

INDUSTRY TIMELINESS: 3 (of 97)

The Auto Parts Industry, which has been on the road to recovery since the recession, has performed well of late. These equities are, for the most part, trading at or close to multiyear highs, and nearly a third of the sector registered double-digit price advances over the past three months. Notable mentions here include *Gentherm*, *Standard Motor Products*, *Cooper Tire & Rubber Company*, and *Meritor*. Consequently, the industry's Timeliness rank is top-notch when compared to all sectors covered in *The Value Line Investment Survey* (3 out of 97).

The industry's rebound has progressed nicely into the first quarter of 2014, as companies continued to build on last year's momentum. Automotive sales and production levels, which are directly correlated to industry fundamentals, have improved in North America, Europe, and the Asia/Pacific region. Overall, strength in the U.S., coupled with stabilization in Europe, along with positive emerging market growth, should prove to be a continuing trend this year. Sector stocks, for the most part, appear poised for healthy top- and bottom-line advances this year.

The Domestic Market

Despite a slow start to the first quarter, largely due to harsh weather conditions during January and February, the U.S. automotive market has remained relatively strong. The seasonally adjusted annual rate (SAAR) of light-vehicle sales, which has increased year-over-year since 2009, should remain on an upward trajectory. To wit, the SAAR for the month of May reached prerecession levels, hitting marks not seen since 2007. Looking ahead, total light-vehicle sales in 2014 and 2015 are expected to reach 16.0 million units and 16.4 million units, respectively, exceeding the 15.5 million reported in 2013. Indeed, auto sales and production will likely continue to expand at a solid pace, on the strength of improving economic conditions, increasing consumer confidence, lower unemployment, and low interest rates. Pent-up demand, the average vehicle age (which is over 11 years), number of vehicles in operation, and miles driven, should also generate demand, especially for replacement parts. All told, we think favorable demand/production momentum will persist in 2014 and into 2015. However, the rate of recovery of the last several years will likely continue to moderate.

Prospects In Europe

The economic direction in Europe, particularly the automotive industry, has turned the corner. Conditions appear to be stabilizing, prompting a slow rise in European auto sales/production off of the bottom, which was at a 20-year low in 2013. Still, Europe has yet to fully recover, reflecting soft demand and low consumer confidence, primarily in the Western region. This will likely continue to pose challenges both this year and next. Consequently, those with high exposure to Europe have implemented restructuring programs and various cost controls, such as downsizing or closing manufacturing facilities, moving production to lower-cost sites, and realigning capacity and spending to the current environment, to offset these headwinds. Companies, including *Federal-Mogul Corporation*, *Fuel Systems Solutions*, and *Delphi Automotive*, among others, are aiming to streamline their cost structures, expand margins, and mitigate pressure on the bottom line.

China And Emerging Markets

Emerging-market growth has, in most cases, been a bright spot, but lately, has shown increased signs of volatility in certain regions, specifically South America, India, Brazil, and Russia. Factors, such as currency losses, tempered automotive production, and a slowdown in consumer demand for vehicles, could adversely impact the revenue and profit outlooks for those companies with high exposure to these locations.

Nevertheless, China, the largest automotive market in the world, remains a highlight. Despite a modest slowdown in its economy, which is a cause for concern, China is still well positioned for solid gains in the year ahead. We reiterate that although growth has moved in a positive direction, it tends to waver on a sequential basis, which may pose certain near-term challenges. Meanwhile, large car manufacturers continue to globalize platforms, which augurs well for suppliers with a strong international presence, rather than smaller, domestic ones.

Conclusion

The Auto Parts Industry, as a whole, holds short- and long-term appeal. The sector offers a wide selection of momentum plays, reflecting favorable price and earnings gains of late. Indeed, *Goodyear Tire & Rubber*, *Tenneco*, *Standard Motor Products*, *Magna International*, *Lear Corporation*, *Federal-Mogul Corporation*, *China Automotive Systems*, *TRW Automotive Holdings*, *Delphi Automotive*, and *American Axle & Manufacturing Holdings* all hold our Highest (1) Timeliness rank. In addition, investors with a long-term agenda may want to take a look here, as many equities offer above-average capital appreciation potential over the pull to 2017-2019. This assumes continual growth in automotive demand/production over time.

Still, conservative accounts should proceed with caution, as the majority of stocks have Below-Average Safety ranks, above-market Betas, and low Price Stability scores, indicating volatile price movements.

We encourage investors to read the individual reports for a more detailed evaluation of the investment merits of these stocks before committing funds.

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