

INDUSTRY TIMELINESS: 58 (of 97)

The business outlook for the Auto Parts Industry has continued to improve over the past few months. Most companies in the industry have been benefiting from the recovering global economy, thanks to surging vaccination efforts across much of the world. As a result, we believe most auto parts firms will post significantly stronger sales and profits this year. Car sales were up significantly in the March quarter, which drove robust demand for auto parts. Demand from China, the world's largest market, has been especially strong thus far in 2021, with passenger vehicle sales jumping 76% year over year in the first quarter.

However, there is still a good amount of uncertainty related to the coronavirus pandemic, particularly in India and South America, where the coronavirus has been raging. Sales to customers in those countries will likely remain soft in the near term, as business shutdowns and shelter-in-place orders will probably remain in effect over the coming weeks and months. Other concerns facing the industry include ongoing supply chain disruptions and semiconductor shortages. High commodity costs, including for steel, and elevated freight expenses will also likely remain a headwind in the near term.

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 Good Start To The New Year

Most companies in the Auto Parts Industry reported good results in the March period. The U.S. economy began to reopen during the period, and shelter-in-place restrictions began to be lifted. This helped drive a solid rise in vehicle production which, in turn, helped boost demand for auto parts. China has seen especially robust demand in recent weeks, which has helped boost results for those companies with a strong presence in that country, including *Adient plc*. Other companies are benefiting from the recovery of the construction and infrastructure markets, including *Allison Transmission*. Most firms are also seeing tail winds regarding favorable foreign exchange rates and pricing.

However, the industry is still facing some headwinds. Supply chain disruptions, due to the impact of the coronavirus pandemic, remain a problem for many. While this situation is slowly getting better, this may continue to pressure margins in the near term. Other challenges include the ongoing shortage of semiconductors, which has tempered auto production growth, and elevated costs for materials, including steel. Freight expenses have also been very high. However, management at most companies have done a good job of passing these costs on to customers through higher prices. The bottom lines at the majority of companies have also been supported by restructuring efforts, including cost controls, and the return of share-repurchase programs.

Vehicle Electrification

The Auto Parts Industry is poised to benefit from the ongoing trend toward the electrification of vehicles. *Aptiv plc* should see significant growth in its High-Voltage electrification segment. Sales of these products ought to jump 55%-60% this year, thanks to strong demand from China and Europe. Many auto companies are prioritizing electric vehicle production as a way to pivot away from traditional cars and trucks that are powered by internal combustion engines. We think this will drive strong earnings for those manufacturers that are focused on that segment of the industry.

Top Pick

One of the top picks in the Auto Parts Industry is *Magna International*, the largest auto parts manufacturer in the United States. It is expected to position itself as a leader in electric motors and self-driving systems. March-period results were impressive, with sales jumping 18% and share net more than doubling the previous-year tally. The company's ongoing investments in China are also expected to pay off handsomely. Another top pick is *Valvoline Inc.*, the producer of automotive lubricants and chemicals. The company has been on a roll of late, and its stock price has reflected that, increasing 30% in value in the past three months. Valvoline has been benefiting from the overall improvement in the broader automotive market.

Conclusion

All told, business prospects for the Auto Parts Industry continue to improve, thanks to the broader global economic recovery, which is boosting vehicle production. Robust pent-up demand for vehicles and their related parts should support good sales and earnings gains for most companies this year. While supply chain issues and elevated material costs remain a concern in the near term, most companies have done a good job alleviating these short-term problems. As always, investors are advised to review the following individual reports before making any commitments.

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