

## Still too many links in the auto supply chain?

By David Barkholz and Robert Sherefkin  
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In the spring, as auto suppliers braced for the bankruptcies of Chrysler L.L.C. and General Motors Corp. and steep production cuts by other automakers, their industry associations pleaded for a federal bailout of up to \$10 billion to prevent a bloodbath of bankruptcies and liquidations.

The money never came. But neither did the bloodbath. Parts suppliers survived better than anyone had forecast. The relatively few large-scale bankruptcies filed by suppliers have been mostly financial restructurings rather than liquidations.

Now, though, some industry executives and consultants are lamenting a lost opportunity. They say a shakeout would have been in the best long-term interest of the industry.

Without the forecast wave of liquidations, they say, price competition will remain ferocious. Stronger suppliers will be dragged down by weaker ones willing to make unrealistic, low-ball bids for business. Only when healthy suppliers can insist on contracts that allow them to turn a profit will they be able to make the necessary investments in R&D that the industry needs, the executives and consultants say.

To be sure, the winnowing continues as the credit crunch drives suppliers to file for bankruptcy. But few in the industry expect to see a massive wave of failures.

"Too many mouths'

“We have a vehicle market of 10 to 12 million,” said one senior executive of an interiors maker. “But we still have supplier capacity for at least 15 million vehicles. The fact is we have too many mouths to feed out here.”

Suppliers such as Glenn Reid survived the summer by putting their auto parts companies into what amounted to hibernation.

Reid is owner of Auburn Hills-based Flexible Products Co., a maker of molded rubber muffler hangers. When Chrysler, his largest customer, stopped making vehicles during its bankruptcy, Reid laid off nearly half his 253 employees, furloughed his R&D staff, slashed salaries and sales commissions and halted customer entertainment.

It was a drill repeated across the parts industry, allowing Flexible Products and other resilient suppliers to survive a two-month production shutdown by Chrysler, rolling plant closures at General Motors and steep North American production cuts by virtually every other carmaker.

Suppliers got a break from decisions Chrysler and GM made in bankruptcy. The two automakers went to great lengths to minimize the impact of their restructurings on suppliers. The automakers' treatment of suppliers contrasts starkly with their culling of dealers.

For example, Chrysler convinced the U.S. Bankruptcy Court in New York that the preservation of its supply base required Chrysler to pay nearly the entire \$1.7 billion that it owed suppliers for parts delivered before the bankruptcy filing.

Those types of unsecured claims typically are paid only partially, at best, at the end of a bankruptcy.

#### Keeping contracts

When Fiat S.p.A. took control of Chrysler at the end of the 41-day bankruptcy, it decided to keep contracts with 1,200 of the 1,300 direct parts suppliers that Chrysler had in its stable. Chrysler could have asked the court for permission to shed unwanted contracts.

Contrast that with the way Chrysler dealt with dealers while in Chapter 11. With the court's permission, it chose not to pay nearly a quarter of the \$1 billion in incentive payments it owed dealers. It followed that up by terminating 789 of its 3,200 dealerships.

Chrysler spokesman Max Gates said Chrysler paid suppliers in bankruptcy to protect future production. "We were driven by self-interest," he said.

Not having paid the claims would have damaged suppliers already hurt by production cuts, he said. Gates noted that Chrysler shares more than three-quarters of its suppliers with GM and Ford Motor Co., calling into question whether Chrysler could have encouraged a shakeout on its own.

In contrast, Chrysler's ties with its dealers were exclusive and direct, he said. That allowed dealership reductions without any influence from competitors. "We didn't close any Toyota stores," Gates said.

GM also paid most of its suppliers in bankruptcy for pre-bankruptcy parts deliveries, spokesman Dan Flores said. But unlike Chrysler, which halted all production while in Chapter 11, GM's factories took turns closing so that at least one plant somewhere was always building vehicles.

Failure to pay suppliers could have caused parts interruptions for the GM plants that continued to operate, Flores said. "You can't build cars and trucks with most of the parts," he said. "You need all of the parts."

Flores said GM has been reducing aggressively its number of direct suppliers to concentrate business with the ablest few. By the end of 2011, GM intends to reduce its direct North American suppliers to 1,000, from about 1,500.

The reduction will be accomplished largely by moving work as vehicles are re-engineered or new models are brought out, Flores said.

GM acknowledges that its suppliers need bigger volumes to provide the development budgets for technologies that will serve the automaker in the future, Flores said.

More consolidations ahead?

Investor Wilbur Ross still predicts a round of supplier consolidation.

The New York financier said that a recent uptick of liquidations and Chapter 11 filings should accelerate by year's end. The failed companies' contracts will be transferred to surviving suppliers, he said. Ross' giant International Automotive Components Group, the North American arm of which is headquartered in Dearborn, was formed by a series of mergers with several interior parts companies.

Magna International Inc. is seeing the same trend. Year-to-date, the Aurora, Ontario, supplier has picked up \$650 million in additional annualized revenue by taking over the work of distressed suppliers or acquiring some of their facilities, Magna CFO Vince Galifi said last month during an earnings call with analysts and the media.

Some of that business came from the defunct Troy-based Cadence Innovation L.L.C., which was sold during Chapter 11 reorganization, and from Dearborn-based Meridian Automotive Systems Inc., which also is being liquidated, Magna co-CEO Don Walker said during the earnings call.

Plastic trim supplier Cadence had North American sales of about \$746 million in 2007, according to Plastics News, a sister publication of Crain's Detroit Business. Bumper systems supplier Meridian had estimated North American sales to automakers of \$500 million last year.

But consolidation is moving slowly. The estimated 19 supplier bankruptcies so far this year is double the number for all of last year. But in a year of seismic disruptions, that hardly suggests wholesale collapse.

And overpopulation in the supplier ranks breeds cutthroat bidding that is lethal to a segment's financial health.

For example, an executive at a North American interiors company said he is bidding to supply a center console on a new vehicle. He's up against 10 competitors; in his opinion, there should only be two or three others. That plethora of bidders is likely to lead to a contract with little or no profit margin, he said.

Dan Sharkey, a lawyer whose firm represents many supplier clients, said automakers have pushed consolidation, but “there are no dumb or fat companies left.” The suppliers that are still standing had to survive the steel and resin price surges of 2004 and the recession and historically low volumes of 2008 and 2009, said Sharkey, a partner with the Birmingham firm Brooks Wilkins Sharkey & Turco P.L.L.C.

Survival of the fittest?

**The attrition will continue, turnaround expert John Groustra said. Automakers will concentrate business among fewer, stronger suppliers as new program awards are made.**

**That, in fact, is Ford's strategy. In 2008, Ford cut the ranks of its global direct production suppliers eligible for future business 26 percent to 1,600. Its goal is 750, though Ford hasn't set a date for reaching that level. Just five years ago, the company had 3,300 suppliers worldwide.**

**But Groustra, senior managing director of Birmingham-based Conway MacKenzie Inc., says, “It will be interesting to see if the automakers stick to that plan.**

**“In the past, automakers could not resist having several suppliers” for a given part, in the hope that one of the companies competing for the contract would offer a low-ball price. “It's a cultural thing.”**

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