

GM, Chrysler Shutdowns Could Prompt Supplier 'Armageddon'

By Andrew Edwards, Of DOW JONES NEWSWIRES

NEW YORK -(Dow Jones)- Auto suppliers are about to face a stress test of their own, and the results are unlikely to be pretty for the banks and investors that hold their debt.

Shutdowns at General Motors Corp. (GM) and Chrysler LLC this summer will put already-lean auto suppliers on the equivalent of a starvation diet. Over the last decade as demand for cars shot up, much of the industry, which employs more than three times as many people as the Detroit three, gorged on debt to build up capacity in the boom years. The average debt-to-equity ratio in the \$200 billion industry stands at four or five times. Now that same debt is strangling them.

Hundreds of smaller parts manufacturers are in breach of their bank-loan agreements - meaning they are already having trouble servicing their debt. As the trickle of money coming in from car makers comes to a stop this summer, many of them will not recover.

This puts lenders in a tough spot. If they force companies on the ropes to liquidate, they aren't likely to get much of their money back. If they decide to swap their debt for an equity stake they're not much better off - auto-parts suppliers will need about 75 days of working capital to get ramped up for renewed car production in the fall, and would likely come to their new owners hat in hand. As a result, lenders have frozen up.

"The banks are being a lot more hesitant to pull the trigger on a lot of these suppliers," said Jim Gillette, Director, Supplier Analysis at CSM Worldwide, who had predicted more bankruptcies earlier in the year. "They've been hanging on, trying to keep these things going rather than owning this junk they can't liquidate."

Lender Of Last Resort

Suppliers are saying the only way out of this predicament is government involvement.

"We're still hoping that our friends in Washington will recognize that in order to ensure that money does not go to waste they also have to support the supplier community," said Neil De Koker, President of the Original Equipment Suppliers Association, an auto-parts manufacturing group.

He estimates the government will need to commit around \$20 billion in addition to the \$5 billion in guarantees that have already been put up. The support should come in the form of guarantees on loans channeled through existing lenders, he said.

In the end, \$20 billion may just be a down payment. Richard Tilton, former head of the bankruptcy group at Greenberg Traurig LLP, now an analyst on autos for Covenant Review, pegs the final price to the government for restructuring the auto industry at "\$100 billion plus."

However, other options may be worse. The auto industry is to the real economy what Lehman Brothers was to finance: catastrophically interconnected. Since the 1980s, car makers have taken much of the slack out of the system, as just-in-time parts delivery and single-source suppliers became more common. A single, small manufacturer shutting down can cause temporary plant closures across the U.S. A wave of them would be what one industry expert called "Armageddon."

"If it's 500, that will shut down the entire North American auto industry," De Koker said. "It could take 2 to 3 months to get plants running again, and that affects 2.4 million jobs."

The wave has already begun to hit amid a drastic contraction in production. North American auto production is expected to fall by a third from 2008 to 8.4 million vehicles. Laser-welding company Noble International Ltd. (NOBLQ), wheel and power-train component maker Hayes Lemmerz International Inc. (HAYZ), and Internet Corp. (INMTQ) have already filed for Chapter 11. According to industry strategist Craig Fitzgerald, many smaller companies have also disappeared, going into what he called "quiet liquidations."

Others appear to be on the verge. Last week, Lear Corp. (LEA) revealed that under the terms of the waiver with its secured lenders that put it into a Catch-22 bind. In order to get the waiver it agreed not to pay its June coupon payment to unsecured bondholders. Lear has remained unwilling to commit to whether or not it will make the payment.

"I think Lear's destiny is essentially out of its hands and in the hands of its secured lending group," said auto-company debt analyst Kip Penniman of KDP Advisors.

In the end, the restructuring will likely be good for the industry. Making auto parts hasn't been a good business for decades, as car manufacturers tried to wring every efficiency from their supply chain. So a consolidation could allow for better pricing and eliminate companies whose capital structures were unsustainable to begin with.

"For the first time I can see these companies starting to make some money," said Greg Charleston, an auto supplier turnaround specialist at Conway MacKenzie Inc. "It's terrible what's happening, but for those that can get through it, there may be light at the end of the tunnel. it's going to be a long tunnel, believe me."

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