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AUTO SUPPLIERS HAVE A CRITICAL WINDOW TO TAKE ACTION BEFORE THE SLOWDOWN

It may be spring in North America, but for the automotive industry, winter is coming. The industry is on the cusp of a potential cyclical slowdown, which is compounded by changes in technology and evolving consumer preferences. For automotive players—particularly suppliers—it's critical to start examining worst-case scenarios in their planning and taking decisive action today to ensure that they can ride out the storm.

In AlixPartners' recent Turnaround and Restructuring Experts survey[1], automotive was cited as the third most likely industry to face distress in 2019, with 34% of respondents expecting an increase in restructuring activity. That was a fivefold jump over the number of respondents who said the same of automotive in the 2018 survey.

Why the pessimism? Cyclical factors are one big reason. In macro terms, the global economy is nearing the end of a very long expansion, and while it's impossible to predict this cycle's turn, it's a question of "when" and not "if." The auto industry is more cyclical than the overall economy—with higher highs and lower lows—and the North American market is in the early stages of a cyclical downturn. This cycle is expected to trough near 15.1 million US sales, nowhere near the previous 10.4 million bottom in the 2009 financial crisis, but it's still painful and requires prudent preparation.[2]

A second contributor to industry stress is the ongoing disruption from technology. The shift to a "C.A.S.E" ecosystem—vehicles that are connected, autonomous, shared mobility, and electrified—is the biggest disruption in the auto industry since the Model T. Between 2012 and 2017, capex and R&D spending for the industry grew by $72 billion—an increase of roughly 50%, in line with volume growth during this time period.[3] Automotive companies have to invest enough for future C.A.S.E. vehicles in order to stay relevant, even if the market for that technology is still in its infancy, and so the mid-term returns from these investments cannot be counted on.

Lastly, increased leverage concerns our survey respondents, particularly among certain segments of the supply base. Overall, leverage among suppliers is still low compared to the financial crisis, but 2018 saw an increase, with a few large suppliers piling debt on top of weaker EBITDA. Several have already seen credit downgrades, earnings misses, or revisions to their earnings projections for 2019. The coming volume declines may leave some vulnerable suppliers unable to cover their debt—leading either to balance-sheet restructurings or more chapter 11 filings. Strong demand covers up a lot of issues, but in the current market, even a small drop in demand will have a dramatic impact on a capital intensive sector like automotive.

1. *AlixPartners 14th Annual Turnaround and Restructuring Experts Survey* was conducted in Dec. 2019 and surveyed more than 300 lawyers, investment bankers, financial advisors and other turnaround and restructuring industry experts
2. *The AlixPartners Global Automotive Outlook*, published in June 2018, was based on months-long analysis of data from public and proprietary sources and included two online consumer surveys of Americas aged 18 and older
3. *The AlixPartners Global Automotive Outlook*

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In this environment, leadership teams need to get proactive about identifying ways to shore up their balance sheet, while participating in but being smart about C.A.S.E. investments. The right response depends on a supplier's particular circumstances. For example, some may need to refinance existing debt or negotiate better terms, which they can currently do from a position of strength. While spreads for new leverage loans for automotive suppliers are significantly higher than the general debt market, refinancing will likely be even more difficult a year from now.

Even companies in a sound position to withstand a decline in production need to ensure that new start-up customers and key suppliers do not have their own liquidity issues. The automotive industry is particularly leaned out and intertwined. Supply chain disruptions ripple across the industry quickly, and the tier I suppliers are often held responsible for their supplier's performance.

A common theme among these options is the need to be proactive and vigilant. By looking forward and taking pragmatic steps to prepare, starting today, companies can buttress their business plans to work through the whole cycle.

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ABOUT US

For nearly forty years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.