



Dennis DesRosiers

The 2010s: The Decade of Opportunity

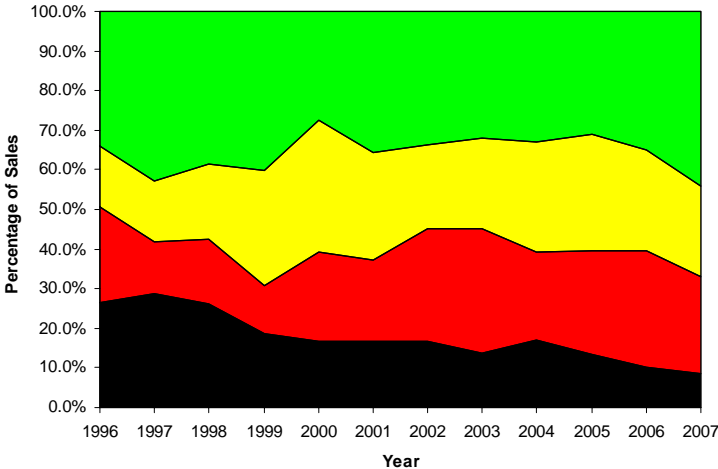
The story these days is that a common-sense cocktail of climate change fears, rising energy costs and mile-high Corporate Average Fuel Economy (CAFE) standards will conspire (or are already conspiring) to mire the automakers - particularly the Detroit-based OEMs - in a 1970s-style black hole. Recall that inadequate emissions technology and a fundamental size/weight problem created a gap in the 1970s and early-1980s between Detroit and the import-nameplate OEMs that has only recently been tightened up. Staying with or ahead of the curve is crucial to the survival of automakers in the U.S. and elsewhere.

This is the story that has been adopted by people inside and outside the industry - naysayers and evangelists alike. While this view is not without merit, it is profoundly pessimistic. Those purveying the 'dark future' outlook see radical changes rocking the industry and many resultant negative outcomes: lower volumes, higher prices, more potential job losses, and - much to the chagrin of North American vehicle buyers - slower and smaller cars. Buzz Hargrove, president of the CAW, recently speculated that there will come a day when GM, Ford and Chrysler no longer build vehicles in North American. I couldn't disagree with him more strongly.

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Age of Vehicle Platforms 1996 - 2007 Percentage of Sales by Platform Age

Total Canadian Industry



0-2 Years Old 3-4 Years Old 5-8 Years Old 9+ Years Old

Source: DesRosiers Automotive Consultants Inc. AIAMC, CVMA, and CSM Worldwide

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It is important to understand that GM, Ford and Chrysler are presently going through a comprehensive three-stage response to the market share losses they have endured over the past decades. The first two stages - capacity reduction and labour/supplier restructurings - have been largely completed and have lined Detroit vaults with fresh capital. This money represents a newfound sort of flexibility for the Detroit-based vehicle companies. They will, of course, take care of shareholders and continue their labour buyouts - buyouts that have and will cost a lot of money - but a large portion of the cost structure savings will be re-invested in product development.

Starting in 2006/7 and continuing for the foreseeable future, the

product offensive - nay, product assault - has begun in earnest and the results are starting to show. Nothing inspires greatness like strong competition, so you can fully expect matching efforts from North American and global players alike. A quick glance at last year's Canadian sales-weighted platform ages should give some indication as to the direction OEMs are headed: record high levels of new product and record low levels of old-platform products are populating Canadian showrooms. Our full analysis of current platform trends will follow in a future Observation.

I prefer to look at the coming decade as one of opportunity. We are entering a new automotive heyday - one in which product, long an important

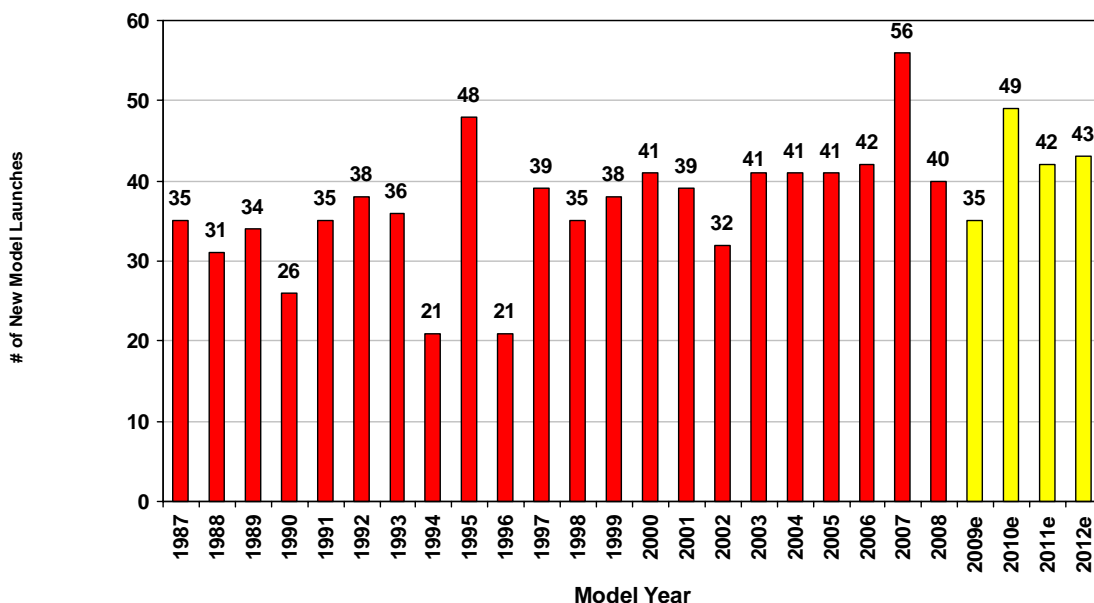
determinant in commercial success, will become the make or break factor in this marketplace. The 2010s will be a decade of opportunity for specific OEMs, for suppliers and for ordinary vehicle buyers. I honestly believe that GM, Ford and Chrysler are in a very good position to capitalize on these opportunities.

Opportunities for OEMs

During a recent lunch with GM Vice President Research & Development Larry Burns, it became clear to me that there are very few entities capable of truly driving the auto industry into its next era. Burns suggested that only General Motors and Toyota possess the broad engineering backgrounds, marketing experience, supplier clout, distribution system and -

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New Model Launches by Model Year 1987-2012e



Source: DesRosiers Automotive Consultants Inc. and Merrill Lynch

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most importantly - available capital to develop, bring to market, and re-sell/license the relevant innovations that will underpin our future vehicles. Some companies may also be capable of shepherding brilliant eco-innovations to market, but many of their present developmental efforts appear tied to short term alternative fuel solutions. Most seem intent on maintaining the internal combustion status quo through diesel and HCCI gasoline engines. This may be a solid strategy for the near and medium terms, but it is unlikely that the future of the automotive industry lies with combustion technology.

Whereas smaller OEMs have tied their development dollars to specific technologies, GM (and to a lesser degree, Toyota) has refused to play sides. This strategy is both applauded and derided by various pundits, but it has paid some dividends. With its feet wet in conventional biofuel engines (read: Ethanol), gas-electric hybrids, hydrogen fuel cells, full electric vehicles and range-extended electrics, GM is poised to jump onto whichever bandwagon breaks free of the herd. Facing massive CAFE hikes and possessing a strong R&D budget, GM would be negligent in not positioning itself with experience on all potential fronts. It is a safe strategy and it is one that other OEMs may wish they had pursued when the

next major energy paradigm takes hold.

As it is, we do not know which alternative fuel technology will gain distribution support - and neither do the automakers! If hydrogen fuel cells develop an ascendancy in North America (i.e., if a hydrogen distribution network coalesces), certain OEMs stand to profit from the development gamble they've been undertaking during the past decade. Indeed, manufacturers like Honda and BMW may form an important second-tier of technology specialists in much the same way as they are now regarded as the "engine companies" among their OEM peers.

Opportunities for Suppliers

The coming decade is exciting not just for vehicle manufacturers but especially so for others in the supply chain. Opportunities exist for all suppliers, including companies that have not traditionally been associated with original equipment automotive parts.

U.S. buyers still appear unwilling to move away from larger vehicles. Sales of large SUVs are down, but they remain a much easier sell in the U.S. versus Canada. Given that powerful, towing-capable vehicles are pillars of both work and leisure culture south of the border, it is evident that the most realistic way to attack the fuel

efficiency problem is through technology, not sales mix. Alternative fuels and hybrid powertrains, lightweight materials, efficient transmission and engine management designs: these are the tools through which OEMs will vault the CAFE hurdles.

Anyone in the value chain stands to benefit from technological change, but investment and innovation are crucial for supplier success and will continue to separate the good from the great. Stagnant suppliers will not win contracts, and as major value-added components continue their shift from mechanical to electronic, only those companies investing in equipment, infrastructure and human resources will rise to the top. The winners of the 2010s will be those companies - companies at any tier level - that invest in research, leverage resources in other countries, and continue taking risks. This theme has played out several times in decades past, but enhanced supplier rigour is of utmost importance now that OEM cost structure and quality-of-manufacture are more visible than ever.

One of the fundamental themes of this period is change. It seems as though denizens of every era think theirs is the hinge generation, but I truly believe that this is one of the auto industry's major breakpoints. The coming five to

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ten years may determine the course of things to come for the next fifty.

As automotive technology changes, so will the mix of companies supplying that technology. Players from outside the traditional supplier pool are already making inroads in the automotive industry.

Traditional battery suppliers, for example, will face serious (some might say existential) problems as burgeoning hybrid and range-extended EV sales ramp up demand for high-tech lithium ion batteries and battery control systems. A manufacturer of traditional lead acid automotive batteries cannot flip a switch and convert from old-style to new-style batteries without significant investments in research, development, testing, training, and production infrastructure. Non-automotive battery suppliers that normally compete in the cellphone and laptop arenas will gain enormous volume as manufacturers work towards integrating hybrid technology into regular vehicles. There will come a time in the near future when most mainstream vehicles will be offered with some sort of "efficiency aids" package, be it an engine start/stop feature, mild hybrid capability, or full-blown hybrid electrics.

Equally likely is that OEMs will begin insourcing parts and assemblies that have historically been manufactured by external players. If and when mainstream automobiles move

Retail Consumer Sales vs. Fleet Sales

Combined Segments	Retail Consumer Share			Fleet Share		
	1997	2007	Chg. +/-	1997	2007	Chg. +/-
Entry Level	34.4%	51.8%	17.4	17.9%	24.9%	7.0
Mid-size/Family	40.3%	23.9%	-16.4	58.1%	39.7%	-18.4
Large/Luxury/Sport	9.1%	11.7%	2.6	3.7%	6.6%	2.9
Primarily Commercial	16.2%	12.6%	-3.6	20.3%	28.8%	8.5
TOTAL	100.0%	100.0%		100.0%	100.0%	

Source: DesRosiers Automotive Consultants Inc., AIAMC and CVMA

to a sufficiently high level of technology, some in the supplier community may not be able to handle the manufacturing demands and low tolerances associated with modern vehicles.

Opportunities for Consumers

Ultimately, the consumer wins. All of the hand-wringing and arm twisting going on at vehicle companies, automotive parts suppliers and government bureaucracies will deliver extraordinary benefit to ordinary vehicle buyers.

With a cost structure reduction of approximately one-third, the MSRPs of union-made vehicles could potentially drop by as much as ten percent over the next decade. Couple this cost reduction with the countless improvements brought about by stiffer domestic and international competition and it becomes easy to see why this industry is entering a new heyday for producers and consumers alike.

The people buying these less-expensive cars may appreciate their soft-touch interiors and

Euro-taut suspensions, but they are guaranteed to love the reduced fuel bills. As turbo-4s replace V6s and hybrids continue their mainstream march, the 35 MPG CAFE target will seem more reasonable with each passing year.

Last - and perhaps most profound - is the positive effect that emissions reduction will have on the environment. Over thirty years of vehicle emissions regulation has made the air in our cities more breathable. Imagine if the past three decades' gains could be compounded and multiplied, then applied in a single swoop. This is what the alternative powertrain revolution offers: freedom from smog, guilt, worry and sky-high energy costs.

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