



Canadian Metals Outlook '10

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What the Heck is going on in the Automotive Sector: Can Canadian Suppliers Survive?

Dennis DesRosiers – November 10, 2009



**Two Fundamental
Problems in play in the
North American
Automotive Sector and
there is very little that any
Government can do about
these issues**



**First and foremost there is a
Revenue issue ... there are
very serious demand Issues in
the North American Market**



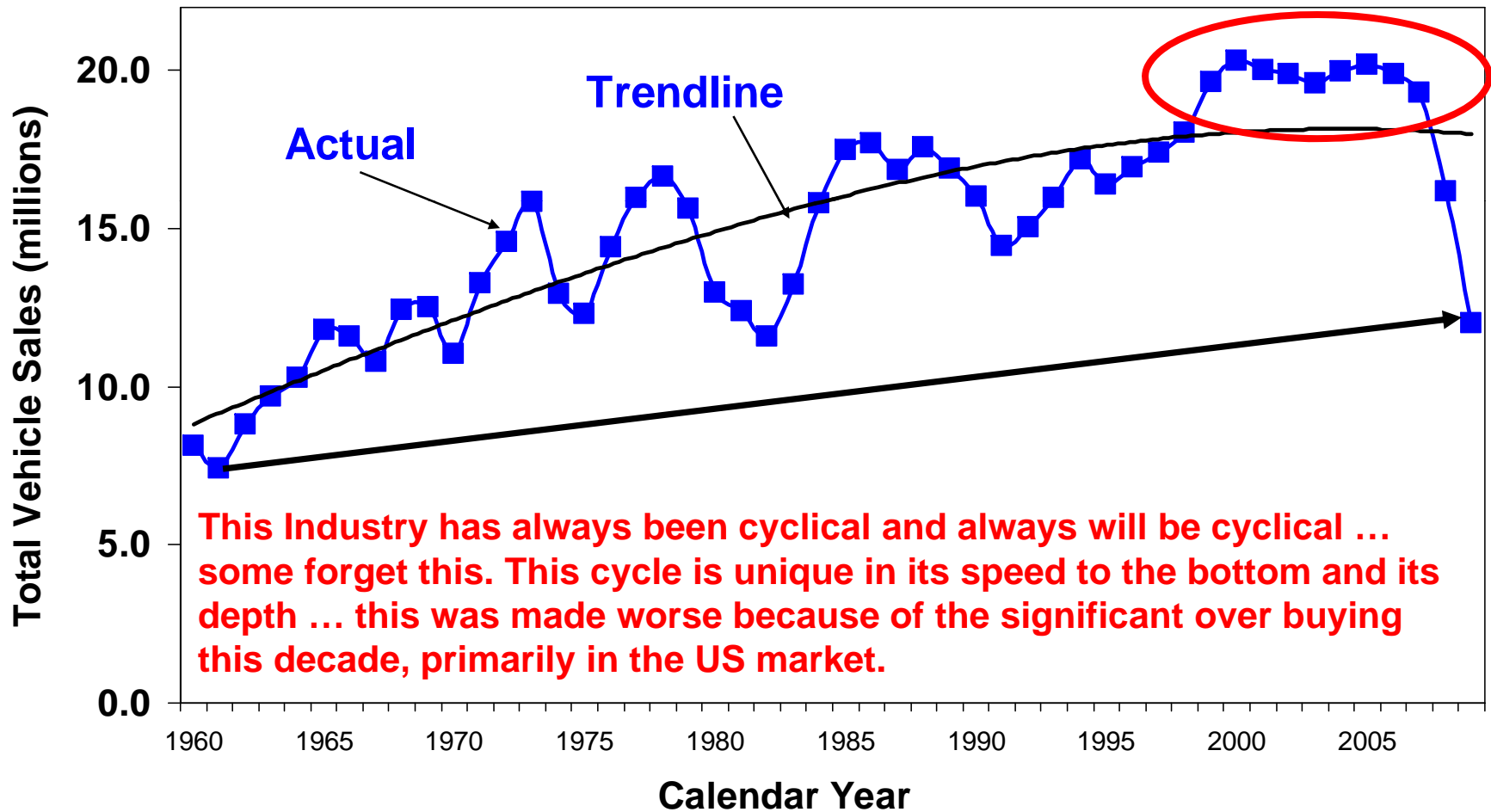
- Most of the current problems in the auto sector are the result of the the most serious cyclical downturn in the market that the U.S. has ever witnessed and to a degree in Canada and Mexico as well
- There also are serious structural issues and they are made much worse by the current cyclical issues but the market downturn trumps all structural issues at this point
- Most structural issues revolve around “Detroit” and they have become “Critical” since the cyclical downturn killed the time they needed to change their organizations



Total North American Vehicle Sales

1960 - 2009F

**Significant Over Buying
The Great Plateau**





- The current cyclical downturn emanates from a number of different sources:
 - Deregulation of the banking sector provided Americans with incredible liquidity.
 - Generous incentives, triggered by 9/11 when GM responded with their “Get America Rolling” campaign

**Americans responded and over bought vehicles
by the millions**



- Over buying set the stage and led to a collapse that also emanates from a number of different sources:
 - Rationalization of U.S. housing market and reduction in homeowner equity ... IE: taking away the piggy bank
 - A return to more rational credit risk
 - The inability to securitize a lease/loan portfolio cutting off much of the debt consumers needed to purchase a vehicle
 - The poor economy

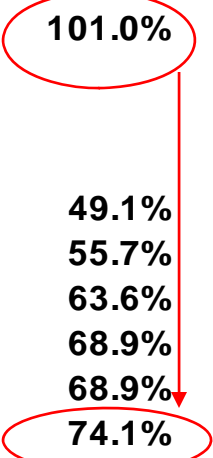


There is a Nightmare Scenario where American consumers move to lower ownership levels of vehicles and this depresses the market for much of the next decade ... and this is a very real scenario!!!!



Vehicle Ownership Trends USA vs. Canada

	TOTAL UNITS IN OPERATION	DRIVING AGE POPULATION MILLIONS	VEHICLES PER DRIVING AGE POPULATION	MILES DRIVEN PER VEHICLE
UNITED STATES				
1960	67,905,635	124.6	54.5%	10,521
1970	98,135,968	147.1	66.7%	11,262
1980	139,831,316	176.4	79.3%	10,879
1990	179,299,202	195.1	91.9%	11,977
2000	200,415,312	221.9	90.3%	13,706
2008	244,893,963	242.5	101.0%	12,217
CANADA				
1960	5,787,703	11.8	49.1%	12,714
1970	8,394,444	15.1	55.7%	13,039
1980	12,039,552	18.9	63.6%	11,912
1990	15,128,911	22.0	68.9%	13,669
2000	17,100,899	24.8	68.9%	14,341
2008	20,467,144	27.6	74.1%	14,740



Canada meets its transportation needs very well with much less vehicle ownership ... what would happen if the US moved to Canada levels



New Vehicle Sales In the U.S.A. to 2020 under Different Ownership Assumptions

	Ownership Level by 2020 Percent	Implied Average Annual Sales Millions Of Units
Note: These are US only Sales		
2000 - 2008 Average	101.0%	16.8
Scenario #1 by 2020	75.0%	9-10
Scenario #2 by 2020	85.0%	11-12
Scenario #3 by 2020	95.0%	12-13
Scenario #4 by 2020	105.0%	14-15

- **Even with an increase in ownership, new vehicle sales average only 14-15 million units per year in the US to 2020 compared to 16.8 million units per year this decade ... at Canadian ownership levels new vehicle sales in the US would average only 9 to 10 million units per year this coming decade ... truly a nightmare scenario.**



Expect a very lean decade in the North American Automotive Sector

	TOTAL VEHICLE SALES UNITS	VEHICLE USAGE BILLIONS OF MILES	DURABILITY MILES	TOTAL UNITS IN OPERATION	VEHICLES PER DRIVING AGE POPULATION
1960-1969	95,223,800	8,684	91,934	80.6	59.9%
1970-1979	127,804,942	13,357	105,200	117.6	73.2%
Percent Change	34.2%	53.8%	14.4%	46.0%	
1980-1989	135,364,952	17,650	132,074	155.9	83.9%
Percent Change	5.9%	32.1%	25.5%	32.5%	
1990-1999	148,782,909	23,991	161,631	192.5	93.5%
Percent Change	9.9%	35.9%	22.4%	23.5%	
2000-2009F	160,635,675	29,148	188,079	224.3	95.9%
Percent Change	8.0%	21.5%	16.4%	16.5%	
2010-2019F	135,500,000	30,638	228,066	258.1	97.4%
Percent Change	-15.6%	5.1%	21.3%	15.1%	

• High gas prices slows usage, better vehicles extends durability and slower driving age population growth all mean a much leaner US market this coming decade and thus a smaller market for Ontario to produce for!

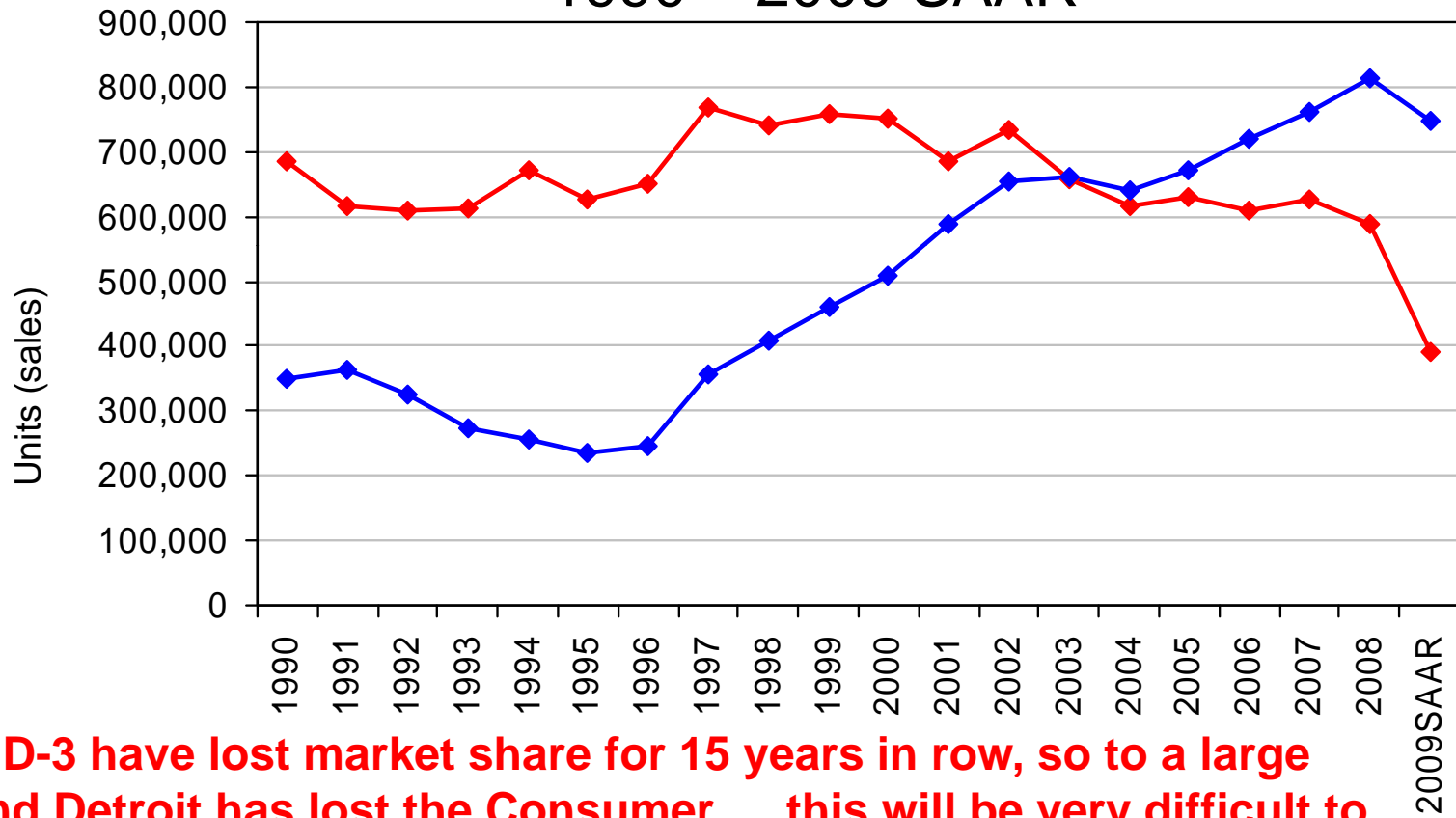


Secondly, there are very serious structural Issues for the Detroit Three in the Market leading to significant market share losses



Cdn Consumer Market – Example – Same is true in the U.S.

1990 – 2009 SAAR



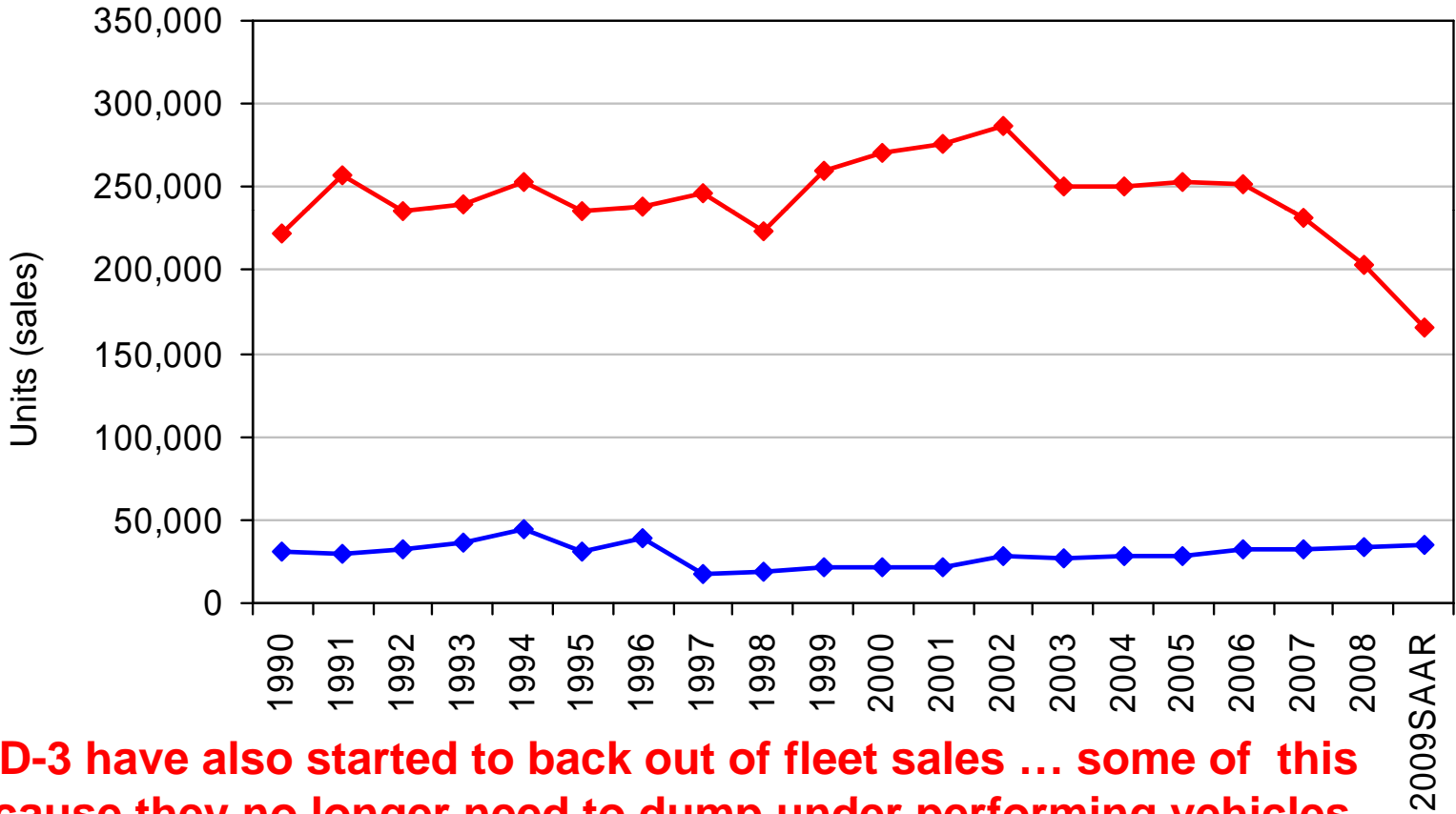
•The D-3 have lost market share for 15 years in row, so to a large extend Detroit has lost the Consumer ... this will be very difficult to get back

—◆— GM/Ford/Chrysler —◆— Import Nameplates



Canadian Fleet Market – Identical in the U.S.

1990 – 2009 SAAR



•The D-3 have also started to back out of fleet sales ... some of this is because they no longer need to dump under performing vehicles into fleets

◆ GM/Ford/Chrysler ◆ Import Nameplates



North American Production to Sales Ratio

1990	78.3%
1991	80.6%
1992	84.7%
1993	88.9%
1994	91.1%
1995	93.1%
1996	90.9%
1997	92.1%
1998	88.8%
1999	89.6%
2000	87.0%
2001	79.0%
2002	84.1%
2003	82.8%
2004	81.2%
2005	80.8%
2006	79.8%
2007	80.0%
2008	80.1%

- Fortunately, most of the increase in market share by the import nameplate brands has come from them building a substantial supply base inside NAFTA which have kept most of the manufacturing jobs inside North America

- The P – S ratio has been consistently in the 80 percent range for many years ... so import leakage is, give or take, around 20 points and hasn't really changed this decade.

- IE: This is **NOT** an off-shore import vehicle problem like some contest ...



**The Market downturn together
with the loss of market share
has resulted in very serious
Issues on the Manufacturing
Side of the Auto Sector**



North American Production of Vehicles # of Units

Year	GM, Ford, Chrysler Units	Share	New Domestic Units	Share
2000	13,196,873	74.7%	4,117,212	23.3%
2001	11,593,637	73.3%	3,997,567	25.3%
2002	12,281,894	73.5%	4,168,305	24.9%
2003	11,499,933	70.9%	4,422,906	27.3%
2004	11,060,100	68.2%	4,805,539	29.6%
2005	10,372,739	63.6%	5,511,476	33.8%
2006	9,676,079	60.9%	5,714,369	36.0%
2007	9,200,835	59.6%	5,961,536	38.6%
2008	7,248,444	56.0%	5,521,947	42.6%
	-21.2%		-7.4%	



North American Production of Vehicles # of Units

YEAR	Total North America Units	GM,Ford, Chrysler Units	GM,Ford, Chrysler Share	New Domestic Units	New Domestic Share	Other MD/HD Truck Units	Other MD/HD Truck Share
2000	17,659,700	13,196,873	74.7%	4,117,212	23.3%	345,615	2.0%
2008	12,950,258	7,244,942	55.9%	5,498,076	42.5%	207,240	1.6%
2008/2007	-16.1%	-21.3%		-7.7%		-23.1%	
2009 F	8,797,500	4,596,224	52.2%	4,086,908	46.5%	114,368	1.3%
2010 F	9,949,770	4,959,429	49.8%	4,821,195	48.5%	169,146	1.7%
2011 F	11,217,772	5,423,194	48.3%	5,559,005	49.6%	235,573	2.1%
2012 F	12,102,934	5,645,372	46.6%	6,142,885	50.8%	314,676	2.6%
2013 F	13,057,045	5,894,559	45.1%	6,770,775	51.9%	391,711	3.0%

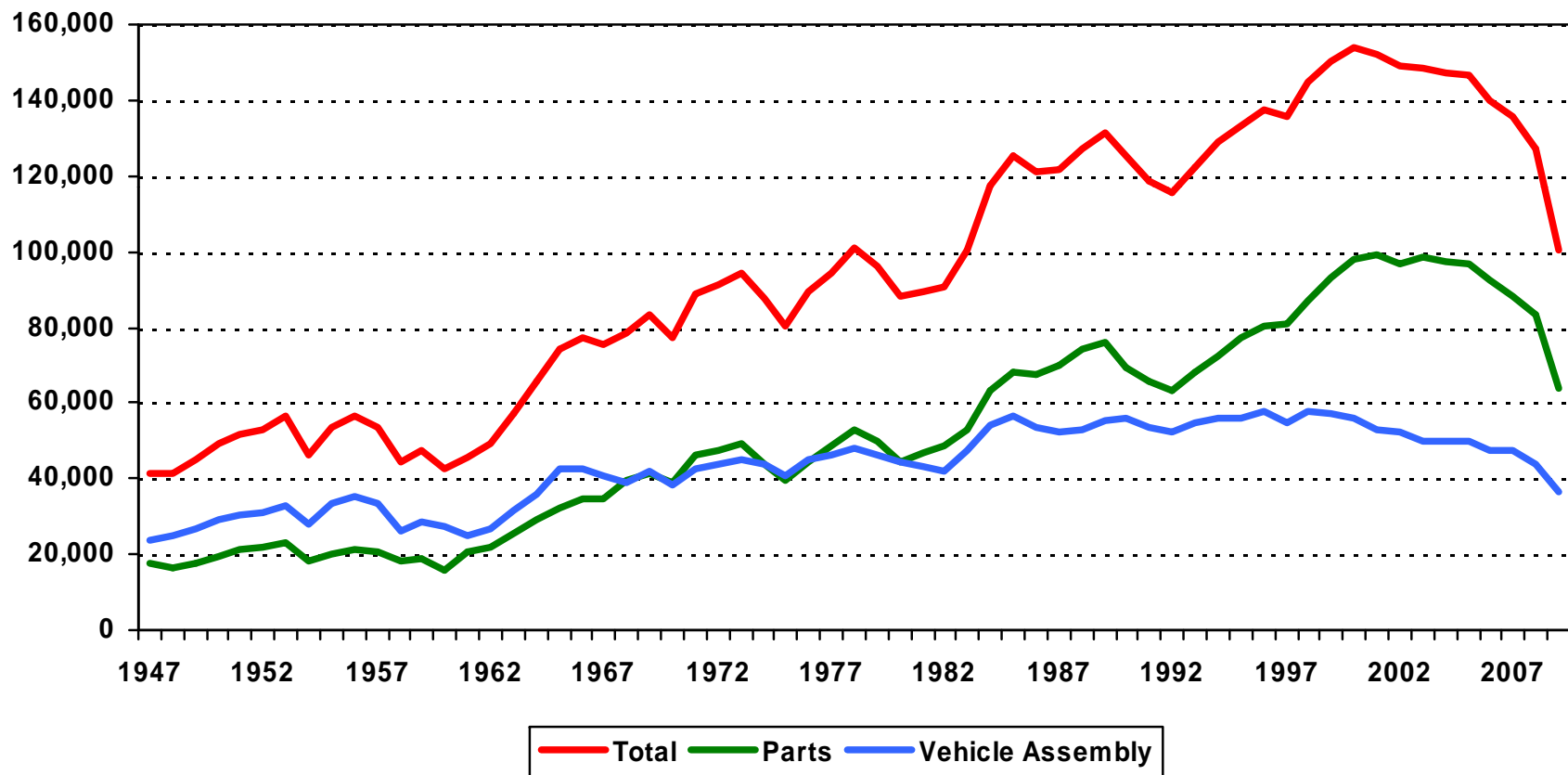
- Analysts have the market and thus production down for both 2009 and 2010 and the Detroit-3 continuing to see less production relative to the new domestics so these problems will be with us for at least another 4 to 6 quarters.



Where is Canada in this MESS?



Canadian Automotive Employment 1947-2009



Source: Statistics Canada Survey of Employment, Payrolls, and Hours



- **The Canadian Assembly sector has been able to remain competitive and reasonably strong within North America by investing in plants and equipment at near record levels.**
- **Canada has attracted a very large share of North American assembly investments although this share would be much smaller if Mexico were factored into the equation ... we have no Mexican data.**
- **Our Assembly sector is decimated this year but we still are holding our share of North American produced vehicles ... about 16 percent.**



New Capital Expenditures in Canada and the US - \$CDN Millions

Assembly Sector

	United States	Canada	North America	Canada Percent
2000	\$7,096	\$1,806	\$8,902	20.3%
2001	\$6,884	\$2,338	\$9,221	25.3%
2002	\$7,533	\$2,206	\$9,739	22.6%
2003	\$7,244	\$2,843	\$10,087	28.2%
2004	\$6,100	\$2,260	\$8,360	27.0%
2005	\$4,954	\$2,327	\$7,281	32.0%
2006	\$4,310	\$2,736	\$7,045	38.8%
2007	\$3,742	\$2,846	\$6,589	43.2%
2008	\$4,212	\$2,450	\$6,662	36.8%



- The roots of the problems in the Canadian supplier base appears to be the **LACK** of investment in new plant and equipment
- This has improved slightly in the last two year as suppliers are beginning to invest more relative to their US competitors
- The reason for the lack of investment is a “chicken and egg” problem.... Unsophisticated suppliers don’t invest but without investing a supplier can’t move up the value added chain and become sophistacted.



New Capital Expenditures in Canada and the US - \$CDN Millions

Parts Sector

	United States	Canada	North America	Canada Percent
2000	\$13,163	\$905	\$14,068	6.4%
2001	\$12,968	\$683	\$13,651	5.0%
2002	\$11,867	\$1,097	\$12,964	8.5%
2003	\$10,396	\$1,005	\$11,401	8.8%
2004	\$8,146	\$1,008	\$9,155	11.0%
2005	\$8,240	\$820	\$9,060	9.0%
2006	\$8,052	\$864	\$8,916	9.7%
2007	\$7,912	\$1,231	\$9,143	13.5%
2008	\$7,560	\$881	\$8,441	10.4%



The Future of the North American Supplier Sector

- A strong case can be made that the Supplier Sector in North America has entering its biggest ‘decade of opportunity’ since the 1960’s and at the same time the biggest ‘decade of threat’ in its history.
- The only way the Detroit – 3 will be able to stop market share erosion will be through the introduction of new products and with healthier balance sheets (GM and Chrysler at least) we expect significant investments to beef up their product pipeline .. This normally represents opportunity for suppliers
- And the ‘climate change’ regulatory environment will trigger the largest technology spend this industry has ever experienced. This could be positive for suppliers with innovation capabilities?



The Future of the North American Automotive Sector

- This record level of ‘technology’ spend actually could be a serious downside threat to the supplier community although ‘capable’ suppliers who invest in their products and factories will see significant upside opportunity
 - Serious rationalization of number of components per vehicle
 - Non traditional supplier players in the mix
 - Unprecedented demands on product and process innovation at the supplier level
 - Increased need for capital
 - And if the current supplier base falters even a little, the OEMs will quickly in-source rather than wait for suppliers to catch up



- In summary the Canadian supply base is confronted by both a serious cyclical downturn under-mining their revenue base and a number of serious structural problems related to their exposure to the Detroit – three and their generally poor level of sophistication
- Current “metrics” have never been worse and although a cyclical upswing in sales will help restore some of this sector, for the first time in 60 years it is uncertain whether the Canadian supply base will be able to fully recover and grow to new peaks.
- There is however unprecedented opportunity for selected suppliers to capitalize from the current restructuring on the OEM side of the sector



What is the role of Government Policy? Can the Gov't play in this sector, if so how, how aggressively, where etc.

Need to set the Rules of Engagement for Government Policy



Rules of Engagement for Government Policy

- Absolute neutrality between corporate players since nobody can predict who the winners and losers are going to be! Current Governments are violating this rule in a very big way with the 'bail out' of GM and Chrysler.
- A global approach to development since the industry itself is becoming very global ... The 'Bail out' is problematic in that it is North American Centric!
- A focus on promoting efficiency where-ever possible since only the lowest cost jurisdictions will thrive ... there is still opportunity for Governments to play in all of these areas:
 - **Investment promotion to get latest technologies into North America**
 - **Infrastructure development**
 - **Taxation and regulation**
 - **Human Resource Policy**



Rules of Engagement for Government Policy

- Extreme Caution on approach to social policy agenda items since they are usually extremely expensive to the industry and can divert massive resources away from developing a sound business model.
- No amount of positive industrial policy initiatives are enough to offset even the smallest policy mistake on these social policy agenda items.



The Future of the Automotive Sector is the “Six Inches Between our Ears”

- **Wages and jobs are increasingly being linked to skill/intellectual capability**
- **N.A. Automotive sector annually spends about \$30-35 Billion in Research, Design, Development and Testing of Vehicles and Parts**
- **In essence there are four possible scenarios for the US and Canada**
 - **Low wage – Low skill (currently China, Korea, Mexico ...)**
 - **Low wage – High skill (currently India, possibly Mexico ...)**
 - **High wage – Low skill (Historically in Canada, U.S.)**
 - **High wage – High skill (The Future for Canada, U.S.???)**



Governments at all levels in North America need to use policy tools available to them to help the automotive sector embrace higher skills and to move up the intellectual curve. The other options are not acceptable to most in the sector



Questions?

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