

The Auto Industry Looks Ahead: 2010 Model Year brings Renewed Signs of Optimism

The last six months have brought remarkable – and often devastating – change to the automotive industry. General Motors and Chrysler have died, only to be reborn through bankruptcy. Tier 1 Magna is poised to complete its takeover of Opel, putting it into direct competition with its customers. Consumer demand patterns have changed drastically, forcing automakers to balance between the competing styling and efficiency preferences of drivers and governments.

Simplicity Tactics LLC has completed a study of the impact of this market upheaval on manufacturing firms who supply the automotive markets. A continuation of initial research undertaken in October 2008, the study examined how forward looking volume expectations impact manufacturer's commercial, operational, and fixed investment decisions. Survey data was collected between June 22nd and July 9th, 2009.

Executive Summary

Key Findings at a Glance

1. Volume expectations have solidified, with 80% of respondents anticipating higher production in 2010.
2. Stronger order books have been reported by participants throughout the supply chain. 88% of business leaders expect flat to increased business in the next six months, compared to roughly 50% last October.
3. Realism has returned: while 60% of participants anticipating higher or much higher auto production volumes in the next six months, only 51% had similar expectations for their own businesses.
4. Volume enhancement, cost reduction, and new product development are key issues for manufacturers in the automotive supply markets.
5. Credit concerns abound, with 37% of automotive firms concerned that lack of capital will stymie their ability to remain competitive.

Key Questions for Executives

1. What is the single largest issue for your business?
2. Do you have a clear-cut plan to overcome this particular problem?
3. With rounds of staff reductions completed, does your organization have the depth to capitalize on market opportunities?
4. Do you have the resources necessary to redeploy and compete in the new automotive market?

With the hardest days behind us, businesses now face the reality that yesterday's solutions have become today's problems. Rapid staff reductions have allowed companies to survive, but now these hollowed-out firms must reposition and rebuild for growth. While each business has different needs, there is one thing all should remember: you are not alone. Today competitors all face the same challenges, and chance favors the prepared. Are you prepared?

Automotive Production Outlook

The news in the automotive sector is that the world is beginning to look a little less frightening. At least this is the message which can be inferred from the responses of participants at all levels of automotive supply. From OE's down to tier 3's, expectations for the coming six months' volumes have stabilized,. 60% of participants anticipate increased automotive production.

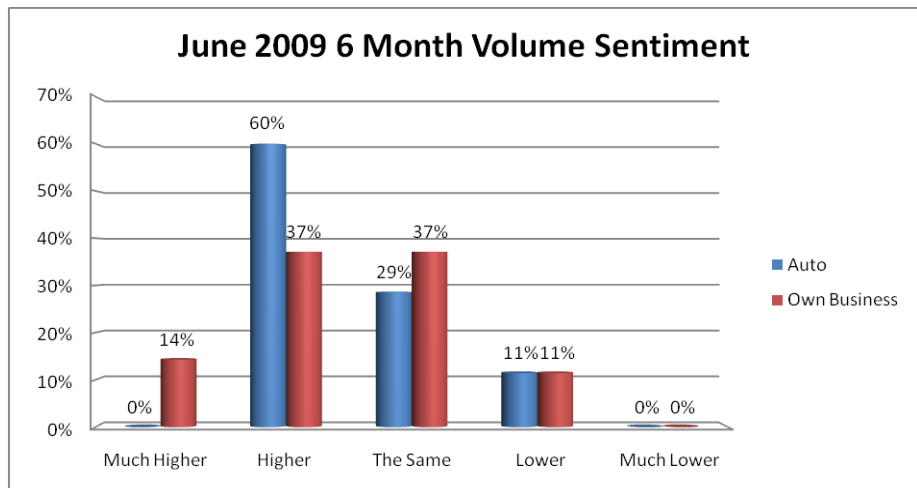
This increase, however, comes with a pessimistic vestigial twin. Despite broader expectations of increased economic activity, only 51% believe that their own business will see higher sales. And while 39% of the market participants felt that business levels would stay flat, just over 37% believed that their business would perform at current levels during the next six months.

This moderated enthusiasm strikes a stark contrast with the unbridled optimism of October 2008. At that time, the stock market had crashed, consumer credit dried up, and major financial institutions began to fail. Nonetheless, manufacturing executives expressed their confidence that while the economy would get worse, their own companies would outperform both the market and their own prior quarter's sales.

Today we know that this position was unfounded and ill advised. Companies anticipating an 11 million unit automotive build in 2009 entered the year overstaffed, with weak cash flows and comparatively bloated balance sheets. And they have suffered for it. A straightforward question still lingers: have firms learned the lessons of this most recent downturn, or will the collective delusion of ongoing outperformance against the market leave a wider swath of destruction in the automotive supply base?

A Question of Rationality

At the surface, it appears the answer is yes. As noted above, executives' expectations of their own business performance have begun to lag behind that of the overall marketplace. This shift toward a more moderated stance reflects the reality that many were unprepared for the depth and severity of this downturn. This rationality



is further evidenced by expectations on the cost side. While 80% planned to launch major cost cutting programs in the coming six months, more than a third expected credit restrictions to limit their ability to implement said plans.

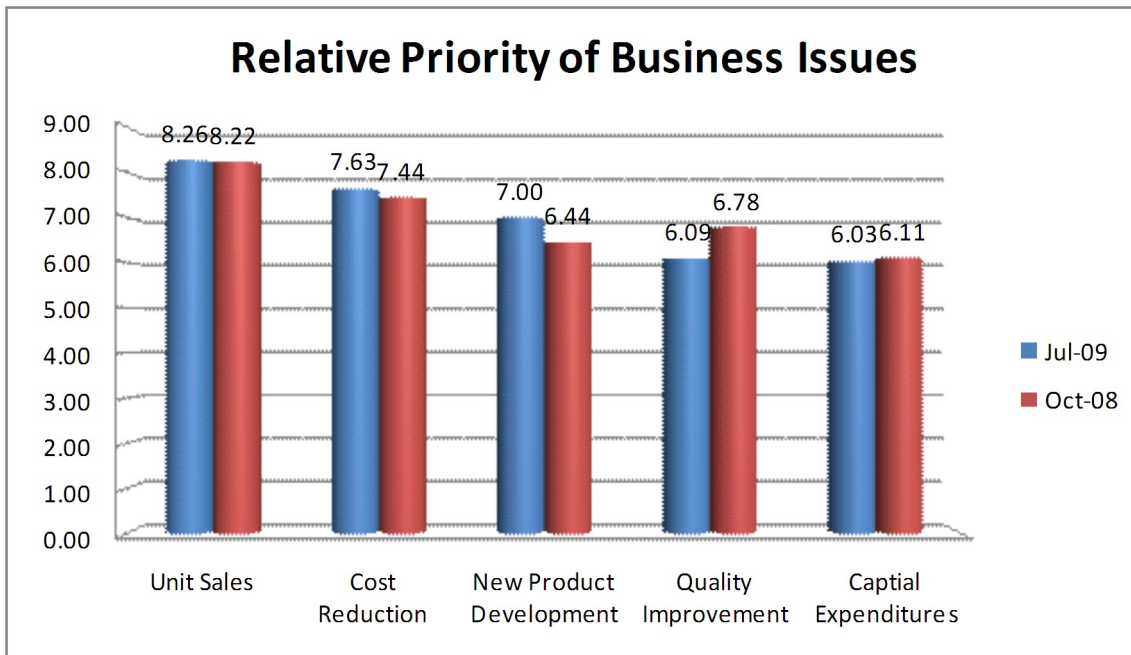


This statement, however, offers a glimpse into the dichotomy of perspectives in the automotive supply base. There appears to be a clean break between the haves and have-nots. This is evidenced most directly when comparing the CapEx plans of today with those of October 2008. The percentage of firms anticipating no capital expenditures has increased slightly at 25.71%. However, far fewer firms expect lower capital expenditures in the coming six months. This data shows that the lagging 25% of the marketplace is unable or unwilling to re-invest in its future business.

This figure most likely represents the continued reality that banks are hesitant to expand manufacturing lending beyond their current customer base. Anecdotal evidence supports this statement: out of nine global and regional banks, only one expressed increased appetite for manufacturing – the one outlier a small community bank seeking to expand its lending base at historically high margins. So as credit continues to play a larger role in firms' planning, the lagging performers are finding themselves increasingly at risk of obsolescence.

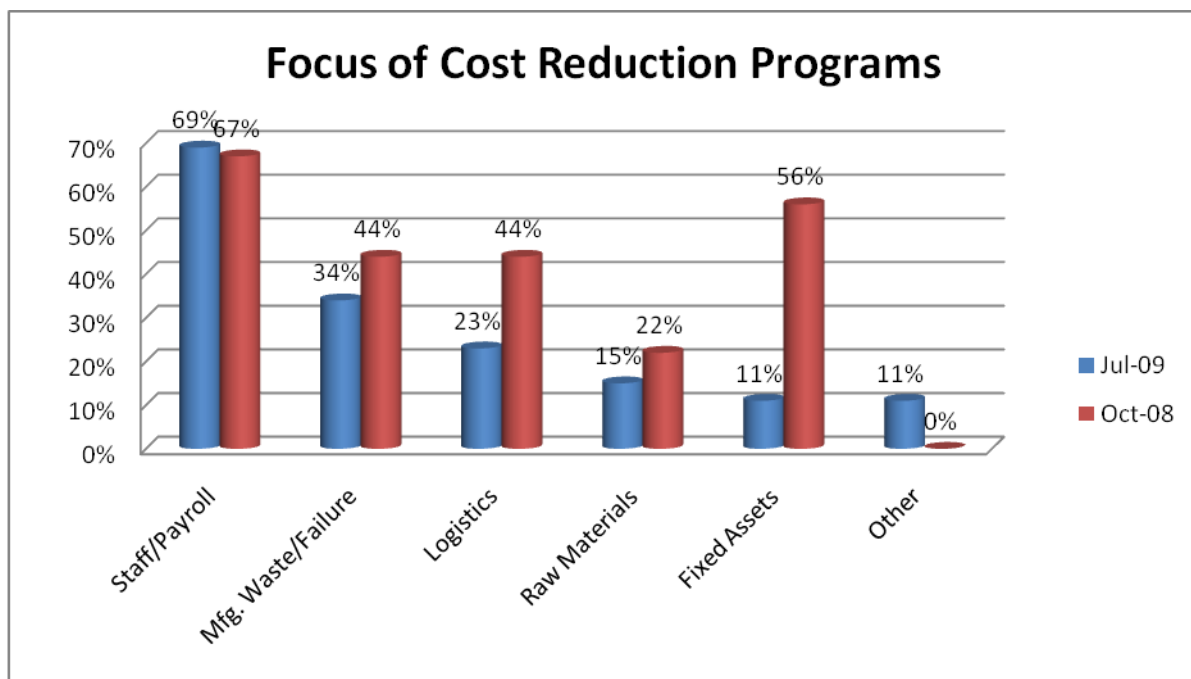
Firms Look Outward, then Inward

With volumes lower throughout the industry, it is no surprise that the manufacturers chose unit sales as the single largest issue to be addressed in their firm. And given the upheaval in consumption and OE manufacture, the expectation that own-firm sales will lag the general marketplace should provide a much needed boost in sales development execution.



And while cost reduction efforts continue to remain in most firms' crosshairs, the development of new products has moved up in overall business priority. The data suggests that this is a correlation to the need for increased unit sales, a suggestion strongly echoed by observations from the general marketplace. 63% of executives polled stated that quoting activity had either increased or significantly increased in the last quarter, with 28% planning to increase engineering staff through recall or hiring in the coming six months.

Once these volume-related issues are dealt with, firms plan to continue aggressive cost cutting. And responses from manufacturing firms suggest that their initial rounds of cost cutting have left few areas on which to focus.



Staff levels and payroll costs continue to be the priority for cost reduction efforts in the next six months. However, it is important to note the reduction of priority for fixed assets and logistics costs. Where these were the second and third largest priorities only a few months ago, we now see that few firms plan to focus efforts in these areas.

This suggests that while some firms are expanding their scope and opportunity to improve costs, most have moved from larger structural cuts into more nuanced personnel based improvements. The data also suggests that credit-starved firms have simply run out of options. And while continued staff and payroll cuts can be effective in the short term, this tactic is more akin to chemotherapy: it will allow the firm to survive, but overall health can be imperiled. All firms face the risk that when the market demand increases, they will be left unprepared for growth. This is particularly important for those firms already short on working capital.

Where to Go From Here

As seen in participant responses, companies are preparing themselves to simultaneously reduce payroll costs while preparing for future growth. Irrespective of relative working capital strength, this is a significant challenge. Successful implementation will require an honest accounting of the following issues:

1. Does your company have a clear vision of what it must become? Regardless of its focus – service leadership, product leadership, or cost leadership – execution remains a critical issue. And as market sentiments have begun to improve, so have business expectations of success. In fact, 97% of respondents believed that they could successfully implement their upcoming cost reduction projects, despite the fact that more than 90% of all cost initiatives fail to meet their goals.
2. Does the company have a clearly defined plan to bridge the gap between where it stands today and where it must be tomorrow? And are your managers united in its implementation? With implementation an absolute requirement, can the organization's leadership rise above departmental objectives? As always, your planning should include dollar-based metrics which are reviewed regularly.
3. Has the firm retained enough of the intellectual capital required to adapt? Broad staff and managerial headcount reductions can leave a company starved for knowledge. Be sure to address the critical line issues: customer service staff, technical support, and manufacturing expertise.
4. Is working capital sufficient to support investment in growth? With respondents indicating that both cost reduction and new product development are seen as critical to survival and growth, will your firm's capital structure support multiple coordinated projects? Remember, more than a third of participants indicated that capital constraints would be an issue in completing needed cost reductions.

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About The Firm

Simplicity Tactics provides hands-on problem solving and support to manufacturing companies, governmental and non-governmental entities, and service firms. Offering expertise in areas as varied as commercial development, operational effectiveness and efficiency, and labor relations, the firm offers discrete counsel for firms in transition.

