

# TOOLING & EQUIPMENT

## CAPITAL SOLUTIONS INC.

CDN. OFFICE: 1759 CHORNOBY CRESCENT, TECUMSEH, ONTARIO, CANADA, N8N 5A1  
TEL: 519-979-7477 FAX: 519-979-6366 CEL: 519-965-0393

December 4, 2008

### **Proposed Canadian Assets to be Eligible for Financing via Government Loan Programs for Automotive:**

Tooling & Equipment Capital Solutions Inc. (T&E) has a multi-pronged approach to the deployment of potential government assistance to the automotive industry. This paper will focus solely on automotive tooling. "Tooling" is defined as those production assets (dies, molds, jigs, fixtures and automation) purchased by Tier 1's from tool, die and mold manufacturers, which are on-sold to OEMs by parts suppliers at start of parts/vehicle production. This definition can be expanded to include direct OEM acquisition of vehicle program specific production equipment.

*We have lead our discussion/proposal with Tooling as it will have the highest political resonance, and it impacts small businesses to parts companies of many sizes to the OEMs themselves. In addition to Tooling, an even more dire need of financing for the parts industry is "Production Equipment Financing", which T&E also specializes in. We have left this discussion to another paper.*

### **Part 1: Production Tooling Financing Proposal and Rational**

In order to formulate a proposal we will first outline the current scenario:

GM Canada and Cami (50-50 Joint Venture between GM and Suzuki) have two upcoming launches: Camaro at GM Oshawa and Equinox at Cami. VERY conservative estimates for the amount of tooling procured would likely exceed \$100 million per vehicle launch. While Ford and Chrysler also have tooling being readied for vehicle launches, however we have limited our example to GM Canada.

Tooling procured by the various Tier 1 parts suppliers from their tooling sources, that was then to be paid/purchased by the GM Canada at PPAP achievement (Production Parts Approval Process – a process in the control of the OEM) was largely:

- Commissioned by Tier 1's in the 2<sup>nd</sup>-3<sup>rd</sup> quarter of 2007 [Note: Steel dies would be commissioned before some plastic molds. The exception may be fascias for bumpers];
- Completed by tool, die and mold makers in early 2008;
- PPAP was originally to be in 4<sup>th</sup> quarter of 2008 for Camaro and has since been pushed back to 2009;
- PPAP for Equinox and its Pontiac variant is scheduled to be 2<sup>nd</sup> quarter 2009 and 3<sup>rd</sup> quarter 2009;
- Canadian tool sources and Canadian parts suppliers are awaiting payment in excess of \$100 million on jobs that the tool sources substantially completed over six months ago.



If this money does not flow, and flow as planned [the Camaro has already been delayed and the future of many GM 2009 launches is now uncertain], it will have a catastrophic impact on Canada's tool die and mold industry; likely wiping-out 50% of this presently fragile industry.

Domestic (Canadian and US) tool, die, and mold makers are expected to finance the tooling from start of manufacturing until the OEM pays the Tier 1 parts maker for the tooling, whom in turn pay the tooling source. This process can range from twelve months to twenty-four months. In most cases tooling is substantially completed by the tooling source five to twelve months prior to receiving payment. [Ironically, Chinese tooling sources are provided progress payments given the desire to source from Low Cost Countries, although even this scenario is changing with the current crisis.]

**Why does an OEM not want to pay for production tooling until PPAP or Job 1?**

Firstly, it is important to recognize that this practice of delaying payment until Start of Production was not always the case in the industry: OEMs used to give progress payments for tooling and several of the non-Big Three still do. So while liquidity is scarce presently, this practice occurred when the debt markets were wide-open. The crux of the rationale for this practice is OEMs do not want to invest in a non-revenue producing assets prior to revenue generation. Investing in non-revenue producing assets negatively affects Return on Net Assets (RONA), an important Wall Street measure and employee bonus metric.

**Why does a Tier 1 parts maker not provide progress payments, as providing them would make the tool acquisition cost cheaper?** The OEM does not allow the parts maker to add an interest carrying charge to the tool, and the OEMs do not allow parts makers to enjoy any profit opportunity on the tools. The parts maker must pass the tools through to the OEM at the lower of "Target Cost" or "Actual Acquisition Cost". With no opportunity to profit, or to recoup interest carrying charges, there is no incentive for the parts maker to provide a progress payment to reduce the cost of the tool, as any reduction in tool costs goes directly to the OEM despite the generally lower interest carrying cost incurred by the Tier 1 than by a tool source.

**What is the cost consequence of doing this?** The least efficient borrower in the industry chain and the smallest – the tooling source - must not only carry the burden of financing but also deploy scarce capital for incredibly long cradle-to-grave contract cycles that may be delayed by no fault of the tooler.

**With the above scenario in mind, T&E's proposes the following...**

A portion of the government loans should be earmarked for tooling procured in Canada. A further caveat should be implemented that while the government loans are outstanding, the OEMs are to pay for the tooling: a) at buy-off on the Tier 1 floor versus PPAP, thus accelerating payments by 5-12 months; b) immediately if they cancel a program; and c) immediately if they delay a program longer than 90 days. [T&E presently finances several million dollars in production tooling per month and has existing financing



structures to accommodate this proposal.] This will lead to a number of significant positive consequences directly attributable to the proposed caveat:

1. The tooling expense/investment is a necessary funding requirement of the OEM for all new technology/vehicle programs, so loaning against this asset is entirely viable purpose of the loan proceeds – and it is T&E’s experience that it is one of the most valuable assets in the industry to secure loans against;
2. This will reduce the cost to the OEM [who at this stage should be less concerned about RONA and more concerned about ABSOLUTE cost reduction] as the tooler will no longer have to add their “self finance costs” to the tooling purchase order cost, thus reducing interest costs by some 5% per annum on over \$100 million plus in tooling, WHILE simultaneously reducing risk in the industry chain;
3. This will shorten the contract cycle for the hundred plus Canadian tool, die and mold sources by 25-50%. This will have the impact of immediately improving the liquidity of tool source and alleviating significant bank pressure. With contract cycle reduced by some 50% the impact is equivalent to doubling the liquidity of the tool source. This will IMMEDIATELY improve their debt related ratios, which are presently under significant stress;
4. This will also allow Export Development Canada, who insures a substantial amount of the tool sources contracts, to re-deploy existing insurance capacity that was necessary for a 24 month contract cycle which will no longer be necessary with a 12 months contract cycle. More companies can get EDC coverage without EDC increasing exposure;
5. By doing this the government also avoids a possible scenario twelve months out where the restructuring plans have not played out and the OEM’s must file CCAA or Chapter 11. Under that scenario EDC will likely end up paying substantial insurance claims. So in effect, if the government does not deploy the caveat to accelerate payments to tool sources, the government will have paid once for the “bail-out” [which the loans will be perceived if the industry fails], and will then pay again when EDC pays out insurance claims. This scenario could be mitigated or avoided by instituting the caveat and exposure would be minimized to a one-time event;
6. The Tier 1 parts companies would also view this proposal as being in their interest. In the event that an OEM cannot pay for tooling to the Tier 1 parts company then the Tooler’s recourse is to its direct customer, the Tier 1 parts company and not the OEM Thus the Toolers will pursue avenues against the parts companies, which may well include: a) legal action which may cause a “financial tipping point” for the parts company, many of which are already under financial duress; b) holding “hostage” tooling destined to the parts company for other OEM contracts creating a “snowball effect” across the industry; and/or c)



outright failure of the tooling source leading, thus leading to increased costs and launch risk throughout the industry.

Requiring the OEM to substantially pay for tooling 5-12 months earlier would significantly curtail the collateral damage from a singular OEM program cancellation or OEM failure, as less unpaid tooling would be exposed at any given point in time and thus the Tier 1 would be less exposed to the repercussions of its supply base.

**In the proposed scenario, that \$1 dollar loaned by the government has a 3 times leveraging impact as it: 1) improves the OEM financial position, 2) directly improves the toolers financial position, and 3) frees up EDC capacity to aid more toolers. These benefits accrue while assisting the OEM launch its new products, reduce its cost, and reinforces a previously fragile tooling base whose banks are withdrawing present operating/liquidity reserves.**

It is also imperative to keep in mind the present state of the tooling sector.

- Their banks are addicted to EDC insurance. Without EDC insurance many banks will not lend on tooling contracts;
- Recently EDC has stopped insuring new clients for any tooling destined to a Big Three OEM regardless whether the Tier 1 parts company, who is contracted to pay for the tooling, is in satisfactory financial condition;
- Their banks are withdrawing credit facilities at an alarming rate due to industry exposure and capital reserve requirements;
- Banks traditionally despise single purpose assets, work-in-progress financing and lengthy payment terms, all traits in the tooling industry;
- The tooling sources have been battling a strong Canadian dollar that has reduced sales revenue while Canadian denominated costs have not been reduced by similar amounts. And most tool shops are not of the size to have dedicated financial personnel trained to hedge this risk.

If one tool source collapses it affects multiple tier 1 parts companies, multiple OEMs, and multiple OEM assembly facilities and engine facilities.

***I cannot think of another distinct, discreet, identifiable asset with the multiplier effect that would not only be perceived to positively impact companies from Oshawa to Windsor, as well as small business to large enterprises, but would have a significant, HIGHLY VISIBLE, and measurable impact for government funding.***

“Tools do not go bankrupt companies do”. So if you believe in the Camaro and the Equinox then the production tooling is a great asset to lend/secure against, because they cannot build vehicles without the tooling.

This proposal, while focussing on two GM launches due to the near term “tipping point” event that the failure of GM to pay for the incurred tooling costs for these two vehicles,



can be extrapolated to all other vehicle launches where the government values the vehicle being produced.

Tooling & Equipment Capital Solutions Inc. (T&E) is a boutique that specializes in structuring, arranging, deploying and administering credit facilities for production related automotive assets. T&E arranges its funding of client credit facilities from EDC, TD Bank, BNS, Bank of Montreal and a number of US lending institutions.

T&E can structure a “Loan Program” for both levels of government for...

- Canadian OEMs and Tier 1’s for production related tooling [as discussed herein];
- For Canadian Tier 1’s non-tooling production related machinery and equipment [the biggest financing void that Tier 1’s presently face];
- OEM specific project financing;
- Foreign OEMs procurement of Canadian manufactured tooling and production equipment.

T&E, and its principal, have a stunning record of structuring loans that have **always been repaid** despite some borrowers, at both the Tool Sources and Tier 1 level, experiencing CCAA of Chapter 11.

The principal of T&E – Craig Wiggins – was largely responsible for establishing EDC’s Automotive Industry Team and many of the products that EDC still deploys today. During his tenure the EDC’s automotive volume grew from \$50 million in 1995 to \$1.1 billion in 2001, his last full year at EDC.

References who can speak to T&E knowledge and experience in the automotive sector and supply chain finance include:

- Eric Siegel, CEO of Export Development Canada
- Diana Smallridge; CEO of International Financial Consulting
- Stephen Dempsey; Chairman of Greater Halifax Partnerships and Director of Canadian Chamber of Commerce;
- Gerald Fedchun; President of Automotive Parts Manufacturers Association [whom has passed a proposal for T&E to Industry Canada]; and
- Other industry, senior bank and client references can be provided upon request



---

We urge you to call T&E and take advantage of our unique expertise in this industry and our distinct multi-stakeholder perspective.

Yours very truly,

TOOLING & EQUIPMENT CAPITAL SOLUTIONS INC.

D. Craig Wiggins  
President &  
Director Tooling Solutions  
519-979-7477