Business prospects for the Auto Parts Industry remain very challenging. The global spread of the coronavirus pandemic has caused a historic drop in demand for auto parts, as many OEMs were forced to shut down production facilities in March and April. The sector was already seeing signs of weakness before COVID-19 appeared, with auto sales declining roughly 4% in 2019, the second-consecutive year of contraction. Given the current environment, 2020 will almost certainly be the third year in a row of auto production declines.

While most auto manufacturers are now back up and running, we do not expect a return to pre-COVID-19 production levels in the near term. Manufacturing facilities began to reopen in May and June, but the coronavirus is still spreading in many parts of the United States, and we are also seeing a resurgence in some areas of Europe. As a result, we anticipate continued volatility in the coming months, as no one can predict the magnitude or duration of the pandemic's effect on business.

As indicated in previous reports, our discussion on the Auto Parts Industry is centered around automotive 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.

A Disastrous June Quarter For Most

It is safe to say that the June quarter was probably one of the worst quarters in history for the Auto Parts Industry. The vast majority of companies in the sector posted significant declines in sales, while many posted huge operating losses. This, of course, was not unexpected, as the industry has been devastated by the global spread of the coronavirus. The disease spread from China, to Europe, and finally to the United States, wreaking havoc in its path. Several companies posted revenue declines in excess of 50%, as production facilities were suspended or idled for several weeks and governments imposed strict stay-at-home measures.

One of the hardest hit companies was *Lear Corporation*. The Tier 1 supplier of automotive seat systems and electrical power management systems reported a 55% drop in volumes in its major global vehicle markets during the June period. This caused the company to post a significant loss of $4.14 per share for the quarter. While the company expects results to improve in the second half of the year, it still anticipates a 10%-15% decline in global auto production.

Taking Steps To Improve Cost Structures

Given the unprecedented drop in demand in the June quarter, management at most companies took drastic steps to keep expenses in line with the significantly lower volumes. Those who were able to do so quickly and efficiently were able to salvage some profitability in the June interim, while those who did not were crushed with significant operating losses. Many companies cut salaries, discretionary spending, and SG&A costs. Others undertook restructuring actions to improve manufacturing efficiency. Several furloughed employees for a few weeks and shut down branches. These steps helped to partially soften the blow from the pandemic.

INDUSTRY TIMELINESS: 69 (of 95)

Shoring Up The Balance Sheets

Many companies in the Auto Parts Industry have taken steps to strengthen their balance sheets. Some have continued to pay down debt, or repay loans from revolving credit facilities. Sufficient cash on the balance sheet can provide a company with some breathing room, allowing it to weather short-term uncertainty related to COVID-19. *Dorman Products* is a good example, as it recently paid off $100 million from its revolving credit line and currently has no outstanding long-term debt. It also has a solid cash balance of roughly $360 million.

Top Pick

At the current juncture, there is only one stock in the Auto Parts Industry that is ranked favorably for year-ahead price performance, *Gentex*, and even that company struggled mightily in the June interim. Management noted that it expects a significant sequential improvement in total light-vehicle production in the second half of the year, particularly in North America. Demand for the company's core auto-dimming mirror units ought to pick up in the coming months, especially as these products become more widely sought after in the industry. Cost-reduction initiatives should help the company return to year-over-year earnings growth in the December period.

Conclusion

All told, the business outlook for the Auto Parts Industry remains difficult. The sector reported arguably one of the worst performances in its history during the June quarter. While prospects appear to be improving, with most companies expecting to report better second-half results, there is still a significant amount of uncertainty related to COVID-19 and its effect on the sector. While many stocks in the industry offer wide price appreciation potential over the 3- to 5-year period, visibility remains very limited, and volatility will probably remain elevated in the near term. As a result, most investors should proceed with caution, and are advised to review the following individual reports before making any commitments.

Iason Dalavagas