Business prospects for the Auto Parts Industry remain mixed. While the majority of companies in the sector reported good June-quarter results, thanks to improving demand for auto parts, there are some headwinds that are still concerning. These include persistent inflationary pressures on costs, high interest rates, and the potential for a recession in the United States, although the economy has continued to perform surprisingly well thus far. Another concern is the softer-than-expected growth in China, the largest auto market in the world.

Despite these challenges, the overall demand picture remains firm. Global vehicle production volumes are expected to rise modestly this year, driven by solid demand from North America and Europe, partially offset by softness from China. Improving supply-chain constraints, along with increased availability of semiconductor chips, are also positives for the industry. Most firms also continue to have strong pricing power, which has allowed companies to raise prices on their products without hurting demand much. All told, we expect most companies in the industry to post higher sales and earnings in 2023.

As indicated in previous reports, our discussion on the Auto Parts Industry is centered around vehicle sales and production levels, as they are directly correlated with the industry's fundamentals. These market conditions vary greatly geographically. As such, results can diverge vastly for companies with different core geographies, so investors should take note.

Favorable Trends Thus Far

The majority of companies in the Auto Parts Industry reported good top- and bottom-line growth in the March and June quarters. Most have been benefiting from solid overall demand trends. Light-vehicle production in both North America and Europe has continued to rise at a modest rate during the first half of 2023, and we expect this trend to continue for the remainder of the year. However, light-vehicle production remains muted in China, as that country's economy has grown at a slower-than-expected rate after its reemergence from COVID-19 restrictions. The sector has been seeing an easing of supply-chain constraints, which has allowed for more-efficient production of auto parts. Semiconductor chip shortages have also diminished in recent weeks. Many companies, including *Aptiv*, have seen favorable trends in which dealers are restocking their inventories. That company is also benefiting from greater content-per-vehicle. Many firms have also benefited from favorable fundamentals, which has allowed them to raise prices. Too, the average vehicle age is high by historical standards, which also augurs well for the Auto Parts Industry.

But Some Headwinds Persist

Despite the solid demand environment, some clouds remain on the horizon. Inflation, while slowing, is still a problem for many companies, as costs for everything from labor to materials remain elevated. This has pressured margins for most. Higher interest rates, used by the Federal Reserve to combat inflation, is also making it more costly for customers to borrow and make purchases. Elevated rates have significantly increased interest expense for many parts makers, too, which has hurt the bottom lines. We are also concerned about the global macroeconomy. While the United States has thus far avoided a downturn, this could very well change in the next six to 12 months. If this happens, it will certainly temper demand for auto parts. The ongoing conflict in Ukraine is another unwelcome headwind.

INDUSTRY TIMELINESS: 29 (of 93)

Top Pick

One of our top selections in the Auto Parts Industry is *Lear Eaton Corporation*, a supplier of complete automotive seat systems and electrical power management systems to nearly every automotive manufacturer in the world. In the June quarter, the company recorded record sales, driven by gains in both the Seating and E-Systems divisions, thanks to higher production volumes on Lear platforms and new business. Share earnings jumped 87%, to $3.33, driven by the higher sales and ongoing cost savings initiatives. The outlook seems favorable at the current juncture, thanks to the expectation of solid global industry vehicle production, particularly in North America and Europe. *Lear* should also benefit from its expanding electrification business, as more vehicles shift away from internal combustion engines toward electric and hybrid systems.

Conclusion

All told, the business outlook for the Auto Parts Industry remains mixed. On the one hand, fundamentals remain firm, which is driving solid sales growth. Global industry vehicle production should rise modestly, supporting demand. Favorable pricing is another positive. However, inflationary pressures on costs, while moderating, are still hurting margins. High interest rates are also a concern. Global macroeconomic uncertainty is a negative, as well. As always, investors are advised to review the following individual reports before making any commitments.

Iason Dalavagas