Detroit – Washington D. C.

The Supplier Sector: These are the Days, We will Remember

May 30, 2014

Dave Andrea
Senior Vice President, Industry Analysis and Economics
OESA – Original Equipment Suppliers Association

“These are the Days” …. You Never Knew Natalie Merchant was an Auto Analyst

- **Sustainable year-over-year production increases in North America**
- **The worst year-over-year declines in Europe are over – financial charges will turn into financial gains**
- **South America and Thailand are new hot spots – but no where near the revenue/profit exposure**
- **Record number of vehicle and part program launches is forcing “I need you, you need me” collaboration**
- **Regulatory lull – yes, we have conflict minerals and other operational concerns – but we know the product regulations . . . Through 2018**
- **Macro-economic tailwinds: OK growth, no inflation, employment more positive than negative, gasoline +/- $3.50, credit interest rates and terms favorable**
- **For suppliers this means: cash flow, dividends, stock buy-backs, investment grade ratings, favorable valuations**

The State of The Supply Base

- **We are defining "the good old days"** – at least by industry performance, maybe not by fun
- **There is no room for error** – learning to manage to constraint not excess
- **The half life of what we know is being compressed** – more product and process technology will be introduced in the next 10 years than the last 20

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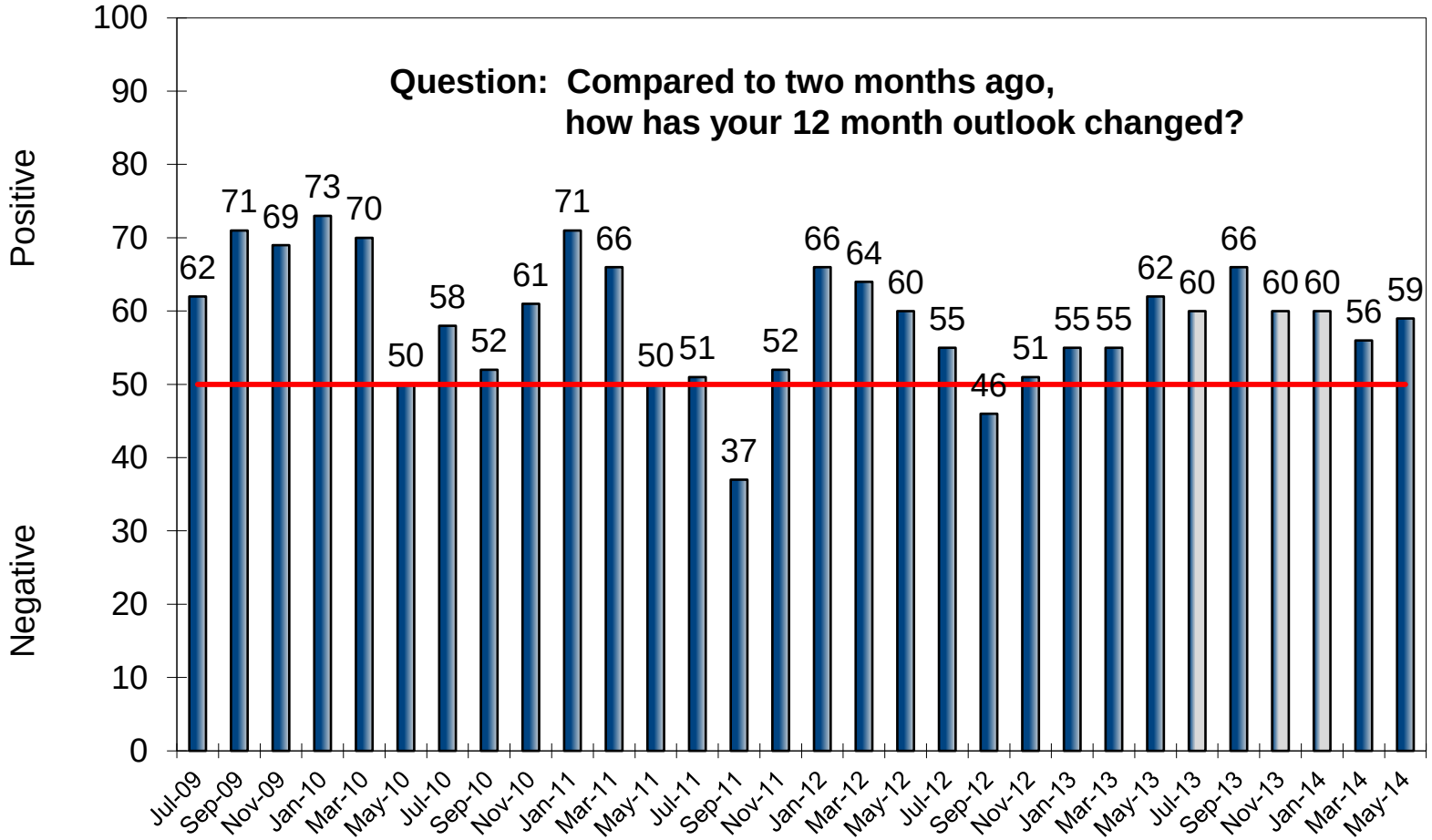
OESA Automotive Supplier Sentiment Index

Positive Territory for 20 Straight Months



No. of Responses = 107

North America
2014-2016 Production Forecast Comparison
(Volumes represent NA Car, Lt Truck class 1-5)

Δ compares prior reported forecast volume

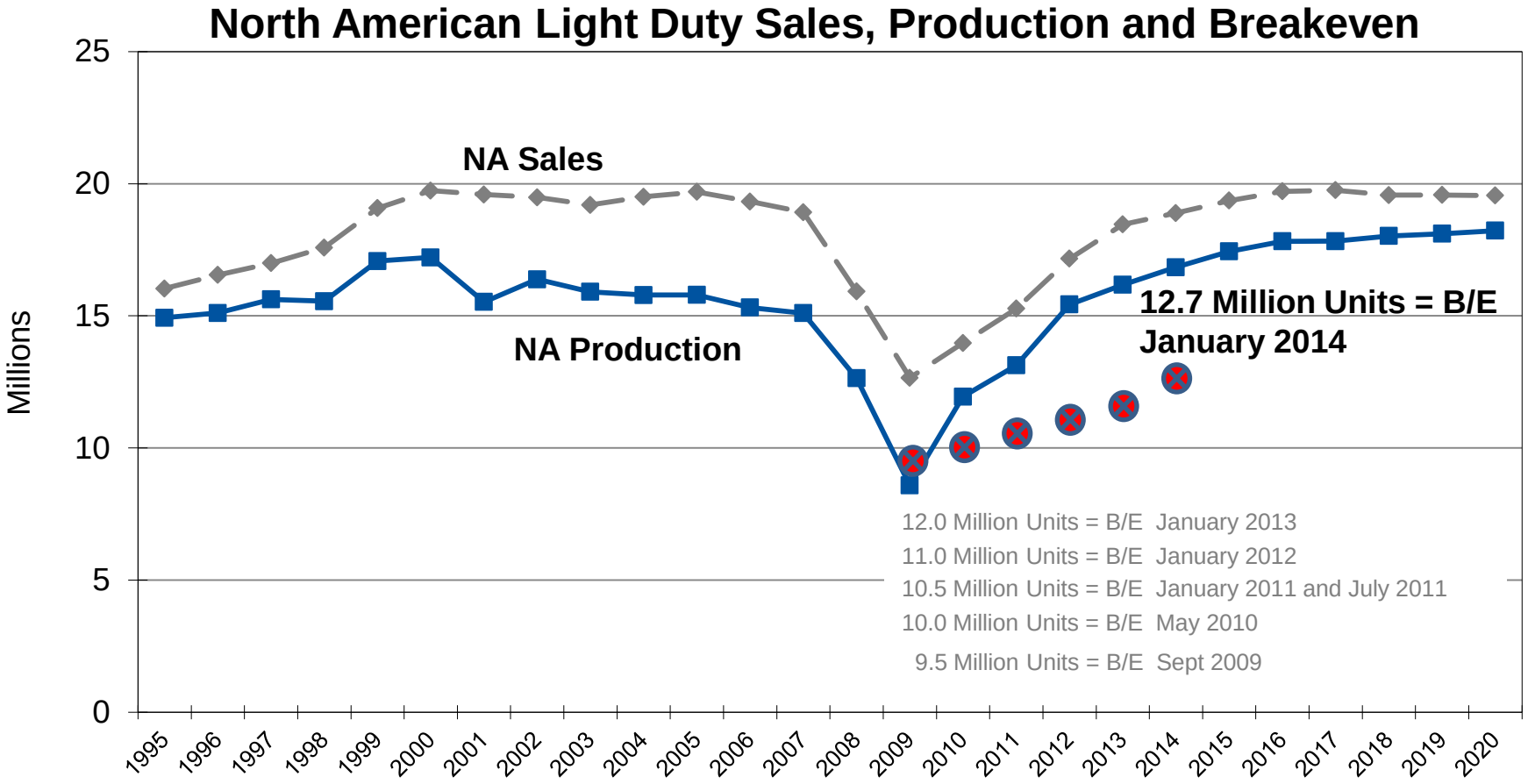
(in millions)

	2014					2015 Forecast	2016 Forecast
	1Q Actual	2Q Forecast	3Q Forecast	4Q Forecast	2014 Forecast		
pwc Autofacts®	4.19	4.39 0.02	4.10 0.03	4.14 0.03	16.82 ↑0.04	17.46 ↓0.03	17.60 ↓0.31
IHS AUTOMOTIVE driven by POLK	4.21	4.39 0.07	4.22 0.03	4.03 0.02	16.84 ↑0.06	17.16 ↓0.12	17.45 ↓0.20
LMC AUTOMOTIVE	4.18	4.25 0.07	4.10 0.05	4.11 0.02	16.65 ↑0.12	17.32 ↓0.02	17.94 ↑0.18
IRN	4.17	4.53 0.04	4.13 0.04	3.93 0.03	16.76 ↓0.07	17.28 ↓0.05	17.60 ↓0.02
WELLS FARGO	4.18	4.31 0.02	4.12 0.02	4.11 Δ0	16.72 Δ0	17.07 ↓0.16	NA
Forecast Average	4.19	4.37	4.13	4.06	16.76	17.26	17.65
Forecast Spread	0.04	0.28	0.12	0.21	0.19	0.39	0.49
2013 Average	***4.01***	***4.25***	***3.87***	***4.03***	***16.17***		

Last Updated: May 2014

OESA

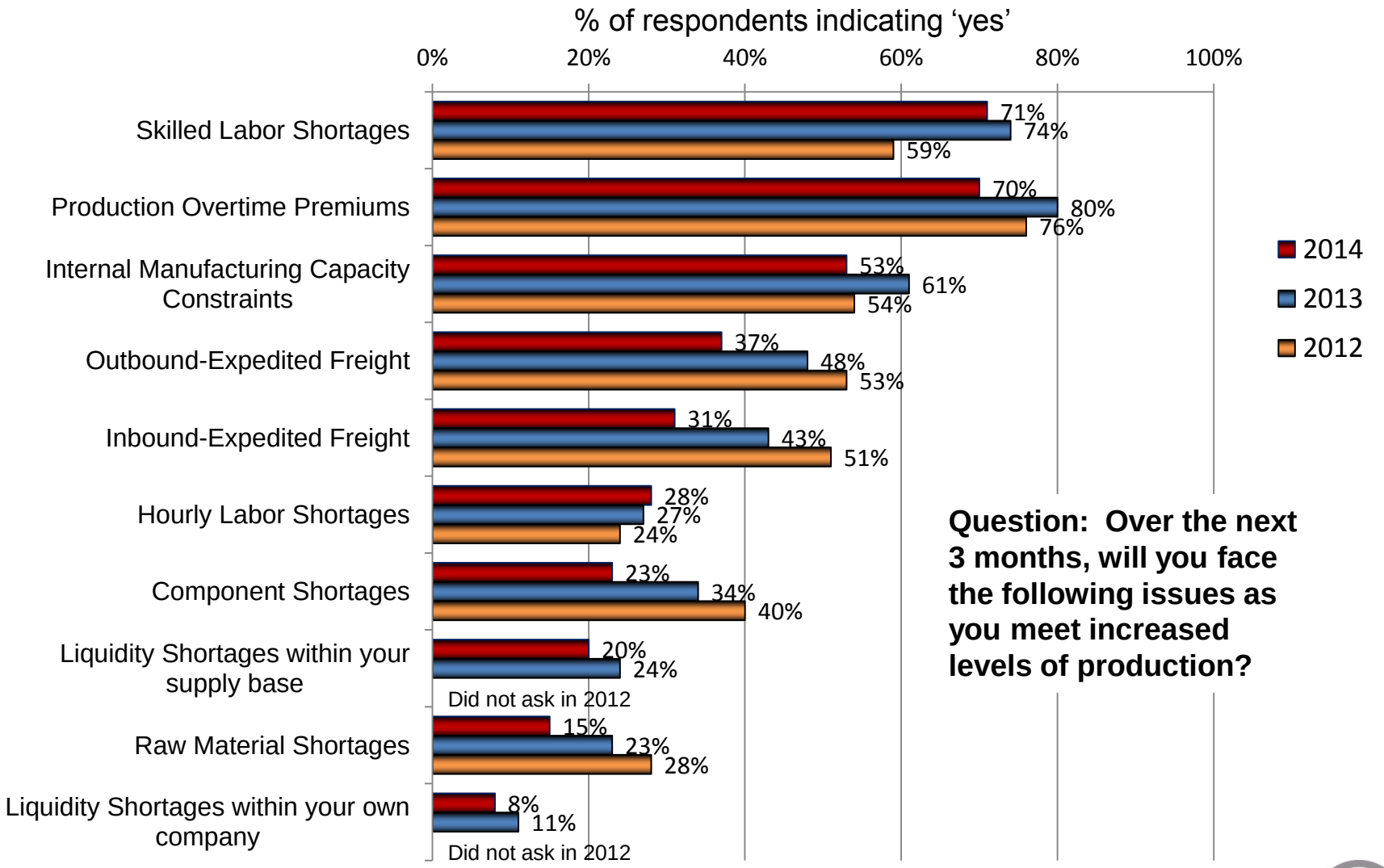
Fixed Costs Keeping Pace with Demand – There is No Room For Error Anywhere in the Chain



Production will increase by 96 percent between 2009 and 2014 (using a 16.8 million projection) while breakeven levels will increase by just 34 percent

Sources: IHS Automotive (December 2013) and January 2014 OESA Automotive Supplier Barometer

The Supply Base is Stretched – There are a Number of Issues; Suppliers are Ahead of the Curve



No. of Responses = 87-91

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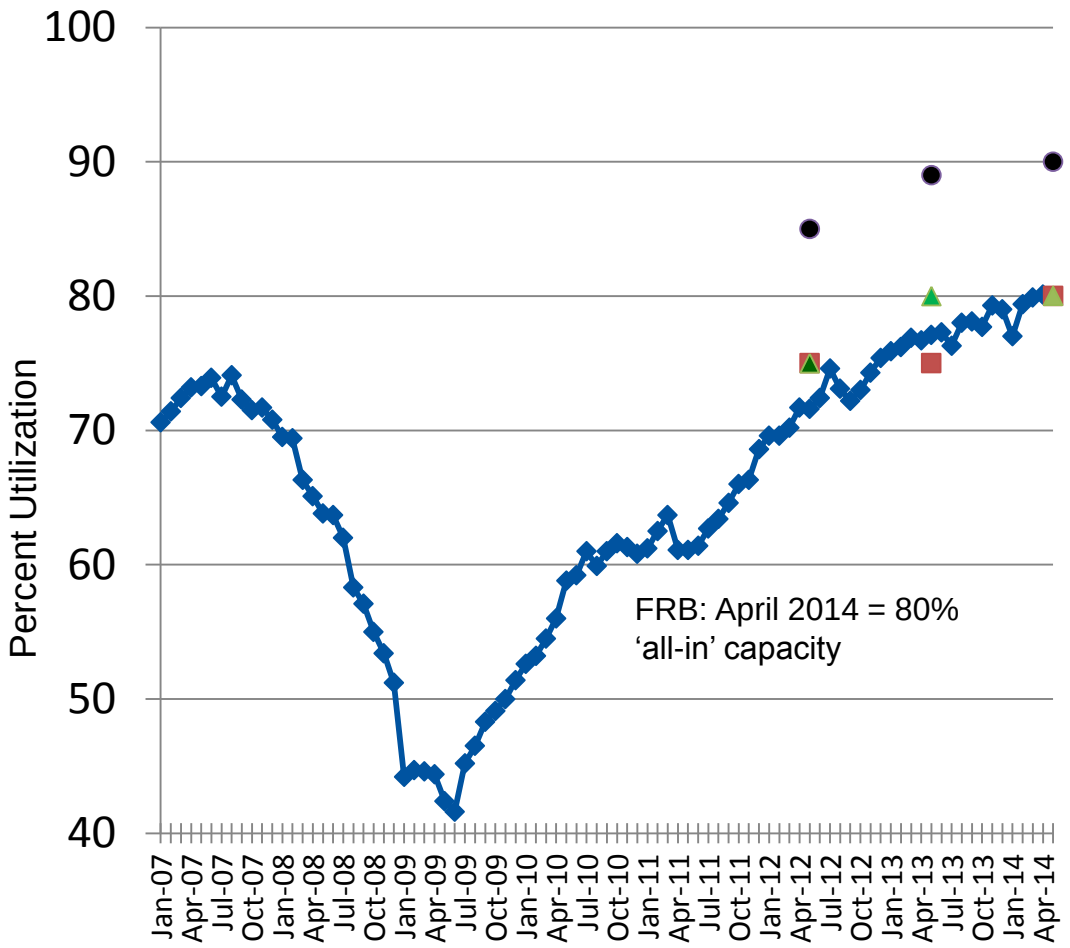
No Room For Error: Top Quartile, 95% Utilization



Capacity Utilization data from the OESA Automotive Supplier Barometer May 2012, May 2013 and May 2014:

Supplier Current Running Capacity (90%)

Current + Warm-idled capacity (80%)

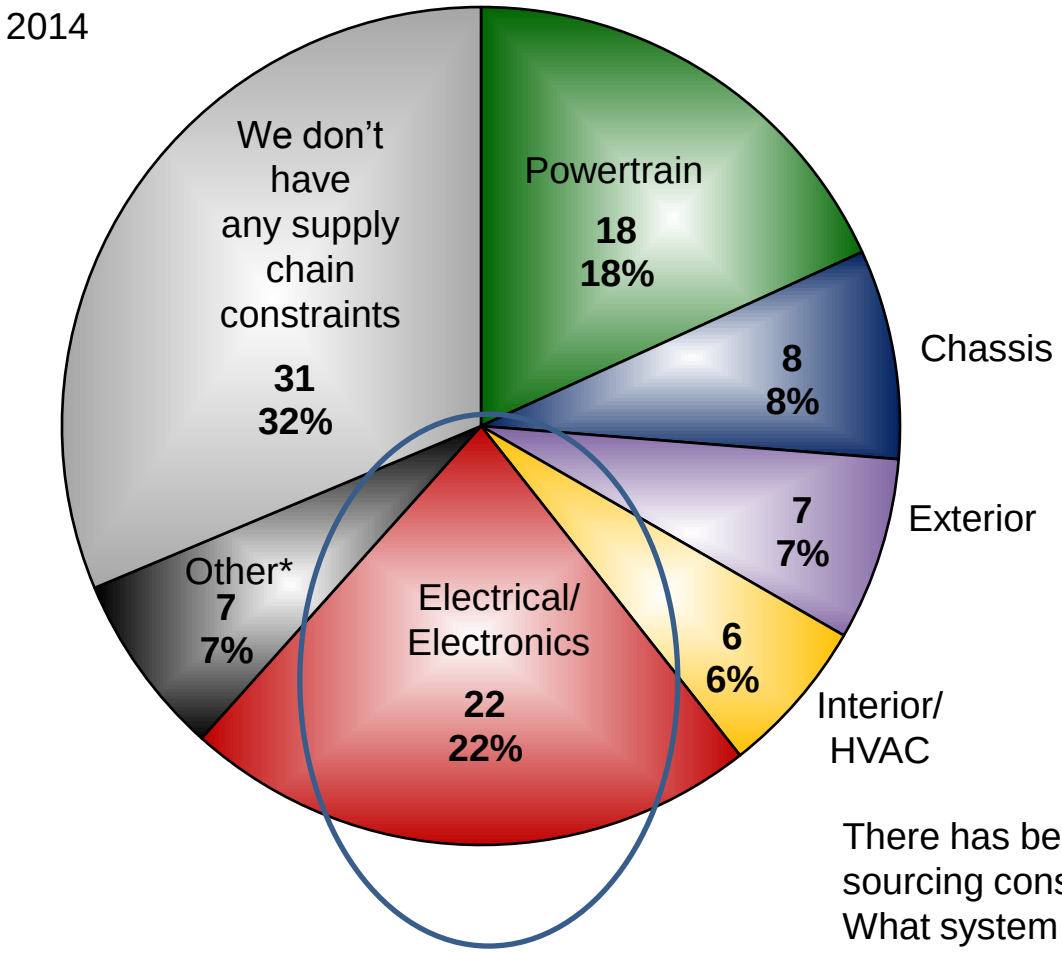
Current + Warm + Cold-idled capacity (80%)

- When asked about utilization rates, the **upper quartile** of companies are running at 95%; 90% including their warm and cold-idled capacity– and this is at a 16.8 million unit level
- The **lower quartile** companies are operating at 80%; 70% including all available capacity

NAICS 3363 capacity utilization corrected in April 2013 to reflect updates in FRB dataset

Source: U. S. Federal Reserve Board of Governors

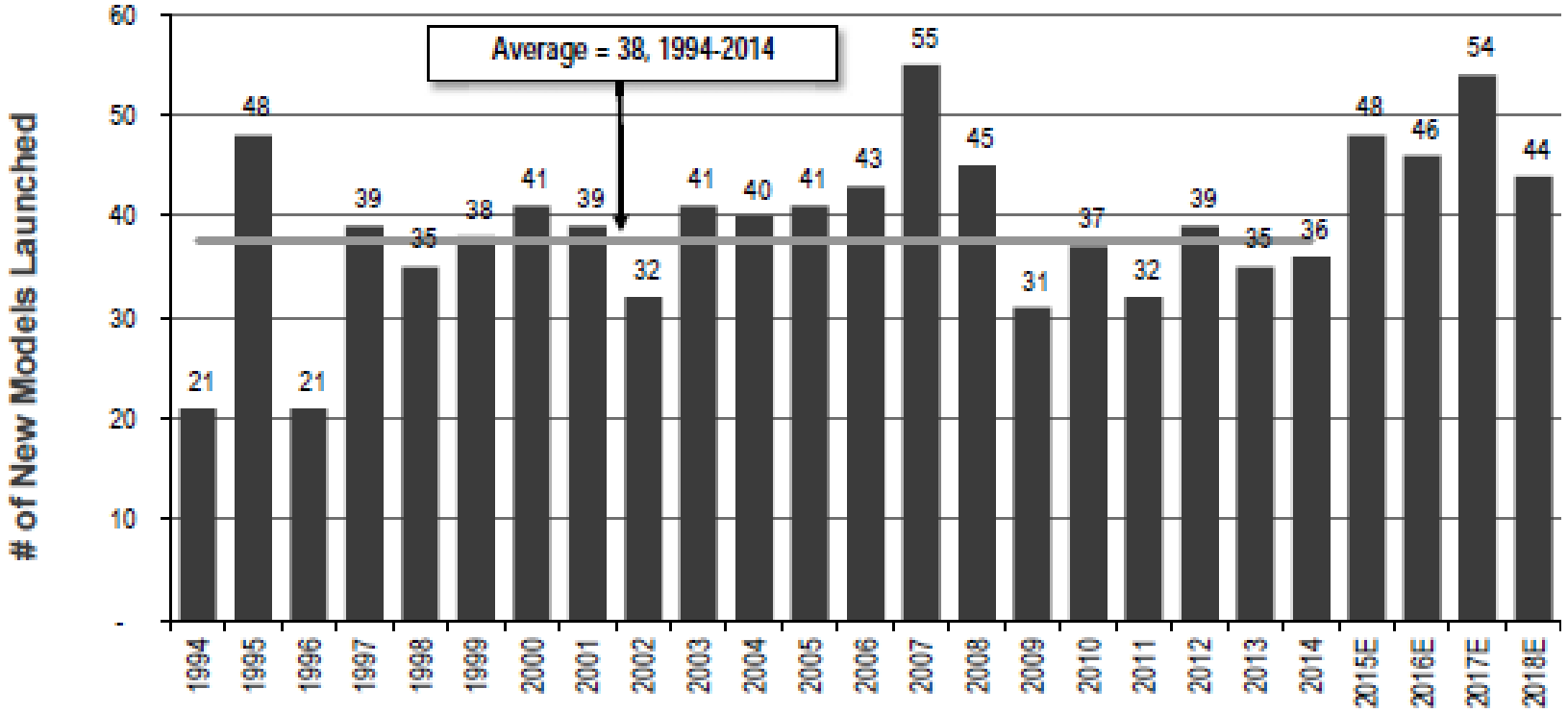
While Capacity Constraints are not Systemic; They are Focused in Capital-Intensive and Long-Leads



There has been a great amount of discussion about sourcing constraints down through the supply chain. What system area, that you build in to, has the most significant supply chain constraint?

No. of Responses = 99

OEMs Investing Billions in New Vehicle Launches – Each Provides Great Opportunities for Suppliers



Suppliers Support 2/3 the Value of a Vehicle – This Means Suppliers will Launch a Record Number of New Programs in 2014 and 2015

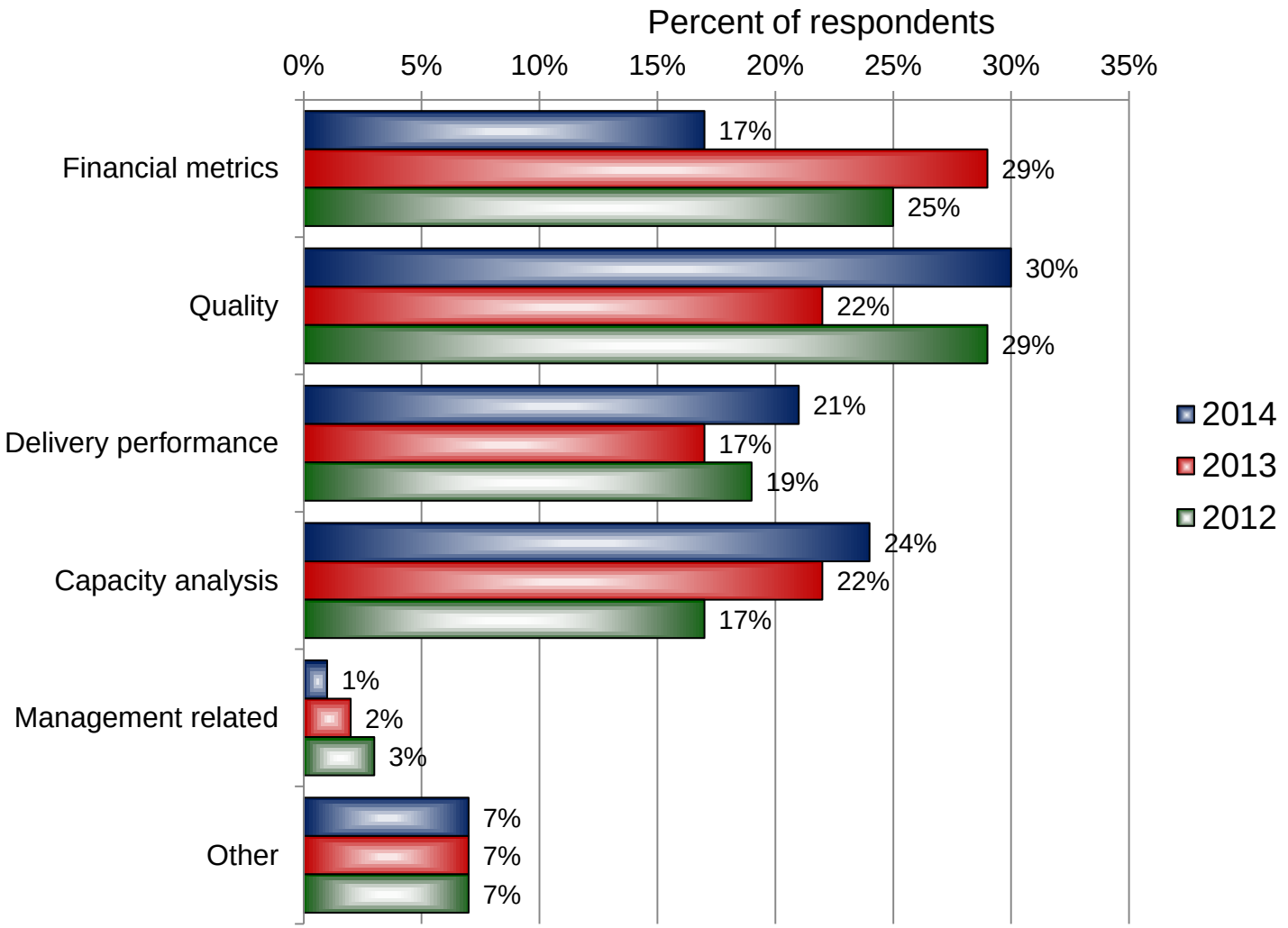
Global Auto Revenue	Lower Quartile Value	Median Value	Upper Quartile Value
2014 Launches			
More than $500 million	21	45	138
$151-$500 million	20	25	40
$150 million or less	15	35	73
2015 Launches			
More than $500 million	20	31	75
$151-$500 million	25	30	50
$150 million or less	15	50	100

Given the record number of vehicle launches over the next 2 years, on average, how many new base part numbers will you be launching in 2014 and 2015?

No. of Responses = 75

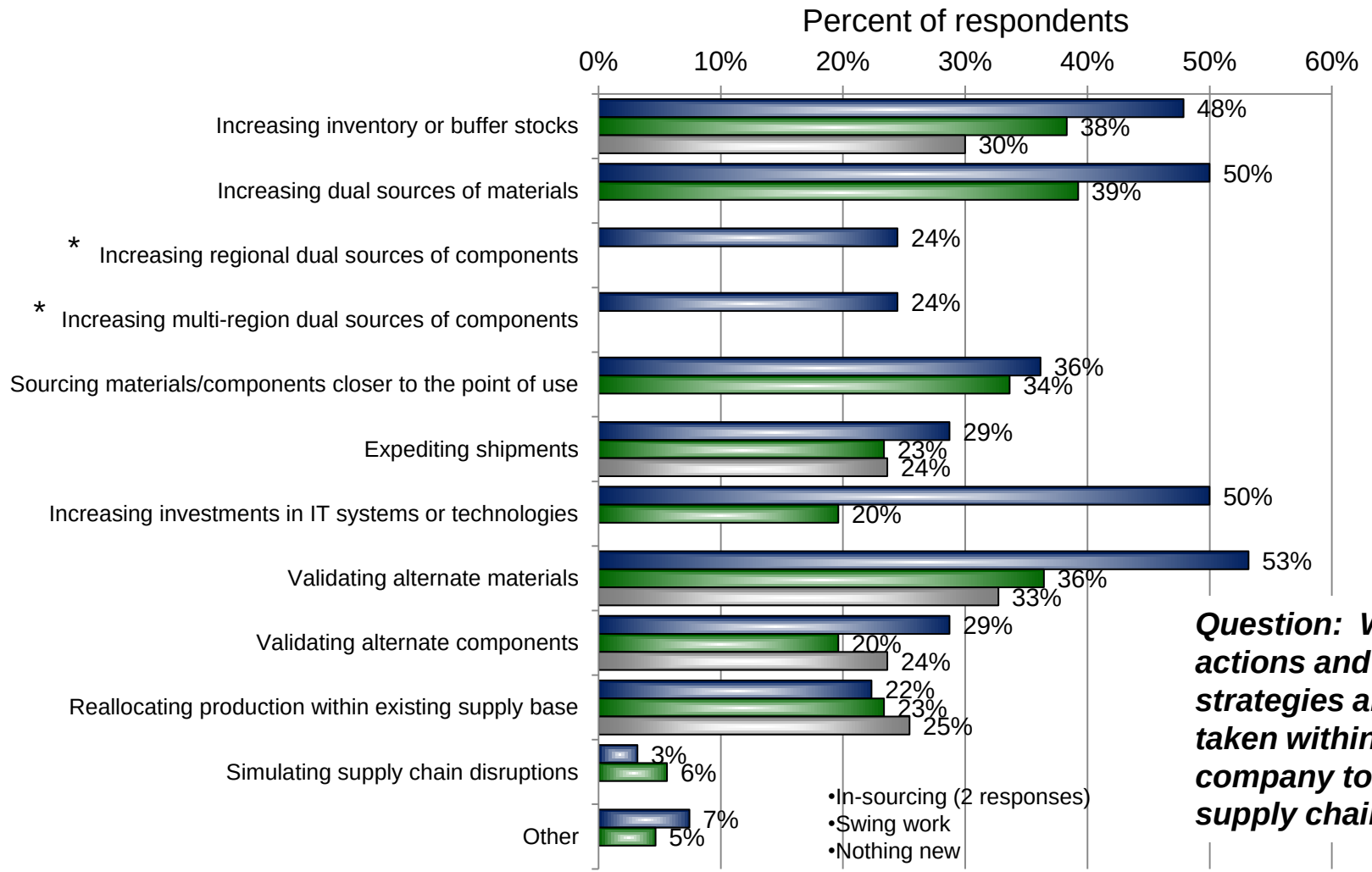
OEMs and First Tiers are Focused on Their Suppliers Assuring Quality, Validating Capacity, and Supporting Launch and Production Schedules

Question:
What is the primary reason companies are being added to or continuing on the supplier "watch list?"



No. of Responses = 76

Suppliers are Implementing a Number of Supply Chain Risk Mitigation Efforts

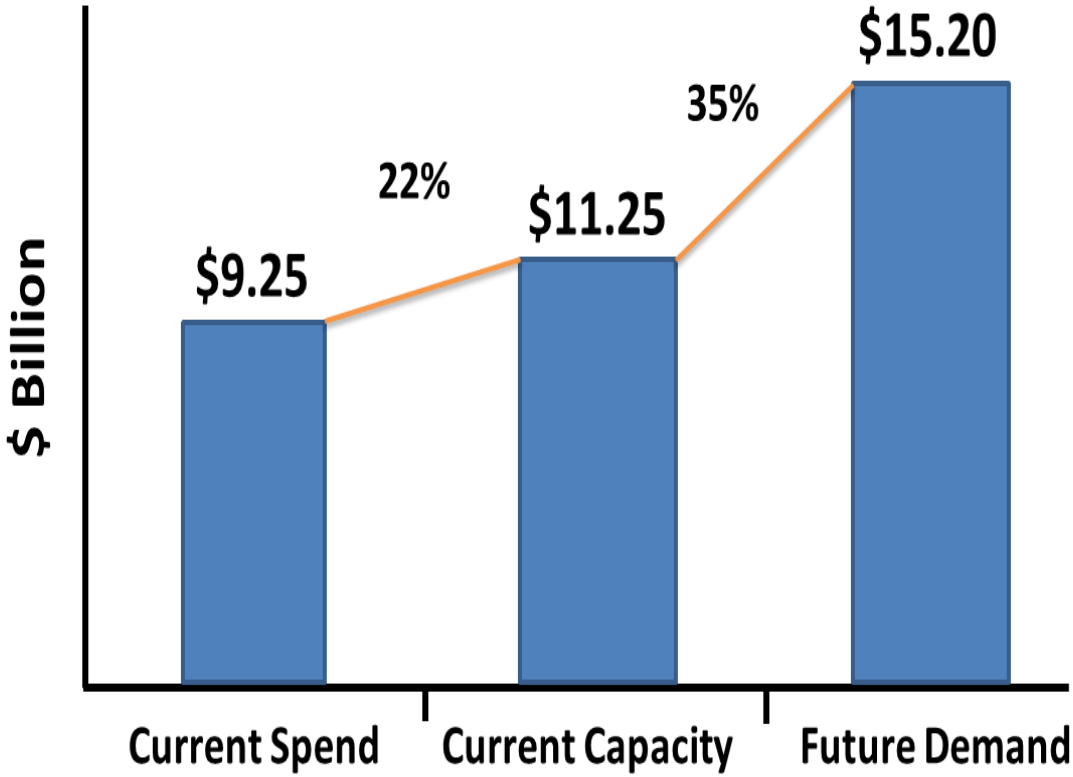


Question: What actions and strategies are being taken within your company to mitigate supply chain risk?

* In 2012 'Increasing dual sources of components was indicated by 22% of respondents
In 2011, Resourcing, adding new suppliers = 28% of respondents

No. of Responses = 94

Harbour Results: Capacity Shortage Warning – The Tooling Industry Needs to Support 35% Growth by 2018

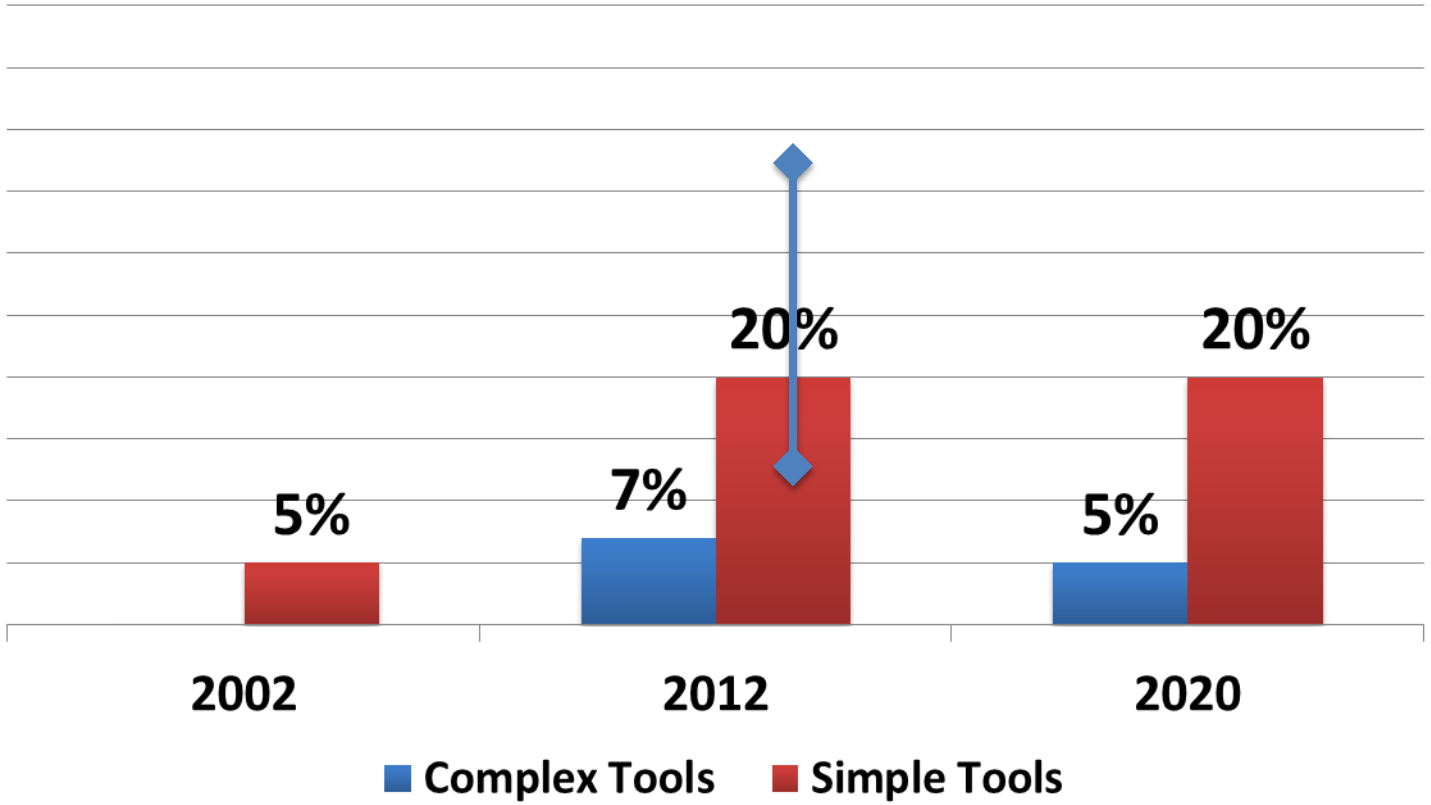


Future Demand is based on a 2012 baseline and estimated North American model launches (all new and major)

Source: LMC Automotive and IHS.

Source: Harbour Results

OEM Average LCC Content – By Value – Offshore Is the Relief Valve, Not the Primary Source of Future Tooling Needs



Variation from OEM to OEM relative to the overall usage of LCC tooling. In most cases, LCC tooling strategy is focused on lower complexity / non-time constrained parts.

Source: Harbour Results

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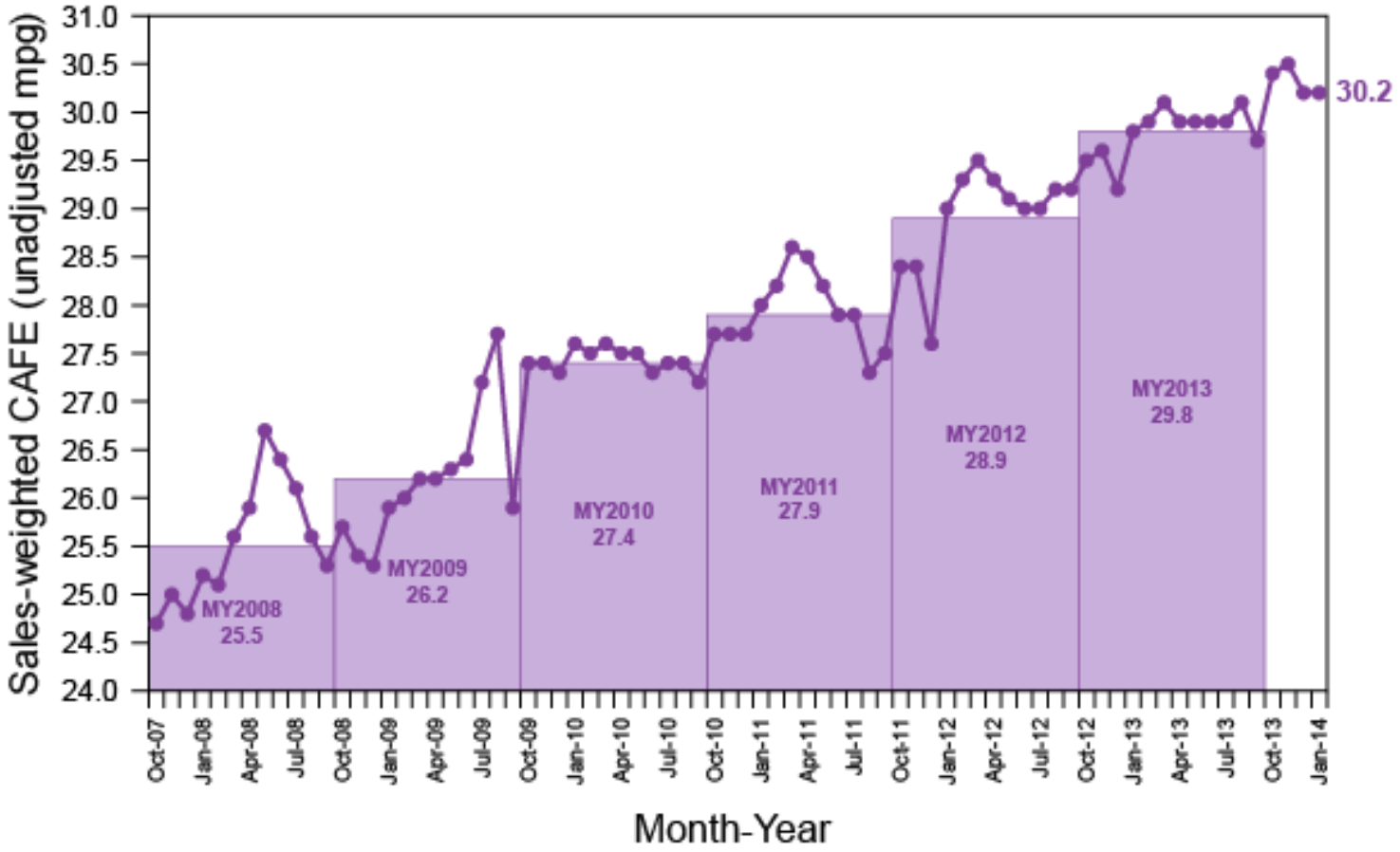
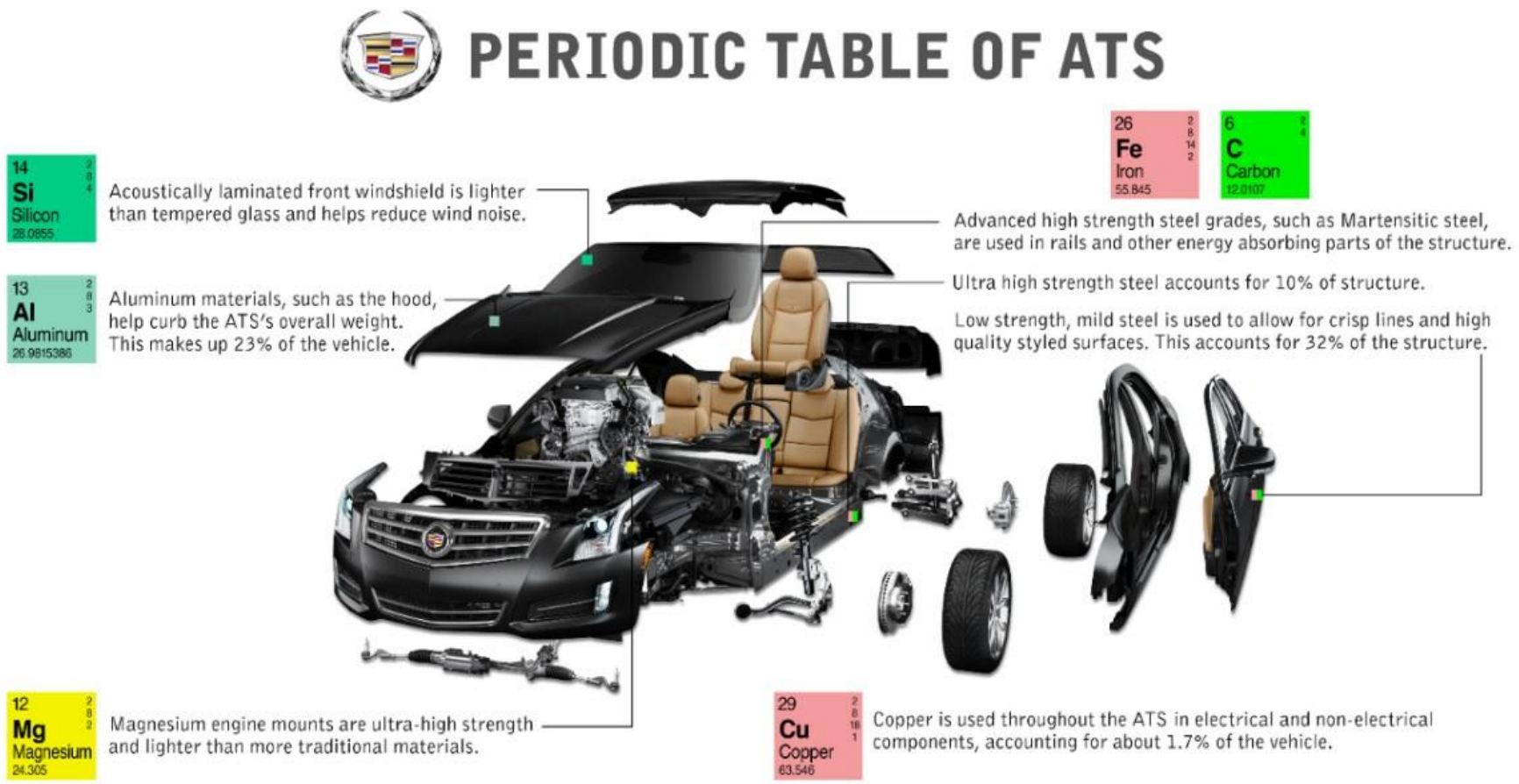
Window Sticker Fuel Economy is Rising – Needs to be at a 5% CAGR or 50% Greater Than Natural Market Forces

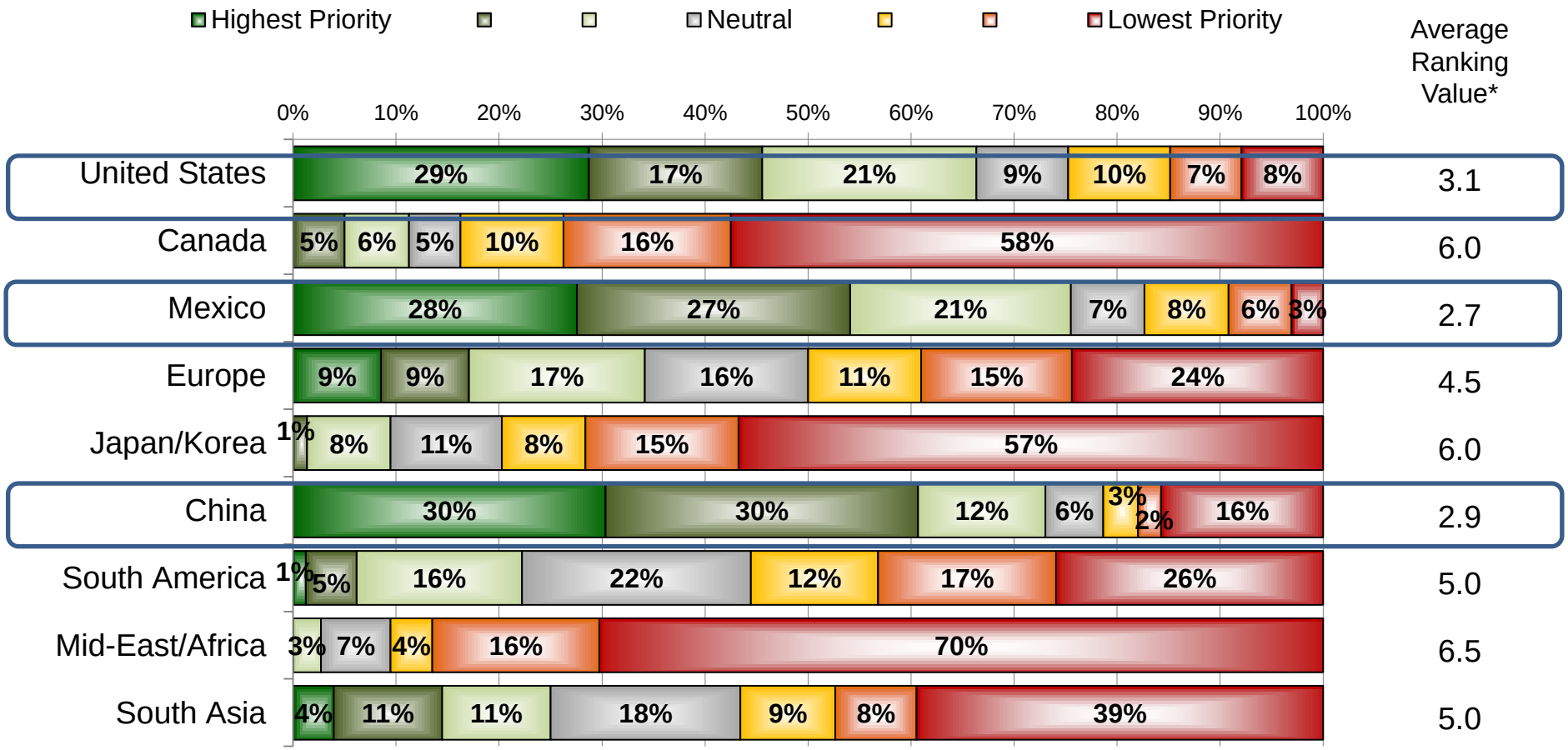


Michael Sivak and Brandon Schoettle
University of Michigan Transportation Research Institute

Material Complexity is Not a 2025 Vision – It is Today's Vehicle



While the Automotive Geographic Footprint is Evolving – It Continues to Mean Incremental Expansion in the Growth Markets and Deepening Regional Supply Chain Capabilities

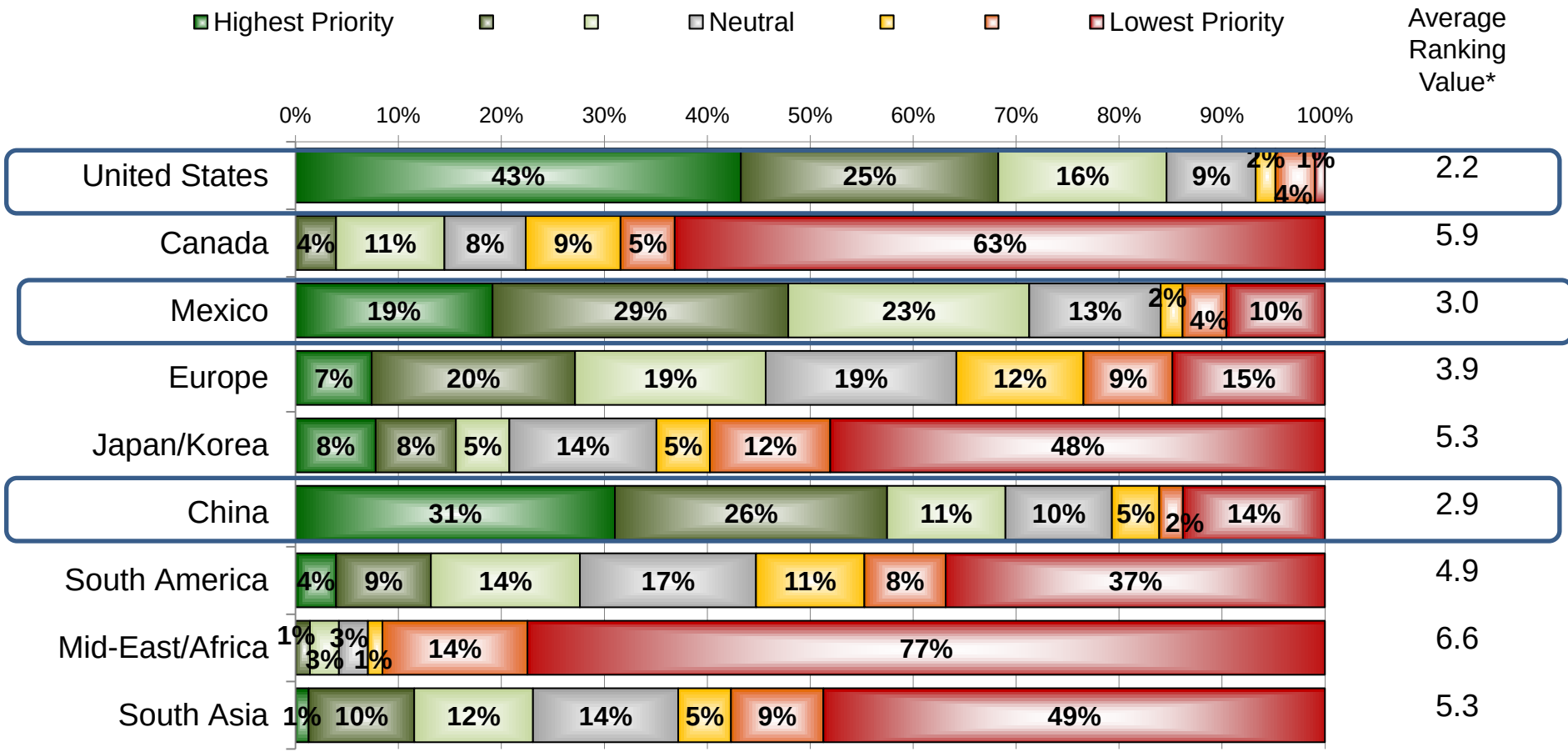


* 1= Highest Priority, 4=Neutral, 7= Lowest Priority

Considering your required production capacity needed to meet your targeted, regional business growth through 2020, rank the regions where you will need to expand capacity.

No. of Responses = 74-101

And That Applies to *Engineering Capabilities* as well as Production Capabilities

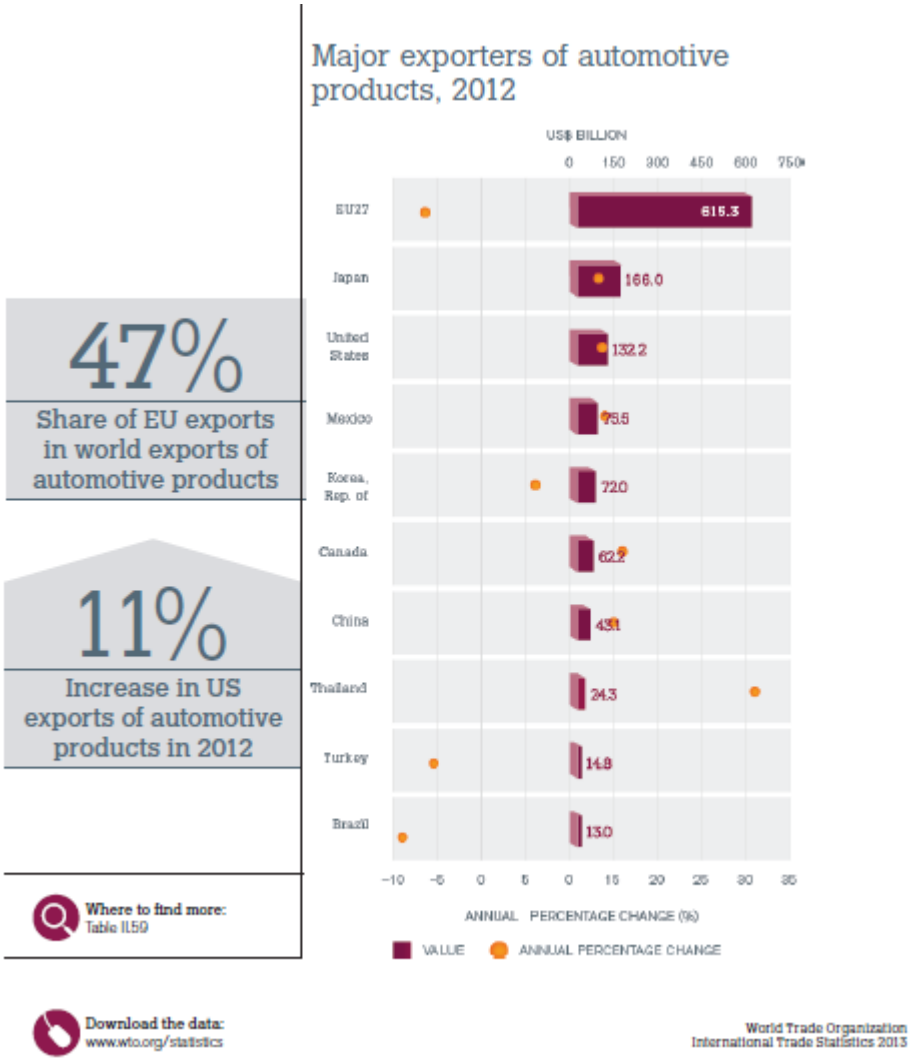


* 1= Highest Priority, 4=Neutral, 7= Lowest Priority

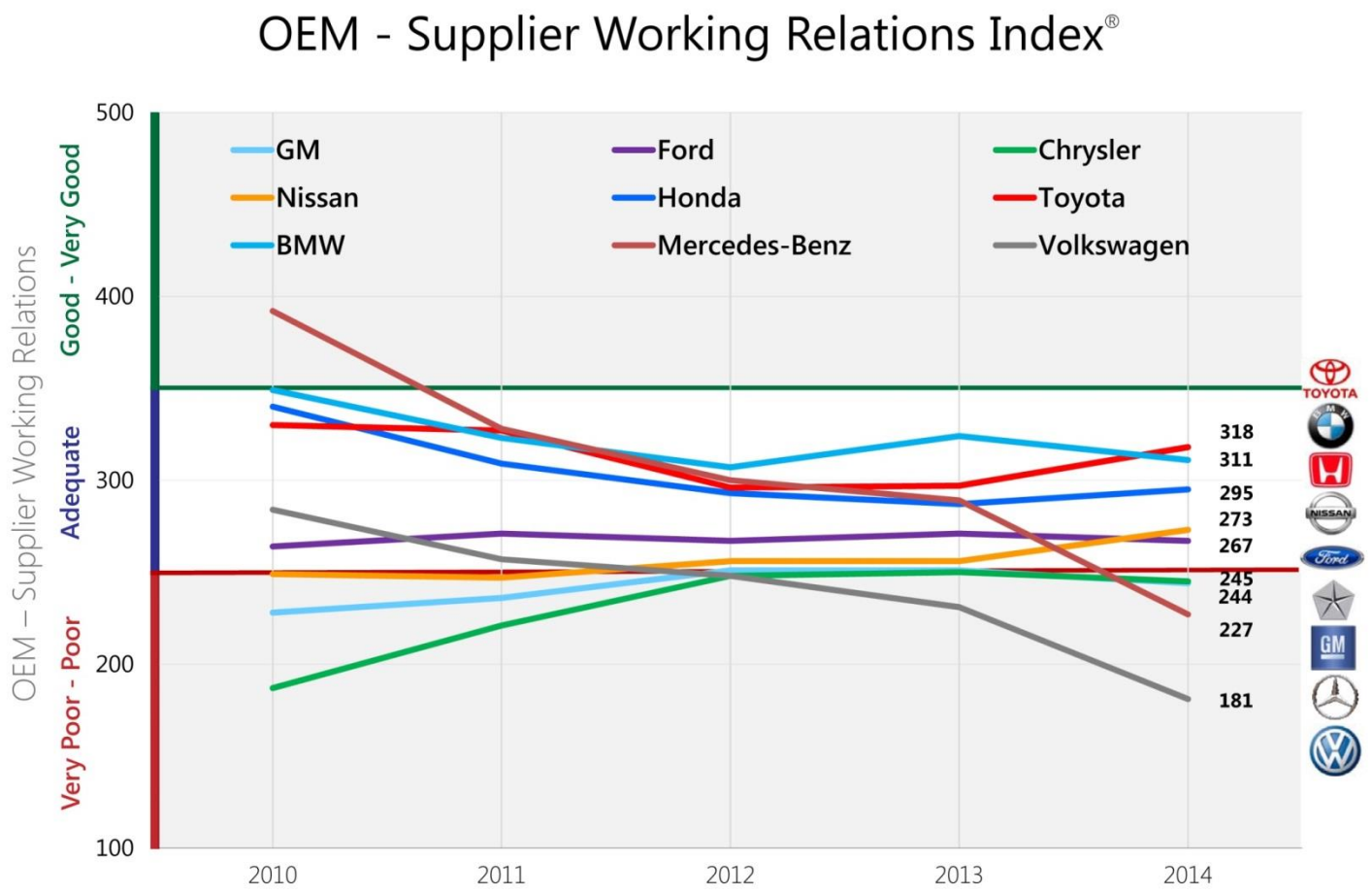
Question: Considering your required engineering capability needed to meet your targeted, regional business growth through 2020, rank the regions where you will need to expand capabilities.

No. of Responses = 71-104

As OEM Market Shares Fractionalize (more local sales) and Electronic-Content Increases (value increases/weight), Trans-Pacific Partnership and the Transatlantic Investment & Trade May Equate Exports Around the World



To Pull All of this Off – Customer-Supplier Relationship Effectiveness Must Improve



Planning Perspectives, Inc.

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OEM-Supplier Effectiveness Will Set Customers and Suppliers Apart

- **Providing Financial Progress Payments –** It's all about being a customer of choice and lowering the cost to serve
- **Developing Cost Reduction Sharing Programs –** Do unto others . . . .
- **Assuring Required Technical/Engineering Support –** New materials, mechatronicware, new products

And This is More Than the OEM-First Tier: Supplier-to-Supplier Effectiveness at the Interface is Required

- **Improving Production Forecasting Accuracy and Communication –** OEMs to first tier have improved total, platform and even nameplate accuracy; next frontier is TRIM AND PT MIX
- **Improving Capacity Modeling and Verification –** The best first tiers have established single models to assure all customers they will fulfil contracts; but with no excess capacity, first tiers are implementing “go and see” as best they can to assure schedules are met
- **Enhancing Supplier Development Resources –** Resources must be available in good times and bad, in launch phase and in production

The Near-Term Outlook for Suppliers is Good

- 16.8 million unit NA production outlook for 2014 will be met
- It may not be optimized for vehicle (retail/fleet, option content) or cost (expedited freight, overtime)
- If the OEMs are launching 45-50 new vehicles in 2014; major suppliers are easily launching at least one new program per week
- Product, plant and people decisions made or played out in 2014 through 2017 will significantly shape the industry going forward

If There Is a Concern, It is:
The Automotive Squeeze Play

- **Revenue Growth Continues – But Slower, Incremental Growth**
  - ✓ NA: 600,000 to 500,000 to 400,000 year-over-year unit growth

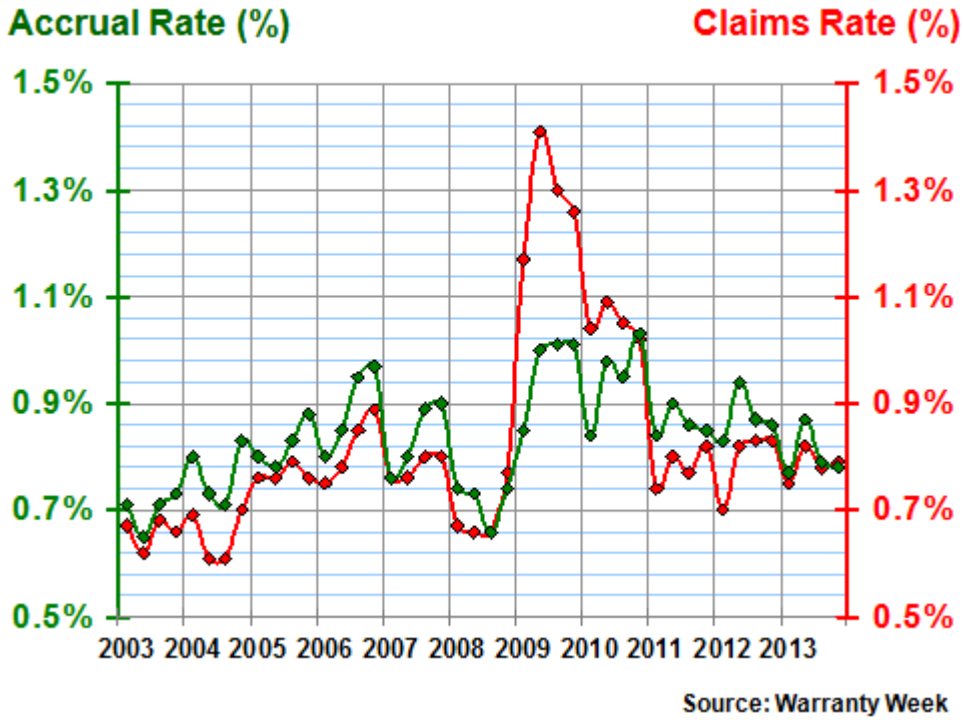
- **Launches Drive Caution – Earnings Warnings**
  - ✓ Ford and suppliers noting caution on outlooks

- **Recalls Drive Panic**
  - ✓ 22 million units through May 2014 (2013 = 23 million)

- **Cash Goes to Shareholders (nothing wrong with that) and Warranty Reserves (non-value added)**
  - ✓ Ford shifts $1.8 billion to dividends and share buybacks; $400 million for reserves

Supplier Trend of Warranty Claims and Reserves of the Drivetrain-related Suppliers . . . In Check, For Now

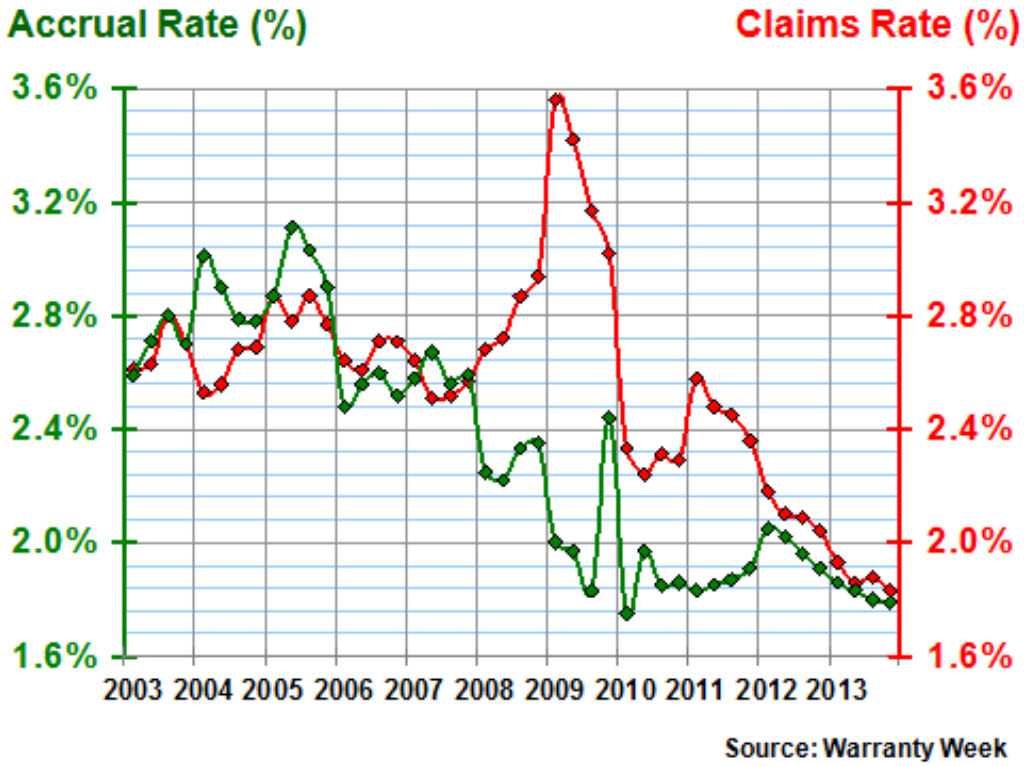
Figure 3
Drivetrain Manufacturers
Average Warranty Claims & Accrual Rates
(as a % of product sales, 2003-2013)



Source: Warranty Week

OEMs – Sales Growing Faster than Warranty Claims and Accruals . . . 2014 will be an Inflection Point

Figure 4
U.S.-based Passenger Car Makers
Average Warranty Claims & Accrual Rates
(as a % of product sales, 2003-2013)



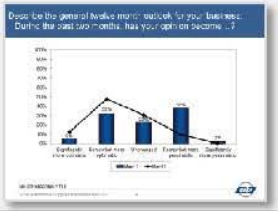
OESA:
The Voice, Forum and Resource for the NAFTA Supply Base

OEM Communication
Open & productive dialogue on behalf of suppliers

Peer Group Councils
Member-driven agendas & roundtables

Industry Studies
Benchmarking, trends, analysis, best practices

Member Surveys
Industry trends & supplier best practices



OESA Events
Thought leadership on critical topics

Advocacy & Voice in DC and the States
Lobbying and interaction with legislators and regulators

OESA Staff
Resources, connections, information, assistance

Global Relationships and Connectivity
Access to global associations & government agencies

The OESA Supplier Network

Thank You

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