



Detroit • Washington D.C.

# Outlook for the Motor Vehicle Supplier Industry

FEDERAL RESERVE BANK *of* CHICAGO

46<sup>th</sup> ANNUAL CONFERENCE

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**Senior Vice President, Industry Analysis and Economics**  
**Original Equipment Suppliers Association**

**June 4, 2010**



# Outline

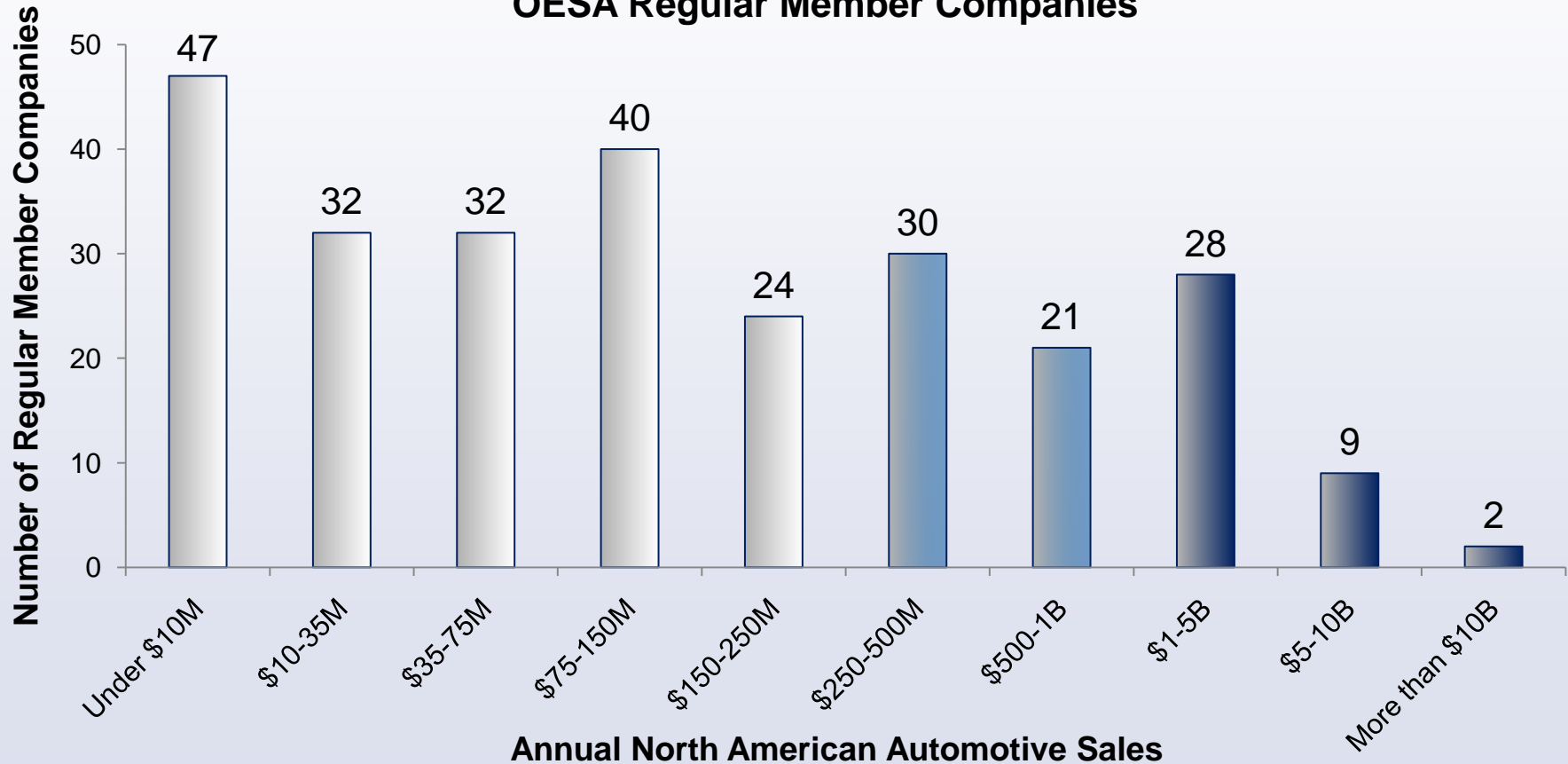
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- OESA and MEMA Overview
- NA Market Outlook
- Industry Restructuring
- Credit Availability
- Economic Significance & Productivity of the Industry
- Conclusion
  
- Appendix of Additional Information



# OESA Represents the NA Supply Base

## 2010 Membership Size Distribution OESA Regular Member Companies



375 Member Companies  
\$300 Billion Global Combined Sales



# OESA Vision and Mission

## Vision

OESA is the preeminent network and leading advocate for original equipment suppliers in North America, and serves as a trusted resource to assure a sustainable and viable automotive industry

## Mission

OESA advances the business interests of automotive original equipment suppliers by:

- ✓ ***providing a forum*** to address issues of common interest
- ✓ ***serving as a resource*** for industry information and analysis
- ✓ ***promoting the interests*** of the OE supplier community
- ✓ ***serving as a voice and positive change agent*** for the industry

OESA is an affiliate of the Motor & Equipment Manufacturers Association



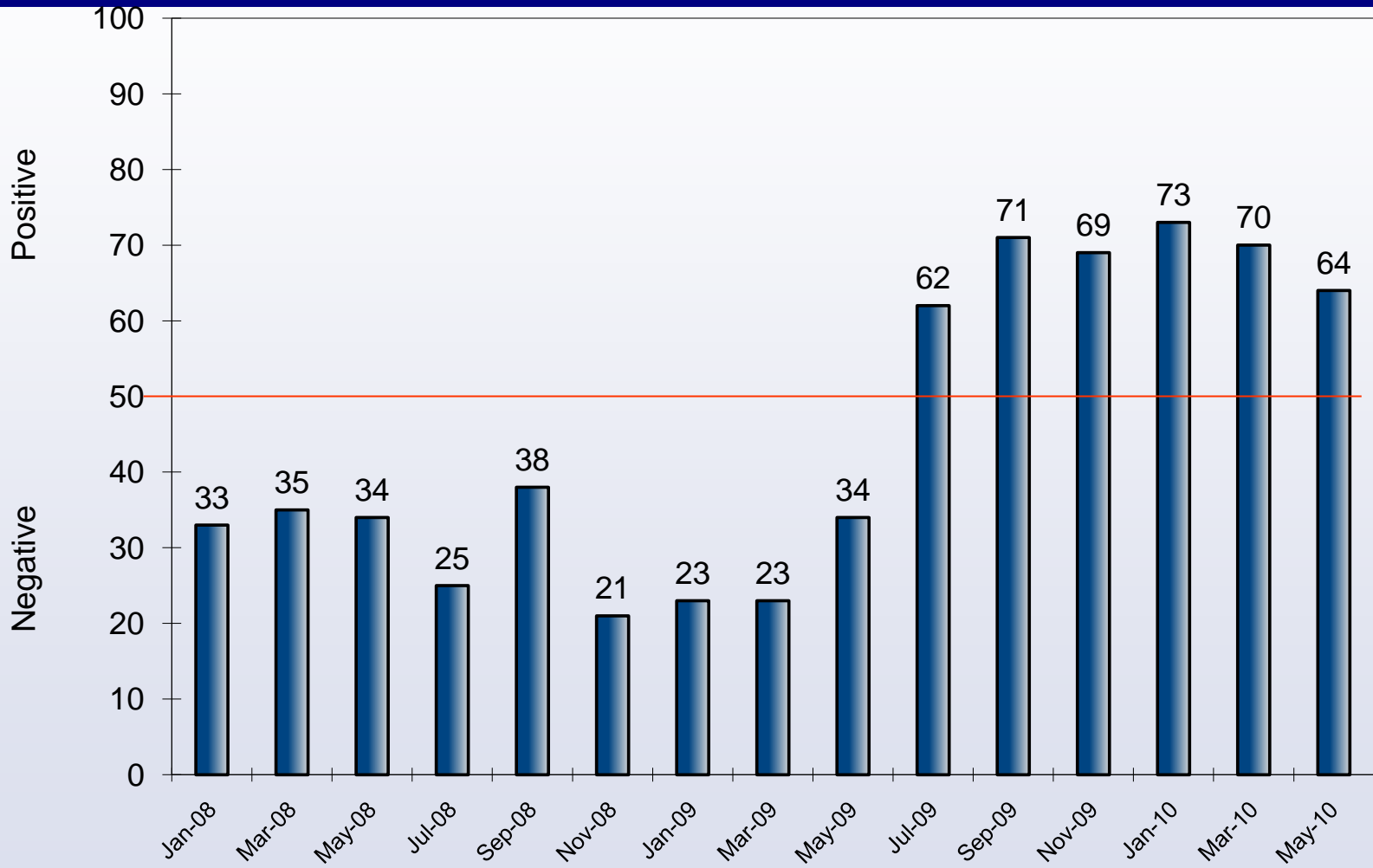
# The North American Supply Base Was at Great Risk of Imploding in 2009. However, . .

- The government provided the DIP backstop for GM and Chrysler preventing liquidation
- Virtually all production suppliers were granted essential supplier status with GM and Chrysler
- The Auto Supplier Support Program assisted several hundred direct GM and Chrysler suppliers
- Chrysler completely shut production and GM would use rolling shutdowns to conserve cash through the entire supply chain
- GM paid its June 2<sup>nd</sup> payables on May 28<sup>th</sup>, supporting the cash flow of its suppliers
- GM increased the frequency of supplier payments



# Supplier Sentiment Index

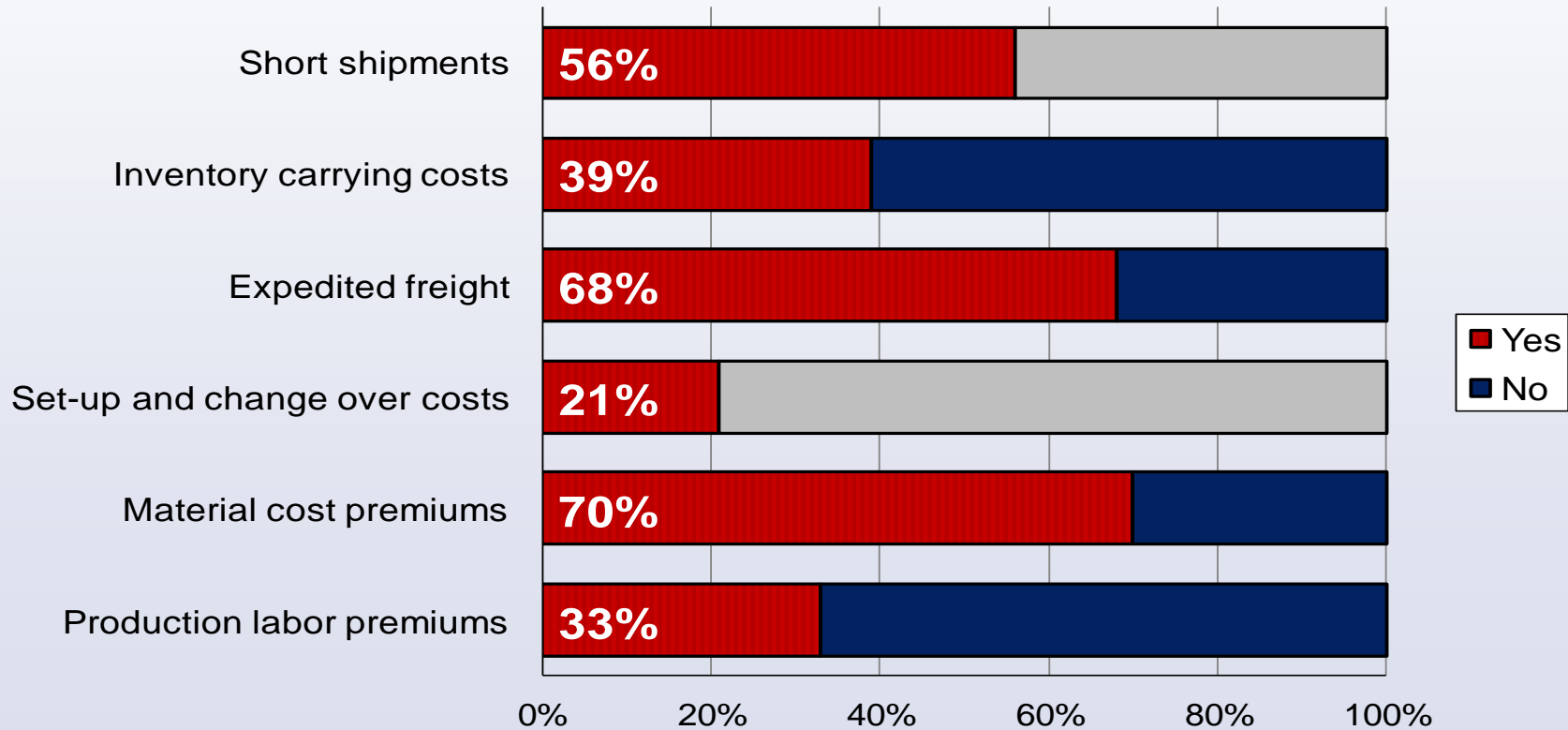
Compared to Two Months Ago,  
How has Your 12 Month Outlook Changed





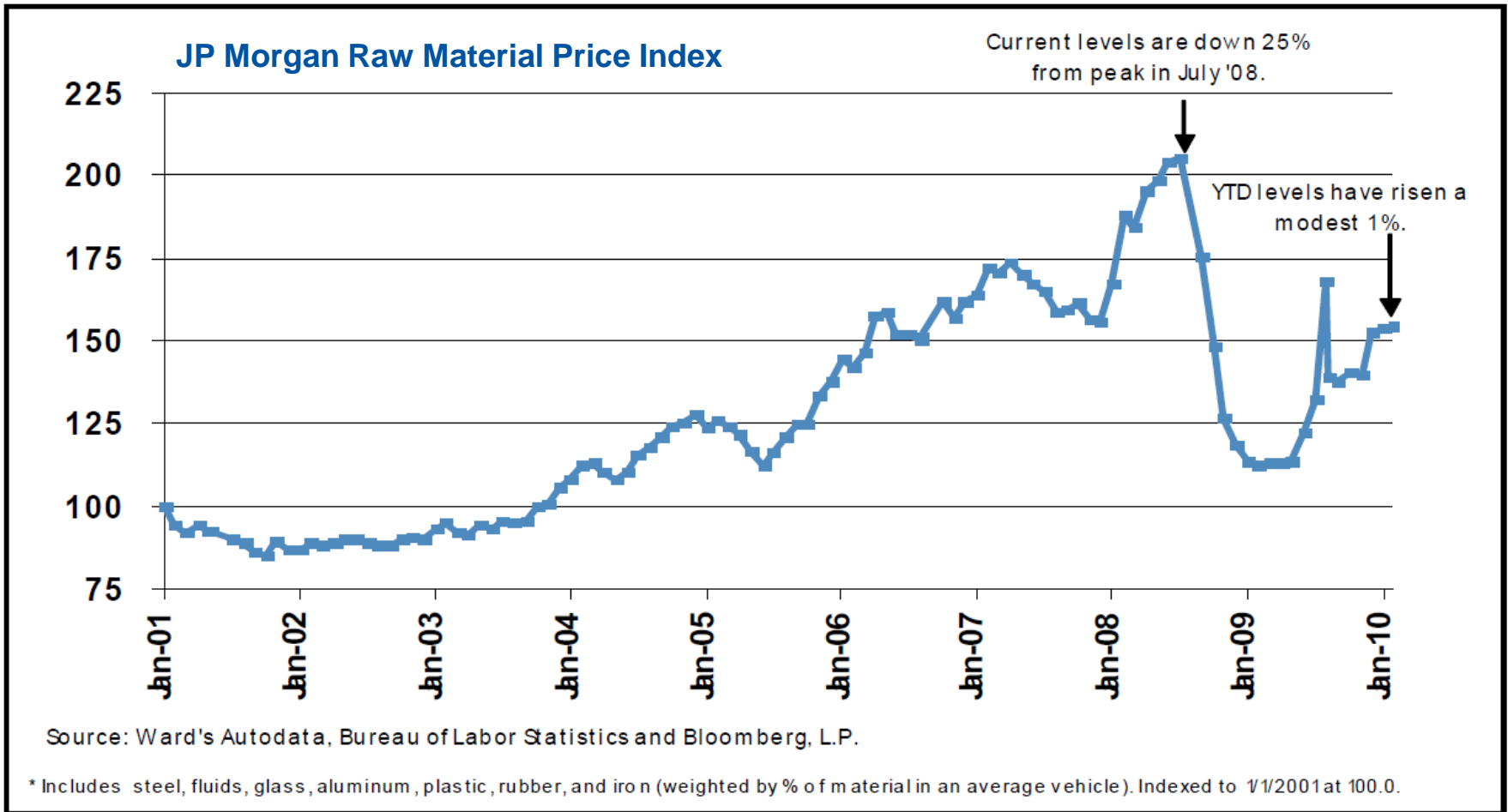
# Short-Term Issues Abound for Suppliers

**March 2010 Automotive Supplier Barometer:** In the last two months, have you experienced INCREASES in any of the following?





# Material Availability is Constrained and Prices are Rising












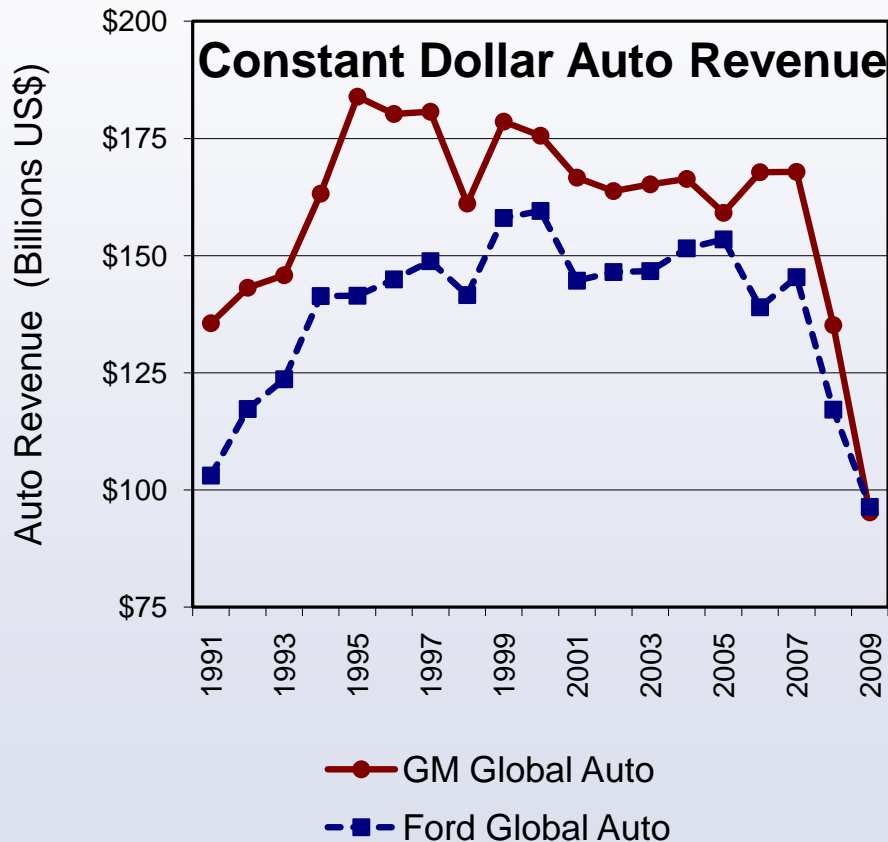
# 2010-2012

## North American Production Forecasts

(in millions)	2010					2011 Forecast	2012 Forecast
	1Q Actual	2Q Forecast	3Q Forecast	4Q Forecast	2010 Forecast		
 Autofacts	2.9	2.8	2.6	2.7	11.0	12.5	13.7
 csm   worldwide®	2.88	2.96	2.85	2.90	11.58	12.67	13.18
 IHS GLOBAL INSIGHT	2.89	2.89	2.73	2.87	11.38	12.54	13.96
 J.D. POWER AND ASSOCIATES® Automotive Forecasting	2.88	2.84	2.63	2.84	11.19	12.70	13.96
 IRN	2.88	2.65	2.87	2.86	11.26	12.85	13.62
<b>Forecast Average</b>	2.9	2.83	2.74	2.83	11.28	12.65	13.68
<b>Reference: 2009 Actuals</b>	1.70	1.78	2.36	2.72	8.56		



# Supplier Fortunes Will Not Turn Until Major Customer Fortunes Turn



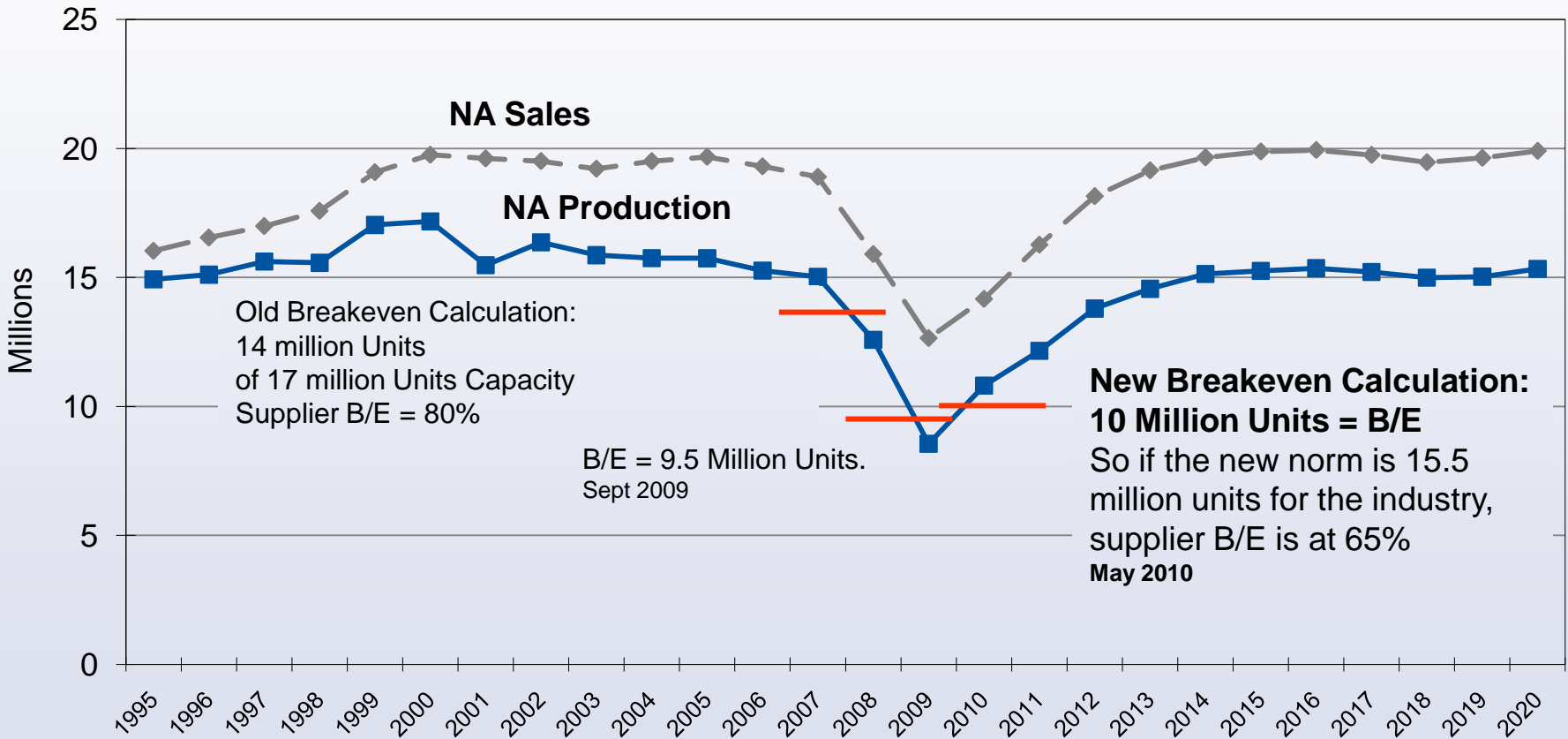
- It is perfectly rational with flat or declining real revenues that a company look to its largest cost component for relief
- There was a clear recognition of a “shared destiny” between the OEMs and suppliers through 2009
- OEMs and suppliers made extra efforts to move tools, accommodate tooling progress payments, speed payments, and obtain raw materials and components
- Will the shared destiny be institutionalized?

Note: constant \$ = 2005 dollars corrected by CPI.



# Long Term Opportunities Are Looking Profitable

## North American Light Duty Sales and Production



Sources: Global Insight March 2010 NA Production and Sales Forecast and May 2010 OESA Automotive Supplier Barometer



# Actions Suppliers Have Taken to Improve Their Profitability

## ➤ **WORKFORCE**

- Workforce reductions
- Renegotiated contracts
- Revised benefits and co-pays
- Redefined essential activities

## ➤ **COST STRUCTURE**

- Sold off underutilized assets
- Shuttered excess capacity
- Consolidated operations
- Improved utilization of all assets
- Greater automation

## ➤ **REVENUE ENHANCEMENT**

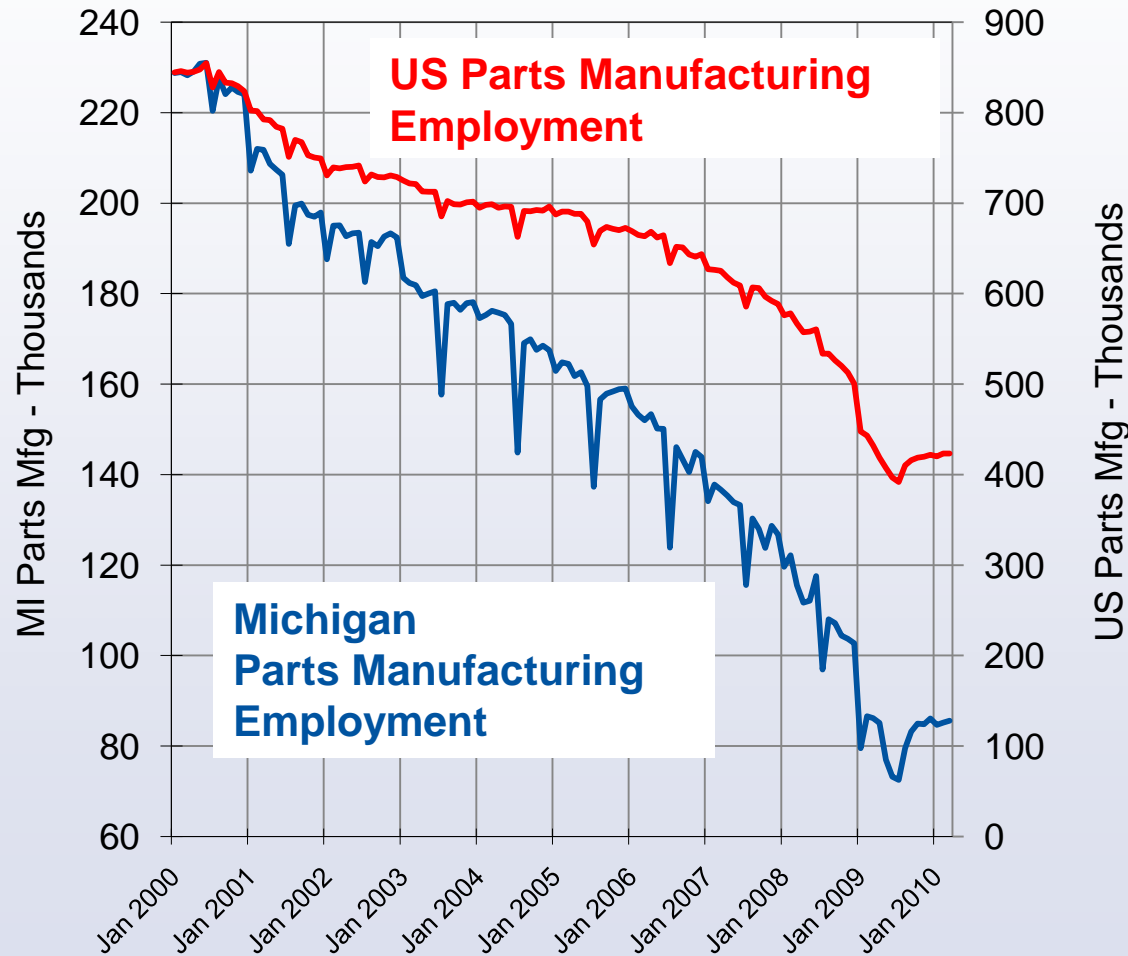
- Took over programs/tools from weaker competitors
- Pursued aftermarket business
- Diversified customers and markets
- Conducted additional marketing and sales calls outside automotive

## ➤ **FINANCIAL MANAGEMENT**

- Developed relationships outside of our traditional lenders
- Attacked late payments
- Renegotiated T&Cs with tier ones
- Pursued tax credits, and pursued state incentives



# Automotive Parts Manufacturing Employment



- U.S. Supplier employment bottomed out in July 2009 at 390,000 direct employment within the narrowly defined government parts producing category – it has since rebounded to 423,000 employees in March
- Between Jan 2000 and March 2010 U.S. parts manufacturing declined 49.9 percent (845,000 to 423,000) while Michigan supplier employment declined 62.6 percent (from 229,000 to 86,000)
- The gap is likely due from Michigan's starting concentration and the growing southern geographic footprint
- Suppliers are slowly bringing back employees. We will see contract workers followed by permanent hires – all suppliers are very reluctant to add fixed costs



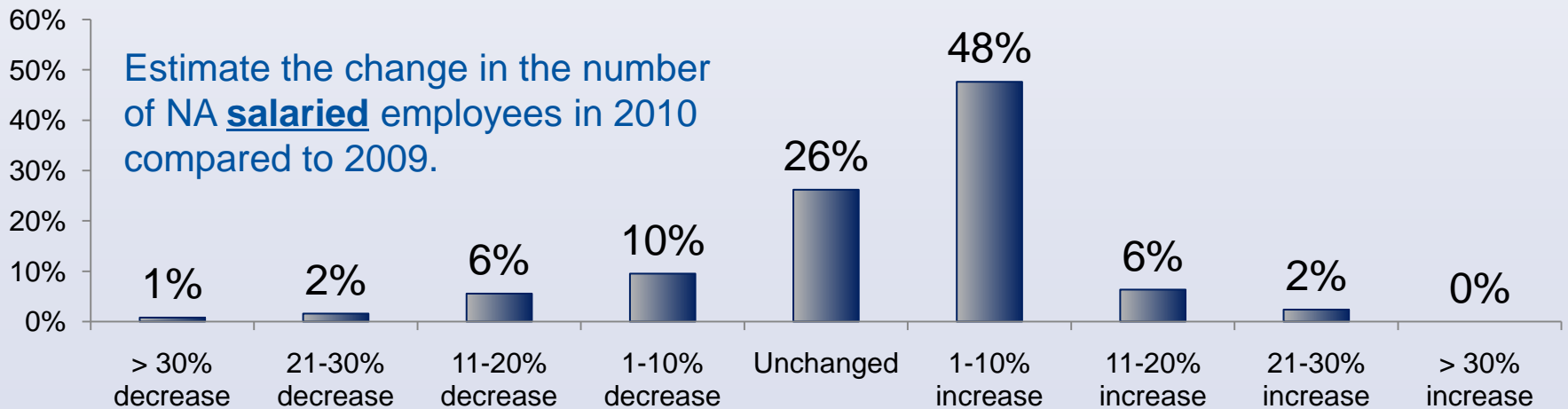
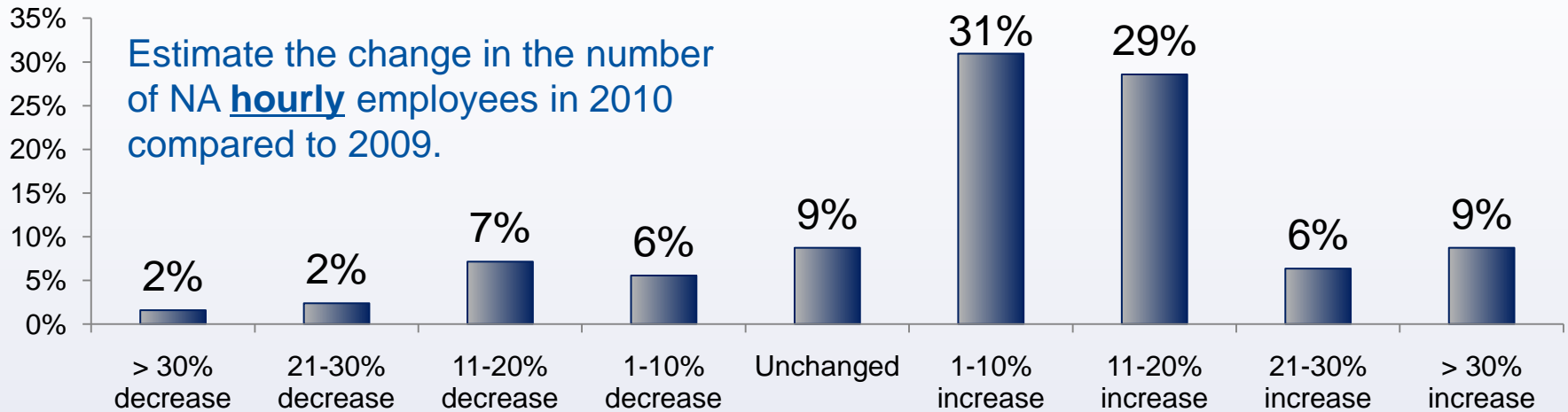
# The Supplier Sector – Top 15 States

State	Direct Jobs (MEMA 2009)	Direct Jobs (MEMA 2006)	CHANGE
→ Michigan	111,224	145,818	(34,594)
→ Ohio	80,600	97,323	(16,723)
→ Indiana	66,721	86,934	(20,213)
→ Tennessee	44,172	45,749	(1,577)
Illinois	36,033	40,063	(4,030)
→ Kentucky	34,656	35,102	(446)
North Carolina	26,078	27,589	(1,511)
California	24,677	28,596	(3,919)
Texas	24,664	20,175	4,489
Alabama	21,654	15,965	5,689
New York	20,367	31,017	(10,650)
→ South Carolina	19,492	20,943	(1,451)
→ Missouri	17,828	18,888	(1,060)
Wisconsin	17,662	21,502	(3,840)
Georgia	16,165	22,701	(6,536)
→ ... and Oklahoma			

→ : Largest manufacturing sector in State



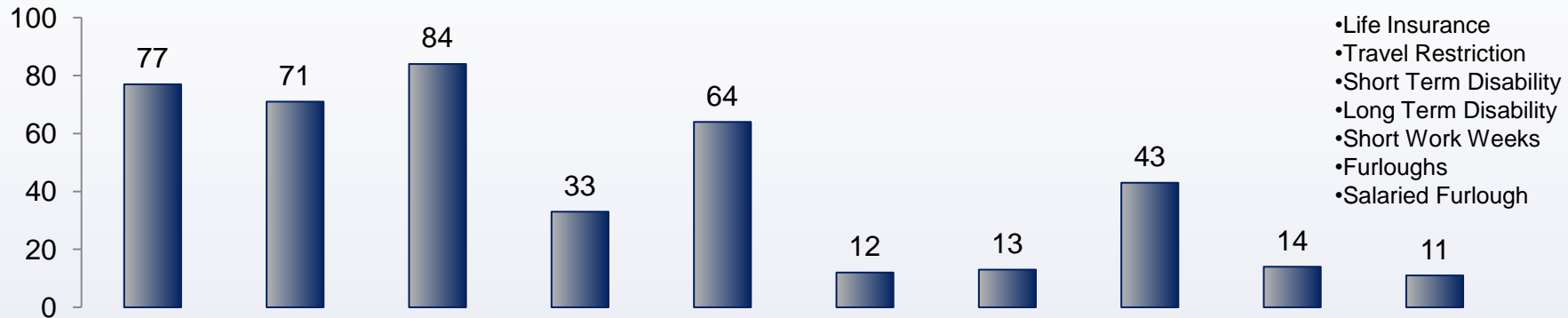
# 2010 NA Employment Will Rebound from 2009 Levels



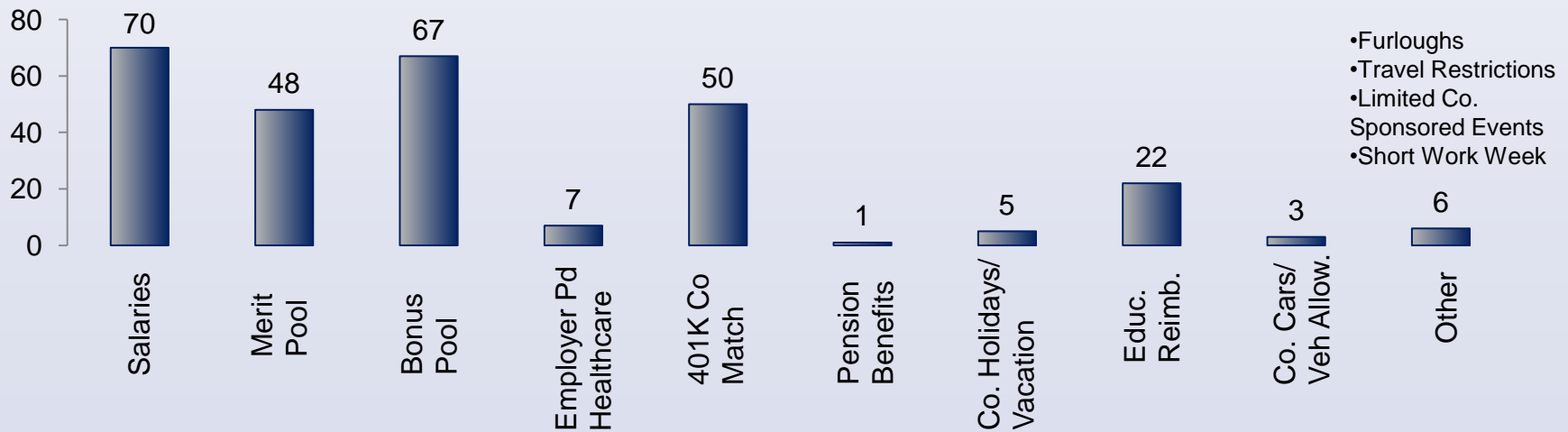


# 2010 NA Compensation Levels Will Rebound from 2009 Levels

Which Employee Compensation and/or benefits did your company reduce or eliminate in 2009?



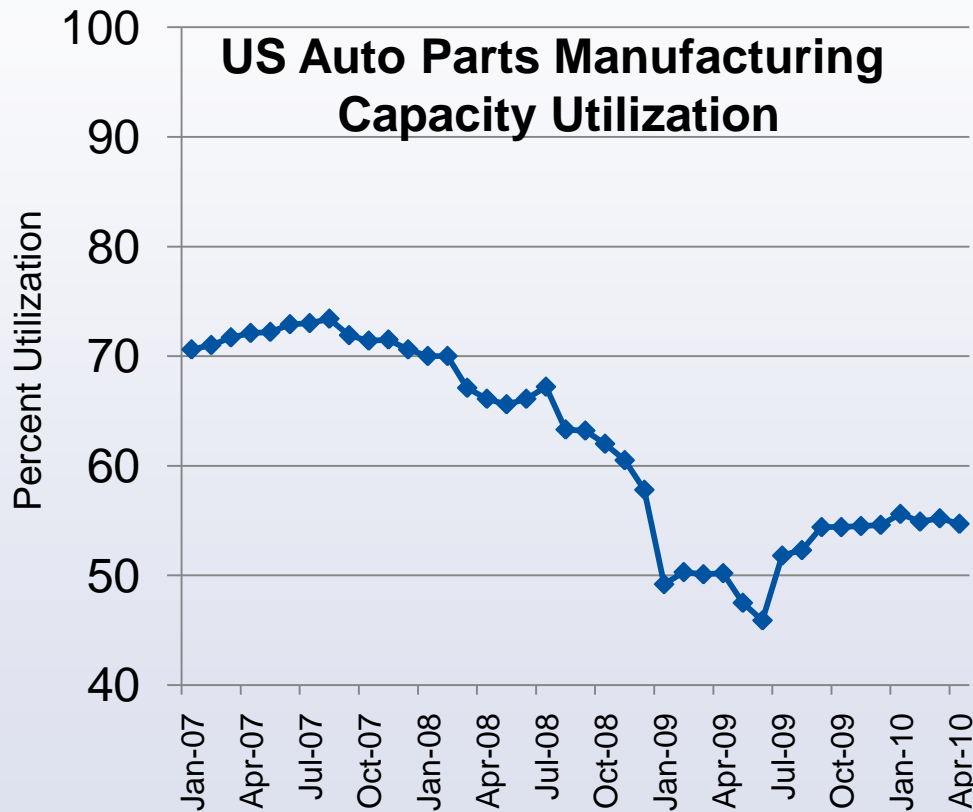
Which employee compensation and/or benefits did/will your company restore or reinstate in 2010?







# The State of the Supply Base is Positive: If A Supplier Survived 2009, 2010 Headwinds Appear Manageable

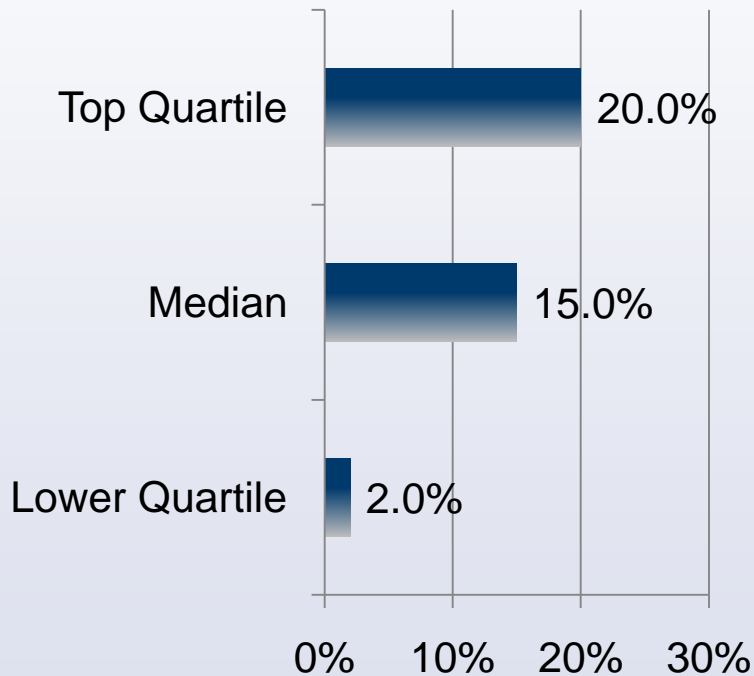


- Running at 55 percent capacity utilization in April
- Constrained bank lending and tight bank terms
- Overtime premiums, material and component shortages, and expedited freight costs from the ramp-up
- Concerns over retaining critical skilled personnel
- Volatile production schedules

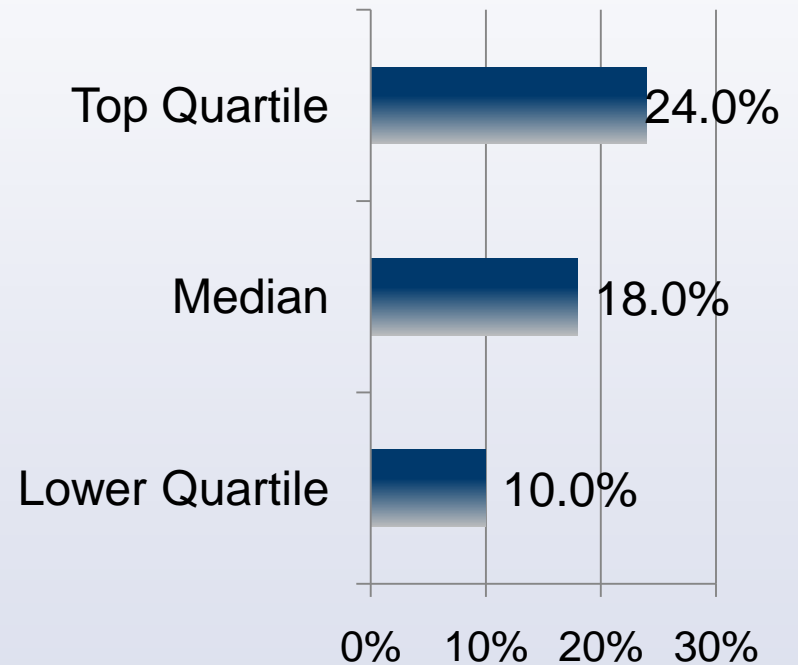


# The Supply Base is Just Half Way Through Its Consolidation – At Best

### 2009 Capacity Rationalization

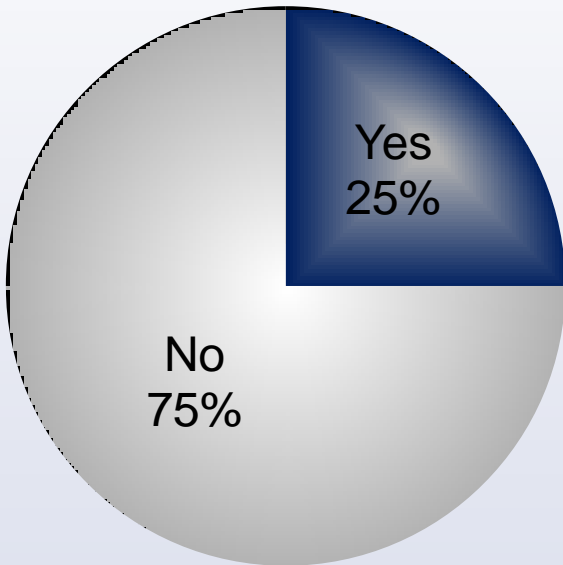


### Additional Rationalization Needed For Breakeven

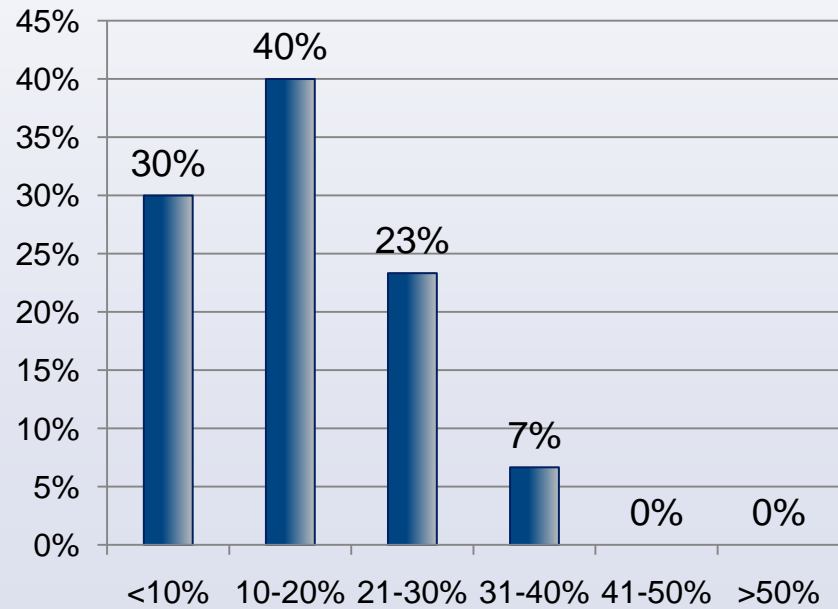




# 2010 NA Capacity Rationalization Will Include Plant Consolidations



If yes, what percent capacity reduction do you plan in 2010 compared to 2009?





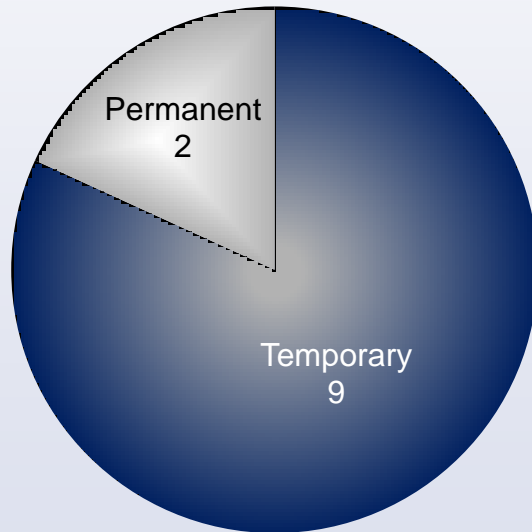
# Credit is Beginning to Flow – From Top to Bottom of the Supply Chain

- It appears lending is the tightest for suppliers under \$100 million in revenue
- Suppliers are hitting credit line ceilings – first half production is up 65 percent and material costs up 33 percent against credit lines that were reduced 20 to 40 percent in 2009. Even if renewed, lines are limited to 12 months.
- Bankers' continued concerns: asset valuation (particularly for regulatory compliance) and industry rationalization (lending into the wrong supplier)
- Suppliers' concerns: program-specific funds (OEM risk still present), general renewal/productivity enhancement funds (general profitability still weak)



# Current Small Supplier Attitudes

Do you believe the evaluation of your company's change in cash flow due to the economic downturn is being treated as temporary or permanent by banks and regulators?

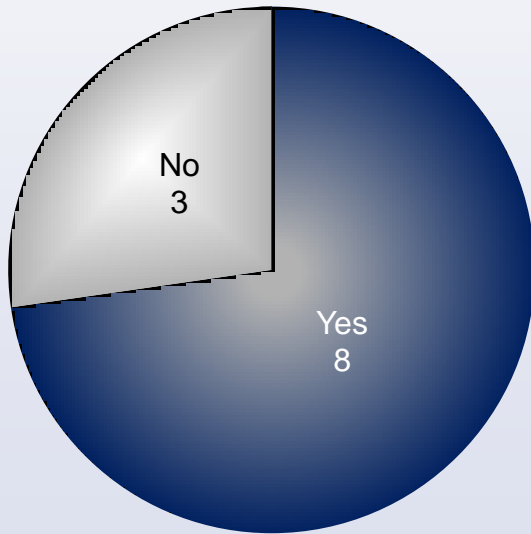


Comment for one of the 'permanent' responses:  
•“Difficult to raise capital”



# Current Small Supplier Attitudes

**Have you had any issues regarding your bank's assessment of assets backing current loans or assets being assessed for new loans?  
If so, please describe.**



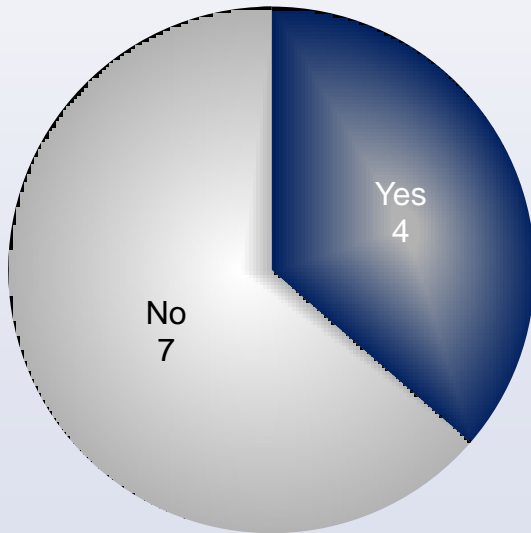
Comments for 'Yes' responses:

- “Much more critical assessment of assets, especially machinery and commercial real estate”
- “Tightened rules for ineligibles including inventory and foreign sales”
- “Do not want to lend based upon asset valuations”
- “Values are extremely depressed and the formulas used to assign loan value have gone from Orderly Liquidation Value to Forced Liquidation. A devastating drop off.”
- “Additional reserves and scrutiny being put on assets securing Asset Based Revolver.”
- “New appraisal reduced borrowing base by 40%”



# Current Small Supplier Attitudes

**Do you believe you have adequate access to capital for working capital, capital equipment investment, and/or restructuring requirements?  
If not, briefly describe your concern.**



Comments for 'No' responses:

- “Working capital is fine but capital for new investment, i.e. new business opportunities, is hard to get.”
- “Have a second quarter covenant review upcoming that was based on forecast in 2009. Slower than forecast economic recovery forecast, off by one quarter is making second quarter covenants a daunting task which very well could lead to higher financing costs going forward and restricted funding.”
- “Banks are restricting loans and credit lines so tool financing is almost impossible.”
- “Capital equipment investment is limited due to very rigid requirements on capital leasing programs.”
- “If we hit 14m SAR, working capital is going to be an issue”
- “Cannot get funds from US without parent company bankers under writing, which only restricts parent company”



# Total Contribution of all Motor Vehicle Manufacturing and Dealership Operations to the Economy of the United States

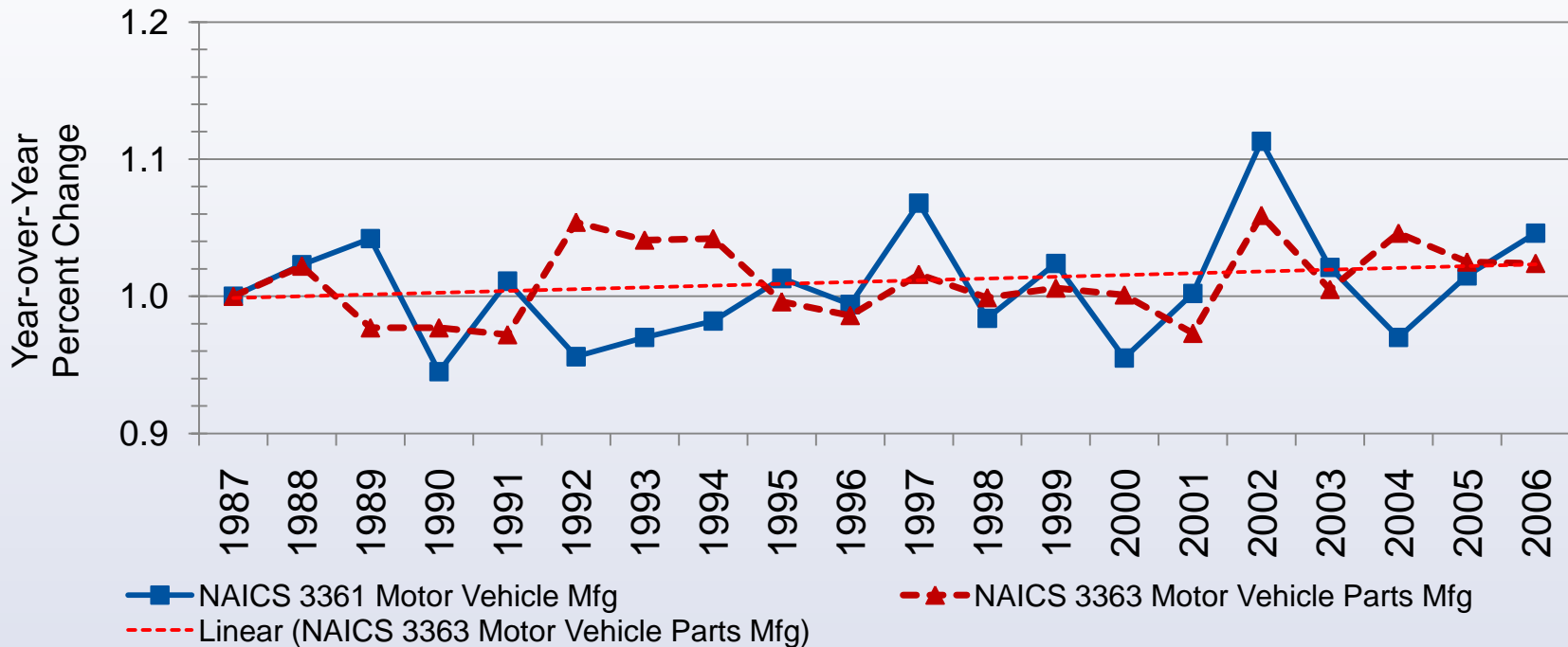
Economic Impact	OEM	Parts Suppliers	Auto Dealerships	Total
<u>Employment</u>				
Direct	313,449	685,892	736,952	1,736,293
Intermediate	1,067,321	898,614	239,356	2,205,291
Total (Direct + Intermediate)	1,380,770	1,584,506	976,308	3,941,584
Spin-off	1,764,643	1,701,816	552,348	4,018,807
Total (Direct + Int. + Spin-off)	3,145,413	3,286,322	1,528,656	7,960,391
Multiplier: (Direct + Int. + Spin-off)/Direct	10.0	4.8	2.1	4.6
<u>Compensation</u>				
(\$ billions nominal)	206.0	216.8	90.6	513.4
Less: transfer payments & Social Insurance Contributions	-25.2	-28.1	-9.7	-63.0
Less: personal income taxes	-29.2	-30.5	-13.4	-73.1
Equals private disposable personal income (\$ billions nominal)	151.6	158.2	67.4	377.3
<u>Contribution as % of total private economy</u>				
Employment	1.7	1.8	0.9	4.4
Compensation	1.4	1.4	0.7	3.5





# Structural Changes Will Show in Productivity Improvements for the Sector

## Multifactor Productivity – OEMs and Suppliers.



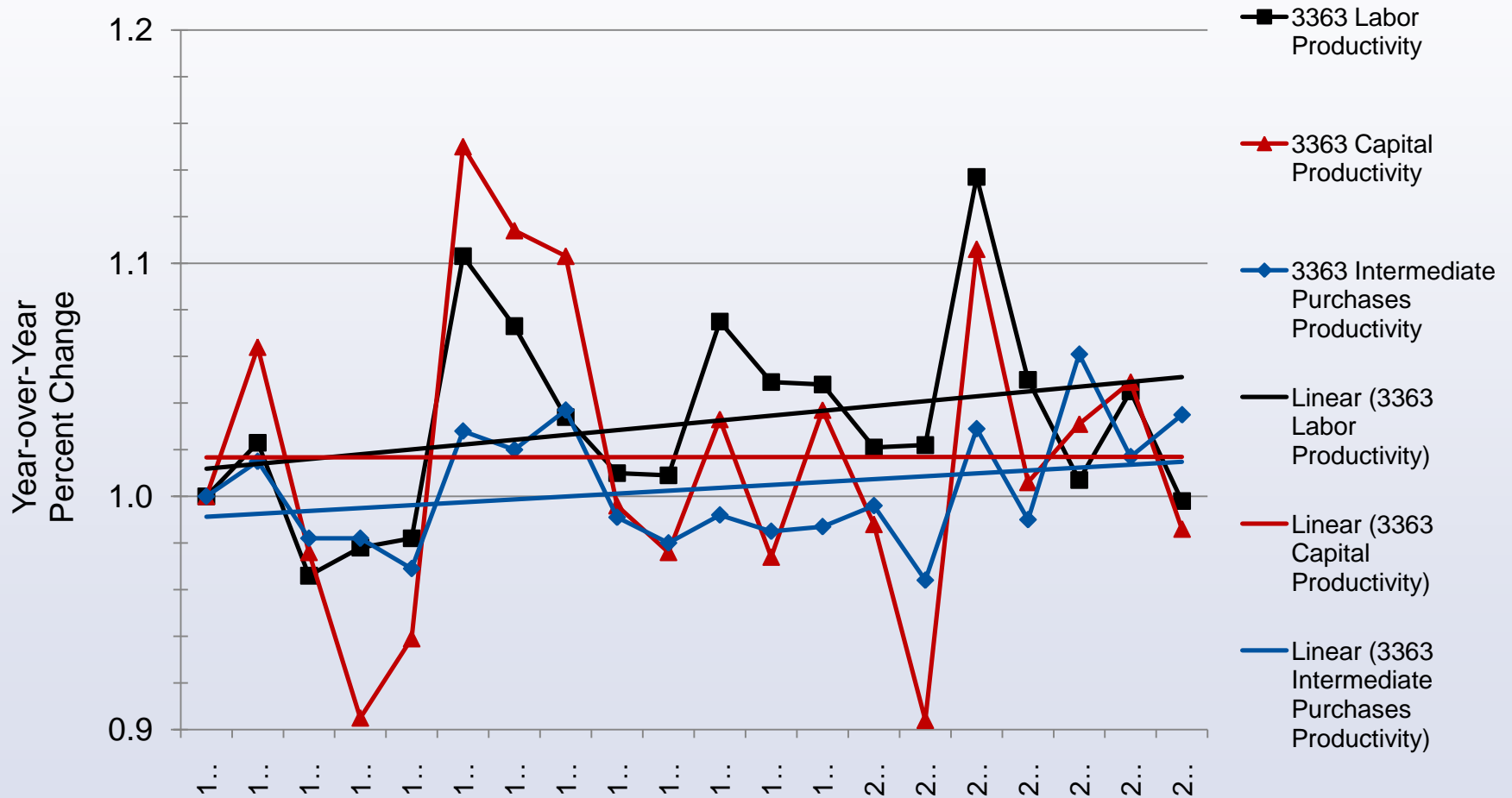
Source: Bureau Labor & Statistics Multifactor Productivity

**Suppliers will win by focusing on engaging the workforce, deepening their capital base and optimizing their supply chain in a balanced fashion**



# Structural Changes Will Show in Productivity Improvements for the Sector

## Productivity Factors-Suppliers





# Washington Activities Remain Active in Support of Technology Development and Credit Availability - Examples

- ***Investments for Manufacturing Progress and Clean Technology (IMPACT) Act (S. 1617/H.R. 3083)*** creates a \$30 billion state revolving loan fund to allow small manufacturers to retool facilities to become more energy efficient, to produce more energy efficient products or to diversify into new, clean energy industries
- ***Advanced Vehicle Technology Act (H.R. 3246/S. 2843)*** creates opportunities for suppliers to enter into federal public private partnerships with the Department of Energy (DOE) to conduct research, development, deployment and commercial application activities for more fuel efficient advanced technology components
- ***Manufacturing Modernization and Diversification Act of 2010*** proposes to re-appropriate \$20 billion of TARP funds to support banks to lend into small manufacturers by supporting loan collateral values or weak cash flows because of low production volumes
- ***Small Business Lending Fund Act*** proposes to re-appropriate \$30 billion of TARP to make capital injections and provide interest rate incentives for community banks to spur lending



# Conclusions

- *The industry has seen the bottom and is on the other side of the GM and Chrysler bankruptcies – however, the ramifications will be felt for decades*
- *Supplier fortunes are improving as industry sales and production volumes rebound with the US economy – but that bottom may not be that far out of view for a period of time*
- *Supplier employment and compensation trends are positive – but will not rebound as quickly as production returns*
- *Industry restructuring will be continuous given global capacity pressures*
- *Credit availability and raw material market volatility are two critical issues facing suppliers today*
- *The supply base provides a two-thirds the value of the vehicle and one-third the R&D investment – a financially viable supply base is critical to financially OEMs*
- *Given continued restructuring pressure, investment needs and credit availability constraints, MEMA and OESA are supportive of public initiatives to support private investment*



**Thank You**

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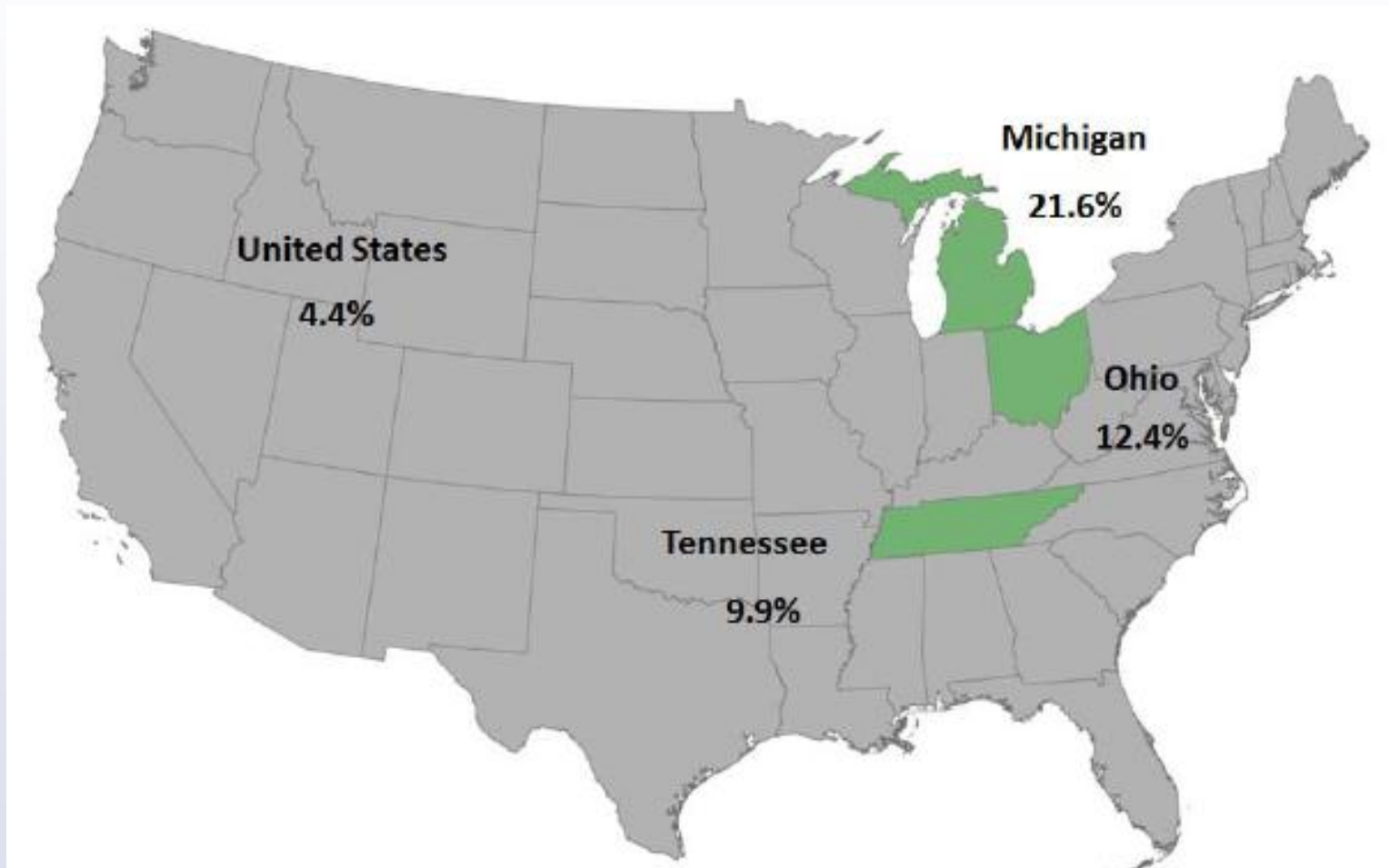


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## Appendix of Additional Information

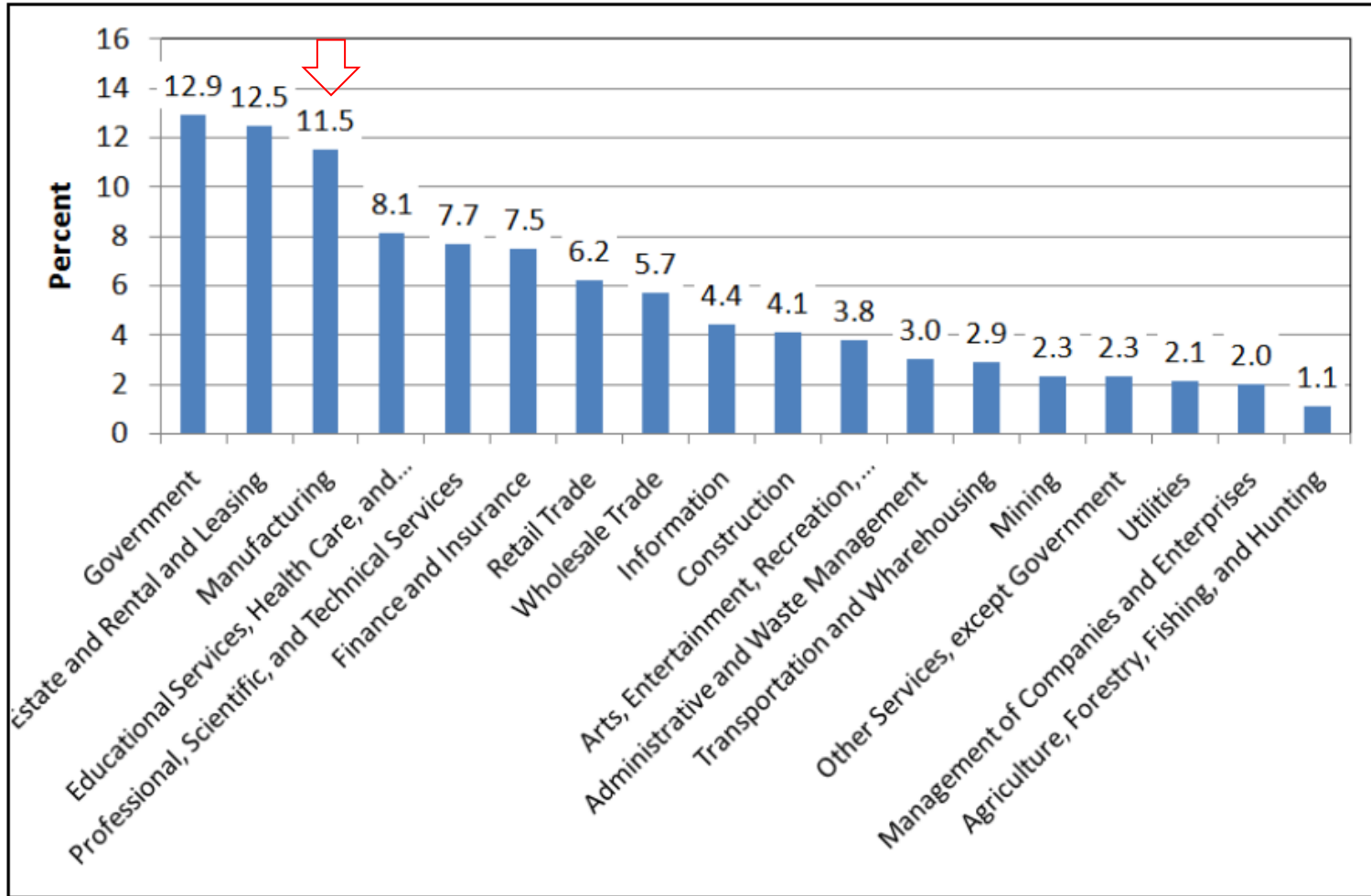


# Automotive Jobs as a Percent of Labor Force





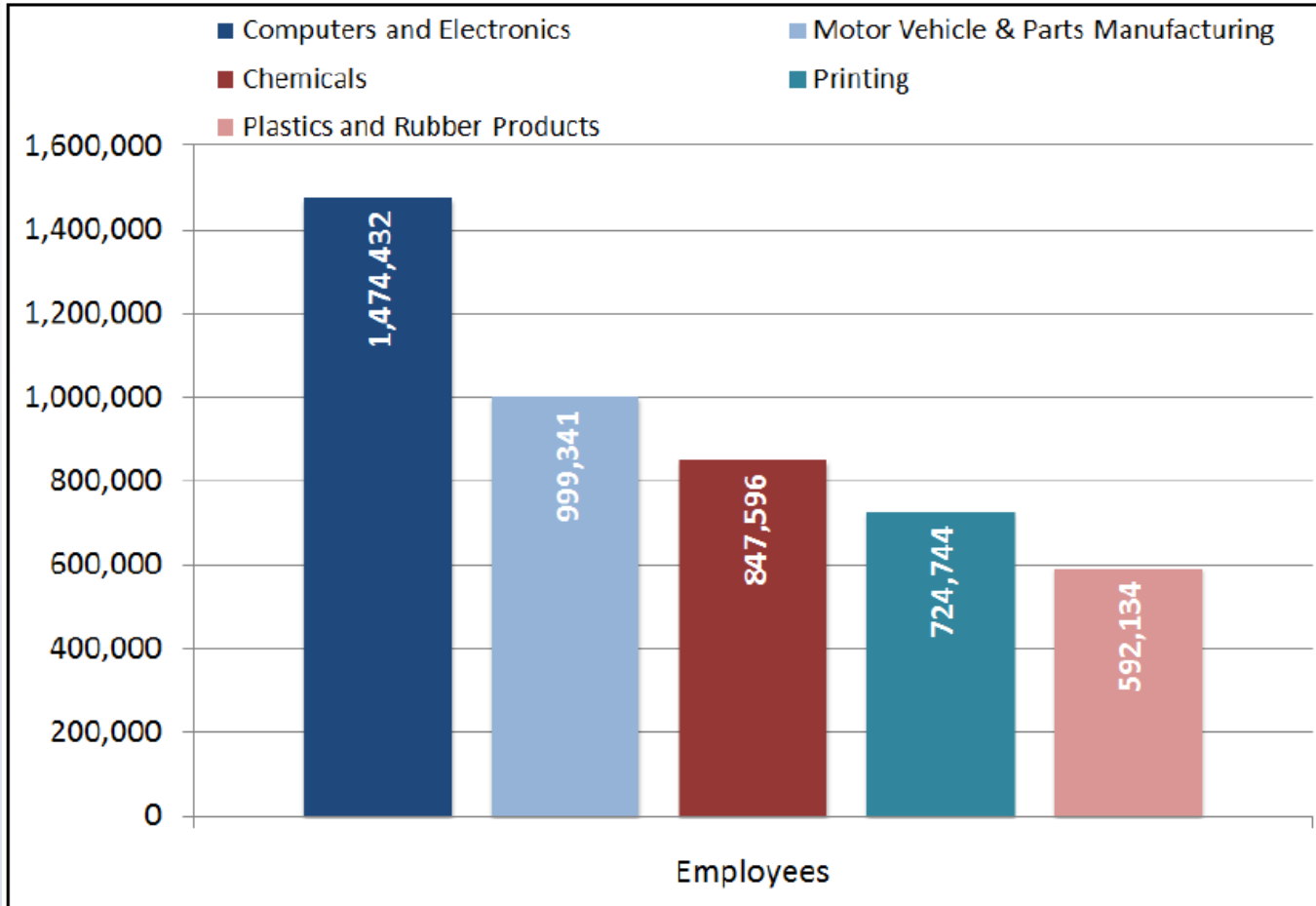
# Percent Contribution to GDP by Industry, 2008





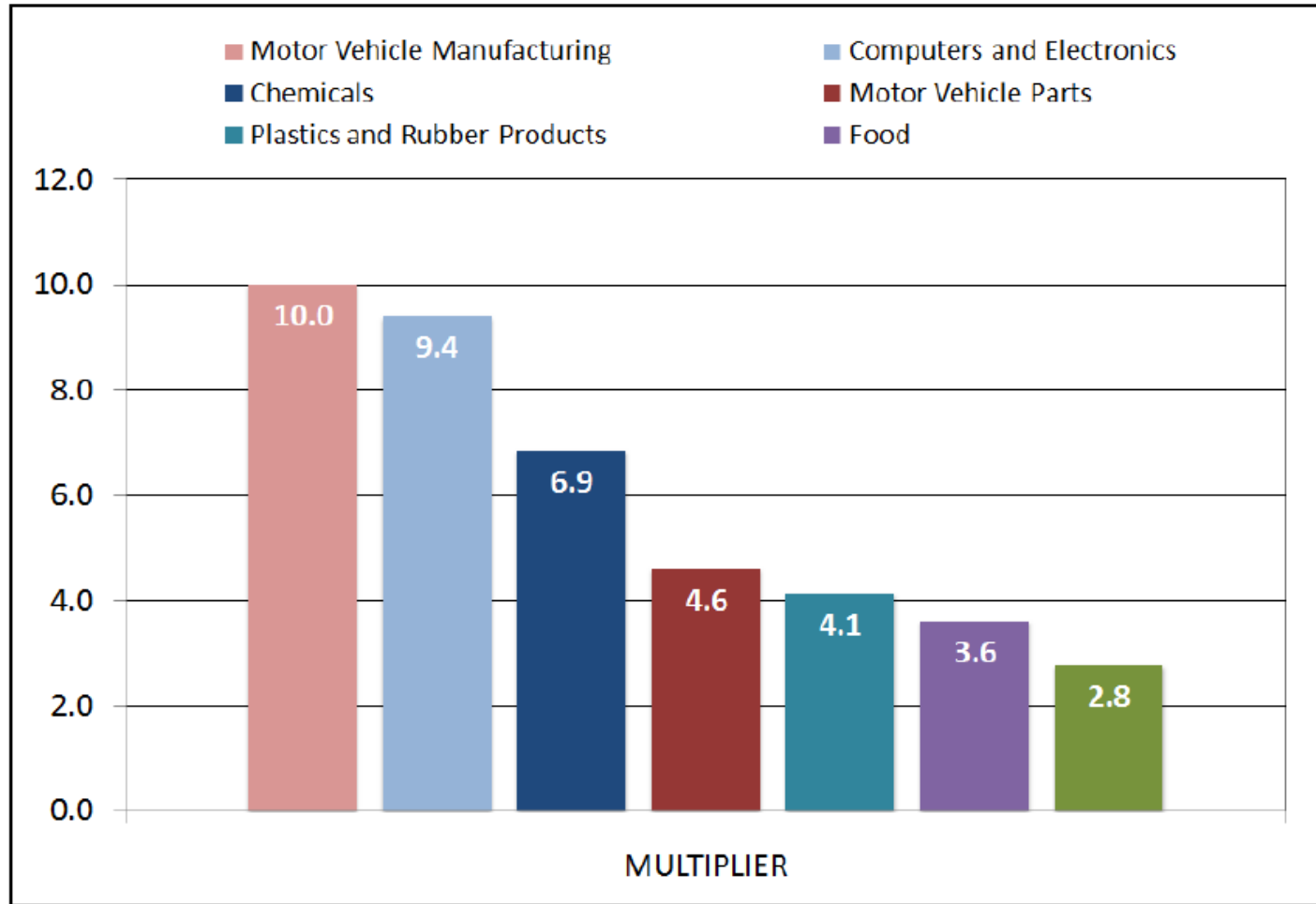


# Employees by Selected Industry



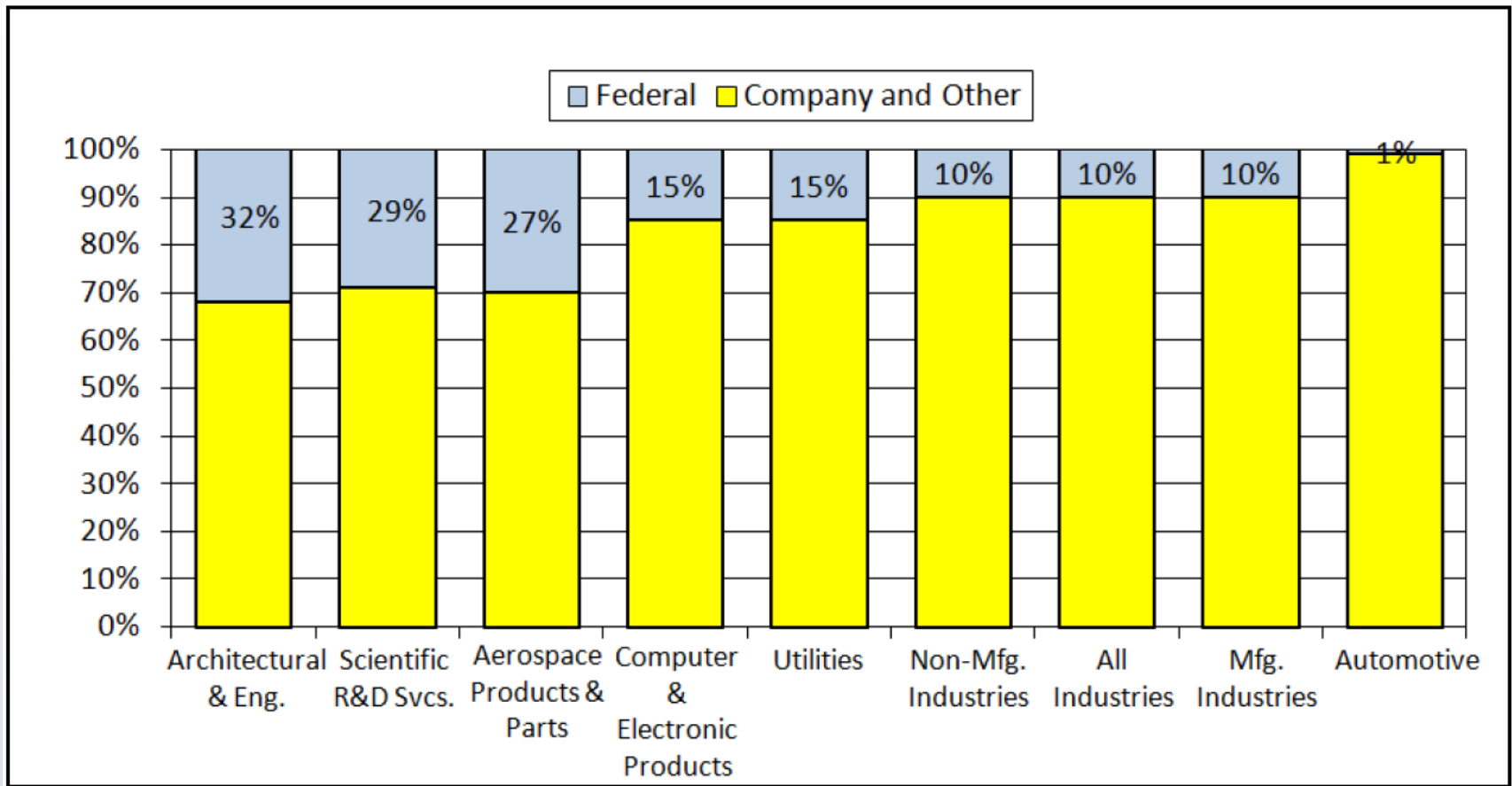


# Job Multiplier by Selected Industry





# R&D Funding Sources by Industry, 2007





# Overview of the Auto Crisis

- Vehicle manufacturers pay suppliers in about 47 days (45-55 days range).
- December 2008 and January 2009 were major shutdown months; payments to suppliers were marginal in February – April 2009.
- March 2009 estimated payments from D3 to suppliers were \$2.4 billion vs. an average of \$8.4 billion per month in the depressed Q4 of 2008.
- D3 production in Q1 2009 was projected to be down 44 percent.
- A February - April ramp-up means substantial cash outflow with minimal inflow.
- By March 1, 2009, a cash crisis could have occurred as raw materials inventories need to be replenished.



# OESA and MEMA Actions

- Meetings with Treasury began in early 2009
- OESA ad hoc advisory committee was formed in January – made up of CFOs and CEOs of member companies
- OESA surveyed members on severity of the financial crisis
- OESA and MEMA discussed the need for supplier assistance with Treasury, members of Congress, and contacts within the Obama administration
- Plans were developed by the ad hoc committee, with input from many OESA members for financial assistance
- A proposal to the US Treasury was drafted, scoped and refined



# OESA Fought for Supplier Assistance to Minimize the Bottom-Up Implosion Risk

- **Short-term Operating Cash Flow**
  - 20 percent of members report they were in or near loan covenant violations
  - Receivable lending significantly constricted
  - Options: government-backed receivables lending and quick pay programs
- **Mid-term Expansion Credit**
  - Commercial banks were severely limiting lending for tooling and capital investment programs
  - Options: government-backed low interest loans or backstopping
- **Long-term Restructuring Capital**
  - DIP financing was unavailable, hedge fund and private equity capital on the sidelines
  - Options: government-backed loans or backstop to encourage new lending



# The US Government Was (and Remains) Instrumental in Direct Stimulus in the Automotive Industry

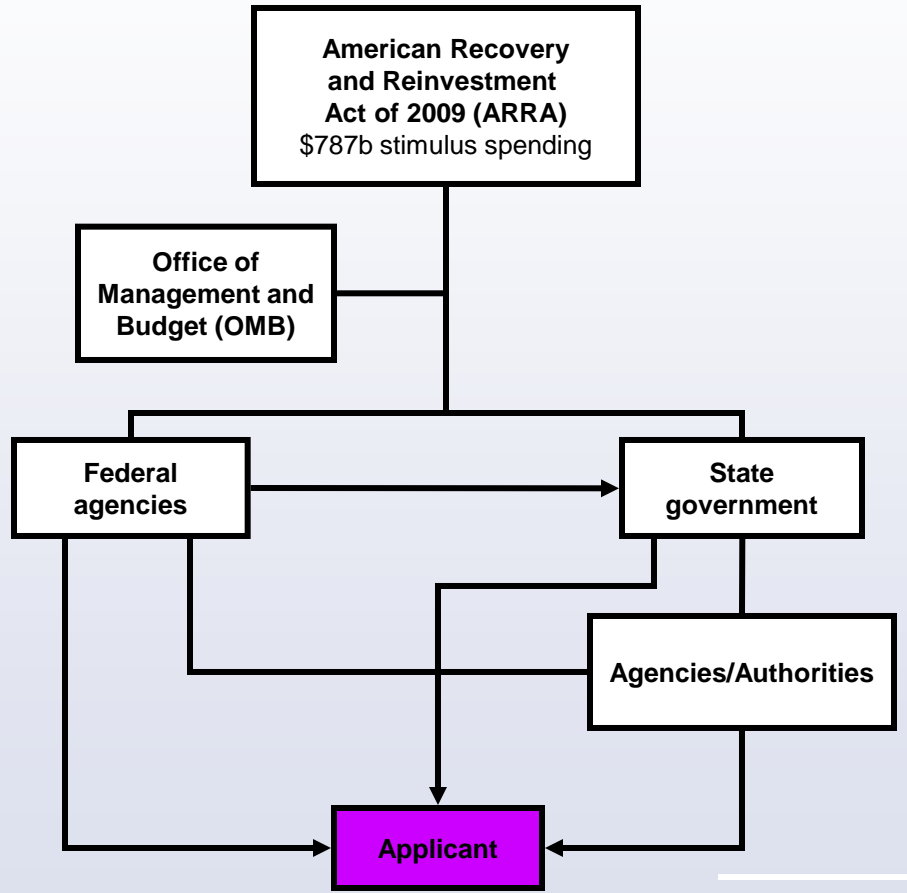
## US Government 2009 Auto Industry Investment

GM DIP:	\$50 billion
DOE Loans:	\$25 billion
GMAC:	\$16.3 billion
Chrysler DIP:	\$12 billion
TALF:	\$4.9 billion
Supplier Assistance:	\$3.5 billion
Cash for Clunkers:	\$2.9 billion
Battery Initiative (Recovery Act):	\$2.4 billion
Chrysler Finance:	\$2.0 billion
Warranty Coverage:	\$0.64 billion
Training (DOL):	\$0.01 billion
<b>TOTAL:</b>	<b>\$119.6 billion</b>

- Government investment from autos to banks will greatly influence the markets for decades, including:
  - The competitive position of GM and Chrysler and the launch of new firms, like Tesla
  - The technology agenda pushing “clean energy” manufacturing



# American Recovery and Reinvestment Act of 2009 (ARRA)



<b>Tax relief</b>	<b>\$288b</b>
<b>State and local fiscal relief</b>	<b>\$144b</b>
<b>Infrastructure and science</b>	<b>\$111b</b>
<b>Protecting and vulnerable</b>	<b>\$81b</b>
<b>Healthcare</b>	<b>\$59b</b>
<b>Education and training</b>	<b>\$53b</b>
<b>Energy</b>	<b>\$43b</b>
<b>Other</b>	<b>\$8b</b>





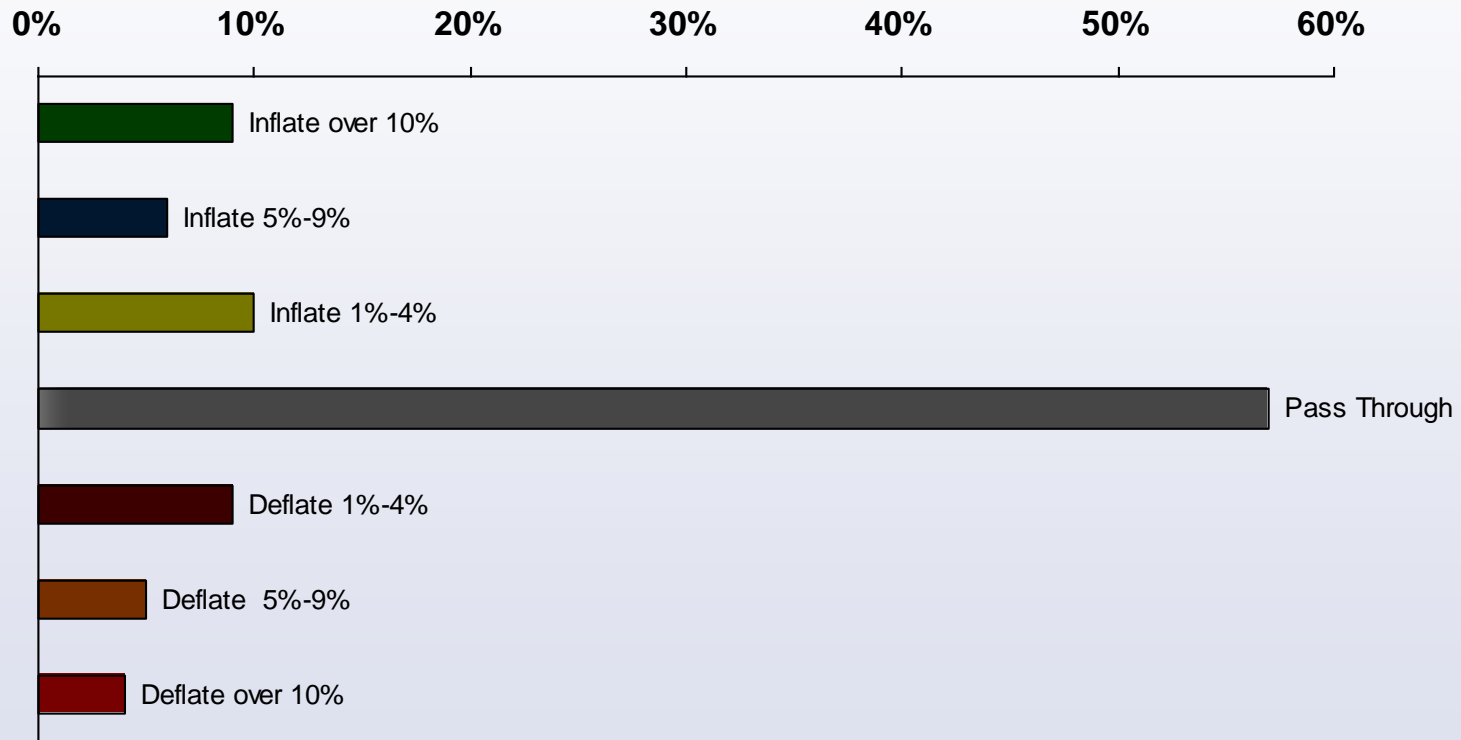
# Capital Availability Continues to Remain Tight

## Suppliers Report Lending Terms Have Basically Remained the Same, with Lines of Credit Becoming Tighter for Many

	Tightened Considerably	Tightened Somewhat	Basically Unchanged	Eased Somewhat	Eased Considerably
	1	2	3	4	5
Maximum Size of Credit Lines	5 %	16 %	72 %	4 %	3 %
Cost of Credit Line	9%	16%	71 %	3 %	2 %
Maximum Maturity of Credit Line	2 %	6 %	87 %	4 %	1 %
Maximum Size of Commercial Loan	3%	12 %	79%	5%	1 %
Commercial Loan Interest Rate	6 %	16%	75%	3 %	1 %
Commercial Loan Covenants	3 %	14%	76 %	5 %	2 %
Commercial Loan Collateralization requirements	6 %	14 %	77 %	2 %	1 %
Maximum Maturity of Commercial Loans	3 %	7 %	87 %	2 %	1 %



# Supplier Barometer: Generally, across customers and programs, are you currently tending to inflate or deflate your releases down through your supply chain?

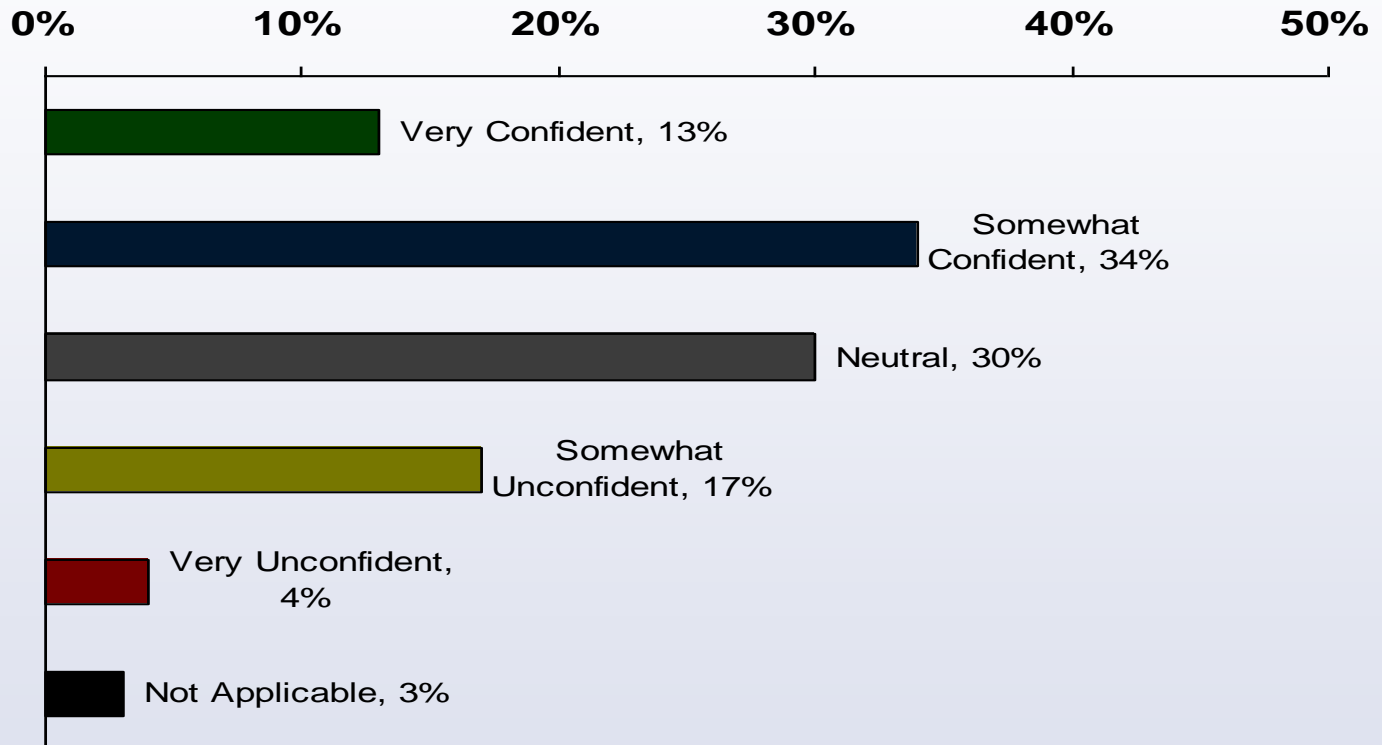


Source: OESA March 2010 Automotive Supplier Barometer

No. of Responses = 97



# Supplier Barometer: How confident are you that your customers' production releases are matching their current sales run rates?



Source: OESA March 2010 Automotive Supplier Barometer

No. of Responses = 97



# 2009 Supplier Bankruptcies (54 Reported)

## Top 150 Suppliers in Blue

- Accuride Corporation
- Advanced Accessory Holdings
- Advanced Materials Group
- Advanced Nitriding Solutions
- AE Group AG
- Aleris International
- Alternative Distribution Systems
- Auto Cast Inc.
- B & C Corporation
- B&C Machine Co., LLC
- Checker Motors Corp
- Contech LLC
- **Cooper-Standard Holdings**
- Court Valve
- **Edscha AG**
- Fabtech Industries, Inc
- Fluid Routing Solutions Inc
- **Foamex International Inc**
- FormTech Industries LLC
- Fort Wayne Foundry Corporation
- Fuba Printed Circuits GMBH
- Gertz Schiele Holding GMBH
- Global Safety Textiles Holdings
- **Grede Foundries, Inc**
- **Hayes Lemmerz**
- Holley Performance Products
- International Metals & Chemicals
- **J.L. French**
- **Karmann**
- Kiekert & Nieland
- **Lear**
- Lindenmaier AG
- LKI Enterprises, Inc.
- LyondellBasel
- **Mark IV Dayco Products**
- Mathson Industries
- **Meridian Automotive**
- **Metaldyne**
- Milacron Inc
- **Noble International Ltd.**
- Pelican Metal Products
- Plastal Group AB
- Proliance International Inc.
- RathGibson Inc.
- Recticel North America
- Sanderson Industries
- Silicon Graphics Inc
- Smurfit-Stone Container Corp
- **Stant Corp.**
- Tricon Industries
- Vincent Industrial
- **Visteon Corp**
- Von Weise Inc.
- Wiltech Industries

**And far few liquidations (likely 200 plus)**



# Economic Significance of the Supply Base: The Largest US Manufacturing Sector

- 686,000 direct employees
  - 898,500 intermediate jobs
  - 1,701,800 expenditure induced
    - 3.29 million jobs (4.8 multiplier effect)
- Considering only direct employees, the supplier sector is the largest manufacturing industry in Michigan, Ohio, and Indiana as well as Kentucky, Missouri, Oklahoma, South Carolina and Tennessee
- In total, the light duty, heavy duty and aftermarket parts suppliers account for approximately \$390 billion of shipments



# Suppliers Support 30% of Industry R&D

