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cutting through complexity

2012 Automotive Industry Outlook Survey:

Bullish Industry Faces Headwinds

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KPMG's 2012 Industry Outlook Survey

KPMG LLP, the audit, tax, and advisory firm, surveyed more than 100 C-suite and other top-level executives in the U.S. auto industry during the second quarter of 2012.

Participants were asked about their sector's business conditions, significant areas of revenue growth, employment outlook, and their priorities for investment. They also were asked to gauge factors that could support or impede progress, including supply chain challenges and government regulation.

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Foreword

I am pleased to present KPMG's 2012 Automotive Industry Outlook Survey which provides the perspectives of more than 100 senior executives in the U.S. automotive industry.

The survey results clearly portray a U.S. automotive industry that is regaining confidence. Even though the overall U.S. economic recovery remains weak, that is not the case in automotive, where pent-up demand for vehicles in the United States is expected to carry over for years. As a result, auto companies and suppliers are ramping up their hiring and production activities, and investing heavily in new products and facility expansion.

The industry has significant cash on hand and companies are focusing on opportunities for investing in new products, innovation, productivity enhancements, and M&A.

Despite record profits, the industry is keeping its eye on costs. Auto executives say that improving manufacturing efficiencies and reducing overhead costs are among the major steps they are taking to improve profitability.

While auto executives express optimism about revenue, growth, and hiring, particularly in the United States, they face global economic headwinds—and they are not projecting an economic turnaround for years.

We are also hearing from U.S. automakers that although they are poised for growth, they are struggling in certain instances to find the right people with the right technical skill sets for open positions. This is becoming an increasing cause for concern; not just for auto companies, but for many organizations in the manufacturing sector. It remains to be seen how companies will fill the gap.

The turnaround of the U.S. automotive industry in such a short period of time has been nothing short of remarkable. It has had a positive impact on the U.S. economy, and the industry continues to invest and innovate.

Gary

Gary Silberg
National Sector Leader, Automotive
KPMG LLP

Key findings from KPMG's Business Outlook Survey

KPMG's survey reflects the responses of more than 100 senior executives in the U.S. auto industry—manufacturers and suppliers—from companies with more than $100 million in annual revenue. Twenty-nine percent of respondents worked for companies whose annual revenues exceed $10 billion, 25 percent represented companies with annual revenues between $1 billion and $10 billion, and 46 percent had revenues in the $100 million to $1 billion range. Fifty-five percent of these companies are publicly held, and 45 percent are privately held.

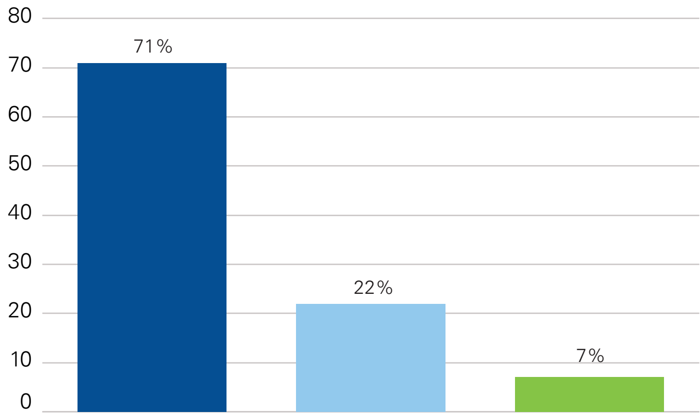
Key findings from the auto industry sector included the following:

- The majority of respondents expect revenue, hiring, and the economy to improve in the coming year. More than three-quarters (76 percent) of auto executives say their companies' revenue has increased over the past year, and 83 percent believe revenue will continue to rise next year.
- Sixty-six percent of sector executives say their companies have added employees since last year, and nearly three-quarters (72 percent) believe they will add more over the next year.
- The number of executives who cite the lack of a qualified workforce as one of the most significant barriers to growth nearly doubled—from 10 percent in 2011 to 19 percent in 2012.
- Fifty-nine percent of U.S. auto executives surveyed say their company's ability to get financing or raise capital has improved since last year. Forty percent of companies with cash on their balance sheets acknowledge that investment is already significantly under way.
- More than half (57 percent) of the executives expect their companies to be involved in a merger or acquisition over the next two years, with 47 percent anticipating their role as buyer in the transaction.
- Key drivers of revenue growth during the next one-to-three years are predicted to be new models/products (53 percent), new geographic markets (42 percent), improved pricing strategies (35 percent), and acquisitions/joint ventures/strategic alliances (32 percent), according to survey respondents.
- Supply chain management is a growing concern for sector executives due to rising commodity costs (55 percent), capacity/availability of product (29 percent), insufficient quality levels (28 percent), and supply disruption (28 percent).
- Seventy-one percent of respondents predict the U.S. economy will improve next year.

Business conditions

Almost three-quarters (71 percent) of auto executives surveyed believe the U.S. economy will see improvements over the next year, while only 7 percent believe it will be worse than last year.

Expectations for U.S. economy in one year



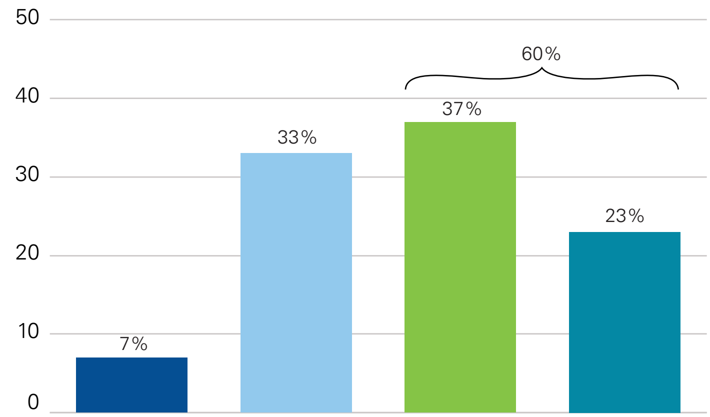
Key

- Improved
- About the same
- Worse

Time line for U.S. economic recovery

Automotive executives surveyed anticipate the projected time line for an overall U.S. economic recovery is still a few years away. Most respondents (60 percent) do not expect the economic recovery to fully occur until 2014 or later.

Expectations for full economic recovery



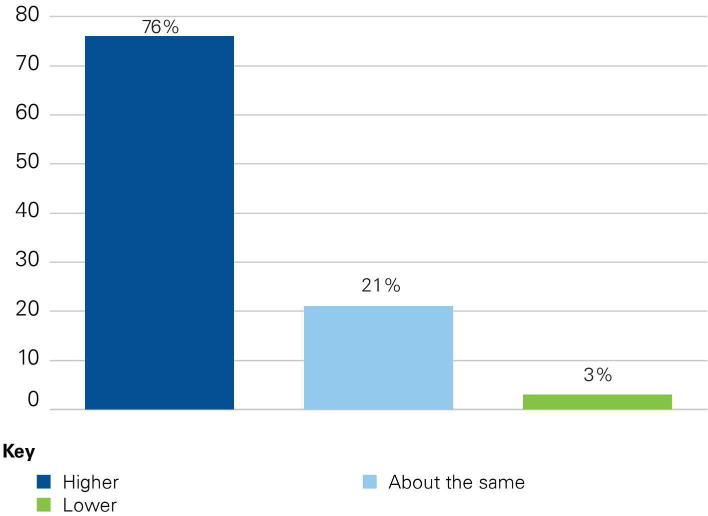
Key

- 2012
- 2013
- 2014
- 2015 or later

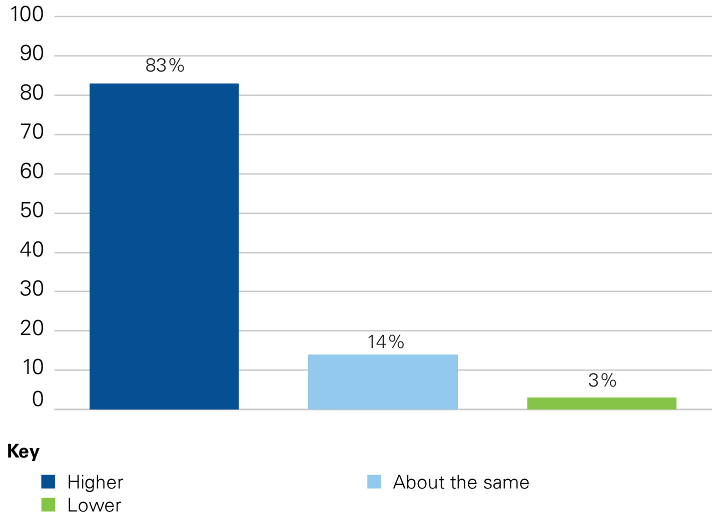
Revenue and profitability

More than three-quarters (76 percent) of executives indicate their companies have experienced an increase in revenue during the past year. An even greater number of respondents (83 percent) believe their companies will continue to see revenue climb over the next year.

Revenue increase over prior year



Expected revenues in year ahead



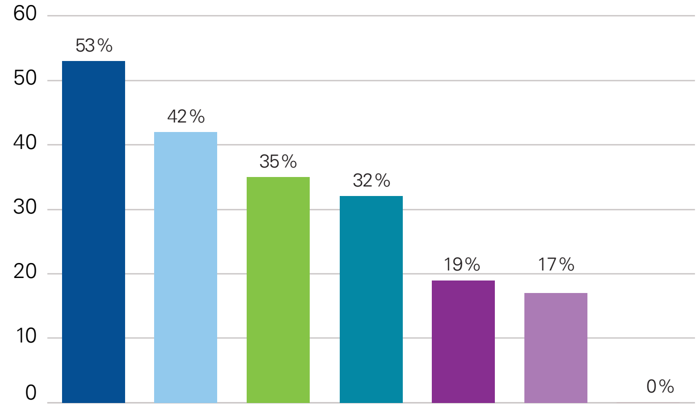
Even though the overall economic recovery remains weak, that is not the case in automotive, where pent-up demand for vehicles in the United States is expected to carry over for years.

Gary Silberg, KPMG LLP

Revenue and profitability (continued)

Sector executives cite new models/products, expansion into new geographic markets and improved pricing strategies as the three top drivers of revenue growth over the next one-to-three years.

Biggest drivers of company's revenue growth in the next 1–3 years



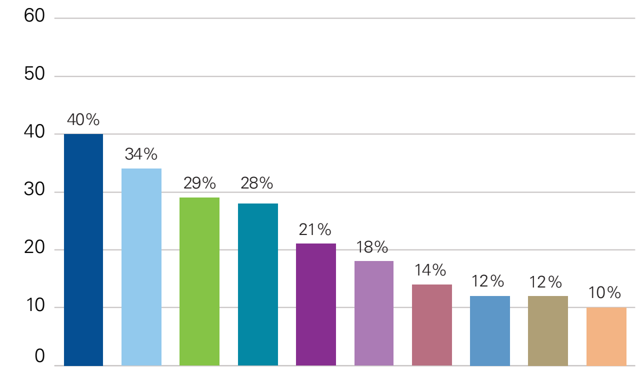
Key

- New models/products
- Expansion to new geographic markets
- Improved pricing strategies
- Acquisition/joint venture/strategic alliance
- Additional dealerships/ distribution channels
- Expanding into other lines of business
- Other

Multiple responses allowed.

Moreover, improving manufacturing efficiencies, new geographic expansion, and reducing overhead costs are expected to have the greatest impact on growing profits over the next three years, according to survey respondents.

Greatest impact on improving profitability in the next 1–3 years



Key

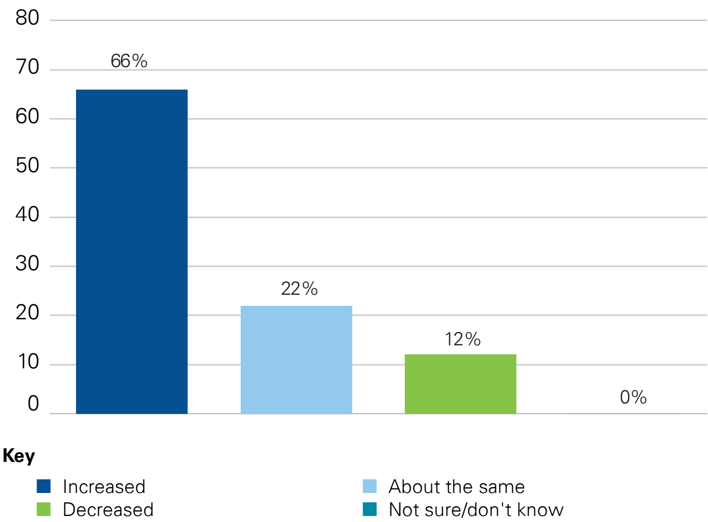
- Improving manufacturing efficiencies
- Expanding into new geographies
- Reducing overhead costs, including moving toward a shared services model
- Increasing investment in innovation/ new products
- Acquisitions/strategic alliances/joint ventures to mitigate investment costs and achieve strategic advantage
- Changing pricing strategy
- Restructuring existing operations, including contemplation of divestitures
- Expanding into other lines of business
- Implementing new supply chain management strategies
- Increasing outsourcing/insourcing

Multiple responses allowed.

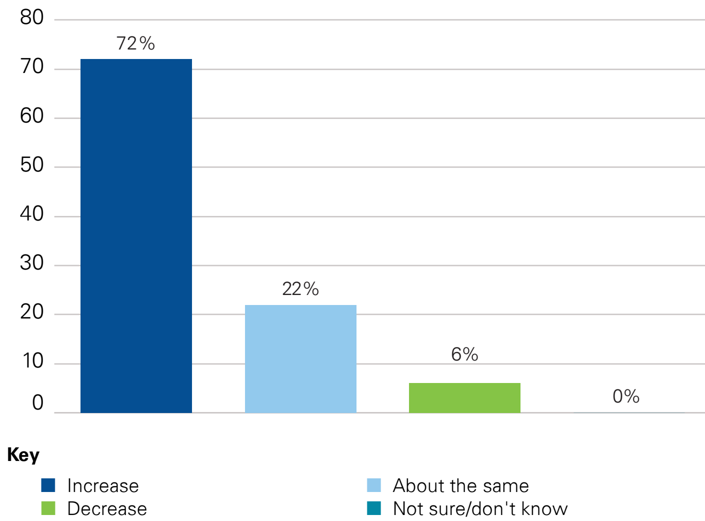
Headcount

The employment picture for the automotive industry continues to improve, and executives predict that trend will continue. Two-thirds (66 percent) of the auto executives surveyed say they have added employees since last year, and 72 percent expect to continue adding personnel over the next year.

Headcount versus last year

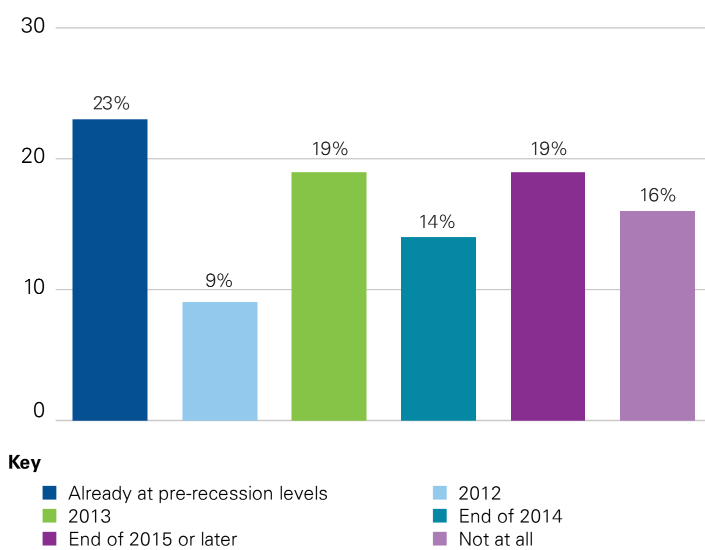


Percent of companies expecting to add headcount in year ahead



Notably, while 32 percent of auto executives say their headcount will be at or above the pre-recession level by the end of this year, 16 percent believe their U.S. headcount will never return to pre-recession levels.

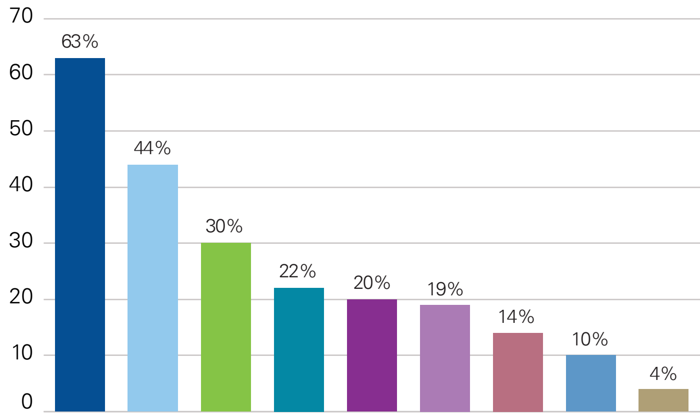
Headcount return to pre-recession levels



Gearing up for growth

North America continues to be a primary growth area for companies, according to 63 percent of survey respondents, followed by China (44 percent) and South America (30 percent).

Top 3 regions/countries for growth



Key

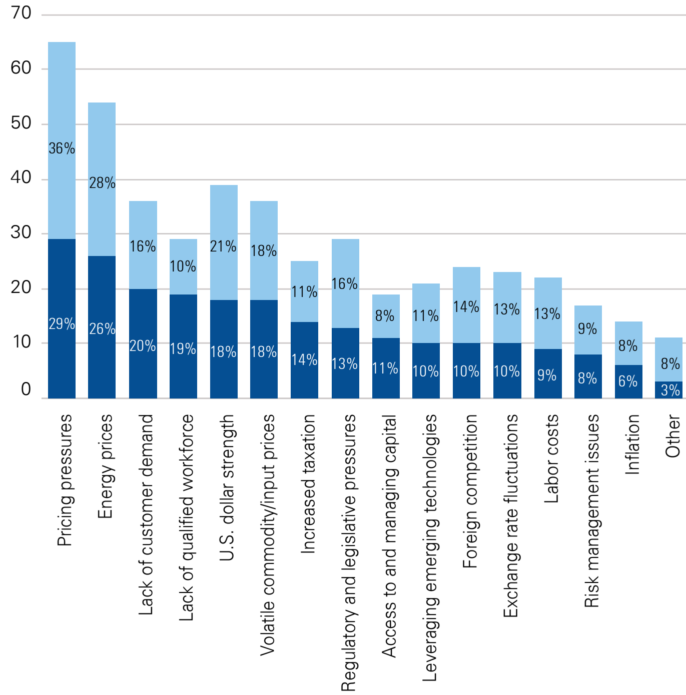
- North America
- South America
- Western Europe
- Eastern Europe
- Middle East
- China
- Asia (other than China)
- India
- Russia

Multiple responses allowed.

Growth roadblocks

In their quest for growth, sector executives cite pricing pressures, energy prices, the lack of customer demand, and lack of a qualified workforce as the most significant barriers over the next year. Significantly, the number of respondents who consider the lack of a qualified workforce to be a barrier to growth almost doubled since 2011.

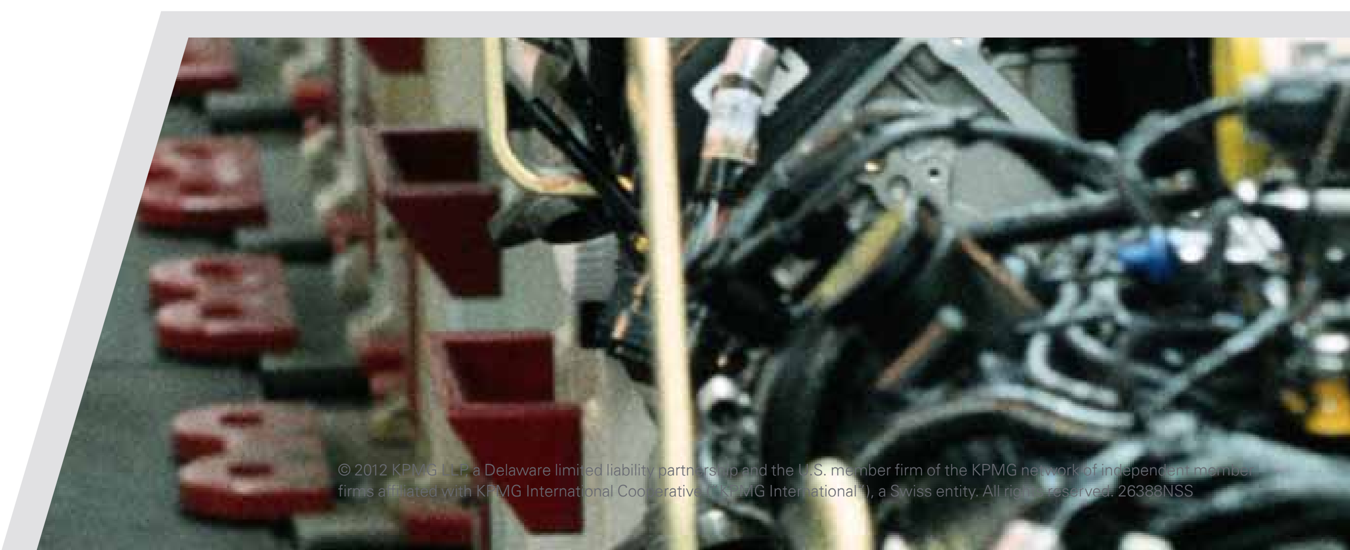
Barriers to growth in the coming year



Key

- 2012
- 2011

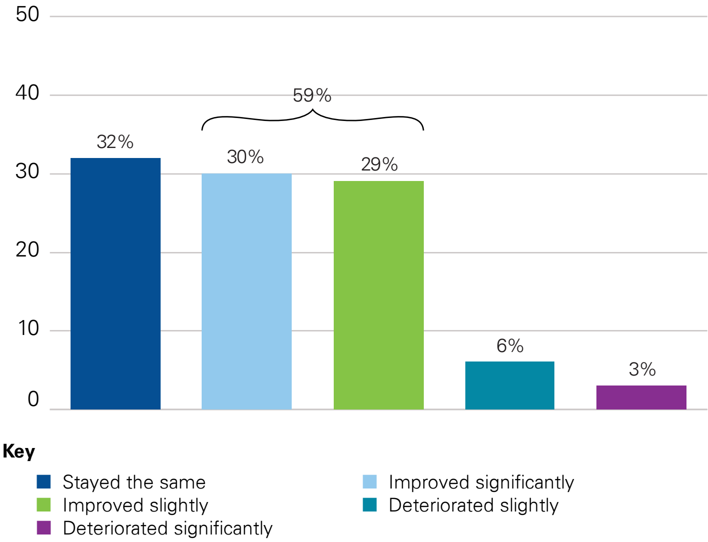
Multiple responses allowed



Capital spending and investing

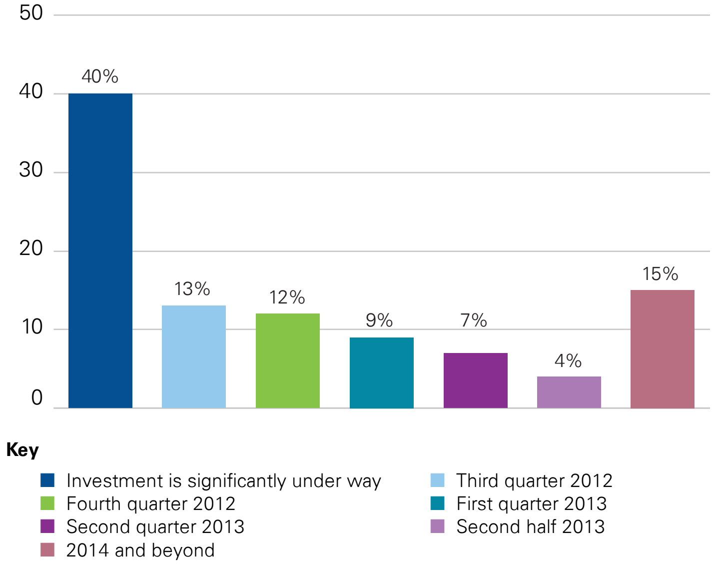
News reports continue to call attention to companies having a great deal of cash on their balance sheets but lacking the confidence to invest. Fifty-nine percent of U.S. auto executives surveyed say their company's ability to get financing or raise capital has improved since last year.

Company's ability to get financing or raise capital over the past year



Moreover, of those companies with cash on their balance sheets, 40 percent acknowledge that investment is already significantly under way.

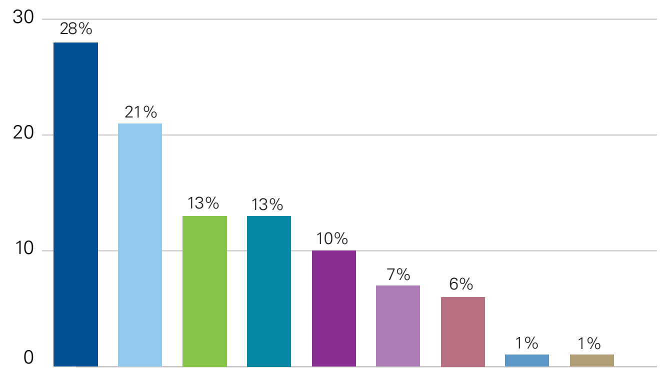
Investment time frame



Capital spending and investing (continued)

Top initiatives for the next two years include process and IT improvements (28 percent), investment in organic growth (21 percent), and M&A and cost reduction initiatives at 13 percent.

Top initiatives for the next two years

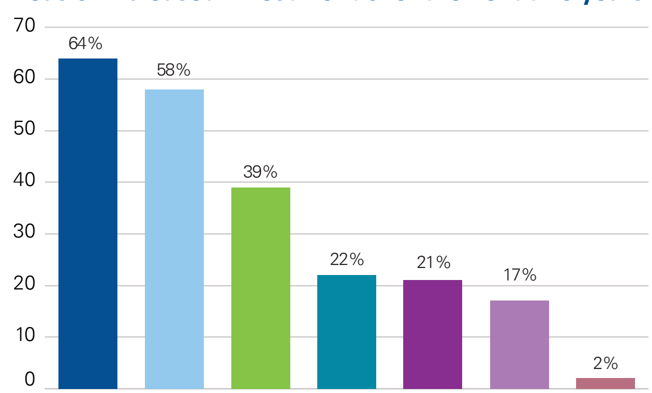


Key

- Significant improvement of operation processes and related technology
- Significant investment in organic growth (new product development, pricing strategies, geographic expansion)
- Merger/acquisition
- Significant cost reduction initiatives
- Significant changes in business model
- Strategic divestiture of current assets
- Navigating significant changes in the regulatory environment
- Significant changes to financial processes and related technology
- Improve enterprise risk management programs/processes

Sector executives expect to increase their investments in new technology (64 percent), new models/products (58 percent) and expansion into new geographies (39 percent).

Areas of increased investment over the next two years



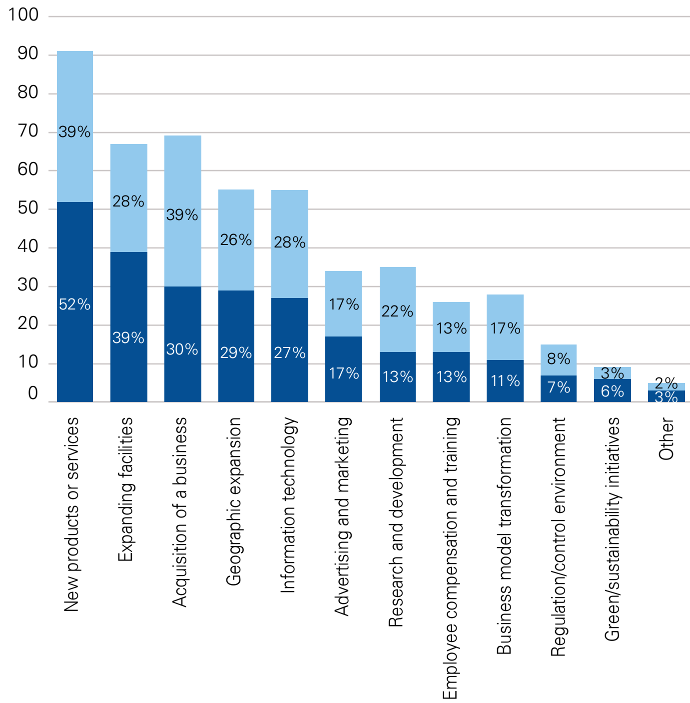
Key

- New technologies
- New models/products
- Expansion into new geographies
- Marketing and advertising
- New plants
- Logistics/distribution
- Do not expect increases

Multiple responses allowed.

For those looking to spend, executives expect most dollars to go to new products and services (52 percent), expanding facilities (39 percent), and acquisition of a business (30 percent). Respondents indicated a significantly increased interest in spending on new products/services and expanding facilities compared to last year.

Areas of increased spending over the next year



Key

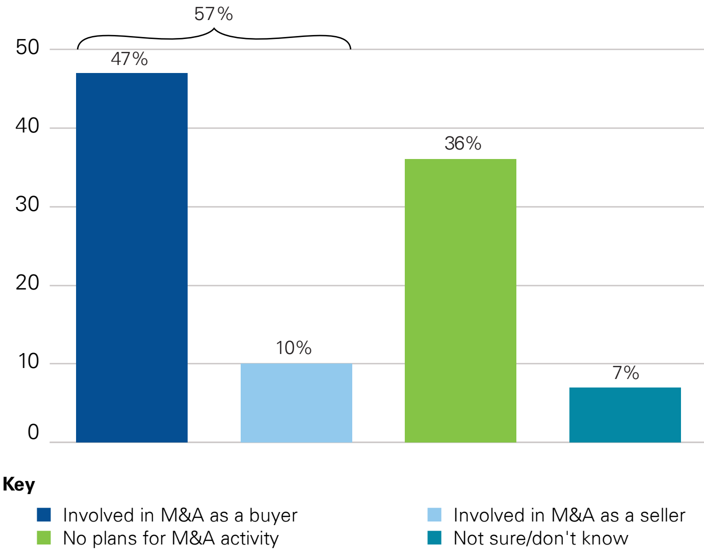
- 2012
- 2011

Multiple responses allowed

Accelerating M&A activity

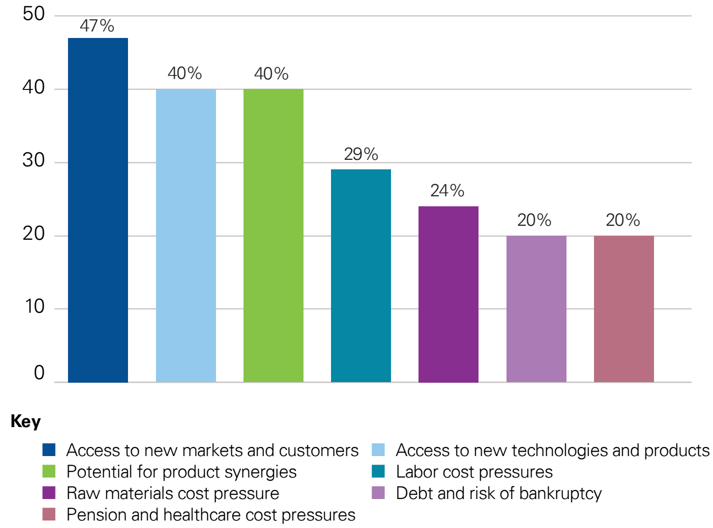
With strategic acquisitions topping the list of auto executives' investment priorities, a surge in M&A activity is likely to occur. Fifty-seven percent of sector executives believe their company will participate in a merger or acquisition, with the majority (47 percent) expecting to have the role of buyer in the transaction.

Likelihood of M&A activity



Access to new markets and customers is expected to be the top key driver of M&A activity.

M&A key drivers

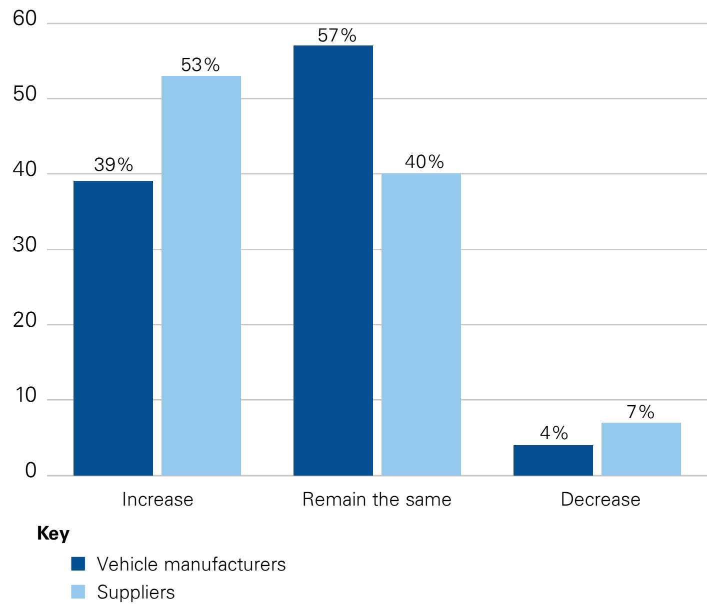


Multiple responses allowed.

Segments of M&A activity

According to survey respondents, the greatest M&A activity within the sector is anticipated to occur mostly among Tier 1 and Tier 2 suppliers over the next year (53 percent).

Expectations for M&A activity by company type

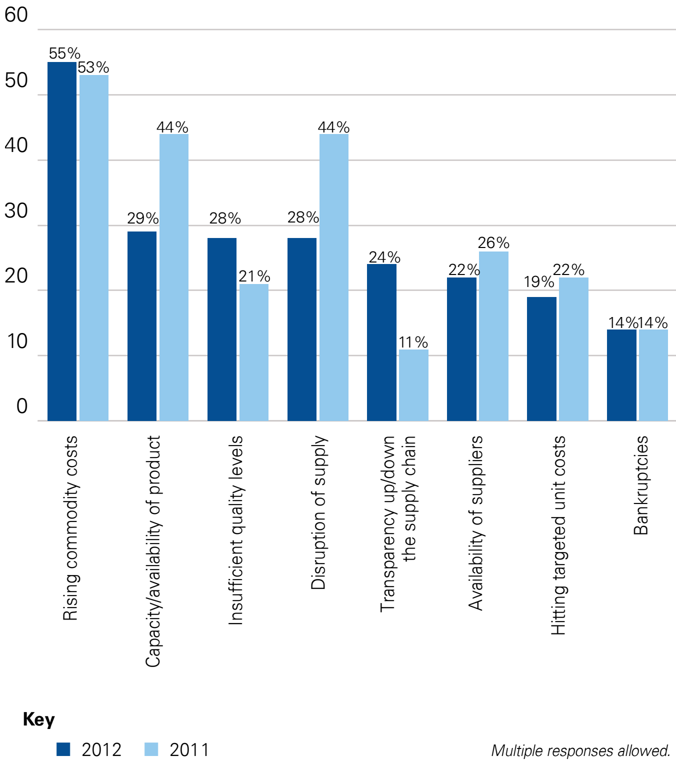


Multiple responses allowed.

Supply chain spotlight

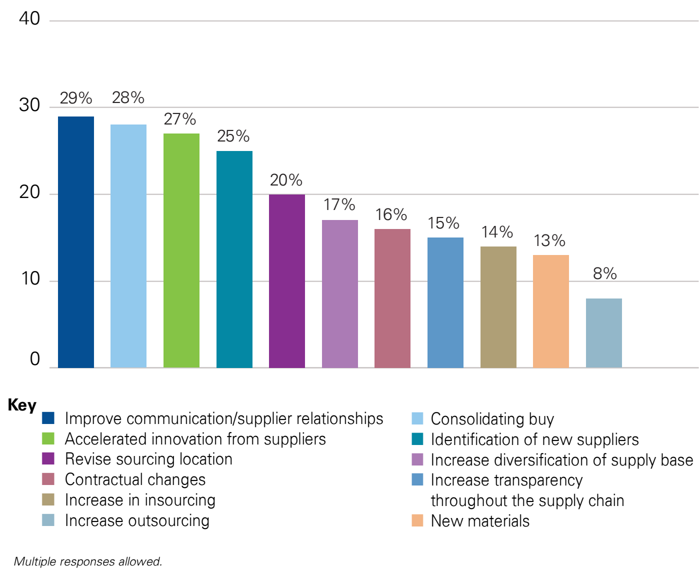
According to the automotive executives surveyed, supply chain management faces significant challenges due to a variety of factors, including rising commodity costs (55 percent), available capacity (29 percent), insufficient quality levels (28 percent), and supply disruption (28 percent). Capacity and supply chain disruption issues have declined in importance since 2011, according to executives.

Most significant challenges to supply chain



However, survey respondents indicate there are several significant opportunities for supply chain improvement. Twenty-nine percent of sector executives cite the greatest opportunity being the ability to improve communication and strengthen relationships with suppliers.

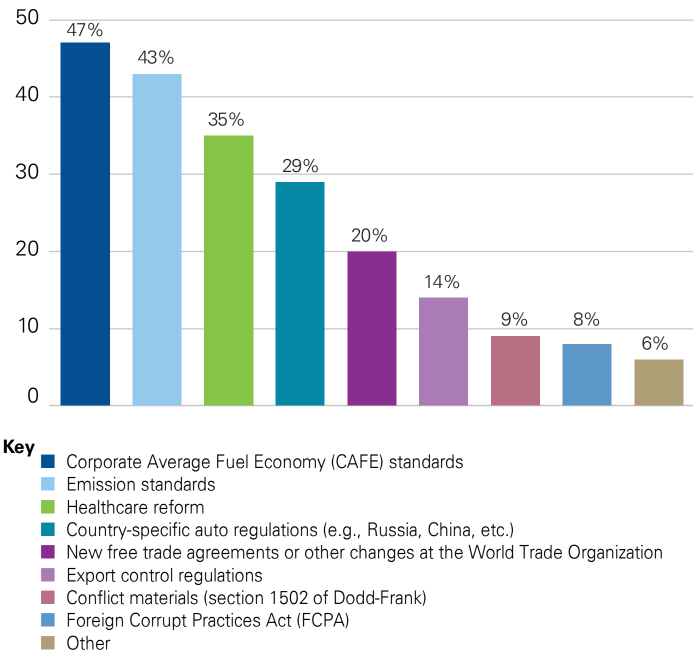
Greatest opportunities for supply chain improvement



Regulations and risk management

Regulatory reform is sweeping across many industries, and the automotive industry is no exception. According to the automotive executives surveyed, fuel economy standards, emissions standards, and healthcare reform are three key areas of regulation that will likely have a great impact on their businesses during the next one-to-three years.

Government regulations with most impact in the next 1-3 years

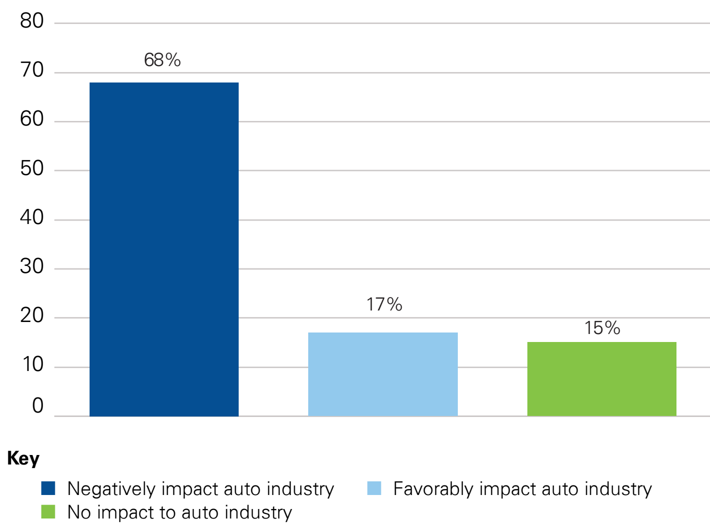


Multiple responses allowed.

Value Added Tax

The introduction of a Value Added Tax (VAT) in the United States has been raised as a way to resolve the budget deficit. Notably, more than two-thirds (68 percent) of executives say they think a VAT would negatively impact the auto industry.

Impact of VAT on auto industry



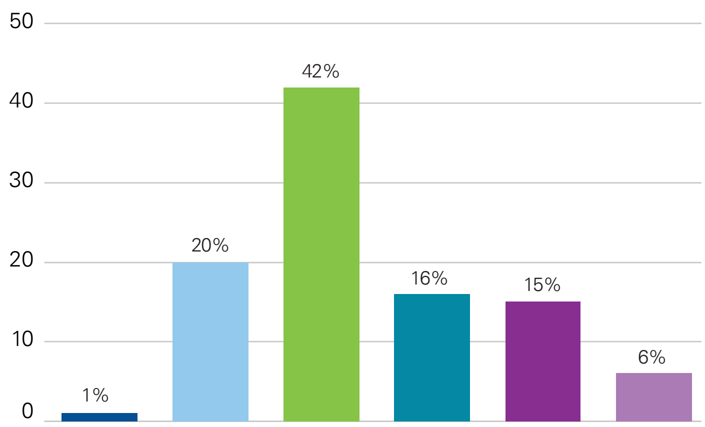
Given that the automotive industry is one of the most heavily regulated, it's critical for industry growth that the regulatory environment become consistent and predictable.

Betsy Meter, KPMG LLP

Responding to the European slowdown

Forty-two percent of respondents think the European slowdown in vehicle sales will last a year and a half.

Length of slowdown in European vehicle sales

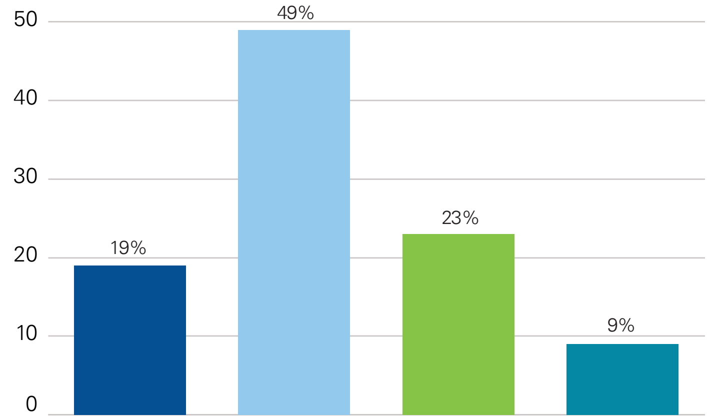


Key

- 6 months
- 12 months
- 18 months
- 24 months
- 36 months or more
- European sales will never return to traditional levels

Almost half of respondents 49 percent say the impact of the European slowdown was only slight. Almost one-quarter of respondents think the impact was moderate.

Impact of European slowdown on company profits



Key

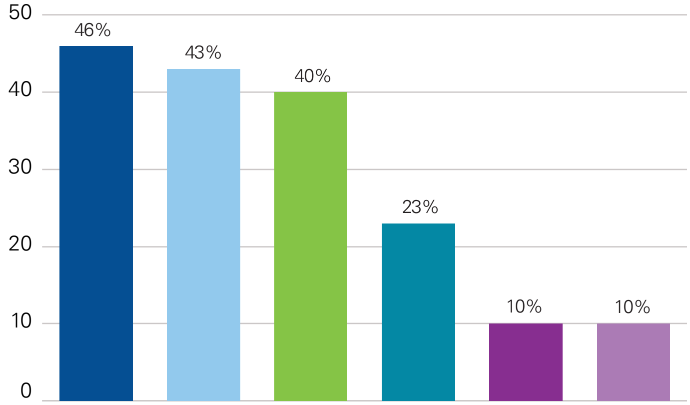
- No impact
- Slight impact
- Moderate impact
- Significant impact

For automotive companies with their large international footprints, VAT outside the United States already has a significant adverse cash flow impact. Any introduction of VAT in the United States should only be considered in conjunction with comprehensive reform and simplification of corporate tax law.

Hans Flick, KPMG LLP

Companies have taken steps to minimize the impact of the European slowdown, from operations restructuring (46 percent) to cost mitigation (43 percent) to capacity rationalization (40 percent).

Steps taken to minimize the impact of the European slowdown



Key

- European operations restructuring
- Cost mitigation
- Capacity rationalization
- Changes to distribution strategies/channels
- Cutbacks outside Europe to compensate
- My company has taken no steps to minimize impact

Multiple responses allowed.

Conclusion

In an unprecedented story, the U.S. automotive industry has come roaring back, thanks to tough decisions during tough times. Now, both the industry and the U.S. economy are enjoying the rewards of those decisions. Companies are bullish and investing in innovation and new products. Armed with growing revenues and strong balance sheets, survey respondents say companies will boost domestic headcount, expand facilities, and invest in new products to keep up with growing demand.

Still, the optimism won't last unless the global economy turns around and economic conditions improve in the United States. For the automotive industry—indeed, for manufacturing as a whole—one of the most serious of these conditions is a lack of skilled workers.

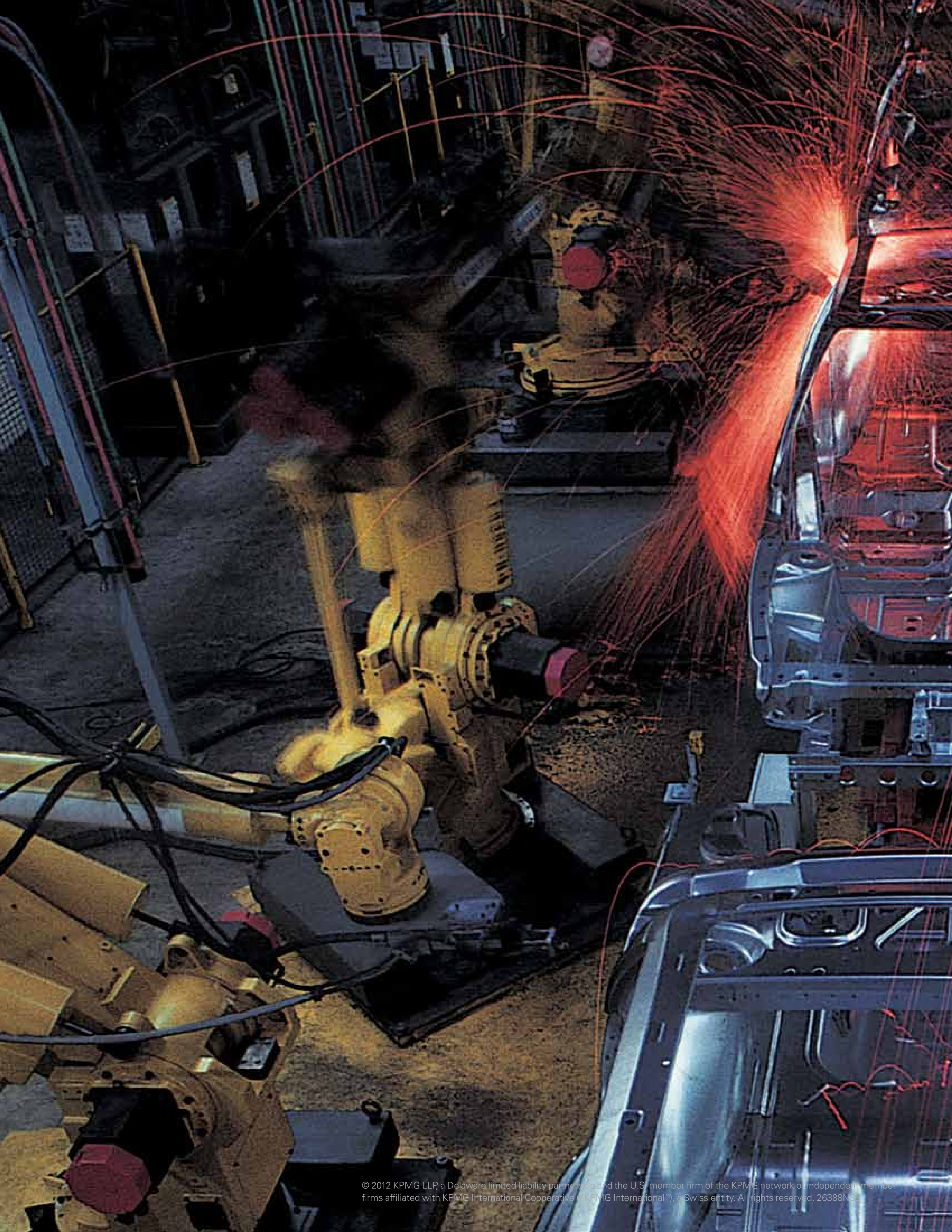
We challenge the automotive industry to work with educators to design and implement training programs at both vocational and higher education levels that will help prepare our domestic workforce for positions in the automotive industry.

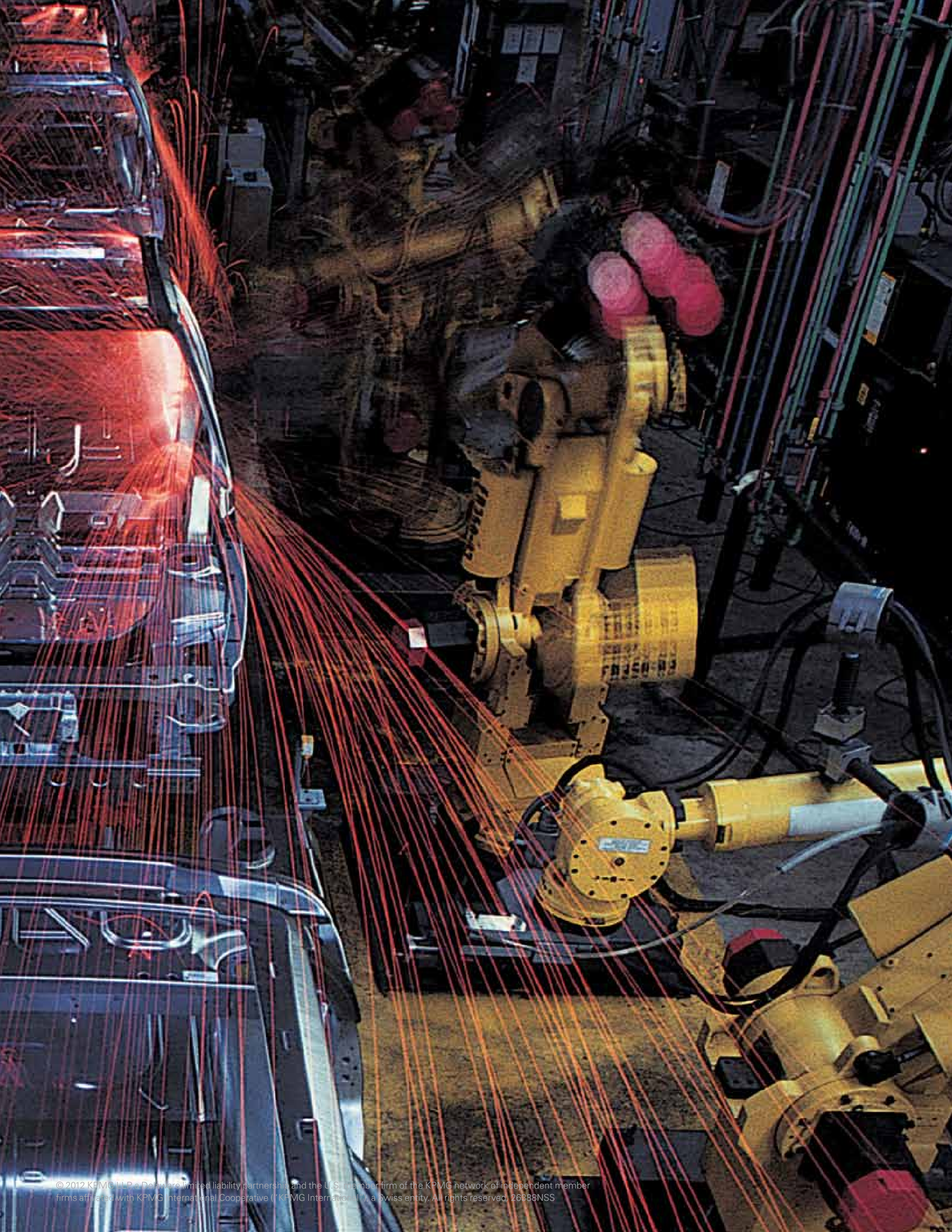
As the U.S. automotive industry achieves increasing growth in revenue and hiring after emerging from years of restructuring, challenges to this important sector continue to arise. Companies must adjust and actively manage the many changes that impact performance.

Having the right professional services firm—one with the industry depth, knowledge and insight to help clients address their most pressing issues and achieve their goals—is critical.

For decades, KPMG's Global Automotive practice has been recognized for its commitment to the industry. Through our international network of member firms, we have the global reach and experience to serve clients anywhere in the world. Our Automotive practice includes professionals with the knowledge, experience, and skills to help our clients address their challenges, sort through today's complex business problems, and achieve their goals.

KPMG: A leader in serving the automotive industry





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