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Credit shortage threatens supplier growth

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As the U.S. economy ramps up for the recovery, we find ourselves creeping up against another roadblock.

Where exactly will auto suppliers — as well as other manufacturers and companies in the Midwest — find the money to borrow to build new goods and hire back some workers to fill new orders?

“Suddenly, it’s good news — bad news,” said Tim Weed, partner in Plante & Moran’s restructuring and operations improvement group in Southfield. “It’s good news as long as you have the means to survive the upturn.”

When banks aren’t sure about who will survive and who won’t, where exactly will they lend

money? Small and midsize businesses are getting turned down for the credit they need to expand operations. And the next six months or longer could be tough. Data show that commercial and industrial loans at banks continue to decline.

“For the past year, we’ve been in pretty much unprecedented territory. We’ve seen a pullback of credit like we’ve never seen before,” said Rob Fowler, president and CEO of the Small Business Association of Michigan, which has 6,500 members across the state.

“It’s what’s got us stalled right now,” Fowler said.

Credit problems are likely to persist because hundreds of small banks are expected to fail over the next couple of years, warned Mark Zandi, chief economist for Moody’s Economy.com. Small banks are the key source of credit for small businesses. Credit card lenders also supply credit to smaller businesses, and they’ve tightened their standards aggressively.

A rack of front cross-members for use on the Dodge and Chrysler Minivan, Dodge Journey, and Chrysler Sebring are moved with a fork lift at the AZ Automotive Corp. Sterling Heights Plant on Thursday, Oct. 29, 2009. (PATRICIA BECK/DFP)

“Banks are taking a much harder look at every company, every deal, every situation,” said Jack F. DiFranco, principal of Grant Thornton Corporate Finance in Southfield. “Even good companies that ought to get financed are having a hard time arranging financing.”



In foreground from left, Plant Manager Sterling Heights and Roseville Thomas Charnesky, 47, of Grosse Pointe Woods, President and CEO Michael J. Alcala, 45, of Lambertville, and Plant Superintendent Paul Dion, 44, of Windsor, Ont. stand near the end of the weld assembly line (where front cross-members for the Dodge and Chrysler Minivan, Dodge Journey, and Chrysler Sebring are loaded onto racks) at the AZ Automotive Corp. Sterling Heights Plant on Thursday, Oct. 29, 2009. (PATRICIA BECK/DFP)



A rack of front cross-members for use on the Dodge and Chrysler Minivan, Dodge Journey, and Chrysler Sebring are moved with a fork lift at the AZ Automotive Corp. Sterling Heights Plant on Thursday, Oct. 29, 2009. (PATRICIA BECK/DFP)

Where's the credit?

The end of the Great Recession is a welcome sight. But business won't be back to normal soon. Instead, you'll hear executives like Michael J. Alcala, who runs AZ Automotive Corp. in Center Line, talking up the "new normal."

"The new normal for us became 75% of last year's daily" sales rate, said Alcala, president and CEO of AZ Automotive.

Fortunately, AZ was able to realign its debt, hire back about 300 of 700 workers who were laid off during the roughest patch and see signs of hope months after two of its main customers, General Motors and Chrysler, went through bankruptcy.

Even so, Alcala said times are difficult for suppliers and his company, which has five plants in metro Detroit, two in London, Ontario, and one in Lenexa, Kan.

"Personally, I think we're not through it as an industry."

Bankers, who face troubled loans in the auto industry and elsewhere, aren't sure where the auto industry is headed. Unless smaller to midsize companies are able to get financing for working capital, they won't be able to take on the new orders. Smaller, private companies rely heavily on banks instead of bond markets. The concern is that the auto industry may face more troubles if suppliers cannot get access to credit when they need to ramp up.

"The problem is growth consumes cash," said Jack F. DiFranco, a principal of Grant Thornton Corporate Finance in Southfield.

Avoiding the auto industry

Last month, Gov. Jennifer Granholm appeared on "Fox News Sunday" noting that the auto industry has been semi-redlined by banks and lenders.

"I can tell you in Michigan anyway, the auto manufacturers and the suppliers have been turned away by banks, people who have worked for 30 years, have been good employers, have always made payroll and now find it very difficult to have access to capital because the industry itself has been semi-redlined," she told Fox host Chris Wallace.

Tim Weed, a partner in Plante & Moran's restructuring and operations improvement group in Southfield, knows of one auto supplier that is making money at current levels but got a call from the bank a few weeks ago. The lender wants the company to cut its ties to the bank in the next six months.

"The bank wants to exit because they have their own portfolio problems," Weed said, declining to name the bank or supplier.



Team Associate Sami Youanes, 45, of Sterling Heights moves a front floor pan extension (for use in the Chevy Camaro) at the AZ Automotive Corp. Center Line Plant on Thursday, Oct. 29, 2009. (PATRICIA BECK/DFP)

Some reduce exposure

Then you have banks like Comerica Inc., which has not stopped lending to manufacturers, but has reduced its exposure.

Comerica's \$1.2 billion in automotive-related loans outstanding are down \$299 million or 20% from the end of last year through August. More startling yet, the shift signified a 55% drop if you look back to Comerica's \$2.7-billion exposure to auto manufacturers and suppliers at the end of 2005.

Comerica wants to continue to diversify its portfolio, but notes that declines in auto-related loans also reflect the auto industry's restructuring.

"Borrowings are down across the country. We are down \$6.9 billion in total loans outstanding, or 14%, since the end of 2008," said Wayne J. Mielke, vice president for communications for Comerica.



Team associates Mark Mici, left, 62, of Sterling Heights and Mrdhi Fransi, 42, of Sterling Heights work the mechanical line for the rear suspension module assemblies for use in the Chevy Malibu and Pontiac G6 at the AZ Automotive Corp. Sterling Heights Plant on Thursday, Oct. 29, 2009. (PATRICIA BECK/DFP)

As auto suppliers go out of business, many banks know that the equipment that's being brought to auction isn't generating much money or attracting many buyers. So if a bank's customer goes out of business, the bank won't be recouping much money by selling the equipment.

"This lack of capital will be a significant factor in forcing the contraction in the supplier base," said David Priestley, a manager in Plante & Moran's restructuring and operations improvement consulting group in Southfield.

Bill Boston, president and owner of Independence Tooling in

Troy, started up his new company in April after the owners of his old company, also an auto supplier, shut the doors.

The old company went out of business after the bank called its loan and the owners decided not put in another cash infusion.

"It was a little bit of a challenge to start when everything was tanking," Boston said. "You're financing a whole lot more yourself."

Boston was able to control start-up costs by buying equipment at bargain prices at auction. But Boston had trouble convincing a bank to lend the company money, so part of the financing included Boston remortgaging his own house.

He also received financing through Huntington Woods-based Hennessey Capital LLC, a company that specializes in working capital solutions when traditional loans are not available.

Hennessey provides financing based on Independence Tool's receivables and Independence pays interest based upon the length of time the cash is outstanding.

The company's overall costs go up the longer it takes for Independence Tooling to get repaid by its customers. So Boston has had to turn down some work because the customer wanted to take a longer time to pay.

One company's ordeal

After a brutal year, AZ Automotive wants to be poised to be one of the survivors and one of the companies that will buy other suppliers down the road. AZ had its own struggles to overcome to get to this point.

In January when the auto industry tanked, sales amounted to just \$1.5 million for the month. Back in 2008, the company's daily sales were close to the \$1 million level.

As GM and Chrysler went through bankruptcy and production was cut back, AZ Automotive found some of its plants in the dark in June.

AZ was among the suppliers who participated in guarantee programs backed by the federal government.

AZ is looking at \$130 million in sales for 2009 vs. \$250 million in sales for 2008.

One solution for survival: Vantage Capital, part of AIG Investments, increased its share to 100% ownership. The exchange eliminated more than half of the company's debt. GMAC, the senior lending agent to AZ, continues its lending support. Orix, who previously held a 37% ownership stake in AZ, is no longer an equity holder.

Alcala said it is helpful that the company's owners and its senior lender are on the same page. "It's going to be a slow ramp-up," Alcala said.