesos to the US\$. This meant that the buyer had to raise 1,436K pesos rather than the 1,030K pesos it had anticipated when he placed the order. As many Mexicans expected the peso

to appreciate against the US\$, the obligation was not hedged. The buyer was faced with an increase in cost in terms of Mexican pesos of approximately 39%.

- During the time between September and December, the price of lentils dropped on world markets and the buyer had to give price concessions in order to sell the product.

All of these factors hurt the buyer's financial position and made this, and other similar transaction carried out

through the period, very unprofitable. The buyer was unable to pay on the due date.

What options did the buyer have?

1. The buyer could request price concessions from supplier, but this is very difficult, as the Canadian trader would have already paid the original supplier.
2. If the buyer were reputable, it could request a Payment Plan to spread the payments over a longer time, while it adjusted its cash flow to the changed circumstances.
3. It could simply default in payment or go bankrupt.
4. It could raise a trade dispute alleging that there were problems with the goods or it had never received the goods.

This example, based on actual cases, shows how economic factors in a buyer's country can affect the credit risk substantially before it is possible to react.



Millennium Expands in Western Canada

Millennium, as a truly national specialist broker in accounts receivable and political risk insurance, has represented clients from Nova Scotia to British Columbia. It is now again strengthening its team by the appointment of Kevin Sullivan, as Manager of the Western Region, which includes B.C, Alberta, Saskatchewan and Manitoba.

Kevin is a graduate of Ashbury College in Ottawa and Dalhousie University in Halifax.

Kevin has gained considerable credit insurance experience over the last 6 years in both Canada and the USA, which will serve the needs of clients well as they emerge from the recession. Kevin will be located in Vancouver, but even in the Winter, he will be regularly calling on clients on the Prairies.



Ask Ron

It has been a tough year. Given the number of claims you have reviewed in the last 12 months, what are some suggestions you would give exporters?

You are right. A few small changes in how exporters conduct their business could save a lot of grief.

1. In an attempt to head off potential trade disputes, after a company ships the goods, it should request an e-mail from the buyer acknowledging receipt of the shipment.
2. Exporters should e-mail Monthly Statements to the buyer showing the account balance and giving the buyer 10 days to notify it of any errors in the Statement.
3. Companies that receive orders by phone and the send Order Acknowledgements to the buyer should set out their procedure clearly and have it accepted by the underwriter, as evidencing a firm contract, thus replacing a written purchase order.
4. In volatile markets, where the political risk can change abruptly, or when dealing in commodities subject to price change, the exporter should receive a down payment prior to placing orders with suppliers.
5. Exporters must constantly be aware of changing economic circumstances in the major markets in which they are dealing. When economic circumstances are volatile, they must constantly be up dating the financial information on the buyer. Past payment experience loses its relevance.
6. EDC recently provided this recommendation with respect to Mexico, "The best document to prove delivery is the Shipper Import (Pedimento de Importacion). We always recommend our clients to track down every shipment and get copies of the shipper imports from the customs broker in Mexico....."
7. Always ensure that your Purchase Order and Invoice show the exact entity approved in the Written Credit Approval.
8. Anytime the buyer asks for the goods to be consigned to another buyer or for the invoice to be issued to another buyer, be sure that the request is clearly documented and the party responsible for payment agrees with the Credit Approval. If not, the new obligor must be approved. and
9. If possible, policyholders should maintain the right to handle collections. By doing so they control the process and ensure that their interests are being protected.

Through out the economic slow down, Millennium has been up dating its clients by a continuing flow of Underwriting Bulletins and blogs. Circumstances change rapidly in today's world and it is good to have an entity to help companies share their problems and solutions.

Does The Bank Pose a Risk

As happened in Mexico, if bank's come under stress due to poor decisions or economic circumstances, they tend to tighten their credit criteria. Buyers have more difficulty in obtaining working capital loans. Buyers can normally deal with tighter credit markets, but what happens when the buyer's bank fails or withdraws from the market? If either situation were to occur, the buyer would be forced to find new financing which may or may not be available and if it is available, may come with higher costs and more restrictions and covenants.

In Canada, we have seen many of the asset lenders, such as Wachovia, GMAC and GE Capital, either withdrawing or reducing their Canadian presence. In addition BNP Paribas, has announced that it is exiting the medium range commercial financing field, thus forcing a number of companies to seek new financing. In these cases, buyers have some time to locate new financing, but what happens when the buyer's bank just simply fails? Here today, but tomorrow the doors are closed.

When a bank simply closes its doors, or it is shut down by the regulator, the client has very little or no time to change its banking and it may be forced to seek protection to allow it to restructure its financing.



In an article, "CIT bankruptcy could create lending vacuum", by Barrie McKenna and Boyd Erman in the globeandmail.com Friday July 17, 2009, it was indicated that the demise of CIT could leave many small companies without good alternatives for financing. CIT is a very important source of financing for many small and medium sized businesses in both Canada and the USA.

The risk of bank failures in the USA is not strictly an academic exercise, in his radio column on CBC Radio "Michael Hlinka" of Tuesday, August 18, 2009, reported the Colonial Bank, with assets of US\$ 25 billion and 4 other USA financial institutions were closed on the same day by the Federal Deposit Insurance Corporation. As at August 28th, 2009, 416 US banks were listed by FDIC as problems.

In a global economy, a broader range of factors must be considered when analyzing a buyer's credit worthiness and its ability to pay future obligations. Many companies have actually reduced their credit expertise over the last few years and appear to be placing increased emphasis on collections and payment experience.

Credit insurance can often compensate for the lack of analytical expertise of policyholders, but it is critical that companies realize that they have millions of dollars of assets exposed in accounts receivable and they should manage these assets in the same way as they would manage any counterparty risk. They should retain, manage and provision for the risks in their comfort zone, but definitely transfer any risks, which they can't properly assess, or which are too large to be adequately provisioned, or which cause concentration issues.

Breaking News!!! The Recession is Over.

Right? Economists consider the recession to be over when the economy shows a quarter with positive growth, even though unemployment may still be increasing and businesses may still be failing. After the recession of 1991-1992, business failures increased substantially. Banks pulled lines of credit of companies whose financial condition had deteriorated through the recession. Refinancing was very difficult to achieve and many companies failed.