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Challenges and Potential Remedies for Auto Suppliers in the Wake of COVID-19

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Manufacturing Interruption

For the past several weeks, in Michigan as well as other states, OEM production temporarily halted, presenting challenges to automotive suppliers, as well as their lenders and investors, to accurately project available liquidity and required capital in the near and medium term. While governmental restrictions on manufacturing are slowly easing, the future is still uncertain. In Michigan, manufacturing facilities are restarting operations on May 11, including automotive suppliers, and the Big 3 have agreed not to restart until May 18 (and only at 25 percent capacity initially). Additionally, manufacturing in Michigan may not restart until the facility has been prepared to follow enhanced safeguards. Such facilities are required to adopt special safety measures, including conducting entry screening protocols for workers and anyone entering the facility each day, requiring a questionnaire covering symptoms and exposure to people with possible COVID-19 infections, and temperature screening as soon as no-touch thermometers may be obtained. Such facilities must also create dedicated entry points and prohibit entry to all non-essential in-person visits, including tours, as well as train employees on COVID-19-related issues like how the virus spreads, signs and symptoms, steps workers must take to notify the business of suspected or confirmed diagnoses, and the use of personal protective equipment. Additionally, all manufacturing workers in Michigan must wear masks when they cannot consistently maintain six feet of separation. These requirements create additional variability and uncertainty as to the timing of the manufacturing restart for the OEMs and their suppliers.

Access to CARES Act Lending Programs

While lenders are generally taking a pause regarding enforcement of loan covenants and remedies, suppliers are under internal and external pressure to project future sales, manage cash flow and liquidity, and plan for required capital expenditures. Accessing short-term liquidity is among the highest priorities. The federal stimulus package known as the CARES Act authorized funding for certain liquidity programs, including the Small Business Association’s Paycheck Protection Program

(PPP).

While the PPP has provided much-needed, short-term liquidity to small businesses with favorable loan terms (including the potential to qualify for loan forgiveness), automotive suppliers have faced challenges accessing this program due to eligibility requirements. An entity generally is eligible for the PPP if it, combined with its affiliates, (i) is a small business concern as defined in Section 3 of the Small Business Act and meets the SBA employee-based or revenue-based size standard corresponding to its primary industry or the SBA's alternative size standard, or (ii) has 500 or fewer employees. Due to these somewhat restrictive eligibility requirements, many automotive suppliers do not qualify for the PPP.

An additional source of financing on the horizon is the Federal Reserve's Main Street Lending Program (Main Street Program), which utilizes CARES Act funding and will provide up to $600 billion in liquidity to lenders that make direct loans to eligible businesses. Compared to the PPP, the Main Street Program will be open to a more expansive pool of businesses. As announced by the Federal Reserve on April 30, the Main Street Program is available to for-profit businesses with up to 15,000 employees or up to $5 billion in 2019 annual revenues. While the Main Street Program does not have a loan forgiveness component, it could be an attractive liquidity option for automotive suppliers that were in sound financial condition before the pandemic and remain bankable in the eyes of their lenders. As of May 9, the Main Street Program is not operational and the Federal Reserve has not confirmed a start date.

Mexico's Shut-Down Order

The global automotive industry inextricably links Mexico to the rest of the North American automotive supply chain, including American companies. Hard on the heels of the ratification of the United States-Mexico-Canada Agreement , in 2020 the automotive supply chain faces a new problem when it comes to Mexico: the COVID-19 pandemic. Mexico, a major supplier of auto parts for U.S. automotive companies, has temporarily shut down non-essential trade and shuttered non-essential business until May 30. This order was originally set to expire on April 30 but was extended for another month. In the U.S., automotive manufacturing is beginning to restart as noted above. To date, Mexico has not provided any indication that it deems suppliers of automotive companies to be essential businesses, creating even more uncertainty for automotive suppliers in the U.S.

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