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Global
Special Report

Life After Detroit Auto Bankruptcy — the Effect upon European and Asian OEMs

Ratings

	Foreign-Currency Long-Term IDR/Outlook
Fitch-rated car manufacturers in Asia	
Japan	
Honda Motor Co., Ltd	A/Negative
Nissan Motor Co., Ltd	BBB-/Negative
Toyota Motor Corporation	AA/Negative
Korea	
Hyundai Motor Company	BB+/Negative
Kia Motors Corporation	BB+/Negative
Fitch-rated car manufacturers in Europe	
Daimler AG	BBB+/Negative
Fiat S.p.A.	BB+/Negative
Peugeot S.A.	BB+/Negative
Renault SA	BB/Negative
Volkswagen Group	BBB+/RWN

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Related Research

- *Global Automotive Industry Outlook 2009 (February 2009)*

Overview

Given the recent Chapter 11 filing by Chrysler (rated 'D') and the possibility of General Motors (GM, rated 'C') taking similar action, the ripples of which may well be felt throughout the world, this report comments on the impact of this likely scenario for Asian and European auto manufacturers. Although Ford (rated 'CCC'/Negative Outlook), the third of the three US manufacturers (the "Detroit 3", or "D3"), has less immediate liquidity concerns, continued operating losses and restructuring costs indicate that the company is expected to reach minimum required levels of cash within the next 12 months without a stabilisation in US industry sales and continuing material realisation of cost-saving benefits.

Overall, whilst Fitch Ratings believes that European manufacturers will hardly be affected, the Asian manufacturers that have already suffered volume declines in the US will probably soak up any available US market share from a Chrysler and/or protracted GM bankruptcy as either US company ceases production of some of its models or US consumers lose further confidence in the incumbents' products.

However, the benefit to Asian manufacturers may be tempered by potential short-term supplier contagion with the D3, the continuation of various forms of incentives to discount US manufacturers' products, which may force overseas manufacturers to reduce their profit thresholds, and the underlying long-term recovery prospects for, and appetite, of the US consumer.

Prospective Rating Action

Fitch does not expect immediate detrimental rating actions for European or Asian auto manufacturers as a result of the US manufacturers undertaking a form of insolvency. If the supply chain falls apart and causes significant disruption in the operations of the Asian or European transplants, there would be an immediate reaction. But given Fitch's assumption of significant government aid to GM in a bankruptcy, and either direct or indirect aid to the suppliers, any immediate rating action is unlikely. The agency will nevertheless continue to monitor sales trends very closely.

Having said that, negative rating actions cannot be ruled out should the effect of a protracted insolvency process profoundly depress US consumer confidence to the point of adversely affecting Asian manufacturers' revenues and profitability. US confidence may also be affected by large job losses resulting from particular insolvency processes. The new US administration has spoken of its commitment to sustain a US domestic car industry but how healthy, cost-competitive and consumer confidence-inspiring that industry will be is currently unknown. Overall, Fitch assumes that the government will provide aid to GM, in or out of bankruptcy, but that bankruptcy poses much higher uncertainties with regard to sales trends and supplier solvency.

Asia – Impact on Asian Automakers Operating in the US

Asian manufacturers had a collective 47.9% market share in the US in Q109 (2008: 43.5%). Consequently, a protracted insolvency process for GM will have a positive impact on Asian automakers given the importance of the US market to their operations. Although there might be negative implications in the shorter term given potential overlaps with GM/Chrysler suppliers, Asian automakers should continue to gain market share in the US.

Short-Term Impact

Impact on Overall US Demand

US purchasers have already been aware of the fragility of GM and/or Chrysler, as seen in the negative effect on demand for their products and brand equity, taking into account after-service and spare parts, but the actual reality of such a Lehman Brothers-like scenario may further decrease volumes.

Supplier Concerns

Another short-term concern is the extent to which these events will affect auto suppliers. According to CSM Worldwide, it is estimated that around 60% of suppliers to the D3 also supply the Asian transplants. Although the US government has also given out loans to the suppliers (USD5bn) through the automakers, it is quite possible that auto suppliers will continue to suffer from further capacity/production restructuring at GM or Chrysler. Financial difficulties at overlapping suppliers could affect Asian automakers with production facilities in the US market. That said, because most US suppliers have had difficulty gaining material share with Japanese OEMs in the US, it may be easier for Asian OEMs to eventually substitute suppliers from their home countries.

US Production Facilities of Asian Automakers

	Factory	Models	Production capacity (p.a. in 000)
Toyota	Fremont, CA (JV with GM)	Corolla, Tacoma & Voltz, GM: Pontiac Vibe	400
	Georgetown, KY	Camry, Avalon & Solara/Engines	500/500
	Princeton, IN	Tundra, Sequoia & Sienna	350
	San Antonio, TX	Tundra	200
Honda	Marysville, East Liberty, Anna, OH	Accord, Civic, CR-V, Element, Acura TL, & Acura RDX, Engines	680/1,180
	Lincoln, AL	Odyssey, Pilot/Engines	300/300
	Greensburg, IN	Civic	200
Nissan	Smyrna & Dechert, TN	Altima, Frontier, Xterra, Maxima, Pathfinder/Engines	550/950
	Canton, MS	Quest, Titan, Armada, Altima, InfinitiQX56	400
Hyundai	Montgomery, Alabama	Sonata, Santa Fe, Engines	250
Kia	West Point, Georgia[a]	Mid sized sedan & SUV	250

[a] Production scheduled to start in 2010
Source: JAMA, company, as of 2007

Currency Movements will Continue to Play a Big Role

Foreign currency movements will continue to play an important role in Asian automakers' operations given that their US production facilities are not able to fully meet likely US demand. Furthermore, profits at the US plants are also converted back to local currencies. As such, although foreign automakers typically do not adjust US retail prices to reflect currency movements, their ability to offer incentives or promotions are affected by how their local currency is performing against the US dollar.

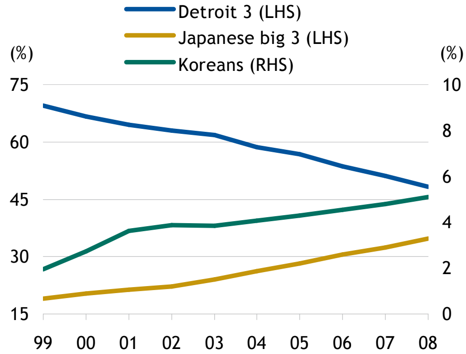
During the current downturn, the profitability of Japanese automakers has been affected not only by volume decline but also a strong local currency, whereas Korean automakers have benefited from a weak Korean won, which partly offset the negative impact of volume decline and which also gave them a buffer to provide more incentives in the US market. But in the longer term, Fitch views that most Asian automakers will try to mitigate the currency impact by trying to reduce overseas shipments to the US out of Japanese and Korean plants.

Medium- to Long-Term Impact

Despite short-term potential disruption and uncertainty, over the medium to long term, the impact will be positive for Asian manufacturers. The US continues to be the most important market for Japanese automakers and, albeit to a lesser degree, Korean automakers. Although the dependence of Japanese automakers on the US market has declined recently with the sharper sales decline in the US than the rest of the world, sales in North America still accounted for 40% of total sales volume as of FY08 (April 2008 to March 2009) for Honda and around 30% for each of Toyota and Nissan. For Hyundai Motor and Kia Motors, US sales accounted for roughly 20% of total sales in 2008. Therefore, market share fluctuations in the US would have a significant impact on Asian automakers' revenue and profitability.

US operators will continue to lose market share to Asian automakers – a process that has been taking place over the past decade. While it may be a long time before the overall industry reaches or even gets near previous levels of profitability after the current downturn, it will take longer for GM and/or Chrysler to reverse the gradual erosion of brand image and consumer confidence. Although the US government has announced several measures such as the backstopping of warranties to support existing car owners and alleviate concerns of potential new buyers, it may not be enough to allay consumer concerns.

US Market Share Trends



Source: Autodata

Will the D3 Become more Cost Competitive with Restructuring?

It may be possible that after forms of bankruptcy proceedings, GM and/or Chrysler will emerge with a much leaner and more competitive cost structure, particularly after restructuring their pension and healthcare liabilities. Although attacking the cost base may create additional cash flow, the ability to provide competitive retail financing through access to capital is also a very material advantage for the non-US OEMs at this point.

On top of additional cash flow, any resurrected US manufacturers would have to recreate volume and reverse the erosion of brand image, loss of consumer confidence and damage to their dealership networks. In addition, they would need to prove they can be competitive in the smaller, more fuel-efficient car market. With this in mind, cash flow to invest in R&D to bring their lagging product lines up to a level similar to their overseas competitors would also be required, as well as next generation technology for hybrids and electric cars. Although no companies currently have a clear edge in next generation technology, it is doubtful that companies emerging from bankruptcy will have enough financial resources or flexibility to invest in long-term or forward-looking technology compared to other automakers.

Impact on Asian Automakers in their Local Markets

The impact of a D3 or part-D3 insolvency scenario on non-US markets is limited. In Japan, it will be minimal as the US automakers' market share there is less than 1%. In Korea, although the market share of the D3 is less than 1%, GM has a majority stake in a local automaker, GM-Daewoo, which has already been affected by troubles at the parent company given its role as a production base for small cars. From a domestic market share of above 12% just two years ago, GM-Daewoo's market share is now below 8% as of YTD March 09. GM-Daewoo has already been asking its creditors for support and Fitch expects its domestic market share to fall further, which will likely benefit the dominant players, Hyundai Motor and Kia Motors, which combined, control more than 80% of domestic market.

Europe – Impact on European Manufacturers in the US

Limited Gain in Market Share Expected

With an 8.3% market share overall in Q109 (2008: 6.8%), European car manufacturers have a limited presence in the US. Fiat, PSA and Renault do not sell cars in the US, although Renault has an indirect exposure to the US market through its 44% stake in associate Nissan. Only German groups BMW, Daimler, Volkswagen and Porsche are present in North America.

However, in spite of this low market shares in the US, this market represents a key source of revenue. In FY08, the US accounted for 21% of BMW automotive and 17% of Daimler's Mercedes Benz Cars unit sales. Volkswagen is the lowest-exposed to the US with only 5% of total group unit sales while Porsche sold 34% of its total vehicles in the country. Profit-wise, the US has traditionally been a source of operating loss or weak operating profit for Volkswagen, whereas for Daimler, BMW and Porsche the US is a crucial market. Therefore, erratic movements in market shares can have a clear impact on these companies' revenues and operating results.

European Manufacturers' Market Share in the US

	Q109 (units)	Q109 (%)	2008 (units)	2008 (%)
Total light vehicles	1,588,212	100	15,975,252	100
Volkswagen	57,932	2.6	324,078	2.0
VW	42,124	1.9	230,572	1.4
Audi	15,808	0.7	93,506	0.6
BMW	51,244	2.3	335,838	2.1
BMW	42,731	1.9	293,795	1.8
Mini	8,513	0.4	42,045	0.3
Daimler	45,171	2.1	253,173	1.6
Mercedes	40,234	1.8	253,173	1.6
Smart	4,937	0.2	0	0.0
Porsche	4,925	0.2	34,693	0.2

Source: Bloomberg

Nevertheless, Fitch would expect a limited effect on European groups from a collapse in GM sales. BMW, Daimler and Porsche are positioned in the premium segment, to which US brands have a traditional lower exposure and penetration rate. A demise of GM's Cadillac brand may provide a small positive momentum to BMW's, Daimler's (Mercedes) and/or Volkswagen's (Audi) market shares, although this is likely to be more limited than the potential positive impact of other GM brand failures for Japanese manufacturers.

However, there is the potential for increased incentives on Cadillac models to help boost demand for the brand. This would limit market share erosion and support GM's sales and could ultimately lead competitors to initiate similar pricing actions, thereby obliging BMW or Daimler to reduce their prices.

Supplier Concerns

Fitch believes that the most notable effect of a GM bankruptcy on European manufacturers would be the negative impact of supplier disruptions triggered by the potential failure of one or several GM-related suppliers. The domino effect of a bankruptcy of a large Tier-1 supplier on smaller groups supplying components to BMW or Daimler could lead to production stoppages.

However, Fitch notes that the locations of European manufacturers' factories are in the south of the US, far from the traditional Detroit area. In addition, only models manufactured in the US would be affected, while cars produced in Europe could still be shipped to North America, mitigating the overall impact on sales and revenues.

European Models Manufactured in the US

	Model	Factory
Daimler	Mercedes R-class	Tuscaloosa, Alabama
Daimler	Mercedes M-class	Tuscaloosa, Alabama
Daimler	Mercedes GL-class	Tuscaloosa, Alabama
BMW	X5	Spartanburg, South Carolina
BMW	X6	Spartanburg, South Carolina
Volkswagen	Production planned to start in early 2011	Chattanooga, Tennessee

Source: Companies

Impact on European Manufacturers in Europe

While Chrysler has 0.7% of the European market, GM has solid market shares. In 2008, it was the fourth-largest player in Europe, with a 9.5% market share, although it was passed by Fiat in early 2009. GM's Opel/Vauxhall brand remains among the top six mainstream brands in Europe, despite a continuous decline since early 2006. The decline of the Saab brand has been somewhat mitigated by the improvement of the entry-level GM-owned Chevrolet brand, but these two brands still have low market shares.

With more than 1 million unit sales in 2008, Opel/Vauxhall is a significant contributor to GM's group revenues. However, a spin-off of GM Europe (GME) has been reported numerous times in the media and could avoid this entity's bankruptcy. Several industrial groups, sovereign wealth funds and banks are reported to be interested in GME. In light of the social and economic importance of GME in Germany, the German government has pledged to find a solution for Opel, but cautioned that any state action would more likely be in the form of loan guarantees than a direct stake in the German carmaker.

Should Opel be spun off or continue to operate, even in the case of a GM bankruptcy in the US, Fitch believes that changes in market shares and a decline in Opel sales should be limited in Europe. In spite of expected media report to comment on Opel being a GM brand, and consumers' speculations that Opel and GM bankruptcies may be related, Fitch believes that this will have a minimal effect.

Upon an Opel bankruptcy, there would be a more dramatic effect on this division's future sales. Direct competitors could benefit from this failure, although it cannot yet be assessed which manufacturers would benefit the most and how Opel/Vauxhall sales would be distributed.