

Is it time to start worrying about inflation?

- ▶ *Better Decisions*
- ▶ *Better Results*

Attendees will be in listen only mode

A recording of this presentation and the
slides will be available on the
APD Website



Jeoff Burriss

Principal, Advanced Purchasing Dynamics

- ▶ >30 years manufacturing purchasing experience
- ▶ Founded APD in 2004
- ▶ Helps clients make their investment in purchasing a competitive advantage

Jon Gabrielsen

President & Chief Executive Officer,
J.T. Gabrielsen Consulting



- ▶ 41 years of expertise in the market economics of manufacturing and distribution
- ▶ Helps customers understand the market and develop corporate strategy



Jon Homrich

Client Support,
Advanced Purchasing Dynamics

- ▶ Project Management Leadership for Consulting and ProcureForce Implementation
- ▶ Helps clients make their investment in purchasing a competitive advantage

2019 Business Planning - Tariffs, Shortages, Inflation & a Hot Job Market

- ▶ A number of issues have come up in discussions with purchasing leaders that we'd like your feedback on.
- ▶ Take the survey at <https://www.surveymonkey.com/r/TC7K2T9>
- ▶ For taking the survey you'll get a report comparing your feedback to the overall group responses
- ▶ Survey ends August 17, 2018

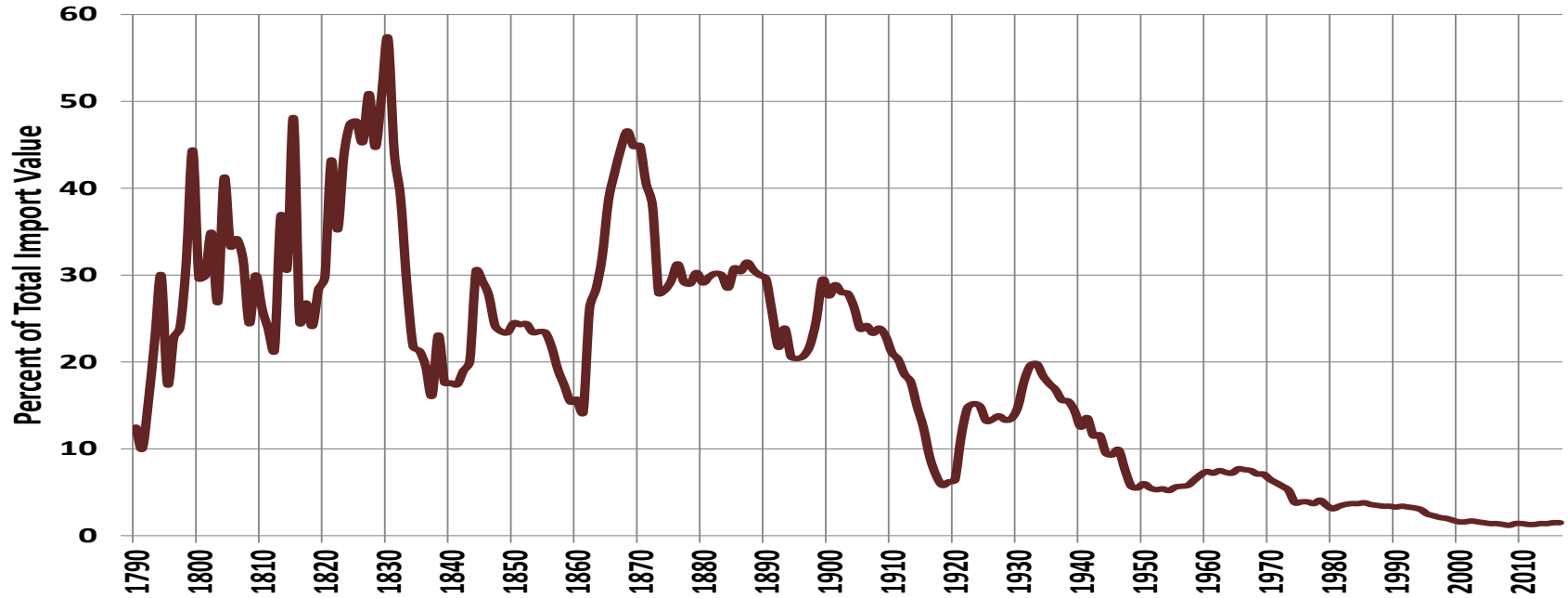


- ▶ Recent market test of MRO items showed increases on steel based replacement parts and tooling.
- ▶ Oil based commodities on the rise.
- ▶ Transportation shortages and price increases to oil and driver shortages.

I am here because:

- ▶ I am worried about tariffs
- ▶ I am worried about inflation
- ▶ I have no worries, I just want to learn more
- ▶ I just wanted to kill a half hour of my day

Tariffs on U.S. Imports



Source: USITC, Historical Statistics of the United States

Better Decisions

Better Results

- ▶ March 2018 – Tariffs applied to Steel and Aluminum
 - ▶ 25% on Steel (As of 6/1/18: All countries of origin except Argentina, Australia, Brazil, and South Korea.)
 - ▶ 10% on Aluminum (As of 6/1/18: All countries of origin except Argentina and Australia.)
- ▶ July 2018 – Additional targeted tariffs were added
- ▶ October 2018 and beyond – more tariffs to be added if trade war continues to escalate

Tariffs – What's Coming

- ▶ Potentially including 20-25% on Auto and Auto Parts

No one in procurement today, who is under the age of 90, has experience dealing with broad and high tariffs.

3 Ways to Cope with Tariffs

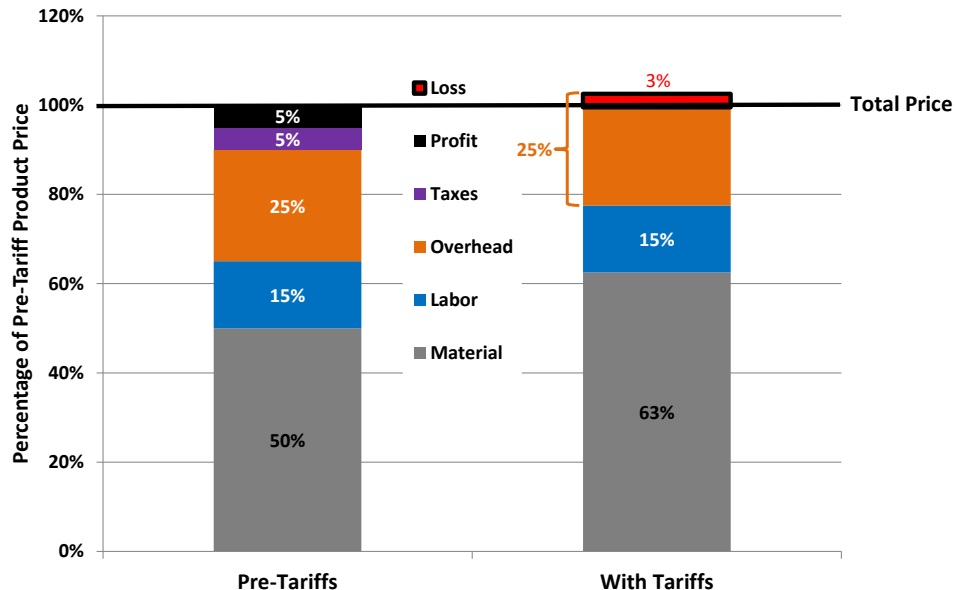
- ▶ Change how you act
- ▶ Offset with productivity
- ▶ Pass along increases -- inflationary

Tell me how you will tariff me and I'll tell you how I'll act.

- ▶ Choose what to produce or source from which countries.
- ▶ Manage percentage of content by country in relation to the trade agreements like NAFTA, etc.
- ▶ Import pickup trucks with cheap plastic seats in back (Subaru Brat) and vans with windows to be covered and cheap plastic seats to be removed to avoid the 25% "Chicken Tax" in place since 1964.

Suppliers cannot absorb that much inflation and tariffs

Example: Impact of Steel Tariffs on a Supplier's Cost Structure



- ▶ A typical supplier of machined forgings and castings will have a cost structure something like this.
- ▶ A foundry or forging shop supplier will have an even higher material percentage and even a worse outcome.
- ▶ No supplier could make this up in productivity and remain viable to continue operating let alone invest in future new programs for its customers under these circumstances.
- ▶ They will have to pass on the material cost increases.

Better Decisions

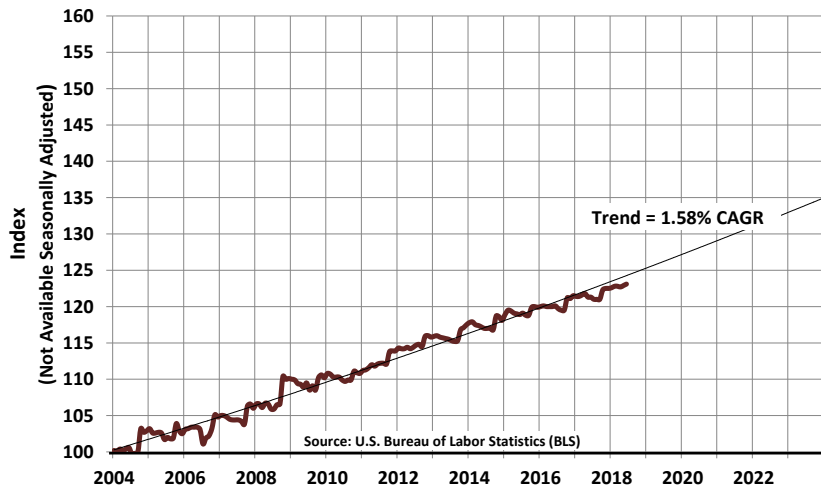
Better Results

Where are we headed?

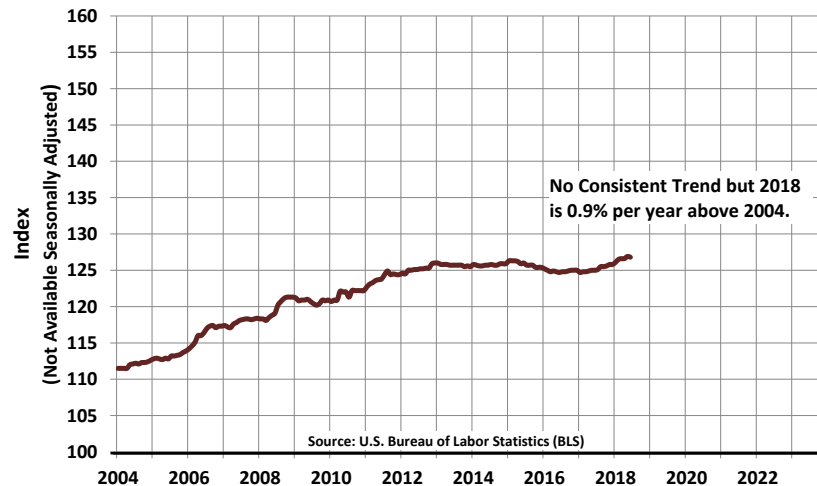
- ▶ Successful negotiations that lead to lower tariffs
- ▶ An escalating trade war of much higher and more broadly applied tariffs that become permanent for at least a few years or even last for decades like the 1920s trade war.

Where is overall supply chain inflation so far?

Producer Price Index - PCU336
Transportation Equipment Manufacturing

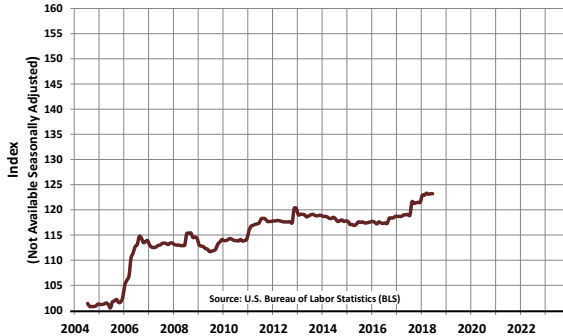


Producer Price Index - WPU1412
Motor Vehicles Parts

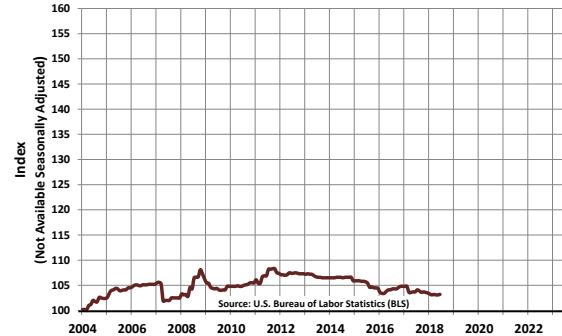


- ▶ From 2004 through June 2018 both End Vehicles (left) and Parts (right) have had less inflation than the total economy (2.3% CAGR)
- ▶ The question is what happens due to tariffs from here on out?

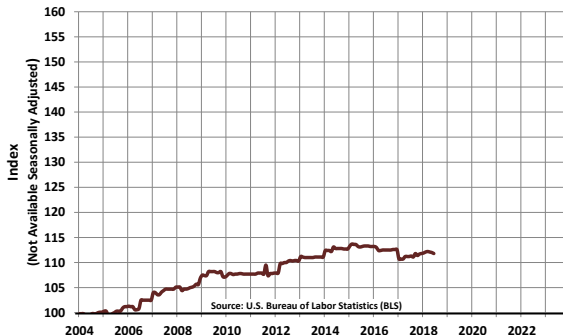
Producer Price Index - WPU14120501
Gasoline Engines and Engine Parts
Excluding: Carburetors, Pistons, and Valves



Producer Price Index - WPU14120502
Motor Vehicle Steering and Suspension Parts



Producer Price Index - WPU14120503
Motor Vehicle Transmission and Power Train



Producer Price Index - WPU14120504
Motor Vehicle
Brake Systems

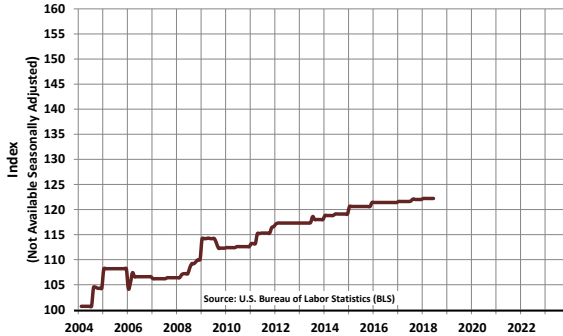


- ▶ Engine inflation began in mid 2017
- ▶ Brake Systems inflation may be beginning now.
- ▶ But so far Transmission and Powertrain, and Steering and Suspension appear not to have been impacted.

Producer Price Index - WPU14120505

Motor Vehicle

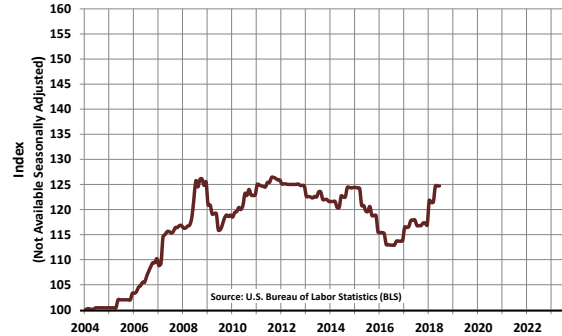
Filters for Internal Combustion Engines



Producer Price Index - WPU14120506

Motor Vehicle

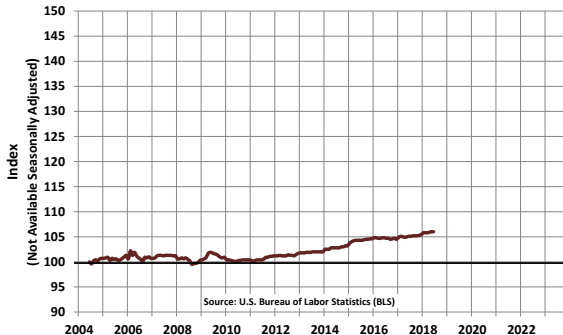
Exhaust Systems



Producer Price Index - WPU14120511

Motor Vehicle

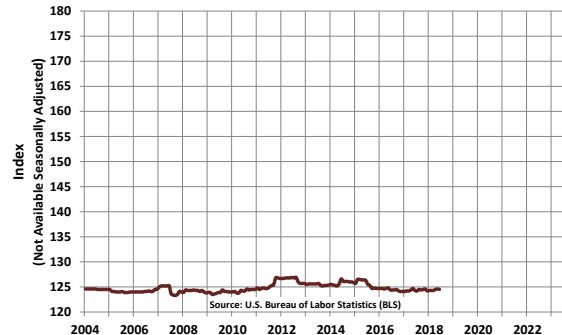
Seating and Interior Trim



Producer Price Index - WPU14120514

Motor Vehicle

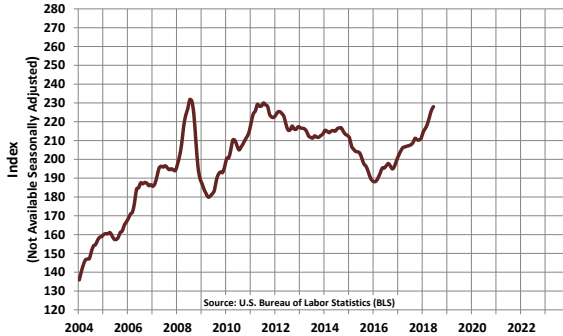
Electrical and Electronic Equipment



▶ So far none of these have been impacted by inflation with the exception of Exhaust Systems.

Lower Tier Metal Products [1 of 2]

Producer Price Index - WPU10
Metal and Metal Products



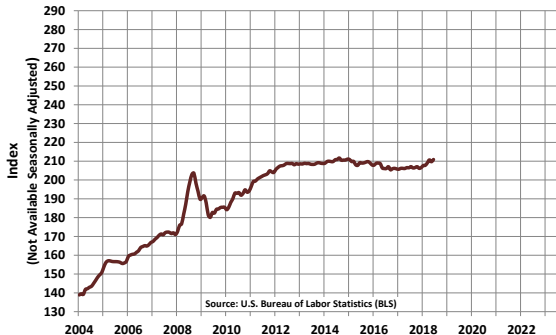
Producer Price Index - WPU1017
Steel Mill Products



Producer Price Index - WPU101
Iron and Steel



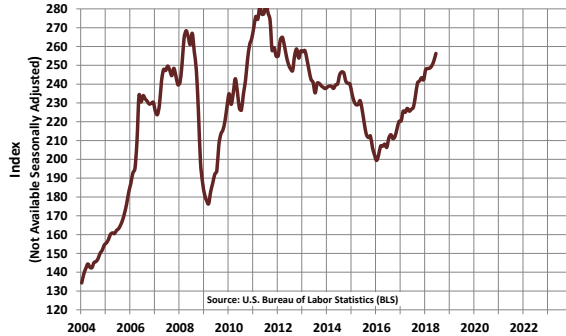
Producer Price Index - WPU1015
Foundry and Forge Shop Products



- ▶ Inflation in all metal products, both ferrous and non-ferrous, took off in early 2016.
- ▶ Iron and steel and steel mill products did as well.
- ▶ How long can the forge shop portion of foundry and forge shop products hold out?

Lower Tier Metal Products [2 of 2]

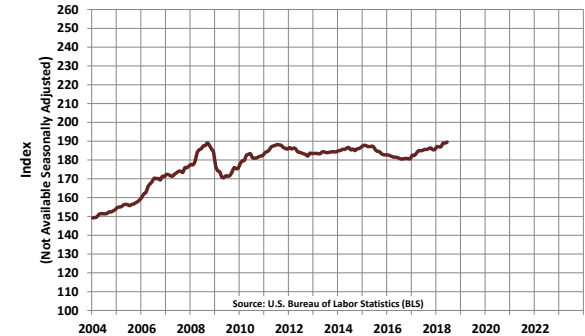
Producer Price Index - WPU102
Nonferrous Metals



Producer Price Index - WPU1022
Primary Nonferrous Metals



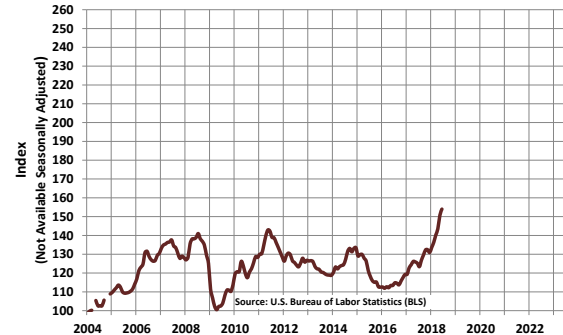
Producer Price Index - WPU102802
Aluminum Castings



Producer Price Index - WPU1024
Secondary Nonferrous Metals



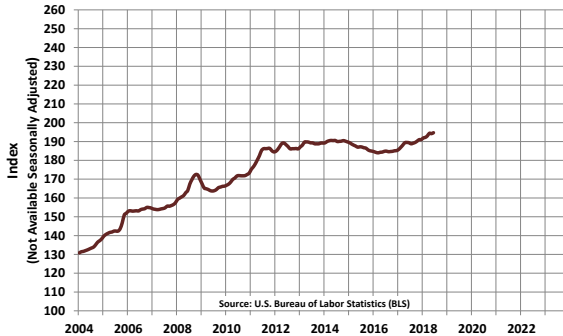
Producer Price Index - WPU10250105
Aluminum Sheet and Strip



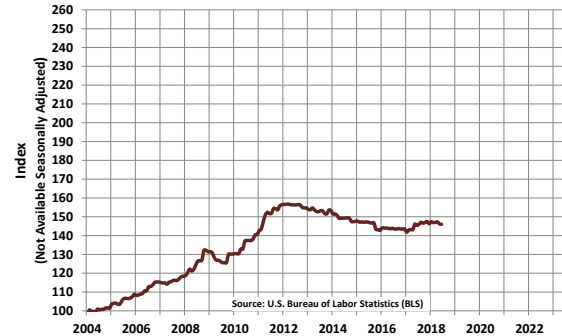
- ▶ So far, inflation has flowed right through the chain except for into aluminum castings

Lower Tier – Rubber and Plastic Products

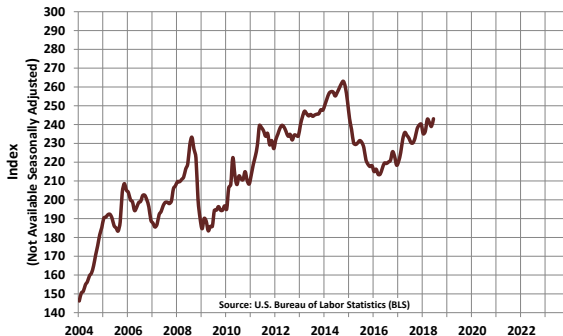
Producer Price Index - WPU07
Rubber and Plastic Products



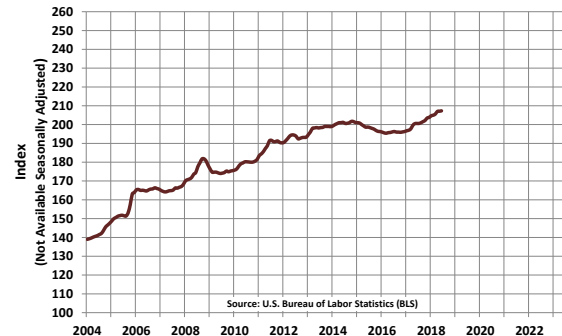
Producer Price Index - WPU071201
Tires



Producer Price Index - WPU066
Plastic Resins and Materials



Producer Price Index - WPU072
Plastic Products



- ▶ Overall rubber and plastic products have not had much inflation in the past 8 years but have a slight uptick beginning in early 2016
- ▶ Tires have remained very tame.
- ▶ But plastic resins and materials have taken off since early 2016, some of which has passed through to plastic products.

- ▶ There appears to be a lot of pent up material inflation in the lower tier supply chain that has not yet had a commensurate impact on inflation in vehicles.
 - ▶ And that is purely from market forces at the peak of the economy.
- ▶ Now tariffs also are entering the mix. Remember:
 - ▶ Metal tariffs only impact the metal portion of each purchase.
 - ▶ But if the 25% auto and auto parts tariffs go through, that impacts the entire purchase price and a portion of procurement of all commodity categories.
- ▶ And normal late cycle inflationary pressures are beginning in cost of labor and in general.
- ▶ Suppliers will be unable to offset it with productivity.

- ▶ To receive the slide deck:
 - ▶ fill out the survey
 - ▶ go to the website

<http://www.procureforce.co/homepage-kc/on-demand-webinars/>

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