

Opportunities in adversity

Automotive survey snapshot

Overview

The automotive industry is facing unprecedented challenges and turmoil in the wake of the prolonged global financial crisis. Declining consumer confidence coupled with the tightened credit market has eroded demand for new vehicles. What's more, the industry is facing other, somewhat familiar challenges: costs of raw materials and fuel remain volatile, regulations are increasing, and pressure is intensifying from both government and consumers to produce greener, cleaner vehicles.

With the Economist Intelligence Unit, in June 2009, we interviewed senior executives from major automotive industry firms around the world to gain insights into how these firms are managing their businesses during this tumultuous period. While it was no great surprise that the respondents were troubled by the impact that the downturn has had on their businesses, there were positive signs about the sector's willingness and ability to implement swift and decisive actions. What's more, respondents even indicated glimmers of promising signs – most notably new products that should emerge from continued investment in research and development (R&D). Automotive company executives that participated in the survey also revealed a fundamental shift in mindset, from an industry-wide focus on profits to one focused on liquidity and cash flow management and forecasting.

With the awareness that the financial crisis has impacted the automotive industry as severely as – if not more so than – any other industry, Ernst & Young highlights how executives are actively managing to secure their companies' present, improve their performance and position to sustain their future.

Market challenges: cash management focus emerges

Worldwide, the market for new vehicles has declined sharply due to the economic crisis. Automakers have responded by reducing headcount and closing factories in the hope of rightsizing their organizations to the new sales reality. Expansion plans in promising markets (such as Russia and India) have been shelved as the industry looks for signs that the market has reached the bottom. Governments around the world have stepped in, taking extraordinary measures – ranging from direct loans to automakers and suppliers to implementing incentive regimes designed to spur vehicle sales – to assist struggling industry participants. Still, the industry has been rife with bankruptcies and the de facto nationalization of distressed automakers.

About this survey

For this study, the Economist Intelligence Unit surveyed 569 C-suite and board-level executives.

Respondents were drawn from across the world and across industry sectors. More than half the executives polled worked for companies with annual global revenue in excess of US\$1 billion.

The research was carried out in June 2009.

Responses are rounded to the nearest percentage.



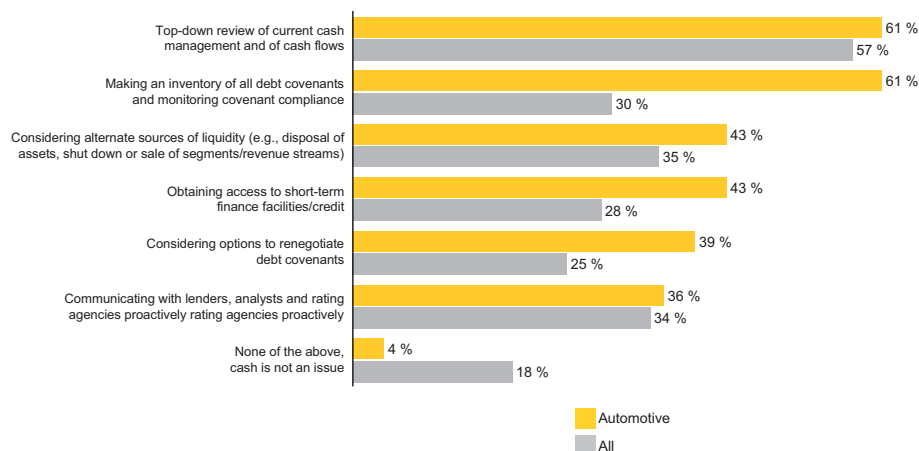
Automotive survey respondents are not just dealing with the past; they also are keeping an eye out for opportunities so that their companies are best positioned to thrive in a recovery.

The decrease in industry revenue, as well as companies' inability to obtain credit to fund operations, has raised the industry's appetite for cash management. Companies are also pursuing cost control initiatives with vigor, focusing on enterprise-wide improvements, along with driving supply chain and procurement efficiencies. Reduced revenue as a result of decreased vehicle production, combined with lessened capital availability has resulted in bankruptcy filings by vehicle manufacturers, which in turn further reduced vehicle production. Accordingly, bankruptcy filings of retail dealerships and component suppliers have also accelerated rapidly in 2009. These market dynamics are forcing industry participants to recalibrate their strategic plans to ensure that they will be able to survive the market downturn and be ready to adapt when sales rebound.

A survey of the auto industry

Automotive industry executives who responded to our survey were more surprised by the speed and severity of the downturn than overall survey respondents. In response, companies in this sector are more focused on cash management, business restructuring and implementing risk management practices. However, automotive executives are not just recalibrating to deal with the past; they also are keeping an eye out for opportunities and are making investments so that their companies are best positioned to thrive in a recovery.

Q: Which of the following steps is your company currently taking to maintain liquidity in the light of current market conditions?

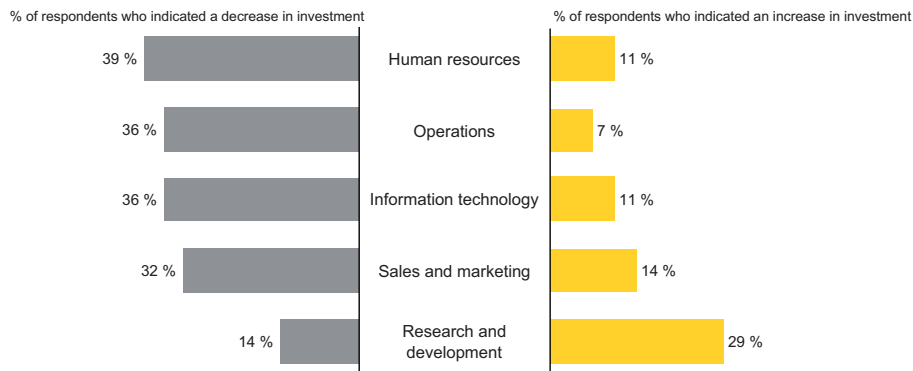


Shown: percentage of automotive respondents compared with overall respondents.

Sector respondents indicated that they are undertaking top-down reviews of current cash management and cash flow scenarios. When asked about other specific steps that companies are taking to maintain liquidity, 61% of auto industry executives said that they are taking an inventory of all debt covenants and are monitoring the compliance of those covenants – more than double the percentage of overall respondents who said they are taking such a step.



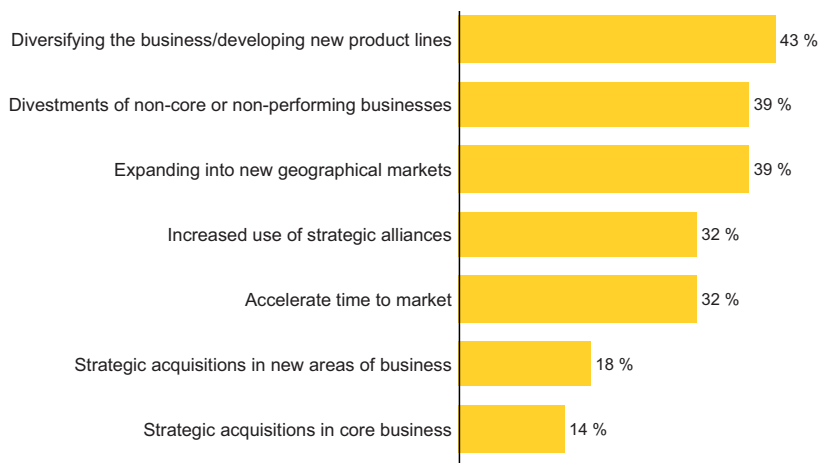
Q: Which of the following functions or activities in your business have been most affected by a decline or an increase in investment at your company in the current economic climate?



Shown: percentage of automotive respondents.

Not surprisingly, the survey shows that auto companies decreased investment in human resources, operations, information technology and sales and marketing – all efforts aimed at reducing spending and conserving precious cash. One area, however, where automotive industry investment is increasing is research and development. This finding emphasizes the acknowledged need for automotive companies to continuously improve their products and processes in order to be globally competitive, in good times or bad.

Q: In the next 12 months, what actions do you plan to take to position your business to emerge stronger from the crisis than your competitors?



Shown: percentage of automotive respondents

Looking forward, sector respondents said they will diversify their business and develop new product lines. Companies will also look to expand into new geographic markets and accelerate time to market. Automotive respondents also indicated that the industry will divest businesses it deems non-core and those that are failing to perform at an adequate level. Additionally, the industry will use strategic alliances to bolster both sales and profitability.

Two responses that were low on the list of potential actions were strategic acquisitions – both in new areas of business or in the core business. Industry consolidation continues to move at an uneven pace, with companies more likely to make selective acquisitions of desirable assets from weakened competitors for the next year or two.

The automotive industry responded to the global economic crisis swiftly and adeptly. It also shifted its focus from profitability more towards cash preservation and improved risk management and forecasting.

Market responses

In response to the financial crisis and the dramatic impact that it has had on the automotive industry, executives are reassessing their strategy, planning and business models. Ernst & Young's work with leading automotive industry participants has helped to identify an optimal path forward, which comprises the following actionable advice:

- ▶ **Securing your present.** Cash management has emerged as a top priority, and companies are heightening their focus on working capital management and cash retention, monitoring key performance indicators, conducting liquidity stress tests and evaluating contingency plans. Cost reduction remains a focus as well, and supplier viability is a major concern since a single failure can jeopardize just-in-time inventory needed for production. Companies can also consider shedding non-core businesses to obtain cash.
- ▶ **Protecting your assets.** The sharp industry and overall economic downturn is compelling automotive industry participants to be even more focused on risk management going forward. As restructurings among automakers, suppliers, and dealers have accelerated, the stability of any one company's entire value chain has become less certain. Automotive companies are decreasing their risk tolerance for customers or suppliers that are showing signs of trouble, and are looking to further shore up their own risk management capabilities.
- ▶ **Improving your performance.** The need for increased efficiencies has never been stronger in the automotive industry, as many companies have been pushed to the financial brink or beyond. In order to do more with less, companies are accelerating their cost control and process improvement efforts, often in a holistic manner that better ensures that the resulting gains to the overall organization will be sustainable. What worked in the past to cut costs incrementally may not be enough for today's circumstances.
- ▶ **Sustaining your future.** During stable times, alliances are seen as a tool to share the cost of non-core functions. Now, strategic alliances have taken on new importance. Auto industry participants are aggressively pursuing cost-sharing, technology and production alliances to focus specifically on a variety of business differentiators. Automotive companies have previously viewed sustainability primarily as an exercise in compliance and been focused on the costs involved in attaining sustainable goals. Now, there is an increased focus on the savings – of cost and resources – that accrue from greater operational efficiency and more flexible, responsive business models.

Conclusion

The global economic slump hit the automotive industry harder than was anticipated by many executives surveyed. The industry, though, responded quickly and has shifted its focus from profitability to preserving cash. At the same time, the industry is looking ahead, spending what precious cash it has on R&D for the vehicles of tomorrow – so that it is positioned to offer consumers more desirable products when market conditions improve.

Contacts

Michael Hanley Global Automotive Sector Leader	+1 313 628 8260	michael.hanley02@ey.com
Jeffrey Henning Global Automotive Markets Leader	+1 313 628 8270	jeff.henning@ey.com
Peter Fuss Automotive Leader, EMEA	+49 6196 996 27412	peter.fuss@de.ey.com
James Wu Automotive Leader, Far East	+86 27 82655288	james.wu@hk.ey.com
Mitsumasa Ueno Automotive Leader, Japan	+81 3 3503 1191	ueno-mtsms@shinnihon.org.jp

Ernst & Young

Assurance | Tax | Transactions | Advisory

About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 135,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

For more information, please visit www.ey.com.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients.

About Ernst & Young's Global Automotive Center

Ernst & Young's Global Automotive Center in Detroit, Stuttgart, Shanghai, and Tokyo is focused on the megatrends in the global automotive industry. It brings together a team of professionals to help you achieve your potential – a team with deep technical experience in providing assurance, tax, transaction and advisory services. The Center works to anticipate market trends, identify the implications and develop points of view on relevant industry issues. Ultimately it enables us to help you meet your goals and compete more effectively. It's how Ernst & Young makes a difference.

© 2009 EYGM Limited.

All Rights Reserved.

EYG no.AU0350

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.