

The business outlook for the Auto Parts Industry has rebounded since our last report in September. After a disastrous June-quarter performance from most manufacturers, due largely to COVID-19-related plant shutdowns and shelter-in-place orders, most companies in the sector posted strong sequential growth in the September period. Global auto production levels rebounded more quickly than most had anticipated over the past several months.

However, the sector is by no means in the clear. The number of coronavirus cases around the globe, particularly in the United States and Europe, has spiked in recent weeks. As a result, we may see the return of plant shutdowns and shelter-in-place orders in the coming weeks as the weather gets colder and the spread of the virus becomes more intense. As a result, we don't anticipate a full recovery of the Auto Parts Industry in the near term. We note that 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.

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 Strong Rebound

After what most investors would call a disastrous June quarter for the majority of the companies in the Auto Parts Industry, many manufacturers reported solid to strong sequential results in the September period. Sales and earnings bounced back thanks to a strong rebound in global auto production levels, which are nearly back to pre-coronavirus figures. The full re-opening of production facilities, and the larger global economy as a whole, helped support the advance. For example, BorgWarner posted June-quarter sales of \$1.426 billion, nearly double the tally from the September period. We note the company also announced the acquisition of Delphi Technologies for \$2.4 billion. The deal ought to help it strengthen BWA's electronics and power electronics products, capabilities, and scale. Another strong sequential performance was from Dana Incorporated, which also nearly doubled sales from the June to September period. Improvement was driven by robust demand for light-truck and agriculture products.

But Concerns Remain

Unfortunately, the outlook for the rest of the year remains cloudy. Many regions across the globe are seeing significant spikes in coronavirus cases, most notably in the United States and much of Europe. California, the largest economy in the United States and one of the top economies in the world if it were a sovereign nation, is seeing a staggering rise in coronavirus cases in recent

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weeks that may well overwhelm the health system and force drastic actions, including stay-at-home orders and production facility closures. The number of cases in the United States is currently far exceeding the peaks seen in the spring and summer. Other countries are dealing with similar concerns. As a result, there is a significant amount of uncertainty related to the Auto Parts Industry as a whole. If stay-at-home orders and production facility closures reappear, the industry could see another disastrous few weeks that it experienced earlier this spring.

Top Pick

One of the top picks in the Auto Parts Industry is *Dorman Products*. The supplier of original equipment dealer auto replacement parts posted strong year-over-year sales and earnings gains in the September quarter. The advance was driven by robust customer demand for most of the company's goods. Margins were boosted by the higher volumes, along with better productivity at its Portland, Tennessee distribution facility. We think the positive momentum will continue through the end of this year, and into 2021, as demand trends remain favorable. However, as we noted, ongoing concerns regarding recent spikes in coronavirus cases add a significant degree of uncertainty here.

Conclusion

All told, business prospects for the Auto Parts Industry have improved in recent weeks, but we are also very concerned about the surge in COVID-19 cases across much of the globe. Most companies are cautiously optimistic about pending December-quarter results, but there is much uncertainty. As a result, visibility remains very limited. Nevertheless, initiatives made by management at most companies, including cutting costs and shoring up balance sheets, should help support results longer term regardless. Most investors should proceed with caution here, and are advised to review the following individual reports before making any commitments.

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