

# TOOLING PROPOSAL - DISCUSSION BRIEF

**SUBJECT:**                    **TOOLING PROPOSAL: ENSURE “TRICKLE DOWN” OF GOVERNMENT LOANS PROCEEDS TO DETROIT 3 OCCURS TO REACH TOOLING INDUSTRY ENSURING THE TOOLING INDUSTRY DOES NOT COLLAPSE AND PUT AT RISK ALL NORTH AMERICAN NEW VEHICLE LAUNCHES.**

Following is a brief outline which was developed to provide you with an overview of the issues facing the Tool, Die, & Mold (TDM) industry in Canada, as well as what we believe presents a viable solution: [*Note: USA, with substantial industry and governmental support, is considering a similar proposal for US Government loans to Detroit 3.*]

## THE GOALS AND BENEFITS OF IMPLEMENTING THE TOOLING PROPOSAL

1. Prevent avoidable bankruptcies in the TDM Sector;
2. Protect existing jobs and stimulate new employment - keeps people working which will contribute to an economic recovery;
3. Allows Export Development Canada (EDC) to redeploy existing insurance capacity, freed up by the Proposal due to shorter project cycles, to more Canadian exporters;
4. Enhance liquidity by improving access to credit for TDM Sector companies (*without the need for banks to amend existing bank credit facilities*);
5. Mitigate the risk of bad debts occurring, which erode company profitability, productivity and access to credit;
6. Creates a mechanism for “trickle-down” for direct loans proposed by Government to the vehicle manufacturers (OEMs) to companies throughout the supply chain with full accountability and transparency for the use of the funds;
7. Ensures that the TDM Sector is properly recognized as a critical supplier in any direct loan agreements or bankruptcy styled restructuring of a vehicle manufacturer;
8. Reduces the risk of taxpayers paying twice for the bailout: once at advancing of loan proceeds to vehicle manufacturer, and a second time when tooling proceeds from the vehicle manufacturer are diverted by the “Middleman” (the Tier 1 parts manufacturer) prior to delivery of funds to the tool source, resulting in a bad debt which forces the tool source to either:
  - i) make claims against EDC insurance, or
  - ii) lay-off employees, or
  - iii) file for bankruptcy and close operations leading to job losses.

## THE ISSUES

1. Vehicle Manufacturers (OEM) driven payment terms for tooling, which result in a delay of their payment obligations, **actually increases the acquisition cost of tooling and vehicle production costs**, and has stretched payments to Tool, Die, & Mold (TDM) manufacturers by up to 24 months from award of contract and beyond. These OEM driven payment terms have resulted in:
  - a) In excess of \$3 billion in completed tooling fabricated by North American tool sources for parts manufacturers waiting for OEMs to make payments to Tier 1 parts companies, who in turn pay the tool source – **payment obligations which are not recorded in the books of the OEM**;
  - b) Payments to tool sources for completed tooling increasing 5-18 months **after delivery** of the tooling to the Tier1 parts company;

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- c) OEMs, at their sole discretion, can delay vehicle programs indefinitely without the requirement to pay for the tooling completed to date NOR pay any additional compensation for the delayed tooling eg. Interest carrying costs;
- d) Parts manufacturers who sell directly to the OEM (Tier 1 supplier) are dictating tooling payment terms such as “TDM is paid only after Tier 1 is paid”, implying that if the Tier 1 never gets paid by the OEM (e.g. bankruptcy), then the TDM has no claim to payment from the Tier 1.

NO OTHER sector in the automotive industry has to wait more than 60 days for payment after delivery of goods. Parts suppliers are paid on average 45 days after parts delivery. The OEM is paid within 5 days of vehicle delivery to the dealership. Tool sources are waiting 5-18 months or more post delivery for payment.

- 2. Banks generally: dislike lending against work-in-progress and single purpose assets; and have a 90-120 day cut-off for accepting accounts receivable as collateral for lending purposes. When these traits of the tooling sector are coupled with the present economic and liquidity environment the results are: a) the closure of a large number of TDM suppliers along with the loss of employment opportunities (30% over the past three years); b) increased stress on the financial covenants with banks for remaining TDM suppliers; c) Access to working capital financing, and the required flexibility in financial covenants, to support tooling operations is severely limited and in many cases impossible to obtain;
- 3. Many new tooling opportunities exist today, which are available for US suppliers to bid on and to win. Tooling is the leading edge indicator of the industry cycle and automotive economic recovery. However, a lack of access to working capital, **COUPLED WITH** a risk profile which is simply **TOO HIGH** with the potential for payment receipts out 24 months, will have many of these shops, who are capable of winning this work, sitting on the sidelines and thereby laying off employees.
- 4. EDC insurance alone does not provide adequate protection for the TDM Sector. **ALL RECENT ANNOUNCEMENTS AS TO EDC INCREASING INSURANCE CAPACITY IN AUTOMOTIVE HAVE BEEN STRICTLY FOR PARTS SHIPMENTS. EDC CAPACITY FOR TOOLING SHIPMENTS HAS NOT CHANGED SINCE NOVEMBER 2008.** Limitations result from limited availability of EDC insurance (EDC insurance capacity is defined and due to current long project cycles is not always available) and pricing for the product. The insurance premiums can prove to be cost-prohibitive to the TDM Sector. These limitations can result in significant exposure to financial loss for the TDM Sector in the event of the failure of an OEM or Tier 1 parts manufacturer.

## **THE SOLUTION**

**The tooling sector is not requesting any form of “bail out”.** We are seeking: a reduction in OEM driven payment terms commensurate with the risk profile of the present industry, AND we wish to ensure these funds “trickle down” and make it through the cash strapped Tier 1 parts manufacturers, who act as Middlemen for tooling proceeds, to the Tool Source – the TDM Sector. As such we are requesting that:

- 1. Conditions be attached to the OEM direct loan package that the Government is currently considering to assist the automotive industry, which ensure that the Tier I & Tier II supply base receives some of the benefit;
- 2. Loan conditions would provide that the OEM (recipient of the Government financing) be required to provide PROGRESS DRAWS at predetermined project milestones where production tooling is sourced with a Canadian tool supplier who manufactures the tool in Canada [*NOTE: A draft sample of the required legal wording for insertion into the Loan Agreements is available for review*] or, at the very least pay 90% of the cost of tooling to the Tier 2 at delivery of tooling to the Tier 1, with 10% held back until PPAP has been completed;

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3. While government loans are outstanding under the proposed aid package, the OEMs would be required to complete payment for tooling:
  - a) Upon shipment to the Tier 1 manufacturer's facility (*versus the current practice of payment of 100% of the cost of the tooling at Production Part Approval Process – "PPAP"- or Start of Production – "SOP"*), thereby accelerating final payment by 5-18 months;
  - b) Immediately, if OEM cancel a program; and
  - c) Immediately, if OEM delay a program longer than 90 days.
  
5. Ensuring that the OEM releases tooling funds at an appropriate interval will not fully remedy the risk to the tool source, as these funds must then navigate through the cash strapped Tier 1 parts companies. [*eg. Collins & Aikman, Progressive Moulded Products, Cadence and Plastech are high profile Tier 1 bankruptcy examples where the tooling funds the OEMs disbursed to the Tier 1 did not make it through to the tool sources.*] As such, an oversight mechanism/structure must accompany the above in order to safeguard a) government loan funds, b) OEMs as the borrowers of these funds, and c) the tool sources as the ultimate recipient of these funds. [*Tooling & Equipment Capital Solutions Inc. has structured a Bankruptcy Remote Trust mechanism for the US*]

## **THE BENEFIT TO THE INDUSTRY**

1. The contract cycle for the large number of Canadian based tool, die and mold manufacturers will be shortened by 25-50%, immediately improving the liquidity, improving their financial ratios – which are presently under stress, and alleviating significant bank pressure which improves access to credit [*Note: Before and After Balance Sheet example is available for review to illustrate the dramatic improvement in financial position resulting from shortening the project cycle*];
2. Tool, Die, & Mold manufacturers will have access to much needed cash flow to support in-progress and future tooling projects, since they will receive payments for tooling projects in a far more timely manner– a practice that will substantially reduce contract cycle time;
3. Because of the immediate improvement in financial condition brought on by accelerating payments, and the far greater certainty of timely payments arising from the proposed Trust structure, banks will develop an increased appetite for providing financing to tooling producers because of enhanced liquidity and more certain cash flow;
6. The Tier 1 parts manufacturers will also benefit from this proposal, since they too would receive cash flow related to project capital in addition to tooling, such as assembly equipment and production fixtures, and the proposal reduces their down stream risk to supplier collapse at the Tier II level;
7. The government greatly reduces the likelihood of having to pay twice for this economic situation: The first time on the OEM bail out. The second time when the TDM sector files insurance claims for losses with EDC; and
8. EDC is able to redeploy existing insurance capacity faster, which ultimately provides access to assistance for more companies and a greater number of projects.

Furthermore, under the proposed structure the Government loans to the OEMs would have accountability - direct, traceable, attribution to several hundred Tool, Die & Mold manufacturers, located in Canada, most of which are small and medium sized, family owned entities employing thousands of Canadians, and not just simply one or more of the OEMs.

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**The Tooling Proposal offers a fair, common sense solution to the issues facing the TDM Sector today. The proposal provides a simple, cost effective structure (Bankruptcy Remote Trust) that can be implemented in a short period of time and does not require a new bureaucracy to operate. The model has already been used in the automotive industry and has proven successful when the Detroit 3 have had to bail out troubled Tier 1 suppliers in the past, while ensuring that their investment in tooling, critical to the production of parts, is protected.**