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GLOBAL IDEAS

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General Motors — Some wheel spin, but GM going into higher gear

"It's a new day at General Motors (GM). Our fortress balance sheet, built on record annual earnings, more than two years of consistent profitability, strong liquidity and minimal debt, is helping us grow profitably around the globe. GM is #1 in total vehicle sales in the world's two largest auto markets, China and the U.S., and well positioned in fast-growing emerging markets like Brazil, Russia and India.
A key focus of today's GM is strengthening our brands around the world. Today, we sell two global brands – Cadillac and Chevrolet – flanked in most markets by regional brands like Buick and GMC, Opel and Vauxhall, Wuling, Baojun, Holden and more. And it's making a difference. In China, GM and its joint-ventures sold a record 2.5mn vehicles last year. And Chevrolet, which turned 100 in 2011, marked the occasion by selling a record 4.7mn vehicles around the world.
All of this is made possible by an outstanding product line-up that delivers the right vehicles at the right time all around the world. Global products like the all-new Cadillac ATS compact luxury sport sedan, Chevrolet Cruze small car and Chevrolet Colorado midsize pickup are just three examples of why we say that, at GM, everything starts and ends with great products."

Source: Company website

Background of the company
The Company develops, produces and markets cars, trucks and parts worldwide.

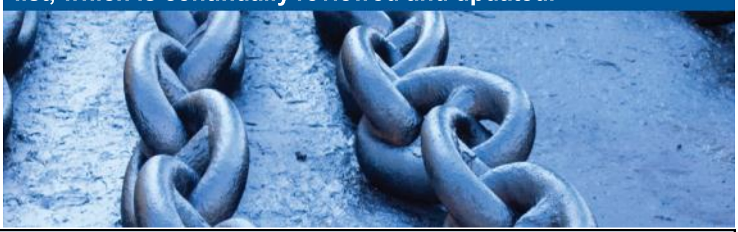
On 10 July 2009, Motors Liquidation Company, formerly known as General Motors Corporation and its direct and indirect subsidiaries Saturn LLC, Saturn Distribution Corporation and Chevrolet-Saturn of Harlem Inc. completed the sale of substantially all of their assets to General Motors Company, which was formed by the United States Department of the Treasury and was the successor to Vehicle Acquisition Holdings LLC. The sale was consummated pursuant to the Amended and Restated Master Sale and Purchase Agreement, dated as of June 26, 2009, as amended between the sellers and GM. The Purchase Agreement was entered into in connection with the sellers' filing of voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York and was completed pursuant to Section 363(b) of the Bankruptcy Code and the Bankruptcy Court's sale order dated 5 July 2009.

On 1 October 2010 the company acquired 100% of the outstanding equity interests of AmeriCredit, an automotive finance company, renamed General Motors Financial Company Inc. for cash of approximately $3.5bn. The acquisition of AmeriCredit will allow them to provide a more complete range of financing options to customers across the US and Canada, specifically focusing on providing additional capabilities in leasing and sub-prime vehicle financing options.

On 18 November 2010 the company's common stock was listed and began trading on the New York Stock Exchange and the Toronto Stock Exchange under the designation GM. It was a brand new company with a strong balance sheet, a competitive cost structure and a strong cash position. This helped the company to compete more effectively with its US and foreign-based competitors in the US and to continue its strong presence in growing global markets. In particular, the company has a competitive operating cost structure, partly as a result of agreements with the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW) and Canadian Auto Workers Union (CAW).

Global Ideas is a newsletter published four times a week (Monday, Wednesday-Friday) and available only to clients of Investor Campus and Anchor Capital. Twice-weekly (in the Monday and Thursday editions) we feature an in-depth analysis of a company on our focus list. The key objective of this newsletter is to provide ideas for investment in the global investment universe.

We scan the globe looking for good opportunities. We provide our model portfolios, as well as news and views on our watchlist, which is continually reviewed and updated.



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Sales to fleet customers are completed through the network of dealers or in some cases sold directly to fleet customers. Retail and fleet customers can obtain a wide range of after-sale vehicle services and products through the dealer network. These include maintenance, light repairs, collision repairs, vehicle accessories and extended service warranties. GM North America primarily meets the demands of customers in North America with vehicles developed, manufactured and/or marketed under the following brands: Buick; Cadillac; Chevrolet and GMC. At 31 March 2010 the company also had equity ownership stakes directly or indirectly through various regional subsidiaries including GM Daewoo, SGM, SGMW and FAW-GM Light Duty Commercial Vehicle Co Ltd. (FAW-GM). These companies design, manufacture and market vehicles under the following brands: Buick; Cadillac; Chevrolet; Daewoo; FAW; GMC; Holden; Jiefang; Wuling.

With the acquisition of Delphi Businesses in July 2009 the company entered into the Delphi Master Disposition Agreement (DMDA) with Delphi Corporation (Delphi) and other parties, which was consummated in October 2009. Under the DMDA, the company agreed to acquire Delphi's global steering business (Nexteer) and four domestic component manufacturing facilities as well as make an investment in a new entity, New Delphi, which acquired substantially all of Delphi's remaining assets. In December 2009, the company and SAIC Motor Hong Kong Investment Limited (SAIC-HK) entered into a joint venture whereby SAIC GM Investment Limited (HKJV) was to invest in automotive projects outside of markets in China, initially focusing on markets in India. On 1 February 2010 the company sold certain of its operations in India, part of its GMIO segment, in exchange for a promissory note due this year.

<u>GM's metrics are as follows:</u>

Spot ($)	29.07
Mkt Cap ($mn)	39 710
12M trailing PE	10.20
12M fwd PE	8.79
FYE	31-Dec
P/Book Ratio	1.46
12M fwd DY	0.00

Source: Bloomberg, Anchor Capital

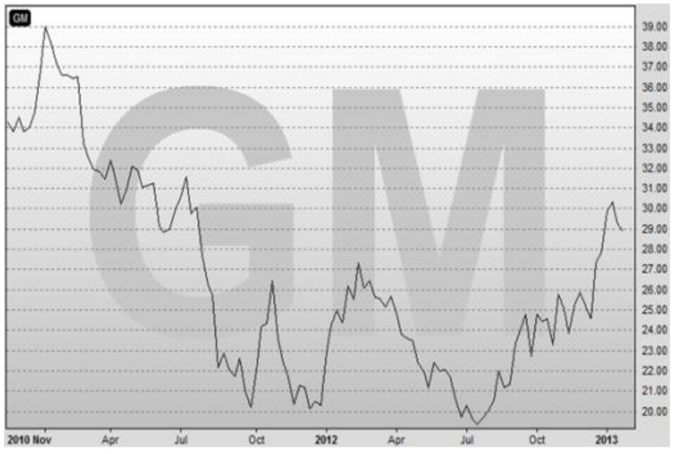
Why we like GM:

- Low P/E business.
- Restructuring will boost earnings and hence investment returns.
- Good exposure to global growth and strong presence in China.
- Massive, world-class company and brands.

Plse see Appendix A, page 6—Figure 1: GM earnings

GM is one of the world's leading vehicle manufacturers producing a wide range of vehicles form electric cars to heavy duty trucks. Their major brands are Chevrolet, Buick, GMC, Cadillac, Baojun, Holden, Isuzu, Jiefang, Opel, Vauxhall and Wuling. GM is the market leader in the US and China and is growing its market share worldwide (+0.4% to 11.9% of world market in 2011).

<u>GM share price ($)</u>

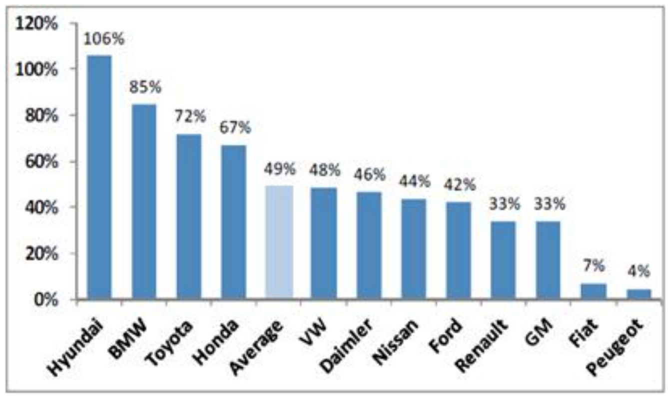


Source: *See More Markets*

We see GM as a bombed-out cyclical and feel that it is already discounting a protracted recession and so the future would have to turn out worse than this to lose money, but only relatively better to make money. Our view is that the odds are in favour of owning a diversified basket of these types of bombed-out cyclical shares. GM is a very good candidate for the bombed-out cyclical basket. The size of this portfolio segment however very much depends on risk appetite and also on the macro view.

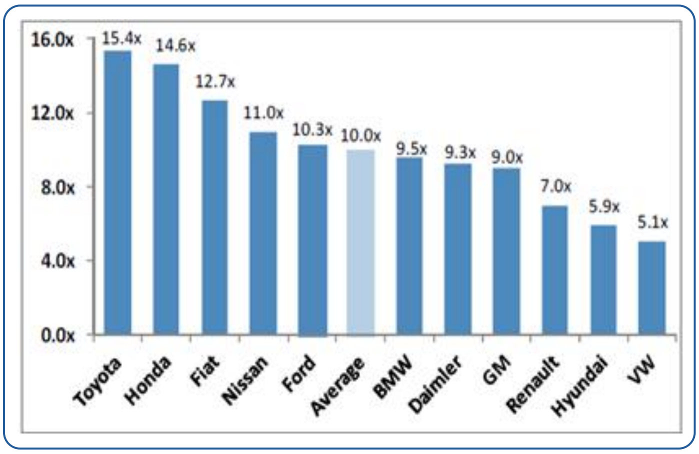
It is also definitely worth mentioning that Warren Buffet's Berkshire Hathaway bought a big stake in the company last year in February when the share price was only slightly lower than it is at present. The share is still very cheap when compared with its global peers as can be seen from the 33% Price/Sales ratio and 9x P/E multiple below:

<u>Auto OEMs: 2012E Price/Sales</u>



Source: Company reports and JP Morgan estimates

Auto OEMs: 2012E P/E



Source: Company reports and JP Morgan estimates

They are aggressively restructuring the business with a specific focus on driving out cost inefficiencies and general complexity. From the CEO's letter it sounds like there is a lot of wastage/inefficiency that can be squeezed out. For what it's worth, the CEO's comment in this regard was encouraging: "...I can cite many other examples of complexity and waste, up and down and throughout the organization. Rest assured we are systematically rooting them out."

Plse see Appendix A, page 6 — Figure 2: Global auto OEMs valuation comparables table

Macro-economic aspect
Some macro concerns are that vehicle manufacturing is a mature industry suffering from over capacity. A mentality of caution associated with economic weakness has damaged global vehicle sales, especially in developed markets. China's booming sales have slowed down in its present economic soft patch.

However, towards the end of 2012 auto and truck sales reached their highest level of buying since February 2008. The biggest movers of this were Toyota and Honda which have fully recovered after the massive impact of the tsunami.

Worldwide growth with focus on China
Regarding China, GM's view is that the market will have grown to over 30mn units p.a by the end of the decade. That is at least 5.5% p.a. for 9 years (sales in 2011 were 18.5mn, only 2.5% higher than 2010, a rapid slowdown as 2010's volumes were 32% higher than 2009. As you can see the numbers vary enormously). Supported by unprecedented demand for all of their major brands, GM and its joint ventures sold a record 2.83mn vehicles in China in 2012. Sales increased 11.3% from 2011.
In addition, exports by GM's manufacturing joint ventures to other emerging markets grew 61% last year to 77,207 units. The Sail accounted for about 80% of this. This took Shanghai GM's total sales in 2012 to 1.39mn units, SAIC-GM-Wuling's sales to 1.46mn units and FAW-GM's sales to 56 395 units.

During December, GM and its joint ventures sold a record 242,486 vehicles in the domestic market, an increase of 23.2% on an annual basis. Shanghai GM's domestic sales increased 41.7% to 110,135 units, while SAIC-GM-Wuling's sales in China were up 11.7% to 126,730 units. Both were December records. FAW-GM's sales were down 0.1% to 5,264 units. To support the ongoing development of products for China and the world, GM's Pan Asia Technical Automotive Center (PATAC) joint venture opened a climate wind tunnel in Shanghai, and GM China and its partner SAIC joined Shanghai GM and PATAC in opening the Guangde Proving Ground in Anhui province. The GM China Advanced Technical Center recorded milestones in lightweight materials and electric vehicle battery development during its first full year of operation, while opening its second phase in November.

GM maintained its support for a greener, safer and healthier community in China as well. Among the key programs launched last year were the GM Restoring Nature's Habitat Project, which is protecting important wetlands; the 2012 GM Safe Road Project, which educated young families about the importance of using safety equipment in vehicles; and the Back to 100 Rural Hospitals and SAIC-GM-Wuling Motorcade initiatives, which are assisting with health care in rural areas.

GM global sales summary

	Units 2012	Units 2011	% Change	% of Industry 2012	% of Industry 2011	Point Change
North America	3,018576	2,925,256	3.2	16.9	18.4	(1.5)
Europe	1,607,176	1,750,599	(8.2)	8.5	8.7	(0.2)
South America	1,046,594	1,066,402	(1.9)	18.0	18.8	(0.8)
International Operations*	3,615,931	3,281,245	10.1	9.5	9.5	0.0
Total Global	9,288,277	9,023,502	2.9	11.5	11.9	(0.4)

Source: Company reports and JP Morgan estimates

GM North America=US, Canada, Mexico and other North American markets.

GM in Europe = Western, Central and Eastern Europe plus Russia/CIS.

GM International Operations = Asia Pacific, North Africa, Sub-Saharan Africa and the Middle East.

*Note : Iran, North Korea, Syria and Sudan are excluded from sales volume and market share calculation; *4,053,550 including Russia/CIS*

Financials

On the flipside of these concerns is the potential for new technology to transform the vehicle industry – the internal combustion engine is still 19th century technology. The economic malaise of the past few years has removed a lot of capacity from the industry, so the extent of overcapacity is somewhat reduced. The very tight financial conditions have also tightened up these companies – they are much leaner and they continue to tighten up, or get 'leaner', now. The mentality of thrift which has resulted in the deferral of vehicle replacements will probably have created a lot of pent-up demand. After almost four years of caution, there is quite a large reservoir of pent-up demand now.

GM quarterly fundamentals ($mn except per share amounts)

Income statement	30-Sep-12	30-Jun-12	31-Mar-12	31-Dec-11	30-Sep-11
New revenue	37 576	37 614	37 759	37 990	36 719
Operating income	1 603	1 821	996	450	1 806
Net income to common stockholders	1 476	1 487	1 004	472	1 726
Diluted earnings per share	0.89	0.90	0.60	0.28	1.03

Source: Company reports

GM annual fundamentals ($mn except per share amounts)

Income statement	2011	2010
Net revenue	150 276	135 592
Operating income	5 656	5 108
Net income to common stockholders	7 585	4 668
Diluted earnings per share	4.58	2.89

Source: Company reports

This theme of 'pent-up demand' is quite generic and perhaps it is overstated. It is most probably there in some size in the US housing market too. Also, much of the worries over overcapacity in markets has been eliminated (vehicle manufacture just mentioned, but investment banking fluff too). But this really is a macro call which is difficult to make. Bond markets are clearly pointing to a lingering recession.

After being a little slow and reluctant at first to participate in the electric car market, GM have made a big statement with their Chevrolet Volt being the top-selling rechargeable car in the US by more than double the sales of the Toyota Prius. With the battery and battery/petrol combination powered car market growing at a massive rate – it has more than tripled in the past year – the performance of the Volt and more models being developed, gives GM a big advantage for the future.

Turning to the balance sheet, the psychological effects of the 2008 crisis are showing up in more robust corporates, GM is one of these in the sense that it is more robust than before. However, their credit rating is still below investment grade (though they have been upgraded). They refer to their "fortress balance sheet" but it's not quite that. They do have nice high cash balances and liquidity lines, but debt levels are still high. To put this in perspective – sales for one quarter are about $37bn, the cash balance is $33bn and credit facilities provide another $6bn (so they have cash and credit lines equal to about one quarter's sales revenue). On the solvency side, total liabilities (not just debt) are $110bn while equity is $42bn (liabilities are 2.6x equity), but we don't think the debt burden is too extreme.

JP Morgan's Investment Thesis

"We rate GM Overweight, for its best-in-class leverage to global growth markets, ongoing operational turnaround, and improving product cadence. We believe GM is well positioned to capitalise upon strong long-term growth in emerging markets, and is winning the race for the future in China in particular. In developed markets, we expect higher profits in North America – spurred by a rising top line and a new generation of full-size pickup trucks – to more than offset continued losses in Europe. We see a multi-year tailwind to GM's North American business from a sustained increase in US industry light vehicle sales, as light vehicle SAAR normalises higher. As well, we expect a new generation of full size trucks will materially benefit GM North America share, volume, mix, and pricing, starting as soon as 2Q13."

Conclusion

GM is the market leader in the US and China and is continually growing its market share worldwide. Its strong presence in China is a major factor in future growth and the share is currently cheap at a 7.9x forward P/E multiple. They are aggressively restructuring the business with a specific focus on driving out cost inefficiencies and general complexity. The company has also taken steps to ensure the availability of vehicle finance even in tough markets and this should reduce the impact of poor credit availability on their vehicle sales in the future.

Overall it's a word-class company with world-class brands. It has a strong and vested US business with very good potential to grow in emerging markets – especially China. The share is currently very cheap and we see it as a good investment to hold in an offshore portfolio looking for capital growth.

FJ Veldman
Blake Allen

Annexure A

Figure 1: GM earnings

Source: Infornt: Infinancials

Figure 2: Global auto OEMs valuation comparables table

Company	Ticker	Rating	Latest Price	Dec-13 Target	Upside/ Downside	Gross Debt/EBITDA 2012	Gross Debt/EBITDA 2013	Gross Debt/EBITDA 2014	Net Debt/EBITDA 2012	Net Debt/EBITDA 2013	Net Debt/EBITDA 2014
Global OEMs (in local FX)											
Ford	F US	OW	14.11	15.00	6%	1.3x	1.1x	0.9x	-0.4x	-0.3x	-0.3x
GM	GM US	OW	29.28	34.00	16%	1.0x	0.9x	0.8x	-0.5x	-0.4x	-0.4x
Tesla	TSLA US	N	34.52	37.00	7%	NM	NM	10.9x	NM	NM	8.3x
US Avg. (ex-TSLA)						**1.1x**	**1.0x**	**0.8x**	**-0.4x**	**-0.4x**	**-0.3x**
BMW	BMW GY	OW	73.33	NA	NA	0.3x	0.3x	0.3x	-0.3x	-0.3x	-0.3x
Daimler	DAI GY	N	43.35	NA	NA	0.5x	0.4x	0.4x	-0.4x	-0.4x	-0.4x
Fiat	F IM	N	4.55	NA	NA	1.9x	1.7x	1.5x	1.5x	1.3x	1.2x
Peugeot	UG FP	UW	6.25	NA	NA	4.4x	3.6x	2.8x	1.9x	1.6x	1.3x
Renault	RNO FP	N	43.60	NA	NA	3.4x	3.0x	2.8x	1.5x	1.3x	1.2x
VW	VOW3 GY	OW	177.90	NA	NA	0.9x	0.8x	0.7x	0.2x	0.2x	0.2x
European Avg.						**1.9x**	**1.6x**	**1.4x**	**0.7x**	**0.6x**	**0.5x**
Honda	7267 JP	OW	3,440	3,100	-10%	0.6x	0.5x	0.4x	-0.2x	-0.1x	-0.1x
Nissan	7201 JP	N	878	710	-19%	0.3x	0.3x	0.2x	0.0x	0.0x	0.0x
Toyota	7203 JP	OW	4,300	3,900	-9%	1.1x	0.8x	0.7x	-1.6x	-1.2x	-1.1x
Japan Avg.						**0.7x**	**0.5x**	**0.5x**	**-0.6x**	**-0.4x**	**-0.4x**
Hyundai	005380 KS	OW	213,500	290,000	36%	0.4x	0.4x	0.4x	-1.1x	-1.1x	-1.0x
Korean Avg.						**0.4x**	**0.4x**	**0.4x**	**-1.1x**	**-1.1x**	**-1.0x**
Global OEM Avg. (ex-TSLA)						**1.3x**	**1.1x**	**1.0x**	**0.1x**	**0.1x**	**0.0x**

Company	EBITDA Margin 2012	EBITDA Margin 2013	EBITDA Margin 2014	EV/Sales 2012	EV/Sales 2013	EV/Sales 2014	EV/EBITDAP NTM	EV/EBITDAP 2012	EV/EBITDAP 2013	EV/EBITDAP 2014	P/E 2012	P/E 2013	P/E 2014
Global OEMs (in local FX)													
Ford	8.2%	9.2%	10.6%	36%	35%	33%	3.8x	4.4x	3.8x	3.1x	10.3x	8.8x	6.9x
GM	8.7%	9.6%	10.5%	26%	25%	25%	3.2x	3.3x	3.0x	2.6x	9.0x	6.7x	5.0x
Tesla	-93.3%	-3.7%	2.2%	1106%	270%	222%	NM	NM	NM	100.1x	NM	NM	NM
US Avg. (ex-TSLA)	**8.5%**	**9.4%**	**10.6%**	**31%**	**30%**	**29%**	**3.5x**	**3.9x**	**3.4x**	**2.8x**	**9.6x**	**7.8x**	**5.9x**
BMW	19.5%	18.9%	18.6%	69%	66%	63%	NA	3.4x	3.4x	3.3x	9.5x	9.5x	9.2x
Daimler	11.2%	11.1%	11.9%	41%	40%	38%	NA	3.5x	3.4x	3.0x	9.2x	9.1x	7.9x
Fiat	9.4%	9.9%	10.7%	32%	31%	30%	NA	3.5x	3.1x	2.8x	12.7x	8.7x	5.6x
Peugeot	3.7%	4.6%	5.5%	8%	8%	7%	NA	1.9x	1.6x	1.3x	NA	NA	32.5x
Renault	7.5%	8.0%	8.2%	-1%	-1%	-1%	NA	-0.1x	-0.1x	-0.1x	7.0x	5.6x	3.4x
VW	10.5%	11.4%	11.8%	44%	42%	39%	NA	4.0x	3.5x	3.2x	5.1x	7.6x	6.7x
European Avg.	**10.3%**	**10.7%**	**11.1%**	**32%**	**31%**	**29%**	**NA**	**2.7x**	**2.5x**	**2.2x**	**8.7x**	**8.1x**	**10.9x**
Honda	6.6%	8.4%	9.1%	62%	57%	54%	NA	9.3x	6.7x	5.9x	14.6x	11.2x	10.1x
Nissan	7.9%	9.4%	10.1%	47%	44%	41%	NA	5.9x	4.6x	4.1x	11.0x	8.4x	7.3x
Toyota	7.0%	8.7%	9.3%	54%	51%	48%	NA	7.6x	5.8x	5.2x	15.4x	11.9x	10.1x
Japan Avg.	**7.2%**	**8.9%**	**9.5%**	**54%**	**50%**	**48%**	**NA**	**7.6x**	**5.7x**	**5.1x**	**13.7x**	**10.5x**	**9.2x**
Hyundai	15.7%	15.6%	14.9%	71%	71%	64%	NA	4.5x	4.6x	4.3x	5.9x	5.8x	5.4x
Korean Avg.	**15.7%**	**15.6%**	**14.9%**	**71%**	**71%**	**64%**	**NA**	**4.5x**	**4.6x**	**4.3x**	**5.9x**	**5.8x**	**5.4x**
Global OEM Avg. (ex-TSLA)	**9.7%**	**10.4%**	**10.9%**	**41%**	**39%**	**37%**	**3.5x**	**4.3x**	**3.6x**	**3.2x**	**10.0x**	**8.5x**	**9.2x**

Source: Company reports, Bloomberg and J.P. Morgan estimates. Sales, EBITDA, EPS, Debt and Cash presented in local currency.

Source: Company reports

The business of money: Global asset management and stockbroking

The business of knowledge: Financial education, information and valuation services