

# What Does Wall Street Want ... From the Auto Industry

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*Federal Reserve Bank of Chicago  
Ninth Annual Automotive Outlook Program  
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# Altarum Institute

- ▲ Altarum Institute – serving automotive, national security, healthcare, and energy and environmental sectors with
- ▲ Research, development, and deployment of advanced data collection, analysis, simulation, and modeling techniques and
- ▲ A broad-base of collaborative initiatives
- ▲ \$50 million of activities with 360 employees in Ann Arbor; Washington, D.C., and San Antonio

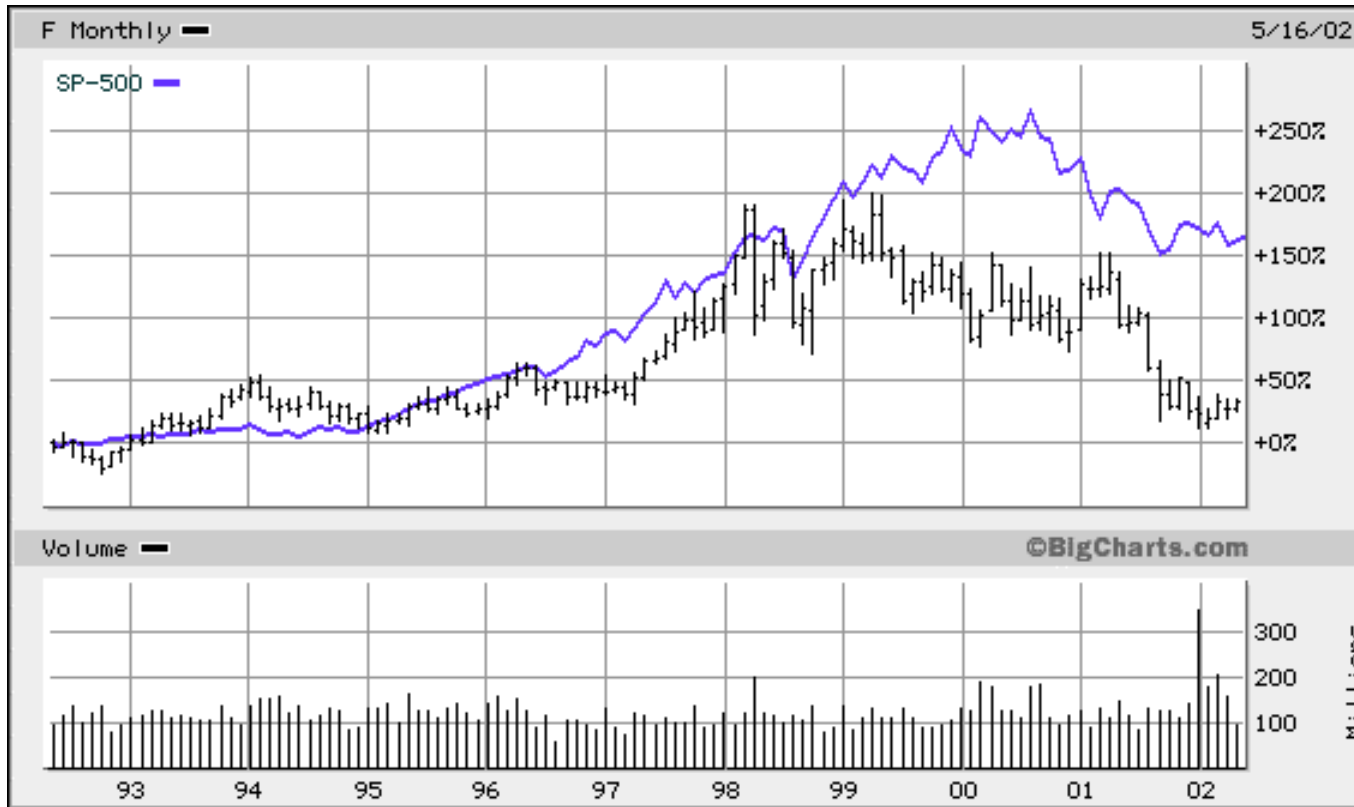
# Center for Automotive Research

- ▲ Research activities
  - Forecasting
  - Economics and Business
  - Manufacturing Systems
  - Transportation & Information
- ▲ Conference activities
  - Management Briefing Seminars
- ▲ Corporate and academic interface
  - MAP membership track record
  - Non-competitive to groups with labs and academic programs
- ▲ Credible partner
  - Protection of proprietary data and access to industry
- ▲ \$4.5 million of activities produced by 22 people

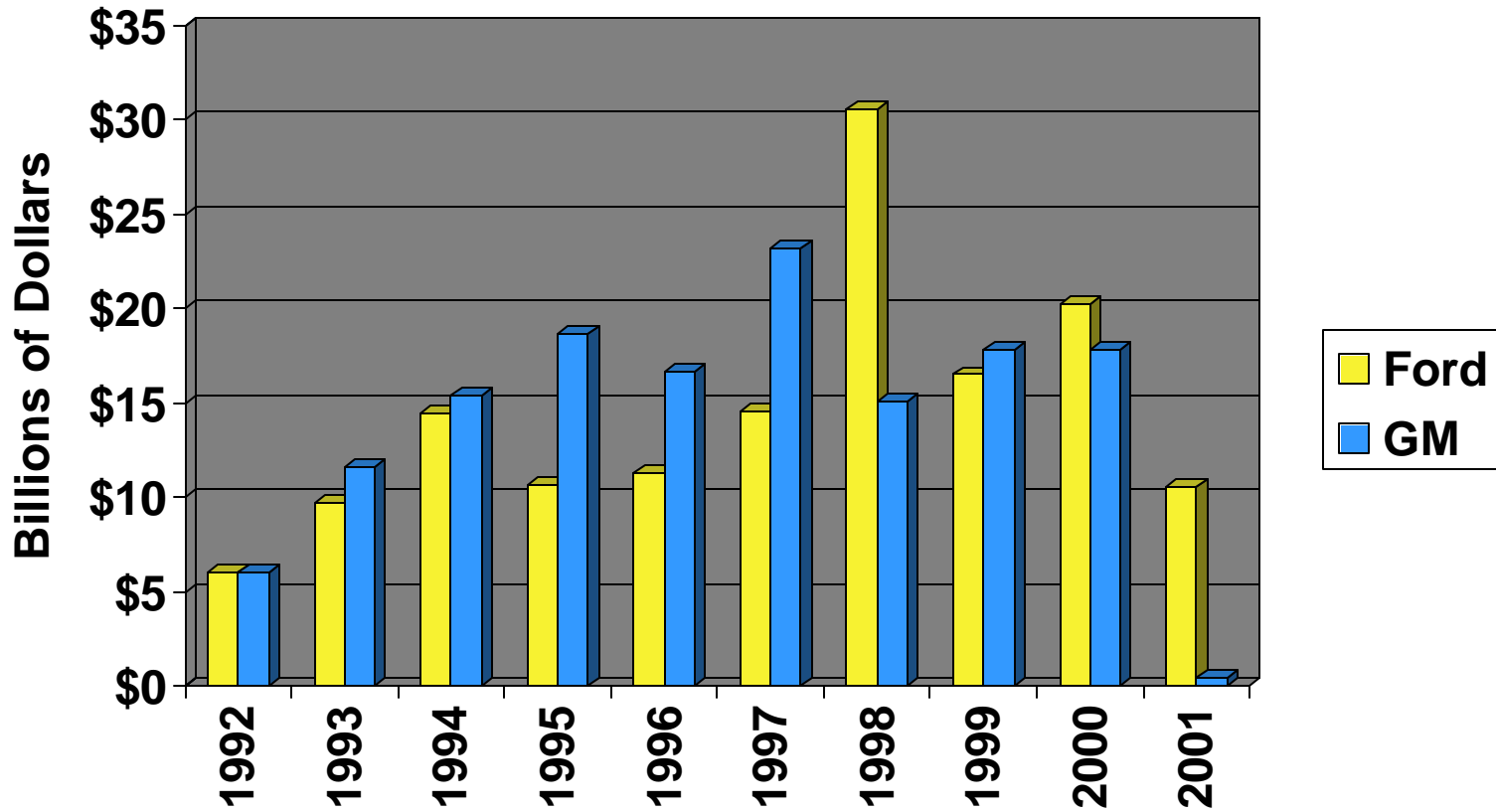
# GM to S&P 500



# Ford to S&P 500



# Cash Flow



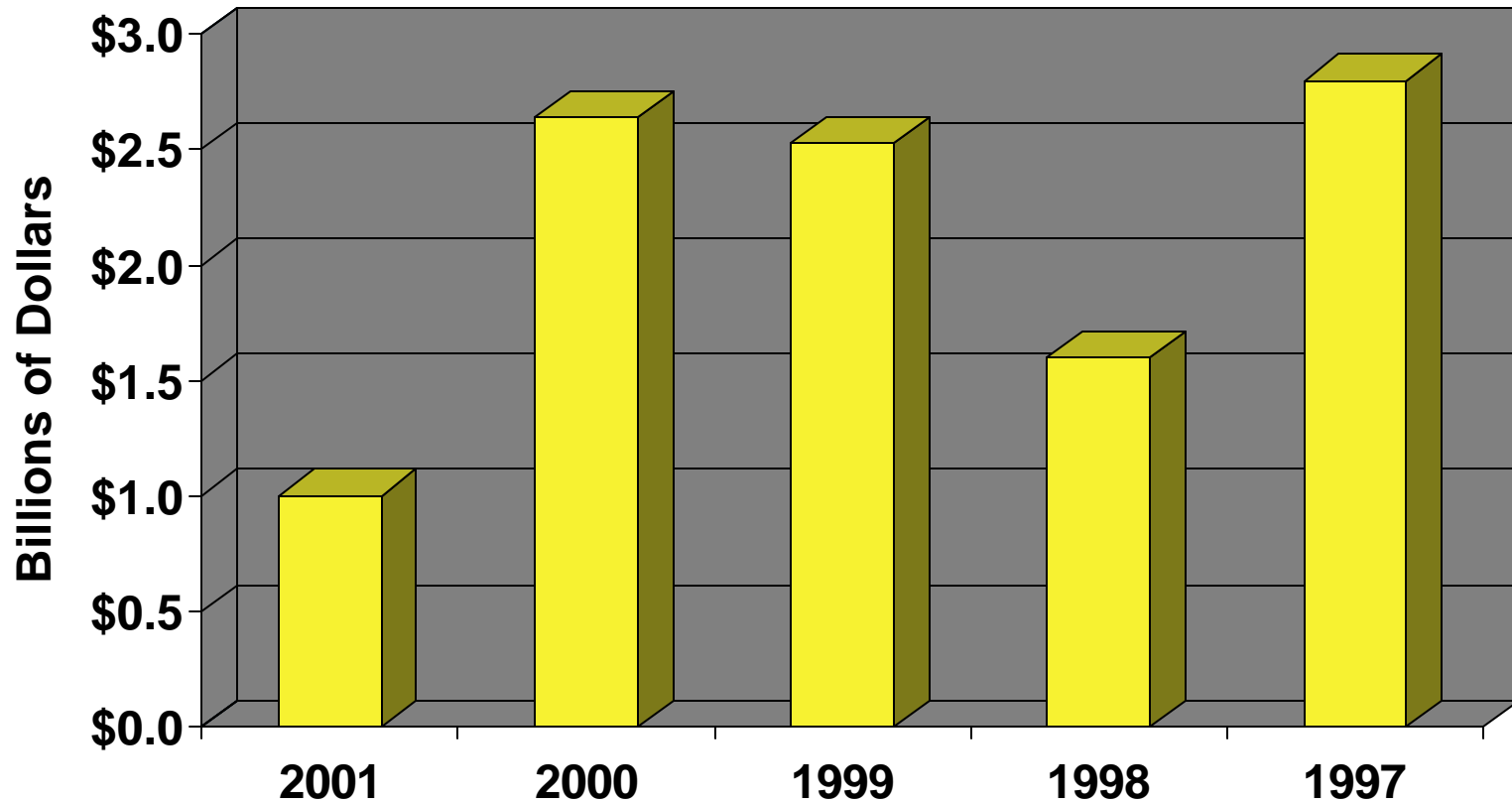
# Delphi and Tower vs. S&P500



# Internet and ArvinMeritor vs. S&P500



# DPH, ARM, TWR, INMT Cash Flow



# Supplier Headlines

**Johnson Controls to cut 350 jobs**  
Visteon commended for cutting costs  
Federal Mogul Parts maker trims nearly 1,600 jobs amid Ford dispute  
Goodyear Tire reports loss, cuts 3,500 jobs  
February 8, 2002

**Dura posts losses**  
Dura Automotive Systems Inc. lost \$7.47 million, or 42 cents per share,...

**Playes Lemmerz**  
Parts maker Lear to cut 6,500 jobs

**Pilot Industries**  
BorgWarner net profit slides 71 percent

**Tenneco, Lear post losses; both will close plants**  
Oxford Automotive  
REUTERS  
CHICAGO - BorgWarner Inc., an automotive powertrain parts and systems maker, reported a 71 percent drop in profit for the first quarter of 2002.

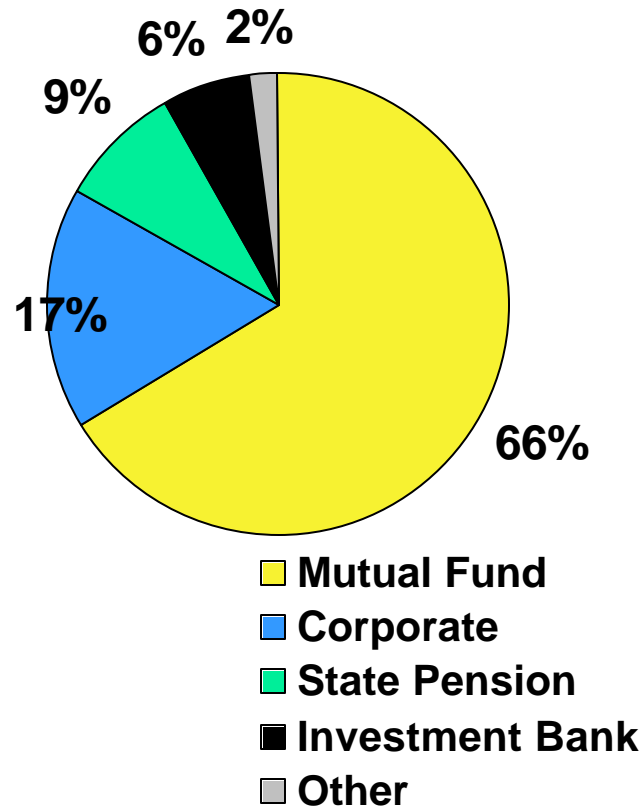
**Newcor**  
Texton Automotive Plans to Expand Rantoul, Ill., Plant

**Valeo Electrical Systems**  
Delphi to Open Plastic Molding Plant in Ohio

**Aetna Industries**  
Price war is key to Visteon layoffs  
Ford restructuring isn't vital

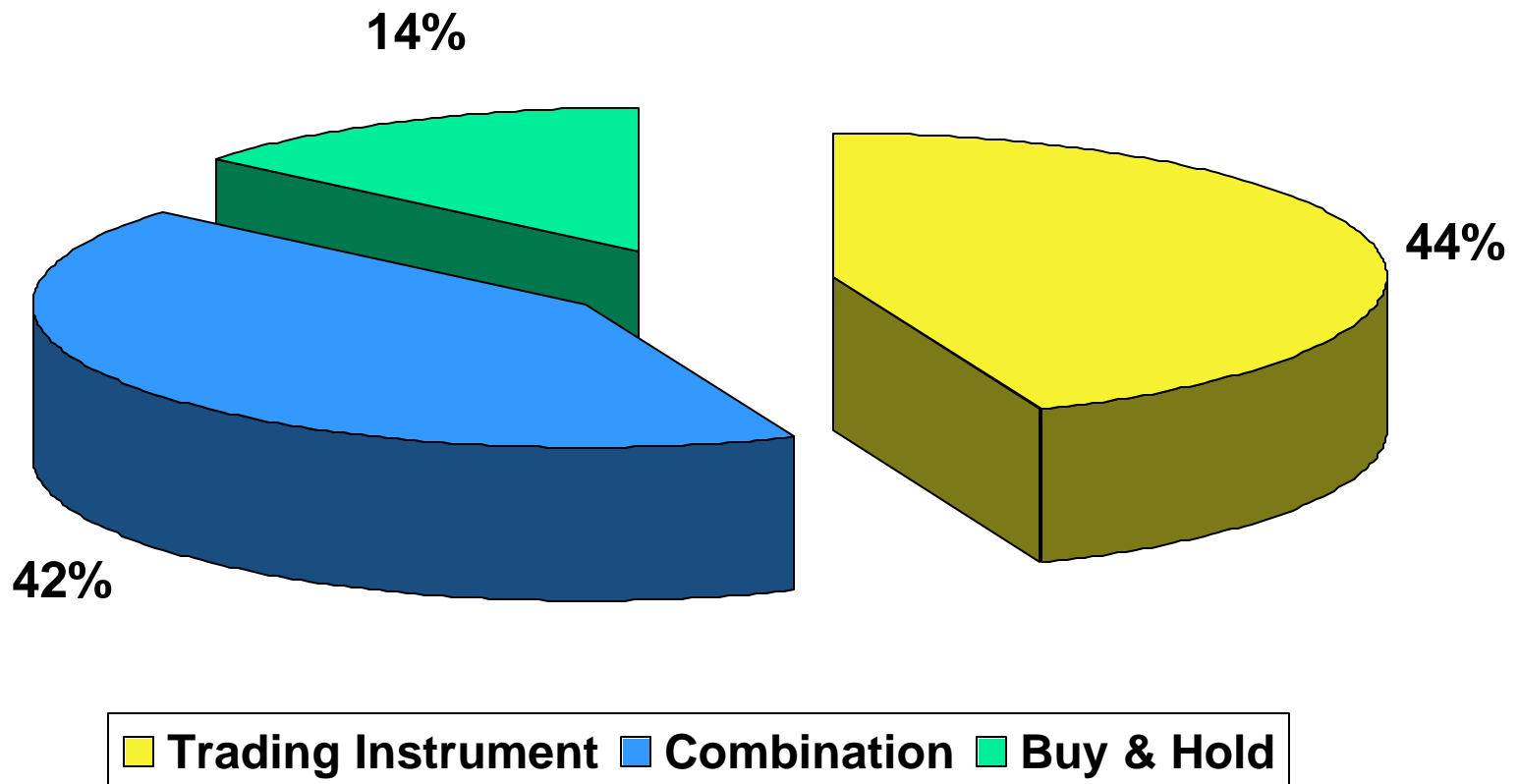
**Eaton Plans Transmission Plant in Mexico**

## Who Participated in the Survey

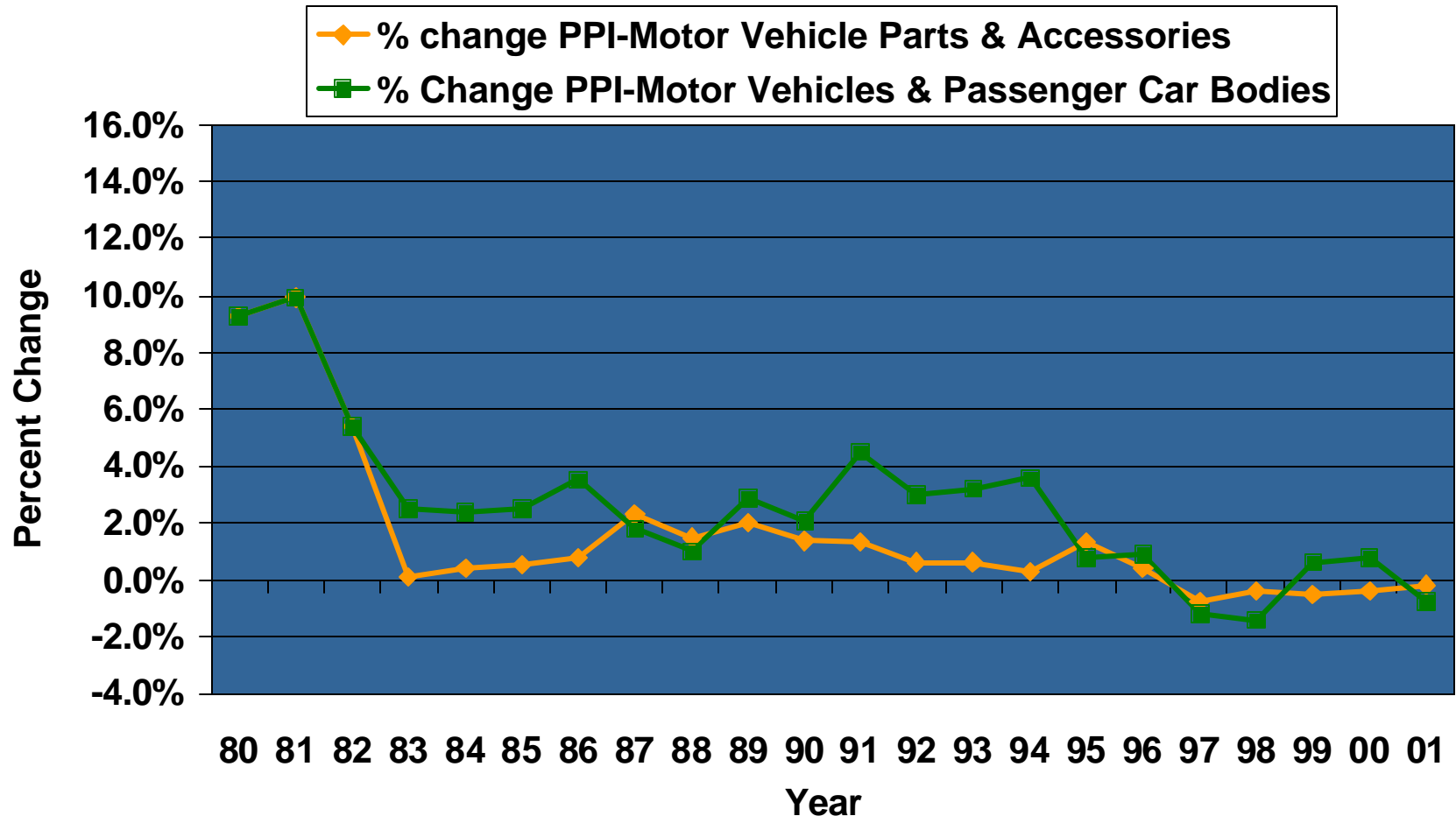


- ▲ Bringing together 2 projects sponsored by Accenture
- ▲ Institutional list of JP Morgan Security automotive analyst David Bradley
- ▲ 53 participants between February – March 2002
- ▲ \$56 billion average equity holdings
- ▲ \$1.4 billion average automotive holdings

# Institutional View of Auto



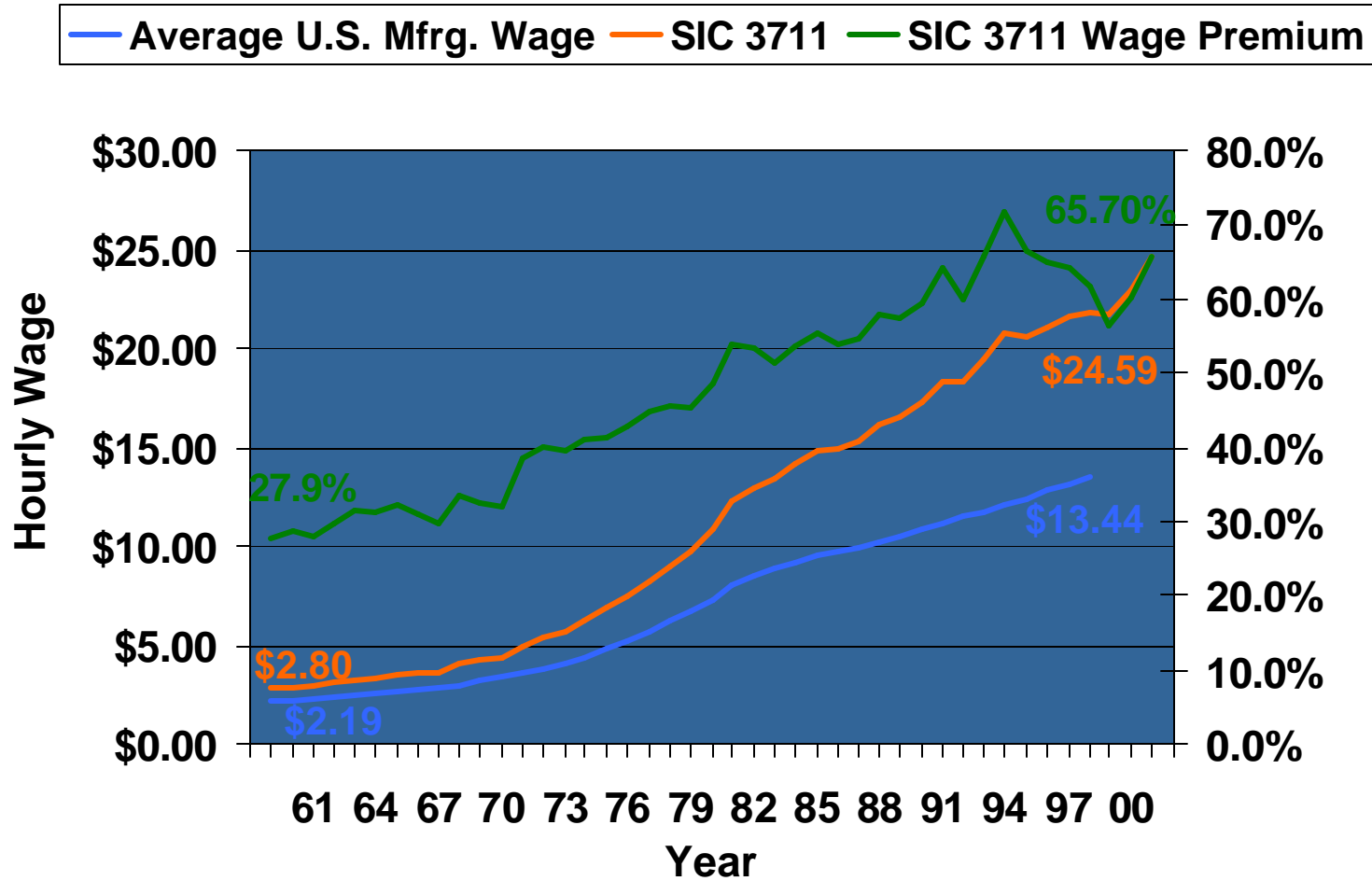
# Automotive Deflationary Environment



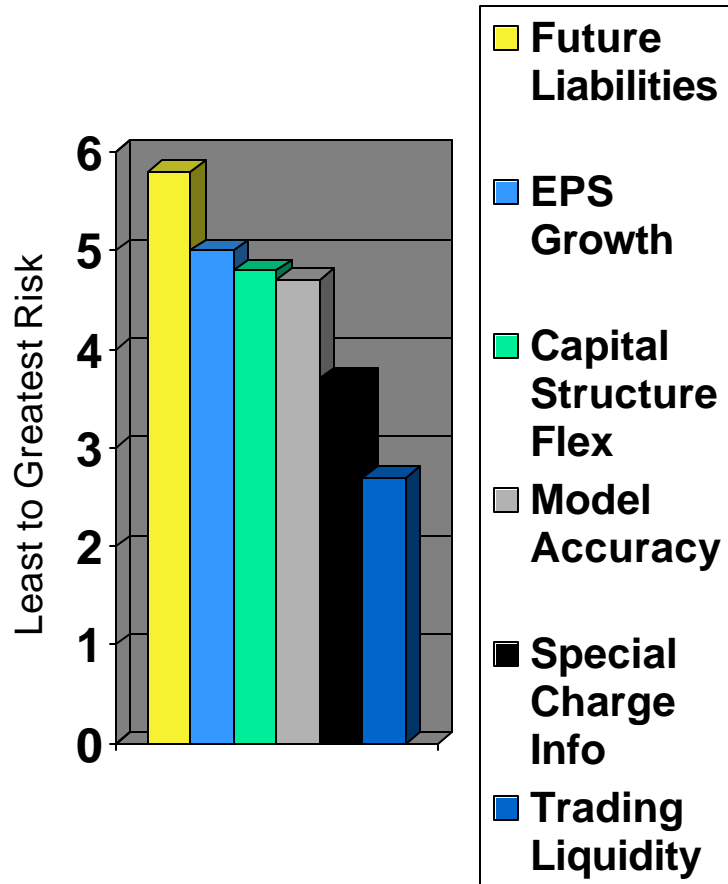
# Pricing Environment

- ▲ Vehicle firms anticipated to see  $-4.9\%$  annual reduction
- ▲ Supplier firms anticipated to see  $-4.3\%$  annual reduction

# Premium for Automotive Labor

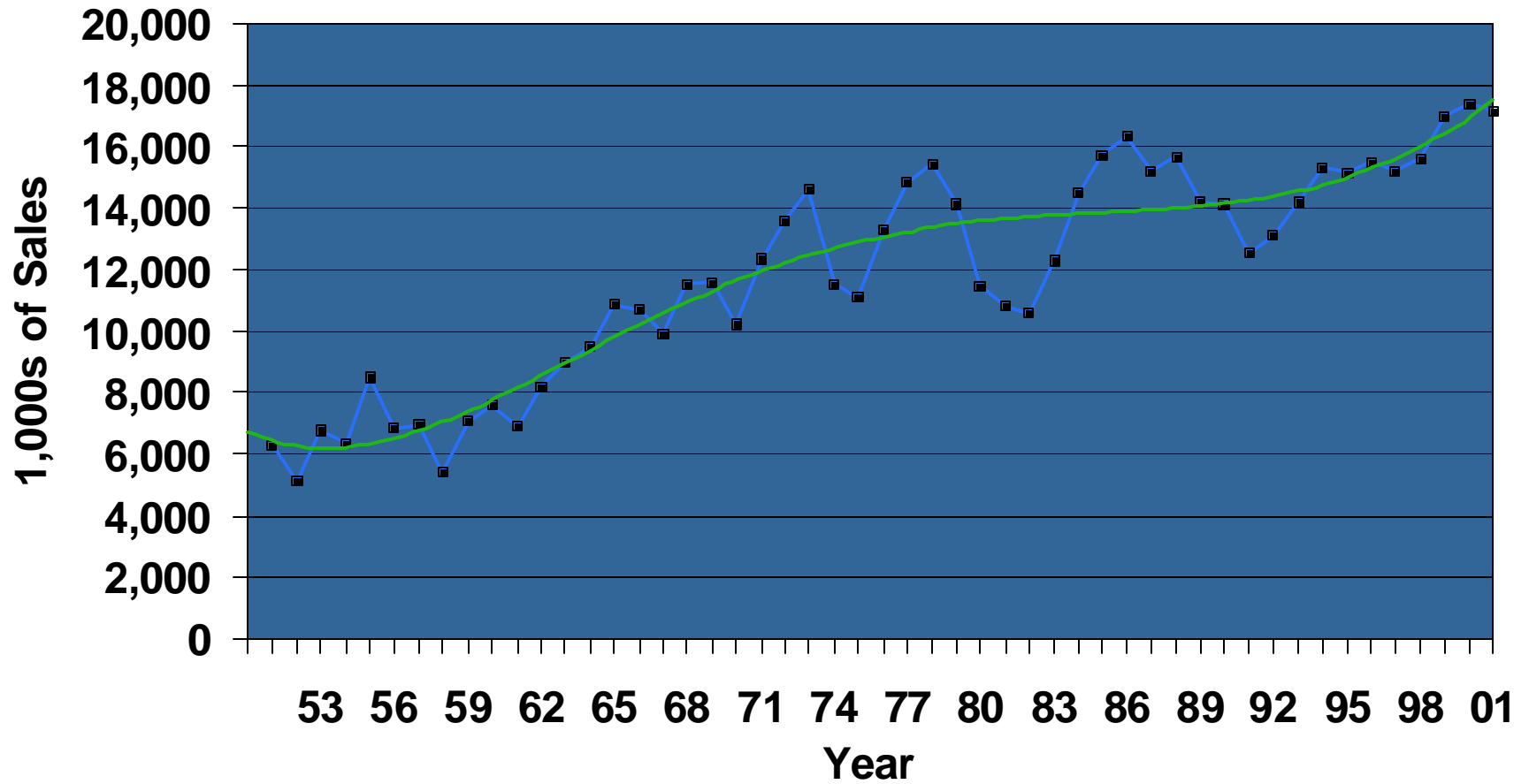


# Auto Perceived Risk vs. Other Equity



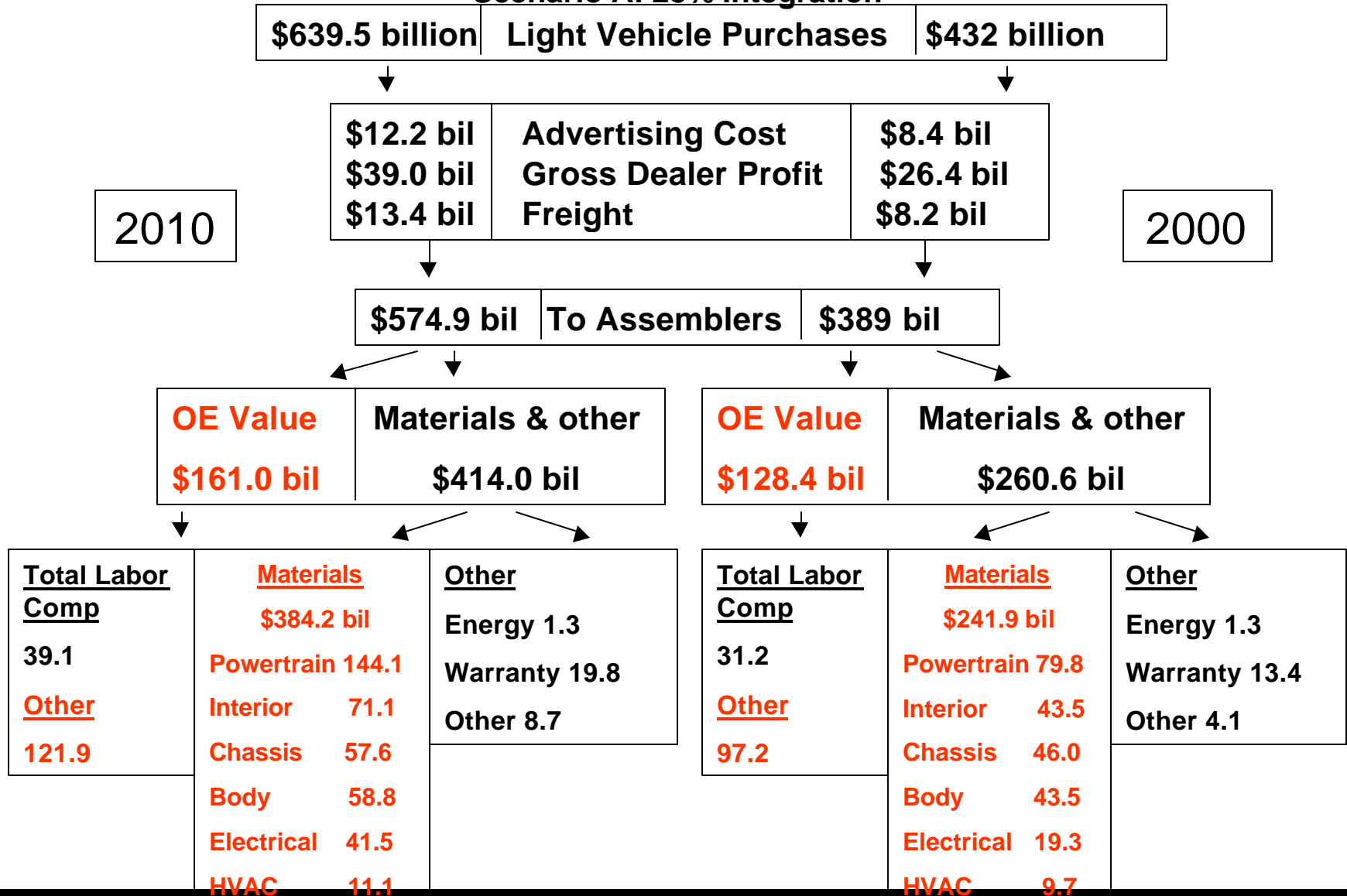
- ▲ Pension, health care, and warranty legacy costs weigh down the industry
- ▲ Merrill estimates: GM \$47.5 billion, Ford \$22.7, Delphi \$5.4 billion, and Visteon \$2.7 billion unfunded health and insurance liabilities
- ▲ EPS growth – cyclical
- ▲ EV/sales or EV/EBIT most used valuation ratio
- ▲ Investor relations doing their job
- ▲ While capitalization compared to top S&P 500 “small,” liquidity not an issue to focus on

# US Motor Vehicle Sales

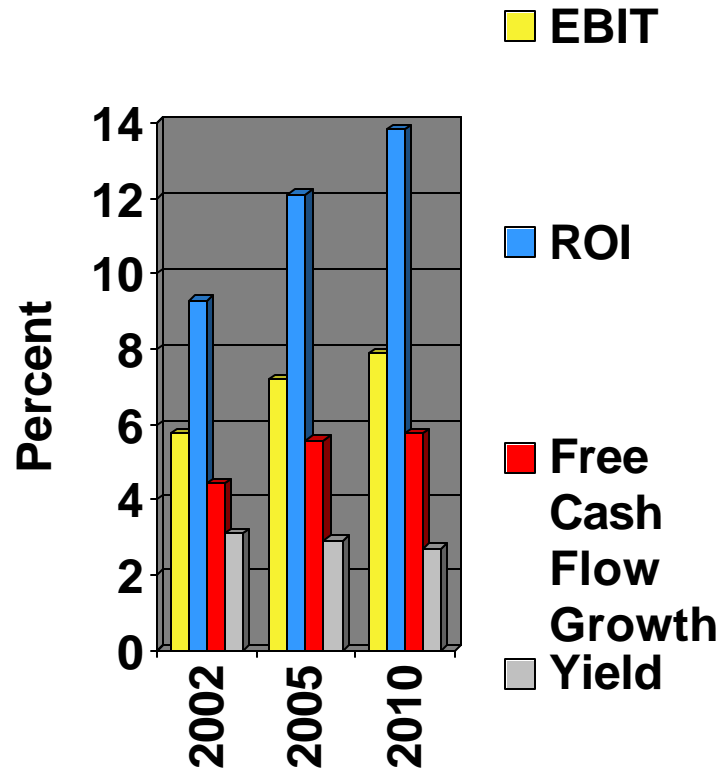


# 2010 Value Chains 2000

Scenario A: 28% Integration

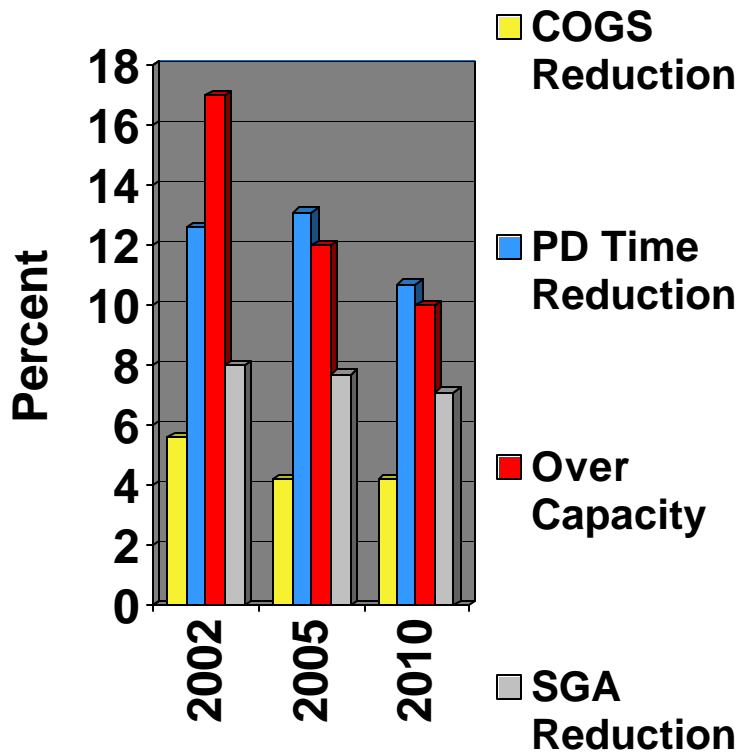


# OEM Financial Expectations



- ▲ EBIT targets expected to grow from 5.8% to 7.2% and 7.9%
- ▲ ROI – greatest pressure to grow from 9.3% to 12.1% and 13.8%
- ▲ Free cash flow growth rates – 4.4%, 5.6%, 5.8%
- ▲ Yields – flat at 3%, but 2X overall market

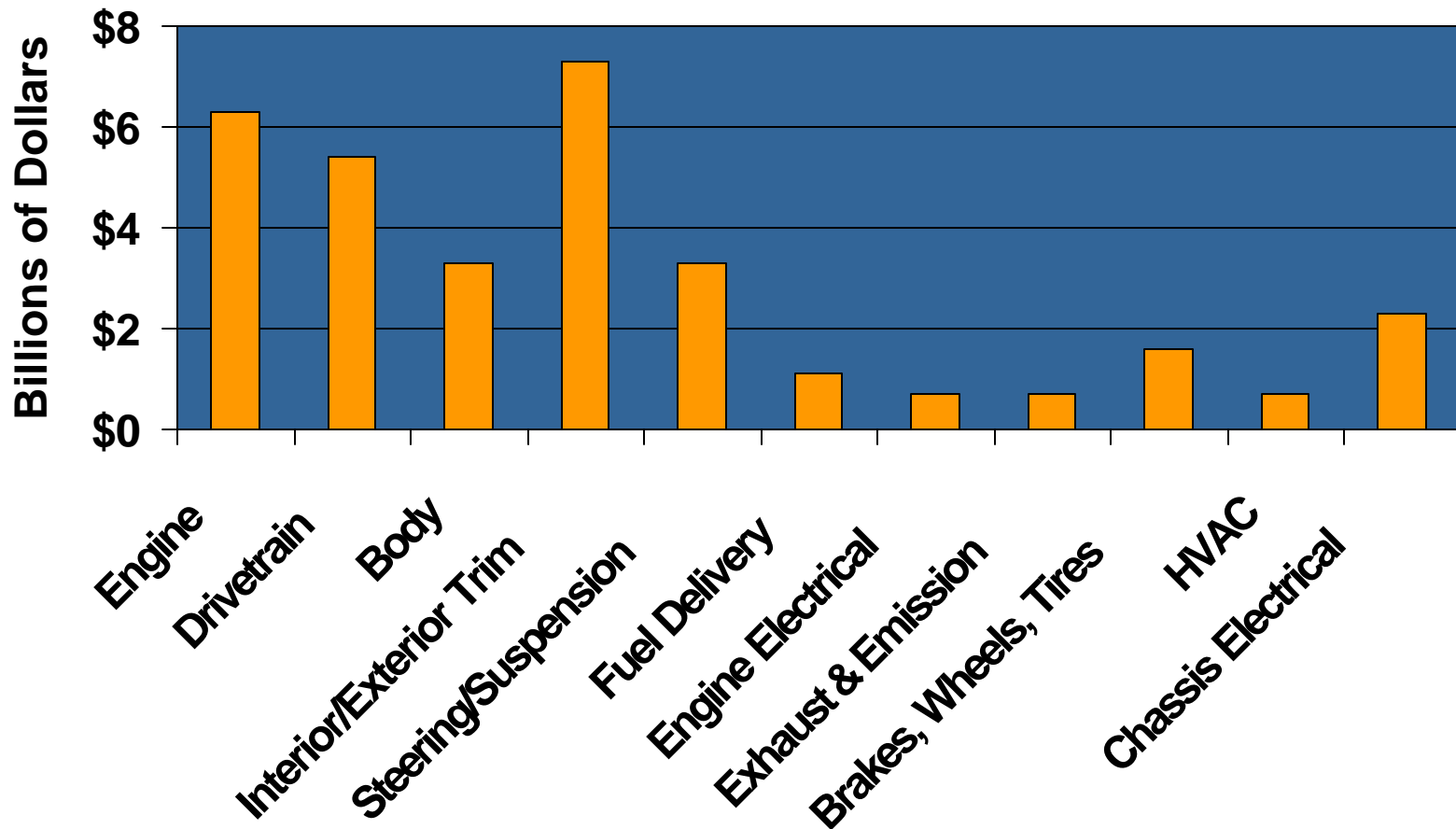
# OEM Operating Performance



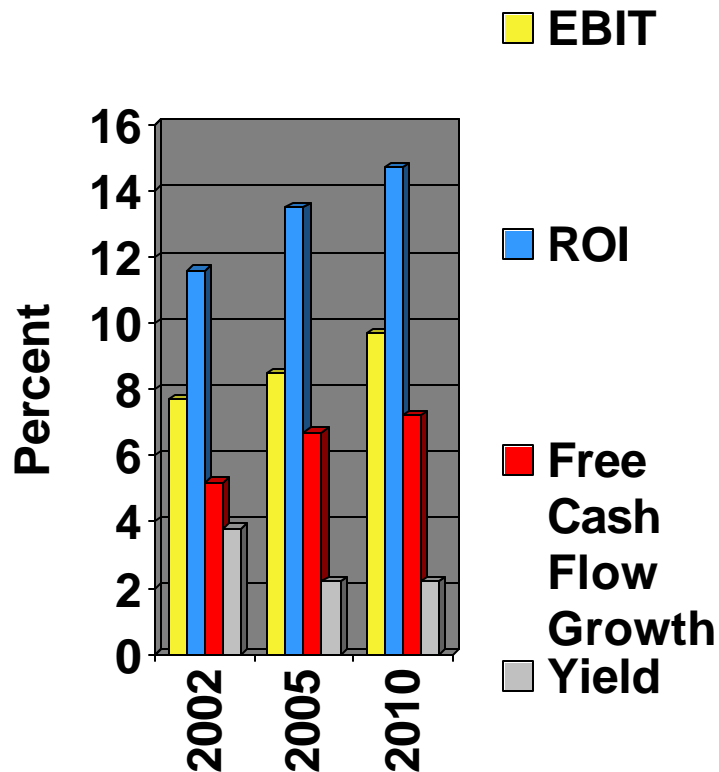
- ▲ Annual COGS reductions of 5.6%, 4.2%, 4.2% expected
- ▲ 10-12% PD time reductions are front loaded
- ▲ Focus on capacity utilization
- ▲ Lean and leveraged

# System Incremental Dollar Value

## Changes 2000 to 2010

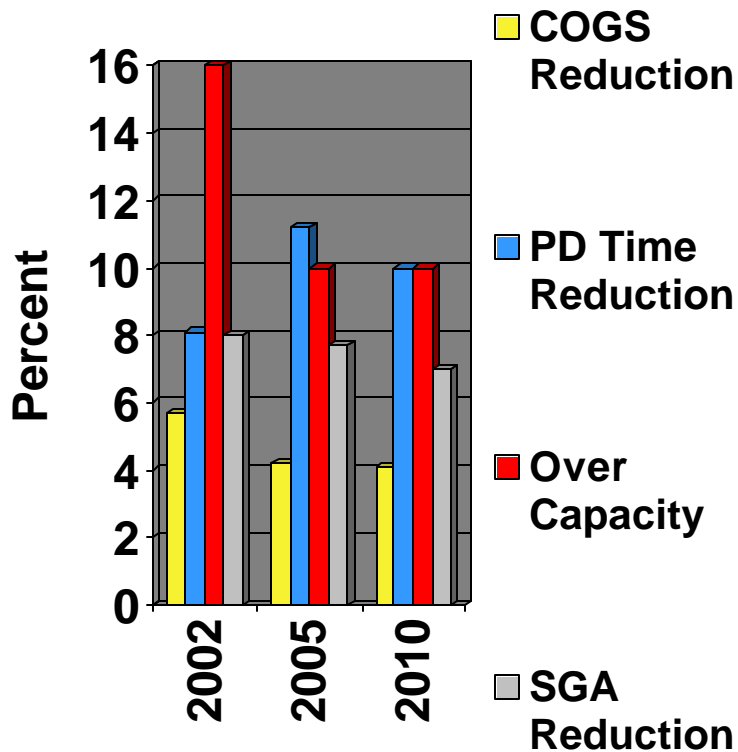


# Supplier Financial Expectations



- ▲ Expected higher absolute and rates of growth
- ▲ EBIT 7.7% to 8.5% and 9.7%
- ▲ ROI 11.6% to 13.5% and 14.7%
- ▲ Free cash flow growth rates – 5.2%, 6.7% and 7.2%
- ▲ Looking for reinvestment with declining yields

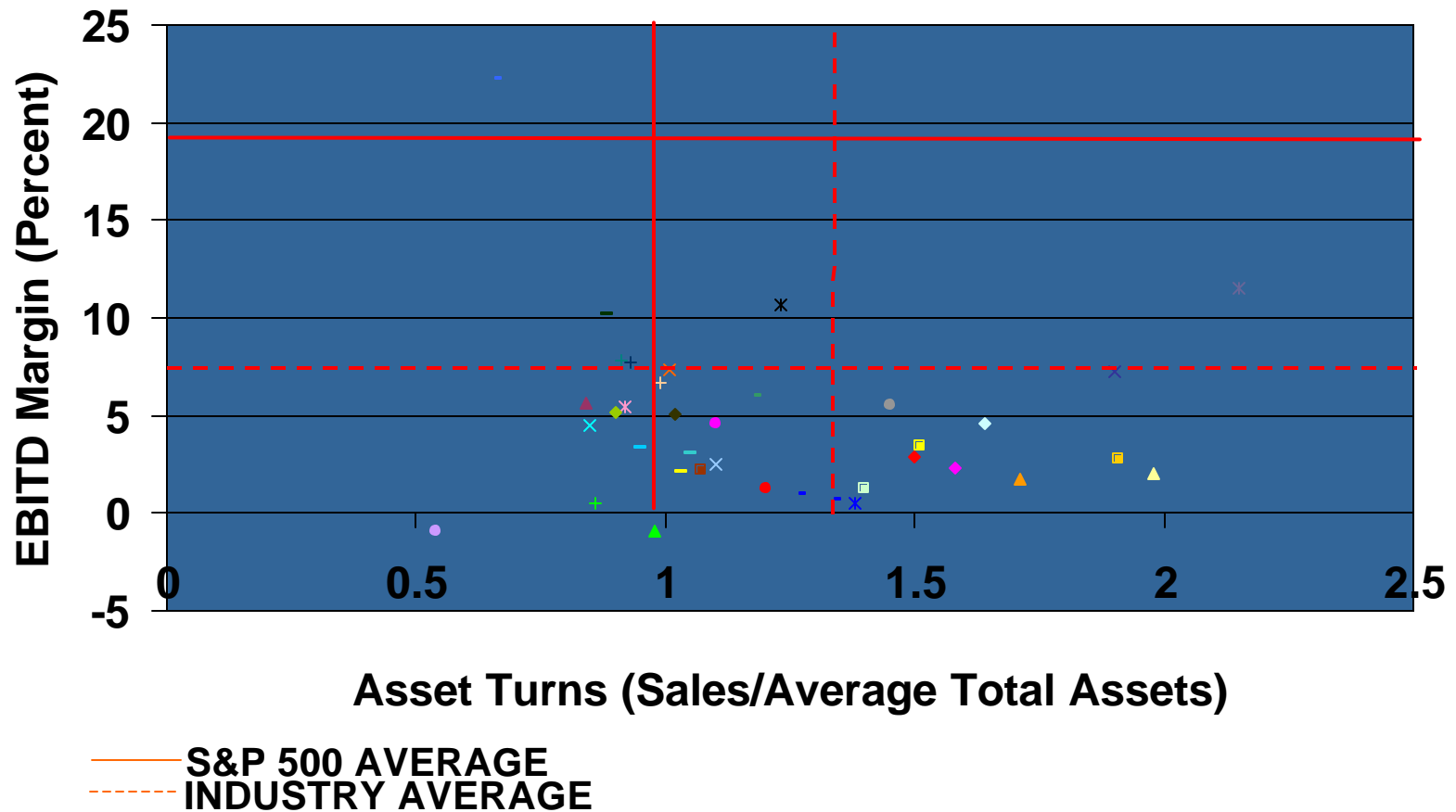
# Supplier Operating Performance



- ▲ COGS reductions consistent with OEMs
- ▲ PD times seen efficient, but must keep pace with OEMs
- ▲ 90% target for operating capacity utilization
- ▲ Lean and leveraged

# Distribution of Supplier Financial Returns –

## EBIT&D v. Asset Turns 2001



# Vehicle Firm Strategies

## Most Popular

- ▲ Reduce capacity
- ▲ Improve PD productivity
- ▲ Increase control over cost structure
- ▲ Reduce capital expenditure
- ▲ Increase innovation

## Least Popular

- ▲ Invest in DIY/accessories
- ▲ Invest in downstream service activities
- ▲ Increase product line
- ▲ Initiate buy-back programs
- ▲ Further consolidation

# Supplier Firm Strategies

## Most Popular

- ▲ Improve control over cost structure
- ▲ Increase vehicle content share
- ▲ Close plants
- ▲ Improve PD productivity
- ▲ Consolidate further

## Least Popular

- ▲ Diversify into non-auto
- ▲ Acquire new capacity/  
product lines
- ▲ Initiate stock buy-back  
programs
- ▲ Asset swaps

# Conclusions

- ▲ Value opportunities and income attract equity investors to the automotive community
- ▲ Legacy issues – the riskiest proposition and most difficult to work through – place pressure on stabilizing production cycles
- ▲ Focus is on firm operating performance, not industry growth expectations
- ▲ Delivering constant, targeted and smart restructuring actions with improving financial returns meets analyst expectations
- ▲ Suppliers face greatest transition in terms of risk assumption, increasing financial expectations, and structural changes
- ▲ Full report on our website ([www.altarum.org](http://www.altarum.org))