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Someone recently asked whether I would have invested in the automotive supply industry a few years ago if I knew then what would happen. My answer was “Yes”. How else would I have added Pune, India; Krefeld, Germany; Wuhan, China; Kyushu, Japan; Jundiai, Brazil; Hodonin, Czech Republic; Teresin, Poland and Lassby, Sweden to my list of luxurious resorts? How else would I have drunk boilermakers with the UAW and Schnapps with IG Metall? And most of all, how else could I have experienced the extraordinary sensation of an industry imploding in no time at all? No sir, I would not give up the excitement of the last few years for hundreds of millions of dollars, although I must admit that for a while that was about what it cost me!

Why am I so delusional? I believe that the next ten years will witness a renaissance of the auto industry as it morphs into a more successful business model. Driving forces will be globalization, consolidation and constructive collaboration between OEs and suppliers.

Globalization will change where cars are made and sold.

U.S. and Europe have been the largest markets, but this is changing. Europe has 255 million driving age people and U.S. 241 million, only two-thirds the driving age population in India and about one-half of China. Also, driving age population in China and India grows faster than the U.S. and vastly faster than Europe. More importantly, Western markets

are 25 to 30 times more saturated than China and India so they have much more potential for further market penetration. At this stage, Asia has little replacement demand. In contrast, the U.S. scraps 12.5 to 13.2 million units per year. Driving age growth adds another million so annual U.S. demand will average 13.5 to 14.2 million units, with cyclicity of a million or two units in a given year. While up one and a half million units from 2009, we will be below average again in 2010. This pent up demand improves the likelihood of at least achieving the average in 2011. Seventeen million will not recur soon. That occurred at the peak of consumers' excessive leveraging which pulled forward demand from future years, contributing to the subsequent 40% decline.

Light vehicle expenditures as a percentage of U.S. GDP dropped to 1.6% last year, less than half its average ratio. Last year, total vehicles in operation dropped by 600,000 to 249 million and the 2.21 vehicles per household was the lowest since 2003, and the number of households continues to rise by 1% per year. But we believe that sales will increase by at least one and one half million units in 2010. The negative effects of the GM and Chrysler bankruptcies will be absent. Dealers' floor planning and financing of customer purchases will be more available than in 2009 because the auto commercial paper market has now reopened and dropped car loan rates from 8.2% in January to 3.5% now. In January 2009, only 7% of new vehicle loans were to buyers with FICO scores below 670. Now, 13% are. Similarly, the Manheim Used Vehicle Value Index

went from 98 in December 2008 to 117, potentially signaling stronger demand for new vehicles.

Finally, the last five months of 2009 were hampered by low inventories due to Cash for Clunkers but now are back to normal. The “poverty effect” of falling home prices will be less severe in 2010.

Meanwhile, fleet demand is recovering from last year’s cyclical low. The combination of all these factors will overcome the lack of clunker subsidies and continued high unemployment.

In contrast, EU countries vary greatly, but like the U.S. are burdened with 10% unemployment and the hangover effect of clunker subsidies on 2.1 million vehicles. Germany, the largest, has the highest and most stable saving rates and had no housing price bubble to burst so consumers are

healthy. Germany also has the largest and most aged universe of cars and at 607 cars per driving age thousand people versus 733 in the U.S., 745 in Italy and 660 in Spain, has some room for further penetration. It has been deflated since 2007 by increased VAT. Germany's scrappage scheme accepted the youngest cars, and at 5.0 billion Euros, was twice the U.S. program. The scrappage fee was one-half the basic price of new low-priced cars. Therefore, A/B and B class vehicle new registrations accounted for 70% of the increase in new vehicle registrations and made Germany's 23% growth the world's second fastest growing market last year. Clunker expiration will reduce German sales in 2010.

French sales rose 10.7% year-over-year although its scrappage incentive was only 200 million Euros and the French will stagger the withdrawal of scrappage so there will be trivial hangover effect in 2010, and the market will remain around 2,300,000 units.

Italy's sales were flat in 2009 due to its recession despite paying up to 5,000 Euros for lower emission alternative fuel-using vehicles. The Italian government has indicated it may extend incentive plans but sales will likely be flat to down again this year.

Spain's severe real estate collapse, 19% unemployment, high penetration of 660 cars per thousand people of driving age, resulted in a 17.8%

decline in volume in 2009. An initial loan program failed and was supplemented by specific low CO₂ incentives which improved sales mainly of smaller cars. The government's extension of incentives may support the market through mid-2010, after which we expect a decline.

U.K. government reacted slowly to declining volume with a 300,000 unit potential scheme in May. Some benefit may spill over into early 2010, but the reinstatement of the 17.5% VAT in January, 2010 will negatively impact volume from a base that had declined by 8% last year.

We forecast EU automotive demand to decline by more than a million units in 2010. Everywhere the trend toward smaller and more fuel efficient cars

continues. Green is cool and consumers are conscious of rising oil prices. Downsizing will cause more market share changes. Meanwhile commodity prices will rise, putting upward pressure on costs.

On a happier note, I just returned on Monday from China with some up-to-date observations. Vehicle sales grew 45% in 2009 to 13.6 million units, the highest growth rate ever. More importantly, government created the growth via VAT reductions on small displacement cars, cash for clunkers and additional subsidies for farmers. Farmers got an overriding 10% discount on new vehicle purchases plus 2,000 to 3,000 Yuan for replacing old three and four-wheeled vehicles with new ones with 1.3 liter or less displacement engines.

Minivans, the most heavily subsidized vehicles, approached two million units, up 80% from 2008. As one provincial farmer told me, there had been three necessities for marriage in the countryside: a TV, a refrigerator and a washing machine. Now there is a fourth, a vehicle.

At the opposite end of the spectrum, Audi became the first to sell 200,000 luxury vehicles in a year, importantly by adding 102 centimeters to the wheel base, a car produced and sold only in China. Officials and wealthy Chinese who sit in the rear seat while being driven favor longer cars.

Government recently announced a 2010 VAT of 7.5%, well below historic levels and increasing cash for clunkers from last year's range of 3,000 to 6,000

Yuan to 5,000 to 18,000. Following introduction last year of 221 new passenger vehicle models, mainly upgrades, will be another 100 introductions this year. Industry volume is expected to grow by 12% to 15.13 million in 2010.

In contrast, our government mounted a feeble 700,000 unit Cash for Clunkers program last year, administered it poorly and now has discontinued it. Instead of complaining about China's currency policies, which we cannot control, our government would better level the automotive playing field if they extended and enlarged Cash for Clunkers, simultaneously improving the environment. The way things are going, China will increase its lead over the U.S. with all of the long term competitive implications that will result. As Chinese companies

become larger, more technologically advanced and more profitable, they will compete in the U.S. and other world markets. And over time, China will make two other important moves. One will be to force consolidation. Most developed countries have few dominant players, but China is highly fragmented. The largest, SAIC GM Wuling, has just a 7.23% market share, and the Top Ten accounted for only 45.6%. The myriad companies dividing up the remainder have market shares too small for long term survival.

Second will be permitting banks to have consumer finance companies to fund auto purchases. Last week for the first time three Chinese banks were authorized to create such subsidiaries for purposes other than autos. But that will change in

the future. In two other emerging countries, India and Brazil, 70% of vehicle sales are financed compared with 10% for China and 90% in the U.S. This will change the next time the Chinese government needs to accelerate growth. The contrast is stark: China has a sensible and well-implemented industry development strategy, but U.S. does not. In view of our government's rescue of GM and Chrysler, it is puzzling why they have not followed through to create a powerful industry dynamic.

Some of China's characteristics are shared by India. Its 1.2 billion population is 50% larger than the combined total of U.S. and EU and is growing twice as fast as the U.S. and China. Car penetration is 14 per thousand people of driving age versus 25 for China and that population universe is 75% the

size of China's. Light vehicle sales last year were 2,000,000 units, one-seventh the Chinese total and less than Brazil, a much smaller country. Light vehicle consumption growth averaged 13.6% over the last five years, half China's growth rate. India's 17.5% unit growth last year, after a weak 2008, ranked as the world's third fastest growing market. Per capita Gross National Income is \$2,960, less than half that of China, so vehicles are smaller and less expensive.

For these reasons and an inadequate road system, industry revenues totaled only \$34 billion in 2009, but last week, Pawan Goenka, President of the Society of Indian Automobile Manufacturers, announced industry plans to quadruple to \$145 billion by 2016. The growth forecast is partly due to

two recent major announcements, the GM-SAIC project in small cars and Volkswagen's venture with Maruti Suzuki, the Indian market leader. Also, there were eleven global product launches announced at the recent Delhi auto show. Some analysts believe that dollar volume growth will be slowed by ultra low cost cars such as Tata's Nano since 40% of compact and hatchback buyers are first timers. Nonetheless, India will remain one of the most rapidly growing markets.

Cash for Clunkers demonstrated the price sensitivity of car buyers worldwide and therefore OE buyer incentives will remain close to \$3,000. High incentives and commodity price pressures will continue the trend toward fewer globalized platforms to create longer and more efficient production runs.

If you have any doubts about this, look at the Ford and GM 2011 and 2012 cars on view here. Global platforms simplify supply channel management. Think about it. Assembling ten platforms in each of 15 countries and using 5,000 subcomponents per car creates 750,000 SKUs, a major challenge. This is changing as the supplier base consolidates internationally. For example, our company, International Auto Components, now produces instrument panels, headliners, interior acoustical materials and other products in 17 countries (U.S., Germany, United Kingdom, Belgium, Netherlands, Sweden, Czech Republic, Slovakia, Spain, Poland, Canada, Mexico, Brazil, Argentina, China, Japan and India).

IAC also has been a consolidator, most recently buying nine European facilities of Stankiewicz, the 150 million Euro high quality supplier of carpets and acoustics. Our U.S. model is “airlift transfer”, where an OE sends a healthy supplier into a bankrupt facility, retrieving OE-owned tools and reinstalling them in its facility to ensure continuity of supply. IAC executed a dozen such transfers from bankrupt companies over the past 18 months.

In 2009, sixty suppliers in the U.S. went bankrupt and 200 shut down. Five years ago who would have thought that Delphi, Lear and Visteon would be simultaneously bankrupt. These phenomena will reduce the over capacity that has plagued the industry. But more capacity elimination

is needed, and we believe that more suppliers will fail in 2010 and others will be distressed sellers.

Prior consolidation consisted mainly of suppliers diversifying into other automotive sectors, but this did not work well because OEs are less willing to help your weakest division if they also buy from more profitable ones.

We believe that future acquisition objectives will be expansion of geography, technology and customer mix within narrowly-defined product segments. There will be heavy two-way traffic between the developed and developing countries a la Beijing Automotive, Geely, Tata, Sberbank, etc. Therefore the competitive position of smaller, local entities will become more difficult. Given the

consolidated customer base, a fragmented supplier universe never was logical. Now as OEs globalize, logic demands suppliers with symmetrical maps. Larger scale facilitates supplier-financed R&D, making them better partners for OEs. Hopefully, as the industry evolves in this way, the OE-supplier relationship will become more like a partnership. The beat-your-supplier-to-death approach of some OEs has often been counter-productive. When an important supplier becomes insolvent, OE customers invariably provide massive aid with little hope of reimbursement. There eventually is also considerable cost to relocate the production and to reprice the contracts to market. Meanwhile OEs' production lines have risked disruption. It would be better to depend on a few well-capitalized, global suppliers earning a reasonable rate of return.

Over time, it also might make sense for OEs to bargain for global commodity pricing directly with raw material producers and direct the supplier purchases. This would create lower commodity costs than individual supplier could obtain. In addition, commodity costs would be the same for each competing supplier and would be known to the OE so competition would be based on vendors ability to manage controllable costs.

In addition, Tier One suppliers will continue to integrate backward and eliminate former subcontractors. For example, IAC has brought in-house many previously purchased parts. In some cases, IAC bought raw resins and formulated them into proprietary compounds with OE pre-approval.

This lowers unit costs and increases value added content.

Some auto suppliers will apply excess capacity to non-automotive products. Our Brazilian company, PLASCAR, found that quality standards for household plastic items were lower than for cars, that retooling was not expensive and that higher profit margins were achievable. As a result, they devoted a discrete portion of their operations to such injection molded items.

Elsewhere in response to the downturn, IAC renegotiated union contracts, cut non-union wages and benefits, put management on 4 days pay for 5 days work and trimmed supervisory ranks. Despite these shared hardships, morale is good because we

have been awarded a couple of hundred million dollars of business from failed competitors, in Europe we acquired Stankiewicz and in Asia we opened new facilities in Shin Yokshama, Japan, Wuhan, China, and Pune, India. Our improved competitive position will reward our teams for their loyalty once the cycle turns. We expect to reap long term investment rewards in addition to the enlightening experiences described at the beginning of this talk.