



Dennis DesRosiers

What's Behind this Auto Sector Crisis?

Crisis.

What do I really mean when I say 'crisis?' This is a word I have avoided using when describing the woes the automotive sector has been facing for the past few months. 'Crisis' has been highly over-used recently and is often uttered in the wrong context.

Our unions use the word 'crisis' to describe the job losses unionized assembly plants are incurring, implying that this is a disaster for the automotive sector. Well, yes - the workers at these unionized plants are facing a crisis, however as long as jobs are being created in non-union plants (which they are), the industry itself is not in a state of crisis.

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TOTAL LIGHT VEHICLE MARKET IN CANADA/U.S.A.

NUMBER OF UNITS SOLD

YEAR	TOTAL MARKET	NORTH AMERICAN SOURCED	MARKET SHARE	OVERSEAS SOURCED	MARKET SHARE
1981	11,331,549	8,304,762	73.3%	3,026,787	26.7%
1982	11,165,576	8,262,325	74.0%	2,903,251	26.0%
1983	13,090,937	9,956,110	76.1%	3,134,827	23.9%
1984	15,519,116	12,128,171	78.1%	3,390,945	21.9%
1985	17,028,551	13,009,977	76.4%	4,018,574	23.6%
1986	17,620,066	13,065,423	74.2%	4,554,643	25.8%
1987	16,417,196	11,951,065	72.8%	4,466,131	27.2%
1988	17,027,907	12,899,850	75.8%	4,128,057	24.2%
1989	15,986,165	12,321,134	77.1%	3,665,031	22.9%
1990	15,186,688	11,795,343	77.7%	3,391,345	22.3%
1991	13,654,281	10,694,362	78.3%	2,959,919	21.7%
1992	14,113,709	11,432,927	81.0%	2,680,782	19.0%
1993	15,110,114	12,666,451	83.8%	2,443,663	16.2%
1994	16,343,862	13,916,627	85.1%	2,427,235	14.9%
1995	15,859,442	13,719,146	86.5%	2,140,296	13.5%
1996	16,268,341	14,443,015	88.8%	1,825,326	11.2%
1997	16,508,057	14,406,976	87.3%	2,101,081	12.7%
1998	16,933,321	14,685,494	86.7%	2,247,827	13.3%
1999	18,507,951	15,770,061	85.2%	2,737,890	14.8%
2000	18,898,864	15,759,747	83.4%	3,139,117	16.6%
2001	18,692,978	15,283,232	81.8%	3,409,746	18.2%
2002	18,519,614	14,847,001	80.2%	3,672,613	19.8%
2003	18,232,545	14,552,444	79.8%	3,680,101	20.2%
2004	18,386,437	14,609,528	79.5%	3,776,909	20.5%
2005	18,531,045	14,738,742	79.5%	3,792,303	20.5%
2006	18,119,782	14,015,051	77.3%	4,104,731	22.7%
2007	17,743,897	13,585,064	76.6%	4,158,833	23.4%
2007/2006	-2.1%	-3.1%		1.3%	
YTD 2007	9,079,289	6,950,542	76.6%	2,128,747	23.4%
YTD 2008	8,267,187	6,160,247	74.5%	2,106,940	25.5%
2008/2007	-8.9%	-11.4%		-1.0%	

Source: DesRosiers Automotive Consultants Inc. AIAMC, CVMA, and Ward's Automotive Reports

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The continued market share erosion GM, Ford and Chrysler are experiencing is also referred to as a crisis, once again implying devastating consequences for the automotive industry. Yes, these individual companies are facing a shift in market share, which has serious negative implications for each of them, but other OEMs are picking up the share the Detroit Three lose, so the industry itself is not in a state of crisis.

Consumers are moving to more fuel-efficient vehicles as a result of skyrocketing fuel prices. This is often referred to as a crisis since plants producing these vehicles are closing. Is this actually a crisis? No, it isn't - it simply represents a shift in market segmentation since plants producing smaller vehicles are increasing production. Vehicle companies with a mis-aligned product mix may be facing serious sales and production issues, but this does not mean that the industry itself is in crisis.

So why do I now use the word 'crisis' to explain the issues in the current automotive sector? Well, the industry is experiencing a major cyclical downturn, the likes of which we have not seen since the early 1990s. This downturn is compounded by a globalization increase within the North American automotive sector. This is creating the real 'crisis.'

That said, it would seem as though even seasoned commentators have forgotten that this industry is cyclical by nature. It

always has been, and always will be. I have detailed statistics going back to 1960 showing that there have been five significant cyclical downturns in the North American vehicle markets as well as at least three smaller hiccups. Indeed, over this nearly five-decade timeframe, the cyclical nature of our industry has operated almost like clockwork. The industry experiences a 3-8 year growth period followed by a decline of at least 10 and often 20 percent over a 2-3 year period before rebounding.

For more than 14 years this industry has been on a serious sales and production binge. This growth lasted roughly twice as long as any previous growth period since the 1960s. In 1991, the North American market bottomed out at 14.5 million and grew to a peak of 20.3 million units in the year 2000. The market seemed to be softening through much of 2001. However, in late 2001, 9/11 occurred and this completely altered the dynamics of the market cycle. GM launched the 'Get America Rolling' incentive campaign and for much of the next five years, sales were supported by artificially high incentives.

Additionally, U.S. consumers also found themselves in a near nirvana situation when the credit markets began lending massive amounts of money to questionable and high-risk creditors with little to no assets backing the loans. This eventually created the whole sub-prime financing mess. These

sub-prime loans were primarily for homes but this issue directly affects the auto sector as much of the money lent to these questionable borrowers was used to finance new or newer vehicles. In a very short period of time, American consumer culture evolved from 'ME' to 'ME NOW' to 'ME MORE NOW' to 'ME MORE NOW WITH BAD CREDIT!' This easy credit market for housing allowed the U.S. consumer to significantly over-purchase new vehicles and to take advantage of all the incentives in the marketplace. Thus, North America witnessed an incredible 14-year growth period in the new vehicle sector. A more normal up-side market would have been 3-8 years. Not since the ending of the Second World War has the market experienced such an extended period of growth.

So after a period of seemingly endless growth, a perfect storm has fallen upon the automotive market. The sub-prime housing crisis hit, finding credit became very difficult, the U.S. economy slowed towards recession, the OEMs backed-off their destructive incentive game, fuel prices skyrocketed and voila - you have a full scale cyclical downturn in vehicle sales. North American consumers will buy roughly 3 million fewer vehicles in 2008 than they did in 2005. Interestingly, all of these lost sales are in the U.S., not in Canada or Mexico as these markets continue to hold steady. In addition most analysts believe that the market will continue to

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downsize for the rest of this year and next year as well.

The North American market is in a classic cyclical downturn, one that was long overdue. Compounding this cyclical downturn is the further globalization of the sector in North America. Sales of vehicles im-

ported from outside North America have been increasing and these sales displace vehicles made in North America. Our production of vehicles is falling faster than our market.

This is a point that has been missed by just about everybody.

We also have to be careful in how we use the word "import" since more than half of these "import" vehicles are made in North America. We have to distinguish between import nameplates and vehicles manufactured off-shore. One way to measure off-shore import penetration is to look at the production-to-sales ratio for the market in North America. This ratio simply determines the number of vehicles made in North America relative to the number of vehicles bought in North America, measured in percentage terms.

What is happening today is nearly identical to what got this industry into so much trouble in the 1970's. The market at that time was also in a cyclical downturn and compounding this was a drop in the P-S ratio from 93.4 percent in 1975 to only 75.1 percent in 1982. Looking at this from a different perspective, off-shore import penetration in 1976 was only 6.6 percent but grew to 24.9 percent by 1982. This caused a collapse in production of close to 5 million units during the 1970's and created a very real crisis.

Conversely, the complete opposite happened for most of the following 20 years. The New Domestic came to North America and by 1995 their capacity had increased by about 3 million units. This brought the P-S ratio back to 93.1 percent. North American vehicle imports were once again below 10 percent. Despite a massive gain in market share by the import nameplates, most of the vehicles bought in

NORTH AMERICAN SALES OF VEHICLES - # OF UNITS

-INCLUDES HEAVY DUTY TRUCK

YEAR	NORTH AMERICA TOTAL	CANADA AS A % OF N.A.	MEXICO AS A % OF N.A.
2000	20,300,128	7.8%	4.4%
2001	20,012,684	8.0%	4.7%
2002	19,874,336	8.7%	5.1%
2003	19,591,598	8.3%	5.1%
2004	19,992,961	7.9%	5.6%
2005	20,201,249	8.1%	5.6%
2006	19,892,089	8.4%	5.9%
2007	19,294,965	8.8%	5.9%
2007/2006	-3.0%		
2008 Tracking	17,894,769	9.7%	6.3%
2008 F	17,435,223	9.7%	6.0%
2009 F	16,940,746	9.7%	6.5%
2010 F	18,781,374	8.7%	6.7%
2011 F	19,999,358	8.2%	6.8%
2012 F	20,607,581	8.0%	7.0%

NORTH AMERICAN PRODUCTION TO SALES RATIOS

-INCLUDES HEAVY DUTY TRUCK

YEAR	NORTH AMERICA TOTAL
2000	87.0%
2001	79.0%
2002	84.1%
2003	82.8%
2004	81.2%
2005	80.8%
2006	79.8%
2007	79.9%
2008 Tracking	76.2%

NORTH AMERICAN PRODUCTION OF VEHICLES - # OF UNITS

-INCLUDES HEAVY DUTY TRUCK

YEAR	Total North America Units	CANADA AS A % OF N.A.	MEXICO AS A % OF N.A.
2000	17,659,700	16.8%	10.9%
2001	15,816,654	16.0%	11.7%
2002	16,717,553	15.8%	10.8%
2003	16,215,337	15.7%	9.7%
2004	16,224,864	16.7%	9.6%
2005	16,318,783	16.5%	10.3%
2006	15,877,161	16.2%	12.9%
2007	15,425,600	16.7%	13.6%
2007/2006	-2.8%		
2008 Tracking	13,630,068	15.4%	16.6%
2008 F	13,921,371	15.5%	15.0%
2009 F	13,509,609	16.3%	15.4%
2010 F	14,958,659	16.5%	15.8%
2011 F	15,908,738	16.5%	16.2%
2012 F	16,371,949	16.8%	17.0%

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North America were manufactured in North America.

However, over the last dozen years, this trend has once again reversed itself. The P-S ratio for North America this year is tracking at 76.4 percent, which is near its all time low. This has seriously impaired the production of vehicles in North America. Production is down by about 3 million units because of the cyclical downturn in the market and another 1 million units because of the growth of offshore imports. Production of vehicles in North America peaked at 17.7 million units in the year 2000 and this year is tracking at 13.9 million units. I don't care how you cut it, when production is down by close to 4 million vehicles there is a lot of blood on the floor in our vehicle and parts manufacturing sector. Everybody in the production value chain is negatively affected.

This is why the auto sector is experiencing a 'crisis' in North America. It is going through a cyclical downturn which is being compounded by an increase in globalization via the growth in offshore imports.

Not all of the automakers are affected equally. This is where most of the current media is focused. GM, Ford and Chrysler are indeed taking the brunt of this downturn. Their combined market share has fallen to below 50 percent and this has resulted in their production output declining from 13.4 million units at the turn of the decade to a forecasted 8.0 million units this year. This represents a decline in production

of 5.4 million units and most analysts believe that Detroit Three production will fall into the mid-7 million-unit range by next year, pushing their total vehicle production loss to about 6 million units. New Domestic production has offset some of this decline but not all of it. Any supplier to the Detroit Three has a serious negative adjustment to make and there is very little they can do about this. Most are not capable of going overseas to produce their components and most have found it difficult to offset the loss in demand for their GM, Ford and Chrysler components with new business from the New Domestic OEMs.

So what does this all mean for Canada? We have not been as seriously hurt by the sub-prime credit crunch and subsequent housing crisis in the U.S. Also, we are not as heavily affected by rising fuel prices. Canadians purchase a greater proportion of entry-level vehicles and relatively speaking, our market is more resilient to these higher fuel prices. As such, despite the major loss of sales in the U.S., sales in Canada are expected to hold for 2008.

Where Canada will be hurt in the short-term is on the production side of the equation. With U.S. sales tracking down roughly 20 percent year-to-date, and the light truck market being down nearly 30 percent over the same period, this poses a considerable problem for Canadian production as approximately 80 percent of the vehicles we manufacture are exported to the U.S. So, a cyclical

downturn of this proportion will undoubtedly impact our automotive manufacturing sector in the short-term.

Led by our unions, many believe that Canada's production sector is going to hell in a handbag. However, truth be told, our production portfolio is very well balanced. We produce a solid mix of smaller, more fuel-efficient vehicles. Indeed, roughly one-third of our production in 2007 was allocated to entry level vehicles. As a result, our production portfolio should be able to weather this storm.

There is light at the end of the tunnel though. As OEMs adapt to changing market conditions by matching their production mix to market demands and further eliminating cost-inefficiencies, and as the North American market recovers from this cyclical downturn, production in Canada will recover. We expect this to happen sooner rather than later. Within the next few years, we expect production figures to surpass those of last year, although it is unlikely that we will see the 3+/- million unit volumes that years prior have brought.

Is the North American market in a severe crisis? Not really. Are we headed for disaster? No! But the market is in a period of serious change and as OEMs struggle to cope with the cyclical downturn and market changes, there will be major challenges to overcome, but we will certainly recover and are most likely to come out stronger on the other side. **DAR**