Automotive Industry Outlook

VERSION 01 | YEAR 13

OUTLOOK: Positive fundamentals & outlook

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Key Points

- Revived consumer spending, improvements in credit availability, the shift to green vehicles, and an aging vehicle fleet will drive growth in the upcoming years.
- The average age of the U.S. light vehicle fleet is at a record high of 11.4 years, which, coupled with rising consumer confidence, should result in growth for both original equipment manufacturers (OEM) and auto parts suppliers.
- Automakers and their suppliers continue to see the shift in demand for fuel-efficient vehicles, as consumers remain sensitive to gas prices.
- An improving housing sector and better mileage are driving truck demand. Domestic manufacturers are benefitting as their product mix is more dependent on higher margin truck sales.
Overview

Many auto companies restructured their operations, in or out of bankruptcy, during The Great Recession. As a result, the industry emerged stronger and more flexible to the current operating environment. Post-recession, the U.S. auto industry landscape has changed significantly resulting in a leaner, more efficient sector. As consumer finances continue to improve, they are more willing to purchase big ticket items like homes and vehicles. Revived consumer spending, improvements in credit availability, the shift to green vehicles, and the aging vehicle fleet are all predicted to drive auto sector growth in the upcoming years.

In 2013, auto manufacturers are seeing and will continue to see an increase in new car sales, with projected revenue growth of 8.6% for the year. Auto parts supplier growth is highly correlated to demand for new vehicles, as 95% of their sales are derived from OEMs. Consequently, higher demand for new vehicles drives growth for auto parts suppliers. Profit margins are expected to broaden, as sales growth outpaces input costs. This profitability and optimism will likely attract many companies that cut their auto business lines during the recession and exited the sector. However, their re-entry will cause little change to the current industry environment.

Current Situation

According to WardsAuto, both 2010 and 2011 U.S. light vehicle sales saw robust growth at 11.1% and 10.2%, respectively, as sales rebounded off the heels of the recession. In 2012, U.S. light vehicle sales growth was 13.4%, and marked the highest annual sales total since 2007. Year-to-date, sales growth has been slower, albeit still strong, around 8.5% year-over-year and is expected to accelerate. In July light vehicle sales on a seasonally adjusted annualized basis crossed over $16M for the first time since 2007. Despite a slow and uneven economic recovery, consumers are clearly willing to spend on big ticket items.

The industry continues to recognize the shift in consumer preference towards fuel efficient vehicles, which consequently has spurred competition to increase production in a cost-efficient manner. Ford and Toyota are expected to focus on hybrids based on existing platforms, resulting in lower costs and wider margins. Gas and battery hybrids along with high-mileage gas engine vehicles have met better demand than plug-in hybrid electric vehicles (PHEV). The market reception for PHEV’s has been lukewarm in spite of tax incentives. PHEV’s continue to face limited upside until prices fall to a level where the consumer can justify the purchase.

The Big Three (GM, Ford, and Chrysler) continue to be major players in the U.S. automotive marketplace, accounting for a combined 45.5% of YTD deliveries through September. Their combined market share is up 51 basis points due to strong performance by Ford, whose revamped line up and continued success of the F-Series truck platform is driving improvement. Improved overall quality and solid market reception for new products has left the Big Three well-positioned for market share growth. Foreign car makers like Toyota, Hyundai/Kia, and Volkswagen all lost market share in 2013, with Hyundai/Kia posting the biggest decline.
U.S. Light Vehicle Deliveries – Year-to-Date – September 2013

<table>
<thead>
<tr>
<th></th>
<th>2013 YTD</th>
<th>2012 YTD</th>
<th>% Change</th>
<th>2013 YTD % of U.S. Market Share</th>
<th>2012 YTD % of U.S Market Share</th>
<th>Market Share ∆ y/y (basis points)</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Motors</td>
<td>2,117,459</td>
<td>1,967,715</td>
<td>7.6%</td>
<td>18.0%</td>
<td>18.1%</td>
<td>-9</td>
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<tr>
<td>Ford</td>
<td>1,887,672</td>
<td>1,685,068</td>
<td>12.0%</td>
<td>16.0%</td>
<td>15.5%</td>
<td>56</td>
</tr>
<tr>
<td>Toyota</td>
<td>1,698,179</td>
<td>1,571,424</td>
<td>8.1%</td>
<td>14.4%</td>
<td>14.4%</td>
<td>-1</td>
</tr>
<tr>
<td>Chrysler</td>
<td>1,357,003</td>
<td>1,250,670</td>
<td>8.5%</td>
<td>11.5%</td>
<td>11.5%</td>
<td>4</td>
</tr>
<tr>
<td>Honda</td>
<td>1,159,012</td>
<td>1,066,458</td>
<td>8.7%</td>
<td>9.8%</td>
<td>9.8%</td>
<td>5</td>
</tr>
<tr>
<td>Hyundai / Kia</td>
<td>964,601</td>
<td>974,728</td>
<td>-1.0%</td>
<td>8.2%</td>
<td>8.9%</td>
<td>-76</td>
</tr>
<tr>
<td>Nissan</td>
<td>941,116</td>
<td>866,484</td>
<td>8.6%</td>
<td>8.0%</td>
<td>7.9%</td>
<td>4</td>
</tr>
<tr>
<td>Volkswagen</td>
<td>431,593</td>
<td>425,812</td>
<td>1.4%</td>
<td>3.7%</td>
<td>3.9%</td>
<td>-24</td>
</tr>
<tr>
<td>All Other</td>
<td>1,229,901</td>
<td>1,091,550</td>
<td>12.7%</td>
<td>10.4%</td>
<td>10.0%</td>
<td>42</td>
</tr>
<tr>
<td><strong>Total Light Vehicle Sales</strong></td>
<td><strong>11,786,536</strong></td>
<td><strong>10,899,909</strong></td>
<td><strong>8.13%</strong></td>
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</tr>
</tbody>
</table>

| Big Three (CM, Ford, Chrysler) | 5,362,134 | 4,903,453 | 9.35% | 45.5% | 45.0% | 51 |

Source: Autodata Corp

Auto suppliers continue to benefit from post-recession restructuring and cost-cutting initiatives resulting in a more profitable and stable future. Consumer demand continues to drive OEM production rates, which bodes well for the auto parts industry, due to the strong correlation between OEM demand and auto parts demand. Suppliers that manufacture parts that augment fuel efficiency will have a competitive advantage and a strong market niche moving forward. Also, due to the aging fleet, suppliers will continue to see robust aftermarket demand.

U.S. Light Vehicle Market Share YTD - September 2013

- 18.0% General Motors
- 16.0% Ford
- 14.4% Toyota
- 11.5% Chrysler
- 9.8% Honda
- 8.2% Hyundai/Kia
- 8.0% Nissan
- 3.7% Volkswagen
- 10.4% All Other

Source: Autodata Corp

Outlook

The outlook for the auto manufacturing industry and its suppliers is bright, as consumer spending is expected to rise and the aging vehicle fleet is at record highs. Automotive sales are highly correlated with consumer confidence which is generally improving as consumers continue to strengthen their finances and reduce household debt levels. As a result, banks are more willing to extend favorable credit terms making it more feasible for consumers to purchase big ticket items. Auto loan originations increased in 2013 to $92 billion, the highest level since 2007. Coupled with an expanding population, favorable demographics, and new vehicle line-ups, these trends further bolster the long-term growth outlook.
Full-size pickup sales and housing starts are highly correlated. Housing starts have seen a positive trend in recent years and as a result have bolstered truck sale growth, regardless of the high fuel costs. Both new truck and car registrations are seeing growth although the spread is not as wide because of the shift to more fuel-efficient vehicles, the notion that trucks and SUVs are not a “need to buy” item for the average consumer and that more fuel efficient cars may be more practical.

Industry revenue is expected to continue to rise but the rate of increase will decline as pent-up demand tapers off and industry sales close in on their long-term historical average. The industry is releasing 41 new launches in 2014, up from 20 in 2013, which could outpace expectations. Rapid increases in gasoline costs would push consumers towards smaller more fuel efficient vehicles, but the product balance between trucks and cars is currently being supported by improved truck mileage and a rebounding housing sector. Although raw material input prices are expected to increase in coming years, auto makers’ profit margins will strengthen due to improved operational leverage from higher sales levels. Finally, inventories are stable and manufacturers do not need to rely on margin cutting incentives to spur purchases.
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