AUTOMOTIVE

# Momentum

## 2007 KPMG Global Auto Executive Survey

AUDIT ▪ TAX ▪ ADVISORY

*Since KPMG's Automotive practice began this survey in 1999, the global auto industry has undergone enormous change.*

*What happens next, in the view of 150 top executives from around the world, is a lot of hard work with uncertain results. Optimism is in short supply. But such is often the case when sweeping changes are in the air.*

*The global auto business is by no means static. A vast restructuring is underway, with active consolidations, shifting alliances, increasing competition, and outside forces entering the business.*

*Perhaps the major reason for all this activity is big changes in what the largest and most prosperous buyer segment, baby boomers, want and value. Recently they've driven makers to increase automotive safety and improve design; now they are starting to demand higher fuel efficiency and more pragmatic vehicles.*

*Globally, the auto industry's strategies are shifting to accommodate, and benefit from, emerging markets in China, India, Vietnam, Eastern Europe, and Latin America. These regions are not only sources of low-cost labor but also growing markets themselves, particularly for small cars and trucks. And as those markets grow, the range of vehicles they need will expand.*

# Notable Trends and Strong Perceptions

- Product quality and cost savings remain huge priorities for industry executives, but fuel efficiency now tops the list of consumer preferences.
- The winners in global market share gains will be, in this order, Chinese, Indian, and other Asian brands. The losers: North American brands. European brands will hold their ground.
- The biggest likely growth areas are hybrids and entry-level vehicles, which tend to be loss leaders.
- Profit expectations are mixed, with a majority favoring "flat" or "volatile" over the next five years, but those predicting a decline have dropped significantly to just above those seeing a rise.
- Uncertainty about future profits is reduced in larger OEMs and suppliers and is higher in smaller suppliers.
- The biggest profit engines, SUVs and pickup trucks, are on the wane. The car is making a robust comeback and crossovers are gaining share, but their profit margins are slimmer and their design and styling need constant attention, unlike a truck.
- Strategic alliances will be more common than mergers or acquisitions.
- Outside investors are gaining influence throughout the value chain.
- The major reason for investing in China is shifting from sales to Chinese consumers to cost-efficient manufacturing. Even so, vehicle sales will grow from 10 to 20 percent annually over the next half decade. The chief beneficiaries, executives think, will be Chinese and Japanese automakers.
- One strategic initiative that is likely to be pursued is bankruptcy protection.

# Taste Shifts for Baby Boomers

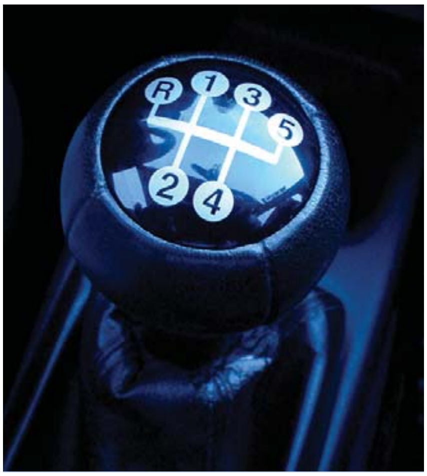
With the most prosperous generation of buyers in history aging, their tastes in vehicles will shift, executives think, which will in turn have a major effect on the types of vehicles produced. Outside factors will also have an effect, such as the cost of fuel. (In fact, four out of five executives interviewed think fuel prices "will have a permanent significant impact on the kind of vehicles consumers buy".)

The biggest winners in global markets over the next five years, as you might expect, are thought to be hybrids and cars, especially low-cost cars. The latter result is surely influenced by the expansion of consumer buying power in developing countries, from China and India to Eastern Europe.

The biggest losers are likely to be minivans, SUVs, and large pickup trucks, with crossovers and luxury vehicles in the middle holding their own.

The shift in expected model mix is unmistakable, even profound. Can hybrids, cars, crossovers, and luxury vehicles keep the industry profitable – or more critically, help troubled companies recover – when profits over the last decade came chiefly from truck-based vehicles shielded from tough fuel-efficiency standards? Executives are plainly worried that the jury is out on the issue.

But expectations vary dramatically by region. Asian executives, who have the strongest growth outlook in general, cite hybrids (76 percent), cars (72 percent), and small pickups and low-costs vehicles (both 70 percent) as their top growth segments. North Americans tend to be second in optimism, citing hybrids (95 percent), low-cost vehicles (68 percent),

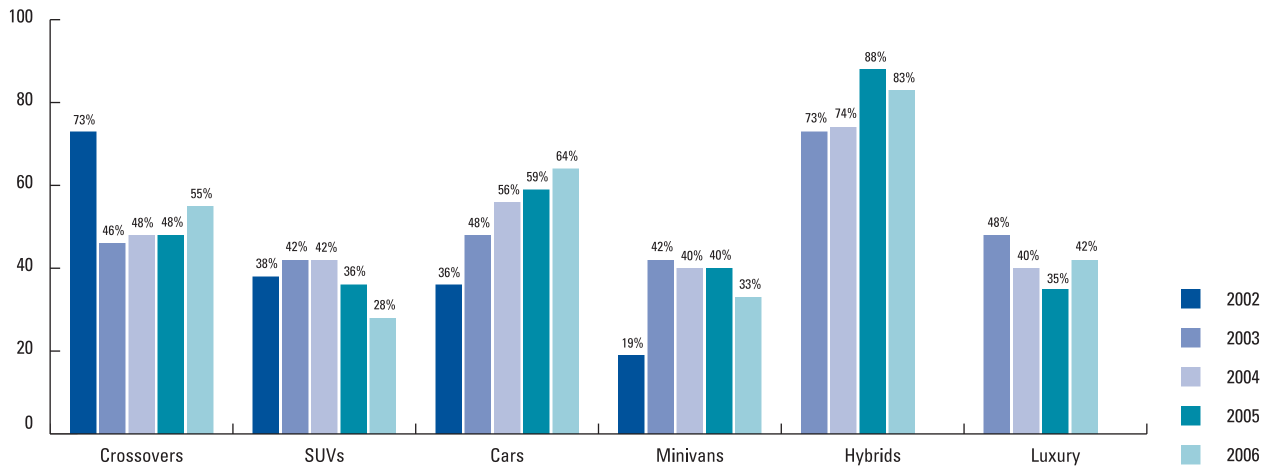



crossovers (67 percent), and cars (62 percent) as their leading four. Europeans have narrower growth prospects, starting with low-cost vehicles (89 percent) and hybrids (73 percent), followed by cars and luxury vehicles (both 57 percent).

## Changes in Market Share by Type of Vehicle

*In terms of global market share, do you expect the following categories of vehicles to increase, decrease, or remain the same over the next five years?*

% Expecting Increase




*Source: Momentum 2007 KPMG Global Auto Executive Survey, 2007*

**2002 data represents U.S. market share.*

Strikingly, North American respondents have rock bottom global growth expectations for SUVs (3 percent), large pickups (5 percent), and minivans (12 percent). Their expectations for small pickups (40 percent) and luxury vehicles (37 percent) are lukewarm.

Changes in regional expectations for vehicle type are also notable. Three stand out: expectations for increased luxury vehicle global market share rose sharply among North American respondents from 10 to 37 percent since last year and among Europeans (from 37 to 57 percent), while tumbling among Asian respondents from 60 percent in 2005 to 35 percent this year. These results are surely influenced by a widening income disparity in Western countries and the growing prosperity of working and middle classes in many parts of Asia.

Second, a fall in expectations for SUV share growth across the board: among Asians (56 to 50 percent), especially Europeans (50 to 39 percent), and most dramatically North Americans, who invented the SUV. They are particularly gloomy about the breed's growth prospects: five percent last year and a mere three percent in 2006.

Third and conversely, executives are bullish about crossovers, which in many ways are an evolutionary step up from SUVs. High expectations hold for crossovers among two of three North Americans and are essentially second in their minds along with luxury vehicles to hybrid growth (95 percent of respondents). Among Europeans, high hopes for crossovers held among two in five, while Asians went through a sea of change from 30 to 52 percent. Consumers are increasingly viewing crossovers as attractive alternatives to minivans or gas guzzling SUVs; Asian executives appear to realize a big transformation in consumer tastes may be underway.

The hybrid mantra recently is that the breed could not fail to grow, given its initially miniscule production numbers. This year we asked respondents how many alternative fuel or hybrid vehicles would be sold next year, assuming 200,000 units by the end of 2006. More than two out of three see a sizable increase, and more than one in three expect sales in the range of 300,000 to 500,000 vehicles overall, roughly double that of the current year. Hybrids, it would seem, are poised to achieve critical mass.

## Changes in Market Share by Type of Vehicle by Region

Significantly more respondents in Europe and Asia still feel that larger vehicles (pickup trucks, minivans, SUVs) will increase in market share as compared to North American respondents. Respondents from Europe are the most optimistic about both luxury vehicles and low-cost cars. North Americans are very bullish about crossovers and hybrid vehicles.

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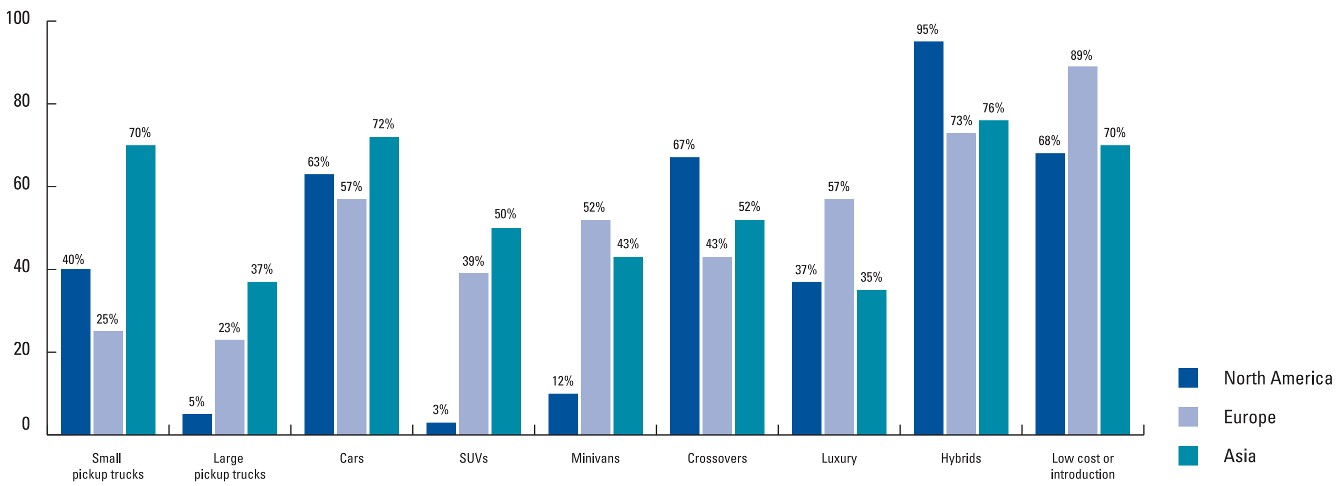



*Source: Momentum 2007 KPMG Global Auto Executive Survey, 2007*

**Fuel Efficiency and Design Emerge as Important**

With many areas of the industry having changed significantly over the past half decade, consumer preferences as perceived by executives have changed remarkably little, with two notable exceptions. Whether this indicates the industry is still largely product and process centric or that consumers continue to buy cars and trucks pretty much the same way is beyond the scope of this survey, but KPMG's Automotive practice suggest that the answer contains large measures of both ideas.

held the same high ground, is a tectonic shift, particularly in an industry that has counted on consumer indifference to good gas mileage.

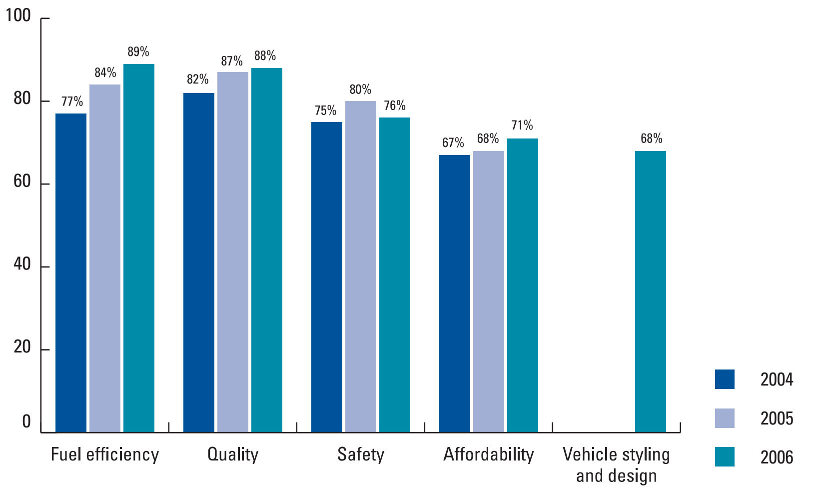
Perennial favorites "safety" (76 percent) and "affordability" (71 percent) stayed within or close to the range registered in previous years. A new category, "vehicle styling and design", came in at a strong 68 percent, clear recognition that industry executives believe many consumers form strong emotional and aesthetic bonds with vehicles they own and, other issues being equal, will often buy a vehicle on looks alone.

## Consumer Purchase Criteria Since 2004

Fuel efficiency and quality have increased in importance since 2004.

*How important do you expect each of the following issues to be to the consumer's purchase decision over the next five years, using a scale of 1 to 5, where 1 means "Not At All Important" and 5 means "Extremely Important"?*

Extremely Important/Important (4–5 on a 5 pt. scale)




*Source: Momentum 2007 KPMG Global Auto Executive Survey, 2007*

Executives still believe "quality" is hugely important but is no longer, as one corporate image campaign famously put it, "Job 1". That spot now belongs to "fuel efficiency" – by only a single point, not a statistically significant margin. But the rise of fuel concerns from 58 percent in 2002 to 89 percent this year, more than 30 points, while quality basically

Surprisingly, "new technologies" dropped 10 points since last year to 50 percent, the lowest level in five years. Contrast this number to the same category among the range of key industry issues, where 81 percent of respondents said it was important to extremely important, third only behind "product quality" and "reducing costs". The seeming disconnect can be explained by what is

## Consumer Purchase Criteria

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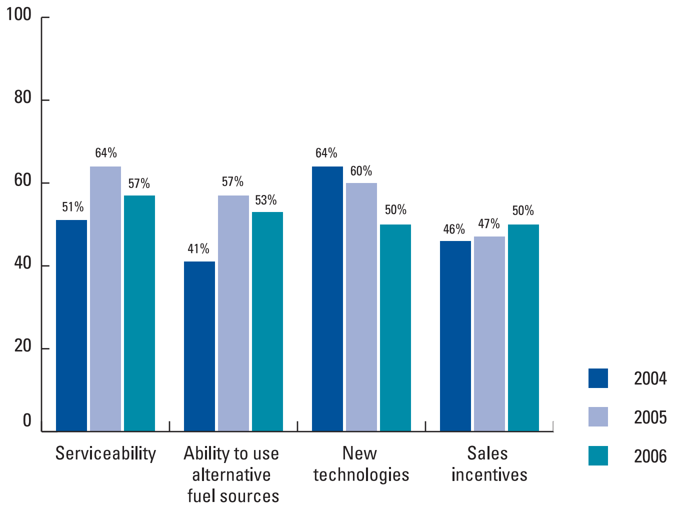



*Source: Momentum 2007 KPMG Global Auto Executive Survey, 2007*

meant by technology – product development and manufacturing technology or onboard vehicle technology consumers want and are willing to pay for. In an era of high car and truck inventories, slower home sales, and talk of a coming recession, executives correctly perceive that consumers will want to forgo technologies and accessories they deem expendable or frivolous.

Two other areas that highlight consumer interest in practical solutions, "serviceability" (57 percent) and "alternative fuels" (53 percent), also held their own in 2006 compared to previous years. A new category this year, "environmental friendliness", came in last at 46 percent, though much higher than the last-place finishers here in previous years' issues – "wireless communications" for example garnered as little as 20 percent. Apparently "environmental friendliness" is not to be confused with fuel efficiency, a remerging core wallet issue.

Even so, that nearly one in two executives thinks "environmental friendliness" will be an important or extremely important purchase decision over the next five years is a strong sign that times are changing.

# Restructuring the World's Major Industry

With competitive pressures felt across the global industry, albeit in varying intensity, companies are beginning to think creatively about solutions. The global realignment continues away from manufacturers and suppliers based in North America and Europe, yet most executives see this as a time of consolidation, not expansion. And no wonder, with global overcapacity thought by many to exceed 10 percent, ranging from 6 to 8 million vehicles.

It can be expected that "product quality" will be the leading issue in a product-driven industry, as it has been for five consecutive years. But the number two issue, "reducing costs", was cited by 9 out of 10 respondents.

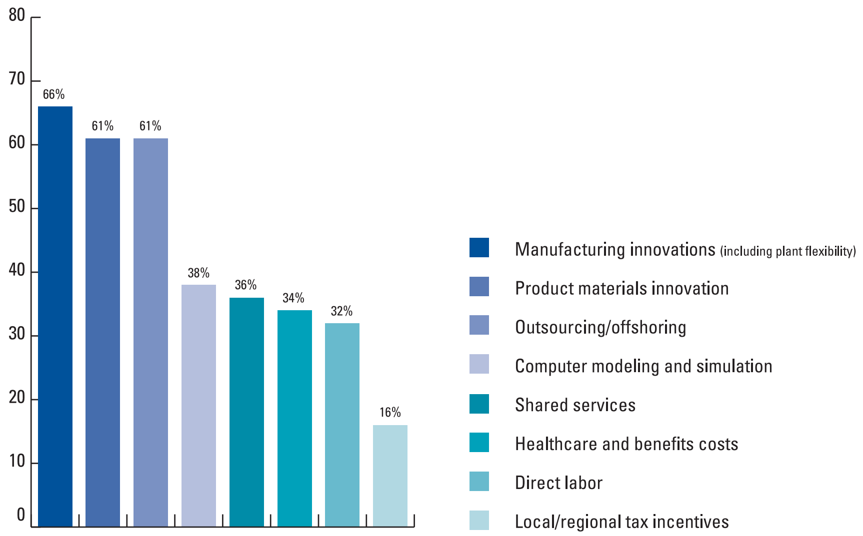
Where will cost savings come from? Another question found that three areas dominated respondents' expectations: "manufacturing innovations" (including plant flexibility), "advances in product materials", and "outsourcing/offshoring", with roughly three out of five favoring these options.

## Major Opportunities for Cost Savings

Innovations in manufacturing are seen to be the greatest source of cost savings, closely followed by materials innovation and outsourcing to countries like China and Eastern Europe.

*Please tell me how great an opportunity for future cost savings each of the following areas offer auto manufacturers and suppliers, using a scale of 1 to 5, where 1 means "No Opportunity" and 5 means "Major Opportunity".*

Major Opportunity/Opportunity (4–5 on a 5 pt. scale)




*Source: Momentum 2007 KPMG Global Auto Executive Survey, 2007*

Asian respondents were significantly more likely to see cost savings opportunities in computer modeling and simulation than North American and European respondents.

North American respondents were significantly more likely to see cost savings in healthcare and benefits costs than European and Asian respondents.

The high expectation for savings in materials, presumably composites, could have significant implications for a long time partner of the auto industry – steel makers.

Meanwhile, "new products" has slipped in importance of "key industry issues" from second in 2004 to fifth this year, behind "the economy". Three out of four executives still believe "new products" is important or extremely important, but the nine point drop this year and the fact that four other issues supersede it in respondents' minds is perhaps indicative that greater effort is being exerted in this area – that the industry's creative juices are flowing a bit more freely than in past years, and thus it is less an unsolved problem than before.

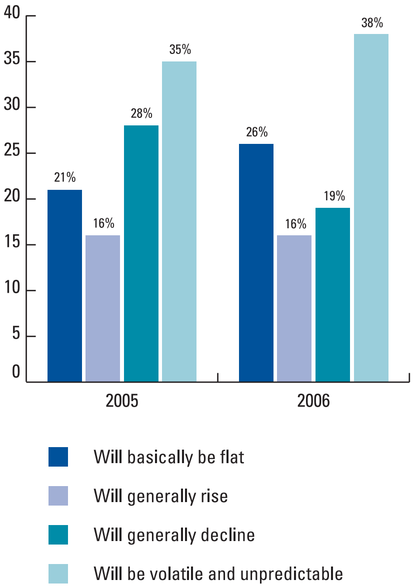
Rising to third from fifth last year among key issues is "new technologies", up from 63 percent to 81 percent this year, the highest level by nine points since the tracking study began in 2001. We believe technology in this context means manufacturing such as robotics and other forms of automation, which should be thought of as another cost cutting measure.

"Healthcare and benefit costs", only a secondary means of cost savings overall, nevertheless offers interesting regional differences. European companies tend to pay high taxes to the state, which ultimately translates to worker benefits. That equation is politically difficult to change. Asian companies expect workers to look after themselves, and Asian workers are traditionally great savers. North American companies through union contracts have obliged themselves to generous health care and retirement deals for line workers. These are being seen as legacies of a more prosperous, less discerning world, we suspect. That executives cite "labor relations" at the low end of the range of critical issues we offered them suggests the strength of

## Profitability Expectations over the Next Five Years

In 2006, 38 percent of respondents felt that the industry would be very unpredictable in the next five years. However, fewer respondents in 2006 than in 2005 believed profits would decline over the next five years.

*Which of the following statements best represents your view of the profitability of the global automotive industry over the next five years?*




*Source: Momentum 2007 KPMG Global Auto Executive Survey, 2007*

**Can the Industry be Profitable?**

The general view is that auto industry profits over the next five years will be somewhere between flat and unpredictable – a combined 64 percent, up from 56 percent last year. Those who think profits will generally fall dropped from 28 to 19 percent, and those favoring a rise held steady from last year at 16 percent, just 24 of 150 respondents around the world, a roundly dour view of the industry's prospects for increased profits.

Assuming some recovery to the profits of the past will occur, when do executives think this might happen? This question has consistently resulted in predictions for increased profits two years out, with the current or previous year being a low point. This pattern has held solid for four years including this one, with 21 percent of respondents selecting 2008 as the highest year of profitability between 2005 and 2010. But the results varied by region – significantly more Europeans than North Americans and Asians said 2006 would turn out to be the year of greatest profitability during the offered span.

Meanwhile, nearly half of respondents expect either 2006 or 2007 to be the year of lowest profits (or greatest losses), while 21 percent – and proportionately more Asians – said 2010 will be the worst year for the auto business financially. Recently, Asian executives have been more pessimistic about profits than their North American and to some extent European counterparts. But fewer North American executives have strong convictions about the future profit picture for the industry: More than one in two continue to think, as was true last year, that the next five years will be "volatile and unpredictable".

By industry segment, vehicle manufacturer executives are both more positive – 55 percent believe profits will either rise or stay the same over the next five years – and less negative (only 8 percent expect a decline) than their suppliers. Tier 1 executives were the

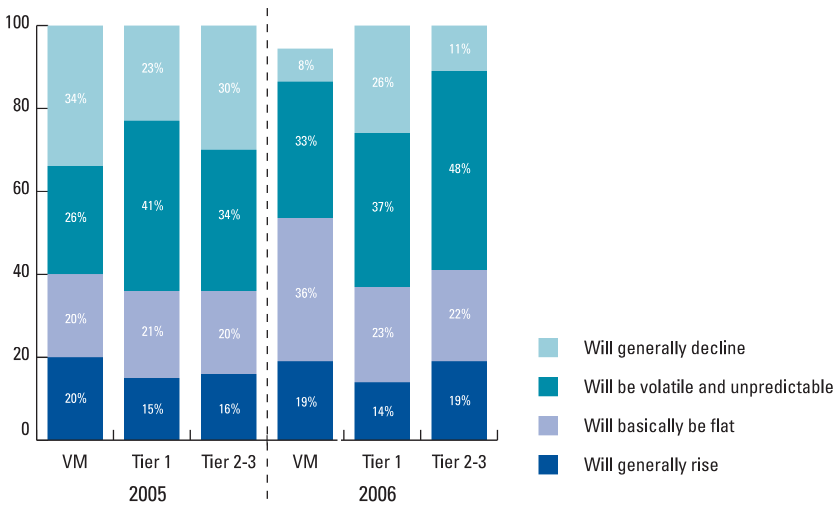
labor unions and the leverage they have over union shops compared to plants in the union averse South and cheap labor out of country. With the new Democratic Congress, calls in the U.S. for saving local jobs are sure to escalate.

Interestingly, Asian executives are more likely (58 percent) than others to pick "computer modeling and simulation" as a key cost saving opportunity. It was chosen by only 38 percent overall. Given the Japanese and Korean penchant for advances in processes, this area might need to be watched closely by their rivals.

## Profitability Expectations over the Next Five Years by Company Type

Vehicle manufacturers, Tier 1 companies and Tier 2 and 3 have grown less pessimistic than a year ago.

*Which of the following statements best represents your view of the profitability of the global automotive industry over the next five years?*

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most pessimistic, with one in four expecting a decline in profits, while Tier 2 and 3 executives were by far the most uncertain, with nearly one in two expecting the next five years to be "volatile and unpredictable".

Mirroring these responses are those about profitability per company type or function. Since last year's results, those surveyed raised expectations only for captive finance companies, up slightly to 41 percent. In 2002 that figure was 71 percent. OEMs have the confidence of just 33 percent of respondents to be best in this area, down from 40 percent last year; Tier 1 companies garnered 23 percent of this vote; Tier 2 and 3, 15 percent and dealers, 10 percent, down from nearly 50 percent in 2002. What a difference four years has made. Dealers are viewed as particularly under seige because of, we feel, their large inventories and in some cases unpopular models. Across the country new car lots are full.

Does this mean the industry still suffers from overcapacity? Respondents say yes, and overwhelmingly the range they pick is 11 to 20 percent – 44 percent of them this year, which has not much changed over four years. There is no appreciable good news here: the level has returned to what respondents felt in 2004, after a dip last year.

## More Consolidation is Expected by Most

How will the industry deal with this challenge? "Alliances, mergers, and acquisitions", say auto executives everywhere but Western Europe, where half think the rate of these activities will stay the same. Even so, 32 percent of Europeans expect the rate of M&A activity to increase over the next five years.

Strikingly, four in five Asian respondents believe consolidations and alliances in the global marketplace will increase over the next half decade. This would seem to recognize that numerous car companies still exist in China and, to a lesser degree, elsewhere in Asia, and that economies of scale and shared manufacturing technologies are necessary to achieve attractive pricing but also quality, as workable systems to reduce mistakes are spread plant to plant.

The same number of North American and Eastern European executives – slightly more than half – think the rate of "alliances, mergers, and acquisitions" will increase over the next five years. This large number – mind you, they could have opted for "remain the same" – seems a strong acknowledgement that the auto business is becoming inevitably more global, and companies will need to make combinations and alliances to effectively compete.

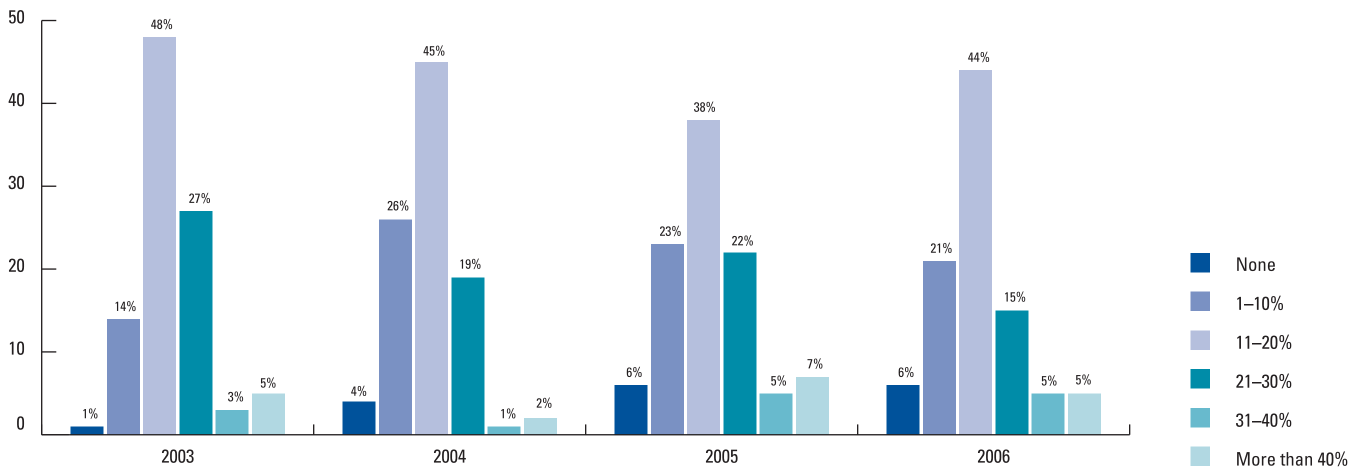
Globally, consolidation is expected to increase over the next five years by three out of five respondents among vehicle manufacturers (VMs), Tier 1 and Tier 2 and 3 suppliers, with fewer – two out of five – expecting an increase in consolidation among dealers. Those who think consolidation will decrease number just 1 in 10.

Why consolidate or form an alliance? The reasons are largely reduced costs or a new opportunity. Half pointed to "product synergies". Slightly fewer (44 percent) cited "access to new markets and customers". Roughly a third went for one or more of three choices: "raw material cost pressures", "risk of bankruptcy", and/or "labor costs". (Multiple choices were allowed.) The economy declining or falling was noted by less than one in four as a consolidation driver.

## Global Automotive Production Capacity

Only one quarter of respondents believe overcapacity is above 20 percent.

*In your opinion, how much production overcapacity is there in the automotive industry?*



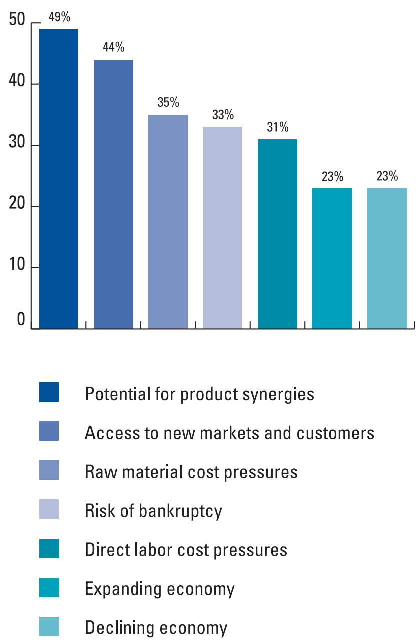

*Source: Momentum 2007 KPMG Global Auto Executive Survey, 2007*

In a four-year trend, alliances (worded "cooperative ventures" in previous surveys) are felt to be more likely than mergers or acquisitions, up slightly this year to 57 percent. Only 15 percent disagreed.

## Consolidation Driven by Potential Opportunities

Product synergies and finding access to new markets are the highest rated motivators for industry alliances and consolidations in 2006.

*In general, which of the following will be the most important drivers of alliances, mergers, and acquisitions in the industry? (Multiple answers accepted.)*

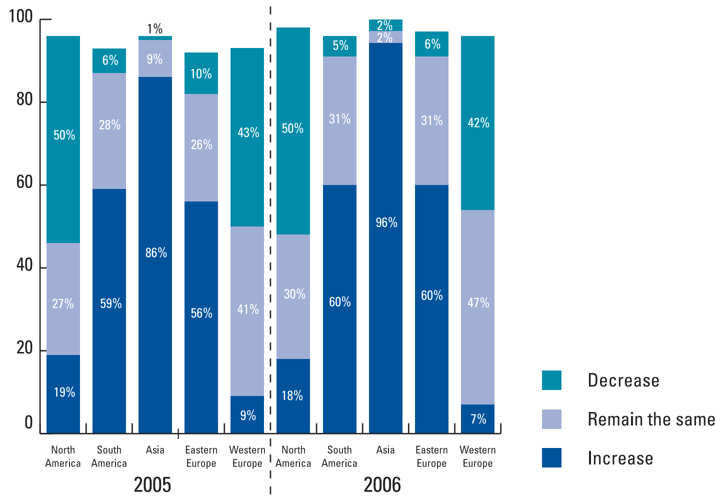



*Source: Momentum 2007 KPMG Global Auto Executive Survey, 2007*

## Expectations for Growth in Asia Continues

Nearly the entire respondent pool (96 percent) expects manufacturing to grow in Asia, a 10 percent increase from 2005.

*Please tell me whether you expect the building of new manufacturing facilities in the following areas to increase, remain the same, or decrease over the next five years.*

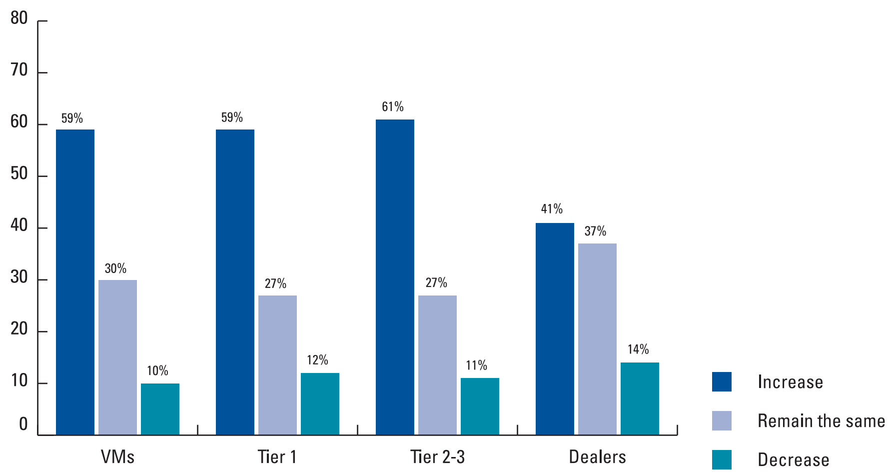



*Source: Momentum 2007 KPMG Global Auto Executive Survey, 2007*

## Consolidation Expected Across the Value Chain

Consolidation and alliances are expected to affect all levels of the automotive supply chain.

*Please tell me whether you expect alliances, mergers, and acquisitions among the following types of companies to increase, remain the same, or decrease in terms of global market share, over the next five years.*

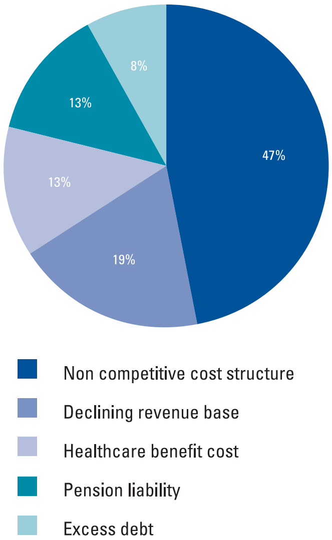



*Source: Momentum 2007 KPMG Global Auto Executive Survey, 2007*

## Drivers of Bankruptcy

In 2006, 47 percent of respondents felt that the automotive industry is handicapped by a non competitive cost structure, which is forcing some companies in the industry into bankruptcy.

*What are the most important factors leading to bankruptcy?*

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### Lower Appetite for Investment

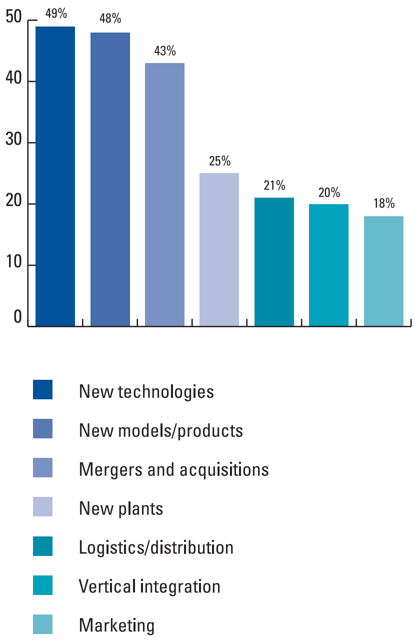
Across the industry, enthusiasm for increased investment has been waning since 2002–2003. In that period, 9 out of 10 respondents thought companies would increase investment in "new models" and "new technologies". This year the figure has fallen to 48 percent for new models, down slightly from last year, a drop to just 49 percent for new technologies, a sizable step down from 58 percent in 2005. The second most cited area for increased investment this year, a new category, is "mergers and acquisitions" at 43 percent. Clearly the investment mood is predominately conservative, and one top area for investment suggests not expansion but consolidation.

Meanwhile, the "development cycle" for new models – note some dispute about what this means – is nevertheless expected by executives to compress. Nearly half of respondents think the cycle will drop to 18 months, and another 31 percent are neutral about the statement, which means 76 percent do not disagree with the idea of a 18 month development cycle and only 23 percent strongly disagree that the cycle will shrink that much.

## Industry Investments

New models and new technologies are the areas where most respondents expect increased investment.

*In which of the following areas do you expect manufacturers to increase their investment over the next five years? (Multiple answers accepted.)*




*Source: Momentum 2007 KPMG Global Auto Executive Survey, 2007*

### Bankruptcy as a Strategic Option

Not surprisingly, bankruptcy is on the minds of industry executives. With shrinking market share, ongoing cost cutting and other pressures, beleaguered North American companies are tempted to reorganize by way of bankruptcy, which provides them protection from creditors while they sort out their businesses.

This by no means says they are going out of business, just that they are gaining breathing room to strategize and meet their obligations.

Strikingly, 87 percent of respondents think the rate of filings over the next few years will increase or remain the same, and slightly more than half (56 percent) think the rate will increase. Only 10 percent say the rate will decrease.

Far and away the reason, global respondents think, are "non competitive cost structure", by 47 percent. The other reasons offered got votes among less than one in five – "declining revenue base" and "healthcare benefit cost" among them.

But viewed by region, striking differences emerge. Since these results do not examine how one region sees another, one must read between the lines. Looking at the most assertive result, 70 percent of European respondents think that the cause of possible bankruptcy will be "non competitive cost structure", with four other causes – minus "pension liability" at 18 percent – falling into single digits.

By contrast, North American respondents put "non competitive cost structure" at 30 percent, equal with "declining revenue base" and "healthcare benefit cost". Asia Pacific respondents offer possibly a more balanced – and more realistic – sense of the causes of bankruptcy. A bit less than half believe that the reason will be "non competitive cost structure". Other causes garner less than one of five responses.

This suggests that European and to a lesser extent Asian executives think that bankruptcies, if they occur, will be partly caused by built-in relationships with suppliers, not pension and other obligations to existing that former employees, though that burden seems more of a worry to lower-tier companies.

When we looked at the likely causes of bankruptcy by industry tier, distinct differences emerge. VM and Tier 1 execs cited "non competitive cost structure" at two to three times the rate of other potential causes, but Tier 2 and 3 supplies favored "healthcare benefit costs". We understand that smaller company management is reacting to expected cost pressures from the benefits obligations of their clients, but this remains to be seen.

### The Captive Finance Play

The trend in captive finance has been decidedly downward in profit expectations, but a solution may have emerged.

Once dependable sources of profit, finance arms have slipped in respondents' expectations lately. While still leading among all industry areas in projected profitability over the next five years (41 percent compared to the next highest, VMs, at 33 percent), they have plunged since the 2003 level of 70 percent. The many and various incentives programs have taken their toll, and apparently will continue to do so, according to those surveyed the last couple of years. A possible response will be to put captive finance on the block, as one major maker has already done.

Was this 51 percent sale a strategic move? You don't have to wholly own or control a business to earn from it, while the costs of ownership can be a drain on funds and management attention. This seems a sound strategic – and financial – move to us.

That doesn't mean executives think captive finance is the gold mine it has been. Tellingly, 36 percent of respondents think "competition" will be the heaviest pressure on captive finance profits next year – one assumes not from other finance units but from the need to top offers from other vehicle makers. The second cited drag on profits, "credit ratings", came in at 20 percent. The other three choices offered – "credit losses", "servicing costs", and "yield curve" – are the mid-teens.

Growth in captive finance, think respondents, is likely to be overseas (52 percent agree or strongly agree, 31 percent are neutral), which echoes respondents' thinking about the use of leasing or credit to obtain new vehicles in China – 47 percent agree or strongly agree that consumers will finance these purchases, 30 percent are neutral. Credit, perhaps the largest engine of economic growth in the West the past few decades, seems likely to migrate eastward.

### Facing Global Regulations

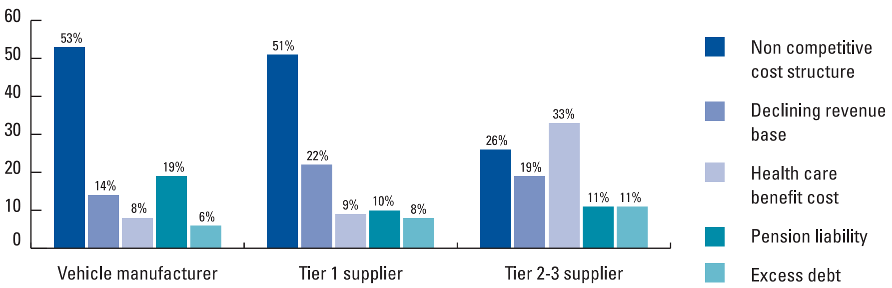
In a business world defined by Sarbanes-Oxley, anti-money laundering (AML) initiatives, and other international finance and anti-terrorist regulations, where will captive consumer finance companies invest to manage risk? One third of respondents each think "consumer regulatory compliance" and "privacy" areas. Far fewer opt for "AML" or "Basel II". One senses the auto business has not focused on these areas yet – another indicator it thinks it is global but is short of that. This is true not only for North Americans, but also Europeans and Asians.

## Factors leading to Bankrupcy by Value Chain

Tier 2 and 3 Supplier respondents were significantly more likely than VM or Tier 1 Suppliers to feel that healthcare benefits cost is the greatest cause of bankruptcies in the industry.

Tier 2 and 3 Supplier respondents were significantly less likely to claim that non competitive cost structure is the main factor leading to bankruptcy.

*What are the most important factors leading to bankruptcy?*

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# Going as Global as Possible

The cliché that the world is becoming more global, like most clichés, contains truth and nonsense. In many ways the world is becoming more local, at least for now. A global expansion for commerce is inevitable. But the idea that globality is a logical march to big profits is being replaced by the more realistic notion that to succeed, "going global" demands a big effort with benefits perhaps years or even decades off.

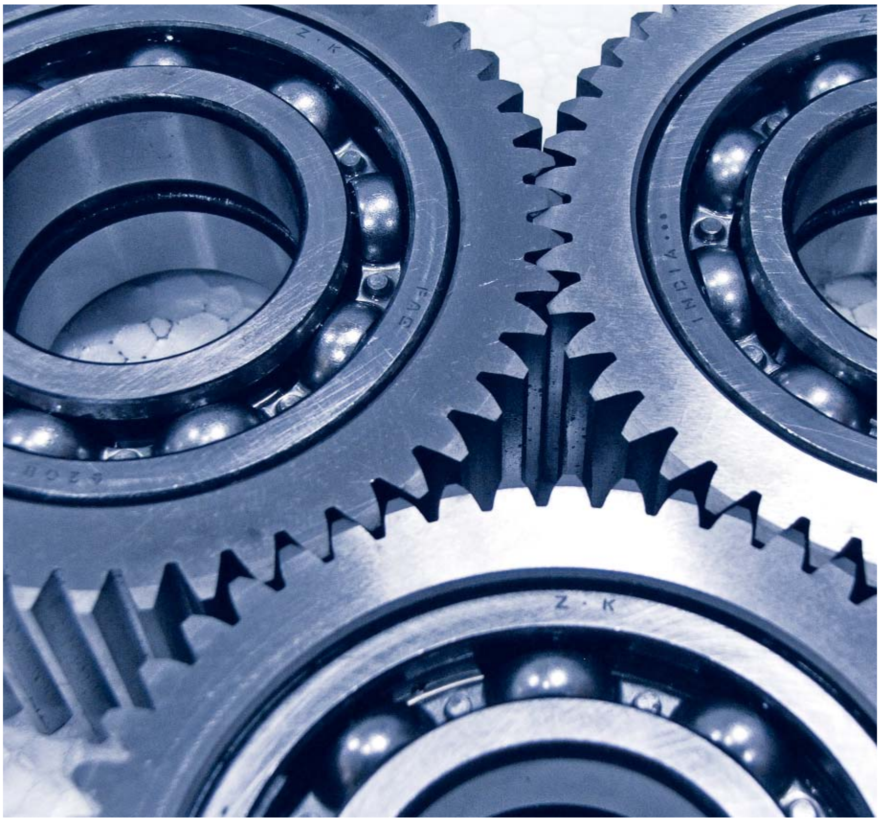
Since the survey's onset in 2002, executives have felt – with the exception of 2004 – that the global market share of North American brands would decrease. That figure rose from nearly 60 percent last year to 71 percent in 2006. The obvious but too pessimistic reading is a bleak outlook for North American brands.

The winners, executives think, will be brands that are Chinese (79 percent) and Indian (55 percent), with Japanese and South Korean brands, which we combined this year into a new category, Asian (other than China), expected by the same percentage to grow at the expense of others. This shows a decisive decline from last year, when 79 percent of respondents thought South Korean brands would gain share and 65 percent said Japanese brands would wrestle market share from others.

Expectations for European brands are almost evenly divided: to grow in market share (28 percent), decline (30 percent), or remain stable (35 percent).

### The Chinese Dragon

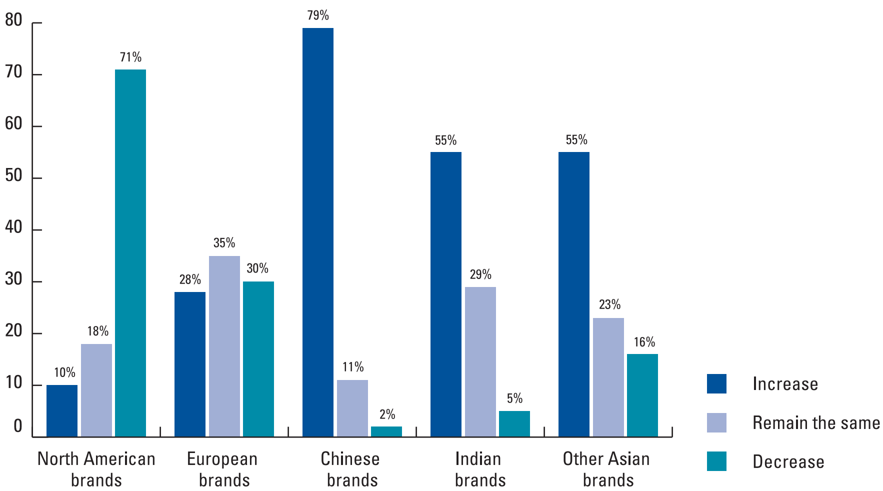
This vast and complex country continues to grow at an economic rate unprecedented in recent times, in no small part due to North American, European, and non-Chinese Asian investment. Executives expect this growth will slow slightly and the reasons for this include unprecedented demand for energy, pollution, logistical challenges and a large central bureaucracy among others.



## Asian Brands Most Likely to Increase Market Share

As in 2005, global market share is expected to continue shifting away from North American brands in favor of Chinese, Indian and Asian brands. European brands are largely expected to remain stable.

*Please tell me whether you expect automotive brands from the following regions to increase, decrease, or remain the same, in terms of global market share, over the next five years.*

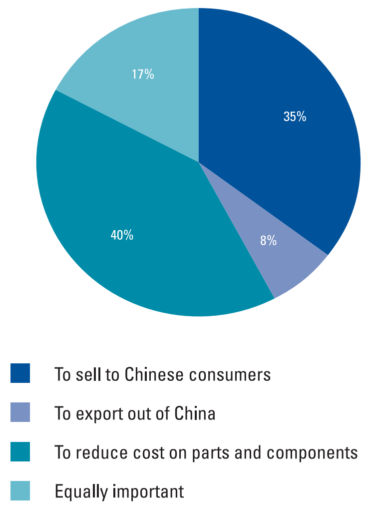



*Source: Momentum 2007 KPMG Global Auto Executive Survey, 2007*

## Drivers of Investment in China

Respondents are divided between cost cutting and local market sales as the main driver of investment in China.

*In your opinion, which is the most important reason to invest in the Chinese auto industry?*




*Source: Momentum 2007 KPMG Global Auto Executive Survey, 2007*

Meanwhile, confidence about making money in China over the next five years remains strong (61 percent), while at the same time expectations of losses remain at a low level (18 percent), both results being similar to last year.

Half of executives polled think unit sales in China will grow annually at an unparalleled rate in the world economy – 11 to 20 percent. Another 20 percent expect five-year sales growth (through 2010) at 21 to 30 percent. In total, 85 percent of executives surveyed think sales growth in China over the next five years will exceed 10 percent annually, and a third of them by more than 20 percent a year.

With all the interest in China, is overcapacity a looming problem? We have asked this question since 2004. There is only a slight change toward the perception of current overcapacity, with roughly a third saying there is "none" and the rest opting for up to 40 percent overcapacity, in diminishing numbers. In a new question, respondents were asked about the chances of overcapacity in China. Opinion is fairly evenly divided on the chances of that happening.

Despite this ambiguity, the vast majority – three out of four respondents – feels that the industry will continue to make significant investments in China over the next five years.

Meanwhile, as China is expected to be the next happy valley in the auto industry's growth, note – as anyone who has visited China recently understands vividly – that rapid gains in car ownership, or the road-based economy for that matter, is optimistic. It is unclear when China's growing middle class will drive vehicle sales at a rate similar to the developed Western world. When (and if) surging growth in China continues, respondents feel it will mainly benefit Chinese companies (38 percent) and Japanese companies (29 percent). North American, European, and Korean companies received 32 percent of the vote combined, all at roughly the same level. However, more European respondents felt European companies are "more likely to succeed in China over

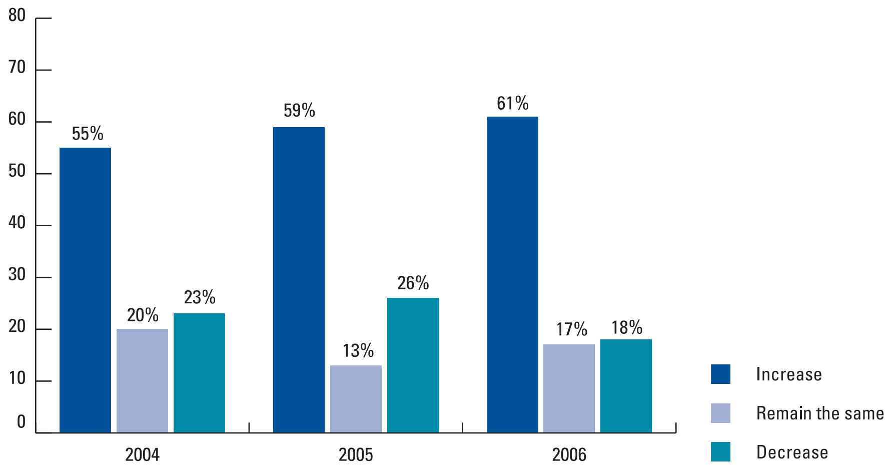
Other growth areas include India, Vietnam, parts of Africa, especially north and south; and regions of Latin America. But what seems clear is that China is different. It represents the first so called "developing world" opportunity to get a sophisticated business right in a challenging place – a place that could redefine the future makeup of the global auto business.

This survey has been asking executives about China for three years. Their responses have been mixed, befitting uncertainties about the market's opportunities. The answer to the question "Why invest in China?" has been to sell vehicles to Chinese consumers. This year, in part because of a new answer option, "reduce costs on parts and components", the emerging rationale is also cost savings (40 percent), not just local sales (35 percent). Only eight percent cite exporting finished vehicles out of China as a reason to invest in the country. Slightly less than one in five say all three reasons are equally important.

## Profit Expectations in China

In 2006, respondents were more optimistic about prospective profits from investment in China. Fewer expected profitability to decrease in the next five years.

*In your opinion, will levels of profitability in the Chinese auto industry increase, decrease, or remain the same over the next five years?*




*Source: Momentum 2007 KPMG Global Auto Executive Survey, 2007*

the next five years", possibly because of the long European presence in the mainland auto business.

What is the next major growth market after China? Overwhelmingly, executives expect it to be India (73 percent), with the three regions of Eastern Europe, Central and South America, and Russia all attracting the confidence of only 1 in 10 or less.

## Conclusion: Working Toward an Orderly World Market

*A pundit recently offered that the auto business was the first to be global. The truth is that many industries labored to become global at roughly the same time – transportation of goods via ship and plane, banking via communications satellites, retail brands such as clothing and shoes, agribusinesses, oil and gas distribution, steel, and a host of others. But not one, including the auto business, is truly global yet.*

*The differences across cultures, borders, and regulatory barriers are surmountable. Overcoming them is a challenging and expensive endeavor, and will be so for some time. Regional officials and bureaucracies will inevitably resist change to their benefit. National and international politics will produce regulatory complications.*

*The point is, the so called "global" car business is in flux. The market for new and used cars in most markets is intact and, in most years, growing, depending on the local economy and buyer confidence. Executives are learning how to serve local needs with global strategies and brands.*

*Reports about the demise of the North American auto industry and the triumph of the Asian auto industry have just about reached a confluence – that is, both may be exaggerated. Nobody wants the North American auto business to fail, least of all the Asians. Few expect that Guangzhou will become Alabama, or that Bangkok will serve as the new Detroit. Meanwhile, the Japanese, European, and now South Korean investments in North America, Eastern Europe, and Latin America have driven economic growth.*

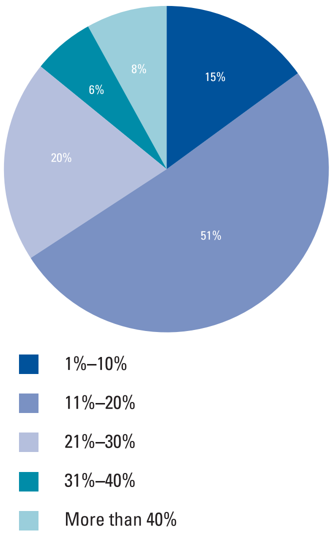
*Change happens. Long established global brands disappear. Companies restructure. But the forces arrayed to keep respected businesses and jobs intact are formidable. Meanwhile, on a cautionary note, no guarantee exists that auto brands will not fall in standing, lose market share, and become less significant. That is their vulnerability and their challenge.*

*It is more than possible that new competitors will emerge to grab market share and eat at the dominance of the current leading auto companies, North American, Asian, and European. The South Korean brands are a model of fast growth and quick acceptance by consumers. Can Chinese and Indian brands be far behind?*

### Profit Fueled by Increased Sales

A majority of respondents feel that sales in China will grow between 10 and 20 percent annually. Nearly a third expect annual growth above 20 percent.

*In your opinion, what will be the annual growth rate of the number of units sold in China over the next five years?*

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Under the auspices of KPMG's Automotive practice, Applied Research & Consulting LLC (ARC) conducted 150 quantitative interviews with executives, 60 based in North America and 90 based in Europe and Asia. Of these, 114 worked for suppliers and 36 for vehicle manufacturers. KPMG LLP, the audit, tax, and advisory firm (www.us.kpmg.com) is the U.S. member firm of KPMG International. KPMG International's member firms have nearly 103,000 professionals, including 6,700 partners, in 144 countries.