

Automotive

Global Automotive Financial Review

An overview of industry data, trends and financial reporting practices*

2007 edition



*connectedthinking


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About the PricewaterhouseCoopers Global Automotive Financial Review

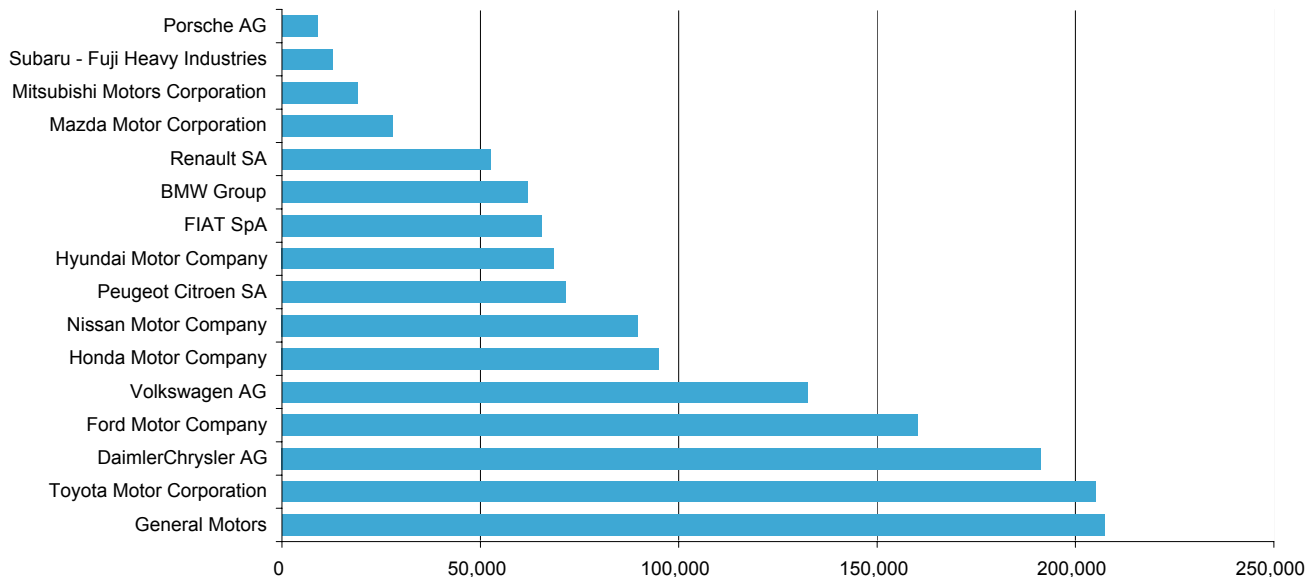
PricewaterhouseCoopers (PwC) is pleased to present its annual Global Automotive Financial Review - a summary of financial data, trends and practices reported by leading global vehicle manufacturers and suppliers, and industry analysis by the global PwC Automotive Practice, which involves over 1,500 professionals around the world in auditing, tax and advisory services.

Within the automotive industry, 2006 and 2007 have been, once again, challenging years. The peak reached in raw materials, the pressure from regulators and public opinion on environmental preoccupations, and the emergence of new players are a few examples of issues that the automotive landscape faces in reorganisation. The review of financial statements of the key players in this market is an extraordinary source of information as to how the manufacturers and suppliers have dealt with these issues and how they plan to tackle them going forward.

To assemble this ninth annual Financial Review, members of the PwC Automotive Practice analysed the Annual Reports of the most significant companies within the Automotive sector for fiscal years ending during 2006 and early 2007. The list of 38 companies included in this Review is presented as Appendices A (OEM segment information) and B (Tier 1 Supplier segment information). These companies consist of 16 global vehicle manufacturers and 22 global suppliers, 18 of which generated more than \$10 billion each in revenue during 2006.

We begin the 2007 Global Automotive Financial Review with an interview of Mr. David Palmer, Fiat Automotive Group's CFO, by PwC's Giorgio Elefante. Mr. Palmer illuminates why Fiat has become an industry success story. Following the interview with Mr. Palmer, analysts from the PwC Automotive Institute review and forecast the global automotive industry and explore the developments in the mature, yet dynamic, markets of the European Union, Japan, and North America.

Vehicle Manufacturers by Revenue (\$ millions)



After our regional analysis, subject matter specialists present several articles that address the automotive industry’s hyper-competitive and regulatory environment. Dr. Derik Evertz and Thomas Steinberger examine the ongoing challenges suppliers encounter and offer suggestions for risk mitigation. The evolving automotive industry and what can be done to maintain a tax-efficient and compliant operating model is analysed by John Ranke. The new so-called Japanese “J-SOX” regulations and their effects on automotive companies are then examined by Hitoshi Kiuchi, while Philippe Vincent and François Jaumain explain how automotive companies can communicate their joint venture economic performance and provide illustrative disclosure examples from a number of suppliers and automakers. Al Vondra reviews the impact of recent corruption enforcement and why the automotive industry needs to maintain vigilance.

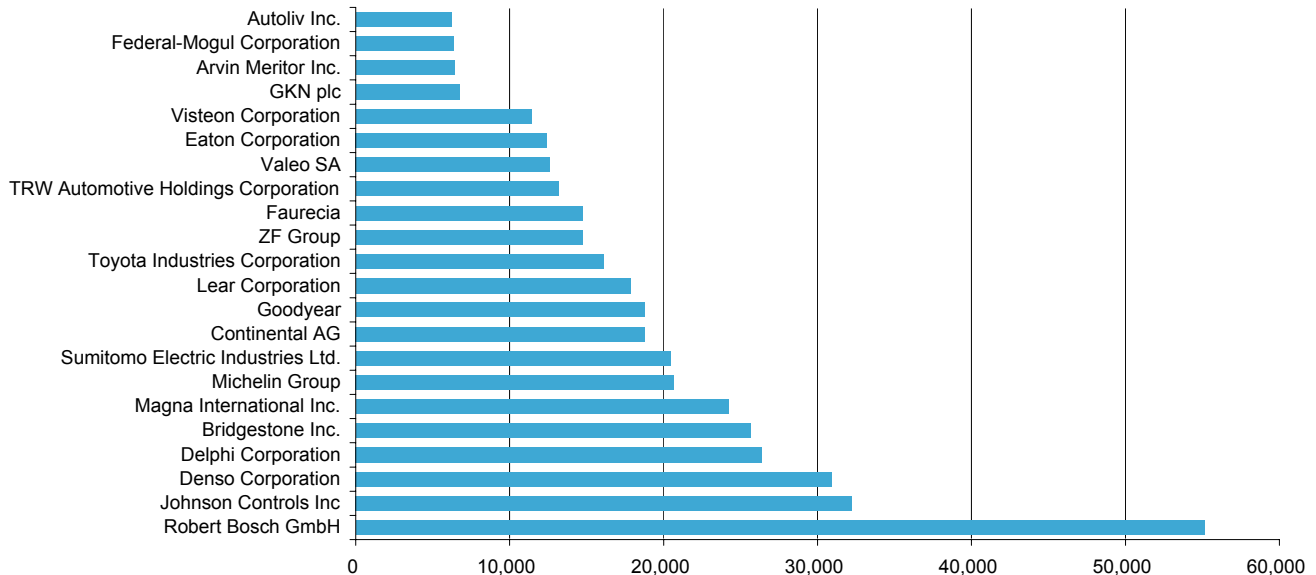
In “By the Numbers,” we present charts that highlight important ratios and performance metrics used by automotive industry executives and analysts. The statistics underlying these ratios are taken directly from annual reports and 10-Ks and are summarised in Appendices A and B.

For additional insights into the priorities of the leaders of automotive companies, the “From the Chairmen” segment provides quotations from chairmen’s letters to shareholders on major recurring themes that were evident across the annual reports. These include technology and innovation, ethics and corporate governance, collaboration, key strategies for success, the environment and global opportunities, among others.

The members of the PricewaterhouseCoopers Global Automotive Practice are ready to assist you as you lead your business through current challenges and toward new successes. For your convenience, a list of contacts can be found at the end of this publication.

Stephen D’Arcy Global Automotive Leader	Karl Gadesmann European Automotive Leader
<i>Stephen R. D'Arcy</i>	<i>Karl Gadesmann</i>
Philippe Vincent Automotive Partner	<i>Philippe Vincent</i>

Vehicle Suppliers by Revenue (\$ millions)





An Interview with Richard Palmer, Chief Financial Officer, Fiat Group Automobiles



An investment of \$100 in Fiat shares on 31 December 2003 would have increased after three years 150 percent, according to the PricewaterhouseCoopers Automotive Shareholder Value Index for Vehicle Manufacturers (the overall PwC SVI for Vehicle Manufacturers increased 63 percent). Over a shorter term, a similar investment in Fiat shares on 30 April 2006 after one year would have earned a return of 95 percent (compared with the PwC European Automotive SVI for Vehicle Manufacturers return of 38 percent).

A few quarters ago, Fiat's aggressive objectives could have seemed unrealistic outside of its Mirafiori headquarters. But now that we have seen the new Bravo (with its time to market), the new 500, the new Linea and the impressive product range plan of the recently renamed Fiat Group Automobiles (FGA), 3.5 million units sold worldwide in 2010 appears a realistic target.

Is Fiat's recent success a miracle? More simply, according to Richard Palmer, FGA's CFO, it is the result of executing the plan.

Q. Who's doing the job then – if you don't allow us to name it a "miracle"?

A. The key is a set of leadership principles. Our CEO Sergio Marchionne has kicked off a significant cultural change within our company, and FGA is now expected to institutionalize the new management style as its culture. This management style is developed along five core leadership principles defined by our CEO.

The first principle is that we are a meritocracy. The privilege to lead is granted to those who demonstrate abilities to lead, or show a clear potential, and deliver in terms of business performance. The second is the fact that leadership means leading people and leading change. Without the ability to drive change, organisations do not survive the continually evolving market and competition. The third principle is focussed on the realisation that we must embrace competition, which is at the heart of everything we do and is reflected in our 2010 targets. The fourth principle is our aim to reach best-in-class performance. We constantly have to challenge ourselves in order to remain one step ahead of our strongest competitors. No superior performance, not even survival, is gained if we don't exceed our competitors' performance. Finally, and crucially, is our commitment to deliver what we promise. We have achieved our targets so far, and we are fully committed to achieve the ones lying ahead of us.

Q. It's fascinating. How is it possible to manage this team of leaders to ensure the achievement of your targets?

A. Our CEO calls it "creative collaboration." The following two aspects have to be considered in unison: individual skills and the organisation itself. In the past, companies have made processes extremely complex and jobs simple. Today's workforce has different features, and therefore creativity and motivation inevitably suffer. Without both of them, we cannot survive nor succeed: we therefore need a modern approach, focussed on simple processes, clear metrics and on the individual person's contribution and performance.

Leadership cannot be a "one man show": inspiration by leaders should pervade and mobilize people across the entire organisation. The organisation is kept as lean and as flat as possible in order to ensure decision and execution speed. Managerial discipline regarding the delivery of results is a terrific enabler for this cultural change.

Q. Within the industry, a common topic of discussion is what kind of profile is better suited to lead the change at troubled makers.

A. Let's take a FGA-specific angle. We have and need the so-called "car guys" in our team, and we also have and need pure "financial-minded" guys. But the leaders we value uniquely combine additional features: they are very good at running the "creative collaboration," are focussed on our mission and vision of the future, as well as on our strategies, and are able to make the organisation run faster than our competitors. Our leaders have to see the industry with unconventional eyes: we even look at our competitors' benchmarking against players outside of our industry. Cars are, in many respects, similar to other fast-moving consumer goods: we can learn from P&G as well as from Toyota.

Q. Which competitive gaps represent your priorities? And where do you see your best opportunities?

A. The driver of profitability is volume growth. In 2006, we sold two million units and our target for 2010 is 2.8 million. This number does not include vehicles sold in China, Russia, India and Turkey through joint ventures and license agreements where the contribution in 2010 will be 700,000 units, compared with the 120,000 in 2006. This volume growth is driven by an intensive product introduction plan and the FGA organisation is absolutely focused on the optimisation of the product launches. In the period 2007-2010, we will launch 23 new models and 23 model upgrades.

In addition, the concept of the brand teams driving the business is absolutely key to allow us to ensure that we understand the customer and design cars that meet the customer's expectations. We consider that we should properly value the historical heritage of FGA's brands, in order to leverage our distinctive features.

FGA is addressing its industrial challenge rationalizing the number of vehicle architectures and leveraging alliances and joint ventures with the most suitable partners for focussed projects. These agreements are aimed at accessing technological and production synergies while, at the same time, sharing development costs and risks.

Q. Will this help Fiat Group Automobiles address the structural issues, such as "excess capacity," rising material costs and downward price pressure?

A. As I said before, ours is a volume business and we plan to increase volumes produced and sold. Therefore, we believe that we are able to handle the cost side of the equation, properly managing economies of scale also by leveraging the synergies with our sister companies CNH and Iveco in the Fiat Group. With regard to global sourcing, we are intensely addressing this internally and are confident that our partners will help us achieve better economic conditions. In the manufacturing area, we have a World Class Manufacturing program that has been introduced in all our factories and that is focussed on identifying and attacking waste and losses.

Q. What about brands then? Are you considering enriching your brand portfolio? Or are you considering concentrating certain brands in certain geographies or segments?

A. We are focussed on delivering results on our current brand portfolio, which already is a rich one, with a lot of potential to express. With regard to specific brands, Alfa Romeo will launch the new Junior in 2008 and Lancia the new Delta. Furthermore, Abarth is back on stage to further enhance the Fiat brand. We also have a strong position in the light commercial vehicle sector through our Fiat Professional brand, which has an 11 percent share in the Western Europe market.

Q. What about low-cost manufacturers? Once they try to enter the mature markets, how will this affect your brand and product strategies?

- A.** Brands and product quality drive the margin between price and costs. The cost side is not enough to be a profitable player in the mature markets.

Regarding the price side, we feel that we have a strong brand portfolio, and the quality of the Bravo and 500 shows that we are absolutely competitive. For the cost side, we are already producing in Poland, we have production platforms in Brazil and through partners in Turkey, India, and China. This gives us access to the lower-cost supplier bases and will allow us to maintain our competitiveness.



Interviewer
Giorgio Elefante
Director
Milan, Italy

Mr. Richard Palmer is English but his career has been significantly impacted by his work in Italy. After qualifying as a Chartered Accountant in 1991 with Price Waterhouse London, Mr. Palmer spent the next three years working in Price Waterhouse's Turin, Italy office where he first came in contact with the Fiat Group. After leaving Price Waterhouse in 1994, he worked in United Technologies Corporation's corporate audit group. In 1997, Mr. Palmer went back to Italy to work for General Electric Oil & Gas in Florence, where he had the roles of Finance Manager of the Gas Turbines and Global Service businesses.

In 2003, Mr. Palmer joined the Fiat Group as CFO of Production Systems (Comau) and subsequently of Trucks and Commercial Vehicles (Iveco). In December 2006, Mr. Palmer was named CFO of Fiat Group Automobiles.

Global Automotive Sector Outlook

The PricewaterhouseCoopers Automotive Institute estimates that global light vehicle assembly will grow from 65.2 million units in 2006 to 77.6 million units by 2014, an increase of 19.1 percent. While the majority of this growth will likely come from China, India and other emerging markets, mature markets are expected to contribute nearly a third of that growth.

On an even more positive note, mature regions are expected to be among the best performers in reducing excess capacity over the forecast period. The European Union is expected to improve manufacturing utilisation 6.6 percent by 2014, while North America improves by 4.5 percent. The European Union will likely lead growth efforts, adding approximately 2.7 million light vehicles to its assembly base over the forecast window. Even North America, with all its structural difficulties, will grow by close to a million units over that time. In Japan, the most mature market in the Asia-Pacific region, light vehicle assembly is expected to remain relatively stable over the forecast window, experiencing a decline of 250,000 units, or 2.3 percent.

The most interesting question in each of these markets is what is happening from a competitive standpoint as we move beyond a pure top-line analysis.

The European Union growth story is rooted in a resurgence of traditional brands and a rebound of assembly in some established vehicle-manufacturing countries, particularly Germany, which will likely see an increase of more than 900,000 units by 2014. This will certainly eclipse the growth contribution of any other EU country; Slovakia, ranked No. 2, is expected to add 500,000 units over the same time period. From a manufacturer perspective, the Volkswagen group of brands is expected to lead in terms of growth, posting a gain of 15 percent in light vehicle assembly to approach 4.4 million units by 2014. Renault-Nissan and the Fiat Group are also among the top five growth OEMs in the EU, each posting increases of 350,000 to 400,000 units.

In contrast, the anticipated growth in North America can be directly attributed to transplant manufacturers, which continue to add assembly operations as they claim a continuously increasing share of the market. For example, in 2006, transplant manufacturers claimed 34 percent of the light vehicle manufacturing base in North America. This is expected to expand to 43 percent by 2014, as the traditional “Detroit 3” OEMs

continue to work through significant restructuring efforts, including sharp declines in light vehicle assembly. Collectively, these three manufacturers are expected to reduce their assembly footprint in North America by 900,000 units over the forecast window.

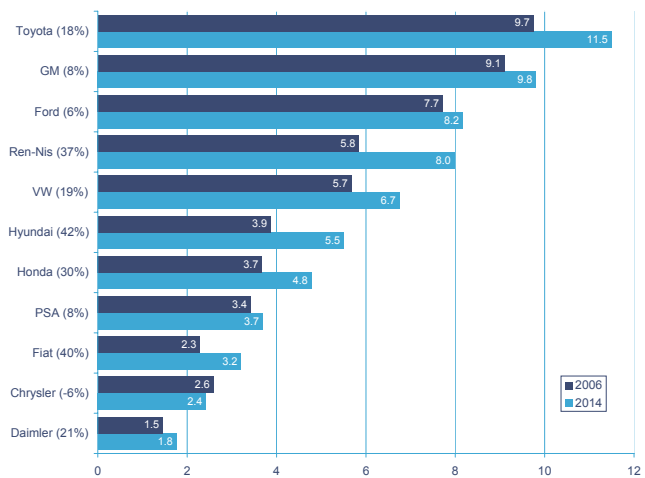
In the North American parts manufacturing sector, many “customer-dependent” suppliers are also in the midst of deep restructuring plans, and the next few years are likely to be filled with continued market challenges. The central question becomes whether these struggling companies have enough time to work through their individual right-sizing initiatives.

Two likely factors in answering that question are the amount of funding available to finance these efforts and the outcome of labour discussions. One result of this situation is a tremendous amount of M&A activity in the automotive space, driven by private equity investors looking to capitalise on undervalued assets and strategic alliance opportunities as suppliers (and OEMs) look for solid footing to enable them to regain lost market share and profitability.

In Japan, the biggest factor contributing to the overall decline in light vehicle assembly is an expected drop of 410,000 units in Toyota’s manufacturing base. This stems mainly from a strategic decision to build more products in local markets around the world, reducing the need for assembly in Toyota’s home market. By contrast, Nissan and Honda are expected to post moderate gains, of 165,000 and 70,000 units, respectively. Interestingly, although Honda is likely to see growth in its home market, it now produces more light vehicles in North America than in Japan and this trend is likely to continue. Honda is expected to produce almost one-third more vehicles across Canada, Mexico and the United States than in Japan by 2014, reflecting a long-term corporate strategy to focus on other sources of growth around the world.

In the following three articles, we will further examine Western Europe, Japan and North America, identifying the key trends and drivers of these markets, along with potential risks to the sources of positive growth.

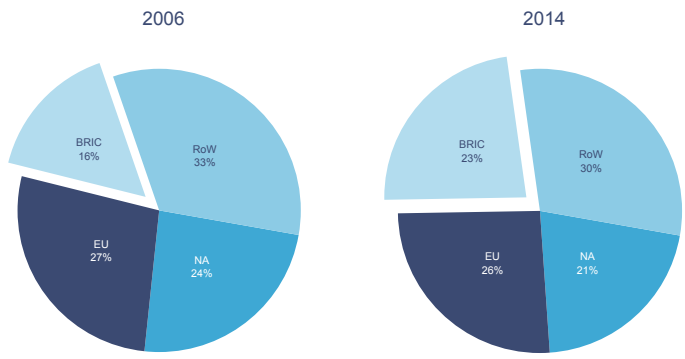
**Global Light Vehicle Assembly Outlook
Top Alliance Groups 2006 vs. 2014 (millions)**



*Percent assembly volume increase 2006-2014

Source: PwC Automotive Institute 2007 Q3 Data Release

**Global Light Vehicle Assembly Share by Region
2006 vs. 2014 (percent)**



2006 = 65.2 million units

2014 = 77.6 million units

- BRIC = Brasil, Russia, India, China
- EU = European Union
- NA = North America
- RoW = Rest of the World

Source: PwC Automotive Institute 2007 Q3 Data Release

Japan Outlook

Assembly volumes in Japan declined drastically in the first half of the 1990s, due to rapidly shrinking domestic sales brought on by the end of the bubble economy and aggressive overseas assembly transfers. Most Japan-based automakers responded with substantial capacity rationalisation throughout the 1990s and early this decade. The bleeding seemed to stop in the mid-1990s and the trend has been reversed in this decade.

Since the mid-1990s, domestic sales have been stagnant or even slowly declining, especially in the last few years, barely sustained by “K-cars”, mini-vehicles that are more popular than ever.

What has contributed to this equation?

The Japanese automotive assembly sector has grown for the last several years, with a majority of growth coming from the export volume that resulted as automakers shifted strategy to leverage Japan as a hub of more value-added products, such as gasoline-electric hybrid powertrains and luxury-brand vehicles.

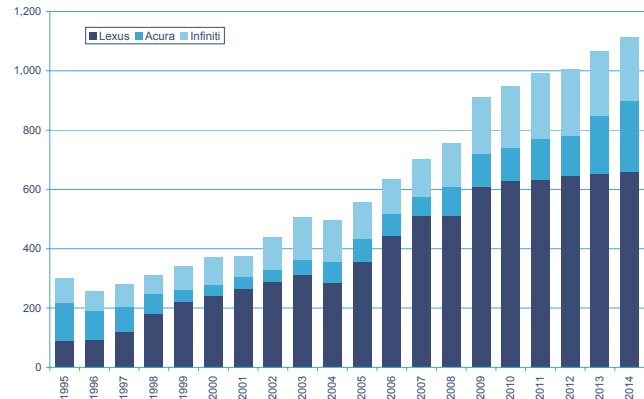
Japan has been an automobile export powerhouse for decades. For the last several years, this has become more apparent; export volumes rose even as automakers aggressively transferred assembly volumes overseas. Japan shipped nearly six million light vehicles in 2006, roughly 50 percent of its total assembly volume. Among export destinations, North America is the largest and most important market in volume and revenue for many Japanese automakers. In North America, Japanese exports, especially premium brands and hybrid vehicles, have been increasingly popular in recent years. It is expected that assembly volumes of these high-value-added products will remain a key factor supporting Japanese automakers’ operations in their home market.

Japanese premium brands, such as Acura, Lexus, and Infiniti, started in the late 1980s in North America. Their popularity in North America has grown in the past 20 years and recently, they have expanded to other markets, including Europe and Japan. Lexus vehicle sales started in Japan in late 2005 with the IS, GS, and SC models, and its flagship LS was introduced in late 2006. Toyota aims to establish Lexus in Japan not as a rebadged Toyota, but as a true global luxury brand that can compete against Mercedes-Benz and BMW. In the stagnant

Japanese market, highly profitable luxury vehicles should contribute to Toyota’s bottom line. However, Toyota seems to be struggling to achieve its sales goals thus far.

Following Toyota’s example, Honda is expected to introduce its Acura brand in Japan in the fall of 2010. At this point, Nissan has not announced Infiniti’s entry into the Japanese market; however, it is expected to follow Toyota and Honda in the future.

Japanese Premium Brand Assembly in Japan 1995 - 2014 (thousands)



Source: PwC Automotive Institute 2007 Q3 Data Release

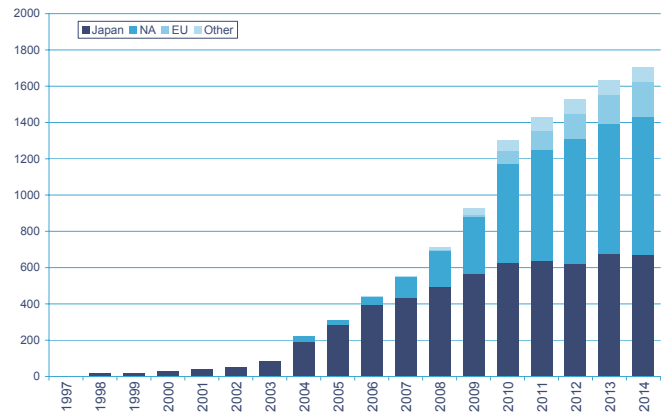
To serve growing demands from both the overseas and domestic markets, Japan is expected to remain as a key assembly base for these three Japanese premium brands. Assembly volumes for these brands, led by Toyota, have been steadily increasing for the last 10 years in Japan. A similar situation can be seen in terms of the growth of hybrid vehicles.

The Toyota Prius, the first mass-produced hybrid vehicle in the world, marked its 10th anniversary in Japan in 2007. The second mass-produced hybrid, Honda's Insight, entered the market in 1999. Since then, Toyota and Honda have dominated the hybrid segment globally. Toyota is very focussed on hybrid vehicle development; as of early 2007, it assembles nine hybrid models, from compact cars to minivans, in Japan. The number of Toyota models assembled in Japan with a hybrid powertrain is expected to grow.

In addition to the Japanese domestic market, North America has developed into Toyota's main market for hybrid vehicles. In 2006, for example, Toyota assembled about 200,000 Prius units in Japan and sold more than half of them in North America. It is expected that the majority of hybrid assembly will stay in Japan in the mid- to long term to support the Japanese manufacturing base.

In addition to the hybrid powertrain, many Japanese automakers anticipate increasing assembly volumes in Japan with diesel-powered vehicles, starting in 2008. Diesel engines are not viewed favourably by consumers across the globe, except in Europe. However, the latest clean diesel engine technology, driven by stringent emission regulations in Europe, Japan, and, especially, the US, may transform consumer perception. While Toyota seems to concentrate heavily on hybrid powertrain applications, Honda applies the hybrid powertrain for small to compact cars and the diesel engine to larger cars and light trucks. Many diesel-powered vehicles are expected to be sold outside Japan and, again, export volumes will play a key role for assembly volumes in Japan.

Global Hybrid Vehicle Assembly by Region 1997 - 2014 (thousands)



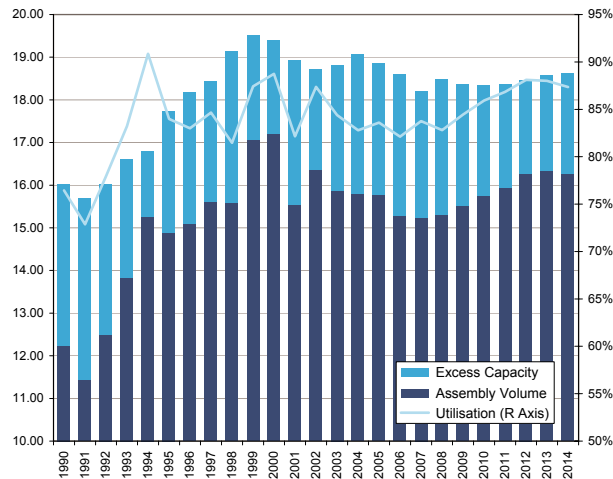
Source: PwC Automotive Institute 2007 Q3 Data Release

North America Outlook

The North American market for the assembly of light vehicles is among the largest and most competitive in the world and has proven to be, historically, among the most profitable. Because this market is undergoing significant change – belated restructuring by the Detroit 3, acceleration of New Domestic (i.e., foreign automakers with North American assembly facilities) growth, and subjection to the results-driven hand of private equity – its outlook has often been painted in the starkest of terms. At the same time, an unbiased analysis of traditional macro-oriented indicators, planned automotive products and capacity localisation strategies will continue to keep the market buoyant, despite growing regulatory and competitive headwinds.

In general, the North American market is regarded as mature – with replacement volumes being a far more important driver of sales than new vehicle ownership or changing demographics (both of which still contribute to growth). The North American market for the assembly of light vehicles is forecasted to rise to as high as 16.3 million units in 2014, from the roughly 15.3 million units achieved in 2006, posting a compound annual growth rate of approximately 0.8 percent. (The high-water mark came in 2000, with 17.2 million units of assembly).

North American Light Vehicle Outlook 1990 - 2014 (millions)



Source: PwC Automotive Institute 2007 Q3 Data Release

The potential exists to increase assembly in the North American market to a greater degree than underlying sales would ordinarily permit – because overall rates of assembly in North America coincide much less with overall sales than they do with sales of domestically produced vehicles. Compared with other mature markets such as the European Union and Japan, vehicle exports are relatively low. Nearly all of the one million units of assembly growth expected is attributable to localised assembly of previously imported vehicles by the New Domestics. Toyota currently has two facilities under construction in North America with a third plant to build subcompacts under study, while Hyundai and Honda are expected expand their capacity footprint in North America as the Detroit 3 contract.

This accelerating trend in import substitution has the potential to reverse in the next decade, as exports from China and even Thailand may begin to find their way to the North American market in increasingly large amounts. The precise timing of the arrival of significant numbers of Chinese imports into North America is subject to some debate, but it is also seen as an inevitable consequence of globalisation and Chinese global growth aspirations.

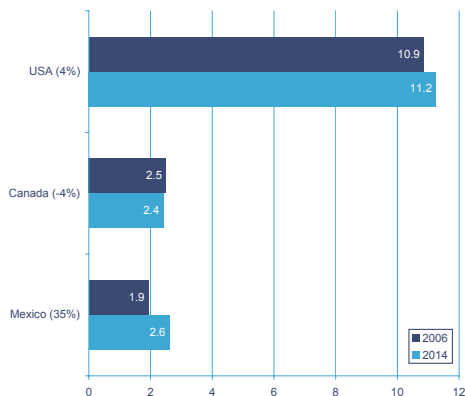
Going forward, Mexico remains the only significant demand growth market in North America, with automotive-related investment over the last two years exceeding US \$3 billion in value. Mexico exported more than 1.5 million vehicles in 2006, nearly 500,000 units more than its domestic sales for the period. This export trend is likely to accelerate as an expected shift in Detroit 3 assembly to Mexico, over the next several years, is fueled by seemingly inexorable cost pressures in the US market. Although the Mexican market experienced only a modest 2.6 percent increase in sales in 2006, demand for new vehicles remains near Mexico's peak.

Multiple factors afflict demand growth, all reducing vehicle affordability. Fuel prices in the US will trade in the near term in an elevated band and are likely to affect consumer purchase decisions. For the near term, strong global demand, a series of refinery outages, breakdowns and controlled supply have caused prices in the US to remain above even the supply-induced highs experienced in the immediate aftermath of hurricanes Katrina and Rita. Over the longer term, prices likely will trend higher due to increased strong demand from emerging markets,

continuing the clear trend of inflationary pressures on not just oil and gasoline, but on commodities of all types.

US sales continue to be beleaguered by housing market worries – people have stopped taking money out of their homes to buy vehicles. The adverse effects of the mortgage refinancing boom is starting to come to light; as rates on adjustable mortgages begin to float upwards, people are finding it less beneficial to offload revolving credit (credit card) debt to their homes. The slowdown of the markets for both new and existing homes compounds this issue and has forced potential consumers to the sidelines as bloated home inventories put significant downward pressure on home prices.

North American Assembly by Country & Growth 2006 - 2014 (millions)



Source: PwC Automotive Institute 2007 Q3 Data Release

While consumers have remained somewhat resilient in 2007, signs are emerging that their enthusiasm is diminishing. Demand in the auto sector has paused, even as the average vehicle finance loan term length is more than five years, with consumers financing an average of \$27,000.

The New Domestic's rise in sales and assembly share placed great pressure on the traditional domestic manufacturers, which have been forced to endure costly restructurings to bring their capacity and workforce in line with their diminished market share. All three Detroit automakers are restructuring and will combine to shed 1.9 million

units of capacity, along with 100,000 employees, from 2006 levels as they "right-size" for today's market reality. Their turnaround efforts are heavily weighted toward eliminating fixed costs and chasing market share – and these efforts are likely to be self-defeating if they fail to correct the core business requirement of building a robust portfolio of competitive vehicles that appeal to consumers.

Significant vehicle segmentation shifts are taking place in the North American market. The rise of SUVs in the 1990s is widely understood to have altered the face and economics of vehicle manufacturing in North America. Now, CUVs (crossover utility vehicles) promise to remake the industry in a similar way this decade. CUVs are fast becoming the SUVs of today; their rise in assembly represents a paradigm consumer shift every bit as profound as the shift to SUVs, and it has occurred in roughly half the time. CUV assembly in North America is expected to overtake the traditional SUV segment at the conclusion of 2007 and it likely will grow by 2.1 million from 2006 to 2014.

A confluence of factors has created a perfect storm within the auto sector that has left many suppliers with clearly unsustainable business models. Automakers have driven cost-savings mandates down through the supply chain in an environment of record high commodity prices. Supplier margins are so razor thin that reductions in OEM volume evaporates profitability as marginal costs increase. The financial distress of these suppliers has catalyzed the rationalisation and restructuring of the supply sector, by making relatively inexpensive assets attractive to potential buyers. However, the buyer pool is shifting away from overleveraged trade buyers to private equity. Undoubtedly, private equity's influence in the automotive sector is growing, from high-profile acquisitions in the supply sector to taking a majority stake in the Chrysler Corporation.

The story of light vehicle manufacturing in North America is one of moderate growth over the foreseeable future. The most significant identifiable trends are the continuing rise of New Domestic manufacturers at the expense of the Detroit 3. This will continue a capacity and operational retrenchment, and shifts in vehicle segmentation and automotive-supply base business models.

European Union Outlook

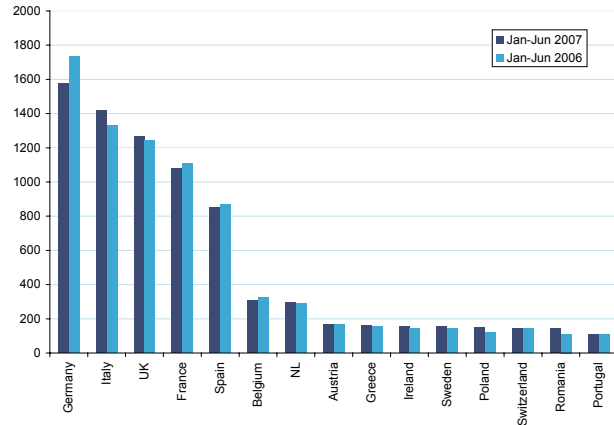
Demand situation

Since the strong growth seen in the late 1990s, followed by a partial reversal between 2000 and 2003, the West European market has been remarkably stable with sales of around 14.5 million units between 2004 and 2006 compared to the 15.1 million peak observed in 1999. The accession of ten new, primarily Central European, members in 2004, followed by another two in 2007, introduced a significant number of smaller emerging markets into the European Union, opening up the possibility for more dynamic growth.

However, any net gains from the new members was initially undermined by the sizeable contraction in Polish new car demand, owing to a flood of used car imports from existing EU members. New car demand in Poland fell from a peak of over 625,000 in 1999 to just 235,000 units in 2005. Although it now appears that Polish demand is on the rise, having grown on a year-on-year basis for the past ten consecutive months (September 2006 to June 2007) and by 24.9 percent in the first six months of 2007. Indeed, taken as a whole, growth in new car demand in the new EU markets, of 14.8 percent or 74,000 units in the first six months of 2007, almost offsets the decline seen in the West European market of 1.1 percent or 89,000 units.

Within West Europe, the automotive sales picture is growing increasingly complex. The market has been undermined by the impact of the 3 percent VAT increase in Germany, Europe's largest new car market, which came into effect in 2007. The net result was a significant pull forward of registrations into the closing months of 2006, with growth of 12.5 percent in Q4 2006, but a resulting decline in the first six months of 2007 of 7.0 percent. Once this distorting effect self corrects, demand in Germany is expected to move back into positive territory, although this is unlikely to occur before 2008, despite an improving economic situation.

EU New Car Sales – Top 15 Countries 2007 YTD vs 2006 YTD (000's)



Source: PwC Automotive Institute 2007 Q3 Data Release

The picture for both the UK and Italy, the third and second largest markets, looks to be improving with sales up 2.0 percent and 6.5 percent respectively in the first six months of 2007. For the UK, this uptick has been unexpected as demand was expected to fall marginally, a continuing correction from the record levels of demand seen between 2001 and 2004. However, it is likely that a correction in underlying demand has taken place within the UK market, so that rather than a 2.3-2.6 million market being the exception, it is now the rule, owing to structural, demographic, and wealth effects. As a result, during a period of continued strong economic growth, demand growth from 2006's 2.344 million market is likely.

Sales growth in Italy, which must overcome a slightly less favourable economic environment, is due in part to the resurgence of Fiat, with the launch of increasingly desirable products, and the introduction of a scrappage incentive scheme. This scheme offers an incentive of up to €800 and an exemption from the annual "bollo" tax when owners scrap a Euro 0 or 1 car and replace it with a car emitting less than 140g/km of CO₂. As a result, demand is expected to increase

to between 2.4 and 2.5 million units in 2007 compared with the 2.32 million sales in 2006.

The French new car market is slightly different from most European markets, tending to be far more stable with less peak to trough variation. Between 2003 and 2006, demand varied by no more than 67k. However, demand has also been relatively weak, averaging 150,000 units less during this period compared to the previous four years and having failed to equal the historic high of 2.3 million sales seen in 1990, while most European markets have grown significantly from their previous cyclical peaks, with the exception of Germany.

In the first six months of 2007, France saw a marginal decline of 2.6 percent although the uncertainty caused by the presidential elections played a part in suppressing demand. With uncertainty since removed, demand should recover in the second half of 2007 and continue its recovery into 2008.

The remaining major market, Spain, has also been correcting from a period of strong and sustained growth, although demand fell by just 1.6 percent in the first six months. The automotive market in Spain has grown significantly over the past decade, driven in part by economic growth, increasing wealth, and house price value. An interesting comparison between demand levels is that new car demand per capita in Spain is 11 percent higher than France despite 17 percent lower GDP per capita, illustrating the relative strength of Spanish demand and weakness of French demand.

Supply Situation

Befitting of the relatively stable demand environment, EU light vehicle output has also been stable this decade, with assembly varying by no more than 2.8 percent. EU output peaked in 2000 at 18.065 million units before declining marginally each year to reach a decade low of 17.565 million in 2003. Output grew again in 2004 and has been largely flat since, varying by no more than 0.4 percent.

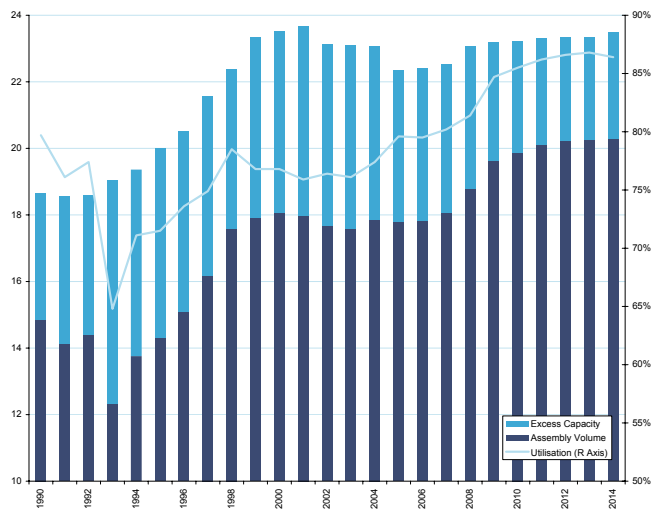
Although the demand and supply pictures largely mirror one another over the window, we anticipate a greater increase in output than demand over the next few years. Between 2006 and 2014, light vehicle assembly is forecasted grow to by around 2.4 million units to 20.3 million units. This is due in part to increased demand from the new EU members and also some of the underperforming West European markets such

as France and Germany. Collectively, these markets should contribute an additional 1-1.5 million units of new vehicle demand.

Increased localised production will also play a large role in the future. Hyundai Group's investment in two new 300,000 capacity plants in Central Europe will make a major contribution to this growth as these plants both localise supply of several current products and help Hyundai Group achieve its ambitious European growth targets. Toyota will be the other main contributor to increasing localised production, again in support of its strong growth agenda.

Export growth will become increasing important, especially among the premium brands. While BMW, Mercedes, and Audi continue to boost production outside Germany, the bulk of their output will remain in Germany with a global brand growth benefiting German production. In the case of the other premium brands, such as Volvo, Land Rover, Alfa Romeo, Lancia and Saab, most growth is likely to be EU sourced. Collectively, we anticipate that these brands will account for around 930,000 units of growth or nearly 38 percent of the projected increase in total EU output. Some of this growth will be accounted for by European consumers' increasing appetite for premium brands, with the remaining increase allocated to export growth.

EU Light Vehicle Manufacturing Outlook 1990 - 2014 (millions)



Source: PwC Automotive Institute 2007 Q3 Data Release

Capacity Utilisation

Despite the relative stagnation in light vehicle output this decade, capacity utilisation has been on an upward trend since 2003, which is expected to continue uninterrupted well into the next decade. Increasing cost pressures have been one of the main drivers behind this increasing utilisation. All else equal, 80 percent is generally regarded as the break-even level for plant utilisation, a figure the European industry was below during the 1990s and will only begin breaching in 2007. With the increase in raw material costs, labour costs and reduction in pricing power that has been felt across the industry, production costs have been one of the main cost reduction targets leading to capacity reduction, either through plant closure or shift reduction.

Europe has observed several high profile plant closures in recent years including Fiat's Rivalta plant in 2001, GM and Ford assembly plants in the UK in 2002, Jaguar's Browns Lane facility and MG Rover's Longbridge plant in 2005, and PSA's Ryton, UK plant and GM's Azambuja, Portugal facility in 2006. Additionally, capacity has been reduced at a number of other plants through the loss of shifts and the closure of final assembly halls. The net result has been a 1.5 million unit capacity reduction in West Europe between 2000 and 2007. However, the story has not simply been about removing capacity as lower cost capacity has been added in new EU member countries. These countries, with their significantly lower labour costs, have so far seen light vehicle capacity grow by 0.56 million units over the same period, while additional investment will contribute another 1.1 million units of capacity in the next few years as capacity in West Europe remains relatively stable.

This evolution, rather than revolution, in European assembly capacity is nevertheless expected to yield very positive results. By 2009, the net result of consolidation and investment for the whole EU is a positive 100,000 units of capacity, because while West Europe has lost 1.5 million units of capacity since 2000, the region as a whole has gained 1.6 million units. Meanwhile, the expected growth in assembly over the next few years indicates excess capacity will fall from 5.7 million units in 2001 to 3.2 million units by 2011, thereby increasing overall utilisation from 75.9 percent to 86.2 percent.



The Supplier Landscape: Still in Trouble

Even with the European economy running smoothly and private consumption growing in most of the economies, large parts of the automotive supply industry are in deep trouble. Apart from the big, well-publicized cases of recent years like Collins & Aikman or Delphi, many traditional and well-known suppliers in Europe, and especially in Germany, have serious problems and must fight for survival.

With nearly all major raw material prices soaring and the automakers continuing to demand steady improvement efforts, price reductions, and pre-financing of R&D, many suppliers are running out of cost-cutting options.

In many cases, because R&D, is not correlated to volume, but to the number of projects, the trend in the automotive industry to offer an increasing variety of products increasingly hurts suppliers and is intensified by rising volatility in projected sales figures.

Pressures from the cost and revenue side are often heightened by a structural change in the automotive supplier industry. Traditional and family-owned businesses are being sold to private equity firms and hedge funds, which are playing a more active role in the industry. That development leads to greater expectations on margins, which are very hard for management to satisfy. Furthermore, in many cases, the traditional “house bank” relationships have vanished and more aggressive financing structures are in place, with high interest payments and tight covenants that dangerously narrow the margin for error.

Challenges for the Automakers

Most Tier 1 suppliers are highly integrated in the value chain of the automakers, and most Tier 2 suppliers are similarly integrated in at least the supply chain of their respective Tier 1’s, so any problem at a supplier almost always becomes a serious problem for the respective automakers.

A classic example of this integration and mutual dependency is a small German supplier of high-tech metal parts. This company has revenues of only US \$50 million and sells much of its product to three Tier 1 suppliers, which in turn, sell their components to a number of automakers. A crisis developed because of the high scrap rate in using

a new technology, and none of the Tier 1 suppliers were able to build up relevant safety stock. An uncontrolled bankruptcy of this small supplier would lead to production disruptions along the value chain very quickly, with possible damages above annual revenues.

In such cases, size often does not matter; the risk management function at a Tier 1 or the automaker has to be on top of all developments in its supplier base in order to avoid losing money.

Because of increased single sourcing by purchasing departments and the high costs for tooling and R&D, suppliers become less interchangeable, with contracts in place until the next generation of a model is developed, or at least until the next major product redesign.

In many sourcing areas, competition has been reduced to a handful of bidders. This dramatically limits the ability to quickly change suppliers in crisis situations. Even if it is technically and commercially feasible, lack of capacity in a certain sourcing area can cause disruption.

The reduction in the supplier base also limits the number of bidders for future products and components and creates oligopolistic structures in certain sourcing areas. From a strategic sourcing point of view, any option that keeps a troubled supplier alive and independent should be preferable to a closure or a fire sale, because having that supplier available provides some price equilibrium in the market.

Depending on the product, automakers are often stuck with a troubled supplier for several months. The consequences of retaining such a supplier can include increasing quality and delivery problems and often a substantial financial burden on the automakers to maintain the continuous flow of products. The suppliers gain leverage in this situation because, as the saying goes, “parts are senior to money.” This is especially true in high-demand situations for certain top-selling models, where only limited chances exist to build up safety stocks, and for leading-edge components of unique and differentiating technology.

The recent crisis situations reveal the fact that even medium-sized suppliers (with less than US \$200 million in revenue) have complex production and supply networks that often span the world. This arose from the increasing demand by automakers that their trusted suppliers go global with them – overstressing management capabilities and financial resources in some cases. Even with relatively small suppliers, a crisis can seldom be limited to one country or one customer.

OEM handling of past and future troubled supplier situations

Traditionally, the automakers take a very low profile in a supplier's crisis for as long as they can, and in some cases, have to deal with insolvency situations

The management of a supplier would do almost anything to continue providing output because it is the main source of cash, and disruptions would most likely have a negative impact on future relations with customers. The situation in an insolvency proceeding is dramatically different because administrators are subject to legal rulings and regulations, and disruptions in production are much more likely to occur (e.g., worker unrest and strikes, liquidity shortages, legal issues about proceedings in certain countries).

On the other hand, dealing with administrators is standard procedure within the automakers – but it is an expensive solution to deal with troubled suppliers.

For any insolvency case, costs, which mainly consist of pre-financing to assure the business runs smoothly after filing, loss-financing and high administration costs, often represent significant portions of the suppliers' annual revenue. But this is not the only burden to be shouldered by the customers in such a situation. Even in cases where investors are interested in the buyout of an insolvent company, concessions are asked from the customers in order to continue the business.

This established model faces major changes that are already challenging the industry.

The first drastic change occurred when private equity firms and hedge funds discovered automotive suppliers as desirable takeover targets. These players usually have neither a legacy with the company nor

any roots in the company's region, and this makes their dealings less predictable than traditional banking relationships. Even with local or regional suppliers it is increasingly common to find global financing with complex structures and several layers of debt that increase the chance for an out-of-court restructuring. But this approach also makes dealing with the situation much more complex and time-consuming.

Such out-of-court restructurings can only be achieved with automakers in a more active position – rather than the position of a “paying observer” that they take in the traditional process. Because big players on the other side of the negotiating table are already lined up, the automakers must bring their joint negotiating power to the table in order to succeed and positively influence the future of their troubled suppliers.

The second major trigger for change is the trend among the European and US automakers to move operations east. With operations and production shifting to Eastern Europe and Asia, a new set of suppliers is developing – with consequences on the supplier side. These include uncertain ownership structures and legal proceedings in crisis situations. For the risk-management functions at European and US-based automakers, this means an expansion of their work beyond traditional supplier bases.

How to deal with troubled suppliers in the future – main drivers for change

The so-called “Japanese model,” which means a much higher degree of cooperation between supplier and automakers and the resultant partnership-like relationships between customers and suppliers, is often discussed in Europe and the US. However, given the current competitive environment between automakers in many market segments and the erosion of margins, especially in the high-volume segment, a change in the relationship between suppliers and customers seems unlikely in the near future.

As a consequence, an improvement in the customer situation has to be achieved by an optimised dealing with the status quo. Among the steps that can be taken are:

1. Stronger focus on financials

Automaker purchasing departments are experts in evaluating supplier performance, but most audits and key performance indicators are centred on production and quality issues. With many supplier problems arising from financial issues like debt ratios, covenants and financing structures, it becomes apparent that the evaluation of suppliers must include their financial stability in order to get a complete picture of one's supplier base. Financial background checks become even more important if you are leaving your traditional supplier base and are in the process of building a supplier base farther east. These background checks should include the validity of the business plan (booked business vs. targets), the balance sheet and cash-flow projections, and ownership structures, especially in developing markets. For suppliers, this would mean greater openness with their customers than they are used to, but they could be rewarded by a more stable relationship and greater support should they encounter difficult times.

2. Level the playing field

In reality, all other stakeholders, like shareholders or lenders in a crisis situation, are usually better informed than customers, for a variety of reasons. These include the information rights of shareholders and lenders and the reluctance of suppliers to disclose information to their customers. It has become a custom in restructuring that virtually all constituents seek professional advice and form opinions about their positions and possible options. If customers adopt that practise in an early stage of a restructuring, the advantage of the other constituents will be reduced, and the customers will have an opportunity to influence the restructuring process in an early stage, without all relevant decisions (e.g., financing, operational restructuring, distressed M&A) already made. But, in order to establish such a position, it is necessary to recognize troubled suppliers in an early stage.

3. Get in early and be well informed

Establishing proactive supplier monitoring that focuses on financial and commercial topics, in addition to the traditional quality and production-driven concerns, is the first step in getting in early and becoming well informed. Financial monitoring has to include hard financial metrics like EBIT or EBITDA-details, as well as the financial structure (e.g., refinancing announcements or rumors about debt trading or covenant breaches), and ownership issues (e.g., buyout by private equity or hedge funds). All this information can be used to create a set of indicators. Guidelines are usually black and white, which means that as long as no insolvency has occurred, the options for support are limited. After insolvency, significant decisions can be made with almost breathtaking speed.

There are a number of areas where customers can support troubled suppliers, even non-financially. This could start with transparency about the business plan going forward, reconciling booked business and targets from the customer side with the sales assumptions of the supplier, and providing support from the automakers' in-house experts for process optimisation and cost-cutting. The better the information, the greater the chances of avoiding crisis situations with time pressure and exploding costs. However, this only works with streamlined decision-making processes and direct management involvement on the customers' side, because crisis situations are, by definition, volatile and necessitate swift and concise action from all stakeholders.

4. Bring power to the table

Strength in numbers brings leverage to the table and helps immensely when dealing with other parties in out-of-court restructuring situations. Being tough competitors in the market should not keep customers from working together to control damage and limit crisis situations. These situations become increasingly expensive when the customers do not appear as a united front. In most cases, it is a waste of time and resources to fight about the distribution of pain beyond simple metrics. In many distressed situations, information about margins and products of the supplier is wrong or imperfect,

and any decision based on this information, in an attempt to achieve a “fair” solution for all, is likely to fail.

5. The focus has to stay on solving the crisis, because any insolvency is much more expensive for everyone

Each troubled supplier case is unique, and in some cases, insolvencies cannot be avoided. But out-of-court restructurings can be a cheaper and better alternative for all stakeholders. One must not forget that the basis for a sustainable turnaround is always management of the supplier. When stakeholders believe management is capable of implementing a sustainable turnaround, plans for out-of-court restructuring can be agreed upon where the burden can be shared among all stakeholders.



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Maintaining a Tax-Efficient and Compliant Operating Model in an Evolving Automotive Industry

Driving Automotive Competitiveness through Global Operating Efficiencies

Today's surviving automotive groups are enterprises with global profiles that enable them to realize operating efficiencies not available to their ancestors – the smaller, more geographically localised companies of the past. Among the numerous efficiency initiatives being vigorously pursued to gain operational advantage are:

- (1) Expansion of automotive supply chains into lower-cost manufacturing jurisdictions
- (2) Consolidation of global support functions such as information technology, human resources and finance functions for greater cost efficiencies
- (3) Evolution of operating models into centrally managed business structures with control and oversight across multiple sources of supply and production

Realigning to Reduce Tax Exposures

As companies have rapidly evolved into these new global operating models, the tax structures that historically supported them have not always kept pace – resulting in a misalignment of the operating models and tax structures. The usual ramification of such a misalignment is that the dispersion of the multinational organisation's worldwide tax profitability (or loss), across the various jurisdictions where it does business, becomes inaccurately skewed. Mechanically, this occurs because intra-organisational transfer-pricing arrangements no longer reflect the economic substance of the organisation's operating model.

Consequently, new tax structures and pricing arrangements must be implemented to capture the changes and realign the operating and tax models. Failure to effectuate these realignments can expose companies to substantial tax, interest and penalty assessments imposed by taxing authorities in jurisdictions with a legitimate claim

to tax a greater portion of profitability than is otherwise reported. Conversely, if those modifications to operating models can be executed in thoughtful collaboration with the realignment of a company's tax structure and pricing arrangements, a foundation can be laid for decades of reduced tax costs – and corresponding improvement in competitive cost advantages.

Among the most common global operational changes in the automotive sector include the expansion of the automotive supply chain, the consolidation of support functions and the centralisation of business operating models. The following sections examine these changes and the potential tax exposures created when those changes occur without proper realignment of the tax structure.

Expansion of the Automotive Supply Chain

Similar to companies in many other industries, automotive companies have been forced by the global economy to frenetically seek sources of lower-cost supply from various geographies in order to remain competitive with peers that may already have gained access to those or similar channels. The search for capable and reliable sources of supply continues to proceed rapidly in Asia and Eastern Europe, with a slowing but continuing trend in Latin America.

Tapping into those low-cost supply sources involves a continuum of arrangements – from purchasing finished materials and components from local suppliers, to entering into contract manufacturing arrangements with local producers- or opening jointly- or wholly-owned manufacturing facilities that utilise the local low-cost labour force. Traditionally, many of these sourcing arrangements were entered into by an organisation for a single beneficiary, such as a manufacturing or assembly operation located in one jurisdiction. Today, as automotive companies design vehicle platforms with interchangeable parts and components, these sourcing activities usually benefit multiple operating units around the globe.

The tax structures of many companies have not maintained pace with the operational changes. As automotive companies dedicate more

resources to expand their supply chains into lower-cost jurisdictions for the benefit of the global organisation, tax exposure is created to the extent that those resources are not appropriately compensated by the benefiting parties.

For example, a purchasing team in Malaysia may be sourcing globally interchangeable components for inclusion in assembly operations in the US, Germany and Mexico. In such a case, the team in Malaysia is entitled to compensation for its efforts. The US, German, and Mexican operations are obligated to pay service fees to the Malaysian team for their work, and should receive a corresponding reduction to their in-country taxable income for the deductible payments. Depending on the extent of the activities, Malaysia may be able to tax that fee income. Failure to implement these arrangements will likely result in tax, interest and penalty assessments by Malaysian taxing authorities.

Corrections to these newly created misalignments are not complicated. They can, however, be difficult to implement as the entire organisation moves from local cost centres to global cost centres.

Consolidation of Support Functions

Similar to globalisation of the supply chain is a technology-enabled trend toward consolidation and globalisation of a multinational organisation's support functions. Many human resource, information technology and finance functions, for example, are being managed more cost effectively in a single location. This consolidation has generally not occurred overnight, but over time, as various modules of software infrastructure have been implemented and as redundant tasks have been consolidated or eliminated. The result has been a movement toward globally supportive functions often consolidated in the multinational organisation's headquarters location.

For tax purposes, many tasks that historically occurred in a headquarters location, but had some relationship to foreign operations, were treated as stewardship expenses – costs incurred by a parent company to oversee and direct its investments in subsidiary operations. Today, many foreign-related costs go well beyond stewardship and relate to globally centralised functions – and the beneficiaries of those functions need to pay a fee for the benefits they receive.

In the US, new tax regulations force greater scrutiny of these globally benefiting costs and require that a portion of them be charged

to the recipients of the services. Once again, global operating efficiencies are changing the tax structure paradigms. Determining the extent of the costs that must be charged out and to whom they should be allocated is no small task. Failure to comply, however, creates substantial exposure to significant tax, interest and penalty assessments by the jurisdiction seeking the income inclusion. Unfortunately, obtaining offsetting deductibility can be a major challenge, because taxing authorities in the paying jurisdictions seek to characterise the payments as reimbursements for stewardship costs, ultimately rendering them nondeductible.

Centralisation of Business Operating Models

Following the consolidation of support functions is a movement toward centralisation of an organisation's entire business or operating model. Today's major automotive groups are not simply multinational in presence and reach. They are striving towards integrated and centrally managed business functions, usually through regional or theatre-based models. Decision making and oversight of sales and marketing, procurement and supply chain, research and development, and other functions are becoming centralised into global or regional management teams to obtain efficiencies and synergies.

Normally accompanying an organisation's evolution or migration to a centralised business model is a geographic relocation of management functions and teams. Organisations that previously were run by multiple autonomous management teams centred locally on full-risk manufacturing or assembly operations are now run by robust regional headquarters teams that call the shots and synchronize the various local operations. Both tax and economic principles dictate that the entrepreneurial profitability of an organisation should reside where the mind and management of the organisational decision making occurs. Accordingly, residual profitability of an organisation should theoretically reside in the headquarters operation. Residual profitability is the organisation's total profit after paying for the performance of routine functions, use of assets and compensation for risks assumed by others.

This evolution toward centralising a business model has created an interesting challenge for tax professionals in many automotive organisations. As business models become centralised and decision-making consolidates geographically into a single location, economic principles should drive the tax structure to reflect greater profitability in

that centralised function. Practically, these adjustments have not been made. Companies with headquarters operations migrating centrally to the UK, for example, may have increased exposure to the argument by UK revenue authorities that this “entrepreneurial” income should be accounted for in the UK even if current transaction flows and transfer pricing arrangements fail to accomplish this alignment. To the extent that income is reported elsewhere under the current tax structure, the UK revenue authorities might successfully argue for increased tax assessments, interest and penalties.

Generating Tax Advantaging from the New Business Models

As companies execute various operating efficiency strategies with the corresponding requirements to realign taxable profits across different jurisdictions, the question arises whether those realignments can be implemented with more favourable tax consequences. Such a realignment could be accomplished if the taxable profits flow to less expensive taxing jurisdictions. Accordingly, as companies move to global or regional models, can they move functions, assets, decision making and risks to lower tax jurisdictions?

This long-term strategy, of course, is not a revelation either to tax executives nor to taxing authorities. Other industries – most prominently high-tech and pharmaceutical sector companies – have been relocating decision making, functions, risks and assets to the most advantageous low-tax jurisdictions for years. In the automotive sector, complex business models have historically prevented that. With the aforementioned move to global or regional operating models, however, such tax-advantaging strategies are, for the first time, becoming feasible.

Interestingly enough, given the profitability challenges faced by many automotive groups in recent times, the least likely jurisdictional candidates for migrating entrepreneurial profits become potential nominees. For US multinationals that have suffered many years of tax losses, the US becomes a low-tax jurisdiction because of the availability of tax loss carryforwards that can offset future taxable income. Accordingly, migrating entrepreneurial income to the US can actually result in significant tax savings for a number of years, while at the same time, aligning well with an operating model that is moving toward global functionality and is headquartered in the US. Other candidates for regionally focussed entrepreneur locations are such low-tax jurisdictions as Switzerland, Hong Kong and Singapore.

Resistance by Tax Authorities

Astute multinational taxpayers seeking to align with these tax structures run some risk of taxpayer “whipsaw.” While they are forced under transfer pricing rules throughout the world to realign their global tax profits to reflect the economic business models to which they have migrated – or face tax assessments, interest and penalties – there ironically may be a tax exit cost assessed on executing the required realignment necessitated by the business changes.

When assets are moved from one taxing jurisdiction to another, tax “exit” charges may be imposed on the appreciation attributable to those assets. Accordingly, movements of intangible property such as contracts, technology and other property rights can cause a tax charge. Historically, the movement of functions, risks and decision-making has not given rise to a taxable event. That may be changing. Authorities in jurisdictions such as Germany are seeking to impose tax charges on the transfer of economic value of the entire business – even if some of that value relates not just to assets, but also to service functions, risks or decision-making. The US Internal Revenue Service has recently taken a position that the transfer of a “workforce in place” from one legal entity to another can give rise to a taxable event.

With this resistance, caution must be exercised at every step of a business migration to ensure that unnecessary taxes are not triggered and to optimise the tax efficiency of a migration.

What is a Company to Do?

Just as legacy costs such as healthcare coverage for retired employees have had a crippling competitive effect on certain companies in the automotive sector, companies with inefficient or noncompliant tax structures could also suffer a long-term competitive disadvantage. Taxes on profitable companies with less favourable tax structures can siphon off as much as 40 percent or more of pre-tax earnings; more efficient companies could pay as little as half that cost. Those additional cash resources available to competitors allow them to better attract talent, invest in new engineering and design, or reduce product costs to customers.

Unfortunately, just as with legacy costs, not all companies are competing on the same playing field when it comes to opportunities to drive tax efficiencies. For example, US-based multinationals are subject to a

worldwide taxation system: All global profits that ultimately are returned to the US through dividend distributions are subject to a 35 percent rate of tax. In contrast, some non-US competitors may be headquartered in countries that follow a “territorial” tax system. Companies headquartered in those countries will not have the earnings of their foreign subsidiaries subject to incremental taxes beyond those assessed in the territories where they are generated. As a consequence, companies with identical global footprints, but with different headquarters locations, may end up with substantially different tax profiles and rates. This potential for disparity and its negative effect on the competitiveness of US companies has been recognized by the US government, which is studying reforms to make the US taxing regime more competitive for US-based companies. Much scepticism continues, however, as to whether any changes will ever be enacted since the dialogue in this area has taken place many times over many years.

Companies must endure the unfortunate frustration of feeling attacked and the natural inclination to hope that ignoring the tax challenge will somehow resolve it. Multinational organizations must be diligent in confronting the tax realignment issue, so as not to inadvertently relinquish the savings achievable from their global efficiency initiatives. In fact, the move toward a global operating paradigm may present a perfect catalyst for operational management and their tax executives to collaborate on a “go-forward” structure that can actually deliver a more favourable tax profile than the company has historically enjoyed. Such a synergistic result may ultimately contribute to the winning edge that every competitor in today’s automotive marketplace so desperately needs to stay in the race.



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Examining “J-SOX” and its Potential Effects on the Automotive Industry

In the past several years, improper practises have been observed concerning disclosures under the Securities and Exchange Law and, in particular, those included in annual reports. These cases may indicate that companies’ internal controls that ensure the reliability of corporate disclosure are not functioning effectively. In order to ensure reliability of disclosures, Japan’s Financial Instruments and Exchange Law, enacted in June 2006, requires the management of listed companies to assess internal controls over financial reporting (ICFR), and this assessment shall be audited by external auditors (so-called “J-SOX”). These requirements take effect in the fiscal year starting on or after April 1, 2008, and will affect how automakers and suppliers disclose information.

To assist management and auditors implementing these requirements, in February 2007, the Business Accounting Council issued “On the Setting of the Standards and Practice Standards for Management Assessment and Audit Concerning Internal Control over Financial Reporting (Council Opinions).” In the near future, the Japanese Institute of Certified Public Accountants and the Financial Services Agency are expected to issue practical guidance.

Because of the lack of current practical guidance concerning J-SOX, this article serves as our first look at the issue. We discuss J-SOX practise standards, in particular those that differ from Sarbanes-Oxley in the US and PCAOB Auditing Standard No.5, and outline the steps companies should take to determine the scope and execute an ICFR to help ensure compliance with Japan’s new law.

The criminal penalties promulgated by the Financial Instruments and Exchange Law are severe and emphasize the importance of compliance. For individuals, the submission of a false internal control report or nonsubmission of the report can result in imprisonment for up to five years and/or a fine of up to 5 million yen. For companies, the penalty is a fine of up to 500 million yen.

Also, for individuals, the submission of a false securities report can result in imprisonment for up to 10 years and/or a fine of up to 10 million yen. The penalty for companies is a fine of up to 700 million yen.

Overview of Practice Standards – Management Assessment

Although the Committee of Sponsoring Organisations (COSO) framework defines three objectives and five components of internal control, the framework of internal control under practise standards defines four objectives and six components – “safeguarding of assets” is added to objectives and “response to IT” is added to components.

Once the framework of internal control is established, the management of automotive companies must assess the effectiveness of internal controls over financial reporting. The “financial reporting” is external reporting of both 1) financial statements and 2) disclosure information and other information that could have a material effect on the reliability of financial statements. This differs from the requirement under US SOX. This second provision includes the following:

- Disclosure information provided as a summary, excerpt or breakdown, or by use of the amounts and values presented in, or notes to, the financial statements;
- Matters that are closely related to the decision of whether an entity is an affiliate, decision on the scope of consolidation or the necessity to apply the equity method, determination of whether a party is a related party and other decisions involved in preparing the financial statements;
- The assessment of ICFR should be performed on a consolidated basis. This means the automaker or supplier issuing the annual report, its subsidiaries and affiliates, under the equity method are subject to the determination of the scope.

Determining the Scope

Management needs to assess company-level controls and determine the business processes to be assessed. Management should assess company-level controls for all locations and business units, except for very small locations and business units, from a companywide

perspective. Also, the period-end financial process, from a companywide perspective, should be assessed in a similar manner as company-level controls.

There are several steps to determining which business processes should be assessed in terms of company-level controls. First, management should select significant locations and/or business units. Since automakers and suppliers often have numerous facilities, significant locations and business units are selected in descending order of sales (or other factors). One method would be to select locations until their combined amount reaches a certain ratio, such as two-thirds, of the consolidated sales.

Second, management should identify processes to be assessed. In significant locations and business units, all business processes relating to the accounts that are closely associated with the company's business objectives should be in scope. In the case of a manufacturing and sales company, business processes relating to sales, accounts receivable and inventories can be scoped in.

In addition, in significant and other locations and business units, management should add business processes relating to significant accounts involving estimates and management's judgment and those that are likely to have a significant effect on financial reporting.

The Process of ICFR Assessment

Assessing ICFR generally consists of four components: assessing company-level controls; assessing process-level controls; assessing information technology (IT) controls; and judging the internal controls' effectiveness.

Company-level controls are internal controls that have a pervasive impact on the company and cover the entire company group. The type of company-level controls varies depending on the business environment and characteristics, but practise standards listed up to 42 assessment items that would most likely be used as minimum items by management.

To evaluate process-level controls, management should understand the flow of transactions in business processes by using charts or diagrams, identifying risks of misstatements and related assertions, and identifying the key controls to mitigate the risks of misstatements.

Once the key controls are identified, management should assess design effectiveness and operating effectiveness of internal controls that are similar to the requirements under US SOX and related guidance. As listed in the practise standards, the procedures for assessing operating effectiveness include: review, inquiry, observation, examination and investigation of self-assessment.

When the testing is conducted on an interim date, management needs to perform update testing. Practise standards allows management to assess the prior year's operation of internal controls over the period-end financial reporting process with the condition that additional procedures are conducted for significant changes in the process.

The controls in period-end financial reporting processes that are appropriate to be assessed from a companywide viewpoint should be assessed in a manner analogous to that of company-level controls. However, other controls in the period-end financial reporting process should be assessed as specific business processes.

IT controls are categorized as general controls (ITGC) and application controls, and management should assess both types of controls. Management determines the scope of assessment by understanding IT infrastructure and identifying assessment units, and then assessing the effectiveness of design and operation of IT controls.

In principle, IT controls must be assessed every year. However, if an automated control was assessed in the previous period as operating effectively without control deficiencies, management may continuously use those results if the following conditions are met and recorded:

- No changes have been made to control since the last assessment.
- No failure or error has occurred.
- Related ITGC have been assessed and found to be designed appropriately and operating effectively.

Judging the Effectiveness of Internal Controls

The bottom line in determining deficiencies in company-level controls should be assessed by considering the likelihood of their causing material misstatements in the financial reports, as well as the deficiencies'

impact on process-level controls. The following examples represent deficiencies in company-level controls that may constitute a material weakness for automakers and suppliers:

- Risk assessment associated with reliability of financial reporting is not performed.
- The board of directors, corporate auditors or audit committee does not supervise, monitor or examine the design and operating effectiveness of internal controls for securing the reliability of financial reporting.
- It is not clear which department is responsible for assessing ICFR.
- Deficiencies in IT controls remain unimproved.
- The board of directors, corporate auditors or audit committee cannot supervise, monitor or examine the design and operating effectiveness due to the lack of records that document the design of internal controls.
- Deficiencies in company-level controls reported to management, the board of directors, corporate auditors or the audit committee are not remediated within a reasonable period of time.

For deficiencies in process-level controls, management should judge whether the deficiencies, individually or in combination with others, constitute material weakness. Management needs to consider quantitative impact of control deficiencies and the likelihood of occurrence of misstatements. Also, management needs to examine whether there are compensating controls and to what extent the compensating controls can reduce the likelihood of misstatements in accounts and quantitative impact.

When there are deficiencies in ITGCs, whether the objective of the reliability of financial reporting is achieved by alternative or compensating controls should be examined. Deficiencies in ITGCs may not immediately be determined to be material weaknesses because they are not directly related to misstatement risks, but they would impact the effective operation of IT application controls.

When there are deficiencies in IT application controls, their impact and likelihood of causing misstatements should be assessed, as is the case with deficiencies in process-level controls.

Performing ICFR Audits

The objective of an audit is to express opinions as to whether management's internal control report fairly states the results of the assessment, in all material respects, in accordance with generally accepted assessment standards for internal control. US SOX requires external auditors to adopt direct reporting, which is not performed in Japan. However, external auditors need to obtain sufficient competent audit evidence to form the basis for expressing their opinions in the internal control audit; to that extent, they shall obtain audit evidence directly from companies and others.

In order to perform an internal control audit effectively, external auditors must establish an audit plan, based on materiality, by considering the company's environment, business characteristics and other conditions, and fully understanding the status of the management's design, operation and assessment of internal controls.

Also, in order to verify the adequacy of the scope of assessment, external auditors must evaluate the reasonability of the methods and grounds used by management, and the auditors especially need to evaluate the reasons for exclusion of the scope.

When evaluating an internal control audit, three separate areas must be considered: assessing company-level controls; assessing process-level controls; and assessing IT controls.

For company-level controls, external auditors should evaluate the appropriateness of the assessment results of management by confirming the results for each assessment item and the grounds on which the results were obtained, and by reviewing the internal control records prepared by management. In this process, external auditors should evaluate monitoring functions performed by the board of directors and corporate auditors or the audit committee. After this process, external auditors should evaluate the deficiencies identified and verify the appropriateness of management's assessment.

For process-level controls, external auditors must evaluate the appropriateness of management's assessment. In the evaluation, external auditors must evaluate whether management has appropriately selected key controls, considered management's assessment of company-level controls and fully understood the company's business processes. Also, external auditors must fully evaluate the design and operation of key controls.

In the process of evaluating operation of key controls, external auditors should obtain the records on management's operation of internal controls. The auditors should then review relevant records, query appropriate personnel, and observe or watch appropriate managers or responsible personnel perform the procedures.

External auditors should obtain appropriate audit evidence by conducting tests using samples they select. To avoid inefficiency, external auditors may use samples selected by management as a part of the overall sample after evaluating their adequacy and verifying a portion of the results from tests conducted by management.

To evaluate the assessment of IT controls, external auditors should understand ITGCs and evaluate the appropriateness of management's assessment. Also, external auditors should evaluate the assessment of the design and operation of IT application controls.

Again, to supplement external auditors' samples, they may use samples chosen by management, provided those samples are evaluated for accuracy.

External auditors may also continuously use the assessment results of the previous year for IT-based automated controls with the same conditions.

Corporate Compliance

Though it is uncertain whether J-SOX regulations will have as far reaching an effect as Sarbanes-Oxley, it is clear Japan is serious about ensuring the reliability of corporate disclosure.



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Do Group Financial Communications Adequately Reflect Their Joint Venture Economic Performances?

To drive faster growth while reducing costs, automotive groups cooperate with each other and with industrial partners to jointly develop and produce vehicles or mechanical assemblies. Such agreements enable the partners to remain competitive, yet independent through sharing R&D costs and capital expenditures and leveraging additional economies of scale in production costs.

Joint venture agreements in the automotive industry potentially cover all areas: research and development, manufacturing, distribution, services and, in certain circumstances, financing. In a context of continual increases in investments, automotive players enter JV agreements to share costs but also to benefit from their partners' specific competencies.

JVs can also be key strategic alliances to help partners grow in emerging countries such as China, India, Russia or South Korea, where for cultural or legal reasons, a local partner is almost compulsory for foreign industrial groups to secure growth in domestic markets.

Joint venture: a key element of automotive groups financial communication

The accounting treatment of JVs in consolidated financial statements depends on the assessment of actual control. When partners exercise only a significant influence on JVs, economic performances of the JV are reflected in a single caption - "share in net results of companies at equity" - of the partner consolidated statement of income. This caption appears below key financial indicators such as sales, gross margin or operating margin, and, therefore, JV performance cannot easily be analysed as part of the total activities performances.

In addition, most automotive groups apply the IAS 31 option, which permits the equity method of accounting as an allowed alternative treatment for jointly controlled entities - a minority of automotive groups use the proportionate method of consolidation. As a consequence, reporting by an investor in a joint venture may be significantly different depending on which alternative is selected under IAS 31. (See Table 1)

So far, this issue has not been deemed as material by most automotive groups that have not systematically disclosed JV key performance indicators in the notes to their financial statements. However, during group financial presentations to analysts, an increasing number of questions relate to JV agreements, which analysts see as indicators of automotive groups' growth capacity.

In this context, the possibility that - as part of the convergence project with US GAAP - the IASB might decide to remove the option of proportional consolidation for jointly controlled entities would be a genuine opportunity for automotive groups. They could revisit the nature and the quantity of information they disclose in the notes to their consolidated financial statements and add a more comprehensive view of sales and margins of companies consolidated under the equity method. (See Table 2)

In order to better reflect JV activities in their IFRS financial communication, and to meet financial analysts' and investors' expectations, automotive groups could further improve the quality of the notes to their consolidated financial statements, adding indicators such as:

- "Pro forma" consolidated statement of income and balance sheet reflecting JV activities as if they were proportionately consolidated.
- Total operating margin of all companies accounted for using the equity method, whether they relate to manufacturing or sales activities.

In addition to the information disclosed in the notes to their financial statements, groups sometimes provide further details on JV activities in their activity reports or during financial presentations to analysts. Groups could improve their financial communication by gathering all this information in the notes to their financial statements.

Some key automotive players' practises regarding proportionate accounting and the weight of companies accounted for at equity in their respective consolidated financial statements are summarised in the table below:

Table 1

Numbers expressed in M€ (2006)	PSA	Renault	Fiat	VW	Porsche	BMW	Volvo	Bosch	Valeo	Faurecia	Toyota	Honda	GM	Ford	Michelin
Use of the proportionate method of consolidation in IFRS books	No	Yes	No	No	No	No	Yes	Yes (**)	Yes (**)	No	N/A	N/A	N/A	N/A	No
Investments in companies accounted for by the equity method	596	12,943 o/w: Nissan (10,715) Volvo (2,087)	1,719	6,876	3,264 (VW)	60	766	-	103	40	11,599	2,611	5,700 (GMAC)	2,111	71
Share in net results of companies at equity	13	2,260 o/w: Nissan (1,871) Volvo (384)	125	373	203 (VW)	(25)	7	-	-	4	1,047	634	139 (includes minority interests)	319	4
Share in net results of companies at equity (in percent of consolidated net income)	21 percent (*)	76,8 percent	10,9 percent	13,6 percent	14,6 percent	0,9 percent	0,4 percent	-	-	0,9 percent	12 percent	16,7 percent	9,3 percent	3,4 percent	0,7 percent

(*) To be compared with PSA 2006 net income of M€ 63

(**) As of December 31, 2006, the impacts of proportionate consolidation on groups' consolidated statements of income and balance sheets are disclosed as follows in Bosch and Valeo notes to the consolidated financial statements:

Numbers expressed in M€ (2006)	Bosch	Valeo
Current assets	2,241	101
Non-current assets	1,405	70
Current liabilities	1,297	88
Non-current liabilities	1,235	12

A benchmark analysis of information disclosed by some automotive players in the notes to their consolidated financial statements is summarized in the table below:

Table 2

	PSA	Renault	Fiat	VW	Porsche	BMW	Volvo	Bosch	Valeo	Faurecia	Toyota	Honda	GM	Ford	Michelin
Information by company															
Name of main companies	X	X	X		X		X		X	X	X	X	X		X
Share of equity by company	X	X	X							X					
Share of net income by company	X	X													
Share in net assets by company	X														
Capital employed by company	X														
Total assets by company															
Other information															
Total income				X	X	X			X		X	X			X
Total expenses				X	X	X									
Total gross profit											X				
Total net income											X	X			X
Sales by company		X													
Total assets									X						X
Total non-current assets				X	X	X				X	X	X			
Total PP&E	X														
Total capital expenditure	X														
Total working capital	X														

	PSA	Renault	Fiat	VW	Porsche	BMW	Volvo	Bosch	Valeo	Faurecia	Toyota	Honda	GM	Ford	Michelin	
Other information (continued)																
Total current assets				X	X	X				X	X	X				
Total cash and cash equivalents										X						
Total equity						X				X	X	X				
Total liabilities									X							X
Total non-current liabilities				X	X	X				X	X	X				
Total long and medium term debt	X															
Total other financial items	X															
Total current liabilities				X	X	X				X	X	X				

Automotive groups could also reinforce the level of information regarding JVS provided in their activity reports, with further indicators in the areas of production (e.g., production capacities, percentage of local integration) and sales (e.g., market share, volumes) communicated to the market.

In thinking about this matter, automotive groups will have to consider how they will apply the new standard IFRS 8, covering segment reporting and applicable for annual periods beginning on or after 1 January 2009, with earlier application permitted. Under this standard, financial information must be reported on the basis that it is used internally for evaluating operating segment performance. This may lead automotive companies to provide management “non-GAAP” financial information where JVs’ economic performances are reflected in further details rather than in the single caption “share in net results of companies at equity,” where they are currently being reduced.

The following paragraphs highlight the illustrative disclosures used by several entities in the automotive industry.

Illustrative disclosures

PSA Peugeot-Citroën

“...Companies in which Peugeot S.A. directly or indirectly exercises joint control or significant influence over operating and financial policies are included in the consolidated financial statements using the equity method.”

Renault

“...The consolidated financial statements include the financial statements of all companies controlled exclusively, directly or indirectly, by the Group (“subsidiaries”). Jointly controlled companies (“joint ventures”) are proportionately consolidated. Companies in which the Group exercises significant influence (“associates”) are included in the financial statements on an equity basis.”

Fiat

“...Jointly controlled entities are enterprises over whose activities the Group has joint control, as defined in IAS 31 – Interests in Joint Ventures. The consolidated financial statements include the Group’s share of the earnings of jointly controlled entities using the equity method, from the date that joint control commences until the date that joint control ceases. Associates are enterprises over which the Group has significant influence, but no control or joint control, over the financial and operating policies, as defined in IAS 28 – Investments in Associates. The consolidated financial statements include the Group’s share of the earnings of associates using the equity method.”

Volkswagen

“...Companies where Volkswagen AG is able, directly or indirectly, to significantly influence financial and operating policy decisions (associates), as well as joint ventures, are accounted for using the equity method. Insignificant companies are carried at cost. Joint ventures also include companies in which the Volkswagen Group holds the majority of voting rights, but whose articles of association or partnership agreements stipulate that important decisions may only be resolved unanimously (minority protection).”

BMW

“...The BMW Group financial statements include, besides BMW AG, all material subsidiaries, 17 special securities funds and 19 trusts (almost all used for asset backed financing transactions) both in Germany and abroad.... 68 subsidiaries (in 2005, 72), either dormant or generating a negligible volume of business, are not included. Their influence on the Group’s earnings, financial and net assets position is immaterial. Non-inclusion of operating subsidiaries reduces total Group revenues by 1.5 percent (in 2005, 1.7 percent). Two joint ventures have been consolidated using the equity method.”

Porsche

"...The consolidated financial statements of Porsche AG include all entities in which Porsche AG has the power to govern the financial and operating policies, either directly or indirectly control.... The equity method is used for investments on which Porsche AG can exercise significant influence. This assumed to be the case when between 20 and 50 percent of the voting rights are held."

Bosch

"...Joint ventures as defined by IAS 31 Interests in Joint Ventures are consolidated proportionately. Pursuant to IAS 28 Investments in Associates, investments are included in consolidation using the equity method if significant influence can be exercised. At present, no entity has been accounted for using the equity method."

Volvo

"...Joint ventures are reported by use of the proportionate method of consolidation. Holdings in associated companies are reported in accordance with the equity method."

Valeo

"...The proportionate consolidation method is used when the contractual arrangements for control of a company specify that it is under the joint control of the two venturers. Companies of this type are called joint ventures. In this case, the Group's share of each asset and liability and each item income and expense is aggregated, line-by-line, with similar items in its consolidated financial statements."

Faurecia

"...Subsidiaries controlled by the Group are fully consolidated. Control is presumed to exist where the Group holds over 50 percent of a company's voting rights, and may also arise as a result of shareholders' agreements. Companies that are between 20 percent- and 50 percent-owned are carried at equity when the Group exercises significant influence."

Toyota

"...The consolidated financial statements include the accounts of the parent company and those of its majority-owned subsidiary companies. All significant inter-company transactions and accounts have been eliminated. Investments in affiliated companies in which Toyota exercises significant influence, but which it does not control, are stated at cost plus equity in undistributed earnings. Consolidated net income includes Toyota's equity in current earnings of such companies, after elimination of unrealized inter-company profits. Investments in non-public companies in which Toyota does not exercise significant influence (generally less than a 20 percent ownership interest) are stated at cost. The accounts of variable interest entities as defined by the Financial Accounting Standard Board ("FASB") Interpretation No. 46(R) Consolidation of Variable Interest Entities (revised December 2003) - an interpretation of ARB No.51 ("FIN 46(R)") are included in the consolidated financial statements, if applicable."

Honda

"...The consolidated financial statements include the accounts of the Company, its subsidiaries and those variable interest entities where the Company is the primary beneficiary under FASB Interpretation No.46 (revised December 2003), "Consolidation of Variable Interest Entities". All significant inter-company balances and transactions have been eliminated in consolidation. Investments in affiliates in which the Company has the ability to exercise significant influence over their operating and financial policies, but where the Company does not have a controlling financial interest are accounted for using the equity method. "

General Motors

“...The consolidated financial statements include the accounts of General Motors Corporation and its subsidiaries that are more than 50 percent owned. In addition, in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 46(R), “Consolidation of Variable Interest Entities, an interpretation of ARB No. 51” (FIN 46(R)), GM consolidates variable interest entities (VIEs) for which it is deemed to be the primary beneficiary. GM’s share of earnings or losses of investees is included in the consolidated operating results using the equity method of accounting, when GM is able to exercise significant influence over the operating and financial decisions of the investee. If GM is not able to exercise significant influence over the operating and financial decisions of the investee, the cost method of accounting is used.”

Ford

“...Our financial statements include consolidated majority-owned subsidiaries and consolidated variable interest entities (“VIEs”) of which we are the primary beneficiary. Affiliates that we do not consolidate, but over whose operating and financial policies we have significant influence, are accounted for using the equity method.”

Michelin

“...Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding between 20 percent and 50 percent of the voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognized at cost.... Joint ventures are entities over whose activities the Group has joint control, established by contractual agreement. Investments in joint ventures are accounted for by the equity method of accounting as described in the Associates section above.”



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Why the Automotive Industry Must Fight Corruption

As growth of the US domestic auto market slows, US auto manufacturers and suppliers are expanding their business dealings overseas into lower cost and more lucrative growth markets. Auto market growth in emerging markets is also driving non-US auto manufacturers and suppliers out of their home countries for better deals, so the trend to leave home is global. As these companies enter into strategic sourcing, M&A and joint-venture agreements, exposure to corrupt foreign officials seeking bribes to facilitate deals has become a flashpoint of concern.

Compounding this problem, in some countries, the bribery of foreign officials (see Table 1), in an attempt to obtain or retain business, is often the status quo and merely a cost of doing business. In fact, more than \$1 trillion is paid in bribes worldwide annually.

What US auto manufacturers and suppliers may or may not know is that the US Department of Justice (DOJ) and the Securities and Exchange Commission (SEC), have increased efforts to strictly enforce the Foreign Corrupt Practices Act (FCPA) of 1977 and fines have reached an all-time high. Also, to track down offenders, the SEC and DOJ increasingly solicit the help of the Federal Bureau of Investigation (FBI).

To put the current US situation in context, the FCPA states, "It is a crime for any US person or company (includes subsidiaries, agents, partners and consultants) to directly or indirectly pay or promise anything of value to any foreign official to obtain or retain any improper advantage." "Anything of value," under the FCPA rules, includes cash, gifts, services, and travel or business opportunities.

In the last several years, other countries have followed the example set by the US and, today, a strong global movement against corruption exists. In addition to the US enforcement of the FCPA, other countries, such as Germany, have adopted companion laws and are pursuing companies involved in similar illegal activities. The Group on Bribery of the Paris-based *Organization for Economic Co-operation and Development*, which "brings together the governments of countries committed to democracy and the market economy ..." wrote its Convention on Combating Bribery of Foreign Public Officials in International Business Transactions that was ratified by the following 37 countries:

Argentina	Germany	Poland
Australia	Greece	Portugal
Austria	Hungary	Slovak Republic
Belgium	Iceland	Slovenia
Brazil	Ireland	South Africa
Bulgaria	Italy	Spain
Canada	Japan	Sweden
Chile	Korea	Switzerland
Czech Republic	Luxembourg	Turkey
Denmark	Mexico	United Kingdom
Estonia	Netherlands	United States
Finland	New Zealand	
France	Norway	

Source: www.oecd.org (cf. *Anti-bribery Convention page*)

Table 1 - Know your foreign officials

Classification of foreign officials under the FCPA:

Political party candidates and employees

Government employees

Employees of government-owned companies

Employees of public international organisations

Others working in "official" capacities

The frequency of FCPA enforcement has come about because of several factors:

- More expansive interpretation of statutory language
- Increased scrutiny of the acts of others (parent companies held responsible for the acts of their subsidiary companies, increased liability for acts of distributors and prosecution of individual employees)
- Increased globalisation
- Cooperation between the DOJ and the enforcement agencies of other countries

How the Securities Exchange Act of 1934, the Alternative Fines Act and Racketeer Influenced and Corrupt Organizations Act Affect the FCPA

The Securities Exchange Act of 1934, the Alternative Fines Act and the Racketeer Influenced and Corrupt Organizations (RICO) Act all affect FCPA prosecutions. The Exchange Act imposes on SEC issuers requirements for maintaining accurate books and records and sufficient accounting and internal controls (refer to sections 13(b)(2)(B) and 13(b)(2)(A) of the Exchange Act): “Devise and maintain a system of internal accounting controls sufficient to provide reasonable assurance that transactions are recorded appropriately and in accordance with rules and regulations” and “Make and keep books, records and accounts, which in reasonable detail, accurately reflect the transactions and dispositions of assets.” Under the Alternative Fines Act, the actual fine could be twice the gross gain sought. Similarly, a violation of the FCPA can give rise to actions brought by private parties under the RICO Act, which can triple damages. In addition, FCPA violations can result in a company being prohibited from doing business with the US government or the loss of a company’s export license(s).

What is at Stake

Aside from the threat of financial and licensure penalties that may be imposed for breaching FCPA rules (see Table 2), automotive companies and suppliers can be globally embarrassed, operations may be disrupted and their reputations tarnished. High costs are also associated with investigating actual and potential violations and responding to regulatory inquiries. In certain situations, penalties require that a third party be designated as a compliance monitor to oversee remediation between the offending company and the DOJ or SEC.

In one recent case, a company was forced to grapple with an FCPA breach in which the parent was responsible for the actions of its subsidiaries. The company provided products and services both in the US and, through some of its subsidiaries, abroad. The SEC alleged that, over the course of approximately 17 years, several of the company’s foreign subsidiaries made illicit payments totalling several hundred thousand dollars to doctors. These doctors were employed by hospitals in under the control of foreign authorities. The SEC said that the company violated the FCPA’s anti-bribery provisions because the payments were made in order to influence the doctors’ decisions

so the company could obtain or retain business with them and the government-controlled hospitals at which they worked.

The SEC maintained that “payment of these referral fees was known to and approved by (the company’s) founder and chairman of the board, among others,” at both the company and one of its foreign subsidiaries. The company settled with the SEC.

Table 2 - FCPA Sanctions and Penalties

Under anti-bribery provisions:

\$100,000 and/or five years imprisonment for individuals and \$2,000,000 for corporations

\$10,000 civil penalty for both individuals and corporations

Fines imposed on individuals may not be paid by their employers or principals

Under the books and records provisions:

US \$5M and/or 20 years imprisonment for employees and US \$25M for corporations (“knowingly” violations)

Red Flags that Indicate Potential Trouble

As auto manufacturers and suppliers move to new markets, they cannot ignore potential risks that these moves can create. They must be aware of “red-flag” countries as well as specific situations that may indicate trouble. To aid in identifying high-risk countries, *Transparency International* publishes the Corruption Perceptions Index (CPI), an index of the perceived level of corruption in countries around the world (See Table 4). The 2006 CPI score relates to perceptions of the degree of corruption as seen by business people and country analysts, and ranges from 0 (highly corrupt) to 10 (highly clean).

Companies sometimes use the CPI index as a benchmark to determine how to approach a new market. It helps them pinpoint the questions they need to ask. For example, “Do we perform sufficient due diligence when we enter into agreements with third parties in this market?”

Other “red flag” indicators of possible trouble:

- State-owned entities
- Excessive compensations/commissions

- Increased compensation during the bid process
- Payments to agents or third parties
- Payments in cash or other bearer instruments
- Payments to P.O. boxes
- Use of a client-mandated third party
- Third-party payments to accounts outside the country of business
- Payments made outside of third-party agreements
- Third-party agreements that lack FCPA and anti-bribery/anti-corruption provisions and representations

Be aware that there may be a higher level of corruption when the local government has a significant share of GNP. In addition, inequality in the distribution of income in certain areas may correspond with increased bribes and other illegal forms of income distribution.

Table 3 - 2006 TI Corruption Perceptions Index (CPI)

Rank	Top 15 Most Corrupt Nations	Top 15 Least Corrupt Nations
1	Haiti	Finland
2	Myanmar	Iceland
3	Iraq	New Zealand
4	Guinea	Denmark
5	Sudan	Singapore
6	Congo, Democratic Rep.	Sweden
7	Chad	Switzerland
8	Bangladesh	Norway
9	Uzbekistan	Australia
10	Equatorial Guinea	Netherlands
11	Côte d'Ivoire	Austria
12	Cambodia	Luxembourg
13	Belarus	United Kingdom
14	Turkmenistan	Canada
15	Tajikistan	Hong Kong

Source: Transparency International

What US Companies Can Do

The ultimate bearers of risk for auto manufacturers and suppliers are their CFOs, CEOs and directors. Although it is difficult for them to know the details of day-to-day operations in every corner of the world, they still maintain responsibility and will be held accountable for global compliance breaches. Sarbanes-Oxley raised the stakes for noncompliance. Section 302 requires CEOs and CFOs to *personally* sign off on the accuracy of financial statements, and Section 404 requires top executives to certify the adequacy of internal controls over financial reporting.

Here is the key to reducing risk: establish, maintain, and enforce effective global compliance programs. As automotive manufacturers and suppliers venture outside their home countries to make strategic deals, particularly in high-risk areas, they also need to consider risk reduction while maintaining focus on the price and quality of a as well as the efficiency of the supply chain.

With effective risk controls in place, auto manufacturers and suppliers can stay ahead of potential hazards. Yet, the potential for trouble is mounting. In fact, even individual employees who act improperly can expect large fines and possible prison terms (see Table 2).

We have routinely observed that in instances of compliance breaches, the SEC and the DOJ both require the establishment of compliance programs in addition to the payment of fines by the offending companies. The government's fining and sentencing structures take into account self-policing, self-reporting remediation and cooperation. Establishing compliance programs before there is a compelling need to do so will also help mitigate future punitive actions.

Today's Compliance Watchword Is Proactivity

Both the DOJ and the SEC have very high expectations, and auto manufacturers and suppliers should demonstrate proactive and robust compliance control programs. These controls must be understood by:

- Management of foreign operations
- Employees
- Agents

Training must be created to support these controls and the system must be reinforced on an ongoing basis. Even if companies do not have problems now, problems may surface if they expand into new markets.

Through the use of periodic internal audits, a company can cut back on unnecessary exposure to red-flag situations. For example, a company can appoint an FCPA compliance officer who will strongly address policy violations and insist on full disclosure of all misconduct and any control weaknesses. Help lines should be available to employees so concerns can be addressed before they evolve into more complex problems.

Further, methods for screening a company's agents, consultants and business partners should be designed, and due diligence should be carried out to eliminate problems before they begin. Ethics statements should be signed by all parties to a deal, and the statements should include separately signed anti-bribery clauses. Businesses must treat adherence to ethics and compliance policies as a strategic competitive advantage, with the goal of -maintaining a zero-tolerance policy towards misconduct.

Appropriate monitoring includes taking a hard look at each transaction to gain an understanding of the deal partner. Is the deal partner government-owned, and what type of compliance has it set up in terms of doing business with foreign officials? These types of questions must be answered before transactions are finalized. It is also important to have business unit or divisional leaders submit confirmations of compliance. Finally, periodic checks of the effectiveness of company controls through independent reviews of organisational compliance policies and procedures are essential.

With strong controls in place, the DOJ and SEC will tend to look more favourably upon a company if an FCPA violation occurs. They want evidence of a good faith effort to avoid potential problems.

A Look Forward

As automotive manufacturers and suppliers continue to expand their global reach, maintaining strong corrupt-practices controls will allow them to venture into foreign markets with a reduced risk of compliance problems. These controls could potentially save companies millions of dollars in penalties, preserve their global reputations, and help them maintain a competitive advantage.

Over time, international deals will automatically include compliance controls, and potential partners will know what they must do to strike a deal with a compliance-driven company. It is a new global business environment and necessity is the mother of risk-resistance.



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By the Numbers

This section provides an analysis of two segments of the automotive supply chain, Vehicle Manufacturers and Tier I or II Suppliers and a graphical comparison of financial operating ratios that are key components in the quest for value creation in the automotive industry.

The ratios reported in this section include the following:

Net income margin

One of the most critical performance metrics in the automotive industry is net income margin — a company's net income as a percent of total revenue.

Gross profit margin

Another key performance metric in the automotive industry is gross profit margin, which is gross profit (revenues less cost of goods sold) as a percent of total revenue.

Capital expenditures as a percent of total revenue

Capital reinvestment is essential for long - term success and is directly correlated to revenue growth. Therefore, capital expenditures as a percent of total revenue for each automotive company have been computed.

Research and development expenditures as a percent of total revenue

New product design and introduction are important elements in the quest for increased marketshare. A good measure of potential future product innovation is research and development expenditures as a percent of total revenue.

Revenue per vehicle / employee

Operational efficiency and productivity — a major priority in the automotive industry — can be measured in a number of ways. For the purpose of this review, we have quantified total revenue on a per vehicle basis for the vehicle manufacturers and on a per employee basis for the suppliers.

Return on assets

Asset utilisation can be measured by dividing net income by total assets to determine return on assets (ROA). Automotive companies typically require a large asset base in order to operate competitively, resulting in a low ROA compared with other industries.

Return on net assets

An increasingly popular measure of asset utilisation which also accounts for the company's liabilities is return on net assets, which is calculated by dividing net income by net assets (total assets minus total liabilities).

Working capital ratio

Working capital is an important metric for all industries, but especially for the cyclical automotive industry. For purposes of this review, we have calculated working capital ratios by dividing total current assets by total current liabilities.

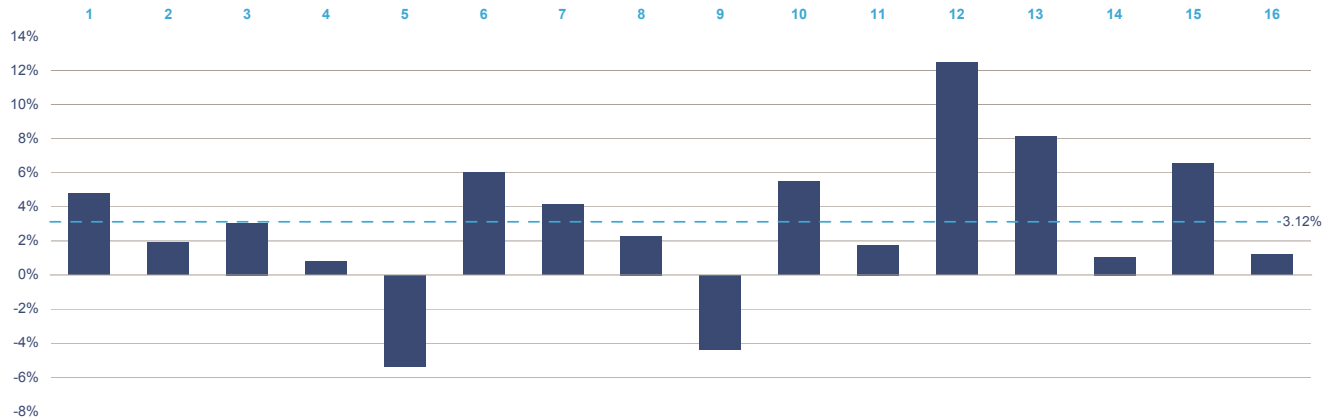
Leverage ratio

This popular measure of a company's ability to service its debt is calculated by dividing net debt (debt less cash) by EBITDA.

Suzuki Motor Corporation is not included in the 2007 Global Automotive Financial Review because of incomplete financial information at time of publishing.

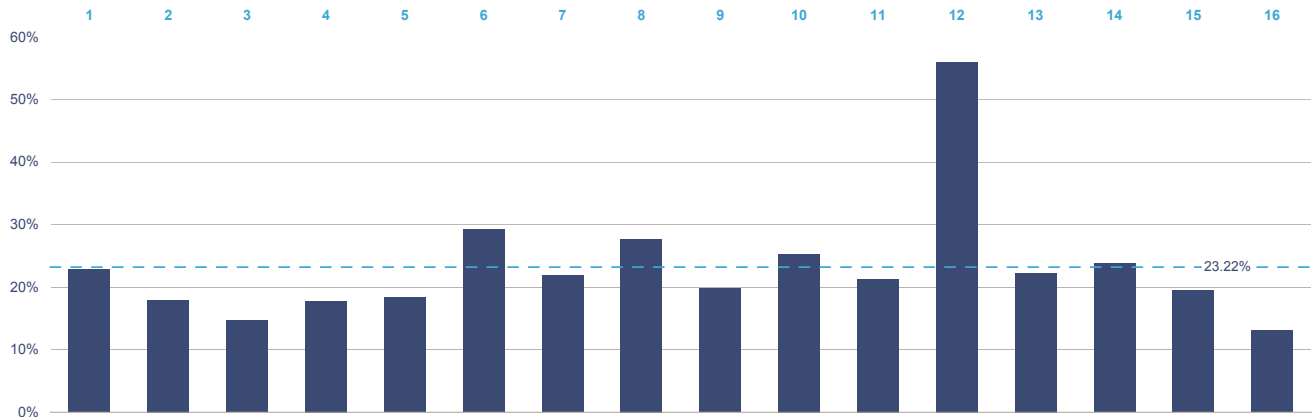
Vehicle manufacturer net income margin

Vehicle manufacturer return on net assets ranged from -5.35% to 12.45% and averaged 3.12%.



Vehicle manufacturer gross profit margin

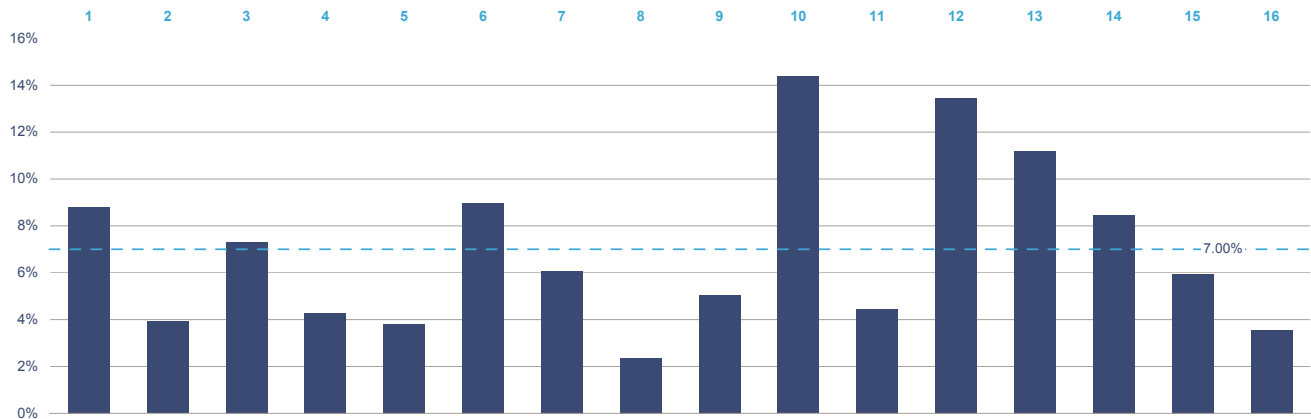
Vehicle manufacturer gross profit margin ranged from 13.05% to 56.08% and averaged 23.22%.



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| 1 BMW Group | 5 General Motors | 9 Mitsubishi Motors Corporation | 12 Porsche AG | 15 Toyota Motor Corporation |
| 2 DaimlerChrysler AG | 6 Honda Motor Company | 10 Nissan Motor Company | 13 Renault SA | 16 Volkswagen AG |
| 3 FIAT SpA | 7 Hyundai Motor Company | 11 Peugeot Citroen SA | 14 Subaru - Fuji Heavy Industries | |
| 4 Ford Motor Company | 8 Mazda Motor Corporation | | | |

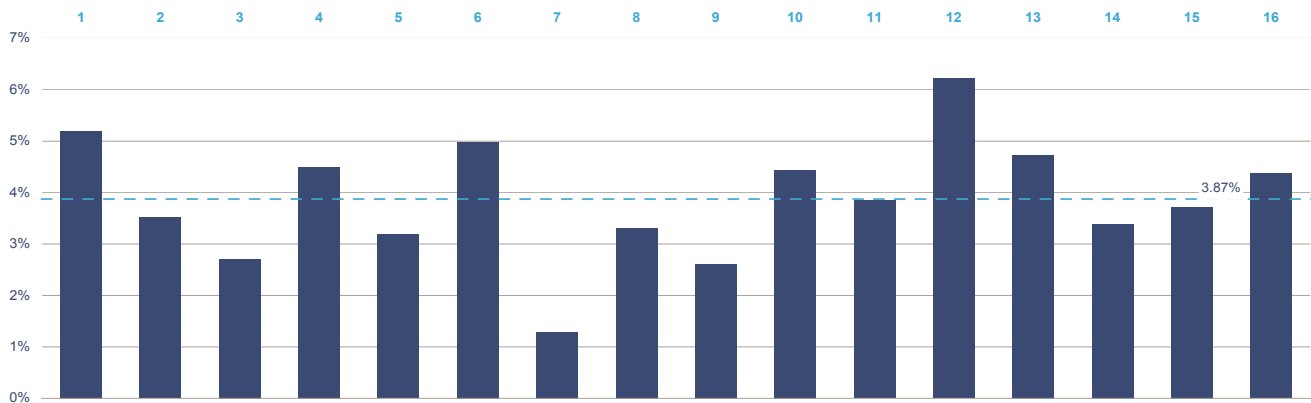
Vehicle manufacturer capital expenditures as a percent of total revenue

Vehicle manufacturer capital expenditures as a percent of total revenue ranged from 2.38% to 14.37% and averaged 7.00%.



Vehicle manufacturer research and development as a percent of total revenue

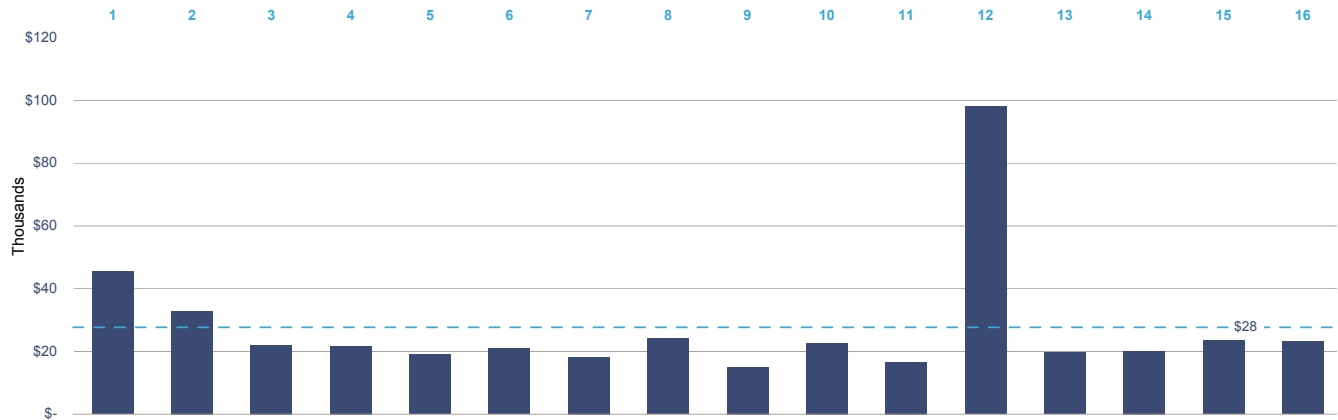
Vehicle manufacturer research and development expenditures as a percent of total revenue ranged from 1.30% to 6.22% and averaged 3.87%.



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| 1 BMW Group | 5 General Motors | 9 Mitsubishi Motors Corporation | 12 Porsche AG | 15 Toyota Motor Corporation |
| 2 DaimlerChrysler AG | 6 Honda Motor Company | 10 Nissan Motor Company | 13 Renault SA | 16 Volkswagen AG |
| 3 FIAT SpA | 7 Hyundai Motor Company | 11 Peugeot Citroen SA | 14 Subaru - Fuji Heavy Industries | |
| 4 Ford Motor Company | 8 Mazda Motor Corporation | | | |

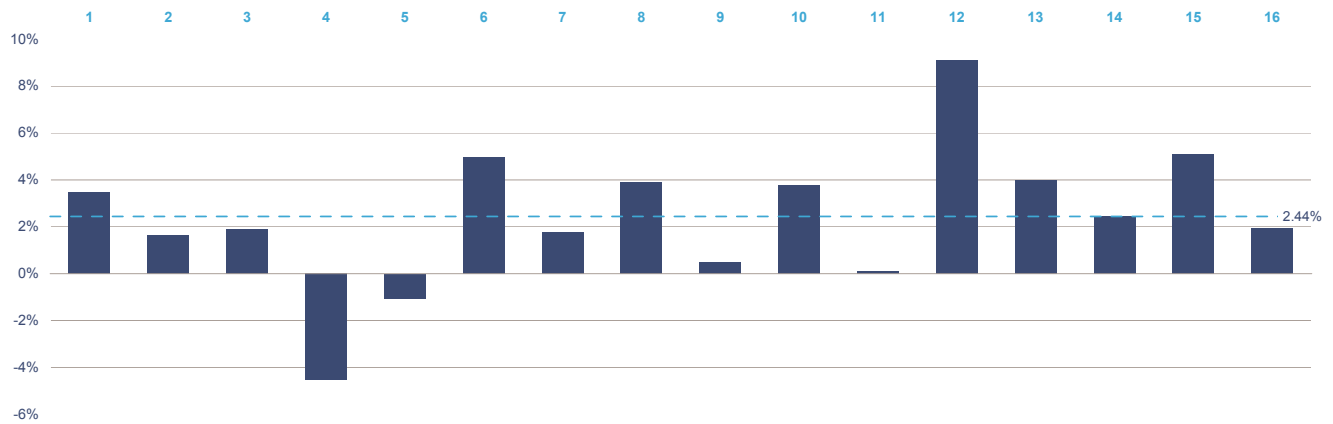
Vehicle manufacturer revenue per vehicle

Vehicle manufacturer revenue per vehicle ranged from \$14,976 to \$98,136 and averaged \$27,696.



Vehicle manufacturer return on assets

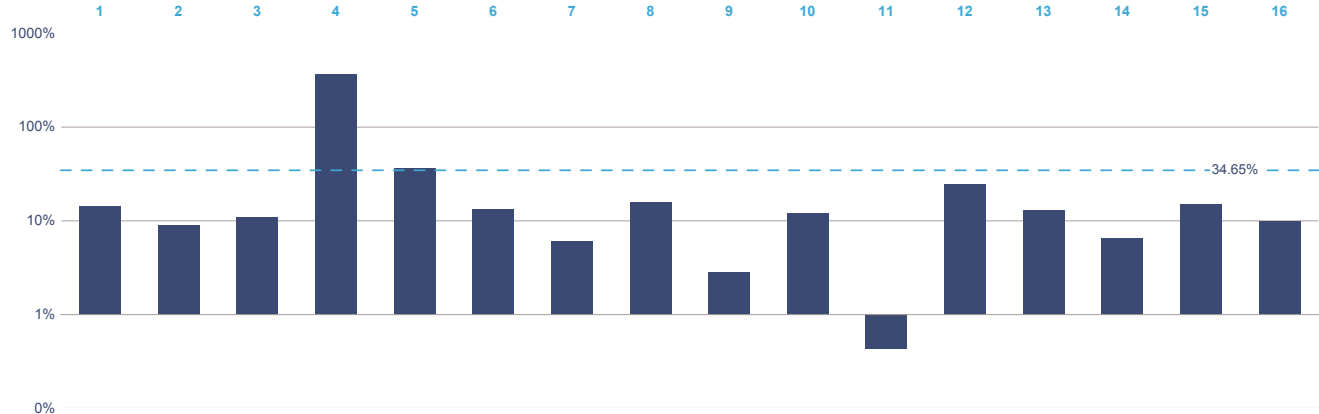
Vehicle manufacturer return on assets ranged from -4.53% to 9.12% and averaged 2.44%.



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|----------------------|---------------------------|---------------------------------|-----------------------------------|-----------------------------|
| 1 BMW Group | 5 General Motors | 9 Mitsubishi Motors Corporation | 12 Porsche AG | 15 Toyota Motor Corporation |
| 2 DaimlerChrysler AG | 6 Honda Motor Company | 10 Nissan Motor Company | 13 Renault SA | 16 Volkswagen AG |
| 3 FIAT SpA | 7 Hyundai Motor Company | 11 Peugeot Citroen SA | 14 Subaru - Fuji Heavy Industries | |
| 4 Ford Motor Company | 8 Mazda Motor Corporation | | | |

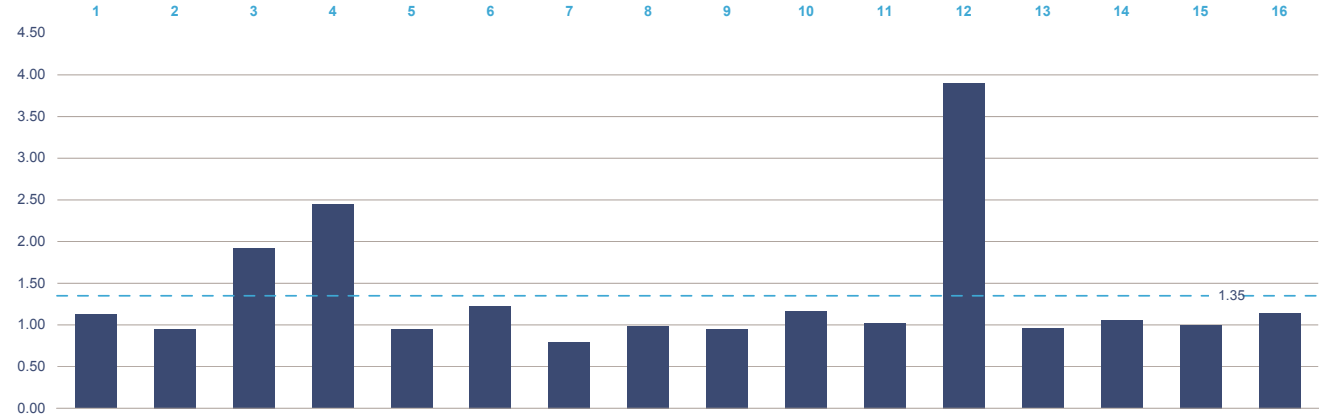
Vehicle manufacturer return on net assets

Vehicle manufacturer return on net assets ranged from 0.43% to 364.01% and averaged 34.65%.



Working manufacturer capital ratio

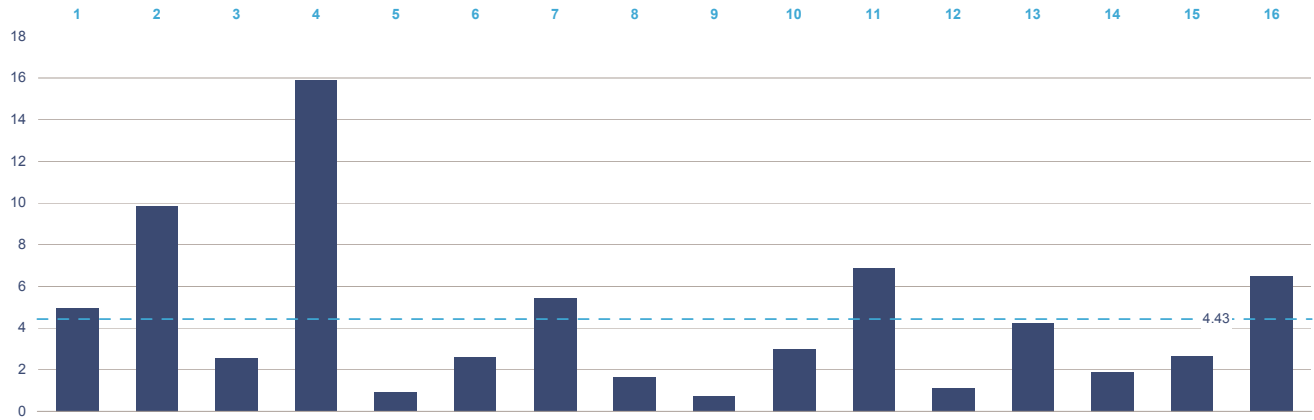
Working capital ratios ranged from 0.79 to 3.90 and averaged 1.35.



- 1 BMW Group
- 2 DaimlerChrysler AG
- 3 FIAT SpA
- 4 Ford Motor Company
- 5 General Motors
- 6 Honda Motor Company
- 7 Hyundai Motor Company
- 8 Mazda Motor Corporation
- 9 Mitsubishi Motors Corporation
- 10 Nissan Motor Company
- 11 Peugeot Citroen SA
- 12 Porsche AG
- 13 Renault SA
- 14 Subaru - Fuji Heavy Industries
- 15 Toyota Motor Corporation
- 16 Volkswagen AG

Vehicle manufacturer leverage ratio

Vehicle manufacturer leverage ratios ranged from 0.75 to 15.88 and averaged 4.43.



- 1 BMW Group
- 2 DaimlerChrysler AG
- 3 FIAT SpA
- 4 Ford Motor Company

- 5 General Motors
- 6 Honda Motor Company
- 7 Hyundai Motor Company
- 8 Mazda Motor Corporation

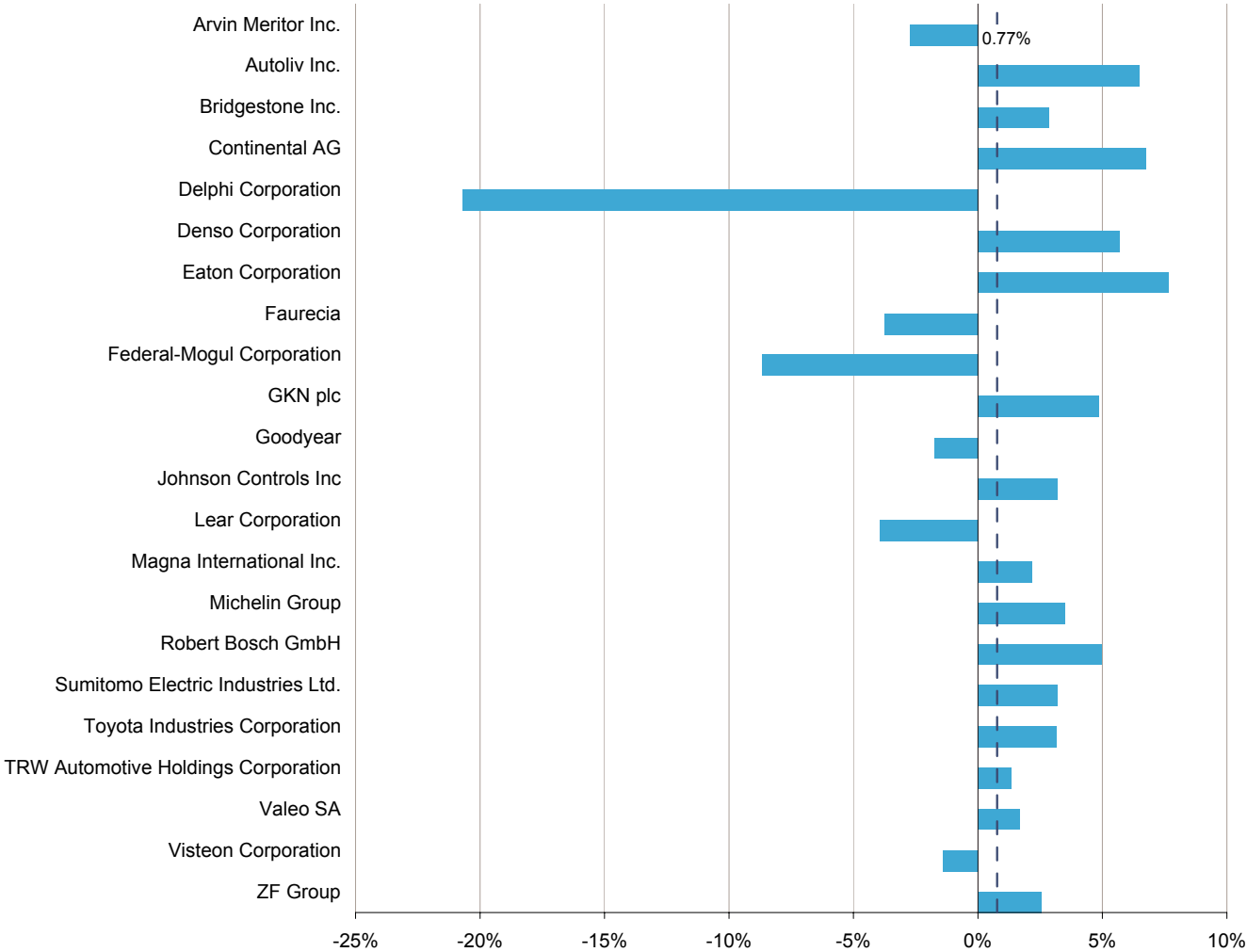
- 9 Mitsubishi Motors Corporation
- 10 Nissan Motor Company
- 11 Peugeot Citroen SA

- 12 Porsche AG
- 13 Renault SA
- 14 Subaru - Fuji Heavy Industries

- 15 Toyota Motor Corporation
- 16 Volkswagen AG

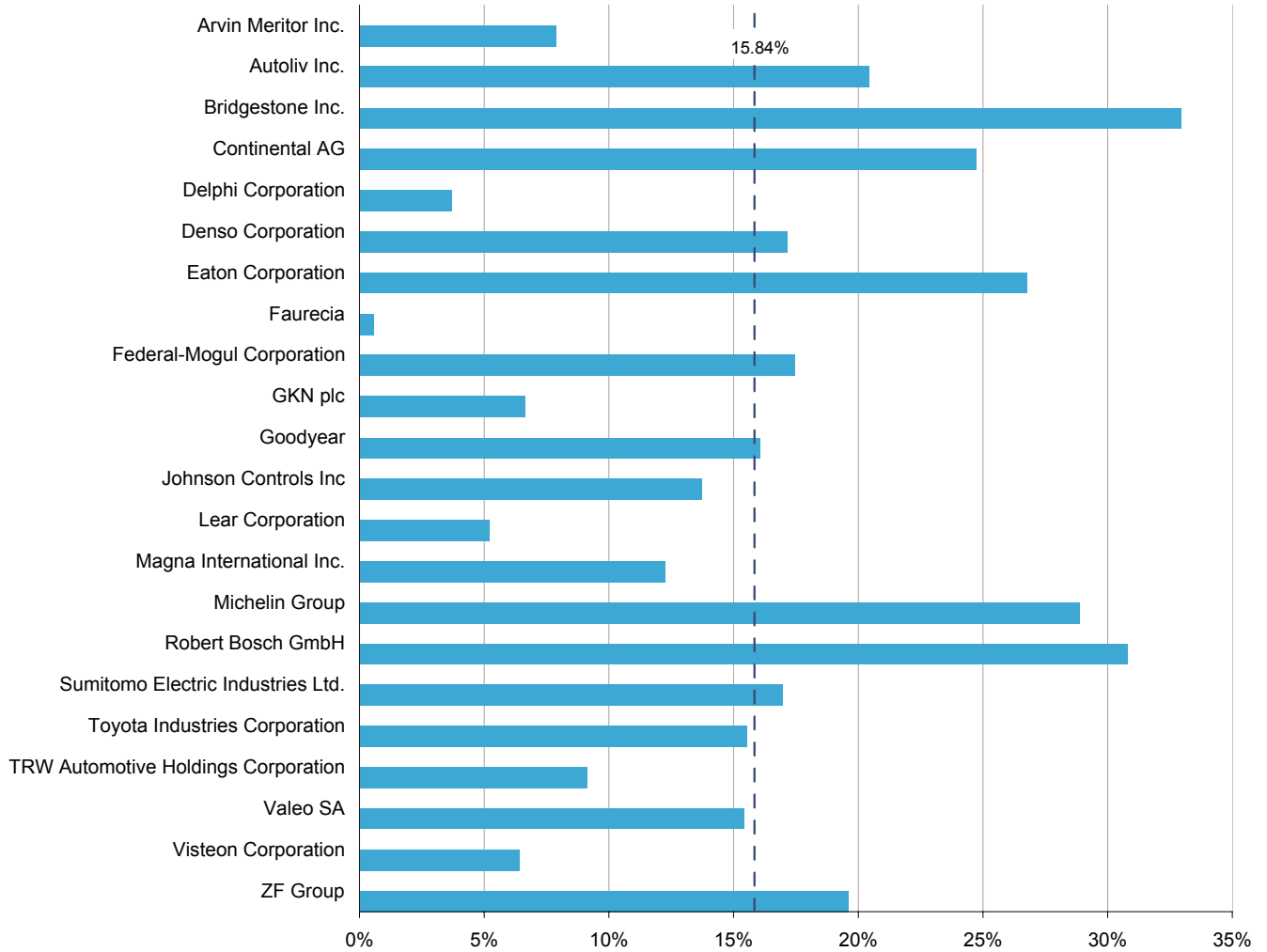
Independent supplier net income margin

Independent supplier net income margins ranged from -20.71% to 7.66% and averaged 0.77%.



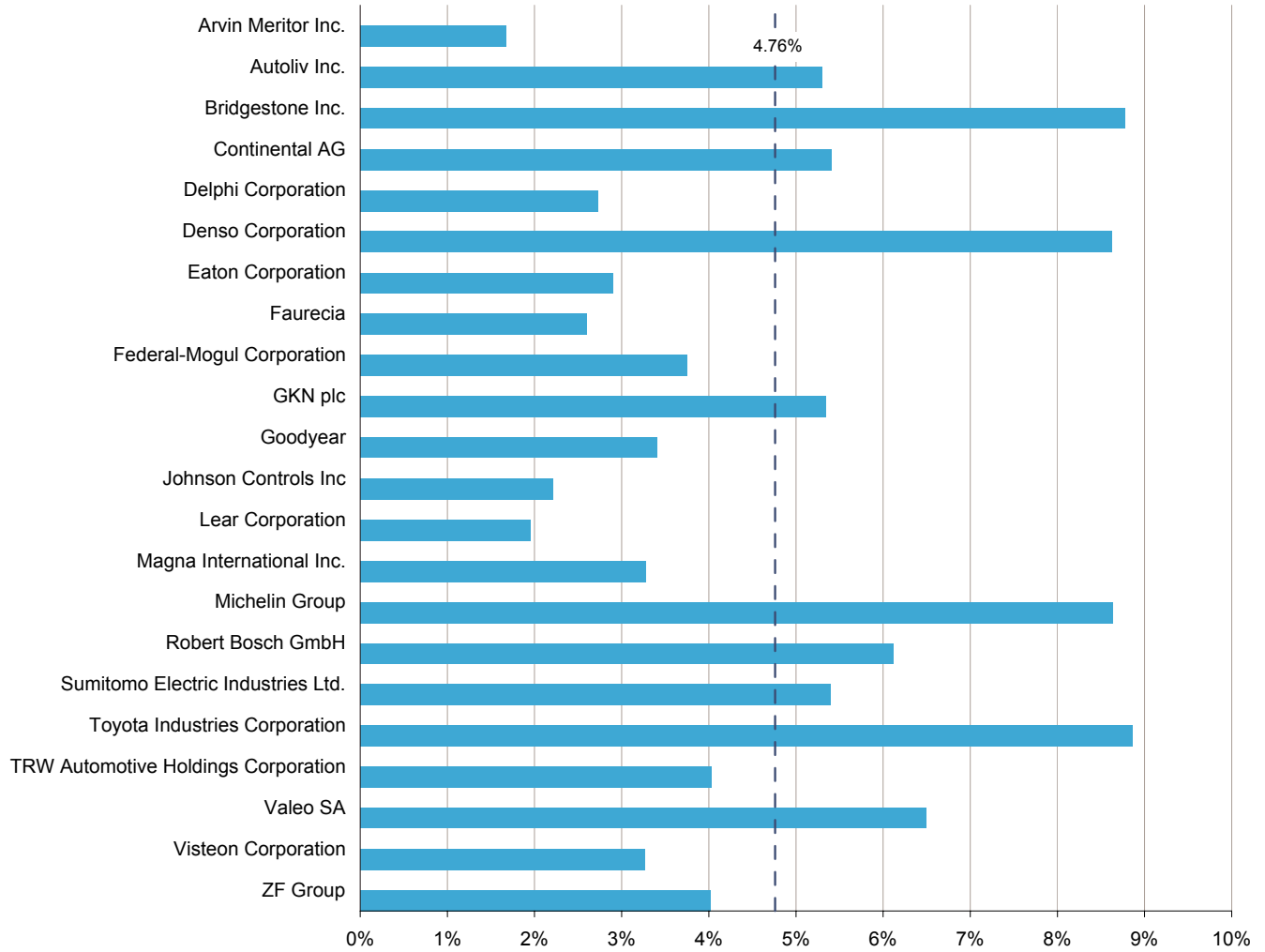
Independent supplier gross profit margin

Independent supplier gross profit margins ranged from 0.59% to 32.95% and averaged 15.84%.



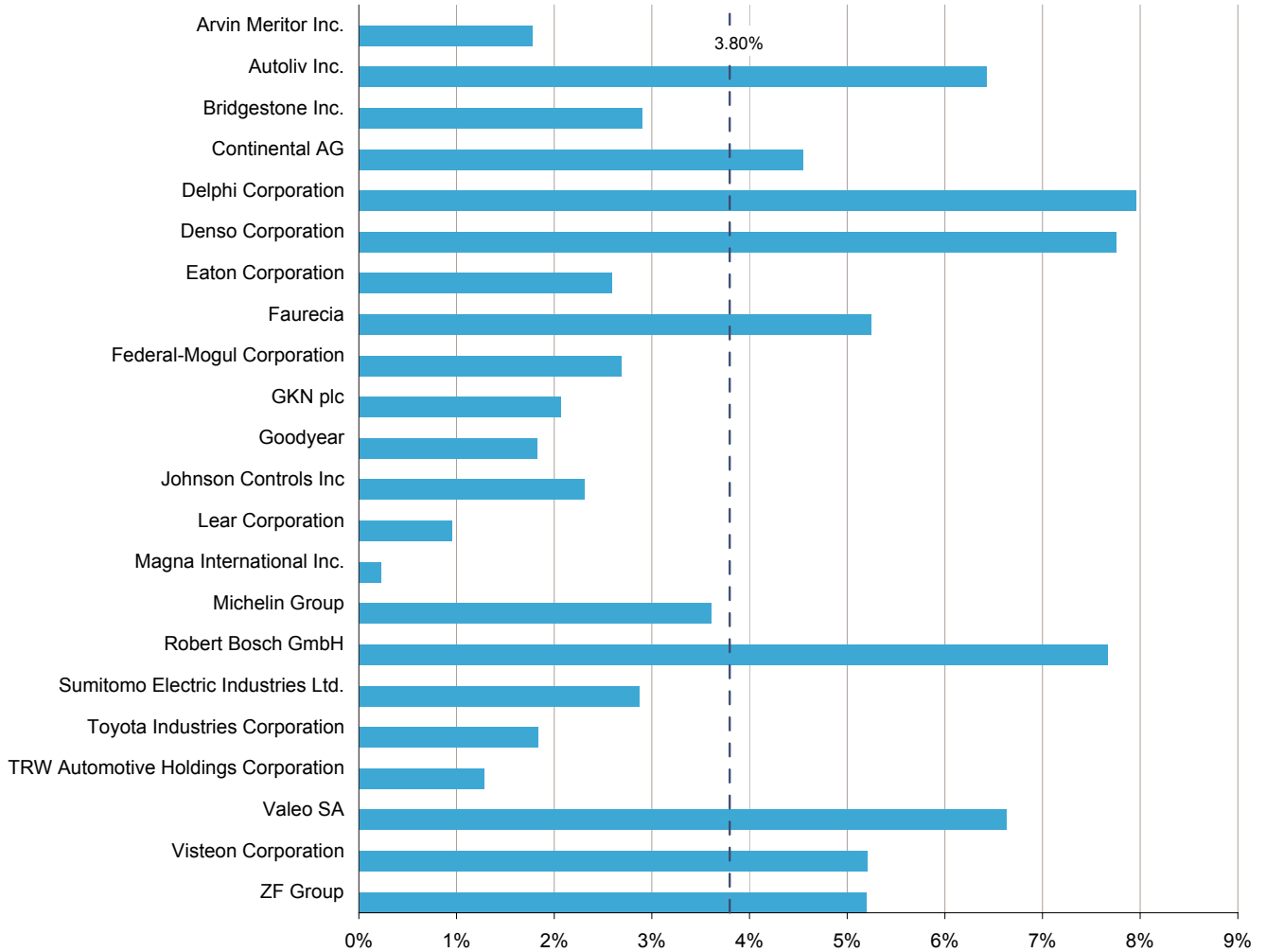
Independent supplier capital expenditures as a percent of revenue

Independent supplier capital expenditures as a percent of total revenue ranged from 1.67% to 8.86% and averaged 4.76%.



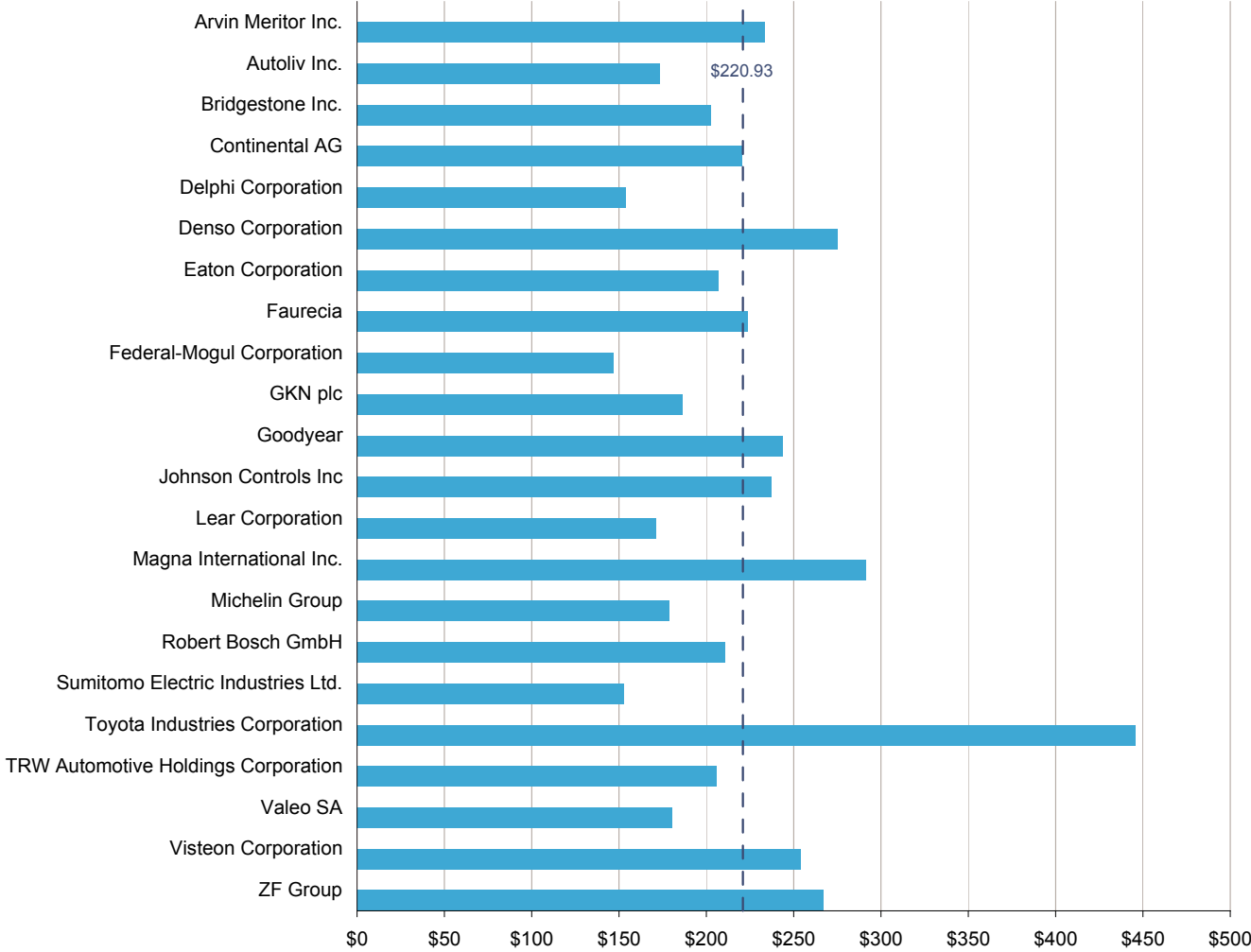
Independent supplier research and development expenditures as a percent of total revenue

Independent supplier research and development expenditures as a percent of total revenue ranged from 0.23% to 7.96% and averaged 3.80%.



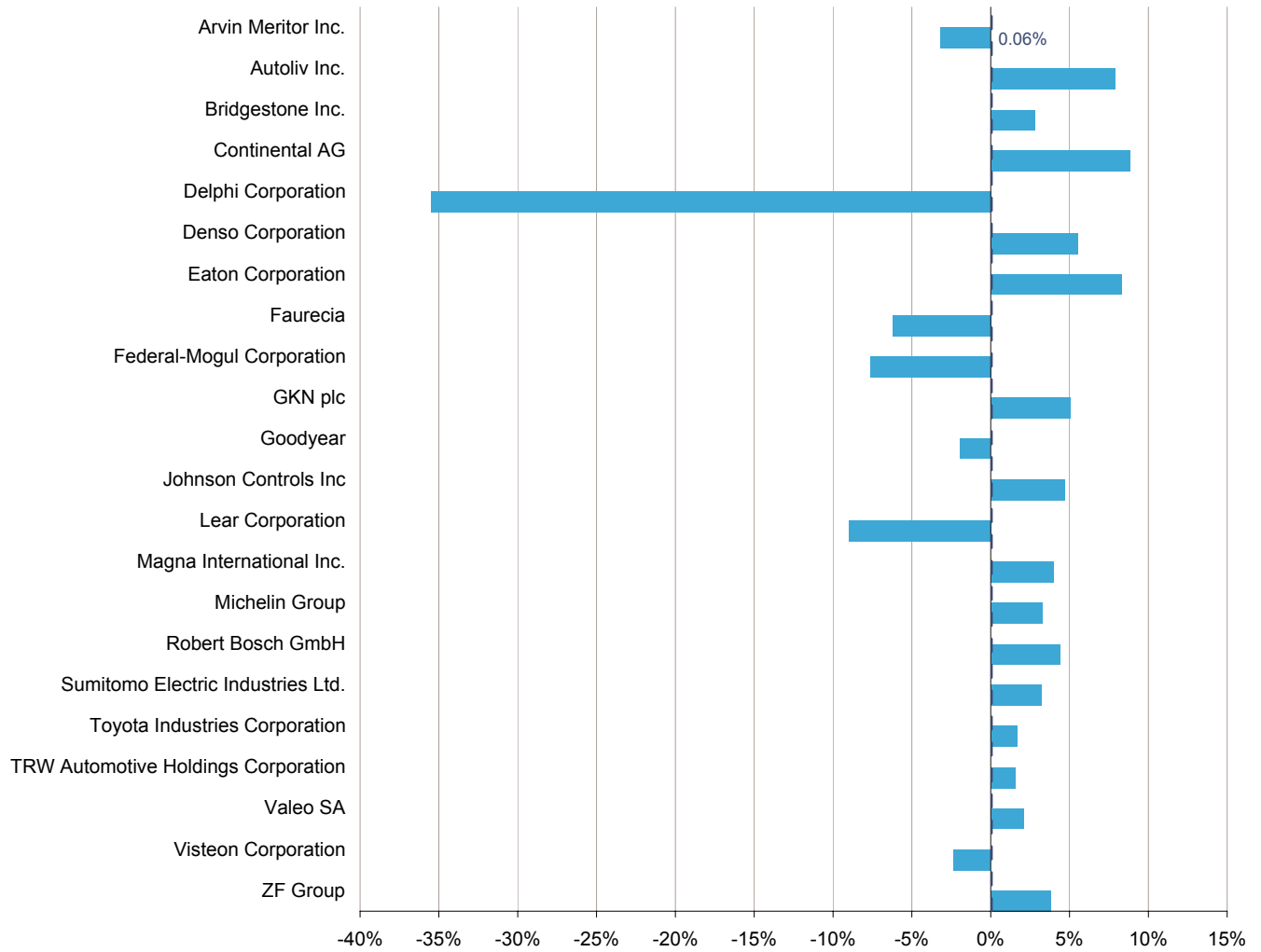
Independent supplier revenue per employee

Independent supplier revenue per employee ranged from \$146.78 to \$445.57 and averaged \$220.93.



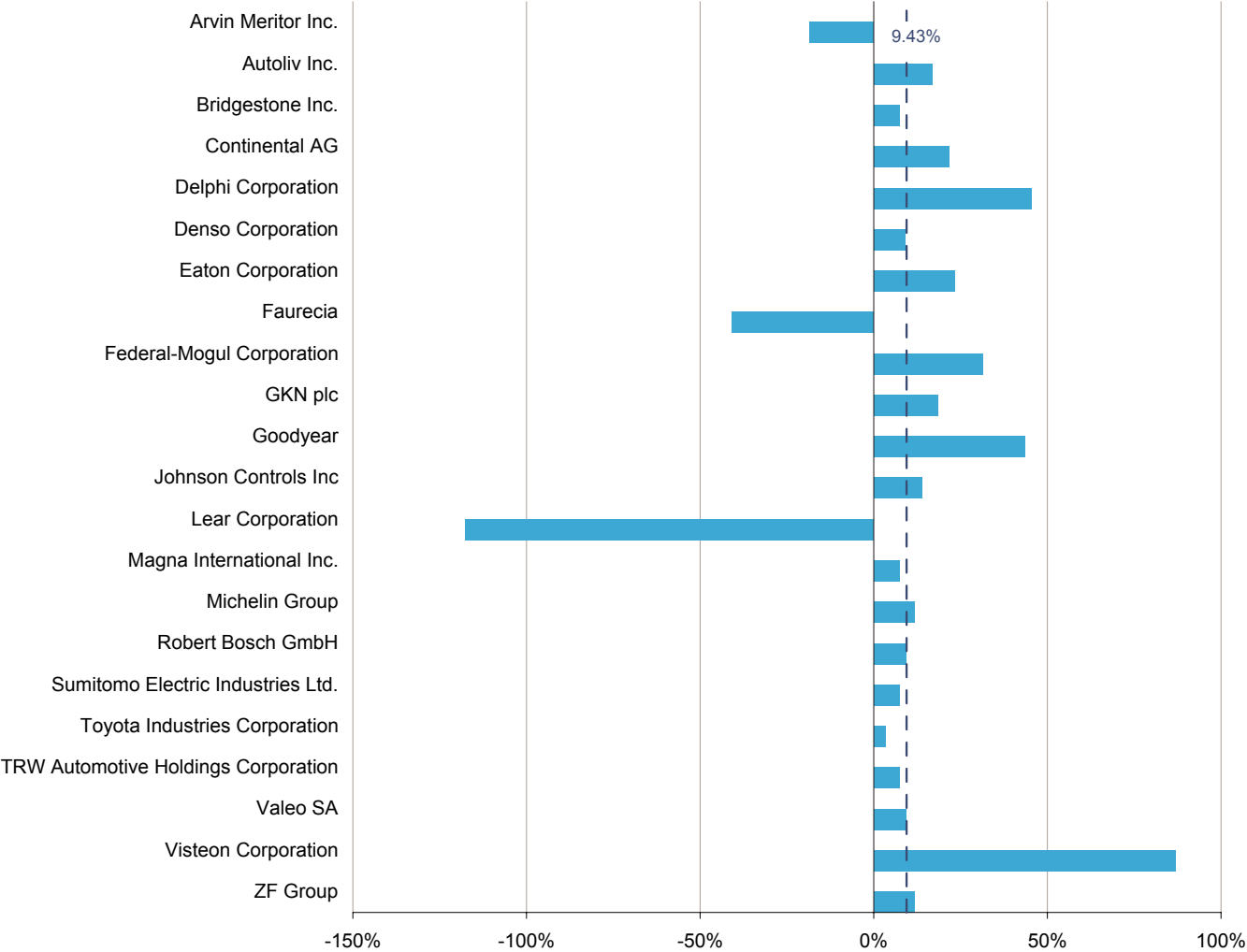
Independent supplier return on assets

Independent supplier return on assets ranged from -35.52% to 8.87% and averaged 0.06%.



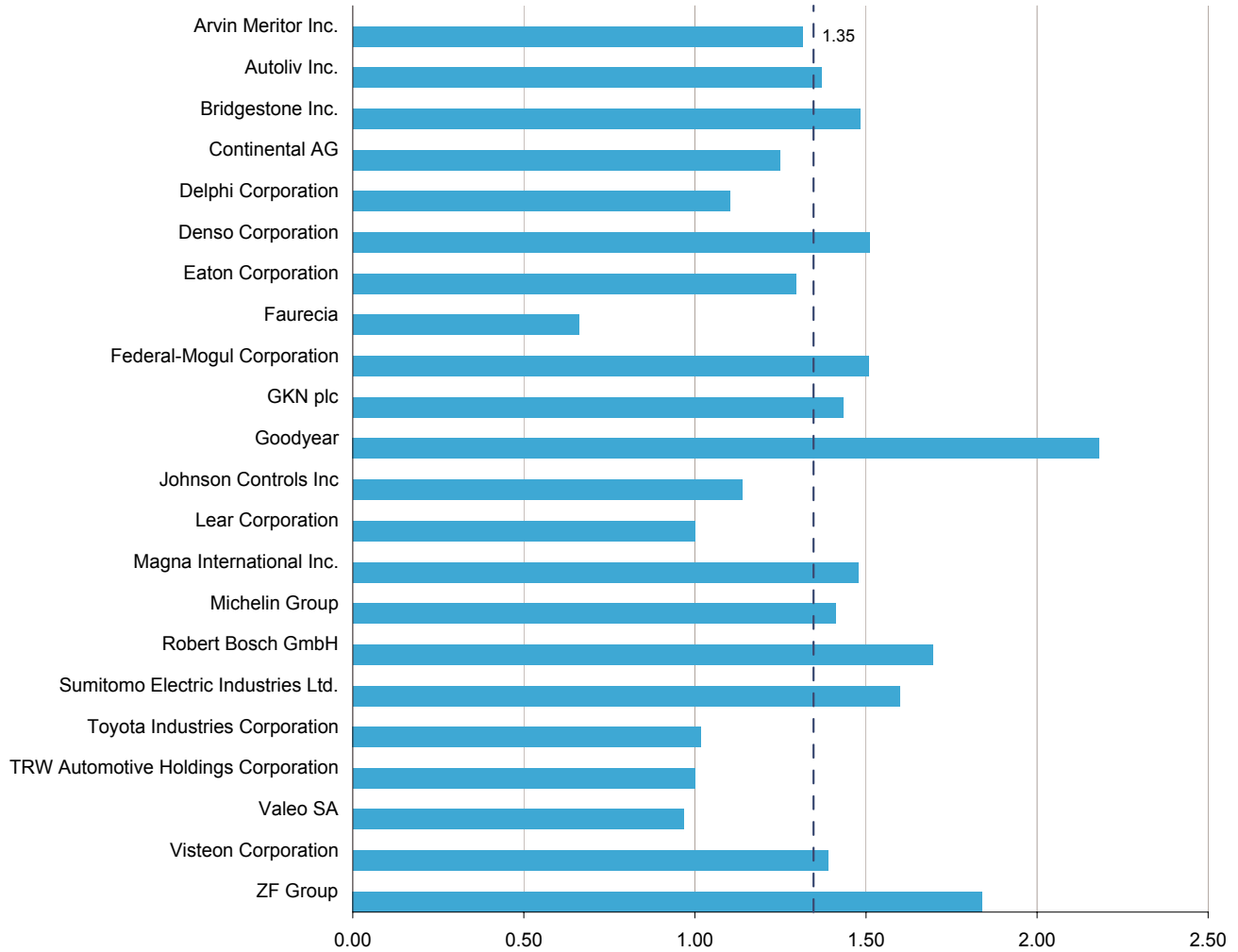
Independent supplier return on net assets

independent supplier return on net assets ranged from -117.52% to 86.70% and averaged 9.43%.



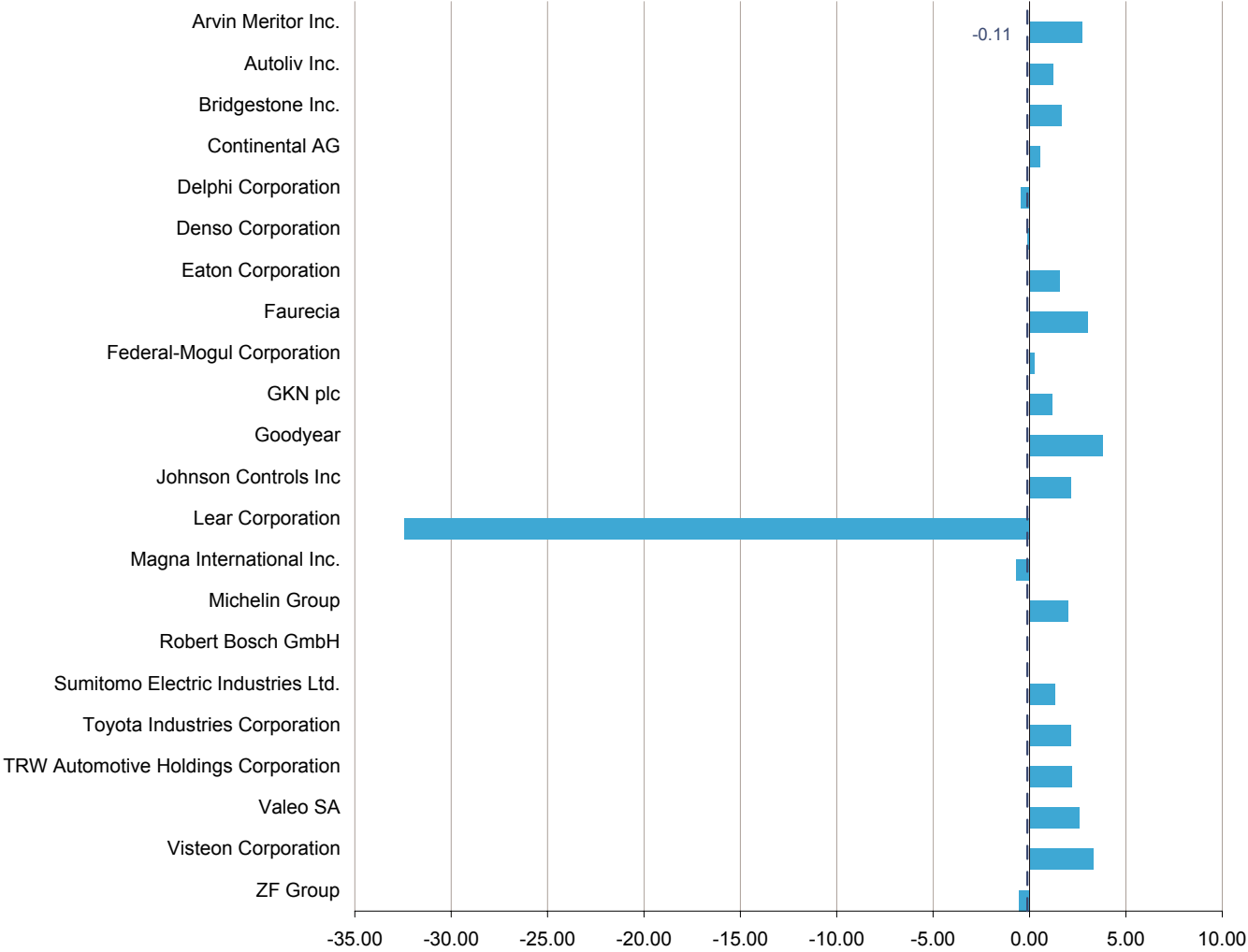
Independent supplier working capital ratios

Independent supplier working capital ratios ranged from 0.66 to 2.18 and averaged 1.35.



Independent supplier leverage ratio

Independent supplier leverage ratios ranged from -32.42 to 3.81 and averaged -0.11.



From the Chairmen

The Letters to Shareholders from chairmen and/or presidents of the automotive companies included in this review illustrate priorities, challenges, accomplishments and visions to which industry executives attribute particular importance. As in prior years, the chairmen refer to a wide range of topics of interest to stakeholders. The selection of excerpts presented below focuses on 8 recurring themes from the 2006 annual reports:

- Overall industry and economic context for 2006
- Strategies for success
- Technology and innovation
- Cost reduction
- People
- Environmental consideration
- Opportunities in China, Asia-Pacific, Central Europe and Russia
- Predictions

Overall industry and economic context for 2006

Economic context remains difficult for the automotive industry. Most chairmen point out the continued increase of raw material prices and difficulties regarding the North American and West European markets. These weaknesses are partially offset for certain companies by strong costs reduction programmes and opportunities in emerging countries.

Arvin Meritor

[...] Fiscal year 2006 was significant for ArvinMeritor and for the motor vehicle industry. We witnessed events that had a dramatic impact on customers worldwide, the vehicle manufacturers, and the entire supply

chain. Record high sales in most of the markets we serve; notable growth in regions such as China and India; and new technologies designed to improve safety, reduce emissions and enhance driver satisfaction, were offset by massive restructuring actions, bankruptcies, production cuts, and rising raw material and energy costs. [...]

Autoliv

2006 was not an easy year. Light vehicle production dropped in our important West European and North American markets. Market prices continued to erode, raw material costs continued to rise, and distressed suppliers caused us problems and made it increasingly more difficult to reduce costs. [...]

Continental

[...] Economic conditions were difficult in 2006. In particular, we were confronted with substantial raw materials price increases for natural rubber, crude oil and aluminium. These increases impacted our results by around €317 million. We were able to absorb these costs through efficiency gains, price increases, and an improved product mix. [...]

General Motors

[...] 2006 was the industry's fifth consecutive year of record global sales: 67.5 million units. In fact, industry sales were up more than 30 percent in the last 10 years, or about twice the pace of growth in the previous two decades. We're forecasting yet another industry-sales record in 2007 of about 70 million units. [...]

GKN

[...] Overall Automotive profits also improved slightly despite well publicised turbulence in our major markets. A significant downturn in US production and a particularly weak third quarter demand in Western Europe combined to significantly challenge the skills of GKN plant management in both markets. [...]

Goodyear

- [...] We experienced unprecedented increases in raw material costs. Our price for natural rubber doubled during the year and remains at high levels. We also faced significant cost increases in our other raw materials including steel, synthetic rubber and other oil-based commodities. In total we saw our raw material costs rise by 17 percent, or well over \$800 million.
- There was a reduction in industry growth, ranging from slow-downs in Latin America based on macroeconomic weakness to the dramatic declines experienced in North America that were driven by the income squeeze on lower-middle income families resulting from higher gasoline and utility costs.
- Some of our major OE customers in North America were encountering their own set of challenges. As an outgrowth of higher fuel prices, reduced demand for SUVs and light trucks resulted in lower OE production volumes and tire needs.
- Finally, the fourth quarter strike in North America at 16 tire and engineered products facilities meant we had to go to extraordinary measures to protect our distribution channels while operating at about half our normal production. [...]

Michelin

[...] In 2006, Michelin has experienced further massive raw materials, energy and logistics external cost inflation. We were able to offset a significant portion of this unprecedented hike (more than EUR 800 million) through selling price increases and further product and service offering enrichment combined with good control of our marketing, administrative and research expenses. [...]

North American tire replacement markets were adversely affected by high fuel prices. [...]

Renault

[...] Like the rest of the industry, we faced three main challenges in 2006:

- First, raw material costs rose significantly, and certainly more than expected. This increase could not be passed on to sales prices.
- Second, our main markets performed sluggishly in 2006. The French market declined by 1.9% and the European market grew by 1.3%, thanks mainly to a dynamic LCV segment, which climbed 4.6%, compared with growth of only 0.8% in the passenger car segment.
- In addition, the product mix on these markets deteriorated. In Western Europe, the mid-range segment lost 5.5%, mainly to the benefit of the entry-level segment, which gained 6.5%.
- And third, competition was tough. In 2006, sales incentives reached their highest level ever in Spain, Germany, Italy and the UK. [...]

Sumitomo Electric

[...] The operating environment for the Sumitomo Electric Group remained difficult in fiscal 2007, ended March 2007. Robust demand continued for our businesses overall. However, factors such as the appreciation of raw material prices, including record high copper prices, strongly influenced our performance, along with the reduction in product prices attributable to tougher international competition. [...]

TRW

[...] The automotive industry is in the midst of accelerating globalization — of consumer demand, of vehicle and component supply, and of human, technological and financial capital.[...] These demands relate primarily to the impact of intense competition among vehicle manufacturers for market share in both established and emerging markets, resource-straining globalization, and rising commodity prices for essential manufacturing resources such as steel, resins and energy. [...]

Valeo

[...] Market conditions were indeed tough once again in 2006, with lower automotive production and continued high prices for raw materials, which of course led to an even tighter squeeze on suppliers. [...]

From the Chairmen: Strategies for success

Strategies presented by chairmen detail different goals and actions to improve or restore profitability in a difficult economic environment such as cost reduction programmes, redeployment of industrial facilities, pursue expansion in emerging countries, new collaboration and partnering, accelerating rationalization of organizations, launch of new innovated products or reinforcement of innovation.

Arvin Meritor

[...] This fiscal year, we divested certain businesses that are no longer part of our long-term business strategy. Completing these transactions improved ArvinMeritor's financial position and allowed us to focus resources on our core light and commercial vehicle businesses. [...]

Our goal is to evolve the current geographic customer mix, through restructuring, alliances and new operations, to a more strategic balance of one-third in North America; one-third in Europe; and one third in South America, Asia Pacific and other growth markets. This strategy will further improve our overall cost structure as we expand into regions like Eastern Europe, South America and Asia, while also enabling us to better support our diversified customer base whose operations are growing in many regions of the world. [...]

Therefore, we recently launched an exciting initiative at ArvinMeritor that we are calling Performance Plus. This transformational program is designed to be much more than a cost reduction activity. Performance Plus will define changes to our structure and our culture that are necessary to maximize cost efficiencies; build manufacturing excellence; increase our research and development commitment; further advance product innovation; identify new business opportunities; and ultimately, enable us to deliver greater shareowner value through increased profitability. [...]

Daimler-Chrysler

[...] Our comprehensive Recovery and Transformation Plan for the Chrysler Group, which we presented on February 14, has two main components. The Recovery Plan consists of a package of measures that will enable us to restructure our business operations in the short term to restore profitability. The strategic Transformation Process aims at redesigning the Chrysler Group's business model in such a

way that it will remain profitable in the long term, even under difficult market conditions.

In order to optimize and accelerate the presented plan we are looking into further strategic options with partners beyond business cooperation in specific areas.

At the Chrysler Group, we are continuing the product offensive we began in 2006.

The ten new models we launched last year, the majority of which did not arrive in dealerships in volume until the latter half of the year, will be followed by eight more in 2007. Many of these new models will satisfy the increased demand for more fuel-efficient vehicles with lower emission levels. [...]

The combination of all these measures – more efficient processes, first-class products and an even stronger brand – ensured that 2006 improved on a difficult 2005. The Mercedes star is starting to shine brightly again! [...]

The Truck Group is also making substantial progress in the implementation of its program to harmonize processes and components across its global brands – creating powerful synergies from development all the way through production. As a result, we have created the conditions that will enable us to achieve sustained success, despite the cyclical nature of the commercial vehicle market. 2007, in which we expect a double-digit decline of the U.S. and Japanese markets, will test the effectiveness of our measures. [...]

Fiat

[...] Restructuring efforts were accompanied by major new and upgrading product program in every area of activity. In the Auto Sector alone, this has meant rolling out 22 new models and restylings in just two years, which has enabled us to gain significant market share both in Italy and in major European countries.

Our future also sees Fiat as a much more international group, and significant steps in this direction were taken as evidenced by the number of international agreements reached during the year. [...]

The plan marked out for the next four years is even more ambitious and challenging. It is a plan geared towards growth. Improved operating

performance across all businesses, accompanied by significant investments, and growing profitability in every business area will consolidate Fiat's position as a major international industrial group. [...]

Ford

[...] We are taking actions to reduce our operating costs and realign our capacity to reflect the realities of the market. At the same time, we are speeding up and strengthening our new product development process to take full advantage of our global resources and growing world markets.

Our turnaround will take time, but we are determined to make it happen. [...]

[...] In December I announced an organizational realignment that puts additional focus on our markets and customers while better leveraging our global assets and capabilities. Under this new structure our three Automotive operations – The Americas; Ford Europe and the Premier Automotive Group; and Ford Asia Pacific and Africa/Mazda – report directly to me.

In support of these operations we also created a single global product development organization. This new structure will enable us to work together more effectively to improve continuously the quality, productivity and speed of our product development process.

In addition, our purchasing, manufacturing, quality, information technology, design, research and vehicle technology functions are all similarly focused on using the company's global assets to better support its Automotive operations. By sharing vehicle architectures, components and best practices from around the world, and taking full advantage of global economies of scale, we will leverage our resources around the world for the greater good of the entire company.

Our entire global team has been focused on four key priorities: aggressively restructuring our company to be profitable at a lower volume and changed product mix, accelerating product development while achieving manufacturing excellence through reduced complexity and improved quality, obtaining financing to complete our plans, and working together with teamwork and accountability. [...]

[...] Our most immediate concern is fixing our business in North America. We are taking the painful but necessary steps to achieve a \$ 5 billion reduction in our annual operating costs by 2008 compared to 2005. And we are accelerating our new product development. By the end of 2008, 70 percent of our Ford, Lincoln and Mercury lineup by volume in North America will be all-new or significantly freshened compared with 2006 models. We also will speed up the time it takes us to get new products to market by 30 to 50 percent. In 2009 and beyond, the pace of new product introductions will accelerate even further. Our plan is to return our North American Automotive operations to profitability by 2009.

Our efforts will be enhanced by leveraging our worldwide resources. Working together as one global company is our biggest single opportunity to make rapid and dramatic progress toward our goal. [...]

Goodyear

The key result of our accomplishments in 2006 was the creation of strong business platforms to better position Goodyear for the future. I look at our business platforms entering 2007 as a combination of:

- Strength in Top Line Growth Capability
- Step Change Improvement in Cost Structure
- Stronger Balance Sheet and
- Tight Focus on Core Businesses

Our top line growth will be generated by price and volume increases and continually richer product, brand and customer mix, all supported by a continued stream of new products, great marketing and an outstanding dealer network. [...]

[...] Our continued progress in these areas is further evidence of our view that we are a marketing company and not simply an automotive supplier.

In mid-2006, we raised our previous target established at our September 2005 investor meeting of eliminating between \$750 million to \$1 billion in cost by the end of 2008 to more than \$1 billion. However, given our rapid progress to date, we are reevaluating that goal with a view toward an even more aggressive target. [...]

[...] We set out four years ago to execute on a balance sheet improvement plan and are now at a stage where we can envision near-term achievement of our Capital Structure goal of 2.5 times debt to EBITDA. [...]

[...] A further improvement in our future business platforms is a sharper focus on businesses and targeted market segments where we can grow profitably. We have taken the necessary actions to exit businesses where we could not successfully compete [...]

Subaru - Fuji Heavy Industries Ltd.

[...] Now with the drafting of a new medium-term management plan running from fiscal 2008, FHI is making a bold new start towards the “customers come first” mindset essential to providing a distinctive Subaru experience. [...]

[...] On the marketing front, we will advance a strategy that views sales from a global perspective. In terms of expanding our earnings base, we have identified overseas markets as the main source for growth, among which we consider the United States to be our highest priority market. Already, we have divided our former Overseas Sales and Marketing Division into the Overseas Sales and Marketing Division I and II. [...]

[...] Another major point in the new plan is our business alliance with Toyota Motor Corporation (Toyota). Over the long term, our collaboration with Toyota will be crucial to enhancing the competitiveness of both companies as they are called on as automakers to make more substantial upfront investments with respect to the environment, safety and other areas. That said, even as we proceed with building ties in production, development technology and on other fronts, we will be more selective and focused regarding fields where Subaru has advantages, and will remain committed to cultivating the distinctiveness of the Subaru brand. [...]

Peugeot

[...] The Supervisory Board has given me the mission of quickly returning the Group to growth and profitability. For the short term, I've defined four operating priorities that should enable us to turn things around. The first is product and service quality, where I expect everyone to broaden and deepen his or her already active commitment.

The second is to reduce costs, and much more quickly than before. The third concerns product strategy, where the product plan will be stepped up and broadened to improve response to changing customer expectations and more aggressive competition in the global marketplace. The fourth priority concerns international operations, where we will leverage our strengths to get bigger in China, become a major automobile industry player in the Mercosur region and continue to expand in Eastern Europe. [...]

Renault

As expected, the first year of the Renault Commitment 2009 plan was a year of transition for the Group. Our strategy involved in-depth changes throughout the company.

- We started by setting priorities, based on our three commitments: quality, profitability and growth. Renault Commitment 2009 was cascaded across the company to enable all 129,000 employees to work towards the same direction in the next three years. We set quantified objectives and prepared action plans for each function in every region. The goal is to mobilize the full potential of Renault and seize every opportunity to make it grow.
- Implementing Renault Commitment 2009 also meant re-examining our organization, methods and processes to ensure that, everywhere in the world, our overriding concern is customer satisfaction. The creation of the Regional Management Committees, for example, put international operations at the center of the company. All functions can now respond to the specific needs of each region and manage operations directly and quickly at the local level. [...]

Toyota Industries Corporation

[...] Greater global demand for compact cars is expected due to rising crude oil prices, while Toyota Motor Corporation's (TMC) domestic production is likely to remain at a high level.

In view of these circumstances, we will strive to expand our role within the Toyota Group backed by our strength – always aiming to be global No. 1 in terms of quality, cost and delivery (QCD) – that we have cultivated as a manufacturer specializing in compact and midsize cars. [...]

[...] Deploying our technological superiority as a competitive advantage, we plan to continue to develop cutting-edge technologies and new products that contribute to new car development as we respond to an ever-greater need for car air-conditioning compressors for hybrid vehicles in addition to conventional engine-powered vehicles.

The Automobile Segment is also involved in car electronics and automotive stamping dies. In other words, this segment is active in a broad range of fields covering the entire automobile business from vehicle assembly and engines to components. To prevail amid severe competition, we intend to strengthen collaboration among these businesses to leverage our strong overall capabilities.

With this in mind, in January 2007 we established the Automotive Headquarters to fortify collaboration among respective businesses in the Automobile Segment. We have now consolidated and achieved close cooperation among the vehicle assembly, engine, automotive stamping dies and car electronics businesses to create synergies. In so doing, we are actively contributing to TMC's global strategy. Besides strengthening each individual business, we plan to focus on increasing our total strengths while elevating the potential and performance of the Automobile Segment. [...]

Volkswagen

[...] That's why we need strong, independent brands with a profile of their own that's tailored to their target groups. They must be able to operate autonomously and have meaningful responsibility for their own performance. To achieve this, we have optimized the Group structures, dissolved the brand groups and returned complete independence and responsibility for their entire business to the brands. One consequence of this is that, starting in fiscal year 2007, we will report the key financial indicators separately for each of the brands. [...]

To make the Volkswagen brand fit for the future, we need a healthy economic foundation. That's why it's so important for us to continue pushing ahead with "ForMotionplus" and to further extend the productivity improvements already underway at our plants. The collective wage agreement signed for Volkswagen AG's six traditional sites in October last year was a major step on the road towards greater competitiveness. This means that Volkswagen's labor costs are now back to comparable industry levels. [...]

ZF Group

[...] There are many challenges for the current year. In 2007, the ZF Group will continue the strategy it has been pursuing. The necessary investments will be made to safeguard and expand our technological leadership, as well as to further strengthen international market presence. ZF will orient itself more intensely toward regional market requirements in order to be an attractive partner for both established and new customers in all relevant market regions, including the emerging markets. The pressure on international sales and procurement markets is doubtlessly large and will not decline. It is therefore very important that ZF realizes competitive cost structures at all international locations. Management and employees must make major efforts to meet these many challenges. [...]

From the Chairmen: Technology and innovation

Innovation remains a strategic element in the automotive industry. During the previous years, chairmen comments focussed on innovation regarding comfort and safety. Most of the chairmen highlighted in 2006, the development of friendly environmental products.

Continental

[...] Internal growth will be driven forward by our innovative products. For example through ESC (Electronic Stability Control): in USA, there are indications that all new vehicles will have to be available with ESC as an option from 2009, and as standard from 2011. ESC is performing more and more additional functions: is not only provides stability control, but also serves as the control centre for safety and comfort functions. [...]

[...] We will further develop the intelligent tire. Thanks to its run-flats capabilities, this tire already allows drivers to comfortably continue to the next service station even if tire pressure is falling. [...]

General Motors

[...]

Technology Leadership

In 2006, we emphasized energy and environmental leadership as a critical element of GM's ongoing turnaround plan and a key part of our business strategy.

In order to reduce the world's dependence on oil, as well as meet the growing demand for our cars and trucks around the globe, we're embracing a policy of energy diversity – that is, offering vehicles that can be powered with many different sources of energy.

GM will continue improving the efficiency of the internal combustion engine, as we have for decades. But we're also redoubling our efforts to displace traditional petroleum-based fuels by building vehicles that run on alternative fuels. Last year, we launched our "Live Green Go Yellow" E85 ethanol campaign in the U.S., and fulfilled our pledge to put more than two million E85-capable vehicles on the road.

We have pledged publicly to double our production of E85-capable vehicles by 2010, and we are prepared to make fully half of our annual vehicle production biofuel-capable by 2012, provided there is ample availability and distribution of E85, as part of an overall national energy strategy.

Later this year, we will debut our pioneering two-mode hybrid system on our fullsize SUVs. This sophisticated hybrid powertrain is based on the system we use in our transit buses that currently are saving hundreds of thousands of gallons of fuel a year on the streets of 51 cities in the United States and Canada. [...]

Goodyear

[...] Despite the challenges of 2006, our team delivered several significant accomplishments:

- We continued our strong product leadership [...]
- [...] A renewed focus on innovative marketing extended our messages about relevant technology to consumers through both traditional and emerging media. [...]

- [...] With significant assistance from our new product and marketing initiatives, we saw a 7 percent improvement in revenue per tire last year driven by strong pricing and product mix. [...]

Sumitomo Electric

[...] the Sumitomo Electric Group has drawn up an R&D vision of always being ahead of social and technological trends, and thus we focus our R&D efforts on themes that will contribute to the expansion of the Group's business. To realize this vision, our R&D teams are engaged in the three priority tasks listed below.

- Providing support to and strengthening operational base for the Sumitomo Electric Group's existing businesses
- Developing new business fields where the Group's core technologies can be effectively utilized
- Creating and maintaining the ideal atmosphere for the development of new products by ensuring close and fruitful collaboration among various R&D facilities of the Group and with external organizations [...]

[...] In our VISION 2012 management plan, we have set an R&D target for the proportion of sales of new products to total sales by the Group of 30% by the fiscal year ending March 2013. For this purpose, we have budgeted an investment of approximately ¥400 billion over the next five years for R&D expenses to enable the aggressive development of new products. [...]

Visteon

[...] *Delivering Product Innovation*

Visteon is leveraging product innovation to obtain new business. Our percentage of business coming from new products and technologies has more than tripled over the past few years.

As an example, in electronics, we are developing in-vehicle wireless charging, a convenient way to ensure batteries for mobile phones, MP3 players or personal data assistants stay charged. This innovation received extensive media coverage and was honored with a design and engineering award at the 2007 International Consumer Electronics Show. Visteon is also a leader in electronics connectivity – connecting

personal devices such as an iPod® and mobile phones to a vehicle's systems. As personal devices proliferate in the market, Visteon has solutions to integrate them intelligently into the vehicle. [...]

Our interiors group has many new applications that can provide our customers cost-effective ways to differentiate their vehicles with enhanced styling. These developments include our innovative surface "skin" technologies such as Visteon's InSkin™ Instrument Panel and Translucent Skin. Our InSkin technology enables true "zero gap" between instrument panel surfaces and decorative panels. With this technology, auto manufacturers can incorporate logos or natural materials such as wood, metal or stone into the instrument panel surface without adding incremental tooling costs.

We are also making the necessary investments to ensure a robust technology pipeline to support customers with first-to-market products. By leveraging our industry-recognized consumer research capability, we are able to understand the differences in consumer preferences and needs around the world. This knowledge feeds our global technical centers to create commercially viable technologies in each of our core product lines.

Nearly 20 percent of the business won in 2006 will go into production in 2007 – demonstrating we can respond quickly to our customers' needs. Equally important, we continue to reduce the time required to bring a product from concept to customer introduction, enabling us to more rapidly seize market opportunities. [...]

ZF Group

[...] Technological leadership is an important cornerstone of ZF's corporate strategy. Only through innovative solutions products with high customer benefit can be offered. Thanks to reduced fuel consumption and emissions, enhanced safety, driving dynamics, and comfort, these products make an important contribution to the improvement of the customers' vehicles and their competitiveness. The continuing market success of ZF products demonstrates that the high level of investment in innovative products pays off. [...]

By the slogan "Innovations of Great Value" at the 2006 IAA Commercial Vehicles, ZF showed that innovative technology and economic efficiency indeed match very well. ZF showcased the customer benefit, particularly through reduced life-cycle costs. New technologies, such as hybrid technology, offer potential if they are economical for the

user in everyday operation. The automatic transmission systems for commercial vehicles and low-floor technology for buses already have an impressive track record. [...]

From the Chairmen: Cost reduction

Cost reduction is considered to be a key success factor for reinforcing competitiveness. Cost reduction programmes include different actions such as moving production capacity to low-cost countries or saving via lower structure costs.

Autoliv

[...] For instance, we reduced cost for purchased components by more than 3%, improved labor productivity by more than 5% and moved more than 1,000 jobs to low-cost countries. [...]

In cost efficiency, we reduced costs by more than \$200 million by redesigning products, consolidating the supplier base, moving jobs to low-cost countries and taking advantage of global and low-cost country sourcing possibilities. We also introduced a new passenger airbag that has 25% less weight, fewer parts and that, consequently, is less expensive to manufacture than the bag it replaces (which, in turn, was 30% lighter than its predecessor). [...]

Continental

[...] Naturally, we will continue to systematically monitor our costs. We will drive forward the expansion of our low-cost locations, focusing not only on production, but also on expanding our research and development capacity. As a supplier to the automotive industry, cost savings are being demanded from us every year. Maintaining our competitive position in the long term requires continuous efficiency gains. [...]

General Motors

[...] We cut \$9 billion in structural costs on a running rate basis by the end of 2006 – \$2 billion above the target I discussed in my letter to you last year, and \$4 billion above our initial target.

We realized \$6.8 billion of these savings in our 2006 financials, and plan to realize the full \$9 billion in 2007.

Major actions included reducing our salaried and hourly workforce, revising U.S. salaried and hourly retiree health care benefits, restructuring our U.S. salaried employee pension plan, decreasing our executive and board of directors' compensation, and aggressively pursuing structural-cost reductions throughout the company. [...]

Goodyear

[...] We continued to achieve strong performance on our cost structure, delivering on our cost savings targets. Our continuous improvement initiatives delivered savings of nearly \$300 million and we reduced our SAG costs by more than \$100 million excluding the unfavorable currency impact. [...]

[...] Cost Savings

In mid-2006, we raised our previous target established at our September 2005 investor meeting of eliminating between \$ 750 million to \$ 1 billion in cost by the end of 2008 to more than \$ 1 billion. However, given our rapid progress to date, we are reevaluating that goal with a view toward an even more aggressive target.

These strong savings are in part driven by faster than expected progress on our manufacturing footprint. With our previously announced plans to discontinue tire production in Valleyfield, Quebec, close factories in Tyler, Texas; Washington, UK; Upper Hutt, New Zealand and Casablanca, Morocco, we will have reduced our excess high-cost global capacity by 21 million units, or more than 12 percent. This is an area where we will continue to take actions to assure we have capacity aligned with demand globally. [...]

TRW

[...] The Company's cost reduction efforts continued at an exacting pace. In addition to the ongoing use of Six Sigma and continuous improvement measures to lower costs, we continued to manage capacity aggressively and to shift production to low-cost countries. Since the beginning of 2005, we have announced the closure of 17 manufacturing facilities, most of which have been completed. TRW has managed to reduce its global manufacturing footprint while our sales have grown significantly, which speaks to the success of our efficiency programs. [...]

Valeo

[...] Valeo has continued to adapt its global footprint in order to support its customers and their global platforms, and to strike a better balance between high-cost and leading competitive cost (LCC) countries in Eastern Europe, Asia and South America. [...]

Visteon

[...] Our restructuring plan also includes expanding our presence in cost-competitive countries. With a focus on lowest delivered cost, we are expanding our global manufacturing and engineering footprints in countries where automotive volume is growing. [...]

From the Chairmen: People

Human resources are highlighted by most chairmen: involvement and mobilisation of employees remains a critical element for success. Other topics described focus on the importance of an attractive workplace, qualitative training and regular discussions.

Ford

[...] In any successful enterprise, people come first.

A skilled and motivated team working together can accomplish incredible things. The principles and practices we have put in place at Ford to run our business are unlocking the full potential of the people who work here.

Everyone with a stake in the outcome is included in the decision making process. Together, we developed a single plan for our entire global enterprise, with clear performance goals. Although we work as a team, individuals are given responsibility and authority, and held accountable for delivering results. Achievements are measured by facts and data, not anecdotes and opinions. [...] Problems and concerns are discussed candidly and the entire team is enlisted to help find solutions. Mutual respect and a "find-a-way" attitude are key elements of every meeting, and the focus of discussion is always our plan. [...]

Johnson Controls

[...] In 2006, we launched our Blue Sky Involve program. Through the program, Johnson Controls supported employees at more than 135 locations around the world as they volunteered their time and energy to improve the local communities where they work and live. [...]

Magna

[...] I believe that the greatest handicap that the North American automotive industry has is the large gap between business and workers. At Magna, we constantly focus on maintaining good employee relations, with open communication in a work environment that is based on fairness and concern for people. Our employees understand that no company, no union or no government can guarantee jobs. They know that the best guarantee of job security is for management and employees to work together to produce high quality products at a competitive price. [...]

Renault

[...] In September 2006, we decided to make an objective assessment of the plan's deployment through a survey conducted by an independent institute. Every employee was given a chance to express their opinions on the quality of management. The results were compared against a panel of 33 international companies considered to be high performers. They show that the men and women of Renault are highly dedicated and committed to the Company's ambitions.

Of the 100,000 who responded, 91% said they are proud to work for Renault. This is 8 points higher than the panel average. 85% of employees consider that our strategy and objectives are clear and motivating – a score that ranks us with the benchmark. These findings demonstrate that Renault is geared up and mobilized to deliver on Renault Commitment 2009. [...]

Toyota Industries Corporation

[...] Attracting Highly Ambitious Individuals and Creating a Vibrant Workplace

Toyota Industries has designated “enhance team strength and spirit” as the main thrust of its Vision 2010 and a core initiative for driving future growth. Realizing this concept hinges on further raising the level

of every employee's unique skills and specialized techniques as well as management capabilities.

As a key focal point, in fiscal 2007 Toyota Industries promoted the cultivation of personnel possessing the skills, perspectives and spirit of TPS (Toyota Production System) in all business divisions, with each division working to attain clearly defined targets. Concurrently, the Corporate Center (corporate headquarters) upgraded TPS training programs and undertook TPS training by encouraging the participation of staff and providing TPS support for each business division. Determined to accelerate the development of personnel possessing top-caliber skills and techniques as well as the required execution capabilities in terms of manufacturing, we further enhanced our Technical Training Center with the establishment of the Engineering Education Office and began operations in January 2007 as the Technical Learning Center. With the adoption of these measures, we believe that the strengths of each individual are steadily advancing. Combined with these assets, we believe that a “spirit of harmony,” namely, teamwork and an overarching sense of humanity, will serve as a cornerstone needed to fully utilize our team strengths. We will press forward with the creation of a spirited workplace where communication flows smoothly and employees can gather for positive discussions and work to their fullest abilities with a high sense of motivation [...]

Volkswagen

[...] The collective wage agreement signed for Volkswagen AG's six traditional sites in October last year was a major step on the road towards greater competitiveness. This means that Volkswagen's labor costs are now back to comparable industry levels. [...]

From the Chairmen: Environmental consideration

Many chairmen present their actions to address environmental issues. Most focus on the development of eco-friendly products, and explain the environmental implications for their firm during the manufacturing processes.

Bosch

[...] The structure we want for our business activities is guided by the comprehensive definition of corporate social responsibility which we have incorporated into our “House of Orientation.” This definition

explicitly includes societal and ecological concerns. In our view, future and result focus can only contribute to securing the company's long-term success if we also explicitly list the economical use of resources as well as the protection of the environment among the key benefits that our products and services have to offer.

Bosch is therefore resolute in its corporate policy to set standards for responsible action in all areas of operation.

In imposing these standards on ourselves, we shall continue to make significant new contributions to sustainably reducing pollutant emissions in road traffic with state-of-the-art technology. Yet our efforts in other areas of activity will by no means be any less ambitious. Very much in the spirit of our corporate slogan "Invented for life", we shall drive forward the efficient use of energy and other resources as well as the deployment of environmentally sound technologies in all our products and services. Rarely has there been a challenge of such globe-spanning proportions as saving the environment and conserving resources. We are standing at the threshold of ecological globalization, and we intend to make an appropriate contribution to its success. [...]

Bridgestone

[...] On the environmental front, we are developing eco-friendly products, such as tires that help to boost fuel economy. Besides producing benefits for the environment, such products also help to differentiate the Bridgestone brand within the global marketplace. At the same time, we are also actively involved in promoting so-called "3R" activities (Reuse, Reduce, Recycle) in a number of fields. Indeed, we will further bolster that eco-conscious philosophy as we grow in the retreading business. [...]

Daimler-Chrysler

[...] It also means that we strive to achieve a sustainable balance between individual mobility and climate protection. We take our commitment to help preserve the natural resources that are the foundation of life on earth very seriously. That's why we're intensively working on developing realistic future-oriented solutions that will further reduce the fuel consumption and emissions of our vehicles. [...]

GKN

[...] Against the background of global concern over the impact of climate change, GKN strives continuously to improve its environmental performance. As well as preserving scarce resources and reducing levels of waste and emissions from our manufacturing processes, this includes the development of lighter weight components which contribute to greater fuel efficiency for both automotive vehicles and aircraft. Through our joint venture, Emitec, we also assist vehicle manufacturers to achieve ever more stringent emission standards through the production of advanced metal substrates for catalytic converters and diesel particulate filters. [...]

General Motors

Energy Diversity

[...] Our commitment to energy diversity also means that we will significantly expand and accelerate the development of electrically driven vehicles – vehicles in which an electric motor turns the wheels.

[...] Overall, we believe that our industry is on the threshold of a major transformation in propulsion fuels and technologies – a transformation that can help us accelerate industry growth in a sustainable way, mitigate and ultimately solve the energy and environmental challenges of the automobile, and create vehicles that are fundamentally better than their predecessors. [...]

Johnson Controls

[...] Our efforts include improving energy efficiency and reducing waste in customer facilities as well as our own locations. We also focus on the development of our employees as global leaders who will support our future growth and make positive contributions to our local communities. [...]

Smart environments are not just about the things we make, but also result from the way we make them. We're committed to manufacturing processes that are environmentally friendly by reducing raw material, waste and regulatory costs. Our hybrid battery technology will help lower vehicle emissions and reduce fuel consumption. Our energy management and battery recycling activities throughout the world are helping to make important contributions to environmental protection. [...]

Toyota Industries Corporation

[...] No discussion concerning corporate management can take place in the 21st century without mentioning environmental concerns. Toyota Industries has continually carried out environmental management and proactive information disclosure over the course of three successive environmental action plans. Under our Third Environmental Action Plan completed in fiscal 2006, Toyota Industries achieved all numerical targets, which included reducing CO2 emissions by 5% compared with fiscal 1991 levels and attaining a 50% reduction of targeted PRTR (pollutant release and transfer register) substances compared with fiscal 1999 levels.

The increased environmental load results not only from the production process but also the use of products by customers. Driven by this awareness, we are making unprecedented efforts to expand our line up of ecological products under our Fourth Environmental Action Plan launched in fiscal 2007. In the automobile field, for example, Toyota Industries is working on the development of products that reduce CO2 emissions, including diesel engines and key components for hybrid vehicles. We believe that these efforts will also spawn new business opportunities further down the road.

We plan to expand this approach to all Toyota Industries Group companies and work to build global environmental management to vigorously reduce emissions of greenhouse gases, utilize resources more efficiently and reduce environmental risk factors, which we believe will allow us to resolutely fulfil our corporate responsibility. [...]

Valeo

[...] “Enabling a better automotive world” is not just a slogan for Valeo; it is an expression of the company’s mission. The innovations we develop aim not only to make vehicles safer and more comfortable, but also more economical and environmentally friendly. Environmental protection and sustainable development have long been top priorities for the group. [...]

From the Chairmen: Opportunities in China, Asia-Pacific, Russia and Central Europe

China and Asia-Pacific continue to constitute key growth areas for the automotive industry. To pursue their international expansion in

accordance with the goal of competitiveness and to find additional outlets, most of chairmen identify other attractive regions such as Russia and Central Europe.

Arvin Meritor

[...] We also see great potential to penetrate Asian and other regional markets with products and services for which we are currently market leaders in North America and Europe. As an example, we plan to expand our Commercial Vehicle Aftermarket (CVA) product and service support business into Europe, as well as Asia and South America. [...]

Adding to our already significant presence in Asia Pacific, this year we established six new operations in China, and began building a new trailer axle and suspension manufacturing facility in Wuxi, China. And, to further accelerate our global expansion strategy, we are establishing a regional headquarters office in Asia. [...]

Autoliv

[...] Global presence has always been a competitive edge for Autoliv. We strengthened this advantage by opening our ninth plant in China, agreeing to make our Korean joint venture wholly owned and by expanding our Korean plant. [...]

We will strengthen our superior presence in Asia, for instance, by building India’s first airbag plant and by building a plant in Southern China, mainly for our Japanese customers in China and Japan. We also need one more plant in Mexico and another one in Romania to meet the continued order intake and to prepare for additional moves to low-cost countries. [...]

BMW

[...] The two boards also discussed the market opportunities available to the group, especially in Asia, as well as other measures aimed at expanding the BMW Group’s market presence. In this context, the members of the Supervisory Board were shown the extended version of the BMW 5 Series Sedan, a vehicle specifically designed for the Chinese market and on sale there since December 2006.

The Supervisory Board was also kept informed about the construction of a new plant in India and the current progress of a new production and sales company which is being set up for that market. [...]

Bosch

[...] In focusing increasingly on Asia, we remain in step with the global shift in economic power, but without overlooking the importance that other regions have for us. [...]

Continental

[...] We see China, India, Brazil and Russia as the markets with the highest growth potential. We can exploit this potential through cooperation or acquisitions, as well as by starting up our own production facilities. In China we set up a sales and distribution system for tires in 2006. [...]

Fiat

[...] The Automobiles Sector focused on reinforcing its presence in two high-growth markets, Russia and India, by entering into commercial and industrial agreements with Severstal Auto and Tata Motors. Iveco significantly accelerated its growth strategy in China by reaching agreements with SAIC, Chongqing Heavy Vehicle Group, and Nanjing Motor Company. [...]

GKN

[...] Driveshaft manufacturing capacity continues to be transferred to the high growth economies of Asia Pacific, South America and Eastern Europe. Whilst we have had production facilities in Japan and China for some 20 years and have achieved significant market penetration in these countries, the scale of the current re-alignment of the Group's manufacturing assets will take full advantage of the new world order in automotive production. [...]

Nine GKN businesses employing around 3,500 people now serve the Chinese domestic automotive and off-highway markets. Two new factories in India will double our employment there and significant expansion is taking place in Brazil, Mexico and Eastern Europe. [...]

Hyundai

[...] Reflecting our customer-first management philosophy, we have made the requisite investments to expand production lines in the USA, China, India and Europe. As a result, we will be closer to our customers and will be better positioned to build our brand. [...]

[...] In China, a market whose importance increases year by year, the ground-breaking for a second plant has begun, further evidence of HMC's China success story. [...]

Visteon

[...] During 2006, we increased our manufacturing personnel in lower cost countries by 6 percent with growth in China and India, while decreasing our personnel in higher cost countries by 9 percent. In engineering, we realized a 12 percent reduction in our higher cost personnel and increased our headcount in lower cost countries by 38 percent. In November, we also initiated an action plan to reduce our salaried workforce in high cost countries by 10 percent, or about 900 positions. Total headcount is down year over year. [...]

[...] We have also been enhancing our joint venture relationships in China, India and Korea. By maximizing these partnerships, Visteon is well-positioned to expand with our customers in Asia, the fastest-growing automotive market. By 2008, we expect Asia will be our largest region in terms of sales. [...]

From the Chairmen: Predictions

A significant improvement of the worldwide automotive economic situation is not expected for 2007 by most chairmen. To offset this trend, different solutions are pointed out such as restructuring processes, development of new vehicles, technological leadership, and expansion into emerging markets.

Autoliv

[...] In 2007, we will continue to reduce costs, move production to low-cost countries and consolidate our supplier base. [...]

During 2007, light vehicle production is expected to be flat in the Triad (i.e., Europe, North America and Japan) and to decline by 4% in the important West European markets. However, Autoliv expects to be able to offset this decline with an improved vehicle mix in Europe and North America, continued introductions of side-curtain airbags and by continued strong performance in emerging markets, primarily Asia.

Based on these assumptions, organic sales for 2007 are expected to increase by at least 3%.

Thanks to higher sales and internal cost reductions, gross margin is expected to be maintained or improve slightly depending on the possibility to further reduce component costs without aggravating the already serious supplier problems. The trend towards higher R,D&E expense in relation to sales is likely to continue. [...]

Faurecia

[...] Faurecia has equipped itself with the capabilities to position itself as a worldwide automotive equipment supplier, with a customer portfolio that includes all the world's major automakers. Strong business development is proceeding in Asia, America and Europe, to provide a sound basis for long-term organic growth. With its worldwide production system, Faurecia is able to serve its customers wherever the demand arises, with consistent design, production and service quality. Faurecia teams must now build on this strong position to achieve lasting profitable growth across all business. The starting point for profitable growth is the highest level of quality in all the services Faurecia offers its customers.

The Breakthrough Quality Plan, launched in late 2006, aims to achieve this by 2008.

Another prerequisite is operational excellence in the design, development and launch of new products, through the Faurecia Program Acquisition & Management System. In addition, Faurecia will be able to offer its customers competitive prices, by optimizing its production network and improving industrial efficiency.

With motivated, highly skilled personnel, Faurecia will be amplifying its product innovation capacities to achieve greater development latitude, especially outside Europe, and to strengthen its position as a strategic partner to the worldwide automotive industry.

After a difficult year in 2006, when profitability suffered serious erosion under the effects of increased competition and rising raw materials costs, 2007 should mark the first signs of an upswing for quality, products and operational efficiency across all Faurecia's businesses. [...]

Fiat

[...] The trading margin target for the Automobiles Business Area, which faces the challenge of a fairly stable market in Europe and a slowly expanding one in Brazil, has been set at 2.6-3.4%. This is almost double the figure for 2006. That result will be supported by the start of sales of new models, especially Fiat Bravo, Fiat Linea, and Fiat 500, and actions to streamline governance costs.

For the other principal activities, the aim is to realize significant trading margins: 9+% for CNH and 7+% for Iveco. [...]

General Motors

[...] The most important element of our future success will always be great cars and trucks. To support that, and despite our financial challenges, we continue to raise spending on new products. In 2007 and 2008, we plan to spend \$8.5 billion to \$9 billion on capital investments, an increase of nearly \$1 billion from 2005 and 2006. Last year, nearly 30 percent of our U.S. retail sales volume came from newly launched products, up from about 20 percent in 2005. In 2007, that number will grow. [...]

Our goal is to fundamentally transform GM into a globally integrated automaker that creates great cars and trucks, with outstanding design and the best technology, building strong brands – a company that is truly global, not just in terms of where we build and sell, but in our mindset.

As important as 2006 was for General Motors, 2007 will be equally critical, as we make continued progress and position your company for long-term, sustainable success. [...]

Johnson Controls

[...] Johnson Controls enters 2007 with sound growth strategies, a strong balance sheet and a dedicated team of employees. We believe we can grow at double the rates of our underlying markets and increase our global leadership in each business. We will be more diverse in terms of our business portfolio and employee base as well as geographically. Our environmental and social performance will continue to improve and increasingly become a competitive advantage. [...]

Michelin

[...] 2007 should see a stabilization of raw material prices and we will further gear up our strategy; a tangible outcome will be our ability to generate increasing cash flow. Michelin's net sales and operating income should post a tangible increase to compared to 2006. [...]

Renault

[...] The second half of 2007 will mark Renault's return to growth, supported by the launch of four new products (Twingo, Laguna sedan and Laguna station wagon and the Group's first cross-over) and the commercialization of Logan in India, Iran, Argentina and Brazil.[...]

TRW

[...] The stability provided by our product depth and industry leading diversification, together with the benefits derived from our cost reduction programs, will be very important in 2007 and beyond as we work to navigate through a demanding global industry environment. [...]

With respect to the major markets in which we conduct operations, beginning with Europe, our largest market by sales, we expect our customer diversification and new product launches will provide a solid and growing base for us in 2007.

We expect sales in China, India and South America will benefit from the growth in industry vehicle production. In North America, which has been the market most impacted by substantial production declines by the major domestic vehicle manufacturers and commodity inflation, we expect conditions to remain challenging. [...]

Valeo

[...] Automotive production is not expected to stabilize in our key markets until the second half of the year and raw material prices will remain relatively high, despite a certain levelling off in the prices of some commodities. In this context, Valeo will focus on improving profitability by stepping up efforts to increase its competitiveness. A re-engineering of the group's principle functions has been launched in order to optimize our resources and processes. These efforts, with the strong commitment of management and ongoing support from employees, customers, suppliers and shareholders, will ensure Valeo's

success as one of the world's top automotive suppliers: a benchmark within the industry. [...]

ZF Group

[...] There are many challenges for the current year. In 2007, the ZF Group will continue the strategy it has been pursuing. The necessary investments will be made to safeguard and expand our technological leadership, as well as to further strengthen international market presence. ZF will orient itself more intensely toward regional market requirements in order to be an attractive partner for both established and new customers in all relevant market regions, including the emerging markets. The pressure on international sales and procurement markets is doubtlessly large and will not decline. It is therefore very important that ZF realizes competitive cost structures at all international locations. Management and employees must make major efforts to meet these many challenges.

Due to the fact that the worldwide economic situation in 2007 will not develop as dynamically as in 2006, ZF anticipates sales growth for the current year as well, however below the growth rate of the year under review. [...]



Appendix A – OEM Segment Information

In \$ millions, except for units sold in thousands

OEMs	GAAP	Total Assets	Revenue	Units Sold	Net Income/ (Loss)	Cap Ex
DaimlerChrysler AG						
	IFRS					
Mercedes Car Group			68,864.4	1,251,800.0		2,097.8
Chrysler Group			59,448.1	2,654,707.0		3,648.7
Truck group			40,360.5	537,000.0		1,146.3
Financial Services			21,643.9			45.4
Van, Bus, Other Activities			16,956.5	293,100.0		561.9
Eliminations			-16,007.7			
Total DaimlerChrysler AG		239,758.0	191,265.6	4,736,607.0	4,071.6	7,492.2
FIAT SpA						
	Local					
Automobiles (Fiat Auto)			29,905.7	1,980,300.0		2,729.1
Agriculture and Construction Equipment (CNH)			13,282.3			497.1
Commercial Vehicles (Iveco)			11,527.2	1,132.0		431.5
Ferrari and Maserati			2,480.6	11,384.0		282.6
Components (Magnetit Marelli)			5,621.0			369.7
Production Systems (Comau)			1,615.0			70.7
Metallurgical Products (Teskid)			1,159.5			40.4
Services (Business Solutions)			842.8			12.6
Publishing and Communications (Itedi)			506.0			56.8
Fiat Powertrain Technologies			7,753.4			320.5
Miscellaneous and eliminations			-9,295.2			-30.3
Total Fiat SpA		73,677.0	65,398.4	1,992,816.0	1,452.3	4,780.7
Ford Motor Company						
	US					
Automotive		122,634.0	143,307.0	6,597,000.0		6,809.0
Financial Services		169,050.0	16,816.0			39.0
Eliminations (intersegment)		-13,130.0				
Total Ford Motor Company		278,554.0	160,123.0	6,597,000.0	-12,613.0	6,848.0

OEMs	GAAP	Total Assets	Revenue	Units Sold	Net Income/ (Loss)	Cap Ex
General Motors Corporation		US				
		164,069.0	172,927.0	9,100,000.0		7,531.0
		22,123.0	34,422.0			402.0
		186,192.0	207,349.0	9,100,000.0	-1,978.0	7,933.0
Honda Motor Company		Local				
		46,033.2	76,113.3	3,652,000.0		4,631.0
		9,834.5	11,735.6	10,369,000.0		589.8
		48,204.6	3,508.0			3,148.6
		2,867.0	3,576.8			140.4
		-5,043.7				
		101,895.6	94,933.6	14,021,000.0	5,071.6	8,509.7
Mitsubishi Motors Corporation		Local				
		14,178.9	18,451.0	1,232,000.0		839.6
		938.1	410.5			121.4
		-59.4				
		15,057.6	18,861.5	1,232,000.0	74.9	961.0
Peugeot Citroen SA		IFRS				
			56,230.6	3,365,900.0		2,712.7
			14,698.0			
			4,094.3			
			2,221.9			
			823.9			
			-6,662.0			
		90,938.9	71,406.8	3,365,900.0		2,712.7

OEMs	GAAP	Total Assets	Revenue	Units Sold	Net Income/ (Loss)	Cap Ex
Toyota Motor Corporation						
	JPY					
Automotive		167,346.8	187,753.4	8,524,000.0		12,111.1
Financial Services		116,278.0	11,135.2			97.1
All Other			11,333.9			
Intersegment adjustment		-7,861.4	-5,173.3			
Total Toyota Motor Corporation		275,763.4	205,049.3	8,524,000.0	14,076.6	12,208.2
Volkswagen AG						
	IFRS					
Automotive		94,935.9	121,131.9	5,733,600.0		4,597.8
Financial Services		84,970.2	11,192.9			106.0
Total Volkswagen AG		179,906.2	132,324.8	5,733,600.0	3,469.8	4,703.8
Renault SA						
	IFRS					
Automobile		63,773.1	49,920.7	2,433,372.0		5,638.7
Sales Financing		33,678.3	2,767.0			247.3
Interdivision transactions and other		-6,886.6	-290.2			-26.5
Total Renault SA		90,564.8	52,397.5	2,433,372.0	3,713.3	5,859.5
Mazda Motor Corporation						
	Local					
		16,150.6	27,805.8	1,177,000.0		681.6
Nissan Motor Company						
	Local					
Automobile		66,963.5	84,075.1	3,699,747.0		4,952.1
Sales Financing		50,034.6	5,778.8			7,071.1
Eliminations		-12,006.6	-388.6			
Total Nissan Motor Company		104,991.5	89,465.3	3,699,747.0	3,945.5	12,023.2
BMW Group						
	IFRS					
Automobile		35,858.0	60,269.4	1,373,970.0		5,280.4
Motorcycles		904.8	1,596.1	100,064.0		80.8
Financial Services		66,546.7	14,773.7			53.0
Eliminations		-6,608.7	-14,264.0			27.8
Total BMW Group		96,700.7	62,375.3	1,474,034.0	3,626.2	5,441.9

OEMs	GAAP	Total Assets	Revenue	Units Sold	Net Income/ (Loss)	Cap Ex
Hyundai Motor Company		Local				
		55,520.0	65,707.0	1,611,062.0		
		16,848.0	3,646.0			
		72,368.0	69,353.0	1,611,062.0	1,355.0	4,162.0
Porsche AG		IFRS				
		16,270.6	8,673.2	96,794.0		504.3
		3,889.6	525.3			700.5
		-894.2	-211.7			5.6
		19,266.0	8,986.7	96,794.0	1,757.6	1,210.4
Subaru		Local				
		8,964.7	11,467.4	578,000.0		1,028.1
		469.4	425.5			13.9
		1,398.3	804.9			35.3
		549.5	101.0			5.7
		-240.9				-1.4
		11,141.0	12,798.9	578,000.0	273.1	1,081.7

Appendix B – Tier 1 Supplier Segment Information

In \$ millions, except number of employees

Company Name	Fiscal Year End	GAAP	Total Assets	Net Assets	Current Assets	Current Liabilities	Working Capital	Revenue	Gross Profit	Net Income / (Loss)	Cap Ex	R&D Spending	# of Employees
Arvin Meritor Inc.	09/30/06	US GAAP	5,508	944	3,390	2,580	810	6,415	505	-175	107	114	27,500
Autoliv Inc.	12/31/06	US GAAP	5,111	2,403	2,098	1,532	566	6,188	1,265	402	328	398	35,700
Bridgestone Inc.	12/31/06	JP	25,849	9,982	12,280	8,283	3,997	25,612	8,440	729	2,248	742	126,326
Continental AG	12/31/06	IFRS	14,293	5,888	6,552	5,250	1,303	18,783	4,646	1,268	1,016	854	85,224
Delphi Corporation	12/31/06	US	15,392	-12,055	9,215	8,370	845	26,392	976	-5,467	721	2,100	171,400
Denso Corporation	03/31/07	JP	31,874	19,360	12,722	8,426	4,296	30,907	5,303	1,757	2,665	2,397	112,262
Eaton Corporation	12/31/06	US GAAP	11,417	4,106	4,408	3,407	1,001	12,408	3,320	950	360	321	60,000
Faurecia	12/31/06	IFRS	8,877	1,352	3,556	5,383	-1,827	14,698	87	-552	381	770	65,682
Federal-Mogul Corporation	12/31/06	US GAAP	7,179	-1,748	2,493	1,655	838	6,326	1,105	-550	237	170	43,100
GKN plc	12/31/06	UK	6,462	1,781	2,675	1,867	808	6,723	448	327	359	139	36,117
Goodyear	12/31/06	US GAAP	17,029	-758	10,179	4,666	5,513	18,751	3,015	-330	637	342	77,000
Johnson Controls Inc	09/30/06	US GAAP	21,921	7,355	9,264	8,146	1,118	32,235	4,420	1,028	711	743	136,000
Lear Corporation	12/31/06	US	7,851	602	3,890	3,887	3	17,839	928	-708	348	170	104,276
Magna International Inc.	12/31/06	US GAAP	13,154	7,157	7,060	4,783	2,277	24,180	2,969	528	793	55	83,000
Michelin Group	12/31/06	IFRS	22,223	6,174	10,381	7,354	3,026	20,672	5,969	723	1,784	746	115,755
Robert Bosch GmbH	12/31/06	IFRS	61,820	29,609	24,027	14,183	9,845	55,118	16,980	2,738	3,369	4,224	261,300
Sumitomo Electric Industries Ltd.	03/31/07	JP	20,185	8,914	8,742	5,468	3,274	20,416	3,465	651	1,101	585	133,853
Toyota Industries Corporation	03/31/07	JP	30,356	14,827	4,808	4,727	81	16,083	2,497	509	1,426	296	36,096
TRW Automotive Holdings Corporation	12/31/06	US GAAP	11,133	2,397	3,676	3,675	1	13,144	1,201	176	529	168	63,800
Valeo SA	12/31/06	IFRS	9,993	2,257	4,615	4,773	-158	12,580	1,942	209	816	834	69,700
Visteon Corporation	12/31/06	US GAAP	6,938	-188	3,565	2,568	997	11,418	734	-163	373	594	45,000
ZF Group	12/31/06	IFRS	9,800	3,227	5,535	3,009	2,526	14,711	2,883	373	592	765	55,050

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