Ontario's Automotive Sector

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ONTARIO

The Auto Industry is Strategic for Ontario

- 6 light vehicle manufacturers in Ontario (Ford, GM, Chrysler, Honda, Toyota, and CAMI) with 13 plants

- Over 500 auto parts companies

- Directly employs 140,000 people in the province - 47,000 in vehicle manufacturing, and 93,000 in vehicle parts manufacturing
  - Nearly all of these are high-paying, capital-intensive jobs

- Another 191,000 people employed in the retail, wholesale and service end of the industry

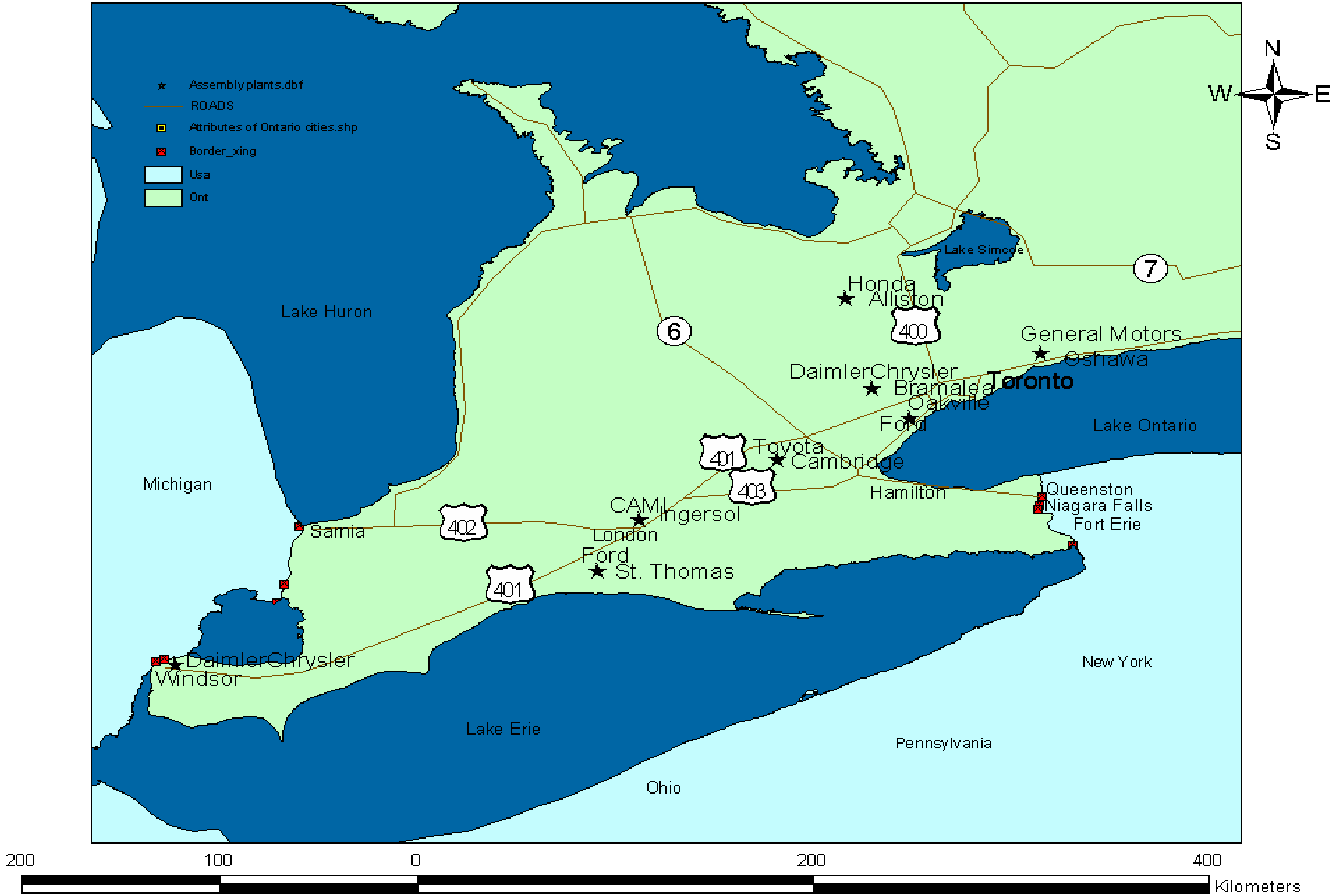
- Thousands more employed in related industries like steel, metals, TDM (tool,die and mold) and plastics

- Approximately 4% of the province’s GDP and 20% of the province’s manufacturing GDP
  - Shipments of $95 billion in 2002

- The auto sector accounts for 27% of Canada’s total merchandise trade surplus.

- About 15.6% of total North American production of 17 million vehicles
  - Ontario is second only to Michigan as a vehicle producing region in North America, ahead of Ohio, Illinois, all southern US states and Mexico

Automotive Assembly Plants in Southern Ontario



Auto Parts Manufacturers in Ontario

source:
2001 Directory of Auto Parts Manufacturers
APMA (Automotive Parts Manufacturers' Association)

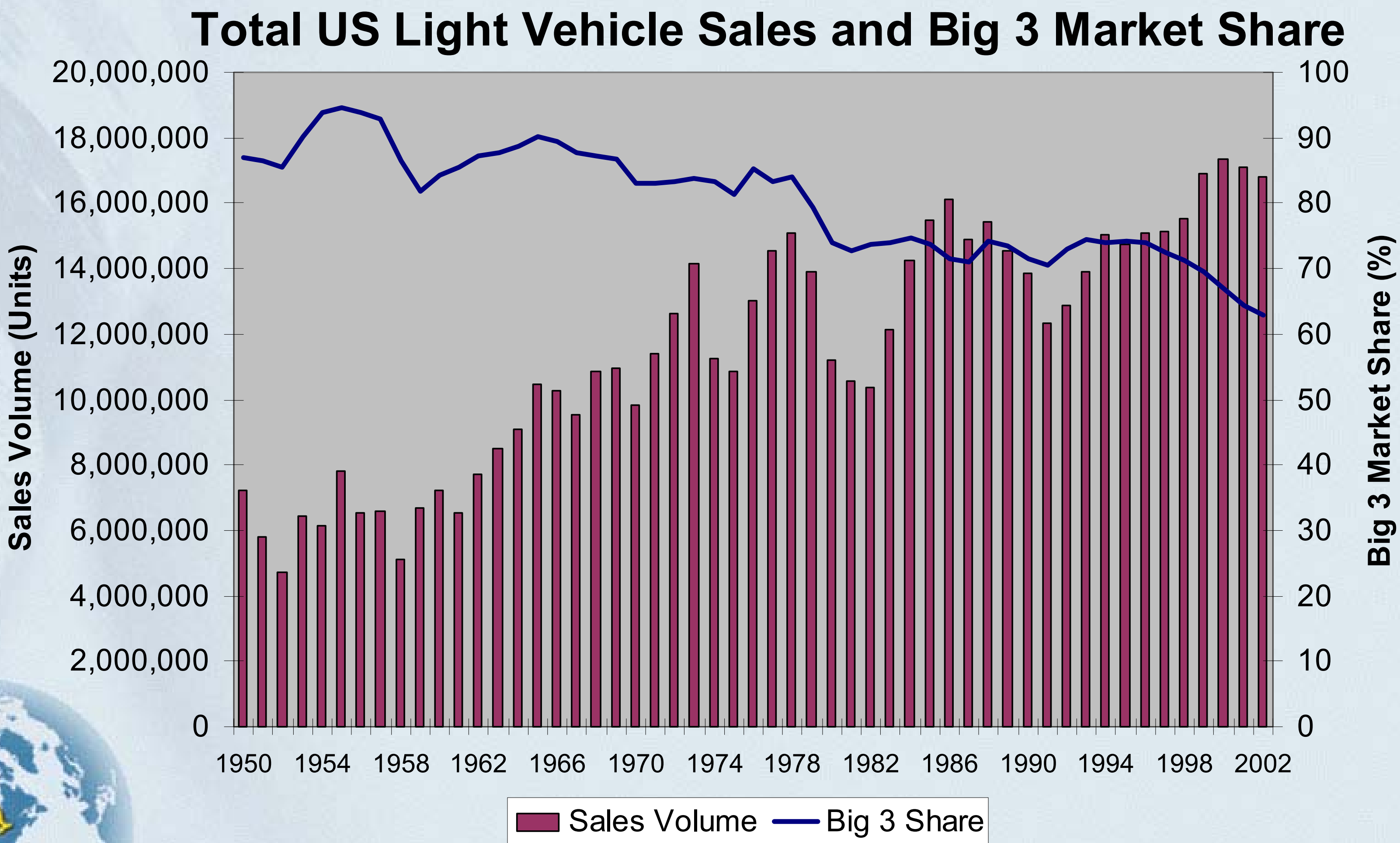
Current Status of Ontario's Auto Industry

- 2002 was a strong year, yet Ontario's auto sector faces several challenges.
- Strong sales in 2002 were driven by retail incentives such as 0% financing rolled out after September 11, 2001, first by GM, then by Ford and Chrysler. Other manufacturers followed suit, though to a lesser extent.
- Sales are down slightly this year, despite increasingly aggressive price competition and retail incentives. US and Canada Year-to-date (Jan-Sep) sales are down about 1.9% from the same period last year, to 13.9 million units.
- Industry watchers continue to be cautious, and warn that hefty sales incentives in late 2002 pulled forward vehicle purchases that might otherwise have been recorded in 2003.
- Slower sales have translated into lower production in Ontario. Year-to-date (Jan-Sep) production is down 8.1% from the same period last year, to 1.8 million units.
- One Ontario auto plant has closed this year, DaimlerChrysler's Pillette Road facility in Windsor. Ford's Ontario Truck Plant in Oakville, is scheduled to close in June 2004.

Challenges for Ontario's Auto Sector

- 77% of Ontario's production is by the Big 3 automakers, which are losing market share.
- Collectively, the Big 3 have only 57% share (and falling) of the US and Canadian light vehicles market. This is down from about 75% in the mid-1990s. (Data from Ward's).
- In the North American light vehicle market, one percentage point of market share is approximately equivalent to the capacity of one auto plant.
- Fortunately, many Big 3 vehicles made in Ontario tend to sell well (eg. Chevrolet Impala, Ford Crown Victoria/Mercury Grand Marquis).
- Ontario is home to many plants which are the sole location for production of several models: Ford Freestar, Crown Victoria, Mercury Grand Marquis, Marauder, Chevrolet Impala, Buick Regal, Pontiac GP, Chrysler Pacifica, Toyota Matrix, Acura 1.7EL
- Intensifying price competition between manufacturers to preserve market share (rebates, 0% financing). Consolidation and restructuring continues.

Traditional Manufacturers are Under Pressure…



Challenges for Ontario's Auto Sector (Con't)

- For some companies (the Big 3), production capacity greatly exceeds demand for their vehicles.

- Worldwide, the auto industry has the capacity to produce about 80 million units annually. However, annual worldwide quantity demanded is only about 57 million units.

- This is a problem in North America also: 24 million units of capacity, less than 20 million units demanded.

- It is important to note that this is a company-specific problem: some companies (Honda, Toyota) are able to make full use of their capacity, because of advanced production management and that their vehicles are selling well.

- Industry is adapting to the presence of excess capacity in several ways:
  - Flexible capacity – Capacity to produce several vehicles on the same line, so that production can respond to shifts in demand.
  - Capacity reductions – Plant closures (Ford-Ontario Truck Plant in Oakville, Chrysler-Pillette Assembly Plant in Windsor)
  - Increased reliance by Big 3 on fleet sales and high retail incentives to keep plants operating fully.

Challenges for Ontario's Auto Sector (Con't)

- In the current environment, many North American jurisdictions are competing for auto manufacturing investment. The sector's high wages and employment multipliers have recently drawn non-traditional auto jurisdictions into this competition, primarily southern US states.

- This competition has led many jurisdictions to offer substantial financial incentives to auto companies that locate there. These may be as high as US$300 million, or over 50% of total investment costs, and more than US$100,000 per direct job created.

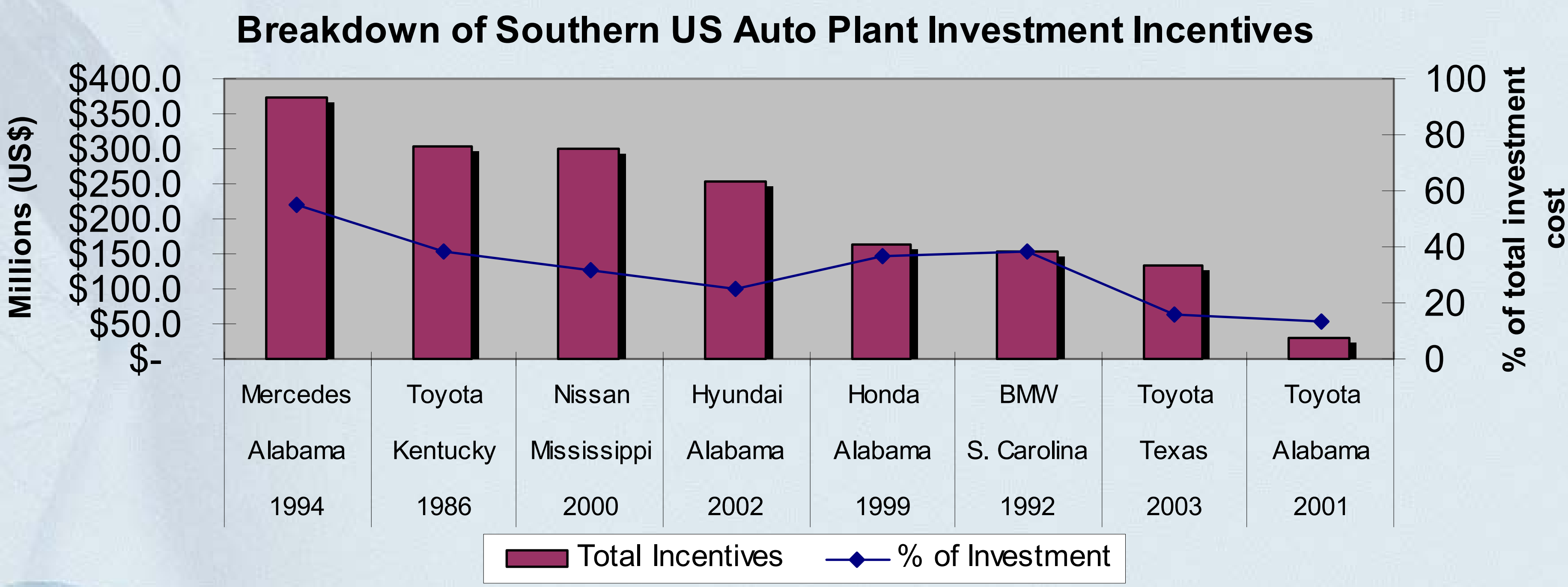
- Parts plants employ more people than assembly plants, and they locate near assembly plants. Attracting assembly investment means getting more parts investment and jobs.

- The Governments of Ontario and Canada are under pressure to provide direct financial incentives to land new automotive plant investments.

- Shifting production in response to location incentives – The US auto industry is shifting southward, along I-65 and I-75.
  - Incentives are now routinely demanded by companies as part of building the "business case" for new assembly plants.

- Ontario has responded by creating the Large Scale Strategic Investment (LSSI) program:
  - $625 million fund (over 5 years) to promote research and development, skills training, and infrastructure.

Investment Incentives



Challenges for Ontario's Auto Sector (Con't)

- Over the past ten years, traffic at Ontario's border crossings with the US has increased dramatically, causing congestion whenever there is a disruption – accident, heightened homeland security alert in US, etc.

- Ontario's auto industry is highly integrated with that of the US. Just-in-Time production systems require the fast, efficient movement of components and assembled vehicles across the border.

- Example: There is only a 4 hour window between the time an assembled engine comes off the line at Ford's Windsor engine plant and the time the finished vehicle it is used in rolls off the line at Ford's Michigan Truck Plant.

- The perceived risk of border disruption has caused companies in Canada to keep uncompetitive levels of inventory. It may also negatively impact future investment decisions.

- The federal and provincial governments announced a joint $300 million project to improve border access at the Windsor border crossing. Several competing proposals have emerged, and there has been opposition from the Windsor community.

- Industry is participation in government programs to speed up border access such as Free And Secure Trade (FAST) initiative, as well as other efforts to increase security and speed up trade/border flows.

Problems Roll Downhill:
The Challenges in Ontario’s Auto Parts Sector

- About twice as many people work in the automotive parts manufacturing sector in Ontario as work in automotive assembly (93,000 vs. 47,000).

- The parts sector is heavily dependant on the auto assembly sector: parts plants co-locate near their customers, etc.
  - The Just-in-Time delivery systems that characterize auto manufacturing make these linkages even more significant.

- The increasingly competitive nature of the automotive sector has led auto companies to demand significant price reductions from their suppliers. This has put serious financial pressures on these suppliers.

- However, at the same time auto companies are downloading increasingly costly and sophisticated activities to their parts suppliers, including substantial R&D activities and large component and system design functions.

- As well, the parts sector faces challenges common to other manufacturing sectors:
  - Skilled labour shortages
  - Border congestion
  - Competition from emerging economies: China, India, Brazil
  - Exchange rate risk (the rising value of the Canadian dollar)

Key Question

- In the context of a fiercely competitive industry plagued by overcapacity and an increasingly expensive investment incentives game, how can traditional auto jurisdictions maintain and expand existing auto manufacturing capabilities?

- Addressing this means facing several related challenges:
  - Training the next-generation of workers
  - Staying innovative
  - Preserving trade

Toward a New Auto Policy for Ontario:
The Challenge for Government

- This is a difficult time for many automakers: profits are down, sales are falling despite increasing retail incentives.
- The auto industry is maturing: new competitors are emerging, prices are falling as retail incentives have become common place.
- In this environment, companies are becoming increasingly innovative: introducing new production technologies, new products/new features.
- Challenge for governments: policy must also become more innovative and responsive to an evolving sector.
- Federal and provincial governments have responded by creating the Canadian Automotive Partnership Council (CAPC), a partnership between industry, government, and labour focused on developing a new policy vision for the auto industry.
- Ontario has many strengths: high productivity, high product quality, skilled workforce.
    - Policy can help maintain these strengths
- But Ontario's main challenge is a lack of investment from new players, and the precarious financial position of many parts makers (exchange rate risk, etc.)
    - Policy must address these weaknesses

Toward a New Auto Policy for Ontario:
Components of a Successful Industry

Competition for New and Existing Markets

Need for Auto Vision/Strategy (CAPC)

Enhanced Skills Training

Auto Cluster Components

Assembly Plants

Parts Suppliers

Other Suppliers (Steel, TDM, Transportation)

Universities, Colleges

Removing Regulatory Impediments

Lower Costs (taxes, energy, labour, etc.)

Keeping Pace with Innovation (R&D, commercialization)

Efficient Border Access

Summary:
The Scope of the Challenge

- Despite claims to the contrary, Ontario's auto sector is not "dying":
  - Automakers and parts companies still invest billions of dollars in the province each year.
  - Ontario-made vehicles are industry leaders in quality, and our plants are some of the most productive in the world.
  - Honda and Toyota continue to perform extremely well: popular products, strong profits.

- Nor are the Big 3 doomed to collapse:
  - A slew of new products are being released over the next several years which have received early praise.

- Nevertheless, the challenges the sector as a whole, and the Big 3 in particular, face are real:
  - Sales have fallen in 2003, and are expected to fall again in 2004.
  - Price wars are seriously cutting into profitability, which is affecting auto companies investment plans, and their ability to spend on new vehicle programs.
  - Ford has staked the company's future on the success of its new F-150 pickup truck at a time when the pickup truck market is becoming increasingly competitive, with new entrants in scheduled in 2004 (Nissan) and 2005 (Toyota).
  - Several analysts are predicting that Chrysler may be sold off by its German parent company due to poor financial performance.

- While these challenges are not insurmountable, ensuring that Ontario's auto sector continues to thrive in this context will require flexibility and creativity on the part of all stakeholders, including governments.