The Automotive Suppliers: State of the Industry

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Original Equipment Suppliers Association

- Formed in 1998, Affiliated with the Motor Equipment Manufacturers Association
- 353 members
  - Global automotive sales over $300 billion
  - Complete supply chain, Tier 1–n
  - Suppliers of modules, systems, components, materials, engineering, tools, dies, molds
  - Represent 65% of NA OE Sales
- Operate nine Peer Group Councils, 400+ executives
- Conducted 20 events in 2003, over 3,000 participants
- Addressing a number of industry issues
- Serve as a credible industry voice
OESA Regular Member Distribution
— by Revenue

- 353 total members
- 288 regular members
- $300 b global sales

- 55% of members have sales below $150 million
- 32% of members have sales between $150 million and $1 billion
- 12% of members have sales over $1 billion ($200 b global sales)
Motor Vehicle Industry
Profitability v. Production—
Are breakeven points increasing?

Source: US Bureau of Economic Analysis
Are Demands for New Business Model from Structural Barriers or Dysfunctional Behavior

Many issues within the industry’s own control

- **Price Deflation**
  - Structural: increased global information, international competition
  - Behavioral: OEM purchasing incentives and budget structures

- **Purchasing Strategies**
  - Structural: consumer-driven deflation, product liability/risk aversion
  - Behavioral: constant resourcing - no thought toward strategic partnership and collaboration

- **Production Cyclicality and Sales Growth**
  - Structural: interest rates, credit availability, vehicle scrap rates
  - Behavioral: sales forecasting euphoria, production schedule volatility

- **Legacy Requirements**
  - Structural: health care and pension benefits
  - Behavioral: price down/risk up, not cost elimination focus
Did the 90s Strategies Create the “Broken Business Model?”

- **Mergers and Acquisitions**
  - Did promised synergistic benefits payoff?

- **Outsourcing**
  - Have total industry costs been reduced or simply re-allocated?

- **Organizational Restructuring**
  - Have product development process efficiencies, consumer orientation, and other objectives been fulfilled?

- **Systems Capabilities**
  - Did supplier industry horizontal “product” consolidation overlook vertical “process” rationalization payoffs?

- **Technology Investments**
  - Did IT capital expenditures pay off – except for getting industry through Y2K?
Outline: Supplier Challenges

Market Pressures

Financial Markets Pressures

Input Cost Pressures

Business Environment Pressures
US Light Vehicle Sales

2004 Forecast: 16.8 to 17.2 million units

Source: US DOC – seasonally adjusted annual rate
US Light Vehicle Production –
2004 Forecast: Steady at 12 Million Units

Source: Wards and CSM Worldwide
North American LV Production
Traditional Domestics hold 1990 – 1993 Levels

Source: McDonald Equity Research
GM North American Auto Revenue –
Flat revenues force concentration on costs

Source: Company reports
Ford Worldwide Auto Revenues – Flat revenues force concentration on costs

Source: Company reports
Revenue = Units X Price

Big 3 U.S. Light Vehicle Market Share

Source: Center for Automotive Research
Average Incentive Per Vehicle
Aggressive Pricing will Continue

- Honda: $874
- Toyota: $876
- Nissan: $1,681
- Industry: $2,932
- Ford: $3,461
- Chrysler: $4,044
- GM: $4,227

2004 Calendar Year through April    Source: Merrill Lynch and Autodata
PPI: Motor Vehicle Parts
OEMs Reducing Variable Costs

Source: U.S. Bureau of Labor Statistics
Pricing Pressures –
No relief in sight

- World vehicle capacity is targeted at the US market
- Distressed businesses in capital-intensive industries focus on capacity utilization – good and bad capacity
- Good capacity brings a price premium on products in high demand
- Bad capacity brings negative pricing for products in low demand
- Greater information by consumers allows more discerning purchases
  -- This results in continuing pricing pressures
Steel Spot Prices – ($/net ton)

Drivers
- China steel production growing 20% + per year over the past 2 years – expectation is 17% growth for 2004
- US and European demand increasing
- Transportation shortages; energy, scrap, and coke price increases

Impact
- Smaller suppliers exposed up to 66% of their buys not on re-sell programs
- 75% of steel buys are cold and hot rolled
- Wide range of purchase impacts: 46% median increase for hot and 37% median increase for cold
- Wide range of recovery impacts: OEMs minimal on current programs; suppliers giving 1/3 of business 75% plus recovery
  Re-adjusting 2005 financial

Source: Purchasing Magazine and Plante & Moran
Short-term
- China steel production growing 20% + per year over the past 2 years – expectation is 17% growth for 2004
- US and European demand increasing
- Transportation shortages

Forecast
- Expectation that peak has been hit or is near
- Q3/Q4 moving back toward 2003 levels – index level of 200 to 250
- Large users may keep sales for domestic market to secure finished steel allocations
- Efforts for US export restraints

Supplier Profitability – One Sample

Source: McDonald Equity Research
Note: 11 company sample including ArvinMeritor, BorgWarner, Dana, Delphi, Gentex, Intermet, Johnson Controls, Lear, Stoneridge, Superior Industries, Visteon. ROC = EBIT/Average Total Debt + Equity
2003 ROC vs. Asset Turns

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Outline: Supplier Opportunities

Customer Mix Management

Market Opportunities

Total Cost Management

Business Processes and Practices
Customer Diversification Strategy

Suppliers aspirations exceed past performance

Source: McKinsey & Company
Industry Price Downs – 2003 Experience

Source: IRN, Inc.
Evaluating Outsourcing –
It is more than just piece price

- Structural Costs ($)
  - Labor
  - Logistics
  - Duties/Tariffs
  - Inventory Holding
  - Raw Materials
  - Energy
  - Capital
  - Technology
  - Complexity
  - Supply Chain Overhead

- Risks (? - $)
  - Currency Exchange
  - Country Risk
  - Wage Inflation
  - Product Launch Risk
  - IP Protection
  - Expediting
  - Safety Stocks
  - Lost Product
  - Shipment Stoppage
  - Product Obsolescence

Source: Booz Allen Hamilton, 2003; Innovation Study
Economics 101 –
Industry Margin Increase through Productivity

If Sales Price (pricing pressures) ↓ Quantity ↔ Input Price (steel, energy, labor) ↑

The only way to ↑ Margin is to

↑ Productivity
Multifactor Productivity 1990-1999

It is no wonder capital flows to other industries

<table>
<thead>
<tr>
<th>Industry</th>
<th>Average Annual % Change</th>
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<tbody>
<tr>
<td>Drugs</td>
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<tr>
<td>Industrial Organic Chemicals</td>
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<td>Multifold Business Forms</td>
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<td>Paints and Allied Products</td>
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<td>Motor Vehicles</td>
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<td>Communications Equip</td>
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<td>Flat Glass</td>
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<tr>
<td>Elec. Components</td>
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<tr>
<td>Computer/Office Equip.</td>
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</table>

Source: US Department of Labor
Multi-Factor Productivity -
Is the Industry Outsourcing Effectively?

Source: US Department of Labor
Premium for Automotive Labor –
Auto wage growth forced Delphi/Visteon restructuring

<table>
<thead>
<tr>
<th>Year</th>
<th>Hourly Wage</th>
<th>Average U.S. Mfrg. Wage</th>
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<td>$70.0%</td>
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</tbody>
</table>

Source: Center for Automotive Research
Restoring Industry Profitability Requires Suppliers and OEMs Coming Together

- **Economies of scale and capacity utilization**
  - Consolidation will continue to concentrate the industry into fewer mega-corporations; but successful companies will be flexible to respond quickly to market needs through the entire supply chain

- **Enterprise efficiency**
  - Industry must address total risks and costs to achieve true productivity improvement; but joint-ventures and outsourcing increase complexity but offer potential market opportunities and total cost reduction

- **Technology**
  - Real time, accurate information will drive the supply chain of the future; tremendous opportunities; but information cannot be used in a retaliatory manner

- **Common sense business behaviors**
  - An efficient business model is based on the best information possible and a common understanding of business practices to allow the best possible investment decisions
Total Vehicle Market Opportunity
Suppliers avenues to improve the revenue side

System Total Market Potential

- OE Outsourcing
  - Cost of Capital
  - Cost Structure
  - Productivity/Innovation

- Content Per Vehicle
  - Regulation (government)
  - Market Demands (customers)
  - Option/Standard Feature (manufacturer differentiation)

Total Units

- Trend Line
- Cyclical Position

Source: Center for Automotive Research
New Vehicle Launches – Path to increased units and content

Source: Merrill Lynch & Co.
New Vehicle Selling Price – Supplier opportunity for content

Source: National Automotive Dealer Association
Incremental Dollar Value – 2000 to 2010 Market by System
Assuming constant unit volumes and on-going pricing trends

Assumes “average” vehicle; total component cost increasing from $13,600 to $15,635 or 16%

Source: Center for Automotive Research, Estimating the New Automotive Value Chain
Overall Index Rating by OEM

Level of support influences who suppliers work with

BMW
Toyota
Honda
Mercedes
Nissan
DCX
Ford
GM
Industry Average

Sources: Automotive News and J. D. Power & Associates News
Financial Incentive Rating by OEM

“Show me the money;” Ranked by overall index rating

BMW
Toyota
Honda
Mercedes
Nissan
Industry Average
Mazda
DCX
Ford
GM

LOW OEM Willingness to Use Economics to Support HIGH

Sources: Automotive News and J. D. Power & Associates
Global Vehicle Production – Suppliers’ Footprint is Enlarging

Source: CSM Worldwide
# Issues Driving Re-Balancing the Global Manufacturing Footprint

<table>
<thead>
<tr>
<th>Action</th>
<th>Priority</th>
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</thead>
<tbody>
<tr>
<td>Move to low labor cost location</td>
<td>Top: 31%</td>
</tr>
<tr>
<td>Move with or closer to customer</td>
<td>Top: 12%</td>
</tr>
<tr>
<td>Idle or close excess capacity</td>
<td>Top: 10%</td>
</tr>
<tr>
<td>Expand current facilities or capacity</td>
<td>Top: 6%</td>
</tr>
<tr>
<td>Build one or more new factories</td>
<td>Top: 4%</td>
</tr>
</tbody>
</table>

Source: RolandBerger, The Odyssey of the Auto Industry, 2004
Growing Global Footprint – Requires Strategic Resource Allocation

- Total cost and risk analysis
- Local market and supply chain due diligence
- Integrating product designs and manufacturing processes to global strategies
- Increasing management skills and capabilities
- “Skate to where the puck is going”
Capital is Available

Senior Bank Debt

High Yield Debt

Source: E&Y and the Loan Connection; March 2004
The Industry Standard Score Card

- Production cyclicality stability
- New vehicle program opportunities
- Increasing alignment of value add and cost structures

- Industry fixed costs; business process efficiency opportunities
- Short-term production schedules: incentives v. inventories
- Capital availability – for the right projects; but commercial risks are increasing
- Globalization – risk and rewards out of sync

- Input costs
- Industry dysfunctional behaviors (OEMs and suppliers)
- Long-term industry share of traditional customer base