

## Automotive News On The Go

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### Suppliers wonder: Is worst over? *Profits are back for some parts makers; revenues still weak*

Chrissie Thompson | November 30, 2009 - 12:01 am ET



BorgWarner  
CEO Tim  
Manganello:  
Cost cutting put  
the company in  
the black.

A year ago, when a \$130.4 million loss broke supplier BorgWarner Inc.'s string of 25 straight quarterly profits, CEO Tim Manganello predicted that an "unprecedented" economic environment would make for a tough 2009. How right he was. Through October, industrywide light-vehicle production in North America tumbled 39 percent, and both General Motors and Chrysler filed for bankruptcy. Yet after a string of four quarterly losses, BorgWarner, like several other suppliers, was back in the black last quarter despite a 22 percent drop in revenue. Although production volumes have rebounded somewhat, Manganello attributed the profits mainly to cost cutting. He predicted more black ink ahead.

#### A rebound -- finally

These suppliers swung to a profit in the 3rd quarter.

	Q3 profit	Last profit
<b>TRW</b>	\$56 million	Q2 2008
<b>Magna</b>	\$51 million	Q2 2008
<b>Lear Corp.</b>	\$24.6 million	Q2 2008
<b>American Axle</b>	\$19.6 million	Q3 2007
<b>BorgWarner</b>	\$17.2 million	Q2 2008

These suppliers posted their smallest losses in more than a year.

	Q3 loss	Last profit
<b>Tenneco</b>	\$8 million	Q2 2008
<b>ArvinMeritor</b>	\$12 million	Q2 2008
<b>Superior Industries</b>	\$12.7 million	Q2 2008

These posted 2nd-quarter profits and increased earnings last quarter.

	Q3 profit	Q2 profit
<b>Gentex</b>	\$23.9 million	\$12.2 million
<b>Federal-Mogul</b>	\$10.4 million	\$3 million

Source: Bloomberg data and company financial reports

#### Bloodbath averted

Dozens of North American companies joined BorgWarner in cutting costs to the point that suppliers have

averted the bloodbath forecast for this year. But the higher cost of credit for most suppliers and uncertainty about the strength of the auto industry's recovery mean most still face a rocky road. "The worst is over," Goldman Sachs analyst Patrick Archambault said. "We were surprised by the effectiveness and extent of the cost cuts. Most of these companies became actually able to turn a profit at production levels that were extremely anemic." A survey of the financial results of 11 major North American suppliers found five were in the black last quarter for the first time in more than a year, even though all but one reported sales declines. One of those posting a profit was interiors supplier Lear Corp., which entered Chapter 11 bankruptcy July 7 and exited Nov. 9. An additional three of the 11 posted their slimmest net losses in five quarters. The largest North American supplier, Magna International Inc., said it became profitable partly because it slashed spending, staffing, workdays, bonuses, wages and benefits. Two suppliers, Gentex Corp. and Federal-Mogul Corp., bounced back earlier, making a profit in the second quarter. Gentex's third-quarter earnings almost doubled from the second quarter, and Federal-Mogul's more than tripled. "The whole industry has changed forever its cost base. It is living in this environment better than people had anticipated," said Tim Leuliette, CEO of Dura Automotive Systems Inc. Leuliette declined to give specifics about the third-quarter results of privately held Dura. But he said the company saw one of its best quarters in a few years. Still, Lieuliette said, suppliers probably will have to wait until this time next year before they can relax and perhaps start hiring again. "There's still a lot of suppliers that are facing renewal of their bank lines," Leuliette said. "The banks right now tend not to be overly generous, so we're still likely to have some bumpy roads there."

### **More expensive**

Credit is once again available for suppliers, but it will cost more than it did a year or two ago, said Goldman Sachs' Archambault. "I wouldn't say it's going to be difficult to get it," he said. "I think it's going to be difficult to get it at the same price." To compensate for tighter credit, some suppliers -- including TRW Automotive Inc., Tenneco Inc. and Dana Holding Corp. -- are using equity offerings to raise money. But that's not an option for everyone. "For smaller suppliers, I don't think you've seen the full impact of the ramp-up in terms of capital needs," Archambault said. "At the Tier 2 level, you're probably going to see a few more casualties. But that said, they've been able to weather it a lot better than we would have thought." Dura's Leuliette said the conventional wisdom among suppliers is that about 200 U.S. parts makers remain at risk of going under or needing to find a buyer. His company is considering acquiring one Asian and one European supplier along with those suppliers' American assets. "It's time to consolidate," Lieuliette said. Neil De Koker, president of the Original Equipment Suppliers Association, said his group estimates that 100 to 200 suppliers have liquidated quietly this year. "They're smaller suppliers," De Koker said. "They didn't file Chapter 11 to restructure because they didn't have financing."

### **Getting tougher**

Despite the improving outlook, don't expect the results in future quarters to mimic those in the third quarter, analysts said. Production volumes bounced higher in the quarter for three reasons: 1. The need to replenish inventories drained by the federal government's cash-for-clunkers rebate program. 2. The production launch of 2010 models. 3. The resumption of output at GM and Chrysler after they left bankruptcy. North American light-vehicle production jumped from 560,430 units in June to 976,790 in September, according to estimates from the Automotive News Data Center. But future production isn't expected to continue rising at that pace. Consumer demand is increasing slowly, but October's 11.2 million-unit annualized sales rate is still well below the 13.7 million clunker-induced rate in August. "Some of these good results could reflect perhaps a pull-forward of volume, and you might see some of a payback," said Stewart Pedder, managing director for the SupplierBusiness division of the market forecasting firm IHS Global Insight. Some companies are starting to undo portions of their cost cuts, said Goldman Sachs' Archambault. They are starting to approve travel to visit customers and reverse shortened workweeks as production ramps up. Tenneco is restoring the 10 percent pay cut its salaried workers took in the second quarter, although the company still has \$58 million in annual savings from other cost-cutting measures.

### **More with less**

Complicating suppliers' problems, automakers are seeking to consolidate contracts within a smaller stable

of parts companies, Pedder said. For example, Chrysler Group dropped 60 troubled suppliers this year. It plans to increase the number of suppliers it shares with Italian partner Fiat S.p.A. from about half currently to more than two-thirds by 2014, said purchasing chief Daniel Knott. The implication: Smaller suppliers that don't have contracts with Fiat in Europe or Brazil may be left out. And, of course, suppliers' near-term fortunes will turn on future production increases -- or decreases. Michael Alcala, CEO of suburban Detroit's AZ Automotive Corp., said the structural components and underbodies supplier was profitable in the third quarter after slashing its breakeven point. AZ Automotive now needs 32 percent less revenue to stay in the black than it did before its restructuring this year. "We have figured out how to make money on that 32 percent less of sales," Alcala said. "But gosh, if production levels plummet to the lows of [earlier this year], that will be a roadblock to profitability." The number of suppliers that survived this year's downturn is a mixed blessing, said Standard & Poor's equity analyst Efraim Levy. "It's good for the companies that they're staying in business," Levy said. "On the other hand, because they're staying in business, they're going to shrink profits [for everyone] because there's more competition."

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