



Statement
of the
Motor & Equipment Manufacturers Association

ABOUT: Impact of the Economic Challenges Facing
U.S. Automakers on Small Suppliers

TO: United States House of Representatives
Committee on Small Business

BY: Wes Smith, President
E&E Manufacturing Co., Inc.

DATE: May 13, 2009



BEFORE THE UNITED STATES OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS

IMPACT OF THE ECONOMIC CHALLENGES FACING U.S. AUTOMAKERS ON
SMALL SUPPLIERS

TESTIMONY OF WES SMITH
PRESIDENT, E&E MANUFACTURING CO., INC.

ON BEHALF OF
MOTOR & EQUIPMENT MANUFACTURERS ASSOCIATION

MAY 13, 2009

The Motor & Equipment Manufacturers Association (MEMA) represents nearly 700 companies that manufacture motor vehicle parts for use in the light vehicle and heavy duty original equipment and aftermarket industries. Motor vehicle parts suppliers are the nation's largest manufacturing sector, directly employing 685,892 U.S. workers and contributing to over 3.2 million jobs across the country. The motor vehicle parts supplier industry is a leader in developing technologies critical to making today's vehicles safer and more fuel efficient and is investing in product development to help meet future consumer demand. Suppliers also manufacture the aftermarket products necessary to repair and maintain over 247 million cars and trucks on the road today. (*See Appendix A*)

Collectively, U.S. motor vehicle parts suppliers are a \$388 billion industry, comprising three distinct segments: original equipment, heavy duty, and aftermarket.

E&E Manufacturing began business in Plymouth, Michigan 45 years ago. Since that time it has grown its footprint from 5,000 square feet to 435,000 square feet and has grown its capabilities to become a full service supplier of highly engineered stamped metal solutions primarily to the auto industry, with yearly sales reaching \$100 million. E&E has been a pioneer in the field of drawn metal fasteners and related products, holding seven patents, with several pending applications. Products influenced by E&E designs can be found on a great many cars on America's highways.

Despite the significant challenges facing the motor vehicle supplier industry, very little assistance has been focused on small manufacturers. We urge the Committee to work with others to craft specific policies to address the needs of these suppliers.

A. THE NEEDS OF THE SMALL SUPPLIER

The supplier industry is populated with small manufacturers providing product and innovation to larger manufacturers. These manufacturers are faced with substantial capital costs including research and development, tooling, plant and equipment, raw materials, and work-in-process inventory. In addition, suppliers carry significant employment costs related to training and

health care. At the same time, since vehicle demand has fallen off significantly, all light and heavy-duty original equipment suppliers are facing unprecedented reduced production schedules. Small suppliers have not been able to take advantage of the vast majority of financial assistance provided to the motor vehicle industry leaving many with no choice but to close their facilities. Since every supplier job impacts almost five other jobs, these closures impact workers, families, and communities nationwide. Small suppliers are essential to the nation's economy and the stability of the motor vehicle industry. Assistance targeted to these manufacturers is critical.

B. FINANCIAL STATE OF SUPPLIER INDUSTRY

Heavy Duty Suppliers

For 27 consecutive months, the U.S. heavy duty commercial vehicle industry has been in recession. Current Class 8 vehicle (tractor-trailer type) sales are down 65 percent since EPA 2007 regulations were enacted. The current year Class 8 sales pace is running at 105,000 units; 51 percent behind 2008. The expected recovery in 2008 was quashed by a dramatic reduction in truckable economic activity; the main driver of new commercial vehicle sales. While EPA 2010 regulations were expected to drive a pre-buy starting late in 2008, none of the market analysts are currently predicting a significant increase in production during this year.

Although there is not as much attention paid to this sector, heavy duty suppliers are witnessing unprecedented challenges. Eighty-five percent of our association's heavy duty members have reported declining sales and less than half are able to meet financial obligations in a timely manner. Access to operating capital and build rates that are well below the break-even point of nearly all heavy duty suppliers place many companies in serious jeopardy of failure.

Light Vehicle Market

The continuing financial crisis is the result of the dramatic and rapid drop off in industry volumes, the nearly complete freeze on new capital into automotive, and the inherent risk caused by the threat of GM and Chrysler bankruptcies. For small suppliers, the drop off in industry volumes can actually be greater, the credit freeze tighter, and the customer risk more significant. In fact, industry financial surveys from the beginning of the year showed that over 60 percent of the association members noted that they faced significant financial distress in 2009 and 75 percent of those in potential distress are small suppliers – those suppliers with revenues under \$250 million.

1. Industry Volumes

North American vehicle production was off 52 percent year-over-year in the first quarter of 2009. For 2009, forecasters estimated production would decline 35 percent to 8.2 million units from 12.7 million units in 2008. Negative volume changes can be greater for smaller suppliers because they are on the very end of the production bull whip. Inventories are drawn down increasingly throughout the entire supply chain as the larger firms cut their production orders first and each successive layer of the supply chain cut their production schedules further to protect increasingly narrower margins. This condition will only be exacerbated over the next 13 weeks as Chrysler shuts down U.S. plants during its bankruptcy proceedings, as GM takes out an additional 190,000 units out of already weak second and third quarter production schedules, and as GM proceeds with rolling shutdowns this summer.

According to Grant Thornton, a leading turnaround firm, they believe that given the continuing decline in sales and risk of on-going OEM bankruptcy activity there could be a significant reduction in vehicle production. “If such an event were to occur without adequate notice, planning and financial support a significant number of suppliers, whose balance sheets are already highly overleveraged and whose sustainability remains highly fragile, would be forced out of business through sale, bankruptcy, or liquidation. The government’s offer of \$5B in selective financial aid to GM and Chrysler in our view is simply not enough to sustain the supply base, especially regarding the high technology and critical component linchpin suppliers critical to OEM production.”

2. Credit Markets

Given the auto industry’s significant capital requirements and the general mismatch of funding, steady access to lines of credit and asset-backed loans is essential for the survival of the supply base. For example, it is not unreasonable for a small supplier to be called on for the investment of \$2 to \$4 million to assist with the design, engineering and tooling for a component on a new vehicle program. However, typically suppliers receive payment for this investment after the launch of production through the piece price of the component. The supplier might not begin receiving any cash flow on their investment for 12 to 24 months and will not be completely reimbursed until the product ends production in another 36 to 60 months.

In a March 2009, association survey of its membership, it found that nearly 40 percent of the companies identifying commercial banks as their lead source of funding characterized their banker as “aggressively exiting” the automotive industry (this compares to only 10 percent that noted their banker as being very engaged with them). Small suppliers have little leverage with the large banking institutions – our loan exposure on any individual loan is very small for a bank and our potential revenue opportunity across all of a bank’s other services – cash management, currency exchange, etc. – is also low. This allows a bank to more easily walk away from our business and that leads to the third significant risk for smaller suppliers.

3. Customer Risk

Frequently, smaller suppliers are two or three levels removed from the final OEM customer. Decisions made at the top by OEMs influence individual decisions down through the entire supply chain. Without a doubt there is tremendous uncertainty where Chrysler and GM will be on the other side of their restructuring. What global competitive position they will hold? What sales market shares they will control? What vehicle programs they will produce? Ford, GM and Chrysler are on a path to significantly reduce their supply bases. For a small supplier, down in the chain, the uncertainty of not knowing what vehicles will be produced or which major first tier suppliers will survive equate to a significant increase in risk.

The financial condition of the supplier base is as precarious as it has ever been. The Federal Reserve Board of Governors reports that in March the entire U.S. supply base was running at 52 percent capacity utilization. Given the high fixed costs of the industry, suppliers typically target at least 70 percent, if not even 80 percent, just to break even.

D. FINANCIAL ASSISTANCE AVAILABLE TO INDUSTRY

Currently there are a number of Federal programs targeted at the automotive supplier sector. However, a number of the programs do come up short given the significant melt down in the

industry, in general, and given the specialized needs of smaller suppliers, in particular. In addition, none of these programs have addressed the needs of the heavy duty or aftermarket suppliers.

1. \$5B Auto Supplier Support Program

The Auto Supplier Support Program at the U.S. Treasury was designed to provide protection against the bankruptcy risk of GM and Chrysler and immediate liquidity. It offered the guarantee of receivables that would be paid on terms (typically 45 to 55 days) and immediate payment options. Of course, the program was not fully operational when Chrysler filed for Chapter 11, which left suppliers significantly exposed. In addition, the program targeted only the direct, first tier suppliers of GM and Chrysler. As such, smaller suppliers in financial distress are completely dependent upon their first tier customer to provide financial assistance down through the supply chain. Bank restrictions and loan covenants prevented many eligible suppliers from participating in the program.

2. Advanced Technology Vehicle Manufacturing Incentive Program (Sec. 136)

Section 136 of the Energy Independence and Security Act of 2007 authorized the Secretary of Energy to make grants and direct loans to eligible applicants for projects that reequip, expand, or establish manufacturing facilities in the United States to produce qualified advanced technology vehicles or qualifying components as well as for the engineering integration costs associated with such projects. The grant program had a set aside for small manufacturers. The program established by Section 136 is referred to as the Advanced Technology Vehicles Manufacturing Incentive Program (ATVMIP).

The FY09 Continuing Resolution authorized up to \$25 billion in direct loans to eligible applicants but did not fund the grant program. The Department of Energy (DOE) issued an interim final rule to establish regulations necessary to implement the loan and grant programs authorized by Section 136. Since the issuance of the rule, the DOE has received over 100 applications. MEMA understands that a majority of the applicants were component manufacturers. Of those component manufacturers, many of the applicants were smaller companies asking for monetarily smaller loan amounts, as compared to larger component manufacturer applicants.

While some of the projects from the smaller applicants may have qualifying components and interesting projects, the ATVMIP is probably not the most conducive or beneficial avenue for them to take, but, at the same time, is one of a very few opportunities currently available. These smaller companies are simply trying to find resources to help their advanced technology vehicle and/or qualifying component project(s) evolve.

3. Small Business Administration (SBA) Program

The Small Business Administration (SBA) programs have been at the foundation of small supplier support for decades. However, the SBA loan programs are limited to only \$2 million loans. Since suppliers are expected to fund a great deal of the research and development in the projects, the net worth and loan amounts have limited utility to our industry. Given the scale on which the auto industry operates, this limit is too low to help many suppliers. A recent OESA survey indicated that a \$3.5 to \$10 million level would be far more valuable for their financial future. Although small manufacturers should be able to turn to the SBA for loans, the current system is simply not designed to meet the needs of manufacturers with substantial raw material, research, and development costs.

4. U.S. Department of Agriculture Rural Development Loan Guarantees

The U.S. Department of Agriculture (USDA) Rural Development program can guarantee quality loans made by private lenders to business and industry involving manufacturing, wholesale, retail and services. Projects must involve the creation and/or saving of jobs. The purpose need not be agriculturally related. Loan purposes can include real estate, machinery and equipment, or term working capital. The USDA provides loan guarantees for manufacturers in rural communities. However, a facility must be located in a community that can not exceed 50,000 in population. These programs will have limited applicability to suppliers.

E. CONCLUSION AND RECOMMENDATIONS

Certainly, motor vehicle suppliers are feeling the brunt of the current downturn and massive restructuring in the industry. Nonetheless, there will be an auto industry on the other side of this major recession, the Chrysler bankruptcy, and GM restructuring. However, action needs to be taken that assures the industry's jobs and innovation will survive too. Suppliers are responsible for a growing share of the cost of innovation. Even so all suppliers, particularly the smaller manufacturers, have been inadequately assisted during these challenging times. Many of the structural issues facing the small suppliers will remain even once production volumes recover. Capital will likely be difficult to raise, the capital requirements will increase, and the knowledge base needed to support advancing technologies will accelerate.

Therefore, MEMA urges the Committee to address the needs of small suppliers by:

- (1) Authorizing a motor vehicle supplier program within the SBA to provide necessary funding for small suppliers;**
- (2) Supporting a simple-to-administer and aggressive new vehicle sales incentive program;**
- (3) Creating incentives for the purchase of new technology on all motor vehicles;**
- (4) Expanding retooling efforts to include small suppliers and allow for a wide range of retooling efforts;**
- (5) Encouraging the banking industry to resume lending money to motor vehicle suppliers once the Chrysler and GM situation is resolved; and**
- (6) Addressing training and other initiatives.**

In addition, MEMA urges the Committee to support:

- (1) Legislation to help automotive suppliers manage or reduce health care costs; and**
- (2) Establishing a mandatory national vehicle inspection program or a voucher program that permits consumers to get their vehicle inspected and serviced.**

We will be pleased to work with the Committee members on these initiatives.

###



APPENDIX A

THE SUPPLIER INDUSTRY

Motor & Equipment Manufacturers Association

MEMA represents its members through three affiliate associations: Automotive Aftermarket Suppliers Association (AASA), Heavy Duty Manufacturers Association (HDMA), and Original Equipment Suppliers Association (OESA).

Automotive Aftermarket Suppliers

U.S. aftermarket suppliers support the light-, medium-, and heavy-duty vehicle markets. In addition to hundreds of companies that manufacture only aftermarket products, a large number of original equipment suppliers also produce products used to service the vehicle following the sale. The result is an aftermarket industry that encompasses nearly 12,000 manufacturing locations supplying motor vehicle parts, chemicals, tools, equipment and accessories.

The aftermarket relies on virtually all of the 4 million employees who, directly or indirectly, owe their jobs to the supplier community. Employees work for manufacturers, remanufacturers, distributors, retailers, and installers that are essential to repair and maintain over 247 million cars and trucks that will travel a total of nearly 3 trillion miles annually, the equivalent of 6 million round trips to the moon. Simply stated, the aftermarket affords Americans the mobility to work, shop, and visit friends and family away from home.

Most aftermarket repair work takes place in a vehicle manufacturer's dealership service facility or an independent repair shop. There is also a strong "do-it-yourself" market – individuals who perform their own vehicle maintenance. Considering how many oil changes, brake jobs, batteries, filters, hoses, belts, and tires a vehicle requires in its lifetime, it is easy to see why the \$244 billion aftermarket segment is steadily growing.

The aftermarket industry also takes great pride in its leadership role by supplying solutions to our energy, environmental, and safety needs. Proper maintenance and repair performed by the aftermarket can improve a vehicle's fuel efficiency by as much as 40%. Aftermarket innovations such as energy-saving halogen light bulbs, tire pressure monitoring systems, improved fuel line technologies, and biodegradable lubricants, to name a few, actually save consumers gas, reduce CO2 emissions into the atmosphere, and utilize renewable, organic materials instead of fossil fuels. Moreover, remanufacturing saves enough raw materials to fill a train over 1800 miles long by utilizing parts that would otherwise be sent to landfills and saves 8.4 million tons of CO2 emissions from entering the atmosphere. Indeed, automotive recycling is 69 percent of all U.S. recycling.

In addition to energy and environmental leadership, aftermarket products such as extended-life brake friction products, LED lighting technologies, and back up detection sensors and camera systems enhance the safety of the driving public and the performance of our vehicles, while protecting American pedestrians and communities.

Heavy Duty Suppliers

Heavy duty suppliers provide the original equipment (OE) parts used to manufacture commercial vehicles and the aftermarket replacement parts needed to maintain the vehicles for service and repair. Heavy duty suppliers are also responsible for developing most of the advanced technologies that make these vehicles more safe, more fuel efficient, and have lower emissions. There are currently over 500 U.S. suppliers in the heavy duty commercial vehicle supplier industry. These companies provide most OE parts to the four major U.S. truck manufacturers – PACCAR, Navistar, Volvo/Mack, and Freightliner/Daimler Truck. The vast majority of these suppliers – over 85 percent – are considered small businesses.

Due to vehicle size, weight, lower volumes, and shipping costs, most heavy duty vehicle and parts manufacturing remains in the United States. This industry is dependent on a healthy economy generating freight ton-miles demand. Supplier success is impacted by economic cycles, changing vehicle manufacturer demands, production schedules, tight credit markets, and new diesel emission-reduction requirements, which have caused both spikes and steep drops in demand. Class 6, 7 and 8 trucks have seen an increase in cost of about \$25,000 per vehicle since the initial stages of the EPA three-phase “clean-diesel” regulations were enacted in 2002. This drives truck owners to avoid the cost of the next generation vehicles with a pre-buy on new trucks, causing a spike and cliff in sales patterns.

Light Vehicle Original Equipment (OE) Suppliers

Original equipment suppliers design, engineer, and manufacture parts required for the assembly of passenger cars and light trucks. OE suppliers interact directly with vehicle manufacturers, and their success is tied directly to the number of domestically produced vehicles. Each year, more than 300 new light vehicle models are sold in the U.S. – and each model contains 8,000 to 12,000 parts or components.

The auto supply base is one of the most intricate and multifaceted industrial complexes. On one side is the vehicle manufacturers – a dozen or so major original equipment manufacturers (OEMs) that dominate world production with sales measured in tens to hundreds of billions of dollars. On the other side are a dozen or so major material suppliers – the steel, aluminum and plastics providers – that also have sales measured in the tens of billions of dollars. In between are some 3,000 suppliers that produce the 10,000 parts that make up every passenger car and truck.

For North America, supplier sales range from \$1 million to \$11 - \$12 billion. The distribution of those 3,000 suppliers is in the shape of a pyramid with two-thirds of the supply base having revenues under \$250 million, the typical upper limit of a small automotive supplier. Mid-size suppliers tend to range from \$300 to \$600 million in revenue. The top 100 suppliers have North American revenues over \$400 million. Because of the significant concentration of sales in the largest suppliers, the industry considers a “small” supplier to be under \$250 million in sales. The majority of these small suppliers has under \$125 million in sales and employs 250 to 500 employees. A \$10 million supplier would be considered exceedingly small, and might represent a specialty tool shop of a fixture supplier.

The suppliers that make up this pyramid are mutually dependent upon one another. To illustrate the point, Supplier “A” can directly compete against Supplier “B” on one vehicle program and Supplier “A” can also act as a supplier or customer to Supplier “B” on another vehicle program. The OEMs and the suppliers are also mutually dependent. For example, 51 percent of GM’s suppliers are also in Ford’s supply base. By revenue dollars, the interdependency is even more dramatic – 90 percent of the dollar amount that GM spends with suppliers is with suppliers that also supply Ford.

Motor vehicle parts suppliers are responsible for more than two-thirds of the value of a new vehicle. In 2006, suppliers were responsible for nearly 30 percent of the total \$16.6 billion automotive research and development investment. Suppliers address a range of technologies on a daily basis and provide much of the intellectual capital required for the design, testing, and engineering of new parts and systems.