

## Automobile Parts Suppliers Struggle Despite Gm Chrysler Bailouts

### Rough Future Ahead for Auto Suppliers

by Suzanne McGee Nov 29 2010

After the government bailouts of GM and Chrysler, auto suppliers are struggling to survive in a market where sales are elusive and profits are even rarer.



GM is racing to reinvent itself in a competitive global market, with prototypes such as this "Pod." That process is putting ever more pressure on its vast network of suppliers, who must deliver world-class products at often unprofitable prices.

Image: GM

For **GM**, near tragedy ended in near triumph earlier this month, when the once-beleaguered automaker pulled off one of the largest initial public offerings in the history of U.S. financial markets, leaving it relatively flush with cash and reducing the government's ownership position and scrutiny of its business operations.

The giant car and truck manufacturer's suppliers, large and small, have always found their prosperity tied to that of GM: When it began to sneeze, they caught pneumonia; when it toppled on the brink of bankruptcy, many of them preceded it over the cliff and,

in contrast to GM, found no government bailout package waiting to cushion their fall. No wonder, as Portfolio.com reported in the immediate aftermath of the GM IPO, that dealers are ebullient about the prospect of a revived, healthy, leaner, and more focused automaker.

But not everyone is convinced that that relationship works as well in reverse; that a revived GM automatically will give its suppliers a new lease on life. “The success of the IPO brought in billions of dollars to General Motors, which is obviously very important for the company, but it doesn’t mean that GM won’t continue to be very careful with its supplier infrastructure,” argues Harlan Platt, a finance professor at Northeastern University in Boston. “It will still require its suppliers to produce best-in-class products at the lowest possible price.”

General Motors may no longer be so cash-crunched that it has to pass on the pain to its suppliers in a quest to hang on to every last nickel. But that doesn’t mean that the company’s new management team won’t keep an eagle eye on the bottom line. Indeed, while the outlook for the automotive industry is showing signs of recovery, GM still needs to prove that it can compete head-to-head against high-quality overseas rivals. It’s in business to post sales numbers and generate profits for its new shareholders, not to behave philanthropically to its suppliers, says James McTevia, managing member of McTevia & Associates, a Detroit-based consulting firm.

“Whether or not the suppliers—especially the smaller suppliers—can break even is not their business,” says McTevia, who has worked with numerous firms of this description on turnarounds and restructuring plans. “It is getting harder and harder to be a smaller provider or supplier to big companies.” He is trying to sound a wake-up call aimed at the owners of these companies, who for years have tried to resist what he sees as inevitable. “For many players, there will be no alternative other than to merge or to liquidate their businesses. “

The story is nothing new for auto-parts manufacturers; they have always found their prosperity is interlinked with the giants that they supply. **Visteon**, for instance, spun off by **Ford Motor Co.** as an independent company in 2000, and with a broader range of business than many smaller players, diversified its businesses to include not only electronics but other components, and decreased its reliance on Ford. That didn't prevent the company from filing for Chapter 11 bankruptcy in 2009, from which it emerged at the end of August. (An accounting scandal prompted the industry's largest bankruptcy filing, that of Delphi Automotive Systems, in 2005. That company's main assets were eventually purchased by a private group of investors to form the core of a new firm, **Delphi Corporation**, last year.)

Even giants like **TRW Automotive** felt the pain. Now, heads of some smaller companies are advocating diversifying not only within the automotive industry, but across a wider array of businesses. Lizabeth Ardisana, CEO of **AGS Renaissance**, a Michigan consulting firm which works with clients like **Chrysler LLC** and Ford Motor Co., is advising smaller clients on finding ways they can sell to the aerospace industry or even to

alternative-energy businesses. She is practicing what she preaches; her own reliance on the auto industry has slid. A few years ago, one auto company accounted for 65 percent of her business; today, she told a local paper recently, only 15 percent of her business comes from the auto industry.

Indeed, a fresh wave of mergers may be taking shape already, motivated by the perception of new, post-crisis opportunities rather than out of fear and desperation. In 2007, says Stephen Spivey, program leader of the automotive and transportation division of Frost & Sullivan, a consulting and market research firm, there were about 338 merger transactions in the auto-supplier space. That number fell to 161 last year, but Spivey is already seeing signs that it's about to rebound.

“There are a lot of private equity firms looking around this space,” he says. “We are getting a lot of requests for due diligence” on potential transactions on behalf of some of those buyout funds. Some of the transactions could involve the already-consolidating parts companies, but Spivey also sees a growing investor interest in aftermarket supplies and service companies.

In September, for instance, consumer products conglomerate **Clorox Inc.** announced plans to sell its auto-care division to Avista Capital Partners in a transaction valued at about \$780 million. The deal will give Avista, which describes itself as an investor in growth-oriented businesses, ownership of brands like Armor All and STP.

**That is just the beginning, predicts Van Conway, CEO of Conway Mackenzie, a firm that provides restructuring and other financial-advisory services to mid-market companies. “The poorly run suppliers are out of business; as the credit markets loosen up, we’ll see more M&A transactions involving the survivors.” A key factor that convinces him of this is the fact that GM reported net income of \$2.2 billion in the third quarter of this year, despite the anemic economy and the fact that consumers remain jittery and reluctant to commit to major purchases—like a new car.**

Spivey doesn't believe that small to midsize auto-industry players will merge or sell themselves to private equity funds out of desperation, however. “Bigger manufacturers like GM recognize that they depend upon their suppliers to come up with more economical and lighter engines, advanced transmission systems and electrical batteries; it's not in their interest to keep them so strapped for cash that they can't invest in R&D,” Spivey argues.

Still, that means that those smaller businesses that rode out the worst of the storm and want to try to profit from the calmer waters now on the horizon will have to ensure that they have plenty to offer both their customers and current and potential lenders and investors. Those likely to fare best are those that, like Armor All, offer aftermarket services and products for consumers who want to hang on to their current automobiles an extra few years rather than handing over thousands of dollars to GM for a shiny new

vehicle. It doesn't hurt that companies like this have their fate tied to the industry as a whole, rather than to the fate of any single automaker.

There are few if any producers of niche products or services that have real pricing power or other kinds of clout with the auto makers. But any supplier with a clean balance sheet and the ability to continue providing nearly flawless products at competitive prices to GM or other manufacturers will have some kind of value. The harsh truth remains: They will never be in a position to even the balance of power between them and their giant customers, who are important enough to the U.S. economy to merit government bailouts. The suppliers will be left to their own devices.

"Every day, we see this—a smaller company, worried about whether or not GM or another customer is going to pay quickly enough to keep them going," says McTevia. When a company is weakened, any customer is going to be more inclined to pull the plug on that relationship rather than invest to keep it going, he says. At the height of the crisis in the automotive industry, McTevia spent hours on the phone with clients worried about whether GM would make good on its receivables.

"I'd have guys telling me, look, GM owes me \$500,000 that I used to borrow \$400,000 from the bank, and if they go under, I won't be able to survive," he recalls. "Today, the danger of GM going out of business before 9 a.m. tomorrow has become very remote."

Now, the challenge for those smaller suppliers is to find a way to parlay their survival skills and their loyalty to their client into goodwill on the part of GM—and then find a way to transform that goodwill into profits for their own bottom lines. Ironically, surviving the recovery may be just as tricky as riding out the crisis.