

## **Small Suppliers Treading Water**

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All eyes are on GM and Chrysler these days as they try to find a course that marries the strategies that they think are appropriate with a package that will satisfy their new, reluctant partner, the U.S. government. A comparable struggle for survival is taking place outside the limelight, within the supply chain. Trade associations representing suppliers are doing their best to raise the visibility of the impact that the market downturn and turmoil is having on the supply base, but the challenge of getting any attention is immense, given the magnitude of the problem represented by the primary actors.

How have suppliers been holding up? In a time when auto sales are down 40% from a year earlier, no one can possibly be doing well, but we still see a spectrum of performance. We looked at some of the public companies in last month's column and observed a range for 2008 results from small net income (Gentex) to appalling losses (American Axle). From what we have seen of the smaller, private companies in the industry, a similar range exists, with some companies making an extremely modest profit, but many more hovering at or below the breakeven mark.

What are the characteristics of the companies that are making money in the current environment? The answers will disappoint anyone looking for a quick fix, much like the would-be dieter is sorry to hear that someone else's success is the result of eating less and exercising more. But it bears repeating, for confirmation of lessons learned. Factors that these companies credit with helping them keep their heads above water include:

**Low/no debt going into the downturn** – Companies with the good fortune and/or good sense to minimize indebtedness have had much greater flexibility in responding to the current crisis. Some less fortunate suppliers have found their financial partners or lenders to be uncooperative, and their scope of control over their own fate is much narrower as a result.

**Relentless focus on cutting variable costs** – Over the past six months, companies have been taking steps that dramatically change their profile to a far greater degree than what the large Tier Ones can do, such as reducing their workforce by half in order to be right-sized for current demand. After years of wringing out waste, these companies are already lean, but emergency measures underway include pay cuts (ostensibly temporary, but indefinite in duration), mandatory unpaid time off, and an even sharper pencil to eliminate items that have moved from “necessity” or “beneficial”, to the “luxury” category. Regrettably, these may be things such as industry conferences for knowledge-sharing, forecast services for better planning, patent filings for intellectual property protection – which can be the seed corn for future crops.

**A favorable customer base** – Recent reports on monthly sales by automaker show the industry-wide nature of the negative dynamics, but it is still true that some automaker customers entered the downturn later and will emerge sooner, as a result of consumer

preferences, brand image, the timing of new products, and other factors. Some companies that operate solely on a lower-tier level report that they feel they have been somewhat insulated from the issues of the automakers. (We suspect that the effects are not avoided, but merely delayed.)

**Poised for takeover business** - The composition of the customer base can affect a supplier's likelihood of benefiting from another industry trend, the opportunity for takeover business. While there are reports that the Japanese automakers have concerns about the viability of some suppliers, it appears to be the case that more of the movement is occurring at the domestic Big Three (case in point: GM is said to have pulled its tooling from 50 parts makers during the year-end shutdown). Suppliers that are on the radar screen as an attractive alternative have been having a crack at large chunks of revenue through this process.

Companies without these advantages are showing up on the Chapter 11 rolls and in the corporate obituaries. Two companies in the news early this year as object lessons in loss of control to their banking partners were Contech LLC, which *Automotive News* noted as having filed bankruptcy after its lenders seized \$11.5 million in cash, and May & Scofield, whose assets were foreclosed on by Bank of America. Examples of suppliers held by private equity groups that are basically throwing in the towel are Nicholas Plastics LLC (~\$30 million in sales) and Fluid Routing Solutions (formerly a division of Dayco Products Inc., approximately \$200 million in sales). Everyone knows what they should be doing, but these companies serve as stark evidence of the fact that intending and achieving are two different things.

The U.S. Treasury Department, in announcing its Auto Supplier Support Program, noted that it did not want the program to "stand in the way of the substantial restructuring and capacity reduction that needs to take place in the auto supply industry." Restrictions on the application of funds that have been made available so far indicate that the mesh of this safety net is very large. The great winnowing of the supply base is the next big story, at least for those who take the time to look beyond the domestic Big Three.