In Failing Auto Supply Sector, 'Big Three' Means Hedge Funds

by Paul Gallagher

A shocking measure of the disintegration of the strategically vital auto-supply industrial sector—the largest and most versatile store of machine-tool skills in the modern economy—was given in early January. The firm Hedge Fund Research published its finding that at the end of 2006, hedge funds and private equity funds (the distinctions between these two varieties of financial locusts have been disappearing) controlled auto-supply industrial assets worth $1.1 trillion internationally, and about $400 billion in North America. The magnitude of this control has doubled in just three years.

The auto industry, until recently, continued to be the largest center of industrial research and development investment in the economy. Auto supply firms have frequently received R&D contracts from NASA, for example, as Delphi Corporation recently did to develop welding methods for NASA's Space Power Development Program. Hedge fund control of, or speculation in, these firms—always contingent on continual reduction in their costs invested in production and research, in order to maximize their profits to investors—is as far as one can get from the entrepreneurial model of closely held firms which have created this industry's unique capabilities since the first days of Henry Ford.

The auto industrial sector is moving under increasing control of hedge funds as it is shrinking more and more rapidly, and as Congress has failed to act on well-known and completely feasible legislative proposals to intervene and save auto for a national infrastructure mission.

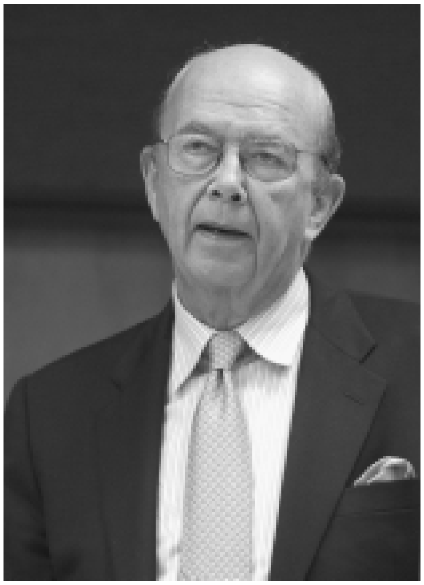
Over the period 2000-06, total auto and auto-parts employment in the United States has shrunk from 1.33 million to 1.047 million, a drop of about 22%; clearly, Toyota, et al. production and suppliers coming in, have in no way offset the massive loss of jobs in existing producers. And that shrinkage rate is accelerating. MLive.com published a comprehensive survey of the auto industry in the Western New York region, which shows that there, from mid-2005 to early 2007 alone, auto employment will have dropped by 27%, from 10,400 to 7,630 or less. In neighboring Ontario, the largest center of auto and parts production in North America, employment fell by 10% just during 2006, from 135,000 to 122,000, with most of the loss coming in auto supply firms rather than major automakers. In Michigan, the second-largest production and design center on the continent, another 12,000 auto jobs were lost during 2006. Further south, the metropolitan area of Norfolk-Hampton Roads, Virginia is a typical example: It is likely to lose about 3,000 auto jobs in 2007 from Ford and suppliers Visteon, Johnson Controls, Tenneco, TDS/US, and truck hauler Allied Systems. TDS's and Visteon's plants, likely to close, are brand new, opened in 2003 at a total investment of more than $20 million.

It is just this shrinkage process that the hedge fund and private equity vultures are watching, pricing, and buying up.

Three-Headed Hedge-Fund Dog

Commenting on the ongoing takeover of control of the biggest U.S. parts producer, bankrupt Delphi Corp., for $3.4 billion by the Cerberus and Appaloosa hedge funds, an equity fund analyst in Chicago, quoted in the *Detroit News,* epitomized the tearing up of the auto industry: " 'If they can buy in on the cheap, lower wages, and cut costs, the deal might make sense. There are attractive growth opportunities for parts suppliers globally in places like China, Eastern Europe, and other emerging markets.' " These motivations make clear that even after the loss of over 20,000 Delphi workers in 2006 through early-retirement buyouts—some, replaced by new hires making half as much and earning no benefits—the United Auto Workers will still confront demands for further wage cuts. And the process of closing or selling off three-quarters of Delphi's U.S. plants will continue. A half-dozen of the the plants may be sold to a private equity shark firm with a 20-year bottom-feeder rap sheet, megalo-millionaire Ira Rennert's Renco Group, Inc. Another 15 or so Delphi plants have closed or will shut down.

Cerberus, the three-headed dog of Hell, started out in 1992 with investments inclusively from the organized crime-linked first funder of the Democratic Leadership Council, Mike Steinhardt. It went from the "distressed debt" market to private equity takeovers, and is now so large it's no longer called a "fund," but a "New York-based financial conglomerate." With its purchase of Austria's BAWAG bank, Cerberus controls two banks and America's seventh-largest financial institution, General Motors Acceptance Corp. (GMAC), and a total portfolio of 50 companies with employment of over 250,000. Hard on taking control of Delphi, Cerberus is heading into a bidding war for what may turn out to be the largest "leveraged takeover" of the current takeover bubble, of Equity Office Properties for something like $40 billion in new



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"Vulture capitalist" Wilbur Ross, Jr. commands tens of billions in takeover capital and "leverage." He is also a moneybags for the New York Democratic Party.

debt. The conglomerate has been involved in a number of Enron-like conflicts of interest and illegalities in previous takeover battles. But since taking over Air Canada in 2004 with the help of Trilateral Commmission insider Brian Mulroney, Cerberus has put forward an Establishment face, hiring Treasury Secretary Jack Snow, as its CEO, for example.

Expecting to continue to return 15-20% annually to its investor-speculators, Cerberus has nothing but a short-term financial-return interest in any of the companies it controls: Yet, it is now dominant in what was the world's largest auto company, GM—which recently included Delphi as a division, as well as GMAC.

The WL Ross & Co. group of hedge funds run by Rothschild, Inc. bankruptcy expert turned "vulture capitalist" Wilbur Ross, is a smaller beast than Cerberus, but with Ross's recent link up with London-based AMVESCAP, he can command tens of billions in takeover capital and "leverage."

Ross was expected by many to take control over Delphi from his old looting partner, Delphi's pirate CEO Steve Miller. Instead, WL Ross's funds during 2006 took control of other big auto-supply firms: the large auto interiors and supply business of Lear Corp.—26 production plants employing 10,500 workers—and the European operations of Collins & Aikman, while apparently walking away at the last moment, from a takeover investment in Collins & Aikman's primary production operations, in North America.

The result: Collins & Aikman suddenly announced in December that it would not emerge from bankruptcy, as it had anticipated with the purchase by WL Ross, but rather liquidate one of America's premier auto-supply and R&D firms.

A Second Delphi Disaster

Collins & Aikman was sunk by rapidly falling orders combined with enforced price-cutting by major automakers, in particular, Ford (its Ford revenue fell from $710 million in 2005 to $540 million in 2006, leading to a production breakdown-cutoff in October); and by Ross's hedge funds' apparent decision not to pick up more of the pieces.

The firm's liquidation is "a second Delphi disaster" for the auto industry and for U.S. machine-tool capabilities, but a more rapid one. This is a 163-year-old family-owned firm, with a high proportion of R&D, machine-tool, and product development in acoustical materials, instrument panels, turbines for small aircraft, etc. The firm has three tool-and-die centers and three other design centers, comparable to GM or Ford with 5-7 times the workforce. C&A owns at least 45 plants in North America with 14,000 employees, and through a partnership with Dura Automotive (also in bankruptcy), as many as 60 plants with 20,000 employees being impacted by the breakup/liquidation plan. In rapid order, six plants will close by March, with the loss of 1,560 jobs: in Americus, Georgia this month; Gananoque and Scarborough, Ontario in February; in Dover and Farmington, New Hampshire and Kitchener, Ontario in March.

As for Lear, it has indicated since WL Ross's December takeover, that it would also likely have liquidated its auto supply division, had the hedge fund not taken it over. Bruce Raynor, the head of the UNITE HERE union which represents its 10,000 employees, says the workers "will be called on to make sacrifices" under the hedge fund's control. But Raynor credits Ross, a big New York Democratic Party and Democratic Leadership Council (DLC) funder, with "saving" Lear—as did Steelworkers President Leo Gerard when Ross took over Bethlehem Steel, "sacrificed" its pension and retiree health-care plans, and sold it off to Mittal Steel.

Thus, big hedge funds and private equity funds are gaining the apparent power of life and death over the most important auto supply companies and their industrial capacity.

Another major, bankrupt auto-parts firm, Tower Automotive, announced on Jan. 12 that three hedge funds had walked away from a $250 million equity purchase on which was based Tower's plan to exit bankruptcy—just what happened to Collins & Aikman. The three are Ripplewood Partners, Strategic Value Partners, and Stark Investors. The result is not yet definitive, since Tower is in other, now-desperate negotiations for capital. But it is likely to default this month, and this hedge fund decision, too, may result in a major auto supply liquidation. Tower has been operating 60 plants with 12,000 workers, including 20 U.S. facilities and 12 in Europe.

Ripplewood will control another large U.S. auto supply firm with 6,500 employees, Metaldyne, whose takeover by Japan's Asahi Tec should be final on Jan. 15. Asahi is controlled, through a Japanese bank, by Ripplewood.

The number of machine-tool-capacity plants in North America and Europe, at the mercy of month-to-month profit and junk-bond "leverage" decisions by hedge funds and private equity funds, is now well up in the hundreds.