RIMS CANADA

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Presents

Supply Chain Panel

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Joe Giannini - Future Electronics

Agenda

1. **Presentations**
    - Financing the Supply Chain:
        - risk analysis and solutions by lenders
    - Supply Chain Exposure Analysis:
        - critical nodes
        - Best practices and solutions
    - Supply Chain Risk transfer:
        - Emerging risks
        - Different coverages
    - Supply Chain: a risk manager perspective
        - Electronics component industry

2. **Panel Discussion and Questions**

Financing the Supply Chain
The Trends

- Continued rapid move from LCs to Open Account intended to:
  - Simplify the financial component of the supply chain
  - Attain greater control over the payment decision (or amount of the payment)
  - Avoid using bank lines for procurement of goods: Increased borrowing capacity
  - Reduce costs associated with the financial supply chain
- Increased Collaboration between Buyers and Suppliers to better understand and manage:
  - Goods flow
  - Processing flow
  - Financial flow
- Continued focus on Working Capital within the supply chain to:
  - Develop effective terms of trade strategy
  - Leverage the Supply Chain as an effective financing mechanism
- Improved collaboration between Financial and Physical Supply Chain disciplines that enables
  - Process re-engineering
  - Change Impact Management – positive and negative
- Engagement with external partners that can influence and assist in the end to end supply chain by understanding and improving
  - Global Financial Institutions
  - Global Carriers and Logistics Providers
  - Larger, stronger and more strategic suppliers

Financing the Supply Chain
The Focus

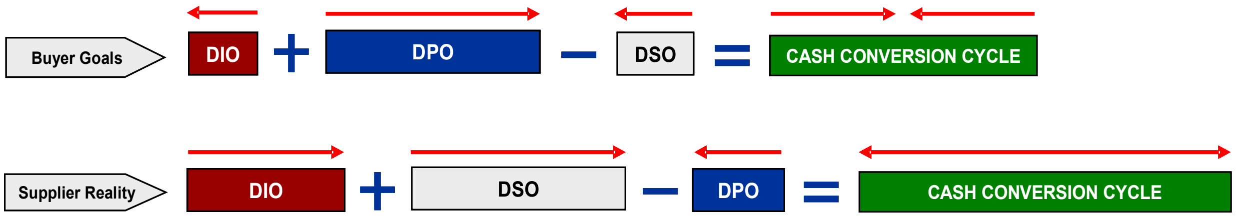
- Major US and European Importers (Retailers and Consumer Products) companies are now focusing on Vendor “needs” vs. “wants” to drive change
  - Buyer Power moving away from historical Supplier Power
- Buyer Driving Forces:
  - Simplify the financial component of the supply chain
  - Attain greater control over the payment decision (or amount of the payment)
  - Avoid using bank lines for procurement of goods: Increased borrowing capacity
  - Reduce the costs associated with the financial supply chain
- Increased Collaboration between Buyers and Suppliers
- Integration between Financial Supply Chain and Physical Supply Chain
  - Need for Processing Efficiency
  - Reduced Transaction Fees – Vendor concerns in 1st cost impact
  - Greater Control over the trading process
  - Ability to control terms
  - Questionable “value” of LC
    - Process Cost
    - LOC Implications
    - Supply Chain Financial Cost
- Focus on Working Capital within the supply chain
- Improving Visibility through broader Partnerships: Less better than More

Financing the Supply Chain
Vertical Awareness: Strategic Objectives

- Consideration and Collaboration
  - Risk, Liquidity and Financial Cost
  - Performance vs. Delinquency
- Financial Trade Structure
  - Understanding Financial Risk
- Terms Management
  - Supplier Credit Risk
  - Supplier Performance Risk
  - Buyer Contract Risk
- Supplier Financial Health
  - Vertically Aware
  - Actions lead to Impact
  - The Financial Chain Benefit

Consideration and Collaboration

- Identification of Needs vs. Wants
  - Identify and appreciate Suppliers' optimal financial cycle; Cash Conversion Cycle
  - Buyers have a responsibility to support the appropriate cycle



- Collaboration vs. Independence
  - Performance risk should be owned and managed by the Supplier
  - If not a vertically integrated company, financially avoid behaving like one
  - Consider effective and applicable options to support the Supplier; variable terms of trade
- Suppliers' Local Banking Environment
  - Be realistic and collaborative; Trade Finance is available, under appropriate conditions
  - Identify and understand what is required to "provide" liquidity
  - Self serving interests benefit nobody today; LCs vs. OA

Financing the Supply Chain
Financial Trade Structure

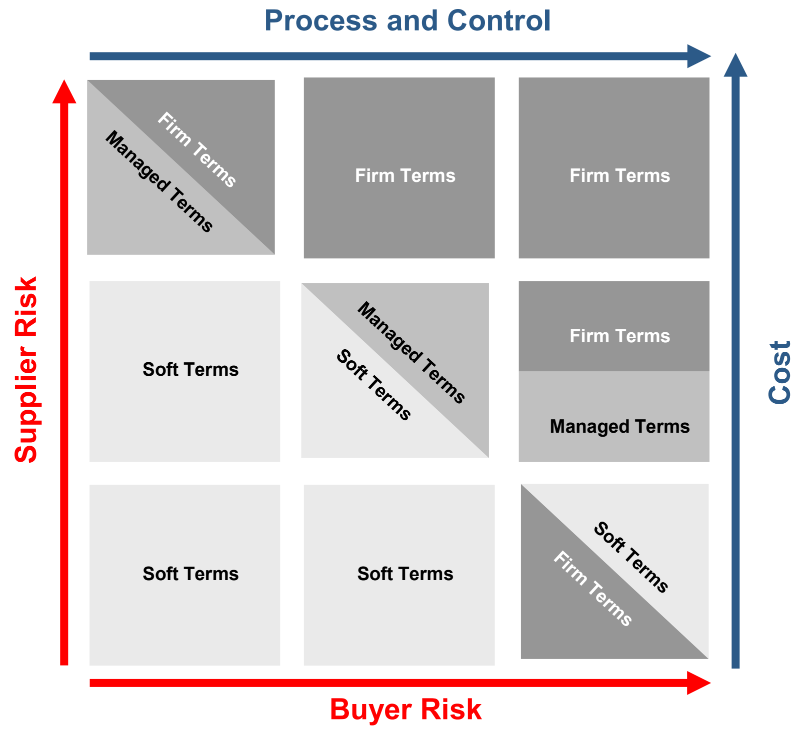
- Access to Working Capital
  - Suppliers struggling to access pre shipment working capital
  - Suppliers are pushed by Buyers to enhance Buyer financial turns
  - Buyers being asked to assume increased financial risk in pre shipment cycle
    - Finance raw materials purchases
    - Suppliers desperately looking for financial / liquidity support

- Financing Structure
  - All parties need to manage financial impact of supply chain events
  - Respect the financial considerations of Suppliers
  - Are your terms impacting Suppliers' ability to perform

- Needs vs. Wants
  - What terms work for your Suppliers and you?
  - Consider all applicable terms
    - JIT or VMI; Inventory Carry Cost
    - Early Payment; leverage liquidity
    - Shorter OA terms

Financing the Supply Chain
Terms Management

- Avoid Linear Trade Structure
  - Remove financial cost from the Supply Chain vs. a redeployment onto the Supplier
  - Don't push cost over to your supplier that you should carry; who is benefitting
- Terms of Trade
  - Open Account
    - Lack of visibility for the Supplier's bank
    - Revocable
    - Lack of structure and tough to monetize pre shipment
  - Sight Letters of Credit
    - Provide structure and visibility; firm PO and Buyer credit worthiness
    - Greater control
    - Can be monetized
  - Time Letters of Credit
    - Provide structure and visibility; firm PO and Buyer credit worthiness
    - Can be monetized providing Buyer and Supplier with enhanced cash flow benefits



Financing the Supply Chain
Supplier Financial Health

- Identification and Evaluation
  - Financial statements a plus; not always available

- How does your Supplier access working capital finance?
  - Do they have access to lines of credit?
  - What are their bankers' terms?
  - What is the local market condition?

- What can you do to support the Supplier?
  - Collateralize orders with LCs
  - Monetize Time LCs

- What are your Supplier's other customers doing
  - What is their customer base behavior pattern
    - Are terms being stretched?
    - Are discounts being demanded?
    - Are orders being cancelled?

- Who does the Supplier bank with?
  - Strength and stability
  - Industry knowledge
  - Is Trade a core competency

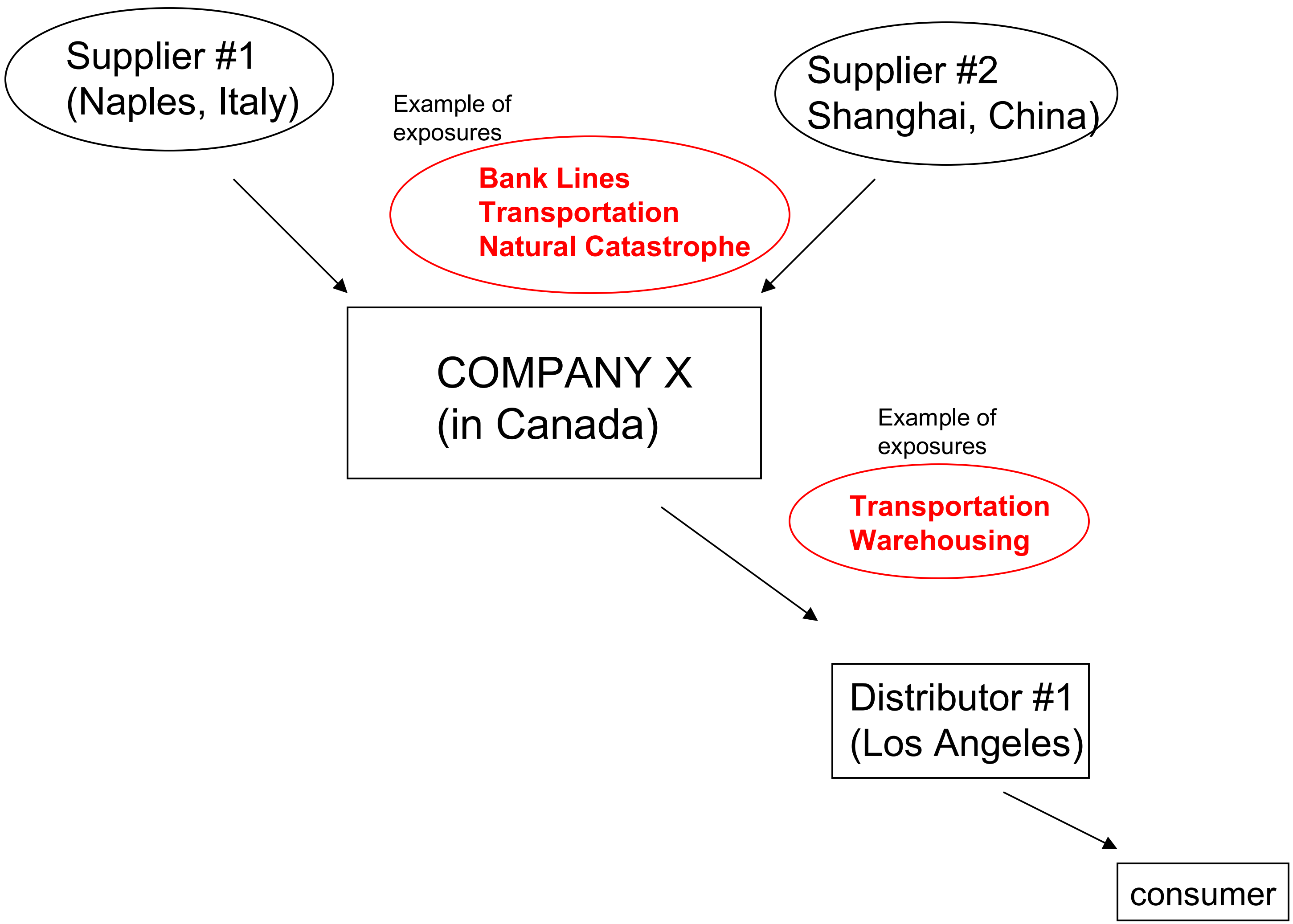
Supply Chain Exposure Analysis
Where to start?

- Inventory of key exposures Upstream and Downstream
- Material vs Catastrophic analysis
  - Product / Service profitability at different stages of the supply chain
- Prioritization of key exposures (catastrophic)
- Review of CBI coverage (if existent)

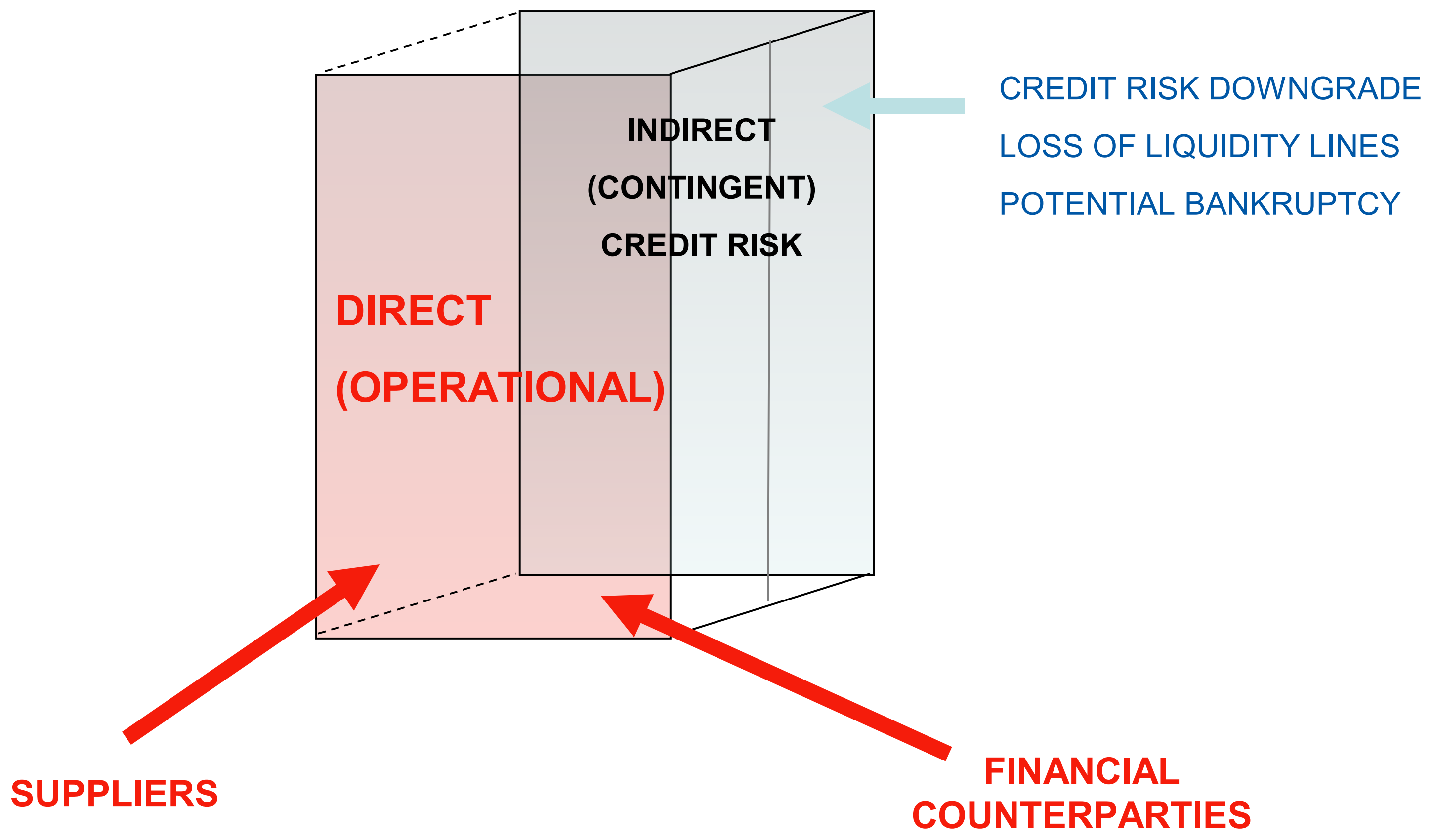
Supply Chain Exposure Analysis
Where are the critical nodes?

- Upstream: suppliers, logistics into your facility, financial counterparties (banks, insurers, etc.)
- Downstream: logistics out of your facility, distribution channel(s)
- Critical Questions:
  - Do we know this supplier well enough to be comfortable?
  - Do we have access to inventory buffers and/or alternative supplier in short order?
  - What is the foreseeable loss beyond lost profits and extra expense? (ie. reputational, market share, etc.)

Supply Chain Exposure Analysis
Example of critical nodes exposure



Supply Chain Exposure Analysis
Direct / Indirect exposures



Supply Chain
Selected Risk Transfer Options

Exposure	Solution(s)	Market	Pros and Cons
Supplier Default	1) Stand Alone Trade Disruption Insurance 2) Contingent Business Interruption	1) Some commercial insurers 2) Property insurers	1P) Tailored to specifc exposures 1C) Need for thorough data on suppliers and alternatives 2P) Widely available 2C) Limited coverage (perils and limit of liability) sometimes need for physical damage
Financial Counterparties	1) Credit Default Swap	- Banks, hedge funds	P) Widely available C) Costly

Supply Chain Risk Best Practices

- Regular **catastrophic** risk mapping
- Supplier inventory priority list with alternatives and buffers identified
- Simulation of loss of key supplier for partial and total production for at least one full financial quarter
- Analysis of potential loss beyond lost profits (reputational, market share, investor response)
- Contingency Planning (key supplier and company)

Supply Chain Risk Transfer

What are the risks?

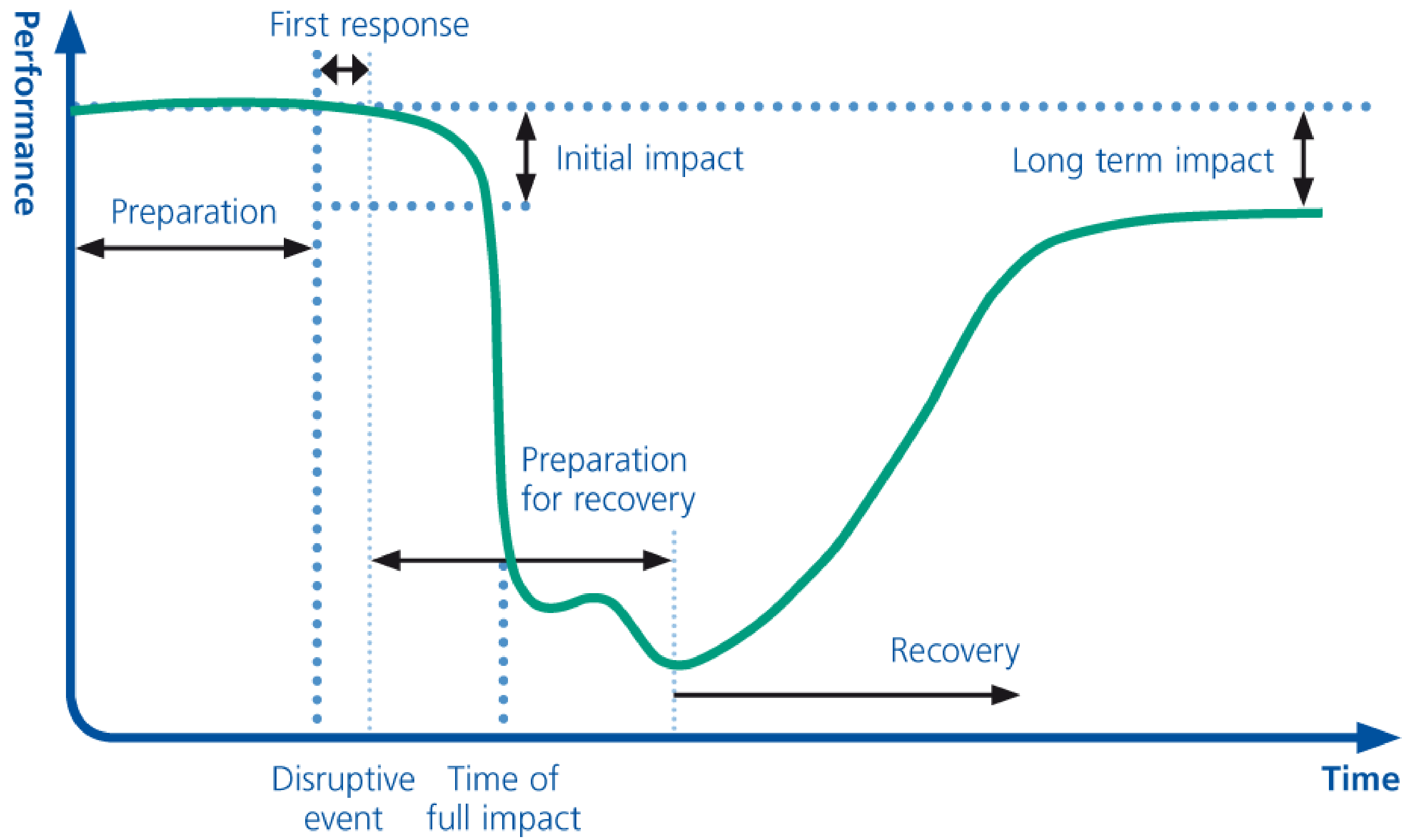
- Dependency
- Product damage
- Insolvency
- Transportation
- Utilities
- Strikes
- Infectious Disease
- Reputation
- Regulatory / legislative changes

Result

The partial or entire disruption to the company's revenue.

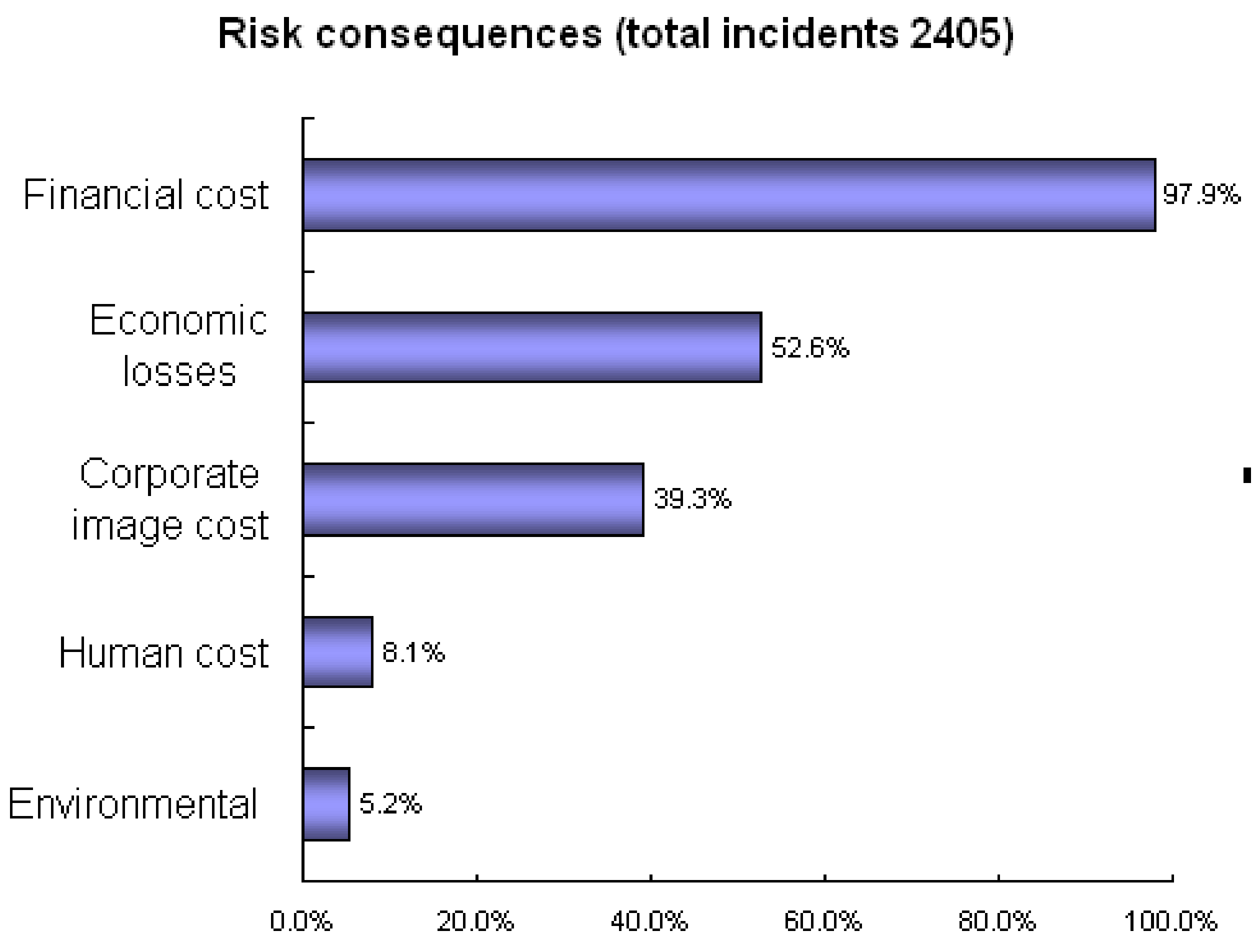
Supply Chain Risk Transfer

Disruption Increasingly Impact Financial Performance



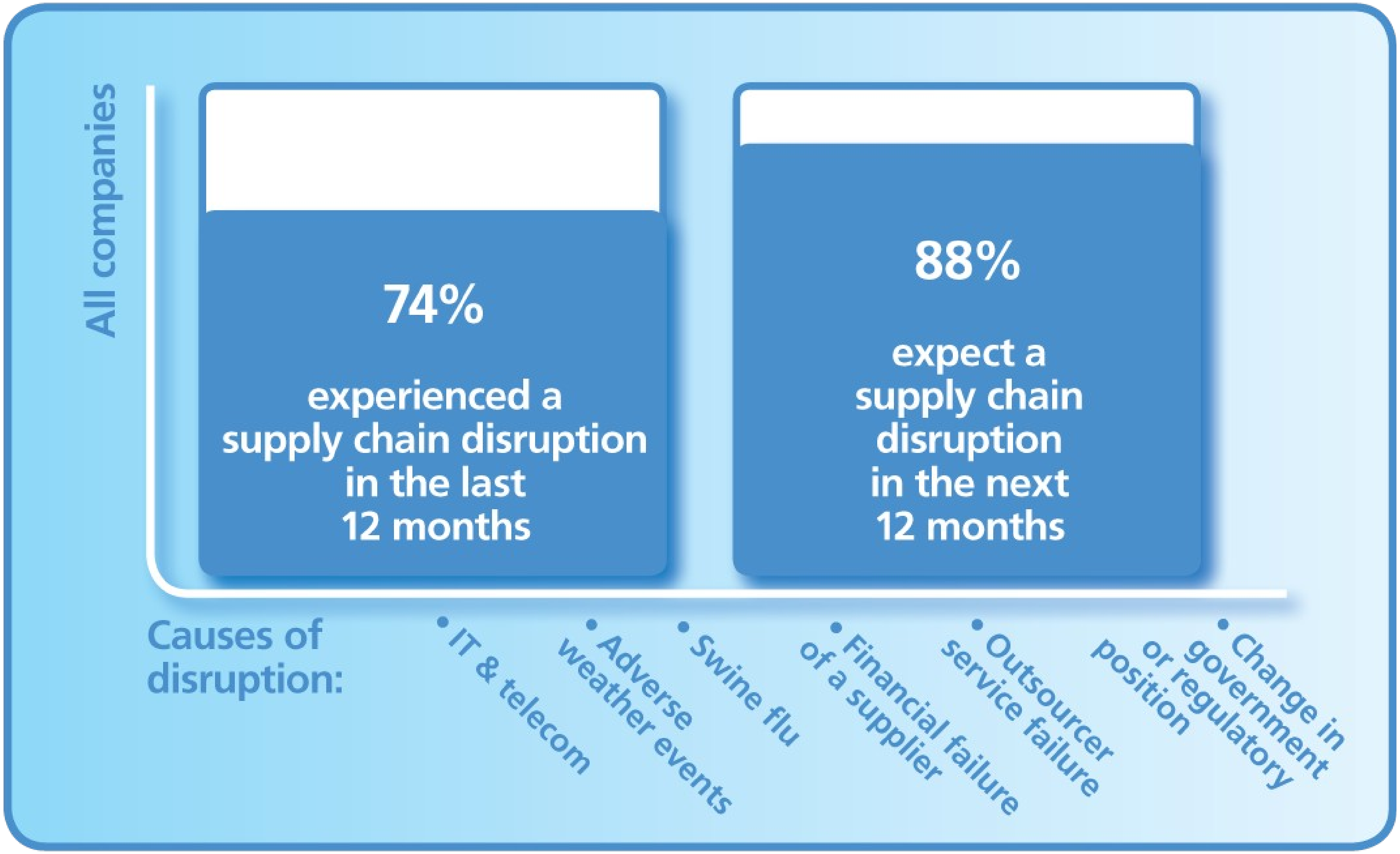
Source: Ycssi Sheffi & James B. Rice Jr., MIT SLOAN MANAGEMENT REVIEW, 2005

Consequences



Sources: The University of Manchester Manchester Business School; EPSRC Engineering and Physical Sciences Research Council

Supply Chain Disruptions Are Not Infrequent



BCI survey over 200 companies responded

Supply Chain Insurance

- Standalone **"all risks"** business and service interruption cover which includes, but is not restricted to physical damage.

- That can dovetail with other coverages such as trade credit, contingent business interruption, political risk, and marine.

- It allows you to risk transfer your supply chain risks for **named supplies and suppliers** with few exclusions.

Supply Chain: a Risk Manager perspective
Joe Giannini – Future Electronics

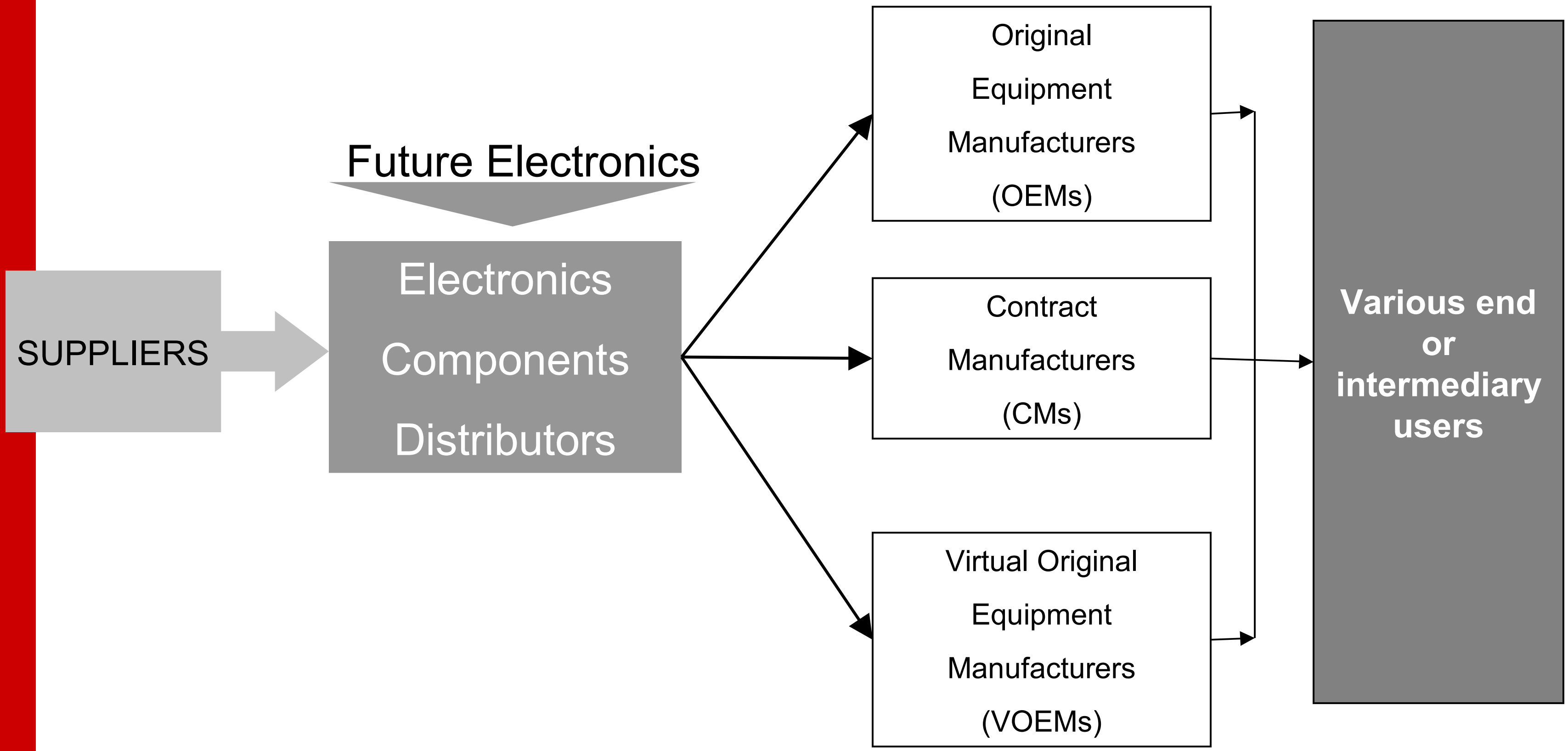
Background

- Privately held - founded in 1968
- Global Distributor of electronic components (# 3 worldwide)
- Operate in 42 Countries
- 4,000 employees
- Sales > $2.5B
- 20,000 customers
- 28 billion units shipped in 2010
- State of the art, distribution centres in 3 regions (NA/Europe/Asia)

What we do…

- Distribution services for product manufacturers and clients
- Semiconductors, passive components, capacitors, LED lighting solutions, memory chips, etc.
- Store, promote, provide advice, and distribute products to complete JIT orders
- Bonded inventory Management (Consignment)
- Engineering - Circuit Design Services
- Component Programming
- LED Lighting Solutions

Supply Chain: a Risk Manager perspective
Our place in the supply chain



Supply Chain : a Risk Manager perspective
Our Suppliers

- Electronic Component Manufacturers
- Logistics Providers (common carriers, freight forwarders, etc.)
- Product service providers
- Design/mfg partners
- Lenders
- Insurers
- Etc.…

Supply Chain: a Risk Manager perspective
Managing the SCR

<u>Component Supply</u>

- **Large product offering** through 500 franchise agreements – product spread is quite diverse (no single Supplier represents > 5% purchases)
- **Inventory mix** is generally fed into a wide range of end applications
- **Relationships** with Suppliers – long standing agreements
- **Inventory availability** – about 60% available to sell (inventory turns 3X)
- In-house financial Risk Assessment Group – **monitors financial performance** of key Suppliers
- Financial risk transfer through **Contingent Time Element insurance**
- Require minimum insurance requirements from Suppliers to support indemnification agreements (i.e. product liability claims)

Supply Chain: a Risk Manager perspective
Managing the SCR

- In-depth **product knowledge** through our Product Marketing group
  - Organized by product families (not mfg) – they are experts in the products we sell
  - Can identify alternate product offerings
  - Constantly working with both Suppliers and Customers to identify market needs
  - Together with asset Management they help mitigate **pricing risks**

- Large investment in highly trained **Asset Management Group**
  - Work closely with Product Marketing
  - Continuous monitor of lead times & inventory positions
  - Sourcing intelligence (i.e. aftermarket product availability)

- Business Continuity Plan (BCP) includes provision that allows for any one DC centre to support another
  - Proprietary “ship from Anywhere to Anywhere”
  - BCP serves dual purpose of mitigating both Future’s and customers’ SCR

Supply Chain: a Risk Manager perspective
Managing the SCR

Design/Manufacturing Partners

- Redundancy through the use of multiple partners
- Quality Assurance Group verifies certifications in place (i.e. ISO 9001 and ESD S2020 certification)
- As with our Component Manufacturers - Risk Assessment Group regularly monitors **financial performance** of Partners

Supply Chain: a Risk Manager perspective
Managing the SCR

Logistics Partners

- Distribution centres strategically located near carrier hubs
- At least 2 separate carrier agreements available for shipping into any country
- Transportation Managers in each region continuously monitor operational stability of carriers (i.e. pending strikes, etc.) – will react to move volume elsewhere if deemed necessary

Supply Chain: a Risk Manager perspective
Managing the SCR

Financial Partners

- Treasury Dept monitors counterparty risk of all **lenders**
  - Credit ratings (S&P and Moody's)
  - Stability of ratings
  - Key recent developments (news)
  - RM, Treasury, VP Finance meet quarterly with CFO to review key economic indicators

- RM monitors **insurer** financial strength ratings
  - Broker web based portal provides automatic alerts for credit ratings and news developments
  - Generally require minimum AM Best B++ or greater with FSC VII or higher

Panel Discussion & Questions

THANK YOU FOR ATTENDING THE

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