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Appraiser Blog

Auto Suppliers May Face Another Tough Year

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We might be in for a fourth year of challenges and setbacks for suppliers.

As parts suppliers navigate the uncertainty in the new-vehicle market and the economy, it's already shaping up to be another bumpy year as inflation and rising interest rates squeeze their finances. Due to a drop in sales volume as well as the continuing rise in raw material and labor costs, suppliers are feeling the squeeze right now.

As margins were cut by those issues and companies scrambled for price relief from customers, the number of suppliers in financial distress spiked in 2022. While automakers reported sizable profits in 2022, the microchip shortage continued into its second year, affecting production schedules and supplier volumes for parts companies.

As publicly traded suppliers report fourth-quarter and 2022 earnings results, the troubles will be revealed.

Suppliers sought pricing relief and changes to their contracts with customers as a result of unstable commodity prices and rising interest rates, which increased business costs. The war in Ukraine, for example, created further uncertainty in supply chains.

Despite signs of easing in inflation and microchip shortages in early 2023, these conditions are expected to persist well into the year ahead. There has been some improvement in the chip situation, and that will probably continue, but to think we're completely out of the woods seems a bit unrealistic.

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Financial Distress	
Period	**Suppliers in financial distress**
2020	45%
2021	27%
First half 2022	42%

Another scenario

Suppliers are preparing for a variety of scenarios in 2023 due to the persistence of those issues and the heightened economic uncertainty.

The expectation is that the first semester will be difficult for the industry, but conditions may improve in the second semester. Especially in North America, there is the possibility that the second half could be better with low demand and a soft landing in the US.

Not from today

Suppliers have been facing constant operating crises since 2019, when the UAW's strike against General Motors shook the supply chain. The pandemic, increment in costs of energy and raw materials, lack of labor, complications in logistics, factory shutdowns in China, production halts at subtier parts factories and market pressures posed by new electric vehicle programs or legacy fuel vehicles' phasing-out have aggravated such circumstances.

Despite this uncertainty, suppliers can now navigate it and emerge stronger than they were in 2019. The focus of this year should be on improving liquidity and profitability, while making sure the company is well-positioned for the era of electrification and connectivity in the long run.

It is likely that there will be many mergers and acquisitions over the next year, particularly in the field of electric vehicles, electronics and software. Companies looking to strengthen their positions in those areas may be able to find some value buys given the financial distress many companies find themselves in.